SEB

Press release

Stockholm, February 7, 2017

Nordic Outlook: Complex cyclical and political forces
Broader-based Swedish growth– Riksbank rate hike in 2017

Political turbulence will open the way for both negative and positive economic outcomes in 2017-2018. Protectionism and isolationism will be offset by optimistic and improved growth signals; 2017 will be dominated by predictable unpredictability, according to SEB economists in the February 2017 issue of the quarterly *Nordic Outlook* report. The United States will show strong growth, but not mainly due to Trumponomics. Emerging market (EM) economies have bottomed out. The European Union and the United Kingdom are at a crucial political and economic crossroads, surrounded by great uncertainty: the "Brexit" process will begin as the EU tiptoes around other political problems. The Swedish economy is shifting into higher gear, while facing major structural and political challenges. The Riksbank will begin to reverse its negative key interest rate towards the end of 2017 – thus also accepting an appreciation of the krona.

The economic signals are generally positive despite major domestic and geopolitical questions, and following rather colourless growth in 2016. We have revised our overall GDP forecasts somewhat higher, but we still believe that the direct contributions to growth from President Donald Trump's economic policies ("Trumponomics") will be modest. **GDP growth in the 35 mostly affluent countries of the Organisation for Economic Cooperation and Development (OECD) will average 2.1 per cent both in 2017 and 2018**, up from 1.8 per cent in 2016. Sentiment indicators – which are globally synchronised – stand at their highest levels since 2011, partly reflecting high expectations of fiscal stimulus by means of tax cuts and infrastructure investments in the US, Europe and elsewhere as well as policy shifts related to the energy and financial sectors. The positive trend is also due to an improved outlook for EM economies, helped by such factors as higher oil prices and a stronger capital spending cycle as resource utilisation continues to rise – all this in a world where improbable scenarios have become more probable.

Arbitrary, provocative and protectionist White House actions

US economic policy as well as trade, foreign and security policies are being reassessed. Details and decisions about these policies are still absent. This increases market uncertainty about the scope, implementation and effectiveness of these policies. The aim of Trumponomics will be to strengthen the US corporate sector through tax reforms that create an "internal devaluation" and drive capital back from abroad. We estimate that its net fiscal impact will total 0.2 per cent of GDP in 2017 and 0.3 per cent in 2018. The US economy is already close to full resource utilisation. **We expect American GDP growth of 2.6 per cent yearly in 2017 ands 2018**.

The global low-inflation environment is now being more clearly tested, although underlying price pressure is low in the absence of robust wage and salary growth. We are adjusting our inflation forecasts marginally upward. The risk of deflation is low, since the economies of many countries are close to normal resource utilisation and inflation expectations have climbed. But disinflationary forces persist, even though tariffs and other obstacles in the global trade system may increase price pressure. Despite cautious steps in many countries to phase out unconventional monetary policy, it remains strongly expansionary as higher inflation keep real interest rates low, and government and corporate borrowing can still be rolled over at lower interest rates than previously.

US monetary policymakers face several dilemmas. For example, American fiscal policy risks becoming pro-cyclical, boosting inflation pressure while its positive impact on economic growth potential take their time to materialise. **The Federal Reserve will hike its key interest rate twice this year and three times in 2018, thus bringing it to 2.0 per cent**. These hikes may be limited due to rising long-term bond yields (about 75 basis points in 2017-

2018), a strong effective exchange rate for the US dollar and a reduction in the Fed's monetary policy securities portfolio (System Open Market Account, SOMA) during 2018. This will make it easier for other central banks to end their unconventional monetary policies, which are increasingly being questioned. Although the European Central Bank will let its refi rate remain at 0.0 per cent throughout our forecast period, we expect that late this spring the ECB will set the stage for a gradual phase-out of its stimulative securities purchases. The Bank of Japan will continue its expansionary monetary policy, while the Bank of England (UK) and Norges Bank (Norway) will raise their key rates during the latter part of 2018.

EU and British leaders navigating uncharted and uncertain political waters

European economies are showing resilience to heightened political uncertainty, with the aid of job growth and an awakening capital spending cycle sustained by expansionary monetary and fiscal policies. Other countries are increasing their pressure on Germany, which will move only part of the way towards satisfying its critics by enacting a more expansionary fiscal policy due to increased risks of imbalances and overheating. The outcomes of upcoming elections in the Netherlands, France, Germany and possibly Italy are expected to confirm the continued strength of anti-establishment forces. Despite the EU's far-reaching and profound identity problems, this year's elections are unlikely to result in major influence for anti-EU forces, but France may prove an exception. Overall **GDP growth in the euro zone will reach 1.8 per cent this year**, the same as in 2016, and **1.9 per cent in 2018**.

Paradoxically, there are many indications that the entire EU is moving in the direction that the UK advocated before its Brexit referendum: less EU integration and federalism, and greater room for national solutions on such matters as social safety nets and control of migration policy. The British exit process from the EU will begin in March, according to government plans, but is surrounded by stress and major question marks. A snap election in the UK cannot be ruled out. **We have adjusted our UK forecast a bit downward: GDP growth will be 1.1 per cent this year and 1.2 per cent in 2018** – almost a halving of the 2016 growth rate.

