# Nordic Outlook

August 2024

Race between lower interest rates and recession risks

Research reports

SEB

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## August 2024


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# A race between interest rate cuts and recession risks

It has been a dramatic summer, largely dominated by political turbulence, nervous financial markets and global uncertainty. The assassination attempt on Donald Trump and the switch from Joe Biden to Kamala Harris as the Democratic presidential candidate have redrawn the map ahead of this autumn's US elections. Suddenly the candidates are neck and neck again in voter polls, and it is just as difficult to know who will win as to say anything certain about what policies will be pursued once a new president is inaugurated. What we do know is that today's campaign rhetoric is highly polarised, the risk of a global trade war is real – especially if Trump wins – and neither candidate seems especially interested in doing anything about America's unsustainably large budget deficits.

As for geopolitics, both the Ukraine war and the Middle East conflict took new turns, as Ukrainian troops began to conquer territory inside Russia and Iran vowed revenge against Israel after the killing of Hezbollah and Hamas leaders in Lebanon and Iran, respectively. Hezbollah recently attacked Israel and the world is now waiting also for Iran's retaliation, something that may both influence and be influenced by the ongoing negotiations between Israel and Hamas.

Economically and financially, the summer looked good for a long time. Continued inflation downturns paved the way for interest rate cuts, and optimistic stock markets reached new all-time highs well into July. But in late July and early August, markets were significantly shaken up. An unfortunate combination of weaker US economic signals, a Japanese interest rate hike, geopolitical turmoil and declining confidence in AI-related tech stocks sent chills through the stock market. Japan's Nikkei index fell by over 12 per cent in one day, and stock markets around the world were dragged along in the decline. With a few weeks' hindsight, these market reactions can be viewed as exaggerated. They reinforced the market's reputation as something of a "drama queen", and most of the losses have been recovered. But the incident is a reminder that we live in uncertain times and that things can move quickly.

Looking ahead, however, we can be somewhat optimistic. The interest rate cuts delivered by Sweden's Riksbank and the European Central Bank, among others, will continue this autumn. Importantly, the US Federal Reserve will soon follow. Because of rate cuts, lower inflation, rising real wages and the absence of major imbalances, a US recession can be avoided after all. This will benefit both the US and the global economy. But it will be an uncertain and intense autumn, with several key issues to keep an eye on:

– How fast will the US economy slow down?
– Who will win the US presidential election, and will the outcome be accepted?
– What will happen to Europe as the German economy sputters, French politics are reshaped, and the European Union is squeezed between the US and China?
– In what direction are ongoing geopolitical conflicts moving? Towards ceasefire? Or escalation?

These are big and important issues that we look forward to continuing to monitor and discuss with you.

This August 2024 issue of *Nordic Outlook* also includes in-depth themes that address the following topics:

- The US elections
- The US deficit
- China's overcapacity
- Swedish fiscal policy

We wish you pleasant reading!

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# The global economy

### The United States | page 18

Growth is slowing, but the US will avoid a hard landing. Inflation and pay hikes are decelerating, opening the way for a Fed key rate cut in September. This autumn's presidential election will create political uncertainty in America and the world.

### The euro area | page 33

GDP has resumed growth, albeit at a moderate pace. Due to a robust labour market, lower inflation and continued ECB rate cuts – the next one in September – domestic demand will accelerate.

### China | page 25

Policymakers are struggling to lift growth and to enact reforms. Confidence in the economy is fragile and the property sector has not bottomed out. Trade relations with the US remain in focus. Growth will reach 5 per cent this year and slow in 2025–2026.

### The United Kingdom | page 36

Economic challenges remain, with a tight labour market driving up wages and service prices. The new Labour government's fiscal policy faces major constraints, forcing the Bank of England to assume the main responsibility for propping up the economy.

# International overview
# **Faster rate cuts will help support economic growth**

**After a late-summer bout of stock market turbulence, falling interest rates and a weaker dollar, markets have calmed down and adapted to US economic deceleration and expected Fed rate cuts. The fight against inflation has been successful, and central banks are on the way to taking clearer steps towards interest rate normalisation. The Fed will start its rate cutting cycle in September with at least a 25-basis point reduction. Growth gaps are narrowing as the United States and China slow down and the euro area accelerates at a moderate pace. Continued resilient labour markets, rising real wages and lower interest rates will drive growth.**

**This summer has been politically and financially, but not economically, dramatic**. The war situation in the Middle East and Ukraine remains very serious, and the US election playing field has shifted radically. Global financial markets – stock exchanges and fixed income markets – hyperventilated in early August when sudden concerns about a US recession coincided with Japan's 0.15 per cent rate hike and increased doubts about the profitability of the US tech and AI sector. The VIX (S&P 500) volatility index rose to 66, its third highest ever, but then quickly fell back.

**We believe the growth picture** has not changed very much since May's *Nordic Outlook*, despite historically high real interest rates. In most cases the fight against inflation has been a success. The US will now launch its interest rate cutting cycle, which will reduce tensions in the central banking world and help support economic growth during 2025–2026.

**Although economic activity is largely following our forecast,** several factors are contributing to high unpredictability. The security policy situation may deteriorate further – with contagion risks – in a way that will lower growth and raise prices. This poses new dilemmas for central banks, with potentially major negative effects on stock markets, among others. The outcome of this autumn's US presidential election will also play a key role in global developments. Meanwhile, sluggish growth is squeezing China in a situation where the European Union, the US and others are increasingly using trade and industrial policy to reduce their heavy dependence on China. Where AI is headed, and at what pace, will determine stock valuations, growth and labour markets – both cyclically and structurally.

**The security policy situation remains serious** and has deteriorated this summer. At this writing, the world is waiting for Iran's counterattack against Israel, which could severely worsen the Middle East situation. How Kyiv's offensive into Russia may affect the outcome of the Ukraine war remains to be seen. Freight prices have risen due to the Middle East situation. But climate effects are also playing a role, for example in the Panama Canal, which is important to global trade. The price of natural gas also includes risk premiums. But global economic activity and inflation have so far been resilient to these developments.

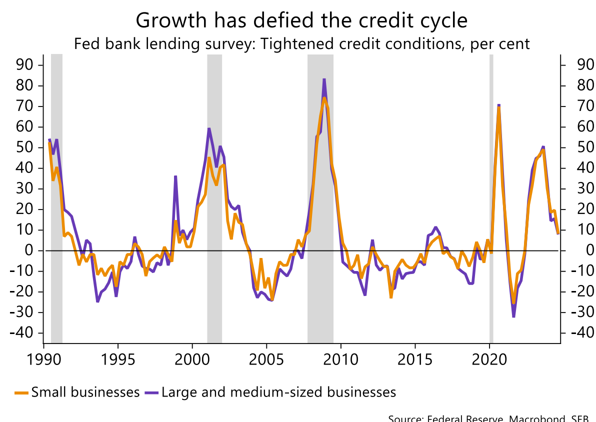
**Global GDP growth**
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| United States | 2.5 | 2.5 | 1.5 | 1.8 |
| Japan | 1.7 | 0.4 | 1.0 | 1.1 |
| Germany | -0.3 | 0.1 | 1.1 | 1.0 |
| China | 5.2 | 5.0 | 4.5 | 4.3 |
| United Kingdom | 0.1 | 1.1 | 1.1 | 1.5 |
| Euro area | 0.4 | 0.8 | 1.6 | 1.5 |
| Nordic countries | 0.4 | 0.9 | 2.5 | 2.6 |
| Sweden | -0.2 | 0.6 | 2.6 | 2.9 |
| Baltic countries | -0.9 | 1.3 | 2.5 | 2.7 |
| OECD | 1.6 | 1.7 | 1.8 | 1.7 |
| Emerging markets | 4.5 | 4.2 | 4.2 | 4.2 |
| **World, PPP** | **3.2** | **3.1** | **3.2** | **3.1** |

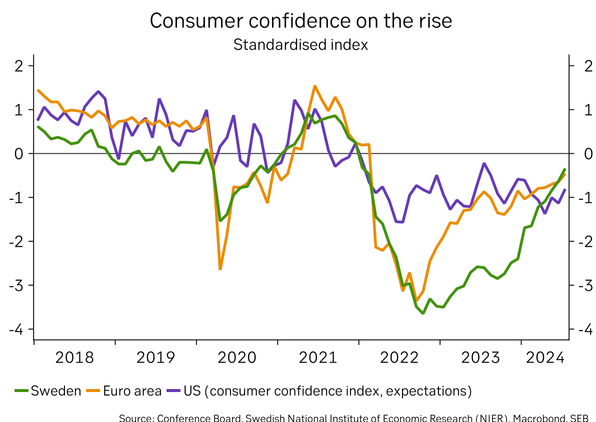
Source: OECD, IMF, SEB. PPP = Purchasing power parities

**The super-election year 2024 is continuing, with a focus on the US** and plenty of drama. The elections in India, the EU and the UK give us reason to expect some economic policy adjustments. The complex political situation in France remains unclear, with political positioning now dominating the negotiations to form a new government; a new presidential election is due in 2027. The outcome of November's US presidential and congressional elections is uncertain, following a dramatic summer that included an assassination attempt on Republican presidential candidate Donald Trump in July and a "last-minute switch" in the Democratic presidential candidate from Joe Biden to Kamala Harris. In both Europe and the US, already high

public sector debt will allow only limited manoeuvring room for aggressive reforms or growth-supporting policies. Historically high public sector debt and already large budget deficits are a risk factor for growth and for global fixed income markets. Harris has enjoyed some tailwind in terms of public opinion, and we choose to base our main scenario in this *Nordic Outlook* on relatively unchanged US economic policies; we analyse different outcomes and effects in "Theme: The US elections" on page 12.

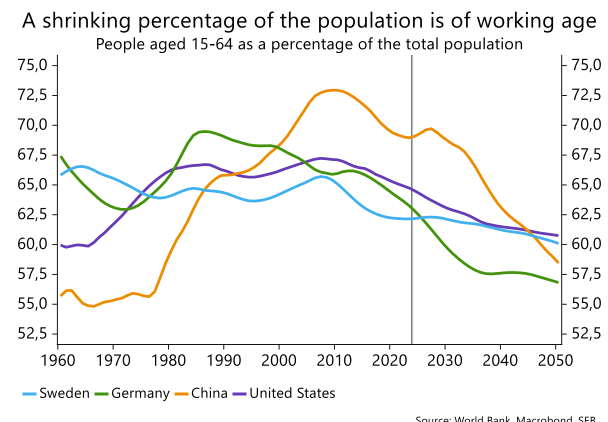



**A slowdown is possible without a recession.** We stand by our assessment that inflation will reach its targets without a deep economic downturn, even if this goes against both historical patterns and signals of approaching recession (a negatively sloping yield curve and the Sahm labour market rule). Each cycle has its unique characteristics. For example, unemployment in the US and the euro area is increasing largely due to rising labour supply, not higher unemployment. One classic imbalance – high debt in the US private sector – is also missing. Such debt has often preceded major economic setbacks and undermined growth. Fewer banks are tightening credit standards, private debt as a share of GDP is down since the pandemic, interest rates are heading lower and the wealth position of households is favourable, helping to support growth.




**Growth is more in tandem.** Growth gaps are narrowing, now that the previously resilient US economy is soft-landing while the euro area has emerged from last year's stagnation. The German economy remains stagnant, but countries in southern Europe are pulling up the region's growth rate. Emerging economies are expanding by over 4 per cent yearly, but Chinese growth is slowing because of weak domestic demand, problems in the real estate sector, half-hearted economic policy stimulus attempts and an export-oriented policy that is encountering more and more headwinds (see the theme article on p 27).

**Lower inflation is essential to growth.** Inflation figures are pointing in the right direction in both the US and the euro area, paving the way for lower interest rates. Chinese overcapacity is contributing to falling prices. Meanwhile, employment continues to rise in both the US and the euro area. The rate of wage growth remains high, especially in Europe. Due to lower inflation, real wages are now rising, supporting consumption. Sentiment indicators, primarily in Europe, confirm that households are more optimistic. Construction and other capital spending will rise once interest rates fall.




**Not much upside potential.** We are extending our forecast horizon to 2026. Looking that far into the future, our analysis will be more structural than cyclical. Global growth in 2022–2025 will be a few tenths of a point below the pre-pandemic average. This is weak in a historical perspective but demonstrates the ability of households, political leaders and businesses to manage a turbulent world. The US slowdown and moderate growth in Europe are leading to a level of GDP growth that in many cases is below trend, which normally results in accelerated growth towards the end of the forecast horizon. But in many cases the supply side, especially the labour market, is stretched. Unemployment is climbing only moderately, and an ageing population and tightening migration are reducing the labour supply. Fiscal policy is also contractive, prices are

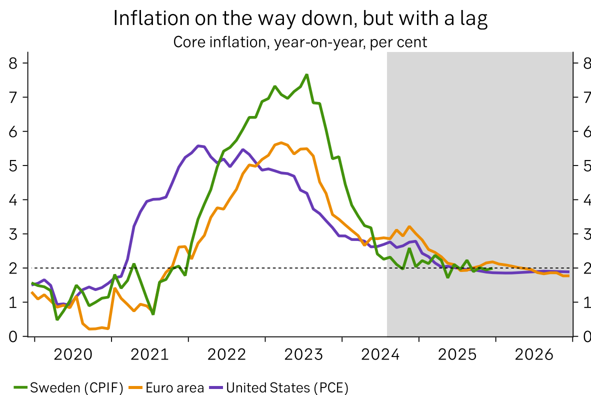
high and real interest rates are slowly falling. There is hope for an AI-driven productivity boost, but before we see more concrete evidence, such a development is an upside risk. Global growth will remain at just over 3 per cent in 2026.

**Can central banks save the economy?** Now that the Fed is poised to cut its key rate faster, other central banks can do their job more easily. In many cases, fiscal policymakers have limited manoeuvring room. Central banks must therefore assume a major role in responding to economic problems. Since interest rate policy has an impact only after a certain lag, there is uncertainty about its stimulus effect in the short term, when lower inflation also causes real interest rates to remain high. Interest-rate sensitive countries such as the Nordics will benefit more in the short term than, for example, the US. Countries with a bit more fiscal manoeuvring room, including the Nordics, are in a more growth-friendly position if policymakers actually utilise this room. Once central banks start cutting rates, this has historically been a rather fast process – faster than in our forecast. If it turns out by early 2025 that growth or inflation is decelerating faster, or that the impact of lower interest rates is weaker and slower than needed to stabilise economies, central banks may cut their key rates at a faster pace, or in larger steps.

## Continued inflation optimism

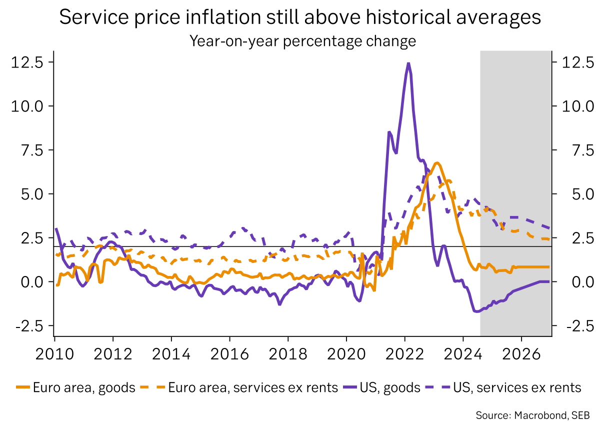
Inflation is continuing to move in the right direction, and the potential for stabilisation at around inflation targets is good. But it clearly takes time for a widespread inflation shock to fully work its way through the system. Especially in services, the inflation rate will remain above normal for some time to come.

Inflation on the way down, but with a lag



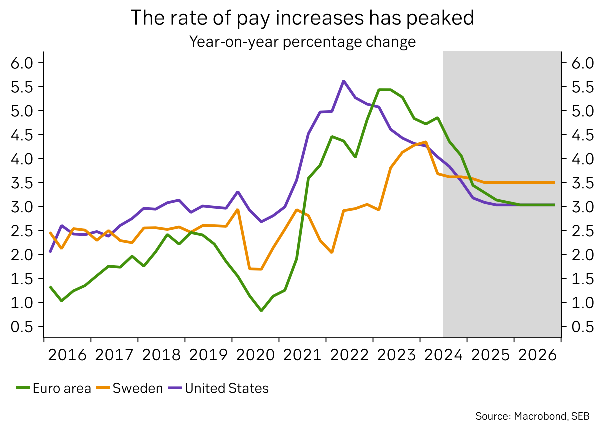

**On the way down, but still a divergent picture.** Inflation dynamics vary between economies and within their consumer price index (CPI) baskets. Inflation is now mainly driven by continued rapid price increases for services. Service prices, and to some extent rents, are last in the inflation process and are still being affected after a time lag by earlier rapid price increases,

Service price inflation still above historical averages




pay hikes and strong demand for services. In our forecast, wages are a major explanatory factor for the speed at which inflation stabilises around central bank targets. US wage growth, which reacts relatively fast to labour demand, has slowed as the labour market has normalised. In Europe, there is less correlation between the economic situation and wages; pay increases are high and will remain above historical averages but will slow in 2025–2026. In the UK, partly due to a continued tight labour market, wage growth has barely slowed at all. This is also reflected in the fact that inflation continues to fall more slowly than in other countries, even though the British economy has problems. Relatively moderate wage demands in Sweden, combined with the fading effect of the weak krona, will help inflation fall faster in an international perspective.

The rate of pay increases has peaked

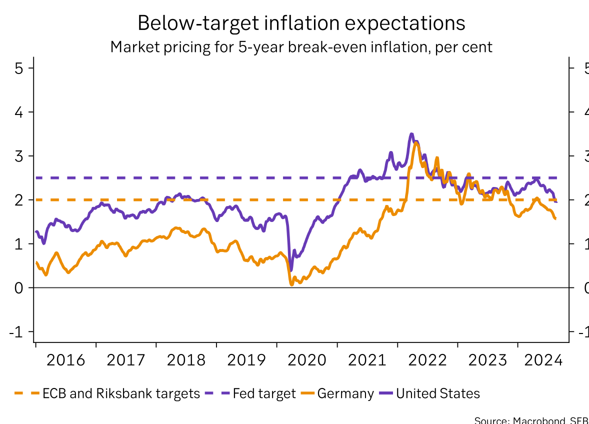



**Mixed risk picture.** We expect lower price volatility in 2025–2026, despite plenty of both upside and downside risks. On the upside, an escalating conflict in the Middle East could quickly change energy prices. The decline in prices of various commodities that began after their peak in 2022 has slowed, and prices have occasionally risen during 2024. We are also seeing higher shipping prices, but we do not expect major spillover effects. Especially in Europe, there is a near-

term upside risk if inflation compensation demands are larger than we expect. There are also downside risks. We have not yet seen high goods prices reverse towards pre-pandemic levels. Weak inflation in China is having a dampening effect globally, with downward pressure on commodity prices that may spread.

## More front-loaded interest rate cuts

First half 2024 inflation and growth gaps, along with sharp fluctuations in what the market expects from central banks, are hopefully now behind us. Although inflation and growth dynamics differ between economies, the Fed and ECB will soon be moving in the same direction. This will eliminate the problem we discussed in the May *Nordic Outlook* about the degree of independence from the Fed enjoyed by other central banks. Inflation is trending downward, although it will take some time until it reaches targets. Inflation expectations have stabilised in a sustainable way. After the Fed's latest interest rate announcement, which shifted more attention to the labour market, the door is open for the Fed to follow the example of the ECB, which has cut its policy rate once, as well as Sweden, Canada and Switzerland, which have done so twice, and begin its rate cutting cycle. Because real interest rates rise when inflation falls, key rates must be lowered so monetary policy does not become more contractive.




**Is the Fed lagging behind?** The latest weak US labour market data raised questions about whether the Fed has waited too long to cut its key rate. We believe this is partly true, now that both the economy and inflation are sending rate cutting signals. We also believe that central banks are moving from being data-dependent to relying more on their own forecasts. This makes things easier when inflation outcomes in many (but not all) cases remain above target for a while longer. The Fed will start its rate cutting cycle cautiously with a 25-basis point cut in September, followed by 50- and 25-bp cuts in November and December, respectively. At present, the market is pricing in a total reduction of 100 basis points in the Fed's key rate during 2024. Wage dynamics in the euro area are worrying, but inflation is coming down and the economy is weak; the ECB will cut its policy rate again in September, followed by another cut late this year. The ECB and Fed will follow with five and six more cuts in 2025, respectively. The Bank of Japan raised its key rate this summer and will hike it from today's 0.25 per cent to 0.75 per cent by summer 2025, then keep it unchanged.

**Key rates largely neutral in 2026.** Central bank key rates will be above neutral until the end of 2025. During 2026 inflation will be at target, and key rates in the US and the euro area will remain unchanged. Various GDP and labour market gap metrics indicate that the quantity of idle resources in economies will be limited, and monetary policy should thus be neutral. Due to fiscal policy constraints and limited pass-through of lower interest rates, the pace of rate cuts may need to be increased and their final level lowered.

**Central banks**

Year-end key interest rates, per cent

| | Aug 22 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Federal Reserve | 5.50 | 4.50 | 3.00 | 3.00 |
| ECB* | 3.75 | 3.25 | 2.00 | 2.00 |
| Bank of England | 5.00 | 4.50 | 3.50 | 2.75 |
| Norges Bank (Norway) | 4.50 | 4.25 | 3.25 | 2.50 |
| Riksbank (Sweden) | 3.50 | 2.75 | 2.00 | 2.00 |

* Deposit rate Source: SEB

## Volatile autumn for long-term yields

Reduced inflation worries have caused the 10-year US Treasury yield to fall by 70 bps since late May to about 3.80 per cent today. Given lower starting levels in the euro area and Sweden, the decline is about half as large. Lower short-term rates normally also result in lower long-term yields, and central bank expectations will also continue to determine longer maturities. Geopolitics and the US elections are sources of concern but currently of secondary importance. However, with long-term yields already low – and very low in some countries – potential for further downturns is limited.

**Fed rate cuts due to a cooler labour market** and economy will push down long-term US yields that usually bottom out around the time of the final rate cut. The 10-year Treasury yield will fall towards 3.50 per cent in mid-2025, then rise somewhat. Weak economic data may create some recession worries in the market and squeeze yields further. Because of already low German and Swedish government bond yields, long-term yields in those countries will not fall, despite lower

policy rates. The ECB's reduced balance sheet will help prevent German yields from falling further. Instead they will remain at 2.20-2.50 per cent for the rest of 2024 and in 2025. Sweden's 10-year yield spread against Germany fell to record-low levels this summer. Less aggressive expectations about Riksbank rate cuts and increased bond supply are expected to push up Swedish long-term yields slightly above German yields towards the end of our forecast period. Norwegian long-term yields often follow global movements. Due to lower Norwegian bond supply in 2025–2026, the yield spread to Germany will fall.

## Fiscal challenges

Public sector finances are a source of concern in many countries, due to high debt and large budget deficits. Weak or moderate growth will provide no relief, although lower interest rates will ease some of the cost pressures from high debt. Meanwhile there are many challenges: growing populism, climate change, the energy transition, security policy, consumers squeezed by high prices and demographic headwinds, to name a few. The balancing act will be difficult, but in most cases fiscal policy can only be neutral or even slightly contractive. Although public sector debt is high, we do not expect general distrust by financial markets in the near future. But some countries may end up in the spotlight, resulting in somewhat higher bond yields – such as France after President Macron called a snap election during the summer. Because of this, and the lessons learned after the 2022 British budget debacle, we believe that political leaders will be cautious.

**Those that might but cannot.** The situation is different for some countries that have low debt but are constrained by self-imposed rules. Germany is one example. Despite relatively low public debt, political leaders are boxed in by a fiscal framework ("debt brake") that prevents them from enacting policies that could prop up the economy and help pay for structural changes. Many countries must instead find other ways to fund needed investments, such as incentives to mobilise private capital or shifting the funding process away from the government budget, for example via guarantees. Within the EU, Brussels financed some of its pandemic stimulus by borrowing; similar tools could possibly be used in defence and industrial policy to make up for lost ground vis-à-vis the US and China.

## Balanced risks

As in May's *Nordic Outlook*, we view the global risk picture as balanced. There are many sources of concern that may cast a shadow over the economy. Meanwhile the latest statistics confirm that the US is experiencing a soft landing and that European growth has bottomed out, leading to relatively minor forecast adjustments. Although the risk picture is balanced, we still foresee a larger divergence from our main scenario on the downside. This is mainly because unemployment is already relatively low at the outset, which limits upside potential in the event of a positive growth surprise.

**Scenarios for the OECD countries**
GDP growth, per cent

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Main scenario | 1.7 | 1.7 | 1.8 | 1.7 |
| Negative scenario | | 1.2 | -0.1 | 1.7 |
| Positive scenario | | 1.8 | 2.9 | 1.9 |

Source: SEB

**Soft landing or policy failure and conflicts?** The inflation downturn is central to our main scenario, and a faster downturn could further improve growth. In many countries, households have had a couple of difficult years, with weak or even negative real income growth, while their interest burden has risen. Positive inflation surprises provide growth drivers in the form of better real incomes and faster rate cuts. In our positive scenario, this lays the foundation for better sentiment, consumption and investment. It should also provide a favourable environment for such asset classes as housing and equities. On the downside, it is possible to list many factors that could trigger worse outcomes. One scenario is that central banks have waited too long to cut key rates and that we have not seen the full impact of earlier tightening. Meanwhile, if geopolitical turmoil worsens – accompanied by rising transport, food or energy prices – interest rate cuts might quickly prove futile, while fiscal policymakers are constrained by already high public sector debt.

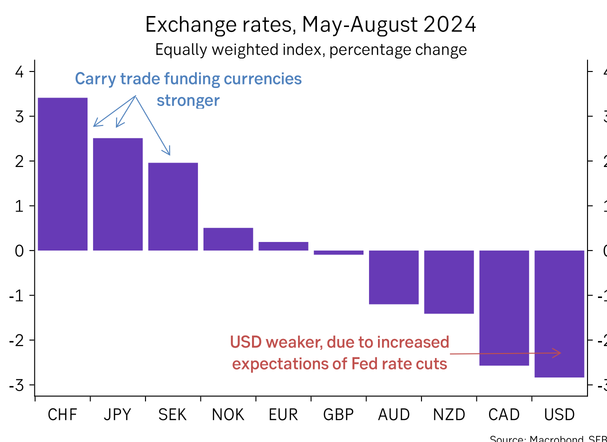
## OPEC+ continues to control oil prices

The average oil price so far this year has been largely in line with the 2023 average. Volatility has been low, with differences between peaks and troughs only half the normal. The reason is that OPEC+ is holding back oil production and controlling prices. Stable prices are beneficial to OPEC+, but they come at the cost of sharp production cuts. OPEC+ now has a reserve capacity that clearly reduces the risk of sharp price increases. This is one reason why oil prices have not reacted more to the conflicts in the Middle East. We expect crude oil prices just above USD 80/barrel late this year, with slightly increased production exerting some downward pressure on prices in 2025. However, geopolitics will remain an upside risk throughout our forecast period.

