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Nordic Outlook

Global: Creeping inflation will force key rates upward
Nordics: Vigorous upturn, risk of overheating

SEB

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The international economy: Continued strength, but inflation creeping up

- The US economy is slowing, but Europe and Asia are resisting. The world economy is growing almost as fast as last year. The long expansion is beginning to show **inflationary tendencies**. There are signs of overheating in China, the UK and the Nordic and Baltic countries. Many central banks are raising their **key interest rates above neutral level**.
- **US growth will decelerate to only 1.9 per cent this year and 2.5 per cent in 2008**, primarily due to the consequences of the weak housing market. The Federal Reserve will wait until the autumn before cutting interest rates. Next year the federal funds rate will be lowered to 4.5 per cent.
- **Euro zone growth will be 2.7 per cent this year: clearly higher than in the US**. The labour market and domestic demand are strengthening. The German economy is acting as a locomotive. The European Central Bank will continue raising its refi rate until it reaches 4.25 per cent; the strong euro will prevent further hikes.
- **The spread between US and European bond yields will shrink greatly**, given growth and key rate trends. **Tensions between currencies will escalate**. European currencies must bear a disproportionate portion of the burden of the falling US dollar. The Chinese yuan will be slowly revalued against the dollar, but the Japanese yen will remain weak.

Sweden: Rapid upturn in wages and disposable income make Riksbank speed up hikes

- **GDP will grow by more than 4 per cent this year** and over 3 per cent in 2008. Disposable income will surge nearly 6 per cent this year.
- The labour market is gaining strength. Unemployment will fall below 4 per cent by late 2008. The 2007 **wage round will result in pay increases of nearly 5 per cent next year**. Unit labour costs will rise and more sectors will experience labour shortages.
- Underlying inflation will climb to 1.7 per cent, and two years from now it will exceed 2 per cent. The **Riksbank must revise its inflation path upward and raise its key rate at a faster pace** than previously announced. By year-end the repo rate will stand at 4.0 per cent, and by the end of 2008 at 4.75 per cent.
- **Fiscal policy is relatively expansive**, and abolishing real estate tax will drive up home prices. Due to strong economic expansion, the public financial savings target of 1 per cent of GDP will still be met by a wide margin, but tensions between the Finance Ministry and the party chairmen in the non-socialist coalition government will increase.

Other Nordic countries and the Baltics: Overheating under way

- **Denmark**: Capacity shortages will drive up inflation and decelerate growth. The property market will continue to cool off, which will slow consumption.
- **Norway**: Unemployment will fall to record-low levels, thus intensifying bottleneck problems. Inflation will climb. Norges Bank will keep hiking its sight deposit rate at a brisk pace; next year the key rate will reach 5.5 per cent.
- **Finland**: Continued economic strength will lead to growth above trend this year and next as well. Unemployment will fall and pay increases will accelerate. Inflation will climb from a low level.
- **Latvia** and **Estonia** continue to show clear signs of overheating, with rapid credit growth and high inflation. Latvia is starting to tighten its fiscal policy, but in both countries monetary policy is blocked by fixed exchange rates. A slow cooling will occur as foreign-owned banks slow their lending, but a hard landing is a clear risk. **Lithuania** will exhibit more balanced growth.

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Continued strength — but increased risks

- **Europe and Asia are resisting US downturn**
- **Mounting financial and geopolitical risks**
- **Threat of Nordic inflation and overheating**
- **Exchange rate policy drama is emerging**

The past few years of global growth have been the fastest in 35 years. Powerful forces — new technology, globalisation, credible central banks — have resulted in rapid productivity growth and low inflation. Low interest rates have driven up asset prices. Profits have reached their highest levels in decades as a percentage of output.

The question is how long these good times can last. **After such a vigorous upturn, a cyclical reversal will be completely natural**. This ordinarily occurs via increasing capacity constraints, which result in overheating, inflation and tighter economic policy. This time, too, these tendencies are growing stronger, although to date the process has been mild and different regions are in different phases.

The American economy has recently shown signs of "stagflation" — more sluggish growth coupled with persistent inflation. In some places — the United Kingdom, the Nordic countries, China and India — inflation has begun to creep upward, and **certain signs of overheating have become discernible**. Productivity growth is slowing and central banks are raising interest rates. This will gradually lead to a cyclical downturn. During the past year, financial markets have also exhibited sharp movements. Poor macroeconomic figures or geopolitical worries have led to profit-taking — a signal that many investors do not dare to believe that the good times can really last, but are instead beginning to wonder how sharp the coming deceleration will be.

GDP growth
Year-on-year percentage change

	2005	2006	2007	2008
United States	3.2	3.3	1.9	2.5
Japan	1.9	2.2	1.9	2.0
China	9.9	10.7	10.0	9.5
Euro zone	1.5	2.8	2.7	2.5
United Kingdom	1.9	2.7	2.8	2.5
Nordic countries	2.9	4.0	3.4	2.9
OECD	2.6	3.2	2.5	2.7
World economy	4.9	5.4	5.0	4.9

Sources: OECD, SEB

Deceleration — but mild

The main message of this ***Nordic Outlook*** is that a **global deceleration is now under way**. However, the positive driving forces are strong enough that the global economy as a whole can quite easily resist the ongoing American deceleration. Our **forecast is thus that the world economy will decelerate cautiously — from a high level — during 2007 and 2008**, although there are various kinds of threats to this comparatively bright picture.

- Clearly, the biggest threat comes from **inflation**. Our main scenario is that underlying disinflationary forces will help keep the cyclical upturn in inflation comparatively small. Yet there is a risk that a combination of good liquidity, higher asset prices and rising employment will lead to a more rapid acceleration in inflation. In that case, the result would be higher interest rates than in our main forecast and a more noticeable economic deceleration.
- **The risks of financial reversals** have increased somewhat, but still seem rather mild. Profit disappointments may trigger new stock market slides. Pessimists claim that hedge funds and derivative positions conceal dark secrets that may trigger a global financial crisis. However, we see no concrete evidence that the risks are this great.
- And — as usual — there are **geopolitical tensions**. Sharply rising oil prices could slow down growth and exacerbate global savings imbalances (see box).

Europe and Asia decouple from the US

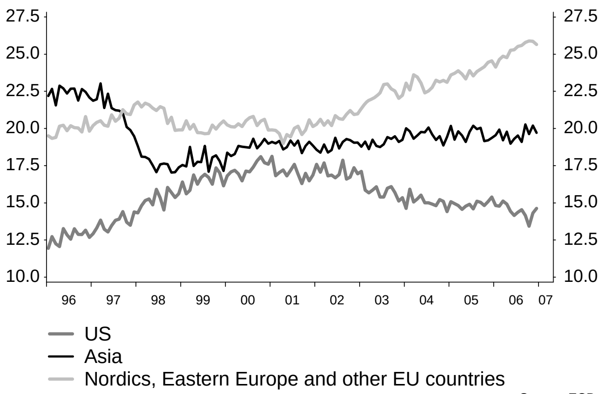
We see **four regions in different phases in the world economy**. The **US economy** is on the way down and showing signs of stagflation. **Asia** is decelerating cautiously for capacity reasons. However, growth in rapidly expanding Asian economies will remain high enough to stimulate the rest of the world, especially bearing in mind that the upturn in China is occurring from a base that comprises a steadily larger proportion of the global economy. In Western Europe, the upturn is continuing. The **euro zone** economies are growing at a decent pace, but a strong euro and initial spare capacity imply that the risk of overheating is small. In the **UK and the Nordic countries**, overheating problems will make themselves felt in varying degrees over the next few years.

- **American growth has been clearly below trend** for the past year or so. Residential construction has fallen and home prices have stagnated. Household consumption has held up so far, but a slowdown is probably on the way. Given high profits and sustained optimism, the risk of a US recession is still small. In our assessment, the **US economy will slow to a GDP growth level of around 2 per cent this year** — clearly below trend and below consensus — and 2.5 per cent next year.

- The **Japanese economy will continue to grow above trend**, by about 2 per cent this year and next. Its driving forces will shift from exports to domestic demand, but there will be no real momentum. Consumers are cautious; weak demographics and large central government debt are weighing down optimism and will force Japan to adopt a tighter fiscal policy.

- **In China, gradual tightening will cause the growth rate to slow somewhat**. But China will still be the fastest-growing major economy in the world, and the country will remain an engine of Asian growth.

Euro zone exports by destination
Per cent of total exports



Source: ECB

- **The euro zone is in the midst of a cyclical upswing**. The German economy, which had been a drag anchor, is now once again an engine. Europe has become less vulnerable to an American deceleration, among other things because trade with the US has diminished in importance. We predict growth above trend and we are revising our GDP forecast for the euro zone to 2.7 per cent growth this year and 2.5 per cent in 2008. This forecast means that the euro zone economies will grow faster than the US for the first time since 2001.

- In the **UK**, after a minor slump last year the economy has gained a second wind. Domestic demand is rising, capacity utilisation is high and property prices are heading upward again.

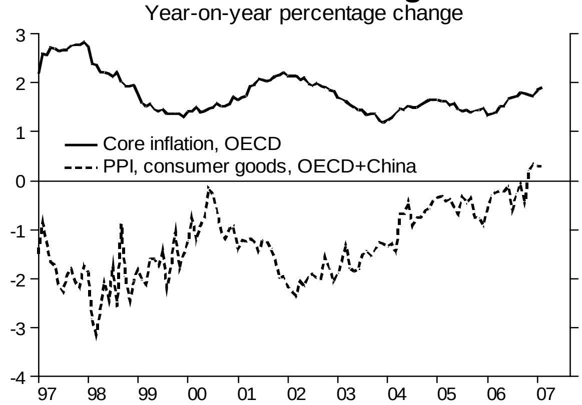
- **All four larger Nordic countries will grow at above trend** again this year. Denmark and especially Norway are showing **symptoms of overheating** in their labour markets. Sweden and Finland are behind them in the economic cycle, but an upturn in employment will also lead to increasing tendencies towards labour shortages in Sweden as well.

- In the **Baltic countries**, Latvia and Estonia are showing clear signs of **overheating.**

Central banks acting against inflation

Because of vigorous growth, the labour markets in most economies are becoming ever tighter. Meanwhile productivity growth is slowing as the economic cycle becomes more mature. The results are rising costs and **gradually mounting inflationary pressures**, both for producer and consumer prices. The graph below shows how the prices of consumer goods now has started to rise, after several years of deflation.

Prices of consumer goods
Year-on-year percentage change



Sources: SEB, national statistics offices

Although inflation levels are still low, the ample supply of liquidity implies risks of a more substantial future upswing in inflation — the “ketchup effect” described in previous issues of ***Nordic Outlook***.

In most cases, central banks thus face the task of continuing to push up their key interest rates. The American central bank is the exception.

The **Federal Reserve** faces an intricate problem. On the one hand, US growth is clearly below trend. On the other, inflation is high and unemployment is low. It is fully possible that in this situation, Alan Greenspan’s Fed would already have lowered its key rate. But Ben Bernanke has argued that the Fed should make its inflation target clearer, which to some extent has blocked interest rate cuts.

Developments in the labour market are likely to be decisive for the Fed. When weaker growth begins to cause rising unemployment — which will also ease inflationary pressure — the Fed will lower its key rate. We anticipate a quarter percentage point cut before year-end and two more early in 2008.

The **European Central Bank** will continue to raise its refi rate. Good growth and falling unemployment in the euro zone are probably not sufficient in themselves to justify further interest rate hikes. Also, a stronger euro is gradually becoming a problem. But credit and money supply growth are still substantially above the bank's targets. As in our last ***Nordic Outlook***, we expect the ECB to reach a key rate of 4.25 per cent in the autumn, then leave it unchanged.

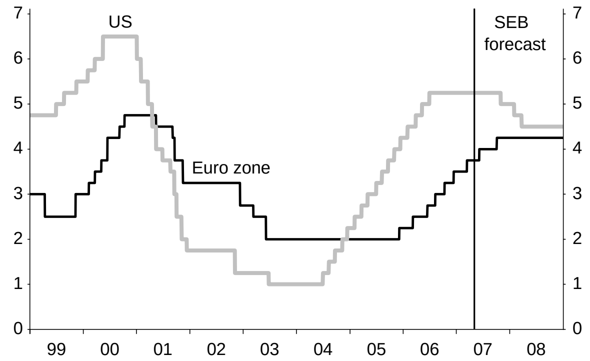
The **Bank of England** will raise its repo rate two more times. Domestic demand is on the way up, and so is the labour market. The BoE needs to curb inflationary pressures and relatively high inflation expectations, as well as cool off the housing market, which remains uncomfortably hot.

The **Bank of Japan** will continue to raise its key rate, but with extreme caution. Deflationary risks are lingering stubbornly. Japan also has to take into account the need to tighten fiscal policy in order to reduce its large central government debt. Given this situation, low interest rates and a weak currency provide welcome stimuli for growth and inflation. We thus do not expect the BoJ's key rate to move higher than 1.0 per cent in 2008.

The Chinese central bank will continue its interest rate hikes. Meanwhile China will tighten the credit market by imposing stricter reserve requirements, for example. Higher real interest rates are needed in order to slow credit growth and capital spending.

The Nordic central banks are also in a rate-hiking phase. Norges Bank has announced sizeable interest rate hikes in order to prevent overheating in the Norwegian labour market from leading to a ketchup effect in inflation. Sweden's Riksbank is forced to back away from its excessively optimistic view of inflation and adjust its interest rate path upward as the economy accelerates. In Norway, the key rate will be raised towards BoE levels. The Riksbank, too, will raise its repo rate well above the ECB level.

Key rates
Per cent



Sources: ECB, Fed, SEB

This means that on an overall global scale, monetary policy will move from expansive to neutral and in most cases to contractive. The Federal Reserve and the BoE are already pursuing contractive monetary policies. Before year-end 2007, Norges Bank and the ECB will also have shifted to contractive. During 2008, the Riksbank will raise its key rate above the neutral level.

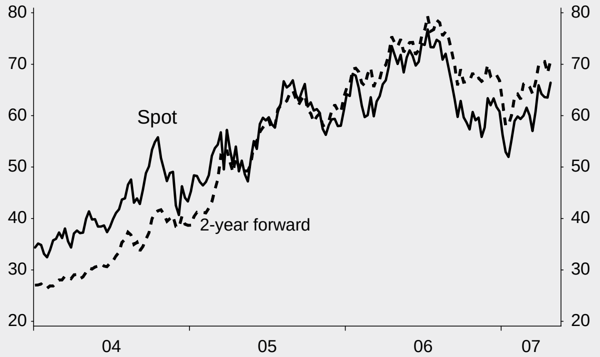
Higher long-term yields

The macroeconomic decoupling between the US and Europe has meant smaller spreads between their key

Iran and the oil threat

Our last ***Nordic Outlook*** in February assumed a crude oil price (Brent) of USD 55 per barrel in 2007 and USD 60 per barrel in 2008. After the sharp upturn of recent months in both spot and forward prices, we see reasons to **raise our oil price forecast to USD 66 per barrel this year and USD 70 per barrel in 2008**. This will contribute to somewhat slower global economic growth and marginally higher inflation in the coming year.

Oil price
USD/barrel NYMEX



Source: Reuters EcoWin

There are several reasons for the upturn: Strong demand, lower reserves in the US and geopolitical unrest in the Middle East.

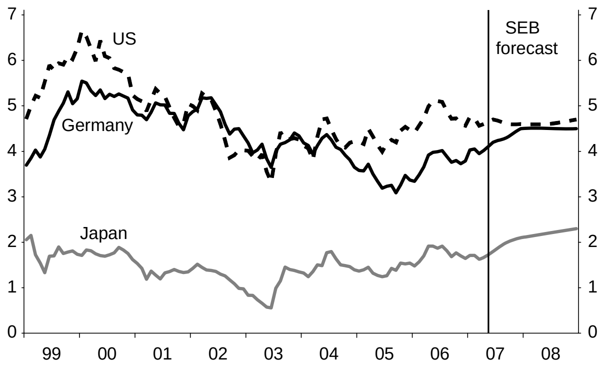
Tensions on the Iran issue remain, and speculations about a US/Israeli attack on Iran's nuclear facilities have not ceased. Our main scenario assumes that no such attack will take place, since the stakes are far too high for the affected parties. For Iran's part, it is probably mainly a matter of brinkmanship — going as far as possible in developing a nuclear capacity, but without producing finished weapons that would risk provoking an attack. Meanwhile the incumbent American administration is probably too weakened, both internationally and domestically, to consider such high-risk operations as this.

If we prove wrong — and an armed conflict actually breaks out — oil prices may spike for a long period at well above USD 100 per barrel. This would create far different and worse conditions for the world economy.

interest rates. This in turn has caused the **spread between American and European 10-year yields to shrink dramatically**, in line with our previous forecasts.

