Research Reports

Focus on inflation risks as COVID-19 recedes and the upturn accelerates

Nordic Outlook

May 2021

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Normality and inflation

Optimism is reasonable, but it requires large doses of realism. Of course vaccinations have given us faith in the future and a clearer contour of our outlook, but the virus has not yet been conquered. We see the finish line looming ahead, though it tends to keep receding due to vaccine setbacks and new mutations. Yet step by step, the world economy is expected to start reopening. Never has "normality" been so longed-for as right now.

Global pandemic relief has totalled USD 26 trillion, equivalent to 30 per cent of global GDP in 2019. US stimulus packages also lift the world. Today economies and financial markets must begin preparing for smaller stimulus as early as next year. If our governments keep on borrowing and spending – and central banks finance this with newly printed money – the risk is that this will crowd out much-needed structural transformations and conceal underlying problems. Once the relief measures dwindle and the "water level" falls, we will see who is swimming naked; many problems must be addressed.

The pace of normalisation in today's high household savings will determine the strength of the recovery. Manufacturers have shown impressive resilience during the pandemic, but a reawakening of the labour-intensive service sector will ensure better economic balance and growth potential. There are still many questions about what new opportunities the pandemic will create, how green and innovative our way back to normality will be, and how much long-term damage COVID-19 has caused to our economies and societies.

How "well-behaved" is inflation? Are we trying to catch a tiger by the tail? Inflation worries have increased in 2021 due to enormous stimulus packages, central bank monetary expansion totalling USD 10 trillion, disrupted production processes and record-high public debt. But there are many indications that we are not heading into a new inflation landscape. If we are wrong about this, stretched asset prices may trigger a stock market slide and a new economic downturn.

Governments have expanded their role in the market economy – for better or worse. Efforts to make countries more disconnected – strategic autonomy – would not only endanger globalisation and recovery, but also the value chains of international corporations.

In this May 2021 issue of *Nordic Outlook* we continue to analyse the global consequences of the COVID-19 crisis. Our path forward will include both setbacks and advances, but these will not change its direction. This issue includes five in-depth theme articles:

- Strategic autonomy
- Energy transition
- Inflation
- The new gold
- Sweden's finances

We hope *Nordic Outlook* gives you new insights about today's challenging global prospects. Stay safe, and let us all help each other get the world back on its feet!

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The global economy

Focus on inflation risks as COVID-19 recedes and the upturn accelerates

The United States

Reopening and historic stimulus will result in the fastest growth since the 1980s. Households will still save some purchasing power for 2022. The Fed will start tapering bond purchases in Q4 but will not raise its key rate until 2023.

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The euro area

After a weak start to 2021, faster vaccinations will enable an easing of restrictions around mid-year. Crisis responses will be supplemented by a new EU recovery package that will mainly help fuel the recovery in 2022.

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China

A brief slowdown early in 2021 is being followed by stronger, more balanced growth driven by higher private consumption. Beijing's control of the credit cycle will dampen GDP. Interest rates and flows will bolster the yuan.

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The United Kingdom

Thanks to a successful vaccination programme, the British economic recovery is off to an early start, but a lot of catching up is needed after extensive lockdowns. There is lingering political uncertainty – domestic and external.

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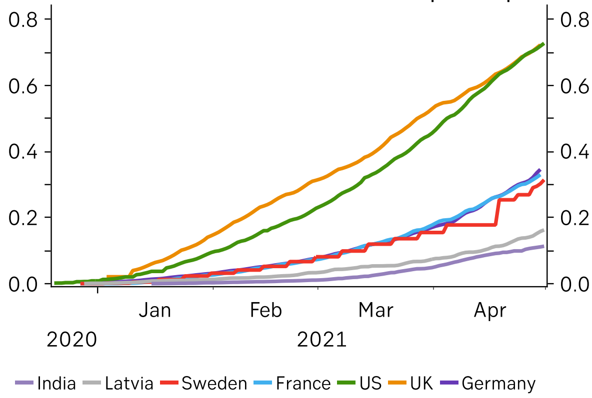
The outlook has improved – with surprising resilience to new restrictions and the US assuming a leadership role. How consumers use the savings they built up during the crisis will determine the next phase. Our main scenario is a balanced global recovery in 2021-2022, but the US will surpass its previous GDP trend by next year, putting the low-inflation environment to the test in a sensitive situation of mounting debt and relatively high stock market valuations.

The past few months have been dominated by continued high levels of COVID-19 transmission worldwide, with increased pressure on health care systems and high death rates as a consequence. As the third wave swept across Europe, new decisions were made to resume restrictions and lockdowns, but the tendency for economies to become more resilient to restrictions has also been confirmed and strengthened. In general, a strategy of designing restrictions in ways that enable working life to continue appears to have been successful. Combined with greater demand for consumer goods, this has sustained industrial production in particular. Other economic sectors have also found new ways to maintain their activity level, even in an environment of ongoing restrictions. Economic forecasts have thus shifted in a positive direction recently. The first quarter of 2021 was not as weak as had been feared, thus outweighing the negative consequences of the extended pandemic for Q2. The latest signals also indicate that easing of restrictions is imminent in major Western European economies.

Vaccinated, selected countries, per capita



Source: Our World in Data, Macrobond, SEB

Vaccinations will not solve everything. We are now rapidly approaching the point where the vaccination process will determine economic performance. One question is whether hoping for an almost complete normalisation of the economic environment is too ambitious. It cannot be ruled out that for various reasons – such as new virus mutations, resistance to vaccination in segments of the population in some countries or slow vaccination campaigns in poor countries – COVID-19 will continue to hamper economic activity and international mobility for a long time to come. Differences in the pace of vaccinations will also play a role. The European Union continues to lag behind the United States and the United Kingdom. This will affect the economic outlook this summer and thus be very important for those sectors and countries which are dependent on travel and tourism, for example. Yet the big picture is that well-functioning vaccines have been developed at an impressive pace and that vaccination processes largely appear to be working as planned. As a result, differences in the pace of vaccinations will also have a relatively small and transitory impact on activity in advanced economies. Poor countries are generally lagging behind, but there are clear signs of growing awareness that reasonable vaccine distribution will be important in order to avoid future setbacks. As vaccine production rapidly increases, distribution efforts are thus likely to intensify.

A greater focus on the inflation outlook. Although there are still various uncertainties related to the pandemic, the focus of attention is now shifting towards more traditional macroeconomic issues. This applies especially to the consequences of the massive economic stimulus measures that have been implemented. Our forecast indicates that in 2022, American GDP will surpass the trend growth rate that prevailed before the COVID-19 crisis. Above all, the strength of the US economy raises questions about inflation risks and the appropriate policy mix in the future. In a theme article on page 25, we analyse the US inflation situation in various time perspectives. The low-inflation environment is being put to its biggest test in decades, but despite upside risks our main conclusion is that it will last.

A continued important role for fiscal policymakers. Long-term behavioural changes due to the crisis remain interesting. It has been popular to draw far-reaching conclusions about how different the "post-coronavirus world" will be. Some sectors will probably suffer a permanent downturn, but we will probably also see vigorous rebounds in many fields due to a strong desire to return to normal life. In general, households have also increased their savings during the crisis. This will provide a buffer when stimulus is gradually withdrawn over time. But savings and wealth are unevenly distributed – creating both short- and long-term risks. Public sector debt is rising sharply in many countries, especially the US. But as long as central banks are prepared to help , we see no big risks that major tightening will become necessary in the next couple of years. Countries with strong public finances have room to continue fiscal stimulus, thereby easing pressure on central banks. One risk is that in the future, prudent fiscal policies in Europe may contribute to larger cyclical differences compared to the US, thereby reviving discussion about global imbalances. In a theme article on page 40, we discuss Sweden's situation in these respects.

Goldilocks scenario under some pressure. Our forecast implies that a balanced recovery will begin during the second half of 2021. Most indications are that economic expansion over the next couple of years can occur without widespread bottleneck problems on the supply side. But financial markets are now clearly focusing on more long-term issues. Our relatively optimistic inflation scenario leads us to believe that the US Federal Reserve will hold off on key interest rate hikes until 2023, yet we have raised our forecast for 10-year US Treasury yields. We are forecasting yields of around 2.40 per cent in late 2022, compared to 1.70 in the previous *Nordic Outlook*. Because of wider gaps between US and Western European growth rates, we are now starting to move towards expectations of more normal central bank behaviour, with the Fed – despite its new, more dovish strategy – initiating the normalisation of its monetary policy well before the European Central Bank. This means that the US dollar will probably appreciate in the long term, after some headwinds over the next six months. After the EUR/USD exchange rate climbs to 1.24 this summer, we believe it will fall to 1.13 by the end of 2022. The stock market has continued to benefit from upside earnings surprises. We believe share prices may enjoy additional support as economic growth accelerates this autumn. But in a more mature cyclical phase, slow growth and an uncertain yield outlook will challenge relatively high valuations.

In a more mature cyclical phase, slow growth and an uncertain yield outlook will challenge relatively high valuations

Biden's roaring start is having a clear impact

Now that the Biden administration has spent just over 100 days in the White House, we have seen a number of initiatives with the potential to affect both the United States and the outside world. Aside from its large stimulus packages, the administration's proposals for various tax increases are concrete examples. As for corporate taxation, the US has now taken the initiative to set a global minimum in order to reduce tendencies towards unfair tax competition. This matter will be discussed at the Group of 20 (G20) meeting on July 9-10. Joe Biden has also proposed higher capital gains and income taxes for the wealthiest. The White House is thereby also following the recent International Monetary Fund (IMF) proposal to introduce greater progressiveness in income tax tables and impose a temporary "solidarity tax" linked to the pandemic.

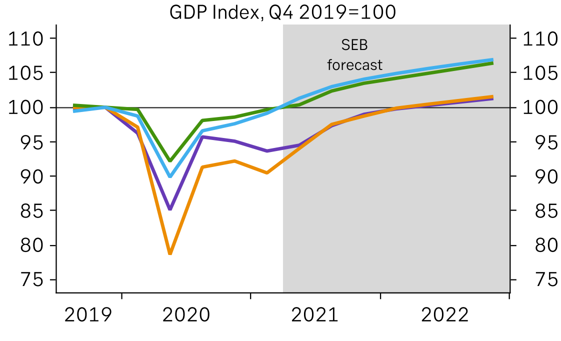
The pandemic has widened economic gaps in the US, which has affected public discourse on taxation. This is also reinforcing a long-term global trend of wider gaps being caused by exceptional monetary policies, and it may thus conceivably mark the beginning of a new international trend. In the near term, some of the tax increases that are now being planned will have a rather minor negative impact on demand, since the households that will be affected are unlikely to change their consumption behaviour significantly. In contrast, low income earners can look forward to tax cuts, including larger deductions for families with children. However, Biden's promises to tax only those who earn the most – the top 1-2 per cent – may place obstacles in the way of a transition to a more European- type welfare system. Capital gains taxes are meanwhile challenged by the risk of vanishing tax bases. It is also risky to launch plans for tax hikes before the recovery is on solid ground. But in a longer perspective, it will probably be of interest to seek new sources of funding, among other things for more climate-related investments.

Biden's decision to bring the US back into the Paris Agreement has increased the probability that the world can meet the 1.5-degree climate target. The White House climate summit on April 22-23 provided further support, including a surprising promise that the US would halve its climate emissions by 2030. This indicates that the Biden administration would like the US to play a leading role on climate issues, but its pledges must be translated into concrete actions. China did not come up with any new climate goals: its pledge of climate neutrality by 2060 will thus remain a benchmark in the future. There are now hopes that even more ambitious goals and concrete action plans can be unveiled at the UN climate summit (COP26) in Glasgow this coming November. In any event, recent progress indicates that climate-related measures will become increasingly important for the economic outlook and financial market pricing. In a theme article on page 16, we call special attention to the consequences and conditions for transforming the global energy system.

"Strategic autonomy" – a new form of protectionism. Global trade has recovered faster than expected, with goods trading expected to increase by 8 per cent in 2021 after falling by 5 per cent in 2020. The relatively rapid recovery of the manufacturing sector, driven by high demand for goods, has contributed to this. During the COVID-19 crisis, there has been a clear tendency to refrain from new trade barriers and tariffs, which has also supported international trade. But another kind of protectionist trend is emerging instead. In the theme article "Strategic autonomy" (page 13), we discuss how political decisions increasingly seem to be moving towards trying to block exports of goods that are deemed critical from an economic, security and health standpoint. Governments thus want to assume greater control over value chains that supply such goods as pharmaceuticals, semiconductors, car batteries and rare earth metals. In February, President Biden initiated a comprehensive review of US company supply chains. China's latest five-year plan expresses similar ambitions. Brussels, too, is moving in this direction with regard to manufacturing, digitisation, trade and security. The forces of globalisation remain strong but are now being challenged by ambitions linked to strategic autonomy.

Recovery at different speeds

GDP Index, Q4 2019=100



Source: Macrobond, SEB

The US pulls ahead of Western Europe

Despite disappointments caused by the protracted course of the pandemic, we have gradually adjusted our GDP growth forecasts higher this spring. We now foresee global GDP growth of 5.9 per cent in 2021, compared to 5.0 per cent in the last *Nordic Outlook* and 5.5 per cent in our early April update. Our 2022 forecast of 4.3 per cent has been stable, however. The dominant change concerns the US, whose economy has recently been unexpectedly strong despite continued COVID-19 transmission. Our forecast is now that American GDP will grow by 6.5 per cent this year and by 4.0 per cent in 2022. In our last *Nordic Outlook*, the corresponding figures were 4.5 and. 3.6 per cent. It is clear that US lockdowns have been less extensive than in Europe, as illustrated by higher mobility levels. To some extent, forecasters have probably also re-evaluated the effects of the Biden administration's first stimulus package, which is equivalent to more than 8 per cent of GDP during 2021. US stimulus packages rely largely on direct payments to households, which have a faster economic impact via strong recovery in household consumption.

Global GDP growth

Year-on-year percentage change

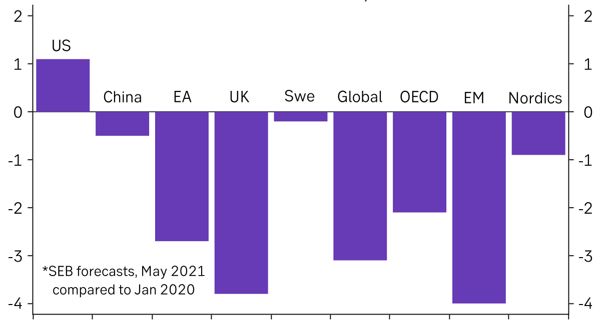
	2019	2020	2021	2022
United States	2.2	-3.5	6.5	4.0
Japan	0.3	-4.8	2.8	1.8
Germany	0.6	-4.9	3.0	3.5
China	6.0	2.3	9.0	5.3
United Kingdom	1.4	-9.8	6.4	5.8
Euro area	1.3	-6.6	3.8	4.2
Nordic countries	1.6	-2.3	3.5	3.7
Baltic countries	3.8	-2.1	4.1	4.4
OECD	1.6	-4.8	4.9	3.7
Emerging markets	3.8	-2.1	6.8	4.8
World, PPP*	2.8	-3.3	5.9	4.3

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

Greater clarity in a chaotic forecasting environment. No wonder there have been major revisions to forecasts in the past year. Aside from the pandemic itself – which is constantly taking unexpected paths, including recurrent waves of infections – lockdown strategies and stimulus measures have been very difficult to predict, and the behaviour of households and businesses has been hard to assess. The final economic response to all of this has also varied between different phases of the pandemic in ways that have been difficult to forecast. One way to illustrate how we now view the overall impact of the COVID-19 crisis is to compare our current forecast for 2020-22 with the one we presented in January 2020, just before the pandemic broke out. At that time, our perspective did not extend through 2022, but in our calculation we used our own trend growth projections and the International Monetary Fund (IMF) forecast at that time. Since the pre-pandemic economy was in a fairly normal cyclical situation, with GDP forecasts close to trend, 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

American GDP will surpass its previous trend by 2022. The US stands out here, with overall GDP growth that is actually 1 per cent higher than in our pre-crisis forecast. In other words, we now expect a higher GDP level in 2022. From a demand perspective this is not so strange, given the Fed's key interest rate cuts and changes in strategy, as well as the massive stimulus packages implemented since then – not least by the Biden administration. But this requires a more detailed supply side analysis. Early in the crisis, our main scenario was that it would take many years before we caught up with the old GDP trend. Today we believe we will surpass it as early as 2022. The time lag for major Western European economies is illustrated by the gaps in the euro area (nearly 3 per cent) and the UK (nearly 4 per cent). The relative resilience of the Nordic economies is indicated by a much narrower gap: in Sweden only 0.2 per cent.

Structural changes may also affect growth gaps. Generally speaking, the gap is far narrower for advanced economies (-2.1 per cent) than for the emerging market sphere (-4 per cent). This can be explained by larger potential for launching economic stimulus measures, but also by a faster vaccination process. However, the differences between the largest EM countries are very wide. It currently looks as if China's fight against the pandemic will be so successful that its negative gap will be only 0.5 per cent. This is a stark contrast with the situation in India, where we now predict that the economy will be 11 per cent smaller in 2022 than in our pre-crisis forecast. Some smaller EM economies are showing even worse figures, for example the Philippines, where we estimate a gap of 17 per cent. Although the size of these gaps may generally indicate room for above-trend growth after our forecast period, they must be supplemented with other data. For example, if the gaps are large and long-lasting enough, it may be hard to avoid permanent damage – which actually means that the gaps are smaller than they appear. In addition, country-specific events must be taken into account, for example whether the impact of Brexit is larger than expected, or to what extent political tensions in India and Russia have worsened their outlook.

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

	2019	2020	2021	2022
China	6.0	2.3	9.0	5.3
India	4.8	-7.1	10.1	7.2
Brazil	1.4	-4.1	3.3	2.7
Russia	2.0	-3.1	3.8	2.9
Emerging markets, total	3.8	-2.1	6.8	4.8

Source: IMF, SEB

Mixed outlook for EM economies

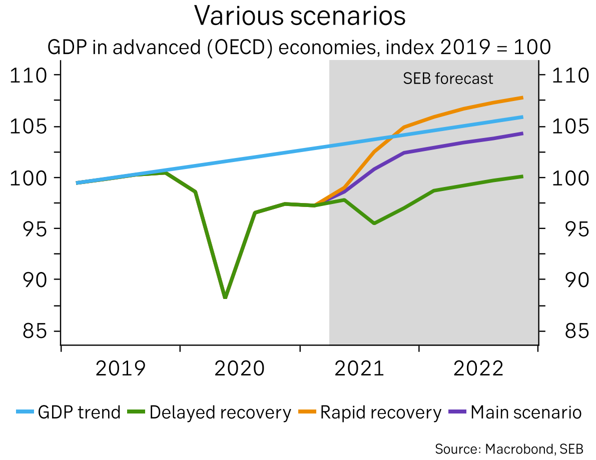
Partly due to strong economic performance this past winter, we have made an upward adjustment in our forecast of GDP growth in the emerging market sphere despite widespread COVID-19, especially in India and Latin America. For 2021 as a whole, we expect GDP to increase by 6.8 per cent, which would be the highest such figure in more than a decade. In light of the record-breaking GDP decline in 2020, it is still a rather modest upturn. In 2022, EM growth will slow to 4.8 per cent – not far above the long-term trend. Among the reasons why EM economies will have difficulty recovering lost ground are their modest stimulus measures, poorer access to vaccines and time lags in the actual spread of COVID-19. There are various reasons for the major differences between regions. China has weathered the pandemic well and is providing support for large portions of Asia, but economic recovery will be weaker in Latin America and Africa – partly because of less access to vaccines. Other factors also contribute to the divergence. This past year, rising commodity prices have benefited some EM economies, for example due to rising investments. Meanwhile EM economies that are highly dependent on income from tourism and business travel are vulnerable.

A slow pace of vaccinations in poor countries has the potential to become an international problem, among other things by hampering international mobility

Reasonable global vaccine distribution is important. Statistics on vaccine purchases show that a majority of the population in the EM sphere and in poor developing economies will not have access to vaccines until 2022. In these countries, restrictions will be periodically imposed in order to reduce COVID-19 transmission, but the authorities will probably avoid widespread national lockdowns, relying instead on local restrictions in order to ease the economic impact. But the slow pace of vaccinations has the potential to become a global problem as well. This applies not only to the humanitarian aspects. Unless COVID-19 is suppressed on a broad front, the risk of new international transmission waves will persist and mobility between different continents will remain limited. But a realisation of the importance of reasonable vaccine distribution seems to be gaining ground. As vaccine production rapidly rises, there will probably be increased deliveries from the US and Western Europe to poorer countries.

Mass vaccinations change the risk situation

As we enter a period of vaccinations for broad population segments, the risk situation is changing. On the downside, there is a risk that we will overestimate the impact of mass vaccinations. For some time, researchers have warned that hopes of normalisation are too ambitious. Vaccine-resistant mutations and new waves of infection, due to the slow pace of vaccinations in poor countries, may contribute to disappointments. If despair about normalisation becomes widespread, we may see a new wave of bankruptcies and financial stress. Looking ahead, downside risks are mainly linked to rising inflation and inflation expectations, which present central banks – especially the Fed – with the dilemma of either tightening their policies or accepting runaway inflation expectations and losing touch with inflation targets.



Ketchup effect may lead to strong consumption. The main possible source of faster growth than in our main forecast is that we may have underestimated the power of economic stimulus measures. A combination of pent-up consumption needs and highly elevated household savings creates major potential. Unlike the situation after the global financial crisis, there is no general need for balance sheet consolidation in the household sector. On the contrary, rising stock market and home prices mean that wealth effects may also fuel higher consumption. A robust increase in consumption may also lead to a positive spiral that triggers a wide range of capital spending. Our positive scenario implies that GDP will surpass its pre-pandemic trend some time in 2022. A robust recovery would reduce the risks of permanent exclusion from the labour market for workers who lost their jobs during the pandemic, and they can be quickly mobilised. It would also reduce the burden on public sector finances and thereby alleviate future vulnerability. But at the same time, such a scenario would also raise questions about how stable the low-inflation environment actually is and whether central banks need to adopt appropriate exit strategies more quickly. Hence, a rapid recovery may be marginally negative for stock markets if it has a substantial impact on inflation. We believe that the probability of our positive scenario is now slightly higher than for our negative one.

Various scenarios for the OECD countries
GDP growth, per cent

	2020	2021	2022
Main scenario	-4.8	4.9	3.7
Negative scenario		1.8	2.7
Positive scenario		6.0	6.0

Source: SEB

Broad upturns in commodity prices

We have raised our 2021 oil price forecast by USD 8 to USD 67 per barrel (Brent crude) compared to the February issue of *Nordic Outlook.* This represents an increase of as much as 56 per cent compared to the average for 2020. In 2022, we expect the average price to fall to USD 62. The 2021 price increase will be driven by stronger global demand, as well as production restrictions. Investments in new capacity have been held back during the pandemic, while the surprising discipline of oil-producing countries has contributed to rapidly falling inventory levels. This makes it easier for OPEC+ (OPEC plus Russia and several other non-OPEC producers) to control oil prices, while the influence of the US energy sector is shrinking. The subsequent oil price downturn is related to the aggressive spread of COVID-19 in India, Latin America and elsewhere as well as Iran's re-entry in the world markets as an important oil producer.

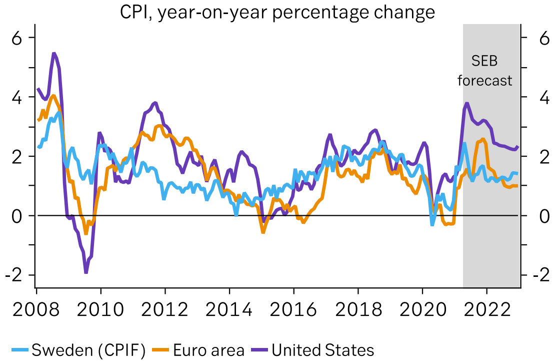
Commodity prices in general have increased over the past six months and are expected to keep climbing as global growth strengthens and broadens. The relative resilience of the manufacturing sector to the pandemic and China's quick recovery, as well as demand for such products as electric cars, has pushed metal prices higher. Future price increases are expected to be more muted, for example because households will steer their consumption increasingly towards services. More extensive production disruptions in global manufacturing also pose a downside risk to commodity prices. Climate-related disruptions in food production, as well as strong demand from China in the aftermath of swine flu, have raised food prices this past year. These effects are expected to be transitory.

Inflation in different time perspectives

How inflation reacts to the prevailing experimental environment, with its large stimulus measures, will be crucial to the entire forecast situation. The rapid US economic recovery raises new questions, which are discussed in a theme article on page 25. During the past quarter, new worries about a supply side-driven inflation have been fuelled by major increases in shipping prices between Asia and the West, as well as shortages of semiconductors. Price increases for many commodities are also higher than for a long time. Among the apparent reasons are a combination of production problems due to lockdowns and strong demand for electronics. Historically, however, , this type of price increases has had a weak correlation with consumer prices. Producer prices for consumer goods are still near zero, year-on-year. Only when they start to rise will CPI be strongly affected.

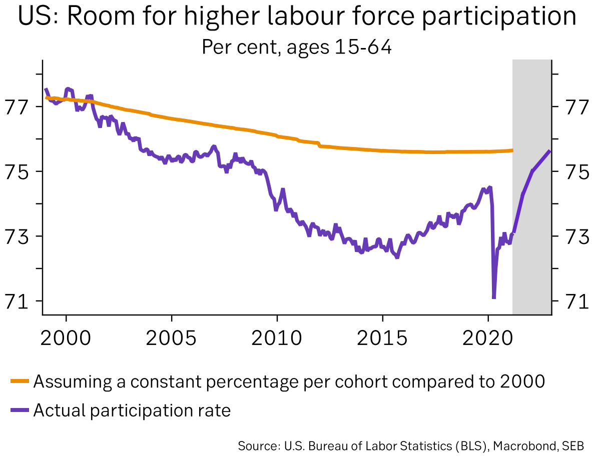
Rapidly rising inflation in the near term. However, various factors are now clearly contributing to higher US inflation. Important inflation components that have been severely depressed during the COVID-19 crisis will probably normalise in the near future. We expect the contribution to core inflation of travel and tourism, as well as the important rent component, to total one full percentage point and thus be instrumental in pushing up core CPI to 2.7 per cent as early as July, followed by CPI of around 2.5 until spring 2022. Although there will be a sharp increase in total consumption, amounting to 11 per cent in 2021 and 2022, we do not believe that this in itself is enough to generate a lasting inflation upturn. One reason is that the shift from consumption of goods to services will also lead to more subdued inflation, through a normalisation in the overblown goods price increases that we are now seeing.

