Macro Research - January 21, 2014

Swedbank Economic Outlook

Global growth at different speeds raises policy-making stakes

Global growth divergence increases with the US and UK pulling ahead. A global economy at different speeds raises the demand on policy making.

The Swedish economy will recover in 2014 before gearing down in 2015. Economic policy will tighten, household demand squeezed by raised interest rates, and export demand is lacklustre.

The growth in the Baltic economies will be quite robust and broad-based. The main challenges lie in the labour markets, which are heating up gradually.

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Executive Summary

Increased global economic divergence…

Global economic developments during the autumn and winter have been characterised by increasing divergence. While several political hurdles have been cleared in the US and the economy has performed better than expected, uncertainty in the euro area is still high, not least regarding monetary policy and financial sector reforms. In China, the financial markets have been volatile, but the political will to implement market-oriented reforms has strengthened. Other emerging market economies, in particular those with large external imbalances, struggled in the aftermath of the strengthened dollar, but appear to be slightly better prepared for the ongoing tightening of US monetary policy. In the Nordic area, the Finnish economy contracted by more than expected due to remaining structural challenges, while growth in Denmark appears to be picking up. The Norwegian economy was hit by slowing domestic demand owing both to weaker private consumption and a slowdown in investments.

…poses challenges for policymakers

Our global outlook remains roughly unchanged, with a gradual increase in overall growth to 4%. However, between countries we make some significant revisions. We raise growth forecasts for the US and UK economies for 2014, based on the strong finish in 2013 and better growth conditions. Still, this is to some extent a rebound from the weak 2013, and, to raise growth in a sustainable fashion, reforms and more fiscal stimulus would be needed. Within the euro area, growth is expected to continue to strengthen moderately in Germany, while the outlook for France and Italy has worsened. We are revising down growth expectations for the main emerging market economies due to the increased global interest and exchange rate volatility, and due to lower demand fromn China. With the downward revision of the growth forecast for the emerging economies, risks have become more balanced, but also more tilted towards the euro area. Economic recovery at different speeds will test policymakers' ability to adapt to changing conditions. We also discuss the longer-term impact of the ongoing technological changes and urbanisation on policy and the labour market.

After a weak performance in 2013, we expect that growth in the Swedish economy will strengthen in 2014. Growth is driven by domestic demand as investments and household consumption pick up, while export will be squeezed by a weak eurozone, We expect the Riksbank to raise the policy rate at end-2014, but that low international interest rates and household income sentivity to interest rate increases will dampen the hiking pace. A less expansionary economic policy in 2015 will hold down growth rates in 2015.

Robust growth in the Baltics, but risks from labour market

The Baltic countries are expected to experience quite robust growth during the forecast period The growth will be broad-based with the main contribution coming from private consumption fuelled, besides other factors, by rapidly rising wages. Falling unemployment rate and persisting or even escalating wage pressures pose risks for labour market overheating. Balancing wage and productivity growth is crucial to reduce risks of growth driven by excessive consumption and deterioration in external price competitiveness that would result in economic slowdown. Lithuania, after joining the euro area in 2015 (according to our baseline scenario) will link the Baltic countries to the same boat using the same currency.

Macroeconomic indicators, 2012 - 2015

	2012	2013e	2014f	2015f
Real GDP, annual change in %				
Sweden (calender adjusted)	1.3	1.0	3.2	2.7
Estonia	3.9	1.0	3.0	3.7
Latvia	5.0	4.4	4.8	4.5
Lithuania	3.7	3.3	3.7	4.2
Unemployment rate, % of labour force				
Sweden	8.0	8.0	7.7	7.3
Estonia	10.2	8.6	8.3	7.9
Latvia	15.0	11.8	10.4	9.3
Lithuania	13.4	11.7	10.0	9.0
Consumer price index, annual change in %				
Sweden	0.9	0.0	0.6	2.5
Estonia	3.9	2.8	2.6	2.9
Latvia	2.3	0.0	2.5	2.8
Lithuania	3.1	1.0	1.5	3.0
Current account balance, % of GDP				
Sweden	6.6	6.3	6.3	6.3
Estonia	-1.8	-2.1	-2.2	-2.3
Latvia	-1.7	-0.3	-0.8	-1.5
Lithuania	-0.2	0.0	-1.8	-3.5

Sources: National statistics authorities and Swedbank.

Global Outlook

The global outlook is characterised by strong performance by a few but large economies (the US, the UK, and Germany) and by the continued struggling of many others. This leads to a number of conflicting developments that will test policymaking dexterity in all countries. Global growth is expected to rise moderately and financial markets gradually to adapt, but the risk of volatile developments should not be ruled out.

US and UK pull ahead, euro area lags

Our global macroeconomic outlook remains cautiously optimistic, and we expect global growth to gradually increase by 3.8% 2015. Although 2013 was characterised by many seemingly false starts, data at the end of the year suggest that growth is picking up. However, it is an uneven development. Both the US and UK economies have performed significantly better than expected, and we raise our growth forecasts for 2014; however, we remain cautious concerning how sustainable the higher growth rates are. Disparity is expected to increase in the euro area, with Germany the main source of growth, while the growth forecasts for France and Italy are revised down. Also, the outlook for the Nordic economies is moderate, with growth forecasts for Norway and Finland revised down, while the outlook for the Danish economy is slightly better. Amongst emerging market economies, we expect that reforms in China will keep growth below 7% in 2014, and other emerging economies will struggle in the near term.

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

	2012	2013e		2014f		2015f	
USA	2.8	1.9	(1.6)	3.2	(2.7)	3.1	(3.2)
EMU countries	-0.6	-0.4	(-0.4)	1.1	(1.2)	1.9	(1.8)
Germany	0.9	0.6	(0.5)	2.1	(1.9)	2.2	(2.0)
France	0.0	0.1	(0.2)	0.6	(1.0)	1.9	(1.9)
Italy	-2.6	-1.9	(-1.9)	0.1	(0.6)	1.4	(1.5)
Spain	-1.6	-1.2	(-1.3)	0.9	(0.8)	1.8	(1.8)
Finland	-0.8	-1.2	(-0.6)	0.8	(1.0)	1.8	(1.8)
UK	0.2	1.9	(1.2)	2.9	(1.9)	2.4	(2.6)
Denmark	-0.4	0.4	(0.4)	2.0	(1.7)	2.1	(1.9)
Norw ay	3.3	1.8	(1.7)	1.7	(2.0)	2.1	(2.0)
Japan	1.4	1.7	(2.0)	1.8	(1.9)	0.9	(0.9)
China	7.8	7.7	(7.4)	6.9	(7.3)	7.1	(7.1)
India	5.1	4.0	(4.7)	6.3	(5.7)	5.8	(7.3)
Brazil	1.0	2.4	(3.4)	2.8	(4.0)	3.9	(4.1)
Russia	3.5	1.3	(1.3)	2.0	(2.8)	2.3	(2.8)
Global GDP in PPP [2/]	3.0	2.8	(2.8)	3.5	(3.5)	3.8	(3.9)
Global GDP in i US$	2.5	2.3	(2.3)	3.0	(3.0)	3.4	(3.5)

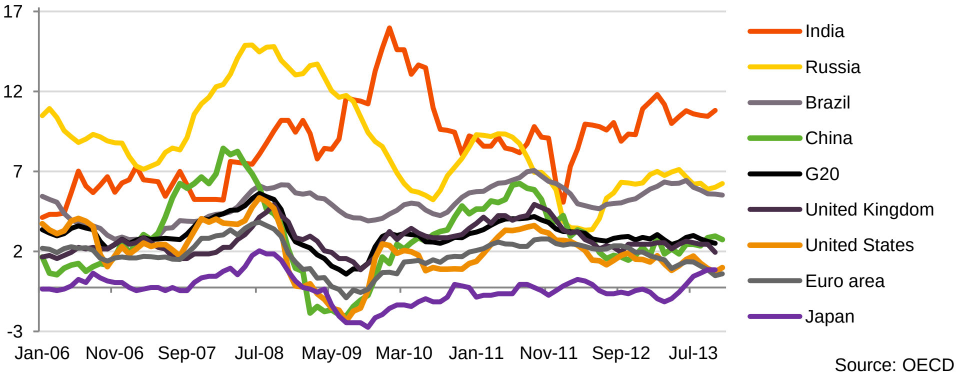
1/ October 2013 forecast in parenthesis; Countries representing around 70 % of the global economy.

2/ Weights from World Bank 2011 have been used. Sources: National statistics and Swedbank.

Despite downward pressures, global inflation stable

A key theme in the report is the declining inflation, most notably in developed economies. At end-2013, headline inflation fell back in both the US and the euro area, and the risk for deflation was once again raised. Global inflation pressures will be muted, not least due to low resource utilisation, stable commodity prices, and technical development stimulating competition. On the other hand, a steady increase in global growth will raise demand, not least for food commodities, and capital depreciation and growing structural unemployment have likely led to an overestimation of the amount of available resources. Also, the recent dip in inflation was mainly explained by the drops in the US and euro area, while inflation in other large economies (such as Japan, India, Russia, and Brazil) are either rising or remain at elevated levels. Overall, G20 inflation has remained fairly stable, at around 3% since early 2010.

Annual inflation rate in selected G20 countries (%)



Source: OECD

Policymaking skills will be essential

Policymakers will face significant challenges in the years to come to adapt to sudden, volatile, and sometimes-conflicting changes in the economy. In the US, the main short-term focus is on rising market interest rates, which, given the still-vulnerable housing market and high-valued equity market, could cause significant turbulence. The Federal Reserve will have to be flexible as it unwinds its stimulus program, while also ascertaining that monetary policy remains a credible anchor for the markets. Fiscal policy in the US will continue to be stymied by the political deadlock, but congressional members will still need to make sure to avoid another debt ceiling debacle later this year. Ideally, the US economy would benefit, also in the medium term, from more fiscal stimulus, not least from infrastructure investments and support to long-term unemployed.

Policymakers in the euro area face even harder balancing acts. The most urgent issue is high unemployment, low inflation and the risk of deflation, which, given the high debt levels, would push recovery back even further. The ECB has chosen to be less expansionary, partly as a result of a lack of appropriate instruments. If more monetary stimulus is necessary, the ECB’s implementation and communication skills will be tested. EMU also faces the launching of the banking union and associated stress tests of major European banks, which will require deft political manoeuvres. Policy skills will also be key in many emerging markets that have to adjust to dearer dollar financing and a slowdown in Chinese growth.

Risks more evenly balanced

The negative risks to our forecast have declined since October, and we raise the probability of our main scenario from 65% to 70%. The risks are also more balanced, with a 15% probability for both a better and a worse outcome. Both upside and downside risks are mainly connected to developments in the euro area, where the risk of deflation is not negligible and where the stress tests could expose banking sector vulnerabilities. However, better-than-expected developments in the euro area would have beneficial effects globally. The risks associated with the emerging markets have become more diverse, as some countries remain vulnerable due to large current account deficits, and others due to upcoming elections (India and Brazil). We have revised down our growth forecast in China, which also could have a negative impact on other emerging markets. We make only minor revisions to our oil price forecasts ($105 in 2014, and $100 in 2015), but larger deviations on either side could raise the threat of deflation (lower-than-expected oil prices) or dampen growth (higher-than-expected oil prices). In our region, the main risk to our forecast is a possible correction of the housing markets, primarily in Norway, but also to a limited extent in Sweden.

A gradual normalisation of markets expected

During the first half of 2014, the development of long-term interest rates will be dominated by the monetary policy in the U.S. The Federal Reserve began phasing out its bond purchases in December 2013, and, if the U.S. economy does not suffer any major setbacks, we expect this process to end in the third quarter of this year. This could cause a significant increase in the U.S. long-term interest rates, but the Federal Reserve has very clearly signalled that a 10-year government bond yield over 3% is high. Add to that the fact that the Feds fund rate will be kept unchanged for a long period after the bond purchases have been eliminated. In our judgment, this would limit significantly rising interest rates in the global fixed income markets, at least in the first half of this year. Over the whole forecast period, we revise down our interest rate forecasts; and proportionally more for German bonds (proxy for euro area).

Correspondingly, we expect the U.S. dollar to strengthen against the euro over the next 12-18 months, after which the euro recovers somewhat. The sterling also gains compared with the euro. The yen depreciates more than we forecast in October, while the Chinese renminbi is expected to gradually strengthen in value.

Interest and exchange rate assumptions, %

	2014 17-Jan	2014 30 Jun	2014 31 Dec	2015 30 Jun	2015 31 Dec
Policy rates					
Federal Reserve, USA	0.25	0.25	0.25	0.50	1.00
European Central Bank	0.25	0.25	0.25	0.25	0.50
Bank of England	0.50	0.50	0.50	0.50	0.75
Bank of Japan	0.10	0.10	0.10	0.10	0.10
Government bond rates					
Germany 2y	0.17	0.32	0.45	0.68	0.97
Germany 10y	1.76	2.05	2.20	2.35	2.50
US 2y	0.38	0.70	1.10	1.70	2.10
US 10y	2.82	3.10	3.40	3.60	3.80
Exchange rates					
EUR/USD	1.36	1.30	1.25	1.25	1.30
USD/CNY	6.1	6.0	5.9	5.8	5.7
USD/JPY	105	107	110	110	110
EUR/GBP	0.83	0.80	0.78	0.76	0.76

Sources: Reuters Ecowin and Swedbank.

Box 1: Continued low global inflation – but no deflation

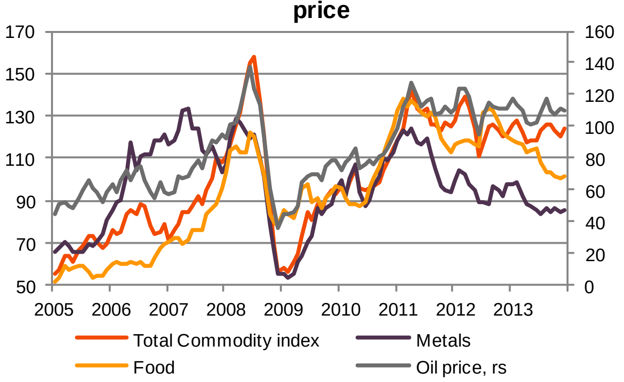
Global inflation came in lower than expected in 2013, which has brought renewed concerns about deflation. This is especially true of the EMU countries and the US. What is the reason for the muted price pressure and what do we anticipate in the next two years? Global inflation has trended lower in recent decades driven by price competition and deregulation in goods and services markets. Technological developments such as digitalisation and the internet have created new trading patterns among businesses and households, which tends to further increase price competition. Structural changes and stable inflation are positive for the global economy, but also pose a challenge for future monetary policy. When inflation is “too” low for long the zero bound on policy interest rates forces central banks into unconventional measures, such as quantitative easing, which could have unintended consequences.

The structural changes are taking place at the same time that the global economy is still facing low resource utilisation following the deep recession in 2009. Unemployment is considerably higher today than before the financial crisis, especially in the EMU countries, though the US labour market is also significantly weaker. While it has dropped to 6.7%, unemployment is still significantly higher than before the crisis. Low resource utilization in the global economy is creating low wage increases. In the EMU countries, wages rose in nominal terms by an annual average of 1.8% in 2009-2013, compared with 2.3% per year between 1996 and 2008. Despite that the American job market has strengthened in the last 2-3 years, nominal wages are rising at half the speed compared with previous. Although we foresee a stronger global economy during the forecast period, the amount of available resources will be significant, not least in the euro area. This will limit global inflation. It will take longer before an aging population and lower workplace participation in the US [US participation rate is already very low and that is partly due to an aging population] and Europe potentially lead to increased matching problems and higher wage increases.

Lower inflation impulses from commodity markets are another factor behind today’s low global inflation. Commodity prices, which rose significantly in 2000-2010, but with a temporary decline in 2008, have trended sideways and/or downward in the last two years. Crude oil has fluctuated around USD 110 per barrel since 2011, though volatility has been high due to geopolitical uncertainty in the Middle East. Expanded production capacity in the mining industry, rising metal inventories, and a sluggish global industrial sector have pushed industrial metals broadly lower since 2011. Good harvests and increased global food production led to falling food prices, particularly for grains and beverages, in 2013.

