Research Reports

Focus on the inflation issue as the economy reaches a more mature phase

# Nordic Outlook

# September 2021

SEB

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# Hard policy choices ahead

The recovery in the global economy is continuing. In many cases it has exceeded expectations. Growth rates are high, unemployment is falling and financial markets are signalling a happy confluence of low interest rates and rising share prices. Most indicators point to continued expansion, with above-trend growth in many places during both 2022 and 2023. But the road ahead is far from smooth. Instead there are both speed bumps and hard choices between alternative routes. And although COVID-19 deaths and pressure on health care systems may decrease, the virus is something we will have to deal with for a long time to come.

**Stubborn reopening problems.** When the USD 85 trillion world economy was supposed to get moving again after the most acute phase of the pandemic, a few slow spots and bottlenecks were expected to appear. But some of these bottlenecks have been more severe and persistent than projected. Shortages of components, especially semiconductors, have created major problems in the automotive industry and other sectors, which have been forced to reduce production. Transport times and shipping costs have soared, disrupting global value chains and pushing up producer prices. And there are serious questions about both the duration and contagion risks of inflation, which is now at its highest since the 1990s in the United States.

**Policy choices are becoming tougher.** On the one hand we see a strong recovery and a bright macro outlook. On the other hand, decision makers face tough trade-offs to resolve persistent reopening problems. There is a growing risk of policy mistakes when it is no longer just a matter of providing stimulus to help households, businesses and countries through the COVID-19 crisis.

**Fiscal policy needs to be redirected** from crisis responses to reconstruction, with close attention to social and climate issues. Central banks must decide when to normalise their policies to avoid overheating and inflation, but without throttling the recovery that the world needs. And governments need to weigh the risks of COVID-19 transmission and new variants against the disadvantages of widespread lockdowns.

**Not everything is about the pandemic anymore.** While both medical and economic efforts to end the global crisis continue, other topics are well worth a close look. For example, central banks worldwide – including Sweden's Riksbank – are now studying the potential for creating a whole new kind of money: e-currencies. And after this summer's Swedish government crisis and the Prime Minister's resignation announcement, we have a unique political situation for the 2022 budget bill that will soon reach Parliament.

This September 2021 issue of *Nordic Outlook* includes five in-depth theme articles that discuss the following:

- E-currencies ahead?
- Extreme weather
- Inflation
- Emerging markets
- The 2022 budget

*Nordic Outlook* will hopefully give you new insights about the world economy, which is moving in the right direction but will offer plenty of speed bumps and hard choices. We wish you pleasant reading and hope you will stay safe and keep on helping others in need.

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# The global economy

## Focus on inflation issue as economy reaches more mature phase

### The United States

Consumption is slowing after a stimulus-driven spring shopping spree. The labour market is exhibiting short-term overheating tendencies but is far from a ceiling. The Fed will start tapering bond purchases, hiking its key rate in 2023.

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### Euro area

The recovery in Q2 surprised on the upside. A new virus wave and supply side problems will slow near-term growth, but we have raised our GDP forecast. Higher inflation is transitory, and the ECB key rate will stay the same.

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### China

China's growth momentum is easing. Further downside risks have intensified due to a lower credit impulse and slower recovery in private consumption, which is being hampered by the strict official COVID-19 containment strategy.

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### The United Kingdom

After the big downturn in 2020, the recovery is continuing. There are good prospects of above-trend growth even in 2023. The Bank of England will start unwinding its crisis policy, hiking its key rate to 0.75 per cent by late 2023.

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Western European economies have recovered surprisingly fast as restrictions have been eased. We have raised our GDP forecasts, although higher COVID-19 transmission is now hampering growth a bit. New lockdowns in Asia are creating global disruptions, for example via inflation-driving bottlenecks. The US is maintaining its leading position in the recovery. Despite upside risks, we expect inflation to fall in 2022 – enabling the Fed to postpone rate hikes until 2023, when unemployment falls below pre-pandemic levels.

Developments in recent months have changed the economic outlook in somewhat contradictory ways. Due to the easing of COVID-19 restrictions, the recovery in the second quarter of 2021 was stronger than expected in Europe. The labour market situation has also improved unexpectedly fast in many places. New forecasts from the International Monetary Fund (IMF) and the European Central Bank (ECB), among others, show a pattern of closing the accounts early on the consequences of the pandemic. GDP forecasts have been adjusted upward. By the end of 2022, economies will largely have reverted to the resource utilisation that prevailed before the pandemic broke out. This becomes especially clear now that we have extended our horizon by another year. Forecasts for 2023 are calm, with minor changes in the labour market and GDP growth close to the long-term trend. But in the past few weeks, new risks have also emerged as virus transmission has again increased. Although renewed restrictions in Europe will be milder than earlier ones, when combined with more cautious behaviours they are among factors that will hamper parts of the economy for quite some time. New lockdowns in Asia, including at vital ports, are also creating disruptions in global transport systems.

**Unexpectedly strong inflation impulse.** High inflation has also raised questions about whether the upturn is only temporary or whether we are underestimating the consequences of extreme economic stimulus. In the United States, core inflation is now around 5 per cent, the highest level recorded since the early 1990s. In a theme article on page 24, we discuss various aspects of this inflation upturn. Although price-raising supply shocks look set to be more long-lasting than previously expected, our conclusion is still that inflation will decline early in 2022. Yet the combination of an unexpectedly rapid downturn in unemployment and high inflation numbers raises questions about the appropriate times for withdrawing stimulus. A rapid, synchronised upturn in home prices is accentuating the negative side effects of ultra-loose monetary policy.

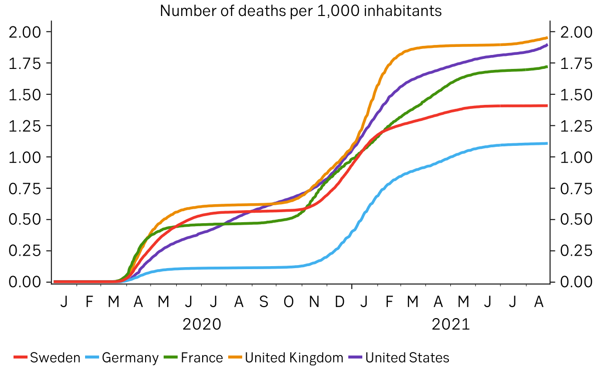
**The market is relaxed about the threat of inflation.** Despite high inflation figures, bond yields have fallen quite sharply in an environment of muted risk appetite. Concerns about renewed virus transmission have contributed to this. But it also seems as if cautious signals from central banks – especially the US Federal Reserve –are causing the market to start sensing impending policy mistakes. It is also clear that the market is not particularly worried about inflation. Although inflation expectations have rebounded since their downturns in 2019 and 2020, they instead indicate an overwhelming likelihood that inflation will end up below central bank targets within a few years.

## Exaggerated expectations about vaccines

The consequences of the pandemic thus continue to affect the forecast situation. Although easing of restrictions has helped push GDP growth higher – in some cases more than expected – hopes that COVID-19 vaccines would ensure a return to normal conditions have proved exaggerated as more infectious coronavirus mutations, especially the Delta variant, have appeared. Israel provides the clearest example that new waves of transmission can come, in spite of a very high vaccination rate. We can also see similar patterns in Western Europe, while setbacks in the US are also due to a slower pace of vaccinations – partly as a result of vaccine resistance. In many emerging market (EM) economies and in poor countries, low vaccination rates are still a problem despite increased global vaccine production. To some extent this is because countries that were successful in suppressing transmission early in the pandemic seem to have underestimated the importance of vaccinating their populations. Delayed vaccination campaigns in these countries also increase the risk of the emergence of new vaccine-resistant virus variants. Further ahead, this would also threaten countries with high vaccination levels.

COVID-19 deaths are continuing to level off

Number of deaths per 1,000 inhabitants




Source: World Health Organization, Macrobond, SEB

**Gentler lockdown strategies in Europe.** Although COVID-19 transmission is now increasing, we are not seeing a corresponding upturn in severe illnesses or deaths. Since vaccinated people suffer milder symptoms, and the average age of those now being infected is lower than before, decision makers have greater scope to weigh the precautionary aspects of COVID-19 policy against the growing need for normalisation. This is reflected in greater restraint in imposing new restrictions. One way is to limit restrictions to unvaccinated groups. In France, for example, vaccine passes are required to enter restaurants, bars and various events, which has led to protests. The trend towards milder kinds of restrictions is likely to continue. But meanwhile, because new mutations may lead to recurring waves of transmission, the virus will affect the economy and society for longer than we had previously expected.

## But a more stable forecasting environment

Our revisions since the last *Nordic Outlook* are generally small, unlike the sharp fluctuations we saw earlier in the pandemic. Despite new COVID-19 waves, we thus seem to have entered a more stable forecasting environment. We now expect global GDP growth of 5.9 per cent this year and 4.4 per cent in 2022: unchanged in 2021 and a marginal upward adjustment of one tenth of a point in 2022 compared to our May forecast. A strong Q2 has contributed to 2021 upgrades for the euro area and Sweden, among other places, but we are making a somewhat more cautious estimate for the US compared to both our May forecast and the consensus for this year. Consumption is now slowing somewhat after an earlier boom, with purchasing power being squeezed by the withdrawal of stimulus measures and high inflation. We have also slightly downgraded projected GDP growth for our EM sphere in 2021, mainly due to new lockdowns.

**Global GDP growth**

Year-on-year percentage change

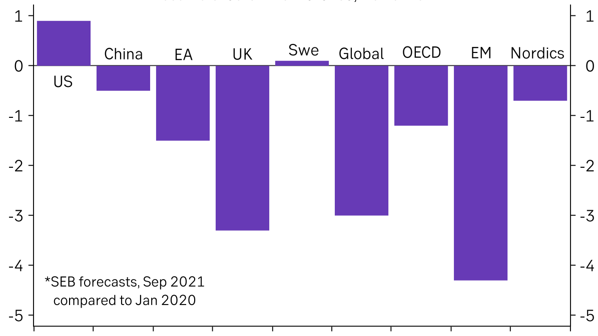
| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| United States | -3.4 | 6.0 | 4.2 | 2.1 |
| Japan | -4.7 | 2.5 | 2.3 | 1.2 |
| Germany | -4.6 | 2.8 | 4.8 | 2.6 |
| China | 2.3 | 8.6 | 5.6 | 5.4 |
| United Kingdom | -9.8 | 7.0 | 5.8 | 2.2 |
| Euro area | -6.4 | 4.6 | 4.3 | 2.5 |
| Nordic countries | -2.2 | 3.7 | 3.7 | 2.1 |
| Baltic countries | -2.1 | 4.8 | 4.3 | 3.4 |
| OECD | -4.7 | 5.1 | 4.0 | 2.3 |
| Emerging markets (EM) | -2.2 | 6.5 | 4.8 | 4.3 |
| World, PPP* | -3.4 | 5.9 | 4.4 | 3.4 |

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

**Supply side restrictions are increasingly important.** Although we generally make slightly more cautious assessments than consensus, it is clear that economies will return to their pre-pandemic trend sooner than expected. This means it is now increasingly important to analyse the supply side of the economy, especially as we now extend our forecast horizon to the end of 2023. In the last *Nordic Outlook*, we tried to illustrate the response of various economies to the crisis by comparing our current forecast for 2020-22 with the one we presented in late January 2020, just before the pandemic broke out. Since the pre-pandemic economy was in a fairly normal cyclical situation with GDP forecasts close to trend, we also concluded that the divergences in the chart below can be interpreted as a rough preliminary assessment of the GDP gap for 2022.

Varying effects of the pandemic on GDP

Accumulated GDP difference, 2020-2022*

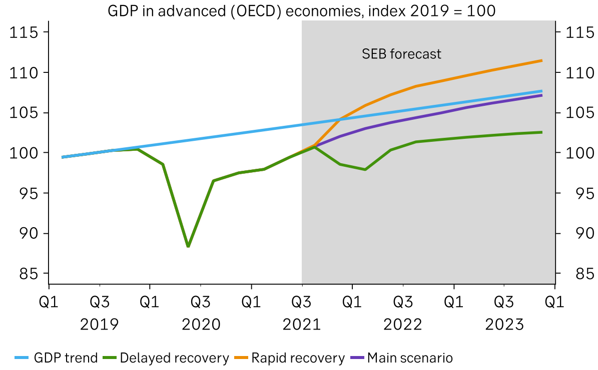



Source: Macrobond, SEB

**Some convergence between the US and Western Europe ahead.** Differences between various parts of the world economy have narrowed somewhat, compared to our May report, but the US still stands out with overall GDP growth slightly above our pre-crisis forecast. In other words, we now expect a higher GDP level there in 2022. This reflects strong demand pressure due to Fed interest rate cuts and massive fiscal stimulus programmes. Major Western European economies continue to show sizeable gaps, although they have narrowed slightly. The relative resilience of the Nordic economies is clearly visible. This gap analysis is the basis for our view that in 2023, GDP growth in Western Europe will again be above trend. But given the uncertainty of forecasting so far in the future, we interpret this relatively cautiously, especially for the United Kingdom, where the consequences of Brexit (withdrawal from the European Union) imply especially great uncertainty about the size of the available labour supply.

Various scenarios

GDP in advanced (OECD) economies, index 2019 = 100




Source: Macrobond, SEB

## New risk situation less related to pandemic

Even though vaccinations have not lived up to all the high expectations, we are now still entering a phase where the risk situation is changing. Resistant mutations and renewed transmission waves due to the slow pace of vaccinations in poor countries may still contribute to disappointments. But inflation and failures linked to central bank exit strategies are starting to play a larger role among downside risks. If inflation and inflation expectations actually soar, central banks – especially the Fed – could face the dilemma of either tightening economies in ways that would trigger dramatic downturns in share and housing prices or else accepting higher inflation expectations and losing touch with their inflation targets. The drama surrounding the Taliban's rapid takeover of Afghanistan is raising the geopolitical risk level. For example, stability in surrounding regions would be threatened if an escalating humanitarian disaster leads to large refugee flows. Looking ahead, we cannot rule out scenarios that contribute to rising tensions between China and the US. But experience tells us that special circumstances are required before crises of this kind have a more lasting impact on economic growth.

**Strong consumption combined with a productivity surge.** Better growth than in our main forecast mainly assumes that we have underestimated the power of economic stimulus measures. A combination of pent-up consumption needs and a high household savings level represents major potential. A robust increase in consumption may also lead to an upward spiral that triggers broad-based capital spending. Vigorous recovery would reduce the risks of permanent exclusion of workers who were squeezed out during the pandemic and who can now be quickly mobilised. This would also reduce the burden on public finances and alleviate future vulnerability. To ensure that such a scenario would not to lead to clear long-term overheating tendencies, relatively favourable labour supply and productivity trends are also required. In our assessment, the risk situation is now quite symmetrical.

**Various scenarios for the OECD countries**
GDP growth, per cent

| | 2021 | 2022 | 2023 |
|---|---|---|---|
| Main scenario | 5.1 | 4.0 | 2.3 |
| Negative scenario | 4.1 | 1.2 | 1.9 |
| Positive scenario | 5.7 | 6.9 | 2.8 |

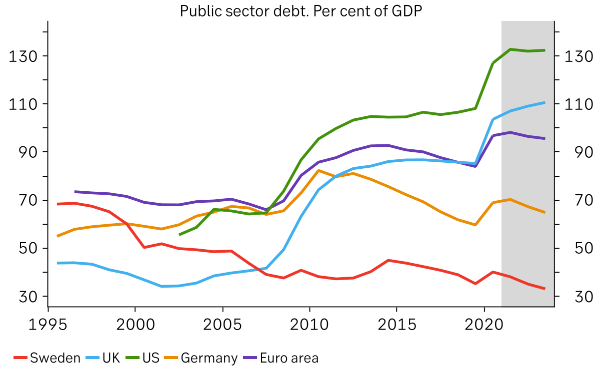
Source: SEB

## Slow fiscal policy normalisation

Recurring waves of infection are one reason why new stimulus packages continue to be unveiled. But even if crisis responses are extended, the burden on public finances eases as needs decrease. Instead, the focus is increasingly on helping sustain the recovery by supplementing traditional stimulus measures with investments in infrastructure, the environment and digitisation. Examples include the Biden administration's USD 1 trillion infrastructure package and attempts to enact another USD 3.5 trillion package. Although the latter package will be fully funded, it is front-loaded, which will have some positive growth effects. The EU is now rolling out its Next Generation EU package, which includes annual investments of about 1 per cent of GDP for 5-6 years.

**Most countries have focused hard on supporting their economies** despite different situations at the outset. The US enjoys a high degree of flexibility thanks to the role of the dollar as a reserve currency. In Europe there is a fairly broad consensus on not repeating the mistake of imposing austerity too soon after the 2007-2008 global financial crisis. In Sweden, the government recently announced that its September budget bill for 2022 will include SEK 74 billion in added spending; well above the 40 billion that would be consistent with a stricter interpretation of the fiscal policy framework (see the theme article on page 40). Overall, fiscal policy in the mainly affluent countries of the Organisation for Economic Cooperation and Development (OECD) looks set to be somewhat expansionary also this year after a uniquely large stimulus injection equivalent to 5 per cent of GDP in 2020. Smaller crisis responses are this year being offset by more aggressive growth initiatives. We also foresee significant spending in 2022 and 2023. If we measure the fiscal impulse as a change in cyclically-adjusted general government balances, there will be a tightening of around 3 per cent of GDP in 2022 and of around 1.5 per cent of GDP in 2023.

Stabilisation at high levels
Public sector debt. Per cent of GDP




Source: International Monetary Fund (IMF), Macrobond, SEB

**The price of extreme weather.** There is an increasing focus on the interaction between climate transition and traditional fiscal stimulus. Extreme weather events this summer – including torrential rains and heat waves – combined with publication of the new report of the United Nations Intergovernmental Panel on Climate Change (IPCC) have created a renewed sense of urgency in discussing climate change and the need for action. Our theme article entitled "Extreme weather" discussed whether this will strengthen the resolve of political leaders at the Glasgow climate conference in early November. This is possible – even probable – but not self-evident. According to the IPCC, we need to invest USD 3.5 trillion per year in climate transition efforts to meet the 1.5 degree target. Today's investments are nowhere near these levels. This summer's events have also highlighted other major investment needs. Both restoration after natural disasters and adaptation measures to ensure that countries, cities and people are more resilient to future disasters will also require major spending. The question is whether there will be enough money for everything, or whether long-term climate transition measures risk postponement due to other needs that are perceived as more acute.

## Downward adjustment in EM growth forecast

Generally lower vaccination levels in emerging market (EM) economies, especially in the poorest countries, are now creating vulnerability. New virus transmission waves have lowered consumer confidence and the willingness of businesses to invest. Except for India, the downward adjustments in our GDP forecasts are largest among Asian countries that were best in stopping the initial stage of the pandemic. China will likely maintain its zero tolerance policy for COVID-19 transmission, but new lockdowns will probably be geographically limited and thus have little impact on domestic growth. Yet disruptions to global supply chains will still be significant, for example when ports close. In Latin America and Russia, however, GDP growth has surprised on the upside – partly because the authorities are reluctant to impose restrictions and have accepted higher transmission figures to avoid throttling economic activity. But upgraded forecasts for these countries have not fully offset downward revisions, especially in China and India. We have thus lowered our growth forecast for the EM sphere from 6.8 to 6.5 per cent in 2021. We are maintaining our forecast of 4.8 per cent in 2022 and expect a slowdown to 4.3 per cent in 2023.

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

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| China | 2.3 | 8.6 | 5.6 | 5.4 |
| India | -7.1 | 8.9 | 6.3 | 4.9 |
| Brazil | -4.1 | 5.3 | 2.5 | 2.2 |
| Russia | -3.1 | 4.3 | 2.9 | 2.0 |
| Emerging markets, total | -2.2 | 6.5 | 4.8 | 4.3 |

Source: IMF, SEB

**Resilient to higher interest rates.** Inflation has also risen markedly among EM economies, and some central banks have hiked their key rates. As long as the global economy continues to recover and inflation does not keep rising, a gradual upturn in global interest rates is not a problem for the majority of EM economies. But if we were to see sharply rising inflation and market interest rates – for example driven by overly expansionary USD fiscal policy – there would be major consequences. EM currencies would then face strong downward pressure, forcing interest rate hikes that would lead to a slowdown in growth.

**Oil prices will fall slightly.** We are sticking to our oil price forecast from the last *Nordic Outlook* in May. The growth in demand for oil and other energy sources looks set to be somewhat lower than we previously thought, due to the increasing COVID-19 transmission. However, OPEC+ oil producers are likely to compensate for this, continuing to limit their output in order to maintain a price in the range of USD 65-75 per barrel in 2021. A normalisation of the global economy, especially travel and transport, will help sustain demand. But meanwhile, investments and research on alternative energy sources as well as ambitions to lower demand. Overall, we expect the average oil price to fall to USD 62.5/barrel in 2022 due to a need among oil-producing countries, especially Russia, to increase sales and a relatively limited increase in demand.

## China's tighter regulations are not a fad

Since early 2021, China has substantially increased scrutiny of its corporate sector, targeting a widening range of businesses – among them many IT companies. Recent reforms will essentially ban private profit-making corporations in the educational sector. A new Personal Information Protection Law (PIPL) will limit how personal data can be collected, used and managed. Beijing officials will curb the ability of companies to use financial leverage and are evaluating the possibility of requiring companies with access to large quantities of user data to assign management of the data to third-party firms before applying for US stock market listings. Due to the surge in regulatory changes, Chinese share price indices have generally performed worse than the MSCI All Country World Index. Regulatory authorities have sought to calm the markets by meeting with major banks, and government-linked funds have bought Chinese shares on stock market dips. But foreign investors remain cautious.

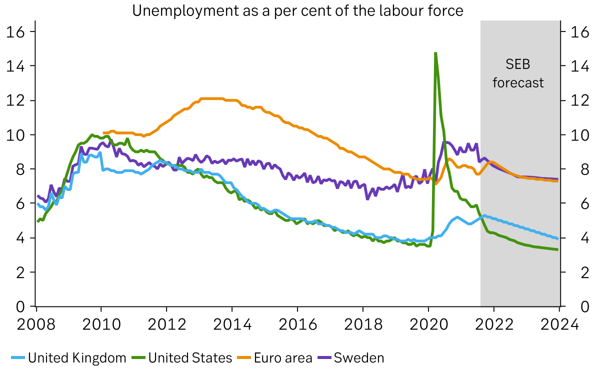
Regulations have hurt Chinese share prices
Equity indices, 100 = Jan 1, 2021


Sources: MSCI, Shanghai Stock Exchange, Hang Seng Indexes Company, Macrobond, SEB

This shift towards tighter regulation is meant to align corporate behaviour with the Communist Party's social goals. President Xi Jinping has intensified his rhetoric about "common prosperity" and taken steps to narrow the country's widening wealth gaps. Beijing's decision to impose controls mainly on parts of the tech sector that have previously had little or no regulatory oversight is thus logical. Fast-growing companies will now have to be mindful of anti-trust, data security, financial de-risking and other practices that are deemed detrimental to social equity. Although tighter rules may be perceived as a threat to billions of dollar in foreign investments, they will also improve consumer protection.

Unemployment is falling at different speeds

Unemployment as a per cent of the labour force

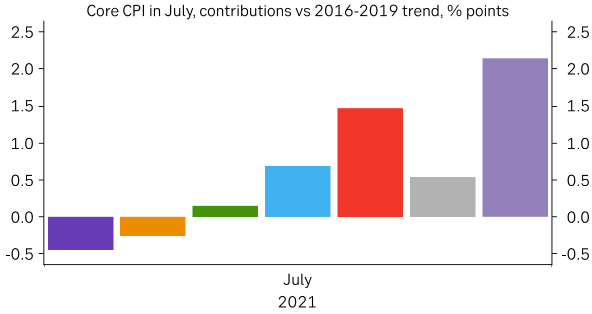



## Artificially rapid downturn in unemployment

Unemployment has continued to surprise on the downside. In the US it fell to a low 5.4 per cent in July. In the euro area the latest figure is 7.7 per cent: only half a percentage point above pre-pandemic figures. In addition, the percentage of companies having difficulty recruiting suitable employees has risen to historically high levels. Against this background, it is natural to ask whether economies can actually grow much faster than trend over the next couple of years. However, we can identify various temporary factors behind the strained supply side situation. In the US, for example, the supply of work is hampered by closed schools and difficulties in commuting to jobs, while temporarily expanded unemployment benefits reduce incentives to work. In the euro area, certain crisis responses are holding down labour force participation. Unemployment is thus likely to climb somewhat this autumn as participation normalises.

Used cars and tourist services are driving up US inflation

Core CPI in July, contributions vs 2016-2019 trend, % points




**The productivity trend is hard to interpret.** Crisis responses related to the pandemic also create various problems in interpreting economic statistics. This is especially true of wage and productivity trends, which are mainly complicated by difficulties in measuring how many hours of work are actually performed. Despite this uncertainty, we can still see signs of an upturn in labour productivity, for example in the US. This has raised hopes that the crisis will help unleash the potential created by digitisation processes over a long period, sometimes called the Fourth Industrial Revolution. If we actually achieve such an upward shift in the productivity trend, this would be highly favourable for the medium-term growth and share price outlook. Such technology shifts often also generate worries about persistently higher unemployment when certain kinds of jobs disappear, but history shows that such adverse effects are short-lived. Technological leaps that boost the economy's production potential tend to generate higher demand in various fields rather quickly.

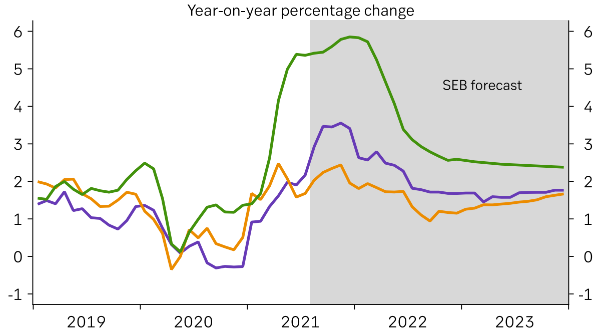
## Inflation problems in various time perspectives

Recent developments have raised the question of how serious the inflation threat actually is. US inflation now exceeds 5 per cent – the highest since the early 1990s. In a theme article on page 24, we discuss various aspects of the inflation process. We are maintaining our view that the US inflation upturn is largely driven by temporary pandemic-related factors. For example, used car auction prices are up 50 per cent, largely because car hire companies quickly need to restore sharply reduced fleets. Rising tourism service prices are now also making a major contribution to CPI inflation due to base effects as prices normalise from very depressed 2020 levels. Western Europe's CPI upturn is not as dramatic, especially in Sweden. We see several reasons for this. The consumption upturn has not been as strong as in the US, partly due to the design of stimulus measures. The used car market also works differently, making a price explosion along US lines very unlikely.

**Temporary impulse, despite longer-lasting disruptions.** It is highly probable that these price surges linked to reopening the economy are temporary and that inflation will thus fall in 2022. But disruptions to production and transport will be clearly longer-lasting than expected. This is largely connected to renewed virus transmission and new lockdowns in Asia, especially port closures, which contribute to higher freight rates. We can see that producer prices on more highly processed consumer goods have also begun to rise. To some extent, elevated commodity prices are also contributing to CPI inflation, but with the exception of oil and food, their impact is likely to be small.

Inflation will fall

Year-on-year percentage change




**New tests of the puzzling Phillips curve.** Since we now appear to be living with high US CPI inflation, it is especially important to also analyse how the long-term inflation environment may be affected. In order for inflation to shift permanently higher, a regime change in the rate of pay increases is also required. Because we believe that today's bottleneck signals in the labour market are temporary, the matter will be decided in the future. In general, wages have long been insensitive to changes in the jobless rate. Record-low US unemployment just before the crisis, for example, generated only minor increases in the pace of wage and salary growth. Unemployment in the US is expected to fall to 3.3 per cent at the end of our forecast period, slightly below its pre-pandemic level. We will thus once again test what the Phillips curve – the association between the labour market and price and wage formation – looks like.

**Will structural forces change wage formation?** Some structural factors may suggest slightly higher pay increases this time. Concerns about growing economic gaps have attracted greater attention in the political discourse. Higher minimum wages may, for example, lead to more broad-based pay hikes. The period of high inflation may also cause the Phillips curve to shift upward via rising inflation expectations. But so far, no strong signs of this are visible. Market pricing for CPI inflation has rebounded after the declines in 2019 and 2020, but it is not at alarming levels either in Europe or the US. Due to lower international mobility, combined with higher pay levels in certain emerging market economies, the wage-restraining power of globalisation may diminish over time, but it is still hard to believe this would change the picture in any decisive way.

**Is monetary stimulus playing with the fire of inflation?** The current inflation surge has also revived the belief that exceptional monetary expansion can itself generate inflation. We estimate that in 2020 and 2021, central bank assets will grow by USD 12.5 trillion. Since the financial crisis, the increase has been USD 20 trillion. Assuming a monetary multiplier of about 4, we end up with a USD 80 trillion total expansion of lending in the banking system (92 per cent of global GDP in 2019). A rough estimate shows that central bank purchases of securities have driven down global long-term bond yields by 120-160 basis points.

