Nordic Outlook
August 2022

Tough policy dilemmas due to energy crisis

Research reports

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August 2022

Slower growth as economic headwinds intensify

During the late spring and the summer, the economic outlook changed. We received some positive news: pressure on global value chains seems to be slowly easing, companies are continuing to perform well, some commodity prices have fallen and labour markets remain strong. But even more things have gone wrong: energy shortages have accelerated; more and more people are now worried not only about sky-high prices but about an energy market collapse, leading to rationing and shutdowns of economic activity. Inflation has continued upward. In the euro area, the United Kingdom, Sweden and elsewhere, we expect inflation to accelerate a bit more before gradually falling next year. At the same time, growth prospects have clearly deteriorated, creating a policy dilemma for central banks. On the one hand, they want to hike key interest rates in order to curb inflation, but on the other they cannot completely ignore the risks of recession, falling asset prices and rising unemployment.

This situation also creates tensions between fiscal and monetary policymakers. While weaker economic conditions and tight household budgets normally justify increased fiscal support to households and businesses, the current situation – with soaring inflation, large labour shortages and central bank tightening – is different. It would be unfortunate if key rate hikes aimed at combating inflation were counteracted by overly stimulative fiscal policies. It will thus be a challenge for policymakers, especially during the current Swedish election year, to be sufficiently restrictive and precise in their support measures.

The forecast situation is more uncertain than normal. For example, no one knows what Russia will do with its winter gas deliveries to Europe, an issue that may be crucially important to the economic outlook. However, our overall view is that there will be a sharp economic slowdown during 2023 and that a recession – at least a mild one – will be hard to avoid. The coming year will be challenging for both households and businesses, before conditions gradually improve again in 2024. There are forecasting risks due to many tough-to-analyse factors such as the war in Ukraine, energy price developments, the interactions between fiscal and monetary policies, the sensitivity of economies to interest rates and bond yields and trade-offs by central banks between fighting inflation and supporting growth. In Sweden, there will also be uncertainty about the national wage round, the outcome of the September elections and the formation of a new government. We thus have a difficult but interesting autumn ahead of us, which we look forward to continuing to monitor, analyse and discuss with you.

This August 2022 issue of *Nordic Outlook* includes four in-depth theme articles that discuss the following:

- The war in Ukraine
- QT and interest rates
- Sweden's election
- Falling home prices

We wish you pleasant reading and a wonderful autumn!

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Chief Economist

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The global economy

The United States | page 22

Rapid key interest rate hikes and high inflation are curtailing home construction, investments and private consumption, but the slowdown will be mild in a historical perspective. We expect the Fed to cut its key rate during the latter part of 2023.

China | page 30

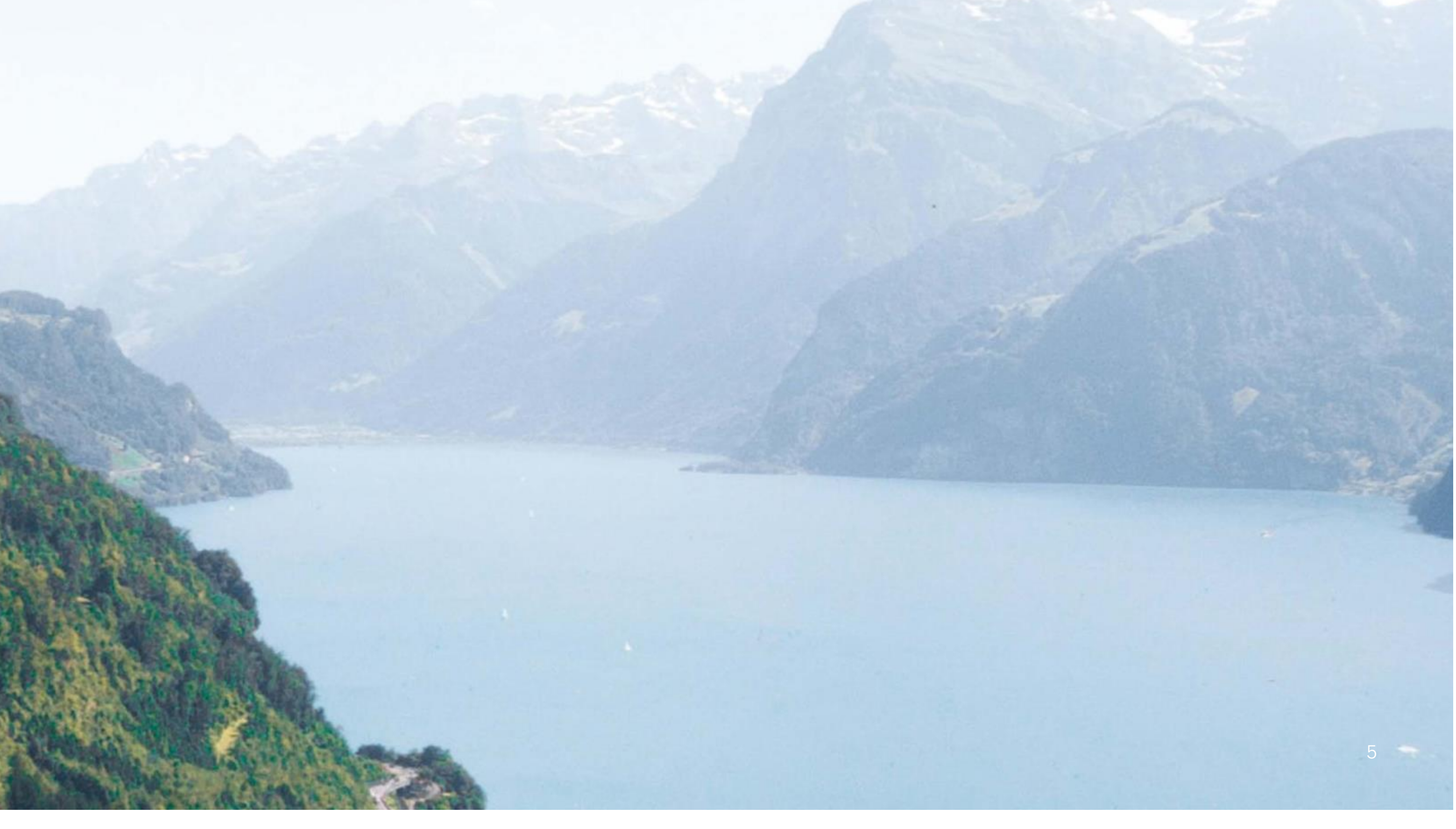
Strict COVID policy and problems in the property sector are causing growth headwinds. GDP will grow by only 3.5 per cent this year. Fiscal policy will become more expansionary, while the People's Bank of China remains more cautious.

The euro area | page 26

The economy has been resilient so far this year, but falling consumption due to the energy crisis will trigger a mild recession. GDP will grow only 0.2 per cent in 2023. The ECB will quickly hike its key rate, but economic weakness will limit the upturn.

The United Kingdom | page 29

The economy faces continued headwinds due to Brexit, the pandemic and the energy crisis. Lower GDP in 2023 and inflation to hit 18 per cent. The BoE key rate will peak at 2.75 per cent late in 2022.



International overview
Mild recession amid energy and interest rate worries

A worsening energy crisis, including soaring natural gas prices, is squeezing households and businesses. Rising inflation is forcing central banks to continue hiking key rates, despite mounting growth worries. We have revised our 2023 global GDP forecast down by 0.8 percentage points. Both the US and Western Europe will enter a mild recession with near-zero growth. Rising unemployment and modest long-term inflation expectations will create room for interest rate cuts further ahead, supporting a cautious recovery during 2024.

Accelerating inflation and rapid key interest rate hikes have contributed to deterioration in the global economic outlook. In the United States, GDP shrank during the first two quarters, while Chinese authorities have been forced to accept that they will not meet their ambitious growth targets for 2022. So far, Western Europe has been unexpectedly resilient, but with the energy crisis assuming increasingly dramatic forms and with no end to the Ukraine war in sight, a consumption-driven slowdown looks inevitable this autumn. Overall, we have revised our GDP forecasts sharply lower, especially for 2023. Over our entire forecast period, our revisions are largest for the US, but the outlook for 2023 has changed most in Western Europe. Next year we expect GDP growth of only 0.9 per cent in advanced economies (the 38 OECD countries), compared to 2.3 per cent in our May forecast. In emerging market (EM) economies, the trajectory is different. China's recovery will slightly accelerate growth in our EM sphere in 2023, helping to smooth the global GDP curve, which will reach a year-on-year low of 2.6 per cent in 2023.

Only a mild recession. Our forecasts are generally more pessimistic than the current market consensus. In both the US and Western Europe, we expect GDP to fall during the second half of 2022, and unemployment is climbing. But several factors suggest that we are facing a relatively mild recession. There are still post-pandemic savings buffers that can be used for pent-up consumption needs. Underlying financial imbalances are nowhere near as large as during the global financial crisis (GFC) in 2008-2009. A deep, protracted balance sheet recession can thus be avoided. Labour markets have been very resilient so far. Although they are now expected to deteriorate, the upturn in unemployment will be relatively limited, reducing the risks of a sharp drop in consumption. Another positive factor is that we now see an easing of disruptions in global supply chains.

Global GDP growth
Year-on-year percentage change

	2021	2022	2023	2024
United States	5.7	1.5	0.5	2.0
Japan	1.7	1.9	1.6	1.1
Germany	2.6	1.3	-0.1	2.5
China	8.1	3.5	5.3	5.0
United Kingdom	7.4	3.4	-0.2	1.3
Euro area	5.3	2.7	0.3	2.1
Nordic countries	4.4	2.5	0.5	1.9
Sweden	5.1	2.6	0.0	1.7
Baltic countries	5.6	1.7	0.7	3.6
OECD	5.4	2.4	0.9	2.2
Emerging markets (EM)	6.7	3.6	3.9	5.4
World, PPP*	**6.1**	**3.1**	**2.6**	**4.0**

Source: OECD, IMF, SEB. *Purchasing power parities

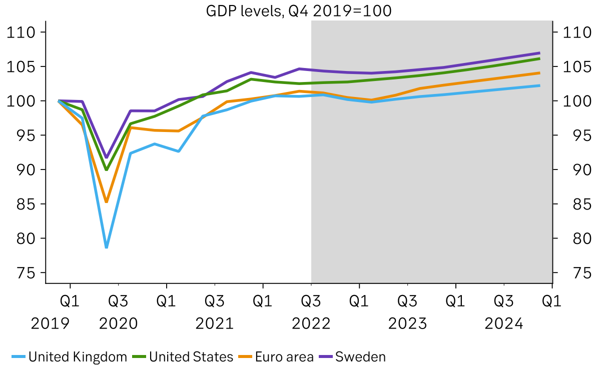
Economic policy challenges. Central banks are now being forced to prioritise inflation-fighting despite the economic slowdown, in order to prevent long-term inflation expectations from soaring. Fiscal policymakers also face a dilemma, especially in Europe. They must launch extensive programmes to soften the acute impact of extreme energy prices, yet such programmes must meanwhile not unduly hamper the efforts of central banks to fight inflation. Support measures will probably have some distorting consequences, such as slowing the green energy transition, but we see good potential for a relatively successful balancing act.

The hiking cycle is almost over. In the short term, runaway energy prices are contributing to significant upward revisions in European inflation forecasts. We will see double-digit inflation in the euro area and the United Kingdom this winter, even though some support measures are designed to significantly dampen CPI inflation in many euro area countries. Various secondary effects, such as compensatory wage hikes, will contribute to elevated inflation a bit further ahead as well. But the central bank hiking cycle will probably soon be over. Our forecast is for the US Federal Reserve's key rate to peak at 3.50 percent at the end of 2022, with central banks in Western Europe ending their hiking cycles at around 2-3 per cent in early 2023. Some months into

2023, labour markets will probably have cooled off quite noticeably. Although the fall in inflation will be sluggish, confidence in central bank targets is likely to strengthen once the downward trend becomes clear. The upturn in long-term inflation expectations has been fairly modest, which also suggests only limited market worries that we are heading into a totally new inflation environment. We thus foresee room for rate cuts late in our forecast period. Such a monetary policy pattern between now and the end of 2024 will provide support to both the economy and asset prices ahead, though there are major challenges during the coming year.

Mild recession ahead

GDP levels, Q4 2019=100



Source: Macrobond, SEB

Long-term yields close to peaking. After a volatile summer, we expect bond yields to rebound this autumn, but without surpassing their June highs. Ten-year US Treasuries will peak at 3.30 per cent just before the Fed ends its hiking cycle in late 2022. German 10-year yields will keep climbing in 2023, reaching 1.75 per cent by year-end. Quantitative tightening (QT) by the Fed and the end to the European Central Bank's quantitative easing (QE) programme will contribute to slightly higher long-term yields. As key rate cuts approach, bond yields will start to fall. By late 2024, 10-year US Treasuries will yield 2.60 per cent and their German equivalents 1.60 per cent. The spread between Swedish and German 10-year bonds narrowed greatly this summer but is expected to widen somewhat in the coming year as the Riksbank both stops its bond purchases and hikes its key rate more than the ECB.

The US dollar will remain strong for another while. Subdued global growth and inflation well above central bank targets will lower risk appetite for the rest of 2022, creating a favourable environment for defensive currencies like the USD, which is also supported by continued Fed tightening. Meanwhile Europe's deepening energy crisis is pulling down the euro, with the EUR/USD rate expected to continue down to 0.95 by late 2022 before regaining some ground. The Swedish krona will also struggle in the prevailing environment, despite Riksbank rate hikes. Near term, the krona will also be weakened by Riksbank foreign currency purchases, which are expected to continue until the end of 2022. After that, we expect the krona to strengthen, with the EUR/SEK falling from 10.55 at the end of 2022 to 10.15 by end-2023.

Energy crisis increasingly serious.

The increasingly chaotic situation in European energy markets is creating unusually large challenges in our forecast. Energy futures prices are now almost indicating a market collapse. Natural gas futures for the coming month are 15 times higher than the historical norm. Even though reserves are approaching normal levels, the market's verdict at this stage appears to be that Europe is not capable of meeting its energy supply needs this coming winter. Industrial companies have usually hedged their prices over a long period, so the big cost increase for European companies will occur in early 2023.

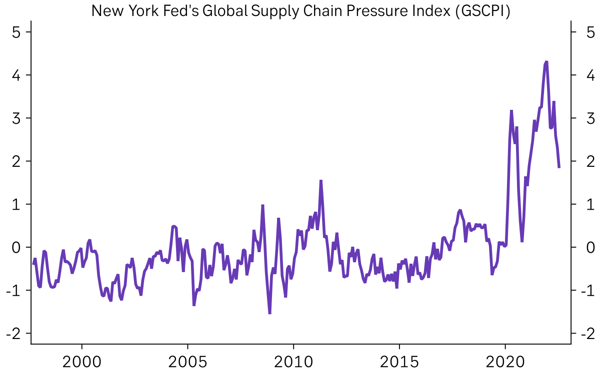
Adjustment mechanisms will ease the crisis over time. But we should be cautious about drawing excessively far-reaching conclusions. High volatility and uncertainty make it hard to interpret what the market is actually pricing in. Liquidity has drastically decreased, since many financial market players no longer dare invest in these instruments. Prices will remain high for some time, but we believe it is not reasonable to rely entirely on futures prices in our forecast. We expect natural gas prices to average EUR 141 and EUR 80 per MWh in 2023 and 2024, respectively, compared to over EUR 300/MWh for contracts during the rest of 2022. Higher liquefied natural gas (LNG) imports and fossil fuel consumption, renewable energy production and efficiency-raising measures will help dampen gas prices a bit, along with lower energy demand. A bit further ahead, steps taken to reduce dependence on Russian energy will make the situation far less critical in the winter of 2023-2024. As for oil, we expect prices to average USD 115 and USD 95/barrel in 2023 and 2024, respectively, compared to USD 100 today. We will see a price uptick in 2023, partly because demand will rise when oil is so much cheaper than other energy forms. Saudi Arabia has also declared that it views the current price level as artificially low and is thus prepared to cut production.

Government support will ease but distort. The energy issue currently tops the political agenda in Europe. Support in the form of tax cuts, lower fees, subsidies, price caps, etc. is helping ease the impact of high energy costs on households and businesses, but such measures destroy price signals and slow the green transition, which poses a dilemma. Today EU countries spend 1-1.5 per cent of GDP on support to households and businesses, but the risks are on the upside.

China will continue its strict COVID strategy

COVID-19 continues to spread around the world, with new virus variants. The number of infections according to World Health Organisation (WHO) statistics remains relatively high, but deaths have fallen sharply. Vaccines, anti-COVID medicines, greater experience in the health care system and milder virus variants are contributing to this. The reopening of economies this past spring after two years of more or less tight restrictions is evident in rising service consumption, for example. Yet despite successes in fighting the virus, lingering problems are hampering economies around the world. China is maintaining its tough COVID policy, with recurrent regional and local shutdowns as transmission accelerates. Given the political prestige at stake, we see little prospect of a change of strategy anytime soon. Beijing seems prepared to pay a price in the form of lower growth.

Easing of stress level in corporate value chains
New York Fed's Global Supply Chain Pressure Index (GSCPI)



Source: Federal Reserve Bank of New York, Macrobond, SEB

Widespread long-term consequences. Elsewhere, too, the pandemic has had an economic impact that may be long-lasting, mainly via lower labour supply. In the US, behavioural changes are clear. For example, older people are apparently not returning to the labour force, worsening recruitment problems in many sectors. New COVID waves are affecting absences from work. In the UK, reports indicate that "long COVID" symptoms are so prevalent that they are affecting the labour supply.

The energy crisis dominates downside risks

Our main scenario implies very high prices for quite a long time, severely hampering economic activity. But an even worse scenario – where Russian gas supplies are completely cut off – cannot be ruled out, especially in light of current futures market pricing. This would force more widespread rationing in the winter and cause a much deeper recession than in our main scenario. We see governments and central banks in Europe now starting to work with such risk scenarios. Our negative scenario in this *Nordic Outlook* assumes a deepening energy crisis in Europe. The GDP decline in the countries that are most dependent on Russian energy, such as Germany and Italy, is projected at 4-5 per cent as an annual average for 2023. In the Nordic countries, we assume that GDP would fall by only around 2 per cent.

Various scenarios for the OECD countries
GDP growth, per cent

	2022	2023	2024
Main scenario	2.4	0.9	2.2
Negative scenario	1.5	-1.0	1.2
Positive scenario	2.7	2.2	3.2

Source: SEB.

Limited upside potential. In the current situation, it is also natural to connect the prospects for a more favourable scenario to developments in energy markets. A faster end to the Ukraine war or unexpectedly strong adaptability in Western Europe may be part of such a scenario. It is also conceivable that we are underestimating the strength of the downturn in inflation over a longer period. Downside risks still dominate growth, but after the sharp downward revisions we have already made in our main scenario, we regard the risk situation as a bit more symmetrical than before. This time we are setting a 20 per cent probability for our negative scenario and 15 per cent for our positive one. In May, our corresponding probabilities were 30 and 10 per cent.

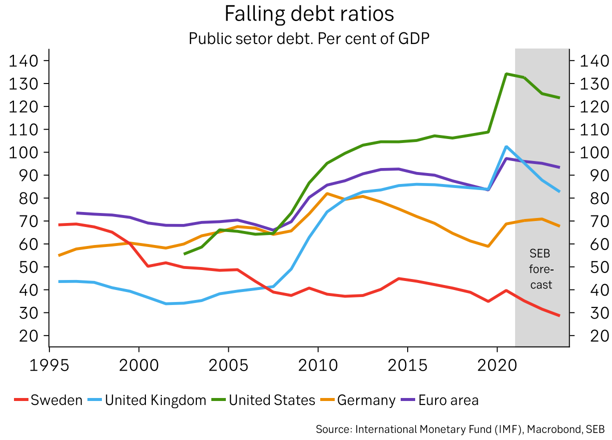
Public sector financial balance
Per cent of GDP

	2021	2022	2023	2024
United States	-11.0	-4.5	-5.0	-6.0
Euro area	-4.3	-3.9	-3.0	-2.5
United Kingdom	-8.0	-5.0	-3.0	-1.5
Sweden	-0.3	0.4	0.2	0.0
OECD	-8.1	-4.7	-4.0	-4.1

Source: Statistics Sweden, SEB

High inflation poses a fiscal policy dilemma

During the pandemic, fiscal policymakers assumed the main responsibility for enacting stimulus measures. Given their relatively empty toolkit, central banks had to accept a supporting role, but in a stable low-inflation environment they could contribute permanently low interest rates. This seemed to lower the risks of rapidly rising public debt due to exceptionally large fiscal stimulus. Now that rapidly rising inflation is forcing central banks to impose key rate hikes, this creates a fiscal policy dilemma. On the one hand, there is a risk that stimulus programmes will exacerbate inflation problems, but at the same time there is a strong need to alleviate the consequences of soaring energy prices.



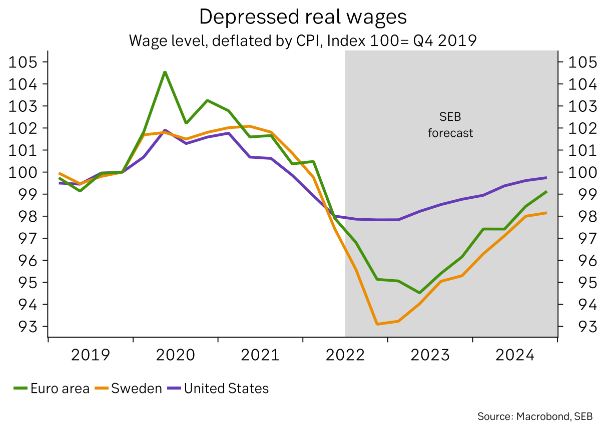
Deficits are shrinking and debt is falling. Given the relatively cautious stimulus measures we view as the most likely, active fiscal policy is expected to be mildly expansionary in 2023-2024 – somewhat more in the EU than in the US and UK. High inflation and extreme electricity prices will drive up tax revenues (and profits of state-owned energy companies) as tax bases expand rapidly in current price terms. In countries where wage growth has accelerated, such as the UK and the US, we will see a similar effect on total wages. Government deficits will actually keep falling in 2023. In a high-inflation environment, current-price GDP is also growing quite fast despite real stagnation, helping push debt ratios lower.

Inflation issues in various time perspectives

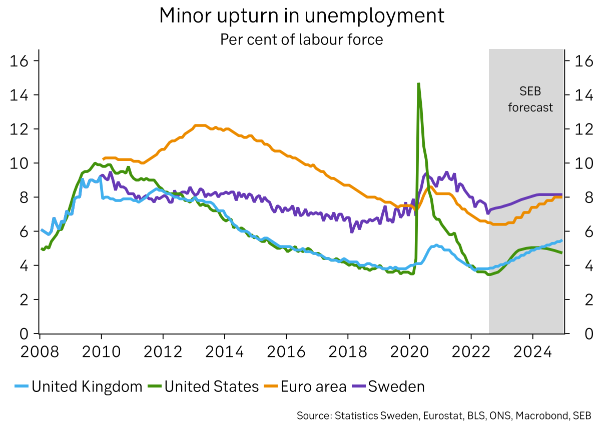
The recent dominance of inflation issues is largely due to the fact that short-term developments threaten to create both medium- and long-term consequences similar to the stagflationary era of nearly 50 years ago. It is therefore appropriate to discuss the inflation outlook in a few different time perspectives.

Energy prices crucial in the short term. Energy market developments continue to dominate the short-term inflation outlook. European natural gas and electricity futures point to extremely high prices over the coming year. UK inflation is expected to peak at nearly 18 per cent this autumn. In the euro area, the market situation looks even more dramatic, but the structure of stimulus measures will cause inflation according to the Harmonised Index of Consumer Prices (HICP) to peak at around 11 per cent. A sensitivity analysis (see page 27) shows that inflation would reach nearly 17 per cent if market prices were allowed to fully feed through as in the Netherlands, for example. Meanwhile there are also forces that are moderating the inflation outlook. Falling demand has contributed to a decline in oil prices, which has also had a particularly strong impact on petrol prices. There are also indications of diminishing price pressures for other goods in the world market, due to a weaker economic outlook and an easing of global supply chain problems. We have also seen some decline in agricultural commodity prices, partly due to the resumption of export shipments from Ukraine. Overall, easing tendencies predominate in the US, while the energy crisis overshadows everything else in Europe.