**Lengthy normalisation process for natural gas.** Despite falling prices and volatility in the natural gas market, major challenges remain. Compared to the oil market, storage capacity is low, resulting in greater uncertainty related to seasons and conflicts. In Europe the outlook has clearly improved, both because of reduced use – demand is still about 10 per cent below previous levels – and because of increased liquefied natural gas (LNG) imports. The path to a new balance situation is long, and delays in new LNG projects will result in a more stretched situation until 2026–2027. This is a longer period than we previously estimated and may also result in more volatility, depending on weather and supply disruptions. Our forecast is that the price of natural gas will be around EUR 35/MWh for the rest of this year. After that, the price will rise slightly before falling towards EUR 30/MWh in 2027.

## USD turnaround ahead of Fed rate cuts

Last spring's disappointing US inflation data and the Fed's subsequent postponement of its rate cutting cycle bolstered the dollar and weakened interest-rate sensitive currencies like the Swedish krona, Norwegian krone and Japanese yen. This summer, as US inflation fell and GDP growth data showed clearer signs of slowdown, there was a turnaround in the dollar. It weakened mainly against carry trade funding currencies (currencies of countries with low interest rates where investors borrow money to invest in more high yielding countries) like the Swiss franc, the yen and to some extent the Swedish krona. But the Norwegian krone and euro have also strengthened against the dollar.




**Focus on central banks and greater focus on currencies.** The Fed's path forward will be particularly crucial to foreign exchange market analysis. If the Fed starts rate cuts in September, the downward USD trend of recent weeks will continue – especially this autumn in relation to more interest-rate sensitive currencies. During 2025, when rate cutting is in full swing among G10 countries, the FX market will focus somewhat less on central banks and pay more attention to how lower interest rates are affecting the economies of various countries. This means that countries with high interest-rate sensitivity, for example due to many mortgage loans with variable interest rates, will benefit more in terms of economic growth and exchange rates. In such an environment, the euro will also appreciate against the dollar – partly because the Fed will be cutting its key rate faster than the ECB, causing the interest rate spread to narrow. Another reason will be a smaller growth gap between the euro area and the US.

**Keep an eye out for setbacks.** In the May *Nordic Outlook* ("Theme: Currency scenarios"), we examined various risks in FX market forecasts and their potential impacts. Like this summer, markets may react strongly if economic data do not come in as expected. We saw examples of this in early August, including large impacts on exchange rates, stock markets and bond yields. Aside from economic data and recession concerns, possible triggers are mainly related to the US elections and subsequent policies but also to the European economy. Among other things, we believe that higher US import tariffs would lead to reduced support for the euro, which would also reduce support for the Swedish krona and Norwegian krone.

## Equites: Correction but renewed support

The stock market has been turbulent this summer. All-time highs in mid-July were followed by major financial market volatility – with lower bond yields and share prices as well as a weaker US dollar – in late July and early August. But in recent weeks the turbulence has subsided, and stock markets have rebounded. The summer sell-off produced large price movements but appears to have been an overreaction unsupported by underlying economic data, combined with rapid repositioning among investors. These events are a reminder of how unpredictable the situation is. Financial markets can overreact to economic data, and there are tensions in the system.

**What the stock market is keeping an eye on.** Stock markets are focusing their attention on several themes: US growth, how rapidly the Fed cuts interest rates, tech company valuations, who will win the US presidential election and how Middle East conflicts will unfold. Our forecast – a soft landing in the US, Fed rate cuts, no big changes in US policies after the presidential election and no major deterioration in the security policy situation – will be favourable to the stock market in the long term, once corporate profits improve. But we will be in a wait-and-see phase for the next 1-2 months.

Theme:

# The US elections

## An even battle focusing on taxes, tariffs and family policy

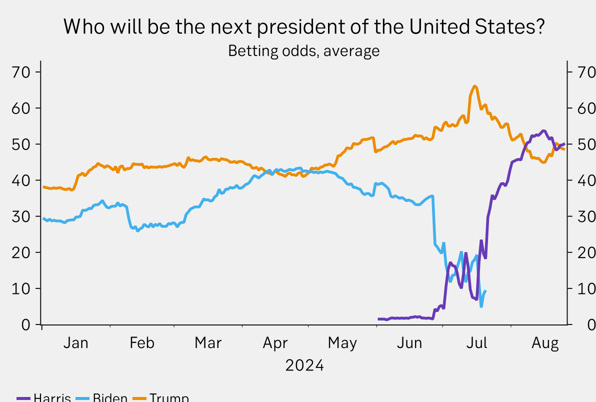
**The change of Democratic candidate has redrawn the map ahead of the November 5 US presidential election. Kamala Harris and Donald Trump are currently running neck and neck. In our main scenario we have thus chosen not to assume any major policy changes. This article examines how the Democratic agenda will change under Harris, the differences between her policies and Trump's and how these policies can be expected to impact the economy and financial markets.**

President Joe Biden's decision not to seek a second term and the nomination of Vice President Kamala Harris have injected new energy into this autumn's presidential campaign. The election will be decided by a small number of swing states where – at this writing – voter opinion is evenly divided between Harris and Trump. Betting odds since Biden left the race have swung more in Harris's favour. Not even a Democratic grand slam – with the party winning the White House and both houses of Congress – can be completely ruled out any longer. However, the Democrats have an uphill battle when it comes to retaining control of the Senate. Republicans will need to gain only one Senate seat if Trump wins, since the vice president has a tie-breaking vote, and two seats if Harris becomes president. West Virginia is likely to elect a Republican to replace retiring Democratic Senator Joe Manchin, but it is uncertain who will win in Ohio and Montana, two other traditionally "red" (Republican) states where "blue" (Democratic) senators are seeking re-election.

Our main scenario is a divided Congress if Harris wins, but a Republican majority in both houses of Congress if Trump becomes president. This means that Trump will have a better chance of pushing through his economic policies than Harris.

**What will decide the presidential election?** Getting your own voters to go to the polls is a key to winning elections. Voter surveys show that Harris has increased enthusiasm among core voters to the same levels as Trump. Harris is stronger than Biden in traditionally Democratic groups such as young and minority voters, and she has attracted voters who had previously leaned towards a third-party candidate. However, Trump still enjoys greater voter confidence on the most important issues – the economy and inflation – as well as on immigration, while Harris is viewed as better on health care and democracy, two other issues that are also high on the voter agenda.

**Households a focus for Harris.** We expect Harris to stick to Biden's preliminary election platform but shift its emphasis from green industrial policy and infrastructure investments to investments in families with children, including subsidies for housing construction and home purchases, expanded childcare and paid parental leave. These areas were also part of Biden's Build Back Better programme but struggled to gain support in Congress. In addition, Harris wants to fight "price gouging" to bring down the cost of food and supports Biden's proposals for rent controls. The overall impression is an agenda of a slightly more left-leaning nature than the reforms that characterised Biden's term of office. At the same time, these reforms will be difficult to get through Congress without Democratic majorities in both houses.




**The fate of Trump's tax reform will be pivotal to politics during the next presidential term.** Parts of the 2017 Tax Cuts and Jobs Act (TCJA), mainly its income tax cuts, will expire at the end of 2025. Trump has promised to extend TCJA in its entirety and has also proposed further cuts in corporate tax as well as the abolition of taxes on tips and – more controversially – on Social Security pensions. On the other hand, Trump will probably scrap some of the tax breaks in Biden's IRA climate package, such as tax credits for buyers of electric cars. Harris has backed Biden's promises not to raise taxes on anyone earning less than USD 400,000 a year, which applies to 95 per cent of all income earners. This would be funded by increased taxes on high-income earners, corporations, capital and capital gains. We also believe Harris would want to maintain and expand the TCJA's child tax credits, an expensive reform that could eat up most of her planned increases in tax revenue. She has also supported Trump's proposal to abolish the tax on tip income. According to an analysis by the Tax Foundation, a think tank, federal budget deficits would be larger under Trump's proposals (by about 1.3 per cent of GDP per year, not including his proposal to abolish tax on Social Security pensions) than under Harris (about 0.7 per cent). The differences are not dramatic in relation to the overall federal deficit of more than 6 per cent of GDP last year (see "Theme: The US deficit" on p 21).

**Trade wars are not good for the economy.** Trump plans to finance tax cuts with revenue from new tariffs. General import tariffs would be raised from the current 3 per cent or so to 10-20 per cent. Tariffs on imports from China would be 60 per cent. According to the Tax Foundation, tariffs could pay for two-thirds of Trump's planned tax cuts, but the damage from a new trade war – including retaliatory tariffs from US trading partners – is estimated to more than erase the growth effects of his tax reform. This analysis is in line with our view that Trump's agenda would be worse for economic growth than if Harris becomes president and governs with a divided Congress.

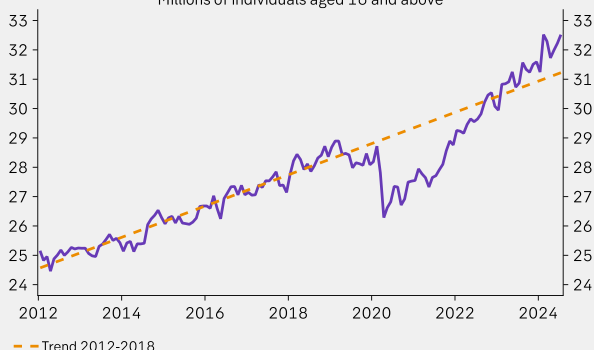
**Does Congress want a new trade war?** One of the proposals in Trump's election platform is to revoke China's permanent normal trade relations (PNTR), the US version of the "most-favoured-nation" that grants a country equal treatment to other WTO members. However, last year such a proposal in the House of Representatives met with opposition by representatives from agriculture-dependent states, among others. The Heritage Foundation's Project 2025, which is led by people close to Trump but whose proposals are not necessarily supported by Trump's team, includes two opposing agendas on the trade front, showing that Republicans are divided on the issue. Trump can also be expected to keep an eye on stock market reactions. The Democrats are not friends of free trade either, but we do not expect them to pursue a trade policy as aggressive as under Trump. Biden has kept all of

Trump's tariffs on Chinese imports and introduced new ones that reach a maximum of 100 per cent (electric cars). However, these tariffs cover only a small part of total import value from the People's Republic of China. A desire to explicitly prioritise domestic manufacturing and employment – "America First" – is shared by both US political parties. Another trade issue going forward is the planned re-evaluation of Trump's United States-Mexico-Canada Agreement (USMCA) in mid-2026.

**Immigration has become a problem for the Democrats as well.** The influx of labour from abroad has exceeded all forecasts in recent years. The high level of immigration has had positive effects on the US economy and contributed to a less overheated labour market and to stronger demand, but it has also worsened housing shortages. However, more than 75 per cent of all voters describe the situation at the border with Mexico as a crisis or a major problem. Among other things, the bussing of refugees from border areas to Democratic cities elsewhere has heightened awareness of the related challenges in many parts of the US. A majority of American voters now want to reduce immigration. Even the Democrats have introduced measures aimed to decreasing illegal immigration across the border with Mexico. However, there are major differences between the parties as well as among voters in terms of their views about legal immigration, rules for seeking asylum and how tough the authorities should be when it comes to deporting people who are in the country illegally. We expect political pressure to reduce immigration regardless of who wins the election, but Trump's policies are more drastic in this area too. Our conclusion is that migration policies will tighten and gradually dampen growth in the labour supply if Harris wins and that this will occur more forcefully if Trump moves into the White House.

A rapid increase in foreign-born workers in the labour force

Millions of individuals aged 16 and above




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

**The Fed could once again find itself under fire from Trump.** One stated purpose of Trump's proposed higher tariffs is to reduce the US trade deficit, but there is little evidence that such a policy would work in a country where large budget deficits meanwhile continue to stoke domestic demand. Trump has also discussed stimulating exports by weakening the US dollar. However, experience shows that tariffs instead push a currency higher, while inflationary impulses from tariffs can make it more difficult to continue cutting policy rates. Given this background, it is perhaps not surprising that Trump has also begun to talk about increasing the president's influence over monetary policy. Today, the president exercises power over the Federal Reserve through the right to nominate members of its Board of Governors to 14-year terms. The president has the right to dismiss members, but not because he disapproves of their policies. However, it is possible that Trump could force Jerome Powell to step down as Fed chair and replace him with one of the other existing members. Powell's mandate expires in 2026. This will enable the next president to appoint a new Fed chair, in Trump's case possibly someone who shares his views on the interest rate and the dollar.

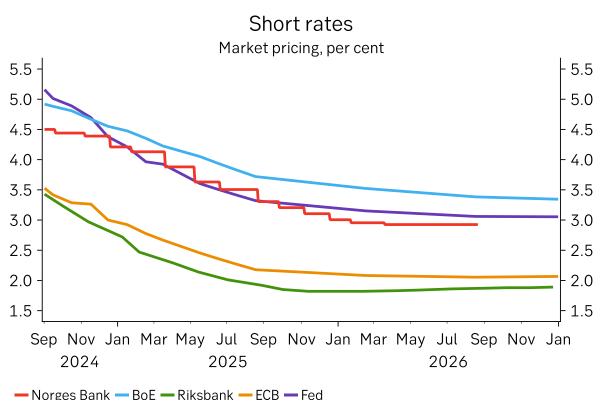
**Increased inflation worries may push interest rates and bond yields higher.** A more compliant Fed could damage confidence in the inflation target and US monetary policy in general. This might push up inflation expectations – which have been remarkably stable even during the inflation shock of recent years – and long-term bond yields. A parallel is Fed Chair Arthur Burns, who in the early 1970s was pressured by then-President Nixon to cut interest rates ahead of an upcoming election. Not until Paul Volcker took over the Fed in the late 1970s and pursued a monetary policy that drove the economy into more than one recession in the early 1980s did the Fed regain control of US inflation.

# Fixed income

## Bumpy autumn road for bond yields

**Easing inflation concerns and weaker growth indicators have opened the door for relatively rapid policy rate cuts. Lower policy rates support declining bond yields, but due to already low levels, the downside will be relatively modest if the soft-landing scenario holds as we expect. Temporary dips in bond yields may be significant.**

The first half of 2024 was characterised by indications of higher inflation, significantly less dovish central bank expectations and a rapid increase in bond yields. But since June, easing inflation concerns and weaker growth indicators have reinvigorated rate cut expectations and pushed bond yields lower. Central bank expectations will remain the key driver in the bond market going forward. Geopolitical turmoil and the US elections add a layer of uncertainty but will be of less importance than central banks.




**US rates: Potentially bumpy road to soft landing.** The cooling labour market and increased rate cut prospects will support the underlying downtrend in Treasury yields during the coming months. Historical precedents suggest that the 10-year yield should trade below the Federal Reserve's key interest rate well into the rate cutting cycle and bottom out near the timing of a final rate cut. Our forecast assumes that market expectations will align with our projected lowest Fed key rate of 2.75-3.00 per cent, in which case the 10-year yield should trade near 3.60 per cent in mid-2025. However, weaker-than-expected macroeconomic data could trigger recession worries and expectations of more substantial rate cuts. In such case, bond yields could undershoot to levels that are not sustained if a soft-landing scenario materialises as we expect.

**Euro area: No downside in long yields unless the policy rate is cut to below 2 per cent.** Long bond yields in core euro area countries are very low relative to our European Central Bank key rate projection, which levels out at 2.00 per cent. The ECB has begun speeding up its balance sheet reduction, which means that long euro yields will likely fail to trend lower despite declining key rates. We think the German 10-year yield will fluctuate mostly in the 2.20-2.50 per cent range during 2024–2025. Possible dips towards 2.00 per cent should be temporary unless prospects change and the key rate bottoms out at 1.75 per cent or below.

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

| | Aug 22 | Dec 2024 | Dec 2025 | Dec 2026 |
|---|---|---|---|---|
| United States | 3.86 | 3.55 | 3.70 | 4.10 |
| Germany | 2.24 | 2.10 | 2.25 | 2.50 |
| Sweden | 1.98 | 1.95 | 2.45 | 2.75 |
| Norway | 3.27 | 3.07 | 3.10 | 3.30 |

Source: National central banks, SEB

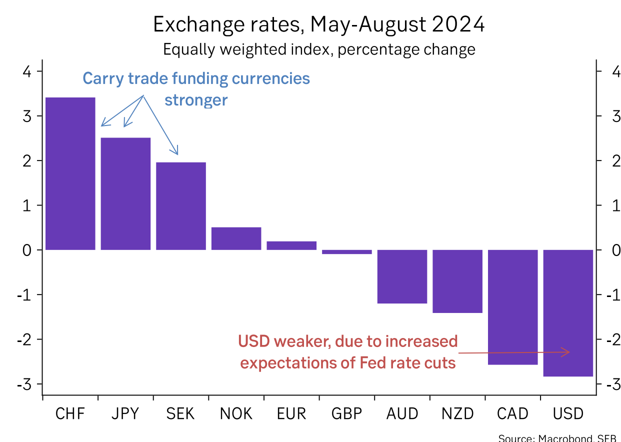
**Sweden: Bond yields will rise as supply increases.** The 10-year government bond yield spread to Germany has trended lower since the end of 2023, falling to historical lows this summer. Some of the recent decline is explained by a pause in both the Riksbank's bond sales and the Debt Office's auctions during the summer. Increasing expectations about Riksbank rate cuts have also contributed to a narrower spread versus Germany. Rising supply and a correction of the current overly aggressive expectations regarding Riksbank rate cuts imply that the spread to Germany will widen, and we continue to expect Swedish yields to be slightly higher than their German counterparts in 2025.

**Norway: Slow convergence towards European peers.** Bond issuance is high this year, with much of the borrowing taking place in longer-dated bonds. Norwegian bonds have generally followed the gyrations in global yields this year, a trend that is likely to continue. We predict bond issuance will decline in the next couple of years, causing a gradual tightening of Norwegian yield spreads against European peers.

# The FX market
# Turnaround as Fed rate cuts approach

**This summer has seen large FX market movements, with a weaker USD against the JPY and EUR standing out especially. For the Swedish krona and Norwegian krone, it has been a bit of a roller coaster. But we are moving closer to a time when we expect more sustained SEK and NOK strength. The catalyst is that the US Federal Reserve will begin its rate cutting cycle in September. Unusually high uncertainty, partly due to the US elections, may put a spanner in the works, but in 2025 our main scenario is still a stronger SEK and NOK and a generally weaker USD.**

**Turnaround in the foreign exchange market.** Since the Fed announced in early November 2023 that its hiking cycle was over, expectations of Fed rate cuts have been the main FX market driver. Early in 2024, expectations of imminent cuts were dashed, leading to a stronger USD and weaker interest-rate sensitive currencies such as the Swedish krona (SEK), Norwegian krone (NOK) and Japanese yen (JPY). Since June, reduced US inflation concerns and weaker growth data have boosted expectations that the Fed will start cutting its key rate soon, leading to expected USD weakening.




**Carry trades a complicating factor in the FX market.** So far this summer, the USD in particular has weakened against carry trade funding currencies such as the CHF and JPY. The EUR/USD upturn was also notable. The SEK and NOK did not keep up at first, but in August they showed strength against both the EUR and USD. Their anaemic performance earlier in the summer can partly be explained by domestic factors, above all surprisingly low inflation figures and falling oil prices. First, mainly for the SEK, because carry trades increased (i.e. low-interest currencies such as the JPY and SEK were sold). Then the Fed became more dovish and the Bank of Japan surprised the market with larger key interest rate hikes than expected, persuading carry traders to quickly scale down these positions (thus buying back SEK and JPY).

**Central banks will remain the focus of FX market attention.** Geopolitical turmoil and the US elections will contribute to uncertainty this autumn, but expectations about central banks and how they act, with an extra focus on the Fed, will still be the most important driver.

**Exchange rates**

| | Aug 22 | Dec '24 | Dec '25 | Dec '26 |
|---|---|---|---|---|
| EUR/USD | 1.11 | 1.11 | 1.17 | 1.16 |
| USD/JPY | 146 | 140 | 130 | 132 |
| EUR/GBP | 0.85 | 0.87 | 0.90 | 0.91 |
| EUR/SEK | 11.38 | 11.10 | 10.75 | 10.55 |
| EUR/NOK | 11.76 | 11.15 | 10.90 | 10.85 |
| USD/SEK | 10.24 | 10.00 | 9.19 | 9.09 |
| USD/NOK | 10.58 | 10.05 | 9.32 | 9.35 |

Source: Bloomberg, SEB

**More attention to growth.** In 2025, we expect the rate cutting cycle to be in full swing among the G10 countries, so the FX market will focus less on central banks. A clearer market driver then will be how rate cuts affect the economies. We now expect currencies that took a beating during the rate hiking cycle (such as the SEK and NOK) – due to their interest-rate sensitive economies – to appreciate as rate cuts provide more and faster growth stimulus. We also believe that in such an environment, the euro (EUR) will appreciate against the USD – partly because the Fed will be cutting its key rate faster and because the interest rate spread to the euro area will narrow. Another reason is that America's large growth rate advantage over the euro area will be shrinking.

**A hard landing, the US elections and European growth** are the three main risks that could upend our main scenario (see also *Nordic Outlook*, May 2024). This summer's US macro figures have pointed more towards a slowdown and a soft landing, but as indicated by the market tumult that followed weaker non-farm payroll figures in early August, recession worries remain widespread. If such worries resurface, we may see periods of temporarily weaker SEK and NOK in the future. If the US elections lead to sharply increased tariffs and/or if European growth recovers more weakly than we expect, the EUR will appreciate less in 2025, which would also reduce the potential for SEK and NOK strength.

# The stock market
# Bull market likely to resume after turmoil

**Global equities hit new all-time highs in July, only to reverse sharply late in the month and in early August on recession concerns. The violent reaction suggests an element of forced deleveraging, but the key issue is the interaction of slowing growth and interest rate expectations. Our base case is that a tactical soft patch will last 1-2 months before earnings growth takes off again. We recommend a neutral allocation to equities while we wait for the evidence.**

Global stock markets have had a turbulent period since the last issue of *Nordic Outlook*. First, at the end of April, the Federal Reserve started talking interest expectations down, which led to new all-time highs for global equities in the early summer. In late July and early August, things took a turn for the worse. Markets initially reacted positively when the Bank of Japan hiked its key interest rate and the Fed kept its rate unchanged, but weak macro data in the following days led to a broad sell-off.

**Violent (over)reaction was triggered.** On Monday, August 5, the VIX volatility index briefly surpassed 65 after starting the day at 23, the biggest intraday move ever recorded. The VIX has only been above 50 twice: after the Lehman Brothers crash of 2008 and in 2020 after the COVID pandemic hit. Nothing like that had happened this time. Since then, volatility has retraced all the way to where it started.

**Reaction out of proportion given economic data.** So, markets underwent a period of turbulence in August following a string of weak economic data. The declines were out of proportion to the economic disappointments, suggesting that some investors were forced to liquidate positions Equities have since bounced back, suggesting this process is complete.

### Five things to look out for now

So far, so good. However, the underlying problem is still there: valuations are high, global growth is too low to lift earnings, and the Fed has still not cut its key rates. What happens next? We think the following five themes will shape the outlook for the rest of 2024:

**1: Is the US headed for recession?** Recession fears rose after July's unemployment data but are not supported by other indicators. Banks have started to lend again, suggesting growth could pick up before year-end with a little help from interest rates.

**2: Will the Fed cut its key interest rate?** Markets now expect the Fed to cut its key rate by 100 basis points before the end of the year. Weak macro data, falling inflation and financial turmoil have opened the door, but we need the Fed to say – and do – it.

**3: Are tech stocks overvalued?** AI-related growth has been driven by big investments in data centres. It will be a while before these investments pay off, but they will continue, and this should support technology stocks.

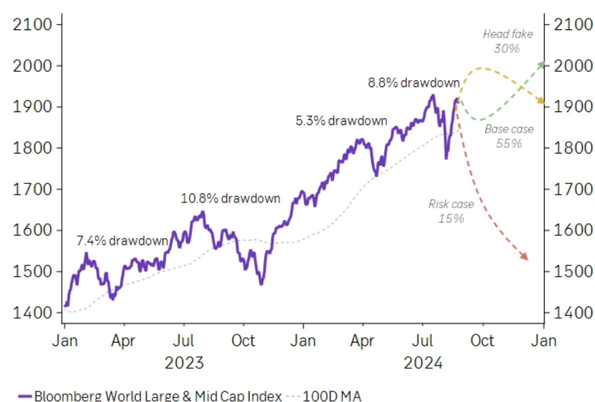
**4: Will Donald Trump return to the White House?** After Vice President Kamala Harris became a presidential candidate, the probability of a Democrat victory has increased. We think markets would welcome that, but it is still early days in the election campaign.

**5: Will the war in the Middle East escalate?** Geopolitical risk rarely moves markets. With two major wars going on, shocks are clearly possible, but it is impossible to assess the probability. Monitor the risks. But do not act before things happen.

### The bull is likely to return

The global economy is not strong enough to lift earnings, but with a little help from the Fed, it should pick up within a few months, allowing a 'proper' earnings-driven bull market to emerge before the end of the year. So, while we are prepared for more tactical volatility, but our base case is that strategic investors should prepare to return to a cyclical overweight within 1-2 months as recession fears fade.

Tactical correction, not a bear market

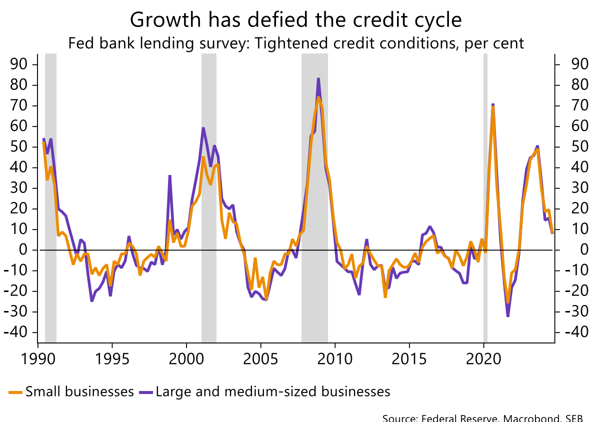



Source: Bloomberg, SEB

# The United States
## Faster Fed rate cuts will rescue the soft landing

**The labour market is slowing down, and indicators have become more mixed. The fact that inflation is approaching the target means that the Fed can now shift its focus after an aggressive hiking cycle. The policy rate will be cut in rapid steps during the autumn and next year. Our forecast is that growth will slow below trend but that a recession will be avoided. The absence of imbalances in the private sector strengthens our belief in a soft landing – historically an unusual phenomenon.**

In early August, there was a rapid shift in the prevailing view of the US economy towards fears of an impending recession. We believe that such a hard landing can be avoided, but that the deceleration we have long expected is now here. Inflation and wage increases are slowing. This will give the Federal Reserve room to cut its policy rate sharply starting in September, thereby reducing the risk of a downward spiral in the economy. The risks from private sector imbalances that have historically often preceded recessions are missing; since the COVID-19 pandemic, debt has fallen as a share of GDP. The private sector interest burden has remained modest, since both households and businesses were able to refinance their loans at low interest rates early in the pandemic and are now earning higher interest income on liquid assets. The credit cycle, which has been a reliable economic indicator, appears to be on its way to normalising again without triggering a recession.

