SEB

Press release

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Nordic Outlook: Global economic strength despite political uncertainty

Sweden: Above-trend growth, but low inflation delays Riksbank action

SEB's economists are sticking to an optimistic forecast in which global GDP will increase by about 4 per cent yearly in 2018 and 2019, followed by a mild deceleration in 2020. The world economy will thus grow at above its trend rate for another couple of years, defying intensified political uncertainty. Late-cyclical stimulus from capital spending and optimistic households will weigh more heavily than the negative effects of trade disruptions. Despite low unemployment there are still some idle resources, and because of moderate pay increases, inflation will slow as energy price surges fade from the statistics. More central banks are now emulating the US Federal Reserve (Fed) by cautiously normalising their key interest rates, and the US dollar will lose ground against the euro and other currencies in 2019-2020. The risk picture is unusually complicated, however, and the positive economic spiral depicted in SEB's main scenario is being challenged by such threats as an escalating trade war. In Sweden, economic growth will be sustained by exports and industrial investments as home construction decreases and households hesitate to spend. Low underlying inflation will persuade the Riksbank to postpone key rate hikes until April 2019. Financial markets are paying more attention than usual to the September 2018 parliamentary election, but a Swedish political risk premium is a distant prospect. Low interest rates will nevertheless play a larger role for the krona, which will remain weak.

Trade war poses manageable risks to economic growth

The world economy has recently shown mixed performance, with an unexpectedly prolonged slowdown in the euro zone and weak indicators in China as well as in several other important emerging economies. Yet growth in the United States accelerated during the second quarter of 2018. Upside surprises were also dominant in Japan, the United Kingdom and India. **Taken together, the overall outlines of our May forecast remain correct**. Despite lower figures, euro zone sentiment indicators remain at levels that signal above-trend growth. In the UK, our main scenario is that an agreement with the European Union on British withdrawal (Brexit) can be reached and that growth will then speed up. Slower growth in China will be offset by acceleration in other emerging market (EM) countries. The US economy is firing on all cylinders, though trade and fiscal policies are creating longer-term risks.

Political uncertainty will remain heightened. This past summer has been dominated by an escalating trade conflict between the US and China, a crisis in Turkey and a complicated Brexit process, but SEB is sticking to the view that **it is mainly underlying economic forces that will determine developments over the next couple of years**, since trade disruptions currently appear likely to be limited.

As the current economic expansion looks set to break historical records in terms of duration, the question is whether we are facing a recession. History shows that soft landings, in which the economy gradually deflates, are unusual. **On the contrary, demand usually shows a strong dynamic late in the economic cycle**, when capacity utilisation reaches levels that lead to heavy pressure for an expansion of production capacity. Capital spending in the Group of 20 (G20) economies is now increasing at a faster pace, indicating that we have entered such a phase. Strong labour markets and ample household wealth will drive consumption at the end of the cycle. Large US tax cuts, even though unemployment has already fallen to low levels, will fuel late-cyclical strength.

Labour market will determine duration of upturn

How inflation and pay increases react to an increasingly tight resource situation is the key to how long the global economic expansion can last. Unemployment is now at historically very low levels in many countries but there are still probably idle resources in many places, which means that there is still a way to go before reaching the critical level where wages and salaries may conceivably soar. Because of subdued pay increases, inflation will probably fall in the near future as the impulse from rising energy prices fades from the statistics, but **the risk picture for inflation has shifted**. In some countries, for example Japan, clear signs of wage acceleration are visible. In a mature expansion, there is a rising probability of general secondary effects from earlier energy price increases. Trade barriers and cost pressures from low productivity growth are other factors that will help to fuel upside risks. In the short term, consequences of drought and extreme weather may also contribute.

Because of low unemployment, a number of central banks are beginning to pay more attention to the downsides of loose monetary policy, for example increased private debt. Despite rather low inflation, **more and more of them are emulating the Fed and starting to normalise their key interest rates**. We expect the US key rate to climb to the mildly contractionary level of 3.25 per cent by 2020. After next year's withdrawal from the EU, the UK will resume its rate hikes, reaching a key rate of 1.75 per cent by the end of 2020. Meanwhile the European Central Bank (ECB) will hike its key rate to only 0.75 per cent. **Long-term yields will be pulled by opposing forces – strong economic conditions and wavering risk appetite – but will gradually climb** from depressed levels. At the end of our forecast period, 10-year government bond yields will be around 3.50 per cent in the US and stand at 1.40 per cent in Germany. **The dollar has regained strength as the risk climate has worsened, but it will lose ground** as key interest rates are raised faster outside the US. By the end of 2020, the EUR/USD exchange rate will be 1.28. **Stock markets are entering a more defensive phase**, with moderate upturns and greater volatility. Valuations will be subdued, but higher corporate earnings will provide continued support.

