Press release

Stockholm, May 16, 2018

Nordic Outlook: Broad-based investment boom continues to drive global economy

Sweden: Weak krona is of little benefit to growth

SEB's economists are sticking to an optimistic forecast. Global GDP will grow by about 4 per cent yearly in both 2018 and 2019, supported by strong labour markets and growing capital spending. Political uncertainty is greatly intensified, but experience tells us that this will not have major consequences for economic activity. The United States is far ahead of Western Europe and is pulling ahead in its recovery, as reflected in growing key interest rate and long-term bond yield spreads, while the US dollar has reacted only cautiously. Swedish economic growth will decelerate as homebuilding falls significantly. Meanwhile industry is taking over as the most important driving force, but the weak krona is not providing the same help as during earlier episodes of currency depreciation. Because of high capacity utilisation in manufacturing and a squeezed retail sector, this time the krona's net stimulative effect is close to zero. Despite inflation above its 2 per cent target during much of 2018, the Riksbank will hold off until next spring before hiking its repo rate, which will remain at a low zero per cent at the end of 2019. It is thus increasingly likely that Sweden will enter its next recession with a central bank that has little manoeuvring room. The krona will appreciate gradually but remain at a historical weak level of SEK 9.70 per euro at the end of our 2018-2019 forecast period.

The world economy lost momentum early this year after a robust ending to 2017, but underlying strengths suggest that this slowdown was temporary. **SEB's economists are making only minor revisions compared to their growth forecast in February's *Nordic Outlook***.

Political uncertainty is greater than it has been in recent decades. The US-Chinese trade conflict – plus tensions in the Middle East following the US decision to withdraw from the Iran nuclear agreement – are the biggest risks, but our main scenario is that a full-scale trade war can be avoided. US President Donald Trump's actions in other areas suggest that even relatively limited concessions from his counterparty may be enough for him to count as a success ahead of this autumn's mid-term elections. In the case of Iran, too, an escalation can probably be avoided, but worries about disruptions in Iranian oil production are one factor behind higher oil prices than before (USD 85/barrel for Brent crude in 2019). Europe is also facing disruptive processes, such as Brexit (British withdrawal from the European Union) and attempts to breathe new life into EU integration efforts, while Russia and especially China are seeking new roles in the international community. **Yet experience says that political events rarely have a major impact on economic activity**.

Instead the focus of financial market attention is on the economic cycle and questions about the durability of the upturn. Temporary factors including delayed US tax refunds and bad weather in Europe slowed first quarter growth, but underlying strength suggests continued above-trend growth during our forecast period. **Labour markets have continued to improve while asset prices have climbed, providing support for private consumption. Above all, there is now broad-based growth in capital spending**. The capital spending argument is of course double-edged. Expanded production capacity increases the potential for long-lasting higher growth, but at the same time an investment boom has often marked the final phase of an economic expansion. But because capital spending as a share of GDP is well below earlier peaks, there is less risk of major reversals. GDP growth since the end of the financial crisis has been lower than in previous recovery periods, which also suggests that it can last. Although global debt is high, it is not easy either to identify obvious excesses. The probability that supply-side restrictions will finally halt the economic upturn will increase as time passes and unemployment falls. Yet wage and price signals indicate that **during the next couple of years, most central banks will have to continue struggling with troublingly low inflation**, with upside risks mainly connected to energy and other commodities.

Unusually large cyclical differences between countries are reflected in their monetary policies. **We now expect the US Federal Reserve (Fed) to raise its key interest rate three more times this year and twice in 2019 to 3 per cent**, a bit more than in our February forecast**. For most other central banks, the adjustments in our forecasts have been in the opposite direction as a consequence of dovish signals due to unexpectedly low inflation**. Only at the end of this year will the European Central Bank (ECB) end its stimulative bond purchases; we now expect the first increase in the ECB's deposit rate for banks to occur in June 2019, followed by a refi rate hike to 0.25 per cent in September. The United Kingdom's central bank is postponing its next rate hike until 2019, and the Bank of Japan is sticking to its ultra-loose monetary policy. Because of still-expansionary monetary policies, central banks in most countries will face the next economic downturn with extremely little interest rate ammunition. This is another argument for placing greater emphasis on the disadvantages of ultra-loose monetary policy, such as the risks of heavy indebtedness.

Long-term yield spreads remain wide across the Atlantic. Ten-year US Treasury yields will be 3.40 per cent at the end of 2019, while a 10-year German government bond will only yield 1.30 per cent. **The US dollar has reacted cautiously to wider key interest rate spreads, but will regain some lost ground in the near future**. Structural factors that benefit the euro will reassert themselves again as the ECB moves closer to rate hikes, and during 2019 the EUR/USD exchange rate will be in the 1.20-1.26 range. Stock markets have shaken off worries about rising US interest rates and threats of trade wars. Instead they have focused on continued good growth prospects, but **a more mature economic cycle and fading central bank support will mean a greater risk of share price volatility**.

