Deeper crisis & shock therapy
On the way to a new world

Economic lunch meeting
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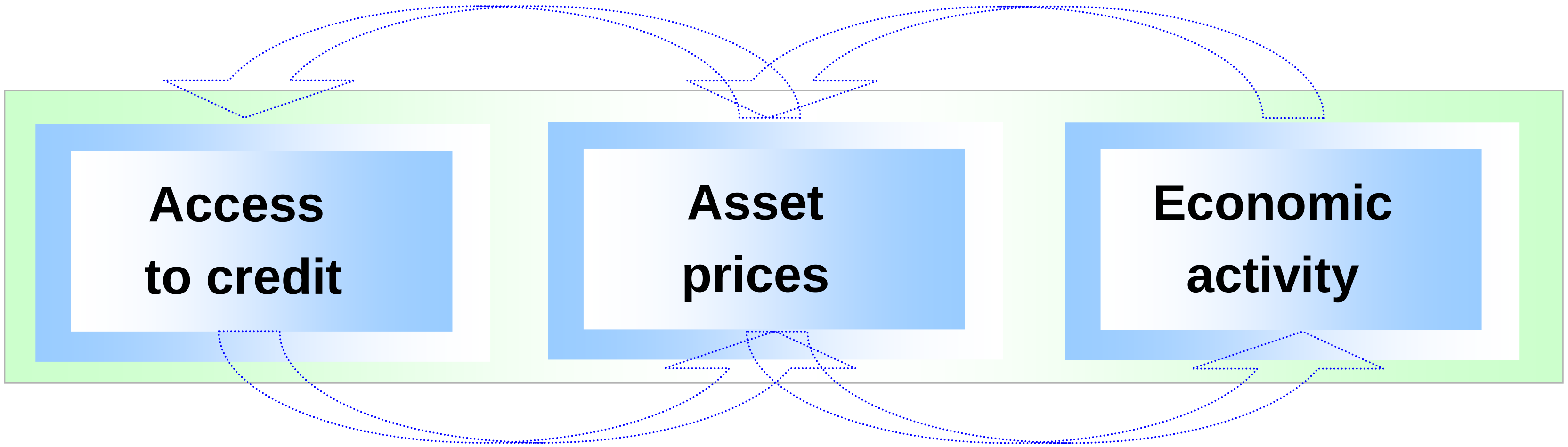
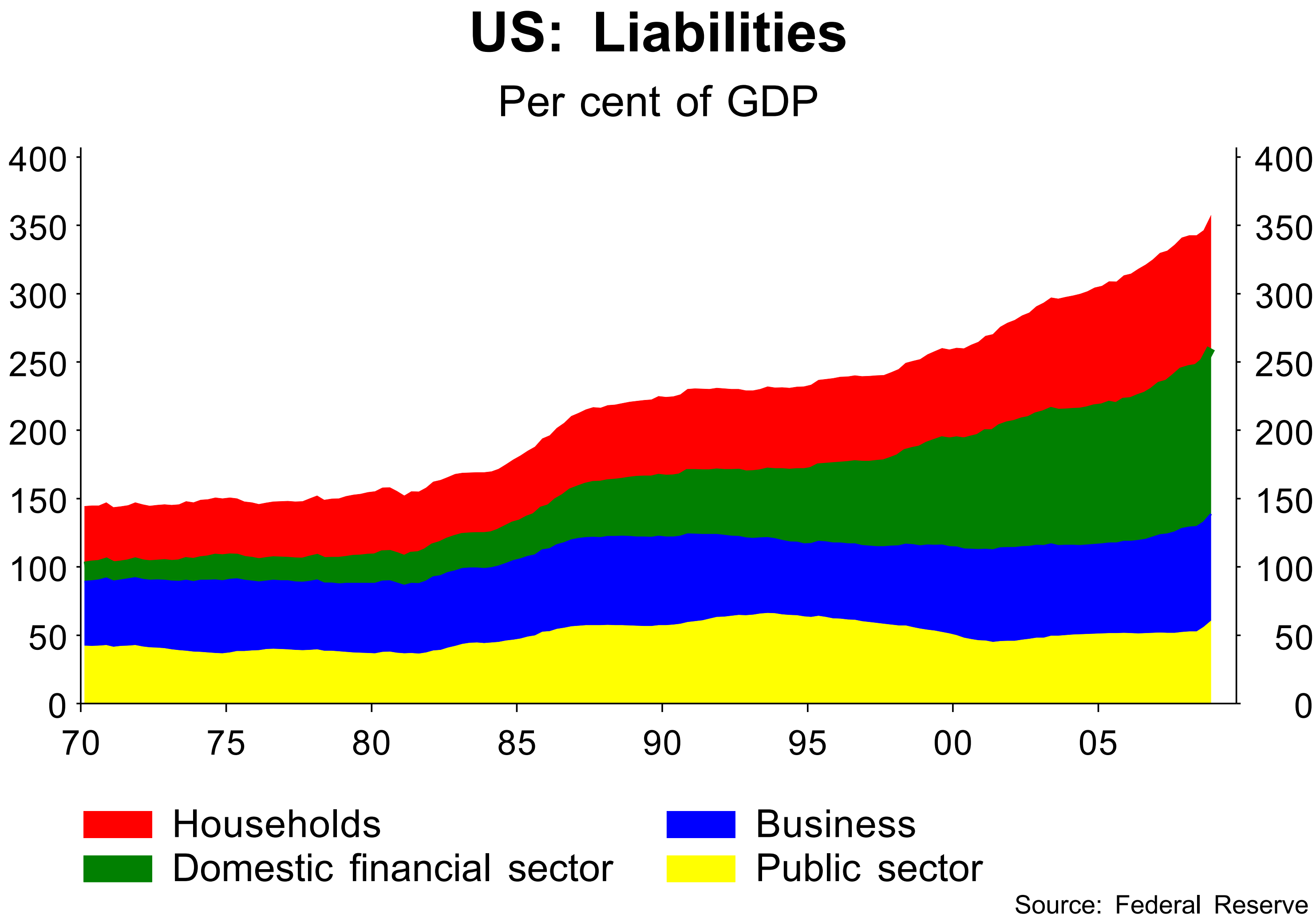
Håkan Frisén
Head of Economic Research
Tel: +468 763 8067
email: *hakan.frisen@seb.se*