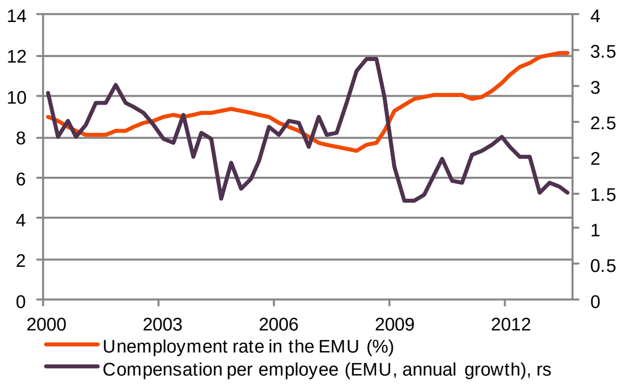
We expect inflation pressures from commodity markets to remain low in 2014-15. Lower than usual and less commodity-intensive growth in emerging economies, led by China, will keep downward pressure on global prices. The price decline for commodities is not expected to be of the same amplitude as in 2013, however. Production limits and fewer investments in new capacity by commodity industries, at the same time that growth in the global economy rises, lessen the likelihood of a major price drop. This applies in particular to industrial metals, which are expected to rise in 2014 and 2015 as global industry gradually grows. Crude oil prices are predicted to fall toward USD 100 dollar by 2015, with the growing importance of the US as an oil producer pushing oil lower. At the same time the prospects of higher oil production in Iran and Libya has increased, which is further restraining prices. Geopolitically, the Middle East is still fragile, however, and the risk of further crises should not be underestimated. The global food market is more in balance than before after last year’s record-high food production. This will also impact prices in 2014, even if we don’t expect a price decline similar to 2013. Global food demand is trending higher, driven by a growing population and changing buying habits, stressing the importance of good production conditions. The biggest risk factor is therefore major production disruptions caused by unfavourable weather effects, which could quickly drive up prices.

Commodity index (2010=100) and oil price



Source: Ecowin

Unemployment and labour costs



Source: Ecowin

Subdued price pressures from commodity markets and low resource utilisation contribute to continued low inflation rates in the euro area in 2014. The cyclical increase in productivity growth and modest wage growth are limiting unit labour cost growth to below the long-term trend. With the economy strengthening in the euro area and commodity prices assumed to begin rising again, the inflation rate will rise 2015. We expect that the average inflation rate in the euro area falls to 1.1% in 2014 from 1.4% in 2013, and later rises to 1.3% in 2015. In our main scenario, we foresee no deflation in the euro area over the forecast period, although the risk is not negligible. It would, however, require a significantly weaker outlook in the euro area than we are forecasting or a significant fall in prices in global commodity prices.

Euro area: Slow and unequal recovery

Slower growth in Q3, weak current situation

Economic growth fell in the third quarter after strong growth in the second quarter. The euro area is out of the recession, but, overall, the economy is still weak. Inflation is 0.9% and declining, well below the 2% target; the unemployment rate has flattened out at a lofty 12.0%; wage inflation is 1%, and declining; growth is 1%, at best; the euro is strong, well above historical averages; credit is contracting in the private sector; and house prices are falling.

ECB cut rate, may do more

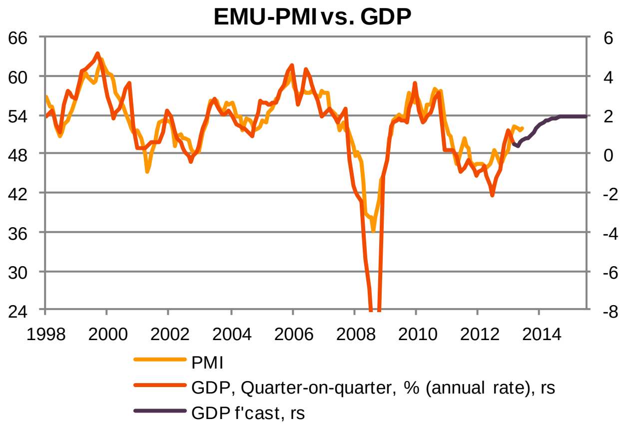
Against this backdrop, the ECB cut its key policy rate in November to a record-low 0.25%. The Bank is signalling that rates will be kept at present or lower levels for a prolonged period. Moreover, Governor Draghi underscored that the Bank has more artillery, including allowing negative interest rates and encouraging banks to borrow more, and for a longer term, at a preferred rate. At some point, the bank may consider private bond-buying programs, perhaps with guarantees from the stability fund in order to offset credit risk. In our view, the ECB would be right in providing even more stimulus in the present environment, but, given the already very expansionary policy stance, the effect on the real economy from additional measures would be small.

Barometers signal improvements

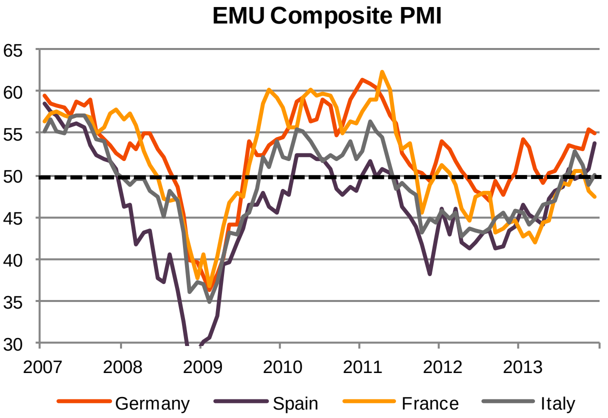
There are nevertheless reasons to be cautiously optimistic about the outlook for Europe. Overall, barometers such as manufacturing purchasing managers' index (PMI) and consumer confidence continued to improve through the autumn, though some have faltered in the latest month. We continue to expect a modest recovery in the coming year.

Divergence within the euro area

The differences within the euro area are, of course, important and look set to increase further in the coming months. In Germany, growth was 1.3% (annual rate) in the third quarter, and the December PMI signals growth of 2%. Other surveys are even more upbeat for Germany. Spain came out of the recession in the third quarter, and the PMI points to growth at around 1.5%. The upswing has not been shared by France, where the economy fell back into recession in the third quarter and the PMI dropped, indicating a contraction of 1% in GDP. The Italian economy saw zero growth in the third quarter, after nine quarters of contraction. Its PMI fell, however, signalling prolonged contraction going forward.



Source: Ecowin and Swedbank



Source: Ecowin

Many adjustments are already complete

Our rather positive outlook is based on several key observations. Private sector consolidation has gone a long way. Investments have already been cut. Households are saving enough, and consumption has probably passed out of the trough. Even if the euro has been strong, the region has gained from a substantial increase in the trade surplus. All the PIGS countries are running surpluses on their current accounts. Costs have been realigned within the zone, through wage cuts in Greece, Portugal, Spain, and Ireland, wage moderation in France and Italy, and somewhat higher wage inflation in Germany. Fiscal policy was contractive in 2013, but this headwind will ease in 2014. Moreover, we expect the euro to depreciate somewhat, perhaps due to more monetary easing from the ECB.

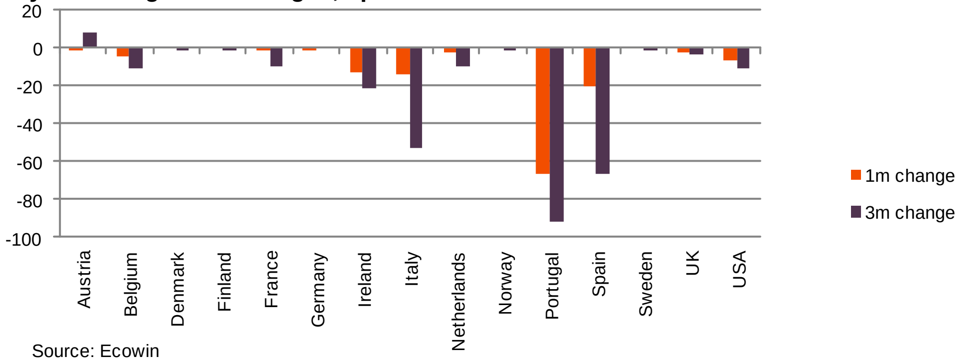
Bank improvements under way

Restricted access to credit remains a drag on firms in much of Europe. The worst may be behind us, however, as banks in most countries – even in southern Europe – now report that they are easing credit conditions vis-à-vis both households and businesses, for the first time since before the 2008 financial crisis. Bank funding has become cheaper and lending margins are probably narrowing. The upcoming third stress test of European banks will probably reveal new problem banks, but, on the whole, the banking sector in Europe is gradually being recapitalised and can withstand substantial credit losses. Moreover, important progress is being made towards banking union, which will strengthen confidence in the sector over the longer term.

Box 2: ECB increasingly dovish

The euro area growth outlook and the general risk sentiment were the most important drivers for ECB policymaking in 2013. But, towards the end of the year there were stronger signs that we were seeing a shift towards inflation as the main driver. Going into 2014, we expect that inflation and normalisation of the interest rate market will be the most important themes. Also, we expect a more stable environment on the periphery, which would be positive for the euro area as a whole. The news flow from the periphery went from “bad” to “neutral” in 2013. This will have important implications going forward. Monetary policy is skewed towards supporting the southern European countries. Periphery risk premiums have fallen and been relatively stable in recent months. This means that the ECB is likely to be doing less crisis management in 2014 and gradually moving towards more traditional monetary policy in the coming years.

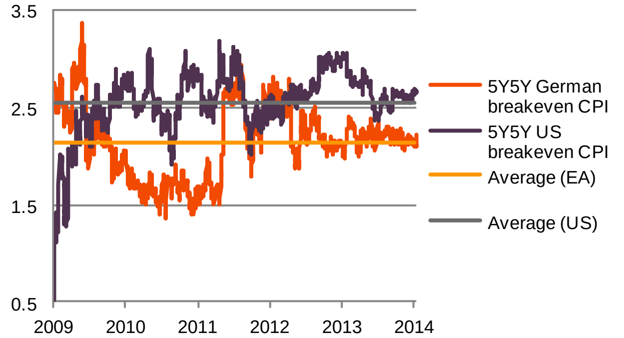
5 yr sovereign CDS changes, bps



Source: Ecowin

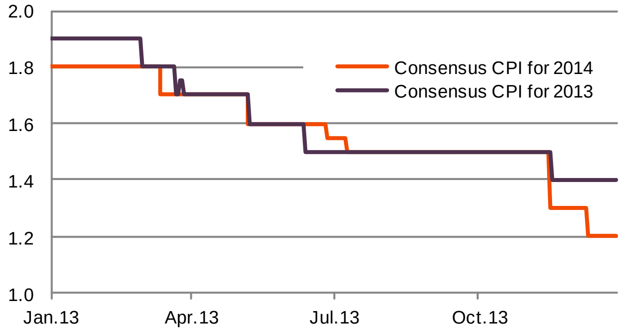
But, there are still clear risks for the ECB’s ability to maintain price stability in the euro area. The most obvious factor is the recent fall in inflation. There is little upward pressure in euro area labor costs, which indicates that inflation will not speed up significantly in the medium term. The euro exchange rate is also quite high, and the ECB has not been aggressively talking it lower. If inflation continues to fall from its current level, it may put the ECB in a difficult situation. Inflation forecasts for 2014 have started to fall, but medium-term inflation expectations have been stable. The ECB follows inflation expectations very closely, and a change in these could be a trigger in 2014. A continued fall in inflation would likely generate more support action. But, for the time being, the ECB is on hold.

Breakeven inflation Jan 2009- Jan 2014



Source: Ecowin

Consensus CPI forecasts



Source: Ecowin

Our main scenario is that the ECB will keep its key interest rate at 0.25% in 2014. A continued fall in inflation could trigger new support measures, but none of these are without drawbacks. The most likely tools would then be the following:

1) Lower the Refinance rate from 0.25%. If this happens, it will likely be less than 25 basis points, and the real effect on the economy would be marginal.

2) Lower the deposit facility rate into negative territory (now 0.00%). The incentive for banks to deposit funds at the ECB would be smaller. However, negative deposit rates would lower banks’ profitability, forcing them to raise lending rates and thus counteracting the original intent. Also, banks currently have very few deposits at the ECB; thus this measure is neither very likely nor would be very effective.

3) Start asset purchases. The ECB has made bond purchases under outright monetary transactions (OMT) before. Bond purchases would push long-term yields lower if the purchases were significant. It is possible that the ECB would also buy other financial instruments. However, this would lead into unchartered legal territory, and in particular Germany has voiced opposition. Germany’s constitutional court ruling on the OMT in May should be watched closely.

4) Conduct more long-term refinancing operations (LTROs). This could enable banks to buy more sovereign debt, which pushes yields lower. The refinancing risk for periphery banks is now lower than when the LTROs started in November 2011, so the pressure on the LTROs is now lower also. The effect from these measures should not be overstated. Banks currently get shorter ECB financing, and the times are now different than when the three-year LTROs started.

5) Implement a combination of the measures above. This would be more aggressive and more likely to produce the desired effect. We expect that asset purchases will have the largest impact on financial markets and general risk sentiment. The effects from other measures would be smaller and/or more difficult to predict.

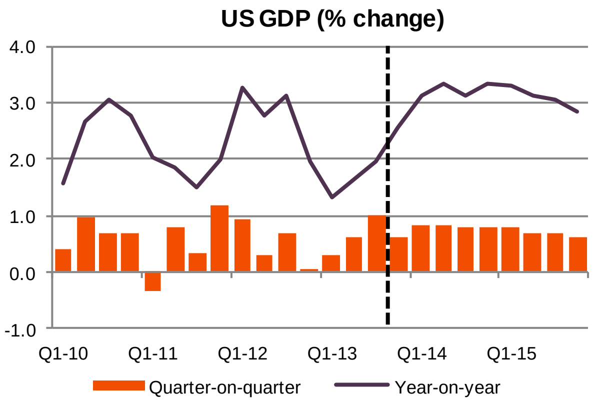
US: The pitch is queered for a pickup in growth

Economic policy getting clearer

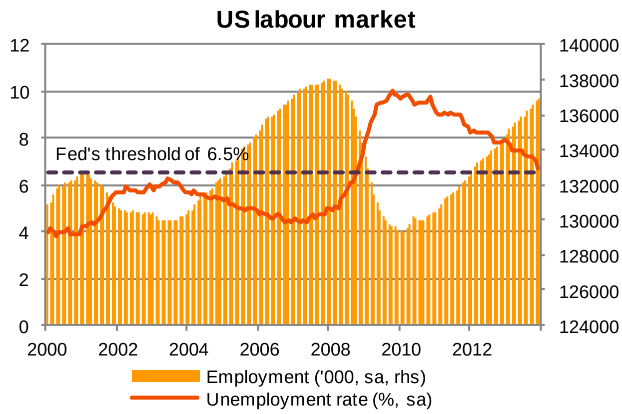
The US economy cleared a number of hurdles during the autumn, and economic growth picked up in the latter half of 2013. In Congress, a deal was reached that, on the one hand, put a two-year budget framework in place, and, on the other, reduced, albeit marginally, the fiscal drag on the economy. The main positive effect from this is the smaller risk of another government shutdown like the one in October of last year, and thus less uncertainty regarding fiscal policy. However, there is room for fiscal stimulus that is not used, in particular more spending on public infrastructure and the extension of unemployment benefits for the long-term unemployed--spending that would rapidly translate into demand. Also, the monetary policy outlook became clearer late last year when the Federal Reserve decided to start reducing the amount of bond buying. At the same time, it made clear that the federal funds rate would be kept low, even if unemployment falls below the previously stated threshold of 6.5%, conditioned on inflation.

Strong short-term outlook

Recent macroeconomic data support a more benevolent short-term outlook than we had forecast during the fall. Third-quarter GDP growth was revised up from the original reading of an annualised rate of 2.8% to more than 4%. Economic developments in the fourth quarter suggest that the strong performance continued. Retail sales growth accelerated, supported by faster income growth. Private sector unemployment continued to improve, albeit not to the same extent as expected. Jobs created in December amounted to a mere 74, 000, but the cold winter weather probably had a negative impact. Labour market participation dropped and thus also the unemployment rate, estimated at 6.5%. Private sector investments have turned around in recent months. Not least, the increase in building permits points to increased activity. We expect growth in the US economy to have remained strong in late 2013 and to continue at a relatively high rate in early 2014.



Source: Ecowin and Swedbank



Source: Bureau of Economic Analysis

Domestic demand still fragile

However, beyond a short-term rebound, private sector domestic demand remains vulnerable. There are signs that households' deleveraging is trending off and that financial savings are declining, and further increases in consumption must be supported by strong income growth, and thus by continued job creation. Household finances are also sensitive to the housing market and mortgage rates, which most likely have reached bottom. The conditions for private sector investments have also improved, with strong balance sheets, high profit levels, and low borrowing costs. Still, resource utilisation remains low, and incumbent firms are not yet exposed to much competitive pressures; this is likely to hold back investment spending in the medium term. Overall, we expect growth to dampen in late 2014 and in 2015, in particular since the public sector is unlikely to provide neither fiscal stimulus to boost the recovery, nor structural reforms to enhance long-term growth.

Negative risks have diminished

That said, risks to the US outlook have generally become less negative since our autumn forecast. Primarily, the policy outlook has stabilised, and the housing market continues to support growth. Inflation, although it has fallen, is likely to have reached its trough. Core inflation amounted to 1.7% in November and, given a pickup in demand, is unlikely to fall further. Upside pressures on inflation are, however, tempered by low employment and small external impulses. We expect the US dollar to strengthen against all major currencies, and this will dampen competitiveness. The main downside risk is rising market interest rates, which would hurt domestic demand. We forecast that, although the federal funds rate will remain unchanged until mid-2015, the market rates will rise. Taking into account the negative impact on the housing market and, thus, household consumption, as well as the increasing financing costs, this limits the upside for the US economy.

