Nordic Outlook
May 2023

New playing field as both inflation and growth fall

Research reports

SEB

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May 2023

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New playing field as both inflation and growth fall

There are more and more signs that high inflation is finally coming down. Energy, commodity, transport and input prices have fallen. This has not led to broad-based declines in consumer prices, but we are at least seeing a slowdown in the pace of price increases. While this is welcome news, there is every reason for continued caution. Inflation is still very high, and underlying inflation in particular seems unwilling to give up without a lengthy fight. This, in turn, means that despite signs of waning inflationary pressures, central banks will keep hiking key interest rates at one or more meetings before rates peak.

Interest rates have exceeded the neutral level and are now having a tightening effect on the economy. Together with falling real wages and lower consumption, they are thus contributing to the slowdown in economic activity indicated by the forecasts cited in this report. The depth and duration of the coming economic downturn will not be easy to determine. For a long time, there has been an unusually wide gap between soft indicators – such as what companies and individuals believe about economic conditions – and hard data such as unemployment and GDP growth. The soft indicators have pointed to a substantial slowdown and an imminent recession, while hard data have continued to surprise on the upside. The strength of the real economy has contributed to continued high inflationary pressures but has also made it easier for central banks to hike their key rates quickly, without worrying about rising unemployment and rapidly declining growth.

But recently, signs of a slowdown have become more evident and the central banks' balancing act between inflation and recession risks has become more difficult. Although some support is coming from China – which has lifted COVID-19 restrictions and where households with plenty of savings will boost economic activity – the overall picture is that the playing field has changed, and it is becoming increasingly hard to raise interest rates without triggering consequences in the real economy.

In March, a new danger also emerged: financial sector stability. California-based Silicon Valley Bank suddenly found itself in acute financial distress. Customers wanted to withdraw their money, while the bank's assets were largely tied up in bonds that could not be sold without realising losses caused by the rapid rise in interest rates. A few more banks got into trouble, but after rapid intervention by government authorities and central banks, the overall situation has stabilised and the likelihood of increased stress in the entire financial system is quite low. But these developments remind us of the risks associated with dramatic changes like those we have seen in monetary policy over the past year.

We can only conclude that we are living in both uncertain and very interesting economic times.

This May 2023 issue of *Nordic Outlook* includes in-depth theme articles that address the following issues:

- The inflation dynamic
- Energy crisis called off
- Monetary policy
- The Turkish elections

We wish you pleasant reading!

Jens Magnusson
Chief Economist

Daniel Bergvall
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The global economy

The United States | page 25

Fed key rate hikes are starting to bite, and the risk of an acute banking crisis has been averted. But due to tighter lending conditions for SMEs and more cautious households, the US will enter a mild recession in 2023.

China | page 28

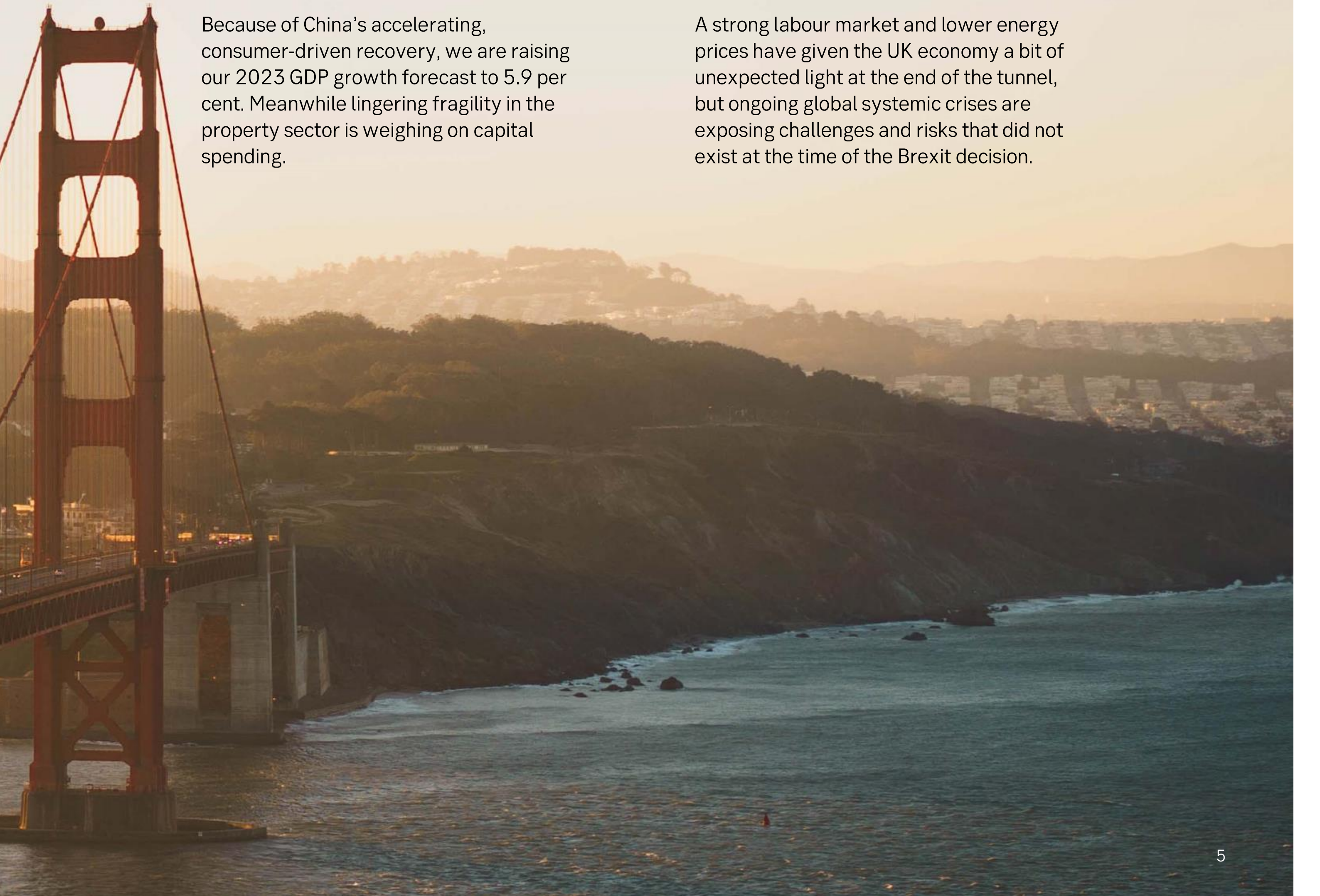
Because of China's accelerating, consumer-driven recovery, we are raising our 2023 GDP growth forecast to 5.9 per cent. Meanwhile lingering fragility in the property sector is weighing on capital spending.

The euro area | page 32

Resilience, especially in the service sector, will help to keep the expected recession relatively mild. Despite increased financial sector turmoil, the European Central Bank will hike key rates in three more 25-basis point increments at upcoming meetings.

The United Kingdom | page 35

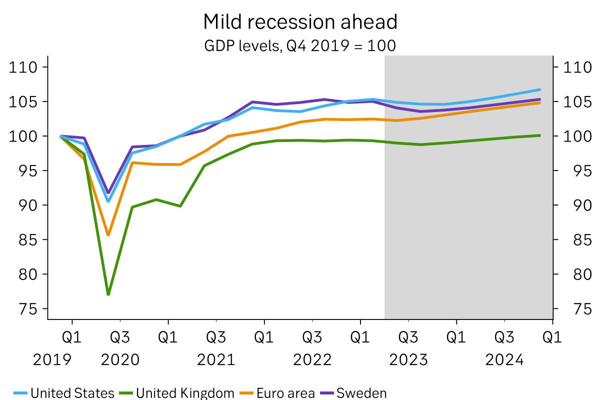
A strong labour market and lower energy prices have given the UK economy a bit of unexpected light at the end of the tunnel, but ongoing global systemic crises are exposing challenges and risks that did not exist at the time of the Brexit decision.



International overview
Mild recession, moderate recovery

A household-led growth slowdown has become clearer. The OECD countries will see weak GDP growth this year and a moderate recovery in 2024. Inflation is falling but core inflation only slowly, as various price components surge one after the other. Recent financial sector turmoil clearly shows the downside of rapid monetary policy change. We are probably at or near the key rate peak but must wait until autumn at the earliest before inflation-focused central banks start cutting rates, with the Fed being the first.

The war in Ukraine remains a source of great human suffering and a very tense global security policy situation. Economic performance will be determined in a triangle drama between inflation, anaemic growth and financial stress. Inflation is historically high, although we are starting to see signs of easing. Central banks are close to peak interest rates, while growth is slowing. The full impact of large, rapid, globally synchronised key rate hikes is uncertain, as exemplified by financial sector stress in the United States and Switzerland in mid-March. We believe this stress is manageable but that it will add to monetary tightening, thereby lowering expectations of peak central bank interest rates.



Geopolitics and moves towards greater regionalisation are increasingly affecting the economic outlook. Companies are rethinking global value chains, i.e., where, when and how they intend to produce in the future. Disruptions during the COVID-19 pandemic demonstrated the risks of complex supply chains with narrow margins. Growing tensions and increased trade restrictions between the US/Europe and China are creating a need for more diversified value chains. Worsening relations between China and the US/Europe – as well as the climate crisis – are thus creating further economic uncertainty.

Delayed recession – again. Global economic resilience continues to surprise on the upside. Household and business confidence is low, but hard data outcomes have not been as gloomy, partly because labour markets have remained very strong in many countries and energy prices have fallen. Meanwhile European households and businesses have adapted to a new energy landscape. Pandemic stimulus policies have also persisted, both in the form of unusually large household savings buffers and recurring crisis packages in recent years, which have probably increased public expectations of new relief actions if the situation worsens. Growth has been driven by a recovery for services, which may also have boosted resilience to interest rate hikes. At the same time, the need for capital spending has risen because of pandemic-related investment programmes as well as the need for climate measures and large defence spending due to the new, serious security policy situation. Yet 2023 will still be largely a lost growth year for many OECD economies.

Global GDP growth
Year-on-year percentage change

	2021	2022	2023	2024
United States	5.9	2.1	0.7	0.9
Japan	2.1	1.1	1.5	1.2
Germany	2.6	1.8	0.2	1.7
China	8.1	3.0	5.9	4.9
United Kingdom	7.6	4.1	-0.3	0.7
Euro area	5.3	3.5	0.6	1.6
Nordic countries	4.5	3.0	0.0	1.2
Sweden	5.4	2.6	-1.0	0.6
Baltic countries	6.0	1.4	-0.1	2.7
OECD	5.7	3.0	0.9	1.4
Emerging markets	7.3	3.6	3.9	4.1
World, PPP*	**6.3**	**3.3**	**2.5**	**2.9**

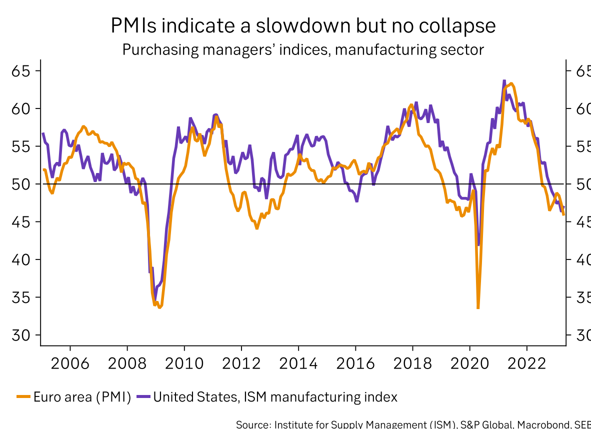
Source: OECD, IMF, SEB. *PPP=Purchasing power parities

A recession is coming but is expected to be mild. In terms of growth, the US and the euro area will enter a mild recession in 2023. Full-year GDP growth will be less than one per cent. Next year there will be a gradual recovery, but despite key interest rate cuts, growth

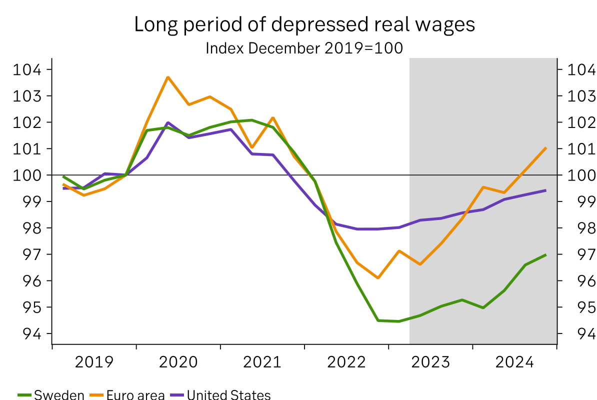
figures will be a bit below trend. This is because households are still hard pressed by high inflation. Towards the end of our forecast period, key rates will still be above their neutral level (2-2.5 per cent). The reopening of the Chinese economy will provide long-awaited growth acceleration and strengthen global demand, which is otherwise weak. Overall global GDP will grow by 2.5 and 2.9 per cent in 2023 and 2024.

Growth slump in the Western world

Since last autumn, we have seen many signs that households are being squeezed especially hard. Consumption is falling and their ability to "bridge over" the cost crisis with the help of large-scale pandemic relief funds is starting to run out. High inflation, rising interest rates and falling home prices – which have temporarily stabilised in some countries – are too many headwinds to cope with in the long term. The savings buffer built up by households during the pandemic is shrinking fast. The savings ratio in the euro area has largely fallen to pre-pandemic levels and even lower in the US. Labour markets will weaken later this year in various countries. Despite falling inflation, real incomes will climb only weakly during 2023 and 2024 in the US and the euro area, after earlier rapid declines. Goods consumption has been hardest hit so far, while service consumption remains relatively strong. One reason is that there is still a pent-up willingness to consume after the pandemic, which has also become a driving force in maintaining employment.



Mild, hard-to-interpret headwinds for manufacturers. Europe and other parts of the world overcame their energy crisis last winter. This has removed a lot of downside economic risks, although energy prices remain high. Sentiment surveys, mainly in manufacturing, have shown lower figures but the mood has not fallen to dramatic recession levels. The surveys are also somewhat difficult to interpret. For example, shorter delivery times in purchasing managers' indices are not only due to lower demand but also to global value chains functioning better or even normalising (according to Fed calculations). Given lower demand, businesses will have to deal with their part of the downturn, but the outlook varies greatly between sectors. Companies whose products are geared towards households face strong headwinds, while companies in other sectors may be positively affected by the geopolitical situation, via defence spending, the energy transition and voluntary or politically driven regionalisation. GDP growth in the 38 mainly affluent OECD countries will be a weak 0.9 per cent in 2023 and 1.4 per cent in 2024 – below trend during both years. We have revised our 2023 forecast upward by a couple of tenths compared to *Nordic Outlook* in January, mainly because growth early this year was better than expected.



Below-trend GDP increase. Growth will not accelerate very strongly towards the end of our forecast horizon despite key rate cuts, due to several factors. Real household incomes are down, especially wages, and consumption will not recover in the near term. Lower demand will push unemployment higher this autumn, and businesses will face continued high interest rates while credit conditions tighten – classic factors behind weak growth. However, businesses may benefit if production costs stop rising and begin to fall. Largely because households and consumption will initially drive the economic downturn, we expect it to be a little shallower but somewhat lengthier. Households simply cannot slow down in the same way as business or residential investments, since much of their spending is on necessities such as food and housing.

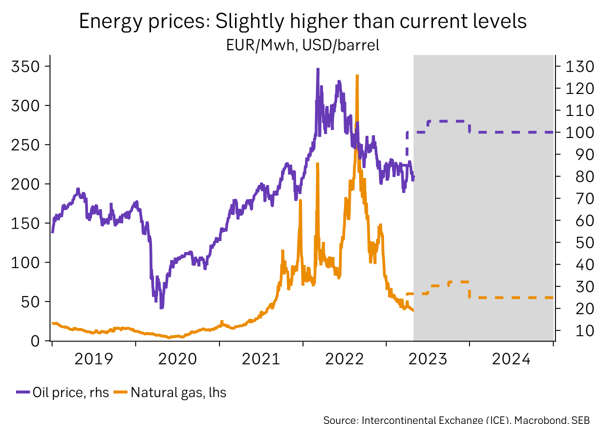
China is accelerating. The Chinese economy is clearly accelerating after Beijing's reversal of its zero-COVID policy. During Q1 2023, GDP grew more strongly than expected. We are raising our growth forecast to 5.9 per cent in 2023 and 4.9 per cent in 2024; this year GDP growth will exceed Beijing's target of about 5 per cent. The upturn is largely driven by household consumption,

especially services. The property sector remains weak, with a small improvement driven mainly by state-owned construction companies. But a strong credit impulse will drive capital spending next autumn. The Chinese government will need to strike a careful balance to achieve its growth target without overheating the economy and boosting the debt burden too quickly.

China is important to global demand, but not as much as before. For other countries, China's recovery means somewhat higher demand, but because many production and supply chains have moved to China, the effects on the rest of the world will likely be more limited than in previous upturns. Another reason is that the service sector, not manufacturing, is growing faster. Other factors are decreased globalisation and greater tensions between China and the US/Europe. But Chinese growth may boost demand for commodities in general and energy in particular, although our own energy forecast indicates a relatively moderate upturn.

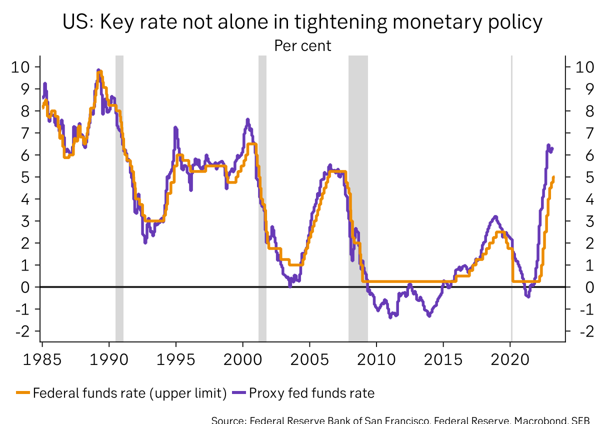
Continued slowdown for other EM economies. Other major emerging market economies will continue to slow this year due to weaker global economic activity. Also holding them back will be tighter financial conditions, continued high and rising interest rates and a strong dollar (although the USD is expected to weaken in the future). This limits debt burdens. But because we expect the US dollar to lose value and interest rates to fall, there is less risk of acute debt stress in many EM economies, which are exposed to large USD loans. Falling energy and commodity prices have recently levelled the playing field somewhat between commodity exporters and other EM countries. A faster-growing China is raising overall EM growth, which will reach 3.9 per cent in 2023 and 4.1 per cent in 2024.

Energy crisis called off. Natural gas and coal prices have fallen by 40 per cent this year but are still twice as high as in 2018-2019. Natural gas inventories in Europe are close to record levels for the season, and the risk of energy shortages next winter is very small. Energy prices will remain elevated, and Europe has also paid a price because some coal power is back. The energy issue remains vital, but once the risk of acute energy shortages is over, the focus will shift back to the ongoing climate crisis and what will be needed to achieve a sustainable energy transition. Major "green" investments will be needed to achieve the transition. This issue is also important to the geopolitical balance; for example, new nuclear power efforts have been dominated by China and Russia over the past five years. Today's high energy prices may well be the new normal. We have made few changes in our gas and oil forecasts compared to the current situation (see "Theme: Energy crisis called off", page 16).



Downside risk from key rates, financial stress

The risk picture has shifted slightly towards the downside, with driving forces similar to those described in January's *Nordic Outlook*. This spring we have seen how stress can quickly flare up in the financial sector. If it spreads, it can lead to clearly negative financial and growth effects. There is great uncertainty about the impact of monetary policy and the lag between key rate hikes and slowdowns in the real economy (see "Theme: Monetary policy", page 20) The US Federal Reserve has raised its key rate by nearly 5 percentage points in just over a year – its fastest tightening in decades. Also under way is quantitative tightening (QT); central banks are selling their bonds holdings. Banks have become less willing to lend money, due to increased financial stress. For example, the Fed's "proxy rate", which attempts to capture the effects of other factors besides the key rate, suggests that actual tightening is about 1.5 points above the key rate. This means that its impact may be underestimated and partly obscured by last year's resilience, while the tightening effect of greater financial stress may be larger than we expect in our main scenario.



Can inflation surprise on the downside? Inflation is falling, but labour markets remain strong. Overall, we do not see signs of wage-price spirals. Historically, large price increases have been corrected after a while. Recent upside inflation surprises have made forecasters more cautious about expecting a full reversal of inflation once price increases slow. Price expectations among businesses have been revised lower. Producer prices in Germany, for example, decelerated more than expected in March. If we experience a stronger downward inflation trend in the future, this may have positive spill-over effects via better real incomes. Above all, central bank key rates may then fall faster. This, in turn, would also benefit equity and property markets, reducing the risk of negative growth effects from falling asset prices and the risk of further financial sector trouble spots.

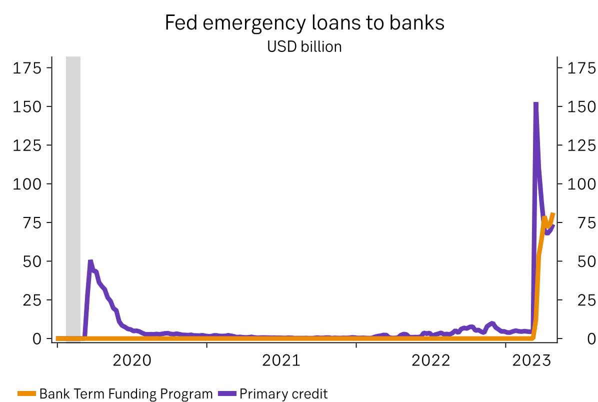
Scenarios for the OECD countries
GDP growth, per cent

	2022	2023	2024
Main scenario	3.0	0.9	1.4
Negative scenario		-0.6	-0.4
Positive scenario		1.6	3.2

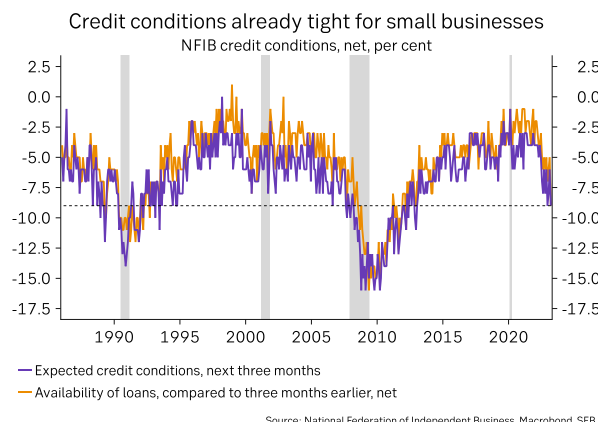
Source: SEB

Financial stress may change playing field

Financial sector stress in the US and Switzerland during March is expected to contribute to tighter credit conditions, thus becoming another growth-inhibiting factor. Tightened credit conditions are of course also a natural adjustment to a weaker economy and central bank tightening, but financial sector turmoil can intensify this trend. Intervention by US authorities, including emergency loans and guarantees, halted an acute crisis of confidence following the collapse of Silicon Valley Bank. Withdrawals of deposits from regional banks, which were the focus of the crisis, seem to have stabilised but the situation remains fragile. It is also clear that in today's digitised world, loss of confidence occurs much faster than before. Despite the stress among US regional banks, broader metrics of financial conditions have remained stable. Tightening credit thus mainly hurts small and medium-sized enterprises (SMEs) that depend on the banking sector for their funding. Connections to events during the global financial crisis (GFC) some 15 years ago are contributing to concerns. During the GFC, stress signals came in several stages, including over a year before Lehman Brothers went bankrupt in September 2008. We are not seeing equally large imbalances in private debt today, but the rapid decline in confidence in certain US-based banks over the past month or so has again demonstrated how quickly the situation can change.



