



GLOBAL SLOWDOWN

MARKET INSIGHT, MARCH 2019

IN FOCUS:
ITALY 
A political challenge!

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CHIEF ECONOMIST'S COMMENTS

THE GLOBAL ECONOMY HAS PEAKED

The global economy peaked last year but continues to grow at a relatively good pace just below its historic average of 3.7 per cent both this year and next year. Part of the economic turmoil that occurred during the second half of last year is considered temporary, especially in the euro area where tighter emission rules in the automotive industry along with weak growth in world trade affected exports negatively. The global economy is in a mature boom period with high resource utilisation and low unemployment in several large countries.

However, the risks in the world economy remain, even though they do not currently burden the forecasts. A global trade war, a rapid decline in growth in China, the threat of a sovereign debt crisis in Italy and a no-deal Brexit, are some of the risks that can quickly pile up and obscure the prospects for global growth.

During the past decade, the world economy has been stimulated by an expansionary monetary policy with low policy rates and massive bond purchases in several large countries. At the same time as the global economy has strengthened, the central banks have gradually been reducing the stimuli and have started to raise policy rates. However, monetary policy remains expansionary with low policy rates in several countries. Should the economic outlook worsen, central banks will have limited possibilities to stimulate their economies. This means that countries will have to increasingly rely on fiscal policy to raise growth. Several major countries such as the US and Japan, but also other countries in southern Europe, have high public indebtedness and large deficits in their public finances.

The outlook for growth differs between regions. In the euro area, the growth rate slowed last year, primarily in Germany and Italy. Growth remained strong, however, thanks to a relatively positive domestic demand. The European Central Bank is expected to postpone its first policy rate increase to the first half of 2020.

Growth in North America reflects the growth profile for the US where the economy peaked last year and continues to slow down this year and next year. To a large extent, this is because fiscal stimulus in the US is decreasing at the same time as a weaker demand from the rest of the world is holding back exports. The US central bank, Federal Reserve, will refrain from increasing policy rates this year and will raise the policy rate only once in 2020.

As a consequence of the ongoing rebalancing of the Chinese economy, its growth rate continues to slow down. At the same time, the US trade tariffs have a negative effect on exports. To prevent an overly abrupt decline in GDP growth, the Chinese government applies various types of economic stimuli. Lower demand from China hits other markets in Asia particularly hard. The decision by US president Donald Trump to postpone the planned tariff increase on Chinese goods may decrease the economic risk for both the Asia region as well as North America, at least in the short term.

The slightly weaker global economy has a negative impact on Swedish exports. Overall, exports, which benefit from the weak krona, are expected to grow by 3.0 per cent this year and 3.4 per cent next year. The fact that exports will increase somewhat faster next year is because the decline in world demand is expected to be moderate. As a result, we are currently looking at a global slowdown rather than a recession.



LENA SELLGREN
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GLOBAL SLOWDOWN

Over the past decade, the world economy has been stimulated by an expansionary monetary policy with low policy rates. Increased fiscal stimuli, particularly in the US, has also contributed positively to global growth, not least last year's tax cuts and increases in expenditure. As the global economy has strengthened, the central banks have reduced their stimulus packages and more central banks have begun to raise their policy rates. The global economy, which reached its peak last year, is now slowing down. In addition to this, risks such as a global trade war, a rapid slowdown in growth in China, a sovereign debt crisis in Italy and a no-deal Brexit have all increased in recent times. Lower growth in world trade (from 4.7 per cent in 2017 to 3.3 per cent in 2018) as well as temporary issues in the automotive industry all contributed to a weakening of exports in the euro area last year. Towards the end of 2018, concerns over weaker global growth increased. This resulted in falling stock markets at the same time as consumer confidence weakened sharply. Nevertheless, financial markets stabilized around the turn of the year, primarily due to modest policy rate indications from the Federal Reserve.

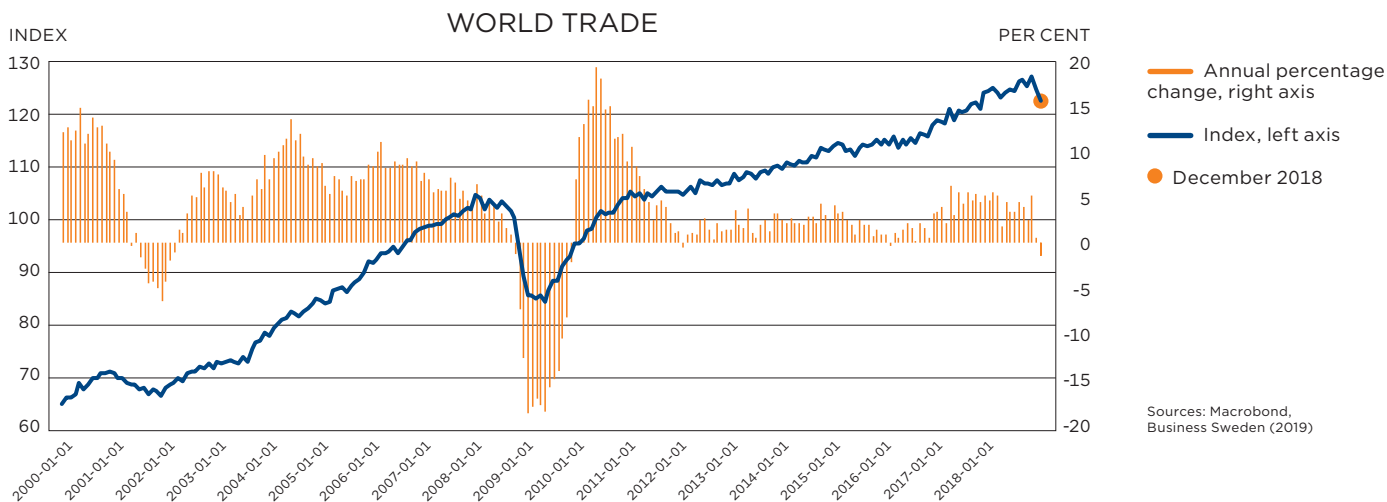
The global economy finds itself at a mature peak but is slowing down during 2019. The decline in the growth rate – from 3.6 per cent in 2018 to 3.2 per cent in 2019 – will, however, be relatively moderate. Since the beginning of last year, confidence indicators for the manufacturing industry in particular show a

declining trend, currently pointing to a weakening in Europe while the US still shows optimism. A part of the economic slowdown that could be seen primarily during the second half of last year is, however, considered to be temporary, especially in the euro area. Continued high resource utilisation and low unemployment in several large countries results in an increase in global growth up to 3.5 per cent by 2020. This is just below the historical average of 3.7 per cent for the period 2000–2017.

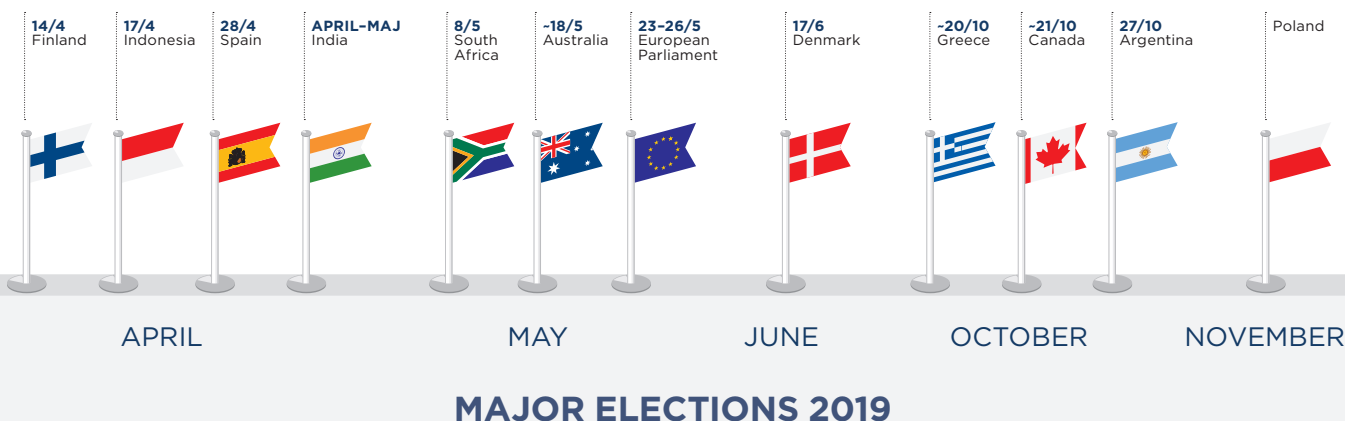
DOMESTIC DEMAND IS THE BRIGHT SPOT IN A WEAK EUROPE

The rate of growth in the euro area declined last year, especially in Germany and Italy. The Italian economy even went into recession (negative growth) in the second half of last year. The growth rate is expected to slow down and become slightly negative this year at -0.1 per cent compared to 0.8 per cent last year. Increased concern over escalating trade conflicts together with a weaker development of world trade contributed to lower export growth in the euro area. The Purchasing Managers' Index for the manufacturing industry has fallen since the beginning of last year and is now below 50, the level that indicates negative growth. Growth in the euro area is maintained by relatively positive domestic demand and it is mainly household spending that is expected to increase this demand.

The labour market is strong, and together with low inflation, contributes to a positive



Sources: Macrobond, Business Sweden (2019)



development in household real income and thereby in purchasing power. At the same time, overall fiscal policy will be somewhat expansionary and the expected time for the European Central Bank's (ECB) first policy rate increase in almost eight years has been postponed to the first half of 2020.

The risks to the European economy are mainly on the down side and consist of a greater economic slowdown than expected, a no-deal Brexit and a sovereign debt crisis in Italy spreading to other euro area countries.

The German economy is the largest in the euro area and accounts for just over 28 per cent of the euro area's total GDP. Due to weak export development, the pace of growth in the German economy shifted sharply into a lower gear last year. Stricter emission regulations for the automotive industry but also weak world demand, especially from China, contributed to the weaker German exports. China is the third largest recipient of German export goods and the subdued activity in China has a major impact on German export development. Growth in the German economy – which will be low this year – is driven by the strong labour market with relatively high wage increases of around 3 per cent.

Also in France, which is the euro area's second largest economy and accounts for 21 per cent of the euro area's GDP, the global economic slowdown is affecting export development. At the same time, the increased political uncertainty in connection with the "Yellow Vests" protests has a dampening effect on investments, which show a slightly lower growth this year compared to 2018.

