

## Press release

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# Nordic Outlook: Upturn broadening despite political threats Sweden: Industry accelerating as housing market slows

**Our bright global economic picture has been confirmed this autumn, and SEB is again revising its outlook a bit higher. There will be a gradual shift in the focus of global growth away from the United States and towards the euro zone and the emerging market (EM) sphere. The euro zone is impressive, and its economic strength as well as diminished political risks are giving the euro common currency a tailwind. Low inflation is challenging the inflation targeting frameworks used by central banks, but their retreat from ultra-loose monetary policies will continue, led by the US Federal Reserve (Fed), while the European Central Bank (ECB) will join it in 2019. Strong industrial activity will keep growth up in Sweden as lower home prices cause construction to decelerate. The Riksbank will postpone its key interest rate hike until September 2018. Along with increased worries about the housing market, this delay will keep the Swedish krona weak during the first half of next year.**

Throughout 2017, SEB's economists have had a more optimistic view than the consensus of analysts. We are once again making small upward adjustments in our GDP forecasts for most countries. **The upturn is occurring even though dark clouds threaten international cooperation in the wake of last year's Brexit referendum in the United Kingdom (approving British withdrawal from the European Union) and Donald Trump's victory in the US presidential election.** Geopolitical sources of concern are becoming more numerous. During the past six months the focus of attention has been on increased tensions on the Korean peninsula and in the Middle East. But we have also repeatedly seen that households and businesses are rather insensitive to political uncertainty.

More important to our forecast are the forces that now dominate the mature economic expansion phase. On the plus side, **strong labour markets and increased capacity utilisation are providing extra late-cyclical demand stimulus through higher private consumption and capital spending.** But with unemployment in many countries at its lowest in decades, questions related to bottlenecks, the inflation dynamic and the sustainability of growth are increasingly in focus.

The US economy will slow down a bit in 2019, but **supply side restrictions will not generally stop the expansion.** Inflation has continued to surprise on the downside, giving many central banks plenty of manoeuvring room to shape exit strategies from ultra-loose monetary policies. But central banks meanwhile face a dilemma when balancing the risks of building up new imbalances against the opportunity to help push down unemployment to even lower levels. The inflation response to low unemployment often occurs after a lengthy delay, while global inflation forces are becoming increasingly important – making it harder for central banks to strike the right balance. **The Phillips curve, which posits an inverse relationship between unemployment and inflation/pay increases, is becoming blurry at the national level.**

We expect the Fed to hike its key interest rate at a faster pace than the market is discounting, but both the ECB and the Bank of Japan will further extend their loose monetary policies in the near term. ECB rate hikes will not occur until 2019. In November the Bank of England reversed the emergency rate cut it made right after the Brexit referendum, but the BoE will wait until 2019 before resuming rate hikes. Global long-term bond yields have remained largely flat this year but **will climb at a slow pace in response to expected tightening by the Fed, and later also by the ECB.** Because of euro zone economic strength and reduced political worries after the results of 2017 elections, the euro is enjoying a

tailwind. After a short-term renewal of US dollar appreciation, the euro will continue its upward trend and **the EUR/USD exchange rate will climb to 1.25 by the end of 2019**. Due to strong global growth and the low interest rate environment, **stock markets can climb at the same pace as corporate earnings even though valuations are beginning to be stretched**.

### **Tax cuts will help US growth, euro zone is impressive, Brexit will hamper UK**

US economic growth has rebounded after a weak beginning of the year. The Trump administration has had problems pushing its policies through Congress, but early next year it can probably enact tax cuts that will provide a stimulus effect of one quarter per cent of GDP. Looking at trade policy, there is some risk that Trump will choose to withdraw from the slow-moving negotiations on the North American Free Trade Agreement (NAFTA), yet the most likely outcome is a renegotiated agreement with Canada and Mexico. **We are revising our GDP growth forecast for the US upward to 2.3 per cent in 2017 and 2.6 per cent in 2018**. Due to labour market bottlenecks, we believe that growth will then slow to 2.0 per cent in 2019.

