Nordic economies: Covid-19 impairs 2020 growth but public debt levels manageable

Like economies around the world, Nordic countries are being severely impacted by the Covid-19 crisis – although the economic blow in 2020 to the region is *comparatively* more moderate. Nordic economies have implemented restrictions and extraordinary fiscal interventions, increasing public debt ratios. However, strong public finances entering the crisis have meant extensive stimulus has not led, to date, to *significant* deterioration in creditworthiness.

Since March, deaths owing to Covid-19 have increased in Nordic nations, especially in Sweden – where the government has been hesitant to impose more stringent restrictions like neighbouring countries have and are now, gradually, exiting from. Despite dissimilar strategies to addressing the health crisis, the economic cost of the crisis is expected to be significant across the region. Scope expects 2020 contraction to be milder, however, in Nordic economies as a whole than in the euro area aggregate. We anticipate -5.0% in Finland (AA+/Stable) in 2020, -4.0% in Denmark (AAA/Stable), -3.75% in Norway (AAA/Stable) and -3.25% in Sweden (AAA/Stable), with all economies impaired by disruptions to production and supply chains alongside significant declines in internal as well as in foreign demand. Labour market dynamics, the speed of 2021 economic recoveries and fiscal and monetary interventions vary across the region.

Figure 1: GDP growth, general government balance and public debt estimates

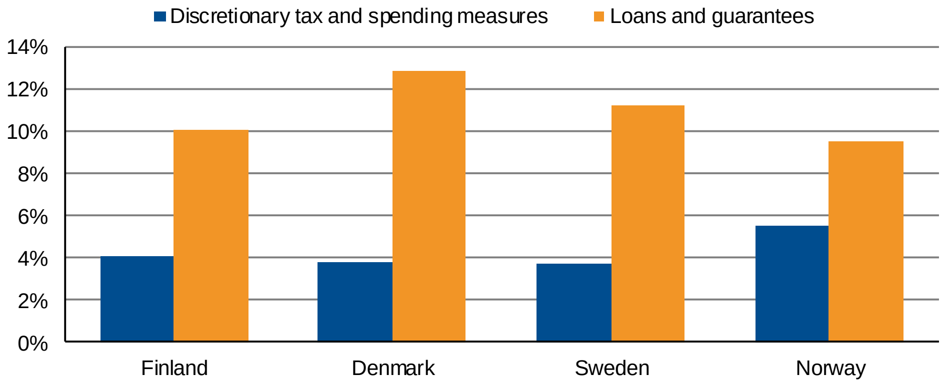
	Denmark	Norway	Sweden	Finland
Real GDP growth, 2020, % (baseline scenario)	-4.0	-3.75	-3.25	-5.0
Real GDP growth, 2021, % (baseline scenario)	3.0	2.5	2.25	3.5
General government balance, 2020, % of GDP*	-8.1 (-11.8)	0.0 (-6.4)	-6.2 (-6.7)	-8.5 (-7.4)
General government debt, 2020, % of GDP*	42.5 (+9.3)	42.4 (+1.8)	42.1 (+7.0)	69.9 (+10.5)

Source: Eurostat, Scope Ratings GmbH forecasts
*Change from 2019 in parentheses

Distinctive challenges for Nordic countries during this crisis are:

- **Finland** will see public finances deteriorate materially, with debt rising to around 70% of GDP, presenting challenges in terms of required fiscal consolidation;
- **Denmark** and **Norway**, whilst having managed the crisis commendably to date and now re-opening, will nonetheless see significant economic losses in 2020, with Norway's recovery, in addition, impaired by subdued oil prices;
- **Sweden**, due to less restrictive virus containment, may experience a comparatively moderate 2020 GDP contraction but this has come at the cost of higher loss of life alongside an impeded recovery as the health crisis remains unresolved.

Figure 2: Covid-19 fiscal responses, % GDP



Source: IMF, OECD, Scope Ratings GmbH

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Related Research (w/ link)

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– 2 April 2020

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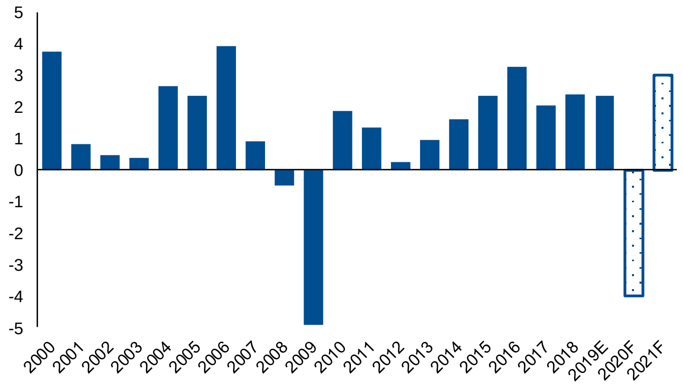
Denmark: significant 2020 recession but public finances remain robust

