Investment Outlook

INVESTMENT OUTLOOK SUMMARY

December 2016

Brief world economic outlook

The trend described in the September issue of Investment Outlook – growing political uncertainty and at the same time increasing economic stability – has been become accentuated in recent months. It is no wild guess that this uncertainty (and news headlines) will continue to focus on political events. Aside from the uncertainty resulting from the US election outcome, major political choices await in Europe. During December, the people of Austria and Italy will make their voices heard. In 2017 there will be elections in the Netherlands, France and Italy. Meanwhile Brexit negotiations will begin. If the populist currents in major English-speaking countries spread to the European elections, the political map will change further, but at present we do not expect cataclysmic changes in major European countries.

The economic impact of the US election is not entirely foreseeable either. The short version is that Trump will probably pursue, and at least partly manage to push through, policies that will promote US economic growth by means of tax cuts and infrastructure investments. Many economists have called for a more expansionary fiscal policy, and it will provide increased hope for global growth. Offsetting this, however, are uncertainties about the financing of these measures in an already debt-burdened economy and risks surrounding global trade policy.

Stronger purchasing managers' indices (PMIs) around the world, combined with decent corporate earnings reports, support forecasts of somewhat faster economic expansion next year. This acceleration will be driven by faster growth in the United States and in former emerging market (EM) problem countries, while others (mainly the euro zone and China) will experience stable growth. But there are still big questions about structurally slower growth ("secular stagnation") and a towering "debt mountain". It remains to be seen if continued stimulative monetary policy and more active fiscal policy will be sufficient to achieve faster growth – there are reasons for hope.

View of regions

US – Clear focus on growth, but greater uncertainty with Trump
We expect the US economy to continue on its current growth path next year, probably helped by more expansionary fiscal policy. Early this autumn several weak indicators caused concern, but those economic headwinds have calmed and business indicators have recouped their losses during the past month. We expect the economy to grow somewhat faster in 2017 than its underlying trend rate, which we estimate at 1.8%. Unemployment will resume its gradual decline, reaching 4.5% two years from now. An ever-tighter labour market will set the stage for faster pay increases, which will gradually take over as a driver of consumption as job growth decelerates. Rising pay levels are another reason why core inflation will be close to the Federal Reserve (Fed)'s 2% target. With the economy approaching Fed labour market and inflation targets, the conditions for resuming key interest rate normalisation are in place. The next rate hike will occur in December, according to our forecasts.

Euro zone – Stable outlook, uncertain policies
The euro zone economic outlook has recently stabilised. Various forward-looking indicators, especially in manufacturing, are now pointing to some acceleration in GDP growth. Rising employment is driving consumption, while higher capacity utilisation is stimulating capital spending, although problems in parts of the banking sector are hampering this development. Several large euro zone countries will be holding elections over the next 12 months. Most indications are that populists and EU/euro-sceptical parties will pick up more support. Although we do not expect major shifts in political majorities, the elections will still require a lot of energy, thereby dimming the possibility of breakthroughs on key future-oriented EU issues. Fiscal policy support is increasingly being asked for, but a number of euro zone countries are still struggling with large budget deficits and debts. In general, the EU will adopt a gentler approach to enforcing its budget rules, and some German fiscal stimulus is likely. Overall, fiscal policy will be largely neutral or only slightly stimulative in 2016-2018.

China – Fiscal policy softening slowdown
The stabilisation we have seen in the Chinese economy in recent quarters is proceeding as expected. The manufacturing and construction sectors as well as exports are still performing sluggishly, but this is offset by a stronger service sector and an upturn in home prices. We expect less monetary stimulus going forward, while reform efforts aimed at reducing industrial overcapacity are moving slowly. Together with the strong housing market, there is reason for concern about financial market bubbles. Recent political signals suggest that the focus of policy is moving from growth support to curbing asset bubbles. In the long term this is positive, but it will hardly promote short-term growth. Given a planned reshuffle of the political elite late in 2017, however, the government is likely to use fiscal policy to support economic growth, which we expect to continue decelerating at a controlled pace.

