Swedbank

Swedbank Economic Outlook

August 2021

Completed: August 25, 2021, 06:00
Distributed: August 25, 2021, 07:00

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Swedbank Economic Outlook presents the latest economic forecasts for Sweden, Norway, Denmark, Finland, Estonia, Latvia, and Lithuania, as well as major global economies.

Swedbank Economic Outlook is a product made by Swedbank Macro Research and is available at www.swedbank.com/seo.

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Recording date of price data 2021-08-23. **Layout**: Jana Eklund, Macro Research, Swedbank. **Images**: Getty Images

The outlook is bright, but clouds surround us

The Swedish summer surprised us positively and showed itself from its best side. It has been a summer with a lot of nice weather and outdoor activities. My 5-year-old daughter's wish from last Easter was also fulfilled: the easing of restrictions made it possible to meet loved ones again. But limited cross-border vacations underpin the continued seriousness of the period we are currently experiencing.

The global economy has also surprised us positively during 2021. The Nordic and Baltic economies have shown unexpectedly rapid recoveries, and continued high growth is expected. The key behind the swift economic growth has been successful vaccinations, seasonal factors, and, not least, expansionary economic policies. However, the spread of the Delta variant, together with low vaccination rates in many countries, not least in Asia, is a source of concern. This risks a worsening of global supply-chain problems that could affect the pace of recovery during autumn globally, as well as in the Nordic and Baltic region.

We also see some dark clouds at home. Economic policy in Sweden needs to focus on the structural problems that have increased during the pandemic. This applies particularly to the labour market and the problems related to high unemployment among foreign-born people. Also pressing is the number of long-term unemployed, which has risen sharply during the pandemic crisis. Furthermore, we also need to make more investments for the climate transition.

For the Riksbank, I see two challenges over the coming years. First, reaching the inflation target, which is set to be difficult even though there are inflation risks beyond the forecast horizon. Second, facing the financial and structural risks that come with ever-higher asset prices, increased indebtedness, and certainly also the greater risk-taking in the financial markets in the search for yield.

Mattias Persson
Global Head of Macro Research and Group Chief Economist

At a Glance

Global growth
GDP in 2021

6.0%

Wage growth in Lithuania
Forecast for 2021

10.3%

German 10Y government bond yield
at the end of 2023

-0.20%

Latvians having had 1 dose
Vaccination rate (by August 21), share of population

44%

Swedish housing prices
Expected annual change in 2022

5-10%

EURSEK
at the end of 2021

10.10

Highlights

- The solid economic recovery is expected to continue, although supply shortages are putting speed limits on global growth.
- The spread of the Delta variant poses a clear downside risk to the outlook, not least to global trade.
- High vaccination rates, together with the restrictions in place, are expected to be enough to contain the virus and keep the US and European economies open.
- In the US, demand for labour is rising and wages are also increasing. Although we expect that the currently high inflation will decline over the coming months, there is a risk that inflation will stay elevated longer. We deem such risks for the euro area as very low.

Financial Markets

- The ECB will struggle to bring inflation to the newly adopted 2% target. We expect the ECB to leave its policy rates unchanged during the forecast horizon.
- The Fed will start a very gradual exit from its stimulus measures by reducing the asset purchases late in 2021. We forecast two rate increases in 2023.
- Government bond rates are expected to rise slowly and yield curves to remain flat over the forecast horizon. Credit market conditions are expected to stay favourable for corporates.
- The Scandinavian currencies are expected to strengthen somewhat, leaving the EURSEK at 10.10 and EURNOK at 10.20 at the end of 2021.

2021 Outlook

Finland

GDP:	3.1%
Inflation:	1.6%
Unemployment:	7.7%

Sweden

GDP:	4.4%
Inflation:	1.7%
Unemployment:	8.8%

Norway

GDP:	2.9%
Inflation:	2.8%
Unemployment:	4.2%

Denmark

GDP:	3.8%
Inflation:	1.3%
Unemployment:	5.6%

Estonia

GDP:	8.0%
Inflation:	3.1%
Unemployment:	6.4%

Latvia

GDP:	4.0%
Inflation:	2.3%
Unemployment:	7.6%

Lithuania

GDP:	4.2%
Inflation:	3.7%
Unemployment:	7.2%

Nordics

- **GDP hit pre-crisis levels already earlier this year in all the Nordic countries, and a continued recovery will lift growth figures to about 3-4% this year and next.**
- **Despite a strong recovery in labour markets and firms' increased concerns about labour shortages, wage growth and inflation are expected to stay low.**
- **The Riksbank is expected to leave its policy rate at 0%, while Norges Bank will gradually lift its policy rate up to 1.25% at the end of 2023.**

Baltics

- **After a relatively mild and short-lived recession, the expected recovery happened unexpectedly quickly. GDP has already surpassed the pre-pandemic levels in all countries.**
- **Growth during the next two years is expected to be slightly above the pre-crisis trend, supported by household consumption, strong external demand, and EU funds.**
- **Unemployment is declining, and an increasing number of companies are facing labour shortages. This is fuelling already-rapid wage growth, especially in Latvia and Lithuania.**
- **Medium-term challenges are related to timely and efficient deployment of EU funds.**

Global growth facing speed limits

Backed by vaccinations and economic stimulus, the recovery in the global economy keeps going. Continued high growth is expected during the whole forecast horizon, although supply shortages are already putting speed limits on growth. Meanwhile, the spread of the Delta variant poses a downside risk to the global outlook.

The global economic recovery continues

The economic recovery over the past year has been impressive. In many countries, economic output was already back at pre-crisis levels this summer. Stronger-than-expected development during the second quarter has caused us to revise up the growth outlook for the euro area, as well as the Nordic and Baltic economies, for this year.

Labour markets have also improved more rapidly than foreseen during the spring. Therefore, labour shortages have increased markedly. In many countries, labour shortages are now at such high levels that they risk holding back the economic recovery; in some countries, wages have started to drift higher. Labour shortages are also in issue in all the Nordic and Baltic countries; see our in-depth on page 37.

The strong economic recovery over the past year has also created a global shortage of many input goods. This is likely to continue and, in some cases even become more severe during the forecast horizon; this will also limit overall growth. Supply simply cannot keep up with the rapid rise in demand, meaning that the global economy is facing speed limits. Thus, without these shortages, our global GDP forecast would be higher in the near term. The speed limits also imply that the economic upswing will probably last longer, as it will take more time to meet the demand.

Swedbank's global GDP forecast

Annual % change	2020	2021F		2022F		2023F
US	-3.4	6.1	(6.8)	4.4	(3.9)	3.3
Euro area (calendar-adjusted)	-6.5	4.7	(4.0)	4.3	(4.0)	2.2
Germany	-4.9	3.0	(3.3)	4.7	(3.6)	2.0
France	-8.0	5.8	(5.4)	4.3	(4.4)	2.3
Italy	-8.9	5.7	(4.3)	3.9	(4.5)	2.0
Spain	-10.8	6.1	(5.9)	5.4	(5.6)	2.5
Finland	-2.9	3.1	(3.0)	2.9	(2.8)	1.2
United Kingdom	-9.8	7.0	(4.8)	5.6	(6.2)	1.5
Sweden	-2.8	4.4	(3.6)	3.6	(3.6)	2.0
Denmark	-2.1	3.8	(3.2)	3.5	(3.7)	2.1
Norway (mainland)	-3.1	2.9	(2.7)	3.8	(4.1)	1.8
China	2.3	8.2	(8.2)	5.4	(4.9)	5.3
Russia	-3.0	4.0	(2.5)	3.1	(3.4)	2.0
Global GDP (IMF PPP weights)	**-3.2**	**6.0**	**(5.9)**	**4.7**	**(4.4)**	**4.1**

Previous forecast in parentheses.
Sources: IMF & Swedbank Research

The supply shortages are also expected to lift consumer price inflation somewhat during the forecast horizon. Overall, however, we deem that price pressures will remain muted in most countries. While shortages related to input goods are mainly expected to have transitory effects on consumer price inflation, the larger labour shortages could have a more sustained effect on wages and inflation pressures.

But the level of labour shortages, as well as their pass-through to wage growth, varies across countries. For most European countries – with the exception of the Baltic countries – we see only moderate wage growth and inflation over the forecast horizon. However, in the US, the demand for labour has been very high and wages are already on the rise. Although we expect that the currently high consumer price inflation in the US will decline over the coming months, there is a risk that inflation will stay elevated for longer on the back of the strong labour market.

Pandemic assumptions

High vaccination rates, together with the social restrictions still in place, are expected to be enough to contain the virus and keep the US and European economies open. The forecast assumes that no significant lockdown measures are reintroduced during the forecast horizon.

During the summer, the highly transmissible Delta variant caused a renewed surge in COVID-19 cases across the globe. The number of cases is rising rapidly not only in Asia and Africa, but also in the US and Europe, including the Nordic and Baltic countries. The Delta variant, which was first detected in India, is so far the most transmissible variant of the coronavirus, according to the WHO.

The renewed spread of COVID-19 is striking unevenly across countries and regions. Data suggests that most of the vaccines are effective also against this mutation. But the vaccine distribution has remained unequal across the world, and many developing countries are lagging far behind. The current recovery is, therefore, uneven across countries and regions, widening the wealth gap between the world's richest and poorest.

In the US and Europe, however, vaccination rates are relatively high, and the number of serious cases and deaths remains low. We assume that the high vaccination rates, together with the current restrictions, will be enough to contain the virus and keep the economies open. Thus, we expect that lockdown measures will not be widely reintroduced during the forecast horizon.

The absence of lockdowns will allow households to return to almost normal spending patterns. Nonetheless, recurring outbreaks could leave a long-lasting impact on some sectors, such as tourism, travelling, and sports and cultural events, as some physical-distancing measures will be kept in place. However, this is not expected to weigh significantly on the overall economy. Companies and consumers have now had time to adapt, and economies have become more resilient to the new waves of the coronavirus.

In other parts of the world, the current spread of the virus will likely weigh more on the economic recovery. Yet, we assume that the impact on the global economy will be limited, and that global trade will not be materially affected.

Risk assessments

The current spread of the Delta mutation across the globe is an evident risk that can weigh on both global supply and demand. Due to this, we mainly see downside risks to our forecasts of the major economies in 2021 and 2022; risks are more balanced for the 2023 forecast.

A large spread of the virus, even in remote parts of the world, risks creating ripple effects for our home markets as well. For example, many Asian countries that are lagging in vaccinations have reintroduced lockdowns, which could worsen the existing disruptions in supply chains and cause even bigger commodity and component shortages than anticipated. The exporting manufacturing sector is particularly vulnerable to this, but it could also dent overall output growth and fuel temporary spikes in inflation.

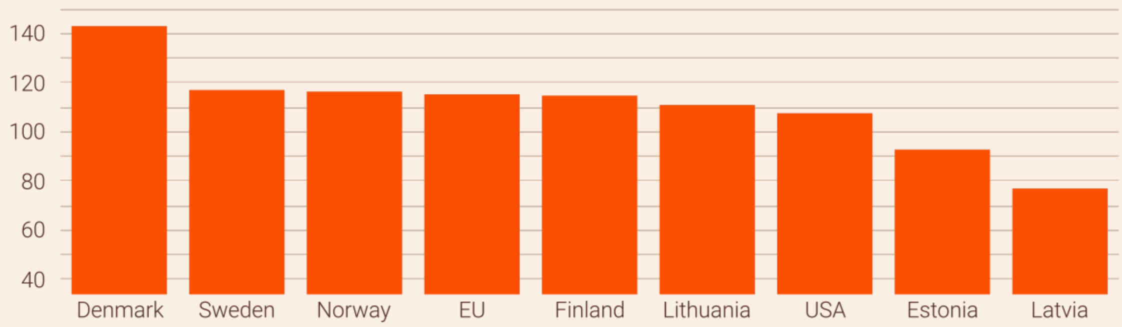
Nor can we rule out that the pandemic will once again seriously affect our home markets more directly. Countries with relatively low vaccination rates – notably Latvia, but to some extent also Estonia – are more vulnerable. But new mutations, possibly with the capacity both to spread easily and cause serious illness despite high vaccination rates, could also emerge. Another round of strict lockdown measures could be devastating for many companies in the services sector that are still not out of the woods, bankrupting them and causing unemployment to rise.

There are also risks associated with the forecast that are not directly related to the Delta variant, but rather to the rapid economic recovery. We cannot rule out that the ongoing recovery could have a larger impact on wage growth and inflation pressures than anticipated. We deem this risk as much higher in the US than in the euro area. Higher wage growth and inflation in the US could prompt the Fed to withdraw stimulus earlier than currently anticipated by financial markets. In turn, this could cause turmoil in financial markets and put pressure on asset prices, also in Europe.

Longer out, we regard the risk assessment to our growth forecasts as more balanced. An upside risk to the forecast is that the low interest rates, together with the pressing need for action against climate change, will eventually cause investments to rise and increase potential growth.

Vaccination rate

Total doses administered per 100 people



Note: Data as of August 19
Sources: Swedbank Research & Macrobond & Our World in Data

Euro area – finally taking off

Recovery in the euro area is finally in full swing. Positive economic surprises in the beginning of the year have set the stage for faster-than-expected growth in Europe. Fairly successful vaccination efforts are allowing the service economy to contribute meaningfully to growth. Meanwhile, economic policy will support growth in the near term.

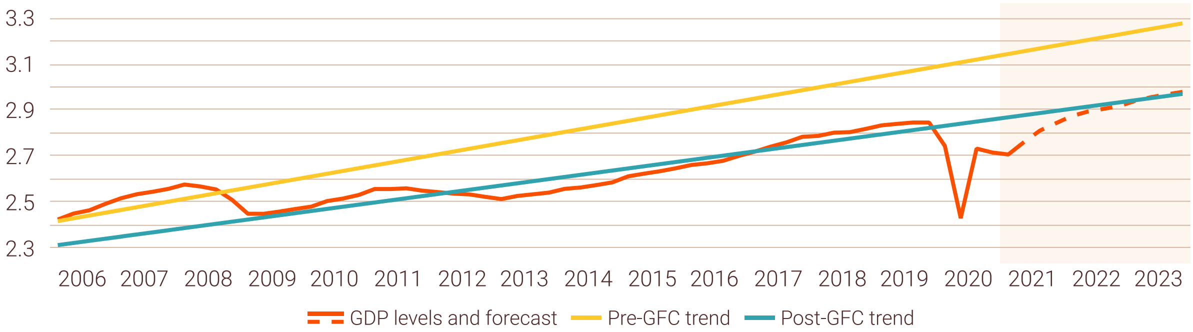
Growth returned as Europe gradually reopened over the second quarter. Europe lagged behind the US in its vaccination and subsequent reopening efforts. However, over the past quarter vaccine supply issues have been resolved and the EU has made remarkable progress in its vaccination efforts, overtaking the US in share of people vaccinated. Previously, Europe relied on manufacturing and global demand to keep its economy afloat; now, the service economy is becoming the main driver of growth.

The euro area economy is expected to grow slightly faster than we forecast in April. This year, GDP is likely to expand by 4.7%, and by 4.3% in 2022. The upward revision arises mostly due to the faster recovery in the southern member states. Faster growth in the economically weaker south is very welcome, although their tourism-reliant economies are particularly vulnerable to risks associated with new strains of the virus. There are signs that supply-chain constraints are starting to affect the manufacturing sector. Despite record-high sentiment indicators, actual output is slow to rise, especially in Germany. Manufacturing underperformance could be another source of disappointment over the rest of the year.

Both fiscal and monetary policy remain very accommodative and will support growth in Europe throughout the forecast horizon. With both arms of economic policy working together, the scarring of the euro area economy is being kept to a minimum – the economy is projected to return to its pre-pandemic trend within a couple of years. Fiscal rules will remain suspended throughout the end of 2022, and the debate is under way regarding in what shape they ought to return. However, the lack of an established central fiscal capacity and member states' reliance on a common ECB policy to conduct domestic fiscal policy mean that stress in the sovereign debt markets and excess fiscal tightening are always looming risks.

Euro area real GDP will recover by 2022

EUR trillion, sa



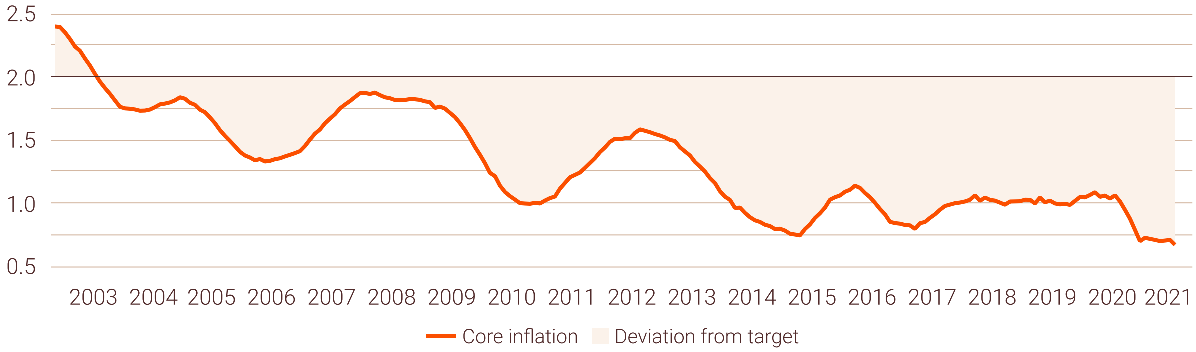
GFC - Great Financial Crisis
Sources: Swedbank Research & Macrobond

A shift in European politics will affect the debate on fiscal frameworks. Emmanuel Macron and Mario Draghi often find a common position on European issues, and the Franco-Italian axis might become a key driver of the European agenda over the next two years, especially with Angela Merkel stepping down. The German elections will also shape the future of the fiscal framework; there is potential for a more relaxed fiscal regime if more left-leaning parties enter the next coalition government. See more in the in-depth on the German election on page 34.

