Research Reports

Central bank U-turn is re-energising tired growth

Low inflation is making the Riksbank even more dovish

Nordic Outlook

May 2019

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U-turn is driving the world
Re-energising tired growth

Welcome to our latest *Nordic Outlook*, clad in a new "costume". We hope you will like our new format. As usual, the report is packed with our analyses of events and key trends that are expected to have a long-lasting impact on economic, financial and political developments in the world, the Nordics and the Baltics.

Over the past few months, the world's central banks have adjusted their monetary policies in response to the downside risks to economic growth that became increasingly evident late in 2018. Their policy shift has enabled stock markets to reach new all-time highs this spring, although the fixed income market has meanwhile signalled a heightened risk of recession. The surge of energy created by the central banks' U-turn and policy pause will allow the United States to celebrate a record-long economic expansion this summer. But this U-turn is not entirely decoupled from higher risks, such as a divergence between asset prices and the underlying strength of global economic growth.

Optimists see signs of growth stabilisation in China, after Beijing shifted its economic policy last year in a clearly more growth-friendly direction. Pessimists see a weak Germany that is holding back Europe's efforts to recover after a bad patch for the auto industry.

Our many meetings with corporate representatives in recent months confirm that most of them view the current situation as still relatively favourable. Companies also seem well prepared for any weakening in demand. This makes it less likely that they will be forced to implement drastic changes in their business plans. But the corporate skies have plenty of dark clouds too: a hard Brexit, possible trade talk setbacks, geopolitical risks, a Chinese hard landing and so on.

World economic growth has decelerated, but we are not seeing forces that will make this slowdown unique or dramatic. Preliminary first quarter 2019 GDP figures for the US, China and the euro zone have also proved somewhat stronger than expected. The overall picture that we painted in the last *Nordic Outlook* thus remains valid and dominates our assessment of the world economy in May 2019 as well.

This issue of *Nordic Outlook* includes four theme articles on exciting areas. We look at the challenges faced by central banks in pursuing conventional monetary policy amid signs of "Japanification" in the global fixed income landscape. In another theme article, we examine how climate change is starting to affect economic forecasts and policymakers. To some extent this includes the central banks whose opportunities and constraints are discussed in the first theme article. This month's elections to the European Parliament will probably have a negative impact on the European Union's decision-making ability, according to our third theme article. The fourth theme article in this *Nordic Outlook* analyses the long-term valuation of the Swedish krona.

We hope that the new *Nordic Outlook* will provide you with enjoyable reading and new insights.

Robert Bergqvist
Chief Economist

Håkan Frisén
Head of Economic Forecasting

Muted inflation prolonging upturn

Central banks have shifted to more dovish monetary policies, helping sustain risk appetite early in 2019. Looser Chinese credit policy has been instrumental in stabilising world trade. GDP growth in both Western Europe and emerging markets will speed up a bit in 2020, enabling global growth to accelerate to 3.5 per cent, despite supply-side restraints that will contribute to a US slowdown. Although unemployment in advanced economies is close to its lowest since the 1970s, inflation pressure remains modest, giving central banks room to post-pone the recession for another few years. Due in part to President Trump's unpredictability and an increasingly divided Europe, the world will be living with heightened political risk. Yet a hard Brexit seems increasingly improbable and according to our main scenario, the US and China will reach a trade agreement shortly.

The pronounced shift in mood that occurred around New Year, especially in stock markets, raises many questions about how we should interpret the current economic situation and how much manoeuvring room is available to policy makers. The sharp downturn in sentiment late in 2018 had several drivers that were partly independent of each other: 1. the US Federal Reserve's determination to hike key interest rate above a neutral level caused 10-year US Treasury yields to climb a bit over 3 per cent; 2. China's credit tightening, which hampered the economy and led to a decline in imports that affected many economies; 3. a gradual worsening of sentiment in Western Europe, especially among German manufacturers; 4. General gloom about the political situation, including Trump-generated trade disruptions, protracted Brexit worries and generally discordant tendencies in the European Union project.

This combination of drivers is related to various topics we have discussed in recent issues of *Nordic Outlook*. They include the difference between recession risks from the supply or demand side of the economy and how they affect economic policy manoeuvring room. We have also highlighted the interplay and relative roles of various parts of the world economy (especially the US, China and Germany) and the question of how important political events are, compared to underlying cyclical factors. The focus of this "International overview" is on analysing the factors that make us believe that the global economy will be resilient to the recession risks that have been discussed recently.

Central banks are the key to the shift in risk appetite. Renewed stock market optimism has mainly been driven by the rapid shift in central bank policies in a more dovish (expansionary) direction. This applies, for example, to the Fed's signals early in January that it intended to become substantially more "data driven" in its interest rate decisions. As for economic data, the picture has been more divided. The US economy has mainly shown signs of strength, with continued rapid job growth and a strong first quarter of 2019, but with GDP partly driven by temporary effects. In Western Europe, however, weaker trends have predominated, although first quarter GDP growth figures were somewhat better than expected.

Global GDP will accelerate again in 2020. We have adjusted our growth outlook for 2019 slightly lower and now foresee global GDP growth of 3.3 per cent this year, compared to our earlier forecast of 3.5 per cent. But we are sticking to our forecast of 3.5 per cent in 2020. This represents a pace that is still somewhat above the long-term trend. We predict that unemployment in advanced economies will fall a bit further from the current 5.0 per cent, which is the lowest since 1980. Inflation has again surprised on the downside. Trends towards accelerating pay increases have faded to some extent, helping improve the outlook for continued stable economic growth. In the United States we have also seen clear signs of rising productivity, which will increase the Fed's manoeuvring room.

Global GDP growth
Year-on-year percentage change

	2017	2018	2019	2020
United States	2.2	2.9	2.3	1.7
Japan	1.7	0.8	1.0	0.8
Germany	2.2	1.4	0.7	1.2
China	6.8	6.6	6.3	6.1
United Kingdom	1.8	1.4	1.3	1.4
Euro zone	2.4	1.9	1.1	1.4
Nordic countries	2.2	1.9	2.0	2.0
Baltic countries	4.4	3.9	3.1	2.7
OECD	2.5	2.3	1.7	1.7
Emerging markets	4.8	4.7	4.6	4.8
World, PPP*	3.8	3.7	3.3	3.5

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

Ambiguous market signals. Share prices have climbed sharply, with US stock markets among those setting all-time highs this spring. Meanwhile the fixed income market continues to price in Fed key rate cuts this coming year – contributing to a very flat yield curve, which has a negative slope in some segments and periods. Since an inverted (negative leaning) US yield curve has historically been a reliable recession indicator, some types of empirically estimated models are showing a relatively high probability of recession.

One interpretation of this is that stock and fixed income market pricing must "converge" in the future into a more consistent picture, but our view of the underlying drivers of corporate earnings, inflation, fixed income markets and central banks suggests that this does not necessarily have to be the case.

The diminished signalling value of yield curve slopes. There is every reason to respect the historical ability of the yield curve to predict recessions. But there are many indications that in the new interest rate landscape – with lower short-term as well as long-term yields – inverted yield curves will be more common in the future without necessarily signalling a recession (read more about the Japanification of the interest rate landscape and the challenges facing central banks on page 15). Unconventional central bank monetary policies, including large-scale bond purchases, also make it harder to interpret long-term yields. Overall, we are maintaining our view that downside risks dominate.

Stretched valuations despite good corporate reports. Stock market valuations (price/earnings ratios) have started to look more stretched this spring. Our global growth scenario, combined with first quarter 2019 corporate reports that were better than earlier downward-adjusted earnings expectations, suggests that stock markets may provide positive returns in the coming year, but that the journey ahead will likely be volatile. In 2018, global equity investors chose more defensive behaviour, which has included overweighting liquidity in their portfolios. That situation will persist, although the most recent upturn has been driven partly by some increased risk exposure in portfolios.

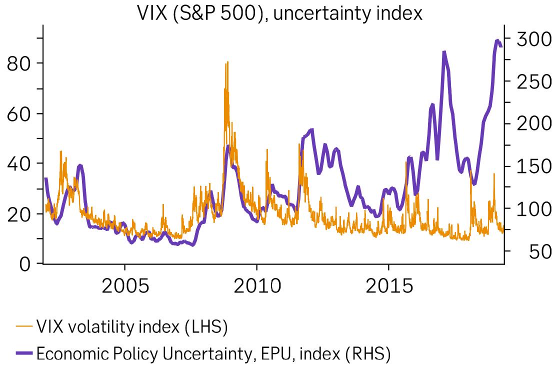
The Fed now faces a balancing act. As the labour market tightens, continued low inflation meanwhile provides extensive manoeuvring room. We believe that the Fed will abstain from rate hikes during our forecast period and that its federal funds rate will thus remain at 2.25-2.50 per cent at the end of 2020. In an environment where other leading central banks are sticking to their zero interest rate policies, and Japanese and German long-term bond yields are also close to zero, the market is likely to continue pricing in a higher probability of a rate cut than a rate hike by the Fed. This contributes to our forecast that US long-term Treasury yields will trend slightly lower from today's level. As for the ECB, we are no longer counting on any rate hikes at all during our forecast period. It is thus also hard to foresee German long-term yields climbing especially far; we expect 10-year German government bond yield to be 0.35 per cent at the end of 2020.

Temporary effects of political risks

The dominant trend in recent years has been that political uncertainty factors have largely had a limited, and above all a temporary, effect on financial markets. As shown in the chart below, the correlation between political uncertainty (measured partly on the basis of media reporting) and financial volatility ended around the same time as the acute euro crisis and European Central Bank President Mario Draghi's pledge to do "whatever it takes" to rescue the euro. This pattern became even clearer starting in 2016, when the Brexit referendum and the election of Donald Trump led the world into an era of heightened uncertainty. During this period, financial market volatility has actually trended lower, except during two periods of market turbulence in 2018 (February and the fourth quarter). And these surges of volatility were mainly driven by worries about the economy and interest rates, showing that central banks are apparently far more important than general political events in the current environment.

Fig 1: High global uncertainity but low volatility

VIX (S&P 500), uncertainty index



Source: Economic Policy Uncertainty, Chicago Board Options Exchange (CBOE), Macrobond, SEB

High but somewhat diminishing political uncertainty. On some issues, we see prospects for some easing of uncertainty. Although Trump has threatened expanded tariffs on imports from China, our main scenario is that the US and China will reach a trade agreement shortly. But it is unclear how far-reaching this will be, considering the controversial underlying issues, including technology transfers, industrial subsidies and demands that the US be allowed to unilaterally impose further sanctions if it does not believe China has met its obligations.

Activist central banks weaken the association between economic policy uncertainty and market volatility

Greater focus on US-EU trade talks. Our main scenario is that the US will announce higher tariffs on imported cars in mid-May but will grant a temporary waiver to the European Union. This will enable the US to pressure the EU in trade talks. But the elections to the European Parliament (EP) late this month may complicate such trade talks when a new Parliament and a new European Commission take office, with nationalist forces gaining increased political influence. The impact of the elections are also likely to be visible on other issues, such as intensified EU and euro zone cooperation, fiscal policy coordination and putting together a long-term EU budget. Read more about the EP elections in our theme article on page 23. As for Brexit, we believe that the likelihood of a no-deal British withdrawal from the EU has diminished, despite Prime Minister Theresa May's failure to win parliamentary approval for the agreement she negotiated with the EU.

Hard Brexit increasingly unlikely

We have passed the originally planned March 29 withdrawal date, and the UK remains a member of the EU. The process of leaving has been far more difficult than most people had imagined. This issue affects the nation at so many different levels and is deeply divisive among the population and within political parties, making its dynamic hard to keep track of. After new government failures to gain passage of the withdrawal agreement in Parliament, the EU has granted the British a respite until October 31. **May is intent on a compromise.** Today there are actually only three possible paths forward for Prime Minister Theresa May: 1. A broad parliamentary solution based on a compromise with the opposition; 2. A new referendum on the withdrawal agreement, which May has so far been very critical to; 3. May's resignation, followed by a snap election. Despite massive internal Conservative Party (Tory) criticism, May is now focusing mainly on Alternative 1. If so, it is a matter of ensuring that the UK actually leaves the EU on the basis of the agreement the two sides have already negotiated. This is likely to succeed, but provisions will be added to the accompanying political declaration that call for a permanent EU-UK customs union or close customs cooperation. However, this would close off the option for the British to negotiate separate trade agreements with non-EU countries.

Important future dates:

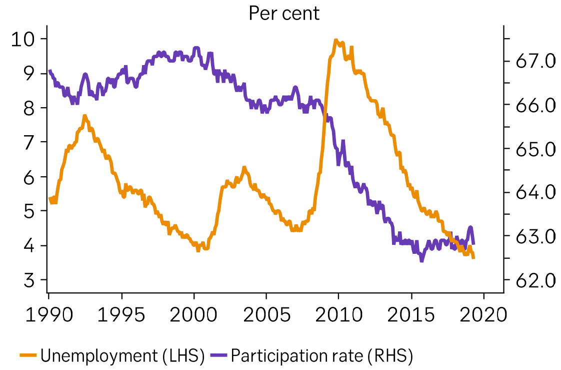
June 1	Withdrawal deadline if the British do not hold a EU Parliament election
June 20-21	EU summit
July 1	The new EU Parliament convenes
Sep 29- Oct 2	Annual Tory Party conference
Oct 17-18	EU summit
Oct 31	The United Kingdom leaves the EU?

Hard Brexit very unlikely. The big losers are the hard-line Tory supporters of Brexit, who must now realise that their dream of a total break-up with the EU will not materialise. There is no broad support for a no-deal withdrawal, either among Tories or in Parliament. A compromise with the opposition would undoubtedly lead to a softer Brexit, with closer ties to the EU. Although the hard-liners will probably continue their fight, their position is unfavourable. May is immune to new attempts to remove her until December. If she should reach a deal with the opposition enabling the UK to leave the EU, she will resign early. Even if she is replaced by a more hard-line Brexiteer, a change of direction is unlikely. Parliament has now taken control of the Brexit process, and it would require large-scale changes in the composition of Parliament after a snap election to achieve a constellation that could seriously pursue the Brexit issue in a different direction.

Distinctly American challenges

In the past six months, the US economy has had a slightly different role than normal during global recession worries. The slowdown has been driven by other parts of the world economy, while the American economy has only been affected to a lesser degree. After a slump around New Year, first quarter GDP growth was unexpectedly strong, reaching an annualised rate of 3.2 per cent. Although this was partly due to temporary factors, the demand situation is robust. The economy is expected to expand faster than its underlying trend this year, even though we are adjusting our GDP growth forecast marginally downward to 2.3 per cent in 2019.

Fig 2: US unemployment at 50-year low



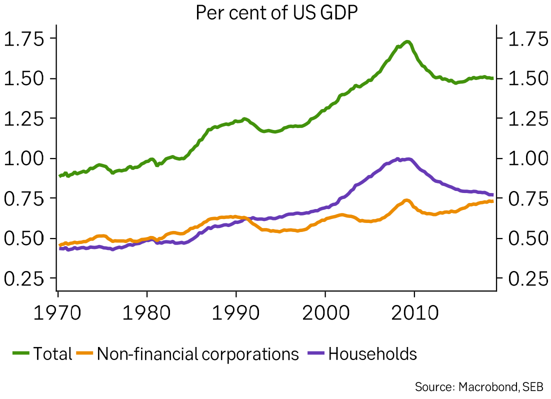
Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

Unemployment close to record lows. Given stable GDP growth and an impressive employment upturn, supply side restrictions in the labour market are instead the focus of attention. After unemployment stood at a 50-year low of 3.7 percent for three straight months last autumn, it rose somewhat early in 2019. Although job growth continued at a rapid pace, an upturn in labour force participation from 62.7 to 63.2 per cent offset a further downturn in unemployment. The increasing labour supply was well-timed from the Federal Reserve's standpoint, providing extra credibility to its shift towards a more dovish monetary policy. In the latest monthly data from April, however, labour force participation fell back to 62.9. Registered unemployment then reached a new low of 3.6 per cent, compared to the Fed's latest equilibrium unemployment estimate of 4.3 per cent.

Lower GDP growth and productivity bump will provide a respite. Looking ahead, we predict a gradual slowdown in US growth. In the near term, we are likely to see a decline due to reversals in several factors that boosted first quarter growth. Next year fiscal policy will be largely neutral after having made positive contributions to GDP growth of 0.7 per cent in 2018 and 0.5 per cent in 2019. This will help cool GDP growth to 1.7 per cent. In the past year, productivity has accelerated to a nearly 2 per cent annual growth rate, which has also helped to ease the overheating risks in the labour market. Our main forecast is thus that unemployment will bottom out somewhat below 3.5 per cent, but after the latest monthly figure there is an apparent risk that it will fall even lower, which may cause some anxiety at the Fed.

Fig 3: Subdued private sector debt

Per cent of US GDP



Moderate financial stress level. Experience from earlier periods of mature economic expansion is that they are able to continue for a long time despite a rather tight labour market. The reasons have included a weak wage and price response. When a recession finally arrives, it is triggered by some acute financial crisis reaction, such as the sub-prime mortgage market collapse in August 2007, which then led to the Lehman Brothers crash just over a year later. The general financial stress level in the US does not seem especially high at present. Household debts have fallen to 105 per cent of disposable income, from a peak of more than 140 per cent in 2007. (Figure 3 instead shows them as a percentage of GDP.) Corporate debts are higher in a historical perspective but the upward trend has been rather slow for a long time.

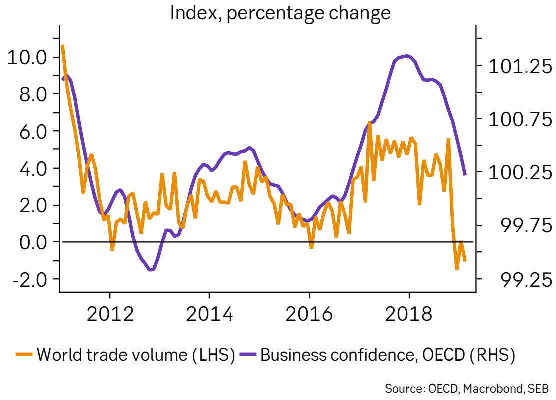
Modest debt means a low probability of a painful balance sheet recession

Low risk of balance sheet recession. Broader metrics for the "financial cycle" from the Bank of International Settlements (BIS), the Bank of England (BoE) and others – including home prices – are well below the historical average. Although the trend adjustment methods created by these methods may be a little treacherous, we can probably draw the conclusion that there is only a limited risk that the financial cycle will amplify a downturn in the traditional economic cycle. Put differently, there is a low probability of an outbreak of balance-sheet recession of the type that characterised the real estate crisis of the 1990s and the Lehman Brothers crisis. Such recessions are normally both deeper and more prolonged than others. This does not prevent overextended financial market pricing – such as dangerously narrow credit spreads due to an increasingly intensive search for returns – from acting as a catalyst for a recession. But then it is more natural to draw a comparison with the 2001 dot-com (IT) crash, which led to a rather mild recession.

Continued downside bias in the risk picture. We are nevertheless sticking to our assessment that the next global recession will also probably have its epicentre in the US. Recent weaknesses in Europe and Asia seem unlikely to lead to a global recession, which has actually reinforced this perception. Downside risk still dominate. We now estimate the probability of a recession at 20 per cent, somewhat lower than in our January report.

Fig 4: Global trade has lost momentum

Index, percentage change

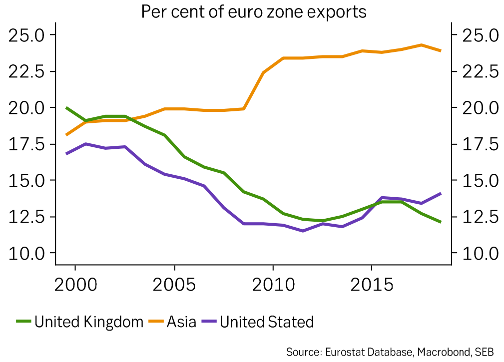


Manufacturing activity stabilising

The economic slowdown that we saw mainly during the latter part of 2018 was largely connected to a downturn in global trade, which rather suddenly fell from a 4-5 per cent volume growth rate to a slight decline. This situation is somewhat reminiscent of the 2015-16 manufacturing-driven slump. Trade flows seem to have decelerated more sharply this time than before, although business confidence held up better. Both the Chinese credit tightening and the German manufacturing dip, especially in the auto sector, played a crucial role. We are beginning to see signs of stabilisation in the global manufacturing slowdown, in the form of greater optimism in emerging market (EM) economies – among other things coinciding with expansionary economic policy in China.

Fig 5: Asia an increasingly vital export market

Per cent of euro zone exports



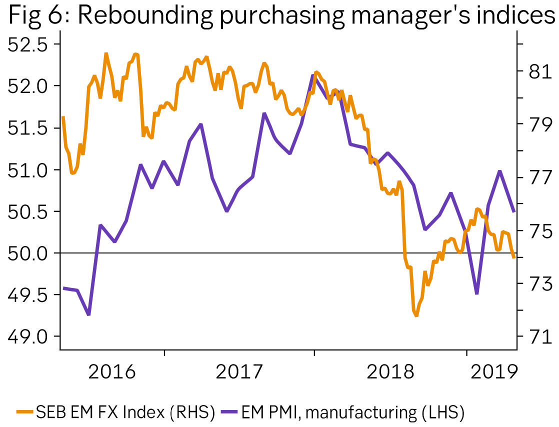
Little spill-over to European domestic economies. Sentiment indicators for German manufacturing remain at levels that we have not seen since the financial crisis, yet despite the importance of German manufacturers for Europe, it is hard to believe that this would foreshadow a broad recession. The euro zone economy as a whole has decelerated significantly, and we have adjusted our 2019 GDP growth forecast to 1.1 per cent, mainly due to weaknesses in Germany and Italy. But domestic economies have meanwhile generally been resilient and labour markets have been strong, with both rapid job growth and continued falling unemployment. Looking ahead, the euro zone will also benefit from the recovery in China and other EM economies. Exports to Asia have gradually become more important and now account for as large a share as the US and the UK combined.

Brexit uncertainty is having little impact on growth. The drama surrounding EU withdrawal has recently had some effects on the British economy. Late in 2018, for example, capital spending fell year-on-year. On the other hand, inventory build-up (which contributed positively to first quarter GDP growth) was driven by companies that felt compelled to take steps to soften the impact of a possible no-deal withdrawal. But this is a temporary effect, which can be expected to slow GDP growth ahead. Otherwise the big surprise has been household consumption. Solid pay hikes and unemployment below 4 per cent seem to have outweighed Brexit worries. Our growth forecast is largely unchanged from January. We expect the British economy to grow by 1.3 per cent in 2019 and 1.4 per cent in 2020. This forecast assumes that the UK will leave the EU with an agreement at the end of October.

China's stimulus will stabilise EM growth

The growth rate in emerging market economies looks set to be a bit slower this year than in 2018. Most of the deceleration has probably occurred already. We expect the stabilisation in trade flows and industrial production that was discernible in March and April to signal a more positive trend in the second half. Although the acceleration will be very modest in 2020, EM countries will remain an important global growth engine, with stable annual GDP growth of 4½ to 5 per cent.

Fig 6: Rebounding purchasing manager's indices



Source: IHS Markit, Macrobond, SEB

Increased Chinese commodity imports. China's fiscal and monetary policy stimulus measures have played a key role in improving the EM outlook a bit. Export and import statistics are still comparatively weak, but increased order bookings and industrial production suggest a gradual stabilisation in China's foreign trade as well. Many EM countries are dependent on commodity exports, and increased activity in the Chinese construction sector will boost demand and prices for metals, energy and wood products. If Beijing should once again begin to tighten lending, now that it has triggered growth again, this would pose a downside risk for our entire EM forecast. Growth also appears to have bottomed out in India, with surging exports and GDP that will increase by nearly 7½ per cent this year.

Resilience in Eastern and Central Europe. Although the region has been squeezed during the past six months – especially by the weak German economy – growth has been sustained by strong domestic demand, especially in Poland and to some extent in Russia. The risk of large-scale sanctions against the Russian government and central bank appears to have diminished after publication of the Mueller report in the US, which could not find conclusive evidence of collusion between Russia and Donald Trump's presidential campaign. We expect the Russian economy to keep growing, though at a leisurely pace of around 1.5 per cent this year and 2.0 per cent next year.

