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FitchSolutions

Q4 2019

Sweden
Country Risk Report
Includes 10-year forecasts to 2028

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Executive Summary

Core Views

- Sweden will remain a growth outperformer among developed states, but the economy is set to cool slightly from well-above trend levels.
- The surge in migrant inflows in 2015-16 will lead to higher economic growth over the medium term, but will present challenges to the fiscal accounts, the labour market, and domestic political stability.
- The Swedish political scene is splintering, and new realignments took place following the 2018 general election. The uncertainty over future policy formation will continue to weigh on the country's political risk score.
- Interest rates will remain low as the central bank (Riksbank) will maintain a negative policy rate until 2020 and inflation will remain around the target.

Major Forecast Changes

- We have revised our central bank policy rate forecast for end-2019 to -0.25% from 0.0%.
- We have decreased our real GDP growth forecast to 1.9% from 2.2% for 2019.

Key Risks

- **House Price Correction:** A sudden fall in residential real estate prices could cause a painful adjustment for private sector borrowers and generate instability in the financial sector.
- **Downside Growth Risks From Europe:** A relapse in the European economic recovery would leave Sweden's open economy vulnerable to external demand shocks. The UK's vote to leave the EU presents longer-term risks to political stability.

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Country Risk Summary

Economic Risk Index

The greatest risk remains the exposure of the economy to real estate prices. In line with our view, prices stabilised following a correction in August 2017. We expect prices to remain relatively stable in 2019 due to supply-side hurdles in the housing market. However, this remains a downside risk with potential negative implications for private consumption, investment, and the financial sector.

Political Risk Index

We at Fitch Solutions have maintained our short-term political risk index score to account for the diverse nature of the new governing arrangement following the September 2018 general election.

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SWOT

Economic – SWOT Analysis

Strengths

- One of the top 10 Western European economies by value of GDP, Sweden has a highly diversified range of industries, from forestry to automobile production, aviation, nuclear power and telecommunications.
- Fiscal prudence and an independent monetary regime give the Swedish authorities flexibility to adjust policy depending on prevailing economic conditions.

Weaknesses

- The very large public sector is believed by some to be a factor holding back the growth rate.
- Heavy dependence on a sluggish eurozone as an export market has depressed the growth of Sweden's export sector.

Opportunities

- Swedish multinationals are noted for high levels of research and development spending, and this level of investment puts them in a position to benefit from new product development, particularly in high-tech areas.
- A surge in immigration could help ease demographic problems and boost economic growth over the long term.

Threats

- Sweden faces the need to adjust to the economic implications of a rapidly ageing population, with the number of people older than 65 expected to increase by 25% in the next decade.
- Globalisation will continue to pose major competitive challenges to the Swedish economy, which needs to pursue its comparative advantage in high-tech and service sectors.

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Political – SWOT Analysis

Strengths

- Solid democratic and peaceful tradition: Sweden has not been involved in armed hostilities with any other nation for the past two centuries.
- After seven decades of social democratic dominance, there has been a trend towards a bipolar political system, with political parties across the spectrum relying more on coalition-making to govern.

Weaknesses

- There have been signs of increasing social tension in recent years, with growing activity by anti-immigrant groups on the right and anti-globalisation groups on the left.

Opportunities

- Membership of the EU and the resulting political and economic integration with the wider European continent provides Sweden with an established multilateral policy anchor and encourages positive foreign relations.

Threats

- The rise of the anti-immigrant Sweden Democrats highlights the risk of growing social divisions within the domestic polity.
- Sweden's traditionally neutral foreign policy may be put to the test, with Russia stepping up military activity in northern Europe and the Baltic Sea region.

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Economic Outlook

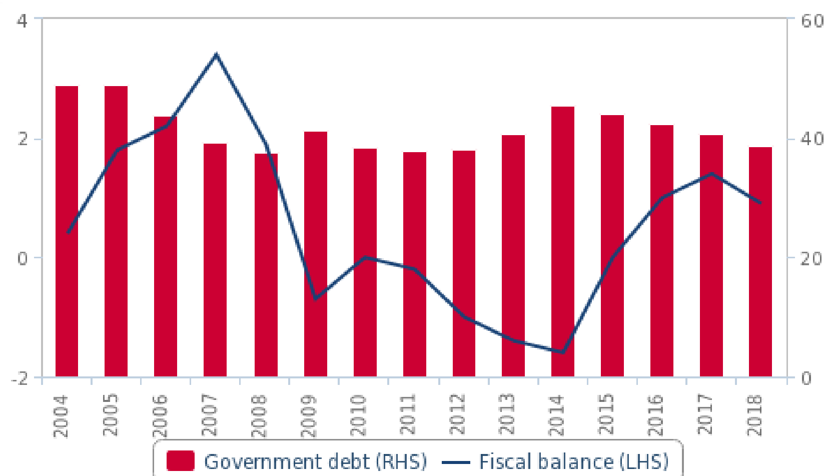
Economic Growth Outlook

Falling Production Expectations In Sweden Point To Stronger Slowdown Ahead

Key View

- We at Fitch Solutions maintain our 2019 GDP growth forecast for Sweden at 1.9% in 2019, but revised downward our 2020 forecast to 1.4% from 1.6% previously.
- We believe that export figures for H219 will weaken, and deteriorate further in 2020, reflecting subdued external demand amid a protracted slowdown in global economic activity.
- The government is likely to undertake a more expansionary fiscal policy in the coming quarters, which will partially offset the external sector's lesser contribution to economic growth.
- Although not our core view, there is scope for a rebound in household consumption in the coming months.

Sweden's Already Strong Fiscal Position Is Improving
Fiscal Balance & General Government Debt, % GDP



Source: Eurostat, Fitch Solutions

At Fitch Solutions, we maintain our 2019 GDP growth forecast for Sweden at 1.9%, but revised downward our 2020 forecast to 1.4% from 1.6% previously. GDP growth decelerated to 1.4% y-o-y in Q219, after a strong start of the year at 2.0% in Q119. This loss of momentum reflected weaker growth in government spending and gross fixed capital formation, which averaged 0.3% y-o-y and -0.6% respectively from 1.1% and -0.4% in Q119. Conversely, the country's external sector remained relatively strong.

Export growth decelerated from 4.9% to 4.2% over that same period, but still remained above the 4.0% average recorded in 2018 and the 3.6% average in 2017. Our view is that exports, which account for almost half of Swedish GDP, will decelerate more strongly in the coming quarters due to a protracted slowdown in global economic activity, and dampen Swedish GDP growth.

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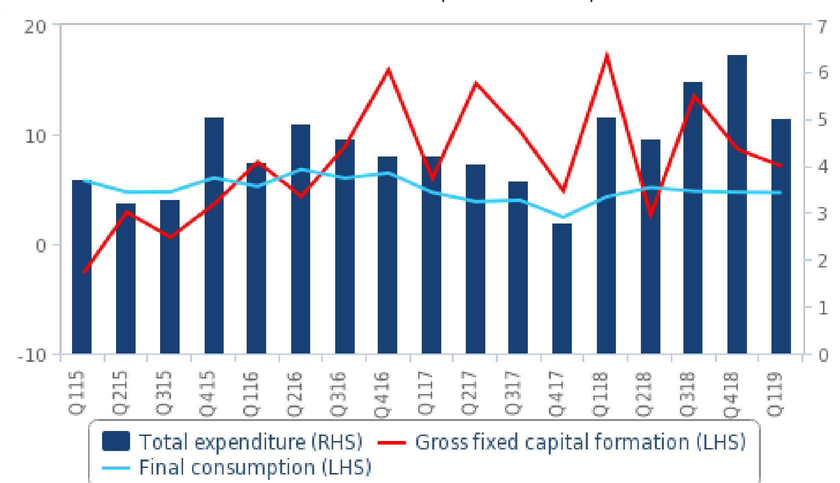
That said, we believe that both monetary and fiscal policy will cushion the impact of weaker external demand and prevent a greater deceleration in GDP growth. We expect the Riksbank to keep rates on hold throughout 2019 and 2020, thus keeping financing costs in the economy from rising during that period. The Swedish government is also likely to increase spending in 2020 for two main reasons:

Increased Government Expenditure Likely To Come From H219 Onward

General Government Total Expenditure & Components

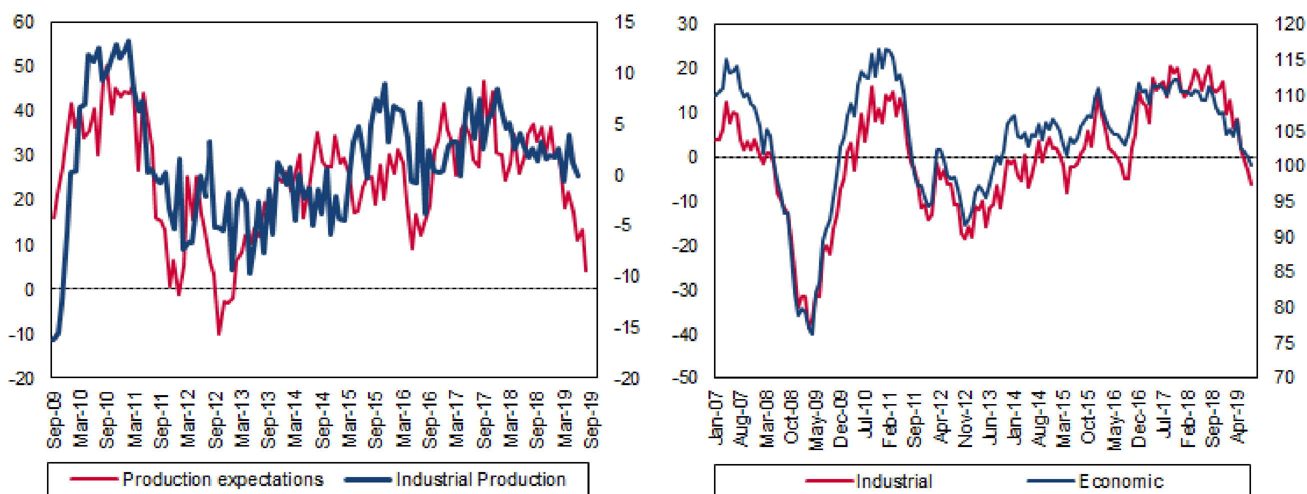


Source: Eurostat, Fitch Solutions

Sweden is in a comparatively robust fiscal position, with considerable scope to spend. Sweden's general government debt has been reduced in recent years, standing at 36.3% of GDP in Q119 from 45.5% in Q414, thus being close to the country's debt anchor set at 35.0% of GDP. The government's fiscal balance has also been in surplus since 2016.

Slump In Industrial Sentiment Announces Strong Fall In Production

Firms Production Expectations (next three months) And Industrial Production, % chg y-o-y (LHS) & Industrial And Economic Sentiment (RHS)



Source: Sweden Statistics, Eurostat, Fitch Solutions

The Swedish Minister for Finance Magdalena Anderson signalled the intention to increase spending in the coming quarters. In April, Anderson fended off criticism from various sectors from civil society accusing her of conducting inappropriate fiscal conservatism,

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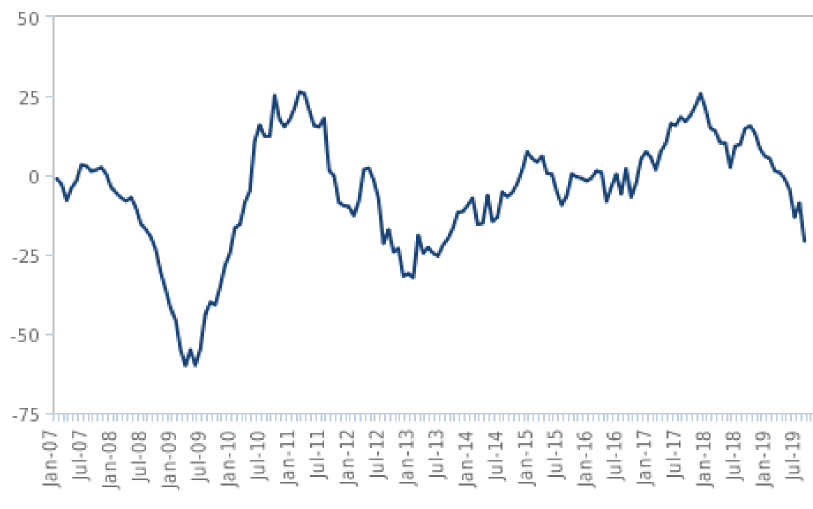
stating that the government would invest in welfare and infrastructure. The government has at least the equivalent of 3.7% of GDP to spend, given that the ministry of finance can deviate from the its debt anchor by 5.0% without having to report to parliament. As of Q119, there had been no acceleration in government spending either on consumption of goods and services or investment, suggesting that stronger spending will come in the later stages of 2019 and in 2020.

Industrial Firms Willingness To Hire Is Collapsing
Industrial Firms Perceptions Of Additional Employment Over Next Three Months

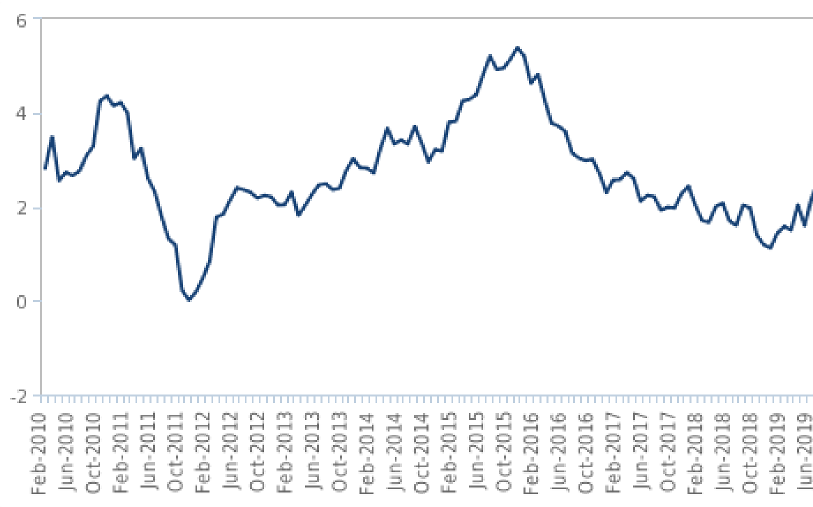


Source: Eurostat, Fitch Solutions

Export Resilience Set To Wane

We believe that export figures will show a more significant deceleration throughout H219 and 2020 due to more subdued external demand amid weakening global economic conditions. Our view is that risks of a more prolonged slowdown in global growth are mounting, partly due to unresolved trade disputes between the US and China as well as persisting Brexit uncertainties (*see 'Recession Risks: What Could Tip The US And Global Economies Over The Edge?' June 28*).

Strong Figures In Q219 Confirm Rebound In Retail Sales
Retail Sales, % chg y-o-y (6mma)



Statistics Sweden, Fitch Solutions

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There are signs that the effects of the global slowdown will already be reflected in data for H219, putting an end to the resilience shown by exports and industrial production in H119. Industrial firms' production expectations have fallen significantly in recent months, and hit their lowest level in over six years in August, pointing to a strong contraction in industrial production in H219. This was also reflected in industrial sentiment, which collapsed over the same period and drove down overall economic sentiment.

Industrial firms' expectations regarding future employment, a strong sign of firms' willingness to invest in future production, has also deteriorated markedly. In August, it fell to its lowest level since July 2013.

Household Consumption Is Upside Risk To Economic Growth

Although this is not our core view, we see scope for a recovery in household consumption throughout the remainder of 2019. Growth in household consumption collapsed in H218 and Q119, averaging 0.4% and -0.3% respectively, compared to a 2.1% average in H118 and 2.3% in 2017. This strong deceleration resulted from a continuous decline in consumer sentiment since a correction in house prices in end-2017. While household consumption rebounded only slightly to 0.3% in Q219, retail sales accelerated over the same period and reversed their downward trajectory in place since Q418. Retail sales accelerated further in July and expanded by the strongest rate since May 2016, suggesting momentum is building up in households' appetite to spend. This might be facilitated by the current reality of house prices which, in line with our long-standing view, have stabilised since the beginning of 2018 (*see 'Stable House Prices To Underpin Stability In Swedish Banking Sector' 14 June 2019*). We also note that base effects will boost H219 figures. Stronger household consumption in H219 could offset weaker exports and lead to a rebound in GDP growth over that period.

GDP By Expenditure Outlook

The Swedish economy has been one of the most resilient in Europe, and is one of the few countries in the region with output higher in 2017 than it had in 2008, prior to the global financial crisis. We expect that resilience to continue, with economic activity boosted in the next decade by a resurgent demographic picture amid high immigration. The key risk is the high level of household debt, which is among the highest in the world, but our core view is that easy monetary policy and continued economic growth provide sufficient conditions for an orderly deleveraging over the next decade. Additionally, on the external front, export growth will improve slowly from weak conditions in 2008-16. Our estimate of long-term potential real GDP growth is 2.0%, which is among the highest rates in the developed world.

Private Consumption: Over the next few years, higher income taxes and more stringent home mortgage amortisation requirements will begin to retard the growth in leverage. Otherwise, conditions for Swedish consumption on aggregate will remain generally

TABLE: GDP GROWTH FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Nominal GDP, SEKbn	4,604.2	4,802.2	4,990.2	5,147.7	5,362.3	5,564.2	5,787.0	6,018.6	6,259.5	6,510.0	6,770.5	7,041.4
Real GDP growth, % y-o-y	2.4	2.7	1.9	1.4	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0
GDP per capita, SEK	446,334.8	489,686.2	509,083.9	510,093.4	523,483.6	538,018.8	560,944.9	582,573.1	602,754.6	623,730.2	645,535.5	668,219.7

e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

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favourable over the long run, with a low interest rate policy likely to persist into 2019. While we have long-expected a correction in the overheating housing market, the massive sudden increase in population should ensure that prices do not collapse. High immigration will have a dampening effect on average wage growth, and it will take time for new arrivals to integrate in the labour force, but this negative effect will be more than compensated for by a boost in the sheer number of consumers and higher overall spending power. Real private consumption growth will average 2.3% between 2019 and 2028.

Government Consumption: The Swedish government has traditionally played a relatively large role within the economy, though we maintain our view that the long-term structural decline in public sector ownership and expenditures will resume once the immigration surge ends in 2018. Government consumption accounted for 29% of GDP in 1993, but fell to 26% in 2016. Our forecasts envisage a further decline to 24% by the end of our forecast period to 2028.

TABLE: PRIVATE CONSUMPTION FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Private final consumption, SEKbn	2,030.0	2,117.3	2,187.1	2,268.1	2,365.6	2,469.7	2,578.4	2,691.8	2,810.2	2,933.9	3,063.0	3,197.7
Private final consumption, % of GDP	44.1	44.1	43.8	44.1	44.1	44.4	44.6	44.7	44.9	45.1	45.2	45.4
Private final consumption, real growth % y-o-y	2.4	2.4	1.5	2.0	2.3	2.4	2.4	2.4	2.4	2.4	2.4	2.4

e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

TABLE: GOVERNMENT CONSUMPTION FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Government final consumption, SEKbn	1,198.2	1,238.9	1,276.1	1,316.9	1,360.4	1,405.3	1,451.7	1,499.6	1,549.1	1,600.2	1,653.0	1,707.5
Government final consumption, % of GDP	26.0	25.8	25.6	25.6	25.4	25.3	25.1	24.9	24.7	24.6	24.4	24.2
Government final consumption, real growth % y-o-y	0.4	1.5	1.2	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3

e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

TABLE: FIXED INVESTMENT FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Fixed capital formation, SEKbn	1,148.6	1,222.1	1,286.9	1,334.5	1,394.6	1,453.1	1,511.3	1,571.7	1,634.6	1,700.0	1,768.0	1,838.7
Fixed capital formation, % of GDP	24.9	25.4	25.8	25.9	26.0	26.1	26.1	26.1	26.1	26.1	26.1	26.1
Fixed capital formation, real growth % y-o-y	6.0	4.5	3.5	2.0	2.5	2.2	2.0	2.0	2.0	2.0	2.0	2.0

e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

TABLE: NET EXPORTS FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Net exports of goods and services, SEKbn	192.2	208.8	215.0	208.2	221.7	236.1	245.7	255.5	265.6	276.0	286.6	297.4
Net exports of goods and services, % of GDP	4.2	4.3	4.3	4.0	4.1	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Net exports of goods and services, real growth % y-o-y	-7.1	6.6	1.3	-4.4	4.5	4.5	2.2	2.2	2.1	2.1	2.0	2.0

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Fixed Investment: The recovery in business investment has been slow-going, resulting in real fixed capital formation returning to 2008 levels only in 2014. We anticipate a pick-up in the next few years though, to 4.0% growth on average between 2017 and 2020, in 2017-18 due in large part to strong residential construction amid a housing shortage, but over 2019-20 due more to business investment. Over the long term, we expect the proportion of the total economy accounted for by gross fixed capital formation to rise from below 24% in 2015 to around 26.0% at end-2028.