The new ECB strategy has lifted the inflation target somewhat to 2% and, more important, allows for a temporary target overshoot. This means that the ECB is very unlikely to react to higher inflation before core inflation reaches 2% and stays above it for at least a few months. Although headline inflation has hovered around 2% recently, this was mainly due to temporary external factors – more expensive commodities, higher transportation costs, and shortages of semiconductors. Despite strong expected GDP growth and an improved labour market, we do not see core inflation rising above 2% in a sustained manner during our forecast period. Hence, the ECB is expected to leave its policy rates unchanged at current levels at least throughout 2023. Although the new ECB strategy now also requires housing costs to be considered, it will take a few years before they are incorporated in inflation measures. Nevertheless, rapidly increasing housing prices and higher inflation in some smaller euro area countries may start giving the ECB more headaches. We do not expect the Pandemic Emergency Purchase Programme (PEPP) to be extended beyond March of 2022 and we do not think that other open-ended asset purchase programmes will need to be adjusted – they are expected to run at least until the end of 2023.

Inflation deviation from 2% target

y/y %, 1yma



Sources: Swedbank Research & Macrobond

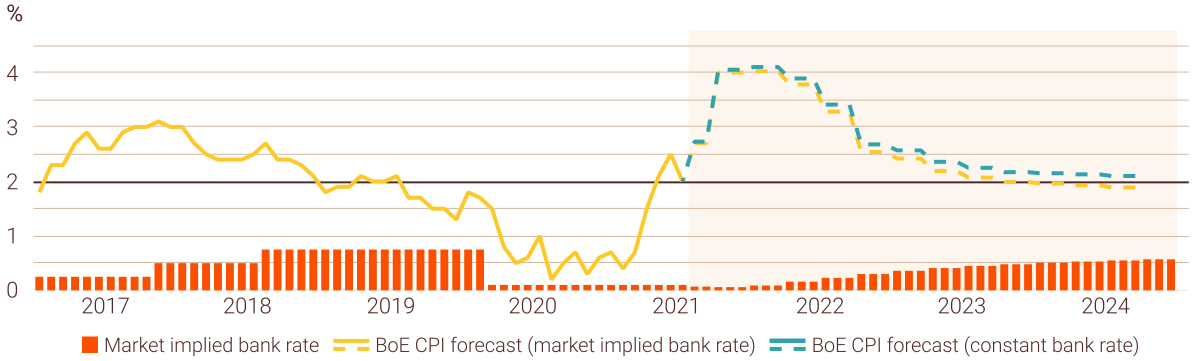
United Kingdom – torn between the short and long term, with a rate hike on the horizon

COVID-19 restrictions have largely been lifted and the UK is set for a robust recovery, but the long-term prospects for the British economy are still weak and clouded by trade concerns. Monetary policy will remain accommodative in the near term, while in early 2023 we expect the Bank of England to raise the bank rate to 0.25%.

The British economy experienced a significant rebound during the second quarter, with GDP rising by 4.8% compared with the first three months of 2021. COVID-19 restrictions have now largely been lifted, and the UK is set for an additional growth contribution from services as household consumption recovers further. We expect the Delta variant to weigh slightly on confidence but still believe that GDP will reach pre-pandemic levels in the fourth quarter. The near-term outlook is partly clouded by supply-and-demand imbalances in both trade and the labour market, which have been exacerbated by the country's withdrawal from the EU; nevertheless, an economic recovery finally seems to be on track.

Meanwhile, inflation has been lifted to the 2% target as base effects from last year have kicked in, while prices for goods have surprised on the upside. The Bank of England has revised up the short-term inflation projection and, more important, expects medium-term inflation to be near target. While the Bank remains cautious, it has been striking an increasingly less soft tone and seems comfortable with markets pricing for two rate hikes until 2025. We expect a slow but steady tightening and foresee a partial rate hike in early 2023, lifting the bank rate to 0.25%; additional rate hikes and a stop to bond reinvestments go beyond our forecast horizon.

Market pricing of rate hikes is consistent with medium term inflation near 2%



Note: The forecasts and market pricing are collected from Bank of England's August Monetary Policy Report.
Sources: Swedbank Research & Macrobond

The year 2023 will not only see tighter monetary policy but also headwinds on the fiscal side, as the corporation tax will be increased. Until then, businesses will benefit from a tax deduction on investments announced in this year's spring budget; however, further investment-facilitating measures will likely be necessary to compensate for shortfalls following Brexit. Aside from the investment outlook, we expect the slow recovery in foreign trade to continue, particularly in exports. Due to the trade barriers with the EU, there is a risk that foreign companies will take advantage of the global trade rebound to reduce British involvement when they rebuild cross-border supply chains, which would speed up the process of trade diversion away from the UK. We anticipate that economic growth will slow considerably in 2023 as policy tightens and the recovery wears off, but additional problems in trade may emerge sooner rather than later.

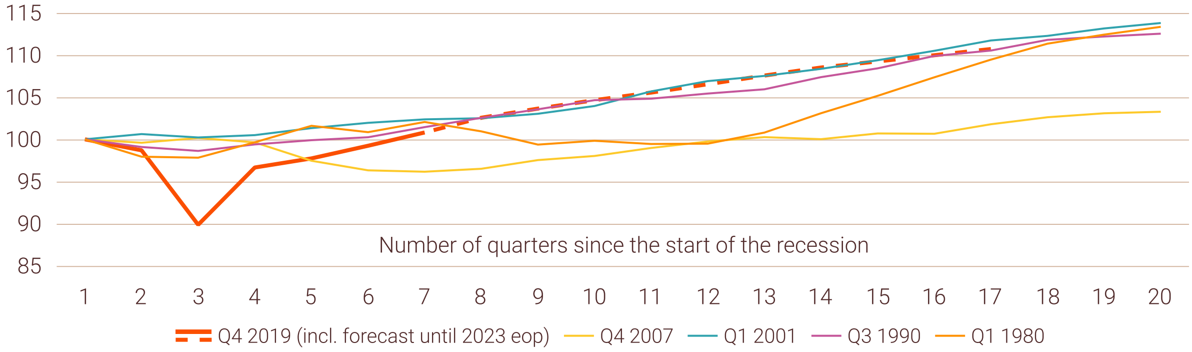
United States – forceful recovery

The US economy is in full bloom – consumer spending and business investments have grown, and large fiscal support will likely raise productivity. The widening spread of the Delta variant is posing risks but will likely not affect the economy too much. As progress on the labour market continues, the Fed will close in on policy normalisation.

The economic recovery has been impressive: halfway through this year, GDP was already back at the pre-crisis level. Vaccination and fiscal policy have fuelled consumer spending, which has been rotating towards services while goods spending has moderated. Business investments during the first half of 2021 expanded as order intakes have been high and companies have made pandemic-related adaptations. To meet the strong demand in the second quarter, businesses turned abroad and imported, as well as drew down on inventories. We expect the economy to continue to improve going forward, but the Delta variant is a cause for concern, and we do already see that it has affected some data. In the US, companies have been instituting vaccine mandates, mask requirements have increased, and federal employees must meet certain criteria. But states with lower vaccination rates have a smaller weight in GDP and in some states the activity is high despite the risk of infection.

In coming years, fiscal policy will boost GDP growth and contribute to investments in infrastructure and the climate, and support welfare. Businesses, on the back of robust earnings, are also expected to invest to counter shortages. Private consumption is expected to remain strong, but momentum will fade somewhat. Public transfers to households will likely be smaller, and the inflation rate has increased drastically, reducing households' purchasing power. Employment remains below pre-pandemic levels; in July, payrolls were 5.7 million below the February 2020 level. However, the labour market is recovering, and we expect it to continue to improve going forward.

Fast recovery in US real GDP
Index, 100 = start of the recession



Sources: Swedbank Research & Macrobond

It will be crucial for the Federal Reserve (Fed) to see substantial further progress on the labour market before it changes its current policy stance. Despite a depressed participation rate, underlying data shows somewhat broader progress, and demand for labour is strong. The mismatch between demand and supply on the labour market may currently hold back growth somewhat but could at the same time lift wage growth higher, as employers must pay more to fill vacancies. Over time, this adds to the inflation pressure, which so far has been driven by corona-sensitive components. We believe that the inflation pressure will remain high in the near term but then gradually ease as the economy's reopening effects fade and productivity rises. This, in conjunction with the Delta variant risks, will allow the Fed to sit still for some months yet. We are maintaining our stance that Fed will start tapering off in December 2021 and conclude net asset purchases in 2022, before hiking the federal funds rate in 2023.

China – solid economic recovery so far but new COVID-19 cases are worrying

Strong exports and industrial production have put China's economy back on track. Meanwhile, consumption and the services sector are gradually catching up. However, the spread of the Delta variant puts a downside risk on the outlook.

China's vaccination rate is on par with many western countries, even outperforming our home markets and the US. However, according to studies by the WHO, the Chinese vaccines, while seemingly less effective at preventing the spread of the virus, are still effective at preventing severe disease and death. To improve China's image, which has taken a beating during the pandemic, President Xi Jinping has pledged to give out 2 billion vaccines to other countries and donate $100 million for vaccine distribution in developing countries this year.

The spread of COVID-19 was relatively calm during the spring, but clusters of cases have recently appeared in populous cities. The recent surge in outbreaks has meant more restrictions and, thus, less economic activity. The increased virus spread might pose challenges for compliance with the national zero-tolerance policy, but China will likely keep its borders closed without further notice.

Export growth remains strong but is set to moderate going forward. Domestic COVID-19 outbreaks, especially in Guangdong province, have led to port closures, causing supply-chain disruptions and bottleneck issues; these have affected not only China's exports but also global trade. Export volumes to other Asian and Oceanian countries continue to increase and are expected to remain strong, while export volumes towards the US and EU have slowed somewhat. China's share of global trade has also risen considerably, especially since the onset of the pandemic.

China's relations with the EU and US remain cold. While there are areas of cooperation, such as climate policy, trade relations see no sign of improving. Both the EU and US have put sanctions on China against human rights violations and abuses towards Uyghurs in the Xinjiang region; China has responded with retaliatory sanctions. This led to the EU's suspending discussions on the Comprehensive Agreement on Investment (CAI) between the EU and China. Since Biden was elected President, no changes in US trade policy towards China have been made.

Manufacturing purchasing managers' indexes (PMIs) have been falling since April, signalling a slowdown in growth. Lately, factors like the spread of the Delta variant and extreme weather in the form of flooding have weighed down manufacturing sentiment. Other contributing factors have been higher material costs, longer delivery times, and fewer new export orders; combined, these factors indicate that exports may slow going forward. The services PMI has mostly remained well in expansionary territory this year, driven by gradual improvements in consumption. However, the spread of the Delta variant has already begun to affect tourism and, if persistent, will likely weigh on the services sector as a whole.

China's real GDP is now back to its pre-pandemic trend, and we expect this growth to continue as activity normalises. Overall, the picture is in line with our view from this past spring. Domestic activity remains supply-side led, with exports and industrial production the main contributors to China's growth; meanwhile, consumption and the services sector are gradually catching up. As China's recovery consolidates in the second half of this year, we expect macroeconomic policies to continue to shift from accommodative to more neutral, as broader easings are no longer necessary to boost growth. Our forecast is that GDP growth this year will amount to 8.2%, in 2022 to 5.4%, and in 2023 to 5.3%.

Several challenges pose downside risks to our near-term forecast, such as escalations in tensions with the EU and the US, higher raw material prices, supply-chain disruptions, a surge in virus outbreaks, and extreme weather events. Moreover, export growth is set to moderate, as global demand patterns normalise towards services consumption and production increases in competing countries. In the medium to long term, China will have to face several major structural challenges: an ageing population; its debt-fuelled, investment-driven growth model, which likely cannot be sustained endlessly; slowing productivity growth; and the country's planned shift to more environmentally friendly production.

Bond yields drop on virus and growth fears

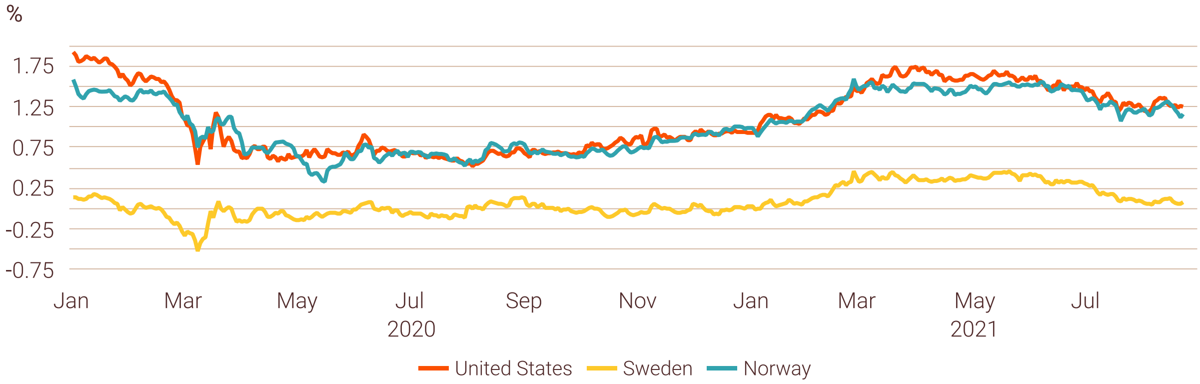
Although most developed economies have shown a solid recovery since the reopening this spring, global bond yields have markedly declined since the peak in May. Fears that the Delta variant is leading to more restrictions and softer global growth momentum are the key reason for the recent decline. With that, the US dollar has strengthened while both the Swedish and the Norwegian currencies have weakened somewhat. Credit markets have weathered the softer period well, as liquidity remains ample.

Real bond yields tumbling on Delta variant spreading

Interest rates on government bonds (bond yields) with longer maturity peaked globally in May this year, as both inflation and economic activity picked up markedly when economies reopened. Since then, longer-dated bond yields have trended downwards. The decline was exacerbated in the summer months as the COVID-19 Delta variant spread to most countries and prompted more restrictions in some economies with predominantly lower vaccination rates. Additionally, some weaker growth signals from leading economic indicators, such as the PMIs, have added to the decline in bond yields. Most prominently, inflation expectations have kept up, whereas in the US and Germany, 10-year real bond yields stood at their lowest-ever recorded levels in early August. Over the coming years, we expect bond yields to increase slightly, reflecting expectations that monetary policy will eventually become less expansionary as economies gain a more solid footing amid global vaccination coverage. Central banks have promised to maintain ample stimulus for many more years, so as not to hamper the economic recovery, and supportive financial conditions will remain an imperative for the global economy. Large public deficits mean the supply of bonds will remain high; this speaks to higher interest rates on government bonds, but at present this is more than countered by the large central bank purchase programmes.

Although asset prices are skyrocketing, the Fed and the ECB have clearly stated they will not start rolling back their monetary policy support before inflation has been sustained around the target of 2% over the medium term. We expect the Fed to announce a reduction in its bond purchases this autumn and to start tapering off by the end of this year; meanwhile, the ECB, as communicated, is expected to phase out its pandemic asset-purchasing programme by March next year.

Bond yields drop on virus and growth fears



Sources: Swedbank Research & Macrobond

Credit market spreads still at tight levels

Corporate credit markets have weathered the recent decline in global bond yields very well. Standing at still very tight levels, historically, these markets have seen only a slight widening of spreads on the back of the Delta variant surge. Together with equity markets, the credit markets still enjoy ample liquidity and low interest rates. In our base case, we expect credit market conditions to remain overall very favourable during the forecast period, with support from the economic recovery as well as central bank policies. However, we see more limited scope for a further tightening of credit spreads for companies with higher credit ratings (so-called investment grade), as investor appetite for close-to-zero, or even negative, coupons is expected to remain moderate.

Risks to this outlook are mostly concentrated around the downside risks of a new COVID-19 mutation, in which less effective current vaccines result in a new round of stricter social-distancing measures. The most prominent upside risk is inflation proving to be temporary, causing more cautious central banks to maintain an expansionary monetary policy for longer.

Scandinavian currencies have weakened somewhat lately

The foreign exchange market has played out the same narrative as seen in the bond market over the past months. As new COVID-19 variants have led to increased infections globally and growth indicators have levelled off, markets have turned their backs on currencies from small, open economies, typically supported by higher global growth. The New Zealand dollar and Norwegian krone are two telling examples of the playing out of this narrative in past months.

Overall, the US dollar has strengthened as general risk sentiment in financial markets has deteriorated. Against the euro, the US dollar is currently at its strongest level since the first quarter of this year. US GDP growth is expected to outpace most of its developed trading partners; supported by strong investor appetite for US assets, we expect the US dollar to maintain a strong footing over the forecast horizon. Moreover, the US dollar is also supported by the Fed, which is expected to signal a tighter monetary policy on the back of an improving labour market, higher wage growth, and, over time, inflation sustained well above the inflation target.

