Research Reports

Short-term relief but long-term risks in a fragile world

Nordic Outlook

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SEB

Contents

Fragile economy
Handle with care

Almost hysterical recession worries last summer faded during autumn amid a new wave of global monetary stimulus – with the US in the driver's seat. A growing number of small rebounds in forward-looking indicators helped fuel 30 per cent stock market upturns. Now that we have entered the 2020s, the question is: *Genuine rebounds, or "dead cat bounce"?* This *Nordic Outlook* examines both the problems and potential solutions.

Like our climate-stressed planet, the world economy is in a precarious state. Political risks are record-high. The global slowdown of 2018-2019 was caused by a mix of cyclical and structural forces, and this does not make it any easier for decision makers to strike an optimal balance in their economic policies.

Central banks in most advanced economies have very limited manoeuvring room. But "lowflation" gives central banks, especially in emerging market (EM) economies, good potential for continued expansionary monetary policies, thus helping to sustain GDP growth. Unconventional monetary policy has some drawbacks, though – such as its impact on risk-taking and pension systems. Its effectiveness is also questionable. In today's low interest rate environment, opinion leaders are also asking to what extent fiscal stimulus measures and budget deficits can – and should – play a role in stabilisation policy and in addressing climate change.

Increased confidence will boost the momentum of global growth in 2020-2021. But the economy is fragile – due to record-high asset prices and debts, as well as constraints on growth as unemployment shrinks to a 40-year low in advanced economies. And the future is far from predictable when it comes to security policies, Brexit, trade agreements, presidential elections and renovated monetary policy frameworks. If economists' analyses about neutral interest rates and inflation prove incorrect, a lot can go wrong in the 2020s.

The first *Nordic Outlook* of the new decade scrutinises positive forward-looking indicators, in light of various risks and expectations about economic policies and financial variables. You will find our overall assessment in this issue, including four in-depth theme articles:

- Fiscal policy
- A world full of debt
- Share valuations
- Energy transition

We hope that this February 2020 *Nordic Outlook* will provide you with both enjoyable reading and new insights. And don't forget that according to research, optimists live about 10 per cent longer than pessimists!

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The global economy

The United States

3.5%

US unemployment is parked at a 50-year low. In the absence of a clear acceleration in hourly earnings and inflation, the Federal Reserve is continuing to test the tightness of the labour market.

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The euro area

46.3

The December purchasing managers' index for the euro area's manufacturing sector was far below the growth threshold of 50. Industrial activity remains sluggish, and production is unlikely to rebound until spring.

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China

USD 200 bn

The increase in China's imports of US goods and services under the new Phase 1 trade agreement. A doubling of its imports of US farm products will require challenging shifts in current trade patterns.

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Japan

2.2%

Japan's unemployment rate stands out, compared to other advanced economies. Strong demand and well as an ageing population are among the reasons behind the low jobless rate.

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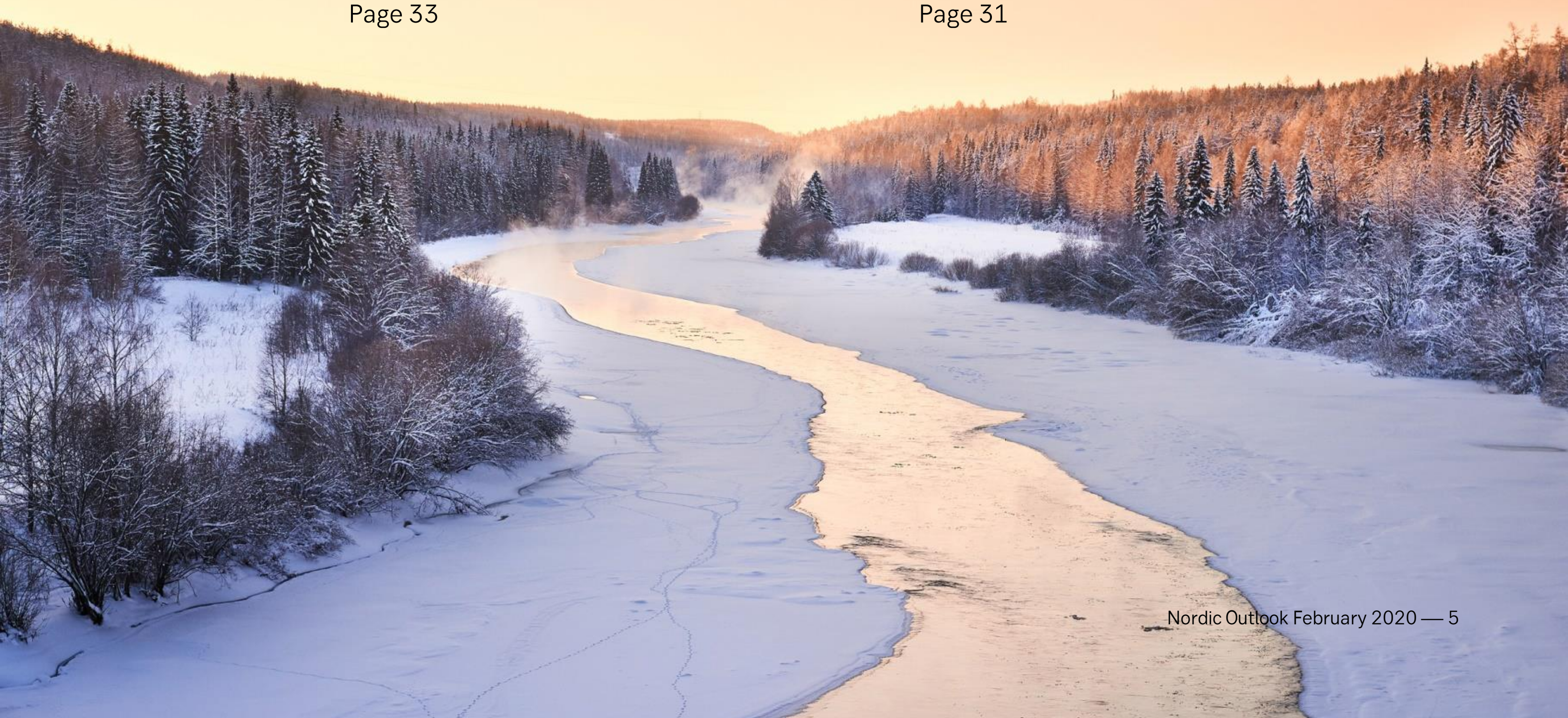


The world economy has emerged from last year's manufacturing slump. Growth is accelerating cautiously, slowed by lingering political uncertainty and supply-side constraints. Central bank signals of low key rates for a long period will provide support but also raise questions about long-term risks of debt build-up and spiralling asset prices. Although fiscal stimulus can play a larger role, rigid rules and weak government finances pose obstacles.

The economic forecasting challenges of early 2020 are, in some ways, diametrically opposite to those of a year ago. Concerns in early 2019 about a tightening of US monetary policy were followed late in the summer by recession worries due to a collapse in Treasury bond yields that led to a negative slope in the US yield curve. This curve is viewed by many as a reliable recession indicator. During the autumn, optimism and risk appetite gradually improved in financial markets. The Federal Reserve's "mid-cycle" correction by means of three key interest rate cuts in 2019 was favourably received, while trade risks decreased due to progress in US-Chinese trade negotiations. Manufacturing activity is showing signs of bottoming out, while domestic demand has remained resilient in most countries.

Global GDP growth
Year-on-year percentage growth

	2018	2019	2020	2021
United States	2.9	2.3	1.8	1.9
Japan	0.3	1.2	0.9	0.6
Germany	1.5	0.6	0.7	1.0
China	6.6	6.1	5.7	5.9
United Kingdom	1.3	1.3	1.0	1.1
Euro area	1.9	1.2	1.0	1.2
Nordic countries	1.9	1.5	2.0	1.7
Baltic countries	4.2	3.4	2.2	2.5
OECD	2.3	1.7	1.6	1.7
Emerging markets	4.7	4.0	4.2	4.5
World, PPP	3.6	3.0	3.1	3.3

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

GDP growth bottoming out in 2019-2020. The sharp fluctuations in the mood of financial markets this past year have generally not coincided with forecasts of the real economy. Downward adjustments in the course of 2019 have been relatively small. Nor have recent signs of recovery discernible among manufacturers in general and depressed sectors like the auto and tech industries in particular led to any significant upward revisions in GDP forecasts. Global GDP growth appears to have bottomed out in 2019 and will now accelerate a bit to 3.1 per cent in 2020 and 3.3 per cent in 2021, mainly due to a recovery in emerging market (EM) economies.

Continued political question marks. The uncertainty factors that have inhibited growth in varying degrees over the past few years are likely to persist in 2020 and 2021. The tensions between the United States and China are based on complex factors, and this past month's drama in US-Iran relations accentuates the latent highly inflammable situation in the Middle East. Negotiations on future relations between the European Union and the United Kingdom will also be complex and prolonged, and this will continue to hamper economic activity – especially in the UK. But at the same time, the actors involved in all these tense encounters have powerful reasons for avoiding escalation. They are thus unlikely to be the main cause of a new recession.

Plenty of manoeuvring room for central banks. When the risks from a demand-driven recession – caused, for example, by the secondary effects of a manufacturing downturn or trade dispute – diminish, this focuses even more attention on questions about supply-side growth potential. Despite historically low unemployment, wage and salary increases remain subdued, contributing to an inflation environment that is giving central banks big opportunities to continue supporting their economies. Changes in policy frameworks and signals from leading central banks that they are prepared to accept some inflation overshooting, after a long period of below-target inflation rates, are helping to create further room for action. Given such clear central bank signals, there is little space for variations in forecasts. The main question, which this issue of *Nordic Outlook* analyses in several theme articles and boxes, is instead: How big are the long-term risks of a continued expansionary monetary policy that may lead, for example, to debt build-up and spiralling asset prices?

Steeper yield curves. Central bank signals of an extended pause in policy changes have helped to stabilise bond yields a bit above their previous lows. In the prevailing low inflation environment, central bank reaction functions are asymmetric. In other words, rate cuts are closer at hand than rate hikes. This pushes short-term yields lower, leading to steeper yield curves. We expect another Fed key rate cut in September 2020, contributing to a temporary downturn in 10-year

Treasury yields, which will then gradually climb slightly above 2.00 per cent by the end of 2021. We expect the ECB to abstain from further rate cuts. Meanwhile its re-started QE programme is putting a cap on the upturn in German government bond yields, which will reach just above 0 per cent by year-end 2021.

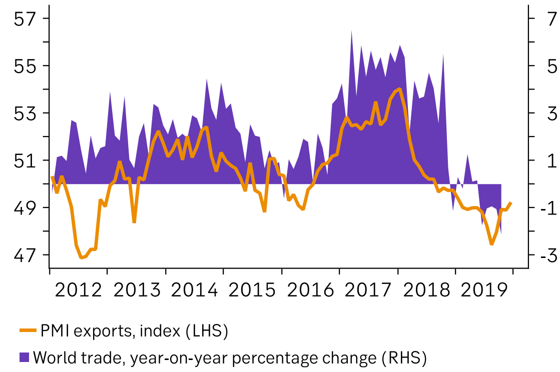
Positive risk sentiment will weaken the US dollar. Risk appetite dominated the foreign exchange market last year, benefiting defensive currencies like the US dollar for most of 2019. Due to positive global growth signals and progress in US-Chinese trade talks, these USD-positive drivers are fading. The USD is overvalued in the long term, which will contribute to its expected depreciation. The EUR/USD exchange rate will gradually climb to 1.20 by the end of 2021. The Riksbank's key rate hike to zero has removed another negative factor for the Swedish krona, which is undervalued in the long term and should strengthen somewhat in a gradually more positive global environment. The EUR/SEK rate will be around 10 by the end of 2021. Diminishing worries about global economic growth, combined with a high key rate in international terms, will support the Norwegian krone. The EUR/NOK rate will reach 9.70 by the end of 2021.

Slightly higher stock markets. A minor acceleration in growth and ultra-low bond yields will help to sustain the prevailing high share valuations. Our main scenario is slightly positive returns, with good performance for both cyclical industrials and structurally favoured growth companies in digitisation and sustainability.

Less, but still high, uncertainty about trade

Global trade remains weak, but as some of the uncertainty about trade policies fades and the auto and telecom sectors recover, we expect trade volume to grow by about 2 per cent both in 2020 and 2021.

World trade remains weak

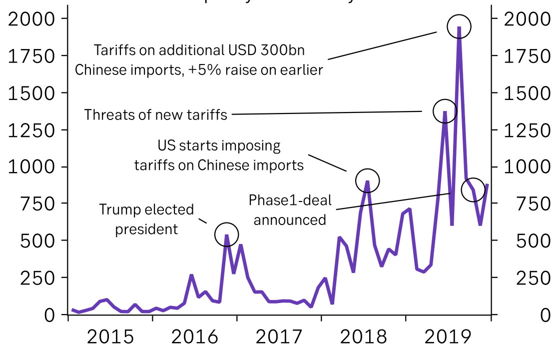


Source: Netherlands Bureau for Economic Policy Analysis (CPB), IHS Markit, Macrobond

Both positive and negative trade policy trends. Now that the US and China have signed their Phase 1 trade agreement and have said they will continue to negotiate, uncertainty has eased. Due to next autumn's US presidential election, the White House is probably less willing to go through new trade conflicts. In addition, the ten ASEAN countries of South East Asia plus Australia, Japan, China, South Korea and New Zealand are expected to agree on a trade pact later this year; the 15 countries are also giving India a chance to join later. This would make it the world's largest such pact, including economies accounting for 33 per cent of global GDP. In 2019 several other trade agreements were reached: between the US and Japan, the EU and several South American countries, the EU and Japan and between nearly all African countries.

US: Trade fears calmed during fall

Trade policy uncertainty index



Source: Economic Policy Uncertainty, Macrobond, SEB

Various sources of concern unfortunately remain. US trade policy is highly unpredictable, with a major risk that already signed agreements may be broken. The US-China relationship is many-facetted and complex. For example, we believe it is rather improbable that a Phase 2 agreement will be signed during 2020. Phase 1 requires China to boost its imports of US goods (including farm products) by USD 200 billion over a two-year period, which is likely to cause China problems in its relations with other countries. The EU must now avoid trade conflicts with the US and reach a new trade agreement with the British in only 11 months, which is likely to be difficult. The World Trade Organisation, which has been handicapped since the Dispute Settlement Body lost its quorum in December 2019, needs to be fixed. At best, the WTO ministerial conference in Kazakhstan this June can approve necessary reforms of the WTO.

Increased support for a US soft landing

The deceleration in the American economy was milder than expected in the fourth quarter of 2019, and early 2020 has been dominated by continued optimism. This has reinforced the picture of an economy that is slowing but will avoid a recession. We are raising our GDP growth forecast for the US by one tenth of a point to 1.8 per cent in 2020 but leaving our 2021 forecast unchanged at 1.9 per cent. Although the US yield curve is no longer signalling a recession (long-term Treasury yields are higher than short-term ones) it is too early to sound the all-clear. Historically it has taken an average of 10 months after the curve inverted until a recession has begun, but the Fed's total strategy reversal has decreased the risk of policy mistakes of the kind that have historically triggered downturns. The economic boom has lasted for a record-long period in modern times, limiting upside potential. We nevertheless believe that the participation rate can continue climbing another couple of points higher and that unemployment will stabilise at around a historically low 3.5 per cent.

Stabilisation trend in the euro area. Manufacturing sentiment remains weak, and the latest PMI figure for the sector is well below the neutral 50 mark. Of the four largest euro zone countries, only in France are manufacturers expecting near-term expansion. The overall indicator situation has stabilised in recent months, although it is likely to take some time during 2020 before GDP growth figures slowly improve. The deceleration of recent years has been most apparent in Germany, largely due to the major role of manufacturing in its economy.

GDP growth, euro area
Year-on-year percentage change

	2018	2019	2020	2021
Germany	1.5	0.6	0.7	1.0
France	1.7	1.3	1.2	1.4
Italy	0.8	0.2	0,5	0.7
Spain	2.4	2.0	1.8	1.8
Euro area	1.9	1.2	1.1	1.2

Source: IMF, SEB

We expect some improvement in Germany, but the growth rate will be lower than we have been accustomed to. Meanwhile France and Spain will continue to grow faster than the euro area as a whole. Looking ahead, structural reforms in the labour market and other fields will probably help to improve growth potential in these two countries. Although protests against President Emmanuel Macron's reform agenda will continue in France, this agenda appears likely to gradually gain broader acceptance. Decreased trade risks and a brighter EM outlook will also help boost exports. GDP growth will continue to slow this year but will rebound to 1.2 per cent in 2021.

Lingering uncertainty about Brexit will hamper the UK economy. To some extent, the strong Tory majority in the newly elected House of Commons has reduced uncertainty about Brexit. The UK will leave the EU on January 31, followed by a period of intensive negotiations between the two sides on a trade agreement and other matters. During the 2020 transition period, in practice the UK will remain an EU member without political influence. As early as 2021, however, the intention is that the new agreement will govern UK-EU relations. Uncertainty about Brexit has held back UK business investments in recent years. As long as there is no agreement with the EU, investments are unlikely to recover. This is illustrated by UK purchasing managers' indices below 50 for all three major sectors. To date, households have been resilient, but a cooler labour market and a depressed savings ratio may hamper future consumption. In this situation, we expect GDP growth to fall from 1.3 per cent in 2019 to around 1 per cent in 2020 and 2021.

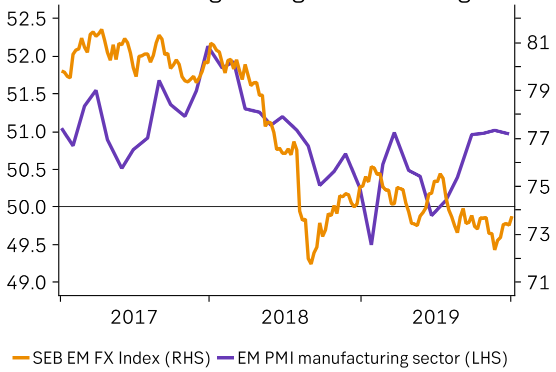
EM growth will accelerate

GDP increases during 2019 in the fast-growing EM market economies appear to have been the lowest since China's economic slump in 2015. GDP growth will gradually speed up to 4.2 per cent in 2020 and 4.5 per cent in 2021 but will be relatively weak in a historical perspective. Chinese growth will continue to decelerate this year, since Beijing is likely to remain restrictive about new stimulus measures. Its overall goal is to reduce financial risks by holding back credit growth. Only if GDP growth risks falling far below the target of around 6 per cent will the government resort to more powerful stimulus measures. The acceleration in the EM growth rate will be driven mainly by other large economies such as India, Russia, Brazil and Turkey.

Only if GDP growth risks falling far below 6 per cent will the government resort to more powerful stimulus measures

Higher inflation will hamper Europe's EM economies. Central and Eastern European economies such as Poland, Hungary and the Czech Republic look set to decelerate somewhat in 2020. To date, strong domestic consumption has made them resilient to the weakening of Germany's manufacturing sector. Looking ahead, however, rising inflation and shrinking fiscal manoeuvring room appear likely to pull down growth in the region. In Latin America, the picture is dominated by Brazil, which – after its deep crisis in 2015-2016 and major reforms – seems to be moving towards a gradual recovery. We also expect a stabilisation in Argentina, provided that the new administration of President Alberto Fernández will seek a negotiated solution to the unsustainable foreign debt that the country has assumed since 2016. Mexico's economy also appears likely to recover somewhat, helped by the new trade agreement with the US and Canada, after a weak 2019. But there is great uncertainty about developments in Chile after continued protests aimed primarily at President Sebastián Piñera, related to the country's wide income gaps and social injustices.

EM: Purchasing managers' indices higher



Source: IHS Markit, Macrobond, SEB

EM inflation will bottom out during 2020. Together with stable monetary policies in the US and the euro area, this will decrease the potential for further monetary easing in the EM sphere. The key interest rate cuts that were implemented in 2019 have not yet had their full effect, however, and are expected to be among the drivers of EM economic growth in 2020.

Escalation of US-Iran conflict can be avoided

A US drone strike in Iraq on January 3, 2020 that killed Qassem Suleimani, an Iranian general, has led to a significant escalation in the geopolitical risk level – including threats of full-scale war in the Middle East and higher global energy prices. But the restrained behaviour of both sides following this event suggests that the situation will not escalate into war. We believe President Trump does not wish to give up his America First strategy, which includes a desire for a reduced presence and involvement in conflicts that do not directly threaten the US. To Trump's core voters, it is an important principle that the US should not act as the world's policeman, for example by fighting wars in faraway countries. Although higher oil prices benefit US producers, they would hurt American voters who drive cars and thereby raise the political price for Trump.

Limited manoeuvring room for the Iranian regime. For its part, Iran has few incentives to be drawn into a war it cannot win, which would undermine its already weak and overextended government finances. Hatred at US involvement in the Middle East is widespread in the region, but Iran's religious leadership would have trouble taking advantage of this, since there is also strong discontent aimed at the Iranian regime – both externally and internally. There would be a very high risk of social and political unrest in Iran if the economy were weakened even further by a war. Higher oil prices would also hurt China, one of Iran's main supporters. We thus believe that escalation can be avoided. We expect oil prices to be relatively stable at around USD 70/barrel in 2020-2021.

China's role will increase over time. It is difficult to assess how US actions may be affected in the long term. Trump's promises to withdraw from the seemingly insoluble conflicts in the Middle East gave him important votes in 2016. But it will still be very hard for the US to reduce its presence in the region, due to both internal American conflicts of interest and pressure from allies like Saudi Arabia. Perhaps the US will come to be viewed as an increasingly unreliable, unpredictable actor, which may worsen the chances for future presidents to mediate and guarantee any peace agreements in the region. The vacuum that arises if the US eventually decreases its Middle East commitments will be filled by China and to some extent also Russia.

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

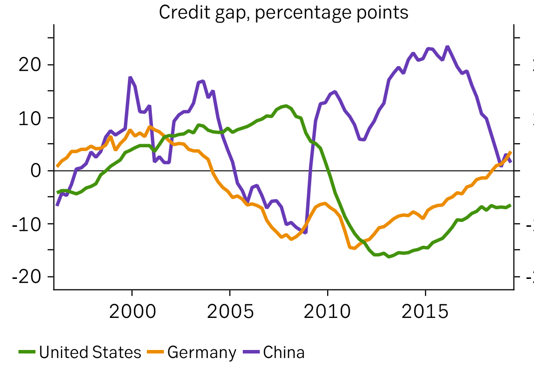
	2018	2019	2020	2021
China	6.6	6.1	5.7	5.9
India	7.4	5.1	6.0	6.5
Brazil	1.1	1.2	2.4	2.8
Russia	2.3	1.2	1.8	2.2
Emerging markets, total	4.7	4.0	4.2	4.5

Source: IMF, SEB

Should we worry about growing debts?

According to the Institute of International Finance, global debts set a new record late in 2019: about 300 per cent of global GDP, if we count both the public and the private sector (including the financial sector). We can discern ambivalence about rising debts both among decision makers and analysts/investors. This trend can be viewed as a natural consequence of exceptionally low interest rates and an economic policy that tries to encourage greater risk-taking. But a high debt level also increases vulnerability and has historically preceded economic downturns. In some countries, such as Sweden, authorities are introducing macroprudential measures that attempt to slow the increase in debt.

China is slowing its credit expansion
Credit gap, percentage points



Source: BIS

"Theme: A world full of debt" (see p. 16) focuses on corporate debts in China and the US as well as America's mounting national debt. Analyses of both the financial cycle and our current position in the credit cycle provide reassuring news about private sector debt in both the US and China. A solid low interest rate environment and central bank QE policies also strengthen the capacity of borrowers to manage historically high private debt. Yet we are finding ourselves in unknown territory. Many years of loose monetary policies may conceal forces that are not revealed until the financial system is exposed to stress.

Reassessing the pain threshold for public sector debt? The question of what is a suitable central government debt level has attracted even more attention this past year as worries about a weak underlying growth rate (secular stagnation) have been combined with an understanding of the weakened effectiveness of monetary policy and its shortage of ammunition (the liquidity trap). "Theme: Fiscal policy" on page 13 analyses to what extent fiscal policymakers can assume a larger role in stabilisation policy in response to central banks' calls for help. There are many arguments suggesting that this will be the case. The effectiveness of fiscal stimulus is amplified in a low interest rate environment. The debt burden also becomes less onerous when nominal interest rates appear likely to remain lower than nominal GDP growth. This frees up financial resources for welcome investments in infrastructure, climate-related projects and education. For example Christine Lagarde, the new ECB president and a former French finance minister, has quickly taken the lead in calling for fiscal stimulus measures. Philip Lane, the ECB chief economist, has also argued that his bank's promise of a lengthy period of loose monetary policy changes the playing field.

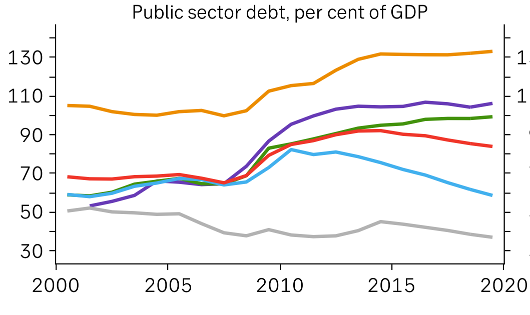
High deficits and falling interest burden
Per cent of GDP

	US	JPN	ITA	GER	SWE
Interest cost, 1995	6.2	3.3	11.1	3.5	5.1
Interest cost, 2018	4.0	1.5	3.7	0.9	0.5
Budget balance, 2018	-5.7	-3.2	-2.2	1.9	0.8

Source: Macrobond

Limited stimulus dose after all. Meanwhile, partly due to various opposing forces and arguments, the yearly dose of stimulus in 2020-2021 is not expected to exceed 0.5 per cent of GDP. In the US, federal budget deficits and the national debt are already high, and Congress will probably be dominated by inherent gridlock. Given weak government finances in Italy and France, the regulations in the Maastricht Treaty impose significant limitations on fiscal stimulus in the euro area, even though enforcement has become a bit more lax. The tight resource situation, including historically low unemployment, is another argument which cautious governments – in Germany and elsewhere – can cite in opposing public sector investments. Other calls for caution are also beginning to be heard. Kenneth Rogoff, a former IMF chief economist, warns against taking low interest rates for granted. He maintains that fast-growing government debts, regardless of the level of interest rates and growth, have always ended in crisis.

Divergent debt trends
Public sector debt, per cent of GDP



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

Still quiet on the Phillips curve front

Labour markets continue to be resilient to the slowdown in GDP growth. Although unemployment is showing levelling-off tendencies, it has continued to fall in the OECD countries as a whole. This is one important reason why domestic consumption has remained steady as industrial activity has weakened, but the flip side is that this reflects continued anaemic productivity growth, which will hamper potential long-term growth. Wages have moved slowly higher in many countries, but in the US and Japan they have recently lost some of their momentum. Their 2-3 per cent rate of increase currently poses no threat to inflation targets. Our forecast means that unemployment has now bottomed out and can be expected to remain rather stable at close to current levels over the next couple of years. The Phillips correlation between unemployment and wages/prices could thus not be tested much harder than has already occurred. But we should recall that historically, it has been very unusual for unemployment to stand still for such a long time in Western advanced economies.