Emerging markets (ex China) – Stable commodities, but Trump a concern
Donald Trump's election victory is boosting uncertainty about EM economies. The better US growth outlook will be offset by risks of trade barriers and a stronger dollar. India remains one of the fastest-growing countries; we expect GDP to accelerate gradually from 7.6% in 2016 to 7.8% in 2017 and 8.0% in 2018. The national goods and services tax (GST) is an important reform measure. The tax may be ready for implementation on April 1, 2017 as planned, but due to obstacles in key reform areas like the labour market and land purchase laws, it will be difficult for India to reach its 8-10% GDP growth target.

Commodity-dependent EM countries will benefit from more stable oil prices, which are higher than in the first quarter. Other commodities, especially industrial metals, have also seen a positive price trend, which will help sustain growth in countries such as Indonesia and various Latin American nations. Brazil has passed its worst GDP downturn. The turnaround is being driven by net exports and capital spending. Aside from structural problems, the budget deficit of 10% of GDP is the biggest near-term challenge. In Russia, the picture is similar. Because of rising commodity prices and improvements in the manufacturing sector, the worst of the recession is now past. Private consumption remains squeezed, while structural problems persist.

Nordic countries – Sweden ahead, others accelerating
In all Nordic countries excluding Sweden, we foresee room for accelerating economic expansion in 2017-2018, although growth figures will not be spectacular.

Despite disappointing first half 2016 growth, we are sticking to our forecast that the Swedish economy will grow at well above its long-term trend in 2017 as well. It will continue to be driven by domestic demand, with public sector consumption and housing investments making especially large contributions. Household consumption will slow somewhat, partly offset by more expansionary public sector investments and stronger exports due to the weak krona. Manufacturing sector indicators have improved this autumn, and PMIs show an upturn in optimism. A weaker krona, combined with higher electricity prices, will push up inflation to nearly 2% in early 2017. Once these temporary effects fade, inflation will fall a bit. We expect continued low interest rates and central bank stimulus in 2017-2018.

Conclusions from our macro analysis

- Demographic headwinds, low productivity growth plus large debts and imbalances will continue to slow global economic growth.
- Stimulative monetary policies are still helping to sustain growth but are not helping it to accelerate. After a weak first half of 2016, indicators are pointing to slight acceleration, which will help sustain corporate earnings.
- Continued good global demand by consumers.
- Emerging market economies are stabilising, largely thanks to modest upturns in commodity prices.
- The Chinese economy is also stabilising, with monetary policy being replaced by fiscal stimulus to ensure a controlled deceleration in growth.
- The election of Donald Trump and a Republican dominated US Congress has raised market hopes of fiscal stimulus – driving growth, inflation, interest rates and bond yields higher.
- Stronger expectations of more fiscal stimulus and reflationary policies may redraw the map in terms of market conditions.
- The Fed will hike its key rate in December and twice yearly in 2017-2018. A strong dollar is likely.
- Political turbulence due to elections and the Brexit process may lead to volatile market performance in Europe.

Expected risk and return in asset classes in the next 12 months

ASSET CLASS	WEIGHT*	EXPECTATION (12 months)	
		RETURN	RISK
EQUITIES			
Global	123**4**567	4,2%	11,7%
Emerging markets (EM)	12**3**4567	5,3%	12,5%
Sweden	123**4**567	9,0%	12,1%
BONDS			
Government bonds	**1**234567	-1,2%	2,6%
Investment grade (IG) corporate bonds	12**3**4567	1,4%	3,0%
High yield (HY) corporate bonds	1234**5**67	3,8%	5,1%
ALTERNATIVE INVESTMENTS			
Hedge funds	123**4**567	N/A	N/A
Commodities	12**3**4567	N/A	N/A
CURRENCIES			
Currency pair	**Nov 17, 2016**	**Q4 2016**	**Q1 2017**
EUR/USD	1,07	1,06	1,04

