



# PERSISTENT HEADWIND

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MARKET INSIGHT

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## PERSISTENT HEADWIND

- ▶ The global economy is recovering at a moderate pace with a GDP growth of 3 percent this year, which increases slightly too about 3.5 percent per year from 2017 to 2018. The growth is weighed down by weak productivity and aging populations in parts of the Western world and in Japan and due to the rise of populism and protectionism globally.

## THE SWEDISH ECONOMY BRAKES IN

- ▶ The Swedish economy has already started to slow down from a high growth rate of nearly 4 percent last year. This year the Swedish economy is expected to grow by 3 percent and the next two years by about 2 percent annually. Exports are weaker than expected and only increases by 2 percent this year. As global demand recovers, Swedish exports do increase. We expect that exports will grow by 3 percent per year during 2017-2018.



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# PERSISTENT HEADWIND

The global economy is recovering at a moderate pace and is weighed down by weak productivity growth, aging populations in parts of the world and increasing populism and protectionism. The Swedish economy is slowing down, while growth in North America is lower than expected. In Europe, political uncertainty makes it more difficult to implement structural reforms. Asia continues to grow rapidly, however, at a slightly more moderate pace than before. The headwind in the global economy is anticipated to continue.

## PERSISTENT HEADWINDS IN THE GLOBAL ECONOMY

The global economy continues to recover at a moderate pace with a growth of 3 percent and is predicted to increase slightly to 3.5 percent annually 2017-2018. Global growth is weighed down by weak productivity growth and an aging population in parts of the West and in Japan. For the global economy to take off, tangible productivity must increase, which requires structural reforms. However, against the background of growing populism it becomes increasingly difficult for governments to implement reforms aimed at for example the labour market or taxation. In addition, several countries are highly indebted and struggle with significant budget deficits. Overall, this means that the global economy faces challenges.

Economic growth is sluggish in advanced economies. Europe continues to recover from the debt crisis and the economy will grow by about 2 percent per year from 2016 to 2018. The North American economy has been weaker than expected this year and only grew 1.6 percent before rebounding marginally to 2 percent. The US economy is booming with nearly full employment. Growth in Japan will not accelerate despite Prime Minister Abe's ambitious stimulus

program. The Japanese central bank stimulates the economy with negative interest rates and bond purchases and the possibility of further measures is limited. In addition, the strong Yen makes it difficult for Japanese exporters.

In emerging economies, the trend varies from country to country. Growth in the Chinese economy continues to shift down gradually. The Indian economy continues to grow rapidly and the Indonesian economy will accelerate further. Both India and Indonesia are favoured by a young population with a high propensity to consume. In India, political progress is overcoming structural problems. Recently agreed tax reforms are particularly noteworthy.

Global, annual BNP growth (%)<sup>1</sup>



Sources: IMF; Business Sweden

<sup>1</sup> Country aggregation according to IMF's definition. Advanced economies consist mainly of OECD countries, with exception of Chile, Hungary, Poland and Turkey. Non-OECD countries that are included are Cyprus, Hong Kong, Lithuania, Malta, San Marino, Singapore and Taiwan.

BNP growth for selected regions<sup>1</sup> (%)

Region	2015	2016P	2017P	2018P	Share of global BNP
Global	3,1	3,0	3,4	3,6	100,0
Sweden	3,9	3,1	2,3	2,0	0,4
Europe	2,3	1,9	1,8	1,9	19,3
North America	2,5	1,6	2,3	2,2	38,8
Asia	5,4	5,3	5,2	5,1	20,6