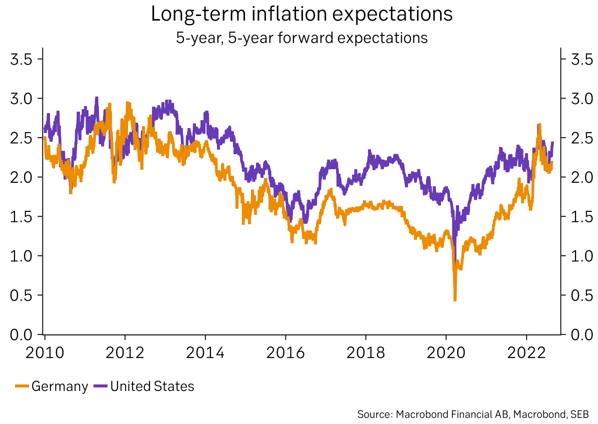
Transmission patterns crucial in the medium term. The inflation trend over the next 6-18 months will be determined by how the initial shock is transmitted through the economy. In recent decades, cost impulses have typically been held back, for example via temporary narrowing of margins and productivity improvements. This time the impulse is so strong that we will see a slower transmission process that helps keep inflation up during the coming year. Many companies will be forced to raise prices when the opportunity arises, in order to survive. The degree to which prices are passed on to customers is determined by the pricing power of businesses, but we are also seeing new political efforts to influence developments. In the US, a discussion on "greedflation" has been under way for some time. In Sweden the government has commissioned the National Institute of Economic Research (NIER) to investigate the existence of "unwarranted" price hikes. In monopoly or oligopoly-like environments, such scrutiny may be justified, but there is a risk that more general attempts to influence price mechanisms may be somewhat naïve.



Falling real wages will create tensions. Rent hikes due to cost increases are another component that comes after a time lag, but the degree of wage compensation for inflation will be the key issue for the medium-term inflation outlook. So far, real wage levels have been pushed down more in the euro area and the Nordic countries than in the US and the UK, where overheated labour markets have contributed to relatively rapid pay hikes. In spite of this, the labour market conflict level has been highest in the UK, with a series of strikes and high wage demands. In Germany and the Nordic countries, central agreements will determine how quickly real wages are restored. The scope for companies to tolerate wage hikes that compensate for inflation will be a major bone of contention in negotiations. Although companies in many sectors are being squeezed by rising costs, so far profitability has generally held up relatively well. Our forecast (see the chart) implies that real wages will recover in late 2023 and in 2024, mainly due to falling inflation. However, the real wage level at the end of our forecast period will remain below the level at the start of the pandemic, which thus implies a five-year period of stagnation in real wages. If real wages had followed the trend of recent decades, they would instead have risen by 7-8 per cent over this five-year period.

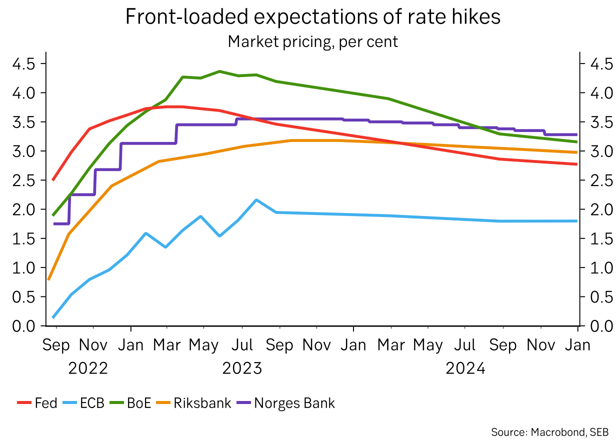


Brighter long-term outlook. If worries predominate in both the short and medium term, we can take a brighter view of the long term. Once the transmission effects work their way through the system, base effects combined with some normalisation of exacerbated price levels will push down inflation. Historically, we have also often seen such "mirror images" on the downside after strong inflationary upturns, suggesting that there is actually a risk of below-target inflation late in our forecast period. Nor do long-term inflation expectations point to any widespread concerns that we are entering a totally new inflationary environment. Recessionary fears may have contributed to the most recent downturn, but there are also various institutional factors that contribute to a far more stable low-inflation environment today compared to the early 1970s.



Reversed monetary policy experiment

The pandemic saw the culmination of a broad monetary policy experiment that began after the GFC, employing negative interest rates and huge asset purchases. Today we are facing the reverse situation, with synchronised rate hikes while asset purchases have been replaced by balance sheet reduction (QE is being replaced by QT). In a relatively short period, central banks have thus moved from signalling that inflationary impulses are relatively temporary to viewing them as a dangerous threat. There is a broad consensus that inflation must be brought down by whatever means are available, despite ever-weakening economic conditions. Inflation is now putting severe strains on households and businesses. This increases acceptance for such a policy. In the short term, a strong labour market also helps ensure that central banks cannot rest on their laurels. The labour market is actually a lagging indicator, but in the current environment this does not seem to be accorded so much importance.



The hiking cycle will soon be over. Because central banks have now speeded up their rate hikes, the end of the hiking cycle is not far away. The Fed, which was early to raise rates, will reach 3.50 per cent in December. The central banks of the UK and Norway are also expected to end their rate hikes before the end of 2022, when they will reach 2.75 and 3.00 per cent respectively. Sweden's Riksbank, which was late out of the starting blocks, has now picked up its pace and is expected to deliver a 75 basis point hike in September followed by 50 bps in November. After a final small hike in February 2023, it will reach a final repo rate of 2.25 per cent. Market expectations of the Riksbank's top rate are still above our forecast. The ECB, grappling with issues related to both the general outlook and the sensitivity of various economies to rate hikes, was the last to begin key rate hikes. We expect its deposit rate to peak at 1.75 per cent and the refi rate at 2.25 per cent in mid-2023. Meanwhile the ECB has developed other tools (especially the Transmission Protection Instrument, TPI) to protect weaker economies and ease tendencies towards widening yield spreads between countries.

Key rate cuts towards the end of our forecast period. Our assessment is that central banks will have some room to cut key rates late in our forecast period, once inflation has more clearly decelerated. Even if growth also rebounds at that time, the gap to the pre-pandemic trend will remain relatively wide in most economies. But in the US, the resource situation looks stretched even in the longer term, especially given the indications of rising equilibrium unemployment we have recently seen. But Fed rate cuts back to a neutral level late in our forecast period are the scenario that now seems most probable.

Central bank key interest rates

Per cent, December	Aug 25	2022	2023	2024
Federal Reserve (Fed)	2.50	3.50	3.25	2.50
ECB (deposit rate)	0.00	1.50	1.75	1.50
Bank of England (BoE)	1.75	2.75	2.75	2.25
Riksbank (Sweden)	0.75	2.00	2.25	1.75
Norges Bank (Norway)	1.75	3.00	3.00	2.25

Source: Central banks, SEB.

Less impact from QT than from key rate hikes. We expect balance sheet reductions to proceed according to the plans that the central banks have announced, putting further upward pressure on long-term bond yields (see theme article, page 17). Central banks are carrying out these reductions both by allowing instruments to mature and by means of outright sales. Experience is limited, but estimates suggest that the effect of these actions on yields is clearly less than what is now coming from key rates. One Fed study concludes that a reduction in Fed asset holdings equivalent to USD 2.2 trillion over 3 years corresponds to an upturn of 30 basis points in yields. Our forecast of a reduction of nearly USD 3.5 trillion would thus be equivalent to about a 50 bp upturn under normal market conditions: roughly in line with the estimates being made in various Fed statements. Overall, our view is that QT policy is less important in pushing up yields than key rates, but this conclusion may change somewhat in environments of more pronounced risk aversion. The flows generated by QT actions may amplify tendencies toward credit market stress, for example. The above study concludes that a given reduction in Fed asset holdings in the current situation has more than twice the impact on bond yields as it would in a more normal market situation.

The delayed effect dilemma. Monetary policy measures have an impact after a rather long time lag, which is now creating an additional dilemma. Changes in key rates normally have their greatest effect on inflation after one or two years. At present, central banks do not have time to wait for these effects but need to hope that their willingness to fight inflation will influence long-term inflation expectations. Estimates of the neutral interest rate (where the key rate has neither a stimulative nor a tightening impact on the economy) have become more important as rate hikes have accelerated, which can probably also be linked to this dilemma. In advanced economies, the neutral level is likely to be around 2-2.5 per cent, but it varies somewhat depending on differences in underlying inflation and growth trends. Although these estimates are uncertain, they have served as a benchmark when central banks have tried to guide the market to see where they are headed in a short-term perspective.

Similarities and differences compared to the 1970s. The question of how firmly anchored long-term inflation expectations are has become increasingly important in this environment. Major international organisations such as the IMF, OECD and BIS have recently focused on this comparison. There are undeniably interesting similarities. In 1973-74, food prices also rose due to the oil price surge that OPEC managed to create. The labour market was also relatively tight at the onset of the crisis. Worth noting is that the initial recession was relatively mild. Average unemployment in the G7 economies was only one percentage point higher in 1974-76 than in the "pre-crisis" period 1971-73, although the US upturn was close to 2 points. The epoch is thus viewed as a failure not because the downturn was especially deep, but because an inability to coordinate appropriate policy responses meant it took a long time to get back to a functioning stabilisation policy framework. In this respect, the stakes are high. If expectations of something similar now take hold, estimates of neutral interest rates would climb rapidly, with major implications for asset prices.

The differences are bigger after all. Fortunately, the differences between today and the 1970s are probably greater than the similarities. Weak international competition, frequent labour disputes and indexation of various prices and wages contributed to an environment of high, volatile inflation. The contrast with today's situation is stark. Thirty year of low inflation have created a high degree of credibility for inflation targeting, with an especially great impact on wage formation in countries where centralised labour agreements play a key role. The degree of formal price and wage indexation in business contracts has been on a downward trend for 40 years and is now almost completely gone. Although there are concerns that global competitive pressures have weakened in recent years, differences compared to the 1970s are still quite large.

Growth is slowing in the EM economies.

Most emerging market economies are now decelerating, in line with the global trend. This slowdown has clear recessionary features, but no clear definition exists. The underlying trend in the EM countries is too strong for the criterion of negative growth in two consecutive quarters to be relevant. High inflation is eroding household purchasing power. Together with declining growth among OECD countries, this is holding back production and employment. With rising global and local interest rates, most governments – especially in Latin America and Africa – will have less fiscal space for stimulus spending. This is also true of India, where the economy will clearly slow in 2023. We expect GDP in our overall EM sphere to grow by 3.6 per cent this year and 3.9 per cent in 2023, but the upturn is only due to China’s recovery next year. Excluding China, EM sphere growth will fall from 3.8 per cent in 2022 to 3.1 per cent in 2023.

Upward revisions for Brazil and Russia. Brazil's economy has been boosted by rising commodity prices in the aftermath of the pandemic and during the Ukraine war, but a slowdown in global demand will probably gradually lower commodity prices ahead. Combined with fiscal tightening after Brazil’s October elections, this will lead to a clear slowdown in 2023. Unexpectedly strong resilience in the face of sanctions has led to a sharp upward revision of our forecast for Russia, with GDP now expected to fall by only 4 per cent this year. The world is too dependent on Russian energy to cut the country off completely from the global economy. But due to sanctions, the EU embargo and a sharp reduction in the activities of Western companies in Russia, the decline will continue in 2023. Shortages of Western technology and input goods will probably also lead to stagnation further ahead (see theme article, p. 13).

GDP growth, BRIC countries and EM sphere
Year-on-year percentage change

	2021	2022	2023	2024
China	8.1	3.5	5.3	5.0
India	8.3	7.4	5.8	6.5
Brazil	4.8	1.6	0.8	2.0
Russia	4.7	-4.0	-3.0	2.5
Emerging markets, total	6.7	3.6	3.9	5.4

Source: IMF, SEB

Complex relationship between Beijing and Moscow. The EU's decision to reduce its dependence on Russian energy has led to a redirection of oil and gas exports to other markets. Russian oil is discounted by USD 20-30/ barrel compared to Brent oil. China, India and Turkey have taken advantage of these lower prices and boosted their imports. Like Brazil and South Africa, they have not agreed to comply with EU and US sanctions against Russia. China's exports of manufactures such as semiconductors have surged during the Ukraine war. Beijing, which is becoming the Kremlin's most important trading partner by far, will not end its "friendship without borders" with Russia. But major Chinese companies will be cautious to avoid being hit by US-led sanctions. To Beijing, friendly relations with the Kremlin are useful given a potentially more tense relationship with the US. But relations with Russia are not especially important to China compared to the Taiwan issue or relations with the US and EU, which are far more crucial to China's economic well-being and domestic political stability.

Payment crises in smaller countries. Concerns about global recession, falling commodity prices and rising interest rates have led to major capital outflows from emerging economies, following the Fed's key interest rate hike in June. Larger, richer EM economies in Asia with government debt below 50 per cent and external debt below 70 per cent of GDP will fare relatively well, thanks to fiscal and monetary policy flexibility. But various economies with low GDP per capita such as Sri Lanka, Zambia and Ukraine have already defaulted on their debts. Around 40 other countries, including Pakistan and Egypt, are at risk of having to restructure their loans. Since these loans are relatively small, such problems are unlikely to lead to a global crisis. However, rising interest rates and a slowdown in growth will have a dampening effect on stock, bond and foreign exchange markets in EM economies over the next 6-12 months.

Theme:

The war in Ukraine

The economic effects of a lengthy war

In the long term, the big loser of the war in Ukraine will be Russia and the Russian economy, which will stagnate under Western sanctions. In the short term, however, the biggest cost will be borne by Ukraine – both in human lives and economically – and to a lesser extent by the EU, which faces an energy crisis and the threat of recession. Support for Ukraine by the US, the EU and others will be challenged by high costs. Yet this support will probably be sufficient to enable Ukraine, potentially for several years, to defend itself and prevent a Russian-dictated peace.

Russia's invasion of Ukraine has turned into a war of attrition, with neither side seeming capable of resolving the war in its favour within the foreseeable future. A more accurate assessment of events is difficult to make, since there is great uncertainty about the reliability of information from the war. Our main scenario is that the war will continue at least until the end of 2022 and probably into the first half of next year, but there is a major risk that it will continue for several years. The intensity of fighting will vary but will probably continue much as before. Russia, which has an advantage in terms of weapons, ammunition and troops, will probably make small, slow advances in eastern Ukraine, causing widespread destruction. Ukraine has launched a counteroffensive in the south but does not appear to have enough powerful weapons or troops to make major gains. Quickly supplying Ukraine with all the weapons it needs to drive out Russian troops carries two main risks: If Ukraine were to turn the tide of the war in a short period, there is an increased risk that Russia would escalate the conflict in desperation, potentially by threatening nuclear war. On the other hand, if Ukraine failed to turn the war around despite increased support, the domestic and international political cost to donor governments would be high.

A war of attrition to break down resistance. We believe that external military support for Ukraine will gradually increase, forcing Ukraine to conduct a war of attrition without a major counteroffensive but by using constant attacks aimed at breaking down Russia's fighting spirit and capability.

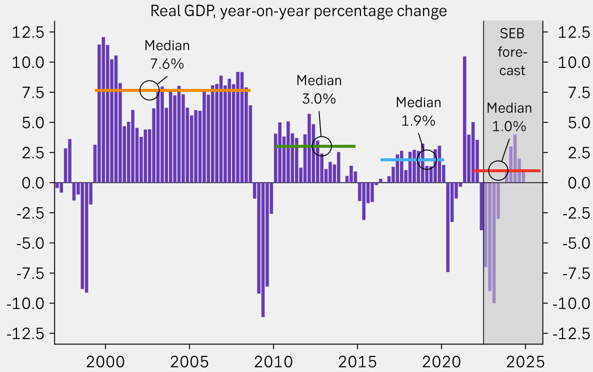
One alternative to this attrition scenario is a major escalation of the war. The Kremlin has been reluctant to declare a general mobilisation (which would probably be politically very unpopular) but by all accounts, President Vladimir Putin is keeping this option open. Talk or implied threats of nuclear or chemical weapons have been more muted recently but these threats might become a reality if the Kremlin perceived that it was rapidly losing the war. An escalation could also draw other countries into the conflict. Russia could attack Poland or one of the Baltic states (which have been the most critical of Russia and have contributed arms and other assistance to Ukraine) if support from or via these countries were to become decisive in the war. This in turn would force NATO to act. However, a Russian escalation would pose an increased risk to the survival of the Putin regime, making that scenario less likely.

A third possible scenario is that both Russia and Ukraine reach a point of exhaustion and seek a negotiated solution. But the probability of this occurring in the near future is almost negligible, despite the agreement allowing exports of Ukrainian agricultural products through the Black Sea. First of all, there is nothing to negotiate. Dmitry Medvedev has said peace will be on Russia's terms, which means that Russia would only accept an unconditional surrender. Beyond a doubt, the Kremlin wants to annex parts of Ukraine, but which parts is unknown. At present, it would also be quite unthinkable for Kjiv to give up the areas occupied since the February 24 invasion. Russia still has a military advantage, but Ukraine may have time on its side thanks to Western support, including increasingly sophisticated weaponry, and an expected gradual deterioration in the Russian economy as a result of the sanctions.

The effects of the war are being felt globally. Ukraine's economy has been hit hard. Its GDP will probably shrink by a third this year due to territorial losses in the war as well as destroyed production capacity and infrastructure. As long as Ukraine manages to halt further Russian advances, the economy should grow next year as some production is moved from the occupied territories and reconstruction begins. The July 22 agreement allowing Ukraine to export agricultural products through the Black Sea offers a glimmer of hope and could generate up to US 1 billion a month in export earnings for Ukraine. We expect the deal to hold but believe Russia will disrupt these deliveries (in order to reduce Ukraine's revenues) on grounds that they are being used, for example, for military purposes. Ukraine's government finances are unsustainable. Kjiv was forced to suspend all payments on its euro bonds in July and devalue the hryvnia by 25 per cent. To meet its budget deficit of around USD 5 billion a month, the government needs greater international assistance. But the war has strengthened the EU's political will to welcome Ukraine, which must mean increased technological and monetary support in the future.

Stagnating Russian economic growth

Real GDP, year-on-year percentage change



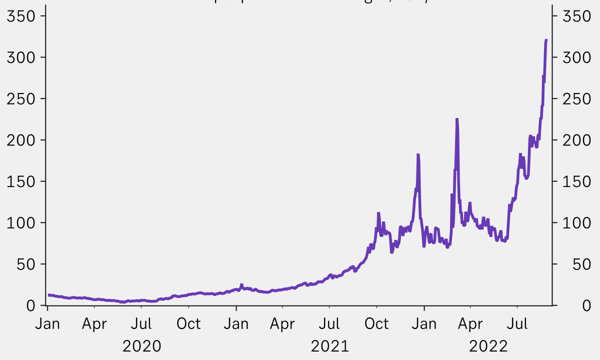
Source: Russian Federal State Statistics Service (Rosstat), Macrobond, SEB

Sanctions against Russia can be divided into three broad categories: 1) restrictions on individuals; 2) economic sanctions, including bans on trade in certain goods and services and on financing of Russian companies and banks; and 3) diplomatic actions. In addition to these sanctions, a number of international companies have decided to greatly reduce their activities in Russia or leave the country altogether. Economic sanctions have been especially harmful to those industries that depend on imported input goods. Auto production, which has almost come to a standstill in Russia, is the clearest example. But industries – including the energy sector – that need imported parts and services will also be hit hard. Unconfirmed reports indicate that tank production has also ceased.

The aim of sanctions is to reduce the ability of the Russian economy to bear the costs of the war. An expected 3-6 per cent decline in GDP is a sign that the sanctions have had such an effect, albeit less than expected. We believe the EU will gradually reduce its imports of Russian energy and that the Kremlin will be unable to fully redirect exports, especially of gas, to other markets. Nor will Russian industry be able to fully replace Western input goods and technology. Compared to the decline in GDP during the COVID-19 pandemic, this downturn will be shallower but far more protracted. Overall, we expect GDP to fall again in 2023 and growth to stagnate at a low level of around 1 per cent after that. According to IMF forecasts, Russia's per capita GDP growth (adjusted for inflation and purchasing power parities) will average 1.6 per cent a year in 2021- 2027, compared to about 4 per cent a year in the rest of the world. If this forecast proves correct true, Russian GDP per capita will increase by about 12 per cent over this period, compared to 32 per cent in the rest of the world and 44 per cent in emerging economies. The Russian economy will not collapse but will probably be increasingly reminiscent of the final years of the Soviet Union.

The war and sanctions have had a significant impact on global commodity prices, especially for energy. Attempts to limit Russia's revenues from energy exports – the Kremlin's main source of income – have not been as effective as restrictions on exports of input goods to Russian industry. Together with pandemic-related factors, weather effects and Kremlin countermeasures, actions targeting Russian energy exports have contributed to sharply rising prices, especially for natural gas in Europe. The EU, the single largest importer of Russian energy, faces a difficult balancing act. It wants to limit the Kremlin's export earnings while keeping these exports going in order to avoid further price increases and a global recession.

Soaring gas prices signal an EU energy crisis
Dutch TTF spot prices for natural gas, EUR/MWh



Source: Intercontinental Exchange (ICE), Macrobond, SEB

One problem, however, is that global energy prices are being driven up as the EU replaces its Russian energy purchases with alternatives such as liquefied natural gas (LNG), for example from Qatar and the US, and oil from the Middle East, Africa and the US. Sanctions have increased the discount on Russian oil compared to Brent from around USD 2/barrel to more than USD 30/barrel. Despite the discount, the average price of Russian oil (Urals) has been higher in 2022 than before. Combined with continued strong Russian production and exports, this has allowed Russia to boost its oil revenue this year. The countries that have increased their imports of Russian oil the most are India, China and Turkey. Russia is the world's second largest exporter after Saudi Arabia and the world's third largest producer of oil, accounting for over 10 per cent of global production. If sanctions were to halt Russian oil exports, this would lead to a global recession and completely undermine international support or acceptance of the sanctions against Russia. An agreement with Iran on its nuclear programme that might allow Iran to resume sales of its oil in the world market would mitigate these effects but would not be enough.

The Kremlin, with the help of state-controlled Gazprom, has reduced the flow of natural gas through the important Nord Stream 1 pipeline to about 20 per cent of capacity in response to EU plans to stop importing Russian oil and reduce dependence on Russian natural gas. We believe Russia will not completely choke off the gas supply but will keep its threats alive. The aim is to drive up prices as much as possible, both to increase revenue and to cause the highest possible costs to the EU, the US and their allies. In the long run, the war is likely to accelerate the green energy transition, but new sustainable alternatives cannot be built fast enough to avoid an energy crisis this winter, especially if Russia totally cuts off the flow of natural gas to Germany and other major EU countries.

No major sanctions packages are expected any time soon. In May the EU decided to stop buying Russian oil imported by ship starting December 5, 2022 and petroleum products starting February 5, 2023. A ban on insuring shipments of Russian oil above a certain value to countries outside the EU and the UK has been postponed due to implementation difficulties and the risk that the ban would create a shortage of oil in the world market and drive prices up further. Given the difficulties in agreeing on the details behind already approved sanctions, we do not expect any major new sanctions packages in the near future. Some US senators are pushing to define Russia as a terrorist state, but the Biden administration opposes this step since it risks forcing the US to punish allies that operate in, or have other relations with, Russia. But further restrictions on individuals and organisations are likely in response to Russian atrocities in Ukraine. Western political efforts in the next year will focus on ensuring sanctions enforcement and closing potential loopholes.

The course of the Ukraine war will depend on economic developments in Russia. The hope that sanctions would prompt the Kremlin to end the war quickly and withdraw its troops was never realistic. It will take time before sanctions affect the Kremlin's current approach to Ukraine, potentially several years.

Fixed income

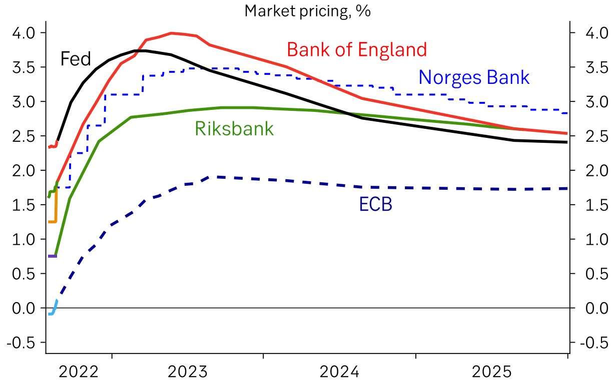
The upturn in long-term yields is drawing to a close

Global fixed income markets are now considered to have reached a more mature phase in their cycle. This implies more volatility in yields and less clear trends. With key interest rates expected to peak either in late 2022 or early 2023, long-term yields will rise a bit further this autumn and then fall in 2023. Riksbank policy shifts are expected to contribute to a widening of Swedish-German long-term yield spreads in 2023, while the Norwegian equivalent will narrow next year.

Long-term yields are close to their peak. The upward trend in long-term bond yields ended in Q2 2022 as market expectations of key rate hikes diminished. Ten-year US Treasury yields peaked at 3.50 per cent in June. This brought the US fixed income market into a more mature, trendless phase with higher volatility as a consequence. Although the European Central Bank started key rate hikes as recently as July, it is now also expected to end its hiking cycle by early 2023, shortly after the US Federal Reserve's key rate reaches its maximum. We expect global long-term yields to continue modestly upward this autumn, but with June 2022 levels marking the peak of this yield upturn cycle.