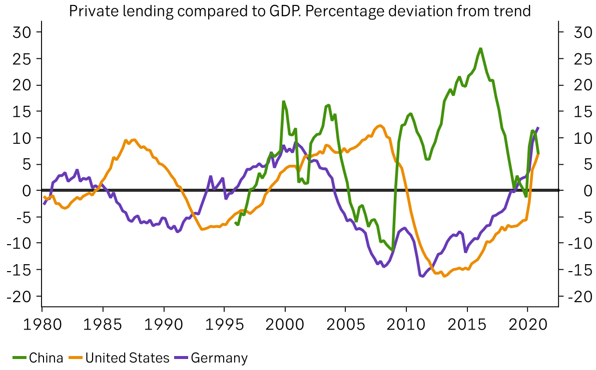
**No monetary shortcuts to inflation**. Yet we are sticking to our view that there are no "monetary shortcuts" to CPI inflation – decoupled from demand pressures on goods, services or labour. We now see how monetary expansion is pushing up prices of assets such as equities and residential property. To some extent, this also increases general demand in the economy, but this "wealth channel" is weakened by uneven distribution of assets. However, the inflation risks of monetary expansion are often played down, since it is assumed that central banks can withdraw stimulus measures rather quickly if inflation targets are fundamentally threatened. But if we begin to suspect that central bank independence is threatened by national governments prioritising other economic policy goals, our conclusion might change. We find it difficult to foresee such a development, though, especially in advanced economies. The changes in monetary policy frameworks that we have seen, especially in the US, should instead be interpreted as an attempt to draw conclusions from previous difficulties in actually achieving central bank inflation targets.

## Synchronised home price upturn

During the pandemic, the home price upturn has been unusually synchronised. Prices have risen in a full 90 per cent of advanced economies. In some countries the annual increase has been higher than for decades. Rising home prices even in the initial stages of the pandemic – despite plunging GDP and rising unemployment – also diverge from the pattern in previous crises. Both monetary and fiscal policy makers responded unusually fast, creating an environment of exceptionally low mortgage rates and good income growth. Underlying household balance sheets were also in much better shape than during the financial crisis, for example. Since the financial system was in good condition at the outbreak of the crisis, it was possible to avoid the kind of credit crunch that often prolongs and deepens economic downturns. There was also a shift in preferences towards larger living spaces, due to increased remote work and fewer opportunities for travel.

The credit gap is growing

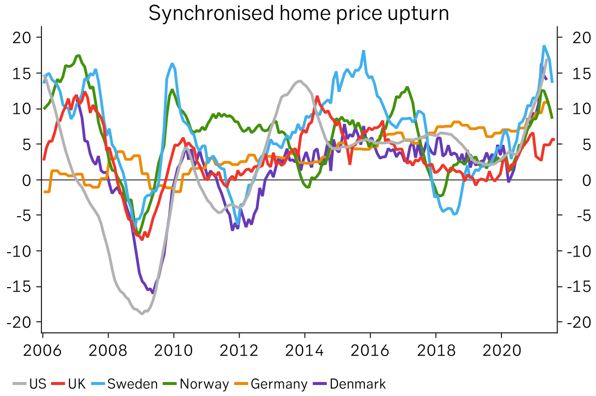
Private lending compared to GDP. Percentage deviation from trend




Source: The Bank for International Settlements (BIS), Macrobond, SEB

**Stabilisation at a high level.** In itself, the rapid home price upturn during the pandemic creates potential for downshifts when the situation normalises in various ways. In Norway and Sweden, price increases have slowed markedly in recent months, although it is hard to determine how much of this is due to seasonal summer effects. SEB's Housing Price Indicator fell sharply in August but remains above its historical average. Although the labour market is gradually returning to more normal conditions, various surveys indicate that we are facing significant changes in preferences, for example with regard to remote work. Meanwhile interest rates will remain very low for the foreseeable future. As long as uncertainty about the pandemic persists, decision makers are also very reluctant to risk a sharp decline in the housing market that would damage household balance sheets and thereby hamper consumption. Our overall assessment is thus that a sharp downward price correction is not very likely. After a slight decline or levelling off in the near future, we forecast that home prices will continue to rise, though at a much slower pace than we have seen in the past year.

Synchronised home price upturn




Source: Statistics Denmark, Association of German Pfandbrief Banks, Real Estate Norway (Eiendom Norge), Valueguard Swe

**More expensive housing creates political tensions.** The long-term policy response is hard to assess, though. Higher home prices have also put upward pressure on rents, worsening the problem of growing economic gaps. Highly educated people, who often own their homes, have generally found it easier to work remotely. Employees in relatively low-paid service sectors, however, have been hurt by both uncertain job prospects and rising rents. It is worth noting that home prices have also surged in countries with a high percentage of rental housing that previously saw more sedate price increases. A typical example is Germany, where this has led to political tensions. In Berlin, there will now be a referendum on expanding the potential to expropriate properties to increase the supply of rent-controlled flats. The European Commission is now also trying to put pressure on the Netherlands to change its highly favourable tax rules for owner-occupied housing by linking this issue to the country's access to the EU's new recovery plan. In Sweden, regulations related to rent-setting are a latently sensitive political issue. This became abundantly clear during the various rounds of the government crisis early this summer.

**Central banks are also showing signs of being affected** by the debate on how monetary policy contributes to increased economic inequalities. High home prices create difficulties for first-time buyers, reduce labour market mobility and increase the risk of financial instability. When it recently approved its new monetary policy strategy, the European Central Bank (ECB) announced that housing costs in particular should be better reflected in HICP inflation (the Harmonised Index of Consumer Prices). This might be a step towards eventually taking greater account of home prices in monetary policy decisions. Norges Bank has a tradition of keeping an eye on the home price trend, and this is once again being factored into its plan to begin key interest rate hikes in Norway this autumn – far ahead of comparable countries. Sweden's Riksbank has moved in the opposite direction since 2014, after the government decided to give the Financial Supervisory Authority (FSA) the main responsibility for macro-prudential supervision and after criticism from labour and employer organisations. The recent report of the Riksbank Commission of Inquiry also actually proposes giving the central bank less room to take home price trends into account. Further ahead, however, it cannot be ruled out that Swedish authorities may change their minds. The drawbacks of extremely low interest rates that drive up home prices – combined with principal repayment requirements and quantitative regulations – are becoming increasingly clear, especially because they create very high thresholds for young people to establish a presence in the housing market.

## Difficult monetary policy trade-offs

The inflation surge due to pandemic-related imbalances in goods and labour markets around the world has also surprised central banks. The main signals are still that these inflationary impulses should be viewed as temporary, but there is increased uncertainty and disagreement in the central bank world about the duration of these imbalances and the elevated inflation level. Recently, for example, the Fed, the Bank of England and Norges Bank have strongly signalled that they are prepared to take small, predictable steps to begin normalising monetary policy.

**The Fed and the ECB are now moving at a different pace** in their efforts to normalise monetary policy. This is logical, since inflation risks are greater in the US than in the euro area. In December, the Fed is expected to initiate a tapering of its monthly securities purchases, USD 120 billion per month. In September 2022 this process should be completed, opening the way for a Fed interest rate hike in Q1 2023. By the end of 2023, the key rate will be 0.75 per cent. The ECB, on the other hand, will not raise key rates during our forecast period, in keeping with its new policy strategy. It will end the Pandemic Emergency Purchase Programme (PEPP) and replace it with a new, flexible QE programme in 2022. We expect the Bank of England to hike its key rate by 15 bps in a cautious first step as early as May 2022, in response to rising resource utilisation. It will then follow this up with two further hikes during 2023, reaching 0.75 per cent by year-end like the Fed.

**Nordic central banks are choosing different paths forward.** The Riksbank will end securities purchases at the turn of the year and keep its key rate at zero in 2021-23. Norges Bank will raise its key rate in September from the current 0 per cent and reach 1.50 per cent by the end of 2023. Danish capital flows will put appreciation pressure on the krone. We expect Danmarks Nationalbank to cut its key rate by another 10 bps to -0.60 per cent in 2022.

**E-currencies on the way.** Central banks are now under pressure to create a new type of money – driven by the need for new technology for fast, efficient payments. Meanwhile the central banks want to continue controlling access to government-sanctioned money and monetary policy, but they still want to be able to meet competition from crypto assets. If improperly designed, e-currencies can jeopardise economic and financial stability. Our theme article "E-currency ahead?" on page 13 describes the threats and opportunities posed by e-currencies.

**Long-term yields will rise moderately.** Global long-term yields fell this summer on worries about data, COVID-19 and more uncertain prospects as stimulus measures fade. US Treasury yields will rise moderately this autumn as the Fed prepares to taper its bond purchases starting in late 2021, followed by cautious interest rate hikes in 2023, while the euro zone is held back by a high bar for rate hikes and by extended asset purchases. Ten-year US yields will rise to 1.50 per cent at the end of 2021 and a bit above 2 per cent at the end of 2023, while German yields will be below zero this year and slightly above at the end of our forecast period. Overly aggressive expectations of the Riksbank rate hikes and low bond supply suggest a certain narrowing of the long-term yield spread against Germany, but Swedish 10-year government bond yields will remain around 45 basis points above equivalent German bonds.

**Stronger USD.** An environment of large liquidity surpluses and zero interest rates favours currencies whose central banks take the lead in monetary tightening. The EUR/USD rate will fall to 1.16 at the end of 2021, bottoming out at 1.13 by the end of 2022. The Swedish krona's potential is limited by a persistent zero key interest rate and structural outflows. The EUR/SEK rate will be 10.10 at the end of 2021 and 9.80 at the end of 2023. Planned key rate hikes have not provided the expected support for the Norwegian krone, but the EUR/NOK rate will move gradually lower and will be just below 10.00 at the end of our forecast period.

**Stock market optimism will be challenged** as the economic situation normalises. Continued corporate earnings upturns and moderately higher bond yields suggest continued, but smaller, stock market gains with increased risk of volatility.

Theme:

# E-currency ahead?

## Hurried, rapid steps into the age of digital currencies

Cash as a means of payment is declining around the world in favour of electronic money. The COVID-19 pandemic has intensified this trend. Central banks are speeding up their development of a new fourth type of money – e-currencies – in response to new public behaviours and demands for fast, simple, efficient means of payment. Behind the scenes, cryptocurrencies like bitcoin are moving ahead. E-currencies have advantages and may give monetary policymakers new tools and boost economic growth. Yet they are “unknown beasts” that, if improperly designed, may jeopardise economic growth and the stability of national and global financial and monetary systems.

**Unlike physical banknotes and coins**, electronic cash can offer fast, cost-effective payments both within and between countries. New behaviours and technological advances are driving developments in the payments market. In Sweden, which holds a leading position in the payments revolution, cash accounts for only 1 per cent of the concept of money; 99 per cent is electronic kronor. Households and businesses around the world simply prefer digital money to physical cash. The 2020-2021 pandemic has undoubtedly helped to increase public interest in contactless payments.

**The world is on the threshold of profound changes** in payments systems. Individuals, businesses and other actors want ever-faster payments. Central and commercial banks are trying to fulfil their wishes, while non-financial institutions are expanding their role in the payments market.

**Today's three types of money are about to become four.** According to the Bank for International Settlements, more than 85 per cent of the world's central banks have ongoing e-currency projects. On a very limited scale, the People’s Bank of China has gone from projects to practical experiments with its e-yuan. Last summer the European Central Bank began work on creating an e-euro within about 5 years, the same time frame as Sweden’s Riksbank is working with. In September, the US Federal Reserve is expected to present a discussion paper on the pros and cons of introducing e-dollars. These steps into the digital currency age are thus both hurried and determined.

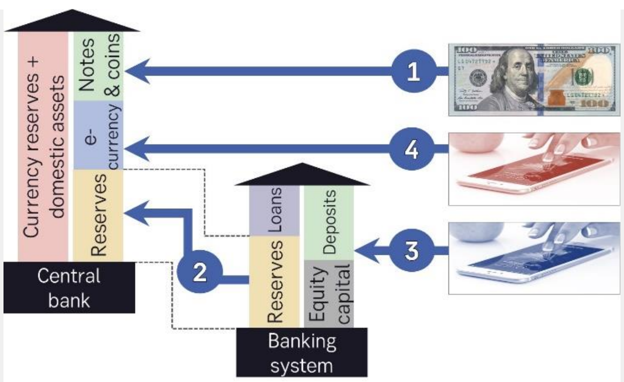
## What is an e-currency, actually?

A new electronic currency, or e-currency, is intended as a digital complement to cash. E-currencies give households and businesses access to a new type of government electronic money, issued by central banks. They can be regarded as "digital banknotes and coins". Today only banks and other financial institutions have access to central bank digital money. An e-currency thus expands the number of actors with direct access to electronic central bank money. A household or business that has an e-currency receivable from a central bank also runs no liquidity, credit or market risks. In other words, e-currency is as risk-free as physical cash.

### Three types of money may become four

Central banks create "central bank money" by printing more physical cash (1) and by lending electronic money to banks (2). Banks create private bank money (3) based on the supply of electronic central bank money and their own balance sheets. Private bank money is exclusively electronic. The introduction of an e-currency (4) thus means the introduction of a fourth type of money (see the figure below).

The **"exchange rate"** between cash and private bank money is 1 to 1; they are regarded as perfectly interchangeable even though they carry different credit risks. The "exchange rate" for e-currency in relation to both cash and private bank money would also be 1 to 1. Exchanges between the four different types of money would thus continue to take place without a change in value. The receivable that the public has in banks in the form of electronic money, or by possessing physical cash, can thus be replaced at any time by an e-currency receivable, which is then used for payments.

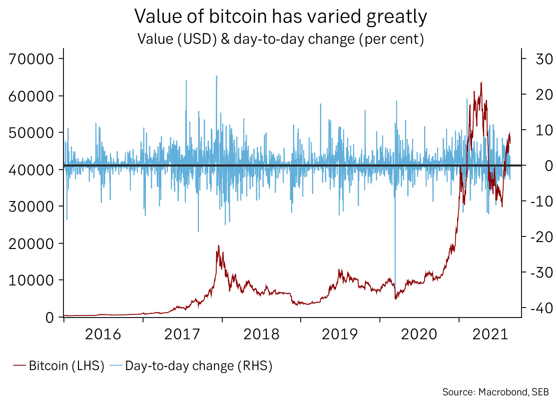


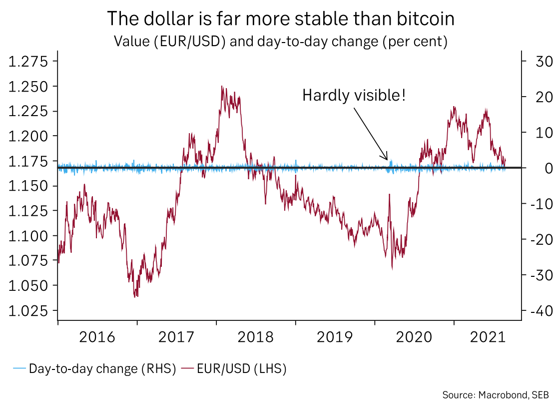

**An e-currency is a double-edged sword.** It has the potential to revolutionise and streamline payment systems and monetary policy. For example, it will be theoretically possible to have different interest rates for different sectors of society and geographies – making monetary policy more targeted and accurate and less dependent on transmission via the banking system. Meanwhile, e-currencies risk weakening and destabilising financial systems at national and global level. The design of e-currency infrastructure will also determine how much information central banks and governments will receive about transactions by individuals and businesses.

**The conditions and objectives for launching e-currencies** seem to be consistent between countries and central banks. For example, they must not complicate the implementation of monetary policy or jeopardise the stability of the financial system. E-currencies are also intended to coexist and complement cash and private bank money and contribute to greater innovation, efficiency and security in the entire payments system. They are also intended to protect people's privacy and offset threats posed by the emergence of competing cryptocurrencies that may undermine monetary policy independence.

### Crypto assets and "stablecoins"

Crypto assets like bitcoin, often misleadingly called e-currencies, can hardly be regarded today as functioning means of payment. They are far from risk-free or backed by a government or central bank. As bitcoin has confirmed, they have varied sharply in value over time.




**Bitcoin** can be a tool (but a volatile asset class) for investors who are looking for portfolio diversification and want to be able to carry out transactions anonymously (for better or worse). Bitcoin probably has little chance of becoming an established means of payment in countries with stable inflation and exchange rates and confidence in national institutions.

**"Stablecoins"** are a subgroup of cryptocurrencies that are designed to track the value of another asset class, for example a national currency like the US dollar. The issuer then holds a certain amount, for example in a dollar reserve, and creates a proportional quantity of "stablecoins". This money may be an attractive means of payment if its value is linked to a government-backed means of payment (such as the dollar) 1 to 1 and if it is backed by a pool of safe, liquid assets.

## New monetary policy flexibility?

In theory, an e-currency has the potential to facilitate the implementation of new unconventional monetary policy, such as negative central bank key interest rates and the expansion of central bank balance sheets (QE policies), in three ways:

1. Monetary policy manoeuvring room can be increased by allowing key rates to be negative, although the potential is limited by any continued access to physical cash;

2. Quantitative easing (QE) policy can be targeted more directly – for example to market players and sectors that have specific liquidity needs – at different interest rates;

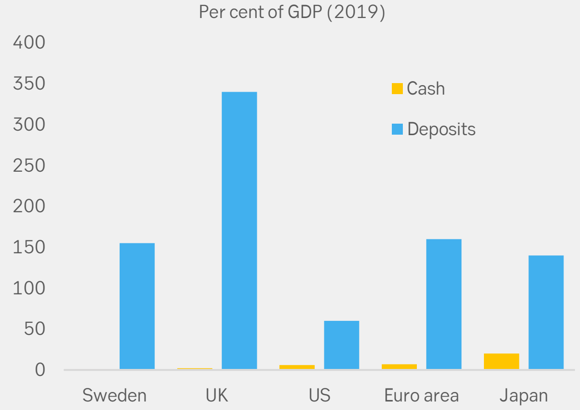
3. Central banks and government are better able to pursue so-called "helicopter money" policies.

**An interest-bearing and generally accepted e-currency** is a potentially versatile central bank tool that will speed up and intensify the impact of monetary policy on the real economy. E-currencies remove the so-called zero bound on key interest rates if cash is not available as an alternative or if cash holdings are limited (for example by eliminating banknotes with higher denominations). In this environment, in practice the negative interest rate on an e-currency becomes a kind of government tax on savings. But if e-currencies are to exist in parallel with physical means of payment, for example mainly for emergency preparedness reasons, in practice it will be impossible for a central bank to have a negative key rate.

**E-currencies that are linked to clearly negative key rates** also run the risk of increased competition from other countries' physical and electronic currencies that carry zero or positive rates. In addition, interest in crypto assets may increase, making it more difficult to implement monetary policy. All in all, this suggests that e-currencies hardly offer greater opportunities for negative key rates.

**If an e-currency, like cash, is interest-free** and without volume restrictions (in other words, e-currency holdings are unlimited), it will be even harder than today to conduct monetary policy with negative key rates; the lower bound is clearly 0 per cent. It is also an increasingly widespread view that fiscal policy is a more efficient and powerful economic tool than monetary policy that employs negative key rates. In situations such as the global financial crisis of 2007-2008 and the 2020-2021 pandemic, there is reason to believe that the task of central banks is to ensure liquidity in the financial system and the maintenance of credit flows.

Private bank money dominates
Per cent of GDP (2019)




## New risks to financial stability?

If the e-currency holdings of the general public are equated with traditional bank deposits, this also strengthens the co-variation between central bank key interest rates and the banking system's deposit rates, regardless of whether an e-currency is interest-free or interest-bearing. This puts the spotlight on the role of banks and other payment intermediaries in the national and global financial system.

**E-currencies can pose a serious risk to the stability** of the financial system – bank deposits risk being replaced instead by e-currency holdings. Looking ahead, this may both reduce and raise the cost of lending by the banking system. Higher financing costs and greater uncertainty about future financing may destabilise the entire system and have negative macroeconomic effects. The risk of instability will increase, especially since the financial system may suffer from stress.

**E-currencies that are perceived as more attractive** than deposit accounts at banks may eventually result in lower bank deposits. Today these funds are mainly used to finance long-term lending to households and businesses. Banks accept short-term deposits and make long-term loans. This transformation of maturities has a significant socio-economic value. If an e-currency becomes a substitute for the banks' interest-bearing deposits, the funding costs of banks may vary to a greater extent than today. This, in turn, may affect lending to the private sector – both in terms of lending volumes and interest costs.

**If the interest rate offered is at the same level**, e-currencies may appear more attractive due to a government guarantee. This may force banks to offer higher interest rates on deposits, thereby increasing costs to the banks' borrowers. To reduce these risks, central banks can limit how much e-currency an individual or a business may hold, for example. Another alternative is for central banks to use other tools to ensure lending to banking systems. This significantly changes credit relations in the market. E-currencies also affect the asset side of central bank balance sheets. If e-currencies are highly popular, central banks will also need to invest such funds in such assets as government securities or other domestic credit instruments – in addition to their current holdings that are a result of QE policies. These purchases of fixed income securities will mean that the role of central banks as suppliers of credit in the economy will increase and that the role of commercial banks will weaken. This may lead to efficiency losses in both the pricing and allocation of loans.

## The age of digital money is here...but...

Technology, a pandemic and cryptocurrencies – in a low interest rate environment – have accelerated the development of electronic money, while cash payments are continuing to decline. Digital money has the potential to transform the payments market, especially in emerging economies, by offering the general public secure and cost-effective tools for making payments.

**Despite declining demand for cash by the general public**, a completely cashless economy seems unreasonable. Some groups in society may need access to physical banknotes for various reasons. E-currencies also increase cyber risks and vulnerabilities in the infrastructure of the digital payments system. Many unclear points need to be addressed before we take our next steps into the age of digital currencies.

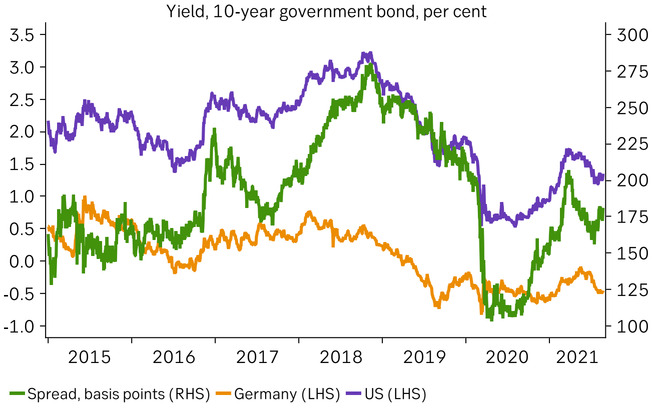
# Fixed income

## From sugar rush to growth anxiety

The mood in the fixed income market changed dramatically this summer, due to increased growth uncertainty prompted by weak economic data and higher COVID-19 transmission. This uncertainty will linger during the autumn, leading to minor changes in long-term yields. The Fed's tapering of securities purchases will put limited upward pressure on US yields, while the ECB's revised inflation target will keep euro area yield upturns moderate. We foresee minor narrowing in Scandinavian yield spreads.

Yield spreads between Europe and the US widening again

Yield, 10-year government bond, per cent




Source: U.S. Department of Treasury, Macrobond Financial AB, SEB

**10-year government bond yield**
Per cent

| | Aug 26 | Dec 2021 | Dec 2022 | Dec 2023 |
|---|---|---|---|---|
| United States | 1.35 | 1.50 | 2.00 | 2.20 |
| Germany | -0.46 | -0.35 | -0.10 | 0.20 |
| Sweden | 0.09 | 0.20 | 0.35 | 0.65 |
| Norway | 1.24 | 1.35 | 1.50 | 1.80 |

Source: National central banks, SEB

**The market has unwound reflation positions.** Led by the US, global government bond yields have fallen dramatically since late May. The market's growth anxiety has gradually risen, due to fading fiscal tailwinds in the US and elsewhere, and continued transmission despite rising vaccination rates. Because of inflated expectations of US GDP growth, it has been hard for macro data to cause upside surprises. Real yields have been squeezed. Liquidation of "reflation positions" – those benefiting from high growth and inflation – has intensified the decline in yields amid a holiday-oriented market with poor liquidity. We believe that yield levels are fundamentally unjustified, given our macroeconomic scenario in this *Nordic Outlook*.

**Expectations of Fed rate hikes are declining.** In June the market had fully priced in a US key rate hike as early as 2022, peaking at 2.50 per cent. Today, the probability of a hike in 2022 is only 50 per cent. Above all, long-term expectations have fallen: the US Federal Reserve's hiking cycle will now peak at 1.70 per cent. This means the market believes a few hikes will suffice to avoid overheating and achieve inflation consistent with Fed's 2 per cent target. In our view, the market's growth anxiety is somewhat exaggerated, but it may take time to change this mood in light of continued COVID-19 transmission. Stretched stock market valuations are also limiting the sell-off potential in the bond market. Yet we believe the Fed's reduction in its securities purchases, which is expected to begin in December, will exert some upward pressure on long-term yields with the help of higher term premiums, even if the Fed tries to dampen expectations of key rate hikes. Given prevailing near-term growth uncertainties, we expect the US 10-year Treasury yield to be 1.50 per cent at the end of this year and 2.00 per cent at the end of 2022, based on our economic scenarios.

**ECB sets the bar high for key rate hikes.** Euro area yields followed US yields upward last spring, after having been stable late last year. As US long-term yields began to fall, euro yields followed. A German 10-year yield is now near the same level as the European Central Bank deposit rate of -0.50 per cent. The ECB's new inflation target – along with its inflation forecast – sets the bar high for raising its key rate. The ECB will also keep buying fixed income securities. This will help keep interest rates down for a long time. We assume the ECB will extend its Pandemic Emergency Purchase Programme (PEPP) and probably launch a new post-pandemic securities purchase programme next year. Euro area yields will thus rise moderately during our forecast period; a German 10-year yield will be -0.35 per cent at the end of 2021 and -0.10 percent at the end of 2022.

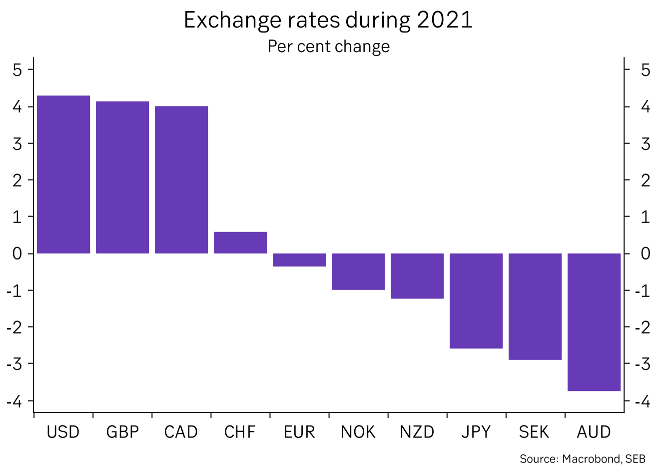
**Swedish-German yield spreads** began to widen when the Riksbank hiked its key rate in 2018-19. Without much drama, in early 2021 the spread on 10-year bonds reached its widest since the 1990s. Lower key rates and ECB asset purchases suggest that the spread will remain wider than after the financial crisis. This summer, it shrank by 10 basis points; overly aggressive pricing-in by the Riksbank, combined with low bond supplies, suggest some further narrowing. The potential is limited and German yields must probably climb for it to materialise. We expect the spread to shrink some 10 bps to 45 bps this coming year and stay there in 2023.

**Norwegian-German long-term yield spreads recently grew again** close to their widest in the past years. Since the market has already priced in a less stringent Norwegian monetary policy, the scope for further widening of long-term yield spreads against Germany should be limited. Although a very flat yield curve points to higher Norwegian 10-year yields, limited bond supply and a weak krone are restraining yield increases. We expect a slight narrowing of long-term yield spreads against Germany in the next couple of years.

# The FX market

## Fed moves boost USD despite fundamentals

The US dollar has risen in line with our long-term forecasts, though unexpectedly fast. The EUR/USD rate will keep falling now that the Fed has prepared markets for a less expansionary policy, which it will probably announce this autumn. Given America's relative strengths in many fields, investors are tolerant of underlying US imbalances. The potential for a stronger SEK is limited by the Riksbank's sustained zero key interest rate. Structural outflows meanwhile weigh the Swedish currency down. Its valuation is also not especially far from equilibrium.




**Exchange rates**

| | 26 Aug | Dec 2021 | Dec 2022 | Dec 2023 |
|---|---|---|---|---|
| EUR/USD | 1.18 | 1.16 | 1.13 | 1.15 |
| USD/JPY | 110 | 111 | 113 | 115 |
| EUR/GBP | 0.86 | 0.84 | 0.82 | 0.83 |
| EUR/SEK | 10.23 | 10.10 | 9.90 | 9.80 |
| EUR/NOK | 10.39 | 10.20 | 10.05 | 9.95 |

Source: Bloomberg, SEB

**Strong risk appetite is not always dollar-negative.** Early in the pandemic, the FX market was dominated by acute policy responses. The US Federal Reserve took drastic steps, which included slashing key interest rate to near-zero. This played a major role in the dollar's slide from strong levels, once it was no longer supported by interest rate spreads against other major currencies. The subsequent phase, when risk appetite returned due to massive government and central bank stimulus, was dollar-negative for traditional reasons. But the USD downturn reversed early in 2021 when the US launched major fiscal packages and the market quickly began assuming that the Fed would soon be starting to withdraw its stimulus measures. Since then there have been several periods when the dollar appreciated at the same time as stock markets rose, which showed that good risk appetite does not always have to be dollar-negative. Strong recovery in the real economy can thus attract investors to the dollar despite large US deficits. Last year's UD depreciation probably occurred as a result of a great need to hedge dollar exposures when the cost of hedging fell sharply. But the market has probably already made the dollar hedges that were needed. Given expectations that the Fed will start raising its key rate again, businesses and institutions will probably increase their dollar exposure again (stop forward selling of USD).

**FX market themes favour "carry" currencies including the USD.** During 2021 the FX market has been characterised by declining volatility. Pricing will continue to reflect expectations of small future movements. An environment dominated by massive liquidity programmes and zero interest rate policies benefits those currencies that still offer a positive interest rate, or at least have central banks that have announced that they will soon tighten monetary policy. Regarding the EUR/USD exchange rate, as earlier we believe that the euro will gradually weaken this autumn when the Fed takes steps towards tighter monetary policy. We expect EUR/USD to fall to 1.16 by the end of 2021 and then bottom out at 1.13 by the end of 2022.