The Swedish krona has been quite stable over the past months but has struggled to break below 10 against the euro since the beginning of the year. Overall, the Swedish krona has been behaving the opposite of the US dollar, i.e., it strengthened as risk sentiment improved and vice versa. In trade-weighted terms (KIX), the krona is a little weaker than the Riksbank projected in its latest Monetary Policy Report (July), but this is nothing that would prompt any change in communication from the central bank. Rather, a stable krona will add to the confidence of the Riksbank that its current stance remains appropriate. Looking forward, as the Swedish economy recovers on the back of firm export sector and vaccine-induced services sector growth, and while inflation expectations remain well anchored, the krona should strengthen somewhat over the forecast horizon.

The Norwegian krone has experienced a more turbulent summer. Following the strong recovery that extended into the first months of this year, the krone has weakened and is now back to levels seen at the very beginning of 2021. Lower oil prices, bond yields, and market sentiment have all weighed on the krone over the past months. But, as Norges Bank is expected to start raising policy rates in September, this should support the krone over the coming quarters. However, we now foresee a somewhat weaker krone in coming years, compared with our previous report from April, as the negative historical trend in the Norwegian krone is expected to continue to some degree.

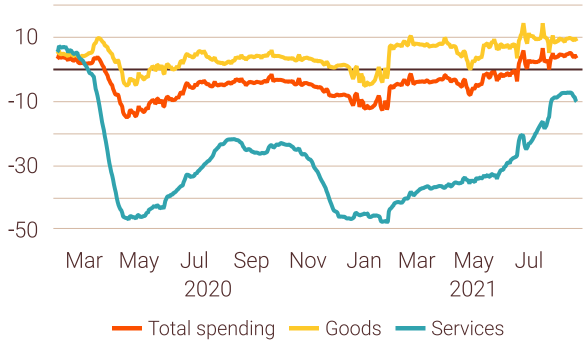
Sweden – full speed but a bumpy ride

The recovery in the economy will continue with full force in the coming years, supported by the easing of pandemic restrictions and an expansive economic policy. But there are risks surrounding the forecast, including the Delta variant of the coronavirus. Inflation remains low, albeit rising slightly and the repo rate is expected to remain at 0%. Fiscal policy has helped sustain the economy during the pandemic but now needs to switch to investments.

The economy is steaming ahead on a broad front

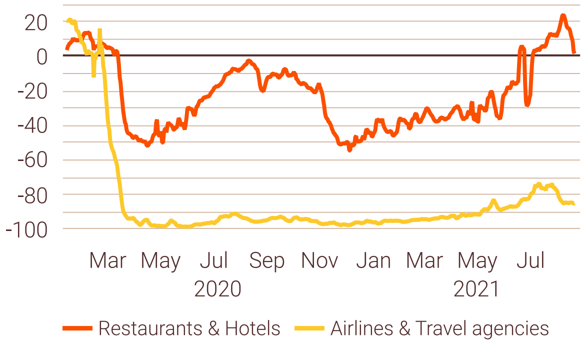
The economic recovery is progressing, and sales in the services sector improved significantly during the summer. Card transaction data from Swedbank Pay shows that households spent more money on services this summer than during the summer of last year, and turnover in the sector is approaching pre-pandemic levels, although the rate of increase slowed down somewhat at the end of the summer. Some sectors affected by the coronavirus, such as hotels and restaurants, recovered rapidly during the summer, while other close-contact services sectors are still well below normal levels. At the same time, the latest statistics show that the whole economy grew rapidly in June, when GDP rose by 2.5% from the month before, which, in line with our April forecast, meant growth in the second quarter of just under 1%. Expectations for future growth are also positive. Swedbank/Silf's purchasing managers' index (PMI) for both the industry and the services sector points to high growth levels going forward, as does the economic tendency indicator from the National Institute of Economic Research (NIER), which reached a new historical high in July.

Daily spending in goods and services sectors
% change compared to 2019, 4wma



Sources: Swedbank Pay and Swedbank Research

Daily spending in selected sectors
% change compared to 2019, 4wma



Sources: Swedbank Pay and Swedbank Research

Export managers are also optimistic, according to sources such as Business Sweden's latest survey, while the Riksbank's business survey indicates that companies' investment plans have resumed following a respite last year. We expect the economic recovery to pick up further in the second half of this year as household consumption and business investment revive, but we expect some slowdown in industrial production and business exports because of continued bottleneck problems. Companies' investments are expected to shift upwards because investment-heavy industries have seen a rapid recovery and will be driven in the future by favourable financing conditions, as well as by the green transition and digitalisation. For example, extensive investment is planned in northern Sweden over the next few years in, among other things, green steel and battery production. Housing investment is also developing positively, supported by low interest rates and high demand. We have revised up our April investment forecast in light of the already-fast pace of construction.

Several uncertainties surround our forecast

Our forecast implies a very good economic recovery over the next few years and can probably be characterised as optimistic. There are risks on both the up- and downside, but we think that downside risks will dominate in the short term. The upside risks that we are seeing are that the economy is once again proving more resilient than expected despite the flare-up of the spread of infection. Another upside risk, at least in the next few years, is that climate-related investments will begin to grow both faster and larger than we expect. However, several uncertainties, globally and domestically, could throw a spanner into the works. The main risk is related to the coronavirus, with Delta or new variants that may occur. This may affect Sweden in several ways. There is a risk that certain restrictions in Sweden will remain in place or even be reintroduced, thereby putting a brake on the normalisation of household consumption; this would particularly affect already hard-pressed sectors in the close-contact industries. Recently, the government proposed extending the COVID-19 Act and the Serving Act by four months until January 31, 2022. Both the length of this extension and whether the planned September easing can be implemented remain open questions.

Another source of uncertainty is the extensive global disruptions that are affecting deliveries of goods to the Swedish business community, generating negative effects on production and exports as a result. If these disruptions persist or worsen, it will be difficult for companies to produce and meet the existing large order backlog. There is already a shortage of certain components, including semiconductors, which has caused production stoppages at individual companies; in recent months, export growth has slowed. But, so far, industrial production has increased in Sweden, unlike, e.g., Denmark and Germany, where production has levelled out. Order intake to Swedish industry also continued to rise in June. However, the situation is strained, and both delivery times and input prices have reached record levels in the Swedbank/Silf PMI.

Record-long delivery times in Sweden

PMI, index, sa

Sources: Swedbank Research & Macrobond

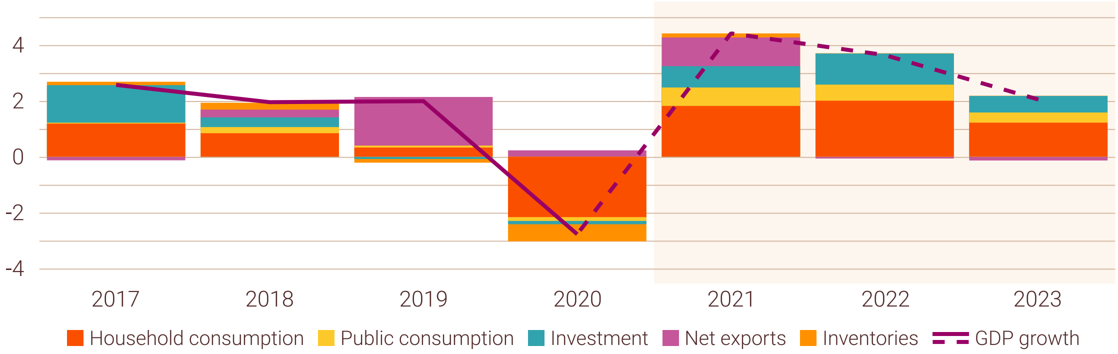
The Land and Environmental Court's decision to stop Cementa's permit for cement production at the Slite plant on Gotland may also be a factor to consider, although the government has proposed a short-term respite until June 30, 2022. This plant accounts for 75% of Sweden's total cement supply. Discontinued production would have major consequences for the Swedish economy in the short- and medium-term regarding construction and jobs, as the government's hastily produced consultant report shows. It is also likely that cement will become more expensive.

Households are in a favourable situation, and their consumption is expected to account for a large part of the growth in the coming years. Economic policy has provided support, including short-term layoffs, better unemployment benefits, and low interest rates. The labour market is improving, which means that more people will find jobs and wage increases will gear up slightly. Households' financial position has also benefitted from their assets' rise in value as both house prices and the stock market have risen sharply. The NIER's consumer confidence indicator shows that households have become increasingly optimistic about the future. During the pandemic, household savings have increased as households have not consumed as normal; we expect that some of these higher savings will go towards increased consumption because there is a pent-up demand, not least for some services.

Overall, we expect GDP to grow by 4.3% this year and 3.6% next year, before reaching a more normal growth rate, around 2% in 2023.

Fast and broad-based recovery in the Swedish economy

GDP growth, %; contribution to GDP growth, pp



Sources: Swedbank Research & Macrobond

Clear brightening in the labour market but structural challenges have worsened

The labour market has weathered the pandemic significantly better than feared, which can be attributed to the successful short-term layoff scheme; another contributing factor was Sweden's avoidance of a total shutdown of the economy. In 2021, we have seen a marked improvement in the labour market, a development that we believe will continue over the next few years. The official statistic, the Labour Force Survey (LFS), is currently difficult to interpret due to a major change in methodology made at the turn of the year. In short, this has meant a narrower definition of who counts as employed. According to the LFS, unemployment has remained high during the year (just over 9%). However, another statistic, the register-based one from the Swedish Public Employment Service, shows a clear decline in unemployment from just above 9% in the summer of 2020 to just below 8% this summer. It is worth noting that the number of hours worked is increasing sharply according to LFS. Other more forward-looking indicators, such as the NIER indicator for employment plans, newly registered vacancies, and the PMI employment index, also testify to a brighter labour market and employers' willingness to hire staff. A notable takeaway from the latest Economic Tendency Indicator is that more and more employers are finding it more difficult to find staff with the right skills.

However, not everyone has been able to benefit from the recovery in the labour market. The divisive nature of labour markets has accelerated during the pandemic. The number of registered unemployed persons out of work for 12 months or more was close to 190,000 in July, an increase of around 25,000 from a year ago. A large proportion of registered unemployed people without work for a long time were born in a country outside Europe. Unemployment for foreign-born people remains at an elevated level (about 20% compared with about 6% for native-born people).

Higher thresholds as house prices rise to new heights

Since last summer, there has been heavy pressure on the Swedish housing market. However, this is not unique to Sweden – there have been sharp increases in housing prices in many other countries as well. Since last July, prices in Sweden have risen by 14%. As many people have spent more time at home and many want larger living spaces, the prices of houses and larger apartments have risen. Mortgage rates are at record lows, while the supply of houses on the secondary market is lower than normal. The high demand for houses and larger apartments can also be seen in such indicators as the unusually short times on the market and much higher premiums than usual for such properties. Not only the desire for larger living spaces, but also increased use of "staycations" and home offices has pushed up prices of holiday homes during the pandemic.

We expect house prices to rise by an average of around 15% in 2021; this means a slowdown in the growth rate during the fall. We expect prices to continue to rise next year as well. The desire for larger living spaces is expected to persist, and, as it takes time to increase supply with new construction, it is likely that the imbalance between supply and demand for houses and larger apartments will continue. In addition, mortgage rates are expected to remain low, although we expect them to have bottomed out for now. Greater competition between mortgage lenders may also help to somewhat dampen the rise in mortgage rates. Given the political landscape, it is also unlikely that, in the coming years, the parties will agree across the block on measures that would moderate price increases, such as reduced interest deductions or reintroduction of a property tax. All in all, these factors will contribute to continued rising house prices; we expect prices to rise by 5-10% next year and then rise at a slightly lower rate in 2023.

For those who already own their homes, wealth increases as house prices rise, but for those still not on the property ladder, the trend is worrying. The rising prices mean that the thresholds for entering the housing market are raised even more. The Swedbank housing affordability index, e.g., shows that more and more households, regardless of where they live, are finding it more difficult to buy a home. Continued high price increases mean that household indebtedness will also keep rising. This will continue to concern politicians, as well as the Swedish Financial Supervisory Authority (SFSA) and the Riksbank. Now that a comprehensive housing and tax policy package is unlikely to become a reality soon, there is instead a risk that the government will give the SFSA a mandate to introduce another macroprudential tool. But it would be better to take a comprehensive approach with a large package of policy solutions to improve the functioning of the housing market than to put another band-aid on the housing market.

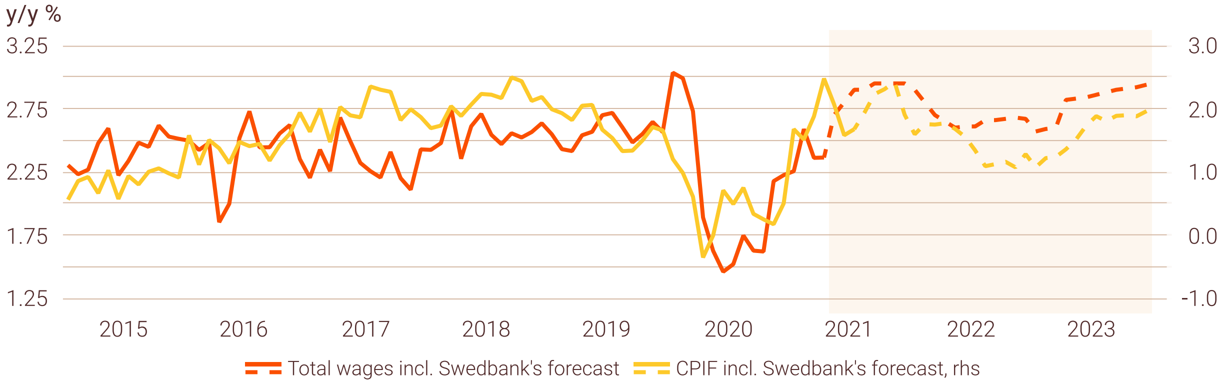
Although unemployment will fall in the coming years, we expect long-term unemployment and unemployment for foreign-born people to remain high. It is, therefore, important that a large part of the public budget is directed towards labour market and education policies, in order to raise the level of knowledge and competence of the unemployed and in order to meet the needs of the labour market. Overall, we expect unemployment to gradually fall in the coming years, to 7% by 2023. Wage growth has returned to about the same level as before the pandemic, 2.5%. Although a slightly increasing wage drift is in the cards over the next few years, in our view of the labour market, it will not be until the next round of negotiations, in March 2023, when more generous central wage agreements can be expected. For the full year 2023, we estimate that wage growth will amount to 2.8%.

Riksbank in a more comfortable position and inflation close to the target

Inflation has surprised somewhat on the upside during the spring and summer, and the CPIF (consumer price index with fixed interest rates) measured an increased rate of 1.7% in July, mainly due to higher energy prices. Underlying inflation, excluding energy, was recorded at a low of 0.5%. Inflation is still affected by the coronavirus, along with different consumption and seasonal patterns, among other things, and should therefore be interpreted carefully. The return to a more normal pattern is still dragging on, and we believe it will not happen until late 2022 and 2023. Commodity prices and freight costs remain high, and, although they have affected producer prices, the impact on consumer prices has so far been limited. Not only decent sales volumes, but also the remaining effects of last year's krona appreciation, are probably outweighing the negative impact so far and have helped to strengthen the companies' profitability. We expect a slow and gradual impact on inflation from higher commodity and freight prices this autumn and early next year. The NIER survey shows that fewer commercial companies believe that demand has held back prices; however, we have not yet reached the point where they see strong demand driving up prices. There is also likely to be some scope for prices in the services sector (e.g., for restaurants and hotels) to continue to rise as the recovery in the economy persists in 2022. During the forecast period, cost pressures will slowly increase in line with rising resource utilisation; at the same time, though, we expect some krona strengthening in the years ahead. Overall, inflation is expected to move slowly upwards, approaching 2% only towards the end of 2023.

Economic development during the spring and summer has gone the Riksbank's way. Growth is strong, and optimism is historically high among both businesses and households. The labour market has clearly brightened, and, according to the Riksbank's resource utilisation (RU) indicator, resource utilisation was above normal in the second quarter. The Riksbank can also be satisfied that inflation expectations are stable and close to the inflation target of 2%. But there is still a lot of uncertainty and risk remaining around future developments. We therefore believe that the Riksbank will be very cautious about withdrawing its expansionary monetary policy and, as far as possible, stick to the monetary policy forecasts it has provided. The net asset purchases will continue this year, as decided, and we expect the holdings to be maintained through 2022. It is not until 2023 that we anticipate a slow de-escalation of holdings will begin. We estimate that the repo rate will remain at 0% throughout the forecast period. The Riksbank's current repo rate forecast, which extends until the third quarter of 2024, will remain unchanged at 0%. If economic and inflation developments during the autumn continue to develop favourably for the Riksbank, we expect it to signal later in the autumn a first increase in the repo rate at the end of 2024.

Rising wage rate and inflation towards the end of the forecast period



Sources: Swedbank Research & Macrobond

The Nordics are back on track

The Nordic economies have weathered the pandemic relatively well, as the immediate downturn was less severe and the upturn stronger than in many other European countries. Despite a strong recovery in labour markets and firms' increased concerns about labour shortages, wage growth and inflation are expected to stay low. Housing prices have risen rapidly but will moderate ahead.