The Italian economy, which went into recession at end of last year, will, due to weak domestic demand, most likely exhibit a zero or slightly negative growth this year after which it is

expected to show a slight recovery. The Italian economy, which is the third largest economy in the euro area and which accounts for 15 per cent of the euro area's GDP, is relatively export dependent. Germany – which accounts for just over 12 per cent of Italian exports – is decidedly the country's most important export market. Weak growth in Germany therefore hits Italian exports severely.

The Spanish economy is slowing down slightly this year. Nevertheless, domestic demand remains robust while exports are expected to lift somewhat after last year's slowdown. In the United Kingdom the uncertainty surrounding Brexit and weaker world trade have dampened the prospects for exports and investments. The low rate of growth in the British economy is upheld by a strong labour market, which in combination with a less restrained fiscal policy, favours household consumption. Growth prospects in the British economy presumes there will be a Brexit with a deal and an extension of the date of exit.

LOWER DEMAND FROM CHINA AFFECTS THE REST OF ASIA

Due to the ongoing rebalancing of the Chinese economy, the slowdown in growth continues. At the same time, the US trade tariffs have a negative effect on exports. The Chinese authorities continue to prevent an overly abrupt decline in GDP growth using various economic stimuli, among others, reduced reserve requirements for banks and lower taxes.

The weakening of growth in the Chinese economy dampens export growth on many other markets in the region that are strongly dependent on investments and demand from China, particularly small, open economies such as South Korea, Singapore and Taiwan. The announcement from Donald Trump to

postpone the planned increase in punitive tariffs on Chinese goods – valued at \$200 billion – from 10 to 25 per cent, can, however, mean an upside risk for the region. More modest policy rate indications from the US also benefits small, open economies that are sensitive to capital outflows. The reason is that more frequent policy rate increases in the US would probably result in a strengthening of the US dollar against various Asian currencies. A stronger dollar encourages investors to choose the dollar as an investment currency which, in turn, leads to capital outflows and further weakening of domestic currencies. Small, open economies with large foreign loans would be severely affected. Slower policy rate increases in the US would therefore mean that the risk of large capital outflows would be reduced.

The Japanese economy continues to grow at a decent pace, even if external headwinds dampen exports. Growth is benefited by a strong labour market and a positive investment climate. However, the level of investment still remains low. By opening up for investments and trade, not least through the trade agreement between Japan and the EU, investment can take off and increase the low growth rate of productivity.

In India, fiscal measures continue to drive economic growth ahead of the parliamentary elections later this spring, at the same time as low inflation (given the inflation target of 4 per cent with a tolerance range of 2 percentage points in each direction) results in a more expansionary monetary policy. The country, which is a large oil importer, also benefits from a lower oil price that reduces the trade deficit. An increased risk is the situation in the shadow

banking sector which has worsened since the infrastructure development company IL&FS had extensive problems with weak finances last year. Access to credit is in danger of decreasing and growth is adversely affected by the fact that it holds back investment and consumption.

NORTH AMERICA'S GROWTH PEAKED LAST YEAR

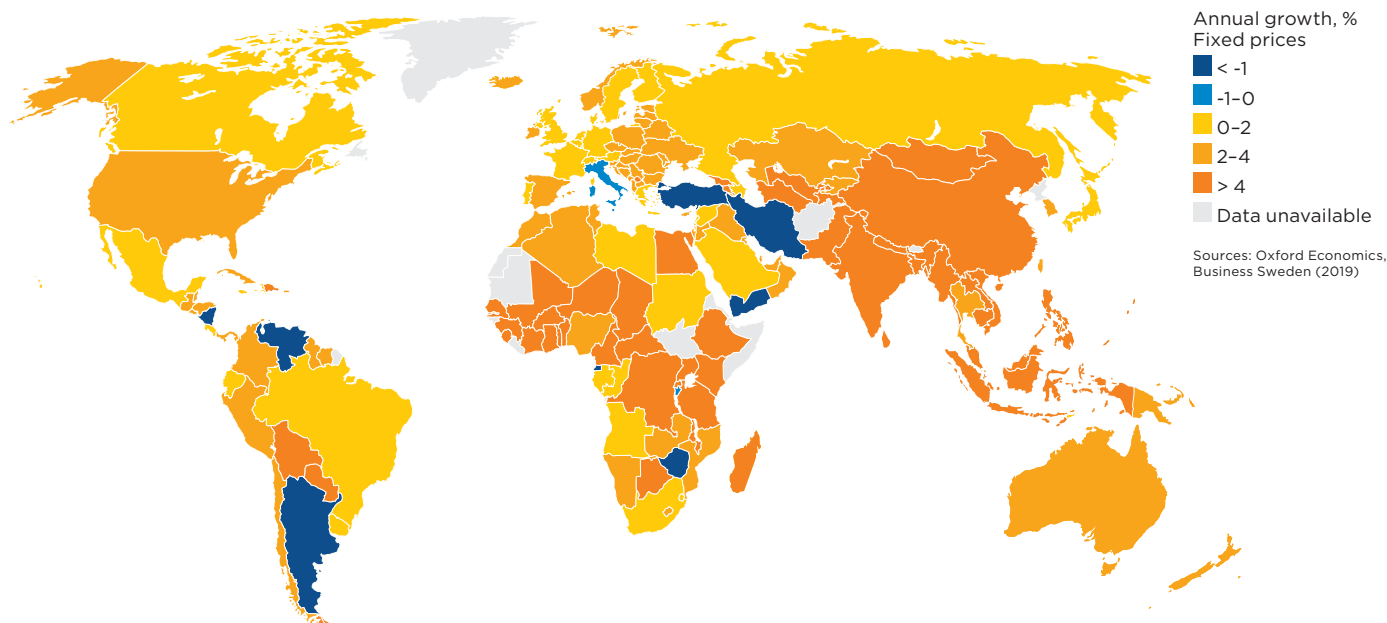
Growth in the US economy peaked last year and continues to slow down both this year and next year. This is largely due to the fact that the positive effects of the fiscal stimulus packages in the US are gradually decreasing while weaker demand from the rest of the world is dampening export prospects this year. Deferred tariff increases between the US and China constitute an upside risk in the forecast (at least in the short term). At the same time, growth prospects can deteriorate rapidly if the trade conflict between the US and China escalates. Activity in the US housing market has decreased but does not currently present any imminent risk. The labour market is strong and the unemployment rate of 3.8 per cent is the lowest since the beginning of the 2000s. The US economy continues to develop well, but with a national debt of 105 per cent of GDP, which continues to increase, it is not sustainable in the long term. Because the US – the world's largest economy – is by far the largest economy in North America its growth profile reflects the growth profile of the region.

FEWER INTEREST RATE INCREASES AHEAD

The US central bank, Federal Reserve, was the first to start normalising monetary policy when

WEAKER DEMAND FROM CHINA HAS A GREAT IMPACT ON THE DEVELOPMENT OF GERMAN EXPORTS WITH A KNOCK-ON EFFECT THROUGHOUT THE EURO AREA

FORECAST GDP GROWTH 2019



the policy rate was raised in 2015 for the first time since the outbreak of the financial crisis 2008. The rate has subsequently been raised a further eight times to today's 2.25–2.50 per cent and is now close to its normal level, i.e., the level that neither stimulates nor restricts demand in the economy. As the US economy peaked last year, inflationary pressure remains close to target and risks in the world are on the down side, there are good reasons for the Federal Reserve to not increase the policy rate this year. The Federal Reserve will closely monitor incoming data – something the central bank has said will become increasingly important to policy rate decision-making going forward. The main scenario is that the policy rate is left unchanged this year and then raised by 25 basis points in 2020.

The ECB closed its net purchases of government bonds at year-end 2018/2019. Economic outlook in the euro area has, however, been surprisingly negative and the risks are, overall, on the down side. At the same time, inflationary pressures are still low. At present, it is therefore difficult to justify raising the policy rate. The assessment is that the ECB postpones the policy rate increase to the first half of 2020 when the economic outlook will probably have improved slightly. The low policy rate in combination with a new series of long-term loans for banks in the euro area which was announced at the monetary policy meeting earlier in March this year, will continue to support growth in the euro area going forward.

FORECAST GDP GROWTH, %

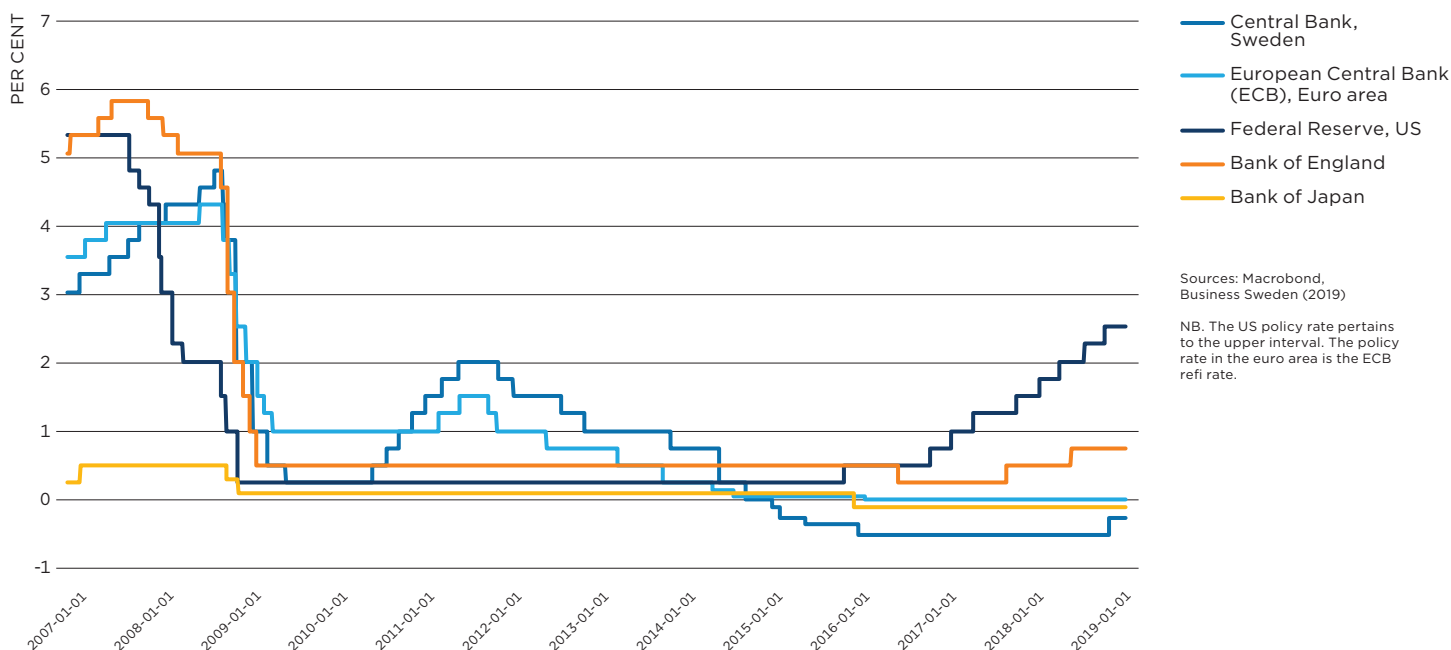
Region	GDP growth, % fixed prices			Share of global GDP 2018 (%)
	2018P	2019P	2020P	
Global*	3.6	3.2	3.5	100.0
Sweden	2.4	1.4	1.6	0.7
Asia & Oceania	4.5	3.9	4.0	35.8
Europe	2.0	1.5	1.7	27.4
North America	2.7	2.1	1.8	25.7
South America	0.9	-0.2	3.1	5.4
Africa	2.9	3.1	3.7	3.1
Middle East	2.3	2.6	3.1	2.6

NB: All calculations in fixed prices.
Due to rounding, shares do not add up to 100
Growth reported as purchasing power adjusted GDP
Sources: Oxford Economics, Business Sweden (2019)

GDP growth in the UK is estimated to remain moderate this year and the uncertainty surrounding Brexit means the risks on the down side will dominate. The Bank of England is expected to exercise caution with regard to policy rate increases until the political situation surrounding Brexit is clarified. The policy rate, which has been raised twice since the outbreak of the financial crisis to 0.75 per cent, will probably only be raised once per year during 2019–2020.

