Swedbank

Swedbank Economic Outlook

Update – March 2018

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Swedbank Economic Outlook

Swedbank Economic Outlook presents the latest economic forecasts for Sweden, the Nordic and Baltic countries and the major global economies. In this update, current issues that have a bearing on economic developments are analysed.

Swedbank Economic Outlook is a product made by Swedbank Macro Research.

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Trade tensions imperil the global momentum

In the past year, the global economy has enjoyed a strong rebound in global trade. This has contributed to lifting the global economy out of the stagnant growth path that followed the financial crisis. US tariffs and the risk of retaliation, in addition to, in the worst-case scenario, a trade war, are now threatening to derail this positive momentum. These risks also pose a dilemma for central banks aiming to normalise monetary policy. Tariffs and protectionism may push up inflation in the near term, while worsening growth prospects.

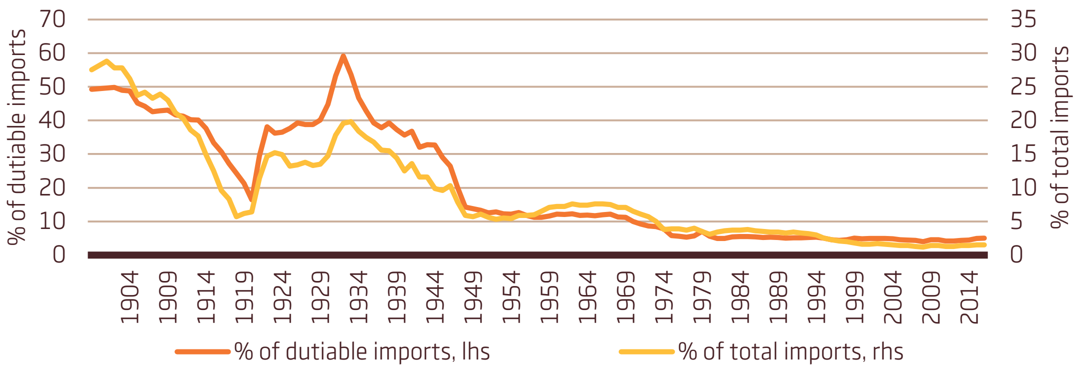
There are no winners in a trade war

China-US trade tensions are at the core of the recently announced US tariffs. The economic consequences of US protectionism, however, have implications for global growth going far beyond these two countries. Our main scenario is that US tariffs and retaliatory measures from China will be fairly limited. The overall global growth momentum is strong enough to withstand the impact of such measures. Trade tensions do, however, risk causing turbulence in financial markets, increase downside risks to the global outlook, and worsen long-run growth prospects.

The US economy is still performing well. The labour market is tight and inflation is on the rise. Tax reform and higher government spending will boost growth in the near term, while worsening the fiscal challenges and driving market interest rates higher. The Federal Reserve (Fed) is facing a difficult policy dilemma. Fiscal policy is expansionary at the height of the business cycle, causing the Fed to signal faster rate hikes, despite an unchanged or worsened long-run outlook. There is, moreover, a risk that tariffs will be inflationary, while dampening medium-term prospects further. As the downsides of trade barriers, so far, remain limited, we expect the positive near-term outlook to incentivise the Fed to continue hiking rates in 2018 and 2019. However, we caution that we see growth slowing towards the end of the forecast horizon. Domestic politics remain a potent risk factor ahead of the November elections.

