Research Reports

Fed rate cuts and bright spots in trade conflict ease soft landing

Riksbank to abandon its negative key rate despite rising unemployment

Nordic Outlook

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Finding the right way out

A labyrinth of challenges

An eventful 2019, to say the least – a year coloured by recession debates, historic negative interest rates and yields, trade conflicts and Brexit confusion – is moving towards the finish line. The distinct slowdown in growth that has characterised almost the whole world in 2019 has, at least partially, been politically self-inflicted and is expected to have an impact in 2020-2021 as well.

We continue to see the slowdown as multi-dimensional: not only caused by trade uncertainty but also having cyclical, structural and psychological elements. Together, these forces disrupt global investment and production cycles as well as the international trade system. We now expect them to have rather larger effects on growth than we thought early in 2019.

In today's low-inflation environment, most central banks – except in Norway and probably also Sweden – have reacted to downside growth risks by cutting key interest rates and resuming QE programmes. But we are not alone in questioning the effectiveness of negative rates/yields and related monetary policies, unless they go hand in hand with more vigorous fiscal and structural policies. We are now looking forward to a potentially new economic policy debate, led – among others – by Christine Lagarde, the new ECB president.

Negative key interest rates and yields on long-term securities have turned the world upside down. But they also allow room for faster growth by means of public sector spending on infrastructure, climate, education and more. The emerging market (EM) sphere – which accounts for some 60 per cent of the global economy – can now benefit from US rate cuts and from investment capital flowing into these countries. EM regions show signs of stabilisation, thus inspiring hope for 2020 and reducing the risk of a global recession next year.

As always, we try to provide a helicopter perspective of events. You will find our overall assessment of the situation in this November 2019 issue of *Nordic Outlook*, including four in-depth theme articles:

- The EM economies: signs of improvement
- Trade war 2.0: hard-fought, unsteady progress
- Negative rates: the "dark sides" of the policy
- Swedish local government: squeezed

We hope that the new issue of *Nordic Outlook* will provide you with enjoyable reading and new insights, and we wish you all a genuinely successful 2020.

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Chief Economist

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The global economy

Low inflation and tight labour market overburden monetary policy and leave fiscal policy passive

The United States

48.3

The October ISM purchasing managers' index for manufacturing. Despite decent GDP growth, the US economy has been hurt this autumn by global industrial weakness and uncertainty related to trade conflicts.

The euro area

13%

The household savings ratio in H1 2019. Uncertainty about economic conditions has dampened consumer spending. If such worries can be eliminated, there is good potential for a consumption rebound.

Emerging markets

4.0%

GDP growth in 2019 – the lowest since the financial crisis. But we foresee a brighter outlook for the EM economies, as trade worries decrease and low inflation allows further central bank stimulus measures.

The United Kingdom

4.6%

The British current account (CA) deficit as a percentage of GDP. Despite the weak pound, the CA deficit has remained wide, and the UK's customary current account surplus in services has also begun to shrink.

Fed rate cuts and progress in trade negotiations have improved global confidence. We have still lowered our GDP growth forecast for 2019 and 2020, but recession risk have decreased and growth will rebound in 2021. Lingering political uncertainties limit the upside, however. Given continued low inflation, monetary policy is carrying the burden of stimulus. Fiscal policy is being blocked by late-cyclical job strength and rigid regulations.

The global economic outlook has stabilised in recent months. The US Federal Reserve's three key interest rate cuts, progress in the trade negotiations between the United States and China and signs that industrial activity is bottoming out – especially in Asia – have contributed to greater confidence. One reflection of this is stock markets, which have climbed significantly and are now at record-high levels. The Fed seems to have been successful in its ambition to prolong the economic upturn with its "mid-cycle" correction. This is also reflected in a rebound for bond yields, which has made the US yield curve a little steeper. Recession signals from the fixed income market are thus not as clear.

Less recession risk, despite our lowered global GDP growth forecast. Partly because of these positive signals, we have adjusted the probability of a recession in the next couple of years downward. We now estimate that it is 20-25 per cent, but at the same time we have lowered our global GDP growth forecast by two tenths of a percentage point for both 2019 and 2020 – to 2.9 and 3.0 per cent, respectively. This is due to a downward revision of our emerging market (EM) economies forecast by two tenths for 2019 and three tenths for 2020. Our forecast for advanced economies is largely unchanged. Although GDP in the US rose a little faster than expected in the third quarter of 2019, sentiment indicators have meanwhile weakened. Growth will thus probably slow down noticeably during the next six months. As earlier, we believe that in 2021 global GDP growth will accelerate to 3.3 per cent, among other things because we are already seeing early signs of stabilisation and a turnaround for the EM economies (see the theme article on page 15).

Soft landing even though history indicates otherwise. Our forecast for global GDP growth is somewhat below consensus, especially for 2020, but generally speaking the late-cyclical environment that we are in today seems to be contributing to an unusually high level of unanimity among forecasters. Continued low inflation is giving central banks substantial manoeuvring room to respond to early warning signals of falling demand. In addition, the Fed has signalled that it is prepared to allow above-target inflation for a while in order to prolong the economic upturn. Such warning signals as extremely high private sector debt or grossly excessive corporate investments are also conspicuously absent. This puts a rather large burden of proof on those who present an outright recession as their main forecast.

Global GDP growth
Year-on-year percentage change

	2018	2019	2020	2021
United States	2.9	2.2	1.7	1.9
Japan	0.8	1.2	0.7	0.5
Germany	1.5	0.5	0.6	1.1
China	6.6	6.1	5.7	5.9
United Kingdom	1.4	1.3	1.4	1.5
Euro area	1.9	1.0	1.1	1.3
Nordic countries	1.8	1.6	1.9	1.8
Baltic countries	4.2	3.4	2.3	2.4
OECD	2.3	1.6	1.4	1.6
Emerging markets	4.7	4.0	4.2	4.5
World, PPP*	3.6	2.9	3.0	3.3

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

Unemployment and geopolitics are imposing upside restrictions. On the other hand, we are now seeing a 40-year low in overall unemployment in the 36 mainly affluent countries of the Organisation for Economic Cooperation and Development (OECD), and a 50-year low in the US. Because of this, a major acceleration in growth this late in the economic cycle seems unlikely. Unemployment may fall a bit more, especially in the euro area, and the trend towards higher labour force participation may also continue in the US and elsewhere. But to make a larger growth surge possible, productivity would have to accelerate significantly. We can see tendencies in this direction, for example in the US, and we cannot rule out the possibility that the effects of technological advances in the "Fourth Industrial Revolution" might manifest themselves with a certain lag. Yet it is unlikely that we will see any clear trend reversal during our forecast period. Lingering political uncertainty is also putting a ceiling on the growth outlook. Although our main scenario is that a no-deal Brexit (British withdrawal from the European Union) can be avoided and that the US-Chinese trade

talks will make cautious progress, uncertainties will persist at both the global and European level.

Hard to strike a balance between monetary and fiscal policy. Forecasters are concluding that the prevailing late-cyclical environment will persist for a fairly long period, and this is also affecting economic policy debate. One question concerns how seriously the disadvantages of today's extreme interest rate and yield situation actually are, for example in terms of increased financial risks, wider economic gaps and weaker pressure for change in the economy (see the theme article on negative interest, page 22, which also discusses the challenges to life and pension insurance companies). We can see a trend in which central banks worry more and more about these disadvantages and about their shortage of ammunition for responding to the next downturn. On the other hand, they have little choice when inflation is low and there is actually a chance of pushing unemployment to even lower levels. There are various reasons to believe that at present, fiscal stimulus measures would be more effective than an even more extreme monetary policy approach, but aside from the obstacles posed by fiscal policy regulations – for example in the euro area and Sweden – there is also a reluctance to shift budget policy in an expansionary direction so late in the economic cycle. In this way, the prevailing environment of both low inflation and low unemployment risks leading to an asymmetry in which monetary policy is overused and fiscal policy remains too passive.

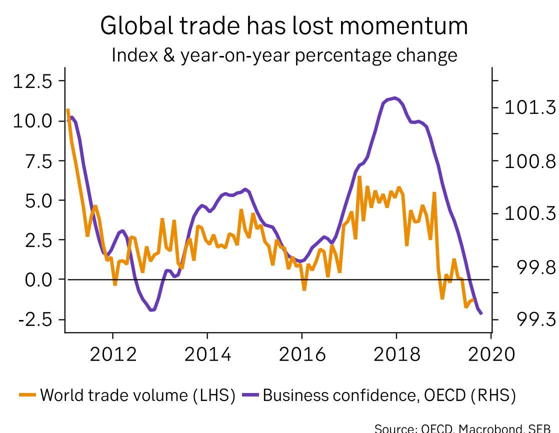
Short-term downside risk to interest rates and yields, then upside. As mentioned above, long-term yields have rebounded after their September lows, due to shrinking recession risks. We believe that central banks are not entirely finished with their stimulus measures. The Fed will deliver a final "insurance" rate cut early next year, while the European Central Bank (ECB) will lower its deposit rate to -0.60 per cent in March 2020. This means that international bond yields are expected to fall somewhat once again until mid-2020, before their upward movement resumes – mainly during 2021. Downward structural forces in the form of low inflation risk premiums and low real interest rates will continue to operate, however. At the end of our forecast period, 10-year US Treasuries will be at 2.00 per cent and German government bonds at zero. Because Sweden's Riksbank and the ECB are moving in opposite directions, this suggests a somewhat wider yield spread between Swedish and German 10-year bonds to more than 50 basis points at the end of 2020 and 2021.

The dollar will fall as the growth outlook improves. Our cautiously optimistic scenario implies that defensive currencies like the US dollar will lose ground. Another Fed rate cut will also help push the EUR/USD exchange rate gradually higher to 1.20 at the end of 2021, although the dollar will continue to benefit from high interest rates compared to other countries. A low near-term risk of a hard Brexit has strengthened the pound, but looking ahead further there are persistent downside risks from future trade negotiations with the EU. Meanwhile it is uncertain whether a return to a zero key rate in Sweden will be enough to lure back flows into the krona, but fewer worries about the global economy will help generate an upward trend for the krona, which will trade at 10.20 per euro at the end of 2020 and 10.00 at the end of 2021. This year's sharp depreciation in the Norwegian krone is hard to explain, but we are sticking to our forecast of a gradually stronger krone, with the EUR/NOK rate reaching 10.00 at the end of 2020 and 9.70 at the end of 2021.

The stock market will enjoy support from ultra-low interest rates and yields plus the combination of dividends and share buy-backs, but a subdued growth outlook, small corporate earnings increases and share valuations close to historical peaks will limit the potential of equities. Our main scenario is a cautious stock market upturn and continued volatility risk.

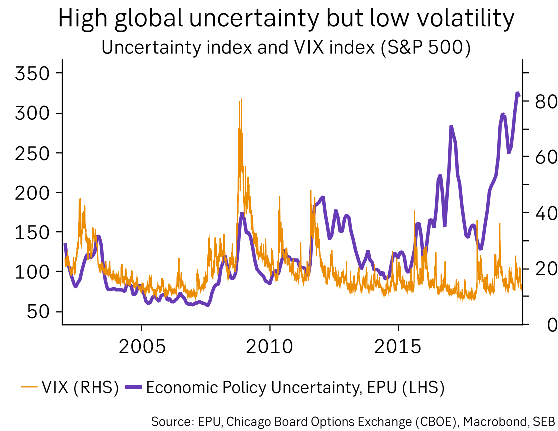
The global trade system has been shaken

The economic disruptions caused by trade conflicts have been more serious than we predicted early in 2019, but their direct impact– such as tariffs – is less than their indirect impact, for example in the form of investment uncertainty. Not only are economic interests at stake, but the US and China in particular are also on a collision course in areas like ideology, security policy and technological leadership. Studies by the Fed and the IMF indicate a maximum negative impact on global GDP of about 0.8 per cent. In our main scenario, the largest effect occurs in 2019 and the negative impulse then gradually fades in strength.



A partial US-Chinese agreement is on the way. Financial markets reacted positively when the latest negotiating round resulted in a limited oral agreement, in which the US has postponed planned tariff hikes from 25 to 30 per cent in exchange for increased Chinese purchases of American farm products. The two sides have also agreed to abstain from currency warfare, while China has pledged to further open its financial market to foreign companies. This has led to hopes of additional progress in upcoming negotiations. We foresee a high probability of a limited Trump-Xi agreement before year-end. President Donald Trump obviously does not wish to jeopardise the US economy during the coming year, which is one reason why the White House will probably also postpone any decision to impose auto tariffs against the EU and others. US negotiations with the EU are complicated, however,

because Trump wants to export more farm products to Europe, which France in particular will likely try to stop.

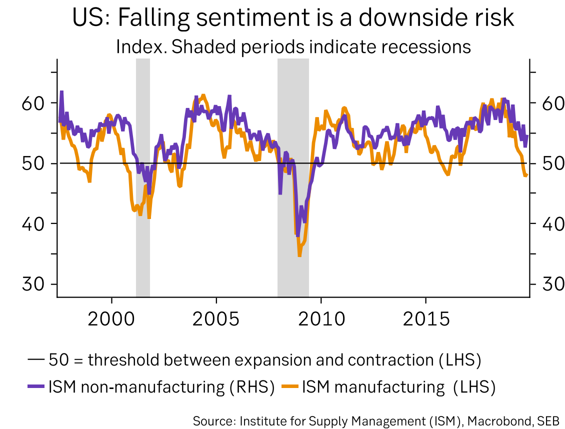


Uncertainty will persist for some time. Despite some progress in the near future, uncertainty about the international trade system is expected to persist. The next step in the trade talks – for example on sensitive issues like Chinese industrial policy and state subsidies – will probably be substantial harder, however, since US demands in these areas would imply far-reaching changes in China's economic model. There is also broad public support in the US for a tough approach towards China, making a decisive breakthrough more difficult. The world has also learned that as long as Trump is president, agreements with the US are not written in stone either. This became obvious last May when the White House chose to threaten Mexico with new tariffs unless that country tightened immigration to the US. There is also great uncertainty about the future role of the World Trade Organisation. The lack of predictability about trade thus risks impeding capital spending in the long term, threatening economic growth and productivity. Read more about these issues in the theme article "Trade war 2.0" on page 18.

US: Fed prolongs historically long upturn

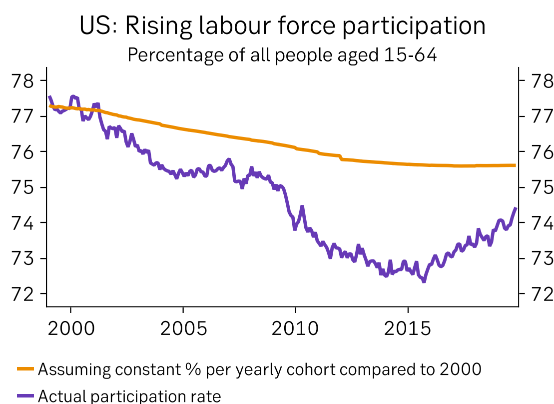
The economy has mainly continued to show resilience. In the third quarter of 2019, GDP grew by an annualised 1.9 per cent, largely unchanged from Q2 and marginally below our estimated long-term trend growth (about 2 per cent). The sharp private consumption upswing in Q2 (4.6 per cent) was followed by a more trend-like 2.9 per cent increase in Q3. Capital spending kept falling despite a renewed upturn for residential construction, while foreign trade provided a largely neutral contribution to the economy. The trade war has thus not brought the US closer to Trump's original goal of a smaller foreign trade deficit, nor can this be expected as long as US economic growth remains faster than in other countries.

Sentiment indicators are signalling weaker activity. The US economy has not been immune to global industrial weakness and trade uncertainty. This autumn the ISM purchasing managers' index (PMI) in the manufacturing sector has fallen to levels that indicate shrinking production, while order bookings have touched their lowest since the financial crisis. Non-manufacturing has also been affected, although its PMI is still a bit above the expansion threshold of 50. But very recently, manufacturing has shown signs of stabilisation, supported by successes in US-Chinese trade talks and early indications of a turnaround in China and other emerging market (EM) countries. This reduces the risk that the manufacturing slowdown will spread even further into the rest of the economy.



GDP will decelerate further in the near term. While large US companies are gloomy, sentiment among small businesses and especially among households has remained relatively healthy. Household consumption is supported by opportunities to refinance home mortgage loans at lower rates, and the high savings ratio offers long-term potential. But due to slower job growth, private consumption is expected to decelerate slowly in line with more subdued growth in household incomes. Low interest rates are helping to sustain residential construction, while business investments will remain squeezed by trade uncertainty and cyclical fatigue. Overall, we believe that negative international impulses and trade worries will lead to a clear slowdown in GDP growth in Q4 2019 and during the first half of 2020. After that, we expect the pace of growth to rebound somewhat. As an annual average, GDP growth will cool from 2.2 per cent this year to 1.7 per cent in 2020 and climb to 1.9 per cent in 2021.

Balanced risks. In the short term, the risks to our forecast are on the downside and are mainly connected to any new escalation in the trade area. Looking ahead a bit further, the risk picture should be analysed on the basis of whether the Fed can prolong the upturn further. This is when the risks of fiscal imbalances and severe labour market bottlenecks will be in focus. The traditional signals of an over-ripe economic cycle – a rapid credit build-up in the household sector and a breakneck pace of business investments – are conspicuously absent. This is fortunate and it increases the prospects of continued expansion, although growing corporate sector debts that are used for funding dividends, share buy-backs and corporate acquisitions rather than capital spending are a source of uncertainty. Yet such risk-taking has historically not caused crises as deep as overheated credit cycles related to households and residential construction.



Continued rapid job growth. US employment has continued to grow at an impressive pace. During the past three months, non-farm payrolls increased by an average of 176,000, still well above the underlying population trend. Sharp declines in service sector employment indicators in recent months are signalling that the demand for labour will weaken in the future, although these indices are notoriously volatile. Yet it is reasonable for job growth to slow in a situation of mounting labour shortages, which is confirmed by reports in the Fed's Beige Book of growing difficulties in finding people to hire.

As long as pay hikes do not take off, it is hard to declare the labour market overheated to an unhealthy degree

Testing supply-side limits. A bit further ahead, the employment growth trend will be determined by supply-side potential. Unemployment fell to 3.5 per cent in September, the lowest in 50 years, and then climbed marginally to 3.6 per cent in October. In other words, we are well below the Fed's latest estimate of equilibrium unemployment – 4.2 per cent – but as long as pay hikes do not take off more dramatically, it is difficult to argue that the labour market is overheated to an unhealthy degree. Fed policy is also expressly intended to push down equilibrium unemployment, by giving weaker groups an opportunity to enter the labour market. Although there are signs of increased upward pressure on wages and salaries for certain groups, according to the Beige Book companies largely used other incentives (bonuses and benefits) to attract employees. Our assessment is that the uncertain economic outlook as well as a keen competitive situation will keep businesses cautious about pay hikes.

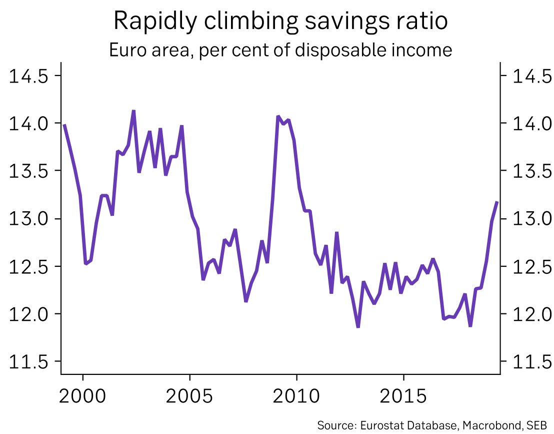
Labour force participation may continue to increase. We also see potential for a continued increase in labour force participation. For individuals aged 15-64, the participation level has climbed from 72.5 per cent to a bit above 74 per cent over the past several years. A further upturn of 1-2 points appears within reach when we adjust for the underlying demographic trend. Productivity growth in the US has also accelerated somewhat in the past few years. Intensified efficiency-raising efforts due to increasing recruitment difficulties or delayed results from earlier technology investments are conceivable explanations for this. Overall, our assessment is that supply-side conditions should not create obstacles to a continued expansion of the US economy during the next couple of years.

