Press release

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Nordic Outlook: Shift in crisis strategy and bail-out for Spain

The world economy has lost some momentum this spring. Growth is not self-perpetuating but is instead vulnerable to reversals. Emerging economies – together with a cautious stabilisation in the United States – are sustaining the world economy but are not enough to lift it. This situation is logical, in light of the ongoing debt and credit contraction in the Western world as well as questions about the future of the euro project. **New bail-out programmes are needed**, and old ones must continue, in order to maintain modest global growth. Less belt-tightening and more growth-oriented policies in the European Union represent a change in crisis strategy and thus the beginning of a watering-down of the EU's recently agreed fiscal pact. **The Gross Domestic Product (GDP) in the 34 industrialised OECD countries will grow by 1.6 per cent in 2012 and by 2.1 per cent in 2013.** This anaemic growth will push down inflation. Despite a dramatic winter and early spring, our forecast implies only **minor revisions** compared to our assessments in February and last November. However, **the risk that growth will be slower than in our main scenario has increased somewhat**, due to the euro zone crisis and high oil prices.

We expect Spain to receive a bail-out loan of about EUR 150 billion soon in order to reform/recapitalise Spanish banks. Meanwhile the **European Investment Bank (EIB) will receive a capital infusion of EUR 50 billion** in order to create a lending capacity of EUR 300 billion for growth-oriented structural projects around Europe. This EIB capital also has **an important political purpose**: to address growing criticism in individual euro zone countries and among the Group of 20 countries (G20) against excessively one-sided belt-tightening policies and the lack of structural growth policies. Unfortunately, the euro zone crisis has thus also become a pawn in an ongoing power game in the International Monetary Fund (IMF) and the G20. Meanwhile, political tensions have escalated in Greece after last weekend's election. The outcome will make it difficult to form a government that will support the country's austerity programme. This has increased uncertainty about Greece's future in the euro zone.

The change in crisis strategy towards promotion of growth involves risks, however. The contribution of central banks to the new strategy will be to continue near-zero interest rates, let their balance sheets grow a little more and be on stand-by to provide new loans in order to guarantee the liquidity of the financial system. However, fewer demands for fiscal consolidation, combined with central banks that buy government securities and other assets, **run a risk of fuelling inflation expectations and rising interest rates.** One vital but difficult question is **what the European Central Bank (ECB), Germany and others are prepared to do in terms of easing belt-tightening requirements on crisis-plagued countries.** At present it is also difficult to determine to what extent the ECB is prepared to loosen its strict inflation target and how it will react, for example, to the IMF's proposal that the euro zone inflation target should be doubled.

Despite **monetary convergence** (a single key interest rate, a single currency), euro zone countries will continue to demonstrate increasing **economic and structural divergence** during the next couple of years, for example in terms of growth and worryingly high unemployment. Three criteria must be met if the euro zone is to stay together: *first, Germany must commit itslef more whole-heartedly to the euro project; second, the policies of the crisis-hit countries must show sustainable results; and third, economic and political power must be centralised and institutionalised.* Elections and public opnion polls in Europe are showing that political systems are being squeezed and that they risk facing a decline in democratic legitimacy. **We expect euro zone growth of -0.6 per cent in 2012 and 0.8 per cent in 2013. The ECB will leave its refi rate unchanged at 1.0 per cent during our forecast period.**

We expect the US economy to grow by 2.5 per cent in 2012 and 2.7 per cent in 2013. Households are still being squeezed by an excessively high debt level. Meanwhile the housing market has not yet stabilised. Macroeconomic statistics during the spring have also caused some concerns. The underlying growth dynamic is nevertheless sufficient to avoid a recession, but not until 2015 will household debt be what can be called "normal". Although the November presidential election is blocking concrete decisions on federal government finances, agreements to extend tax cuts and postpone automatic cutbacks must be reached before year-end 2012 in order to avoid substantially lower growth in 2013. The Federal Reserve will keep its key interest rate at 0-0.25 per cent until 2015. We also expect the Fed to carry out a third round of quantitative easing (QE3), focused on purchasing mortgage-backed securities.