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

	2017	2018	2019	2020
China	6.8	6.6	6.3	6.1
India	6.9	7.4	7.4	7.0
Brazil	1.1	1.1	2.1	2.6
Russia	1.6	2.3	1.6	2.0
Emerging markets, total	4.8	4.7	4.6	4.8

Source: International Monetary Fund (IMF), SEB

Depressed EM currencies. Inflation in the EM countries has generally fallen, in the same way as in more advanced economies. This has led to a more dovish monetary policy outlook in the BRIC countries. The tightening measures we expected during 2019 have ended up as loosening measures, which will help stimulate the EM sphere as well as the global economy. However, central European economies are going against the current, with inflationary forces generated by strong domestic consumption and high pay increases likely to make tightening necessary by early 2020. Despite generally higher risk appetite and economic stabilisation, emerging market currencies remain depressed. Our interpretation is that the appetite for EM assets is somewhat saturated after the upswing that followed the Turkish crisis in August and September 2018. Investors have chosen to wait for clearer signs that the US and Western Europe can avoid a recession before they are ready to boost holdings of riskier assets. We expect a gradual recovery in 2019-2020 as the global economy stabilises.

Oil market equilibrium around USD 75/barrel

Our forecast is that Brent crude oil prices will climb to USD 75 per barrel by the end of 2019 and then remain there on average during 2020. Such a level is compatible with Saudi Arabia's ambition to keep prices fairly high, yet at the same time not so high that it triggers an investment surge in US oil. The impact of US sanctions against Iran on global oil prices has been relatively mild. Both China and India are expected to continue buying oil from Iran, even though starting on

May 1, 2019 the Trump administration is no longer granting waivers from the ban on trade in Iranian oil that the US imposed in November 2018.

Moderate, symmetric price risks. Upside risks are limited by Saudi Arabia's ability to raise production. If prices should begin to climb, there are strong market expectations that the Saudis will boost oil output, partly to please the American president but also to discourage new investments and higher production in the US. The biggest risk that might bring lower oil prices is probably global economic growth disappointments that push down demand for oil. At present it is highly unlikely that Venezuela, which has the world's largest oil reserves, could boost its production enough to affect global prices, considering the country's deep political crisis.

Fig 7: Unemployment at 38-year low

Per cent of the labour force in the OECD countries

Source: OECD, Macrobond, SEB

Hot labour markets but weak wage response

Despite the GDP growth slowdown of the past six months, unemployment has continued to fall – though more slowly than before. OECD unemployment just dropped below 5 per cent for the first time since 1980. Our forecast is that it will continue falling by a few tenths of a percentage point during our forecast period. This means that economic expansion will persist, but at a somewhat slower pace.

Modest wage pressure despite OECD unemployment below 5 per cent for the first time since 1980

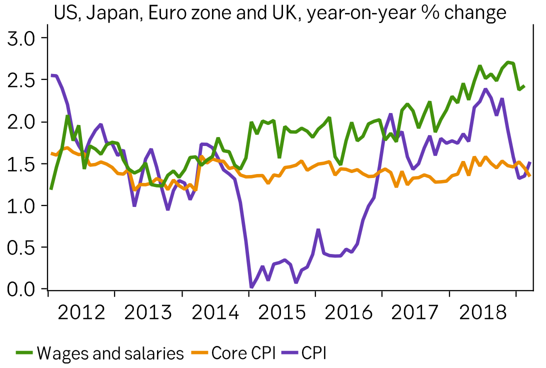
The rate of pay increases remains subdued despite a tighter labour market situation. The accelerating trend we have seen in the past 5-6 quarters in our composite wage and salary metric for the four largest advanced economies also seems to have halted, at least temporarily, at somewhat above 2.5 per cent. This is due to a decline in Japan, where earlier wage and salary figures have also been revised downward, but the upturn has continued in the US and to some extent also in Western Europe. Also notable is that the rate of pay increases in Central and Eastern Europe has accelerated rather significantly.

Inflation has continued to surprise on the downside, both in the US and Western Europe. A new surge of inflation due to oil prices will culminate early in 2020 and may temporarily drive CPI inflation above 2 per cent in many countries, including the US. Otherwise inflation pressure will remain muted. Except for oil, international producer prices are subdued. Dry weather in Europe poses a risk of new food price upturns, but so far no effects are apparent at the producer level. Inflation expectations are also low, especially in the euro zone, where we have seen a new downturn in the past six months. Also interesting to note is that the inflation rate in emerging market economies has generally fallen. The inflation rate in our EM sphere is now not much higher than in the OECD countries.

Slightly rising core inflation ahead. We now expect underlying inflation to move cautiously upward from today's low levels. This is mainly because the rate of pay increases is expected to continue speeding up. Considering the moderate growth rate, this acceleration is likely to be sedate. Most central banks will have to continue to struggle to push inflation up to their target. But the US is at a crossroads; as long as job growth remains impressive, we cannot rule out a more clearly wage-driven upturn in core inflation a bit further ahead. But at present this is not our main scenario. Core inflation excluding rents is record-low, while a strong dollar and a resurgence in productivity will help hold back inflation. Our forecast is that the Fed's favourite inflation variable, core PCE, will increase by 1.6 per cent in 2019 and 1.9 per cent in 2020, which is somewhat below the Fed's forecast.

Fig 8: Faster pay hikes but stable core inflation

US, Japan, Euro zone and UK, year-on-year % change



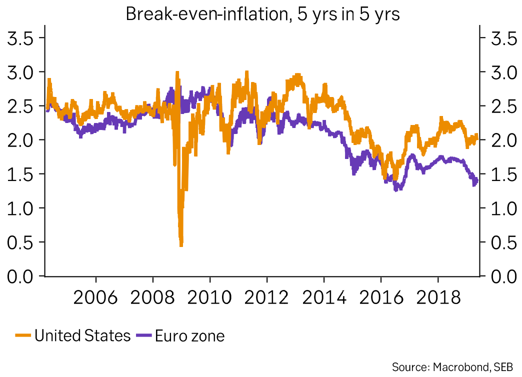
Source: Macrobond, SEB

More dovish central banks around the world

Early 2019 has thus seen a U-turn in global monetary policy, with most major central banks – led by the US Federal Reserve and the European Central Bank – cancelling or greatly postponing their normalisation plans. Both real economic and fiscal factors are behind this reversal. The global economy has decelerated, while wage and price increases have remained moderate despite tight labour markets. Among other things, the U-turn reflects concern about financial markets, with last year's sharp stock market decline fresh in mind and a fixed income market that has begun pricing in Fed key rate cuts. Another factor behind central bank caution is that monetary policy toolkits are rather empty (see the theme article, page 15) in most places, with limited room to correct for any policy mistakes. We expect unchanged or only slightly higher key interest rates in both 2019 and 2020 from most central banks. Compared to January's *Nordic Outlook*, our forecasts for the Fed, ECB, Bank of England and Riksbank are 25 basis points lower at the end of 2020.

Unchanged Fed key rate throughout our forecast period. Since early this year, the Fed has communicated that its interest rate policy is data-dependent. It announced in March that it would halt balance sheet reduction at the end of September. A slight majority of Fed policy makers still expect a rate hike next year, but we believe they will leave the key rate at its current 2.25-2.50 per cent. Considering the modest inflation level, the risk is also on the downside.

Fig 9: Lower expectations squeezing ECB



Further ECB postponement. The ECB has again been forced to delay its key rate hike, this time until 2020 at the earliest. It has also launched a new round of cheap long-term loans (TLTROIII) to euro zone banks starting in September 2019. In addition, ECB President Mario Draghi has initiated a discussion on a transition to a multi-tiered key interest rate system, which may open the way for an even longer period of negative interest rates. Further details on the new targeted longer-term refinancing operation (TLTRO) loans are expected in June. We believe the terms will be generous and similar to earlier loan programme and that the ECB's deposit and refi rate will remain at their current -0.40 and 0.00 per cent, respectively, throughout our forecast period.

Central bank key interest rates

Per cent	May 2	Sep 2019	Dec 2019	Jun 2020
Federal Reserve (Fed)	2.50	2.50	2.50	2.50
ECB (refi rate)	0.00	0.00	0.00	0.00
Bank of England (BoE)	0.75	0.75	0.75	1.00
Bank of Japan (BoJ)	-0.10	-0.10	-0.10	-0.10
Riksbank (Sweden)	-0.25	-0.25	-0.25	0.00
Norges Bank (Norway)	1.00	1.25	1.50	1.75

Source: Central banks, SEB

Bank of Japan signals continued ultra-loose policy. The BoJ's key interest rate of -0.1 per cent and bond purchases aimed at keeping 10-year government bond yields around zero will continue until at least the spring of 2020. We do not expect any changes during the rest of our forecast period either, but the difficulties of bringing Japanese inflation higher have meanwhile ignited a debate on the BoJ's inflation targeting policy. One fundamental question is whether it is reasonable to devote so much energy to pushing up inflation from today's 1 per cent when the economy seems to be working so well in many ways, with high job growth and historically low unemployment. The problems that were originally viewed as associated with a deflationary environment thus seems rather distant.

Small hikes BoE and Riksbank hikes. British monetary policy is on hold while awaiting further information about Brexit. Our main scenario is that the UK will leave the EU before the end of 2019 with an agreement and a transitional period. We expect the Bank of England to raise its key rate one more time to 1.00 per cent in the spring of 2020 due to the tight labour market and signs that pay increases are about to accelerate.

The Riksbank's focus on inflation will mean continued negative or zero interest rates; Norges Bank will go against the current and hike rates at a steady pace

Sweden's Riksbank confirmed at its April policy meeting that its main focus is on meeting the 2 per cent inflation target. It postponed its first rate hike and then eased momentum after that in such a way that the Riksbank's own rate path ends up a full 40 basis points lower at the close of its forecast period. Our forecast is that the second rate hike, from -0.25 per cent to 0.00 per cent, will be delayed until July 2020 after the national wage round is over and inflation is fairly close to target. Since our inflation forecast is lower than the Riksbank's, we do not believe there will be any rate hikes later during our forecast period. The risk to our forecast is also on the downside.

Norges Bank is going against the current. Given the upswing in the oil sector and inflation that has accelerated above target, Norway is in a different position than most other Western economies. Further monetary tightening will be needed to keep inflation on target, with the next key interest rate hike in June followed by another at the end of 2019 and one more in mid-2020. By the end of next year, Norway's key rate will be 1.75 per cent, unchanged from the January issue of *Nordic Outlook*.

The global economy

The United States

3.6%

American unemployment.
The jobless rate is well below estimates of equilibrium unemployment, but meanwhile there are early signs that the labour market is beginning to stagnate.

Page 20

The euro zone

0.4%

Q1 2019 growth, quarter-on-quarter basis.
Despite falling indicators and uncertainty about the economic situation, the growth rate accelerated during the first quarter.

Page 25

China

6.4%

Q1 2019 growth, year-on-year basis.
Expansionary policies are now impacting the economy, providing reasons for optimism.

Page 28

The United Kingdom

3.9%

British unemployment is continuing to fall and is at its lowest level since 1975.

Page 10

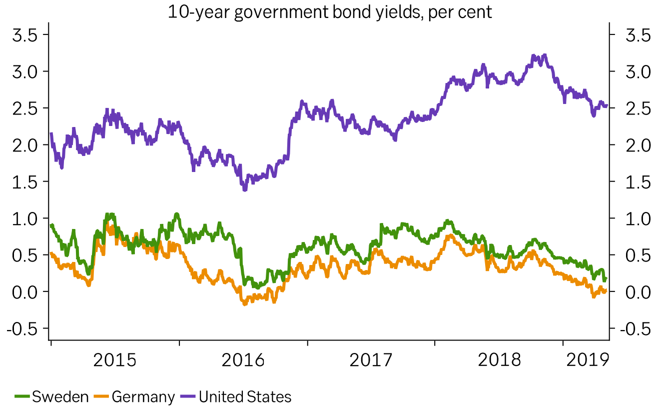
Fixed income

Long-term bond yields are stuck at low levels

In recent months, clear policy shifts by central banks have contributed to a continued slide in long-term government bond yields, despite a recovery in general risk sentiment. Given our revised Fed forecast, we expect 10-year Treasuries to yield less by year-end. An even more dovish ECB will help keep German 10-year yields at close to zero. New delays in key rate hikes from the Riksbank will support a further tightening of the spread between Sweden and Germany.

Fig 10: Bond yields have continued to decline

10-year government bond yields, per cent



Source: Macrobond, SEB

10-year government bond yields

	May 2	Jun 2019	Dec 2019	Dec 2020
United States	2.55	2.45	2.25	2.10
Germany	0.02	0.00	0.15	0.35
Sweden	0.35	0.30	0.40	0.80
Norway	1.71	1.75	2.00	2.05

Source: Central banks, SEB

The Fed's policy shift is pushing long-term yields lower. US 10-year Treasuries have fallen about 70 basis points since peaking last autumn. This decline has continued in recent months, despite a clear improvement in risk sentiment. The downturn was initially driven by speculation about more dovish interest rate policy. Since then, the Federal Reserve's clear shift in communication has reinforced this movement. Given our revised Fed forecast of an unchanged federal funds rate in 2019 and 2020, we see potential for some further downward movement in long-term Treasury yields. During the last two Fed hiking cycles, 10-year Treasuries peaked just before the Fed hiked its key interest rate one last time. After that, they tended to trade below the key rate. At present, 10-year Treasury notes are still about 10 bps above the Fed's effective key rate of around 2.40 per cent. Notably, the market's inflation expectations have recovered after falling sharply late in 2018. Since bottoming out in January 2019 they have climbed more than 20 bps. The downturn in recent months has been entirely due to lower real interest rates.

Continued downward yield trend. Given rapid re-pricing and expectations of slightly stronger data over the next few months, we expect US Treasury yields to remain generally flat during this period. Towards year-end, however, we foresee 10-year yields of 2.25 per cent: a clear downward revision and about 15 bps below the Fed's key interest rate. We then foresee a further downturn to 2.10 per cent by the end of 2020 as the risk of a Fed rate cut increases. We still do not believe that an increased bond supply will be a driving factor for US yields during 2019. The Fed's announcement that it will stop reducing its balance sheet this September reinforces this assessment. Our forecast again raises the issue of an inverted yield curve, since the yield gap between 10-year and 3-month Treasury securities will be negative as early as 2019. But our more cautious Fed forecast implies that 2-year yields will also fall in 2019-2020 and remain below 10-year yields throughout our forecast period. Late in 2019 we believe the curve will actually begin to steepen as the risk of a Fed rate cut increases.

German 10-year yields at zero. The ECB's dovish announcement, due to weak macro data, has been the main driver behind falling long-term euro zone bond yields. Since mid-March, German 10-year government bonds have traded at below 0 per cent most of the time. Although many negative factors have now been priced in, it is unlikely that somewhat better data will be sufficient to create a clear upward trend in German yields. We believe German 10-year bonds will trade within a narrow range just above zero during most of 2019. Compared to the last *Nordic Outlook*, we have revised our year-end 2019 forecast downward from 0.50 to 0.15 per cent. We believe that during 2020, some improvement in the growth outlook will help push yields somewhat higher and that the 10-year yield will reach 0.35 per cent. The spread between the US and Germany has been largely unchanged in recent months. As US yields are expected to continue to decline some while German yields are expected to recover slightly from very low levels, we expect the spread to gradually narrow to 175 bps by the end of 2020.

Dovish Riksbank is lowering Swedish yields, but Norwegian yields will climb. The Riksbank's dovish April announcement caused Swedish government bond yields to fall, and the spread against Germany has narrowed by about 10 bps. Right now we see few drivers that could widen the spread and new delays in key rate hikes will help narrow the 10-year yield gap a bit further, to 25 bps at the end of 2019. Norges Bank stands out among central banks, and given its different interest rate policy outlook compared to the ECB, Norwegian rates should continue to trade at a historically wide spread against their German equivalents. We forecast a yield gap of 170 bps at the end of 2020.

Theme: Monetary policy

A real tight spot

Manoeuvring room is shrinking as the neutral rate falls and negative rates cause problems

Interest rates have trended lower for decades. Structural forces are expected to keep them down. Central bank (CB) manoeuvring room is shrinking as neutral interest rates fall. The potential for using negative rates is highly limited. There is talk of "Japanification" in European monetary policy, while the Japanese are turning sceptical of their inflation target. Our conclusion: CB toolkits are empty and the effectiveness of unconventional policy is increasingly being questioned, so the US debate on monetary policy means and ends is welcome.

The world's CBs, including the US Federal Reserve (Fed) and the European Central Bank (ECB), have quickly changed strategy and paused their monetary normalisation. The reason for this unexpectedly rapid pirouette is probably their desire to head off some potential events that risk creating obstacles to monetary policy in the near term and further ahead.

1. To counteract falling inflation expectations. CBs are worried that the public's inflation expectations are not yet anchored to their own 2 per cent target. Today's already low interest rates, and a growing faith in lower inflation, risk pushing real interest rates higher.

2. To counteract tighter financial conditions. Late in 2018, falling share prices and widening credit spreads threatened to decelerate growth. Markets became increasingly nervous about Fed policy mistakes and US recession, due to signs of yield curve inversion.

3. To reduce risks to emerging economies like China. Tighter US monetary policy in 2018 and a strong dollar have gradually increased pressures on some indebted EM countries (see *Nordic Outlook*, January 2019).

4. *To adjust key rates to continued low neutral rates.* There are stronger signs that neutral interest rates are not rising, which makes further Fed hikes harder (see below for a description and analysis of neutral rates).

5. *To keep CBs independent from political pressure.* The White House has stepped up its pressure and actions to make the Fed pursue a more expansionary monetary policy: a sign of growing populist forces.

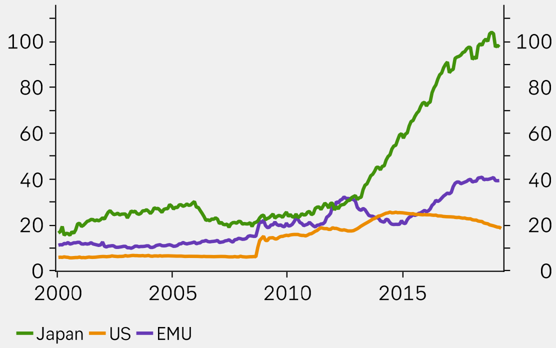
We expect global monetary policy to remain expansionary throughout our forecast period (for more central bank and interest rate analysis, see p. 14). But the world's CBs face increasing policy challenges – these have to do with both their tools and targets.

Monetary policy toolkits are empty

As early as 2010, *Nordic Outlook* analysed the concept of global "Japanese yields", i.e. persistently lower short- and long-term rates. Our conclusion was that a normal key rate might be 1.5-2.5 per cent. Nearly a decade later, the world has seen the same structural forces Japan faced, such as ageing populations and weak productivity growth. The Japanification of the global landscape thus seems to be continuing, with major effects on both asset and debt management.

Fig 11: Unique expansion of CB asset purchases

Per cent of GDP



Source: Macrobond, SEB

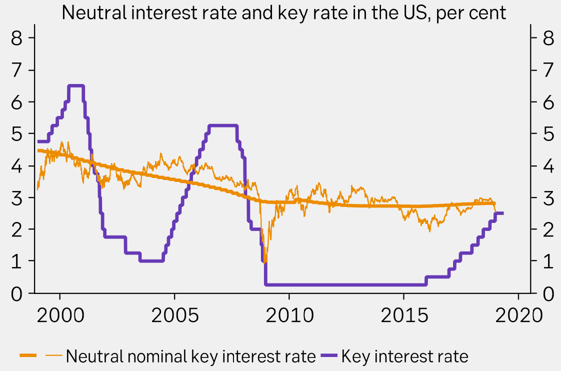
Unconventional **monetary policy** through financial asset purchases (quantitative easing, QE) will become part of the *conventional* CB toolkit in the future. CBs can buy unlimited assets. The purpose of these purchases has been to spare the private sector from market and credit risk, thereby raising asset prices. CBs have also wanted to expand their monetary base and the money supply and send a stronger signal that ultra-loose monetary policy will continue for a long time. But the question is: How effective are these tools in facing a new recession today? The assets in CB balance sheets are historically high (estimated at USD 16 trillion), and interest rates are uniquely low. Additional purchases are thus expected to have a marginal direct impact on the real economy. They also increase the risk of mispricing of assets, while adversely affecting the functioning of markets.

Interest rates have trended lower for decades. This means that in normal periods, CB key rates will also be much closer to zero than before. Due to structural factors and the aftermath of the 2008-2009 global recession, today conventional CB toolkits for dealing with economic downturns are resoundingly empty. History shows that in case of a normal recession, it is desirable to lower key interest rates by 3-4 percentage points. Based on today's situation, this would require interest rates far below zero, making it more attractive for the public to keep its savings in cash. Even the Riksbank, which has been trying negative interest rates since 2015, seems to have concluded that the absolute lower limit is close to -0.50 per cent. In such a situation, if inflation expectations fall – given an already low key interest rate – the situation becomes even worse, because real interest rates rise. How well anchored inflation expectations are around the inflation target is thus as important an issue as the zero lower bound.

One can also argue that the upper limit for key rates has fallen. This is explained by what has happened to the neutral rate. The neutral (or natural) interest rate is the level at which the key rate neither hampers nor stimulates economic growth. These estimated levels are important in several ways. They not only indicate how much room CBs have for cutting nominal key rates in recessions. They also affect how long-term yields will change in the future. Persistently lower short-term rates and long-term yields affect the reasonableness of both record-high global debt and the valuations of various asset classes.

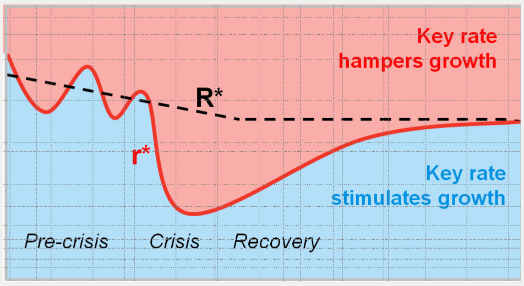
Fig 12: Gravitational forces hold down neutral rate

Neutral interest rate and key rate in the US, per cent



Source: Federal Reserve, Federal Reserve Bank of New York, Macrobond, SEB

The neutral rate is not constant – it varies over time. Various studies[1] confirm that the structural equilibrium rate R* has fallen greatly in recent decades due to ageing populations that increase savings, while weak productivity growth and other factors have held back demand for capital. The resulting savings imbalance has pushed down the neutral rate. Falling neutral rates are a global phenomenon, and the neutral rate is at about the same level in many economies: about 2.5 per cent. Various studies[2] also indicate that downward pressure persists, among other things due to continued ageing of the populations in most economies.



Analysing how expansionary monetary policy is in a shorter perspective is more complicated. R* can be affected in the short term (r*) by temporary shocks. For example, it is reasonable to believe that the Great Recession of 2008-2009 is still adversely impacting the effectiveness of monetary policy and that today r* is lower than R*. This in turn means that from a global

[1] Holston, Kathryn, Thomas Laubach and John C. Williams (2016), "Measuring the natural rate of interest: international trends and determinants", WP 2016-11, Federal Reserve of San Francisco, December 15, 2016.

[2] Rachel, Lucasz and Lawrence Summers (2019),"On falling neutral real rates, fiscal policy, and the risk of secular stagnation", BPEA Conference Draft.

standpoint, monetary policy is probably less expansionary than it appears to be.

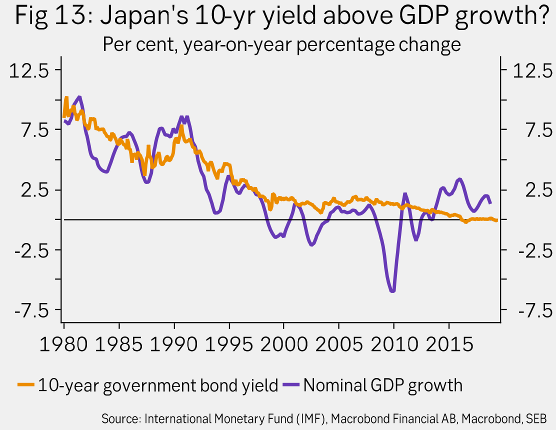
Inflation targets will survive

This new situation, with apparently clear limitations on monetary policy manoeuvring room, is heating up the debate on new tools and adjusted targets. It also raises the question of how monetary and fiscal policies interact. Last autumn the Fed initiated a debate about its review of monetary policy strategies, tools and communication, without questioning the dual mandate it must follow according to the US Congress: that Fed policies should achieve *"maximum employment and price stability"*. The Fed intends to unveil its conclusions on these issues at a monetary policy conference in Chicago on June 4-5. It is already trying to dampen outside expectations by saying its review will produce a monetary policy evolution, rather than a revolution.

