Swedbank

Swedbank Economic Outlook

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Calibration of policy response is essential

Inflation has continued to surprise on the upside and is now at highs not seen in decades. Central banks have responded in a synchronised manner globally with front-loaded policy rate hikes. Signs that global growth has started to deteriorate, driven by households' cost-of-living crisis and tighter financial conditions, are already visible. Recession is coming to many parts of the world this winter. However, monetary policy should stay the course in the near term to restore price stability and avoid inflation de-anchoring, which could result from households' and businesses' basing their wage and price expectations on their current inflation experience.

Fiscal policy needs to incorporate measures carefully crafted to support households and corporates to limit the effect of record-high inflation and energy prices. The priority for fiscal policy should be shielding exposed groups by targeting near-term support to lighten the burden of the cost-of-living crisis, which is now being felt globally.

The depth, length, and severity of the coming recession rests critically on the successful calibration of monetary and fiscal policy. Policy mistakes cannot be ruled out and are already visible in the UK, as the current environment is highly uncertain and risks to the outlook are remarkably extensive. Monetary policy could misjudge the optimal stance needed to reduce inflation and the contractionary forces that are in play as many central banks are tightening aggressively in a synchronised, inflation-fighting cycle.

Central banks will pivot next year; the monetary policy trade-offs will be easier since inflation is fading and demand falling rapidly. Central bank policy rates will start to decline, as central banks have been forced to go beyond the neutral level in order to restore price stability. Global financial conditions will, however, remain tight, as central banks will continue with quantitative tightening and credit spreads will normalise at a high level.

Mattias Persson
Group Chief Economist

4.25% Peak of 10Y US government bond yield, Dec. 2022	**0.0%** Euro-area GDP-growth in 2023	**3.00%** Riksbank policy-rate peak in February 2023
22-24% Current inflation rate in the Baltics	**7** rate cuts by the Fed expected, starting end-2023	**1.00** EUR/USD, June 2023

2023 Outlook

Nordics	GDP	Unemployment*	Inflation
Sweden	-1.1%	7.6%	7.4%
Norway	-0.5%	2.4%	4.6%
Denmark	-0.9%	5.2%	4.3%
Finland	-0.3%	7.0%	4.0%

Baltics	GDP	Unemployment*	Inflation
Estonia	0.0%	7.3%	8.9%
Latvia	0.0%	7.0%	9.0%
Lithuania	0.0%	6.6%	8.7%

* Unemployment refers to LFS except for Norway where it refers to the registered unemployment rate (NAV)

Global Outlook

- Global growth is revised down for both 2023 and 2024. Stubbornly high inflation and rapidly rising interest rates will weigh on household consumption and firms' investments.

- The energy crisis will drag down Europe, not least Germany, which faces a contracting economy. The UK is a mess. The US economy is less affected by the energy crisis but faces a clear headwind on the back of higher interest rates. Labour markets will take a hit in 2023.

- In both the US and the euro area, inflation is expected to fall back markedly in 2023. This is partly due to base effects, but also to lower demand. Lower commodity prices, lower freight prices, and large inventories within the retail sector also suggest reduced price pressures ahead.

- The forecasts are surrounded by uncertainty, not least related to monetary and fiscal policy. In the near term, we forecast aggressive monetary policy tightening and expansionary fiscal policies. Both may turn out to be inappropriate.

Financial Markets

- Both the Fed and the ECB are expected to raise their policy rates further over the next few months, but then start easing during the fourth quarter of 2023.

- Bond markets have been volatile this year. Government bond yields are expected to rise further in the near term, but then gradually decline in 2023 and 2024.

- A hawkish Fed, safe-haven status, and a relatively favourable energy situation will continue to support the US dollar in the near term. The Swedish krona and Norwegian krone are expected to appreciate somewhat beginning next year.

Nordics

- The Nordic economies will enter a recession in the coming year as interest-rate-sensitive households reduce consumption.
- The housing market will take a hit and housing prices will fall as long as mortgage rates are increasing. Unemployment will rise, although to a lesser extent than during the pandemic and to different degrees across the Nordic countries.
- Fiscal policy is less expansive than in many other European countries and public finances will remain strong.
- The Riksbank and Norges Bank are expected to end the hiking cycle at 3% and then start cutting rates in about a year, when growth will have slowed and inflation will have started to ease.

Baltics

- Inflation has continued to increase in all three Baltic countries, but the peak has been reached or is near. We expect average annual inflation to ease below 10% in 2023, and then continue falling to healthier levels in 2024.
- Household consumption is likely to shrink somewhat for a few quarters. A larger fallout is likely to be prevented by supportive fiscal policy – many households are at least partially shielded from the energy shock.
- We expect a few negative quarters of GDP growth and a mild technical recession before growth recovers towards the middle of 2023. In the medium term, we see some risk to cost competitiveness due to continued rapid growth of labour costs.