More protectionist US breaks decades-long trend

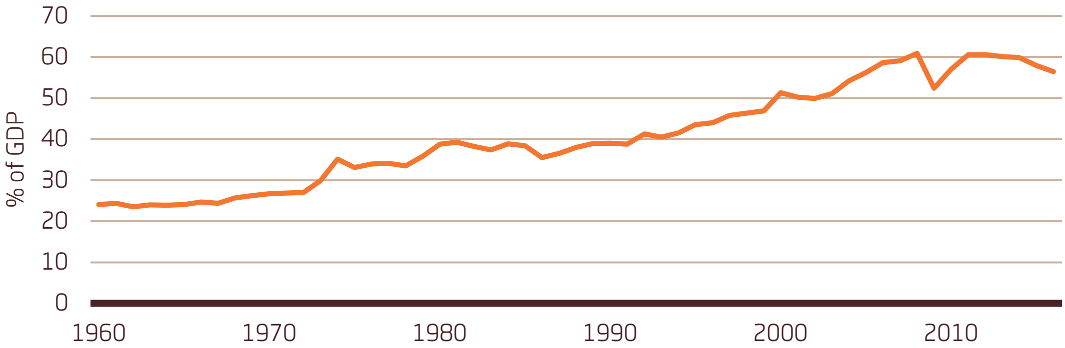
Collected customs duties, USA



Sources: Swedbank Research & United States International Trade Commission

Trade volumes have grown in tandem with liberalisation

Global trade, % of global GDP



Sources: Swedbank Research & World Bank

The Nordic and Baltic economies are benefitting from growth in Europe

Europe is enjoying a broad-based rebound in economic growth. Forward-looking indicators have retreated somewhat from high levels, but the overall outlook for growth remains positive in the near term. The large economies France, Germany, and Spain are all performing well. Low interest rates and structural reforms in France are helping to boost medium-term growth prospects. Still, Europe will be vulnerable if trade sanctions escalate. In particular, US tariffs targeting the European car industry would be detrimental to exports and to investments. In addition, European politics remain a potent risk factor, including uncertainty regarding the formation of an Italian government and the difficult Brexit negotiations. Unless severe negative risks materialise, the ECB is moving closer to normalising monetary policy, albeit at a slow and gradual pace.

All the Nordic and Baltic economies are highly dependent on foreign trade. Investments and exports have enjoyed a boost as global trade has improved. As long as the European outlook remains solid, we are optimistic that the Nordic-Baltic region will enjoy decent growth in the coming years. Emerging markets are also benefitting from the rebound in global trade. Countries such as Brazil and Russia are highly vulnerable to the risk of a trade war. China is increasingly important to many emerging markets, and a slowdown in the Chinese economy would have large spill-over effects for growth in these countries.

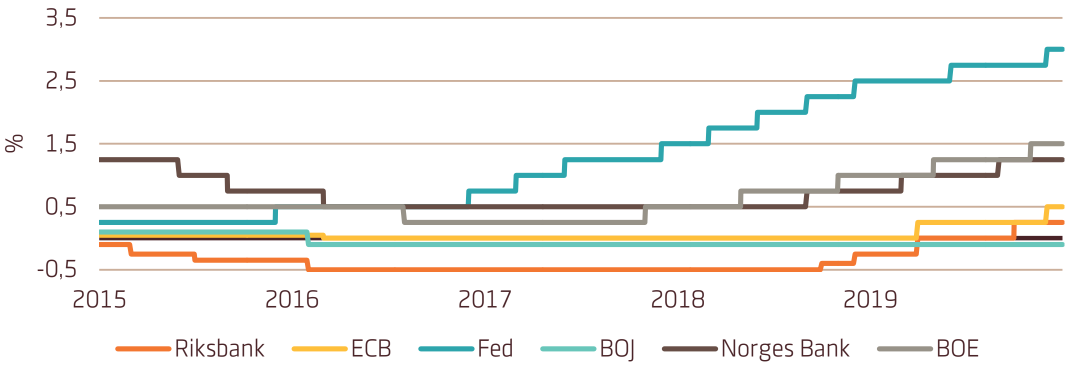
Swedbank's global GDP forecast[1/]

Percentage change	2016	2017	2018F		2019F	
USA	1.5	2.3	2.6	(2.6)	2.2	(2.0)
EMU countries [2/]	1.8	2.5	2.2	(2.3)	1.8	(1.9)
Germany	1.9	2.5	2.3	(2.4)	1.9	(2.0)
France	1.1	2.0	2.0	(2.1)	1.9	(1.9)
Italy	1.1	1.5	1.3	(1.4)	1.1	(1.2)
Spain	3.3	3.1	2.8	(2.7)	2.2	(2.2)
Finland	2.1	2.7	2.5	(2.5)	2.2	(1.9)
UK	1.9	1.7	1.6	(1.6)	1.7	(1.6)
Denmark	2.0	2.1	1.5	(2.0)	2.0	(2.0)
Norway (mainland)	0.9	1.9	2.5	(2.1)	2.2	(1.5)
Japan	0.9	1.7	1.5	(1.4)	1.0	(0.9)
China	6.7	6.9	6.4	(6.6)	6.2	(6.3)
India	7.9	6.4	6.9	(7.3)	7.3	(7.6)
Brazil	-3.5	1.0	2.2	(2.5)	2.0	(2.4)
Russia	-0.2	1.6	2.0	(2.3)	2.0	(2.0)
Global GDP in PPP [3/]	3.3	3.7	3.8	(3.9)	3.6	(3.7)