Net Exports: With the Swedish krona set to remain weak by historic standards, aggregate labour costs remaining subdued due to high immigration, and European demand improving, we expect Sweden's export sector to continue improving slowly. While the currency's depreciation will also limit import growth, the still-strong domestic consumption story means that the propensity to import should remain high. Between 2019 and 2028, we project average annual export and import growth of 4.4% and 4.3% respectively – a substantial acceleration in activity when compared with 1.4% and 2.1% in the preceding five-year period.

Outlook On External Position

Although Sweden has only a modestly positive net international investment position, we believe that net foreign assets are understated by the official accounts, and that the country has one of the strongest external positions in the world. The main vulnerability stems from Swedish banks' borrowing from overseas, which puts the balance of payments at risk from a sudden bout of global risk aversion or a renewed 'credit crunch'.

Net International Investment Position (NIIP): Sweden's net international investment position (NIIP) was 17% of GDP in 2017, the highest since records begin in the early 1980s, having hovered in negative territory for most of the previous decade. While the NIIP is likely to remain steady over the next several years, there are two defining characteristics of the country's external position that bear watching.

First, the net external position may actually be more positive than the official data suggest. Sweden's persistent current account surplus would suggest a much higher accumulation of net assets overseas than has been officially recorded – closer to a positive NIIP of 65% of GDP rather than 17% officially. The balance of payments data perennially include a significant level of errors and

TABLE: CURRENT ACCOUNT BALANCE FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Balance of trade in goods, EURbn	11.4	12.7	13.2	12.8	16.7	17.1	17.5	17.8	18.1	18.6	19.2	20.0
Balance of trade in goods, % of GDP	2.5	2.7	2.8	2.8	2.7	2.7	2.6	2.6	2.5	2.5	2.5	2.5
Balance of trade in services, EURbn	-4.6	-4.7	-4.3	-3.8	-4.5	-4.3	-4.2	-4.0	-3.8	-3.6	-3.3	-3.0
Balance of trade in services, % of GDP	1.0	1.0	0.9	0.8	0.7	0.7	0.6	0.6	0.5	0.5	0.4	0.4
Primary income balance, EURbn	6.7	6.5	6.7	6.7	9.2	9.7	10.3	10.9	11.6	12.3	13.0	13.8
Primary income balance, % of GDP	1.5	1.4	1.4	1.5	1.5	1.5	1.6	1.6	1.6	1.6	1.7	1.7
Secondary income balance, EURbn	-7.7	-5.8	-5.6	-5.4	-6.9	-6.9	-6.9	-6.9	-6.9	-6.9	-6.9	-6.9
Secondary income balance, % of GDP	-1.7	-1.2	-1.2	-1.2	-1.1	-1.1	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9
Current account balance, EURbn	15.1	18.1	18.5	17.9	23.5	24.3	25.1	25.9	26.6	27.5	28.6	29.9
Current account balance, % of GDP	3.3	3.8	3.9	3.9	3.8	3.8	3.8	3.7	3.7	3.7	3.7	3.7

e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

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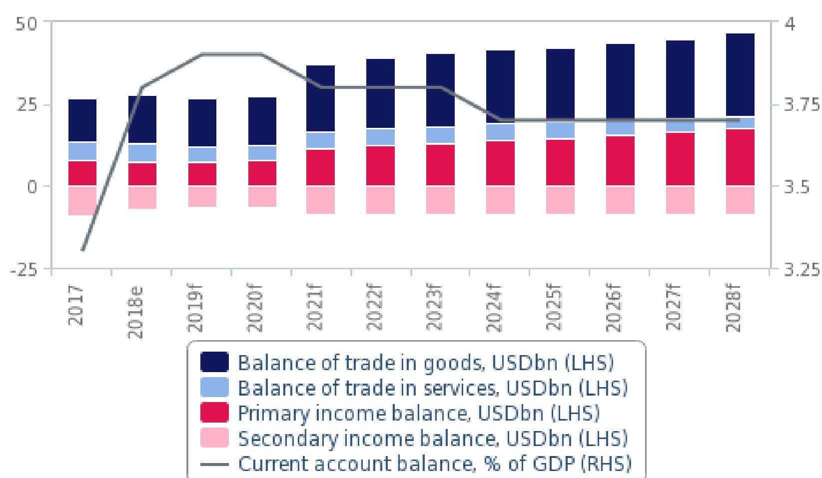
omissions, which added up to a total of 54% of GDP between 1997 and 2017, including 14% in the most recent three years alone. This could be due partly to valuation effects on the assets.

Surplus Will Narrow But Remain Robust

Current Account Balance (2017-2028)

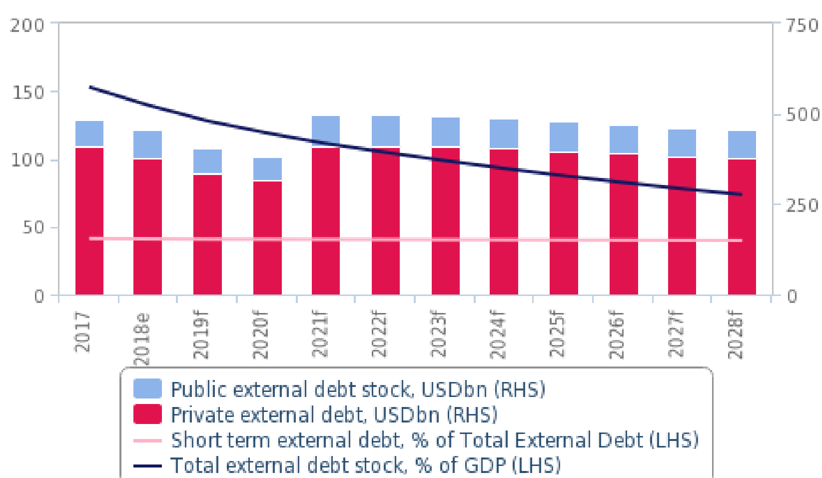


Source: Statistics Sweden, Fitch Solutions

But we believe this discrepancy can be squared by the accumulation of high levels of 'hidden' foreign assets by the Swedish private sector, which is in turn most likely due to wealthier households purchasing assets offshore in order to evade high domestic taxes. The country posts a far stronger net income balance (around 1.0% of GDP) than would be implied given the negative NIIP. In other words, Sweden's net external position is likely to be much stronger than implied by the headline statistics, and the net income created by foreign assets, both visible and hidden, will continue to support the balance of payments.

Reduction In External Liabilities Ahead

Total External Debt (2017-2028)



e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

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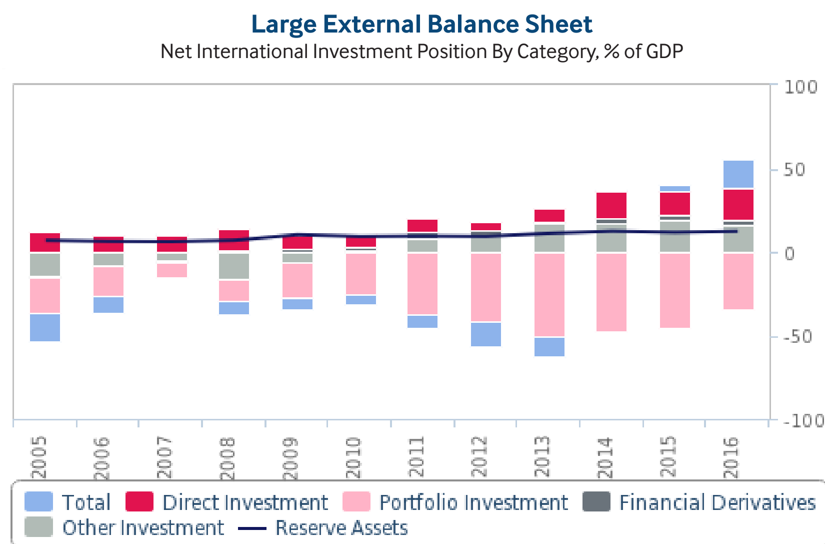
Second, the absolute size of the external balance sheet is very large. Between 2004 and 2017, assets soared from 164% of GDP to 283%, while liabilities increased from 186% to 266%. The current figures are much larger than those of Sweden's peer countries, such as Germany, which has assets and liabilities of 240% and 207%, respectively.

Large External Balance Sheet

Net International Investment Position By Category, % of GDP



Source: Statistics Sweden, Fitch Solutions

As explained in the next section, a large proportion of this increase in Sweden is due to expanding banking sector assets and liabilities, which each now represent more than one-third of the country's total external assets and liabilities. So while the external position is modest on a net basis, on an absolute basis, the NIIP is subject to shift significantly in the event of changes in the valuation of assets or liabilities, or a sudden repatriation of funds in either direction. We are relatively sanguine on the outlook in this regard, as Sweden should remain a relative safe haven for the foreseeable future, but a change in risk appetite could cause instability in the external position.

TABLE: TOP FIVE EXPORT DESTINATIONS AND GOODS EXPORTS (2017)

By Country	% of Total Exports	By Category	% of Total Exports
Germany	10.4	Machinery, transport equipment	44.6
Norway	10.3	Chemicals, rubber products	14.0
United States	7.6	Other products	13.8
United Kingdom	7.3	Wood and paper products	11.1
Denmark	6.8	Minerals	9.7

Source: Statistics Sweden, Fitch Solutions

TABLE: TOP FIVE IMPORT SOURCES AND GOODS IMPORTS (2017)

By Country	% of Total Imports	By Category	% of Total Imports
Germany	17.9	Machinery, transport equipment	43.8
Norway	8.4	Other products	22.7
Netherlands	8.0	Chemicals, rubber products	13.2
Denmark	7.7	Minerals	7.2
United Kingdom	5.6	Wood and paper products	2.8

Source: Statistics Sweden, Fitch Solutions

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External Debt: Swedish external debt loads are manageable, with external non-financial corporate debt of 10% of GDP and overall net external debt relatively limited at 21% of GDP, compared with 26% for the eurozone and 30% for the US. The main vulnerability in the country's external position stems from the financial sector, which borrows heavily from abroad in order to fund domestic lending. In particular, banks are heavily reliant upon wholesale foreign short-term borrowing. The NIIP for monetary financial institutions (MFIs) was -29% of GDP at end-2017, with assets representing 100% of GDP and liabilities 129%.

Over the past decade the regulatory authorities and central bank have pushed lenders to change their funding structure to reduce vulnerabilities. This has led to a significant increase in the growth of long-term vis-a-vis short-term liabilities over the past decade. This should help banks weather external vulnerability due to a global financial crisis or a bout of severe currency weakness. However, there remains a significant mismatch between domestic assets and foreign liabilities, and this leaves Sweden vulnerable to a potential crisis should the asset values upon which domestic loans are made (such as house prices) drop simultaneously with a foreign financing crunch.

Balance Of Payments: Sweden's balance of payments is among the world's strongest, and presents few risks to economic stability. The current and trade accounts of the balance of payments have been in surplus since a financial crisis in the early 1990s, and will remain in surplus over the next decade. We forecast an average current account surplus of 3.8% of GDP between 2019-2028, reflecting Swedish savings in excess of investment. The high savings rate can be attributed largely to the country's ageing demographic profile, which will only become more pronounced over the next decade.

That said, the current account surplus peaked in 2007 at 8.2% of GDP, and will narrow to 3.7% by 2028. The primary income balance will continue to contribute significantly to the overall surplus (to the tune of 1.6% of GDP on average) to 2027 as Sweden receives a higher return on its overseas assets than foreigners get on their Swedish investments. However, the trade surplus will gradually decline, from 4.4% of GDP in 2016 to 3.3% in 2027. We expect Swedish imports to remain relatively robust in line with strong domestic demand, while exports – particularly those to the eurozone – will continue to suffer from weak global demand and high labour costs in Sweden (although that aspect of competitiveness has improved considerably alongside a weak exchange rate).

The large current account surplus will mean that Sweden continues to accumulate foreign assets (notwithstanding the aforementioned errors and omissions). The financial account will continue to be characterised by high levels of foreign direct investment by Swedish firms overseas (averaging 3.0% of GDP in the five years to 2017), and continued foreign portfolio inflows into Swedish assets, including safe-haven government fixed income (averaging 3.0% of GDP between 2013-2017). Overall, this should continue to support the positive 'carry' received by Sweden on its net investments.

TABLE: CAPITAL AND FINANCIAL ACCOUNT BALANCE

	2013	2014	2015	2016	2017
Financial account, EURbn	14.8	14.4	9.1	-15.5	6.2
Net FDI inflows per capita, EUR	2,338.2	-1,015.7	2,298.6	775.7	6,109.3
Net portfolio investment, EURbn	36.5	-17.8	11.8	-5.3	6.4
Net other Investment, EURbn	27.1	-4.8	13.5	-16.3	11.3

Source: Statistics Sweden, Fitch Solutions

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Monetary Policy

Swedish Krona To Depreciate Amid Protracted Trade Tensions

Key View

- At Fitch Solutions, we expect the Swedish krona to depreciate further in the coming six months as the Riksbank is forced into a more dovish position amid weakening industrial data and signs of easing inflation.
- In the longer term, we believe that persisting trade uncertainties stemming from Brexit and US-China trade tensions will continue to put downward pressures on the unit.
- Risks to our view are tilted towards a weaker currency, as a stronger deterioration in global economic conditions than currently anticipated would lead the Riksbank to cut interest rates, putting additional downward pressure on the krona.

Poor Economic Data Releases Between July And August Take A Toll On The Krona

SEK/EUR (daily)

Source: Bloomberg, Fitch Solutions

Short-Term Outlook (three-to-six months)

At Fitch Solutions, we believe that the Swedish krona will depreciate further against the euro over the coming six months as poor industrial data releases and subdued inflation will take a toll on markets' perceptions of the strength of the Swedish economy. In

TABLE: FITCH SOLUTIONS CURRENCY FORECAST

	Spot	2019f	2020f
SEK/USD, ave	9.8	9.39	9.57
SEK/EUR, ave	10.8	10.7	11.20
Repo Rate, %, eop	-0.20	-0.25	-0.25

Updated September 3 2019. Source: Bloomberg, Fitch Solutions

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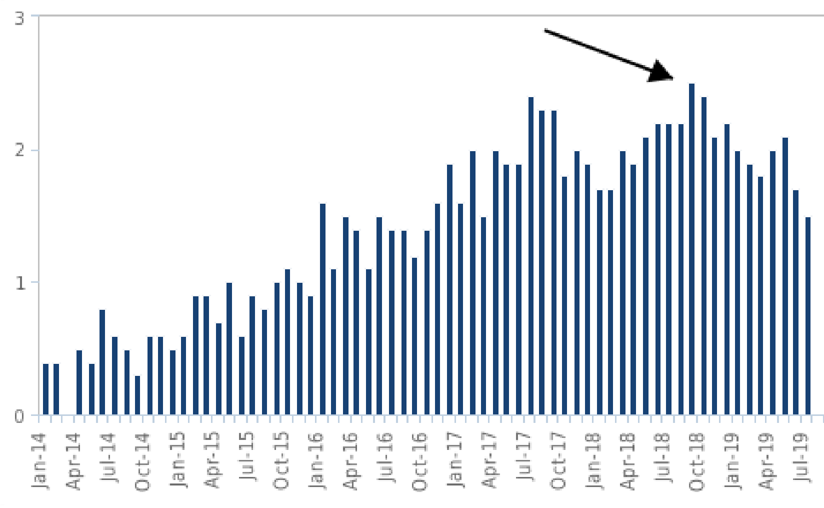
line with our view, the krona continued to lose value against the euro over the past three months and is trading close to SEK10.8/EUR at the time of writing, from close to SEK10.6/EUR in early June.

Base Effects To Dampen Inflation In The Coming Quarter

Consumer Price Index With Fixed Interest Rate, % chg y-o-y

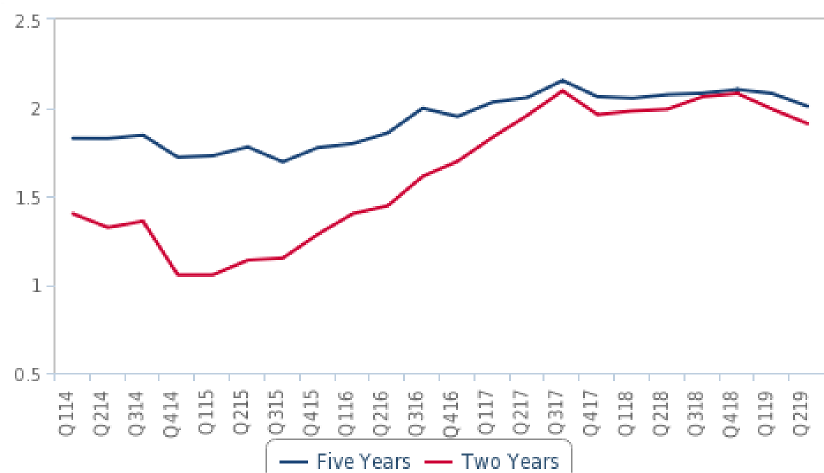


Source: Statistics Sweden, Fitch Solutions

This depreciation was mainly driven by poor economic data releases in July and August, namely decelerating inflation and weaker-than-expected GDP growth figures for Q219. We expect further weakness in economic data releases in the coming months will continue to weigh on the unit. We believe that industrial production data will deteriorate more significantly in the near future, as we have recently noted that forward-looking indicators from Swedish industrial firms have recently collapsed to multi-year lows. Production expectations in August fell to their lowest level in six years, and expectations regarding future hiring hit their lowest level since July 2013.

Inflation Expectations Trending Lower

Inflation Expectations In The Economy, Five & Two Years



Source: Kantar Sifo, Fitch Solutions

We also expect inflation readings in the coming months to remain below the RIksbank's target, for two main reasons. Firstly, the base effects that were partly responsible for the dip in inflation in June and July will continue to have a dampening effect on price

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growth throughout Q419. Secondly, we expect demand-pull inflation to be subdued due to weak household consumption. Growth in household consumption rebounded slightly from -0.03% in Q119 to 0.3% in Q219 but remained well below the 2.4% average in H118 and 2.3% average in 2017. Consumer sentiment has not shown signs of improvement and suggests that households willingness to spend is unlikely to pick up materially.