Energy prices will lift CPI inflation
CPI, year-on-year percentage change

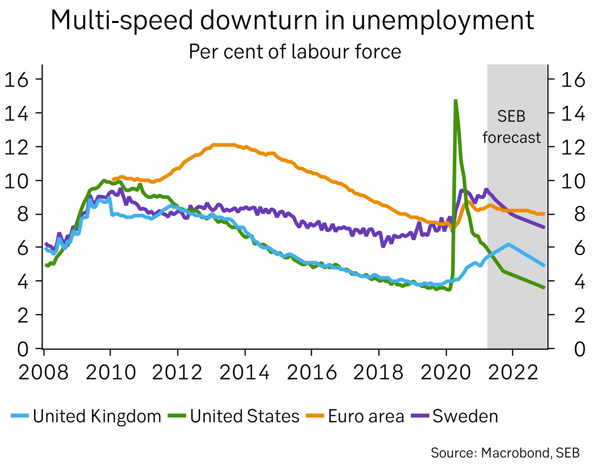


Source: Macrobond, SEB

US unemployment will fall to about 3.5 per cent. In order for inflation to shift permanently higher, the rate of pay increases must also accelerate, but wages and salaries have been insensitive to changes in unemployment for a long time. This was especially clear before the pandemic, when US unemployment fell to a 50-year low of around 3.5 per cent without any significant wage acceleration. Our forecast is that US unemployment will continue downward from the current 6 per cent to about 3.5 per cent towards the end of 2022. Experience from 2018-19 tells us that no clear wage acceleration is likely during our forecast period. Yet even now, there are signs of worrisome bottleneck tendencies. For example, the percentage of small businesses having trouble filling vacancies is larger than ever. Yet these problems are probably attributable largely to the pandemic, for example due to lack of mobility because of closed schools or fear of infection. Looking ahead, our forecast is based on increased labour force mobilisation and a resumption of the rising participation trend that was interrupted by the outbreak of the pandemic. We are assuming that by the end of 2022, labour force participation for ages 15-64 will have risen to 75,5 per cent. This is still a bit lower than the level around 2000, but we should also take into account certain demographic headwinds since then.



Rising average working hours and productivity will slow job growth. While our GDP growth forecast for the US implies that the economy will already have surpassed its pre-crisis level by 2022, the number of people with jobs will take much longer to recover lost ground. One explanation for this is that average working hours will probably rise as sectors open up after long lockdowns and have pent-up needs. Some jobs that disappeared during the pandemic will take a long time to return, while others are probably gone forever. This is a logical consequence of structural changes and investments in automation and digitisation, for example due to reduced business travel and increased e-commerce. We also expect these changes to lead to some acceleration in productivity growth.



Does the Phillips curve have a trick knee? There are certain upside risks in our inflation forecast, however. The Phillips curve, which shows the association between unemployment and price and wage formation, seems to have become flatter than before. Yet there is probably a critical level of unemployment where wages will accelerate more dramatically. If we have underestimated the effectiveness of fiscal stimulus measures, and/or the above supply side assumptions prove too optimistic, unemployment may fall significantly further than we and the Fed have predicted. At that point we will enter uncharted territory and may encounter a critical level of unemployment where the Phillips curve suddenly becomes steeper. Nor is it certain that the Phillips curve is particularly stable. It is possible that the Fed's acceptance of higher inflation may cause expectations to rise so much that pay levels will accelerate faster than the unemployment rate itself indicates.

Change of regime may spread to Europe. The discussion so far has been focused on the US, since cyclically driven inflation seems far away in Western Europe. On the other hand, for a long time we have seen a large co-variation in major features of inflation. Large shifts in the inflation environment have often occurred quite synchronously. If US fiscal policy experiments should lead to overheating symptoms and soaring inflation expectations, with or without acceptance by the Fed, it is possible that we might face such a regime change that could also affect Western Europe. This might be due to the fact that it will be politically attractive in Western Europe to try to copy an experiment that is credited with reducing unemployment to exceptionally low levels. However, such a development would also be associated with major risks that have the potential to cause dramatic re-pricing in financial markets.

Such a development would also be associated with major risks that have the potential to cause dramatic re-pricing in financial markets

Economic policymakers face new challenges

Now that we are about to leave the acute phase of the COVID-19 crisis, economic policy conditions will also be changing. Some stimulus programmes will need to be extended for another while, but crisis responses will now be replaced by recovery policy, and after that the task will be to design well-balanced exit strategies. We have recently highlighted changes in the structural balance of the general government sector as an established and appropriate way of comparing the active fiscal policy measures in different countries. In the last *Nordic Outlook*, we stated that stimulus measures would not be as large as early summaries of these programmes indicated. The total stimulus injection in the advanced (OECD) economies – 5 per cent of GDP – is nevertheless exceptional.

Net stimulus again this year, but tightening in 2022. The big picture is that this year, advanced economies will mainly match their historically large 2020 stimulus measures. In the US, economic policy will be slightly more expansionary thanks to the very large package that was launched earlier this year. In the euro area, crisis responses have been extended on a scale equivalent to last year's programmes. Sweden's relatively cautious crisis response in 2020 will be surpassed this year, which means that a net stimulus effect can also be recorded in 2021. In 2022, tightening is inevitable and is likely to be most evident in the US, where it is expected to be equivalent to 3.5 per cent of GDP. But the final impact of such tightening on consumption and GDP will be softened because households are expected to use some of the income that they saved during earlier pandemic-related lockdowns.

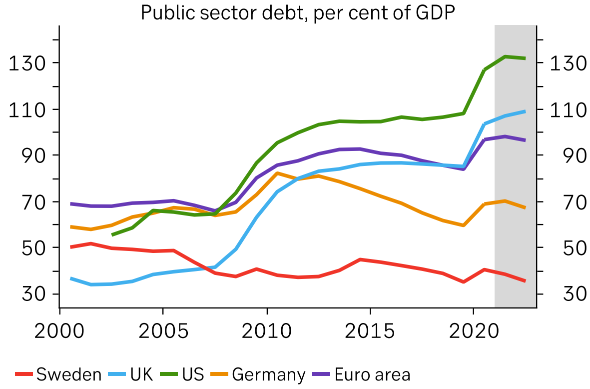
Fiscal stimulus impulse
Change in structural budget deficit, per cent of GDP. Plus signs mean a stimulus effect, negative the opposite

	2020	2021	2022	2020-22
OECD	5.0	0.0	-2.5	2.5
United States	5.5	0.5	-3.5	2.5
Japan	5.5	-2.5	-1.5	1.5
Euro area	3.0	0.5	-1.5	2.0
United Kingdom	7.0	-1.5	-3.0	2.5
Sweden	2.0	1.0	-1.0	2.0

Source: OECD, SEB

Focus on structural programmes ahead. In the long term, there are arguments for continued expansionary fiscal policies, and some deviations from the current framework are likely. Policymakers may emphasise the importance of structural measures that will improve the supply side of the economy, as well as the need for green investments that will help improve sustainability. In the United States, the Biden administration's next package will focus on investments in infrastructure, the environment and digitisation, but also on measures aimed at strengthening human capital, such as spending on education and an expansion of child care. The package that the EU approved last year, Next Generation EU (NGEU), has a similar focus.

Debt will level out
Public sector debt, per cent of GDP



Source: IMF, Macrobond

Increased monetary policy divergence

Central banks are thus likely to receive some help from fiscal policymakers again this year, which is a welcome development considering their own limited room for manoeuvre. Central bank assets have grown by a historic USD 10 trillion (11 per cent of global GDP) since the beginning of 2020. In 2021, we estimate that these assets will grow by another USD 3 trillion as part of existing quantitative easing (QE) programmes. Meanwhile most central banks are expected to keep their key interest rates unchanged both this year and next. Norway is among the exceptions, among other things due to rising home prices; late in 2021 Norges Bank will hike its key rate, and in 2022 two further hikes will bring the rate to 0.75 per cent.

No Fed rate hikes in 2022. Increased inflation risks, including higher inflation expectations, will be a challenge mainly for the Fed. But the US central bank's new policy framework – with its "average inflation targeting" and increased focus on employment will give it room to hold off on policy adjustments. Our forecast is that as early as June or July, the Fed will start preparing the market for tapering of its securities purchases. In October, it will begin to lower its monthly purchases, currently USD 120 billion, by USD 10 billion per month. Meanwhile the American labour market situation will continue to improve. We expect the Fed's adjustment to be completed by the autumn of 2022. Unless the headwinds facing fiscal policymakers are too strong next year, an initial key rate hike may occur in 2023.

Stable inflation expectations and sharply rising home prices will probably close the door to Swedish key interest rate cuts

For the ECB and the Riksbank, rate hikes are distant. After a temporary inflation upturn this spring, the euro zone and Sweden will continue to experience uncomfortably low inflation. The ECB has signalled flexibility about adjusting its monetary policy if, for example, bond yields rise too much. The Riksbank and the ECB will keep their key interest rates unchanged during our forecast period. The Riksbank will continue its QE programme as planned. Swedish inflation is expected to fall below 1 per cent this summer, which may trigger expectations of a return to negative key rates. But stable inflation expectations and sharply rising home prices are expected to close the door to such a step.

Theme:

Strategic autonomy

A challenge to globalisation and company value chains

World trade has recovered faster than expected and is back at its pre-pandemic level. The resilience of manufacturers and global trade has softened the economic impact of the COVID-19 crisis and will contribute to the recovery. There are protectionist tendencies, but they have changed in nature: from traditional import duties to increased export restrictions aimed at reducing a country's vulnerability to the outside world. These political decisions also affect company value chains. Does this pursuit of strategic autonomy spell the end of the globalisation we have become familiar with in the past 40 years? On behalf of SEB, Uppsala University has studied the megatrends and future of globalisation.

The nature of protectionism is changing. Today, political decisions seem to be moving more and more in the direction of trying to stop exports of goods that are critical to countries from an economic, security policy and health standpoint. "Traditional protectionism" has been about protecting a country's companies and jobs from foreign competition by means of import duties and so on. The concept of "strategic autonomy" is the new catchphrase. The pandemic and a deteriorating security policy situation seem to have led governments to reassess their view of the global economy as an important source of opportunities, economic growth and innovation. Today it is also viewed as a possible source of problems and vulnerability. Governments thus want to take greater control of the company value chains that ultimately supply such goods as medicines, semiconductors, car batteries and rare earth metals.

Democracies thus seem to be deciding to retreat from a liberal view of markets, instead advocating restrictions that put their own economy and domestic policy agenda first. This comes after decades of having delegated crucial economic decisions about supply and demand to global markets and companies themselves.

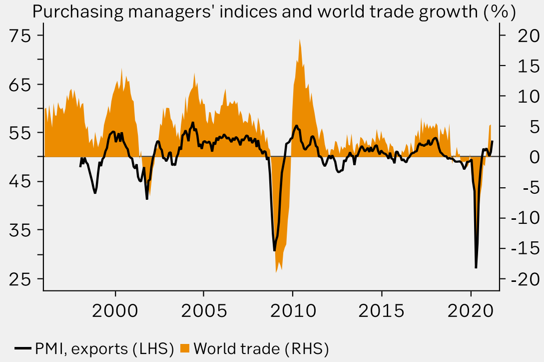
The US, China and the EU are now discussing various initiatives aimed to increasing their independence and autonomy, in order to strength their global position. In February, President Biden ordered a comprehensive review of the supply chains of US companies. China's latest five-year plan expresses similar ambitions. Brussels, too, is moving in this direction with regard to manufacturing, digitisation, trade and security.

Transforming trade and production

The trend of global trade depends on several factors. *First*, it varies pro-cyclically with **the economy** – the economic recovery will eventually lead to increased trade. *Second*, a protracted period of high unemployment and economic inequality may lead increased **popular support** for trade restrictions. *Third*, for reasons of **global and national security policy** the ongoing technological shift – part of the fourth industrial revolution – makes countries and companies want to protect critical products from foreign powers.

Rapid normalisation but uncertain outlook

Purchasing managers' indices and world trade growth (%)



The transformation of trade and production is now being affected by an intensive global race to dominate future technologies and by shifts in the geopolitical landscape. Global recovery – and trade – will depend on countries being able to ensure a trade and investment environment that can lead to gradual adaptation of global production networks. There is a risk that existing and emerging uncertainty will hamper future global trade – and thus growth and innovation.

Increasingly uncertain trade forecasts

The World Trade Organisation (WTO) estimates that global trade in goods will increase by 8 per cent in 2021, after falling by 5 per cent in 2020. Next year, trade is expected to grow by 4 per cent. Manufacturers were able to restart production relatively fast and meet an increased demand for goods, which arose when consumers – due to restrictions – shifted from buying services towards buying goods online. In 2020 and 2021, countries also avoided further trade barriers and tariffs that would have restricted international trade.

Forecasts are shrouded in uncertainty. The recovery may happen much faster than expected and thus have a positive effect on global trade; the election of a new US president seems to have made trade policy more predictable. Meanwhile the likelihood of export restrictions has increased, which is a downside risk. Companies have also recently reported production disruptions due to shortages of components, such as semiconductors. These disruptions may have several causes, including surprisingly strong demand and problems in restoring "just-in-time" production. There is also a risk that increased inventory, perhaps politically initiated, will also create problems.

"Globalisation is not dead"

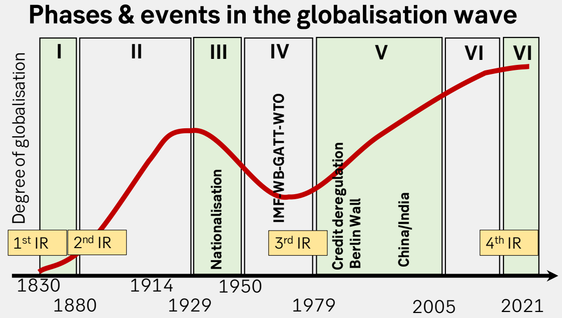
On behalf of SEB, this winter Uppsala University studied and mapped the latest research on the drivers and the future of globalisation, and on the impact of the pandemic on company value chains. The conclusions of the report[1] can be summarised in the following 3 points.

1. **Globalisation has decelerated,** but this was after a period of unusually strong growth: various metrics indicate both continued strength and normalisation.

2. It is possible to identify **four driving forces** behind the strength and impact of globalisation, both in a long- and short-term perspective: ***technology*** (four industrial revolutions), ***political changes,*** the ***financial cycle*** and ***sustainability***. The pandemic may be a fifth driving force, but there are many indications that it is instead amplifying the other driving forces, though it has still had a negative impact on global value chains.

3. Signs of moves towards **"slowbalisation"** are mainly connected to perhaps the most important force affecting globalisation: politics. The political vision and dream of a "global world" has changed in recent years. Economic inequality, identity problems and a lack of potential for influence have contributed to greater scepticism about the advantages of globalisation. In many cases, the political response has been to put one's own economy and domestic policy agenda first.

Phases & events in the globalisation wave



If the global economy is to function smoothly for everyone, companies must be able to compete on equal terms. Recent political steps towards a global minimum corporate tax can be seen as expressing a desire to reduce unfair tax competition between countries and a need to find sources of funding for budget deficits. Another positive interpretation may thus be that countries want to avoid new trade barriers or the use of the currency as a tool to gain advantages. The WTO summit in June – which will aim at laying the foundation for reforming the organisation – may show how willing countries are to limit the role of national borders.

[1] See *"Trumpism, Brexit, Industry 4.0, and COVID-19: What is Happening to globalization?"*. Stefan Arora-Jonsson, Katarina Blomkvist, and Alice Schmuck (2021). Department of Business Studies, Uppsala University.

"Countries view the world as a source of vulnerability, not as a potential source of growth"

What is strategic autonomy?

Strategic autonomy simply means reducing the dependence of one's own country on the outside world through political initiatives in a number of areas. In practice, this also means that other countries may thereby be weakened. Through reduced vulnerability, a country may increase its clout in the global arena. These ideas have a bearing on most policy areas, but mainly on manufacturing, digitisation, trade and security.

A world that is highly dependent on China

The world is experiencing heightened risks: geopolitical, trade-related, technological and health-related. To international firms, some of these risks are not new. But for Beijing, Biden's China strategy creates a more difficult situation than Trump's four years in the White House. Biden apparently wants to assemble a clear, cohesive front against Beijing. The world's conflicts with China are multi-faceted and are found in such fields as human rights, trade policy, intellectual property rights and cybersecurity. Tech-related protectionism is obvious: success in the 4th industrial revolution is likely to affect the balance of power.

The value chains of international corporations are deeply integrated with China's production structure. Many firms will probably find it hard to become entirely independent of China; for years they have invested in a presence in the world's biggest, fastest-growing consumer goods market. China's increasing research achievements are also likely to attract cooperation with its companies. Due to pandemic-related disruptions and political tensions between China and other countries, companies have been under pressure to reduce their dependence on Chinese value chains. This has not happened yet; in the first quarter of 2021, foreign investment in China rose at an annual rate of 45 per cent. Beijing has also sought to make foreign companies interested in operating in China. Their actions suggest that companies would prefer to build separate, parallel chains depending on geography and other factors.

"Steps towards strategic autonomy are challenging globalisation and company value chains"

Biden's 100-day review

On February 24, US President Joe Biden issued an executive order to review the supply chains of US companies related to critical products. The aim of the review is to find ways to reduce US dependence on foreign suppliers – both companies and countries – in sensitive goods sectors. Within 100 days from February 24, two federal agencies will identify opportunities for the United States to increase domestic production in four key areas: semiconductors, pharmaceuticals, car batteries, and rare earth metals that are critical for the high-tech and defence sectors. When announcing the review, Biden said: "We shouldn't have to rely on a foreign country, especially one that doesn't share our interests or our values – The United States needs resilient, diverse, and secure supply chains."

Globalisation is best described as a strong, unified underlying force bringing different actors in different countries into a common system. This force arises when consumers, producers and investors are driven by the desire to take advantage of price and cost differences in markets for goods, services, labour and capital. Consumers want a large product range at low prices. Companies are seeking customers and low production costs. Investors want as high a return at as low a risk as possible. The opportunity to exchange ideas is another important impetus for new innovations. How strong globalisation is allowed to be is ultimately determined by political decisions and systemic interventions.

The increased role of national borders is making companies rethink their strategies. This may include increased inventory capacity and the possibility of relocating or reorganising production to secure and shorten the company's value chains. "Just-in-time" deliveries of input goods have enabled companies to maintain low inventory levels, contributing to higher productivity and lower costs. But the question is whether by relocating production, new units may offer the desired capacity and business climate within a reasonable time frame without adding new risks and costs. Companies today need business models that provide an optimal balance between delivery and production security, as well as cost efficiency.

Working today for clearer national borders at the expense of multilateralism is counterproductive. The world needs constructive, not destructive solutions to international problems. It is easy to paint future scenarios that include increased protectionism, the decline of democracies and even armed conflicts. Yet there are many indications that the underlying drivers of globalisation (as described above) are strong enough to push back against the counterproductive renaissance of national borders which hamper trade and the exchange of ideas. Although there is reason to assume that trade as a share of GDP will not increase as dramatically as during the years before 2008, we also see no reason to expect a sharp deceleration.

Theme:

Energy transition

Investment is the key to reversing the climate crisis

Renewable energy is a powerful technological revolution, and 2021 looks like the start of the disruptive part of the diffusion process. However, successful transition will require massive amounts of investment. All capital equipment used to generate energy must be replaced, but it is also necessary to replace all the capital equipment that uses energy and today requires fossil fuel input. It is feasible to complete this journey by 2050 but it will require very substantial investment.

Innovation will be vital. Technology is always important for our economic development, but it is especially important right now due to the challenge from the climate crisis. Lower CO_2 emissions without lower production levels can only be achieved through innovation. In the February 2020 issue of *Nordic Outlook*, we described a simple model of how revolutionary new technologies diffuse. They start with 30 years in incubation below the macro radar before reaching the cost-parity tipping point and the capital replacement cycle starts. The first 30 years after the tipping point are the disruptive phase, where falling prices go hand in hand with a continued acceleration in volumes, before the diffusion is completed in a golden age that also lasts around 30 years.

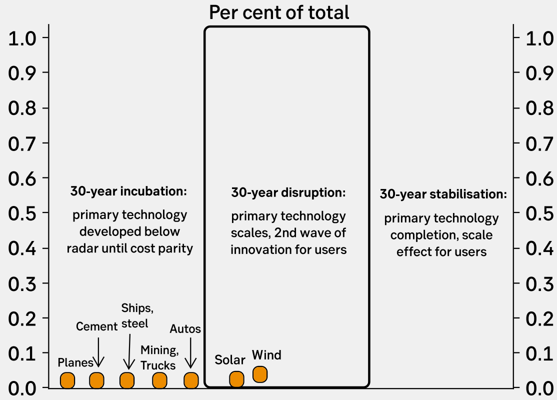
Breakthrough in the green energy transition. After a long incubation period and a short-term stumble caused by the pandemic, it looks like a breakthrough in the green energy transition is at hand, propelling us into a more disruptive and transformational phase. Over the past few months, evidence of such a change has emerged in many areas, but history suggests that this does not mean we can turn on the autopilot now. Technology evolves through a complex process of learning by doing, experimentation and trial-and-error. For decades to come, investment in the new technologies will help make them even more effective, driving a virtuous cycle of falling prices and rising volumes.

Getting capital replacement started

The transition will require significant investments. It essentially means scrapping all current capital equipment that is designed to use fossil fuels and replace it with new electrified capital equipment. The problem is that in most cases, the technology required to electrify the processes either does not exist or remains far too expensive, like all technologies in the incubation phase.

Most sectors still far from cost tipping point

Per cent of total



Source: Macrobond, SEB

It is therefore not enough to just generate cheap, clean electricity. A successful transition also requires innovation and investment on an unprecedented scale from energy users. It also requires coordination across the entire supply chain, because of the interconnected nature of the new technologies. It will not help you to have a brilliant electric vehicle if there are no charging stations or if the charging stations do not run on green electricity. Vertical collaboration is needed to ensure that all the different parts needed for a successful transition become available at the same time.

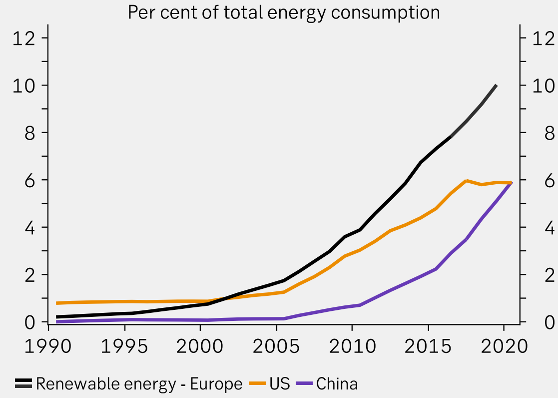
Government and private sector together. This latter part is not one the government can order to materialise. In general, the government can supply the infrastructure needed but the private sector must develop the tools with which to generate value from this infrastructure. The energy transition is no different in this respect from earlier industrial revolutions. It was also governments that built the highway networks and the private sector that figured out what to do with them. Government investment helps solve what otherwise could be an intractable chicken and egg problem.

Infrastructure investment

Public investment in energy infrastructure is being prepared on a larger scale than anything we have seen before. The most important change in the political landscape in the past few months is the aggressive policy changes that President Biden has launched in his first 100 days in office. From the energy transition perspective, this has resulted in both global and local changes. If President Biden's investment plan makes it through Congress and the EU can keep support for its climate action plan together, the coming years are likely to see a substantial shift in global investment levels. This would in turn accelerate the collapse in the cost of renewable energy that is the real driver behind the disruptive nature of the transition.

Energy was the first sector to move

Per cent of total energy consumption



Source: Macrobond, SEB

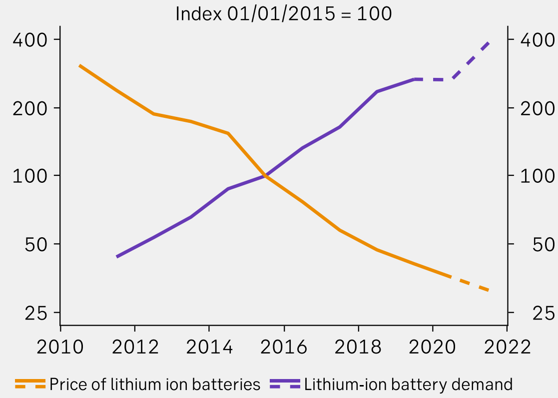
According to Bloomberg New Energy Finance (BNEF), the world's total annual energy transition investment is around USD 500 billion, of which around 300 billion is going directly into primary energy production. In our view, the two big investment plans under way in the EU and the US will lead to an increase in the investment level of 20-40 per cent over the coming 3-4 years as public funds combine with private capital to ramp up the supply of emission-free electricity. If this higher investment level is sustained, the result is likely to be that renewable energy could already supply 50 per cent of the world's energy consumption by the mid-2030s – a key condition for meeting the Paris Agreement deadline of full decarbonisation by 2050.

Autos will start the next wave

Even more significantly, the first sector outside energy has reached an inflection point. Electric vehicles got a head start compared to other production sectors as the new technologies were being tested as early as the 1980s (when they were very far from being ready), evolving at first into hybrids like the Toyota Prius (1997) and then into pure EVs like Tesla's Model S (2011).

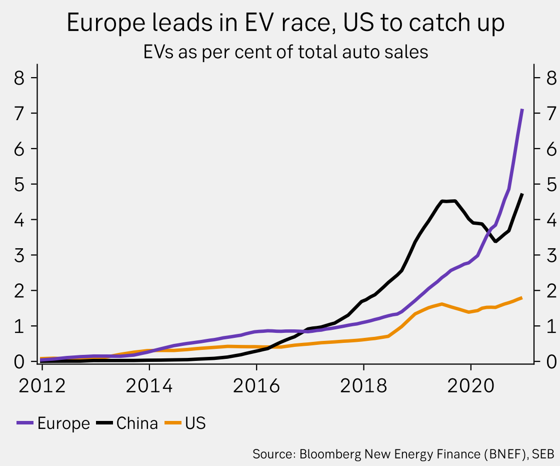
Battery technology & learning curve effect

Index 01/01/2015 = 100



Source: Bloomberg New Energy Finance (BNEF), SEB

Ten years after the Tesla Model S, the price/quality mix has reached a point where EVs no longer require subsidies – and due to the learning curve effect, their relative advantage over traditional autos will just keep widening over the coming decades.



This means that the EV share of car sales is now taking off. Europe is the clear leader, and the exponential nature of the diffusion is clear as the EV share has doubled every 2-3 years over the past half decade and now stands at 7 per cent.

Speed of transition tends to be underestimated. As a result, the time horizon for auto producers before the great fossil sunset has just been reduced sharply. Humans tend to extrapolate in a linear way. Just like with renewable energy production earlier, this means that there is a systematic tendency to underestimate the speed of diffusion in the early stages of the S-curve. A couple of years ago it may have seemed realistic to see a 20-year phasing out of profitable fossil-powered auto production, but it now looks more likely to happen in half that time. And carmakers are now racing to raise capital and speed up their transition.

More sectors to follow

The automotive sector is only the first in line to embark on this journey. Autos had a head start due to the earlier experimentation with new vehicle types in this sector, for example compared to zero-emission ships or steelworks. However, the process is the same for all other sectors where the capital equipment only functions with fossil energy input today, and they may also complete the early stages faster than autos did because the new energy sources now are in place.

Electrification also means digitisation, so the change in energy source opens the way for a major overhaul of operating and maintenance costs. EVs have almost no mechanical parts, and most of the time repairs can be conducted virtually. Hybrid solutions will not yield all these rewards, so they are likely to be an interim solution.

Most sectors apart from autos have not yet reached the stage where large-scale 'demonstration models' are in place and the rapid replacement of existing capital equipment will begin. However, they are most likely not as far away as they think today.

Challenges remain

This does not mean that everything is fine now. Significant political challenges remain, both in the EU, where the new framework of regulations known as the Taxonomy has been held up in political traffic that threatens to damage its credibility and the US, where President Biden's very ambitious infrastructure plan faces a difficult path through Congress.

Political interventions needed. The EU Taxonomy has now become a reality, after some contested parts were set aside for consideration in the future. This means that as early as 2022, companies and investors will have to report their Taxonomy alignment. Initially, in most sectors the technology is not ready for the Taxonomy to guide a reallocation of capital, but it will come. The impact of the framework will grow over time. This kind of political intervention is necessary to speed up the transition. If renewable energy diffusion followed the normal historical pattern, decarbonisation would not be complete until the 2070s. In order to complete it by 2050, as stipulated in the Paris Agreement, all stars must be aligned.

