

## Press release

Stockholm, August 26, 2014

# Nordic Outlook: Continued recovery – greater downside risks Riksbank will cut key rate again in uncharted new political landscape

**Accelerating global growth is the most probable world economic scenario in 2015, helped by an improved outlook in such key countries as the United States, the United Kingdom, China and India. Sweden's recovery is proving more sluggish than expected, and the likelihood of an unclear parliamentary situation after the September election makes it difficult to predict government economic policy, writes SEB Economic Research in the latest issue of its quarterly report *Nordic Outlook*.**

Due to such factors as heightened geopolitical uncertainty and weather effects, growth forecasts for this year and for 2015 are lower than those presented by the SEB economists in the May 2014 issue.

**Growth reversals** in the US, Europe and the BRICS countries (Brazil, Russia, India, China and South Africa) during 2014, partly explained by greater geopolitical uncertainty and weather effects, continue to keep **stagnation and deflation risks** alive. **Accelerating global growth in 2015** is the most probable scenario, helped by an improved outlook in such key countries as the US, the UK, China and India, which together account for nearly 50 per cent of the world economy. Overall, **the 34 mainly affluent countries of the Organisation for Economic Cooperation and Development (OECD) will show GDP growth of 1.9 per cent this year** (2.1 per cent according to May's *Nordic Outlook*), **up from 1.4 per cent in 2013. Next year, growth will be 2.5 per cent**, followed by **2.4 per cent in 2016**, but the SEB economists warn that there is a higher probability that these figures may need to be revised downward than upward. They foresee a greater risk of actual growth falling short of their forecasts than of the economy turning out better than expected.

The many **geopolitical trouble spots** confirm both old conflicts and new ones that have resulted from major shifts in the world balance of power in the wake of globalisation and the recent Great Recession. On their current scale, the trade sanctions between Western countries and Russia will have **relatively little direct impact on growth**, although their effects on such economies as Finland and the Baltic countries will be more noticeable.

"In a long-term perspective we can expect a fading of the stimulative effects that were generated by decades of relaxed tensions due to increased trade, as well as destabilising medium-term economic, financial and political developments in Russia," says Robert Bergqvist, Chief Economist at SEB.

Overall **global monetary policy will remain highly expansionary** during *Nordic Outlook's* forecast period – which runs until the end of 2016 – even though the Bank of England (BoE) and the US Federal Reserve (Fed) will take their first cautious steps towards normalisation of key interest rates in the spring of 2015. At year-end 2016, their key rates will stand at 1.75 and 2.50 per cent, respectively. Due to wider short-term interest rate spreads, the US dollar will strengthen against the euro, which will be worth USD 1.20 by the close of 2016.

"Looking ahead, central banks face difficult trade-offs. In particular, there is uncertainty about the interest rate sensitivity of their economies and how monetary policy will interact with new macroprudential supervision policies. There are many indications that the normal key rate has shifted significantly downward and that central banks may carry out their rate hikes at a cautious pace," says Håkan Frisé, Head of Economic Forecasting at SEB and Editor-in-Chief of *Nordic Outlook*.

Underlying global price trends continue to be **dominated by disinflationary forces**, driven by low global resource utilisation and improved productivity growth – which are squeezing consumer goods prices as well as wages and salaries. Food and energy price increases will also be held back during *Nordic Outlook's* forecast period with the help of increased production and more efficient consumption.

Offsetting US and British monetary policy tightening, the **European Central Bank (ECB) and the Bank of Japan (BoJ) will further expand their balance sheets in 2015** beyond the decisions they have made so far, in order to overcome deflation risks. The effectiveness of monetary policy is relatively low due to structural problems and excessive debt, especially in the euro zone. This increases the risk of financial imbalances; the low interest rate environment both stimulates and compels greater financial risk-taking. So far, there are disturbingly few signs that low interest rates are leading to productive investments.