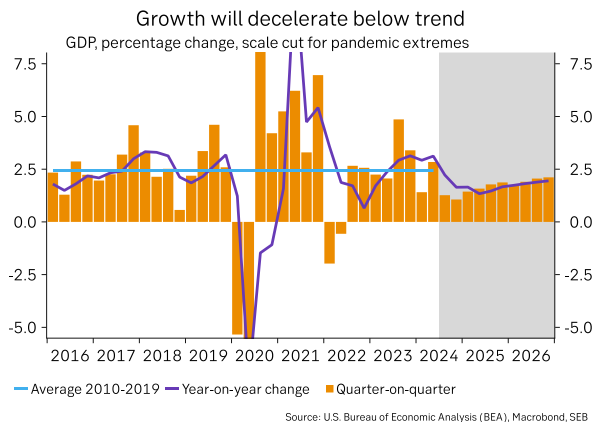



**Key data**
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 2.5 | 2.5 | 1.5 | 1.8 |
| Unemployment* | 3.6 | 4.1 | 4.5 | 4.3 |
| Wages and salaries | 4.5 | 3.8 | 3.1 | 3.0 |
| Core PCE (Fed target metric) | 4.1 | 2.7 | 2.0 | 1.9 |
| Public sector balance** | -7,6 | -8.0 | -7,8 | -7,5 |
| Public sector debt** | 121 | 124 | 128 | 132 |
| Fed funds rate, % *** | 5.50 | 4.50 | 3.00 | 3.00 |

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

**Downwardly revised outlook for next year.** Due to increased downside risks in the labour market, we have nevertheless lowered our growth forecast. Because of a strong ending to 2023 and good momentum during the first half of 2024, our forecast for this year is unchanged at 2.5 per cent, even assuming a more pronounced slowdown in the second half. We have lowered our 2025 forecast to 1.5 per cent (May: 1.8 per cent), followed by 1.8 per cent in 2026.




**Growth below historical trend.** During 2026, growth will remain below the historical trend (an average of 2.4 per cent during 2010-2019) but in line with the Fed's estimate of the longer run growth rate (1.8 per cent). The Fed's view appears to be overly cautious, in light of the strong growth in productivity and labour supply in recent years. We do not believe in quite as strong a supply trend going forward. Foreign-born workers have accounted for the entire increase in the labour force since 2019, but widespread voter dissatisfaction with immigration suggests that the inflow will decelerate going forward, regardless of who moves into the White House next year. It is difficult to estimate productivity growth. Increased demands for efficiency improvements during the labour shortage of recent years, greater labour market mobility and an increase in

new businesses are among factors that have driven up productivity growth after the pandemic and are likely to diminish when the economy slows. However, increased investments in new technology should continue to boost productivity. We thus still believe that potential GDP growth is slightly above 2 per cent.

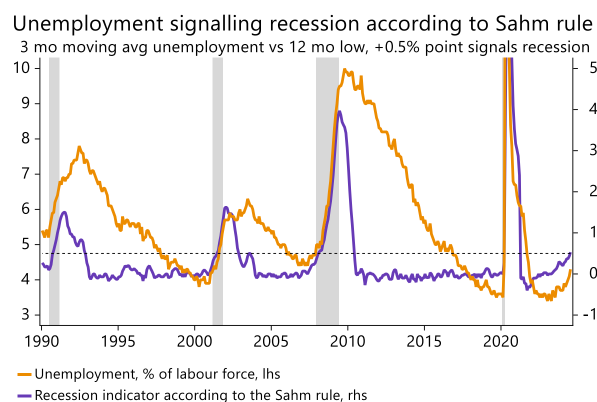
**This autumn's presidential election will increase uncertainty.** At this writing, public opinion polls indicate that Kamala Harris and Donald Trump are running neck and neck. The presidential candidates have not yet presented detailed policy platforms. It is uncertain what support Trump's most radical proposals may enjoy in Congress; neither Harris nor Trump is expected to win a filibuster-proof majority in the Senate (usually 60 out of 100 senators). This precludes major policy changes outside the budget. Historically high deficits will limit fiscal policy manoeuvring room, regardless of who wins the election. Our forecast assumes that there will be no dramatic policy shifts. The candidates' economic policy proposals and their expected impact on the economy and the outlook for central government finances are discussed in two theme articles on pages 12 and 21.

## Indicators are signalling a deceleration

Sentiment indicators for the business sector support the belief that an economic slowdown lies ahead. In July, the ISM manufacturing index – historically one of the most reliable indicators of business cycles – unexpectedly fell. Small businesses remain pessimistic, and the ISM service sector index is at slightly expansionary levels. However, the picture is not entirely clear. The S&P Global purchasing managers' index for the service sector, which includes more companies and focuses solely on developments in the domestic economy, rose during the spring. The ISM industrial index is still above levels that have historically signalled a recession. Housing construction slowed again during the second quarter and indicators signal a continued decline. However, because long-term interest rates have fallen again, the downturn will be limited. Other construction has levelled off after strong support last year from the Biden administration's stimulus programmes, especially its tax subsidies for domestic production of semiconductors. Equipment spending rebounded in the second quarter, but due to weak order bookings and a renewed decline in planned business investments according to survey data, it is too early to expect a sustainable turnaround. However, IT investments should continue to grow.

## Job worries will dampen consumption

Household consumption has continued to climb at a healthy pace, supported by rising real wages and a renewed decline in the savings ratio. Pandemic excess savings buffers appear to be exhausted but rising share and property prices after the pandemic have led to a record-high household wealth position in nominal terms. Rising credit card debt and consumer loan payment problems show that parts of the household sector are under more pressure. Household sentiment surveys continue to paint a mixed picture. Inflation expectations have shifted lower but have been replaced by increased worries about jobs. We believe that a deteriorating labour market will be reflected in more cautious behaviour by households, while wage and salary income will grow at a slower pace as the job market cools. Private consumption – the single most important driver of GDP – will increase by just over 2 per cent this year, followed by less than 1.5 and 2 per cent in 2025 and 2026, respectively. This is slightly below the pre-pandemic growth rate of about 2.25 per cent.




## Greater risks from the labour market

The labour market is slowing down, but how quickly is more difficult to assess. Recession fears were fuelled by the weak July labour market report, which showed a continued rapid rise in unemployment. The historical experience is that it has been impossible to avoid a recession when unemployment has risen by half a percentage point (the so-called Sahm rule; see chart). The fact that the unemployment upturn was driven this time by an increased labour supply makes this interpretation more uncertain. Immigration has been the main driver of rising labour supply. The labour force participation rate among those aged 25-54 is at its highest level since the early 2000s. However, labour force participation among older cohorts has not yet recovered from its decline early in the pandemic. This has held back an upturn in the overall participation rate.

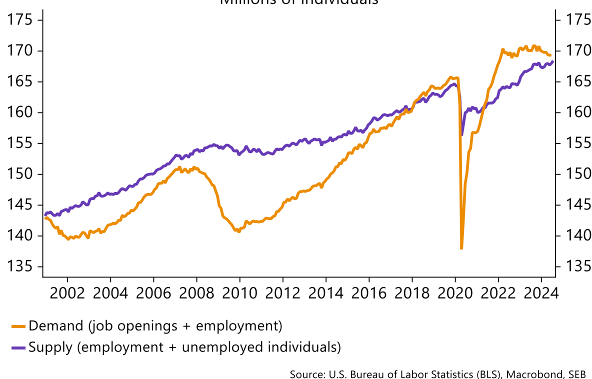
**Jobs statistics are shaky and are often revised.** Employment according to the household survey, which provides the basis for unemployment statistics, has shown significantly weaker growth than the number of

new jobs in the closely monitored and normally more reliable establishment survey ("payrolls"). The household survey is more volatile, but over time the two surveys tend to coincide. However, preliminary revised data show that payrolls likely grew at a markedly slower pace until at least the first quarter of this year than previously indicated.

**Signs of weakness can be seen below the surface,** as we have emphasised in previous reports. Non-cyclical sectors (the public sector and private health care) account for most employment growth. We believe that these hires partly reflect demographic trends, which can be expected to continue, but also the temporary effects of federal subsidies to states and local governments during the pandemic. The labour market has gone from clearly overheated to more balanced, which increases downside risks if job growth continues to slow. We foresee a risk that companies will be less inclined to hold on to employees when labour shortages are no longer viewed as a problem. Historical experience is that changes in the labour market have often taken place quickly and brutally.

**The labour market is still not weak.** Weekly statistics for newly registered unemployment have shown a clear upward trend this year, but from historically low levels. Despite the recent rise, current unemployment of 4.3 per cent is not far from the Fed's estimate of long-term equilibrium (4.2 per cent). Our main scenario is that job growth will slow during the autumn and some months into 2025, but that total employment will not fall. We expect unemployment to rise to just over 4.5 per cent.

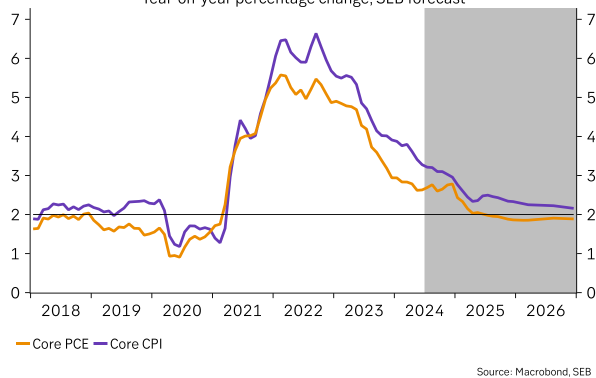
The labour market is now close to balance
Millions of individuals




## Lower inflation opens the way for Fed cuts

The trend of inflation has been uneven in recent years. Periods of slower price increases have been followed by renewed price acceleration, most recently during the first quarter of 2024. In the past few months, the monthly rate of price increases has slowed again and is approaching a more normal pace, in line with the Fed's 2 per cent inflation target. The slowdown is now also taking place on a broader front, not only in goods but also in services. Pay increases have shifted lower as the labour market has normalised. They are now at an annualised rate of about 3.5 per cent, which should be compatible with the inflation target. Rents, which have been the single most important driver of core inflation (headline inflation excluding food and energy), are now increasing more slowly, and the trend of new leases is supporting a continued slowdown. According to the Fed's favourite metric, core PCE, inflation is still slightly above target (June: 2.6 per cent). Base effects – from lower price increases last year – will slow down the decline this autumn, but during spring 2025 we expect inflation to be back at target.

Fed's favourite inflation metric back at target by 2025
Year-on-year percentage change, SEB forecast




**The Fed will begin rapid rate cuts in September.** In July, the Fed changed its view of the balance of risks and is now giving equal weight to both its inflation and employment mandates. This was accompanied by clear signals of an impending rate cut from Fed Chair Jerome Powell. In our view, the recent inflation downturn should be enough to convince the Fed that inflation is returning sustainably to its target, which is the condition established by the central bank for initiating rate cuts. It has now been over a year since the Fed's last rate hike, in July 2023, which is a long period relative to the 9-month average time between final increase and first cut over the last seven hiking cycles. Inflation now appears to be under control, while the labour market is showing clearer signs of slowing down. This increases pressure on the Fed to quickly change its monetary policy to ensure a soft landing in the US economy. We now believe that the Fed will cut its key rate at every meeting this autumn (September, November and December), including one larger cut of half a percentage point, bringing the federal funds rate to 4.50 per cent (upper bound) by the end of 2024. Next year, the Fed will lower its key rate further to 3.0 per cent and then leave it unchanged during 2026.

Theme:

# The US deficit

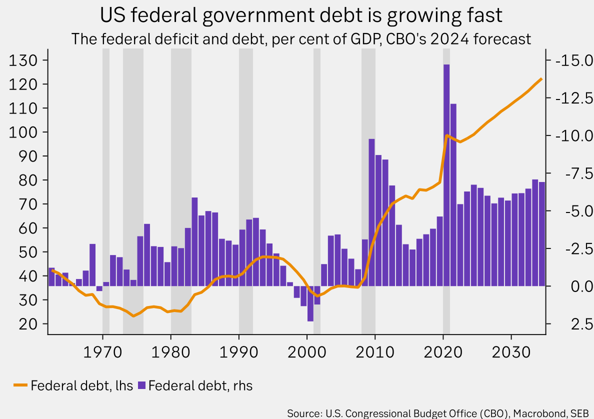
## Unsustainable debt increase, but lack of political will

**The US budget deficit has become entrenched at unsustainably high levels after the pandemic, and public sector debt is approaching historic records. Growing pension and health care spending due to an ageing population and rising interest costs on ever-increasing debt are now the main drivers. The dollar's position as a reserve currency puts the United States in a better position to finance rising debt than most other economies. Growing debt reduces future manoeuvring room for fiscal policy, and there is also a limit to how large US federal debt can be without triggering a crisis of confidence. But there is a lack of political will to deal with the growing deficits, and new campaign promises ahead of the November 5 presidential election risk worsening the situation further.**

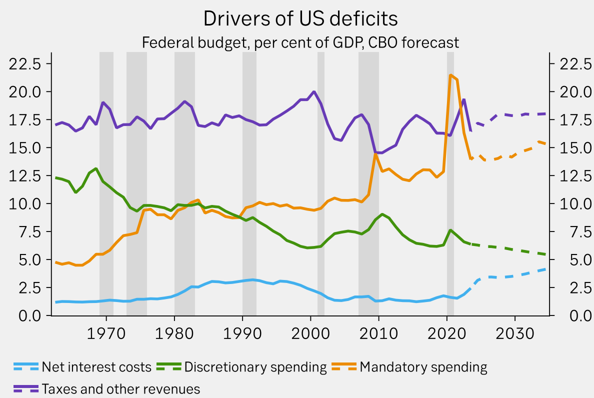
**US public sector debt, as a share of GDP, has doubled in the past 20 years.** Last year's public sector deficit totalled nearly 8 per cent of GDP, and public sector debt was around 120 per cent – the highest levels since the Second World War. Of the 38 mainly affluent OECD countries, only Italy, Greece and Japan have a higher debt ratio.

**Explosive increase in federal debt.** Federal debt, which is more relevant to the financial markets, is now on track to exceed 100 per cent of GDP (excluding internal loans from various funds). According to the latest 10-year forecast from the Congressional Budget Office (CBO), in three years' time this debt will surpass the previous record – 106 per cent of GDP – from just after the Second World War (1946). It will reach 122 per cent of GDP by 2034. Its sharp rise in recent decades reflects several factors: Enormous stimulus programmes during deep recessions related to the global financial crisis of 2007–2010 and the COVID-19 pandemic, military spending for various wars, growing expenditures by the Social Security system and repeated tax reforms that weakened revenues.

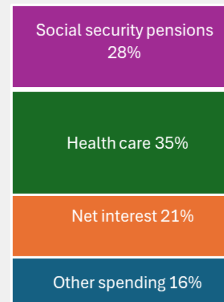
**Are high deficits here to stay?** Historically, deficits have shrunk to more normal levels after economic crises. This has not happened after the COVID-19 pandemic. Despite a strong US economic recovery, this year's deficit is expected to be entrenched at levels historically seen only during recessions or wars. According to the CBO, deficits will remain at around these levels for the next decade.




**A lack of budgetary discipline, plus major reforms.** US fiscal policy has not shown much restraint under either Donald Trump or Joe Biden. The discretionary spending that Congress approves during its annual budget appropriation process appears to be back under control, but this does not provide a complete picture of fiscal policy. President Biden and former Republican Speaker of the House Kevin McCarthy agreed last year on a spending cap. But in addition to this, Congress has approved emergency aid to Ukraine and Israel, among others. Biden's infrastructure investments have continued to cost money, also outside the regular budget process. The propensity of US politicians to push through policies that utilise tax credits rather than subsidies also makes the budget more opaque.



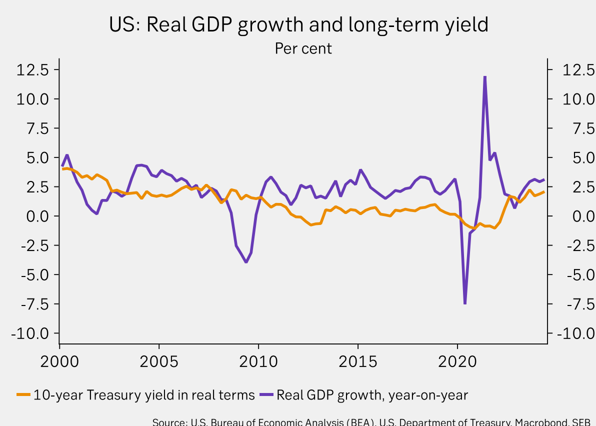

Share of federal spending growth 2024-2034



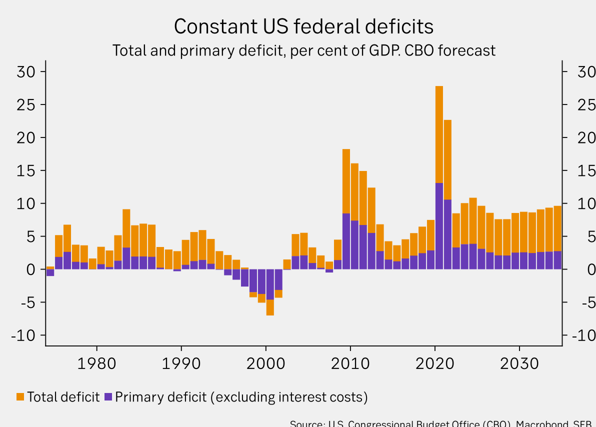

Source: Committee for a responsible federal budget (CRFB), CBO

**High interest rates and an ageing population.** The main reasons for the continued high and increasing deficit are rapidly growing interest payments on ever-increasing debt and rising outlays for health care and pensions. At the same time, in some respects the CBO forecast paints too bright a picture of the budget outlook. First, the CBO assumes that parts of Trump's 2017 Tax Cuts and Jobs Act (TCJA) will expire after 2025, which is expected to boost tax revenues as a share of GDP. That is unlikely to happen if Trump wins the presidential election, since he wants to both preserve the TCJA and cut some taxes further. Nor will it apparently happen under Harris, who has promised unchanged income taxes for the vast majority of Americans, though partly financed by increases in other categories, such as higher corporate taxes. Second, the CBO assumes that discretionary spending will grow at the same rate as inflation, but Congress may very well decide to expand new spending.

**Uncertain debt dynamic.** Reduced military spending after the end of the Cold War helped the federal budget move into surplus during the late 1990s, when forecasts indicated that the US would soon be on the verge of paying off its federal debt. In contrast, over the past 20 years the federal government has shown continuous deficits, with only one year of primary surplus (a surplus when excluding interest costs). The combination of high growth and low interest rates over the past decade nevertheless helped to keep debt somewhat in check. Before the pandemic, there was a discussion in academic circles on whether the US should pursue an even more expansionary fiscal policy. Because of rapid interest rate hikes by the Federal Reserve in recent years, the US no longer shows the same positive debt dynamic.




**Cautious policy rate and growth assumptions.** Official forecasters such as the Fed and the CBO are making cautious assumptions about growth as well as of interest rates going forward. Estimated potential GDP growth of 1.8 per cent reflects deteriorating demographics and weak labour force growth. But in recent years, high productivity growth and immigration have led to a substantial boost in US growth capacity. According to the International Monetary Fund (IMF), potential GDP growth is now around 2.5 per cent and will gradually fall to just over 2 per cent. The Fed's assessment of a neutral policy rate has risen from around 2.5 to nearly 3 per cent, but even this may be too pessimistic. A return to pre-pandemic interest rates would facilitate a stabilisation of debt, but this assumes that the US will come to grips with its primary budget deficits (i.e. excluding interest costs).




**Fruitless budget arguments.** Many politicians, especially Republicans, have loudly demanded a slowdown in the debt increase. Budget arguments usually break out mainly when the US debt ceiling periodically needs to be raised. But this has not worked well as a method for dealing with deficits. On some occasions, arguments about the debt ceiling led to downgraded credit ratings, thereby lowering market confidence in US government finances. The major challenges are related to factors outside of the regular budget process: an ageing population and the fact that the US has the highest per capita health care costs in the OECD (but not the best health outcomes). This requires unpopular decisions, while election campaign promises go in the opposite direction. Both Trump and Harris have promised not to touch federal pension and medical care benefits. The Social Security pension funds are expected to be exhausted within about a decade, but Trump's proposal to abolish taxes on Social Security retirement income would speed up this process. Historically, Democrats and Republicans have been able to compromise on budgets. But their compromises have often increased, not decreased, spending. Even excluding pandemic relief programmes, around 60 per cent of spending increases under both Trump and Biden have been approved by both parties.

**Where is the pain threshold?** The dollar's position as a reserve currency makes US Treasury assets attractive and allows for borrowing that would be difficult to manage in many other countries. Unlike Japan, where large public deficits are matched by high domestic savings, the US is dependent on attracting capital from abroad. But because the US finances this spending in its own currency, it enjoys greater flexibility. A crisis of confidence would be reflected in demands for higher yields rather than by an abrupt halt to purchases of US debt. The market does not currently seem to be demanding a premium for US government financial risks, but if current trends continue, at some point US debt will become impossible to finance. Yields can be expected to start rising even before debt reaches such levels. Failed bond auctions would be a warning signal.

**Reduced fiscal policy manoeuvring room.** A more immediate problem is that the scope for new crisis packages is limited. Weaker automatic stabilisers – which make fiscal policy more expansionary in recessions even without active decisions – are one reason for large crisis relief programmes in the US compared to other countries. Political reluctance to allow debt to grow may deepen the next recession, which would spill over to the rest of the world as well. Like other countries, the US also faces challenges due to climate change and neglected infrastructure, although Biden's reforms have improved the situation. US defence spending is lower as a share of GDP than it has historically been, while geopolitical risks are growing. US economist Herbert Stein (1916-1999) famously said that "If something cannot go on forever, it will stop." This is also true of America's growing national debt, but there is a risk of volatility on the way there.

# Japan
# Normalising the policy rate proves to be challenging

**The sustainability of the inflationary effects caused by last spring's wage agreements is being questioned, while the Bank of Japan is being forced to slow its normalisation of monetary policy to avoid triggering another dramatic stock market nosedive. Yearly economic growth in 2025-2026 will be around 1 per cent. During our forecast period, the BoJ will raise its policy rate to 0.75 per cent in a world of falling key interest rates. Monetary policy, including past BoJ asset purchases, will remain clearly expansionary**

**Hopes remain high** that Japan has finally left its deflationary cycle behind. But most households are unaccustomed to price increases and higher interest rates. The recent stock market plunge has also made households more cautious.  This situation is challenging to the country's politicians and the central bank, while raising reasonable questions about the level of sustainable inflation and the growth impact of last spring's historically high pay agreements. Continued expansionary monetary policy will logically make the yen undervalued against currencies like the US dollar, while long-term domestic and foreign capital will be attracted to Japanese equities – despite the drama of early August.

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

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 1.7 | 0.4 | 1.0 | 1.1 |
| Unemployment* | 2.6 | 2.5 | 2.4 | 2.4 |
| CPI | 3.3 | 2.5 | 2.0 | 1.8 |
| Public sector balance** | -5.8 | -6.5 | -3.2 | -2.9 |
| Public sector debt** | 252 | 255 | 253 | 251 |
| Key interest rate, %*** | -0.10 | 0.50 | 0.75 | 0.75 |

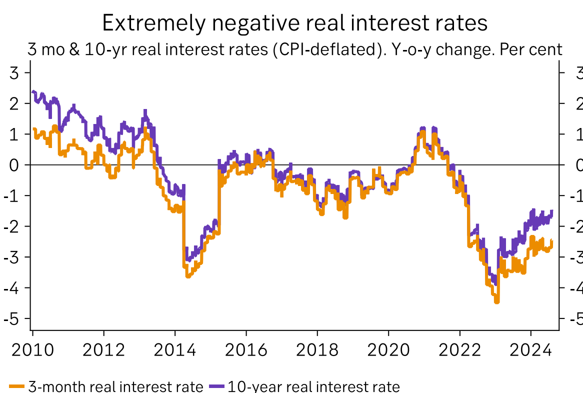
*% of the labour force **% of GDP *** at year-end. Source: IMF, SEB

**Growth will be hampered in the long term** by strong demographic headwinds including an ageing population, which will contribute to a markedly tight labour market. The labour market will remain strong, with unemployment in the 2.5 per cent range. Capital spending growth is being sustained by high corporate profits, which are also favourably affected by a weak yen. There are hopes that new investments in AI and digitisation will boost Japan's productivity in the long term.

**The shift in monetary policy**, i.e. BoJ's key interest rate increases in March and July and its reduced quantitative easing, is expected to have only a marginal impact on economic growth. GDP will increase by around 1.0 per cent per year in 2025–2026 – just above potential growth, which is assumed to be in the range of 0.5–1.0 per cent. The domestic economy continues to benefit from pent-up post-pandemic consumption demand, increased defence investments and higher tourism, partly due to the weak yen. However, the security policy situation in the world and Asia is a downside risk to our forecast. Meanwhile, the country's high public debt – 255 per cent of GDP – remains a potentially destabilising factor, but it can be financed by Japan's private sector.

Extremely negative real interest rates

3 mo & 10-yr real interest rates (CPI-deflated). Y-o-y change. Per cent




Source: Macrobond Financial AB, Macrobond, SEB

**The outcome of this summer's supportive JPY purchases** was underwhelming, but the BoJ's July 31 increase in the key interest rate by 15 basis points to around 0.25 per cent is believed to have helped cause increased global stock market stress and speculation about the unwinding of so-called carry trades. Excessive yen appreciation is undesirable because it would reduce the possibility of sustainably achieving the BoJ's 2 per cent inflation target.

**The BoJ's potential** for eventually normalising its monetary policy and meanwhile achieving a stronger yen will be made easier by the fact that other central banks are now lowering their key interest rates. Our forecast is that the USD/JPY exchange rate will reach 140 by the end of 2024 and 130 by the end of 2025. In December 2026, USD/JPY will be trading at 132.