Box 3: Polarised labour markets – new challenges for monetary policy

Digitalisation, urbanisation, and internationalisation are shifting the drivers of economic growth and rapidly changing the structure of labour markets around the world. Research shows that innovation and productivity growth are, to an increasing extent, concentrated in dynamic regions characterised by cutting-edge universities, high-skilled labour forces, and cultural diversity (see, e.g., Moretti 2013). The result is an accelerating divergence between highly educated and low skilled workers, between dynamic clusters and stagnating regions, and between countries that can meet the demand from technological change and those that cannot and, therefore, are falling behind. These trends affect the demand for labour, productivity, and inflation. In this box, we discuss how these trends have affected labour markets during the financial crisis, and the challenges facing central banks during the recovery.

The most innovative dynamic clusters still reside in the US. Top research universities, access to venture capital, and a steady increase of high-skilled labour have contributed to the success of technology start-ups in Silicon Valley and life science companies in Boston. The prevalence of anchor companies is also an important factor for the success of the new tech start-ups. In the US, there is a vibrant debate in academia and among policymakers on how digitalisation and internationalisation affect labour markets and economic growth (see, e.g., Moretti 2013, Gordon 2013, Brynjolfsson 2013). Research shows that the US labour market is undergoing a momentous shift (Moretti 2013). Technology and innovation have increased the demand for high-skilled labour, while the demand for low-skilled labour has been declining. Data show that real wages, i.e., wages adjusted for inflation, have for employees with advanced degrees improved by 32% since 1980. At the same time, real wages for white, male high school graduates are 8% lower today than in 1980 (see Table 1). The diverging trend in incomes between the high-skilled and the low-skilled has resulted in a higher degree of income inequality.

Table 1: Hourly average wage, men, USA, by education ('11 USD)

	1980	2010	% Change
Dropout	13.7	11.8	-14%
High School	16.0	14.8	-8%
College	21.0	25.3	20%
Advanced Degree	24.9	33.1	32%

Source: Moretti (2013). Data include all full-time workers aged 25-60

In Sweden, the same trend is observed: increasing demand for high-skilled labour and declining demand for low-skilled labour. As in the US, wages are diverging (see Table 2). In addition, further analysis of Swedish data reveals that unemployment is increasingly concentrated among low-skilled workers. Almost 70% of unemployed are those with weak links to the labour market. The unemployment rate amongst college-educated employees in Sweden has been about 5% since 2005, compared with an unemployment rate approaching 20% amongst employees without a high school degree (see graph 1). It is noteworthy that this trend has continued throughout the financial crisis and the ensuing euro zone crisis. Traditional Swedish manufacturing, which is highly dependent on exports, has been severely hit by low demand from the rest of the world. Despite these recent crises, the demand for high-skilled labour has remained strong, while it is increasingly difficult for less educated workers to find employment.

Table 2: Monthly average wage, women, Sweden, by education ('09 SEK)

	1991	2009	% change
Less than 9 years	15406	20948	36%
9 years	15336	22104	44%
High School	16074	23288	45%
College (2 or more years)	Na	29069	Na
Advanced Degree	25275	40634	61%

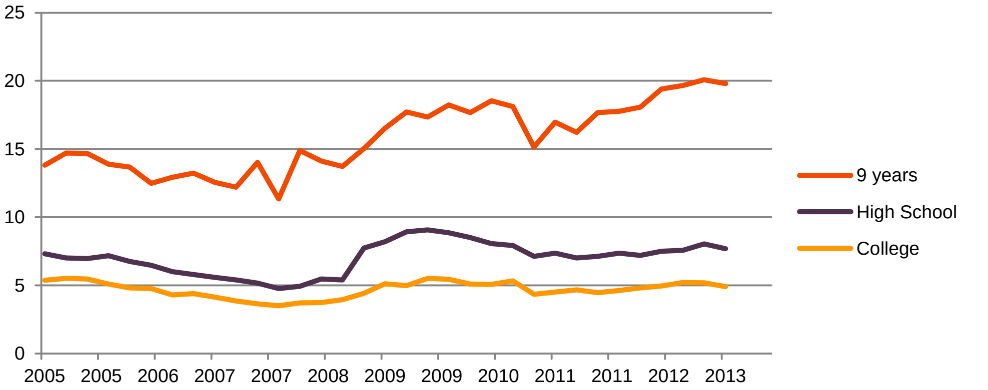
Sources: SCB (2013)

The boom years before the financial crisis masked structural imbalances on the labour market. Due to process automatisation, manufacturing is not going to return as an important source of employment growth as the economy recovers. The high unemployment rates following the financial crisis in the US, as well as in Europe, are partly structural and driven by technological change. The level of resource utilisation on the labour market may not be as low as it seems. In particular, unemployment is increasingly concentrated amongst low-skilled workers as they struggle to meet the demand from a changing labour market. As the economic recovery takes hold, this divergence in the labour market will become even more pronounced.

Box 3: Polarised labour markets – new challenges for monetary policy (cont'd)

As a result of polarized labour markets, central banks will face new dilemmas. High demand for high-skilled labour will push up wages and risks causing wage inflation, and the need for tighter monetary policy. At the same time, unemployment will remain elevated amongst large groups of the population, creating pressure for a continued expansionary monetary policy. If unemployment among low skilled workers is structural, rather than cyclical, more expansionary monetary policy will not be sufficient to achieve full employment. If structural unemployment has increased, wage growth will become a driver of inflation at higher levels of unemployment than previously thought. Federal Reserve has repeatedly raised the issue of structural versus cyclical unemployment. In the latest FOMC minutes (December 2013), they note "reports of labour shortages, particular for workers with specialized skills". They also raise concern for "the risk that the persistent weakness in the labour force participation rate and low rates of productivity growth might indicate lasting structural damage". This dilemma will be particularly strong in the US, where the Federal Reserve has a dual mandate to achieve full employment and to stabilise inflation.

Unemployment by education, Sweden (% of labour force)



Source: National Institute of Economic Research (2013). Unemployed aged 15-74

Data shows that *the Swedish Riksbank faces a similarly polarised labour market*. As a result, it will be increasingly difficult to analyze inflationary pressures. Inflationary pressures depend on the firms marginal costs (such as wages, import prices and productivity), and the extent to which is can pass on costs to consumers (which depend on competition and demand). In Sweden, we believe that inflationary pressures will remain subdued during 2014. As growth picks up and labour markets improve in 2015, we expect a gradual increase in wages, particularly for high-skilled workers. Swedish companies will face cost pressures, but will find it difficult to pass on the costs to consumers due to tough competition from our main trading partners, in particular in the eurozone, where wage increases will remain subdued for an extended period of time. In addition, digitalisation and more competitiveness in product markets reduce firms' ability to increase prices. E-commerce, and the increased internationalization of retail, is contributing to fierce price pressures.

High productivity growth could reduce unit labour costs and inflationary pressures. Digitalisation and technological innovation mean that the potential for productivity gains is large. 3D-printers, big data analysis and further process automatisation can increase the overall level of productivity in the economy. Still, given the shortage of people in the labour market who can meet the technological demands, productivity growth is likely to be below its potential. The interplay between a changing labour market, productivity and inflationary pressures will be central to monetary policy during the recovery.

UK: Rapid turnaround pressures Bank of England

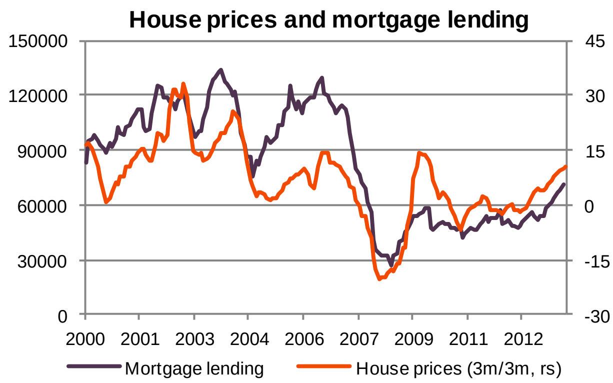
Growth up, unemployment down

The UK economy has started to recover on the back of the Bank of England's (BOE's) stimulus policies. Second- and third-quarter growth is estimated at 0.8%, and the unemployment rate, which fell in December to 7.4%, is rapidly approaching the threshold of 7% set by the BOE. Growth was mainly driven by domestic factors, while external demand remained weak. Short-term indicators at the end of last year, such as the PMI and retail trade, suggest that economic activity remained buoyant, and we revise up our growth estimate for 2013 to 1.9%, compared with our October forecast of 1.2%.

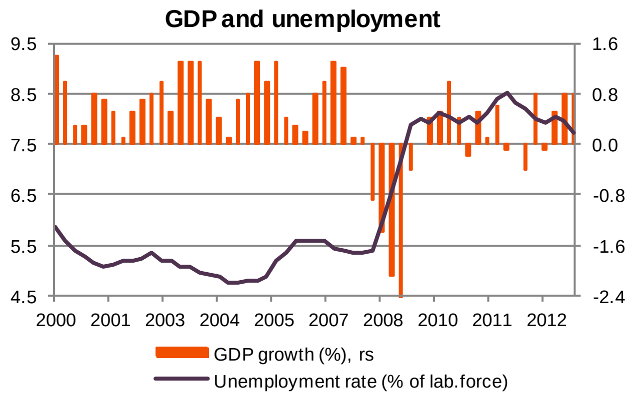
BOE may run into credibility problems

The positive developments are expected to spill into 2014, and we expect real growth to rise to almost 3% annually. The strong rebound and positive labour market developments will challenge the BOE's commitment to a very expansionary monetary policy in the form of a low bank rate (0.5%) and unchanged size of the Asset Purchase Facility. The BOE currently forecasts unemployment will fall below 7% at the end of 2014, but, given the current pace, that could happen as early as midyear. In that case, Governor Carney could find himself in a difficult position, having previously argued quite strongly in favour of an extended period of expansionary policies. Markets are less convinced that the low-for-long policy will last, and short-term yields have risen.

In 2015, we expect the economy to grow at a slightly slower pace, though it will stay above a 2% rate. The road ahead will, however, be bumpy, not least because of the continued strong housing market and the high household debt level. In order to cool the housing market down, the BOE has refocused the Funding for Lending Scheme away from households and towards business lending only.



Source: Nationwide/Halifax and Bank of England.



Source: Ecowin

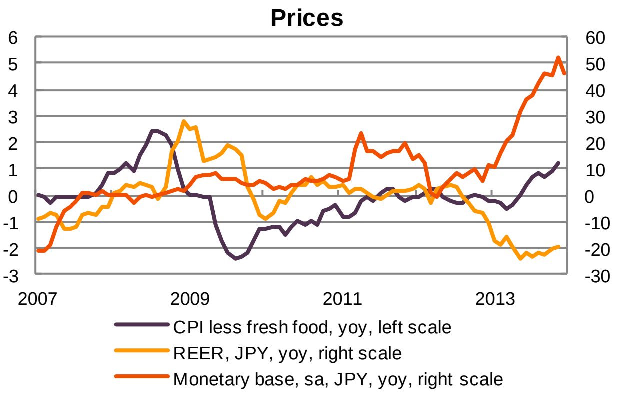
Japan: So far, so good

Two out of three arrows hit mark

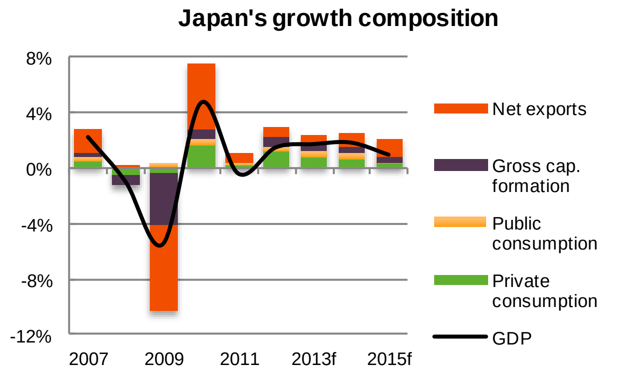
A little more than one year after Mr. Abe took office two of his three economic policy arrows – monetary and fiscal stimuli – are hitting their target. A loose monetary policy has pushed down the yen and boosted the stock market. Although much of it is imported, inflation is gradually increasing, and inflation expectations are on the rise. However, more stimulus would still be needed in 2014 to achieve the government's 2% inflation target towards the end of the FY2015. The growth and bond yield differentials with the US should push the value of the yen even lower against the US dollar in 2014, supporting Japanese exports.

Government stimulus lifts the economy

Despite a planned sales tax hike in April, we expect GDP growth to remain robust in 2014, supported by public investment in infrastructure, a pickup in external demand from the US, and strong consumption and residential investment before the sales tax hike. Energy import needs continue to keep the trade deficit wide as the openings of nuclear reactors are delayed. GDP growth will slow in 2015 due to fiscal consolidation and higher prices.



Source: Reuters, Swedbank



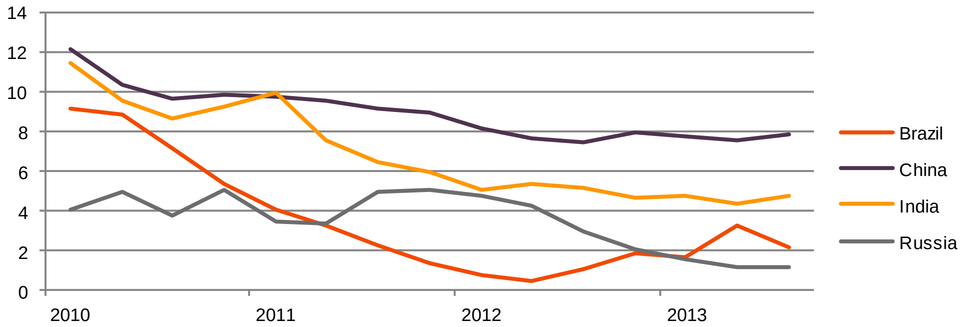
Source: Eurostat, Swedbank.

Emerging markets: More challenges ahead

Political uncertainty adds to economic turbulence

Emerging market economies will continue to be characterised by uncertainty surrounding the effects of monetary policy in the US, and by economic developments in China as policymakers implement new reforms. In addition to these factors, important national elections will be held in several emerging market economies. High inflation rates will keep policy rates high and thereby pose a further obstacle to growth. In general, we expect a tough economic climate with lower growth, albeit with considerable variation across countries. Countries with negative external financing dynamics will be more closely scrutinized; they will find it harder to borrow as the Federal Reserve starts to scale back its monthly bond purchases.

BRIC, Real GDP (YoY, %)



Source: Ecowin

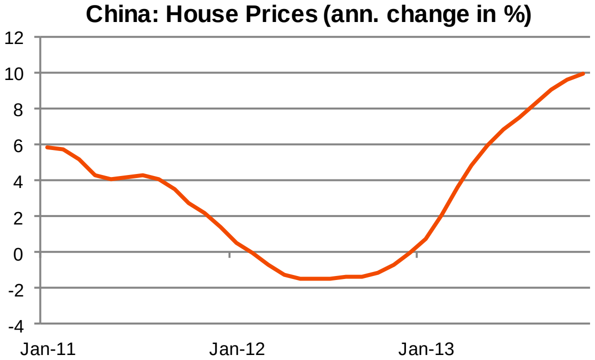
China: Reforms will likely take their toll on growth

The turbulence in the Chinese financial markets that occurred in June when interbank rates rose sharply did not impact the economic numbers as negatively as one might have expected. Business sentiment has improved somewhat, and GDP grew by 7.8% in the third quarter. What's more important, looking forward, is Chinese politics.

Change in growth model not without risks

China has begun an important policy shift that will finally start to tackle years of overinvestments and misallocation of resources. The government announced a new reform plan in November last year that will make the economy more market oriented, where market forces will play a "decisive" role in resource allocation. These structural reforms are necessary for China to achieve long-term sustained growth. However, implementation of these reforms will probably weaken the economy in the near term as credit growth is too high and the property market is bubbling again. House prices are increasing by 10% (year on year). There is a risk that weak players will fall during this adjustment phase and create an unstable environment. We therefore downgrade our forecast for economic growth in China to 6.9% for 2014. Still, the-better-than expected growth outlook for, in particular, the US and the UK will limit the downside risk of Chinese growth. We expect that less demand from China will keep a lid on commodity prices.

China: House Prices (ann. change in %)



Source: Ecowin

China Steel Prices (CNY/Ton metric)

Source: Ecowin

Russia: Bleak growth going forward

No recession, but still very weak

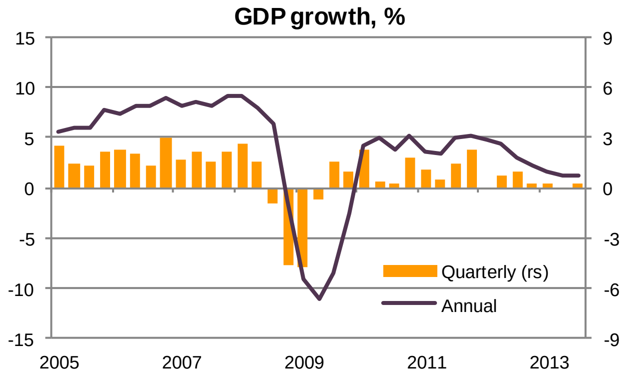
Contrary to the earlier data, recent revisions show that Russia did not slide into recession in early 2013, but the data are still very weak and give little comfort, if any. GDP contracted by 0.1% in the second quarter and had just 0.2% quarterly growth in the first and third quarters. Russia has been teetering on the edge of recession, and while we expect it to report stronger numbers going forward, recovery will be by no means impressive.