Japan's economy faces growing headwinds

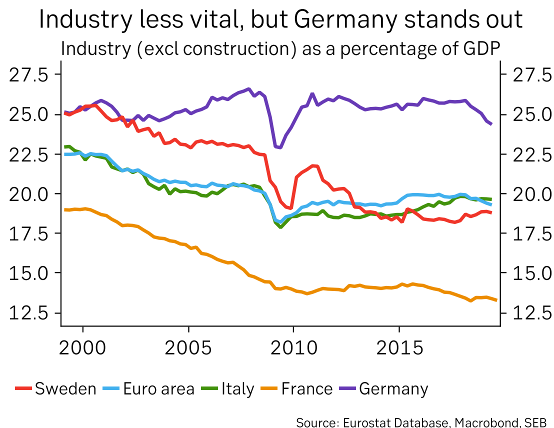
The Japanese government and central bank continue to face powerful headwinds. The consumption tax was raised from 8 to 10 per cent on October 1 as expected, despite falling optimism among exporters and households. This was partly in response to international criticism against Japan's weak public finances and government debt of close to 240 per cent of GDP. Positive forces that helped sustain 2019 growth – such as last spring's installation of the new emperor, 2020 Olympics investments and fiscal stimulus – are fading. We expect yearly GDP growth of about 0.5 per cent in 2020 and 2021. Downside risks predominate, due to China's deceleration and Japan's continued trade conflict with South Korea on technology exports (see theme article, page 18). Due to disinflationary forces in the economy, Japan will not achieve its 2 per cent inflation target during our forecast period. The Bank of Japan is under pressure to make its policy even more expansionary, but even in Japan some people have objected to new easing due to its declining benefits. We expect generally unchanged monetary policy.

Capital spending sustains euro area growth

Euro area sentiment indicators signal continued weak growth ahead. October PMIs remained low after an unexpectedly big decline in September. Service sectors continue to show some resilience, with PMI readings still a bit above the expansion threshold of 50, but some contagious effects from the manufacturing downturn have now made themselves felt. Despite subdued optimism, capital spending has been the most important driver of GDP growth this past year, especially during Q2 2019. Relatively high capacity utilisation and low interest rates will continue to benefit the investment climate, but the general GDP slowdown is likely to gradually lower capital spending as well.



Clear upturn in household saving. For a long time, euro area households have benefited from rising asset prices and employment as well as higher real wages. Although consumer confidence has retreated somewhat, it is still above its historical average. Yet consumer behaviour has been cautious, and the savings ratio has increased relatively sharply this past year. The European Union's Economic Sentiment Indicator also shows that households would actually like to boost their saving further. Household hesitancy is thus mainly connected to the general economic and political situation, not personal finances. Since this uncertainty is unlikely to fade especially much in the near term, we believe that during our forecast period, consumption will increase at a modest pace of less than 1.5 per cent yearly.



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

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

Source: IMF, SEB

No export turnaround yet. Given a muted outlook for the domestic economy, export performance – particularly in Germany – will be crucial to enable the euro area to emerge from its current slump. German manufacturers benefited greatly from the investment-driven global upturn of 2016-2017. Because of their elevated production level, they are especially sensitive to any slowdown in international trade. The vehicle industry is being squeezed by emission regulations, new consumption patterns and other factors. But in fact it does not stand out negatively, and several leading producers are now showing a clear recovery. Instead, the German manufacturing downturn is broad-based, as Germany's IFO indicator and other metrics have confirmed. It is thus difficult to foresee any rapid recovery, although the global acceleration that we are expecting should benefit Germany. Overall, however, we expect both Germany and Italy to grow more slowly than the euro zone average during our forecast period, but President Emmanuel Macron's reform policies and France's smaller export dependence will help that country grow faster. After its earlier deep recession, Spain will continue to show the fastest growth throughout the period 2019-2021.

A pause in Brexit as UK citizens vote

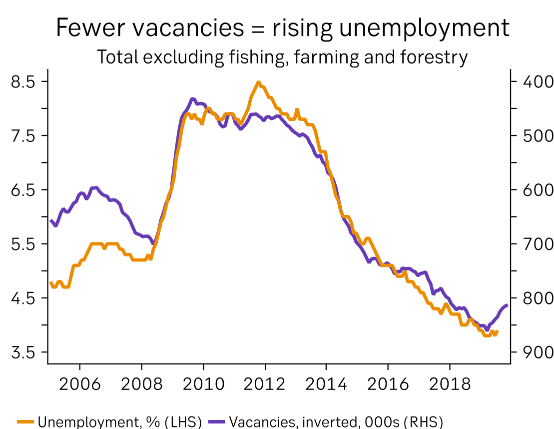
Although the EU side previously refused to renegotiate Prime Minister Theresa May's 2018 withdrawal agreement, her successor Boris Johnson succeeded in replacing the "backstop". The British Parliament still forced him to extend the withdrawal date until January 31. With a government lacking its own majority and a divided Parliament, the Brexit issue remains gridlocked. The Conservative (Tory) government is now hoping that voters are losing patience and that the extra December 12 parliamentary election will give them a clear mandate to leave the EU under the new agreement. Public opinion surveys and betting odds indicate that the Tories will strengthen their position in the election, but history shows that anything can happen when the United Kingdom holds an election.

If the election does not lead to a clear majority in Parliament, we see several alternative ways forward. 1) It is still conceivable that the UK will leave the EU under the new transition agreement. 2) The country can also leave but retain close ties to the EU, for example by staying in the EU customs union. 3) If Parliament is still unable to choose a path, the withdrawal decision will probably be reassessed in a new referendum, where the British can choose between leaving the EU based on the withdrawal agreement or else remaining. Considering how complex the process of breaking away from the EU has been, we would not be surprised if they voted to remain.

In economic terms, the UK has already been hurt by Brexit. The consequences of withdrawal will depend on how close a connection with the EU the country will have in the future. A no-deal Brexit risks slowing British growth dramatically, while a more orderly withdrawal would have a more limited impact.

Decent British growth despite Brexit

The messy Brexit process continues to hold back the British economy. During Q2, GDP fell by 0.2 per cent compared to the preceding quarter. International economic weakness, especially in the EU, makes it hard to determine to what extent political uncertainty is actually hurting the UK economy. British confidence indicators have taken a major beating this summer and autumn, but this is probably because of Brexit-related uncertainty only to a minor degree. September PMIs for both manufacturing and services were below 50, indicating a rather high risk of continued negative growth. In the past two decades or so they have only fallen twice (1998 and 2008).

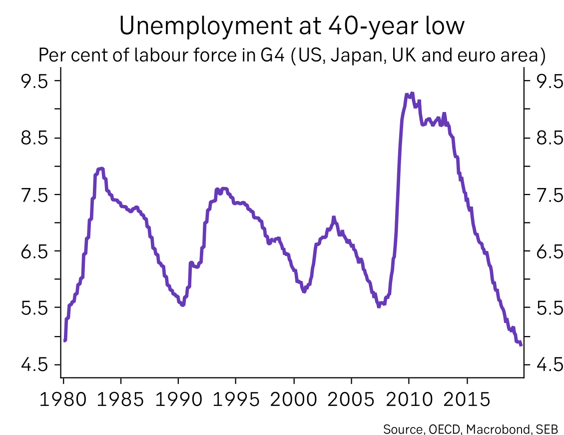


Weak pound propping up exports. Capital spending has definitely been hurt by Brexit, and businesses are likely to be cautious as long as uncertainty persists. Although the export sector has benefited from the weak pound, goods trade showed a record-sized deficit in the first half of 2019. The current account is also being squeezed, since the UK's service export surplus has recently tended to weaken. Household demand has been the main growth driver, but consumption has recently fallen a bit in spite of a strong labour market and solid pay increases. For a long time, record-low saving has made households vulnerable to disruptions, but now there are clear signs of higher saving and lower borrowing. Household vulnerability will thus diminish in the long term but is meanwhile worrisome for short-term growth. Overall, we expect GDP to grow by 1.3 per cent in 2019 and accelerate marginally to 1.4 per cent in 2020 and 1.5 per cent in 2021.

Unemployment has bottomed out. Unemployment is still a record-low 3.9 per cent, but in recent months the downturn has ended. There are also various signs that the labour market is cooling off. The number of new unemployment claims has risen this past year, and vacancies have begun to fall from a record-high level. We believe that the jobless rate will gradually climb to an annual average of 4.3 per cent in 2021. Such a mild slowdown is probably healthy, but a more pronounced deterioration risks accelerating the upturn in household saving, which would be especially serious since Brexit uncertainty is holding back capital spending.

Phillips curve faces new tests

So far, the global labour market has been resilient to the slowdown in GDP growth, but we can see that unemployment has tended to level off in the past 3-4 months. Our forecast implies that the jobless rate has now bottomed out and will remain historically low until the end of 2021. This would imply that labour markets in advanced Western economies will assume more Japanese characteristics, with stable unemployment parked close to record-low levels, but this would diverge from the historical pattern, in which unemployment has generally climbed rapidly once it has bottomed out. Especially in the US, stagnant employment has previously led to weaker private consumption, which in turn has triggered a downward spiral of shrinking capital spending and – after a lag – rising unemployment. It thus remains to be seen whether the drivers behind this dynamic have actually changed.



Source, OECD, Macrobond, SEB

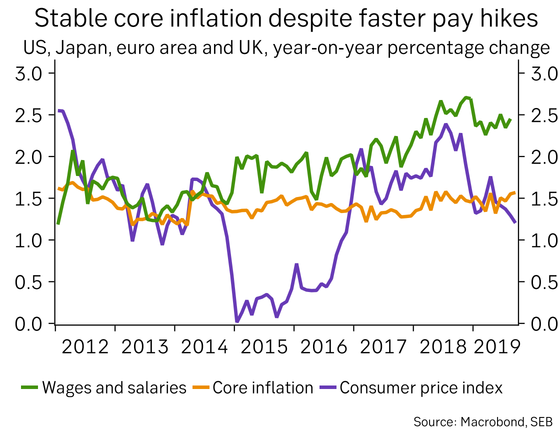
Global inflation convergence trend. Although there are variations, the overall picture of continued weak pay and price pressures is clear. Inflation in EM economies is now apparently showing a trend towards converging with that of the OECD countries. The 2017-2018 acceleration of pay increases in the OECD countries has ended. This is mainly due to a slowdown in Japanese pay hikes, but the upturn in pay hikes has ended in the euro area as well. Even if we assume that wage and salary increases again speed up from 2.0 to 2.5 per cent yearly, inflation in the euro area will remain troublingly low for the ECB.

The Fed's target variable can cope with slightly faster pay hikes. In the US, consumer price index (CPI) inflation(excluding food and energy) this autumn has admittedly accelerated to the highest levels in more than a decade. On the other hand, the Fed's target variable – personal consumption expenditures excluding food and energy (core PCE) – is still below the 2 per cent target. Even if pay increases should speed up slightly further, in response to the tight labour market, we believe that international disinflationary forces will help hold down inflation in the US as well. Market-priced inflation expectations have also continued to fall, and we are sticking to our assessment that recent rapid price increases do not constitute a change in this trend. We expect core CPI to fall

somewhat again and core PCE to remain a couple of tenths of a percentage point below target.

Stable core inflation despite faster pay hikes

US, Japan, euro area and UK, year-on-year percentage change



Source: Macrobond, SEB

Increasing support for active fiscal policies

More and more people are now calling for fiscal policymakers to play a larger role in stabilisation policy. This includes radical ideas that are part of modern monetary theory (MMT) and that are popping up in the campaigns of various Democratic presidential candidates in the US. But they are also heard in the slightly disillusioned calls for fiscal policy help by leading central bankers, such as former ECB President Mario Draghi and his successor Christine Lagarde. Both the shortage of monetary policy ammunition and the conceivable negative side effects of extremely low interest rates (see the theme article on page 22) are contributing to their mood. In addition, low interest rates of course mean that it is unusually cheap for governments to borrow and pay interest on their debt.

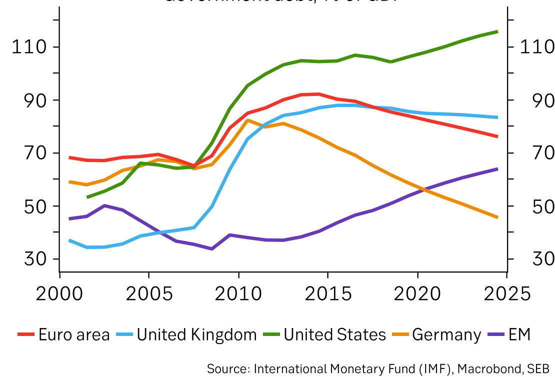
The climate issue is having contagious effects. Broad and intensive public engagement on the climate change issue has not only increased the legitimacy of giving special treatment to "green" investments – thereby making budget frameworks more flexible – but has probably also contributed to a change of tone regarding political interventions in general. At least there seems to be a growing political consensus that the public sector has many urgent tasks to deal with. This is in clear contrast to the earlier neoliberal wave, with its widely influential message that governments should stay out of most things as much as possible, especially stabilisation policy.

There seems to be a growing political consensus that the public sector has many urgent tasks to deal with

Moderate stimulus after all. Although there is always some risk that the pendulum will swing rather strongly when new economic policy trends are launched, in practice we are unlikely to see any drastic fiscal policy expansion during our forecast period. In the US, Trump's stimulus measures will again contribute positively to growth this year, but in 2020 and 2021 American fiscal policy will be largely neutral, with a federal budget deficit that appears likely to level off at about 4.5 per cent of GDP. This means that the national debt will continue climbing and will reach a high 110 per cent of GDP in 2021, but it cannot be ruled out that next year's election campaigns may be dominated by promises of further spending programmes, especially by Democrats. If such policies are approved starting in 2021, they will pose a risk to both growth and interest rates.

Debt curves are pointing in different directions

Government debt, % of GDP



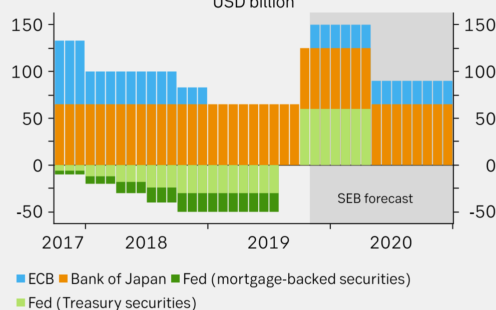
Source: International Monetary Fund (IMF), Macrobond, SEB

European restrictions are creating obstacles. The fiscal policy differences between the US and the euro area have widened. In 2018 the budget deficits in the euro area totalled 0.5 per cent of GDP. Along with the cyclical peak year 2000, this was the strongest figure achieved since the euro was introduced. Government debt has now fallen to about 80 per cent of GDP, some 6 percentage points below the peak after the financial crisis. Pressure from the ECB and others for looser fiscal policies has been reflected in a more relaxed view of budget regulations among euro area politicians. Some national budgets are slightly expansionary, even though a strict interpretation of the rules would mean that they should actually be tightened. But the regulations still seem to create obstacles. In October five countries, including three large ones (Italy, Spain and France), were taken to task because their budgets were not in line with regulations. When so many large countries are handicapped by regulations, overall stimulus measures will not be especially large. Germany is the only country that has room to substantially change the picture, but the recently proposed loosening of the budget process will hardly change the situation in any decisive way.

Has the Fed restarted QE?

In mid-September a serious liquidity shortage arose in the US banking system. Short-term interest rates rose, causing market worries. The Fed carried out repo operations to cover the shortage and managed to stabilise interest rates. Two factors contributed to the shortage: large corporate tax payments and government securities issuance. The liquidity shortage surprised many people. Since the financial crisis, the Fed has built up a monetary policy portfolio of USD 4.2 trillion, funded by expanding bank reserves ("the printing press"). In autumn 2017 the Fed began reducing the portfolio. In September 2019 it halted this process. Today the portfolio totals USD 3.6 trillion.

Monetary base is now growing by USD 150 bn



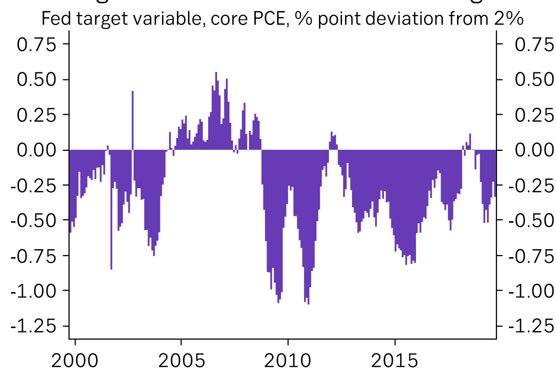
Source: Macrobond, SEB

The Fed obviously underestimated the need for liquidity in the system. Between mid-October and early Q2 2020, the Fed intends to buy USD 60 billion worth of Treasury bills per month. **Has the Fed thereby restarted its quantitative easing (QE) programme?** The answer is No. The explanation is that there is a liquidity shortage that the Fed is responding to (it thus does not intend to monetarise the system) and that its action involves buying securities with very short maturities. The Fed may nevertheless face problems in obtaining enough Treasury bills, since investors are expected to prefer to keep their Treasury bills, which provide higher returns than deposit accounts. Now that the Fed is expanding its monetary base by USD 60 billion monthly, together with the ECB, the Bank of Japan and other central banks it will be increasing the global monetary base by USD 150 billion each month for at least six months.

Central banks digging deep in their toolkits

This year the Fed has studied how a new monetary policy framework might look. One result of this work seems to be a greater tolerance for "testing the limits" of how low unemployment can fall, in order to increase opportunities for more vulnerable groups to enter the labour market and push equilibrium unemployment even lower. The jobless rate is currently more than half a percentage point below the Fed's estimated equilibrium level (4.2 per cent), but this need not be an obstacle to continued rate cuts. An evaluation of the past decade's crisis policies also indicates that the Fed's asset purchases did not trigger the negative side effects that were feared and that the central bank can therefore be even faster and more aggressive in its use of this tool during new downturn phases.

Larger downside deviations from target



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

Compensatory inflation targets on the way? The Fed has generally retained a sceptical attitude towards negative key interest rates, although some Fed studies have pointed to positive effects in other countries. Instead the discussion has focused on strategies in which monetary policy compensates afterward for earlier inflation mistakes ("make-up" strategies) by deliberately letting inflation end up *above* target after a lengthy period of inflation that was *below* target. One way would be to define the target in terms of an average over a long period, or as a range, with greater freedom to let inflation move towards the upper or lower end of the range. It is easy to imagine problems with such a strategy, in a situation where central banks are forced to compensate for earlier upside deviations and tighten their policy in an economic slowdown. Some Fed policymakers have thus advocating letting the Fed compensate only for periods of *excessively low* inflation and not for periods of *excessively high* inflation.

The discussion has focused on strategies in which monetary policy compensates afterwards for inflation mistakes

New Fed rate cut in January. Regardless of where these discussions lead, our conclusion is that in the present situation the Fed is still mainly worried about downside inflation risks, after a long period when inflation has mostly surprised on the downside (see chart) and should therefore not have any problems temporarily letting inflation now end up somewhat above target. Our forecast is thus that the Fed will

follow up its three rate cuts in 2019 by lowering its key rate once more in January and that the federal funds rate will then stay at 1.25-1.50 per cent. The main reason, as earlier, is to provide insurance against downside risks from the global economy and trade.

The ECB keeps searching in a rather empty toolkit. Downside growth disappointments as well as inflation this autumn have forced the ECB to deliver new stimulus measures. The latest ECB policy meetings have offered few surprises, and the focus is now on implementing the package unveiled in September, including a lower key rate, new bond purchases starting on November 1 and tiered key rates in order to ease the impact of negative interest rates on the euro zone banking system. A weak economic outlook, low inflation and falling inflation expectations will continue to push the ECB in an expansionary direction, even though room for further stimulus measures is shrinking. We expect a further deposit rate cut by 10 basis points in March 2020, with the ECB then leaving its policy unchanged during the rest of our forecast period. The October policy meeting was Mario Draghi's last. During his period as president of the ECB, he has taken monetary policy far in an expansionary direction. It remains to be seen whether Christine Lagarde will be more successful in persuading the finance ministers of euro area member countries to provide more fiscal stimulus.

Central bank key interest rates
Per cent

	Nov 6	Dec 2019	Dec 2020	Dec 2021
Federal Reserve (Fed)	1.75	1.75	1.50	1.50
ECB (deposit rate)	-0.50	-0.50	-0.60	-0.60
Bank of England (BoE)	0.75	0.75	0.75	0.75
Bank of Japan (BoJ)	-0.10	-0.10	-0.10	-0.10
Riksbank (Sweden)	-0.25	0.00	0.00	0.00
Norges Bank (Norway)	1.50	1.50	1.50	1.50

Source: Central banks, SEB

Bank of England in the hands of Boris Johnson. The pound depreciation of recent years is the main reason why UK inflation has been above target. This currency effect has gradually faded, though, and we expect inflation to stabilise just below target during our forecast period. For a long time, the Bank of England has focused on the tight labour market. It is still signalling a one-off rate hike ahead. The latest signs from the labour market thus decrease the likelihood of a rate hike. We assumed earlier that a controlled withdrawal from the EU would make a rate hike possible during our forecast period, but this no longer seems likely. The UK's successful negotiations with the EU contributed to a stronger pound this autumn. If the UK should leave the EU with an agreement, there is room for further pound appreciation ahead.

