Swedbank Economic Outlook January 2017

Rays of light amid political clouds

- Strong cyclical uptick in the business cycles of advanced economies
- Underlying trend growth remains weak
- Demography is changing drivers of economic growth

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Global outlook

Growth in Europe and US is showing resilience amid global uncertainties. The labour market keep adding new jobs, inflation is picking up from low levels, and sentiment among businesses and consumers has picked up. Purchasing managers' indices of manufacturing and services as well as consumer confidence point to stronger growth in coming months, in both Europe and the US. The effects of the financial crisis are slowly dissipating. We expect an uptick in global growth in 2017. Still, risks remain high. In 2017, the effects of the Brexit vote and the Trump victory will start to materialise. Upcoming European elections and geopolitical tensions mean that political risks will remain high. In addition, underlying potential growth remains weak. Poor productivity growth and ageing populations are restraining growth prospects. In our forecast, we highlight how demographic changes are transforming labour markets, saving and investment decisions, and politics.

Maturing business cycle in the US

In the US, the business cycle is maturing. The US has enjoyed 82 months of positive employment growth. With a strong labour market, and an uptick in wages and stronger balance sheets, the US consumer has become more optimistic; this will translate into higher growth in private consumption, a key determinant of US growth. Expectations are high that "Trumponomics" will deliver fiscal stimulus and higher growth. We expect the implementation of new reforms to take time and the effects on the economy to start showing only towards the end of 2017 and in subsequent years. We reiterate our belief that by using fiscal stimulus in a mature business cycle, the US risks a boom-and-bust cycle. Two rate hikes by the Federal Reserve both this and next year will dampen the effects of any fiscal stimulus, and a stronger dollar will contribute to weaker exports. In addition, we remain vigilant on trade policy, highlighting the risks of protectionism and import tariffs that would cause inflation and weigh on consumer spending. (See in-depth 1 on global trade).

Stronger sentiment in Europe

In the euro area, the business cycle is less mature than in the US, and there is, hence, more room for several more years of growth above potential. Unemployment has come down to an average level at just below 10%. The business cycle will be supported by low interest rates and the ECB's quantitative easing. The year 2017 will be characterised by the elections cycle, with important elections in the Netherlands France Germany, and possibly Italy. The theme of 2016-- a strong populist movement influencing politics, economics, and markets--will remain. As for economic development, we will see some fiscal expansion, as governments facing populist challenges will aim to keep consumer sentiment and economic growth going in a positive direction. In addition, terrorist threats and geopolitical tensions will contribute to higher military spending in many European countries.

Swedbank's global GDP forecast[1/] (annual percentage change)

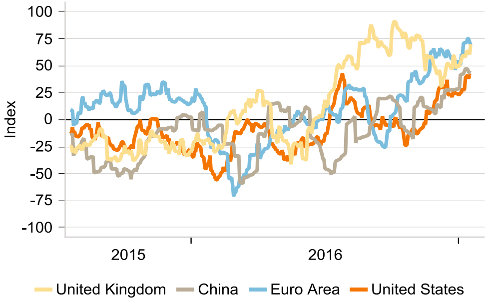
	2015	2016e		2017f		2018f	
USA	2.6	1.6	(1.5)	2.3	(2.0)	1.9	(1.8)
EMU countries	1.9	1.7	(1.6)	1.6	(1.5)	1.4	(1.4)
Germany	1.5	1.8	(1.7)	1.6	(1.4)	1.2	(1.1)
France	1.2	1.1	(1.2)	1.3	(1.2)	1.5	(1.5)
Italy	0.6	0.9	(0.8)	0.6	(0.6)	0.7	(0.7)
Spain	3.2	3.3	(3.2)	2.7	(2.5)	2.2	(2.2)
Finland	0.2	1.4	(0.9)	0.9	(0.8)	1.0	(1.1)
UK	2.2	2.0	(2.1)	1.5	(1.4)	1.2	(1.3)
Denmark	1.6	1.1	(1.0)	1.5	(1.7)	1.8	(1.9)
Norway	1.0	0.7	(0.7)	1.5	(1.5)	2.0	(2.0)
Japan	1.2	1.0	(0.8)	0.9	(1.0)	0.7	(0.6)
China	7.2	6.6	(6.6)	6.3	(6.5)	6.2	(6.5)
India	7.2	6.8	(7.1)	7.0	(7.0)	7.6	(7.7)
Brazil	-3.8	-3.5	(-3.3)	0.2	(0.3)	1.9	(1.6)
Russia	-3.7	-0.5	(-0.5)	1.5	(1.5)	2.0	(2.0)
Global GDP in PPP [2/]	3.2	3.1	(3.1)	3.4	(3.3)	3.3	(3.3)

1/ November 2016 forecasts in parentheses.
2/ IMF weights (revised 2015). Sources: IMF and Swedbank.

Political risks also in emerging markets

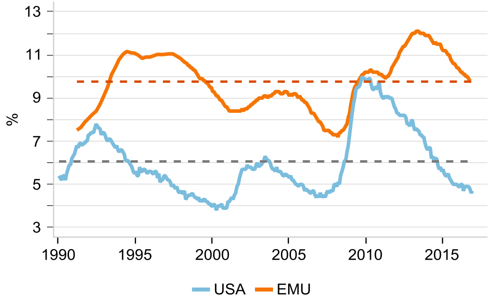
While growth is on a stronger footing in developed countries, emerging markets show signs of weakness. China is struggling to balance high debt with slowing growth. India's economy will take a hit following the currency reform, which abolished bills of higher denominations. Russia and Brazil are bouncing back from recession and benefitting from higher commodity prices and the stabilization in the oil price. Still, fundamentals remain weak. Turkey is struggling with a quickly worsening economy, weak governance, and domestic turmoil. Turkey is not a key economic player in the world economy, but its position as the gateway between Europe and the Middle East makes it a hotbed for global geopolitics. Turkey is an example of a country with large political risks that dim an otherwise rather positive economic outlook.

Global: Citi, Economic Surprise Index



Source: Swedbank Research & Macrobond

Global: Unemployment with averages from 1991



Source: Swedbank Research & Macrobond

Decent growth in the short term should not be confused with higher trend growth. Demography is changing the drivers of economic growth in profound ways (see in-depth 2 on demographics and economy). It directly affects the labour market as ageing populations imply a shrinking labour force. But it also affects economic development through its effect on politics and financial markets. We expect high savings and a small need for investments in ageing societies, and large investment needs in growing societies. In politics, as older people are more likely to vote than the younger generations, their effects in ageing societies on elections and policymaking will become increasingly important. In 2016, an overwhelming majority of younger voters chose to stay in the EU (in the UK) and voted for Hillary Clinton (in the US). Older voters did not, and they voted in larger proportions than their younger counterparts.

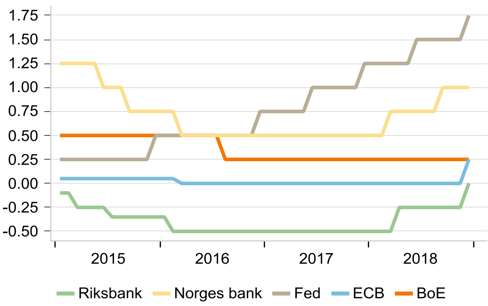
Ageing populations reduces potential growth

For labour markets, ageing populations mean that the working-age population is beginning to shrink in many Western countries. This trend is particularly pronounced in those European countries that have had low birth rates over the past decades. It is also true for China. In the short term, cyclical factors imply that European countries can counteract the negative contributions to growth from a shrinking labour force. High unemployment in many European countries indicates that there are still free resources in the labour market. In addition, structural reforms that push a larger share of the working-age population into the labour force, as well as a higher retirement age, could reduce the pressure of a shrinking working-age population. These countervailing forces are only temporary, however, and a smaller workforce will restrict growth in Europe in the coming years.

Strength of institutions important for short- and long-term economic growth

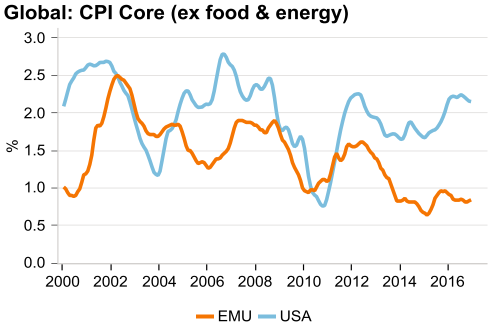
Overall, we remain cautiously optimistic on global growth in the coming years, while keeping vigilant on the downside risks. The political risks dominate. In the coming year, the strength of democratic institutions and the rule of law will be in focus. The UK negotiations with the EU over Brexit will be under parliamentary and judicial scrutiny. Markets will focus on US institutions, as important nominations for the Federal Reserve and the Supreme Court will be announced. Political events, twitter announcements, and rumours will be able to sway sentiments and markets. In this environment, we continue to stress the importance of looking at short-run indicators, as well as underlying fundamentals. Productivity growth and ageing populations are the key determinants of long-run growth prospects. In addition, we need to remember that the strength of democratic instiutions is also a long-run determinant of economic growth and well-being.

Global: Forecast central banks



Sources: Swedbank Research & Macrobond

Global: CPI Core (ex food & energy)



Source: Swedbank Research & Macrobond

Paradigm shift on the market as central banks ease their grip

Central banks shifting from headwinds to tailwinds

After a sharper focus on political risks in the autumn, the significant market turmoil has now subsided, even though there are several forthcoming elections in Europe. The central banks' communications have begun to exude some confidence in terms of the underlying macroeconomic trends. The US presidential election appeared to be a catalyst for a regime shift from a monetary to a fiscal policy. This has spurred inflation expectations and brought a reflationary impetus to the market, which, in turn, has instilled a spirit of optimism. The Fed decided to raise its key interest rate in December but did not take into account the incoming administration's fiscal plan. We expect that the Fed will continue with some restraint its hiking cycle, while the ECB and the Riksbank will continue to gently phase out asset purchasing as part of an impending normalisation. Central bank policies will have a major bearing on the financial markets. However, the next few years will be marked by an increasingly clear divergence in interest rate cycles, which is expected to shape the development of global interest rates and currencies.

Central bank policy will govern the yield curve but the rate cycle is different this time

The interest rate market's response to the optimism took the form of rising long-term rates during autumn; this appears to reflect an expectation of a transition to inflation-driven growth, at least in the short term. We have seen a global shift towards steeper yield curves and rising inflation expectations, with US interest rates setting the direction. This theme will dominate until expectations of rising policy rates take over. We are now seeing that the continuing positive signals from the central banks have the potential to change the trend. A gradual tapering off of the central banks' asset purchases is a first, albeit small, step towards a tighter monetary policy. The US yield curve is expected to be characterised by a flattening trend further into the future in the wake of the rising US policy rate; however this will be much smaller than in earlier hiking cycles. The trend will be partly countered by an eventual increase in supply of US treasuries. Besides that, we expect Fed to start to scale down the balance sheet towards 2018 by gradually phasing out the size of re-investments. The Swedish interest rate market largely follows the international rate market, and the difference in the interest rate spread between Swedish and other markets, especially European long-term rates, will be partly governed by the extent of the Riksbank's asset purchases. We expect the Riksbank to phase out its purchasing programme before the ECB, resulting in a steeper Swedish yield curve and a wider spread between Swedish and European long-term interest rates in the mid of 2017. This trend will then start to be reversed towards the end of 2017, when the ECB gradually initiate the end of its asset purchase programme. The short-term interest rate spread between the US and the European countries will steadily widen during the next few years in the wake of higher US interest rates.

Interest and exchange rate forecasts, %

	Outcome	Forecast			
	2017 17-Jan	2017 30 Jun	2017 31 Dec	2018 30 Jun	2018 31 Dec
Policy rates					
Federal Reserve, USA	0.75	1.00	1.25	1.50	1.75
European Central Bank	0.00	0.00	0.00	0.00	0.25
Bank of England	0.25	0.25	0.25	0.25	0.25
Norges Bank	0.50	0.50	0.50	0.75	1.00
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-0.10
Government bond rates					
Germany 2y	-0.8	-0.6	-0.5	-0.2	0.2
Germany 5y	-0.5	-0.3	-0.1	0.2	0.6
Germany 10y	0.2	0.4	0.6	1.0	1.4
US 2y	1.2	1.5	1.8	2.1	2.3
US 5y	1.8	2.1	2.4	2.8	3.0
US 10y	2.3	2.6	2.8	3.1	3.3
Exchange rates					
EUR/USD	1.07	1.01	1.06	1.07	1.08
USD/CNY	6.9	7.1	7.2	7.2	7.3
EUR/NOK	9.98	8.75	8.75	8.70	8.70
USD/JPY	114	121	122	118	115
EUR/SEK	9.49	9.35	9.15	9.10	9.05
EUR/GBP	0.87	0.87	0.90	0.87	0.85
USD/RUB	59	57	55	52	49

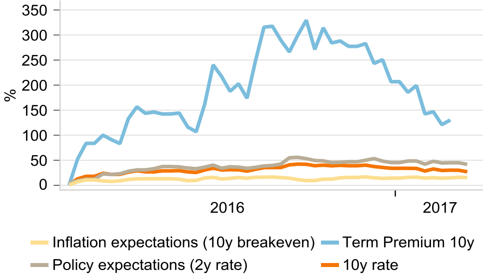
Sources: Macrobond and Swedbank.

Rising rates in sight but levels stay at historical lows

We expect that the upward trend for long-term interest rates will continue, although there is a limit as to how far the rise can go. The economic recovery in the US is still relatively modest, and the recent interest rate increase has largely been led by a normalisation of term premiums, although monetary policy expectations in US also have risen. Swedish and

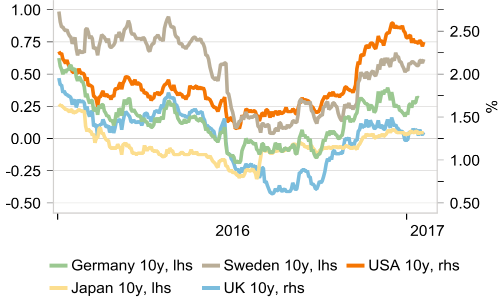
European long-term interest rates are expected to rise, partly due to expectations that asset purchasing will be phased out, but the levels will still continue to remain relatively low historically. There have been numerous reasons for the abnormally low global interest rates seen over a long period. These include expectations of low, and, in some parts, negative interest rates, with the underlying drivers more or less turned from cyclical to secular trends. In addition, term premiums have been pushed down to historically low levels as a result of the central banks' ongoing bond purchasing. The majority of these secular factors, such as high debt, the savings glut, and low productivity, remain partly in place, which means that the risk of a rapid tightening of financial conditions is limiting not only inflation expectations and the Fed's monetary policy normalisation, but also, therefore, an expected rise in long-term interest rates.

Global: US term premium & rate, % increase since the US-election



Source: Swedbank Research & Macrobond

Global: Bond markets highly correlated



Source: Swedbank Research & Macrobond

Dollar benefits from increased European sovereign risk

The trend on the exchange rate market during the previous year was primarily driven by two different factors: political risk and interest rate expectations. The dollar strength that we have seen in the currency market started even before the outcome of the US election and was a natural effect of higher interest rate expectations. Despite uncertainty about how much of Trump's fiscal policy intentions will actually be realised, the dollar's prospects have improved further in the face of increased political risk in Europe. We expect the series of elections in Europe to create a breeding ground for further political unrest and, subsequently, a higher risk premium in the spring for the euro, thereby prompting a continuing overall strengthening of the dollar in the short and medium term. However, it is our assessment that the interest rate advantage for the dollar will need to be maintained by more than two rate hikes this year if there is to be a deeper and more protracted appreciation of the dollar in the longer term. The risk scenario of the present forecast, however, leans towards an even stronger dollar than forecast, if fiscal policy expectations in the US materialise more quickly than envisaged. Our base scenario is built on more or less a status quo in the political landscape in Europe after the French and German elections; this means that the euro has the potential to strengthen against the dollar in the long term, particularly when the ECB starts to phase out quantitative easing. We also expect increased risk premiums for the UK pound sterling during the year, with the outcome of the Brexit negotiations continuing to be marked by great uncertainty and a higher risk of more stringent trade conditions for accessing the EU's single market. We believe that the pound sterling is likely to weaken further as the negative economic consequences of Brexit are increasingly discounted into the exchange rate.