Interaction: Credit cycle, asset price cycle and business cycle

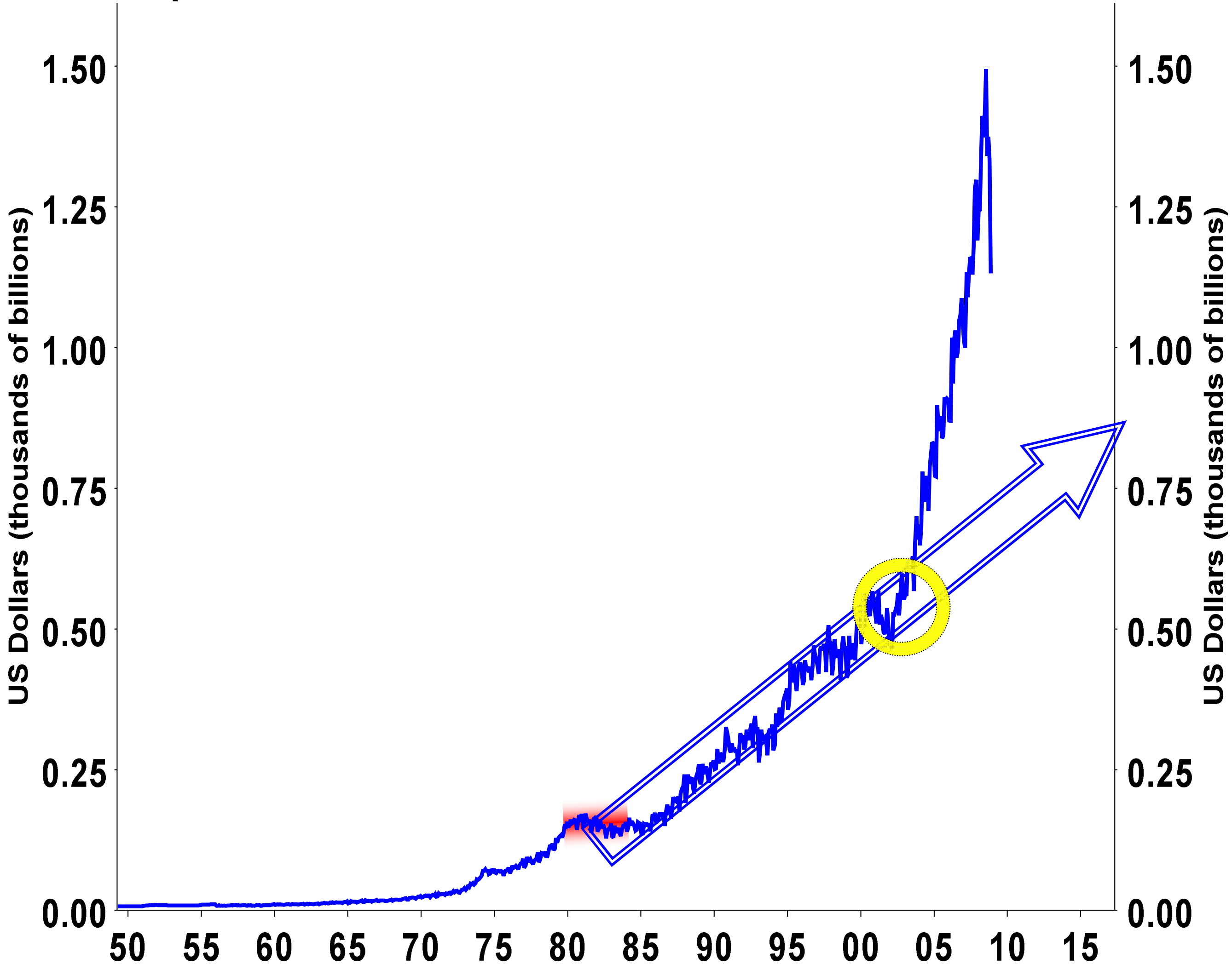


US: Long-term debt build-up

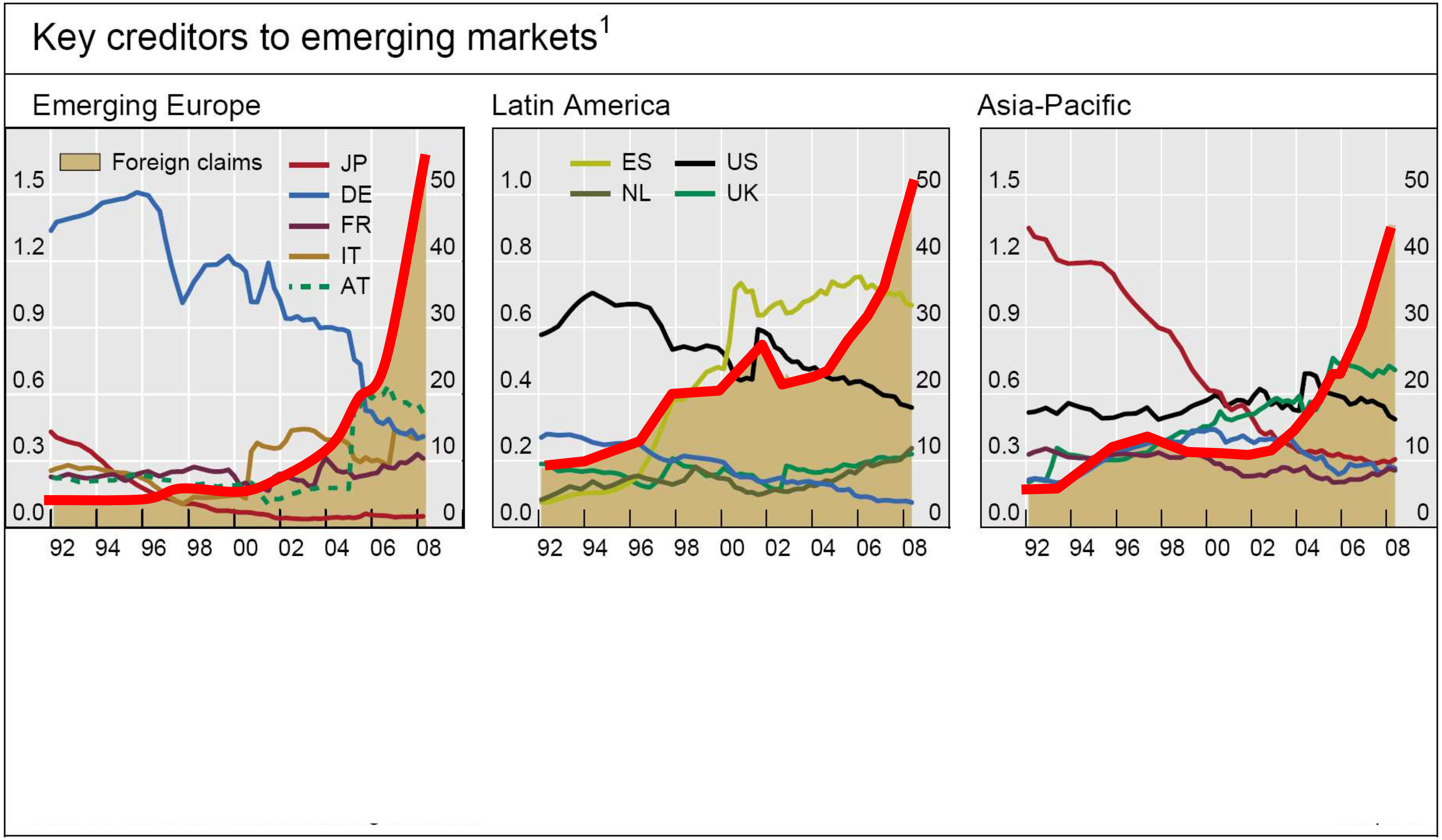


The power of globalisation!

World export, trillions of US dollars



Bank exposure to emerging economies



Our picture of a world in acute crisis

Navigating uncharted territories without a map and a compass

Globalisation “hangover”

Crushed illusions: The super-cycle, decoupling, international dependence, financial risk, price/availability of money

Large adjustment needs in

- The global credit market
- Business models and scale of operations at financial and non-financial companies