The euro zone economy continues to surprise on the upside. We are revising our GDP growth forecast upward to 2.3 per cent in both 2017 and 2018, followed by 2.1 per cent in 2019 – well above trend. **Since the euro zone has substantially slower population growth than the US, our GDP forecast is even more impressive in per capita terms**. The super-election year 2017 did not lead to especially major success for anti-European Union forces. This has generated hopes of a fresh start for the EU integration process. Because of improved economic conditions, EU cooperation efforts will enjoy a tailwind during the next couple of years, creating a decent chance of success for a strategy that gives member countries clear choices as part of a “multi-speed Europe”. But if the EU establishment behaves in excessively tone-deaf fashion, opposition can quickly be mobilised both at the grassroots level around Europe and among sceptical member countries.

The British economy is being hampered by uncertainty about the future relationship between the UK and the EU. The weak pound and robust international economic conditions justify revising our GDP growth forecast for 2018 somewhat higher, but we predict a deceleration from 1.5 per cent growth this year to 1.1 per cent in 2019. Our forecast assumes that negotiated solutions will be achieved that will ensure an orderly British withdrawal from the EU. **The tensions in the UK political system are growing, but at present it is not possible to discern any openness to re-assessing Brexit and remaining in the EU**.

### **Mild deceleration in China is offset by higher growth in other BRIC countries**

The growth rate of emerging market (EM) countries has gradually strengthened since 2015, and **we expect GDP growth in SEB's aggregate EM index to accelerate from 4.3 per cent in 2016 to 4.9 per cent this year and to 5.1 per cent in 2018 and 2019**. Growth in China has surprised on the upside but will gradually slow. This autumn's reshuffle in the Communist Party leadership has strengthened President Xi Jinping's reform mandate and will also increase public acceptance of slower short-term growth in exchange for creating a better long-term structure of economic drivers. The slowdown in India has been sharper than expected, but growth will rebound next year. Meanwhile reform efforts will be put on the back burner until the 2019 election. Brazil is climbing out of its deepest economic crisis in modern times. Russia has also left its recession behind; higher oil prices will help maintain growth.

### **Global acceleration lifting the Nordics and Baltics**

The acceleration in global growth is clearly benefiting the Nordic economies. After three weak years, **Norway** is now on the right path. Private consumption, business investments and exports will take over as drivers when fiscal/ monetary policy stimulus and construction fade. Mainland GDP will grow by nearly 2.5 per cent during both 2018 and 2019 and total GDP (including offshore oil and gas) by more than 1.5 per cent and nearly 2.00 per cent, respectively. Norges Bank will hold off on any key rate hikes until the end of 2018. The outlook in **Denmark** also looks better than it has for a long time; the economy will grow by nearly 2.5 per cent yearly. The biggest upturn has occurred in **Finland**, where growth is 2.5 to 3 per cent yearly. The **Baltic** economies are also expanding at a healthy pace, and we have adjusted our GDP forecasts upward for **Latvia** and **Estonia**.

## Industrial upturn will lift Swedish GDP but home price decline may cause dilemma

The economic boom in Sweden has broadened, as exports and industrial capital spending accelerate with the help of robust global conditions and a weak krona. To some extent, this offsets the signs of weakness that are beginning to be visible in the housing market and that are expected to slow down construction ahead. Yet the strength of economic activity and the labour market, low interest rates and a continued housing shortage suggest a moderate home price downturn. **Our main scenario is that the decline will be limited to 5-10 per cent – not enough to change the economic growth picture to any great extent.** We expect GDP to increase by 3.2 per cent this year and about 2.5 per cent yearly in 2018-2019. Inflation will be supported by service prices – although these are partly driven by temporary effects – and by gradual pay hikes, but the increase will not be enough to sustainably boost inflation to the Riksbank's 2 per cent target even at the end of our forecast period. Political parties in Sweden are now focusing mainly on the September 2018 election and will probably avoid confrontations in Parliament until then.

The Riksbank has continued to signal that high growth, an increasingly hot labour market and inflation close to target do not justify any interest rate hike soon. Our forecast thus postpones the first hike until September 2018. **During 2019 we foresee three further hikes, bringing the repo rate to 0.50 per cent at year-end.** The Riksbank will probably stop its stimulative bond purchases at the end of 2017. A bond shortage due to Riksbank purchases and strong Swedish government finances will further narrow the spread against German long-term yields before the spread widens again as Riksbank rate hikes approach.