[1/] Previous forecast in parentheses
[2/] Calendar adjusted
[3/] IMF PPP weights (revised October 2017)

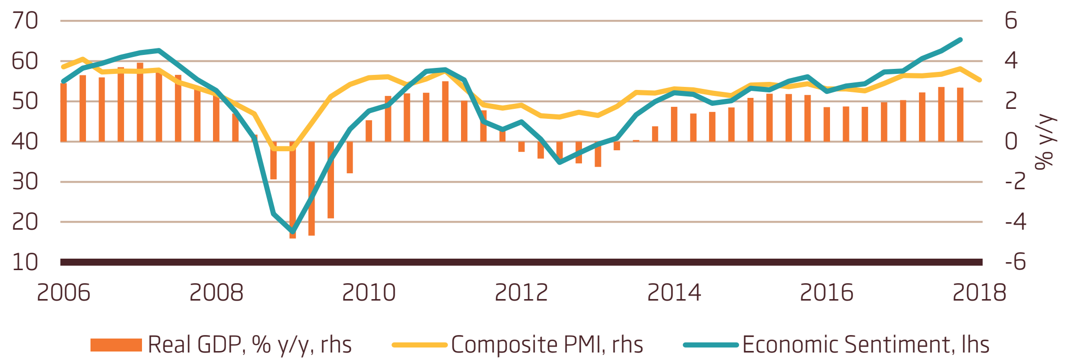
Sources: Swedbank Research & IMF

Globally, the normalisation of monetary policy continues
Central bank policy rates and Swedbank forecasts



Sources: Swedbank Research & Macrobond

The European economy is experiencing broad-based growth
GDP growth and short-term indicators, euro area



Sources: Swedbank Research & Macrobond

Interest and exchange rate forecasts

	Outcome	Forecast			
	2018 22 MAR	2018 30 JUN	2018 31 DEC	2019 30 JUN	2019 31 DEC
Policy rates (%)					
Federal Reserve, USA [1/]	1.75	2.00	2.50	2.75	3.00
European Central Bank [2/]	0.00	0.00	0.00	0.25	0.50
Bank of England	0.50	0.75	1.00	1.25	1.50
Riksbank	-0.50	-0.50	-0.25	0.00	0.25
Norges Bank	0.50	0.50	0.75	1.00	1.25
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-0.10
Government bond rates (%)					
Sweden 2y	-0.47	-0.20	0.25	0.80	1.05
Sweden 5y	0.14	0.35	1.05	1.50	1.70
Sweden 10y	0.70	1.15	1.60	2.00	2.10
Germany 2y	-0.62	-0.35	-0.10	0.35	0.65
Germany 2y	-0.09	0.10	0.60	1.05	1.35
Germany 10y	0.52	0.80	1.20	1.65	1.85
US 2y	2.29	2.40	2.80	3.00	3.25
US 5y	2.63	2.80	3.10	3.20	3.40
US 10y	2.83	3.10	3.30	3.45	3.60
Exchange rates					
EUR/USD	1.23	1.26	1.28	1.29	1.27
EUR/SEK	10.11	9.90	9.70	9.50	9.40
USD/SEK	8.18	7.76	7.44	7.27	7.17
KIX (SEK) [3/]	115.9	112.2	109.6	107.2	106.7
EUR/NOK	9.53	9.34	9.24	9.13	9.13
NOK/SEK	1.06	1.06	1.05	1.04	1.03
EUR/GBP	0.87	0.88	0.90	0.92	0.92
USD/CNY	6.32	6.60	6.55	6.60	6.50
USD/JPY	106.1	110.0	112.0	115.0	115.0
USD/RUB	56.8	55.0	53.0	51.0	50.0

[1/] Upper Bound
[2/] Refi Rate
[3/] Trade-weighted exchange rate index for SEK. A higher value of the index means that SEK has depreciated

Sources: Swedbank Research & Macrobond

Sweden – vulnerable to increased protectionism

The Swedish economy continues to grow, but the challenges are building. US protectionist measures are a threat to global trade that could adversely affect Swedish exports. The housing market is showing signs of stabilising, but the new mortgage amortisation requirement and large housing supply are weighing on prices in metropolitan areas in 2018. The Riksbank is, again, hesitating whether to begin raising interest rates. In addition, 2018 is an election year. A tricky political landscape is creating uncertainty about future fiscal policy.