In Japan, the deviation from the inflation target of 2 per cent will be substantial, both this year and next year. The Japanese central bank, Bank of Japan, is therefore continuing with its low policy rate policy in the coming years as well as its bond purchase programme which aims to keep the 10-year policy rate at zero per cent.

POLICY RATES



ITALY

A POLITICAL CHALLENGE

Italy is the third largest economy in the euro area and the country's GDP is just over 15 per cent of the region's GDP. The country also has the second largest manufacturing industry in Europe after Germany with cutting-edge expertise in several areas.

The financial crisis of 2008 and the subsequent debt crisis in the euro area had a serious impact on the Italian economy. In recent years, Italy has slowly recovered. However, last year, concerns about the economic and political situation in the country increased. Weak growth, high public indebtedness and a populist government have fuelled market anxiety.

Interest rates on Italian government bonds have risen to almost 3 per cent and are to be paid by the Italian state. At worst, the country runs the risk of ending up in a sovereign debt crisis that can spread to the entire euro area. In order to avoid a sovereign debt crisis, the country must reduce its budget deficit as well as its public debt, strengthen the banking sector and implement structural reforms in order to increase long-term growth. The scale of the necessary structural reforms, combined with the high level of public debt, means that it is likely to take many years before the Italian economy picks up.

CHALLENGES ON A BROAD FRONT

LOW GROWTH FOR A LONG PERIOD

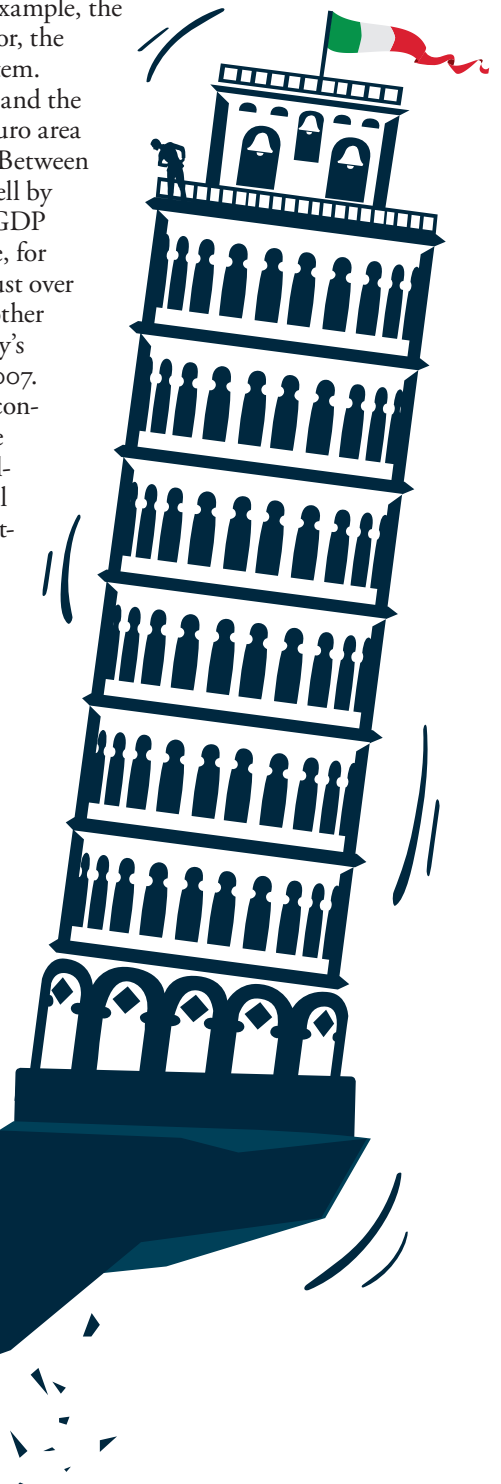
From the European perspective, Italy's rate of growth has been low for a long time. During the period 2000–2018, the country's GDP grew

by an average of 0.4 per cent per year. In the euro area, GDP rose by an average of 1.4 per cent per year over the corresponding period. This historically low growth is mainly due to structural weaknesses in, for example, the labour market, the public sector, the judiciary and the banking system.

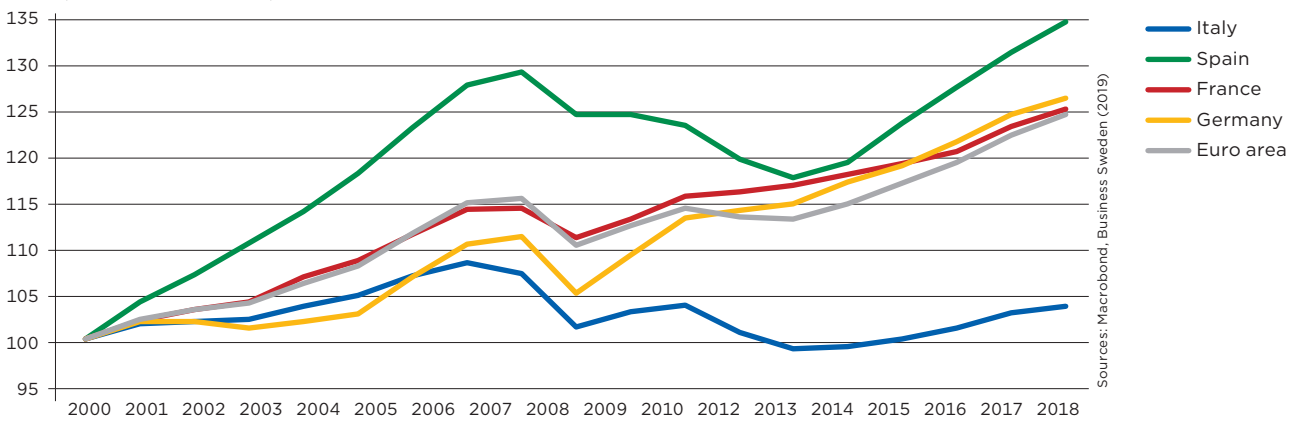
The financial crisis of 2008 and the subsequent debt crisis in the euro area hit the Italian economy hard. Between 2008 and 2014, Italian GDP fell by almost 8 per cent. The fall in GDP was lower compared to Greece, for example, where GDP fell by just over 25 per cent. However, unlike other major euro area countries, Italy's GDP is today lower than in 2007. Over the past four years the economy has recovered, but despite an expansionary monetary policy from the European Central Bank (ECB), the level of investments is lower than in 2007.

Even the development of GDP per capita – a measure that reflects a country's production taking into account the development of the population – has been weak, down by almost 8 per cent since the outbreak of the financial crisis. This decline in GDP per capita is mainly due to the poor development of GDP.

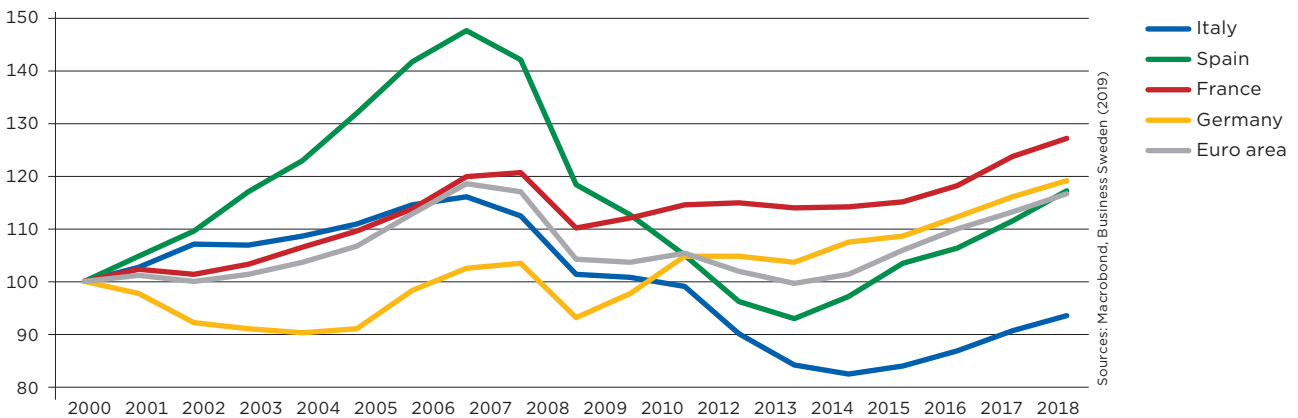
The Italian economy is characterised by high unemployment even though unemployment has fallen



GDP, FIXED PRICES, INDEX 2000=100



INVESTMENTS, FIXED PRICES, INDEX 2000=100



from about 13 per cent during the crisis years, when it peaked, to just under 11 percent in 2018. A significant proportion of high unemployment is of a structural nature and can only be resolved through structural reforms, for example by modernising the wages bargaining system. Youth unemployment of just over 30 per cent is among the highest in Europe; only Spain and Greece have higher levels. The level of unemployment also differs greatly in different parts of the country. In northern Italy, unemployment is just under 7 per cent while in southern Italy it is significantly higher, almost 20 per cent. Northern Italy is the engine of the economy and together with the central region of the country accounts for almost 80 per cent of production, while the share of production in the southern parts amounts to slightly more than 20 per cent.