We should recall that historically, it has been very unusual for unemployment to stand still for such a long time

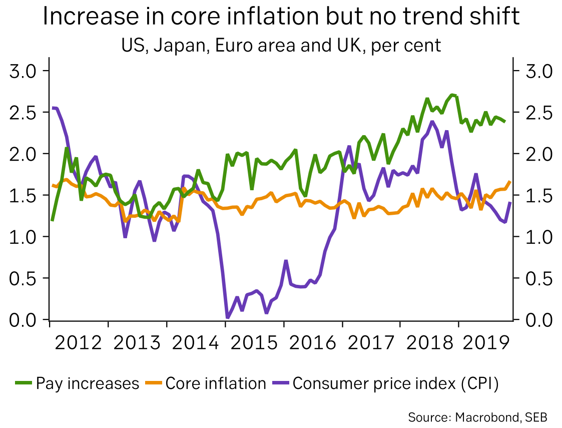
The "lowflation" environment will persist. Other factors also suggest a continued restrained inflation rate. World market prices for consumer goods are showing no general signs of acceleration. African Swine Fever has led to rising food prices in China and some secondary effects in neighbouring countries. There are signs that Europe may also be affected, but generally speaking the world market prices for farm products have not increased especially much. Taken together, this means we do not believe that the recent cautious upturn in core inflation in the US and the euro area is the beginning of any new trend.

Unemployment at a 38-year low
Per cent of labour force in OECD countries

Source: OECD (Organisation for Economic Co-operation & Development), Macrobond, SEB

Fed inflation benchmark will remain below target. In the US, core inflation reached 2.3 per cent during the second half of 2019. We expect CPI inflation to fall this year to 2.0 per cent, followed by a slight uptick in

2021. However, the Fed focuses on the personal consumption expenditures deflator (PCE), which most recently stood at a low 1.6 per cent. The gap between these two metrics has been historically wide for a long time. This is primarily due to relatively fast-increasing rents, which carry nearly twice as large a weight in core CPI as in core PCE. We believe that this gap will largely persist. Core PCE is not expected to go higher than 1.8 per cent by the end of 2021. It will thus fall short of the Fed's inflation target throughout our forecast period.



Greater focus on the risks of negative rates

Central bank monetary policies remain challenged by downward pressure on neutral interest rates due to surplus savings and low investment propensity. In many EM economies, mainly in Asia, there is still room to ease monetary policy during 2020-2021, given fading inflation pressure. But for most European central banks and for Japan, interest rate cuts are virtually impossible. Instead there is an increasing focus on the risks of zero or negative rates. The Riksbank's December 2019 decision to end negative key rates in Sweden can be interpreted as an indirect "confession" of the risks and drawbacks of negative rates.

Central bank key interest rates

Per cent	Jan 15	Jun 2020	Dec 2020	Dec 2021
Federal Reserve (Fed)	1.75	1.75	1.50	1.50
ECB (deposit rate)	-0.50	-0.50	-0.50	-0.50
Bank of England (BoE)	0.75	0.50	0.50	0.50
Bank of Japan (BoJ)	-0.10	-0.10	-0.10	-0.10
Riksbank (Sweden)	-0.00	-0.00	-0.00	-0.00
Norges Bank (Norway)	1.50	1.50	1.50	1.50

Source: Central banks, SEB

Cautious tinkering with monetary policy frameworks. The Fed's ongoing policy review will be completed by mid-2020, while the ECB is now beginning the task of evaluating its policy objectives and tools. No big revolutions are likely; instead there will be more emphasis on easing inflation targets a bit. For example, the Fed is likely to aim for inflation "averaging 2 per cent", meaning that a period of inflation below 2 per cent may be followed by a period above 2 per cent (a "make-up strategy"). We believe the ECB will revise its target in a more symmetric direction compared to the current "below but close to 2 per cent". The Fed and ECB are expected to confirm that unconventional tools like asset purchases and clear guidance about future policy should now be regarded as normal policy tools.

Minor adjustments in key interest rates. With regard to the practical consequences for interest rate policy, the above discussion leads in two different directions. On the one hand, a greater understanding of the drawbacks of extreme monetary policy strategies implies that the threshold for further stimulus measures has been raised, for example in the euro area and in Sweden, which at best can be offset by slightly more active fiscal policy measures. On the other hand, framework revisions that make central banks more flexible about accepting higher inflation also imply that the threshold for key rate hikes will be raised. These changes are among the reasons why we believe there will be only very minor interest rate policy changes in advanced economies over the next couple of years. Fed rate hikes appear distant, and we believe that the US central bank will instead deliver another rate cut in September 2020 when low inflation pressure and framework reforms allow manoeuvring room. Because of a sizeable downward adjustment in the UK growth outlook, the Bank of England will probably shift its strategy and deliver a rate cut in May. However, we expect the Bank of Japan and the ECB to leave their key rates unchanged. The ECB will retain a dovish bias; if anything new needs to be done, a rate cut is more likely than larger asset purchases.

GDP growth, the Nordics
Year-on-year percentage change

	2018	2019	2020	2021
Sweden	2.2	1.1	1.1	1.7
Norway	1.3	2.3	3.6	2.1
Denmark	2.4	2.1	1.8	1.5
Finland	1.7	1.6	1.5	1.5

Source: IMF, SEB

Key interest rate pause in the Nordics, too. Last year the Swedish economy was also pulled into the global slump. Growth decelerated to well below trend. Despite a cooler economy and labour market, the Riksbank hiked its repo rate to zero in December 2019. The bank is now signalling a lengthy pause at zero, and the bar for both lowering and raising its key rate will be high. We believe that the repo rate will remain unchanged during our forecast period, but low inflation still suggests that new stimulus measures are more likely than new moves towards interest rate normalisation. Bond shortages will limit the Riksbank's ability to stimulate the economy via asset purchases, but this may change in case of a deeper downturn situation and increased government borrowing requirements. The positive impulses from the oil and gas sector to Norway's mainland economy are now fading, and growth is decelerating towards its long-term trend. Norges Bank has shifted after a final rate hike last September to a relatively neutral stance. Decreasing risks to financial stability, among other things due to regulations, have also reduced the need for further monetary tightening. However, due to continued high resource utilisation and inflation close to target, Norges Bank is still unlikely to cut its key rate. We believe that Norway's key rate will stay at 1.50 per cent until the end of our forecast period.

Deceptive risks in unfamiliar waters

Although it is too early to relax, the secondary effects of the manufacturing slump appear likely to be limited. This follows the pattern of recent decades, when manufacturing downturns have not had the power to trigger broad recessions. It seems to require some form of economic policy tightening or financial market shock to do so. In this situation, international organisations seem to be setting the tone – with forecasts that imply a recovery in 2020 and 2021, but with a global growth rate below the average of recent decades. This may be justified by the fact that many EM economies have reached such a high level of development that they find it difficult to maintain their earlier high trend growth. In addition, advanced economies are experiencing supply-side restrictions due to unemployment levels that are at their lowest in 40-50 years, and in many cases below earlier estimates of equilibrium unemployment. The jobless rate will remain stable at low levels during the next couple of years.

Soft landings are historically unusual. Such a forecasting approach is appropriately modest in a situation where it is difficult to credibly single out specific triggers that will cause the economy to collapse. Meanwhile such a forecast has history against it, because in modern times the economies of North America and Western Europe have never seen a soft landing during a similar period of long-lasting low unemployment. It is thus important to consider the risk picture and how the record-long economic expansion that we are now experiencing might end.

Potential for creeping financial market excesses. The Fed's 180-degree turnabout to rate cuts during 2019, combined with signals and promises of long-lasting highly expansionary monetary policies by other central banks, have entrenched an image of generally very low interest rates and yields during the foreseeable future. This opens the way for a re-evaluation of reasonable equilibrium levels for asset prices, for example in the form of price-earnings (P/E) ratios in the stock market. In such an environment it is natural for asset prices to continue higher and for share prices to keep climbing faster than the underlying corporate earnings trend justifies. Meanwhile it is hard to anticipate all the consequences of such financial repricing, such as the level of political tensions due to widening gaps, the degree of demand stimulation via the wealth channel or the effects on pension systems. Spiralling asset prices always create vulnerability on the day when underlying conditions change, for example in the interest rate environment. History also shows that economists have a hard time predicting when such "regime changes" in underlying fundamentals will occur.

The Phillips curve may come back to life. The weakening of the association between price and wage formation and the labour market situation (the Phillips curve) has frequently been discussed in recent years. We can now see a trend towards slightly faster pay increases in many countries, but the level is still nothing that will threaten the low inflation environment. Yet it is slightly remarkable that there is a debate under way about further stimulus needs, among other things by loosening fiscal policy regulations. If the level of unemployment reaches a point where wages and salaries take off more dramatically, this could have major consequences. Although central banks do not need to slam on the brakes, but instead can tolerate some overshooting beyond their inflation targets, we may still end up in a volatile environment of squeezed profits and confusion about economic policy that may have a major negative impact.

Reinforcing effect from geopolitical tensions. Various forms of political uncertainty have been in the news this past year, yet their impact on financial markets has been limited and, above all, temporary. This also follows the historical pattern, in which the underlying economic cycle has normally played a dominant role. But the 1990-91 Gulf War and the 2001 attacks on the World Trade Center along with related conflicts occurred in an environment that was especially vulnerable due to "overripe" economic cycles, high debt levels and large sectoral imbalances. In such a situation these events were capable of triggering and/or reinforcing a broader economic slowdown, which may serve as a cautionary tale.

Balanced risks during our forecast period. We are sticking to our view that the risk picture during the next couple of years is rather balanced. In a slightly shorter perspective, downside risks are mainly connected to trade-related disappointments. There is also upside potential if manufacturing activity recovers faster than expected. An acceleration in the pace of productivity growth – for example due to technological advances – may also improve the supply-side outlook to a greater degree than implied by our main scenario. The risks discussed in this box mainly concern a somewhat longer perspective and will become increasingly relevant the more the economic cycle ages and the longer financial repricing progresses.

Theme:

Fiscal policy

With central banks calling for help, what can fiscal policymakers do?

As central banks exhaust their stimulus toolkit and the dark sides of low interest rate policy become clearer, the role and possibilities of fiscal policy are gaining in importance. This follow-up to “Theme: Negative rates” in *Nordic* Outlook, November 2019 looks at the world of fiscal policy and analyses the potential for a changed relationship between monetary and fiscal policy. There are signs that we may see more collaboration and a better policy mix – as central bank promises of low rates strengthen the effectiveness of fiscal policy – but the different roles of central bankers and politicians limit room for fiscal stimulus in a world of already high debt and strained resource utilisation in many countries.

From divided responsibility to more collaboration? To begin with, we should ask how the fundamental division of economic policy responsibility should look. One reason why central banks were given greater independence and inflation targets were introduced in the 1980s and 90s was that active fiscal policy had partly failed, especially in the 70s. It was plagued by timing problems; the effects of policy shifts often arrived too late. There was also a tendency towards gradually rising tax burdens and structurally fragile public finances. The new role allocation assigned to independent central banks the chief responsibility for stabilisation policy. Their main task – ensuring price stability – was gradually formulated as explicit inflation targets. Government fiscal policy would instead focus on structural issues, limiting its counter-cyclical role to automatic stabilisers built into tax and benefit systems. In European economies with relatively high tax burdens and ambitious welfare systems, automatic stabilisers are more effective than in the US, for example.

Can fiscal policy avoid historical mistakes? Monetary policy is now running low on ammunition and is probably also less effective than before, which also suggests a fiscal policy renaissance. But it is reasonable to ask whether fiscal policymakers are now better equipped to avoid old sins. Timing issues are also highly topical when considering expansionary fiscal policies today. Unemployment in advanced economies is at its lowest in 40-50 years, while government debt and budget

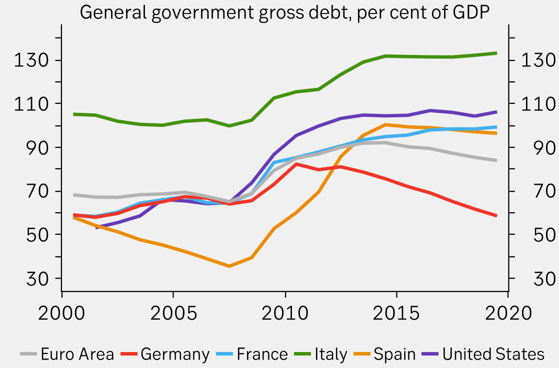
deficits are already high in many countries. Another question is to what extent a more formalised coordination of fiscal and monetary policies will affect central bank independence.

Risk of imbalance between monetary and fiscal policies. Central banks are calling for help at a time of high resource utilisation, which undoubtedly complicates the situation. One problem may be that central banks focus on narrow inflation targets while fiscal policymakers have a broader perspective. This is apparent in German and Swedish public discourse. In Germany, the government describes the economy as too strong for stimulus measures to be appropriate, as long as the outlook does not worsen. In Sweden, too, for years the government has described the economy as overheated. Considering how uncertain estimates of equilibrium unemployment and output gaps are, fiscal policymakers should also take the opportunity to stimulate the economy – as long as the risks of a damaging price and wage upturn appear very small. This would reduce tendencies towards over-utilising monetary policy and keeping fiscal policy too tight.

Important to separate structural and cyclical policy. Yet fiscal policymakers must take into account aspects other than inflation targets. Many actions now being discussed will have long-term structural consequences and cannot be reversed when the focus instead shifts to the need for tightening. For example, public investments that provide sufficient returns should be implemented regardless of the economic cycle. Some tax cuts may also have such a large positive supply-side impact that they even lower inflation. The fundamental purpose of fiscal stimulus thus cannot be to help central banks push inflation higher. But in practice, this dilemma should not be exaggerated. It is not difficult to find examples of structurally justified stimulus measures that clearly tend to boost demand and inflation, for example carefully selected tax cuts or investments in social services, infrastructure or sustainability.

Most countries at a new, higher debt level

General government gross debt, per cent of GDP



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

High debt level but light interest burden

Public sector debt in most countries has gradually increased in recent decades, limiting the manoeuvring room of fiscal policymakers. Despite decent GDP growth and falling unemployment, in many countries debt has become stuck at the high levels that resulted from the global financial crisis. Public debt in countries like the US, France and Italy is at or above 100 per cent of GDP, but there are exceptions like Germany and Sweden, where the debt ratio has fallen significantly. In the euro area as a whole, the debt ratio has also fallen..

Shrinking deficits and low interest burden. Looking at budget deficits, the picture is also mixed. In Western Europe the situation has improved. In the euro area as a whole, deficits are on a par with the lowest levels achieved since the euro was introduced in 1999, although some large countries like France, Italy and Spain are grappling with sizeable deficits. Due to exceptionally low interest rates and bond yields, however, most countries now have historically low interest expenses for their government debts.

High deficits and falling interest burden

Per cent of GDP

	US	JPN	ITA	GER	SWE
Interest cost, 1995	6.2	3.3	11.1	3.5	5.1
Interest cost, 2018	4.0	1.5	3.7	0.9	0.5
Budget balance, 2018	-5.7	-3.2	-2.2	1.9	0.8

Source: Macrobond

A high debt burden is never unproblematic. A low interest burden decreases the risk of an unsustainable debt dynamic, which is one important argument in favour of a fiscal policy renaissance. For example, it decreases risks of squeezing out other public spending, since it is reasonable to believe that interest rates will remain low in the foreseeable future (see "Theme: A world full of debt", p. 16). Yet there are potential risks and drawbacks related to high public debt levels, since politicians ultimately always face important prioritysations. Low public debt is a form of insurance against unexpected spending, such as for climate-related events. Burdens resulting from an ageing population – for example pensions, health care and social services are also hard to predict. Moderate government debt makes it easier to respond to unforeseen shocks, keep promises and meet expectations in ways that lower the risks of political instability. Central banks are currently promising low interest rates for a long time, but this is nothing that can be taken for granted. Many economies are also vulnerable to institutional changes, as efforts to resolve the euro crisis of the early 2010s demonstrated. The clumsy initial responses of the ECB and other EU institutions actually worsened market mistrust of crisis-hit countries and their chances of resolving their debt problems. When ECB President Mario Draghi launched his "whatever it takes" strategy, the pendulum swung in the other direction.

Divergent regional conditions

When discussing the potential for a global fiscal vitamin injection, Japan is an exceptional case. With government debt at 235 per cent of GDP, Japan needs consolidation measures such as the recent consumption tax hike but at the same time new stimulus packages are being launched. As for the US and Europe, there are several interesting differences. After the Trump administration's large-scale stimulus measures, culminating in 2017 and 2018, government finances in the US are generally far worse than in Europe. This does not prevent a spirited American debate on further stimulus measures, especially radical and revolutionary ideas that are part of modern monetary theory (MMT). The institutional situation is simpler in the US than in the euro area, and the dollar is still by far the world's most important reserve currency, which allows extra room for experimentation. If one of the left-wing Democratic candidates (Elizabeth Warren or especially Bernie Sanders) wins the presidential election, the subsequent flood of fiscal stimulus could be dramatic. But most indications are that Trump or one of the moderate Democratic candidates will win. Our main forecast is thus that post-election fiscal policy will be less expansionary than during Trump's first term.

European framework a straitjacket? Public discourse in Western Europe will be especially interesting to follow. But the question is to what extent the euro area is prepared to loosen its regulations. Less than a decade has passed since the existential euro crisis broke out. The crisis was perceived as being at least partly rooted in a lack of budget discipline. The main rules – which require national budget deficits of below 3 per cent of GDP, while public sector debt should not exceed 60 per cent of GDP – obviously limit fiscal manoeuvring room in France, Italy and Spain. In addition, there are self-imposed restrictions in Germany. Chancellor Angela Merkel's government has introduced a "schwarze Null" (balanced budget) rule, and the constitution only allows a federal deficit of 0.35 per cent of GDP.

Open to change. Despite these tight regulations, various openings to change have appeared – partly due to increased cooperation. For example Christina Lagarde, the new ECB President and a former French finance minister, has quickly taken the lead in calling for fiscal stimulus measures. Philip Lane, the ECB chief economist, has also argued in favour of the ECB's promise that a long period of loose monetary policy will make fiscal policy more effective. His reasoning is also consistent with OECD studies which show that the effectiveness of fiscal expansion increases if combined with measures that keep interest rates low, such as quantitative easing (QE) programmes. This conclusion is not especially surprising, since it is based on comparisons with traditional model runs and experiences where the response to budget stimulus is interest rate hikes that offset the initial stimulus effect. There are also political motives for easing EU regulations, which include countering populism. Measures that facilitate ongoing responses to climate change probably have the best chance of acceptance, even if they formally violate the deficit and debt regulations.

Significant trend reversals unlikely. On the whole, although we may see certain signs of fresh thinking – with the central banks' call for help perhaps leading to greater consensus and coordination – actual changes will be small over the next few years. Political gridlock and large deficits in the US play a major role here. In the euro area, there are signs of a thaw in some fields, and record-low budget deficits will provide a degree of freedom, while Brussels seems to be adopting a more flexible approach. We believe stimulus measures will not exceed 0.5 per cent of GDP per year, giving a limited contribution to growth. Sweden – with very strong government finances, acute spending needs in various fields and lower resource utilisation than most other countries – basically offers major potential for adoption of the ideas behind a fiscal policy renaissance. But the official budget framework and the government's 73-point budget agreement with two opposition parties will only allow a small dose of stimulus. The newly published final report of the Riksbank Committee pointed out that central banks, politicians and public authorities need to take into account how their own actions affect other areas, but these formulations were too vague to have any major practical consequences.

Can a German expansion get Europe moving?

Germany is the only large euro area country with a budget surplus. In 2018 it was record-high: nearly 2 per cent of GDP. Germany's debt ratio is falling towards 60 per cent of GDP. This situation has led to repeated calls for stimulus from the OECD, IMF and others.

How large an impact would a stimulus package have on Germany and the euro area? Let us ignore the restrictions imposed by EU regulations and assume a stimulus of 2 per cent of GDP spread over two years, in other words a dose of 1 per cent of GDP per year. The actual growth effect would depend on various factors, for example which taxes and expenditures would be changed. Most estimates indicate that the multiplier effect on GDP would be larger in case of expenditure changes than tax changes. The effect would also be larger the lower resource utilisation is at the outset.

Estimates by economic researchers and international organisations indicate that a stimulus dose equivalent to 1 per cent of GDP would boost German growth by about 0.5 per cent. Given Germany's 30 per cent weighting in the euro area, the direct effect on the overall area would be 0.15 per cent. There would also be indirect effects of about the same size, since greater German demand would stimulate exports from other euro area countries. Altogether, we would thus see a 0.3 per cent boost in euro zone GDP growth per year. If we also assume that this stimulus would take place in an environment without counter-reactions from monetary policymakers, but would instead be strengthened by a low interest rate environment, the effect might be larger and could approach 0.5 percentage points. This is a significant effect, but it would hardly change the overall picture of rather sluggish euro area growth.

Theme:

A world full of debt

Low interest rates and potential crises

World debt is record-high, but the debt situation is far from homogeneous. Meanwhile interest rates and bond yields are extremely low, boosting asset prices. Economists disagree on whether governments should take advantage of low rates to allow large budget deficits, and whether the US and Chinese corporate sectors may trigger a global debt crisis. Yet overall, our continued analyses of financial cycles are reassuring. Low interest rates give governments increased fiscal resources, too, but we are in uncharted territory. Years of loose monetary policy may now conceal forces that will only emerge when the system is exposed to stress.

According to the Institute of International Finance (IIF), global debt – public and private, including the financial sector – is expected to have set a new record of over USD 255 trillion at the end of 2019. That is equivalent to some 300 per cent of annual global GDP. Around 60 per cent of last year's increase came from the US and China. Since 2007, the year before the Lehman Brothers collapse, global debt as a share of GDP has increased dramatically: by some 40 percentage points.

This growing mountain of debt is a source of concern among investors, who fear that economic growth may collapse under its weight. Heavy debts increase vulnerability at national and global levels in case of a serious economic slowdown or interest rate shock, for example due to crises of confidence (see "Negative rates – The 'dark sides' of unconventional monetary policy" in the November 2019 *Nordic Outlook*).

Three main debt categories seem to cause concern among markets, economists and political leaders:
1. Rapidly growing US corporate debt,
2. US federal budget deficits of 4-5 per cent of GDP,
3. The credit situation of China's state-owned firms.

But low interest rates and yields also help reduce the costs of public sector debt, freeing up resources for infrastructure, climate and educational spending.

Permanently lower interest rates?

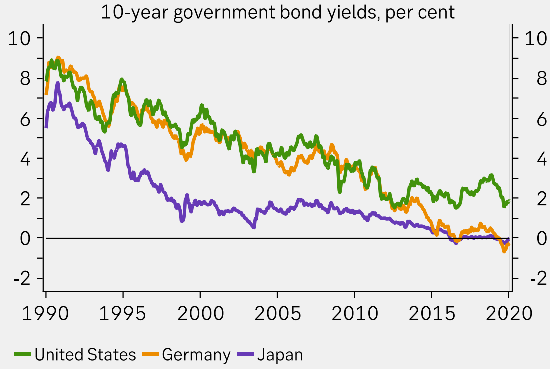
Interest rates play a key role when assessing whether debt levels are sustainable and reasonable. They also indicate whether governments have extra fiscal room to support growth when the monetary toolkit is empty – in order to reduce economic inequality and invest in reforms that will promote future economic growth. Economists seem to concur that if the real interest rate (r) can be expected to remain lower than real growth (g), the risk of unsustainable debt levels will be less.

Crucial: r - g < 0?

Global interest rates and yields have fallen for at least 30 years. Although central bank monetary policies have contributed to this trend, structural and thus permanent forces are obviously helping to drive the decline. Nominal rates are low partly due to lower inflation risk premiums, but there are also other structural drivers. Real interest rates are low for reasons that include an ageing population in many countries and growing savings surpluses that partly reflect a bigger appetite for safe investments. When a growing savings surplus is combined with weak productivity growth and a weak investment cycle, the neutral rate is pushed lower to find the rate that leads to an equilibrium for both savings and investments.

Three decades of falling long-term yields

10-year government bond yields, per cent



Source: Macrobond, SEB

Blanchard vs Rogoff in the debt debate

Olivier Blanchard and Kenneth Rogoff – both former chief economists at the International Monetary Fund (IMF) – are on a collision course in the debt crisis debate. Blanchard argues that low interest rates mean budget deficits and debts are less risky. Today's high debts are not good, but they are not disastrous either. If the world is suffering from demand-led stagnation, fiscal policy has a role to play. But he specially warns countries with public sector debts largely denominated in foreign currencies: currency depreciation may cause interest payments to climb rapidly. If public sector debt is in domestic currency, there is a greater degree of freedom, since the central bank can always buy these government securities by creating new bank reserves.

Rogoff, who for years has been warning the world about a debt crisis, emphasises that the size of the actual debt is being underestimated since the costs of an ageing population are not being factored in, and that the debt we measure today is only the tip of the iceberg. Rogoff argues that today's low interest rates reflect a fear of future problems and are temporary. He does not believe the world is suffering from a lasting shortage of demand, either. Instead, a shortage of production capacity is hampering growth. Inflation may thus rapidly resume, driving up interest rates.

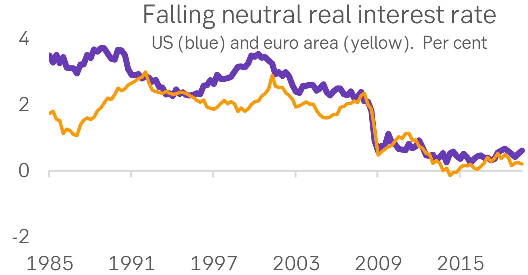
Blanchard and Rogoff agree on one point. If future real interest rates are sustainably lower than real growth, today's high public debts will become more manageable,[1] as indicated by an equilibrium analysis of 10-year US Treasury yields (see box).

Long-term US equilibrium rates

* Short-term real interest rate: According to the New York Fed's latest estimate, the global neutral interest rate is 0.5 per cent. It has fallen by 2 percentage points in the past 20 years. In much of the world, demography is expected to contribute to continued high savings ratios. Increased demand for capital - for example necessary climate-related investments – may push the real interest rate upward over the next couple of years, but our main thesis is that the interest rate will remain at today's level of 0.5 per cent or somewhat lower.

Falling neutral real interest rate

US (blue) and euro area (yellow). Per cent



* Inflation risk premium: Today the market is pricing the CPI inflation risk premium at about 2 per cent. Asymmetric risks suggest lower instead of higher inflation ahead, perhaps around 1.5 per cent, which has been the average core CPI in the OECD countries since 2000.
* Term premium: Large central bank holdings of fixed-income securities (which are currently growing) and market demand for safe/liquid assets (due to regulatory requirements etc.) are squeezing the term premium, which is -0.5 per cent today in the US. Since the Lehman Brothers collapse, the premium has averaged around zero. A premium in the 0-0.5 per cent range seems reasonable.

These three components indicate a long-term US yield of 0.5+1.5+0.5=2.5 per cent.

[1] See "Debt Is Not Free", IMF Working Paper WP/20/1, January 2020. The IMF's analysis shows, for example, that when public sector debt exceeds a certain level, debt crises often arise regardless of whether rates (r) have been lower than growth (g).

1. Rapidly growing US corporate debt

Since the Lehman Brothers crisis, US household debt has fallen by about 40 points as a percentage of GDP. Meanwhile corporate debt has increased by about 30 points to 170 per cent of GDP – the highest in 50 years.

Fed policy since 2008 has increased the risk that zombie companies will emerge and has increased investor risk-taking. At the same time, it is reasonable for corporate debt as a percentage of GDP to show an upward trend if interest rates are projected to be sustainably lower. Fed research[2] also shows that corporate earnings have increased since 2008, making it easier for companies to make interest and principal payments. Meanwhile the "zombie risk" among US companies seems to be lower than in other countries, since higher debt has not primarily gone towards inefficient/non-productive investments, but instead mainly for acquisitions of companies, share buy-backs and dividends. Despite reassuring factors, it is always wise to keep an eye on the pace of debt growth.

The US repo market showed signs of stress in September 2019, with sharply rising short-term rates, but this cannot be linked directly to growing American corporate risk exposure. According to research by the Bank for International Settlements[3], for example, the reasons were mainly structural problems rather than warning signs of an approaching debt crisis: the largest US banks prefer owning government securities to depositing liquidity with the Fed, and in today's more low-return environment, hedge funds are more dependent on funding via the repo market.