Industrial Wage Increases Likely To Be Modest
Central Wage Agreements & Actual Wage growth, y-o-y

Source: National Mediation Office, Fitch Solutions

Weaker economic activity will, in turn, force the Riksbank to adopt an increasingly dovish forward guidance over the coming months, which will add downward pressure on the krona. At its September 4 meeting the Riksbank's executive board reiterated its intention to hike by four basis points (bps) in Q419 and 23bps in Q320, with only minor changes to the amount of basis points to be increased. We believe that the Riksbank will postpone its first key policy rate hike by six months at its October 23 meeting, in face of weaker economic data. It will ultimately decide to keep rates on hold throughout 2020, at either its December 18 meeting or at its first meeting in 2020, as economic indicators deteriorate further. We expect the Riksbank to keep its key policy rate at the current -0.25% throughout 2019 and 2020.

A more subdued inflation outlook for 2020 will be an additional factor underpinning the Riksbank's decision to hold:

- Inflation expectations in the economy have been declining in recent quarters, both in the mid and longer term. Hiking would likely cause inflation expectations to fall further, dampening price growth and putting at risk the Riksbank's ability to meet its inflation target of 2.0%.

- We are less sanguine than the Riksbank on the contribution of wage growth to higher inflation in 2020. We expect negotiations between employers' confederations and trade unions, which will set the wages for nearly 3mn workers, to yield only modest results. The economy-wide negotiations traditionally reflect the benchmark set by industrial workers. Given our view that industrial activity will deteriorate in the coming quarters due to faltering external demand, we do not expect wage increases to be agreed above the levels of recent years.

Overall, the Riksbank's accommodative monetary policy will be an incentive for investors to dispose of Swedish assets, driving depreciation of the unit. We maintain our view that the krona will reach SEK10.70/EUR by end-2019.

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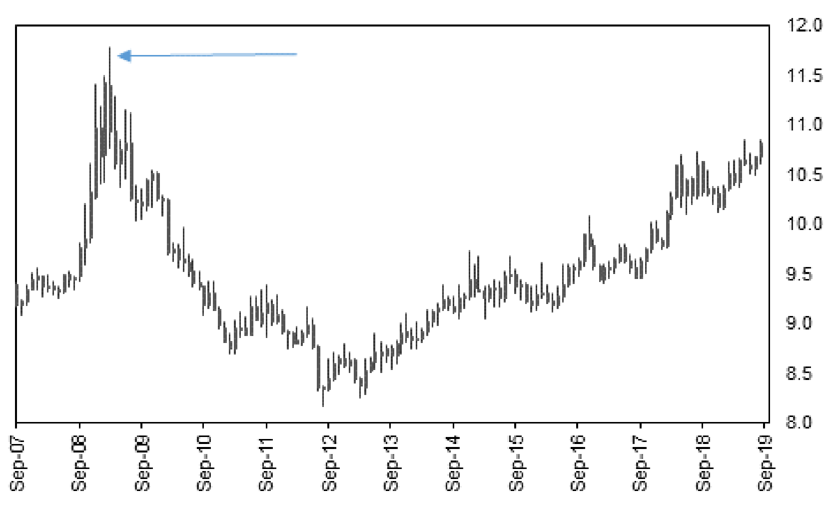
Long-Term Outlook (six-to-24 months)

In the longer term, we believe that persisting trade uncertainties will drive further depreciation of the krona. As we have noted previously, Brexit-related uncertainties and trade tensions between China and the US have been a key driver of krona depreciation as markets anticipate that the Swedish economy will be disproportionately affected due to it openness to trade. These dynamics will remain in place in the coming months, and might even worsen further:

Krona Could Reach 2009 Levels

SEK/EUR (monthly)



Source: Bloomberg, Fitch Solutions

- Uncertainty regarding the outcome of Brexit negotiations has increased in our view. We now believe that there is an equal probability of a deal or no-deal Brexit. Increased clarity is likely to only come in late October, possibly after a snap general election has reconfigured parliament. The general election could result in a no-deal majority, eventually culminating in a no-deal Brexit. In case a no-deal majority is avoided, the outcome could still be a hung parliament and ,thus, the need for an article 50 extension beyond January 2020. All considered, risks are tilted towards trade uncertainty between the UK and the European Union continuing in the coming quarters.

- Our view on a trade deal being reached by the US and China is becoming increasingly bearish. China and the US engaged in another round of tit-for-tat imposition of additional tariffs on August 23. Further escalation remains likely in the coming months as both sides are unlikely to compromise on fundamental disagreements. Even if the escalation eventually dissipates in the run-up to the 2020 US presidential election, de-escalation does not seem to be on the cards in the coming quarters.

For these reasons, we reiterate that over the coming 24 months, the unit could depreciate close to levels last seen in 2009.

Risks To Outlook

Risks to our outlook are mainly tilted to the downside, and are tied to the developments in global economic conditions. Although not our core view, the protracted economic slowdown could develop into a global recession. A global recession would in turn force the Riksbank to become even more dovish than we anticipate, leading it to cut rates at least once in 2020, putting additional downward pressure on the krona.

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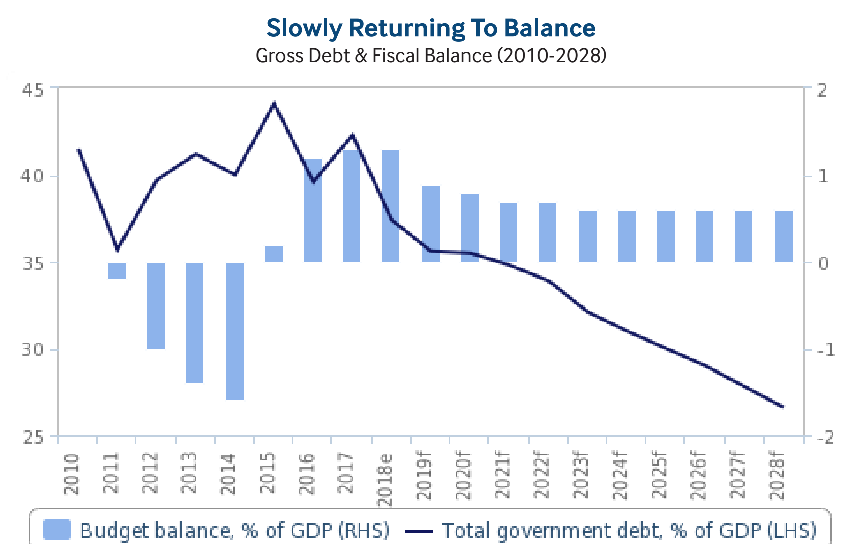
Structural Fiscal Position

Sweden's fiscal accounts will be negatively impacted in 2018-19 by elevated costs to accommodate foreign migrants and increases in other spending, but will recover over as economic growth increases and expenditures subside. We expect budget surpluses to persist over the long term.

Slowly Returning To Balance

Gross Debt & Fiscal Balance (2010-2028)



e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

Fiscal Position: The general government budget surplus in Sweden will narrow in 2018, as various spending programmes pick up. However, the structural budget position over the longer run is likely to change. For nearly two decades, the Swedish government has obeyed an official budget goal of maintaining a 1.0% of GDP surplus 'over the business cycle'. The target was put in place in 1997, following a severe economic crisis that put the public debt pile and the government's fiscal credibility under extreme scrutiny. Since that time, the budget balance has averaged a positive 0.4% of GDP. But with the Swedish fiscal accounts now in much better health, and with the government looking to increase spending, the parliamentary fiscal committee in 2016 agreed to drop the target from 1.0% of GDP to 0.33%. The 2019 budget already included income tax cuts that came into effect in January 1. The 2019 spring budget then implemented cuts to employers' labour taxes and additional spending in measures to fight climate change. However,

TABLE: GENERAL GOVERNMENT EXPENDITURE AND REVENUE BREAKDOWN

Government Expenditure as % of Total		Government Revenue Sources as % of Total	
Social protection	41.2	Indirect Taxes (eg VAT)	36.0
Health	13.5	Direct Taxes (Income and Corporate)	35.6
Education	13.3	Social Contributions	15.0
General public services	13.3	Sales	6.8
Economic affairs	8.7	Other Current Revenue	5.6
Defence	3.0	Capital Revenue	0.8
Public order and safety	2.6		
Recreation, culture and religion	2.3		
Housing and community amenities	1.4		
Environmental protection	0.6		

Note: 2016 data. Source: OECD, Eurostat, Fitch Solutions

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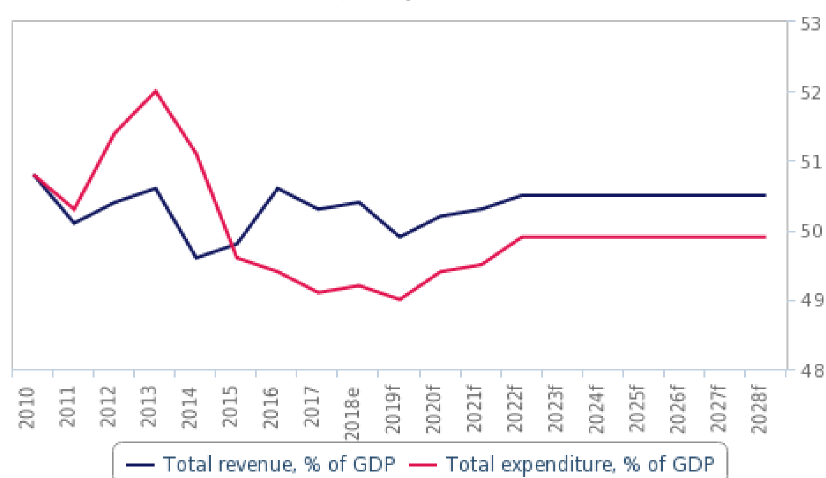
the government remains committed to reducing public debt to 35.0% of GDP by end-2019, effectively meaning that fiscal policy will not become significantly expansionary in the coming months.

Depending on the agreement that is reached on the reform, we may revise our budget balance forecasts to reflect fiscal expansion plans. For instance, the government is abandoning the complementary 'krona-for-krona' policy, in which any additional budget expenditure must be matched by a corresponding spending cut or tax increase.

Immigration-Related Spending Surge To Fade
Government Spending & Revenue (2010-2028)



e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

Government Share of GDP: Fiscal policy turned slightly expansionary with the 2019 budget, following the 2018 general election. The new centre-left government implemented tax cuts in exchange for the support of the liberal and centre parties in a confidence and supply agreement. However, fiscal policy is unlikely to expand further as the government remains committed to reducing public debt to 35.0% of GDP by end-2019. The government is seeking to use freed-up funds from a change in the fiscal rule to finance investment in infrastructure, housing, research and education. Additionally, spending on newly-arrived immigrants has spiked between 2015 and 2017. Offsetting this growth in spending however will be strong nominal real GDP growth, which will result in general government expenditures remaining steady as a percentage of GDP at around 50% to 2028.

TABLE: FISCAL AND PUBLIC DEBT FORECASTS

	2017	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Total revenue, SEKbn	2,317.7	2,422.0	2,489.8	2,584.5	2,695.6	2,811.5	2,924.0	3,040.9	3,162.6	3,289.1	3,420.6	3,557.4
Total revenue, SEK, % y-o-y	3.9	4.5	2.8	3.8	4.3	4.3	4.0	4.0	4.0	4.0	4.0	4.0
Total expenditure, SEKbn	2,259.2	2,360.9	2,443.5	2,541.3	2,655.6	2,775.1	2,888.9	3,004.5	3,124.7	3,249.6	3,379.6	3,514.8
Total expenditure, SEK, % y-o-y	3.8	4.5	3.5	4.0	4.5	4.5	4.1	4.0	4.0	4.0	4.0	4.0
Budget balance, SEKbn	58.5	61.1	46.3	43.2	40.0	36.4	35.0	36.4	37.9	39.4	41.0	42.6
Budget balance, % of GDP	1.3	1.3	0.9	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Total government debt, EURbn	190.0	179.5	165.6	160.3	212.6	214.3	212.9	214.5	215.8	217.0	216.3	215.3
Total government debt, % of GDP	42.3	37.4	35.6	35.5	34.8	33.9	32.1	31.0	30.0	29.0	27.8	26.6

e/f = Fitch Solutions estimate/forecast. Source: Statistics Sweden, Fitch Solutions

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Debt Position: As fiscal deficits mount, we project that the government debt load will remain around 40% of GDP through end-2018. However, we see the debt load coming down thereafter as the budget comes closer to balance, with debt-to-GDP falling below 30% by 2028. The new fiscal rules include a 35% debt-to-GDP target, with any deviation of more than five percentage points (pp) from that target triggering a parliamentary review, so the structural underpinnings of debt reduction are strong.

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10-Year Forecast

The Swedish Economy To 2028

Well-Positioned For The Long Term

Key View

- Sweden is among the most strategically well-positioned economies in the developed world, and this is reflected in our 10-year growth forecasts, which expect steady expansion through to 2028.
- The balance of payments will remain stable, buoyed by a robust current account surplus; the fiscal dynamics are among the best in Europe; and the country will continue to benefit from a highly productive workforce over the long term.

Sweden retains a broadly favourable long-term macroeconomic outlook. We forecast long-term trend growth of 2.0%, which is slightly above the developed states aggregate of 1.9%. A revival of export growth and sustained private sector demand will be the key to lifting headline real GDP expansion in excess of the Western European average. The country's high degree of economic integration with the global marketplace – through the EU and rapidly growing emerging market trade links – will be the key underlying factor driving economic expansion over the long term. Additionally, the surge in immigration in 2014-16 will pay a demographic dividend, offsetting the ageing of the native-born workforce and helping to grow the population by as much as 10% to 2020.

Following the country's deep recession and financial crisis in the early 1990s, the government has continuously pushed forward on a structural economic reform agenda which includes the lifting of labour market restrictions, the privatisation of large parts of the corporate sector, tax rate reductions and new incentives to bolster foreign investment. While there are risks to further progress depending on the degree to which the centre-left government elected in September 2014 is able to implement expansionary fiscal policy and raise taxes before the 2018 elections, the business environment has changed for the better over the past decade.

On the back of this agenda, Sweden will very likely integrate further with the global economy, acting as a significant destination for foreign investment as well as a major exporting nation. In the decade to 2016, Sweden attracted a cumulative USD100bn in gross foreign direct investment, roughly equivalent to 13% of GDP. This, in turn, has been a key factor driving capital investments, with gross fixed capital formation (GFCF) increasing by 22% in real terms over the same period. Over the long term, we expect the proportion

TABLE: LONG-TERM MACROECONOMIC FORECASTS

	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Nominal GDP, USDbn	534.2	537.8	752.0	796.3	841.4	878.6	913.7	950.3	988.3	1,027.9
Real GDP growth, % y-o-y	1.9	1.4	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Population, mn	10.04	10.10	10.16	10.22	10.28	10.33	10.38	10.44	10.49	10.54
GDP per capita, USD	53,222	53,246	74,009	77,919	81,885	85,042	87,988	91,050	94,233	97,544
Consumer price inflation, % y-o-y, ave	1.8	1.7	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Current account balance, % of GDP	3.9	3.9	3.8	3.8	3.8	3.7	3.7	3.7	3.7	3.7
Exchange rate SEK/USD, ave	9.34	9.57	7.13	6.99	6.88	6.85	6.85	6.85	6.85	6.85

f = Fitch Solutions forecast. Source: Statistics Sweden, Fitch Solutions

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of the total economy accounted for by GFCF to rise from 24% at end-2016 to around 26.0% at end-2028. Residential construction will play a key role as well, with homebuilding set to rise considerably between 2017 and 2020 as the country copes with a housing shortage. The trends in capital investments will depend heavily on expansion in the country's export sector, which has long been a core anchor of the Swedish economy. Leveraging strong growth in large emerging markets, including those in Eastern Europe and Asia, and moving further away from sclerotic Western European demand, Sweden's goods and services account is forecast to remain in surplus through the forecast period.

The strength of Sweden's externally oriented industrial sector and resulting capital investments will in turn filter through to domestic consumption. Household consumption growth is forecast to average a healthy 2.3% in real terms over the long run. The Swedish government has traditionally played a relatively large role within the economy, though we maintain that a structural decline in public sector ownership and expenditures is under way. Government consumption accounted for 29% of GDP in 1993, but fell to 26% at end-2016. Notwithstanding a brief increase between 2015-18 due to the costs of accommodating new immigrant arrivals, our forecasts call for a further decline to around 24.2% by the end of our forecast period to 2028.

External/Fiscal Dynamics Bode Well For Stability

In addition to the reforms in economic policy, macroeconomic indicators suggest that Sweden is well positioned for long-term secular growth. Sweden maintains extremely stable external accounts, with a robust current account surplus and high net international investments. The country's gross external debt load, while spiking to 153.9% of GDP at the peak in 2009, has fallen markedly to an estimated 130.0% at end-2016. This is well within the stable parameters for a developed state.

Furthermore, continued public sector deleveraging over the long run will place Sweden within an enviable position, especially relative to the rest of developed Europe. Government debt is around 40% of GDP, and in spite of a short-term uptick amid a surge in temporary spending on accommodating migrants, will fall further over the long run. This will add to the country's external account stability, while also providing the state with significant ammunition to iron out cyclical downturns in the decade to come.

Risks To Outlook: Major Threats Are Exogenous

While the underlying macroeconomic story in Sweden is positive, we stress that the external climate remains highly uncertain through the long term. With Sweden's high trade and investment exposure to the global market, the country will remain vulnerable in the event of sudden downturns – as was seen in 2009 when real GDP contracted by 5.2%. While we stand by our strategic view for long-run emerging market convergence, we continue to stress that the trajectory is unlikely to come in the form of a straight line. Risks from over-leverage in China and an unsustainable capital investment boom are particularly worrying at this stage, as is Russia's over-reliance on the oil and gas sector, particularly in the context of lower long-term oil prices. In the event of any major global downturn in growth, while Sweden is sufficiently protected to avoid crisis, it will certainly be vulnerable to a commensurately rapid decline in growth.

Our long-term macroeconomic forecasts are based on a variety of quantitative and qualitative factors. Our 10-year forecasts assume in most cases that growth eventually converges to a long-term trend, with economic potential being determined by factors such as capital investment, demographics and productivity growth. Because quantitative frameworks often fail to capture key dynamics behind long-term growth determinants, our forecasts also reflect analysts' in-depth knowledge of subjective factors such as institutional strength and political stability. We assess trends in the composition of the economy on a GDP by expenditure basis in order to determine the degree to which private and government consumption, fixed investment and the export sector will drive growth in the future. Taken together, these factors feed into our projections for exchange rates, external account balances and interest rates.

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Political Outlook

Domestic Politics

Confidence And Supply Agreement In Sweden To Remain Stable

Key View

- At Fitch Solutions, we believe that the results from the May 2019 European Parliament elections suggest that the confidence and supply agreement governing Sweden will remain in place over the coming quarters.
- The centre-right Liberal and Centre parties conserved their combined number of seats, suggesting that they aren't being punished by voters for supporting the centre-left government led by the Social Democrats.
- Domestic polls also confirm this view, with both parties broadly maintaining their level of support since the September 2018 general election.

