ARTICLE – Economic development according to two alternative scenarios

This article presents two scenarios for future development to illustrate the great uncertainty surrounding the main scenario set out in this report. One scenario assumes that there will be a new, larger wave of infection later this year and that restrictions on society will again become necessary, affecting economies abroad and in Sweden. A new downturn in economic activity is assumed to entail a development in which the Swedish housing market is clearly weakened, weighing down the recovery. In the longer run, output is also affected by bankruptcies increasing, unemployment falling more slowly and investment being restrained further. Overall, in a scenario with a second wave, the recovery will proceed significantly more slowly than in the main scenario. In contrast, the second scenario entails a faster recovery than in the main scenario. One important condition for such a development is that restrictions on society can be eased increasingly over the summer in Sweden and internationally, and that the spread of infection stays on a low level over the autumn and winter. The heavy downturn in the second quarter of the year may then be followed, in principle, by an equally large upturn in the second half of the year. The recovery will then continue at a good pace next year, supported by rapidly improved sentiment among households and companies.

In its Monetary Policy Report in April, the Riksbank presented two scenarios, two conceivable paths that the economy could take. One scenario assumed that the spread of the infection is decreasing and that some restrictions on the life of the community will start to be eased relatively soon, with more substantial easing to follow in the summer. The other scenario assumed that the measures to limit the spread of infection would remain in place to a significant extent over the summer. Both scenarios involved the return to a normal situation for the economy being relatively lengthy. In addition, development in the second scenario was assumed to be worsened by a clear downturn on the Swedish housing market and greater long-term effects on the economy.

Since the previous monetary policy meeting, two months have passed and it has become slightly clearer how the coronavirus crisis has affected economic development, even if the National Accounts for the second quarter have not been published yet. As Chapter 3 describes, the economy abroad has been hit hard and the economic downturn in March and April was greater in the euro area than the scenarios in the Monetary Policy Report in April had assumed. At least so far, however, the recovery abroad seems to be proceeding slightly faster than expected since May, as more countries have started to ease restrictions on society.

In Sweden too, various indicators show that the economy was hit hard by the coronavirus pandemic during the spring. The labour market has developed in line with the scenarios in the previous Monetary Policy Report. However, the fall in GDP in the second quarter does not seem to have been fully as large as the scenarios assumed.

Continued great uncertainty over developments in the period ahead

The approximate magnitude of the economic downturn in the second quarter is thus starting to become clearer. However, future development is still very uncertain. As previously, this is mainly due to it being very difficult to to know how rapidly restrictions will be eased over the coming months, both in Sweden and internationally. As long as there is no vaccine and a sufficiently large proportion of the population has not developed immunity to the virus, there is a clear risk that the spread of infection will increase again and that this will be followed by new shutdowns and restrictions to limit physical contact.

Two scenarios for economic development in the period ahead

This article includes two scenarios for future development. The scenarios illustrate the great uncertainty surrounding the main scenario presented in this report, both as regards the spread of infection and the effects of the measures taken 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 that a new, larger wave of infection will occur later this year and that new restrictions will be imposed on society, which will again hit economies abroad and in Sweden. The second scenario instead illustrates a more favourable economic development, both in Sweden and abroad, in which the heavy downturn in the second quarter of this year is followed by a faster upturn in the second half of the year 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
• Second wave of increased infection in the United States and Europe in the fourth quarter of 2020. No major outbreaks in 2021. • After easing in the summer, new measures are introduced to restrict physical contacts when infection picks up again in the fourth quarter. However, these measures are less comprehensive than in the spring. • A more protracted period of low economic activity leads to more bankruptcies, persistently higher unemployment and reduced investments, affecting output in the longer term. • Higher unemployment and more pessimistic sentiment affects the housing market, where prices fall and new construction declines.
Scenario with faster recovery
• Control measures and restrictions on society are lifted increasingly over the summer in Sweden and abroad. • The spread of infection decreases to a low level in the autumn and most restrictions are lifted. • Sentiment among households and companies improves rapidly. • The economic downturn over the spring has a minor effect on output in the long term.