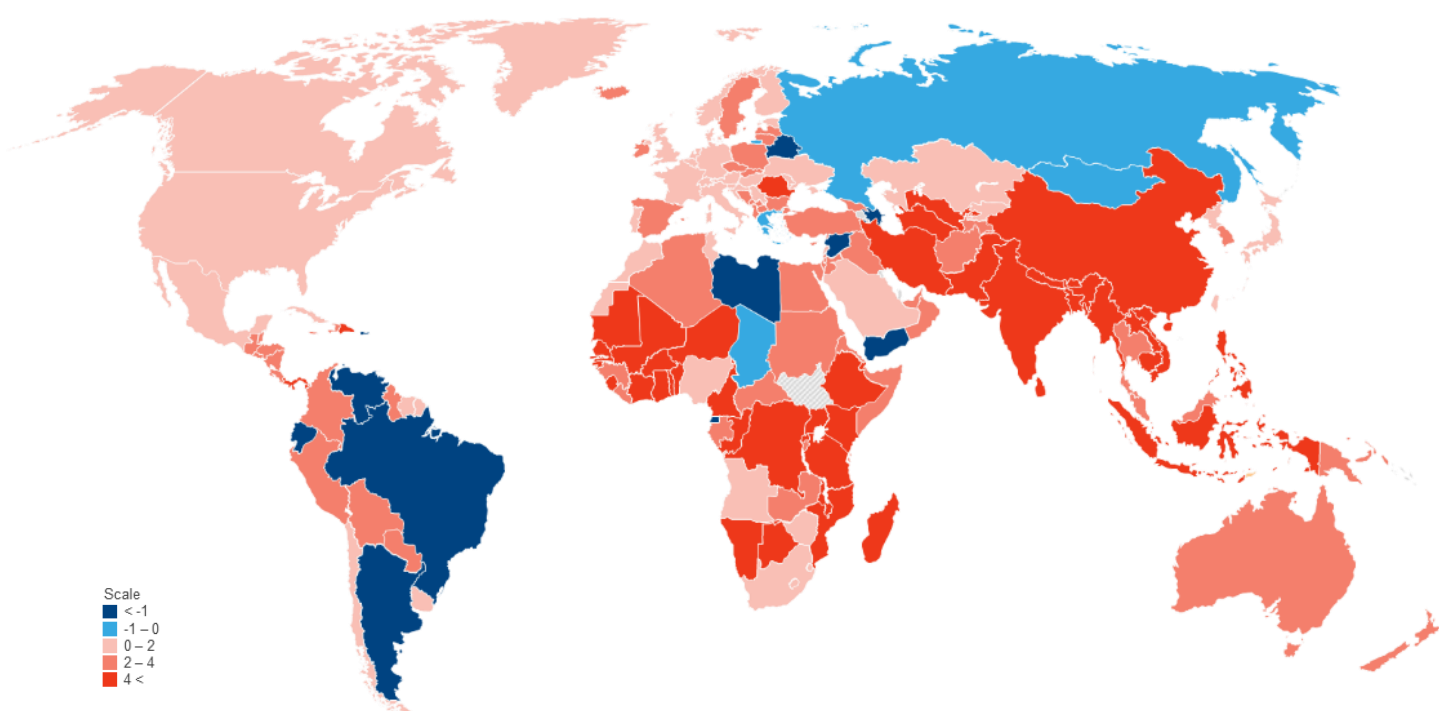
Sources: Oxford Economics; Business Sweden

Overall, the expected development in the Asian economies is projected to be relatively stable over the forecast period, reaching an annual growth of 5 percent. The recovery in commodity prices favours commodity-producing emerging economies. Oil prices continue to rise gradually from the current level of around USD 45 per barrel and are expected to climb to between 55 and 60 USD per barrel in 2018. Pending a more stable political development, the increase in oil prices will result in countries like Russia and Brazil going out of recession.

The expansionary monetary policy in the West has reached a state of normalcy. The Federal Reserve continues to raise interest rates at a slow pace and the ECB will likely begin to downsize their support in the coming year. However, interest rates are expected to remain low for a long period of time.

A major source of concern in regards to the development of the global economy is the rise of populism as protectionist winds prevails. An important reason for the increasing populism is that the economic conditions of large social groups in many Western countries have stagnated or declined since the financial crisis of 2008. This is a big challenge for the politicians.

Annual growth of GDP 2016 per country (%)



Sources: Oxford Economics; Business Sweden

<sup>1</sup> Selected regions important to Swedish exports. Covers approximately 80 percent of the world's GDP.

## THE SWEDISH ECONOMY BRAKES IN

Last year the Swedish economy grew strongly and broadly with an annual rate of 4 percent, but already in the first half of this year growth rates began to slow down. Indicators point to a stronger performance in the second half of 2016. We expect the Swedish economy to grow by around 3 percent this year and about 2 percent from 2017 to 2018.

The unexpected slowdown in the Swedish economy during the first half of the year is mainly due to falling exports. Most export indications, including Business Sweden's Export Managers' Index (EMI), indicate continued weak export performance in the future. A small, open economy like Sweden is largely dependent on demand from abroad. Exports contribute about half of the Swedish GDP. The global economy continues to expand, which contributes positively to the development of exports over time. Exports are unlikely to pick up significantly during the forecast period, which is why growth in the Swedish economy remains reliant on domestic demand.

