

ARTICLE – Two alternative scenarios for the development of the economy

To illustrate the great uncertainty surrounding the main scenario, this article presents economic development in two different scenarios. In one scenario, a new, greater wave of infection arrives later this year, leading to restrictive measures in society becoming more severe than at present. This leads to a new decline in economic activity in Sweden and abroad. The scenario also assumes that the downturn weakens the Swedish housing market and that output in the longer term is affected by increasing numbers of bankruptcies, a slower decrease in unemployment and further restraints on investment. Compared with the main scenario, it therefore takes significantly longer for the economy to return to its pre-crisis level.

In contrast, the other scenario involves recovery taking place more rapidly than in the main scenario. The assumption here is that infection falls to very low levels in the autumn and that social life largely returns to normal at the same time as sentiment among households and companies improves rapidly. Together with continued large economic policy stimulation, this may help recover the fall in production in the second quarter sooner than in the main scenario.

A technical assumption in both scenarios is that monetary policy is the same as in the main scenario, but the Riksbank is always prepared to act if economic and inflation prospects should change. However, a more rapid upturn in the economy would not automatically give reason to make monetary policy less expansionary in different ways.

The corona pandemic continues to dominate the risk outlook

The corona pandemic continues to hold social life in its grip and, as in the spring and summer, the pandemic is dominating the risk outlook and making forecasts for economic development highly uncertain. There is a clear risk of the spread of infection increasing again, as illustrated by developments in several European countries recently. Restrictions and voluntary limitations on social life to reduce physical contacts could then hold back economic development to an even greater extent than they are doing at present. On the other hand, the number of people in intensive care and numbers of coronavirus-related fatalities have fallen in several of the countries that were badly affected in the spring. The recovery going forward will therefore largely be determined by what happens with the spread of infection, whether any increase in the infection rate leads once again to more intensive care admissions and deaths, and how much social life is affected.

Developments have been roughly in line with the Riksbank's main scenario in July

Economic developments abroad over the summer have overall been in line with the picture that the Riksbank

presented in the main scenario in July, even if the restrictions on social life have not been lifted to the extent that the main scenario assumed. GDP abroad and in Sweden fell sharply during the first six months of the year, but output has started to recover and indicators of short-term growth indicate that the upturn is continuing.

Two scenarios for the development of the economy

To illustrate the substantial uncertainty surrounding the main scenario in Chapter 3, two alternative scenarios for future developments are presented here. The alternative scenarios resemble those in the July report in the sense that they are based on more optimistic and more pessimistic assumptions than the main scenario as regards the spread of infection and the effects of the measures implemented to restrict it. They also illustrate how the recovery may look if the crisis has long-term effects on the economy.

The first scenario assumes a new wave of infection later this year in both Sweden and other countries. Restrictions and voluntary limitations on social life therefore increase again, causing a new economic downturn. The second scenario instead illustrates a more favourable development both in Sweden and abroad, where the spread of infection and restrictions fall to very low levels in the autumn, forming

the basis for a faster economic upswing than in the main scenario. The main conditions for the scenarios are summarised in Table 3:1. Diagrams illustrating the development of the economy in scenarios can be found at the end of the article, as can tables showing annual mean values (see Tables 3:2 and 3:3).

Table 3:1. Summary of the assumptions in the scenarios

Scenario with a second wave of infection
<ul style="list-style-type: none"> • The degree of immunity is low and infection rises at the end of 2020. • New restrictions and voluntary limitations on physical contact affect social life both in Sweden and abroad. • Major stimulation measures by governments and central banks support growth but cannot prevent a new economic downturn. Additional monetary policy measures may also need to be implemented. • A more protracted period of low economic activity leads to more bankruptcies, long-term higher unemployment and reduced investment, affecting output in the longer term. • Higher unemployment and more pessimistic sentiment affect the Swedish housing market, where prices fall and new construction declines.
Scenario with faster economic upswing
<ul style="list-style-type: none"> • The spread of infection falls to very low levels over the autumn and has basically stopped by next year. • Social life returns to normal to a large extent and sentiment rapidly improves among households and companies. • Continued economic policy stimulation supports the recovery. Price rises on the financial markets also contribute to increasing demand and the funding situation of companies improves. • The downturn in economic activity over the spring of 2020 has minor or no effects on long-term production capacity. • House prices continue to rise.