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.

Second wave of infection this year leads to slow recovery abroad

One threat to the development of the economy in the period ahead is the possibility that the recovery will be interrupted by a new wave of infection in the autumn as the influenza season starts. A new outbreak could also take place if the restrictions on society are lifted too rapidly or if infection cannot be held in check.

The alternative scenario with a second wave assumes that, for one or both of these reasons, a new, larger outbreak of infection takes place later this year. The economic recovery from the downturn in the spring is therefore interrupted by new measures to break the spread of infection. The scenario assumes that this happens in the fourth quarter. Developments would essentially be the same if new measures were introduced in the third quarter, but the economic effects described below would then probably occur slightly sooner.

The new wave will probably not affect output in the United States and euro area as seriously as the first wave this year did; see Figure 3:34. This is partly due to preparedness for the coronavirus now being higher and partly due to measures to hinder the spread of infection probably not being as comprehensive as they were in the spring. Just as in the spring, the restrictions are assumed to be in place for a couple of months before they start to be eased again.

The restrictive measures entail shocks to companies' output and weaker demand from households. Economic activity abroad therefore decreases clearly again towards the end of the year. This means that the economic recovery is delayed and it takes until the end of 2022 before output in Europe and the United States returns to the levels prevailing before the coronavirus pandemic. Inflation is lower than in the main scenario. Energy prices fall initially and then normalise, which affects short-term inflation. The weaker resource utilisation affects inflation with a certain time lag, meaning that inflation in the longer term develops significantly more weakly than in the main scenario.

Second wave of infection and downturn on housing market hold back Swedish economy

A new downturn in economic activity abroad means that demand for Swedish export goods and services is dampened. Even if the restrictions introduced in the United States and Europe are not as comprehensive as they were in the spring, they will probably also entail new shocks to transport systems and shortages of intermediate goods, affecting output in Sweden.

The second wave of infection leads Sweden to reintroduce some of the restrictions on travel and measures to reduce physical contact between people lifted over the summer. In addition, sentiment among households and companies deteriorates again, contributing to falling demand.

Overall, this leads to a renewed fall in Sweden's GDP in the fourth quarter of the year; see Figure 3:35. However, this fall is not as heavy as during the spring, as the scenario assumes that the restrictions are less comprehensive, above all abroad. Overall, GDP decreases by 5.7 per cent in 2020. No new, major outbreak of infection is expected to occur next year and a gradual easing of social restrictions will thus be possible in 2021.

It will, however, be a slow recovery in which the combined period of very low economic activity in 2020 weighs down development. The new downturn in demand over the fourth quarter puts companies under further pressure, particularly in the most exposed sectors, leading to more bankruptcies. Unemployment continues to rise to a level close to 11 per cent and does not start to fall until the middle of next year; see Figure 3:36.

As redundancy notices and unemployment again increase in the autumn, sentiment deteriorates, as do households' expectations for their private economies. This probably has greater repercussions for the housing market than were experienced 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. This contributes to the recovery being slower.

The long-term effects on output are also greater in this scenario, as bankruptcies become more and investments fewer. It takes about a year longer for GDP to return to the same level as prevailed before the coronavirus pandemic, compared to the main scenario; see Figure 3:35. It also takes significantly longer for unemployment to fall, which is partly due to the problem of unemployed people losing their connection to the labour market being greater in a scenario with a second wave; see Figure 3:36. This could also mean a weaker development of the labour force than in the main scenario, which would restrain the rise in unemployment slightly.

The new downturn in economic activity, which includes a larger downturn on the Swedish housing market, holds price increases back. In the short term, this development is driven by variations in energy prices, which cause inflation first to fall and thereafter to rise rapidly; see Figure 3:37. However, underlying inflation will be low. CPIF inflation will therefore fall again in the slightly longer term, after which it will rise slowly as activity in the economy increases.