Various new or "renovated" monetary policy targets have been debated in reviews conducted by various CBs (for example in Canada and Norway). These are:
a) Keep the inflation target – many CBs see shortcomings in today's target but end up concluding it is the best choice – or the least bad alternative. If anything, the debate leans more towards raising the target from today's 2 per cent than towards lowering it.
b) Temporary/permanent price level target – if inflation has diverged from target for a long time, monetary policy should be designed to restore prices to a certain price level path = compensate for earlier low inflation.
c) Nominal GDP target – includes both a volume and price component, which appeals to politicians (more focus on growth and employment) and CBs (price component replaces inflation target). Nominal GDP targeting feels distant, however, due to major quality shortcomings and revisions surrounding GDP statistics.

An embryo of debate in Japan is worth following: to abandon – temporarily or permanently – the 2 per cent Bank of Japan (BoJ) inflation target if other targets, such as for the labour market, have been met. Japan has historically low unemployment, under 2.5 per cent. The BoJ will not achieve its inflation target in the next couple of years. Advisors to Prime Minister Shinzo Abe and one of the architects behind Abenomics are now open to re-assessing monetary policy as it has been formulated as one of the three pillars of Abenomics.

Fig 13: Japan's 10-yr yield above GDP growth?



More and more people expect government budgets to play a growing role in stabilisation policy – in countries where there is room for fiscal expansion. This development is accompanied by risks: that fiscal policy will be governed to a greater extent by political rather than economic cycles. This may lead to higher risk premiums and currency depreciations, for example in countries where populist forces have gained strength.

Debate: higher debts, low interest

Amid continued low and even falling neutral rates, and with controlled low inflation, the potential for fiscal policy stimulation opens up when monetary policy manoeuvring room is essentially non-existent. But this issue is far from simple and persuasive.

Early in 2019 Olivier Blanchard, former chief economist of the International Monetary Fund (IMF), launched a revised conceptual framework about public sector debt. This included the idea that as long as nominal government bond yields are below nominal GDP growth, debt as a share of GDP is expected to be stable or even fall. According to Blanchard, the conclusion for the US is that this situation has been the norm, not an exception, for the past 70 years.[3] This is not as clear if we look at developments in Japan (see above chart). Yet Blanchard believes there is no reason to worry that today's budget deficits will lead to higher future taxes, for example. He also concludes that public sector debt may not be desirable but is no disaster.

CB independence is being debated

For the past year or so, the Trump administration has increased its political pressure on the Fed by publicly demanding a far more expansionary monetary policy. The White House is also trying to influence the Fed by nominating Trump loyalists to its board. Various other CBs, for example in India and Turkey, have also been subjected to political pressures. This is happening as populism of both the left and right has gained strength.

There are several reasons for such pressures. Governments, especially in the US, are hampered by big budget deficits that limit their manoeuvring room. Today's low inflation enables them to pursue looser monetary policies. There is thus a major risk that in practice, monetary policy will become subordinate to fiscal policy. It remains to be seen how fiscal and monetary policy makers can interact without generating new uncertainties.

[3] Blanchard, Olivier (2019), "Historically, GDP growth has been higher than the interest rate", PIIE Chart.

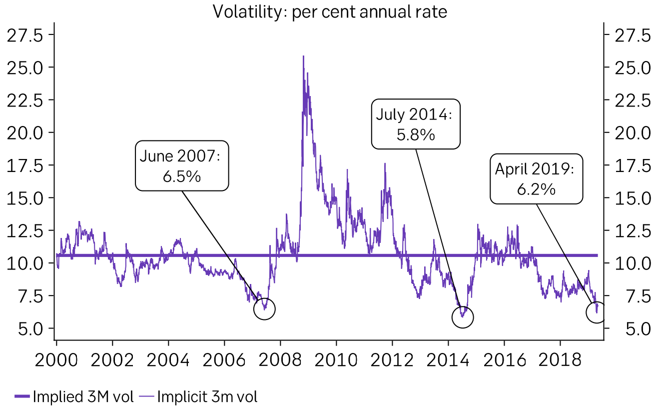
The FX market

Low volatility reflects lack of conviction

The FX market shows ever-lower volatility and a lack of drivers, which complicates forecasting. The stock market has been pushed upward by rising risk appetite, but this has had no clear impact on the FX market early in 2019. Recent more dovish ECB signals have strengthened the US dollar. We expect dollar-positive forces to lower the near-term EUR/USD rate to 1.10. Then the relative growth picture will favour the euro and EUR/USD will gradually move towards 1.18.

Fig 14: Extremely low FX market volatility

Volatility: per cent annual rate



Source: Macrobond, SEB

Exchange rates

	May 2	Jun 2019	Dec 2019	Dec 2020
EUR/USD	2.51	1.10	1.13	1.18
USD/JPY	112	108	106	100
EUR/GBP	0.86	0.83	0.83	0.86
EUR/SEK	10.60	10.80	10.90	10.20
EUR/NOK	9,.68	9.50	9.30	8.90

Source: Central banks, SEB

The foreign exchange (FX) market still lacks a common driving force. Meanwhile volatility continues to fall from already low levels. Today the 10 largest currencies have an implicit volatility (a metric based on option pricing) for the coming 3 months of less than 7 per cent, compared to an average of some 10 per cent since 2010. Average currency forecasts are also cautious, with expected movements of a low 3 per cent until the end of 2019. This may be due to a genuine belief among market players that the FX market is stable, but it more likely reflects great uncertainty about macroeconomic trends, making it hard to define strong driving forces for currencies. Despite the dramatic stock market recovery, higher risk appetite has had little impact on the FX market. Instead, defensive currencies like the USD, CHF and JPY have appreciated. The absence of traditional correlations complicates forecasting.

Euro zone recovery will eventually push the USD lower. During 2018 the dollar was driven mainly by defensive qualities, rising in response to negative events. Traditional drivers such as interest rate differentials and the growth outlook also favoured the dollar, but today the main drivers seem to be events outside the US. For example, the European Central Bank's policy retreat early in 2019 led to USD appreciation. The USD is now rather close to its equilibrium level against the euro but is probably overvalued against smaller currencies like the Swedish krona. Dollar-positive factors will predominate in the near term. As long as the US Federal Reserve indicates unchanged key rates, while euro zone economic performance remains weak, the dollar is likely to appreciate further. We foresee an EUR/USD rate of 1.10 by mid-year. Further ahead, USD-positive forces will weaken as euro zone growth stabilises, while a US slowdown becomes more evident. We then expect the EUR/USD rate to climb gradually to 1.18 by the end of 2020.

Brexit developments will determine the value of the pound, which has been clearly undervalued since the 2016 referendum. Parliament has rejected a no-deal EU withdrawal, even though it does not accept the withdrawal agreement negotiated by the government. This has helped the pound recover a bit early in 2019, despite lingering uncertainties. We still believe that a controlled, agreement-based withdrawal will help the pound climb further. Our forecast is that the GBP will then gradually appreciate to 0.83 by the end of 2019. During 2020, lingering uncertainty will help weaken the pound again. If the government fails to achieve an agreement-based withdrawal, two alternatives remain: a new referendum or a snap election. A referendum should strengthen the pound, while an election is likely to weaken it.

The SEK will remain weak, but not especially undervalued. The Riksbank's actions and negative interest rates are the principal negative drivers of the krona. After its dovish announcement in April, we expect the Riksbank to maintain its negative key rate until the second half of 2020, thus reinforcing the krona-negative environment, but clear signs of a turnaround in euro zone economic growth might support the krona. We foresee a gradual krona appreciation, with the EUR/SEK rate at 10.90 by the end of 2019 and 10.20 at the end of 2020. The krona's undervaluation will thus be relatively moderate. Rising unit labour costs and falling real interest rates have driven the equilibrium exchange rate to 9.70.

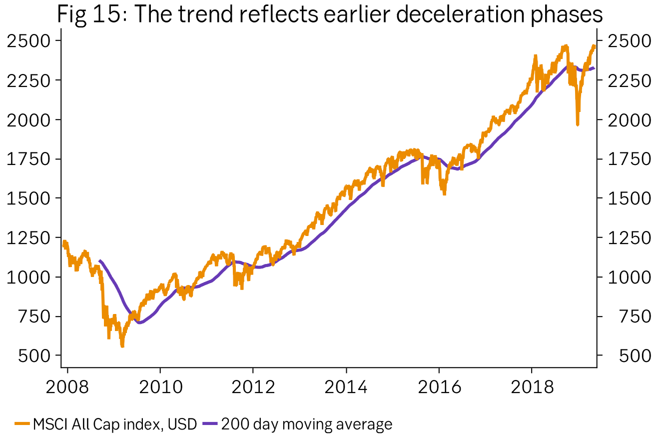
All signs point to a stronger NOK. Robust domestic demand, growing oil investments, higher oil prices and further key rate hikes by Norway's central bank should push the NOK higher this year. After the Riksbank's retreat, Norges Bank is now the only central bank that continues to signal further tightening. We expect three more rate hikes during our forecast period. We predict that the EUR/NOK rate will be 9.00 at the end of 2019, continuing to 8.90 at the end of 2020.

The stock market

High valuations after share price rebound

This year's stock market upturn has continued, although the initial surge has faded. Our main economic scenario, which includes a possibility for renewed growth acceleration, should provide support for an upward revision in depressed corporate earnings forecasts and allow for temporary stock market rallies. Yet economic uncertainties, high valuations and new reversals in trade talks pose obvious downside risks.

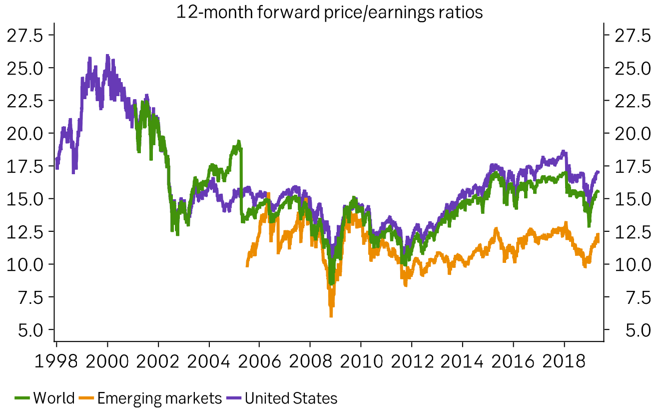
Fig 15: The trend reflects earlier deceleration phases



Source: MSCI Barra, Macrobond, SEB

Fig 16: Stretched valuations after the last rebound

12-month forward price/earnings ratios



Source: Bloomberg, SEB

Late-cyclical stabilisation, or mini-cycle in an upward trend? So far this year, world equity indices have risen to around previous all-time highs, yet the past 18 months have been dominated by above-trend volatility. In a late-cyclical phase, it is natural for stock markets to shift from a steadily rising trend to more trendless volatility. Signs of economic deceleration create worries about growth and justify downward revisions in earnings forecasts. This winter's downward adjustments followed that pattern, though the process was both faster and more dramatic than for a long time. Lower expected future growth, in turn, justifies lower valuations than during a preceding growth phase, in this case the Goldilocks period 2016-17. Another possible explanation for market volatility is that we are going through a "mini-cycle". Even in growth phases, the pace and prevailing expectations vary. This sets the stage for periodic volatility and occasional sharp dips in an upward trend. In the US, 200-day moving averages – which more clearly reflect the long-term trend – have levelled off in the way resembling earlier decelerations in the 2011-12 euro crisis and the 2015-16 slump.

The Fed is creating new hopes for growth. The Federal Reserve's remarkable monetary policy shift early in 2019 – combined with stimulus measures in China and signs of progress in US-Chinese trade talks – have created hopes that continued growth deceleration can be avoided. This year's powerful stock market upturn has not been accompanied by upward revisions in earnings forecasts, however. This has driven valuations higher. With price-earnings ratios of around 17 in the US (S&P 500) and 15.5 for the MSCI All Country World Index, we are now at levels that since the millennial-shift bubble have only been clearly exceeded during the robust 2016-17 growth phase. US equities carry the highest valuations, but this can be explained in part by greater dominance by sectors and companies at the technological cutting edge.

High valuations and uncertain prospects limit upside potential. If growth slows further, given today's valuations there is certainly room for share prices to fall. But due to relatively cautious investor positioning, continued extremely low interest rates and the outlook for a relatively limited economic slowdown, we foresee little risk of a stock market plunge like those we experienced after the turn of the millennium and the Lehman Brothers crash. Neither the dot-com (IT) bubble nor the very deep recession associated with the financial crisis appear to have equivalents in today's situation. In a "normal" recession, share price slumps of 15-30 per cent are more likely. Today we see no signs of imminent recession. Our stock market scenario is instead based on a combination of deceleration and mini-cycle scenarios. A degree of growth acceleration should justify upward revisions in today's excessively depressed earnings forecasts, which – combined with more dovish central banks – is, in turn, likely to justify temporary stock market upturns. Uncertainty and already relatively high valuations suggest, however, that in the future we will again see above-trend volatility.

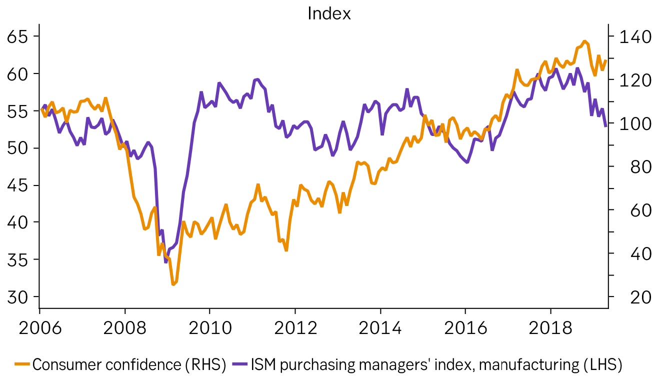
Cautious positioning. Worth noting is that this year's upturn is not fully reflected in the portfolios of long-term investors. Pension and mutual fund managers say they have recently boosted their relative holdings of equities and riskier investments, but their portfolios are still relatively defensive in nature. This can be interpreted as a limited faith in the durability of the upturn, but it also means there is capital that can drive further upturns if today's positive trend persists. We might thus end up in a situation where investors are "forced" to join the stock market party in order to avoid losing ground compared to competitors. Such a final sprint often marks the close of a long stock market upturn, but this is not our main scenario now, given the growth situation.

The United States

Gradual deceleration but no recession

After a late-2018 dip, first quarter growth was surprisingly strong, though largely fuelled by temporary factors. We foresee continued deceleration in the second half, driven by fading fiscal stimulus and a stagnating labour market. We expect the Fed to leave its key interest rate unchanged in 2019 and 2020, but the risks are on the downside. Balance sheet reduction will continue until the end of September, but the Fed will begin slowing the process in May.

Fig 17: Sentiment indicators at decent levels despite slowdown



Source: Institute for Supply Management (ISM), Conference Board, Macrobond, SEB

Key economic data

Year-on-year percentage change

	2017	2018	2019	2020
GDP	2.2	2.9	2.3	1.7
Consumer Price Index (CPI)	2.1	2.5	1.8	2.2
Core PCE (Fed's target variable)	1.6	1.9	1.7	1.9
Hourly earnings	2.6	3.0	3.4	3.2
Federal budget balance *	-3.8	-4.6	-4.7	-4.8
Federal debt held by the public *	105.8	106.4	108.5	109.1
Unemployment**	4.4	3.9	3.6	3.8
Fed funds rate***	1.50	2.50	2.50	2.50

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

GDP growth is sagging as fiscal stimulus fades

The American economy decelerated late in 2018, with fourth quarter GDP growth slowing to an annualised 2.2 per cent rate, but Q1 2019 turned out far stronger than expected. Growth surged to 3.2 per cent; however, we believe that temporary factors hampered economic activity around year-end but also contributed to a strong close to the first quarter of 2019. The sharp stock market decline in late 2018 most likely hurt year-end household consumption. Unexpectedly low income tax refunds probably also contributed to slower consumption growth. Other factors were the shutdown of some federal agencies and corporate worries about trade policy. January-March 2019 growth was supported by strong net exports and sizeable inventory build-up. We view both of these factors as temporary and unlikely to be repeated in the next few quarters. We will probably see a clear growth downturn in Q2.

Deceleration to continue after unexpectedly strong Q1. A lot of data have come in weaker so far during 2019, but business and household confidence indicators have proved resilient. The ISM purchasing managers' indices for both the manufacturing and non-manufacturing sectors have retreated, but they remain at historically high levels. Household confidence indicators show similar patterns and signal continued good activity in the next few quarters. Although GDP growth speeded up in the first quarter, we expect continued deceleration during the rest of 2019. Because of the tight labour market, supply-side restrictions are increasingly evident. Slower job growth ahead will also contribute to more muted consumption growth. Fiscal stimulus is gradually fading as well. Our assessment, based on IMF estimates, is that federal stimulus will shrink from 0.7 per cent of GDP in 2018 to 0.5 per cent in 2019. In 2020, fiscal policy will be essentially neutral. Despite the surprisingly strong first quarter, we have revised our GDP forecast somewhat lower. GDP growth will cool from 2.9 per cent in 2018 to 2.3 per cent this year. The slowdown will continue in 2020, with GDP growth reaching only 1.7 per cent.

Rising uncertainty surrounding trade talks

US-Chinese trade negotiations have continued during the spring but have been delayed by a number of controversial issues related to technology transfers, intellectual property rights, industrial subsidies and US demands to be allowed to impose further sanctions if China fails to meets its obligations. On May 5, President Donald Trump unexpectedly threatened to increase tariffs on imports from China. This has increased uncertainty and caused negative equity market reactions, mainly in China. There is a significant risk that the US will raise import tariffs in the near term, further delaying the trade talks. Our main scenario is still that an agreement will be reached, however, although it is unclear how far-reaching it will be and to what extent China will implement the agreement. The geopolitical conflict will live on, with China expected to continue expanding its global economic, political and military presence.

US auto tariffs on the way. In mid-February the US Commerce Department submitted its report about tariffs on imported cars to the White House. Its conclusions have not been made public, but it probably recommends higher import tariffs. Our scenario is that the Trump administration will announce higher imported car tariffs in mid-May but grant a temporary waiver to the EU. This will enable the US to put general pressure on the EU in trade negotiations. An announcement on higher car tariffs is expected to have a clear negative impact on European and Japanese stock markets.

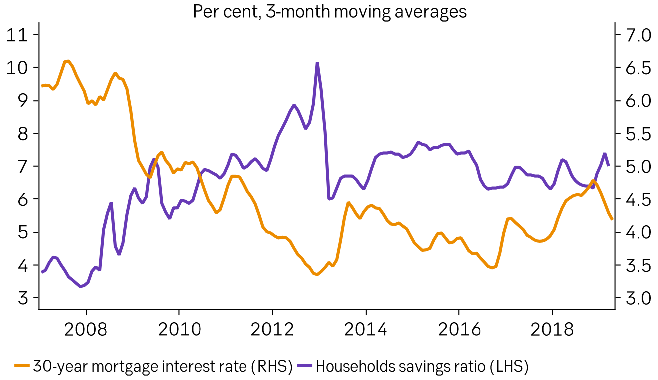
Capital spending and consumption to decelerate

Capital spending has gradually slowed since the first half of 2018. Worries about trade disruptions and somewhat higher interest rates have probably contributed. Its total first quarter 2019 contribution to GDP growth was 0.9 percentage points, but inventory build-up accounted for two thirds of it. This means we will likely see a downturn in the coming quarters. Indicators of corporate hiring intentions have weakened markedly and we expect investment growth to slow this year compared with the strong rise last year. However, a decline in interest rates since their peak last autumn will support interest-sensitive sectors. For example, there are signs that construction is the way up after weakening in 2018. This spring's oil price recovery will also stimulate mining and oil investments.

High consumer confidence, low household debt and a relatively high savings ratio means a sharp decline in consumption is unlikely

Fig 18: High savings ratio, cheaper mortgages support consumption

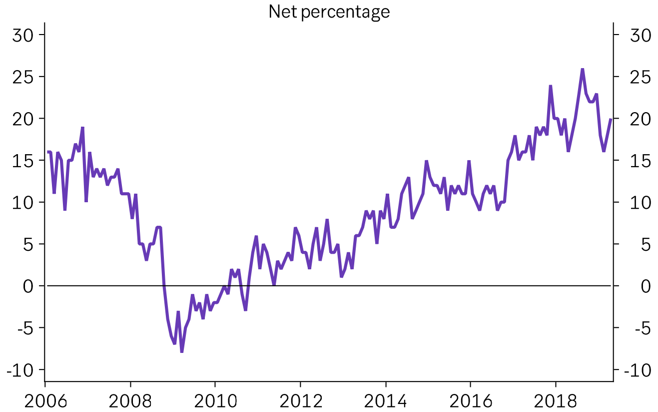
Per cent, 3-month moving averages



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

Fig 19: Small business less inclined to hire new employees

Net percentage



Source: National Federation of Independent Business, Macrobond, SEB

Although capacity utilisation has fallen somewhat in recent months, it has shown a clear upward trend since early 2016 and was just below 80 per cent in March. Total capital spending is now at around 17-18 per cent of GDP, 2 points below its peaks in 2000 and 2006.

Neutral net exports ahead. Exports accelerated in the first quarter, while imports declined. Net exports thus provided a sizeable positive contribution to GDP growth. Although larger Chinese imports from the US – in line with commitments during the trade negotiations – will provide a temporary export injection, we do not expect net exports to contribute very much to future US economic growth. Because of dollar appreciation this past year, combined with weak international demand, export growth looks set to decelerate in the coming months. Due to the expected slowdown in domestic demand, import growth will meanwhile be subdued. The narrowing of the trade deficit over the past few months is expected to end, and we believe that the current account deficit will remain between 2 and 3 per cent of GDP during the coming year.

Underlying household resilience. Household consumption growth continued to slow during the first quarter, reaching only 1.2 per cent. Unexpectedly low income tax refunds and household caution following the sharp stock market slide late in 2018 restrained consumption. Although the rapid rate of increase during 2018 will not return in the near term, there are several factors that will provide support. The labour market remains strong and petrol (gasoline) prices are relatively low, despite a clear upturn since the beginning of the year. After the Federal Reserve's shift towards a more dovish monetary policy, mortgage interest rates have fallen during 2019. High consumer confidence, along with low household debt and a relatively high savings ratio, will also help ensure that a sharp decline in consumption is unlikely. We are sticking to our assessment that consumption growth will gradually decelerate to 2.4 per cent in 2019 and to 1.9 per cent in 2020.

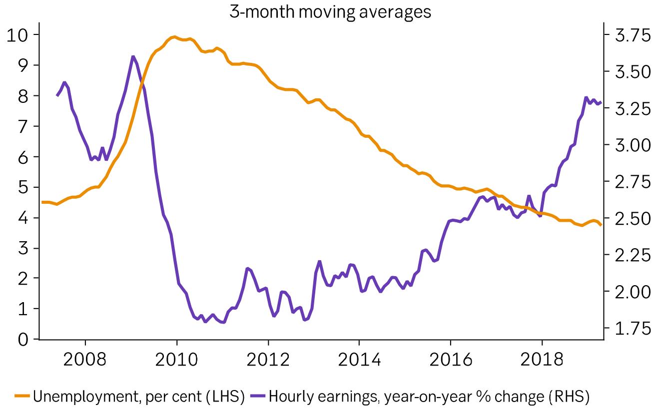
Stagnating employment and subdued inflation

Employment has been strong for a long time. During 2018 non-farm payrolls rose by an average of 223,000 per month, but so far this year job growth has fallen to 205,000. There are also other indications of a cooler labour market; for example, small business hiring plans have fallen from peak levels last year, while job openings compared to the number of people with jobs has levelled off in the past six months. As GDP growth slows, job growth is likely to slacken further. In 2020 we expect employment to increase by an average of 140,000 jobs per month.

Unemployment will fall further in the near term. The labour market is still tight. In April the jobless rate stood at 3.6 per cent, well below the Fed's equilibrium unemployment estimate of 4.3 per cent, but unemployment has not fallen that much during the past six months even though it only takes around 100,000 new jobs per month to absorb the underlying expansion of the workforce. This is because labour market participation has climbed, but the current rate of 63 per cent is well below the peak of 67 per cent in 2000. We see potential for a further upturn in the participation rate but still believe that unemployment will fall to slightly below 3.5 per cent by the end of 2019: the lowest level since the 1960s. The rate of pay increases has continued to climb but is still moderate considering that the US is in a mature expansion phase. For a long time productivity growth has been weak, but in recent quarters there has been an improvement as the rise in unit labour costs has slowed despite accelerating pay hikes. In the first quarter, productivity rose by 2.4 per cent year-on-year.

