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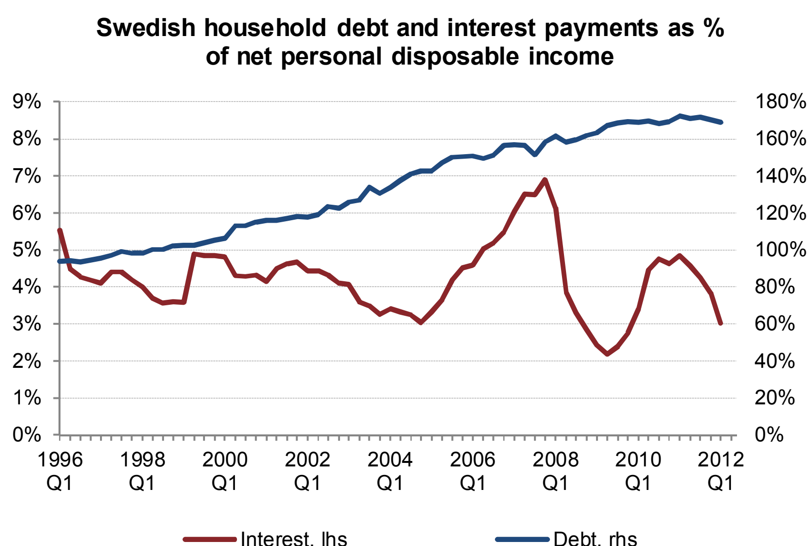
Swedish outlook improving but still weak

- **Swedish household debt rises and falls - slightly**
- **Broad money growth remains anaemic**
- **Fall-out from Cyprus will be difficult to contain**

Swedish household debt continued to rise in absolute terms in Q4 2012. But relative to net personal disposable income (PDI), the ratio fell. Not by much – seasonally adjusted debt/PDI was 169%, down from 170.2% in Q3 and a peak of 172.3% a year earlier. Interest payments fell to 3% of PDI, helped by continued interest rate cuts by the Riksbank.



The lower relative debt burden is partly a result of continued healthy (between 1% and 2% per quarter) growth in net disposable income. But households also held back slightly on their borrowing in 2012, while at the same time increasing their savings. The household savings rate reached 11.4%in 2012, the highest rate since at least 1993. As a result, the Swedish household sector financial surplus widened to a three-year high of just under 5% of GDP (please note that this is a four-quarter moving average to smooth out seasonal fluctuations). This is balanced by lower public and corporate sector surpluses, while the foreign sector deficit (ie, Sweden's current account surplus) is broadly moving sideways. Notably Swedish public sector finances are already showing a small deficit which is likely to widen in 2013.

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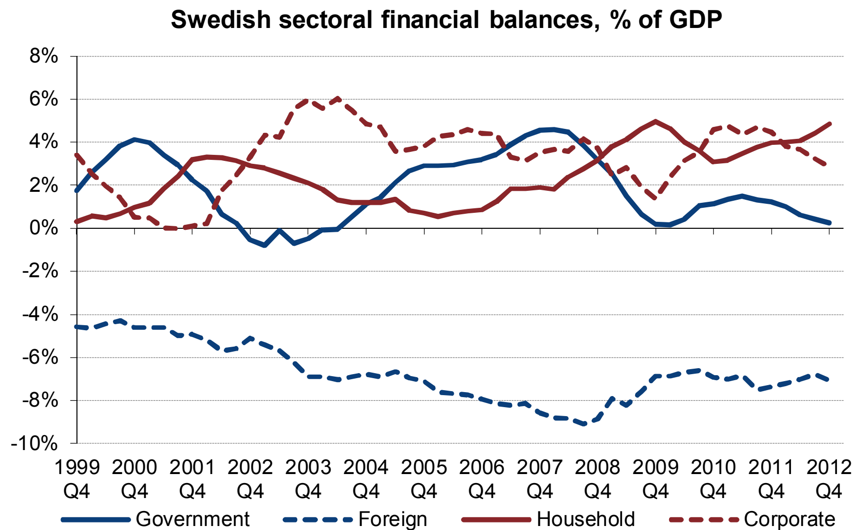

The wider household sector surplus extended a trend in place since late 2010. As noted in a previous comment (*High household savings are a cushion, not a cure-all*, 18th October 2012), higher household savings enable the carrying of a higher debt burden for some time, but they do not make it possible for ever. It is therefore positive to see that the growth of housing loans eased further in January and February, to a monthly rate of 0.3% in each month from 0.4-0.5% for much of the previous two years. On a twelve-month basis, housing loan growth remains broadly unchanged, alternating between 4.6% and 4.7% since July 2012.

However, one consequence of weaker household borrowing growth is that with corporate borrowing also weak, broad money growth has slowed. A year ago, Swedish M3 growth was above 6%; the average of the past five months is 1.8%, well below any number consistent with medium-term trend rate output growth. Nor does there seem any likelihood that broad money growth will recover in the near future.

On the positive side, there is no reason to expect a recession. Recent business and consumer survey data confirm the broad money numbers of the past year in so far as these point to positive, but below-trend growth.

Good news though that is, Sweden has another looming problem. At the moment, Swedish export prices are falling. But they almost have too. A report published today by the German Federal Statistical Office shows that the Swedish private sector has the highest hourly labour cost in the EU. This may not be a major problem in itself; but Swedish labour costs in 2012 also rose faster than in any western EU country apart from Finland and Austria and a god bit faster than most eastern European countries as well.

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While the outlook for the Swedish economy thus remains better than for a number of its European neighbours, the high household debt burden and rapidly rising labour costs remain warning signals. It is unlikely that the Riksbank will cut interest rates any further in this cycle.

* * *

Moving from one end of Europe to the other, it is far from clear that the Cypriot crisis is over. Although Greek subsidiaries of Cypriot banks have now reopened (after being transferred to Greek supervision), banks in Cyprus remain closed at least until tomorrow. Even when they open, they will be subject to withdrawal restrictions, whilst Cyprus as a whole is subject to capital controls. These are said to be 'very temporary'. However, as John Plender points out in today's *Financial Times*, the 'temporary' capital controls introduced in Iceland in 2008 are still in place. Of course, the history of capital controls shows that they can be circumvented if with some difficulty. But more importantly, in a monetary union, you really cannot have internal capital controls. If you do (at least if they remain for more than a 'very temporary' period), it is no longer a monetary union. Put simply, a euro in Cyprus is today worth less than a euro in – say – Greece.

But that issue is possible to deal with. What is far more worrying from a general euro area perspective is the factor of uncertainty that has now been thrown into any future rescue package. This will have been heightened – probably to certainty – by the President of the Eurogroup, Jeroen Dijsselbloem's comments (since disavowed) implying that hitting depositors (and presumably shareholders and bondholders) is a possible template for the future. As noted in previous comments, there is a strong argument that if a bank fails, shareholders, bondholders, management and, yes, depositors – should lose money. But, if you do that, then you cannot have a deposit guarantee scheme in place. In future crises, it doesn't matter whether depositors fear that their deposits are at risk from a possible rescue. It is enough that they fear that *other depositors* will fear this and will withdraw their money. Add to this increasing bail-out fatigue in the creditor countries, and the uniqueness of Cyprus is likely to end up being just as unique as that of Greece – ie, not at all if deemed necessary, not least to placate creditor-country voter-taxpayers.

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