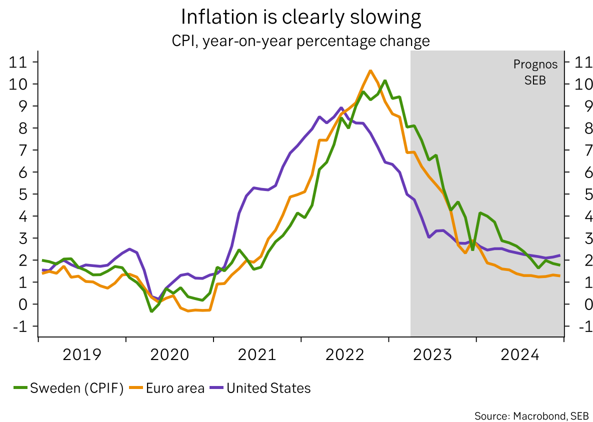
More regulation on the way? Even parts of the financial system not classified as banks are now in the spotlight. Following the turbulence in March, US federal agencies pointed out the need for further regulation, closer supervision and more information from non-banks. Similar signals have come from such organisations as the Financial Stability Board, an international association of financial regulators. The FSB estimates that close to 50 per cent of global financial assets are found in this less regulated and less transparent part of the economy, which demonstrates its importance.



More signs that inflation is slowing

After surprising on the upside for much of 2022, inflation has started slowing. Forecasts indicate a continued downturn. But early 2023 was characterised by setbacks, largely due to inertia in the inflation process. In the early phase of the process – which includes commodity, energy and freight prices – we saw declines. Prices of some other categories of goods also fell, although in many cases their level is still higher than before the pandemic. Rapid price increases during 2022 are now producing "base effects" that are lowering the inflation rate, but high levels of many input prices are continuing to push up consumer prices, contributing to a sluggish decline in inflation (see also "Theme: The inflation dynamic", page 13).

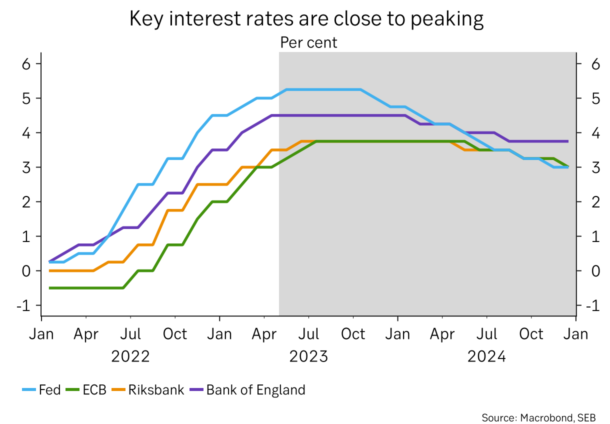
Time lag even when prices fall. One important issue for inflation forecasts going forward relates to the size of time lags at different stages of the downturn phase. For example, German producer prices peaked in May 2022, but consumer goods prices keep rising. However, the percentage of companies expecting rising prices has fallen sharply. After a few months lag, we should see a bigger impact on CPI as well. Looking ahead, components that are later in the inflation process such as rents, services and wages will be more important.



Shifting inflationary forces. We have seen rents become a driving force behind inflation in the US, and there are signs of a similar trend in Sweden and elsewhere. In addition, wages and salaries are rising somewhat faster; again, earlier in the US than in Europe. Although the risk of a classic wage-price spiral appears very limited, higher pay increases will lead to higher service prices. Because some price components are still accelerating, the inflation downturn will be slower. Overall inflation will fall in 2023 but will remain above two per cent throughout the year, for example in the US, the euro area and Sweden. As for core inflation, it will take until well into 2024 before we achieve central bank inflation targets. Uncertainty about how much inflation is left in the system means that the risks are on the upside until this summer, while the long-term risk picture is instead on the downside.

Key rates soon peaking – Fed cuts this autumn

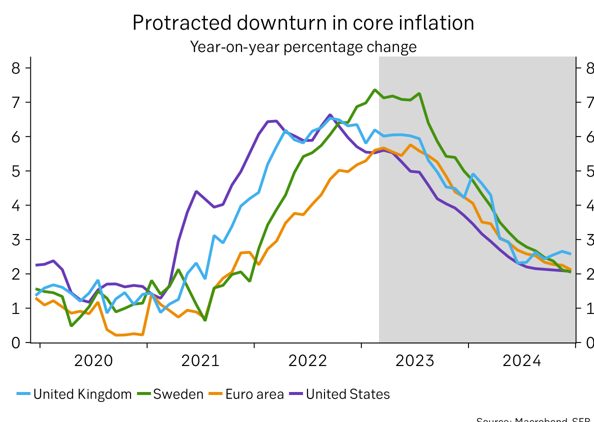
Key rates are now close to their peak, but several central banks have one or more steps to go. Expectations have fluctuated sharply this spring. Financial sector stress in March pushed rate hike expectations lower, in part because this stress itself has a tightening effect – marginally lowering the need for further rate hikes. Markets are now awaiting the effects of earlier rate hikes. The Fed will deliver a final 25 basis point hike this May to the 5.00-5.25 per cent range (the same day as this report is being published). The European Central Bank (ECB) and Sweden's Riksbank, which are a few steps behind, will raise rates another 75 and 25 bps respectively by summer, bringing both the ECB deposit rate and the Riksbank policy rate to 3.75 per cent.



There is still a focus on combating inflation, while other problems are being dealt with on a continuous basis. Key rates will soon peak, and there is a risk that central banks may have gone a little too far and fast in their rate hikes. The Fed, the ECB and others are continuing to hike their key rates, even though their internal forecasts this spring have pointed to weak growth or even recession. This shows their strong, clear focus on bringing down inflation and has helped to keep inflation expectations in check. The risk of a "monetary policy hangover" is thus another risk to the real economy and the financial system.

The market is running too fast with interest rate cuts. Inflation problems are difficult to manage, and although headline inflation is on its way down, core inflation is more persistent and higher than we previously thought. We believe that central banks which have gone all out to stop inflation – at the cost of a weak economy and increased financial sector stress – will want solid evidence that core inflation is also coming down before cutting key rates. We expect core inflation to decline more clearly this summer (US) and autumn (Europe),

with key rate cuts happening a few months after that. A wage-price spiral will be avoided, as indicated by new pay agreements in Sweden, Germany and elsewhere. Another reassuring factor for central banks is that inflation expectations are generally fairly close to their targets. Central banks that have said they are prepared to continually reassess their policies based on incoming data are thus harder to interpret and more short-term. Their signalling may fluctuate, depending on the latest statistics.



Fed will be first, cutting by 25 basis points in November. Next year, other central banks will follow suit. By the end of 2024 the Fed, ECB and Riksbank will be close together at around 3 per cent. Even though key rates will be cut, mainly in 2024, monetary policy will remain tight; a level of around 3 per cent is still above the estimated equilibrium interest rate of 2-2.5 per cent.

Japan's monetary policy shift is moving slowly, despite the arrival of a new, less dovish central bank governor, Kazuo Ueda. The Bank of Japan is still expressing doubts about the sustainability of the core inflation upturn, due to global growth risks and the country's deflationary history. At the same time, Ueda is warning against waiting too long to normalise policy. In December, the BoJ widened its tolerance range for 10-year government bond yields from ±25 to ±50 basis points. It has purchased securities on a large scale. We expect the BoJ to carry out its first key rate hike in the third quarter of 2023, abandoning negative rate of 0.10 per cent. The key rate will then be raised in 10 bp steps to 0.30 per cent by year-end. The rate will then remain at this level during 2024. Quantitative easing policy is being phased out very slowly.

Key interest rates also affect long-term yields. As we approach peak central bank key rates, the upside for long-term bond yields is limited. We currently believe that the level of key rates is the most important driver of long-term yields. Historically, the yield curve has steepened (with long-term yields higher than short-term rates) when key rates are being cut. US yields will fall more than German ones, largely due to a higher starting level and more key rate cuts. Other factors such as quantitative tightening (QT), public sector bond issuance volumes and the US debt ceiling are secondary forces, although they may add to volatility at various times. We do not regard these forces as large enough to change the trend in long yields further ahead.

The US dollar is losing ground

The US dollar has weakened against various other currencies early in 2023, although the pace of this decline is slowing. Relative key interest rates are again an important factor in currency forecasts. As the Fed cuts its key rate and global interest rate differentials narrow, the dollar will continue to lose ground, although much has already been priced in and the downturn is happening in an orderly fashion. Geopolitical developments and increased polarisation will have spill-over effects on the currency market and on discussion on the role of the dollar as a reserve currency. As for the euro, we are also seeing a positive effect from better terms-of-trade (export prices relative to import prices) as energy prices have fallen. China's growth acceleration is also expected to favour the euro more than the dollar. Our forecast is that the EUR/USD exchange rate will be a bit above 1.10 at year-end, which is essentially where we are today. Then the EUR/USD rate will climb to 1.20 by the close of 2024, once the Fed has carried out more key rate cuts.

Small currencies are struggling, but some recovery is on the cards. Small currencies like the Swedish krona and Norwegian krone have struggled, losing value against both the euro and the dollar. Despite good global risk appetite – which usually provides some support to Scandinavian currencies – the krona has traded at close to record-low levels against the euro. This has prompted a discussion, mainly in the media, about whether the euro would be a better alternative for Sweden. The krona will regain some ground this year as the housing market stabilises, inflation slows and the Fed cuts its key rates during the second half, but we revised the end-2024 EUR/SEK rate upward to 10.50.

Bumpy stock markets – but brighter prospects

Despite today's turbulence, equities are resilient. Current prices probably discount future key rate cuts and a mild, short-term slowdown in growth. Earnings forecasts for 2023 have been downgraded to slightly negative, and investors are defensively positioned. Valuations in line with historical averages, despite higher interest rates and fundamental headwinds in

coming quarters, suggest continued volatility and some downside near-term risks, but as the growth picture brightens, stock market sentiment may improve.

Changing business conditions

In recent years, we have seen many examples of how vulnerable global production chains are to various types of disruption – with major effects on both production and consumption. In 2020, during the pandemic, the world locked down in waves. The war in Ukraine, increased tensions between China and the US/Europe and various types of sanctions and trade barriers have put a further spotlight on who we trade with and what different items are being produced. These developments affect businesses in many ways – for example, the need for increased inventories and greater resilience in production chains, including subcontractors and commodity producers. It is difficult to statistically confirm these changes, but anecdotal information points to the importance of this issue and indicates that decision-making processes are under way.

De-globalisation will drive growth but is costly and may drive inflation. Boosting production and delivery reliability requires larger inventories and new production facilities. While inventories are being built up, this will temporarily increase orders and production. The fact that orders and production have been decent despite low sentiment indices may be partly due to such a trend. This also applies to investments in new production facilities. How large this growth spurt is, and how long it will last, is highly uncertain. The same applies to investment and relocation decisions. On the margin, this will lead to new/revised business objectives, aside from merely achieving the cheapest possible production. This may contribute to a surge in medium- and long-term inflation unless higher productivity can offset rising costs. Larger inventories and new production facilities tie up capital, which may push interest rates and business costs higher.

Fiscal policymakers await lower inflation

Fiscal policymakers have some very active years behind them. The COVID-19 pandemic forced them to launch broad relief measures to keep households and businesses going. Deadlocks – of various kinds – will contribute to more cautious fiscal policies in the near term. The fiscal policy balancing act is clearly harder now that interest rates are rising, the economy is decelerating and inflation remains high. Relief programmes are needed to soften the impact of inflation, but they are being limited so as not to increase price pressures. Another restraining factor is that public sector debt is historically high after years of crisis responses and that markets can quickly become stressed in a situation of higher interest rates. We saw such effects in the UK last autumn and in the euro area during the euro crisis more than a decade ago. In some cases, high inflation may strengthen short-term public revenues but also increase spending in the long term. As economies slow, this will soon start to show up in deteriorating fiscal balances.

Weakly stimulative fiscal policy, but contractionary economic policy overall. Fiscal policy in general is weakly stimulative, especially in Europe, with a focus on easing the effects of high energy prices in 2023. However, the impact is difficult to assess, because such tools as price regulations are being used and are unlikely to be reflected in public budgetary statistics. In the US, the current discussions on the debt ceiling are an uncertainty factor that could lead to greater fiscal tightening. Yet we believe that, as earlier, this issue will be resolved without excessive public sector austerity measures in the near term. If we also include monetary policy, we can see that there is a substantial difference now in the degree of economic policy stimulus compared to just a couple of years ago. In its latest forecast, the International Monetary Fund (IMF) published a global compilation of policy stances. It shows that in 2020 a large majority of countries were pursuing both expansionary fiscal and monetary policies. Two years later, this situation was almost exactly reversed; a large majority of countries were tightening both their fiscal and monetary policies.

Energy transition and forward-looking investments. With a war under way in Europe, a generally heightened security policy situation and an increasing focus on energy transition and climate change issues, there is clear pressure for more publicly funded initiatives. Various programmes developed in the US and Europe during the pandemic have focused on such long-term issues as climate, digitisation and infrastructure, and they are now funding new investments. This includes America's big climate package, oddly entitled the Inflation Reduction Act (IRA). Although the public coffers are under pressure from many directions, we may well see a surge in capital spending to meet these challenges, if the political will is there. Countries with strong public finances, such as the Nordics, have manoeuvring room that could give their economies a short-term growth boost. This might also yield other benefits in terms of increased productivity and positive spill-over effects in the economy.

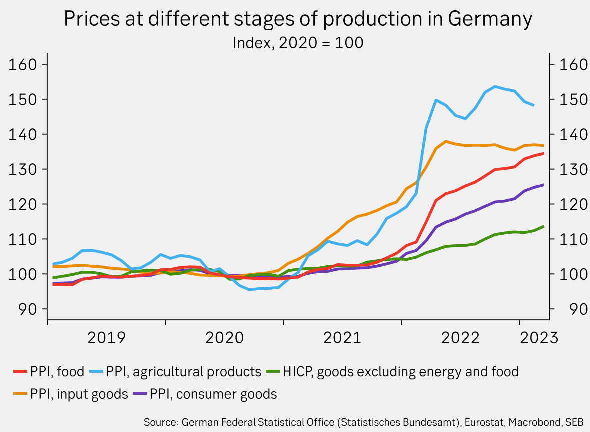
Theme:

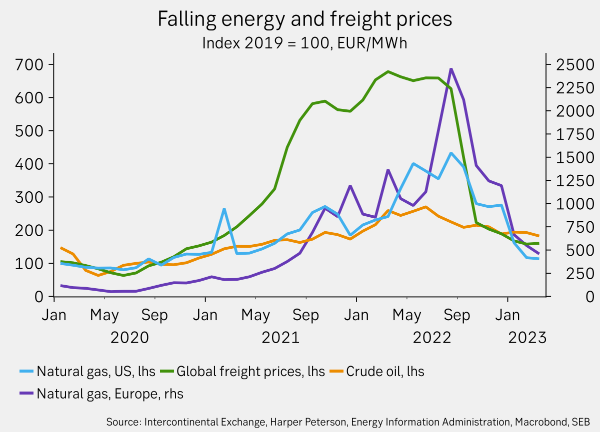
The inflation dynamic

Long lead times and shifting drivers in the inflation factory

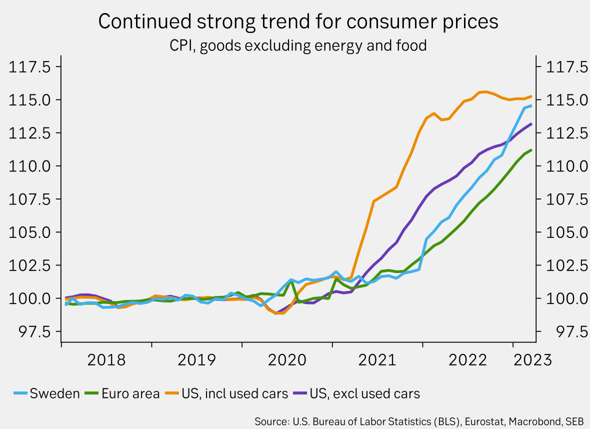
Rising inflation in the United States and Europe was initially driven by sharply rising commodity prices. For example, food prices in Sweden increased faster than at any time since the 1950s. Although energy and some commodity prices have fallen, producer and consumer prices are continuing to climb rapidly. But in recent months, we have seen signs that price hikes at producer level are slowing. This increases the likelihood that goods inflation at the consumer level is also about to fall, although we believe this is still some way off.

In recent years, the conditions for broad-based price increases have resembled what can be described as a perfect price storm. During and after the pandemic, prices were driven up by a combination of supply and demand factors. Supply shrank as production shut down, coinciding with disruptions in global freight flows. Expansionary fiscal and monetary policies contributed to a boom in demand for goods. By mid-2021, the energy situation also became increasingly strained, especially natural gas and electricity in Europe. Businesses found themselves in a situation where virtually all input costs had risen. As early as the beginning of 2021, companies started to pass on rising costs to consumers – breaking with the pattern of the 2000s, when for years they found it hard to do so. This was one important reason why forecasters were cautious in their assumptions about pass-through to consumers when input prices began to rise. Broad-based input price increases started taking hold, lifting overall consumer goods inflation above 10 per cent in a relatively short time.



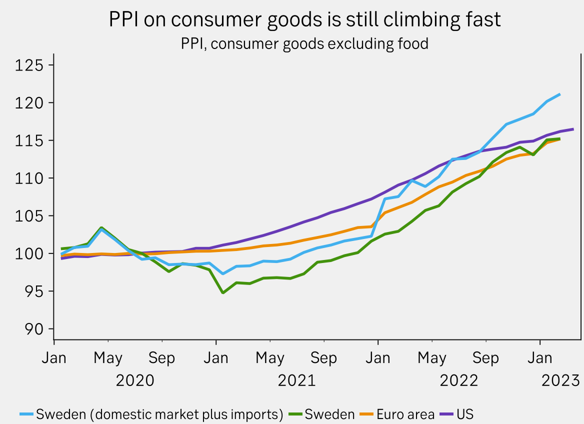


US ahead, but not by as much as one might think. US inflation was the first to take off, but the difference is somewhat exaggerated by used car prices, which rose due to auto production problems, semiconductor shortages and rapid shifts in demand. Overall price increases have been roughly equal in the US, the euro area and Sweden. There were large differences in timing when it came to lifting pandemic restrictions and in the shape of fiscal and monetary relief measures, but most goods are traded in shared international markets – which helps ensure that the final impact of price hikes is fairly similar.

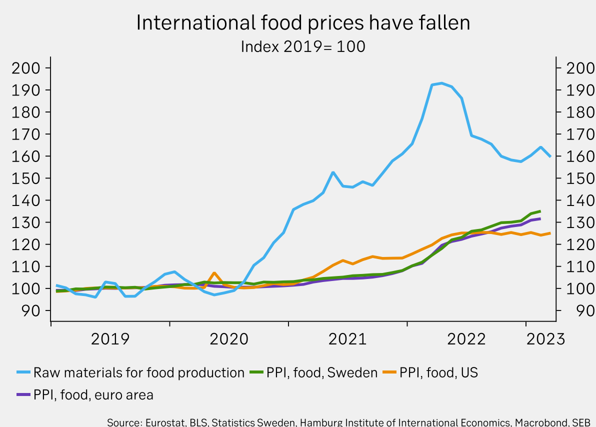


Falling prices, but continued setbacks... Several factors indicate that inflation will continue falling, but setbacks instead dominated early 2023, largely due to sluggishness in the process. For European companies, increased costs due to high energy prices are also a factor. Interest rate hikes are now tightening demand, which should produce a reversal of the pandemic effect (when expansionary relief measures fuelled demand) – eroding real household purchasing power. Prices of some commodity groups have fallen fast, although levels are well above pre-pandemic ones. One clear example is energy; gas and electricity prices have fallen, especially in Europe. Lower freight rates and better-functioning global trade are also easing the situation.

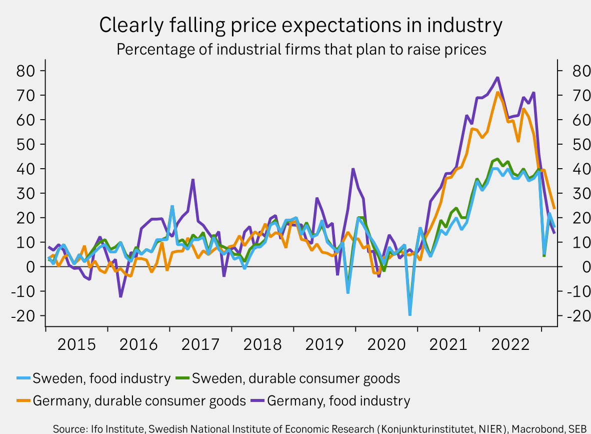
.... but many prices remain high. Although some upstream prices have fallen, many downstream prices continue to rise, albeit somewhat less. High price increases in 2022, known as base effects, are now helping to dampen consumer inflation, but high levels of many input prices continue to push up consumer prices and contribute to a sluggish decline in inflation. In Sweden, domestic supply indices are climbing more, since we import a large share of our consumer goods.



Food prices are important to CPI trends. The food price dynamic has generally followed patterns similar to those for other goods, but since food consumption can only be cut back to a limited extent, food prices have a greater impact on household living conditions. Global food prices started rising in late 2020, and the Ukraine war reinforced what was already an upward trend. Rising input costs in food production have been an important general driver of high food prices. Rising wholesale and distribution costs have also had significant effects on the food prices paid by consumers. For example, high energy costs make the operation of refrigeration facilities and transport more expensive. Although energy costs and raw material prices for food have fallen, they remain high and earlier increases have not yet been fully reflected in consumer prices, especially in Europe.

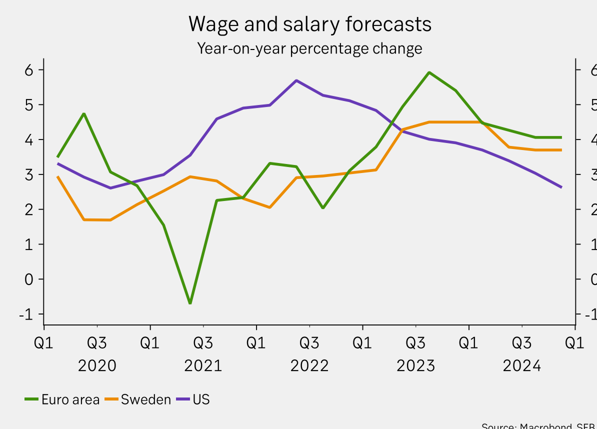


Time lag even when prices fall. One important question for future inflation forecasts is connected to how long the time lags in different stages will be during the downturn phase. Intermediate goods prices in the German producer price index (PPI) peaked in May 2022, but price levels for consumer goods in the producer stage are still rising, though slightly less than a year ago. This suggests continued sluggishness in the consumer stage. A large majority of retailers still expect rising prices for both food and other consumer goods.



Some will go down, some will go up. But there are signs that the upturn in food and other goods prices is approaching a slowdown in the producer stage, where the percentage of firms intending to raise prices has moved closer to historically normal levels in recent months. With a lag of 3-4 months, it is likely that consumer price increases will also slow. The time lag is not as clear for services, which are not only affected by rising costs of goods but increasingly by rising labour costs. Similarly, rents are often affected by the general inflation level, so this component also moves with a historical lag. Rents in the US accelerated sharply in early 2022, and rents in the euro area and Sweden have started to rise faster in 2023, though not as clearly as in the US.