10-year government yields

Per cent



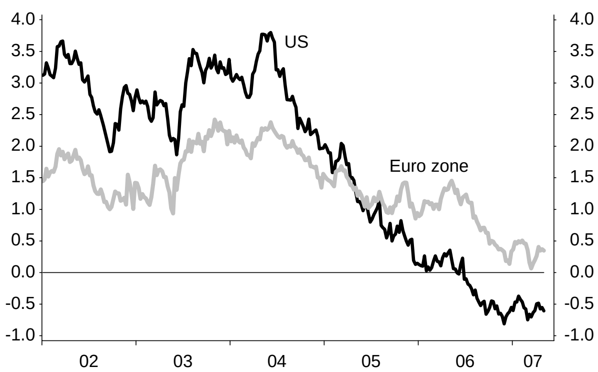
Sources: Reuters EcoWin, SEB

Our inflation and key rate scenario indicates that this trend will continue. We expect German 10-year yields to reach 4.50 per cent by year-end and remain there during 2008. In the US, however, long-term yields may fall somewhat as inflationary threats ease and the Fed begins to cut its key rate. By the end of 2007, the spread between American and German 10-year government bond yields will be only 10 basis points.

In the Nordic countries and the UK, the upturn in bond yields will be larger than in the euro zone. Towards year-end the negative spread between Sweden and Germany will be eliminated, and the already large Norwegian spread will become even larger. Both Norwegian and British long-term yields will be above American ones by the close of 2007.

Slope of the yield curve

Differential between 10-year yield and key rate, %-points



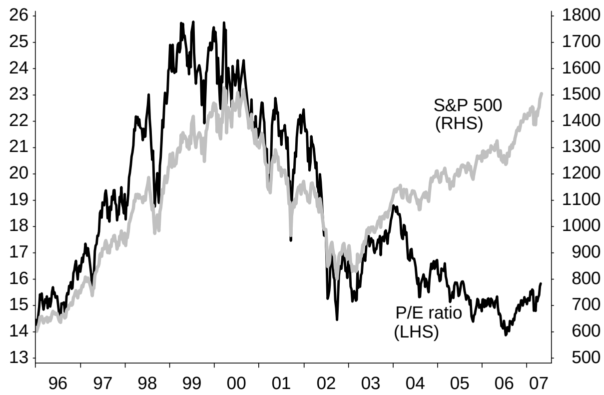
Source: Reuters EcoWin

Our forecast implies continued **flat yield curves**. In the US, 10-year yields have now been lower than the key interest rate for nearly a year. In the euro zone, the differential between short-term interest rates and long-term yields has narrowed to nearly zero in the past six months. The driving forces behind comparatively low long-term yields, and thus behind the flat yield curve, are highly persistent. The forces of globalisation are keeping inflationary pressure down, central bank inflation targets are credible and there is a great need for pension funds and others to invest in long-term government securities. At the same time, it is likely that in the long term the yield curve will revert to a slightly positive slope, which illustrates a certain upside risk for our bond yield forecast.

Increasing stock market risks

The long global boom has been very favourable to the world's stock exchanges. Risk capital has benefited from low interest rates. Global liquidity is rising rapidly, fuelled by growth of money supply and credits. High profits have caused a number of stock exchanges to reach all-time highs in recent weeks.

US: S&P 500 and P/E ratio



Sources: Standard & Poor's, Reuters

Now that the cyclical upturn has matured, the risks of reversals will increase. In the US, profit forecasts have been lowered a bit, but remain optimistic. The Shanghai stock exchange is showing clear bubble tendencies, and the coming economic policy tightening in China will squeeze share prices. In Western Europe, the macroeconomic outlook and share valuations point towards a continued stock market rally. However, tighter labour markets and faster pay increases will gradually put pressure on profits.

Taken together, the positive driving forces of globalisation along with moderate valuations nevertheless provide a positive basis for stock market gains ahead. The biggest risk factors that might trigger a global stock market slide are a sharper American deceleration and powerful inflationary impulses that might force central banks to push their key rates higher than in our main forecast.

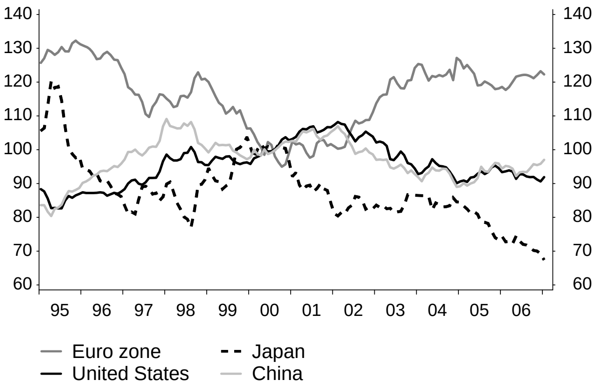
Tensions between major currencies

In recent years, our currency analysis has been guided mainly by short-term interest rate spreads and to a somewhat lesser extent by global imbalances.

Today both these factors point towards **continued weakening of the dollar**. The Fed's key rate has peaked, while those of the ECB and other central banks are on the way up. The American current account deficit remains at an unsustainably high level, which points towards a weaker dollar in the long term.

Real effective exchange rates

Index 100 = 2000



Source: IMF

But the hard question is how the continued weakening of the dollar will be allocated among its various counterparties. Among major currencies, to date mainly **the euro and the pound have carried the burden of the falling dollar**.

- It is true that the yuan has been revalued against the dollar during the past year, but the Chinese currency has weakened against the euro and the **real effective exchange rate of the yuan has actually fallen** since 2000. Meanwhile China's trade surplus has exploded.
- **The weakening of the Japanese yen has been even more dramatic**, contrary to all forecasts. The yen is now weaker than at any time in the past 25 years. Low Japanese interest rates have led to large currency outflows — partly as speculative "carry trade" (borrowing in low-interest currencies and investing in high-interest currencies) and partly as long-term asset reallocations from Japanese portfolios to higher yielding markets abroad.

In the mid-1980s the strength of the dollar and the weakness of the yen resulted in the Plaza Agreement, which led to a sharp strengthening of the yen and a weakening of the dollar. Today both the yuan and the yen ought to bear a significant larger adjustment burden as the dollar continues to fall. But such a development is being blocked in various ways. Both China and Japan obviously want the export sector to remain a driving economic force. In Japan's case there is also a need for deflation-fighting.

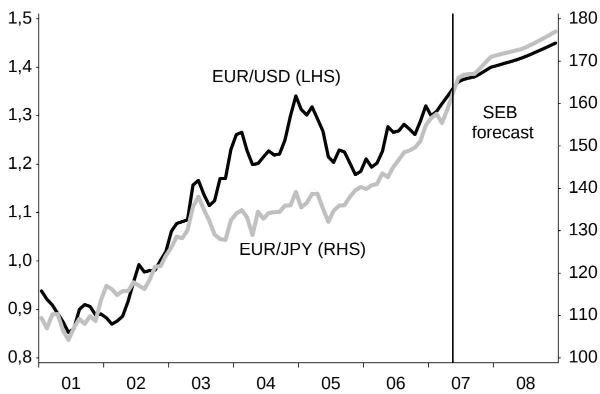
In recent years, American criticism of Chinese exchange rate policy has been strident. This is likely to continue, and concerns over the weak Japanese exchange rate will probably also increase both in the US and in Europe. A **triangle drama between the US, the UK/euro zone and China/Japan is thus emerging**.

Our basic forecast is that the dollar will continue to trend downward against the euro. **By year-end the euro will stand at USD 1.40, and we expect the dollar to continue weakening to USD 1.45 per euro next year.** Lingering deflation risks allow little room for interest rate hikes in Japan, which will contribute to continued weakness for the yen. We expect USD/JPY to stand at 122 at the end of the year and reamain at this level in 2008. The appreciation of the yuan will move somewhat faster than during the past year.

Our exchange rate forecast implies that **tensions in international currency relations will continue and intensify**. The burden on European currencies will remain very heavy. On top of the appreciation vs the USD, we must now add that Japanese investors' appetite for European assets seems to be growing. This will lead to currency flows from the JPY and into EUR, GBP and the Nordic currencies. The EUR/JPY exchange rate will reach a record of around 175, which implies an appreciation of more than 50 per cent over the past five years.

Such currency relations entail **risks of dramatic corrective movements**. A diminished risk appetite in the world economy might lead to an unwinding of carry trade positions, resulting in a rapid upturn for the yen.

Exchange rates EUR/USD and EUR/JPY



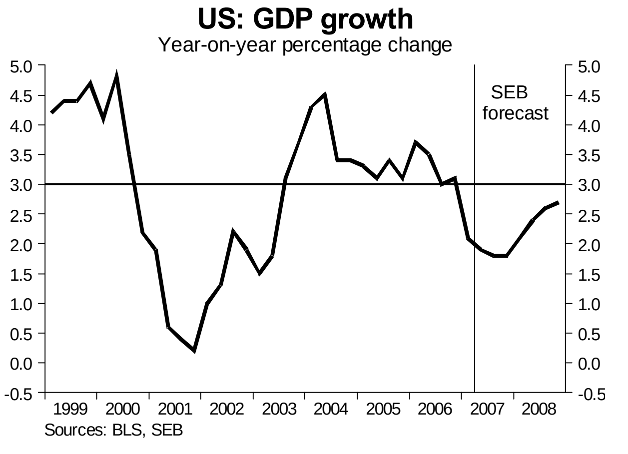
Sources: Reuters EcoWin, SEB

Mounting stagflation risks

- **Growth below trend in both 2007 and 2008**
- **Stubborn inflationary forces**
- **Unemployment will turn upward this autumn**
- **Fed will cut its key rate to 4.5 per cent**

The outlook for the American economy has darkened in recent months. GDP growth in the first quarter of 2007 was 1.3 per cent, which means that the growth rate has now been clearly below trend during four consecutive quarters. While the ISM rebound in April, other indicators do not suggest that a turnaround is in sight. Hence, we do not expect growth to begin moving slowly upward until early next year. GDP growth as an annual average will thus be 1.9 per cent this year and 2½ per cent in 2008. This is a downward revision since our last ***Nordic Outlook*** in February and implies **growth below trend in both years**.

A typical late-cyclical pattern now characterises the US economy. Productivity growth has slowed, leading to a rise in inflationary pressures and strained resource utilisation. In this **stagflation-like environment**, the Federal Reserve's stabilisation policy task is far from easy. The Fed has continued to signal that interest rate cuts are not on its agenda. However, there are many indications that weak growth will lead to an upturn in unemployment during the coming autumn. This would give the Fed room to support the economy with interest rate cuts. Our forecast is that the **federal funds rate will be lowered** to 5 per cent during the fourth quarter and further to 4.5 per cent during the first half of 2008.



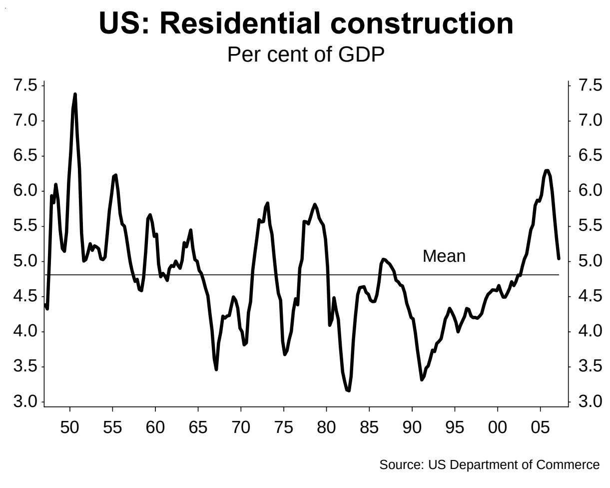
Inventories, homes restraining growth

The hopes of rapid recovery that characterised early 2007 have come to nought. Warm year-end weather stimulated construction activity and had a positive secondary impact on various economic indicators. But this weather effect was temporary. A return to normal temperatures also cooled down the economy.

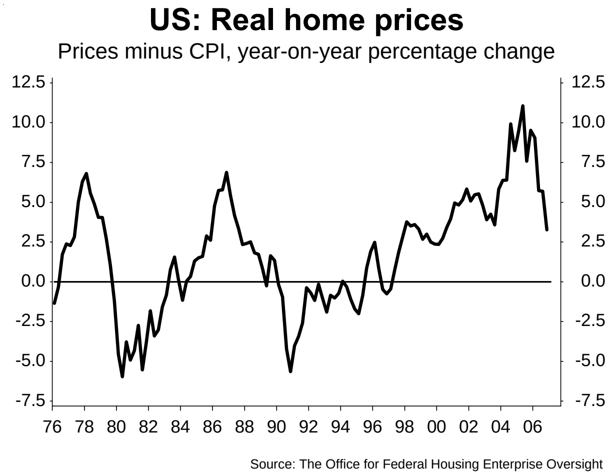
The preliminary GDP figure for the fourth quarter of 2006 that was initially published indicated that growth had bounced back to trend level, causing consensus forecasts to take a temporary leap of joy. But a downward revision of the figure snuffed out this hope as well.

Two other more underlying factors go a long way towards helping explain recent weakness in GDP growth.

- An **inventory adjustment** is under way, in line with the historical pattern during slowdown phases. During the past two quarters, inventory drawdowns have cooled GDP growth substantially. Part of this adjustment process still lies ahead, which will restrain the recovery.
- The **fall in residential construction has now been under way for a year**. During the first quarter of 2007, this led to a negative contribution to GDP well above 1 per cent. Yet residential construction is still above the historical average of just below 5 per cent. This indicates that the contribution of residential construction to GDP growth will continue to fall for another year or so. There will also be secondary effects in the form of declining infrastructure investments, lower consumption of interior fitting products and so on.



The trend of **home prices** is pivotal in determining to what degree housing market weaknesses will spread to the rest of the economy. The latest signals are mixed, both when it comes to price trends and other housing market indicators. Estate agent statistics for newly constructed homes actually point towards a rebound early in the 2007, but according to the same source there was a year-on-year price drop of around 2 per cent for existing homes. The most advanced national statistics from the Office for Federal Housing Enterprise Oversight (OFHEO) show that prices still rose by 5-6 per cent year-on-year during the fourth quarter of 2006.



Our view is that **there is additional room for price declines**. To date, nominal US home prices have never fallen at the national level (according to ODHEO). However, earlier price corrections occurred in a higher-inflation environment, which meant that relative home prices could be adapted without nominal declines. But when the adjustment in relative prices continues in the current low-inflation environment, we expect this to result in **nominal price declines** (according to OFHEO) towards the end of 2007.

Consumption will slow

Despite the slowdown in the housing sector, **household consumption has actually been surprisingly robust**. A strong labour market, good real wage growth and rising share prices have offset the effects of the weaker housing market.

Household consumption cannot remain unaffected by housing market developments, though. Household saving remains historically low and should rise in the months ahead. According to rules of thumb, the price changes we will see later this year might squeeze consumption by as much as 2-3 per cent.

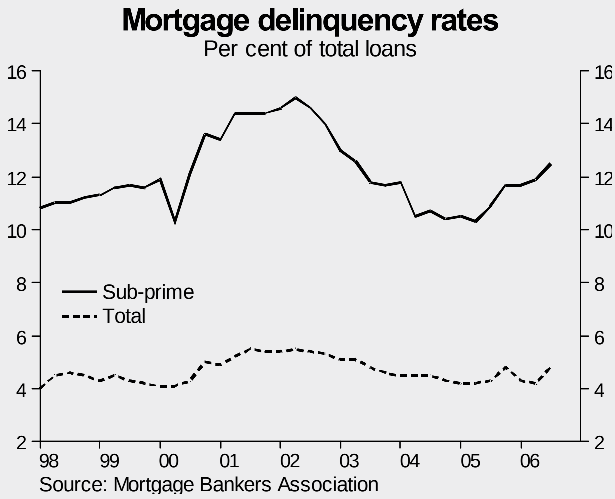
No major mortgage lending crisis

During the dizzy days of the real estate market boom and soaring mortgage debt, many households took out loans in a risky way. They were fooled by low interest rates and because some mortgage lending companies used "teasers" — temporarily discounted interest rates. Lenders also made overly hasty risk assessments, influenced by the short-term market mood. By repackaging mortgage loans and selling them as asset-backed securities to institutional investors, it was also possible to reduce the immediate credit risk to mortgage originators specialising in households with poor credit scores (the **"sub-prime"** sector).

Today this sector has run into trouble, since borrowers — usually low-income households with poor collateral — are being squeezed by higher adjustable interest rates and stagnating home prices. Once the teasers have expired and interest rates have climbed, the problems of insolvent households have accelerated. A number of mortgage lenders in the sub-prime sector have gone bankrupt, and credit losses are fairly extensive. Mortgage delinquency rates have risen from 10 per cent to 13 per cent in the past two years.

It should be noted, however, that this sector has traditionally experienced high credit losses. It is also comparatively small. The sub-prime sector accounts for 14 per cent of total residential lending. There is currently no indication that the solvency of major banks might be threatened. Credit losses in the banking sector as a whole are small, and the solvency of the banking system is record-high.

Mortgage delinquencies naturally have certain **negative macroeconomic effects**. Many low-income households will be forced to cut their future consumption. Loss levels in the exposed segment of the residential mortgage lending market will rise. Credit institutions will consequently tighten their lending criteria, and not only in this segment. Home prices will be further squeezed. Some households will be forced to sell their homes, thereby increase supply while potential buyers are being squeezed by tougher creditworthiness standards.