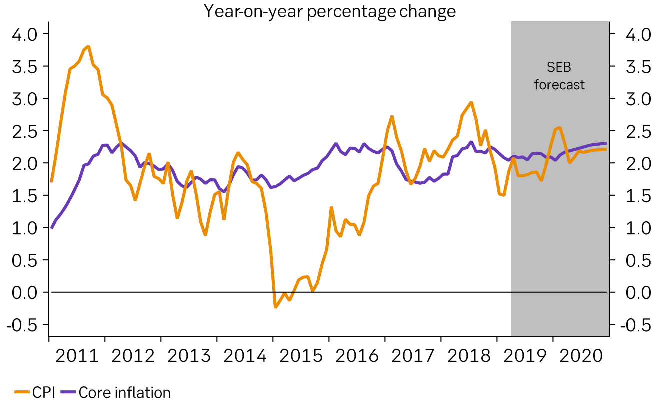
Subdued inflation pressure. Lower energy prices eased inflation pressure further early in 2019, although CPI inflation rebounded to a year-on-year rate of 1.9 per cent in March. Core inflation has trended downward in recent months and was 2.0 per cent in March: the lowest since February 2018. The accelerating rate of pay increases has not yet had an impact and is being offset by rising productivity. A strong dollar is holding down import prices, and President Donald Trump's new import tariffs have not affected prices to any greater extent. Different measures of inflation expectations have fallen since last autumn although market's inflation expectations have recovered some in 2019.

Fig 20: Accelerating pay hikes and falling unemployment
3-month moving averages



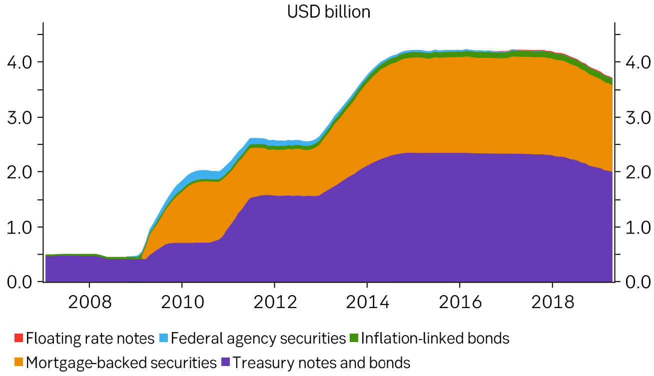
Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

Fig 21: Inflation pressure remains subdued
Year-on-year percentage change



Source: Macrobond, SEB

Fig 22: The Fed has not yet decided on long-term asset class allocations in its balance sheet
USD billion



Source: Federal Reserve Bank of New York, Macrobond, SEB

Overall, there are few signs that inflation is about to take off. Measured as full-year averages, CPI inflation is expected to end up at 1.8 per cent in 2019 and 2.2 per cent in 2020. The Fed's favourite target variable, core PCE (using the personal consumption expenditures deflator), has also slowed. In March it was 1.6 per cent. The Fed expects inflation to be at its 2 per cent target at the end of both 2019 and 2020. Our forecast is that core PCE will increase by 1.7 per cent in 2019 and by 1.9 per cent in 2020.

Fed adopts a wait-and-see attitude

After shifting towards a clearly more dovish stance around the end of 2018, the Fed has continued to communicate that its monetary policy is data-dependent and that it believe it is not under any pressure to adjust interest rates in either direction. The current federal funds rate of 2.5 per cent is somewhat below the US central bank's own estimate of a neutral level, and a slight majority of Federal Open Market Committee members expect a rate hike during 2020. But due to uncertainty about the growth outlook, continued muted inflation pressure and worries about growth prospects in other countries, the FOMC prefers to leave things unchanged until further notice. At its March policy meeting, the Fed announced it would halt balance sheet reductions at the end of September, which is somewhat earlier than we had predicted. It will also slow the pace of reductions as early as May.

The Fed will leave its key rate unchanged during 2019 and 2020. We agree with the Fed that US inflation pressure will remain muted and that economic activity will decelerate at a gradual pace. This leads us to conclude that an unchanged key interest rate is the most likely outcome during our forecast period, but there are both upside and downside risks. The upside risks are mainly connected to bottleneck problems in the labour market. Faster hourly earnings acceleration would generate upward inflation pressure. Nor is this unlikely to occur at the same time as growth is decelerating, thereby forcing the Fed to face a classic late-cyclical dilemma. On the other hand, there is also a risk that the economic slump will be so powerful that the Fed is forced to cut interest rates. Because of restrained inflation, it is also possible for the Fed to cut its key rate for "insurance purposes". Our overall assessment is that the risk to our forecast of an unchanged key interest rate is on the downside.

Review of policy framework will open the way for fresh thinking. In November 2018 the Fed began a review of its monetary policy framework, with the aim of unveiling its conclusions during the first half of 2019. The fundamental issue is how a central bank should behave in an environment where its key interest rate is close to the zero lower bound, making unconventional monetary policy (such as using its balance sheet) more important. Even if the review will be thorough, any changes are expected to be limited. Fed Chairman Jerome Powell said early in March that he sees a "high bar" for fundamental changes. The most likely outcome is that the Fed will be content to improve its communication. A change in the inflation target or a reform of the framework is unlikely. Read more about the challenges facing the Fed and other central banks in the theme article on page 15.

Theme: Elections to the European Parliament

Increased tensions

Success of Eurosceptic parties will affect EU's future

The May 2019 elections to the European Parliament will result in a change of EU leadership over the next five years – probably including more populist elements. The EU faces major internal and external challenges: to keep developing and deepening EU and euro zone cooperation, approve a long-term budget, manage Brexit, adapt to the Fourth Industrial Revolution, achieve a trade agreement with the US and find its global identity in relation to the US, China and Russia. We foresee a far slower, more defensive and decentralised EU. More political uncertainty is a negative factor for economic growth and the euro.

Efforts to complete EMU will be put on hold
In the aftermath of the severe euro crisis – and partly as a reaction to the United Kingdom's decision to leave the European Union – in recent years the European Commission has presented concrete and sometimes far-reaching proposals[1] on how to complete the EU's Economic and Monetary Union (EMU). These proposals include increased supranationalism and common financing solutions ("mechanisms"). Germany and (especially) France have driven these processes while northern European countries have reacted negatively and thus tried to decelerate these efforts (see also the theme article in *Nordic Outlook*, May 2018).

Nationalist forces are expected to increase their influence on both the Parliament and Commission. This means that such development efforts will probably come to a complete halt. Also hampering these processes are French President Emmanuel Macron's domestic political problems and the imminent retirement of German Chancellor Angela Merkel. Overall it is clear that there is a limited desire to create new mechanisms and collaboration that will involve financial and political transfers between countries to promote structural and economic convergence.

The euro zone lacks fiscal policy coordination to complement its common monetary and currency policies. This is not just a matter of the absence of fundamental systems to ensure long-term euro stability. A more acute and immediate question is how the euro zone countries can cope with the next recession, when the European Central Bank's monetary policy toolkit is empty. In such a situation, fiscal policy coordination may be crucial for managing a recession and avoiding increased unemployment.

[1] For example, see *The Five Presidents' Report*, June 2015 and the European Commission's *Reflection Paper on the Deepening of the Economic and Monetary Union*, May 2017.

Such crisis coordination is not made easier by an expansion in nationalist influences. The events of recent years have also shown that crisis resolution recipes vary between countries. Considering how integrated the euro zone economies are, and how different their room for stimulus looks, there is a great need for coordination.

The EU's long-term budget is another difficult issue that will require a solution within the coming year. The budget will cover the period 2021-2027 and is complicated, among other thing, by how the British EU contribution will be replaced. Many countries not only want the EU budget to shrink in size but also want to reprioritise among its spending areas. For example, they want to cut agricultural support in order to increase the focus on the EU's security, migration, competitiveness, research and climate adjustment. In some of these areas there ought to be potential for cooperation.

The role of the EU in the world will be determined by its ability to stick together internally. With a protectionist United States retreating from the global arena and China trying to expand its influence, the EU will have to establish its own global identity in a new geopolitical landscape. The EU needs to protect its role and its vote in such forums as the G7 and G20.

The elections: When, where and how?

From May 23 to May 26, the 28 EU member states (including the UK) will elect 751 Members of the European Parliament for a five-year term of office. The new Parliament begins operating on July 1. Its role is to pass laws, supervise the European Commission and enact EU budgets. The Parliament must approve the Commissioners and Commission President; the new European Commission takes office on November 1.

Party activities in the European Parliament (EP) are organised into pan-European party groups that are divided along ideological lines. Party groups are created with the aim of becoming larger entities, thereby enabling them to pursue their policies with greater influence and receive extra party subsidies and guaranteed seats on parliamentary committees. Forming a party group requires at least 25 members from at least 7 countries.

A more divided Parliament will make it harder for the two largest groups (see table) – the centre-right EPP and centre-left S&D – to divide up power in Parliament between them. They also risk losing the ability to influence the election of the European Commission president (who normally comes from the biggest party group). This would give EU heads of state and government greater influence in choosing the Commission president.

The big party groups will lose influence

New and varied types of populist and Eurosceptical parties have gained ground in national elections over the past few years. The public opinion situation ahead of the EU elections is harder to interpret, but a compilation of public opinion polls by the *Financial Times* shows that the outcome is likely to reflect the nationalist currents of recent years. This means that traditional leftist and rightist parties will lose votes and new and/or smaller parties will gain. But not all parties that will expand their presence are Eurosceptic; some are EU-friendly, like En Marche in France, which will probably try to form a new party group in the European Parliament, where Spain's Ciudadanos and others might fit in. Surveys currently show that the two traditionally biggest groups, the centre-right EPP and centre-left S&D, will maintain their lead but will lose their majority.

Public opinion situation ahead of EP elections

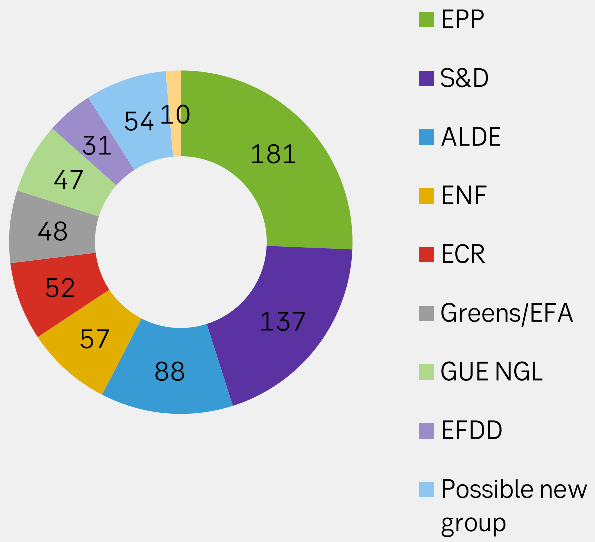
Allocation of EP seats according to the *Financial Times*

	2019	2014
EPP (European People's Party)	181	217
S&D (Socialists & Democrats)	137	189
ALDE (Liberals and Democrats)	88	68
ENF (Europe of Nations & Freedom)	57	37
New (Macron's En Marche et al)	54	0
ECR (Conservatives & Reformists)	52	74
Greens/EFA (Greens/Free Alliance)	48	51
GUE NGL (United Left/Nordic Green Left)	47	52
EFDD (Freedom & Direct Democracy)	31	45
Independent	10	18

Source: FT

Opinion polls

Number of seats in the European Parliament

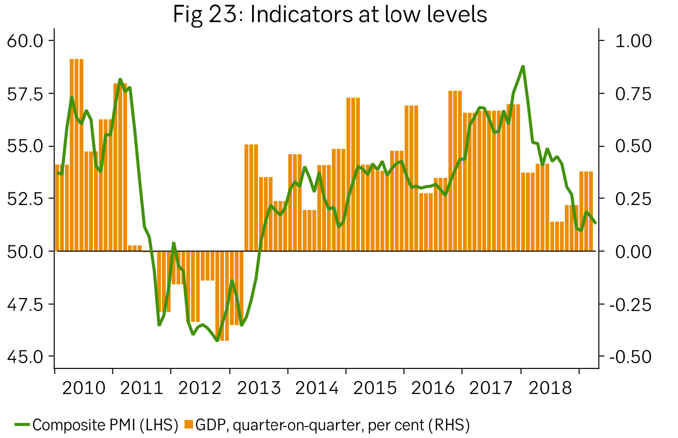


The euro zone

Growth will bottom out around mid-year

The euro zone growth slump has lasted longer than expected, but a slow improvement is discernible. Pessimism among manufacturers will fade in the second half, supported by China's recovery and other factors. Domestic sectors have been resilient. Household purchasing power is benefiting from strong labour markets and fiscal stimulus. Growth will fall to 1.1 per cent this year but improve to 1.4 per cent in 2020. The ECB is being forced to remain dovish and will keep its deposit rate negative throughout 2020.

Fig 23: Indicators at low levels



Source: Eurostat Database, IHS Markit, Macrobond, SEB

Key economic data

Year-on-year percentage change

	2017	2018	2019	2020
GDP growth	2.4	1.8	1.1	1.4
Consumer Price Index (CPI)	1.5	1.8	1.4	1.5
Unemployment, % of labour force	9.1	8.2	7.7	7.5
Pay increases	1.6	2.2	2.4	2.5
Public sector balance, % of GDP	-1.0	-0,5	-0.7	-0.8
Public sector debt, % of GDP	87.1	85.1	84.8	82.9
Refi rate, end of year	0.00	0.00	0.00	0.00
EUR/USD exchange rate, end of year	1.20	1.14	1.13	1.18

Source: Eurostat, SEB.

Recovery during the second half of 2019

The mood in euro zone economies has become noticeably gloomier in the past year. Composite purchasing managers' indices (PMIs) are close to their lowest level since 2014, but there are big differences between sectors and countries. Optimism in manufacturing has fallen significantly, and at present Spain is the only large euro zone country where the manufacturing PMI still indicates expansion. In contrast, the service and construction sectors have a far brighter view of the future. Service PMI has already rebounded and is at largely the same level as during the expansive years 2016-2017. The German economy, which served for years as the engine of the euro zone, is hampered by crisis symptoms in the car industry and generally weak growth in exports to the important Asian, US and British markets. Sentiment indicators in German industry have fallen to the same low levels as during the 2011-2012 euro crisis. Italy entered a new recession last autumn, partly due to relatively high interest rates in the wake of an uncertain fiscal outlook. Spain continues to show decent growth, however, and the contagious effects of the slowdown in other countries have been marginal. French economic growth rebounded late in 2018, despite strikes and other unrest that hampered production and consumption.

Resilient domestic demand. Some of the problems behind the 2018 deceleration have proved more stubborn than expected, leading us to revise our GDP growth forecast lower compared to the last *Nordic Outlook*. This is especially true of 2019, with a revision from 1.6 to 1.1 per cent. Yet at the same time we see good prospects that the growth climate will improve somewhat during the second half. Weaknesses in manufacturing have not interrupted strong labour market performance or weakened household optimism very much, which contributes to robust domestic demand. Despite weakness in manufacturing, capacity utilisation is high and capital spending was one of the few components that accelerated in 2018. We expect a degree of caution among companies, with investments increasing by 2-2.5 per cent annually in 2019-2020. Overall quarter-on-quarter GDP growth will climb from 0.1 per cent in the third quarter of 2018 to 0.3 per cent late in 2019. As an annual average, GDP growth will speed up to 1.4 per cent in 2020.

Persistent growth divergences between countries. The improvement we expect this year will include relatively large divergences in growth figures. The German economy will face supply-side constraints but still accelerate from 0.7 per cent growth to 1.2 per cent in 2019-2020. Despite some temporary negative effects – aside from the car industry, also transport problems on certain rivers and base effects in pharmaceuticals – Germany's very weak indicators are hard to explain, given still-decent global economic conditions. Italy, which has long suffered from structural weaknesses, will grow by nearly 1 per cent in 2020 after staying just above zero this year. France will enjoy a fiscal stimulus, but the positive impact of President Emmanuel Macron's reform efforts is likely to be delayed, while the risk of new protests hangs over the economy; growth will increase from 1.2 per cent this year to 1.3 per cent in 2020. Spain will remain the big euro zone country with the fastest growth: GDP will climb by 2 per cent or so annually.

Export headwinds will ease. US demand has held up decently, but this has not been enough, as euro zone exports to the UK and increasingly important Asian markets have fallen noticeably. Looking ahead, some sources of concern will persist. The Brexit issue remains unresolved, with repeated postponements of UK withdrawal. There is also a risk that the Trump administration's focus on trade conflicts will shift towards Europe as progress is made in US relations with China. Among other things this may hurt the car industry, which is moving towards recovery after the introduction of new emission rules last autumn. But there are good prospects for rising exports to China, now that Beijing has shifted fiscal and monetary policies in an expansionary direction. Because trade with Asia has been trending upward, exports may thus be resilient to US deceleration and continued Brexit uncertainty (Figure 3). Export growth slowed in 2018 to 3 per cent in volume terms. Due to a gradual acceleration, the 2019 figure will be somewhat better. But even if exports keep increasing in 2019-2020, net exports will contribute only marginally to growth. The euro zone's current account surplus fell below 3 per cent of GDP last year, even though more subdued economic activity also contributed to a slowdown in imports. We expect the current account surplus to remain a bit below 3 per cent of GDP during our forecast period.

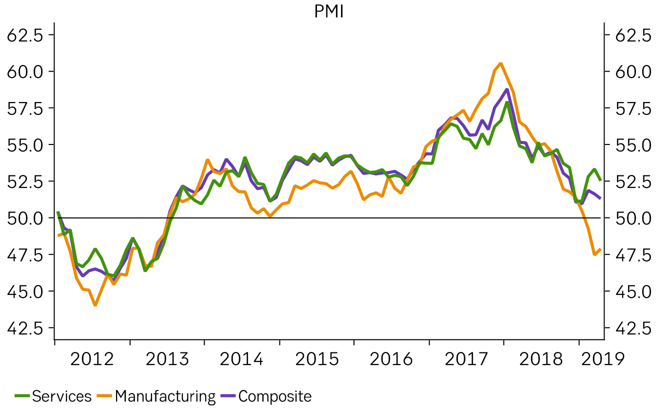
Table 2: GDP growth forecasts

Year-on-year percentage change

	2017	2018	2019	2020
Germany	2.2	1.4	0.7	1.2
France	2.2	1.6	1.2	1.3
Italy	1.6	0.9	0.2	0.9
Spain	3.0	2.6	2.3	2.0
Euro zone	2.4	1.8	1.2	1.4

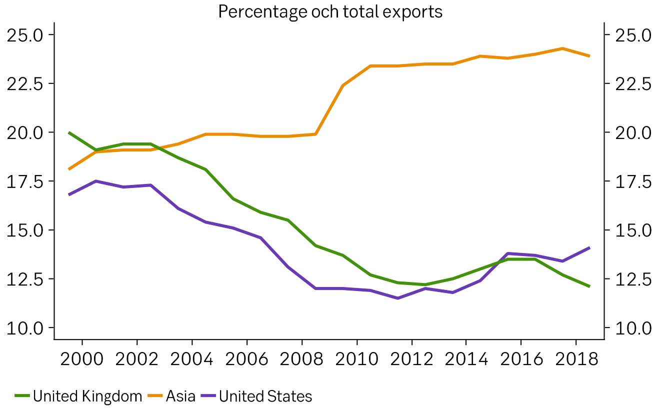
Source: Eurostat, SEB

Fig 24: Divergence between manufacturing and services



Source: IHS Markit, Macrobond, SEB

Fig 25: Asia an increasingly important market



Source: Eurostat Database, Macrobond, SEB

More stimulus measures on the way

The euro zone's public sector fiscal balance continues to improve. Last year's deficit was 0.5 per cent of GDP, the best figure since 2000, and the debt ratio has fallen five years in a row. Today only Cyprus has a deficit larger than 3 per cent of GDP, but Spain, France and Italy are all running deficits of 2-2.5 per cent. Given already ultra-loose monetary policy, fiscal manoeuvring room is increasingly important. In 2018 Germany's surplus reached 1.7 per cent of GDP, the best outcome in at least half a century. Considering the economic slowdown, the German government is likely to open its wallet, though without abandoning its conservative fiscal tradition.

Big countries still struggling with big deficits. Because large euro zone countries like France, Italy and Spain continue to struggle with significant deficits and high debts, manoeuvring room is nevertheless limited. Given domestic political instability in Italy and Spain and the "yellow vest" protests in France, Brussels will likely have to accept somewhat more expansionary policies than EU regulations prescribe. Fiscal stimulus will account for about 0.25 per cent of GDP growth in both 2019 and 2020, which implies that the public sector deficit will be nearly 1 per cent of GDP throughout our forecast period. Public sector debt will slowly continue downward, reaching 83 per cent of GDP in 2020.

Cautious households, despite favourable conditions

Household finances have developed favourably in recent years, a trend that is expected to continue. Incomes are improving as employment and pay, which are now in line with averages for the past 20 years, increase. Meanwhile households continue to behave cautiously and boost their savings. Consumption growth slowed in both 2017 and 2018, when it amounted to 1.3 per cent. Although job growth will be somewhat slower ahead, pay hikes and a downward adjustment in the inflation rate will help maintain purchasing power. Consumption is also benefiting from rising asset prices, low interest rates and continued high consumer confidence. We expect household consumption to become an important growth driver in 2019-2020, but we foresee continued cautious behaviour that will limit the rate of increase to 1.5 per cent yearly.

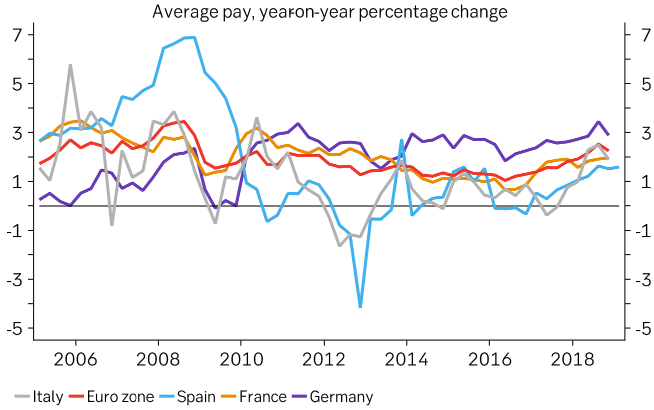
Rising employment despite decelerating growth. In spite of slower growth and weaker optimism among businesses, labour markets are showing continued strength. Although job growth decelerated somewhat late in 2018, the rate of increase was still as high as 1.3 per cent year-on-year. Euro zone countries created more than 2 million new jobs in 2018. Of the larger countries, Spain took over the top position from Germany as a job creator. The upturn in employment is driving down the jobless rate, which reached 7.8 per cent in February: 0.7 percentage points lower than a year earlier. Unemployment is now only 0.5 percentage points above the figure when the global financial crisis struck, and 4.3 percentage points lower than at the peak of the crisis. Difficulties in finding suitable employees today seem greater than at the previous cyclical peak. Hiring plans have also slowed but continue to indicate job expansion. Our forecast is that employment will increase by around 1 per cent yearly in 2019 and 2020.

Tighter labour markets mean rising wages. It is clear that wages and salaries climb faster in countries where the labour market is strongest, which is natural and is helping to improve the relative competitiveness of southern Europe compared to Germany. The rate of pay increases has cautiously crept higher, and the latest figure is 2.2 per cent for the euro zone as a whole. We expect a continued acceleration to nearly 3 per cent by the end of 2020. The unemployment levels in different countries lead to different challenges; in Germany, supply-side restrictions are contributing to slower economic growth, while there are still idle resources in most euro zone countries. We expect the jobless rate to fall somewhat further, reaching 7.5 per cent by the end of 2020, which we believe is in line with equilibrium unemployment.