The Riksbank changes its reaction function. Sweden's Riksbank is sticking to its intention of hiking the repo rate to zero in December. Swimming against the current in this way – despite weaker economic conditions and falling inflation expectations – suggests that the central bank is now easing up a bit on its earlier strong inflation focus. The Riksbank is not very clear about its motives, but our interpretation is that it now genuinely wants to leave negative interest rates behind. It has also probably embraced criticism about the disadvantages of an increasingly weak krona and is no longer so interested in the temporary inflation impulses that may result from the exchange rate. The increasingly robust Swedish housing market situation may also play a part. As a counterweight to its rate hike signals, the Riksbank lowered its long-term rate path in a way that now implies a zero key rate until early 2022. Looking ahead, we believe that the threshold for a resumption of rate cuts back into negative territory has been significantly raised. Since we believe that the Riksbank is once again overestimating inflation in its forecast, we see no reason to believe a more aggressive stance from the Riksbank than the central bank is now signalling for the years 2020 and 2021.

We believe that the threshold for a renewed rate cut into negative territory has been significantly raised

Unchanged key interest rate, despite high inflation. Norges Bank hiked its key rate to 1.50 per cent in September but meanwhile signalled a pause in the hiking trajectory. The central bank's flexible approach and the weak krone have enabled it to hike rates four times despite dovishness abroad. Although Norges Bank has maintained a hawkish bias, we do not believe it will deliver more hikes unless global growth improves and uncertainty related to trade and Brexit eases. A rate cut is equally distant due to above-trend growth, a positive output gap and inflation forecasted to remain above target. We expect the key rate to remain at 1.50 per cent throughout our forecast period.

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

	2018	2019	2020	2021
Sweden	2.4	1.2	1.2	1.7
Norway	1.3	2.3	3.2	2.1
Denmark	2.4	2.1	1.6	1.5
Finland	1.7	1.2	1.6	1.6

Source: OECD, SEB

Theme:

The EM economies

Signs of improvement

The outlook for the emerging market (EM) countries has been gloomy in the past two years. Growth has slowed sharply. There are major concerns about the negative effects of President Trump's trade policies, since more protectionism would have a particular impact on trade-dependent EM economies, but we are seeing signs of improvement in three areas. Growth seems to have bottomed out and rebounded slightly. Inflation is close to record lows, which, along with lower US and EU interest rates, creates opportunities for stimulus measures by EM central banks. We also believe the US-Chinese trade war is entering a calmer phase, since Trump does not want to risk negative market effects in an election year, while China wants to minimise the risk of a sharp economic slowdown.

Emerging markets have faced headwinds these past two years. Global growth has slowed – one reason why structural weaknesses in economies like Turkey and Argentina have turned into currency crises and spiking interest rates. Contagion effects have been apparent in the whole EM sphere and have also affected the mainly affluent OECD countries. President Trump's policies, especially towards Mexico and China, have dampened the mood and led to concerns about how these countries might cope with a global recession.

Slowdown since 2017. As in wealthier countries, growth has decelerated sharply since 2017, when GDP expanded by 5.1 per cent in the overall EM sphere. We lowered our aggregate EM forecast for 2019 from 4.2 to 4.0 per cent in September's *Nordic Outlook*. Growth has been below expectations in all regions, from Asia to Latin America, Africa and Eastern Europe. The slowdown has been clearest in the manufacturing sector, while the service sector has coped better.

Even though GDP growth in the OECD countries will decelerate further in 2020, we see signs of some improvement for the EM economies, with growth bottoming out and rebounding slightly. Although China's deceleration is continuing, we foresee the EM upturn being driven by economies like Russia, Brazil, Mexico, and Turkey, as well as to some extent India, Indonesia, Malaysia, the Philippines and South Korea.

Many of these economies have recently undergone recessions and are thus showing relatively low resource utilisation, giving them growth potential in the short term. India is an important piece of the puzzle, and we expect monetary and fiscal stimulus measures in the second half of 2019 to have an impact, stabilising and even boosting its economic growth rate in 2020. India's performance is difficult to interpret, however, due to a shortage of reliable and timely statistics.

Half of the BRIC countries are in a recovery phase, while the other half are decelerating. The slowdown in Chinese growth is part of Beijing's economic policy strategy, but it looks set to be somewhat sharper than expected in 2019 and 2020. Growth has been held back by both weak domestic demand and sagging exports. Unlike earlier periods of weakness, the authorities have abstained from stimulating the economy by boosting credit growth on a broad front. China's deceleration is most clearly apparent in manufacturing, which accounts for around 40 per cent of the economy, but residential construction has been relatively strong. Support to the construction sector is partly due to the government's ambition to maintain employment and partly to decrease property speculation and sharp price increases. The labour market is showing continued weakness. We expect Beijing to try to stimulate the economy by increasing the space for local authorities to make infrastructure investments. Next year we also expect new measures to strengthen private consumption. Combined with fiscal stimulus, this will speed up GDP growth from 5.7 per cent in 2020 to 5.9 per cent in 2021.

Russia's economic slowdown has been broad-based, but has been no worse than can be expected in light of decelerating global growth. The country's agreement with the OPEC oil cartel to limit increases in oil production has only been a minor restraining factor. Weak exports, low capital spending and tight fiscal policy have been more important. We expect growth to rebound slightly in late 2019 and in 2020 due to larger government investments and rising oil and gas exports.

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	5.5	6.0	6.5
Brazil	1.1	0.8	2.0	2.8
Russia	2.3	1.0	1.7	1.9
Emerging markets, total	4.7	4.0	4.2	4.5

Source: IMF, SEB

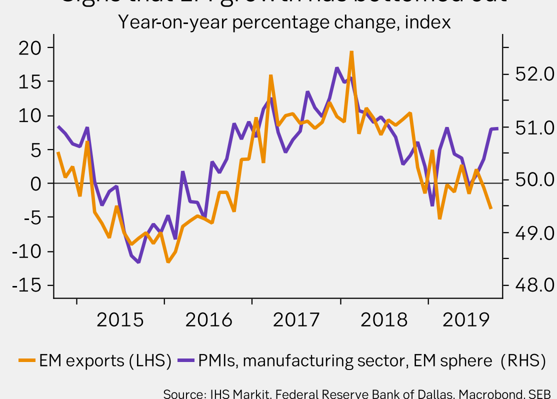
The effects of Brazil's reforms will take time to become visible in GDP statistics. The global economic deceleration, falling commodity prices and to some extent the crisis in neighbouring Argentina have had a big impact on the Brazilian economy, which has been propped up by a slow recovery in private consumption and capital spending. We believe that a gradual recovery among EM economies and in commodity prices will lift Brazil's GDP growth in 2020 and that structural reforms — including the pension and tax systems – will begin to have an impact in 2021, when Brazilian growth will climb to 2.8 per cent.

Signs of a gradual EM turnaround are starting to appear. Our cautiously optimistic forecast that EM growth will accelerate to 4.2 per cent in 2020 is based on three observations and assumptions. First and foremost, we see signs that growth has bottomed out and has begun to rebound slightly. Real GDP growth in our EM aggregate picked up in the second quarter of 2019. The clearest indication that the slowdown continues to bottom out is Markit's purchasing managers' index (PMI) for EM manufacturers. Although the PMI moved sideways in October, it has climbed noticeably since the most recent trough in June. The upturn in both the EM and world manufacturing PMIs since June is largely driven by China, but even without China, the index has been bottoming out. The correlation between sentiment indices and actual manufacturing sector and GDP growth rates is weaker in EM than in more advanced economies. Nevertheless, a clear upturn over 3–4 months usually shows up in hard production data as well.

Third quarter stabilisation. Monthly data on economic activity in the third quarter indicate that industrial production has stabilised or even increased gradually in key economies such as South Korea, Brazil, Russia, Mexico, Turkey, Indonesia, South Africa, and even Singapore. Another sign that industrial production has begun to stabilise is that commodity prices have recovered somewhat, with the Commodity Research Bureau's (CRB) index rising by almost 2 percent since early September. The increase has been driven by food and metals, while the raw industrials sub-group has moved sideways since late September.

Signs that EM growth has bottomed out

Year-on-year percentage change, index



Source: IHS Markit, Federal Reserve Bank of Dallas, Macrobond, SEB

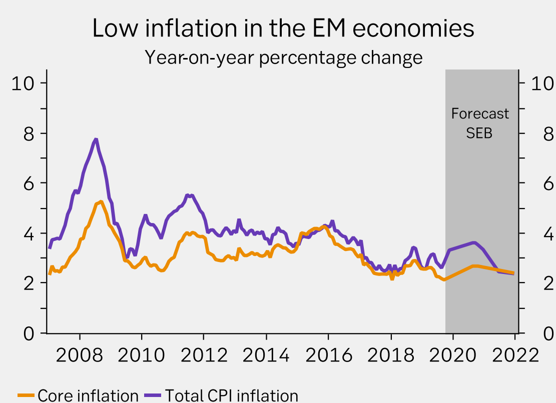
International trade has also begun to stabilise, especially EM exports. Although the latest available monthly figure for the entire EM sphere in September was relatively weak, the level is essentially the same as at the end of 2018. In our EM universe, South Korea has reported trade statistics for October, which confirm that a stabilisation of trade has occurred. Trade volume is indeed still lower than a year ago, but this is because of a significant decline in late 2018 and in the first half of 2019. Importantly, PMIs for new export orders rose notably in a majority of our EM economies in October,

representing a tentative sign of recovery in international trade.

Low inflation allows room for key interest rate cuts. The potential for looser monetary policies is another reason for our forecast of some recovery among EM economies. Core inflation (adjusted for food and energy prices) is the lowest ever measured in the EM sphere. Our total aggregate EM inflation figure looks set to rise somewhat in 2020, but mainly due to higher food prices. The single most important factor behind the food price upturn is swine fever in China. This has driven up the price of pork, which has had contagious effects on other food products. Core inflation will be pulled somewhat higher by food prices, but this will not prevent central banks from making continued rate cuts.

Low inflation in the EM economies

Year-on-year percentage change



Source: National sources, Macrobond, SEB

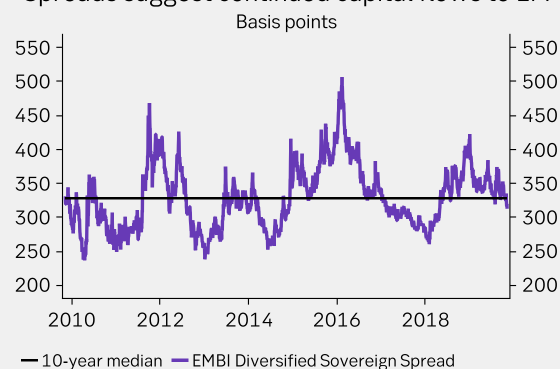
Low inflation and weaker growth – combined with key interest rate cuts in the US, the euro area and elsewhere – are opening the way for EM central banks to loosen monetary policy further. Some 20 central banks have already followed the US Federal Reserve by lowering their key rates, but rate-cutting is not over yet. The spread between EM and advanced economy investment returns has remained relatively stable in 2019 and has been well above levels prevailing during periods of strong risk appetite. The fact that this spread is hovering around its 10-year median and that a record-high percentage of bonds worldwide are generating negative returns suggests that capital will keep flowing into EM financial markets in search of yield. Monetary easing and capital inflows should provide support for economic activity in EM economies and for their currencies.

As long as the US avoids a recession and China slows down gradually, there is reason for optimism

One risk related to lower interest rates and to capital flows into EM economies is that they may lead to excessive credit growth, larger current account deficits and accelerating inflation. Today we do not see any market that is showing signs of this kind of overheating, but some economies are in the danger zone – for example Turkey, South Africa and perhaps India in the absence of structural reforms of its property and labour markets. For now, China is abstaining from broad monetary easing and strong credit growth after its debt level approaching 250 per cent of GDP, according to official statistics. Developments in China are very important to other EM economies. If China decelerates more than expected, and if Beijing – out of desperation – should make the banks increase their lending, this would represent a significantly higher risk of global market volatility.

Spreads suggest continued capital flows to EM

Basis points



Source: J.P. Morgan, Bloomberg, Macrobond, SEB

The US-Chinese trade war is entering a new phase. The third reason for our relative optimism is recent progress in trade talks between the US and China. A final agreement – including intellectual property rights, industrial policy, technology transfers and IT security – will most likely not be reached before the November 2020 US presidential election, but a limited pact will probably be achieved as early as this year. It is likely to include increased Chinese purchases of US farm products, a pledge not to manipulate the Chinese yuan currency and a framework for negotiating intellectual property (IP) rights in exchange for a freezing and even a partial rollback of US tariffs. Both the US and China have strong incentives to reach a limited pact. Trump does not want the cloud of a trade war hanging over the US economy and corporate sector during an election year. China, for its part, does not want to worsen the slowdown in economic growth that has been under way since late 2017. Beijing is also aware that neither Trump nor any other president occupying the White House will let the US diverge from a hard line in the negotiations, since there is a strong political consensus that the US must force China to "play by the rules".

The US-Chinese trade war in particular has been a strong contributing factor behind the pessimism that has prevailed towards the EM sphere. A trade agreement, though limited, would probably lead to a change in attitude. This, in turn, would provide support for investments, growth and markets in the EM economies in the coming year. Although our forecasts include risks, as long as the US avoids a recession and China slows down gradually, there is reason for optimism.

Theme:

Trade war 2.0

Hard-fought, unsteady progress in the right direction

We believe that uncertainty will now have a somewhat larger negative impact on global growth than we predicted early in 2019, though the overall direct effects are still manageable. The US presidential election will help prevent further deterioration in trade relations. Global trade will recover in 2020, aided by an improved outlook for Asian and South American emerging economies, but the WTO will be handi-capped in December when its Appellate Body drops below the membership required to issue rulings.

The abrupt world trade slowdown (in volume) can be explained by multiple, often inter-related factors: the tariff war, less predictable economic policies that have rattled global supply chains, a weakened telecom cycle, cyclical and structural challenges in the auto sector and export financing obstacles (for a detailed discussion of these forces, see "Trade war & peace", *Nordic Outlook*, September 2019). The conclusion of our analyses is that although many countries have signed new trade agreements in 2019 – and US-Chinese talks are making progress – there are forces that will continue to have a negative impact, both in the short and long term.

Global trade has caused continued disappointment this autumn, yet we have chosen to retain our forecast of a 1 per cent volume increase in 2019. We also continue to forecast about a 2 per cent annual trade volume acceleration in 2020-2021. This past year, trade has fallen by about 2 per cent for Asian emerging economies but there has been a recent recovery. There is still some uncertainty about its sustainability.

The US-Chinese trade war, along with other factors, has had a somewhat bigger adverse impact on 2019 global growth than we expected early this year, due among other things to weaker capital spending growth. This also affects 2020 and 2021 GDP forecasts. Progress in US-Chinese talks, monetary easing in various countries and an improved outlook for Asian and South American emerging economies will limit adverse effects on global trade and growth.

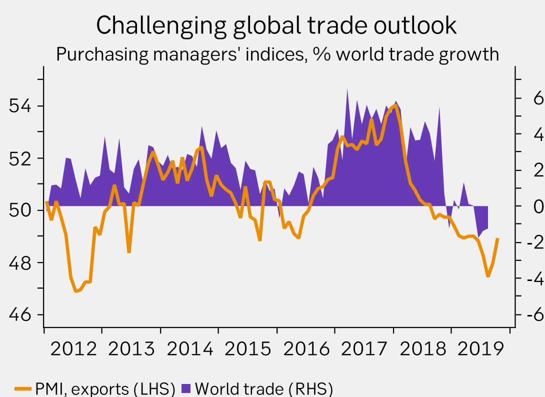
Global trade system faces challenges

US-Chinese trade war escalation threatens to further hamper global consumption and capital spending. According to the latest International Monetary Fund (IMF) analysis[1] as much as 0.7-0.8 percentage points in yearly global growth may disappear in 2020 and 2021. This worst possible outcome emphasises that euro area and Japanese key interest rates cannot be cut further in order to offset the adverse impact of the trade war.

The trade war – effects on global GDP growth
Year-on-year percentage change

GDP, %	2019	2020	2021	2022
IMF main scenario	3.0	3.4	3.6	3.6
Worst possible outcome*	2.6	2.6	2.9	3.2
% point difference	-0.4	-0.8	-0.7	-0.4

Source: SEB, IMF. *Including direct impact of tariff hikes already announced, plus negative effects on business investment, credit spreads and productivity.



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

So far there has been no progress in the **Japanese-South Korean trade conflict**, which threatens the entire Asian telecom sector. The conflict, fuelled by unresolved issues from the period when the Korean peninsula was occupied by Japan (1910-1945), has festered in the shadow of the US-Chinese trade war. Japan continues to obstruct exports to South Korea of materials that are critical to telecom companies. Although the effects have been limited so far, there is a great risk that these export restrictions will impact not only Asia but the entire global telecom sector.

[1] See *"Scenario Box 1.2. Trade Tensions: Updated Scenario"*, IMF World Economic Outlook, October 2019.

Very large economic interests are at stake both in the US and China, but their conflict also includes deliberate political tactics. The two countries are on a collision course in areas like ideology, security policy and global as well as regional leadership of the Fourth Industrial Revolution. The IMF's analysis (see above) shows that based on currently available information, the trade war may cost the Americans USD 125 billion in lost near-term growth and the Chinese about USD 300 billion.

Average tariffs paid by US and Chinese importers, respectively, on goods from the other country

Tariff, %	Jan 2018	Today	Dec 2019
United States	3.1	21.0	23.8
China	8.0	21.1	25.1

Source: SEB, The Peterson Institute (October 11, 2019)

US importers of Chinese goods and Chinese importers of US goods now face the same average tariff: 21 per cent. Virtually all US imports from China are burdened with tariffs, while the figure for Chinese imports from the US is about 70 per cent. Chinese exports to the US have benefited somewhat from a 13 per cent decline in the Chinese yuan's exchange rate against the US dollar between the beginning of 2018 and autumn 2019.

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

US imports from China have declined by 8 per cent in 2019, but US exports to China are also down roughly 20 per cent in one year. Today the US has a trade deficit of USD 390 billion with China. The export decline is probably disappointing to the White House. To US households and firms, lower trade with China is a challenge. It is hard to find substitutes for Chinese goods. US firms are also part of Asian supply chains.

Total earnings in Chinese industry have fallen more than 2 per cent so far this year compared to the same period of 2018. The decline reflects both price and volume effects. The performance of state-owned companies was even gloomier, with earnings down nearly 10 per cent, while earnings of privately owned businesses still grew by more than 5 per cent. Chinese company debt – especially in US dollars – has climbed rapidly in recent years. Falling profits and economic slowdown that can be linked to the conflict with the US also boost the risk of increasing corporate bankruptcies, which may jeopardise financial stability.

According to the latest credit statistics, company debt is still growing by more than 5 per cent year-on-year.

America's November 2020 presidential election will play a part in shaping US trade policy during the coming year. A further escalation of conflicts with China would risk destabilising stock markets and lowering US growth in 2020. A president who loses control of economic performance and the labour market often also loses control of the White House and Congress.

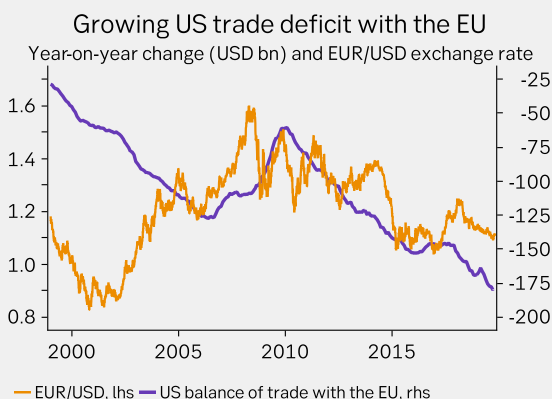
The US-China trade war: A Phase 1 pact

The presidents of the US and China are expected to sign a "Phase 1" agreement later this year. Its contents will be based on the deal the two countries reached on October 11. They agreed on the following: In principle, the White House abstains from raising tariffs or imposing new ones, but existing tariffs will stay in place (December 15 is the next date when the US might impose 15 per cent tariffs on electronics), as will the decision to label China a "currency manipulator". China has pledged to buy USD 40-50 billion worth of US farm products per year. The pact includes intellectual property and technology protections. If the US and China sign the Phase 1 agreement later this year it now seems likely that Washington and Beijing will simultaneously cancel some existing tariffs on one another's goods.