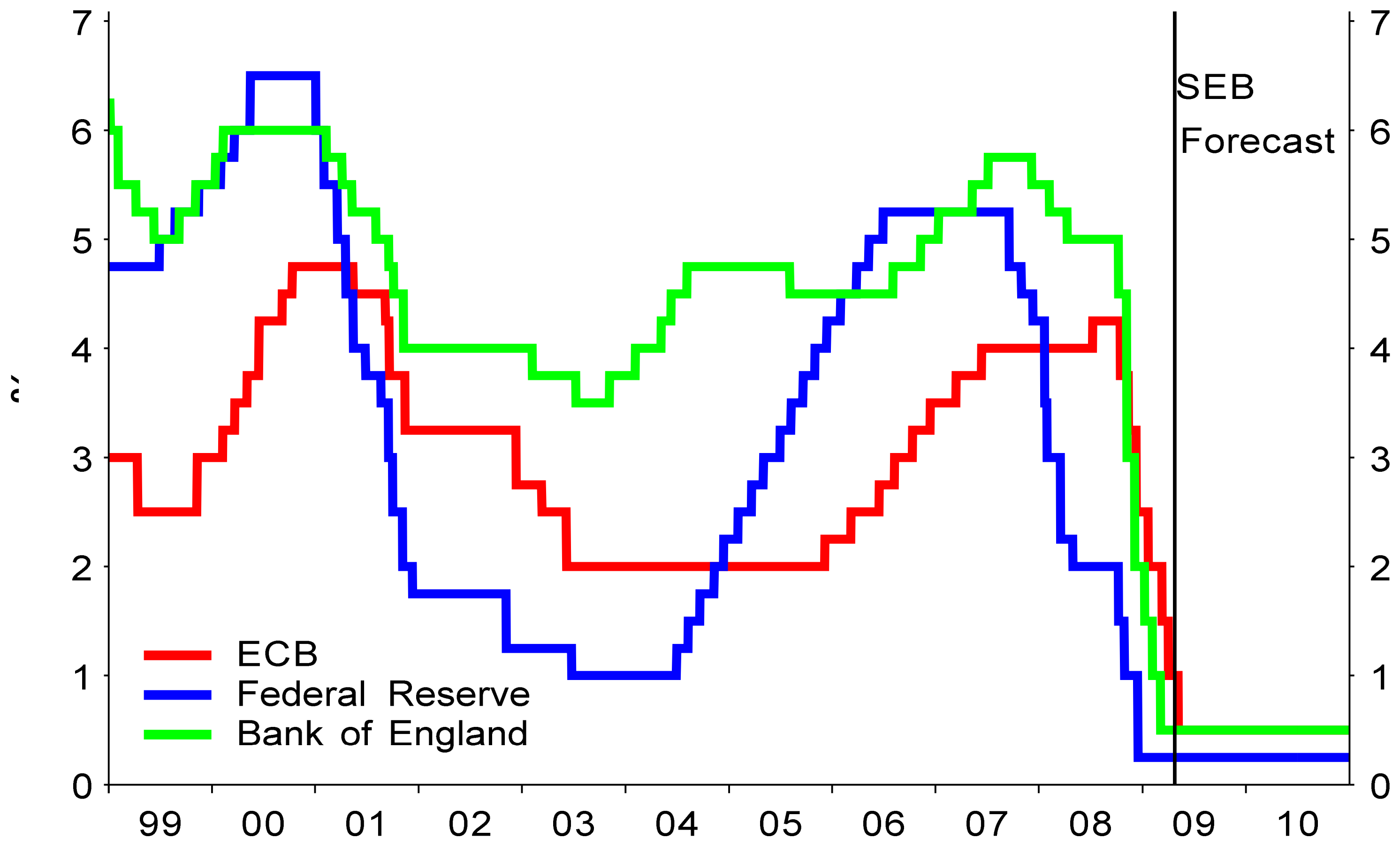
Which crises can we learn from?

- **1930s and Japan**
  - Deflationary threat scenarios after financial bubbles
- **1970s**
  - Stagflation after American over-extension, systemic collapse for exchange rates plus oil price shocks
- **1980s**
  - Recession as the price of a new system based on low-inflation policies
- **1990s and post-millennium shift**
  - Property and stock market bubble without lasting impact

Conclusion: Today's threat scenario most resembles the 1930s and Japan, but this time the policy response was mobilised much faster