Shifting drivers in the inflation factory. Despite this easing trend, wage and salary growth will now take over as the driving force behind inflation. We saw early on that US and UK pay hikes, for example, speeded up as the labour market tightened during the reopening after the pandemic. In those parts of Europe where pay increases are more closely linked to collective bargaining, we are only now seeing a clearer acceleration. This is partly reflected in our wage forecasts. It is also clear from both inflation statistics and wage responses that the economy is reacting more quickly in the US than in Europe. A more sluggish upturn and downturn in wage response is thus one major reason why inflation now looks set to decline over a longer period in Europe.



But inflation will fall in 2023. Inflation is now falling in most countries, but the decline is mainly in total inflation, with base effects from energy amplifying the downturn. Adjusted for energy, the downturn is much slower. In the US, wage and salary growth is slowing. Although a lot of collective bargaining negotiations are still ahead of us in Europe, most indications are that pay increases will soon accelerate. The upturn looks set to be slightly higher for a while than the level that is compatible in the long term with inflation targets. This indicates that in 2024, core inflation will be a bit above 2 per cent in Sweden and in the euro area. Because of uncertainty about exactly how many price-raising effects remain in the system, short-term risks (until summer) are on the upside. But due to a likely normalisation of international prices, long-term risks will instead be on the downside. Inflation risks are somewhat higher in the euro area than in Sweden due to greater uncertainty about wage forecasts. Even if the inflation rate declines and central banks are able to ease their tightening, high price levels will continue to rise.

Theme:

Energy crisis called off

Focus is shifting back towards the environment

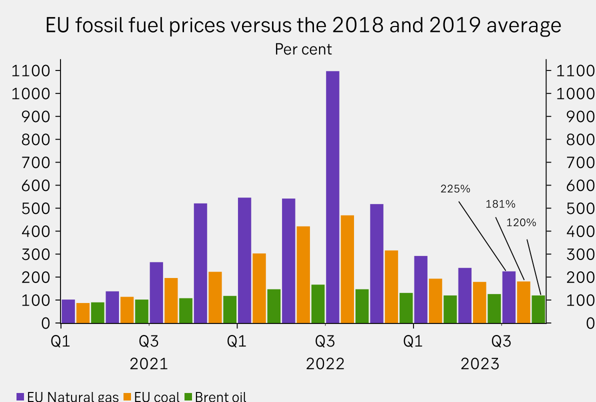
Natural gas and coal prices have fallen 40 per cent so far in 2023. They are still close to twice as high as in 2018-2019, but current levels could possibly be the new normal after adjusting for inflation and other factors. European natural gas inventories are close to an all-time high for the season, and 90 per cent full in November should be easy to reach. Next winter will probably be manageable unless it is severely cold. The sense of urgent crisis is fading fast, though the EU will still have to curb natural gas demand. The energy situation remains problematic, but the focus has now started to shift back towards environmental issues. Interest in nuclear energy is rising strongly as it ticks the boxes for both security of supply and the environment.

Nuclear energy has made a major comeback over the past year. Geopolitics, energy and climate crises and mature as well as new nuclear technologies are the driving forces. China and Russia have been behind 87 per cent of all new nuclear power plants built or initiated since 2017. Today China is the global leader in solar, wind, EV battery and EV technology. China plans to build 150 new nuclear plants in the coming 10-15 years. It will then also be a global leader in nuclear technology and construction.

The OECD countries cannot let themselves be left behind in these fields, given the new geopolitical alignments. The US is following up with new legislation to support nuclear energy; the Department of Energy recently said that the US needs to build 200 new nuclear power plants by 2050. Eastern Europe can no longer rely on Russian gas and cannot use coal due to EU emission regulations. Renewables are an option, but the tried and tested bet is nuclear energy. Attitudes are changing. Sweden is looking into possible new nuclear plants. Polls in Norway now show a majority in favour of nuclear energy.

Falling energy prices and easing nerves. Natural gas and coal prices in the EU have fallen 40 per cent since the start of the year. They have fallen 80 per cent and 60 per cent, respectively, since Q3 2022. Despite the decline, natural gas and coal prices today are still roughly twice what they were in 2018 and 2019.

Current fossil fuel prices may be the new normal, however – due to inflation adjustments, higher EU dependence on the global liquefied natural gas (LNG) market, increasingly monopolistic control by OPEC+ over the oil market and a coal market where prices now seem to be set by China. Today's EU natural gas prices of EUR 40-50/MWh, EU coal prices of USD 130-140/tonne and Brent crude oil prices of USD 80-90/barrel may be the new normal and thus nothing to pay much attention to. Security of energy supply and the environment are still major issues, however.



Source: Macrobond, SEB

Well positioned for the coming summer and winter. The EU is exceptionally well positioned for next summer and winter when it comes to natural gas, given the circumstances. Inventories are close to record highs for this time of year. Demand for natural gas remains significantly subdued even after major price declines. The EU still needs large LNG imports from the global market. But competition with Asia for marginal LNG cargoes does not seem too tough, maybe due to the ongoing cool-down in the global economy. The EU has plenty of wiggle room in the run-up to next winter to steer inventories to 90 per cent of capacity in November. There is hardly any risk that the EU will not be able to reach that target and thus get through next winter safely. The question is more what price it will take to get inventories to that level in November. And what we will have to pay for natural gas will largely depend on economic activity in Asia over the coming 12 months.

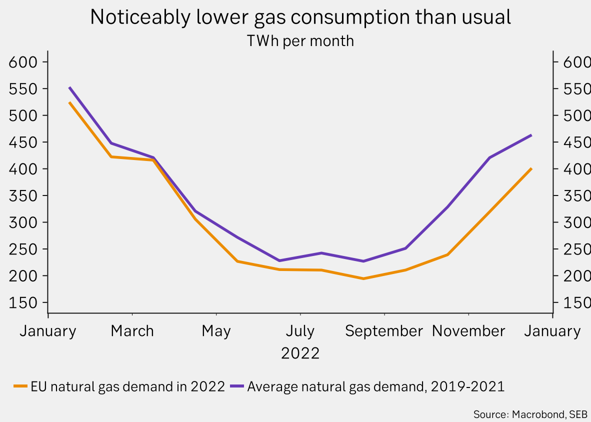
Piped Russian gas volume is trickling to a minimum and its relevance is fading. During the second half of 2022, Russia's tight grip on the natural gas supply to Europe sent shivers through the EU. There were fears of a total economic collapse. Since mid-third quarter 2022, Russian natural gas exports have remained low – hovering between 10 and 20 per cent of the historical norm. Yet due to falling demand and very strong LNG imports, prices continued to slide during Q1 2023. The EU has managed the energy crisis exceptionally well, despite losing more than 1,000 TWh in natural gas imports from Russia compared to earlier norms.

A mix of factors averted Europe's energy crises. The European winter of 2022/23 was milder than normal, and this has been given most of the credit for "averting the crisis". However, reduced demand as a function of mild weather only accounted for 15 per cent of the solution last year and during the winter of 2022/23. The rest, 85 per cent, was a reduction triggered by high prices: both EU demand destruction due to high domestic natural gas prices and North-east Asian demand destruction due to high global LNG prices. The latter released a massive amount of LNG cargoes to the market with the highest willingness to pay, namely Europe, offsetting much of the lost piped volume from Russia.

High prices and highest bidder. In terms of inventory filling, the warmer-than-normal weather has been very important on the margin, but only a small part of the solution. High prices and the market response have been the major elements. It has not been a question of a shortage of global gas molecules, but more a question of price. The EU needs high natural gas prices in order to keep EU demand low and LNG imports high, which also implies demand destruction in North-east Asia.

Few near-term options for Russian gas. In the process of withholding gas molecules from the EU, there are many indications that Russia has drawn the short straw. Its most important customer, Europe, will probably not commit to any new long-term obligations in the wake of the ongoing war in Ukraine. Currently, Russia has the capacity to deliver 215 TWh per year to China; 466 TWh per year to Turkey; and 1,238 TWh per year to Europe (excl. Nord Stream infrastructure). A minor pipeline expansion (254 TWh/yr) to China will happen in 2026/2027 at the earliest, while the much-discussed Power of Siberia 2 (489 TWh/yr) will not be online until 2030 at the earliest. In the short term, the majority of "lost" Russian gas sales will either stay underground, be flared, or be transported by sea via the country's four operational liquefaction terminals (366 TWh/yr). Consequently, Russia's relevance in the European gas market is fading and will likely be questionable in the

long run. American LNG, in particular, has become the saviour of the European gas market.



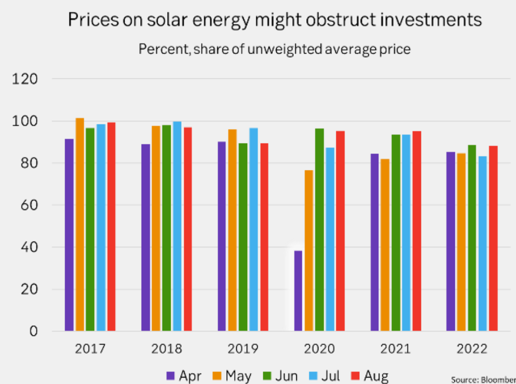
American LNG exports are likely to flourish, since US and EU energy costs are far apart. Historically, the EU+UK imported around 840 TWh per year of LNG, versus the current 1,600 TWh per year (EU+UK natural gas consumption is roughly 5,000 TWh/yr). LNG is a commodity with global reach and the highest bidder receives the marginal cargo. Thus, EU prices need to remain high for the bloc to keep attracting sufficient cargoes to meet demand. An increasing amount of LNG sales to the EU has originated in the US. The US has an abundance of cheap natural gas, and with limited domestic demand and pipeline infrastructure to neighbouring countries, prices are likely to remain low until new infrastructure comes online (a big wave starting in 2025). At the same time, EU natural gas prices will likely remain high as the continent relies more on LNG as the marginal cost of natural gas. Thus, the US–EU nexus will likely remain tight going forward.

LNG = Europe's marginal cost of energy. Natural gas continues to represent the marginal cost of EU power. On top of that price of emitting carbon is yet another layer, forming the EU wholesale power price. On the contrary, the US wholesale power price does not include any costs associated with emitting carbon, which also underpins the strong business case of transporting natural gas from the US to the EU.

RePower EU – getting rid of Russian natural gas for good. EU's RePower plan entered into force on March 1. It aims to raise EUR 20bn from the auctioning of emission allowances. The money will be spent to diversify away from Russian energy by 2030.

Risks of solar and wind price collapses. It is well known that the supply of solar and wind power from hour to hour is uncontrolled. That is quite OK, as long as installed capacity is well below total demand and there are other sources of energy which are flexible and can adapt to the fluctuating supply of renewables.

But individual hourly power prices will start to weaken and suffer as installed capacity of uncontrolled renewable energy rises closer to total demand hour by hour. When renewable supply is high, power prices will be increasingly subdued. While these dynamics have not yet reached critical levels, they are increasingly noticeable. German solar power is selling at a growing discount to average prices. The risk is that prices could collapse during the specific hours that solar power is producing the most. This may happen at first gradually, then suddenly, as in April 2020.



Large investments are needed to ensure that price swings do not hurt renewables. These issues are partially redeemable through large investments in super-grids, batteries and sophisticated regulation systems, but one major risk is that such investments will not flow at the necessary pace. If so, power prices will collapse under the weight of surplus renewable energy supply. In other words, when renewable sources really produce a lot of energy and normally earn their profits, they will get nothing.

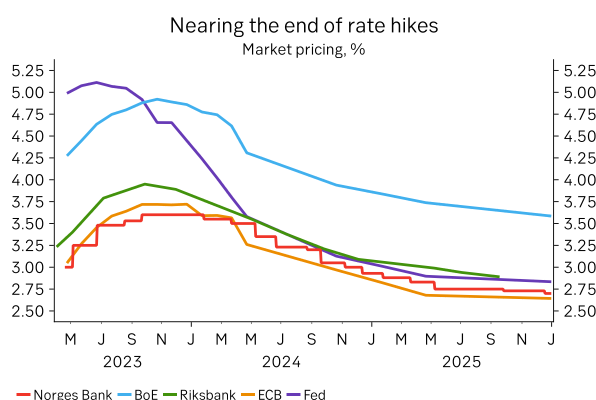
Will markets solve the problem? If and when this happens at large scale, market forces will build out batteries, grids and regulating systems at full speed. But further solar and wind energy investments could come to a halt until these problems are resolved, since there could be very little profitability in new projects.

Fixed income

Downtrend in bond yields to emerge by the autumn

With central banks nearing the end of the rate hiking cycle, the upside in bond yields is becoming capped. Volatile markets are likely to lack direction in the near term, but we expect a downtrend in yields to emerge in the second half of 2023. Historically, yield curves steepen throughout rate cutting cycles, which we expect to occur this time too. German yields are expected to decline less than US ones, thus narrowing the spread.

Turbulent markets lacking direction. Global bond markets have been on a roller coaster ride these past few months, witnessing some of the largest daily moves in modern times and fuelled by banking sector turbulence in March. While volatility has been high, US and German long government bond yields currently trade almost unchanged relative to end-2022 levels. Historical precedents suggest sideways but volatile markets in the final stages of rate hiking cycles before the downtrend in yields gains traction as the inception of the rate cutting cycle approaches.



US rates: One more... and done. We expect the Federal Reserve to raise its key rate by 25 basis points in May and initiate cuts before the end of 2023. The 10-year Treasury yield will fluctuate mostly in the 3.40-3.70 per cent range in the coming months before declining, reaching 2.90 per cent by the end of 2024 when cuts have brought the key rate to 2.75-3.00 per cent. Deadlocked discussions on the US debt ceiling may add to volatility in the coming months but we expect it to be solved, as earlier.

Euro area: Declining less than in the US. The European Central Bank (ECB) will keep raising rates until it receives more compelling evidence of easing inflation pressures, which in our forecast will not be until this autumn. We predict another 75 basis points of rate hikes, with the deposit rate peaking at 3.75 per cent in July. The German 10-year yield may revisit its previous highs near 2.75 per cent in the coming months, but the yield will turn lower during the second half. The ECB will wait until mid-2024 before cutting rates and is likely to speed up the reduction of its asset holdings this summer. With net issuance of European government bonds set to increase sharply, long yields in the euro area are expected to decline less than in the US during the coming year.

10-year government bond yields

Per cent

	April 27	Jun 2023	Dec 2023	Dec 2024
United States	3.50	3.50	3.30	2.90
Germany	2.45	2.45	2.35	2.00
Sweden	2.46	2.50	2.60	2.30
Norway	3.17	3.15	2.95	2.60

Source: National central banks, SEB

Sweden: Upward pressure from QT. After the Riksbank announced that SEK 3.5bn of government bonds per month will be sold until further notice, the 10y spread vs Germany increased from around -25bps to close to zero. We predict that the Riksbank will increase the volume of its bond sales later this year, contributing to a somewhat smaller decline in yields vs Germany during our forecast horizon. The spread will widen to 30bps by year-end, then largely stabilise in 2024.

Norway: Norges Bank lagging the ECB. Norwegian yield spreads have tightened substantially against Germany. Norges Bank's cautious approach, reflecting high household interest rate sensitivity and a flexible inflation target, implies that it cannot keep pace with ECB policy tightening. Sticky core inflation will bring the key rate to 3.50 per cent by summer, with rate cuts starting simultaneously with the ECB. We expect the Norwegian 10-year yield to follow the international trend, but a relatively favorable supply outlook for bonds suggests a slight potential for further outperformance. We expect a 10-year spread vs Germany of 60 bps by end-2024.

Theme:

Monetary policy

Thoughts about the transmission mechanism and inflation

The global monetary policy tightening of the past 1.5 years is unique in scope. The usual rule of thumb is that it takes 1.5-2 years for such tightening to fully affect inflation. So far, its seemingly limited impact on growth and inflation has come as a surprise, but this also raises concerns about an impending "hangover" in the real economy and financial sector. These developments raise questions about possible changes in the nature of inflation and monetary policy transmission mechanisms. We are in uncharted territory but need insights that reduce the risks to the real economy and financial sector, which – if they materialise – could ultimately affect the political independence of central banks.

The risk of a monetary policy "hangover" is high. The pace and historically size of rate hikes, and simultaneous rate hikes by many central banks, raise legitimate concerns about impacts on economic growth and the stability of the international monetary system. With global private and public debt at historically high levels, understanding the transmission mechanism – when, where and how monetary policy affects growth and inflation – has probably never been more important. Among questions being asked are whether the huge shocks and systemic crises of recent years, the unconventional monetary policies pursued since the 2008-2009 crisis and extreme economic stimulus during the pandemic have changed the mechanism in a short- and long-term perspective.

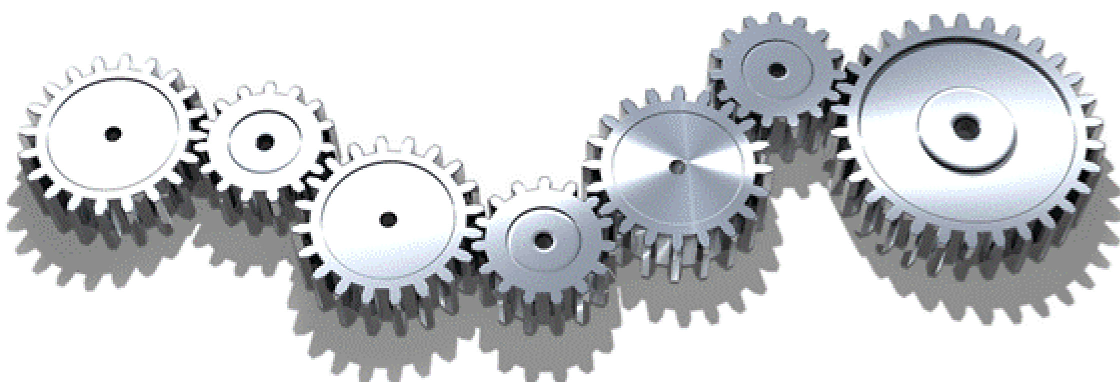
We agree with the International Monetary Fund (IMF), the Bank of International Settlements (BIS) and the Bank of England that the limited impact on growth can be explained by:

1. underestimation of the expansivity of stimulus,

2. structural changes in the transmission mechanism,

3. positive expectations about the future,

4. the changing characteristics of inflation.



Underestimated pandemic crisis policies

Monetary policy transmission and its effects on inflation and growth are determined both by the level of monetary stimulus and changes in policy. In addition – especially when there are clear limits on how far key interest rates can be cut – financial and macroprudential policies play a role in the impact of monetary policy. For example, energy subsidies, exemptions from mortgage principal repayments or expectations of relief measures indirectly influence the impact of policy. Our conclusion is that a number of factors create major question marks about the expected effects of the monetary policy conducted.

Global pandemic relief measures, 2020-2021 (est.)

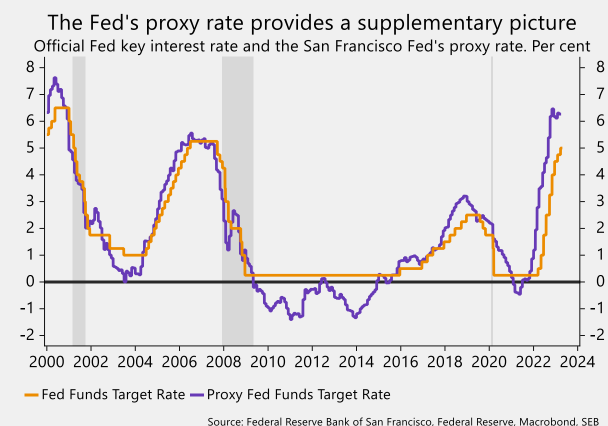
Per cent of global GDP (2019)	
Fiscal policies – direct budget effect	9
Fiscal policies – indirect budget effect	9
Monetary policies (expansion of balance sheet)	11
Total	**29**

Source: SEB (based on material from the IMF and others).

Enormous relief measures during the pandemic. We have previously presented estimates of the size of global fiscal and monetary policies pursued during the 2020-2021 pandemic. 1) Major central banks cut key interest rates to zero per cent (see below on the neutral rate). Some – including the Riksbank, ECB and Swiss National Bank – introduced negative key rates. 2) Central banks increased their balance sheets by USD 9.6 trillion, or 11 per cent of global GDP (2019). 3) Governments worldwide let fiscal policy become more expansionary, an amount we estimate at USD 15.8 trillion, bringing the total amount of relief in 2020-2021 to USD 25.4 trillion.

Household goods consumption rose sharply during the pandemic, while restrictions limited opportunities to consume services. Household savings climbed significantly in many economies due to direct fiscal stimulus measures, business subsidies that facilitated job retention and lower interest rates on loans. The distribution of savings between various income groups is unclear, but household savings increased. Households were able to maintain some of their consumption in 2022 and 2023 despite high inflation, interest rates and energy prices, as a direct result of our underestimation of the magnitude of pandemic-related fiscal stimulus.

Unconventional monetary policies also provided significant support to the global economy, in addition to interest rate cuts. The expansion of central bank balance sheets is also believed to have contributed to downward pressure on interest rates. The rule of thumb is that a balance sheet increase by 1 per cent of GDP pushes down interest rates by 5-7 basis points. The pandemic's unconventional relief policies, equivalent of 11 per cent of GDP, would thus roughly equal minus 60-70 basis points.

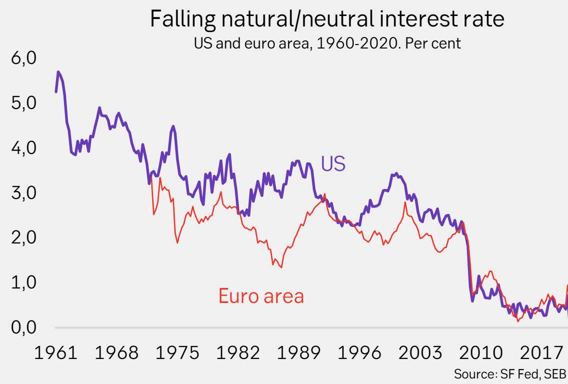


Central banks have used new metrics to try to illustrate where the official key interest rate would be if we also considered such factors as their balance sheet expansion and policy guidance. When the Bank of England cut its official key rate to 0.10 per cent during the pandemic, the "Wu-Xia shadow rate" showed that these combined policies were equivalent to a key rate of minus 4-6 per cent. Similarly, the San Francisco Fed has developed a "proxy rate" to estimate the overall impact of monetary policy. The proxy rate showed that when the Federal Reserve cut its key rate to a minimum of 0-0.25 per cent after the Lehman Brothers collapse in 2008-2009, it was equivalent at times to a key rate of between -1.5 and -1 per cent. Both of these policy metrics suggest that there is a risk that the level of expansionary behaviour may have been underestimated and that the steps taken in 2022-2023 would have had a greater impact if the starting point had been less expansionary.

Key rates vs natural interest rates

Even if we manage to translate the different policy tools to a nominal "shadow or proxy" rate, the question remains: How expansionary was monetary policy? The natural (or neutral) rate is a reference point that central banks use to make that judgement. This natural rate has been in a downward trend for 60 years.

On the eve of the pandemic, the natural real interest rate in the US and Europe was just above zero per cent. Given an inflation target of 2 per cent, a benchmark for monetary policy is 2-2.5 per cent. If the key rate or "shadow/proxy rate" is higher than this range, monetary policy is contractionary; if it is lower, it is stimulative.

