Swedbank Economic Outlook

Update – April 2016

Global recovery threatened by political risks

- **Global growth is gradually regaining strength…**
- **…but risks are mainly political**
- **Different strokes in the Nordic-Baltic area**

A long hot summer in the global economy

We expect the global economy to regain strength following the unexpected sharp slowdown in recent quarters. The growth pickup will be supported by accommodating central banks, which will slowly start to retreat as inflation pressure gain strength. However, the risks are abundant, not least the political. Possibilities of a “Brexit” or “Grexit” are likely to raise uncertainties, and this summer the two major US political parties will select their presidential candidates. The biggest elephant in the room is, still, China and its authorities’ ability to handle the increasing strains on the Chinese growth model. Failure here would have worldwide repercussions.

Less volatile markets calm central banks and vice versa

Major central banks took a step back during the winter and spring in the face of rising financial market turmoil, and under threat of falling inflation and inflation pressures. Furthermore, the G20 meeting in Shanghai is reputed to have ended in an informal accord to not use monetary policy to directly target the exchange rate in order to push up inflation. Consequently, the ECB refrained from introducing a tiered deposit rate structure, opting instead to increase QE measures; the US Fed decided to hold of on a previously pencilled-in hike in March. It remains to be seen whether the Bank of Japan will be able to withstand pressure to try to stem the recent appreciation of the yen. Outside Japan, inflation appears to be picking up; this should allow central banks to gradually normalise policies over the next couple of years.

Different strokes in the Nordic-Baltic area

In **Sweden**, the Riksbank is done cutting the policy rate and fiscal policy is aiming for a balanced budget. Growth is driven by strong domestic demand, in particular household consumption, and government consumption and investment. However, the underlying forces in the Swedish economy are likely to weaken. High growth provides an opportunity for implementing reforms to correct growing imbalances.

There is no growth in the **Norwegian** Mainland economy and the contraction in oil-related activities is set to continue. The weak krone has significantly improved competitiveness, but thus far there have been relatively few signs of an upswing in non-oil-related activities. The best part of the recent news on the Norwegian economy is that the downturn remains concentrated in oil-related sectors and regions, and that it is not getting worse.

We have revised down **Estonia** growth forecasts of account on a weaker European outlook; meanwhile, uncertainty and downward risks are still high. However, the story behind the outlook has not changed: we expect foreign demand and exports will improve sluggishly, consumer prices will start to increase this year, and the steep deceleration of the real growth of net wages will gradually slow consumption.

Despite rather weak activity at the turn of the year, we still expect **Latvian** growth at 3% in 2016 and 2017. Export and investment growth is likely to be slower in 2016 than forecast before. On the other hand, an upside is likely, especially in 2017, as the credit and investment cycle takes off. The labour market is heating slower than expected – economic growth is mostly productivity driven, with nearly no employment growth.

Unlike in many countries around the world, the economic developments in **Lithuania** have not disappointed at the beginning of this year. Despite a very uncertain global environment and volatile financial markets, we have seen stable or improving consumer and business confidence, while retail trade and manufacturing growth has accelerated. Our outlook remains largely unchanged – gradually accelerating inflation, strong domestic demand, and a widening trade deficit.

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The global economy: a long hot summer

We expect the global economy to regain strength following the unexpected sharp slowdown in recent quarters. The growth pickup will be supported by accommodating central banks that will slowly start to retreat as inflation pressure gain strength. However, the risks are abundant, not least the political. Possibilities of a "Brexit" or "Grexit" are likely to raise uncertainties, and this summer the two major US political parties will select their presidential candidates. The biggest elephant in the room is, still, China and its authorities' ability to handle the increasing strains on the Chinese growth model. Failure here would have worldwide repercussions.

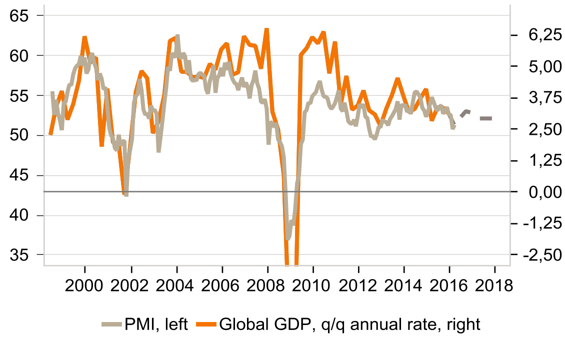
The global economy lost traction

The global economy slowed markedly at end-2015, and indicators suggest that 2016 is off to a slow start, too. Uncertainty about the true state of the Chinese economy, accompanied by currency devaluations vis-vis-vis the US dollar, heightened these concerns and led to intensifying capital outflows. The negative impact of the oil price decline exceeded any benefits as producers slashed employment and investments, and energy-abundant countries tightened fiscal policy and off-loaded assets through their sovereign wealth funds. This exacerbated the financial market turmoil. The strengthening of the US dollar increased the uncertainty about the Chinese currency regime, while putting pressure on US manufacturing and export-oriented sectors. At the same time, inflation pressures abated and sentiments eroded, and major central banks took a step back and further increased monetary policy stimulus.

Growth to pick up from here, albeit slowly

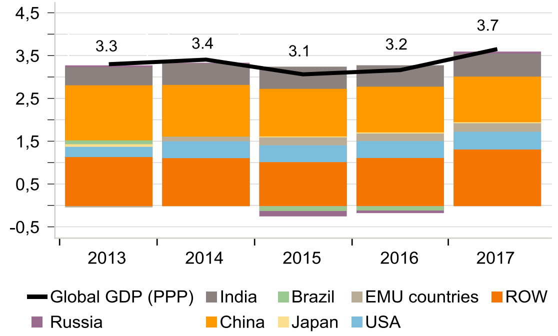
On account of the weak recent outcome, we are lowering the overall global growth forecast for 2016 to 3.2%, only marginally better than last year. However, as risks of a Chinese meltdown slowly evaporate we expect growth to resume, in particular in the US but also in the euro area. The global purchasing managers' Indicator could suggest a bottoming out of global growth. We are optimistic regarding India, while Chinese growth is expected to hold up, according to the China's official forecast. Oil prices have turned a corner, and we now forecast prices hitting levels close to USD 70 per barrel at end-2017. This will both alleviate some of the pressures on energy producers while increasing inflation pressures. Although we expect monetary policy to remain expansionary, in particular in the euro area, there will be an opportunity for the Federal Reserve to slowly start normalising rates. The main risk to the outlook, with a low probability but high impact, is still a sharp slowdown in China. In addition, political risks are abundant: they range from the referendum on UK's membership in the EU over a possible repeat of last summer's Greek debt crisis to turmoil associated with the US presidential election, starting with the conventions this summer. Overall, however, we are cautiously confident that policymakers across the world will be able to handle these challenges. If not, the global economic outlook will be far worse.

Global: PMI vs GDP



Source: Swedbank Research & Macrobond

Global: Contribution to growth (p.p.)



Source: Swedbank Research & Macrobond

A gradual strengthening of growth will allow the Fed to resume tightening

The US economy has been hit by a number of headwinds early this year, and current estimates (such as the Atlanta Fed's "now"-cast model) suggest that growth in the first quarter will barely rise above zero. This follows a weak ending of last year, and, in general, global developments have worked against US growth. Low oil prices have reduced investments in the energy sector, and a strong dollar has worked against manufacturing and exports. The turmoil associated with the Chinese uncertainty most likely affected sentiments among households and companies. While household spending held up fairly well in the fourth quarter, indicators for the first two months of this year suggest a sharp slowdown. On account of the weak start, we revise down our annual growth forecast for 2016 by 0.3 percentage point to 2.4%.

US economy faces a multitude of headwinds

We expect, however, the momentum in the US economy to pick up. According to our forecast, oil price declines should be behind us; this will reduce the drag on the energy sector. Also, the recent strong depreciation of the dollar should increase US competitiveness. The labour market has continued to deliver strong job creation--on average, above 200,000 over the last 12 months--which underpins the strengthening of consumer confidence. As savings rates have been building up, we now believe there is room for a pickup in household consumption. Inflation is rising, although wages are lagging, and, barring any significant negative surprises, the Federal Reserve should be able to hike the policy rate in June. This, in our view, will be the start of a gradual hiking pattern encompassing twice-yearly raises to slowly normalise rates.

Euro area growth still above (a weak) trend

Indicators on the real economy in the euro area were quite mixed during the first quarter. Financial markets started the year on a weak note but have since mostly recovered. In addition, the political scene has not been calm regarding refugees, terrorism, Brexit, or monetary policy. The ECB's decision to cut rates, to introduce a new long-term borrowing scheme for banks, and, more important, to include substantial amounts of corporate bonds in the quantitative easing (QE) programme has contributed to easier credit conditions in Europe. Actual credit flows to the private sector turned positive even before the new measures were introduced. Still, highly leveraged European banks are a major risk in Europe, and markets are still worried on their behalf.

Growth set to continue

We continue to expect growth above trend in the euro area in the coming quarters. Germany is approaching its capacity limit, but other countries in the region are not there yet. Productivity growth is slow in most countries in Europe, as well as in other rich countries, and, at approximately 1.5%, our GDP growth forecast is surely not impressive. Nevertheless, it will remain sufficient to reduce unemployment by at least 0.5 percentage point this year. Underlying (excluding energy) inflation remains quite stable, at 1% annually--below the inflation target but not worryingly low. The deflationary angst, which we have always considered misplaced, will subside as headline inflation picks up alongside higher oil prices. Over time, increasing wage inflation will push underlying inflation slowly upwards, but monetary policy will remain very expansionary in order to ensure growth above trend and a further decline in unemployment. New steps to stimulate credit growth to the private sector through channels outside banks cannot be ruled out. However, further cuts in policy interest rates, which are already negative, are less likely, as are measures to push more credit through the banking system, at least before banks get better capitalised. Fiscal policy will turn slightly expansionary, mostly due to increased refugee costs in Germany.

