November 2018

Continued global expansion,
but supply-side restrictions pose risks

Riksbank poised to begin rate hikes
despite slower economic growth

Nordic Outlook

SEB

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International overview

Continued global expansion, but risks from tight labour market

Slower growth tendencies in Western Europe and Asia, plus ever-tighter resource use and rising US interest rates, have increased downside risks to the global economy. We have lowered our GDP outlook slightly, but global growth will stay a bit above trend in 2019-2020, providing support for corporate earnings and equities, though we must become used to heightened volatility. Accelerating pay hikes will challenge any notion of the death of inflation, but higher inflation risks still leave central banks room for cautious rate hikes.

Global economic performance has shown divergent tendencies in recent months. The US economy has continued to show signs of strength, with robust GDP growth again in the third quarter of 2018, while the pace of job growth is impressive. In Western Europe, the slump that dominated early 2018 lasted longer than expected. There has been a continued trend towards slower activity in important emerging market (EM) economies, although optimism has now generally bottomed out. Alongside their concerns about slowing short-term global growth, financial markets are increasingly starting to **worry that supply-side restrictions will bring an end to the US and global economic boom further ahead**. Overall unemployment in the advanced economies (the 36 member countries of the Organisation for Economic Cooperation and Development, or OECD) is now at its lowest since 1980. In the United States, the latest figure, 3.7 per cent, is the lowest since the 1960s. This has helped to speed up pay increases, although their pace is still subdued. This *Nordic Outlook* will thus focus largely on discussing **the sustainability of growth and the interaction between the real economy and financial markets late in an economic cycle**. The report is structured differently than normal: we have left out country-by-country sections and instead summarise developments in an international overview plus Nordic and Baltic overviews. In addition, there are four theme articles on current topics.

Partly due to weaker economic trends, **we have lowered our forecast by about ¼ percentage point per year**. We now believe that global GDP will grow by **3.8 per cent in 2018, and 3.6 per cent in 2019 and 2020**. These downward adjustments are mainly due to EM economies and Western Europe, with the euro zone, the United Kingdom and Sweden having performed more weakly than expected. Trade tensions and uncertainty about the Brexit process look set to have a slightly larger impact that we had expected earlier, though they are overshadowed by more traditional cyclical forces.

Despite these downward revisions our forecast implies that global expansion will continue, with above-trend GDP growth again in 2019-2020. This also means that **unemployment will fall by about another ½ point in the OECD as a whole**. In this environment, pay increases are showing signs of speeding up. For example, in the past year or so a weighted average of pay hikes in the four largest OECD economies (the US, the euro zone, Japan and the UK) has accelerated from 1.7 to 2.6 per cent. This is still a relatively modest increase, but given the slow productivity growth of recent years, it will still push up costs and eventually add to inflation pressure. But so far, **core inflation is around 1.5 per cent in most countries**. Whether or not consumer price index (CPI) inflation – now swollen by rising energy prices – will fall again depends on a tug-of-war between different forces. Rising unit labour costs due to slow productivity growth, the potential for passing on costs to consumers in an overheated economy and tendencies towards greater isolationism, including tariffs and other barriers to free exchange, are reasons why inflation may not fall. Yet for decades CPI inflation has had difficulty reaching the 2 per cent inflation targets of central banks without the help of rising energy and commodity prices. Upside risks have risen, but our main scenario is that **inflation will not climb in a way that will force central banks to change their plans** for a very gradual normalisation of monetary policies.

Global GDP growth
Year-on-year percentage change

	2017	2018	2019	2020
United States	2.2	3.1	2.6	1.9
Japan	1.7	1.1	1.0	0.8
Germany	2.2	1.9	1.8	1.7
China	6.9	6.6	6.3	6.1
United Kingdom	1.7	1.3	1.4	1.6
Euro zone	2.4	2.1	1.9	1.8
Nordic countries	2.2	1.9	2.3	2.2
Baltic countries	4.4	3.7	3.3	2.8
OECD	2.5	2.5	2.1	2.0
Emerging markets	5.0	4.9	4.8	4.8
World, PPP*	**3.7**	**3.8**	**3.6**	**3.6**

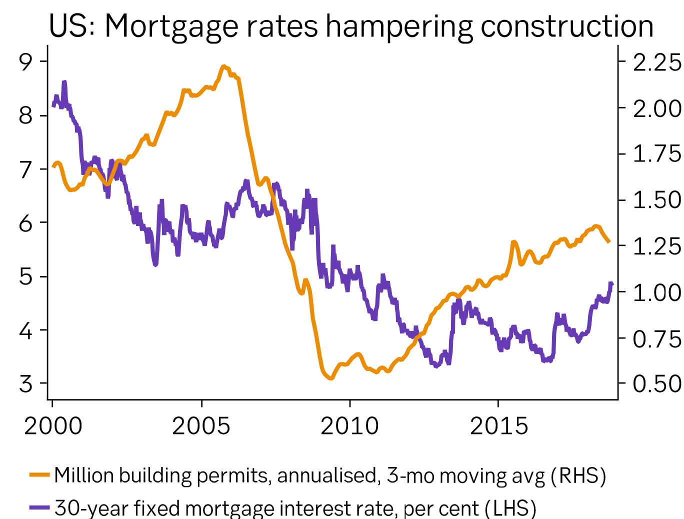
Source: OECD, IMF, SEB. * Purchasing power parities

Macroeconomic conditions, with slightly weaker demand yet increasingly tight resource utilisation, **make the situation a little more complicated for central banks**. Yet we see no strong

reasons for the US Federal Reserve (Fed) to change its strategy; instead we expect it to raise the American key interest rate four more times during our forecast period to 3.25 per cent. We also expect Western European central banks to hike their key rates as announced. **We predict that US 10-year Treasury note yields will peak at 3.60 per cent in mid-2020**, then fall as the market adjusts to the end of the Fed's hiking cycle. German bond yields are expected to climb slowly to 1.30 per cent late in 2020. This implies that we will see a long period of historically wide US-German yield spreads. At least in the medium term, it looks as if the European yield cycle – in the Japanese manner – will largely become decoupled from US yields. One consequence of this is that Western Europe will have little monetary policy room in response to the next recession. On the other hand, the opposite is true regarding fiscal manoeuvring room. **The budget situation has greatly improved in Western Europe**, whereas President Donald Trump's tax cuts are contributing to a **large US public sector deficit in the midst of an economic boom**.

The renewed stock market turbulence that we have seen in the past month or so accentuates the late-cyclical challenges we now face. High resource utilisation and rising US interest rates/yields will contribute to latent concerns that **relatively high corporate earnings expectations will need to be lowered** or that rising rates and yields will make stock market valuations seem stretched. This will probably lead to continued high stock market volatility. But given our forecast that there is room for relatively good GDP growth for another few years, we believe that today's earnings estimates will not need to be adjusted downward to any major extent. **We thus see prospects for continued relatively favourable stock market performance**.

However, we believe that stock market turbulence also reflects increased downside risks in the economy. Apart from risks that the US economy will hit its capacity ceiling earlier than expected, these risks include a messy Brexit process, Italy's budget policy, an escalating trade war and other geopolitical tensions. Nor can a Chinese hard landing be ruled out. **Today we are estimating the probability of a recession during the next couple of years at 20-25 per cent**. The outlook for a better outcome than in our main scenario is mainly connected with the possibility that we are underestimating the consequences of ongoing technological advances, for example in digitisation and robotisation. We are continuing to estimate the probability of higher growth than in our main scenario at 15 per cent.

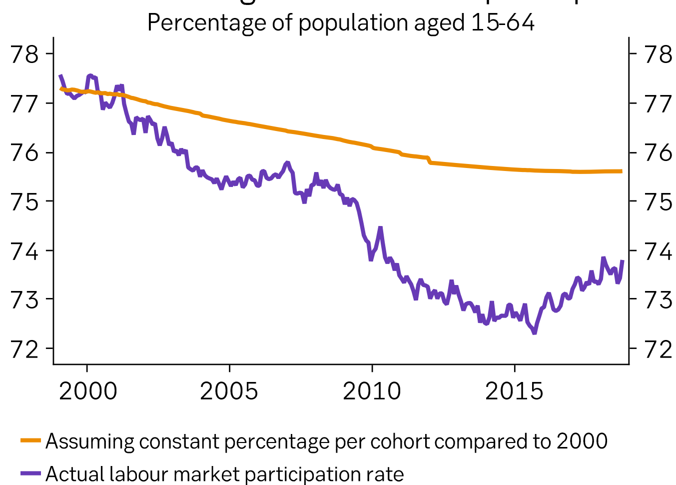


Source: Freddie Mac, Conference Board, Macrobond, SEB

US economy is chugging along, but will slow ahead

The US economy continues to perform strongly. Third quarter GDP growth was an annualised 3.5 per cent: only a minor slowdown from the 4.2 per cent achieved in Q2 with the help of temporarily surging export and consumption figures. There are few clear signs of deceleration. The labour market keeps gaining strength. Cautiously accelerating hourly earnings – combined with tax cuts – are sustaining consumption, which is still the main GDP growth driver. Consumer confidence remains close to record highs and there are not yet any clear signs that business investments have been adversely affected by trade worries.

But looking ahead, several factors will contribute to **gradually slower GDP growth in 2019 and 2020**. The US has now concluded a renegotiated version of the North American Free Trade Agreement (NAFTA) with Canada and Mexico, but trade tensions with China and the European Union have continued this autumn (see theme article, page 20). Our main scenario implies that trade disruptions will have only a minor impact, but business investments and exports are likely to be squeezed. Fed key rate hikes will also have a gradual tightening effect on interest rate-sensitive parts of the economy, such as the housing market. Thirty-year fixed mortgage rates are close to 5 per cent, their highest since 2011. Although US households have paid down their debts substantially in the past decade, interest rates affect construction sector activity. Building permits are down 7-8 per cent in the past six months. Higher interest rates also help push up the USD, especially against EM currencies, curbing exports to some extent.



Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

The labour market situation is important to the future growth outlook. Signs of strength continued to dominate. So far this year, non-farm payrolls have increased by an average of about 213,000 per month, and the October registered employment figure of 3.7 per cent was the lowest since the 1960s. There is little potential for further downturns, but we believe that **unemployment may fall to a bit below 3.5 per cent**.

Yet slightly broader metric indicate that **the resource situation is not as tight as it was in 2000, for example**. In that year, the "underemployment" metric (U6) was below 7 per cent, compared to 7.4 per cent today. Labour force participation among those aged 16-74 is now 4 percentage points below its peak around 2000. Demographic factors explain only a small part of the downturn (see chart), which means there is potential for a continued upturn. If the chances of further downturns in

unemployment can contribute a few tenths of a point to job growth, this potential may reach several points, if the US actually manages to mobilise more labour by boosting participation. To what extent this is successful will depend on developments in such areas as social exclusion and drug-related problems, pension levels, the role of women in the labour force and fee levels in the educational system. We believe such efforts will succeed at least to the extent that continued above-trend GDP growth will be possible without severe bottleneck problems. **We have adjusted our GDP forecast upward to 3.1 per cent in 2018 and 2.6 per cent in 2019**, but in 2020 growth will slow to about 2 per cent.

As expected, the November 6 mid-term election resulted in a divided Congress, with the Democrats taking control of the House of Representatives, but this will have hardly any major economic effects. President Trump's manoeuvring room will shrink during the second half of his four-year term. A new round of tax cuts now appears even more unlikely, since the Democrats are not prepared to accept spending cuts in order to fund tax cuts, but Trump's earlier tax cuts have already weakened the federal budget in a way that has undermined support for further cuts, even among Republicans.

Euro zone slowdown, but continued good job growth

The slump in euro zone economic growth has proved lengthier than expected, leading us to adjust our GDP forecast a bit lower. Unlike the situation in the US, it now looks as if growth peaked in 2017. **Manufacturing and exports have been the big disappointments so far this year**. The upturn has clearly slowed. Although order bookings still look good, the influx of orders has begun to dwindle. One contributing factor is weakness in the automotive industry, with new emission standards triggering a sharp downturn in recent months. New registrations are still rising year-on-year, but there are big question marks – especially for Germany, a major automotive producer. Despite the slowdown, however, business sentiment indicators are still compatible with continued decent growth. Household confidence also remains historically high. There is thus potential for continued fairly broad-based growth, driven by exports and capital spending as well as by household consumption. We thus expect euro zone **GDP growth of about 2 per cent yearly in 2018-2020**, or somewhat above trend.

GDP forecasts
Year-on-year percentage change

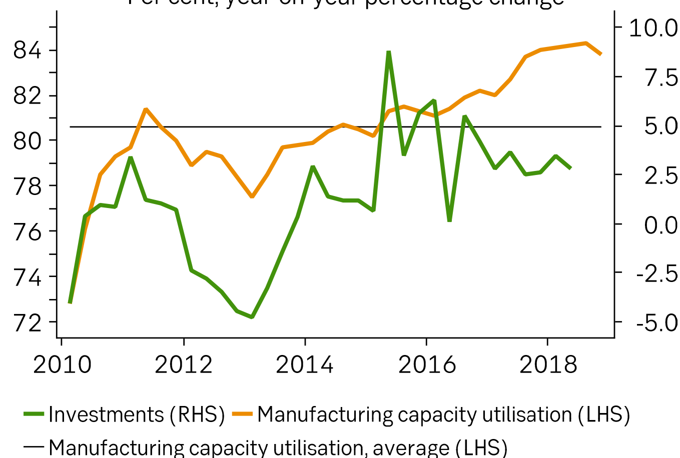
	2017	2018	2019	2020
Germany	2.2	1.9	1.8	1.7
France	2.2	1.6	1.8	1.8
Italy	1.6	1.2	1.2	1.3
Spain	3.0	2.7	2.4	2.2
Euro zone	**2.4**	**2.1**	**1.9**	**1.8**

Source: Eurostat, SEB

Political storm clouds may have contributed to the somewhat slower euro zone economic momentum. Risks of expanded trade barriers may be one reason why **companies are cautious about investing, even though their capacity utilisation is high**. In addition, there are lingering uncertainties about long-term developments in the EU and euro projects, connected among other things to the success of populist parties and the domestic problems now facing German Chancellor Angela Merkel and French President Emmanuel Macron. The Italian government's actions in challenging EU budget regulations represent a gamble (see box). Meanwhile somewhat more expansionary fiscal policies in Italy and other countries will provide support to growth in the next couple of years. With public sector budgets close to balance in the euro zone as a whole, there is pressure on political leaders to ease up on fiscal austerity.

Companies hesitant despite high resource use

Per cent, year-on-year percentage change



Source: Eurostat, Eurostat Database, Macrobond, SEB

Euro zone labour markets have continued to improve. In August, unemployment stood at 8.1 per cent: not far from its pre-crisis level. The number of jobs is increasing by more than 2 million a year, helping to sustain household incomes. Company hiring plans remain expansionary, which suggests a continued positive trend. We expect unemployment to fall towards 7-7.5 per cent by the end of 2020, which would be less than the low reached before the financial crisis broke out. We believe that the jobless rate will then be close to its equilibrium level and that supply-side restrictions will become a mounting problem ahead. Staff recruitment difficulties have also led to higher pay increases. Companies' reluctance to boost capital spending despite high capacity utilisation will also limit their growth potential.

Positive signs for the Japanese economy

The Japanese economy continues to grow faster than its trend rate of about 0.5 per cent, but growth will slow from an impressive 1.7 per cent in 2017 to about 1 per cent yearly in 2018-2020. The effects of earlier fiscal stimulus measures are gradually fading, while investments related to the 2020 Tokyo Olympics are approaching completion. Later during our forecast period, the economy will also be hampered by an increase in the consumption tax from 8 to 10 per cent in October 2019.

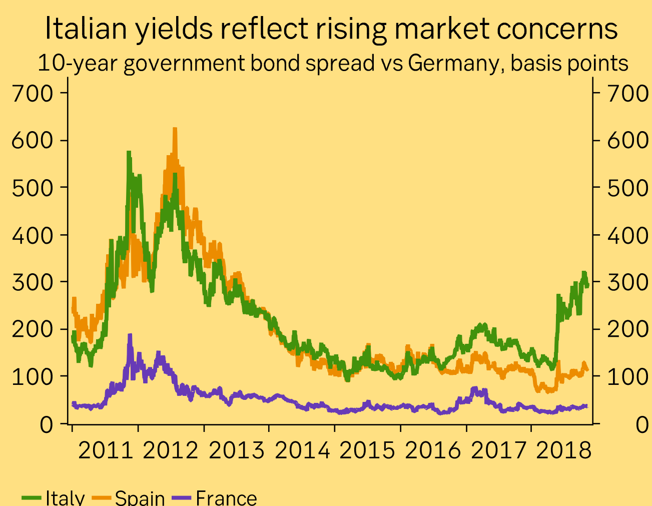
With unemployment at about 2.5 per cent, the Japanese economy is actually overheated, which has caused noticeable acceleration in pay increases. On the supply side of the economy, **demographic headwinds** represent continued strains, but government ambitions to expand the labour market are now starting to bear fruit: participation by women and older people has risen, while the number of foreign-born workers has increased. In spite of this, inflation risks are on the downside and the central bank faces continued challenges in achieving its target of keeping inflation above 2 per cent. Complicating the situation is that fiscal manoeuvring room is limited by astronomical public debt. The government has now postponed its target of balanced public finances from 2020 to 2025.

Italy's fiscal stimulus drive is a gamble

The Italian government's plan to jump-start growth with a dose of fiscal stimulus is a gamble. Its ambition to **implement election promises is expected to widen the public sector deficit to 2.4 per cent of GDP** (the previous government's forecast was 1.6 per cent). Objections from Brussels risk adding to financial market reactions in a way that will generate an even more powerful negative impulse for the economy.

