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Nordic Outlook

Tighter credit conditions hampering global economic growth
Interest rate cuts in Europe as well

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SEB Economic Research

Nordic Outlook - November 2007

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Global: Tighter credit hampering growth – rate cuts in Europe as well

- The impact of the credit crisis is spreading in the world economy. The US mortgage crisis is deepening, with the financial sector forced to write down lending portfolios further. The result is tighter credit. Along with high energy prices, a weak dollar and falling home prices, this is hampering economic activity. No country can escape the effects, but the robust strength of emerging economies, mainly in Asia, will buoy global growth.
- Inflation is fuelled by rising commodity and food prices as well as higher labour costs, but will culminate in the spring of 2008. After that, the economic deceleration will gradually ease inflationary pressures.
- US growth will drop below 2 per cent in 2008. Home construction will keep falling sharply and capital spending will slow, while the dollar slide will stimulate exports. The Federal Reserve will continue resolutely cutting interest rates. Its key rate will be 3.50 per cent in mid-2008.
- Euro zone GDP growth will be 1.8 per cent in 2008. The European Central Bank will cut its refi rate to 3.50 per cent. Other central banks will also shift monetary policy. The Bank of England will make its first key rate cut this December. Bond yields will continue downward a bit.
- The dollar will continue to weaken, reaching USD 1.55 per euro next spring, then recover somewhat as the focus shifts to the euro zone slowdown and ECB rate cuts. Asian currencies will stay low in value, even though the Chinese will allow the yuan to strengthen faster.

Sweden

- The economy will gradually slow. GDP growth will be only 2.3 per cent next year and 2.0 per cent in 2009. Exports have decelerated significantly. Capital spending will also gradually cool. Continued high saving will prevent a potential consumption boom.
- The labour market will remain strong for another year. During much of 2008, job creation will predominate and unemployment will fall. In 2009, the jobless rate will start to climb. Large public sector surpluses and a less strained resource situation will open the way for further fiscal stimulation before the 2010 parliamentary election.
- Inflation will climb as higher unit labour costs are reinforced by rising energy and food prices. The Riksbank may hike its key rate one more time, but as growth slows in 2008 it will cut its repo rate to 3.75 per cent by year-end.

Other Nordic countries and the Baltics

- **Denmark:** Consumption-driven deceleration will continue, despite the government's income tax cuts. GDP growth will fall a bit below its 2 per cent trend. The housing market will continue to weaken, with falling home prices next year.
- **Norway:** Growth will culminate this year at more than 5 per cent. Strained resources and effects of earlier interest rate hikes will trigger economic deceleration in 2008. Norges Bank will raise its key rate to 5.50 per cent in the next six months, before beginning a rate-cutting cycle in 2009.
- **Finland:** Growth is past its peak. The global slowdown and the stronger euro will dampen exports, but domestic demand will keep the economic wheels turning briskly. GDP growth will end up at around 3 per cent in 2008 and 2009.
- **The Baltic economies** will be dominated by major imbalances. Growth will decelerate somewhat, especially in Estonia. The problems of high inflation and large current account deficits will persist.

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Gripped by the credit crisis

- **Tighter credit will hamper growth**
- **Asia is resisting better than Western Europe**
- **Central banks will cut rates to below neutral**
- **The US dollar will weaken further**

The credit crisis is having a clear impact on the international economy. The problems of the US home mortgage loan market have spread, triggering losses in the global financial service system. This will lead to a tightening of credit that will hamper growth. The rapid upturn in energy prices is amplifying the slowdown.

In the last ***Nordic Outlook*** from August, our main scenario consisted of the *"interest rate adjustment scenario"*. Thus we already regarded the prevailing credit market turmoil as so serious that it would cause some reassessments of interest rate policy in the Western world. Given the duration and broadening of the crisis, we are now going one step further. We are revising growth downward, and our GDP forecast for the euro zone and the US is significantly below the consensus scenario. We now expect central banks, led by the US Federal Reserve, to take action to prop up their economies and cut their key interest rates to below neutral levels.

Meanwhile stabilising forces are at work in the world economy. Globalisation is continuing and domestic growth in emerging economies remains vigorous. Meanwhile the balance sheets of companies in the OECD countries are generally still strong. Moderately valued share prices and rather cautious capital spending behaviour by companies to date are also sources of support. These factors, together with interest rate cuts by central banks, will keep the world economy from sliding into recession.

GDP growth

Year-on-year percentage change

	2006	2007	2008	2009
United States	2.9	2.1	1.8	2.4
Japan	2.2	2.0	1.7	1.8
China	11.1	11.5	10.0	9.0
Euro zone	2.9	2.6	1.8	1.8
United Kingdom	2.8	3.1	1.8	2.0
Nordic countries	3.8	3.1	2.5	2.1
OECD	3.1	2.6	2.1	2.2
World economy	5.4	5.1	4.5	4.5

Sources: OECD, SEB

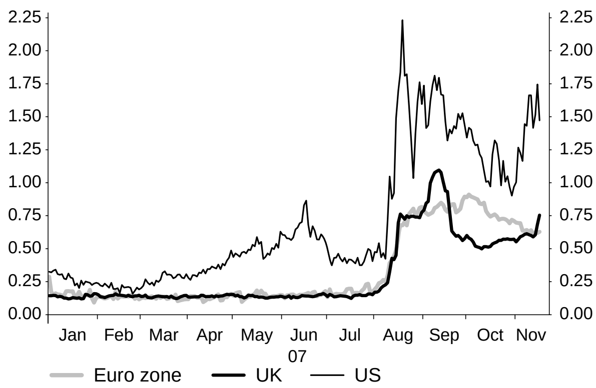
The world economy is characterised by rapid growth in countries like China, India and Russia while a deceleration is becoming apparent in the OECD. Measured in purchasing power-adjusted terms, the slowdown in the global economy will thus be moderate. GDP growth will decline gradually from 5.4 per cent in the peak year of 2006 to 4.5 per cent in 2008 and 2009. As shown in the analysis in the box on page 6, however, this way of measuring global growth provides an excessively bright picture in important respects.

Credit crisis not over

Even though the most critical stage of the liquidity crisis was passed in mid-August and financial conditions have improved to some extent since then, many problems and challenges for the global financial system remain. Lack of confidence between market participants is reducing the functioning and efficiency of the financial system while the hunt for short and medium term funding goes on. The current abnormal price of bank money relative to government debt securities illustrates the liquidity and confidence problems. Rising unrealised losses and write-downs of financial assets have mainly affected US banks in recent weeks. However, it is very likely that the tendency towards rising losses could become evident also among non-US financial institutions.

Spread between interbank rate and T-bills

3 months



Source: Reuters EcoWin

At first the crisis primarily manifested itself in the form of liquidity shortages, due to a sudden weakening of trust between financial market players. This has gradually turned into a credit crisis in which losses are proving even larger, leading to lower valuation of various assets and creating further holes in income statements. In that sense, at least the American economy is already undergoing a "credit crunch" process, with lenders becoming more and more cautious.

The way back to balance will probably include going through a negative spiral. Tighter credit will lead to continued declines in home prices and capital spending, which in turn will generate further credit losses. This spiral poses a recession risk for the American economy, but aggressive interest rate cuts and a weak dollar will help prop up the economy. Strong balance sheets in the corporate sector, fairly low stock market valuations and alternative engines of growth in the global economy are other factors that differ from recession periods. Taken together, we thus foresee an extended slump in the American economy but no recession.

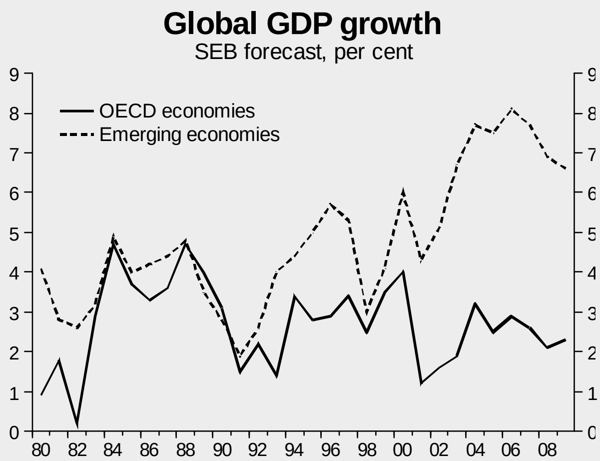
Europe slowing; Asia resisting better

The past year has been characterised by a clear decoupling between different parts of the world economy. Growth in Europe and Asia has largely held up, despite the American slowdown. We have previously pointed to factors that have helped reduce the secondary effects from the American deceleration, for example the fact that other countries have become less dependent on trade with the US and that the American slowdown has primarily affected sectors with low import content.

In recent months, however, obvious secondary effects have begun to reach Western Europe. Credit conditions have tightened due to losses in the financial service sector, caused among other things by exposure to the American housing market. Meanwhile the strong euro and rising energy prices are squeezing

How high is global growth?

The dual nature of the world economy is apparent. While the emerging economies, led by China, continue to grow rapidly, the OECD countries are decelerating to GDP growth of around 2 per cent. Nowadays the most common way of calculating global GDP growth is on the basis of purchasing power parities (PPPs). This means taking into account the often significantly lower price levels in emerging economies. Measured in this way, emerging economies represent more than half of the global economy. In growth terms, they are totally dominant. For example, next year OECD countries will account for only one percentage point of global growth. The rest of the world will account for 3½ percentage points, of which China will represent more than half.



Sources: IMF, SEB

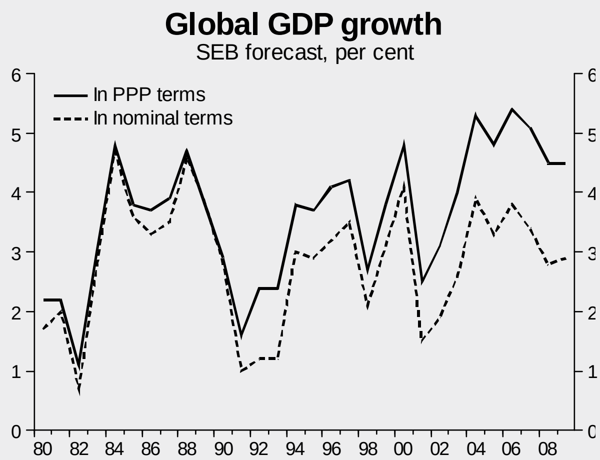
Contributions to GDP growth, 2008

Percentage points

	PPPs	Nom
United States	0.34	0.51
Japan	0.09	0.17
Euro zone	0.23	0.38
United Kingdom	0.05	0.10
Rest of OECD	0.31	0.23
OECD	1.01	1.39
China	1.91	0.58
Rest of world	1.65	0.88
World	**4.5**	**2.8**

Changes in world living conditions are best reflected by PPP-adjusted growth. However, the role of the OECD countries is significantly more important to financial trends, international trade flows and thus the export performance of various industrialised countries than PPP-adjusted figures indicate. If each country's weight is instead determined by its actual GDP in a common currency (for example USD), we get a better picture of what drives financial developments and the export climate in different countries. In terms of level, the OECD economies thus still make up around 75 per cent of the world economy. As for their importance to global growth, the OECD and emerging economies are approximately equal.

In nominally weighted terms, global GDP growth will slow from 3.8 per cent in 2006 to 2.8 per cent in 2008. Growth in 2008 and 2009 will be somewhat below its 3.0 per cent average for the past 25 years. Even measured in nominal terms, the emerging economies will play a significant role in sustaining global growth.



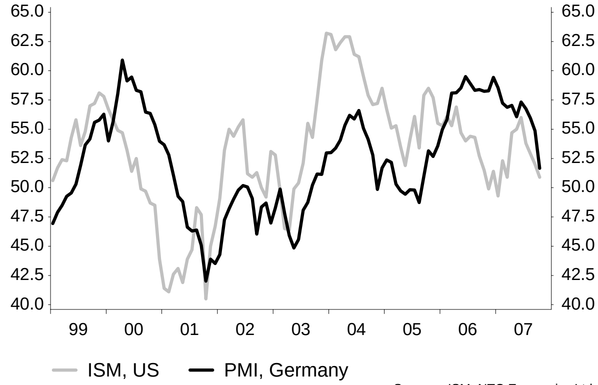
Sources: IMF, SEB

growth. In many countries the housing market is also cooling down. This does not have its roots in the US, however. Instead it is in part a consequence of the same kind of forces that have driven the American housing market upturn and downturn, which are also operating in some parts of Europe. As a result of these factors, euro zone growth will fall from 2.6 per cent this year to 1.8 per cent in 2008. We have thus made a significant downward revision in our forecast for next year.

In Asia (excluding Japan) and other **emerging economies, rapid growth will continue**. The domestic growth dynamic is very strong in many countries. Internal trade in Asia has also become increasingly vital to expansion, generating a positive dynamic. In addition, currency exchange rates are not squeezing growth in the same way as in Western Europe. The appreciation of the Chinese yuan is occurring at a moderate pace, and the Japanese yen has weakened in effective terms, despite a certain rebound against the dollar during the past few turbulent months.

Industrial indicators

Index



Sources: ISM, NTC Economics Ltd

The **Nordic economies** are still characterised by good growth and high resource utilisation, but a slowdown is gradually occurring. This is due to both supply side restrictions and weaker international economic conditions. In **Denmark** and **Norway**, unemployment

Oil prices will peak at record levels

Oil prices have continued towards new heights. Spot prices are now around USD 90 per barrel (Brent), compared to a bottom level a bit below USD 50 at the beginning of 2007. A combination of continued strong demand, low reserves and an unusually slow increase in production is behind the upturn. Other factors include the weak dollar and renewed unrest in the Middle East. In recent months, tropical storms in the Gulf of Mexico have also led to major disruptions in production, further pushing up oil prices. Rising prices, in turn, have attracted speculators who have ridden the upward price movement.

Meanwhile prices have reached such levels that the Organisation of Petroleum Exporting Countries has expressed some concern that oil prices may be close to reaching an upper pain threshold. OPEC's reserve capacity is higher than for many years, making it possible to boost production quotas to a greater extent than previously. Major investments in new production capacity and more efficient energy use among large consumer such as China also point towards more moderate oil prices ahead. Pricing in the futures market also indicates a downturn.

In a very short perspective, however, risks of temporary supply disruptions and political tensions remain. There is also great uncertainty about how fast it will be possible to boost production capacity. Although strong incentives exist for expanding capacity, the expansion is being hampered by shortages of trained staff, oil rigs and other equipment. Meanwhile there is uncertainty about future energy and climate change policies in many OECD countries. Another uncertainty factor is how oil-producing countries outside OPEC, for example Russia, will act. Nationalisations and less favourable conditions for investments have caused production growth to decelerate sharply in recent years.

In this forecast, we assume that oil prices will fall somewhat more than futures market prices indicate. This means an average oil price of USD 80 per barrel in 2008, compared to our last forecast in August of USD 69. Traditional rules of thumb say that if oil prices are permanently USD 10 per barrel higher, this will have a GDP effect of nearly half a percentage point and a marginally higher effect on inflation in OECD countries.

However, experience tells us that these rules of thumb – to date, in any case – have exaggerated the role of oil prices. This can partly be explained by the fact that the price upturn has occurred gradually and that economies have thus had time to transition to more energy-efficient production. In recent years, the oil price upturn has also occurred concurrently with, and partly as a consequence of strong growth in the global economy. However, the price upturn of the past year is primarily due to capacity constraints. With the OECD countries now experiencing an economic deceleration at the same time as limited supply and strong Chinese demand are keeping oil prices at high levels, the risks of a clearer slowdown in the world economy are greater.

As for the actions of central banks, we expect that such adverse effects on growth will play a larger role in their interest rate decisions than the effects of higher inflation.

has reached historically very low levels. The growth slowdown in **Sweden** and **Finland** is more clearly being caused by tougher conditions for exporters.

Inflation on the way up

In the short term, inflationary pressure in the world economy is now increasing, for various reasons:

- **Commodity prices** are rising, primarily in the form of higher energy prices. Crude oil prices have soared in recent months, driven by strong demand and supply side uncertainty. In addition, there have been strong elements of speculation (see box). Meanwhile electricity prices are climbing in many countries. The contribution to CPI inflation in the OECD during the coming six months will be around 1 percentage point.

- **Food prices** have trended upward since last summer. Among other things, this is because increased biofuel production and greater purchasing power in Asia have pushed up global demand unexpectedly fast. Meanwhile supply has been kept down by unfavourable weather conditions. We expect the price upturn at the consumer level to peak at around 4 per cent, thus contributing about ½ percentage point to CPI.

- **The global price squeeze on consumer goods** seems to have eased somewhat. This may be due to a number of reasons, such as a rising cost level in China, strong international demand and early signs that tighter environmental standards are beginning to affect prices.

- **Unit labour costs** are climbing. Rising resource utilisation in most countries means higher wage pressure. Meanwhile productivity growth has slowed in many places, amplifying upward cost pressure in the short term.

- Large **currency rate fluctuations** are also affecting inflation in various ways. In Europe, inflation is slowing because imported consumer goods are becoming cheaper. Meanwhile increases in commodity prices are not so large when nominal increases in USD are converted to euros and other European currencies. In the US, however, the weakening of the dollar implies upward inflationary pressure.

Despite the inflationary forces now in operation, we believe there is relatively little risk that the prevailing low-inflation environment will be threatened in a lasting way. Core inflation has remained low in most regions, with downside surprises in both the US and Japan. Global inflation will shift to a downward path when the effects of rising energy and food prices have culminated early next year. Towards the end of 2008, cyclical inflation-slowing forces will begin to make themselves felt, especially in the US.

Many central banks will cut key rates

With growth now slowing as inflation rises, interest rate policy faces a dilemma. However, most central banks have normalised interest rates during the past few years. This makes the situation easier. These rate hikes were largely carried out for preventive purposes, in order to combat inflationary tendencies. The central banks have thus strengthened their credibility as inflation fighters. Although short-term inflation expectations are on their way up, there is no particularly great danger than this credibility will be fundamentally threatened.