Policymakers choose stability over short-term growth

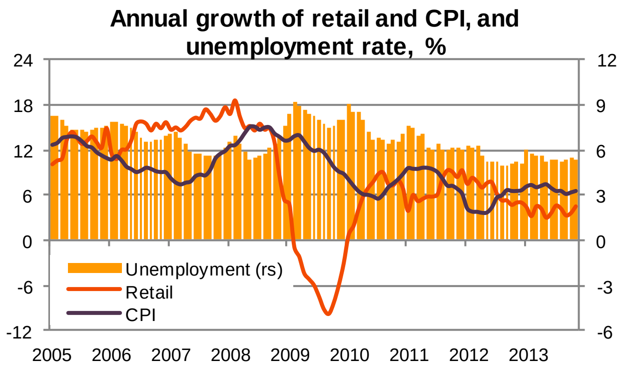
In 2013, the key driver of growth was household demand, supported by a strong labour market. Exports and investment activity suffered from weak external demand and the lack of structural reforms. There is no major improvement expected over the next two years. Global demand for commodities (especially in the hydrocarbon sector) is anticipated to be weak. The authorities have failed to address major institutional weaknesses (e.g., corruption and the rule of law) that weigh on private sector investment activity. Consumption will remain the key driver of growth but its growth rate will weaken, as the public sector wage freeze comes into effect and the central bank is aiming to dampen swelling consumer lending. Fiscal and monetary policy will remain restrictive as policymakers seem to be choosing stability over a short-term boost to growth, pointing to the structural nature of the slowdown in growth. The recent reshuffle of policy-makers that has brought in liberals is a welcome move, but its positive impact is still unknown and distant.

Lack of reforms means poor growth

The government has acknowledged the slowdown in growth and revised its long-term forecast down from 4% to 2.5%. We retain unchanged our GDP growth estimate for 2013 at 1.3% but reduce our forecast to 2.0% and 2.3% for 2014 and 2015, respectively. The weakening of the rouble will continue, and the current account could slide into negative territory in 2015.



Source: EcoWin



Source: Reuters EcoWin

Brazil: Between a rock and a hard place

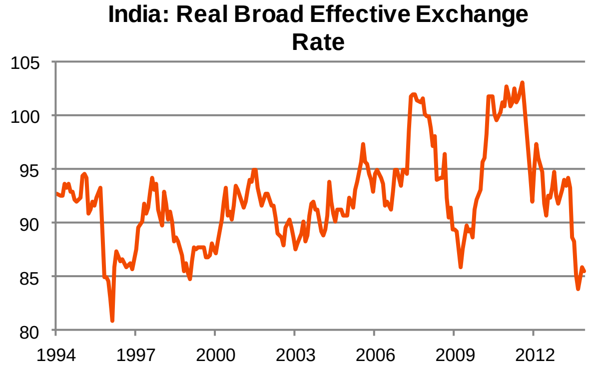
A continued weak growth

Growth in Brazil has been far too dependent on private consumption in recent years. Economic policy has focused on offsetting a decline in exports with substantial stimulus of private consumption. The effects, however, have gradually weakened in recent years. Structurally, economic growth is held back by inadequate investment. Investments account for less than 20% of GDP—a lower level than most other emerging economies. A complicated tax system and lack of regulation impact the investment climate negatively. We see downside risks in exports to China, which would further widen the current account deficit and keep Brazil vulnerable to tighter US dollar conditions. President Rousseff faces general elections at the end of 2014. The economic situation is more challenging now than it was in 2010, due to weak growth and high inflation. We consequently expect the President to use budget measures to keep voters in a good mood. However, the room for a more expansive fiscal policy are restrained by the risk of a downgrading of Brazil's sovereign credit rating.

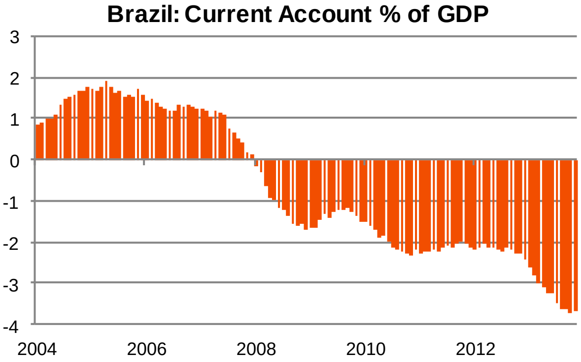
India: Stronger growth going forward

External competitiveness has strengthened

In India, expectations have increased that parliamentary elections in May will bring a change of government. The prospects of a more growth-friendly economic policy following the elections appear more favourable than they have been for a long time. The incumbent has governed during a period of weakening growth, which, combined with a general lack of decisiveness, has inspired only weak confidence in policies. Inflation is still a problem, increasing by double digits, which will keep monetary policy tight and further restrain the already-weak domestic demand. However, we expect that the low rupee will lead to continued good growth in exports. The real effective exchange rate has fallen to its lowest level in 17 years. On the whole, this causes us to foresee a considerable improvement in economic growth and in the current account. This means that the rupee will be less vulnerable to disruption in global liquidity, moving forward.



Source: Ecowin



Source: Ecowin

Nordic area: Downward convergence

Norway continues to slow down

Weak growth due to domestic demand

Economic growth in Mainland Norway slowed to below 2% in the third quarter of 2013 from rates above 3.5% in 2012. The slowdown is due to domestic factors, as private consumption, housing investments, and mainland business investments have slowed. Export growth has decelerated, but imports have too, leaving the net impact close to zero. Inflation picked up throughout the year, in part due to the depreciation of the Norwegian krone. Wage inflation has gradually come down, employment growth has slowed, also, and unemployment has increased somewhat. Thus, growth in real disposable income has decelerated. The housing market has turned, with prices now falling, and the inventory of unsold homes has risen. Norway is no longer the exceptional high-growth (developed) economy.

Housing market a risk for near term

The housing market slowdown may to some extent be attributed to higher bank lending rates and tightened credit standards. In any event, this effect should now be over. We expect banks to become more accommodative in the coming months, as revealed by bank surveys. Their lending margins are unusually high, and their capital base is increasing by the day. House prices have risen phenomenally for many years, and have become very high compared to income and rents, as well as long-term construction costs. A significant decline in prices, therefore, cannot be ruled out. Housing investments and private consumption will certainly suffer in this scenario. Nevertheless, the contraction should be limited as the households' savings rate is already high, at close to 10%, and their net cash flow is not that weak (around zero). Moreover, low interest rates, currency depreciation, and unlimited fiscal capacity will certainly help.

Lower oil investments expected for the longer term

The other major risk factor for the Norwegian economy is oil investments, as oil companies have become more selective in a world full of attractive hydrocarbon investment opportunities. The high-cost Norwegian petroleum sector has not improved its competitive position in recent years. Oil investments may be peaking now, according to surveys, and order inflows are already sharply down. Due to several ongoing, large, and very profitable projects with long lead times, investments will in any case keep up rather well in 2014 and probably in 2015, too. Nevertheless, the period of expansion seems to lie behind, not ahead, of us.

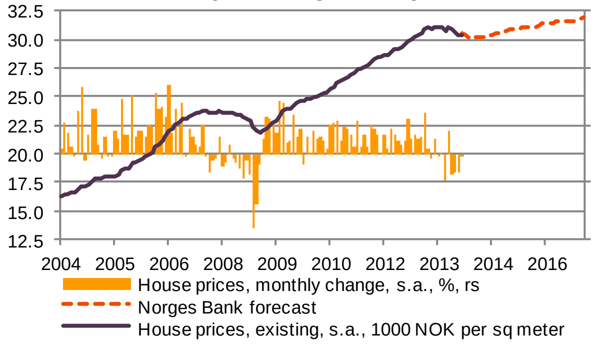
Norwegian krone has weakened substantially

Financial markets have responded to the economic turning point by low valuations of the Norwegian krone. Throughout 2013, the krone depreciated 10% on a trade-weighted basis, much more than can be justified by changes in fundamentals, and, as a consequence, we expect the krone to strengthen somewhat in the short term. Part of the explanation for the overreaction may be found in the unwinding of carry trades that became popular in the preceding years. The high cost level is a longer-term argument for a weaker krone, and, if oil investments or the housing market weaken substantially, current krone levels will be justified. The weak krone provides favourable conditions for many Norwegian companies competing on international markets. This, together with prospects of improved growth in many of Norway's trading partners, makes the export outlook fairly good. On the other hand, the terms of trade have improved significantly over the past decades and are more likely to deteriorate than to improve further in the years ahead.

Policy rate to stay low for long

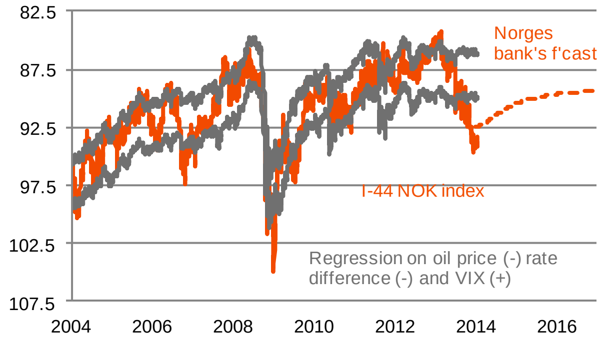
Norges Bank has responded to the growth slowdown by postponing the expected hike in the policy rate by another year to the summer of 2015. The central bank expects the weak krone to lift consumer prices in the years ahead, but it is not worried that it will ignite a price-wage spiral. We expect wage inflation to remain tame due to slower growth, somewhat higher unemployment, and the trade unions' recognition of the need to contain costs. Norges Bank expects a soft landing in the housing market and a gradual pickup in private consumption, and sees no need to cut the policy rate further. Rather, the central bank continues to worry about the strong growth in household credit. In our view, the scene is set for a rate cut following a downturn in the housing market, but only if and when the consequences for housing investments and private consumption become blatantly clear.

Norway: existing house prices



Source: Ecowin and Swedbank

NOK I44 vs "fair value" band



Source: Ecowin and Swedbank

Denmark: A corner has been turned

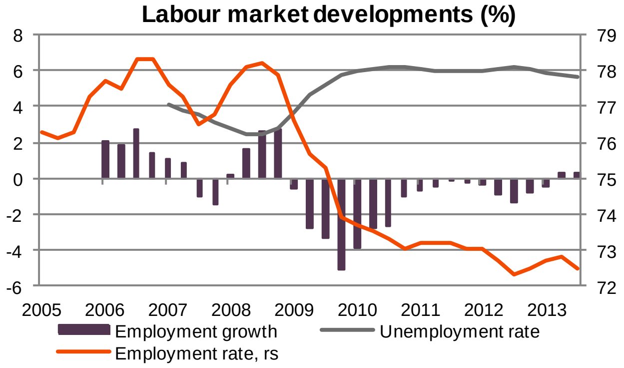
Growth is picking up

After the deep and protracted recession in Denmark over the last couple of years, short-term indicators are finally starting to show signs of recovery. Consumer confidence has gradually strengthened since mid-2013, and sentiment in manufacturing and services signals growing activity; meanwhile, construction still lags, reeling from the burst real estate bubble. External developments are also mildly positive as growth in important trading partners, such as the UK, Germany, and Sweden, is picking up. Competitiveness is also benefitted from sharply reduced wage increases and from higher productivity growth.

GDP is still below pre-crisis levels

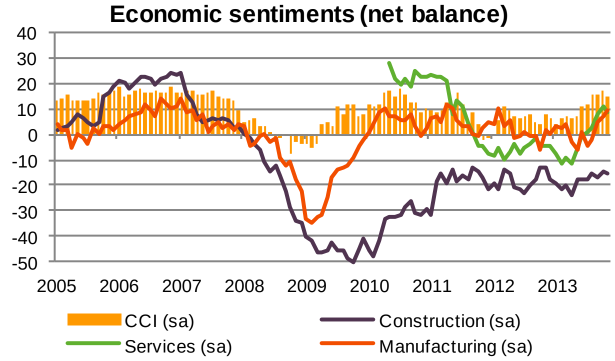
However, there are still areas of concern. There is significant slack in the labour market, with the unemployment rate decreasing only slowly. With employment rates still down by more than 5 percentage points from the peak, the Danish “flexicurity” model is pressuring fiscal balances, resulting in a budget deficit of around 4% in 2012. Thus, restoring fiscal policy will continue to drag down growth in 2014. Furthermore, the Danish banking sector, which has still not recovered from the crisis, is an area of significant uncertainty. Credit to companies has declined, and there are no signs that this will be reversed in the short term. We revise up our growth forecast for 2014 and 2015 to 2.0% and 2.1%, respectively; from an estimated 0.4% growth in 2013. The main contribution to growth will come from household consumption, while later in the forecast period external demand and investment growth will pick up.

Labour market developments (%)



Source: Statistics Denmark

Economic sentiments (net balance)



Source: EC Consumer survey

Finland: Growth turns positive

Although Finland has passed through the trough of the economic recession, the recovery will be sluggish. We expect that after the accelerated decline of 1.2% last year, GDP will grow by 0.8% in 2014 and reach 1.8% in 2015.

Weak cost competitiveness and ongoing structural changes inhibit recovery

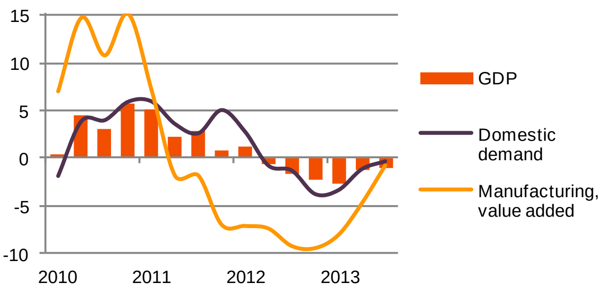
Improving external demand alone is not enough for steady growth. Both weak cost competitiveness and the ongoing structural changes inhibit the robust acceleration of production and export growth. The agreement on salaries reached in the autumn of 2013 will decelerate wage growth and the rise in unit labour costs, but the expected results will take effect only after several years.

As spare capacity is gradually decreasing, supplementary investments are needed for outmatching the possible resource constraints if demand will impove. Due to the persistent high number of unemployed, as well as the decrease in employment, deceleration of wage growth, increase in the consumption tax, and still-weak consumer confidence, private consumption is weak and will continue to decline this year. An accelerated growth of productivity and implementation of policies to raise the participation rate are needed to compensate for the decrease in the number of working-age people and employment.

Public finances are under pressure

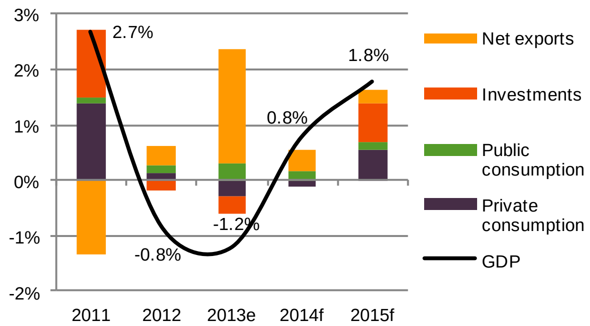
Because of the sluggish recovery from the recent recession, public finances are under pressure. Although the general government budget deficit will gradually lessen, debt could rise above the 60% threshold if structural policy measures are not applied swiftly.

Growth of domestic demand and manufacturing, % YoY



Source: Statistics Finland

Contributions to GDP growth, pp



Source: Statistics Finland. Swedbank

Sweden: Growth takes off

After a weak performance in 2013 we expect growth in the Swedish economy to pick up in 2014. Growth is driven by domestic demand, with increased investments and consumption, while export demand is weakened by a crisis-hit Europe. We expect the Riksbank to raise the policy rate at the end of the year, but that low interest rates abroad and households' sensitivity to interest rates will hold back the pace of hikes. A less expansionary economic policy dampens growth in 2015.

Rise ended a weak 2013

Growth in the Swedish economy was surprisingly weak in last year's third quarter. The final demand, however, showed a recovery that was driven by increased investment, particularly residential investment, while consumption did not accelerate as expected. Swedish exports continued to decline due to weak global demand for manufactured and capital goods, as well as the strengthening of the Swedish krona. The labour market improved, but employment growth was followed by an increased labour supply, which limited the decline in unemployment. Economic policy remained expansionary, and the year ended with the national bank cutting its key rate after, primarily, service prices pushed inflation down. However, short-term economic indicators indicate that growth was strengthened at the end of the year.

