17 november 2019

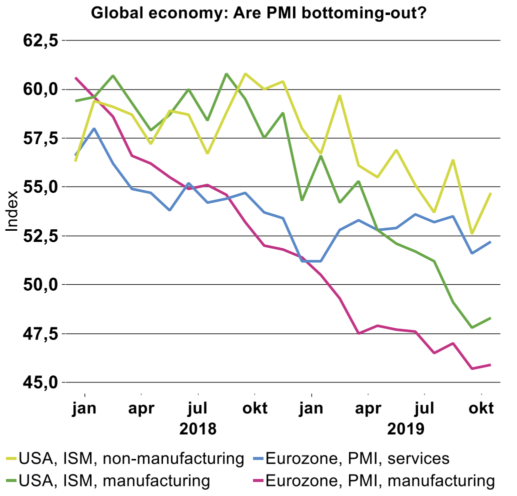
On the brink of recession

In late 2017-early 2018 the global economy started to lose steam. The slowdown has continued in 2019 and Teknikföretagen do not expect global GDP growth to bottom out until mid 2020. Thanks primarily to additional central bank stimulus in the US and China, a deeper downturn can hopefully be avoided and the foundation is laid for a gradual, investment-led recovery towards the end of next year. However, there are no signs suggesting that the decade-long decline in global productivity is about to end: *The New Normal* is here to stay. Hence, we only expect a slow and sluggish recovery.

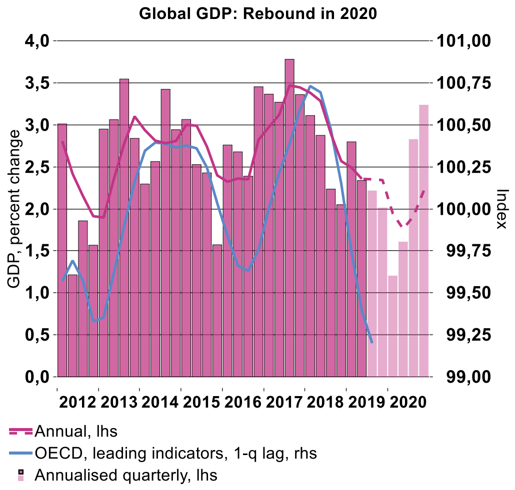
The prime engine for the global GDP acceleration in 2017-2016, a synchronized rebound in corporate investment, has been followed by a synchronized investment slowdown in the last couple of years.

Moreover, persistent uncertainty related to factors like the Sino-US trade conflict and Brexit, induces corporates to postpone major investments. Hence the manufacturing sector has taken the biggest hit and dived into a global recession in 2019, excluding China. Even with China included, global growth in manufacturing production has approached previous lows. The slowdown in manufacturing has been particularly steep in Europe but production has recently stagnated also in the US.

Thus far low production growth has mainly been reflected in a productivity slowdown. However, recently the labor market has also been affected with decreased demand for labor reflecting attempts to reduce costs and restore corporate productivity and profitability. We expect this process to continue for most part of 2020, boding for a gradual recovery towards the end of next year.



Source: ISM, Markit

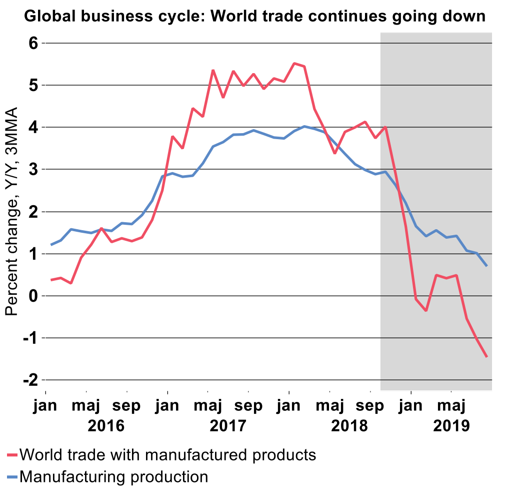


Source: OECD, World Bank

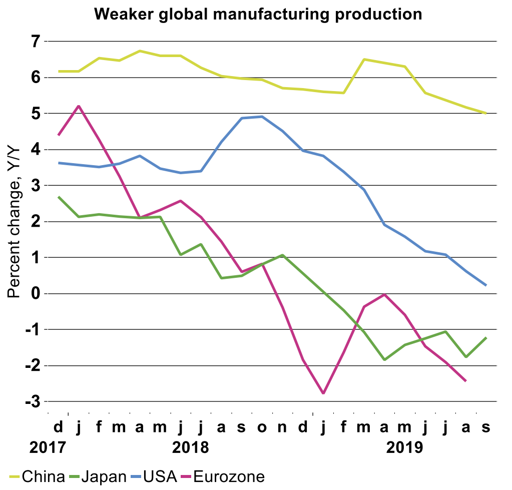
Global economy: First indications of bottoming-out?

