SEB

Press release

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Nordic Outlook: Central banks provide breathing space, as the world slowly navigates away from the brink of recession

The world is weary of crises and would like to – but cannot – run away from its old debt sins. Growth and competitiveness problems are creating obstacles, and **the future of the euro is still uncertain. Yet the situation has stabilised somewhat** compared to late autumn 2011. Today the risk picture surrounding our global slowdown scenario is more symmetrical. The world has moved away from the brink of recession, thanks to historically forceful central bank actions. SEB has adjusted its global growth forecast a bit upward, but unemployment remains troublesome in many countries. The **Gross Domestic Product (GDP) of the 34 industrialised OECD countries will grow by 1.4 per cent this year and 1.9 per cent in 2013**. The large quantity of idle resources will push inflation downward, giving households somewhat greater purchasing power and **enabling historically low key interest rates to last throughout 2012-2013**. Inflation expectations are stable. Inflation risks are primarily connected to changes in indirect taxes and disruptions in food and commodity production (for example in the Middle East).

During his first 100 days as President of the European Central Bank (ECB), Mario Draghi is off to a roaring start with two key interest rate cuts and a programme of cheap three year loans to the banking system. Combined with the liquidity support measures of other central banks, the ECB has thus **probably succeeded in the task** – which the political system had failed to resolve – **of building the necessary "firewalls"** to stop last autumn's approaching credit crunch and prevent negative contagion between the financial and economic systems of various countries. One side effect worthy of attention, however, is the **heightened concentration of credit risk that arises in individual euro zone countries**.

The difficult task facing economic policy makers is to find an optimal path for saving, stimulus and regulation that generates confidence, provides stability and prevents simultaneous debt consolidation in the public and private sector (households and banks). Meanwhile there is an increasing need for international coordination. Greater flexibility and harmonisation between the fiscal consolidation programmes of various countries will reduce the risk of synchronised declines in growth, but instead they will increase international pressure on countries that possess manoeuvring room – for example Germany and Sweden – to enact more aggressive stimulus measures.

The euro zone cannot avoid a recession in 2012. Hardest hit will be Greece, Spain and Portugal. Meanwhile Germany will end up with just above zero growth. Unemployment will rise, squeezing wages and salaries as one element of restoring competitiveness. There is a greater risk of rising emigration similar to that of Latvia, for example, which has lost 10 per cent of its population in just a few years. There is growing pressure on Germany to prop up the system by means of stronger domestic growth stimulus measures as well as further guarantees and financial resources. The question is whether the European political system possesses the necessary decisiveness and perseverance that will enable it to guide the euro project towards greater coordination, monitoring and supranationalism. At present, support for the European Union is declining in many countries.

The United States and China provide welcome counterweights to the problems of Europe. A surprisingly rapid stabilisation in the US economy – despite continued weakness in the housing and labour markets and a visibly gridlocked political environment – is providing support to the stock market and helping improve consumer and business optimism. Positive support to the world economy is also coming from China, which is expected to make a soft economic landing and whose new leadership team appears willing to shoulder responsibility for global imbalances. **In 2012 the growth gap**

between the US and the euro zone will be the widest in two decades, helping push the EUR/USD exchange rate down towards 1.20 by the end of 2013.

The Swedish economy ran out of steam late in 2011. **GDP growth in 2012 will be a mere 0.5 per cent** (0.2 percentage points lower than our November forecast) **and 1.7 per cent in 2013**. Unemployment will climb by about 1 percentage point to 8 per cent in 2013. We are sticking to our forecast that home prices will fall by a total of 10-15 per cent. Because of more cautious households and businesses, consumption and capital spending will slow. A less strained resource situation, low inflation and the ongoing credit market cool-down will create room for the Riksbank to continue easing monetary policy; the central bank will lower its repo rate to 1 per cent by summer. On the whole, we expect Sweden's ongoing wage round to result in annual pay increases of about 3.5 per cent in 2012-2013, which will give households real wage increases without posing a threat to the Riksbank's inflation target.