The labour market continued to develop strongly this year before slowing down. It is due to weaker growth in demand and the increasing difficulty of finding labour with the necessary skills and is applicable both in the private sector as well as in the public sector. A more efficient labour market, however, bring wages up as well as the rate of inflation. In recent years, domestic demand has been the growth engine. Last year, public consumption significantly increased as a result of the influx of refugees, while household consumption is continuously stimulated by low interest rates. In the coming year both household consumption and investment is projected to weaken somewhat as the economy is no longer

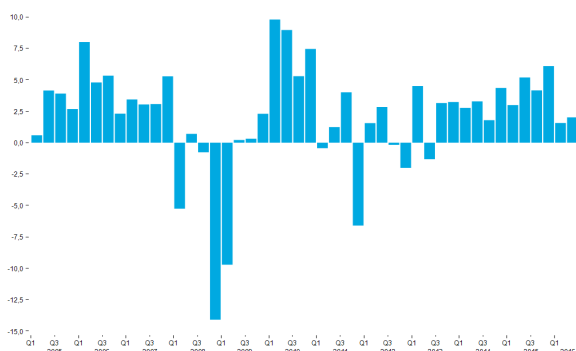
stimulated by expansionary policies. Most indications demonstrate that the Swedish Riksbank not will lower the interest rate again. The key interest rate is expected to stay unchanged at -0.50 percent next year to gradually increase to 0.00 percent in 2018. This reinforces the SEK against both the Euro and the Dollar.

## GROWTH IN THE SWEDISH EXPORT MARKET STRENGTHENS

The world economy continues to recover, albeit at a moderate pace, which strengthens the Swedish export market. To get an estimate of market growth for Swedish exports, we assume our forecast for GDP growth in different regions. Market growth for exports is defined as the total demand for imports in the countries to which Sweden exports, weighted by each country's share of Swedish exports. Our forecast is that the Swedish export market will be growing by almost 2 per cent this year, 2.6 percent in 2017 and 3 percent in 2018 (constant prices). There is a much lower growth rate than the average of 5.7 percent per year since the early 1990s. It indicates that the aftereffects of the global financial crisis that erupted in late 2008 continue, with sustained weak demand from abroad, which in turn holds back demand for Swedish goods and services.

Demand from Sweden's most important export market, namely Western Europe, is considered weak this year but is expected to increase during the period of 2017-2018. From Central and Eastern Europe, demand is stable. Demand in North America has slowed sharply in the first half of this year, but from next year replenishes itself. Asian and Oceanian demand remains weak in 2016 and is then expected to take off. Demand from South America still looks bleak although the region is considered to brighten somewhat in the near future. For regions like the Middle East, Turkey and Africa, the outlook is uncertain, especially considering sustained low oil prices and geopolitical risks. The two last-mentioned regions account for a small share of the Swedish export market.

Swedish GDP development per quarter (%)



Sources: Macrobond; Business Sweden

Swedish export market share development<sup>1</sup> (%)

	2016P	2017P	2018P	Share of Swedish exports 2015, (%)
Swedish export market growth, globally	1,7	2,6	3,0	100,0
Western Europe	1,8	2,4	2,6	62,4
Central and Eastern Europe	4,7	4,3	4,5	7,9
North America	0,5	2,6	3,5	9,0
South America	-7,6	2,6	4,1	1,1
Asia och Oceanien	1,4	2,6	3,8	10,0
Middle East, Turkey and Africa	0,4	2,9	4,3	4,8

Source: Oxford Economics, Business Sweden

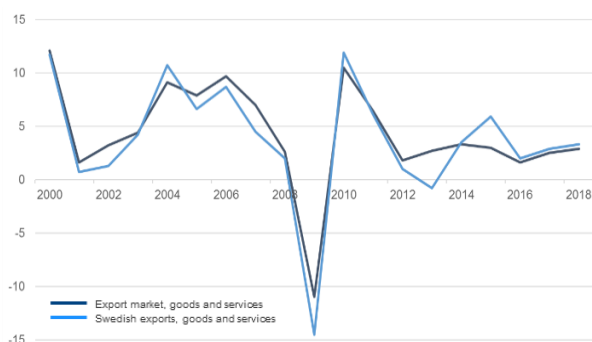
A similar picture is provided by the Business Sweden's Export Managers' Index that for the third quarter demonstrates that exporting companies expect a decrease in demand in all regions. Foremost in Western Europe as well the Middle East, Turkey and Africa, where the index has fallen below the 50 mark which indicates that more companies believe in a decrease than an increase in demand in these regions. It is clear that the export temperature has dropped but overall the Export Managers' Index is still above the 50 mark indicating a positive outlook on export developments. Konjunkturinstitutets Economic Tendency Survey similarly paints a similar picture, with falling export orders.