Policy makers are raising new questions about sustainable growth models without new debt build-up and secondary global and political effects. Because of major policy challenges – and divergences between countries – economic policy makers will be **“testing new ground”** during the next few years in such fields as infrastructure investments and redistributive tax policies with the aim of boosting growth, supported by continued very expansionary monetary policies.

Looking ahead, **households will be the engine of US growth**. But increased business investments will also help drive the expansion, due to increasingly worn-out machinery and factories. American **GDP will climb by 3.4 per cent in 2015, up from 2.2 per cent this year. In 2016 the growth rate will reach 3.1 per cent**. Unemployment will fall to 5.0 per cent by the end of 2016, or somewhat below equilibrium level. This will increase the chances of bringing pay hikes to about a 3.5 per cent rate, which is compatible with the Fed's 2.0 per cent inflation target using the personal consumer expenditure (PCE) deflator. Real wage increases and wealth effects – home prices are expected to climb at a decelerating pace totalling 17 per cent during 2014-2016 – will help to fuel increased consumption, but residential construction will lag due to cautious banks and lower household mobility. Labour force participation will be among key issues for the Fed. A stronger dollar and higher long-term yields will dampen the outlook somewhat. As inflation accelerates, real interest rates are expected to remain unchanged. This will contribute to a more sustainable investment cycle.

**Euro zone growth has stagnated**. The divergent trends in the 18 member countries of the currency union are continuing, and high unemployment persists. The political integration process in the European Union has further lost momentum since the European Parliament election in May, but the era of major budget-tightening is over and public finances are moving in the right direction. Public debt is expected to peak at more than 96 per cent of GDP, with countries like Ireland, Portugal and Italy at levels around 120-135 per cent of GDP (Greece 175 per cent). The euro zone countries, soon to number 19 including Lithuania starting January 1, 2015, are expected to achieve **weak growth, with lingering deflationary tendencies. Euro zone GDP growth is expected to be 0.7 per cent this year, rising to 1.1 per cent in 2015 and 1.5 per cent in 2016**.

**Asian growth is gradually gaining strength, mainly helped by China and India**, yet this acceleration will be gradual since high credit growth will no longer be a key driving force. Inflation pressure generally remains low in the region. The authorities in Beijing have demonstrated great skill in addressing and dealing with economic challenges. The Chinese real estate sector poses the most serious downside risk. Monetary policy will remain soft. In the event of a more pronounced slowdown, there is room for both monetary and fiscal stimulus measures. Tighter monetary policies in the US and UK are not expected to have a major impact on the growth outlook. In India, the potential for structural reforms has improved since the recent change of leadership, but so far the new government's proposals have been meagre. **Annual GDP growth in China during 2014-2016 is expected to be 7.5, 7.3 and 6.9 per cent, respectively**. The corresponding figures for India are **5.0, 5.8 and 6.2 per cent, respectively**.

**Russian economic weakness** – with GDP expected to be largely unchanged both this year and in 2015, followed by weak growth in 2016 – and trade sanctions will slow the economic recovery in Estonia, Latvia and Lithuania. Overall growth in the Baltics will accelerate somewhat, following a slump in 2013-2014. Low inflation will allow significant real wage increases in all three countries, helping private consumption to offset weak external demand. **Estonia**, with its large

export dependence, will see GDP growth of **0.5 per cent this year, 1.8 per cent in 2015 and 3.0 per cent in 2016**. The corresponding GDP growth forecast for **Latvia** is **2.5, 2.7 and 3.4 per cent**. The fastest growth is expected in **Lithuania: 4.0 per cent in 2016 (following 2.7 per cent this year and 3.2 per cent in 2015)**.