A more dramatic home price decline might pose a new type of dilemma for the Riksbank. There is a risk of gloomier economic growth prospects at the same time as greater scepticism about the Swedish economy weakens the krona, thereby creating an inflation impulse. **Swedish inflation tends to occur late in an economic cycle, a pattern that might amplify this impulse.** On previous occasions, most notably in 2008, the Riksbank has hiked its key rate in a late-cyclical inflation environment amid a deteriorating economic situation. Yet we do not believe that it will repeat this behaviour. After all, the Riksbank has signalled that it is not opposed to accepting above-target inflation after earlier divergences on the downside. If the bank is prepared to accept "overshooting" in a strong growth situation, it would be too paradoxical not to do so during an economic downturn as well.

This autumn the krona has weakened as the Riksbank has again dashed expectations of an imminent normalisation in its monetary policy. Mounting uncertainty about the Swedish housing market is a contributing factor. With the first repo rate hike now likely to occur only in the second half of 2018, the krona will remain weak for a long period. **Our EUR/SEK exchange rate forecast is 9.70 at the end of June 2018. Even at year-end 2019 we expect the EUR/SEK rate to remain above 9.00.** The general strength of the euro also plays a role; the krona has appreciated against most other currencies during 2017, especially the US dollar. The USD/SEK rate will fall as far as 7.35 by the end of our forecast period.

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

<b>International economy, GDP, year-on-year changes, %</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
United States	1.5	2.3 (2.2)	2.6 (2.4)	2.0 (2.0)
Euro zone	1.8	2.3 (2.1)	2.3 (2.2)	2.1 (2.0)
Japan	1.0	1.5 (1.3)	1.2 (0.8)	1.0 (0.7)
OECD	1.8	2.4 (2.1)	2.1 (2.1)	1.9 (1.9)
China	6.7	6.9 (6.8)	6.6 (6.4)	6.2 (6.1)
Nordic countries	2.2	2.6 (2.5)	2.3 (2.3)	2.2 (2.2)
Baltic countries	2.0	4.0 (3.5)	3.4 (3.3)	3.1 (3.1)
The world (purchasing power parities, PPP)	3.2	3.8 (3.8)	3.9 (3.8)	3.8 (3.7)
<b>Nordic and Baltic countries</b>				
Norway	1.1	2.0 (1.7)	1.6 (1.6)	1.8 (1.9)
Denmark	2.0	2.3 (2.3)	2.3 (2.4)	2.3 (2.4)
Finland	1.9	2.9 (2.5)	2.5 (2.2)	2.3 (2.2)
Estonia	2.1	4.1 (3.6)	3.3 (3.2)	3.0 (3.0)
Latvia	2.0	4.5 (4.1)	3.7 (3.7)	3.5 (3.2)
Lithuania	2.3	3.7 (3.7)	3.2 (3.2)	3.0 (3.0)
<b>Swedish economy. Year-on-year changes, %</b>				
GDP, actual	3.3	3.2 (3.2)	2.6 (2.8)	2.4 (2.4)
GDP, working day corrected	3.1	3.5 (3.5)	2.7 (2.9)	2.5 (2.5)
Unemployment, % (EU definition)	6.9	6.7 (6.5)	6.2 (6.0)	6.2 (6.1)
Consumer Price Index (CPI) inflation	1.0	1.8 (1.8)	1.8 (1.8)	2.1 (2.0)
CPIF (CPI minus interest rate changes)	1.4	2.0 (1.9)	1.8 (1.7)	1.8 (1.8)
Government net lending (% of GDP)	1.1	1.0 (1.0)	0.7 (0.9)	1.0 (0.8)
Repo rate (December)	-0.50	-0.50 (-0.50)	-0.25 (0.00)	0.50 (0.75)
Exchange rate, EUR/SEK (December)	9.19	10.00 (9.35)	9.45 (9.00)	9.20 (9.20)

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