A new European Commission is about to take office, including Phil Hogan as the commissioner with special responsibility for EU trade policy. The Irishman has thus been granted a new post after five years in charge of the EU's "agriculture portfolio". On paper, Hogan seems to be a person who can advance EU trade talks with the US. On the other hand, the new Commission president, Ursula von der Leyen, has clearly signalled the importance of protecting EU values while building on the Union's relations with the US and China.

Growing US trade deficit with the EU

Year-on-year change (USD bn) and EUR/USD exchange rate



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

In October the US decided to impose tariffs on a variety of EU goods – totalling an import value of USD 7.5 billion – in response to a ruling by the World Trade Organisation (WTO) that EU subsidies benefited Airbus. The EU has filed a similar complaint against the US for illegally favouring Boeing. We forecast that the US will not impose new tariffs on EU-built cars when the White House makes its decision in November. US tariffs pose a serious threat to the EU (especially German) auto sector. In US-EU trade talks, the White House is expected to demand – as in negotiations with China – that the EU should open the way to buying more US farm products. This, in turn, is likely to irritate France, which is reluctant to increase the competition facing French agriculture. Today's negotiating situation looks tricky. The White House has also been critical of the EU and of the European Central Bank's monetary policy, which it perceives as an attempt to weaken the value of the euro. In US negotiations with China, Beijing's currency policy has been a major theme. This is also likely to be true of the EU. The negotiating climate risks worsening if US and EU economic growth slows more than we expect in 2020 and 2021.

Despite hopes of trade policy successes, uncertainty about the international trade system is likely to persist as long as Donald Trump is president. Nor is a signed agreement with the US written in stone, as was evident in May when the White House chose to threaten Mexico with new tariffs unless it tightened immigration to the US. There is also great uncertainty about the future role of the WTO. The lack of predictability related to trade threatens to slow globalisation and hamper capital spending, thereby hurting growth and productivity.

WTO – an organisation in crisis

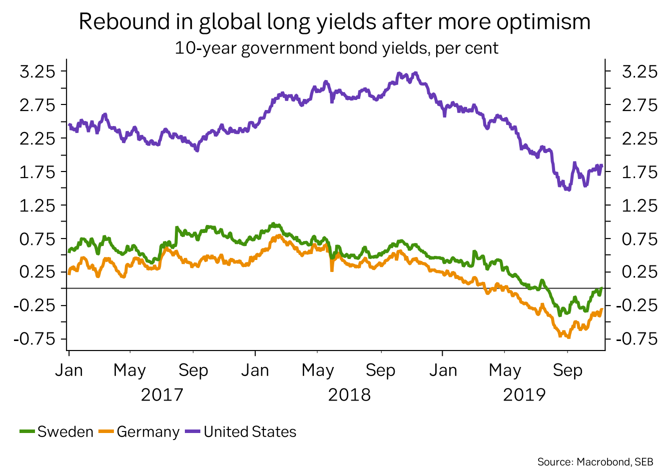
The 164 member countries of the World Trade Organisation (WTO) account for no less than 98 per cent of international trade. These countries have agreed on trade rules and ways to ensure compliance. At the G20 summit in Osaka last June, world leaders emphasised the importance of quickly reforming the organisation, with the aim of achieving results at the WTO meeting in Kazakhstan in June 2020. Criticism of the WTO – widely regarded as an independent institution tasked with resolving international trade conflicts – focus on regulations that have not kept up with the evolution of trade and the emergence of new economic superpowers such as China. The WTO is also regarded as dealing with areas like goods, services and data in separate silos.

In December, the WTO's Appellate Body will be put out of business, since the US has blocked the appointment of new members. Around its 25th anniversary on January 1, 2020, the Appellate Body will stop functioning. The short-term effects may be manageable, but there is an increased risk of new disputes when the rights of countries cannot be adjudicated and defended.

Fixed income

A roller coaster ride

Global long-term bond yields have rebounded since reaching record lows early in September. Cyclical, structural and regulatory forces have all played a part. Despite what we view as exaggerated pricing of recession risk late this summer, the market has now made allowances for upside surprises. Since we anticipate some further deceleration in growth, global long-term yields are expected to fall, partly due to another Fed rate cut, before their upward movement resumes – mainly during 2021.



10-year government bond yields

	Nov 6	Dec 2019	Dec 2020	Dec 2021
United States	1.81	1.50	1.50	2.00
Germany	-0.31	-0.50	-0.40	0.00
Sweden	0.00	-0.05	0.15	0.55
Norway	1.50	1.40	1.45	1.75

Source: Central banks, SEB

Positive growth expectations are reflected in the fixed income market. Progress in US-Chinese trade talks, cautiously positive signals in emerging market economies and less concern about a no-deal Brexit have contributed to increased optimism. In addition, at least 20 central banks including the Fed loosened their policies in Q3, causing the US yield curve to resume its positive slope (the spread between 10- and 2-year yields). This eased market worries about a recession. Ten-year US Treasury yields have risen by 45 basis points from a low of 1.43 per cent in early September. German 10-year yields traded as low as -0.74 per cent at the same time. This is believed to be due to a shortage of German government bonds as well as regulations affecting pension companies (see the theme article “Negative rates” on page 22).

First down, then up. We agree with the market’s conclusion that the Fed will take a break and leave interest rates unchanged at the December policy meeting. The market is pricing less than one rate cut by end-2020. We believe the Fed will make another “insurance” cut early in 2020 due to decelerating economic growth, which we expect to push US long-term yields down to 1.40 per cent in spring 2020. After that we predict a gradual increase to 2.0 per cent late in our forecast period – a level we regard as relatively normal in the long term, based on the neutral interest rate and risk premiums.

Stuck well below zero. As expected, the ECB delivered a major stimulus package in September. Since then, expectations of future rate cuts have fallen due to less faith in further US rate cuts and the market’s perception that ECB policymakers disagree on the benefits of further stimulus measures. Our conclusion is that this disunity mainly concerns the QE programme. We are thus sticking to our forecast that the ECB will lower its deposit rate to -0.60 per cent in March. Given market pricing that indicates only a 5 basis point cut and data that remain generally weak, our assessment is that German 10-year yields will again move lower. But we have adjusted our forecast a bit and estimate that yields will bottom out at -0.50 per cent in 2020 and then follow US yields higher during 2021.

Global core inflation has been surprisingly stable at about 1.5 per cent over the past 15-20 years. Today there are few indications that the market should price in a higher risk premium. Real interest rates are low, for example due to an ageing population in many countries and growing savings surpluses that partly reflect greater appetite for safe investments. When higher savings coincide with weak productivity growth and a weak investment cycle, this pushes the neutral interest rate lower in search of an interest rate that enables savings and investments to reach equilibrium. The potential for higher interest rates and yields is mainly connected to the fiscal policy outlook. For example, if euro area countries in general and Germany in particular launch more expansionary fiscal policies focusing on issues like climate change, long-term yields may climb further than in our main scenario. Yet the demand for risk-free, liquid assets is expected to be high due to saving surpluses and regulations governing the pension industry and other companies.

Wider yield spread due to hike. Despite the Riksbank’s clear signal of a rate hike in December and the National Debt Office (NDO) announcement that it will increase the government bond supply starting next year, the spread between Swedish and German 10-year government bonds is largely unchanged from early 2019, just above 30 basis points. One reason why Swedish yields have not climbed further since late October may be index extensions when the maturity of the shortest-term Swedish bond falls below one year in early December. We believe that the yield spread will widen in the coming months as the Riksbank and the ECB move in different directions, while the NDO increases the supply of nominal bonds from a record-low level.

Theme:

Negative rates

The "dark sides" of unconventional monetary policy

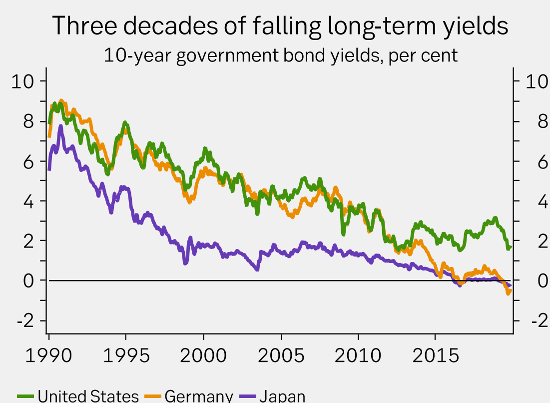
Low interest rates are good for asset prices and also help keep down the costs of public sector debt, freeing up financial resources for spending on infrastructure, climate and education. More and more people believe that the main task of monetary policy today is to create fiscal manoeuvring room. But unconventional monetary policy has "dark sides" that need to be weighed against these pluses. We see 6 potential reasons why central banks may want to abstain from negative key rates and new bond purchases. One of these concerns pension companies.

On September 3, 2019, German 10-year government bonds set a new record-low of -0.74 per cent. These yields were no exception. Several countries reported record-low yields. About USD 17 trillion in global investment grade bonds (see chart) – nearly 30 per cent of the total – traded at negative yields in August.

The decline in long-term yields has been underway for decades but intensified in July and August. It reflects a greater appetite for safe investments and regulations that force pension-related companies to take positions for further declines in yields (see box, page 24).

In the second half of 2019 at least 20 countries have chosen to cut their key interest rate. The ECB has resumed bond purchases (EUR 20 billion/month) and the Fed has stopped reducing its large asset portfolio earlier than planned. Central bank policy changes and market assessments of recession risks partly reinforced each other and thus the downward trend for long-term yields. Looser financial conditions encourage increased financial risk-taking, including purchases of assets with lower creditworthiness and poorer liquidity.

Market expectations for the world's sovereign bonds – the safest, most liquid investments – are that over the next couple of years 20-25 per cent of the total supply will trade at negative yields, 70 per cent at 0-2 per cent yields and only around 10 per cent at 2-3 per cent. In other words, this is a whole new landscape for yields.



The complex world of negative rates

Although the decline in both long-term yields and short-term interest rates has obvious structural causes,[1] in recent years central banks have aimed at cutting key rates to stimulate consumption and capital spending and push up inflation and inflation expectations. Their large-scale purchases of assets such as government and mortgage-backed bonds have gone hand in hand with key interest rates close to zero or even lower.

Nominal key rates and long-term yields that fall below zero for a short time have limited, transitory negative effects on the real economy and the financial system. When unconventional policies were launched during the 2008-09 recession, they were regarded as untested emergency measures. As time has passed and negative interest rates and yields have persisted, the risk of negative side effects has increased.

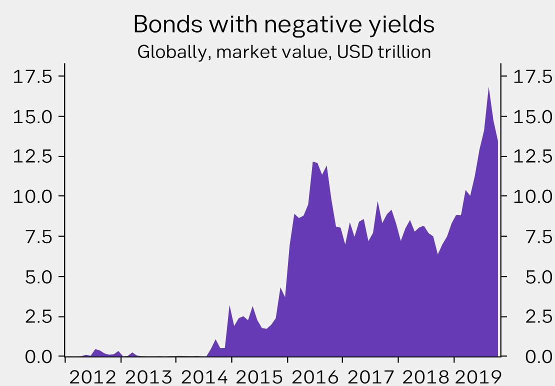
We can identify the following potential risks that may cause central banks to weigh the advantages and disadvantages of unconventional policies and justify returning to zero key rates and halting bond purchases:

■ **Zombie companies, capital destruction & climate change.** Low rates and yields enable inefficient and perhaps also climate-unfriendly companies to borrow money. "Zombie companies" – averaging 40 per cent more debt than more profitable firms[2] – risk collapsing when the economy slows and/or interest rates rise. They inhibit productivity growth by being inefficient, crowding out more efficient and probably also more climate-friendly companies. Their bankruptcies may also hurt financial market stability. In its latest Stability Report, the IMF warns that nearly 40 per cent of all corporate debts – totalling USD 19 trillion – may be jeopardised if companies are hit by a deep downturn.

■ **Increased insecurity and precautionary saving**
Unconventional monetary policy with negative key rates may lead to a sense of crisis, making households and business more cautious. If inflation expectations are already low, a negative key rate may help lower inflation expectations, thereby pushing up real interest rates – the opposite of what the central bank wants in a situation where downside risks dominate forecasts.[3]

■ **Abnormally weak currency lowers reform pressure**
Some central banks, including the Riksbank, have used the currency to help meet their inflation target. A weak currency should boost imported inflation and stimulate exporters to invest and hire new employees, leading to economic growth and higher inflation. The impact on inflation is temporary, however. By taking steps that weaken the currency, central banks help create an abnormal exchange rate that influences efficiency and reform pressure, for example in the export sector. This may lower productivity growth in the long term.

■ **Risk-taking and build-up of financial market risks**
Central bank monetary policy and low interest rates force investors further out on the yield curve and/or cause them to buy securities with higher credit risk and often poorer liquidity. Because of new regulations, banks no longer have the same capacity to keep credit risk in the balance sheet. The credit market has never been tested for stress if credit spreads start widening.



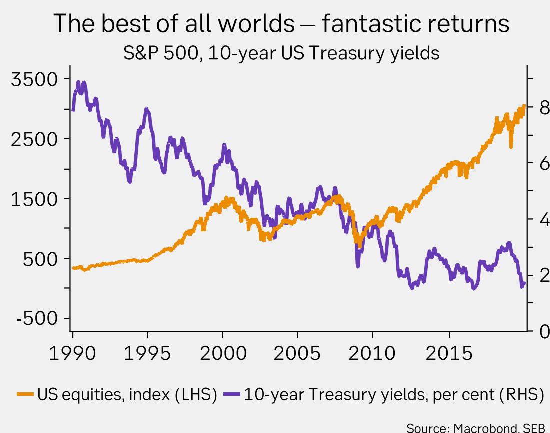
■ **Credit supply affected by the profitability of banks**
For many banks, net interest income provides a major share of earnings. Since in some cases central banks seem to be encouraging banks to abstain from negative interest rates in their household deposit accounts, net interest income is squeezed by lower rates for both short and long maturities. A weaker banking system may ultimately worsen credit supply, especially in Europe where banks provide some 65 per cent of total lending. In the US, the banking system provides about 20 per cent of credit supply; 80 per cent comes from corporate bond issues.

■ **Squeezed pension industry – risk of higher saving**
Falling interest rates and regulations (see box, page 24) lower the discount rates employed to calculate future pension liabilities. When liabilities rise and solvency falls, pension companies may be forced to allocate more assets to safe fixed income investments, thus pushing down interest rates and yields even further.

[1] Falling nominal and real interest rates are a global phenomenon. Nominal rates are low partly due to lower inflation premiums, but there are also other structural drivers. Real rates are low for reasons including an ageing population in many countries and growing savings surpluses that partly reflect a bigger appetite for safe investments. When increased savings are combined with weak productivity growth and a weak investment cycle, the neutral rate is pushed lower to find the rate that leads to the equilibrium level for both savings and investments.

[2] See the BIS Annual Economic Report 2019, June 2019.

[3] See "Negative Interest Rates and Inflation Expectations in Japan", FRBSF Economic Letter, August 26, 2019.



Source: Macrobond, SEB

Do we have a ticking pension time bomb…?

The prevailing low-interest environment, including negative rates and yields, puts pressure on companies and public authorities that have set aside funds for future pensions. So far, healthy economic growth, rising stock markets and falling long-term yields over the past 30 years (see above chart) have helped boost pension assets. But many companies seem to have unrealistic expectations about future returns.

The value of pension insurance company obligations is calculated using the present value of expected future cash flows, discounted by a long-term equilibrium interest rate intended to reduce volatility as market rates vary. This allows a more long-term approach to asset management, which is good for the market, companies and future pension recipients. Meanwhile, this method implies a higher risk that too little capital may be set aside for pension recipients, if the assumed long-term equilibrium interest rate is above actual market rates over a lengthy period. This has been the recent situation. Companies are more vulnerable when rates and yields are low and/or share prices fall.

There is thus a risk of self-fulfilling prophecies. When interest rates fall, regulators require companies to lower their discount rates, boosting liabilities and worsening solvency. The rules then require that companies lower their risk to guarantee that they can meet their obligations. This forces them to buy securities that lower their returns further, thereby making their solvency even worse. In this scenario, pension recipients cannot benefit from rising share prices (see above chart) since the regulations require risk reduction and decreased exposure to equities.

European pension companies and corporations are struggling to generate the returns needed to cover growing obligations. This also applies to many US firms and also to public authorities with various types of pension obligations, which are now growing as interest rates and yields fall. US public sector pension liabilities (not covered by assets) are estimated at USD 5.2 trillion. But the amount may also be much higher, depending on who is estimating the funding shortfall.

Is there a solution to the problem?

The pension industry needs to determine the degree of underfunding and how this "burden" should be allocated between pension providers and recipients. For companies and institutions that must deal with the growing problem of a) lower returns on safe assets and b) pension liabilities that are growing as rates and yields fall, there are three ways to solve the problem:

1. Generate higher returns. This implies diversifying into riskier assets that are probably more illiquid and volatile. If low rates and yields persist, pension companies must accept lower returns as bonds mature and assets are reinvested in lower-yielding securities.

2. Increase deposits in the system. For public authorities in the US and elsewhere, this may mean increased borrowing and poorer public finances.

3. Change compensation structures. This may include less favourable pension terms and/or new methods for calculating pension liabilities. The trend towards shifting risk to individuals in the form of more defined-contribution pension products is expected to continue.

The problem of underfunded pension liabilities does not seem to have reached such levels that it is highlighted in the financial stability reports of regulators and central banks. Solvency levels are satisfactory, while returns have been high thanks to rising share prices and falling interest. A stock market slide would quickly make things worse, especially if it occurs in conjunction with a further decline in interest rates and yields.

Sweden: Regulations lowering rates?

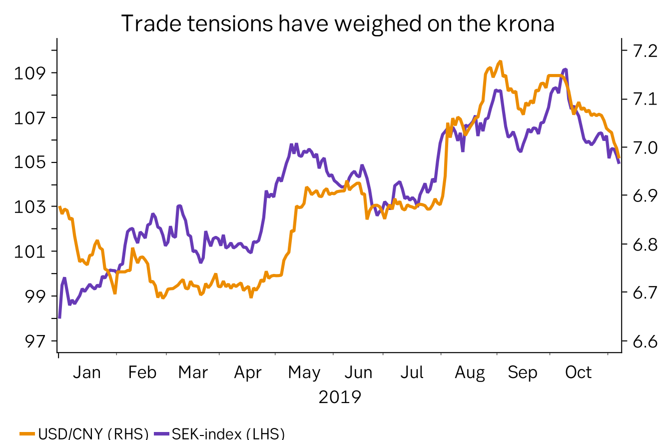
In December 2019 the Swedish Financial Supervisory Authority (FSA) is expected to announce new occupational pension regulations, including how companies should calculate actuarial allocations and what capital requirements apply if they own risk assets like equities and real estate. For example, the discount rate curve for calculating pension obligations will be lowered and the previous zero interest rate floor is being abolished. In practice, the regulations mean that the market value of pension liabilities will be revised upward and the liabilities can be stress-tested using negative interest rates. Solvency is expected to fall by only 2-3 per cent. Swedish companies look strong in a European context. Yet the new regulations, which are arriving in an environment of major declines in rates and yields, may have led to actions that have further lowered Swedish rates and yields.

Under the new rules, Swedish pension companies must hold capital in case already negative rates and yields keep falling. In a worst-case scenario, large declines in rates and share prices may lead to increased demand for bonds that already carry negative yields. The risk of a downward spiral will increase due to abolition of the interest rate floor.

The FX market

In the clutches of the invisible hand

Uncertainty about global growth continues to dominate FX market trends, without providing any clear guidance. As long as the world economy keeps weakening, this should provide some support to defensive currencies like the US dollar. In our cautiously optimistic main scenario, such forces should fade in 2020, leaving some room for hard-pressed currencies like the Swedish krona to get their revenge during our forecast period.



Exchange rates

	Nov 6	Dec 2019	Dec 2020	Dec 2021
EUR/USD	1.11	1.12	1.17	1.20
USD/JPY	109	106	112	114
EUR/GBP	0.86	0.87	0.86	0.88
EUR/SEK	10.64	10.50	10.20	10.00
EUR/NOK	10.14	10.30	10.00	9.70

Source: Bloomberg, SEB

Divergent trends. FX market trends this autumn have not been easy to capture using traditional explanatory models. Earlier in 2019, currency movements were dominated by worries about global growth. This autumn certain bright spots – such a progress in US-Chinese trade talks – have been offset by gloomier news related to global growth. While the stock market has a more hopeful attitude, the FX market is ambivalent. During our forecast period, it is likely to closely follow the direction of global growth.