Italy's underlying problems are well known. Recent decades have been characterised by political uncertainty, rising central government debt, a weak banking system and poor competitiveness. This negative picture is not all-encompassing, however: the country has a trade surplus, and its net external position is only slightly negative. To a greater extent than elsewhere in the euro zone, central government debt is owned by domestic investors. For example, Italian banks own 20 per cent of outstanding government bonds, leading to an especially close mutual dependence between the government and the banks. Now that the yield spread vs Germany has climbed above 300 bps, government interest expenses have risen. The banking sector, which already has problems with a high percentage of bad loans, is also being further squeezed because higher yields are decreasing the book value of its bond holdings.

These developments are concerning but still manageable. Bond yields are still well below their euro crisis peaks and **can hardly be interpreted as pricing in an especially large probability of Italian withdrawal from the euro zone**. Although EU authorities have rejected a national budget bill for the first time, pressure from Brussels is hardly sufficient to make the government back down. Market reactions and credit ratings will probably be more important. Moody's recently downgraded Italy's government debt, while Standard & Poor's left its rating at BBB (but with a negative outlook). The European Central Bank (ECB) can thus continue to buy Italian government bonds. We do not believe Italian political leaders will end up in a situation where financial markets or bail-out programmes will dictate their policies. Rome also recently declared clearly that euro zone withdrawal is not a forward path. Our main scenario is thus that **Italy will successfully manoeuvre through the current turbulence, thus enabling the yield spread to shrink**. If developments should move in the opposite direction, the Italian economy is large enough to create a new existential crisis for the euro zone.



Source: Macrobond Financial AB, Macrobond, SEB

Brexit worries continue to hamper UK economy

The British economy recovered quickly from its first quarter 2018 slump. Both Q2 and Q3 showed GDP growth close to trend. We are maintaining our forecast of 1.3 per cent GDP growth in 2018. Uncertainty about the terms of the United Kingdom's withdrawal from the EU will nevertheless continue to hamper UK economic performance throughout our forecast period. So far, this has mainly been apparent from a deceleration in business investments. Although we still expect an agreement that will avoid a "hard Brexit", uncertainty about the UK-EU relationship will linger in many respects. A historically low household savings rate is also hampering the potential for higher consumption, even though wages and salaries are now growing by about 3 per cent. A tight labour market, with unemployment down to 4.0 per cent, is also creating restrictions. Nor do restrained business investments suggest that the UK is moving towards solving slow productivity growth problems. Overall, we thus do not expect any major upswing in British growth during the next couple of years. **We have adjusted our 2019 and 2020 forecasts lower** and now expect GDP growth of **1.4 and 1.6 per cent, respectively** (down from 1.8 and 1.9).

Last-minute Brexit agreement

Negotiations between the EU and the UK are taking a long time. The UK will formally withdraw from the EU on March 29, 2019, and we are still unsure about how the EU-UK relationship will look. So far the two sides have reached agreement on withdrawal terms, that is, how much the UK will pay the EU for future commitments, and on conditions governing EU citizens living in the UK and vice versa. The two sides have also pledged to find a solution that will enable the border between Ireland and Northern Ireland to remain open, even after withdrawal. Earlier this year, they agreed on a transition period until December 31, 2020, during which the UK will still be an EU member in practice and belong to the customs union and single market.

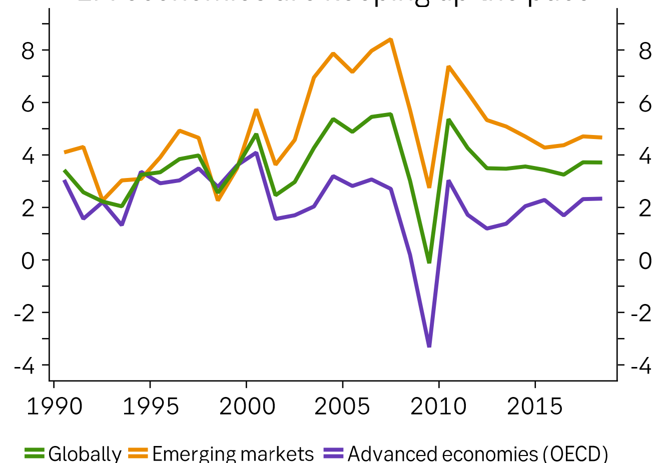
According to the EU, the final agreement is about 90 per cent complete, while the British have said 95 per cent. This may sound hopeful, but that last 5-10 per cent is causing problems. The remaining obstacles basically concern two problem areas. **One is how a future trade agreement should look. The other is how to fulfil the promise of an open border between Ireland and Northern Ireland** in practical terms, if the UK leaves the customs union. At their September summit, EU leaders rejected a British proposal on grounds that it risked undermining the role of the single market and giving the UK too much of a special position. The EU has instead demanded that Northern Ireland or the entire UK should stay in the EU customs union and the single market even after withdrawal, if no other solution is possible. Since the October EU summit, negotiations have continued, but aside from a few rumours that have quickly been shot down, no progress has been apparent. The next stop is December 13-14, when EU leaders gather for their last 2018 summit. A solution must be reached by then in order to give the UK Parliament and the European Parliament time to approve the agreement early in 2019. Failing this, the UK risks crashing out of the EU in March, without a transition or a trade agreement.

Available estimates of how various Brexit solutions would affect the UK economy vary sharply. Aside from fundamentalist euro-sceptics, most observers agree that their impact will be negative. There are already signs that the economy has been hurt by the uncertainty surrounding Brexit. Despite strong global growth and a record-weak pound, British growth has been lower than in the euro zone and the US since late 2016. Existing estimates indicate that **during the next 15 years, Brexit will lower GDP growth by an average of 2-3 tenths of a point per year, assuming the two sides reach an agreement**. If they should fail, the estimated negative effect on British growth may instead be as much as 1 point per year during the next 15 years. This probably means that the UK will fall into a recession. So there is a lot at stake for both sides as the negotiations enter their final round.

EM economies are creating both risks and stability

Risks related to emerging market (EM) economies have recently been a focus of attention in various ways. This includes market worries about Chinese growth as well as a number of crises that have flared up in smaller economies such as Turkey and Iran. In a theme article (see page 16), we discuss our forecast for EM economies and their vulnerability in different respects. Although Fed rate hikes and a strong dollar are now testing the stability of many countries, our conclusion is that EM resilience has generally strengthened during the past decade. It is thus **unlikely that the EM economies generally will suffer a severe slowdown** as long as US/European economic expansion persists. This is reflected in our forecast of continued overall growth in the EM sphere of close to 5 per cent yearly in 2019-2020.

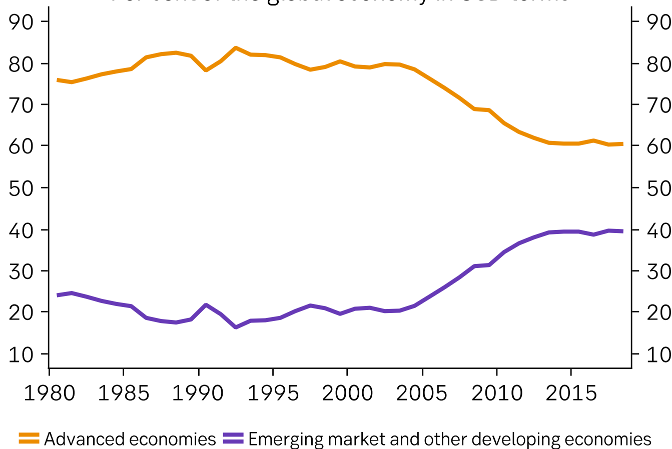
EM economies are keeping up the pace



Source: International Monetary Fund (IMF), Macrobond, SEB

Yet there are reasons to look a bit more closely at the global role of the EM countries and their interaction with advanced economies. Since the early 1990s, EM economies have grown faster than the OECD, but **only in the 2000s did this catch-up process really accelerate**, with growth rate gaps of around 5 percentage points per year. When the OECD countries plunged into a deep recession after the Lehman Brothers crash, with GDP falling more than 3 per cent in 2009, of course the whole world was affected. GDP growth in the EM countries slowed sharply too, but since their average growth in 2007 was an improbable 8.4 per cent, they maintained positive GDP growth throughout the crisis, bottoming out at 2.8 per cent in 2009. **This helped to ease the global crisis in various ways**, especially since EM

countries led by China propped up the demand for commodities and thereby softened deflationary forces in the world economy.



Source: International Monetary Fund (IMF), Macrobond, SEB

Since the Lehman crisis, EM economies have continued to grow much faster than the OECD countries, although not at the record levels of 2003-2007. This means they have further increased their share of the world economy. Measured in purchasing power parities, which incorporate adjustments for different price levels, and including poorer countries (developing economies) they account for nearly 60 per cent of the world economy. Assuming annual growth of nearly 5 per cent, their contribution to global GDP growth is nearly 3 percentage points – totally dominant in an environment where the world economy is growing by about 3½ per cent. **Yet there are many indications that this metric – actually intended to measure changes in living standards – exaggerates the role of the EM sphere.** As the chart and table show, the OECD still accounts for 60 per cent of the world economy if we measure current prices in one currency. The relative ranking of the US and China also depends on what metric we use. China has made big advances in goods trade and is now by far the world's biggest exporter. For years, China has also been the world's biggest oil and steel consumer. In PPP terms, it is now the world's biggest economy but in current prices the US has a 24 per cent share and China 15 per cent.

Shares of the global economy, 2017
Per cent

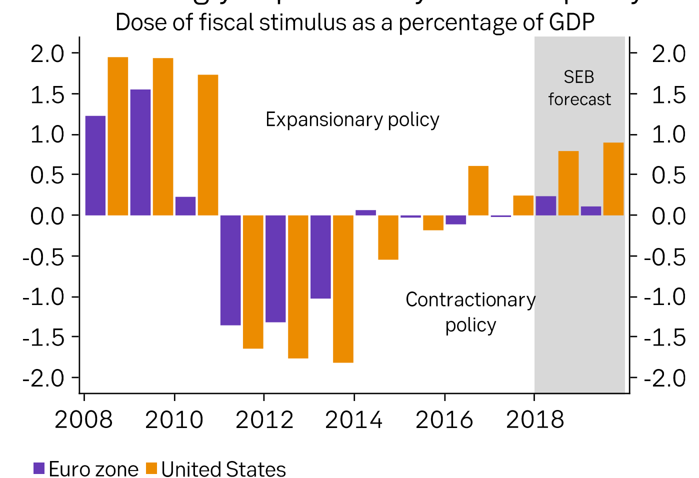
	US	China	EU	Japan
GDP in purchasing power parities	15	18	16	4
GDP in nominal terms	24	15	22	6
Exports	9	13	12	4
Stock market capitalisation	55	4	8	4
Oil consumption	20	13	13	4
Steel consumption	6	43	11	4

Source: OECD, SEB

Generally speaking, comparisons in current prices are probably more relevant when looking at the relative international importance and influence of various economies. The importance of the US also increases even more because of its dominant role in the world's financial systems. This is especially true of the stock market, where the weight of the US in global indices is above 50 per cent, while China's is only 4 per cent. There are thus many indications that the pattern of recent decades will persist, with **American downturns generally spreading and becoming broad global recessions, while crisis outbreaks in other parts of the world remain regional**. This will not prevent a future global recession from starting elsewhere in the world, but domestic conditions ultimately determine how large the contagious effects on the American economy will actually be.

Varying degrees of fiscal stimulus

The direction of fiscal policy has shifted dramatically over the past decade. During the most acute phase of the financial crisis (2008-2010), stimulus measures helped ease the recession. Then the outbreak of the euro zone crisis forced major budget austerity in response to mistrust of unsustainably weak government finances in many countries. But figures from the International Monetary Fund (IMF) indicate that the US tightened its fiscal policy to an even greater extent in 2011-2013, with a negative impact in the range of 1½ per cent of GDP per year. After the relatively neutral fiscal policy of 2014-2017, **the Trump administration is now aggressively stimulating the US economy, mainly through tax cuts**. The dose of stimulus in the US is close to 1 per cent of GDP, while euro zone fiscal policies are only marginally expansionary. A comprehensive metric for the EM sphere indicates neutral fiscal policies.

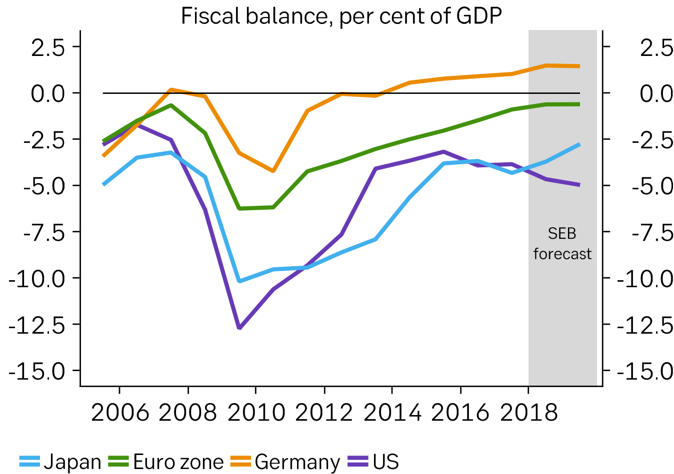


Source: International Monetary Fund (IMF), Macrobond, SEB

The consequences of late-cyclical stimulus in the US become clear when comparing budget deficits and government debt. Although unemployment is now is at its lowest since the 1960s, the federal budget deficit is nearly 5 per cent of GDP. In the euro zone, which has a significantly looser overall resource situation than the US**, the average budget deficit has been pushed down to 0.5 per cent of GDP**. Germany, which has a cyclical position more in line with the US, is showing a budget surplus of 1 per cent of GDP. Before the financial crisis a decade ago, both the US and Germany had central government debt of about 65 per cent of GDP. German debt has now been pushed below this level while US debt is around 110 per cent of GDP. This divergence in performance may have a number of potential consequences. Among other things, it contributes to wider global trade imbalances and may thus **intensify trade policy tensions**. Divergent government finances contribute marginally

to wider yield spreads between the US and Western Europe. Although several important euro zone countries are struggling with continued financial problems, Western Europe has now generally built up increased fiscal policy ammunition to respond to future economic slowdowns. This creates a certain balance compared to the US, where the Fed's rate hikes are instead creating manoeuvring room.

Big US budget deficits despite hot economy



Source: IMF, SEB

Upside risks for oil prices

After Brent crude prices peaked at nearly USD 87/barrel in early October, they dropped to USD 70-75 amid stock market turmoil. Members of the Organisation of the Petroleum Exporting Countries (OPEC) are now pumping hard to meet rising demand in an ever-tighter market. We believe OPEC in general, and Saudi Arabia in particular, **will have no problems cutting output as needed to stabilise oil prices on the downside**.

Upside risks, however, may be harder to manage. In the short term, supply will be limited by large production cuts in Venezuela and the consequences of new sanctions against Iran that are now taking effect. A bit further ahead, oil output may also be hampered by lower global investments in oil and gas extraction after the 2014 price drop. There are also signs that rapid productivity growth in shale oil extraction will soon slow. In the near term, US shale oil supply will also be limited by a capacity shortage in pipelines to the Gulf of Mexico.

Overall, we are sticking to our forecast that prices will move a bit higher, reaching **annual averages of USD 85/barrel both in 2019 and 2020**. To keep prices from rising further, Saudi Arabia must produce nearly 11 million barrels per day, which is more than the country has ever done. If the oil market suffers supply disruptions in addition to those of Iran and Venezuela, it may be difficult for OPEC to prevent even sharper price increases.

Pay increases finally accelerating

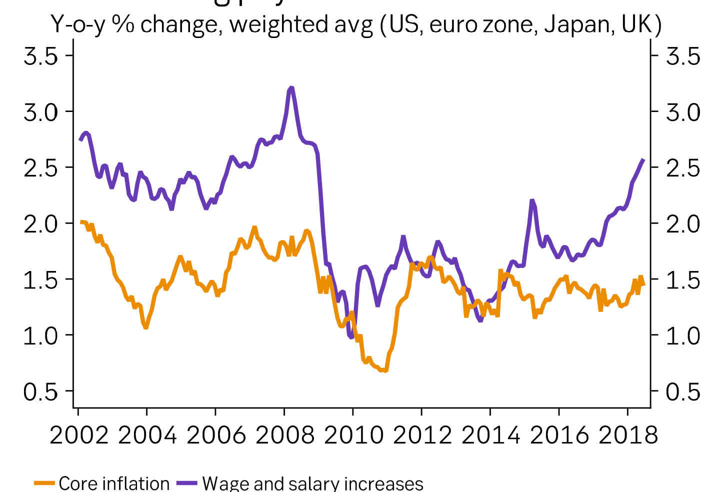
In many countries, unemployment has now fallen to levels that we have not seen for decades. In the OECD countries as a whole, we must go back to 1980 to see as low a weighted average as the 5.3 per cent jobless rate reported in October. Some countries are approaching the point where recruitment difficulties are seriously starting to slow economic expansion, while elsewhere resource utilisation is far less stretched. Major euro zone economies such as France, Italy and Spain may be the main contributors to a continued downturn in overall joblessness in advanced economies**. Our forecast implies that unemployment can keep falling and reach 4.8 per cent in 2020.**

Unemployment at 38-year low

Source: OECD, Macrobond, SEB

The sensitivity of price and wage formation to the labour market situation has been a focus of attention in recent years. The question has been to what extent the Phillips curve, which describes the correlation between unemployment and prices/wages, has changed and become less clear. Recent developments have shown that it was premature to announce the death of the Phillips correlation. **A weighted index of pay increases in the four largest advanced economies speeded up from 1.7 per cent in the spring of 2017 to 2.6 per cent today** (see chart). Excluding a short-term peak in the spring of 2008, we are now back at about the same rate of pay increases as during the economic boom before the Lehman Brothers crash of September 2008. This is still a modest rate, considering that unemployment is now generally lower than in 2007. From an inflation perspective, though, we should also take into account that underlying productivity growth since the Lehman crisis has clearly fallen. If this trend persists, **a lower rate of pay increases than before will be required in order to achieve 2 per cent inflation**. For the US and the UK, for example, our estimates indicate that the correlation between pay and prices is fairly intact, if we adjust for the lower productivity trend.