Low economic growth and high unemployment have resulted in record levels of emigration, mainly to other countries in Europe. This high emigration – which has also increased

among professionals – also dampens the country’s future growth prospects. Moreover, millions of people have moved north to the major industrial cities.

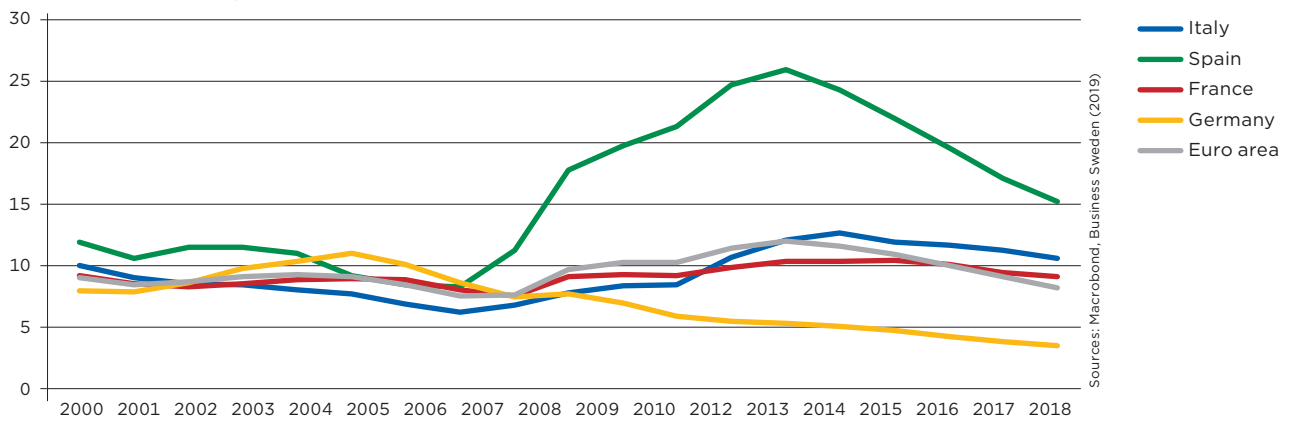
LACK OF FLEXIBILITY ON THE LABOUR MARKET AND WEAK PRODUCTIVITY DEVELOPMENT

Italy has – seen from the international perspective – problems with high labour costs per unit produced. This reflects in high wages relative to productivity. The high cost situation is negative for competitiveness and has resulted in a weak export development. This is hampering growth as the export sector is relatively large and accounts for just over 30 per cent of GDP.

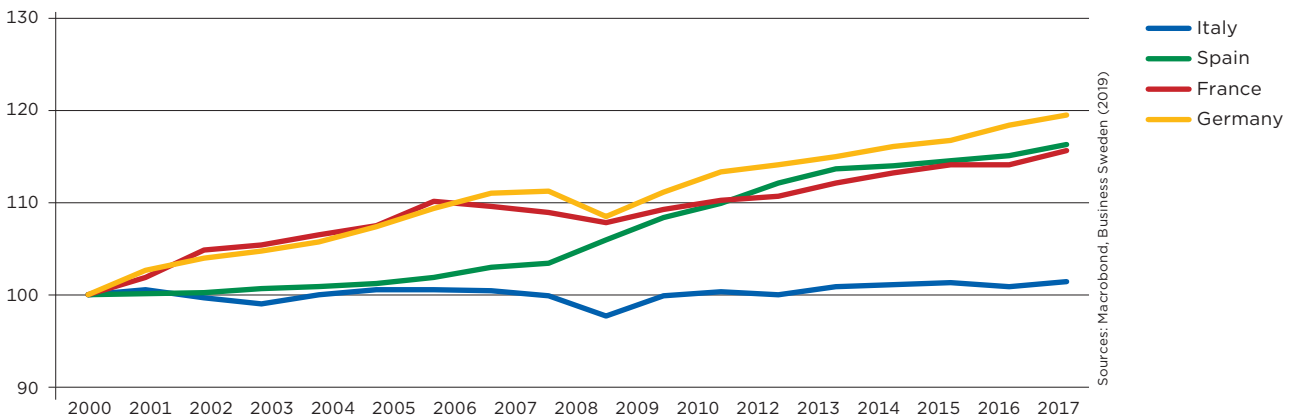
The overall goal of the Italian government is to increase economic growth. Reforms in the areas mentioned above are therefore necessary. Italy is in great need of modernising and digitalising its industry. Italy has the second largest manufacturing sector in Europe after Germany with cutting-edge expertise in several areas such

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NORTHERN ITALY IS THE ENGINE OF THE ECONOMY

UNEMPLOYMENT, PER CENT



PRODUCTIVITY, (GDP PER WORKING HOUR, FIXED PRICES) 2000=100



as engineering, pharmaceuticals, chemicals and automotive. Many companies in Italy, however, are small and often family-owned. Some 90 per cent of the companies have fewer than 10 employees. Many of these operate within traditional sectors and it has become increasingly difficult for them to compete with international, low-price alternatives. The government's industrial policy focuses, among other things, on investments in Industry 4.0 and digitalisation, which is likely to contribute to increasing Italy's competitiveness.

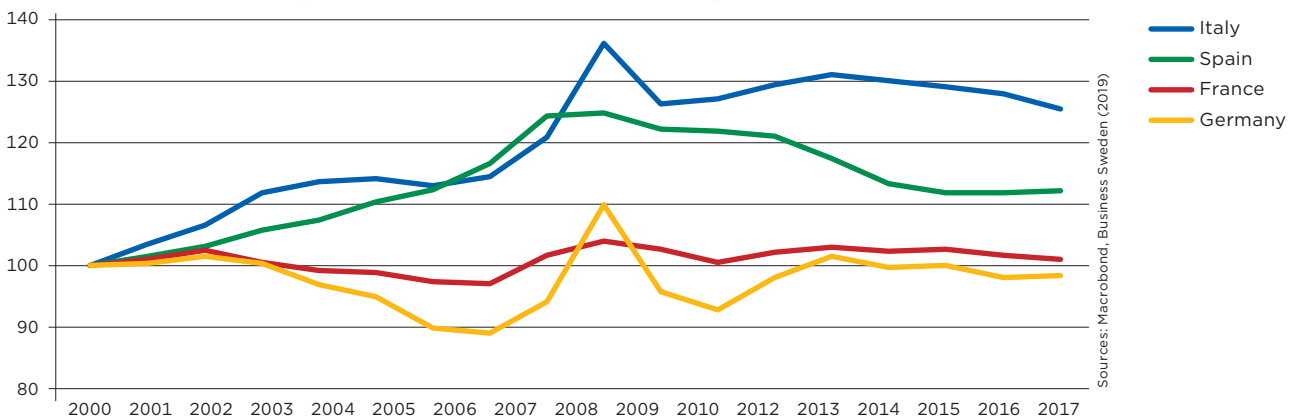
The weak productivity development is mainly due to structural factors such as a weak education system with a low proportion of university and college graduates, high start-up costs for new companies, inefficient public administration and legislative processes, corruption, low investments in research and development, an inefficient tax system and the lack of ability of many smaller companies to embrace modern information and communications technology.

WEAK BANKING SECTOR POSES AN IMMINENT RISK

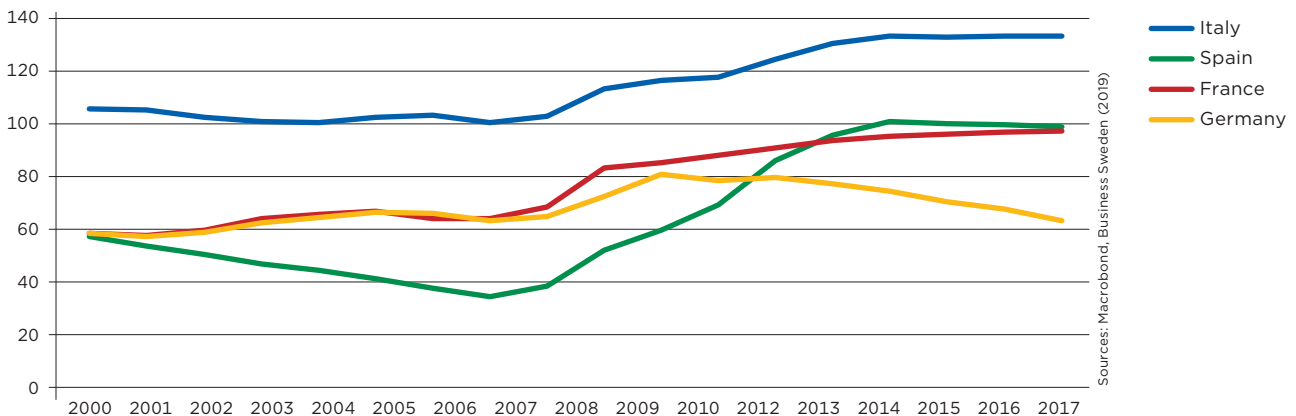
The debt crisis in the euro area resulted in a sharp deterioration in the state of Italian banks. Even before the crisis, the proportion of bad loans (so-called non-performing loans) was high and peaked at 17 per cent in 2015. As a result of the low GDP growth, the share of bad loans increased further and the banks' profits worsened.

The Italian banks still have low levels of equity compared to the EU average. The need for capital injection therefore continues to be substantial. The problem is exacerbated by the fact that neither the private nor the public sector has the will and/or sufficient financial means to strengthen the banks with capital. If the interest rates on Italian government bonds continue to rise, the value of the banks' balance sheets also risk falling, which is negative for an already weak Italian banking system. The Italian state has previously rescued failing banks, but it is doubtful whether the Italian state has the economic muscle necessary in order to save yet

UNIT LABOUR COSTS, MANUFACTURING INDUSTRY, INDEX 2000=100



PUBLIC SECTOR CONSOLIDATED GROSS DEBT, MAASTRICHT DEBT, PER CENT OF GDP



another bank. The EU’s new rules for bank resolutions – which are aimed at protecting taxpayers by making the banks’ creditors pay in the event of any liquidation, known as “bail-in” – make it more difficult for the Italian state to save a failing bank. If the situation becomes exacerbated, the rescue issue may eventually end up with the ECB, which for political reasons may find it difficult to directly step in and support the Italian banking system. This is because Italy violates the EU’s Stability and Growth Pact.

RISK OF SOVEREIGN DEBT CRISIS AND SPREAD EFFECTS TO THE ENTIRE EURO AREA

The stagnant economy has contributed to public debt growing significantly in relation to GDP. Today, it accounts for more than 130 percent of GDP, the second highest in the EU after Greece. The high level of public debt implies limited room for manoeuvre in the event of a financial shock or recession.