Key rates, per cent

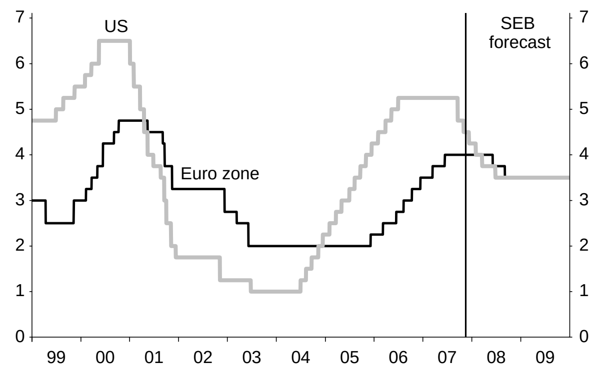
	Currently	Dec 2008	Neutral
United States	4.50	3.50	4.25
Euro zone	4.00	3.50	4.00
United Kingdom	5.75	4.50	4.50
Sweden	4.00	3.75	4.25
Norway	5.00	5.50	5.00

Source: SEB

Given their great credibility as well as continued underlying disinflationary forces, central banks will be in a position to respond to the existing threats of a sharp cyclical deceleration. Looking ahead, we thus believe that central banks in Western countries will lower interest rates on a broad front.

The **Federal Reserve** has already lowered its key rate by 75 basis points. Although it has avoided clearly signalling that it will continue such rate cutting, we believe that the economic situation will weaken enough that the Fed will lower its funds rate by another 100 points to 3.50 per cent by mid-2008.

Key rates
Per cent



Sources: ECB, Fed, SEB

After the summer, the **European Central Bank** interrupted its refi rate hiking cycle. There are now sufficient signals of weaker growth and a stronger euro to persuade the ECB to refrain from resuming its hikes, but high and rising inflation over the next six months or so will delay any rate cuts. We expect the ECB to wait until mid-2008 before lowering its key rate to 3.50 per cent in two steps. The **Bank of England** will begin cutting its repo rate in December. British inflation has cooled and the housing market is now rapidly weakening. In the course of 2008, the BoE will lower the repo rate to 4.50 per cent.

Due to strong domestic economies, the **Nordic central banks** will face an even starker dilemma than major central banks elsewhere in Europe. **Norges Bank**, which is battling increasingly clear overheating tendencies in Norway, will raise its sight deposit rate further to 5.50 per cent; it will not begin cutting this rate until 2009. The Swedish economy is normally affected to a greater extent by international fluctuations. Domestic motives will persuade the **Riksbank** to raise its repo rate one last time. During the autumn of 2008, however, we expect the slowdown in the economy to have become clear enough that the Riksbank will be prepared to cut its key rate. By the end of 2008 the repo rate will stand at 3.75 per cent.

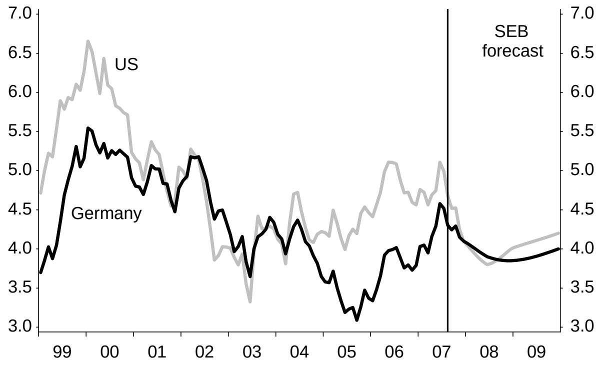
In Asia, interest rate hikes will continue. In **China**, the risk of overheating will necessitate further tightening of economic policy, including interest rate hikes. The **Bank of Japan** will raise its key rate at a very cautious pace. The threat of deflation has re-emerged, but a slight recovery will still make some interest rate hikes possible. We expect the BoJ to raise its key rate to 1.0 per cent during our forecast period.

Long-term yields will fall further

Long-term bond yields have fallen in recent months as threats to growth have become apparent and as central banks have softened their policies in various ways. Rising inflation has not succeeded in turning around this trend, resulting in a sizeable downturn in real interest rates.

10-year government yields

Per cent



Sources: Reuters EcoWin, SEB

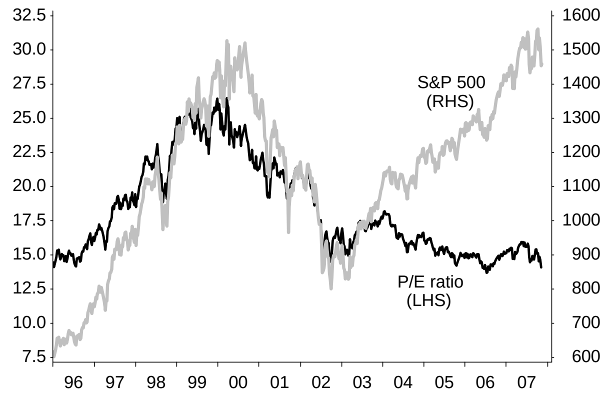
Our forecast of economic conditions and of the response of central banks implies further potential for falling bond yields. This is most obvious in the United States, where we expect 10-year Treasury bonds to fall to 3.80 per cent during the spring. The Fed's vigorous interest rate cuts will also cause the spread between 10-year Treasury yields and the central bank's key rate to move back into positive territory, after a record-long period of a negative yield curve.

In Germany, the downturn in government bond yields will be a little more subdued, ending up at 3.90 per cent. This means that for a while, German 10-year yields will be higher than American ones for the first time since 2004. Swedish government bond yields will be 15-20 basis points above German ones, mainly as a consequence of a somewhat higher key interest rate. Due to overheating tendencies in Norway, long-term yields are no less than 65 points above the German level. Over the next couple of years, the spread will narrow somewhat, but at the end of 2009 it will still be 50 points.

Moderate valuations, but greater risks

Stock markets will be dominated by continued instability. Tighter credit will weigh down markets due to direct losses in the banking sector as well as secondary effects via slower economic growth. In countries with appreciating currencies the margins will be squeezed further.

US: S&P 500 and P/E ratio



Sources: Standard & Poor's, Reuters

Meanwhile several positive factors are affecting stock markets. Profits held up relatively well in the third quarter, and profit forecasts indicate fairly strong performance in 2008. Many companies active on the global scene are managing to benefit from continued strong demand in various parts of the world. Meanwhile, stock market valuations are generally rather low. After the recent correction, P/E ratios have come down further. Assuming that the cyclical slowdown will be no deeper than we have predicted, there should be potential for decent stock market performance in a somewhat longer perspective. The greatest risk of a global stock market slide will occur if the US economy enters a recession that spreads via further declines in the dollar.

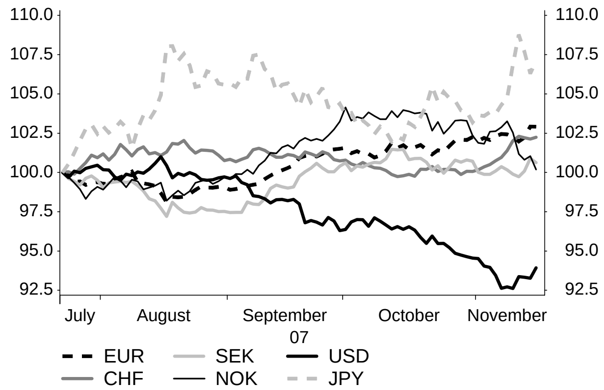
End of dollar slide discernible

In the past year, our currency analysis has been guided mainly by short-term interest rate spreads. These spreads have driven a flow of funds into currencies with higher interest returns (carry trade). Since the recent financial market turmoil began, **reduced risk appetite has led to unwinding of carry trade positions**, which has strengthened currencies in typical low interest rate countries like Japan and Switzerland.

In keeping with the historical pattern during periods of instability, the dollar strengthened at the beginning of the crisis. As concerns about American economic performance mounted and the Fed began cutting

Exchange rates during recent market turmoil

Index July 23 = 100



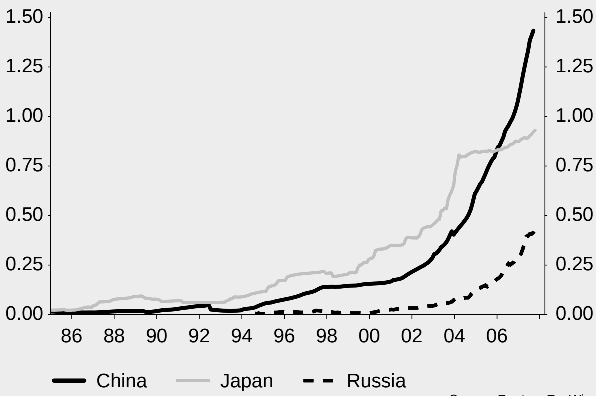
Source: Reuters EcoWin

Imbalances creating political tensions

Right now, global imbalances are contributing to a rapid redistribution of wealth and thus to shifts in economic and political power: from deficit-plagued countries to those with capital surpluses, and from West to East.

Foreign exchange reserves in selected countries

USD trillion



Source: Reuters EcoWin

At present, China's foreign exchange reserve is growing by USD 33 billion per month (+40 per cent year-on-year). Meanwhile, thanks to oil revenue, Russia — which as recently as in the late 1990s was at the edge of sovereign bankruptcy — can show even faster growth in its foreign exchange reserve (+55 per cent year-on-year). This makes Russia and China important investors in the international capital market. Deficit-ridden countries risk ending up being dependent on these exporters of capital.

In recent years, conditions have not been especially favourable for the emergence of rampant protectionism. Rising demand in the world market, good corporate profit growth as well as rising global employment and relatively stable exchange rates have helped keep trade policy conflicts from arising. World Trade Organisation negotiations have admittedly been slow, but the related conflicts have not escalated.

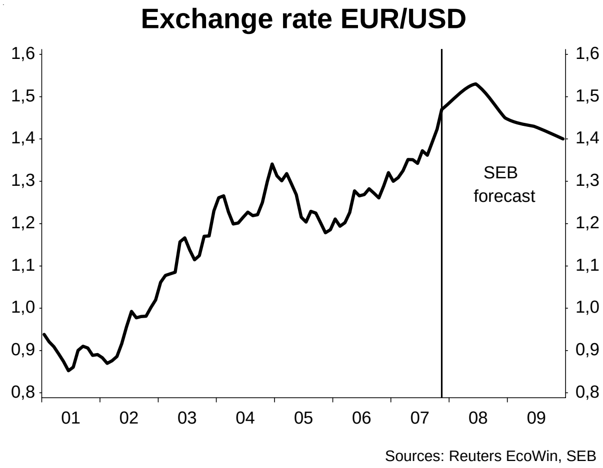
Although a favourable macroeconomic climate will continue to make trade policy easier, we foresee mounting risks. Rapidly growing wealth in Asia and the oil-exporting countries is a source of political tensions. One reason is that this wealth may build up in government controlled "sovereign wealth funds". This type of funds has already been established in such places as the Middle East, China and Russia. Their ambition generally seems to be diversification of their holdings from government bonds into such asset classes as corporate bonds, shares, property or foreign companies.

The existence of these funds may also be linked to tensions in currency exchange policy. The funds may help keep a currency at a weak level that cannot be justified by economic or structural reasons. This gives domestic industry competitive advantages at the same time as a country's growing foreign currency wealth can be used to buy strategically important foreign companies, for example commodity producers.

The fear that sovereign wealth funds in countries with strong capital resources will pursue a political agenda has led the European Commission and German Chancellor Angela Merkel to raise the idea of creating "golden shares" that give central governments veto rights in cases involving foreign buy-outs of companies. Some Russians have also proposed the right to veto foreign investments in Russia. In the past, American authorities have stopped transactions regarded as affecting national security.

Financial imbalances may create international political tensions that hamper direct investments and help protectionism to build up its muscles. If this trend should gain a foothold, it would adversely affect the prospects for stable long-term economic growth.

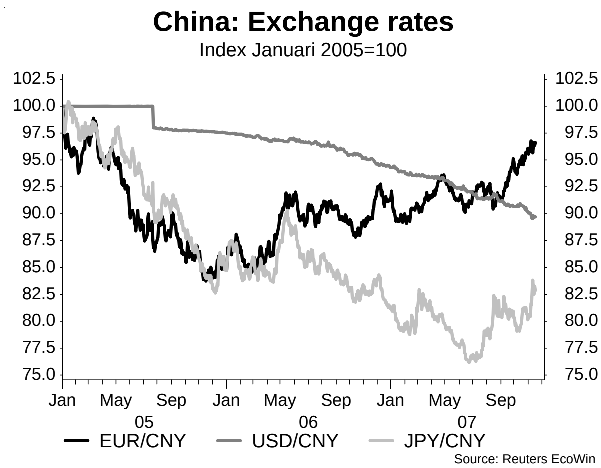
interest rates, the dollar slide regained momentum. We expect the dollar to continue downward against European currencies for another while. The Fed's interest rate cuts during the first half of 2008 will result in a lower key rate in the US than in the euro zone by mid-year. Meanwhile continued large current account deficits will push down the dollar. Psychological and technical factors in the foreign exchange market may amplify this downturn, among other things through an increased interest in currency-proof dollar-denominated assets. We expect the euro to peak at around USD 1.55 during the spring of 2008.



After that, we foresee reasons why the trend towards a weaker dollar against the euro may end. Attention will gradually focus on weaker economic performance in Western Europe. According to our forecast, the ECB will begin cutting its key rate, once the Fed has stopped doing so and the light at the end of the tunnel is discernible for the American economy. Meanwhile the downturn in the US trade deficit will have progressed further. The dollar will thus gradually recover to USD 1.40 per euro by late 2009.

The Swedish krona will move weakly upward against the euro, supported by somewhat higher short-term interest rates than those prevailing in the euro zone and by a continued large current account surplus. By the end of 2008, the EUR/SEK exchange rate will stand at 9.10. During the spring of 2008 the krona will strengthen to somewhat below SEK 6 per dollar. We also foresee relatively small changes for the Norwegian krone. In the coming months, the currency will enjoy support from additional interest rate hikes by Norges Bank. Once oil prices have fallen and short-term interest rate support fades, the krone will weaken somewhat.

The pattern in which **European currencies must bear the burden** of the American adjustment will persist. The yen will admittedly stay at around JPY 110 per dollar during the coming year, in a world of rather weak risk appetite, but will lose ground against the euro. Given the lingering deflationary risks in Japan, interest rates there will remain very low. Further ahead, the yen will fall to JPY 118 per dollar.



Nor do we foresee any radical change in Chinese currency rate policy. China's unwillingness and inability will prevent a revaluation of the yuan to a level based more on fundamentals. It is true that the pace of yuan appreciation against the dollar has accelerated and will average 7-8 per cent next year, according to our forecast, but measured in effective terms or against the euro, the Chinese currency has instead weakened. This has contributed to lingering imbalances in the world economy.

Greater downside risks

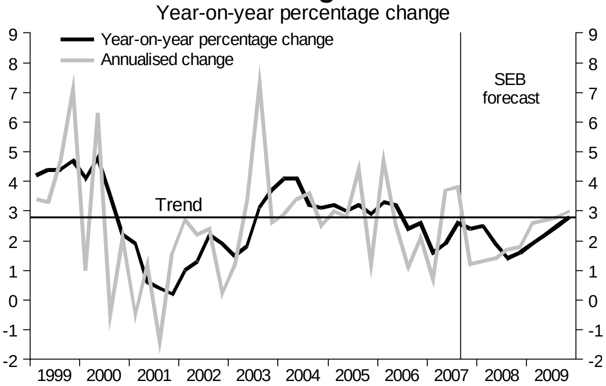
- **Growth far below trend next year**
- **Housing market with no bottom in sight**
- **Core inflation will move sideways**
- **Fed will bring key rate down to 3.5 per cent**

The credit market crisis is putting a damper on the American economy, slowing GDP growth in the coming year. The Federal Reserve will be forced to prop up the economy with additional interest rate cuts. **By mid-2008 the federal funds rate will stand at 3.5 per cent;** we have adjusted our August ***Nordic Outlook*** forecast downward by 50 basis points. The US can thus probably avoid a recession; the domestic slowdown will soften, while the weak dollar will make rapid export growth possible. We expect GDP to grow by 1.8 per cent next year, which is below the consensus forecast.

Statistics on the real economy published in recent months have actually included important positive surprises. Because of a third quarter surge, year-on-year GDP growth has risen from 1.6 per cent early in 2007 to 2½ per cent. Indicators related to the labour market and household spending plans have also mainly been positive.

US: GDP growth

Year-on-year percentage change



Sources: BLS, SEB

But these bright spots have been overshadowed by gloomier events. Losses in the financial service system will apparently end up being larger than expected. A broad, rather long-lasting credit market tightening is therefore likely. Its impact on the real economy is just starting to emerge and will not culminate until some time next year. **This is why GDP growth will now slow again.**

Dual economy

The ever-weaker dollar is now having a deep impact typical of a "depreciation economy". In recent quarters, the contribution of net exports to growth has amount to one percentage point. Both this year and next, we predict that net exports will provide a significant positive contribution to growth. This represents a shift in the American economy, which was previously very domestically driven.

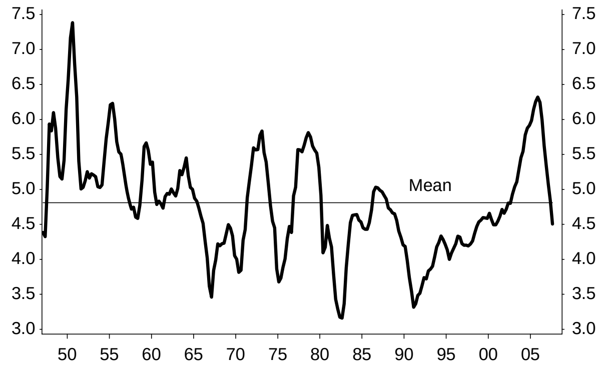
In the wake of strong net exports, the current account deficit has finally turned downward during the past six months or so. This is partly because imports have slowed in the wake of declining domestic activity. It is also likely that we are finally seeing **a reorientation of the American economy towards exports**. Such a trend will help ease global imbalances.

Housing market with no bottom in sight

Meanwhile the crisis in the housing sector is clearly deepening. The problems are not only related to the sub-prime sector but now appear likely to paralyse the housing market on a broader front. At present, it is difficult to foresee any end to the downturn, either in terms of home prices or volume.