What a difference a G20 meeting makes

Market fears have eased considerably since the G20 meeting in February. A weaker dollar, together with capital controls, has stabilised market sentiment, and China now needs to stabilise growth to avoid renewed capital outflows. So far, policy support has been successful in restoring growth in the property market. Other data are more mixed, but we expect further policy measures and credit expansion to keep growth in line with the official target of 6.5-7%. Structural issues will remain in China. Regarding India, we are becoming slightly more positive on developments after a period of economic disappointments and political setback. The recently approved state budget paves the way for much-needed rate cuts. The government still lacks a majority in the upper house. However, farmers, the largest voting group, will benefit from new budgetary spending, which may increase the government's popularity and help it to implement new reforms. Political turmoil continues in Brazil, with a high probability of a new government. Challenges of reversing growth and restoring confidence in Brazil are huge. We remain negative on growth prospects in Brazil, as, at the moment, we see no credible political alternative that is up to the task.

Japan

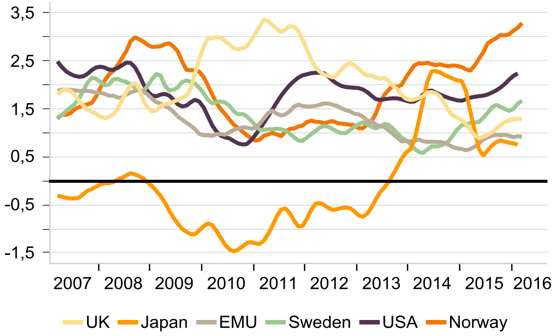
As the beginning of the year has been much weaker than expected, we have revised our 2016 growth forecast for Japan down to 0.7%. Softer demand in Asia and a stronger yen have dampened exports, and private consumption remains weak, too, despite marginally growing real wages. The value-added tax (VAT) hike planned for April 2017 has become more uncertain, and will probably be decided in May. If postponed, general elections could be announced. Low inflation, weaker inflation expectations, disappointing growth, and a stronger yen will probably trigger more action from the government. We expect both policy sides to deliver, i.e., a new monetary as well as fiscal stimulus (lower rates + a supplementary budget).

Less volatile markets calm central banks and vice versa

G20 meeting limits focus on exchange rate as policy instrument

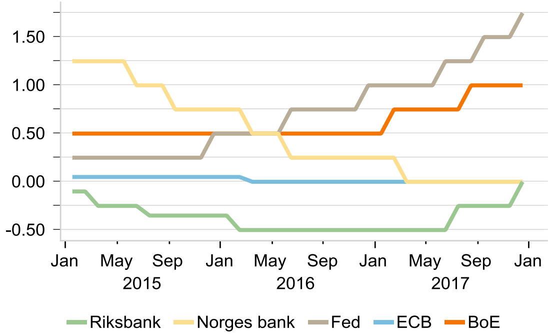
Major central banks took a step back during the winter and spring in the face of rising financial market turmoil, and under threat of falling inflation and inflation pressures. Furthermore, the G20 meeting in Shanghai is reputed to have ended in an informal accord to not use monetary policy to directly target the exchange rate in order to push up inflation. Consequently, the ECB refrained from introducing a tiered deposit rate structure, opting instead to increase QE measures, and the US Fed decided to hold of on a previously pencilled-in hike in March. It remains to be seen whether the Bank of Japan will be able to withstand pressure to try to stem the recent appreciation of the yen. Outside Japan, inflation appears to be picking up; this should allow central banks to gradually normalise policies over the next couple of years (see Indepth 1).

Global: CPI Core ex. energy etc. (% smoothed)



Source: Swedbank Research & Macrobond

Global: Central bank forecasts (%)



Sources: Swedbank Research & Macrobond

Easy monetary policy dominates currency markets

Currency markets have recently been characterized by the generally weaker dollar and central banks' accommodative monetary policy. The dollar has fallen by nearly 7% in trade-weighted terms since mid-January. The G20 meeting in Shanghai resulted in an informal agreement that that monetary policy should not be used to directly weaken the exchange rate, as all central banks are fighting low inflation and interest rates are close to or below zero. The recent appreciation of about 10 percent of the Japanese currency is an example of the central banks' dilemma. The yen has long been perceived as undervalued. The Bank of Japan's record-low interest rates and extensive QE have not succeeded in strengthening inflationary expectations. What remains now is outright currency intervention; in the long run, this has not proved particularly successful in sustainably raising inflation if it is not accompanied by sharp interest rate cuts.

Fear of Chinese devaluation restrains Fed

Our basic scenario that the Federal Reserve implements a couple of interest rate hikes this year should strengthen the dollar slightly, as this is not priced in. The deflationary impulse from the rapid dollar appreciation in 2014 and 2015 will gradually peter out, but Governor Yellen has made clear that a rapid interest rate tightening would risk detaching the Chinese currency from the US dollar, resulting in deflationary impulses to the U.S. and financial turmoil.

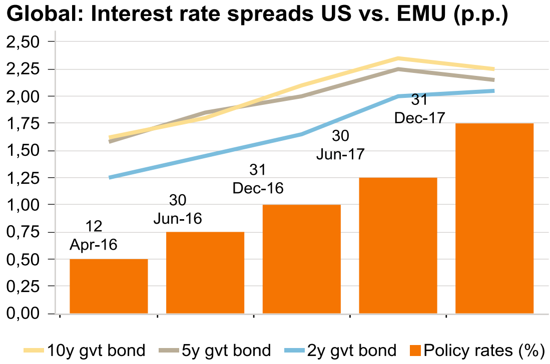
Brexit decisive for the pound

The pound has weakened in anticipation of the British EU vote on June 23. With a concrete date set, foreign investors are forced to secure all or part of their exposures to the pound. With a record-large current account deficit, the UK is dependent on continuing financial inflows. Our base scenario is that the UK votes to remain in the EU and that the pound recovers most of its loss later this year.

Rising oil price supports the krona

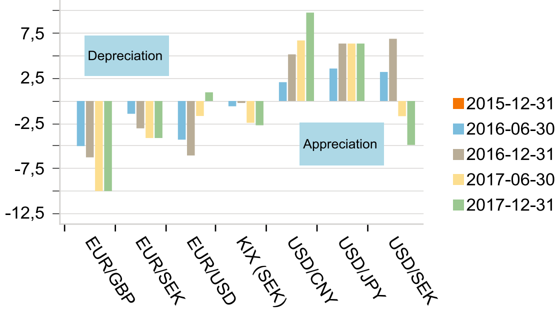
The Norwegian krone has stopped falling as the price of oil seems to have found a bottom level, while Norges Bank is already priced in to cut interest rates to near zero. The Norwegian economy is moving sideways in terms of growth and has so far avoided a steep fall. Inflation in Norway is currently above 3%--higher than Norges Bank's target of 2.5%. Although inflation is expected to fall going forward, the current level should not cause any significant panic at the Norges Bank.

Global: Interest rate spreads US vs. EMU (p.p.)



Source: Swedbank Research & Macrobond

Global: Exchange rate movements 2016-2017 (April 12, 2016)



Source: Swedbank Research & Macrobond

Significantly calmer interest rate markets

The international financial turbulence has eased gradually, as soft central bank policies are leading to sideways movements in short-term interest rates. In the long term, our main scenario envisages slightly rising interest rates: the uncertainty surrounding the global economy will be settling at the same time that the imminent end of monetrary expansion will be putting pressure on rate to to increase. In the short term, we foresee limited interest rate movements in those countries where the current soft monetary policy is setting the tone, especially for short-term rates. At the same time the ECB's asset purchase programme is a restraining factor for long-term interest rates; this is also holding back domestic interest rate movements. Considerable uncertainties still characterise the markets, as, especially, the low inflationary pressure in Europe, combined with continued bond purchases by the ECB, portend a sideways development also for bond yields in the near term. As the global economy strengthens, and international macro data confirm the recovery, bond yields will face upward pressure. In our main scenario, however, we see interest rates rising at a very moderate pace despite the current depressed levels.

Ahead, we see slower growth and more moderate inflationary pressures in Europe compared with the United States, which, along with a continued QE programme in Europe, will widen interest rate differential between the euro area and the US. This also will slightly limit the Swedish rate rise. The uncertainty increases in the long term, as we approach a time when bond purchases cease.

Central banks – alone, and in the dark

When it comes to overcoming crises or boosting economic growth, countries usually rely on monetary instruments, fiscal policies, and structural reforms. These three major policies have been dubbed the "three arrows of Abenomics" in Japan. However, in Japan and in most of the rest of the world, only one arrow is being used to the full extent – monetary policy. Central banks have swelled their balance sheets in an attempt to boost confidence, stimulate lending, and increase the broader money supply. In Denmark, Sweden, Switzerland, the euro area, and Japan, they have gone one step further – to a place that was hard to imagine just a few years ago – and introduced negative interest rates. Central banks have been pushed into this position by the fear of a repeat of the Great Depression of the 1930s and the desperate need to avoid deflationary stagnation and push up inflation. So far, they have been able to achieve the first objective – unemployment is declining, and economies are growing, although often at an unsatisfactory pace. Inflation, however, and its expectations remain very low, especially in the euro area and Japan. There are suspicions that at least some central banks have yet another objective – to weaken their currency and thereby stimulate exports and import inflation. As this "beggar thy neighbour" policy intention becomes more obvious, more central bankers are starting to talk it down. The Fed's Janet Yellen said she is not happy with the further strengthening of the dollar, while the BOJ's Governor Kuroda ruled out "competitive devaluation." What now?

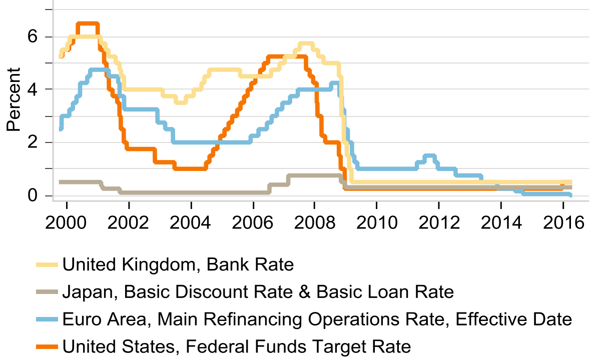
Captain Obvious would say that central banks have done enough--now, the governments should step in with proper fiscal policies and, most important, structural reforms. Those that have room can afford bigger public deficits, while others can tweak taxes to stimulate investments, employment, and wage growth. The list of pressing structural reforms, of course, is country specific, but usually a lot can be done to improve the functioning of labour markets, the quality and accessibility of education, and the general allocation of public resources. But governments around the world have proved to be slow in accepting this challenge, and, as long as we are not facing another financial meltdown or global recession, this is unlikely to change.