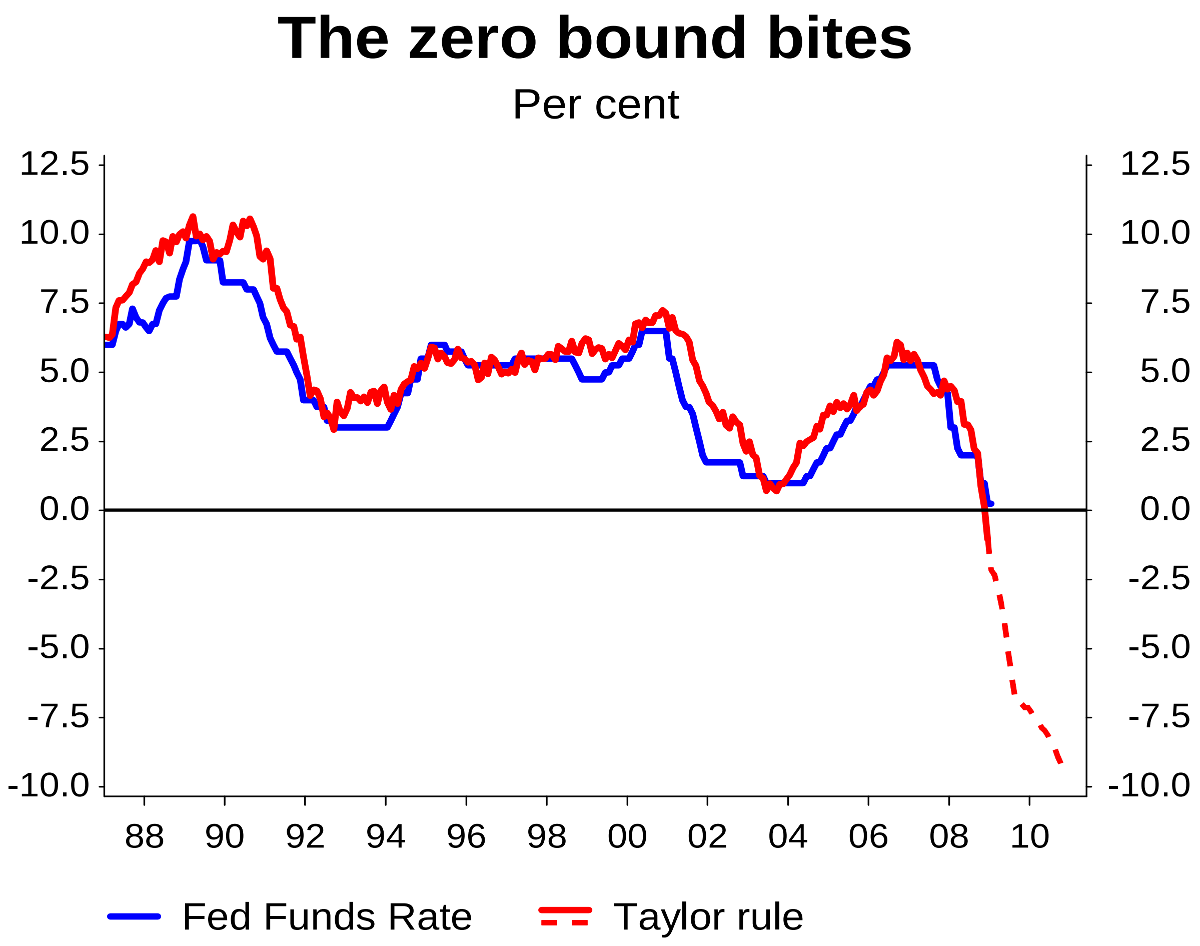
Approaching zero rate policy

SEB



Sources: ECB, Fed, BoE, SEB

US: Zero Fed funds rate is not enough



Source: Goldman Sachs

Next act of the inflation drama

- **Commodity price effect will culminate in 2009**
- **Record-sized output gaps will squeeze pay**
- **Will wage and salary cuts save jobs or make the deflation spiral permanent?**
- **Purpose of today's crisis policies is, in practice** *"to play with inflation fire"*
- **How do the warning stages of inflation work?**

  1) Transmission begins to work

  2) Demand takes off

  3) Output gaps close
- **Inflation risks appear only after that**

The renaissance of Keynesian fiscal policy

- **Monetary policy overworked**
- **Fiscal policy effective in times of crisis**
  But there are drawbacks
  - **Increasing government debt means future burdens**
  - **Ricardian equivalence may reduce impact**
  - **Crowding out via interest rates in long term**

Squeezed from two directions

Combined “credit crunch" and “crowding out"