Positive long-term outlook for Scandies

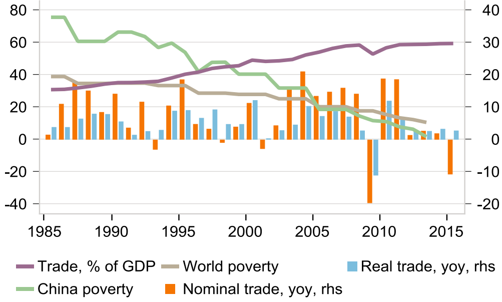
The Swedish krona has recently recovered some of its previous depreciation, mainly because of a better Swedish macro outlook. The krona's fundamentally low valuation over a long period may be partly explained by the Riksbank's continuous signalling of further stimulus measures, in line with the krona's assigned status as high-risk currency in a generally turbulent market. However, the Riksbank's latest interest rate decision has generated some optimism in terms of the underlying economic trends, as the diminishing support for continuing asset purchases presents an opportunity for the krona to strengthen against the euro. The Swedish krona is expected to strengthen, though at times in volatile market, against the euro in parallel with the Norwegian krone, as the upside potential for Norwegian and Swedish interest rates is greater than for the European rates.

In-depth 1: weakening trade – turning inwards will not support the global recovery

Despite the growing discontent with globalisation among developed countries' voters, it is hard to deny the benefits of free trade. Plentiful research has made it clear that trade liberalisation can improve productivity, boost economic growth, and raise overall living standards. The explosion in world trade has lifted hundreds of millions out of poverty in China and other emerging economies and has lowered global (cross-country) income inequality. Furthermore, consumers in developed countries, especially those at the lower end of income distribution, have benefitted from the efficiencies of freer trade through lower prices, as well as increased variety of products. Despite all its merits, globalisation has also created losers, in particular those who have lost their jobs or have found their incomes eroded by foreign competition.

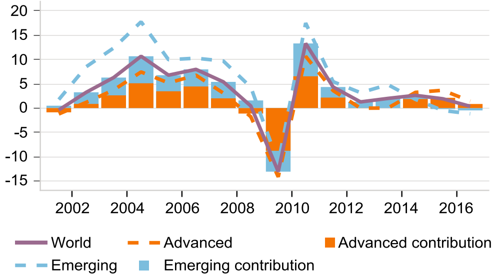
Nevertheless, given all the positive effects of free trade, the recent developments in global trade are unsettling. Over the two decades leading up to the global financial crisis, global trade (measured as exports plus imports of goods and services) volumes had been expanding by an average of 6.3% - twice the rate of global GDP. But this remarkable performance is nowhere to be seen these days – real trade growth has slowed considerably since 2012 and has fallen close to that of global GDP. The slowdown in global trade growth has been widespread, affecting advanced as well as emerging economies. The slowdown has become more pronounced in the emerging markets in recent years, due to slowing growth of imports to China and the unfavourable economic situation in many commodity-exporting countries.

Global trade and poverty rate (at $1.25 a day), %



Source: Swedbank Research & Macrobond

Real growth of imports (%) and the contribution to growth (pp)



Source: Swedbank Research & Macrobond

The IMF and the OECD find that the general weakness in world economic activity, particularly weak investment, was the biggest culprit behind the recent slowdown in trade. This may be cyclical – e.g., investment, which is trade intensive, may pick up as economic growth accelerates. However, given the rapid ageing of the world population, high levels of debt, political uncertainty, and many other headwinds, the revival in investments could be very slow; thus a strong cyclical upturn in trade in the medium term is unlikely.

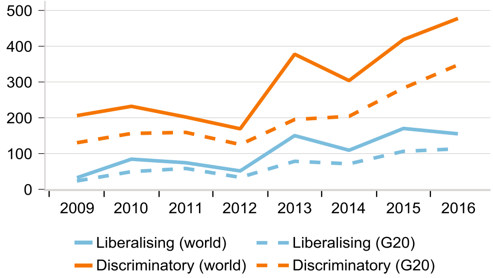
Moreover, growth in trade could have also been dampened by China's rebalancing away from investment towards consumption-driven growth, as well as by the global sectoral shift from goods to services. The shift of economic activity from advanced towards emerging economies, which tend to have lower trade intensity, could have been another factor behind the slowdown in trade, relative to GDP. These developments are largely structural and are unlikely to stop or be reversed in the near future.

Other structural determinants have been also playing an important role in the recent slowdown in trade. Trade liberalisation, marked by the formation of the WTO—which was later joined by China--deeper integration within the European single market, and the formation of large free-trade agreements (e.g., NAFTA), have been giving way to a creeping protectionism. The free-trade consensus is breaking up, and anti-trade sentiment is on the rise in some of the largest developed economies, e.g. the US and the EU.

Given the current political environment, it is unlikely that the Transatlantic Trade and Investment Partnership (TTIP), involving the US and EU, or the Trans-Pacific Partnership (TPP) among 12 Asia-Pacific economies will be implemented. Moreover, a shakeup of the established trade rules and agreements (e.g., NAFTA) cannot be ruled out, either. Questions, such as whether the UK will keep its access to the European single market after Brexit and how its trade relations with the EU and other countries will evolve, are still unanswered; they also pose a threat to free trade.

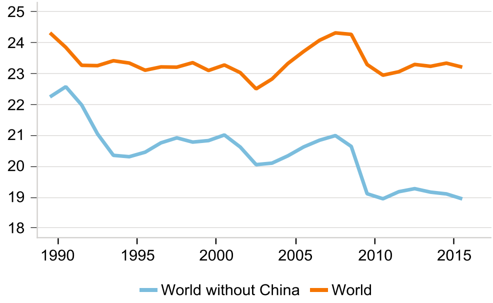
The weakening of global value chains (GVCs) is also slowing trade growth. The integration of the emerging economies, particularly China, into the world economy, advances in transportation and communication, the removal of trade barriers, and, thus, lower trade costs boosted the expansion of GVCs. However, the process of fragmenting production across borders has been slowing over the last decade. The OECD estimates that the US and Japan reduced their participation in GVCs by 20% and 10%, respectively, in the five-year period prior to 2015. These developments could be the effect of a more moderate decline in trade costs, rising labour costs in key emerging markets, the increased need to shorten time to market and move production closer to customers, the advancements in technology, the slowing pace of trade liberalisation, and the rise in protectionism—as well as, possibly, the natural maturation of existing GVCs.

Number of implemented trade policy measures (by September 30th)



Source: Centre for Economic Policy Research

Gross fixed capital formation, % GDP



Source: Swedbank Research & Macrobond

It is likely that global trade will pick up somewhat as world economic growth accelerates and the developing economies become richer. However, it is unlikely that the growth rates seen prior to the Great Recession will return - those were to a large extent the result of one-off events (such as the integration of the world economy and expansion of free-trade agreements) that cannot be repeated. We might even see less trade in the years to come, as indicated by the strengthening protectionist rhetoric and growing number of trade-restricting measures.

Protectionist actions could lead to trade wars, which would not only weaken global trade, but could also dampen global economic growth, lower incentives for investment and innovation, and lead to rising unemployment. According to the Peterson Institute for International Economics, a trade war resulting from protectionist actions by the US (punitive tariffs, withdrawal from the WTO, the breakup of NAFTA) could even send the US economy into recession and cost millions of Americans their jobs. The repercussions of such developments would undoubtedly be felt globally. Lack of leadership in trade liberalisation is another negative aspect of a turning inwards by the US. China would probably push for more trade openness in the Asian region, but, given the lower purchasing power of the emerging countries, these actions may have a limited effect on the global economy.

Small, open economies with shrinking populations (e.g., the Baltic countries) would be hit hardest by the rise in protectionist measures. Such countries cannot rely on domestic demand for driving future growth; thus, they will increasingly depend on external demand, exports in particular. Trade barriers would damage the growth prospects for these countries to a much larger extent than they would for countries that can grow by boosting domestic demand.

Turning inwards would not help the disadvantaged workers, but would only ensure that there is less prosperity to share. Convincing the voters of the benefits of free trade by ensuring that the gains from trade are spread more widely and compensating the ones who lose out from free trade is the right way to go. This is the big challenge facing policy makers around the world in the years to come.

Laura Galdikiene
Linda Vildava

Sweden: growing pains intensify

Sweden is showing record-fast population growth. At the beginning of 2017, the 10 million mark was crossed. According to Statistics Sweden's latest forecast, the population will increase by another million in seven years, reaching 11 million in 2024. The rapidly growing population will be an important factor for economic development. This could be highly positive for Swedish growth, both in the short and the long term, while also changing and challenging the drivers of the economy. This is largely because the housing market is coming under further pressure. The population growth also accentuates the polarisation of the Swedish labour market, and matching problems may worsen. Reforms to achieve better-functioning housing and labour markets are becoming increasingly urgent. The lack of reforms is a constraint on the otherwise strong growth in the Swedish economy and increases risks.

Domestic demand - key for growth

In an uncertain world, Sweden has good prospects for continued strong growth. Although there are still major global political risks, the short-term indicators point to a positive GDP uptick in both Europe and the US. Despite great uncertainty about the actual impact of the Brexit referendum and the US presidential election, it is our assessment that the global economy has strengthened slightly. This is contributing to higher private investment growth and rising exports for Sweden. However, this is not a decisive factor for Swedish growth over the next few years. Instead, it is mainly domestic demand that continues to drive the Swedish economy.

Population growth boosts growth…

The rapid population growth means that investment needs are great. Investments in the public sector and housing are the main contributors to growth. Public consumption is also rising as a growing population raises the demand for welfare services such as health care, schools, preschools, and nursing homes. Employment will continue to grow. Needs are large in the public sector, although many jobs will also be created in the private services sector. This will contribute to positive growth in household disposable income, private consumption, and public finances. Increased tax revenue is expected to continue to strengthen public finances, and we expect a surplus in the state budget in 2017.

Key Economic indicators, 2015-2018 [1/]

	2015	2016f	2017f	2018f
Real GDP (calendar adjusted)	3.8	3.2	2.6	2.4
Industrial production	3.9	2.0	2.4	2.9
CPI index, average	0.0	1.0	1.8	2.2
CPI, end of period	0.1	1.7	1.7	2.6
CPIF, average [2/]	0.9	1.4	1.8	1.7
CPIF, end of period	0.9	1.9	1.5	1.7
Labour force (15-74)	0.8	1.0	1.3	1.0
Riksbank policy rate, end of period	-0.35	-0.50	-0.50	0.00
Unemployment rate (15-74), % of labor force	7.4	6.9	6.6	6.6
Employment (15-74)	1.4	1.6	1.6	1.1
Nominal hourly w age w hole economy, average	2.4	2.5	3.0	3.3
Savings ratio (households), %	16.3	16.0	15.9	16.2
Real disposable income (households)	2.5	2.9	1.8	2.1
Current account balance, % of GDP	5.4	4.9	4.8	5.1
General government budget balance, % of GDP [2/]	0.3	1.0	0.1	-0.3
General government debt, % of GDP	43.9	41.2	39.2	37.5

1/ Annual percentage growth, unless otherwise indicated.
2/ CPI with fixed interest rates. Sources: Statistics Sweden and Swedbank

…but also imbalances

However, economic developments are not entirely positive. Sweden is suffering from growing pains. There is a desperate housing shortage in the metropolitan regions and university cities. The polarisation in the labour market, with a large gap in unemployment between the native and non-native groups, and between levels of education, is expected to intensify. The major housing shortages make it more difficult to move to where there are jobs and training, which is restraining employment growth. Despite the high growth in residential construction, not enough is being built to meet demand. Most of the homes that are being built are relatively expensive and do not match the need for affordable rental housing. This is creating pressure to buy homes for households with small margins. An already-high level of debt and significant interest rate sensitivity are creating vulnerability in Swedish households.

Expansionary monetary policy to be gradually phased out

We expect that the Riksbank's expansionary monetary policy will continue this year, but that the extended bond buying will cease at midyear. In the spring of 2018, the Riksbank will raise the repo rate, which will mark the start of a gradual but cautious normalisation of interest rates in Sweden.

Population growth may alleviate strains from age-ing

During 2017 and 2018, it will be increasingly important for economic policy to facilitate continued growth in Sweden while reducing vulnerabilities. This is particularly important because an uncertain external environment can quickly reverse economic development. It is also important to exploit the opportunities presented by the strong population growth. Sweden is facing the problem of an ageing population and an increasing dependency ratio. However, the high population growth may make it possible to alleviate pressures in tax and welfare services. The positive effects are dependent on new arrivals and young people receiving a good education and finding employment. Reforms to establish a more inclusive labour market and a better-functioning housing market are more urgent than ever.

Swedbank's GDP Forecast - Sweden

Changes in volume, %	2015	2016f		2017f		2018f	
Households' consumption expenditure	2.7	2.1	(2.4)	2.1	(1.9)	1.8	(1.5)
Government consumption expenditure	2.5	3.6	(3.9)	2.0	(2.4)	1.8	(1.7)
Gross fixed capital formation	7.0	6.8	(7.3)	4.0	(3.5)	3.3	(3.2)
private, excl. housing	6.6	3.8	(6.0)	2.5	(2.2)	2.6	(2.3)
public	-0.5	5.9	(3.9)	5.2	(5.0)	5.3	(5.6)
housing	16.1	18.0	(14.4)	7.5	(6.3)	3.8	(4.1)
Change in inventories [1/]	0.3	0.3	(0.0)	-0.2	(-0.1)	0.0	(-0.1)
Exports, goods and services	5.6	3.2	(2.6)	3.7	(3.3)	3.6	(3.1)
Imports, goods and services	5.5	4.3	(4.7)	3.8	(3.6)	3.5	(3.1)
GDP	4.1	3.3	(3.0)	2.4	(2.2)	2.3	(1.9)
GDP, calendar adjusted	3.8	3.2	(2.8)	2.6	(2.5)	2.4	(2.0)
Domestic demand [1/]	3.5	3.5	(3.8)	2.4	(2.4)	2.1	(1.9)
Net exports [1/]	0.3	-0.3	(-0.7)	0.1	(0.0)	0.2	(0.1)

1/ Contribution to GDP growth. Sources: Statistics Sweden and Swedbank
November 2016 forecast in parentheses.

Pickup in exports

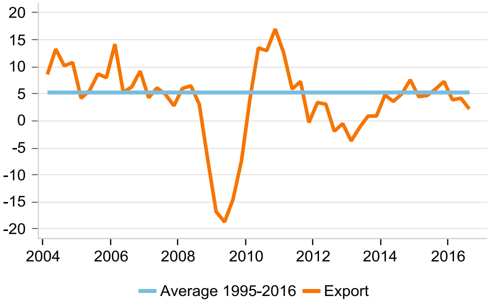
External demand increased at end-2016

Swedish exports strengthened in the second half of last year following a stronger outcome in several of Sweden's most important markets. Increased sales of R&D services pushed up services exports in the third quarter, while goods exports benefitted from a weak krona. In November, goods exports rose by 13% in nominal terms. In the goods category, exports of road vehicles have shown the strongest growth, both in nominal and volume terms.

Swedish trade threatened by protectionism

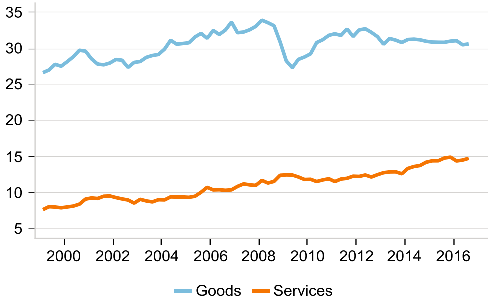
Conditions for the Swedish export industry will improve during 2017-2018, as we expect slightly stronger global growth. This is particularly the case in Europe, where there has been a clear improvement in recent months, led by Germany. The commodity-related industries will be supported by the commodity market recovery. At the same time, we expect Swedish competitiveness to strengthen during the forecast period due to slow growth in unit labour costs (slightly more than 2% per year) and a weak krona. Overall, we expect an annual increase of 3.5% in total export volumes during 2016-2018, which is slightly higher than in the three-year period 2013 to 2015. Exports of services are not expected to maintain the high growth rate of the last three years (average 8.7%), mainly due to the impact of Brexit. However, after many years of low investment in Europe, goods exports will be supported by replacement investment. Swedish export growth is constrained by sluggish world trade and a weak global investment climate. There are downside risks here, particularly if the United States imposes trade restrictions. For this year and next, net exports will make a positive contribution as imports gradually tail off in the wake of lower consumption and investment growth.