**Limited room for SEK appreciation.** We continue to believe that the Swedish krona will strengthen further against the euro but now foresee smaller potential than before. We have raised our near-term EUR/SEK forecast for several reasons: 1) we expect central banks (Fed vs ECB and Riksbank) to start diverging, which benefits the dollar: 2) during the summer we have started to see signs that the Swedish krona is suffering from structural outflows. The krona does not seem able to benefit from Sweden's large foreign trade surpluses because there is a preference for saving in foreign assets, mainly equities; 3) when it comes to valuations, it is no longer obvious that the krona is so undervalued that it justifies a "positioning" based on its attractive valuation. We are thus forecasting that the decline in the EUR/SEK rate will be extremely moderate, reaching 10.10 at the end of 2021 and then continuing down to 9.80 by the end of 2023.

**We foresee a similar trend for the EUR/NOK rate**, although our forecast is surrounded by uncertainties. Norges Bank began to hesitate at its policy meeting in August but is still likely to deliver its planned key interest rate hikes in September and December. The Norwegian krone has proved highly vulnerable in times of risk aversion, and the surge in oil prices has not benefited the currency in the normal way. There is also a risk that these rate hikes may have to be moderated in the future, since inflation is below Norges Bank's target. Assuming the NOK is undervalued, we still believe it will show some appreciation. We expect the EUR/NOK rate to fall to 10.20 at the end of 2021 and continue to 9.95 by the end of 2023.

Theme:

# Extreme weather

## The summer's weather and the IPCC's Sixth Assessment Report are putting climate investments back in focus

The summer of 2021 was marked by extreme weather: fires and droughts in some places, torrential rains and floods elsewhere. The costs of reconstruction and lost assets will total tens of billions of dollars. Along with the IPCC's sixth report, these events may serve as a wake-up call that accelerates the transition to sustainability. But conflicts may also arise between short- and long-term perspectives – short-term reconstruction and adaptation measures risk displacing climate transition investments. We will get an initial glimpse of the outcome in Glasgow this November.

**This past summer saw an unusual range of extreme weather phenomena.** Extreme heat waves prevailed in North America, southern Europe and the Middle East, with temperatures nearing 50 degrees C in some places. In Central Europe and parts of Asia, the problem was instead torrential rain, storms and floods. In Zhengzhou, China, 200 mm of rain fell in one hour and a full year's rain in three days. The overall effects of natural disasters on people, nature, property and the economy are hard to assess, but even the most conservative estimates point to tens of billions of US dollars in costs.

**Until recently, the connections between extreme weather events and long-term climate change have been relatively uncertain.** Most researchers believed that such connections probably exist, but have preferred to express themselves cautiously in their published reports. However, many of these uncertainties were swept aside in the Sixth Assessment Report of the United Nations Intergovernmental Panel on Climate Change (IPCC), published on August 9. The report presents clear support that human activity is causing climate change and clarifies the connections between long-term climate change and extreme weather events. Even now, at 1.1 degrees of warming, we are influencing weather systems. The warmer the climate becomes, the more common and severe these weather phenomena will be, according to the IPCC.

**Our experiences this past summer** and the new scientific facts in the IPCC report will provide important input during the big UN climate conference to be held in Glasgow between October 31 and November 12 this year. Among other things, the IPCC points to the need for a major increase in sustainable energy investments. The transition to a temperature trend that adheres to the 1.5 degree target will require an estimated USD 3.5 trillion of investments per year, compared to the current level of around USD 500 billion per year. The question many people are now asking themselves is whether this summer's extreme events can serve as the wake-up call required to boost investment levels to the scale that the IPCC believes is needed. Perhaps, but far from self-evident.

> ”Everybody talks about the weather, but nobody does anything about it.”
>
> Mark Twain

**One factor that may pull in the opposite direction** is that this summer's weather disasters have also highlighted other large-scale needs, which may be perceived as even more urgent. One is reconstruction. In Germany alone, the costs of restoring devastated communities after the summer floods are estimated at over USD 35 billion. Many other countries have similar damage to repair. Another need is climate adaptation. Countries must adapt their town and city planning and emergency preparedness to increasingly extreme weather. The Netherlands, which is now investing large additional amounts on improving barriers against future flooding, is just one of many examples. Measures to protect against heat, improve fire preparedness, protect cities from floods and secure food production will require large-scale investment in the relatively near future. Such adaptation investments are estimated at USD 1.8 trillion from 2020 to 2030 – limited sums in relation to total transition costs, but still over three years of total investments at the current level.

## Tough choices await ...

Will there be enough money for everything? Or will the "wake-up call" effect from this summer's extreme weather be offset by the displacement effect that occurs when short-term reconstruction and adaptation investments compete with long-term climate transition investments? There are some reasons why such displacement may be significant:

**The time perspective.** Although the IPCC makes it clear that climate change is already contributing to extreme weather, short-term reconstruction and perhaps also adaptation still may appear more urgent than climate transition measures. Since the value of future events, good or bad, is intuitively discounted by both decision makers and citizens, immediate problems tend to enjoy higher priority than future ones.

**Politics.** Whereas climate adaptation and reconstruction take place at home, climate transition investments often need to be made in other countries. This is because they have a decreasing marginal impact, and for the planet it is most effective if countries that have already come a long way in such areas as reducing greenhouse gas emissions prioritise additional investments in countries lagging behind in climate transition. Politically, however, it is easier to approve and advocate initiatives that generate clear local results and jobs than to finance initiatives in other countries. The latter may also be associated with real or perceived “free rider” problem – that some countries avoid taking responsibility because other countries will invest in them.

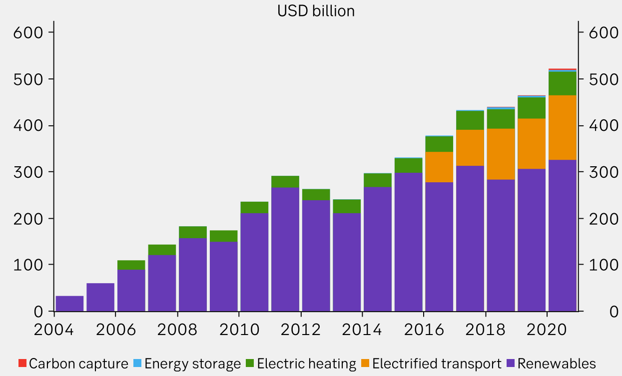
**“Moral hazard”** refers to the danger that those who are, or who feel they are, protected (for example they are convinced that government will assist if needed) will take greater risks than they otherwise would. In this context, it may mean that if large enough sums are spent to adapt to climate change, the sense of urgency to actually avoid it will diminish.

## ...but there is a strong willingness to invest

The above arguments should not be underestimated, but there are also counter-arguments. Although today's investments in energy conversion are only a fraction of what is needed, there is heavy demand for the products being manufactured. Many investors and asset managers want at least part of their portfolios to consist of distinctly sustainable assets. The issuance of both green (environmental and climate) and blue (water) bonds is increasing. Greater demand has also led to better tools for defining what investments can be classified as sustainable. Of these, the main tool is the European Union’s new “taxonomy”. It is complicated to calculate exactly how much these green tools contribute to total investments, since it is hard to say how much is "extra" money and how much would have been invested anyway. But the overall impression is that there is plenty of potential capital for investments in climate transition measures, especially if they are channelled properly and today’s low interest rate environment persists.

Investments in green technology

USD billion




Source: Macrobond, SEB

**No single country,** organisation or company can raise all the money that is needed. Investment volumes will depend on whether the public and private sectors pull in the same direction, albeit with some division of responsibilities. Investments in climate adaptation, such as levees around seaside cities, are 90 per cent paid for by the public sector. Investments in climate transition, such as new energy technology, are today more than half financed by the private sector – a share that is likely to grow. During the climate transition process, it will be the public sector's responsibility to steer developments in a sustainable direction with the help of regulations, taxes and global agreements. The Glasgow climate conference will be an important indication of whether and how this summer's events have affected how politicians view their responsibility and envision the way forward.

# The stock market

## Normalisation will test upbeat market outlook

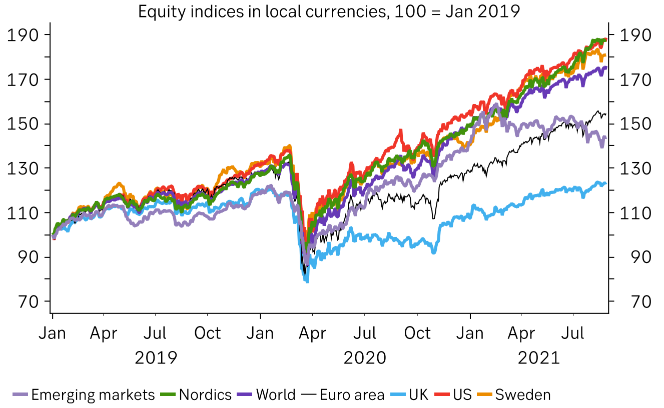
The transition from recovery to normalisation will challenge stock market optimism. Looking ahead, both stimulus measures and growth rates will decline. After the price surge in 2021, this will boost uncertainty and dampen upside potential. Healthy economic growth and continued ultra-low interest rates still suggest a positive stock market trend. Investors have also begun adjusting to the next phase, the upturn has broadened and high valuations have been trimmed by strong earnings.

Global price to earnings (P/E) ratio


Source: Bloomberg, SEB

Record share prices on many stock exchanges

Equity indices in local currencies, 100 = Jan 2019




Source: Nasdaq OMX Nordic, S&P Dow Jones Indices, FTSE, STOXX, MSCI, Macrobond, SEB

**Stock market investors are positioning themselves for a more normal economy.** This summer has seen a continued rise in share prices, though the trend has been flatter in recent weeks. But the upturn has changed shape. Early in the recovery, cyclical and low-priced ("value") companies were the main beneficiaries, while growth stocks and more defensive quality companies have been among the recent winners. This is consistent with previous patterns and is natural, given the interest rate declines that we have seen. The resurgence of more defensive companies will probably be regarded as a sign that investors are now positioning themselves for the next phase: from a stimulus-driven recovery to a more normal economy, with a gradually slower positive growth rate.

**Healthy earnings growth has lowered share valuations...** Earnings forecasts for 2021 have been revised sharply higher in the past year. Due to surprisingly strong growth and successful corporate cost control, projected increases for this year have been raised from 20 to just over 45 per cent globally. Forecasts for 2022 have largely followed suit and are now at 7-8 per cent. Because of these strong earnings forecasts, P/E ratios based on 12-month forward earnings have been flat or have trended slightly lower in recent quarters (see chart). These valuations are still high in a historical perspective. The global P/E ratio is around 19, with the US at the top at nearly 22. Europe at 16 and emerging markets at around 13 appear to be less stretched. Compared to the return on an alternative fixed income investment, equities are still attractively valued. Such a comparison is most easily made by inverting the P/E ratio, giving us a percentage "return" on shares (earnings divided by price). Calculated in this way, the return on US listed shares is around 4.5 per cent, while in Europe the figure is above 6 per cent.

**... even based on alternative metrics.** As we know, earnings can fluctuate, but based on companies' more stable distributions to shareholders in the form of dividends and share buy-backs, the picture is similar. Company distributions are expected to be around 4 per cent in the US (calculated at today's share prices) and about the same in Europe. Compared to low or negative returns in the fixed income market, shares thus remain attractive, at least as long as we do not wish to speculate in a stock market slide so that shares can be bought more cheaply in the future.

**The stock market is sensitive to changes in bond yields, interest rates and earnings.** However, the above argument assumes that yields and interest rates will remain low. It is probably also necessary for corporate earnings to show good performance in order to justify today's high P/E ratios. Both of these parameters are currently being challenged. The economic growth rate is declining, while stimulus doses are falling. Meanwhile inflation – which we believe is mainly temporary – and expectations of future key interest rate hikes may put pressure on bond yields.

**There is a risk of increased volatility, but economic growth and earnings will provide continued support.** Stock exchanges will thus face increased headwinds in the future. This will limit upside potential and increase the risk of corrections, especially after this year's market upturn. Reduced monetary stimulus will also risk hurting the stock market mood. However, investors have at least partly begun adapting to a new, slightly less favourable situation, as reflected in lower valuations and less aggressive positioning. We do not expect valuations to climb again, but instead believe P/E ratios will keep falling slowly. This should allow minor share price upturns, especially since 2022 earnings forecasts appear cautious, given our growth forecasts. Uncertainties caused by normalisation are nevertheless likely to create some market volatility this autumn. Continued good fundamentals suggest that any corrections can be regarded as buying opportunities.

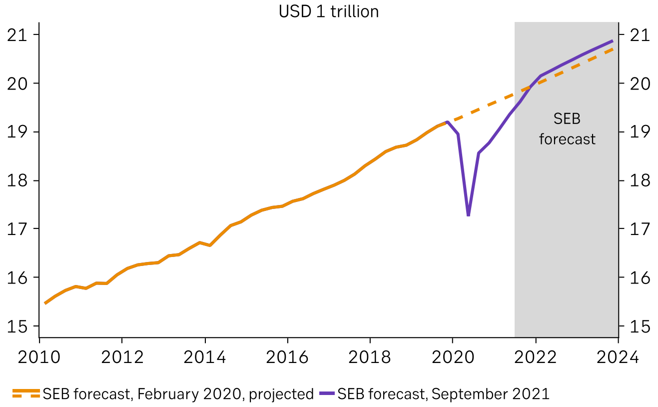
# The United States

## Fast recovery runs into some speed bumps

Fiscal headwinds and erosion of purchasing power due to of high inflation are slowing private consumption after last spring's shopping spree, tempered by high savings. GDP will grow by 6 per cent this year, followed by gradual deceleration towards trend growth late in our forecast period. The labour market shows overheating tendencies, largely for short-term reasons. Employment is far from any ceiling. The Fed will soon make a decision on tapering and begins cautious rate hikes in 2023.

GDP will move higher than its pre-pandemic growth trend

USD 1 trillion




Source: U.S. Bureau of Economic Analysis (BEA), Macrobond, SEB

### Key data

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -3.4 | 6.0 | 4.2 | 2.1 |
| Unemployment* | 8.1 | 5.4 | 3.9 | 3.4 |
| Wages and salaries | 5.0 | 3.5 | 3.6 | 3.5 |
| CPI | 1.3 | 4.4 | 3.7 | 2.4 |
| Core PCE (Fed target variable) | 1.4 | 3.1 | 2.8 | 2.1 |
| Public sector balance** | -15.5 | -15.0 | -8.0 | -5.0 |
| Public sector debt** | 127 | 132 | 132 | 133 |
| Fed funds rate, %*** | 0.25 | 0.25 | 0.25 | 0.75 |

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

### A messy transition from the pandemic

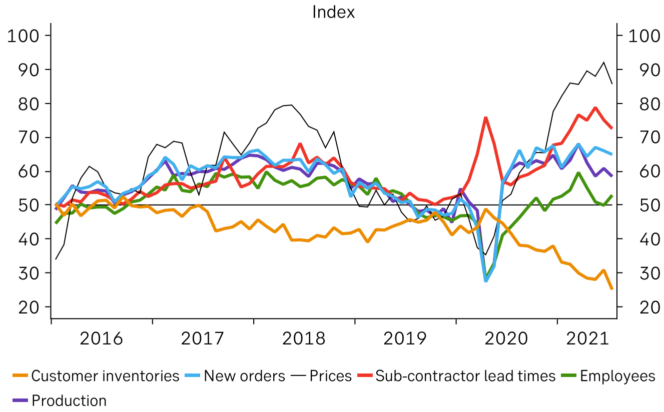
During the first half of 2021, the US economy grew at an annualised rate of more than 6 per cent, bringing the economy higher than its pre-pandemic level at the end of 2019. At the end of 2021, GDP is expected to be above its earlier growth trend. Seen over the entire period 2020–2023, GDP is now expected to grow somewhat faster than in our pre-pandemic forecast – a clear confirmation of America's powerful crisis policy. Several forces suggest that the pace of recovery will slow: higher virus transmission, supply side restrictions, falling fiscal stimulus and higher inflation, which erodes household purchasing power. We have trimmed our growth forecast for 2021 from 6.5 to 6.0 per cent, followed by 4.2 per cent in 2022: a bit higher than in our May forecast. In 2023, GDP growth will shift down to 2.1, still somewhat above trend.

**The US has lost its COVID-19 vaccination lead.** A number of European countries surpassed the US this summer in terms of vaccination percentages. Meanwhile the Delta variant is spreading rapidly in regions of higher vaccination resistance. Unvaccinated young people are being infected to a greater extent, which is limiting the death toll, but hospital systems in some areas have been overwhelmed. The currently worst-affected states have generally been more sceptical of pandemic-related restrictions. The economic consequences will thus depend on voluntary behavioural changes. National mobility data have not yet been greatly affected. We believe that increased virus transmission will slow activity in the near future, but a decline as severe as last winter's seems unlikely.

**Supply side restrictions are making themselves felt.** A bigger problem for economic growth is large-scale supply side restrictions in both production and the labour market, as well as sometimes difficult adjustments back to a more normal economy. The massive cash payments to households early in 2021 were accompanied by disrupted production chains and shortages of components, especially semiconductors. The auto industry is particularly vulnerable: Motor vehicle production has fallen by almost 14 per cent since the start of the year. A nearly 9 per cent increase in private consumption year-on-year during the first six months of 2021 coincided with continued large inventory reductions and increased imports. The need to replenish low inventories is likely to provide new impetus for growth as the problems of strained supply chains ease, but it is hard to say how soon this may happen. A worsening pandemic, mainly in parts of Asia, is contributing to uncertainty. The ISM index of US manufacturing sentiment shows that companies are finding it difficult to meet strong demand, although delivery times from subcontractors appear to have decreased somewhat from historically very high levels. In the service sector, the situation has instead deteriorated and the labour market is showing overheating tendencies, but several factors still indicate that the economy has not yet hit any ceiling. Employment still has a long way to go before reaching pre-pandemic levels and its earlier trend. Capacity utilisation in manufacturing is above its previous low from 2016 but is below the historical average. We thus regard today's disruptions as mostly transitory, but with the economy approaching its earlier trend there will be a continued focus on supply side issues.

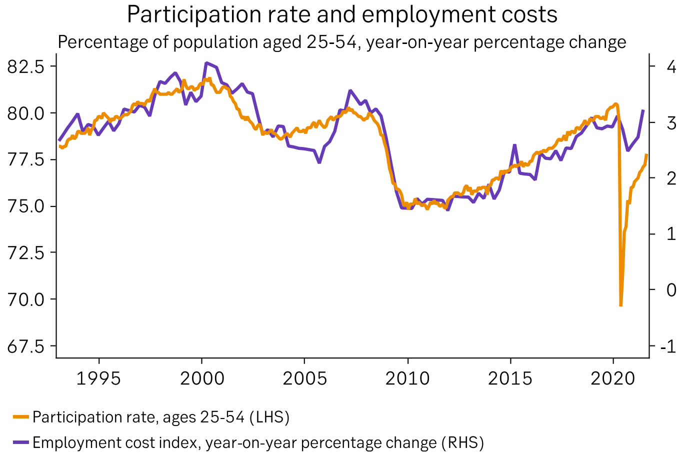
**Mixed demand situation.** Strong import demand, as the US economy grows faster than the rest of the world, has so far led to large negative contributions to GDP from foreign trade. But looking ahead, calmer domestic demand will improve the balance. Exports are benefiting from increased international demand, and exports again contributed positively to the economy in the second quarter. Business investments are growing at a healthy pace, and order bookings for capital goods and high order-related indices in sentiment surveys indicate that this trend is continuing. Total capital spending was dampened during Q2 by a further decline in federal government investments and a setback for home construction after an expansive period. Low interest rates, strong household finances and changed housing patterns strongly boosted home building during the pandemic, but these factors are now being offset by higher construction costs and a labour shortage. Home sales are falling again, building permits are down and surveys indicate that households have significantly reduced their home-buying plans, which indicates a risk of continued declines in the short term.

ISM: Strong demand is encountering supply side constraints



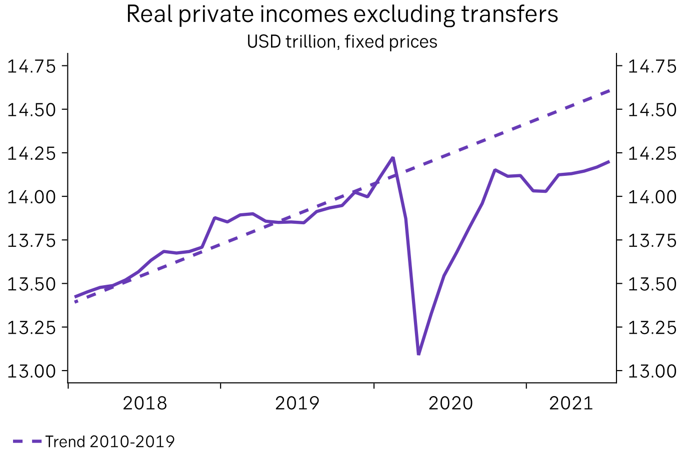

Source: Institute for Supply Management (ISM), Macrobond, SEB

Participation rate and employment costs




Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

Real private incomes excluding transfers




Source: U.S. Bureau of Economic Analysis (BEA), Macrobond, SEB

Looking ahead, public sector investments will probably benefit from the USD 1 trillion federal infrastructure package (nearly 5 per cent of GDP) just approved by the Senate. Worth noting, however, that only half is "new" money and that some of the planned investments would have occurred anyway. Spending is also spread over a rather long time period, but the package should still contribute to an investment surge in 2022-2023, if also approved by the House.

## Calmer pace of consumption as real incomes decline

Household consumption has been the main engine of the recovery but is now facing resistance from reduced real incomes and saturation of needs after an earlier shopping spree. Various wage metrics are difficult to interpret due to changes in the labour mix during the pandemic, mainly affecting low-paid service jobs. However, the employment cost index (ECI), a quarterly metric that adjusts for structural changes, showed surprising resilience during last year's decline in employment and is at levels more compatible with a tight labour market. Monthly data indicate that wages are rising slightly faster than normal, while employment has picked up again. However, household income was eroded by rising inflation this past spring, while fiscal stimulus declined markedly following large disbursements to households in early 2021. Excluding government transfers, real household incomes have remained broadly unchanged since the end of 2020. We expect real disposable income to fall by about 4 per cent in 2022 after total increases of over 10 per cent during the two previous years.

**High savings are helping households cope with the loss of income.** As before, we expect spending of stimulus money to be spread out over several years. Demand is shifting to services, which have not yet returned to pre-pandemic levels, while consumption of durable goods has already begun to fall. This will bring a welcome reduction of overheating risks in goods production. We also expect consumption of services, such as travel, to be limited in the short term by the recent increase in COVID-19 transmission. According to the University of Michigan, the August decline in consumer confidence was one of the most dramatic in the history of its index series. The index is now below its lowest level early in the pandemic and is probably being depressed by concerns about the Delta variant and higher inflation expectations. Looking ahead, we expect the situation to improve in these respects, but the decline in the confidence index still supports a forecast of subdued future consumption. Despite a slowdown in the immediate future, we expect household consumption to climb at a historically high 7.5 per cent rate this year, followed by 2.8 per cent in 2022 and just over 2 per cent in 2023. This forecast implies a savings ratio below 8 per cent at the end of 2023, or slightly higher than pre-pandemic levels.

## What will be the new normal in the labour market?

Employment accelerated sharply in July. At its current growth rate, it would be back at pre-crisis levels by year-end, but we believe this will not happen until early 2022. Demand for labour is very strong. The number of vacancies is record-high and the number of unemployed per vacancy is close to pre-pandemic lows. The problem is instead on the supply side. There are also matching problems. Labour force participation has been largely unchanged at low levels since late 2020, mostly due to temporary reasons: concerns about the virus, closed schools and expanded unemployment benefits in about half of the states until early September. Strong demand for labour also enables employees to seek better-paying or more suitable jobs. "Quits", the number voluntarily leaving their jobs, have set new records in recent months. We expect employment to grow rapidly this autumn, when the effects of these forces fade and people return to the labour market. We expect the jobless rate to fall from 5.4 per cent in July to just over 4 per cent by year-end and to somewhat below its pre-pandemic 50-year lows of around 3.5 per cent by the end of 2023. It is harder to estimate how quickly the participation rate can return to pre-crisis levels. Early retirements rose during the pandemic. People over age 55 make up 1.2 million of a total labour force decline of just over 3 million. Meanwhile the participation rate among the older people is stuck at low levels. Rising participation among older people added significantly to the workforce before the pandemic. We see no reason for this pattern to change in the long term, but it is conceivable that many of those who retired early in the pandemic will not return.

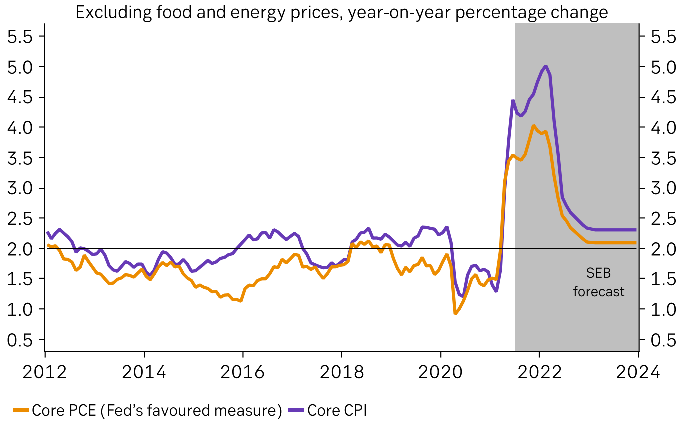
Rapid downturn in unemployment

Unemployment, per cent of labour force over 16 years


Source: US Bureau of Labor Statistics, Macrobond, SEB

Base effects and reopening boosting inflation temporarily

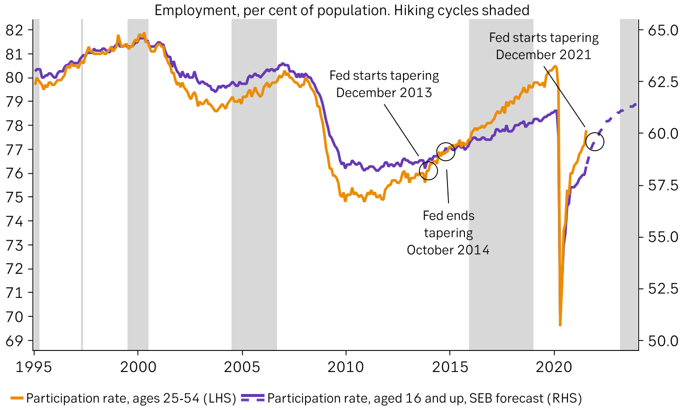
Excluding food and energy prices, year-on-year percentage change




Source: US Bureau of Labor Statistics, Macrobond, SEB

The Fed has waited long enough now

Employment, per cent of population. Hiking cycles shaded




Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

This will delay a return to the pre-pandemic participation rate, helping keep employment somewhat below its earlier trend. In our view, its effects on the economy will be offset by faster productivity growth due to increased digitilisation during the pandemic, and more efficient utilisation of existing labour (increased hours). Late in our forecast period, slower working-age population growth and lower tolerance for immigration will limit expansion in any event.

## High but mainly transitory inflation

During spring inflation soared, sharply exceeding forecasts. A few pandemic-related categories such as used car prices and normalisation of depressed service prices for hotel stays accounted for much of the increase, which suggests that it is mostly temporary. Core inflation, excluding volatile food and energy prices, is expected to peak at around 5 per cent early next year but then quickly revert to previous levels. General supply side disruptions have not yet been fully reflected in prices, which is an upside risk. Producer prices for consumer goods, excluding food and energy, have risen at the fastest rate since the 2008 financial crisis and are usually reflected in consumer prices after a lag. Our forecast means that the Fed's key core PCE measure will level off at slightly above the 2 per cent target late in 2023. Read more about inflation on page 24.

## Fed preparing to reduce its bond purchases

The discussion about "tapering" the Fed's monthly bond purchases from today's USD 120 billion/month gained momentum at the July policy meeting. We believe the bank will present a clearer plan at its September 21–22 meeting. The Fed has downplayed the risks of the Delta variant but needs to see a few more months of rapid job growth to meet the criterion of "substantial further progress" towards its targets. It has also pledged to announce any policy change well in advance. In December, we believe it will begin to lower purchases by SEK 15 billion per policy meeting, which means they will end during Q3 2022. After the last "tapering period", the Fed waited over a year to hike its key interest rate. We believe it will move faster this time, delivering the first hike in Q1 2023. The Fed's full employment requirement should have been met by then. Its requirement of inflation on target and "on track to moderately exceed 2 per cent for some time" has already been fulfilled, in the view of some Fed policymakers. Because of greater uncertainty about the labour supply, the Fed may lower its ambition with regard to a rapid return to pre-pandemic participation rates. Due to slower economic growth in 2023, the Fed can act cautiously. At the end of 2023, its key interest rate will be 0.75 per cent.

**Fiscal policymakers face new obstacles.** The Biden administration quickly pushed through its unfunded pandemic stimulus package in Q1 2021 (nearly USD 2 trillion or 10 per cent of GDP), laying the foundation for this year's rapid growth. But the next two packages – investments in physical infrastructure and climate and welfare initiatives – have taken longer to pilot through Congress, mainly due to increased disagreements among Democrats. Biden's chances of enacting his policies are expected to be severely limited after the 2022 mid-term elections, which puts pressure on the Democrats to stick together. We see a certain downside risk for spending volume. The main assumption is that further spending of around USD 3.5 trillion (including the bipartisan infrastructure package) will be approved by Congress before the end of 2021. These reforms run for 10 years and must be fully funded. Since they are front-loaded, they will still make a positive contribution to growth in 2022-2023.