These effects have been taken into account in our forecast scenario. In order for mortgage loan problems to trigger a more acute recession risk, credit losses must increase sharply in the regular mortgage loan market, or hedge funds and more speculative investors must turn out to have high exposure to the sub-prime market, with losses on these investments forcing them to sell assets on a large scale. Today there are few indications that these things will happen.

Given the offsetting effects of the strong labour market and rising stock market wealth, and bearing in mind that the adjustment in consumption will probably be spread out over several years, we nevertheless expect a rather moderate slowdown. Our forecast implies that **household consumption growth will decelerate from 3¼ per cent in 2006 to just below 2½ per cent in 2008** (measured as annual averages). This will mean only a minor adjustment in saving, which will barely exceed zero next year.

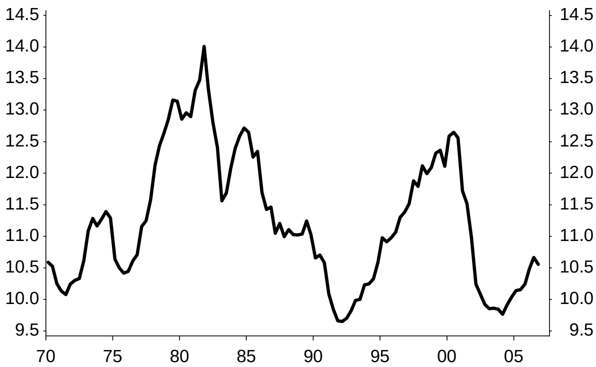
Capital spending outlook less certain

While consumption has remained healthy, capital spending has shown a tendency to slow, even outside the housing sector. This combination is worrisome. A slowdown in consumption, driven by a low saving rate and a weaker home price trend, risks creating a situation where the capital spending end will not show sufficient dynamism to keep total demand up. As a result, the **risks of a deeper downturn have risen** and the likelihood of a rapid recovery has diminished.

At the same time, it is difficult to believe that the signs we now see are the beginning of a deep capital spending slump. A historically low capital spending level, high capacity utilisation and good profitability point towards rising fixed investments.

US: Gross fixed investments

Excl dwellings, per cent of GDP



Source: US Department of Commerce

In addition, the weaker US dollar will contribute to an increasing **growth contribution from net exports**. After more than a decade of negative contributions, foreign trade had a neutral impact on economic growth in 2006. This year we expect a positive contribution of 0.4 percentage points; exports will climb by nearly 6 per cent, while imports will increase by only 2 per cent. Given these developments, it is likely that the **weakening of the American current account balance will finally end**, at least for a few years. Less alarming deficits in public sector saving are one reason for this.

Our overall conclusion is that the **American slowdown will be lengthier and thus somewhat deeper** than according to the consensus scenario. But although downside risks have increased, it is likely that rising capital spending and stronger foreign trade will help the US avoid a recession.

Strained resource situation for a while

The labour market has continued to demonstrate signs of strength. Unemployment remains at around 4½ per cent. Job growth has continued at a decent pace, although the year-on-year rate has slowed from around 2 to 1½ per cent.

US: GDP and employment

Year-on-year percentage change

Sources: US Department of Commerce, Bureau of Labor Statistics

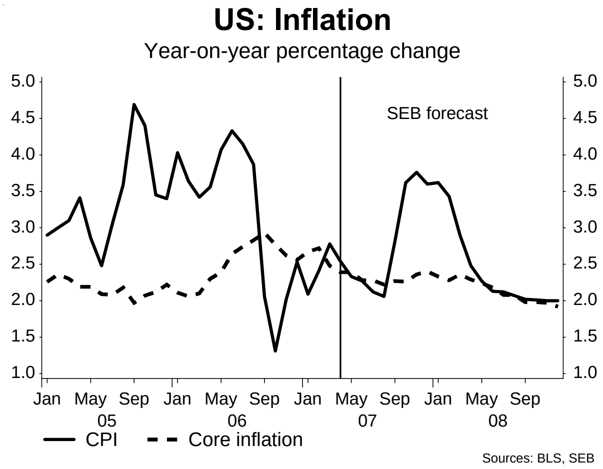
There are many indications that **employment growth will slow** further in the months ahead. As the above chart shows, the correlation between employment and GDP growth is stable. Year-on-year GDP growth has now dropped to 2 per cent, after a steep decline in the first quarter of 2007. The historical pattern indicates that employment is affected with a lag of a few quarters. A GDP increase of around 2 per cent should result in a slowdown in employment growth towards 50,000 new jobs a month.

According to Fed assessments, 100,000 new jobs a month are consistent with a constant unemployment rate. Hence, **unemployment is likely to turn upward** this autumn. The upswing may be moderate, however, since **labour supply rigidities are tending to become more and more apparent**. Older people are retiring earlier, students are entering the labour market later and more families seem to be choosing to survive on one income.

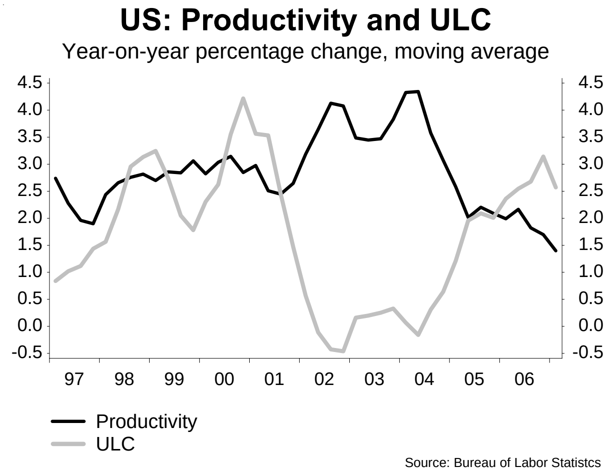
The weakening of labour supply means that **potential US growth has fallen**, something that the Fed's economists have recently emphasised. In our view, potential US economic growth has dropped from about 3½ per cent during the 1990s to about 3 per cent today. Lower potential growth **naturally limits the room for interest rate cuts**.

Stubborn inflationary forces

Base effects from variations in oil prices will dominate short-term CPI movements. In the next few months, CPI will fall, but will then rise sharply during the autumn when a year-on-year comparison is made against the low prices prevailing last autumn. As an annual average, **CPI will thus fall from more than 3 per cent in 2006 to about 2¾ per cent in 2007:** a more moderate downturn — and thus a more gentle injection of purchasing power for households — than foreseen in our last ***Nordic Outlook*** in February.



The outlook for underlying inflationary pressure does not look too promising in a short perspective. Core CPI — inflation excluding energy and food — has admittedly peaked, but various factors indicate that its continued decline will be a drawn-out process. Our forecast is thus that **core inflation will stay above 2 per cent throughout 2007**.



Pressure from high **unit labour costs** will persist for another while. Due to slower productivity growth, the increase in unit labour costs will be around 3 per cent the coming year.

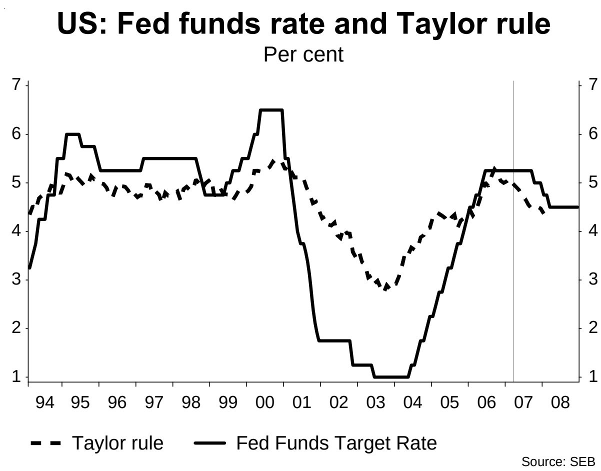
- **Costs of input goods will be pushed upward**. Energy prices have rebounded, while other commodity prices are rising at a rapid pace. The weakness of the dollar will contribute to the surge in costs. **Producer prices of consumer goods** will climb too, showing that these effects have now moved close to the consumer level.
- On the other hand, we expect that the **shelter component** in inflation will soon ease. This factor shows a close co-variation with the Fed's key interest rate, but with a one year lag. Since the latest Fed rate hike occurred nearly a year ago, this means that the shelter component's contribution to inflation will gradually normalise.

Interest rate cuts will not come soon

In recent months, the Fed has pointed to the risks of a lengthier, deeper downturn in the economy. Yet the central bank is sticking to a comparatively optimistic main scenario, where the downturn in the housing market does not lead to such major repercussions in the rest of the economy. Meanwhile it is natural that for as long as possible, the Fed wants to avoid fuelling expectations of interest rate cuts. As long as inflationary risks are apparent and unemployment is at a low level, the Fed is not willing to act unless severe financial or real economic threats are imminent.

Our conclusion is that it will not be until late in 2007 that inflation will have slowed and unemployment will have risen to such a point that the Fed sees reasons to change its key interest rate. This is based, among other things, on the Fed's historical pattern of reactions (Taylor rule), which is summarised in the chart below.

After that, we anticipate two interest rate cuts early in 2008. This implies a **federal funds rate of 4.50 per cent towards the end of our forecast period**.



Moderate upturn

- **Growth just above trend**
- **Inflation at a snail's pace**
- **Undervalued yen will remain weak**

Japan's recovery after its "lost years" is continuing, but the dynamic of this upswing has weakened slightly. Export growth is slowing in the wake of the American downturn, while the upturn in consumption remains tentative. **GDP will increase by about 2 per cent in both 2007 and 2008**. Inflation will barely rise above the zero level this year. This is **delaying further interest rate hikes** and will help to keep the yen weak.

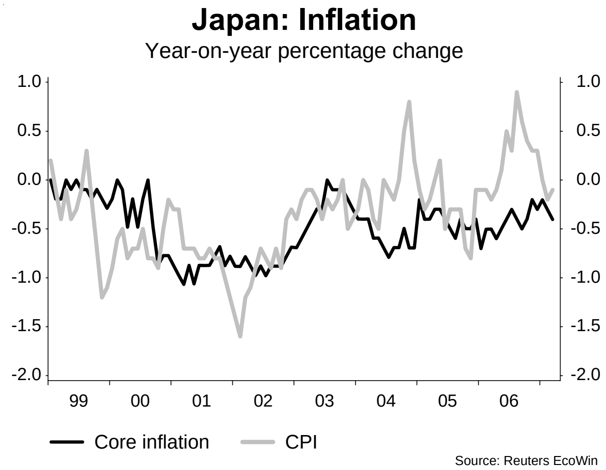
Fourth quarter 2006 growth was the strongest for three years. However, the upturn was largely a rebound after a weak third quarter. These rapid fluctuations applied especially to private consumption, which was pushed down by temporary factors during the third quarter. Available indicators provide little support for any short-term surge in consumption, but underlying factors point towards gradual acceleration over the next couple of years.

Consumption up in spite of everything

The labour market has improved, and corporate plans indicate that today's cautious upturn in employment will continue. The improvement has also led to mounting optimism among households. One reason why consumption has still not started to rise in earnest may be weak pay increases. However, mounting labour shortages should lead to some **upturn in wages and salaries** during the next couple of years.

The outlook for the manufacturing sector continues to look bright. However, we expect a minor dip during the first half of 2007, due among other things to an inventory correction in the electronics industry. Exports will weaken only moderately due to the American slowdown. Growth in nearby Asian countries will remain strong, while a weak yen is giving Japanese industry a competitive advantage. Capital spending by manufacturers, which has been the most expansive growth force in recent years, appears set to slow a bit, but underlying strength in the form of robust profitability and high capacity utilisation are providing support. In addition, business sector investments outside of manufacturing appear likely to strengthen. Meanwhile the downturn in public sector construction will slow down slightly.

Inflation has fallen during the past six months. In February it even crept below zero. CPI excluding energy and food, like the GDP deflator, shows a weakly rising trend, but the level of prices is falling marginally even according to these measures. Most indications are that inflation will remain near zero in the short term, and that after that it will increase very slowly as resource utilisation rises. Due to almost nonexistent inflationary pressure, **it will take time before the Bank of Japan (BoJ) raises its key interest rate** further after its last hike in February. Our guess is that the key rate, currently 0.5 per cent, will stand at only 1 per cent at the end of 2008.



Another reason for the BoJ to move ahead cautiously is to facilitate **efforts to restore order to public finances.** With public sector debt at a staggering 185 per cent of GDP and with an ageing population, further efforts are needed to bring public finances under control. Revenue raising measures such as higher consumption tax and a broadened tax base as well as reforms that boost economic growth potential are likely to be necessary.

To date, however, Prime Minister Shinzo Abe has been notably passive in the economic field compared to his predecessor Junichiro Koizumi. This cautious attitude may reflect an unwillingness to clash with various factions in the ruling LDP before this summer's election to the upper house of Parliament. A favourable outcome might help breathe life into the government's currently moribund reform policies. But a poor outcome may create further obstacles.

Interest rate differentials between countries remain an important driving force in foreign exchange markets, which largely explains the continued weakening of the yen. This is despite Japan's current account surplus of more than 4 per cent of GDP and a yen that is undervalued in terms of real effective exchange rate. In a longer perspective the yen should appreciate, but given our interest rate scenario, **the weakness of the yen will persist for the remainder of our forecast period.**

Tougher tightening ahead

- **Excessively fast growth, rising inflation**
- **Tightening and shift in strategy**
- **Revalued and more flexible yuan**

The Chinese economy is continuing to grow faster than desirable. The GDP growth rate was more than 11 per cent in the first quarter. Inflation is now also starting to climb. Although productivity is still rising rapidly, the authorities are trying to stem the flow of liquidity. We anticipate continued tightening ahead, including somewhat faster revaluation of the currency. **GDP growth will slow somewhat, to 10 per cent this year and 9.5 per cent in 2008.**

At this autumn's Communist Party congress, the main issue will be how to make growth less dependent on exports and capital spending. The aim is to achieve a **"harmonious society"**, with rural consumption playing a more pace-setting role. Certain steps have been taken. China is expanding infrastructure in its inland regions, while cutting health care and educational fees for farmers. The number of rural mass protests seems to have fallen in the past year.

Higher inflation

For several years inflation has been low, mainly because excessive capital spending has led to oversupply, resulting in intensive price pressure. But this past winter and spring, **inflation has climbed to above a 3 per cent rate**. Pay increases for trained staff in coastal regions are in double digits and the shortage of such staff has begun to be clear. In major cities, housing prices rose sharply during 2005-06. One reason was property speculation by the growing middle class, since they had few alternative investment opportunities. Preparations for the Olympics in Beijing have also helped to fuel a hot regional property market in the Chinese capital.

China has tightening its monetary policy by raising the key interest rate and boosting reserve requirements at banks. The yuan has been allowed to appreciate against the US dollar, and the capital account is being opened to larger flows. The banking sector is being strengthened by spinning off bad loans, injecting new capital and listing major banks in the stock market. Some effects have begun to be visible. The pace of capital spending has slowed. The trade surplus has fallen, partly on a temporary basis due to higher export tax.

But the banking system as a whole remains fragile. Although the largest banks have been restored to economic health, there are many indications that the scale of bad loans at smaller state and regional banks remains large.

And despite revaluation against the dollar, the real effective exchange rate of the yuan — against all currencies and taking relative inflation into account — has actually fallen in recent years. The reason is that the dollar has weakened against other currencies, while productivity has climbed rapidly in China's manufacturing sector. Rapidly rising salaries for experts and skilled workers in coastal regions can also be partly offset by the influx of cheap labour from rural areas.

Continued tightening

The government has tried to crack down on property speculation through administrative intervention and higher taxes. One result is a **major shift towards equity investments**. The Shanghai stock market shot up 130 per cent last year, but now appears overvalued. In recent months it has showed great volatility, and large fluctuations are likely to continue.

Another reason for the flow of funds into the stock market is that liquidity is increasing, due to the current account surplus. The influx of short-term capital hit a new record level during the first quarter, making it difficult for the People's Bank of China to sterilise the entire influx. **Tighter monetary policy and continued yuan appreciation** are the obvious recipes against overheating risks.

We foresee **continued interest rate hikes.** Since interest rates are still politically controlled, this means an upward shift in the entire yield curve.

China will continue revaluing the yuan against the dollar. For a long time, our forecast was **5 per cent annual appreciation**. But the extremely strong GDP growth and influx of foreign currencies point in recent months towards a **somewhat accelerated pace** ahead. China will also continue to experiment with a gradual widening of the trading band against the dollar, but it is likely to be several more years before the yuan becomes fully convertible.

China has established a new government authority to invest about USD 200 billion (one sixth of the foreign exchange reserve) in foreign assets: shares and commodities. There has been some concern in the market that these financial investments, together with a diversification of the remaining foreign exchange reserve, might lead to currency market turbulence. However, we believe the Chinese authorities are serious when they state that these **investment reallocations will take place in a way that does not disrupt the global foreign exchange market**.

German spring

- **More growth above trend in 2007 and 2008**
- **Falling unemployment**
- **Inflation around 2 per cent**
- **ECB rate hike to 4.25 per cent in October**

The euro zone upswing has now been under way for more than a year. GDP growth accelerated to 0.9 per cent between the third and fourth quarter last year. For 2006 as a whole, GDP thus hit 2.8 per cent, the highest figure since the IT boom at the turn of the millennium.