US federal government finances – forecast
Per cent of GDP and USD billion

	2020	2021	2022	2023
Budget balance, %	-5.5	-5.5	-5.6	-5.3
Deficit, USD bn	1,228	1,159	1,345	1,319
National debt, %	108	110	112	114

Source: IMF, SEB

2. Large US federal budget deficits

After the White House's large-scale tax reform in 2017, and due to the political situation in Congress, US federal finances are rapidly deteriorating. Among the G20 countries, only Japan (238) and Italy (133) have a higher national debt than the US as a percentage of GDP (see table).

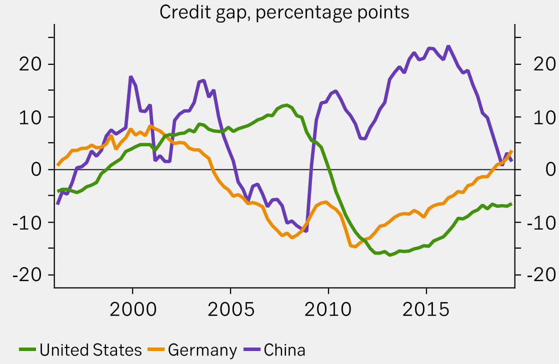
But the US is not facing an increased credit risk. If our thesis that US long-term yields may fluctuate around 2.5 per cent proves correct, neither the budget deficit nor the national debt is a problem as such (see above). However, there is a risk that the US political situation will lead to even larger budget deficits than we are projecting. Nor is the US Federal Reserve expected to divest its holdings of USD 2.329 trillion in government securities, which are three times larger than before the global recession and about USD 1.2 trillion more than should be normal for the Fed to own.

The BoJ and ECB are meanwhile continuing their quantitative easing. The world's three largest central banks – the Fed, Bank of Japan and European Central Bank – together buy USD 150 billion worth of securities a month (USD 1.8 trillion/year). With yields of around 2 per cent, US Treasuries are globally attractive, though central banks around the world would like to become less dependent on the US dollar as a reserve currency. But this is a lengthy process, and US Treasuries are still the market with the best depth and liquidity.

3. Indebted state-owned enterprises

Since the 2008-2009 recession, China has used credit expansion as a policy tool to maintain GDP growth of 6.5-7 per cent. In recent years Chinese companies, especially government-controlled ones, have taken advantage of cheap USD loans, expectations of yuan appreciation and the world's appetite for investing in the fast-growing Chinese economy.

China is slowing its credit expansion
Credit gap, percentage points



Source: BIC

China has successfully slowed its credit growth (see chart) to decrease risks in the financial system while preventing expansion in the shadow banking sector. This has slowed GDP growth. China's total debt as a share of GDP today is 310 per cent; Beijing now seems to be aiming at stabilising debt at this level.

More problem loans and increased corporate bankruptcies due to tighter credit and the trade war with the US are expected to challenge the Chinese banking system. Bankruptcies among companies and banks will become more common in China as credit risk increasingly shifts towards market pricing. China has meanwhile lowered its bank reserve requirement, but this should not be viewed as a desire to resume credit expansion; it is more a matter of replacing the loans that will disappear as shadow banks are forced to shut down their operations. Our conclusion is therefore that Beijing has an economic policy toolkit that is capable of responding to these risks.

[2] "Is There Too Much Business Debt?", Federal Reserve of New York, May 29, 2019.

[3] See "September stress in dollar repo markets: passing or structural?", *BIS Quarterly Review*, December 2019.

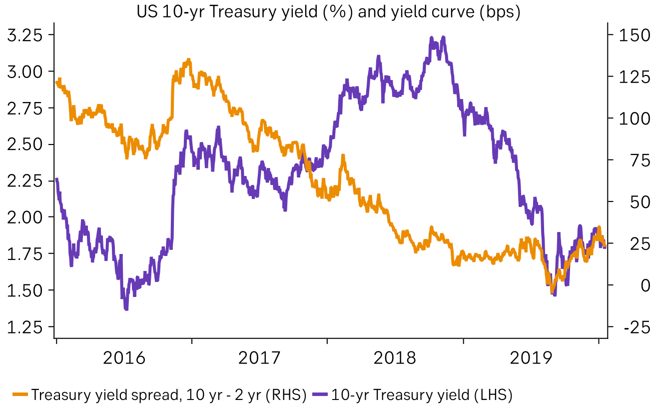
Fixed income

Uncertain direction as central banks pause

Global bond yields have consolidated at higher levels and volatility has fallen after sharp declines late summer. With central banks clearly signalling a lengthy pause in monetary policy action, long-term yields will mainly be affected by changes in risk appetite. The "lowflation" environment and its asymmetric risk picture are making central banks more inclined to cut key rates in a negative scenario than to hike them in a positive one, pushing down short-term yields and steepening the yield curve.

Rising long-term yields and steeper curve

US 10-yr Treasury yield (%) and yield curve (bps)



Source: Bloomberg, Macrobond, SEB

10-year government bond yields
Per cent

	Jan 15	Jun 2020	Dec 2020	Dec 2021
United States	1.79	2.00	1.80	2.20
Germany	-0.22	0.00	0.05	0.20
Sweden	0.15	0.50	0.60	0.75
Norway	1.41	1.50	1.50	1.60

Source: Central banks, SEB

Uncertain direction for long-term yields as central banks pause. After a volatile summer and early autumn, yields have consolidated at higher levels. US 10-year Treasuries have been largely unchanged at around 1.8 per cent since autumn, now that the Federal Reserve has paused after three key interest rate cuts. The Fed intends to leave its key rate unchanged at 1.50-1.75 per cent in 2020. The market has adjusted to Fed communication in the short term but is pricing in an 80 per cent probability of a 25 basis point (bps) cut late in 2020. Our adjusted Fed forecast, with a cut in September, is therefore close to market pricing and justifies no major yield movements. As a consequence, we have revised our long-term US yield forecast higher from the last *Nordic Outlook*; better risk sentiment will cause an upturn to 2.0 per cent this spring.

Asymmetric reaction function suggests continued downward pressure. Our assessment is that at present, the Fed is more inclined to cut its key rate in a negative scenario than to hike it given a more positive outcome. A "lowflation" environment, combined with below-target inflation, suggests that the upside for US yields is limited. We believe that 10-year US Treasury yields may again fall to 1.8 per cent next autumn. The slope of the US yield curve (the spread between 10- and 2-year yields) has continued to steepen and is about 25 bps today. Market worries about recession have thus diminished, but in a historical perspective the curve remains flat. Based on our assessment that the Fed's reaction function is asymmetric, we expect the curve to continue steepening in 2020.

Moving slowly towards a long-run level. Our 2020 forecast implies that the 10-year US Treasury yield will remain below the level we view as its long-run equilibrium. This equilibrium yield has fallen in recent decades. Based on our analysis of short-term real interest rates, inflation and term premiums, equilibrium yield is around 2.5 per cent or slightly lower (see "Theme: A world full of debt", p. 16). Despite our assessment that yields will rise somewhat in 2021, we do not believe they will reach this level by year-end.

Higher German yields in 2020. Like the Fed, most other central banks have signalled that they will probably keep key rates unchanged over the next couple of years. Already low key rates are constraining the European Central Bank and Sweden's Riksbank from pursuing more expansionary monetary policies, while more and more critical voices have been heard recently about negative interest rates and yields (see "Theme: Negative rates", *Nordic Outlook*, November 2019). New ECB President Chrstine Lagarde and others have called for more fiscal stimulus to ease the burden on monetary policymakers. But central banks continue to struggle with below-target inflation, and combined with a continued vulnerable economy the pressure on short-term rates should mainly be downward in 2020. This is supported by market pricing, which now indicates about a 0 per cent probability of key rate cuts during the next couple of years. The direction of long-term yields is more uncertain. Aside from risk appetite, it is connected to any new fiscal stimulus measures. We view the probability of a major expansion in European bond issuance volume in 2020 as low, but calls for green investments may still lead to some upward pressure on yields. As a consequence of the marginal revision in our ECB forecast, as well as increased risk of a bit more supply, we have adjusted our forecast of German 10-year government bond yields upward and now believe that they may climb towards 0 per cent towards the summer.

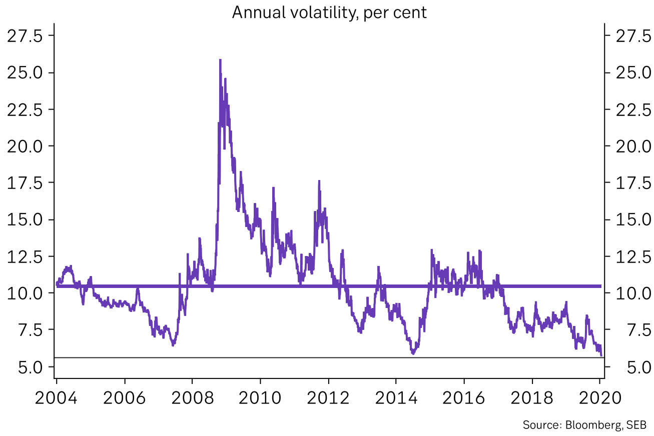
The spread between Swedish and German 10-year government bond yields has widened somewhat since the Riksbank's December rate hike but remains close to last year's average of about 35 bps. Assuming unchanged ECB and Riksbank monetary policies, a somewhat higher bond supply from Sweden's National Debt Office should exert a certain upward pressure on Swedish bond yields.

The FX market

Political uncertainty requires humility

During much of 2019, the FX market was mainly driven by the global growth outlook, trade worries and political uncertainty. This was beneficial to defensive currencies. But in the fourth quarter, sentiment shifted in response to positive growth signals and progress in US-Chinese trade talks, which partly reversed earlier currency movements. Our exchange rate forecasts assume that these positive drivers will continue to dominate developments over the next couple of years.

G10: Average implied FX volatility, 3M



Exchange rates

	Jan 15	Jun 2020	Dec 2020	Dec 2021
EUR/USD	1.12	1.15	1.17	1.20
USD/JPY	110	109	110	112
EUR/GBP	0.86	0.88	0.88	0.84
EUR/SEK	10.55	10.25	10.10	10.00
EUR/NOK	9.88	9.80	9.90	9.70

Source: Bloomberg, SEB

Varying drivers during 2019. During much of 2019, the FX market was mainly driven by the global growth outlook, trade worries and political uncertainty. This was beneficial to defensive currencies such as the US dollar. But in the fourth quarter, sentiment shifted in response to positive growth signals and progress in US-Chinese trade talks, which instead benefited many smaller currencies. Our exchange rate forecasts assume that these positive drivers will continue to dominate developments. Increased tensions between the US and Iran early in 2020 nevertheless had an immediate impact on exchange rates. At present, developments are hard to predict, but a substantial escalation of the crisis is hardly compatible with our exchange rate forecasts. Worth noting is that FX market volatility meanwhile continues to fall and is now at historically low levels. Shrinking central bank manoeuvring room and narrow interest rate spreads are probably contributing to this.

The dollar has trended higher for the past two years. The drivers have shifted from key interest rate hikes by the US Federal Reserve and wider rate spreads against other countries to weaker economic performance in the euro area and a general environment that has favoured defensive qualities. We expect these USD-positive drivers to fade during our forecast period, as further signs of stabilisation in global growth and in the euro area appear. In the long term, the dollar is still overvalued, which will also support the expected USD depreciation ahead. Our forecast for the EUR/USD exchange rate is 1.17 at the end of 2020 and 1.20 at the end of 2021.

The value of the pound has been determined for a long time by the risk of a no-deal withdrawal from the EU, which would have major consequences for the British economy. The outcome of the December 2019 election – a sizeable parliamentary majority for the ruling Tories – can be seen as a popular endorsement of Brexit and has resulted in greater political stability. Above all, it is now clear that the British will leave the EU in January with a transition agreement. But the transition period runs only until December 31, 2020, which will require a trade agreement with the EU to be in place before year-end. Otherwise there is a strong risk of a no-deal withdrawal and a significantly weaker pound. Unpredictable trade negotiations will thus continue to make our pound forecast highly uncertain. We expect the EUR/GBP rate to climb a bit to 0.88 during 2020, but the pound will then recover to 0.84 by the end of 2021.

Cautious Swedish krona appreciation during our forecast period. The Riksbank's December key rate hike to 0 per cent, which was expected, removed another SEK-negative factor. The krona's mainly negative trend during 2019 was in line with the movements of various other small currencies in response to global growth worries and political risks. Long term, the krona is undervalued. In a somewhat more positive international environment, like that of the final quarter of 2019, the krona should have room to strengthen during our forecast period. We expect a decline in the EUR/SEK rate to 10.10 during 2020; the rate will fall below 10.00 only in 2021.

Norwegian krone movements remain difficult to assess. In recent years the NOK has trended lower even though normal explanatory factors have pointed in the opposite direction. It is hard for us to find reasons to diverge from the consensus view that the NOK will appreciate, driven by such fundamentals as economic growth, interest rate spreads and the oil price outlook. We forecast that the EUR/NOK rate will stand at 9.90 by the end of 2020 and that pricing will be more in line with a reasonable long-term exchange rate of 9.70 by year-end 2021. Yet we are not convinced, and we suspect that flow-related factors are holding back NOK appreciation. For example, Norway has a trade deficit with other countries despite large export revenues related to the oil sector.

Theme:

Share valuations

Bond yields, sector allocation crucial to performance

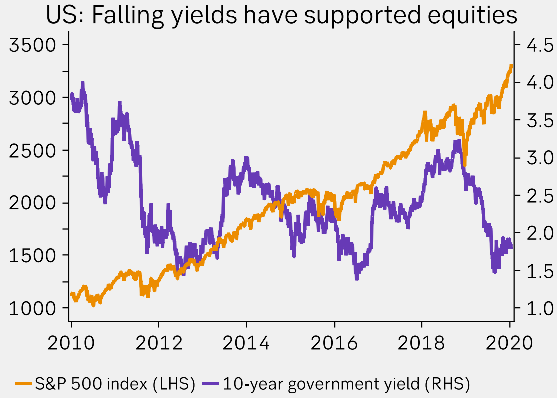
It is well-known and perhaps puzzling that stock markets have climbed at the same time as economic growth and corporate earnings forecasts have been lowered. With low earnings forecasts and historically high valuations, the burden of proof rests with optimists. Two questions are crucial for our future stock market strategy and positioning: Can already high valuations be defended and even improved? Which sectors stand out in valuation terms, and which have the best growth outlook? We believe valuations are reasonable, given our forecast of slightly accelerating growth at decent levels and continued ultra-low bond yields. Our main scenario foresees weak positive returns in 2020. At the sectoral level, low valuations of more cyclical industrials may pay off as recession worries fade. Among growth companies, beneficiaries may include those riding structural trends – digitisation and contributing to a more sustainable world. More stable companies look overvalued.

A good decade for equities ended with an outstanding stock market year, surpassed only by two years in this millennium (measured by the S&P 500). Stock markets have been sustained by uninterrupted, though relatively subdued, economic growth and almost constantly falling bond yields, helping valuations move from rock-bottom in the wake of the deep 2008-09 recession to peak levels today, in terms of price-earnings (P/E) ratios. It is natural for lower bond yields to trigger higher share valuations and thus rising stock market indices, as the return on safe alternative investments falls. Of course this is true provided that lower bond yields are expected to persist for a long time; we believe this to be the case (see the theme article on p. 16). The question is then how much higher share valuations can be justified. This depends, in turn, on the returns that shares can be expected to pay, based on earnings forecasts. Investors at least need to see that earnings are rising to accept higher valuations, otherwise a zero interest rate or yield may seem a reasonable alternative.

A decent earnings outlook. Earnings generation in listed companies cooled significantly last year. Compared to strong earnings in 2017 and 2018, when companies benefited from healthy global growth and earnings-boosting US tax cuts, global corporate earnings appear to have fallen somewhat in 2019. The biggest reversals occurred in emerging market (EM) companies, while US and European earnings appear to have been largely unchanged. This year, analysts are predicting an

increase of some 9-10 per cent in global corporate earnings: about the same estimate that has applied since these forecasts began to be produced more than a year ago. GDP forecasts for 2020 were gradually lowered as the economy decelerated last year. This implies that corporate earnings forecasts have room to fall – also illustrated by the fact that according to surveys, most equity strategists and portfolio managers expect substantially lower earnings increases, in the range of 3-5 per cent. We also belong to this camp. Such increases are below historical norms but are still decent figures. In light of this, how should we view today's historically high share valuations? If we exclude the extreme valuations during the IT (dotcom) bubble around the turn of the millennium, today's P/E ratios (based on official earnings estimates) of around 18-19 in the US and 16-17 globally are in line with earlier peaks. Although history does not always guide us correctly about the future, these levels still serve as a clear frame of reference for many investors. If economic growth should surprise us on the upside, and if earnings forecasts are revised higher, we foresee room for valuations to climb further, but such developments are not part of today's growth and earnings forecasts.

US: Falling yields have supported equities



Source: Macrobond Financial AB, S&P Dow Jones Indices

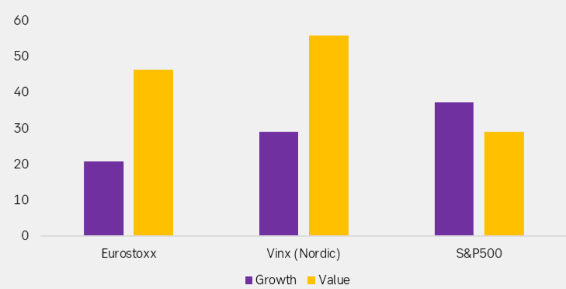
Potential for even higher valuations. Theoretical models (such as Gordon's) nevertheless show that justifiable P/E ratios climb sharply if long-term bond yields fall in tandem with long-term nominal GDP growth, and even more if yields fall more than growth. This presupposes that corporate profitability does not fall at the same pace as yields, which does not appear to have been the case during the downturn in yields and interest rates over the past few decades. Overall, this more than justifies today's P/E ratios. In order for higher P/E ratios than today's peak levels to be more permanently acceptable, however, investors must probably receive confirmation that return on equity will sustainably remain at healthy levels in an environment of subdued growth and low bond yields. Reality needs to provide support for these models.

Lack of alternatives. On the other hand, the acronym TINA (There Is No Alternative) is very much alive and goes a long way towards explaining last year's stock market upturns. When the risk-free alternative (government bonds) is free of returns, equities look more attractive. This is also supported by the fact that distributions by listed companies to their shareholders (dividends and share buy-backs) are around or above three per cent on most major stock exchanges. Ongoing returns on listed shares have exceeded bond yields in recent years, unlike in preceding decades. Put simply, making it rational to sell shares requires an expectation that their prices will fall, so that the shares can be repurchased more cheaply. Otherwise it is better to receive the ongoing returns from these shares. In recent years, this has also been apparent from the actions of portfolio managers. Although they have adjusted the proportion of equities in their portfolios somewhat – based on changes in their market views – changes within their shareholdings have seemed more dramatic and have included clear rotations between market segments (styles) and sectors.

Index structure determines geographic differences. In an increasingly globalised world, the domestic market and/or the geographic location of the head office plays a diminishing role in the performance of companies and thus stock markets. The clear difference we have seen in the performance of American and euro zone stock market indices is partly explained by higher US economic growth, but structural differences in stock markets have been of greater importance. One common way of dividing listed companies is between "Growth" and "Value" companies. In its simplest form, this allocation consists of placing companies with the highest valuations in the Growth segment, on the basis that a higher valuation reflects higher growth, while companies with lower valuations (often with larger fluctuations in earnings performance) end up in the Value company category. This typically means that classic fast-growing companies in fields like information technology (IT) and health care are defined as Growth companies, while more cyclical companies in sectors like industrials, commodities (including energy) and financials dominate Value company indices.

Differences in index structure

%



Source: Bloomberg

More fast-growing companies in US equity indices. Cross-Atlantic differences are illustrated by the chart above where the above-mentioned Growth sectors account for a significantly larger share of the US index while Value-sectors dominate a broad euro area index, and even more so for the Nordics. Some of the fast-growing digitisation companies in the US were reclassified last year from the IT sector to the communications service and durable goods sectors; if they are included, the difference in index structure is even clearer.

Poorer performance by Value company shares. It is no surprise that earnings increases have been larger for Growth companies, which is reflected in stock market performance. Growth shares performed better than Value shares during virtually the entire past decade, with the exception of a minor rebound during the past six months. This difference naturally also has an impact on valuations. If we study the changes in P/E ratios over the past decade, we see that valuations for broad euro area indices have followed the valuations of American Value shares, while US Growth companies have gradually been rewarded with higher P/E ratios. From this perspective, investors view Europe as a "Value market". It is of course reasonable for companies with faster earnings growth to be assigned higher earnings multiples. The higher valuations of American shares are thus attributable to the difference in sectoral structure. This is made clear by the so-called price/earnings-to-growth (PEG) ratio, where the P/E ratio is divided by expected earnings growth (higher growth leads to higher P/E ratios). At present, the PEG ratio for the global IT sector is somewhat lower than for the broad index, after having largely followed it in recent years.

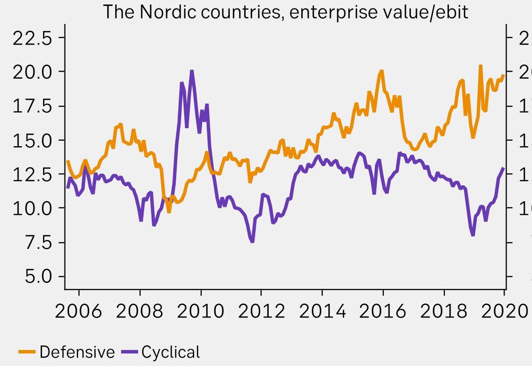
Signs of higher growth in the euro area and EM sphere. At present we thus regard the valuation gap as reasonable, and return forecasts for stock markets are thus determined by the economic growth outlook. If the signs of imminent recovery that were detected late in 2019 should materialise in the form of higher growth, this should benefit euro area stock markets and also (probably to a greater extent) stock markets in emerging market (EM) countries, which are also Value-oriented and include a high proportion of cyclical companies that also performed more weakly last year due to growth uncertainty and trade war risks. Another part of the global financial markets with conditions similar to those in the euro area and the EM sphere are the Nordic stock markets. They are also dominated by cyclical Value sectors. Value shares account for a full 55 per cent of the Vinx Nordic index. On the dominant Stockholm exchange, the figure is even higher: 58 per cent, driven by a high proportion of industrials.

Cyclicals have lagged defensive companies. In the Nordics, the proportion of Growth companies is low and the segment is dominated by a few firms, making comparisons less relevant. But Nordic stock markets include a relatively high proportion of companies that are more defensive in nature. These are often described as a third market segment, alongside Growth and Value companies. They typically consist of companies with stable but slow growth. This stability distinguishes them from Value companies, and their slower growth distinguishes them from the Growth segment, while because of their combination of qualities these companies are often called "bond proxies". Based on the Nordic listed company universe, we have constructed two equity baskets of ten cyclical companies (Swedish and Finnish industrials and commodities) and nine more defensive companies (Swedish, Danish and Finnish companies in convenience goods and portions of the health care sector). They all have in common that they are among the largest companies and have had largely the same corporate structure for the past decade, so that comparisons are relevant.

If we study how the share valuations of these two groups have performed, we see how the more defensive companies have appreciated significantly in value. In itself this is reasonable, although some shares in the group have earnings multiples that seem difficult to comprehend. But for the cyclical group, valuations (on a debt-free basis) are largely the same as ten years ago. It seems a bit remarkable that these companies have not shared in the appreciation caused by lower bond yields. This conclusion is reinforced by the fact that the profitability of the companies in this cyclical group has clearly improved during the period, which should mean lower cyclical sensitivity (higher stability).

Still low valuation of cyclical shares

The Nordic countries, enterprise value/ebit



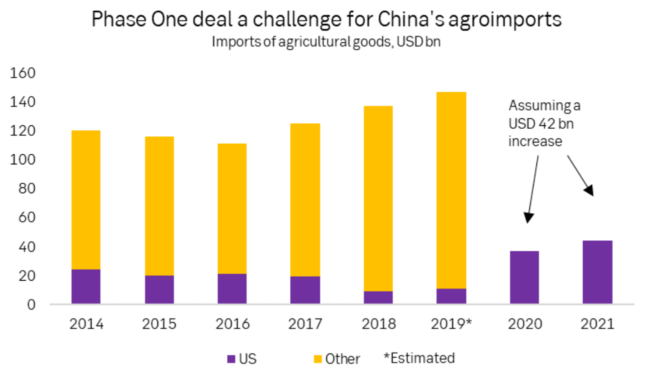
Source: SEB

Reasonable valuations with upside potential. To summarise: A long as bond yields remain ultra-low and there is enough economic growth to generate earnings growth in listed companies, this should be enough to justify today's global share valuations. Looking ahead, if the same situation continues, higher valuations will be justified, but we are not there yet. Our conclusion is that globally, equities should be able to deliver a total return consisting of about a 3 per cent distribution to shareholders and a further per cent or more in earnings increases – we are aiming at 5-8 per cent returns in the coming 12 months. From a geographic perspective we foresee similar potential, despite differing conditions, for the growth-dominated US stock market (where we expect fast-growing digital companies to continue benefiting more) and for Value companies with lower multiples in the euro area – with the latter enjoying an advantage in case of a more positive growth situation. The same applies, to an even greater extent, to EM equities and to the Nordic stock markets. We also foresee structurally healthy growth potential for those companies whose products and services will contribute to the transition to a more sustainable world – a trend that is as important as it is strong.

The United States

Focus on supply side as trade worries fade

Diminishing trade and external risks have increased the probability of a soft landing, with US growth remaining close to trend during 2020-2021. Manufacturing will still be a weak link but be offset by resilient households and improved construction activity. Higher labour force participation means that the economy is not yet hitting its ceiling, despite a record-long growth period. Due to low inflation and a new monetary policy framework, the Fed will cut its key rate one more time.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	2.9	2.3	1.8	1.9
Unemployment*	3.9	3.7	3.5	3.5
Wages and salaries	3.0	3.2	2.8	3.4
Consumer Price Index (CPI)	2.4	1.8	2.0	1.9
Core PCE (the Fed's target variable)	2.0	1.6	1.6	1.8
Federal budget balance**	-5.7	-5.7	-5.6	-5.5
Federal debt held by public**	104.3	106	108	110
Fed funds rate***	2.50	1.75	1.50	1.50

* Per cent ** Per cent of GDP *** At year-end. Source: Macrobond, SEB

Soft landing scenario has gained further support. Early 2020 has been dominated by continued optimism about the US economy. The storm clouds that hung over 2019 – in the form of a pessimistic fixed income market, trade conflicts and weak global demand – have faded. Sentiment indicators in other countries, especially China, have stabilised. The Phase 1 agreement with China is expected to freeze the trade conflict until November's US presidential election. Economic policy is expansionary. The deceleration that occurred in the fourth quarter of 2019 also seems to have been milder than expected. What thus remains is the picture of an economy that will slow to just below trend but will avoid a recession. We are revising our 2019 and 2020 GDP growth forecasts one tenth of a point higher – to 2.3 and 1.8 per cent, respectively – but are keeping our 2021 forecast at 1.9 per cent.

An ageing economic boom, with balanced downside risks. Partly because of the Federal Reserve's three key interest rate cuts, the yield curve (measured as the gap between 10-year and 3-month Treasury yields) is showing a positive slope again. From this perspective, however, it is still too early to sound the all-clear when it comes to recession risks; historically it has taken an average of 10 months after the curve inverted until a recession has begun. But the Fed's total strategy reversal, in a situation where the labour market is still strong, has decreased the risk of policy mistakes of the kind that have historically triggered downturns. In addition, there are still few apparent financial imbalances in the credit and real estate markets. Record-high lending to non-financial companies is one exception, but we believe that because of good earnings and low interest rates, the sector can bear large debts at present. Increased borrowing has also mainly funded acquisitions, share buy-backs and dividends and is thus not an expression of excessive capital spending. Yet the economic boom has lasted for a record-long period in modern times, limiting future potential and shifting the focus of attention to supply-side restrictions as demand-side downside risks fade. Meanwhile the economy remains sensitive to political and market shocks. The focus is again on geopolitical risks as the US-Iran conflict escalates. The outlook is hard to assess, but one difference compared to earlier Middle Eastern crises is that the US is now self-sufficient in oil and negative GDP effects from high fuel prices are largely offset by rising investments in oil production.