Accelerating pay hikes but low core inflation



Source: European Central Bank, Macrobond, SEB

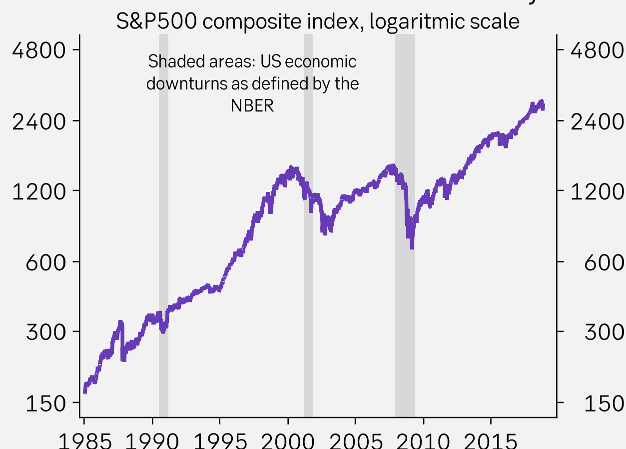
Stock market dips not a reliable recession indicator

Cyclical shifts tend to be preceded by falling stock markets. But it is far more common for share prices to drop sharply without really impacting the rest of the economy. We have identified 18 periods when US equities (S&P 500) fell 10 per cent or more. Only three were followed by global recessions (July 1990, September 2000 and October 2007). In 1990 the start of the stock market dip coincided with the outbreak of recession as defined by the NBER. The 2000 and 2007 dips preceded the outbreak by 6 and 2 months, respectively.

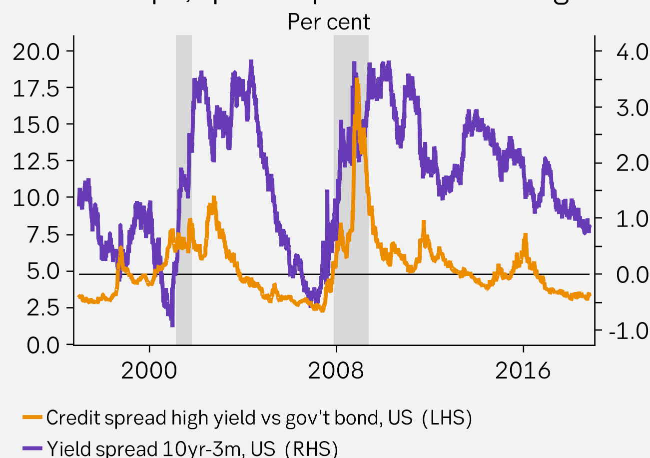
Beginning	End	Downturn %	Events
1987-08-25	1987-12-04	-34	" October crash "
1990-01-02	1990-01-30	-10	
1990-07-16	**1990-10-11**	**-20**	**Global recession**
1997-02-18	1997-04-11	-10	
1997-10-07	1997-10-27	-11	Asian financial crisis
1998-07-17	1998-08-31	-19	Russian/LTCM crisis
1999-07-16	1999-10-15	-12	
2000-03-24	2000-04-14	-11	
2000-09-04	**2002-10-09**	**-49**	**Global recession**
2002-11-28	2003-03-11	-15	
2007-10-09	**2009-03-09**	**-57**	**Global recession**
2010-04-23	2010-07-05	-16	Greek crisis
2011-04-29	2011-10-03	-19	Euro crisis/recession
2012-04-02	2012-06-01	-10	
2015-07-20	2015-08-25	-12	Turbulence in China
2015-11-03	2016-02-11	-13	Oil, China
2018-01-26	2018-04-02	-10	Interest rate worries
2018-09-20	2018-10-29	-10	?

Other stock market dips have been connected to regional crises that did not lead to global recessions: the Asian financial crisis of 1997, the Russian crisis of 1998 and the Greek crisis of 2010. The broader euro crisis of 2011 triggered a recession in the euro zone as a whole, though. Some 10-15 per cent market dips have occurred due to even "narrower" shocks related to oil prices, changes in Chinese currency policy or credit/interest rate worries. Some market slides have had hardly any connection to the real economy, for example "Black Monday" in October 1987 or the fall caused by the collapse of the LTCM hedge fund in October 1998.

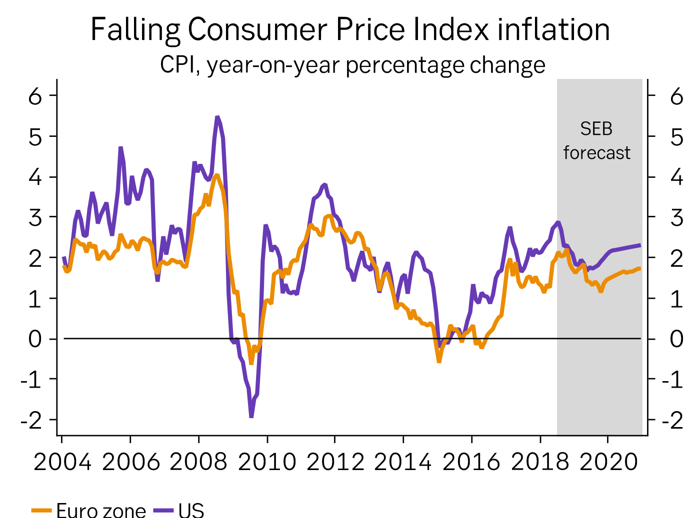
Downturns of 10-15 per cent have thus not normally signalled recessions. The latest stock market turbulence, which began in early October, has so far resulted in a 10 per cent downturn (until the low on October 29) and in itself does not portend an approaching recession. But this does not mean that we can declare an all-clear. The recession dynamic is characterised by financial market and cyclical downturns that reinforce each other, so that an initial stock market slide leads to the downgrading of macro forecasts, which in turn cause further downward adjustments in earnings forecasts etc. Such a negative feedback loop most easily takes hold during periods of high resource utilisation, when central banks have little chance of reviving growth. It is thus natural for nervousness to increase as unemployment hits new record lows, but in recent decades supply-side restrictions as such do not seem to have been sufficient to trigger an outbreak of recession. Instead they had to be combined with some type of financial market shock.



Signals from the fixed income market may be even more interesting, since the central bank channel makes its macroeconomic connection clearer. The slope of the yield curve – the spread between long- and short-term bond yields – is again being watched as a historically reliable indicator. The US yield curve is quite flat, which is a warning signal, but we are sticking to our view that quantitative easing (QE) programmes and extremely low bond yields in Europe and Japan are pushing down US long-term yields. There are thus unusually strong reasons why the flat yield curve does not need to be connected to cyclical worries and expectations of future Fed rate cuts. Stress symptoms in the pricing of corporate bonds with low credit ratings are another indicator. But in the prevailing environment of low yields and ample liquidity, the search for returns is likely to squeeze the yield gap between corporate and government bonds in a way that suppresses such warning signals, which – for partly different reasons – was also true before the outbreak of the financial crisis a decade ago. To summarise, we can note that it is difficult to find any stable leading financial market indicators that we can rely on to predict the next recession.



Total CPI inflation in advanced economies has generally exceeded 2 per cent over the past six months, due to a rather large contribution from the energy component. **At present, there are various reasons for arguing that inflation may remain at a high level, even though base effects will now cause the energy component to fall**. An escalation of underlying cost pressures – due to a combination of slightly higher pay increases and low productivity growth, greater opportunities for companies to pass on their higher input costs to consumers in a more heated economic climate and the effects of increasing trade barriers and extreme summer weather– are factors that have the potential to push up CPI. On the other hand, for decades inflation has had difficulty reaching 2 per cent without the help of rising energy and commodity prices. Core inflation in major economies remains at around 1½ per cent, without clear upward tendencies. The fact that companies continue to report good earnings suggests that cost pressure is not so troublesome. This may, in turn, indicate that macroeconomic statistics are exaggerating the weakness of productivity growth. Although upside risks have increased, especially in the US, **we are therefore sticking to our forecast that CPI inflation will continue falling to levels that do not put pressure on central banks to speed up the pace of interest rate normalisation**.



Source: Eurostat, BLS, SEB

CBs will act as planned, despite market turmoil

Recent stock market volatility and doubts about the longevity of the expansion are raising new questions about the risks of central bank normalisation plans. Too much (Fed) or too late (Sweden's Riksbank and the ECB) is the question, especially given the banks' limited room for undoing policy mistakes. In the Fed's case, a stock market plunge might increase pressure to postpone its planned December rate hike, with clear parallels to the autumn of 2015, when it delayed the first hike in the current cycle. **Yet we believe these weakening tendencies are insufficient to persuade central banks to change their plans**. Because of low unemployment and robust growth, the Fed's situation now is completely different from 2015. The ECB has also set a high standard for extending its unconventional monetary policy, for example by changing its bond-purchasing plans. Only if downside tendencies intensify greatly are central banks likely to consider softening their signals of future hikes. But there are also risks in the opposite direction, especially in the US, where overheating tendencies may force the Fed to speed up its hikes and reach rates more clearly above neutral.

In September, when the Fed enacted its eighth rate hike, it signalled a readiness to continue upward a bit beyond the neutral level. This announcement suggests that the Fed has become less worried about trade tensions. There is a consensus among Fed decision makers that the key rate needs to be hiked further, but there are different opinions about how far it is appropriate to continue. At present, the Fed's own median forecast indicates a hike in December, three in 2019 and one in 2020 to a federal funds level of 3.5 per cent. Assuming a cautious economic slowdown in 2019 and inflation close to target, a main scenario of continued gradual policy tightening is reasonable. We believe **a December hike will be followed by further hikes in March and June 2019**. After that the Fed will take a break and monitor the response of the economy, then **hike its key rate one more time early in 2020 to 3.25 per cent**.

After the ECB unveiled its exit strategy in June, the main features of its monetary policy are clear until the summer of 2019. It has cut bond purchases to EUR 15 billion per month and will end them in December 2018. The ECB has also declared that its interest rates will remain at today's levels at least until the end of summer 2019. There is thus little potential for near-term surprises. We believe **the ECB will raise its refi rate** (plus its entire interest rate corridor) **by 25 basis points in September 2019** and continue with **two more hikes in 2020 to a refi rate of 0.75 per cent**. Since various other central banks have begun hiking their key rates, it is difficult to believe that the euro zone's slightly weaker recent economic growth will cause the ECB to postpone its normalisation measures. Yet if the ECB sees reasons to increase its support to the economy, one alternative would be a new round of targeted longer-term refinancing operation (TLTRO) loans in mid-2019 to offset the end of bond-buying and the beginning of slow rate hikes. This would give euro zone banking systems continued access to cheap liquidity, instead of being forced to increase market-rate funding in a situation of rising interest rates. Italian banks in particular depend on ECB funding and may experience strains when earlier TLTRO loans begin to fall due in June 2020.

Central bank key interest rates
Per cent

	Nov 7	Dec 2018	Dec 2019	Dec 2020
Federal Reserve (Fed)	2.25	2.50	3.00	3.25
ECB (refi rate)	0.00	0.00	0.25	0.75
Bank of England (BoE)	0.75	0.75	1.25	1.75
Bank of Japan (BoJ)	-0.10	-0.10	-0.10	-0.10
People's Bank of China (PboC)	4.35	4.35	4.35	4.35
Riksbank (Sweden)	-0.50	-0.25	0.25	0.75
Norges Bank (Norway)	0.75	0.75	1.25	1.75

Source: Central banks, SEB

The British central bank (BoE) hiked its key interest rate to 0.75 per cent in August. Above-target inflation during most of our forecast period, and perhaps especially a tight labour market,

will drive rate hikes. The BoE has also expressed an explicit desire to leave behind zero interest rates. **In 2019 we expect two further hikes, with the first at the May 2019 meeting assuming a controlled withdrawal from the EU in March**. During 2020 two additional hikes seem reasonable, given the continued tight British labour market.

We are sticking to our forecast that **the Bank of Japan will keep trying to manage government bond yields so they remain close to 0 per cent at least during 2019** and that the monetary base will grow by 5-10 per cent yearly. Long-term (5-10 year) inflation expectations among households, businesses and economists have remained troublingly stable at about 1.2 per cent over the past 2-3 years. BoJ policy implies continued **strains on the financial system** due to a **profitability squeeze** while ultra-loose monetary policy encourages **more risk-taking**.

Higher bond yields will mean a steeper yield curve

The upturn in US Treasury yields accelerated late in August, and in October the 10-year yield surpassed 3.20 per cent for the first time since 2011. A combination of strong data and rising expectations of Fed rate hikes was behind this movement. The market's inflation expectations remain subdued, however. Break-even inflation, measured as the difference between nominal and real yields, has been largely unchanged this year, both in a 2-year and a 10-year perspective. The market is now pricing in between 2½ and 3 further Fed rate hikes until the end of 2019, but none after that – in other words, less than our forecast. The bond market's interaction with the stock market in recent weeks has followed a typical late-cyclical pattern. Rising yields initiate concerns and volatility in the stock market, which in turn triggers a downward correction in yields. But 10-year Treasuries remain close to 3.20 per cent.

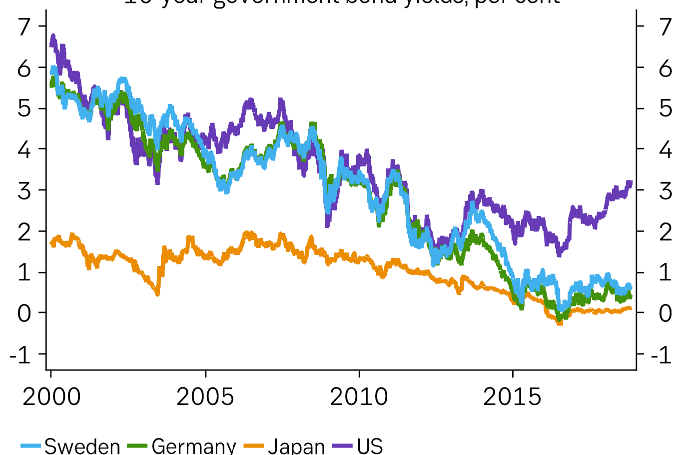
10-year government bond yields

	Nov 7	Dec 2018	Dec 2019	Dec 2020
United States	3.20	3.20	3.50	3.50
Germany	0.43	0.50	1.00	1.30
Sweden	0.72	0.90	1.60	1.90
Norway	2.00	1.90	2.10	2.35

Source: Central banks, SEB

So far the Fed has been successful in its balancing act of raising the key interest rate fast enough to keep inflation expectations under control without creating recession worries. As the Fed approaches a neutral key interest rate, its actions will be determined more by real economic and financial data, but we believe that continued relatively healthy US growth and expansionary financial conditions will allow further Fed rate hikes totalling 100 basis points without excessive risks of creating recession worries in the market. If so, it is **reasonable for 10-year Treasury yields to move about 40 bps higher – reaching around 3.60 per cent by mid-2020** and then fall somewhat as the market anticipates the end of the Fed's hiking cycle. The effect of rising long-term yields is a bit ambiguous from a Fed perspective. We will reach levels that may generate some stock market valuation stress, but meanwhile the yield curve will be somewhat steeper. As long as inflation expectations do not rise excessively, this may curb speculation about an approaching recession, which has historically been preceded by a flat or negative yield curve.

German government bond yields followed American ones higher after the summer, but since mid-October they have fallen: the 10-year yield is again just over 0.40 per cent. The yield spread between US and German bonds is thus nearly 280 bps. German yields are being pushed down, because weak economic data, worries about Italian government finances and Brexit negotiations have created uncertainty about the ECB's ability to normalise its monetary policy. If, as we believe, the ECB sticks to its plan to end net purchases of bonds at year-end, this will contribute to somewhat higher long-term yields in Germany, but especially in the euro zone periphery – with a focus on Italy. The ECB's plan to continue for a long time to reinvest all its holdings in its EUR 2.6 trillion quantitative easing (QE) portfolio will remain a restraining factor, but during 2019 these reinvestments will only total about half of the ECB's purchases during 2018. Current market pricing indicates no initial ECB rate hike before late 2019 or early 2020, and very cautious hikes after that. If our scenario of somewhat more aggressive hikes proves correct, we should see **a modest and gradual upturn of German 10-year yields to 1.30 per cent by the end of 2020**.

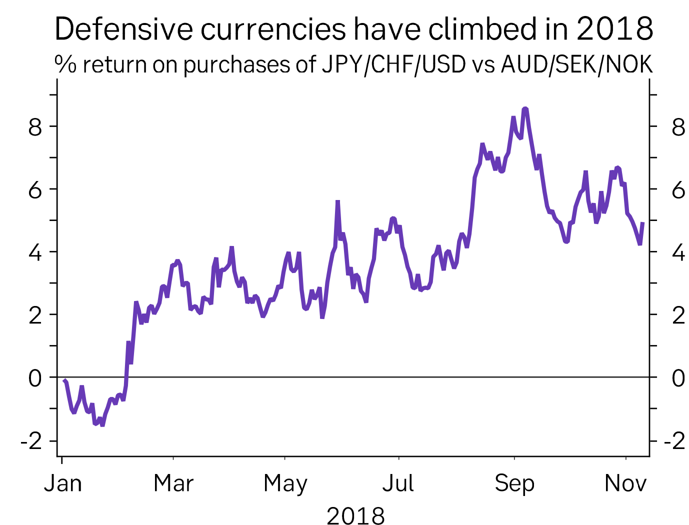


The yield spread between US and German bonds will thus remain **historically wide, more than 200 bps**, throughout our forecast period. As the above chart illustrates, the spread was generally rather close to zero until 2013, but since then German (and Swedish) yields have been closer to Japanese levels. It is reasonable to ask whether we are about to see a change of regime in this respect, with Germany and Western Europe becoming rather de-coupled from US yield cycles. The medium-term outlook for central banks suggests that at least we are likely to find ourselves in such an environment for a decade.

