

# Economics Group

## Special Commentary

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# Scandi Slump Pressure Policymakers

## Executive Summary

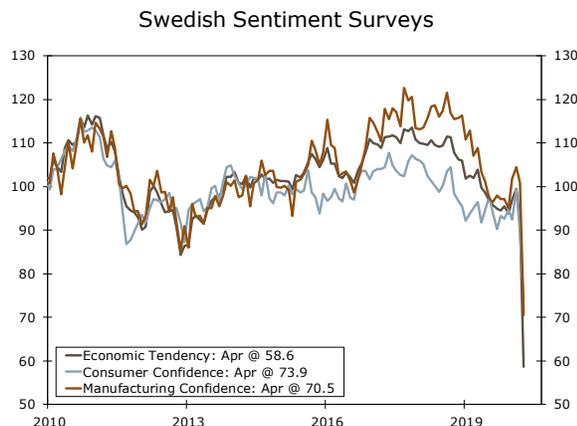
- The outlook for the global economy continues to darken given the dual shock of the coronavirus pandemic and sharply lower oil prices. Given this backdrop, we downgraded our 2020 growth forecast for Sweden and Norway, but look for a stronger recovery next year.
- In response to the coronavirus outbreak and global uncertainties, the Swedish and Norwegian authorities announced further measures to support the economy. On the monetary policy front, both central banks introduced several policy measures to help alleviate the negative impact resulting from the virus outbreak. Despite these actions, we expect the Norges Bank to cut its deposit rate further to protect its economy from collapse. In neighboring Sweden, however, we now look for the Riksbank to maintain a steady policy rate at zero given policymakers reluctance to return interest rates to negative territory.

***We downgraded our 2020 growth forecast for Sweden and Norway.***

## Coronavirus Weighs on Scandinavian Economies

The Swedish and Norwegian economies, like many others, have been hit hard by the coronavirus outbreak, with Norway also particularly impacted by low oil prices. The pandemic that has now infected nearly 3.2 million individuals globally has triggered varying responses, including strict lockdowns and social distancing rules, as governments try vigorously to contain the spread. Despite Sweden’s case and fatality count climbing to over 20,300 and 2,400 respectively, the government took a different approach and is among one of the few nations with minimal restrictions on individuals. The government kept its primary schools, gyms, restaurants and bars open, as well as made practicing social distancing a choice rather than a mandate, encouraging those individuals deemed “at risk” to stay at home. The government defended its approach in part by Sweden’s smaller population and its highly-functioning health care system. While Sweden did not introduce strict laws nor shut down large parts of its economy, it is nonetheless still exposed to disruptions in the global economy.

**Figure 1**



Source: Bloomberg LP and Wells Fargo Securities



*We look for the Swedish economy to contract -5.5% in 2020.*

Recent data from Sweden point to a sharp slowdown in the months ahead, as overall economic confidence plunged to 58.6 in April, the lowest level on record (Figure 1). According to the National Institute of Economic Research, values below 90 indicate much weaker growth than normal. The especially low level of confidence is putting some pressure on policymakers to provide additional support to the economy. Consumer and manufacturing confidence also declined in April, falling to 73.9 and 70.5, respectively.

As the Swedish economy deteriorates, declining demand has also weighed on prices. March CPIF inflation softened to its slowest pace since 2015, to just 0.6% year-over-year, in particular led by lower electricity and fuel prices. The outcome was well below the central bank's forecast and with the economy likely to remain under pressure, we expect subdued inflation in the year ahead. Given the recent developments, we have lowered our Swedish GDP growth forecast and **now look for the economy to contract -5.5% for full-year 2020**, with significant weakness expected in both the consumer and investment sectors. Under the assumption the virus recedes in a relatively timely manner, and any return is less severe, **we expect a modest bounce back in growth over 2021.**