It should be noted that this scenario was developed under the assumption that monetary policy stays the same as in the main scenario. It is probable that the slow recovery of output and the labour market and the weak development of inflation in the scenario would partly be countered with an even more expansionary monetary policy.

More rapid recovery possible given low infection and few restrictions in place in the autumn

A more optimistic scenario than in the forecast described in the main scenario is that the spread of the coronavirus decreases more rapidly and that infection stays on a low level over the autumn and start of next year. For example, this could be the case if methods and programmes for tests, tracing and isolation of new cases are implemented and developed, and turn out to be effective in restraining the spread of infection. Naturally, it would also be restrained if the pandemic were to be weakened or disappear by itself.[27]

Assuming that the spread of infection continues to decrease and stays on a low level over the autumn, measures to restrict physical contacts may be lifted increasingly over the summer and, in principle, be removed by the autumn, both in Sweden and abroad. This allows community life to return relatively rapidly to pre-crisis conditions. Negative production shocks among companies become ever smaller and demand increases steadily.[28] Activity in the economy therefore gets started and a heavy increase in output is seen in the second half of the year in the United States, euro area and Sweden; see Figures 3:34 and 3:35. For Sweden, this means that GDP could return to the same level as before the crisis by as early as the start of next year. In 2020, GDP decreases by 4 per cent on average.

The economic recovery then continues at a good pace in 2021, probably also supported by the rapid improvement of sentiment among households and companies as it becomes clear that the pandemic will no longer affect the life of the community.

Even though the strong economic downturn in the spring brought bankruptcies and rising unemployment with it, the rapid recovery means that the effects on output in the long term become relatively moderate. Unemployment falls steadily and, assuming that economic activity continues to develop strongly, it may return to the pre-crisis level in a couple of years' time; see Figure 3:36. Under the same conditions, once the effects of fluctuating energy prices have worn off, inflation will rise faster towards the target of 2 per cent as the economic situation normalises; see Figure 3:37.

Table 3:2. Scenario with a second wave
Annual percentage change, annual average

	2020	2021	2022
CPIF	0.3	0.9	0.8
GDP*	–5.7	1.0	4.9
Unemployment, 15–74 years**	8.8	10.6	9.7
No. of employed, 15–74 years	–2.3	–1.7	1.6
GDP abroad (KIX2)*	–9.3	4.5	4.9
CPI (KIX2)	0.6	1.1	1.3

*Calendar-adjusted growth rate **Per cent of labour force

Note. KIX2 is the euro area and the United States combined with their respective relative KIX weights (approximately 0.86 and 0.14 respectively).

Sources: Bureau of Economic Analysis, Bureau of Labour Statistics, Eurostat, Statistics Sweden and the Riksbank

Table 3:3. Scenario with faster recovery
Annual percentage change, annual average

	2020	2021	2022
CPIF	0.4	1.7	1.8
GDP*	–4.0	7.0	3.3
Unemployment, 15–74 years**	8.6	8.7	7.5
No. of employed, 15–74 years	–2.0	0.6	2.3
GDP abroad (KIX2)*	–6.9	10.1	2.3
CPI (KIX2)	0.7	1.6	1.7

*Calendar-adjusted growth rate **Per cent of labour force

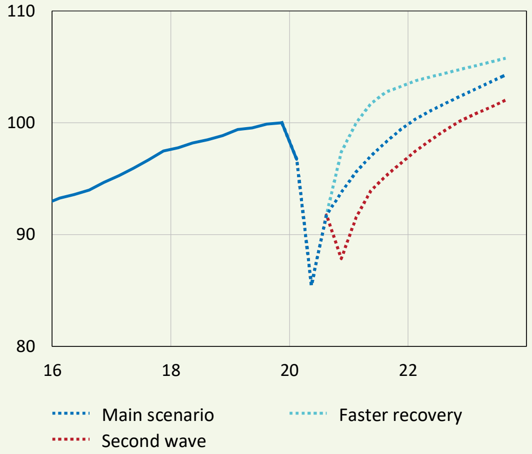
Note. KIX2 is the euro area and the United States combined with their respective relative KIX weights (approximately 0.86 and 0.14 respectively).