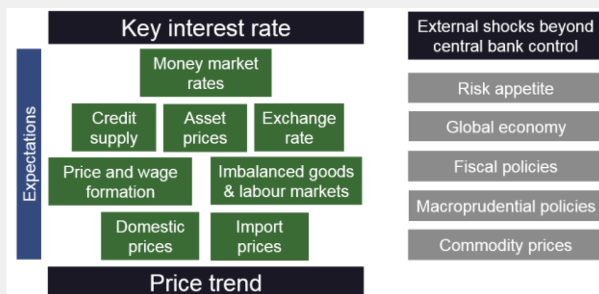


> **What is the natural interest rate?**
> The natural rate is the price of money at which the supply of savings equals the market demand for capital. This interest rate is usually calculated in real terms (adjusted for inflation) and should correspond to a level at which the economy is in equilibrium (full employment and price stability). The natural interest rate tends to co-vary between different countries.

Is 2-2.5 per cent still a valid benchmark for monetary policy? The answer is yes, although the pandemic led to greater uncertainty. New IMF calculations show that US and European real normal interest rates remain in the 0.2-0.6 per cent range. When inflation eventually falls to normal levels, the benchmark will stay at 2-2.5 per cent for the foreseeable future, says the IMF. The main reasons are an ageing population and weak productivity growth (savings surplus – downward pressure on natural interest rates), largely offset by continued high public debt and financial fragmentation (upward rate pressure).

Impact on the transmission mechanism

The strength, degree and speed of monetary policy transmission may depend not only on the level of stimulus policies, but also on possible changes in the underlying structure of the economy and financial system and the behaviour of financial markets, firms and households. One way to illustrate the mechanism is to take the ECB's model and make some adjustments.



The effects of monetary tightening have been limited due to underestimated stimulus policies, but also because the market has absorbed some of this tightening and expectations are influenced by faith in crisis responses.

Asset prices have generally shown resilience, reflecting the degree of large-scale stimulus, the structurally declining natural interest rate and the expectation of various actors that there will be new crisis responses when economic activity declines and/or financial stress arises. The market's reaction function, and thus the transmission mechanism, should have been weakened.

During the period of negative key rates, for example, households with bank deposits were not hit by negative interest rates. This had a major adverse impact on the net interest income and profitability of banks. Now that interest rates are rising, costs are being reduced, allowing lending institutions to diverge from normal patterns. According to the Swedish Financial Supervisory Authority, the gross margin of banks on mortgages (actual variable lending rate minus cost of funding) has decreased by 0.6 percentage points to 0.8 per cent over the past year. In addition, changes in macroprudential policy – a new element of economic policy – may affect lending opportunities and the monetary transmission mechanism.

Recent financial stress among US regional banks and the Credit Suisse crisis provide new insights into the transmission mechanism. In a world where depositors manage money and information digitally, the financial landscape is also changing, with increased risks to financial stability. This has implications for the real economy via changes in risk premiums that affect the price of money and the supply of capital. These events highlight the potentially destabilising role of monetary digitisation in the financial system. Although the causes of these events can be linked to weaknesses in business models and regulatory failures – not primarily monetary policy – aggressive interest rate increases can nevertheless amplify transmission.

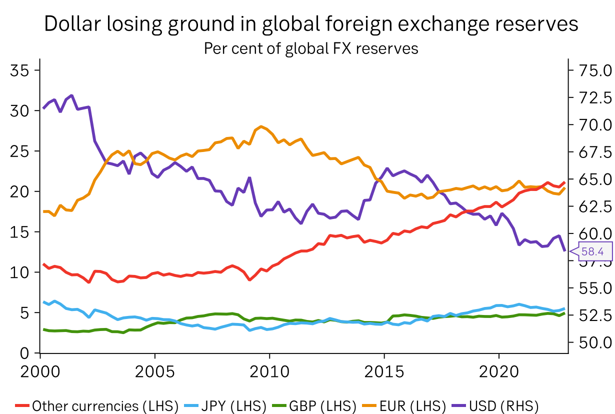
Epilogue: New inflation properties, too?

The ultimate goal of central banks – restoring price stability – may also prove challenging. The BIS likens inflation to water: its properties and behaviours change from frozen to liquid to gas as the temperature rises. Thus, the properties and behaviour of inflation could also change, especially in our current high-inflation environment. This unfortunately adds new complexity to the effectiveness of monetary policy.

The FX market
The US dollar is losing ground in an orderly manner

In recent months, FX trading has not been fun for small, illiquid currencies like the krona. Despite stable and improving risk appetite, it has lost ground and is trading at near-record lows against the euro. It is very undervalued, but this does not seem to help in a world dominated by geopolitical uncertainty and a focus on Sweden's indebted households and falling growth. A turnaround will come when the Fed starts rate cuts in late 2023 and the US dollar weakens against most currencies.

A weaker dollar, but small currencies are still struggling. Early in 2023, the US dollar continued to weaken against most currencies. In recent weeks, however, there was some consolidation as the banking crisis rattled the foreign exchange (FX) market. The outlook for key interest rate hikes was quickly revised downwards. An emerging discussion theme this past year has been how the role of the dollar as a future reserve currency will have a negative impact. We are now seeing the world diversifying out of the dollar.



Federal Reserve will cut key rate first; USD will weaken. According to current forecasts, the US is the first to see a sizeable decline in inflation. The Fed will be the first to deliver key rate cuts, which in turn is expected to drive the dollar lower. Meanwhile there are big question marks about how the economy will perform after the major tightening measures that central banks have already delivered. Risk sentiment has nevertheless already priced in a soft economic landing. We thus believe that the dollar will be affected by somewhat more dovish monetary policy in the coming years. We do not expect a continued stock market rally (normally a slightly more positive environment for the dollar). Our conclusion is that the dollar will continue to fall, but at a cautious pace, with reversals if/when global risk appetite falls. The depreciation of the dollar means that the euro (EUR) will continue to recover. The British pound (GBP) should continue to trade weakly against most currencies, given the structural challenges facing the United Kingdom.

Exchange rates

	Apr 27	Jun 23	Dec 23	Dec 24
EUR/USD	1.10	1.11	1.12	1.17
USD/JPY	134	131	124	120
EUR/GBP	0.80	0.87	0.89	0.93
EUR/SEK	11.36	11.20	10.85	10.50
EUR/NOK	11.73	11.60	11.30	10.50

Source: Bloomberg, SEB

Weak krona triggers new euro debate. The fact that the EUR/SEK rate is again close to 11.50 is both surprising and a bit scary. In the short term, corporate dividends have pulled down the krona, but this does not explain its divergence from other ordinarily explanatory variables, such as risk appetite and growth sentiment indicators. Geopolitical risk premiums may be a partial explanation, as well as the strong focus of global markets on Swedish household debt and falling home prices. But here, too, we have seen stabilisation and encouraging signs in real estate markets. Since the pandemic, equity flows have been very negative for the krona, along with the Riksbank's FX purchases. We believe the krona will recover once Swedish inflation eases and the Fed starts cutting its key rate again late in 2023.

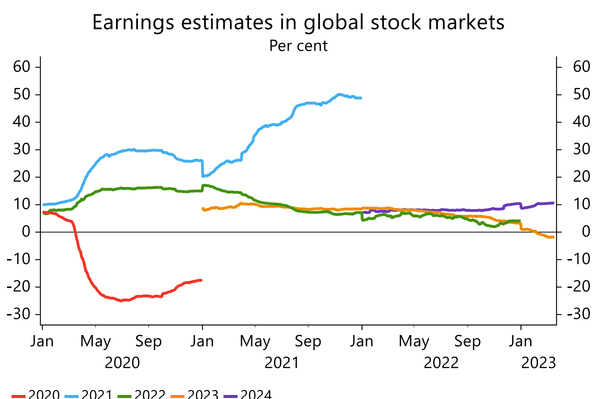
NOK weakest of all, despite Norwegian oil money. So far this year, the Norwegian krone is by far the weakest G10 currency. High interest rate sensitivity among households is one factor, with highly leveraged borrowing and a low percentage of fixed mortgage rates (which also helps explain the weak NZD and AUD). Oil prices have not provided support either. Norges Bank, one of the first central banks to start its hiking cycle, is also expected to be among the first reach its key rate peak. Monetary policy has thus been another drag on the NOK. Looking ahead, other central banks should be approaching the end of their hiking cycles. This should mean that relative monetary policy will not pull down the NOK as much during the second half, when oil prices will also recover according to our forecast.

The stock market
A bumpy ride, but brighter prospects ahead

Stock markets are showing resilience in today's turbulent environment. They are likely to discount a mild, short-lived slowdown in economic growth. Corporate earnings forecasts for 2023 have been downgraded to slightly negative, and investors are maintaining defensive positioning. Valuations in line with historical averages – despite higher interest rates and fundamental headwinds in the coming quarters – suggest continued volatility. As the growth picture brightens, stock market sentiment may improve.

The stock market rally around the turn of the year has come to an end. Recent months have seen an overall sideways trend, but there have been large variations, both for indices and between sectors. The strong markets rebounded after the recent banking sector turmoil – a sign of strength, given potential negative growth effects.

Global corporate earnings forecasts for 2023 have been revised downwards in recent months. This is following a common pattern, in which forecasts usually start at 10 per cent and are then adjusted as the year approaches and begins. In 2022, rising costs for commodities and input goods were among the reasons why aggregate earnings rose by only 4 per cent. Forecasts for 2023 were in the same vicinity for a long time but have been cut to just below zero. Forecasts for 2024 are around the traditional 10 per cent.



Declining demand. Demand is more than likely to weaken this year. The question is whether companies can compensate for both falling demand and increasing costs by raising their prices. Last year led to falling profit margins, which may well rebound this year, but the full-year effect remains unclear. We still see some downside risk to earnings, but much of this downward adjustment has been made without the stock market taking too much of a beating – which provides some hope.

Globally, share price valuations are in line with 10-year averages. Looking at price-earnings (P/E) ratios – based on rolling 12-month forecasts – world stock markets are trading at around 16.5. The figure is driven higher by the United States, which is clearly above its historical average, and lower by Europe and emerging markets, where the picture is the opposite. One explanation for the gap is that the sectoral composition has changed radically in the US, due to the exceptional growth of the "digital dragons".

The valuation parameter rarely drives stock market movements by itself, especially when valuations are at these levels. Since interest rates going forward are likely to be higher than in the past 10 years and near-term earnings forecasts look gloomy, this limits upside potential. But the forward-looking nature of the market means that expected earnings upturns after the growth slump will be supportive.

Quality in the near term, industrials after the slump? Stronger economic growth in China and investment needs related to the defence industry and the climate transition should have a positive impact on demand. This, in turn, suggests that manufacturing-related sectors may benefit once the growth slump is over. In a slightly shorter perspective, "quality" companies look attractive: companies with solid finances, stable profit generation and good returns on capital. Some of the past decade's growth companies in the technology sector now qualify for this definition. Growth should generally benefit from lower interest rates.

Politics an obstacle for the EM sphere. From a geographic perspective, both growth fundamentals and valuations favour emerging markets, especially in Asia. But criticism of Asia's economic giant, China, complicates the picture.

Neutral, but a brighter outlook. World stock markets have moved sideways this past year, but with large fluctuations. Our own perhaps slightly boring positioning near a neutral risk level has thus been reasonable. We will stick to this view until inflation and growth, which are now disrupting the picture, show a clearer direction. But if the fundamentals unfold as we forecast, there is reason to be optimistic about equities.

The United States
Credit squeeze increases the risk of recession

Fed key rate hikes are starting to bite in financial markets and the economy. Because of tighter lending conditions for SMEs and more cautious households, the US will enter a mild recession in 2023. Late-cyclical inflationary forces in the labour market will offset falling goods prices. Core PCE inflation will not revert to target until 2024. The Fed will start rate cuts in late 2023, once the labour market has clearly weakened.

The window for a soft landing has shrunk. GDP growth dampened in Q1, due to a large inventory correction. Underlying demand was strong, however, challenging the Federal Reserve's efforts to cool the economy to a level that is sustainable in the long term. Sticky inflationary forces – with upwardly revised CPI data at the end of 2022 – and a hot labour market are creating pressure for further key rate hikes. Meanwhile tighter credit conditions are likely to cause the market to do part of the job for the Fed. The need to agree on raising the federal debt ceiling adds to the uncertain outlook.

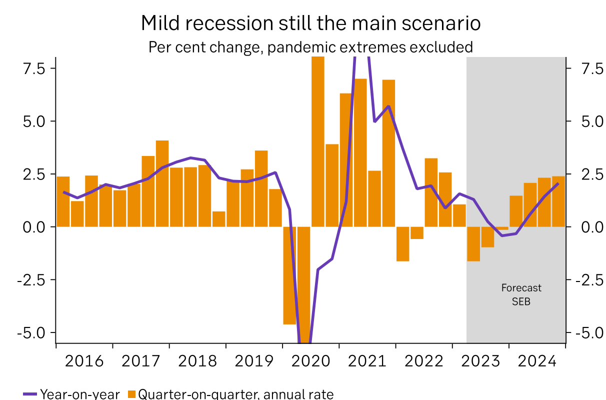
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	5.9	2.1	0.7	0.9
Unemployment*	5.4	3.6	3.8	4.6
Wages	4.3	5.3	4.0	3.2
Core PCE (Fed target metric)	3.5	5.0	4.0	2.0
Public sector balance**	-11.6	-5.5	-6.0	-5.5
Public sector debt**	126	122	124	126
Fed funds rate, % ***	0.25	4.50	4.75	3.00

*% of labour force **% of GDP, ***Upper end of the Fed's range.
Source: Macrobond, SEB

Our main scenario remains a mild recession, with GDP ending up a bit below its year-end 2022 level by the close of 2023. We believe that strong consumer demand early this year reflects temporary factors, including abnormally warm weather during January-February and a large one-off social security payment in January. We still expect several quarters of declining GDP, but our full-year 2023 forecast is above zero – and raised to 0.7 per cent from 0.5 per cent in January's *Nordic Outlook*. We are lowering our 2024 forecast from 1.2 to 0.9 per cent.

Mild recession still the main scenario
Per cent change, pandemic extremes excluded



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

Pessimistic companies and households. Sentiment surveys support a loss of momentum. The purchasing managers' index for big manufacturing firms (ISM) is at levels that have historically often been followed by recessions. The service sector showed strength early in 2023 but declined in March. Consumer sentiment bottomed out when inflation peaked last summer but has remained weak, according to the Michigan survey.

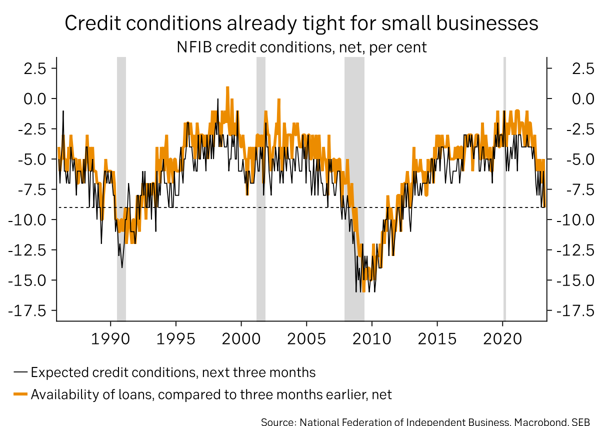
Credit crunch despite signs of stabilisation

For a few weeks in March, it looked as if the collapse of California's tech-oriented Silicon Valley Bank (SVB) might trigger a new US banking crisis. Government actions – guarantees for all deposits in SVB and another crisis-hit bank, reassuring statements from the White House and new Fed borrowing facilities – appear to have stemmed an acute crisis of confidence, at least temporarily. Bank deposits and demand by banks for emergency loans from the Fed have stabilised. The regional banks that have been the focus of concern are included among statistics for large banks, which may conceal flows within this category. But so far, overall data show neither a general exodus beyond the previous downward trend nor an acute credit crunch.

Higher borrowing costs. Yet we expect that events will reinforce the already ongoing credit squeeze. The consequences of excessive risk-taking tend to surface during rate hiking cycles, and we are likely to see more trouble spots. The fundamental problems that triggered the collapse of SVB are found – though in less extreme form – at other banks: large uninsured deposits that face competition from higher yields on Treasury bills and money market funds, as well as large unrealised losses on government and mortgage bond holdings as

yields have climbed. The Fed's new one-year loans, secured by government and mortgage bonds, reduce the risk of acute liquidity crises but are expensive. Bank deposit rates are thus likely to be raised to stop further outflows. The bill for insuring deposits at SVB is being paid by other banks, via increased contributions to the Deposit Insurance Fund. Smaller banks run the risk of being subjected to stricter regulation and supervision.

Small and medium-sized enterprises (SMEs) are the most vulnerable. Indices of financial conditions have not moved very much, and credit spreads have narrowed again. However, credit conditions for SMEs, which depend on banks for their funding, are being tightened. According to a survey by the National Federation of Independent Business (NFIB), in March credit availability and expected credit conditions were the tightest since late 2012 and were at levels normally seen during economic downturns. We believe this will lead to a downturn in business investments, which is supported by weak new order assessments (ISM) and a slowdown in factory orders. A bottoming-out trend for housing activity is also being challenged by tighter lending conditions. We expect residential investments to continue falling during the first half of 2023.



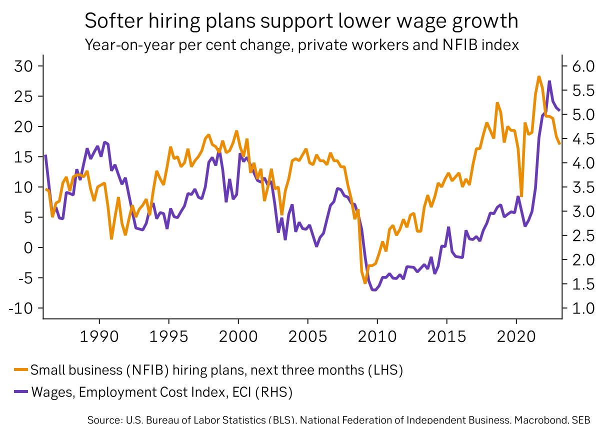
Pandemic savings buffers are emptying

Large post-pandemic household savings buffers caused consumption to defy both falling real incomes and higher interest rates. More than half of these buffers had probably been emptied by end-2022. We believe they will be completely exhausted by end-2023 and increasingly concentrated among affluent households with lower consumption propensities. But pay and employment growth will provide new support. Real wages are no longer falling. Households are also still spending a larger-than-usual share of income.

We believe that households will become more cautious as the labour market starts to slow down more clearly. We expect such a trend to begin this spring and lead to falling consumption during the second half. But due to the strong start to the year, we are raising our full-year forecast for private consumption from 0.9 to 1.2 per cent, while lowering it to 0.8 per cent in 2024.

Resilient service jobs

The number of new jobs is still growing faster than the pre-pandemic average of around 180,000 jobs per month and the 100,000 or so the Fed views as compatible with labour market stability. Over the past three months, job growth has been dominated by health services, leisure/ hospitality and the public sector, with the last two areas not yet having regained pandemic losses. Looking ahead, we believe that hiring in these sectors will also decelerate, contributing to a general slowdown. But the current economic cycle, being led by non-interest rate-sensitive service sectors, has probably dulled and delayed the impact of rapid Fed rate hikes.



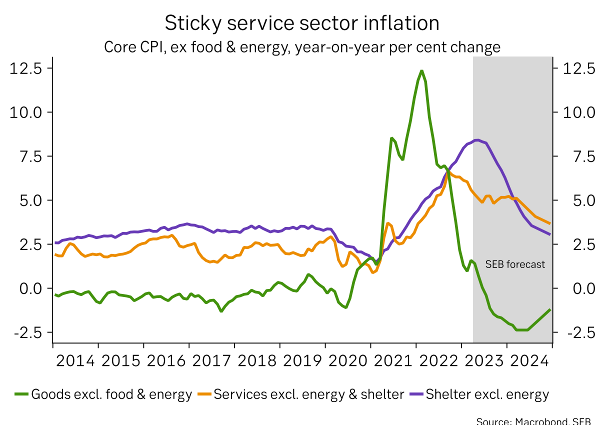
Early signs of normalisation. Unemployment is expected to start rising this summer from today's 50-year low of around 3.5 per cent, peaking at over 4.5 per cent in 2024. Rising lay-offs, and a slow increase in initial jobless claims, support expectations of a gradual labour market cooldown. The number of job openings is falling faster, from high levels, while small businesses have revised hiring plans below pre-pandemic levels. Meanwhile the supply side has improved. Labour force participation for prime ages 25-54 is back at early-2020 levels. Immigration has recovered from Trump's restrictions and pandemic border closures. Overall participation remains lower, but this reflects an ageing population. Labour supply would probably have undergone a declining trend even with no pandemic.

Pay hikes continue to signal a tight labour market. Hourly earnings growth dampened during the first quarter and is approaching levels broadly consistent with the 2 per cent inflation target. According to the more reliable employment cost index, ECI, wages

continued to rise at an annualised pace of nearly 5 per cent, however.

Hard-to-assess Philips curve a Fed dilemma

The period 2000-2019 was characterised by a flat Philips curve (the relationship between unemployment and inflation), in which inflation was stable at low levels over an economic cycle. Inflation became entrenched at high levels after the pandemic, which may indicate that the non-accelerating inflation rate of unemployment (NAIRU) has shifted upward. If so, 5-6 per cent unemployment may be needed to return to the 2 per cent inflation target. But another interpretation is that the relationship is stronger, and the Philips curve steeper, when the labour market is very tight. If so, the Fed may not need to cool off the economy as much. We are leaning towards the latter hypothesis, which is also supported by data. The Philips curve's uncertain shape is likely to make the Fed less inclined to react pre-emptively to signs of a weaker economy until it sees clear evidence that inflation is on its way back to target.



Sluggish service prices a Fed headache. Total inflation has fallen fast as energy prices have decreased. Other goods prices have also declined due to normalised supply chains, falling freight rates and shrinking wholesale and retail margins. Falling used car prices – following a sharp rise during the pandemic – have also been important for the decline. But the Fed has shifted its focus to service prices excluding energy and rents. According to the Fed, this metric best captures impulses from wages and underlying inflationary pressures in the economy. It has stayed largely flat at uncomfortably high levels around 4.5 per cent since mid-2022. The lack of progress in lowering underlying inflation is one reason why the Fed continued rate hikes in March despite the SVB crisis, and why almost all Fed policymakers stuck to their plan for a further hike. Despite easing pay increases, our forecast suggests that service inflation will remain a headache for the Fed this year.

No key rate cuts until late 2023. Still, the Fed can hardly ignore a situation of falling employment and rising joblessness, which is what we expect to see in the second half. We are therefore sticking to our forecast of a final hike in the federal funds rate to 5.00-5.25 per cent at the meeting in early May. As before, we believe that the Fed will start cutting during Q4. We expect the key rate to stand at 4.50-4.75 per cent by the end of 2023 and at 2.75-3.00 per cent by end 2024. We think it will be hard for the Fed to separate the slimming of its balance sheet (quantitative tightening, QT) from its rate decisions and expect that QT will end next year.

Debt ceiling negotiations deadlocked. The inability of congressional Democrats and Republicans to agree on an increase in the federal debt ceiling is a new threat to financial markets and the US economy. The estimates of the Congressional Budget Office (CBO) indicate that the federal government will run out of cash between July and September 2023. A decline in tax revenues means that it may happen as early as June. Congress has three options: raise the ceiling, suspend it temporarily or postpone the problem by raising it slightly.