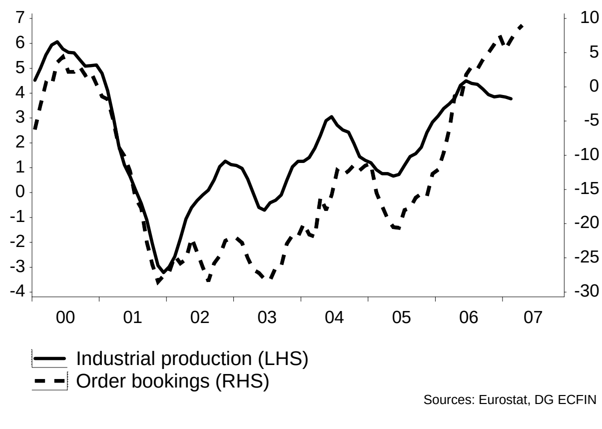
Germany is acting as a locomotive, mainly due to the major successes of its export industry. Unemployment is falling briskly throughout the euro zone. The US slowdown, the value-added tax (VAT) hike in Germany, higher interest rates and a stronger euro are restraints, but they are still not capable of spoiling the good times. **Euro zone growth will reach 2.7 per cent in 2007 and 2.5 per cent in 2008**. This means the euro zone will grow faster this year than the US.

Renewed expansionary strength

Various indicators point towards a **continued upturn**. Germany's IFO index is at a high level. Business confidence in the German economic situation strengthened dramatically in April and has trended upward for nearly two years. The recent upturn in the future outlook component of both the IFO and ZEW indices also indicates that businesspeople are less concerned than before about the negative impact of the US slowdown and the German VAT hike.

Euro zone: Production and orders

Year-on-year percentage change and net balance



Order bookings in the euro zone have continued to climb, and industrial production rose more than expected in February. This indicates that industrial production has maintained its rate of increase in the first quarter. Earlier fears that the manufacturing sector had peaked are thus being proved premature.

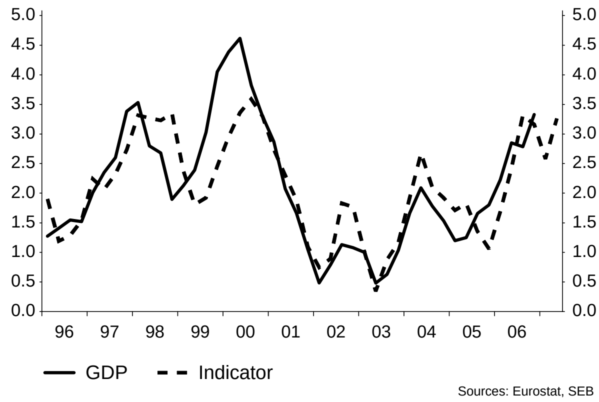
Our own growth indicator also suggests that the expansionary strength of the euro zone economies as a whole is somewhat larger than there was previously reason to believe.

Germany takes the lead

The German economy has awakened in earnest. GDP growth reached 2.7 per cent in 2006, well above the consensus forecast at the beginning of the year. Germany is thus in its **fastest growth phase since reunification**.

Euro zone: GDP and indicator

Year-on-year percentage change



The upturn is driven by strong exports. By means of **effective cost savings** in recent years, German industry has become increasingly well equipped to benefit from strong global demand. The domestic economy, too, is on its way up. One illustration of this is that **construction has finally taken off** after ten years of downturn.

However, German households stubbornly continue to hold on to their wallets. Last year, consumption rose by a mere 0.7 per cent, even though the VAT hike in January this year made it advantageous to accelerate consumption from 2007 to 2006. This weak upturn diverges substantially from other countries, even on the Continent. In France, for example, private consumption rose by nearly 3 per cent last year.

We believe that German growth will be broader this year, however. Capital spending has begun to rise, and although households have been cautious so far, we anticipate that falling unemployment and rising optimism will cause private consumption to take off gradually. It will increase by about 1 per cent this year, the highest figure since 2001. A continuing rise in clothing sales in April supports this forecast. **The German economy will grow by 2.7 per cent in 2007 year and about 2.5 per cent in 2008** — above the consensus view during both years.

As economic performance strengthens, tax revenue is also increasing in a number of countries. **Budget deficits have fallen** sharply — last year to 1.6 per cent of GDP in the euro zone as a whole, down from 2.5 per cent in 2005. Only a few years ago, Germany failed to stay below the deficit ceiling in the EU's Stability Pact, 3 per cent of GDP, but this year the German budget shortfall will probably be only some ½ per cent of GDP. Next year a balanced budget seems likely.

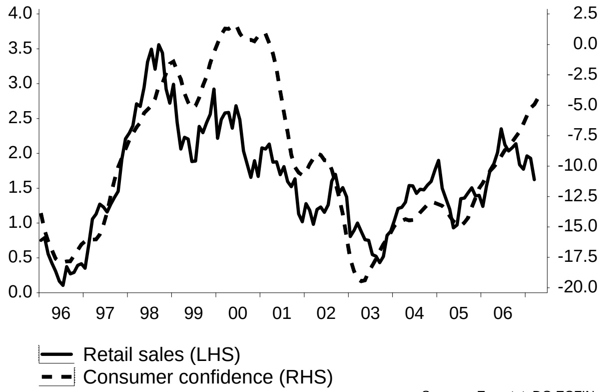
Broad upturn

Italy and France are growing at a relatively healthy pace as well. Italian GDP growth totalled nearly 2 per cent last year and will be slightly higher this year. Domestic demand is proving better than expected, thanks to a more robust labour market, while exports will be sustained by demand from elsewhere in the euro zone. French growth will benefit from strong private consumption and reach just above 2 per cent both in 2007 and 2008.

Ireland and Spain remain the fastest-growing euro zone economies — Ireland will grow by more than 5 per cent this year and Spain by nearly 4 per cent. The **euro zone as a whole will grow by 2.7 per cent this year and 2.5 per cent next year**.

Euro zone: Retail sales and confidence

Year-on-year percentage change and net balance



Sources: Eurostat, DG ECFIN

The euro zone will thus resist the American slowdown. One reason is that the domestic contribution to growth will gradually become larger. In addition, trade is increasing between the euro zone and neighbouring countries in Western Europe, as well as the rapidly growing economies of Asia and Eastern Europe.

Somewhat higher pay increases

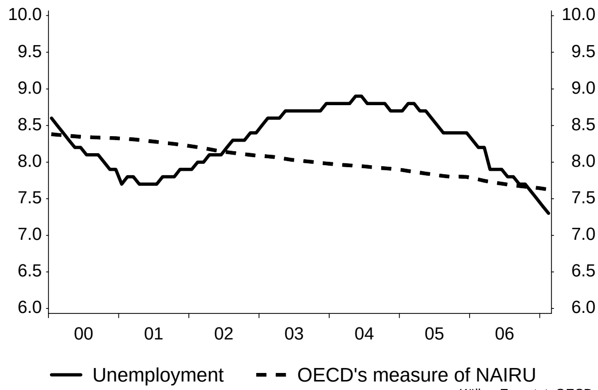
Companies are now reaping the fruits of the economic upswing. Profits are rising faster than pay. European stock markets have recently rallied. But as interest rates rise, the euro appreciates and global growth slows, profits will be squeezed, while the need to hire new employees will increase.

In the future, a larger proportion of profits will go to employees. Last autumn, Germany's largest steel producer signed the highest pay agreement in ten years. This year, new pay agreements for nearly seven million employees go into effect. High profits and a desire to compensate for earlier low wage and salary hikes will contribute to higher pay demands than for many years.

IG Metal and employers have just agreed on a contract implying almost a 4 per cent wage increase this year and about 2 per cent in 2008. Altogether, we expect German wages and salaries to climb about 3 per cent annually, slightly more this year. This would represent a modest increase in an international perspective, but the largest hikes in Germany since the mid-1990s.

Euro zone: Unemployment

Per cent



Källor: Eurostat, OECD

Unemployment falling rapidly

The upswing in France, Italy and Germany has left its imprint on the labour market. Unemployment is continuing to fall on a broad front. **The jobless rate is thus on its way below the traditional measure of equilibrium unemployment** — the non-accelerating inflation rate of employment, NAIRU — in the euro zone as a whole. Measured as annual averages, euro zone unemployment will end up at 7 per cent this year and 6.5 per cent in 2008.

Inflation around 2 per cent

So far this year, HICP inflation in the euro zone has stayed at somewhat below a 2 per cent rate. Core inflation — excluding alcoholic beverages, energy, food and tobacco products — has climbed and is now at about the same level as total inflation. The upturn in core inflation early this year is largely due to the German VAT hike, which instantly pushed up inflation by 0.3 percentage points in the euro zone as a whole and by nearly 1 percentage point in Germany.

The short-term pattern of inflation is largely being driven by energy price-related base effects. These will contribute to a decline in the HICP towards 1.8 per cent late in the summer, then a gradual rise to 2.4 per cent by year-end 2007.

The French presidential election

The French economy is in great need of reforms. The country has relatively low growth, high (though falling) unemployment and rapidly growing central government debt. It has slid a number of places downward in international prosperity league tables. Growth is being sustained by private consumption, but both exports and capital spending are lagging. One major problem is that the manufacturing sector has a difficult time maintaining its share of the world market. Poor competitiveness is due, not least, to a **rigid labour market**. France ranks low in international comparisons of how easy it is to hire and fire.

The euro-critical political statements of recent weeks in France are a symptom of the country's unwillingness so far to tackle its underlying problems. The stronger euro is being blamed in many ways for jobs that disappear abroad, high unemployment and the difficulty of selling French aircraft (Airbus) to the US.

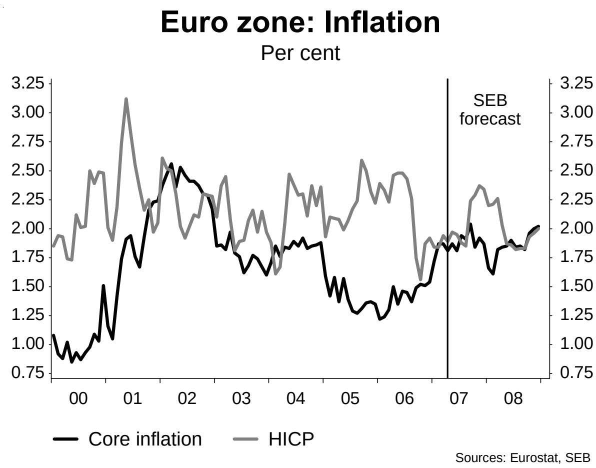
For individuals, the problems are more about high prices and weak buying power. People are also fearful that jobs will vanish from France to low-cost countries in Eastern Europe and Asia. The country's high unemployment has admittedly fallen gradually in recent years, but more than 8 per cent of the labour force remains jobless, a high proportion of which is long-term unemployed. There is high youth unemployment.

Yet a budding desire for renewal is now visible. The winner of the presidential election, Nicolas Sarkozy, campaigned on an explicit promise to liberalise the French labour market and abolish the 35-hour week. At the same time, his programme has a protectionist vein, since he wants to safeguard French industry.

The most important element of Sarkozy's economic programme is a **reform of labour legislation** providing greater flexibility for companies — while raising unemployment benefit. Labour supply will be stimulated by reduced employer fees, and capital spending by tax rebates to medium-sized companies.

It is fully possible that in time such measures may revitalise the rigid labour market. However, we expect that it will take time before the programme has been implemented and has yielded the intended effects; it is unlikely to result in a measurable impact during our forecast period.

Until then, the French economy will thus continue to rely on domestic consumption. Growth will chug along at around today's 2 per cent level but is unlikely to soar towards any real heights.



Underlying inflationary forces are currently pulling in somewhat different directions. The increasingly strong euro is exerting downward pressure on import prices. Pay increases remain at rather low levels, while there are hardly any signs of declining productivity growth.

- But unemployment is close to its equilibrium level. Other measures of the output gap — the difference between actual and potential production — also indicate that the economy is close to normal resource utilisation. This will cause upward pressure on core inflation.
- Price pressures from energy and other commodities have gained renewed strength. There is also an international trend towards less price pressure on consumer goods.

Our overall conclusion is that inflationary risks will increase slightly and that there are reasons to revise our inflation forecast somewhat. **Measured as annual averages, HICP inflation will be around 2 per cent** both in 2007 and 2008.

ECB key rate to 4.25 this autumn

To date, the European Central Bank has raised its key interest rate seven times since late 2005. The current refi rate of 3.75 per cent is close to what is regarded as a neutral level, but the ECB has signalled that its fundamental view is that the growth outlook remains strong and inflationary risks are on the upside. We thus expect the ECB to hike its refi rate to 4 per cent in June.

After that, the ECB has not provided much guidance on its strategy. We nevertheless expect it to carry out an additional **hike to 4.25 per cent during the autumn**. The strong growth signals we now see probably mean that the ECB will revise its forecasts upward in June. Given rising resource utilisation, slightly higher pay increases and continued rapid credit and money supply increases, the ECB is likely to see **continued reasons to raise the refi rate for preventive purposes,** in order not to be surprised by high future inflation.

At present, we find it hard to see justifications for the ECB to go further than this, even if it cannot be ruled out. Our forecast is that inflation will stay at around 2 per cent and that inflationary expectations will thereby be kept in check. A strong euro and a tightening fiscal policy will also help slow inflation and growth. In recent months, ECB President Jean-Claude Trichet has expressed **some concern about the ever-stronger euro**. In such a situation, there are obvious risks if the ECB more emphatically shifts its interest rate policy in a tightening direction.

Differing interest rate needs

One argument against the euro was that Western Europe is not an optimal currency area. Critics felt that a common monetary policy may lead to an incorrectly designed stabilisation policy in some countries.

A “Taylor rule” — which takes into account both inflation and unemployment — can be used in order to see how large the differentials are between countries. By calculating a policy rule and applying it both to the euro zone as a whole and to each specific member country, it is possible to gain a rough idea of how much today’s ECB interest rate deviates from the one each country “should” have if interest rates were still being set on the basis of national criteria.

The rule that we have used indicates that the ECB’s key rate is already comparatively high — but it does not take into account the ECB’s inclination to attach great weight to monetary factors such as money supply and credit growth.

- The table below shows that Greece and — especially — Spain need higher interest rates than they have today; both countries are exhibiting high inflation and low unemployment.
- Italy and Germany also need a somewhat tighter monetary policy than the euro zone as a whole, due to falling unemployment in Germany and high inflation in Italy.
- France, Ireland, Belgium, the Netherlands and Austria, in contrast, would manage well with somewhat lower rates than the ECB’s.
- Portugal would do nicely with a far lower key rate.

Another finding (which is not shown in the table) is that Ireland, Italy and Spain would have done nicely if the interest rate had been higher during the period 2000-2006, due to high inflation and falling unemployment. Germany, however, would have needed lower interest rates (due to low inflation and high unemployment) during the same period, whereas France would have had about the interest rates that the ECB chose.

Country-specific key rates according to the Taylor rule

	Deviation from euro zone average
Spain	+1.46
Greece	+0.79
Italy	+0.52
Germany	+0.32
Finland	+0.13
France	-0.30
Ireland	-0.51
Belgium	-0.62
Netherlands	-0.81
Austria	-0.86
Luxembourg	-2.10
Portugal	-2.30

Source: SEB

More rate hikes on the way

- **Domestic demand shifting upward**
- **Export growth fading**
- **High inflation means more interest rate hikes**

The British economy is continuing to grow at somewhat above the 2.5 per cent trend. Last winter's labour market recovery is helping to stimulate domestic demand. We foresee **GDP growth of 2.8 per cent this year and 2.5 per cent in 2008**. Inflation is uncomfortably high, and rising resource utilisation is creating continued underlying inflationary pressure. Home price appreciation has reverted to double digits year-on-year, which implies risks of future imbalances in the economy.

Good growth, excessive inflation

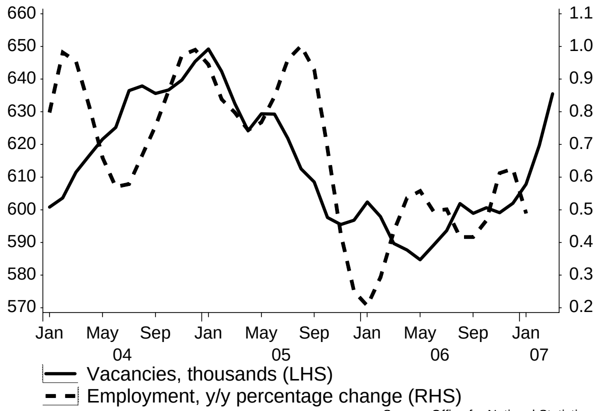
Since late 2005, annual GDP growth has parked just above trend. There are many indications that the economy will continue to grow at this rate for another couple of quarters. Household confidence has bounced back from a depressed level, and consumption has regained strength. Capital spending is continuing to grow, stimulated by high capacity utilisation and record profitability. However, exports are decelerating from their exceptionally high growth rate in 2006. Due to continued strong demand from the euro zone, the slowdown will nevertheless be moderate, despite the overvalued pound.