Note. Both scenarios have been made under the technical assumption that monetary policy in Sweden will be the same as in the main scenario in Chapter 3.

A second wave of infection causes economic activity abroad to fall significantly again this year

The alternative scenario with a second wave is based on the assumption that infection rates increase noticeably later this year. Even if the outbreak is not as large as in the spring, it is assumed to be comprehensive enough for restrictions on social life to increase again, rather than staying more or less unchanged over the rest of the year as the main scenario assumes.

Compared with developments in the spring, a new wave of infection would probably not have as large negative effects on GDP growth in the United States and euro area. Measures to limit the spread of infection will probably be less comprehensive and preparedness for the coronavirus is also higher. However, it will disrupt output and affect households negatively. Economic activity abroad therefore decreases significantly again towards the end of the year. Inflation will also be substantially lower than in the main scenario due to resource utilisation becoming weaker.

The second wave of infection holds the Swedish economy back and a downturn on the housing market burdens growth further

The significant decrease in economic activity abroad towards the end of the year affects Swedish exports negatively. In addition, greater restrictions on social life entail decreased demand, and sentiment among households and companies deteriorates again. Overall, this leads to a new fall in GDP in Sweden in the fourth quarter of the year (see Figure 3:32). However, as restrictions abroad are assumed to be less comprehensive than in the spring, the fall is not as great as in the second quarter. In this scenario, GDP decreases by 4.9 per cent in 2020.

The scenario assumes that infection rates decline in 2021 and that restrictions on social life are thus eased next year. However, the long period of very low activity in the economy in this scenario puts companies under further pressure. Bankruptcies therefore increase and unemployment continues to rise to about 12 per cent (see Figure 3:33).

Reduced economic activity and more redundancy notices probably contribute towards the housing market being affected more negatively than in the spring. Housing prices and housing construction are therefore expected to develop more weakly in 2021 in this scenario, compared with the main scenario. Output in the long-term is also affected more, as bankruptcies become more and investments fewer. Even three years ahead, the level of GDP in this scenario is lower than in the main scenario (see Figure 3:32). The number of unemployed people losing their connection to the labour market probably also increases, meaning it takes longer for unemployment to fall (see Figure 3:33).

The new downturn in economic activity restrains price increases. In the scenario with a second wave, inflation becomes significantly lower than in the main scenario, above all in the year ahead (see Figure 3:34).

The scenario has been formed under the assumption that both fiscal and monetary policy are the same as in the main scenario. If a second wave of infection were to arrive and economic activity fall again, it would seem reasonable to expect economic policy measures to be expanded to provide further support for the economy. In a new downturn, the fall would therefore probably be smaller than the scenario indicates.

Demand in the economy can be effectively supported with fiscal policy, as public finances in Sweden are strong and interest rates are low. Monetary policy has plenty of scope to manage problems that might arise on the financial markets, such as poorer credit supply or rising risk premiums that push up interest rates charged to households and companies. The repo rate could also be cut if it is judged effective, especially if confidence in the inflation target was under threat. To give the economy the best support, the interplay of monetary policy and fiscal policy is important.

Low infection rates and decreasing restrictions in the autumn allow faster economic upswing

A more optimistic scenario than in the forecast described in the main scenario is that the spread of the coronavirus slows down to very low levels in the autumn and largely disappears next year. This could involve social life relatively rapidly returning to normal to a large extent and sentiment among households and companies improving, both in Sweden and abroad. Shocks to companies' output then become ever smaller at the same time as demand steadily increases and companies resume investment. An expansionary monetary policy and the major fiscal policy stimulation measures launched contribute to increasing demand.

In this scenario, activity in the economy could rise rapidly and output increase substantially in the second half of this year, both abroad and in Sweden. For Sweden, this could involve GDP returning to the same level as before the crisis as soon as the end of the year (see Figure 3:32). In 2020, GDP decreases by an average of 3.3 per cent but growth then increases markedly in 2021. Even though the sharp economic downturn in the spring leads to bankruptcies and rising unemployment, the relative rapid upturn means that the effects on output in the long term will be relatively moderate. In this scenario, unemployment falls steadily and approaches the pre-crisis level significantly more rapidly than in the main scenario (see Figure 3:33).