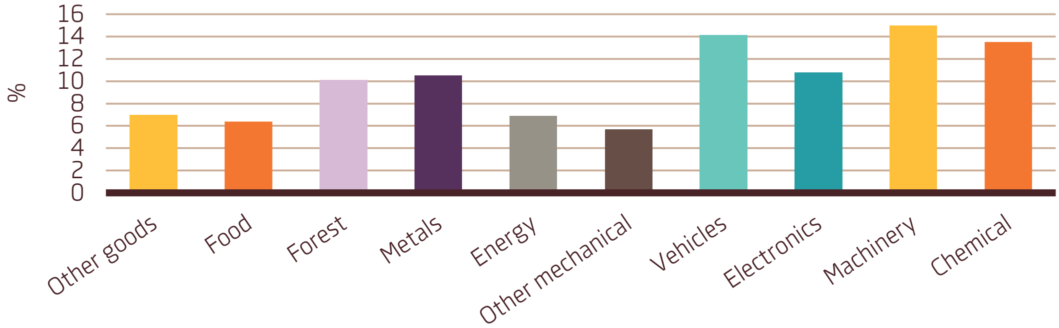
Swedish economy increasingly dependent on external factors

The drivers of the Swedish economy are beginning to shift. For 10 years, domestic demand has fuelled growth; consumer spending and a growing services sector have been important factors. In recent years, housing construction has become a key factor. Now, however, construction is slowing due to the price adjustment in metropolitan areas. In 2018, consumer spending is rising at a decent pace thanks to an expansionary fiscal policy, which is benefitting less affluent households, but beginning in 2019 we expect household spending to moderate.

The Swedish economy is continuing to develop well, however, thanks to strong global conditions. Exports and industrial production have accelerated. Hence, Sweden is vulnerable to tariffs and increased protectionism. Sweden and the rest of the EU are exempted, at least temporarily, from US steel and aluminium tariffs. Further measures may, however, be implemented, e.g. tariffs on European cars. This would affect Sweden directly through exports to the US and indirectly as a subcontractor to the European auto industry. A trade war is not our main scenario, but the risk of further trade barriers has increased.