The labour market is on the road to recovery after last year's slump. Employment admittedly only strengthened marginally during the winter months, but the number of job vacancies has shown a clear upturn. The service and construction sectors are expanding, while the rapid pace of streamlining in manufacturing means continued staff cutbacks. **Unemployment will fall gradually** from an average of 5.4 per cent in 2006 to 5.0 per cent in 2008.

The rate of pay hikes will accelerate somewhat this year. We foresee an increase of less than 4½ per cent, a level that the Bank of England (BoE) regards as compatible with price stability. The upturn is mainly due to rising bonus levels. Early in 2007, the rate of pay increases including bonuses rose to 4.6 per cent; excluding bonuses it remained unchanged at 3.6 per cent. Rising labour supply, due among other things to immigration from Eastern Europe, will help restrain pay hikes.

Inflation has remained around 3 per cent since December 2006. Base effects from last year's oil price hike will pull down the rate somewhat this spring, and further ahead tighter monetary policy will help slow inflation. Meanwhile there is underlying cost pressure at companies, after several years of rising commodity prices. Notably, in the latest survey, manufacturers ratcheted up their inflationary expectations; the percentage of companies predicting domestic price hikes was the highest since 1995. This happened at the same time as household inflationary expectations were cooling slightly. Overall, we anticipate that **inflation will end up clearly above the BoE's 2 per cent target this year**.

United Kingdom: Labour market



Source: Office for National Statistics

Some distance left to key rate peak

So far, the BoE's three interest rate hikes in the past six months have only marginally slowed credit demand and expectations of future home price increases. We thus believe that the BoE will **raise its repo rate two more times**, first in May and then during the third quarter to 5.75 per cent. That will be the peak of its cycle. This relatively severe monetary policy tightening should be sufficient to cool off the property market and slow economic activity.

In the short term, interest rate hikes will **help the pound retain its strength**. Next year when the market begins to expect an easing of monetary policy, however, the currency will weaken.

Fiscal policy is mildly expansive, even though the budget deficit last year remained above 3 per cent of GDP. Income and corporate taxes is being lowered somewhat while environmental taxes are being raised. The expected handover of the post of Prime Minister from Tony Blair to the current Chancellor, Gordon Brown, will hardly lead to any shift in economic policy. However, the government's growth forecasts are on the optimistic side, and a **tightening of fiscal policy may become necessary** in order to push the budget deficit below 3 per cent of GDP.

Imbalanced strength

- **Imbalances will shrink somewhat**
- **Only Slovakia will adopt euro before 2010**
- **Central European currencies will appreciate**
- **Overheating in Latvia and Estonia**

The Central and Eastern European economies will remain strong in 2007-2008. **Growth will decline marginally** due to higher interest rates and somewhat weaker external demand; in the Baltic countries and Russia also due to mounting supply constraints. The US slowdown will have little impact since exports to America are very small and since the more important euro zone trade partner will continue to grow above trend. In many countries, **domestic demand is the central driving force**. High pay increases will stimulate consumption. Extra fuel for capital spending will come from the EU structural funds, an especially large factor in Poland, which is the largest net recipient in the EU 2007-2013 budget.

GDP in the region, including Russia, will increase by 6.1 per cent in 2007 and 5.7 per cent in 2008. We have adjusted our forecast slightly upward since the February ***Nordic Outlook***. We expect Latvia, Ukraine and Estonia, in that order, to have the fastest growth: averaging 7.5-8.5 per cent in the next couple of years. Hungary will continue to diverge from this pattern. Fiscal austerity will strangle domestic growth there this year, leading to GDP growth only a bit above 2 per cent. On the other hand, the country's twin deficits (budget and current account) will shrink to less serious levels.

- **Russia** is growing at a healthy rate (8 per cent in the first quarter), aided by high commodity prices and driven by domestic demand. Fiscal policy is expansive in the run-up to the parliamentary election in December 2007 and the presidential election in March 2008. We anticipate no change in political or economic policy direction after the elections. Investments have taken off in recent years. However, their level is still relatively low from the standpoint of long-term growth needs. WTO accession in 2008, which is within reach after the conclusion of bilateral agreements, would speed the investment upturn.

- **Ukraine**, like Russia, is benefiting from the strong global commodities boom. Consumption and investments are strong despite political turbulence. We predict annual GDP growth around 8 per cent in 2007-2008. Tensions between the president and the prime minister will lead to an election later this year. The European Commission recently warned that continued political crisis may delay a new cooperation treaty between Brussels and Kiev.

Euro will have to wait

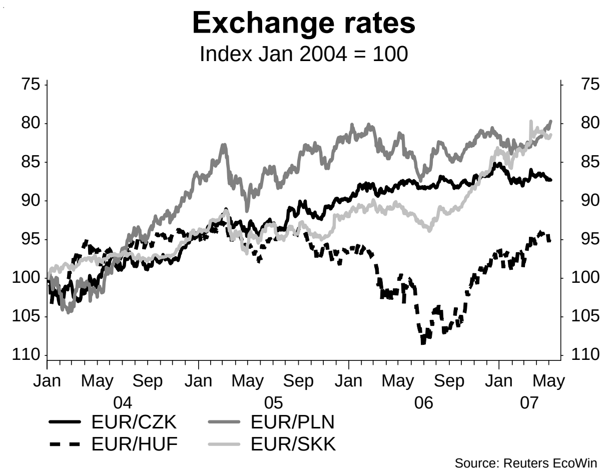
Concurrently with strong growth, the **Baltic countries and Central Europe** will be plagued by continued **large internal and/or external imbalances** (see the box on the next page and the March issue of ***Eastern European Outlook***). These pose risks of economic and financial instability down the road. Budget deficits in Central Europe will admittedly shrink somewhat in 2007-2008, mainly due to high growth. Except for Hungary, there are no signals of vigorous action in the form of fiscal austerity. Only Slovakia will have a deficit below the threshold for euro adoption, 3 per cent of GDP.

The imbalances will affect plans to adopt the euro. We still believe that Slovakia will join the euro zone in 2009, whereas it will take a number of additional years for the other EU countries in the region. This includes the Baltics, where budgets are balanced but inflation is too high. Over the past six months the governments of Estonia and Latvia have given up unrealistic hopes of membership in 2008.

Euro adoption timetable

	Official	Our view
Slovakia	2009	2009
Estonia	No target	2010 at earliest
Lithuania	2010 or later	2011
Czech Republic	No target	2011 at earliest
Latvia	No target	2012
Poland	No target	2012
Hungary	No target	2014

The imbalances in the Central European economies are not a headache for the financial markets, however. Strong growth and high productivity growth promise continued appreciation of their currencies.



Continued overheating in Latvia

Latvia and Estonia exhibit increasingly clear signs of overheating, after several years of excessively fast, domestically driven growth.

Imbalances in the form of high inflation, large current account deficits and burgeoning private foreign debt have led to **financial market unrest in Latvia**. The acute devaluation worries about the Latvia lat which erupted in February have admittedly receded. After central bank interventions, the currency is back on the strong side of the exchange rate band. But short-term market interest rates seem to be stuck at around 10 per cent. Both Latvia and Estonia have also attracted closer scrutiny from international rating institutions. Since February, Standard & Poor's and Fitch have lowered their credit rating outlook from stable to negative.

Credit-driven growth

Growth is far above long-term sustainable levels of 6-7 per cent. Last year both countries noted GDP growth of 11-12 per cent. This growth is largely credit-driven. **Early in 2007, credit growth in Latvia was around 55 per cent** (year-on-year).

Inflation in Latvia accelerated from 7 per cent in January to 8.5 per cent in March — the highest figure in ten years. The numbers will remain high this spring due to a sharp price hikes for natural gas. The inflationary upturn is broad, driven mainly by rising wages: nearly 30 per cent in late 2006.

Latvia's current account deficit was 26 per cent of GDP in the last quarter of 2006. It was driven by continued high merchandise imports, but it is cause for concern that declining export growth was also a factor. During the winter, export growth recovered, but on the other hand imports climbed further. The estimated **current account deficit in the first quarter was 20 per cent of GDP**.

Monetary policy blocked

To overcome its imbalances, Latvia needs a tightening of economic policy. However, monetary policy is severely restrained because of Latvia's fixed exchange rate system. Nor is there much room left for further tightening of cash reserve requirements at commercial banks.

Unlike Estonia and Lithuania with their currency board systems, the Bank of Latvia can use the interest rate weapon, provided that the exchange rate band of ±1 percentage points against the euro is not exceeded. During the winter, the Bank of Latvia raised its refi rate to 5.5 per cent, and we anticipate continued hikes to more than 6 per cent. The dilemma is that this only affects demand for the local currency, while credit expansion to date has mainly involved euro loans. In order to slow euro-denominated lending, foreign-owned banks must actively decelerate their own lending — i.e. in practice, assume the role of quasi-central banks.

Difficult to tighten fiscal policy

There are also complications when it comes to fiscal policy. The budgets in Latvia and Estonia are more an less in balance. This reduces the potential for gaining political acceptance for austerity measures.

However, in response to pressures due to currency market nervousness in February, the Latvian government took a first step. The aim is to bring down inflation, among other things by balancing the budget in 2007 and 2008 and achieving a surplus in the next two years.

But as yet, Estonia has no ambitions to tighten fiscal policy. The reconstituted government issued promises of further tax cuts during last winter's parliamentary election campaign. Since overheating tendencies are also apparent in Estonia, the government may be forced into a rapid change of course towards a contractive fiscal policy.

Slowly shrinking imbalances

Our main scenario is that imbalances will shrink somewhat in the coming years. Latvia's GDP growth will slow from 12 per cent in 2006 to 8 per cent in 2008, while the corresponding slowdown in Estonia will be from 11½ per cent to 7.0 per cent. The reasons for slower growth will be **burgeoning labour shortages and tighter lending** from commercial banks. In Latvia, tighter fiscal policy and measures to counter high credit demand will help decelerate growth to some extent.

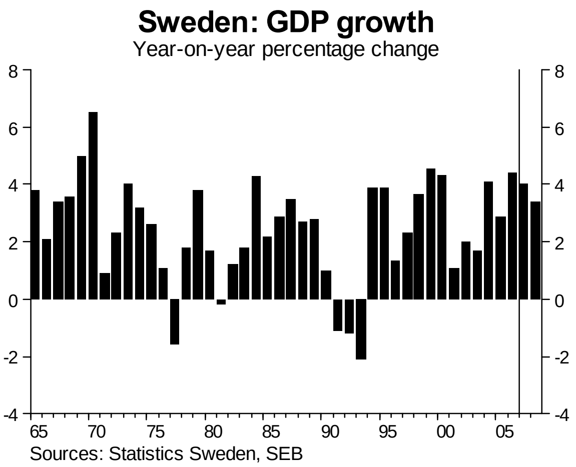
To ensure a soft landing, however, further tightening of lending will be required and possibly also further fiscal policy tightening.

Our risk scenario is a hard landing, which might include exchange rate devaluation as a consequence of growing cost pressures, which in the long term risk leading to competitiveness problems. But in the current situation, devaluation is hardly the right medicine; it would further fuel already excessive inflation and growth. Instead, reduced lending pressure and fiscal austerity are the best cures.

Strong growth, tighter labour market

- **Approaching the peak of the cycle**
- **Unemployment below 4 per cent, growing supply side restrictions**
- **Accelerating pay increases, rising inflation**
- **Tax cuts, expansive fiscal policy**
- **Riksbank will raise key rate to 4.75 per cent**

The Swedish economy is growing briskly. After last year's 4.7 per cent growth, **GDP will increase by 4.2 per cent this year and 3.3 per cent in 2008,** calendar adjusted. The economy will thus grow by an average of more than 4 per cent annually during the period 2006-2008: an upturn only matched during the past half century by the turn-of-millennium boom and the "record years" of the late 1960s.



Demand is growing on a broad front. Export growth is holding up well, despite the US economic slowdown. Household consumption is rising sharply, while high profitability and capacity shortages are driving up capital spending.

Meanwhile it is clear that **Sweden is approaching the peak of its economic cycle**. Growth is increasingly being driven by rising employment, while the increase in productivity is slowing. We expect more than 100,000 new jobs to be created this year, and an additional 60,000 next year. **Unemployment will fall below 4 per cent** in 2008. The rate of pay increases will ratchet up to 4½ per cent during the coming collective contract period. This will help fuel rising inflation: The Riksbank's UND1X underlying inflation measure will reach 1.1 per cent this year and 1.7 per cent in 2008, but **by spring 2009 inflation will pass 2 per cent**.

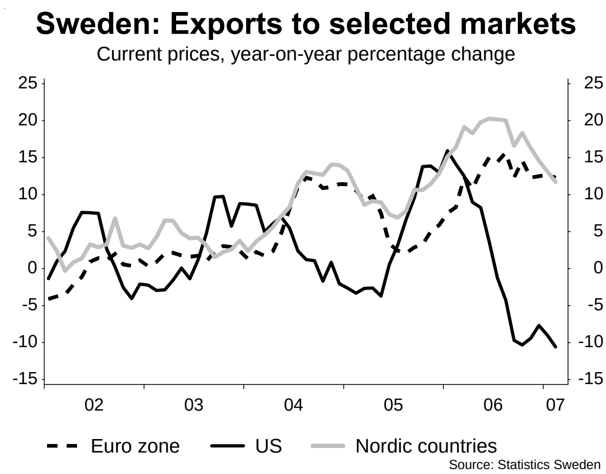
As a result, the Riksbank will raise its key interest rate at a significantly faster pace than indicated in its Monetary Policy Report in February. By year-end 2007, the bank's repo rate will stand at 4 per cent. It will be raised to 4.75 per cent during 2008. Like a number of other central banks, the **Riksbank will thus raise its key rate above the neutral level**.

Fiscal policy will be expansive, due to tax cuts both this year and in 2008. This will also increase pressure for interest rate hikes. The government will nevertheless meet its public finance targets by an ample margin.

Exports resisting US slowdown

Exports increased by more than 9 per cent in 2006, and conditions are favourable for further expansion. However, indicators point to a slight deceleration in export growth compared to last year.

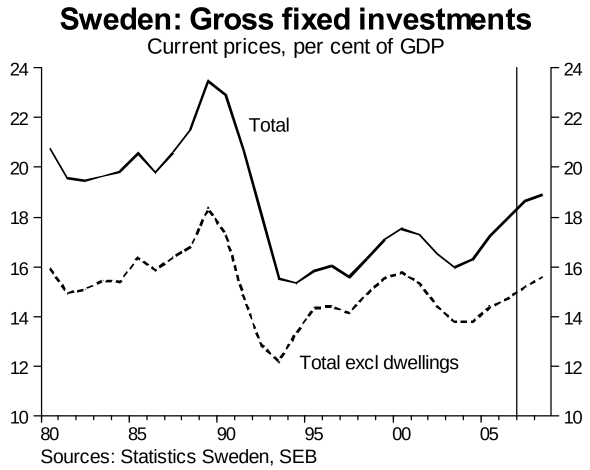
The trends in the international economy — both demand patterns and exchange rate movements — are reflected in Swedish exports. Last year, exports to the US decelerated while exports to the euro zone and neighbouring Nordic countries increased sharply. Germany regained its position as Sweden's largest export market, and in recent months Norway has wrested second place away from the US.



Looking ahead, the pattern of strong demand from European markets will persist, although the upturn in neighbouring Nordic countries will slow somewhat. The strengthening of the krona will decelerate Swedish export growth, which on the other hand will benefit from continuing strong demand for investment goods.

Expansive investment plans

Capital spending will see a renewed acceleration. High capacity utilisation, good profitability and robust demand are strong motives for capacity expansion. Investment plans were admittedly cautious early in 2007, but since then they have been revised upward. Manufacturers are now stating growth figures of more than 15 per cent this year. The investment upturn also look set to be significant in the energy sector and the distribute trades as well.



The central government will increase infrastructure investments at a healthy pace, while residential construction will rise further. Because of the upturn, capital investments as a percentage of GDP in the next few years will exceed the average for the latest 25-year period, recouping a large proportion of their decline since the 1990s.

Rising costs as well as supply side constraints related to both labour and building materials will eventually slow the expansion of construction investments.

The best of times for households

Due to several interacting factors, this year **real purchasing power will increase by nearly 6 per cent**. Wages and salaries will accelerate from just above a 3 per cent growth rate to 4½ per cent, while inflation will remain low and employment will rise sharply. In addition, households will benefit from such tax cuts as earned income tax credits and the elimination of wealth tax. Next year we expect further tax cuts in the range of SEK 10 billion.

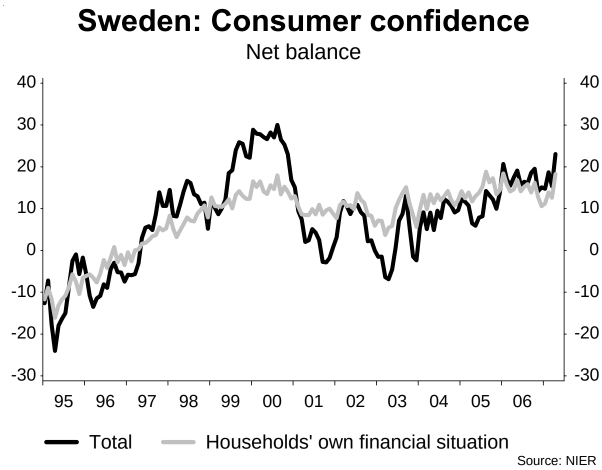
Overall, real household purchasing power will increase by an annual average of 4½ per cent over the next two years, or at about the same level as during the years around the turn of the millennium. Our assessment is that consumption will increase somewhat more slowly than income.