A faster economic upswing will also cause inflation to rise at a faster pace

Larger price increases abroad, combined with ever higher domestic demand, improvements of the situation on the labour market and growing cost pressures in companies, will contribute to inflation in Sweden rising faster towards the target of 2 per cent (see Figure 3:34).

In the scenario, inflation is very close to the inflation target towards the end of 2022 and the rate of increase will probably not slow down after that. However, apart from a temporary peak next year, inflation will be below 2 per cent until then. Furthermore, it takes time for unemployment to come down to more normal levels. Even if developments could thus be stronger than in the main scenario, it would not be a reason to make monetary policy less expansionary in different ways.

Table 3:2. Scenario with a second wave of infection

Annual percentage change, annual average, calendar-adjusted data

	2020	2021	2022
CPIF	0.4	0.7	1.1
GDP	-4.9	1.2	5.4
Unemployment, 15–74 years*	9.2	10.9	9.3
No. of employed, 15–74 years	-2.4	-1.5	2.3

*Per cent of the labour force

Sources: Statistics Sweden and the Riksbank

Table 3:3. Scenario with faster economic upswing

Annual percentage change, annual average, calendar-adjusted data

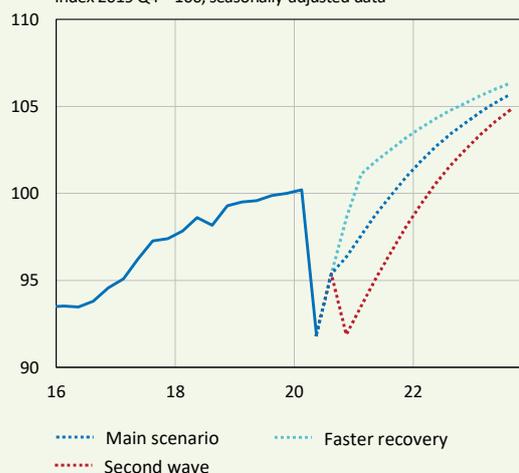
	2020	2021	2,022
CPIF	0.6	1.7	1.5
GDP	-3.3	6.0	2.3
Unemployment, 15–74 years*	8.5	8.2	7.6
No. of employed, 15–74 years	-1.6	1.0	1.5

*Per cent of the labour force

Sources: Statistics Sweden and the Riksbank

Figure 3:32. GDP

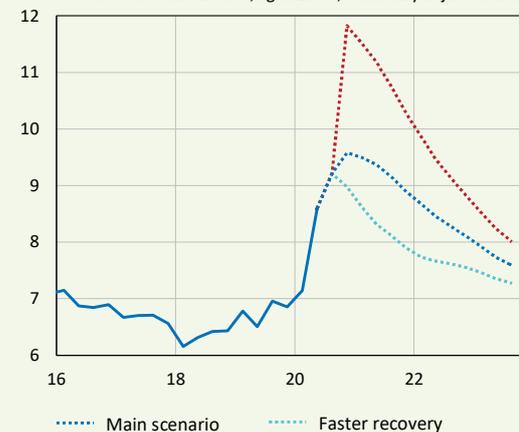
Index 2019 Q4 = 100, seasonally-adjusted data



Sources: Statistics Sweden and the Riksbank

Figure 3:33. Unemployment

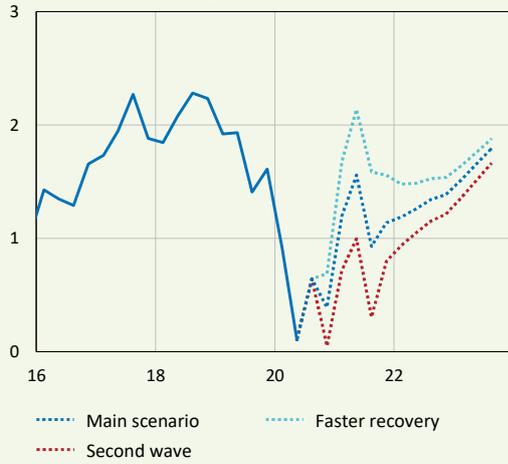
Per cent of the labour force, aged 15–74, seasonally-adjusted data



Sources: Statistics Sweden and the Riksbank

Figure 3:34. CPIF

Annual percentage change, seasonally-adjusted data



Sources: Statistics Sweden and the Riksbank