The transition is also a balancing act. After more than 30 years of effort to develop renewable alternatives, fossil fuels still provide more than 80 per cent of the world's energy, and we have not even passed 'peak fossil' energy consumption yet. Renewables will grow their share exponentially, but even in the best case scenario – where investment is ramped up, fossil-using equipment is withdrawn before the end of its economic life and decarbonisation is completed by 2050 – more than 50 per cent of the world's energy will still be fossil-based in the mid-2030s. Fossil fuels thus have to be phased out very carefully, to avoid blackouts where energy is not in sufficient supply. While the challenges remain daunting, the chances of completing the transition in time to meet the Paris Agreement seem better than at any point in the past decade. Political backing has strengthened significantly, and the technological potential has been confirmed. Now the main task is to raise enough capital.

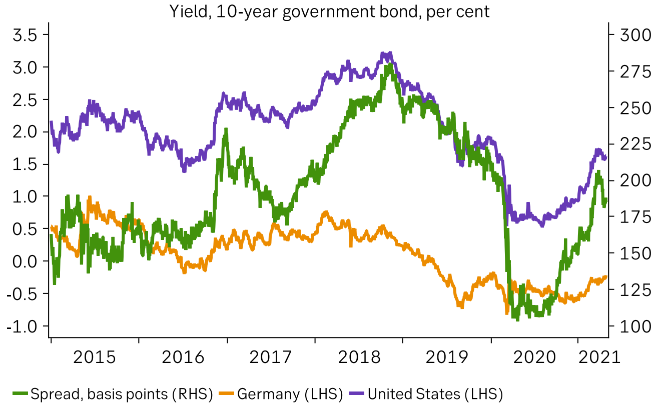
Fixed income

Pause mode before the Fed's next policy steps

The fixed income market is temporarily catching its breath while awaiting the Federal Reserve's next policy steps in the coming months. Long-term US yields have already priced in strong GDP growth, rising inflation and less expansionary monetary policy. The phase-out of the Fed's quantitative easing (QE) policy is expected to push the 10-year US Treasury yield up towards 2.40 per cent. The European Central Bank is ready to act if the market creates an undesired upturn in risk-free real yields.

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, Macrobond, SEB

10-year government bond yields

Per cent

	29 Apr	Jun 2021	Dec 2021	Dec 2022
United States	1.65	1.80	2.00	2.40
Germany	-0.20	-0.15	0.00	0.20
Sweden	0.38	0.40	0.50	0.70
Norway	1.53	1.55	1.70	1.90

Source: National central banks, SEB

The fixed income market is catching its breath. In Q1 its focus on reflation led to rising stock markets and significantly higher US Treasury yields. Long-term yields were lifted by massive stimulus measures, expectations of a strong US recovery and rising inflation. European yields finally also began to rise. Early in Q2, however, the upturn lost momentum, contributing to lower real yields, which in turn pressured the US dollar and strengthened the stock market.

Fed "tapering" is the next step towards higher US key interest rates. The market has already built in expectations of higher key rates, which explains recent moderate reactions to positive macro data. In early April, the market priced in an almost 100 per cent probability of a Fed rate hike as soon as 2022 (with the key rate reaching 2.50 per cent in ten years). By early May, this probability was down to around 75 per cent. In the next few months, we expect yields to move sideways. In June or July, the Fed will start preparing the world for a reduction in its securities purchases (now USD 120 billion/month), which may trigger higher yields. At the end of 2021, we expect a 10-year Treasury yield of 2.00 per cent. The US inflation outlook and labour market situation make this forecast a bit uncertain. If the Fed postpones tapering, we expect yields to trade sideways. Meanwhile US inflation will rise sharply during the coming months (mainly energy and base effects); any subsequent inflation risks do not appear fully priced in and may be a factor contributing to higher yields. At the end of 2022, we expect a 10-year yield of 2.40 per cent. The upturn will be limited, partly since fiscal stimulus will end in 2021, followed by headwinds to growth.

The ECB will slow the rise in euro area yields. At its March meeting, the European Central Bank responded to rising yields by accelerating its monthly securities purchases. The ECB has also made clear how it may address undesired tightening of financial conditions. For example, if US yields climb significantly in the second half of 2021, the ECB may respond by increasing the pace, volume and/or length of its Pandemic Emergency Purchase Programme (PEPP) to hold back rising yields, especially if long-term risk-free real yields start climbing. We believe the ECB will accept a slight upturn if it is driven by better economic prospects and rising inflation expectations. 10-year German yields will reach 0.00 and 0.20 per cent at the end of 2021 and 2022, respectively.

Sweden a high interest rate country in Europe. Long-term yields have risen due to higher US yields. The upturn has been larger than in most European countries. The 10-year spread against German government bonds widened from 20 bps in mid-2018 to around 75 points in early 2021; at or near the highest levels since the mid-1990s – largely due to the Riksbank's two key rate hikes in 2018-2019. The drivers behind the wider spread of this past year are not as clear. We believe expectations of a Riksbank rate hike before the ECB are overblown. Over the past 4-5 months, Swedish yields have moved closer to German ones. Continued lowering of exaggerated expectations about the Riksbank, combined with falling Swedish inflation, will likely narrow the spread to 50 bps by year-end. Since the ECB will keep buying bonds at a rapid pace next year as well, while the Riksbank only reinvests maturing bonds, yield spreads may widen. Meanwhile, Sweden's borrowing requirement is low. The spread against Germany will thus remain at 50 bps in 2022.

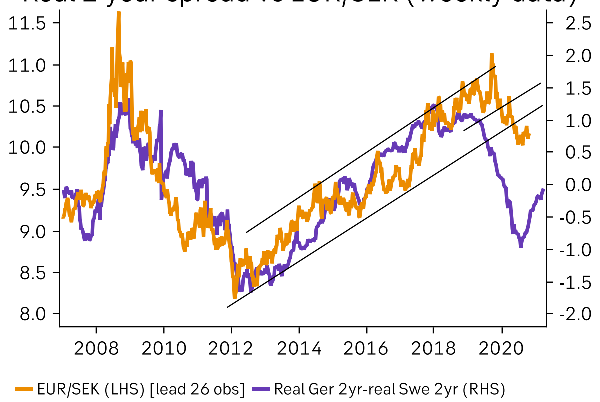
The Norwegian-German long-term yield spread has continued to widen as US yields have risen and expectations of faster Norges Bank rate hikes have grown. Since the market has already priced in clearly higher key rates, further widening should be more limited. Favourable prospects for Norway's bond supply and expectations of a stronger krone will also help keep yield spreads narrower. We foresee small movements in the 10-year spread against Germany in 2021 and 2022 and expect it to be around 170 basis points.

The FX market

Strong US economy will lift the dollar

In 2020, exchange rate movements followed a logical pattern. The dollar fell from historically strong levels when the Fed cut its key interest rate. Today's situation is harder to assess, with small divergences in valuations and near-zero key rates in major economies. Large stimulus measures give the US a growth advantage, but it will take another six months before expectations of Fed rate hikes clearly support the USD. Nordic currencies are doing well, with the SEK benefiting from a strong economy and NOK also supported by rate hikes.

Real 2 year spread vs EUR/SEK (weekly data)



Source: Bloomberg, Macrobond, SEB

Exchange rates

	29 Apr	Jun 2021	Dec 2021	Dec 2022
EUR/USD	1.21	1.24	1.18	1.13
USD/JPY	109	106	104	108
EUR/GBP	0.87	0.85	0.84	0.87
EUR/SEK	10.15	10.00	9.90	9.70
EUR/NOK	9.92	9.90	9.70	9.85

Source: Bloomberg, SEB

Growth and central banks are driving the FX market. In the past six months, cyclically oriented currencies have benefited from an environment where synchronised recovery has been a market theme. Last year was marked by USD weakness, while countries with successful pandemic management and rapid growth look set to emerge as winners in 2021. In particular, countries like Norway and Canada whose central banks are moving towards interest rate hikes have seen stronger currencies. But there are economies where the central bank will not tighten policy in the foreseeable future, like the euro area, Switzerland and Japan. Rate hikes are also far away in Sweden, though the Riksbank will taper its QE purchases in 2021.

USD appreciation is on hold. In 2020 the dollar showed a declining trend as Federal Reserve key rate cuts eliminated gaps between short-term interest rates, but 2021 began with a temporarily stronger USD. This was partly because the Biden administration's big new stimulus measures are having a clear impact on US growth. The short-term direction of the USD will be determined by the extent to which it accelerates Fed action, but we believe the Fed wants to wait for clearer signs of more normal resource utilisation before starting to withdraw stimulus. If market expectations of rate hikes proved wrong, we see potential for weak fundamentals – such as rising public sector and current account deficits – to pull down the dollar a bit in the short term. Given the large Treasury bond supply, a high USD valuation also plays a major role, so we believe the euro may rise a little to USD 1.24 late in Q2 2021. But further ahead, there are many indications that positive employment and growth trends will change the inflation outlook, allowing the Fed to begin normalisation well ahead of other major central banks. Late in 2021 and in 2022, this will provide clearer support for the USD. We believe the EUR/USD rate will reach 1.18 by year-end, continuing down to 1.13 by the end of 2022. As usual, the USD also sets the trend for most other currencies. We can then cite the now well-established "dollar smile theory", which says that the USD strengthens during deep crises or if US growth is much stronger than elsewhere, but in-between periods are not good for the dollar. The US is about to pull away from the rest of the world in a way that will benefit the dollar, but without the Fed's help we are not there yet. See *Nordic Outlook*, November 2020, for our theme article on how weak external fundamentals handicap the dollar.

The krona is pro-cyclical again, but also USD-dependent. Our latest *SEK Views* report shows that Swedish FX and fixed income market professionals generally believe the krona will benefit from strong Swedish exports and positive risk appetite. These are classic drivers for the krona, which has long been viewed as a cyclically dependent currency. We share market expectations of a cautious appreciation and believe the EUR/SEK rate will fall below 10.00 late in 2021. Should the dollar appreciate faster than anticipated, EUR/SEK will have difficulties breaking 10.00. The Swedish banking system handles large liquidity surpluses coming from the Riksbank's QE programme, which means the krona may become more yield-sensitive, since this also involves large foreign currency deposits. Our forecast is that the EUR/SEK will reach its long-term equilibrium exchange rate of 9.70 by the end of 2022. If the EUR/SEK goes even lower, we see an imminent risk that the Riksbank may have to cut its key rate again.

Hawkish Norges Bank will support the NOK. Rising oil prices, positive risk sentiment and a hawkish Norges Bank have continued to support the Norwegian krone, which has recently surged higher. Due to expansionary fiscal policy, Norges Bank will continue its large daily NOK purchases in 2021. We expect the krone to strengthen further against the euro and predict that EUR/NOK will fall to 9.70 by the end of 2021 before turning somewhat higher again.

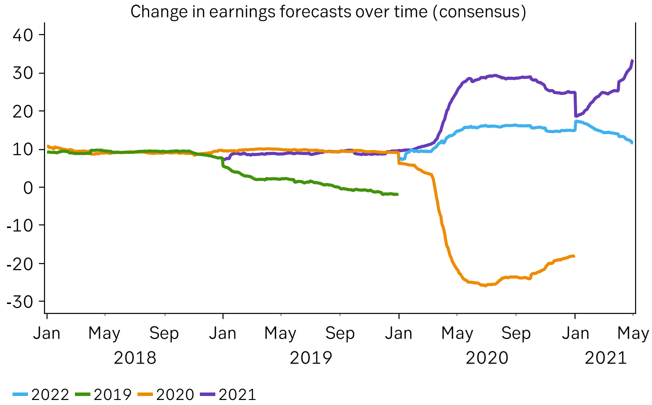
The stock market

A favourable outlook for another while

Surprisingly resilient economies and companies bode well for the post-pandemic reopening. Despite high expectations, companies may well keep surpassing their earnings forecasts during the coming quarters. The reflation scenario is likely to favour risk assets such as equities – especially more cyclical ones – for another while. In the short term, stretched valuations will be challenged as the recovery reaches a more mature phase of subdued growth and more uncertain bond yield prospects.

Sharply higher earnings expectations

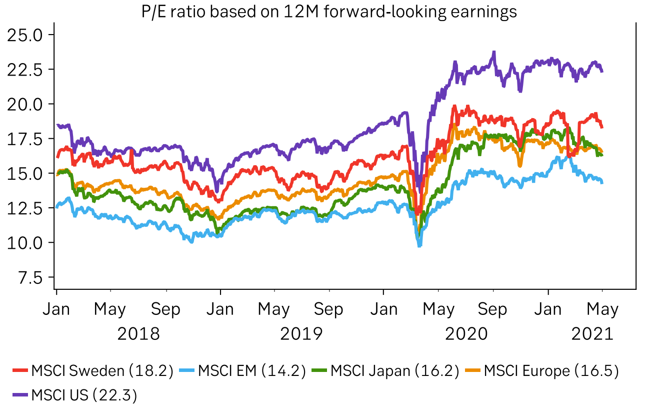
Change in earnings forecasts over time (consensus)



Source: Macrobond, SEB

Stock prices move in response to earnings

P/E ratio based on 12M forward-looking earnings



Source: Macrobond, SEB

Positive earnings reports. Corporate reports for Q1 2021 also mark the fourth quarter since the outbreak of the COVID-19 pandemic. Once again they exceeded analysts' forecasts, this time despite some upward revisions in expectations. The relatively lukewarm market reaction so far probably reflects inflated prices and already rather aggressive positioning among investors.

Room for upward revisions. In line with economic growth forecasts, corporate earnings expectations have gradually climbed during the past 12 months. In 2020 there was an 18 per cent decline in earnings at the aggregate level, but this was still well above the forecasts from last spring. For a long time, gradual upward revisions for 2020 were matched by lowered expectations for 2021, but recently earnings forecasts for this year have again been adjusted higher and are now back at around a 30 per cent increase, driven by US companies. Given revised economic growth forecasts and massive stimulus measures, there is room for upside surprises in the coming quarters as well. Expectations of global earnings increases in 2022 are at a more normal 12 per cent.

Bright outlook is priced in. Early in a recovery, high stock market valuations are natural – given forecasts of strong earnings increases. Powerful monetary and fiscal stimulus measures underscore this scenario. The TINA argument ("There Is No Alternative") that low bond yields and interest rates make traditional non-equity investments unattractive remains persuasive, as long as bond yields do not surge. Low yields, combined with solid earnings growth, are among the reasons we do not consider today's valuations especially concerning, but it is important that optimistic forecasts turn out to be correct. Rising share prices and valuations have been accompanied by higher investor risk appetite and positioning. High risk appetite is limiting long-term potential, but we are not yet at levels that imply an obvious risk of corrections.

The growth picture should favour cyclical companies. It is unusual for fundamental conditions to be as unequivocally positive for equities as they are today. Assuming no unpleasant surprises related to vaccinations and virus spread, there are many indications that this summer's expected reopening of economies will fuel new stock market upturns. In this scenario, more cyclical companies are likely to benefit – sectors such as industrials and non-durable goods, as well as some emerging markets and the Nordic region.

Risks in the next phase. But since the market has largely already priced in the bright outlook that is reflected in forecasts and position-taking, there is reason for caution further ahead. Forecasts indicate economic growth well above trend during the next couple of years. This in itself will provide continued support to the stock market, but the timing is not so favourable. The growth rate is expected to peak in the next few quarters, then slow towards trend growth. In such a situation, continued low yields and interest rates will be especially important to justify inflated valuations. If economic growth again surprises on the upside, equities may be challenged by rising yields, interest rates and inflation expectations and/or reduced central bank stimulus. We saw the latter during the autumn of 2018, which resulted in really unhappy stock markets.

A possible focus on pharmaceuticals. In stock markets that are balancing between an economic scenario that supports cyclical investments and a more subdued scenario that provides renewed fuel for growth stocks, one future winner may be more stable profit generators such as the health care sector, where favourable demographic and technological trends will combine with attractive valuations after a long period out of the spotlight. Strong underlying trends, driven by massive political initiatives, also continue to suggest investments in companies with a focus on sustainability.

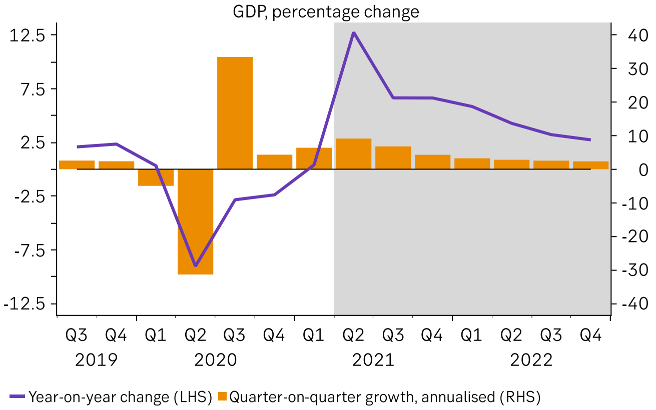
The United States

Bidenomics redrawing post-pandemic map

Household payments and vaccinations will allow a flying start after the pandemic. Consumers will keep the recovery alive by smoothing savings over several years. Uneven fiscal stimulus poses new challenges for the Fed, which will phase out bond-buying from late 2021 but delay interest rate hikes until 2023. Huge stimulus during the pandemic will be followed by green industrial policy, expanded family policy and higher taxes as Biden tightens the government's grip on the economy.

A roaring economic take-off after the pandemic

GDP, percentage change



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

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.2	-3.5	6.5	4.0
Unemployment*	3.7	8.1	5.3	4.0
Wages and salaries	3.3	4.8	2.6	2.9
CPI	1.8	1.3	3.0	2.4
Core PCE (Fed target variable)	1.7	1.4	2.3	2.2
Public sector balance**	-5.7	-15.5	-15.0	-8.0
Public sector debt**	108	127	133	135
Fed funds rate, %***	1.75	0.25	0.25	0.25

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

Full speed ahead, thanks to cheques and vaccines

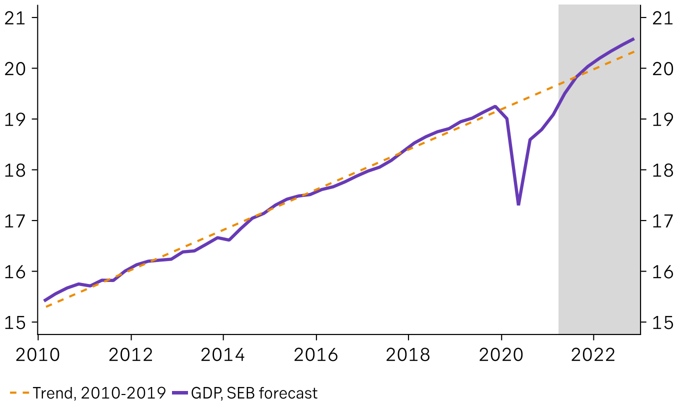
A successful vaccination drive and fiscal stimulus measures unparalleled in modern times will lead to a roaring take-off in 2021. We forecast GDP growth of 6.5 per cent in 2021 and 4 per cent in 2022: an upward revision by two percentage points for this year and almost half a point for 2022 compared to February's *Nordic Outlook*. The US economy will be back at pre-crisis levels this summer, surpassing its previous trend by early 2022. This strong growth outlook raises questions about bottlenecks and inflation risks that may arise earlier than expected. Meanwhile the scale of crisis relief measures creates a risk of a bumpy ride, since the federal government cannot maintain the same rate of stimulus as in 2020 and 2021. Getting COVID-19 under control is a basic precondition for our forecast. Parts of the US are now experiencing surges in transmission of mutated viruses; we expect this to be offset by a continued rapid vaccine roll-out. The dominant vaccines in the US, from Pfizer and Moderna, are based on technologies that have not been affected so far by worrying reports of side effects.

Mixed current situation. The purpose of federal stimulus during the pandemic has been to compensate households and businesses for lost income and avoid lasting damage from what largely resembles a global natural disaster. Goods consumption bounced back quickly, softening the slump in industrial production and in machinery and software investments. Despite the job crisis, low interest rates and financially strong households have raised the temperature of the housing market. Exports remain under pressure, while strong import demand is helping to drive growth elsewhere in the world. Business sentiment indicators, such as the ISM and PMI, rose to historically high levels in both manufacturing and the service sector early in 2021 but are being challenged by bottleneck problems in disrupted supply chains. US automakers have been forced to partially suspend production due to semiconductor shortages. Industry analysts foresee a temporary shortfall of 175,000 cars this year, equivalent to 7 per cent of the more than 2 million passenger cars produced in 2019. In the sectors that are most affected by social distancing, the situation remains weak. A total of over 8 million jobs are still missing compared to before the pandemic, including more than 3 million in the recreation and hospitality sectors.

Tug-of-war between piggy bank and ketchup bottle

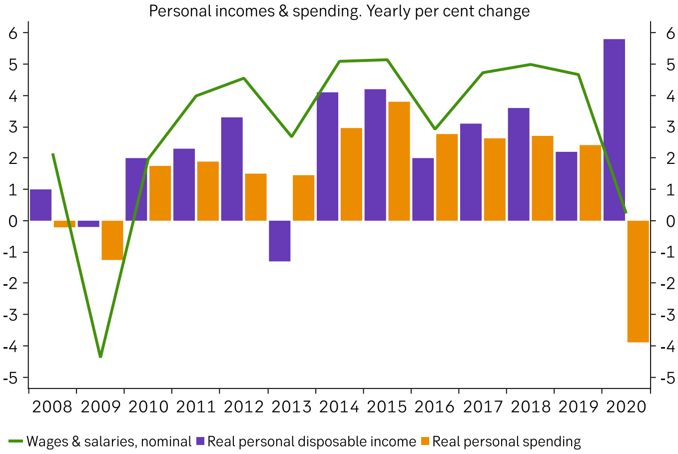
Consumer behaviour, combined with the virus transmission outlook, will determine US growth prospects. Public payments to households totalling more than 4 per cent of GDP, combined with sharply lower service consumption, boosted household savings in 2020. Direct payments to households in the two latest relief packages total nearly another 6.5 per cent of GDP. During 2020- 2021, real household purchasing power is expected to increase by 13 per cent. This creates the risk of a "ketchup effect" when the economy reopens, but also of sudden halt in 2022 when fiscal stimulus fades. The savings ratio rose sharply in 2020. Our forecast is that it will remain at around 15 per cent of income this year too, providing a buffer when fiscal policy tightens in 2022. We expect purchasing power to fall by 4 per cent then, even though certain measures – such as the new child allowances – will probably be renewed next year. Overall, we foresee good prospects of a relatively harmonious recovery process despite fluctuations in fiscal policy. Surveys of how households behaved when they received their 2020 payment support this assessment. According to the New York Federal Reserve, households consumed about a third of their payment immediately, with the balance evenly distributed between saving and debt repayment. The two subsequent rounds of payments, in January and March 2021, show a similar pattern. Households boosted their consumption rather quickly, which had a strong impact on retail sales, while only about a quarter appears to have been consumed. The New York Fed survey shows no differences between income categories in propensity to consume, but low-income households paid off more debt while high-income earners saved a larger share. Households behaved in the same ways when receiving earlier payments, for example in 2008, indicating that saving is not due to lack of consumption opportunities during the pandemic. High goods consumption last year also suggests that purchases of some durable goods should be saturated for a while.

US economy back above trend next year



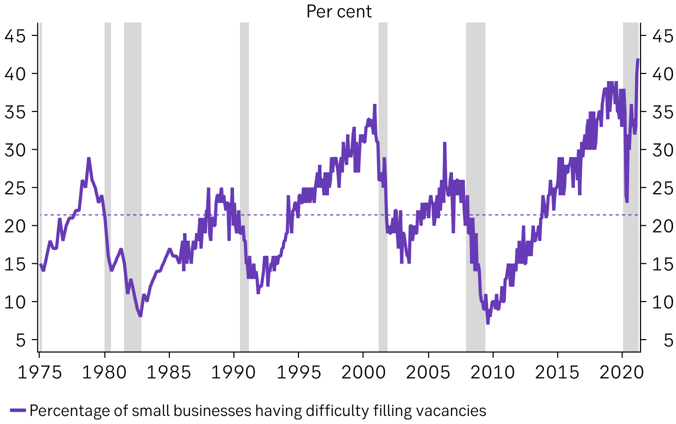
Source: Bureau of Economic Analysis (BEA), Macrobond, SEB

Households have money to spend after weak 2020



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

Labour shortages despite high unemployment



Source: National Federation of Independent Business, Macrobond, SEB

Meanwhile it is hard to believe that households will quickly recoup their lost service consumption from 2020. There is a limit to how many concerts you can attend or trips you can take in one year. We forecast that private consumption will rise by 7 per cent in 2021, by just above 3.5 per cent in 2022 and stay in line with the previous trend, with the savings ratio somewhat above its pre-crisis level.

The labour market will take off again

Employment is still lagging behind the levels on the corresponding dates during previous recessions. This reflects both the deep initial decline during the pandemic and the fact that job growth came to a halt late in 2020 as the pandemic again worsened. US officials expect to have vaccinated all adults by the end of June. This will enable a renewed rebound in private service sectors as well.

Signals of labour shortages in surveys and anecdotal data are one clear difference compared to previous crises. The percentage of small businesses reporting labour shortages, according to the NFIB small business survey, is the highest since the survey began in the 1970s. In the Fed's *Beige Book*, companies report difficulties in recruiting unskilled labour. These problems are in clear contrast to still-high unemployment rates, signalling that the weak labour market is also due to the pandemic's impact on the supply side – such as closed schools and day care – or fear of exposure. This, in turn, suggests that the recovery may be powerful once the economy reopens. During the crisis, household finances have been propped up by employment benefits that have been generous from an American perspective. This enhanced federal support will be phased out in early September, creating an incentive to return to the labour market once COVID-19 is under control.

Employment growth is expected to accelerate this spring and summer, with monthly increases of about 1-1.5 million jobs. Even if the labour supply expands again, this means that unemployment is expected to fall from 6 per cent in March to just under 4.5 per cent at the end of 2021 and just above 3.5 per cent at the end of 2022, close to the pre-pandemic level. The employment level is expected to return to its baseline early in 2022 but remain below its previous trend for the rest of our forecast period. Some jobs that disappeared during the pandemic will take longer to come back; others are probably gone forever. These are logical consequences of structural changes and investments in automation/digitisation, for example as a result of reduced business travel and increased e-commerce. These changes are also expected to lead to a slight acceleration in productivity growth, which explains why we believe that towards the end of 2022, GDP will exceed its old trend level, while employment will need significantly longer to regain lost ground. In the short term, it is also conceivable that increased average working hours will help explain this trend, since sectors that reopen after lengthy closures will have to catch up with pent-up needs in their order books.

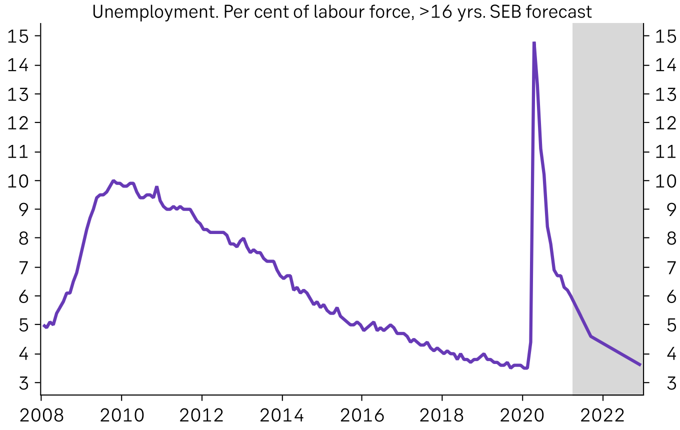
Uncertain inflation landscape a challenge for the Fed

Strong growth, the need to adapt supply to resurgent demand for services as the economy reopens, and bottlenecks in production are expected to push up inflation this year, with businesses taking the opportunity to temporarily raise their margins. Core inflation, excluding energy and food prices, will approach 3 per cent. We believe that inflationary forces will be transient; core inflation will revert to 2.3 per cent by end 2022. The long-term outlook will be determined by the interaction between pay and inflation expectations. Wages and salaries did not soar even during the pre-pandemic peak, which justifies our reassuring conclusion. Inflation expectations, as reflected by the pricing of inflation-linked bonds, indicate upward risks in the short term but a more subdued outlook in the long term (read more about inflation challenges on page 25).