During 2019 the dollar has continued to benefit from the global slowdown; its defensive qualities have thus primarily determined the direction of the US currency. In light of this, it is also logical that the USD has reacted negatively to this autumn's progress in US-Chinese trade talks. In our main scenario – where a recession is avoided – we expect the USD's defensive qualities to lose much of their attractiveness. We thus predict an undramatic depreciation, with the EUR/USD rate reaching 1.17 at the end of 2020 and 1.20 at the end of 2021. Further US key rate cuts will also help decrease the attraction of the dollar, even though the Fed's latest signals that it now foresees an end to its rate cuts suggests a persistent interest rate spread between the US and other countries.

Low risk of a hard Brexit has benefited the pound. With a new agreement between the EU and the United Kingdom in place and a snap election in mid-December, the risk of a no-deal withdrawal has greatly diminished. This has helped to strengthen the pound during the autumn. Today the main Brexit alternatives are leaving the EU with an agreement or staying in the EU. Ideally, this will be decided by the outcome of the December election, but regardless of whether the UK leaves the EU on January 31 or whether the election leads to a second referendum in 2020, the pound's reactions will probably be more subdued. We expect the EUR/GBP exchange rate to remain at about today's level in the near term, but the pound will then depreciate somewhat – bringing the rate to 0.88 by the end of 2021. But we cannot entirely rule out another increase in the probability of a hard Brexit if trade negotiations collapse; such a development would greatly weaken the pound.

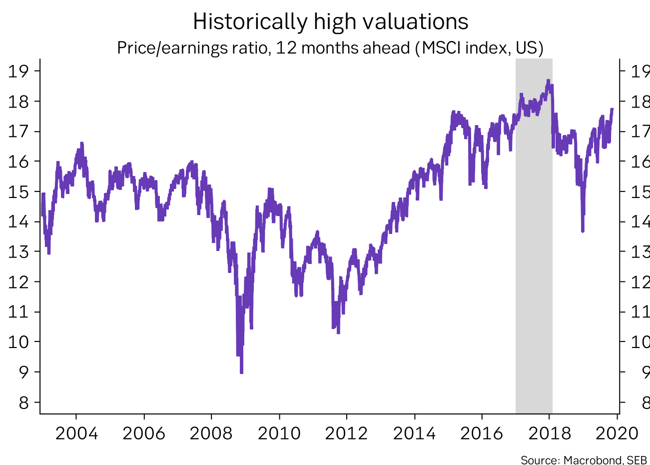
The Riksbank now seems determined to hike its key rate this December, thereby abandoning its negative rate despite Sweden's economic slowdown. Negative rates have contributed to a weaker krona, among other things by dampening natural capital inflows. It is uncertain whether a zero key rate will be enough to attract these flows back. Global growth concerns and risks related to US/China trade tensions have also been negative for the SEK (see chart). In our main scenario where these risks fade away we should see an upward trend for the SEK during our forecast period. Yet the krona's long-term equilibrium exchange rate is weaker than a decade ago and is not far below 10.00 per euro. We are thus forecasting an EUR/SEK rate of 10.20 at the end of 2020 and 10.00 at the end of 2021. However, a risk of temporary reversals in the global economy threatens to trigger setbacks in the recovery of the SEK.

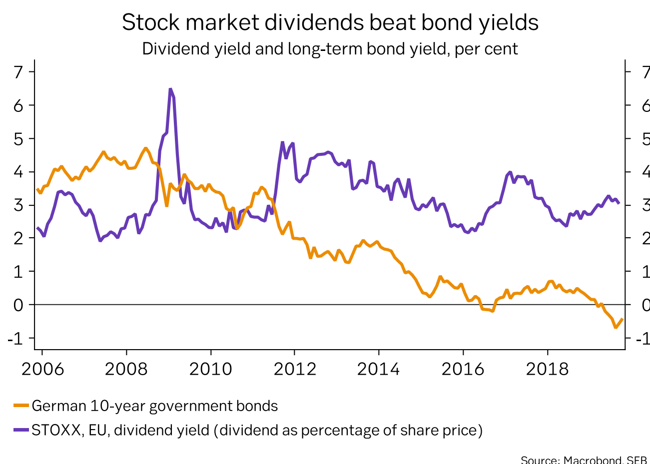
NOK movements are difficult to comprehend. For a long time, the Norwegian krone has been decoupled from fundamental driving forces. Despite a strong economy, rising oil-related investments and four key interest rate hikes since summer 2018, the krone has fallen by nearly 10 per cent against the euro during the same period. Worries about global growth and contagious effects from Sweden's currency are explanations that seem less convincing. Apparently the krone is being weighed down by some form of structural outflows. We continue to expect a slightly stronger NOK in 2020 as the global outlook improves: the EUR/NOK rate will be 10.00 at the end of 2020 and 9.70 at the end of 2021.

The stock market

High valuations limit the potential

Growth is slowing, but stock markets keep rising. Earnings forecasts are levelling off, while continued central bank support and fading trade war worries are buoying the market mood. Quarterly reports are proving better than feared, and in the US most sectors are surpassing low expectations. Continued ultra-low interest rates and healthy shareholder distributions from companies are sustaining share prices, but given weak growth and valuations close to old peaks we foresee above-trend volatility.





Focus shifting from growth to value. Despite an uncertain outlook, central bank support, signs of a mild economic deceleration and progress on trade issues have been enough to generate an upbeat stock market mood. Led by US stock exchanges, world equity indices are now close to all-time highs, but below the surface there is some drama. After a decade of stronger performance by growth stocks than by value stocks, recent months have witnessed a reversal of this trend. Previously depressed sectors like commodities and industrials are among the winners.

Resilient earnings reports. With most of the report season behind us, Q3 corporate earnings can be described as better than feared. In the US, the final outcome appears likely to be a marginal increase in earnings, compared to an expected decline of around 4 per cent. The trend is similar in Europe, although it remains uncertain whether the final outcome will be positive, while Asian earnings were weaker but largely in line with lowered forecasts. At the sectoral level, cyclically sensitive companies foresee weaker demand, but nothing dramatic. Most sectors in the US surpassed expectations, not least growth companies in IT and communication services connected to the surge within digitisation, while the commodity and energy sectors are struggling with headwinds.

High valuations, even considering low interest rates and yields. This year's combination of rising stock markets and downward revisions in earnings forecasts has pushed valuations to historically high levels, measured as price/earnings (P/E) ratios. With US equities at around 17.5 and global equities at 16, since the turn of the millennium we have seen clearly higher levels only in 2017-2018. But that was a "Goldilocks" period, with low interest rates and rising growth and earnings forecasts. There is support for the argument that we should be able to accept higher valuations than the historical average, since interest rates look set to remain low – especially after the Fed's dramatic policy shift this past year. Since we are in an economic slowdown phase and well into a cyclical expansion, however, earlier peak valuations do not seem like reasonable levels to aim for. Our conclusion is that it is hard to foresee valuation-driven stock market rallies, while the interest rate situation justifies valuations above the historical average over time.

Moderately rising stock markets ahead. Surveys on positioning by professional investors indicate that they are somewhat above their normal weighting for equities, but marginally below the historical average. Investors are understandably reluctant to abandon equities on a broad front, given the lack of sensible alternatives. With zero or negative returns in the fixed income market, while total shareholder distributions by listed companies (dividends plus share buy-backs) total 3-4 per cent, equities provide an additional return almost equal to the historical risk premium, and at about the return levels that pension companies and others need to generate in order to meet their obligations. Given our forecast that global growth will bottom out this year, it should be possible for earnings to stay at today's healthy levels. Lower comparative figures in 2020 suggest that we may see minor increases in earnings, although today's forecasts appear somewhat exaggerated. Looking ahead one year, we expect marginal earnings increases along with dividends and buy-backs to justify a total return of around 5 per cent for global equities, despite a minor downturn in earnings multiples.

Solid Nordic outlook. Nordic stock markets benefit from a relatively large proportion of cyclical companies, in a situation where growth is stabilising and recession worries are fading. In recent months, Nordic equities have also recovered from some of their earlier weaknesses, not least due to a strong Stockholm stock exchange, but muted global growth forecasts limit their potential.

The Nordics

Swedish growth will be moderate this coming year. Unemployment will climb. Despite economic headwinds, the Riksbank will hike its key rate once more but then leave it unchanged. The oil sector will contribute to solid Norwegian growth – highest in the Nordics – though a slowdown will occur in 2021. The Danish economy shows early signs of weakness and will lose momentum. Households enjoy support on several fronts, and consumption will remain a growth engine. Finnish manufacturers have shown some resilience, but domestic sectors will take over as economic drivers in 2020-2021.

Sweden

0.00%

Sweden's Riksbank will deliver one further repo rate hike in December – bringing the key interest rate to zero – despite weaker economic conditions. But after that, not much will happen for quite a long time.

Page 28

Norway

3.2%

Projected overall GDP growth in 2020. Unlike many other advanced economies, economic expansion is accelerating. Norway will grow the fastest of the Nordic countries throughout our forecast period.

Page 34

Denmark

1.7%

The projected increase in Danish private consumption during 2020. Household consumption is accelerating and will be one of the most important economic drivers as overall growth slows.

Page 36

Finland

5.1%

The upturn in industrial production during June-August. Despite falling sentiment indicators, weak global trade and Germany's industrial problems, Finnish output is increasing.

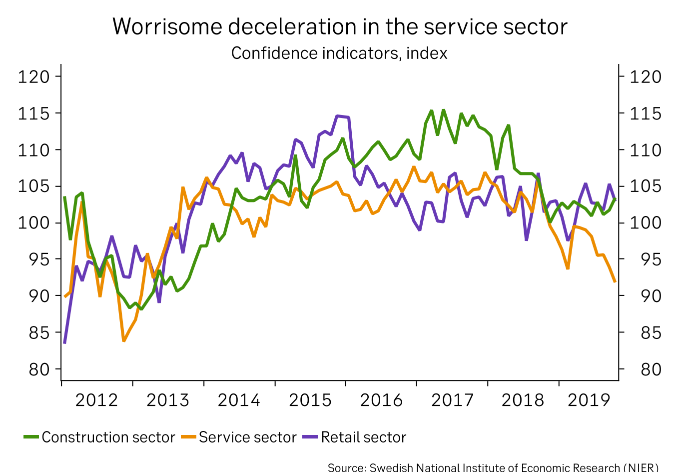
Page 37

Sweden

Weaker conditions than normal in 2020

Economic growth will be very moderate this coming year. Unemployment will climb throughout 2020, and resource utilisation will fall below the historical average. The Riksbank will hike its repo rate to zero this December, and the key interest rate will then remain unchanged until the end of 2021. Because of stronger international economic conditions and a gradual recovery in residential construction, growth in Sweden will recover in the latter part of 2020, enabling unemployment to stabilise in 2021.

Worrisome deceleration in the service sector



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	2.4	1.2	1.2	1.7
Unemployment*	6.3	6.7	7.2	7.4
Wages and salaries	2.5	2.6	2.6	3.0
CPIF	2.1	1.7	1.5	1.6
Net lending**	0.8	0.3	0.2	0.0
General government debt**	38.8	34.8	34.3	33.6
Repo rate***	-0.25	0.00	0.00	0.00
EUR/SEK***	10.15	10.50	10.20	10.00

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

Weak sentiment signals, but resilient hard data

Sentiment indicators have fallen in recent months. The Swedish economy is clearly slowing, but hard data for the third quarter were relatively strong. The construction sector and household consumption show signs of stabilisation. Our overall revisions compared to the last *Nordic Outlook* are thus relatively small. Statistics Sweden's downward revision of first half output contributed to our adjustment of 2019 GDP growth from 1.5 to 1.2 per cent. We have revised 2020 GDP growth from 1.3 to 1.2 per cent. Our forecast of 1.7 per cent in 2021 is unchanged.

Balanced risks. The clear decline in purchasing managers' indices (PMIs) for both the manufacturing and service sectors poses near-term downside risks. A bit further ahead, there is also upside potential. Relatively high unemployment and shrinking labour shortages imply that supply-side restrictions are further away than in comparable countries. Strong government finances will also allow room for more expansionary fiscal policy. In particular, increased central government grants to local authorities would ease the upturn in unemployment while reducing household worries about deterioration in the quality of public services (see theme article).

Manufacturers face mounting headwinds

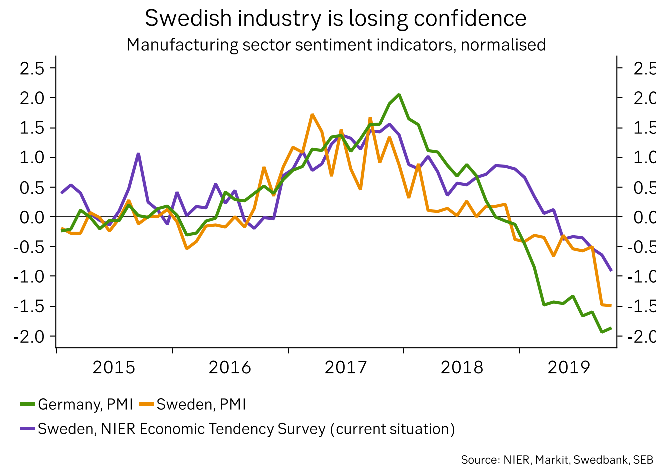
For a long time Swedish manufacturing was resilient to weaker conditions elsewhere, especially in Germany, but in September the purchasing managers' index (PMI) plummeted. It is now well below the expansion threshold of 50. Yet industrial production and goods exports have kept growing at a relatively healthy pace, although some slowing has taken place in recent months. In the next few quarters, exports and industrial production will probably weaken further, even showing negative growth, but recovery tendencies in international manufacturing activity suggest that any downturn will be brief. As early as Q2 2020 we believe exports will start increasing again, and the upturn will gradually accelerate after that. Average annual export growth will slow from nearly 5 per cent this year to 1½ per cent in 2020 and 2 per cent in 2021.

Falling investments in machinery and housing. Another indication of weaker manufacturing activity is that machinery investments have declined after several years of strong upturns. 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 decreased nearly 15 per cent by mid-year 2019. The number of housing starts has now almost stabilised; after a lag this should lead to a similar trend for residential investments. Late in 2020 we expect a cautious upturn in housing starts, resulting in slightly rising residential investments during 2021. Despite significantly lower machinery and residential investments, total capital spending has fallen only marginally – due to a strong upturn in public sector investments. Because of heavy demand for health care, social services and schooling, this upturn will probably continue during 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 2.0 per cent this year and 1.0 per cent in 2020, followed by a 2 per cent increase in 2021.

Signs of recovery in household consumption

Household consumption began a slight falling trend in mid-2018. Changed tax rules that were aimed at encouraging purchases of lower-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 rising 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 only a couple of per cent below their 2017 peak. Offsetting this is a clearly weaker labour market, reflected by a decline in household confidence to its lowest level since 2013. The main source of concern is the general economic situation. Meanwhile households are relatively confident about their own finances. Except for periods of recession and steeply falling employment, declines in consumption are unusual. Consumption also rebounded during the second quarter of 2019, and this upturn seems to have accelerated in the autumn. We expect a gradual upturn during the coming year. Car registrations are now back at the high levels that prevailed before the downturn in mid-2018 – supporting this assessment.

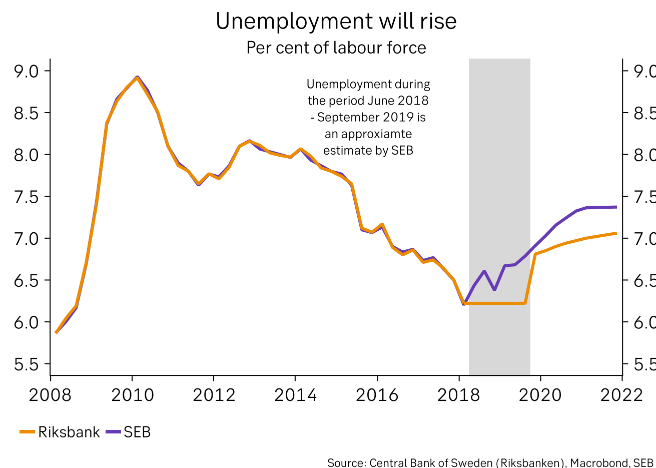


Household incomes and saving

Year-on-year percentage change

	2018	2019	2020	2021
Real disposable income	2.7	2.3	2.1	1.5
Private consumption	1.2	0.7	1.3	1.7
Savings ratio, per cent of income	15.4	16.0	16.2	15.9

Source: Statistics Sweden, SEB



Public sector expansion is slowing. Swedish public sector consumption has risen slightly in recent years, but as we have pointed out earlier this is because public sector productivity is falling steeply – mainly due to changed measuring methods. Employment better reflects the impact of the public sector on demand, and it has climbed sharply for a long time, but in the past few years this upturn has slowed. Although strong demand for public services suggests that the upturn will continue, a growing number of local authorities are beginning to experience a tighter fiscal situation (see the theme article on page 31). This suggests that public sector growth will continue to decelerate.

Slower job growth and higher unemployment

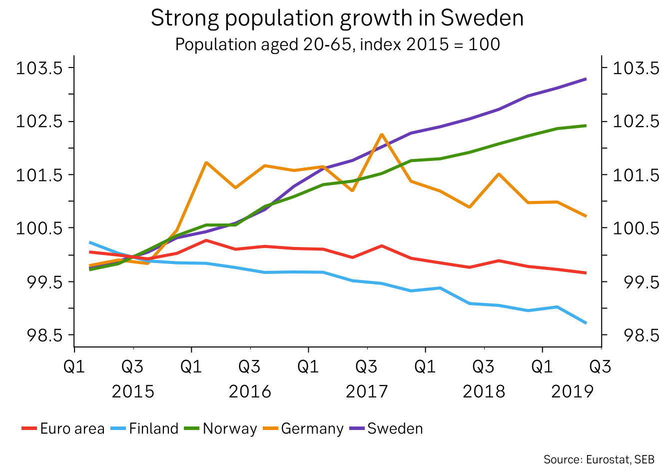
The dramatic Q3 figures in Statistics Sweden's Labour Force Survey (LFS) turned out to be due to a technical error, but it is clear that the labour market has in fact cooled. We believe that unemployment has climbed by about 0.5 percentage points since bottoming out last year, while job growth has slowed significantly. There are many signs that these negative trends will continue during the coming year. Indicators have continued to fall, and business hiring plans have become more cautious – indicating that job growth is now close to stagnation. Our forecast is thus that job growth will be only a few tenths of a point both this year and next. Given Sweden's rapid population growth, this will not be enough to keep unemployment from gradually rising to 7.5 per cent by the end of 2020 and staying at around this level in 2021. The main reasons Swedish unemployment diverges negatively from the pattern in comparable countries are rapid population growth and difficulties integrating newly arrived immigrants into the labour market.

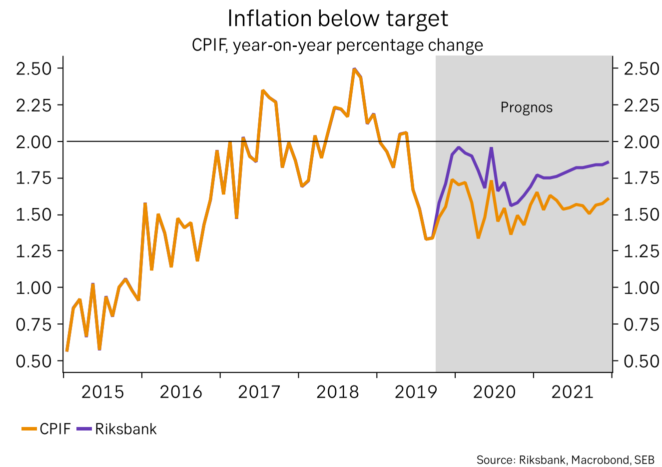
Below-target inflation despite weak krona

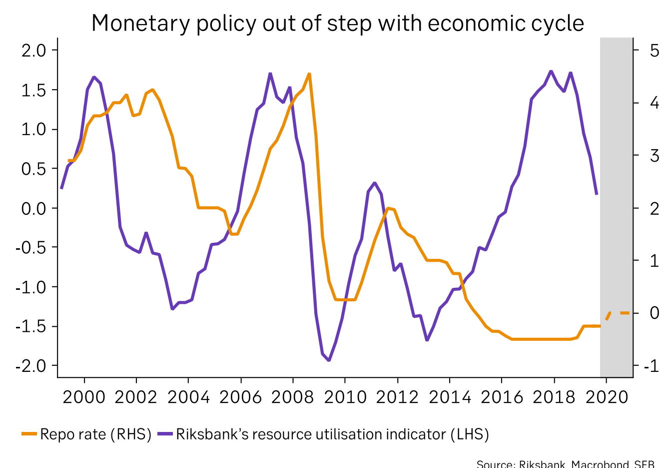
Confirming the cooler labour market, the Riksbank's resource utilisation indicator (RUI) has fallen steeply since late 2018 and is now almost at its historical average. This downturn will probably continue during the coming year, affecting wage formation. Efforts by the Swedish Trade Union Confederation (LO) to establish coordination among all its affiliated unions in the upcoming national wage round have failed; the Municipal Workers and Paper Workers will present their collective bargaining demands separately. This will make the wage round messier than usual. Combined with slightly higher pay increases in other countries, this makes us still believe that contractual pay hikes will end up a bit above the 2.2 per cent yearly level achieved in the 2017 wage round. The industrial unions' initial 3.0 per cent pay hike demand is also slightly higher than last time. But we have adjusted our forecast of total pay increases one tenth of a point lower to 2.6 per cent in 2020 and 3.0 per cent in 2021, due to the weaker labour market situation.