Defensive currencies are winners in 2018

During the past six months, the foreign exchange (FX) market has lacked clear trends. Many currencies are trading within the broad range where they have been for a long time. The biggest movements have been initiated by negative events that have created greater stress in financial markets, such as share price declines or the crisis in Turkey last August. Another underlying driver also seems to be connected to general concerns about slower global growth, as the upward economic cycle approaches record longevity. The chart below shows how a basket of the most defensive currencies has fared against selected riskier currencies so far this year. Such a currency basket is normally expected to generate a positive return in

times of increased financial market worry and stress, which has been the case since February. The USD in particular stands out as a big winner, while EM currencies have generally weakened – though in greatly varying degrees.



The US dollar's reaction pattern seems to have changed this year, since **its defensive qualities have again dominated**. But traditional driving forces such as higher interest rates, stronger US growth and continued Fed tightening have had little effect on the USD compared to other major currencies. Last summer Mr Trump signalled his displeasure with an excessively strong USD.. This may also have had some psychological effect, although we do not expect him to take concrete action to influence the value of the dollar. In the short term, we expect the EUR/USD exchange rate to keep moving somewhat lower, reaching 1.12 at year-end. After that, we believe that the dollar will lose ground as central banks in other countries tighten their policies more clearly, while our macro scenario suggests continued fairly good risk appetite. Our forecast is that **the EUR/USD rate will be 1.18 at the end of 2019 and 1.26 at the end of 2020**.

Exchange rates

	Nov 7	Dec 2018	Dec 2019	Dec 2020
EUR/USD	1.15	1.12	1.18	1.26
USD/JPY	113	111	104	100
EUR/GBP	0.87	0.86	0.82	0.84
EUR/SEK	10.32	10.15	9.80	9.70
EUR/NOK	9.53	9.50	9.00	8.90

Source: Central banks, SEB

The yen's defensive qualities are offset by its negative yield outlook. As soon as anything negative happens in the global economy, the Japanese currency tends to appreciate. This has also been the case in 2018. Early in the year, rising US interest rates and the stock market slide helped push the yen higher. Since then, increased trade tensions between the US and China, political turmoil in Italy and last summer's crisis in Turkey contributed to a stronger yen. Our models indicate that the yen is still undervalued in the long term, yet we find it difficult to foresee a clear yen appreciation in a world of decent economic growth and rising long-term yields outside of Japan. We are maintaining our forecast that **the USD/JPY rate should move down towards 111 by the end of 2018 and eventually towards 100 by the end of 2020.**

Brexit negotiations remain the dominant driver of the British pound. The pound has been sharply undervalued since its depreciation following the 2016 Brexit referendum. Despite great difficulties related to the Irish border issue, we expect the EU and UK to reach an agreement in December that will lead to a controlled British withdrawal from the EU. This would set the stage for the pound to appreciate over the coming year. Our forecast is that the EUR/GBP exchange rate will be 0.82 at the end of 2019. Its trend in 2020 will depend on the next stage of withdrawal, but even assuming an orderly withdrawal agreement, there would be continued uncertainty about how the economy will actually react once ties with the EU are definitively cut in 2021 or 2022. We foresee a predominant risk that the pound may again weaken in such an environment and believe that the EUR/GBP rate will again climb to 0.84 by the end of 2020. If the UK should leave the EU in an uncontrolled way next year, the pound is likely to depreciate sharply, even though it is already undervalued today. Under such circumstances, the EUR/GBP rate would probably move closer to parity.

Baltic overview

Economic growth rates remain among euro zone's highest

The Baltic economies remain in the top ranks of the euro zone in terms of growth, but since they are highly dependent on exports their growth will decelerate as international demand slows a bit. Domestic demand will nevertheless keep yearly GDP increases at about 3-3.5 per cent in all three countries in 2019-2020. Due to strong labour markets, yearly pay hikes of 6-7 per cent will lead to relatively high inflation pressure. Mildly expansionary fiscal policies will provide some support to growth.

Estonia: Strong increase in consumption and exports

GDP growth decelerated from last year's 4.9 per cent to 3.5 per cent in H1 2018. Growth is driven primarily by inventories, private consumption and exports. Strong performance in such sectors as oil and wood products have contributed to a healthy trend in manufacturing, but sentiment indicators and other data point to a slowdown ahead. Weaker growth among main customer countries contribute to a slowdown in merchandise exports, although service exports will partly offset this. The effect of the ongoing tax reform has followed our forecasts, with a relatively moderate reaction for private consumption. This pattern is also likely to be true in 2019, when sizeable tax refunds may go towards increased saving, not consumption. Capital spending has decreased due to the high comparison base of 2017, but very high construction volumes indicate that these figures may be lifted by revision. A decrease in new construction permits signals a gradual slowdown in 2019-2020. Weakening demographics paired with the expected fall in the influx of EU structural funds to Estonia, will put a further downward pressure on infrastructure investments after 2020. Despite fact that unemployment dropped to 5.1 per cent in Q2, wage growth has slightly moderated, increasing by 6.4 per cent. Labour force participation (15-74 years) has risen to 72 per cent and probably cannot climb much further in the near future.

Latvia: Tight labour market due to good growth

GDP surprised on the upside, with growth of 4.8 per cent driven in part by a 10 per cent surge in capital spending. This strong investment activity is expected to persist in 2019 but then slow down. Manufacturing has slumped, but output is now expected to grow by 3.5 per cent yearly in 2019-2020: largely in line with the expansion in retail sales. We predict that slower international demand will push Latvian growth down to about 3.5 per cent in 2019 and 3.2 per cent in 2020. The labour market is continuing to perform well. Unemployment fell to 6.1 per cent in August; this stretched situation will help push up wages and inflation. In September, inflation stood at 3.2 per cent; the largest contributors were transport, rents and alcoholic beverages, but service inflation will be an increasingly important component. In the recent election, seven parties made it into Parliament. The pro-Russian party Harmony is not expected to gain any major influence, but a large minority of seats now belong to new parties, making it harder to form a government and get decisions through Parliament. The new government's first challenge will be to win approval of its budget. Because of improved public finances an expansionary fiscal policy is likely. Another challenge will be to enact measures to help avoid further money-laundering scandals, which may otherwise damage Latvia's reputation and growth prospects, but one positive recent development was that Standard & Poor's upgraded Latvia's credit rating, despite financial sector turbulence.

GDP forecasts, Baltic countries
Year-on-year percentage change

	2017	2018	2019	2020
Estonia	4.9	3.4	3.0	2.8
Latvia	4.5	4.3	3.5	3.2
Lithuania	4.1	3.4	3.0	2.6

Source: Eurostat, SEB

Lithuania: Deceleration, but growth still above trend

GDP growth averaged more than 3 per cent in the first three quarters of 2018, even though poor harvests had a negative impact of nearly half a percentage point. Our forecast is 3.0 per cent in 2019 and 2.6 per cent in 2020, mainly due to poorer export prospects. Companies have become somewhat less optimistic, as reflected in lower sentiment indicators. These indicators remain at high levels, however. Households are also somewhat less optimistic, even though taxes are being cut in 2019. Consumption growth will thus probably slow. Inflation has again accelerated, driven by increased fuel costs, but will remain below 3 per cent for the rest of this year and then fall towards 2.5 per cent in 2019-2020. Because of a tight labour market, wages and salaries are expected to increase by about 7 per cent in 2019. Lending to households and businesses remains balanced; according to the latest statistics, loans to companies rose by 5.9 per cent and to households by 7.2 per cent. The housing market is showing a slight upward trend. Home prices in the capital, Vilnius, have increased by 3 per cent so far in 2018. The government has unveiled a 2019 budget with a 0.4 per cent surplus, somewhat below this year's figure. Overall fiscal policy can be described as neutral or slightly expansionary.

Theme: Emerging markets

Market turbulence in the EM sphere not a sign of global crisis

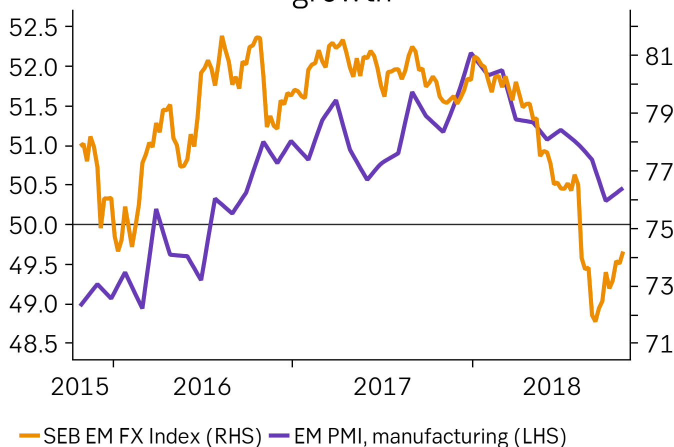
Today emerging and developing countries account for almost 60 per cent of the world economy and thus play a key role in global growth, yet we see a relatively low probability that they will cause a near-term global economic crisis. Underlying EM-related concerns that have taken root in 2018 are signs of global deceleration, US trade wars, a stronger US dollar and higher US interest rates/yields. But indicators point towards good growth, albeit lower than before, while tighter monetary policies are expected to stabilise EM financial markets.

Emerging market (EM) countries have seen considerable drama during 2018. The MSCI Emerging Markets index lost close to 26 per cent and SEB's Emerging Markets Foreign Exchange index almost 12 per cent between January and October. There are differences between EM countries but **the weakening has been broad-based**, affecting EM countries in Latin America, the EMEA region (Europe, Middle East, Africa) and Asia. Concerns about EM countries, led by Argentina and Turkey, peaked in August and early September when the **Turkish lira more or less went into free fall** before the central bank finally raised its key rate by 6.25 percentage points to 24 per cent. There were noticeable **contagion effects in G10 financial markets**, leading to a weakening of currencies perceived as relatively risky, among them the Swedish krona.

Growth deceleration is comparatively marginal

Among the reasons behind plunging EM currencies and stock markets are a global economic slowdown partly due to the EM economies themselves, rising global interest rates and bond yields and rising inflation. EM purchasing managers' indices (PMIs) in the manufacturing sector have fallen virtually every month since December 2017. Yet, **the deceleration in growth is comparatively mild**.

EM purchasing managers' index shows falling growth



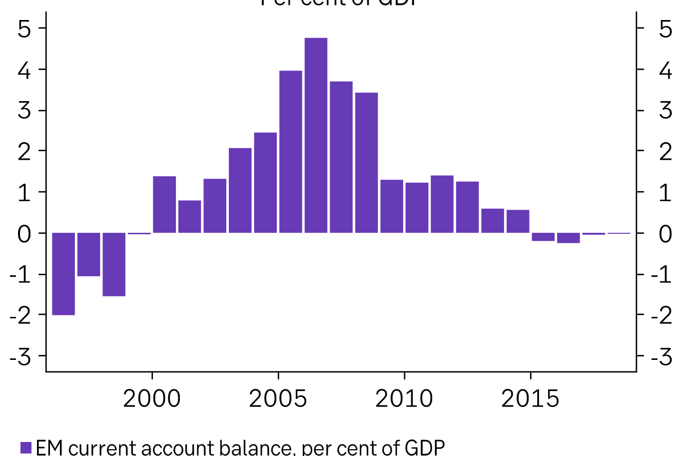
Source: IHS Markit, Macrobond, SEB

Trade between EM economies has increased in importance, but **exports to the US and the EU** still dominate most EM economies. This decreases the risks of an isolated EM sphere recession as long as advanced economies chug along according to our forecast for the US, Europe and China (see below).

USD strength: a complex, but manageable problem

As for US dollar appreciation and its impact on the EM sphere, the risks are substantial and complex, but manageable. One effect of the stronger dollar has been rising concerns about EM external funding needs. However, external funding needs are smaller than before the series of EM crises that began with the **1997 Asian financial crisis** and culminated when Argentina defaulted in 2001. Official current account deficits of EM economies averaged 2 per cent of GDP in 1996, but **today the overall EM sphere is showing balanced foreign trade**. Such countries as **Turkey**, **Argentina** and recently **South Africa** are exceptions, however, with **current account deficits that have widened to between 5 and 9 per cent of GDP**. This will require major tightening and deceleration as global interest rates and yields rise.

EM external funding needs are now lower



Source: International Monetary Fund (IMF), Macrobond, SEB

Indonesia and **India** also saw growing current account deficits during the years of extremely accommodative monetary policies in the US and the euro zone. Unlike countries such as Turkey and Argentina, however, Indonesia in particular has **larger reserves** to deal with volatility in the fixed income and foreign exchange (FX) markets. Another important difference between today and

the Asian financial crisis is that more currencies are floating, which also makes adjustments in trade and capital flows easier.

Rising global interest rates and yields will increase funding needs for the debt burden built up since the 2008 financial crisis. One mitigating factor is that most of the increase in total debt over the past decade is denominated in local currencies. One exception is that **corporate borrowing mainly in US dollars has increased sharply since 2008**, but this increase is driven by China and a limited number of markets. Again, **Turkey and Argentina stand out, with strong growth in foreign debts**. Other economies such as Egypt, Chile and Hungary also have large foreign debt, but like Argentina, Turkey and South Africa they are too small to be capable of triggering a global recession.

GDP growth, BRIC countries and EM sphere
Year-on-year percentage change

	2017	2018	2019	2020
China	6.9	6.6	6.3	6.1
India	6.3	7.8	7.6	7.4
Brazil	1.0	1.3	2.5	2.6
Russia	1.5	1.8	1.7	2.0
Emerging markets, total	**5.0**	**4.9**	**4.8**	**4.8**

Source: OECD, SEB

High BRIC growth contributions, but less than before

At present, growth also seems steady in the EM economies. The **BRIC countries** (32 per cent of the world economy) set the tone for the EM sphere. **India** is showing signs of having reached the peak of its growth potential. Inflation in urban areas and for industrial workers has risen to between 4.3 and 5.6 per cent and the current account deficit has widened to 1.9 per cent of GDP. A weakening of the rupee and rising inflation have forced the central bank to raise its key interest rate, which is expected to slow economic growth ahead, but growth will remain at a high 7.6 per cent in 2019 and 7.4 per cent in 2020. **China** is also moving towards a slowdown but is expected to grow by more than 6.0 per cent annually in the next two years (see box).

Although the **Brazilian** economy has shown some disappointments so far this year, it is on its way out of recession. We expect growth of 1.3 per cent in 2018 and 2.5 per cent in 2019. The parliamentary and presidential elections in October resulted in a new government that has promised a continued focus on economic and fiscal reforms. Congress is fragmented and the new president, Jair Bolsonaro, is very controversial, which is expected to make reform efforts more difficult. Due to low capacity utilisation, even minor reforms will have a positive impact on the Brazilian economy and investor confidence.

In **Russia**, we do not expect any far-reaching reforms. Further US sanctions against individuals and organisations connected to the Russian military will have a dampening effect on investment levels, but higher oil production and fiscal stimulus are expected to result in GDP growth of 1.7-2.0 per cent in 2019 and 2020.

Market turbulence not the beginning of a global crisis

The problems that have emerged in the EM sphere during 2018 are limited to a few countries that are too small to threaten global growth. If any of these countries were to experience market stress, contagion is a risk, but we expect these effects to be relatively small and brief. **One exception is China**. Our main scenario is that China will manage the gradual economic deceleration that authorities are now engineering. Yet, in case of a recession in China, other countries will be affected via lower trade and commodity prices. Since China's financial system is relatively isolated from the global financial system, contagion should be limited. If it were to occur, it would be transmitted via British banks, whose lending to China totals more than 20 per cent of its GDP. **But this is not our main scenario for China**.

China: Focus on domestic economy, not exports

China's cautious deceleration in 2018 has both **structural and cyclical components**. Beijing's objective – creating less credit-driven growth, after several years of excessive debt build-up, especially in US dollars – will lead to medium-term **GDP growth expectations** that should be **about 6 per cent** rather than 6.5-7 per cent. China's cyclical deceleration is due to concerns about the US trade war, which impacts exports, investments and the stock market. To help sustain the domestic economy, especially the service sector, which accounts for more than half of China's economy, Beijing has eased monetary and credit policies in recent months, let the yuan fall against the dollar and cut taxes. **Positive effects on growth are expected to become visible late in 2018 and in 2019**. As the growth picture stabilises, we expect Beijing to resume its policy of reducing risks to financial stability.

China's decision makers are aware of the country's economic and financial weaknesses and risks. They also have both the tools and muscles to **manage growth and stability problems**. China's overall public sector debt (as measured by the IMF) is **68 per cent of GDP**, confirming that there is **fiscal manoeuvring room** that can be used as needed. The People's Bank of China also has a **currency reserve of USD 3 trillion**. As needed, some of this can be directed to Chinese banks (which are largely state-owned) to facilitate foreign currency funding. But there are **no plans to use the reserve as a weapon in the trade war** against the US (by selling US Treasury securities) since this would generate losses (rising yields), strengthen the yuan and hamper exports, and push up the currencies of other countries if US government securities are replaced by European ones, for example.

