Sweden bails out banks as economy enters recession

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On October 20, Sweden’s Alliance government announced a massive sum would be made available to bail out the banking sector. Some 1.5 trillion kronor (approx. $200 billion) was set aside to provide loans to financial institutions with liquidity problems.

Whilst maintaining that Sweden’s banks are well placed to deal with financial turmoil, the government noted in its statement revealing the proposal: “The stability plan gives the government a mandate to manage problems such as liquidity shortages or potential solvency problems in the future, under predictable forms and where taxpayers' interests are protected.”

The financial sector could not hide its enthusiasm for the proposal, with chief analyst at SEB Bank Henrik Mitelman commenting, “This is a very ambitious guarantee programme, which is going to soothe concerns in the financial sector.”

Just a week after announcing the measures, Carnegie became the first bank to avail itself of government support when it agreed a 5 billion kronor loan from the Riksbank. The loan followed a day in which Carnegie’s shares had lost over half their value, precipitated by reports that Finansinspektionen (the Swedish financial supervisory authority) was investigating the bank. Having recently announced third quarter losses of 500 billion kronor, fears are increasing about the degree of the bank’s exposure to the growing global dangers.

Other banks are possible candidates for government aid. Swedbank suffered substantial losses following Lehman Brothers’ demise. SEB Bank is thought to be threatened with considerable losses since it operates a large business in the Baltic states, particularly Estonia and Latvia, which are now in a deep recession. In August, the IMF warned SEB and Swedbank that their investments in the Baltics threatened to trigger a “credit crisis” in Sweden.

The legislation presented by the government remained vague on what form financial support would take, leaving open the possibilities of direct loans or the purchasing of shares by the state, meaning that as in Britain, the government could become a part-owner of some of the country’s largest banks. The measures received the ascent of parliament on October 28, with only the Left Party voting against the proposal. The main opposition Social Democrats abstained from the vote, but the measure received the backing of all four governing parties (Center, Liberal, Christian Democrat and Moderate)

The turmoil on financial markets has been accompanied by figures showing an economic slowdown. To combat this, the Riksbank has in the course of three weeks cut interest rates by a full percentage point to 3.75 percent. On October 8 it joined with a number of other central banks, including the European Central Bank, in announcing a 0.5 percent cut. Then on October 22, with mounting indications of falling output and rising unemployment, the bank issued a further 0.5 percent reduction. Prior to this, the Riksbank had been increasing interest rates in order to combat rising inflation, which at its peak had reached 4.4 percent, well above the 2 percent target.

As concern grew about the impact of the financial crisis on Sweden, the Riksbank entered into a swap agreement with the Federal Reserve in the United States to ensure access to $10 billion of funds which could be made available to Swedish banks. In his statement on the deal, Riksbank governor Stefan Ingves emphasised that Sweden could not avoid the fallout from the global crisis. “Sweden has been affected by the renewed wave of international financial unrest,” he said. “This agreement is a part of our precautionary measures and provides the Riksbank with additional flexibility to provide US dollar liquidity if the need should arise.”

The krona has weakened substantially against other major currencies, falling below 10 kronor to the euro for the first time since the euro began trading. Economists have attempted to downplay this development, declaring that in times of economic uncertainty it is common for investors to move away from smaller currencies to larger ones and claiming that nothing in Sweden was fundamentally wrong. But there is data appearing all the time showing slowing economic growth and companies revealing losses and announcing job reductions.

Having announced a fall in third quarter pre-tax profits of 44 percent compared with the same period in 2007, Saab revealed plans to cut 500 jobs over the coming two year period to cut costs. Volvo has also been affected by weakening demand for cars across Europe, with sales falling by 11 percent in the first nine months of 2008. It was the next major Swedish company to announce job cuts, revealing that 600 workers would be laid off. Unemployment in Sweden is currently around 6 percent and is expected to rise to nearer 7 percent in the immediate future.