US: Residential construction

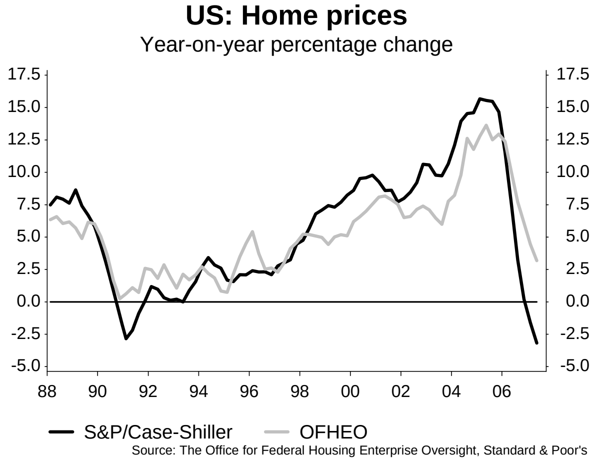
Per cent of GDP



Source: US Department of Commerce

The level of residential construction as a percentage of GDP is somewhat below its historical average, but judging from the credit market situation and housing market indicators, the downturn may very well continue towards record lows. Because the preceding construction boom was so vigorous, the likelihood of a deeper adjustment is also greater. **Residential construction will probably continue to fall sharply throughout next year.**

As for prices, it is even more difficult to foresee when they will bottom out. For a long time, the fact that a nominal price decline had never previously occurred at the national level was put forward as an argument against a price downturn. To date, the quarterly national statistics from the Office for Federal Housing Enterprise Oversight (OFHEO) have not reported any home price declines, but the rate of price increases has fallen steadily. The closely watched S&P/Case-Shiller Index of home prices is now showing a decline of about 3 per cent. Information based on estate agent statistics is also pointing towards negative figures. At present, our assessment is that home prices will have fallen at least 10 per cent by the end of next year.



Consumption growth will slow

So far, household consumption has held up nicely, despite the downturn in the house market. The year-on-year increase is still around 3 per cent. As mentioned in the last ***Nordic Outlook***, this is partially because the housing sector downturn has become more isolated from the general economic cycle than previously. The normal historical pattern has been for home construction to be more closely linked to labour market and stock market trends.

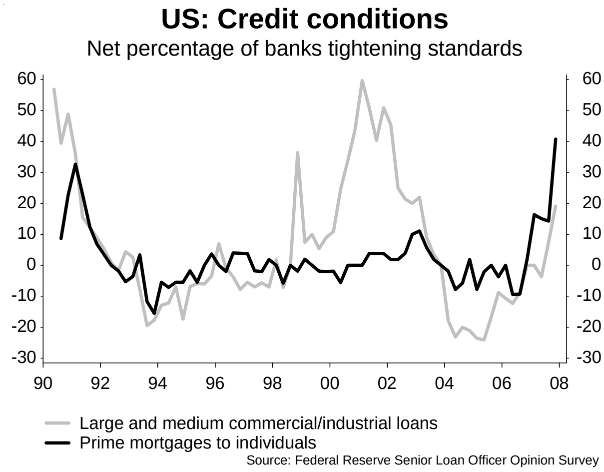
Our consumption model, which includes a number of variables, shows that the offsetting effects of rising stock market wealth and the strong labour market is not enough to explain why consumption has held up so well, either. More than a half percentage point of consumption growth remains unexplained according to our model. This is a sign that the downside risks in the consumption trend are substantial.

On the whole, our forecast means that consumption growth will slow from 2.9 per cent in 2007 to 1.7 per cent in 2008, and then speed up a bit in 2009. This implies a degree of adjustment to the low household savings ratio, which will climb to 2½ per cent of income towards the end of our forecast period.

Cautious capital spending

Capital spending outside the housing sector has shown varying trends in recent months. Due to expansion in many service sectors, especially retailing, there has been a rapid increase in the construction of commercial space. Lower demand for construction resources in the housing sector is certainly playing a role for the upturn in other construction. Capital spending decisions in the manufacturing sector have become more cautious, but increased activity has been discernible in the past few quarters.

To some extent, rising capital investments may help to offset weaker consumption in the months ahead. Capital spending is at a historically low level, while capacity utilisation is high. Many manufacturing companies are also continuing to show strong balance sheets and good profitability. However, the credit market crisis has greatly increased uncertainty and downside risk. This is especially true for commercial construction outside the housing sector, **which is already experiencing significantly tighter credit conditions**.



Our overall conclusion is that the slowdown in domestic demand will be deeper than foreseen by the consensus scenario. Although the risks have increased, it remains likely that **lower interest rates and rising exports can help the US avoid a recession**.

Weaker labour market

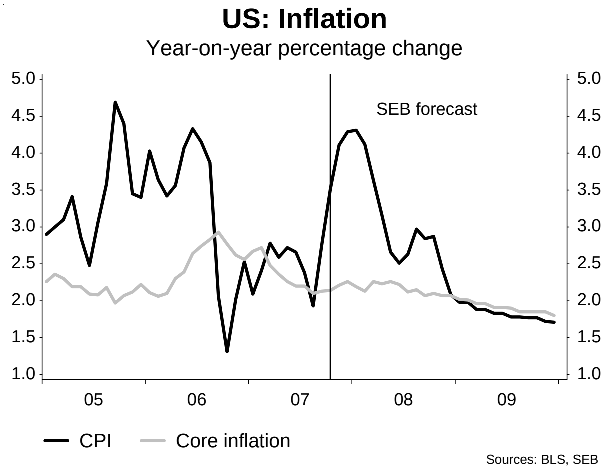
To date, the labour market has weakened only slightly. Job creation has continued to average more than 100,000 per month. Unemployment has crept up by about a quarter percentage point, standing at 4.7 per cent in recent months or quite close to the economy's equilibrium level. The rebound in GDP growth during recent quarters largely explains the resilience of the US labour market. The latest figures also show that the slowdown in productivity growth has not been as sharp as earlier signs had indicated.

Given renewed weakening of growth, a slowdown in job creation seems likely. Historical associations indicate that the 1½-2 per cent growth that we foresee in 2008 should be compatible with 30,000 to 50,000 new jobs a month. We expect unemployment to climb to around 5½ per cent at that time.

Meanwhile the downward trend in labour supply growth has **become increasingly clear**. This weakening of the labour supply means that **potential US growth has fallen**. Our perception is that potential US growth has fallen from about 3½ per cent during the 1990s to below 3 per cent today.

Core inflation will move sideways

Inflation is showing contradictory trends. The Consumer Price Index is now climbing at a rapid pace. Early next year, CPI will peak at above a 4 per cent rate, driven by energy and food prices. Although inflation will then fall relatively fast, our forecast means that for the third consecutive year, CPI inflation in 2008 will be nearly 3 per cent.



In contrast, core inflation has shown a downward trend during the past year. We foresee a marginal upturn in the coming months, since continued high resource utilisation provides an opportunity to pass on the high costs of input goods to consumers. The weakening of the dollar will also help fuel inflation.

Looking ahead, one crucial question is to what extent core inflation will react to the economic slowdown. Historical associations seem to indicate that **core inflation reacts to changing unemployment with a lag of about one year**. For that reason, we do not dare count on any strong cyclical squeeze on inflation as early as next year. In the current cycle, the Fed's interest rate cuts have come unusually early in relation to the labour market situation, which might speed the downturn in core inflation. This is because the shelter component in core inflation seems to react to interest rate cuts.

According to our overall forecast, core inflation will thus remain somewhat above 2 per cent on average in 2008 and then fall in 2009. The Fed's favourite core inflation measure — the Personal Consumption Expenditures (PCE) deflator — is trending slightly lower than core CPI, so it is likely that this measure will end up averaging around 1½ per cent in 2008, in the middle of the Fed's 1-2 per cent preferred target interval.

Key interest rate cuts will continue

The Fed has acted quickly to prop up the economy. After revising its assessment of the economic risks of the August credit market crisis, it slashed the fed funds rate by a total of 0.75 percentage points in September and October. These cuts were delivered at the same time as there were upside growth surprises and as rising energy and food prices drove up CPI inflation, leading some observers to question whether the central bank had acted too hastily. The Fed has also avoided declaring whether it has now initiated a lengthy rate-cutting phase.

We regard it as natural that the Fed does not currently wish to commit itself to a predetermined interest rate policy path. With regard to both inflation and growth, the situation includes enough uncertainty factors that the Fed wants to wait for incoming statistics to the greatest possible extent. However, we expect the negative impact of the credit market crisis on growth and on the labour market to gradually become more apparent, thereby forcing the Fed to continue cutting its key rate. According to our forecast, it will **lower the fed funds rate another 100 basis points to 3.50 per cent by mid-2008**.

Over the past decade, the interplay between interest rate policy, risk-taking and asset prices has created recurrent dramas that have dominated the American economy. The bursting of the late 1990s stock market and investment bubble was followed by extremely loose monetary policy, which succeeded in slowing the economic downturn of the early years of this millennium, apparently at the price of creating the credit and housing bubble that is now on its way towards bursting. The real economic consequences of this situation now appear so serious that the Fed must continue to prop up the economy even if this entails some risks of generating new types of imbalances and delaying necessary adjustment processes.

Deceleration, downside risks

- **Hesitant upturn in consumption**
- **Stubborn deflationary forces**
- **Slow interest rate normalisation**

Japan's growth is slowing somewhat, compared to the trend of recent years. Exports and corporate capital spending, which so far have largely driven growth, are losing some of their momentum as the global economy decelerates. Meanwhile consumption is only slowly and gradually recovering. Overall growth **will cool from 2 per cent this year to a bit over 1½ per cent** in the next couple of years: close to trend.

Economic growth slowed in the spring and summer, but in the third quarter there was a certain recovery. There is continued optimism among exporters. Japan's competitiveness has improved substantially in recent years, due to both successful restructuring efforts and a weaker currency. Combined with persistently strong demand from nearby Asian countries, this will enable exports to keep growing at a decent pace, despite shrinking exports to the US. China has now passed the US as Japan's most important export market, illustrating the independent dynamic in Asian trading patterns.

While optimism remains high among exporters, the mood among smaller, more domestically oriented companies has worsened. Households, too, have become more pessimistic. There is thus a persistent **gap between the flourishing export sector and a domestic economy still unwilling to really take off**. To some extent, the pessimism among households is a mirror image of continued restructuring in the corporate sector. The labour market has become more flexible, with an increased element of temporary jobs and part-time work. It has also become increasingly common for retired employees to be rehired at an advanced age at lower pay. This labour market trend is helping to boost employment and offset Japan's negative demographic trend. Meanwhile it is also helping to push down pay levels and reduce security of employment, thereby curbing the desire of households to spend money. In addition, previous fiscal stimulation measures have been restored.

Downward structural pressure on wages and salaries must be weighed against mounting upward cyclical pressure, as unemployment continues to shrink. The jobless rate is now lower than it has been for a decade. This positive labour market trend should gradually have an impact on consumption. The property market recovery will work in the same direction. Yet the upturn in consumption seems to be taking longer to materialise than we had previously expected.

Strong productivity growth and structural pressure on wages and salaries have helped keep **inflation slightly below zero**. The long deflationary period has also cemented inflationary expectations at a low, though somewhat rising, level. In the short term, inflation will increase a bit due to rising energy and food prices. In a somewhat longer perspective, the ever-tighter labour market will also fuel inflation. However, the upturn will be very modest and the rate of price increases will hardly reach the one per cent that the Bank of Japan (BoJ) has said is compatible with price stability.

The BoJ's ambition is to raise its key interest rate to a "normal" level as the economy normalises. Such a level is probably around 2½ per cent, given trend growth of 1½ per cent and inflation of around 1 per cent, but due to unexpectedly low inflation and the financial market turbulence of recent months, the BoJ has not raised its key rate since February. Provided that credit market turmoil does not worsen, we expect the BoJ to hike its key rate again after the turn of the year but then keep it unchanged for the rest of 2008. By the end of 2009 the key rate will be 1.0 per cent. The higher key rate will not suffice to sustain the yen, which will show a renewed weakening trend from structural outflows when the global credit turmoil has subsided.

While monetary policy slowly becomes slightly less expansive, the government's **consolidation ambitions for public finances have diminished**. The public sector fiscal deficit has admittedly fallen from 8 per cent of GDP to below 3 per cent in the past five years, but if fiscal targets are to be achieved, further measures are required. The new prime minister, Yasuo Fukuda, has promised far-reaching reforms in the tax system. No details of how these reforms might look have been unveiled, but higher taxes on consumption are probably in the cards, along with a broadening of tax bases. Considering the weaker post-election position of the governing Liberal Democratic Party (LDP), however, it is highly uncertain whether and when such reforms can be implemented.

Imbalanced growth

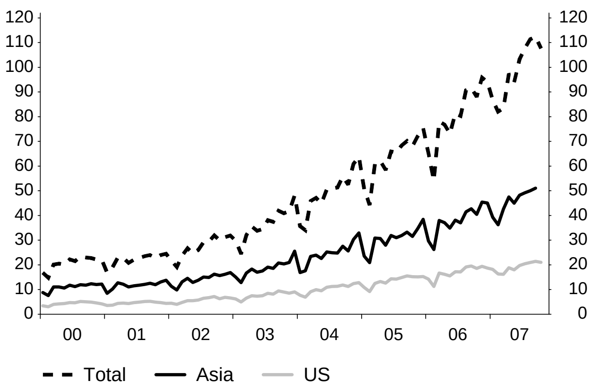
- **Slow transition towards more consumption**
- **Food prices drive inflation**
- **International pressure and economic imbalances push up yuan**

China's economy is continuing at a breakneck pace despite official deceleration measures. During the third quarter, year-on-year GDP growth was 11.5 per cent. This was only marginally below the 11.9 per cent second quarter rate and far above the government's long-term target of 7-8 per cent. As earlier, investments and foreign trade were the prime movers, although the export boom slowed somewhat.

We anticipate a continued **positive but imbalanced trend** but expect China to speed up the appreciation rate of the yuan and keep hiking interest rates, thus helping to some extent to create a better balance both externally and internally. Consumption growth is being driven by rapid pay increases but will continue to account for comparatively small contributions to growth in the next couple of years. The slowdown in the Western world will only have a minor impact on total export growth, since intra-Asian trade has become increasingly important over time. **GDP growth** will end up at **close to 11½ per cent** this year, then **gradually fall** to 9 per cent in 2009.

China: Exports

USD billion



Source: China National Bureau of Statistics

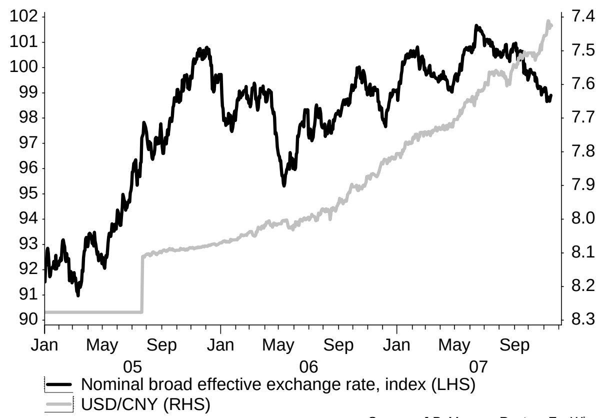
During 2007, exports have continued to rise at about 25 per cent year-on-year, pushing the **trade surplus** to a **record** 9 per cent of GDP. This is a sign that the Chinese yuan is undervalued. Both the latest G7 meeting and IMF statements have pointed this out in clearer terms than previously. External pressure for a rapid revaluation of the currency is likely to intensify as economic expansion slows in the Western world.

There are both external and internal reasons for China to heed these calls. The undervalued yuan is creating major tensions with trading partners and may lead to protectionist counter-measures. The interest rate hikes implemented in China to date have not had the desired cooling effect, another indication of the need to use currency rate policy to help stabilise the economy.

Given strong profits and a more stable financial service system in China, sustained by the presence of foreign banks and interests, we now believe that the authorities are willing to **speed up the appreciation rate vs USD**. Since last summer it is been 5-6 per cent year-on-year; in the coming year we believe it will reach 7-8 per cent.

Since China stopped pegging the yuan to the US dollar in July 2005, the currency has appreciated by nearly 10 per cent against the USD, but the trade-weighted pattern has been different. During 2005 the yuan appreciated rapidly by nearly 8-9 per cent, mainly driven by the dollar's rise against other currencies, but since the end of 2005 it has not strengthened at all in trade-weighted terms. Its revaluation against the USD has been neutralised by the dollar's weakness against other currencies.

China: Effective exchange rate and USD/CNY



Sources: J.P. Morgan, Reuters EcoWin

China's inflation rate has **climbed sharply** this year, from about 2 per cent early in 2007 to 6.5 per cent by autumn. This is not connected to labour cost inflation. Practically the entire upturn is explained by **rising food prices**, which in turn largely reflects supply side-related movements. Adjusted for food, the inflation rate has remained largely constant at 1 per cent since late 2004. In the short term, however, rising energy prices will add to food-driven inflation.

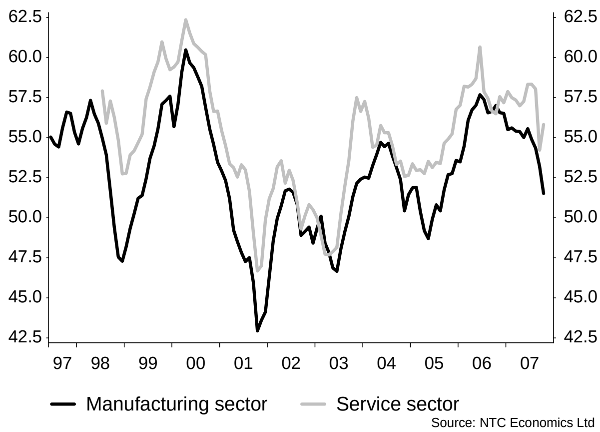
Economic policy strives towards lowering inflation and achieving more sustainable growth. **China's key interest rates** – deposit and lending rates – will be **hiked** further; the one year deposit rate has been lifted in several steps from 2.5 to 3.9 per cent. The **exchange rate** will be allowed to **appreciate** further. Furthermore, there will be some **liberalisation** in **trade policy**. However, during our forecast horizon our conclusion is that these measures only will have small dampening effects on inflation and growth.

Buffeted by westerly winds

- **Growth below 2 per cent next year**
- **Tighter credit conditions hamper investments**
- **Inflation up – then down**
- **ECB will cut its key interest rate next autumn**

Weaker US growth, tighter credit conditions, high energy prices and an ultra-strong currency will now lead to a clear slowdown in euro zone GDP growth. **We expect GDP growth to cool from 2.6 per cent this year to 1.8 per cent in 2008**, then level off somewhat below trend in 2009.