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) has fallen to 1.3 per cent during the past two months. Energy prices contributed strongly to earlier higher inflation and they are one important reason why inflation is now lower. In both 2020 and 2021, we expect the energy component to provide a slight negative contribution to inflation, partly because rule changes will lead to lower network fees for electricity. 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 of around 2 per cent. This summer, for example, CPIF excluding energy reached 1.9 per cent, but it fell to 1.6 per cent in August and September. We expect a continued weak krona to result in a renewed inflation upturn during the next 3-6 months.

Will the persistently weak krona push inflation higher? One upside risk in our forecast is that the krona depreciation trend may trigger a bigger inflation effect than episodes of comparable depreciation in a more volatile foreign exchange environment. Our box in the last *Nordic Outlook*, however, 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. Low international prices and moderate pay increases are also helping to hold back inflation. We expect upward pressure from the exchange rate to ease in the second half of 2020, with CPIF inflation below target throughout our forecast period.







Key rate hike, despite weaker economic conditions

After its October meeting, the Riksbank clearly signalled that it intends to hike the repo rate in December. This autumn we thought the threshold for a rate cut was very high. However, we were not prepared for this determination to raise the key rate. The Executive Board is sticking to its plan despite weaker economic conditions, with both actual inflation and inflation expectations below target. This represents a departure from the inflation focus of recent years. The Riksbank believes that we are now facing normalisation after a strong economic situation and that neither Sweden nor other countries face a recession, but because the Board meanwhile notes great uncertainty about near-term trends it is a bit surprising that the Riksbank is in such a hurry. On various occasions in recent decades, it has tended to fall out of step with the economic cycle. The Riksbank now risks again pursuing pro-cyclical monetary policy.

Changed monetary policy reaction function. The Riksbank is not especially clear about its reasons for the coming hike, opening the way for speculation. Its Monetary Policy Report reflects on possible drawbacks of negative interest rates. Although this was played down at the press conference after the policy meeting, we still believe that the Riksbank sees an intrinsic value in bringing the repo rate up to zero. It has probably also embraced criticism about the disadvantages of a weak krona and is no longer so interested in the temporary inflation impulses that the currency can provide. Housing market developments may also have an impact. The period of strong economic growth in 2017 and 2018 coincided with falling home prices and downside risks. Now that the housing market is gaining strength and households are again starting to believe in robust price increases, it is possible that the Riksbank wants to avoid reinforcing this trend by continuing its negative rate policy.

Lengthy pause at zero. As a counterweight to the rate hike signal, the Riksbank lowered its longer-term rate path, which now implies a zero key rate until early 2022. But once the December hike has occurred, the central bank will need to show its cards clearly. Its strong desire to hike the key rate to zero suggests that it will take a lot to persuade the central bank to cut the key rate again. Governor Stefan Ingves has hinted that expanded asset purchases are more likely. Although at present it is hard for the Riksbank to find suitable government bonds, the situation may change if a deeper economic slowdown increases the government's borrowing requirement. If home prices and household lending decline, this may increase the probability of mortgage-backed bond purchases. But worth noting is that several Board members have indicated that fiscal policymakers should play a more important role during the next downturn.

Riksbank commission of inquiry is open to greater flexibility. Since we believe the Riksbank is again overestimating inflation, a rate hike in the foreseeable future does not seem logical either. We are thus forecasting that the repo rate will be hiked to zero in December and stay there in 2020-2021. The report of the Riksbank commission of inquiry (to be published in November) could change this situation. In an op-ed article, the commission announced that it would propose a number of innovations. For example, in the future the Riksbank should observe a proportionality principle in relation to its actions. This might mean that gains in the form of more exact inflation target fulfilment should be weighed against such negative effects as greater currency volatility or wider gaps, along with increased financial market risks due to runaway asset prices. At present, this marginal reform could increase the probability of a rate hike. On the other hand, the commission also stresses that the Riksbank should contribute to balanced production and employment trends, which probably points in the opposite direction, given the environment likely to prevail in the next couple of years.

Theme:

Local government

Squeezed from all directions – grant money needed

The current economic slowdown is drawing further attention to Swedish local government finances. With both structural and cyclical factors squeezing revenues and expenditures, substantially higher central government grants seem unavoidable. The alternative – major cuts in social service ambitions – appears unlikely, judging from the tone of today's public discourse. But major local government projects will eat up much of the future room for reform efforts, which may create political tensions in funding the January Agreement. One solution, which we have raised earlier, would be to interpret the public sector surplus target less restrictively now that the debt anchor has already achieved its target.

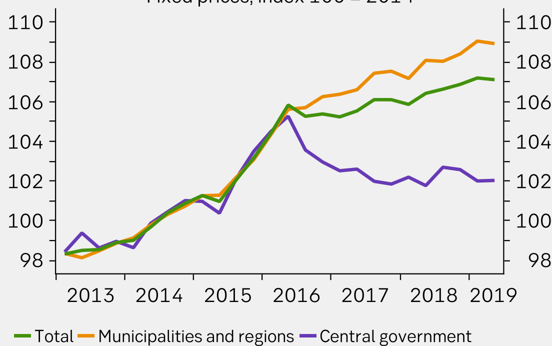
Tensions between the central government and the local government sector (municipalities and regions) are now increasing, due to the economic slowdown and pressures from migration and other demographic changes. Local government operations are at the heart of public social welfare obligations and are expected to remain at a relatively stable level, regardless of the economic situation. Since the sector's operations and revenues are largely controlled by central government decisions, its manoeuvring room is often more limited than general descriptions of "local self-determination" imply. Local tax revenues are also highly dependent on labour market cycles and variations in employment and pay levels. Expenditures, such as social assistance, also depend to some extent on general economic conditions.

The local government sector is being squeezed from all directions. The ability of local governments to cope with changed economic conditions and obligations is also limited by relatively strict requirements concerning the balance between their revenues and expenditures. Since central government instead bears general responsibility for stabilisation policy, it is natural to use both general and targeted central government grants to smooth out fluctuations in local government revenues and spending. Local government revenues come from taxes (70 per cent), central government grants (25 per cent) and other sources (5 per cent).

Central government grants are gradually being undermined. Because these grants are mainly set nominally, inflation and pay hikes undermine their real value. To enable local governments to maintain the quality of their core operations, in practice government and Parliament must approve higher grants each year. These are often misleadingly described as ambitious social welfare spending. It is especially awkward for local governments when compensation for inadequate general grants comes in the form of funds earmarked for some area that the government or some other party wants for public relations purposes. In practice, this forces local governments to face cuts in other areas.

Local government consumption trending higher

Fixed prices, index 100 = 2014



Source: Statistics Sweden (SCB), Macrobond, SEB

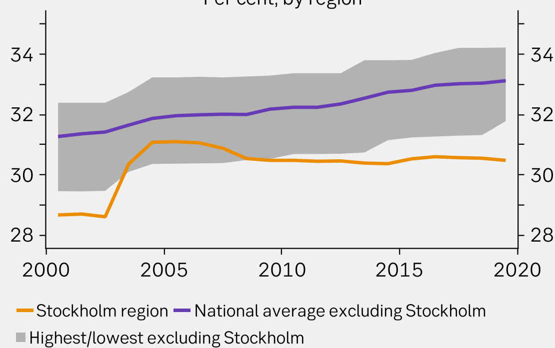
Cutbacks and shortages at the same time. After a number of years of rapid job growth, the demand for local government employees has fallen sharply. According to the Labour Force Survey, employee numbers have even fallen, but it is highly uncertain if this picture will hold up completely once the statistics have been revised. The question is whether any such downturn is attributable to the shrinking real value of central government grants, but it is probably not mainly due to budget constraints. A more reasonable explanation is that local governments may have needed to cut back operations in some areas where activities were especially intensive at the peak of the migration crisis that began in 2015. Cutbacks in labour market programmes may also be having an impact.

Yet shortages of suitable employees remain the main problem for local governments, largely because big cohorts are now retiring and need to be replaced. The Swedish Association of Local Authorities and Regions (SKL) estimates that due to retirements alone, more than 300,000 new employees must be hired during 2017-2026. This is the same as the total increase in employment over the past decade. The dominant union in the sector, the Municipal Workers, has chosen not to participate in Trade Union Confederation (LO) coordination efforts during the upcoming wage round – suggesting that the union sees good prospects of winning slightly higher pay increases in this situation.

Big gaps in local government conditions. The uneven distribution of refugee resettlement activity, in which rural municipalities with surplus housing shouldered the biggest burden, further widened the underlying gaps between different municipalities and regions. The national system of tax revenue redistribution from richer to poorer local governments is continuously being revised, and a new version is about to be launched. The system is designed to take into account variations between municipalities and regions both in terms of revenues and spending. Despite the system, local income tax levels vary substantially. The chart below compares total taxes levied by municipal and regional governments, at the regional level. The Stockholm region increasingly stands out because of its lower tax, now 1.30 percentage points below the next-lowest region. Excluding Stockholm, there was a gap of 2.50 points between the highest and lowest tax level in 2018. Underlying income differences play a major role. Average annual income in the Stockholm region was SEK 50,000 higher than in Västerbotten, which had the highest average local government tax rate in 2018.

Average total local government income tax

Per cent, by region

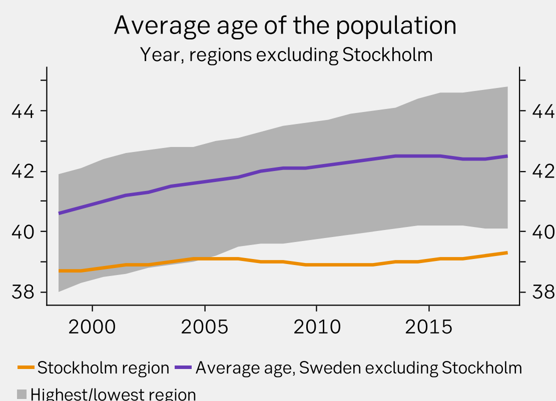


Source: Statistics Sweden (SCB), Macrobond, SEB

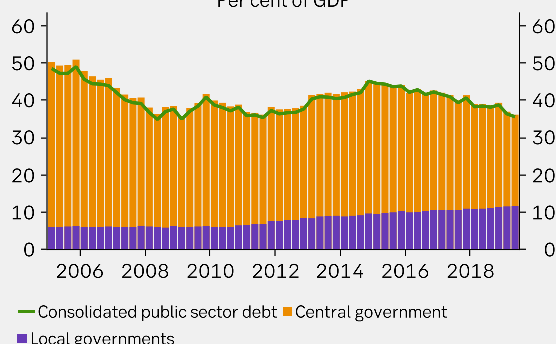
Major demographic differences between regions. The ageing of Sweden's population varies from one region to another, and this also contributes to the gaps in economic conditions. Most regions have seen an upward trend in their average age during the 21st century, but in the Stockholm region the average age has been largely unchanged for the past decade. It is now more than three years lower than in the rest of Sweden and more than five years lower than in Gotland, which has the highest average age. Urbanisation, ageing processes and local income tax levels thus create differences in the local government sector. Meanwhile its obligations to the public are the same everywhere. It is hard to determine where the pain threshold for local income tax lies, but 2018 election debates indicated that many people think it is now close. We thus believe that local governments will generally try to avoid tax hikes, which we expect to average only 0.15 percentage points in 2020. Central government income taxes are being cut via the earned income tax credit and abolition of the 5 per cent surtax on high incomes. This indicates a general ambition to hold down taxation of labour at the national level.

Are worries about pension liabilities exaggerated? This demographic trend also affects local government pension liabilities, which are occasionally singled out as a major threat to the sector's finances. There are currently three types of pension systems, which are treated differently in local government accounts. This may create the impression that some municipalities or regions face a debt explosion. We see no reason to make any assessment different from SKL, which states

that the burden from earlier defined-benefit pension systems will actually diminish as disbursements from old unfunded systems shrink and new defined-contribution pensions increase. The costs are also relatively well-known, although forecasts at the municipal or regional level may sometimes be complex. In other words, the challenges facing local governments are more related to their operations and shifting supply and demand for social services rather than financial factors associated with their former pension systems.



Increased central-local government tensions. Sweden's official fiscal framework is very strict in an international perspective. Meanwhile the growing burden on local governments – largely due to central government decisions on matters like migration or the ambition levels in the social welfare system – will become a major political issue. The central government is, of course, aware of the problem. In June, the finance minister presented a projection showing a funding gap of SEK 90 billion until 2026 due to demographic changes. This is equivalent to 0.2-0.3 per cent of GDP yearly, or well in line with SKL's estimates. This is about the same size as the National Institute of Economic Research (NIER) estimate of the room for reforms.



The central government can afford it, but prioritisation is needed. How to prioritise and finance public sector obligations is a political choice, mainly at the national level. According to NIER's estimate, the necessary SEK 90 billion allocated over seven years is equivalent to a 0.50 percentage point higher income tax per year. Such a large tax hike would probably be regarded as too harmful, so the most likely outcome is that the central government will be forced to pay larger grants to the local government sector. To the central government, an escalation of these grants by 0.2-0.3 per cent of GDP is not especially dramatic either. In fact it is equivalent to the automatic budget tightening that occurs when the central government expenditure side is treated more restrictively than the revenue side in the ordinary national budget process.

Public finances

Per cent of GDP

	2018	2019	2020	2021
Net lending	0.8	0.3	0.2	0.0
Borrowing req (SEK bn)	-80	-120	-14	-2
Gen. gov't gross debt	38.8	34.8	34.0	33.0

Source: Statistics Sweden, SEB

Continued strong public finances. At present, the economic slowdown appears unlikely to change the general picture that Swedish public sector finances are strong in a historical and international perspective. A cooler labour market and a deceleration in construction and consumption will of course contribute to slower future growth in public sector revenues, and the government budget will move from surplus to balance in 2021. General government gross debt will still fall below the debt anchor's benchmark, 35 per cent of GDP, as early as this year and then continue down to 33 per cent. Our estimate is based on a fiscal stimulus of just above 0.5 per cent of GDP both in 2020 and 2021. There is clearly room for a stronger dose, especially considering that international discourse increasingly emphasises the need for more active fiscal stimulus in the prevailing low interest rate situation. We are also sticking to our view that it is reasonable for the debt anchor to take precedence if a goal conflict with the surplus target arises.

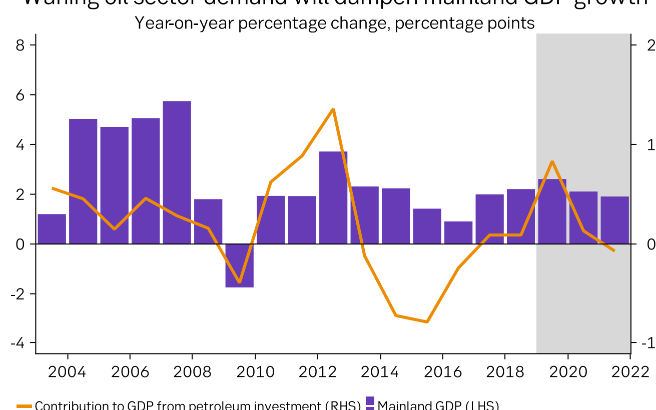
Reform focus will be on local governments. At present, there appears to be a sizeable majority in the Swedish Parliament in favour of increasing central government grants to local governments, since all parties both inside and outside the January Agreement on budget cooperation support this. The issue may nevertheless lead to political tensions. Although the need for higher local government grants is not so dramatic, they will squeeze out other spending priorities, especially in areas covered by the January Agreement. Tensions during the budget process between the governing Social Democrats and Greens and their budget partners, the Centre and Liberals, may thus increase as the parties face strategic choices that may conflict with the January Agreement. The general issue of how strictly to interpret fiscal framework rules may also lead to tensions and distrust. But despite these cautions, it is not difficult to imagine the parliamentary parties agreeing as early as 2020 to allocate larger grants to the local government sector than they have approved to date.

Norway

Slower but still healthy growth momentum

Growth in the mainland economy will decelerate as various sentiment indicators suggest that momentum has peaked. The positive contribution from high petroleum capital spending will fade, but domestic demand should remain healthy. The weak NOK improves competitiveness, preventing a sharp decline in external demand while boosting inflation. Core inflation will continue to run above target and even reaccelerate somewhat, but Norges Bank will remain firmly on hold at a key rate of 1.50 per cent.

Waning oil sector demand will dampen mainland GDP growth



Source: Statistics Norway, Macrobond, SEB

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	1.3	2.3	3.2	2.1
Mainland GDP	2.2	2.5	2.1	1.9
LFS unemployment*	3.8	3.6	3.6	3.7
Annual wage and salary increases	2.8	3.3	3.5	3.5
CPI-ATE inflation	1.5	2.3	2.3	2.0
Key interest rate*	0.75	1.50	1.50	1.50
EUR/NOK***	9.90	10.30	10.00	9.70

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

Growth is slowing but remains above trend

Unlike many other developed countries, Norway's overall growth rate will accelerate this year. Sharply higher petroleum capital spending has boosted oil-related manufacturing and stimulated domestic demand via higher employment and wages. The sharp decline in the krone has improved competitiveness and kept foreign demand intact. Hence, the mainland economy (excluding oil, gas and shipping) has so far been relatively resilient to the slowdown abroad. Looking ahead, however, growth in the mainland economy will slow as various sentiment indicators suggest that momentum has peaked. The positive contribution from high oil-related investments will fade and weaker international growth will dampen growth. Fiscal policy will turn somewhat contractionary in 2020, while we assume a neutral impact in 2021. Economic data have supported the broad contours from September's *Nordic Outlook* and we are only making minor revisions to our growth projections. We forecast that mainland GDP will slow from 2.5 per cent in 2019 to 2.1 and 1.9 per cent in 2020 and 2021, respectively. Total GDP should grow by 3.2 per cent in 2020 and 2.1 per cent in 2021.

A short-lived cyclical upturn in petroleum investment

The investment cycle in the petroleum sector has turned markedly stronger over the past year, reaching more normal levels. The recovery has primarily been driven by the development of new fields on the Norwegian continental shelf, keeping manufacturing activity high despite weakness abroad. The cyclical upturn will, however, be rather short-lived and investment growth will slow notably in coming years. The slowdown does not reflect a structural downturn like after the oil price plunge in 2014. Both cost pressure and employment in the sector are below the levels seen before the correction of recent years. Profitability in the sector thus remains solid, with break-even prices for new development projects ranging between USD 10-35 per barrel. Though several new development projects are scheduled to start in the coming years, they will not fully offset the completions of several larger projects. Statistics Norway's investment intentions survey suggests that capital spending growth will slow but remain positive in 2020. We forecast petroleum investment will increase by 15 per cent in 2019, slowing thereafter to 2.5 per cent in 2020 and -1.5 per cent in 2021.