Sweden: Total export, annual growth, %



Source: Swedbank Research & Macrobond

Sweden: Goods and services export, % of GDP



Source: Swedbank Research & Macrobond

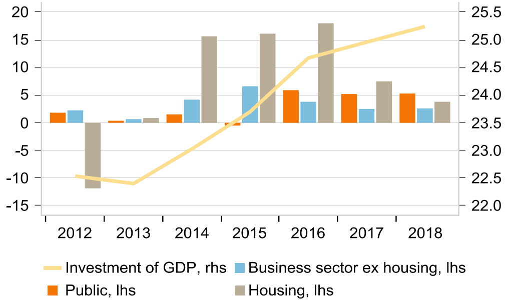
Investments boosted by housing and the public sector

Investments have been rising since the beginning of 2014, the longest upturn since 2006-2007. Overall investment volume has increased by almost 15% over two years, with residential construction accounting for the largest increase, although business and public sector investments have also risen. However, a weaker outcome for business investment led to a slight downward revision from the November forecast for overall investment growth in 2016. Reduced R&D investment has been the main contributor to the slowdown. Residential investment has increased significantly more than expected and is estimated to have risen by as much as 18% in 2016. Public investment also grew more than expected last year, particularly at local levels. At the same time, a large number of public infrastructure projects, in particular in the Stockholm area, have been started.

Lower investment growth due to capacity constraints

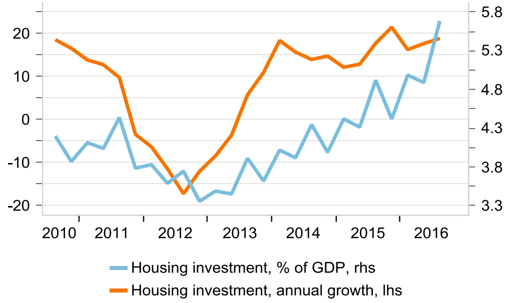
The high level of investment (25% of GDP) and growing capacity shortages will gradually dampen investment growth in 2017 and 2018. However, last year's strong residential construction is spilling over into this year and is increasing more than we forecast in the autumn. In addition to capacity constraints, such as a lack of manpower and available land for building, residential construction will be dampened by lower demand for housing in the wake of higher interest rates and tighter credit conditions. On the other hand, a growing population will increase housing demand, which means that the housing shortage will continue to be worryingly high throughout the forecast period—even though more than 60,000 new housing starts are scheduled for each of the next two years. Rising commodity prices and stronger Swedish exports are supporting business investment, although, with low resource utilisation in industry, investments are lagging. We expect public investment to continue to rise during the forecast period. A growing population and a large need for upgrading municipal services are driving municipal investments.

Sweden: Investments in sectors, annual growth, %



Source: Swedbank Research & Macrobond

Sweden: Investment in housing, %



Source: Swedbank Research & Macrobond

Households are becoming increasingly more careful

Rising inflation and interest rates strain households

Household consumption will be a key driver of growth, although the momentum will gradually ease over the next two years. Household disposable income continues to grow, even though gradually rising inflation is slowing the real growth rate. In addition, interest rates remain low, albeit rising slightly. However, even a slight increase in interest rates means rising uncertainty for highly indebted households. Consequently, even if we see a continuation of the favourable income growth, we expect growth in consumption to tail off in the next two years. This is due to several connected factors.

Household consumption will gradually ease

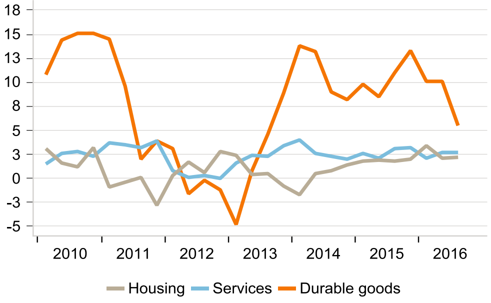
First, there will be a slowdown in consumption of durable goods (just under 10% of total consumption). This is partly an effect of "saturation," as the annual growth rate for the last three-year period exceeded 10%. Car sales have achieved an all-time high for two consecutive years, while other consumer durables, such as furniture and interiors, have benefitted from low interest rates and a high level of residential construction. During the forecast period, we will therefore see a gradual slowdown in the growth rate for durable goods in the face of slowly increasing interest rates, while new regulations point to tighter credit conditions.

Second, it is our assessment that interest rates have bottomed out. But even if interest rates remain low during the forecast period, the upward trend and continuing discussions about high household indebtedness will prompt households to adopt a more restrained stance.

An additional factor is that we are seeing a persistently high saving rate, which to some extent reflects households' increased caution. This is partly a result of the changed interest rate trend and a consistently tight message from both the authorities and credit institutions. This has fuelled a rise in the rate of amortisation, while precautionary saving remains at a high level. On top of this, there is an additional demographic aspect: the number of people in the

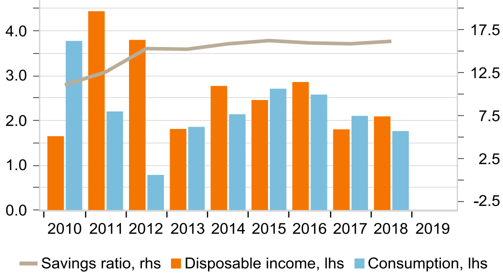
50 - 64 age group will rise during the forecast period. This is an age group with a comparatively good level of income, but with a lower consumption propensity. In addition, the desire to secure a decent standard of living after retirement may induce a higher saving rate.

Sweden: Household consumption, %



Source: Swedbank Research & Macrobond

Sweden: Savings ratio, disposable income and consumption



Source: Swedbank Research & Macrobond

Inflation not quite reaching the target

Inflation trending upward

Inflation showed an upward trajectory towards the end of 2016 – a trend we expect to continue, particularly in the first half of this year. At the same time, tax increases will affect the monthly trend this year (April and July). In the second half of the year, we see a stabilisation in the rate of inflation and CPIF (consumer price index with fixed exchange rate) stabilising a little below 2%. Inflation will then rise moderately in 2018 but not quite reach 2% druing the year.

Weak internal …

A relatively weak domestic inflationary pressure continues to dominate. Inflationary pressure from the labour market is modest, and only towards the end of the forecast period will we see rising wages having an impact on inflation. We have revised down our forecast for unit labour costs, which, together with other factors, such as moderate rent increases, give a lower inflation path. Although we see slightly rising interest rates, the impact will be weak this year; next year, however, there will be a clear divergence between the CPI and CPIF as the housing item in the CPI increases more rapidly.

…and external pressures

Although the international price pressure is increasing slightly, particularly due to rising food prices, it will remain weak and the impact will also be cushioned by a gradual appreciation of the Swedish krona. We expect oil prices to rise somewhat; this means generally higher energy prices will have an impact, particularly next year.

Compared with the Riksbank, we anticipate a slightly higher inflation rate this year, but more restrained development in 2018, which applies mainly to the CPIF.

A strong fiscal position to weaken before the 2018 election

Strong government finances

The solid public sector numbers are expected to continue for some time. In 2015, for the first time since the 2008 crisis, financial saving showed positive figures, and, by all accounts, 2016 is expected to be even better. Strong domestic demand boosted tax revenue as a share of GDP, while the share of expenditure shrank. In addition to tax increases, households' capital taxes and corporate tax increased, while transfers declined during the economic upturn. The balance of the National Debt Office's tax account has swollen, which may be an effect of expected increased tax payments in the wake of the favourable economy. However, net proceeds are at historically very high levels, and some of the deposits are probably due to more favourable interest rate conditions than in banks or the money market. Uncertainty about the duration of these deposits make it difficult for the National Debt Office to forecast the net borrowing requirement and, therefore, future issuance volumes. Meanwhile, politicians are signalling that they want to use the funds for various reforms.

Spending is expected to go up in 2018

The confidence in the red-green Swedish government in key policy areas (welfare and climate change) is weakening, while debate about internal and external security has intensified. At the same time, the issues from the last election (lower unemployment and orderly public finances) are still relevant. The budget for 2017, presented in the autumn, included measures related to education, the labour market, and the environment. When the government unveils the budget for 2018, we can expect to see further investments in education and more reforms in welfare. We are also likely to see more initiatives to reduce the gaps between high- and low-income groups, as well as the native and non-native groups. It is likely that environmental taxes will be raised in order to meet increased public expenditure. It is also possible that some of the more costly reforms will be a burden, particularly in the years following the election. In the lead-up to the election, politicians are expected to be cautious with tax increases, even though total tax revenue from households will rise in 2018 in pace with increased employment. A slightly expansionary fiscal policy will contribute to negative financial saving in the public sector in 2018.

Expenditure pressure on the public sector is expected to remain heavy in the long term. Integration costs are high, while the population is increasing and demographic changes are driving up the dependency ratio. Sustaining the public finances will depend on how well Sweden manages the challenges of the integration, housing, and labour market.

A strong labour market but sluggish impact on wages

Growing employment hampered by increasing mismatch

The labour market continues to strengthen, with solid employment growth and a falling unemployment rate. We believe this will be sustained during the next few years. About 200,000 more people are expected to be in employment in 2018, compared with 2015. Unemployment is expected to continue to fall to a low of 6.5% in 2017 and then begin to rise gradually as new immigrants are integrated into the labour market. The shortage of labour has increased, not least within the public and construction sectors. Recruitment is becoming increasingly difficult and often takes time. There are clear signs that a growing proportion of the available labour supply lacks the necessary skills to match employers' needs. The increasingly difficult housing situation in the country's large and medium-sized urban areas is probably also hampering recruitment.

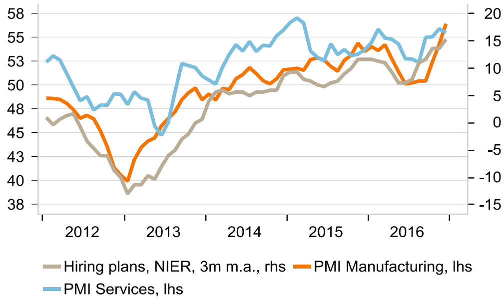
Tough wage negotiations expected

The continued high demand for labour indicates the wage-bargaining process will again be difficult this winter. The industry unions, which set the norm, are facing a delicate balancing act. Swedish industry is meeting continued tough international competition, while the more sheltered domestic sectors are enjoying strong demand. Despite the tightening labour market situation, wage increases in 2016 remained unchanged l in comparison with 2015, i.e., just under 2.5%. The expected acceleration of wage drift has so far been absent. The labour market situation points towards higher wage increases in the coming years. But this will be sluggish, and the connection between resource utilisation and wage growth appears to have weakened. The increased internationalisation, not only of the markets for goods and services but also, increasingly, of the labour market--in a situation where there is plenty of spare capacity in Europe--probably explains this weaker connection. However, we expect to see gradual pressure on wage formation and forecast higher wages over the next few years, especially through wage drift, from just under 2.5% in 2016 to around 3.3% in 2018. This is a revision downwards of 0.2 percentage point from our previous forecast.

Rising unit labour costs important for the Riksbank

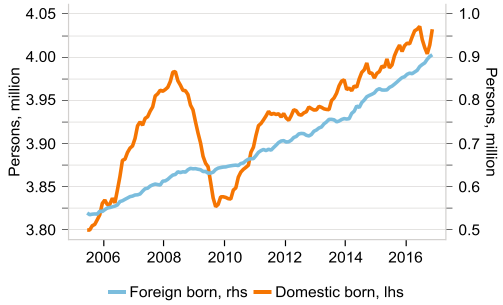
Labour costs are anticipated to pick up. The removal of the so-called youth rebate is a factor, but in the latest agreements there are also increased provisions for pensions, shorter working hours, and overtime payment. Productivity during the forecast period will end on an average of 1%--an historically low figure. Overall, this means that unit labour costs will rise to just over 2% per year during the forecast period, which is about 1 percentage point higher than the average in 2013-2015. From a Riksbank perspective, higher cost pressure is an important prerequisite for a more permanent rise in domestic inflationary pressure.

Sweden: Labor demand indicators, 3m MA



Sources: Swedbank Research & Macrobond

Sweden: Employment, 15-74 yrs, 3m MA



Source: Swedbank Research & Macrobond

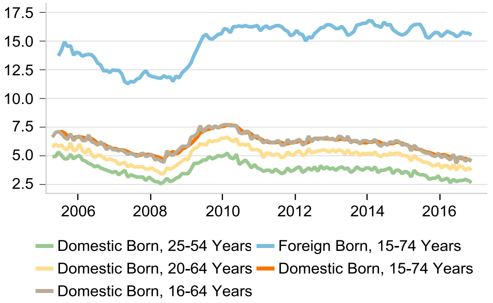
Labour force will grow

While employment growth is starting to slow this year, the workforce will continue to grow at a healthy rate, which will be reflected in a slight rise in the unemployment rate in 2018. The large number of asylum seekers in recent years is now successively obtaining residence permits and can be passed on to the Swedish Public Employment Service's establishment remit. The number of asylum seekers fell significantly in 2016 to just under 30,000, compared with just over 160,000 in 2015, but it will be some years before this begins to be felt in the form of a more moderate rate of increase in the labour supply.

Foreign borns are a key group for labour market reforms

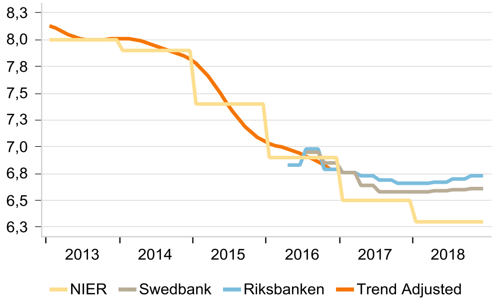
Foreign-born persons accounted for a large share of the rise in employment last year. Specifically, seven out of ten new jobs went to persons born outside Sweden. In the coming years, many of the new immigrants will enter the labour market, and those born outside Sweden will account for virtually the entire increase in the working population. It is thus absolutely necessary to bring foreign-born persons into the labour market for the labour market and the economy to be able to grow in the long term. In this sense, the strong Swedish economy and the continued high demand for labour are beneficial. These facilitate entry into the labour market even for those who do not have qualifications that fully meet employers' requirements. Despite these good conditions, there is a significant polarisation of the Swedish labour market. Already now, unemployment is increasing among people born outside Europe, and these represent an increasing share of those registered as unemployed by the Swedish Public Employment Service. Nearly half of the participants in the establishment remit lack upper-secondary-level educational qualifications. Overall, about 15% of foreign-born persons in the 25-54 age group are unemployed. At the same time, the unemployment rate for native-born persons in the same age group is falling rapidly and is approaching 2.5%. This shows the importance of maintaining the demand for labour and intensifying the integration work.

Sweden: Unemployment rate, %



Source: Swedbank Research & Macrobond

Sweden: Unemployment, %



Source: Swedbank Research & Macrobond

The Riksbank is slowly reaching the goal

Disagreement in the Riks-bank Executive Board

At the Riksbank's December monetary policy meeting, the Executive Board decided to leave the repo rate unchanged at -0.50%. At the same time it was decided to extend the purchases of government bonds in the first half of this year. However, purchase volume will be reduced further from SEK 45 billion during the second half of 2016 to SEK 30 billion during the current half-year. The Executive Board did not agree to extend bond purchases. Three Board members wanted to either completely stop buying bonds or buy for less, including on the grounds that it is not necessary in the current economic situation. The Riksbank will also continue to reinvest maturing debt and coupon payments. By the end of the year, the Riksbank is expected to have bought bonds totalling SEK 275 billion. The Riksbank is currently holding over 40% of the outstanding nominal government bonds.