In the spring of 2018, uncertainty about the economic and political development in Italy

increased. The political agreement – including clear expansionary elements – between Lega and the Five-Star Movement gave cause for concern that the Italian government debt would increase further. The increased concern for rapidly rising public debt has meant that the interest rate on Italian government bonds has risen and in the autumn of 2018 – when concerns peaked – rates rose well over 3 per cent, considerably higher than in countries such as Germany. The higher interest rates, in turn, lead to higher interest expenditure, which can squeeze other public spending and thereby reduce the total demand in the economy. For 2019, interest expenditure as a share of GDP is estimated to be as high as 3.7 per cent. The corresponding figure for Germany is estimated to be only 0.75 per cent.

Two thirds of the Italian public debt is held by domestic investors. Other large countries, such as the US and Japan, also have a high public debt that is domestically financed. If problems with financing the debt arise as a consequence of rising interest rates, Italian banks

Fulfillment of the two criteria that EU countries must meet for sound public finances as part of the EU Stability and Growth Pact.

2019	Max 3 per cent of GDP in budget deficit*	Max 60 per cent of GDP in government debt ratio**	Share of the euro area's GDP (%)
France	-2.8	98.6	20.9
Italy	-2.0	130.0	15.4
Spain	-1.8	95.5	11.0
Germany	1.0	58.0	28.3

*If no abrupt fall in GDP (2 per cent or 0.75–2 per cent) **Or if the debt quota is higher, it should be falling at a "satisfactory rate"
 Source: Member States' Draft Budgetary Plans for 2019

and pension funds also risk becoming insolvent. The resistance in other countries to saving Italy from an economic crisis is great and the euro area's rescue fund (ESM) is too small. The ECB – which has in recent years supported Italy through the purchase of Italian government bonds – ceased its net purchasing of bonds at year-end last year, thus taking small steps towards a normalisation of monetary policy. Without the backing of the ECB, the crisis could spread to the entire euro area with major negative economic effects.

However, at the end of 2018, market movements calmed down somewhat. This was due to the fact that Italy finally agreed to reduce its budget deficit for 2019 to 2.0 per cent of GDP and this was approved by the European Commission. This is less than the 3 per cent of GDP allowed by EU rules. However, the EU Commission is more strict towards Italy than against France, for example, and this is mainly due to Italy's very high level of public debt.

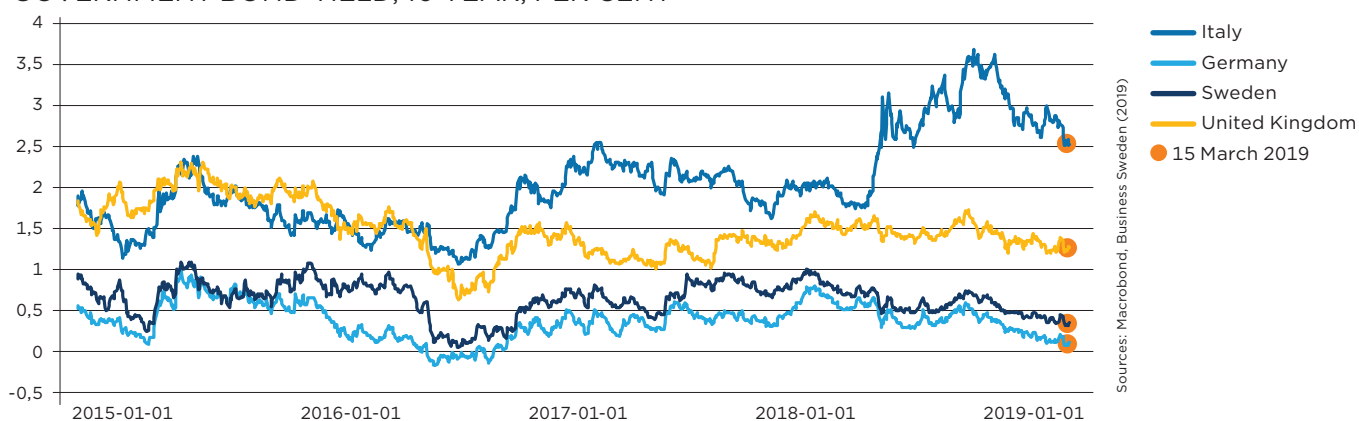
Nevertheless, the risk of rising Italian interest rates remains. The public debt is high and an increased distrust towards the country, which is apparent in the form of higher government bond yields, can have major negative effects.

In the worst case scenario, Italy could be hit by a sovereign debt crisis with even greater interest expenditure than today. Italy's weight in the euro area's overall economy is significant (15 per cent of euro area GDP) and given the outstanding stock of government bonds – the third largest in the world after the US and Japan – a sovereign debt crisis in Italy could, at worst, spread to other key euro area countries.

THE ROAD AHEAD FOR ITALY

In order to increase productivity and long-term economic growth, Italy is in great need of structural reforms in a number of areas. However, in the short term, the risk of a sovereign debt crisis dominates which could have major negative effects on the Italian economy but also widespread effects throughout the euro area. In order to avoid a sovereign debt crisis, the budget deficit and public debt must be reduced and the banking system must be strengthened, while the long-term growth must increase – a process that can take a very long time. The political situation in Italy does not make the situation easier and is a critical factor for the country's future.

GOVERNMENT BOND YIELD, 10 YEAR, PER CENT



Sources: Macrobond, Business Sweden (2019)



” Despite economic and political challenges in Italy, there are solid business opportunities in a range of areas where Italy offers cutting-edge expertise. We can see particularly strong market potential in *equipment manufacturing, pharmaceuticals and the automotive sector*, but also in *digitalisation, the tech- and start-up scene* where the government is making large commitments. ”

Martin Skoogh, Trade Commissioner
Business Sweden, Milan.

Italia

SPECIFIC RISKS FOR THE WORLD ECONOMY

IMPENDING DOWNSIDE RISKS FOR THE WORLD ECONOMY

The downside risks in the world economy continue to be of overriding concern for growth prospects, even if they are not an immediate burden. The biggest global downside risks at the time of writing are escalated trade conflicts or even a full scale trade war and a bigger than expected slowdown in China. For Europe's part, there are quite a few dark clouds on the horizon such as a sovereign debt crisis in Italy, a no-deal Brexit, persistently weak growth (stagnation) and increased political uncertainty, for example the European parliamentary elections to be held later this spring which may increase the influence of various populist parties in the EU.

Although the trade relationship between China and the US has benefited from a temporary "peace solution" with deferred increases in tariffs, the risk of increased trade disputes remains. Tensions between the two superpowers also exists in a number of other areas, for example in the transfer of technology, patents, China's currency policy, etc. Increased trade tensions between the US and the EU is also a major downside risk. Increased tariffs on European cars exported to the US would hit the export-dependent European economy hard and would probably cause the EU to retaliate with counter measures.

Growth in the Chinese economy is expected fall to 6.2 per cent this year, from 6.6 per cent last year. This is in line with official target of around 6.0–6.5 per cent for 2019. Next year, the growth rate will fall further to 5.9 per cent. The downshift depends on the rebalancing of the Chinese economy in combination with more long-term focus on sustainable growth and measures to mitigate credit. A lower rate of growth than expected due to a drop in investment, or a fall in prices on the Chinese real estate and/or housing market for example, would, due to the size of the country's economy, have a major negative impact on the global economy.

The European economy – especially in the euro area – exhibited an unexpected downside throughout 2018. A decline in world trade

slowed activity in the export industry and thus slowed growth in the region. At the same time, the uncertainty surrounding Brexit as well as the risk of a sovereign debt crisis in Italy had a negative impact on investments. The slowdown has also been evident in confidence indicators, such as the Purchasing Manager's Index, which reflects a strong downward trend throughout 2018. This applies in particular to the manufacturing industry. A significant part of the lower growth is due to temporary factors such as stricter emission rights in the automotive industry in Germany. It is estimated that the effects of the temporary factors that pulled down the rate of growth will taper off during the first half of this year and that the growth rate thereafter will increase. There is a risk, however, that the economic slowdown depends on more than just temporary factors and that the upswing in growth will therefore either be moderate or not occur.

Since the turn of the year, the probability of a no-deal Brexit has increased, and it is now clear that the timing of the UK's exit from the EU has moved forward slightly. An exit from the EU without a deal would have significant negative effects on growth in the UK but also in neighbouring countries within the EU. However, the possibility of it spreading to the global economy is considered to be relatively small. In the slightly longer term, this is nonetheless difficult to predict.

Although downside risks dominate the picture, there are also some upside risks. One would be a trade agreement between the US and China. This would benefit not only these countries' exports but also boost global confidence indicators and the willingness to invest.

Given that the downside risks still dominate, the overall picture shows that growth in the world economy will develop at a relatively good pace over the next two years, although slightly below the historical average of 3.7 per cent for the period 2000–2017. The forecast is based on the assumption that none of the downside risks occur. This means that we assess the risk of a global recession as low or moderate and thereby does not burden the forecast.

THE SWEDISH ECONOMY AND EXPORTS

SWEDEN'S GROWTH SLOWS DOWN

In recent years, the growth rate of Sweden's GDP has benefited from a positive development in domestic demand. Since 2014, exports – as a result of a robust world economy – have also taken off. Going forward, however, domestic demand is increasing at a slower rate. This is mainly due to a weaker housing market and declining investment in residential property. At the same time, household consumption has had a weak development during the past year, which can largely be explained by subdued housing prices and increased uncertainty related to the housing market, falling stock markets and general economic anxiety in the rest of the world. Higher interest rate expectations may also have affected household consumption behaviour. The National Institute of Economic Research's confidence indicator, which displays the household's view of their own economy as well as the Swedish economy, shows a falling trend since the second half of last year and indicates a pessimistic image of the economy among households.

The slowing down of GDP growth from the high of recent years is expected to reach 1.4 and 1.6 per cent in 2019 and 2020 respectively, compared to 2.4 per cent in 2018. The estimate is that the economic environment – which is still strong – has matured. The development of the labour market is still favourable with great demand for labour, high levels of employment and workforce participation. Unemployment, which is around 6 per cent, has fallen and is at its lowest level since before the outbreak of the financial crisis of 2008. Unemployed individuals are mainly unskilled people with a relatively tenuous connection to the labour market. This has resulted in companies finding it difficult to recruit staff with the right competence, which explains why the so-called shortage figures are high.