The increasing resilience of the Swedish krona to international turmoil was confirmed during 2011. This will also facilitate a looser interest rate policy. Global investors are intensively searching for AAA-rated government securities, causing Swedish 10-year bonds to continue trading at yields below their German counterpart. **At the end of 2012 the krona will be trading at 8.50 to the euro (6.80 to the US dollar), and by the end of 2013 at 8.40 (7.00)**.

The leadership changes in the opposition Social Democratic, Left and Green parties **will change the Swedish political landscape**. Combined with record-low central government debt, which is expected to fall to 31 per cent of GDP in 2013, these changes will lay the groundwork for an increasingly intensive public conversation on the long-term direction of fiscal and sovereign debt policies. To a greater degree than previously, the opposition is likely to try to display pragmatism and decisiveness in order to challenge portions of the ruling Alliance coalition's "work first principle". Elements of penny-pinching and lack of imagination in the government's policies are creating tensions between and within the governing non-socialist parties. We expect the government's focus to be on infrastructure, local government social service programmes and traditional labour market policies. **The outcome will be a cautiously expansionary fiscal policy, even though Sweden has a golden opportunity to launch more aggressive, future-oriented progammes**.

The other Nordic countries – except Norway – will also be relatively hard hit by the global economic slowdown, and growth will be far below trend. Good government finances and strong external balances will create resilience and have also made the Nordic countries attractive for investors. One expression of this has been their low bond yields. **GDP growth in Norway will be 2.1 per cent in 2012 and 2.4 per cent in 2013**. Norges Bank will support Norwegian growth by leaving its key interest rate at 1.75 per cent this year. Only in 2013 will it raise the key rate to 2.50 per cent. Home prices are a source of concern in the medium term, but fundamentals will sustain prices in the short term. The **Danish economy** is still grappling with a weak property market and with the need for debt consolidation in the household sector, which is dampening private consumption. **GDP growth will reach only 0.5 per cent in 2012** with the aid of fiscal stimulus; **in 2013, growth will reach 1.4 per cent**. In Finland, a stable labour market and good conditions for private consumption will be unable to offset weaker international demand. **Finnish GDP growth will amount to 0.5 per cent in 2012 and 1.7 per cent in 2013 – well below trend**.

The three Baltic countries have bounced back nicely after their deep 2009 recession, very much due to dynamic, competitive export sectors and aggressive budget-tightening. Imbalances have greatly diminished. Wages and salaries are now growing at a modest pace after sharp pay cuts in both the private and public sectors in 2009-2010. Their economies are now better equipped to withstand external shocks, but a sizeable slowdown is unavoidable in the prevailing international climate. We expect GDP growth of 2.5-4 per cent Latvia and Lithuania during 2012-2013. Estonia's growth will be around 1 percentage point lower than its Baltic neighbours.

Key figures: International and Swedish economy

International economy. GDP, year-on-year changes, %	2010	2011	2012	2013
United States	3.0	1.7	2.5	2.5
Euro zone	1.8	1.5	-0.8	0.7
Japan	4.5	-0.6	1.7	1.2
OECD	3.1	1.7	1.4	1.9
China	10.4	9.3	8.7	8.9
Nordic countries	2.9	2.5	0.9	1.8
Baltic countries	1.1	6.0	2.0	3.2
The world (ourchasing power parities, PPP)	5.2	3.9	3.5	4.0
Swedish economy. Year-on-year changes, %				
GDP, actual	5.6	4.3	0.5	1.7
GDP, working day corrected	5.3	4.3	0.9	1.7
Unemployment, % (EU definition)	8.4	7.5	7.6	8.0
Consumer Price Index (CPI) inflation	1.2	3.0	1.3	1.2
Government net lending (% of GDP)	0.0	0.3	-0.4	-0.3
Repo rate (December)	1.25	1.75	1.00	1.00
Exchange rate, EUR/SEK (December)	8.98	8.91	8.50	8.40

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