SEB

Press release

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Nordic Outlook: Full steam ahead for economy and markets

Sweden: EU boom compensating for lower housing construction

SEB is again revising its global economic outlook upward. In the United States, the new tax package has boosted optimism in the economy and is one reason why the Federal Reserve (Fed) will speed up the pace of its key interest rate hikes. Because of strong growth in the euro zone and a more balanced inflation picture, the European Central Bank (ECB) will also move more quickly towards normalisation, although its monetary policy will remain expansionary. Long-term bond yields are gradually trending higher, while increased corporate earnings due to a synchronised global upturn and better investment conditions are lifting stock markets. The US dollar will continue to fall against the euro as other factors besides relative monetary policies take over as main driving forces. Strong demand, especially from Europe, is lifting exports and capital spending in Sweden. Despite a negative contribution from residential construction, GDP growth will remain above trend during the next couple of years. The Riksbank will begin a slow normalisation in September, although low inflation is causing it some headaches. The Swedish krona will climb cautiously to SEK 9.50 per euro by year-end, but its appreciation against the dollar will be larger.

The world economy is growing on a broad front. SEB's economists are adjusting their global GDP growth forecast higher by one tenth of a percentage point per year in 2017-2019, leading to a stable GDP upturn of around 4 per cent. The tax cuts enacted by the Trump administration appear likely to have a somewhat bigger impact on US economic growth than previously expected, especially in 2019. We are raising our GDP growth forecast to 2.8 per cent in 2018 and 2.5 per cent in 2019. In the euro zone, improved political optimism and economic confidence are going hand in hand right now. Growth is accelerating further after reaching its highest level in a decade last year and will end up at 2.5 per cent this year and 2.2 per cent in 2019: still above trend. Emerging market (EM) economies will grow by more than 5 per cent despite a controlled deceleration in China as the country reins in lending. Other major EM countries such as India are meanwhile growing faster. It is beneficial to the world economy that oil prices are settling at a slightly higher level, around USD 65/barrel. The Brexit process (withdrawal from the European Union) is weighing down the British economy, which is lagging behind the global upswing. But if an agreement on the new relationship between the United Kingdom and the EU can be reached in time (March 2019), our main scenario is that the UK can avoid a recession and undergo a soft landing, with GDP growth of 1.4 per cent this year and 1.1 per cent in 2019.

Global growth is now showing a dynamic that is typical of a mature expansion period. Robust labour markets and rising wealth are stimulating private consumption, while capacity utilisation is reaching levels that will drive new capital spending on a more widespread basis. There is also some evidence for our view that the supply side of the economy may surprise on the upside late in the economic cycle. US unemployment has been pushed a bit below the Fed's estimate of its long-term equilibrium level, and continued weak pay hikes are generally giving central banks an opportunity to move forward cautiously with their monetary policy normalisation. Euro zone unemployment remains slightly above equilibrium, and in light of structural reforms in labour markets, it is not unreasonable to expect that this equilibrium can be pushed somewhat lower.

Recent strong economic signals and a changing risk picture for inflation are nevertheless having an impact on central bank prospects. The Fed will speed up its pace of normalisation to four key rate hikes this year, following by one more hike in 2019. In the euro zone, the ECB's hawks have gained the upper hand. The ECB will end its stimulative bond purchases in September, followed by an initial hike in its deposit rate for banks in March 2019, while its refi rate will be raised to 0.50 per cent by the end of 2019. The changing growth and monetary policy outlook has been reflected in a clear upturn in long-term bond yields since mid-December. Our forecast is that US 10-year Treasury yields will climb by another 60-80 basis points to 3.00-3.50 per cent while equivalent German government bond yields will reach 1.50 per cent by the end of 2019. Weak inflation pressure and the fact that the ECB will keep its bond holdings unchanged are downside factors, but the risks in our long-term yield forecast are on the upside.