Global gloom

There are many economic headwinds this autumn. High interest rates and inflation are starting to weigh on real economic activities. We are revising the outlook for 2023 and 2024 down, not least for the European economies, where the energy crisis is hitting hard. The upcoming winter will be particularly challenging.

Overall outlook

The continued rise in inflation and interest rates will dampen economic activity worldwide. In Europe, the ongoing energy crisis will push many countries into a recession in the near term. We are revising the growth outlook down for the US and euro area in 2023 and 2024. In addition, the outlook for China, with its falling real-estate sector and harsh zero-COVID strategy, remains dire.

The outlook for the next few months is particularly challenging, as inflation will stay high or increase further. Meanwhile, central banks will continue to tighten aggressively. On top of this, energy shortages will arise as demand increases during the winter. The sharp fall in asset prices adds further pain, and, in many countries, house prices are already on a falling trend. Economic activity is expected to drop beginning this autumn, while labour markets will take a hit next year. Longer out, however, there are some reasons for cautious optimism. A subdued demand will eventually ease inflationary pressures. At the end of 2023, we expect inflation to have dropped markedly in both the US and Europe, which will lead central banks to start cutting policy rates. This should pave the way for a gradual recovery in 2024.

Swedbank's global GDP forecast

Annual % change	2021	2022F		2023F		2024F	
US	5.9	1.8	(1.5)	0.2	(0.6)	1.5	(1.6)
Euro area (calendar-adjusted)	5.2	3.0	(2.8)	0.0	(0.5)	1.4	(1.9)
Germany	2.6	1.4	(1.1)	-0.8	(-0.5)	1.3	(1.9)
France	6.8	2.5	(2.5)	0.5	(0.5)	1.3	(1.8)
Italy	6.6	3.3	(3.3)	0.2	(0.6)	1.2	(1.8)
Spain	5.5	4.6	(4.6)	1.3	(1.9)	1.6	(2.2)
Finland	3.0	2.3	(1.8)	-0.3	(0.5)	1.3	(1.5)
United Kingdom	7.5	3.4	(3.5)	-1.1	(-1.2)	0.5	(0.2)
Sweden	5.1	2.7	(2.2)	-1.1	(0.2)	1.0	(1.5)
Denmark	4.9	3.0	(3.2)	-0.9	(-0.9)	0.7	(0.7)
Norway (mainland)	4.2	3.0	(3.2)	-0.5	(1.0)	1.4	(1.4)
China	8.1	3.5	(4.0)	4.5	(4.5)	5.0	(5.0)
Russia	4.7	-3.5	(-6.0)	-4.0	(-4.0)	0.5	(1.5)
Global GDP (IMF PPP weights)	**6.1**	**2.8**	**(2.8)**	**1.8**	**(2.0)**	**3.2**	**(3.4)**

Previous forecast in parentheses.
Sources: IMF & Swedbank Research

Significant risk of policy mistakes in Europe

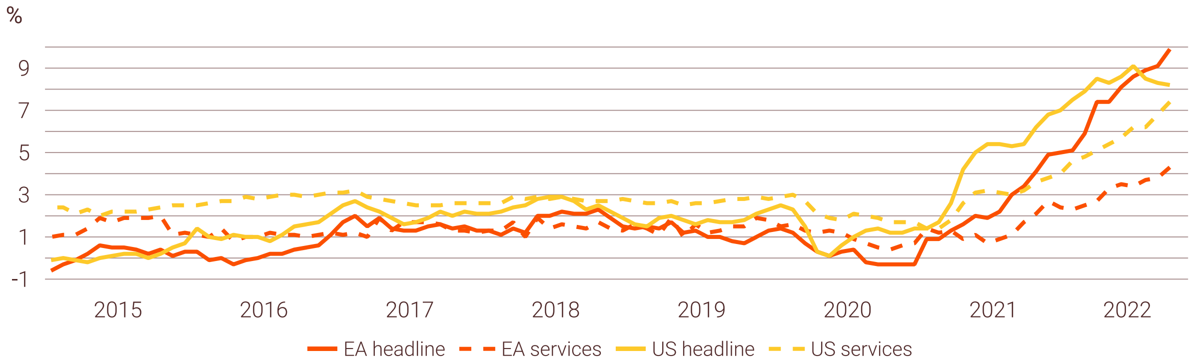
Although inflation has risen almost everywhere, its drivers differ. In the US, inflation is to a large extent driven by demand factors following the massive fiscal stimulus during the pandemic. The hot labour market has boosted wage growth, which will add to cost pressures and, eventually, consumer price inflation. Also, the energy situation is less severe in the US, especially since the oil price has come down in recent months; the negative supply shock is therefore muted. In this environment, the monetary policy response is clear-cut. To curb demand, policy rates have to be raised.