Currency policy – especially the **USD/CNY exchange rate** – plays an important role for China. Today's rate is just below the psychologically important level of 7. On the one hand, a **weaker yuan helps exporters**, which have been hurt by US import tariffs. On the other hand, the prospect of a depreciation policy may **speed up Chinese companies' principal payments on USD loans** (capital outflow), **decrease global appetite** for Chinese equities and bonds (reducing inflows and pushing down share prices) and **irritate China's export customers** including the US. **Our conclusion** is that China views the **financial and political risks as too large** to let the yuan weaken significantly against the USD from today's level.

Theme: Stock markets

Earnings and valuations help sustain prices in volatile markets

The late-cyclical stock market pattern is becoming entrenched. A more uncertain trend and higher volatility, especially between regions and sectors, will remain dominant. Periods of upside growth surprises and increased risk appetite will be followed by economic uncertainty and profit-taking. Although there are many sources of concern, due to good underlying growth for another while and reasonable valuations we foresee potential for a positive stock market trend for another few quarters.

In stock markets, the differences between 2017 and 2018 are increasingly apparent. Last year saw nearly optimal conditions: accelerating growth, low interest rates/ yields and prospects of more expansionary economic policies. While 2018 has shown continued healthy growth, performance peaked in 2017. Meanwhile central banks are more clearly moving towards policy normalisation. Increasing supply-side restrictions also suggest that the expansion is close to an end. The stock market pattern follows the same logic. In 2017 we saw broad-based upturns with record-low volatility. In 2018 price movements have instead diverged in different market segments, while the MSCI AC World Index has been flat, but amid greater volatility.

Will 2019 be the year when conditions worsen, leading to long-lasting stock market problems? We don't think so. Instead we expect 2019 to show great similarities to 2018, characterised by heightened volatility but with room for some upturns. History shows that virtually all really major stock market downturns in modern times have coincided with a clear economic deceleration. Given our relatively optimistic view of the growth outlook over the next couple of years – with a prolonged late-cyclical phase – there is potential for some upturns in stock market indices during the next few quarters. The moderate slowdown in GDP growth that we foresee is quite compatible with a continued rise in corporate earnings. Meanwhile valuations have recently become more attractive. Volatility and divergences between market segments are likely to persist, however.

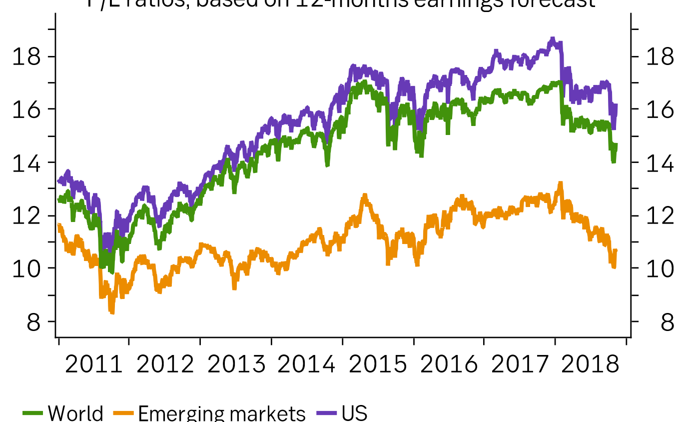
Our overall forecast about which way stock markets will move is based on various assumptions that are saddled with risks. It is now especially important that growth forecasts prove largely correct. Late-cyclical stock market upturns are generally driven by upside surprises in output and earnings, as well as a stable outlook for a prolonged levelling-off in GDP growth. Our growth forecast is somewhat above the market consensus, so it is reasonable to assume that stock markets have not peaked yet.

Investors' caution increases the room for an upturn

The relatively weak stock market performance of recent quarters, in relation to earnings, indicates room for new upturns. Investors as a group have shifted their portfolios to more cautious positions, as seen in capital flows from emerging markets into US equities and from cyclical sectors into sectors like pharmaceuticals. Survey responses also confirm this. Fund managers have greatly lowered their growth expectations. The growth-oriented positions that dominated portfolios early in 2018 are now among the most underweighted categories. But most portfolios are not based on a negative view. The rotation we have seen is more of a risk exposure normalisation, compared to the optimism of last winter. This implies that both positive and negative data may impact share prices, but "bull-bear indicators" of the short-term stock market mood are depressed – close to levels where sentiment is so negative and expectations so subdued that stock markets often rebound.

Stock market valuation are less stressed

P/E ratios, based on 12-months earnings forecast



Source: Bloomberg

Reasonable valuations if earnings forecasts hold true

Stock markets are also behaving reasonably from a valuation perspective, given the cyclical situation. This year's rising profits and flat share prices have pulled down price/earnings (P/E) ratios from stretched to comfortable levels. The MSCI AC World Index has moved from a P/E ratio of more than 16 last January to 14.5 today, based on moving 12-month earnings forecasts.

If consensus forecasts of earnings increases slightly below 10 per cent in 2019 and 2020 prove correct, valuations should not prevent periods of good stock market performance, but **we have likely passed the peak valuations in this cycle**. When earnings forecasts begin to be revised downward, there is an obvious risk that this will lead to lower multiples and share price declines, but we are not there yet.

Higher risk of late-cyclical earnings disappointments

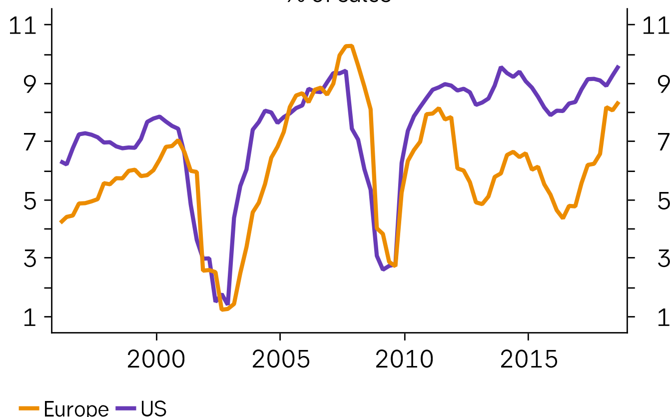
Third quarter 2018 reports showed a stable situation for American companies, with healthy sales upturns (8.5 per cent) and strong earnings increases (27 per cent) that were not merely a result of tax cuts. European reports seem to have been a little weaker. Earnings came in somewhat below expectations and the squeezed margins evident in Q2 have persisted, despite an FX tailwind. In both Europe and Asia, firms are expressing more caution than in the preceding quarterly report season.

Earnings forecasts are following the same pattern as reports, thus supporting stock markets. US forecasts surged after the corporate tax cut and have been revised upward repeatedly since then. In Europe, forecasts have been largely unchanged. Today's consensus forecasts indicate US earnings increases of just above 10 per cent in 2019 and 2020; forecasts in Europe are just below 10 per cent and 8 per cent, respectively.

Late in an economic cycle, the risk of earnings disappointments increases. When sales level off and order bookings shrink, the revenue side comes into question. Meanwhile resource shortages push up both pay and the costs of raw materials and input goods, hurting margins. **At present, US and European profit margins are historically high**; in the US, they are even somewhat higher than at the previous cyclical peak.

Profit margins are at high levels

% of sales



Source:Bloomberg

As the chart shows, US profit margins have been at about the same levels for a while. European margins have improved in recent years but are still somewhat below previous peaks. During the current report season, some companies have expressed concerns about both order bookings and cost pressures, especially Swedish and other Nordic firms. The risk picture also includes political events. Ongoing trade wars have the potential to disrupt performance, especially if they escalate or if negative news coincides with other weak signals that affect market performance. But it would require a sharp escalation of political disruptions to overshadow the actual trend of earnings as a driver of stock market performance.

Rising yields make US bonds more attractive

Another question is what bond yields will mean to the stock market. Low yields caused many investors to seek out riskier assets, such as corporate credits and equities, in order to meet their return requirements. After a period of rising bond yields in the US, and given expectations of future yield increases in Europe too, the situation may be about to change. The most important question is probably at what level of US bond yields these investments will again be regarded as attractive, and what will then happen. The answer is partly related to the growth environment; positive corporate earnings performance will make rising bond yields more acceptable to equity investors. But with US 10-year Treasury yields well above 3 per cent and only marginally lower yields on far shorter maturities, these yields will eventually look attractive to more investors.

We are not yet seeing clear flow effects driven by the new yields, but the two large upturns in flows we have seen in 2018 (January/February, October) have coincided with the year's stock market corrections. The consensus among investors is that they will become more **interested in bonds if/when US 10-year Treasury yields climb above 3.5 per cent**.

Upside for EM and Nordics if growth news is positive

The relative performance of various market segments will probably be determined by economic growth prospects. Looking ahead, it is reasonable to assume that more stable sectors (such as pharmaceuticals and convenience goods) and regions like the US will become more attractive as investors seek to respond to future cyclical weakness. But along the way, there is probably room for upside growth surprises, which would benefit more cyclical investments like industrials and emerging markets. And as usual in times of unclear earnings prospects, sectors enjoying structural growth should benefit, for example technology and consumer companies connected to rapid digital advances.

The relationship between emerging and developed markets (EM/DM) is also interesting. Concerns about the length of the economic cycle, general risk aversion, the impact of the trade war on China, the effects of the rising USD as well as dollar-denominated interest rates and yields, along with various country-specific risks (Turkey, Argentina) have pushed EM equities sharply lower. Valuations are now reminiscent of earlier lows, with P/E ratios of around 10 making the EM/DM valuation gap the widest for many years. Such levels may seem too depressed. Profitability among EM listed companies is on a par with their DM counterparts and there is a rapidly increasing contingent of companies with modern business models (Alibaba, Tencent). China is also enacting stimulus measures to combat an economic slowdown. Commodity prices are at levels that benefit producer countries without creating big problems for (Asian) consumer countries. Combined with our generally optimistic growth outlook, this all suggests that EM equities are close to an excellent buying opportunity, as soon as the situation stabilises.

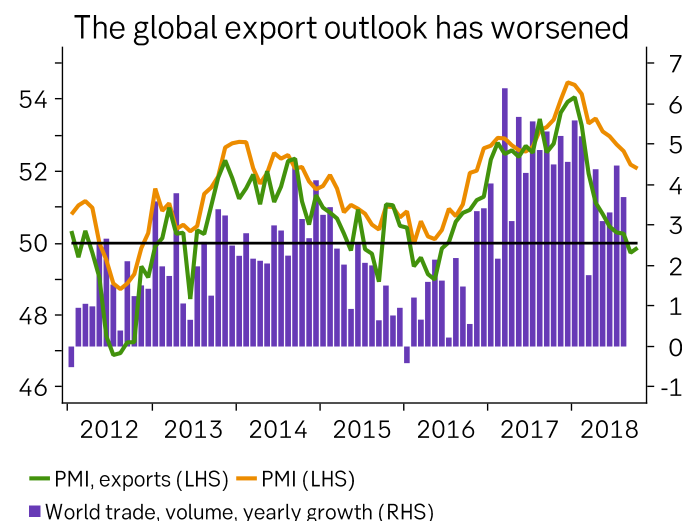
The picture in Sweden and other Nordic countries is similar in some ways. A relatively large cyclical element and a peripheral location on the stock market map create sensitivity to fluctuations in both growth expectations and the general stock market mood. There are also signals of lower order bookings and margins in quarterly reports. Total earnings, adjusted for sectors and companies with weak links to the general cycle, have been above the long-term historical trend for the past couple of years. This situation may very well persist in the short term, especially if our growth forecasts prove correct. Valuations have also fallen to far more attractive levels. In Stockholm, share prices are at P/E ratios averaging just below 14. Ultra-low interest rates and bond yields, along with good dividend yields, also make Swedish equities resilient to any key interest rate hikes**. Together with EM equities, a Nordic positioning may be an appropriate way to take advantage of a stabilising growth situation during the next few quarters.**

Theme: The trade war

Trade policy successes, despite gloomy war headlines

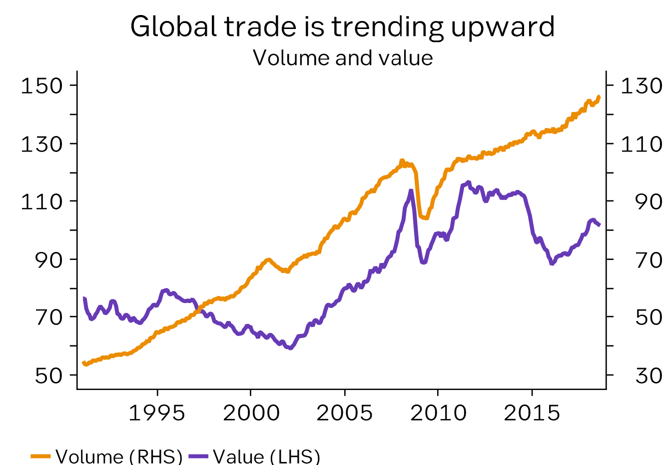
The trade war of 2018 has increased economic policy worries around the world and generated tensions, especially between the US, China and the EU. But there has also been trade policy progress, and WTO rules are being reassessed. The G20 meeting in Buenos Aires may determine the prospects for de-escalating the confrontations and reaching new trade agreements in 2019. We are sticking to our assessment that the trade war is many-faceted and regrettable but still manageable in terms of growth.

During 2018 trade policy has moved into **the epicentre of global politics and strained relationships** between countries, in a way some observers believe the world has not experienced since the Second World War. Free trade advocates and protectionists are on a clear collision course. Yet the global trade policy situation in 2018 is many-faceted and not entirely gloomy. Looking ahead, there seem to be good prerequisites for reaching new agreements and modernising the current rules of trade, but the change in US policy is one factor that **may speed up an already incipient deceleration in economic growth**.



Source: Netherlands Bureau for Economic Policy Analysis (CPB), IHS Markit, Macrobond, SEB

In recent months, several central banks (including the ECB and Bank of England) have published new analyses of the economic impact of trade wars. The IMF has also updated[1] the estimates we used as our starting point for analysing the trade war. IMF simulations include a scenario where **the new tariffs that have been announced so far are enacted**. In addition, it assumes a clear escalation in several areas: 1) The US enacts new **tariffs on all imports from China** (so far, about USD 250 billion in imports have been affected), 2) **China responds** with countermeasures, 3) **the global automotive industry is pulled into the war**, 4) household and business **consumption** and **investments** are hurt, and 5) **stock markets plunge**.



Source: Netherlands Bureau for Economic Policy Analysis (CPB)

A trade war with little direct impact...so far

In the last *Nordic Outlook* we analysed the US trade war and its implications (*"Many-faceted, regrettable but manageable in terms of growth"*). Our assessment was that the trade war – even in case of escalation – would result in relatively **moderate effects on economic and inflation**, and thus on financial markets. This autumn's developments give us **no reason to revise our view**.

A trade war with increased import tariffs affects the real economy mainly via two channels – directly and indirectly.

• **Directly:** Decreased trade, disruptions in global supply chains and higher costs for imported goods (i.e. inflation).
• **Indirectly**: Uncertainty lowers willingness to invest and consume and adversely impacts asset prices, such as shares.

Like the ECB and BoE, the IMF still concludes that the new tariffs imposed so far will have **little impact** on global growth. If we add the above escalation and contagion effects, the impact will be noticeable though not dramatic. According to the IMF, the level of US GDP would fall by 1 per cent compared to a benchmark scenario, while the effect on China would be about 1.5 per cent. **Other conclusions that we draw** are:

1. The trade war is still **primarily bilateral** (between the US and the rest of the world), not multilateral as in the 1930s.
2. Tariffs help **redirect production and trade flows**, benefiting growth in some countries. But high resource utilisation in many countries can make such redeployments harder. Some companies have announced production moves.

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[1] IMF, *"World Economic Outlook – Challenges to Steady Growth"*, Oct 2018.

3. Economic policy can compensate by becoming more **expansionary** to support growth (as in China).

There are many indications that so far, the trade war has had **relatively little direct impact on growth and inflation**, though economic policy concerns are much more heightened than one year ago. Although the growth of world trade has decelerated, it is difficult to link this to the trade war. **Goods impacted by new tariffs still account for a limited percentage of world trade**. Nor do we see any significant inflationary effects from higher import costs. US companies report that they are starting to see higher material and transport costs but increased cost pressures may just as well be due to rising wage pressures and higher energy prices.

Trade policy progress – not just trade war

Global trade contributes to higher economic growth, well-being and incomes for many people in emerging market countries. It has also helped squeeze prices, creating room for low interest rates and rising real incomes in many advanced economies.

Despite the gloomy 2018 trade war headlines, there is also progress in some areas, and key issues are being discussed:

NAFTA: Donald Trump won the presidency promising to bring back US industrial jobs, among other things by renegotiating the North American Free Trade Agreement (NAFTA) and Trans-Pacific Partnership (TPP) and by reducing the US trade deficit with China. Now that **NAFTA** (today the US-Mexico-Canada Agreement, USMCA) **has been renegotiated**, a free trade area covering some **25 per cent of the world economy** lives on.

Source: International Monetary Fund (IMF), Macrobond, SEB

US-China: The trade conflict is complex and also includes security policy dimensions. After about six months of virtually frozen dialogue between Washington and Beijing, **the chances of a breakthrough have improved**. The US and Chinese presidents will meet at a Group of 20 (G20) summit of national leaders on November 30/December 1. **Washington has reportedly initiated efforts to produce a draft trade agreement between the two countries**. Meanwhile the US is reportedly prepared to impose new tariffs on the rest of its imports from China (worth over USD 250 billion yearly), and such a decision may come in early December. Having actually started working on an agreement, apparently **the White House does not wish to escalate its trade war with China**, but there are no clear signs that both sides have moved closer to resolving the most sensitive issues, such as forced technology transfer.