Front-loaded key rate hikes, followed by rate cuts

Market pricing, %



Source: Macrobond, SEB

US long-term yields will fall to 2.80 per cent in 2023. Events over the past 40 years show that US long-term yields typically peak just before the Fed ends its hiking cycle. At that time, US 2- and 10-year Treasury yields will be trading at the same level – or just below the Fed's key rate. We thus expect 10-year Treasury yields of around 3.30 per cent at the end of 2022, based on our forecast that the key rate will have topped out at 3.25-3.50 per cent by then. We consider it quite unlikely that the 10-year yield will climb above 3.50 per cent unless the economic growth outlook clearly improves, which would justify further key rate hikes. Next year, long-term US Treasuries are expected to trade at around 50 basis points below the key rate just before the Fed carries out its first rate cut. Taking quantitative tightening into account (see the QT theme article, p. 17), the 10-year yield will stand at 2.80 per cent at the end of 2023 and 2.60 at the end of 2024.

Long-term German government bond yields have followed expectations about the ECB's hiking cycle. In June – when the market was expecting the ECB deposit rate to reach 2.50 per cent in 2023 – German 10-year yield stood at 1.93 per cent. Despite high inflation, it seems unlikely that these key rate expectations will return, now that growth is falling. The end of the ECB's QE programme is expected to contribute to a modest increase in long-term yields. We expect German 10-year bonds to fluctuate at around 1.75 per cent in 2023, at the same level as the ECB's deposit rate. Long yields will fall somewhat in 2024 as the ECB cuts its key rates.

10-year government bond yields

Per cent

	Aug 25	Dec 2022	Dec 2023	Dec 2024
United States	3.05	3.30	2.80	2.60
Germany	1.32	1.65	1.75	1.60
Sweden	1.62	2.05	2.35	2.20
Norway	3.23	3.45	3.40	3.30

Source: National central banks, SEB

Swedish yield spreads against Germany have shown high volatility this summer, with wider spreads for shorter maturities. Meanwhile the 10-year spread has narrowed greatly. As in the US, Sweden's yield curve has inverted. The Riksbank will almost completely stop buying bonds in 2023 and hike its key rate more than the ECB, suggesting that the long-term spread will widen a bit in the coming year. We expect unchanged spreads between Sweden and Germany during 2024.

Norwegian long-term yields have followed US yields, which has created volatility in spreads between Norway and Germany. The market is discounting a continued front-loaded interest rate policy by Norges Bank. Partly due to cautiously rising Norwegian long-term yields, we believe that the spread against German may narrow, although this autumn's issuance of new 20-year bonds might maintain the yield spread in the short term.

Theme:

QT and interest rates

The world is again testing uncharted monetary policy terrain

Central banks are not the main reason for today's global inflation problems, but they were too slow in starting to withdraw their highly expansionary stimulus policies. Now global monetary policy is moving in the opposite direction, with historically large and rapid rate hikes. This tightening also includes a reduction in central bank holdings of fixed income securities (quantitative tightening: QT). We draw the following conclusions: 1. The effects of QT policy on interest rates, and thus on the degree of monetary stimulus, are marginal. 2. QT policy is expected to continue even if key rates are lowered in 2023-2024; 3. The banking system's need for liquidity, and the possible launch of new repo facilities, will determine when various central banks will end their QT policies.

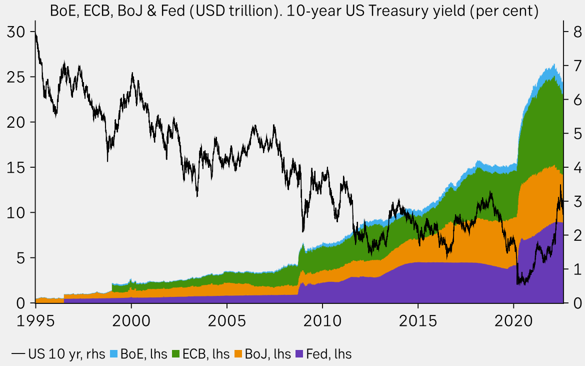
A neutral nominal interest rate of 2-2.50 per cent, calculated by central banks and international organisations, appears to have been a crucial benchmark for the central banks of advanced economies in reducing the expansionary effects of key interest rates on financial conditions, and thus on the real economy (see *Nordic Outlook*, February 2022: "Theme: Monetary exit policy"). Interest rates should be compatible with normal resource utilisation and create an equilibrium between supply and demand for capital, both nationally and internationally. This year more than 70 central banks have hiked their key rates by 0.50 percentage points at a time. Canada surprised the world by raising its rate by one full point in mid-July.

Over the years, we have dealt with the concept of neutral interest rates and their driving forces, based on structural changes that alter the propensity to save and invest at both the national and global level. We have also discussed the effects of rapidly rising public debt, central bank quantitative easing (QE) and increased capital needs due to climate-related investments. Our conclusion is that even though the metric is surrounded by some uncertainty, the neutral interest rate concept can help guide monetary policy.

The Bank of Japan began the QE era back in 2001 and became a pioneer of unconventional monetary policy. But not until the global financial crisis of 2008-2009 did other major central banks begin in earnest to use their balance sheets to influence economic and financial developments. Central bank assets have increased by more than USD 20 trillion since 2008; half of this balance sheet expansion occurred during the pandemic years 2020-2021.

Central bank assets are up by more than USD 20 trillion

BoE, ECB, BoJ & Fed (USD trillion). 10-year US Treasury yield (per cent)

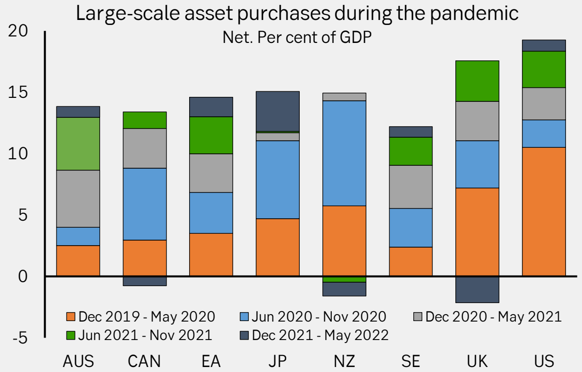


Source: Macrobond, SEB

Reversing the monetary experiment. The pandemic marked the culmination of the major monetary policy experiment that began after the 2008 Lehman Brothers crisis – featuring synchronised key rate cuts, negative interest rates and enormous asset purchases. Today the world is facing a new monetary experiment. In a very short period, central banks have implemented rapid and unusually large rate hikes from historically low levels. Meanwhile they intend to reduce their holdings of such assets as government securities financed by increased bank reserves – newly created electronic central bank funds ("money printing").

Large-scale asset purchases during the pandemic

Net. Per cent of GDP



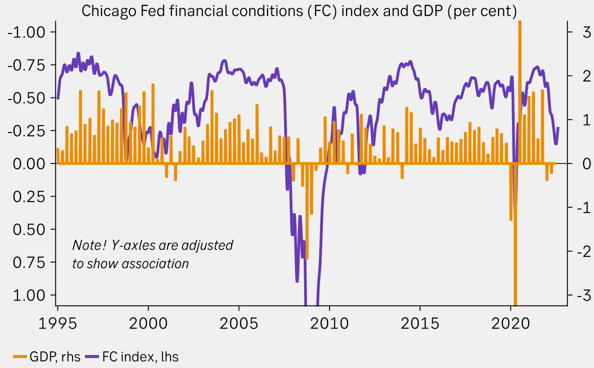
Events during the past year have created a number of challenges for macroeconomic policymakers. High inflation is a growing challenge, further complicated by a fragile growth outlook and financial vulnerability. In addition, real and nominal interest rates are extremely low – far lower than they usually are at the beginning of a tightening cycle. In such an environment, central banks usually find it hard to achieve a soft landing by means of higher key interest rates – to sustainably bring inflation back to target by using economic policy, without sharply limiting economic expansion.

A soft landing is far from impossible. According to a new study by the Bank for International Settlements, half of 129 monetary tightening cycles in 35 countries over the past 30 years have successfully achieved a soft landing. The BIS study also shows that the probability of a hard or soft landing is not affected by either the pace or the size of rate hikes. This will give central banks some courage to act forcefully.

The likelihood of a hard landing nevertheless increases if the policy triggers a correction in – and a weakening of – the so-called financial cycle. A financial cycle refers to the self-amplifying forces that arise from an interaction between different actors' views about valuations and risk, changes in risk appetite and financial constraints. Financial cycles can amplify both economic booms and busts. However, our assessment is that the balance sheet of the private sector – households and businesses in Europe and the US – looks relatively strong. This decreases the risk of a deep recession and makes it unlikely that the recovery will be as protracted as the 7-8 years that have historically been common following so-called balance sheet crises.

US: Tighter financial conditions, but a turnaround soon?

Chicago Fed financial conditions (FC) index and GDP (per cent)

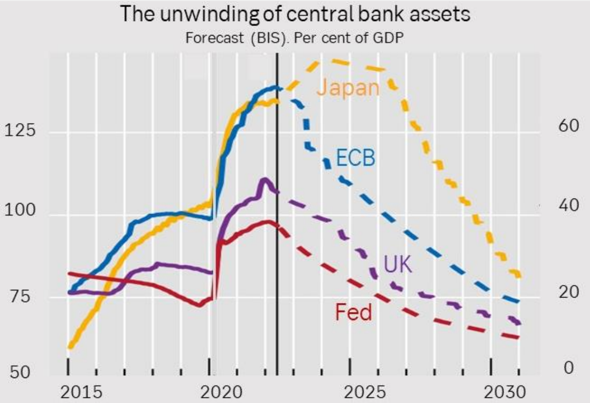


Source: Federal Reserve Bank of Chicago, U.S. Bureau of Economic Analysis (BEA), Macrobond, SEB

The quantification of reduced monetary stimulus includes an assessment of both key interest rate changes and reduction of the balance sheet and their effects on financial conditions (for example via changes in market rates, credit spreads, exchange rates, asset prices, willingness to lend etc.). There are also differences between these tools, which central banks may need to factor into their decisions. Key interest rates mainly affect short-term rates, while QT policy may have a more direct impact on certain parts of the yield curve, as well as on various types of credit spreads. In addition, central banks have far more experience with key interest rates than with QT policies.

The only real QT policy previously implemented was by the Fed from October 2017 to September 2019: it ended with a liquidity crisis in the US repo market.

There are two variants of QT: passive and active. Active QT is the most concrete way to accelerate the normalisation of a central bank balance sheet. Unlike passive QT, which is based on the maturity structure of securities, it implies selling off securities from the portfolio. The remaining maturity of a fixed income security that is sold affects the duration risk of the private sector. The timing of the impact is also different. Active QT implies that the effects occur now; passive QT, when the security approaches maturity.



The effects of QT on the fixed income market are expected to be small. This is in line with our previous conclusions. Analyses this summer by the Fed and the Reserve Bank of Australia (RBA) play down the impact of QT on long-term yields and how much of a key rate tightening it corresponds to. The Fed study suggests that under normal circumstances, passive QT – equivalent to a total of USD 2.2 trillion over a 3-year period (nearly half the Fed's balance sheet expansion during the pandemic) – corresponds to a key rate hike of 30 basis points. If risk aversion doubles, such a QT policy is instead equivalent to about 75 basis points.

Australia has chosen to refrain from active QT until further notice. There are several reasons for this. On the one hand, the RBA states that it is easier to change its monetary policy and more directly influence financial conditions through its key rate, not through QT policy. Asset sell-offs may "disrupt" government debt policy and affect the choice of maturities for borrowing, and the effectiveness of QE policy may decrease if the market needs to factor in the risk that QE policy may quickly change. So far, only the Bank of England (BoE) and the Reserve Bank of New Zealand have chosen to take the step of actively selling securities in the market.

Central bank financial results and equity capital are strongly and adversely affected by rising key rates and long-term yields. In a recent analysis, for example, Sweden's Riksbank notes that its equity may be wiped out this year due to a potential loss of about SEK 65 billion when the market value of both its foreign and domestic fixed income portfolio falls. If these securities are sold, the loss will become a reality. This may be one reason for central banks to hold their fixed income securities to maturity and abstain from active QT.

QT policy may continue even if central banks begin cutting key interest rates. This has recently been confirmed by the BoE. The UK central bank began active QT in September and intends to sell GBP 40 billion worth of government securities over the next year. The BoE says that it would take a lot to persuade the bank to end its QT policy. The BoE maintains that the impact of QT on monetary policy conditions is limited. Meanwhile a repo facility will be created in the UK to cover any future liquidity needs in the banking system.

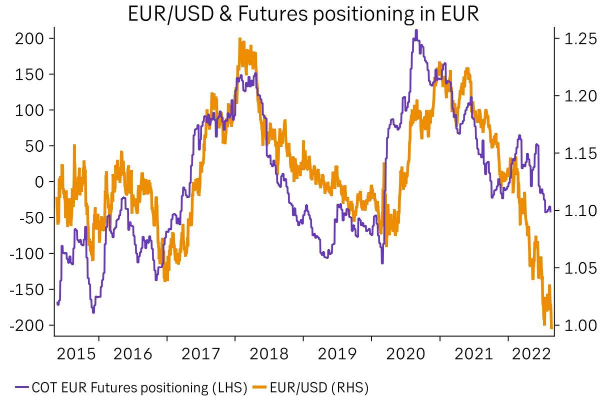
Key rates remain the primary monetary policy tool for reducing monetary stimulus, for several reasons. It is easier for the public to understand how changes in key rates affect both the national economy and their own finances. Researchers are rather uncertain about the impact of QE/QT policy on the real economy and financial markets. It is also easier to adjust policies and to influence financial conditions by calibrating one instrument instead of two when conditions change.

However, a reduced monetary policy portfolio may have consequences for central banks' interest rate management systems. As central bank assets decline, the amount of bank reserves (electronic central bank money) used to fund the purchases of fixed income securities or other crisis policies such as lending – for example during the pandemic – also falls. The amount of bank reserves depends on the liquidity needs of banks.

Today no one knows how great this liquidity need is. As central bank assets shrink, sooner or later banking systems will reach a level where the price of money will begin to rise. To ensure that QT policy does not contribute to an undesirably low liquidity level, the Fed and BoE have set up repo facilities that will allow the banking system to access liquidity for a limited period, in exchange for securities. How big a central bank's balance sheet should be will ultimately be determined by the demand from banks for reserves (liquidity) to meet changing economic and financial conditions.

The FX market
The strong dollar maintains its grip

Global economic growth will slow significantly in the coming year, while inflation remains well above 2 per cent. Periods of stagflation have often been negative for risk appetite. Coupled with continued rapid US monetary policy normalisation, there are few arguments against the USD, even though it is overvalued. The defensive macro environment – including the major challenges facing Europe – is not constructive for the krona, but its outlook will improve next year as the EUR/SEK rate falls towards 10.00.



Source: Macrobond Financial AB, Commodity Futures Trading Commission (CFTC), Macrobond, SEB

	Aug 25	Dec '22	Dec '23	Dec '24
EUR/USD	1.00	0.95	1.09	1.15
USD/JPY	137	138	130	120
EUR/GBP	0.84	0.83	0.86	0.90
EUR/SEK	10.54	10.55	10.15	9.80
EUR/NOK	9.66	9.85	9.70	9.65

During the first half of 2022, FX market forecasts focused on the timing of the shift in focus from rapid US Federal Reserve rate hikes to normalisation processes at other central banks. But Europe's deepening energy crisis is weighing on the euro, while the increased likelihood of a global recession favours the dollar. In this environment, it is hard to foresee any imminent reversal for the EUR/USD rate, even though the USD is now clearly overvalued and today's level just above parity is the strongest we have seen in 20 years. Only when inflation clearly turns around and the Fed can signal that it is nearing the end of its hiking cycle will there be potential for a weaker USD. But the precarious energy situation facing Europe means that gentle signals from the Fed will hardly be enough. We thus expect EUR/USD to fall further to 0.95 late in 2022 before we see the euro start recovering; by the end of 2023, we foresee EUR/USD at 1.09. An unexpectedly rapid end to the Ukraine war or a clearer inflation slowdown are factors that could trigger a stronger euro upturn.

A favourable environment for defensive currencies. We recently published our quarterly *FX Pilot* report, analysing the drivers behind major currencies. Given a macro environment dominated by decelerating growth and weak risk appetite, we concluded that aside from the USD, defensive currencies like the JPY and CHF are benefiting. But currencies favoured by good risk appetite and rising stock markets are facing headwinds. In Europe, this applies to the euro and the Scandinavian currencies. Elsewhere, the currencies of Canada, Australia and New Zealand are other key examples.

The British pound will continue to lose ground. The EUR/GBP exchange rate has been largely unchanged lately as various forces have counteracted each other. Front-loaded key interest rate hikes are keeping the pound up. But given how hard the UK economy will land next year, it is plausible that the pound will lose ground again. We thus expect EUR/GBP to fall to 0.83 late in 2022, then reverse to 0.86 towards the end of 2023.

The SEK will continue to struggle. The Ukraine war has changed the situation of the krona as well. Despite rapid key rate hikes and rising Swedish market rates, the SEK is being weighed down – especially against the USD – by economic fears and risks linked to the European energy crisis. In the short term, the Riksbank's FX purchases (SEK 12 bn/month) help weaken the krona. These will cease at the end of 2022, contributing to an improved flow situation in 2023. We thus expect the krona to appreciate, with the EUR/SEK rate moving from 10.55 at the end of 2022 to 10.15 by the end of 2023.

The Norwegian krone is showing several faces. This year, the NOK has swung between acting like a commodity currency similar to the AUD, CAD and NZD and a risk-sensitive currency such as the EUR and SEK, and we expect this behaviour to continue. The EUR/NOK has declined since the height of summer, but since we expect falling risk appetite and a seasonal pattern including a weak NOK, we believe EUR/NOK will climb to around 9.85 this autumn. In 2023 we believe it will fall to 9.70 but that, as usual for the NOK, much of this movement will occur during the first half of the year.

The stock market
Stock markets are looking ahead despite headwinds

This year's stock market slide reflects weaker global conditions and has normalised share valuations. But the recent rebound, accompanied by continued weak statistics, raises questions about the discount horizon. Investors seem to be looking past short-term problems towards a future turn for the better. If the slowdown is shallow and lower interest rates are in sight, these hopes are not unreasonable, but today's uncertain growth picture and a tough inflation and key rate outlook warrant humility during the coming months.

At mid-year 2022, surveys showed that professional investors were almost record-gloomy about the future, with views on growth and earnings as well as positioning close to global financial crisis (GFC) lows.

The subsequent stock market rally seems like a natural response to this rather negative picture, but the upturn has been surprisingly large given the continued deterioration in international economic conditions. In times of genuine uncertainty, the stock market's discount horizon has a natural tendency to shorten. Instead, the latest rally probably reflects an extended horizon. Investors expect the growth slowdown to be fairly mild and short-lived and believe inflation and key rates will peak and decline. However, this could set the stage for disappointments in the months ahead.

As this *Nordic Outlook* shows, the slowdown in growth will be accentuated and rather lengthy, though not a crash like during the GFC. But with inflation that persistently surprises forecasters on the upside, an emerging European energy crisis, growth problems in China and tightening central banks policies, there will be plenty of storm clouds over markets in the near future.

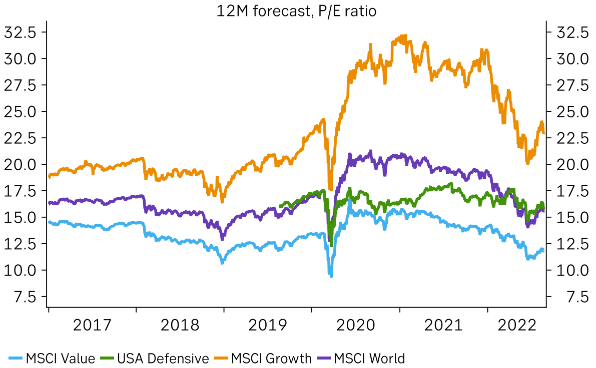
Offsetting these sources of concern – as always – are a number of strengths: continued cautious positioning among investors, signs of easing in global supply chains and, not least, earnings performance. Companies have surprised observers for several quarters and maintained high margins. Perhaps this explains why earnings forecasts for this year and next have remained broadly unchanged over the year, despite clearly worsening conditions. We expect earnings growth of some 5 per cent for both 2022 and 2023, supported by exceptionally good earnings growth for commodity producers. But with commodity prices appearing to peak and profit margins at historically high levels while companies are providing a mixed picture about prices and margins, there is a risk that forecasts will be revised lower. This is part of market expectations, but it still adds to the risk picture. However, due to positive forces we do not foresee a major decline in profits, which is otherwise common in periods of weak growth.

This year's plunging prices indicate that stock markets anticipated much weaker performance ahead. But after a decline of well over 20 per cent in H1 2022, US equities are trading only about 15 per cent below their year-end peak (S&P 500) after their July rally, and the MSCI AC World Index is down about 13 per cent from its peak. The good news is that price declines, coupled with decent earnings gains, have brought valuations (as measured by P/E ratios) clearly lower. As the chart shows, high-valued growth companies have taken the biggest beating, which makes sense because their valuation premiums were record-high and they are more sensitive to rising interest rates. But with a global P/E ratio of around 15 (looking ahead 12 months), we have a bit further to go to the 13-14 range, where the market has often rebounded after previous downturns. Overall, it is still difficult to buy stocks based on low valuations alone, especially if we consider the risk of downgraded earnings forecasts. One possible exception is the euro area, where stock markets have lagged for some time.

If macroeconomic developments this autumn give us reason to look past the deep economic slowdown and rising inflation and interest rates, the recent stock market rally could well mark the beginning of a new positive trend for equities. But given the headwinds and great uncertainty that we see, there is still a risk that this summer's stock market lows will again be tested.

Depressed and converging valuations

12M forecast, P/E ratio



Source: Bloomberg, Macrobond

The United States
A mild recession soon, due to inflation and Fed actions

GDP will continue to fall towards the end of 2022 as rapid key interest rate hikes and high inflation curtail home construction, investments and private consumption. The slowdown will be mild in a historical perspective, with growth bottoming at +0.5 per cent next year, but this will still suffice to end some of the inflation problems that have caused the Fed to hike its key rate at the fastest pace since the 1980s. Late in 2023, the Fed will begin to lower its key rate again.

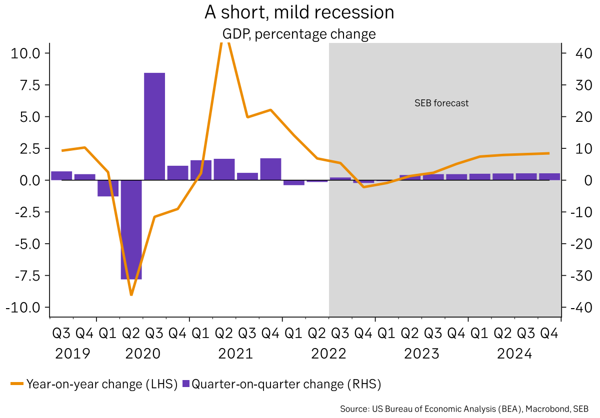
GDP decreased during the first two quarters of 2022, which means that the popular definition of a technical recession has been fulfilled. But as long as employment is growing at a healthy pace, the official criteria of the National Bureau of Economic Research (NBER) are unlikely to be met. We believe it is only a matter of time before all criteria are met, however – since GDP will again decrease late in 2022 as home construction falls, consumption slows and business investments shrink. But we expect the decline to be moderate in historical terms. As full-year averages, GDP growth will slow to 1.5 per cent this year and reach only 0.5 per cent in 2023. In 2024, it will climb to 2.0 per cent, which is in line with the trend rate.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	5.7	1.5	0.5	2.0
Unemployment*	5.4	3.6	4.6	4.9
Wages and salaries	4.2	5.5	5.0	3.5
Core PCE (Fed target metric)	3.3	5.0	3.8	2.2
Public sector balance**	-10.9	-4.5	-5.0	-6.0
Public sector debt**	135	130	130	131
Fed funds rate, % ***	0.25	3.50	3.25	2.50

*% of labour force **% of GDP ***Upper end of Fed funds rate interval. Source: Macrobond, SEB

Underlying weakness. GDP fell more slowly in Q2, but its composition deteriorated, with a slightly slower private consumption and, primarily, lower capital spending. This was in stark contrast to Q1, when GDP fell due to strong imports, while domestic demand kept growing. But the main negative driver was inventories, which will again weigh down GDP this year, partly offset by trade.