Volatility, with risks of both overheating and drastic cutbacks in fiscal stimulus next year, means the Fed faces a difficult balancing act. The US central bank has said it is willing to ignore temporary inflationary impulses as the economy reopens, but major upside surprises combined with continued rising inflation expectations would test the limits of its increased tolerance level. Given the new policy framework, based on average inflation ("inflation memory") and asymmetric employment targets, the Fed will have more room to hold off on tightening measures compared to previous recessions.

Rapid improvement ahead

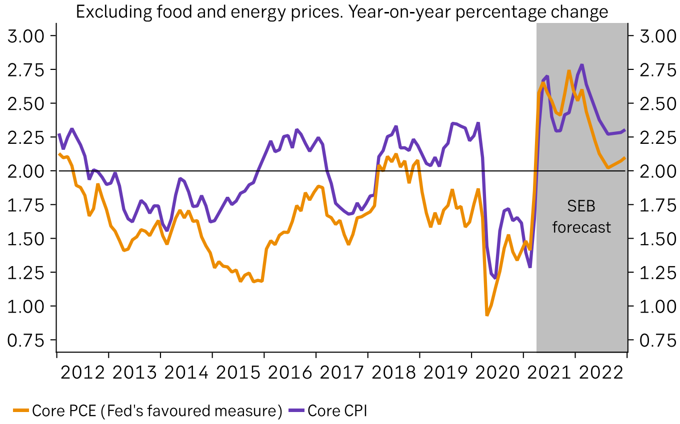
Unemployment. Per cent of labour force, >16 yrs. SEB forecast



Source: US Bureau of Labor Statistics, Macrobond, SEB

Base effects and reopening will boost inflation briefly

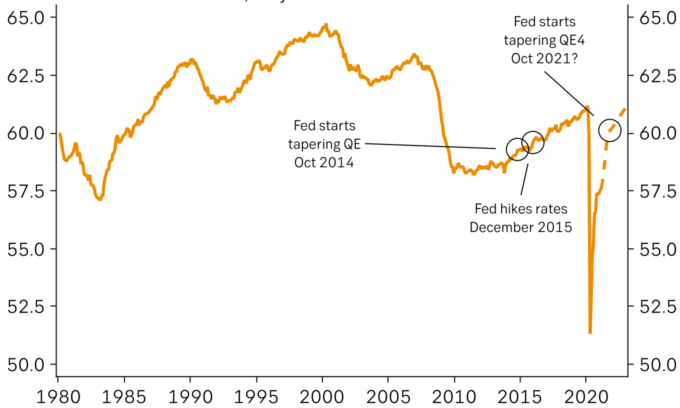
Excluding food and energy prices. Year-on-year percentage change



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

Employment to population ratio

Per cent, 16 years and over. SEB forecast



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

Bond purchases of USD 120 billion per month will continue until the economy has made *"substantial further progress"* towards Fed employment and inflation targets. We believe that rapid job growth and a return to more normal conditions after the pandemic will suffice for this goal to be met by the autumn. The Fed is expected to signal an upcoming policy change at its June and July meetings, followed by decisions in September. In October, it will start phasing down bond purchases by USD 10 billion a month. They will end next year. The path to a key interest rate hike is longer and will require full employment, inflation at the 2 per cent target and an imminent overshooting period. If inflation falls slightly – in line with our forecast – while inflation expectations remain moderate, we believe there will be no key rate hikes until 2023. Our Fed forecast is a bit more dovish than current market pricing. Reduced fiscal stimulus is one reason for the central bank to wait. Meanwhile we believe that the Fed wants to see a return to the pre-crisis employment rate.

Industrial policy with a focus on climate and China

Robust fiscal policy is playing a key role in accelerating the recovery. The three rescue packages during the COVID-19 crisis totalled at least USD 5.2 trillion, or around 25 per cent of GDP. This stimulus dose is probably more than what is needed from a crisis standpoint and is also motivated by political reasons. There is certainly a desire to utilise a temporary window that may be closed as early as the 2022 mid-term elections, when the Democrats risk losing power in the Senate and/or the House of Representatives. Because of their current slim majorities, the path of ordinary legislation is largely closed and political initiatives must be tied to the budget process, where decisions can be made by simple majority. During 2021, the US Congress is expected to pass two more reform packages totalling USD 3-4 trillion – one mainly including investments in climate and infrastructure and the other focusing on education, child care and paid sick leave. Unlike the previous packages, they will be financed by tax increases on companies and high-income households, respectively.

Front-loaded spending and later tax hikes will contribute to a continued large budget deficit in 2022. As a share of GDP, however, the deficit will decrease to 8 per cent, compared to the 15 per cent we expect in 2021. This means a tightening of 3,5 per cent of GDP, measured as a change in the structural budget balance. Infrastructure investments totalling about USD 2.3 trillion will run for 8 years and be fully paid until after 15 years. Overall, these investments represent the biggest policy shift since the Reagan era, with a sharp expansion of the federal government's role in the economy, including climate change responses and investments in roads, railways, electric vehicles, broadband and power transmission that seeks to pave the way for a revitalisation of US industry, productivity growth and higher real wages for the middle class. According to the White House this industrial policy is justified, among other things, by the need to respond to competition from a state-controlled Chinese economy, both in green sectors (where China has taken the lead in electric vehicles, for example) and other technologies. President Biden wants to invest in research and increased domestic production of semiconductors. The extent to which these plans materialise will be decided by future negotiations, mainly internal. Our forecast assumes faster growth in public consumption and investments, as well as in business investments, which may partly take over as growth engines when federal support for private consumption falls next year.

Theme:

Inflation

Higher US inflation, but the low-inflation era is not over

Highly expansionary US economic policies, combined with supply disruptions because of the pandemic, have put the low-inflation environment of recent decades to its toughest test so far. Due to the normalisation of low price levels during the pandemic and very strong consumption, US core inflation will be higher in the coming year than for a long time. The wage response to falling unemployment will eventually determine whether inflation moves higher more permanently, but we predict that rising labour supply and productivity will cause unemployment to stabilise at around 3.5 per cent, a level that did not lead to a clear pre-crisis shift in the rate of wage growth. Our main forecast is thus that the low-inflation environment will persist, although there are upside risks linked to inflation expectations and even lower unemployment.

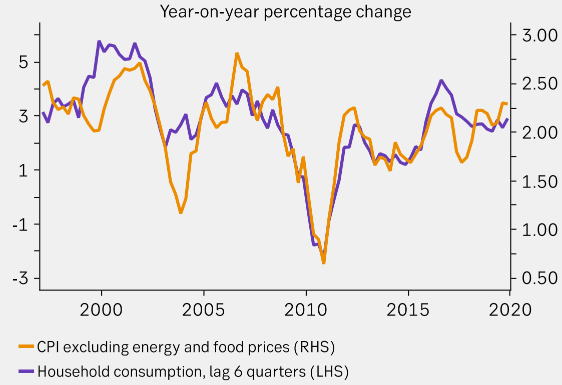
Lockdowns during the COVID-19 pandemic and extreme stimulus measures have made inflation risks more topical than for many years. Several leading economists are warning that inflation may climb to levels we have not seen in decades. There have also been comparisons with the inflation-plagued 1970s. Because the Democrats finally won a majority in the Senate too and were thus able to push through an even more expansionary stimulus package, we have adjusted our US inflation forecasts higher. So far, however, we do not regard the inflation upturn as sufficient to change our view that the Federal Reserve can hold off on monetary tightening. Nor do we believe that inflation in line with our forecast will drive up market rates in a way that threatens the recovery. But since uncertainty is greater than for a long time, there is reason to keep monitoring the issue closely. February's *Nordic Outlook* included a broad theme article on 10 dimensions of inflation. This article focuses on more short-term threats, with an emphasis on the United States, which will grapple with these issues first.

Decades of very stable inflation

Since the mid-1990s, inflation has been highly stable. Although there have been large fluctuations in energy and food prices, driven by shortage situations in the world market, these have not expanded into general inflationary impulses. Core inflation in the US, excluding energy and food prices, has ranged from 0.6 to 2.9 per cent year-on-year since 1997. For 80 per cent of the time, core inflation has deviated by less than 0.5 points from the average. Dramatic fluctuations in the real economy – including a downturn after the global financial crisis that was the deepest since the 1930s, whereas unemployment hit a 50-year low before the outbreak of the pandemic – have had minor short-term effects on core inflation. The pattern is similar in most advanced economies and, with some exceptions, also among large emerging market (EM) economies. Another general pattern is that inflation has tended to average a few tenths below the 2 per cent that gradually became the usual target for the world's central banks. The pattern of slightly too low inflation was clearest after the financial crisis. Even earlier, core inflation tended to be slightly below 2 per cent, but before the financial crisis, fairly long periods of sharp oil and food price upturns resulted in total inflation that was closer to target.

Modest US inflation impulse, with a time lag

Year-on-year percentage change



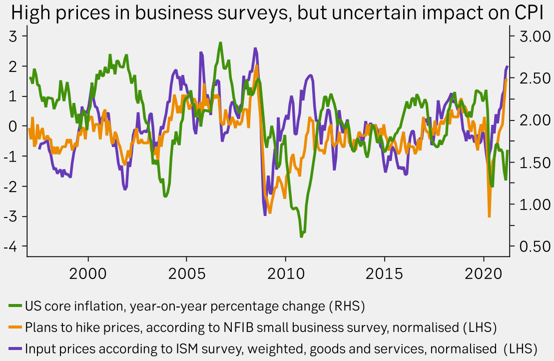
Source: BEA, BLS, SEB

Low core inflation is on the way up. At present, US core inflation is around 1.5 per cent. It has fallen below this only a few times since the 1960s. But this low inflation conceals large price movements in different directions. For example, prices of tourism and transport services – among the sectors that were hit hardest by the pandemic – fell sharply last spring and have remained at low levels since then. There are many indications that prices of such services will rise rapidly when travel recovers, and the price level will probably revert to earlier trends. A normalisation of tourism and transport prices will temporarily boost overall inflation by 0.3-0.4 percentage points. It is thus one important reason why we expect core inflation to rise to among its highest levels in the past 25 years. Another important explanation for today's low US inflation is that rent hikes slowed significantly during the pandemic. Rents have a weight of more than 40 per cent in core inflation and 33 per cent in total CPI. They largely consist of indirectly estimated (so-called imputed) prices for households that own their homes. The annual rate of increase in rents has slowed from about 3.5 per cent at the beginning of 2020 to about 1.5 per cent. This means that this component has helped lower core inflation by about half a point. Weak demand for rental housing, partly due to relocations from large cities during the pandemic, is probably behind the slowdown. The rate of rent increases will also normalise and make a significant contribution to rising inflation. Core inflation is expected to rise to 2.5 per cent during the next couple of years, generally because we expect significant contributions from the normalisation of the rate of price increases for components that have fallen during the pandemic. Initially, base effects from low prices in the spring of 2020 will also be important.

The production engine is spluttering a bit

During the earliest phase of the pandemic, there was concern about supply disruptions, for example due to broken international supply chains, employee absenteeism, closed borders or protectionism. After some initial disruptions in food production, along with hoarding of medicines and personal protective equipment, these fears proved exaggerated. Production and trade seemed to function quite normally for a long time. During the past 3-4 months, new warning signs have appeared – with sharp increases in shipping prices between Asia and the West as well as shortages of semiconductors and computer chips as major examples. Price increases on many commodities have also been higher than for years. A combination of production problems due to lockdowns and strong demand seems to explain this. Although resource utilisation in the overall world economy is still well below normal, the demand for certain goods – especially electronics – has been strong. So far, these imbalances have mainly been reflected in longer delivery times and rising input prices according to various business surveys, but producer prices for commodities have also risen quite a lot in official data.

High prices in business surveys, but uncertain impact on CPI



Source: Macrobond, SEB

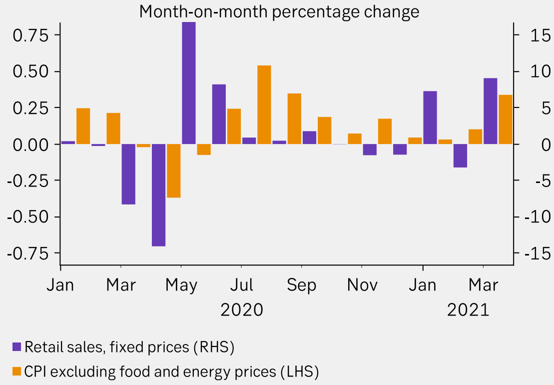
Weak association between inflation and input prices.

In the current situation, it is important to note that the correlation between core inflation and indicators at the producer level is normally quite weak. Even at times when price expectations were close to historic highs, core inflation movements have been moderate. Instead, increases in core inflation have often occurred in a more mature economic situation, driven by rising wages and clear upturns in producer prices for more highly processed goods than those that are now showing price increases. Producer prices for consumer goods are still rising slowly at the global level, though they have begun to climb from low levels in the US. Our forecast assumes that the semiconductor shortage and Asian shipping problems will be resolved in the not too distant future, but so far price indicators are in line with our predicted upturn in US inflation.

Consumption and inflation are not a simple story. Nor is the association between real consumption growth and inflation particularly strong, at least not in the short term (see chart). Periods of strong consumption growth are instead characterised by falling inflation. This is because recoveries often get off to a flying start – with rapid consumption growth – while the inflationary impulse is delayed until consumption culminates at a high level. This pattern will be put to the test this year, when consumption in the US is expected to grow by 7 per cent. Because consumption is starting from a low level and will not surpass its pre-pandemic trend even after a further increase of around 3.5 per cent in 2022, a moderate inflationary impulse seems likely this time as well. If consumption were to reach several percentage points above trend, inflation risks would increase significantly. The correlation between consumption and inflation in individual months is also low, but that pattern was interrupted to some extent in the spring of 2020, when we saw big surges in consumption due to federal stimulus payments and the easing of restrictions. Retail sales rose by 10-15 per cent in May and June 2020, followed by high monthly growth figures for core inflation during June-September. Retail sales in March 2021 increased by almost 10 per cent, and there is a risk of a new inflation impulse with a slight delay, especially since inflation is now clearly higher than last year. But last summer's acceleration was short-lived and was followed by six months of low inflation figures.

Moderate inflation, despite extreme consumption

Month-on-month percentage change



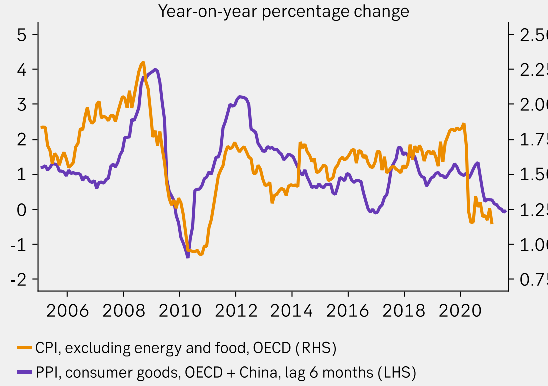
Source: BLS, SEB

Does the Phillips curve have a trick knee?

The inflationary forces discussed above are of a rather short-term nature. Even if they should become stronger than we have expected, there are many indications that inflation will fall again once consumption and production patterns normalise. In order for inflation to shift permanently higher, it must be combined with acceleration in the rate of wage and salary growth. However, wages have been insensitive to changes in unemployment for a long time. In the years before the pandemic, when unemployment fell to a 50-year low of around 3.5 per cent without any significant acceleration in wage growth, many analysts – including the Fed – were surprised. The so-called Phillips curve, which shows the association between unemployment and wages, thus seems to have become flatter than before. Our forecast is that unemployment will again drop to 3.5 per cent by the end of 2022. Experience from 2018-19 suggests that there will be no clear wage acceleration during our forecast period. However, our forecast is based on relatively optimistic assumptions about productivity growth and labour supply. This means it cannot be ruled out that unemployment may fall even lower. Several leading economists – such as former IMF chief economist Olivier Blanchard, who warns that the US federal stimulus dose is too large – also believe that unemployment will fall significantly further than the Fed's forecasts and ours. At that point, we will enter uncharted territory; the question is whether there is a critical level of unemployment where the Phillips curve suddenly becomes steeper. It is also not certain that the Phillips curve is particularly stable. Recent research emphasises the role of inflation expectations. It is possible that the Fed's acceptance of higher inflation may cause expectations to rise so much that wages and salaries will accelerate faster in the future than the unemployment rate itself indicates.

Low producer price increases for processed goods

Year-on-year percentage change



Source: OECD, SEB

Few spill-over effects in the short term

The direct spill-over effects from higher US inflation to Western Europe will be small. The long time lag in our recovery thus suggests that it will take a while before the risk of undesirably high inflation become significant here as well. On the other hand, for a long time we have seen large co-variations in the inflation trends of advanced economies, with "regime changes" in the inflation environment occurring quite synchronously. If US fiscal policy experiments should lead to overheating symptoms – leading to soaring inflation expectations, with or without acceptance by the Fed – it is possible that we could face such a regime change that might also affect Western Europe. This could be due to the fact that it will seem politically attractive in Western Europe to try to copy an experiment that is credited with reducing unemployment to historically exceptional lows. However, such a development would also be associated with major risks and would lead to dramatic re-pricing in financial markets.

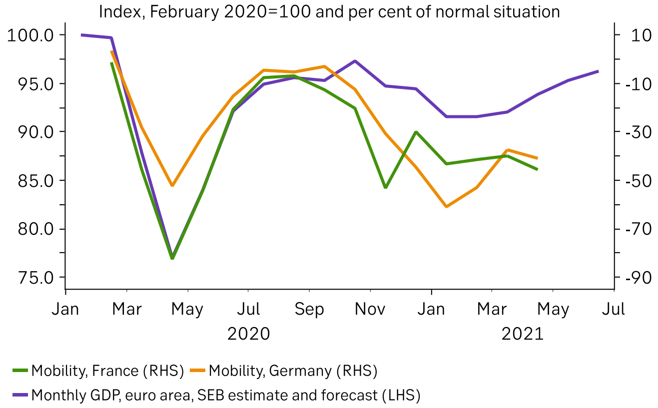
The euro area

The recovery will take off in the second half

This spring's extended restrictions are delaying the recovery. Although steps are now being taken to reopen euro area economies, their recovery will not be on firm ground until Q3. Crisis responses will continue to prop up growth – supplemented by the EU's Next Generation package, which will play a more significant role only starting in 2022. After peaking at above 2 per cent, inflation will drop back below target, contributing to continued asset purchases by the ECB.

More resilience, but still a weak start in 2021

Index, February 2020=100 and per cent of normal situation



Source: Google, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.3	-6.6	3.8	4.2
Unemployment*	7.6	8.0	8.1	7.8
Wages and salaries	1.9	1.5	1.5	2.0
CPI	1.2	0.3	1.7	1.2
Public sector fiscal balance**	-0.6	-7.2	-6.4	-4.6
Public sector debt**	84.0	98.0	102.7	101.2
Deposit rate, %***	-0.50	-0.50	-0.50	-0.50
EUR/USD***	1.12	1.20	1.13	1.18

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

Lagging behind the US and UK

The slow pace of COVID-19 vaccinations is causing the euro area to lose ground compared to the United States and the United Kingdom. Although the process has accelerated, extensions of far-reaching restrictions have been unavoidable. The association between mobility metrics and economic activity has weakened, but we believe that the upturn in Q2 will be modest, reaching only 1 per cent after a decline of 0.6 per cent in Q1. This means that a clearer euro area recovery will not arrive until late in the first half – a few months behind the US and UK. Because the recovery will take off only in mid-2021, annual average GDP growth will reach 3.8 per cent this year and will accelerate to 4.2 per cent in 2022.

Hard to read the mood of business. Sentiment indicators have recently climbed markedly on a broad front. Although pandemic-related restrictions continue to hamper activity in many sectors, non-manufacturing PMIs are now around the neutral 50 mark. This upturn partly reflects adaptability to restrictions. But it is also likely that businesses in hard-hit service sectors do not believe the situation can get worse, contributing to hopes that things will soon improve. Manufacturing PMIs are close to historic highs but looking at sub-indices the picture is complex. Total indices are driven by longer delivery times and expectations of rising purchase prices. Sub-indices should reflect demand, but if they are instead driven higher by supply-side problems such as a semiconductor shortage, we must be cautious about interpreting high sentiment levels as leading indicators of rapid production growth. But the big picture is still that manufacturers have shown growing resilience to lock-downs. Looking ahead, rapid recovery in China and the US will have a positive impact on the euro area too. Despite large fluctuations, industrial production was largely unchanged in 2020 and will rise by 3-4 per cent yearly in 2021-2022.

Households poised for a spending spree. Household consumption will be a key element of the recovery process. Increased goods consumption has only partially offset the decline in areas of service consumption that have been hampered by restrictions. Meanwhile fiscal stimulus measures, including wage subsidy schemes, have propped up household incomes and contributed to higher saving. We estimate the savings ratio at around 20 per cent; some 7 points higher than before the pandemic. This will allow room for a surge in consumption when economies reopen more broadly – with pent-up needs in many areas. Home prices continue to rise, albeit at a slower pace than last year, strengthening the potential for an upturn in consumption. However, certain factors have had a dampening effect. For example, the European Central Bank (ECB) has pointed out that saving has risen mainly among groups with a low inclination to consume, such as older generations and high-income earners, not as much among those with a higher marginal propensity to consume, such as younger people and other groups with generally lower incomes. Overall, we believe that household consumption will increase by about 4.5 per cent in 2021 and 5 per cent next year.

Stubborn unemployment. During the pandemic, the upturn in the jobless rate has been held back by various wage subsidy programmes and a drop in labour force participation. Between March and August 2020, unemployment rose by 1.6 percentage points, compared to nearly 5 points during the global financial and euro crises. We are again revising our unemployment forecast lower but still believe there will be a slight further increase in the coming months. Unemployment will average 8.1 per cent in 2021 and 7.8 per cent in 2022. Spare labour capacity and the general crisis situation have led to low pay hikes and agreements. Contractual wages and salaries will increase by about 2 per cent yearly in 2021 and 2022; actual wages will be affected by the course of the crisis, which resulted in falling wages in 2020 and a sharper rise this year.

Fiscal stimulus has provided support but will weaken

Fiscal policy has been highly expansionary in the past year, as EU budgetary rules have been partially suspended. The continued pandemic will create a need for further spending this year. National stimulus programmes will be supplemented by the Next Generation EU (NGEU) package, which will invest EUR 750 billion (over 6 per cent of GDP) in projects that must be completed by 2026. NGEU is an important piece of the fiscal puzzle, with a structural focus on investment, digitisation and green reforms. If NGEU is to provide the expected stimulus, projects must start at the national level.

GDP growth forecasts

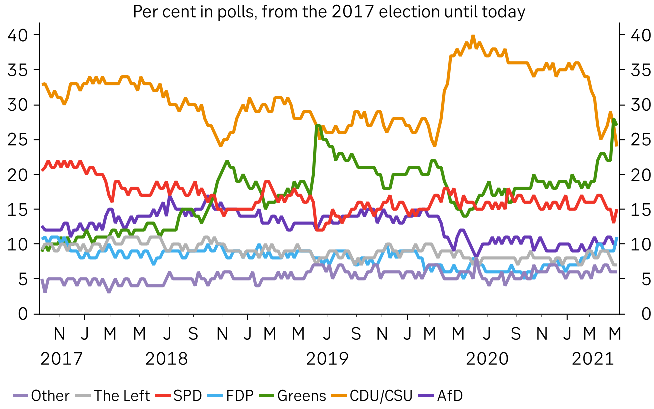
Quarter-on-quarter and year-on-year, per cent

	Q1	Q2	Q3	2020	2021	2022
Germany	-1.7	2.0	2.0	-4.8	3.0	3.5
France	0.4	0.5	1.5	-8.1	5.5	3.6
Italy	-0.4	2.0	2.0	-8.9	4.0	4.2
Spain	-0.5	1.5	2.0	-10.8	4.8	5.1
Euro area	-0.6	1.0	2.0	-6.6	3.8	4.2

Source: Eurostat, SEB

Tailwind for the Greens in Germany

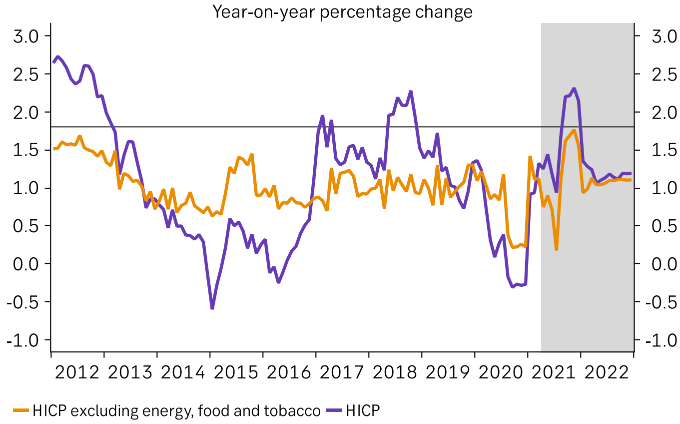
Per cent in polls, from the 2017 election until today



Source: Wahlrecht.de, Macrobond, SEB

Inflation will climb this autumn but then fall again

Year-on-year percentage change



Source: Macrobond, SEB

Low utilisation of various earlier EU programmes is a bit concerning. The fact that the NGEU has become a symbol of increased solidarity in the EU project makes it especially important that it is successful. Overall, we estimate that the stimulus dose in the euro area totalled 3 per cent of GDP in 2020 and that spending will be slightly larger this year, providing around 0.5 per cent in additional stimulus. As crisis responses are gradually scaled back in 2022, the tightening effect will be 1.5 per cent of GDP. The public sector deficit, over 6 per cent of GDP this year, will fall to under 5 per cent in 2022. The debt ratio, which was close to 100 per cent of GDP in 2020, continues higher this year. On the political front, the German election this autumn will be especially exciting. Angela Merkel, who is in her 16th year as federal chancellor, will be replaced. The Christian Democrats (CDU/CSU) and Social Democrats (SPD) in today's government are under pressure, and new coalitions may emerge. Who takes over as the CDU/CSU candidate for chancellor is probably not so important to economic policy. But if the Greens are part of the governing coalition, we might see a clearer pro-environmentalist shift in government policies.

ECB: Low inflation will lead to continued expansion

After falling below zero in August-December 2020, inflation has rebounded. In April it reached 1.6 per cent, driven mainly by base effects and rising energy prices. Here too, the pandemic and the resulting policy responses are affecting developments. For example, last year's German value added tax reduction is now ending, which will contribute to higher inflation. In the short term, there are various other inflation-generating forces to keep in mind. In sentiment surveys, businesses are reporting higher input prices. Meanwhile international food prices have risen. We are also likely to see price hikes in sectors that are poised for a dramatic upturn in demand once restrictions are eased, such as restaurants and travel. These upward tendencies are reinforced by continued supply-side constraints in certain areas. Yet it is still hard to imagine that these forces will be dominant, in an environment of idle resources and low contractual pay increases. We are thus forecasting an increase of 1.7 per cent in total CPI this year, falling to 1.2 per cent in 2022.