Historically, a last-minute agreement has always been reached, avoiding a self-inflicted US default. However, increased polarisation between and within the parties has increased the risk that something will go wrong. Republican House Speaker Kevin McCarthy has proposed a 10-year savings plan in exchange for a one-year raise in the debt ceiling, but the Democrats do not want to face a new debt ceiling crisis during the 2024 presidential election campaign and are opposed in principle to the debt ceiling being used as a bargaining weapon. Demands for drastic cuts next year and slashing large parts of President Biden's climate agenda, the Inflation Reduction Act, IRA, are hard to stomach.

Starvation diet or panic cuts? A long-term austerity policy like the one that President Obama was forced to accede to in 2011 could limit the federal government's ability to help sustain the US economy in case of a new downturn. But a failure to raise the debt ceiling would be much worse. The latter option would create demands for immediate and drastic spending cuts, including defence, health care and pensions, given a deficit of over 5 per cent of GDP. However, we believe that the US Treasury has the tools to prioritise interest payments on the federal debt. In sum, the budget process needs to be reformed to address both persistent deficits and underfunded social security systems. But the latter are politically sensitive and do not lend themselves to a "game of chicken" over America's willingness and ability to make good on its obligations.

China
Consumption recovery kicks in

China's growth outlook is on track to exceed the government's 5 per cent target in 2023. After GDP comfortably beat expectations in the first quarter, we are raising our 2023 growth forecast to 5.9 per cent. The recovery will likely pick up speed in the months ahead with consumption doing the heavy lifting. However, lingering weakness in the property sector is weighing on investment.

GDP growth is on track to exceed the modest 5 per cent target in 2023 without requiring fresh major stimulus. Recent economic data has overall exceeded expectations ever since China loosened its strict COVID policies late last year. With seasonally adjusted quarter-on-quarter growth of 2.2 per cent in Q1, we are raising our growth forecast to 5.9 per cent in 2023 and 4.9 per cent in 2024.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	8.1	3.5	5.9	4.9
CPI	0.9	2.4	2.8	2.4
Fiscal balance	-3.8	-4.9	-5.0	-4.7
Bank reserve req,%**	11.5	11.0	10.50	10.50
1-year loan prime rate, %**	3.80	3.65	3.65	3.65
7d reverse repo rate, %**	2.20	2.00	2.00	2.00
USD/CNY**	6.36	6.55	6.60	6.45

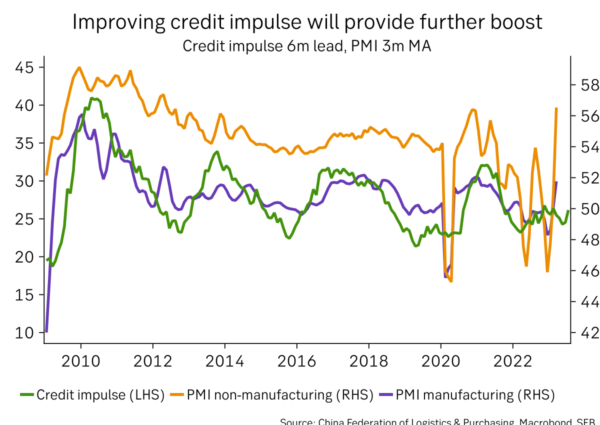
*% of GDP **At year-end. Source: IMF, SEB

Household consumption does the heavy lifting. Retail sales has consistently exceeded expectations so far. In particular, the largest improvement can be seen for in-person services, outstripping total household consumption growth. For now, the fastest recovery is occurring in hospitality and catering services.

Larger credit impulse will provide support to capital spending beyond the second quarter. Historically, credit growth leads real activity by 1-2 quarters. Accelerating long-term credit growth bodes well for corporate loans but for now, investment has yet to gather steam.

Infrastructure investment slowed in March, reflecting Beijing's caution on pursuing more aggressive stimulus.

Besieged property sector dampens recovery. Property prices continue to post monthly improvements. Still, confidence in the sector remains weak. Moreover, the recovery in construction is led by state-owned property developers. While some of the distress among private developers has eased, it will take time before these can initiate new projects as the focus has remained on completing stalled existing projects.



Despite domestic demand recovering, a balanced policy response is required. In late March, the People's Bank of China (PBoC) reduced its reserve requirement ratio by 25 bps to 10.75 per cent. As long as inflationary pressures remain at bay, we believe the central bank has room to maintain a supportive stance. However, the 3 per cent inflation target set by Beijing dampens expectations of larger stimulus. If the recovery in domestic demand broadens faster than expected, upward pressure on core inflation may emerge. This may prompt the PBoC to tighten financial conditions before end-2023, especially if the growth target is expected to be met. Tighter financial conditions do not require key rate hikes and, in the past, the PBoC has guided interest rates higher by withholding liquidity provisions.

Yuan to appreciate. China's growth outperformance should allow the yuan to appreciate against the dollar towards 6.60 by the end of 2023. Improving earnings expectations should usher in more foreign inflows to Chinese A-shares. The Shanghai Composite index has risen almost 9.6 per cent year to date. We estimate net inflows have reached USD 27.9 billion so far this year, as of mid-April. As long as regulatory surprises are kept to a minimum, foreign inflows should remain robust.

Theme:

The Turkish elections

Policy change will require more than an opposition victory

Dark economic clouds shroud Turkey's May elections. After years of recurrent currency crises, the policy roadmap ought to be straightforward. Elections could herald real change, but risks remain even if there is an opposition victory. Despite optimistic opinion polls, political institutions raise barriers to transition of power. Furthermore, the internal fragility of the opposition remains an issue. A change of government in Turkey looks like a necessary – but in itself not a sufficient – condition for a return to more sustainable economic policies.

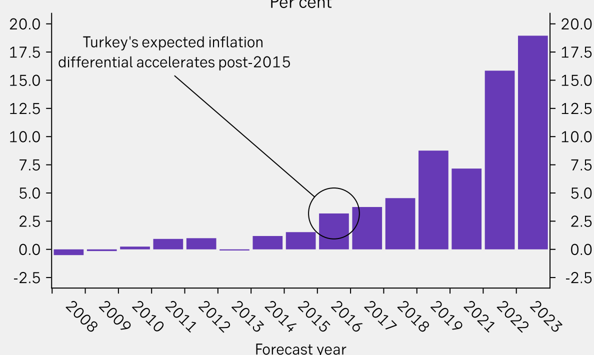
Dark economic clouds shroud May elections

On May 14, Turkey will hold presidential and parliamentary elections. These will take place on the backdrop of increased geopolitical risks, a higher global interest rate environment, as well as severe domestic economic policy challenges. Even with its peak in the rear-view mirror, consensus forecasts show Turkish inflation averaging roughly 46 per cent this year. Moreover, recent IMF forecasts reveal the extent to which the inflation outlook has deteriorated over time. In last month's publication, the IMF expects five-year average inflation to remain close to 19 percentage points above the emerging and developing country aggregate. This gloomy inflation outlook thus weighs on the elections.

Never-ending currency crises

Turkey experienced a currency crisis in 2018, and for practical purposes another in late 2020, following ineffective backdoor currency interventions. Despite a brief attempt to stabilise inflation under Naci Agbal, his unceremonial dismissal and subsequent key interest rate cuts in late-2021 further revealed Turkey's existing financial vulnerabilities.

Turkey: IMF Average 5-year Inflation Forecast Relative to Emerging & Developing Economies



Source: International Monetary Fund (IMF), Macrobond, SEB. The graph shows, for each April WEO forecast release year, the difference between the average five-year inflation forecast for Turkey and that of emerging & developing economies.

What followed was accelerated lira depreciation and rampant inflation. By the end of 2021, Turkey had entered what could be classified as another currency crisis. With monetary stimulus coupled with fiscal expansion, economic growth rebounded strongly, even as many other countries struggled with their recovery from the COVID-19 pandemic.

Major current account imbalances. After further rate cuts from September 2022 onward, the lira again came close to yet another crisis. Pressures on the lira were relieved by foreign exchange market interventions, a new "FX-protected" deposit scheme and a range of macroprudential and regulatory measures. The war in Ukraine increased economic strains, especially through higher energy import prices, but recent current account data also show growing imports of non-monetary gold. Since 2020, this periodic higher demand for gold has correlated with increased signs of economic distress. The Turkish economic growth strategy, as seen through the loss of an inflation anchor and historically extreme current account deficits, appears unsustainable.

New construction boom? The devastating earthquake in February will require significant reconstruction efforts, and estimates range from USD 35 to USD 100 billion. Absent a larger inflow of external financing, more expansionary fiscal policy will undoubtedly be required. Construction investments drove much of Turkey's GDP growth up until 2013: The catastrophe could provide an opportunity to rebuild much of Turkey's housing stock in a sustainable manner to ensure that future disasters will not have the same humanitarian consequences. Yet the limited transparency over procurement processes also raises concern about the efficient allocation of resources in such a venture.

Temporary calm, but the problems remain unsolved. On the surface, some asset price data suggest relative stability for now. Yet this appears largely artificial, a by-product of government interventions and regulations, not an expression of a market-driven equilibrium between supply and demand. A growing current account deficit has been financed by a historically anomalous contribution from undocumented funding sources. A housing boom and volatile stock market exemplify the consequences of investors chasing havens safe from inflation.

The policy roadmap should be straightforward

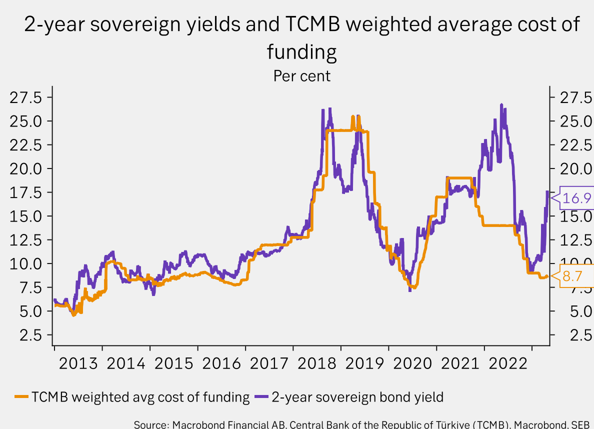
What is needed on the economic policy front is actually not so complicated. Commentators typically point to the need for near-term key interest rate hikes accompanied by moves to strengthen the central bank's independence, specifically to assist in reducing inflation and allow reserve buffers to be rebuilt over time. Tighter fiscal policy would also help, given rising fiscal risks and high inflation, with provision made for targeted assistance to the most vulnerable. Meanwhile, to the extent these policies are implemented, and disinflation materialises, macroprudential and regulatory measures such as FX-protected deposits could be phased out carefully. This would allow a return to more market-based determinants of asset prices and for the Turkish state to assume a less dominant role in financial markets and credit allocation.

No improved outlook in sight for investors. Despite these obvious economic policy needs, Turkish policymakers have remained adamant that investors should not expect real policy change after the elections. Reports of previous policymakers who were popular with investors returning to the AKP fold are unlikely to do much to improve dented investor sentiment.

Risks will remain even if the opposition wins

Investors look to the opposition and its election prospects as a catalyst for a potential return to more economic policy orthodoxy and free market principles. The outlook for such changes appears reasonably bright. Opinion polls show opposition presidential candidate Kemal Kilicdaroglu with a reasonable lead. Moreover, signs from the short end of the sovereign bond markets suggest an at least partial reversal of monetary policy after the elections. A return to economic orthodoxy – a central bank committed to lowering inflation and a government willing to accept lower and more sustainable economic growth while also reducing regulatory measures stifling the free flow of capital – should provide incentives for resumed inflows from abroad. But this scenario assumes a) that opinion

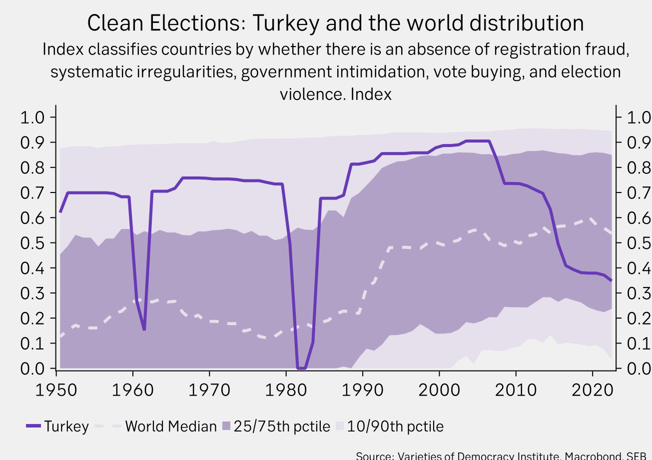
poll results will translate into election results, and b) that an opposition government can deliver.



Political institutions raise barriers to transition of power. The first challenge is Turkey's political institutions. The election landscape is different from previous situations of peaceful transitions of political power. Commonly quoted indicators of the quality of elections show Turkey at a record low (outside of historical episodes of extreme instability). The media landscape is heavily tilted toward the incumbent government and several opposition leaders are either in jail or facing imprisonment. In addition, this ought to be Erdogan's last chance to run for president – the current constitutional stipulates a limit of two terms (for a given political system). As such, his final term in power would thus be needed not only to avoid losing power directly, but also to either set up a valid successor for a future political transition or work towards undoing the term limits themselves.

Deep disagreements among opposition parties. The second challenge is an opposition coalition with seemingly divergent preferences over Turkey's political future. An outburst of disagreement ahead of the nomination of opposition presidential candidate Kemal Kilicdaroglu was quickly resolved but could be a sign of deeper internal disagreements going forward. And whereas an opposition victory will likely require the voting support of HDP, a pro-Kurdish political party, future cooperation between it and the more nationalist Good Party (IYI) looks difficult.

A disunited parliament poses major post-election risks. A disunited parliament may not prevent a future president from appointing a new central bank governor or setting Turkey on the road to more orthodox economic policies, but investors should be aware of risks to the stability of a future opposition coalition as a going concern. When the AKP lost power in June 2015, the failure of the opposition to unite and set up a new government left Erdogan in office in the meantime, and a few months later voters once again fell in behind the AKP. Rules determining under what conditions, and how, parliament could force through new elections remain untested and, as such, the sustainability of a future president with a fragmented parliament remains in question.



Opposition to Erdogan the only political glue. Overall, beyond the desire to see a new government in place – as well as a desire to end the executive presidency – there may be little political glue to keep the opposition alliance together. A transition to a strengthened parliamentary system will likely require constitutional amendments, for which parliament's expected disunity could become a hurdle.

How much will a new government want, and dare, to change? Furthermore, the opposition's goals to undo some of the authoritarian excesses of the AKP era may run counter to an interest in, or need to, assert control over the state apparatus, such as key positions within the bureaucracy, judiciary and security apparatus. During this period, economic policymakers might still be left out of politics to right previous economic policy wrongs, but for how long is unclear. And the threat of political instability could keep risk premiums high, potentially exacerbating the job of the central bank by requiring an even higher key interest rate. The ensuing slowdown in economic activity could then feed back into lower support for the new government which, with a fragmented parliament, could test the fortitude of the ruling party coalition.

Necessary, but not sufficient. As such, a government transition in Turkey looks like a necessary – but not necessarily a sufficient – condition for a return to more sustainable economic policies.

The euro area
Core inflation keeps the ECB in hiking mode

The expected weaknesses in consumption that eluded us during much of 2022 have become more evident, and consumption fell around year-end. We expect a weak 2023, but resilience – especially in the service sector – will improve the situation. Energy insecurity has diminished, but high prices are still hampering growth. Despite increased financial sector turmoil, the ECB will hike key interest rates in three more 25-basis point increments at its upcoming policy meetings.

Despite energy problems, high inflation and rising interest rates, euro area economies are still showing resilience. Rising cost pressures are squeezing all parts of the economy – mainly households – but the outlook diverges across sectors. The expected slowdown for households became increasingly apparent last autumn. Consumption fell sharply amid unchanged real GDP in the final quarter of 2022. Meanwhile, confidence indicators rebounded late last year and early in 2023. The service sector is showing relatively good confidence, which is a bit surprising given the number of challenges the region still faces. In the manufacturing sector, optimism about the near future has fallen in recent months, but this is mainly because global value chains are functioning more normally.

Mild recession. All in all, we believe it is too early to dismiss the recession scenario, but the downturn looks likely to be protracted. A weak 2023, with economic growth totaling only 0.6 per cent, will be followed by a mediocre 2024. Despite it being a recovery year, growth will be a mere 1.6 per cent, barely above trend.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	5.3	3.5	0.6	1.6
Unemployment*	7.7	6.7	7.0	7.8
Wages and salaries	4.1	4.5	5.2	4.3
CPI	2.6	8.4	5.4	1.5
Public sector balance**	-5.1	-3.9	-3.3	-2.5
Public sector debt**	95.4	92.0	91.0	90.0
Deposit rate, %***	-0.50	2.00	3.75	3.00

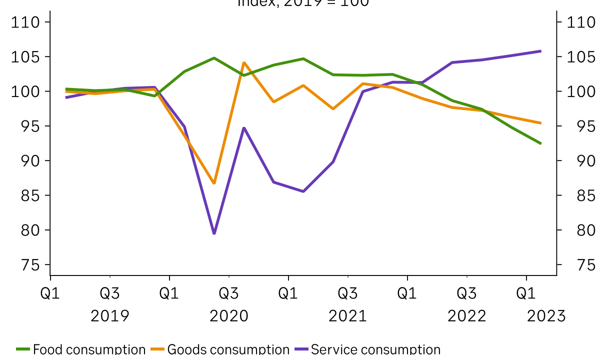
*% of labour force **% of GDP ***At year-end. Source: Eurostat, SEB

Better than expected, but partly for the wrong reasons. GDP fell less than expected around year-end 2022, partly due to weak imports and inventory build-up, which both push up growth. The inventory build-up is in line with a global trend among companies towards creating larger buffers in response to supply problems in recent years. Larger inventories temporarily lead to higher demand, as reflected in order statistics. More surprisingly, imports meanwhile fell. A decline in imports at the same time as inventories are growing is a clear sign of weakness – driven by lower consumption and construction investments as well as by companies preparing for tougher times. We interpret GDP statistics as indicating that a further slowdown lies ahead and that consumption will fall by 2 per cent in the next three quarters.

An improved energy situation reduces downside risks. Energy supply and prices were better than previously feared, especially towards the end of last year. This was one major reason for euro area economic resilience. Yet many types of energy remain substantially more expensive than two years ago, and electricity prices have not fallen to the same extent as natural gas prices. Meanwhile, continued high food prices and tighter monetary policy have taken over as growth headwinds.

Continued strong service sector. Rapid inflation, but also a high initial level of consumption, are now causing goods consumption to fall. Consumers were expected to shift towards more service consumption as economies re-opened, but this shift took a long time and seems to have been almost unaffected by sharply rising prices.

France: Shift in consumption between goods and services

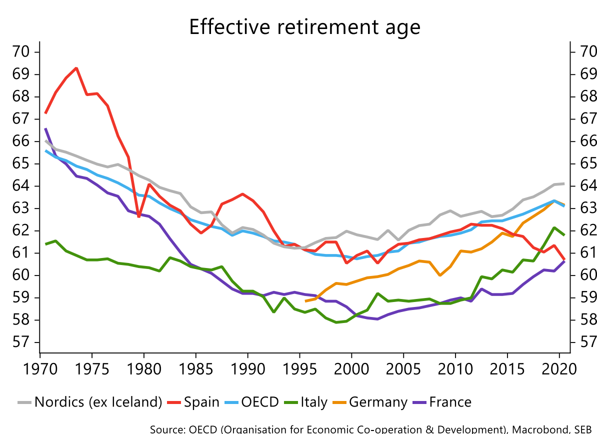


Source: French National Institute of Statistics & Economic Studies (INSEE), Macrobond, SEB

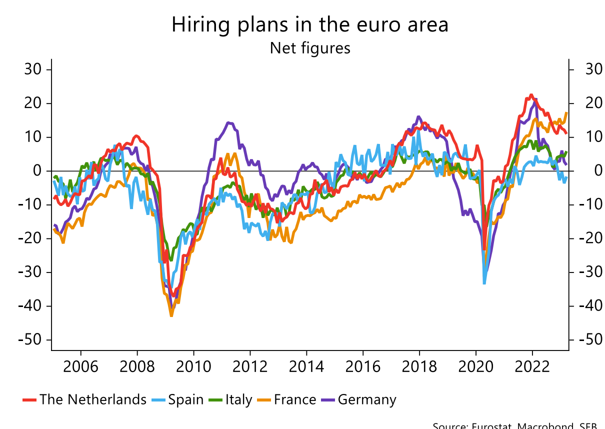
High savings a finite buffer. High pandemic savings are now being used as an additional source of funding. But because of negative real wage growth, continued high

inflation and rising interest rates, these funds will run out sooner or later, and overall consumption will have to deal with lower purchasing power. The timing varies between consumer categories, and exactly when households will have totally exhausted these savings is highly uncertain. The savings ratio has come down but still remains above its pre-pandemic level. Our conclusion is that households will be forced to restrict consumption, compared to their previous habits. This is the main reason why we forecast weak GDP growth.

A messy start to the year, also politically. Tensions are rife in the euro area. Energy and inflation problems are just one part of the picture. Various kinds of protests are pressuring governments. In Germany, collective bargaining negotiations are continuing, punctuated by strikes in which employees are essentially demanding full compensation for inflation. German wage rounds usually end with pay hikes of half as much as unions have requested but often include one-off solutions that are hard to interpret. France has seen massive protests but there the focus, as so often, has been on unpopular solutions to structural problems such as raising the retirement age. The reasons for public anger vary. Some people oppose a higher retirement age as such, while others are upset about the way President Macron rammed through his proposal. Meanwhile global tensions – for example related to the Ukraine war and US-China relations – will force the EU to find its place in a world of changing trade patterns and climate transition. The EU is caught between major blocs and risks having to make tough decisions while dealing with a complex internal political agenda.



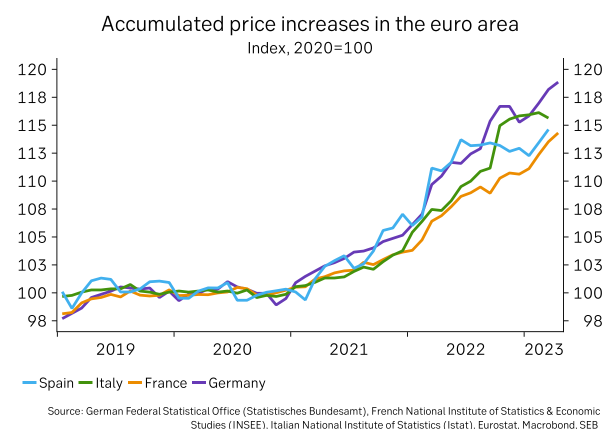
The labour market is holding up, despite weaker growth. Despite a decline in GDP around the end of 2022, employment rose. The explanation is strong demand in the service sector. Difficulty in finding staff after the pandemic is probably another reason why companies are choosing to retain employees, despite falling demand. Right now, hiring plans remain decent, but we believe that employment will fall as the economy decelerates further. Unemployment will increase by just over one percentage point from 2023 to 2024, a relatively moderate rise.



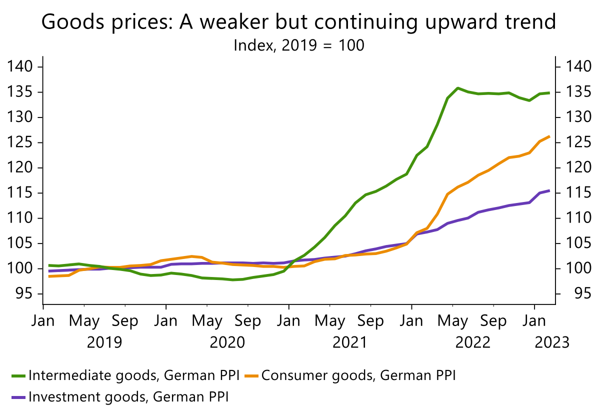
Spill-over effects crucial to the ECB

Inflation is the biggest constraint on growth, both directly and indirectly via central bank key rate hikes. If energy prices were the focus of attention when rate hikes began, uncertainty is now more connected to how much inflation remains in the system and how today's high inflation will affect such costs as wages and rents. In addition to general uncertainty, government subsidy programmes that have softened past price upturns will conversely reduce downside potential, depending on how and when they are phased out.