Pessimistic households and businesses. Sentiment indicators are signalling that the US economy is on its way down, although the situation stabilised a bit this summer. According to the University of Michigan index, consumer confidence fell to record lows in June. Both the Michigan and Conference Board surveys show falling optimism. Normally, forward-looking components are more strongly correlated to consumption than current assessments, though this pattern was disrupted during the pandemic. Small business sentiment (NFIB) is now below the bottom levels during the pandemic. The ISM purchasing managers' index for large companies remains expansionary, but forward-looking sub-indices – mainly new orders – reflect a weaker situation among manufacturers in particular. The difference between ISM orders and inventories, which usually determines the trend of the full index, has fallen to clearly negative levels. Meanwhile one positive development is that bottlenecks seem on their way to being resolved; in July the index for delivery times among manufacturers fell to its lowest level since before the pandemic.

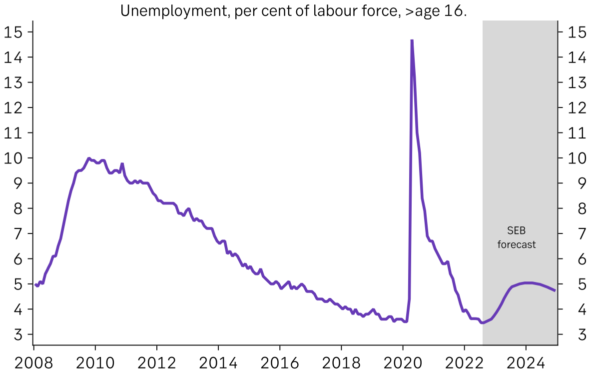
Federal Reserve hikes are starting to curtail interest rate-sensitive sectors. Business investments in equipment and premises fell in Q2, and small businesses have lowered their investment plans. Order bookings for capital goods, excluding defence and transport, remain high but are probably being driven upward by soaring investment goods prices. The decline in the ISM new orders index shows that the post-pandemic investment recovery has ended. We expect growth in business investments to turn negative late in 2022.

Falling construction, but no collapse. Home construction is the sector most affected by Federal Reserve monetary tightening. Its decline is expected to continue during the rest of this year and into 2023. Sales of new and existing homes have fallen by more than their entire increase during the pandemic, and high interest rates make further decline likely. With 30-year mortgage rates at their highest in nearly 15 years, following rapidly rising home prices during the pandemic, the housing affordability index has fallen to global financial crisis (GFC) levels. Yet there is reason to believe that these housing market adjustments will be milder and secondary effects on the rest of the economy less serious this time around. Today households mainly borrow for long periods, and the shaky sub-prime loans that contributed to the housing crash are uncommon. The current upturn in interest rates is mainly affecting first-time home buyers. A housing shortage, after a long period of depressed construction, is another supporting factor. Home prices will probably fall, but the kind of negative wealth effects we saw during the GFC are still unlikely. Household debt as a percentage of GDP is also low in historical terms, though it has surpassed pre-pandemic levels. Finally, the construction sector makes up a smaller share of the economy than before the GFC.

The party is over. Household consumption has been supported by a pent-up need for services as the economy has reopened, but the increase in Q2 was the lowest since the declines seen early in the pandemic. The slowdown in goods consumption occurred from the artificially high level established during the pandemic. This was especially true of non-durable goods, with demand now being squeezed by high energy and food prices, while last year's extended government grants for low-income families with children have expired. The household sector as a whole still has a significant savings buffer. The savings ratio has now fallen to about 5 per cent, the lowest since 2009, but households have still only just begun to draw down buffers that were equivalent to 10 per cent of GDP after pandemic stimulus measures and earlier consumption declines. This should reduce the risk of the kind of downward spirals that have historically affected the US economy during labour market reversals, due to weak safety nets. But there are warning signs related to uneven distribution of savings. Credit card debt is again soaring, indicating that more households are being squeezed by high inflation and falling real wages. Our forecast is that consumption growth will slow to a mere 0.5 per cent next year after a few quarters of lower consumption.

An overheated, poorly functioning labour market. Employment kept growing at a healthy pace during Q2 and accelerated in July, but the statistics are not unequivocal. The household survey that provides the basis for the unemployment statistics indicates a weaker situation. The ISM employment index shows stagnating employment. Labour shortage figures appear to have peaked, although their levels indicate a continued tight labour market. Unemployment is now back at the 50-year lows seen before the pandemic. But this is not only a sign of strength. It is also due to a stagnating participation rate since early 2022, partly because many older people who left the labour force during the pandemic have not returned. In addition, drug abuse problems appear to have worsened during the pandemic. According to one study, higher drug abuse accounted for up to a quarter of reduced participation until mid-2021. An ageing population and increased barriers to immigration are underlying factors that are inhibiting the potential for increased labour supply. Our forecast includes a more pessimistic labour supply assessment than before. Yet the decline in employment that we are expecting will cause the jobless rate to climb from 3.5 per cent in July to 5 per cent by the end of 2023, followed by a slow downturn in 2024.

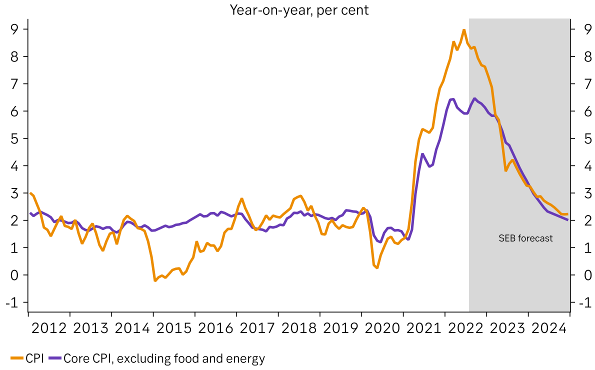
Slight labour market cooldown
Unemployment, per cent of labour force, >age 16.



Source: US Bureau of Labor Statistis (BLS), Macrobond, SEB

Pay increases pose a challenge for the Fed. High job vacancy levels compared to the number of unemployed people are a warning signal that matching problems have worsened since the pandemic. This has raised the question of whether the unemployment rate that is required to ensure stable wages has risen more permanently. But the upturn in vacancies is accompanied by large voluntary resignations. This also shows that demand for labour is being driven by greater labour market mobility, with businesses being forced to compete for the same workforce by offering more generous employment conditions in today’s very tight labour market situation. Our price and wage forecast assumes that a moderate labour market slowdown will be sufficient to achieve a better balance and that the Fed will not need to drive unemployment much higher. But we are not there yet – as illustrated by the fact that average hourly wages have accelerated in recent months and that the Atlanta Fed's median wage metric remains at high levels. The main metric that the Fed relies on is the quarterly employment cost index (ECI). According to the ECI, wage growth among private sector workers gained new momentum in Q2. It is of course worrying that this happened when inflation was at its highest in more than 40 years. The Fed's July statement predicted a period of below-trend growth and a slightly weaker labour market. We believe that a sharper slowdown than this is required to overcome inflation problems, but this is what now seems about to happen.

Inflation back at Fed target by end of forecast period
Year-on-year, per cent

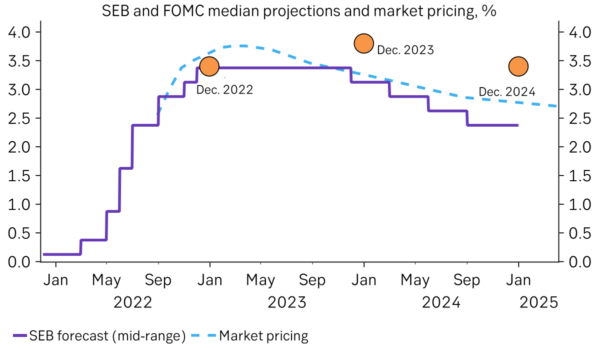


Source: Bureau of Labor Statistics, Macrobond, SEB

Some favourable inflation signals. Market-priced inflation expectations, but also some household surveys, moved lower this summer. Our forecast is that June CPI (9.1 per cent) represented the peak of inflation. The July downturn was mainly due to falling energy prices, but the increase in underlying consumer prices excluding food and energy also slowed. Tendencies towards an easing of bottleneck problems in the business sector, falling commodity prices and a slower upturn in PMI purchasing price indices provide reason for optimism about goods prices. But the inflation outlook is mixed. A tight labour market and rapid pay increases are upside risks for services. Due to base effects (from low price hikes in Q3 2021), we expect core inflation to accelerate again this autumn. The Fed's favourite inflation metric, core PCE, has risen less than core CPI, partly due to lower weighting for rents, which are now rising rapidly. But even this metric is well above the Fed's target. It stood at 4.6 per cent y-o-y in July, while the m-o-m rate declined from 0.6 to 0.1 per cent.

A tough balancing act for the Fed. At the Fed's July meeting, Chairman Jerome Powell said he was open to another huge 75 basis point rate hike in September, but he also emphasised that the Fed is approaching a point where it may slow down and evaluate the effects of the hikes it has already implemented. One reason to proceed more cautiously is that the key rate has now reached around 2.50 per cent, which the Fed views as neutral. The credibility of the inflation target is crucial, and the Fed is dependent on factors beyond its control such as the risk of a renewed energy price surge due to the Ukraine war. But our forecast of a mild recession in late 2022 and early 2023 suggests that the Fed hiking cycle will end at the turn of the year. We are forecasting that the key rate will peak at 3.25-3.50 per cent after a 50 bp hike in September followed by two 25 bp hikes in November and December. Due to persistently high inflation, the Fed will pause its hikes through the third quarter of next year, a bit longer than according to the historical pattern. The average since the 1994 hiking cycle has been slightly over 8 months from the last hike to the first rate cut, but shorter if the prolonged hiking cycle after the global crisis (14 months) is excluded. We expect the key rate to be back at neutral levels of around 2.25–2.50 per cent by the end of 2024.

Fed key rate to peak by year-end
SEB and FOMC median projections and market pricing, %



Orange dots, median rate projections, FOMC members, June 2022

Source: Federal Reserve, Macrobond, SEB

Some successes for Biden, finally. Joe Biden's presidency got off to a flying start with a new COVID-19 stimulus package in March 2021, followed by a bipartisan agreement on infrastructure investments. After that, discord within the Democratic Party put an end to further economic reforms. But at the last moment before this November's mid-term elections, when the Democrats are expected to lose control of one or both houses of Congress, Biden has scored some successes. One is a proposal to expand domestic semiconductor productions – aimed at strengthening the US against China – which attracted some Republican support. Another is USD 350 billion worth of climate transition investments, financed by lower pharmaceutical costs, higher corporate taxes on profitable listed companies and more effective tax collection. The latter package was marketed as the Inflation Reduction Act and is also intended to result in smaller budget deficits over several years. We do not believe that the package, which will run over a ten-year period, will make any major difference to inflation. On the other hand, it gives the US a reasonable chance to fulfil its commitments under the 2015 Paris Agreement. It is expected to reduce greenhouse gas emissions 40 per cent by 2030, not far from Biden's original goal of halving such emissions.

Japan
Slow steps towards monetary exit policy

Inflationary external forces are being offset by deflationary domestic factors – allowing a divergent, more expansionary monetary policy than in other G7 economies. Pent-up demand will boost GDP growth in the near term, but weaker international conditions and structural forces will continue to slow the recovery. The Bank of Japan (BoJ) is expected to initiate its monetary exit policy during the latter part of 2023, but monetary policy will remain clearly expansionary.

Both monetary and fiscal policy are continuing to provide Japan's economy with the necessary growth support, but their impact is limited by higher inflation and energy prices as well as by weaker global demand. GDP recovery is possible because of the diminishing negative effects of earlier virus-related shutdowns and production disruptions. After a weak start to 2022 a cautious acceleration will thus take place, with the help of pent-up domestic demand. GDP growth in 2022 will be 1.9 per cent as the government's big stimulus package from last spring – equivalent to 2.4 per cent of GDP – takes full effect. Due to the gradually fading impact of economic policy and mounting demographic headwinds, GDP growth fall back towards trend levels, reaching 1.6 per cent in 2023 and 1.1 per cent in 2024. Trend growth is estimated at 0.5-1.0 per cent.

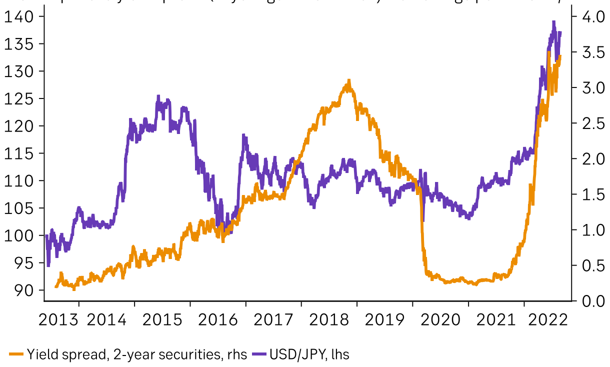
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	1.7	1.9	1.6	1.1
Unemployment*	2.8	2.6	2.5	2.5
CPI	-0.2	2.0	2.1	1.3
Public sector fiscal balance**	-7.6	-7.8	-3.5	-2.5
Public sector debt**	263	263	258	259
Repo rate, %***	-0.10	-0.10	0.00	0.25

*% of labour force **% of GDP ***At year-end. Source: IMF, SEB

Households will be a growth engine during 2023 and 2024. Unemployment remains at a historically low 2.5 per cent in Japan due to a continued decline in labour supply and an ageing population. Government grants aimed at easing high household energy bills are expected to continue in the coming year. The household savings ratio will fall from 8.5 per cent in late 2021 to pre-pandemic levels of around 3 per cent at the end of our forecast period, boosting private consumption. New and growing COVID-19 transmission will pose a risk to Japan's recovery. Companies are also challenged by weaker global demand, but profit levels are high and export earnings are being maintained by a much-weakened yen. This is bolstering corporate optimism and encouraging investments. The direct short-term impact of the Ukraine war is limited, but more than 90 per cent of Japan's energy supply must be imported.

Short-term yield spread weakens yen against dollar
US-Japanese yield spread (2-year gov't securities). Percentage points. USD/JPY



Source: Macrobond, SEB

A lacklustre economic recovery after the pandemic – and the country's history of deflation – are among the reasons why Japan is facing far less serious inflation problems than other economies. Inflationary pressure is expected to remain weak. Despite low unemployment, wage and salary growth will be moderate; deflation worries are still deeply rooted in the economy. This is confirmed by small movements in household inflation expectations. Producer price inflation of around 9 per cent is stressing companies, which do not want to see higher wage growth. This year, Japan's inflation will be 2.0 per cent, rising to 2.1 per cent next year and then falling back to 1.3 per cent in 2024. Gradually higher inflation expectations will increase the possibility that household and business wage and price behaviour will change. They will also improve the Bank of Japan's prospects of more sustainably meeting its 2 per cent inflation target.

Domestic inflationary pressure will not reach levels that justify any rapid shift in monetary policy. Global recession risks will also ease the pressure on the BoJ to change its policy direction. One joker in the pack is the yen, which remains weak as other countries quickly hike their key interest rates. We expect the BoJ to keep its repo rate at minus 0.10 per cent until the second half of 2023, while gradually reducing its asset purchases.

The euro area
From chill wind to storm

The energy crisis and other inflationary forces are contributing to the current shift towards a recession in the euro area, driven by a sharp decline in household consumption. GDP will fall during late 2022 and full-year 2023 growth will be only 0.3 per cent. Late in our forecast period, some recovery will occur as inflation gradually declines. The ECB will hike its key interest rate quickly over the next six months, but economic weakness will limit the upturn, and there will be room for cautious rate cuts in 2024.

Despite rising inflation, galloping energy prices and general uncertainty, economic activity in the euro area was surprisingly strong during the first half of 2022. This was especially true during Q2, when service consumption rebounded due to the lifting of restrictions. For example, southern European economies – which were hardest hit by the pandemic – have benefited from a recovery in tourism. But the German economy has shown weakness, partly due to its manufacturers' close ties with China and heavy dependence on natural gas.

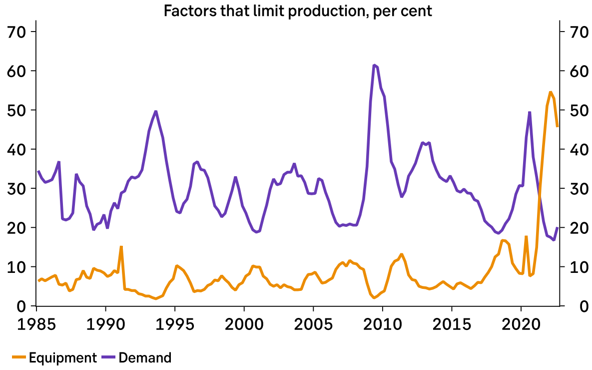
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	5.3	2.7	0.3	2.1
Unemployment*	7.7	6.6	6.8	7.8
Wages and salaries	4.1	4.3	4.5	3.8
CPI	2.6	8.2	6.3	0.3
Public sector fiscal balance**	-4.3	-3.9	-3.0	-2.5
Public sector debt**	95.6	96.1	94.8	93.7
ECB deposit rate, %***	-0.50	1.50	1.75	1.50

*% of labour force **% of GDP ***At year-end. Source: Eurostat, SEB

Record-high energy prices are expected this winter. Despite ambitious attempts to rapidly decrease the euro area's dependence on Russian energy, the process will be lengthy. Germany, Italy, the Netherlands and a number of smaller economies are heavily dependent on Russian gas. Natural gas is not only used for electricity generation and for heating buildings, but is also a direct source of energy for industry. Market prices for electricity and natural gas in the run-up to winter are extremely high, creating major challenges for our forecast, but forward prices several months ahead are highly volatile. It is possible that extremely high prices will lead to such large adjustment processes that lower demand will push down prices, even in the relatively short term. For example, the German government has presented an action plan on energy priorities, but the question is how businesses and households will act. Our main forecast is that energy prices will remain very high for most of 2023. Some energy rationing is possible, but authorities are likely to be wary of introducing administratively cumbersome systems. At the same time it is a balancing act to curb the peak in prices but at the same time not unplug the price mechanism fully. In many respects, the impact on the economy will be similar. However, a risk scenario where the supply of Russian gas is completely cut off would lead to more widespread rationing and a deep recession (see "International overview", page 6).

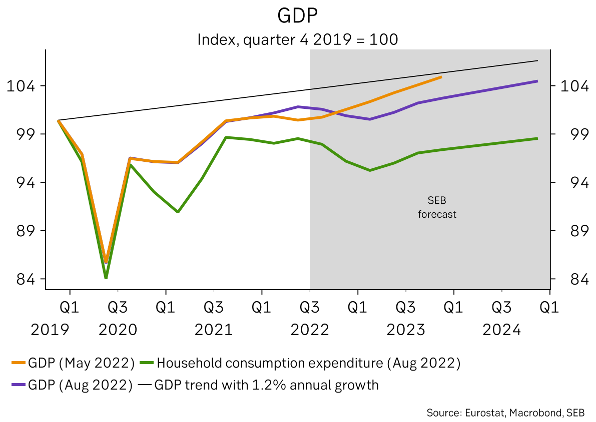
Still strong demand in the manufacturing sector
Factors that limit production, per cent



Source: European Commission (DG ECFIN), Macrobond, SEB

A slowdown is under way, according to indicators. Sentiment indicators have gradually weakened since the beginning of the year, especially in manufacturing, but the order situation remains relatively healthy and demand is creating relatively few limitations on output, according to business sentiment indices (see chart above). Instead, shortages of equipment and input goods are causing continued problems and are the main constraint, although the situation is expected to improve as global supply disruptions gradually ease. Because forward-looking indicators have weakened, industrial production – which has stagnated since late 2020 – is likely to continue languishing. Aside from gas supply uncertainties, there are transport problems due to low water levels in the rivers of Germany and elsewhere.

Mild recession as households face an uphill battle. After two years of restrictions, households have largely chosen to return to a more normal life rather than save as prices have risen. However, because of a further upturn in inflation, savings buffers built up during the pandemic are not sufficient. Consumer confidence has fallen to record lows in many places. The fact that prices have risen most sharply for necessities such as energy and food is increasing pressure on firms producing non-essential services. We estimate that total household consumption will fall by more than 3 per cent during the next three quarters. This is the main reason why the euro area is now entering a recession, albeit shallow and brief. Because of the strong start to the year, GDP growth will reach 2.7 per cent in 2022, but the downturn during the coming winter months will lower GDP growth in 2023 to a mere 0.3 per cent. As wage increases accelerate slightly and inflation normalises, GDP will rebound in late 2023. Full-year growth in 2024 will be around 2 per cent: a bit above trend.



The pandemic and war have led to reassessments. The pandemic and Russia's attack on Ukraine have brought the European Union together. Policy positions have been reassessed across the board. For example, Germany has softened its fiscal strategy, and the EU has agreed that trade relations with Russia should be reduced to a minimum. Increased self-sufficiency is essential in order to cut ties with Russia. As during the pandemic, the EU is prepared to incur significant costs to do so, but high debt levels in some countries are forcing policy makers to adopt clearer priorities. Budget deficits in the euro area as a whole are projected at 3.9 per cent of GDP in 2022 and 3.0 per cent in 2023. But high inflation is causing GDP at current prices to rise rapidly, contributing to a decline in government debt to 93 per cent of GDP towards the end of our forecast horizon.

Will EU cohesion survive a cold winter? With national elections in Germany and France over, the focus is turning to Italy's national election in September. After a long period of relative political calm, heightened political uncertainty combined with high natural gas dependence have contributed to higher risk premiums. Ten-year Italian government bond yields are now more than 200 basis points above German yields, while the Spanish yield spread is just more than 100 points. Germany has put itself, and thus Europe, in a difficult position due to its heavy dependence on Russian gas, which could create new political tensions. We have already seen evidence of this, with German proposals for solidarity in gas distribution being criticised – including reminders about Germany's strict policy during the euro crisis of imposing harsh discipline on countries with weak public finances. Any energy rationing this winter would add to these tensions. If the population is freezing, it will not be easy for politicians to defend the current increasingly interconnected EU energy market.

GDP forecasts
Year-on-year percentage change

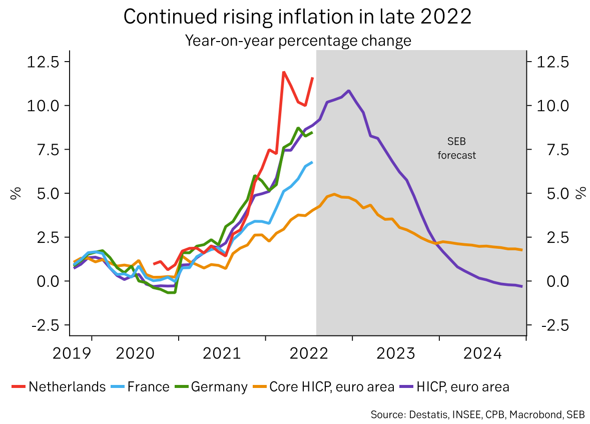
	2021	2022	2023	2024
Germany	2.6	1.3	-0.1	2.5
France	6.8	2.2	0.2	2.4
Italy	6.6	3.6	0.3	2.1
Spain	5.1	4.5	0.0	1.8
Euro area	5.3	2.7	0.3	2.0

Source: Eurostat, SEB

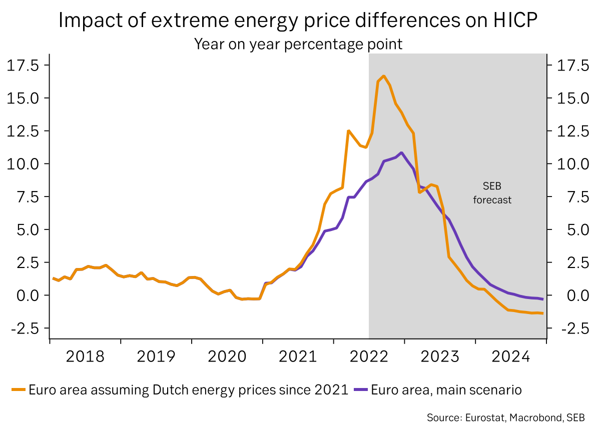
Inflation more persistent than expected

Prices have continued to climb, and the euro area inflation rate is now the highest since the early 1980s. Almost half of the increase is explained by rising food and (in particular) energy prices. Food prices are expected to keep rising for some time, even though world market prices have started to fall. This year's summer heat wave in Europe is also helping to push up the prices of some foodstuffs. In addition to food and energy, other goods inflation has also been well above historical peaks. Although service prices are also rising rapidly, they are not diverging as far from previous historical peaks. Inflation according to the Harmonised Index of Consumer Prices (HICP) is expected to level off at around 10 per cent this autumn and then start falling in early 2023. We expect core inflation to peak at relatively moderate levels of around 4.5 per cent in September and October and then fall slowly, mainly due to base effects.

Stimulus policies important to inflation trends. Differences in the design of programmes to ease the effects of rising energy prices will have an impact on CPI trends. Their cost does not always directly burden the government budget. In France, for example, the energy company EDF is taking the biggest hit due to the price cap that is being imposed on electricity. Since the government owns most (and plans to buy the rest) of the company, the burden still falls indirectly on the government. In other countries, various taxes and fees have been lowered. Some governments are paying cash subsidies.