Trade conflict on back burner until after election

The Phase 1 agreement with China was signed in mid-January, as planned, but various uncertainties persist. For example, are the Phase 1 requirements that China must buy more energy as well as industrial and farm products from the US realistic? According to the US, Chinese imports of American goods must grow by a total of USD 200 billion over the next two years compared to 2017 levels, including USD 40-45 billion in farm products. In both cases this represents a major increase: China's merchandise imports from the US totalled USD 130 billion in 2017 and imports of farm products amounted to less than USD 20 billion. During the tariff conflict the US has lost market share for soya beans to Brazil, for example. China's farm product purchases from the US peaked at USD 26 billion in 2012, which shows that the agreement will require China to shift away from other suppliers on a massive scale to avoid building up large inventories. China's total import commitment will be partly met in the energy field, but one challenge is that in many cases technology purchases will be limited by stricter US export controls.

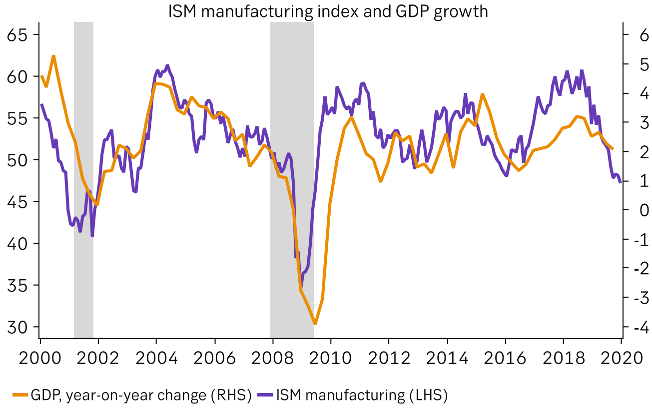
Protecting consumers. Phase 1 will not solve all the problems that the trade war was intended to resolve concerning primarily government subsidies. This controversial issue appears to have been postponed until the Phase 2 discussions that will soon begin, now that Phase 1 has been signed. The US announced a Phase 1 agreement before all details were in place, which indicates a desire to win a partial victory and avoid further damaging the economy, especially households. It suggests that the US will be careful not to re-escalate the conflict, at least until after the November presidential election. Both the now-scrapped December tariff hike – with its focus on toys, mobile phones and computers – and the September tariffs that were halved from 15 to 7.5 per cent by Phase 1 were targeted to consumer goods. But the highest US tariff, a 25 per cent levy on industrial input goods, is not being changed, and the burden on the manufacturing sector will continue. In December the Fed published an analysis of the effects of the tariffs on US manufacturers. It concluded that the adverse impact of higher input goods prices and counter-tariffs by other countries outweighs the positive impact of protection from import competition, but as a whole the direct effects are moderate. We are sticking to our assessment that the main risks are related to unpredictability, especially when making investment decisions, as other analyses by the Fed and the IMF have also concluded. The lowering of the conflict level may help improve future sentiment, but December manufacturing sentiment indicators did not show any positive effects on confidence. However, industry should get some support from demands on China to buy manufactured goods (in total an additional nearly USD 80 billion over two years).

3.5%

US unemployment is expected to remain at or near its current 50-year low.

ISM exaggerated the upswing in 2017/18

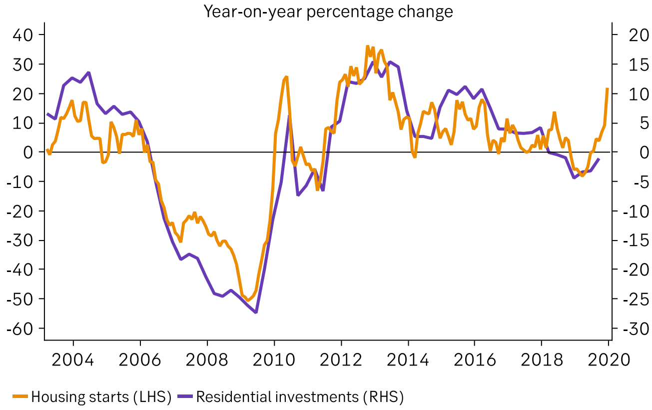
ISM manufacturing index and GDP growth



Source: Institute for Supply Management (ISM), U.S. Bureau of Economic Analysis (BEA), Macrobond, SEB

Revival of the housing market

Year-on-year percentage change



Source: U.S. Bureau of Economic Analysis (BEA), U.S. Census Bureau, Macrobond, SEB

A two-speed economy

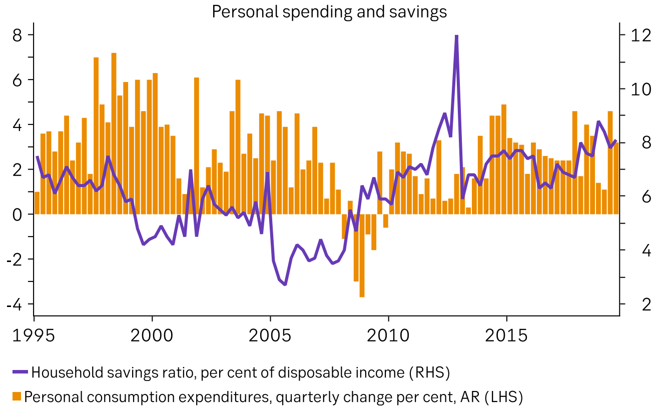
In December the ISM purchasing managers' index for US manufacturing fell to its lowest point since June 2009. The index is now at the same level as in September 2008, just before the global financial crisis broke out. This is concerning, given the strong historical correlation between the ISM manufacturing index and the economy, but actual data on industrial production and order bookings have still not deteriorated to the extent that the ISM index indicates. The ISM index clearly diverges on the downside compared to regional manufacturing surveys and purchasing managers' indices. This probably reflects an oversized share of large export-dependent companies that are more exposed to trade wars and international weakness, suggesting that the ISM index does not provide a fair assessment of conditions in the overall manufacturing sector. The ISM index exaggerated the global export boom of 2017-18, which supports this conclusion (see chart). In the short term, the Boeing crisis appears likely to contribute to further manufacturing sector weakness. The effects of the crisis on Boeing's aircraft exports began last year, but the company meanwhile kept up production. It has now decided to suspend production of the grounded 737 Max model. Given the role of aviation in total US manufacturing, this implies a negative GDP effect of about two tenths of a point in the first quarter of 2020, plus the secondary effects on Boeing's suppliers. Foreign trade pulled down GDP in Q2 and Q3 2019, but an unexpectedly large drop in imports seems to have made a positive contribution in Q4 despite a continued export decline. Anaemic imports are not normally a sign of strength, but in this case they may reflect postponements due to tariffs, which should thus be transitory given the easing of tariffs in the Phase 1 agreement. A calmer pace of US consumption and better international demand suggest continued, but smaller, negative GDP contributions in 2020-2021.

Resurgent construction activity. Business investments fell during both the second and third quarters of 2019 and probably remained weak during the final quarter, but signs of stabilisation in capital goods orders have decreased future downside risks – although this statistic is volatile on a monthly basis. Falling mortgage interest rates due to the Fed's policy shift have meanwhile breathed new life into the residential market. Home sales rebounded early in 2019. Sentiment among home builders has climbed nearly to historical peaks, and residential construction is again contributing positively to GDP after six quarters of downturns. On a full-year basis, we expect residential investments to climb in both 2020 and 2021 after declines during the two previous years.

The US service sector is showing resilience, although sentiment is below its 2018 peak. The easing of tariffs in the Phase 1 trade agreement removes a downside risk. This was reflected by an upturn in December's ISM non-manufacturing index. Sentiment among small businesses appears to have stabilised at healthy levels. Consumer confidence has held up, although the future outlook index – which is more correlated with consumption – fell somewhat during the second half. Last year consumption gained new momentum from the opportunity to refinance mortgage loans at lower interest rates, but late in 2019 household demand seems to have slowed to a more trend-like growth rate. A strong labour market, expansionary economic policy, rising real estate prices and a high household savings ratio suggest that there will be no further deceleration, however. We expect consumption growth to slow from 3 per cent in 2018 to around 2.5 per cent during 2019-2021.

Private consumption supported by high savings

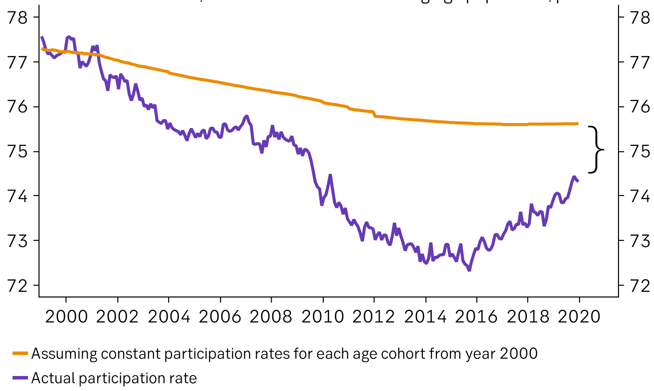
Personal spending and savings



Source: U.S. Bureau of Economic Analysis (BEA), Macrobond, SEB

Room to increase labour market participation further

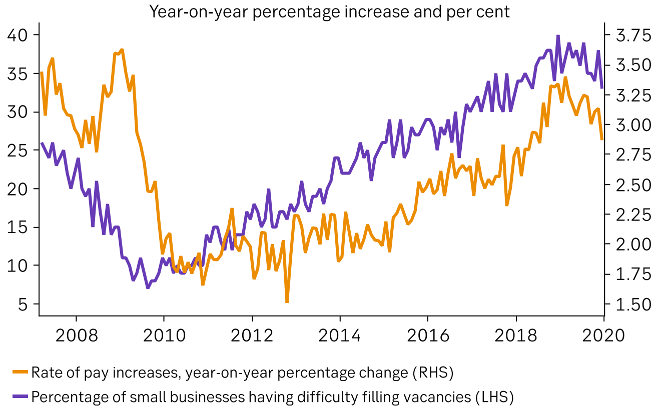
Share of total civilian, non-institutionalised working age population, per cent



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

Wage increases do not signal overheated labour market

Year-on-year percentage increase and per cent



Source: National Federation of Independent Business, U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

The labour market has not yet hit its ceiling

Last year US non-farm payrolls grew by an average of 176,000 per month, compared to 223,000 the year before. However, job growth accelerated during the second half to a monthly pace averaging nearly 190,000: well above the 100,000 or so previously regarded as a sustainable long-term level. Looking ahead, we believe that job growth will decelerate further but that the labour market will remain strong – with unemployment close to the current 50-year low of around 3.5 per cent. The employment index for the service sector, which accounts for more than 80 per cent of private sector jobs, has rebounded after a temporary dip last autumn. Other labour market indicators such as consumer surveys, small business hiring plans and job vacancies seem to have peaked, but in most cases they remain at high levels. This spring's census will temporarily boost public sector recruitment needs; during the two previous censuses in 2000 and 2010, the federal government hired more than half a million census workers, with a peak in May. The ever-tighter labour market is raising more acute concerns about supply-side restrictions. The ISM non-manufacturing index, the Fed's Beige Book and small business surveys all indicate that companies view labour shortages as a major problem, but still-moderate pay hikes suggest that the total labour market is not overheated.

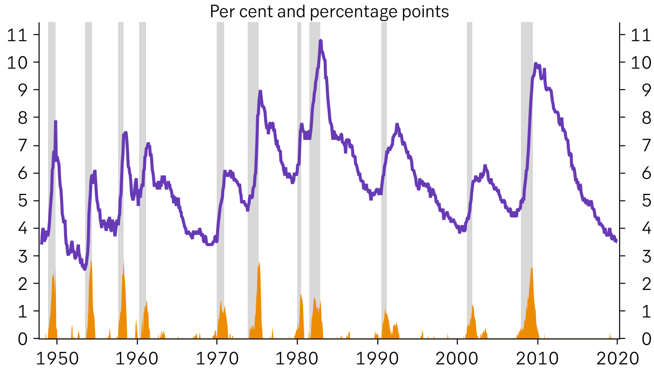
More openings for weak groups. One key issue in determining the degree of labour market tightness is how much further the participation rate can climb. Due to the ageing population, it will probably be difficult to reach previous participation levels, but even after taking demographics into account we see potential for higher labour force participation. Excluding people over age 64, we see room for participation to increase by another 1-2 percentage points (see chart). Increased incentives for vulnerable groups to enter the labour market support this conclusion. The Fed's meetings with private sector and local government representatives this past year have revealed that groups previously far removed from the labour market are gaining better opportunities to land jobs. This is also reflected in a trend towards faster pay increases for low-skilled jobs, partly driven by higher minmum wages. Pay increases in the overall economy slowed somewhat towards the end of last year, however, and remain at levels well below historical peaks. Yet we expect the tight labour market to help trigger a further acceleration in overall pay increases as well, with hourly earnings speeding up from a bit above 3 per cent last year to nearly 3.5 per cent by the end of 2021. It is worth pointing out that the soft landing scenario we foresee is unusual in a historical perspective – probably due in part to weak "automatic stabilisers", including lower unemployment compensation than in Europe. Once unemployment has risen by about 0.5 points, the economy has usually entered a downward spiral (see "Theme: Recession risks", *Nordic Outlook*, September).

Fed inflation metric remains below target. Core inflation excluding food and energy prices rose during the second half of 2019 to 2.3 per cent, which is at a par with the highest levels since the financial crisis. Behind this upturn were faster price increases for goods, but also health care. Health care is an uncertain factor, but earlier price hikes have proved temporary and there are many indications that some of the higher goods inflation will be temporary, too. Producer prices for consumer goods cooled substantially in the second half, while the risks of price increases due to higher tariffs have decreased. We expect CPI core inflation to fall somewhat to 2.0 per cent, followed by a slight acceleration in 2021. Core inflation according to the personal consumption expenditures (PCE) deflator – the metric preferred by the Fed – has been stable or even fallen a bit during the past six months. In November 2019 the inflation rate was 1.6 per cent, well below the 2 per cent target. This was because health care, which is measured differently from CPI, accelerated far less according to PCE. Historically, core PCE inflation has averaged 0.2-0.3 points below CPI, but in the past five years it has averaged a full 0.5 points lower. One important reason is that rents, which have almost twice the weight in core CPI as in core PCE, have climbed relatively fast. This suggests that the difference between PCE and CPI will remain larger than the historical average.

The Fed's new framework is expected to open the way to letting inflation overshoot its target

Unemployment and recessions

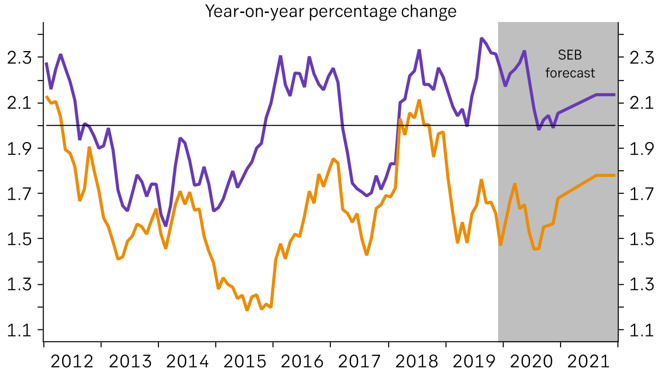
Per cent and percentage points



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

Fed's favourite measure remains below target

Year-on-year percentage change



Source: Macrobond, SEB

Core PCE is expected to accelerate gradually to 1.8 per cent in the second half of 2021 but remain below target throughout our forecast period.

Downside risks still predominate for the Fed

Having cut its key rate at three consecutive policy meetings, the Fed is signalling a lengthy period with a key rate of around the current 1.50-1.75 per cent. An overwhelming majority of Fed policymakers are forecasting no changes this year. According to Chairman Jerome Powell, Fed forecasts beyond 2020 should be seen as underscoring that long-term equilibrium interest is higher than today's level. The Fed's actions last year are similar to those of the 1990s, when on two occasions the Fed cut its key rate in rapid succession despite a strong labour market. But now the standard for reversing Fed rate cuts is far stricter. According to Powell, it will require a significant, lasting upturn in inflation – which is not in the cards. The Fed has also clearly opened the way to letting the labour market continue expanding, even though unemployment is already well below its own estimated equilibrium of 4.1 per cent. We believe that downside risks for the key interest rate still predominate, but in the short term the Fed will focus on evaluating the effect of the easing it has already implemented. We now believe that the Fed will leave its key rate unchanged at least during the first half of 2020.

More room for overshooting the inflation target? The ongoing review of the US monetary policy framework is scheduled for completion in mid-2020. Discussions in Fed meeting minutes and speeches have focused on the lack of future manoeuvring room when nominal interest rates remain close to zero. One conclusion is that the Fed needs to place more emphasis on the downside risks for inflation and inflation expectations, especially since inflation has mostly tended to stay below target over time. This opens the way for periodically letting inflation overshoot the target, for example by reformulating the inflation target as an average. The Fed has also discussed the possibility of controlling bond yields – like the Bank of Japan – though only for shorter maturities, in order to reinforce the outlook for low yields when other tools are exhausted. Our conclusion is that the Fed's new monetary strategy will strengthen arguments for expansionary interest rate policy. We forecast that inflation will stay below target, helping persuade the Fed to cut its key rate once more to 1.25-1.50 per cent in September 2020.

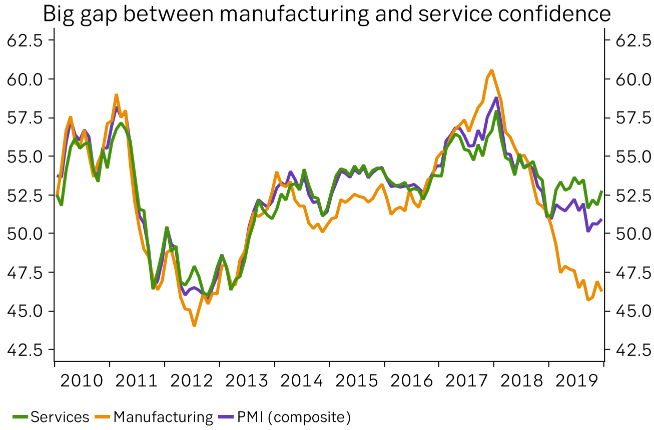
Uncertain post-election outlook. The stimulus effects of the 2017 tax reform have gradually faded, but because of the generous budgets approved by a divided Congress, fiscal policy is likely to remain slightly expansionary this year – equivalent to about two tenths of a per cent of GDP – and the federal budget deficit will again exceed 5 per cent of GDP. In political terms, the year will be dominated by the impeachment process and the upcoming presidential election. Although extensive negative information has emerged about Donald Trump's actions, it remain highly improbable that the Republican-run Senate will find the president guilty. The voters remain polarised, but the president's support among his own sympathisers does not appear to have been damaged. Continued healthy economic growth and a lack of strong Democratic candidates will give Trump a good chance of being re-elected. His second-term agenda will thus be important to events during 2021; a renewed focus on the trade conflict with China and possibly also the EU is a downside risk. On various occasions, Trump has promised a new tax reform for middle income earners, but the prospects of such a reform are probably limited as long as the Democrats are in charge of the House of Representatives. Military actions between Iran and the US are a new source of uncertainty. Our forecast assumes that the conflict will be limited and not lead to a new war.

The euro area

Stabilisation, but German weakness

The region shows continued divergence between manufacturing and service sector growth. Although we see signs that German-led industrial weakness is bottoming, the outlook remains weak. Decreased trade uncertainty and the EM turnaround will help boost exports, however, while domestic economies and labour markets show resilience. Growth will continue to slow this year but will rebound to 1.2 per cent in 2021. We do not expect the ECB to change its monetary policy direction in 2020-2021.

Big gap between manufacturing and service confidence



Source: IHS Markit, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	1.9	1.2	1.1	1.2
Unemployment*	8.2	7.6	7.7	7.5
Wages and salaries	2.2	2.4	2.5	2.5
CPI	1.8	1.2	1.5	1.5
Public sector balance**	-0.5	-0.7	-0.8	-0.9
Public sector debt**	85.9	85.4	84.4	84.0
Deposit rate***	-0.40	-0.50	-0.50	-0.50
EUR/USD***	1.14	1.12	1.17	1.20

* Per cent **Per cent of GDP *** At year-end. Source: Eurostat, SEB

Continued gaps, but a trend towards stabilisation

Sentiment indicators remain weak. The problems of the manufacturing sector, especially in Germany, are clearly not over. The latest purchasing managers' indices (PMIs) for manufacturing are still well below the neutral 50 mark. Of the four largest euro zone countries, only in France are manufacturers expecting near-term expansion. There are persistent gaps between sectors as well as countries, but it is worth noting that indicators seem to have stabilised in recent months. We expect an improvement in GDP growth figures later in 2020. Sentiment indicators should keep improving slowly if our forecast is to become a reality.

Structural reforms in France and Spain. Developments in recent months and in the outlook show relatively large divergences between Germany (with about 30 per cent of euro area GDP), France (20 per cent), Italy (15 per cent) and Spain (10 per cent). The deceleration of recent years has been most apparent in Germany, largely due to the major role of manufacturing in its economy. As we have highlighted before (for example in "Theme: The auto industry", *Nordic Outlook*, September 2019), Germany's problems are both cyclical and structural in nature. As in Germany, Italian growth has been close to zero during the past year and the outlook still looks weak. We expect an improvement in 2020, but at least in Germany the growth rate will be lower than we have been accustomed to. Meanwhile France and Spain will continue to grow faster than the euro area as a whole. Both countries have been relatively resilient to the global deceleration. While German GDP growth fell from 2.5 to 0.6 per cent in 2017-2019, growth in France and Spain only decreased to about 1 per cent. Looking ahead, structural reforms in the labour market and other fields will probably help improve growth potential in these two countries. Although protests against President Emmanuel Macron's reform agenda will continue in France, this agenda appears likely to gradually gain broader acceptance.

Mixed export outlook. The slowdown in global manufacturing activity has generally hurt the export-dependent euro area. The export order situation remains weak in many of these countries, which suggests subdued performance during the first half of 2020 as well. A slow global economic improvement will help, but because of a continued squeeze on the auto industry, euro zone export recovery will be slow. Political worries will also persist. Although the US and China have made progress – reaching a Phase 1 trade agreement – there will still be great uncertainty. And although PM Boris Johnson and his Tories now have a majority in the British Parliament, complex negotiations on a new EU-UK trade agreement still lie ahead. Because of continued weakness in manufacturing, euro area capital spending will decelerate and remain weak throughout our forecast period.

Households are holding back on spending, despite decent sentiment. Rising employment and asset prices have helped keep consumer confidence resilient, as other indicators have fallen. Yet weakness elsewhere in the economy, combined with slowing job growth, has contributed to cautious consumer behaviour and a continued rise in the household savings ratio. Although high savings – now equivalent to 13 per cent of disposal income, is now creating the potential for increased consumption further ahead – it is difficult to expect any noticeable acceleration during our forecast period as employment cools and unemployment levels off. We thus believe that consumption will continue to increase by just below 1.5 per cent yearly in 2020 and 2021.

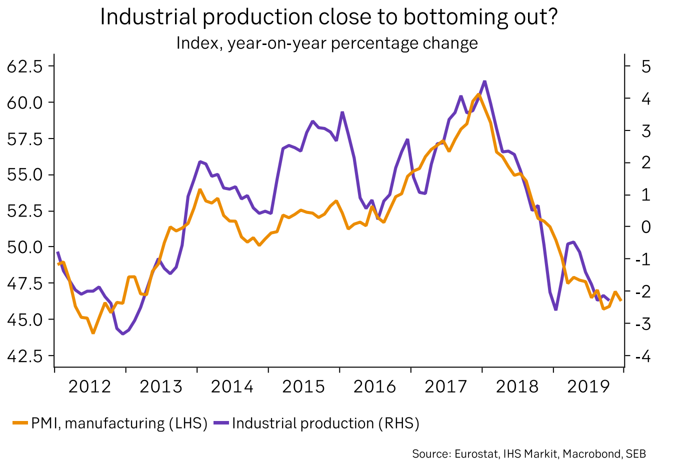
Symmetrical asymmetrical risk picture. Our overall assessment is that the probability of a better or a worse trend than in our main scenario is rather balanced, now that we have begun to see some positive signs in the data flow. However, the risk picture is asymmetrical when we look at the magnitude of the divergences from our main scenario. Although there are currently some idle resources in the economy, the potential for a surge in growth is limited. If the world economy should enter a recession, for example due to escalating geopolitical conflicts or sharp declines in asset prices, there would be major consequences for the rather fragile euro zone economies.

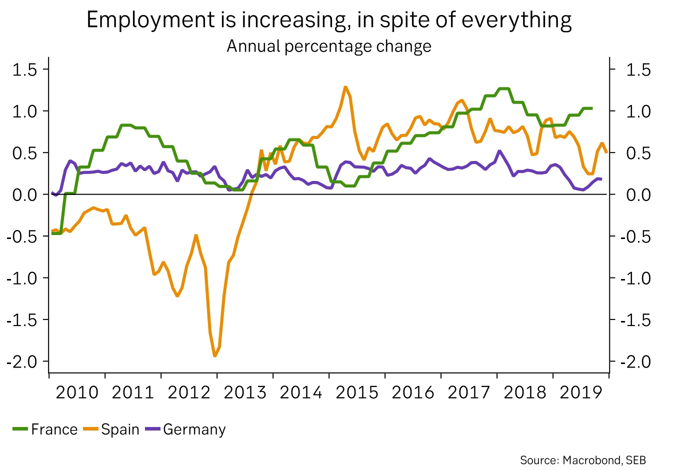
GDP growth forecasts

Year-on-year percentage changes

	2018	2019	2020	2021
Germany	1.5	0.6	0.7	1.0
France	1.7	1.3	1.2	1.4
Italy	0.8	0.2	0.5	0.7
Spain	2.4	2.0	1.8	1.8
Euro area	1.9	1.2	1.1	1.2

Source: Eurostat, SEB





Slightly expansionary fiscal policies

Public sector fiscal deficits are now on a par with the lowest levels recorded since the euro was introduced. Yet countries like Italy and France are still being criticised by the European Commission for lack of budget discipline. The pressure for looser policies is coming from many directions and is aimed primarily at fiscal surplus countries like Germany and the Netherlands. But these countries are already pursuing slightly expansionary fiscal policies, and absent a deeper slowdown than we have seen so far, their political leaders are unlikely to change strategy. Overall, the economic slowdown and slightly expansionary policies resulted in a small increase in deficits during 2019. Deficits are expected to total just below 1 per cent of GDP both in 2020 and 2021. Measured as a percentage of GDP, public sector debt will continue to fall, reaching 84 per cent in 2021.

Limited boost from green stimulus. Environmental issues are occupying more and more space on the public agenda, and green investments may be one way of gaining acceptance for more expansionary fiscal policy. Although some countries would like to exempt green investments from the regulations that limit fiscal flexibility, opposition is generally strong enough to prevent the main scenario from changing. In the near term, the main focus will be on incentives for private sector spending via the European Investment Bank and the EU budget. The plan recently presented by the EU ("European Green Deal") looks significant (EUR 1 trillion) but is spread over 10 years and corresponds approximately to an annual 1 per cent of GDP. It is not fully clear to what extent this is "new" money and to what extent other spending will be reduced. But considering the wide-ranging discussions under way and the global focus on these issues, the situation may change dramatically in 2020-2021.