ECB will adapt its asset purchases to the prevailing market situation. The central bank has not changed its toolkit and policy since it expanded the Pandemic Emergency Purchase Programme (PEPP) in December 2020. PEPP, its main bond-buying programme, will now total EUR 1.850 trillion, allowing monthly purchases in the range of EUR 80-100 billion until March 2022. The ECB is still signalling that it will do what it takes within the existing programmes or by expanding them if necessary. Overall, the ECB is communicating that it does not wish to commit itself to specific actions in the form of fixed amounts but wants to maintain flexibility to respond to economic and financial market developments. For example, ECB President Christine Lagarde stated earlier this year that total bond purchases may be smaller or larger than the current framework of PEPP. At their March meeting, ECB policymakers stated that bond purchases would increase significantly in response to rising US Treasury yields, which then largely failed to materialise.

Symmetrical targets for the ECB as well? In light of international discussions and the US Federal Reserve's choices, the question of launching a symmetrical inflation target will be interesting when the ECB completes its strategic review later in 2021. Leading figures at the ECB have signalled that it is logical to overshoot their target of just below 2 per cent inflation after a period of "excessively low" inflation. We believe the ECB will take steps towards a more symmetrical policy, although the issue may be controversial given the different attitudes and inflation histories of euro zone countries.

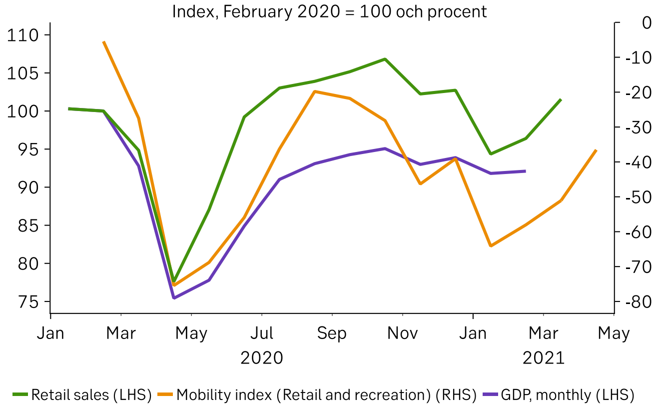
The United Kingdom

Early out of the gate

Despite some of the most far-reaching lockdowns, a successful vaccination campaign has made the UK the first out of the gate in Europe. The road to recovery has begun. But there is plenty of catching up to do, and there is a risk that the labour market will become an impediment to British growth. Uncertainty about Scotland's future and escalating unrest in Northern Ireland are adding to political risks, which were already high because of Brexit.

Increased activity after the phase 2 entry

Index, February 2020 = 100 och procent



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

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.4	-9.8	6.4	5.8
Unemployment*	3.8	4.5	5.8	5.6
Wages and salaries	3.4	1.8	2.5	2.9
CPI	1.8	0.9	1.6	2.2
Public sector balance**	-2.2	-14	-12	-6
Public sector debt**	85.4	103	107	109
Key interest rate, %***	0.75	0.10	0.10	0.10
EUR/GBP***	0.85	0.89	0.84	0.87

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

Ready – steady – go! The British economy is first out of the European starting gate, on its way to the new normal. After the UK experienced some of the most extensive lockdowns, its successful vaccination campaign has now changed the picture. In addition, the economic impact of the third lockdown has been significantly milder than feared. This is especially true of service production related to the corporate sector, which has performed far better than service segments that are more dependent on household consumption. After last year's 10 per cent GDP decline, a lot of catching up is under way. Compared to our previous forecasts, we now believe in a stronger recovery as early as this year, when we expect GDP to climb by 6.4 per cent, followed by an increase of 5.8 per cent in 2022. All four countries in the United Kingdom have now entered phase 2 of the reopening plan that Prime Minister Boris Johnson presented in mid-February. By late June, the economy is expected to be fully reopened. The recovery will thus be strongest during the second and third quarters. Further ahead, however, the negative consequences of Brexit will gradually become clearer and will slow the pace of recovery compared to the European Union, for example.

A risk that the labour market will soon tighten. Despite the large decline in GDP, the number of people with jobs has remained relatively high. This is largely because average working hours followed the movements in GDP, thereby muting the downturn in employment. The government's Job Retention Scheme covered about 25 per cent of all employees during the first wave of the pandemic and was about half as extensive during the third wave. Unemployment is expected to peak at the end of 2021 at 6.2 per cent and then fall to just under 5 per cent by the end of 2022, about one percentage point higher than the end of 2019. However, there is unusually high uncertainty in this forecast, since the pandemic caused a large number of foreign-born workers to move home and it is difficult to know how many of them will return to the UK. Withdrawal from the EU (Brexit) will also contribute to a lower labour supply, since the influx of EU citizens will decrease. Overall, this means that we may see bottleneck problems in the British labour market earlier than in other European economies.

Fiscal policymakers will set the pace. In March, the government unveiled a budget bill with bold features. In the midst of the COVID-19 crisis, the government is signalling a willingness to eventually raise taxes on the largest companies to help reduce the deficits created by its crisis responses. At present, however, this seems unlikely to lead to corporate taxes that exceed the average for the G7 countries. In the UK, however, we expect 2023 total tax rate to GDP to be the highest since the late 1960s. To compensate, the government has offered a super deduction to stimulate investments. The Bank of England (BoE) is currently in a wait-and-see mode. Its November 2020 plan for asset purchases is still in place and will probably be sufficient. The outlook for economic growth, the labour market and inflation has not changed in a way that justifies any major BoE policy shifts. We thus believe that the key interest rate will remain unchanged during our forecast period

Several dimensions of political uncertainty. In addition to the uncertainty associated with Brexit, questions are growing about the future fate of the United Kingdom. In the run-up to Scotland's May 6 parliamentary election, the ruling Scottish National Party (SNP) has promised a new independence referendum if it wins, although the constitutional situation remains unclear. The fact that unrest has flared up again in Northern Ireland underscores why that region has been such a major stumbling block in previous negotiations. Northern Ireland is caught between the old and the new, and no matter how we look at these issues it is hard to see the contours of any stable solution.

Theme:

The new gold

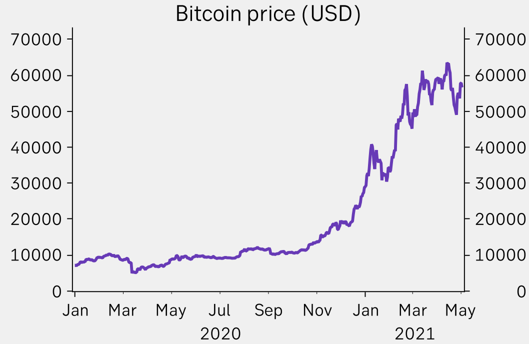
Cryptocurrencies will find their role in financial markets

Cryptocurrencies and bitcoin have surged in value over the past year. They are now starting to establish themselves in earnest as an asset class accepted by more and more investors and businesses. The future of cryptocurrencies looks bright, but they must overcome many obstacles before they can play a bigger role and become a natural element of the future financial system. Above all, there is a great need for market regulation. Even in the long run, for various reasons an independent cryptocurrency like bitcoin is unlikely to be allowed to threaten the role of traditional currencies as a means of payment. But bitcoin may very well continue evolving into a more widespread investment asset and an alternative to traditional stores of value like physical gold.

Amid increased risk appetite and recovery in financial markets this past year, one of the big winners has been cryptocurrencies and especially bitcoin. From below USD 5,000 when market turmoil was at its greatest in March 2020, the price of bitcoin peaked at about USD 63,000 in 2021. Aside from strong risk appetite, bitcoin has benefited from growing concern that unprecedented money-printing by central banks will erode the value of traditional currencies, and from the example set by various high-profile investors and businesses which have announced that they have started investing in cryptocurrencies. Today there are also many financial instruments for bitcoin, such as a functioning futures market as well as funds and other investment products. To summarise, the upturn in bitcoin over the past year can be explained by favourable market conditions and increased acceptance of cryptocurrencies as an asset class.

As with many other assets that have risen sharply in a short period, there is a great risk of market bubbles. But analysing the value of bitcoin is especially difficult. Traditional assets such as stocks, bonds or real estate all have an intrinsic rate of return that can be used to calculate a reasonable value in relation to what other assets cost. For bitcoin and commodities, which lack such an intrinsic rate of return, it is harder to calculate a reasonable value. For many commodities, you can still get a good idea of how their value will evolve by creating a scenario of changes in demand. Anyone who makes oil price forecasts knows roughly how much oil will be used in the world, given assumptions about economic growth etc. It is harder to price bitcoin because all price forecasts must be based on an assumption about how widespread and heavily used this "currency" will be in the future. There is an enormous range of predictions on possible outcomes – from those who believe that bitcoin will replace ordinary currencies to those who believe that it will be prohibited and become worthless. As is so often the case, the truth will probably be somewhere in between.

Bitcoin price (USD)

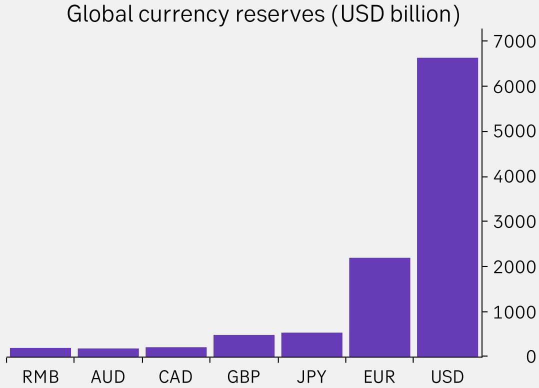


Source: Macrobond, SEB

More and more people like crypto. In recent years, bitcoin and other cryptocurrencies have made great progress towards becoming more widely accepted by both businesses and established investors. Last year one of the world's most successful hedge fund managers, Paul Tudor Jones, said he had invested in bitcoin. Earlier this year, Tesla announced that it had bought USD 1.5 billion worth of bitcoin. Last month Coinbase, the world's largest cryptocurrency exchange, gained a listing on the Nasdaq stock exchange, with a market value of more than USD 60 billion. There are numerous other examples of businesses and banks announcing that they will start offering various types of services for cryptocurrencies. Overall, during the past year bitcoin has taken major steps towards becoming more widely accepted as an investment asset.

Sceptical central banks want to keep their currency monopolies. But although more and more investors and businesses are embracing cryptocurrencies, there are also many sceptics. Among their biggest opponents are central banks, which view cryptocurrencies as a growing threat to their own currency monopolies. Actually, they are probably not worried mainly about independent cryptocurrencies like bitcoin. A bigger headache for central banks is the plans for private currencies created by large tech companies, with a fixed exchange rate against traditional currencies (so-called stablecoins). The most prominent example is Facebook's diem (formerly libra), which might in fact become a major threat to ordinary currencies if it were used for payments by billions of people around the world. Libra was originally supposed to be launched at the beginning of 2020, but the project ran into great suspicion from public authorities and politicians in the US and the EU, leading to delays and changes in the concept. Today there are plans to launch the new variant, diem, later this year. But none of these plans are written in stone, so we should not be surprised if there are new delays. The problems of diem/libra are a good example of governments and central banks not being prepared to relinquish all the power represented by their currency monopolies. The US in particular has strong reasons to do whatever it can to preserve the status of the dollar as the world's biggest currency by far, used today in almost 9 out of 10 global transactions. The fact that the dollar is so dominant gives the US, which controls the supply of dollars, enormous power. Those who want to use dollars electronically are also totally dependent on the American banking system, which makes US influence even bigger.

Global currency reserves (USD billion)



Neither the US, the EU, China nor any other country with its own currency is interested in allowing bitcoin or any private cryptocurrency to take over as a means of payment. The main weapon that countries have to preserve their monopolies is their regulatory systems. By restricting the usefulness or legality of cryptocurrencies in various ways, countries can prevent them from becoming a genuine threat.

Regulation for better or worse. More regulation of the cryptocurrency market is expected. The EU has already presented a draft of what such a regulatory framework might look like. Regulations are not a bad thing. Instead they are viewed by most people as absolutely necessary to enable cryptocurrencies to continue becoming more accepted and seriously integrated into the financial system. Regulation and better monitoring are important to make it harder for cryptocurrencies to be used in various kinds of illegal activities and would strengthen consumer protection as well as increase predictability for the companies operating in the cryptocurrency industry.

Official e-currencies. Many central banks have also realised that the success of cryptocurrencies is partly due to the shortcomings of regular currencies. Put simply, traditional currencies are ill-suited to meet the demands that future services will impose on the payment system. In an attempt to remedy this, many central banks have plans to launch their own electronic currencies, which will work better and have more functions than today's traditional currencies. The Riksbank has far-reaching plans to launch an e-krona, and in China the authorities have already begun testing an e-yuan among ordinary consumers. However, it will not be possible to use any of these currencies anonymously in the form of cash and they probably cannot be used outside the borders of each respective country.

Bitcoin and ESG. One recurring criticism of bitcoin is that the virtual "mining" that takes place to extract new bitcoins consumes large amounts of energy. Put simply, the mining process involves powerful computers that use random guesses to try to find solutions to a complicated cryptographic problem. The computer that fins the correct solution first is rewarded with a number of new bitcoins, then the process resumes. The computers around the world that participate in mining use large amounts of energy. Last year, the bitcoin network consumed 77 TWh of electricity, equivalent to more than half of Sweden's annual electricity consumption. Just as more people want to look for gold if the gold price climbs, a rising bitcoin price will lead to more computers being used for bitcoin mining, thereby increasing electricity consumption even more. Many people view this electricity consumption as a waste of energy, but it is not entirely true. The mining process is what continuously guarantees the security of the bitcoin blockchain, ensuring that no one can sell their bitcoins multiple times. High electricity consumption can thus be regarded as a cost to keep the network secure. But that does not change the fact that electricity consumption is a growing problem. Today, it takes the same amount of energy to make a single bitcoin transaction as over 700,000 ordinary payment card transactions. A growing interest in climate and sustainability issues among both investors and businesses may lead to a greater focus on the environmental, social and corporate governance (ESG) debate on bitcoin. As more and more investors and businesses want to show that they are doing what they can to help reduce greenhouse gas emissions, energy consumption may become a growing image problem for bitcoin. At the same time, cryptocurrency-related technological innovations should not be underestimated. The people behind some currencies have announced a transition to more energy-efficient methods for maintaining security in the blockchain that are not based on virtual mining.

Bitcoin as a means of payment. One Achilles' heel for bitcoin, which has become increasingly obvious in recent years, is that the currency does not work particularly well as a means of payment. Aside from the problem that price movements are so large that they make it essentially impossible to set prices in bitcoin, except in the very short term, blockchain technology – on which bitcoin is based – is slow compared to other payment solutions. The bitcoin network simply does not have the necessary capacity to handle all the transactions required for bitcoin to function as a global means of payment. Bitcoin's blockchain currently handles a maximum of 7 transactions per second, and it takes ten minutes for a transaction to be confirmed. This can be compared to VISA's payment system, which, despite being 30 years old, can still handle 1,700 transactions per second. Technical development to speed up payment processing for bitcoin and other cryptocurrencies is ongoing. Various solutions have been proposed, but the capacity problem has not yet been solved.

Crypto and crime. One area where bitcoin is actually being used as a means of payment is in various forms of crime. For criminals, the shortcomings of bitcoin as a means of payment have more than been offset by the anonymity that bitcoin transactions offer. Although bitcoin transactions can now be traced, this is difficult and requires a lot of resources. There are also other cryptocurrencies that are specifically designed to ensure that transactions are not traceable. For criminals, it is far easier to use cryptocurrencies – especially when moving money between countries – than to use cash or try to exploit weaknesses in the global banking system. Although cryptocurrencies are used in criminal activities, today they probably represent a small fraction of all transactions. According to the blockchain analytics firm Chainalysis, only 0.34 per cent of bitcoin flows during 2020 could be linked to known illegal services, a downturn from 2.1 per cent in 2019. However, there is sizeable under-reporting in these statistics, since Chainalysis cannot identify flows originating from such activities as money laundering and tax evasion. Reducing the illegal use of cryptocurrencies will be an important focus area in future regulation and monitoring of the cryptocurrency market, but of course it will not be an easy task.

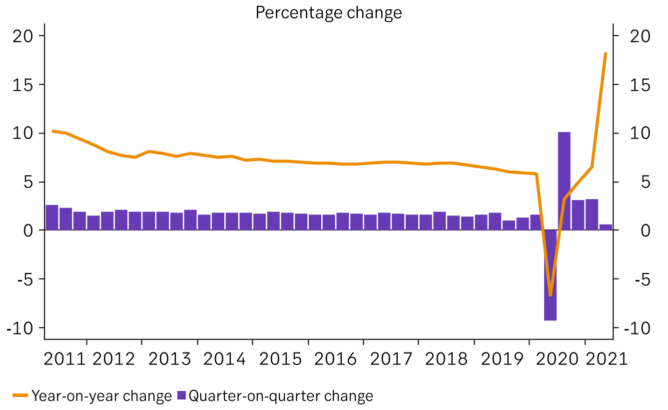
The future of bitcoin. Today, bitcoin and most other cryptocurrencies are used to a fairly small extent to make payments. Instead, these currencies have become something that is bought and sold primarily as a financial investment. In its role as an investment asset, bitcoin pose no more of a threat to traditional currencies than physical gold does today. Bitcoin has increasingly evolved into a commodity-based currency, just like the gold it is designed to emulate. Although bitcoin has only been around for a little over one decade, the value of all bitcoins today is more than USD 1 trillion. This is equivalent to 11 per cent of the value of all physical gold in the world. Today people own gold as an investment and store of value; almost no one uses gold coins anymore as money. There are many indications that this is the function bitcoin will also have in the future. As long as it does not threaten traditional currencies as a means of payment, governments and central banks around the world can let it live on. But the ultimate dream of all bitcoin enthusiasts – that bitcoin will one day achieve world domination in the global currency market – seems likely to remain only a dream.

China

Recovery is becoming more balanced

We have raised our 2021 GDP growth forecast to 9.0 per cent and lowered our 2022 forecast marginally. The credit cycle peaked last autumn and is slowing in line with Beijing's targets. This will dampen China's growth. But consumption will resume its role as an important growth driver. We expect that because of flows, interest rate factors and external balances, yuan appreciation will re-emerge, with the USD/CNY exchange rate reaching 6.20 by the end of 2021.

Base effects raised yoy growth, but momentum eased in Q1



Source: CEIC, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	6.2	2.0	9.0	5.3
CPI	3.1	2.5	1.6	2.0
Public sector fiscal balance*	-2.8	-3.6	-3.0	-3.0
Bank reserve requirement, %**	13.0	12.5	12.5	12.0
1-year loan prime rate**	4.15	3.85	3.85	3.85
Deposit rate, %**	1.50	1.50	1.50	1.50
7-day reverse repo rate, %**	2.50	2.20	2.20	2.20
USD/CNY**	6.96	6.50	6.20	6.00

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

China's economic recovery is becoming more balanced. We raised our full-year 2021 growth forecast to 9.0 per cent – from our previous 8.0 per cent prediction – after first quarter GDP soared by 18.3 per cent year-on-year. Consequently, we shaved our 2022 forecast from 5.6 to 5.3 per cent. The high growth figures in early 2021 are largely due to base effects, reflecting weak growth in early 2020 as the pandemic began. Similarly, nominal GDP rose by a dramatic 21.2 per cent year-on-year in January-March.

Despite these high figures, the economy lost momentum in Q1. Although a moderation in quarterly growth was expected after fourth quarter 2020 GDP growth was revised upward to 3.2 per cent, the 0.6 per cent quarter-on-quarter rise in Q1 came in below market forecasts. Growth will improve, but the turn in the credit cycle will limit sequential gains. The credit impulse, defined as the change in new credit issued as a share of GDP, peaked in October 2020. Historically, China's credit cycle tends to lead real activity by 2-3 quarters. Since last autumn, overall credit growth has continued its downward trend. Policymakers have made it a priority to minimise structural risks related to elevated leverage. Thus, the People's Bank of China (PBoC) is working to keep liquidity conditions balanced, providing only enough liquidity to meet real demand in the economy. Beijing's 2021 economic targets include lowering credit growth towards the pace of nominal GDP.

GDP growth drivers will shift in the coming quarters. Although the service sector posted 15.6 per cent year-on-year growth, its output level remains below the pre-pandemic trend. This is probably a result of travel restrictions implemented around the 2021 Lunar New Year. Prior to the 7-day public holiday period, a local cluster of the COVID-19 virus was found in a number of cities in northern Chinese provinces. This prompted Beijing to close travel routes in the surrounding areas and send out advisories aimed at limiting unnecessary travel and consequently suppressed the normally strong seasonal boost related to Q1 holiday spending. After mobility restrictions were lifted, consumer spending regained traction in March. Retail sales thus beat the levels of the previous two months. Throughout 2020, private spending had been suppressed by a weak recovery in consumer confidence. This led to an increase in household savings. Looking ahead, we expect confidence levels to improve on the back of continued gains in employment. However, industrial production eased substantially from a strong start early in 2021. Favourable base effects for manufacturing, which recovered relatively fast in 2020, are likely to fade from the year-on-year figures in the near term.

The yuan will appreciate, reaching 6.20 to the US dollar by year-end. Although opposing factors will keep the pair stable in Q2, we believe that yuan appreciation will re-emerge in the second half of 2021. We expect US short yields to remain within a range in the near term, now that the outperformance of the US economy is broadly priced in. There will be upside risks to US yields when the US Federal Reserve eventually hints at tapering its asset purchases. On the other hand, China's strong external balance will limit the USD/CNY upside. During Q1 2021, China's merchandise trade surplus reached USD 117.1 billion. Although capital flows related to bond trading have recently turned negative, we expect a return of bond inflows in the coming months. In October, the FTSE Russell will begin its inclusion process for Chinese bonds in its flagship bond index, ushering in around USD 120-150 billion of inflows. Moreover, we expect the PBoC to maintain its hawkish bias, even as the Fed takes gradual steps towards less monetary stimulus.

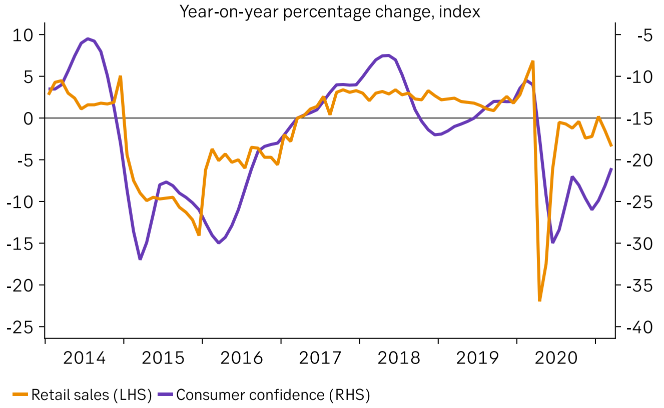
Russia

Political and policy factors impede growth

Russian GDP fell by 3.1 per cent in 2020, a relatively small decline – for example, compared to the euro area's 6.8 per cent drop. Rising household consumption and increased fiscal stimulus measures ahead of the State Duma elections in September will drive growth this year. In 2022, rising oil production will take over the baton amid increased global demand. Further sanctions against Russia can be expected but are unlikely to greatly reduce already low potential economic growth.

Vaccines and rising confidence to lift consumption

Year-on-year percentage change, index



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

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.0	-3.1	3.8	2.9
CPI	4.5	3.4	4.7	3.9
Government debt*	13.8	19.3	18.1	17.7
Current account surplus*	5.8	2.8	3.5	3.5
Wages and salaries (nominal)	7.3	5.8	8.0	7.0
Key interest rate, %**	6.25	4.25	5.50	6.00
USD/RUB**	61.9	74.0	71.0	75.0

* % of GDP **At year-end.
Source: IMF, Rosstat, Central Bank of the Russian Federation, SEB

The Russian economy weathered the effects of the pandemic relatively well in 2020, when GDP shrank by a moderate 3.1 per cent. One reason was that the most sweeping restrictions to ensure social distancing were only in force between March and May 2020. Increased virus spread during the autumn of 2020 led to tighter restrictions only at regional and local levels, not nationally. Official statistics on the number of people who have been infected and who have died of COVID-19 are low compared to most countries in Europe, but excess mortality statistics indicate that Russia has been hit about as hard as the United Kingdom. At present, Russia seems to have avoided the sharp increase in virus spread that is being observed elsewhere in Europe and especially in India and Latin America. However, Russia is fighting a battle against the clock. The vaccination of the population is slow – just below the global average – even though Russia was among the first to develop and approve a vaccine, Sputnik V.

The recovery during the second half of 2020 was robust, but the economy slowed down in Q1 2021 due to stagnant household consumption. Low oil production also constituted a headwind for industrial production and economic activity, even if manufacturing was a bright spot, growing by 0.9 per cent year on year in Q1. The outlook is improving. Unemployment is declining and consumption is expected to recover this summer. Oil production is likely to be the main economic driver starting in Q3 2021 due to rising global demand. As a result of Russia's agreement with OPEC, production cuts will be reversed as pandemic-related restrictions are gradually eased around the world. Our forecast is that GDP will grow by 3.8 per cent in 2021 and 2.9 per cent in 2022. Next year's slowdown is a result of structural weaknesses in the Russian economy, such as widespread corruption, weak property rights and inefficient state-owned enterprises. Combined with international sanctions, the result is low potential growth of around 2.5 per cent.

Inflation has climbed more than expected. The consumer price index gained 5.8 per cent year-on-year in March 2021, which is well above the inflation target of 4.0 per cent. Although price increases have been driven by energy and food prices, core inflation has also risen to around 5.4 per cent. Part of this increase is temporary, but the central bank tightened monetary policy in March and April 2021 to curb rising inflation expectations and support the rouble. The bank has been keen to build a reputation for not compromising on its inflation target. It is expected to raise the key interest rate further from the current 5.0 to 5.5 per cent before the end of 2021. We expect a key rate of 6.0 per cent at the end of 2022.

Cautious use of room for fiscal stimulus. Fiscal policy will be cautious, since the authorities want to build up buffers and reduce dependence on private creditors in order to minimise vulnerability to possible further, more far-reaching external sanctions. However, a school start allowance for all families with children in August 2021 and some increases in infrastructure investments are to be expected before the September 2021 State Duma election.

The risk of US-Russian tensions has risen with Joe Biden in the White House. The United States imposed new sanctions on Russia on April 15, 2021. Most of these measures were aimed at organisations and individuals in the Russian security services, limiting their impact on the economy as a whole. But together with existing sanctions, the new restrictions will hold back long-term potential growth and economic development in the country. Threats of further sanctions will also curb investment appetite and growth.

The Nordics

Sweden

While lingering restrictions will hamper near-term growth, pent-up needs will allow a fast recovery in the second half. Subdued pay hikes will contribute to uncomfortably low inflation, but the Riksbank will avoid negative key rates.

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Norway

The outlook has improved this year, as fiscal stimulus and pent-up demand provide support to consumption. Norges Bank will lead the way by hiking its key interest rate in late 2021.

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Denmark

The economy looks set to reopen earlier than expected. The housing market is red-hot, despite weak consumer sentiment. The labour market has some catching up to do, but Denmark will approach full employment by next year.

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Finland

In terms of health care and economic policy, Finland has performed relatively well over the past year. EU recovery funds will boost investments, but weak productivity growth will limit the country’s prospects.