Various contract mechanisms that determine when, and how much, market prices will affect household also have an impact on CPI. In the Netherlands, however, the electricity and gas components of the HICP have clearly correlated with market prices. In order to get some idea of the inflation trend in the absence of support measures, we have calculated the HICP for the euro area – assuming that the impact across the region had followed the pattern in the Netherlands. The results show that inflation would be as much as 7 per cent higher than in our baseline forecast, peaking at almost 17 per cent this autumn. This calculation shows why inflation in the euro area not ends up much higher than in Sweden despite the substantially higher energy prices.



Potential for a sharp 2024 reversal in inflation. The futures market is now indicating that the period of extreme energy prices will become more protracted. This points to a relatively lengthy period of high inflation. However, in the long term, elevated price levels in various areas imply significant potential for a slowdown in the rate of inflation. Many of the forces behind the inflation upturn are temporary, though protracted. This suggests that price levels for energy and food, for example, will fall in 2024, leading to low inflation – with the HICP around zero late that year.

Modest acceleration in pay increases. Where the underlying inflation ends up will largely be determined by labour market and wage growth trends. There are still widespread labour market shortages rooted in the pandemic, and these can probably be alleviated a bit further ahead. Corporate hiring plans have moderated since their peak in early 2022 but remain at high levels. Reduced demand and consumption will weaken the labour market again, with a time lag. Euro area unemployment will rise towards 8 per cent by the end of 2024: roughly on a par with the pre-pandemic level. Pay increases in the euro area are traditionally more sluggish than in the US and the UK, partly due to the stronger role of centralised labour contracts. High inflation is now creating clear employee demands for compensation. Wage and salary growth will probably accelerate, but employees are likely to be compensated over a longer period of time, in line with historical patterns, thereby reducing the risk of a destructive price and wage spiral. In Germany, parts of the manufacturing sector have recently signed 18-month collective contracts at a level that will provide less than 4 per cent annual pay hikes. We expect overall euro area wage growth to accelerate slightly from 4.1 per cent in 2022 to nearly 4.5 per cent in 2023 and just below 4 per cent in 2024. This is at the upper end of what is consistent with inflation targeting over the long term, but it is still manageable and is clearly lower than US wage growth.

The ECB will also speed up its rate hikes

The upturn in euro area inflation has lagged the US by about six months and has also been more supply-driven. The European Central Bank's more cautious stance over the past year has thus been natural, but the recent acceleration in euro area inflation has prompted the ECB to change tack. In July, the bank raised all its key rates and also took a step in a more hawkish direction by signalling that future decisions will be data-driven and taken on a meeting-by-meeting basis. We expect the ECB, like other central banks, to carry out some large rate hikes in the near future in order to quickly make its monetary policy less expansionary. However, the neutral policy rate level for the euro area is significantly lower than for the US, partly due to weaker growth potential. A slower pace of wage formation also means that some degree of caution is still warranted. After three 50-point and one 25-point hikes, the ECB's refi rate will reach 2.25 per cent in February 2023. A slowdown in the economy will then allow the ECB to cut the refi rate to 2.00 per cent in the second half of 2024. In addition, the ECB will introduce a new instrument (TPI) to address excessive differences in borrowing costs between euro area countries

The United Kingdom
Higher inflation risk due to structural GDP headwinds

The 2022–2024 outlook for the British economy continues to be coloured by the major shocks of recent years: Brexit, the pandemic, the energy crisis and negative long-term demographic trends. Short-term indicators now point to a slowdown in growth. GDP is expected to fall in 2023. The Bank of England's rate hiking cycle will end by the close of this year. When the inflation target is reached in 2024, this will allow the BoE to lower its key interest rate slightly.

The British economy continues to face headwinds. A squeeze on real incomes due to the pandemic and the energy crisis, plus domestic supply constraints as a result of Brexit and an ageing population, are creating short- and long-term challenges. Indicators point to an ongoing deceleration, but base effects will still lead to GDP growth of 3.5 per cent this year. In 2023, GDP is expected to fall by 0.3 per cent (a sharp downward revision from the previous forecast of +2.5 per cent) as households and businesses suffer the full impact of high inflation and tighter monetary and fiscal policies. Falling inflation and slightly lower interest rates will lead to stabilisation in 2024, with GDP growth of 1.3 per cent.

Key data
Year-on-year percentage change

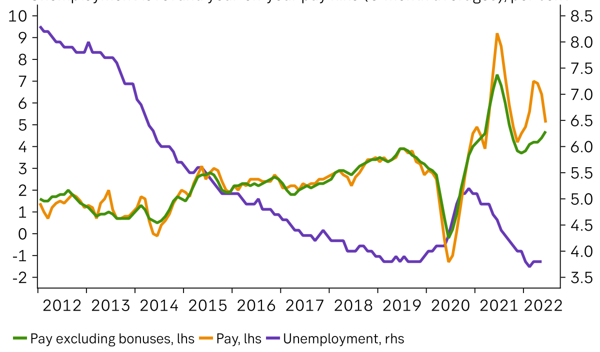
	2021	2022	2023	2024
GDP	7.4	3.5	-0.3	1.3
Unemployment*	4.5	4.1	4.4	5.2
Wages and salaries	5.9	5.0	4.2	2.1
CPI	2.6	9.9	11.8	1.6
Public sector fiscal balance**	-8.0	-4.3	-2.3	-1.5
Public sector debt**	95.3	91.0	89.0	87.0
Key interest rate, %***	0.25	2.75	2.75	2.25

*% of labour force **% of GDP ***At year-end. Source: ONS, SEB

The labour supply keeps shrinking. Brexit and the resulting drop in immigration, as well as a rapidly ageing British population, are lowering the country's potential growth. The labour shortage will lower long-term growth prospects and poses an upside inflation risk, due to sustained wage and salary growth.

Inflation is expected to continue rising, peaking at close to 18 per cent in January; full-year 2022 inflation will be 9.9 per cent. Electricity prices are being adjusted as much as 80 per cent higher in October and 40 per cent in October after the most recent review of regulated electricity prices. Inflation is being sustained by a strong labour market, rapid pay increases, a weak British pound and fairly high inflation expectations. However, global commodity inflation is expected to fall, due to worsening economic conditions and better functioning value chains. CPI inflation is expected to reach 11.8 per cent in 2023, then slow to 1.7 per cent in 2024.

Low unemployment due to reduced labour supply
Unemployment level and year-on-year pay hike (3-month averages), per cent



Source: U.K. Office for National Statistics (ONS), Macrobond, SEB

Households are receiving some help. High inflation, especially for food and energy, is causing households to cut back on other consumption as real incomes decrease. We estimate that consumption will fall by 2 per cent in 2023. The decline will be softened by a drawdown in the household savings buffer and some fiscal stimulus. A 25 per cent windfall tax on British energy producers has helped to finance a stimulus package of about GBP 15 billion aimed at households, equivalent to some 0.7 per cent of GDP. Next year, corporation tax will be increased from 19 to 25 per cent. With Liz Truss expected to become the new prime minister, income taxes will be lowered mainly for low and middle income earners. Higher nominal GDP will help lower the public sector debt ratio to 87 per cent of GDP by the end of 2024.

Monetary policy is becoming less expansionary. The Bank of England (BoE) will continue to hike its key interest rate this year, while its divestment of fixed-income securities will take place at an annual rate of GBP 80 billion, half consisting of active sales. Our forecast is that the BoE will raise its key rate to 2.75 per cent at the end of 2022 and keep it at that level during 2023. As inflation falls more clearly during the second half of 2023 and reaches the central bank’s 2 per cent target in 2024, this will open the door for the BoE to lower its key rate slightly during that year.

China
Growth takes backseat to COVID policy

Chinese policymakers have finally signalled flexibility on their economic targets. While this has eased the pressure on some local governments to produce unrealistic economic targets, further stimulus measures are needed to stabilise the economic outlook. Aside from the strict COVID policy, persistent problems in the property sector are adding to the growth headwinds.

China's Politburo downplayed its ambitious growth target for 2022 by failing to mention the "around 5.5 per cent" target at its latest quarterly meeting in July. This eased pressure on local government finances, which have been heavily impacted by COVID containment measures. Policy response to the slowdown remains restrained, reflecting Beijing's lingering caution over flooding the economy with too much stimulus. Thus, since the last *Nordic Outlook* we have revised down our GDP growth outlook to 3.5 per cent in 2022, before a rebound to 5.3 per cent in 2023.

Key data
Year-on-year percentage change

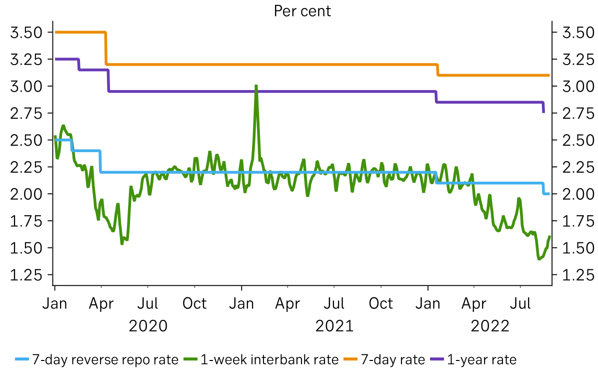
	2021	2022	2023	2024
GDP	8.1	3.5	5.3	5.0
CPI	0.9	2.4	2.3	2.1
Fiscal balance	-3.8	-4.9	-4.5	-4.0
Bank reserve req,%**	11.5	11.25	10.75	10.75
1-year loan prime rate, %**	3.80	3.60	3.60	3.60
7d reverse repo rate, %**	2.20	2.00	2.00	2.00
USD/CNY**	6.36	6.85	6.65	6.30

*% of GDP **At year-end. Source: IMF, SEB

China's COVID containment policy remains the strongest headwind to growth. While COVID infections in the biggest cities remain contained after the reopening of Shanghai, the omicron variant has spread to other localities. This has led to rolling lockdowns in various parts of the country, keeping consumer sentiment soft. Even as unemployment rates in major cities have continued to decline, retail spending has come in below expectations. A moderation in COVID policy would contribute to a recovery in consumption but appears unlikely.

The liquidity crisis in the property sector has now turned into a confidence crisis. Refinancing conditions have remained tight for most property developers. On top of rising bond defaults, some developers have suspended the construction of some of the pre-sold developments. This has triggered unprecedented mortgage strikes from unhappy homebuyers and suppliers to the real estate sector. Beijing has called on local governments to ensure the resumption of construction, but we expect further action since uncertainty about how the government plans to divide the financial burden of stabilising the sector has undermined Beijing's efforts to restore confidence.

PBoC is going its own way with policy easing



Source: PBoC, China FX Trade System, Macrobond, SEB

The worsening growth outlook requires a bigger policy response. The loss of activity momentum in July provoked an immediate monetary policy adjustment. The People's Bank of China (PBoC) cut some key interest rates by 10 basis points in August, taking the cumulative reduction to 20 bps so far in 2022. Although the PBoC has been easing overall financial conditions since the start of 2022, it has been favouring ample liquidity provision over outright interest rate cuts. The rise in overall credit growth has been due to faster issuance of government bonds, but depressed sentiment has kept demand for bank loans weak. Even so, the space for further monetary easing may be limited. The PBoC will be cautious about stimulus in order to reduce the risk that inflation may rise further.

Regional and national policymakers will pursue a more expansionary fiscal policy. Premier Li Keqiang has urged officials of six key provinces to ramp up growth measures via more debt issuance. Beijing is also likely to increase public investments in an effort to stabilise the labour market.

The Nordics

Sweden | page 35

Falling real incomes, rising interest rates and elevated housing costs are lowering consumption, growth and home prices. The key rate will reach 2.25 per cent in April 2023; rate cuts will begin in 2024.

Norway | page 42

Growth is softening. Shortages of qualified labour and high input costs are weighing on production. Households are squeezed, but high oil and gas demand, prices and capital spending will allow the fastest total GDP growth in the Nordic countries.

Denmark | page 44

Reopening effects gave GDP a temporary boost. We are revising our 2022 economic growth forecast from 2.4 to 3.0 per cent. But the energy crisis, inflation and tighter credit conditions due to ECB key rate hikes will lead to zero growth in 2023.

Finland | page 46

So far, Finland has shown surprising resilience. Industrial production is strong, and full order books imply continued good fortune. But headwinds will increase as global conditions worsen, especially for Finland's main trading partner Germany.

Theme:

Sweden's election

Tough negotiations expected in order to form a government

Sweden is approaching an exciting parliamentary election on September 11. The political situation is new in many ways, public opinion is evenly divided and the outcome is hard to predict. Neither the current majority nor the opposition consists of parties that are fully prepared to join the same government or even cooperate on budgets. Whatever the outcome, the election will thus probably be followed by lengthy negotiations before a new government is in place. New written accords along the lines of the previous January Agreement can be expected. Yet given the stability of Swedish public finances, a political risk premium is unlikely. Neither election promises nor proposals about the fiscal policy framework are expected to have a decisive macroeconomic impact.

Sweden still has two main political blocs, but they have changed. Although the leaders of the Social Democrats (S) and the Moderates (M), Magdalena Andersson and Ulf Kristersson respectively, are still the clear prime ministerial candidates for each side, the situation within the blocs is different from before. They include both new parties and new internal contradict-tions. Forming governments has recently become a lengthy process from a Swedish perspective, and the exercise of power has been complicated by weak parliamentary support. For example, this has meant that during some periods the government has run Sweden based on opposition budgets, a phenomenon that until a few years ago seemed almost impossible. In just such a budgetary situation, when the Centre Party (C) allowed Magdalena Andersson to become prime minister last autumn but did not support her government's budget, the Green Party (MP) chose to quit the government. Since then, the country has had a single-party Social Democratic government. Recently, C has signalled a further rapprochement to S by saying it is willing to join an S-led government after the elections, albeit with some reservations. The former Alliance (M+KD+L+C) that governed Sweden between 2006 and 2014 is thus definitely a closed chapter.

The Moderate-led opposition has been re-joined by the Liberals (L) and has clearer links with the right-wing populist Sweden Democrats (SD). Sweden's two blocs thus again enjoy roughly equal popular support, ensuring an exciting election with an uncertain outcome.

Can voter trust, the 4 per cent parliamentary threshold or policy issues decide the election? One advantage for the government is that PM Andersson is the party leader who enjoys by far the highest level of trust among voters. She is the only one who regularly exceeds 50 per cent in such surveys. Second place is a dead heat between Ulf Kristersson (M), Ebba Busch (KD) and Jimmie Åkesson (SD) at around 40 per cent. In a situation where both international and domestic conditions feel uncertain, the issue of voter trust may become important. On the other hand, the party leaders who will have to form the basis for an S-led government (V, MP and C) are at the bottom in voter trust polls.

Still eight parties in Parliament after the election. Over the past two years, MP and L have struggled to stay above the 4 per cent parliamentary threshold in opinion polls, but in recent months both have found themselves on firmer ground. L has been clearly helped by the accession of new party leader Johan Pehrson, and MP has probably benefited from the fact that this summer "Climate & Environment" has become the second most important issue among voters. Since failure to get into parliament could be decisive in the battle to form a government, tactical voting for small parties (a common feature of Swedish politics) cannot be ruled out either. Combined with the historical fact that it is rare for a party to leave Parliament (the last time was in 1994), there are strong indications that all eight parties now represented will remain there after the election.

"**Law & Order" is the most important issue for voters.** In third place, according to surveys, is "Sweden's Finances". On both issues, the M-led opposition enjoys an advantage, since voters feel these parties have the best policies. But "Law & Order" has been the top issue for years (with the brief exception of "Defence" at the outbreak of the Ukraine war) and the question is whether it can still drive voters from one bloc to the other. As for the second and fourth place issues, "Climate & Environment" and "Health Care", the S-led leftist parties enjoy an advantage, though the differences are smaller than they have been historically.

At present, the voter trust question thus slightly favours the left and the ranking of major issues among voters slightly favours the right, while the battle to overcome the 4 per cent parliamentary threshold is dead even. There are thus strong indications that the final stages of the campaign may be important. Success or failure in media interviews, party leader debates and presentations of proposals and promises could be crucial. The current government may be handicapped by the fact that it has been in office for two terms and that it is famously difficult to be elected for a third term.

Even match between blocs ahead of the 2022 election
2018 election outcome and public opinion situation, %

	Election 2018	Aug 2022	Max	Min
Social Democrats (S)	28.3	29.4	31.8	27.5
Green Party (MP)	4.4	5.0	5.7	4.3
Left Party (V)	8.0	8.4	9.4	6.8
Centre Party (C)	8.6	6.5	7.9	5.4
Moderates (M)	19.8	17.7	18.7	16.2
Liberals (L)	5.5	5.3	6.3	4.5
Christian Democrats (KD)	6.3	5.8	6.3	5.3
Sweden Democrats (SD)	17.5	20.4	22.8	18.3
S+MP+V+C	**49.3**	**49.3**	**54.8**	**44.0**
M+KD+L+SD	**49.1**	**49.3**	**54.1**	**44.3**

Source: Compilation based Pollofpolls.se.

Because of intra-bloc contradictions, uncertainty will persist after the election. The days when voters knew on election night what their new government would look like are long past. On the left, C has said it cannot join or even support a government that includes V. On the right, M, KD and especially SD have expressed hesitation about letting L into government. Nor do M, KD or L accept the inclusion of SD. This sets the stage for lengthy negotiations and discussions before a new prime minister can be approved by Parliament.

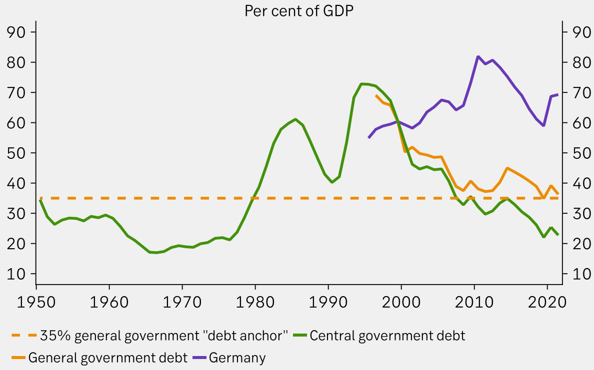
Despite criticism, a new agreement will probably be needed. Over the past eight years, Swedish domestic politics has been dominated by written agreements. The December Agreement was signed by the government and three non-socialist parties in 2014 in an attempt to keep SD out of power and allow the larger of the two traditional blocs to govern, despite insufficient parliamentary support. The January Agreement was concluded in 2019 between S, MP, C and L and contained 73 points detailing what policies the government (consisting of S and MP) would implement in exchange for being allowed into power and being supported in budget votes by C and L. Both agreements ended prematurely and were subsequently heavily criticised. Yet this autumn's government negotiations will probably include similar deal-making. On the left, for example, V is unlikely to be invited into government, due to differences of opinion on fundamental issues such as security policy and NATO membership, and because C has flatly refused to support a government that includes it. V will then demand far-reaching commitments from the government that will most likely need to be set down in a written, public agreement. A similar solution may be required for MP and/or C if they are not offered cabinet posts. On the right, the safe government parties are M and KD. However, they have been cool towards L and outright dismissive of SD's desire to join the government. When the smoke clears and negotiations are over, L will probably be admitted after all, while SD remains outside. SD will then demand an agreement with the government on various commitments in exchange for its support. It is thus hard to see how forming a government – on either side – could take place without some form of new written agreement.

Little risk of a political risk premium

There is thus a significant risk of both a protracted government formation process and a minority government without stable support in Parliament. This raises the question of whether we should be worried about a risk premium (such as a weaker krona, higher interest rates or reduced investments) linked to politics. We believe this risk is limited. One reason is Sweden's strong public finances, allowing room for manoeuvre. In Sweden, unlike in many other countries, neither weak parliamentary support for the government nor the crises of the past decade have pushed up public debt.

Low public sector debt despite recurrent crises

Per cent of GDP



Source: Eurostat, Statistics Sweden (SCB), Macrobond, SEB

While pandemic fiscal packages increased public debt substantially in many countries, in Sweden the increase was almost marginal and the level is currently below 35 per cent of GDP – which is the "debt anchor" in the fiscal framework. This low debt level makes Sweden less vulnerable and reduces the policy risk premium. Instead, what might hurt Sweden is current global uncertainty – including soaring inflation, rising interest rates, geopolitical unrest and decelerating economic growth. In such a situation, global risk appetite decreases and small countries like Sweden tend to lose their attractiveness. Politically, however, the Swedish tradition of consensus instead seems to be regarded as a strength. It is unlikely that even a lengthy process to form a government will upset this picture.

A trickier policy balancing act is contributing to some restraint ahead of the election. Large-scale stimulus packages were common during the pandemic, and economic policy coordination was relatively unproblematic. Both fiscal and monetary policies were expansionary and both sides were keen for the other to do even more. Now inflation has soared and the situation is different. The Riksbank is implementing a front-loaded interest rate hiking cycle, while the economy is slowing. Households and businesses are being squeezed by rising prices and interest rates. The normal reaction of fiscal policymakers is to provide support in a downturn, but their balancing act is now becoming harder, since demand cannot be stimulated so much and so broadly as to fuel inflation. This is one reason for the relative restraint that has characterised election promises so far during the campaign. Many promises focus on tougher criminal penalties, the structure of the health care system, the right of independent schools to make profits and other issues that do not come with a clear fiscal price tag. The biggest exceptions are the parties' proposals for compensation to households and businesses for high electricity prices. To date, S has gone furthest by proposing SEK 60 billion in compensation – to be financed from the increased revenues of Svenska Kraftnät, a state-owned distributor of electricity.

Another restraining factor is that due to the uncertain parliamentary situation, no one knows what can actually be implemented and no one wants to alienate potential future partners. Yet one area that is being handled largely along traditional left-right lines is tax issues. M in particular has promised tax cuts on incomes and fuel, while S has cited the need for tax hikes, especially by launching a "preparedness tax" reminiscent of the recently abolished "defence tax" on higher income earners. Meanwhile S's would-be partner C has demanded no tax increases by any government that wants its support, making it hard to assess the likelihood of implementation. The tax burden will probably end up slightly higher under an S-led government than an M-led one, but in terms of budget-balancing it is hard to see clear differences in advance. Regardless of which side wins the election, we believe fiscal policy will be expansionary in 2023-2024, but not enough to keep the debt ratio from falling below 30 per cent of GDP.

Sweden
Inflation and falling home prices squeeze households

Households are being squeezed from many directions. Falling real incomes are lowering consumption and growth. We expect home prices to fall by 15-20 per cent amid rising interest burdens and other elevated housing costs, but spill-over effects will be relatively limited. The formation of a government after the upcoming election will probably be complicated, but this is unlikely to worry financial markets much. Front-loaded Riksbank hikes will bring the key rate to 2.25 per cent in April 2023 but rate cuts will begin in 2024.

A clear rebound upwards in the second quarter has contributed to GDP growth for 2022 being adjusted up to 2.6 percent despite sentiment indicators suggesting that GDP growth is now slowing. Households are under severe pressure from rising prices and higher interest rates. We expect consumption to start falling late in 2022 and continue downward for most of 2023. GDP will fall sequentially this autumn and winter. Full-year 2023 growth will be 0.0 per cent: a significant downward revision from our forecast of 1.7 per cent in the previous *Nordic Outlook*. During 2024, GDP growth will approach its long-term trend, but the annual average will be only 1.7 per cent. High inflation will lead the Riksbank to accelerate its interest rate hikes. The key rate will peak at 2.25 per cent by early 2023. Falling inflation and a weakening economy will open the way for rate cuts. We expect a key rate of 1.75 per cent at the end of 2024.

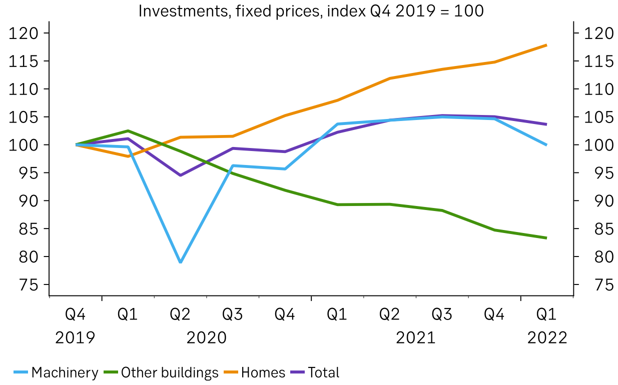
	2021	2022	2023	2024
GDP	5.1	2.6	0.0	1.7
Unemployment*	8.8	7.5	7.8	8.1
Wages and salaries	2.7	2.6	4.5	3.5
CPIF	2.4	8.2	5.9	1.5
Net lending**	-0.3	0.4	0.2	0.0
General government debt**	36.7	31.7	29.3	28.1
Key rate, %***	0.00	2.00	2.25	1.75

*% of labour force **% of GDP ***At year-end. Source: SEB, Statistics Sweden

Demand is weakening as manufacturers' supply problems ease. After a fast recovery from the pandemic, the manufacturing sector began to slow down in mid-2021, mainly due to supply problems and shortages of some input goods. Now that production problems appear to be easing, demand seems to be on the wane. Purchasing managers' indices (PMIs) and manufacturing sentiment indicators have fallen from relatively high levels. This downturn is expected to continue. It is worrisome for Sweden that German PMIs have fallen to levels suggesting a decline in production. Soaring energy prices point to cautious investment internationally, which would hurt the input and capital goods-oriented Swedish industry relatively hard. But Swedish manufacturers are not so dependent on natural gas. Electricity prices, despite large increases, are low by European standards. This is especially true in northern Sweden, where electricity prices are close to normal levels. This suggests that the manufacturing downturn will be milder in Sweden than in Germany and the euro area generally. Due to falling international demand, exports are likely to fall late in 2022 and the decline will continue during the first half of 2023, but in terms of full-year averages, exports will still grow by 1.0 per cent in 2023 after an upturn of 3.7 per cent in 2022.