-0.40%

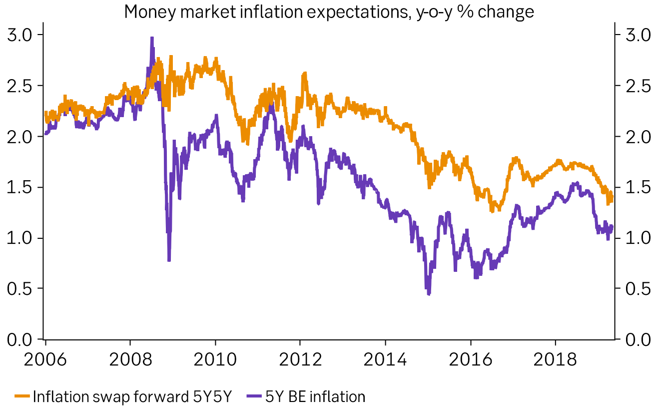
Because of weak inflation and disappointing growth, the ECB will lean in a dovish direction; the deposit rate for banks will remain negative throughout 2020.

Fig 26: German wages and salaries rising faster than average
Average pay, year-on-year percentage change



Source: ECB (European Central Bank), Macrobond, SEB

Fig 27: Inflation expectations have fallen
Money market inflation expectations, y-o-y % change



Source: Bloomberg, Macrobond, SEB

Inflation will remain at around 1.5 per cent

Having peaked at just above 2 per cent last summer and autumn, inflation has slowed again despite an uptick in April to 1.7%. Underlying inflation pressure seems likely to remain weak throughout our forecast period. The acceleration in pay increases is not large enough to change this picture. Core inflation looks set to remain around 1 per cent, where it has been for the past 5-6 years.

Hard to boost inflation without help from oil and food. Last summer's drought does not appear to have had any impact. Instead, international commodity and food prices have trended flat. On those occasions when inflation has reached around 2 per cent in recent decades, it has required substantial contributions from more volatile food and energy components. Although we expect oil prices to climb somewhat during our forecast period, this will not be enough to push inflation to the ECB target. We thus expect inflation according to the Harmonised Index of Consumer Prices (HICP) to climb towards 1.5 per cent late in 2019 and then remain at that level in 2020. Such a forecast is also consist with the market's repricing of the inflation outlook, with a clear decline in inflation expectations.

ECB on hold – key interest rate hikes will be delayed

During 2018 the European Central Bank (ECB) took tentative steps towards policy normalisation, for example by ending QE purchases. Since then, weaker growth and inflation prospects have forced the ECB to postpone its key rate hikes and marginally add to its already dovish policy. At its March policy meeting, the ECB promised new long-term loans to banks (TLTRO III) and signalled that current interest rates will apply at least until the end of 2019. New TLTRO loans would ensure that the ECB's balance sheet will not shrink when earlier TLTRO loans fall due, thereby guaranteeing continued good access to cheap liquidity. After that the question of whether the ECB, like the Swiss central bank and others, should introduce a system of tiered deposit rates was added to the agenda.

Details of new actions to be decided later. The ECB has already announced that it will offer new TLTRO loans on a quarterly basis starting in September. The terms of the loans, as well as more details on what the ECB thinks of a multi-tiered system of deposit rates, will be presented at future policy meetings. At the press conference following the April meeting, ECB President Mario Draghi declared that the design of the new loan terms will depend on how the economic and financial situation develops. We believe that the terms will be similar to those offered during the previous round of loans (TLTRO II). This implies that the interest rate will be based on the refi rate, but there will be a structure including incentives for banks to boost their lending, allowing the interest rate to fall below zero if banks achieve certain targets for lending expansion. The question of a multi-tiered deposit rate system is connected to the need to compensate for the adverse impact of negative interest rates. Above all, a system like this can make negative interest rates possible for a lengthy period. We believe that such a change in regulation – if it comes – will not occur until this autumn, when we believe that the ECB must again signal a delay in its first rate hike.

Unchanged interest rates throughout 2020. Due to unexpectedly weak economic performance, more restrained central banks around the world and dovish ECB signals, we now believe that the ECB will leave its key interest rates at their current level in 2019 and 2020. Together with more TLTRO loans and a possible multi-tiered interest rate system, the ECB is instead preparing itself for moves towards keeping negative interest rates in place for a long time.

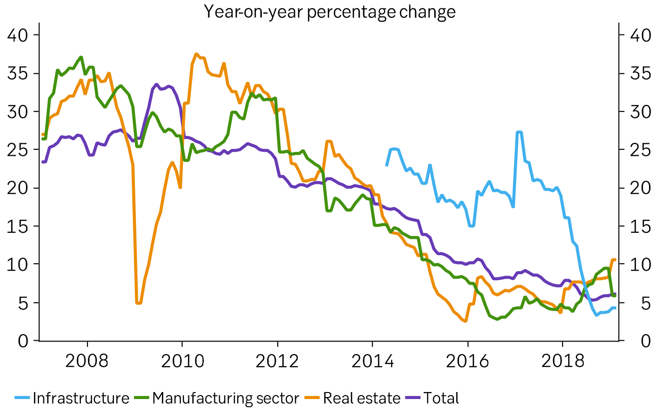
China

Investments rescue economic growth

China's economic deceleration has bottomed out. Domestic demand is now stabilising thanks to faster capital spending growth. Bank lending is also increasing. This will enable the central bank to continue pursuing a cautiously expansionary monetary policy. Global headwinds are holding back GDP growth, even though a solution to the trade conflict with the US is expected soon. This eases downward pressure on the yuan – capital inflows are also helping support the currency.

Fig 28: Investments

Year-on-year percentage change



Source: CEIC, Bloomberg

Key data

	2017	2018	2019	2020
GDP growth, %	6.9	6.6	6.3	6.1
Consumer price index (CPI), %	1.6	2.1	1.9	1.5
Bank reserve requirement, %	17.0	14.5	12.5	12.5
Lending rate, %	4.35	4.35	4.35	4.35
Deposit rate, %	1.50	1.50	1.50	1.50
7-day reverse repo rate, %	2.50	2.55	2.55	2.55
USD/CNY exchange rate	6.51	6.88	6.65	6.55

Domestic demand is stabilising. The expansionary policies of the government and the People's Bank of China (PBoC) this past year are now starting to have a positive impact on the real economy. Because Beijing set its official GDP growth target for 2019 at "6.0-6.5 per cent", its ambition is still to implement a controlled slowdown. First quarter 2019 GDP growth of 6.4 per cent is cause for optimism. In light of Beijing's desire to eventually reduce the economy's dependence on credit expansion, we are sticking to our forecast of 6.3 per cent growth this year and 6.1 per cent in 2020.

Capital spending is rebounding, with infrastructure investments an important source of growth. This is in sharp contrast to the deceleration that took place late in 2018. We believe that infrastructure spending will keep increasing at a stable pace for the rest of 2019, supporting domestic demand. Public infrastructure projects are being funded by a combination of special local government bond and corporate bond issues. Although the quota for special bonds is being raised, we do not believe they will account for more than the 1 per cent of public funding they contributed in 2018. Bank lending growth is also accelerating, enabling the PBoC to keep pursuing a moderately expansionary monetary policy as planned. We expect the authorities to aim for funding growth that essentially follows nominal GDP growth. Another objective is for PBoC policy to improve transmission mechanisms in the private sector, with a emphasis on small and medium sized enterprises. We expect the PBoC to lower reserve requirements for major banks by a total of 1 percentage point during the rest of 2019.

International headwinds. The global economic deceleration is hampering the recovery in China's industrial sectors. Despite the thaw in trade talks with the United States, we expect a persistent downturn in demand for electronic products. Export growth in South Korea and Taiwan, Asia's electronic superpowers, is continuing to decelerate. Although leading indicators suggest that electronic exports are bottoming out, no confirmation of the upturn in the region and in China is expected until late in the second quarter.

Chinese price pressures remain under control. CPI inflation has climbed somewhat this spring, mainly due to vegetable supply shortages and higher pork prices. A more broad-based inflation upturn due to higher domestic demand is still elusive. Producer prices also remain weak. Global commodity prices have climbed, pushing producer prices higher, but Chinese companies appear to have accepted narrower profit margins instead of raising prices.

Depreciation pressure on the yuan has eased. Growth worries, which triggered noticeable yuan depreciation in 2018, have essentially disappeared. The market has already priced in a solution to the US-Chinese trade conflict, which has meant that positive signals from the talks have had little impact on the currency. The combination of a more dovish US central bank and stronger Chinese domestic demand will lead to yuan appreciation against the dollar. At the end of 2019 the USD/CNY exchange rate will be 6.65, and at the end of 2019 it will be 6.55. China's capital flow conditions will be increasingly important to the yuan, as current account surpluses shrink. Chinese bonds are now formally included in the Bloomberg Barclays Global Aggregate Index. As global equity indices are reweighted to include Chinese company shares, this will generate inflows that will help support a gradually stronger yuan.

Theme:

Climate change

Hard-to-quantify, potentially major effects on the economy, but limited impact on monetary policy

The effects of global warming and the transition to a sustainable level of fossil fuel emissions pose new challenges and opportunities for companies and investors. Meanwhile economic policy makers and forecasters are under growing pressure to pay attention to these issues. The main responsibility rests with governments and fiscal policy makers, but climate change-related challenges have also turned up on the agendas of central banks. Various consequences to financial stability are clear, but the impact of climate change on macro forecasts is highly uncertain and often double-edged, so any direct impact on monetary policy is unlikely.

Complex risks over long periods of time

Assessing the economic consequences of climate change is very complex. One reason is that carbon dioxide emissions are long-lasting, with consequences far beyond the normal decision-making horizon. Although there is strong scientific consensus on the fundamental connections between greenhouse gas emissions and rising temperatures, the probability of different outcomes is highly uncertain. Moreover, there are risks of ripple effects on ecosystems and rapid, irreversible climate change – due to such threshold events as the melting of polar ice, changes in ocean circulation or methane gas emissions from the Arctic tundra. So-called *fat tails* in probability distribution imply that there is an appreciable likelihood of more extreme outcomes, with dramatic consequences.

Fiscal policy makers bear the main responsibility. There is little doubt that via their taxation and fiscal policies, governments command the most direct means of reducing carbon dioxide emissions. The fundamental problem is the externality or market failure that occurs when the societal costs of climate-changing emissions do not need to be taken into account. This market failure must be managed via taxes ("Pigou tax") or politically mandated quantitative limits. The "tragedy of the commons" was early 19th century British economist William Foster Lloyd's classic name for the dilemma that no market player needs to take responsibility for shared negative consequences. Bank of England Governor Mark Carney has perceptively described "the tragedy of the horizon" as a further complication: today no one needs to take responsibility for consequences beyond their traditional decision-making horizon.

Global solutions are needed. Because emissions are not geographically containable, international agreements are necessary to achieve effective results. One dilemma may be that advanced economies – which have the greatest potential to initiate and implement effective measures – are likely to be less directly affected by climate change than poor countries.

They may instead see indirect effects connected to political instability and migration flows. How we evaluate hard-to-quantify damage, with a horizon of a century or more, also depends on how the well-being of future generations is weighed against that of today's generations. This is expressed in the sensitive issue of choosing discount rates in socio-economic calculations.

GDP growth since 1980 has essentially been zero, if we take into account the environmental impact in the broad sense

Some impact on economic forecasts

There are a number of channels through which climate change may affect economic forecasts and thereby also economic policies. This is true of direct physical risks and damage as well as costs of transitioning to a fossil fuel-free society, plus indirect financial risks that primarily affect deliberations related to financial stability (see below). This past year the most newsworthy forecasting questions have involved the short-terms impact of extreme weather events, such as the consequences of storms, floods, fires or crop failures. Last year's Swedish drought, for example, led to somewhat lower production and higher prices for agricultural products. In addition, the economy may be affected by political adjustments to climate change and ultimately by how popular opinion reacts to them. Last year's German economic slowdown was partly due to lower auto production, as a consequence of new emissions tests in response to "dieselgate". The "yellow vest" protests in France were triggered by petrol tax increases and contributed to reduced activity in the service sector in the fourth quarter. Higher taxation of fossil energy sources may lead to both changes in relative prices and to generally higher inflation, depending on the extent to which increased energy costs are passed on to prices of other goods and services, as well as wages.

Tricky but limited consequences for monetary policy. Climate events often take the form of supply side-related shocks that tend to marginally boost inflation while hampering growth. This combination causes central banks to face more difficult trade-offs than demand side shocks that push down both inflation and growth. There may thus be reason to extend the analysis to cover dispersal mechanisms etc. But fundamentally, natural disasters, commodity price fluctuations and changes in taxation are not new issues for central banks. As long as the effects of these shocks are viewed as transitory, and do not affect the long-term trend, monetary policymakers can normally see past them. Most central banks, including Sweden's Riksbank, have also toned down the importance of climate change in their actual policy decisions, but repeated climate-related supply side shocks can perhaps no longer be viewed as temporary, but rather as permanent, as the Reserve Bank of Australia and others have pointed out.

Lower inflation and growth trends? Further ahead, other types of effects are conceivable. For example Yves Mersch of the European Central Bank has focused on the possibility that successful transition to renewable energy may lead to a lengthy period of general downward pressure on energy prices. If this coincides with a new productivity surge due to a Fourth Industrial Revolution, we could face a new period of strong disinflation on a par with the most intensive phase of the globalisation process. A lower GDP growth trend is another conceivable consequence. The San Francisco Federal Reserve, for example, highlights studies (such as Ric Colacito et al, *"Temperatures and Growth"*, 2018) suggesting that the large-scale need for "defensive" investments such as air conditioning, protective walls or reinforcement of railways and other infrastructure will squeeze out more productivity-raising investments. The study estimates that this may lower trend GDP by 0.5 points within a few decades.

Virtuous circles are also possible. Assuming long-term downward pressure on both inflation and trend GDP, estimates of the neutral interest rate may also need to be re-assessed. But as with other long-term changes such as demographic trends, such re-assessments are uncertain. It is thus hard to draw clear conclusions for monetary policy. The effects also need not be lopsidedly negative. Increased investments in climate-friendly infrastructure may have positive growth effects, while innovations in climate-friendly technology may spread through the economy, for example in the form of more efficient energy use. The need for climate adaptations may also increase public acceptance of a generally active fiscal policy in many countries, strengthening arguments for looser fiscal policy advanced by economists such as Olivier Blanchard and Larry Summers in an environment of weakened monetary policy effectiveness and less risk of crowding out by other private investments.

Greater consequences for financial stability

As for the financial stability policy area, it is easier to see clearer consequences of climate change. This may explain why central banks whose remit includes main responsibility for these areas, such as the Bank of England, have had a higher profile on climate-related issues than such peers as the ECB and the Riksbank. The various kinds of risks are also more concrete when it comes to financial stability.

- Physical risks, for example a higher frequency of extreme weather events that create major damage.

- Risks from the adjustment to a more climate-friendly society.

Generally speaking, technological and policy changes pose greater transitional risks while "business as usual" involves greater physical risks.

Higher insurance costs. Climate change has already begun to have a clear impact on insurance-related costs. For example, a 20 cm rise in sea level around Lower Manhattan since the 1950s is believed to have increased insured losses by 30 per cent during Superstorm Sandy in 2012. Major climate events may cause bankruptcies among insurance companies or force them to divest financial assets on a large scale, leading to downward price pressure. It may also become harder to insure certain assets at all, resulting in other risks to financial stability when uninsured households and businesses are hit by the consequences of natural disasters. Another concern is that climate events or environmentally related damage may threaten the value of collateral for borrowing and cause credit losses, especially in geographically or sectorally concentrated loan portfolios.

The transition process may create stranded assets. Major changes in the pricing of various assets may also pose risks to financial stability. Price declines for fossil commodities or shares in companies with business models that are dependent on fossil energy sources, may be extensive in the future. Examples of such stranded assets are coal reserves that, due to changed regulations, would no longer be worth extracting. A "carbon budget" – stating how much carbon dioxide emissions are compatible with limiting the global temperature increase to 2 degrees Celsius – would, for example, require that 2/3 of currently known fossil fuel reserves stay in the ground. Most of this consists of coal. Worries about correlated credit losses and falling asset prices – and in the worst case, crises throughout the financial system – have resulted in global initiatives to increase transparency about the exposure of individual companies to climate-related risks.

Greener markets: Opportunities and risks

Aside from direct effects on forecasting and economic policy, discussions are now under way on other institutional changes. One area concerns the introduction of macroeconomic metric and targets that take into account environmental changes such as climate change or degradation of natural resources. According to various studies (such as *"Mismeasuring Our Lives: Why GDP Doesn't Add Up"* by Joseph Stiglitz et al, 2010), one can argue that GDP growth since 1980 has essentially been zero, if we take into account the environmental impact in the broad sense. Overall metrics such as "green GDP" have the potential to provide better guidance for decision makers to operate in a more complex world.

But new metrics are also associated with risks. For example, it may be hard to design metrics without making genuinely difficult trade-offs that sow divisions in the research world or deal with political conflict zones where there are no easy answers. We should also bear in mind that the existing GDP metrics are not primarily intended as goals in themselves. Although per capita GDP is sometimes used as an indicator of well-being or even "happiness", GDP is primarily designed to serve as a stabilisation policy tool to enable fiscal and monetary policy makers to orient themselves in matters of a more cyclical nature. Green elements would make these metrics harder to interpret in that function. It is thus more a question of finding complements to traditional metrics, not replacing them.

Initiatives for a greener financial market. Central banks and other regulators can play a key role in developing a financial infrastructure in which green bonds are used to finance climate-related investments. Their purpose is not only to encourage the private sector to provide resources for climate transition, but perhaps above all to stimulate climate innovations. But there is a risk that the burgeoning interest in "green investments" will lead to price bubbles. The ECB's Yves Mersch has gone so far as to label this phenomenon a systemic financial risk of its own. This worry, in turn, underscores the need to create transparent and uniform rules about what may be labelled "green". One example is the European Union's "green taxonomy".

Central banks have generally distanced themselves from "green" monetary policy concepts, however. One example is proposals that central banks should prioritise green bonds as part of their quantitative easing. At the ECB, for example, bonds in carbon dioxide-intensive companies accounted for nearly half of the total universe when the central bank launched its corporate bond-buying programme. Such a policy change, central banks maintain, might conflict with the overall goal of price stability as well as requirements that such policies must be neutral from a competitive standpoint. In addition, the supply of available bonds for the private market would be limited, further accentuating the above-cited bubble risks. But the fundamental reason behind central bank reluctance is concern that increased elements of political deliberation may threaten central bank independence. Still, the risk of more frequent and extreme weather events and disruptions to the financial system from both climate events and adjustment process create a greater need for an understanding of climate change and its economic consequences.

Type of risk		Examples of risks to the economy	Examples of risks to financial stability
Physical risks	Extreme weather events	Unexpected supply (and demand) side shocks	Costs of damage (insured & uninsured), damage claims, credit losses
	Global warming	Lower productivity & trend growth	
Adjustment risks Technology & policy changes		Effect of supply (and demand) side shocks on inflation & (trend)growth	"Stranded assets", impact on business models, "green bubbles"
"Business as usual" => greater physical risks Changes in policy & technology => greater adjustment risks			

The Nordics

Loose fiscal policy and a weak krona will help keep Swedish growth close to trend in 2019 and 2020. Given below-target inflation, the Riksbank will postpone more hikes until mid-2020, then leave its repo rate at zero. Increased oil and gas investments enable both Norwegian growth and Norges Bank to go against the current. Strong household fundamentals and good competitiveness will support Danish growth. Finland's slowdown will be softened by continued decent domestic demand and somewhat better global demand.

Sweden

17.1%

A record-high household savings ratio. But due to worries about the economy, households are hesitant to boost their consumption.

Page 33

Norway

1.75%

The key interest rate at the end of 2020. Norges Bank is going against the global current, hiking its key rate a total of three times this year and once in 2020.

Page 40

Denmark

2.0%

GDP growth in 2019.
After last year's slowdown, which underestimates the underlying trend, economic growth has recovered.

Page 39

Finland

6.4%

Unemployment, April 2019.
The jobless rate is now only a couple of tenths of a percentage point above its lowest level before the global financial crisis struck.

Page 42

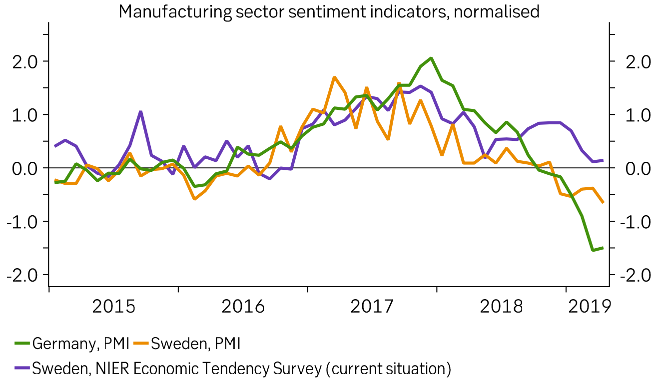
Sweden

Steady growth and below-target inflation

GDP growth is slowing due to soft international demand and falling home construction, yet loose fiscal policy and a weak krona will keep growth close to trend in 2019 and 2020. Unemployment will stabilise. Resource utilisation will fall slightly. Pay hikes agreed in early-2020 labour contracts will end up at 2.5-2.6 per cent yearly, eventually helping lead to inflation of below 2 per cent. The Riksbank is postponing its rate hikes further; the repo rate will be 0 per cent at year-end 2020.

Fig 29: Worsening mood among manufacturers, but better than Germany

Manufacturing sector sentiment indicators, normalised



Source: Swedish National Institute of Economic Research (Konjunkturinstitutet, NIER), Swedbank, IHS Markit, Macrobond, SEB

Key data

Year-on-year percentage change

	2017	2018	2019	2020
GDP	2.1	2.3	1.6	1.7
CPIF (CPI less interest rate changes)	2.0	2.1	1.9	1.5
Unemployment	6.7	6.3	6.3	6.3
Wages and salaries	2.3	2.5	2.7	3.2
Net lending *	1.4	0.9	0.7	0.5
General government debt *	40.8	38.8	34.6	34.0
Repo rate**	-0.50	-0.25	-0.25	0.00
EUR/SEK***	9.84	10.28	10.90	10.20

* Per cent of GDP. ** Per cent. ***Year End. Source: Statistics Sweden, SEB.

Weaker sentiment, but bright spots nonetheless

Although most sentiment indicators have weakened since January, we are sticking to our GDP growth forecast of 1.6 per cent in 2019. Preliminary hard data for the first quarter have been so strong that we even foresee an upside risk to our forecast, but various signs suggest that we are moving towards more sedate growth. Due to weaker international demand, industrial production and exports will slow during the first half. Domestic demand is also weakening; this is clearest for residential investments, which fell significantly during 2018 after making positive contributions to GDP growth for several years. Despite both domestic and international sources of concern, we forecast that Swedish economic growth will remain stronger than in many other parts of Europe, but we have lowered our 2020 growth forecast by two tenths of a point to 1.7 per cent.

Swedish manufacturers will avoid a German-type slowdown. Manufacturing sentiment indicators have gradually fallen this past year, but unlike Germany the Swedish purchasing managers' index (PMI) has stabilised in recent months (see Figure 1) and remains at a level compatible with expansion. The weak krona and less Swedish exposure to the auto industry may partly explain the difference. Yet the historical correlation between Swedish and German manufacturing PMIs is so high that it is hard to believe the current wide gap will be long-lasting. Sweden's PMI has tended to lead Germany's by a month or so. The stabilisation in Sweden supports our forecast of a certain recovery in German manufacturing. The NIER Economic Tendency Survey is more upbeat, indicating GDP growth in line with the historical trend. Although the signals are mixed, the Swedish manufacturing sector is now likely to slow down. We have adjusted our export growth forecast to 2.8 per cent this year and 2.6 per cent in 2020: 0.5-1.0 per cent yearly below our January estimate.

Residential investments are falling. The downturn in Swedish housing starts began in mid-2017 and has been reflected since then in falling residential investments. Compared to the peak in Q1 2018, such investments have fallen by nearly 10 per cent. The decline will continue this year. We are maintaining our forecast that residential investments will provide a negative growth contribution of more than 0.5 percentage points in 2019. In 2014-2017 they contributed a positive 0.6-0.7 points per year to growth. As expected, the downturn has primarily been due to tenant-owner flats, while rental unit and single-family home construction is far more stable. During the fourth quarter of 2018, a levelling off was apparent. We are sticking to our forecast that housing starts will fall to about 45,000 this year, some 30 per cent lower than in 2017. In 2020 we predict a slight upturn to 50,000 units. The outlook for other capital spending is mixed. Manufacturing investments will remain weak, while the rapid upturn in public sector investments will continue. Partly due to a slight upturn in service sector and commercial real estate investments, total capital spending will increase by 2.0 per cent this year despite the large decline for housing.