Resilient labour markets

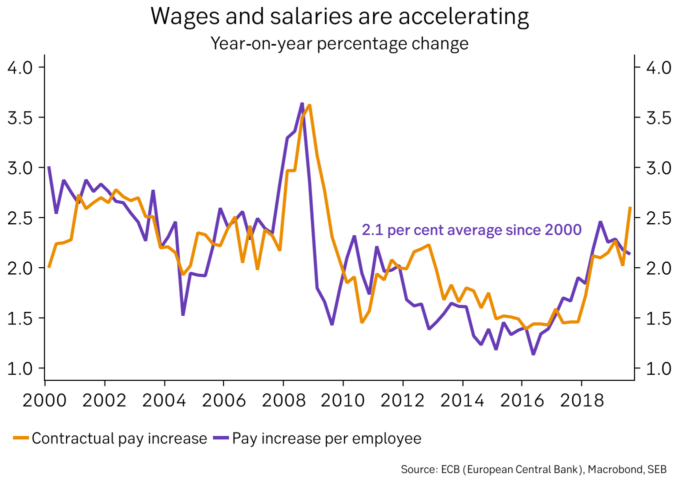
Euro area labour markets have shown net job growth of about 13 million over the past five years. Meanwhile unemployment has fallen sharply to 7.5 per cent. This is 0.5 points lower than a year ago and only marginally a few tenths above the level before the global financial crisis. Although the downturn in unemployment has decelerated, labour markets have shown resilience to production slowdowns. Labour market indicators have fallen but are above the employment expansion threshold in most countries. Even in hard-pressed Germany, the PMI employment index was below 50 for only a few months in 2019. In the German manufacturing sector only, late last year we saw a slight decline in the number of jobs.

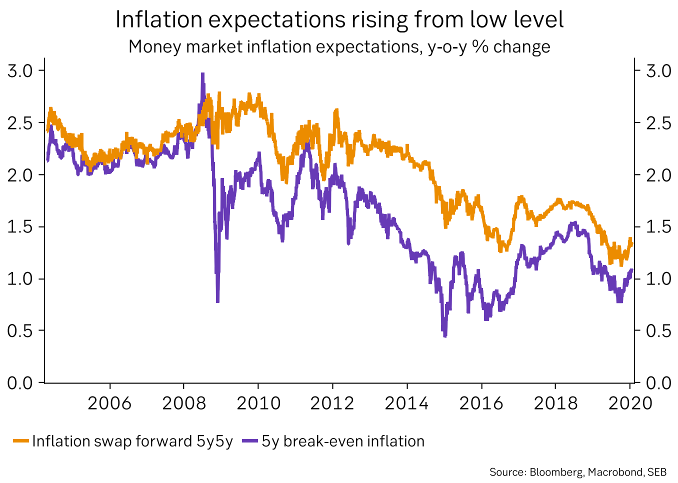
Labour markets being impacted after a delay. Since a production slowdown normally impacts labour markets after a certain lag, we are likely to see somewhat clearer effects in the near future. We thus expect euro zone unemployment to move slightly upward during 2020 but then fall again in 2021, reaching 7.4 per cent by year-end. Since unemployment is now at a par with both the low levels before the global financial crisis and the estimates of equilibrium unemployment reported by the European Commission and other authorities, supply-side analyses will be important. As unemployment has declined, businesses have signalled increasing recruitment problems, but the shortage figures have recently fallen somewhat. Although supply-side factors will eventually create restrictions on how fast employment can increase, experience from elsewhere in the world economy give reason for hope. In the US, Japan and the United Kingdom, a long period of strong demand for labour has helped to gradually push estimates of equilibrium unemployment lower. Although many euro area countries – including France, Italy and Spain – face structural problems in their labour markets, there is good potential for this pattern to repeat itself in the euro area as well.

Wages and salaries are accelerating. As euro area labour markets have improved, wage and salary increases have slowly begun to move higher. Germany has led this trend, but the rate of pay increases has slowly accelerated from low levels in other countries too. Italy and Spain are now showing increases of 2 per cent. The rate of pay hikes in the region as a whole is currently just above 2 per cent. Even if labour markets cool off a bit this year, we expect the rate of pay increases to creep upward over the next couple of years, reaching 2.5 per cent or slightly higher by the end of our forecast period.

1.3%

Core inflation moved higher in November, among other things driven by German service inflation. Even if inflation continues to accelerate slowly, it will remain well below the European Central Bank's target of just below 2 per cent throughout our forecast period.





Continued low inflation, despite faster pay increases

Weaker economic performance is one reason why the ECB's hopes of a gradual upturn in the rate of inflation again failed to materialise in 2019, with monthly figures often surprising on the downside. For nearly two years, core inflation has remained stable at around 1 per cent, but hopes resumed in November-December when core inflation suddenly rose to 1.3 per cent. The main explanation was an unexpected acceleration in German service sector prices. It is still too early to determine whether this is the start of a lasting trend, especially considering that the 12-month figure may have been affected by unusually weak inflation in November 2018 which have kept down the full year 2019.

Unclear impact of faster pay increases. Accelerating pay increases are contributing to slightly higher underlying inflation pressure, but ECB research indicates that businesses can still adapt their profit margins and other costs. They have thus not needed to raise prices at the same pace as pay increases. This follows the international pattern, in which globalisation, automation and the expanded information available to consumers is holding down price increases. Yet we expect rising labour costs to eventually force businesses to charge slightly higher prices ahead. Weak GDP growth, which is primarily demand-driven, will nevertheless make it difficult for the ECB to achieve its inflation target during our forecast period. Inflation according to the ECB's harmonised index of consumer prices (HICP) will reach 1.5 per cent, and core inflation will reach 1.4 per cent by late 2021. Rising food prices will create an upside risk to this forecast, however. African swine fever has contributed greatly to rising food prices in Asia (especially China) and also has the potential to affect Europe. The disease has been present for a long time in Poland, but reports of new cases close to the German border have led to actions by the authorities. Since Germany accounts for 15 per cent of the global pork trade, disruptions in production there would have noticeable effects.

ECB awaiting initiatives by new leadership

During her first press conference as ECB President, Christine Lagarde made it clear that a new leadership has taken over the euro zone central bank. Earlier ECB communication will thus be less important as guidance for the bank's future monetary policy decisions. During 2020 the ECB will conduct a far-reaching review of its monetary policy strategy, based not only on traditional policy perspectives but also including such issues as technological developments, climate challenges and increased inequality. Such an extensive review may of course lead to various changes, but it is difficult to imagine the ECB being given a mandate essentially different from that of the US Federal Reserve after its own review. It is also possible that Lagarde, given her experience as a former French finance minister, can help create a more lively dialogue with the European Commission and national governments when it comes to interaction between fiscal and monetary policies, in a situation where monetary policy manoeuvring room is extremely limited.

ECB will leave its key rate unchanged but has a dovish bias. We expect the ECB, following its actions last autumn, to leave its key interest rate unchanged in 2020-2021, in line with several other central banks. But the risk picture is asymmetrical: the probability of a rate hike is low, but if euro zone economic data should worsen, the threshold for delivering new stimulus measures is not especially high – despite opposition by some euro zone countries. In such an event, we believe that the ECB will mainly prioritise lower interest rates rather than further government bond purchases.

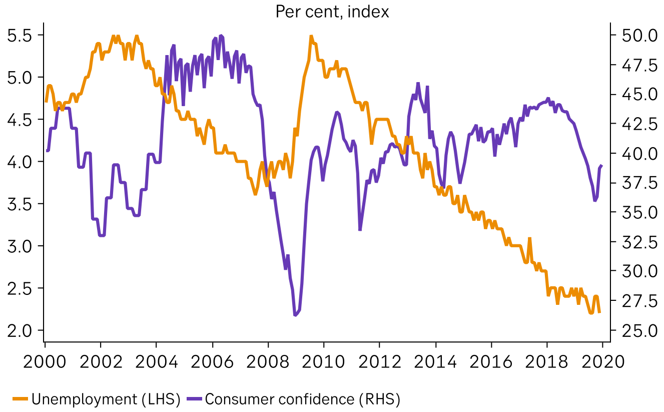
Japan

More fiscal stimulus will ease BoJ stress

A vulnerable economy and low inflation pressure have forced the government to launch new fiscal stimulus. The installation of Emperor Naruhito and expected consumption tax hike led to volatile GDP growth in 2019. Growth is slowing but will be close to trend this year and next. New free trade pacts with the US, the EU and others and an Asian tech sector upswing will provide support. Monetary policy will remain loose; the Bank of Japan will not reach its inflation target in 2020-2021.

Japanese unemployment pushed lower by demographics

Per cent, index



Source: Japanese Cabinet Office (CaO), Japanese Statistics Bureau, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	0.3	1.2	0.9	0.6
Unemployment*	2.4	2.3	2.2	2.1
CPI excluding food prices	1.0	0.5	0.7	0.8
Public sector fiscal balance**	-3.2	-3.0	-3.1	-3.1
Public sector debt**	237	238	239	240
Repo rate**	-0.10	-0.10	-0.10	-0.10
USD/JPY***	110	109	110	112

* Per cent ** Per cent of GDP *** At year-end. Source: IMF, SEB.

Japan's economy is expected to have grown by 1.2 per cent during 2019, somewhat above its 0.5-1.0 per cent trend, despite a strong headwind for exports and other sectors – with negative consequences for capital spending and industrial production. On the plus side is the strong labour market. Economic growth was volatile in 2019. Our forecast is that the increase in GDP will decelerate to 0.9 per cent this year and 0.6 per cent in 2021. Japan's ageing population will continue to impede economic expansion and contribute to low unemployment and weak trend growth, compared to other countries. The 2020-21 slowdown also reflects less impact on growth from investments related to the 2020 Tokyo Olympics.

Japan, especially its manufacturing sector, is vulnerable to changes in the tech cycle and the risk of stagnating globalisation and increased protectionism. During the second half of 2019, the tech sector showed signs of higher activity. A thaw in relations with South Korea will also benefit exports, as will the new US-Japanese trade agreement. The outlook for the export sector will improve.

Shinzo Abe's government launched yet another major stimulus package late in 2019, totalling about USD 240 billion over the next couple of years. The package, which includes infrastructure spending, is intended to offset downside global risks (such as in China and the EU) and fill some of the gap left after the positive growth effects of the Olympics have faded. According to the government, the package will help boost GDP growth by nearly 1.4 percentage points in the next couple of years.

Abe kept his promise to other countries by raising the consumption tax from 8 to 10 per cent last autumn in an effort to achieve a more sustainable trend in public finances. By "embedding" the tax hike in temporary tax cuts and expenditure increases, the government hoped to avoid excessive fluctuations in private consumption. This strategy seems to have failed. The new stimulus package (see above) will put Japan back on a path that will allow public sector debt – now 238 per cent of GDP – to grow. We have adjusted our budget deficit forecast compared to the last *Nordic Outlook* to more than 3.0 percent of GDP yearly. If confidence in Japanese public finances should fall, this might jeopardise both financial stability and global growth.

Structural reforms will be required to boost the production side of the economy by means of higher employment and productivity. Labour shortages, along with tax incentives for companies and minimum wages, have pushed up unit labour cost and helped the country escape the grip of deflation. Some reforms have borne fruit: Japan has opened its borders to foreign workers while making female labour force participation easier. We believe that unemployment, now 2.2 per cent, may fall even further. But in spite of somewhat higher wage inflation, we do not believe that the Bank of Japan (BoJ) will manage to achieve its 2 per cent inflation target during out forecast period. We expect core inflation (CPI excluding food prices) to be 0.5-1.0 points below target, while low inflation expectations will remain deeply rooted among households and businesses.

The work of the BoJ will become easier because of more expansionary fiscal policy, especially in 2020. The BoJ can thus refrain from further monetary easing in a situation where more and more observers question the effectiveness of its monetary policy. The overall result will be an unchanged key interest rate of -0.10 per cent, while the BoJ continues its efforts to keep 10-year government bond yields at close to zero, letting the monetary base (by means of securities purchases) grow by 5-10 per cent yearly. Our forecast is that the USD/JPY exchange rate will be 110 at the end of 2020 and 111.5 at the end of 2021.

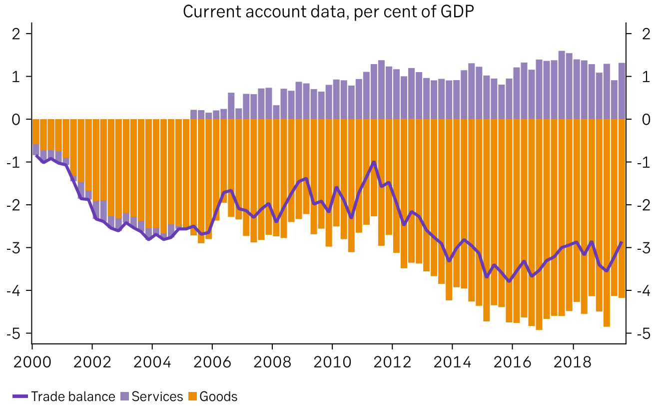
The United Kingdom

Uncertainty will persist during 2020

The British economy has been adversely affected by the uncertainty that Brexit (withdrawal from the EU) has created in recent years. This uncertainty will persist during 2020. Like the US, the United Kingdom is a consumer-driven economy. The situation of British households still looks satisfactory, but there are now some troubling signs that the labour market is weakening. This increases downside economic risks, at a time when the household savings ratio is at a low level.

UK Trade balance with EU27

Current account data, per cent of GDP



Source: U.K. Office for National Statistics (ONS)

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	1.4	1.3	1.0	1.1
Unemployment*	4.1	3.8	4.1	4.3
Wages and salaries	2.9	3.5	3.0	2.5
CPI	2.5	1.8	1.3	1.6
Public sector balance**	-1.4	-1.4	-1.5	-1.5
Public sector debt**	86.8	85.6	84.8	84.6
Key interest rate***	0.75	0.75	0.50	0.50
EUR/GBP***	0.90	0.85	0.88	0.84

* % of labour force ** % of GDP *** End of period. Source: Macrobond, SEB

Four years of uncertainty. Since then-Prime Minister David Cameron announced in late 2015 that there would be a referendum on EU membership, most analyses of the British economy have revolved around Brexit and its consequences. Although much remains unclear about the effects of leaving the EU, the new Tory majority in Parliament after last month's election has reduced this uncertainty. We now know that the UK will leave the EU on January 31, followed by intensive negotiations on a UK-EU trade agreement. During the 2020 transition period, in practice the UK will remain an EU member, without political influence. As early as 2021, however, the intention is that the new agreement will govern UK-EU relations.

Downside risks for consumption. The adverse consequences of the prevailing uncertainty are clear. Comparing UK growth with that of the EU or the US, Brexit seems to have had a negative impact especially during 2017 and part of 2018, but less impact in 2019. Like the US, the UK is an economy mainly driven by consumer demand. The situation of British households still looks satisfactory, with a strong labour market and decent pay increases. During 2019 unemployment stabilised at around 3.8 per cent and wage growth was around 3-4 per cent, but certain signs – such as fewer job vacancies – suggest that the labour market is about to cool. With a depressed savings ratio that diminishes household resilience, a weaker labour market may significantly hamper consumption.

Uncertainty will persist. Uncertainty about Brexit has held back UK business investments in recent years, and during some quarters capital spending has declined year-on-year. As long as there is no agreement with the EU, uncertainty is likely to inhibit investments and production. This is illustrated by purchasing managers' indices below 50 for all three main sectors: manufacturing, construction and services. In this environment, we expect GDP growth to fall further to 1.0 per cent in 2020, then increase slightly to 1.1 per cent in 2021. The Tory (Conservative) election manifesto suggests a rather tight fiscal policy over the next couple of years, yet we believe that the period of falling budget deficits is past, with deficits stabilising at around 3 per cent of GDP in 2020 and 2021.

The lack of a trade agreement for services will hurt the current account balance. The current account has fluctuated sharply in the past year. The reason is that at various times, businesses have carried out major inventory adjustments in response to various political pronouncements about Brexit deadlines. Future developments will be uncertain as well. At present, future UK-EU trade agreements appears likely to cover mainly merchandise trade, where the UK has a sizeable deficit with the EU. Trade in services, where the UK instead has a large surplus, will suffer various restrictions. The immediate effect may thus be that the UK's deficit with the EU will increase further after withdrawal.

No further recovery for the pound. A calmer labour market trend and the recovery of the pound late in 2019 are expected to ease British price and wage pressures. Inflation will fall to 1.3 per cent in 2020 but pick up again in 2021. Despite signs of weaker growth, so far the Bank of England has stuck to its signals of a cautious tightening in monetary policy ahead, but BoE monetary policymakers are divided. We thus foresee a shift in the central bank's forward guidance and a rate cut to 0.50 per cent at the May meeting. This policy shift, combined with the continued uncertainty surrounding Brexit and UK economic performance, will cause the pound to lose ground following its recent appreciation. The GBP has the potential to recovery if negotiations on a trade deal are successful. We expect the EUR/GBP exchange rate to rise to 0.88 at the end of 2020 and to fall back to 0.84 by the end of 2021.

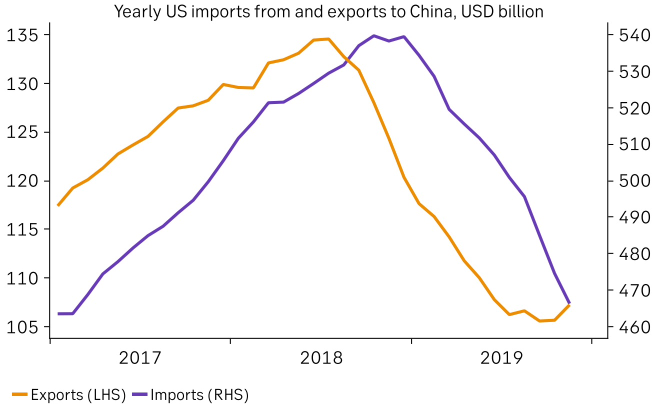
China

Beijing tapping lightly on the accelerator

China's GDP growth will slow in 2020 despite a lower risk of trade war escalation. It will remain a bit below 6 per cent during our forecast period. A minor easing of US tariffs on Chinese goods will help exporters, but many Chinese companies still face high tariffs. Signs of cyclical recovery in global trade and an expected rebound in private consumption will reduce the need for further stimulus by Beijing, although there is room for it.

US trade with China has decreased

Yearly US imports from and exports to China, USD billion



Source: U.S. Census Bureau, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	6.6	6.1	5.7	5.9
CPI	2.1	2.9	3.6	2.2
Public sector fiscal balance*	-2.6	-2.8	-2.8	-2.8
Bank reserve requirement**	14.5	13.0	12.5	12.5
Lending rate**	4.35	4.35	4.35	4.35
Deposit rate**	1.50	1.50	1.50	1.50
7-day reverse repo rate**	2.55	2.50	2.45	2.45
USD/CNY***	6.88	7.00	7.15	7.20

* Per cent of GDP ** Per cent *** At year-end. Source: IMF, SEB

The announcement of the Phase 1 trade deal with the US lowered downside risks to China's economy but we foresee a deceleration in GDP growth to 5.7 per cent in 2020, compared to 6.1 per cent in 2019. We expect GDP growth to rebound slightly to 5.9 per cent in 2021. This forecast assumes unchanged US tariffs this year. Meanwhile the risk of re-escalation in the trade war will be significant. The White House's unpredictability in bilateral trade negotiations over the past two years calls for caution in drawing conclusions about the US-Chinese agreement. The next round of trade talks will begin relatively soon, but a Phase 2 deal is unlikely to be reached during 2020 due to the US presidential election in November.

According to the Phase 1 deal, China will increase its purchases of US goods by about USD 200 billion during 2020-2021. This will have a negative impact on China's trade relations with other countries. Trade uncertainty will thus be one reason for Chinese companies to hold back investments. A stabilisation in infrastructure spending has not been sufficient to offset weak private investments. Statements from China's leadership suggest a cautious fiscal stance and a desire to avoid a budget deficit much larger than the expected 2019 shortfall: 2.8 per cent of GDP. Unless Beijing accepts a bigger budget deficit or higher quotas on special local government bonds (in 2019 the combined target was 5 per cent of GDP), infrastructure investments are unlikely to increase especially much in 2020 and 2021 either.

Indicators suggest stronger household consumption ahead. Although the auto sector continues to face many challenges, for example due to tax adjustments and somewhat tighter credit conditions, we expect a slight rebound after weak 2019 figures. Trade-related uncertainty will discourage companies from new hiring, however. Although there is room for a generally more expansionary economic policy, we believe it will only be implemented if the labour market shows mounting weakness in the next six months. Beijing will thus continue its overall fiscal strategy of launching targeted actions rather than major stimulus packages.

Weakened monetary policy transmission. As expectations of further US Federal Reserve monetary easing diminish, there will be less room for the People's Bank of China to cut its key interest rates. We assume unchanged key rates during our forecast period. As expected, however, the PBoC chose to lower its bank reserve requirement ratio by 0.5 points to 12.5 per cent early in 2020. Generally low inflation pressure – except for pork and other food prices – have made monetary easing possible. But financial conditions have tightened, with fewer corporate bond issues, lacklustre bank lending and increased oversight of shadow banking, thereby weakening the monetary policy transmission mechanism. Yet Beijing's efforts to address financial risks will benefit stability in both China and the world in a medium- to long-term perspective.

During 2019 the yuan has traded in the range of 6.67-7.18 per US dollar, occasionally driven by advances and setbacks in trade talks with the US. The exchange rate issue is an important component of the Phase 1 agreement. The PBoC will probably try to limit the upward movement of the USD/CNY rate but will still not accept a yuan appreciation, due to the headwinds felt by the export sector from US tariffs. At year-end the USD/CNY rate will be 7.15, and in December 2021 it will reach 7.20.

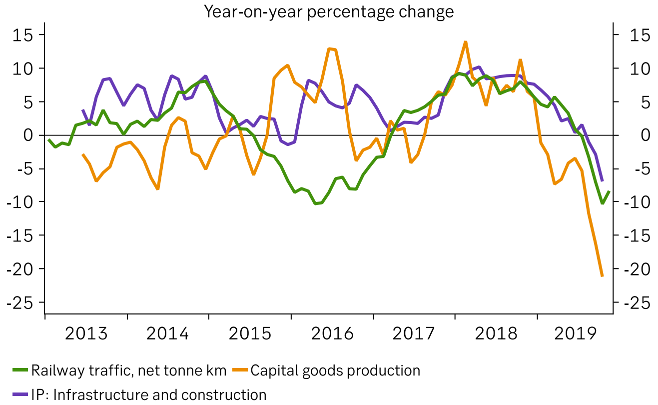
India

Near-term uncertainty, long-term challenges

India's near-term outlook is highly uncertain. We are again lowering our GDP growth forecast, after a weak third quarter. Indicators suggest continued weakness due to domestic challenges. Credit expansion has collapsed, reflecting both greater risk aversion and tougher regulation of shadow banks. Deteriorating public finances are forcing the central bank to provide support for growth by pursuing even looser monetary policy ahead.

Beleaguered economy forces monetary easing

Year-on-year percentage change



Source: CEIC, Macrobond, Bloomberg, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	7.4	5.1	6.0	6.5
CPI	4.0	3.5	3.5	4.1
Public sector fiscal balance*	-3.4	-3.7	-3.5	-3.4
Current account balance*	-2.1	-1.8	-1.9	-2.1
Key interest rate**	6.50	5.15	4.90	4.90
USD/INR***	72.1	71.0	73.0	74.5

* Per cent of GDP ** Per cent *** At year-end. Source: IMF, SEB

India's economy is under pressure. Year-on-year GDP growth of 4.5 per cent in the third quarter of 2019 was the lowest for 6-7 years and the sixth consecutive quarter of falling growth rate. We have thus downgraded our GDP growth forecast to 5.1 per cent in 2019 and 6.0 per cent in 2020. The 2020 rebound reflects positive base effects, but also good agricultural output after favourable monsoon rains and some delayed effect from monetary policy easing during the second half of 2019. In spite of this, we expect GDP growth to remain below trend during our forecast period.

Domestic demand is showing weaknesses. Shakier real economic activity and challenges in the financial sector are interacting in a negative way, pushing the economy lower. The slump in credit growth continues: bank lending expanded by less than 7 per cent late in 2019, while the pace of corporate bond issuance has now fallen to a bit above 4 per cent. The downturn in credit growth reflects risk aversion as well as concerns about the stability of the financial system. The authorities need to present a proposed framework for resolving non-bank credit problems. Considering that this sector accounts for some 13 per cent of GDP, we expect such measures to cost Prime Minister Narendra Modi some political capital.

The capital spending outlook is also challenging due to weak global demand, exerting a further drag on the Indian economy. Third quarter real fixed investment grew by a meagre 1 per cent year-on-year – the slowest pace in six years. Recent small steps taken by the government to stimulate investments are probably insufficient to resolve structural failings.

Weak public finances limit the potential for using fiscal policy to stimulate demand. Government revenues are lagging behind targets as nominal GDP growth decelerates. Tax collection is also being slowed by the corporate tax cuts implemented late in 2019. The government is thus not expected to meet its deficit target of no more than 3.4 per cent of GDP. To narrow the deficit, the government could potentially raise fees and/or sell off publicly owned assets.

The Reserve Bank of India unexpectedly refrained from cutting its key interest rate in late 2019 and thereby risked worsening India's economic situation. Although the RBI downgraded its own economic growth forecast for India, the central bank chose to leave its key rate at 5.15 per cent after having lowered it by 135 basis points during the year. In light of India's limited fiscal manoeuvring room, domestic demand therefore risks continued weakness. We thus expect the RBI to resume its interest rate cuts, but it is important to ensure that further monetary easing does not increase the uncertainty surrounding shadow banks, which may lead to negative contagion effects on the real economy.

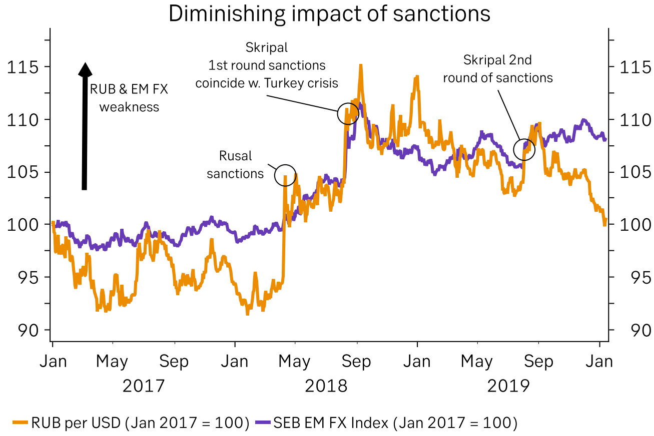
The rupee has traded at stable exchange rates despite growing uncertainties in the real economy and the financial system. The RBI's pause in its easing cycle adds further challenges for India's economy by propping up the value of the rupee. A stronger current account balance is providing some respite for the currency, but since this improvement is mainly attributable to lower imports, it provides a further indication of a weak economy. Given an expected recovery in domestic demand, imports are likely to rebound. This may weaken the currency. We expect the rupee to trade at 73.0 per US dollar at the end of 2020 and at 74.5 by December 2021.

Russia

Gradual recovery, but slow pace of reforms

Infrastructure, school, research and health care investments announced by the Kremin will boost Russian economic growth in 2020 and 2021 but are not sufficient to enable Putin to achieve his goal of raising potential growth above 3 per cent. The effects of US, EU and other sanctions seem to have diminished over time. Tougher sanctions now being discussed in the US Senate will probably not be implemented, since they also risk damaging American business interests.