Emerging market (EM) economies, which make up nearly 60 per cent of the world economy, are showing strength despite the risks of trade barriers, more expensive US dollar debts and political question marks. We predict that **aggregate GDP growth in the EM sphere will accelerate from 4.1 per cent in 2016 to 4.6 per cent in 2017 and 4.8 per cent in 2018**, thanks to continued solid growth in China and India as well as a rebound in economies such as Brazil and Russia from recent lows. A political reshuffle in China late in 2017 will ensure that Beijing will be cautious about new reforms, in order to achieve stable growth and low volatility this year.

The economic growth outlook in other Nordic countries and in the Baltics is improving. The **Norwegian economy** is still struggling with the consequences of subdued oil sector investments, but demand in the mainland economy (excluding offshore oil and gas) is gaining strength, with heightened risk in the housing market. In **Denmark**, authorities are trying to tighten credit conditions but exports will contribute to faster economic growth ahead. The **Finnish economy** can look forward to a much-anticipated and now broad-based acceleration in economic activity, with households as an important driver. In **Estonia, Latvia and Lithuania** too, hopes are that private consumption – which is benefiting from high pay increases and strong job growth – will gradually be helped by increased capital spending and growing exports.

Full speed ahead in Sweden – Riksbank will hike key rate in December

Sweden's economic growth outlook is improving further. We are adjusting our high forecast – compared to the consensus – even higher. **GDP growth will be 3.1 per cent this year** (up 0.3 percentage points from our November forecast), somewhat lower than **3.5 per cent in 2016**. Ever-higher resource utilisation will slow **GDP growth to 2.4 per cent in 2018**. An industrial upturn is broadening Swedish GDP growth further, and residential construction is approaching a 40-year high. Households will benefit from nominal wage and salary growth of 2.7 per cent this year and 3.2 per cent in 2018 after new national collective bargaining agreements are signed, with yearly pay hikes 0.2 per cent higher than in the 2016 wage round; average unemployment will fall from 6.9 per cent in 2016 to 6.1 per cent in 2018.

Despite higher costs related to integration and migration policies, public sector finances are very strong thanks to the economic boom. The Swedish government is expected to unveil an expansionary autumn budget for the election year 2018 including around SEK 20 billion worth of reforms, yet the budget is still expected to show a small surplus in 2017-2018. The fact that the Riksbank will continue buying sovereign bonds until the end of June is expected to increase the shortage of Swedish government securities, holding down long-term yields in relation to other countries. As markets price in the Riksbank's key rate hikes, the yield spread against Germany and other countries will widen.

Higher resource utilisation in Sweden promises more inflation ahead. During 2017, inflation will be elevated by higher energy and food prices as well as by a weak krona. Partly because of accelerating pay increases and international prices, underlying inflation (CPIF, the Consumer Price Index minus interest rate changes) will stabilise at levels above 1.5 per cent but below the Riksbank's 2 per cent target. Several members of the central bank's Executive Board are reluctant to loosen Swedish monetary policy further. We are sticking to our forecast that the Riksbank will begin to **reverse its negative key rate in December, hiking it by 0.25 percentage points to -0.25 per cent. At the end of 2018 the repo rate will stand at 0.25 per cent**. The bank will communicate its shift in monetary policy this coming summer. Because other countries are beginning to leave unconventional monetary policy behind and are even hiking their key rate (for example the US), this will help to moderate krona appreciation. **At the end of 2017, the EUR/SEK exchange rate will be 8.95 and the USD/SEK rate will be 8.70. At the end of 2018 these rates will be 8.80 and 8.15, respectively**.

Key figures: International & Swedish economy *(figures in brackets are forecasts from the November 2016 issue of **Nordic Outlook**)*

International economy, GDP, year-on-year changes, %	**2015**	**2016**	**2017**	**2018**
United States	2.6	1.6 (1.6)	2.6 (2.3)	2.6 (2.2)
Euro zone	2.0	1.8 (1.8)	1.8 (1.6)	1.9 (1.6)
Japan	1.2	0.9 (0.5)	0.6 (0.5)	0.5 (0.5)
OECD	2.4	1.8 (1.7)	2.1 (2.0)	2.1 (2.0)
China	6.9	6.7 (6.7)	6.6 (6.4)	6.2 (6.0)
Nordic countries	2.3	2.0 (2.0)	2.1 (2.0)	2.1 (2.0)
Baltic countries	2.0	1.8 (1.8)	2.7 (2.7)	3.0 (3.0)
The world (purchasing power parities, PPP)	3.3	3.1 (3.1)	3.6 (3.5)	3.7 (3.6)
Swedish economy. Year-on-year changes, %				
GDP, actual	4.1	3.5 (3.7)	3.1 (2.8)	2.4 (2.3)
GDP, working day corrected	3.9	3.2 (3.4)	3.4 (3.1)	2.5 (2.4)
Unemployment, % (EU definition)	7.4	6.9 (6.9)	6.3 (6.3)	6.1 (6.2)
Consumer Price Index (CPI) inflation	0.0	1.0 (0.9)	1.7 (1.2)	1.6 (1.9)
CPIF (CPI minus interest rate changes)	0.9	1.4 (1.4)	1.8 (1.4)	1.6 (1.7)
Government net lending (% of GDP)	0.2	0.5 (0.3)	0.3 (0.2)	0.1 (-0.2)
Repo rate (December)	-0.35	-0.50 (-0.50)	-0.25 (-0.25)	0.25 (0.25)
Exchange rate, EUR/SEK (December)	9.19	9.55 (9.30)	8.95 (9.30)	8.80 (9.05)

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