This forecast represents a downward revision since our August ***Nordic Outlook***, especially for 2008. The decoupling of growth that dominated 2007, when euro zone growth was gradually revised upward despite disappointments in the US, will not continue. The contagious effects of the American economic slowdown are gradually becoming more apparent, especially via financial channels.

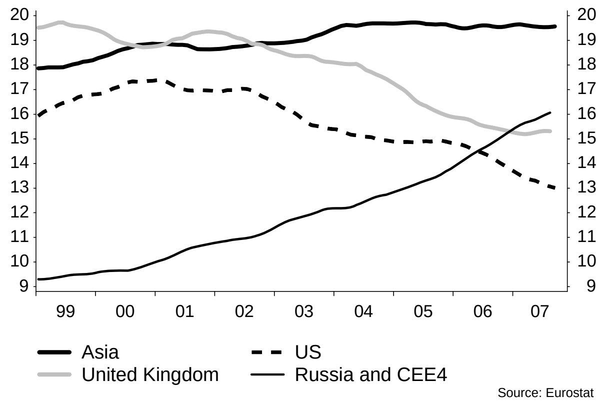


Meanwhile there are reasons why euro zone growth can hold up relatively well. Underlying factors point towards some acceleration in private consumption, while exports to rapidly growing markets in eastern Europe and Asia will stimulate the manufacturing sector.

Asia and Eastern Europe more vital

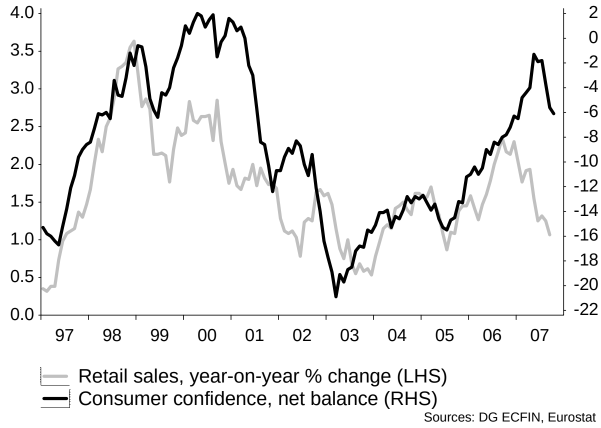
The euro zone is now being impacted by a broader downturn in American import demand, while the ever-stronger euro is putting further pressure on exports.

Meanwhile the effects of the US slowdown are being offset by changes in the euro zone's export structure. The US share of total euro zone exports has gradually fallen from 17 per cent in 2000 to 13 per cent. The share destined for fast-growing economies has instead risen. Most apparent is the upturn in exports to Russia and Central Europe (the CEE-4 countries of Poland, Slovakia, the Czech Republic and Hungary). This region has boosted its share of euro zone exports from 9 per cent in 1999 to 16 per cent. The share going to Asia has increased from less than 18 per cent to nearly 20 per cent today. Exports to Middle Eastern oil producing countries have climbed especially fast in recent years, stimulated by high oil prices.



Consumption will help offset slowdown

Private consumption has continued to disappoint forecasters, especially in Germany. So far, the improvement in the labour market has not led to soaring consumption, but looking ahead we expect consumption due to rising real income and relatively high savings to help offset weaker exports and capital spending.

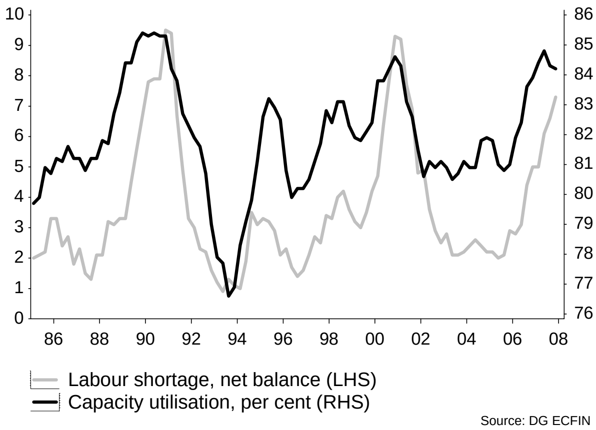


We thus expect private consumption growth in the euro zone to rise from 1.3 per cent in 2007 to 1.5 per cent in 2008. But the potential for a more significant upturn seems likely to be undermined by declining consumer confidence in the wake of the international slowdown.

Labour market will soon level off

The labour market has greatly improved in recent years. Since 2005, unemployment has fallen by 2-3 percentage points in the largest euro zone countries. Now that the growth peak is past, there are indications that we are approaching the end of a long period of falling jobless rates. As an annual average, however, we expect unemployment — measured according to the harmonised ILO standard — to continue falling from 7.4 per cent in 2007 to 7.2 per cent in 2008, then rise somewhat in 2009.

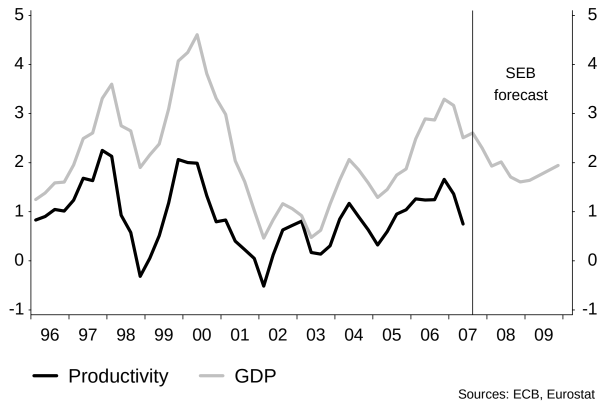
Labour shortage and capacity utilisation



The jobless rate has fallen rapidly towards the OECD's **traditional measure of equilibrium unemployment —** the non-accelerating inflation rate of unemployment (NAIRU). This implies that the euro zone risks late-cycle wage-driven inflation. Various measures of output gaps, shortage figures and capacity utilisation point in the same direction. In Germany, for example, we can see tendencies towards accelerating pay hikes. Last spring, the IG Metall union and metalworking employers signed an agreement that will result in pay increases of about 4 per cent this year. Employees in the steel industry and the railway sector have won their highest wage agreements in ten years.

Euro zone: Labour productivity and GDP

Year-on-year percentage change



Yet this is not clearly evident from broader measures of employee pay. The rate of increase in unit labour

Will the housing market decline in the euro zone too?

How large is the risk that the housing market is also on its way down in the euro zone? The International Monetary Fund has warned that there is a risk of rapidly deteriorating conditions in several markets. In this context, it is worrisome that there is a co-variation between American and euro zone home prices.

The IMF estimates that about 75 per cent of the upturn in OECD home prices is due to such real factors as rising stock prices, higher income, stronger labour markets and lower interest rates. The remaining 25 per cent is driven by speculation. According to this study, there is little difference between the degree of speculation in the euro zone as a whole and the United States.

The differences between the various euro zone countries are often sizeable. Countries like Spain, the Netherlands and Ireland have all witnessed a long period of rapid home price appreciation. Especially in Spain, there has been a large speculative element. Spanish home prices are now on their way down after previously having been driven up to unsustainable levels, in part by foreign buyers. The construction sector's great importance enlarges the risk of a hard landing in Spain.

Credit losses originating in the American market have already made euro zone banks and mortgage lenders more cautious in their domestic markets as well, which risks amplifying the downturn since financing for many residential purchases will become more difficult. However, there are still certain reasons not to be too pessimistic about the housing market in the euro zone as a whole:

- There is no direct equivalent to the sub-prime market in the euro zone. As a result, direct lending to households has been more restrictive than in the US.
- Average home prices in Germany stood completely still for nearly a decade. This means that the average price upturn in the euro zone has been slower than in the US, even though several individual euro zone countries have experienced a significantly more dramatic upturn.
- In recent years, the level of residential construction has been lower in the euro zone than in the US, leaving less room for volume to fall.

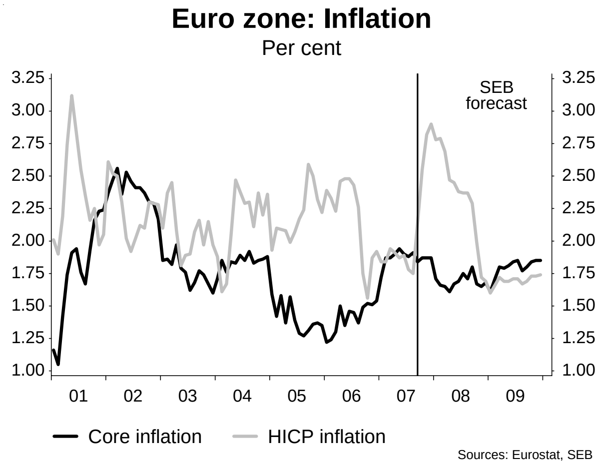
Our overall conclusion is that many euro zone countries now face a housing market downturn. Lending practices will be tightened. Prices and volume will cool. However, the total strains on the macro-economy and the financial service system will not be as dramatic as in the US.

cost is still as low as 1 per cent. It is possible that due to positive supply side changes in the economy, the traditional equilibrium measures exaggerate the danger of wage inflation. A stronger productivity trend has also helped to push down unit labour cost. The downturn in the growth rate during the second quarter nevertheless illustrated risks of a cyclical setback, now that economic growth is slowing.

Inflation up, then down

Due to rising energy and food prices, inflation will climb rapidly during the next six months or so. The Harmonised Index of Consumer Prices (HICP inflation) is expected to rise from 1.7 per cent at the end of the summer to 2.9 per cent by year-end. Petrol prices will contribute a full 0.8 percentage points to HICP inflation this winter, before base effects soften their impact in the second quarter of 2008. Food prices also rise rapidly. The rate of increase will peak at 5 per cent by mid-year, on a par with the record set in 2001. Towards the end of 2008, we expect food price increases to have cooled to 2½ per cent. Germany's January 2007 value-added tax increase will disappear from the 12-month figures, contributing to slower inflation early next year.

Despite high resource utilisation, wage inflation has been surprisingly low. However, some upward pressure is likely to occur in the coming months in conjunction with a late-cycle slowdown in productivity growth. Meanwhile downward global price pressure on consumer goods will continue. Although this may tend to weaken somewhat, the effect of the strong euro will be to maintain downward price pressure from imported goods in the euro zone, even in a slightly longer perspective. Energy prices, too, will gradually shift in an inflation-slowing direction.



Overall, our inflation forecast implies that HICP inflation will be at a high level during most of 2008, but will fall sharply towards year-end. Core inflation, excluding the effects of energy and food prices, will mainly move sideways during the forecast period. The average core inflation level will be somewhat below 2 per cent.

Sarkozy will under-finance the budget

Six months after his election victory, French President Nicolas Sarkozy is noting the highest popularity figures seen since the era of General Charles de Gaulle. However, his popularity is hardly attributable to his having carried out his promises to jump-start the French economy. In fact, Sarkozy has had a difficult time getting his policies off the ground. His plans to change the pension rules that grant special privileges to employees of publicly owned companies were met by strikes. He has also been forced to back off from his election promise to replace only one out of two civil servants who retire.

Despite the country's fairly good economic performance, the French government does not expect to achieve a balanced budget until 2012. France is also diverging from the pattern elsewhere in the euro zone, where the public budget situation is generally improving quite rapidly. For example, Germany will probably manage to show a balanced federal budget as early as this year.

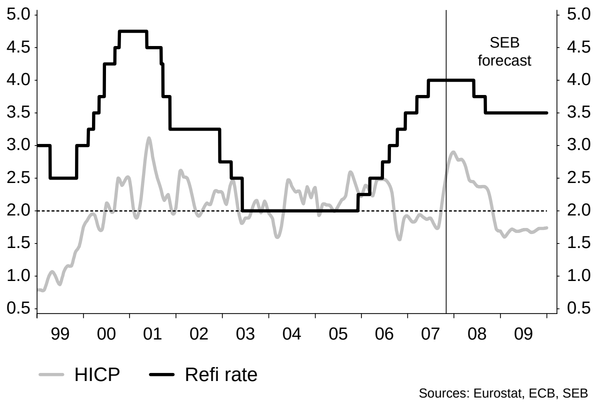
Budget forecasts in France may also rest on overly optimistic assumptions. The 2007 GDP forecast from the National Institute for Statistics and Economic Studies (INSEE) was recently revised downward to 1.8 per cent, well below the government's official forecast. Partly due to economic problems on the domestic front, Sarkozy has reiterated France's criticism of the euro zone economic policy framework. Its criticism of the European Central Bank's interest rate policies is further fuelled by the threat of economic slowdown and the record-strong euro.

The high resource utilisation will pose an upside inflationary risk, but this must be weighed against a downside risk to growth if the international slowdown intensifies. Our assessment is that **the inflation risk is symmetric in the medium term**.

Inflation expectations have risen somewhat in recent months, and household expectations will probably climb somewhat further when spot inflation is driven up by surging energy and food prices. It is, however, difficult to foresee any major risk to medium-term confidence in the ECB inflation target.

Euro zone: HICP inflation and refi rate

Per cent



Sources: Eurostat, ECB, SEB

ECB will lower its key rate next year

During the autumn, the European Central Bank has halted its refi rate hiking cycle. Its wait-and-see approach to future interest rate policy is also indicated by its avoidance of the earlier code word “vigilance” and by the fact that the ECB no longer describes the prevailing interest rates as “stimulative” for the economy.

On the other hand, the ECB has toned down the impact of the US slowdown, while highlighting upside inflationary risks in its customary fashion. Our forecast implies that in the short term, the ECB’s inflationary worries will be confirmed. The ECB will thus, to at least the same degree as other central banks, face a dilemma in which inflation is being driven upward by supply side factors and late-cycle forces while the economy is weakening in other respects. The disagreements within the ECB’s decision-making bodies, which have been apparent during the autumn, are likely to persist in the coming months. Among other things, divergent threat scenarios in the housing market will affect the way that the ECB will weigh the risk picture.

However, we expect the threats to growth to gradually assume the upper hand. In an environment where the US Federal Reserve is continuing to cut its key interest rate, the euro will be pushed upward to new record heights. Even if the direct effects of the stronger euro on inflation will be limited, the ECB will find it increasingly difficult to defend continued rate hikes. Tighter credit has already begun to have a clear impact on the corporate debt environment, which the ECB has emphasised in its monthly bulletin.

Given below-trend growth and varying degrees of cooling in the housing market, we see an overwhelmingly likelihood that the ECB’s next step will be to lower its key interest rate. Our forecast implies that the ECB will cut its refi rate to 3.5 per cent during the second half of 2008. By that time, it will be sufficiently clear that inflation has turned downward, while the labour market will have begun to show certain signs of weakness.

The ECB’s rhetoric normally focuses largely on the trend of inflation. Meanwhile, experience from the period 2001-2003 shows that the ECB is not especially dogmatic. At that time, the bank gradually lowered its refi rate from 4.75 per cent to 2 per cent even though spot inflation was higher than 2 per cent. In a situation where the medium-term inflationary outlook is under control and the inflation rate will peak as early as December this year, it is likely that the actions of the ECB will again be determined by growth and labour market prospects.

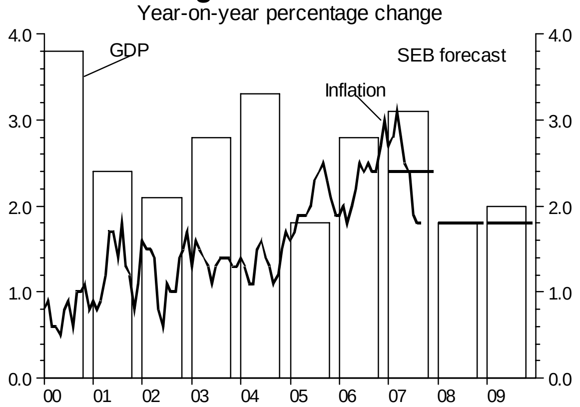
Weak home prices slow GDP

- **Growth below trend in 2008 and 2009**
- **Weaker housing market will stimulate saving**
- **First key interest rate cut in December**

The British economy is poised for a clear slowdown. The property market is on its way towards cooling off in response to a relatively sharp tightening of monetary policy by the Bank of England (BoE) in 2006-2007. The result will be a lengthy period of **weaker consumption growth**. Meanwhile exports will be restrained by continued weakening in the important US market next year. We expect **GDP growth to fall** to 1.8 per cent in 2008, then recover marginally to 2.0 per cent in 2009. This represents a slight downward adjustment compared to our August ***Nordic Outlook*** forecast, due to weaker prospects in the US and Western Europe.

United Kingdom: GDP and inflation

Year-on-year percentage change



Sources: Eurostat, Office of National Statistics, SEB

So far, however, the economy has largely maintained its strength. During the third quarter, GDP rose by 3.3 per cent year-on-year, driven by a certain acceleration in service sectors. Growth has thus remained above its 2.5 per cent trend for eight consecutive quarters. The latest confidence surveys exude continued optimism. The recent credit market turmoil has thus not affected households and companies to any great extent.

This autumn, exports have recovered after a slump over the past year, even though exports to the US are falling year-on-year. Lingering effects from the earlier strength of the pound, along with slower global growth, will result in relatively tepid export performance in 2008-2009. Corporate capital spending plans have become less expansive in recent months, among other things due to somewhat lower capacity utilisation. Capital spending activity is thus gradually cooling from a high level. Private consumption remains strong. Retail growth, for example, has accelerated slightly since last summer.

In recent years the high household consumption rate has largely been based on rising property prices and increased borrowing. Now the conditions for this are gradually changing. **Home price increases** are **cooling quickly**, due among other things to tighter credit conditions in the wake of financial market turmoil and the problems of the mortgage lender Northern Rock. The price expectations of estate agents, measured by the RICS survey, have continued to cool during the autumn. Most respondents now anticipate falling prices. This survey is a good forward indicator. We expect home prices to drop by 5-10 per cent next year.

Consumption will decelerate

The interest burden is rising, since interest rates on loans are now continuously being adjusted higher in the wake of earlier BoE rate hikes. Their high debt level makes households extra sensitive to this process. With a very low household savings ratio at the outset, and with the labour market beginning to weaken next year, **the adjustment in saving** may be significant. We expect households to begin boosting their saving during the first half of 2008. Consumption will thus decelerate from more than 3 per cent this year to slightly below 2 per cent in 2008.