This means that the burden of further stimulus and crisis management will stay on the shoulders of the central banks. When so many major central banks are implementing unconventional measures and sticking to them for prolonged periods of time and continuously pledging to do even more, it starts to seem as the "new normal." But this situation is far from normal. It distorts incentives and creates a risk of capital misallocation and asset price bubbles. In Switzerland and Japan, 10-year government bond yields are below zero. You would have to lend for longer than 9 years to the German government to get a positive yield. In this environment, not only is the capital likely to be misallocated, but future pensioners are likely to suffer, while many "defined-benefit" pension systems become unsustainable. That is why we should be hoping and looking for an exit from these monetary policies.

When and how that will happen is a big mystery. Interest rate futures suggest that we will be stuck with very low inflation and this monetary policy for a very long time. However, we think that the market may be wrong. Inflation is likely to pick up next year – not least because we expect the oil price to approach USD 70 at the end of 2017 – and so will inflation expectations, which recently have been too much correlated with oil prices. For now, central banks are more concerned with the risk of deflation, not inflation. But this may change, and more central banks than currently expected may follow the Fed in 2018.

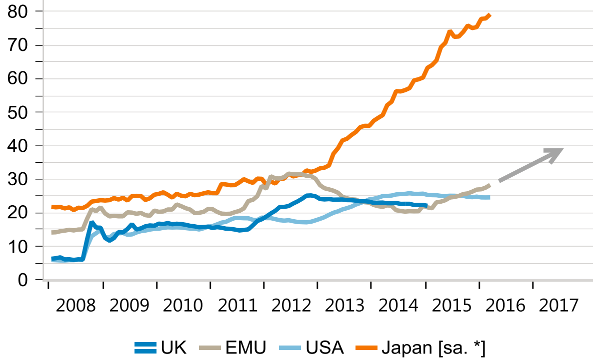
When central banks start raising interest rates, it will not be smooth and, in all likelihood, will be followed by higher volatility and risk aversion in financial markets – something we have seen after the Fed's lift-off. Central banks are operating in the dark. They were not certain how tripling or quintupling the size of the balance sheet or setting negative interest rates would affect financial institutions, asset prices, and inflation. They are equally uncertain how taking away these crutches will affect economic growth or which asset price bubbles might burst. But there is no doubt that some of the countries, companies, and individuals are overleveraged – once the tide of cheap money goes out, we will see who has been swimming naked.

Policy Rates



Source: Swedbank Research & Macrobond

Central bank balances, % of GDP



Source: Swedbank Research & Macrobond

Nerijus Mačiulis
Chief Economist Lithuania

In-depth: a turning point - oil prices set to rise again

Our calculations suggest a significant rebalancing of the oil market this year. We estimate that global overproduction has sharply fallen from about 2 million barrels per day (mb/d) in 2015 to 1.4 mb/d in February this year. We think the turning point has been reached and expect overproduction to cease and, thus, inventories to stop increasing by the end of this year or early next year. Based on these developments, we expect the oil price to rise markedly in the coming two years. We project Brent oil to average USD 43 per barrel (/b) this year and USD 61/b next year, well above the futures curve.

Demand for oil is rising

Global oil consumption grew by almost 2 mb/d last year, twice the growth in 2014. Compared with global GDP growth, this is one of the best years in decades. The indications of weaker demand around year's end were most likely due to the warm winter. As growth in global GDP continues, we project oil consumption to grow by an additional 1 mb/d this year.

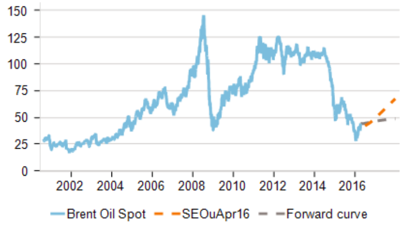
Production outside OPEC is adjusting

As expected, given lower prices and reduced investments, oil production is falling outside the OPEC countries. For most oil fields, the operational cost (excluding, e.g., investment costs) of producing an additional barrel of oil is well below USD 20. For some wells, however, the operational cost is higher, especially in mature wells. As the oil price fell below USD 40/b early this year, there were many reports of production cuts because operating costs were not covered.

Over time, the impact on production from the decline in investments, both infield (new wells in existing production fields) and in new fields will be greater still. Developments are particularly pronounced in shale oil fields in the US. Prior to the oil price collapse, US shale oil production grew by almost 1 mb/d per annum. This growth came to a halt last year, and production has started to fall. Production lags drilling of new wells by a few months, which tends to similarly lag declines in oil prices. As oil investments have halved in the US – horizontal rigs used mostly for drilling new shale oil wells are down 75% from the peak – experience suggests that production could fall as much as 1 mb/d over the coming year.

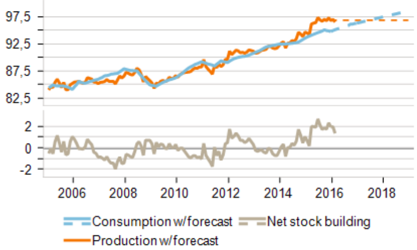
In conventional oil fields, cuts in infield drilling, which usually contribute around 5-6 mb/d in increased production from existing fields outside OPEC, will also have a significant impact on production in the year ahead. But, for new fields, the lead time from investment decision to production is very long, usually several years. Many projects that are coming onstream today were approved when the oil price was still above USD 100/b. Additional capacity from such fields in coming years is substantial. Prospective new investment projects are being shelved because they are not deemed to be profitable, given the outlook for the oil price, but projects that are well under way may still be profitable to complete.

Oil price: Forward curve versus Swedbank estimates (USD)



Source: Swedbank Research & Macrobond

Global oil production & demand, mb/d



Source: Swedbank Research & Macrobond

OPEC decisions remain as uncertain as ever

Overall OPEC oil production has been stable since last summer. Future developments in OPEC production remain uncertain but could go either way. On the one hand, Iran remains committed to increasing its production following the withdrawal of international sanctions; actual production has so far fallen short of the authorities' ambitions. On the other hand, OPEC countries have a strong collective interest in reducing production in order to raise prices and alleviate the large budget deficits. It seems, however, to be impossible for Iran to agree to participate in a common cut, a condition required by Saudi Arabia, OPEC's de facto leader. Russia, which is not an OPEC member, has so far also made no commitments. Our projections are based on an 0.5 mb/d increase in Iranian production, but on otherwise approximately unchanged production volumes in OPEC in the year ahead.

Over the longer term, count on competition from electricity

The lion's share of oil production supplies the transportation sector, where, for a long time, oil has held a privileged position because it is easy to transport and allows quick refuelling. But rapid advances in battery and electrical vehicle technology hold the potential to change this basic premise in the coming decade. This is most noticeably evidenced by Tesla's new electric car (the Model III), which looks set to be comparable in price to similar conventional cars and provide sufficient range for regular uses. In terms of operating costs, electric vehicles are already cheaper, by a wide margin, than fossil fuel-driven vehicles.

So far, adoption of electric vehicles has been very slow, but this could change rapidly. Continuing improvements in battery technology and falls in costs, point to a potentially major disruption in the business of producing new cars. Most if not all the major car manufacturers have launched large investment programmes in electric vehicles. The existing car pool is, however, set to change only slowly. Demand for oil is, therefore, likely to keep up in volume terms for many years yet. Without further investments, oil production would deplete at a far faster rate than any reasonable rate of decline in oil consumption. Consequently, oil production will remain the relevant margin of adjustment in the oil market for the foreseeable future. Due to shorter lags from investment to production than in other types of oil production, we expect US shale oil to remain the marginal producer in the years ahead.

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In-depth: Russia - a higher tide also lifts broken boats

The recession has been deep. But most of the contraction is over, and quarterly growth rates may turn positive this autumn. The key reason for the swifter bottoming out of the recession is the expectations of a swifter and sharper recovery in the price of oil. This will strengthen the rouble, taper off inflation sooner than expected, and allow the Central Bank of Russia to start cutting its policy rates in the third quarter. A strengthening of the rouble (at 65 per US dollar in late 2016 and 60 in late 2017) will fall short of the oil price recovery, as recessionary forces still need to work through, and both the fiscal side and exports still need support from a weak rouble. As to financial markets, this promises ample and volatile speculative flows.

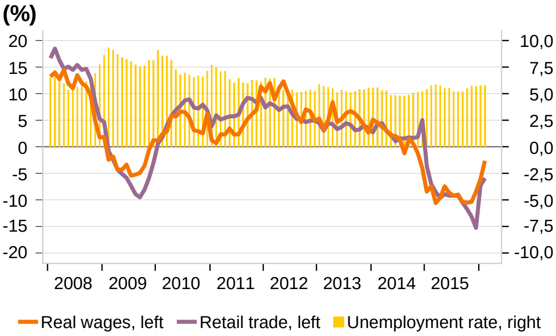
We expect the Russian GDP to shrink by 1.8% in 2016 (following a 3.7% drop last year) and return to patchy 1.5% GDP growth in 2017. From a historic perspective, it looks very much like a "dead cat bounce": the recovery is not only likely to be shallow, but, in the absence of a continued rise in the price of oil, will very soon tail off to about 1% GDP growth per annum, as the fundamentals remain poor. Indeed, the role of hydrocarbons has decreased (e.g., oil revenues down to 43% of federal budget revenues in 2015 from 51% just a year before), but this is mainly because the oil price is down rather than because other sectors have sharply grown. Hydrocarbons is still the core sector. Gains from import substitution are limited and concentrated in only a few sectors, such as agriculture and food processing. Exports were surprisingly strong in 2015 (up 3.7% in volume), also because Russia has pushed its oil sector output significantly above its own past forecasts. Yet, funding will remain poor (e.g., bank loan overdues are above the 2009 post-recession peak and rising); with the past years' underinvestment, it is hard to see how Russia can avoid a decrease in export volume growth (only if exports are grown at the expense of contracting domestic demand).

Labour market adjustment works through real wages, and no major rise in unemployment is expected. Incomes and consumer spending will remain subdued, with perhaps only a slight uptick in 2017. Fiscal discipline is set to remain quite decent, but the actual size of tightening this year is unclear (e.g., the sequester announced early in the year is still uncertain). Yet, fiscal drag will be sizable, limited only by the burning up of the Reserve fund. A minor fiscal tailwind may be expected in 2017 in the run-up to the 2018 presidential elections.