Residential investments: From growth engine to anchor

Investments, fixed prices, index Q4 2019 = 100



Source: Statistics Sweden (SCB), Macrobond, SEB

Broad downturn in investments. Capital spending recovered strongly from the early pandemic downturn, but early 2022 saw renewed weakness due to increasing uncertainty. International headwinds suggest that machinery investments will continue to fall. Investments in commercial premises has shown a downward trend over the past two years, and due to rising interest rates and construction costs the decline is likely to accelerate now. Higher costs and a weaker housing market have also contributed to a steep fall in housing starts so far this year. After being a positive driver of growth in recent years, residential investments will make a negative contribution to GDP growth in the range of 0.5 percentage points in 2023 and 2024. But there is great uncertainty, and anecdotal information from municipal housing companies indicates a near-total halt in new projects. The low level of home construction relative to population growth will ease the downturn, though. We expect total capital spending to fall by 1.0 per cent in 2023, before rebounding to an increase of 3.0 per cent in 2024.

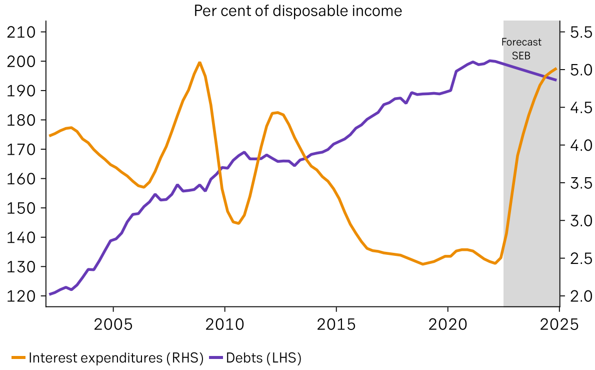
The response of households will determine the depth of the downturn. Due to a strong recovery in service consumption and continued high consumption of goods, total consumption reverted to its historical trend in early 2022. But concerns are now mounting. Eroding purchasing power has pushed household confidence to its lowest since the early 1990s, despite a strong labour market. So far, consumption has held up, although signs of weakness were discernible in June. Continued high inflation and a likely weakening of the labour market suggest that confidence will keep fading and that we are likely to see a consumption downturn. Despite fiscal stimulus to households amounting to SEK 40 billion, real household incomes will fall in 2022, and e we expect a decline of more than 3 per cent in 2023, despite another SEK 40bn in fiscal support. Consumption will be supported to some extent by reduced savings, but since the 2022 savings ratio is expected to be 5-6 percentage points lower than in 2020, the potential for further downturn in 2023 and 2024 has decreased. Households normally increase their savings when the economy is showing a clear downside, which lowers our consumption forecast.

Household incomes and savings ratio
Year-on-year percentage change

	2021	2022	2023	2024
Real disposable income	3.2	-0.7	-3.1	1.1
Private consumption	6.0	4.0	-1.5	2.0
Savings ratio, % of income	15.4	12.3	8.8	8.4

Source: Statistics Sweden (SCB), ,SEB

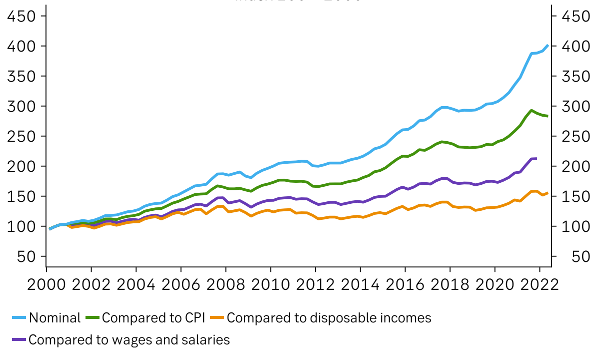
Household debts and interest expenditures
Per cent of disposable income



Source: Statistics Sweden, SEB

Home prices will probably fall by 15-20 per cent. Between February and July, home prices fell by 8 per cent according to Valueguard's metric. Only a small part of the price increase during the pandemic has been reversed, but the speed of the downturn is worrying. The combination of rising interest rates and eroding purchasing power has rapidly changed the situation in the housing market. We expect interest expenditure as a share of disposable income to rise from 2½ per cent in early 2022 to over 5 per cent in 2024 and anticipate that nominal home prices will fall by 15-20 per cent by mid-2023, negatively impacting household consumption and home construction. The theme article on page 39 discusses the state of the housing market, including an analysis of similarities and differences compared to earlier periods of home price declines.

Surging home prices
Index 100 = 2000



Source: Valueguard, Statistics Sweden, SEB

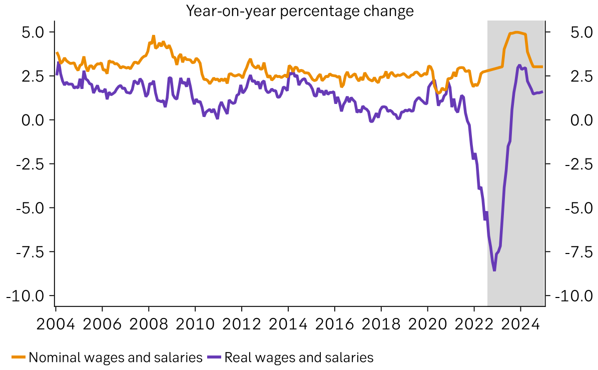
Strong labour market at the outset. Despite the production slowdown, the labour market has shown continued strength. Employment is now slightly above the pre-pandemic trend, and short-term indicators are pointing to a continued upturn in the near term. Although unemployment has remained relatively high, this is largely due to rising labour force participation, especially among the foreign-born, but weaker consumption and construction will reduce labour demand. We thus expect unemployment to rise this autumn and reach 8.2 per cent by late 2023.

Challenging environment for the wage round. Rising electricity prices this winter look set to dash earlier hopes that pay negotiations could be helped by a calmer inflation environment. Swedish CPI inflation is also being driven higher by rising mortgage rates, further complicating the talks; CPI is expected to increase by more than 8 per cent this year and more than 7 per cent in 2023. The labour market situation will also be important for the negotiations. According to the National Institute of Economic Research's Economic Tendency Indicator, labour shortages were record-high in Q2, but when contract talks enter a decisive phase in February-March 2023, the situation is likely to be much cooler, with lower inflation pressure. Government compensation for high electricity prices should also make the talks easier but will probably not formally affect CPI outcomes. Moderate long-term inflation expectations also suggest modest labour agreements.

Some wage compensation is likely. In what will be the most difficult wage round environment since the 1990s, it is hard to believe that employees will be left without any compensation for soaring prices. Tough negotiations await, but we expect some acceleration in contractual pay hikes from the relatively low figures of the past decade. Negotiations are likely to result in front-loaded wage and salary hikes, possibly with some form of one-off payment for 2023 similar to what we have seen in Germany. This would send a signal to the Riksbank that this is an exception and that the parties are keen to act in a way that does not challenge the long-term inflation target. In light of this, we have adjusted our pay hike forecast upward to 4.5 per cent for 2023 (from 3.5 per cent in May). In 2024, wage and salary growth will slow to 3.5 per cent due to the contractual structure and relative labour market weakness.

Record-sized real wage decline during 2022

Year-on-year percentage change

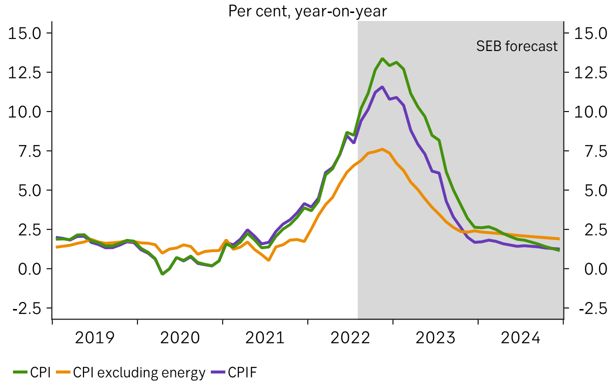


Source: Mediation Office, Statistics Sweden, SEB

Record-high electricity prices will delay the inflation downturn. After rising steeply during the first half of 2022, CPIF (CPI less interest rate changes) fell to 8.0 per cent in July, driven by lower energy prices. The slowdown is likely to be temporary, with the futures market indicating electricity prices this autumn and winter almost three times higher than those of last winter, which were perceived at the time as dramatically high. We expect CPIF inflation to peak above 10 per cent this autumn. CPIF excluding energy has risen steadily throughout 2022, reaching 6.6 per cent in July. A strong surge in food prices (13.5 per cent in July) is a key driver, but prices of other goods and services have also climbed rapidly. Signs of moderation in international prices of food and other goods suggest that CPIF ex energy is now relatively close to peaking and will level off a bit above 7 per cent this autumn.

Continued high inflation in 2023

Per cent, year-on-year



Source: Macrobond, SEB

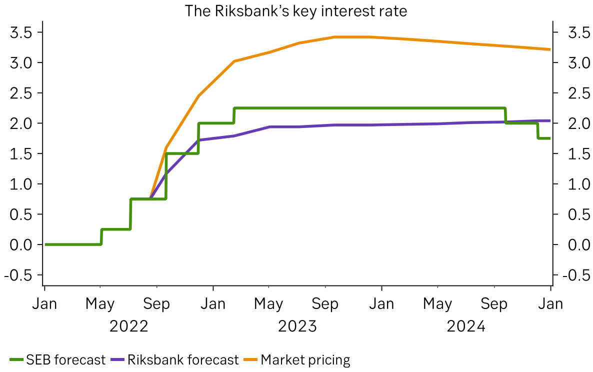
Inflation will eventually fall. Various factors point to lower inflation further ahead. Weaker consumption due to eroding real incomes will exert downward pressure on the demand side. Even if pay increases accelerate somewhat, a domestic wage-price spiral that permanently lifts inflationary pressures is unlikely. The most important factor, though, is that international inflation is expected to fall and or at least not keep rising. Yet due to uncertainty about energy prices and the risk of underestimating their spill-over effects, upside risks will predominate in the coming year. In the long term, risks are balanced and some normalisation of energy prices suggests that inflation will fall below 2 per cent in 2024. Unlike nearly all other countries, rising mortgage rates will provide an additional boost to CPI inflation, which is projected to exceed 12 per cent by the end of 2022. Key rate cuts in 2024 will then allow interest costs to help lower CPI inflation instead.

Higher interest rates despite an economic slowdown. Rising inflation led to an abrupt shift in monetary policy. In June, the Riksbank signalled key rate hikes of 50 basis points at the year's two final decision points, with the key rate set to reach 1.75 per cent by the end of 2022. Since then, inflation has surprised the Riksbank on the upside. We believe the gap will widen further, with the August figure for CPIF excluding energy ending up more than one percentage point higher than the Riksbank's June forecast. This is one reason why we consider a rate hike of 75 basis points the most likely outcome of the September policy meeting.

Difficult policy dilemmas will lead to a rate cut in 2024. The Riksbank is now fully focused on fighting inflation but will face tougher trade-offs ahead. The economic outlook has deteriorated in recent months, and although the Riksbank made allowances in June for a weak 2023, downside risks have increased greatly. Home prices have clearly started to fall – another factor that cannot be completely ignored. In itself, a home price adjustment is not a problem for the Riksbank, but the combination of rising unemployment and falling asset prices risks leading to a larger slowdown in consumption, which could ultimately lead to excessively low inflation. Due to the high proportion of mortgage loans with variable rates or short maturities, the tightening effect of rate hikes occurs much faster than in the US and the euro area. After September's 75 bp hike, we expect a further 50 bp hike in November. After that, the Riksbank will round off its hiking cycle in early 2023, with the key rate reaching 2.25 per cent in February. As inflation starts to approach the 2 per cent target during the first half of 2024, the bank will lower the key rate again to 1.75 per cent by the end of our forecast period.

The market expects aggressive near-term rate hikes

The Riksbank's key interest rate



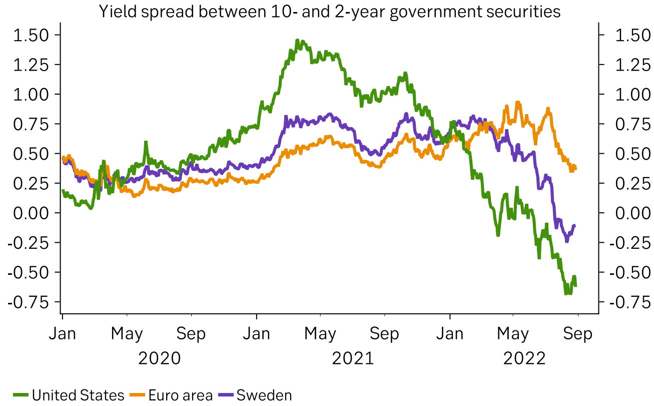
Source: Central Bank of Sweden (Riksbanken), Macrobond, SEB

Bond purchases close to zero in 2023. In April, the Riksbank decided to halve its bond purchases during the second half of 2022. In June, it changed this decision and will make purchases only a quarter as large as in the first half, for a total of SEK 18.5 billion. These purchases are evenly divided between mortgage, government and municipal bonds, while corporate bonds are limited to SEK 0.5 billion. As earlier, the Riksbank has presented a wide range of scenarios for future purchases, but we believe that in principle these purchases will be phased out during 2023. Given the short average maturity of the Riksbank's bond holdings, its balance sheet will shrink rapidly in the next couple of years.

Varying bond spread trends. Swedish and German bond yields have followed different paths recently. Short-term spreads have widened greatly, while long-term spreads have narrowed. The upturn in short-term yields is explained by the fact that the Riksbank is expected to raise interest rates much more aggressively than the ECB. The drivers of long-term yields are not obvious, but the decline came from a previously highly elevated level. The Swedish yield curve has now inverted. The 10-year yield is about 30 basis points below the 2-year yield. The Swedish curve thus resembles that of the US, reflecting expected interest rate cuts ahead, although they are a bit further in the future in Sweden. We expect Swedish 10-year yield to rise to 2.35 per cent by end-2023, which means that the yield spread against Germany will widen again slightly.

Inverted yield curves in Sweden and the US

Yield spread between 10- and 2-year government securities



Source: Macrobond Financial AB, Macrobond, SEB

Tricky balancing act for fiscal policymakers. The interaction between fiscal and monetary policy is now more complex than for a long time. Strong public finances and households squeezed by eroding real incomes suggest fiscal stimulus, yet there is a risk that such stimulus will complicate the Riksbank's battle against inflation. The phase-out of pandemic support and high short-term inflation are bolstering Sweden's public finances and making fiscal policy tighter overall this year, despite new compensation programmes to ease the impact of high electricity prices.

Government debt is falling despite election promises. During the election campaign, we are seeing a willingness to introduce more ideological elements into economic policy, after pandemic support measures have dominated for quite some time. In 2023 and 2024, we expect stimulus programmes in the range of SEK 30-40 billion per year, though uncertainties about the election results and the outcome of negotiations to form a new government make our forecast especially uncertain (see the election theme article p.32). Meanwhile, government revenues continue to benefit from high inflation and electricity prices. The government's budget balance (net lending) is thus projected to improve from -0.3 per cent of GDP in 2021 to zero in 2024. General government debt – currently close to the debt anchor of 35 per cent of GDP – will fall to below 30 per cent of GDP in 2023-2024. The issue of easing the government's fiscal framework will thus remain topical.

Theme:

Falling home prices

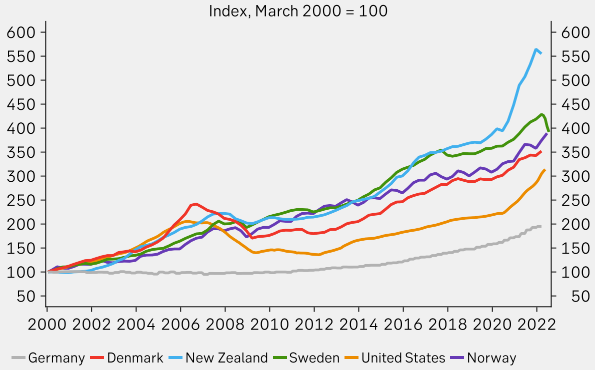
But only a limited risk of a negative spiral

Rapidly rising interest rates and a loss of purchasing power are pushing down home prices. After a sharp and unusually synchronised international price upturn during the COVID-19 pandemic, we are now likely to see Swedish home prices fall relatively far in a historical perspective. A decline of 15 to 20 per cent is expected, but there are various reasons to believe that spill-over effects to the real economy will be limited. While there are some similarities with the deep financial crisis of the 1990s, it is thus unlikely that we will now face a similar downward spiral. Fiscal and macroprudential policies might limit the downturn compared to our main scenario, but the government is likely to proceed cautiously in order to avoid a policy conflict with the Riksbank.

Unexpected upturn during the pandemic. The sharp economic downturn in the early stages of the pandemic led to concerns about plunging home prices, based in part on historical correlations between home prices, GDP and unemployment. But the initial decline was marginal, and it rather quickly morphed into a strong upturn. There were many different reasons for this. GDP growth recovered quickly, easing the impact on the labour market. Key interest rate cuts and the prospect of a long period of very low rates – combined with the extra purchasing power created by fiscal stimulus programmes – benefited homebuyers. The housing market was also supported by restrictions on other types of consumption and by greater demand for both remote work and "staycations". Most advanced economies were similarly affected, and the upturn in home prices was unusually synchronised. By the end of 2021, prices were around 20-40 per cent higher than at the start of the pandemic in the US, Germany, the UK and the Nordic countries.

High home prices in Sweden, Norway and elsewhere

Index, March 2000 = 100

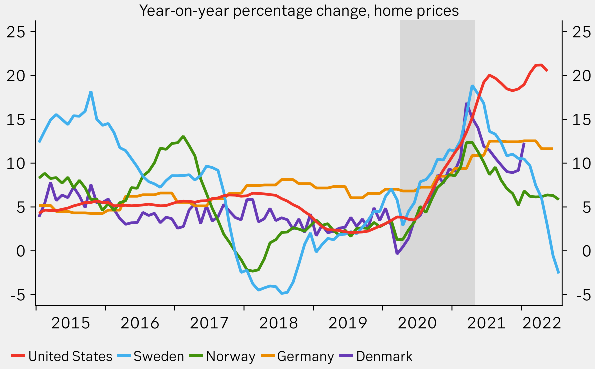


Source: Macrobond, SEB

Pumped-up price levels in Sweden and Norway. Home prices in Sweden, Norway and Denmark rose at roughly the same rate for a long time during the pandemic, but late in 2021, Swedish prices surged even faster. As 2022 began, home prices in Norway and Denmark were nearly 20 per cent above their level at the start of 2020, while the corresponding upturn in Sweden was around 25 per cent. Developments during the pandemic reinforced the picture of high home prices in Norway and even more so in Sweden. The clear home price decline during the Lehman Brothers crisis of 2008-2009 contributed to more subdued price levels in Denmark. Overall, home prices in the Scandinavian countries have risen much faster than the average for OECD members and major industrialised countries in recent decades.

Synchronised pandemic upturn, but more divergent now

Year-on-year percentage change, home prices

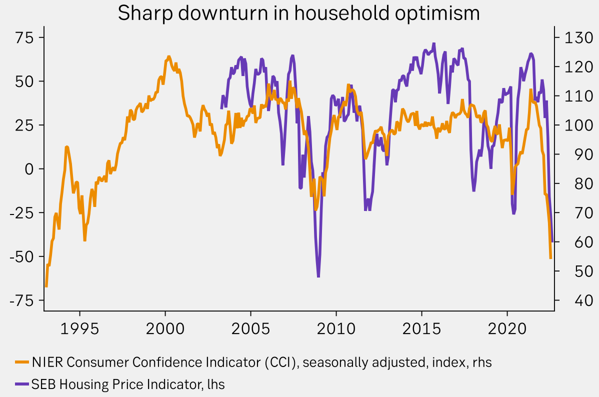


Source: Macrobond, SEB

Structural drivers are important. A long-term trend towards rising home prices has created the potential for large price declines in Sweden, as pointed out by such international organisations as the IMF and OECD for many years. However, there are various structural explanations for this price trend that will also help to mitigate the risks. For example, demand in Sweden has been driven mainly by owner-occupied housing, while elements of speculation has been more prevalent in other countries where the buy-to-let system is widespread. The abolition of the wealth tax and a sharp reduction in property tax in 2006-2007 have also helped to push up equilibrium prices for housing.

The pandemic tailwind has now turned into a strong headwind. A weakening economy and rising interest rates are now reversing many of the forces that previously drove up prices. Swedish household optimism has fallen dramatically. SEB's own Housing Price Indicator fell to near-historical lows in August, and consumer confidence according to the National Institute of Economic Research (NIER) monthly surveys is close to the lows seen during the 1990s financial crisis. Among other things, this reflects worries about rising interest rates. Our calculations suggest that household interest expenditures will rise from 2.2 per cent of incomes in early 2022 to just over 5 per cent by the end of 2023 (see the chart in the "Sweden" section). In addition, sharp price increases for other housing costs, mainly electricity and heating, as well as a general downturn in real wages, will further limit the scope for home purchases. The issue of energy efficiency in various types of housing is also likely to become increasingly important for long-term price trends.

Sharp downturn in household optimism



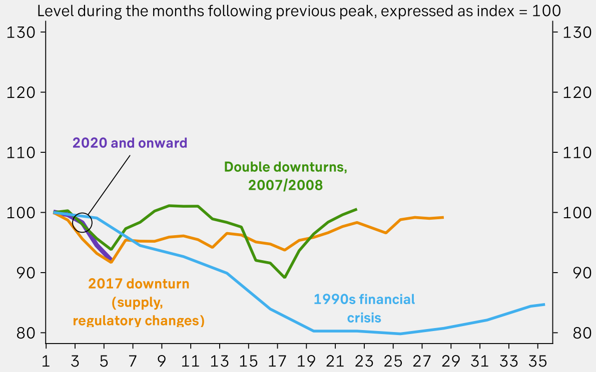
Source: Macrobond, National Institute of Economic Research, SEB

Turnaround unlikely soon. So far, according to Valueguard's index, Swedish home prices have fallen by around 8 per cent since peaking in early 2022. Due to lagging statistics, the international situation is a bit unclear, but we have seen some price declines in New Zealand and Denmark too. The question is how deep and prolonged the decline will be. During the 2008-2009 crisis, the SEB Housing Price Indicator fell for eight consecutive months. The current decline has lasted four months; a gloomy economic outlook and continued rising interest rates suggest a turnaround is not imminent. Our key rate forecasts imply that floating mortgage rates will peak some months into 2023, with home prices likely to bottom out in mid-2023. Declines have been relatively mild in recent decades. In 2008-2009, prices fell by around 10 per cent. The decline associated with the construction boom and new macroprudential measures like minimum mortgage repayments around 2017 was of similar magnitude. In the 1990s crisis, the fall was larger (some 20 per cent) and more prolonged, due to high interest rates and a deep recession after a building boom. But these comparisons apply only to single-family house prices, since we have no long time series for prices of tenant-owner units (mainly flats), which are more volatile.

A 15-20 per cent price decline our main scenario. The rapid price upturn during the pandemic – combined with dramatic reversals in mortgage rates and household incomes – makes it likely that declines will be deeper than we have seen so far this century. Our main forecast is that prices, as measured by the Valueguard index, will fall between 15 and 20 per cent from their early 2022 peak. In broad terms this would bring us back to levels prevailing when pandemic broke out. During the pandemic, single-family house prices rose faster than those for tenant-owner units, suggesting that the decline may also be of the same magnitude. The historical pattern of more volatile tenant-owner prices would thus no longer apply. Given faster price increases in Sweden, both short and long term, the price decline is likely to be greater in Sweden than in countries like Norway and Denmark.