Expectations of aggressive Fed action have not contributed to dollar appreciation; forces other than relative monetary policy prospects now appear to dominate the EUR/USD exchange rate. The strength of the euro zone economies and a more stable political landscape have boosted confidence in the euro as a reserve currency. Efforts to increase the proportion of euros in the currency reserves of central banks and other institutions will help bring about a continued gradual appreciation of the euro to USD 1.32 by the end of 2019. A good corporate earnings outlook, against a backdrop of synchronised global economic expansion and increased business investments, will help sustain a continued upturn in stock markets, which have also received an extra injection from the US tax cuts. Although relatively high share valuations may create some nervousness, a generally stable macroeconomic environment combined with surplus liquidity suggest that the the stock market's "fear indicator", the VIX volatility index, will remain at historically low levels. Such "calm" periods have previously turned out to be a little treacherous, but at present there are several underlying explanations for low volatility.

Despite optimistic forecasts for the next couple of years, there will be lingering sources of concern further ahead. President Donald Trump is gaining greater appreciation for his economic policy programmes. But that will not prevent today's deep US political conflicts from being dangerous further ahead. US trade and foreign policy actions will generate continued uncertainty. Ambitions to create a more federalist EU may create future tensions in relations with Eastern European member countries as well as Denmark and Sweden. The US tax cuts are occurring rather late in the economic cycle. This will decrease the room for fiscal stimulus during the next recession, when they will actually be more needed, since there is a major risk that the monetary policy toolbox will still be empty then. A long period of ultra-loose monetary policy may weaken pressures for change and create new financial bubbles. Generally slow upturns in household purchasing power are hampering consumption, although in many places consumption is being propped up by less saving.

Above-trend Nordic growth, due to increased exports and capital spending

Strong European conditions are benefiting the Nordic economies. Increased exports and business investments are contributing to above-trend growth in all these economies. An industrial upswing, also sustained by a clear turnaround in oil investments, is compensating for the decline in residential construction in Norway. In Finland, last year's acceleration in growth and good future outlook will finally help GDP reach its 2008 level during 2018. Households in Denmark are cautious in relation to fundamentals and are expected to increase their consumption ahead, helping to accelerate the economy. The Baltic countries showed robust economic growth last year, helped by good export conditions. This expansion will continue, although tight labour market conditions will lead to some deceleration this year. Weaker residential construction in Sweden will pose a downside risk for Estonia and Lithuania in particular.

Europe is lifting Swedish industry; Riksbank rate hike despite low inflation

The Swedish economy has been resilient to increased uncertainty in the housing market. We are sticking to our forecast that GDP will grow by 2.6 per cent this year and by 2.4 per cent in 2019. Falling home prices will pull down the economy, with the contribution of residential construction to GDP growth shifting from a positive 0.7 percentage points in 2017 to a negative 0.5 points this year. There is a further downside risk if the overall home price decline exceeds SEB's 10 per cent forecast. Meanwhile strong global economic conditions and a weak krona are lifting exports and industrial investments – boosting GDP growth. Nor are there any signs that households are being adversely affected by falling home prices. An increase in purchasing power, driven by strong job growth and expansionary fiscal policy, instead suggests a continued upturn in consumption during the next couple of years. Record-high household saving will also provide extra potential.

The Swedish unemployment downturn gained momentum late in 2017 but will be slowed by an impressive upswing in labour force participation. The percentage of companies claiming a labour shortage has climbed to new record levels, confirming the picture of a high equilibrium unemployment level. The Social Democratic-led government's target of making Sweden the EU country with the lowest unemployment by 2020 is unrealistic. Because the jobless rate in countries like Germany, the UK, Norway and Denmark has fallen to historically low levels, Sweden is increasingly beginning to stand out in a negative light. Despite record-high resource utilisation, pay increases have remained subdued. Even taking into account the current three-year collective agreements with their relatively low pay hikes, it is surprising that employer complaints about recruitment problems are not at all visible in the pay statistics. We still expect a gradual acceleration in pay increases to 3.5 per cent during 2019: on a par with the average level in recent decades.