We assume that Western sanctions against Russia will remain in force in 2016. There is a quite high possibility that the EU does not extend its sanctions for 2017, but this will not help Russia much: the key sanctions to unlock access to global financial markets are those of the US, and there are no signs that this will be on the agenda any time soon. For populist reasons, Russia is unlikely to lift its sanctions against the EU before the EU does it for Russia.

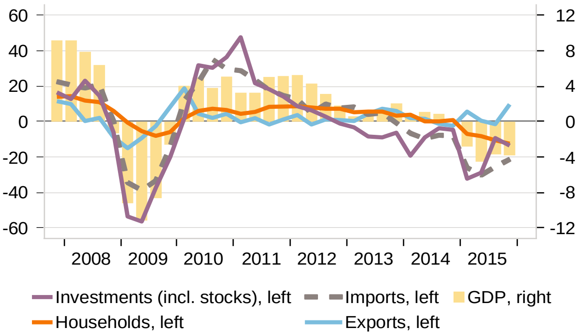
This upward GDP growth revision depends entirely on oil. If the price of oil were to stagnate and then recover more timidly, we are back to our January 2016 forecast, with Russian GDP down 2.5% in 2016 and a recovery of 1% in 2017. Russia has managed to sit through the crisis, but it has not revamped its economy – the boat's engine is still broken and we see no true willingness to mend it. The key risk for Russia is political, not economic.

Russia: Incomes and consumption, annual growth (%)



Source: Swedbank Research & Macrobond

Russia: GDP annual growth (%)



Source: Swedbank Research & Macrobond

Mārtiņš Kazāks
Deputy Chief Economist/Chief Economist Latvia

Sweden: Strong growth on borrowed time

The Riksbank is done cutting the policy rate and fiscal policy is aiming for a balanced budget. Global growth is sluggish and there are many threats to the economic recovery. Currently, the Swedish economy is driven by strong domestic demand with substantial increases in household consumption, public sector consumption and investment. But, growth drivers will weaken in 2016 and 2017. To sustain high growth and a strong labour market, reforms are urgently needed. In the Spring Budget Bill, the government introduced a weak fiscal policy stimulation without delivering the reforms that will strengthen long-term growth in Sweden. Where are the investment and labour market reforms required for long-term growth and competitiveness?

Weaker drivers of economic growth

The drivers of economic growth will change down a gear during 2016 and 2017. High growth and a strong labour market in 2015 and beginning of 2016 are contributing to normalising inflation. Underlying inflation, CPIF, has risen, with the latest figures showing an annual rate of 1.5%. This means that the Riksbank will no longer stimulate GDP growth with lower interest rates. The Riksbank will allow the repo rate to remain at minus 0.5 % in 2017 and very gradually start to normalise the interest rate to zero toward the end of the year 2017/beginning of 2018. We expect that the Riksbank will continue its QE program, although gradually taper, its asset purchases the second half of 2016. The aim is to prevent the krona strengthening too quickly and too much.

Business investment is held back when the large exporters are facing lukewarm demand from abroad. Global growth prospects have been adjusted down - principally in the euro zone and in the Nordic countries - important volume markets for Swedish exporters. The krona is strengthening, which means that exports are not benefiting from the same boost that they got from the weak exchange rate in 2014-2015. In addition, we expect increases in labour costs, which reduce competitiveness. Swedish exporters are likely to lose market shares in 2016 and 2017.

Key Economic indicators, 2015-2017 [1/]

	2015	2016f	2017f
Real GDP (calendar adjusted)	3,8	3,0	2,6
CPI, end of period	0,1	1,7	2,5
CPIF, end of period	0,9	1,7	1,9
Riksbank policy rate, end of period	-0,35	-0,50	0,00
Unemployment rate (15-74), % of labor force	7,4	6,6	6,2
Current account balance, % of GDP	4,9	5,2	4,9
General government budget balance, % of GDP [2/]	0,0	0,0	-0,3
General government debt, % of GDP	43,4	41,3	39,9

1/ Annual percentage growth, unless otherwise indicated.
2/ As measured by general government net lending.
Sources: Statistics Sweden and Swedbank

Higher interest rates and amortization requirement to dampen household consumption

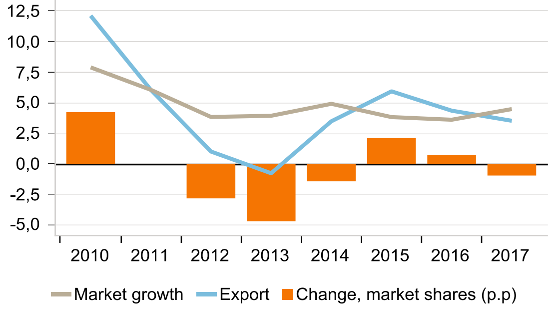
This year, households will benefit from good disposable incomes, but in 2017 growth in consumption will be significantly reduced, primarily by the increase in disposable income falling from 3.5 % this year to 1.6 % next year. Interest costs and amortizations will begin to rise during the year, at the same time as rental increases will be greater next year. This reduces the other consumption, mainly of durable goods and certain parts of services.

When the Riksbank, and other central banks, do not have much powder left in their monetary policy arsenal, focus will increasingly be directed towards fiscal policy. Fiscal policy will continue to provide a certain impetus to growth in 2016-2017 because the wave of refugees leads to increased costs from migration and integration. The government provides extra funding of SEK 10 billion per year for local authorities and increases the appropriations to the police, the Migration Agency and in increased investments in school buildings. This will lead to higher public sector consumption and investment. Higher public sector consumption provides a stimulus to growth in the short term, although in the long term it will undermine government finances and may then become a dampening effect. The long-term effect on the Swedish economy of the refugee wave will mainly depend on the effect of integration on the labour market.

Labour market reforms urgently needed

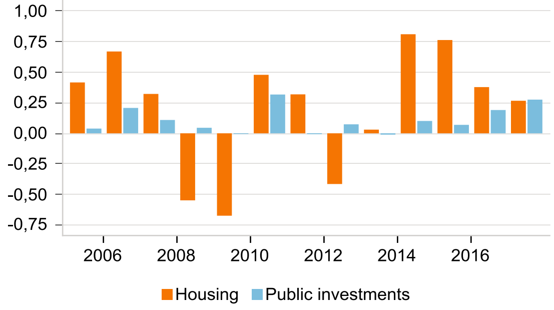
At present, integration of refugees into the labour works badly. At the same time, there are serious shortages of staff in many occupational categories in Sweden. An ageing population creates a great need for labour. The new arrivals have very different preconditions for rapid integration into the labour market. The biggest challenge is the integration of newcomers who have no secondary education. The employment rate is low in this group. But integration of new arrivals with higher education is also made difficult by the long time it takes to validate their knowledge. New arrivals face an increasingly polarized labour market and lack of housing that impairs their ability to move to jobs and training.

Sweden: Export, market shares and market growth (%)



Source: Swedbank Research & Macrobond

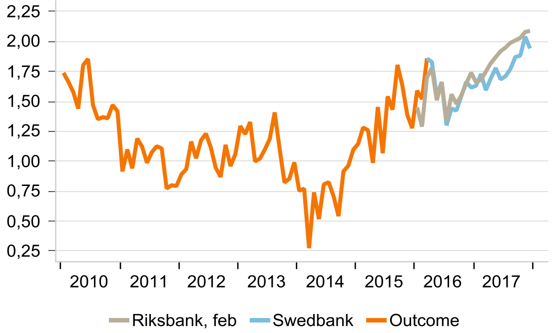
Sweden: Housing and public investment's contribution to GDP-growth (p.p)



Source: Swedbank Research & Macrobond

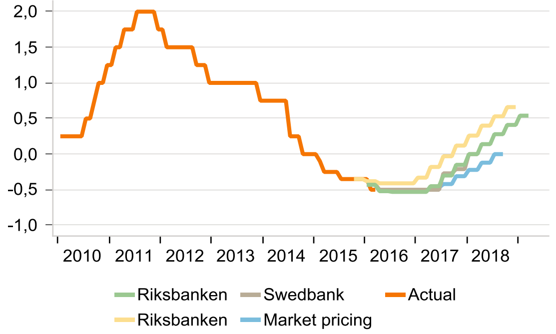
Sweden has fundamentally favourable conditions to manage these challenges; high growth, strong government finances and competitive businesses. An ambitious reform agenda aimed at strengthening Swedish growth in the long term is, therefore, both necessary and desirable. The parliamentary situation, with a weak minority government, however, makes it difficult to pursue an active reform agenda. The polarization of the labour market is ever increasing, with falling unemployment among Swedish-born individuals and rising unemployment among foreign-born persons. As early as next year, total unemployment will begin to rise if reforms to improve integration remain absent. The longer the government and the opposition wait with the implementation of reforms, the more difficult and more expensive it will be. The high growth rate, high tax revenues and strong labour market will not continue and the conditions for the implementation of the reforms will, therefore, deteriorate over time. Now is the right time to carry out investment, and structural reforms, to the labour market.

Sweden: CPIF ex. energy (% y/y)



Source: Swedbank Research & Macrobond

Sweden: Riksbank repo rate forecasts (%)



Sources: Swedbank Research & Macrobond

Norway: is this as bad as it gets?

There is no growth in the Mainland economy. The contraction in oil-related activities is set to continue. The weak krone has significantly improved competitiveness, but thus far there are relatively few signs of an upswing in non-oil-related activities. The best part of the recent news on the Norwegian economy is that the downturn remains concentrated in oil-related sectors and regions, and that it is not getting worse. On account of recent developments, as well as revisions to the national accounts, we have revised down our estimate on Mainland GDP growth for the full year 2016 from 1.1% to 0.8%.

Oil-unemployment rising, weak household demand

Labour market conditions have been deriorating for quite some time now. According to the Labour Force Survey, unemployment has climbed more than 1 percentage point to 4.8%. The rise in registered unemployment has overall been far less, and remains concentrated in oil-related regions and professions. In other parts of the country, registered unemployment has been stable or actually fallen the past two months. Most other indicators continue to point to weak labour demand, but an upswing in the number of new vacancies may indicate a turning point. With almost no growth in employment, we expect unemployment to continue to rise. Nevertheless, the risk of rising unemployment outside the “oil coast” looks smaller now than what we expected only a couple of months ago.