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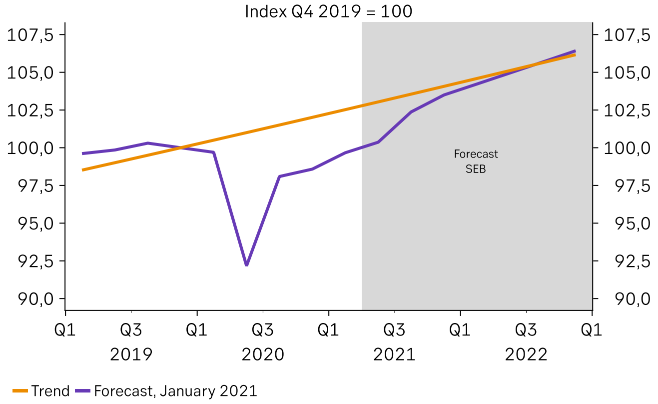
Sweden

Strong rebound in the second half of 2021

In the near term, lingering restrictions will weigh down the Swedish economy. After that, pent-up needs and continued stimulus will set the stage for a rapid recovery. With GDP growth of around to 4 per cent in both 2021 and 2022, we will be back at the pre-crisis growth trend next year. Due to low pay hikes and a stronger krona, inflation will remain uncomfortably low for the Riksbank, but we believe the bank will not cut the repo rate to below zero and that bond purchases will continue as planned.

GDP back at pre-crisis trend in 2022

Index Q4 2019 = 100



Source: Statistics Sweden, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.4	-2.8	4.5	4.0
Unemployment*	7.1	8.6	8.7	7.5
Wages and salaries	2.5	1.7	2.4	2.5
CPIF (CPI excl. interest rate change)	1.7	0.5	1.6	1.3
Net lending**	0.6	-3.1	-2.1	-1.0
General government debt**	35.0	39.9	38.5	35.5
Repo rate, %***	0.00	0.00	0.00	0.00
EUR/SEK***	10.50	10.04	9.90	9.70

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

Growth will take off in the second half of 2021

A renewed COVID-19 surge late in 2020 brought Sweden's mid-year recovery to an end, but the downturn in recent quarters has been milder than observers had feared. According to the flash estimate GDP grew by 1.1 per cent in Q1 2021. Due to widespread virus transmission, it will probably take a bit longer to ease restrictions than in neighbouring countries. No earlier than June we expect a substantial change, which means that Q2 will also be weak. After that, there is good potential for rapid recovery. Despite disappointments related to the reopening, unexpectedly strong economic resilience early this year is one reason why we are revising our 2021 GDP growth forecast to 4.5 per cent, up from 2.8 per cent in February. Very high household savings suggest strong consumption growth as restrictions ease more decisively. We also expect that – given its large manoeuvring room – the government will launch new fiscal stimulus initiatives for 2022. We predict strong GDP growth also in 2022 although the forecast has been lowered to 4.0 per cent GDP from 4.8 per cent in February. This means that GDP growth will have reverted to its pre-pandemic trend next year.

Optimism has returned in the business sector. Sentiment indicators have risen sharply in recent months. This applies specially to purchasing managers' indices (PMIs), with the service sector now also at or near historical peaks. During the spring, business sentiment has also recovered. The upturn in the Economic Tendency Survey of the National Institute of Economic Research (NIER) was initially more concentrated in manufacturing, but in April confidence improved sharply with record large improvements in both the retail sector and other services. We believe that sentiment indices paint an overly bright picture of the situation, among other things because they are boosted by expectations of strong upturns once restrictions ease. This is confirmed by relatively weak production data in Q1. Falling demand from Western Europe was one reason for the loss of momentum in industrial production, although it is not far below its pre-crisis level. Merchandise exports during Q4 2020 were only a few per cent below their level at the beginning of last year and are expected to revert to their previous trend as early as Q2 2021. Shortages of components – mainly semiconductors for the automotive industry – will hamper production in the near future. This will have a relatively large effect on Sweden, since vehicles account for 13.5 per cent of total merchandise exports. A long period of production stoppages would thus have a major impact on economic growth. Looking ahead, the recovery process for service exports will be important. Despite an unexpected increase in Q4, service exports are five per cent below their pre-crisis level. No improvement is likely in the near future. Nor is it likely that business travel, which accounts for almost half of travel service exports, will revert to its previous levels, even in the long term.

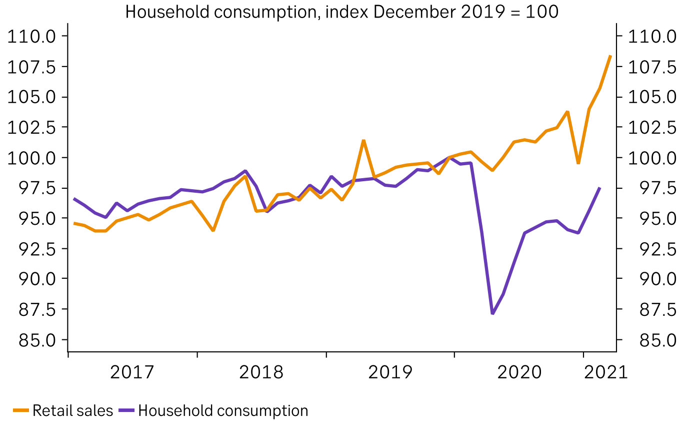
Capital spending has been fairly resilient to the COVID-19 crisis. After a temporary decline in spring 2020, driven by machinery investments, capital spending is now at its pre-crisis level again. The outlook for higher investments is promising, led by continued recovery in machinery expenditures. Residential investments are showing signs of rebounding after several years of falling, while public sector investments will contribute to the upturn. However, real estate investments outside of the housing sector fell during 2020 – a trend that will probably continue in both 2021 and 2022.

Financially strong households ready for consumption

Although restrictions on retail sales were in effect only during certain periods of 2020, consumption fell by 4.7 per cent. This is more than at any time since Statistics Sweden's time series began in 1950. Although worries about the future and rising unemployment may have had some effect, the decline was mainly due to restrictions that prevented consumption of tourist and transport services in particular. Despite expanded restrictions, consumption has recovered to an unexpectedly large degree so far this year, partly due to a slight increase in tourism. However, both tourism and transport services are still 10-25 per cent below pre-crisis levels. A clear normalisation will not be possible until restrictions in Sweden and elsewhere ease more generally. This is unlikely to happen before the summer, which means that consumption will remain at a low level during Q2 as well. Once travel opens up, there are good prospects of a sharp upturn. Although household income fell by nearly one per cent in 2020, this is entirely explained by the ban on stock market dividends, which will largely be reversed this year.

Strong household consumption in early 2021

Household consumption, index December 2019 = 100



Source: Statistics Sweden, SEB

Household incomes and savings ratio

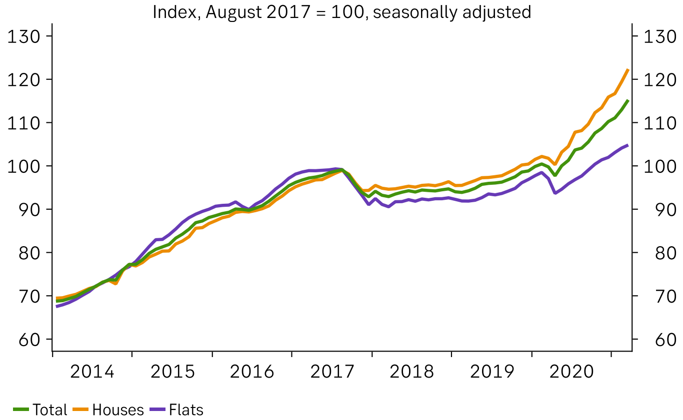
Year-on-year percentage change

	2019	2020	2021	2022
Real disposable income	3.3	-0.8	4.3	3.2
Private consumption	1.2	-4.7	4.0	3.7
Savings ratio, per cent of income	16.1	17.9	17.5	17.6

Source: Statistics Sweden, SEB

Home prices climb to new record levels

Index, August 2017 = 100, seasonally adjusted



Source: Valueguard, SEB

Rising employment, slightly higher real wage increases and fiscal stimulus measures will also contribute to stronger incomes in the future. Together with a record-high savings ratio, this suggests a sharp increase in consumption starting in the second half of 2021.

Home prices keep climbing. Home prices have continued upward at record speed. During Q1 2021, prices rose by nearly 5 per cent compared to December (seasonally adjusted), and a 15 per cent year-on-year increase was recorded in March. This upturn follows an international trend but is still remarkable in view of the moderate decline in Swedish mortgage interest rates. Temporary easing of principal repayment requirements may have played a part, but relatively few households seem to have stopped paying down their loan principal. A shift towards other expenditures when the economy reopens, the reintroduction of repayment requirements in August and increasingly inflated price levels suggest that the price increase will slow down. We expect home prices to climb by 7-8 per cent this year and a further 5 per cent in 2022. The SEB Housing Price Indicator is signalling continued increases in the near future, thereby contributing to short-term upside risks in our forecast.

Unemployment will reverse last year's upturn

After employment fell by 3 per cent last spring, the labour market recovered during the second half. About half of the job losses were reversed. Meanwhile unemployment fell after peaking at 9.4 per cent in June last year. A major restructuring of the Labour Force Survey (LFS), based on new instructions from Eurostat, makes the statistics very hard to interpret. The reported 1.5 per cent decline in employment early in 2021 is probably due entirely to new definitions. When pandemic-related restrictions were re-imposed late in 2020, minor signs of weakness were discernible in labour market indicators. The downturn in unemployment temporarily stopped, according to the Swedish Public Employment Service's alternative metric, but since then this metric has continued lower and most employment indicators have improved. Statistics Sweden will publish linked time series that correct for changes in methodology. But this will not happen until late 2021 at the earliest. To get some idea of the trend, we created our own linked time series. According to our calculations, employment levelled off around the end of 2020, but since then its recovery seems to have resumed. We expect continued labour market improvement, with rising employment and falling unemployment. This trend will accelerate during the second half. At the end of our forecast period, unemployment will be back where it was at the beginning of 2020.

Low inflation, due to modest pay hikes and SEK

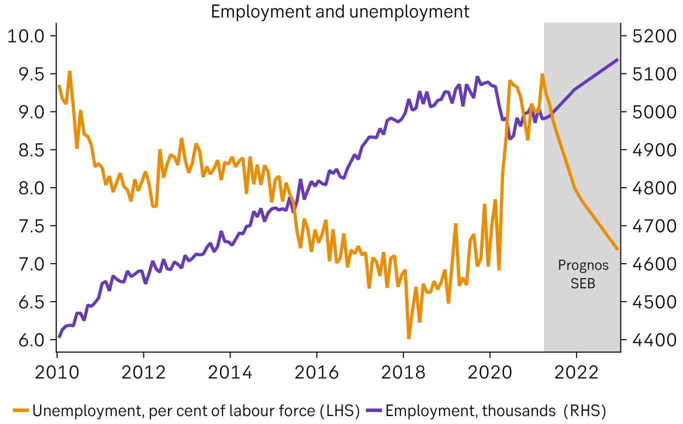
Falling unemployment and rising resource utilisation suggest some wage acceleration during the next couple of years. But because contractual pay hikes are only 2.3 per cent yearly until the end of Q1 2023 we will probably revert to the pre-pandemic pattern, with overall pay increases of around 2.5 per cent. During 2016-2019, non-contractual pay increases were historically low and there is no strong reason to believe that the situation will change during our forecast period. Moderate pay hikes, combined with price pressure on imported goods, suggest that inflation will remain low during the next couple of years. Although the inflation rate rose early in 2021, this was apparently driven by base effects from low prices last spring and shifts in the seasonal pattern due to a sharply reduced weight for foreign travel. Both of these factors will be reversed this summer. After a slight increase in April, we expect inflation to fall noticeably. Following a somewhat volatile first half, CPIF excluding energy will stabilise at around one per cent. In 2022, there will be a slow increase in this metric as the effects of a stronger krona fade. Threats to the low inflation rate come primarily from international prices; rising food prices might trigger higher inflation in late 2021.

Riksbank in pause mode

After repeatedly delivering relief measures in 2020, the Riksbank left monetary policy unchanged at its first two meetings of 2021. CPIF inflation has surprised somewhat on the downside, but real economic developments have continued to move in the right direction and the strong economic upturn in the US has reduced the risk of major setbacks. Prospects of higher US inflation, combined with slightly higher inflation expectations, are other reasons why the Executive Board is not feeling pressured to deliver further stimulus. Several Board members are also signalling increasing scepticism about the benefits of expanded bond purchases in a situation of generally depressed yields and yield spreads.

Rapid drop in unemployment starting in H2 2021

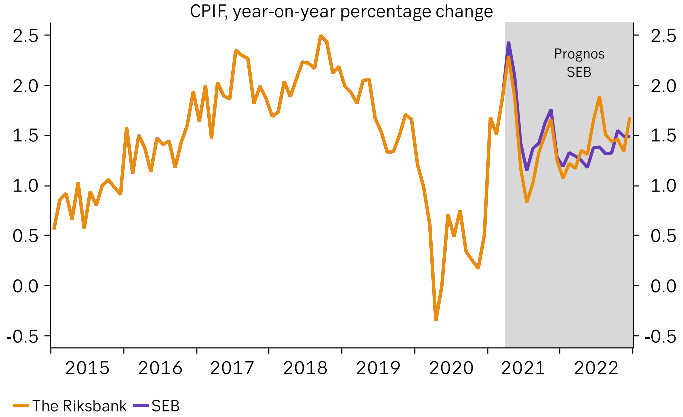
Employment and unemployment



Source: Statistics Sweden, SEB

Large fluctuations in the inflation rate during 2021

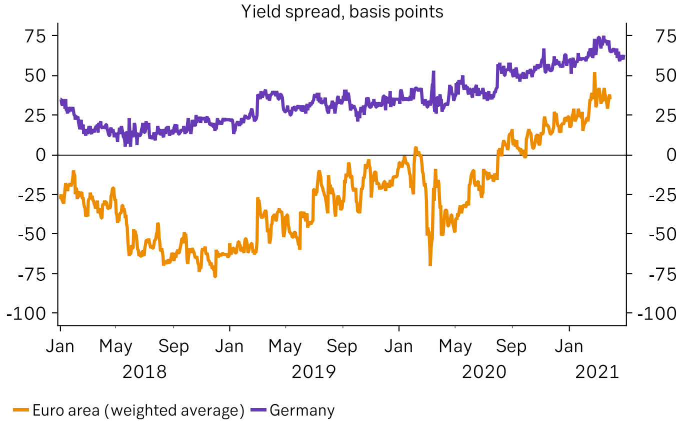
CPIF, year-on-year percentage change



Source: The Riksbank, SEB

Wider yield spread for Sweden

Yield spread, basis points



Source: Macrobond, SEB

We thus believe that the Riksbank will gradually reduce its asset purchases this year according to its November plans and that next year these purchases will be of the same magnitude as maturing bonds. This means the Riksbank will taper its bond-buying earlier than major central banks. Although the US Federal Reserve will reduce its purchases starting in October this year, it will still keep enlarging its holdings for most of 2022. The European Central Bank is expected to continue bond purchases at the current rate at least until spring 2022 and keep expanding its balance sheet throughout 2022. Given the Riksbank's forecast of low inflation, earlier tapering in Sweden seems illogical, but the limited supply of government bonds will make it hard for the Riksbank to expand its balance sheet. Although the Riksbank can buy more mortgage-backed bonds instead, the increasingly heated housing market will probably make the bank reluctant to increase these purchases.

Key interest rate cuts cannot be ruled out. However, the Riksbank Executive Board's main message will continue to be that financial stability is the responsibility of the government and the Swedish Financial Supervisory Authority (FSA). The Riksbank is thus probably ready for further stimulus measures if the picture should change. Expanded bond purchases would then be conceivable, but several Board members suggest that bond purchases are no longer an option and that a key rate cut is the next step if monetary policy must be made more expansionary. The bank has repeated its message that a rate cut is possible if the credibility of its 2 per cent inflation target is threatened. A major downside inflation surprise, for example driven by a further 5-6 per cent upturn from current krona exchange rates, might push inflation below 0.5 per cent in 2022. Such a scenario would probably persuade the Riksbank to cut the repo rate below zero again. However, our main scenario is still that the key rate will remain at zero throughout our forecast period.

Sweden has become a high interest rate country in Europe. Swedish government bond yields have risen in the past year due to higher US Treasury yields. The increase has been larger than in most European countries. Sweden's yield spread against Germany for a 10-year government bond has widened from 20 basis points in mid-2018 to around 75 bps in early 2021; at or near with the highest levels since the mid-1990s. This wider spread is explained largely by the Riksbank's two key interest rate hikes in 2018 and 2019, but the driving forces behind the wider spreads over the past year are not as clear. Expectations that the Riksbank will hike its key rate earlier than the ECB may be one explanation. Since we believe that these expectations are exaggerated, our view for some time has been that Swedish yields should move somewhat closer to German yields. This spring we have seen a movement in this direction. The market's continued hawkish pricing, combined with the prospect of falling inflation in Sweden, suggests that the yield spread will continue to narrow. We expect the spread against Germany to shrink to 50 basis points by the end of Q3. The outlook for next year is more mixed. Because the ECB will continue to buy bonds at a rapid pace next year as well – while the Riksbank only reinvests maturing bonds – the yield spread may widen. Meanwhile the Swedish government's borrowing requirement is low, and outstanding bonds not held by the Riksbank are only growing slowly from a very low level. It is also noteworthy that for the first time since the global financial crisis, the Swedish 10-year yield is higher than a weighted average for the euro area: in fact, only Italy and Greece are clearly higher than Sweden. This suggests that reduced bond purchases by the Riksbank are unlikely to have any major effect on Swedish yields, and we expect the spread against Germany to remain at 50 points in 2022.

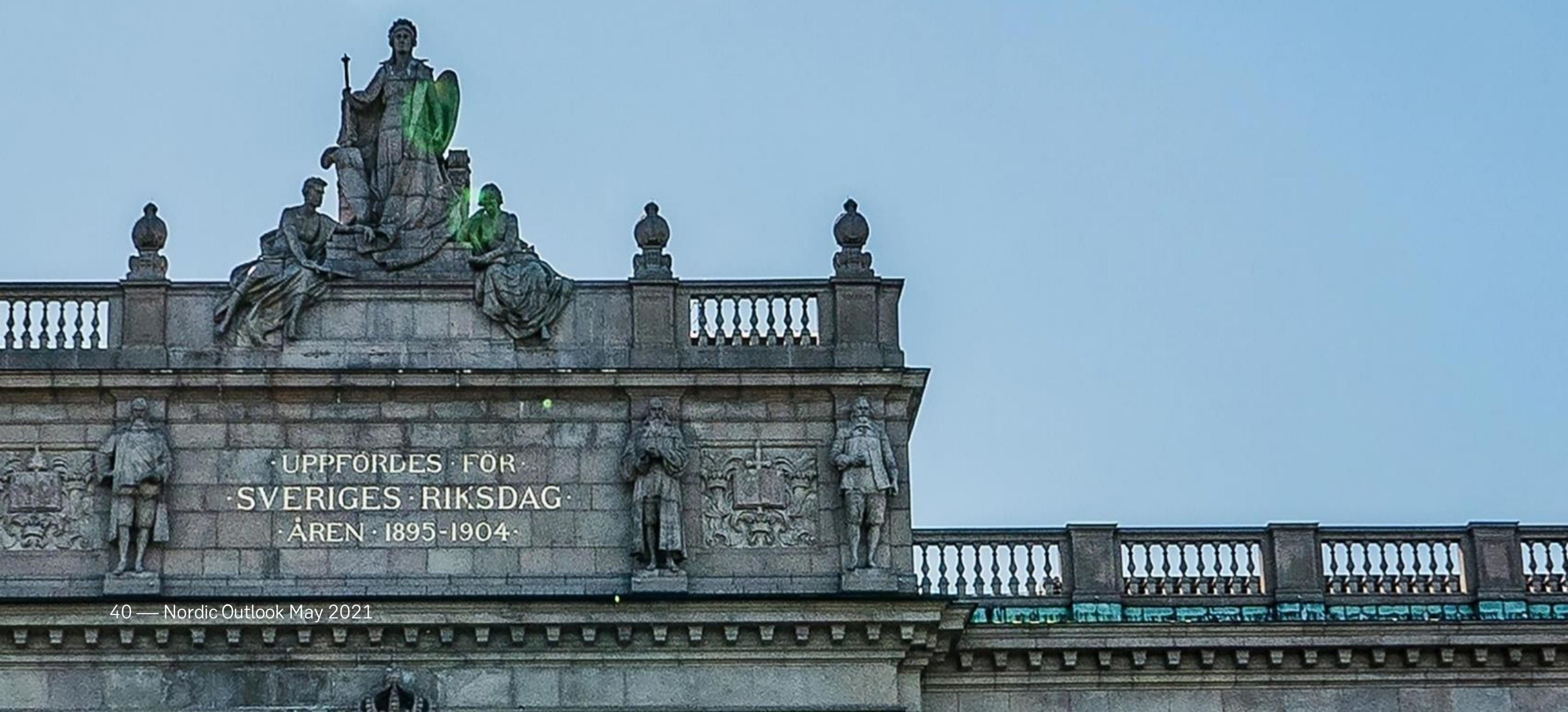
Theme:

Sweden's finances

Resilience challenging strict application of framework

Unlike the situation in many countries, pandemic relief spending in Sweden will be higher in 2021 than in 2020, but the overall stimulus dose during these two years is moderate in an international perspective. Together with a relatively mild GDP decline in 2020, this will help Swedish public finances cope with the crisis relatively well. We believe that government debt will peak at around 40 per cent of GDP. Looking ahead, the question is to what extent the existing manoeuvring room will be utilised. When the four parties that signed the January Agreement in 2019 deliver their final budget in September, they will certainly want to avoid a sharp fiscal tightening in the election year 2022. Yet the official budget framework enjoys strong support, and both its regulatory guardians and the opposition are likely to express criticism.

The pandemic continues to control the budget process. Because of the protracted COVID-19 pandemic, we have seen a steady flow of amending budgets instead of the normal system of one cohesive budget bill in September and one follow-up spring budget in April. In 2020 the government delivered no fewer than 12 extra amending budgets. So far this year, another six have already been presented, in addition to the regular spring budget on April 15. Sweden's crisis responses have undoubtedly been far-reaching. The government says extra measures announced so far have totalled about SEK 420 billion. Frequent amending budgets – and an even larger number of government press conferences – have not made it easy to understand how big all these stimulus packages have been. As in many other countries, it has been especially difficult to determine how large the budgetary impact of all these measures will actually be. But now that we have the final budget figures for 2020 and can also see the government's projections of developments in 2021 and 2022, the picture becomes a little clearer.



Low utilisation of crisis systems

The main focus of Sweden's crisis responses has been on saving jobs and businesses to the greatest possible extent. US stimulus measures have been dominated by various forms of cash payments, but Sweden and other similar countries have maintained household incomes with the help of wage subsidy schemes and their regular social welfare systems. It has been harder to estimate the actual degree of utilisation of such relief measures, but it has become clear that these systems have generally been utilised less than expected, especially government guarantees and loan facilities. Sweden's 2020 government borrowing requirement ended up at SEK 221 billion, compared to the SEK 400 billion that the National Debt Office had forecast in May 2020. This is partly because the GDP downturn was milder than expected, which in turn can be linked to the calming effect of crisis response systems. But there is probably also a lot of truth to criticisms about excessive bureaucracy, long waiting times and unappetising requirements attached to some of the relief measures.

Expanded stimulus dose this year. Last September's budget bill proposed about SEK 100 billion in extra spending for 2021. This was later supplemented by amending budgets plus the spring budget bill. The government estimates that extra spending for 2021 now totals SEK 260 billion, up from SEK 161 billion in 2020. Unlike the situation in most other countries, extra stimulus will thus be larger this year than in 2020. We believe that the protracted pandemic will probably lead to additional spending of SEK 25 billion in 2021.

Fiscal stimulus impulse
Change in structural budget deficit, per cent of GDP.
Plus signs mean a stimulus effect, negative the opposite

	2020	2021	2022	2020-22
OECD	5.0	0.0	-2.5	2.5
United States	5.5	0.5	-3.5	2.5
Japan	5.5	-2.5	-1.5	1.5
Euro area	3.0	0.5	-1.5	2.0
United Kingdom	7.0	-1.5	-3.0	2.5
Sweden	2.0	1.0	-1.0	2.0

Source: OECD, SEB

Stronger finances than other countries

Despite historically exceptional spending, we can now see that Swedish stimulus measures – especially during 2020 – were moderate in an international perspective. We recently highlighted the change in the structural budget deficit of the general government sector as the most common way of comparing the active fiscal stimulus impulse in different countries. In advanced economies, the fiscal stimulus impulse was equivalent to about 5 per cent of GDP in 2020. In Sweden, the stimulus dose was only about 2 per cent of GDP.

Big differences in 2021 forecasts. The Swedish government's new forecast of public sector finances indicates a sharp escalation of stimulus measures in 2021. Despite above-trend GDP growth, it predicts that budget deficit will climb to 4.5 per cent of GDP, up from 3.1 per cent in 2020 (see table). Both we and the National Institute of Economic Research (NIER) believe that the government is probably overestimating the impact of its fiscal stimulus, perhaps partly because it assumes that crisis response systems will be used to a greater extent than last year. We believe the budget deficit will instead fall this year and that 2021 stimulus will be only 1 per cent of GDP.

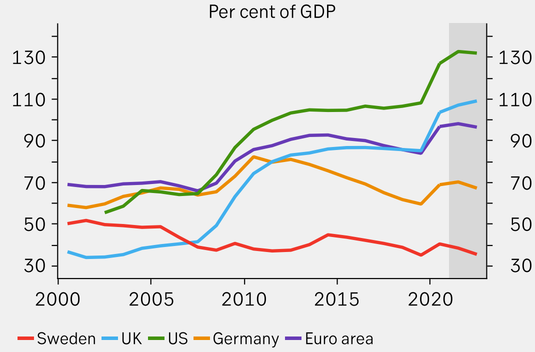
Public sector finances
Per cent of GDP

	2019	2020	2021	2022
SEB				
Net lending	0.6	-3.1	-2.1	-1.0
General government debt	35.0	39.9	39.0	36.5
The government				
Net lending	0.6*	-3.1	-4.5	-1.0
General government debt	35.1*	39.9	39.9	37.0

Source: Statistics Sweden, SEB, *NIER

Government debt will culminate at around 40 per cent of GDP. The big picture is that Swedish public sector finances have been highly resilient to the crisis. Government debt looks set to peak at some 40 per cent of GDP. The gap between Sweden and most other countries is thus growing wider. We should also take into account the effects of foreign exchange reserve management – with the Riksbank now replacing its borrowing via the NDO with foreign currency bought using newly created kronor, reducing the public debt ratio by almost 5 percentage points in 2020-2022.

Continued low Swedish public sector debt
Per cent of GDP



Source: IMF, Macrobond

The 2022 budget will end the January Agreement. The autumn budget will be a test of how Sweden uses its fiscal manoeuvring room. The Social Democratic-Green minority government predicts a deficit of only 1 per cent of GDP – implying a major tightening in 2022 – but this should be viewed as more of a technical assumption, since the government must await negotiations with the other signatories of the January 2019 budget agreement (the Centre and Liberal parties). These talks will be affected by the fact that the four parties will end up in different camps in the election campaign, after the Liberals' decision to work towards a Moderate Party-led government. Now that the agreement is ending, the Centre and Liberals will find it important to check off the remaining strategic points in their original 73-point programme. If the Centre is to credibly keep the door open to continued cooperation with the Social Democrats, they must show some nonsocialist successes in their economic policy.

Moderate tightening likely in 2022. Due to the protracted COVID-19 pandemic, some crisis-related initiatives must be extended. All the parties involved will also probably be careful to avoid a major tightening during the election year 2022. But it will still be hard to match the 2021 spending level. We expect extra spending to end up at around SEK 150 billion in 2022. This means tightening will be only about 1 per cent of GDP. Measures that are likely to be extended in the medium term include higher unemployment benefits and grants to municipalities and regions, among other things to catch up with medical procedures that had to be postponed during the pandemic. Societal weaknesses exposed by the pandemic may also justify other health care, emergency preparedness and infrastructure spending. New green investments are also likely, but they are often more long-term in nature.

