

Strategy Focus

Trading Strategy—SEB Merchant Banking

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Sweden: Election results

More of the same

The Social Democrats remain in power, relying on continued support from the Left and Green parties. Next, we will see some haggling and negotiating between the SDP on the one hand and the Green/Left parties on the other regarding the forms and conditions of co-operation. The result will be a slightly more important position for the Greens – but they will not be allowed Government posts. The conclusion for economic policy will be more of the same. The present fiscal policy stance remains, as will the EMU timetable. Autumn of 2003 is the most likely date for a referendum. The uncertainty risk premium on Swedish assets should decline.

Parliamentary election. Results.

	2002 %	2002 seats	1998 %	1998 seats
SDP	39.9	144	36.4	131
Left Party	8.3	30	12.0	43
Greens	4.5	17	4.5	16
Sum				
SDP/L/G	52.7	191	52.9	190
Moderates	15.1	55	22.9	82
Liberals	13.3	48	4.7	17
Christian Democrats	9.1	33	11.8	42
Centre Party	6.2	22	5.1	18
Sum Non-socialists	43.7	158	44.5	159

Note: The per cent sum does not add up to 100, because of stray votes to other, smaller parties below the 4 per cent threshold. The last Postal votes have still not been counted.

The total outcome is very close to the election result from 1998, except for voter shifts within the two blocs. Among the Non-socialist parties, the Liberals have

grown strongly at the expense of the Moderates (Conservatives); within the left bloc, the SDP has gained at the expense of the Leftists. Thus, the outcome means a weaker position for the extremes in Swedish politics. In particular, the Moderates have suffered a stunning defeat. But the division between the blocs has hardly changed at all. The Social Democrats, Greens and Leftists maintain the majority over the Non-socialist bloc.

What next?

The Speaker of the Parliament now will go to the leader of the SDP, PM Göran Persson, and ask him to form a new Government. Mr Persson will then ask Parliament to vote on his proposal. This takes place on October 1, as Parliament reconvenes after summer recess. For the new Government to get acceptance there must not be a majority of No-votes. Since the Non-socialists will vote against a new SDP Government, **Mr Persson consequently must gain active or passive support from the Left and the Greens.** This is exactly the same task he faced after the election in 1998. At that time, he secured support from the Left and Greens because these parties viewed a SDP Government as more acceptable than a Non-socialist Government. They were not, however, allowed seats in the Government.

During the election campaign, the Greens in particular have expressed frustration over

this situation. They have said that they will not support a new SDP Government unless they get Cabinet posts. Also the Leftists have shown frustration over having been closed out from the Government. Mr Persson, on the other hand, has shut that door, claiming it is impossible for a SDP Government to include parties that want to take Sweden out of the EU and have a radically different view on foreign policy and the war on terror. The response of the Greens to this unequivocal statement from the PM has been to retreat from their initial tough stance; in the final stages of the campaign they simply asked for negotiations, but not explicitly for Cabinet posts.

What form of Green influence?

We believe this conflict will be solved after a rather short chicken race. **It is impossible to conceive of a situation where the Greens and Leftists would support a Non-Socialist Government before a SDP minority Government.** This holds in particular for the Left, which under no circumstance can afford to be viewed as the ones who set the stage for a rightist Government.

The Greens are in a stronger negotiating position, as they formally stand outside the traditional right-left division in Swedish politics. Hypothetically, they could even be midwife to a Non-Socialist Government, since the sum of their Parliament seats and the seats of the Non-socialist parties exceed that of the SDP and Left. But for the Greens to shift horses now, after all the discussion of how to organise co-operation with the SDP would be extremely unlikely.

In our view, the most likely outcome is that **the Greens eventually will give the SDP support** – after having achieved promises from Mr Persson that they will be able to

exert a certain influence on Government policy.

Such a compromise can be shaped in many ways and touch both on organisation and policy.

- One possible solution would be to give the Greens **“observation positions”** in e.g. the Ministry of Finance and the Ministry of Environment, where the Greens could place one or two persons to get more involved in negotiating. This was the solution chosen during the period of the mid-90s when the SDP allowed the Centre party to place their own people in the MoF. Exactly which positions and which level of influence should be settled within a few weeks – before the vote in Parliament.
- As regards politics, the Greens will probably demand a **tougher stance on the closing of nuclear power and on global warming** before accepting to give support to a SDP Government. They will not, however, ask for a softer fiscal stance; on the contrary, they have shown strong support for a firm fiscal policy.
- The Greens are against Swedish EU and EMU membership, but they will not be able to have an impact on Government policy in those issues, since the euro issue will be settled by a special referendum, probably next autumn.