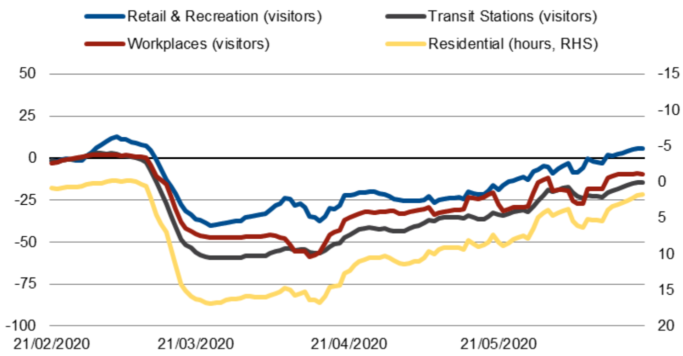
The extensive and speedy lockdown implemented by Denmark on 11 March (and eased since April) will weigh on 2020 economic performance, although the restrictions have constrained coronavirus cases and mortalities (the latter to only just over 600 persons to-date according to latest Johns Hopkins University data). However, we expect a gradual, uneven recovery, although with public finances still in a comparatively strong position.

Figure 3: Real GDP growth, Denmark, 2000-2021F (%)



Source: IMF, Scope Ratings GmbH forecasts

Figure 4: Change in visitors or hours spent by location, % change compared to pre-crisis baseline, seven-day moving average



Date updated to 19 June. Source: Google

Danish economy impaired in part through its travel and tourism sector

The Danish economy has been materially weakened by the 2020 crisis (forecast of -4.0% growth, **Figure 3 above**), as capital spending and consumption have regressed, with investment sentiment and consumer confidence having seen significant deteriorations – before improving since May as the economy re-opened. In addition, the Danish economy has been impaired by the coronavirus shock because trade, travel and tourism (accounting for about 17% of GDP) have been restricted, with Denmark being the only Nordic country that is a net exporter in this sector. However, several core Danish industries, such as pharmaceuticals, agriculture and wind turbine manufacturing, are not strongly cyclical, so exports will decline less in these industries in 2020. Denmark has, in addition, benefitted this year from lesser dependence on global value chains compared with its Nordic peers. Residual economic uncertainties can, however, arise from risks such as those from an ongoing correction in Danish property markets.

Unemployment rose to 5.4% in April (from 3.7% as of February), but the government is proactively supporting the private sector by temporarily paying up to 90% of employee salaries.

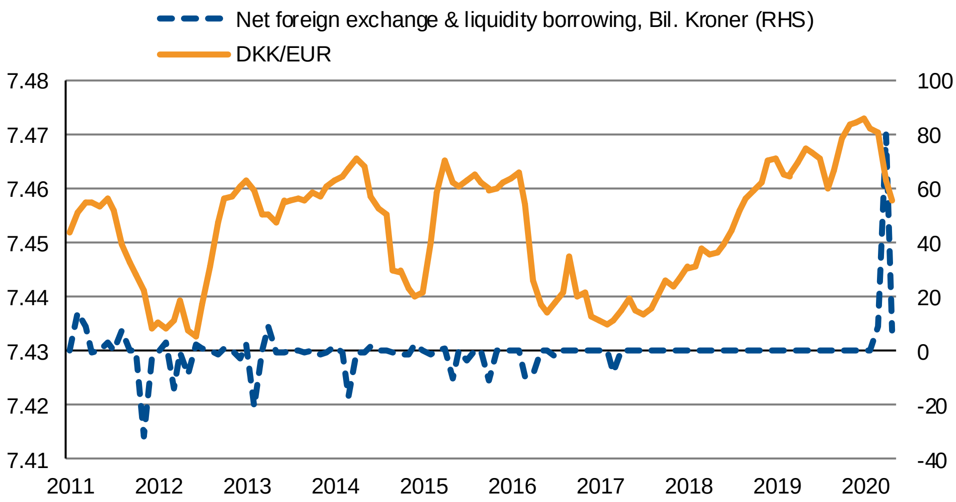
Scope projects 3% growth in 2021

The recovery has picked up speed as re-opening started (**Figure 4**) – with Denmark being among the first European countries to lock down in March at the onset of the crisis on the continent and the first country in Europe to reopen schools, day-care centres and smaller businesses in April. While new coronavirus cases have been low in recent weeks, a second wave remains a significant risk in Denmark and other countries in the second half of this year and in 2021, which may impede the speed and durability of Denmark's recovery. Scope projects growth of 3% in 2021.

The central bank maintains a steadfast commitment to keeping the fixed exchange rate policy to the euro

Danmarks Nationalbank has taken action to defend the fixed exchange rate against the euro. Even before the corona crisis, the krone-euro cross underwent pressure driven by capital outflows as domestic savers sought investments abroad, incentivised by negative domestic deposit rates. Whereas the majority of central banks around the world have cut interest rates during this crisis to provide significant liquidity assistance, the Danish central bank instead *increased* its official deposit rate in March by 15bp to safeguard the krone. In March, the central bank bought DKK 65bn to defend the currency. Although these actions have been effective in protecting the peg to the euro (**Figure 5**), the lack of an independent monetary policy has restricted the government response this crisis. Nevertheless, central bank policies underscore Denmark's long-standing commitment to maintaining its robust fixed exchange rate policy to the euro.