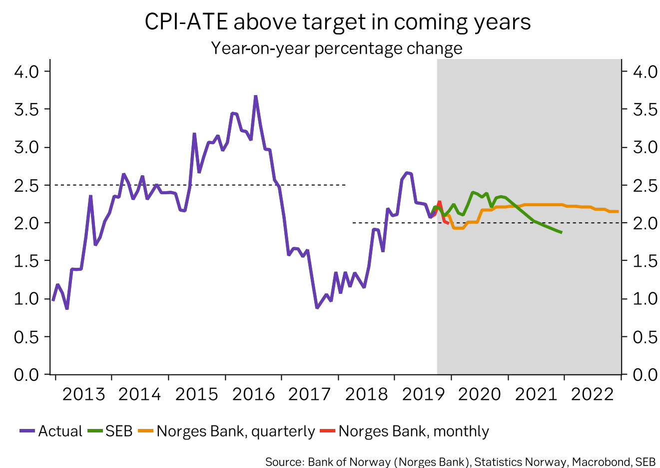
Waning petroleum sector demand will slow manufacturing output. Business sentiment has trended lower in 2019, pointing to a moderation in output growth. The oil service sector has become more uncertain about order bookings, while insecurity in the non-oil export sector has increased in line with deteriorating growth prospects among trading partners. Improved competitiveness due to sharp krone depreciation will prevent a larger decline in foreign demand. We forecast that shipments of traditional goods will grow by 2.2 and 1.8 per cent in 2020 and 2021, respectively. Non-oil business investment has increased notably in recent years, but the manufacturing investment survey suggested that capital spending will remain high in the coming year. We expect business investment to grow by 2.4 and 1.6 per cent in 2020 and 2021, respectively. The residential investment outlook is cautiously optimistic, judging by housing starts and home prices. We believe residential investment will grow by nearly 2 per cent yearly in 2020-2021.

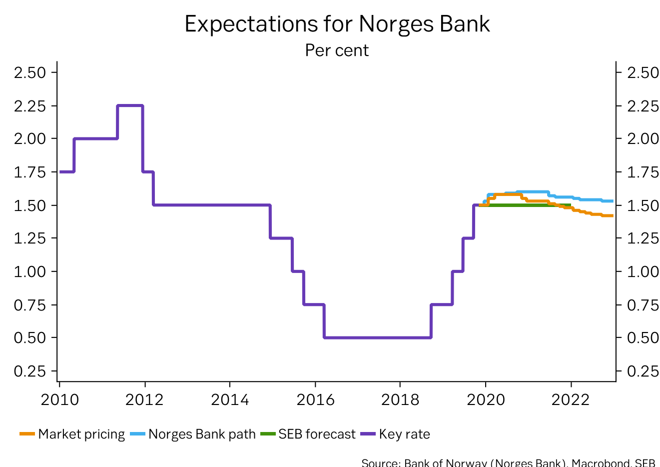
Private consumption to rebound

Momentum in private consumption has softened in 2019, driven by weaker domestic spending on goods. This is mainly due to highly volatile auto purchases this year which do not reflect the underlying trend, in our view. Higher mortgage rates may also have dampened consumption somewhat. Norwegian households have a rather high

debt-to-income ratio and 93 per cent of debt is on floating rate terms. However, softer consumption does not reflect deteriorating household fundamentals. On the contrary, consumer confidence has rebounded, and households' real disposable income should continue to grow solidly. The rebound in existing home prices has gained a firmer footing and demand and supply indicators suggest annual price gains of near 2.5 per cent in the coming years. Spending on services and net consumption abroad, almost half of the total, have remained solid. We have revised the forecast for private consumption downward to 1.9 per cent in 2019, while expecting growth near 2.4 per cent in 2020 and 2021.

The substantial depreciation of the krone this autumn indicates that inflation will continue to run above target





Tight labour market pushing wages higher

Registered unemployment has stabilised just above 2 per cent, near the level consistent with price stability. The Labour Force Survey (LFS) metric has been more volatile and the jobless rate jumped to 3.7 per cent in Q3. However, details are encouraging since the rise in unemployment reflects a higher participation rate. Employment in the most cyclical sectors such as manufacturing and construction and some private services has been strong. Various indicators suggest job growth will remain solid, though the economic slowdown points to moderation ahead. We expect the LFS jobless rate to be relatively stable at near 3.6 per cent in the years ahead. Tight labour market conditions and rising capacity utilisation suggest there is no slack in the economy. We expect annual pay increases of 3.3 per cent in 2019 and 3.5 per cent in 2020.

The weak krone lifts inflation above target

After rising to 2.7 per cent in March, inflation has eased. CPI-ATE (excluding taxes and energy) was just above 2 per cent in August and September. The moderation has primarily been driven by an easing of upward pressure from a weak exchange rate. The substantial depreciation of the krone this autumn indicates that inflation will continue to run above target and even reaccelerate somewhat in the next 6-9 months. The outlook for domestically generated inflation is mixed. Service inflation turned slightly lower this summer after having increased its highest since 2010, but. gradually rising wage pressures indicate that service inflation will stabilise at a relatively high level. Rent increases, though expected to accelerate somewhat, continue to increase more slowly than the historical average and are thus dampening inflation somewhat. Low international price increases will also help to contain the inflationary pressure. Late in 2020, when the effects of recent krone depreciation have faded, inflation will fall gradually. We expect CPI-ATE to average 2.3 and 2.0 per cent in 2020 and 2021, respectively. Total CPI will be higher than core inflation next year, though falling back below target by the end of 2021.

Norges Bank on hold despite high inflation. Norges Bank hiked its key interest rate to 1.50 per cent in September, while signalling a pause in the hiking trajectory. The bank's flexible approach and the weak krone have enabled it to hike rates four times despite dovishness abroad. Although Norges Bank has maintained a hawkish bias, it is unlikely to deliver unless global growth improves and uncertainty related to trade and Brexit eases. A rate cut is equally distant due to above-trend growth, a positive output gap and inflation forecasted to remain above the target. We expect the key rate to remain at 1.50 per cent throughout our forecast period.

Weak NOK dampens demand for NGBs. NOK has been the worst performing G10 currency in the second half of 2019 and set a new all-time-low against the euro in October. Small trade-dependent and less liquid currencies are suffering in this global environment, while domestic conditions are irrelevant. Robust negative seasonal factors are likely to push the krone towards new lows against the euro and dollar before year-end. Absent improving confidence in global growth and/or political progress, it is likely to remain weak. We believe the EUR/NOK exchange rate will fall from 10.30 by year-end to 10.00 and 9.70 by the end of 2020 and 2021, respectively. The weaker trending krone has probably muted foreign demand for Norwegian government bonds (NGBs). NGBs still offer attractive yields compared to German equivalents, but the ECB's aggressive monetary policy is likely to keep spreads historically wide. We forecast a 10-year yield spread against Germany of 185 and 175 basis points by the end of 2020 and 2021, respectively.

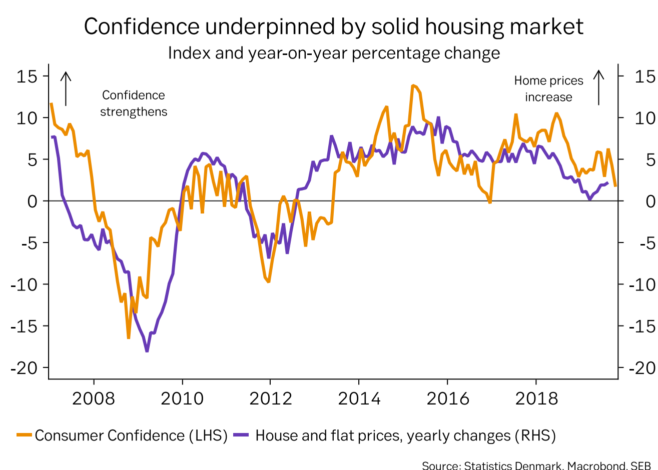
Denmark

Signs of momentum loss

The Danish economy continues to expand faster than its European peer group. However, while newly revised numbers show growth was much stronger than previously reported in 2018, the data so far from H2 2019 show early signs of a momentum loss emerging. We expect a gradual decline from above 2 per cent growth to around 1.5 per cent, which is above our estimate of trend growth. With plenty of cyclical slack remaining, this is unlikely to have adverse effects.

Confidence underpinned by solid housing market

Index and year-on-year percentage change



Source: Statistics Denmark, Macrobond, SEB

Key data

Yearly change in per cent

	2018	2019	2020	2021
GDP	2.4	2.1	1.6	1.5
CPI	0.8	0.7	1.1	1.4
Wages and salaries	2.2	2.0	2.6	2.8
Public sector financial balance*	0.6	1.0	0.5	0.5
Public sector debt*	34.3	33.0	32.0	31.0
Current account*	5.7	7.5	7.0	7.0
Key interest rate (CD rate)	-0.65	-0.75	-0.85	-0.85
EUR/DKK	7.46	7.46	7.46	7.46

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

Significant upward revision of growth. The Danish economy continues to post growth rates far above its European peer group, with newly revised GDP numbers raising 2018 GDP growth from 1.5 per cent to 2.4 per cent. The revisions have yet to be included in the quarterly national accounts, so we don't know yet how it will affect the dynamics. With a year-on-year GDP increase of 2.6 per cent in Q2, however, growth was already surprising on the upside before the revisions, and we have thus raised our 2019 growth estimate to 2.1 per cent. However, while actual growth remains impressive in a European context, the data so far from H2 2019 suggest that early signs of a momentum loss are emerging, most likely reflecting weakness in large export markets such as the UK, Germany and Sweden. The underlying trend still looks like a gradual decline from above 2 per cent to around 1.5 per cent, which remains above our estimate of trend growth.

Consumers remain the main driver. Private consumption was among the key growth drivers in Q2, reversing Q1 weakness with quarterly growth rising from 0.2 per cent to 0.5 per cent, and the reversal would have been even more pronounced if car sales had not fallen 15.9 per cent in Q2 after rising 16.9 per cent in Q1. Yet the first cracks are creeping into the consumption story. Both job growth and wage inflation have slowed over the summer, capping disposable income growth, while consumer confidence has given back all gains from the first half of 2019. However, home prices have meanwhile gained momentum as mortgage bond yields have reached new lows and bank lending conditions have stopped tightening. Household balance sheets also remain strong and the savings ratio is elevated. Consumption growth is thus likely to remain the anchor for Denmark's expansion.

Solid housing market. Business investment declined in Q2, but we do not expect this to be a lasting trend. Denmark's manufacturing PMI recovered in H2 led by new orders, and capacity utilisation remains close to the historical average. However, weak demand in key European markets and concerns about a possible hard Brexit suggest the improvement will be slow and gradual. If demand from Germany and Sweden fails to stabilise, we could see further weakness. On the other hand, construction investment continues to post robust growth, and the renewed increase in home prices is likely to add support. Net exports also continue to provide a strong growth contribution in spite of soft external demand. The overall growth picture thus remains favourable. Although the Q2 numbers likely exaggerate the strength of the economy, we expect Denmark to keep outperforming the rest of Europe over the forecast period.

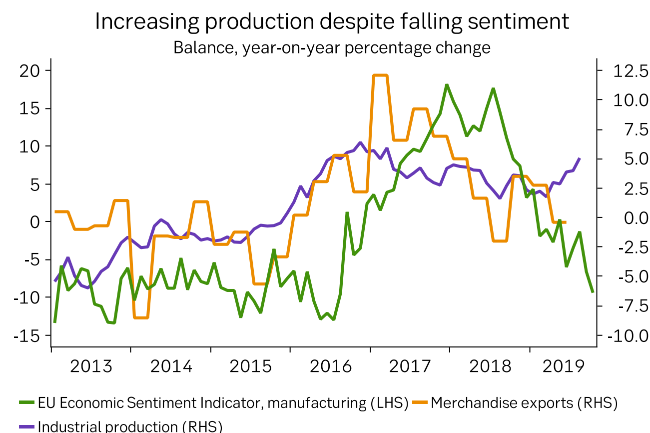
Few imbalances. Despite the lengthy expansion, there still seems to be some cyclical slack left in the Danish economy. Wage inflation has slowed in 2019. While revised data suggest that the employment-to-population ratio in prime age groups continues to improve, they show that it remains below the trough from earlier expansions. The current account surplus has also started to improve again after weakening in 2018 and is now back above the EU's stability rule limits. The modest fiscal stimulus in the 2020 budget proposal is thus likely to support growth without significant adverse effects.

Spot DKK has weakened. The Danish krone has weakened against the euro in spot terms to the point where the Danish central bank (DNB) would normally intervene and it appears there have been some small purchases of DKK. However, FX forwards are stronger than the central parity rate, so the DNB is not rushing to take serious action. It even allowed the money market spread to widen marginally after the ECB's rate cut and introduction of a two-tiered deposit system in September. Further weakening of the spot DKK is unlikely to be accepted, but the DNB can live with the current level.

Finland

Deceleration after strong first half

As in other countries, manufacturers have become less optimistic, yet production and exports have been decent so far this year. Because of sharp fluctuations in exports, imports and inventories, however, GDP statistics are hard to interpret. We expect international weaknesses to hurt Finnish economic performance too. Households have behaved cautiously, despite a gradually improving labour market. By late 2021, unemployment will be a bit above 6 per cent, close to its 2008 level.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	1.7	1.2	1.6	1.6
Private consumption	1.8	1.3	1.5	1.7
Unemployment*	7.4	6.7	6.5	6.3
Wages and salaries	0.8	1.3	1.8	2.0
HICP inflation	1.2	1.1	1.3	1.4
Public sector financial balance**	-0.8	-0.8	-0.7	-0.7
Public sector debt**	59.0	58.5	58.0	57.5

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

Gloomy manufacturers; resilient domestic sectors. Manufacturing sentiment has gradually worsened and is now at basically the same level as during the recession 5-6 years ago. As in other countries, the situation is better in more domestically oriented sectors. Service sentiment has fallen but shows signs of stabilising well above its recession level. Construction and retail sentiment has actually improved a bit in the past six months. Despite European – especially German – weaknesses, the latest GDP statistics indicate that quarterly growth has recently recovered. According to Statistics Finland's monthly GDP indicator, second quarter growth of 0.8 per cent will be followed by an at least equally strong Q3, but these volatile quarterly statistics are hard to interpret. Assuming weak international economic conditions, the end of the year is still likely to show a deceleration compared to the first half. This means that 2019 GDP growth will reach only 1.2 per cent and then accelerate slightly to 1.6 per cent yearly in 2020 and 2021.

Surprisingly robust manufacturing, despite shaky exports. Despite gloomier sentiment, industrial production has recently surprised on the upside. Meanwhile order bookings have worsened and exports have been relatively weak. Growing corporate inventories are a sign that production has been too high. A near-term correction can be expected as weaknesses persist in Finland's vicinity. We expect a slight acceleration in GDP growth during 2020-2021. Downside risks will predominate as long as the German economy is sputtering and global sentiment is weighed down by concerns about trade wars and hesitant Chinese growth.

Very pessimistic households. Household sentiment has plunged this past year and is now at around its earlier lows of the past 10-15 years. The downturn is unexpectedly sharp, since the economy and employment are still growing. The main component of this bad mood is worse confidence in the general economic situation. Households have behaved more cautiously, and consumption has been largely unchanged in the past year. Although purchasing power will increase slowly, it is still likely that consumption will gradually rebound when the growth deceleration ends.

Unemployment will level out as job growth fades. The labour market has improved greatly in recent years. Unemployment reached 6.7 per cent in September. Job growth was surprisingly rapid in 2018 but is now decelerating. Labour market indicators have weakened, yet most data show that job growth will continue during our forecast period, though at a slower pace. Vacancies are record-high and have kept climbing despite slowing job growth and unchanged unemployment over the past six months. The large number of unfilled jobs – with a relatively high percentage of businesses reporting that labour shortages are preventing expansion – suggests there is a matching problem in the labour market. The jobless rate will again start inching lower late in 2019, but the downturn will be relatively limited in 2020-2021. Towards the end of our forecast horizon, unemployment will be 6.3 per cent.

Pay increases have been low for a long time, driven by factors like low productivity growth and efforts to improve competitiveness. They are now slowly accelerating, but the upturn will be relatively limited, reaching about 2.5 per cent by 2021. CPI inflation will stay just above 1 per cent this year, as in 2018, and upward pressure is limited due to restraints on pay hikes and low international inflation.

Persistent public sector deficits. Finnish fiscal policy is a bit expansionary. We expect largely unchanged budget deficits in 2020 and 2021. Public sector debt will remain below 60 per cent of GDP during the next couple of years.

The Baltics

So far, the three Baltic economies have performed nicely while global headwinds have gradually decelerated global economic activity. Sector-specific problems are creating a variety of challenges, contributing to slowing growth. Labour markets in the Baltics remain tight, with a comparatively high (albeit decreased) rate of pay increases, but inflation is being kept in check.

Lithuania

6.6%

The expected rate of increase in exports during 2019, but next year the rate will slow by half. Strong growth in transport service exports has helped the country stay resilient to shaky European growth.

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Latvia

7.3%

The rate of pay increases in 2019. Unemployment keeps falling gradually, and major labour shortages persist in certain skilled occupations, further contributing to continued rapid wage and salary growth.

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Estonia

21%

The upturn in capital spending during the first half of 2019. An expected increase in construction investments was accompanied by surprisingly large spending on new machinery.

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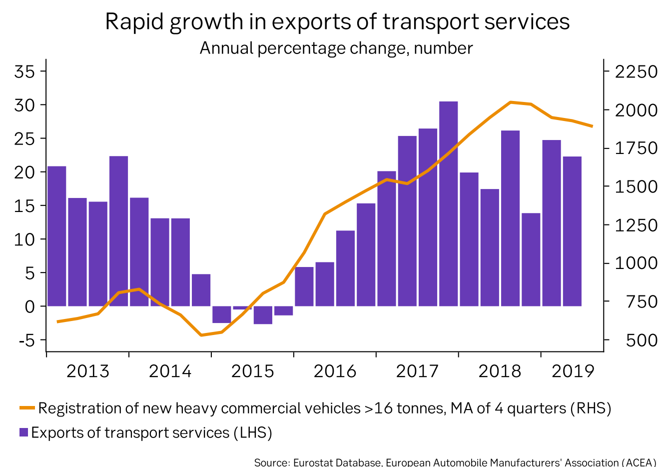
Lithuania

Economic immunity is weakening

This has been another successful year for the Lithuanian economy despite negative global economic trends, but we expect a slowdown in growth from 3.6 to 2.4 per cent next year due to a smaller contribution from net exports. Capital spending will rise at a rather strong pace in 2020-2021 but uncertainty will increase beyond our forecast horizon. Unemployment has stabilised and average gross pay will rise at a slightly slower pace.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	3.6	3.6	2.4	2.5
Private consumption	3.9	3.4	3.2	3.2
Exports	6.3	6.6	3.2	3.7
HICP inflation	2.5	2.2	2.3	2.4
Wages and salaries	9.9	8.2	6.5	5.8
Public sector financial balance*	0.6	0.1	0.0	0.1
Public sector debt*	34.1	36.3	35.4	34.6
Current account*	0.3	1.4	0.4	0.6

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

The Lithuanian economy expanded by an average of 3.9 per cent in the first three quarters of 2019. Compared to the previous year, growth decelerated to 3.6 per cent in the third quarter, supported by around a 20 per cent larger grain harvest. The trend is clear – economic growth is slowing, but at gradual pace. Even the manufacturing sector demonstrated rather satisfactory results in third quarter – output rose by 4 per cent. Although industrial producers remained competitive in export markets generally, some companies have not escaped unscathed from the downturn in the Germany auto industry. We remain cautious about export growth in 2020, since it is vulnerable to expected weak external demand. Slower net export growth is the main reason why we forecast that GDP growth will slow to 2.4 per cent in 2020.

Road transport sector keeps on growing. This sector, which is the largest contributor to exports of services, kept showing double digit growth in exports. Lithuanian carriers have rapidly increased their market share in Western European markets such as Germany and France. However, uncertainties arising from the EU's already approved Mobility Package and more difficult access to financing and labour will make it difficult for this sector to sustain growth.

Public sector investments jumped sharply in 2019, while private businesses were more cautious. Most public investments are co-financed by EU structural funds. We expect money from the EU's 2014-2020 funding programme to flow into Lithuania until 2021 at a pace similar to that of today, with a positive effect on public construction. However, beyond 2021 a drop in public investments will hardly be avoidable.

Slowing private consumption. Private consumption is expected to decelerate to 3.2 per cent in 2020 on slower growth in real wages. Although the government is planning to cut labour taxation further and increase child benefits, fiscal stimulus will be smaller than in 2019. Besides, we forecast that stabilising unemployment and a less optimistic economic growth outlook will slightly ease pressure to raise wages and salaries.

Slower pay hikes in 2020 and 2021. We forecast that average gross pay will increase by 6.5 per cent in 2020 and 5.8 per cent in 2021. Salaries in the public sector will grow faster than in the private sector. Labour costs keep increasing faster than productivity, and employee compensation as a percentage of total GDP is getting close to the EU average. The potential upside in pay increases above productivity growth is becoming more limited.

Inflation will stay marginally above 2.0 per cent during the next two years. First, labour costs will keep growing rapidly – driving price inflation in services. Second, there will be increases in diesel and petrol prices next year if the government's current proposal is approved by Parliament. Third, the price of electricity to households will increase by up to 15 per cent in 2020 and overshadow the effect of an expected drop in the price of natural gas. However, we expect lower vegetable prices next year.