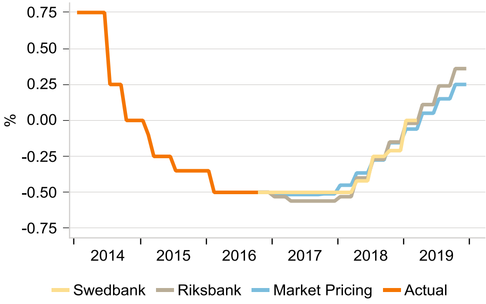
The Riksbank is dependent on external forces

The Riksbank is trying to balance monetary policy in an environment that continues to be difficult to navigate. This is manifested through a continued soft approach but with the readiness to do more, and through an interest rate forecast that continues to indicate a high probability of another interest rate cut. The rate of inflation has certainly risen in recent months, but the increases have been spasmodic and rather fragile. This is reflected not least in the unexpected inflation setback last year. For the Riksbank it is, therefore, of utmost importance to prevent a rapid and substantial appreciation of the Swedish krona. This is particularly so at a time when domestic inflation is not yet on firm ground. This means that the Riksbank is continuing to glance anxiously at the ECB's monetary policy. The Riksbank's policy of keeping the Swedish krona weak has been successful. The Swedish krona saw a weaker trend than expected in 2016. On the positive side, the Swedish economy and labour market keep going strong. Inflation expectations are also stable despite the stop-and-go inflation outturns. Rising oil prices following OPEC's decision to cut production also play into the Riksbank’s hands and should fascilitate a somewhat larger tolerance for a stronger Swedish krona and occasional inflation setbacks. In general, international developments and decisions by foreign central banks have gone the Riksbank’s way. The recovery in the US and in Europe is continuing, albeit slowly, and the US central bank's rate hike in December provides European central banks some breathing space. Overall, this indicates that the Riksbank is now finished with additional expansionary measures.

Policy rate at 0% at end-2018

Swedbank's main scenario is that the Riksbank maintains the repo rate at -0.50% throughout 2017. While there is certainly a willingness to get away from negative interest rates as soon as the opportunity arises, we believe that this will be difficult, given the soft approach that the leading central banks around the world are adopting, especially the ECB. The inflation rate in Sweden is rising right now, but not steadily so. In our view, inflation will find a stable base only in the winter/spring of 2018, making possible at that time a first interest rate hike. Overall, we expect the repo rate to be raised on two occasions next year and to reach 0% at the end of 2018.

Sweden: Riksbank repo rate forecasts



Sources: Swedbank Research & Macrobond

Interest and exchange rate forecasts (%)

	Outcome 2016 17-Jan	Forecast 2017 30 Jun	2017 31 Dec	2018 30 Jun	2018 31 Dec
Interest rates					
Swedish repo rate	-0,50	-0,50	-0,50	-0,25	0,00
10y government bond rate	0,6	1,0	1,3	1,5	1,7
Exchange rates					
EUR/SEK	9,49	9,45	9,15	9,10	9,05
USD/SEK	8,91	9,26	8,63	8,58	8,38
NOK/SEK	0,95	1,07	1,05	1,05	1,04
KIX (SEK)	112,7	113,3	108,3	108,2	107,7

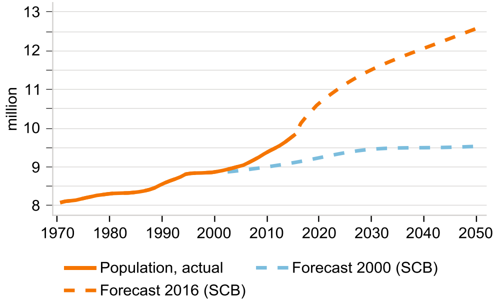
Sources: Macrobond and Swedbank

In-depth 2: the demographic growth boost is no free lunch

Sweden's population passed the 10 million mark in early 2017. According to Statistics Sweden's latest forecast, the population of Sweden will reach 11 million by 2024 and 12 million by 2040. This is historically the fastest-ever measured population growth in Sweden. The main growth is in the proportion of older and younger sections of the population. The population growth is driven by a steadily increasing birth surplus. At the same time, life expectancy is rising and immigration has been far higher than expected. Sweden's demographic outlook is now much better than was feared at the beginning of the 2000s, particularly compared with other European countries. But all that glitters is not gold. These trends place increased demands on economic policy to meet the challenges of demography.

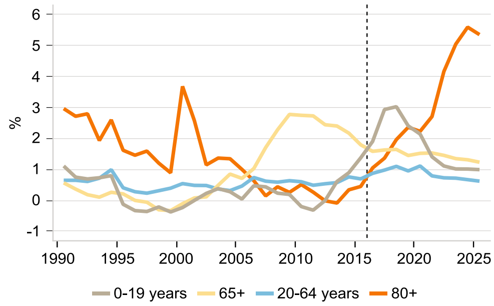
An ageing population will be one of the major challenges for many countries in Europe, and this also applies to Sweden. Demographic trends will have a strong economic impact on a large number of areas. The elderly are not active in the labour market, and, as they grow older, they have more need of welfare services, such as health and social care. With the birth rate rising simultaneously, the proportion of children and young people is increasing. In addition, a large proportion of the newcomers to Sweden in recent years have been children or young adults. This section of the population requires more investment in pre-schools and schools, e.g., which puts further pressure on the public sector. Demographic change will also affect the labour market, pension system, and public finances. There is a short-term risk of aggravating an already desperate housing shortage, accentuating the dualism in the labour market, and increasing pressure on public services.

Population growth forecast, millions of people



Source: Swedbank Research, SCB & Macrobond

Sweden: Forecast for different age groups

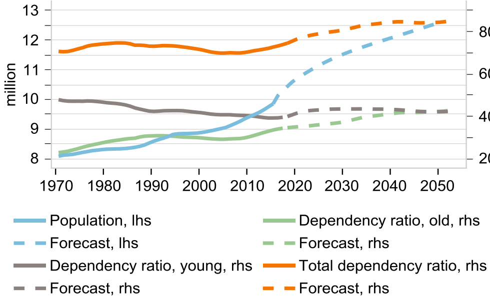


Sources: Swedbank Research & Macrobond

Net immigration will be significantly higher than was previously expected. Statistics Sweden's latest forecast (April 2016) was revised up from 15,000 to 115,000 for the years 2016 to 2019, and 60,000 for the years 2020-2029. Political unrest in the world means that refugee flows remain large, even if they are not at the record levels of 2015. The majority of the actual net immigration has consisted of young people aged 15-39 years, which has had a positive effect on the age structure. The working-age population continues to increase even though Sweden's population is ageing. Seven out of ten new jobs currently go to non-native applicants, and job growth in the future will be largely dependent on non-native participation. A major challenge lies in the large proportion of newcomers with low educational attainment. About half of the participants in the Employment Service's establishment scheme do not have secondary education qualifications, something that virtually all employers currently require. This creates high thresholds for entering the labour market and emphasises the importance of well-functioning adult education.

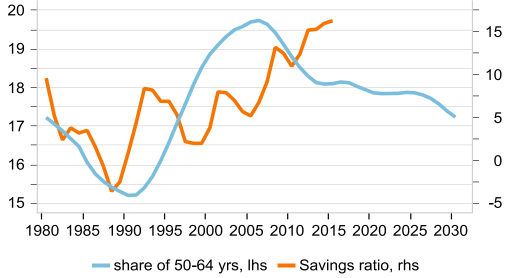
The working-age population represents the potential tax base, and, as such, its work supports children, young people, and the elderly. The rising proportion of old and young people places greater strain on public finances, as the increase of the tax base is not progressing at the same pace as the increase in welfare expenditure. There is a danger that a higher tax levy to safeguard the quality of welfare services might create a vicious circle, as growth prospects would be hampered. However, the challenges have been mitigated by the population growth and the dependency ratio—both of which are more favourable than forecast at the beginning of the 2000s. The number of people in the working-age population is expected to be considerably higher; this will improve the growth potential and, with it, the tax base. So far, the Swedish trend has been more favourable than in many other countries. Europe is also on a "grey" development path, with life expectancy rising and the number of births increasing. Therefore, according to the European Commission, the EU will by 2060 move from having an average of four persons of working age for every person aged 65 years or over, to two persons. With the number of births rising at the same time, there will also be greater pressure on schools, and health and social care.

Dependency ratio and population growth



Source: Swedbank Research & Macrobond

Sweden: Clear connection between savings ratio/ the age group 50-64 yrs



Source: Swedbank Research & Macrobond

The demographic trend is also making its mark on household saving. In the longer term, there will be a decline in saving, reflecting an increased proportion of young and old who are outside the labour market. However, in the short term, saving will rise, with the large proportion of 50-64-year-olds contributing to the increase. This age group has a low consumption propensity and wants to ensure a good standard of living after retirement. In the current situation, this age group has a relatively high loan-to-value ratio (just under 60%). Saving in the form of increased repayments will also rise when this age group begins looking to reduce the risk of rising interest rates on retirement.

Sweden's demographic development has been more favourable than that of Europe; this is positive for growth. Sweden as a market is growing, which enhances investment attractiveness and improves the conditions for strong and sustainable public finances. With proper management, this will ultimately benefit the Swedish economy and the krona. Sweden's potential growth is being sustained thanks to the demographic changes of the 2000s, which will also make Sweden's neutral equilibrium interest rate higher than Europe's. At the same time, the Swedish economy is increasingly connected with the European economy. This restricts the potential for higher interest rates and a significantly stronger currency than Europe's. It also increases the demands on Swedish politicians and authorities to pursue a more active stabilisation policy to prevent the build-up of imbalances, particularly with regard to asset prices.

Knut Hallberg
Nicole Bångstad

Advanced economies: growth momentum is rising

The start of the new year is marked by an increasingly optimistic outlook for global growth. Markets are more focussed on the prospects of fiscal stimulus in the US and less on the risk of trade wars or other undesirable political outcomes. Composite PMIs rose further in December on a broad basis – including in the US, EMU, Japan, and China – and together they now suggest an upswing in global economic growth.

Euro area: Economic growth is rising amid political risk

Barometers indicate economic growth is rising

Developments in the euro area have been far better than expected in recent months. Business surveys have risen markedly, including the purchasing managers' index (PMI) and the European Comission's economic sentiment survey, indicating GDP growth towards 2%. After a longer period with weak growth, we see some signs of improvement in the region's manufacturing sector. New orders are pointing up, and production is on the rise across most of the largest economies. Real investments have been rising continuously for two years and will most likely continue to grow in the years ahead; so far, however, the rise has been relatively slow. Underlying productivity growth remains slow in the euro area, as elsewhere.

Household demand is robust

Consumer confidence has improved, alongside similar results from business surveys, and is well above normal levels, suggesting that consumption growth is likely to be maintained. The effect of falling energy prices on the consumer price index (CPI) has ceased and will reverse in the coming months. This will mute consumption growth as households' purchasing power is weakened. However, an ever-improving labour market will likely counteract this, as employment is rising almost everywhere in the region and unemployment is falling, boosting households' incomes despite low wage growth.

Rising energy prices will impact core inflation

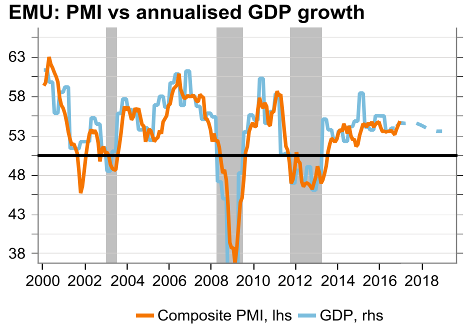
At the monetary policy meeting in early December, the European Central Bank (ECB) decided to extend the asset purchase programme to the end of 2017. However, since April the pace will be slower, down to EUR 60 billion per month from 80 billion. This reduction partially reflects rising inflation expectations and better-than-expected macroeconomic data. But the European economy still has a long way to go, as productivity growth remains weak and the average level of unemployment high. Furthermore, even though credit growth is accelerating, it is still relatively low and is likely to be constrained by weak banks in many places.

Energy prices are excluded from the measure of core inflation which is central to monetary policy. We nevertheless observe that core inflation fluctuates to some degree with energy prices, presumably due to the indirect effects of energy costs on firms which spill over to their prices. We estimate that the rise in energy prices through 2016 will contribute to a rise in core inflation in the EMU of about 0.3 percentage points, bringing it up towards 1.3% this year. This will go a long way to satisfy the ECB's criteria of a sustained increase in underlying inflation. While we believe it remains legitimate for the ECB to pursue an exceptionally expansionary monetary policy for quite some time yet, policy will eventually be normalised here, too.

Political risks remain

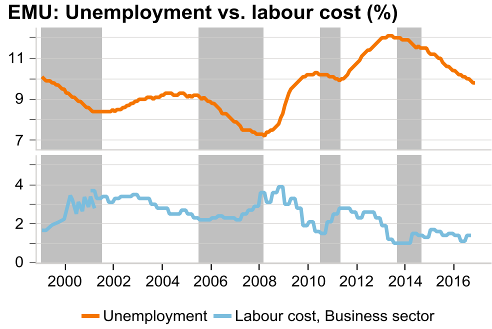
The massive rejection in Italy of the proposed constitutional reform underscores that political risk remains high in Europe. The political situation will remain challenging and hard to predict in the time ahead. Upcoming elections in the Netherlands, France, and Germany are all likely to produce record-high results for eurosceptic political parties. Opinion polls generally indicate a clear majority in favour of the European Union and the common currency in all euro area countries, and we do not expect eurosceptic parties to assume power in any of the aforementioned elections, but the probability of such an event is certainly not zero.

EMU: PMI vs annualised GDP growth



Sources: Swedbank Research & Macrobond

EMU: Unemployment vs. labour cost (%)



Sources: Swedbank Research & Macrobond

In-depth 3: the European economy: A walk on the bright side

Judging from newspaper headlines, one could easily have the impression that the European economy is moving in the wrong direction. Growth in the euro area (EA) is weak, unemployment remains too high, fiscal policy is too tight, government debt is too high, and monetary policy does not stimulate the economy enough but distort financial markets instead. Moreover, immigration and terrorism are increasingly challenging, and there seems to be a lack of political capacity or relevant institutions to address these problems. According to many, the weight of these problems will eventually lead to a breakup of the whole European project of cooperation, which has brought peace and prosperity. We contest this view. Even though political risk remains relevant, we take a much more positive view on the EA economy and the capacity of its institutions to meet the new challenges.

Without doubt, the financial crises revealed serious flaws in the institutional setup in the EA. In the wake of the crisis, several changes had to be made and institutions had to do “whatever it takes,” as the ECB's Governor Draghi once stated. Among the most important changes were the establishment of stabilisation funds to finance weak governments, the addition of flexibility to fiscal policy rules, and the creation of a European banking union in order to strengthen bank supervision. Moreover, interest rates were cut deeper than anybody could have expected, and the ECB more clearly took the role of a lender of last resort for both banks and governments, as is common for central banks. The EA institutions turned out to be rather flexible, when needed.

It is evident that growth in the EA has been weaker following the financial crises. This, however, is not because actual growth is below potential growth, but rather because of slower growth in productivity. This is made clear by indicators of capacity utilisation, such as unemployment, which have fallen both in the EA and elsewhere. Slower productivity growth is the case in all developed economies and is not due to specific European circumstances.

GDP per person in working age in the EA and in the US has developed remarkably closely, barring the particular developments during the euro crisis in 2012. Over the past 9 years, the difference between the EA and the US is, at 2%, barely visible.

Over the past 10 years, the employment rate in the EA has increased by 1.7 percentage points (pp), while it has fallen by 2.9 pp in the US. Germany has been especially successful, with an incredible 11 pp rise. Furthermore, no other EA country has seen larger declines in employment rates than the US over the past 10 years. Employment rates are soaring to record levels in UK, and Japan as well. Employment rates have been increasing fast for women of all ages and for men aged 55 and upwards. A sort of social revolution seems to be under way.

Unemployment in the EA has fallen from its peak at 12% in 2013 to below 10%, and is equal to the average since 1990. Still, there is surely room for a further decline. Unemployment has fallen in all EA countries, but it remains at high levels in both Italy and Spain. Unemployment in France is at the average level since 1990, while unemployment in Germany is at its lowest level in 35 years, at 4%!