Nordic growth surpassing trend despite global uncertainties

The Nordic countries are benefiting from good international conditions and loose economic policies. Generally, trade disruptions represent an especially big threat to small export-dependent economies, but the trade barriers the US is in the process of imposing will have only marginal effects. In Norway, the structure of growth is changing, with increased support from the oil industry and the business sector in general as residential investments shrink. Technical factors are holding back 2018 GDP growth in **Denmark**, but because of a strong consumption and capital spending dynamic, underlying growth will be above trend in 2018-2020. In **Finland**, the economy was resilient to European weakness early this year. We expect GDP growth to exceed 3 per cent in 2018, thereby regaining lost ground after 10 years of stagnation. In the **Baltics**, growth will slow to levels more in line with the long-term trend. Labour shortages and rising cost pressures are a challenge in all three Baltic countries.

Above-trend Swedish growth, but low inflation delays Riksbank action

The relatively bright growth picture in Sweden has improved. **After a strong second quarter, we are revising our GDP growth forecast three tenths higher in 2018 to 2.9 per cent and two tenths higher in 2019 to 2.4 per cent**. During the past year, exports and the manufacturing sector have become increasingly important growth engines, offsetting the downturn in home construction. Expansionary economic policy will help GDP to continue increasing somewhat above trend in 2020 – at a 2.3 per cent pace – but capacity restrictions both in the export industry and in the labour market generally will gradually make themselves felt. The stimulus effects of the weak krona will thus be limited. Imbalances in the housing market will continue to be the main downside risk, but both home price and construction indicators are signalling a stabilisation. **The probability of a soft landing has thus increased, though large supply will test the housing market this autumn**. Despite positive support from employment, incomes and wealth, household optimism is shaky. Partly due to ever-larger savings, consumption growth is subdued, especially after factoring in Sweden's rapid population increase.

Job growth is slowing after a climbing quickly in 2017, but unemployment will still fall below 6 per cent late this year. Despite high resource utilisation, price and wage pressures remain weak. When the effects of the energy price upturn vanish from the statistics, CPIF (the consumer price index minus interest rate changes) will again fall below the Riksbank's 2 per cent inflation target, approaching 2 per cent only late in our forecast period. **Because of low underlying inflation, the Riksbank will postpone its first key interest rate hike until April 2019**, but due to growing divisions on its Executive Board, a rate hike in late 2018 – in keeping with the Riksbank's current rate path – cannot be ruled out. By the end of 2020, the Swedish repo rate will be 0.75 per cent. Ten-year government bond yields will move closer to German yields in the short term, driven by such factors as the Riksbank's early reinvestments in government bonds, but will then gradually climb to 1.90 per cent.

Financial markets are paying more attention to Sweden's parliamentary election than usual. Most indications are that the parliamentary situation will remain complicated, with weak governments and the risk of an extra election during the next couple of years, but **a political risk premium is a distant prospect** in light of the country's strong government finances and its tradition of being able to reach broad agreements in crisis situations. **Low interest rates and the uncertain international environment are a bigger problem for the Swedish currency**. The krona will stand at around 10.50 per euro at the end of 2018 and then reach 10.00 at year-end 2019 and 9.70 at the close of 2020.

Key figures: International & Swedish economy *(figures in brackets are from the May 2018 issue of **Nordic Outlook**)*

International economy, GDP, year-on-year changes, %	**2017**	**2018**	**2019**	**2020**
United States	2.2	3.0 (2.8)	2.5 (2.5)	1.9
Euro zone	2.4	2.1 (2.4)	2.1 (2.3)	1.9
Japan	1.7	1.1 (1.2)	1.0 (1.0)	0.8
OECD	2.5	2.5 (2.5)	2.3 (2.3)	2.1
China	6.9	6.6 (6.6)	6.3 (6.2)	6.0
Nordic countries	2.3	2.4 (2.4)	2.3 (2.3)	2.1
Baltic countries	4.3	3.7 (3.4)	3.2 (3.1)	2.8
The world (purchasing power parities, PPP)	3.8	4.0 (4.0)	3.9 (3.9)	3.8
Nordic and Baltic countries, GDP, year-on-year changes, %				
Norway	2.0	1.4 (2.0)	2.4 (2.3)	2.4
Denmark	2.3	1.5 (2.2)	2.5 (2.3)	2.0
Finland	2.7	3.1 (2.5)	2.3 (2.4)	2.3
Estonia	4.9	3.4 (3.5)	3.5 (3.0)	2.8
Latvia	4.5	4.2 (3.7)	3.5 (3.5)	3.2
Lithuania	3.9	3.4 (3.2)	3.0 (3.0)	2.6
Swedish economy, year-on-year changes, %				
GDP, actual	2.3	2.9 (2.6)	2.4 (2.2)	2.3
GDP, working day corrected	2.5	3.0 (2.7)	2.4 (2.3)	2.1
Unemployment, % (EU definition)	6.7	6.2 (6.0)	5.9 (6.2)	6.2
CPI	1.8	2.0 (1.9)	1.8 (1.8)	2.0
CPIF (CPI minus interest rate changes)	2.0	2.1 (2.0)	1.9 (1.8)	1.7
Government net lending (% of GDP)	1.3	1.0 (1.1)	0.8 (1.0)	0.8
Repo rate (December)	-0.50	-0.50 (-0.50)	0.00 (0.00)	0.75
Exchange rate, EUR/SEK (December)	10.00	10.50 (9.95)	10.00 (9.70)	9.70

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