Total inflation is rapidly declining, driven by such factors as lower energy prices and large base effects from 2022. In this context, it is important to bear in mind that the general price level is continuing to rise from an already high level. As measured by the consumer price index, the situation has been slightly less strained in France than in the other three largest euro area economies. Consumers will continue to have a tough time, even though central banks will find the situation somewhat easier late in 2023 from an inflation-targeting perspective.



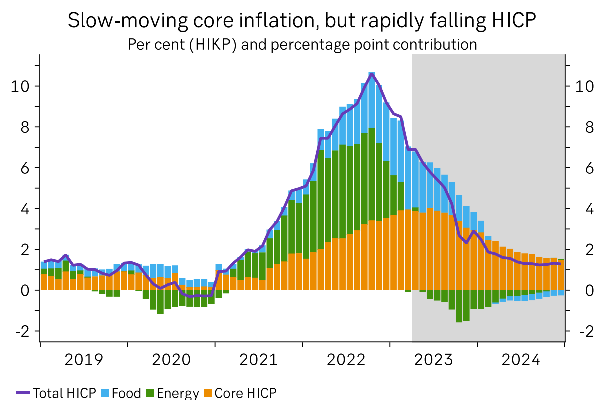
More sluggish core inflation in the spotlight. As energy prices have eased somewhat, the focus of attention has shifted towards how price increases spill over into broader portions of the consumer basket that have a greater impact on core inflation. It is normal to see a certain time lag between highly variable prices such as energy and food, which strongly affect CPI, and more sluggish prices such as rents and wages. This can be illustrated by looking at input goods prices, producer prices and consumer prices (see chart below). Although the impacts of different stages of price formation on each other are uncertain, our view is that there are still price increases in the system that have not yet reached consumers. For example, price changes for services occur after a certain delay, and strong demand also makes it easier for such prices to rise. Although monthly price changes for core inflation do not stand out as much as in certain months of 2022, they are still high in a historical perspective. Our overall view is that no decline in core inflation will occur until after summer 2023.



Small signs of coming price declines. Price expectations of companies in the PMI have declined. In the manufacturing sector, perceptions of intermediate goods price hikes have rapidly fallen, even indicating a price decline. In service sectors, indicators are showing the opposite trend, though at a slower pace than before. Prices of freight and many commodities have fallen greatly in recent months, which may exert downward pressure on prices at various stages of production and consumption. But the total cost situation in downstream production stages remains higher than before. This is why a large total price decline cannot be expected. Higher rental, interest rate and labour costs will be crucial to the inflation dynamic.

Uncertainty about wages is keeping the ECB on its toes. Core inflation will start to slow in the second half of 2023 but will still end up at 2.8 per cent for the full year 2024, above the ECB's inflation target. To get there, we need improved supply chains and lower input prices. The decisive factor in determining where inflation ends up will be the rate of pay increases. Wage formation varies. Some countries (such as Belgium) have labour agreements that automatically raise wages and salaries in response to CPI. Germany is currently in the midst of a collective bargaining round, but it will be protracted and the outcome is uncertain. Wages are a key reasons why the ECB must stay on its toes, prepared to respond to all sorts of spill-over risks that could threaten its inflation target in the long run. High wage agreements increase the risk that the decline in inflation will take more time. Like the ECB, we estimate that pay hikes both this year and next will be close to five per cent in the euro area. Such wage increases is normally considered high from an inflation perspective, since we expect productivity growth to remain moderate over the next few years. But we believe the increases will still be manageable, even if core inflation does not fall to 2 per cent until after 2024.

Another 75 basis points from a data-oriented ECB. What will determine ECB interest rate policy in the near future will be incoming statistics. Both PPI and CPI figures will thus be important in the coming months, almost regardless of what happens in the real economy. We believe that the ECB will not receive any clear signals that inflationary pressures are easing before this summer. As a result, it will raise rates by another 75 basis points during the summer, and the deposit rate will peak at 3.75 per cent. A surge in financial sector uncertainty might completely redraw the monetary policy stance. Previous rate hikes have created tensions in the system and will remain a concern for some time to come. The recent banking sector turmoil has tightening credit conditions. This means that the ECB will not have to hike its key rates quite as much as would otherwise be the case. Once there are clearer signs of a disinflationary trend, along with a slowdown in the economy, the ECB will start cutting rates. We believe it will lower key rates by a total of 75 bps during 2024.



The United Kingdom
Long uphill journey towards higher growth

A strong labour market and lower energy prices have given the British economy a bit of unexpected light at the end of the tunnel. Ongoing global systemic crises are exposing challenges and risks that did not exist at the time of the Brexit decision, but there are few signs of "greedflation". This will allow inflation to fall. The Bank of England will hike its key rate to 4.50 per cent but will cut it to 3.75 per cent during 2024.

The UK economy has surprised on the upside in early 2023. The labour market remains strong, with high nominal pay hikes right now at around 7.5 per cent. Still, GDP growth is markedly anaemic. Repeated strikes in various sectors are hurting growth, but only marginally. Meanwhile there are long-term challenges such as weak productivity growth, stagnant capital spending and falling labour market participation. The economy remains burdened by the aftermath of the pandemic and Brexit and is now being affected by war and inflation abroad. GDP will decline by 0.4 per cent this year. Global trends and improved real purchasing power will lift growth to 0.7 per cent in 2024. Compared to the current situation, we expect unemployment to rise by around 1 percentage point over our forecast period.

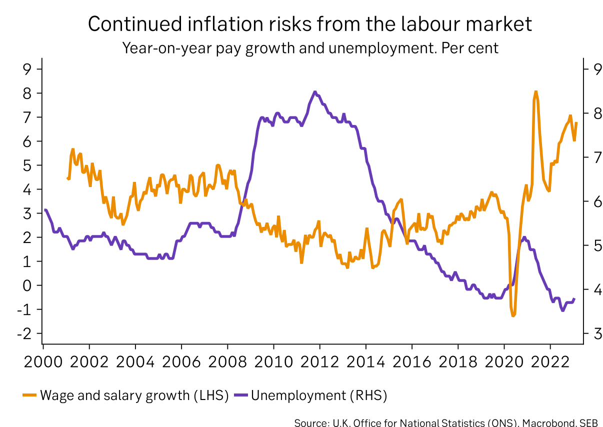
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	7.6	4.1	-0.4	0.7
Unemployment*	4.5	4.1	4.3	4.8
Wages and salaries	5.9	6.0	4.2	2.4
CPI	2.6	9.1	7.0	2.4
Public sector balance**	-8.3	-6.3	-5.5	-4.5
Public sector debt**	108.1	102.6	105.0	107.0
Key interest rate, %***	0.25	3.50	4.50	3.75

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

Real household incomes will fall by 6 per cent during 2022-2023. The historically high household savings ratio – today around 9 per cent – will also fall somewhat, easing this year's decline in consumption. The government budget, including extended energy subsidies to households and companies, is expected to provide marginally higher GDP growth ahead. The recent spring budget also included measures to boost labour market participation and defence spending. But in a world with rising geopolitical tensions, there is a still a lack of credible, sustainable investment and trade strategies to solve some of the country's structural problems. The budget deficit will reach 5.5 per cent of GDP this year and 4.5 per cent in 2024., with public sector debt reaching 107 per cent of GDP by end-2024.

Home prices have been squeezed by inflation and higher mortgage rates and have fallen by 6 per cent since their peak last August. At about 4 per cent, home mortgage rates are now at their highest since 2008. We expect further limited price decline and a total decline of 10 per cent since the peak. When the Bank of England (BoE) cuts its key rate next year and mortgage rates go down, home prices may also start to rise again.



Inflation is troublingly high. Short-term inflation will slow due to the government's extended energy subsidies. There is no clear evidence of "greedflation" – that companies are seizing the opportunity to raise their prices – or that wages are driving inflation. So far, the BoE has hiked its key interest rate by 415 bps to 4.25 per cent, about 2 points above neutral (which is around 2 per cent). This means that its monetary policy is having a tightening effect. In addition, the BoE is slimming its monetary policy portfolio by GBP 80 billion yearly (of which GBP 45 billion in divestments and the remainder through maturities), equivalent to an increase in long-term government bond yields of roughly 20 basis points. The BoE will hike its key rate one last time to 4.50 per cent in May, then lower it on three occasions during 2024 to 3.75 per cent. The British pound will appreciate against the dollar, with an GDP/USD exchange rate of 1.26 at the end of both years.

The Nordics

Sweden | page 37

Swedish growth will be among the weakest in the EU in 2023. Inflation rose far faster than expected early this year, and we believe the Riksbank will hike its key rate one last time to 3.75 per cent in June, with the first rate cut coming in April 2024.

Norway | page 41

Mainland GDP growth has continued to defy expectations of a recession, but we still predict weaker growth ahead. Inflation pressure is preventing Norges Bank from quickly reverting to a more normal key interest rate.

Denmark | page 43

The Danish economy is looking remarkably robust. GDP, driven by exports and capital spending, grew by 3.8 per cent in 2022, almost 1.0 per cent more than expected. Even so, we still foresee a mild recession in 2023.

Finland | page 45

GDP has been falling since 2022, with a rebound during the second half of this year, full year growth will end up at -0.4 per cent The new government will focus on containing budget deficits and improving fiscal discipline.

Sweden

Resilient, but downside risks remain

GDP growth again surprised on the upside in Q1, but hard-pressed households, decreased housing construction and relatively tight fiscal policy indicate that Swedish growth this year will be among the weakest in the EU. After inflation rose far faster than expected early in 2023, there are increasing hopes that it will slow more clearly after the summer. We believe the Riksbank will hike its key rate one last time to 3.75 per cent in June, with the first rate cut coming in April 2024.

After a weak final quarter of 2022, GDP recovered in Q1 2023 according to the flash estimate, rising by a stronger-than-expected 0.2 per cent. Sentiment indicators have stabilised, but they remain at low or very low levels: We expect GDP to fall during the rest of the year. After this strong start, we have adjusted our forecast for 2023 upward to -1.0 per cent from -1.2 per cent in the previous *Nordic Outlook*. But we have adjusted 2024 GDP downward by 0.3 points, with growth reaching only 0.8 per cent – well below trend. Signals of easing price pressure have become clearer. Core inflation will fall after the summer, but in the coming months inflation risks will still be on the upside. The Riksbank will hike its key interest rate one last time to 3.75 per cent in June, followed by three cuts during 2024 to 3.0 per cent.

Key data

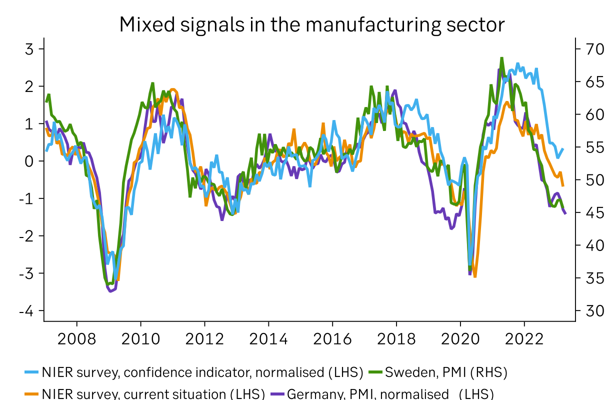
Year-on-year percentage change

	2021	2022	2023	2024
GDP	5.4	2.6	-1.0	0.6
Unemployment*	8.8	7.5	7.8	8.6
Wages and salaries	2.6	2.7	4.1	3.9
CPI	2.2	8.4	8.7	3.4
Net lending **	0.0	0.7	0.5	-1.0
General government debt	36.6	33.1	31.1	32.1
Policy rate, %***	0.00	2.50	3.75	3.00

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

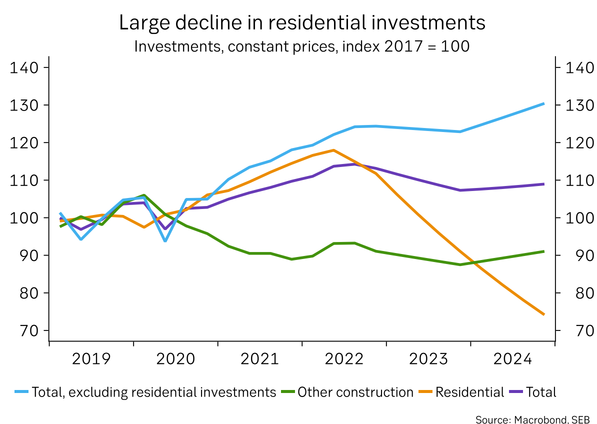
Mixed signals from industry

Manufacturing sector indicators have weakened significantly since early 2022, but in recent months some stabilisation has been discernible. The purchasing managers' index (PMI) is at relatively low levels, while the National Institute of Economic Research confidence indicator is close to its historical average. One important explanation for the gaps is that companies are still fairly satisfied with their order books, which is logical since goods exports and industrial production are still rising.



But order inflow is weak. There are many indications that we are facing a downturn, and we expect gradually falling production and exports this year. Since we expect a relatively mild international recession, there is little risk that we will see as abrupt a decline as during the global financial crisis (GFC) and early in the pandemic. Service exports recovered very strongly in 2021 and 2022 and are now well above their historical trend – driven by business, transport and telecom services. But we now expect a slowdown, with service exports approaching their trend. Total exports will fall more than 1 per cent this year, followed by an upturn of about 4 per cent in 2024.

Construction is facing a clear downturn. The number of housing starts is expected to halve from 67,000 in 2021 to 30-35,000 this year. Residential investments will fall by a total of 30 per cent in 2023-2024, pulling down GDP growth by about 0.7 percentage points per year and total capital spending by over 3 points per year. There is great uncertainty. Anecdotal data indicate downside risks, with signals of a halt to new projects. Some form of housing construction subsidies will probably be launched if the downturn becomes even more dramatic. Lower demand for commercial premises is also contributing to falling construction investments. Overall capital spending will fall by 3.1 per cent in 2023 and a further 3.0 per cent in 2024.



Squeezed households will cut consumption

Financially hard-pressed households will also contribute significantly to weak GDP growth. Our forecast that real wages will fall more than 10 per cent over a two-year period remains unchanged. Although a continued rise in employment and fiscal stimulus measures will ensure that disposable incomes do not fall as much, the situation is tough for many households. In addition to high inflation, they are being squeezed by rising mortgage rates.

Savings are shrinking, but for how long? So far, households have kept increasing their consumption in current prices by reducing their savings, but it is doubtful whether this trend can continue. Household savings were initially high, but this is partly due to compulsory pension savings; the personal financial savings ratio has already fallen below zero. Households have also started to reduce consumption loans. Mortgage lending has stagnated.

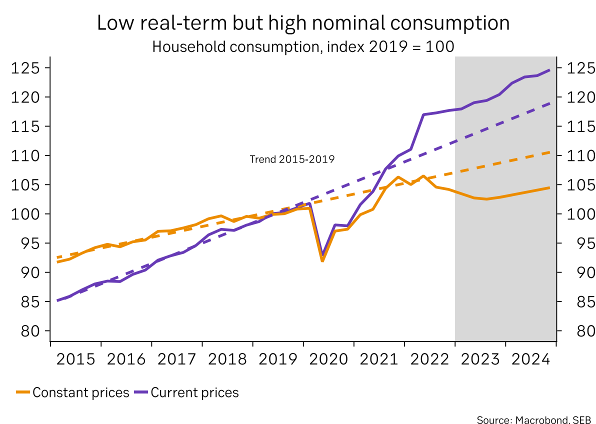
Household income and savings ratio
Year-on-year percentage change

	2021	2022	2023	2024
Real disposable income	4.2	-0.1	-3.9	1.8
Private consumption	6.3	2.1	-2.3	1.4
Savings ratio, % of income	15.9	13.3	12.6	12.7

Source: Statistics Sweden, SEB

Consumption will fall by 4 per cent. As an annual average, consumption volume rose last year, but the explanation was a strong finish in 2021. During 2022, consumption fell by 2.0 per cent. In 2023, we expect a further 2 per cent drop. Such a decline of 4 per cent is almost unique. During the 1990s crisis, consumption fell by 5 per cent, but this was spread out over several years. During the global financial crisis, the decline was only 2.5 per cent. There is great uncertainty about how households will deal with shrinking real income. Our forecast implies that nominal consumption will remain high in a historical perspective and that the savings ratio will stay at the lower level established in 2022.

The decline in home prices will continue. Combined house and flat prices from estate agents (Mäklarstatistik) indicate that home prices have fallen by 12 per cent since peaking in early 2022. Prices stabilised during the first three months of 2023. According to SEB's Housing Price Indicator, pessimism about home prices has decreased. But continued rate hikes suggest that the downturn will continue. We are sticking to our forecast of a total price decline of 20 per cent. Continued strong population growth combined with reduced construction indicate that demand may be a factor that prevents a larger price drop.

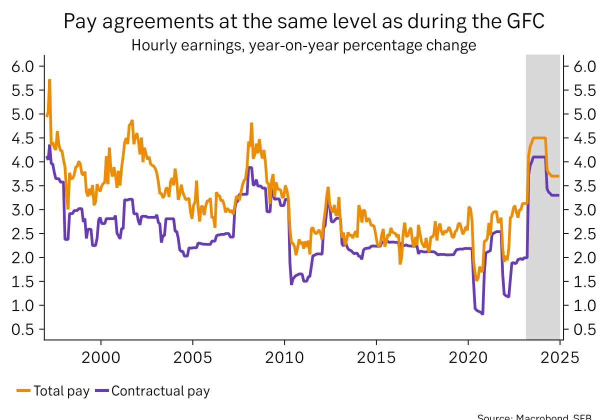


The labour market is important for home prices and consumption. If the economic downturn is prolonged, the labour market risks weakening in a way that may create a negative spiral, with further declines in consumption and home prices. So far, the labour market slowdown has been milder than feared. Employment has continued to increase. Unemployment rose slightly early this year, but indicators like lay-off notices and hiring plans are still at levels that suggest rising employment. Here too, the forecast is more uncertain than usual. Several historical examples indicate that the number of lay-off notices can rise rapidly, driving a surge in unemployment.

Higher and longer pay agreements

Just before the previous collective agreements expired this spring, manufacturing sector employers and labour unions concluded agreements that provide pay hikes of 4.1 per cent effective in April 2023 and a further 3.3 per cent in April 2024. Many other unions quickly signed agreements at similar levels, and the risk of anyone diverging from this model is small. The agreements ended up a bit higher than we expected, with the employer side prepared to pay a little extra to get two-year contracts. Overall, we now expect wages and

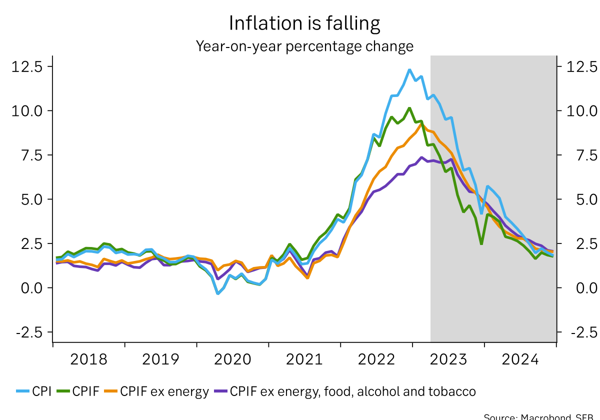
salaries to increase by 4.1 per cent this year and 3.9 per cent in 2024, which together is 0.4 points above our previous estimate. Our forecast implies that total pay will increase 0.4 percentage points per year more than the agreements. This would mean slower wage drift than in 2022 and is in line with the historical pattern that pay hikes above contractual levels are smaller when agreements are higher. The labour market is cooling, which also points to moderate wage drift. Since mid-2022, the share of firms reporting labour shortages has fallen sharply from record levels.



More signs that inflation will ease

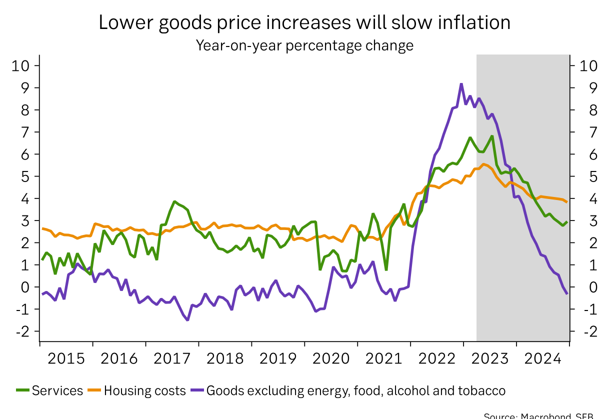
After a sharp upside surprise in early 2023, March inflation figures provided some relief. CPIF (CPI with constant interest rates) excluding energy fell to 8.9 per cent from 9.3 per cent in February. This decline increases hopes that a turnaround is under way, but short-term indicators such as the producer price index (PPI) and company pricing plans in various surveys remain at high levels. We thus see predominantly upside risks to core inflation during the coming months. An alternative core inflation metric similar to the one used in the euro area fell to 7.1 per cent in March from 7.4 per cent. This is almost 1.5 percentage points higher than in the euro area. According to our models, the weak krona may explain almost half of this difference. Inflation in Sweden is mainly driven by the same forces as in the euro area, and developments will largely be determined abroad.

Prices are cooling. International commodity and input goods prices levelled off or began falling as early as mid-2022. In recent months there have been signs that prices of more processed goods are also easing. For example, the share of consumer goods businesses planning to raise prices has approached pre-pandemic levels, according to business tendency surveys. This decline is particularly evident for food. If these plans are confirmed by producer prices this spring, the likelihood of a more pronounced inflation slowdown in the second half increases.



Food prices keep rising rapidly. Food prices included in CPI continued to soar in March, although the year-on-year rate of change fell to 19.6 per cent from 20.9 per cent in February. Several major wholesalers have announced price cuts on parts of this grocery basket in April and May, which we believe will help food prices level off this spring and summer. Although there is great uncertainty, these price cuts may contribute to an easing of food inflation a bit earlier in Sweden than in the euro area.

Higher wages are triggering more service inflation. Service prices accelerated early in 2023, reflecting sharply higher costs for service companies. Falling energy and input costs will increase the likelihood of lower inflation in services as well. Slightly faster pay hikes will provide some upward pressure in 2024, but wages are expected to increase more slowly in Sweden than the average in Western Europe.

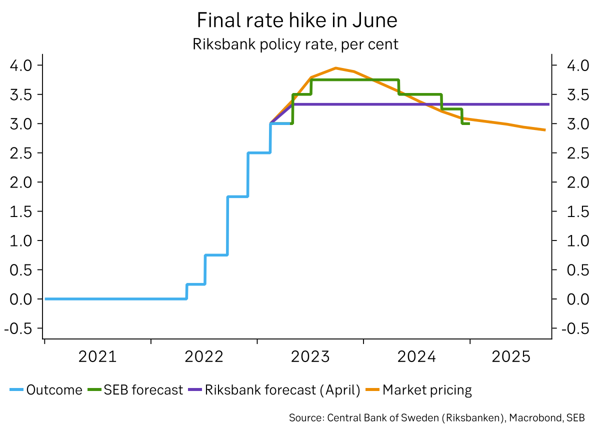


CPIF is falling faster and sooner than the core metric. CPIF has slowed a bit more than core inflation, mainly due to lower electricity prices, which are expected to keep falling slightly this spring and summer. We expect CPIF to be lower than core inflation throughout our forecast period. The difference will be greatest this year, but a possible easing of greenhouse gas reduction

requirements on fuels could widen the difference in 2024.