Pay increases have remained modest, despite the tight labour market so far, with unemployment of around a low 5.5 per cent. Last winter's sharp upturn in inflation ended during the spring, and for several months the inflation rate as been somewhat below the BoE's 2 per cent target. In the short term, inflation will accelerate again due to more expensive energy and foods, but in a longer perspective, the coming economic deceleration will restrain price pressure. We believe inflation will end up somewhat below 2 per cent both in 2008 and 2009.

Growing downside risks in the economy, combined with a stabilisation of the underlying inflationary picture, will open the way for interest rate cuts. The BoE will lower its repo rate starting in December, from 5.75 to 4.00 per cent in 2009. This, in turn, will lead to continued depreciation of the pound against the euro and various other European currencies over the coming year.

Fiscal policy, now mildly contractive, will eventually become expansive after the economic slump and in the run-up to the next parliamentary election.

Resistant to global problems

- **Continued strong domestic demand**
- **Increased inflation risks**
- **Slowdown in Baltics – persistent imbalances**

The economies of Central and Eastern Europe are resisting international financial market turmoil and weaker global demand. The reasons are **improved economic fundamentals** as well as favourable conditions for **growing domestic demand**. The three Baltic countries, and to some extent Ukraine, are exceptions to this scenario.

GDP in the nine countries of the region covered here, including the Baltics, will increase by **6.9 per cent this year**. Growth will fade to **6.2 and 5.7 per cent, respectively, in the next two years**. Inflationary pressure has increased in many places due to high resource utilisation and rising food and energy prices. Looking ahead, **inflationary pressure will slowly ease**.

Exports will continue to climb, although growth figures will slow. In none of the nine countries does the US buy more than 5 per cent of exports, which explains their ability to resist the slowdown to date. But now import demand is also slowing in the important German market, which will have a greater impact on the region. Russia and Ukraine, however, are benefiting from continued high commodity prices.

The most important reason why the region is resisting global problems so well is strong domestic demand. Private consumption is being stimulated by high pay increases and investments including EU structural funds, as well as strong corporate profits. We predict some cooling in domestic demand too, as a result of heightened inflation, rising interest rates in some countries and somewhat more cautious lending practices.

Nominal effective exchange rates

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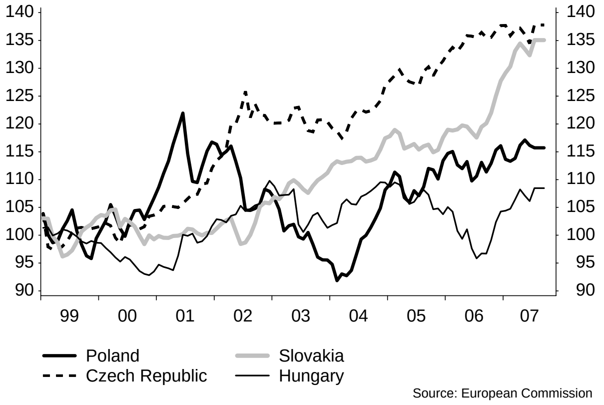

Source: European Commission

It is worth noting that Central European currencies have been robust during a volatile period for various global risk indicators in recent months. We anticipate that a continued gradual decline in public budget deficits and higher interest rates in Poland and Hungary will continue to sustain their currencies.

Russia's GDP will grow by 6-7 per cent annually in the next couple of years, stimulated by high commodity prices and expansive fiscal policy. The December parliamentary election and the March presidential election are unlikely to result in any change in the direction of official economic policy. Inflation will remain at high levels due to the large influx of oil income, high pay growth and more expensive food. In the short term, inflation will be restrained by a price freeze on convenience goods and administratively fixed prices. This will only provide a temporary respite, however, and will not enable Russia to achieve its official target of 8 per cent inflation at year-end 2007.

Ukraine will show yearly GDP growth of a full 8 per cent in 2008-2009. The consumption boom will continue although the country's strong credit expansion will decelerate. As in Russia, inflation problems will persist. Higher food prices, rapid pay increases and continued expansive fiscal policy under the new government will keep inflation in two digits during 2008. The government will thus continue to miss its inflation target.

In **Poland**, GDP will rise by close to 6 per cent next year, after nearly 7 per cent in 2007. Consumption is now faltering in Poland's investment-driven upturn. Resource utilisation is becoming stretched, especially in the construction and service sectors. This is leading to a wage-driven upturn in inflation, albeit from a low level. Due to continued monetary policy tightening, inflation will remain below 3 per cent over the next couple of years. The new government coalition led by the centre-right Citizens' Platform will gradually push through reforms. This implies tax cuts, with a uniform flat tax as the ambition. Meanwhile Poland will speed privatisations, and the euro issue will be revitalised. However, parliamentary resistance and presidential vetoes will slow the pace of reform on certain issues.

Growth in **Slovakia** and the **Czech Republic** will slow marginally. This autumn, industrial confidence indicators have fallen somewhat from high levels, while household optimism has been stable. **Hungary** is gradually emerging from its economic slump. The countries of Central Europe have in common that their budget deficits are shrinking. In the case of Hungary and the Czech Republic, tighter fiscal policy is contributing to this.

Euro zone accession remains **distant for most** EU members in Central and Eastern Europe. Slovakia's goal of adopting the euro in 2009 is well within reach, however. Next in line is Estonia, though no earlier than 2011 in our judgement, but the timing could be accelerated by a year, since budget consolidation may become a top priority of the new government. It is too early to speculate about such a policy shift, however.

Baltics: "Hard soft landing" in Estonia

The consequences of excessively rapid growth in domestic demand have gradually become more and more clear in the Baltics. The three Baltic countries will be plagued by continued major imbalances over the next couple of years. In terms of the current account deficit and high inflation, the situation in Latvia will remain the worst. The risks of a hard landing in Estonia and especially in Latvia have increased, but our scenario is still a **soft landing** in these economies. To make this come true, credit growth must continue to slow, and in the case of Latvia a fiscal stabilisation package must also be launched.

Estonia's growth will decelerate clearly as the exaggerated expectations of economic players become deflated. Property prices have decelerated, and GDP growth has already declined significantly. Measured as annual averages, growth will fall from 11 per cent last year to 4-5 per cent in the next couple of years. This is growth below the potential level of 6-7 per cent.

In spite of this, inflation has continued to accelerate, largely due to rapid pay increases. However, we expect inflation to slow next year. Rapidly rising unemployment will result in a more moderate rate of pay increases, while the sharp deceleration in money supply growth will hold down inflation.

The Baltics: Sentiment indicators

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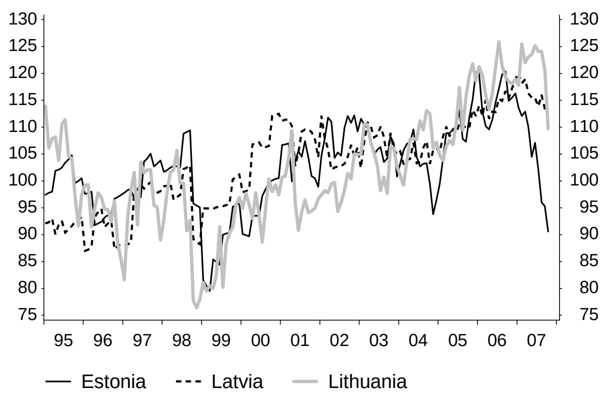


Source: DG ECFIN

Latvia's growth remains rapid. We foresee a cool-down in the annual growth rate from 10.5 per cent this year to 6-7 per cent in 2008 and 2009. The risk of a hard economic landing has increased in the past six months, however. Pay levels are climbing at a year-on-year rate of 30 per cent, causing overall inflation to accelerate to above 13 per cent.

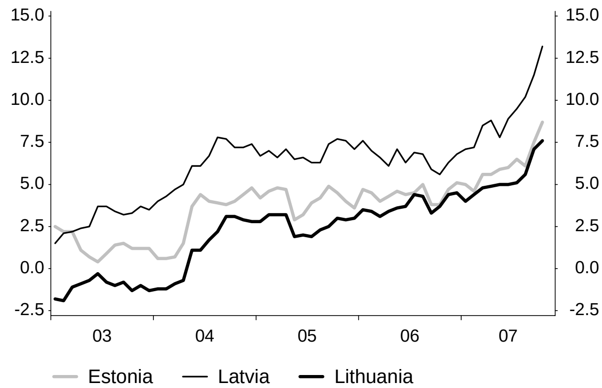
Higher interest rates will help cool the economy somewhat. We also expect the government to introduce an economic stabilisation plan before year-end, with one element of the package expected to be limitations on the rapid pay growth in the public sector. The shaky domestic policy situation and the recent cabinet crisis, including the PM's resignation, poses only a marginal threat to the austerity ambitions.

The coming austerity package will be a follow-up of the "anti-inflation plan" that the government unveiled last spring, following Latvia's currency turmoil in February. This plan focused more on tightening lending practices and gradually lowering inflation via different measures.

The new stabilisation plan may help to slow the upturn in short-term market interest rates. Interest rates are nevertheless likely to remain high due to the tight liquidity situation in the economy and lingering concerns about a currency rate adjustment.

The Baltics: Inflation

Year-on-year percentage change



Source: Eurostat

Lithuania is in the final phase of a growth period that has been somewhat more modest than in its neighbouring Baltic countries. During the third quarter, the growth rate was a surprisingly high 10.8 per cent. Growth will gradually slow from an average of 8 per cent this year to 6 per cent in 2009. The imbalances are less than in Estonia and Latvia, but the problems of a large current account deficit and high inflation will persist in the next couple of years. The risks of an economic downturn predominate here, too, and this is illustrated by the sharp downturn in sentiment indicators that has occurred during the autumn.

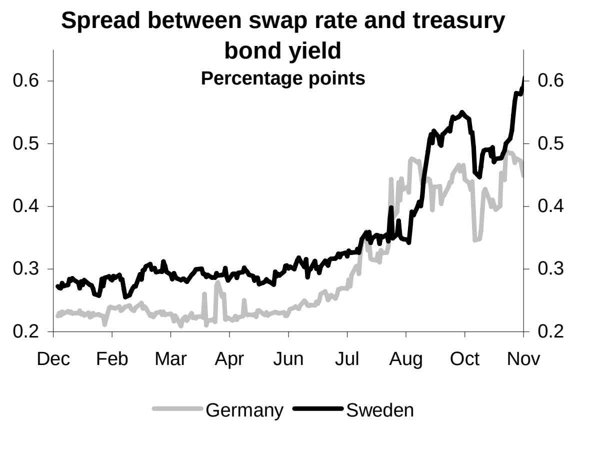
Slower growth due to international cooling

- **GDP growth at around trend in 2008**
- **Strong labour market for another while**
- **Inflationary surge as economic cycle peaks**
- **Riksbank will cut key rate next autumn**

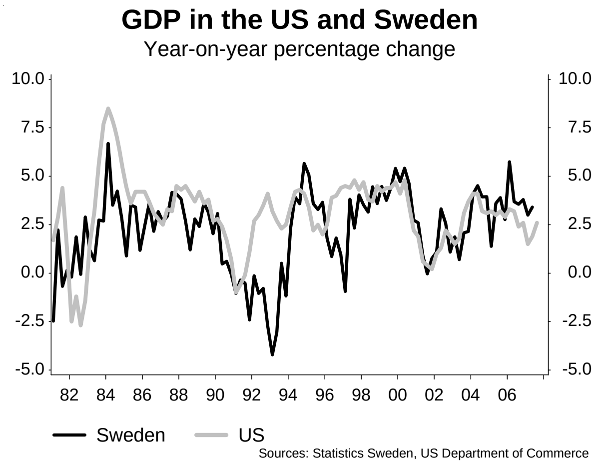
Sweden now stands at an economic crossroads. A seemingly robust domestic economy is facing international storm clouds and persistent financial pressures, creating a difficult balancing act for the forecaster.

Many signs indicate that the economic upturn can continue. Employment keeps growing rapidly, and there is great confidence among companies and households. Our GDP indicator is thus signalling several relatively strong quarters ahead.

Yet we have concluded that **disappointments will predominate in the foreseeable future**. The economy will gradually be slowed by the accumulated effects of tighter credit, high oil prices, the weak US dollar and more subdued international demand. The Swedish economy has historically shown greater co-variation with international economic cycles than most other countries. The reasons are Sweden's cyclically sensitive export sector and great sensitivity to movements in international financial markets. It is also clear that Sweden is affected by the financial turmoil.

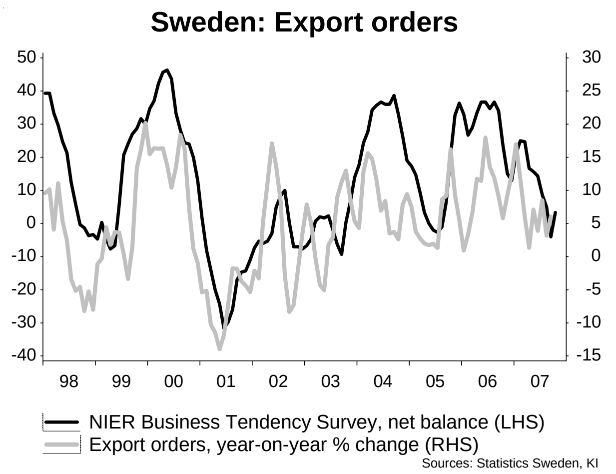


This year, GDP growth will slow to 3.3 per cent (adjusted for the number of work days), compared to last year's increase of 4.5 per cent. **Then GDP growth will decelerate further to 2.3 per cent in 2008 and 2.0 per cent in 2009**. This means that by the middle of next year, growth will have slowed to its trend level and after that will be somewhat below trend. Export growth will cool further, while capital spending behaviour will become more cautious, especially in manufacturing. Due to a continued good labour market and large income increases, however, household consumption will keep growing at a healthy pace.



Job creation will continue at a rapid pace for another while, and unemployment will fall further until mid-2008. Productivity growth will remain weak next year. Combined with rising pay increases, this will drive up inflation. CPIX (Consumer Price Index excluding household mortgage interest expenditure and direct effects of changes in indirect taxes and subsidies, previously called UND1X) will rise to more than 2 per cent next year.

The cyclical slowdown, combined with rising inflation, poses a dilemma for the Riksbank. We expect the bank to raise its repo rate one more time early next year, thus bringing the key interest rate to a peak. As growth slows in the course of 2008 and unemployment levels off, justifications for rate cuts will increase. Our forecast is that the **repo rate will be lowered in two steps to 3.75 per cent late in 2008.**



Public finances will meet their official surplus targets by a wide margin during the next couple of years. Given lower growth, stabilisation policy arguments for fiscal restraint in the run-up to the autumn 2010 parliamentary election will weaken. We thus expect additional stimulation in 2009.

Slower export growth

Sweden's export growth culminated late in 2006. Merchandise export growth slowed from 10 per cent in the fourth quarter last year to 4 per cent during the first half of 2007. According to Statistics Sweden figures on export orders and the National Institute of Economic Research Business Tendency Survey, a further deceleration has occurred since then.

Export growth, Jan-Aug 2007
Year-on-year Current prices

	Weight	Change	Contribution
Euro zone	33	8	2.6
Other Nordic countries	23	8	1.8
United Kingdom	7	5	0.4
United States	10	-13	-1.3
Asia	10	1	0.1
Eastern Europe	6	24	1.5
Other countries	11	5	0.6
Total	100		5.7

Source: Statistics Sweden

The export slowdown so far this year is largely due to a sharp decline in exports to the US. More surprising is that exports to Asia have only increased by 1 per cent in current prices. One explanation for this may be the major price squeeze in the telecom sector, which weighs heavily in exports to that part of the world. Exports to Eastern Europe have shown robust growth.

Looking at individual sectors, exports of engineering products as well as machinery and metal products continued to increase. Interim reports from a number of large engineering companies indicate that demand will remain good in the short term, but a clear slow-down for pharmaceuticals and telecom products is evident. The downward revisions reported by Ericsson and other companies in the telecom industry pose a risk to our 2008 export forecast, although the role of this sector in the Swedish economy has declined since the turn of the millennium. It is worth noting, however, that service exports in the telecom sector have continued to increase.

Dollar squeeze

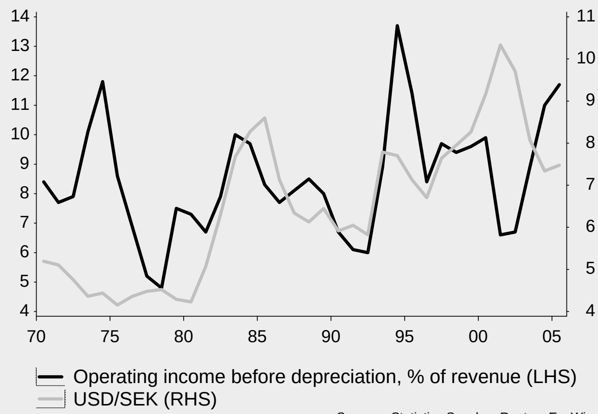
The US dollar is now at its weakest level against the krona since before the Swedish currency's 1992 mega-devaluation. Poorer competitiveness will slow the growth of export volume. According to our forecast, the dollar will weaken further next year. In effective terms, i.e. in relation to Sweden's most important trading partners, the krona will strengthen by 3 per cent during 2008 compared to 2007. Various rules of thumb for exports indicate that this would result in a negative volume effect of 2 per cent.

The ever-weaker dollar has also begun to impact company earnings, although the association between dollar exchange rates and corporate profits has diminished in the past decade. One explanation for this is the increased internationalisation of companies, with production and sales in a number of different currency areas. Many companies also have large dollar-denominated costs, which reduce exposure.

When we study production in Sweden, profitability also seems to be less dependent on fluctuations in the dollar. One reason for this may be a change in industrial structure, with a shrinking proportion of companies whose prices are set in dollars; for example, the forest product industry's diminishing share of exports contributes to this trend. Yet taken together, the strengthening of the krona combined with a clear upturn in the unit labour costs of companies will mean a tougher earnings climate ahead.

The short-term impact on profits is determined by how companies have protected themselves against exchange rate fluctuations. According to an SEB survey of chief financial officers, hedging of current foreign exchange transactions by major Swedish companies extends for an average of 8 months. This means that foreign exchange losses will continue to pull down earnings during the first half of 2008 if current exchange rates persist.

Sweden: Industrial earnings and USD/SEK



Sources: Statistics Sweden, Reuters EcoWin

According to the survey, export companies also state that they have increased their foreign exchange exposure. The degree of currency hedging is only around 25 per cent. The negative interest rate spread against many countries may be one explanation, since it creates an extra expense when hedging currencies. For this reason, US interest rate cuts may help boost the degree of currency hedging. All else being equal, this implies that the krona will strengthen.