# China
# An economic policy rethink is needed

**Chinese policymakers have struggled to lift growth and push through reforms. Confidence remains fragile in the economy, and the property sector has yet to rebound. Trade relations with the US remain front and centre. We expect GDP growth of 5 per cent in 2024 and even lower rates in the following years. The PBoC is likely to hold interest rates constant throughout our forecast horizon but cut the reserve requirement ratio (RRR) by another 25 basis points (bps) in Q3. We foresee the yuan trading at 7.10 per US dollar by year-end.**

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

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 5.2 | 5.0 | 4.5 | 4.3 |
| CPI | 0.4 | 0.6 | 1.6 | 1.8 |
| Fiscal balance | -4.6 | -4.9 | -4.9 | -5.0 |
| 1-year loan prime rate, %** | 3.45 | 3.35 | 3.35 | 3.35 |
| 7d reverse repo rate, %** | 1.8 | 1.7 | 1.7 | 1.7 |
| USD/CNY** | 7.10 | 7.10 | 6.80 | 6.80 |

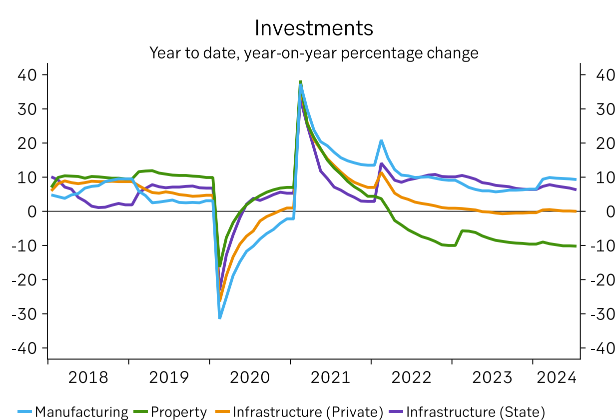
*% of GDP **At year-end. Source: IMF, SEB

**Momentum fizzled in Q2.** Hard data released for the second quarter of 2024 showed the economy stumbling, with flagging GDP growth of 4.7 per cent year-on-year, falling retail sales as well as persistently low inflation. Public infrastructure investments in large projects rose – boosting associated production – but private investments remain close to zero. Consumption growth is still depressed, as retail sales have largely remained flat in recent months.

**Production-consumption divergence.** Year-on-year industrial production growth fell to 5.1 per cent in July, from 5.1 per cent the month before. The divergence between production and consumption has thus widened further, underscoring weak household demand.

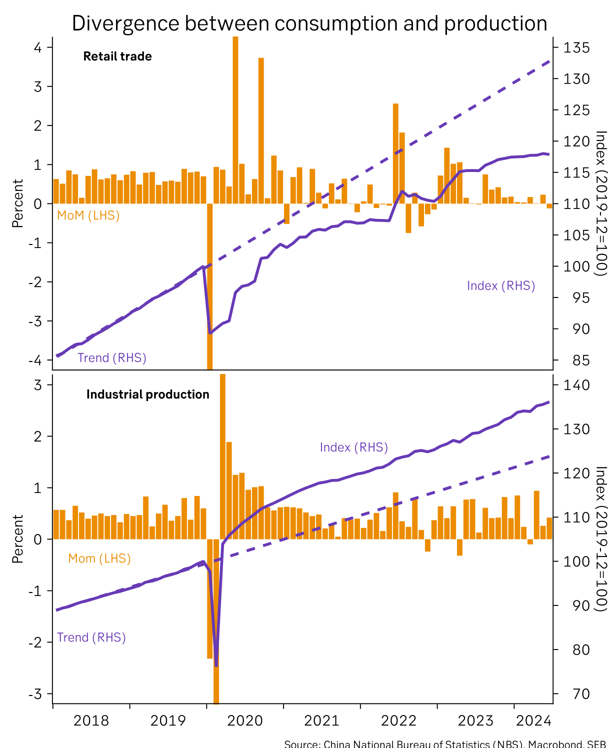
**The elephant in the room is structurally weak private demand.** As we have argued previously, because of structural reasons holding back consumer demand, GDP growth is likely to remain on a lower trajectory for the foreseeable future. With the authorities' current unwillingness to provide a broader social safety net or to expand the welfare system, household consumption is unlikely to sustain anything but soft growth from here on. In its latest Article IV report, the International Monetary Fund (IMF) underscored the need for significant structural reforms – including a strengthened social safety net, labour market reforms to lower job skill mismatches, pension reforms, better market integration, fostering competitive neutrality between state-owned and private enterprises, as well as improved insolvency and restructuring frameworks.

**Growth will decelerate.** We have kept our GDP forecast for this year at 5 per cent and expect even lower growth of 4.5 per cent in 2025 and 4.3 per cent in 2026. The IMF sees China's GDP growth at 3.3 per cent by 2029, a sign of the country's economic slowdown.




**The biggest internal threat to the Chinese economy remains the property sector.** Continued soft readings on China's housing indicators, despite some policy support, indicate that the correction is still underway. Home prices continue to fall further from their peaks, and tumbling housing sales squeeze the finances of developers – keeping default risks elevated. The first half of this year has seen continued weaknesses, and we expect only a gradual stabilisation occurring during the second half. That said, risks remain to the downside.

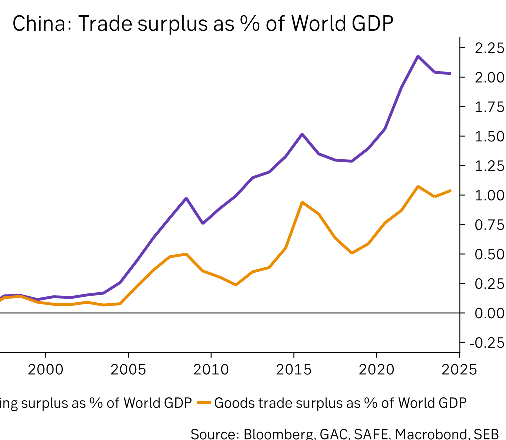
**We expect fiscal policy to drive growth this year**. The government has set the broad fiscal budget deficit (including local government, special and ultra-long treasury bonds) at 8.96 trillion yuan, or 6.6 per cent of GDP. This includes a CNY 4.06tn deficit (3.0 per cent of GDP) in the general budget, CNY 1tn in special bonds to be issued by the central government and CNY 3.9tn in special local government bonds. The issuance of government bonds has increased in recent months and the looser fiscal stance detailed at the National People's Congress suggests that government borrowing should remain considerable in coming months.




**Fiscal reforms are coming.** One area where the government appears to be tackling reform is fiscal policy. Falling tax revenues and lower land sales have been squeezing local public sector budgets, while the need to restructure debt is growing. The fiscal structure poses challenges due to the imbalance in the distribution of revenues and expenditures across regions and the central government. But in the concluding report of the recent Third Plenum, the government indicated fiscal reforms designed to strengthen local and regional government finances, notably by expanding central government transfers and a larger cut of fiscal revenues from consumption taxes and surcharges. Moreover, the central government will assume more expenditure responsibilities.

**In with new productive forces....** One of the top priorities for 2024 in the government reports this year has focused on innovation and on so-called "new productive forces". This involves fostering high tech sectors and innovation to drive growth with the aim of supporting new industries to break foreign chokeholds on key technologies, increase supply chain independence and develop new drivers of economic growth.

**...and out with old unproductive forces?** But while new productive forces should boost GDP growth, China must also deal with overcapacity (see the theme article on page 27). Analysts have warned of overcapacity in a large and contracting property sector, a weaker steel sector, as well as the risk of zombification in the legacy automotive sector. In addition, many factories in China's traditional more low-tech manufacturing sectors are struggling with anaemic orders from Western buyers, trade restrictions in foreign markets and growing competition from countries such as Vietnam and Indonesia, as well as Bangladesh and India.




**Export growth capped by geopolitics.** China's manufactured goods surplus has steadily increased over time, to the point where it is now 2 per cent of global GDP. However, a Trump presidency and higher tariffs would likely restrict export contributions to growth. As we noted in our recent *Emerging Markets Explorer*, there may be little daylight between presidential candidates Harris – previously Biden – and Trump in their overall China stance, aside from the level of tariffs. And as evidenced by the European Commission's recent decision to implement duties on Chinese electric vehicles, deteriorating trade relations with the European Union could see the latter introduce even more protectionist measures, further restricting Chinese export revenues.

**Weak inflation, limited room for PBoC.** Low domestic demand should keep inflation weak, but currency concerns limit the People's Bank of China's room for manoeuvre, despite a recent interest rate cut. Annual inflation was 0.5 per cent in July, with core inflation a tad lower at 0.4 per cent. We expect inflation of 0.6 per cent in 2024 and believe it will remain well below the 3 per cent target in 2025 and 2026. We expect the PBoC to lower the reserve requirement ratio (RRR) by another 25bps in Q3 2024, while whereas policy rates should remain on hold throughout our forecast horizon. Despite the recent strengthening of the yuan, we see it reaching an even stronger 7.1 by year-end, and 6.8 by the end of 2025.

Theme:

# China's overcapacity

## A growing headache for both Beijing and the world

**There is overcapacity in the world's second largest economy. This is believed to have cyclical, structural and state aid-related causes. To maintain high GDP growth, China is forced to channel a growing share of its goods surplus to the global market. Low inflation and a weak currency make Chinese goods even more competitive. Looking ahead, China's size will make this a global disinflationary force. There is great concern in the US, the EU and elsewhere that China's persistent macroeconomic imbalances and continued large-scale government subsidies are having a negative impact on growth and job prospects in other countries. Relations with China have become complicated due to Beijing's growing economic strength and a rapidly deteriorating security policy situation. The risk of trade wars and geo-economic fragmentation continues to increase.**

**China's state aid amounts to 5 per cent of GDP** per year, according to the Washington-based Center for Strategic & International Studies (CSIS). That is ten times more than the governments of the United States, Japan, Germany or Brazil spend. This state aid is also targeted to specific industries such as semiconductors, steel and aluminium. According to CSIS, China is exhibiting behaviour that currently points to rising industrial subsidies despite the prevailing overcapacity in China's manufacturing sector, which accounts for about 30 per cent of global manufacturing.

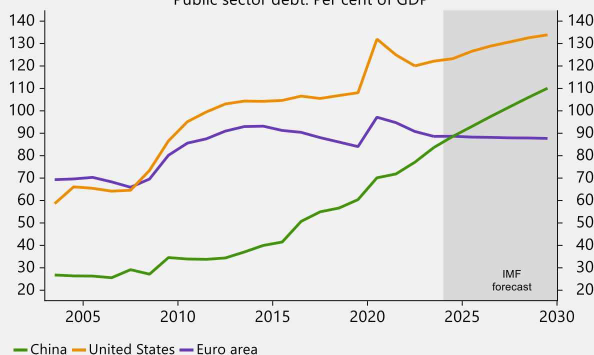
**The EU elections in June, the NATO summit in July and this year's US election campaigns** show a clear political determination to expand tariffs and trade barriers against China. The aim is to protect domestic industry against state-subsidised Chinese goods, reduce economic vulnerability and step up pressure on Beijing to stop supplying goods to the Russian economy – thereby enabling Moscow to continue its unprovoked, illegal and full-scale invasion of Ukraine.

**At present, Chinese inflation is worryingly low**. In a new analysis, the International Monetary Fund (IMF) concludes that the emergence of more persistent disinflationary pressures in China can be linked to both overcapacity and lower food and commodity prices. Export price deflation is currently 5 per cent. This situation poses a challenge not only to China but also to many other countries.

## China and the world are in the same boat

China is the world's second largest economy, after the US but ahead of Germany and only slightly smaller than the entire European Union. What happens in China – positive and negative – has major consequences for the world. The Chinese economy is facing tough headwinds (see "China – An economic policy rethink is needed", p 25). There has been a surge in the country's public sector debt in the past decade (see chart). Meanwhile the private sector – households and private enterprises – has reduced its debt level, according to "credit gap" calculations by the Bank for International Settlements (BIS). Overall, Chinese economic policymakers are still believed to have enough room to reduce the risk of a negative spiral that includes falling consumer prices.

China's public sector debt has soared in the past decade




**China's economic policymakers** currently appear to be focusing mainly on strengthening, not reducing, the role of manufacturing as a growth engine. Given weak domestic demand, an increasing share of Chinese goods needs to be offered in the global market if such a growth strategy is to succeed. This has a major impact on companies in other countries: downward price pressure, lower profitability and the risk of job losses.

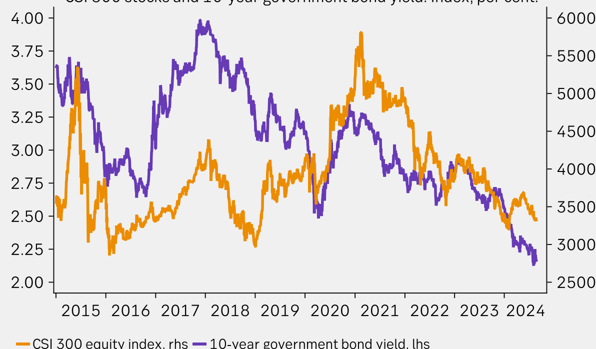
**Beijing's use of state aid** has been extensive, according to the IMF, with significant subsidies targeted to export companies – putting imports at a disadvantage. Large-scale subsidies increase the risk of undesirable negative side effects, such as incorrect resource allocation and less productive investments. A total of 5,400 state aid measures were implemented during the period 2009-2022, according to Global Trade Alert. This represents two thirds of all state aid measures implemented by developed countries in the G20 over the same period. Vehicles, computers, chemical products, metals and industrial equipment are the sectors that have received the most support.

**China's households are in a tough situation**. Despite Beijing's measures to revitalise the depressed property market, housing prices are falling, although the picture is complex. China's stock markets have also suffered setbacks due to deteriorating international relations and threats of tariffs, regulations and restrictions on Chinese goods. Falling asset prices are affecting household optimism and willingness to spend. While such turmoil persists, there is a risk that expansionary fiscal policies targeted to households – which more and more economists are now calling for – will have little impact: an increased public savings deficit will instead turn into an increased private savings surplus.

## Hard to correct China's imbalances quickly

China has exceptionally high private savings. Over the past 20 years, savings have been equivalent to 45-50 per cent of GDP, more than twice the historical average for the OECD countries and about 10-20 percentage points higher than comparable East Asian economies. China accounts for 28 per cent of global savings but only 17 per cent of global GDP. The consequence of high savings is low household consumption. Efforts to persuade households to reduce their savings, in the absence of a more highly developed social welfare safety net, seem to be failing. Higher real interest rates also stimulate savings. Macro imbalances thus remain.

Depressed Chinese equities, despite falling bond yields




**The EU and the US are trying to slow China's flow of goods** for both economic and security policy reasons. The EU's rightward political shift after the June elections, the NATO summit's unusually blunt statement that China is "a decisive enabler of Russia's war against Ukraine" and this autumn's US elections all increase the risk of Chinese isolation. The question is then: Is it possible to boost exports to Russia even more (something the US and EU do not want to see)?

**But Russia's economy is not big enough** for China to redirect more goods across the Russian border. The above table confirms China's large-scale trade with the EU and the US. Russia only comes in at 7th place as a trading partner as of 2023. During 2024 the US has approved tariffs on electric cars and other technology,

as well as export controls on, among other things, AI chips. The EU is also introducing tariffs on electric cars from China. There are sound security policy reasons for new trade and industrial policies, but this should not overshadow the fact that Chinese goods demonstrate impressive innovative power and quality improvements. China is under duress and is being pressured to change its policy direction. The question is which way it will go.

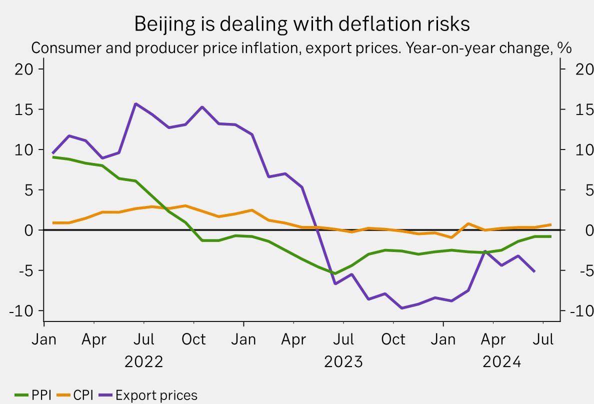
**China's 10 largest trading partners in 2023**
Exports and imports. USD billion

| Partner | Amount | Partner | Amount |
|---|---|---|---|
| European Union | 783 | Taiwan | 268 |
| United States | 664 | Russia | 240 |
| Japan | 318 | Vietnam | 230 |
| South Korea | 311 | Australia | 229 |
| Hong Kong | 288 | Malaysia | 190 |

Source: US Treasury, 2024

## Export prices are falling...

China's deflation risk may be accentuated by factors such as continued high savings and weak consumption, as well as stress in the real estate sector. The level of excess capacity is hard to estimate for a country as complex as China. According to the IMF estimate of the "output gap" (a negative figure is synonymous with excess capacity), it will total -1.2 per cent during 2024 and -0.5 per cent in 2025. However, our conclusion is that Beijing is more afraid of inflation than deflation, since higher prices can create social tensions.

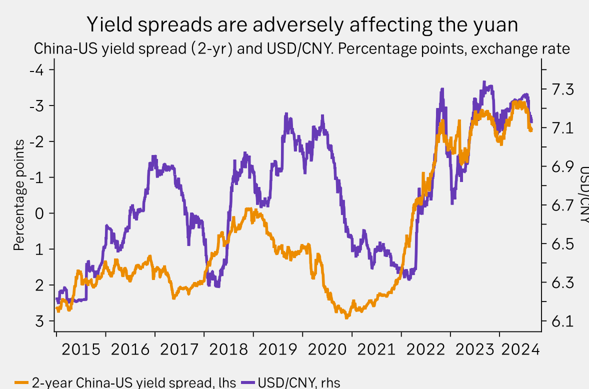



Source: China General Administration of Customs (GAC), China National Bureau of Statistics (NBS), Macrobond, SEB

**China's export price deflation of 5 per cent** is a key global disinflationary force, due to lower import prices in other countries. In addition, weak domestic demand in China is squeezing international commodity prices. In a BIS report, it is estimated that in 2023, China's price developments contributed to reducing the annual rate of import price increases by an average of 6 percentage points. It further notes that this can be translated into downward pressure on CPI inflation averaging 1.5 percentage points (all else being equal).

**But it takes time before this effect reaches the inflation rate** in individual economies, since many of China's export goods are also inputs in long global production chains. Increased competition from China may also force global producers of similar goods to respond by lowering their prices. This pushes down global inflationary pressures, particularly in goods and to a lesser extent on the services side.

**The strength of the dollar during 2022-2024** has contributed to a 11 per cent depreciation of the yuan against the USD. The People's Bank of China has a foreign exchange reserve equivalent to USD 3.26 trillion. The PBoC thus has big financial muscle, enabling it to buy yuan if the currency is considered too weak. Yet its reserves today is as large as at the beginning of 2022. Beijing has thus accepted the yuan's loss of value. This has allowed China's exporters to keep prices unchanged or lower them. The yuan's decline against the euro is about 10 per cent during the same period, but the Swedish krona has lost about 2 per cent against the yuan over the past 2.5 years.




## Lower price of money?

High risk aversion in the Chinese private sector due to the uncertain domestic and international situation, combined with a rapidly ageing population, is adding to an increased supply of savings in the global capital market. Put simply, the neutral rate – a key indicator in determining the degree of monetary policy stimulus/contraction – is affected by the supply and demand for savings at the global level. All else being equal, we can expect an increased savings supply in an economy as big as China to help push down the neutral interest rate. This affects the entire global fixed income market.

**Worrying steps towards increased geoeconomic fragmentation** may be inflationary – even though China is currently having a disinflationary impact on the world economy. What paths countries choose in their trade and industrial policies will be crucial in solving long-term inflation problems, but in a best-case scenario, AI may act as a counterforce to these risks.

# India
# Weaker Modi 3.0 should not upend broad reform track

**Despite less-than-expected voting support in last spring's elections, as well as a trimmed budget, Prime Minister Narendra Modi's third term should see significant reform. Institutional concerns and reform challenges could block progress, however. Inflation convergence to target should continue at a modest pace. We expect monetary policy loosening to start only in the final quarter of this year.**

**Strong growth in the medium term.** The Indian economy has continued to perform well over the past several quarters and is now 23 per cent above its pre-pandemic level. GDP grew by 7.8 per cent year-on-year in the first quarter. GDP data for the past two quarters may have overstated growth somewhat (an alternative metric – gross value added – showed slower but still strong 6.3 per cent growth in Q1). Still, India remains a high-growth outlier compared to most other major economies and continues to accelerate above its own trend.

**Key data**

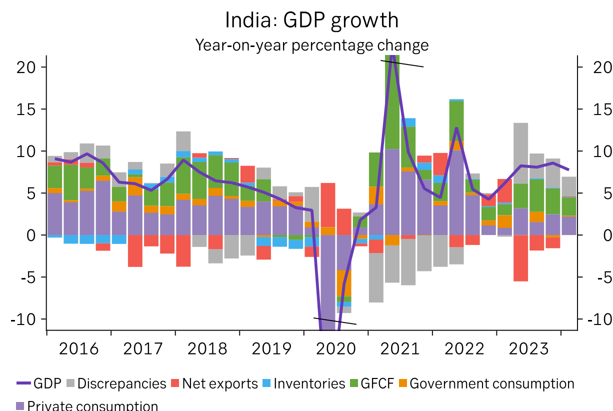
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP* | 7.6 | 6.5 | 6.5 | 6.4 |
| CPI | 5.7 | 4.5 | 4.4 | 4.5 |
| Policy rate | 6.50 | 6.25 | 5.75 | 5.75 |
| USD/INR | 83.10 | 82.50 | 81.00 | 81.00 |

** India's fiscal year runs from April 1 to March 31 the following year. In this table, 2024 thus denotes the period from April 2023 to March 2024.*

Source: IMF, SEB

**Somewhat slower growth as restrictive policy goes into effect.** Growth should slow in the coming quarters, partly due to restrictions on previously unregulated lending volume that will lower household consumption, while a tight monetary policy stance should continue to mute overall credit growth. The projected fiscal deficit was lowered to 4.9 per cent of GDP in the coming fiscal year (compared to 5.1 per cent in the previous budget). Part of this reduction may be due to overly ambitious revenue projections rather than a fallback in spending. Prime Minister Modi's new dependence on coalition allies also leaves open questions over whether spending in the budget may be tilted in ways related to coalition politics rather than efficiency. As we have pointed out in previous publications, India stands to gain from geopolitical realignments, but so far their aggregate impact on foreign direct investment (FDI) has been modest.



Source: Indian Ministry of Statistics & Programme Implementation (MoS&PI), Macrobond, SEB

**All in all, we expect average annual GDP growth of 6.5 per cent in 2024-2026.** This should turn India into the world's third largest economy in USD terms within a couple of years. On the external side, the current account deficit in coming years should stay under 2 per cent of GDP, absent significant commodity prices spikes.

**Disinflation underway but RBI in no rush to cut.** Headline inflation rose to 5.1 per cent in June (up from 4.8 per cent the month before), which is within the Reserve Bank of India's target range but still some way from its mid-point of 4 per cent. The disinflation process has been slowed by stubbornly high food inflation, which was 8.4 per cent the same month and makes up about 46 per cent of the price basket. A slow last mile towards the inflation target remains our baseline forecast, along with the expectation that the central bank will only commence lowering rates in the last quarter of this year. After cuts from 6.50 to 5.75 per cent, we expect the RBI to keep its key rate at 5.75 per cent during 2025-2026.

**Modi 3.0 reforms and institutional concerns.** The elections which ended in June led to continued Modi rule, albeit in a coalition with allies from various Indian states. In our view, this should not upend broader reform plans, and any increased welfare spending should only occur ahead of the next election in 2029. Yet this partnership increases the risk of policy distractions and resources spent on holding the coalition together. The prime minister's agenda this year will revolve around economic reforms, infrastructure development and further bilateral trade deals. But institutional deterioration has remained one of India's key risks going forward. Analyses of political institutions by multiple sources have shown deterioration under Modi's rule. If this should undermine faith in the rule of law, investors may become less amenable to India.

# Emerging markets
## Room for further easing as Fed moves to cut key rate

**The approaching Fed easing should allow more EM central banks to cut rates, providing room for growth to pick up further. But the disinflation process has slowed, and lingering price pressures remain in several countries. Policy paths thus look set to diverge. Growth trajectories vary widely between China and India, and fiscal risks remain in Latin America. Geopolitical and US election uncertainties remain key risks to emerging markets going forward.**

**GDP growth**

Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| China | 5.2 | 5.0 | 4.5 | 4.3 |
| India | 7.6 | 6.5 | 6.5 | 6.4 |
| Brazil | 2.9 | 2.0 | 2.0 | 2.2 |
| Russia | 3.6 | 3 | 1.6 | 1.5 |
| SEB EM aggregate | 4.2 | 4.2 | 4.2 | 4.2 |

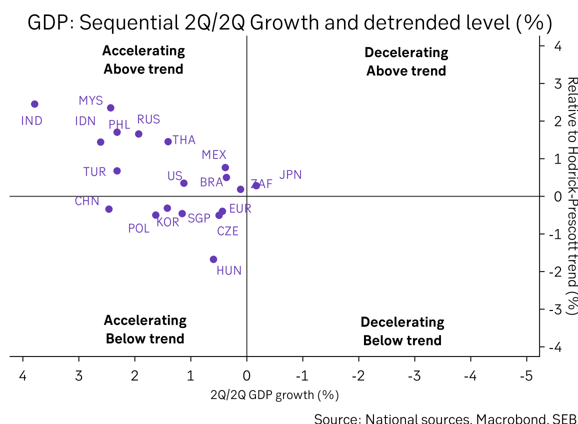
Source: International Monetary Fund (IMF), SEB

**Rate cuts will continue in Q4 once the US Federal Reserve has cut its key rate in September**. Several EM central banks paused their rate-cutting cycle earlier this year, following lingering inflationary pressures and Fed's "higher for longer" rates. Meanwhile, FX weakness year-to-date put further pressures on some central banks, leading Indonesia and Russia to raise rates in recent months, but as Fed cuts come into place EM FX should recoup some of the year-to-date losses.

**GDP growth has accelerated above trend, except for some East Asian countries as well as Central and Eastern Europe (CEE)**. For all EMs we cover, GDP accelerated in the last two quarters compared to the previous two quarters. Sequential growth has picked up the most in Asia (excluding Malaysia, Singapore, and Korea) but the outturn for Q2 is still incomplete among EMs. In annual terms, India, Russia and Turkey have also grown rapidly.

**Most of our EM space is accelerating, above trend levels.** All our covered EMs are now above their pre-pandemic GDP levels. China and Brazil remain close to their respective trends whereas India's high growth rates has seen it reach well above.