Global
credit market
is shrinking

Households
Banks
Companies
Municipalities
Governments

Governments
raising capital
for aid packages

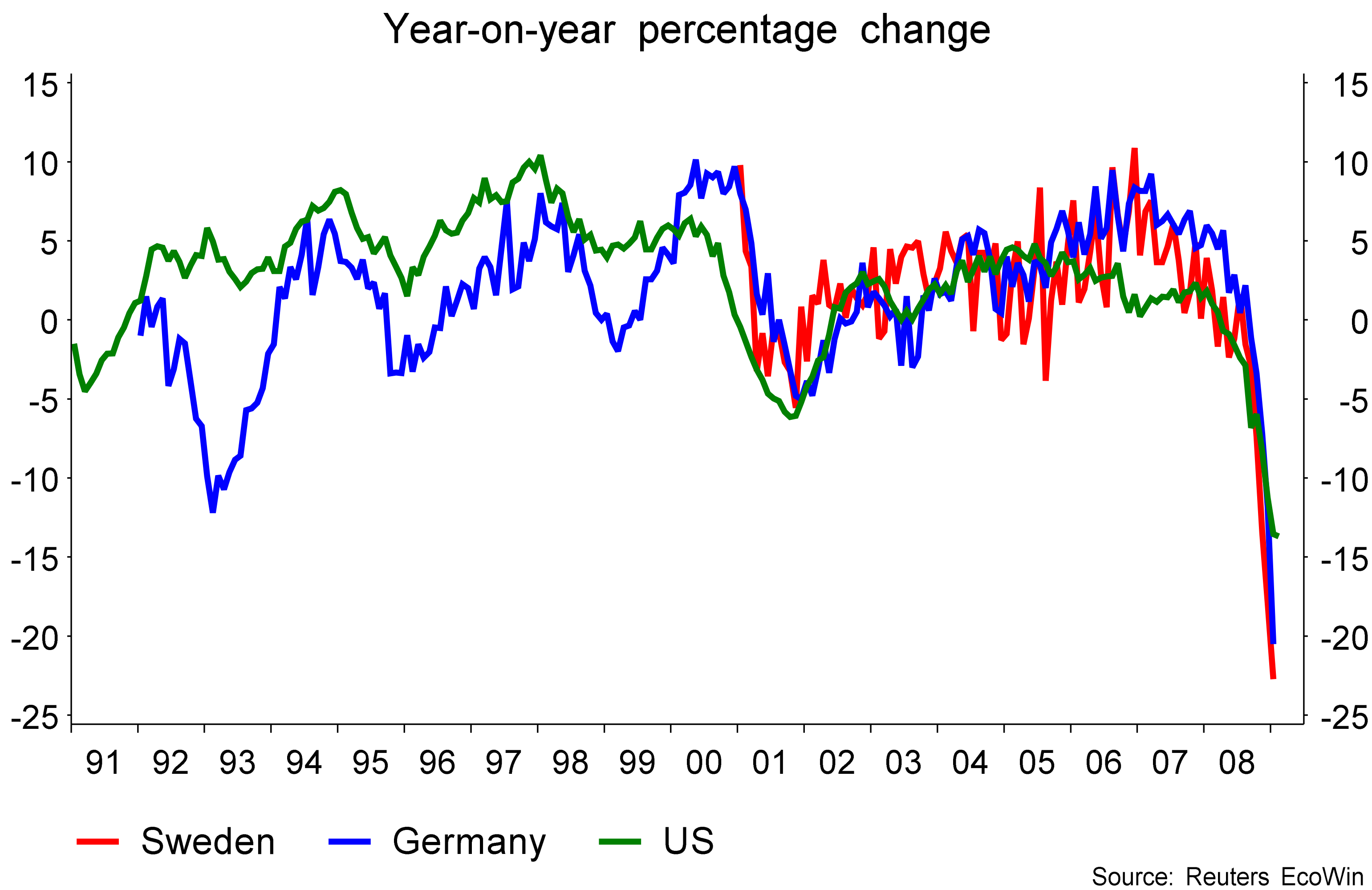
Further
rescue
operations

Central
banks
buy gov't
bonds

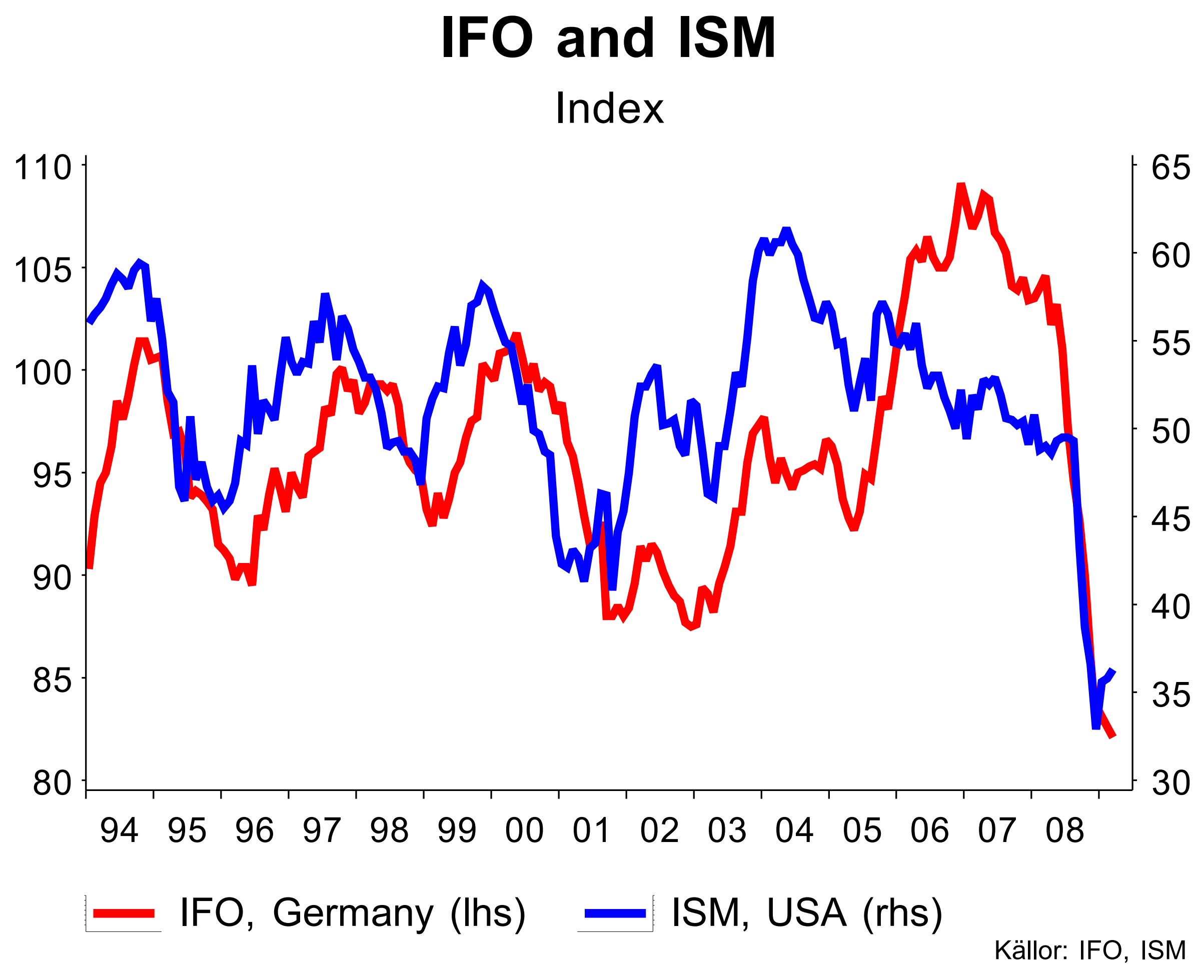
G20 London Summit: Official statements

- Restore confidence growth and jobs
- Repair the financial system to restore lending
- Strengthen financial regulation to rebuild trust
- Fund and reform our financial institutions
- Promote global trade and reject protectionism