Synchronised above-trend Nordic growth

The small, export-dependent Nordic countries all benefit from **strong global economic conditions and continued expansionary monetary policies**. In **Norway**, the economy is gaining strength as the oil price upturn has positive secondary effects, especially on capital spending. Housing market stabilisation has reduced the downside risk for the domestic economy, although higher interest rates will eventually slow household consumption growth. In **Finland** the economy has finally picked up momentum and will grow at a 2½ per cent yearly pace in 2018 and 2019. Exports and capital spending are the main growth drivers, while household spending is limited by tight fiscal policy and low pay increases due to the 2016 Competitiveness Pact between government, unions and employers. In **Denmark**, consumption remains the main driver despite credit tightening, but accelerating business investments and increased residential construction will also help keep up the growth rate. In the **Baltic countries**, growth is slowing but remains high – especially in Latvia – while the forecast for Estonia and Lithuania is more cautious. Resource problems connected to the labour market, rising cost pressures and loss of competitiveness are longer-term challenges.

Swedish growth is gradually decelerating; key rate hike is being delayed despite above-target inflation

Swedish GDP growth will decelerate to 2.6 per cent in 2018 and 2.2 per cent in 2019 as residential construction falls significantly and domestic demand cools. **Home prices have stabilised** after a downturn in the latter part of 2017. **Our forecast that the price decline will be limited to 10 per cent still stands**, but a growing surplus of new homes for sale will mean continued uncertainty. **The manufacturing sector is now gradually taking over as the most important growth driver**. The strong labour market will benefit households, but **rising energy prices and higher import prices due to the weak currency will limit their purchasing power**. We have adjusted our forecast for private consumption growth by nearly 0.5 points to just below 2 per cent.

In a *Nordic Outlook* theme article, SEB's economists examine the stimulus effects of the weak Swedish krona. The normal outcome of a depreciation on the scale of recent years would normally be GDP growth stimulus of 0.5-0.6 per cent over two years. But given high capacity utilisation and cautious capital spending behaviour, this time around SEK depreciation will have rather little impact on export volume. Meanwhile the weak currency is straining household finances and an already squeezed retail sector. **Our assessment is thus that the net stimulus effect of today's depreciation is close to zero**.

Because of sharp currency depreciation and rising energy prices, Swedish **inflation will end up above the Riksbank's 2 per cent target during most of 2018**, but the central bank wants to see evidence that the strong economy will leave a mark on pay and service prices. This creates a risk that a key rate hike will be postponed until 2019. We are thus forecasting that **the first rate hike will occur in April 2019 and that the repo rate will stand at a low zero per cent by the end of 2019**. The Riksbank is playing a high-stakes game by sticking to its extremely loose monetary policy despite an economic boom. **It is thus increasingly likely that Sweden will enter its next recession with highly leveraged households, high home prices and a central bank with little possibility of combating a downturn**. There is also a risk that inflation pressure will surge late in the economic cycle, as it did in 2001 and 2008, making the Riksbank's dilemma even more difficult.

The krona continues to appreciate after the dramatic downturn that occurred because of the Riksbank's signals that it was further raising the bar for the beginning of policy normalisation. **At the end of 2018 the EUR/SEK exchange rate will be just below 10.00 and at the end of 2019 it will be 9.70: still a weak level in historical terms**.

Key figures: International & Swedish economy *(figures in brackets are forecasts from the February 2018 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 (2.8)	2.5 (2.5)
Euro zone	1.8	2.4 (2.3)	2.4 (2.5)	2.3 (2.2)
Japan	0.9	1.7 (1.5)	1.2 (1.2)	1.0 (1.0)
OECD	1.8	2.5 (2.4)	2.5 (2.5)	2.3 (2.2)
China	6.7	6.9 (6.9)	6.6 (6.6)	6.2 (6.2)
Nordic countries	2.2	2.3 (2.4)	2.4 (2.4)	2.3 (2.3)
Baltic countries	2.2	4.3 (4.2)	3.4 (3.5)	3.1 (3.2)
The world (purchasing power parities, PPP)	3.2	3.8 (3.9)	4.0 (4.0)	3.9 (3.9)
Nordic and Baltic countries, GDP, year-on-year changes, %				
Norway	1.1	1.8 (2.0)	2.1 (2.0)	2.1 (2.1)
Denmark	2.0	2.2 (2.1)	2.2 (2.4)	2.3 (2.3)
Finland	2.1	2.6 (3.1)	2.5 (2.5)	2.4 (2.4)
Estonia	2.1	4.9 (4.4)	3.5 (3.5)	3.0 (3.0)
Latvia	2.1	4.5 (4.5)	3.7 (4.1)	3.5 (3.7)
Lithuania	2.3	3.9 (3.8)	3.2 (3.2)	3.0 (3.0)
Swedish economy, year-on-year changes, %				
GDP, actual	3.2	2.4 (2.6)	2.6 (2.6)	2.2 (2.4)
GDP, working day corrected	3.0	2.7 (2.8)	2.7 (2.7)	2.3 (2.5)
Unemployment, % (EU definition)	6.9	6.7 (6.7)	6.0 (6.2)	6.2 (6.0)
CPI	1.0	1.8 (1.8)	1.9 (1.8)	1.8 (2.1)
CPIF (CPI minus interest rate changes)	1.4	2.0 (2.0)	2.0 (1.8)	1.8 (1.8)
Government net lending (% of GDP)	1.2	1.3 (1.3)	1.1 (1.1)	1.0 (1.0)
Repo rate (December)	-0.50	-0.50 (-0.50)	-0.50 (-0.25)	0.00 (0.50)
Exchange rate, EUR/SEK (December)	9,19	10,00 (10,00)	9,95 (9,50)	9,70 (9,30)

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