SEB

Press release

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Nordic Outlook: Increased monetary stimulus is reducing downside risks

In recent months the global growth outlook has deteriorated, with a slowing trend that is more synchronised than in 2010 and 2011. Even emerging economies such as China have decelerated. Uncertainty about the euro and about American fiscal policy will weigh down economic growth this autumn. Global growth is not self-perpetuating, but is instead is heavily dependent on continued monetary stimulus. **Since the world economy is unable to take off on its own, central banks are being forced into increasingly drastic stimulus measures**. For example, we expect the US Federal Reserve to deliver a new round of quantitative easing this autumn, while the European Central Bank (ECB) has signalled that it is prepared to expand its efforts to save the euro, thereby testing the limits of its mandate. Among other things, we expect the ECB to buy government securities after Spain and Italy have accepted the EU's conditions. We are further assuming that the Spanish government will apply for a financial bail-out and that Greece will receive a new debt write-down.

The world's central banks are testing new ground when it comes to unconventional monetary policy, among other things by guaranteeing historically low interest rates throughout our forecast period. This will ease the impact of ongoing debt delveraging and create political manoeuvring room for fiscal consolidation and restructuring policies. A corporate sector with strong balance sheets is also being stimulated into increasing its capital spending. During the next couple of years, growth will be lacklustre, but the **risks of a deep recession have diminished**. In the United States, the economy will be hampered during 2013 by high unemployment, federal fiscal tightening and a stronger dollar, but the downside risks have decreased there as well. We foresee stable US growth prospects as the housing market bottoms out and as household debts approach a new equilibrium level. In 2014 we therefore expect a clearer US recovery. **Overall, Gross Domestic Product (GDP) in the 34 countries of the Organisation for Economic Cooperation and Development (OECD) will grow by 1.4 per cent in 2012, 1.7 per cent in 2013 and 2.1 per cent in 2014**. OECD inflation will remain stable at a low 1-2 per cent. Emerging economies are entering a calmer expansion phase, but a surprisingly rapid downturn in inflation will allow these countries room for official economic stimulus measures which will help growth to slowly rebound.

In the euro zone, the recession is settling in this autumn and GDP will grow by a weak 0.2 per cent in 2013. In 2014 we expect GDP growth to accelerate to 0.9 per cent as the impact of austerity policies in southern Europe softens. Because of the deep downturn in southern Europe, Germany is also showing clear signs of deceleration, but a weaker euro – with the EUR/USD exchange rate expected to move downward towards 1.15 – will help the German economy to avoid recession. The direct effects of euro depreciation on southern European countries growth are small, since most of their trade is with other euro zone countries. Unemployment will continue climbing in the euro zone to 11.9 per cent next year, which will set the stage for political and social unrest.

The ECB's unconventional stimulus measures will create breathing space and allow greater manoeuvring room for the political process. The challenges are formidable, however. During the next six months, the leaders of the euro zone countries must make a number of controversial decisions about the roadmap entitled ***"Towards a genuine economic and monetary union"***, which conerns the future of the euro project. These negotiations are expected to be tough, given the prevailing difficult economic environment, and they will also include constitutional review processes at both the EU and national levels. The future of the euro will depend on the support of the citizenry for major changes in European economic, financial, political and democratic structures. This also includes accepting new revenue sharing and buffer systems, which will collectively allocate risks and financial resources between "North" and "South" and expand mutual responsibility among euro zone countries. **At present there is a looming risk that this new economic and monetary union (EMU) may not be achieved**.

Sweden is showing economic resilience, but growth will remain sluggish in 2013. We expect GDP to increase by 1.3 per cent this year, 1.5 per cent in 2013 and 2.5 per cent in 2014. Sweden's geographic location in northern Europe, with its stronger economic activity, has helped to drive growth, but the **manufacturing sector is downshifting** due to weak international conditions and a Swedish krona that is now establishing itself at a strong but reasonable level in terms of valuations. Households can count on **rising real wages and salaries** thanks to low inflation and a degree of fiscal stimulus, but consumption will be hampered by a weakening labour market, with **unemployment stuck at around 8 per cent in 2013-2014**. Risks to growth related to the housing market have decreased somewhat, but we still expect home prices to drop by a total of 10 per cent from their peak.