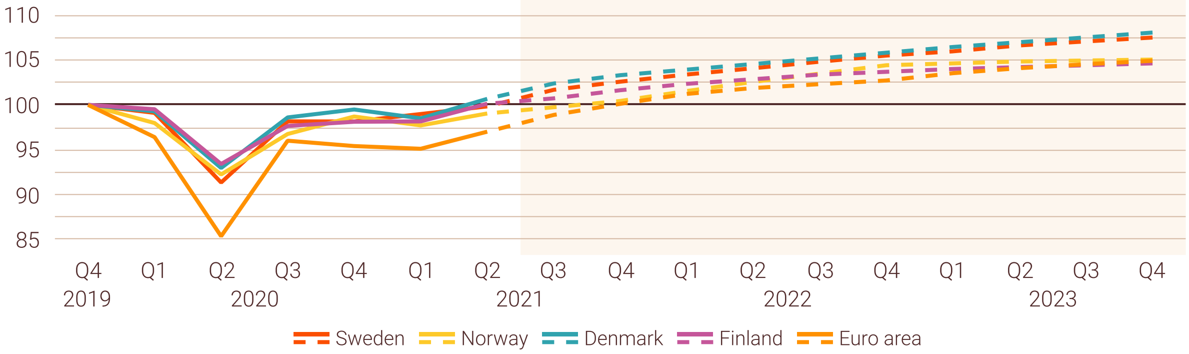
Despite rapidly improving labour markets, inflation will stay low

The Nordic economies have grown rapidly and broadly over the past year. Growth in retail sales and manufacturing production has been robust since last summer. The services sectors awakened during the spring as a smaller spread of the virus allowed restrictions to be eased. Certainly, parts of the services sector, such as travel, are not out of the woods yet, but the economies have in many ways recovered almost fully. In all countries, overall production (GDP) hit pre-crisis levels earlier this year, and the current growth momentum is high.

The labour markets have also recovered faster than expected in all countries. Unemployment has trended downwards this year, and short-term employment indicators point to a further improvement ahead. Employment levels are either already back at pre-crisis levels or will be later this year. Firms are increasingly reporting problems with shortages of labour.

GDP back at pre-crisis level in the Nordics

Index (2019q4=100), sa, ca

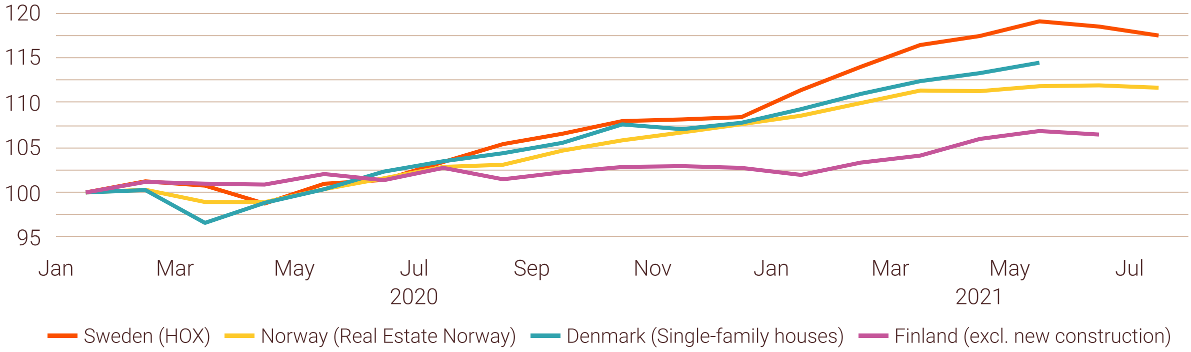


Sources: Swedbank Research & Macrobond

As in many other parts of the world, housing markets are hot. Activity has been high, and home prices have risen markedly since January 2020. Prices have risen most in Sweden, where prices of single-family dwellings (houses) are about 25% higher than before the crisis. Developments have been more muted in Denmark and Norway, with price increases of 12-15%, and even more muted in Finland, where prices are about 6% higher than the pre-pandemic level. Looking ahead, we expect stable or moderately rising house prices over the forecast horizon. In Norway, however, prices might decline somewhat.

Even though the economies are heating up in many ways, we expect overall consumer price inflation to stay low. Both in Sweden and Norway, inflation is likely to undershoot the central banks' 2%-targets during the whole forecast horizon. Historically, inflation has only weakly correlated with the business cycle – and typically with rather long lags.

Hot housing markets in the Nordics
Residential price index (2020-01=100)



Sources: Swedbank Research & Macrobond

Norway – en route towards higher interest rates

The economic recovery is well under way. Norges Bank is expected to start raising its policy rate already in September, despite inflation undershooting the target. The hot housing market is expected to cool going forward.

Once the economy started to reopen in May, the Norwegian economy entered a path of solid recovery, and GDP had already surpassed the pre-pandemic level by June. Unemployment has fallen sharply, and employment is almost back at the same level as before the pandemic. New vacancies are at a record-high level. However, we believe this will mostly be temporary, as many of the vacancies can be traced back to pandemic-specific effects – especially the strict border entry regulations, which have created a shortage of foreign workers in sectors such as construction, farming and tourism.

Infection rates have been low throughout the summer, but the number of cases started increasing again in August. However, with one of the highest vaccination rates in the world, the probability of a new national lockdown seems low.

Household demand has been very solid after the reopening. Consumption of goods has kept up while consumption of services has rebounded. The outlook for corporate investments towards the end of this year and into the next is positive. Corporate deposits have grown considerably during the pandemic, corporate credit growth is now on the rise, and firms' self-reported investment plans are at solid levels.

After more than a year of booming house prices, the housing market now seems to be cooling down. Expectations of a rate hike in September are contributing to this. There are also signs that a housing inventory is starting to build up as the supply of homes is no longer being fully absorbed by the market. In addition, residential construction activity has been increasing for more than a year.

Neither low inflation nor a weaker-than-expected development in housing prices will deter Norges Bank from hiking the rate in September. The positive developments on the labour market, and the strong recovery after reopening, together with a high vaccination rate, will weigh more heavily in the central bank's decision. Therefore, we expect the policy rate to rise from the current 0.00% to 1.25% by the first quarter of 2023.

Denmark – a services-led recovery on track

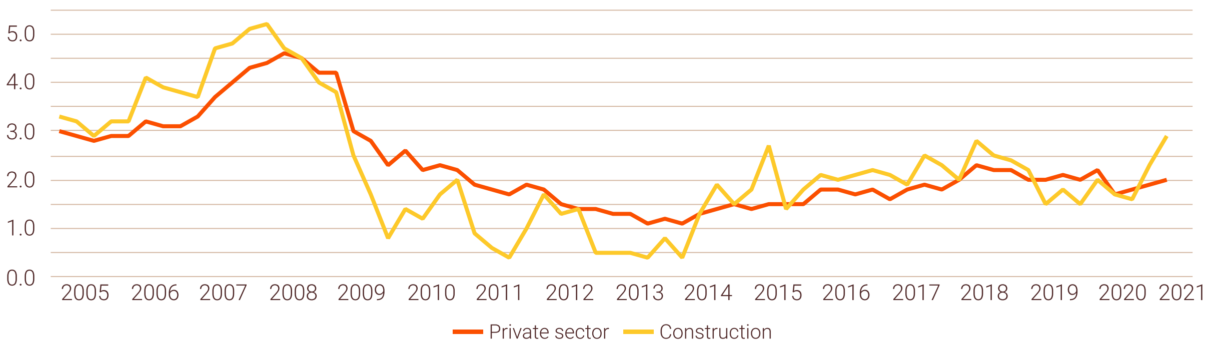
The economy and the labour market are back at pre-pandemic levels, and the recovery will continue. Labour shortages, high growth in housing prices, and increased wage pressure could be signs of overheating in parts of the economy.

The Danish economy has seen a rapid recovery since its reopening in the spring. Card transaction data shows that services lifted spending in July to 10% above the corresponding month in 2019, while retail trade has again been elevated since March this year. However, the travel sector will have to wait a bit longer; new data shows that the number of foreign overnight stays in Copenhagen in June was 86% below the level in 2019. The manufacturing sector and exports have been supported by a global upswing, but growth has been dampened in recent months, possibly due to a shortage of materials and long delivery times. GDP grew by over 2% in the second quarter, reaching the pre-pandemic level, and we expect the recovery to continue in the second half of the year. Consumption will contribute to fast growth during the forecast horizon, as savings are high and consumers have pent-up demand. We expect GDP to grow by 3.8% in 2021 and 3.5% in 2022.

The recovery in the labour market has been faster than anticipated. In May, the total number of employees was back at pre-pandemic levels and the improvement continued in June. In the public sector the number of employed is temporarily high due to testing, vaccination, etc. This exacerbated the problem of labour shortage in the private sector during the reopening (read more in our in-depth on page 37). In the construction sector, where activity has been high during the pandemic, labour shortages are becoming a real issue; average earnings data from the beginning of the year indicates that wage pressure might be starting to increase in the sector. Overall, however, wage pressure remains moderate, and higher commodity prices and freight rates have not yet passed through to core inflation, which rose by a modest 0.9% year-on-year in July compared with last year. Going forward, we expect the underlying price pressure to remain moderate, but an even more unbalanced labour market could change that picture.

Wage pressure is starting to increase in the construction sector

Average earnings, % y/y



Sources: Swedbank Research & Macrobond

The housing market has been characterised by high transaction activity and rapidly increasing prices during the pandemic. Prices rose by 15% for single-family houses and 14% for owner-occupied flats in the second quarter of 2021 on an annual basis, and even more in the Copenhagen area. The housing burden remains low, however, as mortgage lending to households has so far increased in line with household incomes rather than the increases in house prices. But increasing prices, together with loose financial conditions and a rapid economic recovery, provide ground for a possible risk build-up and measures such as amortisation requirements are being discussed.

The Danish krone has been trading on the strong side against the euro throughout most of 2021, and Danmarks Nationalbank has purchased foreign currencies to maintain the fixed-exchange-rate policy. A cut of the benchmark rates in the coming months cannot be ruled out to ease the pressure on the krone.

Finland – recovery driven by household consumption

This summer, the economy has been as hot as the weather. Consumers have high confidence in their finances, exports have bounced back, and the number of employed has grown. However, the spread of the Delta variant brings small clouds on the horizon for the autumn.

Finnish consumers and industries have high confidence in the economy. In July, consumers' view on their own economic and financial situation reached record highs, while confidence figures for all business sectors were above their long-term averages. Confidence has risen especially in the services sector; meanwhile, order books look strong in the manufacturing sector.

The pandemic slowed the recovery of the Finnish economy in the first quarter of 2021. However, according to the flash estimate, GDP grew by 2% in the second quarter, reaching the pre-pandemic level. While the spread of the Delta variant brings clouds for the fall outlook, we expect the recovery to continue also in the second half of the year. This year, the economic recovery will be driven by private consumption growth, benefitting from the release of pent-up demand and the increase in household savings. The recovery of exports will also support economic growth, but the growth trend in exports has reversed somewhat during the past months. We forecast that the Finnish economy will grow by 3.1% 2021 and by 2.9% in 2022.

The labour market outlook is relatively bright. The strong economic growth creates favourable conditions for employment growth, and job openings are on the rise. The number of open job vacancies increased to 51,100 in the second quarter of 2021 from 35,400 a year earlier, returning to the level that preceded the corona pandemic two years ago. At the same time, many companies report that they are struggling to find suitable labour. Thus, problems matching vacancies and job seekers may slow the recovery of the labour market.

In the coming years, it will also be difficult to improve employment due to the shrinking working-age population. All in all, structural factors, including ageing and weak productivity growth, will continue to weigh on the Finnish economy after the pandemic recovery. In 2023, GDP growth will slow to 1.2%.

The public debt-to-GDP ratio will continue to increase in 2021, reaching 70.5%. The general government deficit remains large, but it will decline in 2022 from previous years due to a reduction in expenditure related to the coronavirus situation and an increase in tax revenue. At the same time, the reform of Finland's health and social services, which transfers the organisation of services from municipalities to counties, will raise government expenditures.

Baltics pack a punch

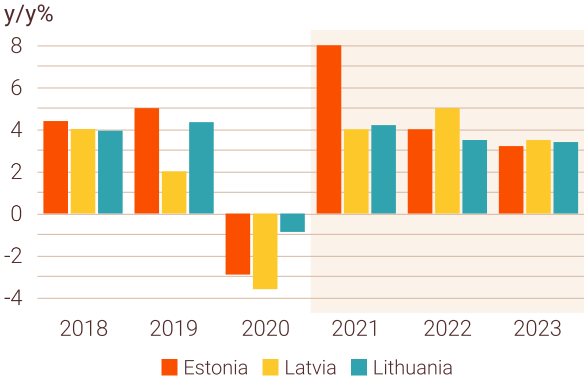
All three Baltic countries have swiftly recovered after last year's recession. Although some sectors are still hurt, GDP has already exceeded the pre-crisis levels and growth going forward is expected to be above the pre-pandemic trends. Although some risks related to the pandemic remain, the biggest medium-term challenge is to invest wisely, avoid overheating, and further transform the Baltic economies.

After a relatively mild and short-lived recession last year, the Baltic economies have rebounded quicker and more forcefully than we expected. The recovery is largely broad-based – economic sentiment has returned to pre-pandemic levels, consumption is growing rapidly, and exports are booming, while business and public investments are rebounding and are likely to be boosted further by EU funds and a favourable credit environment. During the pandemic, there were some success stories in attracting new investments – e.g., Volkswagen moving intellectual property to Estonia and planning to develop software there, and Thermo Fisher Scientific rapidly building a modern factory in Vilnius and producing reagents for COVID-19 mRNA vaccines. Further growth in investments – both greenfield and in automation and digitalisation – will be crucial for maintaining external competitiveness and global export market shares.

Although unemployment remains above the pre pandemic levels, employment is increasing rapidly, and companies across most sectors report rising labour shortages. Increasing vacancies amid still-high unemployment indicate that there may be some lasting post-pandemic effects – there are plenty of opportunities for the skilled in bigger cities, but those who have lost their jobs and have less relevant skills may find it hard to get employed quickly. Labour shortages are already fuelling wage growth, which is especially pronounced in Latvia and Lithuania.

Real GDP growth

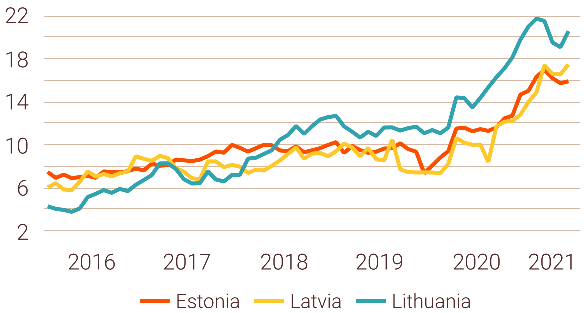
y/y%



Sources: Swedbank Research & Macrobond

Stable income growth and limited possibilities to spend led to surge in household savings

Household deposits, y/y %



Sources: Swedbank Research & Macrobond

External factors and rising wages are reflected in increasing inflation, which has already exceeded 4% or is getting there in all three Baltic countries. Inflation is likely to recede somewhat in the coming years but will stay above the pre-crisis levels. Nevertheless, real household income is expected to continue growing rapidly. Exports have been the main driver of GDP growth during the pandemic, but household consumption is likely to take over as a main factor of growth going forward.

Households have accumulated substantial excess savings, equal to some two months of consumption, but are unlikely to finance their consumption by running them down. One reason is that real income growth will be sufficient to fund rapidly rising consumption; another is that most accumulated excess deposits are in the accounts of wealthier households who have higher saving rates and different priorities and spending patterns. A short-term spike in consumption and higher investments in housing are expected, especially in Estonia, where households were allowed to withdraw their savings from pension funds.

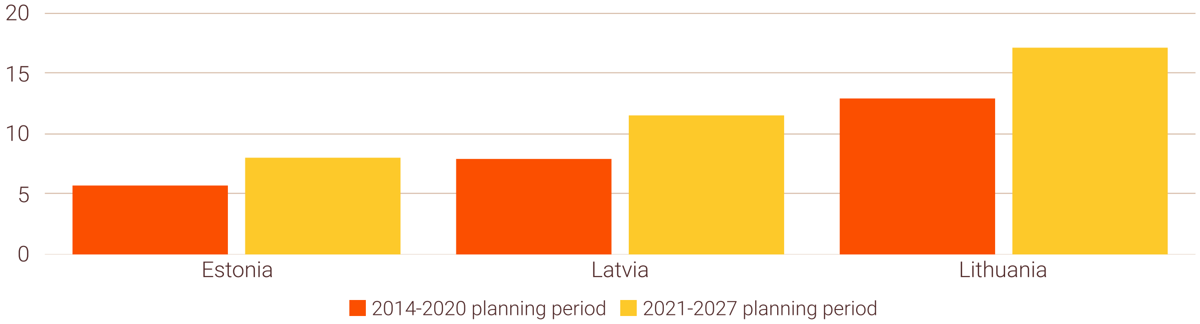
One consequence of fast wage growth and slower export growth will be shrinking current account surpluses or even widening current account deficits. The situation, however, is unlikely to become unsustainable, as in the pre-2008 crisis period, since this time around credit growth is expected to remain moderate and should not overheat the economy. Housing markets have been booming, especially in Lithuania and Estonia – both in terms of number of transactions and prices – but, at least for now, affordability has remained stable. The Bank of Lithuania and Bank of Estonia, however, think that the price increases may be becoming unsustainable and are considering various measures that could cool down the housing market.