GDP: Sequential 2Q/2Q Growth and detrended level (%)

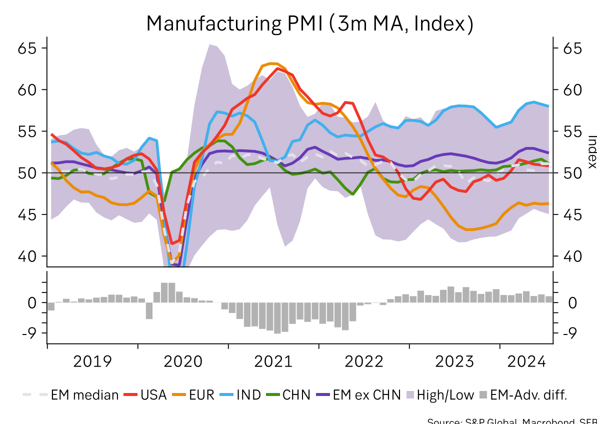



Source: National sources, Macrobond, SEB

Both Czechia and Hungary show at best timid signs of growth following interest rate cuts that started last fall, whereas the Polish economy accelerated in Q2. Turkish growth remains inflationary and lacklustre growth in South Africa has been accompanied by structural problems, even after the successful formation of a new ANC-led coalition. In Russia, the country's transformation to a war economy hides the unsustainable drivers behind high headline growth rates.

**Manufacturing PMIs signal acceleration in economic activity.** Composite purchasing managers' indices (PMIs) in the US, EU and Japan deteriorated in recent months, with the EU remaining in contractionary territory. The EM-DM differential remains favourable and has held up as activity in developed markets (DMs) has weakened somewhat. Momentum in India remains at historical highs. As we noted in our recent *Emerging Markets Explorer*, countries like Mexico and several East Asian countries benefit from friendshoring in trade as the US shifts imports away from China. Yet these trade shifts have yet to result in significant investment shifts and have so far had limited growth effects.

Manufacturing PMI (3m MA, Index)

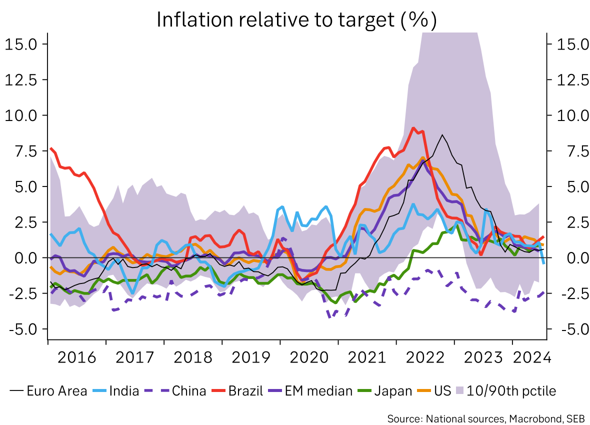



Source: S&P Global, Macrobond, SEB

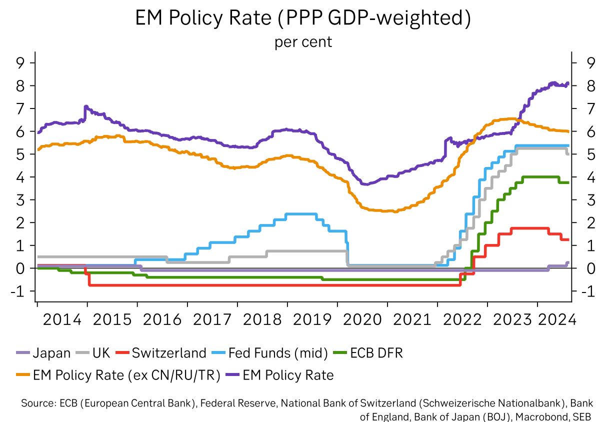
**China is slowing, India to become global number three.** In 2024, we foresee annual GDP growth in China of 5 per cent even as fiscal stimulus only counteracts

some of the weakness in domestic demand. We also foresee the economy falling back to 4.5 and 4.3 per cent in 2025-2026 amid a declining growth trend. In India, GDP growth under the third term of Prime Minister Narendra Modi should average 6.5 per cent during 2024-2026, allowing India to succeed Germany as the third largest country in dollar GDP by 2027. Overall, easing monetary policy – albeit delayed following postponed Fed cut expectations – should open up for stronger household demand. Modi's weaker-than-expected support in his re-election should not derail but may temper some reform prospects over the medium term.

**In Central Europe, real wages should boost activity** but at the same time also limit disinflation. Emerging Asia could see more conservative growth rates as tight policy feeds into the economy and continued weak domestic Chinese demand limits export contributions to growth. Latin America will continue to see meagre growth. In Brazil, we also see heightened fiscal risks as the government's commitment to fiscal prudence is being undone by a widening budget deficit. Even if somewhat more expansive monetary policy could ease the interest rate burden, lower nominal GDP growth implies worse public debt dynamics going forward.




**Inflation remains above target in most EMs.** The disinflation process among EMs has slowed, and inflation remains above target in most of our EMs, except for China, the Philippines and Thailand. Meanwhile, most Central European countries are above their inflation targets. Underlying inflation pressures in Hungary and Poland remain considerable and headline inflation should rise again during the year. Durably high wage growth will boost real wages and support household demand but should over time push up consumer price inflation again. Turkey stands out with its core inflation above 62 per cent, an outcome of the inflationary shock from years of economic mismanagement and unsustainable consumption-driven growth. Cost-push inflation has also receded. Median producer price inflation among the EMs we cover has been roughly flat since mid-2023 and remains in deflationary territory in China. Looking forward, this should allow some cost-push disinflation.




**Risks to the EM growth outlook appear balanced**. Commodity price spikes and spillovers from regional conflicts in the Middle East and Ukraine may generate adverse supply shocks, complicate the disinflation process, delay monetary policy easing and ultimately depress economic growth, with diverging consequences for exporters of commodities versus importers. Higher energy and food prices may lead to deteriorating fiscal balances in countries with significant food and fuel subsidies, and push headline inflation higher. Coupled with risk-on sentiment, this could force EM central banks not just to delay, but even raise policy rates.

**Fragilities in the Chinese economy present continued risks** as adverse shocks dissipate globally, through transmission of disinflation overseas and lower demand for trade partner exports. Uncertainty over the US presidential election remain a key concern. If Donald Trump returns to the White House, this will likely imply higher tariffs. Depending on whether tariffs increase equally across all EMs or whether disproportionate increases occur for China, this will matter significantly, since it will affect the amount of trade and investment that will be rerouted towards other EMs. The conflict in Ukraine, assuming agricultural exports are not adversely affected, should have limited impact on EMs. We expect an increased focus toward a negotiated cessation of hostilities starting next year, even though a peace settlement still appears distant. Continued fighting in the Middle East poses a risk to the global economy, predominantly in the case of an outright war between Israel and Iran. As we noted in April's *Emerging Markets Explorer*, this could potentially draw in other countries in the region, putting oil infrastructure at risk.

# Euro area
# Political obstacles to growth

**After having stagnating late last year, the euro area has resumed its economic growth, albeit at a moderate pace and still pulled down by Germany. Due to lower inflation and continued interest rate cuts by the European Central Bank, domestic demand will accelerate in the second half of this year. The labour market is robust, with only small signs of weakening, and the upturn in unemployment will be marginal. The ECB will cut rates again in September.**

A recovery began in the first half of this year. GDP rose by 0.3 per cent during both quarters – slightly stronger than expected after the euro area showed zero growth in the second half of 2023. Sentiment indicators remain weak overall, although surveys such as purchasing managers' indices (PMIs) have improved slightly this year despite some setbacks in recent months. The outlook continues to vary between countries and sectors. The German economy is especially weak. Most worrying is Germany's manufacturing sector, which continues to struggle against headwinds. But French industry is also under pressure from generally weak demand. More service-dependent economies such as Spain, Greece, Ireland and Portugal have continued to show higher growth rates over the past two years, partly due to the recovery from the pandemic. In the overall euro area, the service sector remains the main driver of growth, as indicated by the services PMI.

**Key data**

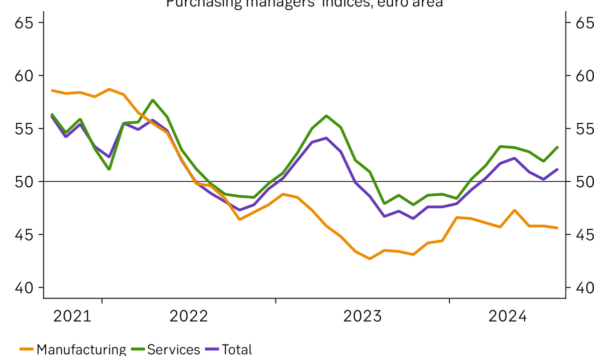
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 0.4 | 0.8 | 1.6 | 1.5 |
| Unemployment* | 6.6 | 6.5 | 6.5 | 6.3 |
| Wages and salaries | 5.3 | 4.6 | 3.3 | 3.1 |
| CPI | 5.4 | 2.5 | 1.8 | 1.8 |
| Public sector balance** | -3.6 | -3.0 | -2.6 | -2.5 |
| Public sector debt** | 88.6 | 88.6 | 88.6 | 88.5 |
| Deposit rate, %*** | 4.00 | 3.25 | 2.00 | 2.00 |

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

Gloomy manufacturing sector, but robust service sector

Purchasing managers' indices, euro area




Source: S&P Global, Macrobond, SEB

**The recovery will begin this year.** Inflation has gradually fallen since peaking late in 2022. Its decline will continue, although some setbacks cannot be ruled out. Inflation will not reach the ECB's target until early 2025, but by June 2024 the central bank felt comfortable enough with the inflation slowdown to begin cutting its policy rates. Combining with high nominal wage increases, the scope for consumption will increase. Capital spending, which fell during the first quarter of this year, will benefit from looser financial conditions as well as the energy and green transitions, digitisation and increased defence spending. But although inflation and interest rates are falling, prices and interest rates remain high, which means the recovery will be moderate. Overall, GDP will grow by 0.8 per cent in 2024 and just over 1.5 per cent in 2025 and 2026 – in both years slightly above trend. Compared to our May forecast, growth will be slightly higher this year and slightly lower next year.

**Robust labour market.** The labour market has been surprisingly resilient, with rapid employment increases despite weak economic growth. A robust service sector and skilled worker shortages partly explain this development. Another explanation may be that, despite lower demand, companies are holding on to employees to avoid labour shortages once the economy rebounds. Some degree of awareness of demographic headwinds, with many countries risking labour shortages, cannot be ruled out either. We believe that the factors that have contributed to labour market resilience will continue to prevent a sharp rise in unemployment and that the jobless rate will begin to fall again in the beginning of 2025. Together with high wage increases, strong employment will enable consumption to increase during the next couple of years.

**Limited support from fiscal policy.** Several major economies are struggling with weak public finances. Fiscal policy is expected to be mildly contractive in 2024 and 2025 and broadly neutral in 2026.

**Weak public finances are a source of concern**. The Maastricht Treaty, with its rules on public sector finances, was placed on hold during the COVID-19 pandemic but went back into effect starting in 2024. Many EU countries will thus need to reduce their deficits and debt levels over the next couple of years. Budget deficits in France and Italy are especially high (5.5 per cent and 7.4 per cent of GDP in 2023, respectively). The EU therefore decided this summer to launch excessive deficit procedures against France, Italy and five other member states because they are regarded as being in breach of the Maastricht regulations. These countries must now negotiate a plan in collaboration with Brussels to reduce both debt levels and budget deficits. This year, the EU adopted a new fiscal policy framework. While countries must comply with the criteria of the Maastricht Treaty, the new framework allows them a certain amount of flexibility to boost capital spending.

**Longer-term growth challenges.** Even if economic growth picks up, the recovery will be moderate. Structural challenges will limit rapid GDP recovery in the longer term. One clear challenge is demographic: an ageing population. For example, projections show that in Germany the working-age population will fall significantly (from about 50 million in 2021 to just over 40 million in 2050). There is a risk that increasing protectionism will dampen exports, which are important for growth. If Donald Trump wins the US presidential election, he has promised to impose higher tariffs on all imports. Trade relations with China have also become more tense since the EU decided to impose provisional tariffs (in the 17-38 per cent range) on electric car imports from China. A final decision on these tariffs is expected this autumn through a vote by the member states. Since China and the US, together with the UK, are the EU's largest trading partners, the growth effects of increased tariffs will probably not be negligible.

**GDP forecasts**

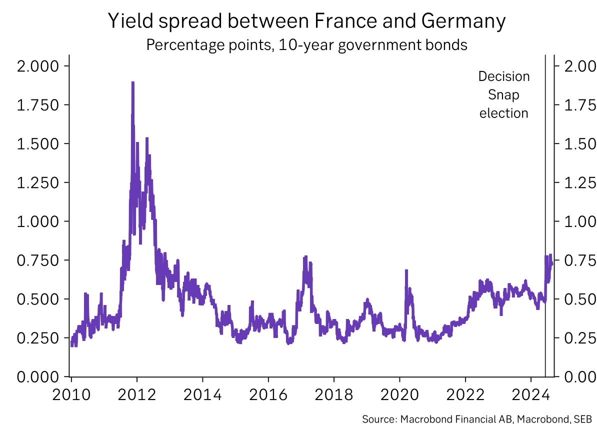
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Germany | -0.3 | 0.1 | 1.1 | 1.0 |
| France | 0.9 | 1.2 | 1.3 | 1.3 |
| Italy | 0.9 | 0.9 | 1.1 | 0.9 |
| Spain | 2.5 | 2.7 | 1.9 | 1.6 |
| Euro area | 0.4 | 0.8 | 1.6 | 1.5 |

Source: Eurostat, SEB

**The European elections did not change the playing field**. Although far-right parties were the big winners in the European Parliament election, the broad centre (conservatives, liberals and social democrats) retained its majority. Within a couple of weeks after the election, Ursula von der Leyen was re-elected as President of the European Commission for another five years. In her policy declaration, von der Leyen called for strengthening the EU economy and security and tackling climate change – including a new clean industry deal.

**Political turbulence in France.** President Emmanuel Macron's decision to call a snap election to the National Assembly this summer caused yield spreads to widen. However, they are clearly narrower than during the euro crisis, but in line with previous peaks in French social unrest. Financial markets are worried about the political intentions of both the leftist alliance and the right-wing populist National Rally, which risk increasing the country's already high budget deficits. After two election rounds, it was clear that the left-wing alliance had won the most seats, Macron's centrist alliance came in second and the National Rally third. Since no party received a majority of its own, forming a government and choosing a prime minister will be a complicated task. The country is being governed by a caretaker cabinet. A new prime minister and government are expected to be appointed soon. There is a risk that political turmoil in France will increase this autumn, especially since the most likely potential governments support policies that would increase already high budget deficits, while a divided parliament will find it hard to continue pursuing Macron's reform agenda.



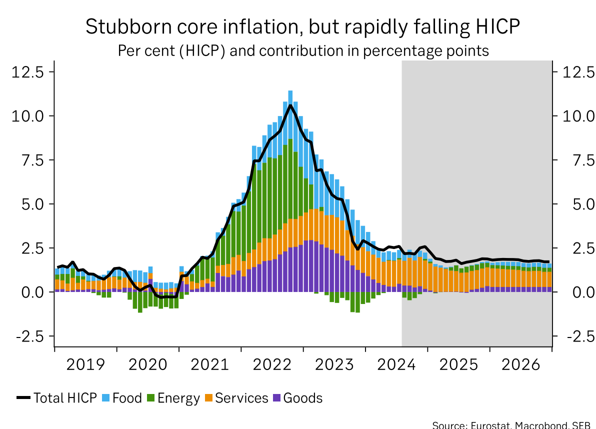

**In Germany, too, the political situation is tense.** The parties in the governing Traffic Light Coalition (the Social Democratic SPD, the liberal FDP and the Green Party) are far apart, especially when it comes to issues related to economic policy. Despite its low debt and large potential compared to other major euro area economies, Germany is being hobbled by its own fiscal rules in a situation where the economy is in a state of decline. The issue of the "debt brake" (which mandates a cyclically adjusted budget deficit of no more than 0.35 per cent of GDP and is laid down in the Constitution),

divides the coalition parties. It thus cannot be ruled out that Germany's budget problems will continue and that a fiscal crisis like the one that took place in late 2023 will occur again this year. Tensions within the government, its inability to make decisions and slow economic growth have increased popular discontent, while support for the xenophobic party AfD and the newly formed left-wing populist party Bündnis Sahra Wagenknecht (BSW) has increased (see the theme article "Germany – a sputtering EU growth engine" in *Nordic Outlook*, January 2024). This autumn, there will be elections in the states of Saxony, Thuringia and Brandenburg. By then it may become clear which way the political winds are blowing ahead of the national Bundestag elections in the autumn of 2025, although the outcomes may diverge from the country as a whole.

## The inflation downturn is still slow

Although inflation has now fallen for almost two years, reaching levels that provide some relief to households, the rate is still high. In addition, it also looks as if the final stages of inflation downturn will be more protracted. This is because service prices have shown stronger increases than expected during most of 2024. It thus seems as if demand still enables companies to pass on high costs to consumers, even though overall consumption has been stagnant for a long time. Consumer goods will add little to inflation, while increases in the price of services will be the main driver of inflation during 2024-2026.

Stubborn core inflation, but rapidly falling HICP
Per cent (HICP) and contribution in percentage points

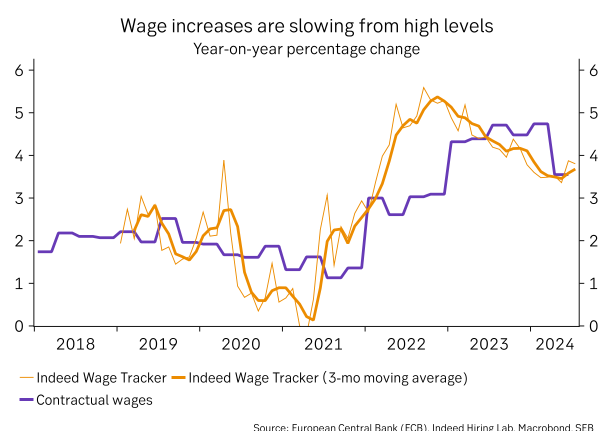



Source: Eurostat, Macrobond, SEB

**Upside risk.** It may seem strange that the decline in inflation rates will be so sluggish, in a situation where the real economy has so far barely shown any strength. But there is a significant backlog of proposed high wage increases, with employees demanding larger inflation compensation than is desirable. Looking ahead, both slower pay hikes and lower corporate profit margins will be needed if a decline in inflation is to materialise. A slower rate of wage growth is the primary risk in our inflation forecast and will largely be determined by wage formation in Germany. This year, international commodity prices have also stopped falling and have in fact risen slightly – a trend that must not continue if commodity inflation is to be as moderate as our current forecast suggests.

**A high but declining rate of pay increases.** Although we foresee a continued recovery in the real economy and a barely noticeable rise in unemployment, we believe that that the rate of wage growth will slow towards more sustainable levels. The main reason is that after a couple of years, households have in fact received the inflation compensation they demanded. Wage formation is thus normalising, although traditional wage metrics are still showing no signs that a major downturn has actually begun.

Wage increases are slowing from high levels
Year-on-year percentage change




Source: European Central Bank (ECB), Indeed Hiring Lab, Macrobond, SEB

**The ECB will continue to cut key interest rates.** We believe that given lower inflation and a relatively weak economy, the ECB will feel comfortable about continuing to cut interest rates, albeit gradually. Interest rates are still contractive and the ECB, like other central banks, will need to lower real interest rates after inflation has fallen. It will be crucial to get confirmation that wage growth and service prices will be lower. Since the main policy rate is lower than in countries like the US and the UK, the number of rate cuts will be fewer in the euro area. In recent months, the ECB Governing Council has also emphasised that its quarterly reviews of statistics, including forecasts, are important to its decision-making. It is thus natural to schedule interest rate cuts at these meetings. We expect the ECB to lower its key rates twice more this year and then continue to cut the deposit rate to 2 per cent by the end of 2025. At that point, we believe that the deposit rate will be neither contractive nor expansionary. However, the above-mentioned challenges related to fiscal policy constraints may persuade the ECB that it should assume marginally greater responsibility for supporting the economies late in our forecast period and it may thus cut its key rates more than we have predicted in our main forecast.

# The United Kingdom
# Interest rate relief, but tough fiscal trade-offs

**During the first half of 2024, the British economy performed better than expected. Meanwhile previous challenges remain, especially a tight labour market that is driving up wages and service prices. The new Labour government's fiscal policy faces major constraints, forcing the Bank of England (BoE) – which has started cutting its policy rate – to assume the main responsibility for propping up the economy.**

GDP growth has proven to be more resilient than expected. Rapidly rising wages have partly compensated households for high inflation but are meanwhile creating major risks of a more protracted decline in inflation, particularly on the services side. Private and public capital spending has been robust in recent years. However, this will not prevent GDP growth from gradually adding strength. GDP will increase by 1.1 per cent in 2025, followed by 1.5 per cent in 2026.

**Key data**

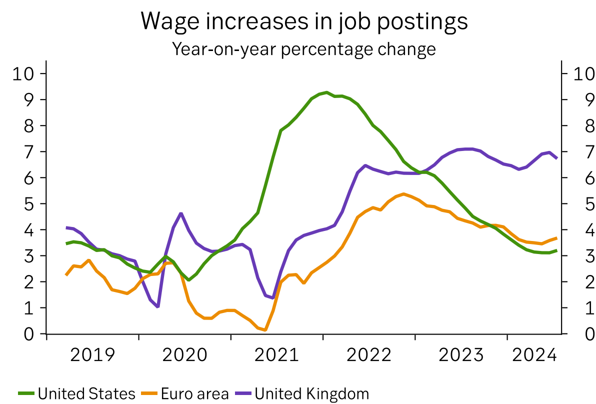
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 0.1 | 1.1 | 1.1 | 1.5 |
| Unemployment* | 4.0 | 4.4 | 4.6 | 4.7 |
| Wages and salaries | 7.1 | 5.1 | 4.5 | 2.5 |
| CPI | 7.3 | 2.6 | 2.2 | 1.9 |
| Public sector balance** | -6.0 | -4.5 | -3.8 | -3.5 |
| Public sector debt** | 101 | 104 | 106 | 107 |
| Policy rate, %*** | 5.00 | 4.50 | 3.50 | 2.75 |

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

**Slower inflation**. The inflation rate has fallen quickly, which can largely be attributed to so-called base effects from 2023. Service prices are still rising at an annual rate of nearly 6 per cent and will not decelerate more significantly until next year. The same pattern can be seen in wages, where increases do not seem to be slowing in the same way as in other comparable economies. Despite some deceleration in the labour market, the labour supply is a major challenge for the UK, contributing to expectations of continued high wage growth. Nevertheless, early indicators from surveys and other statistics on the number of job adverts and vacancies suggest a slowdown in the labour market.

**More interest rate cuts can be expected.** The BoE has lowered its policy rate once. We expect further cuts, albeit at a gradual pace. BoE policymakers are divided; several would have preferred to leave the policy rate unchanged in August. There seems to be a conflict between either basing monetary policy on signs of a slowdown and a weak economic outlook or pointing out that service inflation does not yet appear to have subsided to any great extent. Another unfortunate circumstance is recurring problems with the quality of labour market statistics, which makes the situation hard to interpret. Although we expect a continued recovery driven by household consumption, we foresee a lower rate of wage growth (and service prices). The BoE can thus continue to cut its key rate to avoid overly contractive economic policy. We expect the policy rate to be cut three times this year, i.e. two more times, and four times in both 2025 and 2026. We are forecasting a rate of 2.75 per cent at the end of 2026.




**New fiscal plan.** After 14 years of Conservative rule, Labour won this summer's election by a landslide. The party now has a sizeable parliamentary majority in favour of changing the direction of fiscal policy, although the exact content of these changes is still unknown. While waiting for a new budget (due this autumn), Labour is currently pointing to the major challenges it has "inherited" from previous governments. With high public sector debt and large deficits, tough trade-offs await. Meanwhile there is a need for reforms that can boost weak productivity and growth. During the election campaign, both Labour and the Conservatives promised to reduce the budget deficit to less than 3 per cent of GDP within five years. We do not see room for any major fiscal stimulus measures that can get the economy going. Instead, we believe that fiscal policy will be a mix of spending cuts and tax increases.

# The Nordics

**Sweden | page 38**

GDP growth will be above trend in 2025–2026. Household consumption will be the main driver, supported by rising real wages, expansionary fiscal policy and lower interest rates. The Riksbank will cut its policy rate to 2 per cent in 2025.

**Norway | page 45**

Growth is weighed down by falling residential investments and weak consumption. Recovery will be delayed until next year. Core inflation will keep falling. Norges Bank will gradually cut its key rate starting in December 2024.

**Denmark | page 47**

The recovery will broaden after several years of being driven by pharmaceutical exports. Consumption will be a key driver, buoyed by higher real wages. GDP will grow by 2 per cent in 2024 and about 3 per cent yearly in 2025 and 2026.

**Finland | page 49**

There are few bright spots in the Finnish economy. Subdued household demand, weak exports and high interest rates are hampering exports and investments. GDP will decline by 0.6 per cent this year but will begin to recover in 2025–2026.

# Sweden
## Clear upturn, supported by fiscal and monetary policy

**After more than two years of stagnant GDP, many preconditions for a strong recovery are in place. Lower interest rates and taxes will help ensure faster GDP growth in 2025-2026 than the long-term trend. Household consumption will be the main driver, underpinned by better real wages, expansionary fiscal policy and lower interest rates. The Riksbank will lower its policy rate to 2 per cent in 2025, and the government will spend SEK 75-80 billion on unfunded reforms in 2025.**

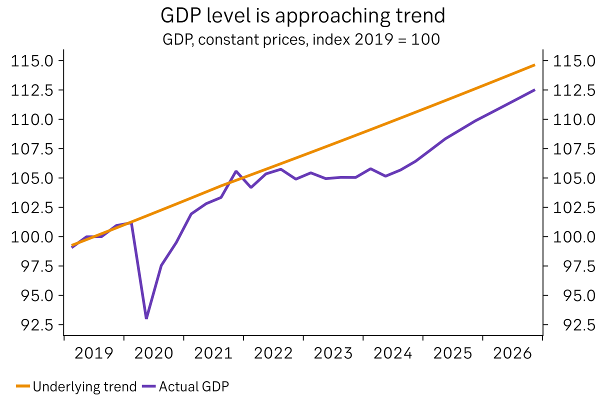
Growth has been bumpy but generally weak over the past year. A large GDP increase, 0.7 per cent, during the first quarter was completely reversed in Q2. Our impression is that the sideways GDP growth trend that has prevailed since early 2022 continued during the first half of 2024. But sentiment indicators suggest that the situation is improving and that growth will pick up, starting in the second half. Due to Riksbank rate cuts and an expected shift to a more expansionary fiscal policy, we are sticking to our optimistic growth forecast for 2025. We expect GDP to increase by 2.6 per cent next year and accelerate to 2.9 per cent in 2026. Compared to our May forecast, this is one tenth of a percentage point higher in 2024 and two tenths lower in 2025.