Emerging economies, led by China, will avoid a hard landing. During the second half of 2012, the growth outlook will improve in China and falling inflation will make room for economic stimulus policies. **GDP growth in China will average 8.5 per cent in 2012 and 8.7 per cent in 2013.** Inflation and home prices are manageable in China. In most other Asian economies, we believe that GDP growth has already begun to accelerate. **We expect India's GDP growth to reach 7.0 per cent in 2012 and 7.3 per cent in 2013.**

Sweden is in an economic slowdown, with GDP growth of only 0.7 per cent this year and 1.9 per cent in 2013. Unnecessarily tight fiscal policy – we foresee only SEK 15 billion worth of stimulus measures in this autumn's budget for 2013 – will hold back growth. Because of the euro zone crisis, exports will stagnate this year and then increase by 3 per cent in 2013. Stronger growth will thus be dependent on household consumption and corporate capital spending. Real wage and salary increases of 1-1.5 per cent will give **households purchasing power**, while **strong company balance sheets** will create the potential for fixed investments, but **turbulence elsewhere in Europe will lower the capital spending outlook.** We are sticking to our forecast that **home prices will fall by 10-15 per cent** from their peak, although indicators are currently pointing towards a stabilisation and even rising home prices. Given expected unemployment of more than 8 per cent in 2013 and inflation of around 1-1.5 per cent, there is room for the Riksbank to lower its key interest rate. **We are thus forecasting a further Riksbank rate cut to 1.25 per cent in September.** The repo rate will then remain at this level throughout 2013 as well. If the trend towards a renewed upturn in home prices persists, however, we expect the Riksbank to abstain from further key rate cuts. The krona will appreciate against the euro (**EUR/SEK exchange rate of 8.40 at the end of 2013**) but weaken somewhat against the US dollar (**USD/SEK rate of 7.00 at end-2013**). There is potential for even stronger krona appreciation, among other things due to the continued international search for AAA-rated government securities as well as the growing foreign currency assets and limited currency hedging of Swedish companies. If the EUR/SEK exchange rate moves below 8.00, this would create deflationary pressure that would be difficult for the Riksbank to manage by using conventional monetary policy, while it would push down long-term bond yields further.

Historically low yields on Swedish sovereign debt securities, combined with low public sector debt, give the Alliance government room to spend more, but we expect a continued cautious and weakly expansionary fiscal policy. Under the prevailing economic conditions, we see it as **more suitable for fiscal policy, not monetary policy, to shoulder the task of generating growth** and strengthening Sweden's economy in the short term and its competitiveness in the long term. Unemployment of 8 per cent shows a need for both structural and cyclical measures. The lack of demand-side measures seems to be the most obvious reason why unemployment is persistently high. By abstaining from stimulus measures in a low-growth environment, the government risks not being able to test its "work principle" and other supply-side reforms in practice. This may hurt its chances of winning the 2014 parliamentary election.

We expect growth in Denmark and Finland to end up in the same vicinity as in Sweden (around half a per cent growth this year and less than 2 per cent in 2013). The outlook in Denmark is clouded by lingering problems in the real estate market, while we expect the Finnish export sector to benefit from a stronger Swedish krona against the euro. Good Nordic fundamentals have created more stable performance than was the case during earlier international crises. **Norway's GDP growth stands out** in a Nordic perspective. This growth, which we expect to be **2.3 per cent in 2012 and 2.6 per cent in 2013**, is being sustained by low interest rates, which further complicate an already high-priced housing market. Norges Bank has a clear focus on keeping the Norwegian krone weak, but we expect the central bank to begin hiking its key interest rate in the course of 2013.

We foresee GDP growth in Latvia and Lithuania of 2.5-3.0 per cent in 2012 and 3.5-4.0 per cent in 2013, helped by slightly stronger private consumption, which had been squeezed earlier by harsh austerity policies. Due to heavy export-dependence, combined with the weaker economic climate in northern Europe, growth in **Estonia will be 1.5-2.5 percentage points lower** than in the other two Baltic countries. The underlying balance in the Baltic economies has improved, but some inflation problems persist in Estonia, for example, while labour market structural problems have worsened. Despite the euro zone crisis, our forecast is that Latvia will introduce the euro as planned in 2014; Lithuania's transition to the euro will be delayed until 2015.

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	2.7
Euro zone	1.9	1.5	-0.6	0.8
Japan	4.5	-0.7	2.2	1.7
OECD	3.1	1.7	1.6	2.1
China	10.4	9.3	8.5	8.7
Nordic countries	2.7	2.5	1.1	2.0
Baltic countries	1.1	6.2	2.5	3.4
The world (purchasing power parities, PPP)	5.3	3.9	3.6	4.1
Swedish economy. Year-on-year changes, %				
GDP, actual	6.1	3.9	0.7	1.9
GDP, working day corrected	5.9	4.0	1.0	1.9
Unemployment, % (EU definition)	8.4	7.5	7.5	7.9
Consumer Price Index (CPI) inflation	1.2	3.0	1.2	1.2
Government net lending (% of GDP)	-0.1	0.1	-0.5	-0.1
Repo rate (December)	1.25	1.75	1.25	1.25
Exchange rate, EUR/SEK (December)	8.98	8.91	8.50	8.40

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