Economic situation of households
Year-on-year percentage change

	2005	2006	2007	2008
Private consumption	2.4	2.8	4.3	3.9
Disposable income	1.5	2.0	5.8	3.2
Savings ratio, % level	8.7	8.1	9.5	8.9

Sources: Statistics Sweden, SEB

In light of the stock market upturn and rising home prices, the risks are mainly on the upside. The household savings ratio is a full 8 per cent, which can also be interpreted in the same direction, but it is worth recalling that the net surplus in the national premium pension (PPM) system is now included in household savings. The savings that households themselves have at their disposal, i.e. excluding PPM and contractual pensions, totals a more modest 2½ per cent and have fallen by 3½ percentage points since 2002.



Unemployment below 4 per cent

Because of strong economic growth, demand for labour is increasing sharply. According to the National Labour Market Board (AMS), the number of new job vacancies is about 50 per cent higher than one year ago. We expect more than 100,000 new jobs to be created this year, equivalent to 2.5 per cent of the labour force. Next year the increase will be 1½ per cent. This implies **250,000 new jobs altogether during the period 2006-2008**. The upturn is clearest in construction and a number of service sectors. But local governments are also hiring new employees and even the manufacturing sector is increasing its employee rolls.

Registered unemployment is falling, despite cutbacks in AMS-sponsored "labour market policy programmes" (employment training and temporary jobs).

Additional fuel for home prices

The abolition of wealth tax and central government property tax will affect the housing market and consumption patterns. These government proposals come at a time when a robust labour market and continued low interest rates have given renewed strength to the upturn in home prices. SEB´s own housing price indicator shows that the number of households who anticipate higher home prices has reached a record high. Greater wealth will thus further stimulate consumption, while higher prices in the second-hand market will drive construction (“Tobin’s q”).

Annual tax revenue will decline by SEK 16 billion when the central government real estate tax disappears. This shortfall will be financed in part by a new municipal fee that will yield SEK 10 billion in revenue. The remaining SEK 6 billion will come from higher capital gains tax. In the long term, the proposal will thus be fiscally neutral, although there is some uncertainty concerning the timing rules for the capital gains taxes.

Yet this reform, combined with the abolition of wealth tax, will **stimulate consumption**. Lower taxation improves the housing cost projections of households; they can borrow more for their home purchases, which in turn will drive up the price of the country’s housing stock. Part of this increase in wealth can be used for increased consumption. Our calculations indicate that an average buyer can now pay over 10 per cent more for an average single-family home. The effect would be an increase of SEK 160 billion in residential real estate wealth.

A common assumption is that about 5 per cent of wealth gains go towards higher consumption. In this sample calculation, the result would be a maximum consumption increase of SEK 8 billion or three quarters of a per cent. The effects of the elimination of wealth tax on homes can be added to this.

But the increase in capital gains tax pulls in the opposite direction. The correlation between residential real estate wealth and consumption seems to have decreased so far during the 21st century and appears to be weaker in Sweden than in English-speaking countries, which is another reason to be cautious about drawing conclusions.

The number of people in such programmes will continue to decrease for another while. However, new labour market policy programmes will gradually be launched. The most important is the **“job and development guarantee”** being introduced on July 1, 2007. According to Finance Ministry estimates, it will cover more than 40,000 people next year. The purpose of the programme is to increase efforts to find jobs for the chronically unemployed. Statistically, the programme will mean that some of those unemployed will end up outside the labour force, which will thus lower registered unemployment.

In addition, the previously approved “new start jobs” for young people are being supplemented with “step-in jobs” aimed at asylum seekers and their relatives, combining work with Swedish language training. Employers who hire these categories of employees will receive tax relief, and participants in the programme will be counted for statistical purposes as regular employees.

The government’s **programmes are clearly aimed at groups regarded as far removed from the labour market**, among other things in to avoid to counteract crowding-out mechanisms. These measures will be added to earlier programmes aimed at removing obstacles to joining the labour market, but it will probably take time for them to have an impact.

Labour supply is also affected by other factors. The working-age population rose last year by one whole per cent, mainly because a temporary asylum law led to **very high immigration**. Increasing labour force participation among immigrants is thus becoming increasingly important.

The trend towards increased labour supply among older people is having a major effect, due to the large number of people born in the 1940s. Meanwhile there is some room left for a cyclical rise in labour supply as new hiring increases.

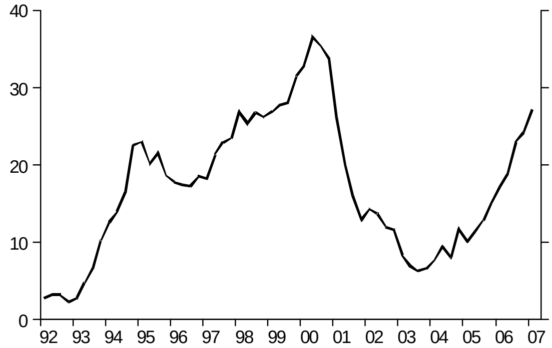
Labour market and productivity
Year-on-year percentage change and level

	2005	2006	2007	2008
GDP	2.9	4.7	4.2	3.3
Productivity	2.0	2.6	1.8	1.8
Employment	0.7	1.9	2.5	1.4
Hours worked	0.6	2.0	2.3	1.5
Labour supply	0.7	1.3	1.6	0.8
Unemployment, %	5.9	5.4	4.5	4.0
AMS programmes, %	2.7	3.0	2.0	2.0

Sources: Statistics Sweden, SEB

Overall, the labour supply will increase by 1.6 per cent in 2007 and 0.8 per cent in 2008. As a result, unemployment will fall from today's 4.8 per cent to 4¼ per cent at the end of 2007 and will continue to a bit below 4 per cent by the end of 2008. Given the new definition of unemployment, this is probably below the non-accelerating inflation rate of unemployment (NAIRU). Overheating tendencies will thus probably become noticeable in various sectors.

Sweden: Labour shortage according to NIER survey
Share of firms in per cent



Sources: NIER, SEB

The upturn in the labour market has already meant increasing problems in matching job seekers and vacancies. **Labour shortage figures have increased at a relatively rapid pace** in the past year. The biggest recruitment problems are in construction and certain service sectors. In spite of this, labour supply does not yet seem to have been a general obstacle to continued growth. For example, employment in the construction sector has continued to increase rapidly, even though companies have long complained of difficulties in recruiting labour. However, we expect shortage figures to rise, gradually resulting in **bottlenecks and mounting wage and salary pressure**.

Wages accelerate

A majority of wage negotiations in the private sector are now finalised. The settlement in manufacturing, which has served as the norm for industry as a whole, raises pay by a total of 10.2 per cent for the next three years. The last year, however, is re-negotiable. In our judgement, the settlements will mean wage increases that are one percentage point higher per year compared to the previous agreement period 2004-2006. The agreements differ in a number of technical aspects, however, which makes it difficult to forecast the final outcome of pay hikes.

In the run-up to the 2007 wage round, trade unions demanded special increases targeted to low-wage groups and women. It was thus logical that the outcome of the negotiations for Sweden's female-dominated distributive trade sector was higher than the outcome in manufacturing. For the same reason, we expect pay increases for local government employees to be higher than in manufacturing as well.

Pay increases
Year-on-year percentage change

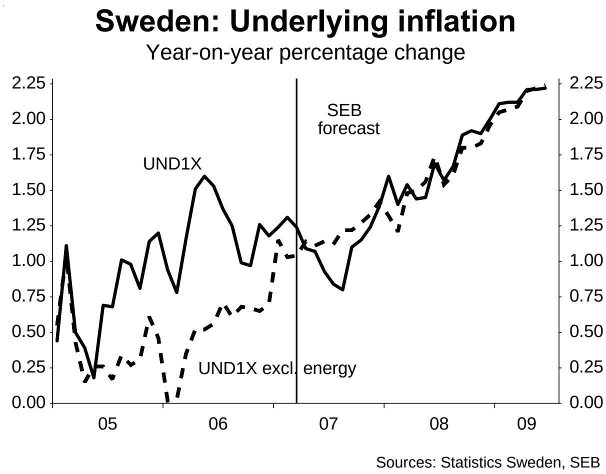
	2005	2006	2007	2008
Manufacturing	3.1	3.2	4.0	4.5
Construction	3.1	3.3	4.3	4.8
Business sector	3.2	3.2	4.2	4.6
Public sector	2.9	3.1	4.4	4.9
Total	3.1	3.1	4.2	4.7

Sources: Statistics Sweden, SEB

Since most collective agreement sectors will end up with pay increases higher than the manufacturing sector, this may give rise to compensatory demands, especially since manufacturing employees received somewhat slower pay increases in 1998-2005 than other groups. The pay trend for white collar groups in other sectors will determine whether manufacturing unions will demand the re-negotiation of wages for their third contract year.

The strong labour market implies that there is pressure for wage and salary hikes above collective agreements. Overall, we estimate that the **rate of pay increases will accelerate from just above 3 per cent annually in the previous agreement period to 4½ per cent** during 2007-2009. Since many collective agreements go into effect on April 1, this year's pay increase will be somewhat lower than in 2008 and 2009, even though a number of agreements are front-loaded.

Our pay forecast is higher than the increase that National Institute of Economic Research (NIER) regards as compatible in the long term with the Riksbank's inflation target. The outcome of the wage round thus underscores that the cyclical situation in the Swedish economy has changed and that inflationary risks are now rising.



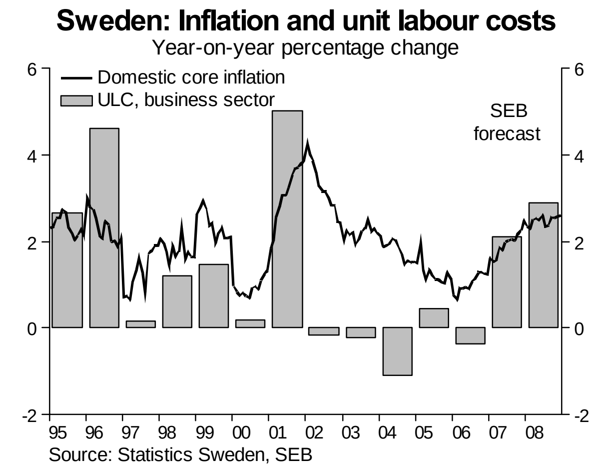
Rising domestic inflationary pressure

Inflation measured as UND1X (CPI minus mortgage interest and changes in indirect taxes and subsidies) has moved sideways in recent months, amounting to 1.2 per cent in March. In a short-term perspective, the various indicators provide a divided picture. The trend of producer prices points towards rising inflationary pressure. Higher oil prices are leading to higher petrol prices, which will drive up the inflation rate during the autumn. Meanwhile unit labour costs are still low. In the next few months, falling electricity prices will also contribute to low inflation.

Somewhat further ahead, inflationary risks will increase. The most important reason is that **domestic cost pressure will rise** due to higher pay increases and lower productivity growth. Unit labour costs largely stood still during the period 2002-2006 but will now rise by 2-3 per cent this year and next.

Food prices have once again begun to climb. An important price-lowering factor has thus disappeared. Rising rents will also contribute to higher inflation, although the upturn next year will be slowed somewhat by the abolition of real estate tax. Reduced international price pressure will also mean that the negative contribution from import prices will slow.

As an annual average, the increase in UND1X will amount to only 1.1 per cent in 2007, then rise to 1.7 per cent next year. In two years, **by spring 2009, underlying inflation will have risen above 2 per cent**.

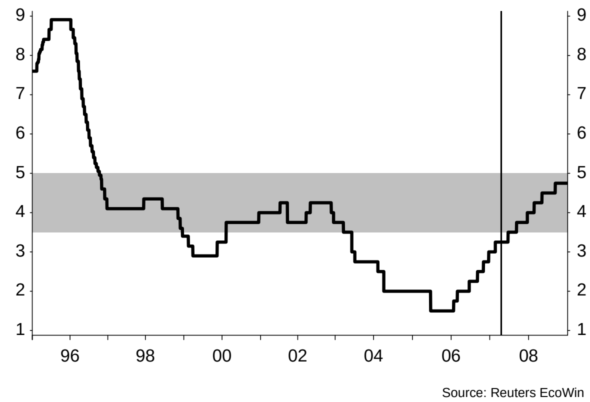


Consumer prices are increasing faster than UND1X, mainly because of rising interest rates. CPI is also affected by changes in taxes and fees. The net effect of such changes will contribute 0.5 percentage points to inflation by the end of 2007, due to higher taxes on energy and tobacco, a new tax on car insurance premiums and traffic congestion fees in Stockholm. Next year, abolished real estate tax and lower dental care fees will result in a negative contribution of 0.4 percentage points. They will also lower UND1X inflation by two tenths in 2008.

Riksbank will speed up the pace

In its Monetary Policy Report in February, the Riksbank surprised observers by unveiling a repo rate path of its own that only climbed to 3.50 per cent in December this year and levelled off at 3.75 per cent at the end of 2009. Strong confidence in globalisation and in the inflation-restraining effect of domestic supply side policy was behind this. Also discernible was an unwillingness to continue delivering inflation outcomes below target.

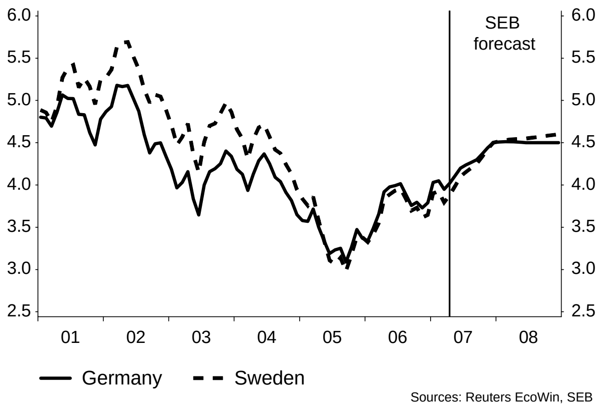
The Riksbank has now begun to back away from this optimistic picture. At its meeting in May, the Executive Board announced that it will hike the repo rate more than it stated in the February report. We anticipate that **at its June meeting the Riksbank will hike the repo rate to 3.5 per cent and present an interest rate path that exceeds 4 per cent within a few years.** The reasons are not difficult to find. Employment is increasing fast. Resource utilisation will be higher and pay increases will be larger than in the Riksbank's main scenario. In addition, both home prices and lending have continued rising at a rapid pace. The contents of the government's spring budget, including the abolition of the real estate tax and certain unfinanced tax cuts pull in the same direction.



Our own forecast is that cyclical forces are so strong that the Riksbank will finally act even faster. We predict three more rate hikes this year, to 4.00 per cent in December. Then three hikes will follow during 2008, resulting in a **repo rate of 4.75 per cent by the end of 2008**. The Riksbank will thus be moving in the upper part of the interval that the bank previously called neutral. In previous issues of ***Nordic Outlook***, we have maintained that nowadays the neutral level is somewhat below what the Riksbank claims. Our forecast thus means that the bank's **monetary policy is moving from expansive to contractive**.

Higher long-term yields, stronger krona

At present, Swedish bond yields — in a break with their historical pattern — are below German ones. Since the Riksbank will be raising its key interest rate at a faster pace than the ECB, while the pace of inflation in Sweden and the euro zone converges, **Swedish interest rates will rise faster than German ones** in the future. By the end of our forecast period, the Riksbank's key rate will stand 50 points higher than the ECB's. Our assessment is that this will result in Swedish long-term yields of 10 points above Germany. The rapid decline in Swedish central government debt will mean a smaller supply of bonds, which will help prevent the spread in long-term bond issues from being larger than this.



Short-term interest rates rising faster than in the euro zone, continued large current account surpluses, elimination of wealth tax and rising domestic capital spending are indications that the **krona will continue to appreciate**. At the end of 2007 the EUR/SEK exchange rate will be 8.95, and at the end of next year 8.85. The krona will strengthen even more against the dollar — we predict an exchange rate of SEK 6.39 per USD at year-end and 6.10 at the end of 2008.

The new Executive Board

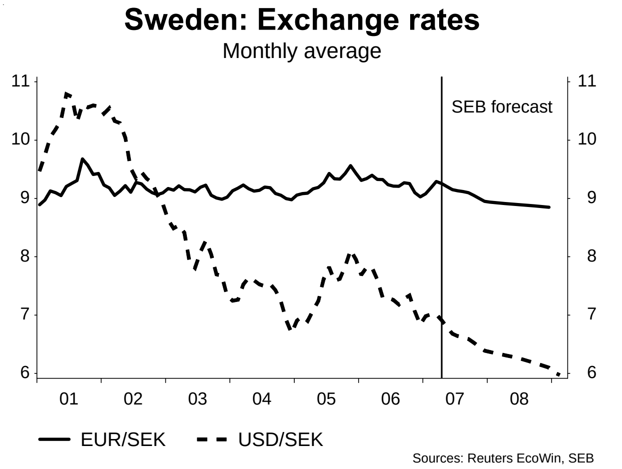
In May the Riksbank's Executive Board welcomes two new members: Barbro Wickman-Parak, chief economist at the home mortgage institution SBAB, and Lars E O Svensson, a professor at Princeton University.