Downturns in Swedish single-family house prices

Level during the months following previous peak, expressed as index = 100



Source: Valueguard Sweden AB, Statistics Sweden (SCB), Macrobond, SEB

Similarities and differences compared to the 1990s. Our main scenario implies that the decline in single-family house prices is in line with the 1990s, while we will now see a milder decline in prices of flats. There are general similarities with the 1990s crisis. Then, too, an inflation shock was combined with a rise in housing costs, albeit with different drivers. Instead of today's energy price shock, there were problems like lower interest deductions – part of a major tax reform. The economic crisis will not be as severe and long-lasting this time around. In particular, the upturn in interest rates is expected to be much more modest. But the sensitivity of households to interest rates and to the level of home prices is greater than in the early 1990s.

Moderate contagion effects: A decline in home prices risks initiating a negative spiral, slowing economic activity via wealth effects on consumption, while new home construction decreases as existing home prices fall (Tobin's Q). Reduced economic activity may then lead to higher unemployment, worsening downward pressure on home prices. But since the price decline is occurring so soon after the steep upturn during the pandemic, its impact on consumption will be moderate. Due to this dynamic, relatively few households will run into problems with mortgages that exceed the market value of their homes. Given normal home re-sale levels, this might apply to 3-4 per cent of homeowners. For most homeowners, the psychological impact caused by an unrealised decline in wealth will thus be more crucial.

Limited potential for construction downturn. Falling home prices will slow new production and worsen the downturn already caused by shortages and high input goods prices. But rental flats account for over half of new construction, and this volume is driven by factors other than home prices. Compared to the outbreak of the 1990s crisis, housing construction much lower, reducing the risks of a sharp downturn. Our forecast implies that the negative contribution of home building to GDP growth will not exceed 0.5 percentage points, which is not enough to trigger a downward spiral. On the other hand, a slowdown in residential construction might marginally slow the decline in home prices.

Can economic policy measures ease the price decline? Very high inflation is blocking the Riksbank's ability to take falling home prices into account. Perhaps the results of the exceptional reversals in interest rate policy may eventually lead the bank to rethink the one-sided focus of its policy on inflation. In today's system, the Financial Supervisory Authority is responsible for macroprudential rules affecting the housing market. Early in the pandemic (April 2020-September 2021), minimum mortgage repayment requirements were put on hold. Such a move could be repeated but we do not believe this will happen, given the relatively mild economic downturn. There is also a general risk of future conflicts between policy objectives, given the Riksbank's fight against inflation. This also applies to the government's room for fiscal stimulus. Compensation for high energy costs may ease the home price decline, but as long as the design of such a system remains unclear, uncertainty about electricity costs will pull down home prices in the near term. As for home-related taxes, there are hardly any measures on the agenda that could ease the price decline. But in the current environment, it is likely to be even harder to gather support for such politically sensitive measures as property tax hikes or lower interest rate deductions, given the risks of further exacerbating the price decline.

Norway
Stalling growth momentum going into 2023

Economic activity rebounded last spring, but underlying growth momentum is softening. Rising prices for goods, food and electricity – combined with sharply higher mortgage rates – will curb private consumption. Business activity is cooling due to weaker global growth and high production costs. Domestic demand will weaken, slowing mainland GDP growth to below trend in 2023. Core inflation will peak at close to 6 per cent in late 2022 and will then fall.

Economic activity recovered during the spring after the government removed national COVID-19 restrictions in early February. Sequential growth in mainland GDP rose 0.7 per cent in Q2, led by the reopening of the service sector. Underlying momentum was weaker. Supply disruptions, shortages of qualified labour and high input costs weigh on production. The squeeze in household real disposable income has taken its toll on consumer confidence, which has been further pressured by aggressive key rate hikes. The government is partly subsidising higher electricity costs, but geopolitical and economic uncertainty along with falling home prices are likely to contribute to a cautious consumption pattern.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	3.9	2.3	1.5	1.9
Mainland GDP	4.1	3.2	0.8	1.1
LFS unemployment*	4.4	3.1	3.4	3.8
Wages and salaries	3.5	4.1	4.5	3.6
CPI-ATE inflation	1.7	3.9	4.3	2.6
Key interest rate, %	0.50	3.00	3.00	2.25

*Per cent of labour force. Source: Macrobond, SEB

Deteriorating domestic demand will slow mainland GDP growth to below trend in 2023. Fiscal policy will also be an impediment, since the government is calling for reduced spending to avoid boosting inflationary pressures in the economy. The government will unveil its 2023 budget on October 6. Mainland GDP is expected to grow by 3.2 per cent in 2022, slowing to 0.8 in 2023 and a trend-like 1.1 per cent in 2024. Heavy demand for Norwegian oil and gas, and petroleum capital spending in the petroleum sector, will support total GDP growth of 1.5 and 1.9 per cent in 2023 and 2024, respectively.

Mixed outlook for investments

The global energy crisis has enhanced demand for Norwegian petroleum exports. Norway produced close to 1,110 TWh of natural gas in 2021. More flexible production will allow for a 10-15 per cent increase in 2022-2023. Beyond this, substantial investments in existing and new fields and in pipeline infrastructure are required. Petroleum capital spending has declined 12 per cent since end-2019, but high demand and energy prices are cause for optimism. Statistics Norway's investment survey suggests the decline will be limited to 4.0 per cent this year, followed by a cyclical upswing of 8.0 and 12.0 per cent in 2023 and 2024, respectively. Even so, Norway will not be able to replace the shortfall from Russian natural gas exports.

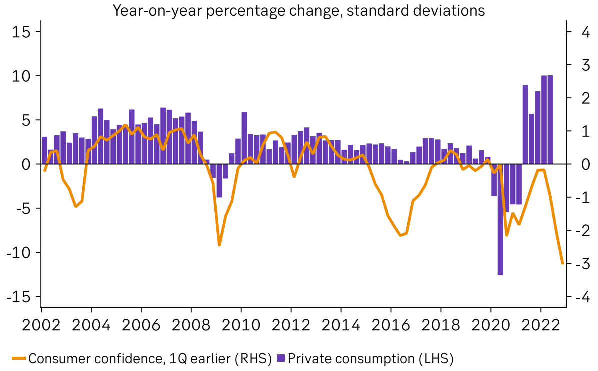
The mainland economy will enjoy positive secondary effects via petroleum suppliers and new green investment. Meanwhile high costs, supply constraints and weaker global growth are likely to dampen business activity in other industries despite high capacity utilisation. This will be especially pronounced in construction. The forecast for mainland private investments has been lowered, and the positive contribution to mainland GDP growth will be partly offset by a deficit from net trade in traditional goods.

Low confidence to curb private consumption

Private consumption rose 2.2 per cent in H1 2022, driven by sharply higher service consumption, while spending on goods has declined. The consumption pattern will normalise further, but growth in private consumption will slow. High prices for goods, food and electricity are squeezing household real disposable income. The government has strengthened subsidies in order to offset part of higher electricity costs, but the cost of living is nonetheless abnormally high. Disposable incomes will be further pressured by aggressive key rate hikes, since household interest rate sensitivity is very high. Despite solid financial buffers, consumer confidence has plunged and households have never been more pessimistic about their financial situation. Combined with a decline in existing home prices, this suggests cautious consumer behaviour ahead. We have lowered our forecast for private consumption growth, implying a moderation from 6.9 per cent in 2022 to 1.1 and 1.3 per cent in 2023 and 2024, respectively.

Consumer confidence at all-time low

Year-on-year percentage change, standard deviations



Source: Statistics Norway, Kantar TNS (Norway), Macrobond, SEB

Existing home prices in Norway rose 8.8 per cent in the first half of 2022. This strong upturn mainly reflects temporary supply-side bottlenecks stemming from new regulations. Price momentum has slowed, since supply is gradually normalising. Notably higher cost of living and mortgage interest rates will dampen demand. We forecast that annual price growth will slow markedly from 5.1 per cent in 2022 to -1.4 per cent in 2023 and 1.2 per cent in 2024. Structural supply-demand imbalances reduce the risk of a larger price correction.

Tight labour market adding wage pressures

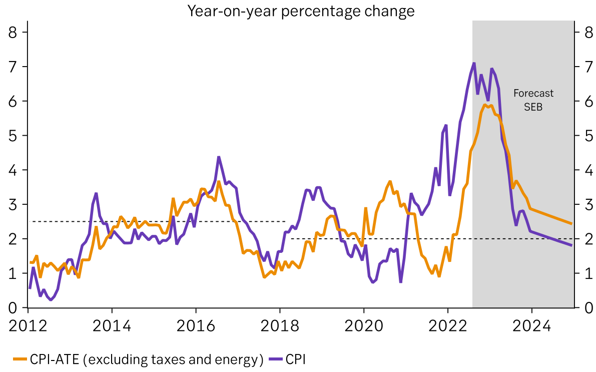
The labour market has continued to strengthen as the number of furloughs has normalised. Labour demand appears strong, with employment up 1.4 per cent in H1 2022 and job vacancies at an all-time high. The registered jobless rate has fallen to 1.6 per cent, well below Norges Bank's 2¼ per cent estimate of natural unemployment. Unemployment is expected to reach a trough this autumn and then trend somewhat higher over the next couple of years. Annual wage and salary negotiations are centred on demands for positive real wage growth. The wage norm in this year's negotiations is 3.7 per cent but including wage drift we forecast 4.1 per cent annual increases. Two years of negative real wage increases are likely to generate compensation demands in next year's round, but lower headline inflation will curb nominal pay increases to 4.5 per cent in 2023 and 3.6 per cent in 2024.

Core inflation will peak at close to 6 per cent

CPI-ATE (excluding taxes and energy) accelerated from low levels in late 2021. Monthly data have been volatile, but underlying inflation moved clearly higher during the summer to 4.5 per cent. Strong food price increases in both June and July, totalling almost 10 per cent, are the most important driver. Norwegian food prices normally fall significantly in the second half of the year. We expect a smaller decline this year, and the annual rate will continue to accelerate to near 15 per cent in early 2023. The upturn in underlying inflation is relatively broad-based, since prices for both goods and services have accelerated significantly. International prices will contribute to a further upturn in CPI-ATE during 2022, although this co-variation has historically been relatively low. The strong labour market and rising demand suggest that service inflation will continue upward. We forecast that CPI-ATE inflation will peak at close to 6 per cent towards the end of 2022. Inflation will gradually fall next year, and weaker growth both in Norway and internationally suggests that CPI-ATE will begin to approach target in 2024.

Inflation to peak in late 2022

Year-on-year percentage change



Source: Statistics Norway, Macrobond, SEB

Sharply rising electricity prices lifted CPI inflation above 5 per cent at the end of 2021. Strong subsidies to households, with the government compensating for 90 per cent of the costs above NOK 0.70/KWh, prevent high prices from being passed on to households. Norwegian CPI is thus significantly lower than in most other countries. We forecast that CPI inflation will remain in the 6-7 per cent range during 2022 and then fall significantly at a slightly faster pace than CPI-ATE.

Norges Bank is front-loading its rate hikes

Sharply higher inflation and a tight labour market forced Norges Bank to abandon its gradual rate hike approach this summer. The bank has delivered two consecutive 50 basis point hikes to 1.75 per cent, bringing its key interest rate to a neutral level. Another large upward revision in the inflation trajectory is expected in September's Monetary Policy Report, suggesting more front-loading is required to achieve the desired policy tightening. Inflation expectations have also risen to uncomfortably high levels, increasing the risk that they become entrenched at a high level. Norges Bank is expected to deliver two additional large hikes followed by one normal increase, implying a key rate of 3.00 per cent by year end. We expect more front-loading to result in a fast but short hiking cycle, since a sharply higher cost of living looks set to have a profound effect on household demand. We expect rate cuts in 2024 to 2.25 per cent by year end.

Denmark
A short recession

Growth recovered in Q2 as the economy reopened, but the combined effect of the energy price shock and tighter credit conditions suggests that this relief is temporary. We have lowered our GDP increase estimate for 2023 to zero and expect higher unemployment to delay labour market overheating. Growth will move above trend again in 2024.

Zero growth in 2023. Despite negative growth in the first quarter, the GDP indicator suggests that reopening effects after the winter lockdown gave GDP a boost in Q2. We are thus revising our GDP growth estimate for 2022 upward from 2.4 per cent to 3.0 per cent, but we now expect a recession to start in H2 2022 and have reduced our 2023 forecast of 2.4 per cent to 0 per cent.

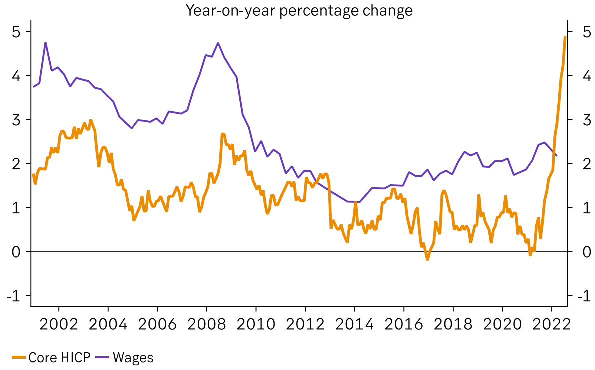
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	4.9	3.0	0.0	2.5
CPI	1.9	8.2	7.2	1.7
Wages and salaries	2.3	2.5	2.9	3.4
Public sector fiscal balance*	0.5	2.0	1.5	1.0
Public sector debt*	40.0	35.0	34.0	32.0
Current account*	8.3	6.0	6.0	7.0
Key interest rate (CD rate),%	-0.60	1.40	1.65	1.40

*% of GDP. Source: Statistics Denmark, DØRS, SEB

Inflation and interest rate headwinds. There are two main reasons for the downward adjustment to our growth estimate for 2023. First of all, like the rest of Europe, Denmark has seen a significant energy shock. Over the summer, energy prices have moved closer to what we regarded as the worst-case scenario last spring. The resulting surge in inflation, which is expected to peak around 12 per cent, reduces disposable incomes significantly. Furthermore, rising bond yields and ECB rate hikes have led to a tightening of financial conditions, as well as weaker demand in key export markets.

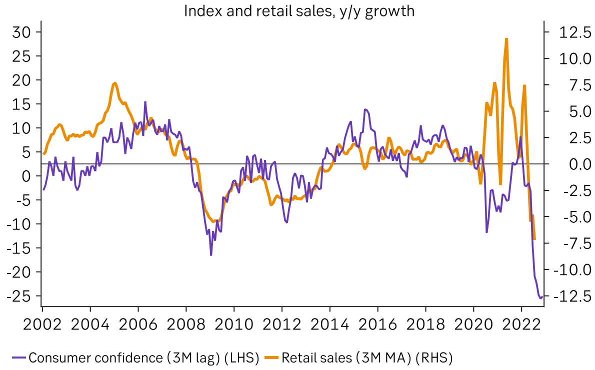
Real wages decline as inflation rises
Year-on-year percentage change



Source: Statistics Denmark, Eurostat, Macrobond, SEB

Consumption set to retreat. The negative shock is already reflected in an all-time low for consumer confidence. At -25.9 the aggregate confidence indicator is not only weaker than after the global financial crisis, but also significantly below the troughs after the 'Potato Diet' in 1987 and the second oil crisis in 1980. This is starting to show in retail sales, which at the end of Q2 had declined more than 5 per cent from the same period last year. The historical relationship to consumer confidence suggests further downside for retail sales, particularly if energy prices remain elevated heading into the winter season. We expect private consumption growth to decline from 2.2 per cent in 2022 to 0.7 per cent in 2023 before increasing to 2.1 per cent in 2024.

Consumer confidence down, retail sales adjustment to come
Index and retail sales, y/y growth

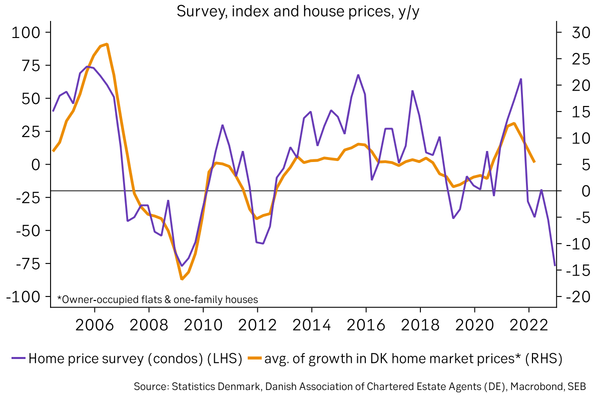


Source: Statistics Denmark, Macrobond, SEB

Tighter credit conditions. In a further setback for consumption, broad credit conditions started to turn less favourable after the start of monetary tightening by the ECB. Due to the EUR/DKK currency peg, this will be tracked by Danmarks Nationalbank (DNB). The latest lending survey shows that Danish banks are now tightening lending conditions for both businesses and households. Since the start of the year, Denmark's 10-year government bond yield has increased by 150 basis points and the 30-year mortgage rate has gone from 0.5 per cent to 4.5 per cent. Home prices continued to climb in Q1, but a decline of 10-20 per cent likely started last spring as rising costs of financing were added to increased costs for heating, electricity etc.

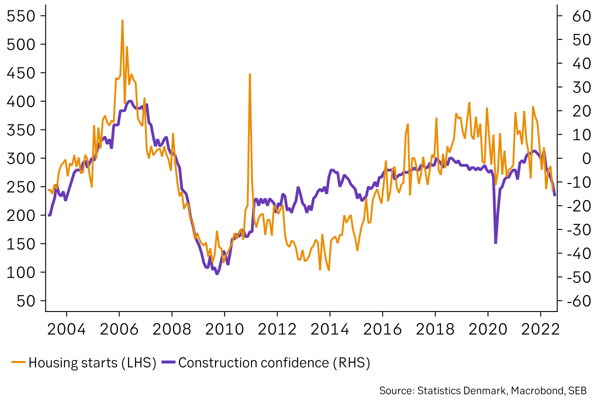
Latest home price survey suggests decline in prices ahead

Survey, index and house prices, y/y



Construction slowdown underway. Falling home prices and rising financing costs are also starting to weigh on construction investments. Housing starts already declined sharply in Q1 and falling construction sector confidence suggests continued weakening. Several companies in the construction sector have issued profit warnings, indicating lower construction activity in 2023 as well. Other fixed investment components are holding up better so far, due to relatively high capacity utilisation in the manufacturing sector.

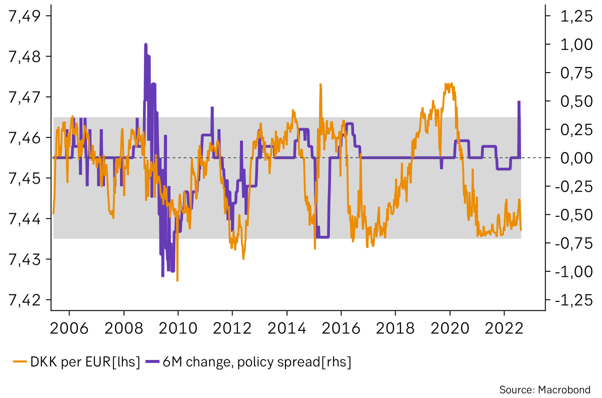
Construction slowdown ahead



Delayed wage inflation. The labour market has yet to show any significant weakness. Employment data continue to show growth, and unemployment has so far levelled off. However, we expect a trend shift as the economy meets headwinds from high inflation, rising interest rates and falling home prices, with unemployment peaking at 5.4 per cent at the end of next year. This is likely to further delay the expected increase in wage inflation. A rising employment-to-population ratio has so far not led to a commensurate increase in wage inflation, but there is normally a time lag. The delayed effect of the reopening is likely to keep wages rising through 2022 by up to 3 per cent, before a temporary dip next year. We expect wage inflation to reach 4 per cent by the end of 2024, a year later than we expected last spring.

Strong Danish krone. The krone remains strong following the ECB tightening in July and the DNB's consequent 50-basis point hike. Since the early summer, market expectations of the terminal rate in the ECB rate hike cycle have been lowered by around 100 basis points. Furthermore, the introduction of the TPI scheme to protect peripheral bond markets has led to a substantial decline in interest rates further out on the curve, suggesting doubts about the ECB's ability to implement quantitative tightening (QT). This could potentially start a discussion about whether the DNB should match the ECB's moves 1:1 going forward. Under the peg system Denmark cannot carry out its own quantitative easing (QE), so changes in euro zone liquidity policies may lead to upward pressure on the krone, at first triggering intervention that lifts local liquidity and subsequently a lower interest rate relative to the ECB if needed.

DKK still too strong



Elections ahead. The government intends to pursue a tight fiscal policy in 2022, mainly due to the expiration of temporary measures introduced during the pandemic. The budget for 2023 has yet to be officially presented, but according to the government we should expect a negative fiscal impact of around 0.5 per cent of GDP in 2023. It remains to be seen whether the Danish government will follow the lead of other European countries and introduce price caps or broad income support to counter the energy price shock. Denmark's current plans look relatively limited by comparison. This could change, since elections – which must take place by June 2023 – are likely to be held before year-end 2022.

Finland
Surprising resilience

Finland has demonstrated resilience to various risks threatening its economy. Neither high inflation, severed trade ties with neighbouring Russia nor economic malaise in Germany – its largest trade partner – have managed to dent growth. However, difficult times lie ahead. In 2022 GDP will increase by 2.1 per cent, but headwinds blowing from elsewhere in the euro area will slow the GDP increase to 0.7 per cent in 2023. In 2024 growth will again accelerate, but only by a comparatively modest 1.5 per cent.

Inflation will remain below the euro area average. As in most countries, inflation has become the main economic concern. July's HICP increase of 7.9 per cent was actually one of the lowest in the euro area, but it was the highest such figure recorded in Finland since the 1980s. Thus far, the government's reaction has been rather modest, but new measures are expected. Among proposed actions to tackle inflation are a VAT reduction on electricity, price caps and extra child benefits. Inflation will surpass our earlier forecasts, reaching 6.7 per cent in 2022 and 3.0 per cent in 2023.

Key data
Year-on-year percentage change

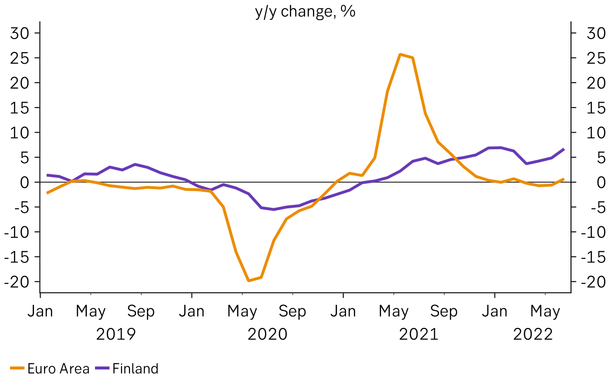
	2021	2022	2023	2024
GDP	3.0	2.1	0.7	1.5
Private consumption	3.6	1.8	0.7	1.6
Exports	5.6	3.2	1.3	3.0
Unemployment*	7.6	6.5	6.5	6.3
Wages and salaries	2.3	2.4	2.2	2.1
HICP inflation	2.1	6.7	3.0	1.4
Public sector fiscal balance**	-2.6	-2.2	-2.0	-1.8

*% of labour force **% of GDP. Source: Eurostat, SEB

A pessimistic shopping spree. Against the backdrop of Russia's invasion of Ukraine and high inflation, Finnish household sentiment is setting new historic lows. This reflects consumers' bleak assessment of the country's economic situation rather than of their own personal finances. Regardless of low consumer confidence, retail sales as well as service consumption have remained strong so far. With sales increasing by 5 per cent in constant prices it is no wonder that retail sector confidence has actually improved in recent months. During the second half of the year, demand should ease somewhat, with private consumption increasing by 1.8 per cent overall in 2022 and 0.7 per cent in 2023.

Strong industrial production. Unlike many countries, Finland has seen faster manufacturing growth in recent months. In June, industrial output grew by 8 per cent year-on-year. In addition to energy production, other industries such as large manufacturers of machinery have made strong contributions. Solid business confidence, high capacity utilisation and full order books imply good fortune for some time to come. Yet at some point, the headwinds blowing in from the global economy, especially Finland's largest trade partner Germany, will start to affect business. Trade will slow in 2023, with exports growing by 1.3 per cent, down from 3.2 per cent in 2022.

Industrial production is bucking the trend
y/y change, %



Source: Statistics Finland, Eurostat, Macrobond, SEB

The labour market has quickly improved. In June, employment among 15- to 74-year-olds reached 66.3 per cent, the highest rate since 2008. Wage and salary growth is expected to have increased at a decent pace in Q2, but far behind inflation, and real wages are expected to fall by around 4 per cent. Slower growth will not jeopardise recent gains, and unemployment will remain at 6.5 per cent or less during our forecast period.

Lower construction activity to hamper capital spending. Despite the uncertain outlook, business investments seem to have remained relatively solid for the moment. A different outlook is evident in the housing market, where residential building permits have been in continuous decline since last August.

Ongoing budget negotiations will result in a large deficit. Among other reasons, this is due to the need to cover increased spending on defence. The government has also announced that it will cut the number of visas issued to Russian nationals by 90 per cent but the economic impact of this measure will be limited.