Swedish inflation surprised on the upside in 2017 despite low pay increases. Several of the forces that pushed inflation higher last year are expected to weaken in 2018, but rising energy prices will have the opposite effect. CPIF (the consumer price index minus interest rate changes) will climb by an annual average of 1.8 per cent, but CPIF does not seem likely to reach the Riksbank's 2 per cent target, even in 2019. The Riksbank has stuck to its plan for an initial interest rate hike during the third quarter of 2018, and because of higher inflation its Executive Board is starting to prepare to let go of the Riksbank's link to ECB policies. Pricing in the fixed income market is close to the Riksbank's rate path, making it easier to hike the key rate without too great an impact on the krona. SEB's forecast implies that inflation will be surprisingly low during the next six months, compared to the Riksbank's forecast. In an environment where more and more central banks are moving towards monetary policy normalisation, it is unlikely that the Riksbank will further postpone its starting date. We are reiterating our forecast of a first rate hike in September, followed by three more hikes in 2019, bringing the repo rate to 0.50 per cent by year-end. The Riksbank's rate hikes will probably lead to a gradually widening spread between Swedish and German government bond yields, but in the short term the spread will narrow, due to a combination of continued Riksbank bond purchases and a reduced need for National Debt Office bond issues.

In the past six months, the krona has traded at unsustainably low levels against the euro. Partly due to the Riksbank's slow shift away from negative interest rates, the downturn in the EUR/SEK exchange rate will occur very gradually, reaching 9.50 by year-end, followed by 9.30 at the end of our forecast period. Because of its strong connection to the euro, the krona will also move up as the euro appreciates against the dollar. The USD /SEK rate will thus be only a bit above 7.00 by the end of 2019.

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

International economy, GDP, year-on-year changes, %	2016	2017	2018	2019
United States	1.5	2.3 (2.3)	2.8 (2.6)	2.5 (2.0)
Euro zone	1.8	2.3 (2.3)	2.5 (2.3)	2.2 (2.1)
Japan	0.9	1.5 (1.5)	1.2 (1.2)	1.0 (1.0)
OECD	1.8	2.4 (2.4)	2.5 (2.3)	2.2 (2.0)
China	6.7	6.9 (6.9)	6.6 (6.6)	6.2 (6.2)
Nordic countries	2.2	2.4 (2.7)	2.4 (2.3)	2.3 (2.2)
Baltic countries	2.2	4.2 (4.0)	3.5 (3.4)	3.2 (3.1)
The world (purchasing power parities, PPP)	3.2	3.9 (3.8)	4.0 (3.9)	3.9 (3.8)
Nordic and Baltic countries, GDP, year-on-year changes, %				
Norway	1.1	2.0 (2.0)	2.0 (1.6)	2.1 (1.8)
Denmark	2.0	2.1 (2.3)	2.4 (2.3)	2.3 (2.3)
Finland	2.1	3.1 (2.9)	2.5 (2.5)	2.4 (2.3)
Estonia	2.1	4.4 (4.1)	3.5 (3.3)	3.0 (3.0)
Latvia	2.1	4.5 (4.5)	4.1 (3.7)	3.7 (3.5)
Lithuania	2.3	3.8 (3.7)	3.2 (3.2)	3.0 (3.0)
Swedish economy. Year-on-year changes, %				
GDP, actual	3.2	2.6 (3.2)	2.6 (2.6)	2.4 (2.4)
GDP, working day corrected	3.0	2.8 (3.5)	2.7 (2.7)	2.5 (2.5)
Unemployment, % (EU definition)	6.9	6.7 (6.7)	6.2 (6.2)	6.2 (6.2)
Consumer Price Index (CPI) inflation	1.0	1.8 (1.8)	1.8 (1.8)	2.1 (2.1)
CPIF (CPI minus interest rate changes)	1.4	2.0 (2.0)	1.8 (1.8)	1.8 (1.8)
Government net lending (% of GDP)	1.2	1.3 (1.0)	1.1 (0.7)	1.0 (1.0)
Repo rate (December)	-0.50	-0.50 (-0.50)	-0.25 (-0.25)	0.50 (0.50)
Exchange rate, EUR/SEK (December)	9.19	10.00 (10.00)	9.50 (9.45)	9.30 (9.20)

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