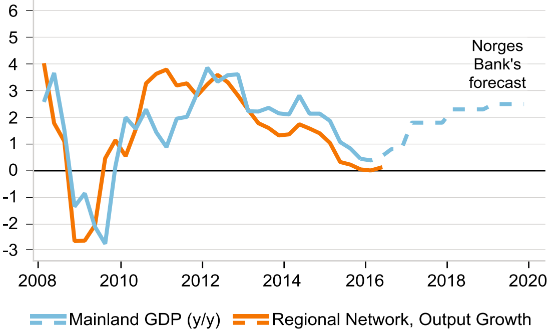
With rising unemployment, slowing employment growth, and no real wage growth, a slowdown in household demand was to be expected. Growth in retail sales has halted. Indeed, consumer confidence has fallen to a level previously associated with a significant contraction in consumption. House prices and debt, on the other hand, continue to rise. The contrast between oil and non-oil regions is evident both for retail sales and house price growth. Sales volumes and house prices are falling in Rogaland, the centre of the oil region, whereas Oslo still has decent growth. We expect household demand to remain weak, but high saving rates and generous public transfers, such as unemployment benefits, provide buffers. This suggest that households may be capable of sustaining their consumption level fairly well, and we thus see the risk of a severe contraction in consumption as very small.

Low interest rates for longer, but the krone is probably past the trough

As widely expected, Norges Bank cut the main policy rate by 25 basis points to 0.5% in March. At the same time, the Bank signalled a continued cautionary approach to further rate cuts. The Bank sees the need to continue to gradually stimulate the economy, but financial imbalances remain an important concern. As unemployment is staying flat, or falling in more than half of the country, house prices continue to grow, and credit is expanding at a faster rate than household income; this is understandable. Moreover, the impact of exceptionally low rates is uncertain. The Bank therefore prefers to keep the rate low for longer rather than cutting the rate too low. Consequently, we expect Norges Bank to keep rates unchanged until September. We do not doubt that the Bank will cut the rate to zero, if needed, but we see the likelihood of negative rates as very small.

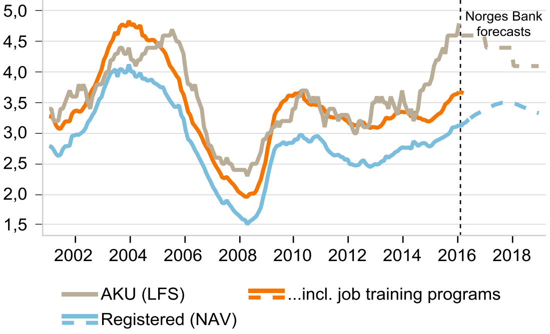
The krone has depreciated significantly, mainly driven by falling interest rates and oil prices. We believe the downside risk is very limited from here as the market already prices the main policy rate at zero and oil futures indicate oil prices rising rather than falling. We thus expect a gradual appreciation in the years ahead. The weak krone has significantly improved competitiveness for all firms exposed to international competition. However, expanding business activity take time, in particular if new investments are needed. So far, non-oil-related manufacturing shows no signs of an upswing, and non-oil exports are rising very slowly. We nevertheless remain confident that the weak krone will work, eventually, since it will appreciate only gradually in the years ahead.

Norway: Norges Bank's network vs. GDP (%)



Source: Swedbank Research & Macrobond

Norway: Unemployment (%)



Sources: Swedbank Research & Macrobond

Estonia: in need of more investments

Recent months have brought about successive downward revisions of the economic outlook in Europe; meanwhile, uncertainty and downward risks are still high. This is why we have made some downward revisions to Estonia's figures as well and expect that the economy grows 2% this year and 2.5% in 2017. However, the story behind the outlook has not changed: we expect foreign demand and exports will improve sluggishly, consumer prices will start to increase this year, and the steep deceleration of the real growth of net wages will gradually slow consumption.

Import demand from major trade partners is expected to improve

Last year, exports of goods produced in Estonia decreased the most to the Swedish (primarily electronic products) and Latvian markets (electricity), followed by the Belgian (shale oil products) and Russian (relatively broad based) markets. In 2015, Estonia's export value increased in only four European countries - the Netherlands, the UK, Denmark, and Romania – out of the ten largest. Primarily, shale oil products, wood products, furniture, and electrical equipment contributed to the growth in these markets. Russia is the weakest market among the major trade partners of Estonia. However, its share in the exports of Estonian origin dropped to only 2.8% in 2015 and thus had a relatively modest impact on the total economy. As the share of re-exported goods to Russia through Estonia is very high (71%), the decline of exports to this market has a negative impact on Estonian transport services. The average import demand from Estonia's major trade partners is expected to improve, albeit still sluggishly, in 2016 and 2017; this will gradually create more export opportunities for Estonian enterprises. According to the Swedbank survey, among industrial companies, Estonian exporters in 2016 intend to increase their market share in export markets, focussing more on Germany, Denmark, and the UK, besides the Scandinavian countries.

Growth of investments is expected to recover slowly

Although the decline of total investments slowed towards the end of last year, business sector investments have not yet shown clear-cut improvement yet. The major negative impact came from the exceptionally smaller investments in transport equipment. We expect that the somewhat better outlook for foreign demand will enhance the business sector's need for more investments. According to the Swedbank survey mentioned above, the average volume of investments will increase, while the main focus will be on improving efficiency. More and more attention is being paid to product development, as well. The larger investments are expected in the food and wood industries. At the same time, the sluggish recovery of demand and prices, while labour costs are putting increasing pressure on business sector profitability, could inhibit a more robust growth of investments in the near future.

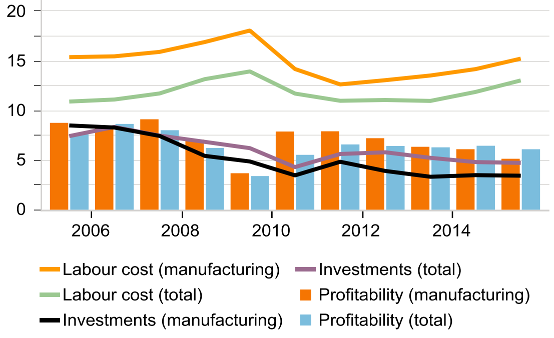
Modest inflation expected for this year

Inflation will be modest in 2016 as external price pressures remain subdued. Crude oil prices, in euro terms, will be below last year's level until the fourth quarter of 2016; this will suppress the prices of transportation and housing in Estonia. Changes in tax policy will push prices higher by an estimated 0.7 percentage point in 2016, as the excise tax on alcohol, tobacco, and fuels will be lifted. In 2017, price growth will accelerate as world market prices of commodities will rise and excise tax rates will be lifted again.

Labour market might loosen up somewhat

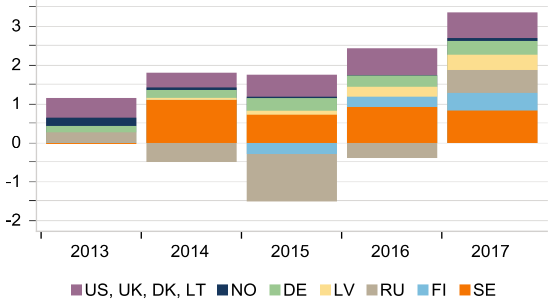
In 2016-2017, employment is expected to fall because of a smaller supply of (a shrinking working-age population) and demand for labour (weak export demand, investments in machinery). A state reform will reduce the number employed in the public sector. A cutback in the number of public workers and the reorganisation of the social benefits system for the disabled (forcing them to find jobs) will lift the number of unemployed, at least temporarily. Wage growth will remain fast, however, as the lack of suitable labour remains a concern. An agreed 10% increase in the minimum wage in 2016 and again in 2017 will lift the average wage level by around 0.5% each year. The growth of wages in real terms will slow in 2016-2017, as nominal growth of wages will be somewhat slower, prices will grow, and labour taxes will be lowered less than in 2015. This, in turn, will gradually limit households' consumption.

Estonia: Business sector profitability (% in sales)



Source: Swedbank Research & Macrobond

Estonia: Contributions to import growth by major trade partners (%)



Source: Swedbank Research & Macrobond

Latvia: waiting for the summer

Despite rather weak activity at the turn of the year, we still expect growth at 3% in 2016 and 2017. Yet, export and investment growth is likely to be slower in 2016 than forecast before. On the other hand, an upside is likely, especially in 2017, as the credit and investment cycle takes off. The labour market is heating slower than expected – economic growth is mostly productivity driven, with nearly no employment growth.

After the strong third quarter, the last quarter of 2015 was rather feeble, showing a slightly negative quarterly growth. Early 2016 also was a bit disappointing. As a result of weaker-than-expected exports and investments, we are revising downwards our GDP growth forecast for 2016 from 3.3% to 3%. Yet, we still expect GDP growth to pick up a bit this year (2.7% growth in 2015) and to remain at 3% also in 2017. Our outlook thus largely remains the same as published in January. Public finances are not too stretched for now – tax revenues grew by 4.2% in the first quarter of 2016, marginally below the plan.

Exports to pick up gradually

Exports are forecast to recover after a temporary weakness in January 2016 (-7% annually in value terms). The rebound in manufacturing in February supports this view. Exports are expected to grow a bit stronger this year than in 2015, owing to (i) improvements in external demand (e.g., the bottoming out in Russia and modest appreciation of the rouble, and stable growth in the euro area), and (ii) even better penetration of more distant markets, especially in Africa and Asia, as previous investments are starting to pay off. The lifting of international sanctions vis-à-vis Russia and termination of the Russian food embargo against the EU are positive risks for 2016. Labour costs are rising, but are not yet critical for competitiveness – profit margins of Latvian companies are coming under pressure in some industries after two very good years, but the situation is still comfortable enough.

Labour market is heating up slower, but risks to competitiveness are still sizable

New job creation is largely stagnating, and employment is not forecast to grow in the coming two years either. Economic growth feels too slow for companies to significantly expand the number of employees, and they are meeting a fragile growth in demand mostly via productivity growth. It is a challenge to find qualified employees, given that it is more difficult to employ previously inactive (e.g., pension-age persons) or unemployed, who might be unmotivated (about 30% of job seekers have been searching for a job for more than two years). Companies thus keep investing in machinery and equipment to reduce the number of employees. The unemployment rate was flat during the last three quarters. Yet, as the labour supply keeps falling due to negative demographics, unemployment will gradually go down (from 9.9% last year to 8.3% in 2017), and the participation rate will keep rising. Wage growth seems to have slowed a bit in the first quarter of 2016, in line with our expectations of about 6% growth for gross nominal wages in 2016 and 2017. This keeps exceeding productivity growth, though.