Key interest rates are close to peaking

As expected, the Riksbank raised its key rate by 50 basis points at the April policy meeting. Its rate path signalled 60 per cent (15 basis points) probability of another hike in June or September. We believe the key rate will be raised by 25 bps to 3.75 per cent in June and that this will be the last hike in this cycle. Although risks to core inflation in the coming months are larger on the upside, our forecast suggests a slightly larger decline in August. The Riksbank will receive new inflation statistics (for August) a week before its September rate decision. If our forecast proves correct, this outcome should reduce pressure for further hikes.

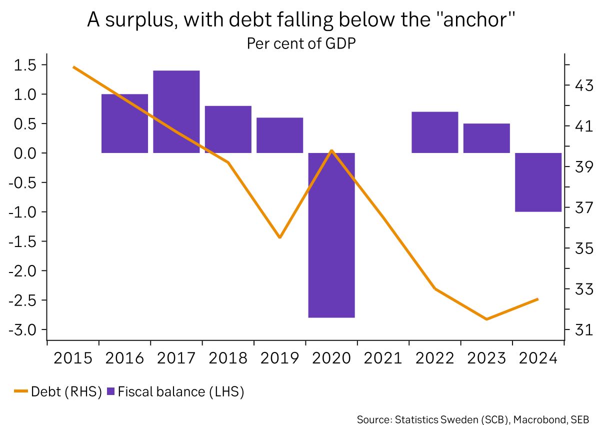


Difficult balancing act for the Riksbank. Because of continued delay in the inflation downturn, the Riksbank faces tough choices in a situation where the Swedish economy and labour market have shown resilience so far. Meanwhile there is increasing criticism of the Riksbank's strategy. More and more people are questioning the appropriateness of hiking the key interest rate during a recession, especially when inflation is largely being driven by international trends. Falling real household incomes increase the risk that rate hikes will make households and companies unable to pay their loans. Moderate collective wage agreements have greatly reduced the risks of a harmful wage-price spiral, and wage growth is likely to slow in 2025. For now, financial markets seem to have put the March banking crisis behind them, but the bankruptcies that occurred are still a reminder that historically rapid rate hikes can threaten financial stability.

SEK headaches. The weak Swedish krona is a source of concern for the Riksbank. Several Executive Board members have emphasised that government bond sales could help strengthen the krona by pushing up long-term yields and thus attracting foreign investors. We believe the Riksbank will expand bond sales at the June meeting.

No help from fiscal policymakers

The Swedish government has announced expansionary measures for 2023 totalling SEK 50-55 billion, of which around SEK 25 billion will be directed to households in the form of tax cuts and higher transfers. Overall, fiscal policy is expected to be neutral or even slightly contractive this year. The finance minister continues to emphasise the importance of not letting fiscal policy fuel high inflation, and the spring budget in April only contained reforms totaling SEK 3 billion. This is extremely cautious, given the weak economic outlook. An overly passive fiscal policy also has obvious downsides. However, our impression is that the government is prepared to provide more stimulus when inflationary pressures ease, or if growth falters. There are many indications that there will be fairly strong fiscal expansion later in the government's term of office, although the timing is somewhat uncertain. We expect tax cuts and spending increases of SEK 50-60 billion in 2024, corresponding to about 1 per cent of GDP.



Strong central government finances. Government finances have continued to show surprising strength. At least initially, high inflation has boosted tax revenues more than expenditures. In recent months, the central government budget surplus has been SEK 50 billion better than the National Debt Office's forecast. Both net lending and the budget are likely to continue showing surpluses this year. As inflation falls and economic growth slows, public finances are likely to weaken, and we expect continued deficits in 2024. We also believe that the government will be forced to borrow next year in order to restore the Riksbank's equity capital after large losses on its government bond holdings.

Norway
Sticky core inflation

Mainland GDP growth has defied expectations of a recession. Economic activity indicators still point to a slowdown ahead, though there is considerable variation across sectors. We still predict weaker growth, higher unemployment and falling home prices ahead. Inflationary pressures remain high and broad-based. Norges Bank does not directly target the krone, but higher imported inflation is one reason why CPI-ATE remains well above target, preventing a fast return to a more normal key interest rate.

The mainland economy grew by 3.8 per cent in 2022, driven by solid domestic demand. Underlying growth momentum is showing signs of weakening, but activity has undoubtedly held up better than feared and labour markets have remained strong. Economic sentiment indicators have improved, though they still signal a fall in activity ahead. There is considerable variation across sectors; strong cost inflation and high interest rates are weighing on the retail and construction sectors, while a cyclical upswing in petroleum investments is supporting parts of manufacturing. Unsustainably high consumption growth and gradually higher unemployment will result in a slowdown in economic activity starting this summer. We have nonetheless lifted our forecast for mainland GDP this year to 0.8 per cent, in line with improved global growth prospects. Sticky core inflation will keep interest rates high throughout 2024, resulting in a smaller revision of our growth forecast for next year – with mainland GDP rising by 1.3 per cent. Total GDP will be supported by petroleum investments, with growth of 1.1 and 1.5 per cent in 2023 and 2024, respectively.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	3.9	3.3	1.1	1.5
Mainland GDP	4.2	3.8	0.8	1.3
LFS unemployment*	4.4	3.3	3.5	3.7
Wages and salaries	3.5	4.4	5.4	4.2
CPI-ATE inflation	1.7	3.9	6.0	4.0
Key interest rate, %	0.50	2.75	3.50	3.00

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

Divided outlook in manufacturing

After three consecutive years of falling petroleum capital spending, a cyclical upturn is looming. It is being driven by development of new fields, supported by tax incentives and global demand for Norwegian oil and gas. Operators' nominal investment estimates were lifted significantly in Statistics Norway's Q1 survey, with a major part of the accrued investment materialising from 2024 onward. We forecast that petroleum capital spending will rise by an accumulated 11 per cent in 2023-2024. Although such investments have a high import share, they will underpin output and investments in Norwegian petroleum-related manufacturing, as evidenced by rising optimism in various sentiment surveys. Meanwhile, the outlook for manufacturers of intermediate and consumer goods is being weighed down by weak foreign demand, strong cost inflation and high interest rates. After surging in 2022, growth in business investments will slow notably in coming years. Mainland capital spending will be pressured further by lower residential investments. Order backlogs are sinking and the fall in activity will accelerate. Improved household purchasing power and easing cost inflation will support a rebound in residential investments by 0.8 per cent in 2024 after a 3.5 per cent decline this year.

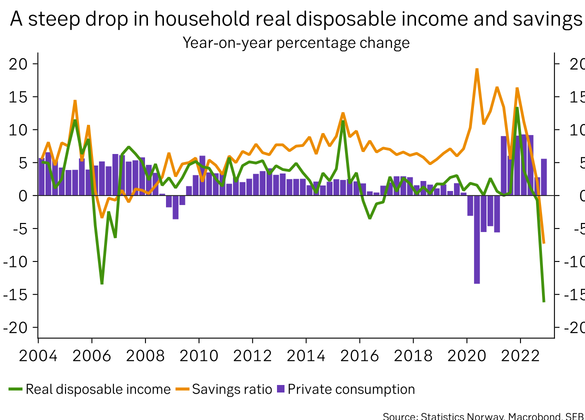
Surprising housing market resilience

Existing home prices have held up surprisingly well, given the cost-of-living shock facing households. New regulatory changes supported prices during the first half of 2022, due to supply bottlenecks. A downward correction started last autumn, when the number of existing homes for sale rebounded sharply, but a revival in demand for existing homes has stabilised prices in recent months. The slight easing in mortgage lending regulations (effective on January 1) has been supportive, but the strength in the housing market is nonetheless a bit puzzling, given the squeeze in household real disposable income and substantially rising mortgage rates. Gradually higher unemployment and further key rate hikes will push existing home prices lower starting this summer. We forecast a decline of 1.6 per cent in 2023, followed by a minor 0.3 per cent rebound in 2024.

Sharply weaker household income

Private consumption rose 6.8 per cent in 2022, driven by a further normalisation in service consumption. Households have maintained their consumption despite depressed consumer confidence, but current consumption growth is not sustainable. Spending has been upheld by a record-fast decline in savings. Real disposable household income fell 16.2 per cent in 2022.

The household savings ratio plunged to -7.7 per cent in Q4 from 2.8 per cent the previous quarter, and 16.4 per cent in Q4 2021. According to Statistics Norway, part of the decline reflects a surge in auto purchases. But excluding this, the savings ratio was still -3.3 per cent, which is the lowest measured since 1999. Though real wage growth will gradually accelerate in coming years, households are likely to build up their savings buffers. We forecast private consumption growth of 0.5 and 1.1 per cent in 2023 and 2024, respectively.

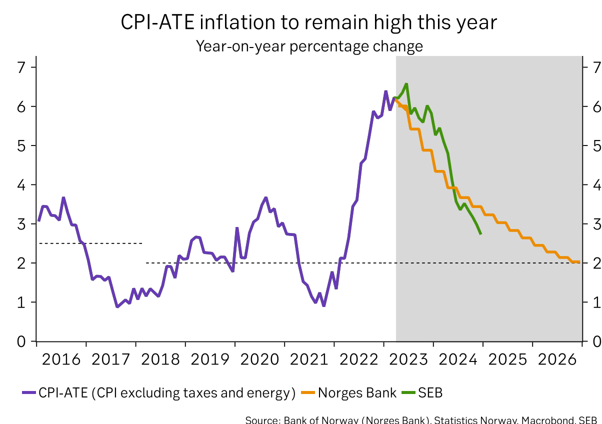


Tight labour market will support wages

The labour market has shown strength, with employment rising 3.9 per cent last year. Job vacancies reached a record high in late 2022, when there were almost two job openings per registered unemployed person. Registered unemployment has thus defied expectations of a gradual rise, staying at 1.7 per cent for eight consecutive months. But there are some early signs of a cooling, with primarily interest rate-sensitive sectors planning to reduce staff. Weaker demand will ease pressure in the labour market, resulting in gradually higher unemployment. We project a rise in the registered jobless rate to 2.4 per cent by end-2024. The tight labour market and compensation demands from last year put labour unions in a strong position in this year's wage negotiations. The unions are calling for positive real wage growth for all members, which implies nominal pay increases in excess of 5 per cent. Weaker growth prospects and falling headline inflation should slow wage growth to 4.2 per cent in 2024.

Sticky CPI-ATE partly due to weak NOK

After accelerating in 2022, CPI-ATE (CPI excluding taxes and energy) has stabilised at around 6 per cent for the past 5-6 months. Considerably more limited food price increases imply that CPI-ATE is rising more slowly than the corresponding metrics in Sweden and the euro area. Excluding food, alcohol and tobacco, the Norwegian inflation rate is just above 6 per cent, or slightly higher than in the euro area. Base effects from strong price increases early last year will prevent the inflation rate from rising further, although prices for both producer and imported consumer goods suggest that CPI-ATE will continue to rise rapidly. The substantial depreciation of the krone will also contribute to keeping inflation high during the next 6-9 months. According to our estimates, the contribution from the exchange rate will peak at around one percentage point by year-end and then gradually decrease in 2024.



Service inflation will remain high, among other things due to wages and salaries. Rents are accelerating more than in many other countries, driven by increased costs and higher interest rates. In Norway, rents account for 22 per cent in CPI-ATE, or more than twice as much as in Swedish CPI. We forecast that CPI-ATE inflation will remain at around 6 per cent this year and then slowly decline in 2024. Our trajectory implies a upside risk to Norges Bank's forecast for the coming year. Strong electricity price subsidies to households will limit the impact on CPI from big shocks in market prices. Falling electricity prices will thus only marginally lower CPI this year, which is expected to average 5.5 per cent.

Norges Bank's job not done yet

A higher inflation trajectory and surprisingly strong domestic demand justified Norges Bank's decision to re-accelerate policy tightening in March. Its rate path implies key rate hikes in both May and June, with further tightening possible after the summer. Norges Bank is sticking to 25 bps increases. It wants to move gradually to avoid tightening policy too much, which would amplify the economic downturn and increase financial stability risks. We predict that the key rate will peak at 3.50 per cent this summer. Risks are skewed to the upside due to the weak krone and higher-than-expected wage growth. However, in the event of slower economic activity, we believe that high and sticky core inflation will mainly delay the timing of rate cuts rather than lifting the terminal rate. We forecast a key rate of 3.00 per cent by end-2024.

Denmark
Remarkably robust

GDP grew by 3.8 per cent in 2022, almost 1.0 per cent more than expected. We still foresee a mild recession in 2023, with households being the dampening force, but the economy is looking remarkably robust. Home prices will remain soft posing challenges for construction. The unusually high current account surplus will go down but will remain above 10 per cent.

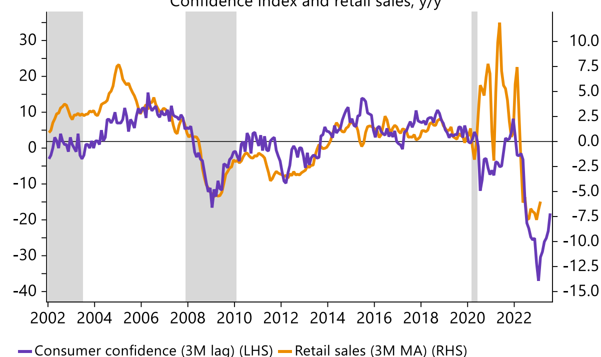
Strong GDP numbers for Q4. GDP growth was much stronger than expected in Q4, rising 0.6 per cent on a quarterly basis after a 0.1 per cent gain in Q3. We have increased our forecast for 2023 from 0 per cent to 0.5 per cent but reduced the 2024 forecast from 2.5 per cent to 2.0 per cent. The main driver for growth both in Q4 and for all of 2022 were exports and capital spending. Both private and public consumption posted significant year-on-year declines in Q4.

Key data
Year-on-year percentage change

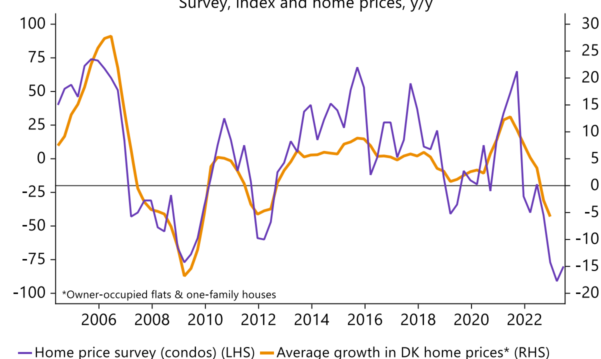
	2021	2022	2023	2024
GDP	4.9	3.8	0.5	2.0
CPI	1.9	7.7	4.8	1.8
Wages and salaries	2.3	2.5	2.9	3.4
Public sector fiscal balance*	2.6	1.5	1.5	2.0
Public sector debt*	40.0	35.0	34.0	32.0
Current account*	8.3	14.8	12.0	10.0
Key interest rate (CD rate), %	-0.60	1.75	3.25	2.60

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

Consumption is still weak. Household consumption was down 5 per cent in Q4 from a year earlier, but just 0.1 per cent lower than in the preceding quarter, so the decline in energy prices in the last part of the quarter may have had a stabilising effect. Consumer confidence bottomed out in October at a multi-decade low but has partly recovered since then, reaching its highest level since April 2022, even though it remains very low by historical standards. Unemployment is edging higher, but total employment was still hitting new all-time highs in early 2023. We expect unemployment to peak at 5.4 per cent at the end of 2023. Wage pressures have been suppressed compared to the strength of the labour market, but the acceleration we have seen since the beginning of 2022 is likely to pause in 2023. The main challenges for consumption in the coming quarters are the continued decline in real wages and signs of a sharp tightening of credit conditions, which we expect to continue pushing house prices lower and holding consumption back.

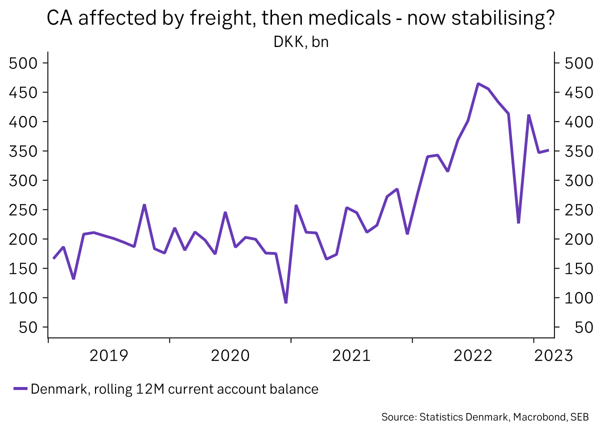


Housing market still soft. The housing market remains a weak spot, with prices likely to correct by at least 20 per cent from top to bottom – the largest decline ever except for the 2008-09 crisis. Thirty-year fixed rate mortgage rates have fallen, but short adjustable-rate loan costs are still rising, putting pressure on both home prices and construction activity. Nonetheless, housing investments posted 7.8 per cent growth in 2022. Home prices are likely to remain soft and construction activity challenged during the coming months.



Ballooning current account surplus. Exports posted growth of 8.6 per cent in 2022. Interestingly, the driver has changed over the course of the year. At the start of

2022, the main driver was service exports, reflecting Mærsk's container freight windfall gain. As container freight rates normalised, that contribution declined, but a new driver has emerged in the shape of Novo Nordisk's successful new obesity products. However, goods exports appeared to have broader support than just Novo Nordisk, taking the current account surplus to close to 14.8 per cent of GDP at the end of 2022. The first months of 2023 have seen less volatile movements, but we expect the medical sector in particular to keep the current account surplus at above 10 per cent of GDP.



Key interest rate spread is capping DKK. In light of the unprecedented current account surplus, it is perhaps understandable that Danmarks Nationalbank (DNB) has been forced to fend off some appreciation pressure in foreign exchange markets. The key rate spread to the European Central Bank (ECB) was widened by 15 basis points on two occasions in Q4, and this finally appears to have done the trick, taking the DKK/EUR exchange rate to neutral territory at around 7.45 and removing the need for FX intervention. However, if the current account surplus remains elevated, there could be more chronic upward pressure on the Danish krone.

Finland
Muddling through

The Finnish economy slid into recession late in 2022, with GDP falling by 0.4 per cent on an annual basis. The downturn will continue during the first half of 2023, but due to a rebound during the second half, full-year economic output will remain close at the previous year's level. The recovery will nevertheless be sluggish, and in 2024 the economy will expand by a meagre 1.2 per cent.

A slight improvement in sentiment. After plunging in 2022, this year economic sentiment has improved somewhat. The upturn derives from increased consumer confidence, which also seems to have benefited business sentiment in services and retail trade. So far, retail sales have continued to decrease at a steady 3 per cent pace, but a strong labour market and recovering sentiment may improve this. A significant increase in debt servicing costs has hampered consumption. Household debt as a share of disposable income stands roughly at 140 per cent. This is high, but less than in other Nordic countries. We expect private consumption to decline by a marginal 0.2 per cent this year, rebounding to 1.3 per cent in 2024.

Less optimism in construction. A decline in real estate prices started in late 2022. As of February 2023, existing home prices were down by 5 per cent from one year earlier. The share of households planning to buy a home has fallen to the lowest level since 2016, and new housing loans have fallen to a level last seen in 2003.

Key data

Year-on-year percentage change

	2021	2022	2023	2024
GDP	3.0	2.1	-0.1	1.2
Private consumption	3.6	2.1	-0.2	1.3
Exports	6.0	1.7	1.0	2.5
Unemployment*	7.6	6.8	7.1	6.9
Wages and salaries	2.3	2.4	4.2	3.5
HICP inflation	2.1	7.2	5.0	2.0
Public sector fiscal balance**	-2.7	-0.8	-2.2	-1.5

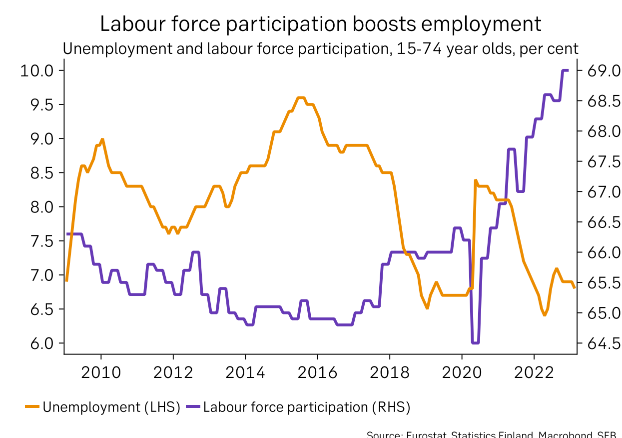
*% of labour force **% of GDP. Source: Eurostat, SEB

The number of housing starts as well as building permits has dropped by a third and will remain low for some time, but home prices may not have much more room to fall as a strong labour market lifts sentiment.

Exports holding up. Finnish export-dependent industry has historically been slow to react to changes in global demand. For now, this has benefited trade as well as production levels, which have held up surprisingly well. Slowly resurging demand will help to sustain this edge. In 2023, exports will grow by 1.0 per cent.

Inflation to come down. After peaking in November, headline inflation has been trending downward, but core inflation has continued to rise and stood at 5.1 per cent in March. Lower energy prices and base effects will further ease inflation. HICP will climb by 5 per cent in 2023. In 2024 we expect consumer prices to increase by 2.0 per cent.

Solid labour market. As in many countries, the labour market has outperformed expectations. The number of people with jobs exceeded the pre-COVID level by 120,000 in Q4 2022. While the unemployment rate has remained almost unchanged, these gains have been made possible by a large increase in labour market participation. After the recent collective bargaining round, the increase in wages and salaries will be the highest for years. Due to the economic slowdown, unemployment will nevertheless inch marginally higher.



Voters drift to thrift. On both sides of the Gulf of Finland, new governments will focus on containing budget deficits. Contrary to neighbouring Estonia, the need for increased fiscal discipline was already on the agenda before the election results came in, which means that the Finns opted for public sector frugality. The new government will be led by the centre-right National Coalition Party. In 2023 the budget deficit will still exceed 2 per cent of GDP.

The Baltics

Lithuania | page 47

Weaker merchandise exports are holding back growth, and the economy is stagnant in 2023. The labour market and wages have surprised on the upside. The fiscal impulse will be positive in 2023. So far, home prices are resilient.

Estonia | page 49

The recovery after last year's recession is being held back by weak exports. GDP is continuing to fall. Despite lower energy prices, inflation is stubbornly high. Not until 2024 will growth return, with a broad recovery to GDP growth of 2.5 per cent.

Latvia | page 48

Despite easing inflation and a stabilisation in the energy market, weak growth will dominate 2023. A stable labour market will protect the economy from a deeper decline. GDP is expected to grow by 0.4 per cent this year and 2.7 per cent in 2024.

Lithuania
Weak merchandise exports weigh on GDP growth

Weaker exports of goods are holding back economic growth. Stagnant household consumption is a bit surprising, since the labour market remains resilient and real wages are improving. Lower-than-feared energy prices have calmed businesses and consumers. Headline inflation is expected to be in single digits as early as this summer. Despite sharply higher interest rates, residential property prices have so far avoided a correction. The fiscal impulse will be positive in 2023.