**Key data**

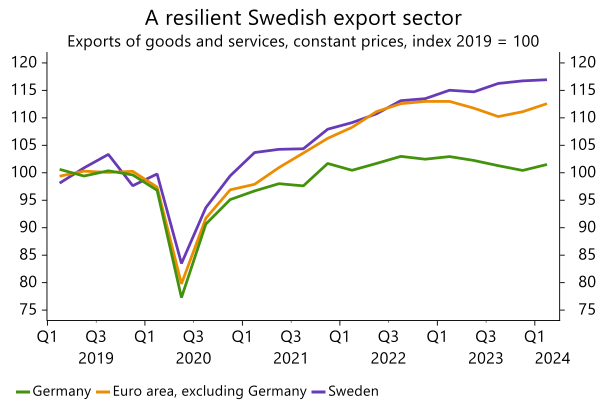
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | -0.2 | 0.6 | 2.6 | 2.9 |
| Unemployment* | 7.7 | 8.2 | 8.6 | 8.2 |
| Wages and salaries | 3.8 | 3.9 | 3.4 | 3.4 |
| CPIF | 6.0 | 1.9 | 1.8 | 1.8 |
| Public sector balance** | -0.6 | -1.0 | -1.3 | -0.5 |
| Public sector debt** | 31.7 | 33.0 | 33.5 | 34.1 |
| Policy rate, %*** | 4.00 | 2.75 | 2.00 | 2.00 |

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

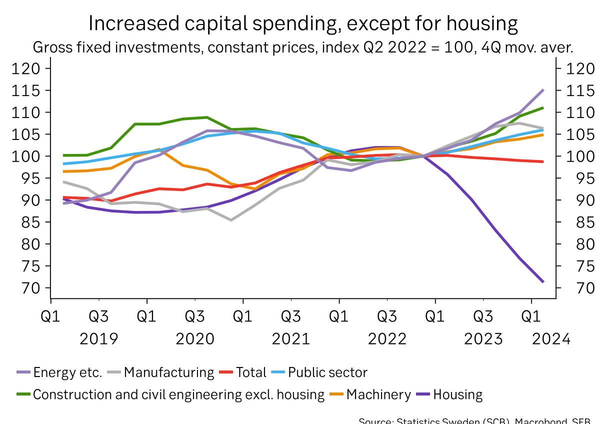



**Swedish manufacturers** have remained resilient amid weak European conditions. Exports continue to increase, though at a slower pace. The difference is striking compared to Germany. A weak krona is one explanation, and relatively low Swedish energy prices are probably also a contributing factor. Manufacturing sentiment surveys such as purchasing managers' indices (PMIs) and the National Institute of Economic Research (NIER) economic tendency indicator are close to historical averages, pointing to continued, albeit moderate, growth. Assuming a European rebound in 2025-2026, there is good potential for continued Swedish export growth. We expect a 4 per cent upturn in 2025 and 5 per cent in 2026. More than 70 per cent of exports go to European countries. Today's low PMI figures in the region are a downside risk to exports.



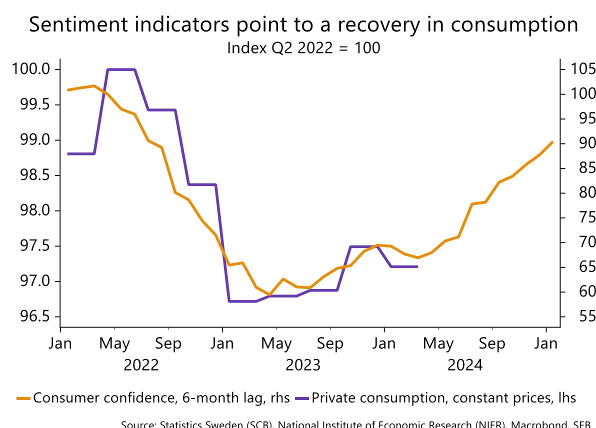

**Strong investments, except for housing.** Investments have shown continued resilience and a relatively broad upturn – apart from a steep decline for housing. Total capital spending has thus fallen slightly – driven by both the private and public sectors, including buildings and machinery. Green investments in northern Sweden are a driving force, but not the only one. Capital spending is increasing in many industrial sectors, but mainly energy. One risk is that several northern green investment projects have had problems with both production and demand. Various projects have been cancelled or scaled

down; some consolidation or even a decline is likely. It is hard to quantify the importance of green investments for overall capital spending, but growing pains and a generally high spending level will probably dampen growth in 2025–2026. A bottoming out and gradual increase in residential investments will provide support starting in the second half of 2025. Due to weak residential investments, overall capital spending declined in 2023 and 2024, but a construction turnaround will contribute to gains in 2025 and 2026.

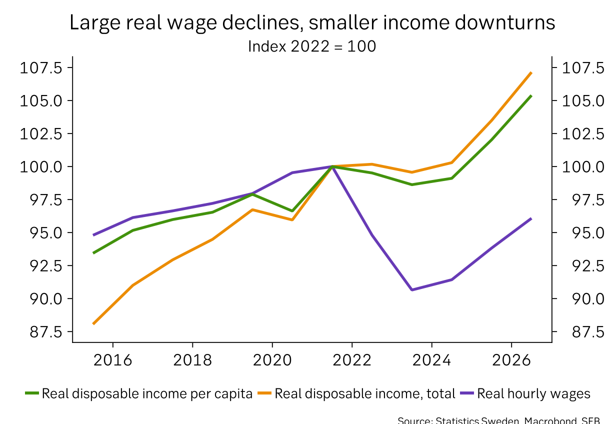



## Happier households

Between Q1 2022 and Q1 2024, household consumption volume fell nearly 3 per cent, on a par with the declines of the early 1980s and 1990s. Now, as then, the drop is explained by high inflation. Meanwhile consumption in nominal terms has continued to grow relatively fast. Monthly statistics indicate a continued decline in Q2 2024, but there are many signs that a turnaround is near.




**Things are looking better for households.** Hopes of clearly lower interest rates have rapidly pushed up consumer confidence this year, although its level is still far lower than in 2021 and compared to the historical trend. If the Riksbank cuts its policy rate in line with expectations (ours and the market's), this upturn will probably continue. The share of households with variable interest rate loans has risen to over 70 per cent, which will quickly improve household finances. Real wages are gradually rising. In 2025–2026, households will benefit greatly from expansionary fiscal policy. We expect SEK 20 billion/year, or 0.7 per cent of incomes, in tax cuts and grants. Household savings fell in 2022–2023 but not dramatically. In 2024, they look set to end up at nearly pre-crisis level.




**Rising unemployment is an uncertainty factor.** Because unemployment will be rising for the next 6-9 months, households may continue to be cautious in the near term. Yet we expect the factors that support household sentiment and incomes to nevertheless accelerate consumption during the second half of 2024. The conditions for a strong upturn in 2025 and 2026 are good.

**Income and consumption**

Year-on-year percentage change

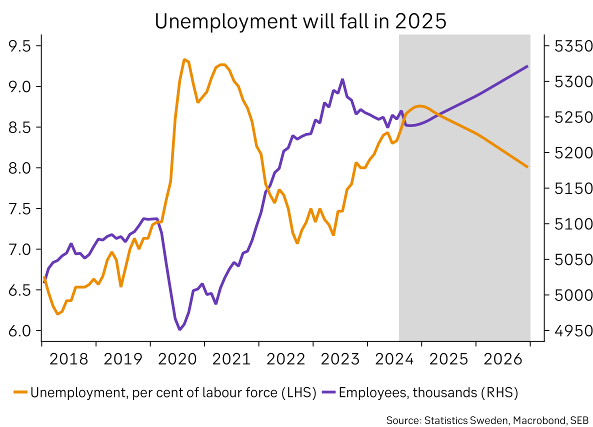
| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Real disposable income | -0.6 | 0.7 | 3.2 | 3.5 |
| Household consumption | -2.3 | -0.1 | 3.2 | 2.7 |
| Household savings ratio* | 14.9 | 15.2 | 14.2 | 14.0 |

*% of household income. Source: Statistics Sweden, SEB

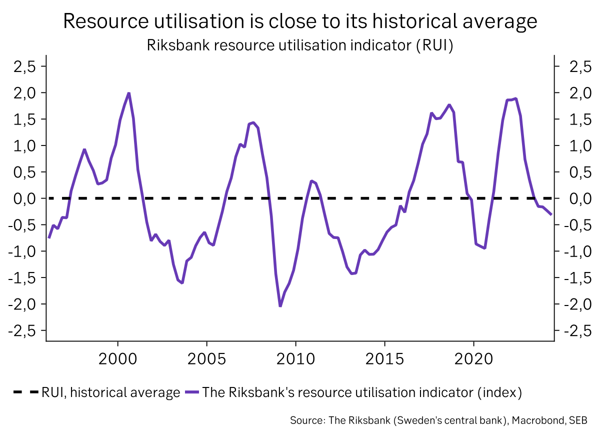
**Slightly rising home prices.** After stabilising at the end of 2022, home prices have been largely stable and have only increased by a bit more than 1 per cent so far this year. Falling interest rates will provide support for home prices in 2025–2026, but the current price level is more than 10 per cent higher than before the pandemic, while interest rates are still significantly higher. Our forecast – that home prices will rise by 2 per cent this year and around 4 per cent yearly in 2025 and 2026 – still seems reasonable.

**Weak labour market for a bit longer.** The labour market has weakened since summer 2023. Unemployment has risen by about one percentage point, according to the Labour Force Survey (LFS). Employment has fallen by nearly 1 per cent in the same

period. Other metrics, such as Swedish Public Employment Service statistics and register-based figures, indicate slightly less labour market deterioration. Short-term indicators are divided, but a renewed upturn in layoff notices and fewer new job vacancies are worrying. However, the share of companies saying their headcount will increase (according to the NIER survey, normally a reliable indicator) has rebounded. We believe unemployment will increase to nearly 9 per cent early next year. Due to stronger economic growth, employment will then climb. The jobless rate will gradually fall to 8.0 per cent by the end of 2026. The labour market is clearly weakening, but it started off strong and its deterioration will not be dramatic compared to earlier economic cycles.



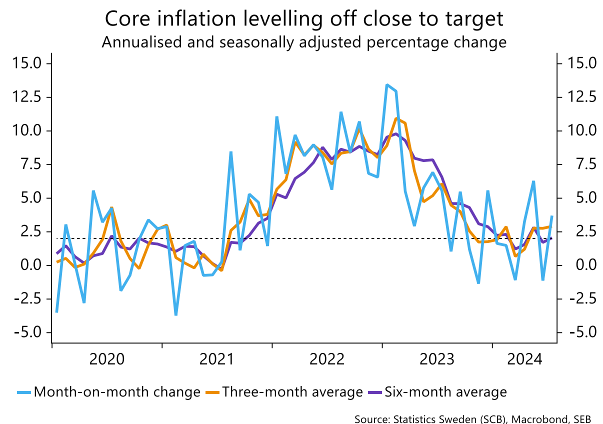

**RUI is falling, but more slowly.** The Riksbank's resource utilisation indicator (RUI), which is primarily based on the percentage of companies reporting a shortage of labour according to the NIER survey, has fallen from record highs in mid-2022 to just below its historical average. The decline has slowed during the past 2–3 quarters.




**Low inflation ahead of the next national wage round.** Pay hikes slowed in April 2024, when the second year of the 2-year collective agreement (with lower contractual increases) came into force. Contractual increases fell during the spring from 4.1 to 3.3 per cent. Total pay hikes appear to be decelerating somewhat less, which is in line with normal patterns. During the second half of 2024, the overall rate of pay increases looks set to reach 3.7 per cent. The Riksbank's (and our own) forecast that wages and salaries will increase by an average of a bit less than 4 per cent in both 2023 and 2024 still looks reasonable. The 2025 wage round is approaching. In late October, the Swedish Trade Union Confederation (LO) is expected to unveil its wage demands. The large declines in real wages in 2022 and 2023 suggest that agreements will end up above their pre-pandemic levels. But due to low inflation, real wages can increase at a healthy pace even if their nominal growth rates are relatively moderate. Total pay hikes of just under 3.5 per cent seem reasonable. This is slightly below the Riksbank's forecast.

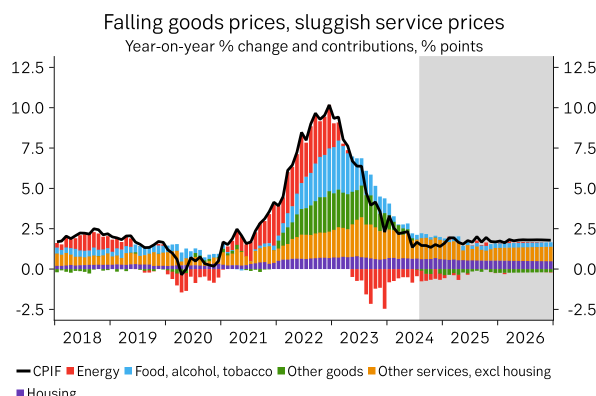
## Inflation back at target

Inflation has fallen rapidly since summer 2023. CPIF (consumer price index with constant interest rates) rose by 1.7 per cent in July this year. Falling energy prices are an important driver, but CPIF excluding energy was also only 2.2 per cent, marginally above the 2 per cent Riksbank inflation target. Month-on-month changes over the past 3-6 months suggest that core inflation is currently levelling off broadly at close to target.



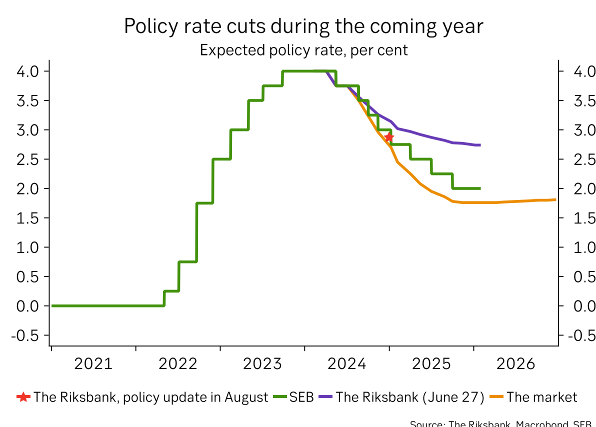

**Good chance that inflation will stabilise at a low level.** International prices for food and other consumer goods have accelerated this summer, but not dramatically, and there are signs that the upturn is reversing. Rents and some administratively set prices are expected to continue climbing more than usual, but at a slower pace than earlier this year. Wage and salary increases have also shifted upward, which is also contributing to higher inflation. Meanwhile, some of the higher costs that contributed to the rise in inflation have reversed, especially energy prices. In addition to their impact on headline inflation, they may also have an indirect effect on core inflation. Reversals of price increases are unusual, but inflation may tend to remain low for

relatively long periods after major cost shocks. We expect total yearly inflation a bit below 2 per cent in 2025 and 2026.




## Rapid normalisation of the policy rate

The Riksbank lowered its policy rate by an additional 25 basis points in August, the second cut in this cycle. The Executive Board also said it expects to lower the interest rate two or three more times this year. We expect three additional cuts, i.e. at every Executive Board meeting for the rest of 2024. In 2025, the central bank will cut its policy rate three more times to 2.00 per cent, which is 25 basis points lower than we expected in May. Our inflation forecast is close to the Riksbank's. Instead of surprisingly low inflation, reduced uncertainty about inflation and larger rate cuts by other central banks are reasons for our downward revision.




**50-point cuts cannot be ruled out.** The Riksbank hiked its policy rate to clearly contractive levels when inflation was around 10 per cent and uncertainty was high. Now that inflation is close to target and unemployment is rising, a likely strategy is for the Riksbank to cut the policy rate relatively rapidly towards neutral levels. Larger-than-usual cuts, by 50 basis points, cannot be ruled out if inflation and inflation expectations clearly surprise on the downside. Higher inflation, on the other hand, could delay the process. We believe the Riksbank will have some tolerance for both upside and downside inflation divergences. Our prediction is lower than the Riksbank's June forecast, but slightly higher than market pricing.

## Here comes our tax refund!

At a press conference this summer, Finance Minister Elisabeth Santesson declared that "the fight against inflation has been won" and opened the way for a more expansionary fiscal policy. At the start of its yearly budget negotiations in August, the government estimated the scope for unfunded reforms in 2025 at SEK 60 billion (about one per cent of GDP). The three governing parties and the Sweden Democrats will now negotiate how the money will be allocated. We believe tax cuts – a new earned income tax deduction, lower taxes on investment savings accounts and for pensioners – as well as larger grants to municipalities and regions will be the most important reforms. We expect a further expansion of SEK 15-20 billion in 2025 unfunded spending in the spring budget next April. Fiscal policy is likely to remain expansionary in 2026, which is an election year. We have assumed unfunded reforms of an additional SEK 70 billion, equivalent to more than one per cent of GDP, in 2026.

**Weaker savings but continued low debt.** Public sector net lending will weaken significantly this year, due to weak economic growth and a capital injection for the Riksbank (SEK 25 billion). We expect both the central and local government sectors to show relatively large deficits. Local government finances will also be weakened by unusually large pension allocations. Expansionary fiscal policy will weaken public finances in 2025–2026, but strong growth will lower deficits. In addition, some of the local government pension allocations and the Riksbank capital injection will disappear, though there is risk that the Riksbank may need more money in 2025. We believe that aid to Ukraine will boost central government spending by SEK 20 billion in both 2025 and 2026; the framework for this aid is SEK 25 billion/year over four years, with great uncertainty about when these payments will affect Sweden's finances. The government has decided to exclude aid to Ukraine from the calculation of its fiscal targets. This autumn, a commission of inquiry will unveil proposals on how central government fiscal targets should be changed. We expect the existing surplus target – 0.3 per cent of GDP – will be changed to a fiscal balance target (see "Theme: Swedish fiscal policy", p 42). Such a change is hardly likely to affect central government finances within our current forecast horizon.

Theme:

# Swedish fiscal policy

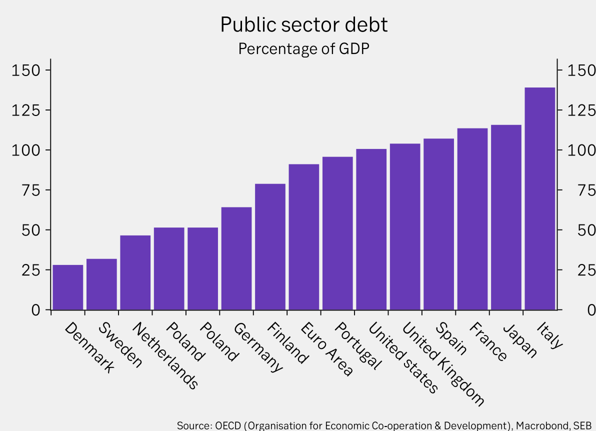
## Transforming the budget framework

**The consolidation of the 1990s, a long-standing policy of budgetary restraint and good economic growth give Sweden a strong fiscal starting point – but also pose challenges. Fiscal policy will now become more expansionary and will stimulate growth, when many other countries are cutting back. But policymakers remain cautious. Fiscal austerity has created tensions, and strong finances have a downside. Central government debt is falling, but local (municipal and regional) governments are borrowing more. Spending pressures from deferred maintenance, the green transition, energy and security policies are growing. Another question is who in a society should borrow – central government or other parts of the economy? In this environment, Sweden must reassess its fiscal policy framework. It has become more and more clear that a surplus target (or fiscal balance target) is not compatible with the "debt anchor". However, it is uncertain how far political leaders want and dare to go.**

### Will more expansionary policy be enough?

With inflation under control, the government has signalled a shift towards more expansionary fiscal policy. At the recent start of budget negotiations, it estimated the scope for unfunded reforms in 2025 at SEK 60 billion (one per cent of GDP). We believe the government will also continue this policy in its budgets for the election year 2026 without threatening its strong fiscal position. Due to uniquely strong central government finances, Sweden has far greater potential than many countries to stimulate its economy by using loose fiscal policy. Given the country's economic situation, structural challenges and fiscal position, we believe the government could pursue a policy even more expansionary than it is proposing. Without such policies, there is a risk that central government debt will fall so low as to cause more problems for the market presence and liquidity of government securities. A less restrictive fiscal framework or a clear multi-year plan to improve the functioning of the economy while strengthening its demand side may ease such problems.

Nytt ramverk för finanspolitiken



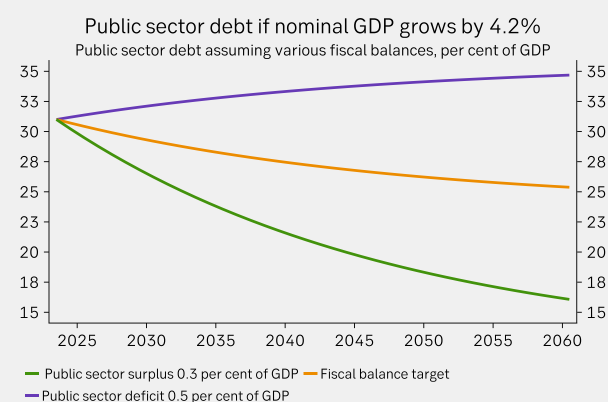

**Changes in regulations would make room for long-awaited reforms** and remove some obstacles. A deficit target of 0.5 per cent of GDP, which is in line with Sweden's debt "anchor" (=target) of 35 per cent of GDP, would make room for nearly SEK 50 billion in additional reforms. A higher debt anchor would also allow temporary spending to ease the burden on other expenditure areas when investments must be made in the green transition, electrification and defence.

**Debt anchor or fiscal balance target – policymakers must eventually choose.** A long period of falling debt has gradually rendered the fiscal surplus target – introduced after the financial crisis of the early 1990s – increasingly unnecessary. Admittedly, the target has not always been achieved and adjustments to the framework have been made along the way, but the overall picture is still that policymakers have complied with the framework. Central government debt as a share of GDP has trended lower for a long time. In 2016, Parliament decided to reduce the surplus target from one to one-third per cent of GDP over an economic cycle. At the same time, a debt anchor of 35 per cent of GDP was introduced. The government must explain deviations of more than ± 5 percentage points and stipulate how a return to the debt anchor should be carried out. A government commission of inquiry – tasked with examining whether and how the surplus target should be changed – will present its conclusions and proposals no later than November 15, 2024. The government has hinted that it would like a fiscal balance target, but if such a target is adopted and GDP keeps growing, the debt ratio still risks continuing to fall.

## Falling debt even with a balance target

After a slight upturn during the pandemic, the overall public sector debt ratio has gradually continued to fall. Weak growth and the need for capital injections to the Riksbank (SEK 25 billion) will contribute to a slight upturn in the debt ratio during 2024 and 2025. These factors will postpone the decline in the debt ratio, but eventually the government will face some important choices to keep the debt ratio from falling again and ending up below target.

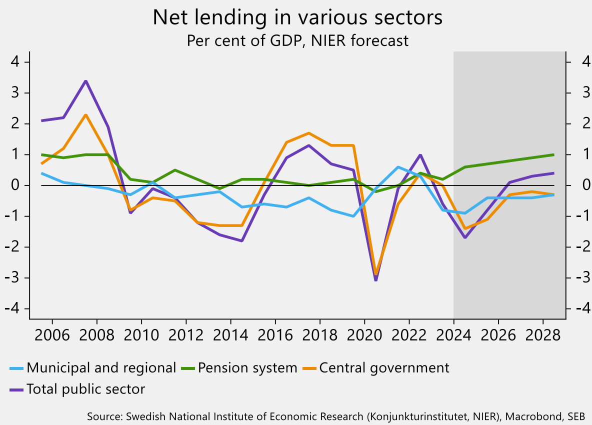
**Deficit targets are needed to stabilise debt around the anchor.** Public savings are the sum of savings for central government, local government sector (municipalities and regions) and the pension system (AP funds). They are usually calculated as a ratio, i.e. nominal debt divided by nominal GDP; the ratio is determined by changes in both debt and GDP. If nominal GDP keeps increasing in line with its historical trend (4.2 per cent yearly), the public sector balance needs to be around -0.5 per cent of GDP in order to stabilise the debt ratio at around the 35 per cent debt anchor. The current target is a surplus of 1/3 per cent of GDP.




**Surplus in the pension system and deficit in...?** According to calculations by the National Institute of Economic Research (NIER), the surplus in the pension system will grow to one per cent of GDP. Given this surplus, the central and local government sectors can run a deficit of 1.5 per cent of GDP, assuming that a total balance of -0.5 per cent of GDP will stabilise the debt ratio. A fiscal balance target (a 1 per cent surplus in the pension system and a 1 per cent deficit in central + local governments) imply that the debt ratio will fall, albeit very slowly. Given a surplus target in line with today's target, the debt ratio (if achieved) will rather quickly fall far below the debt anchor. It remains to be seen what the commission of inquiry will propose. But so far, the government has signalled that it is unwilling to introduce a deficit target.

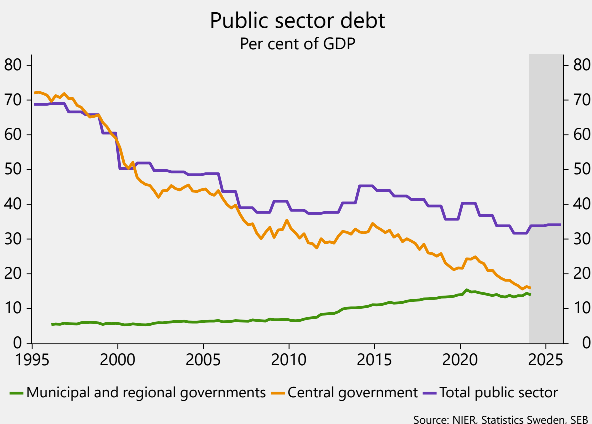
**Which sector should borrow? – central government will borrow less, local authorities more.** Another question that will be discussed in the commission report is what part of the public sector is and should be indebted –central government or the municipalities and regions? Historically it has mainly been the central government – the main smoother of economic cycles – that has been indebted. The declining debt ratio of

recent decades is entirely explained by a lower central government debt ratio. Meanwhile, municipal and regional indebtedness has gradually increased. By early 2024 it was almost as large as central government debt. If local government debt keeps growing, central government debt will be constrained so as not to exceed the debt anchor.




Source: Swedish National Institute of Economic Research (Konjunkturinstitutet, NIER), Macrobond, SEB

**Increased municipal investments are not only negative.** Municipalities and regions are required to balance their day-to-day operating budgets, but their capital investments may be financed by loans. This is the main driver of their increased debt and is largely explained by the fact that many local authorities borrow for on-lending to local government companies, which then invest in amenities such as housing, water and wastewater systems. If the local government sector keeps increasing its borrowing, the central government's already low debt (16 per cent of GDP) must fall as a share of GDP in order to keep total debt in line with the anchor.