Key Economic indicators, 2012-2015 1/

	2012	2013e	2014f	2015f
Real GDP (calendar adjusted)	1.3	1.0	3.2	2.7
Industrial production	-3.2	-2.5	4.0	5.2
CPI index, average	0.9	0.0	0.6	2.5
CPI, end of period	-0.1	0.1	1.4	2.9
CPIF, average 2/	1.0	0.9	0.9	1.8
CPIF, end of period	1.0	0.8	1.3	1.9
Labour force (15-74)	0.8	1.1	1.0	0.6
Unemployment rate (15-74), % of labor force	8.0	8.0	7.7	7.3
Employment (15-74)	0.6	1.1	1.3	1.0
Nominal hourly w age w hole economy, average	3.0	2.7	2.9	3.2
Savings ratio (households), %	12.2	12.0	11.8	10.1
Real disposable income (households)	3.6	2.1	2.8	0.7
Current account balance, % of GDP	6.6	6.3	6.3	6.3
General government budget balance, % of GDP 3/	-0.5	-1.4	-1.2	-0.7
General government debt, % of GDP 4/	38.3	41.2	40.6	39.3

1/ Annual percentage growth, unless otherwise indicated. 2/ CPI with fixed interest rates.
3/ As measured by general government net lending. 4/ According to the Maastricht criterion.
Sources: Statistics Sweden and Swedbank.

Recoil during 2014, growth will slow in 2015

We maintain our growth forecast for 2014 largely intact at just over 3%, compared with the October forecast. Growth is driven by relatively strong consumption growth and a continued recovery in investment. Not least, housing investment is taking off in light of the growing lack of housing in the main metropolitan areas. Although if we anticipate a stronger global market, Swedish exports' growth will be limited by the weak global investment climate and a stronger krona. Economic policy remains expansionary, in which low inflationary pressures obstruct key rate hikes and the election year causes an expansionary fiscal policy. The rate of growth will fall back in 2015. We expect household consumption to be limited by modest increases in disposable income, as well as the increasing interest rate sensitivity. Exports benefit from an improved external environment, but the increase in the krona will push competitiveness. Imports will rise hand in hand with a continued increase in investment, limiting the contribution of net exports to growth. Inflationary pressures will increase slightly, and combined with continued high levels of household debt, will mean that the national bank will start to tighten monetary policy, albeit at a

Swedbank's GDP Forecast - Sweden

Changes in volume, %	2012	2013e		2014f		2015f	
Households' consumption expenditure	1.6	1.8	(2.2)	2.9	(3.1)	2.6	(3.1)
Government consumption expenditure	0.3	1.2	(1.1)	0.9	(1.2)	1.1	(1.0)
Gross fixed capital formation	3.3	-0.8	(-3.1)	5.7	(4.6)	6.8	(7.8)
private, excl. housing	7.5	-3.0	(-5.2)	5.5	(5.7)	8.9	(9.4)
public	4.0	-0.8	(-1.9)	1.5	(2.4)	1.9	(2.3)
housing	-11.2	7.7	(3.7)	10.1	(3.4)	3.8	(6.5)
Change in inventories 1/	-1.3	-0.3	(0.4)	0.3	(0.0)	0.0	(0.0)
Exports, goods and services	0.7	-1.5	(-1.5)	3.5	(4.7)	6.5	(6.5)
Imports, goods and services	-0.6	-2.2	(-1.5)	3.7	(4.5)	7.2	(7.5)
GDP	0.8	1.0	(1.1)	3.1	(3.1)	3.0	(3.1)
GDP, calendar adjusted	1.3	1.0	(1.1)	3.2	(3.2)	2.7	(2.9)
Domestic demand 1/	1.5	1.1	(0.8)	2.7	(2.7)	2.9	(3.2)
Net exports 1/	0.6	0.2	(-0.1)	0.1	(0.3)	0.1	(-0.1)

1/ Contribution to GDP growth. Sources: Statistics Sweden and Swedbank.

slow pace. This will restrict households' disposable income, which along with a less expansionary fiscal policy, will hold back consumer spending.

The sluggish global economy limits Swedish exports

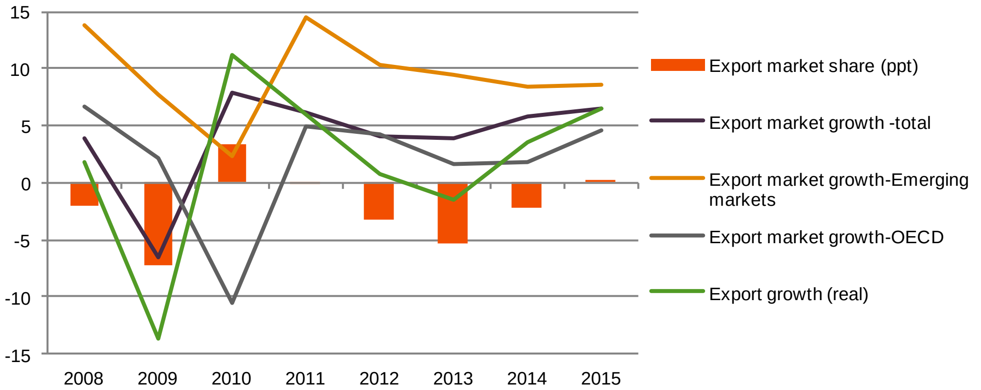
Weak external demand in 2013

The global economy is improving, but has not yet had any clear impact on Swedish exports. Commodities' export volumes have declined and will probably continue to shrink during last year's fourth quarter. The weak trade in commodities has also restricted growth in exports of services. We estimate that the total volume of exports fell by 1.5% in 2013, making it the longest period of declining exports since the recession year of 2009. The trend is counter to Germany's. This is probably due to the composition of Sweden's exports, which has a high exposure to raw materials (paper/forest products) and by the strengthening of the krona. Weak demand in Europe, but also in the larger emerging markets, has led to a sharp decline in exports of raw materials and capital goods, while deliveries to the Nordic markets withstood the trend relatively well in 2013. The business sector's adaptation to the weak external demand has also led to a decline in imports, and net exports, therefore, made a positive contribution to GDP growth in 2013.

Exports are rising despite loss of market shares

We expect exports to once again find solid ground and increase over the course of 2014, in the wake of stronger global demand. Compared to our October forecast, we expect market growth for Swedish export companies to rise at a faster rate in the OECD countries, which will compensate for the emerging economies' lower growth. Industry's assessment of its export order book has strengthened in recent months and production plans have been adjusted upwards. The start-up of the oil refinery at Lysekil has also contributed to the recovery of the Swedish exports in 2014, after the production shutdown last fall. We anticipate that the total export volume will rise by more than 3.5% in 2014 which will give a higher quarterly rate than the historical average. Low resource utilisation and low investment activity in Europe will continue to limit Swedish exports. A slightly faster increase in unit labour costs than in the autumn forecast and the continued strength of the krona flattens the rise. Overall, this means that Swedish industry continues to lose market shares. In 2015, we anticipate that Swedish export volumes will grow by more than 6%, as the global demand for manufactured and capital goods strengthens. After several years of declining investment and higher capacity utilisation, the need for new investment increases if obsolete production capacity is to be replaced. The contribution of net exports to GDP growth is expected to be slightly positive.

Exports - markets and growth (in %)



Source: Statistics Sweden and Swedbank

Broad rise in investment

Investments stronger than expected

Investments have been better than we expected in the autumn. Instead of a decline of more than 3% for the full year 2013, we anticipate that the reduction will be limited to less than 1% after the strong third quarter investment boom and the upward revision of the first six months. Housing investment rose by more than 14% in the third quarter and accounted for a large part of the increase, but investment also took off in the industry and service sector. The recovery in investment is reflected in the SCB's recent investment survey in which the majority of industry sectors revised their investment plans upwards. This sits rather well with the growing optimism that has emerged in the PMI and in the NIER business survey.

Housebuilding will take off in 2014

We are revising investment growth in 2014 to 5.7 per cent, mainly due to higher housing investment. The number of apartments begun has risen by 32 per cent over the first three quarters of last year, compared to the same period in 2012. Low interest rates, high prices in the existing housing stock and a growing shortage of housing, stimulate an increase in residential construction. We expect housing investment to increase by 10 per cent in 2014. For next year, we expect the growth rate of housing investment to decline to 4 per cent, due to emerging supply constraints. The lack of available labour can combine with the sluggishness in the planning process.

Broad rise in investment in 2015

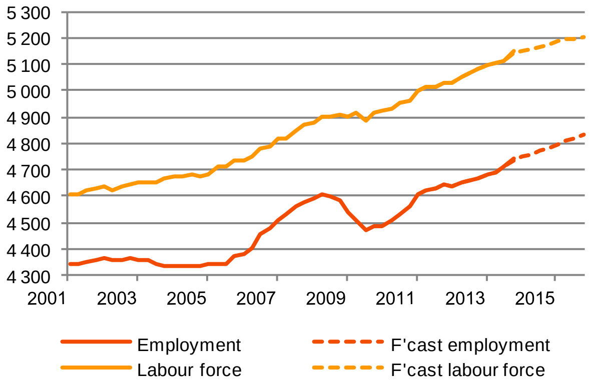
Business investment is expected to grow faster in 2015, an increase of 9 per cent, in line with higher production growth and increased capacity utilisation. The increase in purchasing power for households is expected to lead to greater investment in commercial and household services. The growing service segment in the Swedish economy and the emergence of new companies is also expected to lead to increased investment in the commercial service sector. The energy sector is another area of business in which large investment is planned in the near future. Investment is planned in the expansion of the national grid, the gas and district heating infrastructure, development of wind power, and upgrades of nuclear and hydropower. Continued investment in the local government sector means that total public investment is expected to grow faster next year than this year. Overall, we anticipate that total investment will rise by almost 7 per cent in 2015, which means that the investment ratio in the Swedish economy will reach 20 per cent of GDP, a level that was last reached in 2007.

Increasingly difficult to reduce unemployment

Employment and the workforce continue to increase

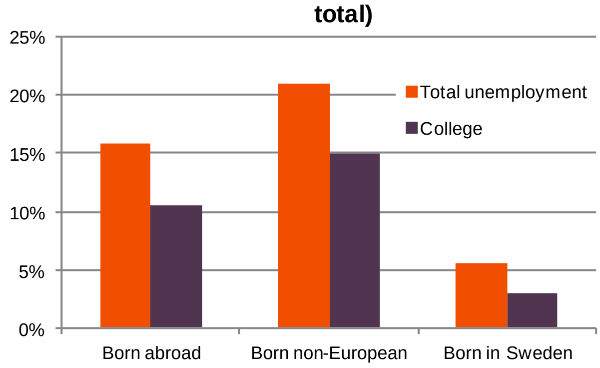
The labour market improved in the last year, a trend that is expected to continue in the near future. After a slow start, 2013 finished strongly. Employment rose by almost 50,000, an increase of approximately one per cent compared to 2012. The labour supply also continued to exceed expectations, which maintained the level of unemployment. Forward-looking labour market indicators, such as new job vacancies, employment plans according to the KI barometer and PMI, as well as surveys, suggest that the upturn in the economy is now giving an increasing demand for labour. This provides a greater footprint in the form of falling unemployment. The labour force is expected to grow at a healthy pace over the next few years, although it is somewhat dampened for demographic reasons. Immigration has increased more than expected and the Employment Service's recent responsibility for establishment means that newcomers will quickly enter the job market. Labour immigration has also become more common and the group enters the workforce directly. The increase in immigration and increased labour force participation among foreign-born citizens, from 65% in 2006 to 69% last year, account for most of the increase. Labour force participation among native-born citizens remained unchanged at about 73%. The participation rate is expected to continue to rise over the forecast period. The fifth work tax credit, which was introduced at the end of the year, is also expected to stimulate to an increased supply of labour.

Labour market ('000 persons, 15-74 yrs)



Source: Statistics Sweden and Swedbank.

Education level unemployed (share of total)



Source: Statistics Sweden and Swedbank.

Jobs are created mainly in the service sector

The new jobs over the past few years have primarily been created within the service sector. The increase was broad in the sense that there has been a rise in government-funded services, such as healthcare and education, as well as in corporate and household-related services. In the latter category, jobs are increasing in the catering industry, culture, entertainment, recreation and miscellaneous service companies. Meanwhile, the number employed in industry continues to decrease. Within the building industry, conditions have begun to improve and the number of jobs is expected to increase in coming years.

The composition of the unemployed changes

The relatively stable unemployment rate hides a growing proportion of unemployed who occupy a weak position in the labour market. These include the overseas-born from outside Europe (whose unemployment rate has tripled since 2008) and persons with disabilities (1/5 of the unemployed, double that of five years ago). A characteristic feature is that the unemployeds' level of education has gradually weakened, which is a consequence, among other things, of a high proportion of new arrivals having a very little education. *Nearly 30 per cent of registered unemployed have a level of education which corresponds to primary school level. This proportion is expected to increase in the coming years. Nearly 60% of the new arrivals in the establishment scheme only have a lower secondary education, most of whom have a level that is lower than primary school. More and more young people also leave secondary school with incomplete grades.* This will place great demands on the labour market and labour market policies when the demand for labour increases.

Recruitment problems in the trades

Wage growth is currently low and is well below 3% per annum, thanks to low central wage agreements and plenty of spare capacity in the labour market, which holds back wage increases. At the moment, there seem to be no general recruitment difficulties. The labour shortage is expected, however, to increase gradually over the forecast period, which is expected to provide an upward pressure on wages and increased matching problems as the labour market strengthens more clearly. There is a connection with increasing numbers of the unemployed being found in groups with a weak position in the labour market and that there are fewer and fewer jobs with low skill requirements. Qualification requirements have increased significantly in recent years, see Box 3. Shortages will gradually increase in parts of the private sector and in large parts of the public sector (including teachers and qualified medical personnel), not least in the wake of the impending generational change. The differences between regions and industries will also start to grow. It is likely that labour shortages will become more apparent in 2015 and beyond when the economy continues to strengthen.

Falling unemployment is not yet inflationary

The gradual change in the composition of unemployment raises questions about how much spare capacity is actually available in the labour market. The unemployment share of vulnerable groups is growing and the Employment Service estimate that it will constitute about 70% of the unemployed in about a year's time. Calculations by NIER, the OECD and the Ministry of Finance indicate that the Swedish equilibrium unemployment rate is between 6-7%, a level not reached in our forecast. The national bank considers that the equilibrium unemployment rate is in the range of 5.5 to 7 per cent, although the bank has given a risk scenario that in fact it may reach a little above the mid-point (6.25 per cent). NIER has recently revised down its estimate of equilibrium unemployment by a few tenths to about 6.7% in the current situation, which will drop to just over 6 per cent in 2023.

If the good employment growth is to continue in the years to come, the level of equilibrium unemployment could be tested in practice fairly soon. At present, the bottlenecks are limited but there is growing urgency to raise the educational level of the unemployed and to support entry into the workforce for the disabled and young people. This is usually a multi-year old process and it will place great demands on the Employment Service, local authorities and the education system in general.

Inflation picks up in 2015

The inflation rate has been low over the past two years and the CPIF has hovered around 1% since the beginning of 2012. The CPIF rose by a moderate 0.9% in 2013, with a surprisingly low service inflation helping to dampen price growth.

Subdued service prices keep inflation down ...

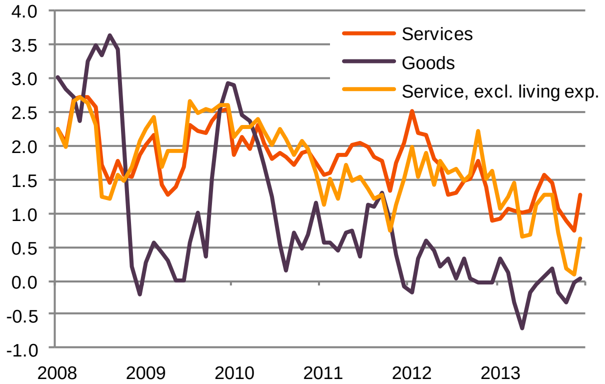
Measured as an annual rate, service prices excluding housing rose by 0.6% in December 2013, according to the Riksbank's shadow index. This means that inflation in Sweden differs to some extent from the international trend, where the present low inflation rates are essentially due to declining goods prices (see Box 1). The current low rate of price increases for services is explained by falling prices for transport services (annual rate of minus 1.5% in December 2013) and a decline in package holiday prices (annual rate of minus 3.4% in December 2013). Another factor is historically low price growth in hotels and restaurants, recreation and culture and other services.

... but the decline is temporary

However, the underlying trend varies between the different service sectors, and the annual growth rate in transport services and package holidays fell rapidly in autumn 2013, a trend which we consider to be temporary in nature. Positive base effects are expected to have an impact during the second half of this year. Price increases have also been low in other service sectors, although in recent months the annual growth rate has pointed upwards if anything, albeit from historically low levels.