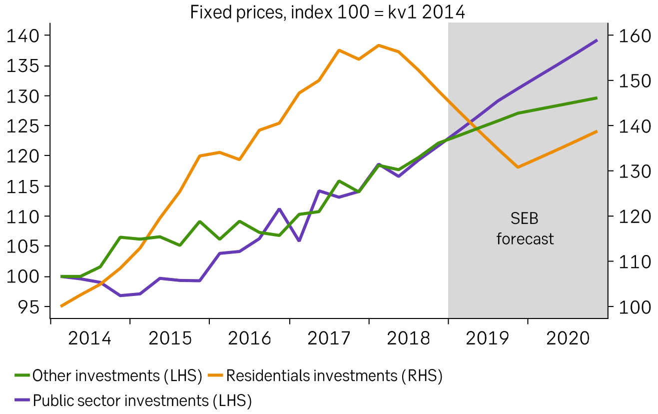
Hesitant households will continue to save

Despite the strong labour market and rising incomes, consumption decelerated noticeably during the second half of 2018. One reason was a decline in auto sales due to adoption of a "bonus-malus" tax – aimed at encouraging lower-emission vehicles – but consumption in general was unexpectedly weak. A stable increase in household incomes suggests rising consumption ahead. Although job growth is slowing, the increase in energy prices over the past few years is no longer undermining purchasing power. Taxes are being lowered significantly, this year mainly in the form of a new stage in the expansion of the earned income tax credit and lower taxation of pensions; next year Sweden will abolish the extra 5 per cent income tax on high earners imposed as a "temporary" austerity measure in 1995. Household income taxes will be cut by a total of SEK 16 billion this year and SEK 10 billion in 2020, even assuming a slight increase in local income taxes.

Record-high savings. Households remain cautious, however. The savings ratio rose to a new record level of 16.8 per cent in the fourth quarter of 2018. We expect it to remain there during our forecast period. Worries about the economy were among the reasons why household confidence indices fell to their lowest levels since 2012 in late 2018. Despite rebounding in recent months, confidence is historically low. Assuming strong incomes and stable asset prices, however, a continued upturn is likely. This is supported by positive signals from retailers and consumption figures in early 2019. We are maintaining our forecast that consumption will increase by nearly 2 per cent both this year and in 2020.

Fig 30: Rising public sector investments

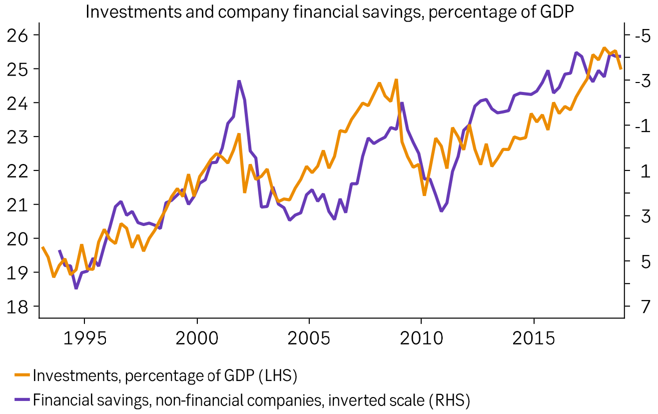
Fixed prices, index 100 = kv1 2014



Source: Statistics Sweden, SEB

Fig 31: Companies are borrowing to invest

Investments and company financial savings, percentage of GDP



Source: Statistics Sweden, SEB

Household incomes and saving

Year-on-year percentage change

	2017	2018	2019	2020
Real disposable income	1.8	2.9	1.8	2.1
Private consumption	2.2	1.2	1.7	1.7
Savings ratio, per cent of income	15.1	17.1	17.0	17.3

Source: Statistics Sweden, SEB

High domestic demand is shrinking the current account surplus. Sweden's trade surpluses have gradually fallen since the financial crisis. In 2018 the current account surplus was a moderate 2 per cent of GDP: far below the 8 per cent surplus in 2007. Strong domestic demand, including capital spending that rose to 25 per cent of GDP (highest since the 1980s), was the main reason. Yet there are also signs of poorer competitiveness: Swedish exports have increased more slowly than those of Germany and other euro zone countries. Given the slowdown in capital spending, we believe that the current account surplus will again widen in 2019 and 2020.

Loose fiscal policy will help sustain GDP growth

Swedish public sector consumption has been in an expansionary phase since the 2015-2016 refugee crisis. The upturn is now decelerating, but demand for public services remains strong. Public sector employment is rising by nearly one per cent a year. This is above the historical trend, though slower than during the previous three years, but because of special measurement methods the productivity trend in the public sector remains negative. As a result, volume growth is close to zero. Because Sweden is largely alone in applying Eurostat's recommendations for estimating public sector consumption, Swedish GDP growth ends up 0.2-0.3 percentage points lower each year than in other countries.

The finance minister will allow some stimulus after all. Although economic growth is slowing, public finances still look strong. Last year's budget surplus was nearly 1 per cent of GDP, and public sector debt fell below 40 per cent of GDP, the lowest in about 40 years. The budget cooperation agreement between the ruling Social Democrats and Green Party and the opposition Liberals and Centre Party will give fiscal policy a more expansionary bias ahead, despite Finance Minister Magdalena Andersson's statements when she submitted the Spring Budget in April that there was no room for more stimulus measures. To ensure that the cooperation agreement works, while not creating intra-party tensions, the reforms listed in the four-party pact must be implemented. Although they can be funded partly by spending cutbacks and tax hikes, we expect stimulus of 0.5-1.0 per cent of GDP yearly in 2019 and 2020, but the surplus will be around 0.5 per cent of GDP in 2019 and 2020. Government debt will fall below 35 per cent of GDP by this year.

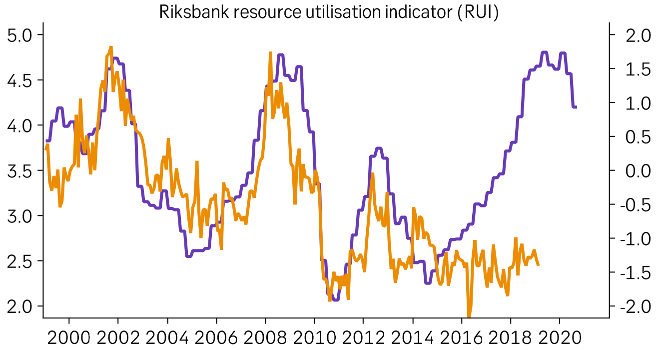
Fiscal policy goal conflict. The official fiscal policy framework that went into effect this year includes a surplus target of 1/3 per cent of GDP and a "debt anchor" of 35 per cent of GDP. When debt falls towards the anchor, while the surplus is above target, a goal conflict arises in which we believe that the debt anchor should take precedence. It is hardly reasonable to push down debt when there are major needs in a number of publicly funded areas. Meanwhile the Riksbank is holding nearly half the outstanding supply of government bonds, which further accentuates the liquidity problems in the Swedish government securities market.

Unemployment will level out

Signs of strength have continued to dominate the labour market, even though rapid job growth has slowed in the past 6-9 months. Weaker GDP growth suggests that this deceleration will continue, but indicators point to year-on-year employment expansion of nearly 1.5 per cent in the next six months. Although job growth has been stronger than anticipated, unemployment has risen more than expected. Unusually high volatility in this past year's statistics has made developments hard to interpret. An unexpectedly clear upturn in the participation rate explains this. Along with a definite population increase, it is leading to significant expansion in labour supply. Although a growing percentage of the population belongs to groups with a "weak connection to the labour market", as defined by the Public Employment Service, we are beginning to approach a participation rate on a par with the record levels of the late 1980s. This is extremely high in an international perspective. We continue to expect the upturn in labour supply to come to a halt and believe unemployment will stabilise at about its current levels.

Fig 32: Resource utilisation falling from high level

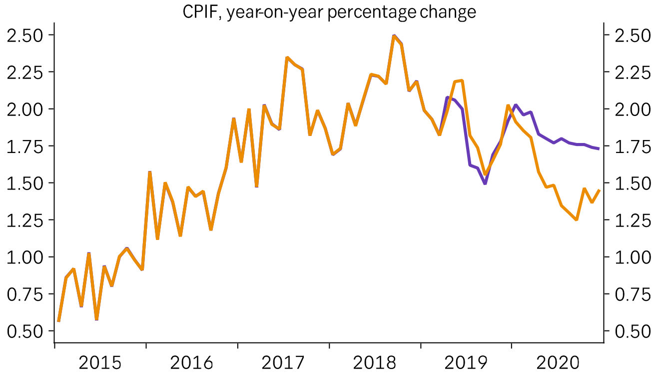
Riksbank resource utilisation indicator (RUI)



Source: National Mediation Office (Medlingsinstitutet), Macrobond, SEB

Fig 33: Inflation below Riksbank target

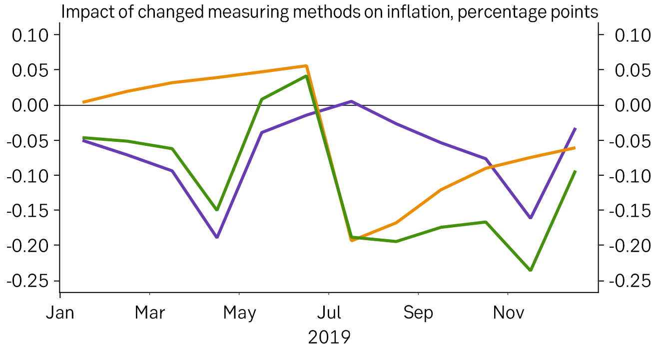
CPIF, year-on-year percentage change



Source: Central Bank of Sweden (Riksbanken), Macrobond, SEB

Fig 34: Changed measuring method will lower inflation 2019

Impact of changed measuring methods on inflation, percentage points



Source: Macrobond, SEB

Sluggish pay hikes and headwinds for inflation

Although resource utilisation reached historical peaks in 2017 and 2018, pay hikes accelerated only marginally. Early in 2019 the rate of increases was just above 2.5 per cent. Because of gradual labour market cooling, the Riksbank resource utilisation indicator has fallen in the past six months. Pay hikes are thus unlikely to speed up significantly in 2019. The existing three-year collective contracts, with their 2.2 per cent yearly pay increases, expire at the end of March 2020. The first major step in the upcoming national wage round will be this autumn's union coordination process. Actual union-employer negotiations will take place early in 2020. Higher inflation expectation and somewhat faster pay hikes in Germany suggest that contracts will end up somewhat higher than last time around, but meanwhile the labour market situation is moving towards a cooldown. We expect yearly contractual pay hikes of 2.5-2.6 per cent, marginally below our previous forecast. Assuming wage drift at the prevailing levels, this would mean total pay increases of more than 3 per cent in 2020.

Near-term CPIF inflation close to target. Inflation surprised on the downside early in 2019. CPIF (CPI less interest rate changes) was at 1.8 per cent in March, but rising energy prices will help push the inflation rate a bit above 2 per cent in the next few months. The weak krona and higher food prices will also contribute to rising inflation. These forces were already in play early in 2019, but lower package tour prices – because Statistics Sweden is using a new source of data – were among factors that pushed inflation a few tenths of a point lower in March (see box). Overall, CPI inflation will be close to the Riksbank's 2 per cent target throughout 2019.

New metrics disrupt inflation figures

A new source of package tour statistics will help hold down inflation during much of 2019, due to increased seasonal variations. During the second half, an additional technical effect will push inflation lower, since Statistics Sweden has introduced a new way of estimating the impact of subsidies on the price of dental care. Together, these technical effects will lower CPIF by nearly 0.2-0.3 points in the second half, with variations between months. Starting in December 2019 these effects on the inflation rate will disappear.

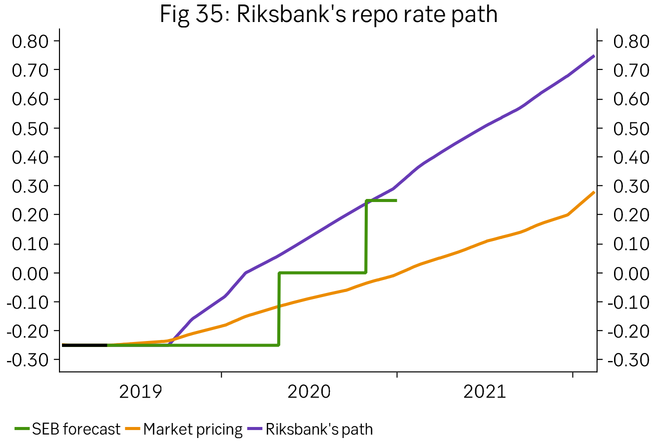
CPIF below 2 per cent in late 2020. Looking ahead, however, we foresee a falling trend for CPIF inflation. The effects of the weak krona and higher food prices will gradually fade from the 12-month inflation rate. Forward prices for both oil and electricity are now also pointing downward. We thus expect the energy price component to shift and become a negative contributor to inflation starting in the second half of 2019, after being a positive contributor for years. In the absence of upward pressure from energy prices and the currency, we believe that a pay increase of somewhat above 3 per cent yearly is not enough to provide stable underlying inflation on a par with the Riksbank's target. This applies to an environment of weak increases in international prices. We thus believe CPIF inflation will be a bit below 2 per cent during 2020.

Unclear reaction function in monetary policy

At its April policy meeting, the Riksbank lowered its rate path and postponed its next key rate hike until late 2019 or early 2020. The rate path at the end of its forecast horizon is now 40 percentage points lower. In explaining these actions, the Riksbank mainly cited new negative surprises related to inflation and inflation expectations. It also cited greater uncertainty about international economic trends and more dovish rhetoric from leading central banks. The Board thus sent a clear signal that it is continuing to focus completely on bringing inflation back to its 2 per cent target. This ended speculation that last December's initial key rate hike was a sign that the Riksbank wanted to leave negative interest rates behind and was thus more tolerant of inflation-related disappointments.

Our main scenario is a Riksbank rate hike in July 2020, but if the reaction function from the April 2019 policy meeting sets the tone, it is hard to foresee any rate hikes at all in 2020.

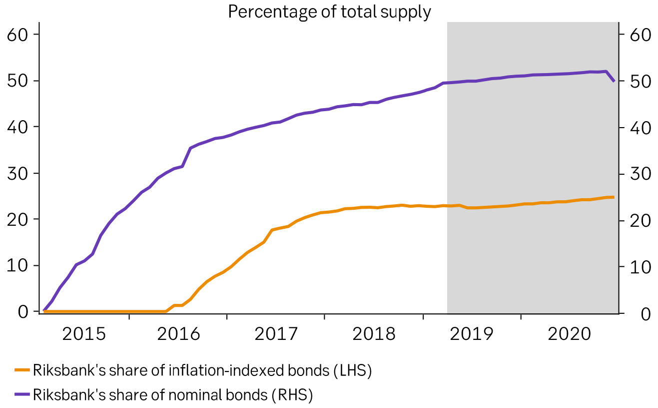
Fig 35: Riksbank's repo rate path



Source: Central Bank of Sweden (Riksbanken), Macrobond, SEB

Fig 36: Riksbank owns half of nominal government bonds

Percentage of total supply



Source: Riksbank, Macrobond, SEB

Key interest rate hike postponed further. If the Riksbank's actions at the April 2019 meeting continue to set the tone, we believe it will be hard for the central bank to deliver more rate hikes during our forecast period. Higher energy prices and a weaker krona will push inflation upward, but in spite of this our CPIF forecast is a bit below that of the Riksbank at the end of this year, and even more so during 2020. In particular, we believe that as the date approaches, the Riksbank will refrain from raising its key rate in the middle of an ongoing national wage round. Because of the Riksbank's inability to meet its inflation target, the unions and employer organisations have questioned its function as an "anchor" in their pay negotiations. This problem is now also being accentuated by inflation expectations which – both according to surveys and the pricing of inflation-linked bonds – have fallen below 2 per cent.

There will be only one rate hike in 2020. The question is whether the Riksbank will be able to hike its key rate at all in the prevailing environment, where leading central banks are becoming more dovish in their plans. During earlier periods of even stronger economic growth, the Riksbank rejected arguments in favour of rate hikes – such as the wisdom of gathering ammunition ahead of the next recession or the need to slow the increase in home prices and household borrowing. One argument for hiking the key rate may be that resource utilisation is higher than normal, but it seems likely to fall during the next couple of years. We have postponed our predicted date for the next rate hike from April to July 2020 and believe that the Riksbank will then choose to hike its key rate after the national wage round is over and inflation is reasonably close to target. Because our inflation forecast is lower than the Riksbank's, however, we do not believe there will be further rate hikes after that. The repo rate will thus reach 0 per cent at the end of 2020.

Dovish Riksbank pushing down Swedish bond yields

The Riksbank's dovish announcement in April has caused Swedish market yields to fall, and the yield gap against German government bonds has narrowed by about 10 basis points since then. At present we do not foresee many forces that would widen the spread again, considering our forecast that the next Riksbank key rate hike will be postponed until July 2020. The central bank's announcement that it will buy an additional SEK 45 billion worth of government bonds until December 2020 will also push down yields, and so will the Financial Supervisory Authority's proposal on increased liquidity reserves in Swedish kronor – which is expected to lead to increased demand for safe Swedish assets. We believe that new delays in key rate hikes will help narrow the yield gap a bit further, to 25 bps (from 32 bps) by the end of 2019. During 2020, when the Riksbank is expected to hike its key rate before the ECB does, we believe the spread will widen somewhat and reach 45 bps by the end of 2020.

The National Debt Office (NDO) is too pessimistic about Swedish government finances. The Riksbank's decision to reinvest about half of its government bond holdings that mature in December 2020 and half its coupon payments in advance means that it is again allowing its balance sheet to grow and is temporarily boosting its share of the total nominal bond supply to 52 per cent. In most short-maturity nominal government bonds, the Riksbank's holdings already amount to about 60 per cent of the total supply. The NDO is forecasting that weaker macroeconomic data will help transform this year's government budget surplus into a deficit in 2020. This assessment is behind its plans to increase the volume of nominal government bond issues from SEK 30 billion to SEK 40 billion. We believe that the NDO forecast is too pessimistic and foresee a major risk that the bond supply will remain low for a lengthy period, which is also expected to push Swedish government yields downward.

Theme:

The Swedish krona

Structural factors explain why the SEK equilibrium exchange rate is trending weaker

For many years until the 2008 financial crisis, the krona was steady at around SEK 9.00 per euro. Now that the EUR/SEK exchange rate is above 10.50, the krona is perceived as highly undervalued. Most would probably agree that the krona's depreciation in recent years is connected to the rather extreme monetary policy of the Riksbank. Meanwhile more underlying structural factors seem to explain this post-crisis depreciation.Our estimates suggest that the equilibrium exchange rate against the euro has climbed from about 9.20 in 2008 to about 9.70 today. This is one reason why we must probably get used to a weaker krona ahead, and why the krona's undervaluation is not as sizeable as we may have believed.

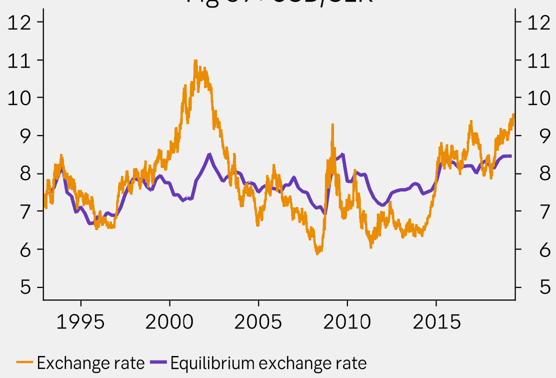
Ultra-loose monetary policy has contributed to krona depreciation. There is widespread consensus that the depreciation of recent years is connected to the Riksbank's extreme monetary policy, including negative key interest rates, large-scale bond purchases and – for a while – an open mandate to intervene in the foreign exchange (FX) market to counter krona appreciation. In recent years, wide interest rate and yield spreads against the dollar and other currencies have made it attractive for Swedish insurance companies and financial institutions to increase their foreign currency exposure, especially because the krona has trended weaker. Low rates and yields may also have helped make the SEK a funding currency for speculative FX market players that can take advantage of the spreads. Meanwhile negative interest has probably helped to change the behaviour of Swedish exporters. It is reasonable for them to try to avoid converting their foreign revenues to kronor, since negative interest means it costs money to keep these funds in Swedish accounts.

There are also other reasons for krona depreciation. Yet the krona would probably have depreciated even if Swedish monetary policy had been less extreme. During the 2011-2012 euro crisis, the krona soared as Swedish economic fundamentals helped make the SEK look like an attractive alternative to a threatened euro. During this period, the SEK reached levels that were probably overvalued against the euro and various other currencies. After a normalisation in the euro zone, this advantage has long since disappeared from FX pricing. Meanwhile there has apparently been a gradual negative change in several structural factors that determine the long-term value of the krona.

Four variables behind our equilibrium metric. There are several ways of trying to determine the equilibrium exchange rate of the krona against other currencies, a correct long-term value for the krona against these currencies. At SEB, we apply a more empirical approach, where four different factors determine a currency's long-term equilibrium level. These factors are relative inflation, relative unit labour cost, relative terms of trade – that is, export prices in relation to import prices – and relative 10-year real yield.

The equilibrium exchange rate has crept higher. Estimates using this model suggest that the long-term USD/SEK equilibrium rate is now close to 8.50. The model also indicates that the krona's equilibrium rate against the dollar has steadily worsened from about 6.90 in 2008.

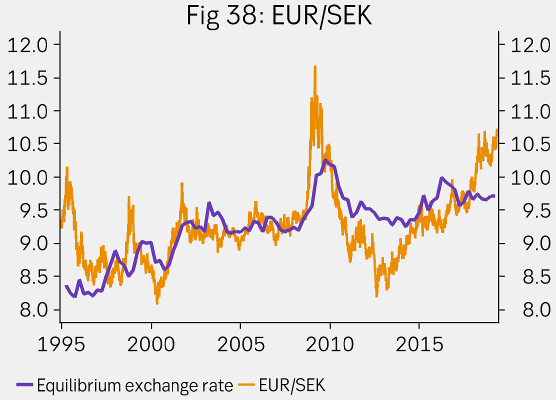
Fig 37: USD/SEK



Source: Bloomberg, SEB

The EUR/SEK equilibrium rate has changed in a similar way. Estimates suggest it is now around 9.70, compared to about 9.20 before the 2008 financial crisis and about 8.30 if we go back to 1996 (based on a weighted average of pre-euro currencies). A sizeable proportion of the deterioration has occurred in the past few years.

Fig 38: EUR/SEK

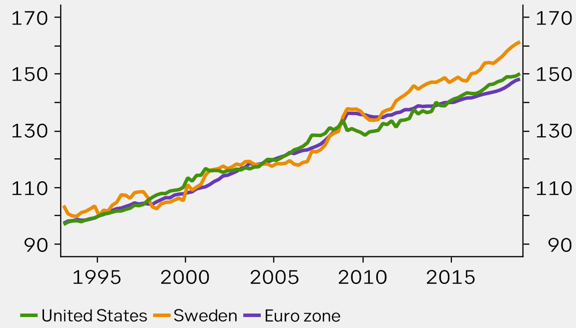


Source: Bloomberg, SEB

Similar factors behind depreciation against EUR and USD. A downward trend in real-term yields compared to other countries appears to be the most important explanation. Real-term yields on 10-year Swedish government bonds have trended lower against their euro zone and US equivalents. For example, the 10-year real-term yield was about 150 basis points above its euro equivalent in 1995; today it is more than 100 bps below. This is partly connected to the Riksbank's actions, but there are also underlying factors. For example, the krona's equilibrium exchange rate has weakened because Swedish unit labour costs – mainly wage costs adjusted for productivity gains – have increased much faster than in other countries. In the past 4-5 years, CPI has also been higher than in the euro zone, which should also lead to a somewhat weaker nominal exchange rate in terms of purchasing power parities (PPP). In the US, however, the CPI trend has been roughly the same as in Sweden. But Sweden's terms of trade have worsened compared to the US trend. This deterioration has been under way since 1995 and has resulted in Swedish terms of trade that are about 30 per cent worse against the US today.

Fig 39: Unit labour cost

Index 100=1995



Source: OECD

The krona is not undervalued against all currencies. Although our calculations suggest that the krona is still undervalued against most currencies, some – like the GBP, NOK and AUD – are apparently a bit undervalued against the krona. In trade-weighted terms, we believe the krona is about 8 per cent undervalued against other G10 currencies. Today's krona levels are thus not as extreme as they may first appear.