The unemployment rate in the US has fallen by 5 pp, more than twice as much as in the EA, and is now far below its historical average. However, the US outperformance is essentially due to a sharp decline in the labour force participation rate. In the EA, the participation rate has increased on a broad basis. A higher participation rate probably means that potential growth in the coming years is better in the EA than in the US. Thus, there is far less need for tighter monetary policy in the EA than in the US, where the Fed has already started hiking interest rates.

Following years of fiscal tightening, the EA has a far smaller public sector deficit than the US, Japan, or the UK. The EA deficit stands at 1.5% of GDP while it is 3 – 5% of GDP for the other three countries. Furthermore, no EA country has a larger deficit than Japan or the US. In 2017, EA fiscal policy will most likely turn marginally expansionary, due not only to higher security and military spending but also in order to counter populist challenges.

The EA is running a record-high surplus on the current account of 4% of GDP, in line with Japan. The US economy has a deficit of 2.5% of GDP, and the UK’s deficit is 5%; in both these countries, savings are likely too low for the longer term.

No EA country is running a material current account deficit anymore, and the imbalances between them have been sharply reduced. During the years before the financial crisis, wages increased much faster in many EA countries relative to Germany—a circumstance that eroded competitiveness. Since 2010, the lion’s share of these developments has been reversed. Wage inflation has accelerated somewhat in Germany while it has slowed sharply elsewhere. This has been a ‘”hard way” to realign cost levels because it has depressed income growth and demand and probably deepened the downturn in several countries. But most of the necessary repair work has now been done.

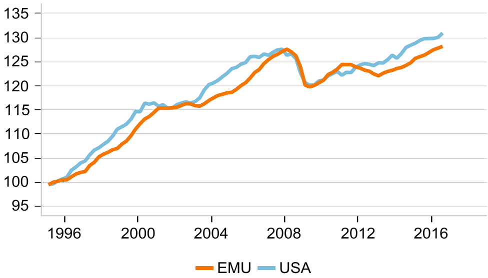
Real wages are increasing. Overall wage inflation in the EA is slowly on the way up but remains muted, at approximately 1.5%. Even so, due to low overall inflation, real wages have increased and have, together with higher employment, ensured decent growth in private consumption. Savings have remained at high levels. Income inequality has widened only marginally in the EA, if at all, in contrast to developments both in the US and the UK, as well as in many other countries.

Credit to the private sector is flowing again in the EA, following a contraction during 2012 – 2014. Banks in Europe were, regrettably, not put under the same pressure as their US peers to recapitalise quickly following the financial crisis. The new European Banking Union and more real-life stress tests have no doubt contributed to a change for the better since 2014. Real bank capital ratios are still too low in many banks, but they are moving upwards.

Are these rather favourable fundamentals being appreciated by the public in the EA? Despite all sorts of bad newspaper headlines, consumer confidence has strengthened in recent months and is now well above average in almost all EA countries. Business confidence has increased as well, and most surveys are signalling growth above trend. Moreover, actual economic data have been much better than expected in recent months. Consequently, we have revised up our growth forecasts for this year.

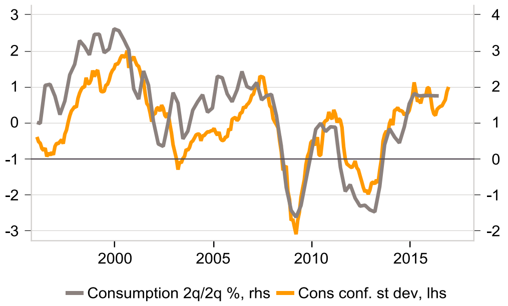
Over the coming years, a stronger economy should make it easier to tackle many of the political challenges, both at the national and EU level. In addition, immigration to Europe has slowed, and support for right-wing populist parties may not increase further. In December, Austria elected a devoted Europhile president who is also a strong supporter of immigration and favours decisive actions to counter climate change. Not everything is dark in Europe.

EMU vs US: GDP per person in working age, 1995=100



Source: Swedbank Research & Macrobond

EMU: Consumer confidence & demand



Source: Swedbank Research & Macrobond

Öystein Börsum

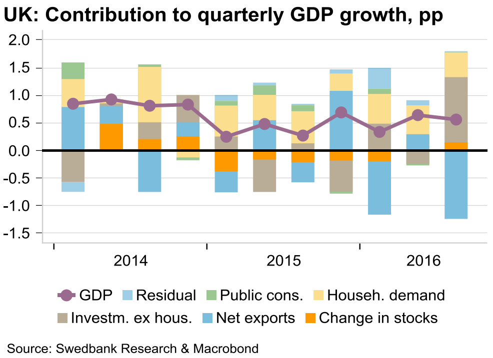
UK: deadline approaching - (Theresa) May the force be with you

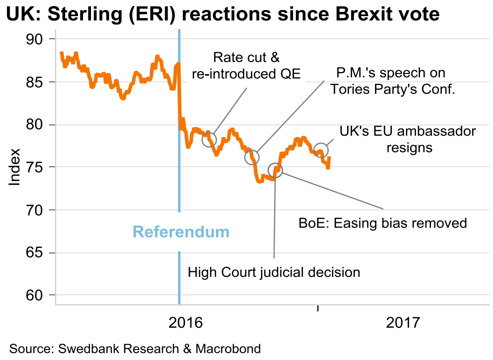
Brexit strategy clearer in the first half of 2017

Solid economic development was the theme for 2016, but the resilience may be short-lived. Prime Minister Theresa May has announced a Brexit plan. The UK will leave the European single market and take back control of immigration ("hard" Brexit). The UK's wish list is as free trade as possible with EU, where some trade areas could be inspired by the single market. A full membership of the Customs Union is also excluded, although May wishes to enter a customs agreement with the EU. The wish list is long with few sacrifices, an unsolvable equation. Europe is now awaiting the UK's invocation of Article 50. It will be submitted no later than March (the government's deadline), but the Supreme Court's decision whether or not to involve the parliament in the process may affect the timetable. Neither House of Parliament is expected to block a Brexit. We expect the Britons to initially take a tough approach, which likely will soften as the negotiations develop. The final deal that will be agreed between the UK and the EU will be put to a vote in the parliament. Much uncertainty still remains, not least on how long the implementation phase will last and the price for it.

Growth lower for longer

The risks relating to Brexit are significant. The economy is gradually expected to adjust to new circumstances, forcing growth lower for longer. Surveys suggest that this year will start on a strong footing, with good domestic demand, but the cost pressure is rising. During 2017-2018, this will translate into worsened consumer purchasing power, reducing demand. Companies are already expecting small increases in business investment in the months ahead, and gross fixed capital formation is likely to remain lacklustre. Public investments will mainly focus on infrastructure, housing, and R&D. The major gain for companies is thus the improved competitiveness on the back of a weaker sterling. Improving trade balance and blossoming tourist businesses are likely outcomes. Monetary conditions will remain expansionary, while fiscal policy more or less will be neutral to growth. The Bank of England is expected to hold the bank rate unchanged as slower growth will be balanced against an overshooting of the inflation target.





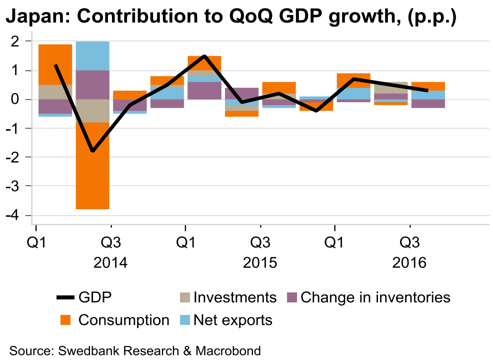
Japan: some good news, finally

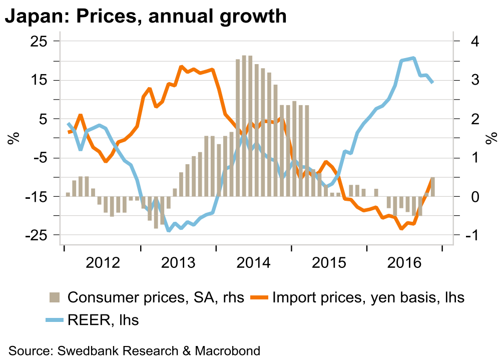
Loose monetary and fiscal policy support Japanese growth

The Japanese economy is continuing its modest recovery with the help of an ultra-loose monetary policy and a fiscal stimulus. The government has approved the third supplementary budget for the current fiscal year, ending in March 2017, to provide disaster relief following powerful earthquakes and typhoons, and to bolster Japan's defence against ballistic missiles. The government will issue bonds worth around Y 100 billion to finance additional expenditure. We expect economic growth to slow somewhat in Japan in 2017-2018. Export volumes and manufacturing production have strengthened in recent months, but consumption growth remains disappointing due to slow growth of real wages.

Weaker yen helps the central bank

A weaker yen and higher energy prices have started to lift consumer prices, finally. Inflation rose to 0.5% in November from 0.1% a month earlier, the highest reading since May 2015. It looks unlikely that the central bank will be able to achieve the 2% inflation target during Kuroda's term, which ends in April 2018. Due to the decreasing availability of government bonds (the Bank of Japan (BoJ) owns more than 40% of government bonds by now), the focus of the BoJ is expected to shift to controlling the long-term and short-term rates, but no major shifts in policy are expected during 2017.





US: faster momentum to carry over into 2017

Faster momentum to carry over into 2017 for US

The US economy gathered steam during the second half of the year. The third-quarter GDP was twice revised upwards, and data suggest a strong fourth quarter. Though the third quarter saw a surprise contribution from trade, we expect domestic demand to remain the main growth engine throughout the forecast horizon. Renewed momentum leads us to believe that the cycle has a bit more to give before peaking; we thus raise our US growth forecasts.

Households remain the main growth engine in short term…

Short term, we expect consumers to drive economic growth. Consumption growth slowed somewhat in the third quarter, but remains in line with post-crisis averages. Tax cuts, strong wage growth, and a tight labour market, in combination with high consumer confidence, are why we believe that household spending will pick up and remain a potent growth engine during 2017. Structurally, large increases in coming years in the labour force aged 25-40 also provide support. This period in life, prime household formation, is consumption intensive.

… but they will be increasingly constrained …

By the second half of the forecast period, however, inflation will begin to noticeably erode consumers' purchasing power. While a benign trade scenario remains the base case, imposing trade barriers on imports would hit inflation-adjusted consumption. Tightening financial conditions will also increasingly constrain consumers. Initial signs of this are appearing, but thus far mostly through the pricing rather than the availability of credit. Mortgage rates have risen considerably lately, leading to sharply falling refinancing activity.

… and will pass the baton to government investments

We are still awaiting more clarity on government spending under President Trump, but we expect overall fiscal policy to turn more expansive. However, we estimate that increased infrastructure spending will be partially offset by cuts to other spending. Due to time lags, we expect that infrastructure will begin to contribute positively during the second half of 2017, before peaking sometime next year as capacity constraints become increasingly bothersome.

Private investments to remain subdued

Our view of private investment is slightly more sanguine than in November, though we still expect it to remain soft. Uncertain future trade and tax policies, as well as rising interest rates, will act as constraints. Survey data lend credence to the assessment that the private sector will begin investing again after not having invested, or even disinvested, during four quarters. Stabilisation of corporate profits, as well as ample credit availability, is supportive, as is the recovering energy sector. Deregulation could also incentivise capital expenditures.

US economy at, or very close to, full employment

The economy is at full employment, or at least it is approaching that state. Unemployment has fallen further to 4.7%, a level that many consider near the natural rate. Job creation has remained brisk, averaging 189,000 monthly during the second half of 2016. As expected, wage increases have picked up, with average hourly earnings up 2.9% over 12 months. A further tightening of conditions likely lies ahead, with wage inflation increasing more.

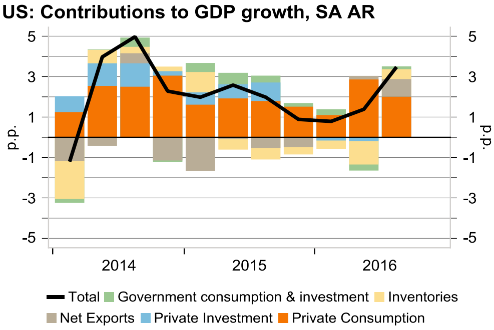
Cost pressure building in economy, will drive inflation higher

Inflation stepped up during the second half of 2016, and the cost pressure looks likely to increase further. Core consumer inflation, regardless of measure, is above or close to the 2% target. Energy has largely ceased to weigh on headline indices, which will likely converge to core inflation in the not-very-distant future. Rising cost pressure in the business sector and the pace of wage increases are further signs of accelerating inflation.

Fed will step up pace of hikes, but remains decidedly gradual

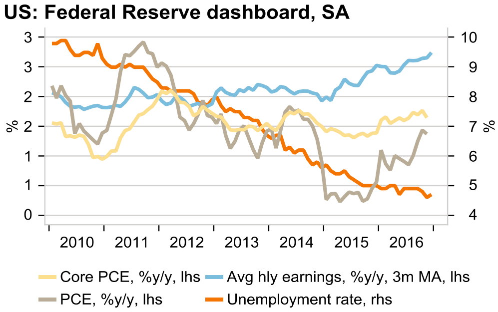
On both aspects of the dual mandate, the Fed is close to goal attainment. At the last FOMC meeting, most participants agreed that present conditions were consistent with maximum employment or close to it. Inflation is also approaching the 2 percent target. With objectives within reach, the discussion of whether they are "behind the curve" will intensify. We therefore expect the Fed to step up the pace of its rate increases, though it will remain cautious. We expect two hikes in 2017, with two further in 2018. Towards the end of the forecast period, we also expect the Fed to very gradually begin scaling down reinvestments. Substantial compositional changes are likely by 2018 as Trump makes his mark on the FOMC. This will not affect near term policy, since doves still dominate, but will be important by 2018.

US: Contributions to GDP growth, SA AR



Source: US Bureau of Economic Analysis, Swedbank Research & Macrobond

US: Federal Reserve dashboard, SA



Source: US Bureau of Labor Statistics, US Bureau of Economic Analysis, Swedbank Research & Macrobond

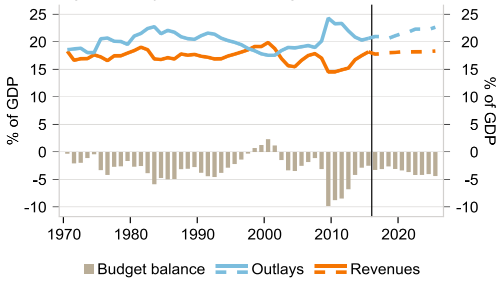
In-depth 4: Trump, the Republican Congress, and the US economy

Most details of the incoming administration's economic policy remain unknown. Some clarity may be revealed soon after the President-elect takes the oath of office on January 20th. In this text, we present the facts known so far and our interpretation of them. The appointments of several protectionists and the establishment of a White House National Trade Council – lead by another protectionist known for his criticism of China – suggest however that Trump will press forward with his agenda on trade. Nevertheless, we maintain our earlier assessment that US trade policy will remain relatively benign. On many economic policy issues, Trump will need to have the cooperation of Congress. The Republican majorities in Congress will be able to determine both actual policy and the order in which issues are addressed. Repealing the Affordable Care Act ("Obamacare") is prioritised over other aspects of "Trumponomics", both chambers already having begun such proceedings. While an important structural factor for the medium term, the near-term cyclical effects of changing health insurance regulations are likely fairly small.

No further specifics on Trump's much-heralded infrastructure package have emerged, such as what will be prioritised. The amount that has been circulated, $1 trillion over 10 years, only represents about 0.5% of annual GDP. Moreover, this amount is far from meeting the nearly $ 4 trillion that the American Society of Civil Engineers deems necessary. Another aspect that remains opaque is financing. Trump and advisors want to mobilise private capital; public-private partnerships, as well as tax incentive schemes, have been floated. In the end, we expect that investments will be financed by a mix of public and private money. The method chosen will have important implications for capital markets, but the expansion should nevertheless result in higher interest rates.