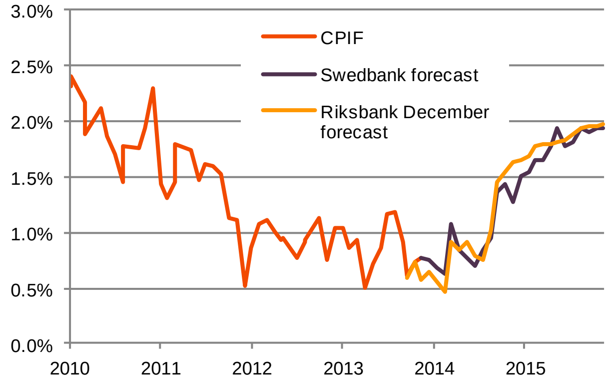
General price growth for goods in Sweden is subdued at present, and, measured as an annual rate, the prices were unchanged in December 2013. This is largely explained by low international price growth and a stronger krona, which keeps the imported inflation at bay, while growing competition reduces the ability of domestic companies' to increase prices in the home market.

Inflation (%, annual)



Source: Statistics Sweden

Inflation forecast (%, annual)



Sources: Statistics Sweden, Riksbank and Swedbank.

Low import price inflation reversed in 2015

With the slow global economic recovery and low growth levels in the major commodity-consuming economies, we expect to see a subdued commodity price trend this year followed by a clear, albeit modest, increase in 2015. These factors, alongside low international capacity utilisation and a gradual appreciation of the krona, will result in very moderate import price inflation this year. Global market prices will rise as the international recovery gathers pace, and the effects will be felt towards the end of the year. This trend will be accentuated during 2015.

Housing costs driving up CPI

During much of 2014, housing costs will be kept down by low interest rates and energy prices, which will also result in low rent increases. We expect the CPI group Housing, water, electricity and fuels, which has a weight of more than 26%, to rise by 0.6%. In the latter part of the year and during 2015, rising interest rates and higher energy prices will contribute to a significant increase in housing-related inflation and we expect the CPI group Housing, water, electricity and fuels to rise by 5.2%. As the majority of the increase will be due to higher interest rates, there will be a greater effect on the CPI than the CPIF.

Broad inflationary pressure in 2015

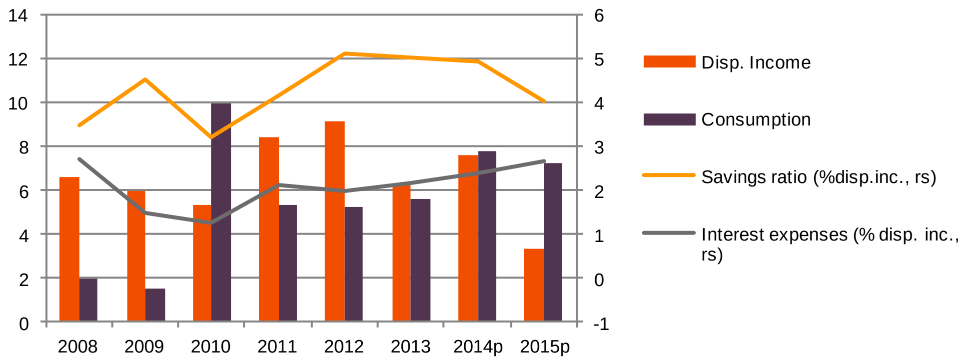
Next year will see rising inflationary pressure in both the services and goods sectors. Goods prices will increase in the face of a stronger global economy and a slight rise in commodity prices. In the service sector, prices will rise due to the combination of higher wage costs and a greater willingness to pay, in the wake of a strong labour market. Overall, we expect annual average consumer prices in the CPIF to rise by 1.8% in 2015, with prices in the broader CPI rising by 2.5%.

Household consumption constrained by rising interest costs

Strong income growth driving consumption

After the restrained household consumption last year, we expect a much stronger trend over the next two years, particularly with the support of good income growth. Total wages, which represent almost two-thirds of household nominal income, will show an annual increase of just over 4% during the next two years, as both the number of hours worked and nominal wages are rising faster than in 2013. With this year's tax cut and continuing low inflation, real disposable income will rise by 2.8% during the year. In a situation of rising inflation and no fiscal stimulus, disposable income will rise by a more modest 0.7% in 2015, which would make disposable income growth in the forecast period (2014 and 2015) lower than the historical average of 2.4%.

Household income and consumption (vol. % change)



Source: Statistics Sweden and Swedbank.

Consumer confidence rising ...

With more stable economic growth and notably less concern about the situation in the eurozone, we are seeing a rise in consumer confidence. Asset growth has been positive, and although we expect a much more modest rise in asset prices, particularly with a more subdued equity market performance, this growth provides support for increased consumption over the next few years. Overall, we expect household spending to increase by 2.9% this year, followed by a rise of 2.6% in 2015. Consequently, private consumption will become a leading economic driver in the coming years.

... but the saving is still high

Despite favourable income and asset growth and a high level of consumer confidence, we expect the household savings ratio to remain high, particularly during 2014. This year's tax cut will contribute to a slightly higher savings ratio this year. Demographic change and high unemployment during recent years, as well as changes in unemployment and social insurance benefits have provided motivation for higher precautionary saving, which we expect to remain high. Despite a gradual improvement in the labour market, unemployment is falling at a slow pace, which implies that the savings rate will continue to be high, at least during 2014. Another factors that points to a continuing high savings rate is uncertainty about new and/or sharper measures to reduce household debt. All this means that some of this year's favourable income growth will go to higher saving. The household savings rate will ease off in the following year due to weaker income growth and an increasingly encouraging labour market and economic growth situation. However, the savings ratio will remain high by historical standards, amounting to almost 12% this year and falling back to just over 10% in 2015.

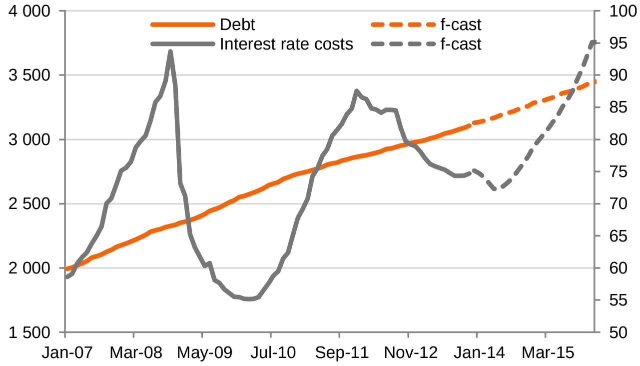
Box 4: Household interest rate sensitivity has macroeconomic consequences

There has been a focus on the ratio of household debt to disposable income in recent years. Household debt has increased continuously, reaching a very high level both by historical and international comparison, and this has led to an intense debate about the risks to financial stability and the role that monetary policy should play.

Although the rate of growth in household debt has slowed down in recent years, debt has been increasing faster than income for a long time, resulting in a continuously rising debt ratio. Low, and in some years falling, interest rates have also played a part in mitigating the increase in total interest expenses expressed in kronor. With the current high debt ratio and the fact that a large proportion of loans carry variable interest rates, households are very sensitive to interest rates, and relatively small changes in interest rates have a significant impact on interest expenses.

Household debt is hardly a major threat in the current year in view of strong growth in disposable income and expectations of low interest rates, but there will be a rapid increase in interest payments at the end of the forecast period. In the example below, we have assumed annual growth in household debt of 5 percent in both 2014 and 2015 (in line with the present growth rate). Interest expenses are based on our interest rate forecasts for mortgage rates in the CPI according to the 2013 maturity distribution. This means that we (probably) underestimate actual interest expenses a little. For 2014, household interest expenses (in kronor) will remain largely unchanged in a situation of falling interest rates.

Household debt and interest costs (mSEK)



Sources: Statistics Sweden and Swedbank.

Table: Household incomes and debt

	2010	2011	2012	2013	2014f	2015f
Disposable income (nom.)						
Change in %	3.2	4.9	4.8	*2.8*	*3.9*	*2.9*
Change SEK bn	51	82	83	*52*	*72*	*57*
Debt						
Change in %	7.5	5.1	4.1	*4.9*	*5.0*	*5.0*
Change SEK bn	188	137	117	*135*	*156*	*164*
Interest rate (%)	3.2	4.0	4.1	*3.5*	*3.3*	*3.7*
Interest costs (change SEK bn)	-0.5	18.5	10.5	*-7.8*	*-0.9*	*11.7*

Sources: Statistics Sweden and Swedbank.

We expect interest rates to rise slightly next year, although with a very moderate rate of increase as the average interest rate will rise by just 0.4 of a percentage point to 3.7 percent. However, even with this slight increase in the average interest rate, household interest expenses will rise by almost 12 billion according to our simplified calculations (corresponding to the year's in-work tax credit). Consequently, just over one-fifth of the increase in disposable income goes directly to rising interest expenses. At the same time, the average calculations are a little misleading. The graph shows interest payments rising significantly over the course of 2015. Interest payments in December 2014 are approx. 79 billion, while at the end of 2015 they have risen to 95 billion, i.e., interest payments during 2015 are approx.16 billion higher, while the interest rates on which the calculations are based have risen from 3.4 percent to 3.9 percent. The combination of high debt and rising (even moderately) interest rates is quickly reflected in interest expenses, which limits the scope for household spending. A similar trend produced a significant impact during 2011, when rising interest expenses resulted in falling consumer confidence and declining retail sales, while house prices fell and a marked decline in the Housing index was noted.

Household interest rate sensitivity is also illustrated by calculating the effects of a more rapid rise in interest rates with otherwise unchanged assumptions. In 2014, we have confined the rise in interest rates to the second half of the year. If interest rates rise by 30 basis points, household interest expenses will increase by a further 7.1 billion in 2015, which means that more than a quarter of the disposable income growth will be eaten up by rising interest expenses. Consequently, our calculations indicate that household interest expenses will rise by approx. 120 million per basis point during 2015.

One measure to bring down household debt that has been discussed is to reduce interest deductions. This may also have a clear effect in the form of rising household interest expenses. If interest deductions are reduced by 5 percentage points to 25 percent, household interest expenses will, in the main scenario, increase by a total of 11.7 billion in 2014 and 2015.

High household interest rate sensitivity is a key factor behind our forecast for a slowdown in household spending in 2015, with a lower growth rate for disposable income and rising interest rates clearly reflected in current interest rates. At the same time, we expect the debate about debt and debt-reduction measures to continue, which is a factor that points towards households maintaining a relatively high level of precautionary saving. Interest rate sensitivity also means that a normalisation of the Riksbank's key interest rate will quickly affect domestic demand, which in itself limits the scope for increases.

Inflation has the Riksbank on the retreat

Last of the interest rate cut surprises for now

The Riksbank lowered its key interest rate to 0.75% in December in the wake of unexpectedly low inflation in the autumn and is working on the basis that the first rate hike will not be needed until the beginning of 2015. We are seeing a gradual strengthening of both global and Swedish growth and the majority of the Riksbank's Executive Board members remain concerned about household debt, although this time the unexpectedly low inflation, particularly in service prices, has been a crucial factor. However, a downward revision of the Riksbank's household consumption forecast has been noted, meaning that the Bank does not believe that the demand-driven inflationary rise will persist for long. It is Swedbank's assessment that this was the last rate cut. With growth is now strengthening, particularly in domestic demand, Swedbank's forecast is that the Riksbank will raise interest rates by the end of 2014. The forecast is for the Riksbank's interest rate increases in the years 2014-2015 to total 100 points, 1.75%.

Interest and exchange rate assumption

	Outcome	Forecast			
	2014 17-jan	2014 30 jun	2014 31 dec	2015 30 jun	2015 31 dec
Interest rates					
Swedish reporate	0.75	0.75	1.00	1.25	1.75
10 year governerment bond rate	2.5	2.6	2.8	3.1	3.5
Exchange rates					
EUR/SEK	8.76	8.60	8.50	8.40	8.40
USD/SEK	6.47	6.62	6.80	6.72	6.46
KIX (SEK)	103.0	102.6	102.,9	102.2	101.7

Sources: Reuters Ecowin and Swedbank

Significant real economic effects of the monetary policy

High household debt and increasing interest rate sensitivity mean that a rise in interest rates will have a negative impact on the housing market and private consumption at a relatively early stage. This suggests a relatively cautious pace for interest rate increases. This is also illustrated by the experience of the housing market and consumer spending from the relatively modest tightening of the monetary policy in 2011.

The Riksbank will continue to take imbalances into account

The government has decided that the Swedish Financial Supervisory Authority has responsibility for macro-prudential supervision. The Authority has already announced that it believes it may be appropriate to increase the risk weighting for mortgages from 15 to 25%. Additional charges are expected during the year, including the introduction of countercyclical buffers which will also increase banks' capital requirements. The Riksbank has expressed major concern about household debt and this is a factor that will continue to be weighed into its monetary policy. The Governor of the Riksbank wants to see a housing commission that takes a broad approach to the imbalances in the housing market. To what extent other measures may reduce the Riksbank's need to consider the housing market in its monetary policy will be partly dependent on how far and at what rate these measures are implemented. It is our assessment that the combination of debt and improving growth and employment rules out further interest rate cuts and will gradually give rise to a less expansionary monetary policy, unless inflation brings any major surprises on the downside.

Swedbank's inflation forecast indicates higher short-term Swedish interest rates for the time being, but low inflationary pressure at the beginning of the forecast period and developments in the U.S. interest rate market are creating the conditions for the Swedish fixed income market to be dominated by carry trades. In addition, the banks' funding situation is good and despite the Riksbank's concern about household debt and the housing market, we see no obvious threat in the short term. Consequently, we see good potential in investment in mortgage bonds, particularly in two-year mortgage bonds during the first half of 2014.

Shrinking scope for fiscal policy

Amid an infected budget row, the government's proposal to raise the threshold for state income tax was defeated. The cost had been estimated at 3 billion, and parliament's decision means a reduced increase in household disposable income in 2014 and some strengthening of financial saving.

Continuing stimulus measures in 2014

The fact that the state received less tax revenue from companies in 2013 increases the uncertainty about budgetary development in 2014. Overall, the budget bill for 2014 involves large income tax cuts for broad groups of workers and pensioners and stimulus measures for household finances. In light of the fiscal policy framework, with a surplus target of 1% over the business cycle, and rising public needs, there will be very limited scope for further fiscal stimulus in the coming years. Consequently, we do not expect any further tax cuts in 2015; instead, we anticipate upward pressure, particularly from the municipalities. At the same time, pension payments are expected to be lower in 2014 due to the "brake" and to increase marginally in 2015 (in nominal terms by about 2%).

Fiscal consolidation from 2015 onwards

Income tax cuts and the absence of large increases in expenditure mean that a moderate increase in public spending is expected in 2014. Financial saving will be negative in 2014 and 2015, and will not return to a positive situation until after the end of the forecast period. This will further fuel the debate about what is required to reach the surplus target and will put pressure on fiscal restraint from 2015 onwards.

Estonia: Serious risks from labour market

Despite the sluggish recovery of Estonia's main trading partners, external demand will gradually improve in 2014-2015, accelerating economic growth with stronger exports and investments. At the same time, the deteriorating labour market poses risks for balanced and sustainable growth, with increased wage pressures reducing corporations' competitiveness and resilience to possible financial difficulties.

Key economic indicators, 2012-2015 [1/]

	2012	2013e		2014f		2015f	
Real GDP growth, %	3.9	1.0	(1.6)	3.0	(3.8)	3.7	(4.2)
Consumer price growth, %	3.9	2.8	(3.0)	2.6	(2.8)	2.9	(2.9)
Unemployment rate, % 2/	10.2	8.6	(8.7)	8.3	(8.3)	7.9	(7.9)
Real gross monthly wage growth, %	1.9	5.0	(3.6)	4.4	(3.7)	4.4	(3.8)
Current and capital account balance, % of GDP	1.7	0.9	(1.7)	1.0	(1.8)	0.7	(1.9)
General government budget balance, % of GDP 3/	-0.2	-0.6	(-0.2)	-0.4	(-0.6)	-0.3	(-0.7)

1/ October 2013 forecast in parenthesis
2/ According to Labour force survey.
3/ According to Maastricht criterion.

Sources: Statistics Estonia, Bank of Estonia, Swedbank.

Upturn of external demand is needed for acceleration of economic growth

The external demand for Estonian exports was weaker than expected in the second half of 2013. The recovery of the economies of Estonia's main export partners - Finland, Sweden, and Russia - was sluggish. Economic growth in Latvia and Lithuania decelerated somewhat in 2013 as well. In manufacturing, the main export sector, the share of exports in turnover decreased towards the end of the year, whereas enterprises directed more of their sales to the domestic market. Since the import content of output is high in Estonia, the slowdown of production volumes, together with the decelerated demand for capital goods for investment, has slowed import growth as well. Since exports grew less than imports in real terms, net exports had negative contribution to the GDP growth in 2013. An upturn of external demand and export growth is a precondition for the acceleration of economic growth. Fortunately, we expect a gradual improvement in the economies of Estonia's main trading partners in 2014-2015, which would strengthen their demand for its exports. An acceleration of the growth of production and investments in the forecast period will contribute to an increase in imports, as well. We expect the negative contribution of net exports to persist in 2014 and 2015, as usual for Estonian economy during the growth period.