We at Fitch Solutions believe that the results from the 2019 European Parliament elections suggest that the confidence and supply agreement governing Sweden will remain in place in the coming quarters. More than four months following the September 2018

TABLE: POLITICAL OVERVIEW

System of Government	Constitutional monarchy, representative parliamentary democracy, Universal Suffrage, unicameral legislature: 349-seat Riksdag (four-year term). Executive Power is held by the Prime Minister
Head of State	King Carl XVI Gustaf
Head of Government	Prime Minister Stefan Löfven
Last Election	Parliamentary – September 9 2018
Composition Of Current Government	Minority coalition led by the Social Democratic Party, with junior coalition partner the Green Party.
Key Figures	Deputy Prime Minister – Isabella Lövin, Finance – Magdalena Andersson, Foreign Affairs – Margot Wallström, Governor of the Riksbank – Stefan Ingves
Main Political Parties (number of seats in parliament)	Social Democratic Party (100 seats): Centre-left, main government party led by Stefan Löfven.
	Green Party (16 seats): Left-wing party, with two spokespeople, Gustav Fridolin and Åsa Romson.
	Left Party (21 seats): Left-wing democratic socialist and feminist party. Led by Jonas Sjöstedt.
	Moderate Party (70 seats): Centre-right liberal party advocating a smaller government and lower taxes. Is the senior party within the Alliance coalition alongside the Centre, Liberal and Christian Democratic parties. Led by Ulf Kristersson.
	Centre Party (31 seats): Social liberal centrist party with agrarian and environmental roots. Led by Annie Loof.
	Liberals (20 seats): Social liberal party advocating market-based welfare programmes. Led by Jan Bjorklund.
	Christian Democrats (22 seats): Centre-right party with a religious base. Led by Ebba Busch Thor.
	Sweden Democrats (68 seats): Far-right, socially conservative, nationalist party. Led by Jimmie Akesson.
Extra-Parliamentary Opposition?	None
Next Election	Parliamentary – September 2022
Ongoing Disputes	
	None
Key Relations/ Treaties	Historically neutral state though a member of the European Union.
Short-Term Political Risk Index	86.5
Structural Political Risk Index	93.7

Source: Fitch Solutions

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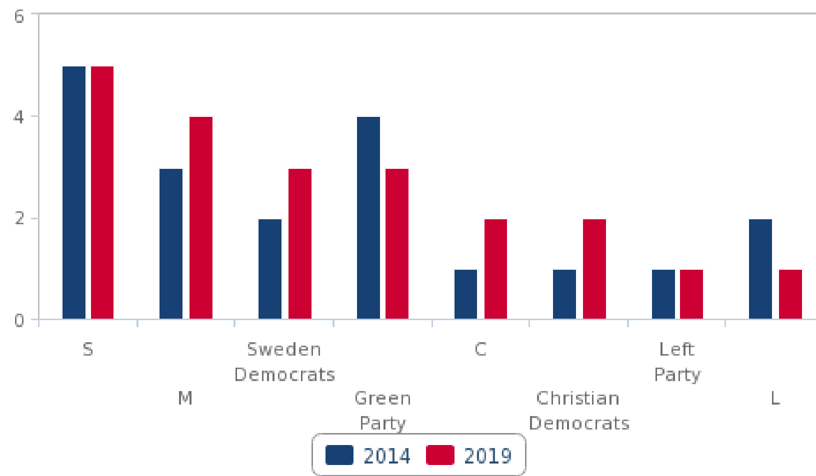
general election, the centre-right Liberal Party (L) and Centre Party (C) agreed to support a new government composed of the Social Democrats (S) and the Greens (MP). The C and L gave their support to the two-party coalition in exchange for important concessions to the right, namely labour market reforms and tax cuts, which allowed the new government to pass the 2019 spring budget.

Centre-Right Parties Conserve Aggregate Number Of Seats

Number Of Seats By Party, European Parliament

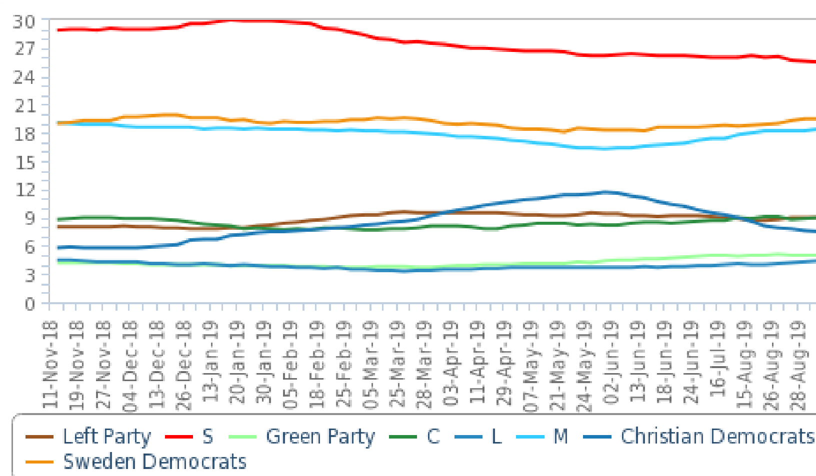


Source: European Parliament, Fitch Solutions

Given the ideological differences between the parties in government and the parties supporting the government, new elections before the end of the current term has always remained a realistic possibility. This possibility would become more likely if centre-voters were to punish L and C for their support to a centre-left-government. However, L and C conserved their combined number of seats in the European Parliament following the May election, suggesting that support remains stable. While L lost one of its seats, this was compensated by the fact that C gained one additional seat.

Centre-Right Parties Hold Their Ground In National Polls

Polls For 2022 General Election, %



Source: National Polling Agencies, Fitch Solutions

Domestic polling numbers seem to confirm that support for L and C remains stable, underpinning our view that the Swedish government will remain in power in the coming quarters. The L is currently polling at around 4.6% of the votes, slightly below the 5.5%

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of votes it received in the 2018 general election. The Centre Party is polling at 8.4%, just below the 8.6% it received in the general election. In addition, C and L do not seem to be losing ground to parties sharing some of their traditional electorate, with the liberal-conservative Moderate Party (M) losing some support over the same period. Stability in the confidence and supply agreement will allow the government to pass the 2020 budget, ensuring that fiscal policy in Sweden remains supportive of economic growth. As we have noted, the Swedish Minister for Finance Magdalena Anderson signalled the intention to increase spending in welfare and infrastructure in the coming quarters. Increased government spending will be central to partially offset the deceleration in exports we forecast, and to support the Swedish economy amid a protracted slowdown in global economic conditions.

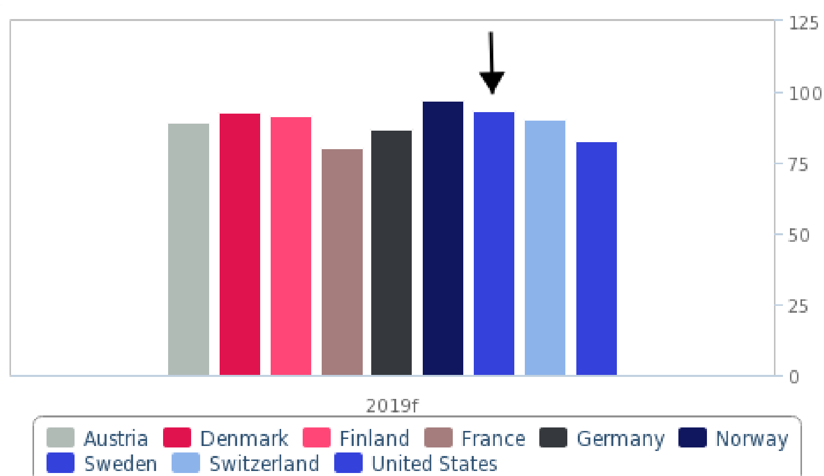
Long-Term Political Outlook

Strong Institutions Underpin Long Term Political Stability

Key View

- With the second highest political risk score out of 34 countries in the region, Sweden is among the most structurally stable countries in the world.
- Benefiting from an advanced level of institutional development, a long history of democratic governance and an established foreign policy based on neutrality, the country faces limited underlying risks to political stability over the long term.
- However, the rise of a populist anti-immigration movement amid a quickly growing foreign-born population poses risks to both governance and Swedish civil society.

Sweden Among The Most Stable
Long-Term Political Risk Index



Note: Scores out of 100; higher score = lower risk; f = forecast. Source: Fitch Solutions

Sweden is among the most politically stable countries in the world, with the risk of a structural shift within our 10-year forecast period extremely limited. Our core view is for the country's political system to remain broadly unchanged over the long term. While

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there are some risks to political dynamics as a result of the unexpected surge in immigration in 2014-16, the country has strong institutions, and benefits from a wide range of factors supporting underlying stability.

First, an advanced level of institutional development, reflected by the country's extremely low rate of corruption and a well-developed civil society, provides Sweden with a robust administrative capacity to manage socio-economic challenges. The extremely low level of government debt (around 40% of GDP) provides further resources to the government, ensuring that Sweden will be able to maintain countercyclical fiscal policies in the event of a downturn.

Second, Sweden has an extremely well-established liberal democracy, supported by historical conventions and norms that have ensured peaceful transitions of authority for more than a century. The political system has proven adept at providing the necessary flexibility and policy initiative during times of recession as well as adapting to change.

Third, membership of the EU and the resulting political and economic integration with the wider European continent provides Sweden with an established multilateral policy anchor and encourages positive foreign relations. This is backed by the country's long-standing political neutrality, which has ensured its ability to avoid foreign conflict since 1814 (one of the longest-standing periods of peace for any country in the world). While EU membership may be put under scrutiny in the next few years, particularly in light of the United Kingdom's vote to exit the union, our base case is that Sweden will remain a member.

Fourth, social factors in Sweden are among the most conducive globally to stability. The country maintains a broadly homogenous ethnic make-up (though this is shifting alongside immigration inflows), extremely low income inequality, a supportive social welfare system with relatively low unemployment by European standards, and an extremely low poverty rate. Furthermore, social harmony is actively encouraged by the government via established systems of wage negotiations between management and labour within large corporations.

There have been schisms, however, with riots in Stockholm and elsewhere in recent years brewing unrest among disaffected and unemployed/underemployed young immigrants in Sweden, raising questions about their degree of integration in Swedish civil society. The country has one of the poorest records in the OECD of integrating foreign-born workers into the labour force, and while the government is putting work-related training of immigrants at the top of its agenda, this is a slow process, and the 'employment gap' with their native-born counterparts is likely to persist.

Long-Term Political Risk Score: Among The Highest In The World

The aforementioned structural conditions in Sweden have translated into an extremely high long-term political risk score. This ranks Sweden third in the world, after only Switzerland and Norway, and reflects our outlook for very low risk of a major policy change or structural shift in the system of government over the long term. The country scores highly across all major sub-components of our risk index – doing particularly well in 'characteristics of polity' (99.7 out of 100), 'characteristics of society' (92.5 out of 100), with the 'scope of state' and 'policy continuity' sub-scores also elevated (both are 90.0 out of 100). Sweden also has a high short-term political risk score which is also among the highest globally.

Economic Liberalisation To Continue Over Long Term

While Sweden is expected to remain an extremely stable country, this is not to say the political environment will be stagnant. One of our core long-term views is that Sweden will continue its broad agenda towards economic liberalisation, which will include tax reductions, proactive encouragement of foreign investment, privatisations and greater flexibility in the labour market. This

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process was put into doubt by the election in 2014 of a government headed by the Social Democratic Party, which has pledged to push back against the previous centre-right government's privatisation drive, raise taxes, and increase the scope of the welfare state. The current government has one of the weakest mandates in recent Swedish political history, holding just 138 out of 349 seats in the Riksdag (well shy of the 175 required for a majority), and it only barely survived a budget vote defeat in December 2014 and a data security scandal in July 2017. As such, we believe that its scope for widening the role of the state in the economy is relatively limited.

From an even longer-term standpoint, the successive deterioration of the Social Democrats' support since the 1980s reinforces our view that there is a broader shift in public opinion towards a greater liberalisation of economic policy and reduction of government within the economy. This is not to suggest a wholesale dismantling of the Swedish social welfare system is on the cards, but rather that the private sector is likely to incrementally increase its role.

Scenarios For Political Change

Beyond the aforementioned long-term shift in economic policy, which forms part of our core scenario for Sweden's outlook, we also highlight the following risk scenarios for political change.

Rise Of A Nationalist Movement: The 2014 elections saw the right-wing nationalist Sweden Democrats party win 49 seats in the Riksdag, as public discontent over issues pertaining to immigration contributed to the party's steady rise in the popular vote. While we maintain that the party's momentum is unlikely to translate into a shift in mainstream politics, we do highlight risks to this view. For now, the major parties have demonstrated significant cohesion in cutting out the Sweden Democrats from major policy debates (and the governing Social Democratic Party says that they will never work with the Sweden Democrats), but should the party continue gaining support over coming local and general elections, this could change. The Sweden Democrats have topped some opinion polls in 2015-17, as a surge in immigration pushed the country's social services to the brink, and the mainstream parties have faltered.

We believe that the hard right in Sweden will be unable to win an election outright, however. The most realistic danger to governance is that the Sweden Democrats continue to win a large chunk of Riksdag seats in future elections, limiting the ability of the traditional major parties to form viable governing coalitions, thus making policy formation more difficult. For instance, the Sweden Democrats' intransigence in the budget approval process in December 2014 nearly led to the first snap election in Sweden in over a half-century, but this was averted only with the agreement of the other major parties to abstain from voting against the government's budget proposals until 2022.

Although this agreement was later annulled, it was reached with the clear intention of freezing out the Sweden Democrats from the policy-making process. Should the Sweden Democrats gain in popularity in future elections, keeping them excluded from governance may become increasingly untenable. In this regard, the centre-right opposition Moderate Party's approach to the Sweden Democrats to cooperate ahead of the 2018 elections was a landmark event that could alter the long-term Swedish political landscape.

Whither The Euro: We do not expect Sweden to abandon the krona and enter the eurozone within our 10-year forecast period to 2027, particularly given the recent questions being posed about the future of the euro altogether. However, there is a limited risk that the momentum could shift in favour of such a policy. This would especially be the case in the event that neighbouring Denmark moves to adopt the euro. Should a close neighbour that is highly socially and economically integrated move to use the euro, this

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would add pressure for Sweden to do the same. Entry into the eurozone, while not fundamentally altering Sweden's political profile, would create the single most significant economic transition for the country since entry into the EU in 1995.

The opposite case is also in play. The UK's exit from the EU could leave Sweden isolated as the largest non-eurozone member within the Union. As the EU becomes more eurozone-centric following the UK's departure, there could be rising pressure for Sweden to adopt the euro. Given a choice between joining the euro and committing to a different relationship, Swedish voters are likely to prefer the latter. Though not our core view, this could bring 'Swexit' into play as a palatable and realistic option for Sweden.

Rising Geopolitical Tensions In Northern Europe: Finally, the Russo-Ukrainian conflict has led to a major cooling in relations between Russia and the West, which we expect will last at least several years. As a neutral country, Sweden has sought to avoid getting caught up in Russia-NATO tensions. However, with Russia stepping up military activity in northern Europe and the Baltic Sea region, some Swedish officials are suggesting that Stockholm abandon its neutrality and join NATO. Although public support for NATO membership is still a minority, we caution that any attempts by Sweden to join the alliance could severely strain relations with Russia, and potentially necessitate higher defence spending by the Kingdom.

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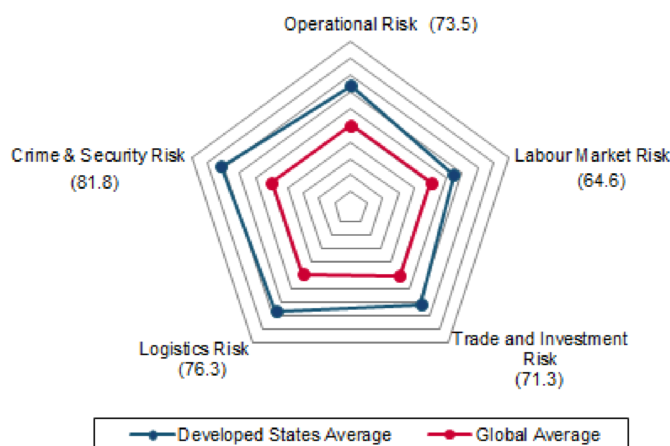
Operational Risk

Developed States

Our Operational Risk report series provides a comprehensive overview of potential risks facing investors operating in a country, as well as a cross-country regional evaluation of threats and advantages. The Operational Risk service evaluates Logistics Risk, Trade And Investment Risk, Labour Market Risk and Crime And Security Risk. Below are sections from these reports.

Businesses in developed states benefit strongly from the availability of reliable, high-quality utilities and transport infrastructure, generally open and more predictable trade and investment policies, deep and sophisticated capital markets and highly skilled workforces. This gives them a distinct advantage over those operating in emerging and frontier markets, particularly in the areas of logistics and trade and investment risks. Additionally, while developed states are at the forefront of surging populism, crime and security risks, especially instances of violent social protest and political change that would endanger business activities, are lower mainly because of their mature democracies and more civilised societies compared to those of emerging markets. Nevertheless, ageing populations underpinned by stagnating fertility rates and upward wage pressure across all sectors are key long-term risks for labour-intensive businesses in developed states. Furthermore, the strong competition in largely saturated developed markets necessitates considerable investment in technological upgrades, cybersecurity and skills development, which raises costs for businesses. Finally, the US's assertive foreign policy under President Trump seeking to put US interests first has significantly contributed towards increasing global tensions, particularly with Iran, China, Venezuela and North Korea. This is elevating business exposure to various forms of interstate conflict risks, such as cyberwarfare, trade protectionism and military confrontations, denting broad-based trade and investment opportunities, particularly in sectors such as manufacturing and ICT.

Superior Security And Logistical Scores Boost Operating Environments
Developed States – Operational Risk Scores



Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Operational Risk Index

Labour Market Risk

Weak demographic trends in developed markets, underscored by low birth rates and ageing populations, will significantly tighten recruitment options for firms and potentially drive up labour costs over the medium term, particularly for manufacturers that generally

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require a steady and large supply of workers. In addition, stringent regulations regarding the protection of workers' rights, onerous social security contributions and tax obligations as well as hefty severance pay requirements drive up labour costs for businesses operating in developed states. For most developed states, the Labour Cost component is their worst performing component in the Labour Market Risk Index, with Italy being the least competitive in this regard with a score of 25.5 out of 100. This is largely due to having one of the highest minimum wages (USD1,898.4), generous labour tax contributions (34.8% of commercial profits) and annual paid leave of 26 days.

Finland, Belgium, France and Portugal are other worst performing markets while the US has the highest (most competitive) score with regard to labour costs among all the developed states. While businesses face high remuneration costs for labour, they are compensated for this by the availability of highly skilled workers due to the strong educational systems and attainment levels across developed markets. This together with strong investment in research and development boost worker productivity and give businesses access to advanced and highly efficient production systems.