Theme:

# Inflation

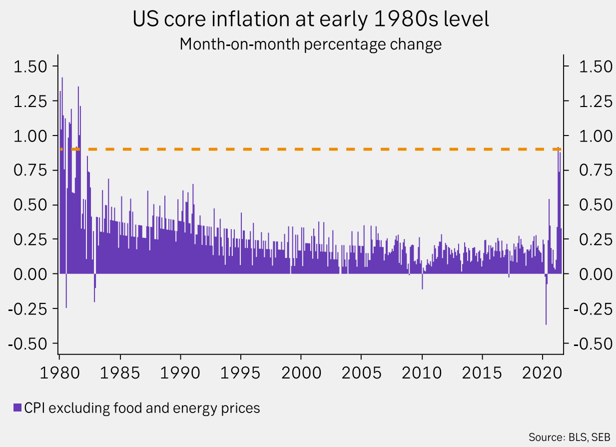
## Higher inflation, but not enough to stress central banks

The United States has seen an inflation upturn that is unparalleled in the past 30 years. This theme article discusses the risks that the current inflation surge will be long-lasting and the potential for similar processes in Europe. Due to unexpectedly high inflation figures in recent months – combined with new signals about production and transport bottleneck problems – we have continued to adjust our inflation forecasts higher. Although upside risks have increased, we still believe inflation will not force a severe central bank tightening that would interrupt the economic recovery. Today's production and trade disruptions are probably temporary, and we believe medium term labour market and income trends will be compatible with inflation targets.

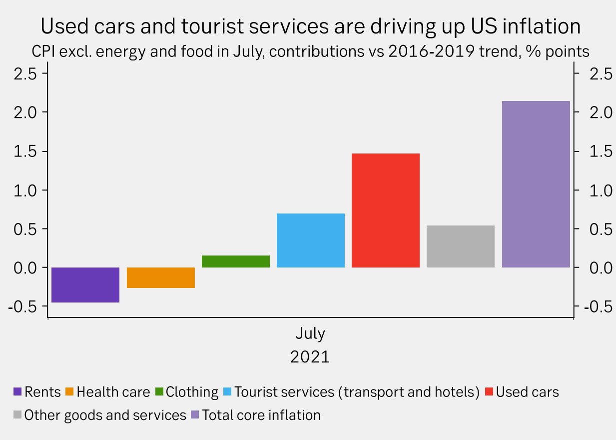
US inflation was expected to climb when the economy reopened and consumption took off, but the upturn in the second quarter of 2021 was far stronger than anticipated. Although the most important underlying forces are temporary, supply side bottlenecks risk prolonging this period of unusually high inflation. Resurgent COVID-19 spread, especially in Asia, has caused new disruptions in international transport and value chains that have now begun to affect prices of more highly processed goods to a greater extent. Theme articles in the last two issues of *Nordic Outlook* have examined various aspects of inflation processes. This article, too, focuses on American conditions, but it also discusses signs of rising inflation in other countries. However, an inflation surge like that in the US seems unlikely in most European countries.

## Strong consumption is driving US inflation

Inflation has been strikingly stable for a very long time. For example, over the past 30 years, core CPI (excluding energy and food) has varied in a narrow range of about ±1 percentage point. During long periods, the variations have also been considerably smaller than this. The recent upturn, with inflation of around 5 per cent, thus stands out dramatically. We must go back to the early 1980s to find higher monthly changed, and if the trend in Q2 2021 continues, the annual rate will be above 10 per cent.

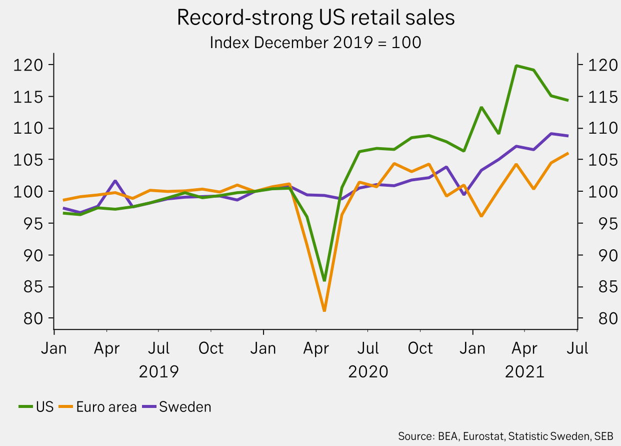



**Used cars are the most important force.** Above all, higher goods prices have driven the inflation rate. The upturn in goods prices has been relatively broad-based, but more than half of the core CPI upturn is due to a 50 per cent increase in used car prices. In the US these prices are affected by auctions. Among other things, bids have been pushed higher by car hire firms that are in desperate need of more vehicles, after having sold off much of their fleets when the economy shut down during the spring of 2020. Service inflation, too, has climbed above its historical trend, but this is primarily a matter of normalising the prices of various tourist services after the sharp fall early in the pandemic. High used car prices and adjustments in service prices thus account for a large share of the upturn in core inflation during Q2. Yet there are many indications that these forces are now weakening significantly. Auction prices of used cars have recently fallen somewhat, while most price declines from the initial phase of the pandemic have been reversed.

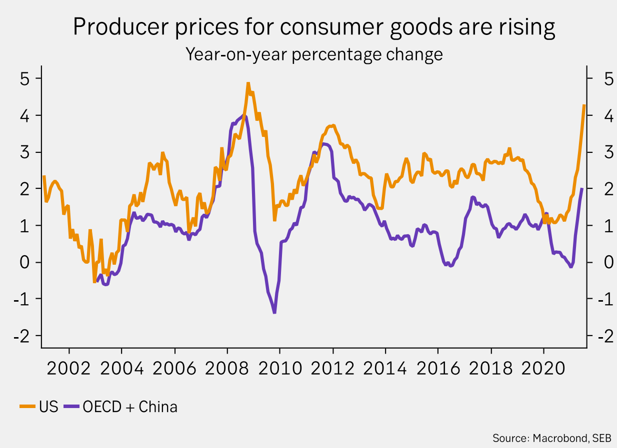



## Weaker inflation impulse in Western Europe

The question now is to what extent we may see similar inflation surges in other countries. There are some similarities, but several factors suggest that the upturn in Europe will be milder. The most important driver behind the US inflation surge is probably the consumption boom that followed in the wake of direct stimulus payments to households. When these fund were distributed early in 2021, for a few months retail sales rose much faster than the historical trend. Retail sales and goods consumption have also risen in Europe, but the rate of increase is not at all as dramatic as in the US.




**Various reasons for a calmer inflation upturn.** Nor is there any equivalent to the inflation-driving US car auctions (with the possible exception of the United Kingdom). Used car prices have climbed at a very modest pace in Europe including the UK. In addition, the CPI weighting for used cars in Europe is only 1/3 as large as in the US. Declines in tourist and travel service prices during spring 2020 were also far smaller both in Sweden and in Europe generally, diminishing the potential for an upward inflation impulse when prices normalise. Because of earlier consumption declines, the weights of these items in the CPI basket have also been adjusted downward, for example in Sweden and the euro area, further lowering their contribution to CPI during the price rebounds that we are now seeing. The down-weighting is especially large for international travel, for which prices have previously fallen the most. We are also seeing a certain "reopening impulse" in Europe, with CPI in the euro area and in the UK expected to peak at around 3.5 per cent. Swedish inflation is not expected to exceed 2.5 per cent. But inflation impulses due to price adjustments are expected to be short-lived. This view is supported by the fact that prices of US tourist services and used cars were unchanged in July.



## Shifting inflation drivers

Although the forces behind the “reopening inflation” are now starting to fade, other factors will keep inflation high for another while. Production and transport disruptions seem to be increasingly serious. This is partly connected to renewed COVID-19 spread and lockdowns in Asia. Producer prices have now also begun to climb for more highly processed consumer goods, increasing the likelihood that CPI will also be affected. Producer prices have risen the most in the US, but an upturn is also discernible in Europe. Although commodity prices have fallen a bit, they are still high and earlier price increases will probably affect CPI inflation after a time lag. We still believe that food prices will climb late this year and early in 2022. To some extent, rising commodity prices will thus help fuel higher inflation, but except for oil and food, the effect will probably be small.

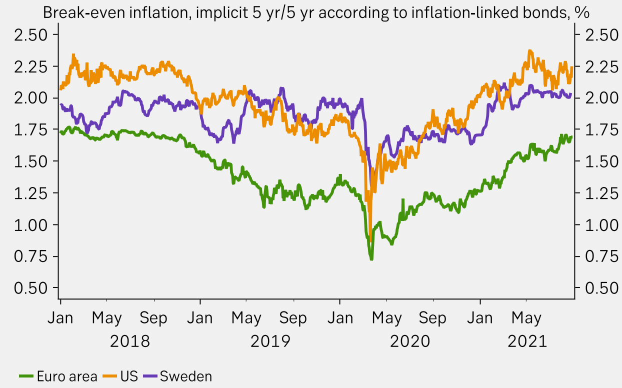
## Can structural shifts cause persistent inflation?

We thus regard the inflationary forces that have been discussed so far as short-term. Even if they turned out to be stronger than expected, it is still fairly certain that inflation will fall once consumption normalises and output disruptions are remedied. Structural problems in world trade might also possibly lead to more lasting inflationary impulses. Indicators such as shortages and capacity utilisation have already risen in many countries, especially the US. But this increase is likely to reflect bottlenecks connected to the rapid but uneven recovery and is thus not due to general overheating trends in labour markets. Yet wage trends this past year have been hard to interpret, since in many cases the statistics have been distorted by furloughs and dramatic variations in the number of people employed and hours worked. But wage metrics that correct for these effects indicate that their impact on wage increases has been small so far.

**New tests of the puzzling Phillips curve.** Looking ahead, the crucial question will be to what extent falling unemployment leads to rising cyclical inflationary pressures. In general, wages have long been insensitive to changes in the jobless rate. Record-low US unemployment just before the crisis, for example, generated only minor increases in the pace of wage and salary growth. Our forecasts indicate that towards the end of 2022, US unemployment will fall to pre-crisis levels. This will once again test what the Phillips curve – the historical association between the labour market and price and wage formation – looks like. Some structural factors may suggest slightly higher pay increases this time. Concerns about growing economic gaps have attracted greater attention in the political discourse. Higher minimum wages may, for example, lead to broader pay hikes. A slightly longer period of high inflation may also cause the Phillips curve to shift upward via rising inflation expectations. But so far, pricing in the fixed income market does not indicate any major inflationary concerns, despite high actual inflation. Market pricing for CPI inflation has rebounded after declines in 2019 and 2020, but it is not at alarming levels either in the US or Europe. Instead, the market foresees an overwhelming likelihood that inflation will fall below target within a few years' time. Such modest long-term inflation expectations reduce pressure on central banks to tighten their policies.

Long-term inflation expectations not at alarming levels

Break-even inflation, implicit 5 yr/5 yr according to inflation-linked bonds, %

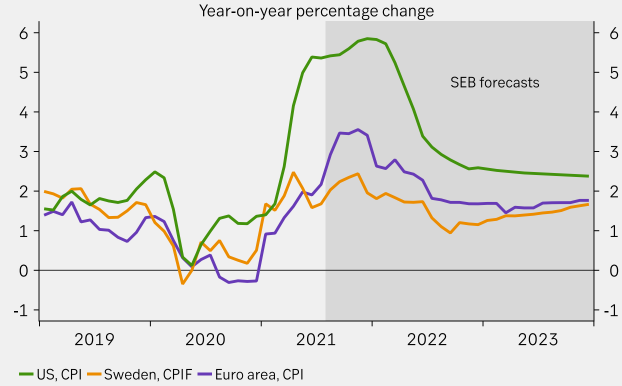



Source: Bloomberg, Macrobond, SEB

**Due to lower international mobility and higher pay levels** in certain emerging market economies, the wage-restraining power of globalisation may diminish in strength. But our main scenario is that continued keen international competition will set limits on how much a heated domestic labour market can speed up its pace of wage increases. It is also notable that the shortages of personal protective equipment and food that arose early in the pandemic were resolved relatively fast. Shortages of semiconductors, shipping containers and transport capacity should also be possible to solve, although it will apparently take a little time.

Temporarily high inflation

Year-on-year percentage change




Source: BLS, Eurostat, Statistics Sweden, SEB

**Inflation will fall despite major challenges.** Sudden demand and supply shifts in various areas, combined with economic stimulus measures, pose greater challenges to the established low-inflation environment than we have seen in decades. In addition, changes in policy frameworks are giving central banks a larger mandate to "play with the fire of inflation". Inflation has clearly surprised on the upside recently and disruptions in production, transport and trade appear to be more stubborn, also increasing the upside risks in inflation forecasts. But our main scenario is still that inflation will fall enough to allow central banks to avoid drastic tightening that would stop the recovery and lead to plunging prices in the housing and stock markets. The market's pricing of inflation risks is thus fairly compatible with our forecasts.

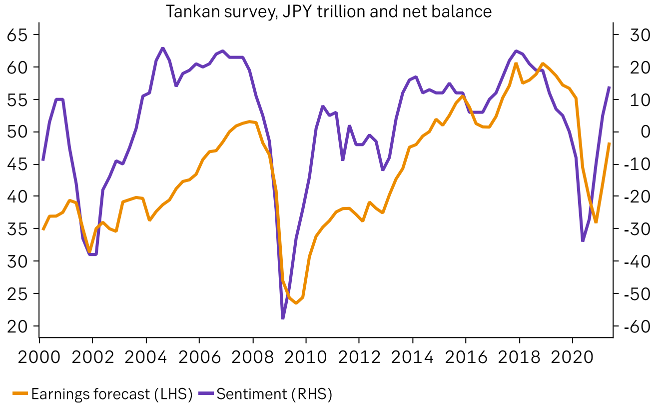
# Japan

## Investment-led upturn, reluctant consumers

There are good prospects for an investment-driven recovery, but households are choosing continued high precautionary saving due to vaccine- and virus-related uncertainty. GDP will grow by 2.5 per cent this year. In 2022 and 2023, growth will stay above its 0.5-1.0 per cent potential level. Inflation will not reach the Bank of Japan's 2 per cent target; the BoJ will continue expansionary policy. There is a great need for reform to prevent Japan from repeating growth setbacks from earlier crises.

Japan: Optimism and corporate earnings pointing upward

Tankan survey, JPY trillion and net balance




Source: Bank of Japan (BOJ), Macrobond, SEB

**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -4.7 | 2.5 | 2.3 | 1.2 |
| Unemployment* | 2.8 | 2.8 | 2.6 | 2.5 |
| CPI | 0.5 | 0.0 | -0.2 | 0.6 |
| Public sector fiscal balance** | -12.6 | -9.4 | -3.8 | -2.5 |
| Public sector debt** | 256 | 256 | 254 | 253 |
| Repo rate***, % | -0.10 | -0.10 | -0.10 | -0.10 |
| USD/JPY*** | 104 | 111 | 113 | 115 |

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

**GDP growth will accelerate this autumn**, but setbacks have been numerous and the recovery is uneven. The manufacturing sector shows growing optimism, aided by stronger international economic conditions, government stimulus and expansive financial conditions. Yet the normalisation of the service sector is being hampered by recurrent COVID-19 outbreaks, which are imposing geographic but not necessarily sectoral restrictions on mobility in Japan. Household worries and caution are expected to dampen consumption. In 2020, GDP fell by 4.7 per cent. **This year GDP will grow by 2.5 per cent**. The structural headwinds due to an ageing population remain. **Our forecast for 2022 and 2023 is 2.3 and 1.2 per cent, respectively.**

**Risks to growth are still on the downside.** There is great uncertainty about the spread of COVID-19 and vaccinations. By August, about 54 per cent of the population had received at least one vaccine dose and 43 per cent were fully vaccinated. The recovery may also be slower because households and businesses are revising their long-term growth expectations downward. The household savings surplus rose by nearly 15 per cent in 2020, which will boost the potential for recovery. The savings ratio – 11 per cent of disposable income – is expected to be halved in 2022. Yet an ageing population and weak pay and employment increases will keep household saving high, hampering private consumption as a driver of growth in 2022 and 2023. Excessively slow GDP recovery also risks exposing vulnerabilities in the financial system, which may impair credit supply during the recovery.

**Optimism among major Japanese companies** is at its highest since 2018, according to the BoJ's Tankan survey, with positive investment plans and a projected volume increase of about 10 per cent over the next year. The yen has lost about 5 per cent of its value in effective terms during 2021, providing extra support to exporters and to growth, but the Japanese automotive industry has been hurt by the global semiconductor shortage. Company earnings are being bolstered by higher domestic demand, and industrial production is now back at pre-pandemic levels. The purchasing managers' index is above the neutral 50 level but is lagging behind strong PMI readings in the US and Europe. The service sector PMI remains below 50. Given the solid earnings trend in the corporate sector, business investments are expected to be an important driver of GDP growth. However, strained geopolitical relations with China may create uncertainty that hampers such capital spending.

**The Tokyo Olympics did not turn out to be the driver of economic growth and public support** that Prime Minister Yoshihide Suga had hoped for. Suga, who has been in power for one year, has seen his popularity among voters plunge from 70 to 30 per cent due to his handling of the COVID-19 crisis. No later than October 22, there will be a lower house election. Japan's recovery is reducing the need for new stimulus packages, but the election is expected to lead to some measures that may attract voters. Japan's public sector debt will remain close to 255 per cent of GDP throughout our forecast period.

**Japanese inflation remains weak.** Temporary effects such as higher energy prices and reduced mobile phone charges will not change medium- and long-term inflationary forces, which are characterised by moderation. Home prices have also not climbed in the same way as in many other countries. Due in part to a long period of deflationary expectations, Japan's inflation will continue to diverge from the rest of the world. Since the BoJ is not expected to achieve its 2 per cent inflation target, the central bank will continue its expansionary policy. We expect a USD/JPY exchange rate of 111 at the end of 2021; at the end of 2022 and 2023 the USD/JPY rate will be 113 and 115 respectively.

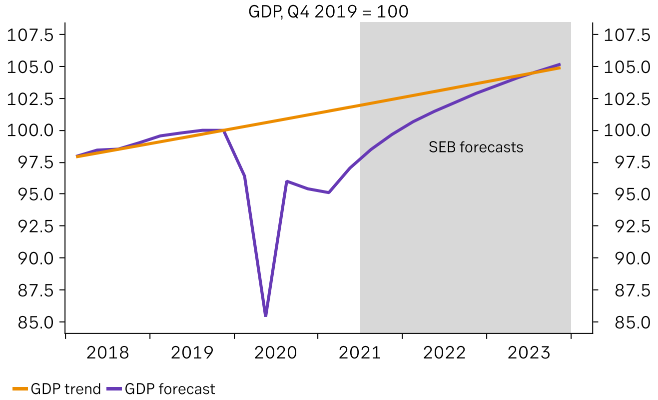
# The euro area

# Growth accelerating earlier than expected

GDP growth surprised on the upside in Q2. Household service consumption will be crucial in the next phase, as manufacturing is hampered by supply problems. The new COVID-19 wave is somewhat inhibiting, but we have revised our GDP forecast upward. We expect inflation to peak at about 3.5 per cent this autumn, then fall below 2 per cent. Given the ECB's new target formulation, this suggests that monetary policy normalisation will begin much later than in the US and UK.

Still some idle resources in the economy

GDP, Q4 2019 = 100




Source: Macrobond, SEB

**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -6.4 | 4.6 | 4.3 | 2.5 |
| Unemployment* | 7.9 | 8.1 | 7.8 | 7.4 |
| Wages and salaries | -0.6 | 3.0 | 2.5 | 2.0 |
| CPI | 0.3 | 2.3 | 2.1 | 1.7 |
| Public sector fiscal balance** | -7.2 | -6.5 | -3.9 | -3.1 |
| Public sector debt** | 98.0 | 102.5 | 100.9 | 98.8 |
| Deposit rate, %*** | -0.50 | -0.50 | -0.50 | -0.50 |
| EUR/USD*** | 1.20 | 1.16 | 1.13 | 1.15 |

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

## Earlier acceleration than expected

After a downturn in the first quarter, euro area GDP grew by 2 per cent in Q2. Restrictions have gradually been eased, but this is happening at different rates within the region. The growth process is clearly showing that recovery is more dependent on lighter COVID-related restrictions than on underlying demand. After initially lagging, the euro area's COVID-19 vaccination rate has moved slightly ahead of the United States. The Delta variant is slowing the recovery, mainly by delaying normalisation in some service sectors. But these effects will probably be quite minor, and growth has generally accelerated a little earlier than we expected in the May issue of *Nordic Outlook*. This is one reason why we have revised our 2021 GDP forecast upward by almost one percentage point to 4.6 per cent. Although quarterly growth will gradually slow as pandemic-related losses fade, GDP will climb by 4.3 per cent in 2022. In 2023, growth will slow to 2.5 per cent – still more than 1 percentage point above trend. We believe there are still idle resources in the euro area economy that can be activated, as monetary policy remains expansionary and national fiscal stimulus measures are supplemented by EU funds. The downside risks in the forecast are mainly linked to new potential lockdowns, which may slow the economy more than expected. On the other hand, it is possible that the EU's reform agenda will have a greater positive impact than in our main forecast, perhaps mainly in the longer term.

**Indicators exaggerate the growth dynamic.** Sentiment indicators show that companies are in a very good mood. The service sector has lagged behind, but after restrictions have been eased, it has also surged higher. Manufacturing sentiment is now close to historical peaks for sub-indices related to order bookings and production. Meanwhile it is clear that due to supply disruptions – such as semiconductor shortages and general transport problems – actual production is not increasing very fast. Looking at indicators, this is reflected in longer delivery times and rising input prices. There are also signs that companies may pass on such costs by raising prices at a later stage of the value added chain. After levelling out in June, industrial production rose only 1 per cent in Q2. Supply problems will continue to restrain production in the short term, but thanks to an upturn this autumn, industrial production will increase by 5 per cent this year and 3-4 per cent annually in 2022-2023. Capital spending has not yet recovered from its big decline in 2020. Relatively high capacity utilisation, along with EU spending packages and environmental investments, suggest increased investment activity in the future. Service production will contribute to this upturn, but some sectors are still far from a normal situation. Tourism, which is so important for many euro area countries, has begun to recover. But in Spain, for example, international travel in June was only 1/3 as high as during the same month of 2019.

**Households still have more to give.** Household consumption is determined by the design of stimulus programmes and by the timing of COVID-19 waves and restrictions. When service consumption has been curbed by restrictions, retail sales and goods consumption have been strong, although not enough to fully compensate. In the second quarter, consumption accelerated when restrictions eased. Consumer confidence is now close to previous peak levels and household finances are strong at an aggregate level. Home prices are rising and the savings ratio is above 20 per cent, compared to a normal level of 12-13 per cent. Pandemic effects complicate the interpretation of wage and salary trends, but contractual pay increases are broadly in line with the pre-pandemic trend.

**The labour market is continuing to improve**, with rising employment and a relatively high number of job vacancies. As service sectors restart, the upturn in the labour market will broaden further. Unemployment was 7.7 per cent in June, which means that about 2/3 of the increase during the COVID-19 crisis has been recovered. But the recovery is probably being slowed because some crisis measures, such as furlough subsidies, are holding down labour force participation in the short term. Joblessness is thus likely to rebound somewhat this autumn as the participation rate normalises. Not until late 2023 do we expect unemployment to revert to its pre-pandemic levels. Various crisis measures have also made it hard to interpret the trend of labour productivity, but after a sharp productivity drop in 2020, there is potential for a fairly rapid upturn in 2021 and 2022, which would also allow room for above-trend GDP growth throughout our forecast period.

**GDP growth forecasts**

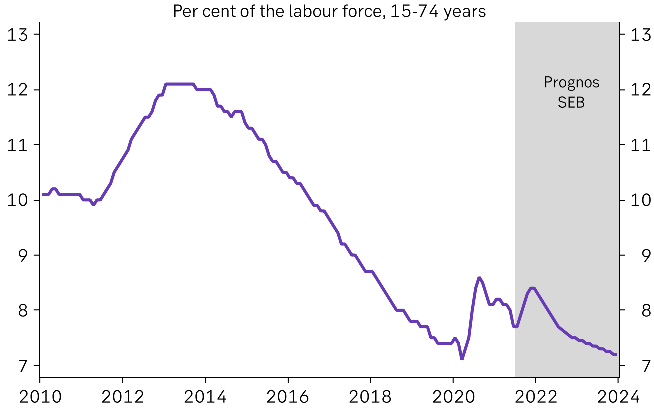
Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| Germany | -4.6 | 2.8 | 4.8 | 2.6 |
| France | -7.9 | 5.8 | 3.5 | 2.5 |
| Italy | -8.9 | 5.5 | 3.9 | 2.4 |
| Spain | -10.8 | 5.9 | 5.4 | 2.8 |
| Euro area | -6.4 | 4.6 | 4.3 | 2.5 |

Source: Eurostat, SEB

Higher unemployment as people get back to the labour market

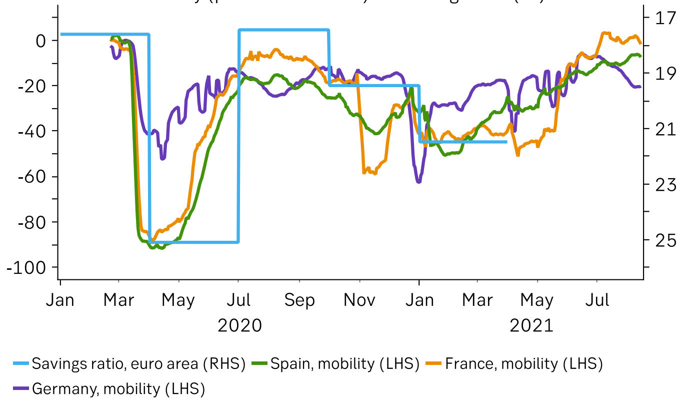
Per cent of the labour force, 15-74 years




Source: Macrobond, SEB

Saving normalises as restrictions are eased

Mobility (per cent of normal) and savings ratio (%)




Source: Google, Eurostat, Macrobond, SEB

## EU programmes supplement national fiscal stimulus

Although the recovery is on firmer ground, dependence on various forms of stimulus remains high. Given low interest rates, fiscal policymakers must shoulder a large stimulus burden, but high fiscal deficits and liabilities will limit future programmes. Yet there seems to be a broad consensus not to repeat the mistakes of the euro crisis, when early fiscal tightening helped to trigger a second recession just a few years after the global financial crisis. The EU's budgetary regulations, including deficit and debt ceilings, have thus been temporarily suspended. In the near future, we expect that because of new pandemic waves, stimulus programmes will be extended and supplemented. In addition, more countries are likely to implement initiatives to support the economic recovery.

**Sizeable crisis programmes will remain in place throughout our forecast period** but will gradually become less extensive, leading to a minor tightening of national fiscal policies in 2022 and 2023. Because of above-trend GDP growth, budget deficits will shrink. But many countries will not meet the formal EU criteria during the foreseeable future. This may lead to tensions, since the official message is that the framework will eventually go back into effect. Discussions on amendments occur regularly, with Germany's strict view contrasting with a more flexible approach in southern Europe. It is uncertain where all of this will lead, but some easing of EU budgetary rules is likely. This applies especially to debt ceilings, but EU countries may also be allowed more time to lower their deficits.

**The Next Generation EU (NGEU)** package is now also supporting growth. National plans have now been approved and the EU is starting to disburse NGEU funds. NGEU totals 6-7 per cent of GDP, or about 1 per cent of GDP annually if we assume that it is rolled out during the period 2021-2026. Although NGEU was negotiated during the pandemic, it should not be regarded as a crisis policy. Instead it consists of more structural initiatives, focusing among other things on environmental and digitisation measures to improve the EU's growth potential. The programme is designed to be front-loaded, but EU countries have a history of using structural funds slowly (or only partially). Just under half of the funds are grants and more than half are loans, and the grant portion is likely to be used to the greatest possible extent. Yet because the countries hardest hit by the pandemic will receive the largest percentage, we believe there will be a relatively high degree of utilisation and that the EU programme will actually help improve EU growth potential.

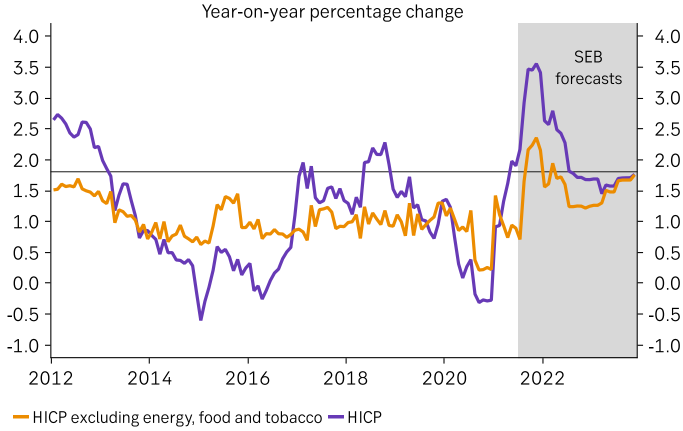
## The ECB is running late in the key rate hiking cycle

Euro area inflation was 2.2 per cent in July. We forecast that it will climb further, peaking at 3.5 per cent this autumn: clearly higher than we are used to, but still a bit below the figures that the US has shown recently. The main driver is high energy prices, but food and other goods prices are also rising. COVID-related factors such as transport and production problems are causing increased uncertainty, but even if demand for goods has been high, there is not nearly the same price pressure on the demand side as in the US. Our forecast is that euro area inflation will fall from 2.3 per cent this year to 2.1 and 1.7 per cent respectively in 2022-2023, as temporary drivers normalise. Further ahead, continued idle labour market resources will help keep core inflation around 1.5 per cent.