US federal budget

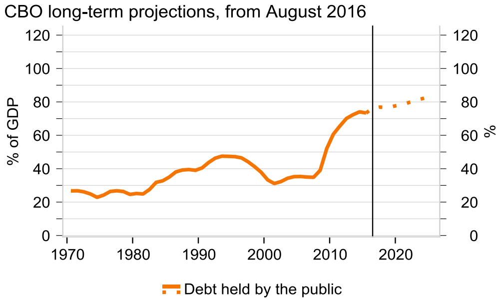
CBO long-term projections, from August 2016



Source: US Congressional Budget Office, Swedbank Research & Macrobond

US federal government debt held by the public

CBO long-term projections, from August 2016



Source: US Congressional Budget Office, Swedbank Research & Macrobond

Note: The Congressional Budget Office (CBO) forecasts assume unchanged policies, i.e. do not yet include the effect of "Trumponomics".

Though smaller than during the Great Recession, the budget deficits the US is running are larger than advanced economies'. Our expectation is that fiscal policy becomes more expansive under Trump. Given the contentious debate over budget deficits in recent years, however, we expect that congressional Republicans will seek to constrain Trump. The appointment of Mulvaney, an outspoken deficit hawk, as Budget Director furthermore signals that fiscal policy will be more restrained than interpreted. Leading figures of Congress also appear less keen on a large infrastructure package, although they are nonetheless likely to go ahead. But we expect cuts to other government spending will be required to partially offset the outlays. In previous years, when Democrats held the White House, the issue of raising the debt ceiling was a perpetual conflict issue. This will likely not be the case now, as Congress, once in agreement with fiscal policy, will lift the debt ceiling.

Tax cuts for both businesses and private individuals will likely feature prominently. There have also been calls for comprehensive tax reform. Streamlining the tax code could boost US productivity, but, although welcome, is unlikely in the current political climate. Republicans have also begun a broad deregulatory agenda. Regulatory reform, if done wisely, could also improve productivity, e.g., by spurring investment. This is likely behind the surge in business optimism. "Trumponomics" and policy changes in a myriad of other areas will entail a full agenda for Trump and the new Congress. We expect the repeal of the Affordable Care Act and the nomination of a Supreme Court Justice to take center stage. Candidates to fill the vacancies on the Federal Reserve Board of Governors will likely not be nominated and confirmed by Senate before the end of spring.

Against the backdrop of a fairly mature cycle, we continue to be concerned that "Trumponomics" will lead to a boom-bust cycle. These cyclical concerns are important, but we also note an important longer-term risk that Trump poses: the risk of irreparably damaging the institutional framework. His open embrace of elements promoting distrust in government, his disdain for the importance of avoiding conflicts of interest, his very public interference in corporate decision making, and his failure to follow conventions and informal institutions that have evolved to support formal institutions. Trump's attitude towards the press and his frequent outbursts against political opponents could further exacerbate the bifurcation of American politics and diminish the public's trust in government and in the press. Such trust is an important aspect of social capital, which, if eroded, risks putting long-term economic prosperity in jeopardy.

Ingrid Wallin-Johansson

Note: The amount of $1 trillion over 10 years is assumed to be inflation-adjusted 2016 dollars and spread evenly over 10 years. The American Society in Civil Engineers estimated in a 2013 report that $3.635 trillion (2010 dollars) were necessary up to 2020 to maintain a good state of repair in US infrastructure. The GDP deflator was used to convert 2010 dollars to 2016 dollars. In light of the financing uncertainty, the entire infrastructure package is included under government investments in our forecast.

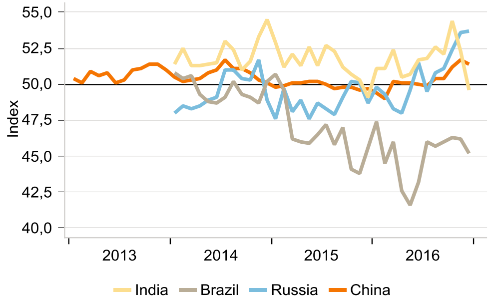
Emerging markets: diverging impact

We expect unusually mixed developments among emerging-market countries in 2017. Resource-based economies, like Russia and Brazil, will benefit from higher commodity prices, while countries with large US trade surpluses, like China, may suffer from US protectionism. The US economic and foreign policies will most likely be the most influential factors going forward. Effects will be felt to various degrees and in various forms. Sanctions may be eased in Russia, while China may be subject to outright trade tariffs or indirect sanctions, where production moves to the US. Expectations of higher US rates and a stronger US dollar are in general a headwind for growth for a number of emerging-market economies and certainly make it more complicated for China to control the renminbi. In China, challenges are high for the government to stimulate growth as the property market became too hot last year. However, we expect China to find measures to stabilise growth in the run-up to the Communist Party congress next autumn. We are slightly more optimistic on growth in Brazil on the basis of higher commodity prices. Growth in India will be hampered by the government's anti-corruption strategy where old money bills are exchanged to new ones. This comes on top of already weak investment growth and slow implementation of structural reforms.

Commodity Indices, CRB, Spot Index, USD

Source: Swedbank Research & Macrobond

BRIC, Manufacturing PMI indices



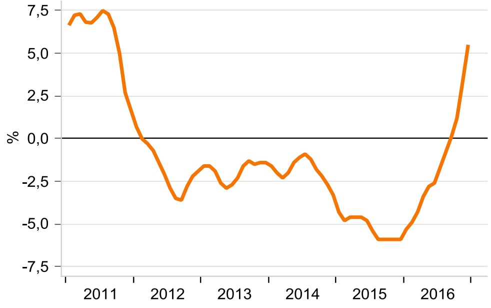
Source: Swedbank Research & Macrobond

China: stop-go policy challenged

Big challenge to stabilize growth and fill the gap from housing

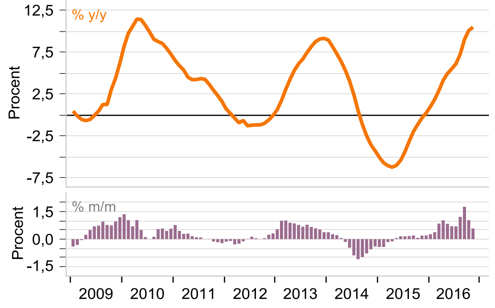
In 2016, growth was supported by fiscal stimulus, easier credit conditions, and a weakening of the renminbi. Deflationary forces lost ground as producer prices, together with commodity prices, bottomed out last year and are now increasing by around 5% on an annual basis. This is welcome news for Chinese corporates as it improves profit margins and eases real borrowing costs. GDP growth last year was driven mainly by strong activity in real estate investments. The government started to unwind its support for the housing market last autumn and implemented cooling measures, as house prices were rising too fast. Incentives for auto purchases also ended in December. We believe it will be a big challenge for the government to stabilise growth going forward and to stimulate other sectors to fill the gap in 2017, as housing is by far the most important growth engine. Stronger exports could compensate to a certain extent. However, export growth has not recovered, despite a depreciation of the trade-weighted currency by 5.5% in 2016. Therefore, we expect the renminbi to continue its negative trend until exports regain more solid ground. Nevertheless, stable growth will be highly prioritised during 2017, as the Communist Party prepares for its 19th Congress, scheduled in the autumn. The political commitment to achieve growth of around 6.5% will be very high in the run-up to the congress. We believe fiscal policy will stay expansionary and directed towards infrastructure investments. We have revised down our growth forecast for 2017-2018 as the pace of the reform process is too slow, which means that the efficiency of the current stop-go policy is waning. Credit growth will still be crucial to stimulate the Chinese economy, which will keep debt worries alive, but the day of reckoning will be postponed as long as China has tools and reserves to use in case of financial disturbances. A stronger US dollar and expectations of rate hikes in the US are putting downward pressure on the renminbi. This presents a dilemma for Chinese policymakers. The Chinese economy would benefit from lower rates. However, these would increase capital outflows and intensify the downward pressure on the renminbi. A lower renminbi vs. the US dollar would, in turn, risk trigger protectionist actions by the new US government. President Trump said during his campaign that he would impose import tariffs on US imports from China, declaring China to be a currency manipulator. We believe these fears are exaggerated as they would risk a trade war on a scale that would be harmful not only for China, but for the whole world, with negative repercussions for the US economy and employment. However, the risk of a deterioration in relations between the two countries will probably remain on the radar for some time. Meanwhile, China will tighten capital controls to prevent a rapid drainage of foreign exchange reserves.

China, Producer Price Index (% y/y)



Source: Swedbank Research & Macrobond

China, House prices in 70 cities, newly built (% y/y)



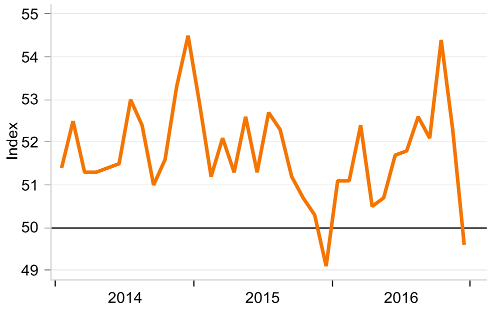
Source: Swedbank Research & Macrobond

India: short-term pain after anti-corruption move

The anti-corruption move comes at a time when investment growth has continued to deteriorate

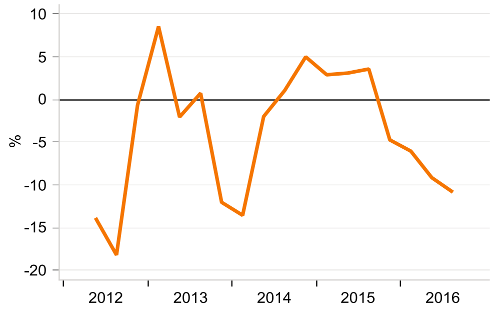
In a surprise move, the Indian government decided in November 2016 to withdraw 86% of all India's money in circulation. We have since downgraded our growth forecast, as demonetisation will be a severe drag on domestic demand. The government's anti-corruption strategy will have a severe negative effect on consumption short term, as the Indian economy is very reliant on cash. Sentiment has deteriorated in the manufacturing industry, according to recent surveys. This comes at a time when investment growth has continued to deteriorate on the back of weak credit growth. Furthermore, the GST (general sales Tax) reform seems to be taking longer to implement and risks being watered down with more tax exemptions than initially planned. The long-term effects of the reform are positive, as they are making a larger part of the economy formal. This also has positive implications for government tax revenues going forward. However, the government's ability to deliver on new reforms will probably be constrained. It is quite conceivable that support for the ruling Bharatiya Janata Party (BJP) will weaken after the demonetisation move. This will make it harder for the BJP to achieve majority in the Upper House, which is crucial to enforce new reforms. Moreover, the retail sector is suffering hard from the demonetisation move--another reason for opposition members to delay implementation of the GST legislation. We expect the government to stimulate the economy with more expansive fiscal policy going forward. This, together with rates cuts from the central bank, will stabilise growth in 2017.

India: Business Surveys, Manufacturing PMI, SA



Source: Swedbank Research & Macrobond

India: Investment in Fixed Assets, annual growth



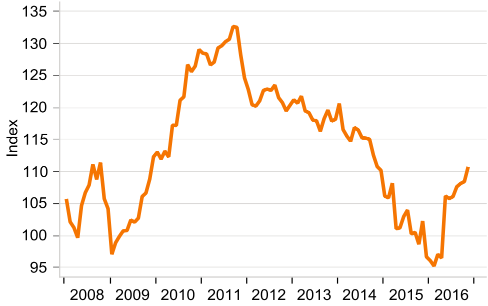
Source: Swedbank Research & Macrobond

Brazil: recovery helped by higher commodity prices

The economy will stabilize with help from higher commodity prices and rate cuts

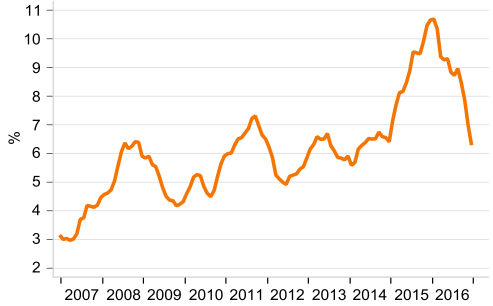
Brazil has officially been in recession since the second quarter of 2014. Economic growth has stabilised at low levels, helped by higher commodity prices. Politically, there has been some progress, as the government passed a ceiling cap reform last year--an important step towards fiscal consolidation. However, for this to work, the social security system needs to be reformed as well. Social security benefits amount to around 40% of government expenditures and are increasing quickly, as the population is ageing rapidly. Therefore, it will become difficult to maintain the spending ceiling if the social security deficit isn't brought down, which, politically, is a very sensitive issue. Meanwhile, economic growth remains very poor. Labour market conditions continue to deteriorate. The high unemployment and sharp job losses pose a political risk and will make it hard for the government to decide on and implement crucial reforms. Household consumption is depressed by rising unemployment, weak purchasing power, and tight credit conditions. Credit growth has been decelerating since 2013 and has been in negative territory since last summer. Growth in real wages and retail sales has been negative since the end of 2014. Consumer price inflation fell sharply last year, which opens up room for necessary rate cuts going forward. This is welcome news for domestic demand. Industrial sector activity has stabilised, although at a very low level. We expect growth to continue to stabilise, with support from rate cuts and higher commodity prices. Political risks, however, remain high as confidence in government politicians is very low.

Brazil, Foreign Trade, Terms of Trade, Index



Source: Swedbank Research & Macrobond

Brazil: Consumer Price Index (IPCA), annual growth



Source: Swedbank Research & Macrobond

Russia: subdued recovery unless sanctions are lifted

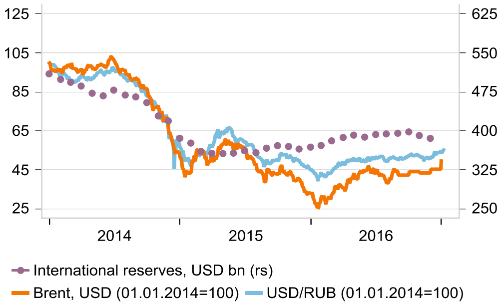
PMIs show recovery broadening and strengthening, but GDP growth still only pale 1.5-2% in 2017-2018

The recovery is slowly rooting in, led by single-digit growth in industry and agriculture. As is typical with business-cycle dynamics, the labour market lags – both real disposable incomes and retail sales are still about 5% lower than a year ago. Household cautiousness is high (e.g., bank deposits up 14.6% in October 2016 vis-a-vis a year ago), but credit to households has inched into positive territory, hinting that retail sales are bottoming out. The purchasing managers' index (PMI) has recently picked up sharply, reflecting a general improvement in expectations of a broadening and strengthening recovery. Gross fixed capital formation is likely to report positive annual growth already in early 2017. Inflation fell to 5.4% in December, which should induce the Central Bank of Russia to resume cutting its policy rate (now at 10%) to 8% by end-2017, and to 6.5% by end-2018, thus easing the cost of financing. With the oil price forecast to rise, the rouble should strengthen to 55 per dollar by end-2017 and to 49 by end-2018--a tad stronger rise than forecast before. The budget deficit is melting the Reserve Fund, but fiscal policy remains quite restrictive, with no immediate risks to sustainability. The privatisation of state-owned companies, boasted of earlier, has produced the selloff of a 19.5% stake in Rosneft late last year, but the opaqueness of the deal raises doubts of whether it will either add to the federal budget revenues or better corporate governance. With the fundamentals as they stand, we keep the GDP forecast unchanged: a 0.5% drop in 2016, with pale 1.5% and 2% growth in 2017 and 2018, respectively.