"Weight" shows how we currently (November 17, 2016) view the asset type as part of a portfolio. These weights are changed continuously, based on our tactical market view, and may thus diverge from our long-term strategic view. Index/basis for calculation: ***Global equities*** *– MSCI All Country World Index in local currencies.* ***Emerging markets*** *– MSCI EM TR in local currencies.* ***Swedish equities*** *– SIX Portfolio Return Index in SEK,* ***Government bonds*** *– OMRX T-bonds in SEK.* ***Investment grade corporate bonds*** *– IBOXX Investment Grade Index in USD.* ***High yield corporate bonds*** *– IBOXX High Yield Index in USD. As for* ***currencies****, the forecast refers to most central currency pair EUR/USD.* ***Hedge funds*** *– HFRX Global Hedge Fund Index in USD.*

GDP – YEAR-ON-YEAR PERCENTAGE CHANGE	2015	2016 (FORECAST)	2017 (FORECAST)	2018 (FORECAST)
United States	2,6	1,6	2,3	2,2
Japan	0,5	0,5	0,5	0,5
Germany	1,7	1,8	1,5	1,6
China	6,9	6,7	6,4	6,0
United Kingdom	2,3	2,1	1,4	1,7
Euro zone	2,0	1,8	1,6	1,6
Nordic countries	2,3	2,1	2,0	2,0
Sweden	4,1	3,7	2,8	2,3
Baltic countries	2,0	1,8	2,7	3,0
OECD	2,3	1,7	2,0	2,0
Emerging markets	3,9	4,2	4,7	4,8
The world (PPP)*	3,1	3,1	3,5	3,6

* PPP= Purchasing power parities; economies have been adjusted to account for price differences.

Source: SEB Investment Outlook, December 2016

Terminology explanation

Terminology used	Explanation
Fiscal policy	Fiscal policy relates to government spending and tax collection. Fiscal policy refers to the use of the government budget to influence economic activity. For example, when economic growth is slowing down, the government can step in and increase its spending to stimulate demand and economic growth. Or it can lower taxes to increase disposable income for people and businesses.
Gross Domestic Product (GDP)	The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.
Household (private) consumption	Transaction of the national account's use of income account representing consumer spending. It consists of the expenditure incurred by resident households on individual consumption goods and services, including those sold at prices that are not economically significant.
Investment grade bonds, high yield bonds	Investment grade bonds – bonds (sovereign or corporate) with credit ratings that indicates a relatively low risk of default. High yield bonds – bonds (sovereign or corporate) with credit ratings that indicates a relatively higher risk of default than investment grade bonds. Because of the higher risk of default, these bonds pay a higher yield than investment grade bonds. Two main credit rating agencies Standard & Poor's (S&P) and Moody's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. S&P designations of 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as high yield or "junk bonds".
Monetary policy	Monetary policy is the process by which the monetary authority (usually the central bank) of a country controls the supply of money (the size and rate of growth of the money supply), for the purpose of promoting economic growth and stability. For example, if the money supply grows too fast, the rate of inflation will increase and the economy will "overheat". If the growth of the money supply is slowed too much, then economic growth may also slow. The main tools to control money supply include open market operations (buying or selling assets), changing interest rates and changing reserve requirements for commercial banks.
Purchasing managers' indexes (PMIs)	An indicator of the economic health of the manufacturing sector. The PMI indexes are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A PMI of more than 50 represents expansion of the manufacturing sector, compared to the previous month. A reading under 50 represents a contraction, while a reading at 50 indicates no change.
Purchasing power parity (PPP)	An economic theory that estimates the amount of adjustment needed on the exchange rate between countries so that an identical good has the same price when expressed in the same currency.
Reflationary policy	Fiscal or monetary policy aimed at boosting the level of economic activity, usually through inflationary means such as public spending or reduction in the taxation level.
SEB Investment Outlook	A public release prepared by SEB economists, strategists and analysts. Investment Outlook gives readers an in-depth look at the investment climate and the prospects for seven asset classes. It also provides advice about current risks and opportunities in the art of investing. The report can be read in its entirety at www.sebgroup.com
Yield	The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.