Next year, growth will slow in the Nordic countries and the euro zone, while the problems of the US will continue. This will slow market growth. Poorer competitiveness due to the stronger krona and higher unit costs also point towards further deceleration in export growth next year.

Capital spending growth culminating

The capital spending upturn is now in its fourth year. This year's upturn is broad, with large growth figures in most areas. Fixed investments will grow by a total of about 10 per cent this year.

Next year we expect a clear deceleration to growth of slightly above 4 per cent. Due to weaker demand, especially in the export market, manufacturing sector investments will level off. In addition, the profit outlook will be tougher due to the stronger krona and higher unit labour costs. The deceleration in service sectors and residential construction will be less obvious, but here too, the upturn will slow in the wake of higher interest rates and weaker property market prices. Construction will also be hampered by sharply rising costs and lower subsidies for the construction of rental housing.

Stable consumption increase

Despite favourable conditions, households have been relatively cautious in their consumption patterns. In the first half of 2007, private consumption increased a bit more than 2½ per cent, while real household disposable income rose by more than 4½ per cent. For 2007 as a whole, the increase in household income will probably exceed 5 per cent, while consumption looks set to increase by less than 3 per cent. The housing savings ratio will thus climb sharply this year, staying at a high level during the next couple of years.

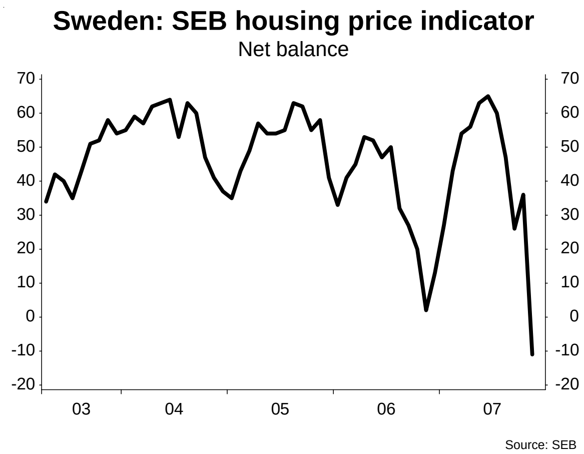
Economic situation of households

Year-on-year percentage change/level

	2006	2007	2008	2009
Private consumption	2.8	2.9	3.2	2.6
Disposable income	2.2	5.5	3.2	2.8
Savings ratio, %	8.3	10.8	10.8	10.7

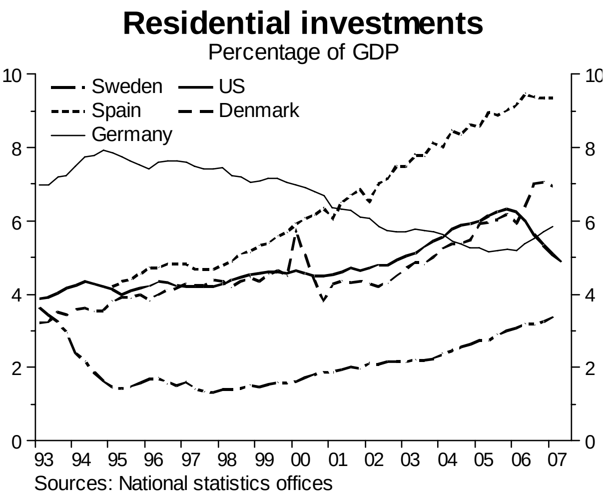
Sources: Statistics Sweden, SEB

In the short term, the strong labour market situation is one motive for households to cut back on their saving for a rainy day. However, it is not likely that consumption will accelerate especially much from its current growth level, in a situation where the economic outlook is becoming more uncertain and stimulation from rising wealth becomes smaller. Overall, we expect consumption growth to average 3 per cent during 2007-2008. This is a downward revision compared to our last forecast in August, but it still means that consumption will serve as an important counterweight to decelerating exports and capital spending.



Whereas home prices have cooled in various countries, the upward price movement has continued in the Swedish housing market. Compared to last year, however, the rate of increase has fallen somewhat. In addition, household expectations of future price increases have become substantially more moderate, according to the SEB housing price indicator and other sources. Data from estate agent surveys also signal that the price upturn may be about to end. Developments in Denmark and to some extent in Norway meanwhile indicate that these previously very robust Nordic housing markets are about to weaken.

Looking forward we see **obvious risks of falling prices for owner-occupied flats in the major cities**. Earlier sharp increases in prices compared to the single-family home market, combined with unfavourable changes in capital gains and property taxes will contribute to this. Due to a relatively high household savings ratio and a low level of residential construction in an international comparison, however, the Swedish economy is less exposed to a downturn in the housing sector than most other countries.



Strong labour market for another year

To date, slower growth has had no impact on the Swedish labour market. Employment has strengthened, especially in terms of the number of hours worked. This has led to a dramatic drop in productivity growth.

This weak productivity growth is mainly explained by traditional cyclical factors, but also by a sharp downturn in absences. Many employers have probably been surprised by the speed of these changes. Looking ahead a bit, employment will thus adapt to weaker productivity growth, but short-term indicators point towards continued strong job expansion in the next few quarters. On a full-year basis, in 2007 employment will increase by 2½ per cent, and in 2008 by almost1½ per cent. Job creation during the years 2006-2008 will thus total almost 6 per cent.

Sweden: GDP and hours worked

Year-on-year percentage

Source: Statistics Sweden

The growth in the labour supply will also decelerate next year. This is partly because slower job growth is making it less attractive to join the labour market. The working-age population is also expanding more slowly. In addition, the government's "job and development guarantee" will mean that a number of people previously registered as unemployed will end up outside the labour market. Increased incentives to work resulting from government job policies will have the opposite effect.

Labour market and productivity

Year-on-year percentage change/level

	2006	2007	2008	2009
GDP	4.5	3.3	2.3	2.0
Productivity	2.5	0.3	0.9	1.5
Employment	1.9	2.4	1.3	0.3
Hours worked	2.0	3.0	1.4	0.5
Labour supply	1.3	1.6	0.8	0.6
Unemployment, %	5.4	4.6	4.1	4.3
Unemployment, % (EU definition)	7.0	6.1	5.6	5.8

Sources: Statistics Sweden, SEB

Taken together, our forecast means that unemployment will continue falling well into 2008, reaching 4 per cent. Then there will be a weak upturn to about 4½ per cent by the end of 2009. Resource utilisation will thus remain relatively strained. The upturn in labour shortage figures nevertheless shows signs of decelerating, while the downturn in unemployment

Sweden: Labour shortage

Share of firms in per cent

Sources: NIER, SEB

Broader measure of unemployment

Starting with its October figures, Statistics Sweden's Labour Force Survey (LFS) is reporting unemployment according to international recommendations. The most important difference compared to the previous definition is that full-time students who apply for jobs are counted as unemployed. In the earlier definition, they were counted as students outside the labour market. Last year this group totalled about 85,000 people. Because of this difference, unemployment using the new definition is 1½ percentage points higher than using the old definition. Above all, the official measure of youth unemployment will increase sharply.

LFS is being expanded to cover ages 15-74, compared to the previous 16-64. As a consequence, the number of people defined as employed will increase. Employment as a percentage of working-age population will be roughly 8-9 per cent lower due to low labour force participation among both 15-year-olds and people aged 65-74. The effect on unemployment will be very small, since very few people in these age categories are job-seekers.

The change in the official measure of unemployment will not lead to any re-evaluation of the Swedish labour market situation, either in terms of the degree of resource utilisation or the situation relative to other countries. It has also been known for some time that a change in statistical methods would occur.

has faltered somewhat. Combined with lower growth prospects, this has led us to revise our unemployment forecast upward compared to our last forecast.

The pay negotiations in the 2007 wage round have largely been completed. A somewhat lower outcome for wages than expected so far this year and an upward revision of our forecast for unemployment imply slightly lower wage increases than in our previous assessment.

Pay increase
Percentage change

	2006	2007	2008	2009
Manufacturing	3.2	4.0	4.4	4,3
Construction	3.4	4.4	4.7	4,5
Business sector	3.2	4.2	4.5	4.4
Public sector	3.1	3.7	4.9	4.5
Total	**3.1**	**4.0**	**4.6**	**4.4**

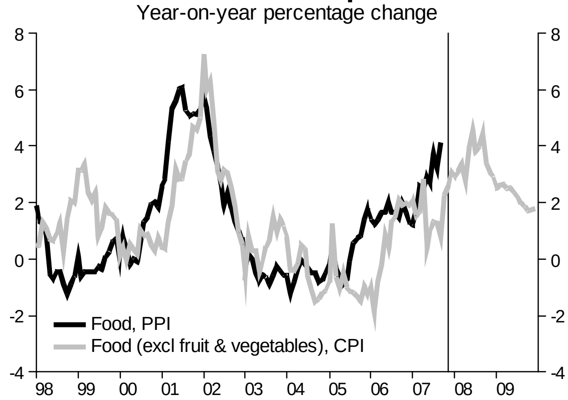
Sources: Statistics Sweden, SEB

Rising inflation pressure

In the past two months, CPIX (formerly UND1X) inflation has risen, after having shown a falling trend until summer. This upturn has been driven largely by rising energy prices. Food prices have also contributed, but the upturn in Sweden has been somewhat smaller than in other countries.

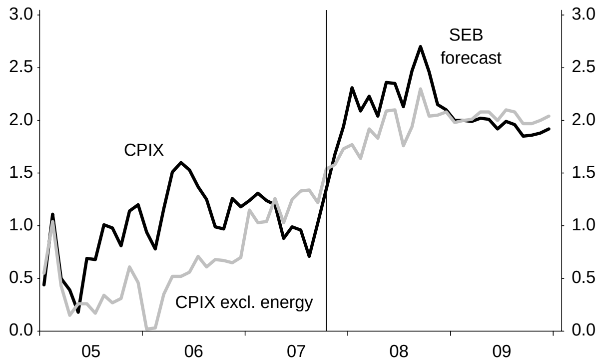
Energy and food will continue to be important inflation-driving forces in the coming year. The increase in food prices at the producer level indicates that a major upturn at the consumer level is on the way. As a confirmation of this, the percentage of companies in the convenience goods trade planning to raise their prices has increased dramatically. We expect a food price upturn of around 3½ per cent next year — the sharpest increase since 2002. Looking ahead, energy prices will also have a larger impact on inflation. To date, the effect of higher oil prices has been softened by the strengthening of the krona against the dollar.

Sweden: Food prices
Year-on-year percentage change



Sources: Statistics Sweden, SEB

Sweden: Underlying inflation
Year-on-year percentage change



Sources: Statistics Sweden, SEB

Domestic core inflation has risen since early 2006 but remains at a low level. The combination of accelerating pay increases and falling productivity growth will lead to a major shift in unit labour costs. Having fallen slightly in recent years, they will rise by an average of about 3 per cent annually during the forecast period.

The strengthening of the krona will slow inflation by holding down import prices. Continued fairly low core inflation in other countries may also be an indication that the upturn in inflation need not be so large in Sweden. Taken together, **we expect CPIX inflation to rise from an average of 1.2 per cent this year to 2.3 per cent in 2008**, then decline somewhat in 2009.

Contribution to inflation
Percentage points

	2006	2007	2008	2009
Imported goods	-0.2	0.0	0.1	0.0
Energy	0.8	0.0	0.5	0.1
Rents	0.1	0.2	0.3	0.4
ULC	-0.1	2.6	2.0	1.5
Profit margins	0.5	-1.6	-0.6	-0.1
CPIX	**1.2**	**1.2**	**2.3**	**1.9**
Interest rate costs	0.1	0.9	0.7	0.1
Indirect taxes	0.0	0.1	0.2	0.1
CPI	**1.4**	**2.2**	**3.1**	**2.0**

Sources: Statistics Sweden, SEB

Due to the interest rate hikes implemented to date, CPI is increasing substantially faster than CPIX. In October, CPI inflation was 2.7 per cent. In the next few months, CPI will exceed a 3 per cent rate, then remain at this level during much of 2008. Changes in indirect taxes will have a small positive net effect on CPI inflation both this year and in 2008. Increased indirect taxes on tobacco and energy and the introduction of a tax on car insurance premiums will push inflation higher, whereas lower property tax will have the opposite effect. Next year lower dental fees will also pull down CPI inflation. Recent government signals in the environmental field may very well imply further increases in indirect taxes during the next couple of years. To summarise, CPI inflation will be 2.2 per cent this year, 3.1 per cent in 2008 and 2.0 per cent in 2009.

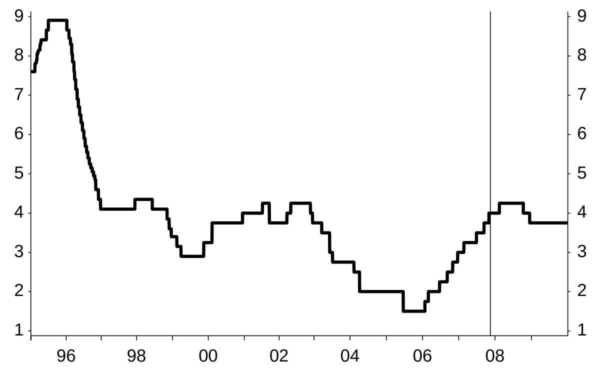
Riksbank will cut key rate next year

The Riksbank faces a dilemma. According to most indicators, the Swedish economy will remain strong for another while. The labour market is improving, and inflation is on the way up. The Riksbank must also take into account the increase in inflation expectations that has occurred recently. According to the NIER Economic Tendency Survey, household inflation expectations have settled at a level of about 2½ per cent in recent months.

In its Monetary Policy Report in October, the Riksbank stuck with essentially the same interest rate path that it had presented in June. It foresaw the repo rate peaking at around 4.40 per cent and indicated that the next rate hike would come in February. The bank also made the assessment that domestic arguments were pointing towards higher interest rates than before, but that uncertainty about the effects of tighter international credit pulled in the opposite direction. Although uncertainty has increased significantly, it is still possible that in February the Swedish economy will still be strong enough that the Riksbank will carry out its announced rate hike.

Sweden: Repo rate

Per cent



Source: Reuters EcoWin

After that, however, the scales will tip in the direction of interest rate cuts. The shift we are now seeing among major central banks in Western countries will also affect interest rate policy in Sweden. Our main forecast implies that the slowdown in the Swedish economy will be moderate and will occur gradually. However, the risks are on the downside, and adjustments by central banks are an important prerequisite for ensuring that soft landings will occur. We thus expect the Riksbank to cut its key rate in the autumn of 2008 by 50 basis points to 3.75 per cent.

The ongoing inflationary upturn involves a certain problem for the Riksbank – as it does for other central banks. This is partly due to the effects of energy and food price increases, which can reasonably be expected to culminate in the coming year, but the underlying force of rising pay and falling productivity growth is enough to push CPIX inflation a bit above 2 per cent next year. Meanwhile we find it difficult to foresee especially great risks of any further escalation of inflationary pressure. Assuming that productivity growth essentially recovers, the outcome of the 2007 wage round is compatible with inflation of around 2 per cent.

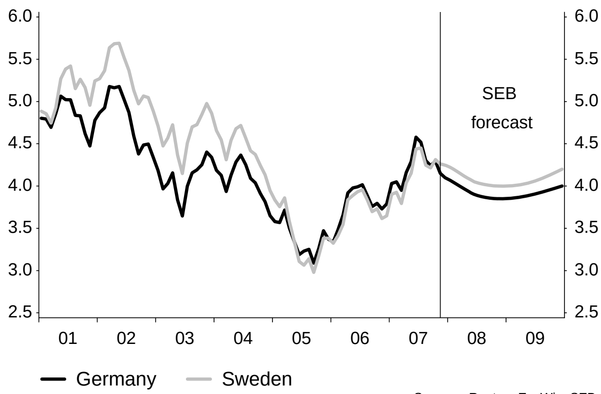
Our forecast means that in a two-year perspective, inflation will be lower than 2 per cent and thus does not constitute a main reason against cutting interest rates. Nor, against the backdrop of the “symmetry debate” started by last year’s report “An Evaluation of Swedish Monetary Policy between 1995 and 2005” (Francesco Giavazzi and Frederic S. Mishkin), do we believe that the Riksbank is overly frightened of inflation staying above 2 per cent for a somewhat longer time period than our forecast indicates.

Widening spread against Germany

Swedish bond yields have fallen due to the international economic slowdown, but less markedly than in Germany. Yields on 10-year Swedish government bonds are now somewhat higher than German ones. The historically unusual negative yield spread that we have seen in recent years has thus disappeared as the Riksbank has closed the gap to the ECB. So far, the Swedish economy has shown greater resistance than the euro zone to the international storm clouds, which also reflects this shift.

Sweden: 10-year government bond yields

Per cent



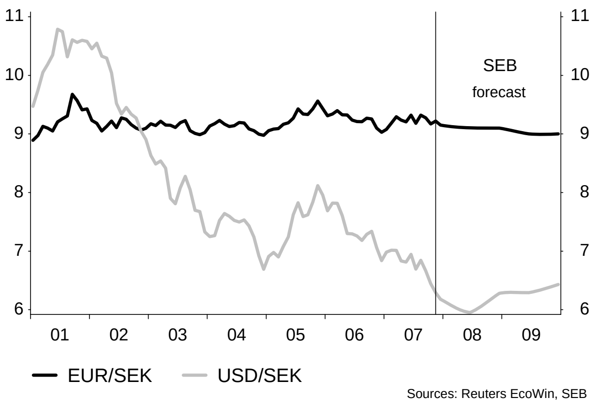
Sources: Reuters EcoWin, SEB

Looking ahead, our forecast implies that the Riksbank will maintain a somewhat higher key rate than the ECB. This indicates that Swedish bond yields will continue to fall somewhat more slowly than German ones. The tendency for inflation rates in Sweden and the euro zone to converge points in the same direction, but the rapid decline in Swedish central government debt will have the opposite effect. We predict that the yield spread against Germany for 10-year government bonds will stand at 15 basis points by the end of this year and will then widen further to 20 points by the end of 2009.

The krona has strengthened against most currencies, but there has again been no appreciation against the euro. Despite the underlying strength of the Swedish economy, the krona has repeatedly weakened when international storm winds have blown. The credit turmoil during the autumn has thus contributed to a certain weakening against the euro. Looking forward we still expect a cautious upturn, driven by somewhat higher short-term interest rates than in the euro zone, a continued large current account surplus and rising domestic investments. By the end of next year, the EUR/SEK exchange rate will be 9.10. However, the krona will continue to follow the euro upward against the dollar in 2008. By mid-year USD 1 will be worth less than SEK 6, but during 2009 the dollar will strengthen.

