Press release

Stockholm, November 26, 2013

Nordic Outlook: Multi-speed recovery
ECB will launch QE – Riksbank rate cut

The conditions for **global GDP growth** will continue to improve during the next couple of years. But it will remain a **modest recovery**, hampered by ongoing economic and financial "healing" processes. The cyclical differences between various parts of the world economy will persist, creating challenges for policy makers. In the **United States**, the fiscal headwind will diminish greatly, while household balance sheets will strengthen and unemployment will fall. **Emerging economies** led by China have decelerated, and structural changes will make it difficult for them to achieve their earlier high growth levels. The **euro zone** will continue to stabilise, but imbalances will remain. **GDP growth in the 34 countries of the Organisation for Economic Cooperation and Development (OECD)** will be **2.3 per cent in 2014**, up from **1.2 per cent this year**, and will increase somewhat further to **2.7 per cent in 2015**. The probability of a worse economic performance is a bit higher than the probability of an upside surprise compared to our main scenario.

Global monetary policy will become even more expansionary, underscoring the vulnerability of the world economy today, more than six years after the global financial crisis broke out. Low resource utilisation and the creation of new policy tools for managing credit and housing markets – macroprudential supervision policy – will give monetary policy makers greater manoeuvring room to focus on growth and jobs. They will also make it easier to implement important structural policy measures and to consolidate government finances, although it is uncertain to what extent political leaders will take advantage of this opportunity. But economic policy conditions vary between countries and regions. The euro zone is facing greater deflation risks, while US inflation is moving towards normalisation. In some places, asset prices are showing signs of climbing far beyond what is needed for balance sheet repair in various sectors. **During the spring of 2014, we expect the European Central Bank (ECB) to launch traditional quantitative easing (QE)**, while the US Federal Reserve will gradually reduce its monthly monetary stimulus measures. The ECB's motive for its action will be to try to stabilise inflation expectations, boost the lending capacity of euro zone banks and decouple European interest rates and yields from US ones, since the economic situation in the euro zone remains fragile.

The Fed will not raise its key interest rate until two years from now, a strategy based on a decision not to take such action until unemployment drops below 6.0 per cent; we are thus predicting a downward adjustment from today's 6.5 per cent benchmark. The Fed will begin "tapering" its QE policy in March 2014. **At the end of 2015, the federal funds rate will stand at 0.75 per cent; the ECB will keep its refi rate unchanged at 0.25 per cent**. The Bank of Japan will stick to its target of doubling the monetary base by the end of 2014, but there are lingering questions about Japan's long-term economic performance. The Bank of England will not hike its key rate until the second half of 2015. The global low interest rate environment will show a weakly rising trend: somewhat more restrained in Europe due to deflation risks and ECB policies. The trend of interest rates and yields will be compatible with a cautiously positive view of share prices. Central banks will influence currency exchange rates. **The EUR/USD exchange rate will be 1.25 at the end of next year and 1.20 at the end of 2015**. The yen will weaken further as a consequence of Japan's expansionary monetary policies.

In the US, GDP will grow by 3.3 per cent in 2014 and 3.7 per cent in 2015: a forecast that remains well above the prevailing consensus view. **The fiscal headwind will diminish greatly next year**. The federal budget crisis is creating uncertainty that hampers growth, but we expect Congress to reach a decision on a medium-term solution early in 2014. Home prices will climb by a total of 14 per cent during 2014 and 2015, and the jobless rate will fall to

5.8 per cent by the end of 2015, which is close to equilibrium unemployment. Consumption will rise, giving the US a self-sustaining and stable expansion.

The euro zone will stabilise further in 2014-2015 but the recovery will be lacklustre, dominated by increasing deflation risks and political challenges. **GDP will grow by 0.8 per cent in 2014 and by 1.6 per cent in 2015**. The financial and structural legacy of the crisis will continue to divide Europe and create tensions. Unemployment will remain at record levels of around 12 per cent in 2014 and then fall slightly during 2015. The ECB's bank stress tests, whose results will become known around mid-2014, will lay the groundwork for a more stable financial system but will increase short-term uncertainty in a region where 85-90 per cent of the total credit supply is managed by the banking system. The debt problems of countries such as Greece and Portugal are far from solved, and the Spanish banking system remains vulnerable. The political decisiveness of the EU will be hampered, since the May 22-25 elections to the European Parliament and the subsequent replacement of the European Commission will take place in an environment of EU- and euro-sceptical winds. Germany and France are showing difficulty in vigorously and constructively leading the European political project. In addition, during 2014 the EU presidency will be held by Greece and Italy: two countries with major domestic political challenges.

Because of structural weaknesses, **emerging economies** such as the BRIC countries – Brazil, Russia, India and China – are expanding at a slower pace than during the 2000s, but in relation to other parts of the world economy their growth is high. The effects of the Fed's QE exit policy will be transitory, and exports will benefit from currency depreciation (except China), but the situation varies between countries. **Brazil** is showing signs of traditional overheating. In **China**, new reforms will instil optimism and because of the country's economic policy manoeuvring room, we expect GDP growth of **7.4 per cent in 2014 and 7.0 per cent in 2015**. A lack of reforms will hamper growth in over-regulated **India (5.2 and 5.5 per cent, respectively)** and in oil-dependent **Russia (2.3 and 2.8 per cent, respectively)**.