The Lithuanian economy is poised to stagnate in 2023. Weaker merchandise exports in Q1 2023 were the main factor behind another quarterly decline in GDP. External demand for goods is hardly likely to recover strongly over the next few quarters. We assume that if inflation decelerates further, household consumption will start contributing to economic growth in the second half of 2023. Increased absorption of EU funds will have a marked impact on the economy this year. We expect a GDP decline of 0.2 per cent in 2023. We also lowered our 2024 projection from 3.5 to 2.7 per cent.

Labour market is showing resilience. The creation of new jobs slowed early in 2023 but lay-offs remained little changed. Surveys confirm that the share of companies complaining about difficulties in finding employees decreased. We are sticking to our projection that unemployment will rise from 5.9 to 6.9 per cent in 2023.

Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	6.0	1.9	-0.2	2.7
Household consumption	8.1	0.5	0.0	3.0
Exports	17.0	11.9	-0.3	4.3
Unemployment*	7.1	5.9	6.9	6.8
Wages and salaries	10.5	13.4	10.7	8.2
HICP inflation	4.6	18.9	9.0	2.6
Public sector fiscal balance**	-1.2	-0.6	-2.4	-1.6

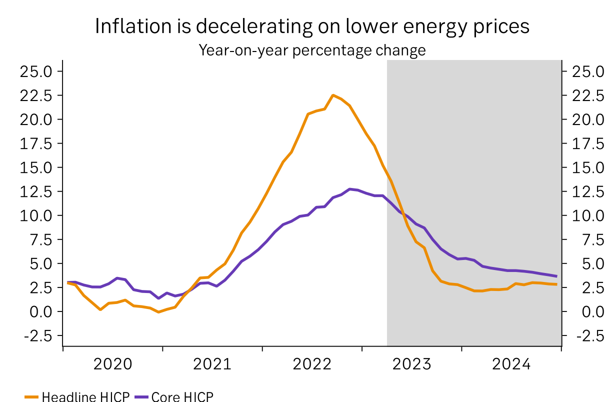
*% of labour force **% of GDP. Source: Eurostat, SEB

Wage growth surprises. Wage and salary growth was well above our expectations in the first months of 2023, indicating that employees have managed to obtain significant pay hikes despite a more conservative attitude about the short-term economic outlook by employers. The 15 per cent increase in the minimum monthly wage also had a positive impact on average pay increases. Such rapid growth in labour costs is not sustainable and will reduce Lithuania's competitiveness in the longer term. We have raised our average wage growth forecast from 9 to 10.7 per cent in 2023.

Consumer confidence is recovering. Household consumption in the first quarter was better than feared due to smaller-than-expected energy prices, a stable labour market, strong growth in nominal wages and reduced anxiety over the war in Ukraine. Higher interest rates have had a limited impact on private consumption so far. Although most loans to households have variable interest rates, the overall indebtedness of Lithuanian households is very low. After a stagnation in household consumption this year, we project a recovery in 2024 as inflation eases. Nevertheless, we have raised our inflation forecast for 2024 due to higher core inflation as labour costs grow faster than previously assumed.

Inflation is decelerating on lower energy prices

Year-on-year percentage change



Source: Macrobond, SEB

Housing prices remain stable. Although activity in the residential property market was 20 per cent weaker early in 2023, prices remained almost unchanged. It appears that strong growth in disposable income is helping to offset the negative impact of higher interest rates. However, we are sticking to our forecast that housing prices will drop by around 5 per cent in 2023.

Easy to propose, difficult to approve. The Ministry of Finance has unveiled a long-awaited tax reform. Higher taxes for self-employed persons and broader property taxation are key proposals. However, the governing coalition is weak in Parliament, and it will be a challenge to find the votes that are needed to approve the reform.

Latvia
Moving sideways

Despite easing inflation and stabilisation in the energy market, weak growth will dominate 2023. The probability of a brief recession is still on the table. Lower energy prices will drive inflation downward, and purchasing power will start recovering in the second half. A stable labour market will protect the economy from a deeper decline. We are sticking to our previous forecasts that GDP will grow by 0.4 per cent in 2023 and 2.7 per cent in 2024.

With the help of lavish government support, public efforts and some luck, Latvia avoided serious shocks and grew by 0.3 per cent year-on-year in the fourth quarter and by 2 per cent in 2022. Despite a less gloomy outlook, growth will move sideways in 2023 before rebounding in 2024. A strong labour market, improved capital spending and better purchasing power will outweigh negative effects.

Broad-based recovery over the past six months. Economic sentiment improved in March, and for the first time since November 2020 it was higher than the EU average. Retail confidence reached the highest level since July 2021 and in services it was positive for the fifth month in a row. Sentiment in manufacturing and construction remained negative but continued to improve. Partly due to pandemic effects, consumption kept rising in early 2023. Retail sales rose by 2.4 per cent in February, but growth may temporarily turn negative.

Key data

Year-on-year percentage change

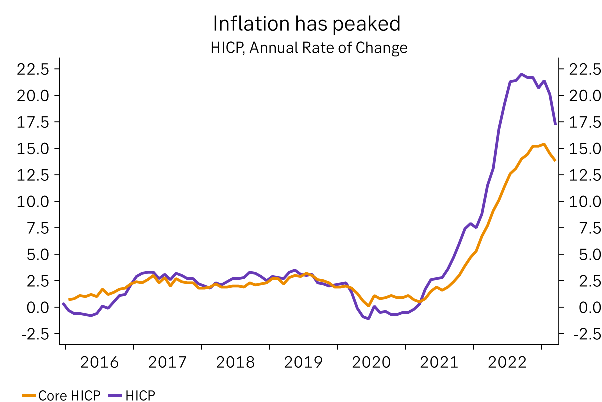
	2021	2022	2023	2024
GDP	4.1	2.0	0.4	2.7
Household consumption	8.5	8.1	1.0	3.6
Exports	5.9	9.1	0.5	3.7
Unemployment*	7.6	6.9	7.1	6.6
Wages and salaries	11.8	7.5	8.5	8.1
HICP inflation	3.3	17.3	9.0	2.9
Public sector fiscal balance**	-7.0	-5.2	-3.2	-2.2

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

Negative impact of sanctions on Russia will intensify. Sanctions proved to have a relatively insignificant effect last year. For example, exports to Russia decreased just by 0.4 per cent. Due to a weaker international environment and falling prices, goods exports will sputter. In February, growth in such exports slowed to 3 per cent. Meanwhile service exports will continue to surge, largely offsetting weaker goods exports. Industrial production fell by 4.5 per cent in the first two months of 2023, as output declined in two out of the top three manufacturing sectors – wood and metal products – reflecting weaker construction demand. We expect construction to begin a marginal revival in the second half due to larger EU fund inflows.

Inflation has peaked

HICP, Annual Rate of Change



Source: Eurostat, Macrobond, SEB

Short-lived rise in unemployment. The unemployment rate ticked up by 0.1 percentage point to 7 per cent in February. We expect a further marginal increase, before it starts turning lower again and reaches just above 6.5 per cent in 2024. The tight labour market will keep wage growth at above 8 per cent for the next two years, largely due to minimum wage increases.

Single-digit inflation coming soon. The inflation rate fell to 17.3 per cent in March and will reach single-digit levels by June. Lower energy prices will lay the groundwork for faster decreases in inflation, but the energy price outlook remains uncertain. This is limiting the potential for declines in prices of goods and services. Food prices will be the main source of household stress for some time. We expect 9 per cent inflation this year and 2.9 per cent in 2024.

Housing market improving. In March activity reappeared in the housing segment, especially in Riga and the adjacent Pieriga region. Potential buyers have been more flexible, whereas sellers are still hesitant to change prices – extending the time that properties are in the market. Prices of existing homes may face further downward corrections, but no sharp ups or downs are expected this year.

Estonia
An invisible recession

Rapid erosion of purchasing power due to high inflation pushed the economy into a 1.3 per cent downturn in 2022. This year, weak exports will hold back the recovery process and GDP will decline by a further 0.4 per cent. The economy will return to an upward path in 2024, when a broad-based recovery will boost GDP growth to 2.5 per cent.

An Invisible recession. GDP have continued to surprise on the negative side, indicating that the economy entered a recession as early as Q2 2022. In Q4, real GDP dropped by more than 4 per cent year-on-year. However, this reflects the rapid increase in prices more than any severe deterioration in the business environment. Everday life is better described by nominal GDP growth, which amounted to 12 per cent in Q4 2022. Preliminary GDP figures in Estonia have historically underestimated economic growth; thus it remains likely that the figures for 2022 could be revised higher later on.

Inflation will be high. A wide gap between nominal and real GDP figures describes the reality of continuing high inflation. Despite lower energy prices, inflation has remained stubbornly high as sellers find it easy to pass on cost increases to buyers. Yet due to base effects, inflation is starting to ease. Annual inflation will average at 9 per cent in 2023. Planned tax increases will drive inflation higher than previously anticipated in 2024, when we expect HICP to increase by 4 per cent.

Key data
Year-on-year percentage change

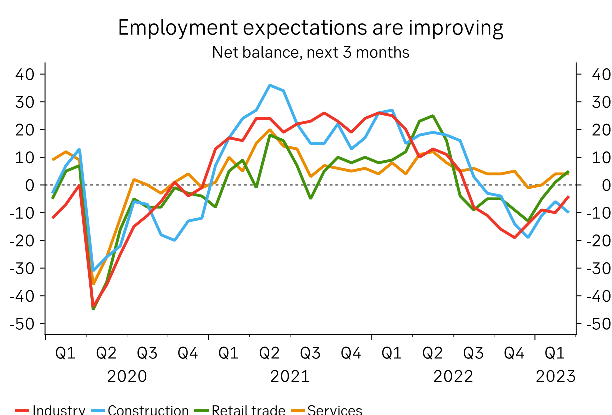
	2021	2022	2023	2024
GDP	8.0	-1.3	-0.4	2.5
Private consumption	6.3	2.2	-0.1	1.5
Exports	19.9	5.0	-2.8	2.5
Unemployment*	6.2	5.5	6.9	6.5
Wages and salaries	6.9	8.8	9.5	6.5
HICP inflation	4.5	19.4	9.0	4.0
Public sector fiscal balance**	-2.3	-1.0	-3.2	-3.0

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

The new government is focused on improving public finances. Parliamentary elections in early March resulted in an overwhelming victory for centrist parties. The new three-party governing coalition is set on improving the state of public finances by raising VAT as well as corporate and personal income tax by 2 per cent. The government also wants to introduce a car tax, a novelty in Estonia. These changes will slow the recovery in household consumption but help to narrow the widening gap between tax revenues and budget expenditures.

Will manufacturing brake or bend? Not much has changed in the manufacturing sector, which has taken a serious hit due to the malaise in the Swedish real estate market. Large buffers from previous years have helped companies to cope with low demand, but some lay-offs seem unavoidable. We don't expect demand to recover for some time, resulting in a 2.8 per cent decline in exports this year, followed by a meagre upturn of 2.5 per cent in 2024.

Households are consuming less. High inflation and low consumer sentiment have finally affected retail sales. However, the initial causes of the decline have been improving; consumer sentiment is better than a couple of months ago and inflation is also easing. We expect household consumption to decline by 0.1 per cent in 2023 and grow by 2.5 per cent in 2024.



The labour market continues to deliver positive surprises. The employment rate reached its highest-ever level in Q4 2022. Recent data indicate that employment growth has continued this year. According to business surveys, employment expectations have also improved in all sectors, but in the manufacturing sector, some lay-offs still seem imminent. Since Ukrainian refugees will now also be included in the Labour Force Survey sample, unemployment will increase to 6.9 per cent in 2023.

Global key indicators

Yearly change in per cent

	2021	2022	2023	2024
GDP OECD	5.7	3.0	0.9	1.4
GDP world (PPP)	6.3	3.3	2.5	2.9
CPI OECD	4.0	9.6	6.4	2.6
Oil price. Brent (USD/barrel)	71	99	99	100

US

Yearly change in per cent

	2021 level. USD bn	2021	2022	2023	2024
Gross domestic product	25,463	5.9	2.1	0.7	0.9
Private consumption	17,357	8.3	2.7	1.2	0.8
Public consumption	3,591	1.3	-0.3	1.7	0.3
Gross fixed investment	5,331	5.6	0.4	-1.7	1.2
Stock building (change as % of GDP)	158.9	0.2	0.7	-0.7	0.0
Exports	2,976	6.1	7.1	2.8	2.3
Imports	3,951	14.1	8.1	-2.4	1.5
Unemployment (%)		5.4	3.6	3.8	4.6
Consumer prices		4.7	8.0	3.9	2.3
Core CPI		3.6	6.2	4.8	2.5
Public sector financial balance. % of GDP		-11.6	-5.5	-6.0	-5.5
Public sector debt. % of GDP		126	122	124	126

Euro area

Yearly change in per cent

	2021 level. EUR bn	2021	2022	2023	2024
Gross domestic product	12,318	5.3	3.5	0.6	1.6
Private consumption	6,284	3.7	4.3	-0.1	1.2
Public consumption	2,718	4.3	1.1	1.2	1.7
Gross fixed investment	2,711	3.8	3.8	0.4	1.8
Stock building (change as % of GDP)		0.3	0.3	0.2	0.3
Exports	6,073	10.6	7.2	3.5	4.0
Imports	5,595	8.4	8.0	3.4	3.7
Unemployment (%)		7.7	6.7	7.0	7.8
Consumer prices		2.6	8.4	5.4	1.5
Core CPI		1.5	3.9	5.3	2.8
Public sector financial balance. % of GDP		-5.1	-3.9	-3.3	-2.5
Public sector debt. % of GDP		95.4	92.0	91.0	90.0

Other large countries

Yearly change in per cent

	2021	2022	2023	2024
GDP				
United Kingdom	7.6	4.1	-0.3	0.7
Japan	2.1	1.1	1.5	1.2
Germany	2.6	1.8	0.2	1.7
France	6.8	2.6	0.6	1.5
China	8.1	3.0	5.9	4.9
India	8.9	6.7	5.3	6.5
Brazil	4.8	2.9	1.1	1.6
Russia	4.7	-2.1	-2.0	1.7
Poland	5.7	1.0	3.0	3.4
Inflation				
United Kingdom	2.6	9.1	7.0	2.4
Japan	-0.2	2.5	3.3	2.2
Germany	3.2	8.7	5.8	2.0
France	2.1	5.9	5.4	1.4
China	0.9	2.0	2.8	2.4
India	5.1	6.7	5.3	4.5
Brazil	8.3	9.3	5.5	4.3
Russia	6.7	13.8	5.0	4.1
Poland	5.1	14.3	6.4	3.7
Unemployment (%)				
United Kingdom	4.5	3.7	4.3	4.8
Japan	2.8	2.6	2.5	2.4
Germany	3.6	3.1	3.2	3.9
France	7.9	7.3	7.3	7.9

Financial forecasts

Official interest rates	27-Apr	Jun-23	Dec-23	Jun-24	Dec-24
US	5.00	5.25	4.75	3.75	3.00
Japan	-0.10	-0.10	0.30	0.30	0.30
Euro area. deposit rate	3.00	3.50	3.75	3.50	3.00
United Kingdom	4.25	4.50	4.50	4.00	3.75
Bond yields. 10 year					
US	3.53	3.50	3.30	3.10	2.90
Japan	0.46	0.25	0.25	0.25	0.25
Germany	2.45	2.45	2.35	2.20	2.00
United Kingdom	3.78	3.75	3.55	3.30	3.10
Exchange rates					
USD/JPY	134	131	124	122	120
EUR/USD	1.10	1.11	1.12	1.15	1.17
EUR/JPY	148	145	139	140	140
EUR/GBP	0.88	0.87	0.89	0.92	0.93
GBP/USD	1.25	1.28	1.26	1.25	1.26

Sweden

Yearly change in per cent

	2021 level. SEK bn	2021	2022	2023	2024
Gross domestic product	5,926	5.4	2.6	-1.0	0.6
Gross domestic product. working day adjustment		5.3	2.7	-0.8	0.6
Private consumption	2,629	6.3	2.1	-2.3	1.4
Public consumption	1,486	2.8	0.0	0.4	-0.2
Gross fixed investment	1,590	6.0	5.2	-3.1	-3.0
Stock building (change as % of GDP)	78	0.4	1.0	-0.6	0.0
Exports	3,116	10.0	6.6	-0.9	3.5
Imports	2,973	9.6	6.9	-4.3	2.6
Unemployment. (%)		8.8	7.5	7.8	8.6
Employment		0.9	2.8	0.9	-0.6
CPI		2.2	8.4	8.7	3.4
CPIF		2.4	7.7	6.3	2.6
Hourly wage increases		2.6	2.7	4.1	3.9
Household savings ratio (%)		15.9	13.3	12.6	12.7
Real disposable income		4.2	-0.1	-3.9	1.8
Current account. % of GDP		6.5	4.3	6.0	6.5
Central government borrowing. SEK bn		-78	-164	-15	80
Public sector financial balance. % of GDP		0.0	0.7	0.5	-1.0
Public sector debt. % of GDP		36.6	33.1	31.1	32.1

Financial forecasts	27-Apr	Jun-23	Dec-23	Jun-24	Dec-24
Policy rate	3.50	3.75	3.75	3.50	3.00
3-month interest rate. STIBOR	3.55	3.70	3.70	3.35	2.85
10-year bond yield	2.37	2.50	2.60	2.50	2.30
10-year spread to Germany. bps	-0.08	0.05	0.25	0.30	0.30
USD/SEK	10.31	10.09	9.69	9.30	8.97
EUR/SEK	11.36	11.20	10.85	10.70	10.50
KIX	125.6	124.1	120.2	117.9	115.6

Finland

Yearly change in per cent

	2021 level. EUR bn	2021	2022	2023	2024
Gross domestic product	252	3.0	2.1	-0.1	1.2
Private consumption	128	3.6	2.1	-0.2	1.3
Public consumption	62	3.9	2.9	0.8	1.0
Gross fixed investment	60	0.9	5.0	-1.0	1.8
Stock building (change as % of GDP)	1	0.5	2.6	0.4	0.1
Exports	99	6.0	1.7	1.0	2.5
Imports	99	6.0	7.5	-2.5	2.0
Unemployment. OECD harmonised (%)		7.6	6.8	7.1	6.9
CPI. harmonised		2.1	7.2	5.0	2.0
Hourly wage increases		2.3	2.4	4.2	3.5
Current account. % of GDP		0.7	-3.7	0.5	-0.2
Public sector financial balance. % of GDP		-2.7	-0.8	-2.2	-1.5
Public sector debt. % of GDP		72.4	73.0	72.0	72.5

Norway

Yearly change in per cent

	2021 level. NOK bn	2021	2022	2023	2024
Gross domestic product	3,597	3.9	3.3	1.1	1.5
Gross domestic product (Mainland)	3,195	4.2	3.8	0.8	1.3
Private consumption	1,571	4.4	6.8	0.5	1.1
Public consumption	950	5.0	0.1	1.3	1.9
Gross fixed investment	942	-0.8	4.4	1.5	1.7
Stock building (change as % of GDP)		-0.3	0.1	0.0	0.0
Exports	1,180	5.8	5.9	4.4	2.8
Imports	1,167	1.7	9.3	3.2	2.4
Unemployment (%)		4.4	3.3	3.5	3.7
CPI		3.5	5.8	5.5	3.4
CPI-ATE		1.7	3.9	6.0	4.0
Annual wage increases		3.5	4.4	5.4	4.2

Financial forecasts	27-Apr	Jun-23	Dec-23	Jun-24	Dec-24
Deposit rate	3.00	3.50	3.50	3.50	3.00
10-year bond yield	3.17	3.15	2.95	2.80	2.60
10-year spread to Germany. bps	72	70	60	60	60
USD/NOK	10.65	10.45	10.09	9.48	8.97
EUR/NOK	11.73	11.60	11.30	10.90	10.50

Denmark

Yearly change in per cent

	2021 level. DKK bn	2021	2022	2023	2024
Gross domestic product	2,504	4.9	3.8	0.5	2.0
Private consumption	1,106	4.3	-2.3	-0.3	2.6
Public consumption	608	4.2	-3.4	-0.9	0.8
Gross fixed investment	566	6.5	8.6	4.9	6.0
Stock building (change as % of GDP)		0.0	0.9	0.0	0.0
Exports	1,494	8.1	8.6	0.8	2.3
Imports	1,315	8.2	4.3	1.6	3.8
Unemployment. OECD harmonised (%)		4.6	4.8	5.4	4.8
CPI. harmonised		1.9	7.7	4.8	1.8
Hourly wage increases		2.3	2.5	2.9	3.4
Current account. % of GDP		8.3	14.8	12.0	10.0
Public sector financial balance. % of GDP		2.6	1.5	1.5	2.0
Public sector debt. % of GDP		40.0	35.0	34.0	32.0

Financial forecasts	27-Apr	Dec-22	Jun-23	Dec-23	Jun-24	Dec-24
Deposit rate	2.60	1.60	3.10	3.35	3.10	2.60
10-year bond yield	2.74	2.70	2.70	2.60	2.45	2.25
10-year spread to Germany. bps	29	25	25	25	25	25
USD/DKK	6.77	6.71	6.71	6.65	6.48	6.37
EUR/DKK	7.45	7.45	7.45	7.45	7.45	7.45

Lithuania

Yearly change in per cent

	2021 level. EUR bn	2021	2022	2023	2024
Gross domestic product	56	6.0	1.9	-0.2	2.7
Private consumption	33	8.1	0.5	0.0	3.0
Public consumption	10	0.9	0.5	0.5	0.0
Gross fixed investment	12	7.8	2.6	3.5	5.0
Exports	45	17.0	11.9	-0.3	4.3
Imports	43	19.9	12.3	1.4	4.9
Unemployment (%)		7.1	5.9	6.9	6.8
Wages and salaries		10.5	13.4	10.7	8.2
Consumer prices		4.6	18.9	9.0	2.6
Public sector financial balance. % of GDP		-1.2	-0.6	-2.4	-1.6
Public sector debt. % of GDP		43.7	38.4	38.4	38.0

Latvia

Yearly change in per cent

	2021 level. EUR bn	2021	2022	2023	2024
Gross domestic product	32.9	4.1	2.8	0.4	2.7
Private consumption	18.0	8.5	8.1	1.0	3.6
Public consumption	6.6	4.4	2.8	0.9	2.2
Gross fixed investment	7.8	2.9	0.7	1.3	3.9
Exports	21.0	5.9	9.1	0.5	3.7
Imports	21.7	13.5	11.6	-3.5	4.0
Unemployment (%)		7.6	6.9	7.1	6.6
Wages and salaries		11.8	7.5	8.5	8.1
Consumer prices		3.3	17.3	9.0	2.9
Public sector financial balance. % of GDP		-7.0	-4.4	-3.2	-2.2
Public sector debt. % of GDP		43.6	40.8	40.0	39.6

Estonia

Yearly change in per cent

	2021 level. EUR bn	2021	2022	2023	2024
Gross domestic product	31	8.0	-1.3	-0.4	2.5
Private consumption	15	6.3	2.2	-0.1	1.5
Public consumption	6	4.0	-0.3	3.0	1.5
Gross fixed investment	9	2.8	-10.9	-1.5	3.0
Exports	25	19.9	5.0	-2.8	2.5
Imports	25	21.0	5.8	-4.0	2.0
Unemployment (%)		6.2	5.5	6.9	6.5
Wages and salaries		6.9	8.8	9.5	6.5
Consumer prices		4.5	19.4	9.0	2.0
Public sector financial balance. % of GDP		-2.3	-1.0	-3.2	-3.0
Public sector debt. % of GDP		17.6	18.4	19.5	22.0

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