**The outlook for the Nordic countries is divergent.** The Norwegian economy is dominated by forces that are pulling in different directions. The headwind is coming from lower capital spending in the oil and gas sector as well as weak residential investments. But the labour market has stabilised, along with the housing market, and good real income increases are providing support to consumption. **Norway's GDP growth will accelerate from 1.6 per cent this year to 1.7 per cent next year and 2.1 per cent in 2016**, which is somewhat below trend growth. Looser monetary policies in the euro zone and Sweden will hold back Norwegian key interest rate hikes. The first rate hike is expected late in 2015, and in December 2016 the deposit rate will stand at 2.50 per cent. In Denmark, there are increasingly clear signs that the recovery will gain a stronger foothold due to falling unemployment, rising home prices and stronger optimism. **Danish GDP growth will be 1.8 per cent this year, 2.3 per cent in 2015 and 2.5 per cent in 2016**. Since there are still spare resources in the economy, inflation will accelerate cautiously. Unlike the other Nordic countries, Finland faces major economic challenges. Structural problems connected to the forest product industry and the information and communications technology (ICT) sector, as well as relatively large exposure to Russia, are squeezing growth. **The Finnish economy cannot avoid a recession in 2014 (growth is expected to be -0.6 per cent)**, and the recovery will thus be weak. **GDP will grow by 0.5 per cent in 2015 and 0.9 per cent in 2016**.

**Sweden's economic recovery is proving more sluggish than anticipated**, but growth is still expected to be somewhat above trend during the next couple of years: **2.1 per cent (2014), 2.9 per cent (2015) and 2.7 per cent (2016)**. Growth is being driven by private consumption, which is benefiting from rising real incomes and asset prices. Tax hikes after this autumn's election will slow income growth but will be partly offset by higher benefit levels in social insurance systems. Employment is showing signs of strength, but due to a rapidly rising labour supply – and because many people are far removed from the labour force due to their lack of requisite skills and integration into Swedish society – the jobless rate will remain relatively high. **Unemployment is expected to fall to slightly above 7 per cent by the end of 2016**, which is above its equilibrium level. The unemployment risk is on the upside.

An **unclear parliamentary situation** after the election, with a minority government of Social Democrats (S) and the Green Party (MP) as the most likely outcome based on the current voter opinion situation, **is making future economic policy difficult to assess and is creating greater uncertainty**.

“The gap between the number of seats won by the ruling Alliance and the red-green opposition bloc, the outcome for the Social Democrats compared to the 2010 election, party leader Stefan Löfvén's choice between leftist or centrist policies, the strength of the anti-immigrant Sweden Democrats and the relative parliamentary strengths of the Alliance parties after the election will affect the chances of putting together a credible, sustainable support base for a government,” Mr Bergqvist says.

A new S/MP government is expected to increase both expenditure and revenue levels. **Fiscal policy will thus be neutral in terms of budget balance. The 2014 deficit, equivalent to 1.8 per cent of GDP, will gradually shrink to 0.4 per cent in 2016**. Further fiscal stimulus is considered possible without jeopardising confidence in Sweden's public finances, but margins are needed in light of continued economic uncertainty and large expected refugee inflows. Today's official surplus target (1 per cent of GDP over an economic cycle) will probably be replaced by a zero balance target during the coming parliament. **General government debt will gradually fall to 40 per cent of GDP during the forecast period**.

**The Riksbank will lower its key interest rate again in October to 0.15 per cent** due to low and falling inflation expectations, a slow economic recovery and further ECB stimulus measures. Inflation pressure will remain low throughout the forecast period. The central bank's choice of monetary policy will not change the prospects of tighter macroprudential supervision policy, including regulations requiring repayment of mortgage principal. Although underlying **CPIF** inflation has bottomed out, it will climb only weakly and reach **1.5 per cent at the end of 2016**. The Riksbank is expected to test new monetary policy approaches: further lowering the end-point of its rate path while strengthening its monetary policy

guidance by making a “promise” not to hike its key rate before CPIF inflation reaches 1.5 per cent. It may also emulate Germany’s Bundesbank and encourage collective wage agreements in 2016 that are compatible with its 2 per cent inflation target, while abstaining from verbal warnings that excessive pay increases might lead to interest rate hikes.