The medium-term risks are symmetric – both positive and negative surprises are similarly likely. Negative risks are related to COVID-19, virus mutations, supply-chain disruptions, and, possibly, weaker demand. Although vaccinations have been progressing in Estonia and Lithuania, the share of those unwilling to get vaccinated remains uncomfortably large, especially in Latvia. At the same time, the continued unprecedented fiscal and monetary stimulus, substantial EU funds, and confident households and businesses are expected to push GDP growth above its potential. Although in the short term this boon may not spell trouble, eventually this may cause an even faster rise of unit labour costs, lead to excessive inflation, and erode business competitiveness.

The large inflow of EU funds need not lead to wasteful spending, overheating economies, and the crowding out of private investments. The Baltic countries have prepared viable plans to make their economies more innovative, greener, and more digital.[1] If this spending is indeed accompanied by structural reforms, we could see not just temporarily hotter economies, but more sustainable, productive, and competitive Baltic economies going forward.

Pre-allocated and expected EU funding*

EUR bn



* Numbers are preliminary and include EU budget pre-allocations, NextGenEU grants and expected funds for Rail Baltica.
Sources: National Ministries of Finance, European Commission, and Swedbank Research

[1] More details on how Baltic countries plan to invest EU funds can be found in our recent macro focus: https://www.swedbank-research.com/english/macro_focus/2021/21-06-22/index.csp

Estonia – unexpectedly swift growth at the start of the year

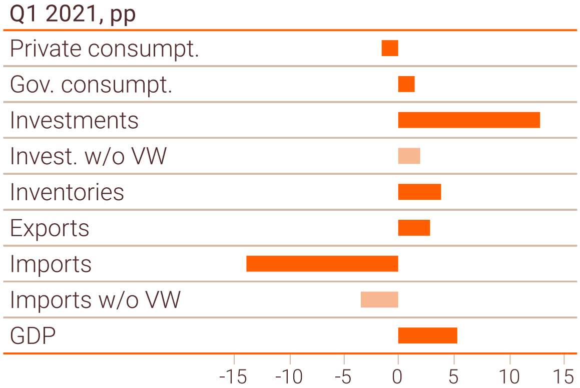
The Estonian economy has made a vigorous recovery from the 2020 recession. In the first quarter of this year, GDP expanded 5.4% year on year (yoy) (4.8% quarter on quarter) and already exceeded the pre-pandemic level. The growth was far above our expectations as three-fourths of the growth came from inventories. Besides inventories, investments' contribution to the growth was strong as well, while private consumption and net exports contracted. We expect the strong economic growth momentum to continue.

Total investments increased 55% yoy in the first quarter, but more than 80% of this came from Volkswagen's software investments in its new Estonian subsidiary. Volkswagen has been making these large investments since the third quarter of last year. However, their impact on GDP growth is small, as these investments are also recorded in imports of services, but they are likely to boost growth in the longer term. Volkswagen is likely to continue to invest in its Estonian subsidiary and contribute considerably to overall investments throughout 2021-2023. In general, most businesses will be more pressed to improve their competitiveness and increase their output volumes, as labour costs have risen, and the labour force is becoming even more scarce. Households will use some of their accumulated savings for investing more in real estate, while the government sector will continue with its large infrastructure projects, especially when it starts to use the EU funds to a greater extent.

Estonian economic sentiment has risen to its highest level of the last 14 years. The same has happened with industrial enterprises' estimation of their export orders. Industrial enterprises' production and expectations for services sector demand have surpassed the pre-pandemic levels. Indeed, the growth of exports of goods in value terms is very robust, but this is partly explained by the base effect from last year and the accelerated growth of export prices. Manufacturing output has almost reached the record levels of the beginning of 2019. The growth of retail trade has been rather strong since last June and has picked up even more in the second quarter of this year. The gap between inward and outward travel compared with the pre-pandemic level is still very wide, while domestic travel is booming.

Contribution to the GDP growth

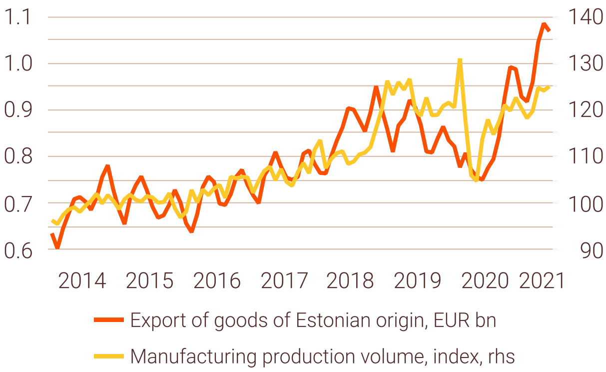
Q1 2021, pp



Sources: Swedbank Research & Macrobond

Export of goods and manufacturing

EUR bn, 3mma; index (rhs)



Sources: Swedbank Research & Macrobond

Although the growth of households' deposit stock peaked already in March, the pace is still robust. The deposit stock is EUR 2 billion higher than at the beginning of 2020, which is equal to 14% of annual private consumption. However, household deposits are distributed very unevenly – households with large deposits have increased their deposits more than less wealthy households. This will have important implications for the usage of the precautionary savings, and we do not expect that most of these will be directed to consumption; some will be invested in real estate, as well. In addition to the increased savings, the pension fund reform will add about EUR 1 billion to households' accounts in

September of this year; this is equal to 7% of annual private consumption. This is expected to boost private consumption and households' investments and to increase the momentum of economic growth this autumn and the effect will be felt in 2022 as well.

We forecast that the Estonian economy will expand by 8% this year, 4% next year, and close to 3% in 2023. We have revised the 2021 forecast substantially higher as growth in the first quarter was considerably stronger than we expected in our previous forecast. In 2021, GDP growth is expected to be broad-based, as the rapid growth of exports, investments, and private consumption is expected to support it. We envisage that the money withdrawn from the pension funds will continue to accelerate the growth of private consumption next year.

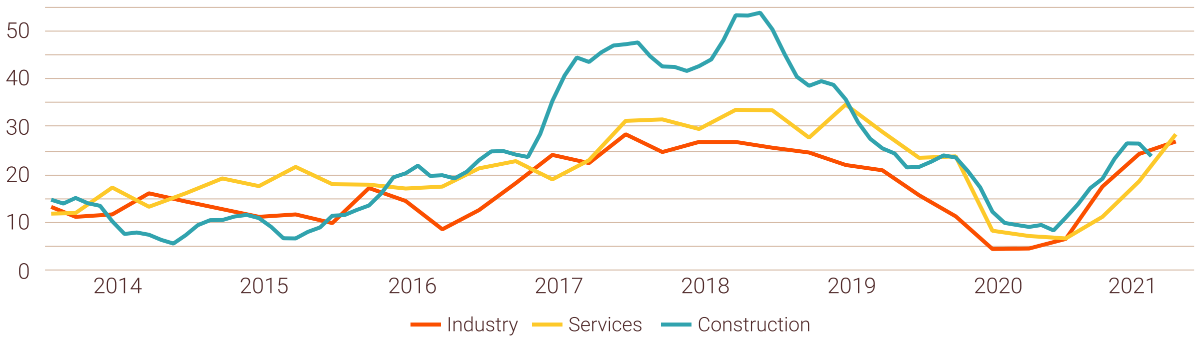
Robust economic growth and the improved outlook have increased the demand for labour. The unemployment rate is declining but during the forecast period it is expected to remain slightly above the 2019 lows. This slow decline is due to structural issues, such as the mismatch between the qualifications and location of the people looking for jobs and the needs of the labour market.

Consumer price inflation surged to 5% in July, but the growth was largely driven by energy components. According to the Swedbank Industrial Survey 2021, 71% of enterprises reported increased input prices and 58% reported problems in supplies. Enterprises are forwarding their rising costs to clients, putting upward pressure on consumer prices. We forecast that consumer prices will increase 3.1% this year, 2.6% in 2022, and around 2% in 2023.

The labour shortage has increased, and this will gradually put more pressure on wages. This August, for 30% of enterprises, the labour shortage became the largest factor limiting business. In addition to the labour market issues, increased inflation expectations could increase the demand for higher wages, as well. The share of nonfinancial enterprises' wages in turnover has increased to a record level and has dented profitability. Therefore, the need for higher efficiency has become very acute. The Swedbank Industrial Survey showed that 87% of enterprises responding consider the improvement of efficiency as the main reason for investments. We expect that nominal wages will increase faster than inflation, and the improvement of people's purchasing power will continue – however at a considerably slower pace than in 2015-2019 on average.

Shortage of labour as the main business constraint

% of respondents, 3mma



Sources: Swedbank Research & Macrobond

Latvia – bright medium-term prospects, but risks for this autumn are high

After a negative start to the year, the Latvian economy accelerated unexpectedly fast in the second quarter, reaching pre-crisis levels. This recovery comes with rising labour shortage and surging price pressures. Wage growth is unexpectedly strong, and inflation is picking up and will keep increasing until the end of the year.

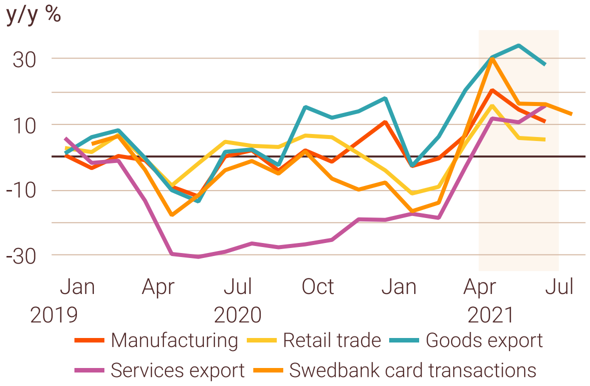
The year started with prolonged restrictions and a consequent expected fall in GDP. Improving weather and increasing vaccination rates in the second quarter allowed for a gradual lifting of restrictions. This resulted in a sharp economic rebound, with GDP growing by 10.3% yoy and 3.7% over the previous quarter. The flash estimate suggests that the Latvian economy has now reached its pre-crisis level – sooner than was expected.

The steepest yoy growth in the second quarter was likely observed in consumption, reflecting increased activity in the services sectors most hurt by COVID-19. However, for most of these sectors there is still a long way to go to reach pre-crisis levels. Manufacturing, on the other hand, continued its strong performance in the second quarter and reached record highs. Goods exports are also setting new all-time-highs, and, even though prices are on the rise, most of the growth is due to rising volumes. Services exports are recovering, but levels are still well below pre-pandemic ones. In such sectors as transit via railway and ports and financial services, which had been suffering long before COVID-19, we do not expect any material improvement. But air transport, travel, IT, and other business services, as well as construction, are all expected to see strong growth in the next couple of years. Investment fell at the start of the year due to a harsh winter, which limited construction activity. But the construction sector and investment more broadly are expected to have picked up notably in the second quarter. EU funds inflows, along with increased appetite for private sector investment, will ensure that investment is likely to outperform going forward.

Recent short-term indicators have been pointing to decent growth ahead. Swedbank card transaction data shows continued growth in consumption. Economic confidence indicators since April signal sentiment above the long-term average, but the previously observed increase came to a halt in July. The reason for the decreasing optimism was consumer sentiment, which saw a sharp drop – likely linked to changes in tax policy. A minimum social security payment entered into force in July, aimed at reducing the previously possible legal tax optimisation and increasing the sufficiency of social protection.

Selected indicators

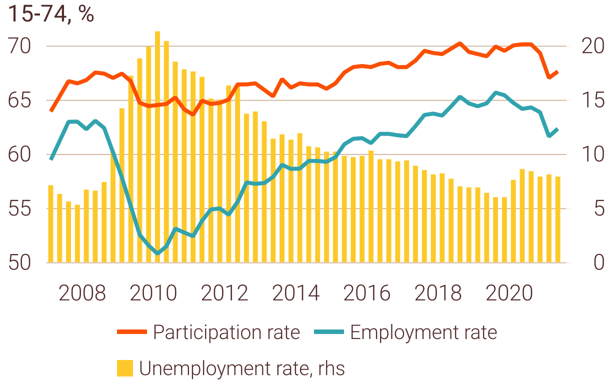
y/y %



Sources: Swedbank Research & Macrobond

Labour market indicators

15-74, %



Sources: Swedbank Research & Macrobond

We forecast economic growth this year to reach 4%, driven by a sooner-than-expected recovery in consumption. However, risks for a third COVID-19 wave this autumn are elevated due to very strong vaccine hesitancy. At the time of writing, only around 44% of the population had received at least one dose of the vaccine, and vaccinations were proceeding at a snail's pace. A resurgence of COVID-19 is especially worrying, given the insufficient vaccination rate among the elderly. The government is proposing changes in legislation to demand mandatory vaccination in certain sectors. However, this has yet to be voted on by the parliament, and the fierce opposition to this proposal and threats to take it to a national referendum suggest that it is far from a done deal. Overall, following the steep rebound in the second quarter, coming quarters should see more muted growth rates as base effects fade and, especially, as some restrictions may need to be reintroduced in winter. Growth in the coming years is expected to be above potential, supported by tailwinds ranging from global recovery and incoming EU funds to increased housing investment and an expected pickup in corporate investment as a response to labour shortages and increasingly strained capacity utilisation.

Although the labour market has been a positive surprise, so far it has been recovering slower than in the rest of Baltics. The increase in the unemployment rate in response to the autumn-winter virus wave was considerably milder than expected. However, the participation rate in the second quarter was still close to its lowest in six years. The survey identified people as falling out of the labour market either because they were on furlough for more than three months or because they were staying at home and taking care of their families. We expect most of these people to re-enter the labour market in the third quarter, as children return to schools and previously limited care services resume.

Labour market conditions have been improving during the summer, mostly helped by seasonality but also due to the gradual economic reopening. The registered unemployment rate has shrunk by about 0.6 percentage points since June. Even though the furlough benefits, along with wage subsidies, expired at the end of June, we have not observed and do not expect a sudden unfavourable impact on the unemployment trend. According to business survey data published by the European Commission, overall employment expectations have rebounded from winter lows and signal positive job growth. Overall, we expect a gradual reduction in the unemployment rate this year, down to 7.6% on average. Labour market conditions will see a more marked improvement in the following two years as the virus retreats and economic recovery gains pace, with unemployment falling to 6% in 2023.

Average wage growth, at 9.6% in the first quarter, did not bow to the raging virus early this year, as higher-paid jobs were more immune to the pandemic disruptions than lower-paid ones. The average wage was also pushed up by the minimum wage hike, as well as by wage increases in the public sector. Wage growth is expected to remain rapid throughout the year, averaging 9%, increasingly supported by the economic recovery and rising labour shortage; meanwhile, the gradual return of harder-hit lower-paid jobs to the market will somewhat limit the upside. As the minimum wage hike effect fades, wage growth will moderate to around 8% in the following two years.

With massive pressures from global prices, deflation at the start of the year quickly turned into inflation. A pickup in inflation was expected, but its strength has surprised us. The main drivers of inflation this year are transportation, housing, and food prices. Supply bottlenecks and prolonged delivery times, as well as inventory hoarding by distributors and manufacturers, are all contributing to rising price pressures on the producer side. Wage increases are adding to that, and these will likely have the most notable impact on prices of services. Price growth is expected to surpass 4%, peaking at the end of this year. Inflation will average 2.3% in 2021, and in the following years we are likely to see inflation rates around 3%.

Lithuania – broad-based and inclusive post-pandemic growth

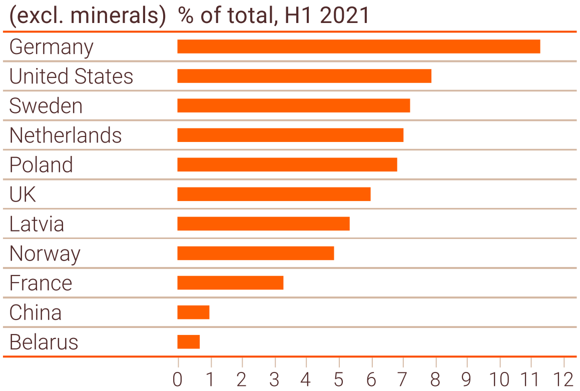
The Lithuanian GDP continues to experience steady and inclusive growth, leaving most of the pandemic woes behind. Not only GDP, but also employment, have already exceeded the pre-pandemic level. Labour shortages are at record highs, and wage growth accelerated further, exceeding 10% and stoking inflation. There are some challenges related to the country's neighbours to the East, but growth is likely to remain above trend.

During the first half of this year, the Lithuanian GDP was 4.2% higher than a year ago, and we expect similar steady growth to continue throughout this year. GDP growth is expected to slow to 3.5%, as the base effects from the pandemic fade and the loss of potash transit from Belarus negatively affects exports of services. OFAC has announced sanctions on potash producer Belaruskali, which exports much of its goods via Lithuanian Railways and ports. Around 20% of all freight transported by Lithuanian Railways is potash from Belaruskali. Furthermore, almost one-third of all freight at Lithuanian ports are products from Belarus, most of which are potash. The negative impact of these losses on exports of services could amount to 0.3-0.5% of GDP; however, there could be some small positive side-effects, such as a decline in smuggling of cigarettes from Belarus, higher local production, and bigger tax receipts. Due to this and the higher base this year, we have lowered the 2022 GDP growth forecast to 3.5%. Nevertheless, we still see growth remaining above the long-term trend also in 2023, as it will be supported by incoming EU funds, continued fiscal and monetary stimulus, still-competitive exporters, and strong household consumption.

