The Nordic and the Baltic economies

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Financial distress reduced

- Financial distress has eased, but not disappeared
- Effect on real economy now more visible
- Policy rates further down
Denmark a leader down, Norway a lagger

- Danish housing market busted in 2007
- Swedish exports and manufacturing hit early and hard
- Norway: Domestic demand slowed in 1. half, exports hit hard in 2. half
- Finland also first hit in 2. half. Consumers paralyzed in Q4
Different structures in the manufacturing sectors

- Sweden: Cars and trucks
- Norway: Metals and equipment for petroleum exploration

![Manufacturing production chart](Source: Reuters EcoWin)
Strong growth in employment, especially in Norway

- Employment decelerated, most in Sweden
- Coming down from a very high level in Norway
  - High import of labour
- Employment will decline and unemployment will increase
Stronger fiscal stimuli than average in EMU

- In Norway increased public expenditure
- In the other countries a mixture of tax reductions and public expenditure

Sources: Norwegian Ministry of Finance, Nordea
Budgets surpluses turns to deficits

- in Denmark, Finland and Sweden
- Norway will have large surplus, but more oil revenue is used than supposed by fiscal rule
Norges Bank and Danish National bank laggers – for different reasons

- Denmark: Weakening of DKK lead Nationalbanken to hike
- Norway: From high inflationary pressure
- Expect the Riksbank to cut to 0.5% and Norges Bank to 1.25%
SEK hit hard
Concern about banks’ exposure to Baltic countries. Weak stock market
Baltic outlook
High inflation ruined competitiveness

- The economies grew too fast, too long
- Supercharged growth boosted inflation
  - Prices up, salaries up
- High inflation ruined competitiveness

![GDP, yoy graph](image)
Inflation is slowing rapidly

- Slowing inflation is not enough to improve competitiveness
- Prices are not declining, they are just rising slower
- Compared to EU average, Baltic inflation is still very high

*Source: Reuters EcoWin*
How to get out of the woods?

- Competitiveness must be improved
- 2 ways to do it:
  1. External devaluation
     - Weak currency boosts export
  2. Internal devaluation
     - In practise internal devaluation means salary cuts
     - Lower cost structure improves pricing power

<table>
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<th>Current account / GDP</th>
<th>Estonia</th>
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<th>Lithuania</th>
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Are Baltic currencies 100% safe?

**Pros:**
- **Political commitment very strong**
  - In Estonia a changing of currency’s values a very slow process
- **Price of the devaluation very high**
  - Most of the loans in euros
- **Solid banking system**
  - Foreign owned
- **Dependency on local currency loans limited**
  - Interest rates can rise without dramatic consequences to the local citizens and companies
- **Prices and salaries are flexible(?)**

**Cons:**
- **Economies are hard landing**
- **Speculation**
- **Devaluation in one Baltic country would increase devaluation speculations in other countries**
- **No supporting examples, where country in the problems of this scale would have coped with fixed FX rate**
- **Increasing unemployment may erode political commitment**
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