**In early July, the European Central Bank (ECB) adjusted its monetary policy strategy**, replacing its previous inflation target "below but close to 2 per cent" with a clearer symmetrical target. The ECB is now aiming for 2 per cent inflation in the medium term. Inflation will be able to fluctuate above and below target, with deviations in both directions being regarded as equally unwelcome. There was some speculation that the ECB would go further and, like the US Federal Reserve, introduce some form of flexible target for average inflation and thus at least partially try to compensate for historical deviations. However, conservative ECB policymakers, such as those from Germany's Bundesbank, were not ready to go that far. There were other policy changes, too, though they will have little impact on monetary policy in the short term. The ECB wants to include home ownership costs in its inflation metric and also develop methods for including climate impacts in monetary policy.

A few more months until inflation peaks

Year-on-year percentage change

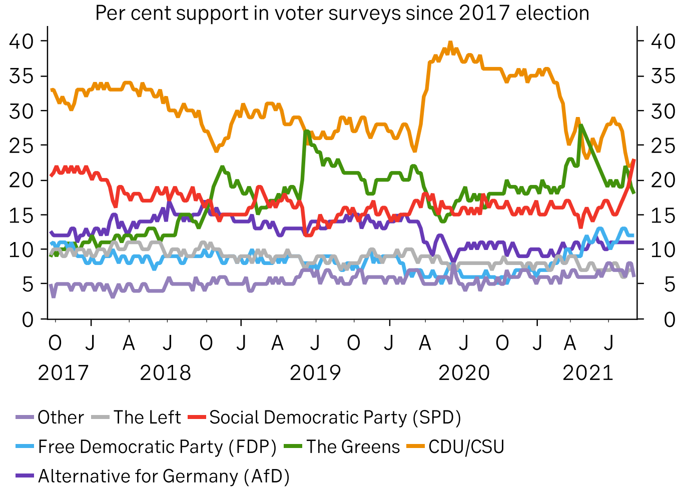



Source: Macrobond, SEB

## The ECB will be the last of the major central banks to normalise monetary policy

Narrowing gaps between CDU/CSU, SPD and Greens

Per cent support in voter surveys since 2017 election




Source: Wahlrecht.de, Macrobond, SEB

**The revised monetary policy framework means slight loosening.** After the ECB's most recent policy meeting in late July, a dovish announcement was expected. The bank has not explicitly wanted to signal that changes in the framework in themselves would delay monetary policy normalisation, but we still think that interpretation will be natural when inflation drops below 2 per cent in early 2022. The ECB's message was that it will not hike its key rates until inflation reaches and stays at 2 per cent in a medium-term perspective. Core inflation must also reach a level in line with the target. Both our own and the ECB's latest forecast indicates that core inflation will be just below 1.5 per cent in both 2022 and 2023.

**Key rates will be stable throughout our forecast period.** The Fed and other central banks are now signalling that the time to ease up on crisis measures may arrive a bit earlier than expected. But for the ECB, not much has changed. Its new framework will marginally postpone monetary tightening in an environment where growth is not sufficient to push up inflation to 2 per cent in the long run. As a result, in this cycle too, the ECB will lag behind its peers in hiking interest rates. During our forecast period, the refi and deposit rate will remain at 0 and -0.5 per cent, respectively. As for ECB bond purchases, however, some steps are being taken. We believe that the Pandemic Emergency Purchase Programme (PEPP) will be extended until mid-2022 and that purchases will gradually shrink this autumn. As conditions normalise, it will be hard for the ECB to maintain PEPP in full, but its "regular" asset purchase program (APP) is likely to be expanded and possibly be made more flexible.

**German election – another Green surge?** On September 24, Germany – with almost 1/3 of euro area GDP – goes to the polls. The election will be especially important since it will determine who replaces Angela Merkel as Chancellor. She has held this position since 2005, dominating German politics for a long time. CDU leader Armin Laschet, Greens leader Annalena Baerbock and Social Democratic (SPD) leader Olaf Scholz are the main candidates. Looking at opinion polls, the outcome is less certain than a few months ago. There are several possible alternatives for building a majority. Gradually higher support for the Greens can be partly explained by voters thinking that the environment is a more vital election issue today than migration. Although the pandemic is now the most important issue, the environment is a strong second. This is not so strange after this summer's floods in Germany. Support for the three largest parties has varied recently with different parties in the lead. CDU's Laschet is far less popular than Merkel. After an initial upswing in popularity, Baerbock has suffered setbacks linked to her lack of experience in leading positions. Recent polls have shown that the SPD's Scholtz, a politician with long ministerial experience, would be the most popular candidate if there were a direct election to the post of Chancellor. SPD's support has increased recently and has even exceeded that of CDU/CSU in a recent poll. With the three largest parties now close to 20 per cent of the votes in polls and tailwinds for SPD it is difficult to pinpoint a clear coalition alternative at present.

**Yet there are many indications that the Greens can play a bigger role** than before in a grand coalition. This may lead to a somewhat more dovish approach to fiscal policy frameworks, at least in the near future, even if Germany remains fiscally conservative. There will also be stronger emphasis on environmental spending and other capital spending if the Greens join the government. This summer's floods will contribute to more spending, and German authorities have promised EUR 30 billion euros for a reconstruction fund. In foreign policy, the Greens may want Germany to play a more active role on issues that might create tensions with China and Russia.

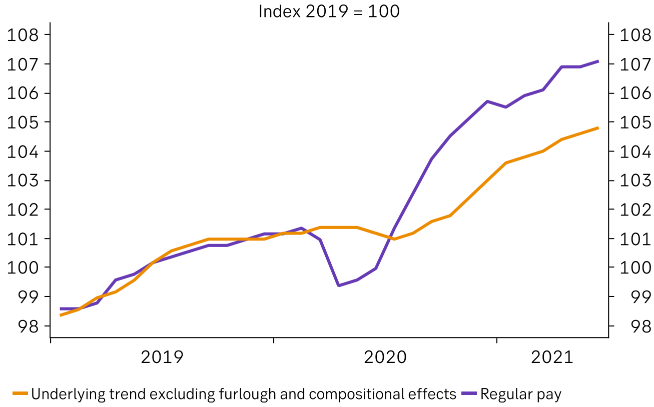
# The United Kingdom

## Near pre-crisis GDP

British GDP will soon be back at pre-COVID crisis level, but it will take another two years before GDP reaches the level that was expected before the crisis. We have adjusted our forecast slightly higher and we now expect GDP to increase by 7.0 per cent this year and 5.8 per cent in 2022. Inflation will fall in the short term, but Bank of England will hike the key interest rate by 0.15 basis points to 0.25 per cent in May 2022. At the end of 2023 the bank rate will be 0.75 per cent.

The pandemic is speeding up pay increases

Index 2019 = 100




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

### Key data

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -9.8 | 7.0 | 5.8 | 2.2 |
| Unemployment* | 4.5 | 5.0 | 4.9 | 4.2 |
| Wages and salaries | 1.8 | 4.8 | 1.8 | 2.3 |
| CPI | 0.9 | 2.1 | 2.4 | 1.9 |
| Public sector balance** | -13.4 | -12 | -6 | -3 |
| Public sector debt** | 103.7 | 104 | 106 | 106 |
| Key interest rate, %*** | 0.10 | 0.10 | 0.25 | 0.75 |
| EUR/GBP*** | 0.89 | 0.84 | 0.82 | 0.83 |

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

**Approaching pre-COVID crisis level.** British GDP rose by nearly five per cent in the second quarter, when the government's strategy of opening up the economy step by step favoured the domestic economy in particular. The Delta variant of COVID-19 is now slowing the return to normal conditions a bit, but we still expect GDP to reach the first milestone – a return to its pre-crisis level – by the end of 2021. As in other countries, the UK economy is struggling with sectoral imbalances between supply and demand. Looking ahead, long-term effects of the country's recent withdrawal from the European Union (Brexit) will hamper potential output. We believe there will still be idle resources at the end of 2022, allowing above-trend GDP growth in 2023 as well. The contribution of fiscal stimulus measures will gradually weaken. Starting in 2023 the tax burden will increase, among other things due to higher corporation taxes.

**Lower unemployment, but still an unclear resource situation.** Even though GDP has mainly increased in line with earlier estimates, we have revised our unemployment forecast significantly lower. Rapid recovery in demand has contributed to rising employment. At the same time, the labour supply has not recovered in the way we expected after the downturn during the acute COVID-19 crisis. This is partly due to a surge in early retirements and greater interest in studies, but it also has broader causes. The pandemic thus appears to be intensifying the negative consequences of Brexit in terms of labour supply, helping to limit the rise in unemployment during the crisis to about one percentage point. We now believe that the jobless rate will fall below 4 per cent as soon as the end of 2023 – clearly faster than we and many others had expected.

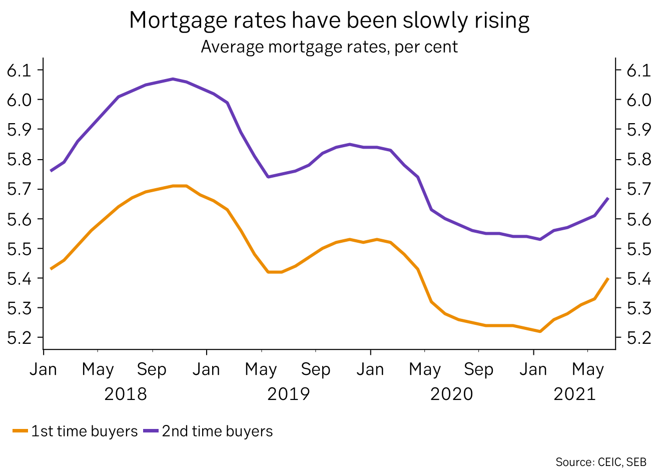
**Rising wages but falling inflation.** Labour shortages have gradually begun to affect wage formation. Official data indicate rapidly rising wage pressures, but as with other statistics, there are major uncertainties related to the pandemic. The Bank of England's underlying wage metric shows a calmer trend, which we believe is more relevant as an inflation indicator. But meanwhile, the BoE's business survey shows that it is becoming increasingly common for cost increases to be passed on to end consumers. Historically, higher input prices due to supply chain problems have usually had only transient effects on inflation. We also believe that wage pressures will diminish as temporary imbalances between supply and demand ease. We expect inflation to peak at 3.8 per cent in the beginning of 2022 and then rapidly decline to 2 per cent by mid-year. Although the resource situation will tighten in 2023, we expect inflation to be relatively stable at close to BoE's 2 per cent inflation target.

**The BoE has a clear plan.** Rising inflation, signs of supply disruptions and a relatively fast GDP rebound pose challenges for the BoE. This summer, members of the BoE's Monetary Policy Committee (MPC) have clearly indicated that the time is approaching to reduce monetary stimulus measures. At the August meeting, the MPC approved a strategy including a mix of various tools. When the key interest rate reaches 0.50 per cent, the MPC intends to stop reinvesting maturing fixed income securities. When the key rate reaches 1.00 per cent, active divestment of securities will be considered. Although our growth path and inflation forecast do not give the impression of the need for faster declining monetary policy stimuli, we believe the BoE want to leave behind the very lowest crisis interest rate and give itself the flexibility to start downsizing its debt portfolio. We therefore believe that the BoE will cautiously hike its key rate by 0.15 basis points in May 2022 and then by 0.25 basis points in early 2023 and again in late 2023. That would bring the bank rate back to its pre-pandemic level of 0.75 per cent.

# China

## Virus strategy delays consumption recovery

China's growth momentum is easing. Aside from fading base effects, downside risks to growth have intensified from the combined effects of an easing credit impulse and a delay in private consumption recovery. The government's virus containment strategy will continue to dampen household spending even as incomes improve.




**Key data**
**Year-on-year percentage change**

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | 2.3 | 8.6 | 5.6 | 5.4 |
| CPI | 2.2 | 1.5 | 2.1 | 2.2 |
| Public sector fiscal balance* | -3.6 | -3.0 | -3.0 | -3.0 |
| Bank reserve requirement, %** | 12.5 | 12.0 | 11.5 | 11.0 |
| 1-year loan prime rate** | 3.85 | 3.85 | 3.85 | 3.85 |
| Deposit rate, %** | 1.50 | 1.50 | 1.50 | 1.50 |
| 7-day reverse repo rate, %** | 2.20 | 2.20 | 2.20 | 2.20 |
| USD/CNY** | 6.50 | 6.40 | 6.30 | 6.20 |

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

**Downside risks to growth are intensifying in China.** This has led us to revise our GDP forecast to 8.6 per cent in 2021, from 9.0 per cent. Favourable base effects have started to fade, with Q2 GDP easing to 7.9 per cent year-on-year. Although average compound growth over the previous 2 years rose to 5.5 per cent in Q2 from 5.0 per cent in Q1, this pace remains below the 6.0 per cent pre-pandemic average.

**High frequency indicators show that growth momentum is easing more than expected.** Although we have assumed that growth would moderate in the second half of 2021 due to the persistent decline in credit impulse (the change in new credit issued as a share of GDP), conditions have deteriorated beyond our expectations. Export growth in July fell to 19.3 per cent y/y from 32.3 per cent in June. Despite this slowdown, exports are far from collapsing. Also, growth remains stronger than pre-pandemic rates. While we continue to expect international demand to provide support to the economy, it may not be sufficient to offset the downward pressure from domestic demand.

**Household spending is unable to sustain a strong pace of recovery**. Considering the delay in improvement of retail sales in 2020, we had assumed that private spending would drive the recovery in 2021. Although incomes have already risen in line with labour market improvement, households continue to maintain a higher savings ratio than before the pandemic. Consumer confidence also remains below pre-pandemic levels.

**China is maintaining its zero-tolerance policy towards COVID-19.** Policymakers have refined containment strategies that include aggressive testing, quarantines and stratified mobility restrictions. From July, targeted restrictions were imposed to varying degrees depending on the level of local risk. Local cases have declined to low single digits per day from a peak of 108 during the Delta-variant surge. Individuals under state-controlled quarantine have also declined to 31,780 from a peak of 50,800. The clear decline in virus incidence has raised hopes for relaxation of current restrictions in more areas, providing support to market sentiment.

**China's on-again, off-again containment strategy is costly**. While the targeted restrictions approach continues to work, the risk of new outbreaks and variants remains. Thus, the repeated imposition of restrictions will continue to dampen consumption. The strategy also has a negative impact on global supply chains when Chinese ports are forced to cease operations due to restrictions, but the incentive to abandon this strategy is low since its effectiveness has been proven time and again. Until this strategy fails to protect the population from COVID, Beijing will be obliged to keep it, in our view.

**Tighter regulation is exacerbating downside risks.** Government regulation has substantially increased in 2021 as policymakers seek to align corporate behaviour with social equity goals. Aside from tighter controls on tech and other fast-growing sectors, China continues to tighten rules on the property market. Even with the broad-based reduction in the banks' reserve requirement ratio on July 15, mortgage rates maintained their upward trend. Banks in Shanghai recently joined those in Hangzhou and Shenzhen in raising mortgage rates.

**To offset slowing growth, some policy easing may be expected**. However, the focus on financial de-risking will keep policies targeted. We expect the authorities to rely on liquidity provisions rather than interest rate cuts. Financial conditions may ease with stronger government bond issuance for the rest of 2021.

Theme:

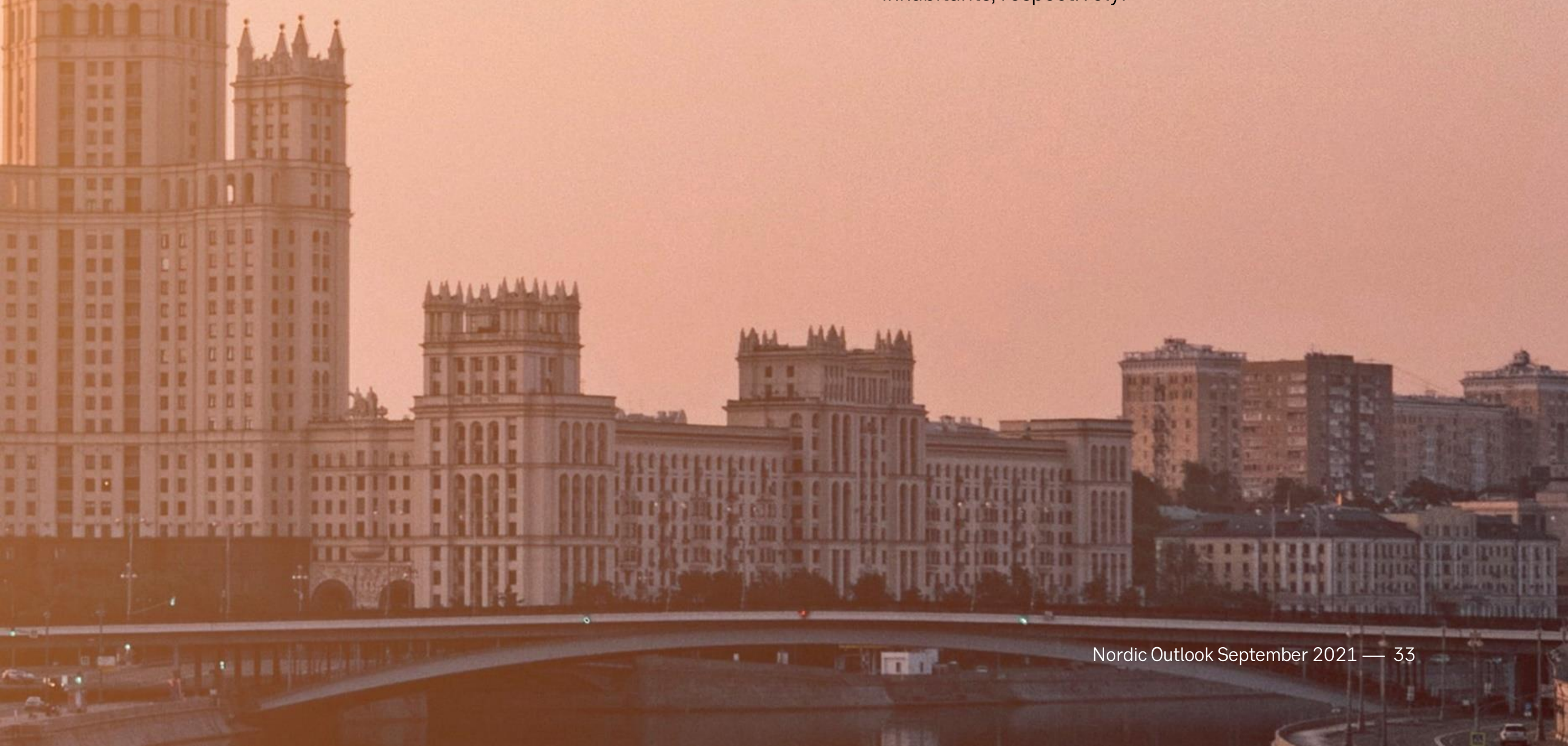
# The EM economies

## Recovery is being delayed by slow vaccinations

The recovery in the emerging market (EM) sphere was expected to suffer setbacks, but it is remarkable that the biggest downward adjustments in our growth forecasts now apply to the Asian economies that were most successful in handling the initial stage of the pandemic. Compared to the May issue, we have lowered our 2021 GDP forecast for the EM sphere by 0.3 percentage points – mainly because new virus outbreaks and increased transmission in South East Asia and China have led to renewed restrictions and local lockdowns, including ports. The biggest threat to a stable EM recovery is the slow vaccination process. Surging global market interest rates – for example due to higher US inflation – would also hit EM economies hard.

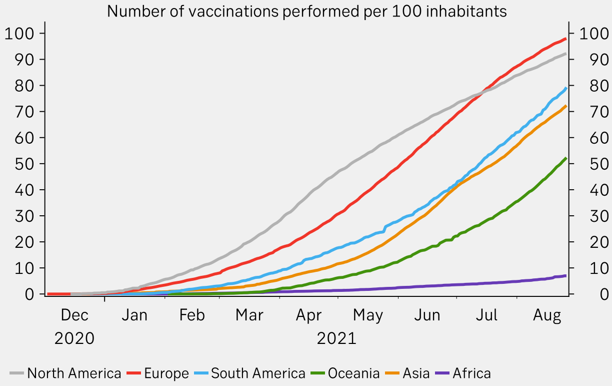
The road to post-pandemic normalisation is fraught with risks that are connected to a fairly large extent to EM and poor developing economies. The biggest single threat is the slow vaccination process. Delayed vaccinations in many countries will also increase the risk of the emergence of new vaccine-resistant virus variants, which in the long run would threaten growth in more advanced economies too where vaccination rates are high. But EM countries are particularly vulnerable, due to their lower degree of economic diversification, less room for fiscal and monetary policy stimulus and smaller health care resources. Disruptions in distribution and supply chains are also especially harmful in EM economies, which are often more trade dependent.

**Since May, China has increased its vaccination rate** and boosted the number of doses distributed to more than 130 per 100 inhabitants, but the number of doses given in Asia as a whole is only around 70 per 100 people. This reflects low numbers in populous countries such as India (40), Indonesia (30) and Pakistan (20). In South America, around 75 doses per 100 inhabitants have been distributed, but that statistic includes Chile and Brazil, which have managed to give 130 and 80 doses, respectively. Africa, with 1.3 billion people or around 16 per cent of the world's population, has by far the lowest vaccination rate with less than 10 doses administered per 100 inhabitants. In North America and Europe, vaccinations performed total just over 90 and 95 per 100 inhabitants, respectively.



Africa is far behind in the vaccination process

Number of vaccinations performed per 100 inhabitants




Source: Our World in Data, Macrobond, SEB

**Initial successes gave false sense of security.** Most Asian countries quickly lowered virus transmission by imposing tough restrictions early in the pandemic. But partly due to this success, they seems to have underestimated the importance of rapidly vaccinating their populations. We are now seeing how increased transmission of the Delta variant is forcing renewed lockdowns and restrictions. This is one reason we have lowered our 2021 growth forecast for the EM sphere to 6.5 per cent from the previous 6.8. Our 2022 forecast, however, is unchanged at 4.8 per cent. The downward revision for this year is mainly due to lower expected growth in India, but also in China. In contrast, we have revised our forecasts for Latin America and Eastern Europe upward.

**GDP growth, BRIC countries and EM sphere**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| China | 2.3 | 8.6 | 5.6 | 5.4 |
| India | -7.1 | 8.9 | 6.3 | 4.9 |
| Brazil | -4.1 | 5.3 | 2.5 | 2.2 |
| Russia | -3.1 | 4.3 | 2.9 | 2.0 |
| Emerging economies, total | -2.2 | 6.5 | 4.8 | 4.3 |

Source: IMF, SEB

**The 2022 slowdown in growth is due to base effects**, but the need to tighten fiscal policies also plays a role. China wants to bring about consumption-driven growth through regulatory and tax changes, but the authorities want to avoid increasing debt, both in the public and private sectors. They are thus cautious about stimulus measures. Brazil and India, among other economies, are planning fiscal tightening to avoid excessive government debt.

**Inflation has climbed in the EM sphere, too.** In a number of countries – such as Brazil, Russia, Mexico, Hungary and Chile – central banks have been forced to tighten monetary policy. Price increases for commodities have slowed somewhat in recent months as COVID-19 transmission has increased and as expectations of demand growth have diminished. This will eventually have a dampening effect on inflation, but the latest impulse will keep inflation up until mid-2022, thereby blocking monetary policy easing for a while.

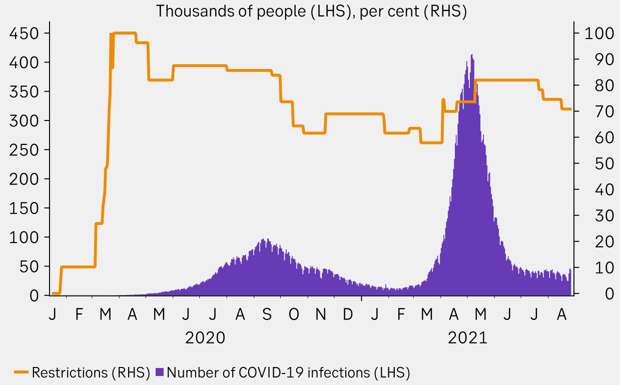
**Resilient to higher interest rates.** Early in the pandemic, monetary stimulus measures in the US, Europe and Japan created a favourable climate for capital flows into the EM sphere. These flows have faded in strength during 2021 but are still positive. Today one important issue is how EM economies will be affected by tighter monetary policy, primarily in the US. Our main scenario of continued global recovery with inflation under control allows for cautious normalisation. This environment will probably benefit risk appetite in the EM sphere even if global interest rates rise a bit. But if we were to see sharply rising inflation and market interest rates – for example driven by overly expansionary US fiscal policy – there would be major consequences. EM currencies would face strong downward pressure, forcing interest rate hikes that would lead to a slowdown in growth.

## India: Eager to loosen restrictions

A sharp increase in COVID-19 transmission between March and June has contributed to a downward adjustment in our 2021 growth forecast by over one percentage point to 8.9 per cent. We have also lowered our 2022 forecast due to the slow vaccination process. If we also take the large GDP decline in 2020 into account, the overall economic consequences of the pandemic are more serious for India than for other major economies. Only 7.5 per cent of the population was fully vaccinated at the end of July, but authorities have already begun to ease the restrictions they reintroduced during the last wave, and this is helping to support the recovery. But we see clear risks that India will now open up too fast. The authorities are facing a dilemma, since they do not have enough resources to support the nearly 35 million workers who lost their jobs during the latest wave. Downside risks thus dominate as long as vaccination rates do not accelerate.

Less transmission, cautious easing

Thousands of people (LHS), per cent (RHS)




Source: COVID19 INDIA, University of Oxford, Macrobond, SEB

**Year-on-year inflation reached 5.6 per cent in July** and has stubbornly remained at or above the Reserve Bank of India's 4 per cent target during the pandemic. Core inflation and inflation expectations are also above target and show few signs of falling in the near future. So far, the central bank has kept its key interest rate at 4.00 per cent, and we do not expect a rate hike until late 2022, but there is an increased risk that it will be forced to revert to a neutral monetary policy earlier. The Indian rupee weakened by eight per cent when the pandemic broke out in 2020 but has recovered part of its decline and has been relatively stable at around INR 74 per USD. We expect it to remain close to that level for the rest of the year and then weaken to 75 against the dollar in 2022.

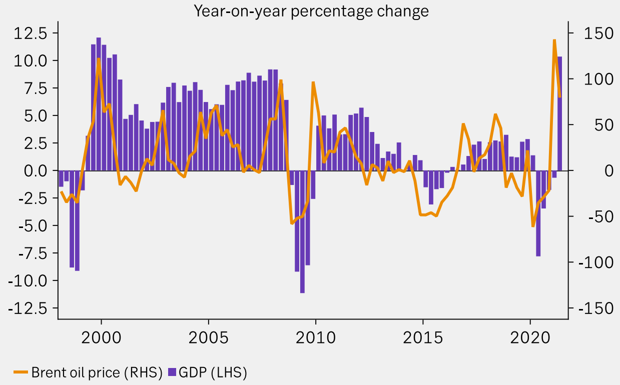
## Russia: Mild restrictions against the pandemic

The Russian economy has coped with the pandemic relatively well. A fairly short period of tight restrictions helped limit the drop in GDP to 3.1 per cent in 2020. We have revised our 2021 GDP growth forecast from 3.8 to 4.3 per cent after a strong second quarter and the OPEC+ decision to give Russia a gradually expanded production framework. Increased oil production starting in May 2022 will help generate GDP growth of 2.9 per cent for the full year 2022.

**Even though Russia was the first to develop a vaccine**, the vaccination rate is low. Production has lagged, while vaccine resistance is widespread. Despite the authorities' attempts to convince people to get vaccinated, so far only around 50 doses have been distributed per 100 inhabitants. Due to increased transmission of the Delta variant, growth is now losing some momentum during Q3, but restrictions still look set to be limited. A strong labour market is sustaining domestic demand. Unemployment has fallen to 4.8 per cent: slightly higher than before the pandemic. Wages have risen by nearly 10 per cent since 2020. Exports – pushed up by high commodity prices – have grown faster than imports and will contribute significantly to GDP growth in 2022 as well.

Russian GDP growth tracks oil price changes

Year-on-year percentage change




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

**Inflation has risen more than expected.** In July it was 6.5 per cent year-on-year. Inflation will average about 6 per cent in 2021 and then fall to 4.5 per cent in 2022. Russia's central bank has been quick to hike its key rate by a total of 225 basis points to 6.5 per cent since March 2021, but inflation expectations have continued to rise sharply. Combined with high core inflation and rapid pay increases, this will drive up the key rate further to 7.5 per cent at the end of 2021. Only in 2023 will lower inflation allow a rate cut to 6.5 per cent.

**Oil prices have fallen recently,** but we believe that this is temporary. Rising demand and continued output restrictions will support oil prices, and thus also the Russian rouble. Higher interest rates will also help strengthen the currency to RUB 72 per US dollar by the end of 2021. In 2022 and 2023, we expect a small weakening, with an exchange rate of RUB 76 per USD towards the end of our forecast period.

**The September 19 parliamentary election** is unlikely to generate any surprising results. Parties loyal to President Vladimir Putin will win an absolute majority. The opposition has more or less fallen silent since the imprisonment of Alexei Navalny. Further US or EU sanctions against Russia cannot be ruled out, but we expect them to be limited to individuals, organisations or companies linked to Russian defence interests or Nord Stream 2. Russia will take steps in the fight against climate change and develop green technologies in the coming years. The Kremlin's new green agenda may also open up attractive investment opportunities for foreign companies in Russia.