In **Sweden** the manufacturing sector has shown a shaky recovery during 2013, while households have held back on spending. Most economic indicators paint a brighter picture than actual hard data and support a forecast of accelerating growth. **We expect GDP growth of 0.7 per cent this year, 2.5 per cent in 2014 and 3.2 per cent in 2015**. Households will benefit from the low interest rate environment, good real income and an expansionary fiscal policy as well as rising home and share prices. Household purchasing power will improve by more than 3 per cent in 2014. Home prices will climb about 5 per cent this year both this year and next, then level out in 2015. Unemployment will continue to fall gradually, with a clearer downturn during **2015**: by the end of that year the jobless rate will be **7.0 per cent**.

Low inflation poses a challenge to the Riksbank's credibility. Public discourse on monetary policy has now also expanded to include questions of democratic legitimacy. Meanwhile macroprudential supervision policy is moving forward. In an environment where other central banks are taking steps to achieve price stability, the Riksbank will now also be forced to deliver. **In December, the Riksbank will thus lower its repo rate by 25 basis points to 0.75 per cent**. Inflation – both today and over the coming 12-24 months – is far below the central bank's 2 per cent target. Long-term inflation expectations are falling, according to various surveys and measures. Meanwhile many forecasters are beginning to predict that CPIF inflation (CPI excluding interest rates) will remain below target in the long term. But an interest rate cut is not an easy or comfortable decision for the Riksbank. Rising home prices and high debt can be connected to the Riksbank's partial responsibility for ensuring financial stability. The playing field has nevertheless changed, since the **government has assigned the main responsibility for macroprudential oversight to the Financial Supervisory Authority** and several macroprudential tools have been, or will be, mobilised during the coming year. **We expect the Riksbank's first interest rate hike to occur early in 2015**, and by the end of that year the repo rate will be 1.25 per cent. Because of the expected repo rate cut this December, the **EUR/SEK exchange rate will reach 9.00** by around year-end. Yet our assessment is that the krona is undervalued, and we thus expect a gradual appreciation against the euro during the next couple of years. At the end of 2014, the EUR/SEK rate will stand at 8.50 (USD/SEK at 6.80) and at the end of 2015 at 8.25 (USD/SEK at 6.90).

Sweden's public sector budget deficit will be nearly 2 per cent of GDP in 2014, among other things because the dose of fiscal stimulus will total SEK 30 billion, or 0.7 per cent of GDP: SEK 5 billion more than currently budgeted. Fiscal policy will also be expansive in 2015, with stimulus measures totalling SEK 10 billion. **Central government debt will nevertheless remain stable at around 35 per cent of GDP during our forecast period**.

Like Sweden, the other Nordic countries will be able to benefit from increased global economic activity. In **Denmark**, a consumer-driven recovery will gain a foothold. Rising home prices will lift consumer confidence, which will also be sustained by increased employment. **GDP growth will be 2.0 per cent in 2014 and 2.5 per cent in 2015**. In **Finland**, however, structural problems will undermine weak economic conditions. Growth will reach only **1.2 per cent next year and then climb to 1.6 per cent in 2015**. Household consumption will remain subdued because of higher unemployment and a deceleration in the rate of pay increases. **Norway** will enjoy decent growth after a slowdown in 2013. Good real income and reduced saving will boost consumption, despite an expected downturn of about 10 per cent in home prices during 2014. Exports will gain strength, but activity in the oil industry will slow significantly. **Norwegian GDP growth will be 2.4 per cent in 2014 and 2.1 per cent in 2015**. We expect Norges Bank to raise its key interest rate in the autumn of 2014 by 25 basis points to 1.75 per cent, and at the end of 2015 the deposit rate will be 2.25 per cent.

The Baltic countries remain at the top of EU growth statistics, but **Estonia** is lagging after a deceleration to 1.3 per cent this year (potential growth is 3-4 per cent) due to weak export performance and capital spending. Estonia's **GDP growth will be 2.6 per cent in 2014 and 2.9 per cent in 2015. Latvia** and **Lithuania** will continue their healthy growth: **Latvian GDP growth will be 4.5-5 per cent yearly in 2014-2015, while Lithuanian growth will end up in the 3.5-4.5 per cent range**. The main driving force in the three Baltic countries is private consumption, fuelled by good real income. After this autumn's continued low inflation data, there is a relative high probability that Lithaunia will be the last of the Baltics to qualify for the euro zone, meeting the government's 2015 target.

Key figures: International and Swedish economy

International economy. GDP, year-on-year changes, %	2012	2013	2014	2015
United States	2.8	1.7	3.3	3.7
Euro zone	-0.7	-0.4	0.8	1.6
Japan	2.0	1.8	1.7	1.3
OECD	1.5	1.2	2.3	2.7
China	7.7	7.7	7.4	7.0
Nordic countries	1.1	0.5	2.2	2.5
Baltic countries	4.2	3.0	3.7	4.2
The world (purchasing power parities, PPP)	3.4	3.2	3.9	4.1
Swedish economy. Year-on-year changes, %				
GDP, actual	1.0	0.7	2.5	3.2
GDP, working day corrected	1.3	0.7	2.6	3.0
Unemployment, % (EU definition)	8.0	8.0	7.8	7.4
Consumer Price Index (CPI) inflation	0.9	0.0	0.6	1.9
Government net lending (% of GDP)	-0.9	-1.6	-1.8	-1.3
Repo rate (December)	1.0	0.75	0.75	1.25
Exchange rate, EUR/SEK (December)	8.58	9.00	8.50	8.25

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