In 2019 Lithuania's fiscal stance was explicitly pro-cyclical. Over the next two years, the structural deficit is expected to decrease slightly. In case of a severe downturn, there is substantial fiscal space, but it is still too early to consider neglecting fiscal discipline. We forecast that public sector debt will drop to 35.4 per cent in 2020 and 34.6 per cent in 2021. Parliamentary elections scheduled for 2020 are influencing the shape of the 2020 government budget. There is a great cacophony of proposals on how to boost both public sector income and expenditures, with rational ideas often being drowned by unreasonable schemes.

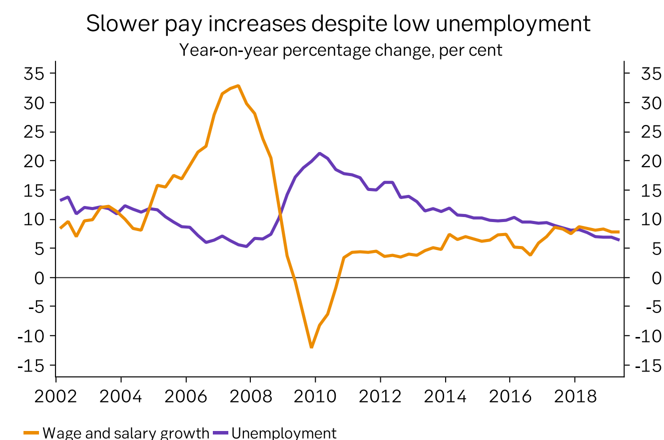
Latvia

Adjusting for lower growth

Following the global slowdown, Latvia's economic growth rate will decline from 2.4 per cent this year to 2.0 per cent in 2020. Domestic demand remains the key driver of the economy, while capital spending and exports are dampened by global uncertainty. Unemployment is rising slightly and pay increases will cool from 7.3 per cent this year to 4.5 per cent in 2021. This will contribute to a slowdown in the inflation outlook.

Slower pay increases despite low unemployment

Year-on-year percentage change, per cent



Source: Statistics Latvia

Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	4.6	2.4	2.0	2.5
Private consumption	4.4	2.8	2.5	3.1
Exports	3.9	-0.3	2.6	3.5
Consumer price index (CPI)	2.5	2.8	2.2	2.5
Unemployment*	7.4	6.5	6.2	6.3
Wages and salaries	8.4	7.3	6.0	4.5
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

Our forecast revisions earlier this year proved well justified. The global economy is decelerating and the Latvian economy has slowed down during the first half of this year. In the near term, growth will be determined by how well private consumption can offset foreign trade, which at best will make a neutral contribution to GDP growth. Despite a favourable situation, private consumption was subdued during the first half. Household spending will remain relatively modest despite strong real wage growth and a tight labour market. We estimate that consumption will rise by 2.8 per cent this year and 2.5 per cent next year, rebounding to 3.1 per cent in 2021. Poorer prospects will slow down capital spending activity, which is partly explained by increased uncertainty and an earlier peak in EU funding inflows. Over next two years, fixed investments will increase by 3-4 percent annually. Global weakness has hurt exports, which fell by 2.5 per cent during the second quarter. Despite a weaker outlook, Latvia will avoid recession. We expect GDP to grow by 2.4 percent in 2019, 2.0 percent next year and 2.5 percent in 2021.

Weak foreign trade as global growth falters. Foreign trade dynamics are reflected in international trade conflicts that are dampening exports. Until these tensions decrease, growth in foreign trade will remain subdued. About 70 per cent of Latvia's exports go to EU countries. For the most part, they are only indirectly affected by ongoing trade conflicts outside the EU. For the first eight months of this year, merchandise exports rose by only 0.4 per cent, while imports increased by 1 per cent. The largest export sector – the timber industry – faces difficulties because of both falling prices and lower demand. Exports of wood products, machinery and appliances, vehicles and oil products show the largest declines. Despite major challenges, industrial production increased by 2.7 per cent in the first eight months. Growth is likely to remain somewhat subdued, with great variations, but will still reach 2.5 per cent this year and around 2.5–3.0 per cent annually in the next two years.

Inflation is cooling. In September, the inflation rate was 2.6 per cent. Inflation was mainly affected by higher prices of goods and services related to housing, food, alcoholic beverages, recreation and culture, catering services and health care. Due to lower cost pressures and lower energy prices, the inflation rate will fall slightly. However, higher food prices are partly explained by higher excise duties. At the same time, lower pay increases and falling inflation expectations should alleviate pressure on service prices. Our inflation forecast is 2.8 per cent this year, 2.2 per cent next year and 2.5 per cent in 2021.

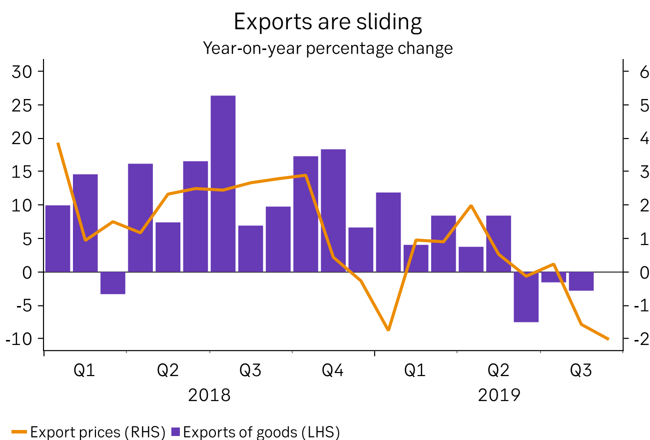
Record-high vacancy rate. Despite the weaker outlook, the labour market will remain tight. In the second quarter, there were just over 30,000 vacancies, some 23.8 percent more than one year earlier. The high vacancy rate underscores the mismatch between supply and demand. This applies especially to differences in skills and heavy demand for low-paid workers. The vacancy rate will therefore remain high even though unemployment will soon reach around 6 per cent. However, in the first half of 2019, pay growth remained high due to inertia in wage setting. Developments in the labour market are slowing pay hikes, which will fall from 7.3 per cent to 4.5 percent in 2021. A tight labor market, demographics and strong expectations from the public sector will maintain pressure.

Ageing population – one of the main challenges. Latvia must address the long-term challenges of low birth rates, including an observed decline for the fourth consecutive year. As of early 2019, the number of young people aged 18–24 years was also declining faster than the total number of inhabitants. Their share of the population is down almost half from 2009 and is thus the second lowest in the EU.

Estonia

Lower growth to be expected

The slowdown in global trade has started to bite the export-oriented Estonian economy. Due to a strong first half, GDP growth will end up at 3.2 per cent in 2019, but will then decline to 2.0 per cent in 2020. In 2021 growth will accelerate due to the second pillar pension reform, which enables people to put their savings on consumption instead.



Key data

Year-on-year percentage change

	2018	2019	2020	2021
GDP	4.8	3.2	2.0	2.6
Private consumption	4.3	3.5	2.8	4.8
Exports	4.3	1.9	1.0	2.4
Consumer price index (CPI)	3.4	2.3	2.0	2.2
Unemployment*	5.4	5.3	5.8	6.4
Wages and salaries	7.3	7.6	6.0	5.4
Public sector financial 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

The Estonian economy grew faster than we previously thought. The latest revisions to the National Accounts revealed that economic growth in the first quarter of 2019 was 5.0 per cent on an annual basis but decreased in the second quarter to 3.6 per cent, still a strong figure. The largest contributor was the information and communications technology (ICT) sector, which has been the main driver of economic growth for a decade. Due to the recent revisions, we predict that GDP will rise by 3.2 per cent in 2019.

Exports are the main dampening factor in the economy. For a long time, Estonia has managed to avoid the downturn in global trade, but starting in June exports of goods decreased. A positive view, however, is that the decline in exports was not very broad-based and is mainly derived from weak trade in energy, such as oil products and electricity. However, there are no success stories in other large sectors, and trading volumes are roughly in line with the same period last year. In addition to gloomy prospects for global trade, a decline in Nordic real estate markets has also had a negative impact on construction-related exports. A weakened competitive position is reflected in falling export prices. Exports will start to make a negative contribution to GDP growth in the second half, and this is likely to continue during the first half of 2020.

The upturn in capital spending has been a big surprise this year. During the first half, fixed investments rose by 21 per cent. While the large increase in new building and housing investments was expected, strong spending on new machinery was more surprising. Investments in non-residential construction are already declining, but the number of building permits for new housing still reflects a great deal of optimism. In a small economy, it is difficult to predict capital spending, but changes in demographics and developments in sentiment indicators make it difficult to assume that the recent strong trend can continue.

Continued strong private consumption. Consumer confidence is still historically very robust thanks to high employment growth and rapid wage increases. We estimate that private consumption will grow by 3.5 per cent this year but decelerate slightly to 2.8 per cent in 2020. Domestic demand will also benefit from lower inflation. Inflation rate will decline to 2.3 per cent this year from 3.4 per cent in both 2018 and 2017. In addition to lower energy prices, the government's decision to lower excise duties on alcohol has had a major impact. We expect the inflation rate to remain around 2 per cent by 2020.

Full employment in the labour market since 2017. Companies continue to hold on to their employees for as long as possible. However, the problems in the energy sector and in a few specific manufacturing sectors such as clothing production have led to rising numbers of unemployed workers in recent months. Should manufacturers be hit by a strong headwind in 2020, companies will be more likely to reduce their number of employees. However, we believe that a rapid increase in unemployment is not so likely, since many companies still seem willing to hire.

Pension reform will have a major impact on the economy. The current government is determined to reform the second pension pillar by enabling savers to withdraw their funds starting in 2021. The estimated total net value is EUR 5 billion, approximately 16 per cent of nominal GDP. It is very difficult to predict the exact amount that will be taken out, but weaker economic performance could increase the amount withdrawn. This will result in a temporary surge in domestic demand, but at the same time cause stresses in the long-term sustainability of the pension system. In addition, negative effects will also become noticeable in the local capital market, since liquidity may become a priority for the pension funds.

Key indicators

Global key indicators

Yearly change in per cent

	2018	2019	2020	2021
GDP OECD	2.3	1.6	1.4	1.6
GDP world (PPP)	3.6	2.9	3.0	3.3
CPI OECD	2.6	1.9	1.9	1.9
Oil price, Brent (USD/barrel)	72	65	70	70

US

Yearly change in per cent

	2018 level, USD bn	2018	2019	2020	2021
Gross domestic product	20,580	2.9	2.2	1.7	1.9
Private consumption	13,999	3.0	2.6	2.4	2.4
Public consumption	2,904	1.7	1.8	1.7	1.2
Gross fixed investment	4,261	4.4	1.8	0.8	2.1
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	1.5	2.4	3.7
Unemployment (%)		3.9	3.7	3.5	3.6
Consumer prices		2.4	1.8	2.0	2.1
Core CPI		2.1	2.2	2.1	2.1
Household savings ratio (%)		7.7	8.2	8.1	8.0
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	1.0	1.1	1.3
Private consumption	6,207	1.4	1.2	1.3	1.3
Public consumption	2,364	1.1	1.0	1.0	1.0
Gross fixed investment	2,406	2.3	2.0	2.0	2.0
Stock building (change as % of GDP)	0	0.0	0.0	0.0	0.0
Exports	5,547	3.3	2.2	2.8	3.1
Imports	5,047	2.7	3.0	3.5	3.5
Unemployment (%)		8.2	7.6	7.2	7.1
Consumer prices		1.8	1.2	1.3	1.5
Core CPI		1.0	1.0	1.2	1.4
Household savings ratio (%)		6.2	6.0	6.0	0.0
Public sector financial balance, % of GDP		-0.5	-0.9	-0.8	-0.8
Public sector debt, % of GDP		85.9	84.8	83.0	83.0

Other large countries

Yearly change in per cent

	2018	2019	2020	2021
GDP				
United Kingdom	1.4	1.3	1.4	1.5
Japan	0.8	1.2	0.7	0.5
Germany	1.5	0.5	0.6	1.1
France	1.7	1.2	1.2	1.4
Italy	0.8	0.2	0.6	0.8
China	6.6	6.1	5.7	5.9
India	7.4	5.5	6.0	6.5
Brazil	1.1	0.8	2.0	2.8
Russia	2.3	1.0	1.7	1.9
Poland	5.1	4.2	3.1	3.0
Inflation				
United Kingdom	2.5	1.8	1.4	1.7
Japan	1.0	0.7	1.4	0.8
Germany	1.7	1.5	1.5	1.6
France	1.9	1.3	1.4	1.5
Italy	1.3	1.1	1.2	1.3
China	2.1	2.5	2.3	2.2
India	4.0	3.2	3.5	4.1
Brazil	3.7	4.0	4.2	4.2
Russia	2.9	4.7	4.0	4.1
Poland	1.7	2.3	2.8	2.7
Unemployment (%)				
United Kingdom	4.1	3.9	4.1	4.3
Japan	2.4	2.3	2.3	2.2
Germany	3.4	3.4	3.6	3.8
France	8.9	8.6	8.4	8.2
Italy	10.6	9.9	9.7	9.5

Financial forecasts

Official interest rates		Nov 6	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21
US	Fed funds	1.75	1.75	1.50	1.50	1.50	1.50
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro zone	Refi rate	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	Repo rate	0.75	0.75	0.75	0.75	0.75	0.75
Bond yields							
US	10 years	1.81	1.50	1.40	1.50	1.70	2.00
Japan	10 years	-0.09	-0.10	-0.10	-0.05	-0.05	0.00
Germany	10 years	-0.31	-0.50	-0.50	-0.40	-0.20	0.00
United Kingdom	10 years	0.63	0.50	0.60	0.80	1.00	1.20
Exchange rate							
USD/JPY		109	106	109	112	113	114
EUR/USD		1.11	1.12	1.15	1.17	1.19	1.20
EUR/JPY		121	119	125	131	134	137
EUR/GBP		0.86	0.87	0.84	0.86	0.88	0.88
GBP/USD		1.29	1.29	1.37	1.36	1.35	1.36

Sweden

Yearly change in per cent

	2018 level, SEK bn	2018	2019	2020	2021
Gross domestic product	4,790	2.4	1.2	1.2	1.7
Gross domestic product, working day adjustment		2.5	1.2	1.0	1.6
Private consumption	2,157	1.2	0.7	1.3	1.7
Public consumption	1,259	0.9	0.2	0.1	0.2
Gross fixed investment	1,254	4.0	-2.0	-1.0	2.2
Stock building (change as % of GDP)	47	0.3	0.0	0.0	0.0
Exports	2,211	3.9	4.9	1.4	2.6
Imports	2,094	3.8	2.3	-0.4	2.0

	2018	2019	2020	2021
Unemployment, (%)	6.3	6.7	7.2	7.4
Employment	1.8	0.7	0.3	0.4
Industrial production	3.4	0.8	-1.5	2.0
CPI	2.0	1.8	1.6	1.6
CPIF	2.1	1.7	1.5	1.6
Hourly wage increases	2.5	2.6	2.6	3.0
Household savings ratio (%)	15.4	16.0	16.2	15.9
Real disposable income	2.7	2.3	2.1	1.5
Current account, % of GDP	1.8	3.3	3.8	4.4
Central government borrowing, SEK bn	-80	-120	4	13
Public sector financial balance, % of GDP	0.8	0.3	0.2	0.0
Public sector debt, % of GDP	38.8	34.8	34.3	33.6

Financial forecasts	Nov 6	Dec-19	Jun-20	Dec-20	Jun-21	Dec-21
Repo rate	-0.25	0.00	0.00	0.00	0.00	0.00
3-month interest rate, STIBOR	0.03	0.20	0.20	0.20	0.20	0.20
10-year bond yield	0.00	-0.05	0.00	0.15	0.35	0.55
10-year spread to Germany, bps	31	45	50	55	55	55
USD/SEK	9.61	9.38	9.04	8.72	8.52	8.33
EUR/SEK	10.64	10.50	10.40	10.20	10.10	10.00
KIX	123.4	121.4	120.3	117.1	115.7	114.1

Finland

Yearly change in per cent

	2018 level, EUR bn	2018	2019	2020	2021
Gross domestic product	243	1.7	1.2	1.6	1.6
Private consumption	124	1.8	1.3	1.5	1.7
Public consumption	53	1.5	1.5	1.0	1.0
Gross fixed investment	55	3.3	1.5	2.0	2.5
Stock building (change as % of GDP)	0	0.8	-0.7	0.0	0.0
Exports	90	2.2	2.5	2.5	2.5
Imports	92	5.0	1.2	2.3	2.7

	2018	2019	2020	2021
Unemployment, OECD harmonised (%)	7.4	6.7	6.5	6.3
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 financial balance, % of GDP	-0.8	-0.8	-0.7	-0.7
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	2.3	3.2	2.1
Gross domestic product (Mainland)	2,853	2.2	2.5	2.1	1.9
Private consumption	1,500	1.9	1.9	2.4	2.3
Public consumption	802	1.4	2.0	1.6	1.5
Gross fixed investment	832	2.8	5.8	1.9	0.9
Stock building (change as % of GDP)		0.1	-0.1	0.0	0.0
Exports	1,194	-0.2	2.6	5.7	2.9
Imports	1,102	1.9	4.0	2.1	1.7
Unemployment (%)		3.8	3.6	3.6	3.7
CPI		2.8	2.2	2.3	2.1
CPI-ATE		1.5	2.3	2.3	2.0
Annual wage increases		2.8	3.3	3.5	3.5

Financial forecasts	**Nov 6**	**Dec-19**	**Jun-20**	**Dec-20**	**Jun-21**	**Dec-21**
Deposit rate	1.50	1.50	1.50	1.50	1.50	1.50
10-year bond yield	1.50	1.40	1.40	1.45	1.55	1.75
10-year spread to Germany, bps	181	190	190	185	175	175
USD/NOK	9.15	9.20	8.61	8.55	8.10	8.08
EUR/NOK	10.14	10.30	9.90	10.00	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	1.6	1.5
Private consumption	1,032	2.6	1.1	1.7	1.6
Public consumption	547	0.4	0.3	0.8	0.8
Gross fixed investment	495	5.4	-0.9	3.5	3.0
Stock building (change as % of GDP)		0.3	-0.1	0.0	0.0
Exports	1,250	2.4	4.1	2.7	2.6
Imports	1,114	3.6	0.7	4.0	3.9
Unemployment, OECD harmonised (%)		5.4	4.5	4.2	4.2
CPI, harmonised		0.8	0.7	1.1	1.4
Hourly wage increases		2.2	2.0	2.6	2.8
Current account, % of GDP		5.7	7.5	7.0	7.0
Public sector financial balance, % of GDP		0.6	1.0	0.5	0.5
Public sector debt, % of GDP		34.3	33.0	32.0	31.0

Financial forecasts	**Nov 6**	**Dec-19**	**Jun-20**	**Dec-20**	**Jun-21**	**Dec-21**
Deposit rate	-0.75	-0.75	-0.85	-0.85	-0.85	-0.85
10-year bond yield	-0.29	-0.45	-0.45	-0.35	-0.15	0.05
10-year spread to Germany, bps	2	5	5	5	5	5
USD/DKK	6.75	6.66	6.49	6.38	6.30	6.22
EUR/DKK	7.47	7.46	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	2.4	2.5
Private consumption	28	3.9	3.4	3.2	3.2
Public consumption	7	0.5	1.0	0.8	0.6
Gross fixed investment	9	8.4	7.7	4.8	3.9
Exports	34	6.3	6.6	3.2	3.7
Imports	33	6.0	6.0	4.3	4.4
Unemployment (%)		6.2	6.2	6.1	6.2
Consumer prices		2.5	2.2	2.3	2.4
Public sector financial balance, % of GDP		0.6	0.1	0.0	0.1
Public sector debt, % of GDP		34.1	36.3	35.4	34.5

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	2.8	2.5	3.1
Public consumption	5	4.0	2.0	1.7	2.3
Gross fixed investment	7	15.8	4.4	2.1	3.5
Exports	17	3.9	-0.3	2.6	3.5
Imports	18	6.4	3.4	3.5	4.0
Unemployment (%)		7.4	6.5	6.2	6.3
Consumer prices		2.5	2.8	2.2	2.5
Public sector financial 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	3.2	2.0	2.6
Private consumption	13	4.3	3.5	2.8	4.8
Public consumption	5	0.9	2.7	1.6	2.5
Gross fixed investment	6	3.3	13.2	0.2	1.2
Exports	19	4.3	1.9	1.0	2.4
Imports	18	5.7	3.6	2.7	3.8
Unemployment (%)		5.4	5.3	5.8	6.4
Consumer prices		3.4	2.3	2.0	2.2
Public sector financial 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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