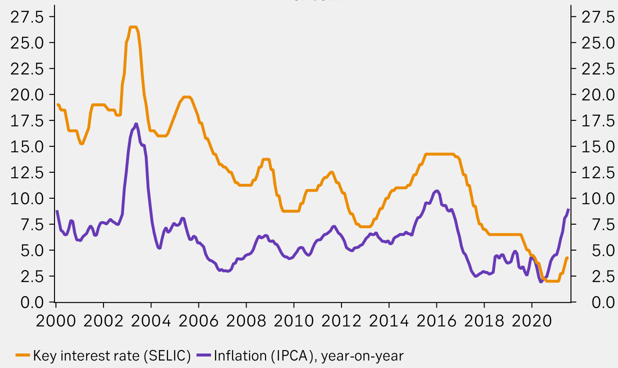
## Brazil: Major fiscal challenges

Brazil's economy recovered quickly after the pandemic broke out last year, despite widespread virus transmission. GDP apparently returned to pre-crisis level as early as Q1 2021. Growth slowed a bit in Q2, but now we are again seeing signs of acceleration. Internet-based high-frequency data and public transport statistics show that mobility has increased since late June 2021 as transmission has fallen.

**The recovery has been driven by domestic consumption,** boosted by cash payments to low-income earners often employed in the informal sector. Exports of commodities, whose prices soared during the pandemic, have also been quite helpful. Fiscal stimulus will be tightened this year, but households will still maintain their consumption to some extent by using part of the savings they have accumulated – about 18 per cent of GDP – since the outbreak of the pandemic. Overall, we expect GDP growth of 5.3 per cent this year, 2.5 per cent in 2022 and 2.2 per cent in 2023.

Central bank aims for positive real key rate

Per cent




Source: Brazilian Institute of Geography & Statistics (IBGE), Central Bank of Brazil, Macrobond, SEB

**Soaring inflation rate.** Strong domestic demand and pandemic-related output shocks, combined with a weakening of the currency, have pushed up Brazilian inflation. In July, CPI rose by 9.0 per cent year-on-year: well above the inflation target of 2.25–5.25 per cent. The central bank has raised its key interest rate by 325 basis points since March 2021 to 5.25 per cent. The rate of increase in money supply has slowed, but credit growth has risen to 16 per cent year-on-year, while inflation expectations have jumped. The central bank has thus signalled plans to hike its key rate above the neutral level. We believe that it will raise the key rate gradually to a peak of 9.00 per cent in 2022 before successively lowering it to 7.00 per cent late in 2023 as inflation approaches its target.

**The Brazilian real weakened by over 25 per cent** against the US dollar when the pandemic broke out. Despite support from rising interest rates and record-high export prices, the real has had difficulty recovering lost ground. Concerns about Brazil's reform process and consolidation of public finances are weighing down the currency. We expect the real to fluctuate around 5.50 per dollar during the rest of 2021, before gradually weakening to 6.00 by the end of 2023.

# The Nordics

### Sweden

Upside GDP surprises, record-high sentiment indicators and fiscal stimulus will help growth return to its historical trend in 2022. The Riksbank will let the key rate remain at zero even in 2023 but gradually reduce bond purchases.

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### Norway

Domestic demand will remain strong, despite uncertainty about the pandemic. A rapid recovery combined with rising home prices – though at a slower pace – is among the reasons why Norges Bank will lead the way with a key rate hike.

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### Denmark

A fast reopening of the economy led to a growth surge in Q2 2021. Households are in a good mood, and consumption is robust. To ease appreciation pressure on the krone, the central bank will cut the key rate by 10 basis points in 2022.

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### Finland

The GDP downturn in 2020 was mild, but recovery has been unimpressive. Home building has surged, but long-term problems – low productivity growth and a shrinking working age population – will hamper Finland's growth potential.

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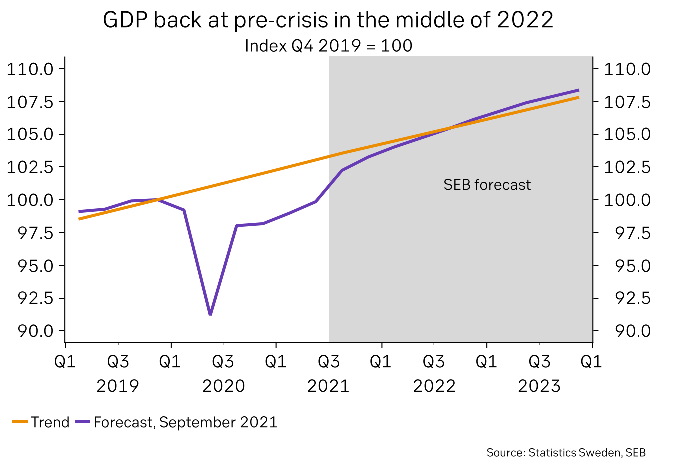
# Sweden

## GDP continues to surprise on the upside

Positive new GDP surprises, record-high sentiment indicators and continued stimulus measures suggest that GDP growth will return to its historical trend in the middle of 2022. Due to higher resource utilisation and rising international prices, the Riksbank will take small steps towards normalisation in 2022 and 2023 by reducing its bond purchases and signalling future increases in the repo rate path. However, we expect the key interest rate to remain at zero even in 2023.




### Key data

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -2.8 | 4.6 | 3.9 | 2.3 |
| Unemployment* | 8.8 | 8.8 | 7.8 | 7.5 |
| Wages and salaries | 1.7 | 2.8 | 2.5 | 2.8 |
| CPIF (CPI excl. Interest rate change) | 0.5 | 2.0 | 1.5 | 1.5 |
| Net lending** | -3.0 | -1.2 | -0.7 | -0.7 |
| General government debt** | 39.7 | 37.6 | 34.6 | 32.5 |
| Repo rate, %*** | 0.00 | 0.00 | 0.00 | 0.00 |
| EUR/SEK*** | 10.05 | 10.10 | 9.90 | 9.80 |

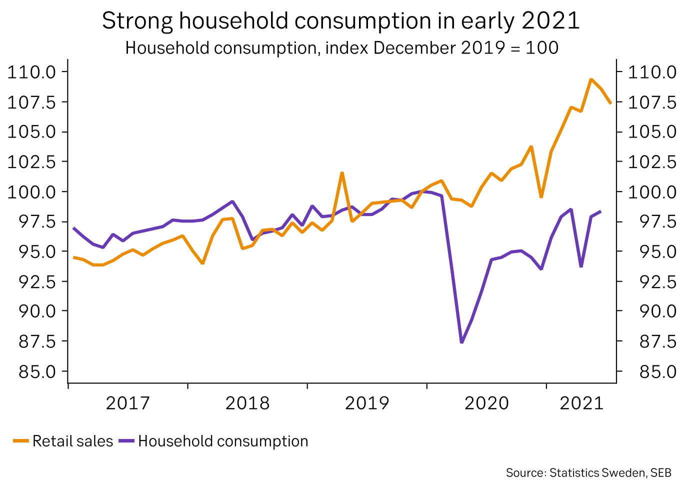
*% of labour force **% of GDP ***Year-end. Source: Statistics Sweden, SEB

### GDP again stronger than expected

GDP growth in Q2 2021 ended up a full percentage point higher than our May forecast, also taking into account upward revisions of previous quarters. GDP is thus already above its pre-pandemic level. The continued large potential for a recovery in household consumption and service exports also points to accelerating growth during the second half. The recovery will have a strong impact on the labour market, although methodological changes in the Labour Force Survey (LFS) make trends hard to interpret. We have adjusted our GDP growth forecast for 2021 to 4.6 per cent from 4.5 per cent in May. To some extent, the strong second quarter is expected to slow the upturn in the second half – one reason why we have adjusted 2022 growth down to 3.9 from 4.0 per cent. In 2023 we see room for continued growth somewhat above trend and expect GDP to increase by 2.3 per cent. Continued low interest rates and an expansionary 2022 election budget will also provide continued stimulus. Downside risks mainly concern the pandemic; increased COVID-19 transmission may delay the fourth step in lifting Swedish restrictions, currently planned for September.

**Business confidence at record levels.** The Economic Tendency Survey of the National Institute of Economic Research (NIER) is now at its highest level since the time series began in 1996. This trend is led by manufacturing, but service sector confidence rose to cyclical peaks this summer. High future expectations contribute the most, but companies are also reporting a strong current trend. This is also confirmed by hard data. For example, industrial production and merchandise exports have risen well above their early 2020 levels. Bottlenecks and component shortages in the automotive industry pose some uncertainty in the near future – with risks of new temporary shutdowns at Swedish production facilities – but continued global recovery will create good prospects for industrial production and merchandise exports further ahead. Service exports have recovered part of their earlier large decline but remain depressed. This is especially true of travel and transport services, but a gradual recovery in tourism suggests that service exports will grow strongly in the coming year. The outlook for business travel is more uncertain, and much of the downshift will probably become permanent. Overall, exports will grow by 9.6 per cent this year and 7.0 percent in 2022. In 2023, the increase will be only 4.3 per cent, in line with the slowdown in global growth.

**Increased construction, but concrete shortage a potential threat.** Capital spending fell sharply in Q2 2020, mainly driven by a downturn in machinery investments. Most of the downturn was reversed in the second half. Since then, total capital spending has been mainly flat. There are many indications that a clear recovery will begin this autumn, although there are major differences between sectors. Rapid production growth in manufacturing is driving up investments, and capacity utilisation has climbed to historically high levels. Residential construction has rebounded. The number of housing starts in Q2 rose to 16,000: on a par with the peak in 2017. Public sector investments are also growing at a healthy pace, although it will take time before infrastructure and green transition spending have their full impact. But construction of commercial properties has gradually fallen since mid-2020. This trend is expected to continue during the coming year. Overall capital spending will increase by 6.0 per cent in 2021 and 7.0 per cent in 2022. The threat of a concrete shortage if Cementa's limestone quarry on the island of Gotland must close is difficult to assess. A consultancy report compiled on behalf of the government concludes that up to 150,000 jobs could be lost in the near future. Industry organisations have warned of even larger consequences. The government has presented a solution allowing operations to continue until mid-2022. What will happen next is uncertain, but the government is likely to do all it can to avoid a halt in construction so close to the September 2022 election. But the issue is complex and the government has little chance of influencing the legal process. Cementa has appealed the environmental court's decision, but it may take several years before the case is decided at a higher level. Given the large impact on the economy, we still believe it overwhelming likely that a solution will be found that allows quarry operations on Gotland to continue.

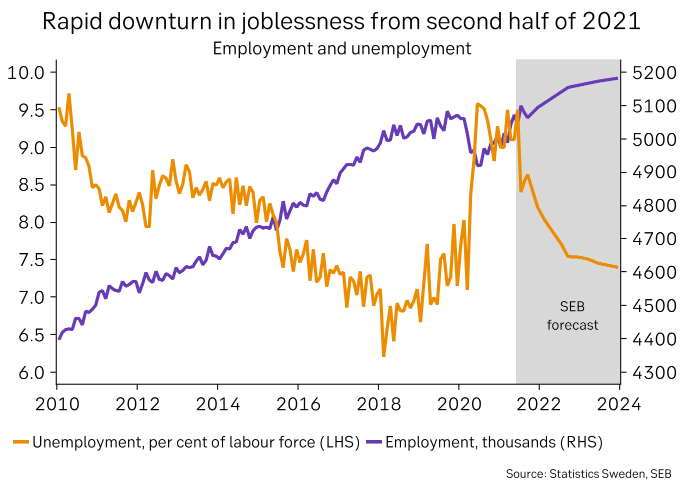



**Household incomes and savings ratio**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| Real disposable income | -0.6 | 4.7 | 3.0 | 1.5 |
| Private consumption | -4.8 | 4.7 | 3.7 | 2.2 |
| Savings ratio, per cent of income | 17.7 | 17.9 | 17.1 | 16.8 |

Source: Statistics Sweden, SEB




## Big potential for increased household consumption

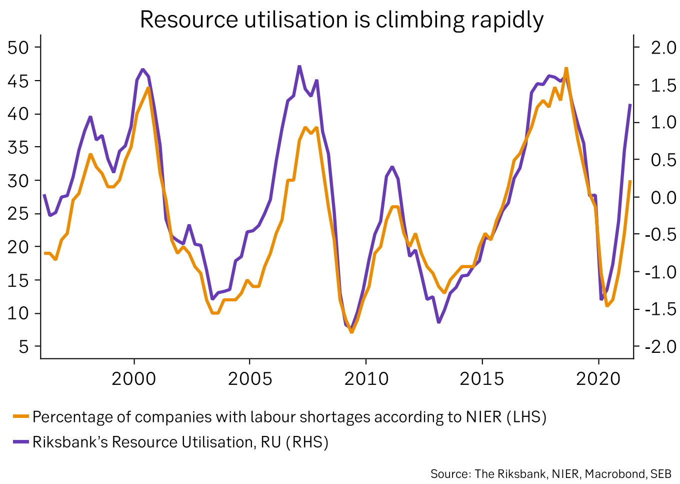
Household consumption bounced back quickly after declining sharply in the spring of 2020. Since then, the recovery has been rather sluggish. Consumption in Q2 2021 was still three per cent lower than in Q4 2019. The decline was uniquely large, but there were large variations between different types of consumption. Retail sales have risen significantly above the historical trend, while consumption of services is a full 13 per cent lower than before the COVID-19 crisis. Differences in sub-categories are also striking, with a strong increase in sales of building supplies, whereas consumption of clothing and tourist services is still 10-20 per cent below normal. Household income fell in 2020, mainly due to a temporary decline in share dividends. A normalisation of dividends, combined with strong employment recovery and fiscal stimulus, will contribute to very rapid income growth in 2021 and 2022. Together with a depressed consumption level, this will create good conditions for normalisation over the next couple of years. The pace at which restrictions are lifted will determine how quickly the demand for travel, restaurants and hotels as well as cultural services can be normalised. Barring major setbacks, extended opening hours and larger parties in restaurants – along with far bigger audiences at theatres and sporting events – will lead to a fairly rapid increase in consumption in the second half of 2021. But restrictions on international travel are likely to persist until at least next year. We expect overall consumption to increase by 4.7 and 3.7 per cent, respectively, in 2021 and 2022 and to be close to its historical trend towards the end of our forecast period.

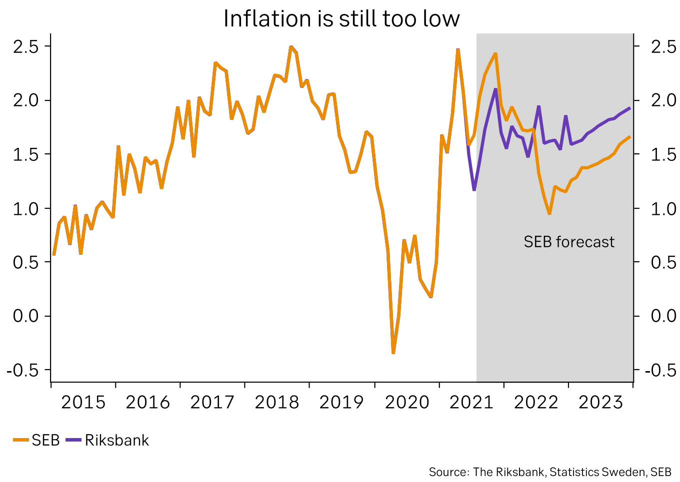
**The housing market has shown clear signs of cooling** this summer, after exceptional earlier price increases. It is still too early to determine whether we are seeing an interruption in the upward trend. Rising employment and continued low interest rates suggest that prices will continue to rise. We are sticking to our forecast that prices will rise by a total of 10 per cent this year and a further 5 per cent in 2022. We see potential for slight price increases in 2023 as well, although elevated price levels will pose a downside risk.

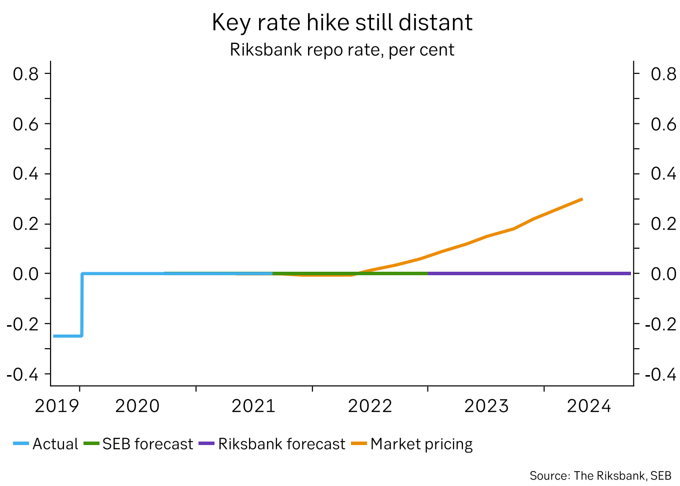
## The labour market is strong, but hard to interpret

Strong growth indicators are being matched by almost equally elevated labour market indicators. According to the NIER's Economic Tendency Survey, hiring plans in the Swedish business sector are at their highest since 2010. The labour market thus seems to have recovered after a sharp decline in spring 2020, but a restructuring of the Labour Force Survey (LFS) starting in January 2021 makes it hard to interpret both the employment and the unemployment situation. Because of new definitions, both the number of people with jobs and in the labour force will be lower, while the net effect on unemployment is unclear. Not until early 2022 does Statistics Sweden plan to unveil revised linked time series for the labour market. We have therefore chosen to try to create our own corrected time series; these are shown in our charts.

**Employment is well on its way to recovering** after falling by 2-3 per cent early in the pandemic. It will reach its pre-crisis level by the end of 2021, according to our calculations. The rate of increase will then gradually slow to 0.5 per cent in 2023. Despite these signs of strength, according to the LFS statistics, unemployment has risen during the first half of 2021 to a level close to its summer 2020 peak. The Swedish Employment Service's alternative metric instead shows a clear downturn, with half of the 2020 increase being reversed. Our view is that the Employment Service's statistics best reflect what is happening in the labour market. It is likely that unemployment according to the LFS will turn downward in the near future. Rising resource utilisation also indicates a stronger labour market, and the percentage of companies with labour shortages is now above the historical average. There is still some way to go to the historical peaks, but the Riksbank's resource utilisation indicator is already beginning to approach its 2019 level. Given our forecasts for growth and for the labour market, resource utilisation is likely to keep rising to historic peaks over the next year.




**Normalisation of pay hikes.** Sweden's population increase slowed in 2020 – a trend that seems to have continued in 2021, although changes in the LFS's population definition create uncertainty. Tighter labour immigration and lower refugee reception suggest a permanent slowdown in population growth, which may affect long-term potential growth and wage formation. Due to higher resource utilisation, we have adjusted our pay forecast a bit higher, but with collective agreements in place until spring 2023, the effect during our forecast period will be small. The next wage round looks set to take place amid a relatively tight labour market, suggesting that new agreements will end up somewhat higher than the most recent wage rounds, which included yearly 2.2–2.3 per cent hikes. We expect overall pay to increase by 2.8 per cent in 2023: slightly higher than 2.8 per cent in 2021 and 2.5 per cent in 2022.

**Core inflation has bottomed out.** Core inflation – CPIF excluding energy – fell in July to 0.5 per cent, the lowest since 2014. Base effects from unusually high summer 2020 prices and a downward adjustment in the weighting of foreign travel – seasonal price increases thus have less impact than before – helped push down the annual increase. These effects will disappear in the next few months, while more underlying forces will help push up inflation from low levels. Downward pressure from exchange rates is about to culminate. Meanwhile there are signs of higher international prices. But domestic price indicators are still weak. Although wages have rebounded slightly from previously depressed levels, the rate of increase will not exceed the moderate figures noted in the years before COVID-19. And even if downward pressure eases, exchange rates will not contribute to higher inflation in line with 2016-2020, when the krona was trending lower. We expect an increase in core inflation to 1.6-1.7 per cent in the first half of 2022, followed by a decline when international price pressures ease. Rising resource utilisation and slightly larger pay hikes will contribute to higher inflation in 2023, but core inflation will stay below 2 per cent throughout our forecast period. Due to sharply rising electricity prices, CPIF inflation will exceed 2 per cent this autumn. However, forward prices for electricity are clearly pointing to a decline in 2022, causing CPIF to temporarily fall below core inflation in the second half of next year.

## Small steps towards tighter monetary policy

Having unveiled new expansionary measures throughout 2021, the Riksbank has not signalled any changes at this year's three policy meetings. Bond purchases – boosted to a total of SEK 700 billion in November 2020 – will continue as planned this year. The Riksbank estimates that its 2022 purchases will be roughly equivalent to the volume of maturing bonds. By ending net purchases at the end of 2021, the Riksbank will be slightly ahead of the ECB and the Fed, but this should be seen in light of the difficulty of continuing purchases when it already owns 50 percent of bonds outstanding. A key rate hike is still remote. The Board continues to signal an unchanged repo rate throughout our forecast period (until Q2 2024, according to the July report), but there are signs that the bank is slowly moving towards a slight tightening policy. The likelihood of a key rate cut or expanded bond purchases has decreased. Rising resource utilisation and inflation expectations lead us to believe that within six months the Riksbank will signal rate hikes at the end of its forecast horizon. We also believe that soon after, the Riksbank will buy bonds more slowly than its holdings mature. The Board may possibly diverge from current plans and taper bond purchases from as early as the second half of 2022. Assuming a strong consensus among Board members that they want inflation to exceed the 2 per cent target before hiking the key interest rate, at present it is likely that the key rate will remain at zero until the end of 2023.

Theme:

# The 2022 budget

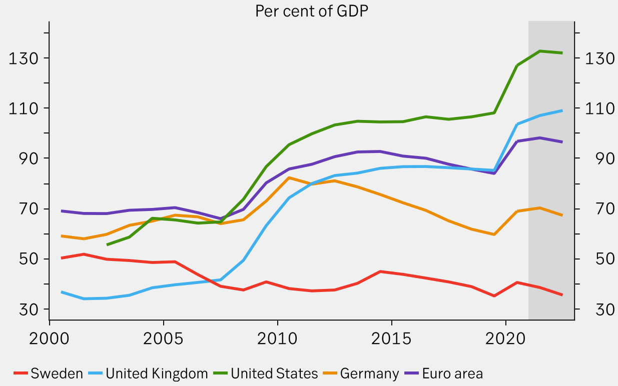
## The economy will recover, but investment needs and a unique political situation require an expansionary budget

Over the past two years, expansionary fiscal policy has aimed at helping Swedish households and businesses make it through the pandemic. The acute crisis is now over and the economy is increasingly self-sustaining. This implies less need for crisis responses, suggesting a more scaled-down autumn budget bill. Yet there are significant investment needs, and the lessons of overly rapid cuts in stimulus measures after past crises are discouraging. This is also the last regular budget before the September 2022 election, and the government needs to secure support from both the Left and Centre parties. This will also take place in a situation where the prime minister has just announced that he will resign and his most likely successor is the current finance minister, Magdalena Andersson. So it is not surprising that on August 26, she announced that the 2022 budget will be highly expansionary, with an estimated SEK 74 million in unfunded reforms.

**The pandemic has created many economic challenges** and the Swedish government has tried numerous tools for addressing them. People's needs and the scope and impact of various crisis measures have all been hard to predict. This is especially apparent from the number of amending budgets (adjustments in appropriation levels and new proposals for the current financial year) delivered over the past two years. The usual spring and autumn budget bills were supplemented in 2020 by an additional twelve amending budgets. During the first half of 2021 alone, there were eight more. Their scope in terms of allocated funds is also large: the government puts the total impact of these amending budgets at close to SEK 400 billion (about 8 per cent of GDP). In addition, there are potential or indirect costs. Various guarantees, a "corporate emergency facility" and, above all, deferrals of tax payments may add up to nearly SEK 1 trillion. The regular 2021 budget bill included more than SEK 100 billion in unfunded reforms, and amending budgets added nearly SEK 120 billion more. Although the most acute phase of both the pandemic and the economic crisis is over, it will probably be necessary to continue some fiscal stimulus measures for another while. Under current rules, some measures such as large-scale wage subsidies will expire this autumn. They are likely to be extended. This means we can expect more amending budgets during 2021.

**Not as bad as feared.** Although the pandemic has had major negative economic effects, the outcome has not been as bad as previously feared. For example, the 2020 downturn in GDP was much smaller than forecasts one year ago indicated. Crisis responses have also cost substantially less than anticipated. Due to lower expenditures for these measures, along with higher-than-expected tax revenues, the impact on public finances have been more limited than most forecasters initially estimated. The National Debt Office predicted a central government borrowing requirement of SEK 400 billion in 2020, while the final figure was only SEK 221 billion. For the entire public sector, net lending deteriorated – but only to about 3 per cent of GDP, which is small in both a Swedish crisis perspective and compared to other countries during the pandemic. The public sector debt ratio increased, but "only" to 40 per cent of GDP. Both the National Institute of Economic Research and the government itself estimate that this upturn will be reversed within a couple of years.

Continued low Swedish public sector debt
Per cent of GDP




Source: IMF, Macrobond

**Unpredictable pandemic will generate continued stimulus needs.** COVID-19 has repeatedly led to surprises. Even though the percentage of vaccinated people is now rising, we are also seeing how new mutations continue to gain a foothold in Sweden, Europe and the world. This means that crisis responses will continue and that forecasts of when we can revert to a more normal situation keep being postponed. In addition to the above-mentioned amending budgets, this September's budget bill for 2022 is also expected to be a mixture of crisis policy and "ordinary" policy. We know that Sweden's official fiscal policy framework – budgetary rules on deficit targets and debt anchors – were put on hold during the pandemic. Instead, there was a fairly broad political consensus that the costs of pandemic-related measures would end up being whatever they turned out to be. We are beginning to hear calls for tighter fiscal policy, but the government will not prioritise a rapid return to the fiscal policy framework. It was no surprise that on August 26, the finance minister announced that unfunded reforms in the budget would total SEK 74 billion – well above the SEK 40 billion scope for reforms that the National Institute of Economic Research (NIER) has identified. Whether this total makes sense will depend on what reforms are implemented.

**Still possible to deal with crisis impacts and structural challenges.** Because Swedish public finances have emerged relatively unscathed from the COVID-19 crisis and political leaders currently view the fiscal policy framework less strictly, there may be room for further spending on reforms both in 2021 and over the next couple of years. This spending should focus on policies that can improve Sweden's growth potential and its green transition. It is easy to identify a number of areas – such as the environment and climate change, the housing market, the labour market, integration of immigrants, deferred health care and the judicial system – that need to be reviewed and upgraded. A broad tax reform is also much-needed and has been high on the agenda for years. It is important to prioritise structurally appropriate reforms, including those that will help create new, future-oriented technologies or improve the functioning of the labour market.

**The focus of fiscal policy can be defined in different ways.** If we want to describe its impact on economic growth, year-to-year changes are decisive. If a budget includes more stimulus than last year, under this definition it is expansionary. In international comparisons, however, it is more common to use year-to-year changes in the cyclically-adjusted general government budget balance as a metric for how expansionary or contractionary economic policy is. Because governments have enacted extremely large crisis responses, fiscal policies over the next couple of years will be contractionary compared with the previous year – despite continued investments beyond what normal fiscal policy frameworks allow. This is a natural development. The need for stimulus measures shrinks as the economy becomes increasingly self-sustaining and as private income generation functions better and better. One example is short-term wage subsidies, one of the more costly stimulus measures, which encompassed 10-20,000 people in Sweden during May-June, compared to a peak of 270,000 in May 2020. According to some metrics, the resulting contraction in public spending will be equivalent to 1 per cent of GDP in 2022. As mentioned, the 2022 budget bill will meanwhile include various new investments that boost growth compared to no new spending, making it expansionary according to other metrics. One metric is no more correct than the other, and the contradictions between them should not be exaggerated.

**Public sector finances)**
Per cent of GDP

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| Net lending | -3.0 | -1.2 | -0.7 | -0.7 |
| Gen'l government debt | 39.7 | 37.6 | 34.6 | 32.5 |
| Borrowing req., SEK bn | 221 | -15 | -50 | -20 |

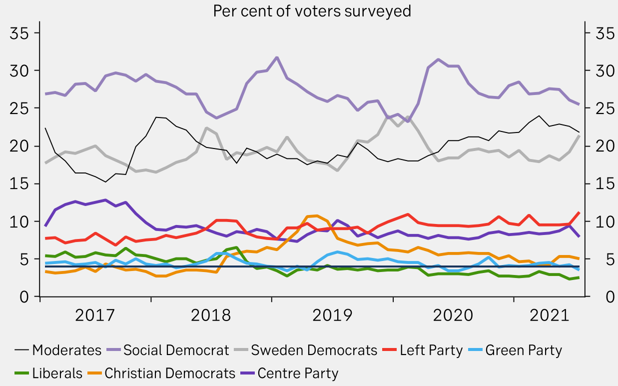
Source: Statistics Sweden, SEB

**A unique political situation.** The annual budget bill to be submitted to Parliament on September 20 will be last one before the 2022 election. Election budgets tend to be more expansionary than others. This year's budget negotiations will also include other political parameters, aside from the election. The summer of 2021 was turbulent and included both the resignation and reappointment of Prime Minister Stefan Löfven. The Left Party opposed changes in existing rules for setting rents in newly built apartments. They started a process that led a parliamentary majority consisting of the Left Party, Sweden Democrats, Christian Democrats and Moderates to declare their lack of confidence in the prime minister, who consequently resigned.

**The Speaker of Parliament** then began to investigate what other party leader was potentially acceptable to Parliament as prime minister. Since the opposition had ousted the Prime Minister, the Speaker's first choice was Ulf Kristersson – leader of the largest opposition party, the Moderates. But after studying his chances of gathering sufficient support in Parliament, Kristersson concluded that such support was lacking. He let the matter revert to the Speaker, without testing his support in a formal vote. The Speaker then went back to Stefan Löfven, who on July 7 underwent another vote of confidence. By this time, the proposed change in rent-setting rules for newly built housing had been withdrawn. The Left Party switched sides and once again accepted Löfven as prime minister. He was reappointed on July 9.