Diminishing impact of sanctions



Source: Macrobond Financial AB, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	2.3	1.2	1.8	2.2
CPI	2.9	4.5	3.5	4.1
Key interest rate*	7.75	6.25	6.00	6.75
Government debt**	14.0	15.5	16.5	16.5
Current account surplus**	6.8	5.8	3.5	3.0
Wages and salaries (nominal)	10.1	7.1	6.0	7.0
USD/RUB exchange rate***	69.4	62.0	65.0	67.5

* Per cent at year-end ** Per cent of GDP *** At year-end.
Source: IMF, Rosstat, Central Bank of the Russian Federation, SEB

Gradual recovery. GDP growth recovered somewhat in the second half, but because of the weak start to the year, overall 2019 growth looks set to end up at 1.2 per cent. The sharp slowdown compared to 2018 was mainly due to weaker net exports, but also stringent budget policy. In addition, the central bank has tightened conditions for bank lending to households, thereby slowing credit growth a bit. Yet private consumption has been relatively stable and is now showing signs of strengthening, sustained by rising wages and modest inflation. After the 2018 election, President Vladimir Putin unveiled 12 "national projects" aimed at boosting potential economic growth above 3.0 per cent from its current level of less than 2.0 per cent. The focus is on increasing central government and private investments, as well as improving infrastructure, research, education and health care. The government has also promised to simplify regulations and support small and medium-sized enterprises. Implementation of the projects has been slow, but they will probably gain momentum over the next couple of years, helping boost GDP growth to 1.8 per cent in 2020 and 2.2 per cent in 2021. Putin is unlikely to carry out reforms of state-owned companies, the labour market and the judiciary that would be needed in order to elevate growth sustainably above 3.0 per cent.

Strong central government finances. The Russian Federation budget probably showed a surplus of 1.1 per cent of GDP in 2019. Although the Kremlin plans to decrease the surplus by 0.3 points annually during the next three years, federal finances are very strong, with central government debt of about 16 per cent of GDP.

Central bank is poised to end interest rate cuts. Inflation fell significantly late in 2019, reaching 3.0 per cent in December. Due to base effects (with the value added tax increase of January 2019 vanishing from the 12-month figure), inflation will fall further, reaching about 2½ per cent in early 2020. However, we believe that subsequent relatively high pay increases will drive up inflation to around 4.0 per cent by year-end. Low inflation early in the year will nevertheless give the central bank room to cut its key rate one more time to 6.00 per cent, which is probably the low point in this interest rate cycle. If the Kremlin implements its plans for gradually increased government investments at the same time that the global economy recovers further, we expect the central bank to stick to its 4.0 per cent inflation target and tighten monetary policy in 2021.

Rouble stability. The budget rule enacted in 2018, which siphons off excess government revenues to the National Welfare Fund, has helped decrease the rouble's sensitivity to oil price fluctuations. Strong government finances and high returns on rouble-denomiated government bonds have also attracted capital inflows and helped sustain the exchange rate. We expect these conditions to continue over the next two years, but the central bank and Finance Ministry will also continue to build up Russia's international currency reserve and National Welfare Fund. The rouble thus looks set to weaken to 65.0 per dollar late in 2020 and to 67.5 in 2021, which will help maintain Russia's competitiveness and dampen imports.

Putin's position is relatively secure. The Kremlin's ambition to control the flow of information and the political landscape will probably persist. Protests do not appear likely to be widespread enough to threaten the president. US sanctions against government bond purchases, banks and the energy sector now being discussed in Congress under the heading of Defending American Security from Kremlin Aggression (DASKA) might lead to market volatility and slower growth, but our main scenario is that that these sanctions will not be enacted, since they risk damaging also American business interests. Putin appointed Mikhail Mishustin as Prime Minister after Dmitri Medvedev and his government resigned on January 15, but we do not expect any economic policy changes.

Theme:

Energy transition

Technology revolution required to avoid an otherwise sharp and necessary reduction in economic activity

Innovation is needed to complete electrification, and markets will eventually fix this, but the problem is speed. If we continue to follow the same diffusion pattern as earlier technology revolutions, we will not be done until the 2070s, which is a quarter of a century too late from a climate perspective. We must turn the 30-30-30 model into a 30-15-15 model if we want to meet the requirements of the Paris agreement.

The 2010s will be remembered as a turning point in the climate crisis – not because it was solved, but because it was at least acknowledged that our current economic model is not sustainable if we include a bigger share of the world's population.

This realisation has been under way since the 1980s, when we both started the IT-enabled industrialisation of Asia and stopped developing nuclear power, which had been lined up as the alternative to fossil fuels, and it became a pressing concern after China tripled CO_2 emissions in the first decade of the millennium.

Today, there is general agreement that we need to reduce global CO_2 emissions fast, but there is less agreement about what that implies. Using the Kaya identity – a formula that breaks down CO_2 emissions into simple sources – we can identify two possible ways forward: either we find technologies that can reduce CO_2 intensity per unit of GDP, or we will be forced to accept a sharp decline in GDP – one way or another.

The first alternative is obviously preferable, but is it also realistic? Our analysis of historical technology cycles suggests that technological solutions clearly are within reach, but that they may be too slow to emerge if markets are left to their own devices.

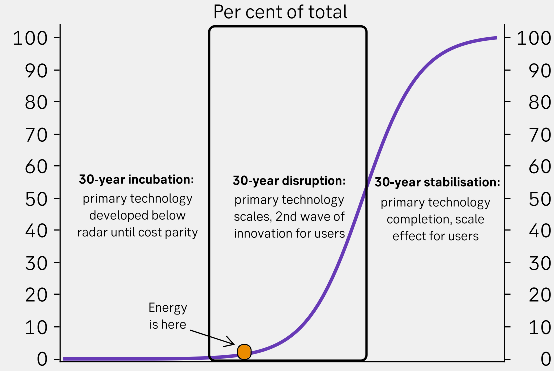
The diffusion of radical new technologies doesn't fit in the standard equilibrium models. In a technology

revolution, the early stages are characterised by positive economies of scale, where prices of new technologies decline faster the more you invest.

In fact, there has been a recurring S-shaped pattern in the major technology diffusions since the dawn of industrialisation, which we refer to as the 30-30-30 model.

- A new technology must first go through a 30-year 'pre-development' period where technology is developed, with subsidies below the macro radar, before it reaches cost-parity with incumbents.
- This is followed by 30 years of explosive growth in volume and collapsing prices due to scale effects, accompanied by a second wave of innovation among the users of the new technology.
- Finally, after reaching around 50 per cent of its ultimate users, growth becomes more incremental and prices level off as the technology is adopted by the most stubborn laggards.

Technology cycles and the 30-30-30 model



Source: Macrobond, SEB

This was the pattern when steamships replaced sailing ships, when autos replaced horses, when steel replaced iron, when electricity replaced whale oil and when computers replaced letters, ledgers and telephones. It has also been the pattern for renewables since the peak of nuclear power in the 1980s.

For thirty years, the cost of solar and wind power declined until it reached cost parity with fossil fuels in the 2010s. Investors in this period either had to be subsidised or willing to pay a higher cost to use them, but that is no longer the case. Now it is just a question of scaling the supply up with infrastructure investment and driving prices further down in the process.

At first, the expansion will look slow due to the low base, but due to the exponential nature of the diffusion, the trickle will turn into a torrent of new capacity over the next couple of decades.

However, even if we were able to produce as much clean electricity as we want, there are still many parts of the economy that lack the technology to replace fossil fuels with electricity.

Sectors like transport, mining, manufacturing and construction never completed the first wave of electrification a century ago, and you cannot just plug electric power in where the diesel engine used to be. We cannot do without them either, as they will play a key role in building the new infrastructure.

Innovation is needed to complete electrification, and markets will eventually fix this, but the problem is speed. If we continue to follow the same diffusion pattern as earlier technology revolutions, we will not be done until the 2070s, which is a quarter of a century too late from a climate perspective. We must turn the 30-30-30 model into a 30-15-15 model if we want to meet the requirements of the Paris agreement.

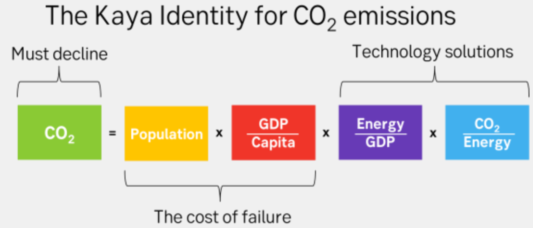
So how do you speed up a revolution? Well, there is an easy part and a difficult part. The easy part is expanding the basic infrastructure, because it only requires capital: the technology is already competitive on a cost basis. However, it will require a lot of capital, because the current investment in renewables only increases capacity enough to cover around 25 per cent of the annual increase in energy consumption.

The more difficult part is about funding the development of new secondary technologies that may not deliver financial (or climate) returns for another 5-10 years. This kind of innovation typically takes place 'on the factory floor', but how do we incentivise companies to do this?

This is where regulators come in: to help investors figure out where to allocate. The EU taxonomy is thus essentially a blueprint for those who want to fund the transition in high-emission sectors. There will be more of these initiatives, also when it comes to banks and other actors, and they will ultimately ensure that companies that do the right thing from society's perspective are rewarded with higher market capitalisation first and stronger competitiveness later.

If we mobilise governments, regulators, companies and investors, a technology solution could in our view be reached before time runs out, allowing us to both cap the temperature increase AND increase living standards across the globe over the next 30 years, using technologies that both improve energy efficiency (because electric motors are more efficient) and reduce energy's CO_2 intensity (using solar and wind).

The Kaya Identity for CO_2 emissions



The alternative is sobering. Without incentives for speeding up technological solutions we are facing elements of a Malthusian scenario of lower living standards and falling population. There is thus every reason to enter a path of Shumpeterian technology solutions instead. We are soon releasing a publication on Green Transition which can be found on our Green bonds website (link here).

The Nordics

Swedish growth has slowed compared to the other Nordics, but a gradual recovery in consumption and residential construction will help the economy accelerate in 2021. Because of a downturn in oil investments, Norway's economy will decelerate towards trend. GDP growth will slow in Denmark and Finland too, even though a somewhat better global outlook will help sustain the entire trade-dependent region. Household consumption will be a key driver in most places, although muted optimism will boost savings. The key interest rate will be left unchanged in all four Nordic countries.

Sweden

0.00%

This far, but no further. Despite rising unemployment, slow growth and below-target inflation, the Riksbank hiked its repo rate to 0. But no more changes for a while.

Page 39

Norway

1.8%

GDP growth in the mainland economy (excl. oil, gas and shipping) will fall towards trend, reaching 1.8 per cent in 2021, but it will be the fastest growth rate in the Nordic region.

Page 44

Denmark

1.7%

Household consumption is increasing at a healthy annual pace and will continue to be the main driver of Danish growth, even though consumer confidence has faltered.

Page 46

Finland

-1%

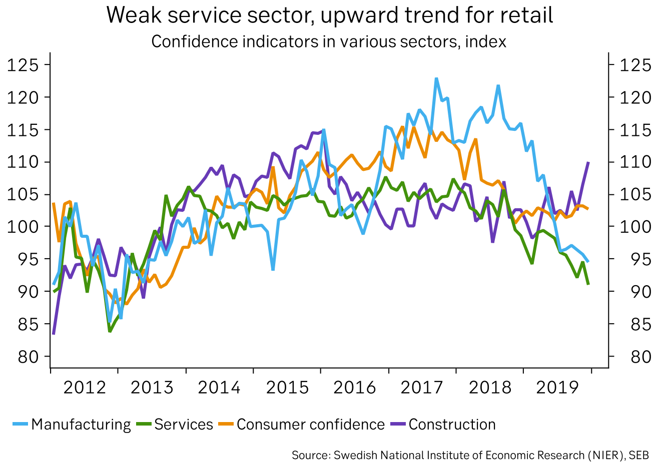
As a share of GDP, Finland's public sector deficit will increase as fiscal policy becomes a bit more expansionary. Yet public sector debt will remain below 60 per cent of GDP.

Page 47

Sweden

Below-trend growth, rising unemployment

Despite certain signs of stabilisation, sentiment indicators point to weak or even falling Swedish GDP in late 2019 and early 2020, but a recovery in household consumption and a turnaround in residential construction suggest that the economy will keep growing in 2020 and that Sweden has a good chance of joining in the international upswing during 2021. Continued strong population growth is one reason why unemployment will keep rising during the coming year.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	2.2	1.1	1.1	1.7
Unemployment*	6.3	6.8	7.3	7.4
Wages and salaries	2.5	2.5	2.6	3.0
CPIF	2.1	1.7	1.4	1.6
Net lending**	0.8	0.4	0.2	0.0
General government debt**	38.8	34.8	33.9	32.8
Repo rate***	-0.25	0.00	0.00	0.00
EUR/SEK***	10.15	10.51	10.10	10.00

* Per cent ** Per cent of GDP *** At year-end. Source: Eurostat, SEB

Risk of falling GDP at the end of 2019

Sentiment indicators have continued to fall in recent months, though there are certain signs of stabilisation. Weakness is more apparent in manufacturing, while domestically oriented sectors are showing signs of some recovery – clearest in the retail and construction sectors. Progress in US-Chinese trade negotiations suggests that manufacturing sentiment will rebound during the next few months. This is one reason why we have only adjusted our 2020 GDP forecast marginally lower, to 1.1 per cent (November: 1.2 per cent). Our 2021 forecast of 1.7 per cent GDP growth is unchanged.

Short-term downside risks, long-term upside potential. Purchasing managers' indices (PMIs) for both manufacturing and services indicate short-term downside risks to growth. Incoming data hint that GDP fell during Q4 2019, but a bit further ahead there is upside potential. Relatively high unemployment and shrinking labour shortages imply that supply-side restrictions are further away than in comparable countries. Underlying conditions will favour demand in the economy, including a continued weak currency. Inflation will remain low, and after December's key rate hike we expect an unchanged zero per cent repo rate throughout our forecast period. Strong government finances will also give the government room for increased fiscal stimulus measures. There are many indications that higher grants to local governments will be part of the spring budget unveiled this April – in an effort to ease the upturn in unemployment while reducing household worries about deterioration in the quality of public services. A strict interpretation of Sweden's official fiscal framework and the gridlock created by the 73-point programme in Social Democratic-Green Party minority government's budget pact with the opposition Centre and Liberal parties will have a general restraining effect, however.

Clear weakening in the manufacturing sector

For a long time the Swedish manufacturing sector was resilient to weaker conditions elsewhere, especially in Germany. In September the purchasing managers' index (PMI) plunged. Despite a minor rebound, it is now well below the expansion threshold of 50. Hard data are also becoming weaker, but so far the downturns for both industrial production and merchandise exports are modest. The downturn is biggest for such basic industrial sectors as forest products and metals, but mechanical engineering is also losing ground. In contrast, the consumer goods sector has been resilient so far, with continued optimism in such segments as pharmaceuticals. Somewhat unexpectedly, the automotive industry is also showing continued strength, although its previously impressive growth rate has slowed considerably. Recovery tendencies in international manufacturing activity suggest that the general downturn in Swedish manufacturing will be brief. As early as Q2 2020 we believe exports will start growing again, and the upturn will gradually accelerate after that. Rising service exports will also help keep total export growth positive as an annual average, but export growth will slow from nearly 4 per cent in 2019 to 1 per cent this year and 2½ per cent in 2021.

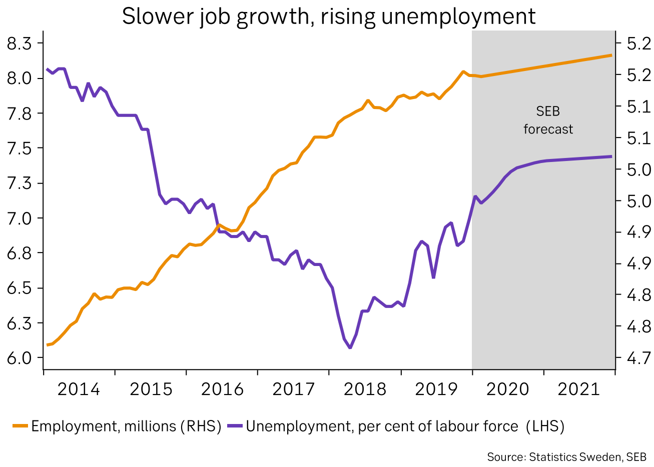
Lower machinery investments, but housing close to turnaround. One indication of weaker manufacturing activity is that machinery investments have declined after several years of strong expansion. A continued production slowdown suggests that this downturn will persist during the coming 12-18 months. Residential investments started shrinking as early as mid-2017 and had fallen by more than 10 per cent by mid-year 2019. Since then there has been a slight recovery, mainly due to an upturn in the volatile repair segment, but new construction is also showing signs of stabilisation. The number of housing starts has now almost levelled off. Late in 2020 we expect a cautious upturn in housing starts, resulting in slightly rising residential investments during 2021. A strong upturn in public sector investments has helped sustain total capital spending. Due to high demand for health care, social services and schooling, this upturn will probably continue for the next couple of years, though at a somewhat slower pace. This is one reason why the downturn in overall capital spending will be only 2 per cent in 2019 and 1.0 per cent this year, followed by a 2 per cent increase in 2021. Weaker local government finances are a downside risk to our forecast.

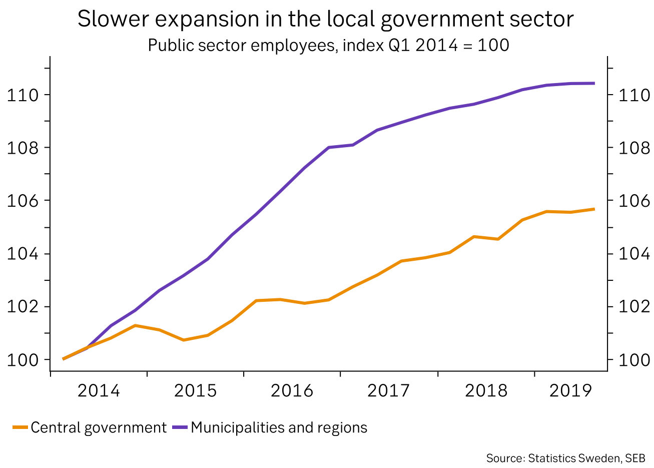
Household incomes and savings ratio

Year-on-year percentage change

	2018	2019	2020	2021
Real disposable income	2.7	2.0	2.5	1.9
Private consumption	1.7	0.9	1.3	1.7
Savings ratio, per cent of income	15.4	15.8	16.0	16.0

Source: Statistics Sweden, SEB





Recovery in household consumption

Household consumption began a slight falling trend in mid-2018. Changed tax rules aimed at encouraging purchases of low-emission vehicles explain part of the downturn, but other consumption has also been weak. The future outlook is mixed. Incomes continue to grow at a healthy pace, driven by job growth, higher real wages and to some extent by tax cuts. The savings ratio is record-high and asset prices are rising: for example, home prices are largely back at their 2017 peak. They gradually rebounded starting in early 2018. Over the past six months, the upturn has accelerated. Statistics such as the SEB Housing Price Indicator suggest that the upturn will continue this year, although slightly higher mortgage rates and rising unemployment make it likely that the pace will slow a bit. We expect a total price increase of 5-7 per cent by the end of 2021.

Shaky household confidence. On the minus side is a clearly weaker labour market, reflected by a decline in household confidence to the lowest level since 2013. However, what is worrying consumers is the general economic situation, whereas confidence in their own finances has recovered and is relatively high. Except for periods of recession and steeply falling employment, consumption declines are unusual. Consumption also rebounded starting in Q2 2019 and strengthened during the second half. We expect a gradual upturn in the coming year. Supporting this assessment, car registrations are now back at the high level that prevailed before the downturn in mid-2018. Further changes in the incentive system for low-emission car purchases effective in January 2020 will make it difficult to interpret coming developments. Among other things, these changes caused a new spike in auto purchases in December 2019.

Public sector expansion is slowing. Swedish public sector consumption has risen only slightly in recent years. As we have pointed out earlier this is because public sector productivity has fallen steeply since a few years ago – mainly due to changed measuring methods. Employment better reflects the impact of the public sector on demand. It has climbed sharply for a long time, but in the past 1-2 years the upturn has slowed and employment is now growing only slightly. This is partly because a growing number of local authorities are facing a tighter fiscal situation. Strong demand for public services, combined with our forecast of increased central government grants, suggests that the upturn in employment will accelerate again, but the pace of increase will be significantly weaker than during the strong expansion of recent years.

Slower job growth and higher unemployment

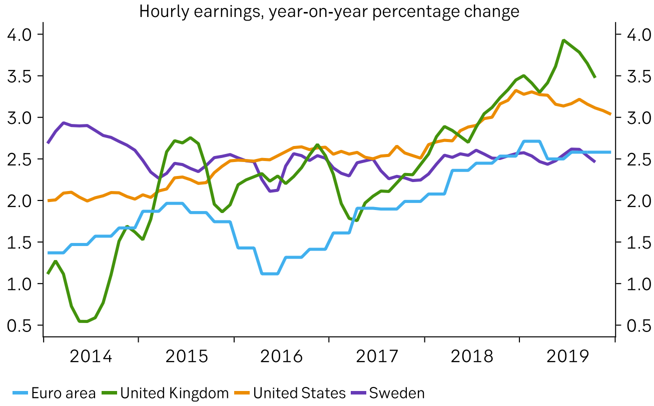
Although the steep upturn in unemployment initially reported for the period July-September turned out to be erroneous, it is clear that the labour market has cooled noticeably. Job growth is continuing, but not fast enough to match an increasing labour supply due to both rising labour force participation and rapid population growth. Since early 2019, unemployment has climbed by more than half a percentage point, and there are many signs that these negative trends will continue during the coming year. Indicators have shown a mixed trend. There has been some recovery in business hiring plans, while the number of newly registered job vacancies at the Swedish Employment Service has continued to fall. Thus, our forecast is that job growth will be less than a half per cent during 2020. The participation rate is now expected to stabilise at a high level, but rising population due to continued high immigration will cause an increase in unemployment to 7.4 per cent by late 2020, stabilising at this high level during 2021. The main reason why Swedish unemployment diverges negatively from the pattern in comparable countries is rapid population growth.

Swedish pay increases stand out

Confirming the cooler labour market, the Riksbank's resource utilisation indicator has plummeted since late 2018 and today is nearly down to its historical average. This decline will probably continue in 2020, also affecting wage formation. Efforts by the Swedish Trade Union Confederation to establish coordination among its affiliated unions have failed; the Municipal Workers and Paper Workers are preparing to pursue separate collective bargaining demands. This suggests that the upcoming national wage round will be messier than usual. The industrial unions' initial 3.0 per cent pay hike demand is also a bit higher than last time. Combined with slightly higher pay increases in other countries, this makes us still believe that yearly contractual pay hikes will end up a bit above the 2.2 per cent level achieved in the 2017 wage round.

Stable wage and salary growth in Sweden

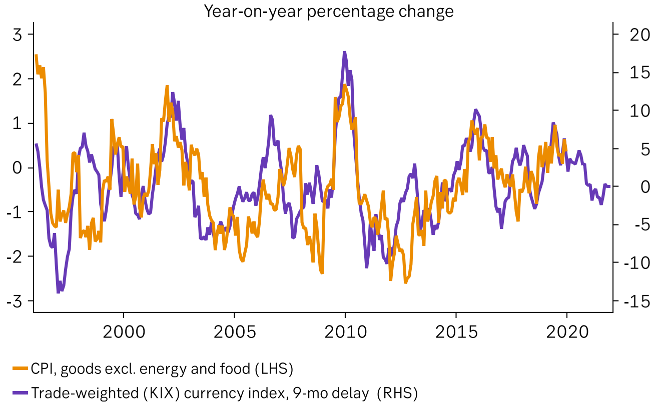
Hourly earnings, year-on-year percentage change



Source: Macrobond, SEB

Exchange rate has increased goods prices

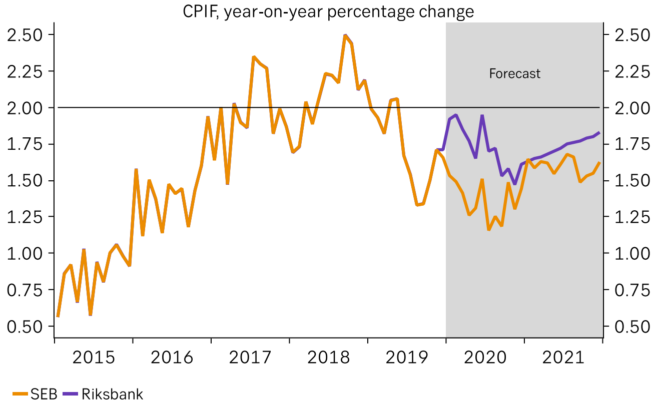
Year-on-year percentage change



Source: Riksbank, Macrobond, SEB

Inflation below target

CPIF, year-on-year percentage change



Source: Riksbank, Macrobond, SEB

Steady pace of pay increases in an international perspective. Although inflation expectations have recently fallen, they remain higher than in 2017. Swedish wages and salaries have climbed at a steady pace of about 2.5 per cent over the past four years. This diverges from the pattern in most European countries and in the US, where pay hikes have shown an accelerating trend although levels are still moderate. Collective agreements at relatively low, stable levels are one reason, but Sweden's internationally very liberal rules for labour immigration (including people with little formal education) have probably also helped depress non-contractual pay increases. The weak labour market suggests that this trend will continue. We expect total Swedish pay increases to accelerate moderately to 2.6 per cent in 2020 and 3.0 per cent in 2021.

Below-target inflation, despite the weak krona. After remaining close to and occasionally above the Riksbank's 2 per cent target since early 2017, CPIF inflation (CPI minus interest rate changes) fell during most of 2019. Energy prices contributed strongly to earlier higher inflation and also explain part of the rebound late in 2019. During the coming six months, falling electricity prices due to unusually mild winter weather will push CPIF inflation down towards 1 per cent. Lower electrical network charges will also contribute to this trend. Core inflation measured as CPIF excluding energy has generally been lower than CPIF and has lacked a clear trend. During certain periods, currency effects have resulted in CPIF inflation excluding energy approaching 2 per cent. Last summer, for example, CPIF excluding energy reached 1.9 per cent. After a downturn, it rebounded to 1.7 per cent in December. Continued upward pressure due to the krona's weak exchange rate will keep CPIF excluding energy just below 2 per cent during the next few months, but after that inflation will fall towards 1.5 per cent.

Will the persistently weak krona push inflation higher? In a box in the September 2019 *Nordic Outlook* we drew the conclusion that inflation pressure from the krona has been in line with the historical pattern so far. At present, there are no signs of "ketchup effects" from the exchange rate. We highlighted the risk that the krona's downward trend might lead to greater inflation pressure than equivalent depreciation episodes in a more volatile currency environment, but since the krona has now appreciated this upside risk is decreasing. Low international prices and moderate pay increases are also helping to hold back inflation. We thus expect CPIF inflation to stay well below target until the end of 2021.

Lengthy key interest rate pause at zero

After a divided Riksbank Executive Board raised the repo rate to zero in December as planned, the four members (out of six) who voted for the hike from -0.25 per cent are now signalling an unchanged key rate until mid-2022. The minutes of their December meeting emphasise that future Swedish monetary policy will be entirely dependent on economic performance and inflation, which we interpret as a signal of a neutral bias ahead of the next monetary policy action. Several members, including Governor Stefan Ingves, maintain that the bank should now be able to accept overshooting of its inflation target. This suggests that very large upside inflation surprises will be required in order for a rate hike to occur over the next two years. The Board hiked the repo rate in spite of rising unemployment, and with both actual inflation and inflation expectations below target. This represents a major departure from its struggle during the past few years to push inflation higher. Significant downside surprises related to both inflation and growth would probably be needed to persuade the Board to reverse such a strong strategy shift and reintroduce negative rates. There are thus many indications that the repo rate will see a lengthy pause at zero.

