

Scandi Economics Update

Change of Government in Sweden

- **Sweden — Social Democrats win election.** Preliminary election results show a change of government, with Social Democratic leader Stefan Löfven likely to become new prime minister. With the Moderate Party earning only 23.2% of the vote (compared to 31.1% for the opposition Social Democrats), Prime Minister, Fredrik Reinfeldt, yesterday late night stepped down and also announced his resignation as chairman of the Moderates. Comment: The election results are well in line with indications from opinion polls in the run-up to the election. It will probably take a couple of weeks before we know what the new government will look like. Our main scenario remains that the Social Democrats will form a minority coalition government with the Green Party.
- **Sweden — Data preview.** There are two important events on the agenda this week; the Riksbank minutes from the 4 September monetary policy meeting (Wed) and revised 2Q national accounts data (Thu).
- **Norway — RNR points to ongoing moderate growth, in line with Norges Bank's forecast.** Norges Bank's Regional Network Report showed a slight deterioration in output in the Norwegian economy over the past three months. Meanwhile, the expectation indicator was revised a tad higher, but still continues to point to below-trend mainland GDP growth ahead of around 0.5% Q/Q in 3-4Q 2014, i.e. in line with Norges Bank's 3Q forecast. The RNR is a very important input for NB ahead of its 18 Sep monetary policy meeting. As the September report is well in line with Norges Bank's forecast of moderate growth and lower capacity utilization, it should, in isolation, not change the Central Bank's view on monetary policy much. Still, with the strong 2Q mainland GDP outcome, Norges Bank will likely have to lift its full-year 2014 growth forecast.
- **Norway — Data preview.** The most important (and only) event this week is Norges Bank's MPC meeting (Thu). Despite signalling a 28% probability of near-term easing in the June Monetary Policy Report, we expect NB to confirm its wait-and-see stance at the upcoming 18 September monetary policy meeting (i.e. keep the sight deposit rate stable at 1.50%). Clearly, the surprise cut from the ECB earlier this month will put NB in a difficult situation, however, with upside surprises in domestic growth, inflation and labour market indicators, we do not reckon this will be sufficient to trigger a rate cut. We also note that NB conditioned a rate cut on "further weakening" of domestic growth in the June policy statement. Meanwhile, there is little doubt that lower foreign interest rates (and associated potential NOK strength), in isolation, will lower the conditional interest rate path. History suggests it primarily will affect the long-end of the path. In other words, NB could well signal an even more gradual pace of monetary tightening in 2016-17, and will probably also refrain from appearing too hawkish at the September meeting. Still, we expect a somewhat more balanced statement in Sep compared to Jun.

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Sweden — Social Democrats win election. Preliminary election results show a change of government, with Social Democratic leader Stefan Löfven likely to become new prime minister. With the Moderate Party earning only 23.2% of the vote (compared to 31.1% for the opposition Social Democrats), Prime Minister, Fredrik Reinfeldt, yesterday late night stepped down and also announced his resignation as chairman of the Moderates (will stay as party head until spring). This suggests that the Moderates most likely will abstain from any large-scale efforts to stay in power, and in turn should reduce the risk of a re-election in the near future. The red-green coalition (the Social Democrats, the Greens and the Left Party) pulled in a total of 43.6% of the votes, with the Alliance earning 39.4% (the Moderates, the CDP, the Liberals and the Centre Party). The third largest party was the nationalist Sweden Democrats with 13% (note, though, that none of the other seven parties in Parliament want to work with). The Feminist Initiative, which looked set to break through the 4% threshold during the exit polls, finished just above 3% and, hence, missed the chance of a spot in parliament. During the coming weeks, Mr Löfven's job is to form a coalition that can pass a budget this autumn. This will most likely prove a complex challenge for Mr Löfven, who has little political experience. Although minority governments are far from being unique in Sweden, the combination of cross-block cooperation, an unusually strong kingmaker party and a historically weak Social Democratic Party has clearly changed the preconditions for government work. The current situation threatens to produce a period of relative political instability and will likely continue to be an issue for financial markets. The turn-out in the elections was 83.3%, up 1.2pp and one of the highest levels in Europe. In other words, such a turnout gives high legitimacy to the election outcome. Comment: The election results are well in line with indications from opinion poll in the run-up to the election. It will probably take a couple of weeks before we will know how the new government will look like. Our main scenario remains that the Social Democrats will form a minority coalition government with the Green Party. Party leader Löfven has been clear about his reluctance to let the ex-communist Left Party into the government and the Left Party has indicated that it is happy to stay outside a government in exchange for other opportunities to get influence on government policy. On the implication from a change of government on fiscal and monetary policy, they are expected to be limited. We continue to expect fiscal policy to be relatively neutral (maybe with a slight expansionary tilt). In line with indications from the centre-left coalition in its election manifesto, fiscal policy will be characterised by higher income and excise taxes. The impact on monetary policy should also be limited. We note, though, that expected tax increases likely will lift CPIF inflation by half-a-percentage-point or so in coming years and that a red-green government likely will pursue policies that will boost short-term growth at the expense of longer-term growth (speak in favour of a marginally tighter monetary policy stance).

Sweden — Data preview. There are two important events on the agenda this week; the Riksbank minutes from the 4 September monetary policy meeting (Wed) and revised 2Q national accounts data (Thu). With no reservations made to the Riksbank board decision, it will be interesting to see where the different board members stand in terms of additional policy easing. We will also look for any potential discussion on more formal forward guidance. On revisions to the preliminary national accounts data, we reckon the 2Q flash estimate underestimates the strength of the Swedish economy. For sure, stronger-than-expected household spending growth in June and its high weight in GDP (50%) supports an upward revision. We look for GDP growth to be lifted by 0.1pp to 0.3% Q/Q in 2Q.

Appendix A-1

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