Still an open political situation

Per cent of voters surveyed




Source: Novus, Macrobond, SEB

**Uncertain support for the budget.** On the surface, this summer's political turbulence may look like an isolated incident, since Stefan Löfven resigned and was reappointed within 3 weeks. But in at least three respects, it changed Swedish politics in general and the task of putting together a 2022 budget bill in particular:

- **The minority Social Democratic-Green government can no longer take the support of the Left Party for granted.** The Left has shown that it is now willing to topple a Social Democratic prime minister if it finds one of the government's policies unacceptable. The government thus has good reason to look closely at the list of demands that the Left Party has published and says are requirements if the Left is to support the government's budget in Parliament this autumn.
- **The Liberals have switched sides**. When the Left Party forced a change in the January Agreement on budget cooperation between the minority government and the opposition Liberals and Centre Party, the Liberals declared that they will no longer cooperate on the budget with the Centre Party and the government, but will instead henceforth work towards bringing about a change of government.
- **The January Agreement is dead**. The change triggered by the Left led to the cancellation of the entire 73-point programme. The Centre Party, which is still prepared to negotiate on the budget with the government, thus regards itself as free to define its position and will present its own list of demands at the negotiating table.

The new situation places heavy demands on the government's ability to negotiate if it is to gather sufficient parliamentary support for its budget. A further complication is that the Centre Party has said it will not support the government's budget if it has been negotiated with the Left Party. It will be a daunting task to make the budget attractive enough for both the Centre and Left parties to accept it.

The prime minister's resignation announcement changes the picture further. After this summer's government crisis and ahead of the upcoming budget negotiations, Stefan Löfven announced that he would not govern in 2022 on the basis of the opposition's budget, but would resign if his own budget did not receive parliamentary support. But on August 22, he announced that he will resign as Social Democratic leader effective at the time of the party congress in early November – in other words after the budget bill has been submitted to Parliament, but before it comes up for a final vote. His announcement raises questions: Will his successor as party leader feel obligated by Löfven's decision to resign if the government's budget is voted down? Will it be easier or harder to gather support for the budget when the prime minister now leading the negotiations will soon be stepping down? These questions remain unanswered, but we believe this situation has certainly added to the expansionary nature of the 2022 budget. The government is likely to be generous to the Centre and Left parties in order to secure their support, both in the budget vote and in the parliamentary vote for the new prime ministerial candidate in November. It will be worth a lot to the government if the new Social Democratic party leader and prime ministerial candidate does not have to start his or her term with a government crisis.

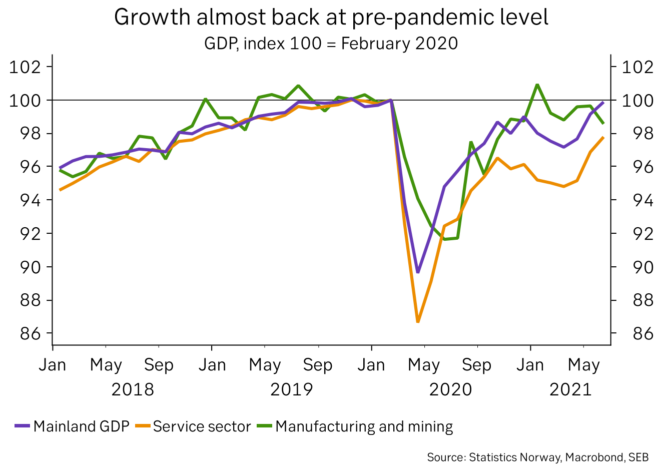
**Can the budget become even more expansionary?** In light of both this summer's political turbulence and the rapidly approaching September 2022 election, our main scenario is that the government will manage to push through both its budget and its prime ministerial candidate. The government is also prepared to submit a highly expansionary budget in order to get there. It probably hopes that its generous SEK 74 billion reform framework will be enough, yet we believe this level is a floor rather than a ceiling. The contents of the budget have not been communicated so far, except in the form of bullet points, but central government grants to municipal and regional governments will probably be increased to allow both increased social service ambitions and a chance to catch up with health care deferred during the pandemic. This is also one point on the Left Party's list of demands, which neither the government nor the Centre Party probably has anything against. Another likely reform is that the unemployment insurance system, which was made more generous during the pandemic, will be permanently adjusted to these higher levels. The Left Party has also demanded that the one-day waiting period for income replacement insurance during illness should be abolished. This may be a harder change to make permanent, but one can imagine an extension of the current waiver at least during 2022. We also expect substantial spending on labour market reforms, climate adaptation and the judicial system. The contents of the budget will probably be published on an ongoing basis until September 20, when it is formally submitted to Parliament.

In a slightly longer perspective, a gradually improving economic situation and smaller scope for crisis responses will improve the budget balance to deficits of 0.7 per cent of GDP in both 2022 and 2023. The debt ratio will fall to 33 per cent of GDP late in our forecast period, not far from the official "debt anchor". This means there may soon be renewed pressure on the government and Parliament to review the fiscal framework. If discussions of the EU Stability Pact lean towards allowing member countries to run larger deficits and debt ratios, this may also affect Sweden's attitude.

# Norway

## Norges Bank will take the lead this autumn

The recovery has regained momentum after a temporary slowdown earlier this year. An easing of restrictions is helping to boost consumption. Fiscal stimulus, high savings and lower unemployment will provide continued support this autumn. We thus expect domestic demand to remain strong, despite uncertainty about the pandemic. Because of the rapid recovery, along with a home price upturn this past year, Norges Bank will hike its key rate in September and probably also in December.




**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -0.8 | 2.7 | 3.7 | 1.9 |
| Mainland GDP | -2.5 | 3.7 | 3.7 | 1.4 |
| LFS unemployment* | 4.6 | 4.4 | 4.0 | 3.8 |
| Wages and salaries | 3.1 | 2.8 | 2.9 | 3.1 |
| CPI-ATE inflation | 3.0 | 1.7 | 1.4 | 1.6 |
| Key interest rate. % | 0.00 | 0.50 | 1.25 | 1.50 |
| EUR/NOK** | 10.48 | 10.20 | 10.05 | 9.95 |

*Per cent of labour force **At year-end. Source: Macrobond, SEB

### Easing of restrictions is reflected in data

Pandemic-related restrictions slowed activity in Norway last spring, but as the economy opened again in late April the recovery took off. In the second half of June, Norway entered step three of its reopening plan, among other things easing service sector and travel restrictions. Increased COVID-19 transmission both in Norway and internationally boosted uncertainty this summer, and in July the government postponed the fourth step in reopening. But, the government's latest message is that Norway will now tolerate a higher transmission level than before, as risk groups and much of the adult population are vaccinated. The fourth step is thus expected to begin in September. After a weak start to the year, the recovery took hold and mainland GDP rose by 1.4 per cent in Q2. In line with both our forecast and that of Norges Bank, the recovery is now being led by strong households with support from fiscal stimulus. We have thus revised our mainland GDP growth forecast for 2021 from 3.5 to 3.7 per cent. Because of continued strong growth, our forecast for 2022 is unchanged at 3.7 per cent. After that, growth will slow in response to rising interest rates and tighter fiscal policy. In 2023 we foresee growth of 1.3 per cent, which is largely consistent with Norges Bank's estimate of the long-term trend.

**Change of government likely, but little fiscal impact.** Households have benefited from expansionary fiscal policy this past year. As expected, the government unveiled new stimulus measures in the revised 2021 budget in May. The 2022 budget is not due until October, but first the country will go to the polls on September 13. Opinion surveys indicate a change of government to a centre-left coalition, but Norway has a long history of minority governments, which has created a broad cross-bloc consensus on economic policy. The election outcome is thus expected to have little impact on fiscal policy. What will really matter for growth is the "fiscal contribution", measured as changes in the structural non-oil-related budget balance, i.e. the change in how much oil money is spent from one year to the next. With the government having spent more than the 3 per cent fiscal policy rule during the past two years, the fiscal impulse is thus expected to shrink over the next couple of years, regardless of who wins the election.

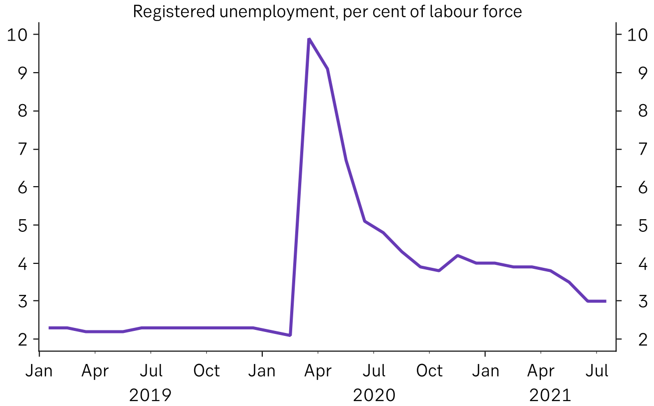
### Service consumption will assume the leading role

After zero or falling growth since November, private consumption rose 3.4 per cent in Q2, driven by both goods and service consumption. Due to the easing of restrictions, we now foresee a clear shift in consumption. Historically high savings, lower unemployment, unexpectedly strong wage growth and pent-up needs suggest a strong recovery in service consumption, which remains more than 10 per cent lower than before the COVID-19 crisis. In contrast, goods consumption has risen by 14 per cent since February last year. The labour market has improved in recent months. Registered unemployment fell in June to 3.0 per cent and was unchanged in July. This is down from 3.9 per cent in March 2021 and 9.9 per cent at the peak in March last year, but it is still higher than the jobless rate of slightly over 2 per cent that was the pre-crisis trend. New inbound travel restrictions – due to increased virus transmission this summer – may marginally hurt some labour market sectors in the coming months, but overall we foresee continued improvement this autumn. Labour Force Survey unemployment remains uncertain after a major restructuring of the survey, but we believe that it will continue to trend downward too, nearing pre-pandemic level towards the end of our forecast period.

**The manufacturing sector has slowed** recently, after surging in Q1. In the Business Tendency Survey for Q2, some manufacturing executives still said that pandemic-related problems such as inbound travel restrictions and component shortages were slowing production. But sentiment indicates strong performance for traditional manufacturing. Meanwhile the sector remains divided: traditional goods output is now 4 per cent above pre-pandemic levels while oil-related production is down 9 per cent. According to Statistics Norway's survey, however, oil industry operators have again revised their investment plans for 2021 upward. They are now indicating weak nominal growth after an initial decline of over 30 per cent. The outlook for 2022 remains bleak, but higher oil prices and the fiscal stimulus unveiled in June 2020 – aimed at boosting incentives for investment – appear to have helped the sector. We expect a slight decline in oil investments in 2021 and an increased downturn in 2022, before new projects lift investments in 2023. A recovery in residential investments will also contribute to a slight increase in mainland investment in both 2021 and 2022.

Rapid labour market improvement once restrictions are lifted

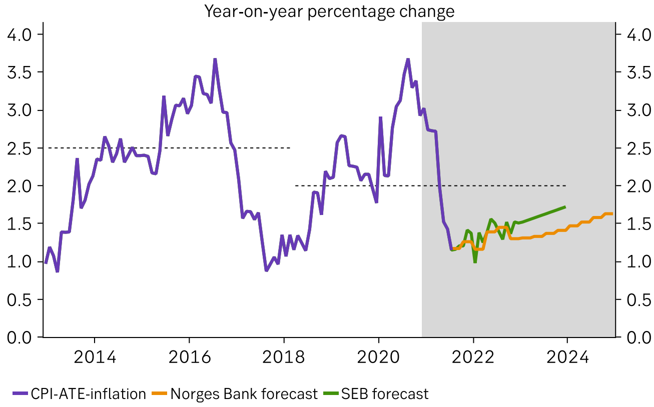
Registered unemployment, per cent of labour force




Source: Norwegian Labour and Welfare Administration (NAV), Macrobond, SEB

Falling inflation will not prevent Norges Bank key rate hikes

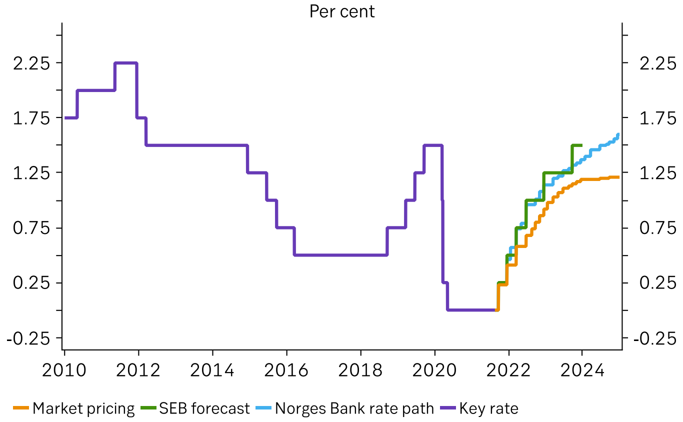
Year-on-year percentage change




Source: Bank of Norway (Norges Bank), Statistics Norway, Macrobond, SEB

Expectations for Norges Bank

Per cent




Source: Bank of Norway (Norges Bank), Macrobond, SEB

## Somewhat more subdued home price trend

After nearing their February 2017 peak and reaching year-on-year growth of 12.5 per cent this past March, existing home prices have shown a somewhat calmer trend. In July, seasonally adjusted prices fell by 0.2 per cent and the year-on-year upturn cooled to 8.5 per cent. We view this slowdown in light of Norges Bank's clear signals that a key interest rate hike is approaching and there is a better balance between supply and demand due to the price surge of the past year. We expect price increases to slow further this autumn and have revised our 2021 growth forecast for existing home prices slightly downward to 8.7 per cent. Over the next couple of years, we expect home prices to stabilise, as rising interest rates subdue demand and higher residential investments boost supply.

**Inflation remains below target.** Underlying CPI-ATE inflation fell from 3.7 per cent year-on-year in August 2020 to 1.1 per cent in July 2021. Last year's krone appreciation is the main driver, but base effects from large price increases in spring 2020 contributed to this dramatic shift. The cooldown has largely been in line with both our and Norges Bank's forecasts, and we both believe that CPI-ATE is now close to bottoming out. The outlook remains uncertain, and inflation is still being affected by some unusual price movements. Goods prices are still rising relatively fast, and earlier krone appreciation may push inflation down a bit more. Meanwhile, recent krone weakening poses an upside risk to our forecast towards the end of 2021. Overall, when downward pressure from the exchange rate fades early next year, underlying inflation will rise slightly. Gradually higher pay increases will also contribute to faster inflation in 2022 and 2023. We believe CPI-ATE will end up somewhat above Norges Bank's forecast for 2023, but we share the central bank's view that inflation will remain below its flexible 2 per cent target. Rising electricity prices have pushed up CPI this summer, and futures indicate that price increases will remain high until next spring. After that, CPI inflation will fall.

## Norges Bank delivers according to plan

Due to its flexible inflation target, Norges Bank can focus on growth and financial stability; below-target inflation is no obstacle to hiking the key rate. Due to faster economic recovery and rising home prices this past year, Norges Bank again revised its rate path at the June policy meeting and accelerated its projected rate hikes. According to plans, it will now hike the key rate in September and three more times to 1.0 per cent by June 2022, then slow its hikes considerably. By the end of 2024 the key rate will be 1.5 per cent. At its August interim meeting, Norges Bank confirmed a September increase but presented no new forecasts or rate path. Renewed uncertainty linked to COVID-19 transmission does not yet seem to have affected these plans for rapid rate hikes. As long as no new restrictions are introduced, we believe Norges Bank can deliver as planned. The bank is eager to leave its crisis interest rate behind, since the output gap is already expected to close this autumn. The fact that home price increases have slowed somewhat more than its June forecast should not be a concern either, since the bank has predicted a much calmer trend in the future. We foresee a key interest rate of 0.50 per cent at the end of this year, 1.25 per cent at the end of 2022 and 1.50 per cent at the end of 2023. Norges Bank thus stands out as a pacesetter in the central bank world.

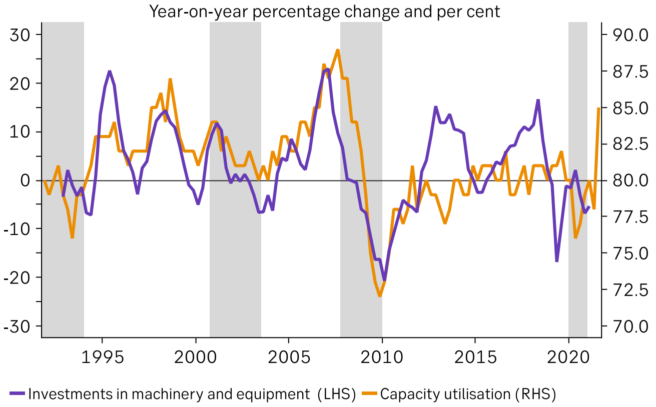
# Denmark

# Fast reopening

Growth continues to improve, driven by a faster than expected reopening. We are raising our 2021 GDP growth estimate but lowering our 2022 forecast slightly. We expect GDP to exceed its pre-pandemic trend level in 2023. Wage inflation will increase as the labour market improves. The krone's continued strength is likely to lead to a key rate cut in 2022, but we believe that in the near term, Danmarks Nationalbank will continue intervening in the FX market.

Capacity utilisation suggests higher business investment

Year-on-year percentage change and per cent




Source: Statistics Denmark, Macrobond, SEB

**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -2.1 | 3.6 | 4.1 | 2.5 |
| CPI | 0.4 | 1.4 | 1.4 | 1.7 |
| Wages and salaries | 1.9 | 2.4 | 3.1 | 3.5 |
| Public sector fiscal balance* | -3.0 | -2.0 | 0.0 | 2.0 |
| Public sector debt* | 44.0 | 41.0 | 38.0 | 35.0 |
| Current account* | 7.5 | 7.5 | 8.0 | 7.5 |
| Key interest rate (CD rate), % | -0.50 | -0.50 | -0.60 | -0.60 |
| EUR/DKK** | 7.44 | 7.43 | 7.43 | 7.46 |

*% of GDP **Year-end Source: Statistics Denmark, DØRS, SEB

**Growth returning to pre-pandemic trend.** According to the preliminarily GDP indicator, Q2 2021 showed unexpectedly high growth of 2.2 per cent due to a faster than anticipated reopening, which we believe has frontloaded a bounce in activity. Over the summer, removal of restrictions has continued at a slightly more rapid pace than originally projected. By September almost all restrictions will be gone. We have revised our 2021 GDP growth estimate from 3.0 to 3.6 per cent – while lowering our 2022 forecast from 4.5 to 4.1 per cent. In 2023, we expect GDP to return to its pre-pandemic expansion trend.

**Vaccines pave way for full reopening.** The faster than expected reopening reflects a favourable trend in the pandemic. The surge in COVID-19 seen in some European countries this summer has largely been absent despite the spread of the Delta variant. Vaccines continue to hold down hospitalisations. Denmark is among the leaders in Europe, with close to 66 per cent of the population fully vaccinated. We expect a full reopening before the end of 2021.

**Robust consumption pattern persists.** During the spring, consumer confidence rose sharply as households' assessment of the current economic situation improved. Positive drivers remain in place. Unemployment declined by close to one percentage point, home prices are still posting double digit gains and banks continue to ease credit conditions. Meanwhile, the household savings ratio reached a new record high of 12.9 per cent in Q1, before the reopening started. We thus expect private consumption to continue very robust growth in the coming quarters.

**Housing market cools off.** The housing market seems to have cooled off somewhat over the summer after soaring last spring. Apartment prices in Copenhagen have edged lower, but the supply of homes for sales remain very limited and banks seem to be more than willing to extend mortgage loans. The Systemic Risk council has so far not announced any measures to tighten access to mortgage loans and the summer has seen 30-year fixed rate mortgage interest come down again.

**Business investments set to rebound.** Business investments are likely to rebound sharply from the pandemic setback and return to a more normal role as a driver of domestic demand. Capacity utilisation has reached its highest level since 2008 after almost a decade stuck in neutral gear. Corporate leaders are more optimistic than at any point since the global financial crisis, and profits are at an all-time high. Thus, the conditions for a large increase in investments are present.

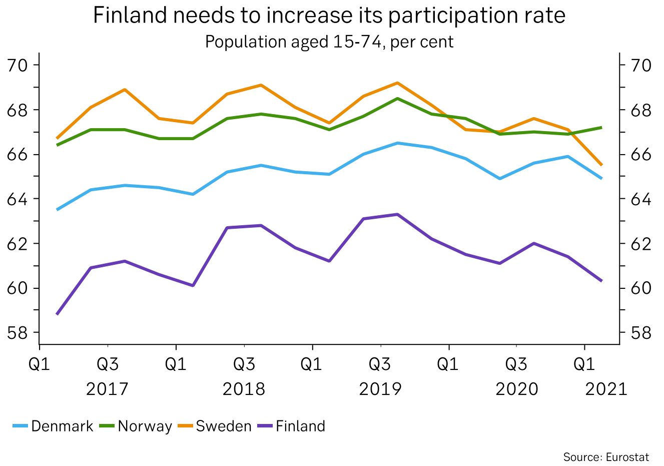
**Wage inflation set to rise.** Denmark's headline CPI inflation is now below 2 per cent, while core inflation is below 1 per cent. The labour market continues to improve, with unemployment falling from just above 6 per cent nearly to 5 per cent in just a few months. Companies are reporting some difficulties attracting labour, but unemployment is still 2 percentage points above its low in the last cycle. We expect wage inflation to reach 3.5 per cent in 2023.

**Rate cut likely in 2022.** Economic policy remains supportive of growth, but the government is under growing pressure to introduce a modest tightening in the 2022 budget, which will be unveiled shortly. The Danish krone remains under appreciation pressure and Danmarks Nationalbank has continued to intervene by selling DKK over the summer with the total amount of more than DKK 50 billion. This has restored sector liquidity, but the total intervention is still some DKK 25 billion less than the intervention in the opposite direction last year. We now believe that a 10-basis point rate cut is likely next year, but only after a full reversal of the 2020 intervention. Thus, in the near term the central bank will continue selling DKK.

# Finland

# A moderate recovery

While Finland's recession in 2020 was among the mildest in the euro area, the recovery has been somewhat less impressive. In 2021 GDP will grow by a moderate 3.2 per cent, followed by a 3.0 per cent rise in 2022. In 2023 growth will fall back to its long-term growth rate, with GDP increasing by 1.6 per cent.




**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -2.9 | 3.2 | 3.0 | 1.6 |
| Private consumption | -4.7 | 3.5 | 3.2 | 1.5 |
| Exports | -6.7 | 5.8 | 5.0 | 4.0 |
| Unemployment* | 7.8 | 7.8 | 7.2 | 6.8 |
| Wages and salaries | 1.8 | 2.4 | 2.2 | 2.0 |
| HICP inflation | 0.3 | 2.0 | 1.5 | 1.2 |
| Public sector fiscal balance** | -5.4 | -4.0 | -2.5 | -2.0 |
| Public sector debt** | 69.2 | 71.0 | 70.5 | 70.0 |

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

**Strong Q2 and almost back at pre-pandemic level.** The Finnish economy stumbled in early 2021. Compared to a year earlier, GDP declined by 1.8 per cent in the first quarter, but growth returned in Q2 and GDP almost reached its pre-pandemic level. Looking at a broader set of economic indicators, the overall recovery has been somewhat less impressive than in neighbouring countries such as Sweden or Estonia. Yet in both 2021 and 2022 GDP growth will exceed 3 per cent, ending up close to its long-term trend in 2023.

**Finland may be one of the few countries not harmed by lower tourism.** Compared to southern Europe, the contribution of tourism to GDP is relatively small. On other hand, the Finns themselves have previously been very keen to escape to warmer climates during holidays. This year, many have decided to stay home, supported by the very conservative approach the government has taken on cross-border travel. Now much of the money usually spent on holidays abroad has instead flowed into the domestic economy, boosting retail sales but also services. Due to continued uncertainty over the COVID-19 situation, these trends are likely to persist for some time. In 2021, private consumption will increase by 3.5 per cent, slowing to 3.2 per cent growth in 2022 and 1.5 per cent in 2023.

**Exports continue to improve in line with the global economy.** Finnish manufacturers managed to stave off a large decline in output during the spring of 2020. Yet now, when a broad-based increase in demand has lifted production above pre-pandemic levels in many countries, Finland's industrial production remains below its 2019 level. This can be partly explained by the less than impressive growth figures seen in the important paper industry. However, improving sentiment and order books hint at better outcomes in the second half of 2021, when industrial production and exports will gain further momentum. Manufacturers will also benefit from surging export prices. In addition, net exports will increase thanks to somewhat slower import growth. In 2021 exports will increase by 5.8 per cent, while in 2022 and 2023 they will grow by 5 per cent and 4 per cent respectively.

**Investments are tilted towards construction.** In Q2 the number of new housing starts was the highest ever recorded. The same goes for new building permits. While few observers expected the business sector to be very active in making investments this year, corporate borrowing is picking up, implying that at least some companies seem eager to use the current low interest rate environment to their benefit. The government is trying to strike a balance between providing enough stimulus and containing higher budget deficits and debt. More investments are widely regarded as a precondition to sustained economic growth in the coming years, since productivity growth is weak and the working age population is declining. In 2021, capital spending will increase by 2.3 per cent.

**The labour market is quickly recovering**. In June, unemployment dropped below 8 per cent for the first time since the beginning of the COVID-19 crisis. It will continue this downward trend but will not reach its pre-crisis lows until 2023. More troublesome than reducing unemployment is boosting employment. Finland's labour market participation rate is by far the lowest among the Nordic countries, instead remaining at southern European levels. Meanwhile the number of vacancies in Q2 2021 was 50 per cent higher than in Q2 2020 and 20 per cent higher than in Q2 2019.

**Government debt will remain high.** Finland's government has not been among most generous in spending its way out of the crisis, but public finances have nevertheless taken a hit. Government debt will not fall below 70 per cent of GDP in 2023.

# The Baltics

## Lithuania

Lithuania is showing continued robust growth after a relatively small decline during 2020. Sanctions against Belarus pose a risk, but their economic impact will probably be minor. The labour market is showing clear improvement.

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## Latvia

Latvia's recovery is continuing. Exports are benefiting from strong demand for building materials. The labour market is improving, but high pay increases may create competitiveness problems.  Slow vaccinations will put a lid on activity.

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## Estonia

Thanks to a rapid recovery, Estonia's GDP is already back at its pre-pandemic level, but supply side restrictions will hamper future growth. Large pay-outs from the pension system are on their way and will boost consumption.

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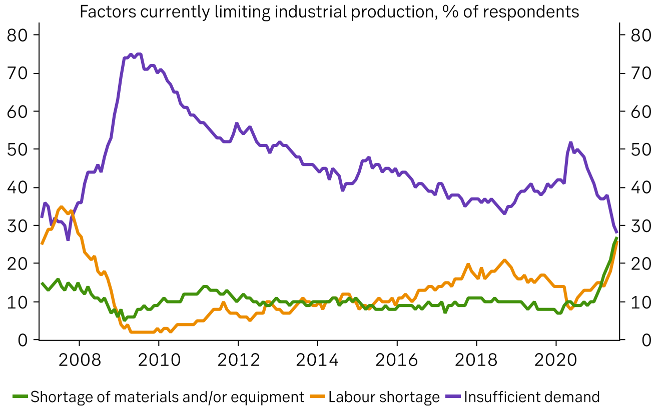
# Lithuania

# Geopolitical tensions on top of the pandemic

GDP growth was slightly below projections in Q2 despite strong industrial production, retail sales and construction data. The current sanctions on Belarus will have a minor impact on Lithuania's economy. Employment will continue to increase over the coming quarters. Annual headline inflation will peak this coming winter at above 5 per cent. Home prices are surging, and discussions will start on what measures can prevent overheating. Fiscal policy will depend on the strength of the recovery.

Robust demand, but labour and materials supply issues

Factors currently limiting industrial production, % of respondents




Source: Statistics Lithuania, Macrobond, SEB

**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -0.9 | 4.3 | 3.6 | 3.3 |
| Private consumption | -2,0 | 4.1 | 4.2 | 3.4 |
| Exports | 0,0 | 10.2 | 4.4 | 4.2 |
| Unemployment* | 8.5 | 7.2 | 6.6 | 6.2 |
| Wages and salaries | 10.1 | 9.5 | 7.5 | 6.5 |
| HICP inflation | 1.1 | 3.4 | 3.5 | 2.3 |
| Public sector fiscal balance** | -7.4 | -6.4 | -3.2 | -2.8 |
| Public sector debt** | 47.1 | 48.6 | 47.9 | 50.5 |

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

**A robust summer for Lithuania's economy.** Few restrictions, a rapid recovery in private consumption and surprisingly strong industrial production have supported economic growth in recent months. Although the flash estimate of 0.4 per cent GDP growth in the second quarter of 2021 was below our forecast, we must recall that in Q1 the economy jumped by 2.2 per cent, while there was a 0.3 per cent downturn in the euro area. The vaccination rate in Lithuania is slightly behind Nordic or Western European countries, and the Delta variant clearly poses concerns. We are marginally lowering our 2021 GDP growth forecast from 4.6 to 4.3 per cent due to the weaker Q2 figure, but we remain cautiously optimistic about the second half of this year. In 2022 we expect GDP to rise by 3.6 and in 2023 by 3.3 per cent.

**Record capacity utilisation in manufacturing**. Industrial production is already 15 per cent above the pre-pandemic level. However, a slowdown in this growth rate is inevitable in the coming months. First, manufacturers are already operating at record-high capacity utilisation levels. Second, supply chain problems are expected to persist until at least the end of this year. Third, the number of companies complaining about a labour shortage is historically high. All these issues should drive business investments, which we expect to increase during the next couple of years.