Commodities and engineering products weighs heavily in exports

Export shares of total export goods 2017, %

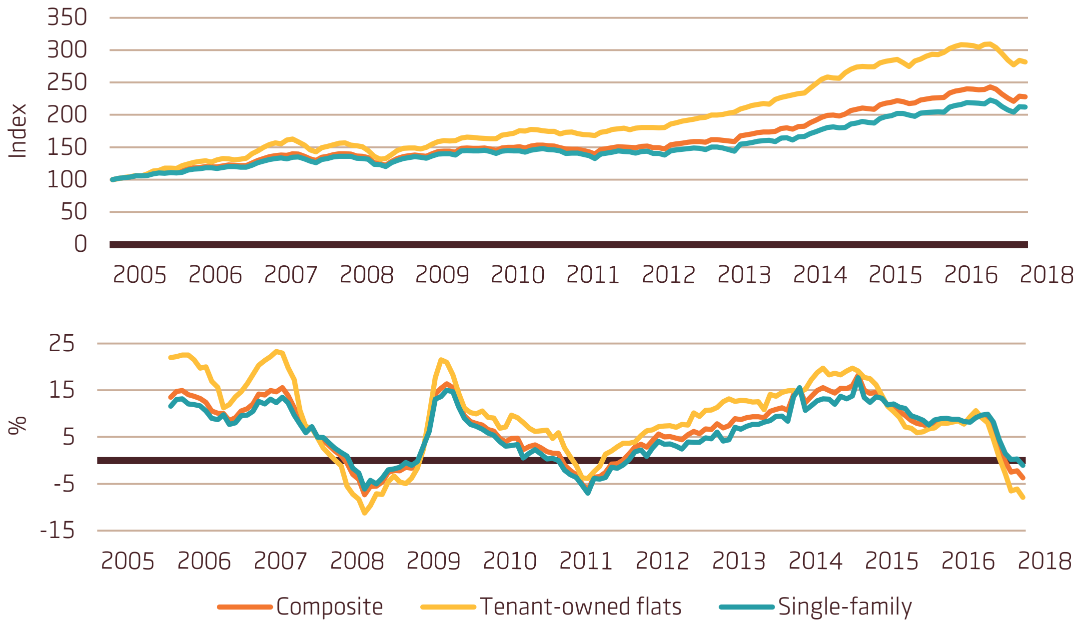


Sources: Swedbank Research & Statistics Sweden

Housing market: substantial regional differences

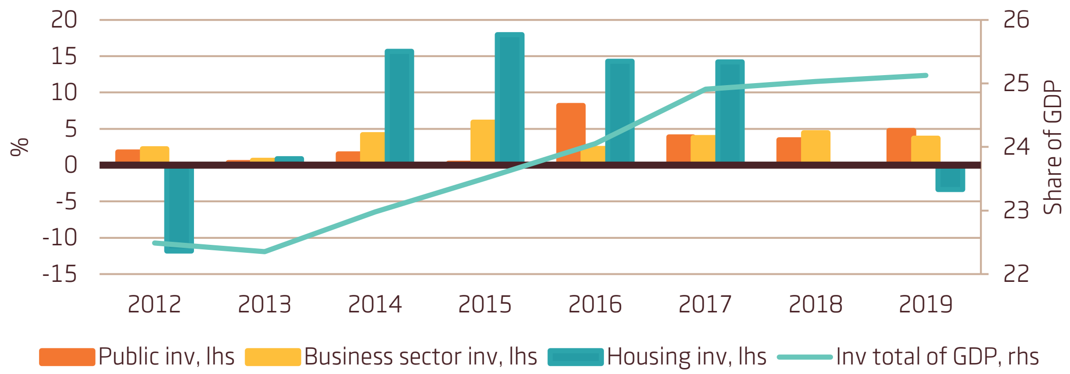
The Swedish housing market has performed in line with our forecast: we are seeing a distinct difference between metropolitan areas and the rest of the country, and between tenant-owned flats and single-family homes. The price decline in the market for flats is driven by Sweden's three large metropolitan areas, where median prices have declined between 6 and 7% in the fourth quarter of 2017 according to data processed by Svensk Mäklarstatistik. In communities with populations of less than 75,000, the decline was only 1% during the same period. We see a similar trend for single-family homes, for which the three major metropolitan areas posted declines of between 1% and 4%, while other locations reported increases. Communities with populations of less than 75,000 saw home prices rise no less than 6% in the same period. Our forecast is that this trend will continue in 2018. A large supply of newly built flats, in combination with the new amortisation requirement, will put continued pressure of up to 5% on prices in major urban areas. Meanwhile, the rest of the country will stabilise, and the single-family home market outside of the metropolitan areas can expect further gains.

Since 2005, the price of flats has risen 182%; houses are up 112%
Valueguard index (Jan 2005=100) and annual growth rate, Sweden



Sources: Swedbank Research & Macrobond

Business and public investments compensate for a fall in housing investment
Investment share of GDP (%) and investment growth, y/y (%)

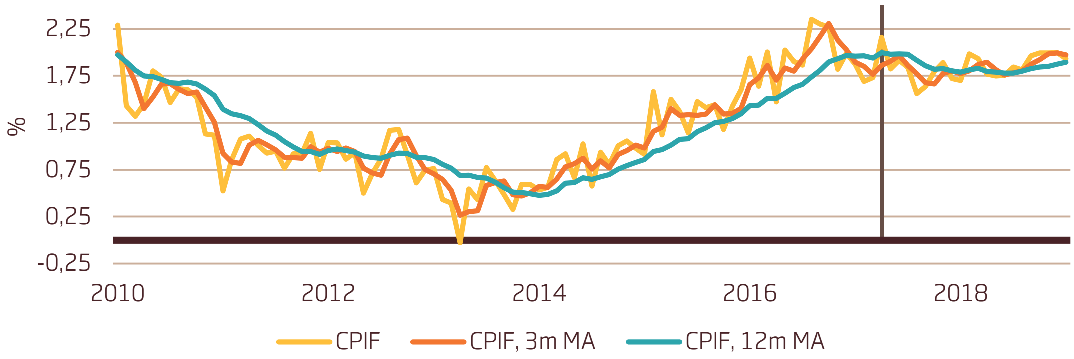


Sources: Swedbank Research & Macrobond

Given slowing construction, the housing shortage in metropolitan areas will persist. Prices may, therefore, start to rise again within a couple of years. Two factors will be important to prices: interest rates and housing policy. We expect that we will continue to live in a low-interest-rate environment for the foreseeable future. Inflation is likely to stay marginally below the Riksbank's target in 2018 before rising towards the target in 2019. The Riksbank has signalled, however, that it has little tolerance for inflation below 2%. Hence, we anticipate an initial, cautious rate hike coming in October 2018 and, furthermore, that the repo rate will not be raised to zero before 2019.