In December 2018, the Swedish Central Bank (The Riksbank) raised its policy rate for the first time in more than seven years. Inflation of around the target of 2 per cent, firmly established inflation expectations and a continued positive development of the Swedish economy, resulted in small steps towards a normalisation

NORDIC AREA IN DIFFERENT DIRECTIONS

The Finnish economy is slowing down this year despite continued robust private consumption. In Denmark, on the other hand, growth is expected to lift slightly in a consumption-driven upswing along with better prospects for exports. The Norwegian economy is in an expansionary phase with strong household purchasing power, an increase in the rate of investment and high activity in the oil industry. Norway's central bank raised the policy rate to 1 per cent at its meeting in March.

of monetary policy. Underlying inflation (inflation minus energy prices) is, however, still low.

Despite a slowdown in the economy, the underlying inflation is expected to rise going forward and be around the target of 2 per cent this year and next year. This is due to high resource utilisation which, with a certain delay, results in higher inflationary pressure. The next policy rate increase is expected sometime in the second half of 2019 but, given the relatively weak inflation outcome so far this year, can possibly be postponed until next year when the policy rate is expected to be increased twice. The policy rate increases are, to a large extent, dependent on the development of inflation which is expected to be close to the target in coming years. The probability of fewer policy rate increases than expected is considered to be higher than for more increases.

WEAKER ECONOMIC GROWTH WORLDWIDE HITS SWEDISH EXPORTS

Growth in world trade lost momentum in 2018 and increased by just over 3 per cent, compared to 4.7 per cent in 2017. This is lower than the historical average of just over 4 per cent for the period 2000–2018. Lower growth in world trade last year resulted in a somewhat weaker development for Swedish exports which increased by 3.5 per cent in 2018. A slightly weaker market

IMPACT OF THE KRONA ON EXPORTS

Since the early 1990s, the participation of Swedish companies in so-called global value chains has increased. The increased activity in global value chains has resulted in a weaker correlation between the exchange rate and exports. Global value chains mean that Swedish exports have had an increasing import content over time, and therefore the cost base for export companies increases with a weakening krona. The cost increase that a weakening of the krona leads to, means that export volumes do not necessarily increase to the same extent as in previous weakening of the Swedish currency.

Finding empirical evidence that supports economic theories of the impact of exchange rates on Swedish exports is not insignificant. However, an analysis by The Riksbank draws the conclusion that participation in global value chains mitigates the impact of exchange rates on exports. Nevertheless, the exchange rate is still an important factor in determining the development of exports, but greater fluctuations in the value of the krona are required than previously in order to impact on export volumes. Other factors, such as which currency export companies price their products in can also explain the impact of currency exchange rates on exports.

demand was also reflected in Business Sweden's Export Manager Index (EMI), which, since the second half of 2018, has shown a downward trend, albeit almost unchanged in the first quarter of this year. However, the EMI is just above the 50 mark which indicates that the mood of the export companies remains better than normal.

Exports are expected to increase somewhat more slowly this year, which can be explained by lower import demand from some of Sweden's most important export markets. Investment growth in the euro area is slowing down, which affects Swedish goods exports negatively as it largely consists of input and investment goods. The development of goods exports is therefore expected to be moderate in the years to come. Services exports – which have developed weakly in recent years as a consequence of a weak development of exports of business services, among

FORECAST FOR SWEDEN'S TOTAL EXPORTS GROWTH (GOODS AND SERVICES), %

Region	2019P	2020P	Share of Swedish goods exports 2018, %
Europe	3.0	3.2	72.8
Asia & Oceania	2.4	4.4	13.2
North America	3.1	2.7	8.0
South America	1.9	4.7	1.4
Africa	3.6	3.4	1.9
Middle East	4.5	6.1	1.6
Globally	3.0	3.4	100.0

NB: All calculations in fixed prices. Due to rounding-up, shares do not add up to 100.

Sources: Oxford Economics and Business Sweden (2019)

other things – is expected to show higher growth rates in the coming years. This can be explained by increased demand and upgrading to 5G in other countries, which benefits sections of Swedish industry. Overall, exports, which benefit from a weak krona, are expected to increase by 3.0 per cent this year and 3.4 per cent next year. This is slightly lower than the historical average of almost 4 per cent during the period 2000–2017. The fact that exports will increase somewhat faster in 2020 is because the decline in external demand is expected to be moderate and will take off again as the global economy recovers next year.

Export development differs slightly between regions. But for all regions – except North America and Africa – export growth will rise next year. This can be explained by the fact that global growth is expected to pick up again next year and thus the demand for Swedish exports will increase.

The impending negative risks for Swedish exports are mainly associated with escalating trade conflicts but also with signs of underlying weaknesses in the European economy to which almost three quarters of Swedish exports go. As an EU member, Sweden would be hit hard by increased trade tensions between the EU and the US, especially if car tariffs are substantially increased. The Swedish automotive industry employs approximately 135,000 people in Sweden (including sub-suppliers) and is a major exporter accounting for more than one tenth of Swedish goods exports. Further risks are associated with the threat of a sovereign debt crisis in Italy with a sharp slowdown in growth, both in Italy and throughout the entire euro area. Even globally, growth would be affected, albeit to a lesser extent than in Europe.

SLOWDOWN WITH SILVER LINING

Early in the first quarter of 2019 it became apparent that growth in Europe had slowed down, but stable private consumption continues to keep the economy going at a decent pace. Household demand is underpinned by an increase in real wages due to moderate wage increases, subdued inflation and a continued robust labour market. Overall, unemployment in the EU fell to 6.5 per cent in January, which is the lowest level that has been recorded since the EU's statistical office, Eurostat, started its monthly monitoring in 2000.

However, exports are noticeably weakening as a result of falling global demand, a situation that could not be fended off with the successive weakening of the euro last year. The slowdown is reflected in industrial production which stagnated during the second half of 2018 and started off 2019 from a very weak position. The Purchasing Manager's Index for the manufacturing industry fell sharply throughout last year and stood at 47.6 in March which indicates negative growth. At the same time, the pace of investment in manufacturing as well as in the construction sector slowed down.

The growth rate in Europe was 2 per cent in 2018 and is expected to fall to 1.5 per cent in 2019 and then to increase to 1.7 per cent by 2020. The ongoing global economic slowdown can, however, worsen the outlook for the European economy, especially if demand in Asia falls further. The US threat of imposing punitive tariffs on cars will be a severe blow to European industry if they become a reality. However, the trade conflict between the US and China seems to be working towards at least a temporary solution. The outcome of Brexit is still completely uncertain.

GERMANY SLOWS DOWN

The growth rate in the German economy is now in decline. Demand is maintained by positive private consumption supported by low inflation, real wage increases and a buoyant labour market. Unemployment has successively fallen since 2010 but is expected to land at just over 3 per cent this year. The shortage of labour is a major bottleneck for industry. Despite this, the rate of

investment remains modest and monthly data for retail and industrial production indicates that the economy is losing strength.

For Germany, the world's third largest exporting country, the slowdown in global demand has a major negative impact, not least on industry. The research institute Ifo's leading indicators for industry and trade are at their lowest levels since the European debt crisis and the forecast is for zero growth in industrial production this year. However, the vital automotive industry is recovering from the temporary drop of autumn 2018 when the manufacturers were forced to deal with stricter European and local emission requirements. Exports are recovering this year and expected to lift slightly next year. Germany's GDP growth is expected to fall to 1.0 per cent in 2019 from 1.5 per cent in 2018, mainly due to a deterioration in net exports. By 2020, growth, thanks to higher export growth, is expected to increase to 1.3 per cent.

France had a relatively better second half last year than Germany, but since then, growth rates in France have significantly weakened. Private consumption continues to develop well. This is explained by the fact that household purchasing power is supported by low inflation, a buoyant labour market and the government's concessions to the protest movement *Gilets Jaunes* ("The Yellow Vests") – tax relief for pensioners and for overtime work and an increased minimum wage. The political pressure that the government of president Macron is under, means, however, that parts of the reform programme have stalled, which is a setback for business: the reduction of employers' social contributions is less than originally planned and the large companies have been excluded from the reduction in corporate tax rates.

Industrial production has slowed down as a result of an increasing headwind in foreign markets, but the rate of investment, which will be somewhat lower this year, remains positive and makes a significant contribution to the economy. Large deliveries of aircraft and ships during the last quarter lifted the export figures for 2018, while developments this year are estimated to be more subdued. France's GDP growth

amounted to 1.5 per cent last year and the economy is expected to grow at the same rate in 2019 and 2020.

CONTINUED UNCERTAINTY OVER BREXIT

The UK's economy is showing moderate growth despite the uncertainty and political chaos that prevails over the country's decision to exit from the EU, which was supposed to happen on March 29, 2019. Growth amounted to 1.4 per cent in 2018, and the forecast for growth in 2019 is at the same level – provided that the country's exit from the EU takes place in an orderly manner. Robust private consumption drives the economy, with households that benefit by continued good demand for labour, rising wages and lower inflation. Unemployment is at a record low of 4 per cent.

However, there are plenty of signs of weakness in the economy. The Purchasing Managers' Index for the important service sector has fallen back and is hovering around the 50 mark between expansion and contraction. The development for manufacturing is characterized by stagnating production and exports with the uncertainty of Brexit which weighs heavily on the willingness to invest. The automotive industry is signalling downsizing, with the Japanese car company Honda's upcoming closure of its factory in Swindon as a prime example. The Bank of England kept the policy rate unchanged at 0.75 per cent at its February meeting and warned at the same time that the economy is heading for its weakest year since the financial crisis.

Prime minister Theresa May's proposed agreement on the UK's exit from the EU was voted down in Parliament for the second time on March 12. A small majority of the members of the House of Commons then demanded, in a subsequent vote, that a deal had to be agreed as a prerequisite for withdrawal. At the European Council meeting in Brussels on March 21 it was decided that the UK's withdrawal be postponed until May 22 if the country's parliament voted yes to the deal in a third vote. Otherwise the exit takes place on April 12 in a disorderly manner ("hard Brexit").

The Italian economy is weakening continuously. The country went into recession in the second half of 2018 and everything indicates that the decline will continue this year. Private consumption is developing very weakly in step with a significantly cooler labour market. Investments are stagnating and industrial production is falling. On the brighter side, exports

are expected to increase somewhat during the year. Italy's economy grew by 0.8 per cent in 2018, while the forecast is slightly negative for 2019 and 0.4 per cent for 2020. Read more in the detailed section on Italy's economy.

Even the strong Spanish economy is now slowing down somewhat. Household demand, however, remains robust. Unemployment continues to fall, but at a slower pace. The high investment level reflects an unbroken optimism in the business community. Exports are expected to lift slightly after last year's deceleration. Spain's GDP increased by 2.5 per cent last year and is expected to grow by 2.3 per cent in 2019 and 2.0 per cent by 2020.