We conclude that a parliamentary majority will accept a new SDP minority Government when Parliament reopens on October 1. There will almost certainly be a **reshuffling of the Cabinet**, with several new names. Such changes should not, however, be given a great political importance; Mr Persson will be the man in charge irrespective of which people he appoints to the different Cabinet posts.

Economic policy

The economic policy challenges for the new Government will look exactly as those we see today:

- The Government must as soon as possible launch a credible and tough program to **lower sick leave and absenteeism**, the rapid rise of which adds to public expenditure and creates supply restrictions on the labour market. This will imply closer co-operation between health care and health insurance, more pressure on doctors not to allow sick leave benefits as generously as today, etc – but in the long run also probably lower benefit levels.
- They must in the autumn budget present credible measures to **cut public expenditure** next year, in order not to breach the expenditure ceiling.
- Longer-term, the main challenge is to **modernise the Swedish tax system**, making it work in a globalised economy with mobile tax bases. The SDP has to overcome its ideological aversion to lower capital taxation in order to promote growth and capital formation.
- Finally, during the election period there will be a **referendum on EMU**, followed by the Swedish krona's entry into the ERM, and then into the currency union.

We do not expect any change in the fiscal policy stance because of the election. With the rather gloomy growth outlook of SEB Economic Research, the budget surplus of this and next year will not reach the targeted 2 per cent of GDP; it will be around 1½ per cent. On the other hand, the Swedish budget position still will be strong compared to that of most other European countries. The same goes for the expenditure ceilings. The Government stands a good chance of keeping public expenditure below the ceiling – but this will

probably to a large extent be achieved through one-off items and measures which border on cheating (such as renaming intra-Government transfer payments “tax rebates”). In the long term this gradually undermines fiscal credibility, but in the near term Swedish expenditure control does not seem worse than in most other European countries.

We do not expect any wealth or income tax cuts in 2003. However, **by 2004, the external and political pressures for tax cuts will have increased sharply**. We expect both wealth and income tax cuts to be implemented by then, also by a SDP Government. It should be noted that the Government in this case is not dependent on Green/Left support, since there will be strong support from the Non-socialist parties for such cuts.

EMU time table in place

With a SDP minority Government, our previous analysis of the EMU timetable still holds. **The most likely date for a referendum is the autumn of 2003**, with an ERM entry thereafter and currency union membership in 2005.

However, those who expect a rapid announcement of a referendum date now that the election is over will be disappointed. It will take some time during the autumn to take the next step in the discussion of buffer funds and for the SDP to formally assess the criteria set up by the PM (is the Swedish economy in phase with that of the euro zone? What about wage formation?).

Thus, we do not expect serious discussion among party leaders on a referendum date to take place until after a couple of months – and the decision then may very well be not to have a referendum during the spring

but to continue the discussion on a specified autumn date at a later stage.

There is a strong pro-EMU majority in Parliament, but it would be utter folly for this majority to set a referendum date long in advance, since this opens the door for unexpected swings of opinion during the campaign. A more likely strategy is to wait for as long as possible to set a date, calling it when opinion polls show a strong and stable Yes majority and then go for a rather short, intensive campaign period.

Consequently, we stick to the autumn of 2003 as the most likely time for the referendum, but still issue a warning that opinion swings during the coming months could well postpone that date.

Conclusions for financial markets

A minor uncertainty regarding the conditions for Green support to a SDP Government may remain for another week or two. If the political forecast given here is correct, however, the small **interest rate risk premium due to uncertainty of the election outcome should disappear** rather quickly. The same goes for the krona: As we are now back on the EMU track, the **election outcome should be favourable for the SEK**.

Post scriptum: A speculative longer-term outlook

We have assumed that the SDP once again shapes a minority Government, with support from the Greens and the Left. However, tensions in such a co-operation could grow during the election period. External pressure from globalisation will sooner or later put tax cuts on the agenda again, in particular as regards the wealth tax. Also, the adaptation of economic policy to the currency union will not be popular with the Green and Left grass roots.

At the same time, the Non-socialist parties will go through a soul-searching period. The Moderates (Conservatives) may decide to change the party leadership after the painful defeat. The Liberals have performed well and there will be a struggle over the leadership of the Non-socialist voters. Also, the Left party is likely to change its leader during the next Parliament.

As a result, it is not totally inconceivable that there will be ruptures within both blocs during the election period. A new governing coalition could emerge, with the SDP, the Liberals and Centre party forming a Centre-Left Government. This is not on the cards right now and is perhaps only a silly wish from yours truly (who thereby reveals his own preferences); nonetheless, the election result – which strengthens the middle of Swedish politics and weakens the extremes – actually makes such a long-term development possible.

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