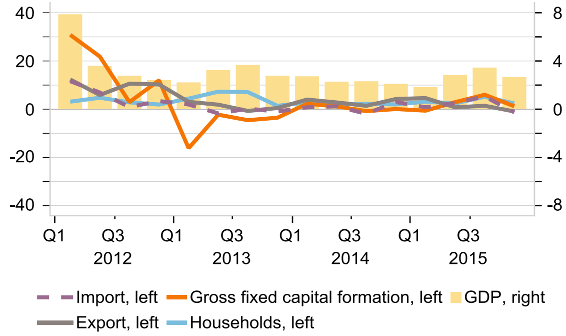
Private consumption to remain the major growth driver in 2016

Owing to yet another fall in oil prices in late 2015 and early 2016, we now forecast consumer price inflation for this year at 0.2% (0.8% before). This will raise the purchasing power and support a pickup in private consumption growth. However, we are not yet altering our forecast about consumption – retail trade grew rather modestly in the beginning of the year. Since a sharper rebound of oil prices is now forecast, inflation in 2017 will be stronger, at 2.8% (2.3% before). Higher inflation will decelerate the growth of purchasing power and household consumption next year, but, as we expect the credit cycle to take off finally, we keep the consumption growth forecast a little faster than that of real income growth.

A pickup in investment growth delayed to 2017

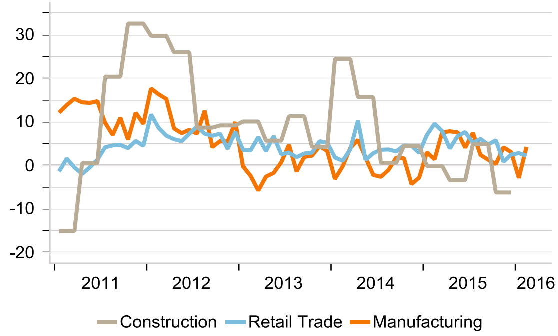
The credit cycle turnaround, together with EU funds, will also support investments in 2017. This year, unfortunately, investment activity growth is expected only in a few areas (like agriculture), which will not be able to boost overall gross fixed capital formation growth. Construction will most likely decline despite largely stable volumes for road maintenance and residential real estate. Investment in machinery will probably remain the largest contributor to gross fixed capital formation.

Latvia: Annual growth of GDP components (%)



Source: Swedbank Research & Macrobond

Latvia: Annual growth in selected industries (%)



Source: Swedbank Research & Macrobond

Lithuania: so far, so good, misty ahead

Unlike in many countries around the world, the economic developments in Lithuania have not disappointed at the beginning of this year. Despite a very uncertain global environment and volatile financial markets, we have seen stable or improving consumer and business confidence, while retail trade and manufacturing growth has accelerated. Our outlook remains largely unchanged – gradually accelerating inflation, strong domestic demand, and a widening trade deficit.

Global uncertainties have left Lithuanian consumers and companies unfazed

During the first two months of this year, retail trade grew by 7.6% compared with the same period last year, indicating that consumers largely ignored the jittery financial markets. Lithuanian households have very little savings in stocks and other financial assets; thus, collapsing oil prices (in tandem with other assets) were largely good news for consumers. Although the consumer confidence indicator was slightly lower at the beginning of this year, the retail trade of non-food products (mainly non-necessities) in February was 10.5% higher than a year ago. Those who have money or can borrow do not have low expectations.

The housing market does not seem to be cooling – during the first quarter the number of real estate transactions was around one-fourth larger than a year ago. Households seem to be willing to borrow, and banks are willing and able to expand their loan portfolios. In February, portfolios of mortgage loans and consumer loans were 5.3% and 5.9%, respectively, larger than a year ago. Going forward, the ECB's extremely accommodative monetary policy is likely to push household debt upwards (from very low levels).

Due to very low oil prices at the beginning of this year, we have lowered our inflation forecast by 0.2 percentage point to 1.8%. However, we have made major revisions in the oil price forecast – we now see oil approaching USD 70 per barrel at the end of 2017. Global food prices have also probably bottomed out and will start rising gradually. These factors, together with rising wages, will push inflation in Lithuania to 3.2% in 2017.

Low inflation, accelerating wage growth, and credit expansion will support household consumption

Developments in the labour market remain positive thus far and continue supporting household consumption. The ratio of unemployed per vacancy at the labour exchange (12-month average) is the lowest in seven years and continues trending downwards. Business surveys show that companies are increasingly constrained by the lack of qualified employees. This, of course, positively affects the negotiating power of skilled employees (at least in some sectors), and bodes well for further growth in household consumption. There is a caveat – unit labour costs are increasing (see the in-depth box on the Finnish flu).

Exports will grow this year, albeit probably a bit slower than previously expected

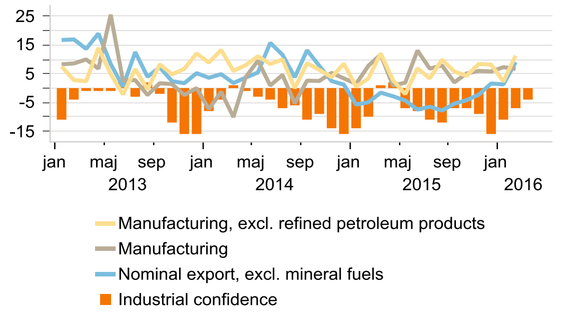
So far, most exporting sectors remain competitive – despite the loss of the Russian market, exports of goods and services increased by 1.2% last year and are expected to increase by 3.0% this year, before accelerating to 5.0% in 2017. Manufacturing (refined petroleum products excluded) grew by 6.9% during the first two months of this year, compared with the same period a year ago, while exports have started growing briskly again. Russia is expected to start growing in the second half of this year, and sanctions are likely to be gradually phased out. However, our base scenario is that, although there is room for positive surprises, trade with Russia will not resume quickly (for many reasons).

National budget revenues above the plan so far this year; many iffy initiatives before parliament elections

National budget revenues during the first quarter this year were 2.6% higher than planned and 5.7% higher than a year ago. Revenues from personal income tax have increased by 8.7% and have exceeded the plan by 3.7%. This probably indicates not only strong domestic demand, and wage and employment growth, but also improved tax administration and less tax evasion.

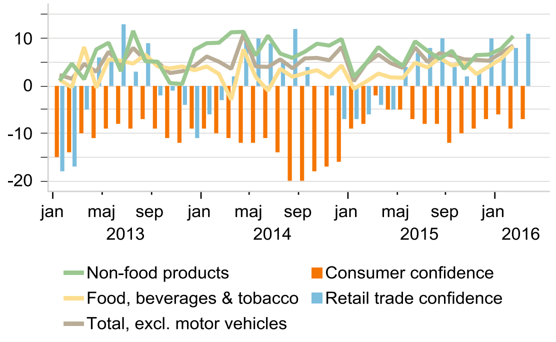
One can feel the upcoming parliament elections in the air. There are many popular initiatives – from cutting the VAT to indexing pensions to the average wage – that, if implemented, risk derailing public finances in the long term. Unfortunately, a rapidly aging society with negative views towards immigration has little leeway to cut taxes or increase entitlements.

Lithuania: Exports of goods and manufacturing (% y/y)



Source: Swedbank Research & Macrobond

Lithuania: Retail trade (% y/y) and confidence

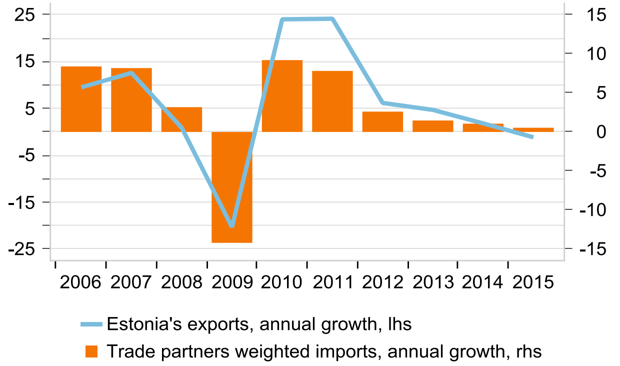


Sources: Swedbank Research & Macrobond

In-depth: has Estonia caught the Finnish flu?

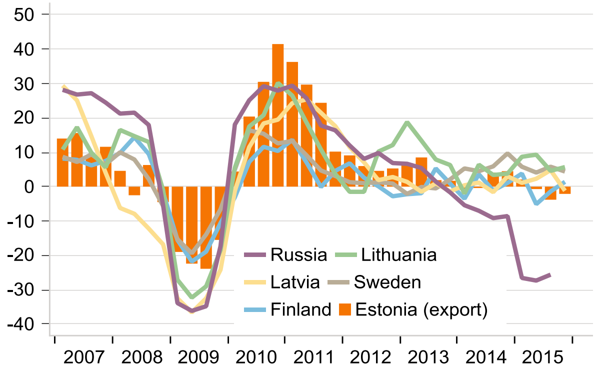
Economic growth in Estonia has been lower than the Central and Eastern European average in recent years. In 2015, economic growth slowed even further, to 1.1% – one of the slowest growth rates in the entire EU. In the last quarter of 2015, Estonia's real GDP was still slightly below its previous peak in the fourth quarter of 2007. Relatively large exposure to two ailing economies, Finland and Russia, is partly responsible, as slower growth of foreign demand means smaller export and investment volumes in Estonia. These two countries' share in Estonia's exports is around one-fourth, while Russia's share in Estonia's exports of goods and services shrank from 10.9% in 2013 to 5.6% in 2015.