“Falling inflation expectations and further ECB stimulus measures will put pressure on the Riksbank. Now that the main responsibility for macroprudential supervision has been lifted over to the Financial Supervisory Authority, it is clear that the Riksbank is fully focused on defending the credibility of its inflation target and will thus use more unconventional methods,” says Mr Frisén.

Not until early 2016 – once the BoE and Fed have made some headway in their respective rate hiking cycles – is the Riksbank expected to begin raising its key interest rate. **By the end of 2016, the repo rate will stand at 1.00 per cent.** Because of changes in short-term interest rate spreads, the Swedish krona will weaken somewhat this autumn to SEK 9.40 per euro and then gradually appreciate to 8.70 by the end of 2016. Our forecast of a gradual strengthening of the US dollar will lead to a slow upturn in the USD/SEK exchange rate to a level of around 7.25 at the end of our forecast period.

### Key figures: International & Swedish economy (figures in brackets are forecasts from the May 2014 issue of *Nordic Outlook*)

<b>International economy. GDP, year-on-year changes, %</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
United States	2.2	2.2 (2.6)	3.4 (3.7)	3.1
Euro zone	-0.4	0.7 (1.0)	1.1 (1.6)	1.5
Japan	1.5	1.1 (1.0)	1.2 (1.3)	0.8
OECD	1.4	1.9 (2.1)	2.5 (2.7)	2.4
China	7.7	7.5 (7.2)	7.3 (7.0)	6.9
Nordic countries	0.6	1.5 (1.9)	2.0 (2.4)	2.2
Baltic countries	2.9	2.1 (2.1)	2.7 (3.3)	3.6
The world (purchasing power parities, PPP)	3.3	3.4 (3.6)	3.9 (3.9)	4.0
<b>Swedish economy. Year-on-year changes, %</b>				
GDP, actual	1.6	2.1 (2.7)	2.9 (3.1)	2.7
GDP, working day corrected	1.6	2.1 (2.7)	2.7 (2.9)	2.5
Unemployment, % (EU definition)	8.0	7.9 (7.9)	7.5 (7.5)	7.2
Consumer Price Index (CPI) inflation	0.0	-0.1 (-0.1)	0.8 (0.9)	1.7
Government net lending (% of GDP)	-1.2	-1.8 (-1.5)	-1.0 (-0.5)	-0.4
Repo rate (December)	0.75	0.15 (0.25)	0.15 (0.75)	1.00
Exchange rate, EUR/SEK (December)	8.86	9.25 (9.00)	8.90 (8.60)	8.70

#### For more information, please contact

Robert Bergqvist, +46 70 445 1404  
 Håkan Frisén, +46 70 763 8067  
 Elisabet Kopelman, +46 8 763 8046  
 Daniel Bergvall, +46 8 763 8594  
 Mattias Bruér, +46 8 763 8506  
 Olle Holmgren, +46 8 763 8079  
 Mikael Johansson, +46 8 763 8093  
 Andreas Johnson, +46 8 763 8032

#### Press contact

Anna Helsén, Press & PR  
 +46 70 698 4858  
[anna.helsen@seb.se](mailto:anna.helsen@seb.se)

SEB is a leading Nordic financial services group. As a relationship bank, SEB in Sweden and the Baltic countries offers financial advice and a wide range of other financial services. In Denmark, Finland, Norway and Germany the bank’s operations have a strong focus on corporate and investment banking based on a full-service offering to corporate and institutional clients. The international nature of SEB’s business is reflected in its presence in some 20 countries worldwide. On June 30, 2014, the Group’s total assets amounted to SEK 2,654 billion while its assets under management totalled SEK 1,605 billion. The Group has about 16,000 employees. Read more about SEB at [www.sebgroup.com](http://www.sebgroup.com).