Sweden: Exchange rates

Monthly averages



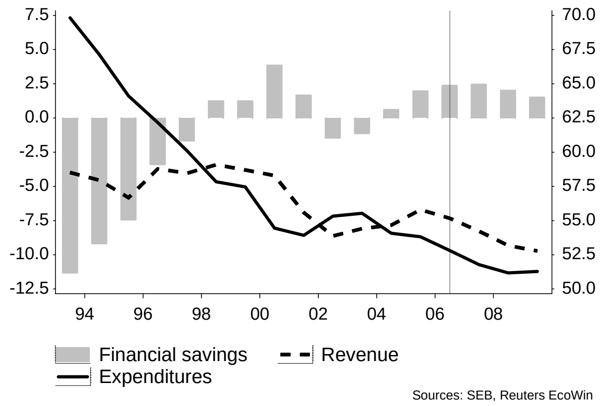
Public sector surpluses above target

Swedish public sector finances remain strong, both in absolute terms and in relation to official budget policy targets. High economic growth and a strong labour market are continuing to benefit the treasury. This autumn's budget for 2008 was also more restrictive than expected. The parallel downturn in expenditures and revenue as a percentage of GDP will continue until the end of 2008. We foresee public expenditures falling from 53 to 51 per cent of GDP between 2006 and 2009, while public revenue drops from 55 to 53 per cent during the same period. Financial savings will peak at 2.5 per cent of GDP this year. Next year they will total 2 per cent of GDP, and in 2009 about 1.5 per cent. Since last spring, this has excluded the premium pension system, which means that the official budget surplus target over an economic cycle was lowered from 2 to 1 per cent of GDP. The surpluses will thus exceed the target by more than SEK 40 billion this year, SEK 30 billion next year and more than SEK 15 billion in 2009.

The budget surplus, i.e. central government payments on debt principal, will end up at SEK 117 billion this year, SEK 108 billion in 2008 and between SEK 80 and 90 billion in 2009. Divestments of shares in companies with state ownership are projected to contribute SEK 150 billion during the three-year period 2007-2009. So far this year, such privatisations have totalled only SEK 18 billion (TeliaSonera). Unlike the assumptions behind the National Debt Office's forecast, we thus do not believe that privatisations will reach SEK 50 billion this year. Due to the underlying strength of central government finances, combined with the privatisations, government debt will fall from about 45 per cent of GDP in 2006 to a bit below 30 per cent in 2009.

Sweden: Public sector finances

Percentage of GDP



This decline in central government debt will mainly lead to a cutback in the quantity of short-term treasury bills. The Debt Office will lengthen the duration of government debt for the purpose of maintaining the overall bond supply, thus ensuring that the market for these securities will continue to function smoothly.

Public finances

Percentage of GDP

	2006	2007	2008	2009
Revenue	55.2	54.2	53.2	52.8
Expenditures	52.8	51.8	51.2	51.3
Financial savings	2.4	2.5	2.0	1.5
Public debt (Maastricht)	47.0	40.1	35.0	31.0
Central government debt	44.8	38.6	33.0	29.0
Central govt borrowing req, SEK bn	-18	-117	-108	-85

Sources: National Debt Office, Statistics Sweden, SEB

Swedish central government finances have historically been very sensitive to economic cycles. This is partly due to high levels of revenue and expenditures.

Government finances are closely linked to factors that vary with the economic cycle, for example corporate profits, capital gains tax on shares and unemployment benefits, thus amplifying their sensitivity.

During the economic crisis at the turn of the millennium, there was a pronounced swing in the central government's financial situation. A surplus of 3.8 per cent of GDP in 2000 turned into a deficit of 1.5 per cent in 2002. In nominal terms, this was equivalent to a shift of more than SEK 120 billion in only two years. A stock market slide, weaker economic performance and expansive fiscal policy contributed to the downturn. The shift in corporate and capital taxes was especially rapid.

It is still far too early to predict anything similar in the current situation, in view of the moderate slowdown we are forecasting, but downside surprises in public savings over the next few years cannot be ruled out.

Expansive policies in 2009

The large surplus in central government finances has led to calls for even lower taxes, among others from the Confederation of Swedish Enterprise. The argument is that there is enough room in the budget to allow a reduction in the high tax burden to more normal European levels. Some groups within the non-socialist Alliance for Sweden, which has governed since October 2006, have expressed a desire to boost expenditures. To date, high resource utilisation has been Finance Minister Anders Borg's most potent argument for resisting enthusiasm for fiscal policy expansion among the ruling coalition parties.

Given our forecast, this stabilisation policy argument has weakened somewhat. The risk of excessive fiscal stimulation will diminish as economic growth slows. With the September 2010 election looming ahead, most signs point towards a more expansive fiscal policy in 2009. We thus expect unfinanced programmes totalling SEK 20 billion or 0.6 per cent of GDP in 2009. Most of this will consist of tax cuts, but the government will undoubtedly increase its commitments to various expenditure areas dear to the hearts of the Alliance parties, which might also conceivably help bring about a reversal in their currently low support in public opinion polls.

Growth below trend

- **Consumption will decelerate despite tax cuts**
- **Continued tight labour market**
- **Pay hikes will push up inflation from low level**

The Danish economic **slowdown will persist** for a couple of years, mainly due to more subdued private consumption in the wake of a progressively weaker property market. But exports will slow as well, at first due to fading international demand and later also weakening competitiveness. Overall **GDP growth** will end up at Denmark's 2 per cent trend level this year and at **1½ per cent annually in 2008-2009**. We have adjusted our forecast slightly downward compared to the last ***Nordic Outlook***. Inflation has brought some downside surprises but next year there will be a clear upturn, mainly due to higher pay growth.

GDP growth cooled from 3½ per cent in the fourth quarter of 2006 to just above ½ per cent in the second quarter of 2007, the lowest figure since 2003. But the downturn was exaggerated by a number of temporary factors; for example, car sales were pulled down by taxation and exports were unexpectedly weak. Confidence survey data indicate a controlled deceleration in the Danish economy. The manufacturing purchasing managers' index turned upward this autumn, after an earlier decline. Service and household sector expectations have stabilised at moderate levels. In construction, the indicator still remains at a relatively high level — despite a weaker property market. Retail growth and exports have bounced back a bit after earlier slowdowns.

Lower home prices and the effects of previous interest rate hikes are **now cooling off consumer growth**. After rising at 3½-4½ per cent rates in 2004-2006, growth will end up around 1¾ per cent in 2007-2009. Higher real pay as well as income tax cuts will admittedly fuel rather vigorous income growth. In a situation of low saving and high debt, however, we believe that households will choose to increase their savings.

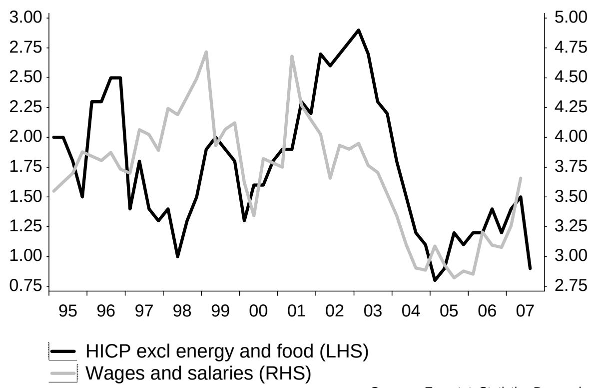
Home prices on the way down

Denmark's previously red-hot **housing market** has **cooled rapidly** during the past year. Year-on-year home price increases fell from 20-25 per cent to 4 per cent in the third quarter. In Copenhagen, single-family home prices fell by 5 per cent in the third quarter and flats by 16 per cent. The price decline for flats recently began to spread outside the capital. We predict that home prices will fall by 5-10 per cent in 2008. Meanwhile sales of both homes and flats have fallen all over the country. Home sales fell by 20 per cent during the third quarter.

To date, declining GDP growth has had a marginal impact on the labour market. Job creation has slowed from a 2 per cent rate last year to below 1 per cent, but unemployment has continued downward and now stands at around 3 per cent. In recent months, companies in the distributive trades have again become more expansive in their hiring plans, while manufacturers have become more cautious. We anticipate that **unemployment** will barely reach **below 3 per cent** this winter, then level off in the next six months or so. At the end of 2008, the unemployment curve will turn upward, with an average jobless rate of 4 per cent during 2009.

With unemployment below its 4.5 per cent equilibrium for a while, pay growth is starting to creep upward. Higher pay agreements last spring resulted in a year-on-year increase of nearly 3¾ per cent during the second quarter. **Wages and salaries will rise** by 4.5 per cent annually during the next two years.

Denmark: Pay and inflation
Year-on-year percentage change



Sources: Eurostat, Statistics Denmark

HICP inflation has fallen from nearly a 2 per cent rate early in 2007 to a bit above 1 per cent in September. Two main reasons are the appreciation of the krone and base effects. Looking ahead, however, **inflation** will **accelerate again**, which also was indicated by the upturn to 1.7 per cent in October. In the short term, the upturn will mainly be due to higher energy and food prices, but later weak productivity growth and rising pay will also contribute. Continued krone appreciation in effective terms, via the upturn in the euro, will continue to hold back import prices. We expect inflation to average 2.2 per cent in 2008.

Fiscal policy will be expansive

As a result of the recent parliamentary election, Prime Minister Anders Fogh Rasmussen is reshuffling his cabinet. The new government will probably pursue an expansive fiscal policy, including **income tax cuts** and long-term educational and health care investments. Despite this, and despite slower growth, public finances will remain strong. The large public surplus will shrink slowly due to the strong labour market.

Supply side restrictions will cool economic growth

- **Growth culminating**
- **Buying spree, but weaker housing market**
- **Tight labour market and high pay increases**
- **Strong krone and international slowdown will lead to lower key interest rate in 2009**

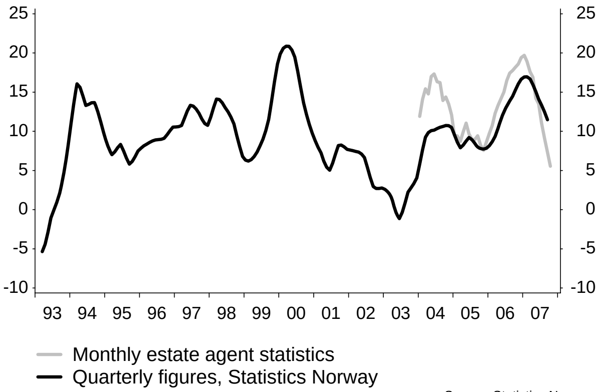
The Norwegian economy, excluding the offshore oil sector, will grow by more than 5 per cent this year. Mainland GDP will thus show average increases of more than 4½ per cent for the past four years. Job creation in 2007 will set a record, and unemployment is at its lowest level in 20 years. Looking ahead, a tight labour market and other capacity constraints will limit economic expansion. Meanwhile lower global growth, a stronger krone and a cooler housing market will curb demand. Our overall assessment is that **growth will decelerate to 2.9 per cent in 2008 and to 2.2 per cent in 2009**. Norges Bank will raise its key interest rate by another 50 basis points in the next few months, but early in 2009 it will initiate a rate-cutting cycle once the European Central Bank has begun its cuts and growth has slowed. By the end of 2009, the sight deposit rate will be at 4.75 per cent.

Buying spree will fade

Because of a rapid upturn in employment as well as in real wages and salaries, household purchasing power will climb by nearly 6 per cent this year. Consumption growth will be even higher: above 6 per cent. In the next couple of years, nominal pay will continue to rise at a healthy pace, but its real growth will be clearly lower than in 2007. This will largely be due to a surge in electricity prices, which will make inflation substantially higher in 2008 than in 2007. Slower job creation and rising interest rates will also eat away at income.

Norway: Home prices

Year-on-year percentage change



Source: Statistics Norway

Financial market turmoil and greater uncertainty about housing market trends have also made households less optimistic during the autumn. Consumption growth will thus slow to an average of 3 per cent annually in the next couple of years.

Norges Bank's interest rate hikes are now beginning to cool off the housing market. Although quarterly figures from Statistics Norway show that home prices are still rising at a year-on-year rate of more than 10 per cent, monthly estate agent statistics indicate that prices have fallen four months in a row. New home sales have also fallen, and housing starts have decelerated. After four years of relatively high growth figures for housing investments, we thus expect a levelling off next year, then a weak decline in volume.

High industrial capital spending plans

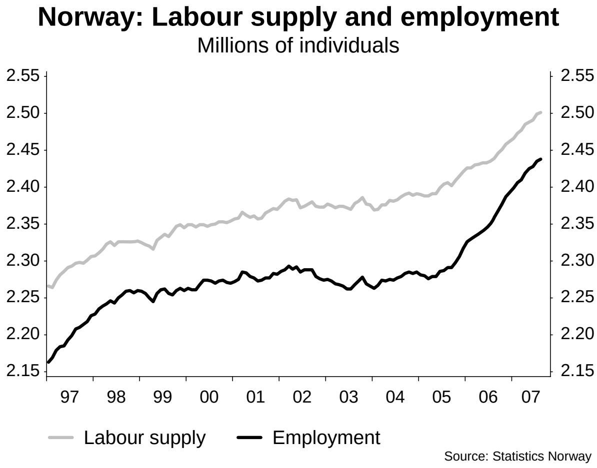
Norway's manufacturing sector has continued to benefit from a favourable trend in terms of trade. Its capacity utilisation is very high, and capital spending plans for 2008 are expansive. Statistics on order bookings have also been surprisingly strong in recent months. Meanwhile the manufacturing confidence indicator has fallen a bit, production has slowed and prospects for traditional exports have deteriorated. Looking ahead, the strengthening of the krone and sharp increases in wage and salary costs will also put pressure on competitiveness and profits. The overall upturn in exports, excluding oil, will slow from 7 per cent in 2007 to 3 per cent in 2008. Capital spending will also gradually decelerate.

The scale of capital spending plans in the oil sector will continue to expand as oil prices soar to new heights. This will continue to stimulate the mainland economy over the next couple of years, although this capital spending largely consists of imported goods.

Record-low unemployment

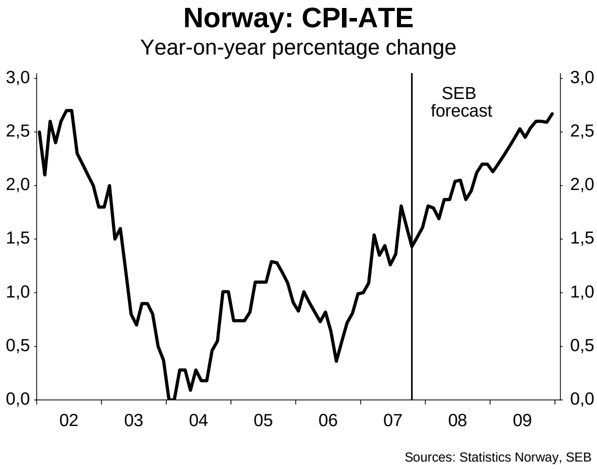
In 2007 we expect employment to increase by more than 3¼ per cent. This sharp expansion has been made possible by a strong upturn in the labour supply, due to such factors as immigration of labour but also due to a continued downturn in unemployment. In recent months, the jobless rate has levelled off at around 2.5 per cent, according to the Labour Force Survey. Hiring plans and job vacancy statistics still indicate that the demand for labour is very strong, but it will be increasingly hard to match vacancies with job seekers. Unemployment is probably close to bottoming out.

However, the number of jobs may continue upward due to an increase in the labour supply. This mainly assumes the form of high labour immigration, which has not slowed so far. However, it is doubtful whether labour force participation can increase so much more from today's high levels. Especially among older members of the labour force, there appears to be little potential for further expansion in the percentage who are economically active.



Gradually rising inflationary pressure

Underlying inflation (CPI-ATE) has trended upward for more than a year, but in the past two months it has declined somewhat. In October, the inflation rate was 1.4 per cent. Food prices unexpectedly fell, despite a relatively sharp rise in the international trend, but most indications are that food prices will turn upward fairly soon. The effects of the krone's appreciation will nevertheless continue to blunt this price increase.



Meanwhile underlying domestic inflation will keep rising. Because of the tight labour market, wages and salaries will increase by about 5½ per cent both this year and next. Combined with a cyclical slowdown in productivity growth, this implies that unit labour costs will clearly accelerate. Altogether, the CPI-ATE will climb by 1.4 per cent this year, by 2.0 per cent in 2008 and by 2.4 per cent in 2009. Due to sharp fluctuations in electricity prices, CPI inflation will be substantially lower this year and substantially higher next year than underlying inflation.

Norges Bank now faces difficult trade-offs. High resource utilisation, including a very tight labour market, would justify further hikes in the sight deposit rate. Tighter international credit markets and the accompanying slowdown in growth — which in turn is softening up central banks elsewhere — are pulling in the opposite direction. Too wide an interest rate spread against other countries will put additional upward pressure on the krone, which has already appreciated by more than 6 per cent in effective terms in 2007. This, in turn, means additional downward pressure on import prices and weaker competitiveness for Norwegian manufacturers. In its latest monetary policy report in October, Norges Bank also lowered its interest rate path. Having previously peaked at 5.75 per cent in mid-2008, the new path will imply a peak of between 5.25 and 5.50 per cent.

We expect Norges Bank to raise its sight deposit rate one more time from 5 to 5.25 per cent before the end of 2007, in line with its own interest rate path. What happens after that is far more uncertain, but we are still inclined to believe that there will be one additional interest rate hike during the first half of 2008. Given our forecast of several rate cuts by the Fed and later also cuts by the ECB and the Riksbank, we also believe that Norges Bank will cut its key rate early in 2009. A faster international slowdown is a downside risk in this interest rate forecast. On the other hand, if the downturn in oil prices should be larger than we have anticipated, this will mean less appreciation pressure on the krone and thus weaker motivation for rate cuts. All things considered, we expect a key rate of 4.75 per cent at the end of 2009.