Lithuania has quit China's "17+1" platform for dealing with Central and Eastern European Countries and has opened a diplomatic office in Taiwan. This has upset Chinese officials to the point where they have recalled their Lithuanian ambassador and demanded that Lithuania recall its top envoy from China. Thus, stronger economic cooperation with China does not seem likely, but current investment and trade ties are relatively weak, and any potential rupture of these is unlikely to have tangible economic effects. Economic ties with Taiwan, on the other hand, are likely to strengthen – there are some rumours of upcoming sizeable investments in semiconductor production in Lithuania.

Lithuania, exports of goods of national origin

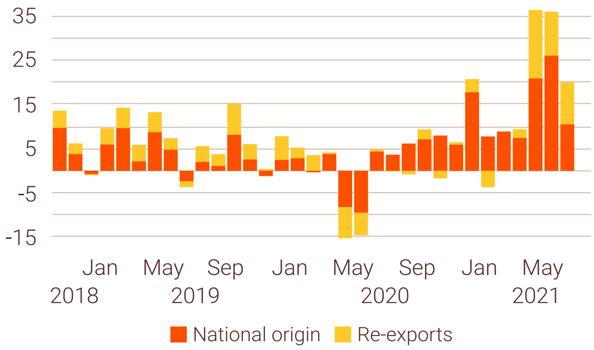
(excl. minerals) % of total, H1 2021



Sources: Swedbank Research & Macrobond

Contribution to nominal export growth

y/y %, excluding mineral products



Sources: Swedbank Research & Macrobond

So far, explosive growth is visible on all fronts. During the first six months of this year, retail trade was 14.2% higher than during the same period a year ago. Catering services during this period were still 12.4% below last year's level, but a strong rebound was already visible in June, after the COVID-19-related restrictions were lifted; further growth is expected during the second half of this year. Manufacturing also increased by a whopping 17.7% during this period, with production of vehicles, chemical products (new factory-producing reagents for COVID-19 vaccines), furniture, and other wood products growing at the fastest pace.

Going forward, growth is likely to shift from export-driven to domestic demand driven. Investments, which as a share of GDP have been below the euro area average throughout the last decade, are set to recover with the help of favourable credit conditions, EU support, and business confidence. In the coming years, household consumption is likely to contribute the most to GDP growth. Employment is already almost 2% higher than before the start of the pandemic, and the record labour shortages indicate that the unemployed and immigrants will continue to be absorbed into the labour market. We project that net immigration will remain positive during the forecast horizon. Interestingly, this year almost three out of four immigrants are Lithuanians – those who emigrated in the past but have decided to return.

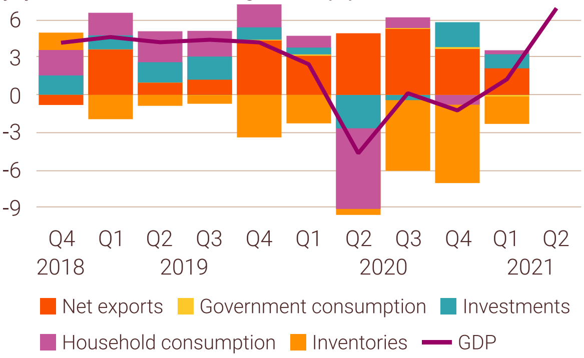
Nevertheless, immigration is not likely to be sufficient to alleviate the problems of labour shortages, especially in the construction and manufacturing sectors. Against this backdrop, it is not surprising that wage growth did not ebb at all – after growing by 10.1% last year, it is expected to increase by 10.3% this year and decelerate only modestly going forward. This is a boon for most employees, but the rapid increase in unit labour costs increases the pressure on exporters to boost productivity and innovate. To some extent, this may also spur more investments in automation.

Wage growth is also already translating into higher inflation. In July, consumer prices were 4.8% higher than a year ago. This was partially due to global factors – more expensive commodities and transportation costs – and an increase in regulated electricity and gas prices for consumers. Some of these factors will weaken next year, but increasing labour costs will not; thus, we forecast that average annual inflation this year and the next will be somewhat uncomfortably high at 3.7%.

Despite the impressive economic performance, so far the government has not seen the need or possibility to reduce the fiscal stimulus – the budget deficit will be around 6.5% of GDP this year and will probably decline to only 3% of GDP next year. Excessive government spending does not necessarily have to increase the risk of overheating, especially if it involves smart investments and is accompanied by much-needed structural reforms. The government plans to introduce comprehensive tax reforms and increase government expenditure as a share of GDP. This implies that government spending will remain higher in a post-pandemic period, but some taxes are likely to be increased also (currently the intention is to collect additional revenues only via the elimination of tax exemptions and the closing of loopholes).

Real GDP growth and contributions

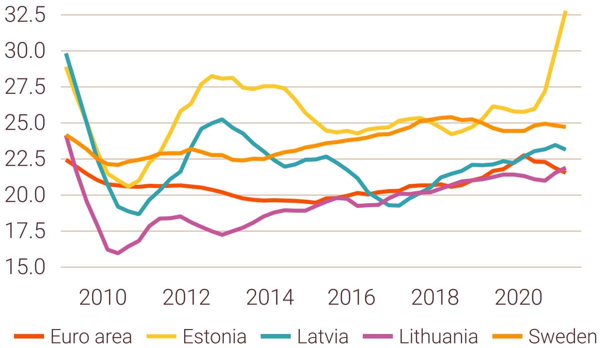
y/y %; contributions to growth, p.p.



Sources: Swedbank Research & Macrobond

Public and private investments, % of GDP

Current prices, swda



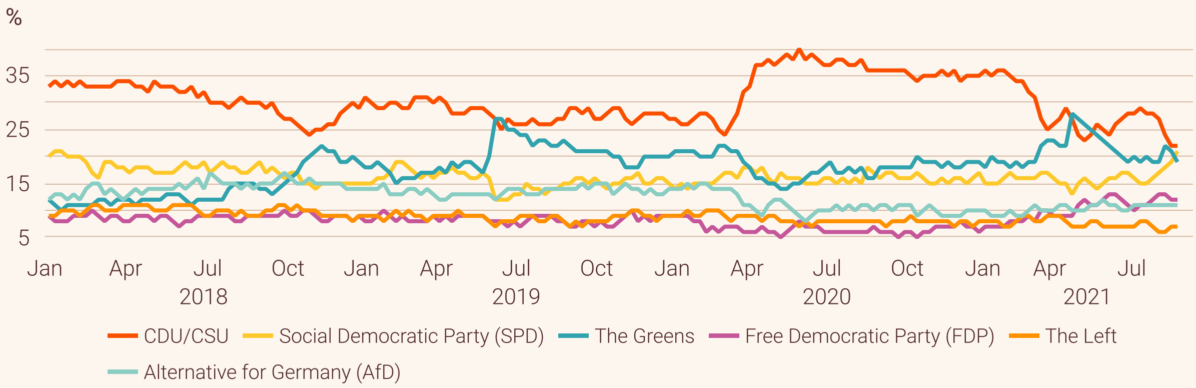
Sources: Swedbank Research & Macrobond

German election in times of challenges

On September 26, the biggest vote in Europe this year will take place – Germans will go to the polls to choose the next parliament. The political temperature is at a boiling point and the election outcome, not to mention the final shape of the next government, is uncertain.

Germany is going to the polls at a time when Europe's largest industrial country is under great pressure to change. The climate issue has emerged as one of the hottest topics, and with it comes the need to rapidly change the energy and transport systems. However, the debate is broader still: Germans are starting to realise that after years of underinvestment, there are massive unmet needs in different sectors of the economy. In addition to climate-related investments, spending on digitalisation and infrastructure is required in a broad sense. Germans acknowledge that their post-war success story has largely been based on their strong industrial competence – something they want to preserve – but for that, it must adapt to a new age.

German Bundestag election polls



Sources: Swedbank Research & Macrobond

The conservative view of fiscal policy is also seen, by some, as a cornerstone of the strong German economy. However, it is a difficult – almost an impossible – balancing act to reconcile all the ambitious objectives. If the climate transition is to be managed in a reasonable time, it will require huge investments; therefore, the fiscal framework will need to be relaxed. Fiscal debate is cautiously starting, and this is of great importance not only in Germany but throughout the European Union. Therefore, there are many reasons to closely monitor the outcome of the German elections and the subsequent formation of the government. The political and economic orientation will likely cause ripples in waters far beyond Germany's borders.

Forming a government will be tricky

During the past year, opinion polls have fluctuated sharply. The governing Christian Democrats (CDU/CSU) are polling far below the 2017 election result. In spring, polls showed a historically dramatic shift in public opinion. The CDU/CSU lost ground, while support for the Greens skyrocketed. The devasting floods in the western part of Germany in July have redrawn the election map once again. The floods hurt voter support for the CDU, and it didn't help that chancellor candidate Armin Laschet was caught laughing in the background of the German President's address when visiting a flooded region. However, perhaps surprisingly, the Greens have found it hard to gain substantial political advantage from the situation, even if they have subsequently inched up in the polls. Instead, the Social Democrats, with their popular chancellor candidate, Finance Minister Olaf Scholz, are now advancing notably in the polls. The Greens' leader, Annalena Baerbock, was regarded very positively in the beginning, but her popularity has waned during the summer. Laschet has been Minister-President of Germany's largest state, North Rhine-Westphalia, since 2017. He cannot be underestimated, but for the moment, his party is struggling in the polls.

In any event, polls suggest that the upcoming government formation will be very tricky, and many parties will be involved. The Greens will probably have a major influence and might emerge as a kingmaker. The surge for the Greens has also put pressure on the other parties to develop a more ambitious green agenda to attract undecided voters. Laschet's Christian Democrats are still in the lead to win the upcoming election and might be able to retain control over Europe's biggest economy. Potentially, they could usher in an unprecedented coalition with the Greens. Overshadowed, but worth noting, is that the liberal Free Democratic Party (FDP) has also risen in popularity and is also a potential kingmaker.

Possible coalitions

Coalition	Parties	Support in %
Black/Green	CDU/CSU and Greens	41
Traffic light	Greens, SPD and FDP	52
Jamaica	CDU/CSU, Greens and FDP	53
Kenya	CDU/CSU, Greens and SPD	62
Grand coalition	CDU/CSU and SPD	43
R2R	Greens, SPD and Left	47

Sources: Kantar and Swedbank Research.

The most likely scenario is that we will see a coalition that includes the Green Party. The CDU and the Greens are already working together in a number of states, and centrist Laschet, like the Greens, is an EU proponent. Laschet has also been open to higher carbon taxes lately and has supported a change in direction regarding energy policy. A fitting move, given the circumstances. In some areas, the Greens will have to compromise, of course, but even within the CDU there are heavy hitters who feel it is necessary to finance the rapid expansion of a new energy system outside the usual budget; Laschet recently proposed a Germany fund, with both private and public capital, to manage the financial challenge. If the mandates of the CDU and the Greens are not enough for a majority, which seems to be the case right now, an alternative is to include the FDP as well, creating the so-called Jamaican coalition. Alternatively, if the "traffic-light" parties succeed in gaining a majority, they may well form a coalition and serve under the leadership of either the Greens or the SPD, depending on the election result. In the prevailing uncertainty, a "Kenya coalition," or even a new "Grand coalition," cannot be ruled out. In any case, formation of the incoming government looks to be both difficult and protracted.

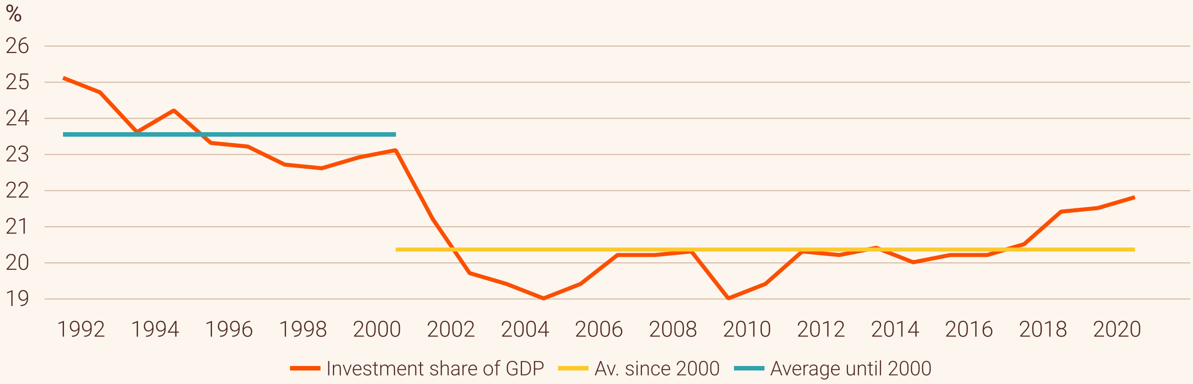
Challenges for Germany and Europe

Despite relative success in crisis-fighting, the German economy was not in a great place even before the pandemic struck. The export-driven economy has been losing steam over the past few years, and German manufacturing was in recession long before March 2020. The success formula that brought the German economy dominance in Europe in the past two decades seems to have run out of steam, and any new government coming into office will need to update its playbook to meet the rising challenges.

Two challenges stand out – digitalisation and climate neutrality. In both areas, progress has been slow. The situation in the energy sector, as Germans are trying simultaneously to phase out both coal and nuclear power, is precarious. The energy gap is primarily being closed using natural gas, which is not very climate-friendly, creates tensions with allied countries, and increases dependence on Russia. Significant investments are necessary to shift to renewable energy sources while maintaining grid stability. Germany, although a master of 20th-century technologies, is so far a laggard when it comes to the jump to the digital age. To maintain its competitive edge, both physical and digital infrastructure needs to be brought up to speed; otherwise, German business will be left behind. To tackle these issues, significant additional net investments are required, especially since Germany has long had low capital expenditures, even compared with other advanced economies. A significant portion of capital expenditures in Germany have to go into maintaining the large existing capital stock, and incremental increases are unlikely to be sufficient in achieving climate and modernisation objectives.

The good news is that Germany has plenty of fiscal space and an outstanding credit rating to finance the needed investment. However, Germany is known to be the centre of fiscal orthodoxy, and its insistence on balanced budgets stands in the way of declared future goals. The situation is further complicated by a rapidly ageing society that will put a drag on public finances. Both achieving necessary objectives and maintaining balanced budgets will be impossible unless the government allows other areas of the economy to fall into disrepair.

Investment share of GDP



Sources: Swedbank Research & Macrobond

The CDU and other right-wing parties proclaim their support for fiscal conservatism and reject significant reform of European fiscal framework. They suggest various forms of private finance mobilisation and off-balance-sheet financing to fund the necessary investments. Greens and other left leaning parties are more flexible; they recognise high investment needs and call for debt brake[2] reform.

It remains our view that most likely the new coalition government would shift the fiscal stance only a little. The next government could try to aim for small budget deficits, rather than the "black zero" of pre-crisis years, but would be unwilling to change the fundamentals of Germany's fiscal policy. The CDU, if leading the next government, might be able to move away from its rigid position by arguing that dealing with the challenges arising from the climate crisis will require sustained public investment.

Challenges facing any new German government are numerous, and Europe is watching closely for the start of the post-Merkel era. Any shift in the fiscal framework would be significant for both European and German future growth and for the long-term sustainability of the monetary union. Sharp policy changes are unlikely in consensus-based Berlin politics, but incremental reform is a necessity.

[2] Debt brake caps the federal government's structural net borrowing at 0.35% of GDP

The return of labour shortages

The swift recovery has resulted in a surge in demand for workforce and increasing concerns about labour shortages. Some of the story is linked to COVID-19-induced changes, e.g., in worker behaviour, but much of it has to do with pre-existing structural challenges. With labour shortages approaching and even surpassing pre-crisis levels in many of the region's countries, wage growth is rapid in the Baltics, while the Nordics are still largely seeing muted wage pressures.

Labour markets recovering fast

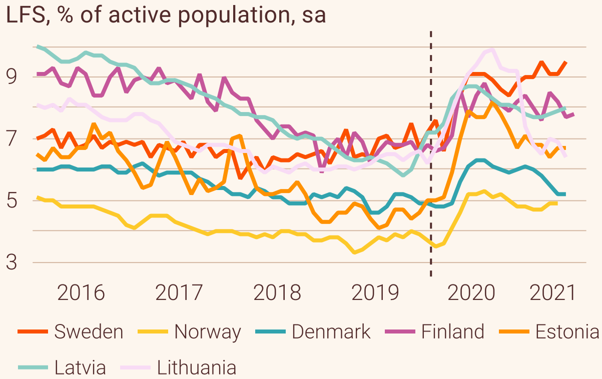
Labour markets across the Nordics and Baltics have been protected by temporary layoff schemes. While in Finland and Norway, temporary leave is a permanent part of the system, in most of the region's countries a novel set of policies was implemented to avoid a labour market crash. As a result, as in the rest of the rich world, unemployment rose less than could have been expected. Even though demand has not recovered fully in all sectors, a labour market rebound is occurring faster than anticipated.

In most of the region's economies, the high point in unemployment rates was reached last year during the first wave of COVID-19. Since then, the overall trend is downward. Labour Force Survey (LFS) estimates suggest that unemployment in June was already nearly back to pre-pandemic levels in Lithuania and Denmark. While the comparable Swedish data points to rising unemployment, this is mostly explained by changes in LFS methodology. Indeed, other data, like Swedish registered unemployment rates, are almost back to pre-crisis levels.

Employment rates picked up in the second quarter in all economies, except Estonia, with all the Nordics and Lithuania very close to, or even above, pre-pandemic levels. The labour market structure has changed for some countries, though. In Denmark, for example, there has been a surge in public sector employment, with many new hires made to help fight off the virus (working with test and trace systems, vaccinations, etc.). Going forward, the structure should largely go back to what we saw pre-COVID-19.

