SEB

Press release

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Nordic Outlook: Global growth defy political uncertainty
Swedish monetary policy and wage formation out of step

Well-founded optimism – not mere hopes – will characterise the world economy in 2017-18. Although conflict levels have escalated and political challenges should not be minimised, protectionist rhetoric is not identical with practical policy, according to SEB economists in the May 2017 issue of the quarterly *Nordic Outlook* report. The increase in economic activity is globally synchronised. We are now lifting our high growth forecast for Sweden further. But with the Riksbank signalling a continued complete focus on inflation, its first key interest rate hike is not likely to occur before April 2018, even though it is generally becoming increasingly difficult for central banks to justify more extreme forms of monetary policy including negative interest rates.

Underlying strength among emerging market (EM) economies, including China, and a rebounding investment cycle are offsetting political risks around the world. Our positive economic scenario will continue to materialise. **GDP growth in the 35 mostly affluent countries of the Organisation for Economic Cooperation and Development (OECD) will average 2.1 per cent this year**, somewhat higher than in 2016, and **2.2 per cent in 2018**. In practice, sentiment indicators are even hinting at somewhat higher growth than our forecasts reflect today, but major social challenges remain, such as economic inequality, ageing populations and sectoral job losses due to digitisation and automation.

Trump more pragmatic and less dogmatic – a relief to other countries

Global economic policy uncertainty is at historically high levels and is coloured by populism and protectionism, which go hand in hand. As expected, US President Donald Trump's economic policies ("Trumponomics") have proved difficult to implement and the president has repeatedly changed his mind. Yet relations between the world's two economic superpowers, China and the United States, have improved. **World trade is showing an upward trend in spite of everything** and seems to be generally robust.

Because of a strong labour market and increased capital spending, after a temporary dip early in 2017 **the US will have GDP growth of 2.3 per cent this year**, up from 1.6 per cent in 2016, and then reach **2.5 per cent in 2018**. Our conclusion that Trumponomics will be incapable of delivering so much stimulus has been confirmed, which will limit growth in 2017-2018. The US labour market will nonetheless become increasingly tight; unemployment will fall nearly to 4 per cent and pay increases will reach 3.5 per cent yearly.

Chinese economy in high gear, but Beijing will tighten credit conditions

Adjustment processes in EM economies are making them more resilient to American key interest rate hikes, but high debts and political risks pose threats. **China's GDP will grow by 6.7 per cent this year and 6.3 per cent in 2018**, with clear improvement in the manufacturing and construction sectors, but the authorities will tighten credit conditions. Looking ahead, this will dampen growth but meanwhile decrease the risk of financial imbalances. The other BRIC economies, especially India, will confirm the important contributions of emerging economies to the improved global outlook in 2017-18.

Europe will also benefit from stronger labour markets and an upswing in capital spending. **Euro zone GDP growth will be 2.0 per cent this year and in 2018, and the upturn is broad-based**. Political uncertainty has decreased after anti-European Union forces have had modest success so far during this year of major national elections. The German parliamentary election is unlikely to change the picture. But there will be long-term threats. The new, untested leadership in France will face major challenges and a weak economy will compel the parties to accept compromises. Italy also stands out as a major financial and political threat to the EU.

The process of British exit from the EU ("Brexit") will be characterised by tough rhetoric and positioning. Prime Minister Theresa May and her Tory government may strengthen their position after the snap election in June, but this does not change the fact that the probability of failed Brexit negotiations has increased. Thus **British economic growth will undoubtedly be hampered** by political uncertainty during our forecast period.

Changing risk picture weakens arguments for extreme monetary policy

There are still good reasons to pursue expansionary monetary policy, but it is becoming increasingly difficult to find arguments for its more extreme forms, such as negative and zero interest rates and large stimulative securities purchases. The risk picture has changed: The deflation risk has decreased significantly and downside risks to growth have faded. In the US, the Fed will continue making its policy less expansionary by **hiking its key rate a total of three times in 2017 plus three times in 2018** and **reducing its holdings of securities**. The risk of a pro-cyclical Amercian fiscal policy has decreased, while financial conditions have become more expansionary despite Fed rate hikes. The European Central Bank (ECB) has also adjusted its risk picture, and in September 2017 we expect it to hike its deposit rate for banks by 15 basis points to -0.25 per cent and then approve a further reduction in its monthly securities purchases. **The low interest rate environment and the presence of central banks focusing on currency exchange rates are resulting in a generally trendless global foreign exchange market**.

Financial market developments are contradictory. Despite political uncertainty and worries about Chinese and American recession triggered by policy makers, global stock markets are close to all-time highs. In addition, the volatility (or "fear") index is at a 10-year low. Based on rising earnings and stronger economic activity, share prices may continue to climb. High cost-effectiveness and initial signs of better pricing power will further reinforce this situation. Rising long-term yields (about 70 basis points during our forecast period) will not prevent stock markets from climbing somewhat further. Brent crude oil prices will remain at USD 55-60 per barrel, but with a clear downside risk in a supply- and US-driven market.