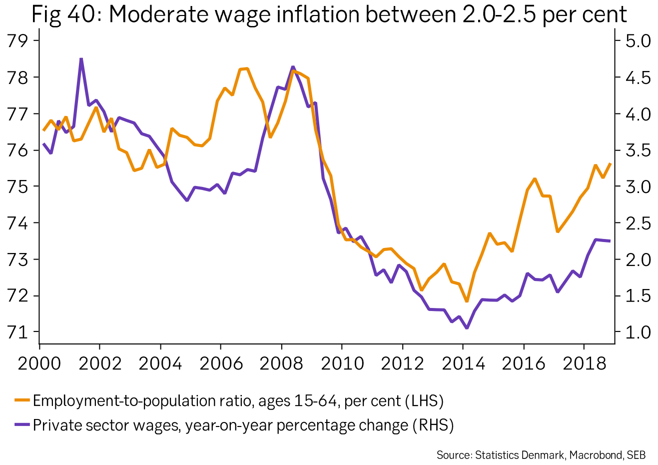
Less appreciation potential and a persistently weak SEK. To some extent, our new estimates change the way we interpret today's krona exchange rate. Given our conclusion that the Riksbank is not entirely to blame for the weak krona, the appreciation potential from today's EUR/SEK rate of around 10.60 is smaller than we previously thought. In the next few years, krona performance will greatly depend on what happens to economic growth inside and outside Sweden, as well as how the Riksbank chooses to shape its monetary policy. Based on our view of Swedish growth, inflation and the clear policy shift among major central banks globally, we believe the next rate hike will not occur until the summer of 2020. Given a continued negative key rate as well as continued negative spreads against most other currencies for another year, it is hard to see any potential for a turnaround this year in the trend towards an ever-weaker krona that has predominated since 2013. We thus expect continued krona depreciation, with the EUR/SEK rate approaching 11.00 this autumn and the USD/SEK rate around 10.00. We still believe the krona is undervalued and expect it to appreciate further ahead, but this assumes that the Riksbank will continue its slow policy normalisation in coming years while growth stabilises in the euro zone. If so, we expect EUR/SEK to fall to 10.20 by the end of 2020.

Denmark

Domestic strength prevails

Denmark's GDP growth recovered in Q4 2018, driven by net exports. The average 2018 growth rate of 1.4 per cent still underestimates the underlying trend, and we continue to forecast growth of 2 per cent in 2019. We expect a slowdown to 1.5 per cent in 2020 due to weaker global demand. The labour market has enough slack for several years of above-trend growth.

Fig 40: Moderate wage inflation between 2.0-2.5 per cent



Key data

Yearly change in per cent

	2017	2018	2019	2020
GDP	2.3	1.4	2.0	1.5
Consumer Price Index (CPI)	1.1	0.7	1.1	1.6
Wages	1.7	2.2	2.3	2.9
Public sector financial balance*	1.2	0.5	0.5	0.5
Public sector debt*	37.0	36.0	35.0	34.0
Current account*	8.0	6.0	7.5	7.0
Key interest rate (CD), %	-0.65	-0.65	-0.65	-0.65
EUR/DKK	7.46	7.46	7.46	7.46

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

The fourth quarter confirmed that previous GDP weakness was temporary. GDP growth for 2018 came in at 1.4 per cent, 0.3 percentage points higher than our previous forecast, but this still underestimates the underlying trend. According to Statistics Denmark, 2018 growth would increase by 0.4 per cent if a patent payment from 2017 is fully factored in. Furthermore, Q4/Q4 growth came in at 2.4 per cent. This is in line with our forecast of a gentler slowdown. Our GDP forecast for 2019 is unchanged at 2.0 per cent, while we have marginally lowered our forecast for 2020 from 1.7 per cent to 1.5 per cent, mainly due to lower international growth expectations.

Consumption drivers remain healthy, but consumers continue to save more. Despite strongly higher disposable income, private consumption rose less than 1 per cent in annualised terms in H2 2018. The savings ratio reached 12.6 per cent. The renewed increase in saving coincided with a decline in consumer confidence, propelled by a weaker assessment of the national economy, most likely due to the global backdrop of trade war fears and sinking stock prices. However, confidence has stabilised in 2019. While the surge in car sales in March is most likely front-loading ahead of a tax increase, stronger retail sales also suggest consumers are finally spending, and the latest lending survey shows that banks have stopped tightening lending conditions for households.

The housing market has lost steam. Although rising home prices add support to consumers, the rate of increase is modest, below 5 per cent, and the past couple of quarters it has been close to zero. However, the Q1 slump in mortgage rates is likely to bring buyers back and prevent a decline in prices, as well as allowing refinancing of existing loans that could support spending. More generally we see the absence of debt-financed spending as a sign of health, as it is the result of successful macroprudential policy that caps household debt despite low rates and high home prices.

Job creation is intact and employment remains a fundamental driver for growth, while wage inflation is moderate yet stable between 2.0-2.5 per cent. Wage inflation remains fundamentally low as there are no current signs of labour shortage. We reiterate our wage inflation forecast of 2.5-3.0 in 2020, as the labour market gradually improves. Danish core HICP inflation has increased and is now on par with euro zone inflation. A weaker trade-weighted DKK eased downward pressure on manufactured consumer goods, while service inflation remains stable.

Over the forecast period, we see little sign of an overheating economy. Danish competitiveness is strong, and we expect exports to drive growth alongside consumption following a mostly weak 2018. Weaker euro zone growth limits the upside, and the near-term risk to the Danish economy is weaker global demand. An accelerated slowdown could have domestic implications affecting credit conditions and income.

Danmarks Nationalbank made a second intervention in January to support a temporarily weak Danish krone. Since then the krone has returned to above 7.465 per euro: still on the weak side. We expect the DNB to mirror any action by the ECB and foresee no rate hikes in the near future. Fiscal policy is broadly supportive ahead of the general election which will be held on or before June 17. In our view, the difference in economic policy between the two main coalitions is negligible. Mild stimulus is likely no matter who wins.

The broad-based economic upswing continues without any pressing issues. Perhaps it can even handle a little more speed, with room left for consumers to increase spending further.

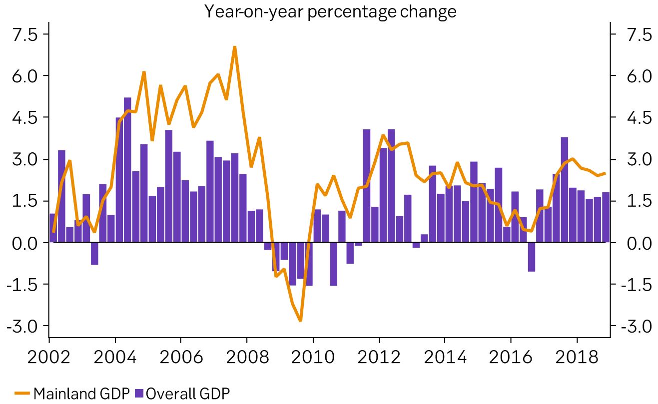
Norway

Defying the slowdown and dovishness abroad

Economic growth is set to accelerate, driven by higher investment on the continental shelf and putting Norway in a different position relative to other western economies. Petroleum activity is stimulating the broader business sector and private consumption, keeping domestic growth drivers intact. Underlying price pressure is rising and the positive output gap adds upside risks. Further monetary policy tightening is required to contain inflation near target in the coming years.

Fig 41: Norwegian economy in a cyclical upturn

Year-on-year percentage change



Source: Statistics Norway, Macrobond, SEB

Key data

Year-on-year percentage change

	2017	2018	2019	2020
GDP	2.0	1.4	2.2	2.7
Mainland GDP	2.0	2.2	2.6	2.2
CPI-ATE inflation	1.4	1.5	2.3	2.0
Annual wage and salary increases	2.3	2.8	3.2	3.6
LFS unemployment rate, %	4.2	3.9	3.7	3.6
Key interest rate, %	0.50	0.75	1.50	1.75
EUR/NOK exchange rate	9.82	9.90	9.30	8.90

Source: Statistics Norway, Norges Bank, SEB

Defying weakness abroad

The Norwegian economy is in a cyclical upturn and has so far defied the weakness stemming from abroad. Its momentum gathered speed at the end of 2018, with sequential growth in mainland GDP (excl. oil/gas and shipping) accelerating to 0.9 per cent (first quarter national accounts will be published on May 13). Growth is expected to accelerate further in 2019, driven by a sharp increase in investment on the Norwegian continental shelf. We forecast mainland GDP growth of 2.6 per cent in 2019. In 2020, higher interest rates will moderate the upturn, but growth is expected to remain above trend at 2.2 per cent. High petroleum sector activity will lift overall GDP to 2.2 per cent in 2019 and 2.7 in 2020.

Boost from petroleum. While global growth should downshift quite a bit in the current year and global events should add downside risks, domestic growth drivers remain intact. The petroleum sector, accounting for 18 per cent of the economy, puts Norway in a different position relative to trading partners. Sharply higher activity in the sector, with expected capital spending growth of 13 per cent in 2019, will add slightly less than one percentage point to overall GDP. This will also lend positive demand impulses to the mainland economy, stimulating the domestic business sector and private consumption via higher growth in employment and wages.

Resilient manufacturing. A large share of Norwegian manufacturing is to some extent exposed to petroleum. This explains why various survey-based business indicators have held up above their long-term averages. Manufacturers' assessments of order bookings and foreign demand are positive and capital spending plans are robust. High petroleum investment activity will underpin activity in the manufacturing sector in coming years, making Norway more resilient to weaker growth abroad. Moreover, despite Norway being a small and open economy, export dependency in the mainland economy is rather low. Excluding oil and gas, traditional goods only account for roughly 15 per cent of exports. We have lowered our forecast for business investment and exports of traditional goods only slightly, expecting growth of 3.9 and 3.8 per cent in 2019, respectively.

Domestic demand recovering. Mainland capital spending will lift growth in the coming years as the drag from residential investments vanishes. Following a 9 per cent contraction from autumn 2017, residential investment levelled out in the second half of 2018 and the annual decline was limited to 6 per cent. Housing starts have regained strength and we expect residential investment to grow by 1.4 per cent in 2019. The outlook for existing home prices remains cautiously optimistic. Supply has been fuelled by a high amount of completions but demand has been solid, resulting in a relatively balanced housing market. We expect yearly price gains of nearly 2.5 per cent in 2019 and 2020. Private consumption slowed over the second half of 2018, dented by stalling domestic spending on goods. Large swings in spending on electricity and autos have masked the underlying trend and a revival is expected during spring. Household real income will rise notably due to strong job and real wage growth, supporting confidence and spending ahead. We expect private consumption to grow by 2.5 per cent in 2019 before moderating slightly in 2020 as higher interest rates start to bite. The risk to the outlook is that Norges Bank is underestimating the strong transmission mechanism.

Rising domestic price pressure

Above-trend growth in the mainland economy and the upswing in the petroleum sector have resulted in a tight labour market. The registered jobless rate is below the level assessed to be consistent with price stability. Job growth was 1.6 per cent in late 2018 from a year earlier and employment expectations in various business surveys remain positive. As measured by the Labour Force Survey, the jobless rate is expected to decline to 3.6 per cent by 2020. Settlements in the private sector suggest economy-wide wage growth will accelerate to 3.2 per cent this year from 2.3 per cent in 2018. Tight labour market conditions and the solid outlook for mainland GDP are evidently putting pressure on available resources. According to Norges Bank the output gap closed last autumn and is expected to remain positive until the end of 2022. Domestic conditions point to rising price pressures and risks of a continued acceleration in underlying inflation.

Norges Bank needs the krone to appreciate to achieve the required policy tightening

Fig 42: CPI-ATE near target in coming years

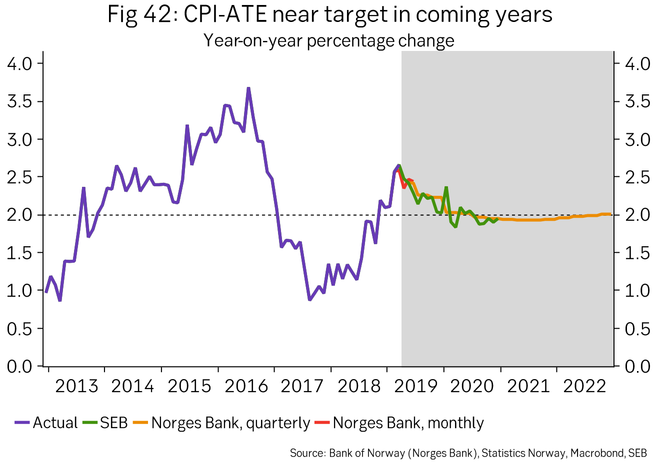
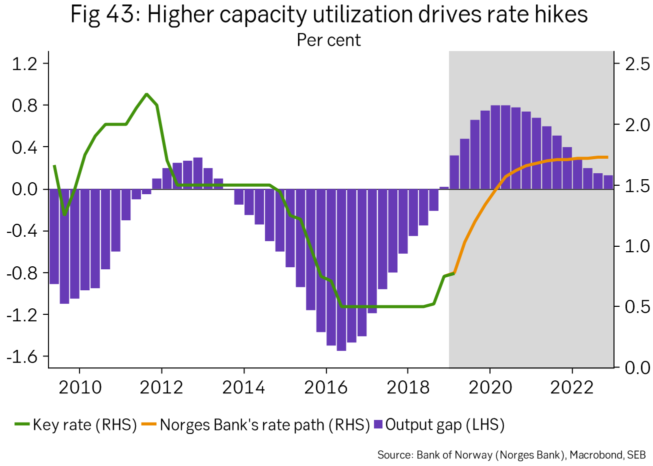


Fig 43: Higher capacity utilization drives rate hikes



Inflation remaining near target. Inflation has continued to surprise on the upside relative to both our and Norges Bank's forecasts. In March, CPI-ATE inflation (excluding taxes and energy) rose to 2.7 per cent, the highest level since the end of 2016. Rising prices for goods driven by the previous krone depreciation are the most important driving force behind the inflation upturn, but the increase is relatively broad-based with a significant rise in service inflation over the past six months. Accelerating wage growth suggest that a gradual increase in service prices is reasonable, but the recent upturn is strong relative to what wage developments imply. Combined with base effects, service inflation is expected to fall somewhat during the second half of this year. Goods prices will also contribute to slightly lower inflation in the coming months. The acceleration in clothing prices is explained by a shift in the seasonal pattern which should normalise in the spring, and unusually high food prices in March are likely to be reversed. Nonetheless, uncertainty about underlying inflationary pressures has increased. We forecast CPI-ATE inflation averaging 2.3 per cent in 2019. In 2020, service prices will accelerate again in line with rising wages, but moderately rising rents and low international prices will result in core inflation falling back towards the target. New price hikes for energy have delayed the fall in CPI, keeping the inflation rate above 2 per cent until mid-2020.

The last hawk standing. The slower economic trajectory abroad has put several global central banks' normalisation plans on hold, but Norges Bank is in a different situation due to the solid domestic outlook. Underlying price pressure in the economy is rising and the positive output gap adds upside risks. Norges Bank has lifted the key rate twice since September 2018 to 1.00 per cent, but further monetary policy tightening is required to contain inflation near the target in coming years. The rate path from the March Monetary Policy Report implied a front-loading of hikes. We believe economic developments will justify a rate hike in both June and December to 1.50 per cent by the end of 2019. Norges Bank is likely to slow the pace thereafter, with one rate hike before summer 2020.

Krone appreciation not an obstacle to hikes. Norges Bank has not conveyed any signs of being restrained by the softness expressed by its peers. The domestic-oriented policy focus suggests that the growth slowdown abroad must have clear negative implications for the Norwegian outlook for the central bank to adjust its policy outlook. The weak exchange rate has so far acted as a buffer. Looking ahead, Norges Bank will appear relatively hawkish and wider interest rate differentials against trading partners are likely to strengthen the krone. However, this is already incorporated in the rate path as the gradually stronger krone will dampen imported inflation. Put differently, Norges Bank needs the krone to appreciate to achieve the required policy tightening. If not, the weak krone would become an argument for faster or more rate hikes. We expect the EUR/NOK exchange rate to fall to 9.30 and 8.90 by the end of 2019 and 2020, respectively.

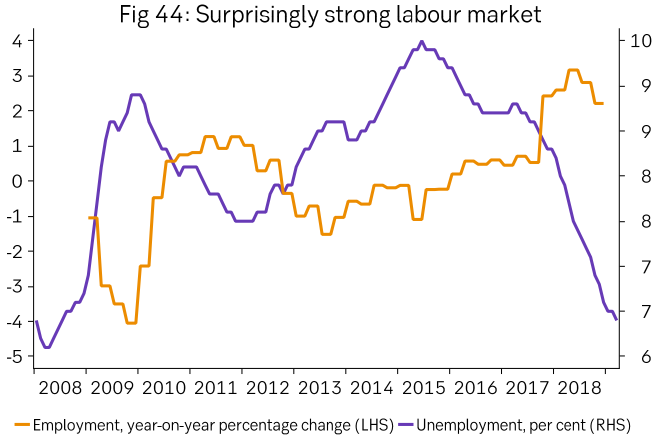
Widening yield spread. The market is discounting a rather cautious key rate outlook, suggesting that Norwegian interest rates will rise further when Norges Bank delivers. This will put upside pressure on Norwegian government bonds yields (NGBs). The divergent policy outlook compared to the the ECB should result in NGBs continue to trade with a historically large spread against their German equivalents. However, the favourable outlook for the krone and the large yield pick-up may trigger demand for NGBs, limiting the upturn in 10-year government yield. We forecast a 10-year yield spread against Germany of 170 basis points by the end of 2020.

Finland

Strong labour market despite weak exports

Economic growth has slowed due to sagging exports and manufacturing, but domestic demand is providing continued support. Although business sentiment has worsened, job growth is strong and domestic sectors are in a better mood. Some improvement in global demand, along with continued decent demand inside Finland, will ease the slowdown in 2019 and 2020. Fiscal policy will also help sustain demand, with the incoming government expected to shift towards more stimulus even though there is only limited room.

Fig 44: Surprisingly strong labour market



Source: Statistics Finland, Eurostat Database, Macrobond, SEB

Key data

Year-on-year percentage change

	2017	2018	2019	2020
GDP	2.7	2.3	1.8	1.9
HICP inflation	0.8	1.2	1.3	1.5
Unemployment *	8.6	7.4	6.4	6.0
Wages and salaries	-1.2	1.5	2.0	2.5
Public sector financial balance **	-0.8	-0.7	-0.6	-0.8
Public sector debt **	61.3	58.9	58.0	56.0

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

Weaker sentiment indicators in line with other countries. The Finnish economy decelerated in 2018 but still showed decent growth: similar to Sweden and well above Germany and the overall euro zone. Indicators point to near-term growth of some 2 per cent, which is also our forecast for 2019 and 2020, but the outlook is divergent. The European Commission's Economic Sentiment Indicator has fallen for over a year, as in the overall euro zone, primarily due to weak manufacturing and exports. Domestic sectors are more optimistic. The service sector foresees growth, and the construction sector has continued its upward trend of recent years.

Export weakness is behind decelerating growth. Exports decelerated mainly during the second half of 2018, while imports kept increasing at a healthy pace. Having been a major contributor to the recovery of recent years, foreign trade thus became a constraint on growth, which also widened the current account deficit. Decent global economic conditions will provide some help to Finnish exports, which we expect to increase by 2 per cent this year and 3 per cent in 2020. High imports combined with weaker final demand contributed to inventory build-up last year. This year we expect a shift, and inventory draw-downs will contribute nearly a negative 1 per cent of GDP to growth. Despite a hesitant manufacturing sector, capacity utilisation is relatively high and investment keeps increasing, though somewhat more slowly than in recent years, since companies' concerns about the economy have led to some caution. Capital spending is also supported by increased construction, and home prices will continue to rise slowly, mainly driven by the Helsinki region.

Strong labour market, but slowdown ahead. The Finnish labour market has recently surprised on the upside. Unemployment has continued to fall, and year-on-year job growth now exceeds 2 per cent: far faster than normally compatible with the prevailing growth environment. In March, unemployment was 6.4 per cent, only a few tenths above the previous low in 2008. We expect unemployment to reach its equilibrium level of around 6 per cent by the end of 2020. After a period when the 2016 Competitiveness Pact between government, employers and unions helped to keep wage and salary increases low, pressure is building for an acceleration. The rate of pay hikes is now some 2 per cent yearly and will speed up to more than 2.5 per cent next year. Rising employment and higher pay increases, combined with inflation of around 1-1.5 per cent, will provide decent real income increases in 2019-2020. Despite the strong labour market, household optimism has fallen. Some of the increase in incomes will probably be used to boost savings from today's low level. The upturn in consumption will thus reach only a bit above 1.5 per cent per year in 2019 and 2020.

New government will allow fiscal stimulus. Finland's April election re-drew the political map. The ruling Centre Party lost big, and all other major parties gained. The Social Democrats received the most votes by a narrow margin (before the far-right Finns Party) and will lead the first attempt to form a government. With no party getting more than 20 per cent of votes, and little desire to collaborate with the Finns, coalition-building may be tricky, yet the most likely outcome is a leftist-centrist coalition. After years of fiscal austerity and low pay increases, any incoming government will be under great pressure to implement stimulus measures. The public budget deficit has also fallen from more than 3 per cent of GDP in 2014 to less than 1 per cent, which increases manoeuvring room. The new government is nevertheless unlikely to diverge too much from earlier cautious policies. We do not expect stimulus to exceed 0.5 per cent of GDP in 2020. Public sector debt, which fell below 60 per cent of GDP last year for the first time since 2013, will thus continue down to 56 per cent in 2020.

The Baltics

The Baltic countries have been relatively resilient to the international deceleration. In 2018 their growth figures were among the highest in the euro zone. But looking ahead, a slowdown in GDP growth is unavoidable as exports weaken. If productivity growth cannot keep up with far faster pay hikes than those in major customer countries this may be become a problem in the longer run.

Estonia

15%

Upturn in construction since 2008. A decline in building permits and EU funding is leading to a downturn.

Page 44

Latvia

3.5%

2019 GDP growth forecast.
Fastest in the Baltics. Main driver is domestic demand. Low productivity growth is a challenge.

Page 45

Lithuania

12%

The transport sector's share of GDP.
This sector will be hurt by the EU's new Mobility Package, leading to a downturn in exports.

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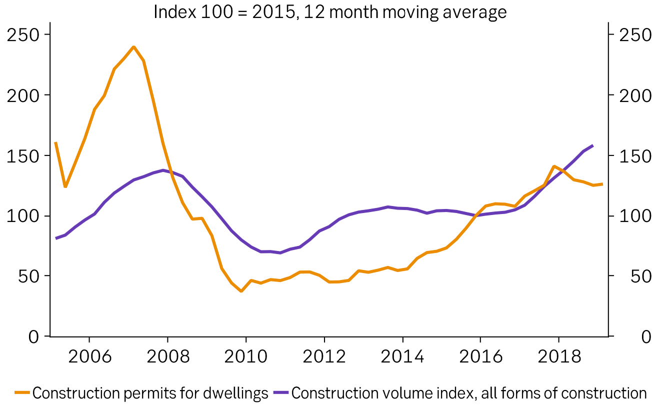
Estonia

A gradual slowdown

Both domestic and external factors will start to weigh down Estonia's economic growth. While private consumption continues to thrive due to full employment and rapid wage growth, demography is already dragging down construction volume. The slowdown in the main export markets and rapid growth in labour costs will have a negative effect on exports. We are sticking to our forecast that due to these factors, GDP growth will slow to 2.8 per cent in 2019 and decline further to 2.5 per cent in 2020.

Fig 45: Construction volume will start to decrease

Index 100 = 2015, 12 month moving average



Source: Statistics Estonia, Macrobond, SEB

Key data

Annual percentage change

	2017	2018	2019	2020
GDP	4.9	3.9	2.8	2.5
Private consumption	2.6	4.7	4.0	3.4
Exports	3.5	4.3	2.2	2.8
Consumer price index (CPI)	3.4	3.4	2.3	2.2
Wages and salaries	6.5	7.3	6.7	6.2
Public sector financial balance*	-0.4	-0.5	-0.2	-0.1
Public sector debt*	8.7	7.9	7,8	7,5
Current account	3.2	1.7	0.6	1.0

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

Slowing demand from trade partners will start to hinder exports. Despite weak economic growth in the euro zone, Estonia's exports held up well in the second half of 2018, increasing by almost 5 per cent in Q4. Yet it is difficult to imagine this trend continuing as the economies of its main trade partners slow. Finland, Sweden and Germany account for almost 40 per cent of total exports, and the average GDP growth in those three countries is around 0.6 per cent lower this year than in 2018. Risks are especially evident in the sectors related to the real estate market, such as sales of construction materials, prefabricated houses and furniture.