Figure 5: Krone exchange rate and Danmarks Nationalbank net borrowing

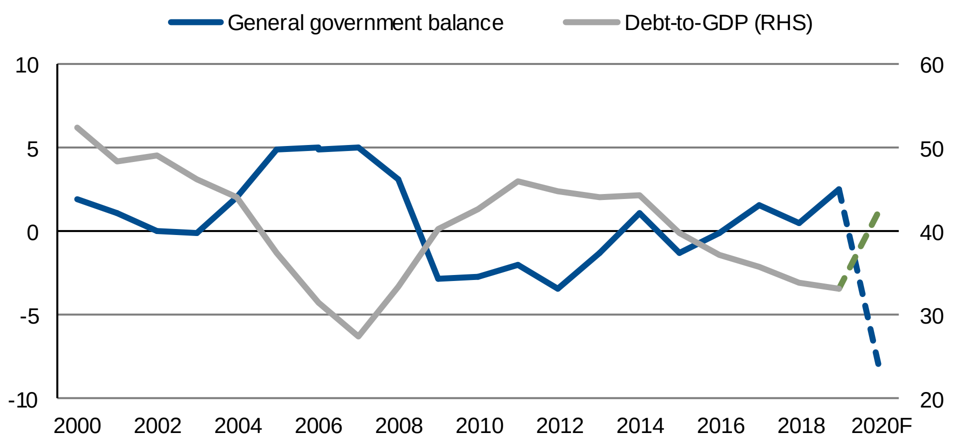


Source: Danmarks Nationalbank

Wide general government deficit of about 8% of GDP in 2020 and public debt to rise to above 40% of GDP

Due to Denmark's strong fiscal fundamentals entering this crisis, the government is able to run a wide 2020 public deficit (estimated at about 8.1% of GDP, **Figure 6** – its largest deficit since the early 1980s) without endangering debt sustainability. Denmark has announced fiscal easing of 3.7% of GDP during this crisis. Additionally, the government has detailed 12.8% of GDP in loans and guarantees. We expect the government debt-to-GDP ratio to increase from 33.2% in 2019 to a still moderate 42.5% in 2020.

Figure 6: General government balance and debt (% of GDP)

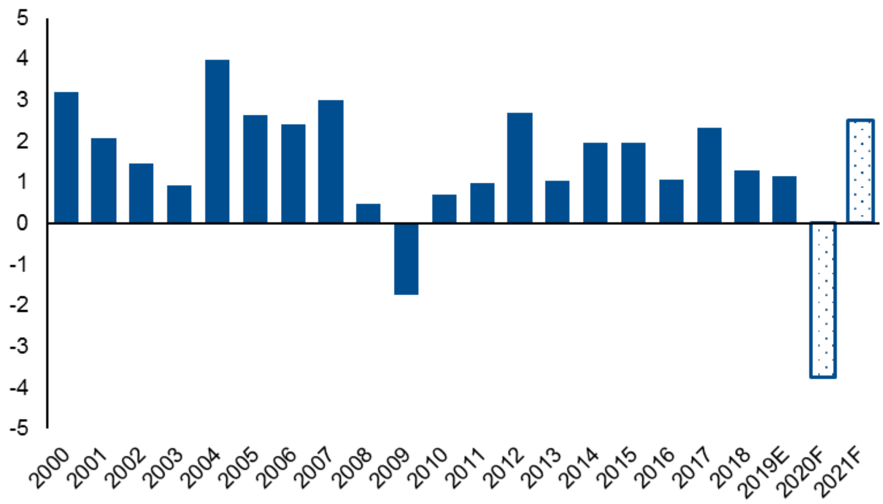


Source: IMF, Scope Ratings GmbH forecasts

Norway: pandemic and oil price crisis bring material recession, but gradual rebound expected

The Covid-19 economic shock and turbulence in global oil markets will push the Norwegian economy into significant recession. Despite high economic uncertainty and negative 2020 output growth, we foresee a rebound in annual growth in 2021.