Source: NIER, Statistics Sweden, SEB

**Who will lend to local governments?** One question related to local government borrowing is thus whether a part can be transferred to, or raised through, the central government. One advantage would be that the central government borrows more cheaply and can still be considered implicitly responsible, if municipalities go bankrupt. More centralised borrowing (for example via the National Debt Office) might result in both lower costs and more control by the central government. The opposition Social Democrats have raised the question of letting central government take over parts of local government sector debt. But such a process is not simple, since incentives for activities and investments in individual municipalities and regions must be taken into account. More local government deficits and debts might make it easier to achieve fiscal policy objectives. But the question is whether the central government actually wants such a development to occur at the same time as it is holding back its own spending.

**Weak economic growth will lead to deficits over the next couple of years**, but the debt ratio will keep declining in the long term given the current framework. The government has also said that aid to Ukraine, totalling SEK 100 billion over a 4-year period, will lie outside the surplus target. It is uncertain when and by how much borrowing will be affected. An additional factor is construction of new nuclear power plants, which according to a recent proposal will largely be financed by central government borrowing. This means that framework changes related to excessively low public debt may be delayed. How nuclear power financing will be handled within the framework is uncertain. If it is also excluded from the framework, like aid to Ukraine, one might ask: What is the point of a framework if more and more spending is excluded?

**Deficit targets are a long way off**, even if they are "needed" to match balance targets and debt anchors. Of course, there are also risks in abolishing the self-imposed straitjacket that the surplus target represents. The list of desired spending hikes is always long, and if budgetary discipline deteriorates, the risk of bad decisions and investments may increase. But today's framework is needlessly strict, and a limited deficit target should not damage confidence – compliance with a regulatory framework is the important thing. Governments have long shown such willingness. Sweden has a chance to stimulate its economy in ways many countries cannot. Economic growth is weak. There are many structural challenges – including the energy transition, infrastructure, security policy, an ageing population and financially squeezed municipalities and regions. Easing the fiscal balance target, or at least letting the debt anchor take precedence, can free up resources to help households, local governments and economic growth while remaining compatible with continued strong central government finances. Regardless of how policymakers change the fiscal framework, the impact of these changes will probably occur beyond our forecast horizon.

# Norway

## Stronger consumption as Norges Bank cuts key rate

**Growth remains anaemic, weighed down by a decline in residential investments and weak private consumption. The high activity in the oil and gas sector will continue this year but decrease later. During 2025 and 2026, improved purchasing power, real wage growth and lower interest rates will help fuel a recovery in mainland GDP, which will grow in line with trend. Core inflation continue to fall, ending up well below Norges Bank's forecast during 2025. The central bank will gradually cut its key interest rate, starting in December of this year.**

Falling residential investment and a subdued recovery in household consumption are holding back growth this year. Norges Bank's regional network indicates that companies are predicting slightly better economic activity during the second half of 2024, but there are still large differences between sectors. We expect mainland GDP to increase by a modest 0.7 per cent in 2024, despite fiscal stimulus and strong export growth, but to accelerate in 2025 as household purchasing power improves. Gradual policy rate cuts will allow residential investments to recover in 2025 and grow rapidly in 2026. Mainland GDP grow in line with trend during both 2025 and 2026. Total GDP is supported by high activity in the oil and gas sector and will grow by 1.8 per cent this year. In 2025 and 2026, capital spending growth in the sector will decelerate and GDP growth will slow to 2.0 and 1.1 per cent, respectively.

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

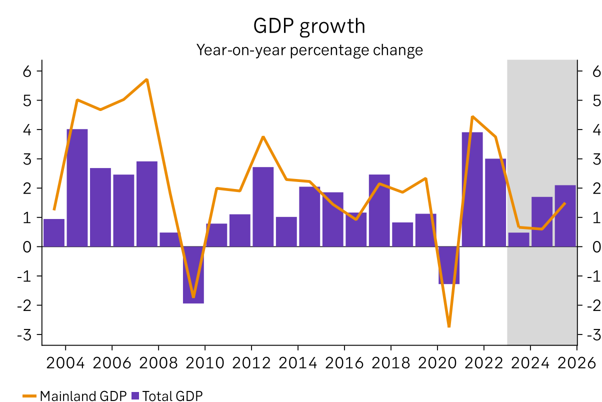
| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 0.5 | 1.8 | 2.0 | 1.1 |
| Mainland GDP | 0.7 | 0.7 | 1.7 | 1.6 |
| LFS unemployment* | 3.6 | 4.1 | 4.2 | 3.9 |
| Wages and salaries | 5.2 | 5.3 | 4.0 | 3.5 |
| CPI-ATE inflation | 6.2 | 3.8 | 2.7 | 2.2 |
| Key interest rate, % | 4.50 | 4.25 | 3.25 | 2.50 |

*% of labour force. Source: Macrobond, SEB

### Residential investments weigh on growth

The government has revised its budget expenditures upward since May's *Nordic Outlook*, mainly due to higher defence spending. Fiscal policy is expansionary, equivalent to 0.7 per cent of mainland GDP in 2024. The government will unveil the budget for 2025 in October; we believe that its expansionary policy will continue, but to a somewhat lesser extent in 2025.

**High investment growth is slowing.** Business investments have increased at a rapid pace in recent years but will fall this year – mainly in the service sector. But non-oil-related manufacturers will also contribute to the decline. Residential investments fell faster than expected early in 2024. Because of this, together with postponed interest rate cuts, we now expect a significantly slower pace of capital spending this year. Lower interest rates and rising home prices will cause residential investments to increase during 2025 and then climb rapidly during 2026.




**Record-high investments in the oil and gas sector.** We expect investments in the oil and gas sector to increase sharply during 2024, with positive indirect effects on the mainland economy as well. This record-high level of capital spending is largely explained by the fact that many projects were launched a couple of years ago due to tax subsidies that expired at the end of 2022. As these projects are completed, the pace of investments is expected to slow, and we predict falling investments during both 2025 and 2026.

**Household consumption will recover.** Consumer spending increased somewhat in the first half of 2024, but gloomy consumer sentiment suggests that consumption will remain subdued. The high cost of living is weighing on households, and we expect private consumption to rise only slightly during the second half of this year. However, a strong labour market, higher wages and lower inflation will provide support to consumption going forward. Dwindling household savings buffers also suggest that consumption is being

partly sustained by savings. Further ahead, further real wage increases, and lower interest rates will contribute to a clearer upturn in household consumption, which grow by slightly more than 2.0 per cent on average in 2025 and 2026.

**A weak Norwegian krone is contributing to higher export growth.** The weak NOK exchange rate is helping exports, which we expect to rise noticeably this year. Increased tourism and strong demand for Norwegian energy and energy-related technology will contribute markedly to this growth. The subdued economic situation in other countries will improve during 2025 and 2026, and we expect this to contribute to continued growth in exports, albeit at a slower pace. Low domestic demand is holding back imports this year, but they will increase in the future as economic conditions improve.

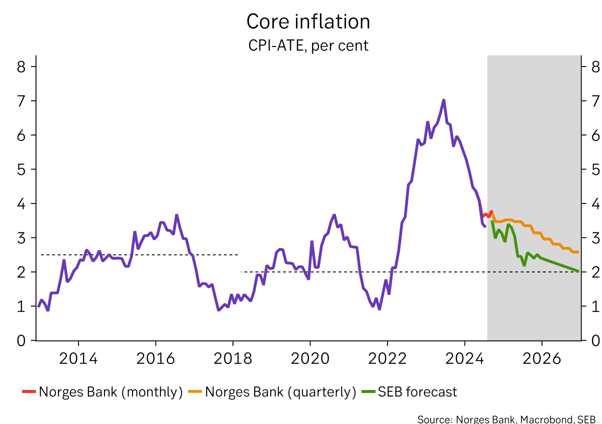
## Low supply is pushing up home prices

Home prices rose surprisingly fast during the first half of 2024, despite high interest rates. Very low housing construction and limited supply are contributing to rising prices. Early in the year, expectations of earlier interest rate cuts probably also contributed. During the spring and summer, however, expectations about Norges Bank have shifted. The signals are now that key interest rate cuts will be delayed. We believe this means that the upturn in home prices will slow somewhat, compared to the first half of 2024, but will pick up again this winter when Norges Bank initiates a series of rate cuts. Home prices will increase by 3 per cent this year and accelerate to a 6.1 per cent gain next year. In 2026, we expect the high growth rate to slow somewhat and home prices to rise by 4 per cent.

## Rising real wages in a tight labour market

The demand for labour is high, and there is currently no indication of a rapid slowdown in the labour market. Employment growth slowed in 2023 but picked up again in early 2024. However, the unemployment rate has also risen slowly since bottoming out in 2022, and underlying data suggest a gradual cooling in the Norwegian labour market. In sectors where growth is low, such as construction, the decline in activity has probably been offset by the departure of many foreign temporary workers, which has limited the rise in unemployment. A significant portion of the increase in jobless numbers consists of Ukrainian refugees. More are likely to register as job seekers in the coming year. We believe unemployment will rise slightly more than before, peaking in 2025. As the economic situation improves, unemployment will then fall again. A tight labour market, combined with high activity in the energy sector, suggests continued real wage increases during 2025. Wages and salaries will rise by 5.3 per cent in 2024 and 4.0 per cent in 2025. In 2026, they will increase more moderately, which mainly reflects lower inflation compensation.

**Core inflation will approach target in 2026**. CPI-ATE (CPI excluding taxes and energy) has fallen sharply over the past year, reaching 3.3 per cent in July. Although this is still above Norges Bank's 2 per cent target, the downward trend is increasingly clear. Food prices have been an important reason why the decline in inflation has taken longer in Norway than in Sweden, for example. However, food prices have now reached about the same level as in Sweden and the rest of Europe, which suggests more normal price increases in the future. The decline in global commodity prices has been rapid, and inflation is now largely driven by Norwegian-produced goods and services. High wage growth and a weak Norwegian krone are also expected to result in a slower downturn in core inflation than in many other countries, but inflation has nonetheless been below Norges Bank's forecasts since mid-2023. We believe core inflation will continue to fall, especially next year, as food inflation and rent increases decelerate. The CPI-ATE will reach target during 2026 when services inflation reaches a more normal level.




**Norges Bank is delaying its key interest rate cuts.** Norges Bank is balancing a better inflation outlook in the near term against a weak krone, high wage growth and low productivity growth. Although economic growth is subdued and unemployment has risen slightly, it is difficult to see any reasons for rapid interest rate cuts by the Norwegian central bank. But as inflation falls, there will be reasons to gradually loosen monetary policy. We believe Norges Bank will initiate a series of rate cuts beginning in December of this year. We expect four cuts during 2025 and another three in 2026, bringing Norway's key interest rate to 2.5 per cent during autumn 2026.

# Denmark
# More parts of the economy are driving growth

**The recovery is likely to broaden, after several years of primarily being driven by exports of pharmaceuticals. Consumption will continue to be a key driver of growth going forward, buoyed by higher real wages. We expect growth to remain robust throughout our forecast period, averaging 2 per cent in 2024 and about 3 per cent in 2025 and 2026.**

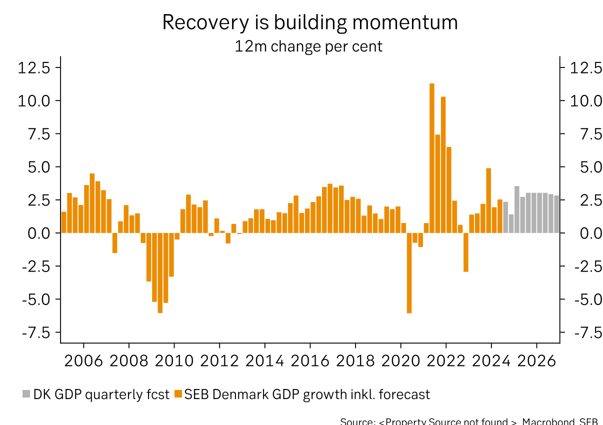
**Large revisions, more key drivers.** Statistics Denmark has made a major overhaul of the national accounts, revising data back to 1990. In 2023, the revised numbers show GDP growth of 2.5 per cent, up from a previous 1.9 per cent. With strong consumption drivers in place in the shape of rising employment, real wages and home prices – and with construction sector headwinds starting to fade – we expect more parts of the economy to lift growth, with GDP increasing by 2 per cent in 2024 and some 3 per cent in 2025 and 2026.

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

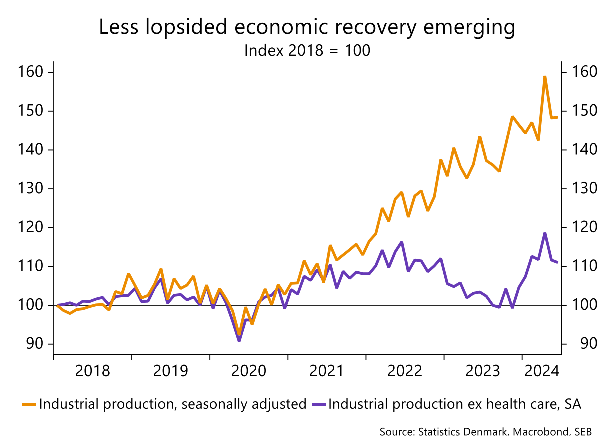
| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | 2.5 | 2.0 | 3.1 | 3.0 |
| CPI | 3.3 | 1.2 | 1.4 | 1.9 |
| Wages and salaries | 3.3 | 3.6 | 4.1 | 4.3 |
| Public sector fiscal balance* | 3.4 | 3.5 | 4.0 | 4.0 |
| Public sector debt* | 29.3 | 29.0 | 28.0 | 27.0 |
| Current account* | 12.5 | 10.0 | 8.0 | 7.0 |
| Policy rate (CD rate), % | 3.60 | 2.85 | 2.10 | 1.60 |

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

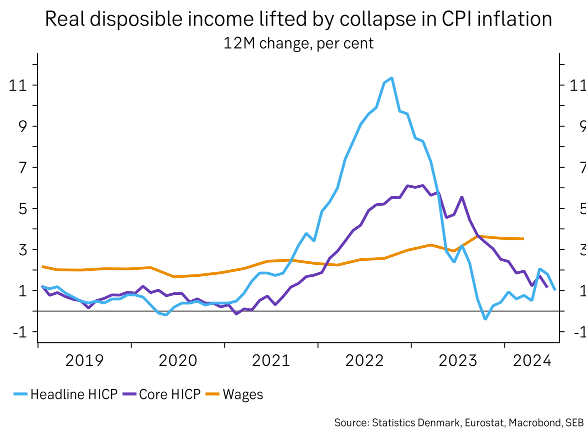
**Volatile quarterly growth data.** Quarterly GDP data have been unusually volatile in recent years. This was also the case in the most recent release, which showed a quarterly GDP increase of 1.7 per cent in Q4 2023, a decline of 1.0 per cent in Q1 2024 and then an increase of +0.6 per cent in the second quarter. Underlying data on the other hand show steadier improvement during this period, and we have assumed past quarters numbers are more noise than signal, but this is the main reason why we are forecasting lower average growth in 2024 than in 2023.




**A broadening recovery.** Over the past two years, Denmark's economic growth has been unusually imbalanced. GDP growth was mainly driven by net exports, powered by the success of pharmaceutical companies – especially Novo Nordisk after the release of its new weight-loss products. The health care sector increased production by 150 per cent over the course of 2022 and 2023, while the rest of the manufacturing sector saw its output decline by 4 per cent. But so far this year, we have started to see a more balanced picture emerge, with a 10 per cent production increase outside health care and a continued surge in the health care industry. To sustain this trend, renewed growth in major export markets is probably needed.

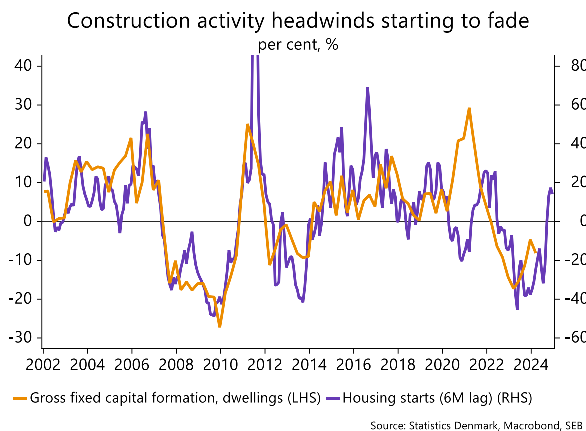



**Real wages and employment are lifting consumption.** Consumer demand is currently supported by several tailwinds. Employment continues to grow at an annual pace of more than 1 per cent, which is being met in part by a strong inflow of foreign workers to the labour force.

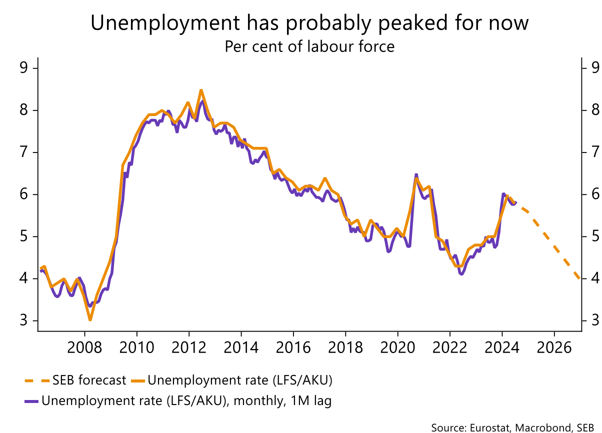



Wage inflation of around 3.5 per cent, coupled with HICP inflation of less than 1 per cent, is also adding to the growth in real disposable income, a development that will continue. Home prices appear to have kept rising after the shift to new tax rules, providing a positive wealth effect. Falling mortgage rates are close to triggering a new wave of refinancing of mortgages. We also see consumer confidence to continued rising and therefore expect consumption growth to accelerate to 4 per cent in 2025 and 2026.

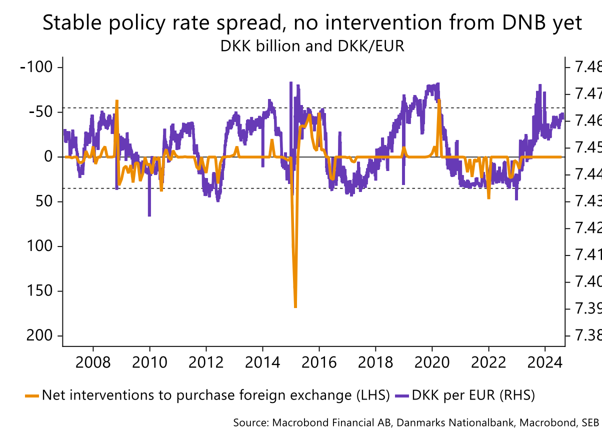
**Construction headwinds are fading.** Private investments are also set to provide a stronger contribution to GDP growth over the next couple of years. Residential investments, in particular, appear to be coming out of a two-year slump as mortgage rates decline and home prices increase. Housing starts posted their first year-on-year increase since the start of 2022 in March 2024, and construction investments are likely to follow in H2. Business investments are also likely to pick up speed, since capacity utilisation in industry remains well above the historical average and funding costs are declining.




**Unemployment to approach historical lows in 2026.** The prospect of a stronger recovery naturally raises the question of how much excess capacity the economy has left. We note that despite the continued increase in employment, the jobless rate has been moving higher over the past two years, peaking around 6 per cent in Q4 2023. Monthly data indicate that unemployment started falling again during the first half of 2024, but it remains well above its 2022 low and the historical lows from before the global financial crisis of the late 2000 decade. Unemployment will be approaching such levels by the end of 2026, with wage inflation in the 4-5 per cent range. Given Denmark's unusually strong internal and external balances, with a current account surplus of close to 10 per cent of GDP and a budget surplus of more than 3 per cent of GDP, this is unlikely to threaten the stability of the DKK/EUR peg, but it would call for a tightening of fiscal policy towards the end of our forecast period.




**Stable policy rate spread.** The Danish krone continues to trade at the weak end of Danmarks Nationalbank's preferred range vs the EUR of above 7.46. However, there does not seem to be the kind of pressure on the currency that could force the DNB to intervene. The latest weakening appears to be related to the global setback in equities, which reduces pension funds' hedging requirements and is likely to be temporary. We expect the DNB to keep its policy rate spread unchanged and to match ECB rate cuts 1:1.



# Finland
# Austerity everywhere

**Finding a bright spot in the Finnish economy is difficult. Low foreign demand is hampering exports, high interest rates are curbing construction and low sentiment is dampening consumer demand. This is all holding back the economy. We expect GDP to decline by 0.6 per cent this year. Lower interest rates spurring exports and capital spending will contribute to an uptick in 2025–2026.**

**Always late in the cycle**. The Finnish economy always seems to react to external shocks with a lag. This is most evident in the manufacturing sector, which only now is feeling the weight of low global demand. While production levels have dropped roughly 10 per cent from their peak in spring 2022, recent months have shown some sign of stabilisation. However new orders remain low, which will cause exports to fall by another 3.5 per cent in 2024. We expect some rebound in 2025, with exports increasing by 3.2 per cent.

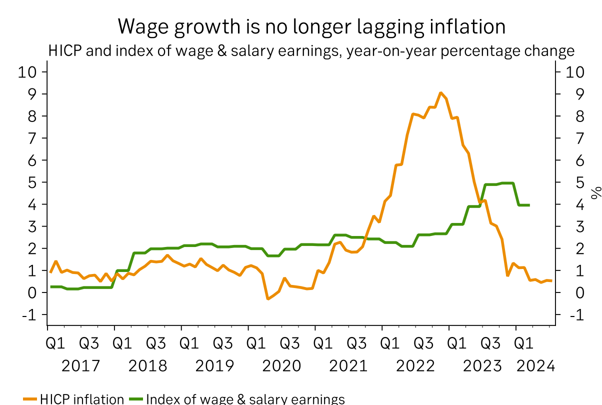
**Key data**
Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | -1.2 | -0.6 | 1.5 | 1.8 |
| Household consumption | 0.2 | 0.8 | 1.0 | 1.5 |
| Exports | -0.1 | -3.5 | 3.2 | 3.5 |
| Unemployment* | 7.2 | 8.2 | 7.8 | 7.5 |
| Wages and salaries | 4.2 | 3.2 | 2.8 | 2.5 |
| HICP inflation | 4.3 | 1.2 | 2.0 | 1.6 |
| Public sector fiscal balance** | -2.7 | -3.8 | -3.2 | -3.0 |

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

**Construction remains underwater.** The construction sector has borne the brunt of the economic downturn. While residential construction has slightly increased compared to 2023, the number of building permits issued is down to about one third of the last peak. Business sector lending shows some signs of revival, but at current rates, investments will remain subdued. We expect capital spending to decline by 3.5 per cent in 2024, with a 3.8 per cent rebound anticipated in 2025 as lower interest rates begin to stimulate investments.

**Some deterioration in the labour market.** Unemployment has slowly been ticking up and is expected to continue doing so. The main drivers are construction and manufacturing, where demand has fallen the most. While both sectors appear to be stabilising, the adjustment to much lower output levels means less need for labour. Consequently, unemployment is projected to increase this year. Recovering demand for construction services and manufactured goods will gradually start to improve the situation in the next couple of years. Wage and salary growth has remained relatively strong, contributing to the recovery of household purchasing power.




Source: Statistics Finland, Macrobond, SEB

**Sorting out public finances.** The Finnish government is continuing its effort to contain the budget deficit, a challenging task given low economic growth. The government has decided to cut spending and raise value-added tax (VAT) to 25.5 per cent in September, one of the highest rates in the EU. This should reduce the budget deficit to 3.2 per cent in 2025 and 3.0 per cent in 2026. However, the deficit will still be significant, causing the public debt-to-GDP ratio to rise to 84 per cent in 2026.

**Austerity by households too**. Austerity measures are not only being implemented by the government but also by households. Low consumer confidence has led to sluggish retail sales, but sentiment is beginning to recover, and we expect growth in real wages to positively impact consumption. In 2024, household consumption is projected to increase by 0.8 per cent, though growth will remain moderate in 2025, at only 1 per cent. A more significant acceleration in spending is expected in 2026, with consumption rising by 1.5 per cent. Despite the VAT changes, we believe that inflation will remain relatively low, averaging 2 per cent in 2025 and 1.6 per cent in 2026.

# The Baltics

**Lithuania | page 51**

High real wage growth will help ensure that domestic demand will become the main growth driver, amid weakness in manufacturing and exports. During 2025–2026, GDP will increase by more than 2.5 per cent yearly.

**Latvia | page 52**

Despite high real wage growth, activity is sluggish as consumers boost savings. But a household-led rebound will come as inflation slows, real wages rise and the job market stays strong. GDP will climb by over 2 per cent yearly in 2025–2026.

**Estonia | page 53**

Weak consumption continues to hold back growth, but for the first time since 2021, the economy is growing again. The labour market is robust; unemployment continues to fall. In 2025–2026, yearly GDP growth will exceed 2.5 per cent.

# Lithuania

## Strong start to the year, but now slowing somewhat

GDP growth is expected to slow during the second half of 2024 after a strong start to the year. Robust real wage growth will help ensure that domestic demand will be the main growth driver, amid weakness in manufacturing and exports. GDP growth during 2025-2026 will exceed 2.5 per cent – close to potential. Employment is rising, and inflation has bottomed out. The parliament already adopted a package of taxes used for defence expenditures, but more changes might come after parliamentary elections this autumn.

**GDP growth in 2024 well above expectations.** Economic activity rose by 2.4 per cent in the first half of 2024, supported by consumption and weak imports. However, we expect the rebound in real household income to slow down, and exports are likely to stagnate during the second half of 2024. We have upgraded our 2024 GDP growth forecast from 1.5 to 2.4 per cent but have reduced our 2025 growth projection from 2.8 to 2.6 per cent due to weak activity in the euro area.

**Key data**

Year-on-year percentage change

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | -0.3 | 2.4 | 2.6 | 2.9 |
| Household consumption | -1.0 | 4.3 | 3.2 | 3.0 |
| Exports | -3.3 | 0.5 | 4.0 | 3.7 |
| Unemployment* | 6.8 | 7.3 | 7.0 | 6.8 |
| Wages and salaries | 12.2 | 9.4 | 8.1 | 7.5 |
| HICP inflation | 8.7 | 1.2 | 3.0 | 2.7 |
| Public sector fiscal balance** | -0.8 | -1.6 | -1.8 | -1.5 |

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

**Manufacturing activity has improved.** Industrial production has recovered somewhat since bottoming out last year. Sentiment indicators do not point to any substantial changes in the short term. Lower interest rates will lead to a recovery in capital spending during the next couple of years. The weakness of goods exports in the first half of 2024 was largely due to lower re-exports of goods to CIS countries.