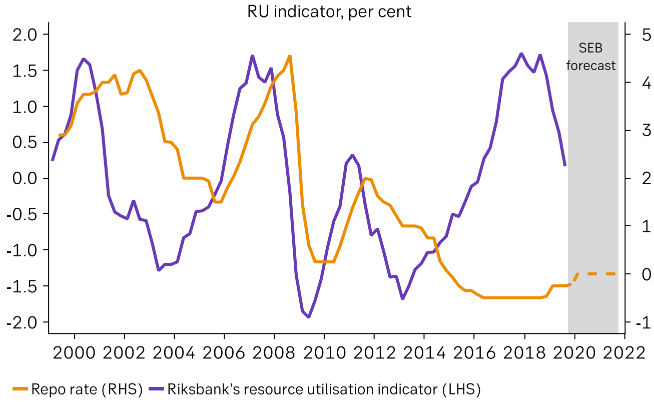
Tacit ambition to leave negative interest rates behind. Although the Board avoided explicitly showing its hand, it is hard not to believe that the Riksbank sees an intrinsic value in bringing the repo rate up to zero. It has clearly been influenced by criticism about the drawbacks of negative rates, especially regarding the trend towards an ever-weaker krona. Housing market developments, including renewed upward price pressure, may also have an impact.

0.00%

"Zero is not a high interest rate." Riksbank Governor Stefan Ingves after the repo rate announcement in December 2019.

Monetary policy out of step with economic cycle

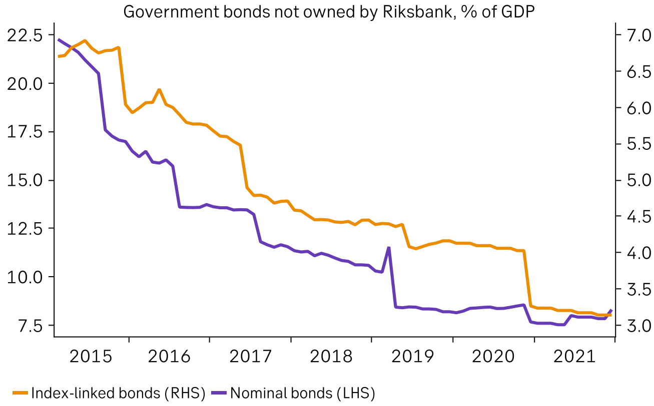
RU indicator, per cent



Source: Riksbank, Macrobond, SEB

Bond supply stuck at low levels

Government bonds not owned by Riksbank, % of GDP



Source: Riksbank, SEB

Higher probability of stimulus than normalisation. Since our inflation forecast is well below that of the Riksbank, we still end up concluding that the probability of monetary easing is higher than new steps towards normalisation. Mr Ingves has hinted that expanded asset purchases are more likely than key rate cuts if new stimulus becomes necessary. Although at present it is hard for the Riksbank to find suitable government bonds to buy, the situation may change if a deeper slowdown increases the government's borrowing requirement. If home prices and household lending decline, this may also increase the probability of mortgage-backed bond purchases. But the shortage of suitable bonds still suggests that major downside inflation surprises will also be needed to persuade the Riksbank to expand its stimulus measures. Also worth noting is that several Board members have indicated that fiscal policymakers should play a more important role if the economy remains weak. But we expect reinvestments of bond principal to continue in 2021 after the current programme expires in December.

The yield spread between Swedish and German 10-year government bonds widened by 15-20 basis points late in 2018, when the Riksbank carried out its first key interest rate hike to -0.25 per cent. Although the Riksbank has hiked the key rate by another 25 bps and the European Central Bank has meanwhile lowered its key rate and resumed is bond purchases, since then the yield spread has moved within a rather narrow range of 25-40 bps. A continued low supply of government bonds is presumably the most important explanation, where the Riksbank has bought up virtually all bonds that the National Debt Office has issued. But this year the NDO plans to increase its issue volume from SEK 30 billion to SEK 52 billion, which is more than the SEK 30 billion that the Riksbank plans to buy in 2020. This means that the bond supply that is available to other market players will increase somewhat, suggesting that the yield spread against Germany will widen to 55 bps during the coming year. The bond shortage problem will persist, however, and the supply of bonds excluding Riksbank holdings is expected to shrink to a new record-low level towards the end of 2020 (see chart) due to large-scale maturities. We also foresee some risks of even lower bond supplies, since we believe that the Riksbank's forecast of central government finances is too pessimistic.

Cautious krona appreciation. The Riksbank's rate hike to 0 per cent in December removed another factor that has weighed down the krona in recent years. Otherwise in 2019 the krona mainly followed the same trend as various other small currencies, in response to weak global economic growth and political risks. The krona is undervalued in the long run, with a long-term equilibrium exchange rate of about 9.75 per euro, but after the effects of the Riksbank rate hikes have faded it is hard to find any driver of a rapid krona appreciation. Yet a somewhat more positive international environment suggests that the SEK will continue to gain ground. We expect a decline in the EUR/SEK rate to 10.10 by the end of 2020, but the krona will reach less than SEK 10.00 per euro only in 2021. At the end of our forecast period, the EUR/SEK rate will be 10.00.

Moderately expansionary fiscal policy

Swedish public finances remain strong in a historical and international perspective, with a central government budget surplus in 2019 for the fourth year in a row. Together with decent GDP growth, this pushed down general government debt to about 35 per cent of GDP. So far the economic slowdown has not had such a clear impact, since tax revenues have remained relatively strong. Looking ahead, weak economic growth and slower job growth will squeeze central and local government budgets during 2020 and 2021. We expect net lending to fall to zero in 2021, but this is still enough to enable government debt to continue falling below Sweden's "debt anchor", 35 per cent of GDP.

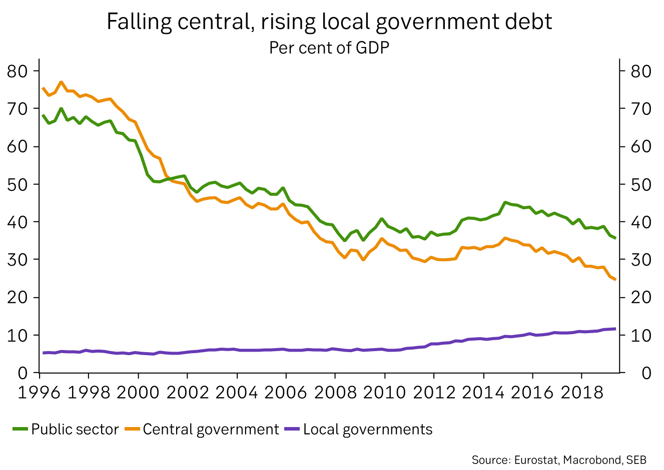
Manoeuvring room is not being utilised when the surplus target controls fiscal policy, even though public sector debt has fallen below the anchor: 35 per cent of GDP

Public finances

Per cent of GDP

	2018	2019	2020	2021
Net lending	0.8	0.4	0.2	0.0
Gen. gov't gross debt	38.8	34.8	33.9	32.8
Borrowing req. (SEK bn)	-80	-112	-9	-5

Source: Statistics Sweden, National Debt Office, SEB



Cautious fiscal policy despite large manoeuvring room. As discussed in the theme article on page 13 there are strong arguments in favour of a more expansionary Swedish fiscal policy, in a situation of strong public finances and rising unemployment, but how political leaders interpret the official fiscal framework will be crucial to the shaping of policy. Since the country has fallen below the debt anchor (35 per cent of GDP), a goal conflict is emerging, but most indications are that a stricter budget target (a surplus of 0.33 per cent of GDP over an economic cycle) will be assigned greater importance, thus resulting in a relatively cautious fiscal policy.

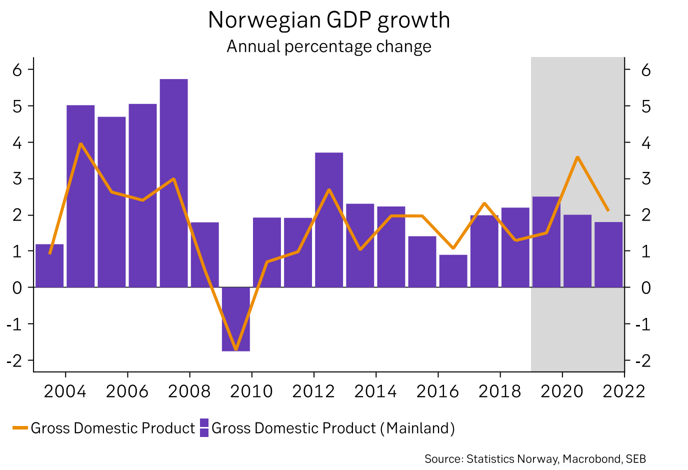
Expansionary fiscal policy will continue. We believe that fiscal policy will provide a stimulus dose equivalent to about 0.5 per cent of GDP in both 2020 and 2021, thus implying that the debt ratio will continue falling below 35 per cent of GDP. Ahead of next autumn's 2021 budget bill, local government operations will be a major focus. Fiscal pressure on municipal and regional authorities is still being driven by such factors as demographics and continued high immigration. The local government sector is also an important market player when it comes to residential construction; both infrastructure for new construction and the construction of rental units by municipal housing companies. We thus believe that local governments will be promised at least SEK 5 billion as early as the spring budget.

Budget collaboration is providing stability but also gridlock. Despite major strains, the January 2019 budget cooperation agreement between the red-green minority government and the opposition Centre and Liberal parties appears likely to survive. As long as the latter two parties achieve many of the reforms on their wish lists, they will probably not end this arrangement, even if it includes many uncomfortable elements that lead to low figures in public opinion surveys. But the joint threat by the Left Party (ex-communists) and three conservative opposition parties to use a vote of no confidence to fire the labour minister unless the government changed its reform plans for the Swedish Employment Service underscored the delicate parliamentary situation. The 73-point programme will continue to play a key role, and reaching agreement on changes will be difficult. This probably means a less expansionary fiscal policy than either a left-wing or a right-wing government would deliver. The political price for this is certainly highest for the ruling Social Democrats, who are steadily losing voters to the Left Party and especially to the populist right-wing Sweden Democrats.

Norway

Economy has passed its cyclical peak

Growth in the mainland economy reached its cyclical peak during autumn 2019. Recent economic data have confirmed the slowdown signalled earlier by sentiment indicators. The capital spending downturn will dampen petroleum-related manufacturing and exports, and mainland GDP growth will slow to a more trend-like pace. The weak NOK will push inflation above target in 2020, but Norges Bank will remain firmly on hold at 1.50 per cent as financial stability risks recede.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	1.3	1.5	3.6	2.1
Mainland GDP	2.2	2.5	2.0	1.8
LFS unemployment*	3.9	3.7	3.7	3.8
Annual wage and salary increases	2.8	3.4	3.3	3.3
CPI-ATE inflation	1.5	2.2	2.0	1.9
Key interest rate*	0.75	1.50	1.50	1.50
EUR/NOK***	9.90	9.84	9.90	9.70

*Per cent ** Year-end. Source: Macrobond, SEB

Slowdown visible in economic data

Growth in the mainland economy (excluding oil, gas and shipping) accelerated in 2019. Our full-year forecast of 2.5 per cent is well above trend (the fourth quarter national accounts will be published on February 7). However, mainland GDP growth probably reached its cyclical high in the third quarter, since monthly national accounts data point to a noticeable slowing between Q3 and Q4 2019. This aligns with various sentiment indicators that point to slower growth momentum going into 2020. The slowdown is related to waning petroleum-related demand, since capital spending growth in the sector will soften noticeably. We reiterate our expectations that growth in the mainland economy will slow to a more trend-like pace in the next couple of years, though the slowdown appears to be materialising somewhat earlier than envisaged. Improving growth among trading partners and rebounding private consumption should prevent any sharper slowing. We forecast growth in mainland GDP of 2.0 and 1.8 per cent in 2020 and 2021, respectively. Total GDP is expected to grow by 3.6 per cent in 2020, supported by rebounding oil and gas exports, before decelerating to 2.1 per cent in 2021.

Waning petroleum sector demand

After a strong 31 per cent increase from its cyclical trough in early 2018 to the third quarter of 2019, petroleum investment will decelerate noticeably in the next couple of years. Several major projects on the Norwegian continental shelf will be completed and subsequent development projects are too small to fully compensate for the shortfall. Statistics Norway's investment intentions survey reveals that operators have lifted their capital spending plans for 2020 due to some postponements of projects initially scheduled for 2019. We have revised our forecast for this year higher and expect petroleum investment to increase by 4.0 per cent, while foreseeing negative growth of 3.5 per cent in 2021.The downturn in capital spending will dampen petroleum-related manufacturing and exports. Momentum in factory output is already showing signs of slowing, in line with the deteriorating Business Tendency Survey indicator. However, the rebound in manufacturing PMI in late 2019 suggests that a severe downturn is unlikely. Capital spending in the sector is nonetheless likely to moderate after years of sturdy investment growth. We expect business investment to grow by 0.8 and 0.0 per cent in 2020 and 2021, respectively. Overall, mainland investment should make a slightly positive contribution to GDP growth. Signs of stabilisation in growth among Norway's main trading partners, combined with the weak krone, should underpin demand for Norwegian exports. We expect shipments of traditional goods to increase by 3.2 per cent in 2020, resulting in a slightly positive net trade balance.

Households remain cautious

Fiscal stimulus and strong job growth have lent support to household disposable income, but consumers have nonetheless remained cautious. Private consumption has moderated over the past two years, dented by stalling domestic spending on goods. Interest-sensitive spending on autos has trended lower. Increased climate awareness, combined with the implementation of a central credit information register, may explain the weaker demand for consumer durable goods. Hence, the savings ratio excluding dividends rose to 4.1 per cent in the third quarter after having been negative a year earlier. We expect the savings ratio to increase somewhat further as job and nominal wage growth moderate ahead. Temporary factors are partly responsible for a downward revision of our forecast for private consumption in 2020 to 2.0 per cent, while a rebound to 2.3 per cent in 2021 is expected.

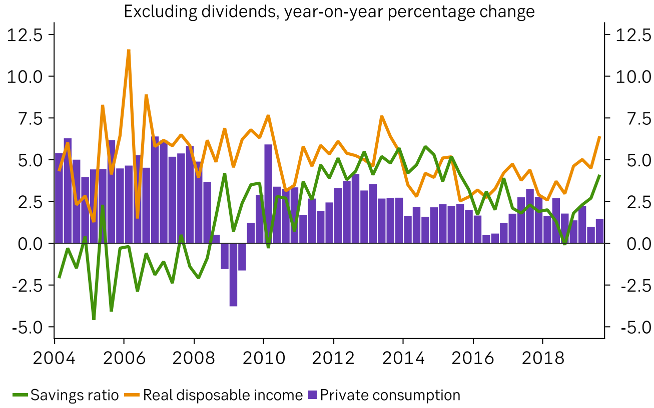
Unemployment is bottoming out

There has been a discrepancy in labour market trends between metrics recently. The Labour Force Survey (LFS) unemployment rate was 3.8 per cent in October, up 0.5 points from 6 months earlier. The registered jobless rate held steady at 2.2 per cent, or 2.7 per cent including people on employment schemes during the same period. It is not unusual for the two metrics to diverge, since the survey-based LFS data can occasionally be very volatile. Job growth has remained solid: 1.7 per cent year-on-year in Q3. Despite strong job growth in recent years, the general labour supply is sufficient, suggesting a somewhat lower structural unemployment level of just below 2.5 per cent. Looking ahead, growth in both the labour force and employment should moderate in line with slower economic growth. We forecast a relatively stable LFS jobless rate of close to 3.7 per cent in 2020-2021. Our forecast for annual pay increases has been lowered slightly to 3.3 per cent yearly in 2020 and 2021.

Despite household debt at 230 per cent of income, the risk of a renewed build-up of financial imbalances is receding

Households prefer saving rather than spending

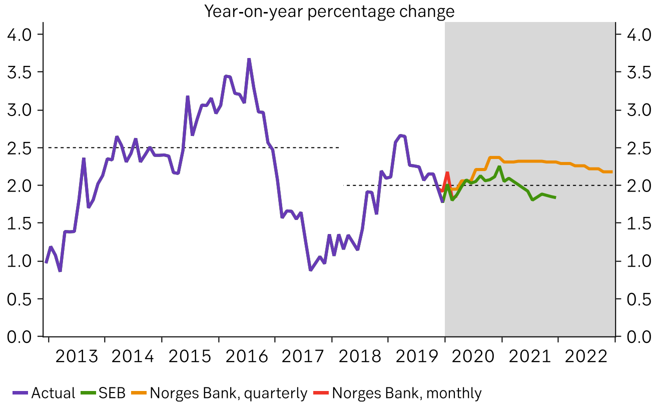
Excluding dividends, year-on-year percentage change



Source: Statistics Norway, Macrobond, SEB

CPI-ATE above target in 2020

Year-on-year percentage change



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

Inflation will rise above target in 2020

Inflation continued downward at the end of last year and the rate of increase for CPI-ATE (excluding taxes and energy) was below 2 per cent for the first time in just over a year. The near-term outlook is mixed; our assessment is that CPI-ATE will rise above target in 2020. A weaker exchange rate is the main driver and is expected to lift inflation by a few tenths. A normalisation of food prices is also expected to contribute to faster inflation, though this part of the forecast is uncertain given softness at the end of last year. Food prices have increased by an average of 2 per cent over the past 5 years and rising producer prices indicate that the decline will be temporary. Service prices have accelerated at their fastest pace since 2010, driven by higher wages in addition to temporary contributions from unusually large telecom and health care price hikes. Base effects from these increases and the earlier weak exchange rate indicate that inflation will subside in 2021 and CPI-ATE will be slightly below Norges Bank's target. Falling electricity prices due to the unusually warm winter will keep CPI below 2 per cent in 2020.

Lower financial stability risks comfort Norges Bank

Existing home prices increased 2.6 per cent in 2019, picking up noticeably from the 0.7 per cent rise in 2018. Though moderate in a historical context, the annual increase is impressive considering rising mortgage rates and near record-high supply of existing homes. Growth in both home sales and homes for sales have slowed and the housing market appears balanced. We forecast moderate price increases of near 3 per cent in both 2020 and 2021. Slower home price inflation, the new credit register and the extension of the mortgage lending regulation until December 2020 have contributed to weaker household credit growth. Though the household debt level remains high at 230 per cent of disposable income, the risk of a renewed build-up of financial imbalances is receding. Norges Bank delivered a fourth rate hike to 1.50 per cent in September 2019 and has kept the key interest rate unchanged since then. Although the bank revised its rate path marginally higher in December, maintaining a hawkish bias, the message was balanced. The bar for either hiking or cutting the policy rate is high. Heightened external risks, slower domestic growth momentum and reduced financial stability risks suggest a cautious approach. Meanwhile, a positive output gap and inflation near target will prevent Norges Bank from adopting a dovish bias. We expect the key rate to remain at 1.50 per cent throughout our forecast period.

A trend shift in the NOK should support NGBs

The Norwegian krone has rebounded, outperforming all G10 currencies since early December. While this partly reflects seasonality, we believe a trend shift is in the making. Expectations of fading concerns about a deeper global slowdown, combined with a relatively high Norwegian interest rate, will support the NOK. The krone will remain vulnerable to setbacks in risk appetite, and liquidity remains a hurdle. We forecast an EUR/NOK exchange rate of 9.90 by the end of 2020, falling to 9.70 by the end of 2021. The stronger krone should underpin FX-related demand for Norwegian government bonds (NGBs). With yield spreads at historically wide levels against German equivalents, NGBs offer attractive pick-up. We forecast a 10-year spread against Germany of 145 and 140 basis points by the end of 2020 and 2021, respectively.

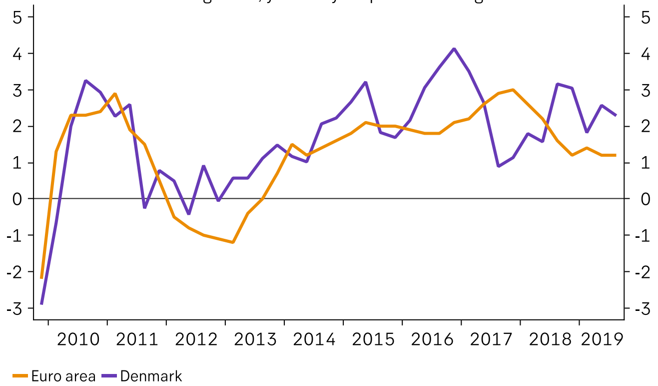
Denmark

Gentle slowdown

Denmark's GDP growth continues to run ahead of the euro area average, and we have raised our 2020 forecast to 1.8 per cent. Consumer demand remains supported by strong employment growth. Slowing wage inflation suggests that the economy still has room for several years of above-trend growth. Temporary DKK weakness may lead to a small adjustment in the key interest rate.

Denmark is outperforming the euro area

GDP growth, year-on-year per cent change



Source: Statistics Denmark, Eurostat, Macrobond, SEB

Key data

Yearly change in per cent

	2018	2019	2020	2021
GDP	2.4	2.1	1.8	1.5
CPI	0.8	0.8	1.1	1.4
Wages and salaries	2.2	2.0	2.5	2.8
Public sector fiscal balance*	0.6	2.0	0.5	0.5
Public sector debt*	34.3	33.5	33.0	32.2
Current account*	5.7	8.0	7.5	7.0
Key interest rate (CD rate), per cent	-0.75	-0.75	-0.75	-0.75
EUR/DKK	7.47	7.46	7.46	7.46

*Per cent of GDP. Source: Statistics Denmark, DØRS

Growth running ahead of euro area average. Denmark's GDP growth continues to outperform the euro area average, with quarterly growth coming in at 0.4 per cent in Q3 2019, up 2.3 per cent from a year earlier and with exports and private consumption providing the bulk of the increase. The Q3 report provided a new quarterly growth profile on the back of November's sharp revision of historical growth, and this is the main reason why we have raised our 2020 GDP growth forecast from 1.6 per cent to 1.8 per cent. The bigger picture continues to point to a gentle slowdown in growth towards 1.5 per cent in 2021.

Consumers remain slightly downbeat. Private consumption continues to be the main driver of Danish growth, supported by strong employment growth and a high savings ratio. Consumer confidence edged lower during the autumn but picked up towards year-end as home prices appeared to regain a little momentum, helped by lower mortgage rates that also freed up liquidity for consumers who refinanced into less expensive loans. Job growth has shifted downward, but the latest data indicate it is stabilising at around 1 per cent, which is still quite strong by historical standards. Wage inflation has slowed to around 2 per cent, but the rising employment-to-population ratio suggests this should pick up over the coming year. All of this suggests that private consumption will continue to provide the foundation for economic expansion.

Investment is subdued. While consumer demand remains strong, capital spending growth has tapered off. Business investment is being held back by relatively low capacity utilisation, largely due to weak demand in some of Denmark's major export markets in Europe, although exports have picked up a bit after a weak first half of 2019. Construction starts have been losing momentum after real estate prices levelled off in early 2019. We expect business investment to pick up as demand stabilises in European export markets, and construction should see some support from higher real estate prices. Nonetheless, this is unlikely to be a dominant driver of growth in the coming years.

Economy still has slack. After half a decade of strong job growth, there are still no real indications of a tightening labour market; the employment-to-population ratio in prime age brackets remains below the trough from the 2001 recession, and wage inflation has fallen to just 2 per cent. We expect wage inflation to move higher over the forecast period, but there is no imminent risk of overheating. Inflation will rise slightly but remain at historically low levels. Meanwhile, Denmark's current account surplus has exceeded DKK 200 billion for the first time, suggesting that domestic demand could expand without any adverse consequences. The modest fiscal expansion embedded in the budget for 2020 is thus unlikely to cause any market concerns.

Weak DKK triggers intervention. Denmark's central bank (DNB) has intervened in the currency market in recent months to support the krone spot exchange rate, which is at the weaker end of the DNB's normal range. Two key factors may have played a role. First, the DNB decision to fully match the ECB's 10 bps deposit rate cut in September may have been too bold, given that the ECB changed to a two-tiered deposit system at the same time. Second, Danish banks have recently started charging negative interest rates on large household deposits, which in practice works like a DKK rate cut. This could also lead to temporary outflows as some savers adjust their position. So far, DNB intervention is modest in scale, and the general view appears to be that the pressure is transitory and thus can be handled mainly using this tool. However, if the DNB has to continue intervening into February, a small adjustment of its key interest rate is not out of the question.

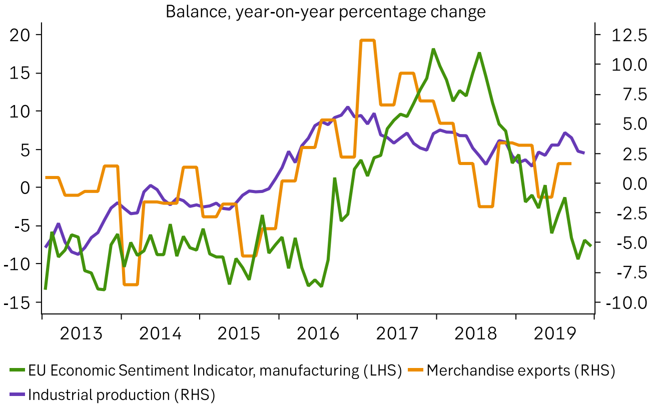
Finland

Resilient, but worried about Germany

Unlike important trading partners, Finland saw its GDP growth accelerate during much of 2019. Service exports have been strong and consumption has revived, in spite of gloomy households. Economic weakness elsewhere in Europe is lowering business sentiment and investments – creating a downside risk – but somewhat better global economic conditions will help keep GDP growth at around 1.5 per cent in 2020 and 2021.

Increasing production despite falling sentiment

Balance, year-on-year percentage change



Source: Statistics Finland, European Commission (DG ECFIN), Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	1.7	1.6	1.5	1.5
Private consumption	1.8	1.2	1.5	1.4
Unemployment*	7.4	6.7	6.7	6.5
Wages and salaries	0.8	1.3	1.8	2.0
HICP inflation	1.2	1.1	1.3	1.4
Public sector fiscal balance**	-0.8	-1.0	-1.2	-1.2
Public sector debt**	59.0	58.5	58.0	57.5

* Per cent ** Per cent of GDP. Source: Eurostat, SEB

Sentiment weaker than hard data. In keeping with the general European trend, Finnish sentiment indicators have worsened. The manufacturing sector is gloomiest, and the indicator level is not far from that of 2012-2014, when growth was very weak. But hard data show better performance, including a continued increase in industrial production and merchandise exports. Service sector sentiment has shown a slight downward trend, with some signs of stabilisation in the past few months. Our overall assessment is that economic growth will remain at around 1.5 per cent yearly, but the risk is on the downside. Germany is Finland's most important export market, and continued weak economic performance there may have major contagion effects in the future.

Weak investments. Finnish capital spending was generally weak in 2019, and the outlook is not bright. Although manufacturing has been relatively resilient to the global slowdown, companies are likely to remain hesitant as long as international uncertainty persists. In the housing market, nominal price increases are at just above zero, while the number of new building permits has fallen and construction industry sentiment has generally worsened. Capital spending will increase by 1 per cent this year and 2 per cent in 2021, well below the average of 3.5 per cent in the past four years.

Labour market slowdown. After two strong years, with job growth and sharply falling unemployment, the labour market has begun to decelerate. Unemployment stood still at 6.7 per cent during most of 2019, but job growth slowed to around 1 per cent late in the year. There are bright spots, however. The number of job vacancies keeps rising from an already historically high level, and companies are indicating that they need more employees. According to business surveys, labour shortages remain a relatively big problem. Given the large number of vacancies, this signals matching problems in the labour market. The headwinds affecting manufacturers in many countries will contribute to a slight upturn in the jobless rate this year before it falls again. At the end of 2021, unemployment will be 6.5 per cent: only a few tenths of a point above its 2008 low.

Slowly accelerating pay hikes. Wage and salary increases have been depressed by economic conditions and by broad agreements aimed at improving competitiveness in the face of weak currencies in Sweden and Norway, among other factors. But pay hikes have accelerated and will reach about 2 per cent in both 2020 and 2021. Inflation pressure remains low, but inflation will be 1.3 per cent this year and 1.4 per cent in 2021, just below the euro area average.