The Baltics

Lithuania | page 48

High inflation and a deteriorating outlook for exports will hurt the economy. Due to a strong first half we are raising our GDP growth forecast for this year, but we are lowering our 2023 projection. Inflation will plunge and unemployment will climb.

Latvia | page 49

Owing to a strong start, GDP growth will be good this year, before cooling down in 2023 and then rebounding in 2024. Extreme energy and food inflation will squeeze consumption. The government will beef up anti-inflation measures.

Estonia | page 50

Soaring energy prices have driven Estonia's inflation to extremes, undermining household purchasing power. Our main scenario is that the economy will slide into recession in Q4 2022 but swiftly recovery during the second half of 2023.

Lithuania
Tough times ahead

Economic activity in the second quarter was slightly better than forecast, but we remain very cautious in the short term, since high inflation and a weaker outlook for major exporters will take their toll on the economy. Sanctions imposed on Russia and Belarus will also have much more visible effect on businesses. The labour market remains very tight, but an economic slowdown will lead to higher unemployment.

GDP declined by 0.4 per cent in the second quarter compared to the first, or less than we assumed in May. Sanctions targeting Russia and Belarus did not have an immediate impact on the economy, since many of them took effect only during the summer. Companies rushed to stockpile various commodities such as wood or metal products from these countries. This bought time for the manufacturing and construction sectors to find new suppliers. Export orders for manufacturers remain historically strong, but they are likely to weaken over the next few months. Exports of goods to Russia, which consist mainly of re-exports, were almost 40 per cent smaller year-on-year and will fall further.

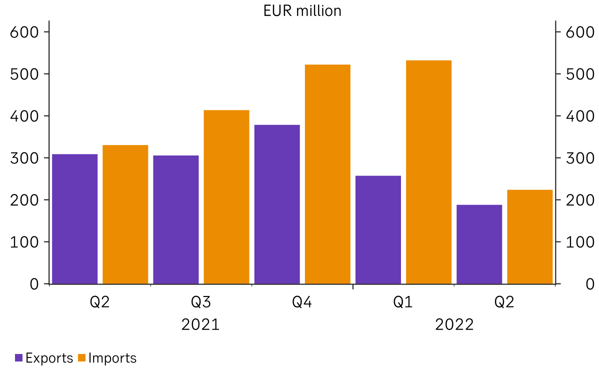
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	5.0	1.5	0.5	3.7
Household consumption	7.4	2.0	0.0	4.0
Exports	15.9	3.3	-2.0	4.0
Unemployment*	7.1	6.0	6.8	6.8
Wages and salaries	10.5	12.2	8.5	6.5
HICP inflation	4.6	17.9	6.2	1.6
Public sector fiscal balance**	-1.0	-1.5	-2.2	-1.0

*% of labour force **% of GDP. Source: Eurostat, SEB

The economy will not avoid a technical recession. We still foresee quarterly GDP declines in both Q3 and Q4 2022. Due to the strong first half, we are raising our full-year GDP growth forecast from 0.9 to 1.5 per cent, but we are lowering our 2023 forecast from 1.8 to 0.5 per cent because of expected slower growth in household consumption and deteriorating net foreign trade.

Trade with Russia slumped, but less than expected



Source: Statistics Lithuania, Macrobond, SEB

Household consumption growth is slowing, but not as fast as expected. Households continued to use savings accumulated during the pandemic to smooth the impact of inflation on consumption. There was also a clear shift from goods to service consumption in Q1 and Q2. In June, yearly growth in retail sales turned negative, and we believe they will remain so for the rest of 2022. We also assume that consumption of services will finally become more constrained this autumn as people reduce their spending on non-essential goods and services.

Labour market overheating has peaked. Unemployment dropped to 5.2 per cent during Q2, the lowest level since 2008. We believe it is very close to bottoming out. In 2023, unemployment will be higher. The current tight labour market is driving historically high growth in wages and salaries, which are expected to climb by 12.2 per cent in 2022. Next year wages will increase at a slower pace, but a lot will depend on the final decision about the minimum wage hike in 2023, which is currently proposed to be 19 per cent.

Inflation will fall from 17.9 per cent in 2022 to 6.2 per cent in 2023. Headline inflation jumped over 20 per cent and core inflation exceeded 10 per cent in June. Energy and other commodities price hikes were passed on to retail prices very fast in Lithuania. Demand-pull factors also played a key role. Annual inflation may already have peaked in July. In the coming months we will see slightly lower inflation, despite a sharp rise in wholesale electricity and natural gas prices.

The lagging response to inflation in household consumption is positive for the public sector budget. But the government cannot avoid public pressure to lower electricity and heating prices for households and businesses this autumn.

Latvia
Inflation hits consumption

A strong start of the year will lift GDP growth to 2.5 per cent this year before cooling down to 1.3 per cent in 2023 and rebounding to 3.5 per cent in 2024. The outlook will depend on the situation in the European energy market. Extreme energy and food inflation is pushing consumption prospects downward. The government will beef up anti-inflation measures to support consumption and social stability. No huge swings in the labour market are expected, although unemployment will increase by year-end.

Slower growth amid headwinds. After a strong start to 2022, economic growth was slightly weaker than expected – slowing from 6.7 per cent year-on-year in Q1 to 2.6 per cent during Q2. In July the economic sentiment indicator recovered to 94.8. Manufacturing and services sector improved slightly, while retail trade and construction continued to weaken. Weak economic sentiment indicates that momentum will slow, further increasing the recession risks by year-end. High inflation and stronger impact from sanctions on Russia will add further headwinds in 2023. There are still good growth prospects for agriculture, manufacturing and exports.

Key data

Year-on-year percentage change

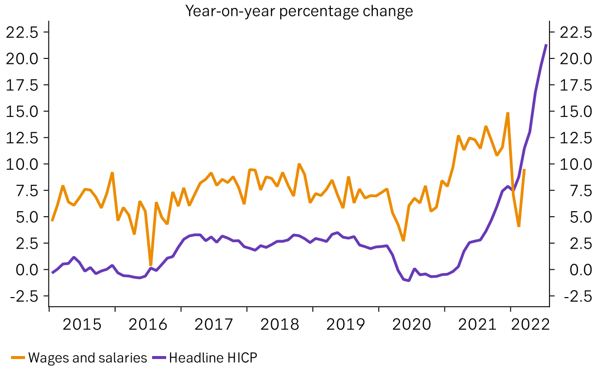
	2021	2022	2023	2024
GDP	4.8	2.5	1.3	3.5
Household consumption	4.8	5.1	1.0	3.3
Exports	6.2	4.6	2.3	3.7
Unemployment*	7.6	6.9	7.1	6.8
Wages and salaries	11.8	6.5	7.5	7.5
HICP inflation	3.3	16.5	9.9	2.1
Public sector fiscal balance**	-7.3	-3.7	-2.8	-2.5

*% of labour force **% of GDP. Source: Statistics Latvia, SEB

More than 20 per cent inflation. In July, the inflation rate reached 21.5 per cent, a level last seen in 1995. Price increases for housing, food and transport accounted for more than 18 percentage points. Extreme inflation is quickly weakening consumption, especially because the heating season is approaching and more people will struggle to cover their expenses. In June, sales of food grew by 2.8 per cent while non-food sales (except fuel) fell by 0.2 per cent. Households will use their savings, but these funds are very unevenly distributed. The government boosted subsidies from EUR 350 million to EUR 430 million – around 1.3 per cent of GDP – but the potential increase in energy bills may reach EUR 2 billion. Inflation will remain high next year but will normalise in 2024. We have lowered our projection for household consumption, especially in 2023, although we still foresee continued positive growth. As inflation slows in 2024, consumption will recover. We expect GDP to grow by 1.3 per cent in 2023 and by 3.5 per cent in 2024.

Inflation rate outpaces wages

Year-on-year percentage change



Source: Latvian Central Statistical Bureau, Macrobond, SEB

Construction faces high costs and lower demand. Investment activity will eventually fall. The government needs to establish efficient mechanisms to stabilise industry, especially for EU projects that may support recovery next year.

Manufacturing a bright spot. Growth in manufacturing was 6.5 per cent in the first half of 2022. Exports should help sustain growth, although the outlook is uncertain due to energy supply risks. So far sanctions have had only a limited impact; Latvia's exports to Russia decreased by only 3 per cent in the first half, since many measures are coming into effect gradually.

The labour market will remain strong. We do not envisage a huge uptick in unemployment, although some structural changes will emerge – for example regionally, due to decreasing transit flows. Wage and salary growth will accelerate from 6.5 per cent in 2022 to 7.5 per cent next year, driven by a minimum wage increase but still lagging inflation. Purchasing power may start to recover by late 2023.

Estonia
Soaring inflation is driving the economy into recession

Soaring energy prices have driven Estonia's inflation to extremes. The government is finally reacting, and we expect inflation to ease slightly towards the end of the year. However, skyrocketing prices have already undermined household budgets and confidence. Our main scenario is that the economy will slide into recession in Q4 and emerge from it in the second half of 2023. The recovery will be swift, but GDP will grow by just 0.5 per cent next year, followed by a 3.5 per cent upturn in 2024.

Record inflation. Estonia's inflation rate has exceeded 20 per cent since May. This is due to a combination of a liberal energy market and a high share of energy and food in the consumption basket, but also strong demand and a tight labour market. The government is planning to provide relief by introducing price subsidies for electricity, natural gas and heating. Our forecast is highly uncertain, since energy prices remain hard to predict. We currently expect inflation to fall to around 6 per cent in 2023.

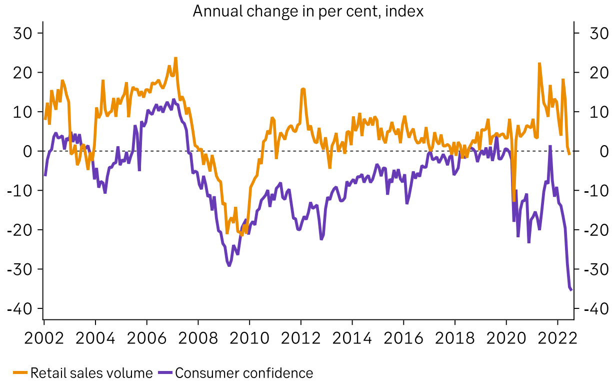
Inflation is hurting households. Domestic demand has taken its time to react to soaring prices. However, in June the previous surge in retail sales volumes turned into a small decline that will deepen in the coming months. Household confidence, which had not fully recovered from the pandemic, has gone through a dramatic drop and is now as low as in 1993. Private consumption is thus under severe pressure and will fall during Q4 2022, followed by only modest growth throughout 2023.

Home-buying rally to end. The number of real estate transactions remained high in Q2 2022, even though the average price of an apartment in the capital Tallinn per square metre shot up by 30 per cent on an annual basis. Such a pace in not sustainable, and demand for housing is starting to fade. However, due to high construction prices, supply is also about to shrink. This will help balance the market, and a large drop in real estate prices is unlikely. Since many public sector projects have been withdrawn, there is a risk of severe consequences for the construction sector, which in 2021 accounted for 6 per cent of GDP.

Exports to lean more on services. The manufacturing sector in Estonia is not so energy-intensive, but a broad-based increase in input prices has dented profit margins. In June growth in manufacturing output turned negative as significant declines were recorded in many large sectors, such as the wood and metal industries. Lower demand will start to hamper merchandise trade, while we expect trade in services to remain stronger.

Retail sales to follow consumer sentiment

Annual change in per cent, index



Source: Statistics Estonia; European Commission

More flex in the labour market. The employment rate has recovered to its pre-pandemic high, while annual growth in wages and salaries reached 11 per cent during the summer. The outlook is hard to predict. After the pandemic, many employers have learned the hard way how difficult it is to hire new people. However, Estonia's labour market has historically been quick to react to changing economic tides. Starting next year, Ukrainian refugees will also be included in the Labour Force Survey sample, which will impact statistics. We assume that current headwinds will also have a negative impact on the labour market, driving unemployment back up to 6.8 per cent in 2023.

Public spending will increase. Parliamentary elections are due in March 2023. After the breakup of the previous coalition, the new government seems eager to buy its way into people's hearts. In addition to energy subsidies, the new year will bring about a large increase in child benefits. This will not improve public finances. We expect the 2023 budget deficit to total 3 per cent of GDP.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	8.3	1.2	0.5	3.5
Private consumption	6.4	2.2	0.6	3.0
Exports	19.8	4.8	2.0	4.5
Unemployment*	6.2	5.8	6.8	6.0
Wages and salaries	6.9	10.3	7.5	7.0
HICP inflation	4.5	18.2	6.0	2.5
Public sector fiscal balance**	-2.4	-3.5	-3.0	-2.5

*% of labour force **% of GDP. Source: Eurostat, SEB

Global key indicators

Yearly change in per cent

	2021	2022	2023	2024
GDP OECD	5.4	2.4	0.9	2.2
GDP world (PPP)	6.1	3.1	2.6	4.0
CPI OECD	1.7	8.6	6.0	2.0
Oil price, Brent (USD/barrel)	71	102	115	95

US

Yearly change in per cent

	2021 level, USD bn	2021	2022	2023	2024
Gross domestic product	22,996	5.7	1.5	0.5	2.0
Private consumption	15,742	7.9	2.2	0.5	2.0
Public consumption	3,250	1.0	-0.9	1.1	1.2
Gross fixed investment	4,942	6.1	0.5	-1.6	3.0
Stock building (change as % of GDP)	-20	0.1	0.6	-0.4	0.0
Exports	2,478	4.5	6.1	4.1	3.2
Imports	3,397	14.0	8.1	-1.2	3.2
Unemployment (%)		5.4	3.6	4.6	4.9
Consumer prices		4.7	8.2	4.8	2.6
Core CPI		3.6	6.2	4.8	2.4
Household savings ratio (%)		12.3	9.5	8.5	8.0
Public sector financial balance, % of GDP		-10.9	-4.5	-5.0	-6.0
Public sector debt, % of GDP		135	130	130	131

Euro area

Yearly change in per cent

	2021 level, EUR bn	2021	2022	2023	2024
Gross domestic product	12,269	5.3	2.7	0.3	2.1
Private consumption	6,269	3.6	2.2	-1.3	1.8
Public consumption	2,717	3.9	1.5	1.9	2.0
Gross fixed investment	2,695	3.9	3.3	2.4	2.5
Stock building (change as % of GDP)		0.3	0.4	0.2	0.0
Exports	6,057	10.5	6.2	4.3	3.8
Imports	5,576	8.2	6.3	4.4	3.7
Unemployment (%)		7.7	6.6	6.8	7.8
Consumer prices		2.6	8.6	6.3	0.3
Core CPI		1.5	3.9	3.3	2.0
Household savings ratio (%)		14.9	9.0	11.0	12.0
Public sector financial balance, % of GDP		-5.1	-3.9	-3.0	-2.5
Public sector debt, % of GDP		95.6	96.1	94.8	93.7

Other large countries

Yearly change in per cent

	2021	2022	2023	2024
GDP				
United Kingdom	7.4	3.4	-0.2	1.3
Japan	1.7	1.9	1.6	1.1
Germany	2.6	1.3	-0.1	2.5
France	6.8	2.2	0.2	2.4
Italy	6.6	3.6	0.3	2.1
China	8.1	3.5	5.3	5.0
India	8.3	7.4	5.8	6.5
Brazil	4.8	1.6	0.8	2.0
Russia	4.7	-4.0	-3.0	2.5
Poland	5.7	4.5	2.0	3.2
Inflation				
United Kingdom	2.6	9.9	11.8	1.6
Japan	-0.2	2.0	2.1	1.3
Germany	3.2	8.6	5.9	0.3
France	2.1	6.6	6.0	0.6
Italy	1.9	7.9	5.5	0.6
China	0.9	2.4	2.3	2.1
India	5.1	6.9	5.2	4.5
Brazil	8.3	10.2	6.0	4.0
Russia	6.7	14.0	8.0	10.0
Poland	5.1	13.7	10.0	4.0
Unemployment (%)				
United Kingdom	4.5	3.8	4.4	5.2
Japan	2.8	2.6	2.5	2.5
Germany	3.6	2.9	3.0	3.7
France	7.9	7.1	7.3	7.9
Italy	9.5	8.1	8.3	9.3

Financial forecasts

Official interest rates	25-Aug	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24
US	2.50	3.50	3.50	3.25	2.75	2.50
Japan	-0.10	-0.10	-0.10	0.00	0.25	0.25
Euro area, deposit rate	0.00	1.50	1.75	1.75	1.75	1.50
United Kingdom	1.75	2.75	2.75	2.75	2.75	2.25
Bond yields						
US	3.03	3.30	3.10	2.80	2.70	2.60
Japan	0.22	0.25	0.25	0.25	0.25	0.25
Germany	1.33	1.65	1.75	1.75	1.70	1.60
United Kingdom	2.60	2.65	2.75	2.75	2.70	2.60
Exchange rate						
USD/JPY	137	138	135	130	125	120
EUR/USD	1.00	0.95	1.02	1.09	1.15	1.15
EUR/JPY	136	131	138	142	144	138
EUR/GBP	0.84	0.83	0.84	0.86	0.90	0.90
GBP/USD	1.18	1.14	1.21	1.27	1.28	1.28

Sweden

Yearly change in per cent

	2021 level, SEK bn	2021	2022	2023	2024
Gross domestic product	5,452	5.1	2.6	0.0	1.7
Gross domestic product, working day adjustment		4.9	2.7	0.2	1.7
Private consumption	2,357	6.0	4.0	-1.5	2.0
Public consumption	1,411	2.8	0.0	0.8	0.8
Gross fixed investment	1,358	6.3	3.0	-1.0	3.0
Stock building (change as % of GDP)	20	0.4	1.1	0.1	0.0
Exports	2,489	7.9	3.7	1.0	4.0
Imports	2,255	9.6	6.4	-0.5	4.7
Unemployment, (%)		8.8	7.5	7.8	8.1
Employment		0.9	2.8	0.4	0.1
Industrial production		5.7	2.5	0.0	2.5
CPI		2.2	8.8	7.8	1.9
CPIF		2.4	8.2	5.9	1.5
Hourly wage increases		2.7	2.6	4.5	3.5
Household savings ratio (%)		15.4	12.3	8.8	8.4
Real disposable income		3.2	-0.7	-3.1	1.1
Current account, % of GDP		5.3	4.0	5.0	4.5
Central government borrowing, SEK bn		-78	-120	-55	-11
Public sector financial balance, % of GDP		-0.3	0.4	0.2	0.0
Public sector debt, % of GDP		36.7	31.7	29.3	28.1

Financial forecasts	25-Aug	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24
Repo rate	0.75	2.00	2.25	2.25	2.00	1.75
3-month interest rate, STIBOR	1.27	2.25	2.35	2.35	2.05	1.80
10-year bond yield	1.63	2.05	2.25	2.35	2.30	2.20
10-year spread to Germany, bps	30	40	50	60	60	60
USD/SEK	10.56	11.11	10.15	9.31	8.61	8.52
EUR/SEK	10.54	10.55	10.35	10.15	9.90	9.80
KIX	122.0	123.2	119.4	115.7	111.4	110.6

Finland

Yearly change in per cent

	2021 level, EUR bn	2021	2022	2023	2024
Gross domestic product	251	3.0	2.1	0.7	1.5
Private consumption	128	3.6	1.8	0.7	1.6
Public consumption	61	2.7	2.5	1.2	0.8
Gross fixed investment	59	1.1	4.1	1.0	2.0
Stock building (change as % of GDP)	1	0.3	0.5	0.2	0.1
Exports	99	5.6	3.2	1.3	3.0
Imports	98	5.6	3.8	0.8	2.7
Unemployment, OECD harmonised (%)		7.6	6.5	6.5	6.3
CPI, harmonised		2.1	6.7	3.0	1.4
Hourly wage increases		2.3	2.4	2.5	2.3
Current account, % of GDP		0.7	-0.8	0.2	0.0
Public sector financial balance, % of GDP		-2.6	-1.9	-1.8	-2.0
Public sector debt, % of GDP		65.8	65.5	65.2	66.0

Norway

Yearly change in per cent

	2021 level, NOK bn	2021	2022	2023	2024
Gross domestic product	3,675	3.9	2.3	1.5	1.9
Gross domestic product (Mainland)	3,115	4.1	3.2	0.8	1.1
Private consumption	1,547	4.9	6.9	1.1	1.3
Public consumption	917	3.8	0.5	1.5	2.3
Gross fixed investment	895	-0.9	1.4	3.0	4.3
Stock building (change as % of GDP)		0.1	0.1	-0.1	0.1
Exports	1,337	4.7	1.1	3.9	3.0
Imports	1,116	2.3	4.9	4.4	4.5
Unemployment (%)		4.4	3.1	3.4	3.8
CPI		3.5	5.7	4.0	2.0
CPI-ATE		1.7	3.9	4.3	2.6
Annual wage increases		3.5	4.1	4.5	3.6

Financial forecasts	25-Aug	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24
Deposit rate	1.75	3.00	3.00	3.00	2.75	2.25
10-year bond yield	3.24	3.45	3.40	3.40	3.35	3.30
10-year spread to Germany, bps	191	180	165	165	165	170
USD/NOK	9.68	10.37	9.56	8.90	8.39	8.39
EUR/NOK	9.66	9.85	9.75	9.70	9.65	9.65

Denmark

Yearly change in per cent

	2021 level, DKK bn	2021	2022	2023	2024
Gross domestic product	2,504	4.9	3.0	0.0	2.5
Private consumption	1,106	4.3	2.2	0.7	2.1
Public consumption	608	4.2	0.6	1.9	0.8
Gross fixed investment	566	6.5	6.3	1.6	6.0
Stock building (change as % of GDP)		0.0	0.3	0.0	0.0
Exports	1,494	8.1	1.6	2.0	4.1
Imports	1,315	8.2	1.5	3.1	4.9
Unemployment, OECD harmonised (%)		4.5	4.8	5.4	5.0
CPI, harmonised		1.9	8.2	7.2	1.7
Hourly wage increases		2.3	2.5	2.9	3.4
Current account, % of GDP		8.3	6.0	6.0	7.0
Public sector financial balance, % of GDP		0.5	2.0	1.5	1.0
Public sector debt, % of GDP		40.0	35.0	34.0	32.0

Financial forecasts	25-Aug	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24
Deposit rate	-0.10	1.40	1.65	1.65	1.65	1.40
10-year bond yield	1.65	1.97	2.07	2.07	2.02	1.92
10-year spread to Germany, bps	32	32	32	32	32	32
USD/DKK	7.45	7.83	7.29	6.83	6.48	6.48
EUR/DKK	7.44	7.44	7.44	7.44	7.45	7.45

Lithuania

Yearly change in per cent

	2021 level, EUR bn	2021	2022	2023	2024
Gross domestic product	55	5.0	1.5	0.5	3.7
Private consumption	33	7.4	2.0	0.0	4.0
Public consumption	10	0.5	0.3	0.5	0.5
Gross fixed investment	12	7.0	4.5	2.0	5.0
Exports	45	15.9	3.3	-2.0	4.0
Imports	42	18.7	4.7	-2.1	4.2
Unemployment (%)		7.1	6.0	6.8	6.8
Wages and salaries		10.5	12.2	8.5	6.5
Consumer prices		4.6	17.9	6.2	1.6
Public sector financial balance, % of GDP		-1.0	-1.5	-2.2	-1.0
Public sector debt, % of GDP		44.3	38.8	40.7	40.7

Latvia

Yearly change in per cent

	2021 level, EUR bn	2021	2022	2023	2024
Gross domestic product	32.9	4.8	2.5	1.3	3.5
Private consumption	18.0	4.8	5.1	1.0	3.3
Public consumption	6.6	4.4	2.4	2.7	3.1
Gross fixed investment	7.8	3.0	1.9	3.8	5.3
Exports	21.0	6.2	4.6	2.3	3.7
Imports	21.7	13.5	9.9	4.2	3.0
Unemployment (%)		7.6	6.9	7.1	6.8
Wages and salaries		11.8	6.5	7.5	7.5
Consumer prices		3.3	16.5	9.9	2.1
Public sector financial balance, % of GDP		-7.3	-3.7	-2.8	-2.5
Public sector debt, % of GDP		44.8	46.1	45.8	44.3

Estonia

Yearly change in per cent

	2021 level, EUR bn	2021	2022	2023	2024
Gross domestic product	31	8.3	1.2	0.5	3.5
Private consumption	15	6.4	2.2	0.6	3.0
Public consumption	6	3.9	1.0	1.2	1.0
Gross fixed investment	9	3.3	-11.3	1.6	5.0
Exports	25	19.8	4.8	2.0	4.5
Imports	25	20.7	0.5	0.6	4.2
Unemployment (%)		6.2	5.8	6.8	6.0
Wages and salaries		6.9	10.3	7.5	7.0
Consumer prices		4.5	18.2	6.0	2.5
Public sector financial balance, % of GDP		-2.4	-3.5	-3.0	-2.5
Public sector debt, % of GDP		18.1	20.5	22.0	22.5

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