Russian GDP and the rouble would get a boost if sanctions were lifted, but outlook of this remains blurred and uncertain

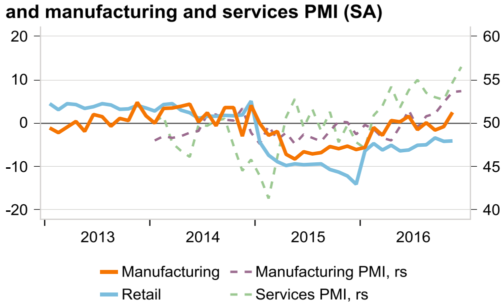
A boost to Russian GDP and the rouble can be expected if the Western sanctions are lifted, but the outlook for this remains blurred. With no progress on the Minsk agreement, the EU has renewed its sanctions against Russia until mid-2017. The US has widened its sanctions (e.g., citing allegations of Russia's meddling in the US presidential elections), but these are aimed at certain individuals and do not represent a significant negative economic impact. It seems that in terms of sanctions the high point is about reached, and in 2017 the US is likely to start easing them, while the EU is likely to extend them only partially. This, however, will not provide major economic gains for Russia, as the most pressing sanctions (i.e., financial market and technology related) are the most likely to remain intact over the forecast period. In return, Russia may gradually lift its sanctions against the West in 2018, but this process is likely to be slow and selective and give little support to Baltic exporters.

Russia: exchange rate, oil, central bank reserves



Source: Swedbank Research & Macrobond

Russia: annual growth of manufacturing and retail (%) and manufacturing and services PMI (SA)



Source: Swedbank Research & Macrobond

Nordic area: growth is stabilizing

Economic indicators suggest the Nordic economies are regaining their footing, albeit with risks emanating, in particular, from buoyant Norwegian and Danish housing markets. The Finnish economy saw a strong recovery last year, driven by domestic demand, but it will be difficult to maintain the momentum over the next two years. In Denmark, past growth numbers were revised upwards, and, after a slowdown in 2016, activity is set to pick up in 2017 and 2018. Norway will benefit from increasing oil prices, but Norges Bank will stay put to balance financial sector risks and a still-weak economy.

Norway: the economy has turned

Growth in the mainland economy remains low

Growth in the Norwegian economy remains meagre, but that does not change the fact that a corner was turned earlier this year. For the country as a whole, recent data confirm our view that unemployment has peaked and that the downturn in employment has ended. The divergence between oil and non-oil regions remains large, but for the country as a whole the risk of a reversal in this trend now seems remote. We expect mainland GDP growth to pick up to 1.5% in 2017, twice that of 2016, as the drag from declining oil investments finally subsides.

Oil unemployment has stopped rising

Oil prices have risen higher in recent months (even measured in a stronger US dollar), and it has become ever more evident that the oil market is being rebalanced. We expect oil prices to rise further in the coming years as the sharp drop in global oil investments most likely indicates a significant shortfall in productive capacity from conventional oil. In order to balance the oil market in the medium term, investments will have to rise, and this would require somewhat higher prices than today. Nevertheless, we acknowledge that much of our case for a rebound in oil prices is now already priced. We also note that exploration activity on the Norwegian continental shelf looks set to stabilise this year, suggesting that many new fields are expected to be profitable at oil prices at or around current levels; this adds strength to our view that the trough in oil investments is imminent. We expect oil-related manufacturing production to stabilise during the first half of 2017, and layoffs to recede.

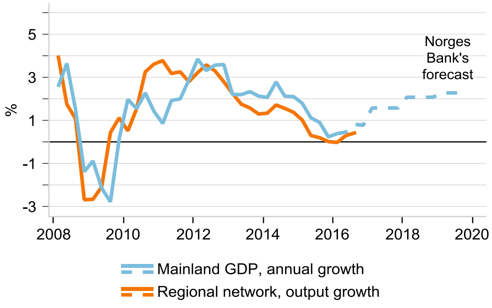
Household demand picks up, housing is booming

Household demand looks set to strengthen this year as consumer confidence barometers continue to rise and inflation recedes. Consumption of goods has been largely flat during this downturn, but consumption of services never weakened and demand for housing has strengthened. House prices have skyrocketed from already elevated levels in the Oslo region, and price growth has picked up almost everywhere. We expect buoyant housing construction activity, at least until the price growth comes to an end. With construction rising as sharply as it did through last year, risks are rising for a boom-and-bust cycle—first in house prices and, eventually, in construction activity. The peak could be passed when more housing units are completed and interest rates start to rise, perhaps early in 2018.

No more rate cuts

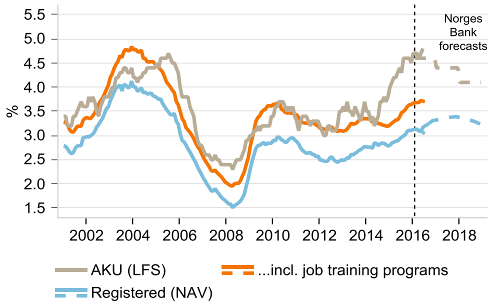
As expected, Norges Bank decided to keep its policy rate unchanged in December despite somewhat weaker economic data than projected. Norges Bank is signalling that the worries about the downturn in oil have receded relative to worries about financial instability. We believe Norges Bank is making the right call and expect no more rate cuts to the key policy rate (currently at 0.5%) in this cycle. Looking forward, there seems to be very little wriggle room for Norges Bank. A rate increase would probably require a significant fall in unemployment, which will take time. In our opinion, the Bank will not raise interest rates just to cool the housing market, and inflation is receding quickly. We do not expect any rate hikes from Norges Bank until 2018.

Norway: Norges Bank's network vs GDP



Source: Swedbank Research & Macrobond

Norway: Unemployment



Sources: Swedbank Research & Macrobond

Denmark: a solid economic performance, also looking forward

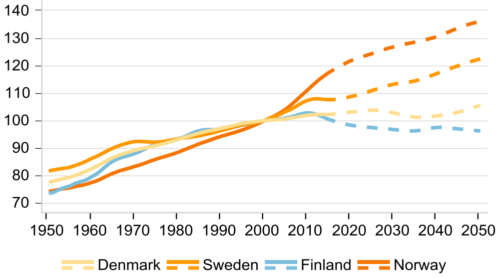
Not as bad as feared

A significant upward revision of past GDP data paints a more upbeat picture of the Danish economy over the last couple of years. Growth of 1.6% in 2015 (vs. a prior estimate of 1.0%) better matches the strong labour market observed in recent years and suggests that productivity developments were not as dismal as previously thought. It was primarily balance of payment data that were revised, based on the change-of-ownership principle (goods that do not cross the Danish border are now also included). Apart from that, the labour market has performed solidly, and real income has also risen on the back of depressed inflation.

Growth at potential

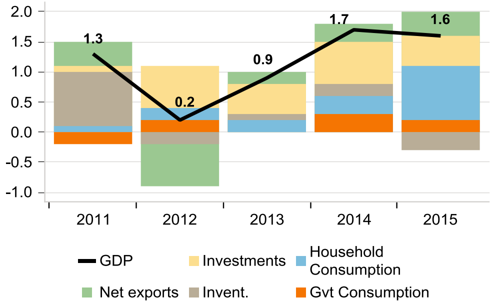
Looking forward, we expect growth to pick up in 2017-2018 from a slowdown in 2016 (estimated at 1.1%). The main drivers will be household consumption backed by rising employment and wages, and growth should reach 1½-2% in the next two years. In fact, a growing shortage of qualified employees risks limiting growth potential, as well as eroding external competitiveness through increasing wages. Over the medium to long term, the labour force is expected to contract, and become significantly smaller than in neighbouring Sweden and Norway. The weak political setup could upend the government's plans of structural reforms and limit public consumption. Furthermore, housing prices and household debt levels remain a significant risk to the economy, and prices in the greater Copenhagen area have surpassed the levels reached prior to the crash in 2008-2009. External risks are mainly related to the fallout from Brexit, UK being one of Denmark's main trading partners.

Nordic countries: Working age population, 2000=100



Source: UN Forecasts, Swedbank Research & Macrobond

Denmark: Contribution to GDP Growth, pp



Source: Swedbank Research & Macrobond

Finland: will it be able to catch the train?

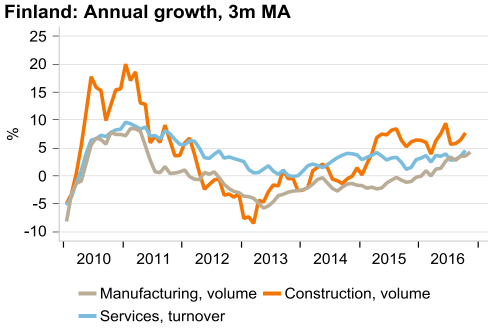
Economic growth driven by private consumption and investmens

In 2016, economic growth in Finland (+1.4%) recovered strongly, primarily through private consumption and investments. Improved consumer confidence, a stabilising labour market, very low inflation, and low borrowing costs were behind the household consumption growth. Investments grew primarily because of the construction sector, which has been one of the major sources of growth during the last two years. The gap between wage and productivity growth has narrowed, which has helped improve cost competiveness. However, export volumes grew only sluggishly, and enterprises' export expectations dropped sharply last year.

GDP growth is expected to slow in 2017 and 2018, amidst tigher fiscal policy

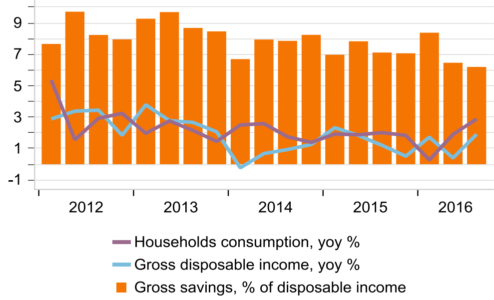
In 2017 and 2018, private consumption and investment are expected to slow, whereas the improvement in exports will not be enough to keep up the pace of economic growth. We, thus, expect growth to slow to 0.9% in 2017 and 1.0% in 2018. Consumption will slow due to a modest acceleration of inflation and the dampening effect of the Competitiveness Pact on wages. Investment is being held back as construction is estimated to have peaked. A better outlook for the main trading partners will lead to improved export growth. Labour productivity will increase only very sluggishly, although the Competitiveness Pact will reduce labour costs and, thus, contribute to export competitiveness. Despite tax cuts, the ongoing fiscal reforms are contributing to a gradual reduction of the government budget deficit; however, the government debt is expected to increase. The growth of public investments is set to slow considerably in 2017 and even decrease in 2018, due to the austerity measures. Government expenditures will hardly grow, as well, for the same reasons.

Finland: Annual growth, 3m MA



Source: Swedbank Research & Macrobond

Finland: Households consumption and savings, SA



Source: Swedbank Research & Macrobond

Estonia: grab the opportunities and grow!

2016 was already the second year of decelerating economic growth (1.2%) in Estonia. However, there is no reason for concern, as the expected recovery of investments and better outlook for foreign demand will push GDP growth to 2.2% in 2017 and 2.8% in 2018. At the same time, inflation is already gathering pace and is expected to pick up sharply this year, whereas wage pressures will persist.

Despite the GDP slow-down, 2016 marked a positive turnaround in several economic indica-tors

Despite the slowdown of GDP growth, several economic indicators actually improved in Estonia in 2016. Export growth accelerated and industrial output volume gradually in-creased. Estonian exporters continued to look for new markets: in only four European countries out of ten did Estonian enterprises increase their exports the most. Economic sentiment indicators have improved and, with the accelerating pace, the credit portfolio of enterprises has increased. The nonperforming loans' ratio is declining, which proves that enterprises can service their liabilities well. At the same time, nonfinancial corporations' profits have declined for three years and their investments for four years in a row. The share of labour costs in corporations' turnover has risen to its highest level of the post-2009-crisis years, endangering their competitiveness.

In 2017-2018 exports will continue to grow and investments are expected to recover

The average import demand of Estonia's major trade partners is expected to improve in 2017; this will create more favourable export opportunities for Estonian enterprises. At the same time, the transit sector may suffer a new setback, if Russia redirects its transit of fertilisers from Estonia to Russian cargo ports. Export prices and producer prices are recovering and this will contribute to a rise in turnover and lessen the negative impact of rising labour costs on enterprises' financial situation. We expect that in 2017 investments will recover. Households will continue to contribute robustly, with their investments in dwellings, and, in the State Budget 2017, the government has already promised to increase substantially public investments with the help of the EU structural funds assigned to Estonia. Nonfinancial corporations' investments are expected to increase modestly, as well, along with the improving export possibilities, gradually rising capacity utilisation, and strengthening sentiment. In the second half of 2017, Estonia will assume the Presidency of the Council of the EU. Besides growth in public sector expenditures, this period is expected to contribute additionally to several activities in the services' sector, primarily in accommodation, catering, transport, conference services, media, and ITC.

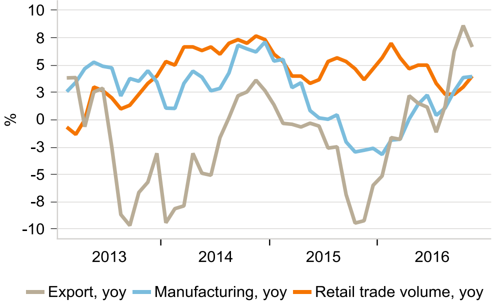
Inflation expected to pick up in 2017

In 2017, inflation in Estonia is expected to accelerate to around 3%, due to more expensive commodities, and to new rounds of excise tax hikes on alcohol, tobacco, and fuels. The growth of wage earners' purchasing power is expected to slow dramatically in 2017, as nominal growth of wages will be slower and prices will rise, after a three-year break. This, in turn, will hold back household consumption. At the same time, the rise in pensions and family benefits, as well as the low-wage income tax returns, will support household spending. In 2018, the average gross wage will grow even less than in 2017, but a substantial increase in nontaxable income (for the majority of wage earners, from 15% of the average gross wage in 2016 to 40% in 2018) will push the growth of the average net wage up by 9% in real terms in 2018. This, in turn, will boost household consumption, again.

People with disabilities forced to look for jobs

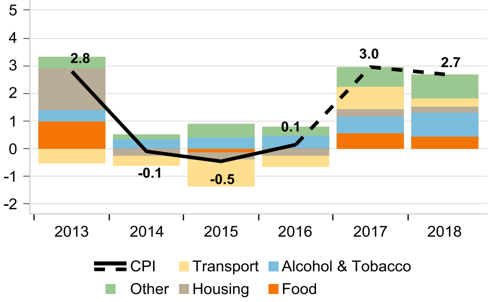
We expect the inactivity in the labour market to decrease further in 2017-2018. Major drivers of this decline, in addition to the tight labour market, are an increase in the retirement age and rearrangement of the social benefits system regarding people with disabilities; these people are now entitled to certain benefits only if they work or actively look for work. As many of them might find it hard to find suitable jobs, the unemployment rate is expected to grow.

Estonia: Manufacturing, retail trade, export, 3m MA



Source: Swedbank Research & Macrobond

Estonia: Contributions to CPI growth, pp



Sources: Swedbank Research & Macrobond

Latvia: growth is picking up

Despite the massive drop in gross fixed capital formation, the economy seems to have grown by a not-that-bad 1.6% in 2016. Recent data hint that the low point is past and growth is to pick up from here, driven by the EU funds' inflows and a stronger credit cycle. Investments will soon rebound, supporting job creation, wage growth, and consumption, and pushing GDP growth to about 3% per annum in 2017-2018. Exports will benefit from a cyclical upswing in the advanced economies. Structural policies are back in focus, with changes in the tax code to be drafted in the spring.

The low point is past. After growing 1.6% in 2016, GDP is to expand by 2.9% in 2017 and 3.1% in 2018

Third-quarter annual GDP growth has been revised down to a flimsy 0.3% (from 0.8%), which seems to have been the low point of 2016. October, November, and preliminary indications of December data on retail, industrial output, and exports hint that growth must have picked up in the last quarter, and we estimate the economy to have expanded by 1.6% in 2016. The past year was marked with a deep recession-type drop in activity--close to 20%--in gross fixed capital formation and the construction sector. Spillovers to the rest of the economy, though small, did keep unemployment elevated and must have held down the speed of wage growth and consumption by weighing down on confidence. But now the tide has turned.