Considering that the Riksbank faces a retreat not entirely free of problems, it is of interest whether these new appointments will lead to a shift in the policy consensus of the Executive Board.

Barbro Wickman-Parak shows no unambiguous pattern. At SBAB she has previously presented forecasts of sharp interest rate hikes. As a member of the financial daily *Dagens Industri's* "Riksbank shadow Executive Board", however, she initially supported the bank's low interest rate path.

Lars E. O. Svensson is one of the intellectual fathers of today's flexible inflation targeting. He may thus conceivably attach great importance to the rapid upturn in the economy. On the other hand, at the time of his appointment he maintained that price level targeting along the lines recommended by Professors Frederic Mishkin and Francesco Giavazzi in their recent government-commissioned evaluation of Swedish monetary policy was worth further investigation. Price level targeting would enable the Riksbank to compensate for earlier years of below-target inflation by being above target for a while — which implies less need for interest rate hikes.

This may possibly indicate that both new members stand for a somewhat dovish policy in the short term. However, we anticipate that at the June meeting they will support a decision to lift the old inflation path. This will hardly reach the level of our own forecast in one single move, though. The Riksbank's new interest rate path will probably peak at 4.25 per cent — which implies that a new upward revision can be expected in the autumn.



Large budget surplus, despite tax cuts

Public expenditures will continue to trend downward as a percentage of GDP. The public expenditure ratio, which totalled a full 70 per cent in 1993, will end up at around 50 per cent next year. Public revenue will also continue to fall as a percentage of GDP, though not as rapidly.

Public finances

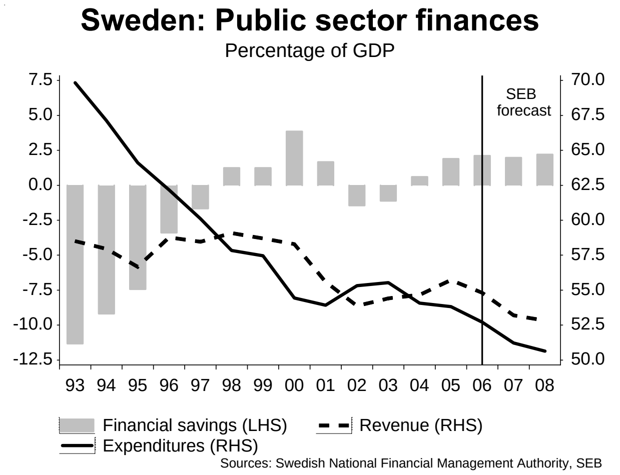
Percentage of GDP

	2005	2006	2007	2008
Revenue	55.7	54.8	53.2	52.8
Expenditures	53.8	52.7	51.2	50.6
Financial savings	1.9	2.1	2.0	2.2
Public debt (Maastricht)	52.2	46.9	39.8	35.9
Central govt debt	49.0	44.7	38.3	33.9
Central govt borrowing req, SEK bn	-14	-18	-110	-80

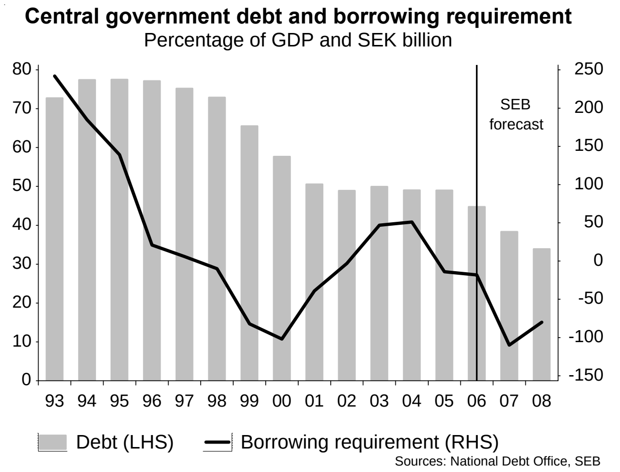
Sources: National Debt Office, Statistics Sweden, SEB

Sweden's favourable economic performance will strengthen public finances, even though lower income taxes and earned income tax credits will work in the opposite direction. Public financial savings — this time excluding the premium pension system, which is now classified as private savings — will continue to show surpluses. We predict that **financial savings will total 2 per cent of GDP this year and 2.2 per cent next year**. This is well above the official target, which after the redefinition of pension savings is now a 1 per cent average surplus over a business cycle. However, the budget balance will benefit from higher tax revenue for cyclical reasons. The government's proposed budget measures are not fully financed, and this will have a positive effect on demand. Their **stimulative effect will be around 1 per cent of GDP, both this year and next**.

We interpret this development as indicating that in some respects the Finance Ministry has had to yield to the party chairmen in the non-socialist government and to the political dynamics of coalition rule. Income tax cuts will admittedly have positive supply side effects. But under current economic conditions, the elimination of real estate tax will fuel demand and drive up home prices in a way that is not desirable.



In his Budget Statement during April, Finance Minister Anders Borg responded by promising stricter monitoring of the expenditure ceilings as well as the establishment of an independent fiscal policy council. We view this as an **attempt to strengthen the Finance Ministry's ability to resist the spending demands of party chairmen** — something likely to be needed later this year when the scandal-plagued Liberal Party elects a new chairman. The Centre Party has ambitious plans to grow its voter base, and the Christian Democrats are losing ground in public opinion surveys.



The position of the government's big spenders is strengthened by the central government budget surplus: SEK 18 billion last year. Privatisations of state-owned companies totalling some SEK 50 billion per year will lead to a **rapid decline in government debt**. Next year, public debt (Maastricht definition) will total only 36 per cent of GDP. This ensures a continued political tug-of-war over government finances.

Slowdown on the way

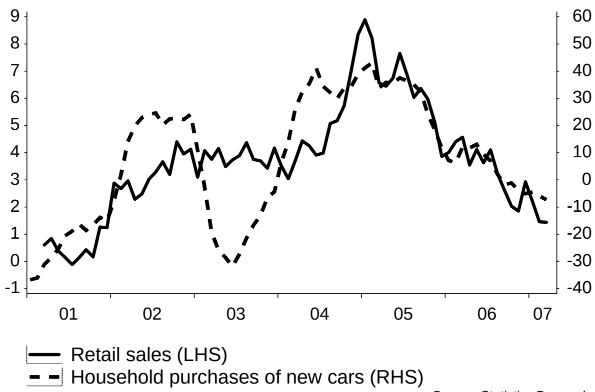
- **Continued cooling in the property market**
- **Manufacturing remains strong as growth fades**
- **Tight labour market leading to surge in pay**

The Danish economy is **past its cyclical peak**, after two years of GDP growth in excess of 3 per cent. Consumption will slow in the wake of a fading property boom. Next year, capacity constraints and slightly weaker competitiveness will also contribute to slower growth. Given a strong manufacturing sector and decent export growth for one more year, the slowdown will follow a gentler curve than we had previously anticipated. **GDP will increase by 2.5 per cent this year and 1.8 per cent in 2008**, but we are sticking to our assessment that **pay and consumer prices will surge** next year. Our inflation forecast of 2.4 per cent is a bit above consensus.

Exports started weakly in 2007, but this was largely due to statistical base effects after last year's high levels. Order bookings from abroad have remained good; overall, new manufacturing orders have risen to their highest level since the millennium boom. Combined with continued strong growth nearby, with Germany and Sweden as major markets, this bodes well for continued strong export growth in 2007. In the longer term, however, continued krone appreciation and rising labour costs will mean that Denmark risks starting to lose market share again.

Denmark: Consumption indicators

Year-on-year percentage change, 3-month moving average



Source: Statistics Denmark

The picture of **domestic demand is divided**. Capital spending, excluding the construction and residential sectors, will continue to grow rapidly due to high capacity utilisation and judging from the latest corporate capital spending plans. But after its earlier rapid growth, consumption will slow. For several years, household consumption has been sustained by a strong labour market that has helped fuel strong confidence in the future. We believe that a weaker property market will now decelerate consumption growth. This is confirmed by the fact that retail and car sales have already started to cool.

The previously red-hot **property market culminated** more than a year ago, when prices of houses and flats rose year-on-year by 20 and 25 per cent, respectively. Since then, there has been a slowdown in prices, sales and residential mortgages. This process has gone hand in hand with rising interest rates. The change has been **clearest in Copenhagen**, where prices of flats had climbed the fastest and where the supply of new residential units continues to increase. In the first quarter of 2007, the region experienced a year-on-year price drop of 6.5 per cent, and the latest reports from estate agents point towards continued weakening. Our overall assessment is that the property market will continue to slow at a controlled pace.

The labour market will remain strong for another year. Job creation will slow somewhat in domestic sectors, but in manufacturing the demand for labour is rising. Since last autumn, manufacturing has been gaining employees on a net basis. The latest hiring plans are the most expansive since measurements began in 1994; three out of four companies intend to expand. Overall, unemployment will remain below 4 per cent. There will be only a slight upturn in 2008 as the economy slows down below its growth trend.

Inflation on the way up

The inflation rate has risen gradually from 1.5 per cent last autumn to 1.9 per cent in March. Excluding energy, the upturn has been somewhat larger. Meanwhile the strong krone has had a restraining effect on inflation and will continue to do so. But in a longer perspective, **inflation will rise further** in the wake of declining productivity growth and higher wages. Pay increases are still relatively low but are expected to accelerate, in keeping with the traditional late-cyclical pattern. Growth has begun to fade but the labour market will remain tight for another while. Last year, wage and salary growth was a bit over 3 per cent. Next year it will reach 4.5 per cent.

Danmarks Nationalbank is continuing to shadow the ECB, with a one quarter percentage point interest rate spread. This will mean a **further 50 basis point hike**, which will contribute to continued slowing in the property and credit markets. Since signs of economic deceleration have already become discernible, the need for fiscal tightening has diminished. We anticipate a largely **neutral fiscal policy**. Due to falling growth, Denmark's budget surplus of more than 4 per cent of GDP will shrink to 3 per cent in 2008.

Greater overheating risks

- **Strong growth this year, deceleration in 2008**
- **Record-low unemployment will trigger accelerating pay increases and rising inflation**
- **Sight deposit rate to 5.50, with upside risk**

Over the past three years, the Norwegian economy has grown by 4½ per cent annually. Vigorous domestic demand, expansive policies and rising employment have been the main driving forces. Strong global markets for commodities have meant improved terms of trade. The cyclical upswing has been prolonged by favourable supply side forces, in the form of good productivity growth, an influx of foreign labour and international price pressures. This has kept down inflation. The CPI-ATE (inflation excluding indirect taxes and energy) increased by an average rate of only 0.7 per cent during 2004-2006.

Since autumn 2005, however, resource utilisation has climbed at an ever faster pace. Unemployment has fallen to its lowest level since the 1980s, and the collective pay agreements concluded so far this spring indicate that **wage and salary hikes will clearly accelerate this year**. Over the past six months, core inflation has also risen — though from low levels. Norges Bank has speeded the pace of its interest rate hikes. The sight deposit rate has now been raised by a total of 225 basis points to 4 per cent. We anticipate that the **sight deposit rate will be raised by another 150 points** in the coming year, to 5.50 per cent.

This relatively rapid interest rate upturn, combined with mounting supply side restrictions, will help **cool down growth in the mainland economy** (excluding offshore oil and gas) from 3.6 per cent this year to 2.4 per cent in 2008. The main risk in our forecast is that if overheating tendencies become even clearer, this may force the central bank to tighten monetary policy even more sharply — leading to a rapid deceleration in the economy further down the road.

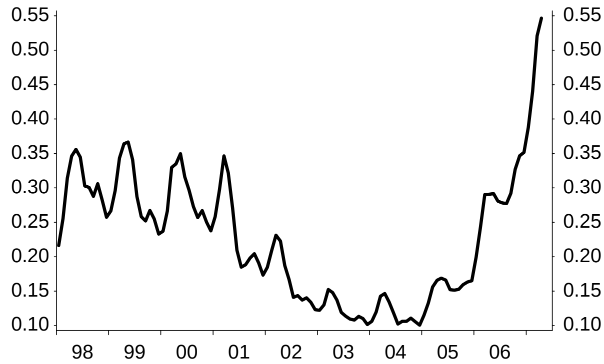
Strong indicators

Last year ended impressively, and indicators show a continued bright outlook for economic growth. Household consumption has climbed sharply in recent months, residential construction has surged and capital spending plans are expansive. Meanwhile rising employment and very high real wage increases mean that household purchasing power will rise significantly. We thus anticipate that **consumption will increase by about 4 per cent this year**, like last year. In 2008 as well, household purchasing power will strengthen but rising interest rates and higher inflation will cause growth to slow and consumption growth to decelerate somewhat.

Robust **capital spending will persist this year as well**. The confidence survey for the manufacturing sector paints a very optimistic picture, and capital spending plans are expansive. Large investment projects in the energy sector are also contributing to the upturn. Next year, however, capital spending activity will slow. Rising labour costs and a stronger krone will weaken profitability. Rising interest rates and mounting supply side constraints will also lead to a deceleration in residential construction. In addition, oil-related investments will stabilise at a high level.

Norway: Tightness of labour market

Vacancies/unemployed



Source: NAV

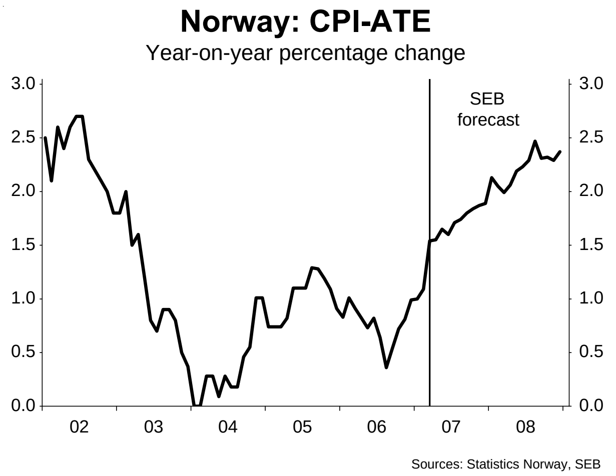
Employment has continued to increase at a rapid pace, and **unemployment is now at its lowest point since 1988**. The labour market will become even tighter in the course of 2007, although the downturn in unemployment is starting to decelerate as matching problems between job seekers and vacancies become ever more apparent. Average unemployment according to the Labour Force Survey will be 2½ per cent this year.

The tight labour market is now more clearly affecting wage formation. This spring's agreements for workers in the manufacturing sector and distributive trades represent pay increases of 4½ per cent, according to the signatories themselves. However, this figure is based on cautious assumptions about wage drift. It is also likely that pay rises among white collar employees and groups that conclude local pay agreements will be larger than for manufacturing and distributive trade employees covered by collective agreements. Wage agreements in the public sector imply pay hikes close to 5 per cent. **We expect total pay increases of 5¼ per cent this year**.

Rising domestic inflationary pressure

The rate of underlying inflation (CPI-ATE) bottomed out at 0.4 per cent in August 2006 but has shown an upward trend since then. The 1.5 per cent rate reported in March was the highest figure in four years.

One reason for the upturn was that the weakening of the krone last year slowed the decline in import prices. The positive contribution from import prices will continue for another while, but then the strength of the krone this year will take the upper hand. However, **domestic inflationary pressure will continue to rise**. Pay increases this year will be 1¼ percentage point higher than in 2006. Meanwhile, fading productivity growth late in the economic cycle will help push up unit labour costs.

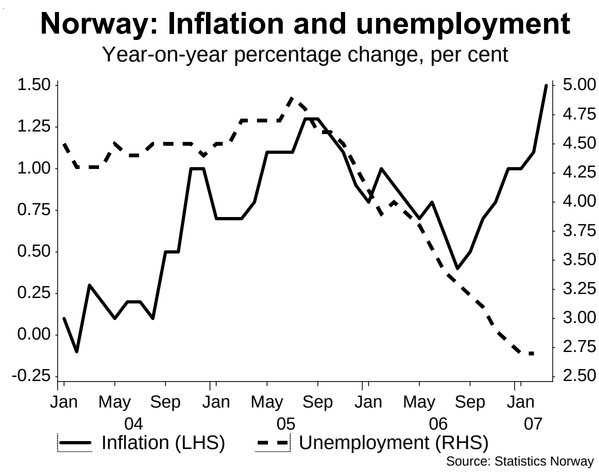


Overall, the CPI-ATE will rise by 1.6 per cent this year and by 2.2 per cent in 2008. Due to falling electricity prices, the CPI will rise substantially more slowly this year.

Inflation has been below the Norges Bank target of 2½ per cent ever since the autumn of 2002. The contrast between low — even falling — inflation and an ever tighter labour market was especially clear from late 2005 until the summer of 2006.