Estonia's exports vs export demand



Source: Swedbank Research & Macrobond

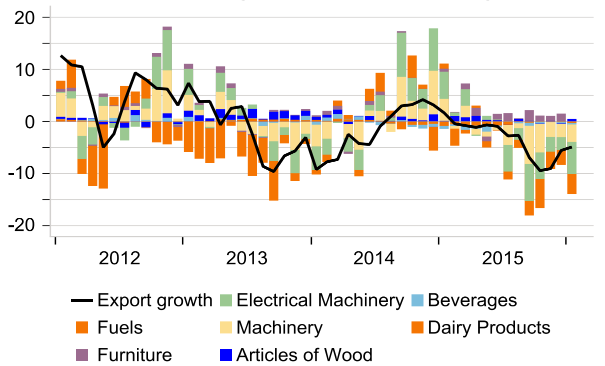
Imports of Estonia's trade partners, annual growth



Source: Swedbank Research & Macrobond

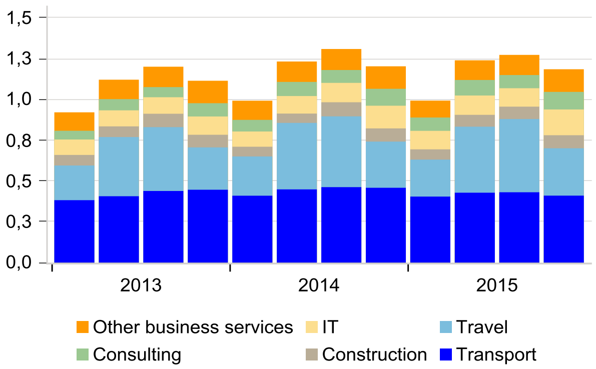
Estonia is a very small and open economy, where a handful of companies have a large impact on macro numbers. Recent declines in the export sales of fuels and electronics make up the majority of the fall in the exports of goods (see the graph below). In addition, the export sales of milk, vodka (Russia is one of the main markets), and petroleum oils (partly transit goods from Russia to other parts of the world) have decreased substantially. Exports of fuels have shrunk not only because Russia is directing more of its oil through its own ports, but also because the price of oil is much lower. Substantially smaller trade volumes with Russia are having a negative impact on Estonia's (rail) transport sector, too, which delivers goods from/to Russia. Still, the exports of services, around one-third of Estonia's exports' turnover, have weathered the current downturn better than goods. A decline in transport services' exports, especially rail transport, was compensated for by higher sales of IT and consulting services.

Contribution to the growth of exports of goods, pp



Source: Swedbank Research & Macrobond

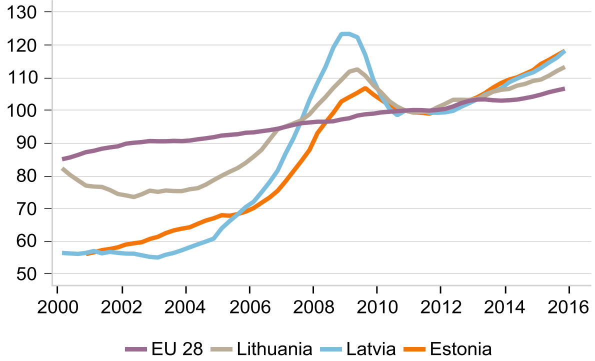
Exports of services, EUR bln



Source: Swedbank Research & Macrobond

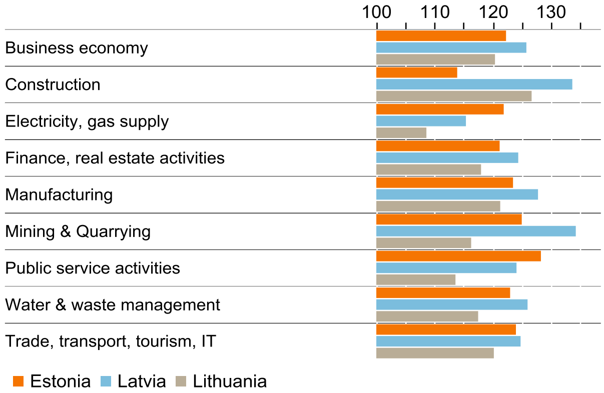
Competitiveness could come under pressure from wage growth, which has surpassed gains in productivity in recent years. Excessive wage growth and lower export competitiveness were among the reasons why growth in the Finnish economy stopped. Between 2012 and 2015, average wage increases varied from 12% in the construction sector to almost 30% in the agriculture and real estate sectors. A shift to higher value added explains part of the rapid wage growth. The European Commission found that employment shifts from low-value-added towards higher-value-added activities, within or between different sectors, added around 1 percentage point to average wage growth in recent years. Labour costs (wages and employers' social security contributions) in the public sector have increased faster than in the private sector (and faster than in the respective sectors in Latvia and Lithuania). In the business sector, since 2012, labour costs have increased the most in Latvia, among the Baltics. Rapid increases in minimum wages have pushed up wages at the lower end of the wage spectrum (minimum wage-earners amount to 4.6% of all employees).

Nominal ULC (hours worked), 2010=100, 4Q MA



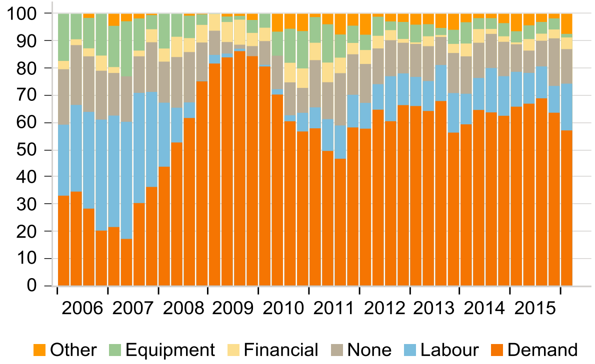
Source: Swedbank Research & Macrobond

Labour cost index in Q4 2015, 2012=100



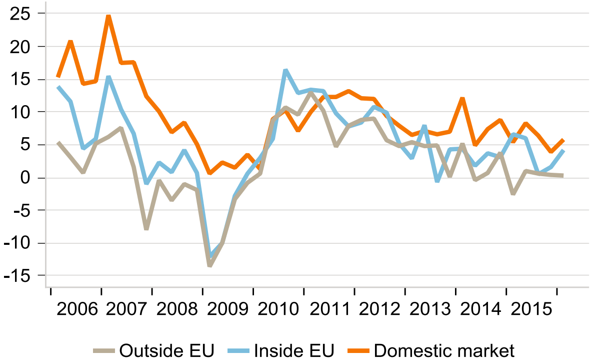
Estonia's export competitiveness was recently analysed by the European Commission and the Bank of Estonia. The Bank's analysis at the micro data level on price-based and non-price components of competitiveness indicated that there were no fundamental changes in Estonia's competitiveness in 2011-2014. At the same time, the Bank concluded that non-price competitiveness had improved for some goods, while the structural trade deficit had grown for other groups of goods. The European Commission, in its report, saw signs of a relative loss in the quality of the exports of manufactured products, as the country's climb up the technology ladder among the exports of goods has been lagging; meanwhile, steady improvements have taken place in the services sector. However, in recent months, Estonia's companies' own assessments of their competitiveness have improved, especially in the EU market. According to the same survey, the importance of insufficient demand as a business constraint has decreased in the past six months.

Factors limiting production



Source: Swedbank Research & Macrobond

Industry's competitive position



Source: Swedbank Research & Macrobond

Despite consumption-driven growth for the past three years, the country's current account balance is still positive. Furthermore, in 2015, the current account ran the largest surplus since Estonia's re-independence. The current account surplus grew mainly because of an improvement in the goods balance. Imports fell more than exports in 2015 as the prices of fuels declined substantially (the trade deficit of mineral fuels amounted to 1.5% of GDP in 2015, down from 2.2% in 2014), and demand for capital and intermediate goods decreased.

In 2016-2017, tensions in the labour market should ease somewhat. The unemployment rate is on the rise, and two state reforms to reduce public labour and to encourage employment of the disabled should increase the labour supply. According to a recent Swedbank survey, industry representatives are expecting gross wage growth to slow to 3% in 2016. In the total economy, we expect average wage growth to slow from 6.0% in 2015 to below 5% in 2016. The growth of productivity is also expected to accelerate once higher external demand pushes up exports and investment (see the chapter on Estonia for more details).

Liis Elmik
Senior Economist

Forecast tables

I. Global Outlook

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

	2014	2015	2016f		2017f	
USA	2.4	2.4	2.4	(2.7)	2.6	(2.6)
EMU countries	0.9	1.5	1.5	(1.8)	1.6	(1.7)
Germany	1.6	1.4	1.3	(1.8)	1.3	(1.5)
France	0.2	1.2	1.3	(1.5)	1.6	(1.7)
Italy	-0.3	0.6	0.9	(1.4)	1.2	(1.4)
Spain	1.4	3.2	3.0	(2.9)	2.4	(2.4)
Finland	-0.7	0.5	0.7	(0.5)	0.9	(1.0)
UK	2.8	2.3	1.9	(2.1)	2.1	(2.1)
Denmark	1.3	1.2	1.5	(2.0)	2.1	(2.1)
Norway	2.3	1.1	0.6	(1.0)	1.4	(1.4)
Japan	-0.1	0.5	0.7	(1.1)	0.6	(0.7)
China	7.4	6.8	6.6	(6.5)	6.5	(6.3)
India	7.3	7.5	7.2	(7.1)	7.7	(7.2)
Brazil	0.1	-3.9	-3.5	(-3.7)	0.0	(0.0)
Russia	0.5	-3.8	-1.8	(-2.5)	1.5	(1.0)
Global GDP in PPP [2/]	3.4	3.1	3.2	(3.4)	3.7	(3.7)

1/ January 2016 forecasts in parentheses.
2/ IMF weights (revised 2015). Sources: IMF and Swedbank.

Interest and exchange rate assumptions, %

	Outcome	Forecast			
	2016	2016	2016	2017	2017
	11-Apr	30 Jun	31 Dec	30 Jun	31 Dec
Policy rates					
Federal Reserve, USA	0.50	0.75	1.00	1.25	1.75
European Central Bank	0.05	0.00	0.00	0.00	0.00
Bank of England	0.50	0.50	0.50	0.75	1.00
Norges Bank	0.75	0.25	0.25	0.00	0.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10
Government bond rates					
Germany 2y	-0.5	-0.5	-0.4	-0.2	0.2
Germany 5y	-0.4	-0.4	-0.1	0.2	0.6
Germany 10y	0.2	0.2	0.4	0.7	1.0
US 2y	0.7	1.0	1.3	1.8	2.2
US 10y	1.8	2.0	2.5	3.0	3.3
Exchange rates					
EUR/USD	1.14	1.09	1.07	1.12	1.15
USD/CNY	6.5	6.6	6.8	6.9	7.1
EUR/NOK	9.18	9.34	9.09	8.99	8.81
USD/JPY	108	112	115	115	115
EUR/GBP	0.80	0.76	0.75	0.72	0.72
USD/RUB	67	65	65	62	60

Sources: Reuters Ecowin and Swedbank.