Figure 7: Real GDP growth, Norway, 2000-2021F (%)



Source: IMF, Scope Ratings GmbH forecasts

Norwegian economy already slowing prior to health crisis, with this year seeing growth of -3.5%

Norway has been heavily impacted by the 2020 crisis. This in significant part comes due to the decline in Brent prices (to USD 40/barrel at time of writing, more than double, nonetheless, on April lows of less than USD 20/barrel) and effects on offshore sector investment, coupled with economic damages from the pandemic, especially on services sectors such as tourism, travel, entertainment and food. The mainland Norwegian economy was moderating even prior to the pandemic, as private consumption – which accounts for around 45% of GDP – declined in Q4 2019 (before severely contracting in Q1 2020), savings increased, and investments in dwellings fell. In 2020, private sector output losses, higher unemployment and more moderate nominal wage growth weaken fundamentals. We forecast 2020 growth of -3.75% (**Figure 7**), as a more moderate fall in GDP over the first half of the year (Q1 came in at -1.5% Q/Q[1]) is weakened by continued drawdown in petroleum sector investment over H2-2020. We anticipate 2.5% growth in 2021, supported by an uneven recovery in global aggregate demand and recovery benefits for external demand for Norwegian oil and gas exports – an industry accounting for around 15% of Norwegian GDP and 35% of exports of goods and services in 2019. Effects of the crisis will still weigh on wage growth, and, as such, on domestic consumption patterns.

The labour market has been hit by 2020's economic conditions

The labour market has been hit by 2020 economic conditions: in March, registered unemployment jumped from 2.3% to 10.4%, although most layoffs were on a temporary basis and unemployment did since ease to 6.4% by May. The labour force survey definition of unemployment has risen by less, to 4.2% in the three months to May (from 3.5% in the three months to March). Alongside Denmark, Norway was among the first European countries to slow virus transmission adequately such as to begin piecemeal re-openings of the economy since late April (after having closed down from 12 March).

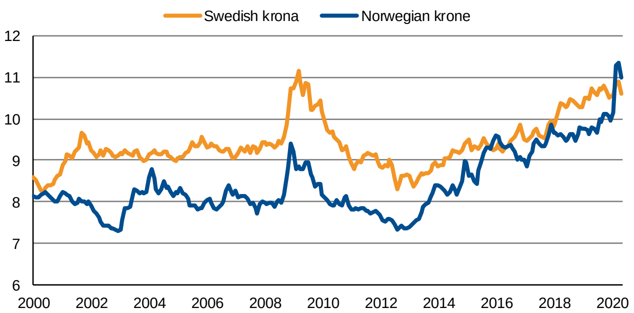
[1] Although monthly GDP weakened to a 3-month change of -8.8% in April.

Covid-19 mortalities have been below those of peer Nordic countries – totalling about 250 persons at the current stage of this crisis.

The Norwegian krone weakened significantly in March

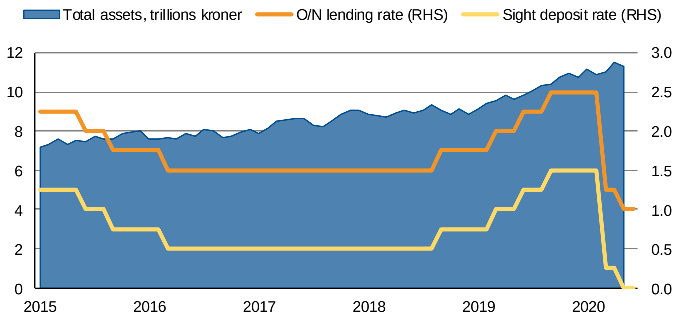
Mid-March, the Norwegian krone was significantly impacted by market volatility and a rush to safe haven currencies, such as the US dollar, the euro and the yen. As **Figure 8** displays, the krone weakened noticeably more than the Swedish krona, amplified by pressure on commodity currencies – although this trend has since stabilised.

Figure 8: Norwegian krone and Swedish krona exchange rates vis-à-vis the euro (monthly averages)



Data through May 2020. Source: Riksbank, Norges Bank

Figure 9: Norges Bank policy rates and balance sheet assets



Source: Norges Bank

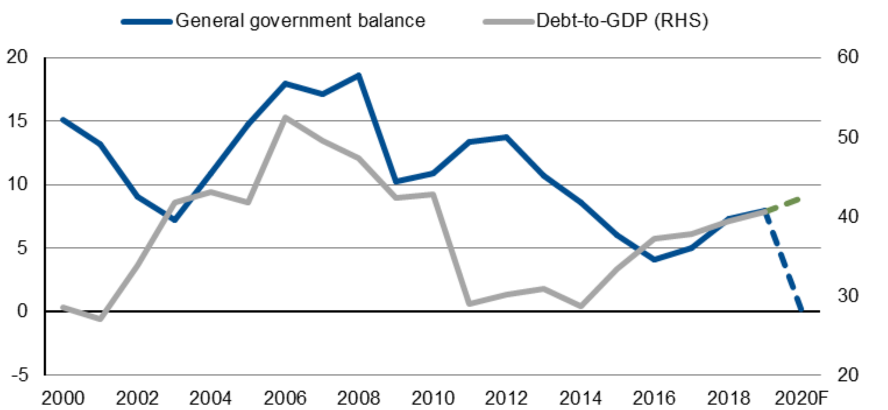
Norges Bank has intervened to support the economy and inflation

During this crisis, Norges Bank has intervened to support the economy, including by cutting the policy rate 150bp since March to a record low of 0% (**Figure 9**) to elevate private sector liquidity and curtail borrowing costs. We do not expect Norges Bank to cut interest rates into negative terrain, however, due in part to repercussions for banks' net interest margins as well as for financial stability. Inflation is expected by Norges Bank to average around 1.2% YoY in 2020 – below the 2% target – before 3.4% in 2021.