The terms of trade improved in 2013, as import prices decreased more than export prices. Exports from Estonia have shifted more towards products with higher value added, whereas the country's position in the chain of subcontracting has risen. This has created a more beneficial surface for the export prices. At the same time, the deceleration of global commodity prices has had a downward effect on import prices. We expect that the terms of trade will remain favourable for Estonia during the forecast period, although the spread between export and import prices will narrow. The expected weakening of euro exchange rate in 2014 will contribute to this, besides other factors.

The major negative contribution to the slowdown of economic growth in 2013 came from the transport and construction sectors, whereas domestic trade and manufacturing contributed solidly. The transport sector was mostly affected by the decrease in the value added of air transport in real tems and dropoff in transit, especially of fuels. Russia is developing its own cargo ports on the Baltic Sea, and the tightening competition will limit the growth of the transport sector in coming years. Air transport together with railway and water transport subsectors are suffering from losses. The construction sector was negatively affected by the strong decline in investments from government compared with the year before. Domestic trade is supported by the rising purchasing power of households due to the stronger wage growth. The manufacturing sector, although suffering from the fall in external demand, has benefited from the improvement in the terms of trade and has been able to increase its value added. Together with the recovery in demand from Estonia's trading partners, the manufacturing sector is expected to continue contributing strongly to GDP growth in the forecast period.

Investment growth will accelerate in 2014 and 2015

The corporations' need for investments is modest due to the underemployment of the capital invested in 2011 and 2012. In addition, the recovery of demand has been slow. Corporations' investments in general were moderate in 2013, and mainly in the energy sector. The main negative contribution came from the strong decrease in government investments as EU transfers and revenues from carbon dioxide quota sales considerably diminished. The decrease in external funds has had the most negative effect on construction sector investments. With government investments decreasing, investment growth will be supported more by the corporate sector. We expect that investment growth will accelerate in 2014 and 2015, as the improving external demand will contribute to production growth, and corporations will have to invest in increasing capital.

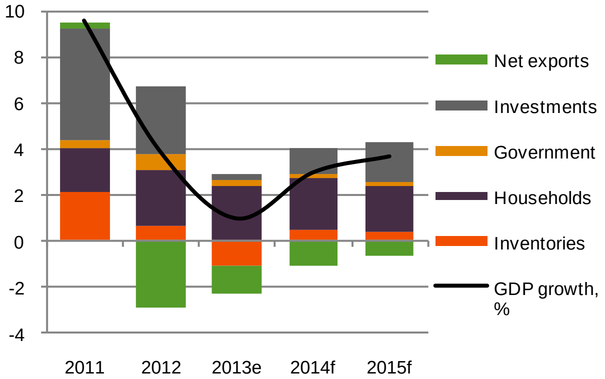
Risks from the labour market have increased

Risks from the labour market to the balanced and sustainable economic growth increased in 2013 as labour force shortage caused substantial wage pressures. Although the expected recovery of economic activity in 2014 will increase demand for labour, the negative natural increase of the Estonian population and net migration, together with the changing age structure, will decelerate employment growth. Employment could even decrease towards the end of the forecast period. Although the unemployment rate is still above 8%, employers have experienced difficulties in finding employees who could meet their expectations. Many of the unemployed lack qualifications and skills, which prohibits them from finding jobs.

Wage pressures will not ease during forecast period

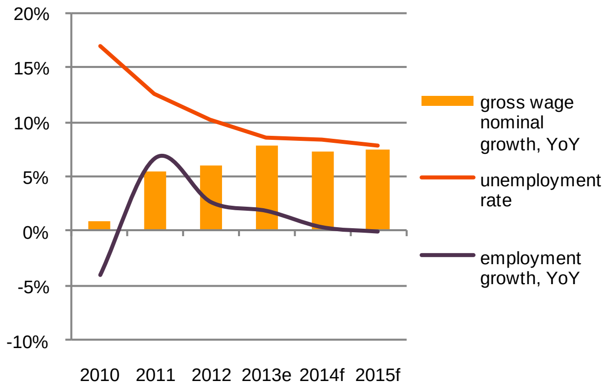
Mainly due to the lack of qualified workers, wage pressures have increased at an alarming rate. A supplementary upward effect on wages comes from the increase in the minimum wage in 2013-2015 and the planned increase of public sector wages in 2014. Labour costs have been rising faster than productivity since 2011; this could impair corporations' ability to hire and maintain jobs, especially if economic problems arise. The continuing growth of unit labour costs can reduce the cost competitiveness of exporters. Higher labour costs have, at least partially, already contributed to lowering corporations' profitability. We do not expect wage pressures to ease during the forecast period as long as the labour force shortages remain. The situation could be mitigated by the advised training of unemployed, as well as by policies to raise the participation rate, although already high. As employment growth will decelerate or even decrease in a few years time, productivity should be improved to ensure stronger economic growth.

Contributions to GDP growth, pp



Sources: Statistics Estonia, Swedbank

Labour market indicators



Source: Statistics Estonia, Swedbank

Both rising real wages and improving consumer confidence kept private consumption robust in 2013. Although the growth rate of private consumption will slow somewhat in 2014 and 2015, as employment growth will fall, private consumption will contribute considerably to economic growth as purchasing power will remain relatively strong.

Inflation expected to stay low

Estonia's inflation has decelerated steadily and will stay below 3% in 2014 and 2015. External price developments will remain favourable. Transport prices are expected to decline further in 2014 and 2015 as the price of oil in euros decreases. Global oil prices are declining because the world's oil supply will increase more than demand. Global food prices in euros will also decrease in 2014 but will then recover to the 2013 level the year after. The contribution of the higher electricity price from the liberalisation of the electricity market that pushed up inflation in 2013, will recede in 2014. At the same time, domestic price pressures will strengthen. Wages are pushing up the prices of labour-intensive services. Because rising incomes and strong consumer confidence will also keep consumption strong this year and the year after, prices will increase in the sectors where the competitive situation will allow it.

Primarily due to the postponed and sluggish recovery of the external demand of several of its trading partners, Estonia's economy will grow by only 1% in 2013, i.e., less than we forecast in the *Swedbank Economic Outlook Update* in October. We expect that external demand will gradually recover and push GDP growth to 3% in 2014 and 3.7% in 2015.

Main risks have not changed

The main risks set out in the previous *Swedbank Economic Outlook* have already been partially realised. The improvement of external demand has been delayed, and the lack of qualified workers has caused alarmingly strong wage pressures; this latter could worsen the competitiveness of exporters if wage pressures will remain.

Latvia: New government, old challenges

Latvia enters 2014 with a new currency and, soon, a new government. The short-term effects of the euro on growth are likely to be small. In 2014-2015, GDP is forecast to grow by 4-5% annually. Exports and investments will pick up due to external demand recovery. The labour market is heating up slowly, supporting household spending growth, but raising risks to competitiveness towards the second half of 2015.

Key economic indicators, 2012-2015 1/

	2012	2013e		2014f		2015f	
Real GDP growth, %	5.0	4.4	(4.3)	4.8	(4.3)	4.5	(4.2)
Consumer price growth, %	2.3	0.0	(0.1)	2.5	(2.8)	2.8	(2.8)
Unemployment rate, % 2/	15.0	11.8	(11.5)	10.4	(10.5)	9.3	(9.5)
Real net monthly wage growth, %	1.6	5.8	(4.9)	4.4	(3.1)	4.6	(4.1)
Current account balance, % of GDP	-1.7	-0.3	(-1.4)	-0.8	(-2.3)	-1.5	(-2.9)
General government budget balance, % of GDP 3/	-1.3	-1.3	(-1.3)	-0.6	(-0.6)	-0.7	(-0.6)

1/ October 2013 forecast in parenthesis

2/ According to Labour force survey.

3/ According to Maastricht criterion.

Sources: CSBL and Swedbank.

The New Year has brought a new currency…

As of January 1, Latvia became the 18th member country of the euro area. We forecast the short-term positive effects of this on the economy to be rather small, though we do expect larger foreign direct investment inflows in 2014 after very weak flows last year. At the same time, we expect the gains from euro adoption to accumulate gradually in the coming years (e.g., lower funding costs for both the public and private sectors). We see euro adoption as an opportunity to make the economy more resilient to shocks and promote fast and sustainable growth; however, this will happen only if structural reforms to improve public sector governance and speed up overall productivity growth are implemented.

… and very soon, also, a new government

Prime Minister Dombrovskis unexpectedly resigned in November 2013, assuming responsibility for the Zolitude tragedy, in which 54 people died when a supermarket roof collapsed. The new government is expected to be formed very soon; it is likely to be less reform ambitious, but we see no major shifts in economic policy. Given the upcoming parliamentary elections in October 2014, the reform drive had already faded before the government change. There could be policy changes after the elections, but so far it seems that the general direction will remain the same. Yet, the current government change seems to have postponed a bit a rise in the sovereign credit ratings.

GDP growth in 2013 was largely in line with our forecast, and we estimate it to have reached 4.4%. Robust household consumption was the main driver of growth, while exports and, particularly, investments were weak. Imports fell, since household consumption growth was to a large degree driven by services, while investments were concentrated more in construction, and both services and construction rely mainly on domestic inputs.

Economic growth to remain in 4-5% range over the next two years

In 2014, we expect economic growth to be driven more by exports, both directly and indirectly through investments. Household consumption growth is forecast to slow somewhat due to higher inflation (but less so than in our October *Outlook*, since price growth is now also expected to be slower). At the same time, the improving global outlook, rising confidence, and still-low interest rates will promote exports and investments. We expect exports still to grow a tad slower than household consumption in 2014, but to take the lead in 2015. We revise the GDP growth forecast up to 4.8% in 2014 and 4.5% in 2015 (4.3% and 4.2% before), as faster-than-expected wage growth will translate into stronger consumption. Imports are anticipated to pick up gradually, increasingly deducting from growth. This baseline scenario thus depicts a broad and quite robust growth outlook for the next two years.

Labour market, gradually heating up, is the main risk to sustainable growth

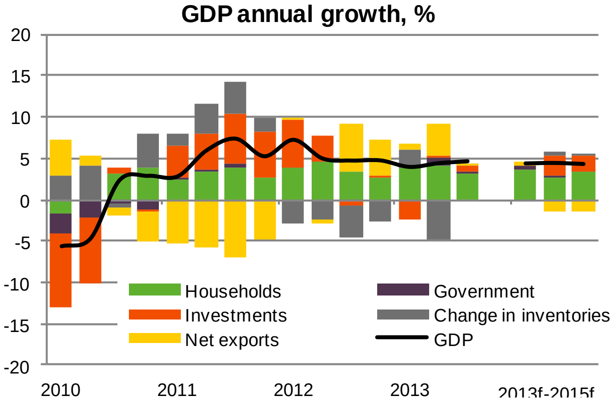
Growth could turn out to be more forceful than this. The main driver is likely to be the labour market – if this heats up quicker than expected, it would first accelerate growth via stronger consumption. Yet, this raises the risks of a sharp correction afterwards when undue wage increases hit competitiveness. A question is whether Latvia − a small, open economy with free cross-border labour flows and large income gaps with more developed countries in the EU − can effectively lessen such overheating. It is a key domestic risk to the baseline scenario, causing stronger growth in 2014-2015 followed by a sharp slowdown afterwards. As for external risks, a stronger or weaker global demand predominates.

In the baseline scenario, we see over the next two years the labour market tightening up gradually without a major hit to competitiveness. Real gross wages have been growing somewhat faster than productivity over the past year, but competitiveness has remained good so far. We anticipate the employment and participation rates continuing their rise, and the unemployment rate in 2015 permanently sliding below 10%., We see wage pressures building up gradually, as unemployment falls, which will yield about 6-7% nominal gross wage growth per annum (in 2014, partly due also to a minimum wage hike).

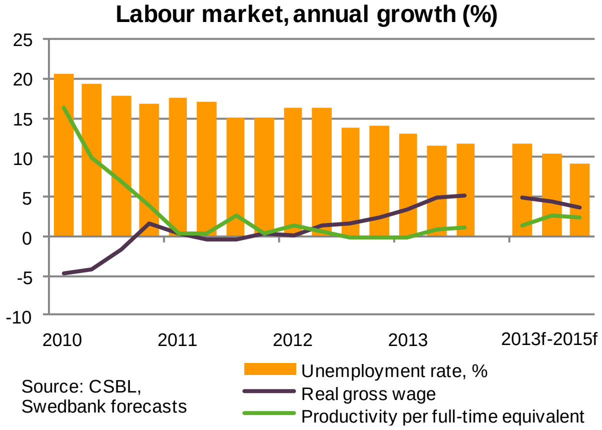
The updated medium-term budget framework for 2014-2016 sets a somewhat slower pace of labour tax cuts than earlier envisaged. This is likely to put more pressure on companies to raise wages, as the government's contribution via lower taxes is now less clear cut. Wage growth is forecast to exceed somewhat that of productivity, but the gap is unlikely to yield major competitiveness problems in the coming two years. However, we now see that labour market overheating risks in the medium term have risen – the Estonian evidence shows that imbalances can escalate quickly. The most effective way to counteract this is for policymakers to implement productivity-enhancing structural reforms. Unfortunately, these are likely to be slow to come (see the *Baltic Sea Report*[1] for details) and labour market imbalances to become more acute.

Inflation to remain moderate

We do not see inflation to be a problem over the forecast horizon as gradually building up domestic pressures will be mitigated by favourable global price developments. Given the weaker-than-expected inflation in the second half of 2013, we now forecast somewhat lower inflation for 2014, at 2.5%. Lower gas and heating tariffs (due to a lower global oil price) will partly compensate for a hike in electricity tariffs for households due to the forthcoming market liberalisation in April and the planned Riga water supply tariff hike in May-June. Food price inflation is expected to remain moderate, owing to favourable global trends. In 2015, we forecast inflation to pick up a tad as, e.g., the euro weakens, but still to remain below 3%.



Source: CSBL, Swedbank forecasts



Source: CSBL, Swedbank forecasts

Household income growth will drive spending

The tightening labour market will continue to support household consumption, as will pension indexation, labour tax cuts, and lending to households (even though their credit stock will keep falling as amortisation and write-offs of existing loans will still exceed new lending). Real income growth will ease up somewhat in 2014 due to higher inflation, but will pick up again in 2015 as net wage growth strengthens.

Export growth to pick up with global recovery

In the third quarter of 2013, export volumes were smaller than a year ago. We expect this to have been temporary, as it largely reflects base effects of the exceptional grain crops in 2012 and the standstill at the Liepājas Metalurgs as of spring 2013. Meanwhile, exports of other major product groups continue rising, and growth in services exports remains good (a decline in freight transportation is being compensated for by tourism and business services' figures). When growth in the euro area roots in, Latvian export growth is expected to pick up.

Companies need to invest more to build up capacity for future growth

The fall in investments seems to have bottomed out in mid-2013. We expect investments to pick up in 2014 (especially in the private sector), mainly for two reasons. First, the need for investments is high (i.e., high capacity utilisation, and the need to develop infrastructure and raise productivity to reduce labour dependency and wage pressures). Second, companies have the means to invest (i.e., large deposit volumes and forthcoming EU fund reimbursements for the previous period), while interest rates will remain low. In 2015, we expect investment growth to weaken somewhat as companies postpone their investments to take advantage of the new-period EU funds that are anticipated to become available in late 2015 or early 2016, after the administrative issues are set.

A fall in imports in 2013 reduced the current account deficit. Thus, we now expect smaller deficits also in 2014-2015, although imports are set to recover (e.g., more investments in machinery and equipment, which is import intensive, and more imported consumer goods).

Fiscal policy to remain prudent

The 2013 budget deficit most likely was lower than the 1.6% of GDP planned by the Ministry of Finance. Tax revenues were 6.6% above those of 2012 and 3.7% above plan. The 2014 budget is fiscally prudent, with a deficit target of 0.9% of GDP. We see the authorities taking very moderate steps to reduce the labour tax wedge, and some of the measures will slightly ease income inequality as well. However, the 2014 budget is very much a pre-election type of budget and not ambitious in terms of structural reforms.

[1] http://www.swedbank-research.com/english/baltic_sea_region_report/2013/11/28/index.csp

Lithuania: A spell of disappointing growth

Growth was somewhat disappointing in 2013, mainly due to the weak performance of manufacturers of chemical and petroleum products. We expect growth to pick up this year and, especially, in 2015, when the Lithuanian currency is likely to be replaced by the euro. Despite the lack of structural reforms, economic growth remains balanced, and the main risks are related to possible external shocks.