Given plunging share prices and indications of slower growth in China, Trump will arrive at the G20 in a position of strength and thus not be prepared to accept a pact that is unfavourable from his perspective. Even if the two sides strike an agreement at the G20, it will probably be fragile and be based on US expectations that China will enact clear changes in a number of areas. **Geopolitical tensions** between the US and China also actually seem **likely to intensify** in the next couple of years.

The **midterm elections** were a setback for Trump as the Democrats took control of the House of Representatives but this will have **little impact on Trump's ability to direct US trade policy**. The president has great leeway to make decisions on introducing trade barriers and in addition to this many Democrats share Trump's protectionistic stance.

Trump's reasons for pressuring China and others

1. **Reduce import leakage**. Trump's recent tax cuts and higher federal spending (about USD 1.7 trillion over two years) will also lead to higher imports. Tariffs make imports more expensive and may help steer demand towards more US goods.
2. **Slow the growth in foreign debt**. Due to years of trade deficits, today the US has net external debts of USD 7.9 trillion (41 per cent of GDP). This makes the US vulnerable, despite the USD's reserve currency status.

US-EU: Since July there has been a US-EU **agreement to avoid escalation** of their trade conflict while negotiations continue. Our impression is that these talks are moving slowly. Before the G20 summit, the US and EU will also hold high-level meetings. Hopefully progress on NAFTA/USMCA and perhaps US-Chinese talks will also lead to a **US- EU breakthrough**.

EU-Japan: In June, amid the raging trade war, the EU and Japan signed a **new free trade agreement** that will go into effect at the beginning of 2019. It removes many existing tariffs between them and means that an area accounting for 30 per cent of the world economy is moving towards lower tariffs.

Japan-China: In October 2018 China's Xi Jinping and Japan's Shinzo Abe met for what was described as historic talks, aimed among other things at deepening their economic relationship.

WTO: The 2018 trade war has put a spotlight on the World Trade Organisation (WTO). More and more critics are saying that the **WTO needs to modernise** so as not to undermine its legitimacy and effectiveness. The **US is threatening** to withdraw from the WTO, and nowadays the White House seems to prefer **bilateral rather than multilateral trade agreements**. At Canada's initiative, a preparatory meeting was held in late October. The EU and others are hoping that WTO trade rules can be updated and revised, the WTO's monitoring role can be strengthened and long-running trade disputes between countries can be resolved quickly. The G20 summit in Argentina may show whether these initial efforts have made progress.

The World Trade Organisation (WTO)

Established in **1995**, the WTO is aimed at **liberalising** and **promoting** open, fair global trade through **regulations** and **monitoring** of its **164 member countries**. It covers **98 per cent of world trade**. In case of trade disputes, it acts as an impartial mediator.

Nordic overview

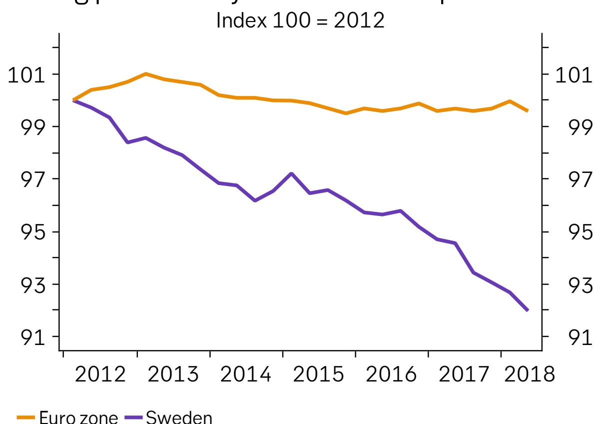
National factors providing resilience in a more uncertain world

The Nordic economies are affected by the euro zone slump but continue growing at a healthy pace despite lower forecasts, mainly for 2018. Norwegian industry is defying trends due to an oil sector upswing, while a Danish slowdown this year is partly due to temporary factors. Strong labour markets will support private consumption, despite higher inflation and interest rate hikes in Norway and Sweden. Sweden's housing sector will pull down the economy, but in Norway, which is ahead in the housing cycle, construction looks set to bounce back.

Sweden: Slowdown despite strong labour market

Despite a weak krona, record-low interest rates and fiscal stimulus, the Swedish economy is not gaining real momentum. Falling home construction, consumer concerns about housing market risks and future shortcomings in the social welfare system – plus an export sector without enough capacity to take advantage of its favourable competitive situation – may be among the reasons. Another factor is the special method used for measuring public sector productivity in Sweden. For technical reasons, which the statistical authorities themselves regard with scepticism, productivity has shown a sharp declining trend, which in turn could lead to underestimates of public consumption volume in the range of 0.3-0.4 per cent of GDP. We have thus lowered our GDP growth forecast compared to September's *Nordic Outlook*. This applies especially to 2018, with a downward revision of official Q2 figures contributing to our adjustment from 2.9 to 2.2 per cent. In 2019-2020 we expect GDP growth to stay somewhat above 2 per cent, a few tenths of a point below our previous forecast. But the picture is not consistent: a continued strong labour market contrasts with slowdowns in other areas. A combination of rapid job growth and moderate economic growth implies a mediocre productivity trend. Corporate earnings performance has held up well, so quarterly reports and macroeconomic data are providing somewhat different signals, indicating a risk that the National Accounts may be underestimating GDP growth.

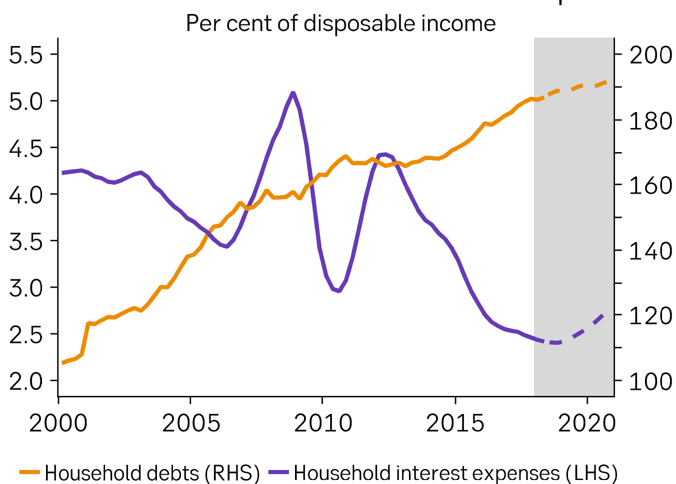
Falling productivity in the Swedish public sector



Source: Eurostat Database, Macrobond, SEB

Temporary manufacturing weakness. Manufacturing sector indicators have weakened in line with trends elsewhere in Europe and are now close to historical averages. As in other European countries, we see good prospects that the slowdown will be temporary. According to the Economic Tendency Survey of the National Institute of Economic Research (NIER), firms are satisfied with both the size of their order books and profitability. Export sector earnings are exaggerated by a weak krona, but combined with capacity utilisation close to historical peaks, still support the possibility that industrial investments will start to accelerate. We also expect service exports to rebound after being largely unchanged since 2016. We believe overall exports will climb by more than 4 per cent this year and 5 per cent yearly in 2019 and 2020. Sweden's current account surplus has gradually shrunk over the past decade. This trend has accelerated in the past year, mainly due to rapid import growth. Weaker domestic demand and stronger export growth suggest that the current account surplus will widen a bit in 2019-2020.

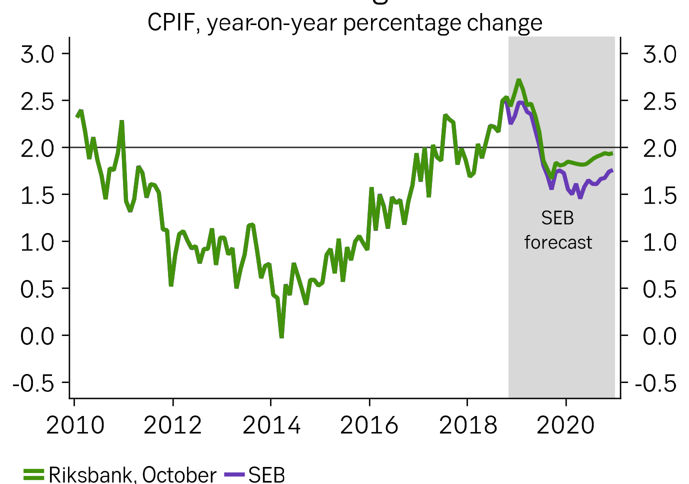
Downturn in residential construction is accelerating. Home construction has now begun to slow after several years with numerous housing starts. Sagging prices and a large supply of expensive tenant-owner cooperative units contributed to a slight decrease in housing starts in the first half of 2018. We expect this downturn to accelerate due to a sharp decline in construction of tenant-owner units, while activity related to rental units and especially single-family homes will remain at decent levels. We expect overall housing starts to fall from about 65,000 in 2017 to 57,000 this year and 47,000 in 2019. The effects on capital spending volume will arrive after a certain delay, and we believe the negative contribution to GDP growth will culminate in 2019, totalling 0.5 percentage points.



Stabilisation of home prices so far this year. After falling by more than 5 per cent during the second half of 2017, home prices have been unchanged since January. A continued increase in the supply of newly built flats suggests that prices will fall by another 3-5 per cent in the next six months, although short-term indicators do not currently point to a further decline. We believe that the Riksbank's cautious key interest rate hikes, as such, will have only minor consequences for the housing market. The 50 basis point per year rate hike now in the cards is significantly slower than the most recent hiking cycles, when the repo rate was raised by 100-150 bps per year. During the 2010-2011 hiking cycle, widening margins also contributed to a rate increase of 275 bp for mortgage loans with a 3-month refixing period. In spite of this, home prices and consumption remained resilient in an environment where the labour market and general economic conditions were stable. Although higher loan-to-value ratios and increased principal repayments ("amortisations") make households more sensitive today, it is unlikely that the moderate rate hikes we now foresee will lead to a sharp deceleration, especially since key interest rate hikes will probably not have a full impact this time around.

Downward trend in unemployment will continue. The labour market remains strong, although signals are now more mixed than before. Job growth has slowed somewhat, while unemployment has surprised on the upside and is now back at the same level as at the beginning of 2018. The main reason is that labour force participation has continued to climb from already high levels. At present, it is difficult to estimate how much more the labour supply can increase. Developments are largely dependent on how integration of recent immigrants will turn out (see theme article, page 27). We believe that job growth will be about 1.5 per cent in the coming year and that it is likely that unemployment will resume the downward trend of the past five years. The alternative metric to the Labour Force Survey (LFS) reported by the Swedish Public Employment Service has continued to show a falling jobless rate, supporting our forecast that the upturn in the LFS figure is temporary.

Acceleration in pay increases will be delayed. The labour market remains strong – underscored by the NIER Economic Tendency Survey, which shows that a record-high share of companies are having difficulty finding suitable employees. This was one reason why the Riksbank's resource utilisation indicator (RUI) rebounded in Q3 after falling slightly in the first half of 2018. Despite the tight labour market, the rate of pay increases remains around 2.5 per cent year-on-year. We expect some acceleration in line with other countries soon, but before Sweden's new centralised wage and salary agreements go into effect in the spring of 2020, pay increases are unlikely to exceed 3 per cent yearly.



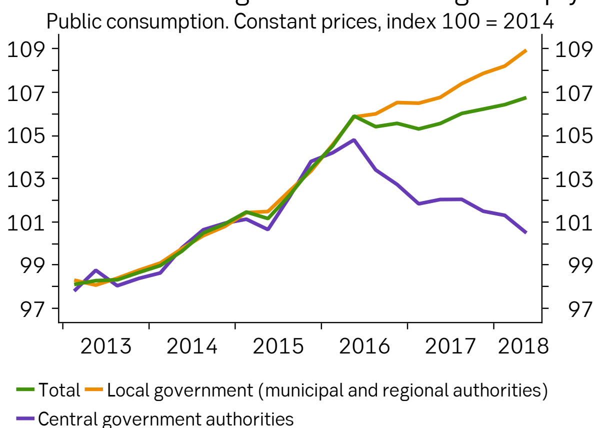
Drought and SEK providing inflationary push. CPIF inflation (CPI excluding interest rate changes) has gradually climbed in recent years. It stood at 2.5 per cent in September, mainly driven by rising energy prices that are now lifting inflation by nearly one percentage point, in an environment of major price upturns for both oil products and electricity. CPI excluding energy has trended lower since the summer of 2017 but rebounded relatively sharply in September. Behind this upward shift were rising goods prices due to krona depreciation, and to some extent higher food prices. These factors may continue to push prices upward in the next six months, and we expect CPIF excluding energy to reach 2 per cent next spring. The dry summer is contributing to the food price upturn, but since this bump in food prices is isolated to Sweden so far, its final impact will depend on the extent to which Swedish products are replaced by imports, mainly from other EU countries. The combination of price pressure from energy, exchange rates and agricultural goods will keep CPIF inflation above 2 per cent until mid-2019. When these partially temporary drivers fade, CPIF is likely to fall towards 1.5 per cent later in 2019. During 2020, inflation will again rise, driven by higher pay agreements and somewhat higher international prices.

Interest rate hikes despite low inflation. At its October policy meeting, the Riksbank continued to signal that it will raise the repo rate either in December or February, but a majority of Executive Board members chose to abstain from signalling which of these two dates was more probable. Our assessment is now that the most likely outcome is a December rate hike, but since our forecast indicates that the Riksbank is overestimating inflation in the next few months, a delay until February cannot be ruled out at all. During 2019 and 2020 we expect the repo rate to be raised twice a year, reaching 0.75 per cent by the end of our forecast period. This is in line with the Riksbank's rate path. Although our inflation forecast is lower than the Riksbank's starting in mid-2018, in an environment where other central banks have begun their normalisation the Riksbank seems to have become more accepting of minor deviations from its inflation target. When CPIF excluding energy falls again next

spring, according to our forecast, we will see a test of whether the Riksbank's reaction function has changed in this respect.

Wider spread vs Germany as Riksbank acts before ECB. As the market has priced in a higher probability that the Riksbank will hike its key interest rate in December 2018, the yield spread between Swedish and German government bonds has widened somewhat. We expect the spread to keep widening if we are right about the Riksbank hiking its key rate at least nine months before the ECB. One can draw a parallel to 2010-2011, when a similar time difference led to a widening by around 60 bps. A slower pace of rate hikes is likely to result in a smaller reaction this time around, but by the end of 2019 we expect the spread to have widened from today's approximately 30 to about 60 bps. The Riksbank has undertaken to reinvest its holdings of maturing government bonds and coupon payments until at least mid-2019. After that the first maturity will occur in December 2020, and we believe that in mid-2019 the Riksbank will announce a lowering of its ambition to reinvesting only coupon payments. This would decrease its six-monthly purchases from the current SEK 20 billion to about SEK 5 billion, but the Riksbank will still own nearly 50 per cent of the outstanding bond supply until the end of 2020.

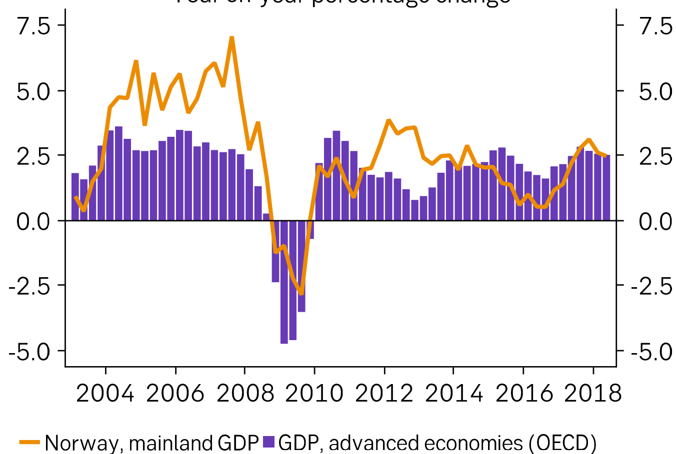
Gradually stronger krona. The actions of the Riksbank still appear to be the most important driver of the Swedish krona. Our forecast of an initial key interest rate hike as early as December 2018 suggests a stronger krona. We have thus revised our forecast and now believe that the EUR/SEK exchange rate may reach 10.15 as early as year-end 2018. Although this appreciation is largely expected, experience shows that the currency may still surge by about 4-5 per cent once the Riksbank delivers its first rate hike. In September, however, Norges Bank showed that a central bank can offset this effect by combining a rate hike with an otherwise dovish message. During 2019 the krona will continue to appreciate slowly. The EUR/SEK rate will reach 9.80 by the end of 2019 and 9.70 by the end of 2020. Given a weak krona at the outset, we also expect significant appreciation against the dollar during our forecast period. We believe that the USD/SEK rate will fall from about 9.00 to 7.70 by the end of 2020, but recent developments have shown that the krona is still adversely affected when geopolitical uncertainty flares up and during periods of falling risk appetite. Our forecast of SEK appreciation thus depends on whether our more optimistic growth and risk appetite scenario materialises.