Significant policy response, with deficits and debt seen increasing in 2020

In order to mitigate adverse public health consequences of the crisis, the Norwegian government has adopted significant countermeasures. It implemented travel restrictions, adopted social distancing regulations and closed schools at an early stage, while intervening with discretionary economic measures such as new rules concerning business layoffs, income protections for the self-employed, tax relief and the granting of loan guarantees. Fiscal support announced has totalled so far 5.5% of the GDP in direct spending, with loans and guarantees of up to 10% of GDP. We currently expect a general government balance of around 0% of GDP in 2020 (**Figure 10**), representing, nonetheless, a significant deterioration from a surplus of 6.4% of GDP in 2019. The debt-to-GDP is foreseen increasing modestly to 42% of GDP in 2020.

Figure 10: General government balance and debt (% of GDP)

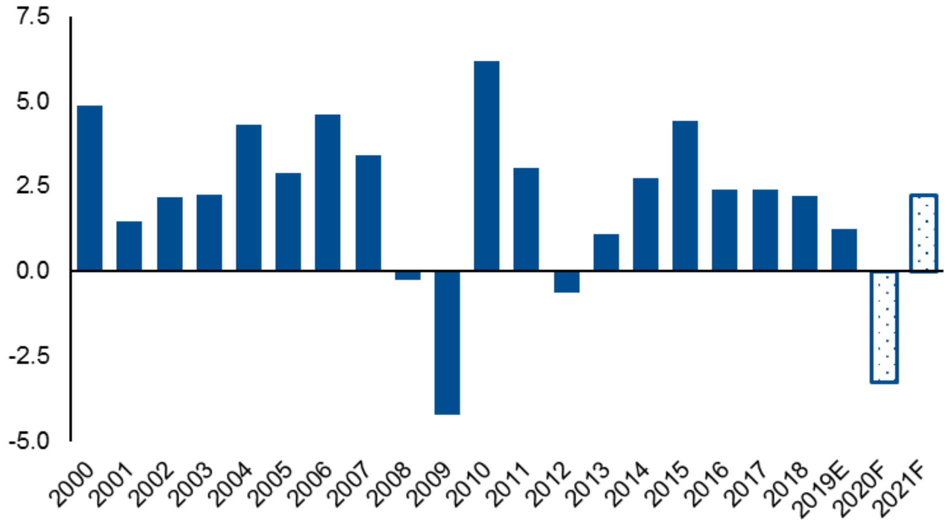


Source: IMF, Scope Ratings GmbH forecasts

Sweden: comparatively moderate 2020 economic contraction but at significant cost to lives during the health crisis

Sweden has seen the most significant confirmed cases of and mortalities due to the novel coronavirus in the Nordic region. We anticipate a moderate economic contraction in 2020 compared to Nordic peers, due to less stringent economic restrictions imposed. However, with the virus having reached peak case counts in June, the recovery will be impeded so long as the virus is not brought under control.

Figure 11: Real GDP growth, Sweden, 2000-2021F (%)



Source: IMF, Scope Ratings GmbH forecasts

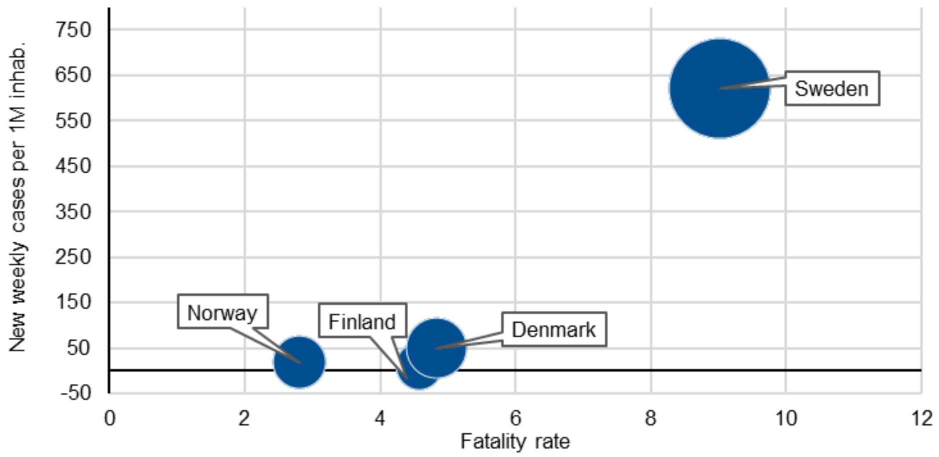
We foresee a 3.5% 2020 contraction, followed by 2.5% growth in 2021

Even absent nationwide lockdown, restrictions to travel and large gatherings alongside international supply chain disruptions have weighed on 2020 growth in Sweden. As coronavirus continues to spread, this will, moreover, impact consumer behaviour in the second half of the year and impede recovery. The automotive sector drastically cut production in March and April due to shortages of components. There will also be structural bottlenecks to restoring production even after international trade normalises. Our baseline foresees a 3.25% 2020 contraction (the shallowest among Nordic economies), followed by a 2.25% rebound in 2021 (**Figure 11**).

