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PRESS RELEASE

New Nordic Outlook: Deeper recession – despite aggressive stimulus policies

The most acute phase of the financial crisis is probably past, but the situation remains strained. The crisis is now having very potent contagious effects on the real economy. The world economic downturn is becoming more and more synchronised. Gross Domestic Product in the OECD countries will fall by more than 1 per cent in 2009 – the weakest performance since the Second World War. Meanwhile powerful, synchronised global stimulus policies are taking shape. Interest rates are being cut significantly as the threat scenarios of central banks are increasingly dominated by recession, financial crisis and deflation worries. In addition, fiscal policy is being used on a broad front to soften the downturn. Stimulus packages will contribute to a slight recovery in 2010, a year that will still be dominated by the economic slump.

The downturn in the Swedish economy is continuing at a rapid pace. Next year GDP will fall by 1.3 per cent, and economic weakness will persist in 2010. The recession will have a growing impact on the labour market. The job market will shrink by nearly 150,000 people altogether, and unemployment will climb to nearly 10 per cent by the end of 2010. The Riksbank will cut its repo rate at least to 1.50 per cent next summer. The government will implement additional fiscal stimulus packages, and by 2010 Sweden's annual surpluses in public sector finances will have turned into a deficit equivalent to 3.5 per cent of GDP.

The consolidation of the global credit market will dominate economic developments in the next couple of years. The global economy will suffer on a broad front from tighter lending practices, falling asset prices, increased saving and reduced risk-taking. The **United States** will undergo **one of its deepest recession in modern times**. Unemployment will climb to 9 per cent. Lower resource utilisation will squeeze wages and prices. We expect a sharply declining Consumer Price Index for a while, and the battle against unemployment and falling prices will be the most important economic policy tasks. The Federal Reserve will cut its key interest rate one more time to 0.50 per cent before the end of 2008 and maintain this rate during both 2009 and 2010. The new Barack Obama administration will launch a large stimulus package, which will help soften the downward economic spiral, but this policy will meanwhile lead to major strains in public sector finances.

Economic developments in Western Europe are closely following American trends. Higher household savings and balanced foreign trade points towards somewhat greater resilience than in the US, but on the other hand, home prices in many European countries are at least as excessive as in the US. Economic stimulus measures will also be less aggressive in Europe. The European Central Bank will continue cutting its refi rate, which will reach 1 per cent next autumn.

Having rebounded, the US dollar will maintain its strength for the next six months in an environment of weak risk appetite and de-leveraging. After that, underlying forces will gain the upper hand and the euro will rebound to USD 1.40 by the end of 2010. Bond yields will fall further, in the wake of sluggish growth and lower key interest rates. German ten-year government bond yields will bottom out at 2.7 per cent next summer and American ones will dip even lower. After that, long-term yields will turn slightly upward, among other things because of very large central government borrowing requirements in many countries.

The Swedish economy will follow the downward path of the synchronised international recession. **Next year GDP will fall by 1.3 per cent**, adjusted for work days, **and 2010 will be another weak year**. Average annual growth will be 0.2 per cent in 2008-2010, or significantly weaker than during the slowdown just after the millennium shift, but substantially better than during the crisis of the early 1990s. The labour market downturn has accelerated in recent months, and unemployment is clearly on the way up. Calculated as annual averages, the jobless rate will climb from 6.2 per cent this year to 9.4 per cent in 2010.

Inflation has peaked and will fall sharply in the near future. As early as this coming spring, inflation will be below the Riksbank's target. A combination of recession and financial stress will help persuade the Riksbank to continue cutting its key interest rate at a rapid pace. By next summer the repo rate will be 1.50 per cent. The Swedish krona will continue to weaken for another while, but then it will recover as the financial situation gradually normalises.

The role of fiscal stimulus in stabilisation policy will become increasingly important in a situation characterised by a deep economic downturn and tighter credit. We expect further stimulus packages in Sweden equivalent to SEK 50 billion. This, combined with weak economic conditions, will lead to a rapid deterioration of public sector finances. The government will now face a difficult balancing act when it comes to interpreting the official budget target. We will probably see an adjustment to less ambitious budget targets in a slightly longer perspective.

Key figures, Swedish economy
Year-on-year percentage change

	2007	2008	2009	2010
GDP, adjusted for work days	2.9	0.8	-1.3	0.6
GDP, actual	2.7	1.1	-1.4	0.9
Unemployment (%, ILO definition)	6.2	6.2	7.9	9.4
CPI inflation	2.2	3.6	1.2	0.9
Public financial saving (% of GDP)	3.5	2.6	-1.3	-3.5
Repo rate (December)	4.00	3.00	1.50	1.50
Exchange rate, EUR/SEK (December)	9.43	10.30	10.10	9.50

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