Inflation decelerates in 2018 but picks up in 2019, due to costs of labour and energy

Consumer price index with fixed mortgage interest rate, % y/y and moving averages



Sources: Swedbank Research & Macrobond

There is considerable uncertainty as to who will form a government after this autumn's election. Regardless of the outcome, it will be necessary to reach a cross-party agreement on the conditions in the housing market, in order to set household debt dynamics on a sustainable path and to achieve a better-functioning housing market. Housing construction has to better match demand, both on a regional basis and regarding the types of homes built. Otherwise, low interest rates and a housing shortage will quickly lead to new price increases and higher debt levels.

Baltics – at the mercy of global winds

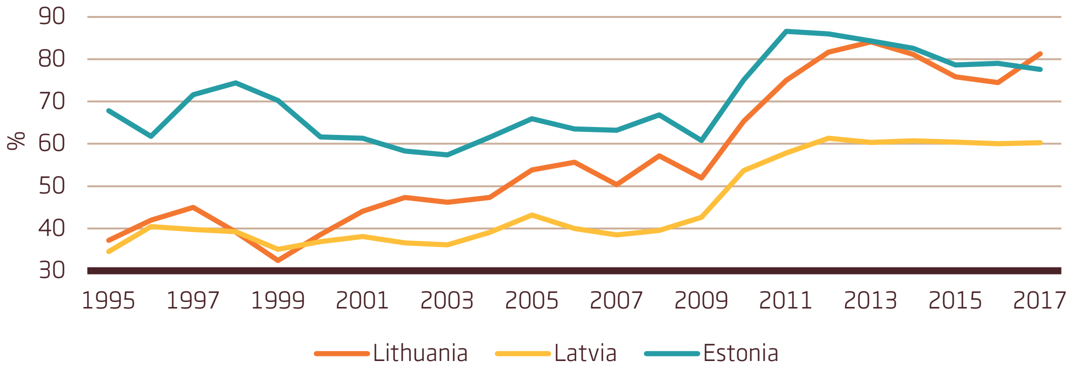
The three very open economies, especially Lithuania and Estonia, have benefitted from stronger global growth and, in particular, lower uncertainty, higher confidence, stronger consumption, and recovering investments in the euro area. However, this could end quickly if protectionist policies become more widespread.

Growth has peaked, but balanced and not overheating yet

Due to a spike in investments last year in Latvia and Estonia and a surge in exports in Lithuania, all three Baltic countries grew at an accelerated pace last year. This feat is unlikely to be repeated this year, but growth rates will remain solid, in the 3–4% range. A more rapid inflow of EU structural funds will boost investments in Lithuania and Latvia. Labour shortages and minimum wage hikes, especially in Latvia, will continue boosting wage growth and support consumption. Foreign trade and the current account are likely to remain balanced in Estonia and Lithuania, while deficits are expected to rise but remain low in Latvia. All three Baltic countries have sound public finances and a mildly leveraged private sector.

Trade is important to all the Baltic countries

Export of goods and services as a share of GDP, current prices, %



Sources: Swedbank Research & Macrobond

Major risks are external; slow-burning local issues remain

Geopolitical tensions, counterproductive populism, protectionism, and trade wars – all this and unknown factors could derail exports and dent economic growth. The Baltic countries, especially Estonia and Lithuania, are very open economies and are vulnerable to trends in global trade – tailwinds could become headwinds. As the Latvian business cycle is lagging somewhat and it took longer for the private sector to deleverage, there is more room for growth; however, there are some bottlenecks. Latvia's banking sector has encountered some obstacles – the third-largest Latvian bank (ABLV), mainly servicing non-residents, was liquidated after US authorities expressed concerns about money-laundering. Nonresident deposits and transactions will decrease further and will dent growth but are unlikely to have a major negative impact or to spill over onto other sectors.

Ageing and shrinking populations are starting to take their toll – employment is close to its peak in Latvia and Lithuania, but will continue to increase slightly in Estonia for a couple of years. Wages continue to grow faster than productivity, but the gap has narrowed somewhat, and Baltic countries have managed to slow the deterioration of their cost competitiveness and not lose global export market shares yet. But stay tuned.