II. The Swedish Outlook

Key Economic indicators, 2014-2017 [1/]

	2014	2015	2016f	2017f
Real GDP (calendar adjusted)	2.4	3.8	3.0	2.6
Industrial production	-0.8	3.8	4.0	3.8
CPI index, average	-0.2	0.0	1.0	2.3
CPI, end of period	-0.3	0.1	1.7	2.5
CPIF, average [2/]	0.5	0.9	1.4	1.9
CPIF, end of period	0.5	0.9	1.7	1.9
Labour force (15-74)	1.3	0.8	0.9	1.2
Unemployment rate (15-74), % of labor force	7.9	7.4	6.6	6.2
Employment (15-74)	1.4	1.4	1.8	1.6
Nominal hourly w age w hole economy, average	2.8	2.5	3.1	3.5
Savings ratio (households), %	15.2	16.0	16.6	16.4
Real disposable income (households)	2.2	3.0	3.5	1.9
Current account balance, % of GDP	4.2	4.9	5.2	4.9
General government budget balance, % of GDP 2	-1.7	0.0	0.0	-0.3
General government debt, % of GDP	40.6	43.4	41.3	39.9

1/ Annual percentage growth, unless otherwise indicated.
2/ As measured by general government net lending.

Sources: Statistics Sweden and Swedbank

Swedbank's GDP Forecast - Sweden

Changes in volume, %	2014	2015		2016f		2017f	
Households' consumption expenditure	2.2	2.6	(2.6)	2.9	(3.1)	2.1	(2.7)
Government consumption expenditure	1.3	2.5	(2.2)	3.7	(3.7)	2.6	(2.8)
Gross fixed capital formation	7.5	7.3	(7.3)	5.0	(5.9)	4.4	(5.3)
private, excl. housing	6.1	6.3	(5.8)	4.1	(4.8)	3.7	(4.6)
public	2.3	1.6	(3.7)	4.6	(6.1)	6.4	(5.6)
housing	19.8	16.7	(16.3)	7.9	(9.7)	5.4	(7.3)
Change in inventories [1/]	0.1	0.1	(0.0)	0.0	(0.0)	0.0	(-0.0)
Exports, goods and services	3.5	5.9	(4.9)	4.4	(5.0)	3.5	(4.1)
Imports, goods and services	6.3	5.4	(4.6)	5.3	(6.5)	4.8	(5.4)
GDP	2.2	4.1	(3.8)	3.3	(3.4)	2.3	(2.9)
GDP, calendar adjusted	2.4	3.8	(3.5)	3.0	(3.1)	2.6	(3.1)
Domestic demand [1/]	3.1	3.6	(3.5)	3.5	(3.8)	2.7	(3.3)
Net exports [1/]	-0.9	0.4	(0.3)	-0.2	(-0.4)	-0.4	(-0.4)

1/ Contribution to GDP growth.
January 2016 forecast in parentheses.

Sources: Statistics Sweden and Swedbank

Interest and exchange rate assumptions

	Outcome	Forecast			
	2015	2016	2016	2017	2017
	12-apr	30 Jun	31 Dec	30 Jun	31 Dec
Interest rates (%)					
Policy rate	-0.50	-0.50	-0.50	-0.50	0.00
10-yr. gvt bond	0.50	0.55	0.90	1.30	1.70
Exchange rates					
EUR/SEK	9.24	9.15	9.00	8.90	8.90
USD/SEK	8.08	8.40	8.70	8.00	7.74
KIX (SEK) [1/]	108.6	108.3	108.7	106.3	106.0

1/ Total competitiveness weights. Trade-weighted exchange rate index for SEK.

Sources: Macrobond and Swedbank

III. The Estonian Outlook

ESTONIA: Key economic indicators, 2014-2017 [1/]

	2014	2015	2016f		2017f	
Real GDP growth, %	2.9	1.2	2.0	(2.3)	2.5	(2.6)
Household consumption	3.6	5.0	3.4	(3.8)	3.0	(3.0)
Government consumption	2.9	2.1	1.9	(1.5)	2.5	(2.5)
Gross fixed capital formation	-1.8	-4.9	2.0	(2.0)	4.5	(5.0)
Exports of goods and services	1.8	-1.1	1.5	(2.0)	3.7	(4.0)
Imports of goods and services	1.4	-1.8	2.3	(2.6)	4.7	(5.0)
Consumer price growth, %	-0.1	-0.5	0.5	(0.3)	2.6	(2.2)
Unemployment rate, % [2/]	7.4	6.2	6.5	(6.3)	6.7	(6.6)
Real net monthly wage growth, %	5.7	8.0	4.6	(4.9)	2.6	(3.1)
Nominal GDP, billion euro	20.0	20.5	21.4	(21.3)	22.6	(22.5)
Exports of goods and services (nominal), % growth	1.4	-2.5	0.9	(1.4)	4.3	(4.6)
Imports of goods and services (nominal), % growth	0.0	-3.5	1.7	(2.1)	5.3	(5.7)
Balance of goods and services, % of GDP	3.4	4.0	3.3	(3.2)	2.6	(2.4)
Current account balance, % of GDP	1.0	1.9	1.0	(0.8)	0.2	(0.0)
Current and capital account balance, % of GDP	3.1	5.8	3.8	(3.4)	2.2	(1.8)
FDI inflow, % of GDP	5.9	-0.8	3.3	(3.3)	4.0	(4.0)
Gross external debt, % of GDP	94.7	93.6	88.5	(85.4)	83.7	(81.0)
General government budget balance, % of GDP [3/]	0.7	0.4	-0.3	-(0.2)	-0.4	(0.0)
General government debt, % of GDP	10.4	9.7	9.7	(9.6)	9.9	(9.4)

1/ January 2016 forecast in parenthesis
2/ According to Labour force survey
3/ According to Maastricht criterion

IV. The Latvian Outlook

LATVIA: Key economic indicators, 2014-2017 [1/]

	2014	2015	2016f		2017f	
Real GDP growth, %	2,4	2,7	3,0	(3,3)	3,0	(3,0)
Household consumption	2,3	3,3	4,2	(4,2)	3,5	(3,5)
Government consumption	4,9	3,1	1,5	(1,6)	2,0	(2,3)
Gross fixed capital formation	0,5	2,7	4,0	(7,0)	10,0	(10,0)
Exports of goods and services	3,1	1,4	2,5	(4,0)	4,0	(4,0)
Imports of goods and services	0,8	1,8	4,5	(6,2)	7,0	(7,0)
Consumer price growth, %	0,6	0,2	0,2	(0,8)	2,8	(2,3)
Unemployment rate, % [2/]	10,8	9,9	9,2	(9,2)	8,3	(8,3)
Real net monthly wage growth, %	7,9	7,4	5,8	(5,2)	3,1	(3,6)
Nominal GDP, billion euro	23,6	24,4	25,6	(25,8)	27,0	(27,3)
Exports of goods and services (nominal), % growth	2,3	2,1	3,1	(5,1)	5,7	(5,5)
Imports of goods and services (nominal), % growth	0,6	0,8	4,2	(6,9)	9,8	(8,4)
Balance of goods and services, % of GDP	-2,2	-1,4	-2,0	(-2,8)	-4,3	(-4,5)
Current account balance, % of GDP	-2,0	-1,2	-1,9	(-2,3)	-4,1	(-3,8)
Current and capital account balance, % of GDP	1,2	1,6	0,6	(0,3)	-1,3	(-1,0)
FDI inflow, % of GDP	1,9	2,4	3,1	(3,1)	3,1	(3,1)
Gross external debt, % of GDP	142,2	137,7	133,3	(138,6)	130,8	(136,3)
General government budget balance, % of GDP [3/]	-1,6	-1,5	-1,3	(-1,2)	-0,9	(-0,9)
General government debt, % of GDP	40,8	36,5	39,9	(38,4)	37,4	(37,7)

1/ January 2016 forecast in parenthesis

2/ According to Labour force survey

3/ According to Maastricht criterion

V. The Lithuanian Outlook

LITHUANIA: Key economic indicators, 2014-2017 [1/]

	2014	2015	2016f		2017f	
Real GDP growth, %	3.0	1.6	3.3	(3.3)	3.0	(3.0)
Household consumption	4.2	4.9	4.9	(4.7)	3.8	(3.8)
Government consumption	0.4	2.0	3.0	(3.0)	1.5	(1.5)
Gross fixed capital formation	7.0	10.3	9.0	(9.0)	6.0	(6.0)
Exports of goods and services	3.3	1.2	3.0	(4.0)	5.0	(5.0)
Imports of goods and services	3.2	7.0	7.0	(6.5)	6.5	(6.5)
Consumer price growth, %	0.1	-0.9	1.8	(2.0)	3.2	(3.0)
Unemployment rate, % [2/]	10.7	9.1	8.1	(8.1)	7.4	(7.4)
Real net monthly wage growth, %	5.1	5.8	5.0	(4.8)	2.6	(2.8)
Nominal GDP, billion euro	36.4	37.2	39.0	(38.8)	41.3	(41.1)
Exports of goods and services (nominal), % growth	0.7	-2.9	2.5	(3.0)	8.0	(9.0)
Imports of goods and services (nominal), % growth	-0.2	-0.4	5.5	(5.0)	8.5	(10.0)
Balance of goods and services, % of GDP	1.9	-0.3	-2.5	(-1.5)	-2.9	(-2.3)
Current account balance, % of GDP	3.6	-1.7	-3.3	(-2.3)	-3.6	(-3.0)
Current and capital account balance, % of GDP	6.3	1.3	-0.7	(0.3)	-0.8	(-0.2)
FDI inflow, % of GDP	0.7	1.5	1.5	(1.5)	2.0	(2.0)
Gross external debt, % of GDP	70.6	75.3	72.9	(74.6)	69.5	(71.1)
General government budget balance, % of GDP [3/]	-0.7	-1.0	-1.4	(-1.4)	-0.4	(-0.4)
General government debt, % of GDP	40.7	42.6	40.5	(41.0)	42.1	(42.9)

1/ January 2016 forecast in parenthesis
2/ According to Labour force survey.
3/ According to Maastricht criterion.

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