Sweden is the outlier when viewed in terms of adverse public health outcomes

Sweden has taken a strikingly alternative route to that of many European countries in its response to the coronavirus. Sweden has neither closed schools nor imposed strict shutdowns of non-essential economic sectors. Consequently, while 2020 economic projections for Sweden do not look as dark as those for Nordic peer economies, Sweden does stand out as an outlier from a public health perspective (**Figure 12, next page**). With over 62,000 confirmed cases and above 5,200 confirmed Covid-19-related fatalities as of 24 June, Sweden is by far the worst hit by the pandemic in the Nordic region.

Figure 12: New weekly cases (14-19 Jun) and fatality rate from Covid-19 (%)

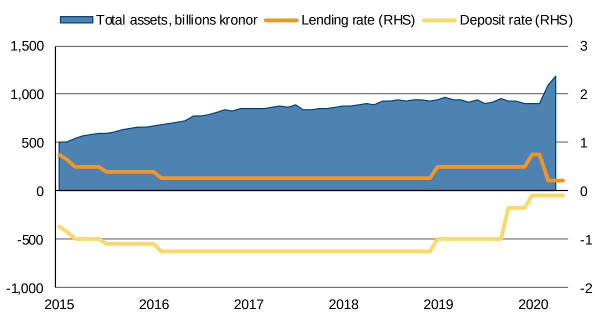


Source: University of Oxford, COVID-19 Corona Tracker, Scope Ratings GmbH
NB. Bubble size is proportional to the percentage of the population infected.

Despite an expanded QE programme, Sweden has experienced modest deflation in the second quarter

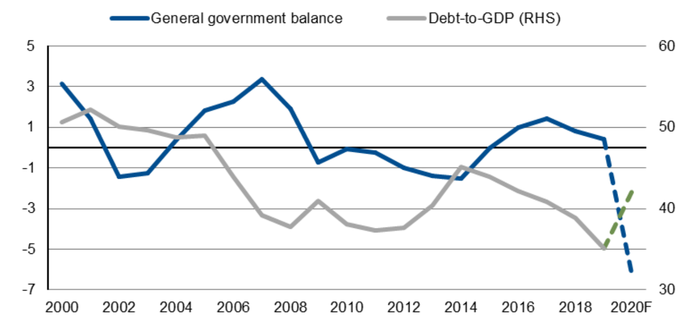
Riksbank has maintained an accommodative monetary policy to mitigate economic and financial damages from the crisis, by keeping the policy repo rate at 0% and expanding quantitative easing (**Figure 13**). The lending rate has been cut to support the banking sector and to provide liquidity. Despite expanded QE, Sweden has experienced modest deflation in the second quarter of 2020 through May. We expect a year-end 2020 inflation rate of about 0% YoY.

Figure 13: Riksbank official rates and balance sheet



Source: Riksbank, Scope Ratings GmbH

Figure 14: General government balance and debt (% of GDP)



Source: IMF, Scope Ratings GmbH forecasts

Sweden will see significant budget deterioration in 2020 after five consecutive years of balanced budgets

The Swedish government has intervened in support of the economy with budgetary spending (of, to date, 3.7% of GDP) alongside loans and guarantees (of up to 11.2% of GDP). Supportive fiscal measures include tax deferrals, lowered social fees and contributions to payments of sick leave or short work-week schemes to domestic firms and workers. We expect a fiscal deficit of 6.2% of GDP, after five consecutive years of general government budgets in balance or in surplus entering 2020 (**Figure 14**). The debt-to-GDP ratio is expected to rise from 35% in 2019 to a still moderate 42% in 2020.

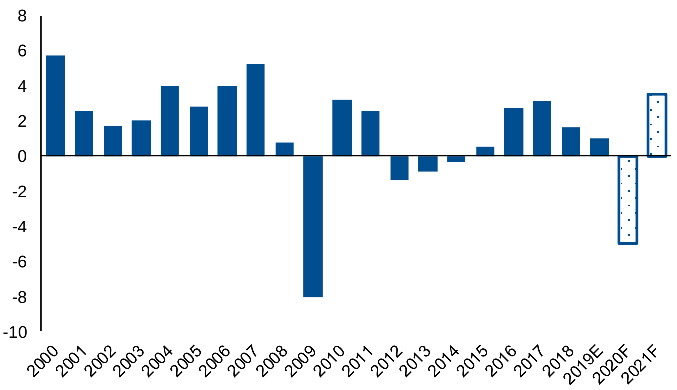
Finland: rising debt during 2020 crisis requires consolidation steps post-crisis to stabilise and reverse debt trajectory

Economic contraction, government stimulus and economic weaknesses that pre-date the pandemic are elevating government debt in Finland and could present risks to long-run creditworthiness if a swift response to stabilise the debt trajectory is not acted upon.