Appendices

SWEDEN: Key economic indicators, 2016–2019 [1/]

	2016	2017	2018F		2019F	
Real GDP growth (calendar adjusted), %	3.0	2.7	2.7	(2.7)	1.8	(2.1)
Real GDP growth, %	3.2	2.4	2.6	(2.6)	1.8	(2.0)
Household consumption	2.2	2.4	2.6	(2.5)	2.0	(2.0)
Government consumption	3.1	0.4	1.5	(1.6)	1.1	(1.5)
Gross fixed capital formation	5.6	6.0	3.1	(4.1)	2.3	(2.2)
Change in inventories, contribution to GDP growth	0.0	0.1	-0.1	(-0.1)	0.0	(0.0)
Exports of goods and services	3.3	3.7	5.7	(5.4)	4.4	(4.6)
Imports of goods and services	3.4	5.0	5.5	(5.6)	4.6	(4.6)
Industrial production (calendar adjusted), %	2.7	3.7	5.4	(5.1)	4.0	(3.8)
CPI, % (average)	1.0	1.8	1.8	(2.1)	2.6	(2.8)
CPI, % (end of period)	1.7	1.7	2.1	(2.5)	2.7	(3.0)
CPIF, % (average) [2/]	1.4	2.0	1.8	(1.9)	1.9	(1.9)
CPIF, % (end of period) [2/]	1.9	1.9	1.7	(1.8)	1.9	(2.0)
Riksbank policy rate, end of period	-0.50	-0.50	-0.25	(-0.25)	0.25	(0.50)
Unemployment rate (15–74), %	6.9	6.7	6.3	(6.4)	6.3	(6.3)
Change in labour force (15–74), %	1.0	2.0	1.2	(1.2)	0.8	(0.8)
Change in employment (15–74), %	1.5	2.3	1.6	(1.5)	0.8	(0.9)
Nominal hourly wage (NMO), whole economy, %	2.4	2.5	2.8	(3.1)	3.2	(3.4)
Household savings ratio, %	16.6	16.2	16.6	(16.9)	16.5	(16.5)
Household real disposable income, %	3.3	2.2	2.6	(3.3)	2.0	(1.5)
Current account balance, % of GDP	5.2	4.8	4.9	(4.6)	5.0	(4.8)
General government budget balance, % of GDP [3/]	1.2	1.2	0.5	(0.9)	0.0	(0.6)
General government debt, % of GDP [3/]	42.2	39.4	37.6	(36.9)	36.3	(35.0)

[1/] Previous forecast in parenthesis
[2/] CPI with fixed interest rates
[3/] According to Maastricht definition
Note: Historical data is based on the KIBAS distributed by NIER on March 1, 2018

Sources: Swedbank Research & Statistics Sweden

ESTONIA: Key economic indicators, 2016–2019 [1/]

	2016	2017	2018F		2019F	
Real GDP growth, %	2.1	4.9	3.9	(3.9)	3.0	(3.0)
Household consumption	4.4	2.2	4.5	(4.5)	2.7	(2.7)
Government consumption	1.9	0.8	2.0	(2.0)	2.0	(2.0)
Gross fixed capital formation	-1.2	13.1	6.0	(6.0)	4.5	(4.5)
Exports of goods and services	4.1	2.9	4.5	(4.5)	4.0	(4.0)
Imports of goods and services	5.3	3.5	5.0	(5.0)	4.0	(4.0)
Consumer price growth, %	0.1	3.4	3.0	(3.0)	2.5	(2.5)
Unemployment rate, % [2/]	6.8	5.8	6.2	(7.0)	6.3	(7.2)
Change in employment, % [2/]	0.6	2.2	0.5	(0.0)	0.3	(0.2)
Gross monthly wage growth, %	7.6	6.5	6.0	(6.0)	5.5	(5.5)
Nominal GDP, billion euro	21.1	23.0	24.8	(24.7)	26.4	(26.3)
Exports of goods and services (nominal), % growth	4.2	7.1	8.3	(8.3)	6.6	(6.6)
Imports of goods and services (nominal), % growth	4.4	6.4	7.7	(8.4)	6.6	(6.6)
Balance of goods and services, % of GDP	3.9	4.5	4.4	(4.0)	4.4	(4.0)
Current account balance, % of GDP	1.9	3.2	2.8	(2.4)	2.7	(2.2)
Current and capital account balance, % of GDP	4.9	7.2	6.7	(5.8)	6.3	(5.4)
FDI inflow, % of GDP	3.2	2.7	3.0	(3.0)	3.0	(3.0)
General government budget balance, % of GDP [3/]	-0.3	-0.3	-0.3	(-0.3)	-0.3	(-0.3)
General government debt, % of GDP [3/]	9.4	9.0	8.6	(8.6)	8.5	(8.5)

[1/] Previous forecast in parenthesis
[2/] According to Labour Force Survey
[3/] According to Maastricht definition