Sweden is moving towards a better economic policy mix. Both fiscal and monetary policy will become more expansionary. The strategy of the Riksbank, however, is fairly strict compared to central banks elsewhere, which will lead to a stronger currency. Swedish economic policy is thus also in better harmon with international calls for countries with good government finances and foreign trade surpluses to help decrease imbalances. The government's autumn budget for 2013 will include a dose of stimulus equivalent to SEK 25 billion focusing on research, infrastructure and corporate taxes. In 2014 we expect the government to boost its dose of fiscal stimulus by a further SEK 25 billion (significantly more than announced to date), with an emphasis on tax cuts for households. Fiscal policy will thus contribute both cyclically (by stimulating demand) and structurally (by improving long-term production capacity). The central government borrowing requirement will be about SEK 20 billion annually in 2012 and 2013, but as early as 2014 public sector finances will be in balance. Central government debt will continue downward to 31 per cent of GDP in 2014. Sweden's economic growth will also gain support, though to a smaller extent, from **two key interest rate cuts by the Riksbank** – in September and December – to 1.00 per cent. What makes these decisions easier is that inflation is well below target and total household debt is growing more slowly. **We expect the real key interest rate to be slightly negative (0.5 per cent)** during our forecast period. Because of expansionary fiscal policy will be combined with tight monetary policy (compared to other countries), the krona will strength to SEK 8.00 per euro late in 2012. Looking further ahead, we expect the EUR/SEK rate to be around 8.10. **Foreign exchange market interventions** may be considered if the krona appreciates too much.

The Nordic countries as a whole will also continue to show resilience. The Norwegian economy will follow its own path, helped by strong private consumption. Unemployment will be stable at a low 3 per cent. Home prices are continuing to rise. Our assessment is nevertheless that there are fundamental reasons for these high prices, although they may still become a problem further ahead. **GDP growth in Norway will be 3.7 per cent in 2013 and 2.7 per cent in 2014**. We expect Norges Bank to begin hiking its key interest rate in the spring of 2013 from today's 1.50 per cent, and at the end of 2014 Norway's key rate will stand at 3.25 per cent. Because of tight monetary policy compared to other countries, the Norwegian krone will strengthen to NOK 7.00 per euro at the end of 2014. In Denmark, economic growth will be slow but fiscal policy will serve as an important positive force. Private consumption is being held back by high gross debt and some uncertainty about home prices. Unemployment is on the way up. Denmark enjoys international confidence and the foreign exchange reserve has continued to increase sharply, causing the central bank to set a negative deposit rate. **GDP growth in Denmark will be 1.4 per cent in 2013 and 1.7 per cent in 2014**. Finnish exporters can benefit from a weaker euro, especially in relation to the Swedish krona, yet economic growth will slow during the second half of 2012. Public sector finances remain stable, but unemployment will remain stuck at around 8 per cent. **We expect GDP growth in Finland to be 1.6 per cent in 2013 and 2.0 per cent in 2014.**

The **export-driven economic slowdown in the three Baltic countries** is being softened by continued **decent domestic demand**. GDP growth – which has fallen sharply during the past year, especially in Estonia – will gradually recover in 2013, sustained by growing private consumption and capital spending. Our GDP forecasts for

2012 (Estonia's and Lithuania's especially for 2013) are somewhat higher than in the May issue of *Nordic Outlook*. GDP growth in Estonia will be 3.0 per cent in 2012 and 4.9 per cent in 2014; in Latvia 4.0 and 4.5 per cent, respectively; and in Lithuania 4.0 and 4.0 per cent, respectively. Overall growth in the Baltics will thus reach its potential pace of 4.0-4.5 per cent only in 2014. This means that high unemployment will shrink slowly. Inflation will remain low in Latvia and Lithuania but relatively high in Estonia, where the impact of wages and later also money supply will be larger. We expect Latvia to meet the criteria to join the euro zone in 2014.

Key figures: International and Swedish economy

International economy. GDP, year-on-year changes, %	2011	2012	2013	2014
United States	1.8	2.2	2.2	2.6
Euro zone	1.5	-0.4	0.2	0.9
Japan	-0.7	2.7	1.5	1.5
OECD	1.8	1.4	1.7	2.1
China	9.3	7.8	8.0	8.2
Nordic countries	2.4	1.7	1.9	2.2
Baltic countries	6.2	3.1	3.8	4.4
The world (purchasing power parties, PPP)	3.9	3.3	3.6	4.1
Swedish economy. Year-on-year chages, %				
GDP, actual	3.9	1.3	1.5	2.5
GDP, working day corrected	3.9	1.6	1.5	2.6
Unemployment, % (EU definition)	7.5	7.5	7.8	7.9
Consumer Price Index (CPI) inflation	3.0	1.1	0.8	1.4
Government net lending (% of GDP)	0.1	-0.2	-0.3	-0.1
Repo rate (December)	1.75	1.0	1.0	1.0
Exchange rate, EUR/SEK (December)	8.91	8.0	8.10	8.10

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