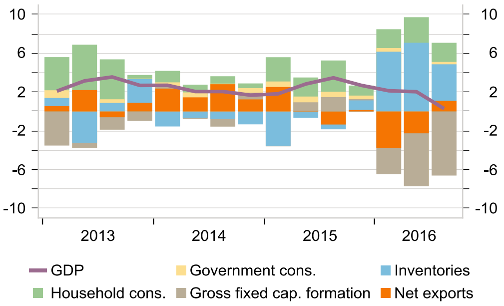
Unemployment rate will fall below 8% in 2018, pushing up wage growth and consumption

The signing of contracts for the EU fund's projects has sped up (to about 30% of the EUR 4.4 billion package assigned for the 2014-2020 period, from just 8.4% in late 2015), with about EUR 650 million, or 2.6% of GDP, scheduled to flow into the economy in 2017. From the low base of 2016, we expect gross fixed capital formation this year to grow by double digits and move construction back to growth. Construction employment expectations in the past few months have been steadily rising. Russia will keep redirecting its foreign trade flows away from the Latvian ports, but these plans are less aggressive than earlier thought: the target date to cease oil product exports in 2018 remains, but the target for the rest of exports is to cut the share of third-countries' ports from the current 9.1% to below 5% of all Russian foreign trade by 2030, rather than to stop them fully by 2020. Thus, the hit to transit volumes and employment will be smaller. Hence, with job creation reviving in construction and spilling over to other domestic demand sectors, the stronger growth outlook for Europe and, thus, more jobs in the export sectors, combined with less job loss in transit, will push the unemployment rate down faster--below 8% already in 2018. Lower unemployment will strengthen pressures on nominal gross wages, which we forecast to rise from just above 4% last year to 5.5-6.5% in 2017-2018. Inflation is picking up as domestic factors (driven by the warmer labour market) are now joined by external factors--the euro is weaker and commodity prices are rising. Yet, incomes will rise faster and push household consumption up by a robust 4% per year. With a stronger cyclical upswing in export markets, export volumes will expand, though wage growth will put rising pressure on competitiveness. Overall, GDP is forecast to expand by 2.9% in 2017 and 3.1% in 2018, which is twice as fast as last year.

Structural policies back in focus; education reform is stepped up and changes in tax code to be drafted this spring

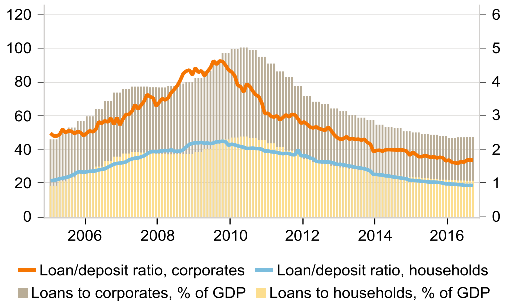
The credit cycle has turned up for corporates, but households are unlikely to hit positive numbers before 2018. Leverage levels are very low, though the credit flow is likely to remain timid due to low and inelastic demand (i.e., cautiousness to invest) and truncated supply (i.e., lending is not accessible to those in the shadow economy due to opaque financial flows). If the government were to speed up structural improvements, credit could lift GDP growth towards 4% or more. The period of low growth has put structural policies back in focus: education reforms are stepping up, tax code changes are to be drafted in the spring, and health care and regional reform are likely to be next in line. Structural improvements are the only way to sustainably push growth above a mediocre 2.5-3%, but it will be a tough uphill struggle. It is still too early to make the call. As before, the key negative risks to the outlook relate to weak external demand, global policy uncertainty, and geopolitical tensions.

Latvia: contributions to GDP growth, pp



Source: Swedbank Research & Macrobond

Latvia: bank loan and deposit statistics



Source: Swedbank Research & Macrobond

Lithuania: wages grow, people leave

After an estimated 2.0% growth last year the Lithuanian economy is expected to accelerate to 2.8% in 2017, before easing to 2.5% in 2018. Temporary factors, such as shrinking inventories, contracting public investments, and a poor crop harvest, are unlikely to drag down on growth this year. However, a jump in inflation, weaker wage growth, and shrinking employment will dent consumption. Exports will accelerate somewhat, but cost competitiveness has been eroded and the era of rapid growth is behind us.

Most sectors and households would agree that 2016 was a good year

2016 was a good year for most sectors and households. Only the agriculture and construction sectors contracted last year – the former due to a lousy crop harvest, which shrank by one-tenth, and the latter due to shrinking public investments in infrastructure. The value added in most other sectors grew by some 3%, and retail and wholesale trade increased by around 5%. This is not unexpected, as household consumption, which increased by 5.6%, contributed almost three-fourths of total GDP growth last year.

The average wage has increased, but not all have felt that

Households enjoyed an average wage growth of 7.7% in 2016, while in the private sector wages increased by some 9%. Of course, the average wage is a bit like the average temperature in a hospital – it does not tell us much about the situation in different wards and beds. Minimum wage earners could not complain – their income increased by 17% in 2016, unless, of course, they lost some of their unofficial pay (some data seem to be pointing to just that). This year, their wages may not rise, but the nontaxable income threshold has increased by 55% (from EUR 200 to EUR 310 per month). The additional nontaxable income threshold for each child in a family has also increased (from EUR 120 to EUR 200). Unfortunately, most public sector employees have not seen wage increases in years, and many earn just slightly above the minimum wage (even those with higher education). On top of that, regional inequalities are huge and do not seem to have declined.

Emigration has unexpectedly increased again, and employment has probably peaked

One of the most worrying recent trends – again – was emigration. After declining steadily for three years, it increased by 21.6% in 2015 and by 14.5% in 2016 – despite higher wages and more job vacancies. Most of the increase in emigration was among males, and especially the ones aged between 15 and 24. Employment in "male sectors," such as transportation, construction, and agriculture, has recently declined somewhat. As to the younger emigrants, it is possible that some of them had already left in the past but did not register their emigration until conscription was reintroduced in 2015. In 2016, some may have been encouraged to register their emigration following the Brexit referendum.

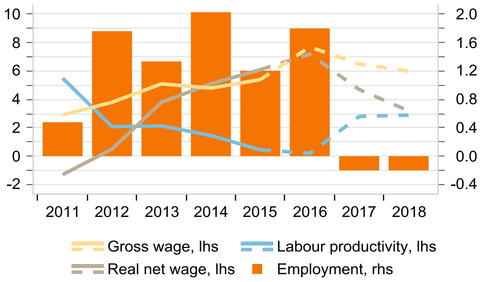
Employment increased by some 24,000, or 1.8%, last year, and unemployment declined by more than a percentage point, to 8.0%. Alas, growth in employment slowed at the end of 2016, and we estimate that, despite the rising labour force participation rate, it will start shrinking this year. There will be plenty of jobs, but not enough people to take them.

In addition, we will see slightly slower wage growth – 6.5% and 6.0% this year and the next, respectively – while inflation will accelerate to 3.0%. Thus, we forecast that household consumption growth will ease to 3.5% in both 2017 and 2018. However, investments, after stagnating in 2016, are expected to increase by 7% this year, thanks mainly to rising public investments, but also due to a faster distribution of EU funds

Price growth will start to bite, but investment growth will resume

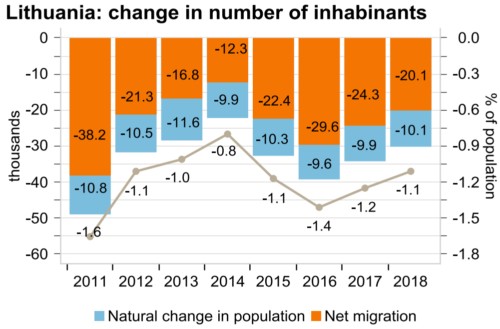
As with the global environment, positive and negative risks are balanced. We expect only a slight increase in export growth, but the euro area, and even Russia, could become a positive surprise during the next two years. However, the risk of global trade wars is also uncomfortably large (exports make up some 80% of the Lithuanian GDP). Medium- and longer-term prospects will largely depend on policy and reforms implemented by the new government, which, so far, has been quite enthusiastic and, in most cases, looking in the right direction.

Lithuania: Growth in wages, employment and productivity



Source: Swedbank Research & Macrobond

Lithuania: change in number of inhabinants



Source: Swedbank Research & Macrobond

Appendices

I. The Estonian outlook

ESTONIA: Key economic indicators, 2015-2018 [1/]

	2015	2016e		2017f		2018f	
Real GDP growth, %	1.4	1.2	(1.3)	2.2	(2.4)	2.8	(2.5)
Household consumption	4.6	4.0	(3.8)	3.2	(3.0)	3.8	(3.0)
Government consumption	3.4	1.4	(0.5)	3.0	(2.0)	2.0	(2.0)
Gross fixed capital formation	-3.4	-1.0	(2.0)	5.0	(6.5)	4.5	(5.0)
Exports of goods and services	-0.6	4.0	(2.6)	3.5	(3.6)	3.7	(3.7)
Imports of goods and services	-1.4	5.6	(4.6)	5.0	(5.0)	4.5	(4.5)
Consumer price growth, %	-0.5	0.1	(0.1)	3.0	(2.6)	2.7	(2.4)
Unemployment rate, % [2/]	6.2	6.9	(6.9)	7.5	(7.2)	7.7	(7.5)
Change in employment, %	2.6	0.8	(0.9)	-0.2	(-0.2)	-0.1	(-0.1)
Real net monthly wage growth, %	8.0	7.4	(7.5)	2.2	(2.5)	8.7	(2.1)
Nominal GDP, billion euro	20.2	20.8	(20.9)	21.8	(21.9)	23.0	(23.0)
Exports of goods and services (nominal), % growth	-2.1	3.7	(2.4)	4.5	(4.1)	5.3	(5.2)
Imports of goods and services (nominal), % growth	-3.1	4.1	(3.4)	5.5	(5.5)	6.1	(6.1)
Balance of goods and services, % of GDP	4.1	3.9	(3.4)	3.2	(2.4)	2.4	(1.7)
Current account balance, % of GDP	2.2	2.2	(1.1)	1.5	(0.2)	0.7	(-0.6)
Current and capital account balance, % of GDP	6.5	5.4	(3.1)	4.8	(2.2)	3.2	(0.4)
FDI inflow, % of GDP	-2.9	3.4	(3.8)	3.7	(3.7)	3.9	(3.9)
General government budget balance, % of GDP [3/]	0.1	0.2	(0.3)	-0.6	(-0.6)	-0.4	(-0.2)
General government debt, % of GDP	10.1	9.4	(9.4)	10.5	(10.2)	10.9	(11.0)

1/ November 2016 forecast in parenthesis
2/ According to Labour Force Survey
3/ According to Maastricht criterion

II. The Latvian outlook

LATVIA: Key economic indicators, 2015-2018 [1/]

	2015	2016e		2017f		2018f	
Real GDP growth, %	2.7	1.6	(1.6)	2.9	(2.6)	3.1	(2.9)
Household consumption	3.5	3.5	(3.5)	3.5	(3.5)	4.2	(4.0)
Government consumption	3.0	1.6	(1.5)	3.0	(3.0)	3.0	(3.0)
Gross fixed capital formation	2.8	-20.0	(-11.0)	12.0	(8.0)	10.0	(10.0)
Exports of goods and services	2.6	2.5	(2.5)	4.0	(4.0)	4.0	(3.7)
Imports of goods and services	2.1	3.8	(3.8)	6.0	(6.0)	6.5	(6.5)
Consumer price growth, %	0.2	0.1	(0.0)	2.5	(2.5)	2.0	(2.0)
Unemployment rate, % [2/]	9.9	9.7	(9.5)	8.5	(8.7)	7.9	(8.3)
Change in employment, %	1.3	-0.2	(0.2)	0.6	(-0.2)	0.7	(0.2)
Real net monthly wage growth, %	7.5	4.0	(5.0)	2.9	(2.9)	4.4	(3.4)
Nominal GDP, billion euro	24.3	24.8	(24.8)	26.0	(26.0)	27.5	(27.3)
Exports of goods and services (nominal), % growth	2.1	0.1	(0.4)	4.5	(5.0)	5.6	(5.7)
Imports of goods and services (nominal), % growth	0.8	-2.7	(-0.9)	7.7	(8.1)	8.1	(8.6)
Balance of goods and services, % of GDP	-1.1	0.6	(-0.3)	-1.2	(-2.1)	-2.6	(-3.8)
Current account balance, % of GDP	-0.8	1.0	(0.5)	-0.6	(-1.3)	-1.9	(-3.1)
Current and capital account balance, % of GDP	2.0	2.1	(1.6)	1.9	(1.2)	0.3	(-0.9)
FDI inflow, % of GDP	2.8	0.8	(0.8)	2.3	(2.7)	2.4	(2.8)
General government budget balance, % of GDP [3/]	-1.3	-0.9	(-0.9)	-1.0	(-1.1)	-1.1	(-1.1)
General government debt, % of GDP	36.3	40.0	(39.7)	38.3	(40.8)	37.0	(41.3)

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III. The Lithuanian outlook

LITHUANIA: Key economic indicators, 2015-2018 [1/]

	2015	2016e		2017f		2018f	
Real GDP growth, %	1.8	2.0	(2.0)	2.8	(2.8)	2.5	(2.5)
Household consumption	4.1	5.6	(5.5)	3.5	(3.5)	3.5	(3.5)
Government consumption	0.9	1.1	(1.5)	2.0	(2.0)	1.0	(1.0)
Gross fixed capital formation	4.7	0.0	(4.0)	7.0	(7.0)	6.0	(6.0)
Exports of goods and services	-0.4	3.0	(5.0)	5.0	(6.0)	4.5	(5.5)
Imports of goods and services	6.2	2.0	(4.0)	6.0	(7.0)	5.5	(6.5)
Consumer price growth, %	-0.9	0.9	(1.0)	3.0	(3.0)	2.5	(2.5)
Unemployment rate, % [2/]	9.1	8.0	(8.0)	7.4	(7.4)	7.2	(7.2)
Change in employment, %	1.2	1.8	(1.9)	-0.2	(-0.4)	-0.2	(-0.4)
Real net monthly wage growth, %	6.0	7.2	(7.1)	4.7	(4.7)	3.2	(3.2)
Nominal GDP, billion euro	37.3	38.5	(38.5)	40.6	(40.6)	42.7	(42.7)
Exports of goods and services (nominal), % growth	-4.3	0.0	(1.0)	7.0	(8.0)	6.0	(6.5)
Imports of goods and services (nominal), % growth	-1.2	-2.7	(-1.5)	9.0	(9.5)	7.0	(7.5)
Balance of goods and services, % of GDP	-0.7	1.4	(1.2)	0.0	(0.2)	-0.7	(-0.5)
Current account balance, % of GDP	-2.3	0.0	(-0.6)	-0.7	(-0.5)	-1.4	(-1.2)
Current and capital account balance, % of GDP	0.7	1.3	(1.0)	1.5	(1.7)	1.6	(1.8)
FDI inflow, % of GDP	2.3	0.0	(0.5)	1.0	(1.0)	1.0	(1.0)
General government budget balance, % of GDP [3/]	-0.2	0.0	(0.0)	-0.8	(-0.8)	-0.5	(0.5)
General government debt, % of GDP	42.7	40.0	(39.9)	43.1	(43.5)	38.9	(39.0)

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IV. Main macroeconomic indicators for home markets

Macroeconomic indicators, 2015 - 2018

	2015	2016f	2017f	2018f
Real GDP, annual change in %				
Sweden (calender adjusted)	3.8	3.2	2.6	2.4
Estonia	1.4	1.2	2.2	2.8
Latvia	2.7	1.6	2.9	3.1
Lithuania	1.8	2.0	2.8	2.5
Unemployment rate, % of labour force				
Sweden	7.4	6.9	6.6	6.6
Estonia	6.2	6.9	7.5	7.7
Latvia	9.9	9.7	8.5	7.9
Lithuania	9.1	8.0	7.4	7.2
Consumer price index, annual change in %				
Sweden	0.0	1.0	1.8	2.2
Estonia	-0.5	0.1	3.0	2.7
Latvia	0.2	0.1	2.5	2.0
Lithuania	-0.9	0.9	3.0	2.5
Current account balance, % of GDP				
Sweden	5.4	4.9	4.8	5.1
Estonia	2.2	2.2	1.5	0.7
Latvia	-0.8	1.0	-0.6	-1.9
Lithuania	-2.3	0.0	-0.7	-1.4

Sources: National statistics authorities and Swedbank.

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