The Covid shock exacerbates structural challenges

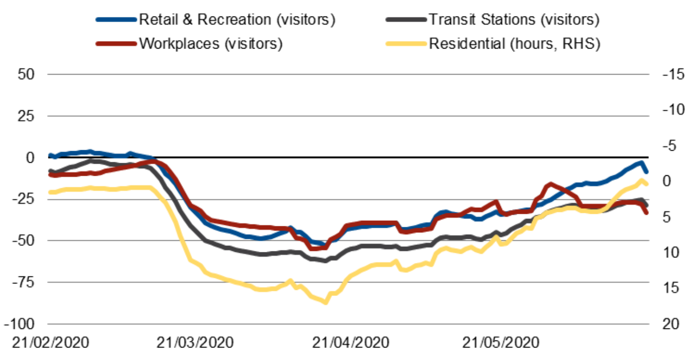
In the two years before 2020's crisis, real growth in Finland was slowing (**Figure 15**) and output shrank in the last quarter of 2019 (-0.6% Q/Q before -0.9% in Q1 2020 to enter technical recession). This year's unprecedented shock to domestic and foreign demand, together with the economic costs of border, public facility and school closures alongside limitations to public gatherings (although Finland never introduced a strict lockdown or a curfew) implemented over the first half of 2020, is exacerbating the structural challenges that Finland faces. The pandemic will impact exports as well as private consumption, with the latter having been a key driver of economic growth in recent years. Finland exports predominantly investment products, demand for which has been severely impaired.

Figure 15: Real GDP growth, Finland, 2000-2021F (%)



Source: IMF, Scope Ratings GmbH forecasts

Figure 16: Change in visitors or hours spent by location, % change compared to pre-crisis baseline, seven-day moving average



Date updated to 19 June. Source: Google

We expect a GDP contraction of 5.0% in 2020, with a recovery of 3.5% in 2021

In our baseline, we expect a GDP contraction of 5.0% in 2020, with a rebound of 3.5% in 2021. 2020's contraction is the deepest of the four Nordic economies analysed in this report. However, Finland's projected output contraction remains comparatively moderate compared to those in many European peer economies in 2020 such as that in France, Italy or Spain. As Finland has begun re-opening the economy since May, mobility indicators have demonstrated recovery (**Figure 16**). While risks of a second wave of infection remain elevated, which could threaten the sustainability of the recovery in H2-2020, a more durable recovery in private expenditure is expected after the public health crisis more permanently ebbs, with household balance sheets in fairly good shape. However, Finland needs to implement structural reforms that address demographic ageing and reduce bottlenecks to long-run growth potential.

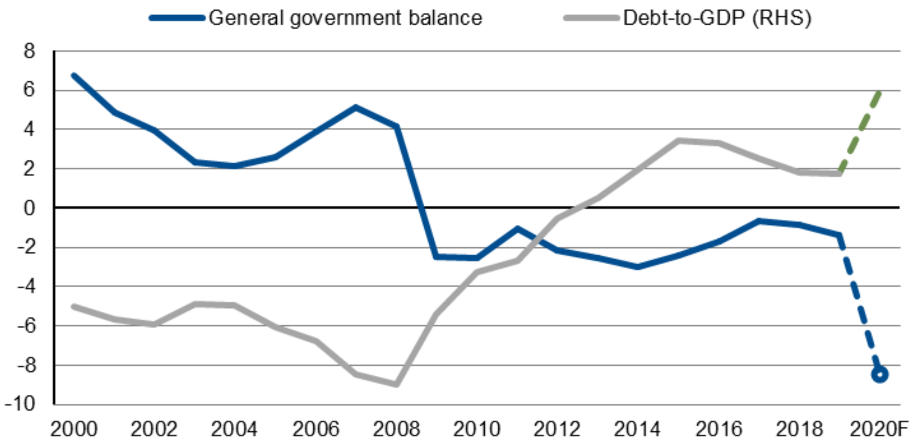
The Finnish government has adopted significant fiscal countermeasures

The Finnish government has put in place significant measures to counter the economic crisis, which include direct spending on the healthcare sector and pensions and the lowering of value-added tax rates, totalling to around 4% of GDP. The government has, also issued significant guarantees on loans (of as much as 10% of GDP). Additionally, as a euro area member state, Finland benefits from Eurosystem support, which includes the lowering of banking capital requirements to facilitate lending and the significant unconventional actions of the ECB – including negative rates, very affordable loans and the purchases of Finnish government bonds.

