CONFIDENCE IN THE GLOBAL ECONOMY PREVAILS DESPITE UNCERTAINTIES

MARKET INSIGHT

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CONFIDENCE IN THE GLOBAL ECONOMY PREVAILS DESPITE UNCERTAINTIES

- The world economy continues to struggle. Nevertheless, the growth rate increased to almost 3.5 percent annually from 2017 to 2018, from 3 percent this year. In the coming year, it is expected that effectively all economies in the world will demonstrate positive growth. However, Brexit, Trump and important elections in several countries in Europe make the world more insecure.

LOWER GROWTH RATE IN THE SWEDISH ECONOMY

- The Swedish economy is booming. Lack of housing and skilled labour in most sectors will dampen growth. The growth rate has already begun to shift down from last year’s 3.9 percent. This year, growth is expected to increase by 3.1 percent to shift down to about 2 percent per year from 2017 to 2018. As the global economy strengthens, world trade increases and the outlook for Swedish exports brighten.

ELECTION YEAR IN EUROPE 2017

- Increased uncertainty in the world, post Brexit and presidential elections in the United States, along with several important elections in Europe next year, inhibits the growth prospects in Europe. This year, growth is expected to increase by 1.9 percent in Europe, and then slow down to 1.7 percent per year from 2017 to 2018. Growth in Central and Eastern Europe has slowed significantly during the year. Continued robust consumption cannot compensate for falling investment and weak exports.

UNPREDICTABILITY IN NORTH AMERICA

- Growth in the North American economy is expected to grow by about 2 percent per year from 2017 to 2018, from a weak 1.6 percent this year. Risks to the outlook have increased as a result of uncertainty about what policies Trump will bring. Growth can be higher or lower. Trump’s vision of the Free Trade Agreement NAFTA is central to both the Canadian to the Mexican economy.

TRUMP PUTS PRESSURE ON ASIA

- Growth in Asia has increased slightly faster than expected. This year, growth is expected to increase by 5.5 percent. The next two years, growth is expected to increase by more than 5 percent per year. This is an indication that the uncertainty linked to Brexit and Trump, at least in the short term, is affecting Europe and the U.S. to a greater extent than Asia.
CONFIDENCE IN THE GLOBAL ECONOMY PREVAILS DESPITE UNCERTAINTIES

The world economy continues to struggle in headwind. Nevertheless the growth rate will increase to almost 3.5 percent annually 2017 to 2018, from 3 percent this year. The outcome of the presidential election in the United States takes us into a new era afflicted with increased uncertainty and risk of turbulence. Along with Brexit and several important political elections in European countries next year, the growth prospects of Europe and the United States have eased somewhat. Contrary, growth prospects in Asia strengthened, albeit marginally. World trade is weak but recovers gradually in pace with increased international demand. Most indications are that Swedish exports are growing at the same pace as world trade over the next two years. Growth in the Swedish economy continues to slow from 3.1 percent this year to about 2 percent per year from 2017 to 2018.

AN UNCERTAIN WORLD

Next year, the global growth rate accelerates to 3.3 percent, from 3.0 percent this year. Growth in the developed economies is expected to continue to increase by about 2 percent per year from 2017 to 2018. The moderate growth can be largely explained by weak productivity growth and an aging population. Industrial production has been weak in advanced economies since the financial crisis of 2008. In addition, the political risks have increased significantly over the past six months, which is holding back growth further. In emerging economies, by contrast, industrial production developed strongly and the demographics are favourable. Emerging economies recovering from the sharp commodity price slump is expected to grow by about 5 percent per year overall from 2017 to 2018.

Important events which occurred in the past six months, including Brexit and the outcome of the presidential election in the United States, contribute to increased uncertainty in the world. The development inhibits investment but also consumption, thus the rate of growth especially in Europe and the U.S.

We now enter an era afflicted by increased uncertainty with risk of turbulence, linked to a new and emerging geopolitical landscape. Europe and the United States risks becoming relatively weaker, while Asia is strengthening. Already now, Asia is the economically dominating continent.
At present, it is unclear what policies Donald Trump will implement. If he continues the protectionist rhetoric and focus on tax cuts and infrastructure investments, it may have a positive effect on the US economy in the short term. Overall, growth in North America is expected to be about 2 percent per year from 2017 to 2018, from a weak 1.6 percent this year. The US central bank, the Fed, increased the key interest rate as expected in December.