As the world economy recovers, demand is strengthened in all regions. Meanwhile, Sweden's competitiveness face challenges due to a stronger krona and higher unit labour costs, i.e. companies' labour costs per unit produced.

## SLOW GROWTH IN EXPORTS

Last year, Swedish exports increased by 5.9 percent which is faster than the average growth in world trade. However, in the first half of this

Swedish export market and exports development (%)

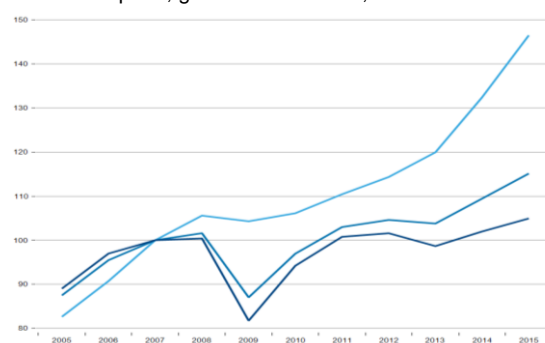


Sources: Macrobond; Business Sweden

year exports performed poorly. Our forecast is that exports will increase by 2 percent this year, 2,9 percent 2017 and 3,3 percent 2018, marginally faster than expected market growth. In 2014-2015 Swedish exports grew faster than the market. It is partly due to a temporary high level of services and a weak exchange rate as well as relatively low unit labour costs, which gave Sweden a competitive advantage. This effect will fade from 2017 onwards. The decline in Swedish exports, compared with market growth in 2013 is mainly explained by the weak growth abroad, especially in Europe, which is receiving about 75 percent of Swedish exports.

It is above all exports of services that are increasing at a rapid pace, while exports of goods increased more slowly. Service exports now account for over a third of total exports. Services exports, however, declined in the first quarter of this year, partly due to a temporary high level at the end of 2015 due to royalties and management fees. In the second quarter services exports rebounded, while exports of goods fell. Much of the weak export performance can be explained by low global commodity prices, that inhibits investment in commodity industries in foreign countries, particularly emerging economies, including China, which holds back demand for Swedish exports. We anticipate that commodity prices will increase and demand recovers.

Swedish exports, goods and services, index 2007=100



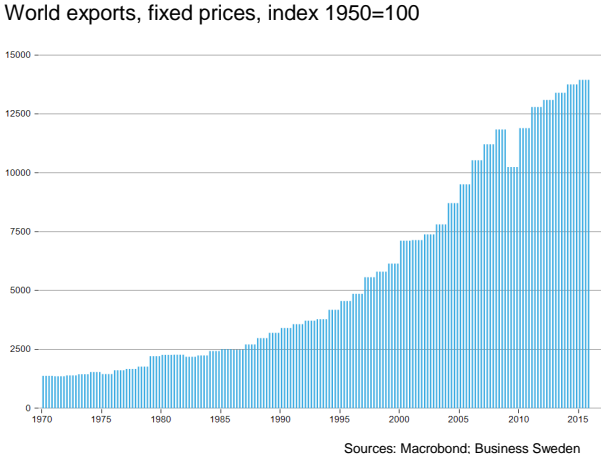
Sources: Macrobond; Business Sweden

After the financial crisis, the growth in world trade slowed down. In the past four years, total world exports increased by an average of 2.2 percent per year, slower than the global GDP growth. For a small and open economy like Sweden, where about half of GDP consists of exports, this development has a relatively large impact. During the period 1995-2007 world trade grew rapidly by almost 8 percent per year. The

<sup>1</sup> Covers selected markets in regions where Business Sweden operates. Included countries cover 95,6 percent of Swedish total exports.

liberalization of world trade interacted with national deregulation, an IT and communications revolution, the emergence of a global financial market and greatly improved infrastructure. Together these factors created a favourable environment for global growth.

The reasons that world trade started to slow down is partly due to cyclical factors such as weakened external demand and capitalization as well as a sharp fall in commodity prices. But above all, structural factors slowed down a more positive growth. Amplified trade in data and information replaced physical trading and shortened global value chains. It is reasonable to expect a slightly higher growth rate in world trade as the global economy continues to recover. However, it will likely continue to increase at a slower pace than in the period before the financial crisis.



# “SWEDISH EXPORTS IS COMPETITIVE, AND SWEDEN HAS POTENTIAL TO GROW ITS MARKET SHARE INTERNATIONALLY”

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