DIMINISHING IN EASTERN EUROPE

The fast growing economies of Central and Eastern Europe are also experiencing a slowdown. The Polish economy is expected to grow by 3.5 per cent this year – down from a high of 5.1 per cent in 2018 – and is characterized by continued high growth in private consumption, investments and public expenditure. In the Czech Republic, industrial production and exports are shifting down under the influence of a weakening German market. The Hungarian economy continues to develop well, spurred by rapidly rising real wages, a positive export development and high growth of EU-financed investments. In the Baltic countries the development is weaker and growth is noticeably falling back this year.

Russia's economy recovered some strength last year, but weakened again in the beginning of 2019 as a result of a slowdown in private consumption. Household purchasing power is undercut by rising inflation – mainly as a result of last year's sharp depreciation of the ruble – and the recently implemented increase in VAT. The Government's proclaimed social policy initiatives are probably not enough to lift consumption significantly during the year. However, the labour market has remained strong with unemployment at the low rate of 4.9 per cent.

Business investment is maintained by the state-owned enterprises while industrial production slows. Government revenue from the important oil exports is challenged by a very volatile market where oil prices fell sharply from September until the turn of the year, and then recovered. Russia's GDP growth in 2019 is expected to fall back to 1.4 per cent, from 1.8 per cent last year. The forecast for 2020 is a growth of 1.7 per cent.

ECONOMIC POLICY SUPPORTS GROWTH

Economic growth in the Asia region is supported by increased economic policy stimuli in combination with a stable development of household consumption. Growth in the Chinese economy is slowing down further, both this year and next year. However, reduced reserve requirements in the banking sector and tax cuts prevent an overly abrupt decline in Chinese growth. China's lower growth has a negative impact on the rest of the countries in the region through lower export growth. Particularly small, open economies with large export dependency, e.g. South Korea, Singapore and Taiwan are affected but the export development in countries such as Japan, Vietnam and Indonesia is also more subdued. One exception, however, is Australia where exports – thanks to increased production of liquid natural gas and increased service exports – will experience an upswing this year. In India, growth continues to benefit from fiscal stimuli ahead of the election this spring.

Overall, GDP growth of 3.9 per cent in the region will be lower this year compared to last year's growth of 4.5 per cent. A somewhat lower, but still satisfactory economic growth in China means that growth in the region will stabilize during the second half of 2019 and next year growth in the region will increase marginally up to 4.0 per cent. Even if increased tensions between China and the US constitute a downside risk in the region, a postponement of tariffs between the two superpowers and possibly a trade agreement will mean an upside risk to growth.

GROWTH RATE TAPERS OFF IN CHINA

The Chinese economic growth rate showed a broad-based slowdown at the end of last year. Exports fell sharply, which is explained by weaker growth in global trade and increased trade conflicts with the US. Also, domestic demand was dampened by weak sentiment, lower credit growth and decreased activity on the property market. For the full year 2018, total GDP growth amounted to 6.6 per cent, which is in line with the official growth target

of about 6.5 per cent for 2018. The development of exports will – as a result of lower growth in world trade – be weaker this year at the same time as domestic demand increases at a slower pace.

Reduced activity in the Chinese economy has resulted in increased financial and monetary stimuli. Examples of measures that have been implemented are reduced reserve requirements for the banks and investments in various infrastructure projects. Last year, the reserve requirements were lowered four times and this year the reserve requirements have been lowered again – from 14.5 to 13.5 per cent for large financial companies and from 12.5 to 11.5 per cent for small and medium-sized finance companies. The stimulus measures – which this year also include tax cuts primarily aimed at the Chinese business community – continue this year as well but from a historical perspective are considered to be relatively restrained. The stimulus measures are aimed at trying to halt the downturn in growth rather than to accomplish a sharp upturn in growth.

In the coming years, investments are expected to grow slower due to lower activity in the property market. Consumption growth is expected to be somewhat lower but is still

EXPORTS AS SHARE OF GDP, % 2017

Singapore	199.3
Vietnam	119.7
Thailand	77.2
Taiwan	76.3
Malaysia	72.8
Philippines	56.9
South Korea	54.0
China	23.4
Indonesia	21.7
Australia	21.2
India	20.1
Japan	17.0

Sources: Oxford Economics and Business Sweden (2019)

NB: The reason certain countries have an export share that exceeds 100 per cent of GDP is due to high import figures. Imports affect GDP negatively.

expected to be the growth engine of the economy and support the expansion of the service sector. The rebalancing of the Chinese economy continues with the aim to increase the contribution to growth made by consumption. This year, growth is expected to be 6.2 per cent which is in line with the official target of 6.0–6.5 per cent for 2019. Next year, the growth rate will drop further to 5.9 per cent.

The Chinese regime has every reason to counteract an overly sharp downturn in economic growth. In 2020 an evaluation of the 60-point reform plan will take place – the majority of which consists of structural reforms – that the Central Committee listed in the Third Plenary session in 2013. The following year, 2021, the Chinese Communist Party celebrates its 100th anniversary. On both of these occasions China's good economic development is likely to be highlighted. The growth target – a doubling of GDP from 2010 to 2020 – will most likely be achieved.

The risks to Chinese growth are negative overall. Escalating trade conflicts with the US dominate, although the situation has stabilised somewhat since the US decided to postpone an increase of tariffs from 10 to 25 per cent on USD 200 billion worth of Chinese goods. The risks for the Chinese domestic market are, however, significant. One imminent risk is the enormous debt accumulation, particularly the total private debt which amounts to more than 200 per cent of GDP. The size of the private debt could, for example, in the event of a collapse in prices on the Chinese property and/or housing market, in all likelihood result in significantly weaker growth of the Chinese economy and even spread to the global economy.

In the longer term, growth is dependent on continued reforms on the supply side, for example within state-owned companies and the financial sector, at the same time as high quality urbanisation in the form of increased access to public services must be ensured.

EXTERNAL HEADWINDS IN THE JAPANESE ECONOMY

The Japanese economy is characterised by continued decent growth in domestic demand but a weaker export development. This year, consumption benefits by the strong labour market at the same time as investments increase as companies continue to expand their capacity and invest more resources in research and development. However, investment growth is hampered somewhat by the fact that the investment cycle is entering a more mature phase at

the same time as export growth is weak. The strong labour market also creates incentives for investment in labour-saving technology, an effective way of meeting the demographic challenge that Japan faces with its sharply declining population of working age.

This year, domestic demand supports growth while export growth will be low due to weaker regional demand, primarily from China, and global trade tensions. China is Japan's most important export market and accounts for about 20 per cent of Japanese exports. A lower import demand from China therefore has a negative impact on Japanese exports. Increased protectionism and a greater slowdown than expected in the global economy are likely to further subdue exports. Industrial production continues to increase, but a weak Purchasing Managers' Index (PMI) below 50 in February, indicates a weakening of growth, probably due to increased concern for weaker demand from the outside world and increased global uncertainty.

GDP growth is shifting marginally downwards from 0.8 per cent in 2018 to 0.7 per cent in 2019. The growth rate of 0.3 per cent by 2020, although lower than this year, is largely explained by the planned VAT increase of two percentage points to 10 per cent in the fourth quarter of 2019. Compared with earlier VAT increases, however, the effects will be relatively small and counteracted by expansionary elements in the economy, for example measures to stimulate consumption but also the expansion of free child care and education. Net exports (exports minus imports) are expected to contribute the most to growth in 2020. Inflationary pressures are very weak and inflation is estimated to be far below the target of 2 per cent. This year, inflation is expected to be 0.9 per cent and next year 1.2 per cent. The low inflationary pressure – which is largely due to impending lower costs for mobile phones and education, lower energy prices and subdued growth – does not give rise to a change in the view of the Bank of Japan's measures. The bank will most likely retain the negative policy rate of -0.10 at the same time as extensive bond purchases, in order to maintain the 10-year yield on government bonds close to zero, will continue.

INDIAN ECONOMY SUPPORTED BY POPULISTIC MEASURES AHEAD OF SPRING ELECTIONS

Growth in the Indian economy has accelerated fast in recent years. The growth rate increased to 7.3 per cent in 2018, from 6.6 per cent in

2017. The main driver of this strong growth was increased public expenditure ahead of the general election in April–May this year. As support for the incumbent government has declined, the increased expenditure probably reflects an attempt to attract voters. This means that the necessary long-term reforms in areas such as education, the labour market, infrastructure etc., may be delayed. Instead, regional parties have received increased support and these can probably become decisive in the upcoming election. A weak minority government with difficulty in getting its policies through, is therefore a downside risk for growth in the medium term.

Growth will continue to benefit from fiscal stimuli, both this year and next year, and GDP growth is expected to amount to 7.1 and 7.0 per cent respectively. Low inflation leaves room for more expansionary monetary policy, but the positive effects are counteracted by higher market interest rates as a result of increased public spending. Growth is subdued by the increased concerns over the shadow banking sector after one of India's largest infrastructure companies exhibited financial weaknesses. Liquidity, interest rates and investments will probably be affected. The economy benefits, however, by a lower oil price going forward, which eases the current account deficit as India is a major oil importer.

GOOD DOMESTIC DEMAND IN THE REST OF ASIA

Lower demand from China and the risk of escalating trade conflicts affected the rest of Asia at the end of 2018. The spread effects of the weaker growth in China will remain in 2019, however, but is not expected to result in a recession.

Economic growth in the region remains positive, but is slowing down in most of the countries in the region both this year and next year. The lower growth rate depends mainly on lower import demand from China and increased protectionism, which dampens export development. Particularly small, open economies with large export shares such as South Korea, Singapore and Taiwan are affected. Export growth in these economies is also slowing down because of lower global demand for electronic goods, which are important export products in the aforementioned countries.

The region's economic growth is supported by lower but continued stable growth in China, resilient domestic demand, investments in infrastructure and accommodating economic

policies. Several economies are holding elections, for instance, the Philippines and Indonesia. Thailand has also held elections and the political situation in the country is a downside risk because a new potential government will probably be curtailed by the military which has been in power for the past four years. Increased political tensions risk holding back consumption and the willingness to invest, thereby restricting the country's economic activities.

The risks for the countries of the region are of both an internal and external character. A common downside risk for all countries is a faster slowdown than expected in China and/or escalated trade disputes between China and the US. China is a major export market for the region and more than half of Chinese imports comes from other Asian countries. Lower than expected growth in China has significant negative effects throughout the region.

