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Article

Swedish politics: Will it all be over by Christmas?

As Swedish politics settles into trench warfare, the key question is whether anyone can form a sustainable government. New elections early next year could be the only way out

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Yesterday, Swedish Prime Minister Stefan Lofven lost a vote of confidence in parliament, putting an end to his four-year centre-left government and triggering the start of negotiations on forming a new one. Given, no natural coalition holds enough seats to form a government - a compromise of some kind will be necessary. But with most parties doubling down on a set of mutually incompatible restrictions on what kind of government they will accept, a solution looks some way away.

What happens now?

The newly elected speaker will start consultations with the eight parties. He will then give the party leader he judges has the best chance of successfully forming a government a mandate to propose a new government to parliament. If the proposal is voted down, the speaker will seek to give another party leader the chance. There can be up to four rounds of consultations and voting before new elections are called, which are likely take place in March next year.

A key date to watch is November 15th, the deadline for a new government to propose a budget for 2019

While the current budget can be rolled forward by parliament, it seems plausible to conclude that if a new government is formed by mid-November then new elections are likely. And if a compromise government is formed, the budget will be the key test of whether it can govern - failing to pass a budget likely means falling at the first hurdle.

Forming a government is arguably easier in Sweden than most countries because it only requires a majority of parliament that doesn't vote against the proposed government (rather than a majority in favour). In practice, a government also needs to be able to pass a budget, which requires a plurality in favour - a somewhat higher bar, and this is what led to the government crisis in 2014 when the centre-left's budget failed to pass.

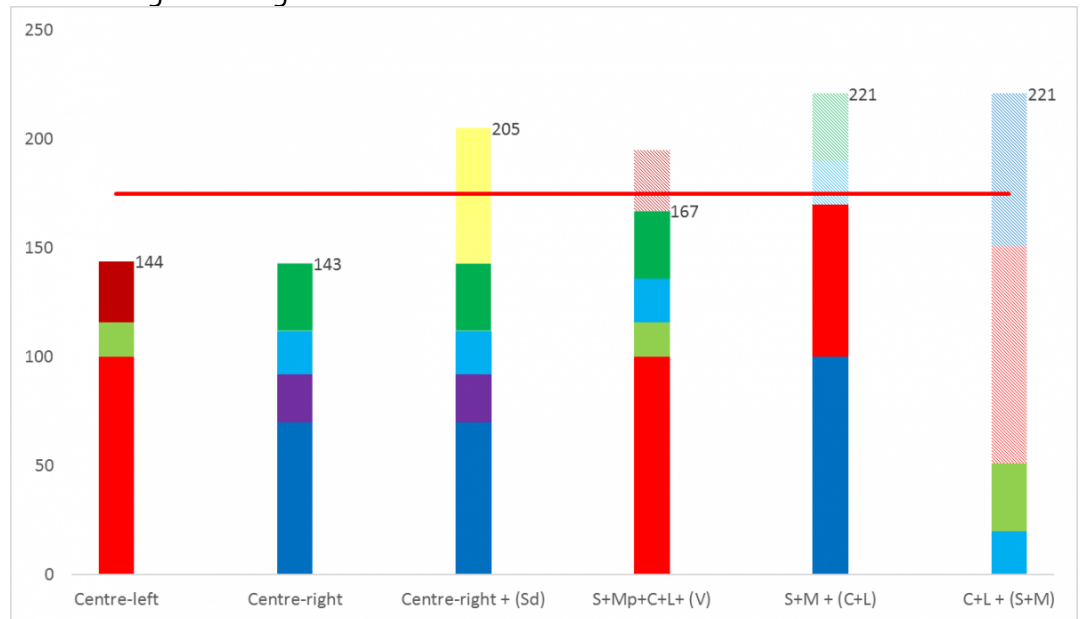
Stalemate result requires compromises

The current parliamentary situation resembles that of the past eight years. Neither the centre-right nor the centre-left coalitions hold a majority, giving the far-right Swedish Democrats a

potentially influential role. But most of the mainstream parties have ruled out cooperating with the far-right. They also won't continue the arrangement agreed in 2014 that allowed the centre-left to govern on the basis that it was the larger of the two mainstream coalitions.

In fact, over the course of the election campaign and in weeks since, the main parties have set out a set of restrictions on who they will cooperate with to form a government which, taken together, imply that no government can take power without someone breaking their pre-election commitments.

Potential governing combinations



Source: ING

But none of the options look appealing

The fact that the new speaker is from the Conservative party might increase the chance that the Conservative leader Ulf Kristersson gets the first shot at forming a government. Having won the speakership for his party, thanks to votes from the Swedish Democrats (without giving anything in return), Kristersson could push for a similar solution to forming his government.

Still, the question boils down to what options might be tolerable for parties holding a majority of seats.

As we pointed out [before](#), that will depend on what position the two centrist parties (Centre and Liberals) take. If they accept a government supported by the far-right (either the M+C+L+Kd constellation that governed from 2006-2014 or a Conservative-Christian Democrat cabinet) or a Social Democrat-led government with support from the Green and Left parties, then that would settle the government issue. Given their clear preference for a centre-right government, the former looks more plausible, though it would require them to stomach some level of support from the far-right.

The other option, which is still seen as the fall-back, would be for the two largest parties to cooperate directly to govern from the middle. This could either be through a grand coalition between the Social Democrats and the Conservatives (the two have never been in government together aside from the 1939-45 period) or a minority centrist government (C and L) tolerated by

the two larger parties (for which there are a couple of, short-lived, precedents). Neither are likely to prove particularly stable but could provide a stopgap solution that would at least postpone new elections.

But the economy will probably be okay for now

The economy can probably manage without a government for some time, as in other European countries with protracted government formation processes like Germany and Netherlands in 2017 and Spain in 2016. As we've said before, there are no urgent decisions that can't wait another six months if that's what the political system needs to get a clearer answer on who should govern.

If no government is formed and the budget simply rolls forward, that would make the fiscal stance for 2019 largely neutral. This would be marginally negative for near-term growth, as a new government is likely to propose some combination of higher spending and lower taxes given the current surplus in government finances. But the difference is likely to prove fairly minor, given stimulus would be constrained by Sweden's fiscal rule.

That said, the difficulty in forming a new government suggests that, whatever the shape of the next government, governing will prove difficult as well.

This is a medium-term concern, given that the Swedish model relies on continuous structural reforms to keep the economy as competitive as possible. And the acrimonious political climate over recent months at least raises the question how the system would respond to a major economic shock.

If there are new elections, we expect that in the near-term some of the political risk premium that appeared to be priced into the krona in August and early September would return, especially if polls indicated the far-right were increasing their share of the vote. Conversely, if a government is formed, it may provide a brief boost for the krona.