A slowdown is expected also in domestic construction. Construction volume peaked in 2018 at around 15 per cent higher than in 2007. A decline in the number of building permits implies lower activity in 2019, but the slowdown will be gradual. The outlook for the construction market will become more troublesome in the longer term due to the significant population decline in the younger age cohorts as well as reduced EU funding for public investment projects. The effect on the economy is being softened by the fact that the high construction volume of recent years was sustained largely because of the increased use of foreign labour. Unlike the pre-financial crisis era, this has prevented a large shift of labour to construction from other sectors.

The main driver of the economy in 2019 and 2020 will be strong private consumption. Fast wage and salary growth, paired with large tax refunds, will give households confidence to continue their shopping spree. Consumer confidence has recovered from a temporary dip at the end of last year, and recession worries seem less visible in the media. Household spending will also benefit from lower inflation. After surging energy prices and hikes in excise duties in recent years, inflation will finally ease. Stronger oil prices will nevertheless hold inflation above 2 per cent, pushing our forecast for CPI growth to 2.3 per cent for the year.

Booming labour market shows little change. In Q4 2018, Estonia boasted the highest employment rate among the EU countries with 69.3 per cent of the population aged 15-74 being employed. Large inflows of foreign labour, mainly from Ukraine, have helped to balance the situation. Yet wage growth in a tight market has been substantial, with average pay increasing by 7.3 per cent last year. Looking ahead, Estonia's meagre productivity gains will start to change the picture. Large layoffs have already been announced by businesses unable to bear increased costs. This will cause the unemployment rate to increase slightly, but the changes will not be dramatic. Wage growth will nevertheless remain strong, and average monthly pay could reach almost EUR 1,400 this year.

The political climate has changed substantially. The aftermath of the parliament election held in March was surprising, as the winning Reform Party failed to form a government and a coalition has been set up instead by the left-leaning Centre Party and two right-wing parties. While the coalition agreement remains vague in many areas, one thing that is clear is that the 2nd pension pillar will be reformed, allowing people to take out their savings or transfer them to their investment account. This threatens to generate excessive growth in private consumption, while increasing the probability of future tax increases to support the country's ageing population. The new government also seems more willing to tolerate budget deficits and issue public debt in order to boost social benefits and carry out large-scale infrastructure investments. The nationalist party in the new government has fiercely criticised the inflow of foreign labourers, which may put further pressure on the labour market and have a negative effect on Estonia's reputation as an open and welcoming business environment.

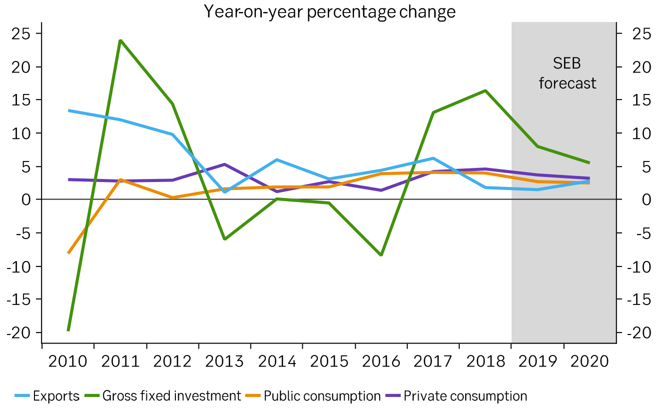
Latvia

Robust domestic demand, weak exports

The economic outlook remains positive, although growth will slow down from 4.8 per cent last year to 3.5 per cent in 2019, mainly driven by resilient domestic demand. The start of the year has seen weakening conditions for export growth. In the second half of 2019, exports should rebound. The labour market will become even tighter, though wage growth may slow somewhat. Inflation is expected to be slightly higher than last year.

Fig 46: Investment activity had peaked

Year-on-year percentage change



Source: Latvian Central Statistical Bureau

Key data

Yearly change in per cent

	2017	2018	2019	2020
GDP	4.6	4.8	3.5	3.2
Private consumption	4.2	4.6	3.9	3.5
Exports	6.2	1.8	1.5	2,8
Consumer Price Index (CPI)	2.9	2.5	2.8	2.4
Wages and salaries	7.9	8.4	7.0	6.5
Public sector financial balance*	-0.6	-1.0	-0.9	-0.8
Public sector debt*	40.0	35.9	33.5	32.0
Current account*	0.7	-1.0	-1.5	-1.6

* Per cent of GDP Source: Latvia CSB, SEB

Shifting towards domestic consumption. As export conditions have weakened, economic activity this year will shift towards domestic consumption. Latvia's growth will moderate to 3.5 per cent. Despite increased uncertainty, overall economic sentiment has remained stable so far this year. In March, sentiment weakened a bit in manufacturing and retail, but improved in services and construction as well as among consumers.

Temporary weakness in exports and production. Facing headwinds, export volume stagnated in January and February. Uncertainty and factors holding down global trade will abate and growth will resume. Another drag on growth is falling industrial output. In the first two months, output was down by 2.5 per cent. This was due to base effects in electricity and gas supply, which was driven by extremely favourable conditions last year. Manufacturing surprised on the upside, growing by 4.7 per cent and showing overall good resilience. However, some manufacturing sectors such as apparel are shrinking, since surging labour costs are eroding the existing business model. With mounting cost pressures, more and more industries will face similar challenges.

Somewhat weaker wage and salary growth. In 2018 wages rose by 8.4 per cent. The median wage was up by 9.5 per cent. Slower productivity growth and surging pay levels will continue to shrink profits. This year, wage growth will slow to 7 per cent and average gross wages will reach to EUR 1,100. Structural shortages and skills mismatches in the labour market are becoming more evident each year. We forecast that unemployment will drop to 6.1 per cent by the end of 2019 and to 5.6 per cent next year.

Questions about spare capacity in construction. With growth of 22 per cent in 2018, construction will stay at the centre of economic activity. This year construction volume will be up by around 13 per cent. Questions remains about spare capacity and what measures can be taken to improve efficiency in order to manage surging costs. We expect the information and communication technology (ICT) sector to be a key driver of growth and employment during our forecast period. Investment growth will be half that of last year – 8 per cent. Current trends in the transport and storage sectors point to a small positive GDP contribution.

Robust consumption. Weak retail data in January raised some worries that consumers are becoming cautious, but the 5.9 per cent increase in February eased these concerns. Positive sentiment and rising real incomes will boost private consumption by 3.9 per cent this year.

Inflation at current levels. Inflation stood at 2.8 per cent in March. Higher utility costs have become the main factor contributing to inflation as limited competition and favourable economic conditions make it easier for providers to shift costs to consumers. Another factor is the higher excise tax. The latest oil price developments signal potential upward pressure later this year. Food prices are expected to keep climbing moderately, though swine fever in China and signs of drought may cause skyrocketing prices for certain foods. Our inflation forecast is 2.8 per cent in 2019 and 2.4 per cent in 2020. Last year the budget deficit was 1 per cent of GDP. Government debt fell from 40 per cent to 36 per cent of GDP. Plans to move gradually towards a balanced budget will be challenged by slower growth and recently launched reforms. Nearly four months after elections the Parliament approved the new government in January. A five-party centre-right coalition headed by Krišjānis Kariņš (New Unity party) has a chance to serve a full four-year period.

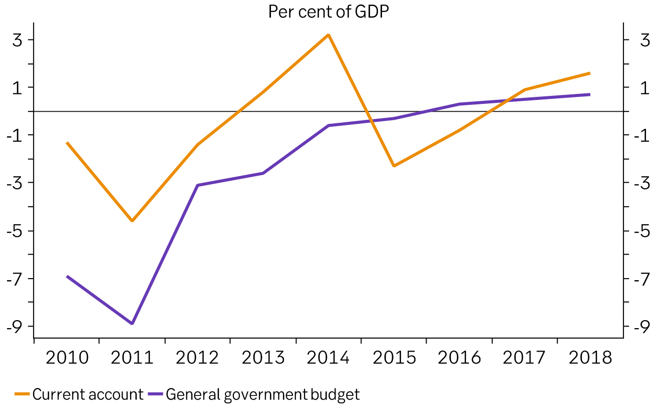
Lithuania

Gentle moderation in growth

The economy has so far managed quite well to withstand the deteriorating situation among major euro zone countries. In the past year, industrial confidence has been largely unchanged and consumer confidence has even improved. Domestic demand is still the major factor for growth this year, supported by higher employment and rapid growth in real wages, but productivity growth is significantly lagging behind higher labour costs. Government fiscal policy is slightly expansionary this year.

Fig 47: Twin surpluses persist

Per cent of GDP



Källa: Statistics Lithuania

Key data

Year-on-year percentage change

	2017	2018	2019	2020
GDP	4.1	3.5	3.2	2.4
Household consumption	3.4	3.9	4.0	3.2
Exports	13.6	5.1	3.6	2.8
Consumer Price Index (CPI)	3.7	2.5	2.5	2.5
Wages and salaries	8.2	9.9	8.2	6.5
Unemployment	7.1	6.2	6.0	5.9
Public sector fiscal balance*	0.5	0.7	0.3	0.1
Public sector debt*	39.4	34.2	37.4	36.9

* Per cent of GDP. Source: Statistics Lithuania.

Strong performance despite euro zone weakness. Recent monthly macroeconomic figures have been surprisingly strong despite sluggish growth in major euro zone countries. Manufacturing output was up by 5.2 per cent year-on-year in Q1 2019 and capacity utilisation remained virtually unchanged. However, it will be rather difficult to maintain a similar growth pace in the coming quarters if the economic situation does not improve abroad. After strong first quarter growth we revise our 2019 forecast higher to 3.2 per cent and keep 2020 unchanged at 2.4 per cent.

Tax reform boosts net wages. Private consumption will increase by 4.0 per cent in 2019, supported by still rapid growth in real wages. However, growth in household expenditures will slow to 3.2 per cent in 2020. Although average gross wages and salaries in Lithuania will rise at a slower pace, net wages will jump even more due to the effects of the tax reform implemented in 2019. Wages will rise more for public sector employees as the result of already approved measures from the government. The average old-age pension has already increased by 13 per cent and universal child benefit went up from 30 to 50 euros this year. However, income inequality remains very high in Lithuania and government efforts to reduce it are having only a minor effect.

Unemployment will fall more gradually ahead. Unemployment decreased to 6.2 per cent in 2018 and job growth totalled 1 per cent. However, we expect that the drop in unemployment will decelerate in the next two years. The number of temporary workers from Ukraine keeps increasing, but the future trend in employing foreigners will depend on the final version of the EU's Mobility Package for international road transport. Besides, Lithuania's net external migration balance has finally become positive this year and has started supporting the labour market.

Inflation will stay close to 2.5 per cent. Increased competition between the largest grocery retail chains, favourable tendencies in global food prices, and the drop in apparel and footwear prices has helped contain inflation in the last several months. However, labour costs keep rising at close to a double-digit rate and that will naturally keep pushing prices of services up further.

EU legislation to dampen service exports. At the beginning of April, Lithuania's transport sector, which accounts for 12 per cent of GDP, got bad news from the European Parliament, which voted in favour of the Mobility Package. The controversial changes will dampen the competitiveness of Lithuania hauliers in Western Europe, with the largest impact on small domestic road transport companies. If the final version of this legislation does not change, it is certain to reduce Lithuania's exports of services.

Rising activity in the real estate market. Higher income and stronger household sentiment boosted the activity in the residential real estate market. In the capital Vilnius, the number of apartments sold was up by 15 per cent and the average price rose nearly 5 per cent year-on-year in Q1 2019. Higher mortgage rates and a larger supply of new apartments will limit the increase in housing prices.

Budget surplus in 2019 and 2020. In 2018, the general government fiscal surplus was better than expected at 0.7 per cent of GDP, mainly due to the delay in public investments and EU support distribution. This year fiscal policy is slightly expansionary due to the implementation of a tax reform that aims to reduce the "tax wedge" for average wage earners. The government expects to compensate budgetary losses with additional income from better tax administration, but that is rather an ambitious task. Proposals to increase the role of recurrent property and car taxation are not getting much attention from the government. We expect the budget balance to be slightly above zero in 2019 and 2020.

Key indicators

Global key indicators

Yearly change in per cent

	2017	2018	2019	2020
GDP OECD	2.5	2.3	1.9	1.7
GDP world (PPP)	3.8	3.7	3.3	3.5
CPI OECD	2.2	2.6	2.0	2.1
Oil price, Brent (USD/barrel)	55	72	70	75

US

Yearly change in per cent

	2018 level, USD bn	2017	2018	2019	2020
Gross domestic product	20,865	2.2	2.9	2.3	1.7
Private consumption	14,188	2.5	2.6	2.4	1.9
Public consumption	3,569	-0.1	1.5	1.4	1.1
Gross fixed investment	3,766	4.9	5.5	2.7	2.1
Stock building (change as % of GDP)		0.0	0.1	0.0	0.0
Exports	2,541	3.0	4.0	2.7	2.6
Imports	3,200	4.6	4.5	2.3	2.6
Unemployment (%)		4.4	3.9	3.6	3.8
Consumer prices		2.1	2.5	1.8	2.2
Core CPI		1.8	2.1	2.1	2.2
Household savings ratio (%)		6.7	6.9	6.9	7.0
Public sector financial balance, % of GDP		-3.8	-4.6	-4.7	-4.8
Public sector debt, % of GDP		105.8	106.4	108.5	109.1

Euro zone

Yearly change in per cent

	2018 level, EUR bn	2017	2018	2019	2020
Gross domestic product	11,574	2.4	1.9	1.1	1.4
Private consumption	6,230	1.6	1.3	1.2	1.3
Public consumption	2,344	1.1	1.1	1.0	1.0
Gross fixed investment	2,430	2.6	3.3	2.0	2.0
Stock building (change as % of GDP)	0	0.0	0.1	0.0	0.0
Exports	5,539	5.2	3.1	2.9	3.3
Imports	5,038	3.9	3.1	3.5	3.5
Unemployment (%)		9.1	8.2	7.6	7.4
Consumer prices		1.5	1.8	1.4	1.5
Core CPI		1.0	1.0	1.1	1.3
Household savings ratio (%)		6.3	6.2	6.0	6.0
Public sector financial balance, % of GDP		-1.0	-0.5	-0.7	-0.8
Public sector debt, % of GDP		87.1	85.1	84.8	82.9

Other large countries

Yearly change in per cent

	2018	2018	2019	2020
GDP				
United Kingdom	1.8	1.4	1.3	1.4
Japan	1.7	0.8	1.0	0.8
Germany	2.2	1.4	0.7	1.2
France	2.2	1.6	1.2	1.3
Italy	1.7	0.9	0.2	0.9
China	6.8	6.6	6.3	6.1
India	6.9	7.4	7.4	7.0
Brazil	1.1	1.1	2.1	2.6
Russia	1.6	2.3	1.6	2.0
Poland	4.8	5.1	4.0	3.2
Inflation				
United Kingdom	2.7	2.5	1.7	1.8
Japan	0.5	1.0	1.0	1.3
Germany	1.5	1.7	1.8	1.8
France	1.2	1.9	1.5	1.7
Italy	1.3	1.3	1.0	1.2
China	1.6	2.1	1.9	1.5
India	3.3	4.0	3.5	4.1
Brazil	3.5	3.7	4.0	4.2
Russia	3.7	2.9	5.0	4.1
Poland	2.0	1.7	2.0	2.5
Unemployment (%)				
United Kingdom	4.4	4.1	3.9	3.9
Japan	2.8	2.5	2.2	2.0
Germany	3.8	3.4	3.4	3.6
France	9.1	8.9	8.6	8.4
Italy	11.3	10.6	10.2	9.9

Financial forecasts

Official interest rates		02-May	Jun-19	Dec-19	Jun-20	Dec-20
US	Fed funds	2.50	2.50	2.50	2.50	2.50
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10
Euro zone	Refi rate	0.00	0.00	0.00	0.00	0.00
United Kingdom	Repo rate	0.75	0.75	0.75	1.00	1.00
Bond yields						
US	10 years	2.55	2.45	2.25	2.20	2.10
Japan	10 years	-0.05	-0.05	0.00	0.00	0.00
Germany	10 years	0.02	0.00	0.15	0.25	0.35
United Kingdom	10 years	1.20	1.20	1.35	1.55	1.65
Exchange rate						
USD/JPY		112	108	105	102	100
EUR/USD		1.12	1.10	1.13	1.16	1.18
EUR/JPY		125	119	119	118	118
EUR/GBP		0.86	0.83	0.83	0.84	0.86
GBP/USD		1.30	1.33	1.36	1.38	1.37

Sweden

Yearly change in per cent

	2018 level, SEK bn	2017	2018	2019	2020
Gross domestic product	4,791	2.1	2.3	1.6	1.7
Gross domestic product, working day adjustment		2.4	2.4	1.6	1.5
Private consumption	2,113	2.2	1.2	1.7	1.7
Public consumption	1,252	0.0	0.9	0.2	0.1
Gross fixed investment	1,214	6.0	3.3	2.0	2.2
Stock building (change as % of GDP)	47	0.1	0.4	0.0	0.0
Exports	2,249	3.2	3.5	2.8	2.6
Imports	2,085	4.8	2.9	2.4	2.0
Unemployment, (%)		6.7	6.3	6.3	6.3
Employment		2.3	1.8	1.1	0.7
Industrial production		4.5	4.1	2.5	2.0
CPI		1.8	2.0	1.9	1.7
CPIF		2.0	2.1	1.9	1.5
Hourly wage increases		2.3	2.5	2.6	3.2
Household savings ratio (%)		15.1	17.1	17.0	17.3
Real disposable income		1.8	2.9	1.8	2.1
Current account, % of GDP		2.8	2.0	2.5	3.0
Central government borrowing, SEK bn		-62	-80	-130	-5
Public sector financial balance, % of GDP		1.4	0.9	0.7	0.5
Public sector debt, % of GDP		40.8	38.8	34.6	34.0

Financial forecasts	02-May	Jun-19	Dec-19	Jun-20	Dec-20
Repo rate	-0.25	-0.25	-0.25	-0.25	0.00
3-month interest rate, STIBOR	-0.07	-0.05	-0.15	-0.05	0.10
10-year bond yield	0.35	0.30	0.40	0.65	0.80
10-year spread to Germany, bps	33	30	25	40	45
USD/SEK	9.56	9.82	9.65	9.05	8.64
EUR/SEK	10.69	10.80	10.90	10.50	10.20
KIX	123.5	126.2	127.1	122.0	118.1

Finland

Yearly change in per cent

	2018 level, EUR bn	2017	2018	2019	2020
Gross domestic product	242	2.7	2.3	1.8	1.9
Private consumption	125	1.5	1.4	1.6	1.7
Public consumption	53	-0.4	1.4	1.5	1.0
Gross fixed investment	53	4.3	3.2	3.0	3.0
Stock building (change as % of GDP)	0	-0.5	1.7	-0.9	0.0
Exports	91	7.7	1.5	2.0	3.0
Imports	92	3.8	4.2	0.0	2.7
Unemployment, OECD harmonised (%)		8.6	7.4	6.4	6.0
CPI, harmonised		0.8	1.2	1.3	1.5
Hourly wage increases		-1.2	1.5	2.0	2.5
Current account, % of GDP		-0.3	-1.9	-1.5	-1.5
Public sector financial balance, % of GDP		-0.8	-0.7	-0.6	-0.8
Public sector debt, % of GDP		61.3	58.9	58.0	56.0

Norway

Yearly change in per cent

	2018 level, NOK bn	2017	2018	2019	2020
Gross domestic product	3,226	2.0	1.4	2.2	2.7
Gross domestic product (Mainland)	2,828	2.0	2.2	2.6	2.2
Private consumption	1,473	2.2	2.0	2.5	2.4
Public consumption	790	2.5	1.5	1.9	1.6
Gross fixed investment	826	3.6	0.9	4.5	2.3
Stock building (change as % of GDP)		0.1	0.5	-0.4	0.0
Exports	1,087	-0.2	-0.8	2.2	4.1
Imports	1,074	1.6	0.9	2.8	2.3
Unemployment (%)		4.2	3.9	3.7	3.6
CPI		1.9	2.8	2.7	2.0
CPI-ATE		1.4	1.5	2.3	2.0
Annual wage increases		2.3	2.8	3.2	3.6

Financial forecasts	02-May	Jun-19	Dec-19	Jun-20	Dec-20
Deposit rate	1.00	1.25	1.50	1.75	1.75
10-year bond yield	1.71	1.75	2.00	2.05	2.05
10-year spread to Germany, bps	169	175	185	180	170
USD/NOK	8.75	8.64	8.23	7.84	7.54
EUR/NOK	9.79	9.50	9.30	9.10	8.90

Denmark

Yearly change in per cent

	2018 level, DKK bn	2017	2018	2019	2020
Gross domestic product	2,218	2.3	1.4	2.0	1.5
Private consumption	1,059	2.1	2.3	1.7	1.9
Public consumption	546	0.7	0.8	1.0	0.9
Gross fixed investment	492	4.7	5.1	1.9	3.8
Stock building (change as % of GDP)		-0.1	0.1	-0.2	0.0
Exports	1,213	3.7	0.6	2.8	2.7
Imports	1,094	3.6	2.8	1.6	4.0
Unemployment, OECD harmonised (%)		5.4	5.2	4.5	4.2
CPI, harmonised		1.1	0.7	1.1	1.6
Hourly wage increases		1.7	2.2	2.3	2.9
Current account, % of GDP		8.0	6.0	7.5	7.0
Public sector financial balance, % of GDP		1.2	0.5	0.5	0.5
Public sector debt, % of GDP		37.0	36.0	35.0	34.0

Financial forecasts	02-May	Jun-19	Dec-19	Jun-20	Dec-20
Lending rate	-0.65	-0.65	-0.65	-0.65	-0.65
10-year bond yield	0.09	0.05	0.20	0.30	0.40
10-year spread to Germany, bps	7	5	5	5	5
USD/DKK	6.68	6.78	6.60	6.43	6.32
EUR/DKK	7.47	7.46	7.46	7.46	7.46

Lithuania

Yearly change in per cent

	2018 level, EUR bn	2017	2018	2019	2020
Gross domestic product	45	4.1	3.5	3.2	2.4
Private consumption	28	3.4	3.9	4.0	3.2
Public consumption	7	-0.4	0.8	1.0	0.8
Gross fixed investment	9	6.8	6.5	6.0	5.0
Exports	37	13.6	5.1	3.6	2.8
Imports	36	12.0	4.3	4.7	3.9
Unemployment (%)		7.1	6.2	6.0	5.9
Consumer prices		3.7	2.5	2.5	2.5
Public sector financial balance, % of GDP		0.5	0.7	0.3	0.1
Public sector debt, % of GDP		39.4	34.2	37.4	36.9

Latvia

Yearly change in per cent

	2018 level, EUR bn	2017	2018	2019	2020
Gross domestic product	30	4.6	4.8	3.5	3.2
Private consumption	17	4.2	4.6	3.9	3.5
Public consumption	5	4.1	4.0	2.7	2.5
Gross fixed investment	7	13.1	16.4	8.0	5.5
Exports	17	6.2	1.8	1.5	2.8
Imports	18	8.9	5.1	5.2	5.2
Unemployment (%)		8.7	7.4	6.4	5.8
Consumer prices		2.9	2.5	2.8	2.4
Public sector financial balance, % of GDP		-0.6	-1.0	-0.9	-0.8
Public sector debt, % of GDP		40.0	35.9	33.5	32.0

Estonia

Yearly change in per cent

	2018 level, EUR bn	2017	2018	2019	2020
Gross domestic product	26	4.9	3.9	2.8	2.5
Private consumption	13	2.6	4.7	4.0	3.4
Public consumption	5	0.6	0.3	1.8	1.8
Gross fixed investment	6	12.5	3.3	3.6	2.0
Exports	19	3.5	4.3	2.2	2.8
Imports	18	3.6	6.1	4.2	3.4
Unemployment (%)		5.8	5.4	5.9	6.3
Consumer prices		3.4	3.4	2.3	2.2
Public sector financial balance, % of GDP		-0.4	-0.5	-0.2	-0.1
Public sector debt, % of GDP		8.7	7.9	7.8	7.5

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