The rise of populism in Europe will be tested in several significant elections in the coming year, in particular at the parliamentary elections in the Netherlands in March, the presidential election in France in May, and the presidential election in Germany in September. However, the recent pro-European victory in the presidential election in Austria provides hope for the future of Europe.

Meanwhile, the Italian people voted no to a new constitution, which resulted in the resignation of Prime Minister Renzi. The result of the vote might create political chaos in Italy. The growth rate in Europe has slowed down slightly to 1.7 percent annually from 2017 to 2018. Inflation is expected to increase significantly in the coming months due to lower oil prices.

The European Central Bank (ECB) decided at its December meeting to reduce the scope of their monthly support asset purchases and to extend the purchasing program until at least the end of 2017.

Growth prospects for the Japanese economy look brighter despite the strong yen that are holding back exports. A new fiscal stimulus package has been launched in order to increase household consumption and government investment in infrastructure and thus growth.

In large parts of Asia a young population and growing middle class contributes to a relatively stable development. The Asian economies are expected to collectively grow by more than 5 percent per year over the forecast period.

The oil-producing countries both within and outside the OPEC recently agreed to reduce oil production in order to curb excess supply. Thus, oil price is expected to rise. The forecast is that oil prices will increase to around 60 dollars per barrel by the end of 2017 and 65 dollars per barrel by the end of 2018. The recovery in oil and commodity prices is important to South America (with the exception of Venezuela) and Russia as they are leaving times or recession behind. Despite a stated policy to diversify the private sector leading companies of the Middle East are still heavily dependent on oil revenues. The expected price rise gives some breathing space for the Middle Eastern oil economies, but they remain under fiscal pressure.

Next year, almost all countries in the world are expected to have positive growth, although uncertainty increase.

### Global, annual GDP growth (%)¹

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<td>5.3</td>
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Sources: Oxford Economics; Business Sweden
LOWER GROWTH RATE IN THE SWEDISH ECONOMY

The Swedish economy is experiencing a boom. Lack of housing and skilled labour in most sectors are, however factors that are holding back growth. Growth in the Swedish economy has already begun to shift down from last year’s high 3.9 percent. This year, growth is expected to increase by 3.1 percent to cycle down to about 2 percent per year from 2017 to 2018.

At the beginning of the year exports developed weakly. It contributed to the unexpectedly sharp slowdown in the economy during the first half of 2016. The third quarter, exports surprised positively. Several indicators of export development, including Business Sweden’s Export Manager’s Index (EMI) for the fourth quarter, indicates a rise in the export temperature.

As the global economy continues to recover the rate of growth in Swedish exports increases, although, uncertainty is extensive due to Brexit and Trump. Small open economies such as Sweden, like the other Nordic countries, which are dependent on external demand, are particularly vulnerable. Sweden's most important trading partners are found in the Western world where growth is moderate. More than 70 percent of Swedish exports go to Europe and 9 percent to North America. This means that exports are not expected to pick up more significantly during the forecast period. The Swedish economy will therefore continue to depend on a strong demand from the domestic market.

The dichotomy between industry and services remain. The weak demand from abroad continues to hold back industrial output, despite the weak krona and indicators that point to a rise in manufacturing activity. The service sector is favoured by the strong domestic economy and will continue to be a locomotive of the Swedish economy.

Employment continues to grow strongly, but labour is divided. Nearly 80 percent of the unemployed are in groups with a weak position in the labour market. This group include the low-skilled, non-European born and disabled. Along with housing shortages, lack of skilled labour is a major challenge for the Swedish economy.

The Swedish krona (SEK) is still central to the Riksbank for increasing inflation and inflation expectations. The policy rate is expected to remain at -0.50 percent in 2017 and increased to 0.00 by the end of 2018. Asset purchases are likely to be extended to the first half of 2017. Despite the krona is expected to strengthen against both the euro and the dollar.

INCREASED EXPORT DEMAND IN ALL REGIONS

As global demand recovers the Swedish export market strengthens. Market growth for exports is defined as the total import demand in the countries to which Sweden exports, weighted by each country’s share of Swedish exports. The Swedish export market is expected to grow by just under 2 percent this year, 2.4 percent in 2017 and 3 percent in 2018 (constant prices). It is is a much lower growth rate than in the 1990s until the financial crisis when the market increased by 5.9 percent per year on average.