Several of the Asian countries are also characterized by domestic imbalances that are worth mentioning. As a result of good growth and low interest rates, debt has increased. Countries such as South Korea and Malaysia are heavily indebted among households, 99 and 83 per cent respectively of GDP. The high level of indebtedness is increasing sensitivity to interest rate increases and risks squeezing other forms of spending such as private consumption. Also, international policy rate increases risk affecting the countries of the region, especially countries that have taken loans on the international capital market, for example, Indonesia. Just over 40 per cent of the stock of government bonds is owned by foreign investors, something that risks an increase of capital outflows at the same time as the US central bank, Federal Reserve, continues, albeit slowly, to increase the policy rate.

THE SUMMIT HAS BEEN REACHED

The political and economic debate in the US is dominated and continues to be inspired by president Trump's election promises and actions. The mid-term elections in November last year, however, resulted in a setback for the president and the republican party when the Democrats won a solid majority in the House of Representatives. The Republicans kept their majority in the Senate. The division of power means that the political polarisation is increasing further, especially in view of the fact that many newly elected Democrats represent the party's left wing.

The president's proposal for the 2020 federal budget on February 11 was characterized by cutbacks in social programmes, permanent tax cuts and a sharp increase in defence spending. Trump's simultaneous announcement of a national emergency at the border with Mexico – for the purpose of financing a wall or other type of barrier from other funds in the federal budget – has encountered opposition in Congress and forced the president to use his first veto.

Relations between the US and Canada are frosty after a conflict last summer between Trump and the Canadian prime minister Justin Trudeau. The renegotiation of the North American Free Trade Agreement, NAFTA, could still be closed with a new agreement – US–Mexico–Canada–Agreement (USMCA) – signed at the G20 meeting in Buenos Aires in November of last year. Among other things, the new agreement tightens up the conditions for tariff-free trade in the automotive industry with a demand that at least 75 per cent of a car's components are to be made in North America. Half of the components should be made by workers who have a minimum wage of at least \$16 per hour.

A continued source of conflict is that the agreement does not exempt Canada and Mexico from the US-introduced punitive tariffs on steel and aluminium. However, in a separate agreement, the countries are exempt from any US future car tariffs. The USMCA will be reviewed every six years and then reapproved by the parties in order to continue to be valid. It is still uncertain if and when the new US Congress will ratify the agreement. North America's

GDP growth amounted to 2.7 per cent last year. For 2019 and 2020, it is expected that the growth rate will be reduced to 2.1 and 1.8 per cent respectively.

WEAKER GROWTH AWAITS THE US

The US economy remains strong, but there are indications that show growth has now peaked. The effect of the big tax cut – Tax Cuts and Jobs Act – adopted by Congress in December 2017, is slowly tapering off. Private consumption is solid, supported by reduced inflation, rising wages and a dynamic labour market. However, the rate of increase for investment and industrial production is somewhat in decline, as is export growth. The ongoing trade conflict with China has a negative impact in certain industries and some state economies. At the Federal Reserve's March meeting, the deteriorating growth outlook was stated as a reason for the decision to leave the policy rate unchanged in the 2.25–2.50 per cent interval.

US GDP grew by 2.9 per cent in 2018. This year, the growth rate is expected to decline to 2.3 per cent and fall further to 1.8 per cent by 2020. From the growth rate figures broken down to state level, it is apparent, however, that the US economy is developing at significantly different speeds. Figures for the first three quarters of 2018 show that growth was high in the western and southern US, while much of the east coast and the midwest lagged behind.

FREE TRADE AGREEMENT NO ROPE TRICK

The relief is great in Canada and Mexico that the USMCA was finally signed after a long negotiation period edged by exhaustive political wrangling and harsh accusations against neighbouring countries by the US administration. For the immediate economic development, however, the agreement means little.

The growth rate is falling in Canada's economy with a clear slowdown in private consumption. Household purchasing power is diminishing due to high indebtedness in combination with rising interest rates and increased inflation. The demand for discretionary goods – which

are partly financed by loans – for example, cars – is falling back. Unemployment has dropped to a record low of 5.8 per cent, which should be seen in light of the fact that new jobs are now mainly created in low paid segments of the service sector. The important energy sector is going strong, but seen overall, the pace of investment is stagnating at the same time as industrial production is slowing down. The economy grew by 1.8 per cent last year, and the rate of growth is expected to fall to 1.1 per cent in 2019, then turn up slightly to 1.2 per cent by 2020.

Also in Mexico, the economy is cooling. However, private consumption remains solid and households are favoured by subdued inflation, a strong labour market and good access to credit. The new president, Andrés Manuel

SOUTH AMERICA

Brazil's economy is slowly recovering after the deep recession of recent years. The country's newly elected, controversial president Jair Bolsonaro's political programme includes certain privatisations and reforms of the tax system and pensions including an increase in the retirement age. The government wants to strengthen its economic ties with the US and adopt a more reserved attitude towards China, which is Brazil's most important trading partner and largest investor.

The economy offers a mixed picture, but there are no real signs of strength. Private consumption is on the way up. Unemployment remains high and shows no sign of falling significantly. Investments are growing at a good pace and industrial production has risen slightly. The export outlook is relatively bright for 2019. However, the budget deficit is expected to continue to be excessive at around 6.5 per cent of GDP as the national debt increases. Brazil's economy grew by only 1.1 per cent in 2018, but the growth rate is expected to lift to 1.7 per cent this year.

Other South American countries such as Argentina and Venezuela are in recession. The growth rate of South America was a weak 0.9 per cent last year and is expected to fall further to almost zero growth, 0.2 per cent, in 2019.

López Obrador ("AMLO"), and his administration enjoys strong popular support which is reflected in a boost for consumer confidence in the economy. However, investments and industrial production growth is close to zero and the outlook for exports has deteriorated, mainly due to the expected slowdown in the US market. The growth rate of the Mexican economy amounted to 2.0 per cent in 2018 and is expected to fall back slightly to 1.8 per cent this year and 1.6 per cent in 2020.

TOWARDS A TRUCE IN THE TRADE WAR?

The ongoing trade conflict between the US and China escalated in September last year. When the US imposed a punitive tariff of 10 per cent on imports from China – among other things on electronics, foodstuffs, tools and white goods – to the value of USD 200 billion. To this could be added previous punitive tariffs placed on Chinese imports to the value of USD 50 billion. China immediately responded to the US measures and on September 24 introduced their own punitive tariffs of about 5–10 per cent on American goods to the value of USD 60 billion. Previously, China had imposed punitive tariffs on US imports to the value of USD 50 billion in response to the US measures. President Trump announced that the tariffs should be increased to 25 per cent from year-end, and threatened to impose these on the remaining imports from China of USD 260 billion.

Nearly half of all US imports from China (USD 510 billion in total) and over 80 per cent of all Chinese imports from the US (total USD 130 billion) are thus covered by punitive tariffs. The recent conciliatory tone indicates, however, that both parties are seeking a scaling down of the conflict. The US plan to raise the tariffs from 10 to 25 per cent has been postponed. The reason is the alleged progress in the bilateral trade negotiations between the US and China taking place in Washington. Trump has signalled the possibility of a forthcoming summit meeting with president Xi Jinping to resolve outstanding issues and to sign some kind of agreement. Primarily, the US wants to halt the forced transfer of technology from US companies operating in China, increase the amount of imports of US goods to China as well stop China's interventions to weaken the country's currency for export purposes.

APPENDIX

SWEDISH EXPORTS, GDP GROWTH AND INFLATION

Country/Region	Swedish goods exports, current prices			GDP growth, fixed prices, %			Inflation, %
	Exports 2018 Bn SEK	Change 2017-2018,%	Share of Swedish exports 2018,%	2018P	2019F	2020F	2018P
EUROPE							
Sweden				2.4	1.4	1.6	2.0
Denmark	99.9	11.6	6.9	1.2	1.9	2.0	0.8
Estonia	12.3	12.0	0.9	3.9	3.0	2.7	3.4
Finland	100.8	11.6	7.0	2.2	1.8	1.8	1.1
France	62.1	13.3	4.3	1.5	1.4	1.5	1.9
Netherlands	84.6	19.0	5.9	2.5	1.7	1.7	1.7
Italy	40.4	14.7	2.8	0.8	-0.1	0.4	1.1
Latvia	4.7	29.6	0.3	5.0	3.6	3.0	2.5
Lithuania	9.8	17.9	0.7	3.4	3.2	2.6	2.7
Norway	151.6	13.7	10.5	1.7	2.3	1.9	2.8
Poland	48.2	21.0	3.3	5.1	3.5	3.2	1.8
Russia	20.0	6.7	1.4	1.8	1.4	1.7	2.9
UK	81.8	0.9	5.7	1.4	1.4	1.9	2.5
Czech Republic	12.3	11.9	0.9	3.0	2.7	2.3	2.2
Germany	156.9	10.5	10.9	1.5	1.0	1.3	1.7
Spain	30.1	19.8	2.1	2.5	2.3	2.0	1.7
AMERICAS							
United States	98.0	9.0	6.8	2.9	2.3	1.8	2.4
Brazil	8.0	8.6	0.6	1.1	1.7	2.7	3.7
Chile	3.5	27.8	0.2	4.0	3.0	2.9	2.3
Colombia	1.0	7.3	0.1	2.7	3.0	3.3	3.2
Canada	11.0	6.4	0.8	1.8	1.1	1.2	2.2
Mexico	6.3	-3.1	0.4	2.0	1.8	1.6	4.9
ASIA, OCEANIA							
Australia	17.4	15.6	1.2	2.8	2.2	2.7	1.9
India	12.6	10.2	0.9	7.3	7.1	7.0	4.0
Indonesia	4.2	5.1	0.3	5.2	5.0	5.1	3.2
Japan	22.2	13.5	1.5	0.8	0.7	0.3	1.0
China	67.1	14.7	4.7	6.6	6.2	5.9	2.1
Malaysia	2.9	8.3	0.2	4.7	4.4	4.0	1.0
South Korea	14.4	17.4	1.0	2.7	2.3	2.4	1.5
Thailand	4.1	-8.0	0.3	4.1	3.4	3.3	1.1
Vietnam	1.7	-16.7	0.1	7.1	6.7	6.2	3.5
MIDDLE EAST, TURKEY AND AFRICA							
United Arab Emirates	5.4	-14.7	0.4	2.7	3.1	3.4	3.5
Saudi Arabia	8.0	-12.5	0.6	2.1	2.0	2.6	3.2
South Africa	7.7	5.0	0.5	0.8	1.3	1.8	4.6
Turkey	14.3	1.6	1.0	3.1	-1.5	3.8	16.2

NB: P=Preliminary, F=Forecast

Sources: Statistics Sweden, Oxford Economics, Business Sweden (2019)



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