TABLE: LABOUR MARKET RISK INDEX

Country	Education	Availability Of Labour	Labour Costs	Labour Market Risk
US	91.5	71.3	81.0	81.3
Switzerland	82.3	68.0	74.8	75.0
Denmark	83.3	63.0	78.0	74.8
Canada	89.4	70.0	63.7	74.3
New Zealand	78.9	71.0	71.2	73.7
Japan	86.6	63.4	67.3	72.4
UK	86.5	70.4	57.4	71.4
Israel	83.8	72.9	57.4	71.4
Isle of Man	82.5	54.6	70.2	69.1
Australia	87.5	73.1	42.8	67.8
Sweden	85.5	70.4	47.3	67.7
Ireland	80.7	63.9	55.7	66.8
Netherlands	82.4	68.9	46.5	65.9
Germany	89.5	68.0	39.0	65.5
Norway	82.2	68.8	40.9	64.0
Estonia	79.0	57.6	51.9	62.9
Austria	82.9	61.2	38.2	60.8
Latvia	77.9	51.3	52.9	60.7
Iceland	70.2	68.4	43.3	60.6
Lithuania	79.8	49.6	51.4	60.2
France	81.2	67.7	31.3	60.1
Liechtenstein	62.2	58.3	59.1	59.8
Spain	77.9	63.3	37.1	59.4
Belgium	78.7	64.8	31.2	58.2
Finland	76.0	61.4	30.0	55.8
Malta	55.1	52.7	56.8	54.9
Italy	76.9	61.2	25.5	54.5
Luxembourg	62.8	57.7	42.1	54.2
Greece	71.6	52.2	38.7	54.2
Portugal	67.7	53.8	33.6	51.7

Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Labour Market Risk Index

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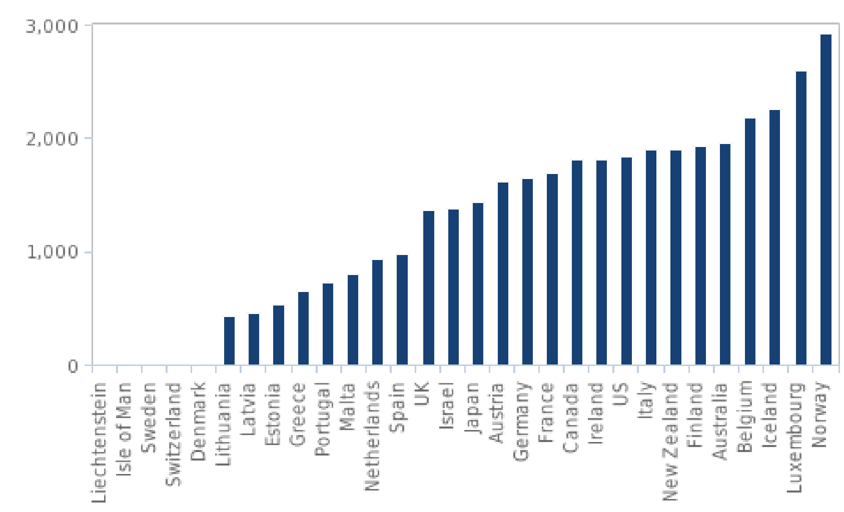
According to the World Bank, the average labour tax and contributions in developed states was equal to 21.1% of commercial profits in 2018 (latest available data). This is substantially higher than the global average labour taxation and contributions rate of 15.1% of commercial profits and therefore poses significant cost risks to businesses considering entering these countries. In particular, we highlight France and Belgium as having the highest labour taxation and contributions rates of 49.7% and 46.2% respectively. Therefore, these countries expose businesses to the most significant risks in this regard. Spain, Sweden, Italy and Austria all have labour tax rates above 33% of total profits. In some of these countries, such as Belgium, Italy, Sweden and Austria, the high taxation rate is partly mitigated by the lack of legally required severance pay for redundancy dismissals. In Spain, however, high labour taxes are further accompanied by exorbitant severance pay requirements of 15.2 salary weeks in case of redundancy dismissal, which is far above the regional average of 5.1 salary weeks.

High Minimum Wages Partially Compensated For By Strong Productivity Levels

Developed States – Minimum Wages (USD/month), 2018



Note: As applicable to the worker assumed in the case study. Source: World Bank 'Doing Business'

Certain developed states, however, have extremely competitive labour tax rates, offering advantages to those businesses keen to establish themselves in a developed state with the benefits of good physical infrastructure, a well-educated labour force and a well-developed bureaucratic environment. These lower-risk countries include the UK and the US, with labour tax rates of 10.8% and 9.8% respectively, as well as New Zealand at only 2.8%, which is one of the lowest labour tax rates in our Operational Risk Index among those countries that have labour tax and contributions in terms of statutes. In addition to low labour tax rates, businesses looking to enter these three markets will further benefit from low or a lack of severance pay requirements, with only the UK requiring mandatory severance pay (at 4.0 salary weeks).

Additional costs to employers stem from the relatively high minimum wages seen in developed states. At USD1,260.0 per month on average, minimum wages in developed states are substantially higher than the majority of emerging markets and significantly higher than the global average of USD377.2 per month in 2018. This is largely due to the more established legislation protecting the workforce and the stronger unionisation seen in many of these countries. The highest minimum monthly wages are found in Norway, at USD2,923.3 per month and Luxembourg, at USD2,603.0 per month. In contrast, for those states in the region that have legislated minimum wages, Lithuania, Latvia, Estonia and Greece have some of the lower monthly minimum wage requirements at USD424.8, USD461.3, USD530.7 and USD652.5 respectively. However, even in these latter markets actual wages are highly likely to

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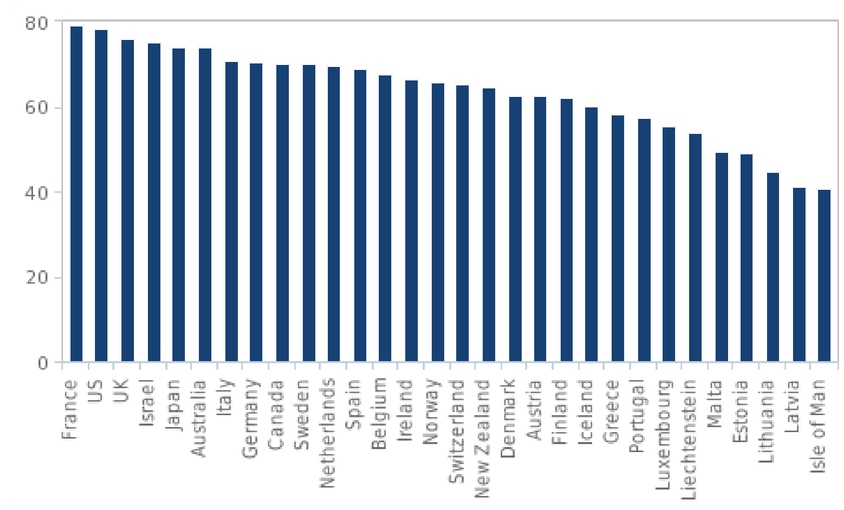
be well above the minimum wage due to the high competition for labour and the fact that workers in developed states have good educational attainment levels that will push wages higher.

Ample Recruitment Options In Developed Markets

Developed States – Size Of Labour Force



Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Labour Market Risk Index

Five countries (Denmark, Switzerland, Liechtenstein, the Isle of Man and Sweden) have no legislated minimum wage, offering a substantial reduction in labour costs for incoming businesses. Nevertheless, we note that average wages in these countries remain among the highest globally and most businesses will face elevated wage bills even when employing relatively low-skilled workers. Furthermore, due to tightening demographic trends, underscored by ageing populations, particularly in countries such as Italy (among others in Western Europe) and Japan, wages relative to productivity may become increasingly uncompetitive while recruitment options are likely to tighten as the relative proportion of working-age population to total population in developed states decline over the medium-to-long term.

Although wages are generally high in developed states, the redundancy requirements for the majority of these countries are relatively low, or even non-existent. Half of the countries included in the developed states rankings have no legal requirement for severance pay, including the US, Norway, Finland, Denmark, Japan, the Netherlands, Malta and New Zealand. However, on the other end of the spectrum, Spain (with requirements of 15.2 weeks of severance pay for redundancy dismissal), Greece, Israel and Germany pose significant cost risks, as businesses are obligated to provide more than 15.9 weeks, 23.1 weeks and 11.6 weeks of severance pay to dismissed workers respectively.

Other key operational considerations that businesses must take into account include labour market vectors such as the size, composition and skill set of the workforces in developed states (however, these are comparatively minimal compared with less developed peers). This is largely due to the fact that developed states have good urbanisation levels (Belgium, Malta, Iceland, Israel, Netherlands, Luxembourg and Japan have urbanisation rates of above 90%), which reduces the risk of additional costs or delays for businesses reliant on workers travelling large distances. In addition, it increases the ease of employment if large pools of skilled and unskilled labour are easily available in centralised locations. We note that the average urbanisation rate in developed states stands at 77.3%, far above the global average of 57.6%. The lowest levels of urbanisation are found in Liechtenstein (at 14.3%, though we highlight the small size of the country in terms of both land mass and population size), Isle of Man (52.5%), Austria (58.1%) and Ireland (63.0%).

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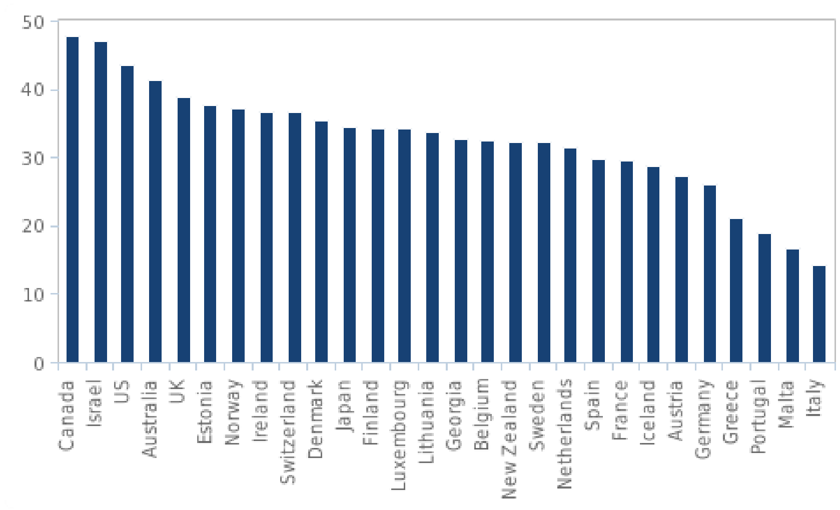
Developed states offer highly skilled labour on the back of well-established education systems. This is reflected in the high primary school enrolment rates found in these countries. The predominantly high quality of primary education systems and compulsory school attendance (with an average mean of more than 11.2 years of schooling) has resulted in large, well-educated workforces – the majority of whom are literate and numerate. The high levels of basic skills are accompanied by large shares of the labour force with tertiary education; the regional average here stands at 32.6%, which compares favourably with the global average of 19.0%. We highlight Canada, Israel, Australia and the US in particular, where the proportion of degree holders stands at more than 41.0% of the population, indicating especially high levels of qualifications among the labour force in these countries that benefit employers seeking highly skilled employees such as in the ICT, manufacturing, services and power sectors. The US is a significant bright spot in terms of tertiary educational attainment levels, producing almost 4mn tertiary level graduates annually.

High Levels Of Educational Attainment Boost Productivity

Developed States – Labour Force With Tertiary Education, %



Source: World Bank, Fitch Solutions

Developed states also offer very high life expectancy, at an estimated 81.7 years on average, due to the well-developed healthcare systems that help to boost worker productivity. The well-being of the labour forces in these countries is further highlighted by the high level of healthcare expenditure per capita, which stands at around USD4,389.9 on average in the region – which is around four times higher the global average of USD1,087.1 per capita. Countries that spend over USD5,000 on healthcare include the US (with the highest at USD10,630.6 per capita), Switzerland, Norway, Luxembourg, Denmark, Australia, Austria and Iceland. Australia is among the countries with the highest life expectancy (83.4 years), ranking fifth in the region, marginally behind Japan (84.2 years), Italy (83.5 years), Switzerland (83.8 years), Spain (83.6 years) and Iceland (83.2 years). We note that Australian businesses further benefit from good urbanisation and employment rates as well as very good education systems, resulting in a large, skilled labour pool. Consequently, Australia is an outperformer with regard to Availability Of Labour in our Labour Market Risk Index, with a score of 73.1 out of 100, ranking slightly above Israel, the US, Canada and New Zealand.

Nonetheless, over the medium-to-long term, overall labour risks remain skewed to the downside in many developed states. In particular, we highlight that many of these countries continue to have limited female labour participation rates (the majority resting around the mid-50% range), representing a large untapped pool of workers. In addition, the percentage of the working-age population in employment also remains somewhat subdued, with only 10 out of 30 developed states having over 60% for this indicator. In descending order these states are Iceland, Liechtenstein, New Zealand, Switzerland, Israel, Norway, Canada, Australia, Netherlands and Sweden. Meanwhile, Greece, Italy, Spain, Belgium and France are all regional underperformers, with below 51%

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of their working-age populations in employment. Greece, Italy, Spain and Belgium are the worst performers here, with just 41.5%, 43.3% and 49.1% and 49.6% of the working-age population in formal employment respectively. Moreover, many of the countries still suffer from historically poor healthcare and education, resulting in a poorly educated workforce in the 50+ age bracket, many with health conditions resulting in high levels of absenteeism and lost productivity.

Furthermore, labour market performance in various developed states is being increasingly challenged by demographic shifts. In particular, ageing populations and low birth rates compounded by low labour force participation rates will have negative ramifications on productivity in the medium-to-long term. For example, the labour markets in Italy, Portugal and Greece are at comparatively high risk, due to factors such as an extremely low level of the working-age population in employment and low female labour force participation rates and growing population clusters of people over 65 years. In Greece, the population group of over 65 years constitutes 20.6% of the total population in 2018, while the proportions of this age group in Italy, Portugal and Japan stand at 23.3%, 21.9% and 27.5% respectively (against a global average of 8.9%).

Meanwhile, over the next decade (barring significant shifts in global migration), many developed states will struggle to replenish their working-age populations given the fact that in 2018 those aged between 0-15 years constituted around 15% or less of the population, particularly in Japan (13.7%), Greece (15.1%), Italy (14.4%) and Portugal (also 14.4%). These concerning demographic trends have direct structural implications for labour markets through three primary channels: labour supply, labour productivity and labour demand (largely due to shifts in the structure of aggregate demand).

We see the education systems in developed states as offering the fewest risks and the best advantages to businesses with regard to Labour Market Risk. This is due to the fact that the quality of the education received is extremely good, as is the education infrastructure, due to substantial government spending on the sector and technological advances. Developed states on average allocate 12.8% of total government spending on education. In addition, the majority of the countries covered here have high attendance levels at both secondary and tertiary levels, good female participation levels and large numbers of graduates in key science, mathematics, engineering and manufacturing subjects, offering a large pool of highly trained skilled labour. France, Japan, the UK and the US have some of the best education systems among the developed states based on our metrics, with high education spending levels, very strong secondary and tertiary enrolment levels and some of the largest numbers of science and engineering graduates in the countries covered in our Operational Risk Index.

Logistics Risk

The superior availability of basic utilities, more sophisticated transport infrastructure and smoother customs and border compliance procedures in developed states over their emerging market peers are reflected in their far better scores for the Logistics Risk Pillar of our Operational Risk Index. The developed states regional average score for this pillar stands at 76.3 out of 100, compared to the global average score of 49.0 out of 100.

The top five scoring developed states for Logistics Risk include the Netherlands, Denmark, Sweden, Finland and France. The five regional underperformers for this pillar include Greece, Australia, Liechtenstein, Malta and the Isle of Man (*see Logistics table*).

Greece's weakest point is its score for the Utilities Network segment. Greece's electricity and fuel costs are higher than the developed states averages for these. Greece also loses an estimated 8.24% of national power generated in the transmission and distribution phases, indicating weaknesses in the national grid infrastructure, as this is the fifth highest percentage loss rate during these phases out of the 25 developed states for which data is available for this indicator.

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Australia's weakest point is also its utilities network, where the country's reliance on crude and refined fuel imports have caused some concerns, as well as its water availability. Australia's net crude imports stood at an estimated 150,300 barrels per day in 2018, with our Oil & Gas team forecasting that its dependence on crude oil imports will deepen over the coming years. This will be due to continued output declines largely from mature offshore fields. In April and May 2018, local media outlets in Australia reported concerns of nationwide fuel shortages occurring due to shortages of supply with US airstrikes in Syria. It was reported that Australia only had around 43 days' worth of fuel supply at this time. While nationwide fuel shortages did not come to pass in Australia, we emphasise that the country is the largest refined fuel net importer out of all the developed states.

Additionally, while the country has water infrastructure of excellent quality and high levels of water availability (an estimated 20,971 cu m per capita), its agricultural sector remains highly water intensive (accounting for around 60% of total water withdrawals). This makes Australia's agricultural output highly vulnerable to droughts. In October 2018 parts of New South Wales is Australia had been declared '100% in drought', as rainfall levels over the course of 2018 in this region of Australia have been declared as the lowest seen for an extended period. Consequently, in December 2018 Australia lowered its wheat production forecast by 11% (the lowest forecast in around a decade). In response to these risks, we note that Australia is a major market for the construction of desalination facilities, currently having the seventh largest capacity globally.

TABLE: LOGISTICS RISK INDEX

Country	Utilities Network	Transport Network	Trade Procedures And Governance	Logistics Risk
Netherlands	70.7	96.9	98.3	88.6
Denmark	78.0	91.8	95.0	88.3
Sweden	78.0	88.4	96.2	87.5
Finland	78.0	84.9	87.2	83.4
France	64.9	91.3	93.4	83.2
Belgium	62.8	90.8	96.0	83.2
US	67.5	92.5	88.7	82.9
Germany	61.3	93.2	89.2	81.2
Spain	59.6	91.9	91.2	80.9
Portugal	65.9	87.4	89.4	80.9
Norway	80.4	76.2	85.7	80.8
Austria	71.2	75.0	95.3	80.5
Luxembourg	64.6	78.1	97.4	80.0
UK	56.0	90.8	88.7	78.5
Japan	61.9	91.9	79.8	77.9
Canada	62.1	83.4	84.6	76.7
Italy	58.4	79.8	90.3	76.2
Switzerland	58.0	81.3	86.1	75.1
New Zealand	58.9	82.3	75.2	72.1
Ireland	56.0	82.2	77.8	72.0
Israel	57.7	83.2	72.5	71.1
Iceland	76.9	67.7	64.2	69.6
Greece	56.2	76.7	73.7	68.9
Australia	61.6	76.0	67.4	68.3
Liechtenstein	54.2	66.0	64.4	61.5
Malta	42.7	71.0	68.7	60.8
Isle of Man	38.9	54.6	54.3	49.3

Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Logistics Risk Index

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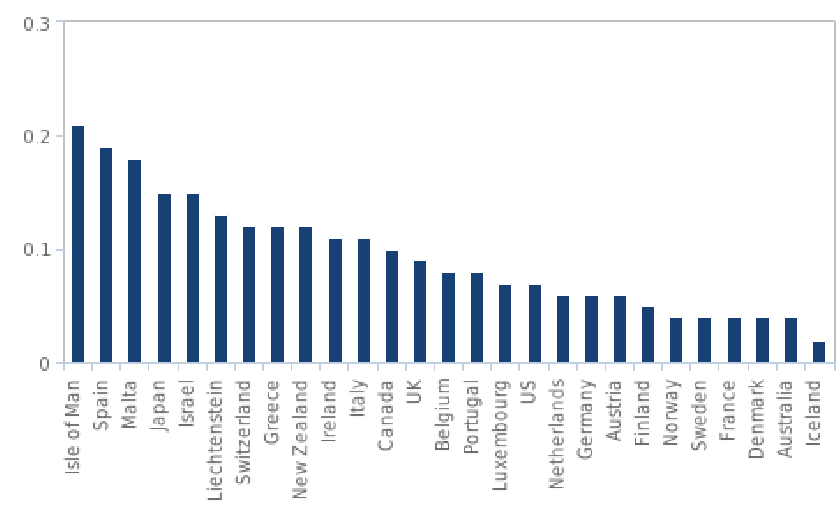
The third lowest scoring developed state for Logistics Risk is Liechtenstein. Liechtenstein's most salient area of weakness is its utilities network, with its comparatively higher utility costs weighing down its score. For example, in terms of the average electricity costs in the country these come in at around USD0.13/KWh, which is the sixth highest electricity cost out of the 27 developed states. Furthermore, fuel costs in Liechtenstein average at around USD1.59 per diesel litre. This stands just above the developed states regional average fuel cost of USD1.57 per diesel litre.

Malta ranks second from last in terms of its logistics environment out of the 27 developed states. Its weakest point is its utilities network, with the reliability of the electricity, fuel and water supplies being the most pertinent concerns. Malta's electricity supply is not perceived as being highly stable, given that several major electricity outages have been reported as occurring on the island over the course of 2018. Most of these electricity outages lasted several hours and were caused by technical difficulties, storms and problems with the grid-interconnector from Cyprus. The country is also a refined fuel net importer, which increases its vulnerability to fuel shortages caused by supply chain delays. From a water availability perspective, Malta is one of the only two developed states (along with Israel), within which its natural, renewable water resources available per capita are exceeded by its water consumption levels per capita. The European Environmental Agency (the EU's environmental wing), noted in a report dated December 2018 that ground water levels in Malta are drying up at a rapid rate. The World Research Institute has also noted that Malta is one of the most water-stressed countries in the world, and is increasingly relying energy-intensive desalination methods to meet the local population's water consumption demands.