Gradually, however, Norges Bank began to shift its focus from low inflation to the country's increasingly strained resource utilisation. The bright inflationary picture was hardly due to low demand in Norway, but mainly a consequence of globalisation, which made the bank's public educational task easier. Once inflation began rising last autumn, this strengthened arguments for accelerating the pace of interest rate hikes. In its latest Inflation Report (March), the bank said it expected to raise the sight deposit rate by another 100 basis points to 5.0 per cent during 2007 to a peak of 5.25 per cent some months into 2008.

Our assessment is that Norges Bank will continue its rate-hiking cycle somewhat longer than this and that the **sight deposit rate will peak at 5.50 per cent some months into 2008**. Furthermore, the risk in this forecast is on the upside. Given our forecast, real interest rates will end up just above the range that Norges Bank itself deems a neutral level. The very tight resource situation that we foresee may justify firmer tightening. Because the ECB will keep raising its refi rate until it reaches 4.25 per cent, this will also make it easier for Norges Bank to hike its own key rate without creating excessive appreciation pressure on the krone. We expect the krone to appreciate to 7.60 against the euro and to 5.35 against the dollar by mid-2008.



No fiscal tightening

Given the high resource utilisation in the economy, a tighter fiscal policy would be natural. The Government Pension Fund — Global (formerly the Petroleum Fund) will grow rapidly in the next few years. If the "fiscal activity rule" guiding spending of this money were applied mechanically, this would lead to additional economic stimulation ahead. The government has admittedly hinted that perhaps it makes sense to use less oil money than the 4 per cent rule allows. But the budget presented last autumn was slightly expansive, according to the Finance Ministry's calculations.

Nor is it likely, since the **government is restricted by previous promises and commitments**, that there will be any significant austerity measures in the revised budget to be unveiled on May 15. This underscores the fact that Norges Bank must shoulder a heavy responsibility in Norway's stabilisation policy.

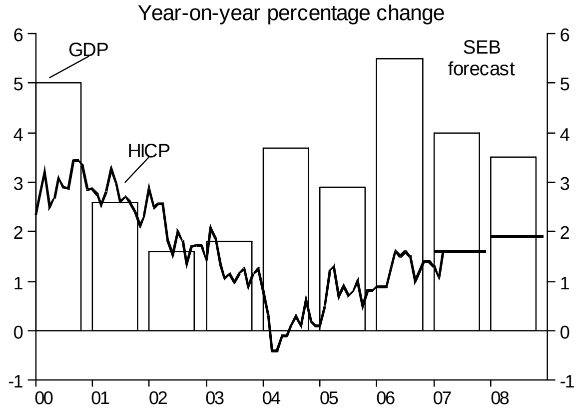
Continued economic strength

- **Exports enjoy strong demand from neighbours**
- **Hiring plans remain expansive**
- **Inflationary pressure weak but will rise in 2008**

Finland's GDP increased by 5.5 per cent last year, driven mainly by record exports. A rebound after the 2005 paper industry shutdown helped push up GDP growth nearly one percentage point. **Growth will slow to 4.0 per cent this year and 3.5 per cent in 2008**, a slight upward revision compared to our February forecast and substantially higher than the consensus forecast. Unemployment will fall from 7.7 per cent in 2006 to about 6.5 per cent in 2008.

Finland: GDP and inflation

Year-on-year percentage change



Sources: Eurostat, Statistics Finland, SEB

Exports are benefiting from robust global economic conditions and, above all, strong demand from neighbouring countries. However, the **terms of trade weakened** last year when import prices were driven up by higher energy prices.

Leading indicators still look strong. The positive trend in construction and the manufacturing sector is continuing, and the drop in confidence in the service sector early this year proved to be temporary.

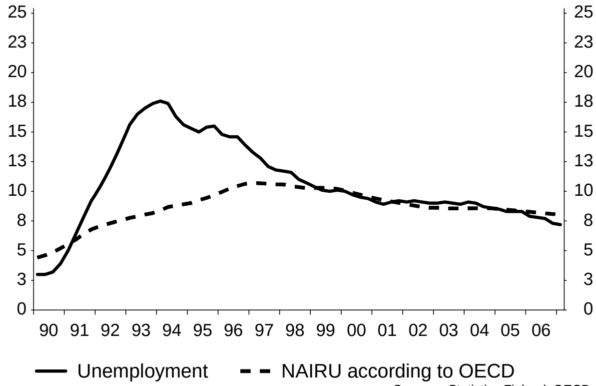
Capacity utilisation in manufacturing has risen but remains a bit below the high level prevailing at the turn of the millennium. High capacity utilisation, relatively high profits and good confidence in the future are driving **capital spending**, which will grow by almost 5 per cent both this year and next.

The gradual improvement in the labour market — with more than 40,000 new jobs last year and a continued decline in unemployment — will stimulate household consumption. The most recent retail sales number (in March) hit a seven-year high. However, rising interest rates will gradually lead to a certain slowdown in consumption.

Unemployment has reached its lowest level since 1992. Hiring plans remain expansive, and we anticipate more than a one per cent upturn in jobs this year. Unemployment — which today is already below the OECD's measure of non-accelerating inflation rate of unemployment (NAIRU) — will fall to an average of 6.5 per cent in 2008.

Finland: Unemployment

Per cent



Sources: Statistics Finland, OECD

Inflationary pressure has been weak in recent years, among the lowest in the euro zone. Inflation will remain low this year, but an increasingly robust labour market will cause **upward pressure on wages and salaries**. We expect pay increases to accelerate from 3 per cent this year to nearly 4 per cent next year. This will **contribute to an increase in inflation to nearly 2 per cent** next year.

Tax cuts

The conservative National Coalition Party was the big winner of the March 18 election and will dominate the new four-party government together with Prime Minister Matti Vanhanen's Centre Party.

The new coalition hopes to create 80,000-100,000 new jobs by 2011 by stimulating entrepreneurship and human resource development. **Tax cuts** equivalent to nearly EUR 2 billion by 2011 are also on its agenda. Certain tax increases will also be implemented, however; this applies to taxes on alcoholic beverages and tobacco products as well as energy and environmental taxes. Our assessment is that the strong economy will help increase Finland's **budget surplus** during our forecast period, despite a net tax reduction.

Nordic key economic data

Nordic Outlook - May 2007

DENMARK

Yearly change in per cent

	2005	2006	2007	2008
Gross domestic product	3.2	3.1	2.5	1.8
Private consumption	4.2	3.8	2.2	1.9
Public consumption	1.1	1.3	0.8	0.8
Gross fixed investment	9.7	11.5	6.0	3.5
Stockbuilding (change as % of GDP)	-0.1	0.5	0.0	0.0
Exports	7.5	9.6	7.0	5.0
Imports	10.7	14.1	7.4	5.3
Unemployment (%)	5.7	4.5	3.7	3.8
Consumer prices, harmonised	1.7	1.9	1.9	2.4
Wage cost	2.9	3.1	3.8	4.5
Current account, % of GDP	3.8	2.4	2.0	1.5
Public sector financial balance, % of GDP	4.7	4.2	3.8	3.0
Public sector debt, % of GDP	36.3	30.2	24.0	20.0

FINANCIAL FORECASTS	May 3	Jun 07	Sep 07	Dec 07	Jun 08	Dec 08
Deposit rate	4.00	4.25	4.25	4.50	4.50	4.50
10-year bond yield	4.26	4.20	4.30	4.50	4.55	4.55
10-year spread to Germany, bp	2	0	0	0	5	5
USD/DKK	5.50	5.44	5.40	5.32	5.25	5.14
EUR/DKK	7.45	7.45	7.45	7.45	7.45	7.45

NORWAY

Yearly change in per cent

	2005	2006	2007	2008
Gross domestic product	2.7	2.9	2.7	2.6
Gross domestic product (Mainland Norway)	4.5	4.6	3.6	2.4
Private consumption	3.3	4.3	4.2	3.0
Public consumption	1.8	2.2	2.9	3.0
Gross fixed investment	11.2	8.9	6.9	3.1
Stockbuilding (change as % of GDP)	0.9	0.8	0.3	0.0
Exports	0.7	1.5	2.9	3.6
Imports	8.6	9.1	6.4	4.6
Unemployment (%)	4.6	3.5	2.5	2.6
Consumer prices	1.6	2.3	0.8	2.6
CPI-ATE	1.0	0.8	1.6	2.2
Wage cost	3.3	4.1	5.3	5.4
Current account, % of GDP	15.5	16.7	15.2	15.0
Public sector debt, % of GDP	16.2	19.3	18.5	18.5

FINANCIAL FORECASTS	May 3	Jun 07	Sep 07	Dec 07	Jun 08	Dec 08
Sight deposit rate	4.00	4.50	4.75	5.25	5.50	5.50
10-year bond yield	4.86	4.80	4.90	5.05	4.90	4.90
10-year spread to Germany, bp	63	60	60	55	40	40
USD/NOK	5.99	5.84	5.72	5.54	5.35	5.38
EUR/NOK	8.12	8.00	7.90	7.75	7.60	7.80

Nordic key economic data

SWEDEN

Yearly change in per cent

	2005	2006	2007	2008
Gross domestic product	2.9	4.4	4.0	3.4
Gross domestic product, working day adjusted	2.9	4.7	4.2	3.3
Private consumption	2.4	2.8	4.3	3.9
Public consumption	0.3	1.8	1.4	1.4
Gross fixed investment	8.1	8.2	9.5	5.0
Stockbuilding (change as % of GDP)	-0.1	0.0	0.0	0.0
Exports	6.6	9.1	6.3	5.5
Imports	6.9	7.8	7.6	5.9
Unemployment (%)	5.9	5.4	4.5	4.0
Employment	0.7	1.9	2.5	1.4
Industrial production	4.1	6.0	4.7	3.8
Consumer prices	0.5	1.4	2.0	2.2
UND1X	0.8	1.2	1.1	1.7
Wage cost	3.1	3.1	4.2	4.7
Household savings ratio (%)	8.7	8.1	9.5	8.9
Real disposable income	1.5	2.0	5.8	3.2
Trade balance, % of GDP	5.5	5.5	5.9	5.7
Current account, % of GDP	5.8	7.0	7.3	7.1
Central government borrowing, SEK bn	-14	-18	-110	-80
Public sector financial balance, % of GDP	1.9	2.1	2.0	2.2
Public sector debt, % of GDP	52	47	40	36

FINANCIAL FORECASTS	May 3	Jun 07	Sep 07	Dec 07	Jun 08	Dec 08
Repo rate	3.25	3.50	3.75	4.00	4.50	4.75
3-month interest rate, STIBOR	3.59	3.84	4.09	4.34	4.84	5.09
10-year bond yield	4.08	4.10	4.25	4.50	4.55	4.60
10-year spread to Germany, bp	-16	-10	-5	0	5	10
USD/SEK	6.75	6.68	6.59	6.39	6.27	6.10
EUR/SEK	9.15	9.15	9.10	8.95	8.90	8.85
TCW	123.6	124.1	123.1	120.5	119.4	118.1

FINLAND

Yearly change in per cent

	2005	2006	2007	2008
Gross domestic product	2.9	5.5	4.0	3.5
Private consumption	3.8	3.0	3.2	2.9
Public consumption	1.7	0.9	1.3	1.2
Gross fixed investment	3.7	5.1	4.8	4.3
Stockbuilding (change as % of GDP)	1.1	-0.1	0.0	0.0
Exports	7.1	10.7	6.8	5.8
Imports	12.2	5.4	5.3	4.9
Unemployment (%)	8.4	7.7	6.7	6.4
Consumer prices, harmonised	0.8	1.3	1.6	1.9
Wage cost	3.9	3.0	3.1	3.9
Current account, % of GDP	5.1	5.8	6.1	6.3
Public sector financial balance, % of GDP	2.7	3.6	3.9	4.1
Public sector debt, % of GDP	41.3	39.1	37.0	35.3

International key economic data

Nordic Outlook - May 2007

EURO ZONE

Yearly change in per cent

	2005	2006	2007	2008
Gross domestic product	1.5	2.8	2.7	2.5
Private consumption	1.5	1.8	2.0	2.1
Public consumption	1.4	2.3	1.8	1.6
Gross fixed investment	2.7	4.3	4.2	3.8
Stockbuilding (change as % of GDP)	0.1	0.0	0.0	0.0
Exports	4.4	8.1	7.2	5.4
Imports	5.4	7.5	6.1	5.3
Unemployment (%)	8.6	7.9	7.0	6.5
Consumer prices, harmonised	2.2	2.2	2.0	2.0
Household savings ratio (%)	10.8	10.7	10.5	10.4

US

Yearly change in per cent

	2005	2006	2007	2008
Gross domestic product	3.2	3.3	1.9	2.5
Private consumption	3.5	3.2	3.2	2.4
Public consumption	0.9	2.1	1.5	0.4
Gross fixed investment	7.5	2.9	-3.5	3.4
Stockbuilding (change as % of GDP)	-0.3	0.2	-0.4	0.0
Exports	6.8	8.9	5.6	7.2
Imports	6.1	5.8	1.9	3.9
Unemployment (%)	5.1	4.6	4.7	5.0
Consumer prices	3.4	3.2	2.7	2.4
Household savings ratio (%)	-0.4	-1.1	-0.8	-0.2

LARGE INDUSTRIAL COUNTRIES

Yearly change in percent

	2005	2006	2007	2008
GDP				
United Kingdom	1.9	2.7	2.8	2.5
Japan	1.9	2.2	1.9	2.0
Germany	0.9	2.7	2.7	2.5
France	1.2	2.0	2.3	2.2
Italy	0.2	1.9	2.1	1.8
Inflation				
United Kingdom	2.0	2.3	2.4	2.0
Japan	-0.6	0.2	0.2	0.5
Germany	1.9	1.8	2.1	1.9
France	1.9	1.9	1.6	1.9
Italy	2.2	2.2	2.1	2.3
Unemployment (%)				
United Kingdom	4.8	5.4	5.2	5.0
Japan	4.4	4.1	3.9	3.7
Germany	11.7	10.8	8.9	8.0
France	9.9	9.0	8.3	8.0
Italy	7.7	6.8	6.3	6.0

International key economic data

CENTRAL AND EASTERN EUROPE

	2005	2006	2007	2008
GDP, yearly change in percent				
Czech Republic	6.1	6.1	4.8	4.5
Estonia	10.5	11.4	8.0	7.0
Hungary	4.2	3.9	2.3	2.8
Latvia	10.6	11.9	9.2	8.2
Lithuania	7.6	7.5	7.0	6.5
Poland	3.2	5.8	5.8	5.4
Russia	6.4	6.7	6.5	6.0
Slovakia	6.0	8.3	8.0	6.5
Ukraine	2.6	7.1	7.5	8.0
Inflation, yearly change in per cent				
Czech Republic	1.6	2.1	2.8	2.7
Estonia	4.1	4.4	4.0	3.5
Hungary	3.5	4.0	7.0	4.3
Latvia	6.9	6.6	7.0	5.8
Lithuania	2.7	3.8	4.0	3.0
Poland	2.2	1.3	2.3	2.5
Russia	12.4	9.7	8.5	8.0
Slovakia	2.8	4.3	2.5	2.3
Ukraine	13.5	9.1	8.5	8.0

FINANCIAL FORECASTS

		May 3	Jun 07	Sep 07	Dec 07	Jun 08	Dec 08
Official interest rates							
US	Fed funds	5.25	5.25	5.25	5.00	4.50	4.50
Japan	Call money rate	0.50	0.50	0.75	0.75	1.00	1.00
Euro zone	Refi rate	3.75	4.00	4.00	4.25	4.25	4.25
United Kingdom	Repo rate	5.25	5.50	5.75	5.75	5.75	5.50
Bond yields							
US	10 years	4.68	4.70	4.60	4.60	4.60	4.70
Japan	10 years	1.63	1.80	2.00	2.10	2.20	2.30
Germany	10 years	4.24	4.20	4.30	4.50	4.50	4.50
United Kingdom	10 years	5.11	5.05	5.00	5.20	5.20	5.10
Exchange rates							
USD/JPY		120	121	121	122	122	122
EUR/USD		1.36	1.37	1.38	1.40	1.42	1.45
EUR/JPY		163	166	167	171	173	177
GBP/USD		1.99	2.11	2.09	2.06	2.06	2.07
EUR/GBP		0.68	0.65	0.66	0.68	0.69	0.70

GLOBAL KEY INDICATORS

Yearly percentage change

	2005	2006	2007	2008
GDP OECD	2.6	3.2	2.5	2.7
GDP world	4.9	5.4	5.0	4.9
CPI OECD	2.4	2.4	2.2	2.1
Export market OECD	7.6	9.3	7.2	7.9
Oil price, Brent (USD/barrel)	54.2	64.8	66.1	70.0

Economic Research available on Internet

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Technical requirements

Most of our research is published in Portable Document Fomat (PDF). Adobe Acrobat software, which reads PDF documents, is free of charge and can be downloaded from Adobe's web site at: www.adobe.com.

Since its founding in Sweden in 1856, SEB has evolved from having a national focus into a bank with an international presence. Today more than half of our business occurs abroad.

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