

Strategy Focus

Trading Strategy—SEB Merchant Banking

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Sweden: Political insights

Swedish “pytt i panna”

“Pytt i panna” is a Swedish dish where chopped meat is mixed with chopped potatoes – in other words a real mess. That’s pretty close to the chicken race now taking place in Swedish politics before the opening of Parliament and the policy declaration of the new government on October 1. However, we believe there is a good chance that the mess will be short-lived. Even though they may have to live through a vote of no confidence, the SDP will probably next week - once again – form a minority Government, with or without Green support. If so, there is actually a possibility that the EMU referendum will be held as early as the spring of 2003.

A recap

Firstly, a recap: The Greens have refused to give the SDP the kind of support they gave in the previous Parliament without the concession of Cabinet posts. The SDP has refused to agree, claiming that such a Government (which also would have to include Left Party Cabinet members) would be too divided over foreign policy. In response, the Greens have opened negotiations with the Liberals, Christian Democrats and Centre Party in order to exploit the opportunity presented by an “unholy” coalition. In response to that move, the SDP has offered political concessions to the Greens so that in exchange for parliamentary support the Greens would secure the imposition of higher energy and environmental taxes, stricter animal protection laws, a more rapid dismantling of nuclear

power and observation posts in key ministries – but no Cabinet posts.

On Wednesday, the Greens rejected this offer, instead toughening their own negotiating stance by asking not only for Cabinet posts but also the chair of the Parliamentary Finance Committee(!). The PM, Mr Persson, regarded this demand as totally frivolous and broke off negotiations. He did not want, he said, to engage in a “bidding war” with the Liberals.

Therefore the only current negotiations are those between the Greens on the one hand and the Liberals/CD/Centre on the other. These negotiations must be completed before the weekend, when the Green party board meets. Also, the Liberals have announced that the weekend also marks their deadline. On Monday, September 30, Parliament opens and a Speaker is to be elected. On October 1, the PM makes his Government policy declaration and presents the new Government. If this Government receives more No votes than Yes votes, then he will have to resign and the Speaker would then have to try to form a new Government which enjoy greater Parliamentary support.

Four options

Four options exist at present and we enumerate them in descending order of probability:

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1. The Greens as king-makers

The Greens may decide not only to abstain from supporting a SDP government but also to abstain from giving support to a Non-Socialist government – after finding that political disagreements with the Liberals et.al are too stark. In this situation, the SDP would remain in power by default; even though short-term developments may have to be messy and include a vote of no confidence. Their number of seats in Parliament, including support from the Left amount to 174. The Non-Socialists would get 158 and the Greens would be king-makers with 17 seats.

This solution would give the Left increased importance in their supporting role. It would also seem to put the Greens in a stronger position than they enjoy currently, since they could defeat the Government by voting together with the Non-Socialist bloc. This would create initial nervousness on financial markets.

However, we believe this situation would not be so very different to that prevailing in the previous Parliament. The SDP budget proposals would still in all likelihood survive Parliamentary ballots: according to the Constitution the entire opposition – from Conservatives to Greens – must unite around one common budget proposal (which seems unlikely) in order to defeat the Government's budget. So after the situation had calmed down, we would actually return to a situation fairly similar to that prevailing in the previous Parliament.

This solution would also mean an EMU referendum in 2003. Therefore the SEK would strengthen and bond yield spreads eventually fall, although it would take some time before ballots in Parliament would be able to confirm the return to stability.

2. The Greens step back

The second alternative would be that the Greens find that they cannot find common ground with the Liberals et.al. In this case they may decide to back down from the tough attitude they have adopted towards the SDP, accept the bid from the SDP and decide to remain outside the Government. In that case, the SDP would continue in power, with the support of the Greens and the Left and enjoy a parliamentary majority of 191 seats (for SDP + G + L) to 158 seats for the Non-Socialist opposition. This would closely resemble the situation in the previous Parliament, albeit with somewhat stronger political concessions from the SDP to their Green partner.

In this case, financial markets would conclude this is "more of the same". The current budget policy rules and restrictions would also apply in the next Parliament. The EMU issue would be handled in a separate referendum in 2003. The election risk premium on bond yields would subside to levels prevailing before election uncertainty took hold. The SEK would strengthen, as the EMU issue came back on track.

The likelihood of this scenario has however decreased during the last couple of days. Many harsh words have been said between the Greens and the SDP, while animosity between the two parties continues to make it more difficult for them to shake hands and save face. It would also imply that the Green Party board, when it meets on Sunday, would totally reject the way their own Party leaders have handled negotiations so far.

3. A Green/Liberal coalition

The Prime Minister has thrown the ball into the laps of the Greens on the one hand and the Liberals/Christian Democrats/Centre

Party on the other. The negotiations between these four parties will proceed – with the hypothetical end result of a coalition Government. This is the third alternative, and is less likely than an SDP minority Government.

A coalition Government with G+L+C+CD would control only 120 seats in Parliament, compared to 174 seats for the SDP's and Left combined. Such a government would therefore be totally dependent on support from the Conservatives with 55 seats. Even in this case it would have to maintain complete discipline with not a single MP from any party (including the Conservatives) deviating from the common line.

Also, such a Government would be characterised by internal strife. The various parties have diametrically opposed views on foreign policy, child care, taxes, energy policy, EMU, EU, etc etc. Therefore such a Government would be highly prone to internal crises. The risk premium from financial markets would be high for two reasons: Firstly, because of the uncertainty surrounding such a creature's tax and fiscal policy and secondly because this Government may decide to postpone an EMU referendum because both the Centre Party and Greens oppose Swedish euro accession, the Christian Democrats are lukewarm, while the Liberals are strongly in favour. To postpone the issue would be the easiest way out.

All in all, the likelihood of such a coalition coming to power is low – although not wholly impossible at present.

4. Mayhem

There is, of course, also the (low) risk that none of these scenarios occurs. Maybe the parties block each other even in the election

of a Speaker when Parliament reconvenes. Maybe the PM will be defeated by a vote of no confidence, and maybe the new Speaker will fail to find a new PM who is acceptable to Parliament. In that case, a snap election may be called. The result of such an election is impossible to call, but we surmise that the voters would punish those they saw as guilty of manoeuvring and bickering. The blame game will therefore be crucial and maybe – maybe – in that eventuality the SDP would gain by presenting itself as the more stable Government. Maybe such a chaotic situation may even open up new combinations, where old fault lines can be crossed. But this is merely speculation.

What next?

We think it unlikely that there will be any news before the weekend. The Greens and the Liberals/Centre/CD parties must continue their negotiations. Therefore the next couple of days will see more pytt i panna, adding to the nervousness of financial markets. If our assessment is correct, the parties negotiating over the weekend will conclude that they cannot form a Government. Therefore the Speaker will next week – when push comes to shove – ask Mr Persson to form a new minority Government, even though this new government may have to go through a vote of no confidence.

In that event the EMU referendum will take place during 2003. And just to round off on a slightly different note: in this event the chances of an early Spring vote may actually increase with a new SDP Government. The blue collar workers' trade union Chairperson, Ms Lundby-Wedin, whose support is crucial for the SDP, has declared in two recent interviews that she prefers a Spring referendum – provided that the new (SDP) Government has at that time presented proposals for "buffer funds" in

order to protect employment against asymmetric shocks. Maybe, if Mr Persson is able to retain his grip on power, he may attempt to push this issue through, once and for all...

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