Fiscal policy still expansive

The government's budget proposal for 2008 indicates that its fiscal policy will again be weakly expansive next year. For the second consecutive year, spending from the Government Pension Fund — Global (formerly the Petroleum Fund) will be lower than the 4 per cent of expected return that is allowed by the "fiscal policy rule". However, this is actually due to an unexpectedly sharp increase in government oil wealth, rather than tight fiscal policy. The government is partly constrained by earlier promises of social spending and a pledge to keep the tax burden at its 2004 level. Given the government's projections of its oil wealth over the next couple of years, nearly NOK 15 billion more per year could be used if the rule were fully utilised. Fiscal policy will thus probably remain expansive in 2009 as well, even if the government falls somewhat short of the 4 per cent maximum.

Growth is past its peak

- **Growth and job creation are slowing**
- **Unemployment has bottomed out**
- **Inflation will remain below 2 per cent in 2008**

The **Finnish economy is chugging along at a healthy pace despite global deceleration**. GDP rose on a broad front and at about a 5 per cent rate in the first half of 2007, but a deceleration is now occurring. Export growth has already slowed clearly, following last year's double-digit pace. Expansion in domestic demand is gradually fading. Growth will end up above 3 per cent next year and somewhat lower in 2009.

So far this year growth has cooled somewhat, after peaking in the fourth quarter of 2006. Sentiment surveys show that the construction, manufacturing and service sectors have all lost momentum since summer, but manufacturers' capital spending plans remain expansive. Overall, our indicators point towards a slowdown in GDP growth to roughly a 3 per cent rate by mid-year 2008.

Household income will keep rising at a healthy pace, benefiting from a continued upturn in employment and good real wage growth. Due to high interest rates and a certain cooling in the demand for capital goods, however, private consumption growth will slow from more than 4 per cent last year to a bit above 3 per cent this year and somewhat lower in 2008 and 2009.

The global economic deceleration and the stronger euro will dampen exports, although trade with the US continues to hold up rather nicely. It admittedly fell last summer, but has regained some ground since then. Export growth will end up a bit above 5 per cent this year, clearly lower than in 2006, and then slow further. Due to a favourable product structure, export growth will only temporarily drop below 5 per cent next year.

Total capital spending also faces a deceleration, due to weaker exports and the fact that global instability in itself will cause many companies to postpone investments. The forest product sector risks being especially hard hit by the high costs of input goods and the strong euro; several Finnish forest product companies have also issued profit warnings recently. The construction sector, however, remains relatively steady despite higher interest rates and some downturn in residential construction. Construction projects already under way will keep up the level of construction investments next year. Total capital spending will increase by nearly 4 per cent in 2008 and grow somewhat faster in 2009.

Unemployment has bottomed out

The jobless rate has trended downward since the economic crisis of 1991-1993. In recent months, however, unemployment has risen somewhat. Since hiring plans remain relatively expansive, especially in manufacturing, we foresee a continued rather strong labour market. As an annual average, unemployment will fall slightly in 2008 and then level off in 2009.

The increasingly strong labour market of recent years is now helping to fuel a certain wage and price upturn. We expect total hourly pay hikes of about 4 per cent in both 2008 and 2009, but decent productivity growth will keep unit labour costs down. HICP inflation will accelerate from last year's low 1.3 per cent to 1.9 per cent in 2008 and will move somewhat higher in 2009.

Finland's economic deceleration will set a ceiling on the central government budget. We expect a budget surplus of less than 4 per cent of GDP next year and somewhat lower in 2009.

Nordic key economic data

Nordic Outlook - November 2007

DENMARK

Yearly change in per cent

	2006 level, DKK bn	2006	2007	2008	2009	
Gross domestic product	1,642	3.3	2.1	1.6	1.5	
Private consumption	794	3.4	2.0	1.5	1.7	
Public consumption	420	1.6	1.6	1.8	1.3	
Gross fixed investment	371	13.0	6.1	3.2	3.0	
Stockbuilding (change as % of GDP)		0.4	0.0	0.0	0.0	
Exports	853	10.1	2.8	2.6	4.0	
Imports	804	14.5	4.3	3.3	4.7	
Unemployment (%)		4.5	3.4	3.2	4.0	
Consumer prices, harmonised		1.9	1.5	2.2	2.2	
Wage cost		3.1	3.8	4.5	4.4	
Current account, % of GDP		2.6	1.5	1.3	1.7	
Public sector financial balance, % of GDP		4.6	4.1	3.7	3.2	
Public sector debt, % of GDP		30.3	24.0	20.0	18.0	
FINANCIAL FORECASTS	**Nov 15**	**Dec 07**	**Jun 08**	**Dec 08**	**Jun 09**	**Dec 09**
Deposit rate	4.25	4.25	4.00	3.75	3.75	3.75
10-year bond yield	4.23	4.20	3.95	3.90	3.95	4.05
10-year spread to Germany, bp	11	10	5	5	5	5
USD/DKK	5.10	5.03	4.87	5.14	5.21	5.32
EUR/DKK	7.45	7.45	7.45	7.45	7.45	7.45

NORWAY

Yearly change in per cent

	2006 level, NOK bn	2006	2007	2008	2009	
Gross domestic product	2,152	2.8	3.2	2.8	2.2	
Gross domestic product (Mainland Norway)	1,563	4.6	5.1	2.9	2.2	
Private consumption	874	4.4	6.2	3.2	2.8	
Public consumption	418	3.3	2.7	3.0	2.7	
Gross fixed investment	400	7.4	7.3	4.5	2.1	
Stockbuilding (change as % of GDP)		0.4	0.0	0.1	0.1	
Exports	1,003	1.6	2.9	2.4	2.1	
Imports	610	8.2	7.0	4.0	3.1	
Unemployment (%)		3.5	2.5	2.6	2.9	
Consumer prices		2.3	0.5	3.3	2.6	
CPI-ATE		0.8	1.4	2.0	2.4	
Wage cost		4.1	5.5	5.6	5.0	
Current account, % of GDP		16.4	16.8	18.5	16.0	
Public sector financial balance, % of GDP		19.3	19.5	19.0	18.0	
FINANCIAL FORECASTS	**Nov 15**	**Dec 07**	**Jun 08**	**Dec 08**	**Jun 09**	**Dec 09**
Sight deposit rate	5.00	5.25	5.50	5.50	5.00	4.75
10-year bond yield	4.81	4.75	4.50	4.40	4.40	4.50
10-year spread to Germany, bp	69	65	60	55	50	50
USD/NOK	5.49	5.30	5.16	5.52	5.66	5.82
EUR/NOK	8.02	7.85	7.90	8.00	8.10	8.15

Nordic key economic data

SWEDEN

Yearly change in per cent

	2006 level, SEK bn	2006	2007	2008	2009
Gross domestic product	2,832	4.2	3.1	2.5	2.0
Gross domestic product, working day adjusted		4.5	3.3	2.3	2.0
Private consumption	1,338	2.8	2.9	3.2	2.6
Public consumption	759	1.8	1.6	1.2	1.2
Gross fixed investment	507	7.9	10.2	4.2	1.0
Stockbuilding (change as % of GDP)		0.0	0.3	-0.1	0.0
Exports	1,451	8.7	5.0	4.3	4.8
Imports	1,225	7.9	7.9	5.2	4.8
Unemployment, (%)		5.4	4.6	4.1	4.3
Unemployment, (%) (EU definition)		7.0	6.1	5.6	5.8
Employment		1.9	2.4	1.3	0.3
Industrial production		5.4	3.5	2.8	2.9
Consumer prices		1.4	2.2	3.1	2.0
CPIX		1.2	1.2	2.3	1.9
Wage cost		3.1	4.0	4.6	4.4
Household savings ratio (%)		8.3	10.8	10.8	10.7
Real disposable income		2.2	5.5	3.2	2.8
Trade balance, % of GDP		5.3	4.4	4.3	4.4
Current account, % of GDP		7.2	6.4	6.3	6.4
Central government borrowing, SEK bn		-18	-117	-108	-85
Public sector financial balance, % of GDP		2.4	2.5	2.0	1.5
Public sector debt, % of GDP		47	40	35	31

FINANCIAL FORECASTS	Nov 15	Dec 07	Jun 08	Dec 08	Jun 09	Dec 09
Repo rate	4.00	4.00	4.25	3.75	3.75	3.75
3-month interest rate, STIBOR	4.59	4.49	4.64	4.19	4.19	4.19
10-year bond yield	4.25	4.25	4.05	4.00	4.05	4.20
10-year spread to Germany, bp	13	15	15	15	15	20
USD/SEK	6.34	6.18	5.95	6.28	6.29	6.43
EUR/SEK	9.27	9.15	9.10	9.10	9.00	9.00
TCW	123.5	121.6	119.6	121.4	119.9	120.4

FINLAND

Yearly change in per cent

	2006 level, EUR bn	2006	2007	2008	2009
Gross domestic product	167	5.0	4.1	3.1	2.8
Private consumption	86	4.3	3.1	2.7	2.3
Public consumption	36	1.0	1.4	1.2	1.2
Gross fixed investment	32	4.1	4.4	3.9	4.0
Stockbuilding (change as % of GDP)		0.2	0.3	0.0	0.0
Exports	74	10.4	5.3	4.8	5.2
Imports	66	8.3	3.7	4.1	5.0
Unemployment (%)		7.7	7.0	6.9	6.9
Consumer prices, harmonised		1.3	1.6	1.9	2.0
Wage cost		3.0	3.2	3.9	4.0
Current account, % of GDP		5.2	5.9	5.6	5.8
Public sector financial balance, % of GDP		3.8	4.0	3.8	3.4
Public sector debt, % of GDP		39.2	36.7	35.3	34.8

SEB

International key economic data

Nordic Outlook - November 2007

EURO ZONE

Yearly change in per cent

	2006 level, EUR bn	2006	2007	2008	2009
Gross domestic product	8,438	2.9	2.6	1.8	1.8
Private consumption	4,801	1.9	1.3	1.5	1.6
Public consumption	1,719	2.0	1.8	1.7	1.8
Gross fixed investment	1,789	5.4	4.8	3.1	3.8
Stockbuilding (change as % of GDP)		-0.1	-0.1	0.1	0.0
Exports	3,389	8.1	5.7	3.9	4.3
Imports	3,288	7.7	4.9	4.4	5.3
Unemployment (%)		8.3	7.4	7.2	7.3
Consumer prices, harmonised		2.2	2.1	2.3	1.7
Household savings ratio (%)		10.0	9.9	9.7	9.4

US

Yearly change in per cent

	2006 level, USD bn	2006	2007	2008	2009
Gross domestic product	13,247	2.9	2.1	1.8	2.4
Private consumption	9,626	3.1	2.9	1.7	2.2
Public consumption	2,096	1.8	2.0	0.9	0.6
Gross fixed investment	2,476	2.4	-2.7	0.9	5.6
Stockbuilding (change as % of GDP)		0.1	-0.3	0.0	0.1
Exports	1,466	8.4	7.8	7.9	6.1
Imports	2,229	5.9	2.4	4.0	6.4
Unemployment (%)		4.6	4.6	5.2	5.5
Consumer prices		3.2	2.8	3.0	1.8
Household savings ratio (%)		0.4	1.0	1.8	2.6

LARGE INDUSTRIAL COUNTRIES

Yearly change in per cent

	2006	2007	2008	2009
GDP				
United Kingdom	2.8	3.1	1.8	2.0
Japan	2.2	2.0	1.7	1.8
Germany	2.9	2.5	1.8	2.0
France	2.2	1.8	1.8	1.9
Italy	1.9	1.7	1.5	1.6
Inflation				
United Kingdom	2.3	2.4	1.8	1.8
Japan	0.2	-0.1	0.4	0.7
Germany	1.8	2.2	2.3	2.0
France	1.9	1.7	2.2	1.9
Italy	2.2	1.9	2.2	1.9
Unemployment (%)				
United Kingdom	5.4	5.5	5.6	5.7
Japan	4.1	3.8	3.6	3.3
Germany	9.8	8.4	8.1	8.1
France	9.5	8.7	8.5	8.6
Italy	6.8	5.9	5.6	5.7

CENTRAL AND EASTERN EUROPE

	2006	2007	2008	2009
GDP, yearly change in percent				
Czech Republic	6.4	5.8	5.1	5.0
Estonia	11.2	7.0	4.0	5.5
Hungary	3.9	1.8	2.8	3.7
Latvia	11.9	10.5	7.5	6.0
Lithuania	7.7	8.0	6.5	6.0
Poland	6.1	6.5	5.5	5.0
Russia	6.7	7.6	6.8	6.0
Slovakia	8.5	9.2	7.8	7.0
Ukraine	7.1	7.5	8.0	8.0
Inflation, yearly change in per cent				
Czech Republic	2.1	2.4	3.0	3.0
Estonia	4.4	6.5	5.0	3.0
Hungary	4.0	7.4	4.0	3.5
Latvia	6.6	9.9	8.5	7.0
Lithuania	3.8	5.8	6.5	5.0
Poland	1.3	2.3	2.8	2.5
Russia	9.7	8.4	7.9	7.0
Slovakia	4.3	2.3	2.4	2.3
Ukraine	9.1	12.0	10.0	9.0

FINANCIAL FORECASTS

		Nov 15	Dec 07	Jun 08	Dec 08	Jun 09	Dec 09
Official interest rates							
US	Fed funds	4.50	4.25	3.50	3.50	3.50	3.50
Japan	Call money rate	0.50	0.50	0.75	0.75	0.75	1.00
Euro zone	Refi rate	4.00	4.00	3.75	3.50	3.50	3.50
United Kingdom	Repo rate	5.75	5.50	5.00	4.50	4.00	4.00
Bond yields							
US	10 years	4.15	4.10	3.80	4.00	4.10	4.20
Japan	10 years	1.51	1.50	1.55	1.60	1.70	2.00
Germany	10 years	4.12	4.10	3.90	3.85	3.90	4.00
United Kingdom	10 years	4.69	4.65	4.40	4.35	4.40	4.50
Exchange rates							
USD/JPY		110	110	110	112	118	118
EUR/USD		1.46	1.48	1.53	1.45	1.43	1.40
EUR/JPY		161	163	168	162	169	165
GBP/USD		2.04	2.03	2.01	2.01	1.99	1.94
EUR/GBP		0.72	0.73	0.76	0.72	0.72	0.72

GLOBAL KEY INDICATORS

Yearly percentage change

	2006	2007	2008	2009
GDP OECD	3.1	2.6	2.1	2.2
GDP world	5.4	5.1	4.5	4.5
CPI OECD	2.4	2.2	2.4	1.8
Export market OECD	8.9	6.5	6.1	6.7
Oil price, Brent (USD/barrel)	64.8	73.0	80.0	75.0

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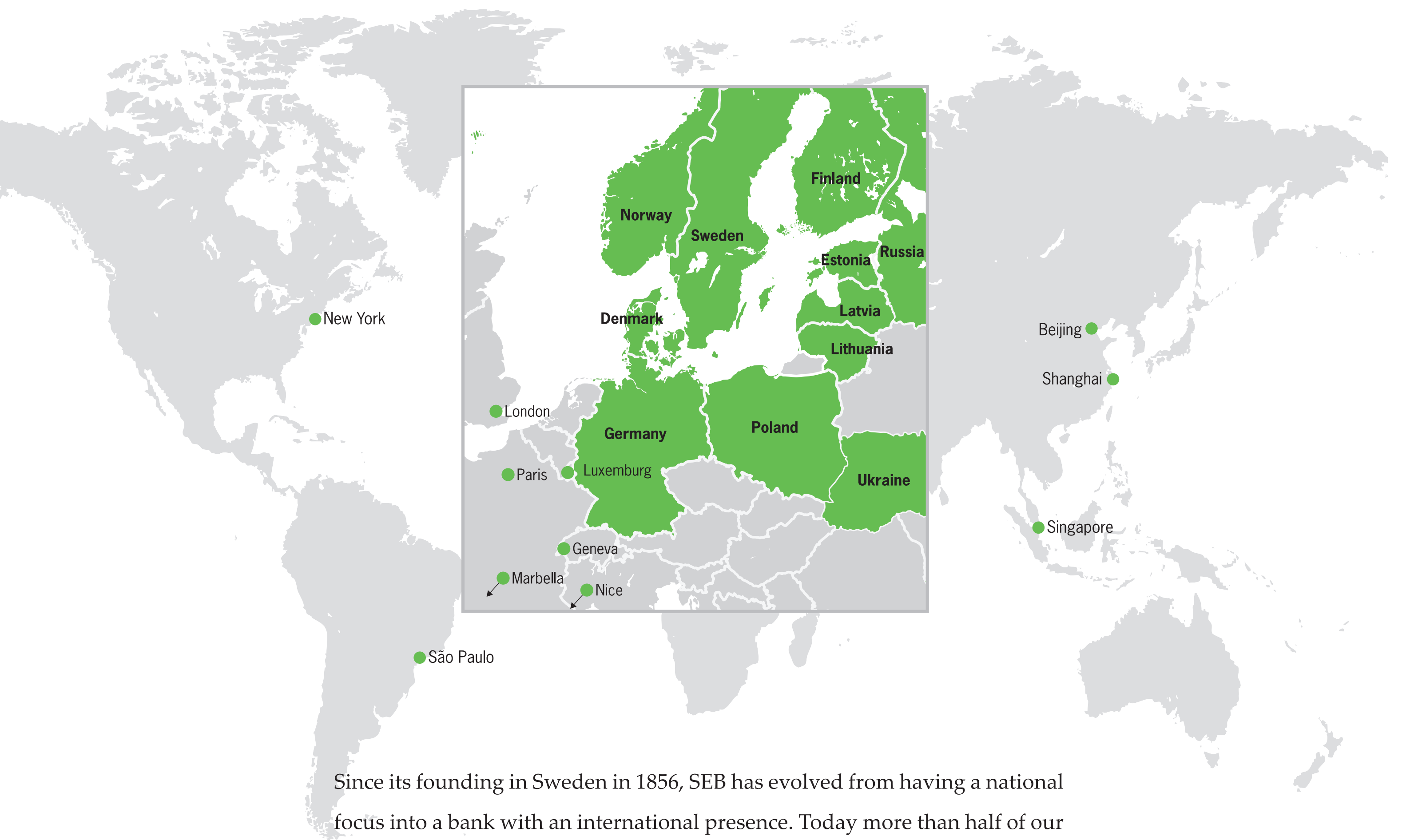

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One of the key publications from the Economic Research unit is the quarterly Nordic Outlook, which presents analyses covering the economic situation in the world as well as Europe and Sweden. Another publication is Eastern European Outlook, which deals with Central and Eastern Europe including Russia and appears twice a year.