The Isle of Man is the lowest ranking developed state in terms of its logistics environment. This is largely because its utilities network is the lowest scoring out of the 27 developed states. Utility costs are the Isle of Man's particular weak point, as demonstrated by the fact that at USD0.21/KWh, the island has the highest electricity costs out of all the developed states. The Isle of Man also scores well below the regional average scores for the Transport Network and Trade Procedures And Governance segments.

High Tariffs Add To Operating Costs

Developed States – Electricity Costs, USD per KWh



Source: National sources, Fitch Solutions

Although the supply of electricity is reliable and readily available in the majority of these countries, costs are on average much higher than in emerging markets and developed states have some of the highest electricity costs globally. This is due to the fact that many developed countries, such as Germany and Japan, are engaged in expanding their renewable electricity generation capacity. This is a costly and protracted process and the outlays made by utilities to implement renewable developments are being passed onto

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the customers in many cases. In addition, a number of countries import thermal fuels from abroad, further driving up costs and undermining the reliability of the supply. For example, Western European countries are reliant on Russian gas and to a lesser extent US coal, while Japan imports a great deal of costly liquefied natural gas following the closure of its nuclear facilities.

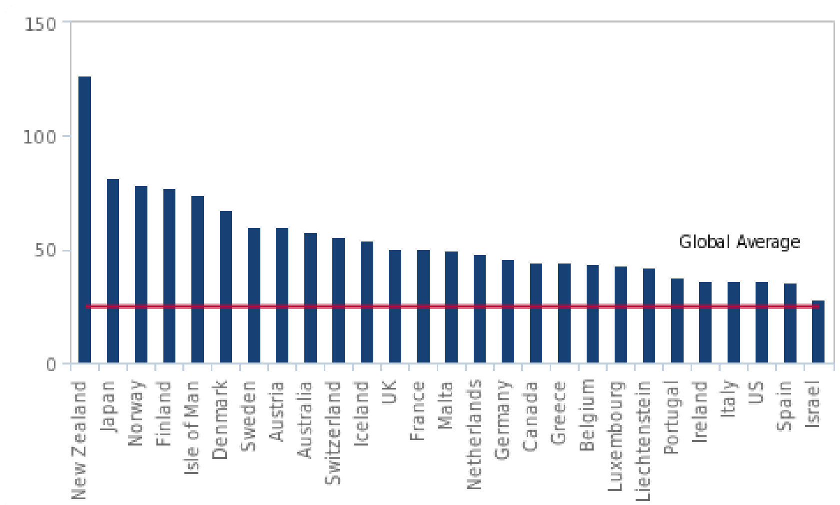
The cost of fuel is also extremely high in many of these countries due to a combination of high taxation on the end user via various means and the high import requirement. The average price of fuel in developed states is USD1.57 per diesel litre, and prices in a number of countries are substantially higher than that. In particular, businesses reliant on road-based supply chains face substantial cost risks in countries including Norway, the UK, Sweden and Iceland.

However, it is worth highlighting that although utilities costs remain a substantial burden in many countries, most developed states benefit from increased reliability of supply and do not face the risk of major shortages or restrictions. In addition, some countries boast domestic natural resources which confer advantages in terms of lower costs. For example, in Australia and the US both fuel and electricity prices remain relatively low by global standards. Electricity costs currently stand at an estimated USD0.07/kWh in the US and USD0.04/kWh in Australia, while a litre of fuel costs around USD0.84 in the US and USD1.12 in Australia. In terms of electricity costs, we note that Iceland is the regional outperformer, with costs of only USD0.02/kWh, significantly below the regional average of USD0.09/kWh.

In terms of utilities risk, we note that businesses looking to enter developed states will benefit from high internet penetration rates and a generally high proportion of secure internet servers. In terms of broadband penetration rates, New Zealand is the regional outperformer in this regard, with over 100 broadband subscribers per 100 people, indicating a high level of internet connectivity. Conversely, the lowest penetration rates can be found in Israel, with just 27.9 broadband subscribers per 100 people.

Good High-Speed Internet Availability A Boon For Business Operation

Developed States – Broadband Subscribers (per 100 people)



Source: Fitch Solutions

Developed states also perform extremely well in terms of the number of secure internet servers, especially important for businesses reliant on cybersecurity. On average, developed states offer 1,729.2 secure servers per 1mn people. This is far above the global average of 361.4 servers per 1mn people. However, we note that a handful of countries sit below the global average. Businesses reliant on secure internet connections must be aware of increased risk of cybercrime in Greece (with only 146.5 servers per 1mn

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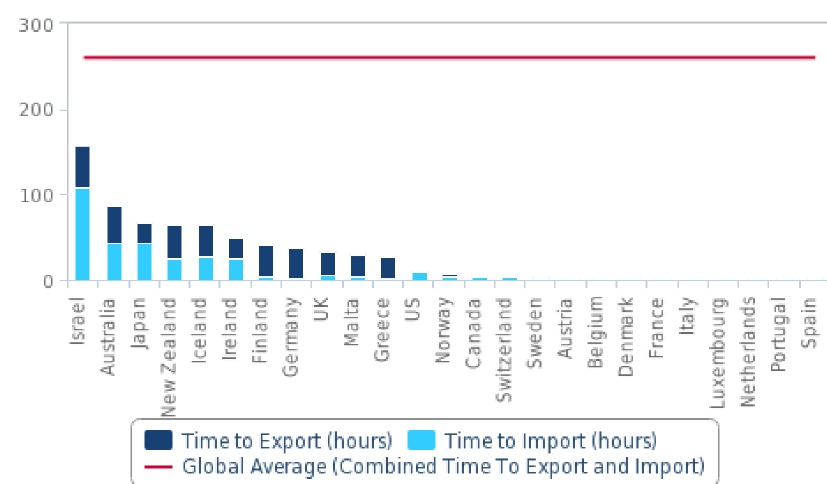
people), Italy (253.5), Israel (255.8) and Portugal (261.6). In contrast, Liechtenstein provides by far the most secure online environment, not only among the developed states but also on a global scale, with more than 9,837.8 servers per 1mn people, followed by Iceland and Switzerland.

Limited Trade Barriers Between Major Economies Ease Economic Activity

Developed States – Time To Export & Import (hours)

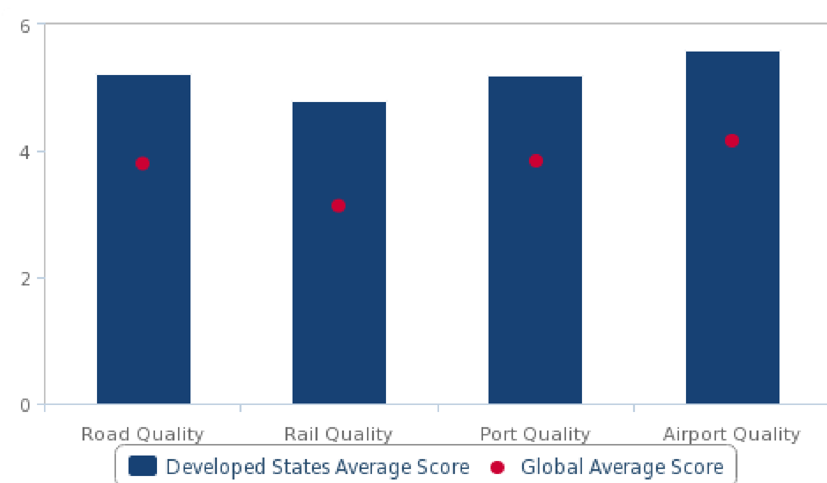


Source: World Bank 'Doing Business'

Trade procedures and governance risks are minimal for incoming businesses and investors. Advantages include the investor-friendly, trade-focused nature of the majority of the developed states, in conjunction with good connectivity and a large number of trade agreements.

Superior Quality Of Transport Infrastructure Eases Logistical Risks

Developed States & Global – Average Infrastructure Quality



Note: 7 = highest score, 1 = lowest score. Source: World Economic Forum's Global Competitiveness Index, 2018-2019

Most developed states boast wide-ranging free trade agreements with major trade partners, with those countries in the EU benefiting from particularly low trade barriers and negligible costs due to the absence of non-tariff barriers and free movement of goods. These factors contribute to the limited bureaucratic requirements for importing and exporting goods. This, in conjunction with the strong internal transport infrastructure seen in most of these countries, results in rapid turnaround times and shorter lead times for deliveries.

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As noted, the good connectivity seen in these countries is due to their well-developed transport networks. Good physical infrastructure is one of the main advantages that developed states offer, with more extensive, better quality and more efficient road and rail networks, and more numerous ports and airports, with higher capacities, than their emerging market peers.

In particular, we emphasise the strength of the developed Western European states, which offer particularly extensive domestic transportation options, accounting for 14 of the top 20 countries globally for road density and 16 of the top 20 for rail density. This is highlighted in our Operational Risk Index, where the nine highest-scoring countries for the Transport Network component are developed states, with scores above 80.0 out of 100.

Crime And Security Risk

The operating environments of developed states have a distinct advantage over those of their emerging market peers because of their high scores for the Crime and Security Risk pillar of our Operational Risk Index. Overall, businesses operating in developed states benefit from stable political and economic systems, higher average household incomes, strong armed forces, good bilateral relations and well-funded military and police forces, all of which serve to reduce risks of domestic social unrest and international conflicts.

TABLE: CRIME AND SECURITY RISK INDEX

Country	Conflict Risk	Crime Vulnerability	Business Crime	Crime And Security Risk
Norway	84.8	96.8	97.8	92.3
Switzerland	89.4	95.1	94.0	91.8
Finland	84.6	90.5	99.5	91.2
New Zealand	85.9	89.9	91.5	89.4
Luxembourg	83.4	93.0	95.8	88.9
Netherlands	86.0	93.6	81.5	88.4
Austria	83.4	94.8	87.5	88.3
Iceland	69.4	93.8	97.5	86.6
Portugal	84.1	84.0	93.5	85.0
Japan	77.0	94.4	84.5	84.7
Australia	79	88.8	78.8	84.3
Denmark	77.5	87.9	78.3	84.0
Sweden	77.6	84.4	83.5	83.8
Liechtenstein	72.1	86.9	93.5	82.6
Ireland	75.3	90.5	76.0	82.5
Isle of Man	64.3	92.0	87.8	82.3
Canada	81.4	85.1	76.0	82.1
Germany	80.3	86.5	67.0	81.7
Spain	69.1	91.9	83.8	81.3
UK	74.1	86.9	77.5	81.3
Malta	67.9	80.1	90.0	80.1
France	69.8	77.9	69.5	75.5
Belgium	70.5	77.3	68.0	75.3
US	69.6	65.5	64.5	70.5
Italy	79.5	76.4	26.0	68.7
Greece	51.1	66.6	68.0	63.2
Israel	38.6	70.5	70.5	62.4

Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Crime And Security Risk Index

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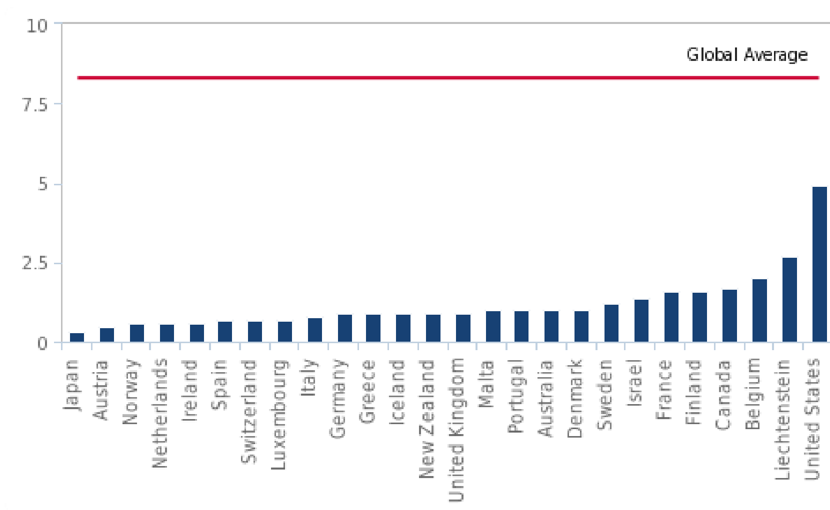
The top five scoring developed states for Crime and Security Risk include Norway, Switzerland, Finland, New Zealand and Luxembourg. The five regional underperformers for this pillar include Belgium, the US, Italy, Greece and Israel (*see Crime And Security table*).

Belgium's weakest point is its score for the Business Crime segment. While the country has low corruption levels, its organised criminal activity levels remain high. For example, the IMF estimates that the average size of Belgium's shadow economy between 1991 and 2015 stood at around 20.6% of GDP. This is higher than the estimated sizes of the shadow economies of the top five ranking developed states for Crime and Security Risk, with Norway (14% of GDP), Switzerland (7.4% of GDP), Finland (13.5%), New Zealand (11.7%) and Luxembourg (10.7%). The US Department of State's 2018 International Narcotics Strategy Report identifies Belgium's Port of Antwerp as a primary entry point for cocaine being smuggled from South America to Europe. The US Department of State's 2018 report also classifies Belgium as a 'major money laundering jurisdiction', emphasising that most of funds being laundered in Belgium are derived from foreign illicit activities due to the significant amount of illicit goods which transit through the Port of Antwerp.

The US's weakest points are its high violent crime rates compared to other developed states and its comparatively higher levels of organised crime. According to the latest UNODC statistics, the US has the highest homicide rate out of the 27 developed states currently standing at 4.9 homicides per 100,000 people. While this is still well below the global average homicide rate, it stands at almost four times the regional average homicide rate. Several recent and high-profile events such as the mass high school shooting which occurred in Parkland, Florida, in February 2018 have now refocused the spotlight on the dangers posed by widespread gun ownership in the country and re-ignited the national debate on gun control. While there has been little political appetite to introduce wide-ranging gun controls in the past, this incident has put renewed pressure on the US government to pass more stringent gun control laws. Regarding financial crime, the US Department of State's own 2018 International Narcotics Strategy Report identifies the US as a 'major money laundering jurisdiction', with its proximity to South America also making it a prime destination country for many illicit narcotics.

Low Homicide Rates Indicate Secure Environment

Developed States – Homicide Rates (per 100,000 population)



Source: UNODC

The third lowest scorer for Crime and Security out of the developed states is Italy. This is largely as a result of the high levels of corruption and entrenched organised crime which still remain huge problems in the country. The IMF estimates that its shadow economy had an average size of around 25% of GDP between 1991 and 2015. According to Transparency International's 2017 Global Corruption Barometer, around 40% of Italians surveyed rated 'most' or 'all' government officials as being involved in corruption.

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The US Department of State's 2018 International Narcotics Strategy Report identifies Italy as an important transit country and final market for illicit narcotics, mostly from Asia and South America. The US Department of State also classifies Italy as a 'major money laundering jurisdiction', largely due to high levels of domestic organised crime such as tax evasion, tax fraud, smuggling, drug trafficking and extortion.

Greece ranks second from last in terms of its crime and security environment out of the 27 developed states. Its weakest point is the Conflict Risk section of our Crime and Security Risk Index, for which it scores a low 51.1 out of 100. This largely because of higher security risks posed to business operation by terrorism and political violence threats in Greece than in many other developed states. These have primarily been caused by the activities of insurgent organisations on the far left. These include the November 17 Revolutionary Organisation and the Revolutionary Struggle. In November 2013, a new group called The Fighting People's Revolutionary Powers shot dead two members of the neo-Nazi Golden Dawn political party outside the organisation's headquarters in Athens. These events highlight the risk of ongoing political violence in the country, which have been exacerbated by the country being involved in economic bail-out programmes for the past eight years. Greece's other weak points include its high levels of corruption, and that its organised crime problem has worsened with its economic crisis. Its strategic geographic location makes it a popular thoroughfare for the trafficking of illicit narcotics, goods and people from the Middle East and Asia to Western Europe.

Israel is the lowest ranking developed state in terms of its crime and security environment. This is because Israel suffers from multiple internal and external security threats which pose significant risks to business operations. Since its establishment in 1948, the state of Israel has been involved in numerous conflicts with its neighbours and its relations with most Arab countries remain hostile. Furthermore, the inability to find a lasting settlement to the intractable Israeli-Palestinian conflict has spawned a number of terrorist organisations which target Israeli interests.

The major crime and security themes which have caused security risks for businesses operating in all developed states globally over 2017 and 2018 have been in relation to the continued risk of terrorist attacks from extremist Islamic groups, cybercrime and cyberattacks and the ramifications of US President Donald Trump's trade policies and style of international diplomacy. Political events with security implications mainly impacting businesses operating in the UK and EU member developed states, include the ongoing 'Brexit' debacle and the rise of populist, right-wing political movements across various EU states.

A significant spike in the number of terrorist attacks in 2017 have occurred in developed states globally with more of these attacks than in previous years being perpetrated by lone-wolf actors with alleged ties to jihadist Islamic groups such as Islamic State (IS) or for which IS has claimed responsibility for. According to the EU's 2018 'Terrorism Situation and Trend' report, for the year 2017 there were 205 terrorist attacks (failed, foiled and completed) reported by nine EU-member states (the UK, France, Spain, Italy, Greece, Belgium, Finland and Sweden). This was a 45% increase in the number of terrorist attacks reported by EU states in 2016, with the number of jihadist-related attacks increasing from 13 in 2016 to 33 in 2017. In 2017 both the US (in New York) and Canada (in Alberta) witnessed their first terrorist attacks by lone-wolf perpetrators using a vehicle as a weapon to target pedestrians. In terms of terrorist threats impacting business security in Australia, New Zealand and Japan, this type of risk remains highest in Australia, as New Zealand and Japan have yet to be the targets of jihadist-related terrorist plots. We note, however, that the risks of such attacks occurring in New Zealand and Japan are not completely unlikely, as 2017 and 2018 have seen a significant spike in jihadist-related activity in the East and South East Asian region.

In terms of interstate conflict risks impacting developed states, the US is directly involved in a number of conflicts, and it is indirectly at risk of conflict via defence agreements with countries such as Japan, South Korea and Israel. However, the likelihood of an inward

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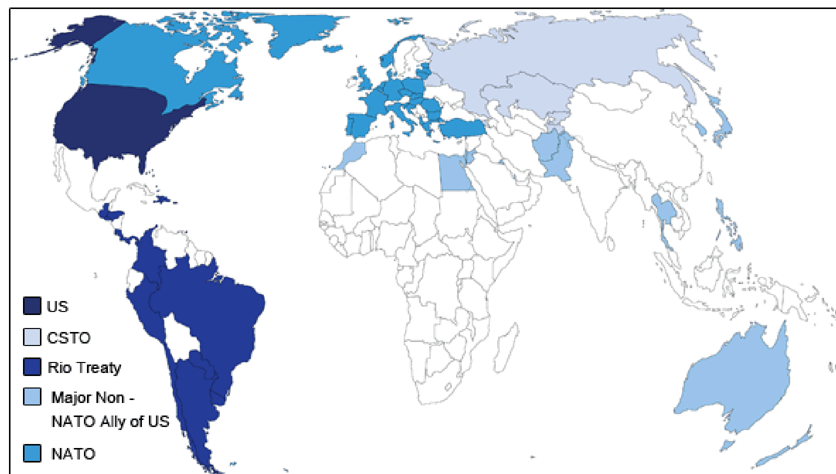
incursion into the US is greatly reduced by the fact that the country retains the world's most highly sophisticated armed forces. Furthermore, the army, air force, navy, marine corps and coast guard are among the largest in the world. Since the end of the Second World War, they have accrued significant combat experience across the entire spectrum of military operations. This boosts the US's score for Interstate Conflict to 80.0 out of 100.