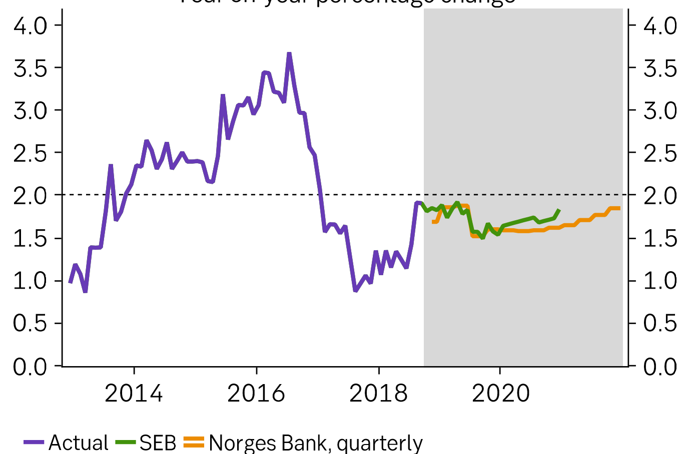
Non-political but slightly expansionary budget. In line with our earlier analyses, since the September 9 election Sweden has had great difficulty removing obstacles to forming a new government. Although the deadlock in the Alliance bloc has been more severe than expected, we still foresee a Moderate-led government as the most likely outcome. But the 2019 budget process will be unusual, since the incumbent Social Democratic-led caretaker government will unveil a budget bill on November 15. The government apparently intends to present a budget without new policies, except for a few points on which there is broad political consensus, such as tax cuts for pensioners. A new government will have a chance to include stimulus measures in its updated spring budget, but 2019 fiscal policy is likely to be less expansionary than we previously expected. It will provide stimulus of not more than 0.5 per cent of GDP. One important question in the budget is the extent to which grants to the local government sector are allowed to increase. Currently Sweden has entered a phase where the earlier large refugee inflow is increasingly causing rising cost pressures for local governments, while that of the central government is decreasing (see chart). The budget process may be further complicated, since Members of Parliament have until November 30 to submit party bills. The handling of the Moderate bill may then become part of Moderate efforts to form a government if the bill wins support from the right-wing populist Sweden Democrats (and the Christian Democrats). Yet short-term difficulties in forming a government do not appear to greatly worry financial markets. One reason is strong government finances. We expect a continued budget surplus of around 1 per cent of GDP in 2019 and 2020, with general government debt falling towards 30 per cent of GDP by the end of 2020, despite any new stimulus measures.

Norway: Above-trend growth in rough waters

The Norwegian economy has been expanding above trend for the past 1.5 years. Growth in the mainland economy slowed somewhat in the first half of 2018, but the dip should prove temporary (the national accounts for the third quarter are being published on November 13). The industrial sector is seemingly unaffected by global political risk and protectionism, helped by an upswing in the petroleum sector. Norges Bank's cautious approach to rate hikes combined with strong labour markets should sustain moderate growth in private consumption. We continue forecasting above-trend growth in mainland GDP in 2019 and 2020 of 2.5 and 2.1 per cent, respectively. The forecast for growth in 2018 has been lowered to 2.4 per cent.



Source: OECD, Statistics Norway, Macrobond, SEB



Source: Bank of Norway (Norges Bank), Statistics Norway, Macrobond, SEB

The upturn in petroleum sector activity is lending positive demand impulses to the mainland economy. Strong petroleum investment growth makes Norway less sensitive to the global industrial cycle. This is confirmed by business sentiment holding up despite increased trade-related uncertainties and seemingly slower business activity in the euro zone. We expect total petroleum investment to rise by 17 per cent in 2018-2020.

Mainland investment rebounding. The second quarter GDP report included a large upward revision to business capital spending over the past years. However, capacity utilisation in manufacturing remains below normal and business investment expectations remain positive. We expect capital spending to expand further but have lowered our forecast compared to September's *Nordic Outlook*. Residential investment has declined sharply, but there are early signs of stabilisation. Housing starts have begun to rebound, suggesting a pick-up in construction activity. We expect gross capital formation to contribute positively to growth in 2019 and 2020.

Rising home prices. The momentum of the upturn in existing home prices has slowed this autumn, reflecting a renewed surge in supply. Prices will still rise by nearly 1 per cent in 2018 due to healthy underlying housing demand. Home price increases should remain moderate due to higher interest rates. We expect annual price gains of 2.4 per cent in both 2019 and 2020.

Solid household fundamentals. Households' consumption of goods has been volatile due to the exceptionally warm summer weather, but the outlook remains cautiously optimistic. However, rising real disposable income and job growth are predicted to underpin consumption. Various employment indicators suggest that labour demand will remain solid. Limited slack in the labour market indicates that upside pressure on wages will intensify. The cyclical upturn in the petroleum sector will also contribute to larger pay hikes in coming years. We forecast a minor decline in unemployment to 3.5 per cent in 2020. Private consumption is expected to grow by 2.5 and 2.4 per cent in 2019 and 2020, respectively. High household sensitivity to interest rates remains a downside risk.

Inflation does not pressure Norges Bank. CPI-ATE inflation (excluding taxes and energy) rose unexpectedly to 1.9 per cent in August/September and while inflation declined in October the underlying trend is a bit stronger than expected. The upturn is driven mainly by higher goods prices reflecting the weaker exchange rate early in 2018. Service prices have also risen somewhat more than expected. We expect CPI-ATE to remain just below target in the short term, before falling to 1.5 per cent by next summer as exchange rate effects fade. Strong economic activity will lift core inflation to 1.7 per cent in 2020. CPI inflation rose to almost 3.5 per cent in September, driven mainly by higher electricity prices. This effect is now being reversed; we expect CPI to reach just above 1 per cent by next summer.

Gradual rate hikes. Norges Bank lifted its key rate to 0.75 per cent for the first time in 7 years this autumn. More rate hikes are likely to be needed considering inflation close to the bank's target, a positive output gap and above-trend growth in mainland GDP. The rate path signals a gradual hiking cycle which takes the strong transmission mechanism into consideration. The long-term inflation trajectory is not signalling an urgent need to speed up the pace of rate hikes. We expect the next rate increase in March 2019 and maintain our forecast of two hikes per year to 1.75 per cent by the end of 2020.

The positive krone outlook may enhance demand for Norwegian government bonds (NGBs). Net supply will be negative in 2019 and a shift in the ECB's monetary policy will make NGBs attractive on a relative basis. We expect the 10-year spread against Germany to tighten to 110 basis points by end-2019.

Denmark: Balanced growth, small downside risks

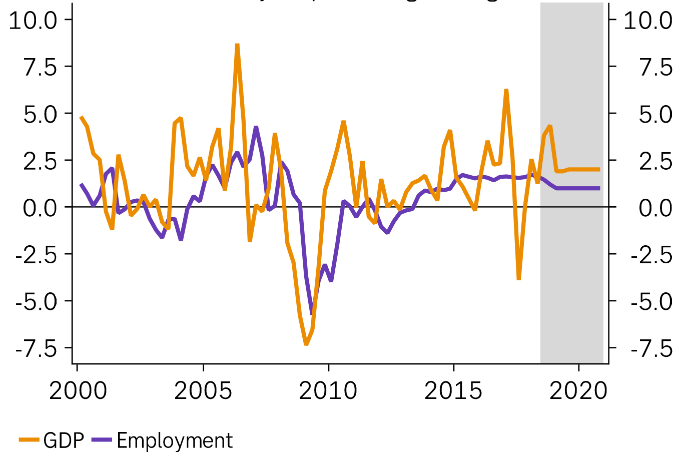
During our forecast period, GDP growth is expected to average around 2 per cent. Our 2018 forecast is unchanged at only 1.5 per cent, but this is mainly due to the overhang from larger patent exports in Q1 2017 and the effects of an unusually warm summer. This has all contributed to a temporary dip in growth, with 2019 growth expected to bounce back to 2.5 per cent.

Apart from these disruptions, the Danish economy remains anchored in stable job and wage growth, which taken together continues to drive disposable income. Household wealth is also supported by moderate growth in home prices. Thus we believe that consumption may pick up further.

Greater business optimism after earlier dip. Business sentiment surveys have fallen, in line with euro zone

counterparts. Exports remain subdued, but the past few months have seen Denmark's PMI post a rebound before a similar trend has materialised elsewhere in Europe. Business investment continues to trend higher.

Accelerating pay hikes in a somewhat tighter labour market. We expect wage inflation to approach 2.5 per cent in 2018 and to speed up during 2019, which fits well with the current low, but gradually rising, overall employment-to-population ratio. If wage inflation exceeds 3 per cent by 2020, as our forecast suggests, capacity constraints may again become a major issue, but there is room for a couple of years of growth before we get there. With home prices and debt capped by macroprudential policy, overheating fears are premature today.



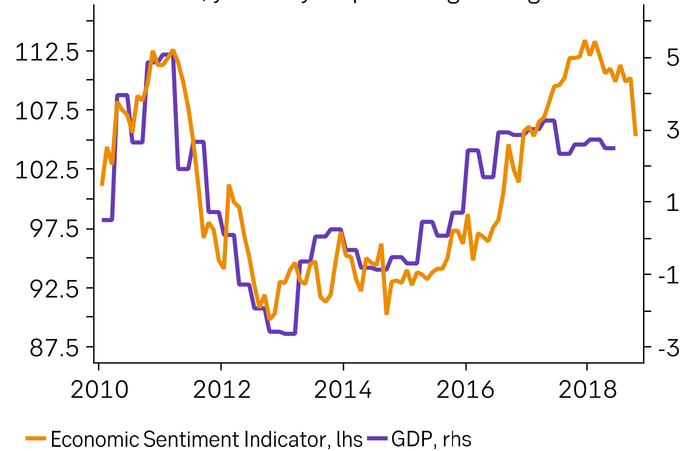
Low underlying inflation. The gap between Danish and euro zone HICP inflation has been widening. So far this seems to be due to food prices and may be due to weather effects from the summer. With wages picking up, we expect the underlying core inflation trend to be higher over the next 6-12 months.

The Danish krone has not benefited from European political uncertainty this time around, and the spot rate is 7.46 per euro. As long as the spot rate doesn't move, central bank policy will not be affected. Fiscal policy is likely to be largely balanced as we head into the election year 2019.

Finland: Above-trend growth despite euro zone dip

The Finnish economy continues to grow at a healthy pace, although disappointing growth in the euro zone will have some impact on the export-dependent Finns during 2019-2020. During much of 2018 sentiment indicators remained high despite euro zone weakness, but the decline in October was the most dramatic since late 2014. Yet most signs point to above-trend growth. We expect GDP to increase by 2.7 per cent this year and by 2.2 per cent yearly in 2019-2020. Looking ahead, the economy looks set to be more balanced, after being largely investment-driven in 2016 and export-driven in 2017.

Slower manufacturing expansion. Domestically oriented sectors of the economy are more optimistic than export-oriented ones. Industrial production and exports are continuing to increase, though more slowly than before. Order bookings remain relatively good, although their influx has worsened. Capacity utilisation is at such a high level that companies will probably increase their capital spending. We expect this spending to expand by 4.5 per cent this year and around 3.5 per cent yearly in 2019-2020, even in an environment where worries about trade dampen optimism. Manufacturing output will increase by 3.5 per cent this year, followed by a renewed acceleration during 2019-2020. Exports will increase by 4-5 per cent a year, or somewhat faster than imports.



Employment upturn will help sustain consumption. The labour market situation keeps improving, and the pace of job growth today is about 3 per cent annually. Unemployment has fallen by 2.2 percentage points since its peak in 2015, and we predict a further downturn to 6.5 per cent towards the end of our forecast period. Wage and salary increases are also accelerating after an earlier slowdown due to the 2016 Competitiveness Pact between government, employers and unions. The upturn is relatively limited, however, and by the end of 2020 we expect the rate of increase to be 2.5 per cent yearly. Somewhat higher inflation will also keep real wage increases moderate. Overall, this means that household purchasing power will mainly be driven by expanded employment. Consumption will increase by less than 2 per cent yearly in 2018-2020, which means that the household savings ratio will remain at just below zero.

Healthy growth has improved public finances. Earlier cost-cutting programmes and good economic conditions are continuing to improve fiscal balances. The budget deficit fell below 1 per cent of GDP for the first time since 2008 and will continue down towards zero in 2020, while government debt will fall below 60 per cent of GDP.

Theme: Swedish labour market

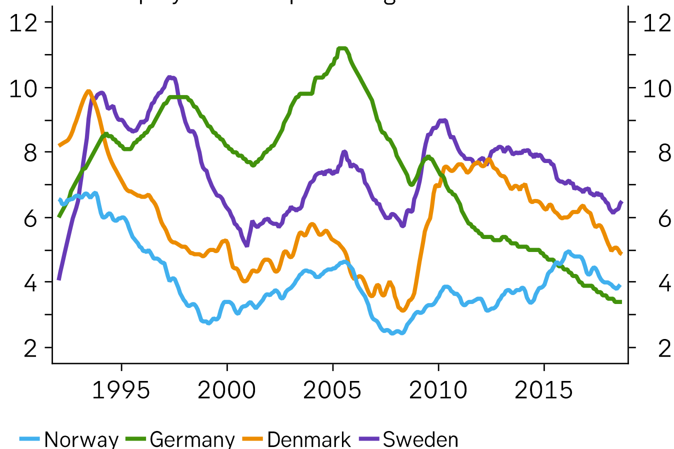
Pessimism on overheating risks may lead to unduly tight policy

Swedish equilibrium unemployment has been pushed higher, since many non-European immigrants have a low educational level, but we believe assessments by the Finance Ministry, National Institute of Economic Research and others are too pessimistic, thus exaggerating the risks of economic overheating. This may lead to excessively low growth forecasts and eventually to an unnecessarily tight fiscal policy that fails to give weak groups better opportunities to establish themselves in the labour market.

Today the Riksbank, Finance Ministry and National Institute of Economic Research (NIER) and other observers believe that the Swedish economy is overheated. This means that GDP is above its long-term sustainable level and unemployment is below its equilibrium level. Given this outlook, it is logical to forecast that the output gap will close and GDP growth will thus fall below its long-term (potential) trend growth, often estimated at 2 per cent. Another conclusion is that the structural budget balance is lower than the actual figure. The result is a more worrisome picture of Sweden's fiscal situation, which NIER and others often use as arguments in favour of tighter fiscal policy. In this article we discuss various perspectives on Swedish resource utilisation.

Higher unemployment than neighbours

Unemployment as a percentage of the labour force



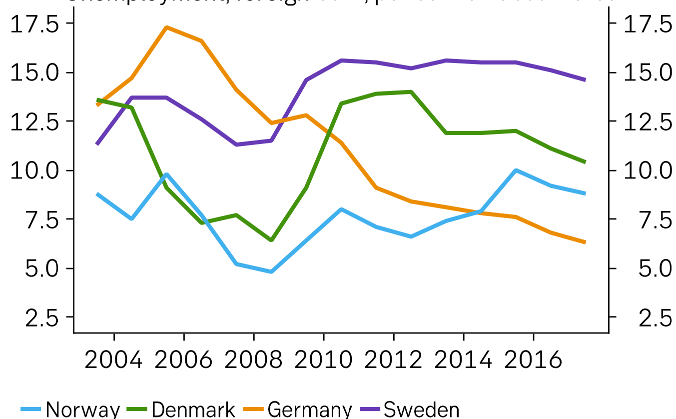
Source: Eurostat, Statistics Sweden

NIER estimates that equilibrium unemployment is 6.8 per cent, which **implies that actual unemployment right now is 0.5 percentage points below equilibrium**. This interpretation seems pessimistic, however. Despite trending downward in recent years, Swedish unemployment is significantly higher than in such neighbouring countries as Germany, Denmark and Norway. In these countries, there are no clear signs of overheating tendencies, for example with regard to accelerating pay increases. It is thus difficult to argue that unemployment should be significantly below its equilibrium in these countries.

Large-scale immigration pushes equilibrium higher

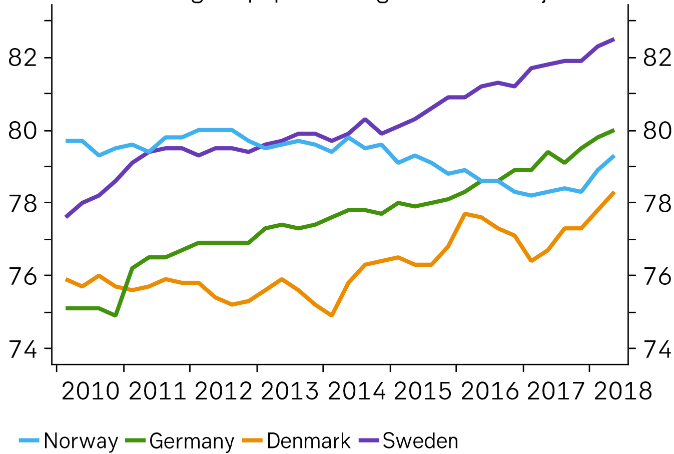
There are probably several reasons why Sweden has higher unemployment than its neighbours. The most important one is that large-scale immigration has greatly increased the number of people with little formal education. National Employment Service figures show that about **75 per cent of the unemployed have weak ties to the labour market, of which a majority** were born outside the EU and/or lack a secondary education.

High unemployment among the foreign-born



Source: Eurostat

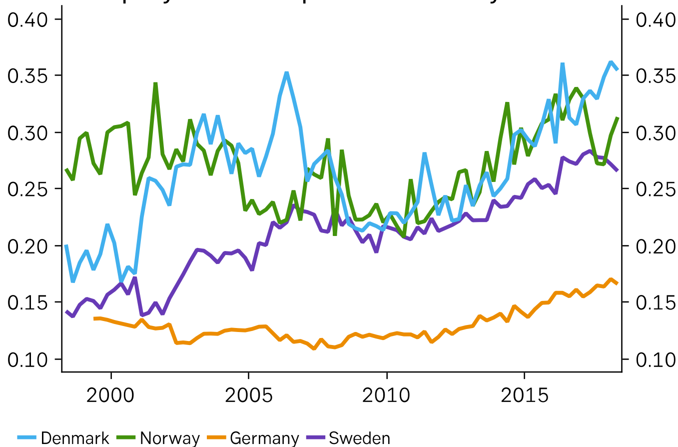
Sweden's **high labour force participation rate may also contribute to higher equilibrium unemployment**. The share of the population participating in the labour market in Sweden is generally higher than in neighbouring countries, and these in turn are still high in a broader international comparison. This also applies to individuals born outside Europe; even though labour force participation by this group is well below the Swedish average, it is higher than in neighbouring countries. High labour force participation by groups that are generally difficult to hire tends to push equilibrium unemployment higher. Unemployment in Sweden among foreign born people, for example, is nearly 10 percentage points higher than in Germany, but the percentage of people in this group who hold jobs is higher than in Germany. One reason for this is that there are more subsidised jobs in Sweden, but the comparison still provides ambiguous signals about how well Sweden succeeds in integrating newly arrived immigrants.