Although it's too early to tell, recent data for instance in terms of PMI, might indicate that the bottom is within reach for manufacturing. However, even if this would be the case, we are still far away from a genuine recovery, *hard data* do not give reason to budding optimism since global trade as well as industrial production continue to be weak. We only have access to global data for production until August (see the graph to the left below). However, for most of the large economies, we have data also for September and it's clear that the Eurozone as well as Japan are caught in a regular industrial recession while manufacturing in the US has come to a halt.

Moreover, the deep and prolonged manufacturing slowdown and cooling of the labor market are likely to ultimately affect the rest of the economies, particularly the service sector and households.



Source: CPB, World Bank



Source: Eurostat, Federal Reserve, Ministry of Finance, NBS

Against this background Teknikföretagen expect global GDP growth of only two percent[1] in 2020 but with a modest acceleration towards the end of next year (see the figure to the right on page one).

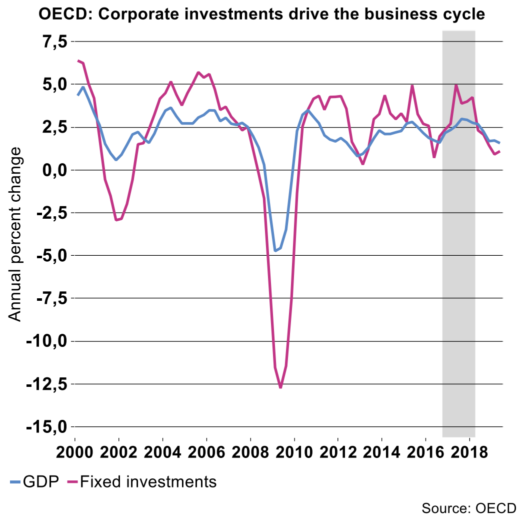
There are, however, significant risks for a weaker and even postponed recovery if trade tensions persist and central bank stimulus proves to be insufficient. Admittedly, the Federal Reserve has room for further stimulus but the ECB doesn't have much ammunition left with a policy rate deep down in negative territory. Furthermore, extremely low interest rates for a very long period risk boosting credit growth to low-performing zombie-corporates, reinforcing the declining productivity trend.

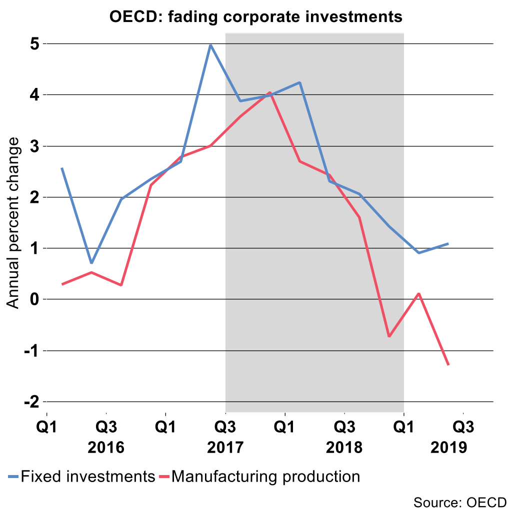
Even in case negative risks do not materialize and corporate investment rebounds in line with improved profitability, it's unlikely that productivity growth will return to the strong pre-recession pace of the early 2000s. A return to *The Old Normal* with significantly higher productivity growth will most likely require disruptive structural changes.

Corporate investments are key to the business cycle

On several occasions Teknikföretagen have stressed the key role played by corporate investments in the business cycle dynamics: corporate investments are much more volatile than for instance household consumption and GDP and that was also the case during the most recent upswing (see the graph to the left below). Although the graph illustrates developments within the OECD, the pattern is similar for the global economy as a whole.

[1] In constant prices, non-PPP adjusted.





It is obvious (see the graph above to the right) that the strong upswing in manufacturing in 2016-2017 to a large extent was driven by strong demand for investment goods. However, corporate investment started to lose steam already in early 2018, has continued to cool in 2019 and will most likely slow further during the rest of the year into 2020.