Key economic indicators, 2011-2015 [1/]

	2012	2013f		2014f		2015f	
Real GDP growth, %	3.7	3.3	(4.0)	3.7	(4.0)	4.2	(4.5)
Consumer price growth, %	3.1	1.0	(1.3)	1.5	(2.5)	3.0	(3.0)
Unemployment rate, % [2/]	13.4	11.7	(11.5)	10.0	(9.5)	9.0	(8.5)
Real net monthly wage growth, %	0.5	5.0	(3.0)	3.8	(2.8)	3.0	(3.0)
Current account balance, % of GDP	-0.2	0.0	(-0.9)	-1.8	(-2.2)	-3.5	(-3.1)
General government budget balance, % of GDP [3/]	-3.2	-2.9	(-2.7)	-2.0	(-1.7)	-1.0	(-0.7)

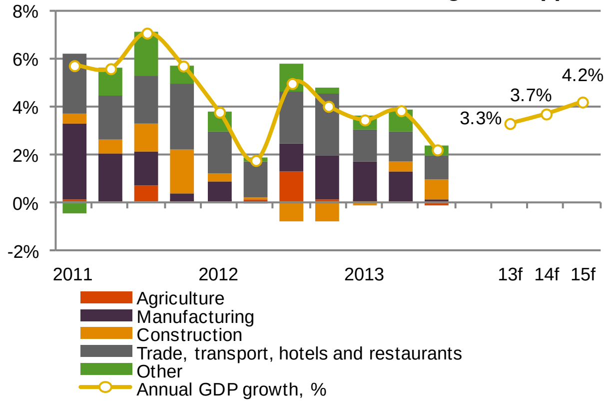
1/ October 2013 forecast in parenthesis
2/ According to Labour force survey.
3/ According to Maastricht criterion.

Sources: Statistics Lithuania, Bank of Lithuania and Swedbank.

Growth was weaker in 2013 but is likely to accelerate in 2014 and, especially, in 2015

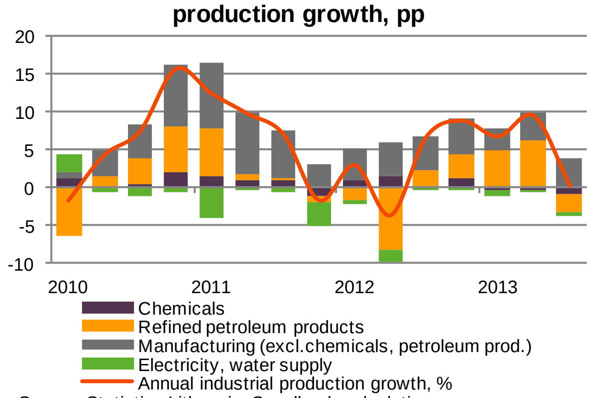
GDP growth in 2013 was weaker than in 2012 and below our forecast. We estimate that the economy expanded by 3.3% last year, despite a rapid increase in household consumption and strong rebound in investments. The main drag on economic growth was the very weak performance of manufacturers of fertilisers and refined petroleum products. The agriculture sector disapointed as well – despite a larger area of crops, the output was lower than in 2012 and had a negative (-0.2 pp) impact on growth in the third quarter of 2013. On the other hand, the construction, trade, accomodation, and catering sectors contributed strongly to overall growth and will probably continue doing so in 2014.

Contribution to annual GDP growth, pp



Source: Statistics Lithuania, Swedbank calculations

Contribution to annual industrial production growth, pp



Source: Statistics Lithuania, Swedbank calculations

Domestic demand became the main driver of growth

As we expected, domestic demand was the main driver of growth in the second half of last year. Investments surprised on the upside – gross fixed capital formation during the first three quarters of last year was 12.2% higher than a year ago and was boosted by all investments— business, public, and household. The number of residential real estate transactions increased by 22% during the first three quarters of 2013 compared with the same period a year ago, indicating a clear turn in households' expectations. Growth in investments in fixed tangible assets was on an upward trend throughout the year and was affected by both private and public investments. Investment growth last year was also boosted by some one-off factors, such as higherpublic investment related to Lithuania's Presidency of the Council of the EU, as well as by an increase in land purchases induced by new regulations on agricultural land. Public investment will increase by 8% this year, and we expect a similar pace ofprivate sector investment growth. The lack of other ways to remain competitive will provide grounds for rapid investment growth. We expect business investment to grow faster in 2015, when companies can access the EU structural funds for the new 2014-2020 programming period.

Renovating Soviet-era buildings will support investment and employment growth

Investments and employment will be supported by the program to renovate old buildings. Since the beginning of this program in 2005, only 500 energy-inefficient buildings have been renovated. However, after some changes in the program, it is likely that the process will gain momentum during the next couple of years. Last year alone, the number of apartment buildings that were renovated increased to almost 200. Almost 2,500 apartment buildings still need to be renovated, and most of the construction will likely take place during the next two years. According to our estimate, this construction alone would increase GDP growth by up to 0.3 percentage point (pp) in each of the coming two years.

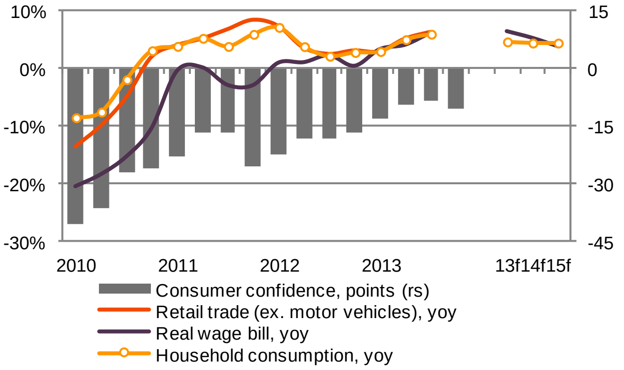
Not least because of the recovering construction sector, employment is expected to increase at the same pace as last year – by 1.4%. However, due to the more evident signs of structural unemployment and lack of labor market reforms, we raised the unemployment forecast for 2014 and 2015 to 10% and 9%, respectively. As the social benefits will be distributed by municipalities at the beginning of this year and benefits for long-term unemployment will be phased out, we expect the labor market participation rate, which reached a record high of 72.6% in the third quarter of last year, to continue increasing.

Faster wage growth, increasing employment, and improved expectations will support strong household consumption growth

Household consumption also suprised on the upside – we estimate that it increased by 4.7% last year, on the back of faster wage growth, rapidly rising employment, and improved expectations. Although an estimated 6.4% growth in gross wages last year was boosted by a one-off increase of the minimum wage, we expect the rapid growth of wages to continue. The real growth of the wage bill almost tripled last year to 6.4% and will remain strong this year and the next, at 5.3% and 3.8%, respectively. Thus, we forecast that, in the coming two years, household consumption will remain the main driver of growth.

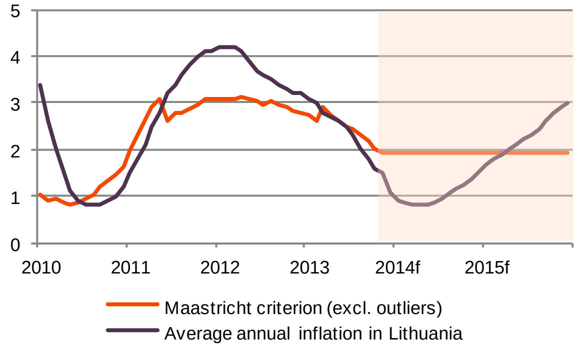
Stable prices have supported household purchasing power and consumption as well. Average annual inflation declined to 1.0% last year and remains comfortably below the Maastricht criterion. Due to the expected weakness of commodity prices, we lowered this year‘s forecast to 1.5% but expect prices to grow by 3.0% next year, mainly because of increasing labour costs.

Annual growth of retail trade, real wage and consumption



Source: Statistics Lithuania

Average annual inflation and Maastricht criterion, %



Source: Eurostat and Swedbank

Despite the expected stronger domestic demand, we have cut the GDP forecast for both 2014 and 2015 by 0.3 pp, mainly due to an expected widening of the trade deficit. Exports probably contracted in the final quarter of last year; this will have some negative carryover into 2014. A rebound in export growth is likely, but not certain – although most of the sectors continued growing fairly well, producers of fertilisers face big competition issues, and it is not clear if these can be eliminated soon. New fertiliser factories in Africa and record exports of carbamides from China have pushed down prices significantly, whereas the biggest producer of fertilisers in Lithuania buys relatively expensive gas and has limited possibilities to cut costs and prices. The Temporary russian embargo of dairy products from Lithuania in the third quarter will not have long-lasting effects.

Export growth has lost its steam

Overall, the impressive growth of exports during the last three years – they increased by 67% from the trough in 2009 – has obviously lost its steam. This slowdown is partly due to the fading one-off effects, but underinvestment in recent years and increasing competition in foreign markets also played a part. If the gap between labour productivity and wage growth continues to widen, rising unit labour costs are likely to start weakening the competitiveness of Lithuanian producers and thus dampen export growth. In addition, stagnating structural reforms have failed to boost competitiveness. Tax reform, which was expected to slash labour costs, has petered out, and only symbolic adjustments have been made so far. More important, the problems of labour market inflexibility and the lack of skilled labour have not been addressed, although the government plans to revisit the establishment of a labour code this year. However, not too much progress should be expected before the European Parliament elections and Lithuania‘s presidential elections this May.

The chances that Lithuania will adopt the euro in 2015 are very good

Although national budget revenues were slightly above the plan last year, nominal GDP was probably slightly below the Ministry of Finance forecast. We estimate that the ratio of general government deficit to GDP was probably very close to 3.0% last year, but the exact number will not become clear until the spring. However, since the government plans to cut the budget deficit to 1.9% this year, the European Commission will most likely assess positively Lithuania's convergence, and Lithuania will become the 19th euro area country in 2015, following Latvia's accession this year.

ESTONIA: Key economic indicators, 2011-2015 [1/]

	2011	2012	2013e		2014f		2015f	
Real GDP growth, %	9.6	3.9	1.0	(1.6)	3.0	(3.8)	3.7	(4.2)
Household consumption	3.8	4.9	4.7	(5.1)	4.2	(4.6)	3.8	(3.8)
Government consumption	1.3	3.8	1.2	(0.6)	1.3	(1.1)	1.0	(1.0)
Gross fixed capital formation	37.6	10.9	1.0	(-2.0)	4.0	(4.0)	6.0	(5.8)
Exports of goods and services	23.4	5.6	1.9	(3.5)	4.5	(5.5)	7.0	(7.3)
Imports of goods and services	28.4	8.8	3.0	(4.0)	5.5	(5.3)	7.5	(7.0)
Consumer price growth, %	5.0	3.9	2.8	(3.0)	2.6	(2.8)	2.9	(2.9)
Unemployment rate, % [2/]	12.5	10.2	8.6	(8.7)	8.3	(8.3)	7.9	(7.9)
Real gross monthly wage growth, %	0.4	1.9	5.0	(3.6)	4.4	(3.7)	4.4	(3.8)
Nominal GDP, billion euro	16.2	17.4	18.4	(18.5)	19.6	(19.7)	21.1	(21.1)
Exports of goods and services (nominal), % growth	28.9	7.5	2.6	(4.9)	5.6	(7.6)	8.9	(9.7)
Imports of goods and services (nominal), % growth	35.6	11.7	2.2	(4.2)	6.4	(6.8)	9.2	(9.3)
Balance of goods and services, % of GDP	6.1	2.5	1.0	(1.3)	1.0	(1.6)	1.1	(1.9)
Current account balance, % of GDP	1.8	-1.8	-2.1	(-1.4)	-2.2	(-1.3)	-2.3	(-1.1)
Current and capital account balance, % of GDP	5.9	1.7	0.9	(1.7)	1.0	(1.8)	0.7	(1.9)
FDI inflow, % of GDP	1.5	6.8	3.6	(1.4)	4.6	(4.6)	4.3	(4.3)
Gross external debt, % of GDP	94.0	95.4	92.3	(91.4)	88.9	(86.9)	84.9	(82.2)
General government budget balance, % of GDP [3/]	1.1	-0.2	-0.6	(-0.2)	-0.4	(-0.6)	-0.3	(-0.7)
General government debt, % of GDP	6.1	9.8	10.1	(10.0)	10.0	(10.1)	10.0	(10.2)

1/ October 2013 forecast in parenthesis
2/ According to Labour force survey
3/ According to Maastricht criterion

Sources: Statistics Estonia, Bank of Estonia and Swedbank.

LATVIA: Key economic indicators, 2012-2015 [1/]

	2012	2013e		2014f		2015f	
Real GDP growth, %	5.0	4.4	(4.3)	4.8	(4.3)	4.5	(4.2)
Household consumption	5.8	5.7	(5.8)	5.0	(4.0)	5.5	(5.2)
Government consumption	-0.2	1.8	(2.0)	1.7	(2.1)	0.7	(0.5)
Gross fixed capital formation	8.7	-1.0	(0.5)	9.0	(11.0)	8.0	(8.0)
Exports of goods and services	9.4	1.3	(1.3)	4.5	(4.8)	6.5	(7.0)
Imports of goods and services	4.5	-0.9	(0.5)	6.5	(7.0)	8.0	(8.6)
Consumer price growth, %	2.3	0.0	(0.1)	2.5	(2.8)	2.8	(2.8)
Unemployment rate, % [2/]	15.0	11.8	(11.5)	10.4	(10.5)	9.3	(9.5)
Real net monthly wage growth, %	1.6	5.8	(4.9)	4.4	(3.1)	4.6	(4.1)
Nominal GDP, billion euro	22.1	23.6	(23.6)	25.8	(25.7)	28.2	(28.0)
Exports of goods and services (nominal), % growth	13.9	2.8	(2.2)	6.9	(7.6)	9.7	(10.7)
Imports of goods and services (nominal), % growth	12.0	-0.5	(1.3)	8.1	(9.1)	10.9	(11.5)
Balance of goods and services, % of GDP	-3.6	-1.3	(-2.7)	-1.9	(-3.5)	-2.6	(-4.0)
Current account balance, % of GDP	-1.7	-0.3	(-1.4)	-0.8	(-2.3)	-1.5	(-2.9)
Current and capital account balance, % of GDP	1.3	2.3	(1.4)	1.7	(0.2)	1.3	(-0.0)
FDI inflow, % of GDP	3.9	2.4	(3.0)	3.7	(3.7)	3.2	(3.2)
Gross external debt, % of GDP	136.2	129.5	(135.6)	122.5	(129.2)	114.0	(119.8)
General government budget balance, % of GDP [3/]	-1.3	-1.3	(-1.3)	-0.6	(-0.6)	-0.7	(-0.6)
General government debt, % of GDP	40.6	38.4	(42.7)	36.9	(39.6)	30.6	(31.2)

[1/] October 2013 forecast in parenthesis
[2/] According to Labour force survey.
[3/] According to Maastricht criterion.

Sources: CSBL and Swedbank.

LITHUANIA: Key economic indicators, 2011-2015 [1/]

	2011	2012	2013f		2014f		2015f	
Real GDP growth, %	6.0	3.7	3.3	(4.0)	3.7	(4.0)	4.2	(4.5)
Household consumption	4.8	3.9	4.7	(3.8)	4.5	(4.0)	4.5	(4.5)
Government consumption	0.3	0.6	1.7	(3.0)	2.0	(2.0)	2.5	(5.0)
Gross fixed capital formation	20.7	-3.6	11.0	(6.5)	8.0	(7.0)	10.0	(8.0)
Exports of goods and services	14.1	11.8	7.6	(9.0)	6.0	(7.0)	6.4	(6.0)
Imports of goods and services	13.7	6.1	8.8	(10.0)	9.0	(9.5)	8.0	(7.5)
Consumer price growth, %	4.1	3.1	1.0	(1.3)	1.5	(2.5)	3.0	(3.0)
Unemployment rate, % [2/]	15.4	13.4	11.7	(11.5)	10.0	(9.5)	9.0	(8.5)
Real net monthly wage growth, %	-1.3	0.5	5.0	(3.0)	3.8	(2.8)	3.0	(3.0)
Nominal GDP, billion euro	31.0	32.9	34.5	(34.6)	36.3	(36.8)	38.8	(39.6)
Exports of goods and services (nominal), % growth	27.5	15.7	6.5	(9.5)	7.0	(8.0)	7.5	(9.0)
Imports of goods and services (nominal), % growth	28.2	10.6	7.5	(10.7)	9.0	(9.5)	9.5	(10.5)
Balance of goods and services, % of GDP	-2.6	1.0	0.2	(0.1)	-1.4	(-1.2)	-3.1	(-2.4)
Current account balance, % of GDP	-3.7	-0.2	0.0	(-0.9)	-1.8	(-2.2)	-3.5	(-3.1)
Current and capital account balance, % of GDP	-1.2	2.0	2.3	(1.1)	0.4	(0.1)	-1.2	(-0.4)
FDI inflow, % of GDP	3.4	1.7	1.5	(3.0)	2.5	(3.5)	3.5	(4.0)
Gross external debt, % of GDP	77.4	75.4	74.5	(73.5)	72.8	(70.5)	69.8	(66.6)
General government budget balance, % of GDP [3/]	-5.5	-3.2	-2.9	(-2.7)	-2.0	(-1.7)	-1.0	(-0.7)
General government debt, % of GDP	38.3	40.5	39.7	(39.5)	42.4	(38.6)	40.8	(36.6)

1/ October 2013 forecast in parenthesis
2/ According to Labour force survey
3/ According to Maastricht criterion

Sources: Statistics Lithuania, Bank of Lithuania and Swedbank.

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