- Build an inclusive, green and sustainable recovery

Synchronised decline in output



Stabilization under way?



Gloomier global outlook

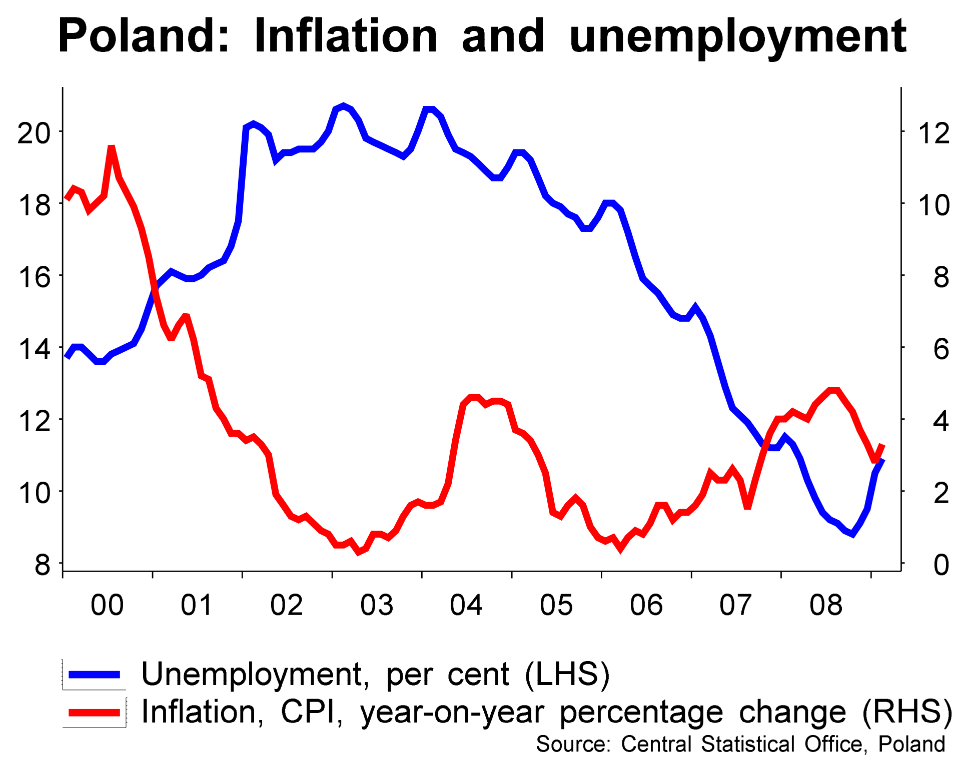
GDP: Year-on-year percentage change

	2007	2008	2009	2010
United States	2.0	1.1	-3.4	0.7
Euro zone	2.7	0.7	-3.6	0.0
Eastern Europe	7.4	4.5	-5.2	0.6
Poland	6.7	4.8	-2.5	1.0
The world (PPP)	5.0	3.2	-1.5	1.4
Oil, USD/barrel	72.9	97.2	40.0	45.0
EUR/USD, Dec.	1.46	1.40	1.20	1.40

Central and Eastern Europe: Three “risk categories”