Initially, cooling corporate investment primarily reflected slower productivity growth and profitability, not least in manufacturing. More recently, geopolitical tensions and particularly the Sino-US trade conflict have contributed to the investment slowdown.

It is unrealistic to count on a significant global recovery unless corporate investment rebounds. This would in turn likely require restored business profitability and, at least a truce in the trade conflict. Improved profitability would in turn require a rebound in productivity which involves an adaptation of the working force to lower production. This argument applies in particular to German manufacturing but also to the US where productivity growth in manufacturing has plunged in recent years. In addition, it's unrealistic to bet on an investment rebound unless China and the US come to an agreement. Studies show that uncertainty related to the trade conflict in 2018 caused 0,8 percent lower global GDP in the beginning of 2019.[2] The escalation of the trade conflict in the spring of 2019 is expected to extract further from global GDP in 2019-2020. It is impossible to have a strong opinion about the geopolitical risks going forward but we still expect a gradual investment recovery over the course of 2020.

Sweden: Also hit by slowing investments

On the back of a sluggish global economy and very weak global trade growth, we expect Swedish GDP to grow with a mediocre one percent in 2019. We expect a continued slowdown during the first half of 2020 and a modest improvement during the second half, resulting in one percent GDP growth on average also for 2020.

The synchronized global slowdown in corporate investments hits Sweden's manufacturing industry, which export about 3/4 of its value added. The accelerating growth in 2017 has been replaced by gradual slowing rates of production over the last two years. Teknikföretagen calculate with negative growth in manufacturing next year, from 1,5 per cent in 2019 to -1,5 per cent 2020.

[2] "Does Trade Policy Uncertainty Affect Global Economic Activity?", Federal Reserve, September 2019.

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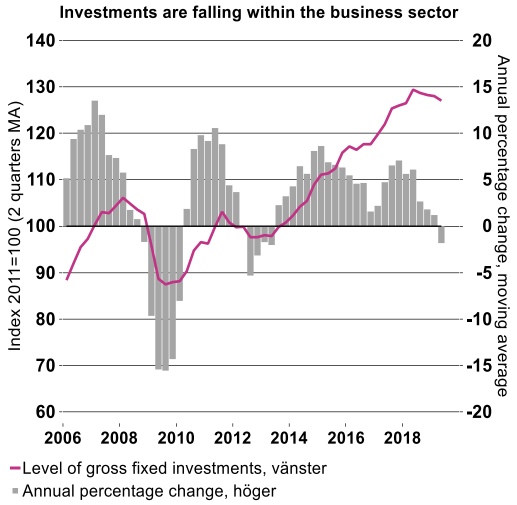
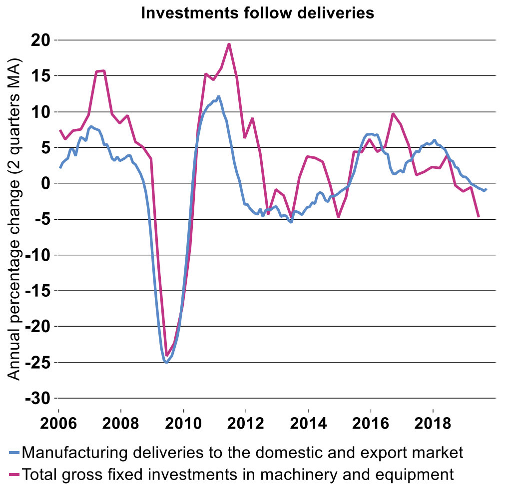
Sweden's manufacturing has a relatively large share of capital goods production, not the least in machinery and equipment as well as of passenger cars and trucks, which will weigh down on manufacturing next and the following years. Normally, it takes longer time for the investment cycle to turn for these particular industries, which explains why Teknikföretagen do not foresee any major recovery for the engineering as well as the manufacturing industry overall in the near future. The lower deliveries from manufacturing to the weaker home- and export markets clearly reflect the halt of investments in machinery and equipment, se figure to the right below.



Source: Statistics Sweden



Source: Statistics Sweden

Sweden also has a relatively large share of production in business services, with close ties with the export industry. Consultant companies within areas like IT, software, engineering, research and innovation, design, architecture and staffing, are closely connected with the export industry. Furthermore, Sweden's exports of business services have been growing by themselves, playing a larger role for Sweden's exports. This explains why demand from export markets has a relatively large impact on Sweden's service sector, indirectly as subcontractors or directly. That explains an important part of why Sweden's service sector has slowed considerably during 2019.