Baltic and Nordic economies lifted by international and domestic strength

The Baltic economies will benefit from both an improved international outlook and domestic growth engines – consumption and capital spending – but they are not free of challenges. **Estonia's** GDP growth will accelerate to more than 3 per cent in 2018, but with question marks about long-term economicx drivers. **Latvia** will benefit from a tax reform that strengthens its competitiveness and growth potential: we expect GDP growth to reach 3.5 per cent both in 2017 and 2018. In **Lithuania**, exports will push growth levels higher but pay increases may eventually become a problem. GDP growth will exceed 3 per cent.

The outlook in **Finland** has improved, with sentiment indicators at multi-year highs. Industry and capital spending will drive growth and **GDP growth will be 1.6 per cent in 2017 and 1.7 per cent in 2018**. The recovery will also continue in **Norway** with the help of increased private consumption and capital spending. **GDP growth will be 1.4 per cent per year 2017 and 2018.** As for inflation, downside risks dominate. This gives Norges Bank a reason to keep its key interest rate low; its first rate hike will occur in December 2018. In Denmark, we expect tighter credit conditions to slow job growth, but **GDP growth will be 2.0 per cent this year and 2.4 per cent in 2018**.

High, broad-based Swedish growth and low inflation create tensions

Sweden's GDP will grow by 3.1 per cent this year and 2.6 per cent in 2018 – a slight upward revision of our earlier already optimistic forecast. Sentiment indicators suggest an even faster expansion, but clear **production restrictions and bottlenecks** will hamper growth. The government will take advantage of the very favourable fiscal situation – annual budget surpluses of 0.6 per cent of GDP and government debt that will fall by 4 percentage points to 38 per cent of GDP – and will unveil an **election budget this autumn** with an expansionary direction. Our main scenario is that the minority government will allow the opposition to block a few items, thereby avoiding a government crisis before the scheduled September 2018 election.

Inflation has reached a higher and more stable level than before, but after this spring's low contractual pay hikes the Riksbank will find it difficult to achieve its 2 per cent inflation target. In April an obviously divided Riksbank also chose to extend but reduce its bond purchases. In other respects, the arguments for a less expansionary monetary policy are becoming broader and stronger. **Home prices and debts have again begun to accelerate**, accentuating how a lack of coordination and cooperative spirit between different economic policy making bodies is becoming more and more problematic.

Higher resource utilisation, **changes in the Swedish monetary policy framework and the probable replacement of the Riksbank's Governor late in 2017 will finally open the way for a hike in the negative key interest rate to -0.25 per cent in April 2018**. By the end of 2018, the repo rate will stand at 0.0 per cent. **In the short term, the krona will remain 5-10 per cent undervalued**, but it will strengthen to SEK 9.30 per euro and 8.45 per US dollar at the end of 2017, then SEK 8.95 per euro and 7.85 per dollar at the end of 2018.

Watch filmed summary here

Key figures: International & Swedish economy *(figures in brackets are forecasts from the February 2017 issue of* ***Nordic Outlook****)*

International economy, GDP, year-on-year changes, %	**2015**	**2016**	**2017**	**2018**
United States	2.6	1.6 (1.6)	2.3 (2.6)	2.5 (2.6)
Euro zone	2.0	1.8 (1.8)	2.0 (1.8)	2.0 (1.9)
Japan	1.2	1.0 (0.9)	0.8 (0.6)	0.5 (0.5)
OECD	2.4	1.8 (1.8)	2.1 (2.1)	2.2 (2.1)
China	6.9	6.7 (6.7)	6.7 (6.6)	6.3 (6.2)
Nordic countries	2.3	2.0 (2.0)	2.2 (2.1)	2.1 (2.1)
Baltic countries	2.0	2.0 (1.8)	3.1 (2.7)	3.2 (3.0)
The world (purchasing power parities, PPP)	3.4	3.2 (3.1)	3.7 (3.6)	3.8 (3.7)
Swedish economy. Year-on-year changes, %				
GDP, actual	4.1	3.3 (3.5)	3.1 (3.1)	2.6 (2.4)
GDP. working day corrected	3.9	3.1 (3.2)	3.4 (3.4)	2.7 (2.5)
Unemployment. % (EU definition)	7.4	6.9 (6.9)	6.4 (6.3)	6.1 (6.1)
Consumer Price Index (CPI) inflation	0.0	1.0	1.6 (1.7)	1.6 (1.6)
CPIF (CPI minus interest rate changes)	0.9	1.4	1.7 (1.8)	1.6 (1.6)
Government net lending (% of GDP)	0.3	0.9 (0.5)	0.6 (0.3)	0.6 (0.1)
Repo rate (December)	-0.35	-0.50	-0.50 (-0.25)	0.00 (0.25)
Exchange rate. EUR/SEK (December)	9.19	9.55	9.30 (8.95)	8.95 (8.80)

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