Households are gloomy but keep consuming. Consumer confidence has plunged after two upbeat years and is even lower than during some recession periods in the past decade. This sharp downturn is a bit surprising but may be related to crisis awareness and worries that the faster growth of the past 2-3 years was temporary. Consumption followed sentiment downward during the first half of 2019 but then rebounded. Slight job growth and faster pay hikes are providing a decent increase in purchasing power. At the same time, households have a need to improve their savings, which have been close to zero for a number of years. Consumption rose by more than 1 per cent last year and will grow somewhat faster in 2020-2021.

Expansionary fiscal policy in spite of deficits. The government plans to pursue an expansionary policy, including higher spending for education, investments and health care. This will worsen the fiscal balance slightly in 2020 and 2021. The budget deficit will grow to more than 1 per cent of GDP, but public sector debt will remain below 60 per cent of GDP throughout our forecast period.

The Baltics

After a lag, the three Baltic economies are now beginning to be affected by the slowdown in global demand that was apparent during 2019 in particular. Lower industrial production and weaker demand for transport services in Europe are among the reasons behind the deceleration in the Baltics. Yet despite slower growth, labour markets are comparatively tight and pay increases are high.

Lithuania

2.5%

Expected Lithuanian GDP growth this year, after a noticeable slowdown in manufacturing last year. Various factors suggest that growth will remain at around the same level in 2021 as well.

Page 49

Latvia

0.6

The number of percentage points wiped off GDP growth last year, among other things due to shutdowns in the banking sector and weaker European demand for transport services as a result of declining coal haulage.

Page 50

Estonia

30%

The information and communications technology (ICT) sector's contribution to 2019 growth in Estonia's value added, even though the sector only accounts for 4.5 per cent of the country's total employment.

Page 51

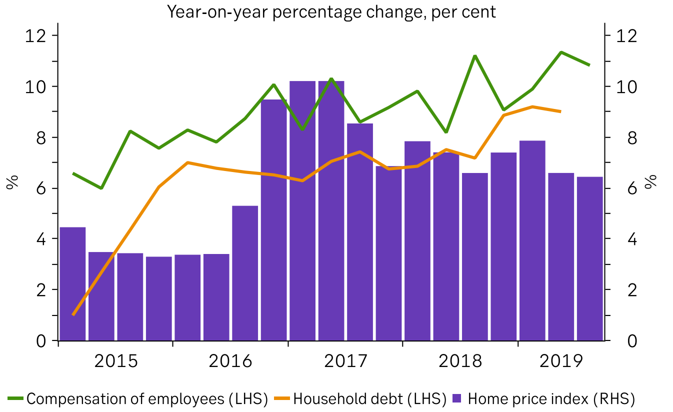
Lithuania

Moderation in growth ahead

Economic expansion decelerated slightly in the second half of 2019, mainly due to a more marked slowdown in industrial production growth. This moderation will extend into 2020, when GDP will rise by 2.5 per cent. The positive contribution from transport service exports will fade in 2020-2021. Consumption will rise at a marginally slower pace on stabilising employment and slower real wage growth. The upturn in inflation will be limited.

Household debt increasing, but still lagging income growth

Year-on-year percentage change, per cent



Source: Eurostat, Statistics Lithuania, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	3.6	3.6	2.5	2.4
Private consumption	3.9	3.2	3.1	3.1
Exports	6.3	9.0	3.8	3.7
HICP inflation	2.5	2.2	2.4	2.3
Wages and salaries	9.9	8.6	7.1	5.8
Public sector fiscal balance*	0.6	-0.3	0.0	0.1
Public sector debt*	34.1	36.4	35.4	34.6
Current account*	0.3	2.1	0.8	0.6

* Per cent of GDP. Source: Statistics Lithuania, SEB

Economic growth decelerated in the last quarter of 2019 as protracted weakness in the global economy finally took its toll on Lithuania's net exports. Industrial production, which demonstrated solid growth in the first nine months, barely expanded at the end of the year. Nevertheless, 2019 was a successful year for Lithuania's economy as GDP rose by 3.6 per cent. The year was fruitful in attracting foreign direct investors and Lithuania finally got its first start-up unicorn. We remain cautious about growth prospects in the coming two years – GDP will expand by 2.5 per cent in 2020 and by 2.4 per cent in 2021. Our expectations of slower growth during our forecast period are based on assumed smaller contributions from the transport, manufacturing and construction sectors.

Business sentiment declined marginally in 2019. However, this has not had a substantial negative impact on capital spending so far. Fixed investments in machinery even surprised on the upside, with growth that was faster than in 2018. Peaking EU funding flows also boosted investments in the energy and transport sectors. Capital expenditures will increase at a slightly slower pace in 2020, still supported by public investments. Despite higher output, the construction sector is not very healthy, with some large companies facing liquidity and profitability problems.

Private consumption growth in 2019 was below our forecast. Growth in real wages and salaries exceeded our expectations and consumer confidence has not showed any weakness. The number of employees rose in 2019, but our concerns regarding changes in unemployment increased. Contrary to other Baltic economies, unemployment in Lithuania climbed in the second half, mostly due to higher long-term unemployment. We assume that structural problems such as low mobility and skills mismatches will persist in 2020, accompanied by a continued strong influx of employees from other countries. Unemployment will stay close to 6.2 per cent during our forecast period. Pressure to increase wages will ease slightly in 2020, but the government's decision to hike the monthly minimum wage and boost public sector salaries supports our forecast of a 7.1 per cent increase in gross wages this year.

Inflation declined to 2.2 per cent in 2019 on lower energy prices, but we expect that it will increase to 2.4 per cent in 2020 due to higher prices for such energy products as fuels and electricity. The impact of increasing labour costs on service inflation will remain largely unchanged in 2020.

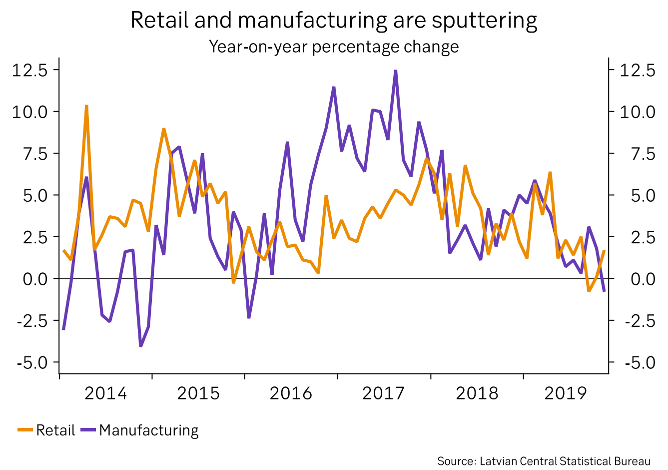
Property prices keep rising at a steady pace of 6-8 per cent, which is still below wage growth and supports housing affordability ratios. Household debt growth accelerated in 2019 but remained close to the rate of increase in wages. The supply of new residential properties will not decrease this year. Forecasted slower growth in wages will lead to slightly smaller increases in residential property prices in 2020 and 2021.

The government approved a 2020 budget with a surplus of 0.2 per cent of GDP, but we believe this projection is overly optimistic about tax revenues. In 2019 the budget balance fell short of forecasts. We should not be surprised about the government's generosity, since a parliamentary election take place in the autumn of 2020. The introduction of an auto pollution tax is welcome, but tax rates are still too low.

Latvia

Still strong wage growth

GDP growth in the second quarter of 2019 awakened fears that the economy would soon slowdown markedly. Exports have proved resilient, while domestic demand is expected to increase at a good rate as unemployment remains at low level and wage continues to rise at a good rate. Downside risks have diminished, but weak global economy is worrying. Growth will slow to 2.0 per cent this year and recover to 2.5 per cent in 2021.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	4.6	2.4	2.0	2.5
Private consumption	4.4	3.4	2.8	3.2
Exports	3.9	2.1	2.6	3.5
Consumer price index (CPI)	2.5	2.8	2.1	2.5
Unemployment*	7.4	6.5	5.9	6.1
Wages and salaries	8.4	7.9	6.5	5.9
Public sector financial balance**	-0.7	-0.9	-0.9	-0.9
Public sector debt**	36.4	35.5	34.9	34.2

* Per cent ** Per cent of GDP. Source: Statistics Latvia, SEB

Marked decline in GDP growth. Latvia's 2.5 per cent GDP growth in the first nine months of 2019 was the weakest among the three Baltic countries. Performance varied by sector, but the construction boom is in a sunset phase. The slowdown was reinforced by major structural changes in the banking sector – the closure of two banks and the scrapping of business models focused on serving non-residents. This was accompanied by a fall in the transit sector, due to low demand for coal in Europe and Russia's policy of steering cargo to its ports. Weather conditions led to a low level of electricity production. These sectors wiped some 0.6 percentage points off the growth rate. Continuing structural changes in the financial and transit sectors will pull down growth this year as well. We are maintaining our cautious outlook, expecting GDP to rise by 2 per cent in 2020 and rebound to 2.5 per cent next year.

Lowest sentiment since 2017. Economic sentiment recovered in November but remains at the lowest levels since January 2017, with the clearest downward trends in construction and manufacturing. Although construction grew by around 5 per cent in 2019, this year growth will turn negative. There is no reason to expect a crisis in the sector yet, but major challenges lie ahead in 2021 and 2022. Late in 2019 manufacturing started to sputter, with output dropping in more than half of sub-sectors in November, hence the start of 2020 may be weak. Following a global rebound in the second half, Latvian manufacturing may return to 2-2.5 per cent growth this year.

In 2019 information and communications technology performance was disappointing, but ICT is expected to contribute more to GDP this year. Real estate activity is subdued; due to lending conditions, limited supply, price levels and demographics we do not expect a rapid recovery. Other sectors focusing on domestic consumption will see relatively decent growth, although retail activity lately has been rather weak. Exports have been surprisingly resilient, growing by 2.3 per cent in the first nine months of 2019. Although demand is weak, flexibility and cost advantages are providing opportunities for further expansion.

Inflation fell to 2.1 per cent in November. Average annual inflation was 2.8 per cent in 2019 and will slow to 2.1 per cent this year. Drivers this year include domestic factors such as excise tax, public transport prices and costs dictated by wage dynamics. The economy is slowing, but the situation is far from critical. Wage growth accelerated to 8.3 per cent in the third quarter due to labour shortages, despite the macro environment. Its pace should slow to 6.5 per cent this year. Employers will increasingly focus on ways to offer alternatives (bonuses, flexible working hours, better work environment) to reduce fixed wage costs.

Lowest unemployment in 13 years. In the third quarter of 2019, unemployment dropped to 6 per cent. Demographics are inexorable. Although the employment rate has increased to 65.6 per cent, the number of employed people is shrinking. This year unemployment will continue to decline, but not much. Strong regional and skill disparities, exacerbated by lack of mobility, limit Latvia's chances of reaching the unemployment rate seen in many EU countries. With construction cooling, demand for lower-skilled workers will diminish.

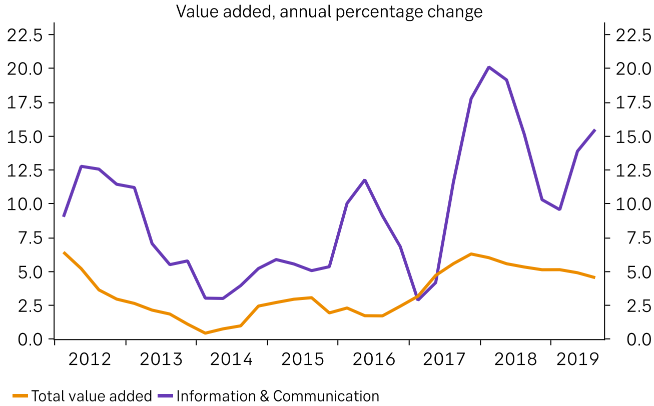
Estonia

Strong end to a golden decade

Despite weak indicators, 2019 ended on a strong note with GDP growth driven by the increasingly important, export-dependent ICT sector. Gloomy manufacturers indicate that exports will be a drag on growth ahead, though. A continued strong labour market and 6 per cent annual pay increases will boost consumption despite households keeping up their savings. We are sticking to our forecast that GDP will grow by 2.0 per cent this year and 2.6 per cent in 2021.

ICT's share in the economy is growing fast

Value added, annual percentage change



Source: Eurostat, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	4.8	3.8	2.0	2.6
Private consumption	4.3	3.1	2.8	4.8
Exports	4.3	4.0	1.0	2.4
Consumer price index (CPI)	3.4	2.3	2.0	2.2
Unemployment*	5.4	4.7	5.5	6.2
Wages and salaries	7.3	7.6	6.4	5.7
Public sector fiscal balance**	-0.5	-0.2	-0.1	0.0
Public sector debt**	7.9	7.8	7.5	7.5

* Per cent ** Per cent of GDP. Source: Statistics Estonia, SEB

Exports of ICT services are driving growth. Regardless of the cautious outlook of many economists, 2019 was once again a success for the Estonian economy, ending a golden decade which saw nominal GDP almost double. In the third quarter as well as during the whole year, the main contributor to growth was the country's relatively small information and communication technology sector. While its share of total employment is a mere 4.5 per cent, it provided almost 30 per cent of overall growth in value added. The sector's growth seems to have been driven primarily by exports of services, which have thrived for many years.

Mixed signals from manufacturing – difficult to assess the overall outlook. Both industrial production and exports of goods have been falling since June. Yet according to the third quarter national accounts, exports of goods were booming – with a 8.6 per cent growth in volume. However, business confidence in the manufacturing sector has been in free fall since last January and is now at its lowest since late 2009. Industrial confidence has not been a perfect predictor of future manufacturing output, but such low levels imply that the beginning of 2020 could be very weak for the sector. Despite the gloomy manufacturing outlook, the service sector should help total exports grow by 1.0 per cent this year.

Disappointing consumption. While the contribution of exports to GDP growth was a big upside surprise, private consumption was a major disappointment. Despite strong retail sales and wage growth above 8 per cent, private consumption increased by a meagre 1.2 per cent in the third quarter. Since later revisions have tended to result in significant adjustments, this will probably be the case again. The labour market continues to outperform expectations. In the third quarter, unemployment reached a historical low of 3.9 per cent while the employment rate of 69.4 per cent was the highest in the EU. Consumer confidence also remains far above its historical average. While headwinds in manufacturing may start to have a negative effect on the labour market, we expect the increase in unemployment to remain marginal. Labour shortages will continue to push up wages and salaries by around 6 per cent annually. Due to these factors, private consumption will increase by 2.8 per cent in 2020. In 2021, a significant surge in private consumption will take place as the controversial pension reform takes effect, allowing people to withdraw their savings from the second pension pillar. Forecasting the exact amount of money flowing from pension savings to consumption is difficult, but in our view, the effect will be more limited than many expect. Yet it will be enough to propel private consumption growth to 4.8 per cent.

Robust household savings. Despite strong retail sales, household savings are piling up rapidly. While total lending to households has increased by 6 per cent, household deposits rose by 10 per cent. However, the increase in savings has not been even across different income brackets, and a large percentage of households remain vulnerable to financial shocks.

Construction expected to weaken. The construction market has thundered on at full capacity, and new building permits for residential development are at their highest level since the financial crisis. However, sales periods seem to be lengthening and the outlook is becoming increasingly questionable. The main cause is changes in demography. The number of people aged 25-34, when Estonians typically buy their first home, has started to decrease. By 2022 there will be 10 per cent fewer people in this age range than in 2018. In addition, public sector investments will be curbed by the decreasing inflow of EU funds. Due to these factors, capital formation will increase by only 0.2 per cent in 2020 and 1.2 per cent in 2021.

Key indicators

Global key indicators

Yearly change in per cent

	2018	2019	2020	2021
GDP OECD	2.3	1.7	1.6	1.7
GDP world (PPP)	3.6	3.0	3.1	3.3
CPI OECD	2.6	2.0	2.0	1.8
Oil price, Brent (USD/barrel)	72	64	70	70

US

Yearly change in per cent

	2018 level, USD bn	2018	2019	2020	2021
Gross domestic product	20,580	2.9	2.3	1.8	1.9
Private consumption	13,999	3.0	2.6	2.5	2.3
Public consumption	2,904	1.7	1.8	1.7	1.2
Gross fixed investment	4,261	4.4	1.8	0.8	2.0
Stock building (change as % of GDP)		0.1	0.2	-0.1	0.0
Exports	2,510	3.0	-0.3	1.1	2.8
Imports	3,149	4.4	1.3	1.9	3.5
Unemployment (%)		3.9	3.7	3.5	3.5
Consumer prices		2.4	1.8	2.0	1.9
Core CPI		2.1	2.2	2.2	2.1
Household savings ratio (%)		7.7	8.0	7.8	7.9
Public sector financial balance, % of GDP		-5.7	-5.7	-5.6	-5.5
Public sector debt, % of GDP		104.3	106.0	108.0	110.0

Euro area

Yearly change in per cent

	2018 level, EUR bn	2018	2019	2020	2021
Gross domestic product	11,561	1.9	1.2	1.1	1.2
Private consumption	6,207	1.4	1.4	1.4	1.3
Public consumption	2,364	1.1	1.5	1.0	1.0
Gross fixed investment	2,406	2.3	4.5	1.3	2.0
Stock building (change as % of GDP)	0	0.0	-0.3	0.1	0.0
Exports	5,547	3.3	2.6	2.8	3.0
Imports	5,047	2.7	4.0	3.5	3.5
Unemployment (%)		8.2	7.6	7.7	7.5
Consumer prices		1.8	1.2	1.5	1.5
Core CPI		1.0	1.0	1.4	1.4
Household savings ratio (%)		6.2	6.0	6.0	0.0
Public sector financial balance, % of GDP		-0.5	-0.7	-0.8	-0.9
Public sector debt, % of GDP		85.9	85.4	84.4	84.0

Other large countries

Yearly change in per cent

	2018	2019	2020	2021
GDP				
United Kingdom	1.4	1.3	1.0	1.1
Japan	0.3	1.2	0.9	0.6
Germany	1.5	0.6	0.7	1.0
France	1.7	1.3	1.2	1.4
Italy	0.8	0.2	0.5	0.7
China	6.6	6.1	5.7	5.9
India	7.4	5.1	6.0	6.5
Brazil	1.1	1.2	2.4	2.8
Russia	2.3	1.2	1.8	2.2
Poland	5.1	4.2	3.1	3.0
Inflation				
United Kingdom	2.5	1.8	1.3	1.6
Japan	1.0	0.5	0.7	0.8
Germany	1.7	1.4	1.6	1.6
France	1.9	1.3	1.5	1.5
Italy	1.3	0.6	1.0	1.1
China	2.1	2.9	3.6	2.2
India	4.0	3.7	3.5	4.1
Brazil	3.7	3.7	4.0	4.2
Russia	2.9	4.5	3.5	4.1
Poland	1.7	2.3	2.8	2.7
Unemployment (%)				
United Kingdom	4.1	3.8	4.1	4.3
Japan	2.4	2.3	2.2	2.1
Germany	3.4	3.2	3.2	3.1
France	8.9	8.3	8.1	8.0
Italy	10.6	9.9	9.5	9.3

Financial forecasts

Official interest rates		Jan 15	Jun-20	Dec-20	Jun-21	Dec-21
US	Fed funds	1.75	1.75	1.50	1.50	1.50
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10
Euro area	Refi rate	0.00	0.00	0.00	0.00	0.00
United Kingdom	Repo rate	0.75	0.50	0.50	0.50	0.50
Bond yields						
US	10 years	1.79	2.00	1.80	2.00	2.20
Japan	10 years	0.00	0.00	0.05	0.10	0.15
Germany	10 years	-0.22	0.00	0.05	0.10	0.20
United Kingdom	10 years	0.58	0.80	0.85	1.00	1.20
Exchange rate						
USD/JPY		110	109	112	113	114
EUR/USD		1.12	1.15	1.17	1.19	1.20
EUR/JPY		123	125	131	134	137
EUR/GBP		0.86	0.88	0.88	0.86	0.84
GBP/USD		1.30	1.31	1.33	1.38	1.43

Sweden

Yearly change in per cent

	2018 level, SEK bn	2018	2019	2020	2021
Gross domestic product	4,790	2.2	1.1	1.1	1.7
Gross domestic product, working day adjustment		2.3	1.1	0.9	1.6
Private consumption	2,159	1.7	0.9	1.3	1.7
Public consumption	1,258	0.4	0.5	0.1	0.2
Gross fixed investment	1,250	4.2	-2.0	-1.0	2.2
Stock building (change as % of GDP)	47	0.4	0.0	0.0	0.0
Exports	2,213	3.2	3.6	1.2	2.6
Imports	2,092	3.6	1.3	-0.4	2.0

Unemployment, (%)	6.3	6.8	7.3	7.4
Employment	1.5	0.6	0.5	0.4
Industrial production	3.4	1.2	-1.5	2.0
CPI	2.0	1.8	1.5	1.6
CPIF	2.1	1.7	1.4	1.6
Hourly wage increases	2.5	2.6	2.6	3.0
Household savings ratio (%)	15.4	15.8	16.0	16.0
Real disposable income	2.7	2.0	2.5	1.9
Current account, % of GDP	1.9	4.5	4.6	4.4
Central government borrowing, SEK bn	-80	-112	-9	-5
Public sector fiscal balance, % of GDP	0.8	0.4	0.2	0.0
Public sector debt, % of GDP	38.8	34.8	33.9	32.8

Financial forecasts	**Jan 15**	**Jun-20**	**Dec-20**	**Jun-21**	**Dec-21**
Repo rate	0.00	0.00	0.00	0.00	0.00
3-month interest rate, STIBOR	0.20	0.20	0.20	0.20	0.20
10-year bond yield	0.15	0.50	0.60	0.65	0.75
10-year spread to Germany, bps	37	50	55	55	55
USD/SEK	9.45	8.91	8.63	8.44	8.33
EUR/SEK	10.54	10.25	10.10	10.00	10.00
KIX trade-weighted currency index	122.1	117.9	115.6	114.6	114.6

Finland

Yearly change in per cent

	2018 level, EUR bn	2018	2019	2020	2021
Gross domestic product	243	1.7	1.6	1.5	1.5
Private consumption	124	1.8	1.2	1.5	1.4
Public consumption	53	1.5	1.6	1.4	1.4
Gross fixed investment	55	3.3	1.0	1.0	2.0
Stock building (change as % of GDP)	0	0.8	-0.3	0.0	0.0
Exports	90	2.2	3.0	2.6	2.5
Imports	92	5.0	1.5	2.3	2.5

Unemployment, OECD harmonised (%)	7.4	6.7	6.7	6.5
CPI, harmonised	1.2	1.1	1.3	1.4
Hourly wage increases	0.8	1.3	1.8	2.0
Current account, % of GDP	-1.4	-1.2	-1.0	-1.0
Public sector fiscal balance, % of GDP	-0.8	-1.0	-1.2	-1.2
Public sector debt, % of GDP	59.0	58.5	58.0	57.5

Norway

Yearly change in per cent

	2018 level, NOK bn	2018	2019	2020	2021
Gross domestic product	3,338	1.3	1.5	3.6	2.1
Gross domestic product (Mainland)	2,853	2.2	2.5	2.0	1.8
Private consumption	1,500	1.9	1.7	2.0	2.3
Public consumption	802	1.4	2.4	2.3	1.5
Gross fixed investment	832	2.8	5.8	1.6	-0.2
Stock building (change as % of GDP)		0.1	0.0	0.0	0.0
Exports	1,194	-0.2	1.2	6.7	2.7
Imports	1,102	1.9	5.1	1.9	0.8
Unemployment (%)		3.9	3.7	3.7	3.8
CPI		2.8	2.2	1.8	2.1
CPI-ATE		1.5	2.2	2.0	1.9
Annual wage increases		2.8	3.4	3.3	3.3

Financial forecasts	**Jan 15**	**Jun-20**	**Dec-20**	**Jun-21**	**Dec-21**
Deposit rate	1.50	1.50	1.50	1.50	1.50
10-year bond yield	1.41	1.50	1.50	1.55	1.60
10-year spread to Germany, bps	163	150	145	145	140
USD/NOK	8.86	8.52	8.46	8.10	8.08
EUR/NOK	9.88	9.80	9.90	9.60	9.70

Denmark

Yearly change in per cent

	2018 level, DKK bn	2018	2019	2020	2021
Gross domestic product	2,246	2.4	2.1	1.8	1.5
Private consumption	1,058	2.6	1.4	1.7	1.6
Public consumption	547	0.4	-0.1	0.7	0.8
Gross fixed investment	495	5.4	0.7	3.2	3.0
Stock building (change as % of GDP)		0.3	-0.1	0.0	0.0
Exports	1,250	2.4	3.3	3.9	2.6
Imports	1,114	3.6	0.3	4.2	3.9
Unemployment, OECD harmonised (%)		5.4	4.5	4.2	4.2
CPI, harmonised		0.8	0.8	1.1	1.4
Hourly wage increases		2.2	2.0	2.5	2.8
Current account, % of GDP		5.7	8.0	7.5	7.0
Public sector fiscal balance, % of GDP		0.6	2.0	0.5	0.5
Public sector debt, % of GDP		34.3	33.5	33.0	32.2

Financial forecasts	**Jan 15**	**Jun-20**	**Dec-20**	**Jun-21**	**Dec-21**
Deposit rate	-0.75	-0.75	-0.75	-0.75	-0.75
10-year bond yield	-0.20	0.05	0.10	0.15	0.25
10-year spread to Germany, bps	2	5	5	5	5
USD/DKK	6.70	6.49	6.38	6.30	6.22
EUR/DKK	7.47	7.46	7.46	7.46	7.46

Lithuania

Yearly change in per cent

	2018 level, EUR bn	2018	2019	2020	2021
Gross domestic product	45	3.6	3.6	2.5	2.4
Private consumption	28	3.9	3.2	3.1	3.1
Public consumption	7	0.5	1.1	0.8	0.6
Gross fixed investment	9	8.4	7.8	4.8	3.9
Exports	34	6.3	9.0	3.8	3.7
Imports	33	6.0	8.5	4.7	4.4
Unemployment (%)		6.2	6.2	6.2	6.3
Consumer prices		2.5	2.2	2.4	2.3
Public sector fiscal balance, % of GDP		0.6	-0.3	0.0	0.1
Public sector debt, % of GDP		34.1	36.4	35.4	34.6

Latvia

Yearly change in per cent

	2018 level, EUR bn	2018	2019	2020	2021
Gross domestic product	30	4.6	2.4	2.0	2.5
Private consumption	17	4.4	3.4	2.8	3.2
Public consumption	5	4.0	2.2	1.5	2.3
Gross fixed investment	7	15.8	4.5	2.2	3.5
Exports	17	3.9	2.1	2.6	3.5
Imports	18	6.4	2.2	3.0	3.6
Unemployment (%)		7.4	6.5	5.9	6.1
Consumer prices		2.5	2.8	2.1	2.5
Public sector fiscal balance, % of GDP		-0.7	-0.9	-0.9	-0.9
Public sector debt, % of GDP		36.4	35.5	34.9	34.2

Estonia

Yearly change in per cent

	2018 level, EUR bn	2018	2019	2020	2021
Gross domestic product	26	4.8	3.8	2.0	2.6
Private consumption	13	4.3	3.1	2.8	4.8
Public consumption	5	0.9	3.2	1.6	2.5
Gross fixed investment	6	3.3	13.8	0.2	1.2
Exports	19	4.3	4.0	1.0	2.4
Imports	18	5.7	4.1	2.7	3.8
Unemployment (%)		5.4	4.7	5.5	6.2
Consumer prices		3.4	2.3	2.0	2.2
Public sector fiscal balance, % of GDP		-0.5	-0.2	-0.1	0.0
Public sector debt, % of GDP		7.9	7.8	7.5	7.5

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