The 2020 crisis reverses fiscal progress of recent years and edges debt/GDP to around 70%

Since the global financial crisis, the government has run annual fiscal deficits, which were, however, corrected to near a balanced position by 2017-19 (**Figure 17**). The extraordinary fiscal interventions adopted this crisis reverse this progress, with an expected general government deficit of 8.5% of GDP in 2020. As a result, we expect the debt-to-GDP ratio to increase to 70% in 2020 (from 59% in 2019) – rising back above an EU 60% threshold – requiring fiscal consolidation steps after the crisis to re-safeguard Finland's debt sustainability.

Figure 17: General government balance and debt (% of GDP)



Source: IMF, Scope Ratings GmbH forecasts

Annex: Methodological assumptions overview

Assumptions for 2020 economic growth projections

For 2020, we use a model based on a gross value-added calculation of GDP, defined by the timing of "normality" resuming across industry sectors. We classify industry sectors into categories as operating over the crisis either at (i) near full capacity, (ii) medium capacity or (iii) low industry capacity by assessing the severity of the impact of a synchronised demand and supply shock across sectors in the Nordic region.

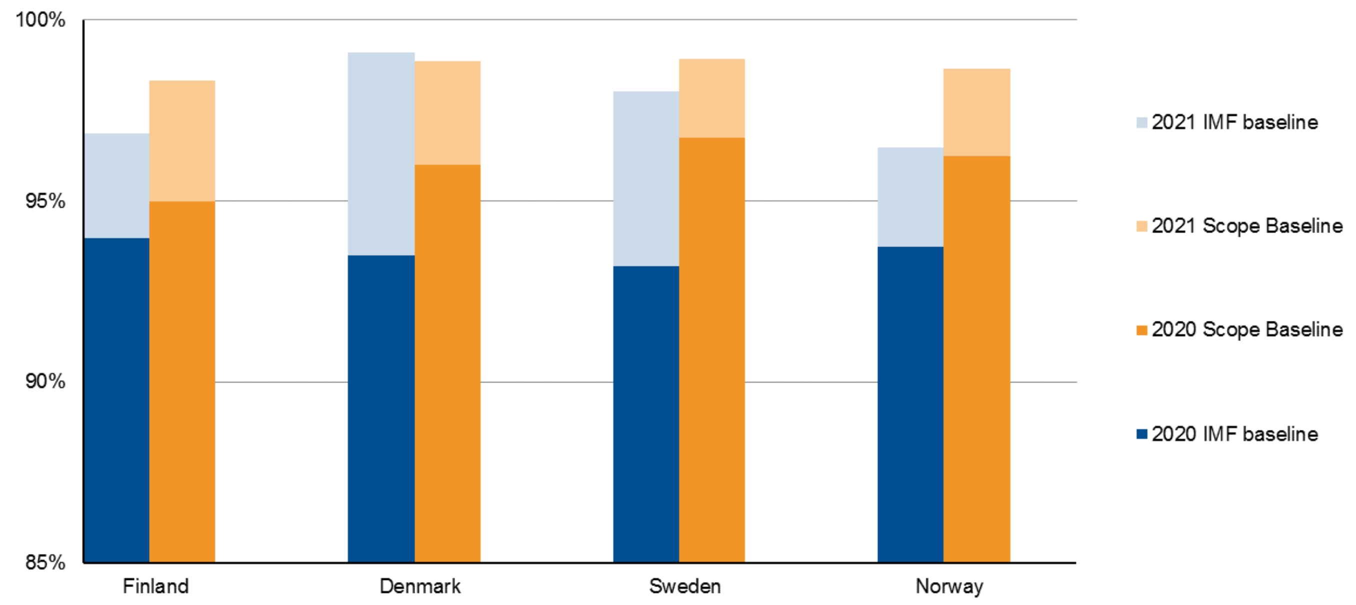
Impact of concurrent demand and supply shock		
Low impact	**Medium**	**High impact**
• Agriculture, forestry and fishing • Information and communication • Public administration, education and social work	• Industry (ex. oil and gas extraction) • Construction • Financial and insurance • Professional, science and technology	• Trade, travel, accommodation and food • Real estate • Arts, entertainment and recreation • Oil and gas extraction

We make assumptions about monthly levels of productive output compared with pre-crisis levels for each of the three above classifications and consider growth support from fiscal countermeasures as announced to date by governments.

In our baseline scenario, we expect a gradual relaxation of containment measures after April or May and a gradual return in the direction of broad economic "normality" by the third quarter. We assume declines in economic activity of around 0-10% for low-hit sectors, 20-40% for medium-hit sectors, and 50-60% drop for hard-hit sectors in productive capacities, which we further adjust to consider country-specific idiosyncrasies. We then adjust up growth for the impact of announced fiscal stimulus measures, differentiating between various types of government spending and liquidity assistance in terms of their respective fiscal multipliers.

Figure 18 displays the output results for the four Nordic economies.

Figure 18: Real GDP level (% of 2019 GDP), 2020-2021



Source: IMF April 2020 World Economic Outlook, Scope Ratings GmbH

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