The slowing GDP-growth in 2019 is also explained by falling investments in housing construction as well as in machinery and equipment. In total, gross fixed investments fall, despite positive numbers for investments in infrastructure. The gloomier prospects for the Swedish economy also seem to have made households more reluctant in their consumption. It's still growing, but with a slower pace compared with previous years, contributing less to GDP-growth. Weaker domestic demand also leads to weaker import growth, even weaker than the slowdown in exports. Therefore, net exports give an unusually strong contribution to Sweden's GDP-growth in 2019, a whole percentage point, according to our forecast.

Sweden's GDP-growth has fallen under its potential, which normally affects the labour market with a certain lag. Business surveys and other labour market statistics indicate that employment growth is slowing down and the unemployment rate is rising. Due to incorrect measurements of Sweden's Labour Force Survey by Statistics Sweden since last summer, forecasts for the labour market are uncertain. Nevertheless, we foresee a gradual increase in unemployment over the coming year based on historic correlations, business indicators and other statistics.

The weakening labour market and household demand will be a drag to Sweden's inflation, which will move further away from the Central Bank's inflation target of 2 per cent. According to our forecast, Sweden's inflation with constant interest rates (CPIF) will fall, from 1.7 per cent in 2019 to 1.4 per cent in 2020 on average. Despite the global downturn and weaker domestic demand, Sweden's Riksbank has kept signalling another hike in its policy rate in December, as it seems determined to leave the years with negative rates once and for all. Even if this second hike since December last year will come true, the key rate is predicted to stay at zero at least until the beginning of 2022. On the other hand, we count on further cuts of the target rate by the US Federal Reserve next year, down to one per cent. We also expect The European Central Bank to leave its deposit rate at -0.50, which probably is the lowest level it will reach, showing the very limited space for further monetary stimulus in the Eurozone.

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KEY RATIOS SWEDEN

ANNUAL PERCENTAGE CHANGE

Engineering industries	2018 level	2019	2020
Value added 2018 prices Billon SEK	356	+1.0	-2.0
Export volume engineering Billion SEK	603	+2.0	-1.0
Employment, engineering	280 900	+1.5	+0.0
Labour market and inflation Sweden	2018	2019	2020
Employment, total economy level/ percentage change, average	5 113 000	+0.9	+0.7
Unemployment level. Share of labor force, average, percent	344 000	6.7	7.1
CPIF year end		+1.6	+1.2
National accounts (volume)	2018	2019	2020
GDP Billion SEK 2018 price level, annual percentage change	4833,7	+1.0	+1.0
GDP, calendar adjusted		+1.0	+0.7
Household consumption	2157,2	+1.2	+1.2
Public consumption	1258,5	+0.7	+0.7
Fixed gross investment	1254,0	-1.9	-0.9
Inventory investment, contribution	46,5	-0.,3	-0.1
Exports	2211,1	+3.4	+1.4
Imports	2093,6	+1.2	+0.2
Net exports, contribution to GDP growth		+1.0	+0.6

KEY RATIOS GLOBAL

Annual percentage change, volume	GDP		Engineering	
	2019	2020	2019	2020
Eurozone	+1.1	+0.9	-3.0	-0.5
of which				
Germany	+0.5	+0.7	-4.5	-1.0
Finland	+1.0	+0.7	+5.5	+1.0
UK	+1.7	+0.3	-3.0	-2.0
USA	+2.2	+1.2	+0.5	-2.0
Japan	+0.6	+0.2	-3.0	-1.5
China	+6.1	+5.8	+6.0	+5.5
Norway	+1.4	+2.2	+10.0	+3.0
India	+5.5	+5.0	-4.5	+1.5
Brazil	+0.8	+0.5	+0.5	+1.0
Global, market exchange rates	+2.5	+2.0	+2.0	+1.5
Global excl China	+1.5	+1.1	-1.0	-1.0

FINANCIAL FORECASTS

Year end	**Sweden**			**Eurozone**		**USA**
	Policy rate	SEK/EUR	SEK/USD	Policy rate	EUR/USD	Policy rate
2019	0	10.60	9.70	0.00 (-0.5)	1.16	1.75
2020	0	10.50	8.80	0.00 (-0.5)	1.19	1.00