Changes in the fiscal framework ahead?

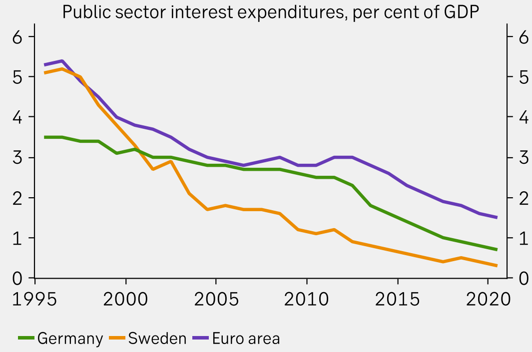
So far, there has been broad political agreement on crisis responses – if anything, the opposition has criticised the government for being too slow and passive. Given the big GDP decline in 2020, these responses cannot be said to have violated the official fiscal policy framework. Once the economic situation gradually normalises, debate on the application of the fiscal framework is likely to heat up. There are various arguments in favour of continued aggressive fiscal stimulus. Unemployment will remain elevated in the next couple of years. Although this is largely due to structural factors – mainly difficulty in integrating low-skilled workers with poor Swedish language skills into the labor market – aggressive fiscal stimulus would probably improve opportunities for these groups to land jobs. The Riksbank is also signalling that it welcomes fiscal stimulus, so that it can avoid overly dramatic monetary policy measures. Also worth recalling is that only a few years ago, there was widespread dissatisfaction about certain consequences of negative key interest rates, for example in the form of a weak and volatile krona and rising home prices.

International warnings are of limited relevance. A gentler application of the fiscal framework would also be consistent with the main international trend. In the EU, calls for easing the Maastricht criteria have begun to attract some support from Germany. Although there are signs that international organisations no longer unequivocally favour expansionary policies – but instead point out that long-term action must be taken to reduce deficits and debt – such warnings are of limited relevance to Sweden, since its government debt is already low in both historical and international terms.

Strong support for the fiscal framework. The next formal review of the framework will not take place until after the 2026 election, but before that the conflict between the surplus target and "debt anchor" will be debated again. If Sweden is to meet its budget surplus target, 0.33 per cent of GDP – set after the 2018 review – government debt will soon fall well below the anchor: 35 per cent of GDP. But what will probably happen is that 2022-2026 will be characterised by prudent fiscal policy, causing government debt to fall to levels that create a supply shortage in the bond market. In most respects, the current situation is very different from the 1990s financial crisis. For example, today's interest expenses for government debt are equivalent to 0.2 per cent of GDP, compared to more than 5 per cent in the mid-1990s. Nevertheless, parallels to the 1990s crisis are constantly emerging in the debate whenever there is a threat of minor deviations from the framework. For example, a number of government authorities have more or less taken it upon themselves to sound the alarm about deviations from strict application of the framework. This, in turn, strongly influences media attitudes towards the issue.

Falling interest burden despite higher debt

Public sector interest expenditures, per cent of GDP



Source: Eurostat, Macrobond, SEB

Will new political blocs complicate reform policies? It is also worth thinking a bit more broadly about the ability of the political system to deal with future economic policy challenges. For some years, there has been a fairly broad consensus on the need for a new, holistic approach to taxation and housing policies. Studies by experts on these issues have concluded that income taxes should be cut and various taxes on capital should be raised to improve the functioning of the economy and make Sweden's tax system more similar to that of other countries. But there has been a lack of political will to craft a broad agreement. The way that political blocs now seem to be forming, it is hard to foresee any change. The two most likely governing coalitions seem to have built-in contradictions in their economic policy. The Social Democrats are internally divided and may also have to balance the diametrically opposite economic policies of the Left and Centre parties. Meanwhile the right-wing Sweden Democrats are probably keen to maintain the widespread support they have built up among blue-collar workers. This means that in key areas, the coalitions will both oppose classic nonsocialist economic policies. Because the two coalitions are not strictly based on a traditional right-left scale, this may weaken their power of initiative on economic policy matters and will probably also affect the Swedish tendency to follow international trends in taxation policy, which we are now beginning to discern.

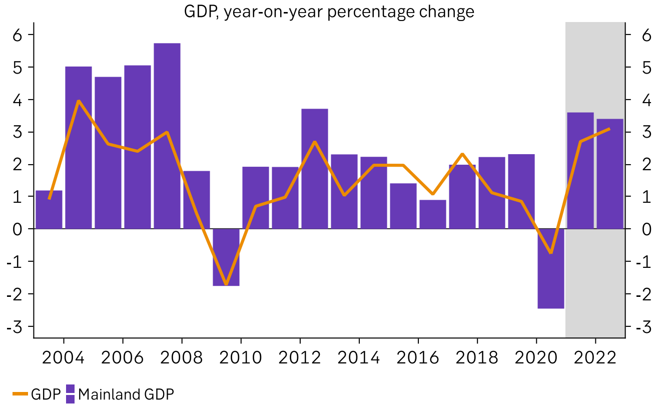
Norway

Norges Bank first out with key rate hike

After a temporary slowdown in early 2021, the outlook for a strong Norwegian recovery later this year has improved. Fiscal stimulus, high savings and pent-up demand will support consumption. We also expect unemployment to fall as restrictions ease. Due to better growth prospects, combined with rising home prices, Norges Bank will hike its key interest rate this year, but in response to short-term uncertainty about the COVID-19 vaccination process the central bank will wait until December.

Recovery will be delayed but should take off later in 2021

GDP, year-on-year percentage change



Source: Statistics Norway, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	0.9	-0.8	2.6	3.5
Mainland GDP	2.3	-2.5	3.5	3.7
LFS unemployment*	3.7	4.6	4.2	4.0
Wages and salaries	3.5	3.1	2.5	2.7
CPI-ATE inflation	2.2	3.0	1.9	1.5
Key interest rate, %	1.50	0.00	0.25	0.75
EUR/NOK**	9.84	10.48	9.70	9.85

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

New restrictions delay recovery

Despite a second COVID-19 wave and new restrictions, late 2020 turned out better than had been feared. The mainland economy grew by 1.9 per cent in Q4. The full-year 2020 decline was thus only 2.5 per cent, but expanded restrictions continued to weigh down the economy in early 2021. Recent restrictions were the toughest since March 2020. Due to local outbreaks the Oslo and Bergen regions, among others, have been almost totally locked down at times. Since late January, almost all visits to Norway have been stopped. In recent weeks there has been some easing. This process is continuing as transmission slows and vaccinations progress. In a second step in May, Norway will consider easing restrictions related to social distancing, events and domestic travel. In step three, these rules will be loosened further. In step four most things should be back to normal, though some entry restrictions are likely to remain. The government believes step four can be implemented this summer, but the Norwegian Institute of Public Health has recommended discontinuing the AstraZeneca and probably also the Johnson & Johnson vaccine. This calls into question the forecast that everyone over age 18 should have been offered a vaccine by the end of July. The government is expected to provide information on the vaccine issue by May 10. Questions about the reopening process will, in turn, create continued uncertainty about when the economic recovery can pick up speed.

Weak start but more robust recovery. Tougher restrictions impeded the economy in early 2021. Mainland GDP fell by 0.8 per cent in January and 0.5 per cent in February. This was a far milder than 10.5 per cent slide in March-April 2020, but data now indicate that recovery will be delayed. We forecast that the economy will shrink by 0.5 per cent in March and Q1 mainland GDP will thus fall by 0.8 per cent. The remaining restrictions will dampen growth in Q2 as well, but after that the outlook will turn brighter. The recovery will be led by strong households, which are benefiting from continued fiscal stimulus. In late January, new crisis responses were unveiled. Further measures are likely in the spring budget to be unveiled on May 11. The delay in the recovery is one reason we have adjusted our full-year 2021 forecast somewhat lower, while making upward adjustments for 2022. We expect full-year average increases of 3.5 and 3.7 per cent respectively in 2021 and 2022. Overall GDP is projected to grow by 2.6 per cent in 2021 and 3.5 per cent in 2022.

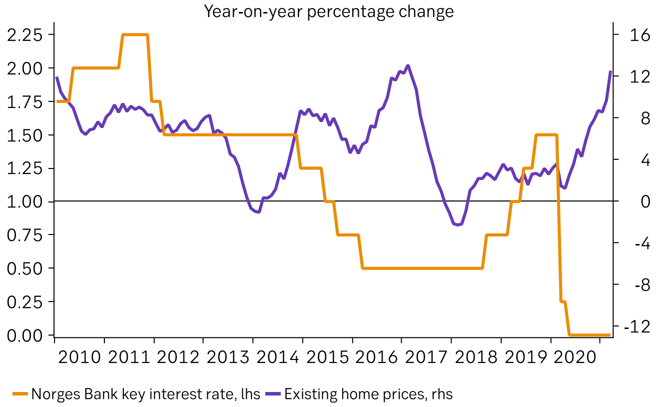
Strong manufacturing sector softens the slowdown

Manufacturing has shown strength in recent months. Oil industry investments appear to be hampering the sector less than previously feared. In Statistics Sweden's Q1 survey, oil operators continued to revise their capital spending plans for 2021 upward. Rising oil prices, as well as greater incentives for investments in increased capacity and prospecting, are helping to create a brighter outlook. Overall, we now expect petroleum-related investments to fall by 3.0 per cent in 2021 and by 4.0 per cent in 2022. Sentiment indicators suggest continued strong performance in traditional manufacturing, supported by higher international demand. Capacity utilisation in the sector remains below normal, but the Norges Bank regional network report and sentiment surveys point to a recovery. A rebound in residential investments will also contribute to slight increases in mainland capital spending during both 2021 and 2022.

Consumption will bounce back as restrictions ease. Household goods consumption has benefited from a changed pattern due to the pandemic but has slowed in recent months, because of new lockdowns and probably also some saturation. Consumption of services continues also to be hampered by restrictions and has now fallen by 16.5 per cent from pre-pandemic levels. Historically high savings, unexpectedly strong wage and salary growth and pent-up service needs suggest a strong recovery in consumption when restrictions ease. Registered unemployment rose again early in 2021, but most of the increase was due to a larger number of lay-offs, which is expected to reverse as the economy gradually reopens. Temporarily higher unemployment should thus have a limited effect on consumption. Instructions from Eurostat have led to a major reorganisation of the Labour Force Survey (LFS). Statistics Norway has temporarily halted publication of LFS unemployment data. We believe that LFS unemployment will trend downward in the future, but will remain slightly above its pre-pandemic level throughout our forecast period.

Rising home prices will speed up key interest rate hikes

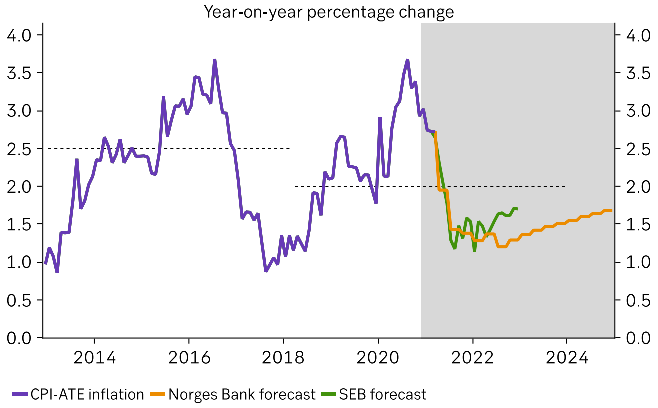
Year-on-year percentage change



Source: Real Estate Norway (Eiendom Norge), Bank of Norway (Norges Bank), Macrobond, SEB

Below-target inflation not an obstacle to interest rate hikes

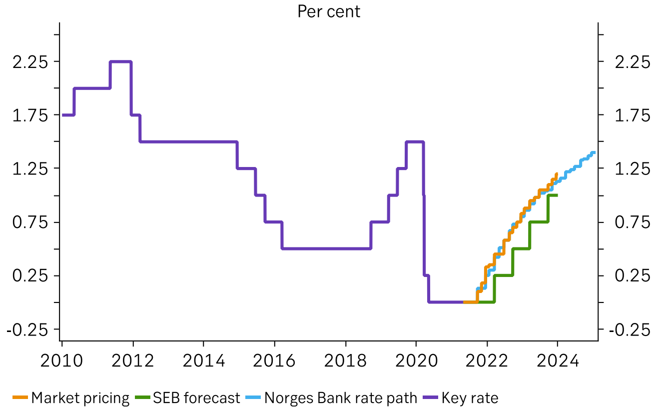
Year-on-year percentage change



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

Expectations for Norges Bank

Per cent



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

Rising home prices put pressure on Norges Bank

Prices of existing homes have continued to rise steadily in recent months. The annual rate of increase reached 12.5 per cent in March and is thus close to the 13.1 per cent peak recorded in February 2017. The housing market has been sustained by a combination of low supply and strong demand attributable to historically low mortgage rates. Due to the strong start to the year and continued low interest rates for most of 2021, we have revised our forecast higher. We predict an average price increase of 10.3 per cent for existing homes in 2021.

Inflation will quickly fall below target. As in many other countries, inflation showed large fluctuations in 2020 due to unusual price movements caused by lockdowns, but unlike elsewhere inflation actually seems to have become higher than usual – mainly due to high goods prices, driven by a weak exchange rate. The krone has appreciated greatly since last spring. This is one reason why CPI-ATE has fallen. The combination of continued downward pressure from the exchange rate and base effects from high prices in 2020 suggests a continued sharp decline. We expect CPI-ATE to fall below 1.5 per cent as early as this summer. After that inflation should stabilise, before core inflation slowly starts to climb a bit again during 2022, driven by higher international prices and accelerating wages. Yet CPI-ATE will end up well below the 2 per cent target throughout our forecast period. Total CPI will remain relatively high during 2021 due to somewhat higher energy prices, while temporary tax cuts on tourist services in July 2020 will be reversed. We expect this to lift CPI by 0.3-0.4 percentage points.

Key interest rate hike late this year

A flexible inflation target allows Norges Bank to focus on growth and financial stability; below-target inflation is not an obstacle to hiking the key interest rate. In December 2020 the central bank unexpectedly declared it was open to a key rate hike as early as 2022. The bank took a further step in March by signalling a 50 per cent probability of a rate hike by September 2021 and a 100 per cent probability in December this year. Despite a clear economic slowdown early this year, the Bank believes that a faster vaccine roll-out will enable growth to pick up this spring and summer, with the economy reverting to its long-term trend by the end of 2021. Once the recovery is on firmer ground, risks to financial stability will be accorded greater weight. Sharply rising home prices highlight the risks of excessively low interest rates over a long period and justify early rate hikes. Norges Bank based its March forecast on the public health institute's predictions that risk groups would be vaccinated by the end of May and all adults by the end of July, with major restrictions starting to be eased by the end of May. Although a rate hike in September cannot be ruled out, recent developments related to virus transmission, vaccines and restrictions suggest that Norges Bank will hold off on raising its key rate until this December. In order to slow the increase in home prices, it will then hike the key rate twice during 2022 to a level of 0.75 per cent.

Norges Bank's hawkish policy will support the NOK. Rising oil prices, positive risk sentiment and a more hawkish Norges Bank have provided continued support to the Norwegian krone, which has climbed sharply in recent months. Meanwhile expansionary fiscal policy will cause the central bank to continue purchasing large amounts of NOK on a daily basis in 2021. We expect the krone to appreciate further against the euro and forecast that the EUR/NOK exchange rate will fall to 9.70 by the end of 2021. Thereafter, we expect EUR/NOK to turn somewhat higher again to 9.85 by the end of 2022 as fundamental factors speak for a weaker krone and other central banks will start to catch up.

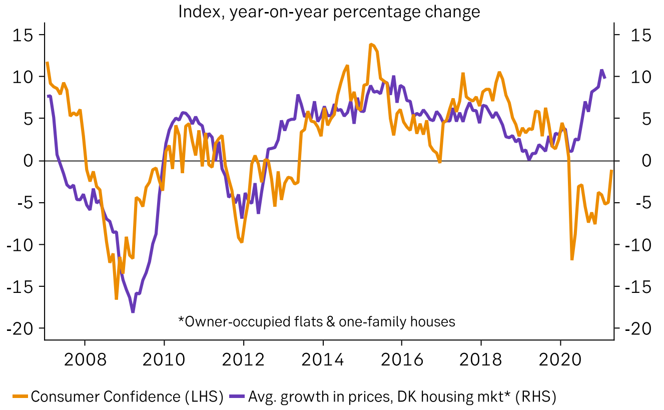
Denmark

Reopening under way

Denmark's GDP declined less than expected in 2020, but Q1 2021 likely saw a renewed setback. We are maintaining our forecast for 2021 and 2022 due to an unexpectedly rapid reopening. By the end of next year, the economy is likely to approach full employment.

Strong housing market despite cautious consumers

Index, year-on-year percentage change



Source: Statistics Denmark, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.9	-2.7	3.0	4.5
CPI	0.8	0.4	1.2	1.3
Wages and salaries	2.0	1.9	1.9	2.9
Public sector fiscal balance*	3.8	-3.0	-2.0	0.0
Public sector debt*	33.3	44.0	41.0	38.0
Current account*	8.8	7.5	7.5	8.0
Key interest rate (CD rate),%	-0.75	-0.60	-0.60	-0.60
EUR/DKK**	7.47	7.44	7.43	7.46

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

Strong growth in 2020. Since the February issue of *Nordic Outlook,* Statistics Denmark has both published full-year GDP numbers for 2020 and revised them higher. GDP growth in 2020 is now reported to be -2.7 per cent compared to -3.3 per cent in the first release and -4.0 per cent in our previous forecast. Our GDP growth forecast is unchanged at 3.0 per cent for 2021 and 4.5 per cent for 2022, since the Q1 slump lasted longer than expected but the Q2 reopening is proceeding faster than anticipated.

Consumers to drive Q2 recovery. The main reason for the better outcome in 2020 appears to be a surge in consumer spending following the Q4 release of frozen holiday pay. This trend is unlikely to have carried into Q1, since most of the retail sector entered a lockdown just after Christmas. Retail sales data suggest a sharp drop in spending in January and February, but anecdotal evidence indicates some spending may have moved online. Nonetheless, we expect the national accounts to show a GDP decline in Q1, driven by a sharp setback for private consumption. On the other hand, March saw a second round of frozen holiday money. Expectations have turned positive for both retailers and consumers, since the reopening has proceeded faster than planned, with most of the service sector starting to reopen before the end of April. We therefore expect Q2 to show a significant rebound and predict that private consumption will post 3 per cent growth in 2021.

Housing market runs hot. Spending and consumer sentiment remain subdued, but the housing market has received a major boost from low mortgage rates, easy credit conditions and increased focus on housing quality during the lockdowns, not least related to working from home. Home prices have increased by more than 10 per cent over the past year, the fastest upturn since before the global financial crisis. Turnover is high, and like before the GFC, bidding over asking price and very short sales periods are reportedly becoming the norm again. The Systemic Risk Council has already proposed tightening lending rules this summer to prevent a housing bubble. But as long as unemployment is falling and bond yields remain low, we believe that home prices will keep rising.

Labour market still has slack. While the housing market is showing signs of overheating risks, the labour market is still being held back by the pandemic shock. The employment-to-population ratio has only recovered half of last year's decline and is still well below the last two cyclical peaks, but wage inflation is likely to pick up as employment recovers. We expect it to move above 3 per cent by late 2022. In light of Denmark's excessive current account surplus this is unlikely to be a major concern, but looking beyond our forecast period the economy is likely to reach full employment in 2023 and this will limit the potential for above-trend growth.

Stable economic policy outlook. Fiscal policy is likely to remain expansionary throughout 2021, but if the reopening proceeds at the pace that currently looks likely, there will be no need for direct fiscal stimulus in 2022. So far, the budget situation has been a lot better than anticipated by the government, and we expect cyclical improvement to lead to a balanced budget within 1-2 years. The Danish krone remains under upward pressure and Danmarks Nationalbank has been forced to intervene to prevent the DKK from becoming too strong. The adjustment of the deposit rate framework in February was merely technical. But in principle, the central bank could cut its deposit rate further with reference to the krone-euro exchange rate peg. However, we believe that for now the bank will stick to interventions through liquidity injections, since the net liquidity position is low.

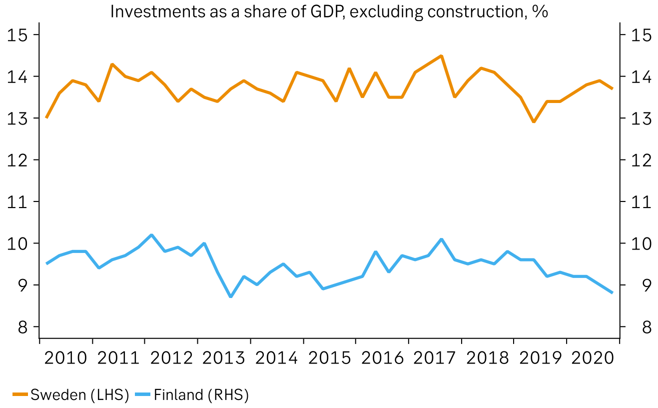
Finland

Bouncing back

Finland has been remarkably successful in navigating through the COVID-19 crisis, both in terms of health care and economic policy. A strong rebound in private consumption will help the economy to grow by 3.0 per cent in 2021. In the long term, faster economic growth can only be sustained by making more investments to boost productivity. Yet investment appetite will take a while to return, and GDP growth will be limited to 2.5 per cent in 2022.

More investments needed

Investments as a share of GDP, excluding construction, %



Source: Eurostat, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.3	-2.8	3.0	2.5
Private consumption	0.7	-4.9	3.8	3.0
Exports	6.7	-6.6	5.0	4.0
Unemployment*	6.7	7.8	7.8	7.3
Wages and salaries	2.1	1.8	2.2	2.0
HICP inflation	1.1	0.3	1.2	1.5
Public sector fiscal balance**	-1.0	-5.4	-4.5	-3.5
Public sector debt**	59.5	69.2	70.0	71.0

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

Stopping the spread of the coronavirus has been a top priority for the Finnish government during the past year. These efforts have not been in vain and as of April 22, the cumulative death toll per million inhabitants was only 163, by far the lowest among EU countries. Despite prioritising lives over livelihoods, the economy has performed relatively well. In 2020, GDP declined only 2.8 per cent. This will enable the Finnish economy to return to its pre-crisis level as early as this year, growing by 3.0 per cent. In 2022, growth will moderate to 2.5 per cent.

Private consumption will be the biggest contributor to the economic recovery process. In 2020, private consumption fell by almost 5 per cent. This mostly reflected scarce opportunities to consume services. Households were relatively safe from the crisis, and retail sales flourished. Household deposits have increased by almost 13 per cent in a year. Consumer sentiment has started to improve and will climb further as restrictions are eased. Major expenditures such as holidays abroad will still be postponed at least until Q3, when a higher vaccination rate makes travelling safer. In 2021, private consumption is expected to increase by 3.8 per cent and in 2022 by 3.0 per cent.

Exports declined by 6.6 per cent in 2020, which was worse than in Sweden, Norway and Estonia. However, this was caused by a steep decline in service exports, since goods exports fell by only 1.8 per cent. In Q4 2020, goods exports even increased by 4 per cent, helped by some large one-off deals late in the year. Recent data on exports, industrial production and new orders in manufacturing have surprised on the positive side. The economies of Finland's main export partners are also gaining momentum, but low investment appetite may hamper trade prospects, since capital goods make up a large share of trade. The recovery of service exports will of course take time. So on average, exports of goods and services will increase by 5.0 per cent in 2021 and by 4.0 per cent in 2022.

A rebound in investment appetite will be crucial for the economy. Slow productivity growth has long been an issue for the Finnish economy. This could be improved by investing more. As a share of GDP, capital spending for intellectual property, ICT equipment and machinery remained far below the level of neighbouring Sweden even before the crisis. Yet the business sector remains cautious. At least for now, households will carry most of the burden. Residential construction started to gather pace at the end of 2020. An upturn in new construction permits and housing starts shows that the positive trend will continue. A 2.1 billion euro grant from the EU's Recovery and Resilience Fund will help boost public sector investment. According to preliminary plans, around half of this will be spent on green investments. A stronger investment upturn will happen in 2022, when capital spending will grow by 2.5 per cent.

The labour market has performed better than expected. After peaking at 8.4 per cent, unemployment started to decline in late 2020 and this trend has not been hampered by the recent restrictions. Unemployment will gradually fall to 7.3 per cent in 2022, accompanied by 2 per cent wage and salary growth.

Inflation trends are being shaped by fluctuations in energy prices. In 2020, falling oil and electricity prices slowed inflation to 0.3 per cent. This year, the reversal of the same trends will push consumer prices up by 1.2 per cent. In 2022, the growing price of services will push up inflation to 1.5 per cent.

Government debt is soaring again. The COVID-19 crisis has effectively sabotaged the efforts of Finnish government in recent years to lower deficits and debt. In 2021, the budget deficit will total 4.5 per cent and public debt will climb to 70 per cent of GDP.

The Baltics

Lithuania

The economy has again proved more resilient than feared. Newly started production of vaccine components is strongly supporting exports. More fiscal stimulus measures will add to already strong preconditions for consumption.

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Latvia

A positive trend for wood production, along with unexpectedly high pay increases, has maintained growth. But the economy risks a slowdown unless the COVID-19 vaccination drive regains lost ground.

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Estonia

A consumption boom is on its way. Due to falling unemployment, pay hikes will accelerate. Savings are high, and certain early pension fund withdrawals become possible this autumn. Fiscal stimulus will provide continued support in 2021.

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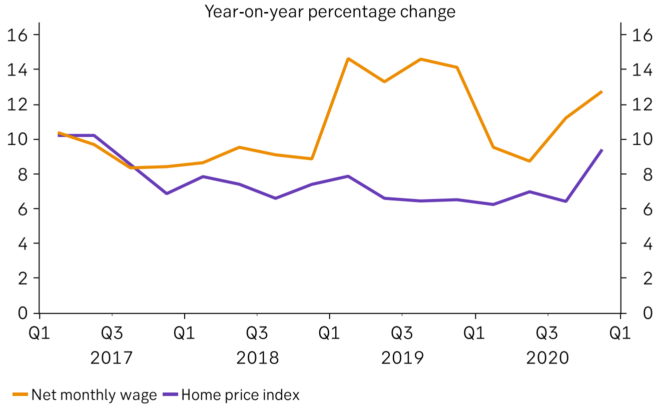
Lithuania

Vaccine-powered recovery is very close

GDP fell by only 0.9 per cent in 2020 and Lithuania's economy has already exceeded pre-pandemic level in the first quarter of this year. Manufacturing has played a key role in supporting GDP so far in 2021. Private consumption has been recovering since March, too, and is likely to accelerate rapidly due to accumulated savings. The labour market avoided huge losses, supported by stimulus measures. Inflation surprised on the upside in early 2021.

Wages have continued to outpace home price growth

Year-on-year percentage change



Source: Statistics Lithuania, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	4.3	-0.9	4.6	3.8
Private consumption	3.3	-2.0	3.2	4.3
Exports	9.5	0.0	6.2	4.5
Unemployment*	6.3	8.5	8.4	7.4
Wages and salaries	8.8	10.1	7.5	6.5
HICP inflation	2.2	1.1	2.6	2.6
Public sector fiscal balance**	0.5	-7.4	-7.3	-4.5
Public sector debt**	35.9	47.1	50.2	51.3

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

Stronger-than-expected start to 2021. Lithuania entered this year after re-imposing tough restrictions, which continued longer than we anticipated. However, the economic downturn was much smaller than during the first COVID-19 wave. A flash estimate shows that GDP rose by 1.0 per cent year-on-year in the first quarter. Solid outcomes in the manufacturing sector helped to mitigate the decline in private consumption, which was driven by restrictions on non-food retailers and providers of various services.