Sources: Bureau of Economic Analysis, Bureau of Labour Statistics, Eurostat, Statistics Sweden and the Riksbank

[27] Infection could also be contained if a vaccine is in place by the autumn. However, it seems less likely that this will happen.

[28] The scenario differs in this way from the main scenario. Here, the recovery in the summer and autumn is assumed to be basically unaffected by measures to restrict physical contact. In contrast, the forecasts in the main scenario entail economic activity, both abroad and in Sweden, continuing to be affected, to some extent, by restrictions this year, albeit not to such a large extent as in the event of a new, larger outbreak of infection as seen in the first alternative scenario.

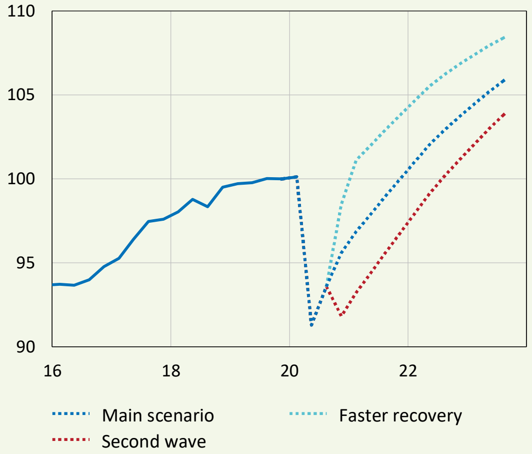
Figure 3:34. GDP abroad (KIX2)
Index 2019 Q4 = 100



Note. KIX2 is the euro area and the United States combined with their respective relative KIX weights (approximately 0.86 and 0.14 respectively).

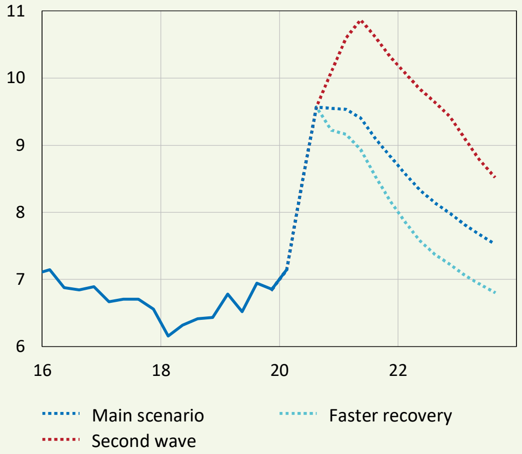
Sources: Eurostat, Bureau of Economic Analysis and the Riksbank

Figure 3:35. GDP
Index 2019 Q4 = 100



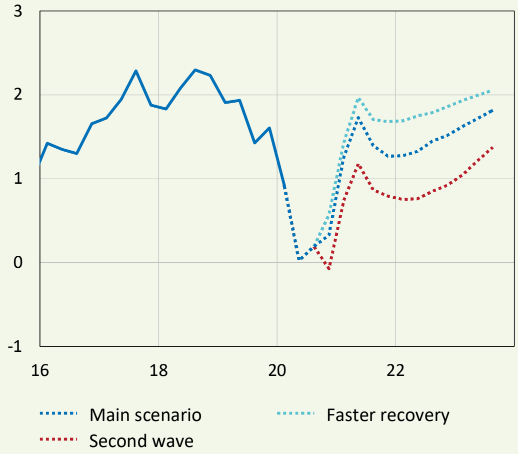
Sources: Statistics Sweden and the Riksbank

Figure 3:36. Unemployment
Percentage of labour force, aged 15–74, seasonally-adjusted data



Sources: Statistics Sweden and the Riksbank

Figure 3:37. CPIF
Annual percentage change



Sources: Statistics Sweden and the Riksbank