**Manageable economic impact from the deteriorating relationship with Belarus**. EU sanctions on Belarus have had a very negligible impact on Lithuania's economy so far, but a stronger effect is expected from US sanctions. Transit and handling of Belarusian potash fertilisers is very likely to end in December, leading to a sharp drop in exports of railway and cargo handling services. The estimated impact on Lithuania's economy from the loss of this cargo is up to 0.3 per cent of GDP. Tensions with Belarus are still rising and further negative economic effects are possible.

**Labour market keeps on improving.** Unemployment was 7.4 per cent in Q2. Although this is still above the pre-pandemic level, the vacancy rate is historically high. We still believe that the jobless rate will reach its pre-pandemic level only in 2023. Average gross wage in 2021 is expected to rise by 9.5 per cent – only marginally smaller growth than in 2020. Unlike the past two years, in 2022 private sector pay will increase more than public sector pay. We expect the monthly minimum wage to rise by at least 9.5 per cent in 2022.

**Inflation has accelerated.** Annual HICP inflation jumped to 4.3 per cent in July due to sharp energy price increases. Meanwhile core inflation stood at 2.6 per cent and has been quite stable since spring. As expected, the decrease in the VAT rate from 21 to 9 per cent on catering services from July 1 had no impact on inflation. We expect headline inflation to exceed 5 per cent this autumn. Inflation will average 3.4 per cent in 2021. In 2022 inflation will average 3.5 per cent, since it is already clear that household electricity and natural gas prices will climb and service prices will accelerate, too.

**Increased focus on the housing market**. In July, the average price of apartments in Vilnius was up by 15 per cent from the year-earlier level. The economic environment is projected to remain favourable for historically strong home price growth in the coming quarters. However, some proactive measures from the central bank are expected in order to prevent the housing market from overheating.

**Smaller budget deficit on the horizon.** The government will continue its targeted stimulus measures for individuals and businesses, but we assume that utilisation will be relatively low. Since Lithuania will not apply its fiscal discipline rules in 2022, the year's budget deficit will remain slightly above 3 per cent of GDP.

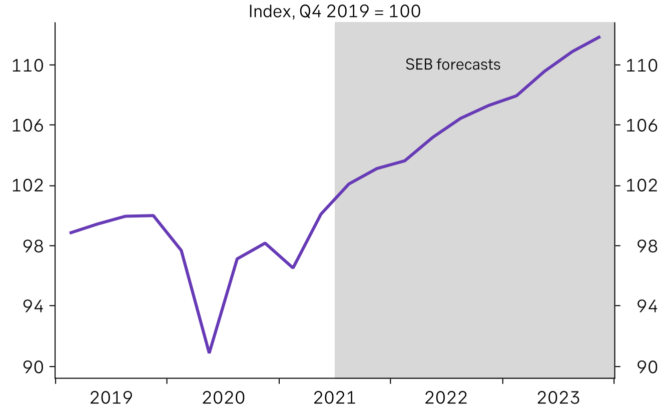
# Latvia

## Back on its feet

Strong growth in the second quarter of 2021 brought the economy back to its pre-crisis level. Exports and higher capital spending will drive growth. A slowing pace of COVID-19 vaccinations will sustain high uncertainty, putting a lid on activity and private consumption. The labour market is recovering. Wage growth will accelerate, outpacing faster inflation. GDP will increase by 4.3 per cent in 2021, pick up to 5.2 per cent growth in 2022 and then retreat to 4.2 per cent in 2023.

GDP is back to pre-crisis levels

Index, Q4 2019 = 100




Source: Macrobond, SEB

**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -3.6 | 4.3 | 5.2 | 4.2 |
| Private consumption | -10.0 | 5.5 | 6.0 | 4.7 |
| Exports | -2.7 | 4.9 | 5.2 | 4.3 |
| Unemployment* | 8.1 | 7.8 | 7.2 | 6.4 |
| Wages and salaries | 6.2 | 7.0 | 7.5 | 7.5 |
| HICP inflation | 0.1 | 2.4 | 2.5 | 1.8 |
| Public sector fiscal balance** | -4.5 | -8.1 | -3.7 | -2.1 |
| Public sector debt** | 43.5 | 49.2 | 48.5 | 46.5 |

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

**Surprisingly strong growth**. The economy was quickly back on its feet in Q2, with GDP surging by 10.3 per cent year-on-year. Manufacturing sectors rose by 6.7 per cent and services by 11.3 per cent. Somewhat unexpectedly, the strength of the rebound brought the economy above pre-crisis levels. From April onwards, there were strong signs of economic recovery. In June economic sentiment jumped to among its highest levels in more than a decade, but it declined in July as survey respondents adjusted to the new normal. Sentiment fell in services and manufacturing but improved in retail and construction. This year we expect the economy to grow by 4.3 per cent. Next year it will speed up to 5.2 per cent growth, then slow to 4.2 per cent in 2023. The recovery is expected to stabilise in the second half of 2021, but downside risks are still elevated. Despite vaccinations being under way, their pace is slowing. This makes new waves of restrictions unavoidable. The most affected sectors – catering, accommodation, entertainment and leisure – will stabilise, but a full recovery will take longer. The downturn will continue in the transport and storage sector, since transit cargo volume is still in decline. Construction faces overheating risks due to an approaching EU fund tsunami and other big projects such as Rail Baltica. Some 65 per cent of the EU Recovery Fund's EUR 1.82 billion will be spent on infrastructure projects.

**Construction-related exports in the limelight.** Exports remain a key driver for the manufacturing sector, while consumption is still restrained. In June retail sales rose by a mediocre 5.9 per cent. Spending patterns are cautious, while deposits in the banking sector continue piling up. In June exports of goods increased by 31.7 per cent, with solid increases for all major categories except pharmaceuticals. Growth in wood product exports was particularly spectacular: 87 per cent. An approaching worldwide construction boom means that the demand for various materials used in construction, including timber, will be strong. Manufacturing was up by 10.9 per cent in June. The good news is that there was a significant increase in production in the high and medium-high technology sectors. The medium-term outlook remains clearly positive. The primary challenges are how to deal with labour shortages, rising costs, supply chain disruptions and infection risks.

**Competitiveness issues are likely to become even more pressing**. In the first quarter, wages were somewhat surprisingly up by 9.5 per cent. The number of low-income earners has decreased significantly, but those who receive more than the average wage increased. There is a threat of wider income disparities and greater inequality. Although the economy is recovering, fiscal stimulus measures are more lavish than last year. We expect this year's budget deficit to reach 8.1 per cent of GDP. Tax revenue was up by 8.8 per cent in the first six months of this year.

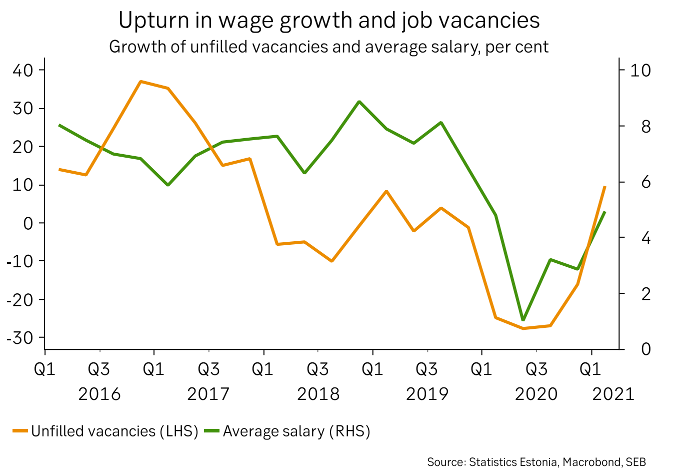
**The labour market has passed the most difficult stage**, with unemployment falling by 0.2 percentage points to 7.9 per cent in the second quarter. Despite strong GDP growth, the pace of improvement has been very cautious. Due to structural issues, improvements in the labour market will be quite gradual.

**Higher energy and food prices are raising frustration.** Higher prices for transport, housing and food pushed up inflation to 2.8 per cent in July. Food inflation has been among the highest in the EU, but there is no indication of an uncontrolled rise. After a period of low inflation, this increases frustration and undermines purchasing power amid conditions of uncertainty. Although inflation will still lag behind wage growth, certain support measures for socially vulnerable groups should be considered. By the end of the year, inflation will peak just above 4 per cent and then gradually ease.

# Estonia

# Swift recovery, but supply side constraints

The Estonian economy has undergone a swift recovery, with GDP surpassing its pre-crisis level as early as Q1 2021. Due to strong exports and high domestic demand, GDP growth is expected reach 6.6 per cent this year. The same factors will continue driving the economy at least until the second half of next year. After that, old problems like low productivity and labour shortages will return, limiting further growth. In 2022 growth will reach 4.5 per cent, slowing to 2.5 per cent in 2023.




**Key data**

Year-on-year percentage change

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP | -2.9 | 6.6 | 4.5 | 2.5 |
| Private consumption | -2.3 | 4.8 | 7.3 | 3.5 |
| Exports | -5.0 | 9.5 | 5.0 | 5.0 |
| Unemployment* | 6.8 | 6.7 | 5.8 | 5.2 |
| Wages and salaries | 2.9 | 5.7 | 6.2 | 5.5 |
| HICP inflation | -0.6 | 3.2 | 2.7 | 2.3 |
| Public sector fiscal balance** | -4.8 | -3.8 | -2.5 | -2.0 |
| Public sector debt** | 18.2 | 20.8 | 24.2 | 27.5 |

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

**The speed of the economic recovery has been surprising**. Against all odds, GDP surged by 5.4 per cent during the first quarter of 2021 compared to a year earlier, fuelled by large gains in the IT sector and domestic trade. The Q2 national accounts are being released on the same day as SEB's *Nordic Outlook*, but due to a low comparison base, a double-digit growth figure is likely. Economic activity will also remain very high this autumn when – as the result of a controversial reform – a large proportion of pension savings will find its way into consumption. The main risk to our optimistic growth scenario is of course related to COVID-19. Estonia was one of the pacesetters in vaccination campaigns last spring, but the process stalled significantly in the summer. By mid-August just over 50 per cent of the population had received at least one dose of vaccine. The government has vowed to keep society as open as possible, but this of course depends on the ability of the medical system to deal with an increasing number of patients.

**The consequences of the pension reform will soon be revealed.** Under the pension system reform, people who decided to withdraw their 2nd pension pillar savings will receive a total of almost one billion euros in their bank accounts during September. Predicting exactly how the money will flow into the economy is tricky, but a shopping spree seems imminent. This will boost private consumption by 4.8 per cent in 2021 and 7.3 per cent in 2022. In 2023 this growth will ease to 3.5 per cent, in line with the economy.

**Industry is struggling to meet high demand**. Double-digit growth in both industrial production and exports has continued, even as the effect of last year's low comparison base receded. High demand will persist, since order books are full. Sentiment among manufacturers now stands at a level last seen at the peak of the 2007 economic boom. This will translate into 9.5 per cent export growth in 2021. From there, growth will slow to 5 per cent in 2022. Yet this will not hide the problem of very low productivity in the manufacturing sector, which will again inhibit further growth when the current boom comes to an end. The contribution of net exports to GDP will also be lower than usual, due to increased demand for imports driven by the temporary jump in household consumption.

**Two-tiered labour market**. Although unemployment is on the decline, it remains far above the level seen before the COVID-19 crisis. This is mostly caused by continued weakness in the tourism industry. However, in many other sectors the competition for employees is as fierce as before the crisis, putting further pressure on wage growth. While the previous extremely low unemployment rate will not be reached even by 2023, the growth in average pay will exceed 5 per cent as early as this year.

**Capital spending surge**. Due to very large investments by an automotive industry giant, this year's growth in capital spending will reach double-digit figures. The investment upturn is also supported by accelerating construction activity, mostly due to a rebound in the housing market. High demand for new homes will, however, prove short-lived because of rapidly changing demography.

**High energy prices are driving inflation. I**n the first half of 2021 inflation averaged less than 2 per cent, but due to a low comparison base in the second half, HICP will increase by 3.2 per cent in 2021. High economic activity during the first half of 2022 will continue to raise prices, but we expect inflation of only 2.3 per cent in 2023.

**Elections are on the agenda**. In October, Estonia will choose a new president as well as new municipal councils. While the economic impact of both elections will be limited, they will set the tone in political life. While in early spring there was discussion of the need for budget cuts, large tax receipts have toned down such concerns.

# Key indicators

# Global key indicators

Yearly change in per cent

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GDP OECD | -4.7 | 5.1 | 4.0 | 2.3 |
| GDP world (PPP) | -3.4 | 5.9 | 4.4 | 3.4 |
| CPI OECD | 1.3 | 3.2 | 2.9 | 2.3 |
| Oil price, Brent (USD/barrel) | 43 | 67.4 | 62.5 | 57.5 |

# US

Yearly change in per cent

| | 2020 level, USD bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 20,894 | -3.4 | 6.0 | 4.2 | 2.1 |
| Private consumption | 14,048 | -3.8 | 7.5 | 2.8 | 2.3 |
| Public consumption | 3,078 | 2.0 | 1.8 | 2.4 | 1.4 |
| Gross fixed investment | 4,479 | -2.0 | 7.5 | 5.1 | 3.1 |
| Stock building (change as % of GDP) | -60 | -0.6 | -0.2 | 0.6 | -0.2 |
| Exports | 2,123 | -13.6 | 6.7 | 9.0 | 4.3 |
| Imports | 2,775 | -8.9 | 12.9 | 4.7 | 4.4 |
| | | | | | |
| Unemployment (%) | | 8.1 | 5.4 | 3.9 | 3.4 |
| Consumer prices | | 1.3 | 4.4 | 3.7 | 2.4 |
| Core CPI | | 1.7 | 3.5 | 3.4 | 2.3 |
| Household savings ratio (%) | | 16.6 | 14.3 | 8.3 | 7.7 |
| Public sector financial balance, % of GDP | | -15.5 | -15.0 | -8.0 | -5.0 |
| Public sector debt, % of GDP | | 127 | 132 | 132 | 133 |

# Euro area

Yearly change in per cent

| | 2020 level, EUR bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 11,359 | -6.4 | 4.6 | 4.3 | 2.5 |
| Private consumption | 5,905 | -7.9 | 5.0 | 4.8 | 2.3 |
| Public consumption | 2,573 | 1.4 | 3.0 | 0.0 | 1.0 |
| Gross fixed investment | 2,488 | -7.4 | 4.0 | 5.0 | 4.1 |
| Stock building (change as % of GDP) | 0 | -0.5 | 0.1 | 0.0 | 0.0 |
| Exports | 5,177 | -9.0 | 10.0 | 6.0 | 4.0 |
| Imports | 4,751 | -8.9 | 10.0 | 5.0 | 4.0 |
| | | | | | |
| Unemployment (%) | | 7.9 | 8.1 | 7.8 | 7.4 |
| Consumer prices | | 0.3 | 2.3 | 2.1 | 1.7 |
| Core CPI | | 0.7 | 1.4 | 1.5 | 1.5 |
| Household savings ratio (%) | | 19.5 | 17.6 | 13.6 | 13.0 |
| Public sector financial balance, % of GDP | | -7.2 | -6.5 | -3.9 | -3.1 |
| Public sector debt, % of GDP | | 98.0 | 102.5 | 100.9 | 98.8 |

## Other large countries

Yearly change in per cent

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| **GDP** | | | | |
| United Kingdom | -9.8 | 7.0 | 5.8 | 2.2 |
| Japan | -4.7 | 2.5 | 2.3 | 1.2 |
| Germany | -4.6 | 2.8 | 4.8 | 2.6 |
| France | -7.9 | 5.8 | 3.5 | 2.5 |
| Italy | -8.9 | 5.5 | 3.9 | 2.4 |
| China | 2.3 | 8.6 | 5.6 | 5.4 |
| India | -7.1 | 8.9 | 6.3 | 4.9 |
| Brazil | -4.1 | 5.3 | 2.5 | 2.2 |
| Russia | -3.1 | 4.3 | 2.9 | 2.0 |
| Poland | -2.7 | 5.0 | 4.6 | 4.0 |
| | | | | |
| **Inflation** | | | | |
| United Kingdom | 0.9 | 2.1 | 2.4 | 1.9 |
| Japan | 0.0 | -0.2 | 0.6 | 0.7 |
| Germany | 0.4 | 2.9 | 2.0 | 1.6 |
| France | 0.5 | 1.8 | 1.6 | 1.2 |
| Italy | -0.2 | 1.6 | 1.8 | 1.6 |
| China | 2.5 | 1.5 | 2.1 | 2.2 |
| India | 6.6 | 5.1 | 4.8 | 4.7 |
| Brazil | 3.2 | 7.5 | 5.0 | 3.5 |
| Russia | 3.4 | 5.9 | 4.5 | 4.0 |
| Poland | 3.4 | 4.0 | 3.5 | 3.0 |
| | | | | |
| **Unemployment** (%) | | | | |
| United Kingdom | 4.5 | 5.0 | 4.9 | 4.2 |
| Japan | 2.8 | 2.8 | 2.6 | 2.5 |
| Germany | 3.8 | 3.9 | 3.9 | 3.7 |
| France | 7.8 | 8.5 | 8.6 | 8.6 |
| Italy | 9.3 | 10.0 | 9.8 | 9.8 |

## Financial forecasts

| **Official interest rates** | | 26-Aug | Dec-21 | Jun-22 | Dec-22 | Jun-23 | Dec-23 |
|---|---|---|---|---|---|---|---|
| US | Fed funds | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.75 |
| Japan | Call money rate | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 |
| Euro area | Refi rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| United Kingdom | Repo rate | 0.10 | 0.10 | 0.25 | 0.25 | 0.50 | 0.75 |
| | | | | | | | |
| **Bond yields** | | | | | | | |
| US | 10 years | 1.35 | 1.50 | 1.80 | 2.00 | 2.10 | 2.20 |
| Japan | 10 years | 0.02 | 0.05 | 0.05 | 0.05 | 0.10 | 0.10 |
| Germany | 10 years | -0.46 | -0.35 | -0.20 | -0.10 | 0.10 | 0.20 |
| United Kingdom | 10 years | 0.69 | 0.65 | 0.80 | 0.90 | 1.10 | 1.20 |
| | | | | | | | |
| **Exchange rate** | | | | | | | |
| USD/JPY | | 110 | 111 | 112 | 113 | 114 | 115 |
| EUR/USD | | 1.18 | 1.16 | 1.15 | 1.13 | 1.14 | 1.15 |
| EUR/JPY | | 129 | 121 | 122 | 118 | 121 | 124 |
| EUR/GBP | | 0.86 | 0.84 | 0.83 | 0.82 | 0.82 | 0.83 |
| GBP/USD | | 1.37 | 1.38 | 1.39 | 1.38 | 1.39 | 1.39 |

## Sweden

Yearly change in per cent

| | 2020 level, SEK bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 4,977 | -2.8 | 4.6 | 3.9 | 2.3 |
| Gross domestic product, working day adjustment | | -3.0 | 4.6 | 3.9 | 2.4 |
| Private consumption | 2,187 | -4.7 | 4.7 | 3.7 | 2.2 |
| Public consumption | 1,332 | -0.6 | 1.9 | 1.2 | 1.2 |
| Gross fixed investment | 1,234 | -0.4 | 6.0 | 7.0 | 5.0 |
| Stock building (change as % of GDP) | 0 | -0.7 | 0.6 | 0.2 | 0.0 |
| Exports | 2,221 | -4.6 | 9.6 | 7.0 | 4.3 |
| Imports | 1,991 | -5.7 | 10.7 | 7.7 | 5.2 |

| | | | | |
|---|---|---|---|---|
| Unemployment, (%) | 8.8 | 8.8 | 7.8 | 7.5 |
| Employment | -1.3 | 1.4 | 1.6 | 0.7 |
| Industrial production | -3.9 | 7.0 | 6.0 | 3.0 |
| CPI | 0.5 | 1.8 | 1.4 | 1.5 |
| CPIF | 0.5 | 2.0 | 1.5 | 1.5 |
| Hourly wage increases | 1.7 | 2.8 | 2.5 | 2.8 |
| Household savings ratio (%) | 17.7 | 17.9 | 17.1 | 16.8 |
| Real disposable income | -0.6 | 4.7 | 3.0 | 1.5 |
| Current account, % of GDP | 5.7 | 5.5 | 5.0 | 4.5 |
| Central government borrowing, SEK bn | 221 | -15 | -50 | -20 |
| Public sector financial balance, % of GDP | -3.0 | -1.2 | -0.7 | -0.7 |
| Public sector debt, % of GDP | 39.7 | 37.6 | 34.6 | 32.5 |

| Financial forecasts | 26-Aug | Dec-21 | Jun-22 | Dec-22 | Jun-23 | Dec-23 |
|---|---|---|---|---|---|---|
| Repo rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 3-month interest rate, STIBOR | -0.01 | -0.10 | -0.05 | -0.10 | -0.05 | -0.10 |
| 10-year bond yield | 0.09 | 0.20 | 0.30 | 0.35 | 0.55 | 0.65 |
| 10-year spread to Germany, bps | 55 | 55 | 50 | 45 | 45 | 45 |
| USD/SEK | 8.70 | 8.71 | 8.65 | 8.76 | 8.64 | 8.52 |
| EUR/SEK | 10.23 | 10.10 | 9.95 | 9.90 | 9.85 | 9.80 |
| KIX | 115.1 | 114.3 | 112.9 | 112.9 | 112.1 | 111.2 |

## Finland

Yearly change in per cent

| | 2020 level, EUR bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 237 | -2.9 | 3.2 | 3.0 | 1.6 |
| Private consumption | 120 | -4.7 | 3.5 | 3.2 | 1.5 |
| Public consumption | 58 | 1.2 | 1.8 | 1.0 | 1.0 |
| Gross fixed investment | 56 | -0.7 | 2.5 | 3.5 | 1.0 |
| Stock building (change as % of GDP) | 1 | 0.2 | 0.2 | 0.0 | 0.0 |
| Exports | 85 | -6.7 | 5.8 | 5.0 | 4.0 |
| Imports | 84 | -6.4 | 5.5 | 4.0 | 3.0 |

| | | | | |
|---|---|---|---|---|
| Unemployment, OECD harmonised (%) | 7.8 | 7.8 | 7.2 | 6.8 |
| CPI, harmonised | 0.3 | 2.0 | 1.5 | 1.2 |
| Hourly wage increases | 1.8 | 2.4 | 2.2 | 2.0 |
| Current account, % of GDP | 0.8 | 0.3 | -0.2 | -0.2 |
| Public sector financial balance, % of GDP | -5.4 | -4.0 | -2.5 | -2 |
| Public sector debt, % of GDP | 69.2 | 71.0 | 70.5 | 70 |

## Norway

Yearly change in per cent

| | 2020 level, NOK bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 3,557 | -0.8 | 2.7 | 3.7 | 1.9 |
| Gross domestic product (Mainland) | 2,929 | -2.5 | 3.7 | 3.7 | 1.4 |
| Private consumption | 1,441 | -6.9 | 3.4 | 8.2 | 2.8 |
| Public consumption | 856 | 1.7 | 3.4 | 0.8 | 0.5 |
| Gross fixed investment | 857 | -3.8 | 0.2 | 1.5 | 5 |
| Stock building (change as % of GDP) | | -1.0 | 0.7 | 0.0 | 0.0 |
| Exports | 1,350 | -0.5 | 2.4 | 4.4 | 1.9 |
| Imports | 1,057 | -11.9 | 4.0 | 6.3 | 4 |
| | | | | | |
| Unemployment (%) | | 4.6 | 4.4 | 4.0 | 3.8 |
| CPI | | 1.3 | 3.3 | 1.9 | 1.6 |
| CPI-ATE | | 3.0 | 1.7 | 1.4 | 1.6 |
| Annual wage increases | | 3.1 | 2.8 | 2.9 | 3.1 |

| Financial forecasts | 26-Aug | Dec-21 | Jun-22 | Dec-22 | Jun-23 | Dec-23 |
|---|---|---|---|---|---|---|
| Deposit rate | 0.00 | 0.50 | 1.00 | 1.25 | 1.25 | 1.50 |
| 10-year bond yield | 1.24 | 1.35 | 1.40 | 1.50 | 1.70 | 1.80 |
| 10-year spread to Germany, bps | 170 | 170 | 160 | 160 | 160 | 160 |
| USD/NOK | 8.84 | 8.71 | 8.65 | 8.76 | 8.64 | 8.52 |
| EUR/NOK | 10.39 | 10.20 | 10.10 | 10.05 | 10.00 | 9.95 |

## Denmark

Yearly change in per cent

| | 2020 level, DKK bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 2,330 | -2.1 | 3.6 | 4.1 | 2.5 |
| Private consumption | 1,042 | -1.4 | 2.2 | 5.0 | 2.1 |
| Public consumption | 574 | -1.7 | 0.9 | 0.8 | 0.8 |
| Gross fixed investment | 521 | 5.1 | 6.3 | 7.7 | 5.4 |
| Stock building (change as % of GDP) | | -0.1 | -0.1 | 0.0 | 0.0 |
| Exports | 1,278 | -6.9 | 6.5 | 4.7 | 4.1 |
| Imports | 1,128 | -4.1 | 5.5 | 5.6 | 4.9 |
| | | | | | |
| Unemployment, OECD harmonised (%) | | 6.0 | 4.6 | 4.2 | 3.8 |
| CPI, harmonised | | 0.4 | 1.4 | 1.4 | 1.7 |
| Hourly wage increases | | 1.9 | 2.4 | 3.1 | 3.5 |
| Current account, % of GDP | | 7.5 | 7.5 | 8.0 | 7.5 |
| Public sector financial balance, % of GDP | | -3.0 | -2.0 | 0.0 | 2.0 |
| Public sector debt, % of GDP | | 44.0 | 41.0 | 38.0 | 35.0 |

| Financial forecasts | 26-Aug | Dec-21 | Jun-22 | Dec-22 | Jun-23 | Dec-23 |
|---|---|---|---|---|---|---|
| Deposit rate | -0.50 | -0.50 | -0.50 | -0.60 | -0.60 | -0.60 |
| 10-year bond yield | -0.20 | -0.09 | 0.03 | 0.10 | 0.30 | 0.40 |
| 10-year spread to Germany, bps | 26 | 26 | 23 | 20 | 20 | 20 |
| USD/DKK | 6.33 | 6.42 | 6.46 | 6.58 | 6.54 | 6.49 |
| EUR/DKK | 7.44 | 7.45 | 7.43 | 7.43 | 7.46 | 7.46 |

## Lithuania

Yearly change in per cent

| | 2020 level, EUR bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 49 | -0.9 | 4.3 | 3.6 | 3.3 |
| Private consumption | 29 | -2.0 | 4.1 | 4.2 | 3.4 |
| Public consumption | 9 | 0.6 | 0.5 | 0.1 | 0.3 |
| Gross fixed investment | 11 | -0.2 | 7.5 | 7.5 | 8 |
| Exports | 36 | 0.0 | 10.2 | 4.4 | 4.2 |
| Imports | 32 | -5.3 | 11.4 | 5.7 | 5.5 |
| | | | | | |
| Unemployment (%) | | 8.5 | 7.2 | 6.6 | 6.2 |
| Wages and salaries | | 10.1 | 9.5 | 7.5 | 6.5 |
| Consumer prices | | 1.1 | 3.4 | 3.5 | 2.3 |
| Public sector financial balance, % of GDP | | -7.4 | -6.4 | -3.2 | -2.8 |
| Public sector debt, % of GDP | | 47.1 | 48.6 | 47.9 | 50.5 |

## Latvia

Yearly change in per cent

| | 2020 level, EUR bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 29 | -3.6 | 4.3 | 5.2 | 4.2 |
| Private consumption | 16 | -10.0 | 5.5 | 6.0 | 4.7 |
| Public consumption | 6 | 2.6 | 3.3 | 2.8 | 2.2 |
| Gross fixed investment | 7 | 0.2 | 3.6 | 4.7 | 5.1 |
| Exports | 18 | -2.7 | 4.9 | 5.2 | 4.3 |
| Imports | 17 | -3.3 | 4.7 | 5.0 | 5.0 |
| | | | | | |
| Unemployment (%) | | 8.1 | 7.8 | 7.2 | 6.4 |
| Wages and salaries | | 6.2 | 7.0 | 7.5 | 7.5 |
| Consumer prices | | 0.1 | 2.4 | 2.5 | 1.8 |
| Public sector financial balance, % of GDP | | -4.5 | -8.1 | -3.7 | -2.1 |
| Public sector debt, % of GDP | | 43.5 | 49.2 | 48.5 | 46.5 |

## Estonia

Yearly change in per cent

| | 2020 level, EUR bn | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Gross domestic product | 27 | -2.9 | 6.6 | 4.5 | 2.5 |
| Private consumption | 13 | -2.3 | 4.8 | 7.3 | 3.5 |
| Public consumption | 6 | 3.6 | 4.3 | 1.0 | 1.5 |
| Gross fixed investment | 9 | 18.4 | 12.5 | 6.0 | 3.0 |
| Exports | 19 | -5.0 | 9.5 | 5.0 | 5.0 |
| Imports | 19 | 0.4 | 13.0 | 6.5 | 5.0 |
| | | | | | |
| Unemployment (%) | | 6.8 | 6.7 | 5.8 | 5.2 |
| Wages and salaries | | 2.9 | 5.7 | 6.2 | 5.5 |
| Consumer prices | | -0.6 | 3.2 | 2.7 | 2.3 |
| Public sector financial balance, % of GDP | | -4.8 | -3.8 | -2.5 | -2.0 |
| Public sector debt, % of GDP | | 18.2 | 20.8 | 24.2 | 27.5 |

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