There is also a severe slowdown in the housing market. A recent survey showed that an overwhelming number of estate agents believed that prices for apartments and houses had fallen substantially in the July to September period, particularly in the Stockholm area. Prices for apartments were down by three percent across the country while in Göteborg they have fallen by as much as five percent. Additionally, a report from the state organisation Boverket suggests that new housing projects will decline by 40 percent by the end of the year. They have already been cut in half compared with 2006 levels.

Household debt is on the rise. In the first quarter of the year, Swedish households lost a total of 300 billion kronor in wealth, with 45 billion being withdrawn from savings accounts, most of which went to maintaining levels of previous consumption.

As ordinary people are exposed to the crisis, the attitude of the government has been clearly demonstrated. In September it announced plans to slash corporate tax rates by 1.7 percent from 28 percent in order to create better conditions for business. Christian Democratic leader Göran Hägglund in a recent party leaders' debate claimed that the measure was necessary to prevent further job cuts by lessening the burden on business. Jan Bjorklund, leader of the Liberals (Folkpartiet), made it clear that the government was concerned primarily with attracting foreign investment when he declared, "Corporate tax is one of the taxes which large companies really study when they plan to set up business somewhere."

The budget presented to parliament at the end of September contained 16 billion kronor in tax cuts for business, as well as a 15 billion kronor package of tax cuts and credits to stimulate employment. The tax cuts for business are designed to reduce employers’ contributions towards employees’ social security and other forms of support, while the 15 billion kronor package contains tax rebates intended to encourage people to take up low paying jobs.

Growth figures contained in the budget were revised downward to reflect the gloomy outlook for the coming two year period, with economic growth in Sweden not expected to climb much higher than one percent next year. In the second quarter of 2008, GDP virtually stalled, increasing by only 0.7 percent year on year.

The economic instability is having a negative impact on the government's privatisation drive, a plan to sell off state shares in six companies to raise 200 billion kronor by 2010. Since coming to power, the Alliance has already sold Vin & Sprit, Vasakronen, and some of its stakes in Telia Sonera and the stockbroker OMX. But plans to sell mortgage lender SBAB and a 20 percent share in Nordea bank look set to be shelved. "It is the wrong time to sell," said a senior investment banker. "I don't think they will be able to sell SBAB at a price that would be acceptable for Swedish voters."

Sweden has so far been able to avoid making major cutbacks to social spending as a result of the economic downturn, primarily because it has been running a budget surplus in recent years. With the commitment of over a trillion kronor to the banks, this situation will change. The only way in which the government could fund such a vast sum would be to initiate swingeing cuts across the board in social programmes and public spending.

Since the bailout plan was announced in the US, a number of stories have appeared in the press claiming that the most effective method to deal with the current danger would be to follow the approach taken by Sweden in the early 1990s to its banking crisis. Such articles have claimed that governments should use taxpayers’ money to buy shares in any bank which finds itself in trouble. Then, when the situation improves, the shares can be sold to recoup the government funds.

In an article in the *Washington Post* of October 10 entitled “Our new Capitalist Model: Sweden,” Andrew Zvirzdin wrote, “Sweden is happy to help out. After all, they successfully navigated through their own bank crisis in the early 1990s. During a comparable period of loan defaults and failing banks, the Swedish government intervened dramatically and quickly by assuming control of certain bank assets while also receiving equity shares in the banks. As the crisis passed, the equity shares in the banks were sold, toxic assets were liquidated, and the government recouped most of the taxpayer cost of the bailout. Most importantly, the moves restored faith in capitalism and the banking system.”

These arguments ignore one fundamental difference. Following the near collapse of its banking system in the early 1990s, the Swedish government was only able to make back its losses due to an economic upswing. This was facilitated above all by the opening up of markets in Eastern Europe in the aftermath of the collapse of the Soviet Union and the growth of the major economies in Europe. The current crisis is not, as was the case in the early 1990s, primarily a regional problem affecting the Scandinavian countries. Rather, capitalism confronts a global crisis, with no prospect of an upturn in the world economy for years to come.