In neighboring Norway, economic activity appears to have been hit hard by the dual challenges of coronavirus disruptions and extremely low oil prices. Norway was one of the first European nations to limit activities in an effort to rein in the spread of the virus, which led to thousands of layoffs. Since March 9, the Norwegian Labor and Welfare Administration received over 418,000 applications for unemployment benefits. As the economy ground to a near halt, the country opted to ease some of its restrictions after the health minister suggested that the country has managed to gain better control of the virus. Beginning April 20 day-care centers were reopened and health practitioners who perform one-on-one services were able to resume care, while schools, universities and technical colleges as well as services that require personal contact such as hairdressers, massage and skin care professionals reopened starting April 27. Other restrictions still remain effective, however, such as restricting major sporting/cultural events, with these industries continuing to follow social distancing protocol and maintain quarantine/isolation rules.

On the data front, Norway March retail sales fell a relatively moderate 0.9% month-over-month, although we note that grocery store sales, which account for roughly 40% of sales in the index, rose 11% month-over-month, helping to limit the decline. Meanwhile, Norway's leading indicators plunged as the March manufacturing PMI dropped to an 11-year low of 41.9 amid the coronavirus outbreak and lower oil prices. The decline was driven in part by new orders and employment falling to 34.0 and 33.3, respectively. Providing further evidence of a slowdown, the unemployment rate rose to 10.7% from 2.3% in February, the highest level since at least 1984, and is expected to jump further. Inflationary pressures have also eased in Norway, as CPI rose 0.7% in March, the slowest pace since 2012, weighed down by falling fuel and electricity prices. Meanwhile, underlying inflation was steady.

Aside from the coronavirus weighing on the economy, oil markets have also come under extreme pressure this year after an oil price war between Saudi Arabia and Russia. Despite a deal to cut oil production by 9.7 million barrels per day starting on May 1, crude prices remain depressed as excess oil supply persists given a lack of oil demand. Brent crude is down around 70% since January and, given the Norwegian economy's reliance on trade and oil, we believe a recession is imminent. As a result, we now forecast **mainland GDP to fall 3.5% in 2020**, and then **recover by 3.2% in 2021.**

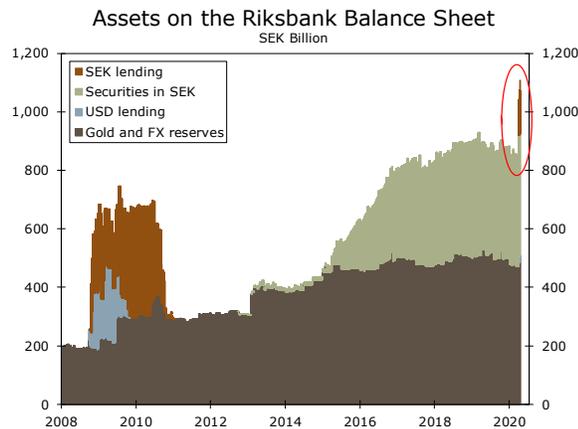
### **Riksbank Relies on its Balance Sheet**

Monetary and fiscal policymakers have implemented extensive actions aimed at supporting the economy. Since March, the Riksbank introduced several measures aimed at facilitating the supply of credit and countering the effects of the coronavirus. Some of these measures included reducing its lending rate for overnight loans 55 bps to 0.20%, expanding its bond purchase program by up to SEK300B, lending up to SEK500B to companies via banks, as well as offering extensive liquidity programs for banks.

*We forecast mainland Norwegian GDP to fall 3.5% this year.*

After a busy two months, at its latest monetary policy meeting on April 28 the Riksbank kept its repo rate unchanged at zero. While the central bank did not rule out further rate cuts, it signaled some hesitation to return to negative interest rates. In the accompanying statement, policymakers indicated that the central bank would continue to evaluate its combination of policy measures, hinting that further balance sheet measures would be the preferred method of providing additional monetary policy support. The central bank also said it would continue its renewed SEK300B bond-purchase program, including the purchases of covered bonds and government bonds, until the end of September. The Riksbank has so far made a fast start to its resumed bond purchases, purchasing securities at a pace of around SEK16B per week since late March.