Sources: Swedbank Research & national statistics

LATVIA: Key economic indicators, 2016–2019 [1/]

	2016	2017	2018F		2019F	
Real GDP growth, %	2.2	4.5	3.0	(4.2)	3.2	(3.2)
Household consumption	3.3	5.1	6.0	(6.0)	5.0	(5.0)
Government consumption	2.7	4.1	3.0	(3.0)	3.0	(3.0)
Gross fixed capital formation	-15.0	16.0	12.0	(15.0)	11.5	(10.0)
Exports of goods and services	4.1	4.4	3.0	(4.5)	3.5	(4.0)
Imports of goods and services	4.5	9.2	7.2	(7.6)	6.6	(7.0)
Consumer price growth, %	0.1	2.9	3.3	(3.7)	2.5	(2.5)
Unemployment rate, % [2/]	9.6	8.7	8.1	(8.1)	7.5	(7.5)
Change in employment, % [2/]	-0.3	0.2	0.1	(0.0)	0.1	(-0.3)
Gross monthly wage growth, %	5.0	7.9	9.0	(9.0)	7.0	(7.0)
Nominal GDP, billion euro	24.9	26.9	28.7	(29.0)	30.5	(30.9)
Exports of goods and services (nominal), % growth	1.9	8.5	5.6	(6.6)	5.3	(5.8)
Imports of goods and services (nominal), % growth	-0.5	12.6	8.8	(9.2)	8.2	(8.6)
Balance of goods and services, % of GDP	0.9	-1.3	-3.2	(-3.2)	-4.9	(-4.9)
Current account balance, % of GDP	1.4	-0.8	-2.5	(-2.6)	-4.2	(-4.3)
Current and capital account balance, % of GDP	2.4	0.0	-0.2	(-0.3)	-1.6	(-1.7)
FDI inflow, % of GDP	0.9	3.7	2.3	(2.6)	2.1	(2.4)
General government budget balance, % of GDP [3/]	0.0	-0.9	-1.0	(-0.8)	-0.9	(-0.8)
General government debt, % of GDP [3/]	40.5	37.8	34.8	(35.4)	34.1	(33.7)

[1/] Previous forecast in parenthesis
[2/] According to Labour Force Survey
[3/] According to Maastricht definition

Sources: Swedbank Research & national statistics

LITHUANIA: Key economic indicators, 2016–2019 [1/]

	2016	2017	2018F		2019F	
Real GDP growth, %	2.3	3.8	3.2	(3.2)	2.5	(2.5)
Household consumption	4.9	3.9	3.8	(3.8)	3.5	(3.5)
Government consumption	1.3	1.2	1.5	(1.5)	1.0	(1.0)
Gross fixed capital formation	-0.5	7.3	9.0	(9.0)	7.0	(7.0)
Exports of goods and services	3.5	13.2	5.0	(5.0)	3.0	(3.0)
Imports of goods and services	3.5	12.8	6.5	(6.5)	4.0	(4.0)
Consumer price growth, %	0.9	3.7	3.0	(3.3)	2.5	(2.5)
Unemployment rate, % [2/]	7.9	7.1	6.9	(6.9)	6.9	(6.9)
Change in employment, % [2/]	2.0	-0.4	-0.3	(-0.3)	-0.3	(-0.3)
Gross monthly wage growth, %	8.4	8.5	7.5	(7.0)	6.0	(6.0)
Nominal GDP, billion euro	38.7	41.9	44.9	(44.7)	47.3	(47.1)
Exports of goods and services (nominal), % growth	1.4	18.2	8.0	(8.0)	5.0	(5.0)
Imports of goods and services (nominal), % growth	-1.0	17.3	10.0	(10.0)	6.0	(6.0)
Balance of goods and services, % of GDP	1.2	1.7	0.2	(0.2)	-0.6	(-0.6)
Current account balance, % of GDP	-1.1	0.6	-0.9	(-0.9)	-1.2	(-1.2)
Current and capital account balance, % of GDP	0.4	1.8	0.9	(0.9)	0.7	(0.7)
FDI inflow, % of GDP	2.2	1.5	1.5	(1.5)	1.5	(1.5)
General government budget balance, % of GDP [3/]	0.3	0.1	0.5	(0.5)	0.2	(0.2)
General government debt, % of GDP [3/]	40.1	41.1	36.5	(36.5)	36.7	(36.8)

[1/] Previous forecast in parenthesis
[2/] According to Labour Force Survey
[3/] According to Maastricht definition

Sources: Swedbank Research & national statistics

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