Unemployment rate

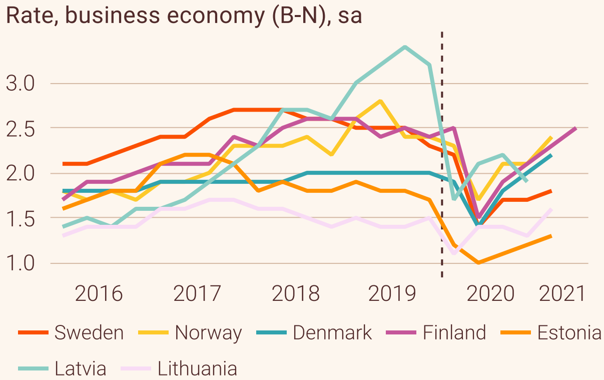
LFS, % of active population, sa



Sources: Swedbank Research & Macrobond

Job Vacancies

Rate, business economy (B-N), sa



Sources: Swedbank Research & Macrobond

Labour shortages are resurfacing

Job vacancy rates in the business sector, reflecting the unmet demand for labour, fell sharply at the start of the COVID-19 crisis. By the first quarter of 2021, these had recovered already to near or even above pre-crisis levels in Denmark, Norway, and Lithuania. In Denmark, e.g., the vacancy rate hit its highest point in over 10 years. For most other Nordic and Baltic economies, higher-frequency data suggests a rapid rise of vacancies in recent months, indicating an increasing labour shortage. Vacant jobs in Finland were not only above pre-crisis levels in the second quarter, but also reverted to the previous increasing trend. In Sweden, remaining vacancies in the second quarter were at their pre-crisis level, while new vacancies were already well above it. Interestingly, from April to July, the number of unfilled vacancies was consistently higher than the number of new vacancies, suggesting that it is difficult and takes longer to hire new workers.

The increasingly tight labour market is also being reflected in surveys – labour shortages are highlighted more and more often in different sectors in all the region's economies.

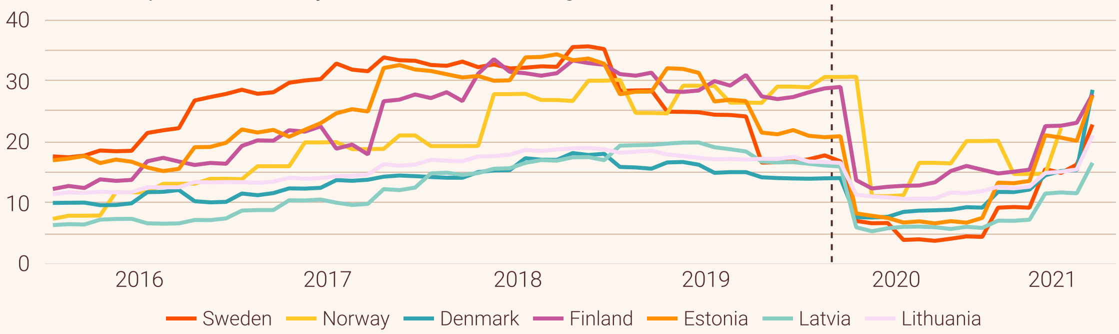
The manufacturing industry is among the sectors affected relatively little by the crisis and is also among the best performers in the recovery phase. Therefore, it is hardly a surprise to see labour shortages in this sector identified in many countries (e.g. Denmark, Sweden, Lithuania, and Estonia) as more of an issue than before the crisis. In Denmark and Sweden,[3] labour shortages are at all-time highs, while in Lithuania the levels are comparable to 2006 boom times. For Norway, Finland, and Latvia shortages are close to pre-crisis levels.

Strong activity is expected in the construction sector in the coming years, especially in the Baltics, with the substantial inflow of European Union funds. Already now in Denmark and Lithuania, labour shortages have become more pressing than at the end of 2019. In the rest of the region's economies, labour shortages in construction are on the rise and – in most – close to pre-crisis levels.

With face-to-face service industries suffering the most during the crisis, labour shortages in services saw the steepest decline in 2020. Increasing vaccine coverage and seasonal factors have ensured that these sectors have finally been able to open up, and, as a result, labour shortages have shot right back up. Most notably, Danish businesses are signalling labour shortages as much more limiting than before the crisis. For the rest, labour shortages in services are picking up, and are close to end-2019 levels in most economies.

Labour shortage in business economy* is picking up fast

Share of companies, %, survey data, value-added weights



*incl. construction, manufacturing and services (excl. retail/wholesale trade)
Sources: Swedbank Research & Macrobond, DG ECFIN, National Statistics Denmark and Bank of Norway

[3] An ECFIN survey shows an all-time high. Even though the NIER Economic Tendency Indicator (ETI) is still below record levels, the ETI reading is very elevated and has been trending upwards with no sign of cooling anytime soon.

Both temporary and structural factors explain the shortages

The region's economies have only just reached the pre-crisis levels of GDP, yet we are already seeing a surge in labour shortages. On the one hand, this is to some extent a consequence of the COVID-19 pandemic and the policy response adopted to battle it. There are still workers who are on temporary layoff schemes, and there is evidence suggesting that the extension of these is preventing employees from searching for jobs in sectors that are in dire need of workforce. Some have left the labour market due to the fear of the virus – others to take care of small children or other family members. Since this crisis has been a life-changing event, some might have decided to leave their jobs to study or to explore other options, especially since many households have been able to increase their savings during the crisis. In countries where immigration previously played an important balancing role in the labour market, such as Norway and Estonia, the pandemic-induced stricter border controls and administrative hurdles have led to a lack of foreign workers.

On the other hand, however, structural issues, such as skills mismatches and worsening demographics, are still a key factor in most of the region's economies, especially Finland, Sweden, Latvia, and Estonia. Strong growth going forward is projected in all countries, suggesting that we are likely to see ever-increasing labour shortages.

What comes next?

To some extent, labour shortages, insofar as they relate to consequences of the COVID-19 crisis, might be alleviated with the return of life to normal. For example, in Norway current labour shortages are largely viewed as temporary. However, for most other Nordic and Baltic economies, the story is largely structural, and, therefore, the solution will take time. It will likely require more investment in automation and digitisation, and reskilling and upskilling programmes in line with employers' needs, as well as, especially in the Baltics, an encouragement of immigration and reduction in red tape to hire immigrant workers.

In theory, labour shortages and the resulting higher bargaining power of workers should also increase wage pressures. And we certainly see that happening in the Baltics, where wages are expected to grow by 6-10% this year, with a slight deceleration going forward. The labour markets in the Nordics are much more rigid in this sense – collective agreements cover a large part of the economies. This means that, even if labour shortage issues push wages up, this might happen with a long lag. Some sectors, like construction, might end up facing higher wage growth, even in the Nordics. For example, construction wages in Denmark and Finland are currently increasing fairly quickly. However, overall wage pressure in the Nordics is expected to stay muted.

Labour shortages, along with supply-chain bottlenecks and skyrocketing input prices, can weigh on economic growth going forward. All else equal, rising wages lift unit labour costs and can hurt the competitiveness of economies, especially in the Baltics. This can result in subpar export performance due to a loss of export market shares, which, up until now, have been increasing in the Baltics.

Faster wage growth, in countries where it does materialise, will also likely feed into higher inflation. Indeed, for the Baltics, inflation forecasts have been raised across the projection horizon. However, price increases are still expected to be rather moderate – slightly above those seen in recent history, but nothing like the double-digit rates experienced before the Great Financial Crisis. Even for the Nordics, despite the muted inflation projections, the risk of higher inflation has increased, not least due to resurging labour shortages.

Are Swedish budget surpluses history?

The political situation is uncertain, but the scope for reform is larger than anticipated. We expect budget deficits in 2021 and 2022, but a balanced budget in 2023. The fiscal surplus target should be put on hold to allow for investments in the climate transition and increased expenses related to the ageing population.

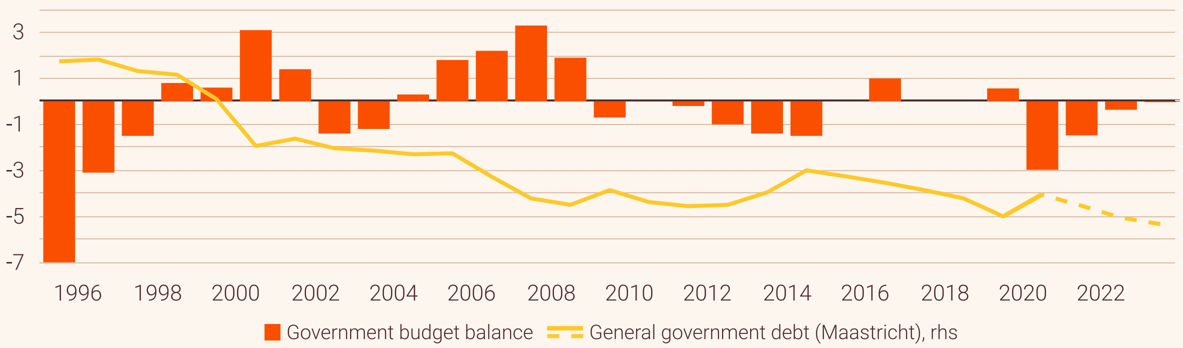
Better public finances allow for more action

Economic development has surprised positively, and tax revenues have grown faster than expected, both compared with our April forecast and with the government's spring bill. Also, business support, in the form of support for short-term work and reorientation, for example, has been paid out to a much smaller extent than forecast by the government. Approximately SEK 13 billion has been paid out through June, which corresponds to only 16% of the support allocated for 2021.

Pandemic-related expenditures have been modest in Sweden from an international perspective. Public debt has increased significantly in most countries – in the G20 countries, the average Maastricht debt rose to 107% of GDP in 2020 – and it is expected to remain high in the coming years. In Sweden, debt rose to just under 40% of GDP last year, which means that it landed just below the upper limit of the debt anchor.[4]

A balanced budget and low Maastricht debt in 2023

% of GDP



Sources: Swedbank Research & Macrobond

Overall, according to the National Institute of Economic Research's latest assessment, there is scope for unfunded measures next year of approximately SEK 40 billion, and SEK 70 billion in 2023, given the fiscal framework. This means that there is capacity for further reforms that the government did not count on in the spring bill.

In total, we expect new unfunded reforms of SEK 75 billion next year and SEK 55 billion in 2023. This means a balanced budget in 2023, and, although the fiscal surplus target will not be reached during the forecast period, Maastricht debt will fall below the debt anchor of 35% of GDP as early as next year.[5]

[4] The fiscal framework contains a fiscal surplus target and a so-called debt anchor, which is a target for public debt at 35% of GDP, with allowance to deviate by 5 percentage points in either direction. The fiscal surplus target implies that the surplus should be 0.33% of GDP over the business cycle.

[5] By 2023, Maastricht debt will decrease by SEK 180 billion as a result of the Riksbank's decision to change the borrowing of foreign exchange reserves, which amounts to approximately 3% of GDP.

An autumn budget overshadowed by political uncertainty

The political situation has changed considerably over the summer. The January agreement between the government, the Center Party and the Liberal Party has ended and, in addition, Prime Minister Stefan Löfven recently announced that he will resign as the party chairman for the Social Democrats as well as from his role as Prime Minister in November. As a consequence, the government coalition will need approval from the parliament to form a government once a new candidate for Prime Minister has been elected. There is also great uncertainty as to whether the budget bill for 2022 will be voted through.

Most likely, active support from both the Left Party and the Center Party will be required for the government's bill to be adopted. The Left Party has demanded, among other things, permanently strengthened unemployment insurance and an increased guarantee pension in exchange for voting for the government's budget. The Center Party backed PM Stefan Löfven in the summer’s vote, while demanding that the government implement changes in labour law, reform the shoreline protection, and strengthen the forest ownership. At the same time, the Center Party insists that it will not support a budget negotiated with the Left Party, so the situation is tricky for the government.

But most parties are likely to want to avoid another government crisis close to the next election, and, in our main scenario, we expect the current government coalition to get approval and that the government's budget proposal receives enough support in the parliament. In a scenario in which the government or the budget falls, a new period of political uncertainty arises; however, the economic recovery will not be significantly hampered in the short term.

Structural challenges in focus going forward

The economic recovery is ongoing, and the direction of fiscal policy is expected to shift focus. We expect business support to be phased out, as planned, later this year and fiscal policy to focus more on the challenges facing the Swedish economy. The pandemic has led to the postponement of planned care, while strengthening the need for action in the labour and housing markets. In addition, the ageing population means that the need for welfare services, especially in elderly care, will increase significantly in the future. Sweden, like the rest of the world, is also facing a major climate challenge, which according to the latest UN climate report needs to be dealt with very urgently.

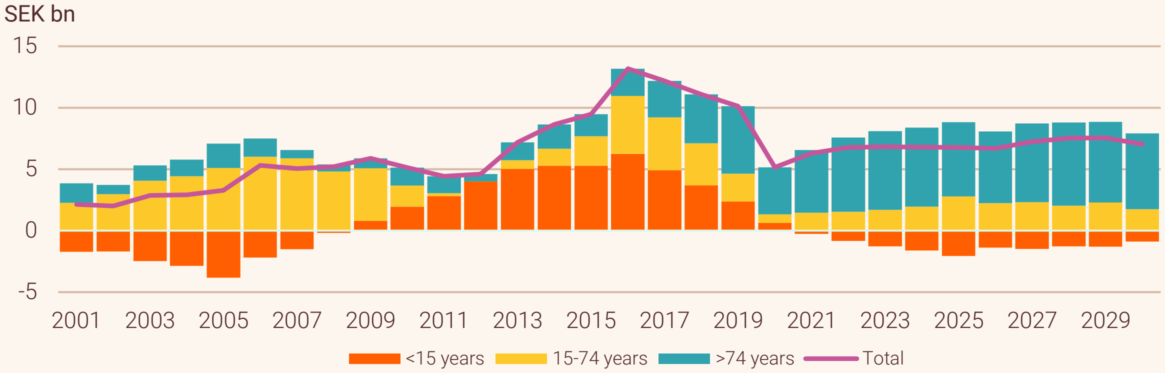
Climate change requires rapid emission reductions

The Intergovernmental Panel on Climate Change (IPCC) published a report in August that compiled the latest research on climate change. The results clearly indicate that human activity has led to widespread changes in the atmosphere, oceans, and land. The changes have taken place much faster than expected. At today's rate of emissions, we are passing the Paris Agreement's target of limiting warming to 1.5 degrees within 10 years. However, it is still possible to limit warming to below 2 degrees, but this requires that emissions be halved by 2050 and reach net-zero emissions by 2075, which means a much faster rate of reduction than hitherto. Evidence is strong that climate change leads to more frequent extreme weather and is expected to increase and intensify further in Europe and globally. Our interpretation is that climate-related risks are increasing both inside and outside Sweden and that the need for action is urgent both to limit warming and to address the impact of climate risks on the economy and financial market. The economic effects that may arise in the wake of weather changes are new migratory patterns, more volatile inflation and new stability risks.

We estimate that public consumption will increase by 2.2% in 2022 and 1.4% in 2023 (at constant prices), which is above the average over the past 20 years. According to Statistics Sweden latest population forecast, the proportion of older people will increase dramatically over the next few years: there are expected to be about 115,000 more people older than 75 years in 2023 than in 2020. This means that spending on welfare services for the elderly is projected to increase by an average of 1.3% over the next few years. Furthermore, the number of health care appointments decreased by just over 9% last year; e.g., there were 72,000 fewer operations than in 2019. The postponed care and the ageing population mean significant cost increases for the local government sector; we therefore expect central government grants to be raised for both 2022 and 2023.

The pandemic has exacerbated the structural problems in the Swedish housing and labour markets as discussed in the Swedish section. The fact that it was a proposed reform of renting prices for new builds that triggered the government crisis reinforces the image that major reforms in the housing market will be delayed. However, high long-term unemployment is something that is likely to affect policy in the next few years. A broad range of measures and further investments are needed in areas such as subsidised jobs and education. The green transition requires not only additional public investment, but also incentives to change other parts of the economy.