Figure 2



Source: Riksbank and Wells Fargo Securities

In terms of our monetary policy outlook, we no longer see the Riksbank cutting rates back into negative territory and instead **look for the Riksbank to hold its repo rate at zero for an extended period**. The next scheduled announcement is July 1, and if any easing were to occur we believe it would be via balance sheet measures. For now, the central bank remains well within its bond purchase limit of SEK300B and still has room to continue those purchases before hitting its purchase cap. If purchases were to continue at the current pace it may near the SEK300B cap by mid-to-late Q3, although whether bond buying continues at the current pace could depend in large part on the performance of the Swedish economy and stability (or otherwise) of markets in coming months. If markets were to remain somewhat stable, and the economy not underperform against already very weak expectations, it is possible the rate of bond purchases could slow. Overall, **we think the risks remain tilted towards some further expansion in the bond purchase program**, perhaps some time during Q3. The Riksbank may also, however, become increasingly cognizant of its holding of government bonds in particular when considering the size of any further program increase, given that the central bank is already a substantial holder of outstanding government bonds.

That said, even based on the currently announced measures (if fully implemented), the balance sheet could increase by a total of SEK1,400B due to those measures, substantially more than during the 2008-2009 financial crisis. In our view as long as the central bank has the ability to use the balance sheet, that would be its first line of defense to help further stimulate its economy. Only if there was a prolonged economic downturn do we believe the central bank would more seriously consider reverting to the use of negative interest rates.

On the fiscal front, the Swedish government has introduced extensive measures aimed at assisting the economy given the negative effects of the coronavirus outbreak. These measures include unemployment benefits, additional funding to municipalities and regions hit hard by the outbreak, loans to small and medium-sized businesses, temporary reduction of employers' social security contributions and credit guarantees for Swedish airlines, among others. The overall

*We look for the Riksbank to keep its repo rate at zero.*

package of fiscal measures is estimated to amount to roughly SEK407B to SEK695B, or 8% to 14% of GDP.

### **Norges Bank Signals More Easing Could Come**

The Norges Bank also announced aggressive easing measures to lessen the negative impact of the pandemic. The central bank has slashed its policy rate a cumulative 125 bps in recent weeks to 0.25%, the lowest level on record. Policymakers have also maintained a relatively dovish tone, saying they do not rule out a further reduction in rates. In addition, the central bank invoked a range of other measures including offering three-month loans to banks for as long as deemed necessary to ensure that the policy rate passes through to money market rates. It also reduced the countercyclical capital buffer for banks to 1% from 2.5% and said separately that it is ready to intervene directly in the currency markets if necessary. Despite this range of actions from the central bank, we think Norway's economy will be hit by the combination of slumping global oil demand as well as financial distress, and should face additional headwinds in the coming months. **We believe that the combination of weaker inflation and lower oil prices is likely to prompt the Norges Bank to lower policy another 25 bps in this cycle to zero**, though we see a move into negative territory as unlikely.

***We look for the Norges Bank to cut its policy rate 25 bps.***

In terms of budget policy, Norway's government has responded with the introduction of significant fiscal measures. It has taken a three-phase approach that so far add up to over NOK139B (~4.6% of mainland GDP). The measures aimed at business and industries support include a compensation scheme for otherwise sustainable businesses with at least a 30% drop in revenue due to the virus, loan guarantees for small- and medium-size businesses, lowering the VAT rate to 8% from 12%, and deferral of various tax payments, among others. The measures aimed at individuals include an extension of the unemployment benefits scheme and larger wage subsidies for temporary lay-offs, skill development measures to improve the skills of those unemployed, doubling the number of days that parents can stay home with sick children, and increased access to loans for students who have lost work income.

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