GDP forecast revised upward. Since the beginning of March, new cases of COVID-19 are on the rise again, but the government has continued its reopening of the economy. Lithuania is one of the EU leaders in the pace of vaccinations, leading to optimism regarding economic activity after mid-2021. Given the smaller economic impact from the second coronavirus wave and manufacturing activity that is exceeding projections, we are upgrading our 2021 GDP growth forecast from 1.8 to 4.6 per cent and expect GDP to increase by 3.8 per cent in 2022.

Reagents boost total goods exports. The main reason behind the unexpected jump in manufacturing output is a production unit in Vilnius for reagents used in making mRNA-based vaccines, which was launched in early December. Exports of reagents in January and February jumped to EUR 224 million (five times), accounting for 8 per cent of all exports of Lithuanian origin goods. Excluding reagents, other goods exports showed more moderate growth.

Private consumption is prepared to soar. Despite the closure of non-essential shops, retail sales increased by 4.9 per cent in the first quarter 2021. Such figures reflect not only a large-scale adaptation of businesses and consumers to online sales, but also sharp revenue growth for grocery chains. In the first quarter, the household savings rate jumped again and will provide an additional boost to private consumption in the second half of this year.

The labour market weathered the second wave quite well. We have revised our 2021 unemployment forecast from 9.1 to 8.4 per cent. The number of employees remained little changed in early 2021. Registered unemployment peaked in February and began falling later. The number of employees reporting downtime climbed at the peak of the restrictions but did not reach the level of the first wave. Pay increases also surprised on the upside, confirming decent demand for labour. We are upgrading our 2021 wage and salary growth forecast from 4.5 to 7.5 per cent.

The residential market remained buoyant despite the second wave. In particular, activity was stronger in the Vilnius housing market. Last year average wages increased more than home prices, but the situation will be different this year.

We have raised our 2021 inflation forecast from 2 to 2.6 per cent. During the first three months of 2021, inflation figures were above our projected trajectory, mainly due to the rebound in energy prices. Our revised forecast of average wage and salary growth is another reason for our higher inflation profile.

The government budget will be updated in May. Appropriations for managing the pandemic will be increased by up to EUR 500 million. Parliament will lower the VAT rate for catering services temporarily from 21 to 9 per cent from July to the end of 2022. Stimulus measures for businesses during the second wave were more targeted, but demand was not as strong as expected. Meanwhile budget revenue has been above projections so far this year. A Recovery and Resilience plan including EUR 2.2 billion in EU grants (4.5 per cent of GDP) was unveiled in April. According to the plan, most funds will be invested in projects that tackle climate change issues and improve the digitisation of public services.

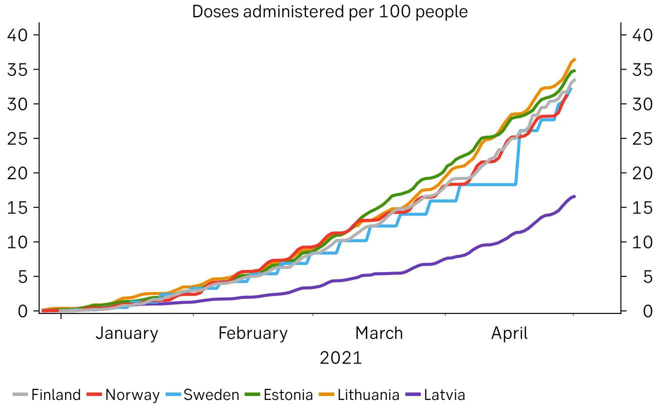
Latvia

Ready for lift-off

Despite a reversal during the first quarter of 2021, growth will resume. Lighter restrictions and improved sentiment will allow consumption to recover. Supported by hefty fiscal stimulus and foreign demand, the economy will expand by 3.7 per cent this year. We expect growth to accelerate further, totalling 5.2 per cent in 2022. One critical prerequisite is to speed up COVID-19 vaccinations to suppress the emergence of new waves and enable removal of restrictions by the end of 2021.

Speeding up the vaccine roll-out is critical

Doses administered per 100 people



Source: Our World in Data, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.2	-3.6	3.7	5.2
Private consumption	3.0	-10.0	5.1	6.2
Exports	1.9	-2.7	3.8	4.5
Unemployment*	6.3	8.1	8.4	7.5
Wages and salaries	7.2	6.2	6.7	6.9
HICP inflation	2.8	0.1	1.7	2.4
Public sector fiscal balance**	-0.6	-4.5	-8.1	-3.7
Public sector debt**	37.0	43.5	48.2	47.2

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

Sentiment climbs as the outlook brightens. As expected, the latest COVID-19 wave led to a tightening of restrictions, choking consumption in January and February particularly. In February retail sales dropped by 8.5 per cent. In March, restrictions were gradually eased and some activity resumed, although the state of emergency was not lifted until April 7. Consequently, economic sentiment improved from 87.2 in January to 90.7 in March. Both sentiment and private sector demand are expected to recover – driven by a high propensity to consume, one-off handouts from the government and pent-up demand. Increased fiscal stimulus will push the 2021 budget deficit to 8.1 per cent of GDP instead of the previously projected 6 per cent. Despite a reversal early in the year, GDP will recover by 3.7 per cent in 2021 and accelerate to 5.2 per cent next year.

Wood production will be instrumental in driving industrial production and exports. In February manufacturing picked up by 0.8 per cent. Data still reflect COVID-19 constraints, and performance across sectors is very uneven. A significant contribution comes from the largest sector – wood production – as well as pharmaceuticals, computers, electronic and optical equipment, chemicals and clothing. Output declined in two of the three largest sectors: the food and fabricated metal industries. Manufacturing will receive further support from recovering export markets, rising by 3 per cent this year. In February exports of goods surged by 7.5 per cent. The outcome is even more impressive considering that last year exports were still in a growth phase. The main driver was the growth of wood exports by one fifth. This may create future challenges for the sector and the economy if prices sharply reverse. Yet the biggest challenge for manufacturing is to maintain process continuity – avoiding infection and maintaining access to components. The stabilising outlook and improved confidence should help boost investment growth to 3.5 per cent.

Inflation will accelerate. In March, inflation climbed by 0.3 per cent, mainly driven by higher service prices. Rising prices for fuel, leisure and cultural goods and services, alcohol and health care – offset by falling prices for housing, clothing, footwear and food – had the largest impact. Inflation will continue to accelerate. Base and reopening effects will bring it to 3 per cent by October.

Wage and salary growth has been surprisingly resilient, slowing only a bit as a belief that problems are temporary predominated and a demand for skilled labour remained strong. This year, growth will speed up to 6.7 per cent. It is very likely that stagnation in wages may be seen in the accommodation and catering industry.

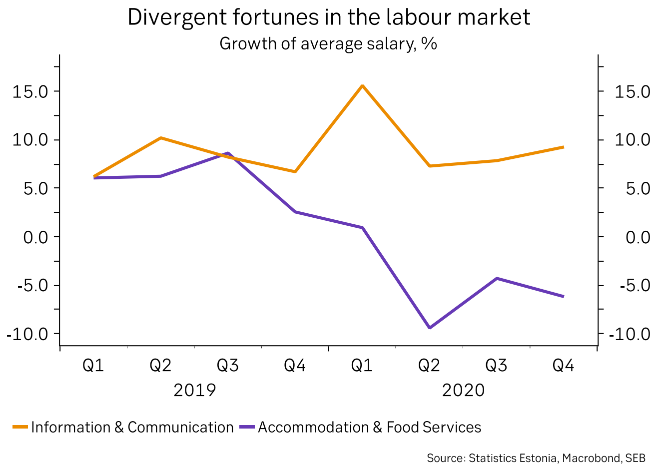
Effective government support has put a lid on unemployment, which will peak at 9 per cent in the first quarter. Early this year, around 7 per cent of the labour force was receiving wage subsidies and other crisis benefits. This means that new hiring may remain cautious for a while, although demand for employees – especially highly skilled ones – will remain strong. By the end of the year the unemployment rate will shrink towards 8 per cent.

Speeding up Latvia's unreasonable slow vaccination roll-out will be critical for the economic outlook. An negligent purchasing process led to a shortage of vaccines. The pace of vaccinations will accelerate but there are doubts as to whether a critical mass will be reached by autumn.

Estonia

Sugar rush in the autumn

Good fortune has accompanied Estonia during the COVID-19 crisis, as the epidemiological situation has allowed the economy to function more or less normally most of the time. Supply-side resilience will be crucial during the second half of the year, when a surge of private demand needs to be met. We are sticking to our earlier forecast and expect GDP to grow by 3.3 per cent in 2021. In 2022 growth will accelerate further, reaching 4.5 per cent.



Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	5.0	-2.9	3.3	4.5
Private consumption	3.3	-2.3	4.5	5.5
Exports	6.2	-5.5	5.0	5.0
Unemployment*	4.7	6.8	7.8	6.3
Wages and salaries	7.4	2.9	3.5	5.0
HICP inflation	2.4	-0.6	1.5	2.3
Public sector fiscal balance**	-0.3	-4.8	-5.5	-3.5
Public sector debt**	8.4	18.2	21.5	24.5

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

Despite being sparing with restrictions, Estonia managed to hold back the second wave of COVID-19 for surprisingly long. A surge in infections finally forced the government to enact tighter restrictions in mid-March, but for most of the time, life has continued almost like normal. GDP was already close to its pre-pandemic level in Q4 2020. The biggest risk to the economy is the speed of the vaccination process, which is being threatened by concerns about the safety of some vaccines. Especially crucial is the return of free movement to and from Finland, which would revive tourism. But we are sticking to a scenario of gradual recovery in the service sector this summer and no return to serious restrictions in the autumn, resulting in 3.3 per cent GDP growth during 2021.

A consumption boom seems imminent when restrictions finally ease. Household deposits have risen by 16 per cent in a year, allowing people high spending power given the opportunity. Yet this will only be a foretaste of the shopping spree that will start in September, when a controversial pension reform will enable people to withdraw their 2nd pillar pension savings. Around 178,000 have applied to do so, with the total pre-tax sum reaching EUR 1.5 billion, or 10 per cent of household disposable income. This will accelerate private consumption growth to 4.5 per cent in 2021 and 5.5 per cent in 2022.

Merchandise exports have recovered well according to the headline figures, but in many areas there is room for improvement. Industrial production data for the early months of 2021 have not been promising, but manufacturing sector sentiment continues to recover and is already far above its pre-crisis level. Exports of services, which used to make up a third of trade, have of course fared much worse. However, a low comparison base and the relative economic strength of Estonia's main trading partners should help exports to grow by 5 per cent both in 2021 and 2022.

The labour market has shrugged off the second wave of the virus. Recent restrictions have had no apparent effect on unemployment, which has instead started to fall marginally. On the negative side, the crisis has divided employees into clear losers and winners. In the low-paid service sector, jobs are scarce and people have little hope for pay increases, while in already well-paid sectors such as IT, a chronic labour shortage continue to boost wages and salaries. In 2021 unemployment will be only 7.8 per cent and pay increases 3.5 per cent. Conditions will improve in 2022, when the jobless rate will fall to 6.3 per cent and pay will grow by 5 per cent.

Capital spending is shaped by divergent trends. Against all odds, investments surged by 18 per cent in 2020, due to a very large transfer of intellectual property to the Estonian subsidiary of an automotive industry giant. That will be hard to beat in 2021, as most businesses remain highly cautious in their investment decisions. There is some hope for construction. After a temporary halt in early 2020, the real estate market accelerated in the second half of the year and continues to thrive. Developers that previously stalled new projects are now trying to catch up with demand. Strong demand is at least in part caused by the need to park savings. Outflows from the 2nd pension pillar will give the market a further boost. However, quickly changing demographic conditions will soon end the party. After an 8 per cent decline in 2021, we expect capital spending to accelerate in 2022 by 6 per cent.

More stimulus is expected from the public sector. A 1.1 billion euro grant from the EU's Recovery and Resilience Fund is expected to give a further boost to an already busy pipeline of public construction projects. This will be accompanied by a rise in public debt, which will reach 24.5 per cent in 2022. The budget deficit will also increase compared to 2020, reaching 5.5 per cent this year.

Key indicators

Global key indicators

Yearly change in per cent

	2019	2020	2021	2022
GDP OECD	1.6	-4.8	4.9	3.7
GDP world (PPP)	2.8	-3.3	5.9	4.3
CPI OECD	2.1	1.4	2.6	2.2
Oil price, Brent (USD/barrel)	64	43	67	62

US

Yearly change in per cent

	2020 level, USD bn	2019	2020	2021	2022
Gross domestic product	20 937	2.2	-3.5	6.5	4.0
Private consumption	14 145	2.4	-3.9	7.0	3.6
Public consumption	3 037	1.8	0.4	2.5	3.1
Gross fixed investment	4 472	2.4	-11	8.9	5.1
Stock building (change as % of GDP)	-73	0.0	-0.7	0.2	0.1
Exports	2 127	-0.1	-12.9	7.1	7.3
Imports	2 772	1.1	-9.3	12.2	5.9
Unemployment (%)		3.7	8.1	5.3	4.0
Consumer prices		1.8	1.3	3.0	2.4
Core CPI		2.2	1.7	2.2	2.4
Household savings ratio (%)		7.5	16.3	14.5	8.1
Public sector financial balance, % of GDP		-5.7	-15.5	-15.0	-8.0
Public sector debt, % of GDP		108	127	133	135

Euro area

Yearly change in per cent

	2020 level, EUR bn	2019	2020	2021	2022
Gross domestic product	11,323	1.3	-6.6	3.8	4.2
Private consumption	5,897	1.3	-8.0	5.0	4.5
Public consumption	2,555	1.8	1.2	1.0	1.1
Gross fixed investment	2,437	5.7	-8.2	5.0	4.0
Stock building (change as % of GDP)		-0.5	-0.3	0.1	0.0
Exports	5,158	2.5	-9.3	9.0	6.0
Imports	4,707	3.9	-9.0	10.0	5.0
Unemployment (%)		7.6	8.0	8.1	7.8
Consumer prices		1.2	0.3	1.7	1.2
Core CPI		1.0	0.7	1.1	1.0
Household savings ratio (%)		13.2	20.1	17.0	14.0
Public sector financial balance, % of GDP		-0.6	-7.2	-6.4	-4.6
Public sector debt, % of GDP		84.0	98.0	102.7	101.2

Other large countries

Yearly change in per cent

	2019	2020	2021	2022
GDP				
United Kingdom	1.4	-9.8	6.4	5.8
Japan	0.7	-4.8	2.8	1.8
Germany	0.6	-4.9	2.6	3.4
France	1.5	-8.1	4.7	4.6
Italy	0.3	-8.9	3.7	5.3
China	6.0	2.3	9.0	5.3
India	4.8	-7.1	10.1	7.2
Brazil	1.4	-4.1	3.3	2.7
Russia	2.0	-3.1	3.8	2.9
Poland	4.5	-2.7	3.8	4.5
Inflation				
United Kingdom	1.8	0.9	1.6	2.2
Japan	0.5	0.0	0.2	0.6
Germany	1.5	-0.7	1.4	1.3
France	1.6	0.0	1.0	1.5
Italy	1.1	0.0	0.7	0.8
China	2.9	2.5	1.6	2.0
India	3.7	6.6	4.6	4.0
Brazil	3.7	3.2	4.3	3.7
Russia	4.5	3.4	4.7	3.9
Poland	2.3	3.4	2.7	2.9
Unemployment (%)				
United Kingdom	3.8	4.5	5.8	5.6
Japan	2.4	2.8	2.7	2.5
Germany	3.2	4.2	4.3	3.9
France	8.2	8.2	8.8	8.6
Italy	10.0	9.3	10.0	9.8

Financial forecasts

Official interest rates		29-Apr	Jun-21	Dec-21	Jun-22	Dec-22
US	Fed funds	0.25	0.25	0.25	0.25	0.25
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10
Euro area	Refi rate	0.00	0.00	0.00	0.00	0.00
United Kingdom	Repo rate	0.10	0.10	0.10	0.10	0.10
Bond yields						
US	10 years	1.65	1.80	2.00	2.20	2.40
Japan	10 years	0.08	0.05	0.05	0.10	0.10
Germany	10 years	-0.22	-0.15	0.00	0.10	0.20
United Kingdom	10 years	0.84	0.85	1.00	1.10	1.20
Exchange rate						
USD/JPY		109	106	104	106	108
EUR/USD		1.21	1.24	1.18	1.16	1.13
EUR/JPY		132	131	123	123	122
EUR/GBP		0.87	0.85	0.84	0.86	0.87
GBP/USD		1.39	1.46	1.40	1.35	1.30

Sweden

Yearly change in per cent

	2020 level, SEK bn	2019	2020	2021	2022
Gross domestic product	4,952	1.4	-2.8	4.5	4.0
Gross domestic product, working day adjustment		1.4	-3.1	4.4	4.0
Private consumption	2,194	1.2	-4.7	4.0	3.7
Public consumption	1,327	0.3	-0.5	1.2	1.2
Gross fixed investment	1,217	-3.1	0.6	4.0	6.0
Stock building (change as % of GDP)	-3	-0.1	-0.8	0.6	0.2
Exports	2,190	4.8	-5.2	6.3	5.9
Imports	1,973	1.3	-5.8	5.0	5.7
Unemployment, (%)		7.1	8.6	8.7	7.5
Employment		0.6	-1.3	0.3	1.8
Industrial production		1.6	-3.9	6.0	5.0
CPI		1.8	0.5	1.4	1.3
CPIF		1.7	0.5	1.6	1.3
Hourly wage increases		2.5	1.7	2.4	2.5
Household savings ratio (%)		16.1	17.9	17.5	17.6
Real disposable income		3.3	-0.8	4.3	3.2
Current account, % of GDP		5.1	5.2	4.7	4.5
Central government borrowing, SEK bn		-112	221	50	60
Public sector financial balance, % of GDP		0.6	-3.1	-2.1	-1.0
Public sector debt, % of GDP		35.0	39.9	38.5	35.5

Financial forecasts	**29-Apr**	**Jun-21**	**Dec-21**	**Jun-22**	**Dec-22**
Repo rate	0.00	0.00	0.00	0.00	0.00
3-month interest rate, STIBOR	-0.03	-0.05	-0.10	-0.05	-0.10
10-year bond yield	0.38	0.40	0.50	0.60	0.70
10-year spread to Germany, bps	60	55	50	50	50
USD/SEK	8.37	7.98	8.39	8.41	8.58
EUR/SEK	10.13	10.00	9.90	9.75	9.70
KIX	113.4	112.0	112.3	110.5	110.1

Finland

Yearly change in per cent

	2020 level, EUR bn	2019	2020	2021	2022
Gross domestic product	237	1.3	-2.8	3.0	2.5
Private consumption	120	0.7	-4.9	3.8	3.0
Public consumption	58	2.0	2.3	2.0	1.0
Gross fixed investment	56	-0.9	-3.1	1.5	2.5
Stock building (change as % of GDP)	1	0.3	-0.4	0.1	0.0
Exports	85	6.7	-6.6	5.0	4.0
Imports	84	2.2	-6.6	4.0	3.5
Unemployment, OECD harmonised (%)		6.7	7.8	7.8	7.3
CPI, harmonised		1.1	0.3	1.2	1.5
Hourly wage increases		2.1	1.8	2.2	2.0
Current account, % of GDP		-0.2	0.8	-0.3	-0.3
Public sector financial balance, % of GDP		-1.0	-5.4	-4.5	-3.5
Public sector debt, % of GDP		59.5	69.2	70.0	71.0

Norway

Yearly change in per cent

	2020 level, NOK bn	2019	2020	2021	2022
Gross domestic product	3,557	0.9	-0.8	2.6	3.5
Gross domestic product (Mainland)	2,929	2.3	-2.5	3.5	3.7
Private consumption	1,430	1.4	-7.6	5.0	6.5
Public consumption	856	1.9	1.7	2.0	1.5
Gross fixed investment	857	4.8	-3.9	0.2	1.5
Stock building (change as % of GDP)		0.0	-0.7	0.4	0.0
Exports	1,345	0.5	-0.9	2.6	3.3
Imports	1,053	4.7	-12.2	4.4	4.0

Unemployment (%)	3.7	4.6	4.2	4.0
CPI	2.2	1.3	2.8	1.6
CPI-ATE	2.2	3.0	1.9	1.5
Annual wage increases	3.5	3.1	2.5	2.7

Financial forecasts	**29-Apr**	**Jun-21**	**Dec-21**	**Jun-22**	**Dec-22**
Deposit rate	0.00	0.00	0.25	0.50	0.75
10-year bond yield	1.51	1.55	1.70	1.80	1.90
10-year spread to Germany, bps	173	170	170	170	170
USD/NOK	8.21	7.98	8.22	8.41	8.72
EUR/NOK	9.95	9.90	9.70	9.75	9.85

Denmark

Yearly change in per cent

	2020 level, DKK bn	2019	2020	2021	2022
Gross domestic product	2,324	2.9	-2.7	3.0	4.5
Private consumption	1,034	1.4	-2.0	3.0	5.0
Public consumption	576	1.2	-0.1	2.1	0.8
Gross fixed investment	527	3.1	2.1	6.6	8.0
Stock building (change as % of GDP)		-0.3	-0.2	0.1	0.0
Exports	1,263	5.1	-7.7	4.1	5.3
Imports	1,112	2.5	-4.8	6.1	5.6

Unemployment, OECD harmonised (%)	5.2	6.0	5.3	4.9
CPI, harmonised	0.8	0.4	1.2	1.3
Hourly wage increases	2.0	1.9	1.9	2.9
Current account, % of GDP	8.8	7.5	7.5	8.0
Public sector financial balance, % of GDP	3.8	-3.0	-2.0	0.0
Public sector debt, % of GDP	33.3	44.0	41.0	38.0

Financial forecasts	**29-Apr**	**Jun-21**	**Dec-21**	**Jun-22**	**Dec-22**
Deposit rate	-0.50	-0.50	-0.60	-0.60	-0.60
10-year bond yield	0.04	0.08	0.20	0.30	0.40
10-year spread to Germany, bps	26	23	20	20	20
USD/DKK	6.14	5.99	6.14	6.32	6.32
EUR/DKK	7.44	7.43	7.43	7.46	7.46

Lithuania

Yearly change in per cent

	2020 level, EUR bn	2019	2020	2021	2022
Gross domestic product	49	4.3	-0.9	4.6	3.8
Private consumption	29	3.3	-2.0	3.2	4.3
Public consumption	9	0.1	0.6	0.5	0.2
Gross fixed investment	11	6.2	-0.2	4.5	8.0
Exports	36	9.5	0.0	6.2	4.5
Imports	31	6.3	-5.3	5.1	5.8
Unemployment (%)		6.3	8.5	8.4	7.4
Wages and salaries		8.8	10.1	7.5	6.5
Consumer prices		2.2	1.1	2.6	2.6
Public sector financial balance, % of GDP		0.5	-7.4	-7.3	-4.5
Public sector debt, % of GDP		35.9	47.1	50.2	51.3

Latvia

Yearly change in per cent

	2020 level, EUR bn	2019	2020	2021	2022
Gross domestic product	29	2.2	-3.6	3.7	5.2
Private consumption	16	3.0	-10.0	5.1	6.2
Public consumption	6	2.6	2.6	3.3	2.8
Gross fixed investment	7	3.1	0.2	3.5	4.5
Exports	18	1.9	-2.7	3.8	4.5
Imports	17	2.3	-3.3	2.5	3.6
Unemployment (%)		6.3	8.1	8.4	7.5
Wages and salaries		7.2	6.2	6.7	6.9
Consumer prices		2.8	0.1	1.7	2.4
Public sector financial balance, % of GDP		-0.6	-4.5	-8.1	-3.7
Public sector debt, % of GDP		37.0	43.5	48.2	47.2

Estonia

Yearly change in per cent

	2020 level, EUR bn	2019	2020	2021	2022
Gross domestic product	27	5.0	-2.9	3.3	4.5
Private consumption	13	3.3	-2.3	4.5	5.5
Public consumption	6	3.0	3.6	3.5	1.5
Gross fixed investment	9	11.0	18.4	-8.0	6.0
Exports	19	6.2	-5.5	5.0	5.0
Imports	19	3.7	0.7	1.5	6.0
Unemployment (%)		4.7	6.8	7.8	6.3
Wages and salaries		7.4	2.9	3.5	5.0
Consumer prices		2.4	-0.6	1.5	2.3
Public sector financial balance, % of GDP		-0.3	-4.8	-5.5	-3.5
Public sector debt, % of GDP		8.4	18.2	21.5	24.5

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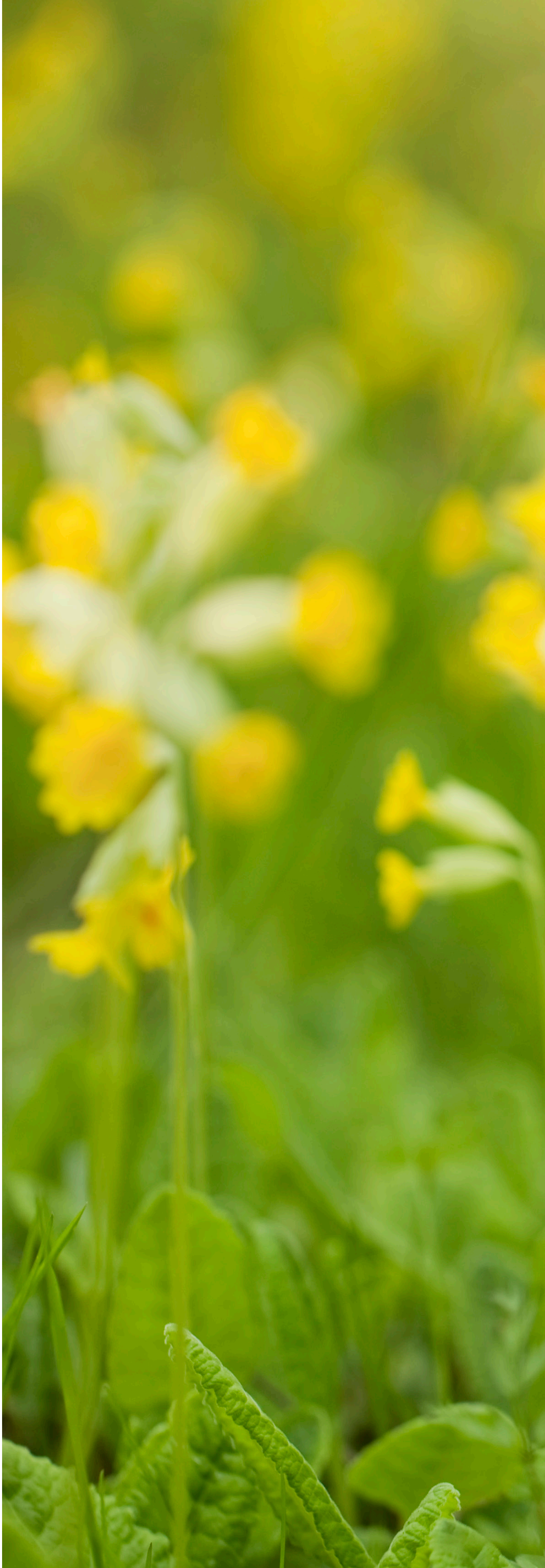
This report was published on May 4, 2021
Cut-off date for calculations and forecasts was April 29, 2021



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