The European situation is different, as inflation is currently driven mainly by the energy crisis. Soaring energy prices have lifted consumer price inflation both directly and via firms passing on their increased energy costs to consumers. In Europe, there were signs of increasing demand following the pandemic–as in the US–but wage growth has remained muted despite tight labour markets. Hence, European inflation is to a larger extent caused by a negative supply shock (soaring gas and electricity prices) and to a lesser extent by demand. Consequently, real wages have fallen markedly, which will weigh on demand and eventually be disinflationary.

It is not obvious how monetary policy should respond in this situation. We forecast that most European central banks (the European Central Bank, Bank of England, Riksbank, and Norges Bank) will continue to raise their policy rates in the near term. The rationale for this could be to keep inflation expectations anchored and prevent currencies from depreciating further. Higher inflation expectations and weaker currencies would lead to more persistent inflation, which, in turn, could harm the real economies even more. That said, there is a risk that the monetary policy tightening in Europe will do more harm than good. The reason is that higher interest rates risk having a major impact on the real economy–not least in the interest-rate-sensitive Nordic countries–while having only a minor effect on supply-driven inflation. Thus, the European economies risk facing particularly hard times ahead.

In Europe, fiscal policy may come to the rescue, but risks for policy mistakes on this matter are also high. A cautious or passive fiscal response could lead to an even deeper recession, while too much stimulus could lead to more persistent inflationary pressures. Even more worryingly, unfinanced spending measures in countries with already weak public finances could pose a threat to financial stability, as investors may lose confidence in the sustainability of public finances. This is what happened in the UK.

Inflation higher in the Euro Area but services inflation remains higher in the US



Note: Refers to CPI in the US and HICP in the Euro area.
Sources: Swedbank Research & Macrobond

Bond yields set to stay volatile and elevated

Bond markets have been volatile and yields have continued up after the summer. Nordic bond yields have tracked their global peers closely. Central banks have front-loaded interest increases and signalled that they will stay on this path for some time yet. As central banks remain data-dependent, not preannouncing their intended policy steps, bond markets will remain sensitive to any news and data releases regarding inflation and labour markets.

The function of the bond markets has been challenged in some places. For this reason, the ECB has put in place a transmission protection instrument (TPI) to limit the bond yield spreads between core and periphery member states by buying more bonds in the latter. We are not ruling out that, as the recession hits, the ECB will be forced to do more to contain the transmission mechanism and to maintain market functioning in some sovereign debt markets. Also, the Bank of England (BoE) has intervened in the government bond markets, trying to calm down markets following the turmoil after the UK government's announcement of unfunded tax cuts. The UK gilt market saw a marked sell-off, which, in turn, triggered fire sales among leveraged pension funds as margin calls forced them to post more collateral.

We continue to see central banks lifting policy rates; hence, shorter-dated bond yields should increase over the coming months. Thus, rate curves should continue to flatten as central banks hike rates into a shallow recession.

Credit spreads to stay wide during the forecast horizon

Credit spreads have continued to widen, especially in Europe and for lower-rated companies. As the winter is set to leave a deeper scarring on the European economy, default risks have increased and investors are demanding higher compensation. Real estate and other rate-sensitive sectors are also seeing widening credit spreads. As growth slows, the number of bankruptcies will most likely rise. This, together with continued fears of a deeper recession, should increase companies' default risks and thereby keep credit spreads wide during the forecast horizon. Also, central banks will be late in offering any support to the slowing real economy. During 2024, as growth regains some footing, we expect spreads to narrow a bit.

US dollar dominance is expected to last

The US dollar has appreciated strongly throughout this year and is close to a multi-decade high. The yen has weakened markedly, as the Bank of Japan insists on maintaining its loose monetary policy. Meanwhile, European currencies have struggled. The energy crisis is weighing on the euro, while the low global risk appetite is weighing on the Swedish krona and Norwegian krone. In October, the Swedish krona hit its lowest level ever against the US dollar.

Looking ahead, we expect the US dollar dominance to continue for some time, as the US economy enjoys a higher momentum than the European economies and the Federal Reserve (Fed) is seen to continue outpacing most European central banks. US dollars also offer a liquidity premium over, e.g., the Swedish krona and Norwegian krone, which many investors will likely continue to enjoy as the economic winter approaches.

US – inflation will soon start to decrease significantly

The economy is slowing on a wide front, and we foresee a mild recession next year. The Fed is still concerned with persistently high inflation and labour market tightness and will continue to tighten monetary policy forcefully in the near term. However, we expect that it will start cutting interest rates at the end of next year.