Spending on welfare services for elderly increases markedly in coming years



Note: The calculation uses spending on welfare services per age group in 2018 and the latest population forecast from Statistics Sweden
Sources: NIER, Statistics Sweden & Swedbank Research

Need for a more flexible fiscal framework as soon as possible

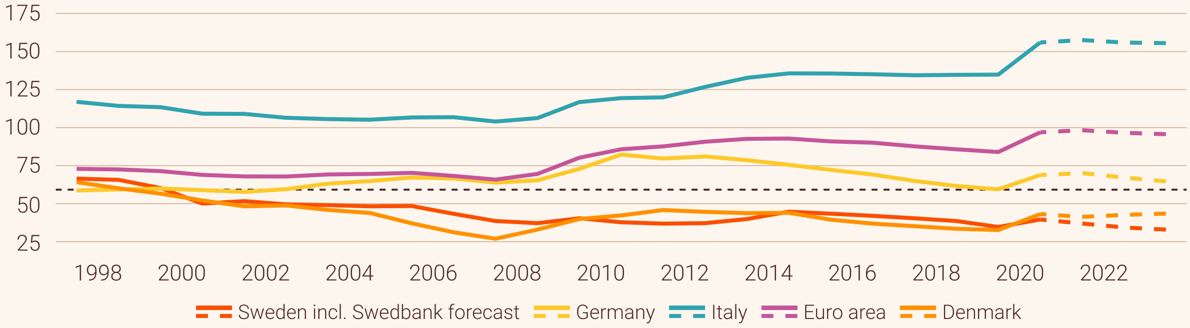
Sweden's low public debt means that public finances are sustainable even though the surplus target will not be reached in the next few years. Instead, the need for investments supporting the climate transition and increased welfare services requires that the surplus target should be put on hold and that the scheduled review, due to start in 2025 and be in place in 2027, be carried out as soon as possible. A discussion about appropriate fiscal frameworks has arisen in both Sweden and internationally. In Germany, the Greens are highlighting the major investment needs arising from the climate transition and proposing a reform of the country's so-called debt brake. This is something that could become a reality after the federal elections in September, and which could then also affect the view of the fiscal framework in Sweden (see more in our in-depth on Germany on page 34). In Sweden, e.g., the Climate Policy Council proposes in its latest report that the review of the fiscal surplus target be brought forward as a result of the climate challenge, and that the climate perspective should be included in the risk analysis of the sustainability of public finances.[6]

[6] https://www.klimatpolitiskaradet.se/rapport-2021/

Whether a more flexible framework would jeopardise public finances or strengthen the Swedish economy depends, above all, not only on whether the benefits of the investments exceed the costs, but also on how Swedish creditworthiness and the role of public debt as a shock absorber are affected. We believe that Sweden can modify the surplus target for the climate and other societal challenges without compromising the long-term sustainability of public finances. The challenges in the climate field, in particular, are great, and both private and public investment are needed to achieve more sustainable development. With smart climate investments, we believe that the benefits exceed the costs, given the low interest rates, and the high cost arising from heightened climate risks in the event of forgone investments. Sweden can afford to invest for the future without accumulating a public debt so high that Swedish creditworthiness is compromised. Sweden's public debt will still be low in an international comparison, and the role of public debt as a shock absorber remains.

Swedish public finances in a good position to face the green transition

Maastricht debt, % of GDP



Note: Dashed line shows Tthreshold for general government gross debt (Maastricht criteria, 60%)
Sources: Swedbank Research & Macrobond

If Sweden replaces the surplus target with a balanced-budget target for five years, approximately SEK 100 billion will be released in extra budget space. Nonetheless, higher investment than that is likely to be possible without compromising the public finances or abolishing the surplus target for longer. In its latest sustainability report, the National Institute of Economic Research finds public finances sustainable in the long term if a balanced-budget target is introduced in 2027.[7]

The biggest risk going forward is the political deadlocks thwarting the necessary structural reforms and smart climate investments, rather than the easing of the fiscal framework, which would lead to large increases in spending that jeopardise the sustainability of public finances.

[7] https://www.konj.se/download/18.354f36bd17763b7407d4ea70/1612862281872/H%C3%A5llbarhetsrapport_2021.pdf

Appendix

Interest and exchange rate forecasts

	Outcome 2021 23 Aug	Forecast 2021 31 Dec	2022 30 Jun	2022 31 Dec	2023 30 Jun	2023 31 Dec
Policy rates (%)						
Federal Reserve, USA (upper bound)	0.25	0.25	0.25	0.25	0.50	0.75
European Central Bank (refi rate)	0.00	0.00	0.00	0.00	0.00	0.00
European Central Bank (deposit rate)	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Bank of England	0.10	0.10	0.10	0.10	0.25	0.25
Riksbank	0.00	0.00	0.00	0.00	0.00	0.00
Norges Bank	0.00	0.25	0.75	1.00	1.25	1.25
Government bond rates (%)						
Sweden 2y	-0.31	-0.20	-0.20	-0.10	-0.10	0.00
Sweden 5y	-0.17	-0.10	0.00	0.00	0.10	0.10
Sweden 10y	0.08	0.20	0.30	0.40	0.40	0.40
Germany 2y	-0.74	-0.70	-0.70	-0.60	-0.50	-0.50
Germany 5y	-0.73	-0.65	-0.65	-0.60	-0.55	-0.50
Germany 10y	-0.47	-0.35	-0.35	-0.30	-0.25	-0.20
US 2y	0.23	0.30	0.50	0.75	0.90	1.10
US 5y	0.78	0.85	1.00	1.10	1.20	1.30
US 10y	1.25	1.45	1.50	1.60	1.60	1.70
Norway 2y	0.68	0.80	0.90	1.10	1.30	1.30
Norway 5y	1.02	1.20	1.30	1.30	1.40	1.50
Norway 10y	1.16	1.40	1.50	1.60	1.60	1.60
Exchange rates						
EUR/USD	1.17	1.17	1.16	1.17	1.18	1.18
EUR/GBP	0.86	0.84	0.84	0.85	0.85	0.85
EUR/SEK	10.29	10.10	10.00	9.90	9.90	9.90
EUR/NOK	10.49	10.20	10.20	10.10	10.00	10.00
USD/SEK	8.79	8.63	8.62	8.46	8.39	8.39
USD/CNY	6.48	6.45	6.40	6.40	6.50	6.60
USD/JPY	109.7	110.0	111.0	112.0	113.0	113.0
USD/RUB	74.12	73.00	73.00	71.00	70.00	70.00
NOK/SEK	0.98	0.99	0.98	0.98	0.99	0.99
KIX (Trade-weighted SEK)	116.0	114.3	113.4	112.1	111.7	111.6

Sources: Swedbank Research & Macrobond

NORWAY (Mainland): Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP	-3.1	2.9	(2.7)	3.8	(4.1)	1.8
Household consumption	-7.3	4.5	(4.1)	7.1	(7.3)	1.7
Government consumption	1.7	2.7	(4.3)	1.2	(2.0)	2.3
Gross fixed capital formation	-3.8	2.0	(2.1)	0.7	(0.2)	3.2
Exports of goods and services	-7.3	4.1	(5.5)	3.5	(2.2)	2.1
Imports of goods and services	-12.0	5.8	(8.1)	2.9	(1.3)	3.3
CPI (average)	1.3	2.8	(2.8)	1.1	(1.1)	1.3
Unemployment (% of labour force, 15-74)	4.6	4.2	(4.5)	3.7	(3.8)	3.5
Employment (15-74)	-1.3	0.7	(0.5)	2.0	(2.0)	1.5
Employment rate (15-74)	67.2	68.0	(67.4)	68.5	(68.0)	68.5
General government budget balance, % of GDP	-4.0	-1.0	(-1.0)	0.0	(0.0)	0.0
General government debt (Maastricht), % of GDP	42.0	42.0	(42.0)	42.0	(42.0)	42.0

Previous forecast in parentheses
Source: Statistics Norway & Swedbank Research

DENMARK: Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP	-2.1	3.8	(3.2)	3.5	(3.7)	2.1
Household consumption	-1.3	3.5	(4.1)	5.1	(4.2)	2.3
Government consumption	-1.7	2.3	(3.2)	3.0	(2.8)	1.9
Gross fixed capital formation	5.1	3.7	(2.4)	1.7	(2.0)	1.9
Exports of goods and services	-7.0	7.4	(4.1)	5.4	(6.6)	2.8
Imports of goods and services	-4.1	5.6	(5.5)	6.1	(6.1)	2.8
CPI (average)	0.4	1.3	(1.1)	1.5	(1.2)	1.6
Unemployment (% of labour force, 15-74)	5.8	5.6	(6.1)	5.2	(5.6)	5.1
Employment (15-74)	-0.7	0.8	(0.4)	1.2	(0.9)	0.9
Employment rate (15-74)	65.5	66.0	(65.6)	66.5	(66.2)	66.7
General government budget balance, % of GDP	-0.6	-3.0	(-3.8)	-1.0	(-2.0)	0.5
General government debt (Maastricht), % of GDP	42.1	41.0	(42.3)	41.8	(41.8)	41.0

Previous forecast in parentheses
Source: Statistics Denmark & Swedbank Research

FINLAND: Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP	-2.9	3.1	(3.0)	2.9	(2.8)	1.2
Household consumption	-4.7	3.7	(3.0)	4.1	(2.7)	1.4
Government consumption	1.2	2.1	(1.7)	-0.2	(0.6)	1.0
Gross fixed capital formation	-0.7	1.7	(1.1)	2.8	(4.0)	2.0
Exports of goods and services	-6.4	6.2	(11.7)	5.9	(7.0)	2.9
Imports of goods and services	-6.7	5.6	(6.1)	5.3	(5.9)	2.9
CPI (average)	0.3	1.6	(1.3)	1.4	(1.4)	1.5
Unemployment (% of labour force, 15-74)	7.8	7.7	(7.4)	7.0	(7.0)	6.8
Employment (15-74)	-1.3	0.6	(0.6)	0.8	(0.8)	0.7
Employment rate (15-74)	61.2	61.8	(61.8)	62.3	(62.3)	63.0
General government budget balance, % of GDP	-5.4	-4.4	(-4.7)	-2.6	(-3.6)	-2.2
General government debt (Maastricht), % of GDP	69.2	70.5	(69.5)	71.2	(70.2)	72.2

Previous forecast in parentheses
Source: Statistics Finland & Swedbank Research

SWEDEN: Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP (calendar-adjusted)	-3.0	4.3	(3.5)	3.6	(3.6)	2.2
Real GDP	-2.8	4.4	(3.6)	3.6	(3.6)	2.0
Household consumption	-4.8	4.1	(3.3)	4.6	(5.3)	2.8
Government consumption	-0.5	2.5	(3.0)	2.2	(1.8)	1.4
Gross fixed capital formation	-0.5	3.1	(2.4)	4.5	(3.4)	2.4
Change in inventories, contr. to GDP growth	-0.6	0.1	(0.3)	0.0	(0.0)	0.0
Exports of goods and services	-4.6	9.1	(7.3)	4.8	(4.9)	4.1
Imports of goods and services	-5.7	7.6	(7.0)	5.5	(5.6)	4.9
CPI (average)	0.5	1.7	(1.4)	1.4	(1.3)	1.7
CPI (Dec.-Dec.)	0.5	1.7	(1.1)	1.4	(1.4)	2.1
CPIF (CPI with fixed mortgage rate, average)	0.5	2.0	(1.5)	1.4	(1.3)	1.6
CPIF (CPI with fixed mortgage rate, Dec.-Dec.)	0.5	1.9	(1.2)	1.3	(1.4)	2.0
Riksbank policy rate (Dec.)	0.00	0.00	(0.00)	0.00	(0.00)	0.00
Unemployment (% of labour force, 15-74)	8.3	8.8	(8.5)	7.5	(7.6)	7.1
Labour force (15-74)	0.3	0.3	(0.1)	0.7	(1.0)	0.9
Employment (15-74)	-1.3	-0.2	(-0.2)	2.1	(2.1)	1.4
Number of hours worked (calendar-adjusted)	-3.8	3.5	(2.5)	3.3	(3.1)	1.3
Nominal hourly wage (NMO), whole economy	2.1	2.9	(2.6)	2.7	(2.5)	2.8
Household real disposable income	-0.6	4.7	(3.5)	2.6	(3.2)	2.1
Household nominal disposable income	0.5	6.6	(5.0)	3.9	(4.5)	3.5
Household savings ratio, % of disposable income	17.7	17.8	(17.4)	16.2	(15.7)	15.5
General government budget balance, % of GDP	-3.0	-1.5	(-3.1)	-0.4	(-1.2)	0.0
General government debt (Maastricht), % of GDP	39.7	37.3	(39.5)	34.7	(37.4)	33.3

Previous forecast in parentheses
Source: Statistics Sweden & Swedbank Research

ESTONIA: Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP	-2.9	8.0	(3.0)	4.0	(5.0)	3.2
Household consumption	-2.3	4.7	(3.5)	6.3	(6.0)	3.0
Goverment consumption	3.6	5.0	(5.0)	2.5	(2.5)	1.5
Gross fixed capital formation	18.4	10.0	(-8.5)	-5.5	(7.0)	6.0
Exports of goods and services	-5.0	13.0	(5.0)	4.0	(4.5)	4.0
Imports of goods and services	0.4	15.0	(1.0)	1.5	(5.5)	4.5
CPI (average)	-0.4	3.1	(1.5)	2.6	(2.0)	2.2
Unemployment (% of labour force)	6.8	6.4	(8.0)	5.9	(6.9)	5.7
Employment	-2.1	1.3	(-1.2)	1.0	(1.6)	0.6
Gross monthly wage	2.9	6.0	(4.0)	5.3	(4.8)	5.5
Nominal GDP, billion euro	27.2	30.1	(28.4)	32.3	(30.4)	34.2
Exports of goods and services (nominal)	-7.5	19.8	(5.0)	7.6	(5.5)	7.1
Imports of goods and services (nominal)	-2.3	21.9	(1.0)	5.0	(6.5)	7.6
Balance of goods and services, % of GDP	0.3	-1.0	(2.8)	0.9	(2.1)	0.6
Current account balance, % of GDP	-0.6	-1.4	(1.9)	0.4	(1.2)	0.0
Current and capital account balance, % of GDP	1.5	1.2	(3.3)	2.9	(2.5)	2.5
FDI inflow, % of GDP	10.4	8.3	(3.3)	3.3	(3.3)	3.3
General government budget balance, % of GDP	-4.9	-2.4	(-6.0)	-2.1	(-3.8)	-1.9
General government debt (Maastricht), % of GDP	18.2	18.6	(21.2)	20.7	(25.0)	22.6

Previous forecast in parentheses
Sources: Statistics Estonia & Swedbank Research

LATVIA: Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP	-3.6	4.0	(3.1)	5.0	(5.5)	3.5
Household consumption	-10.0	9.5	(6.8)	6.8	(8.6)	4.2
Goverment consumption	2.6	3.2	(3.2)	2.6	(2.4)	2.5
Gross fixed capital formation	0.2	7.4	(7.9)	12.3	(13.7)	8.6
Exports of goods and services	-2.7	5.0	(4.0)	4.4	(5.3)	3.7
Imports of goods and services	-3.3	12.0	(7.0)	6.7	(9.3)	5.4
CPI (average)	0.2	2.3	(1.8)	3.2	(3.0)	3.0
Unemployment (% of labour force)	8.1	7.6	(8.4)	6.7	(6.7)	6.0
Employment	-1.9	-2.5	(-1.0)	2.5	(1.3)	0.3
Gross monthly wage	6.2	9.0	(6.5)	8.0	(7.0)	8.0
Nominal GDP, billion euro	29.3	31.6	(31.0)	34.3	(33.7)	36.8
Exports of goods and services (nominal)	-3.5	17.7	(6.6)	4.4	(6.5)	4.8
Imports of goods and services (nominal)	-6.6	22.0	(9.7)	6.7	(10.6)	6.5
Balance of goods and services, % of GDP	1.2	-1.1	(-0.6)	-2.4	(-2.9)	-3.4
Current account balance, % of GDP	3.0	-0.7	(0.7)	-2.0	(-1.8)	-2.6
Current and capital account balance, % of GDP	4.7	1.1	(2.7)	0.0	(0.3)	-0.8
FDI inflow, % of GDP	2.6	3.0	(2.5)	2.9	(2.5)	2.8
General government budget balance, % of GDP	-4.5	-9.0	(-7.5)	-3.6	(-2.2)	-2.1
General government debt (Maastricht), % of GDP	43.5	49.4	(48.0)	49.7	(46.8)	48.2

Previous forecast in parentheses
Sources: Statistics Latvia & Swedbank Research

LITHUANIA: Key economic indicators, 2020-2023

Annual % change unless stated otherwise	2020	2021F		2022F		2023F
Real GDP	-0.9	4.2	(3.0)	3.5	(4.9)	3.4
Household consumption	-2.0	5.2	(3.8)	5.0	(6.0)	4.5
Goverment consumption	0.6	2.0	(2.0)	1.5	(1.5)	1.5
Gross fixed capital formation	-0.2	7.5	(7.5)	9.0	(9.0)	7.0
Exports of goods and services	0.0	7.0	(5.5)	4.0	(4.5)	3.8
Imports of goods and services	-5.3	10.5	(8.2)	6.5	(7.1)	5.6
CPI (average)	1.2	3.7	(2.3)	3.7	(3.3)	2.8
Unemployment (% of labour force)	8.5	7.2	(8.5)	6.7	(7.3)	6.3
Employment	-1.0	0.5	(0.9)	1.0	(0.9)	0.5
Gross monthly wage	10.1	10.3	(7.0)	8.2	(6.4)	7.0
Nominal GDP, billion euro	48.9	52.2	(51.4)	55.8	(55.7)	59.4
Exports of goods and services (nominal)	-4.1	14.0	(7.5)	6.0	(6.5)	5.0
Imports of goods and services (nominal)	-10.6	21.5	(10.5)	9.5	(9.5)	7.5
Balance of goods and services, % of GDP	9.7	5.8	(8.0)	3.3	(6.0)	1.5
Current account balance, % of GDP	8.3	4.1	(6.7)	1.7	(4.2)	-0.2
Current and capital account balance, % of GDP	10.4	5.4	(8.2)	3.3	(5.8)	1.5
FDI inflow, % of GDP	2.7	3.0	(2.5)	3.0	(2.0)	2.5
General government budget balance, % of GDP	-7.4	-6.5	(-6.5)	-3.0	(-2.7)	-1.8
General government debt (Maastricht), % of GDP	47.2	50.7	(49.3)	50.4	(47.8)	49.1

Previous forecast in parentheses
Sources: Statistics Lithuania & Swedbank Research

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