Western Europe is Sweden’s most important export market, accounting for over 60 percent of exports. Demand in Western Europe is expected to increase by about 2 percent per year from 2016 to 2017 to increase slightly in 2018. The demand from Central and Eastern Europe develop stable and is expected to continue to increase by about 5 percent per year over the next two years. The first half of this year, demand from North America has been very weak. Next year it replenishes itself but downside risks have increased as a result of uncertainty about trade policy in the United States with Trump in the White House. Demand in South America is expected to recover significantly from 2017 to 2018. Asian and Oceanian demand has been weak in 2016, but recover in the coming years. The same applies to the Middle East, Turkey and Africa, where prospects improve.

Swedish exports market development (%)
The brighter picture for export demand is in line with Business Sweden’s Export Manager Index (EMI) for the fourth quarter. The export temperature is rising and business expectations in export demand are optimistic for all regions. The index is above the 50 mark for all regions, which shows that more companies anticipate an increase rather than a drop in export demand. According to the National Institute of Economic Research’s (NIER) Economic Tendency Survey in November export orders are also increasing throughout the industry.

As the global economy recovers demand from all regions strengthens. Meanwhile, Sweden’s competitiveness is slightly falling due to a stronger krona and larger unit labour costs.

**EXPORTS ARE LOOKING BRIGHTER**

The rate of growth in Swedish exports has shifted down significantly this year from last year’s high 5.9 percent. This year, exports are expected to increase by 2.3 percent. Next year should increase by 2.9 percent and in 2018 by 3.4 percent. This is about the same rate as the increase in the market. Exports grew faster than the market growth 2014-2015 due to several factors. One is a temporary high export of services; and a weak krona and relatively low unit labour costs. With a stronger krona and unit labour costs increasing Sweden lose in competitive advantage.

Swedish exports market and exports development (%)

Services export is growing rapidly, while export of goods is weak. Services exports is accounting for over a third of total exports. Exports of services consist primarily of intangible assets (royalties, trademarks, etc.) and business services including technical consultants.

Growth in world trade has slowed significantly in recent years. This is due to both cyclical and structural factors. The total world exports over the past four years have increased by an average of 2.2 percent per year. As the global economy strengthens world trade will increase. However, it is not likely that the growth rate reaches near the growth rate of 8 percent per year during the 1990’s up to the financial crisis.

**“NEXT YEAR, ALMOST ALL ECONOMIES ARE EXPECTED TO HAVE POSITIVE GROWTH RATE DESPITE RISING GLOBAL UNCERTAINTY.”**

Lena Sellgren, Chief Economist
Business Sweden
ABOUT THE MARKET INSIGHT

Business Sweden publishes the Market Insight three times per year. The Market Insight provides an overview of the development in the world economy, as well as a more in depth view of the economic development in selected regions that are important for Swedish exports. Also, the development of Swedish economy and exports is analysed.

The purpose of the Market Insight is to create an increased understanding of driving forces in Swedish exports, as well as how the economic development in the world impact Swedish export companies.

The analysis is mainly based on data from Oxford Economics, Statistiska centralbyråns and Macrobond, as well as Business Sweden’s external monitoring.

Key assumptions in the trade war scenario page 9, from Oxford Economics:

- Business and consumer confidence are dented. Gives an effect roughly equal to 10 percent of what was experienced during the financial crisis. The effect gradually fades over the course of Trump’s presidency.
- Global financial markets show some modest safe-haven flight, with emerging markets currencies weakening and the euro and yen strengthening against the dollar (in relation to base scenario).
- From Q3 2017, US imposes 45 and 35 percent tariffs on Chinese and Mexican merchandise goods respectively. Then, as US consumers switch away from the higher priced Mexican and Chinese imports, the US raises 20 percent tariffs on South Korea and Taiwan.
- Mexico, China, South Korea and Taiwan all retaliate with similar tariffs on US exports.
- The fiscal package include tax cuts of 500 billion USD over the next 10 years, while spending-cuts are offset. The 125 billion USD infrastructure investment from the baseline scenario fails to materialise.
- Deportation of illegal immigrants and curbs on legal immigrants result in a decline in the US labour force of 1 million per year. Towards the end of the 5-year forecast, labour supply growth is assumed to rise back towards its baseline rate.
Business Sweden’s purpose is to help every Swedish company to reach its full international potential and help companies abroad to reach their potential by investing in Sweden. The purpose is operationalised through 450 staff deployed at 14 offices in Sweden and at 55 offices in 49 key markets abroad. Feel free to contact us for any questions regarding Swedish international trade or foreign investments in Sweden.