Japan's risk of international conflict is reduced by the fact that it enjoys the support of the US armed forces in the event of an external attack, which boosts its overall military capabilities. However, there are a number of flashpoints facing the country with regard to potential interstate conflicts and these pose significant risks to incoming businesses and their workers. The foremost risk is the threat from North Korea, which flew two missiles over Japanese territory in 2017 and carried out a number of further missile and nuclear weapons tests, which resulted in significantly heightened tensions in the region. While these tension have abated substantially in 2018 due to ongoing diplomacy efforts between the US, South Korea and North Korea, they still remain a long-term security concern. Furthermore, Japan also experiences tense relations with China, which have historical roots but have flared more recently surrounding a dispute over the ownership of the Senkaku/Diaoyu islands in the East China Sea, as well as China's imposition of an Air Defence Identification Zone. Consequently, Japan's Interstate Conflict Risk score is lower, at 67.0 out of 100, ranking it seventh from the bottom among developed states

Global Defence Agreements



Note: The US is a member of the Rio Treaty and NATO. Kuwait and Bahrain are also major non-NATO allies of the US.
Source: d-maps.com, Fitch Solutions

Risks of cyberattacks impacting developed states also spiked significantly in 2017, with the 'Wannacry' attacks in May 2017 which targeted over 150 states globally. The impacted developed states included the UK, the US, Canada, Portugal, Spain, Greece and Germany. The attacks targeted the information systems of healthcare providers and hospitals such as the UK's National Health Service, car companies such as **Renault** and **Nissan**, telecommunications and courier companies, schools and universities and railway operators. We emphasise that the most vulnerable developed states to cyberattacks and cybercrime are Spain, Portugal, Italy, Israel and Greece. All of these states have a secure internet server headcount per 1mn people which is lower than the global average of around 424 secure internet servers per 1mn people. This indicates that these states have the weakest national cybersecurity capabilities in the region

We have also seen the rise of right-wing, nationalistic and/or populist political parties across various EU-member developed states such as Austria, France, Germany, Italy and Sweden in particular in 2017 and 2018. This indicates growing domestic support for such

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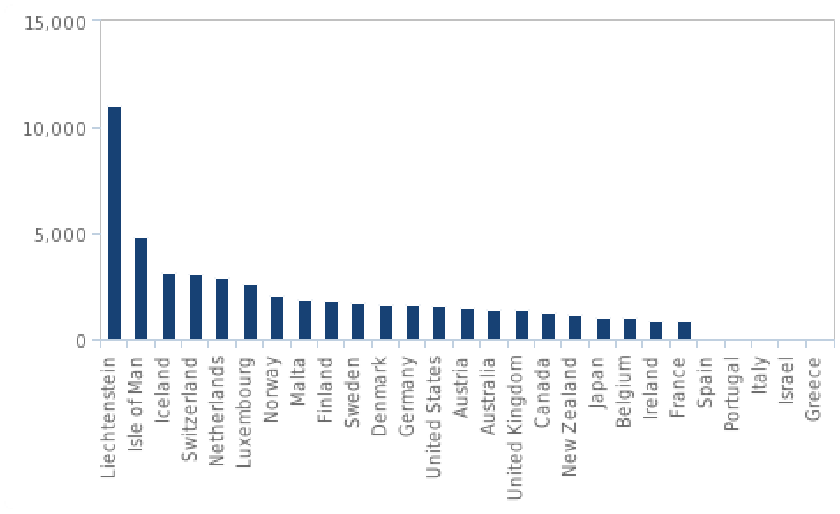
movements and could potentially result in an uptick in attacks on minority groups by extremist right-wing or nationalist groups in these countries. Nevertheless, the chance of creating a significant security threat for business operation in these states remains unlikely. Rather, the direct implications for businesses will be more policy-based, such as an increase in euro-scepticism and more stringent anti-immigration and nationalistic policies being enforced in these states. We maintain, however, that the UK's departure from the EU in March 2019 will not be the catalyst for other countries to leave the bloc over the next five to 10 years (*see 'The Gradual Emergence Of A 'Two-Tier' EU', August 23 2018*). As for the Brexit debacle, we expect this to continue to create navigational difficulties for businesses headquartered in the UK for their EU-based operations over the years to come due to the uncertainty regarding the ultimate resolution of the situation (*see ''Soft' Brexit Becomes Core View As UK Government Flounders', July 19 2018*).

Several Developed States Have Poor National Cybersecurity Capabilities By Global Standards

Developed States – Secure Internet Servers (per mn people)



Source: World Bank, Fitch Solutions

On a global scale, businesses in developed states are expected to continue to face the additional operational headwinds that have come with President Trump's term in office, especially as we expect his assertive foreign policy stance to continue into 2019 (*see 'Trump Administration To Retain Assertive Foreign Policy Beyond Mid-Terms', September 26 2018*). Governments of these developed states are currently maintaining a balancing act of not openly endorsing Trump's particular brand of economic nationalism, but also of not openly opposing it either. Strong criticism of this could compromise trade relations with the US or cause the loss of US military support, factors which remain especially critical for developed states such as the UK, Japan and Australia. The residual overflow of the US-China trade war, increased US sanctions on Iran and Russia and President Trump's style of international diplomacy will also continue to impact businesses in developed states through higher input costs in relation to raw materials, heightened inflation and rising global crude prices.

Trade And Investment Risk

The developed states offer substantial rewards to businesses and investors with regard to trade and investment. They also present minimal risks, with investors benefiting from large established economies open to foreign investment, developed financial markets, strong trade flows, numerous trade agreements and solid reliable intellectual property protection and well-regulated legal systems. Nevertheless, increasing trade protectionism and the risk of further adoption of populist policies over the medium term will heighten risks for investors with global supply chains and encourage localisation at the expense of foreign investment and free trade.

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Among the best performers for Economic Openness are the Netherlands, Luxembourg and Belgium with scores of 92.8, 91.4 and 90.2 out of 100 respectively. In 2017 (latest data available), developed markets received 192.5% more foreign direct investment (FDI), as a bloc, than in 2016 and disproportionately approximately half of all FDI globally (according to UNCTAD and in-house data). Trade estimates demonstrate similar trends, as data for 2018 indicate that 52% of total global trade can be attributed to 27 developed markets, with exports slightly outpacing imports (51.9% and 48.1% respectively). According to our forecasts, developed states will predominantly remain net exporters of goods over the medium term. Trade from developed markets as a percentage of total global trade will, however, gradually shrink over the medium term, but is poised to provide the lion's share of trade activity nonetheless (at an expected 50.8% of global trade in 2023). The US, Israel and Iceland will all remain net importers over the medium term, with Canada, Portugal, Austria and New Zealand joining the group over the period out to 2023.

Eurozone real GDP growth is expected to slow in 2019, which suggests that the region's growth outlook will slip further behind comparable developed markets, such as the US. A confluence of factors looks set to dampen growth across the bloc. The external trading environment will be less accommodating, due to slowing eurozone domestic demand and the EU-US trade dispute. Businesses

TABLE: TRADE AND INVESTMENT RISK INDEX

Country	Economic Openness	Government Intervention	Legal	Trade And Investment Risk
UK	76.0	70.6	89.9	78.8
Netherlands	92.8	57.9	84.1	78.3
Liechtenstein	66.6	83.5	84.4	78.2
Sweden	77.7	65.1	91.3	78.0
Ireland	85.8	66.0	81.9	77.9
Luxembourg	91.4	61.4	79.9	77.6
Switzerland	83.9	66.8	82.0	77.5
Estonia	75.6	64.5	89.1	76.4
Denmark	75.0	60.9	93.0	76.3
Canada	69.7	73.4	83.6	75.6
New Zealand	59.5	71.1	95.4	75.4
US	66.2	72.1	87.8	75.3
Finland	69.0	64.2	89.5	74.2
Belgium	90.2	49.7	78.4	72.8
Norway	60.1	62.8	93.7	72.2
Austria	77.2	55.7	82.5	71.8
Lithuania	69.5	62.3	82.5	71.5
France	66.4	63.0	84.2	71.2
Germany	74.4	52.4	80.4	69.1
Malta	81.4	64.0	61.6	69.0
Spain	72.0	61.9	73.0	69.0
Latvia	67.8	56.1	78.6	67.5
Iceland	57.6	60.9	83.5	67.3
Portugal	71.8	47.8	80.3	66.6
Japan	54.3	61.3	80.9	65.5
Israel	60.5	58.0	74.8	64.4
Isle of Man	43.6	73.3	70.4	62.4
Italy	69.0	44.4	66.2	59.9
Greece	46.0	44.9	57.0	49.3

Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Trade And Investment Risk Index

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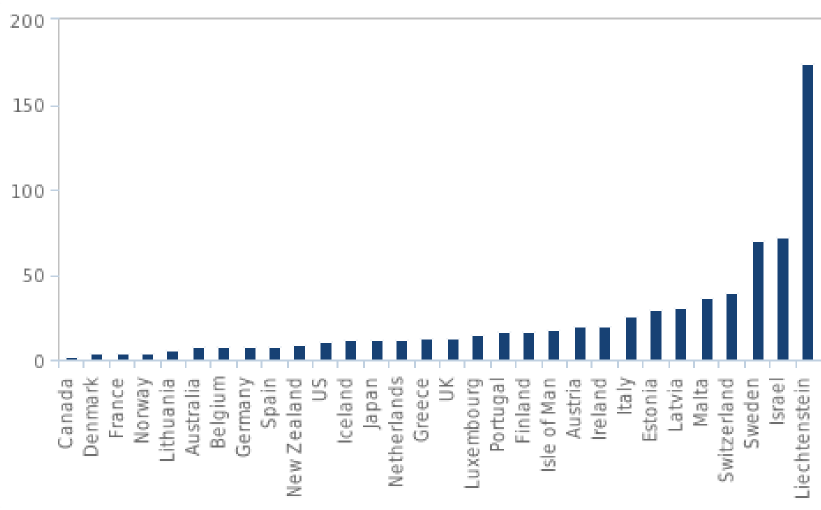
will further be faced with a combination of political uncertainty and a lack of clarity on the UK's future trading agreement with the EU, which will continue deterring investment throughout the bloc. The short-to-medium term growth outlook for the US economy remains constructive due to a tightening labour market, a continued recovery in private investment and expansionary fiscal policy. Wider budget deficits and a higher debt-to-GDP ratio are on the cards in the years ahead, as tax cuts lower revenue, but are not accompanied by offsetting reductions in spending. Although the US is significantly dependent on foreign countries for imports, this is broadly sustainable, given the US's relative wealth and the comparative advantage of producing certain goods and services.

In October 2018, Canada, the US and Mexico reached an agreement on a new and modern trade agreement called the United States-Mexico-Canada Agreement (USMCA). This modernised agreement maintains the tariff-free market access from the original NAFTA, and includes updates and new chapters to address modern-day trade challenges and opportunities. The original NAFTA eliminated virtually all tariffs between the three countries, with very few exceptions. The USMCA maintains these benefits and ensures that the vast majority of USMCA trade will continue to be duty-free. Additionally, a new Customs Administration and Trade Facilitation Chapter standardises and modernises customs procedures throughout North America to facilitate the free-flow of goods. There are also important improvements to disciplines on technical barriers to trade that will make it easier for businesses to export goods within the USMCA region. The USMCA comprises 34 chapters, 3 schedules, 18 annexes and 12 side letters. One of the chapters (on Rules of Origin) is 234 pages in length.

Generally Efficient Bureaucratic Procedures Encourage Investment

Developed States – Time To Open A Business (days)



Source: World Bank 'Doing Business'

The USMCA has made a key change to the autos rules of origin. The revised automotive rules of origin require higher levels of North American content in order to incentivise production and sourcing in North America. The agreement specifies that 40.0% of vehicles sold in the region must come from a market with wages of USD16/hour or more. This wage provision was brought into place in order to attempt to level the playing field between Mexican and US workers and reduce the incentives for companies to outsource manufacturing jobs. However, the USMCA will face a difficult ratification process in the US, as a divided Congress digs in for a protracted debate. In October 2018, the US, Mexico and Canada agreed to a new iteration of the 25-year old North American Free Trade Agreement (NAFTA), with its replacement, USMCA, now requiring ratification by each country's legislature in order to go into effect. The process is expected to be fairly straightforward in Mexico and Canada, but is likely to face substantial hurdles in the US, especially as the opposition Democratic Party regained control of the lower house in Congress in November 2018 mid-term elections.

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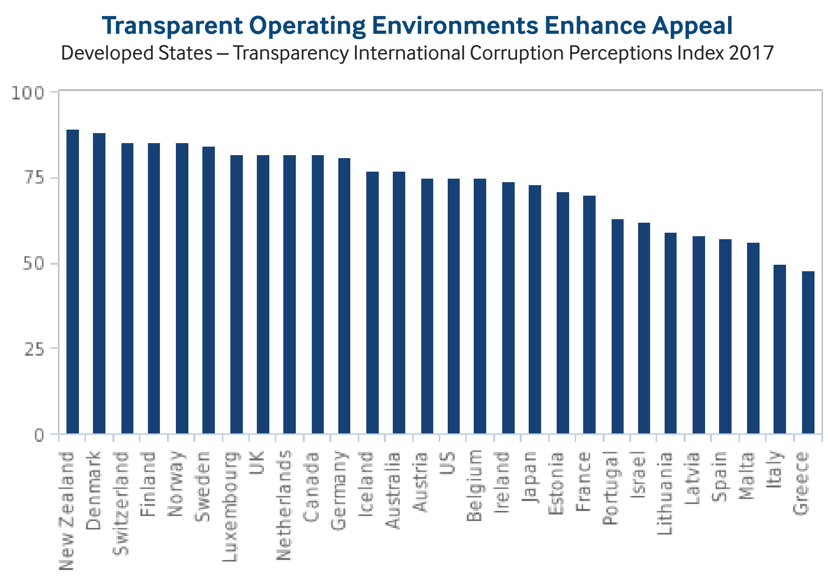
The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) comprising Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam came into effect in 2019. The agreement was ratified in Q418, with the deal representing 13.4% of global GDP, making it the third-largest trade agreement after the proposed USMCA and the EU. The agreement aims to cut tariffs, improve access to markets and set common ground on labour and environmental standards and intellectual property protections, which will be a boon to the trade and investment environments for Japan, Canada and Australia.

In July 2018, the EU and Japan signed a trade deal that promises to eliminate 99% of tariffs that cost businesses in the EU and Japan nearly EUR1.0bn annually. According to the European Commission, the EU-Japan Economic Partnership Agreement (EPA) will create a trade zone covering 600mn people and nearly a third of global GDP. The result of four years of negotiation, the EPA was finalised in late 2017 and came into force on February 1 2019 after the EU parliament ratified the agreement in December 2018. The total trade volume of goods and services between the EU and Japan is an estimated EUR86.0bn. The key parts of the agreement will cut duties on a wide range of agricultural products and it seeks to open up services markets, particularly financial services, e-commerce, telecommunications and transport. Japan is the EU's second biggest trading partner in Asia after mainland China. EU exports to Japan are dominated by motor vehicles, machinery, pharmaceuticals, optical and medical instruments and electrical machinery.

Interventionist governments can pose a risk to incoming businesses and although developed states have historically offered relatively low risks here, an increasing turn towards protectionism threatens this. Taxation is comparatively businesses-orientated, with established e-governance platforms and clearly delineated regulations facilitating the swift payment of taxes.

On average it takes just 139.6 hours a year to pay taxes in the developed states, contrasting positively with the global average of just over 240 hours. Moreover, many countries require less than 100 hours a year, such as Estonia, Finland, Luxembourg, Switzerland, Ireland and Norway.



Source: Transparency International

We note that Israel, Italy and Portugal underperform, with the longest times taken to pay taxes in the region at 238, 239 and 243 hours respectively, placing a heavy burden on businesses operating in these countries. These risks are exacerbated by relatively high levels of taxation and high numbers of annual tax payments. In both Italy and Japan, for instance, businesses face corporate tax rates and numbers of annual tax payments that are above the regional average. Corporate income tax is relatively competitive in

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most developed states, however, with Liechtenstein and Ireland offering the lowest cost risk in this regard, with corporate income taxed at 12.5%, which is among the lowest rates globally.

It is in the bureaucratic environment field where the developed states excel the most over their emerging market peers, with the majority offering rapid turnarounds for the opening and closing of businesses, limited delays with regard to property registration and comparatively low construction permit costs. The majority of developed states perform well relative to the regional average in terms of the efficiency of bureaucratic procedures, requiring an average of just 23.9 days to open a business, 1.6 years to resolve insolvency proceedings and 20.5 days to register a property purchase. We do, however, note that a few countries still exhibit lengthy delays and additional costs for incoming businesses: Austria, Germany, France and Malta, in terms of the World Bank's latest Ease of Doing Business report. In Austria, it takes 21 days to open a business – ranking only ahead of Luxembourg in the regional comparison, where it takes 16.5 days. New Zealand is a particular outperformer for all the ease of doing business indicators and it ranks first globally out of 190 states surveyed. New Zealand scores 95.4 out of 100 for the Legal Risk component of the Trade And Investment Index.

The developed states offer additional advantages, including low corruption risks (barring Italy and Greece, where corruption is fairly endemic in certain sectors), efficient and effective legal systems, reliable contract enforcement for businesses and strong intellectual property rights protection (though again, Greece and Italy perform poorly here). Overall, the poor bureaucratic environment in Spain, as well as corruption and weakness of the rule of law in Greece and Italy, pose the greatest dangers with regard to trade and investment risk among the developed states. These issues are factored into the countries' scores in the Trade And Investment Risk Index, with Greece sitting in last place with a score of 49.3 out of 100, just below Italy, Isle of Man and Israel with scores of 59.9, 62.4 and 64.4 out of 100 respectively. The UK, however, is the outperformer, leading the rankings with a score of 78.8 out of 100, ahead of the Netherlands with a score of 78.3.

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Global Macro Outlook

Potential Policy Missteps Pose The Largest Risk To Global Growth

The global outlook continues to weaken as multiple headwinds buffet the economy. We have revised down our 2019 global real GDP growth forecast to 2.7%, from 2.8% last month. While the revision to 2.7% was largely driven by a slight change to our eurozone growth forecast for 2019 (from 1.4% to 1.2%), we continue to see slight downside risks to the global growth outlook. The manufacturing sector across the globe is in contraction, which will continue to weigh on the services sector over the coming months, while earnings growth is low, bond investors continue to price in recessionary conditions and trade tensions have escalated once again.

Despite these headwinds and the recent rise in market volatility, our forecasts show that the global economy is still in relatively decent shape: 2.7% real GDP growth is in line with the 10-year average, although we acknowledge significant downside risks. At the same time, the US dollar does not seem to be signalling a significant shift in risk appetite yet, although it could still do so as markets digest the various risks at hand. On that note, we believe that policymakers are the single largest risk to the global economy and see several policy flashpoints that could sink the global economy into a much sharper slowdown and even potentially into recession in the next year or so.