- ***Worst affected.* The Baltics, Ukraine**, Hungary and the Balkans. Characteristics: Large external imbalances. Large financing needs after explosive credit growth in some cases. Relatively high share of total borrowing denominated in foreign currencies
- ***Prudent Central Europe.* Poland**, Slovakia and the Czech Republic, with decent fundamentals. Moderate external imbalances. Rapid build-up of private indebtedness but with a modest share of total borrowing denominated in foreign currencies
- ***Russia.*** Strong initial fundamentals: twin surpluses. Rapid build-up of private indebtedness but with a modest share of total borrowing in foreign currencies

Poland: Cannot escape recession

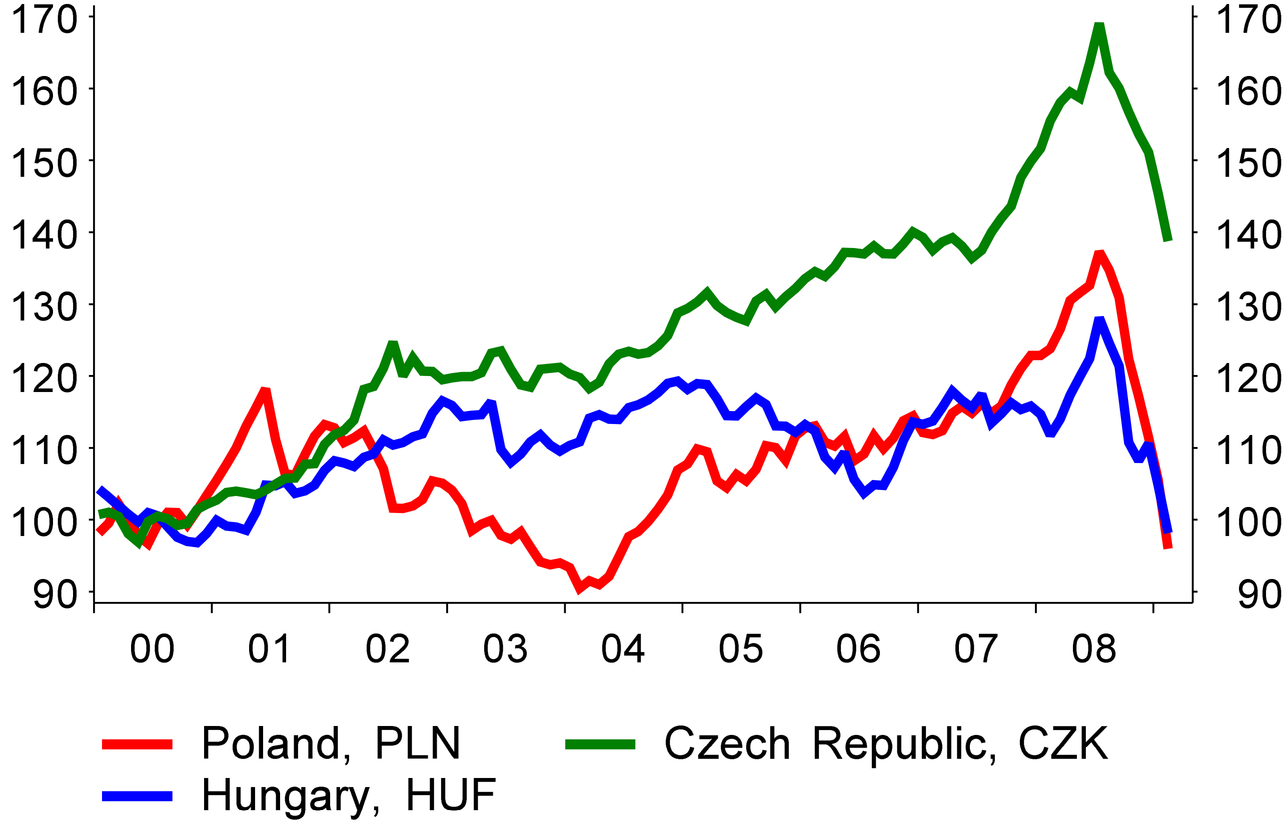


- GDP down 2.5% this year – slight recovery in 2010
- Moderate imbalances and a more closed economy
- Consumption will provide some support, despite rising unemployment
- Inflation will fall to within the central bank's target range
- Further rate cuts to 2.50%
- Short-term foreign debt a source of concern – zloty will slide once again
- ERM2 and euro zone accession will be postponed

A shock wave has hit many currencies in Central and Eastern Europe

Trade-weighted exchange rates

52 countries, index 100 = 2000, until February 2009



Source: BIS

Estonia first in euro timetable

	Official	Our view
Estonia	2010	2012
Latvia	No target	2012
Lithuania	2011-2012	2013
Poland	2012	2013
Czech Republic	No target	2013 at the earliest
Hungary	No target	2014

Summary

- **Crisis policies must deal with the effects of…**
  - Continued global structural reduction in debts
  - De-globalisation, deceleration and downsizing

- **Deep, synchronised recession 2009/2010**
- **Wage and salary squeeze/resource gap = deflation risk > inflation risk**
- **Low interest rate environment, printing of money, huge government budget deficits**