Source: Eurostat

Falling equilibrium unemployment in Germany

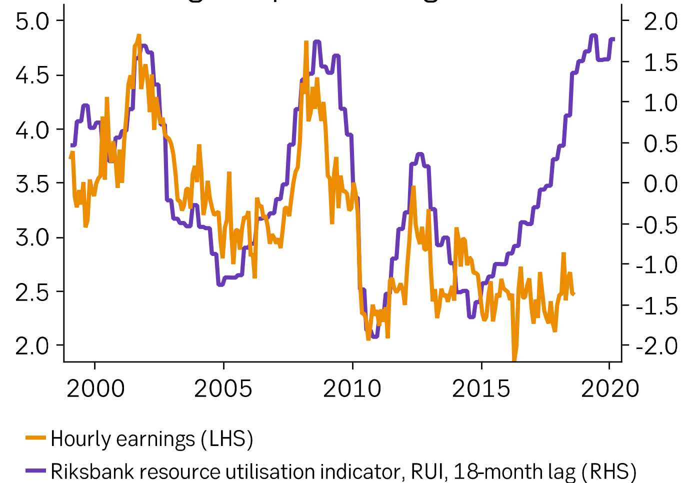
Comparisons with neighbouring countries also show **that it is possible to push down unemployment to historically low levels despite relatively large immigration** (though far smaller than in Sweden as a percentage of the population). For instance, unemployment in Germany has fallen to its lowest since reunification, while only marginally accelerating inflation and pay increases. It should eventually also be possible for Sweden to approach the unemployment levels of its neighbours. When comparing the educational levels of the unemployed, there are both positive and negative factors. On the one hand, Sweden has a somewhat higher percentage of less-educated people who lack secondary diplomas than the neighbours in our comparison. On the other hand, if we look at the percentage of unemployed people with a post-secondary education, it is instead Germany that stands out with a share of only 17 per cent. In Sweden it is 27 per cent, while Denmark is at the top with 35 per cent.



Source: Eurostat Database, Macrobond, SEB

Resource utilisation exaggerates overheating risks

The difficulties of pinning down equilibrium unemployment during major population changes **make metrics like capacity utilisation and labour shortages according to NIER's Economic Tendency Survey especially important**. The Riksbank's Resource Utilisation Indicator, which weighs together indicators of this type, is now close to its 2001 and 2007 peaks, but this high level does not need to be related only to unemployment. It can also be driven higher because **job growth is so rapid that, in itself, it makes recruitment hard for companies**. Such a "speed limit" effect may sometimes make itself felt, as indicated by the strong correlation between pay hikes and the RUI during the boom periods around 2000 and 2007. The chart below shows **a great difference in wage response to high resource utilisation, compared to the current situation**. This is partly due to the pay hikes in collective agreements during these years, but may also be related to increased mobility in the EU single labour market, which holds down pay hikes. Sweden's unusually liberal rules for labour immigration from non-EU countries may be another factor. This more open labour market contributes to our assessment that employment and GDP may keep growing faster than their long-term trend in 2019-2020, with only a moderately faster pay hikes and inflation as a result.



Source: Swedish National Mediation Office, Riksbank, SEB

Room for expansionary fiscal policy underestimated

Today the Riksbank, Finance Ministry and NIER are well aware of the **difficulties of defining metrics such as GDP output gaps and equilibrium unemployment** and do not highlight these metrics with particular enthusiasm. Yet this approach sneaks into their analyses, since they make cautious GDP forecasts looking ahead a few years in order to "factor in" overheating. **Our somewhat more upbeat view of the supply side of the economy** is one reason why we are forecasting higher medium-term growth. This also means that **there is room for a generally more expansionary policy**, for example from an economic stabilisation perspective, since we believe that **bottlenecks are more distant**. We also believe the government and NIER are underestimating structural savings in the public sector by exaggerating overheating. This means they also underestimate the manoeuvring room the fiscal policy framework actually provides. Now that the Riksbank is saying it will start normalising monetary policy, partly due to the obvious disadvantages and risks of sticking to negative interest rates, it will be **especially vital to ensure that fiscal policy is not too tight**. Although it is not obvious how we should interpret the labour market situation, it would be **unfortunate if policymakers did not take the chance to push down unemployment further** and try to reach the levels in neighbouring countries. This would naturally be easier if an expansionary policy is combined with structural measures that lower the threshold into the labour market for weak groups.

Global key indicators

Yearly change in per cent

	2017	2018	2019	2020
GDP OECD	2.5	2.5	2.1	2.0
GDP world (PPP)	3.7	3.8	3.6	3.6
CPI OECD	2.3	2.4	1.9	2.2
Oil price, Brent (USD/barrel)	55	73	85	85

US

Yearly change in per cents

	2017 level, USD bn	2017	2018	2019	2020
Gross domestic product	19,754	2.2	3.1	2.6	1.9
Private consumption	13,654	2.5	2.8	2.7	2.1
Public consumption	3,407	-0.1	1.7	1.5	1.0
Gross fixed investment	3,295	4.9	5.2	3.0	2.5
Stock building (change as % of GDP)		0.0	0.1	0.0	0.0
Exports	2,420	3.0	4.3	3.3	2.9
Imports	3,022	4.6	4.6	3.5	2.8
Unemployment (%)		4.4	3.9	3.5	3.7
Consumer prices		2.1	2.4	1.8	2.2
Household savings ratio (%)		6.7	7.1	6.9	6.9
Public sector financial balance, % of GDP		-3.8	-4.6	-4.8	-4.7
Public sector debt, % of GDP		105.8	106.4	108.5	109.0

Euro zone

Yearly change in per cent

	2017 level, EUR bn	2017	2018	2019	2020
Gross domestic product	10,534	2.4	2.1	1.9	1.8
Private consumption	5,743	1.6	1.5	1.8	1.8
Public consumption	2,173	1.2	1.1	1.2	1.2
Gross fixed investment	2,111	2.6	3.2	3.0	3.0
Stock building (change as % of GDP)	0	0.0	0.0	0.0	0.0
Exports	4,865	5.2	3.8	4.0	3.5
Imports	4,391	3.9	3.3	4.3	4.0
Unemployment (%)		9.1	8.2	7.7	7.4
Consumer prices		1.5	1.7	1.5	1.6
Household savings ratio (%)		9.1	8.2	7.7	7.4
Public sector financial balance, % of GDP		-1.0	-0.8	-0.7	-0.6
Public sector debt, % of GDP		86.8	85.5	83.3	83.3

Other large countries

Yearly change in per cent

	2017	2018	2019	2020
GDP				
United Kingdom	1.7	1.3	1.4	1.6
Japan	1.7	1.1	1.0	0.8
Germany	2.2	1.9	1.8	1.7
France	2.2	1.6	1.8	1.8
Italy	1.6	1.2	1.2	1.3
China	6.9	6.6	6.3	6.1
India	6.3	7.8	7.6	7.4
Brazil	1.0	1.3	2.5	2.6
Russia	1.5	1.8	1.7	2.0
Poland	4.8	4.5	3.4	3.2
Inflation				
United Kingdom	2.7	2.4	1.8	1.8
Japan	0.5	1.0	1.2	1.5
Germany	1.6	1.6	1.7	1.7
France	1.2	1.3	1.4	1.6
Italy	1.3	1.3	1.2	1.4
China	1.6	2.1	2.3	2.3
India	3.3	4.3	4.8	5.0
Brazil	3.5	3.8	4.2	4.4
Russia	3.7	2.8	4.6	4.1
Poland	2.0	1.7	2.7	2.5
Unemployment (%)				
United Kingdom	4.4	4.1	3.9	4.0
Japan	2.8	2.3	2.0	1.8
Germany	3.8	3.6	3.6	3.8
France	9.1	8.7	8.4	8.1
Italy	11.3	10.9	10.5	10.0

Financial forecasts

Official interest rates		07 Nov	Dec-18	Jun-19	Dec-19	Jun-20	Dec-20
US	Fed funds	2.25	2.50	3.00	3.00	3.25	3.25
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro zone	Refi rate	0.00	0.00	0.00	0.25	0.50	0.75
United Kingdom	Repo rate	0.75	0.75	1.00	1.25	1.50	1.75
Bond yields							
US	10 years	3.21	3.20	3.40	3.50	3.60	3.50
Japan	10 years	0.12	0.10	0.10	0.15	0.15	0.20
Germany	10 years	0.44	0.50	0.70	1.00	1.15	1.30
United Kingdom	10 years	1.53	1.60	1.90	2.20	2.35	2.50
Exchange rate							
USD/JPY		113	111	108	104	102	100
EUR/USD		1.15	1.12	1.15	1.18	1.22	1.26
EUR/JPY		130	124	124	118	124	126
EUR/GBP		0.87	0.86	0.84	0.82	0.83	0.84
GBP/USD		1.31	1.30	1.37	1.44	1.47	1.50

Sweden

Yearly change in per cent

	2017 level, SEK bn	2017	2018	2019	2020
Gross domestic product	4,579	2.1	2.2	2.2	2.2
Gross domestic product, working day adjustment		2.4	2.4	2.3	2.0
Private consumption	2,041	2.2	2.0	1.8	1.8
Public consumption	1,196	0.0	0.6	0.5	0.5
Gross fixed investment	1,143	6.1	4.5	3.0	2.8
Stock building (change as % of GDP)	31	0.1	0.1	0.0	0.0
Exports	2,077	3.2	4.1	4.8	4.7
Imports	1,908	4.8	4.5	4.0	3.8

	2017	2018	2019	2020
Unemployment, (%)	6.7	6.3	6.3	6.2
Employment	2.3	1.7	1.2	0.9
Industrial production	4.5	4.0	5.0	4.0
CPI	1.8	2.0	2.1	2.1
CPIF	2.0	2.1	2.0	1.6
Hourly wage increases	2.4	2.6	3.0	3.5
Household savings ratio (%)	15.1	15.5	15.1	15.2
Real disposable income	1.9	2.5	1.5	1.9
Current account, % of GDP	3.3	2.8	3.2	3.3
Central government borrowing, SEK bn	-62	-90	-60	-20
Public sector financial balance, % of GDP	1.3	1.0	0.9	0.8
Public sector debt, % of GDP	40.8	36.9	34.4	32.0

Financial forecasts	07 Nov	Dec-18	Jun-19	Dec-19	Jun-20	Dec-20
Repo rate	-0.50	-0.25	-0.25	0.25	0.25	0.75
3-month interest rate, STIBOR	-0.47	-0.30	-0.15	0.20	0.35	0.75
10-year bond yield	0.73	0.90	1.20	1.60	1.75	1.90
10-year spread to Germany, bp	29	40	50	60	60	60
USD/SEK	9.00	9.06	8.65	8.31	7.99	7.70
EUR/SEK	10.33	10.15	9.95	9.80	9.75	9.70
KIX	118.5	117.4	115.1	113.6	112.4	111.2

Finland

Yearly change in per cent

	2017 level, EUR bn	2017	2018	2019	2020
Gross domestic product	220	2.8	2.7	2.2	2.2
Private consumption	119	1.3	2.0	1.8	1.9
Public consumption	52	-0.5	1.0	0.5	0.5
Gross fixed investment	47	4.0	4.5	3.5	3.2
Stock building (change as % of GDP)	0	-0.2	0.2	0.0	0.0
Exports	78	7.5	5.0	4.2	4.2
Imports	80	3.5	4.5	3.5	3.5

	2017	2018	2019	2020
Unemployment, OECD harmonised (%)	8.6	7.6	7.0	6.6
CPI, harmonised	0.8	1.2	1.2	1.5
Hourly wage increases	-1.2	1.0	1.5	2.0
Current account, % of GDP	-0.7	1.0	1.0	1.0
Public sector financial balance, % of GDP	-0.7	-0.4	-0.2	0.0
Public sector debt, % of GDP	61.3	60.0	58.0	56.0

Norway

Yearly change in per cent

	2017 level, NOK bn	2017	2018	2019	2020
Gross domestic product	3,181	2.0	1.4	2.4	2.4
Gross domestic product (Mainland)	2,768	2.0	2.4	2.5	2.1
Private consumption	1,443	2.2	2.1	2.5	2.4
Public consumption	778	2.5	2.3	1.0	1.2
Gross fixed investment	819	3.6	1.1	4.2	2.4
Stock building (change as % of GDP)		0.1	0.0	0.0	0.0
Exports	1,096	-0.2	2.1	2.8	3.2
Imports	1,064	1.6	3.4	3.0	2.3
Unemployment (%)		4.2	3.9	3.7	3.6
CPI		1.9	2.7	1.7	1.6
CPI-ATE		1.4	1.5	1.7	1.7
Annual wage increases		2.3	2.8	3.2	3.4

Financial forecasts	07 Nov	Dec-18	Jun-19	Dec-19	Jun-20	Dec-20
Deposit rate	0.75	0.75	1.00	1.25	1.50	1.75
10-year bond yield	2.00	1.90	2.00	2.10	2.20	2.35
10-year spread to Germany, bp	156	140	130	110	105	105
USD/NOK	8.32	8.48	8.17	7.63	7.34	7.06
EUR/NOK	9.55	9.50	9.40	9.00	8.95	8.90

Denmark

Yearly change in per cent

	2017 level, DKK bn	2017	2018	2019	2020
Gross domestic product	2,178	2.3	1.5	2.5	2.0
Private consumption	995	1.6	3.0	3.0	2.2
Public consumption	536	0.6	0.9	1.3	0.9
Gross fixed investment	462	4.5	9.4	4.3	4.4
Stock building (change as % of GDP)		0.1	-0.1	-0.2	0.0
Exports	1,188	4.5	0.7	4.2	3.8
Imports	1,033	4.3	4.4	3.0	4.3
Unemployment, OECD harmonised (%)		5.4	5.0	4.6	4.2
CPI, harmonised		1.1	0.8	1.5	2.0
Hourly wage increases		1.7	2.3	2.5	2.9
Current account, % of GDP		9.0	8.0	7.0	6.0
Public sector financial balance, % of GDP		0.0	0.5	1.0	1.0
Public sector debt, % of GDP		37.0	36.0	35.0	34.0

Financial forecasts	07 Nov	Dec-18	Jun-19	Dec-19	Jun-20	Dec-20
Lending rate	0.05	0.05	0.05	0.30	0.55	0.80
10-year bond yield	0.48	0.52	0.72	1.02	1.17	1.32
10-year spread to Germany, bp	4	2	2	2	2	2
USD/DKK	6.50	6.65	6.48	6.31	6.11	5.91
EUR/DKK	7.46	7.45	7.45	7.45	7.45	7.45

Lithuania

Yearly change in per cent

	2017 level, EUR bn	2017	2018	2019	2020
Gross domestic product	42	4.1	3.4	3.0	2.6
Private consumption	26	3.4	3.8	3.4	3.2
Public consumption	7	-0.4	0.7	1.0	1.2
Gross fixed investment	8	6.8	8.2	7.0	5.0
Exports	34	13.6	5.0	4.5	3.5
Imports	33	12.0	5.5	4.7	4.2
Unemployment (%)		7.1	6.5	6.2	6.0
Consumer prices		3.7	2.7	2.5	2.5
Public sector financial balance, % of GDP		0.5	0.5	0.2	0.0
Public sector debt, % of GDP		39.4	35.5	38.0	36.5

Latvia

Yearly change in per cent

	2017 level, EUR bn	2017	2018	2019	2020
Gross domestic product	25	4.5	4.3	3.5	3.2
Private consumption	15	5.1	4.8	3.7	3.0
Public consumption	4	4.1	3.8	3.1	2.3
Gross fixed investment	5	16.0	14.0	7.5	6.5
Exports	15	4.8	3.5	3.1	3.0
Imports	14	9.5	7.8	6.0	5.5
Unemployment (%)		8.9	7.7	7.0	6.5
Consumer prices		2.9	2.5	2.9	2.4
Public sector financial balance, % of GDP		-0.6	-0.5	-1.0	-1.0
Public sector debt, % of GDP		40.0	39.6	38.3	37.6

Estonia

Yearly change in per cent

	2017 level, EUR bn	2017	2018	2019	2020
Gross domestic product	23	4.9	3.4	3.0	2.8
Private consumption	12	2.2	4.0	4.2	3.4
Public consumption	5	0.8	1.4	2.5	1.8
Gross fixed investment	5	13.1	2.8	3.9	2.0
Exports	18	3.5	4.1	3.7	3.8
Imports	17	3.9	4.8	4.2	3.4
Unemployment (%)		5.8	6.0	6.2	6.4
Consumer prices		3.7	3.4	2.5	2.5
Public sector financial balance, % of GDP		-0.1	-0.5	-0.3	-0.3
Public sector debt, % of GDP		9.3	8.3	8.1	7.8

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This report was published
on November 13, 2018

Cut-off date for calculations
and forecasts was November
07, 2018

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SEGR0150 2018.11