TABLE: GLOBAL MACROECONOMIC FORECASTS (2019-2024)

		2019f	2020f	2021f	2022f	2023f	2024f
Real GDP Growth (%)							
	US	2.2	2.0	1.8	1.8	1.8	1.9
	Eurozone	1.2	1.4	1.5	1.5	1.5	1.5
	Japan	0.5	0.5	0.5	0.4	0.4	0.4
	China	6.3	6.1	5.7	5.4	5.4	5.3
	World	2.7	2.9	2.9	2.9	3.0	3.0
Consumer Inflation (ave)							
	US	2.1	2.2	2.2	2.1	2.1	2.1
	Eurozone	1.3	1.5	1.7	1.9	1.9	1.9
	Japan	1.6	1.6	1.2	1.0	1.0	1.0
	China	2.7	2.7	2.2	2.3	2.3	2.3
	World	3.1	2.9	2.7	2.7	2.7	2.6
Interest Rates (eop)							
	Fed Funds Rate	2.0	2.0	2.0	2.0	2.0	2.0
	ECB Refinancing Rate	-0.1	-0.1	0.0	0.5	1.0	1.0
	Japan Overnight Call Rate	-0.1	-0.1	0.0	0.0	0.1	0.1
Exchange Rates (ave)							
	USD/EUR	1.14	1.17	1.22	1.25	1.27	1.27
	JPY/USD	110.00	109.00	108.00	107.50	107.00	106.50
	CNY/USD	6.85	6.95	6.88	6.75	6.65	6.55
Oil Prices (ave)							
	OPEC Basket (USD/bbl)	64.00	62.00	58.00	59.00	61.00	63.00
	Brent Crude (USD/bbl)	67.00	65.00	61.00	62.00	64.00	66.00

f = forecast. Source: Fitch Solutions

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Global policy uncertainty is at the highest it has been in many years, and we see this trend as the biggest headwind to growth as it weighs on business and consumer confidence. From a trade perspective, US-China tensions have re-escalated following Trump's decision to implement a 10% tariff on the remaining USD300bn of imports from China as well as the US Treasury Department's labelling of China as a currency manipulator. While labelling China a currency manipulator will not have an immediate and significant effect, it reflects the widening gulf between both countries as they fail to reach an agreement, while an increase in tariffs would be very negative. President Xi Jinping could be biding his time, potentially looking to secure a better deal as the US election approaches, which is frustrating his US counterparts. Moreover, the tone from both sides seems to have deteriorated, and the risk is that if both sides refuse to compromise, the result could be a 25% tariff on all Chinese goods as well as additional non-tariff barriers, with reciprocal action by China.

TABLE: DEVELOPED MARKETS – REAL GDP GROWTH, % y-o-y

	2018	2019f	2020f	2021f
Developed Markets Aggregate Growth	**2.3**	**1.7**	**1.7**	**1.7**
G7	2.1	1.6	1.6	1.5
Eurozone	1.9	1.2	1.4	1.5
EU-27	2.0	1.5	1.5	1.6
Selected Developed Markets				
Australia	2.8	2.3	2.5	2.6
Austria	2.7	1.6	1.6	1.6
Belgium	1.4	1.2	1.2	1.3
Canada	1.9	1.3	1.9	1.7
Czech Republic	2.9	2.5	2.8	2.5
Denmark	1.4	1.6	1.7	1.4
Finland	2.3	1.7	1.4	1.6
France	1.7	1.4	1.4	1.5
Germany	1.4	0.7	1.1	1.7
Hong Kong	3.0	1.0	2.3	2.5
Ireland	6.7	4.1	3.1	3.0
Italy	0.9	-0.2	0.2	0.2
Japan	0.8	0.5	0.5	0.5
Netherlands	2.5	1.6	1.5	1.4
Norway	1.4	2.4	1.9	1.7
Portugal	2.1	1.6	1.5	1.3
Singapore	3.0	0.9	1.7	2.6
South Korea	2.7	2.1	2.5	2.5
Spain	2.6	2.4	2.0	2.0
Sweden	2.7	1.9	1.6	2.1
Switzerland	2.5	1.5	1.7	1.5
Taiwan	2.6	2.1	2.2	2.5
UK	1.4	1.4	1.5	1.7
US	2.9	2.2	2.0	1.8

f = forecast. Source: Fitch Solutions

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At the same time, Prime Minister Boris Johnson has taken a hard stance towards Brexit and while we still think that a soft Brexit is the most likely outcome – as Johnson renegotiates and re-brands Theresa May's deal – the risks of either a hard Brexit or a snap election (following a potential vote of no confidence) have risen. Lastly, the recent tensions between the US and Iran could result in a policy misstep by either countries, which could impact oil prices and sentiment.

Developed Markets

We have not changed our growth forecast for developed markets (DMs) this month, but we have revised our growth projections downward for the eurozone. While we still expect DM growth to come in at 1.7% in both 2019 and 2020, we now forecast the eurozone to expand by 1.2% in 2019, from 1.4% previously. Our revision largely reflects lower-than-expected growth in Germany this year than previously anticipated, as rising US-China trade tensions and weakening global growth momentum amid protracted

TABLE: EMERGING MARKETS – REAL GDP GROWTH, % y-o-y

	2018	2019f	2020f	2021f
Emerging Markets Aggregate Growth	**4.6**	**4.3**	**4.7**	**4.7**
Latin America	**1.5**	**1.5**	**2.4**	**2.7**
Argentina	-2.5	-1.3	2.5	3.8
Brazil	1.1	1.0	2.4	2.2
Mexico	2.0	1.1	1.5	2.2
Middle East and North Africa	**1.4**	**0.8**	**2.6**	**3.5**
Saudi Arabia	2.2	1.7	1.9	1.6
UAE	1.7	2.4	3.6	2.7
Egypt	5.3	5.6	5.6	4.9
Sub-Saharan Africa	**2.8**	**3.0**	**3.4**	**3.5**
South Africa	0.8	0.7	1.7	2.4
Nigeria	1.9	2.0	1.6	1.4
Emerging Asia	**6.4**	**6.2**	**6.1**	**5.9**
China	6.6	6.3	6.1	5.7
India*	6.8	6.8	7.0	7.1
Indonesia	5.2	5.3	5.4	5.6
Malaysia	4.7	4.2	4.2	4.4
Philippines	6.2	5.9	6.3	6.2
Thailand	4.1	3.0	3.6	3.6
Emerging Europe	**3.2**	**1.7**	**2.7**	**2.5**
Russia	2.3	1.2	1.7	2.0
Turkey	2.6	-1.9	3.5	2.5
Hungary	4.9	3.8	2.6	2.5
Romania	4.1	3.7	3.0	3.1
Poland	5.1	3.9	3.5	2.6

*f = forecast; *Fiscal years ending March 31 (2018 = 2018/19). Source: Fitch Solutions*

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Brexit uncertainties take a toll on Germany's export-reliant economy. We expect Germany to grow by 0.7% in 2019, from a pre-revision rate of 1.2%. Overall, evidence of the impact of the trade war on DM economic momentum is increasingly visible in bearish high-frequency data and leading indicators. In particular, the manufacturing sector is bearing most of the brunt of weaker global trade as suggested by manufacturing purchasing managers' indices (PMIs) across DMs. The PMI readings have come in below – or only marginally above – the 50 mark that separates sectoral expansion from contraction. Furthermore, DM economic sentiment continues to weaken, with confidence indicators deeply rooted in negative territory in the US, the eurozone and the UK.

On the trade war front, tension is re-escalating following the US administration's decision in early August to place a 10% tariff on USD300bn worth of Chinese imports from September 1, to which China retaliated by asking its state-owned enterprises to stop buying US agricultural goods, including soybeans, cotton and pork. While we still believe that a gradual de-escalation of trade tensions is possible in the medium term, our core view remains that a comprehensive trade deal and a rapid removal of tariffs is highly unlikely in the short term, and prospects of a comprehensive deal have been further reduced by the visibly tougher Chinese stance on this issue. A re-escalation remains likely in the short term as both sides are unlikely to compromise on fundamental disagreements. As there appears to be little sign of anxieties from trade disputes disappearing in the near term, we believe this will lead to a further backsliding in terms of sentiment and business activity in the months ahead, adversely impacting the DM economies and further weighing on already slowing global real GDP growth.

Emerging Markets

The re-escalation of US-China trade tensions following the widely anticipated 25bps interest rate cut by the US Federal Reserve on July 31 has turned investor sentiment decidedly more risk averse across asset classes, hitting emerging market (EM) assets particularly hard. The trade war is impacting EMs in two main ways: first, via disruption to China's Asian supply chains, causing collapsing demand for electronics and machinery from broader EM Asia (the main engine of global growth) and second, via weaker Chinese demand for resources from commodities producers (*see 'China-Reliant Exporters To Continue To Feel Fallout From Trade Uncertainty', August 5*). In terms of weaker Chinese demand for resources, the scale of the deterioration in demand is reflected in a major downward revision to our Brent forecast by our Oil & Gas team this month (*see 'Brent: Global Trade Tensions Toppling Prices', August 2*).

Higher market volatility and wider risk premia since late July represents the second bout of sustained financial market weakness in 2019. The renewed risk aversion also comes after a series of policy rate cuts by central banks in a number of EMs – most recently in Turkey and the Philippines – in which economic growth considerations have increasingly been prioritised ahead of financial market stability because of broadly subdued inflation. In view of the deteriorating market environment, the dovish pivot in many EMs looks increasingly likely to leave some exposed to capital outflows similar to or worse than those seen in 2018 – as some go too far with their loosening – and this is something that we have been flagging as a key risk in 2019, particularly if the US dollar strengthens in response to risk aversion.

In terms of our 2019 real GDP growth forecasts, we have revised down our forecasts for all regions this month, with the exception of Latin America, culminating in a modest lowering in the EM aggregate forecast of 0.1 percentage points (pp) to 4.3%, with risks firmly tilted to the downside. At the regional level, the 2019 growth forecast has been lowered by 0.1pp each for the Middle East and North Africa (MENA) to 0.8%, Sub-Saharan Africa (SSA) to 3.0% and emerging Europe to 1.7%. Meanwhile, we still expect 2019 growth of 1.5% in Latin America – which is unchanged from last month – although this is likely to be revised down in the coming weeks as downside risks to demand remain for key commodities exporters. Our forecasts for Brazil, Colombia and Peru are most likely to be revised.

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Most of the regional revisions came on the back of the recent downward revision to the oil price forecast, particularly affecting SSA and MENA. In SSA, we saw a 0.3pp lowering of Nigeria's growth forecast to 2.0% in 2019, with our forecasts out to 2022 also revised down, while Angola's previous forecast of 0.3% growth in 2019 could soon be revised to contractionary territory. If this occurs it would mark Angola's fourth successive year of recession. In MENA, we have lowered Saudi Arabia's 2019 growth forecast by 0.3pp to 1.7% on the back of deteriorating oil market conditions, which now means that Saudi over-compliance with OPEC+ oil production restrictions is likely to extend well into 2020 and even beyond, and persistent caps on production will act as a major drag on headline economic expansion as oil accounts for 42% of the kingdom's GDP.

The downward revision in emerging Europe was driven by Russia, following our lowering of its 2019 forecast by 0.3pp to 1.2% on the back of a weaker than expected H119 as disruptions in the nation's oil and gas sector compounded broader economic weakness in Q219. We believe the recent imposition of new US sanctions on Russia on August 2 will have a limited impact on the Russian economy as these sanctions have been less strict than first expected. However, the underlying increase in political risk in Russia will compound existing pressures on oil production and exports given the weakening external environment.

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Index Tables

	Short-Term Political	Trend	Regional Rank	Global Rank
Singapore	94.0	=	1	1
Norway	92.9	=	2	2
Canada	92.7	=	3	3
Luxembourg	92.5	=	4	4
Switzerland	92.1	=	5	5
Denmark	88.1	=	6	7
Austria	86.5	=	7	9
Japan	86.0	=	8	10
Netherlands	85.6	=	9	11
Sweden	**84.8**	**=**	**10**	**12**
United States	84.2	=	11	13
New Zealand	84.0	=	12	14
Iceland	82.9	=	13	16
Malta	81.7	=	14	18
Ireland	81.3	=	15	19
Estonia	80.2	=	16	23
Finland	78.8	=	17	27
Germany	78.3	=	18	29
Hong Kong	76.9	+	19	37
France	75.6	=	20	38
Portugal	75.6	=	20	38
Taiwan	75.6	=	20	38
Czech Republic	74.8	=	23	42
Slovakia	71.9	=	24	54
South Korea	71.6	=	25	58
Australia	71.5	=	26	59
Slovenia	70.6	=	27	65
United Kingdom	69.2	=	28	71
Israel	66.7	+	29	81
Belgium	66.3	=	30	82
Greece	65.2	+	31	87
Italy	65.0	=	32	89
Spain	64.6	=	33	91
Cyprus	60.2	=	34	111

Regional ave 78.5/Global ave 62.8/Emerging markets ave 59.3

	Long-Term Political	Trend	Regional Rank	Global Rank
Norway	97.3	=	1	1
Sweden	**93.7**	**=**	**2**	**2**
Denmark	92.7	=	3	3
Canada	92.3	=	4	4
Finland	91.8	=	5	5
Iceland	90.2	=	6	6
Switzerland	90.2	=	6	6
Austria	89.5	=	8	8
Czech Republic	88.8	=	9	9
Australia	88.4	=	10	10
Luxembourg	87.9	=	11	11
Ireland	87.6	=	12	12
Japan	87.3	=	13	13
Germany	87.2	=	14	14
Netherlands	86.5	=	15	15
New Zealand	85.8	=	16	16
Slovenia	84.7	=	17	17
Estonia	83.3	=	18	18
Malta	83.1	=	19	20
United Kingdom	82.7	=	20	21
United States	82.6	=	21	22
South Korea	82.5	=	22	23
Singapore	81.1	=	23	26
France	80.6	=	24	27
Slovakia	80.3	=	25	28
Belgium	80.2	=	26	29
Portugal	79.8	=	27	30
Italy	75.3	=	28	38
Taiwan	75.1	=	29	40
Spain	74.9	=	30	41
Cyprus	72.3	=	31	50
Hong Kong	71.3	=	32	56
Israel	69.2	=	33	70
Greece	66.8	=	34	75

Regional ave 83.6/Global ave 61.9/Emerging markets ave 57.1

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	Short-Term Economic	Trend	Regional Rank	Global Rank
Estonia	81.7	-	1	1
Ireland	81.7	-	1	1
Taiwan	79.4	=	3	3
South Korea	78.5	-	4	4
Norway	78.3	+	5	5
Slovenia	78.1	=	6	6
Israel	77.9	=	7	7
Czech Republic	77.3	=	8	8
Luxembourg	75.8	=	9	9
Malta	75.4	=	10	10
Sweden	**74.8**	**=**	**11**	**12**
Finland	74.6	=	12	13
Netherlands	74.4	=	13	14
New Zealand	74.2	=	14	15
Austria	72.9	=	15	17
Hong Kong	72.5	-	16	19
Slovakia	72.3	-	17	20
Germany	72.1	-	18	22
Switzerland	72.1	-	18	22
United Kingdom	71.9	+	20	24
Denmark	71.5	+	21	26
France	71.3	=	22	27
Australia	70.4	+	23	29
Canada	70.2	=	24	30
United States	68.3	=	25	33
Singapore	67.1	-	26	39
Belgium	65.8	-	27	44
Portugal	65.4	=	28	45
Japan	64.8	-	29	48
Spain	63.5	-	30	54
Cyprus	62.7	-	31	56
Italy	61.5	+	32	58
Iceland	59.8	-	33	62
Greece	56.5	=	34	72

Regional ave 71.6/Global ave 52.5/Emerging markets ave 48.2

	Long-Term Economic	Trend	Regional Rank	Global Rank
Norway	81.5	=	1	1
Sweden	**80.8**	**=**	**2**	**2**
Ireland	80.6	+	3	3
Germany	80.0	=	4	4
South Korea	79.1	=	5	5
Austria	78.8	=	6	6
United States	78.6	+	7	7
Switzerland	78.4	=	8	8
New Zealand	78.3	=	9	9
Czech Republic	78.2	=	10	10
Netherlands	78.1	=	11	11
Estonia	77.7	+	12	12
Slovenia	77.4	=	13	13
Israel	77.0	=	14	14
Taiwan	76.6	-	15	15
United Kingdom	76.2	=	16	16
Malta	76.1	-	17	17
Denmark	75.5	=	18	18
Hong Kong	75.3	-	19	20
France	74.8	=	20	21
Australia	74.6	=	21	22
Luxembourg	74.3	-	22	23
Finland	73.4	=	23	25
Canada	73.1	=	24	26
Slovakia	72.6	-	25	28
Belgium	71.1	=	26	31
Japan	70.1	=	27	32
Singapore	69.4	-	28	35
Iceland	68.6	-	29	36
Italy	67.6	=	30	43
Spain	64.8	+	31	51
Portugal	62.8	=	32	56
Cyprus	61.3	-	33	61
Greece	52.1	=	34	96

Regional ave 74.0/Global ave 54.4/Emerging markets ave 50.1

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TABLE: SWEDEN – MACROECONOMIC DATA AND FORECASTS

	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Nominal GDP, EURbn	468.0	468.6	459.6	616.4	639.6	665.2	691.8	719.5	748.3	778.2	809.4
Nominal GDP, USDbn	552.3	534.2	537.8	752.0	796.3	841.4	878.6	913.7	950.3	988.3	1,027.9
GDP per capita, EUR	46,937	46,686	45,509	60,663	62,586	64,731	66,962	69,282	71,693	74,199	76,806
GDP per capita, USD	55,386	53,222	53,246	74,009	77,919	81,885	85,042	87,988	91,050	94,233	97,544
Real GDP growth, % y-o-y	2.7	1.9	1.4	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Private final consumption, % of GDP	44.1	43.8	44.1	44.1	44.4	44.6	44.7	44.9	45.1	45.2	45.4
Private final consumption, real growth % y-o-y	2.4	1.5	2.0	2.3	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Government final consumption, % of GDP	25.8	25.6	25.6	25.4	25.3	25.1	24.9	24.7	24.6	24.4	24.2
Government final consumption, real growth % y-o-y	1.5	1.2	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Fixed capital formation, % of GDP	25.4	25.8	25.9	26.0	26.1	26.1	26.1	26.1	26.1	26.1	26.1
Fixed capital formation, real growth % y-o-y	4.5	3.5	2.0	2.5	2.2	2.0	2.0	2.0	2.0	2.0	2.0
Population, mn	9.97	10.04	10.10	10.16	10.22	10.28	10.33	10.38	10.44	10.49	10.54
Unemployment, % of labour force, eop	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Consumer price inflation, % y-o-y, ave	1.9	1.8	1.7	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Lending rate, %, ave	1.6	1.8	1.8	2.4	3.5	4.3	4.8	5.0	5.0	5.0	5.0
Central bank policy rate, % eop	-0.25	-0.25	-0.25	1.00	2.00	2.50	3.00	3.00	3.00	3.00	3.00
Exchange rate SEK/USD, ave	8.69	9.34	9.57	7.13	6.99	6.88	6.85	6.85	6.85	6.85	6.85
Exchange rate SEK/EUR, ave	10.26	10.65	11.20	8.70	8.70	8.70	8.70	8.70	8.70	8.70	8.70
Budget balance, SEKbn	61.1	46.3	43.2	40.0	36.4	35.0	36.4	37.9	39.4	41.0	42.6
Budget balance, % of GDP	1.3	0.9	0.8	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Goods and services exports, EURbn	210.5	215.4	217.6	297.6	316.2	336.1	357.3	379.8	403.8	429.5	456.8
Goods and services imports, EURbn	193.1	197.9	201.0	276.4	294.8	314.4	335.4	357.9	381.7	407.0	433.8
Balance of trade in goods and services, EURbn	17.4	17.5	16.6	21.2	21.5	21.7	21.8	21.9	22.1	22.5	23.0
Balance of trade in goods and services, % of GDP	3.7	3.6	3.6	3.5	3.4	3.3	3.2	3.0	3.0	2.9	2.8
Current account balance, EURbn	18.1	18.5	17.9	23.5	24.3	25.1	25.9	26.6	27.5	28.6	29.9
Current account balance, % of GDP	3.8	3.9	3.9	3.8	3.8	3.8	3.7	3.7	3.7	3.7	3.7
Foreign reserves ex gold, EURbn	55.7	57.4	57.1	56.9	57.2	58.5	60.2	62.0	63.9	65.8	67.8
Import cover, months	5.0	5.2	5.0	3.5	3.3	3.1	3.0	2.9	2.7	2.6	2.5

e/f = Fitch Solutions Estimate/Forecast. Source: Statistics Sweden, Fitch Solutions

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