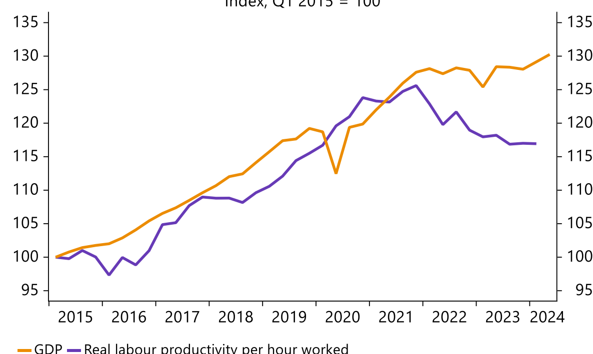
**Household consumption will accelerate.** Consumer confidence is at record levels. Real household income will continue to increase, albeit at a slightly more moderate pace than in 2024. The increase in consumption will slow but will remain the key growth engine throughout our forecast period.

**Inflation will climb back to 3 per cent in 2025.** This year, HICP inflation rate will fluctuate around 1 per cent and remain close to our forecasts. The declining impact of lower energy prices, an expected increase in excise duties and continued strong growth in service prices will lead to higher inflation in 2025 and 2026.

**Wage growth is still high.** So far this year, wage increases have exceeded our expectations. The government is close to approving a 12 per cent increase in the minimum monthly wage in 2025. We now expect next year's total wage growth to reach 8.1 per cent. There is a clear risk that wages will grow too fast. Wages as a percentage of GDP are record-high: among the highest in the EU. Real labour productivity has fallen from its peak in 2021, but real wages are record-high.

Labour productivity is stagnant, but GDP keeps climbing

Index, Q1 2015 = 100




Source: Eurostat, Statistics Lithuania, Macrobond, SEB

**A minor increase in home prices.** Activity in the residential property market fell by around 10 per cent during the first half of this year. We believe that the drop in EURIBOR rates and rising real wages will help improve demand. Prices of houses are slightly above last year's level. However, activity in the commercial property market is low – at its lowest level in a decade.

**Largely neutral fiscal policy in 2025-2026**. This year's budget deficit will increase but will be smaller than feared, due to stronger economic growth. In 2025 the deficit will increase somewhat, mainly due to higher social spending. Defence spending will also increase, reaching at least 3 per cent of GDP, but will be partially financed by an extension of the solidarity tax for banks, an increased corporate tax rate and higher excise duties.

# Latvia
## Restrained consumption is holding back growth

**Despite strong real wage growth, the economy is struggling as consumers boost their savings. Meanwhile exports and capital spending have surprised on the downside. Sentiment indicators provide no signals of an imminent turnaround. The labour market remains strong. Inflation averaging 2 per cent in 2024-2026 will allow a surge in real wages. GDP will grow by 0.8 per cent 2024 and just over 2 per cent in 2025-2026.**

**A lack of driving forces.** After some positive signals at the beginning of 2024, second quarter GDP growth surprised on the downside. Weakness in the manufacturing sector was expected, but not the decline in the service sector, driven by weak exports. Although exports of air transport services are surging, there is a notable decline in exports of other transport services and other services. We see many indications that the decline in service exports as well as in goods exports will remain a drag on the economy for several quarters, since it will take time for export markets to recover and for exporters to find new markets.

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

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | -0.3 | 0.8 | 2.2 | 2.5 |
| Household consumption | -1.3 | 1.1 | 2.1 | 2.4 |
| Exports | -5.9 | 0.5 | 2.6 | 2.5 |
| Unemployment* | 6.5 | 6.8 | 6.6 | 6.5 |
| Wages and salaries | 11.9 | 10.1 | 8.8 | 7.9 |
| HICP inflation | 9.1 | 1.4 | 2.4 | 2.1 |
| Public sector fiscal balance** | -2.2 | -3.0 | -2.9 | -2.8 |

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

**Pessimistic indicators.** According to sentiment indicators, economic confidence weakened further, including downturns in retail trade, services and manufacturing. Delayed inflows of EU funds are contributing to greater pessimism in construction, and private investments remain weak. Although consumption-driven growth will pick up, we have lowered GDP growth for 2024 by 1.1 percentage points to 0.8 per cent. In 2025-2026, the economy will grow by more than 2 per cent yearly.

**A slight inflation upturn ahead.** The inflation rate has bottomed out as the negative contribution of falling energy prices has faded. Food, alcohol, transport and health care showed the biggest price increases. The only category in which the price level decreased was housing. As in other countries, service price dynamics will push up the inflation rate in 2025-2026. Total inflation will average about 1.5 per cent this year and climb to a bit above 2 per cent next year.

**Manufacturing faces continued headwinds.** The downturn in manufacturing is a mixed bag. While machinery and equipment production fell by 26.2 per cent, the printing industry saw a 25.5 per cent upturn year on year in June. The situation in two of the three largest manufacturing sub-sectors – fabricated metal and food production – has stabilised while wood production is still in a deep slump. Due to weak international demand, we do not expect any turnaround in the manufacturing sector before next year.

**Restrained consumption.** Despite strong real wage growth, so far this year consumers have been cautious. Retail sales remain weak, deposits are rising, hence households seem to prefer saving to spending. We expect that continuously improving purchasing power will boost sentiment and lay the groundwork for a clear upswing in consumption.

**Wage growth will slow to a more sustainable level.** Rapid wage growth and low capital spending will contribute to potential competitiveness issues in the future. The prospect of lower interest rates has revived previously stagnant credit demand, but geopolitics will remain a major obstacle to capital spending. As expected, unemployment rose to 7.2 per cent early this year. Given the slow recovery, unemployment will remain largely unchanged.

# Estonia
# Recovery on the way

**For the first time since 2021 the economy is growing, albeit at a modest pace. However, the recovery will not be as strong as previously expected, due to significant fiscal policy changes. We have adjusted our forecasts downward and now project modest growth of 2.5 per cent in 2025 and 2.7 per cent in 2026. Weak consumption continues to dampen growth, but despite this the labor market is robust with decreasing unemployment rates the coming years.**

**Major tax policy changes**. A government reshuffle has ushered in significant changes to the fiscal outlook which will hamper growth. The new administration has implemented stringent measures to achieve a more sustainable budget deficit. Over the next three years, government expenditures will be cut by 10 per cent. Also, substantial tax increases are planned. The value-added tax (VAT) will rise to 24 per cent starting in 2025. In addition, a temporary increase in income tax by 2 percentage points is scheduled for the period 2026–2028 to fund increased defence spending. For the first time since 1999, a 2 per cent income tax will also apply to corporate profits, which are currently only taxed when distributed. Furthermore, a new motor vehicle tax will be introduced in 2025, along with increases in various excise duties. These measures should help the government reach the 3 per cent deficit threshold next year.

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

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP | -3.0 | -0.7 | 2.5 | 2.7 |
| Household consumption | -1.2 | 0.0 | 1.5 | 2.0 |
| Exports | -6.5 | -1.7 | 4.0 | 5.0 |
| Unemployment* | 6.4 | 7.5 | 7.2 | 6.8 |
| Wages and salaries | 11.4 | 7.2 | 5.0 | 5.0 |
| HICP inflation | 9.1 | 3.8 | 3.5 | 3.0 |
| Public sector fiscal balance** | -3.4 | -3.5 | -3.0 | -3.0 |

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

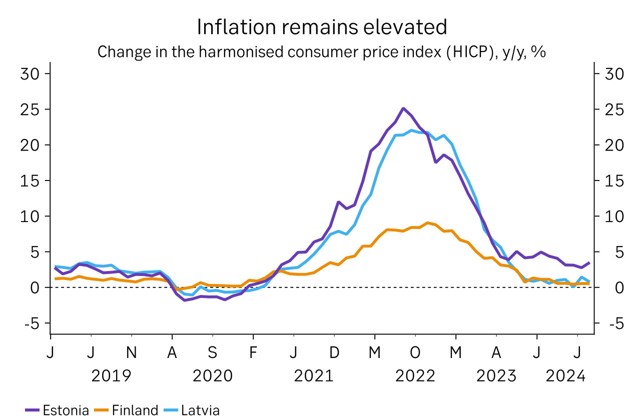
**Consumption facing headwinds.** The planned tax increases are expected to significantly curb household consumption, compounded by a likely further decline in consumer sentiment. The consumer confidence index has hovered around historic lows for two years, and its recent gains are likely to be erased following the fiscal policy announcements. As a result, subdued consumer spending is expected to persist into next year, with household consumption projected to increase by only 1.5 per cent in 2025, clearly below the 2014-2022 trend.

**Slower wage growth, high employment.** Despite the weak economy, the labour market has been resilient. Employment rates are high, and unemployment has been trending lower. As the recession fades, unemployment is expected to continue its downward trend, reaching 6.8 per cent by 2026. Wage growth has slowed, dropping from last year's double-digit figures to 6 per cent, and is expected to remain around that level in 2025-2026.

**Some relief to industry**. The export sector continues to struggle with low demand in key markets, but there are signs of improvement. Production levels have begun to increase marginally in recent months, and recovering business activity in the Nordic countries suggests that a slow recovery is likely to continue. Exports are expected to grow by around 4 to 5 per cent in 2025 and 2026.

**Stubborn inflation**. Unlike its neighbours, Estonia has not yet seen inflation drop sharply. This cannot be entirely attributed to the VAT increase at the start of the year. It appears that many businesses still view higher prices as a way to boost profitability. Due to ongoing tax increases, inflation is expected to remain elevated, staying above 3 per cent through 2025 and 2026.

Inflation remains elevated
Change in the harmonised consumer price index (HICP), y/y, %




Source: Eurostat, Macrobond, SEB

**Capital spending: it could be worse**. New investment activity remains suppressed. However, considering the current interest rate environment, the situation is not as dire as it could be. New lending to the corporate sector has even increased slightly compared to last year. Due to a low comparison base, capital spending will increase by 1.8 per cent in 2024. A rebound of close to 4 per cent is anticipated in 2025.

## Global key indicators

Yearly change in per cent

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| GDP OECD | 1.6 | 1.7 | 1.8 | 1.7 |
| GDP world (PPP) | 3.2 | 3.1 | 3.2 | 3.1 |
| CPI OECD | 6.9 | 4.9 | 3.2 | 3.1 |
| Oil price, Brent (USD/barrel) | 82 | 83 | 75 | 88 |

## US

Yearly change in per cent

| | 2023 level, USD bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 27,361 | 2.5 | 2.5 | 1.5 | 1.8 |
| Household consumption | 18,571 | 2.2 | 2.1 | 1.4 | 1.9 |
| Public consumption | 3,753 | 2.8 | 1.9 | 1.0 | 0.8 |
| Gross fixed investment | 5,783 | 2.6 | 4.6 | 2.5 | 2.9 |
| Stock building (changes as % of GDP) | 54 | -0.4 | 0.0 | 0.0 | 0.0 |
| Exports | 3,027 | 2.6 | 2.4 | 2.4 | 2.0 |
| Imports | 3,826 | -1.7 | 3.9 | 2.7 | 2.9 |
| | | | | | |
| Unemployment (%) | | 3.6 | 4.1 | 4.5 | 4.3 |
| Consumer prices | | 4.2 | 2.9 | 2.1 | 2.2 |
| Core CPI | | 4.8 | 3.4 | 2.5 | 2.2 |
| Public sector fiscal balance. % of GDP | | -7.6 | -8.0 | -7.8 | -7.5 |
| Public sector debt. % of GDP | | 120.7 | 123.7 | 128.2 | 132.0 |

## Euro area

Yearly change in per cent

| | 2023 level, EUR bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 14,434 | 0.4 | 0.8 | 1.6 | 1.5 |
| Household consumption | 7,605 | 0.6 | 1.1 | 1.6 | 1.4 |
| Public consumption | 3,073 | 1.0 | 1.1 | 1.3 | 1.3 |
| Gross fixed investment | 3,134 | 1.0 | 0.1 | 1.7 | 1.9 |
| Stock building (changes as % of GDP) | | -0.7 | -0.7 | 0.0 | 0.0 |
| Exports | 7,552 | -0.6 | 1.4 | 2.9 | 3.2 |
| Imports | 7,012 | -1.3 | 0.3 | 3.0 | 3.3 |
| | | | | | |
| Unemployment (%) | | 6.6 | 6.5 | 6.5 | 6.3 |
| Consumer prices | | 5.4 | 2.5 | 1.8 | 1.8 |
| Core CPI | | 4.9 | 3.0 | 2.2 | 1.9 |
| Public sector fiscal balance. % of GDP | | -3.6 | -3.0 | -2.6 | -2.5 |
| Public sector debt. % of GDP | | 88.6 | 88.6 | 88.6 | 88.5 |

## Other major economies

Yearly change in per cent

| | | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| United Kingdom | GDP | 0.1 | 1.1 | 1.1 | 1.5 |
| | Unemployment (%) | 4.0 | 4.4 | 4.6 | 4.7 |
| | Inflation | 7.3 | 2.6 | 2.2 | 1.9 |
| Japan | GDP | 1.7 | 0.4 | 1.0 | 1.1 |
| | Unemployment (%) | 2.6 | 2.5 | 2.4 | 2.4 |
| | Inflation | 3.3 | 2.5 | 2.0 | 1.8 |
| Germany | GDP | -0.3 | 0.1 | 1.1 | 1.0 |
| | Unemployment (%) | 3.0 | 3.4 | 3.2 | 3.0 |
| | Inflation | 6.0 | 2.7 | 2.2 | 2.0 |
| France | GDP | 0.9 | 1.2 | 1.3 | 1.3 |
| | Unemployment (%) | 7.4 | 7.4 | 7.4 | 7.2 |
| | Inflation | 5.7 | 2.5 | 1.8 | 2.0 |

## Emerging markets

Yearly change in per cent

| | | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| China | GDP | 5.2 | 5.0 | 4.5 | 4.3 |
| | Inflation | -0.3 | 0.7 | 1.6 | 1.8 |
| India | GDP | 7.8 | 6.5 | 6.5 | 6.4 |
| | Inflation | 5.7 | 4.5 | 4.4 | 4.5 |
| Brazil | GDP | 2.9 | 2.0 | 2.0 | 2.2 |
| | Inflation | 4.6 | 4.1 | 3.7 | 3.5 |
| Russia | GDP | 3.6 | 3.0 | 1.6 | 1.5 |
| | Inflation | 7.4 | 6.7 | 5.0 | 4.2 |
| Poland | GDP | 0.2 | 3.0 | 3.3 | 3.4 |
| | Inflation | 6.1 | 4.0 | 4.0 | 2.9 |

## Financial forecasts

End of period

| Officiall interest rates | 22-Aug | Dec-24 | Jun-25 | Dec-25 | Jun-26 | Dec-26 |
|---|---|---|---|---|---|---|
| US | 5.50 | 4.50 | 3.50 | 3.00 | 3.00 | 3.00 |
| Japan | 0.25 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 |
| Euro area, deposit rate | 3.75 | 3.25 | 2.50 | 2.00 | 2.00 | 2.00 |
| United Kingdom | 5.00 | 4.50 | 4.00 | 3.50 | 3.00 | 2.75 |

| Bond yields. 10 year | 22-Aug | Dec-24 | Jun-25 | Dec-25 | Jun-26 | Dec-26 |
|---|---|---|---|---|---|---|
| US | 3.81 | 3.55 | 3.60 | 3.70 | 3.90 | 4.10 |
| Japan | 0.88 | 1.10 | 1.25 | 1.35 | 1.45 | 1.50 |
| Germany | 2.22 | 2.10 | 2.15 | 2.25 | 2.35 | 2.50 |
| United Kingdom | 3.93 | 3.85 | 3.60 | 3.50 | 3.55 | 3.70 |

| Exchange rates | 22-Aug | Dec-24 | Jun-25 | Dec-25 | Jun-26 | Dec-26 |
|---|---|---|---|---|---|---|
| USD/JPY | 145 | 140 | 133 | 130 | 128 | 132 |
| EUR/USD | 1.12 | 1.11 | 1.15 | 1.17 | 1.18 | 1.16 |
| EUR/JPY | 162 | 155 | 153 | 152 | 151 | 153 |
| EUR/GBP | 0.85 | 0.87 | 0.89 | 0.90 | 0.91 | 0.91 |
| GBP/USD | 1.32 | 1.28 | 1.29 | 1.30 | 1.30 | 1.27 |

## Sweden

Yearly change in per cent

| | 2023 level, SEK bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 6,206 | -0.2 | 0.6 | 2.6 | 2.9 |
| Gross domestic product. working day adjusted | | 0.1 | 0.6 | 2.8 | 2.7 |
| Household consumption | 2,782 | -2.3 | -0.1 | 3.2 | 2.7 |
| Public consumption | 1,621 | 1.0 | 0.3 | 0.8 | 0.8 |
| Gross fixed investment | 1,555 | -1.3 | -1.5 | 3.0 | 5.0 |
| Stock building (changes as % of GDP) | 0 | -1.4 | -0.1 | 0.2 | 0.2 |
| Exports | 3,425 | 3.3 | 1.6 | 4.0 | 4.8 |
| Imports | 3,177 | -1.0 | -0.4 | 4.3 | 5.2 |

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Unemployment (%) | 7.7 | 8.5 | 8.6 | 8.2 |
| Employment | 1.4 | -0.5 | 0.4 | 0.8 |
| Consumer prices | 8.5 | 2.9 | 0.9 | 1.1 |
| CPIF | 6.0 | 1.9 | 1.8 | 1.8 |
| CPIF ex. energy | 7.5 | 2.6 | 1.9 | 1.9 |
| Hourly wage increase | 3.8 | 3.9 | 3.4 | 3.4 |
| Household savings ratio (%) | 14.9 | 15.2 | 14.2 | 14.0 |
| Real disposable income | -0.6 | 0.7 | 3.2 | 3.5 |
| Current account. % of GDP | 6.9 | 6.8 | 6.0 | 5.5 |
| Budget balance, SEK bn | 19 | -71 | -75 | -57 |
| Public sector fiscal balance. % of GDP | -0.6 | -1.0 | -1.3 | -0.5 |
| Public sector debt. % of GDP | 31.7 | 33.0 | 33.5 | 34.1 |

| **Financial forecasts** | **22-Aug** | **Dec-24** | **Jun-25** | **Dec-25** | **Jun-26** | **Dec-26** |
|---|---|---|---|---|---|---|
| Policy rate | 3.50 | 2.75 | 2.25 | 2.00 | 2.00 | 2.00 |
| 3-month interest rate. STIBOR | 3.39 | 2.65 | 2.20 | 2.00 | 2.10 | 2.10 |
| 10-year bond yield | 1.96 | 1.95 | 2.20 | 2.45 | 2.60 | 2.75 |
| 10-year spread to Germany. Bps | -26 | -15 | 5 | 20 | 25 | 25 |
| USD/SEK | 10.19 | 10.00 | 9.43 | 9.19 | 9.03 | 9.09 |
| EUR/SEK | 11.40 | 11.10 | 10.85 | 10.75 | 10.65 | 10.55 |
| KIX | 125.0 | 122.1 | 119.0 | 117.5 | 116.2 | 115.1 |

## Finland

Yearly change in per cent

| | 2023 level, EUR bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 275 | -1.2 | -0.6 | 1.5 | 1.8 |
| Household consumption | 145 | 0.2 | 0.8 | 1.0 | 1.5 |
| Public consumption | 70 | 3.4 | 0.0 | -0.3 | -0.2 |
| Gross fixed investment | 61 | -8.8 | -3.5 | 3.8 | 4.5 |
| Stock building (changes as % of GDP) | | -0.4 | 0.0 | 0.2 | 0.2 |
| Exports | 116 | -0.1 | -3.5 | 3.2 | 3.5 |
| Imports | 116 | -6.6 | -1.8 | 3.0 | 3.5 |

| | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Unemployment (%) | 7.2 | 8.2 | 7.8 | 7.5 |
| Consumer prices | 4.3 | 1.2 | 2.0 | 1.6 |
| Hourly wage increase | 4.2 | 3.2 | 2.8 | 2.5 |
| Current account. % of GDP | -1.4 | -0.8 | -0.2 | 0.0 |
| Public sector fiscal balance. % of GDP | -2.7 | -3.8 | -3.2 | -3.0 |
| Public sector debt. % of GDP | 75.8 | 80.8 | 83.0 | 84.0 |

## Norway

Yearly change in per cent

| | 2023 level, NOK bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 5,127 | 0.5 | 1.8 | 2.0 | 1.1 |
| Gross domestic product (Mainland) | 3,855 | 0.7 | 0.7 | 1.7 | 1.6 |
| Household consumption | 1,923 | -0.8 | 0.9 | 1.8 | 2.4 |
| Public consumption | 1,122 | 3.4 | 2.4 | 2.1 | 2.4 |
| Gross fixed investment | 1,197 | 0.0 | -1.0 | 1.8 | 3.5 |
| Stock building (changes as % of GDP) | 130 | -0.4 | 0.1 | 0.1 | 0.0 |
| Exports | 2,420 | 1.4 | 2.7 | 2.3 | 0.6 |
| Imports | 993 | 0.7 | 0.5 | 2.4 | 3.2 |
| | | | | | |
| Unemployment (%) | | 3.6 | 4.1 | 4.2 | 3.9 |
| CPI | | 5.5 | 3.5 | 3.2 | 2.4 |
| CPI-ATE | | 6.2 | 3.8 | 2.7 | 2.2 |
| Annual wage increases | | 5.2 | 5.3 | 4.0 | 3.5 |

| **Financial forecasts** | **22-Aug** | **Dec-24** | **Jun-25** | **Dec-25** | **Jun-26** | **Dec-26** |
|---|---|---|---|---|---|---|
| Deposit rate | 4.50 | 4.25 | 3.75 | 3.25 | 2.75 | 2.50 |
| 10-year bond yield | 3.27 | 3.07 | 3.05 | 3.10 | 3.15 | 3.30 |
| 10-year spread to Germany. Bps | 103 | 97 | 90 | 85 | 80 | 80 |
| USD/NOK | 10.51 | 10.05 | 9.57 | 9.32 | 9.19 | 9.35 |
| EUR/NOK | 11.75 | 11.15 | 11.00 | 10.90 | 10.85 | 10.85 |

## Denmark

Yearly change in per cent

| | 2023 level, DKK bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 2,805 | 2.5 | 2.0 | 3.1 | 3.0 |
| Household consumption | 1,300 | 1.4 | 0.8 | 3.5 | 4.1 |
| Public consumption | 636 | 0.2 | 1.3 | 0.8 | 0.8 |
| Gross fixed investment | 633 | -6.2 | -1.5 | 6.5 | 7.2 |
| Stock building (changes as % of GDP) | 7 | -1.4 | -0.5 | -0.7 | 0.2 |
| Exports | 1,906 | 10.4 | 4.2 | 4.3 | 4.1 |
| Imports | 1,677 | 3.8 | 0.8 | 5.1 | 5.8 |
| | | | | | |
| Unemployment (%) | | 6.1 | 5.9 | 5.1 | 4.3 |
| Consumer prices | | 3.3 | 1.2 | 1.4 | 1.9 |
| Hourly wage increase | | 3.3 | 3.6 | 4.1 | 4.3 |
| Current account. % of GDP | | 12.5 | 10.0 | 8.0 | 7.0 |
| Public sector fiscal balance. % of GDP | | 3.4 | 3.5 | 4.0 | 4.0 |
| Public sector debt. % of GDP | | 29.3 | 29.0 | 28.0 | 27.0 |

| **Financial forecasts** | **22-Aug** | | **Jun-25** | **Dec-25** | **Jun-26** | **Dec-26** |
|---|---|---|---|---|---|---|
| Deposit rate | 3.35 | | 2.10 | 1.60 | 1.60 | 1.60 |
| 10-year bond yield | 2.18 | | 2.14 | 2.24 | 2.33 | 2.47 |
| 10-year spread to Germany. Bps | -3 | | -1 | -1 | -2 | -3 |
| USD/DKK | 6.67 | | 6.48 | 6.37 | 6.31 | 6.42 |
| EUR/DKK | 7.46 | | 7.45 | 7.45 | 7.45 | 7.45 |

## Lithuania

Yearly change in per cent

| | 2023 level, EUR bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 67 | -0.3 | 2.4 | 2.6 | 2.9 |
| Household consumption | 39 | -1.0 | 4.3 | 3.2 | 3.0 |
| Public consumption | 11 | 0.2 | 0.2 | 0.1 | 0.0 |
| Gross fixed investment | 14 | 10.6 | 2.5 | 4.5 | 5.0 |
| Exports | 59 | -3.3 | 0.5 | 4.0 | 3.7 |
| Imports | 60 | -4.9 | 1.2 | 5.0 | 4.3 |
| | | | | | |
| Unemployment (%) | | 6.8 | 7.3 | 7.0 | 6.8 |
| Consumer prices | | 8.7 | 1.2 | 3.0 | 2.7 |
| Wages and salaries | | 12.2 | 9.4 | 8.1 | 7.5 |
| Public sector fiscal balance. % of GDP | | -0.8 | -1.6 | -1.8 | -1.5 |
| Public sector debt. % of GDP | | 38.3 | 38.7 | 40.8 | 41.6 |

## Latvia

Yearly change in per cent

| | 2023 level, EUR bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 40 | -0.3 | 0.8 | 2.2 | 2.5 |
| Household consumption | 25 | -1.3 | 1.1 | 2.1 | 2.4 |
| Public consumption | 8 | 7.0 | 5.5 | 3.2 | 2.0 |
| Gross fixed investment | 10 | 8.2 | 2.6 | 4.8 | 5.2 |
| Exports | 26 | -5.9 | 0.5 | 2.6 | 2.5 |
| Imports | 27 | -2.8 | -1.6 | 1.4 | 2.2 |
| | | | | | |
| Unemployment (%) | | 6.5 | 6.8 | 6.6 | 6.5 |
| Consumer prices | | 9.1 | 1.4 | 2.4 | 2.1 |
| Wages and salaries | | 11.9 | 10.1 | 8.8 | 7.9 |
| Public sector fiscal balance. % of GDP | | -2.2 | -3.0 | -2.9 | -2.8 |
| Public sector debt. % of GDP | | 43.6 | 44.5 | 45.7 | 46.4 |

## Estonia

Yearly change in per cent

| | 2023 level, EUR bn | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|
| Gross domestic product | 38 | -3.0 | -0.7 | 2.5 | 2.7 |
| Household consumption | 20 | -1.2 | 0.0 | 1.5 | 2.0 |
| Public consumption | 8 | -1.0 | 0.5 | -0.4 | -0.3 |
| Gross fixed investment | 11 | -3.0 | 1.8 | 3.8 | 4.5 |
| Exports | 30 | -6.5 | -1.7 | 4.0 | 5.0 |
| Imports | 29 | -4.5 | -2.0 | 3.0 | 4.5 |
| | | | | | |
| Unemployment (%) | | 6.4 | 7.5 | 7.2 | 6.8 |
| Consumer prices | | 9.1 | 3.8 | 3.5 | 3.0 |
| Wages and salaries | | 11.4 | 7.2 | 5.0 | 5.0 |
| Public sector fiscal balance. % of GDP | | -3.4 | -3.5 | -3.0 | -3.0 |
| Public sector debt. % of GDP | | 19.6 | 22.5 | 27.0 | 29.0 |

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