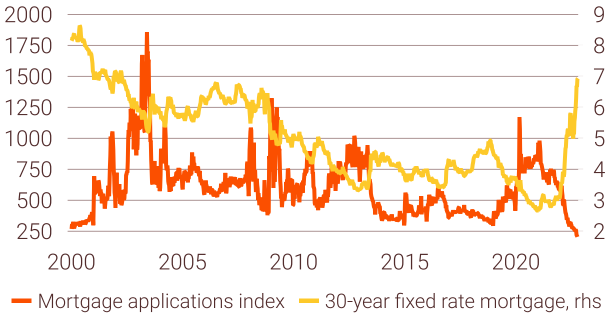
With the Fed continuing to raise interest rates on the back of persistently high inflation and a strong labour market, we expect that consumption growth will soon begin to contract. Higher interest rates will also mean lower investments, and, with the 30-year mortgage rate having risen to almost 7% – the highest level since 2002 – housing market activity will likely decline further. The economic slowdown that we expect in Europe and China will also lower US exports. Although the US economy is not currently in a recession according to the official definition of the National Bureau of Economic Research (NBER), we expect that it will enter one next year. Many short-term indicators, such as the ISM purchasing managers' index and the National Federation of Independent Business (NFIB) small business optimism index, have long been on downward trends. However, we think that it will be a relatively mild recession by historical comparisons. We expect that GDP will grow by 0.2% in 2023 and 1.5% in 2024.

While the monthly increase in nonfarm payroll employment remains robust, this has slowed in recent months, which, together with the decline in job openings, suggests that the previously red-hot labour market is cooling somewhat. As economic activity deteriorates, we expect this trend to intensify. The unemployment rate will then likely increase, but here, too, we expect the uptick to be relatively mild, given that employers have recently struggled to find workers and might think twice before laying off staff. The economic slowdown could also mean that more workers will want to return to the labour market, which could put downward pressure on wage growth.

Several factors, such as an easing of supply-chain issues, point towards a declining inflation, but price increases remain sticky. In September, the CPI decreased by less than expected, to 8.2%, while the CPI excluding food and energy increased to its highest level in 40 years, 6.6%. However, we expect that inflation will soon start to decrease more significantly, in large part due to the economic downturn, the Fed's tightening, and the unwinding of the large inventories in retail trade at discounted prices. Despite the high spot inflation, inflation expectations remain anchored.

Higher mortgage rates and lower mortgage demand

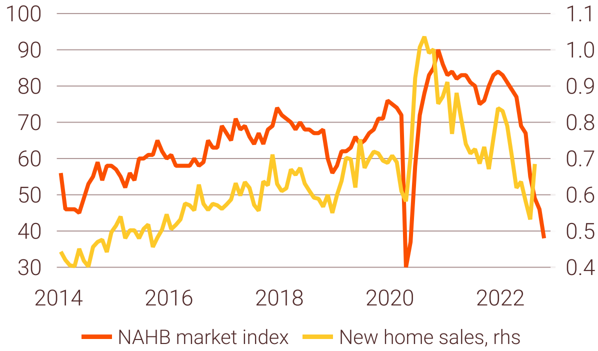
Index (lhs); % (rhs)



Sources: Swedbank Research & Macrobond

Declining activity on housing market

Index (lhs); Millions (rhs)



Sources: Swedbank Research & Macrobond

The Fed has embarked on a historically fast monetary-tightening cycle. The federal funds rate has been raised by 300 basis points (bps) so far this year, including by 75bps three meetings in a row. We expect a fourth hike of 75bps in November, followed by 50bps in December and a final 25bps in February. If true, this would entail a terminal rate within a target range of 4.50-4.75%. We expect that the Fed will start cutting rates at the end of next year, when inflation has had time to come down and growth remains weak.

Euro area – a recession is looming

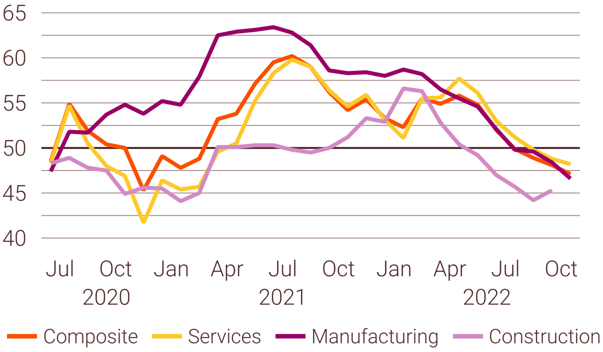
Besieged by slowing global demand and soaring energy costs, the euro area economy is expected to slow sharply. During the cold months, a recession is likely. Governments are scrambling to support falling household real incomes while ensuring sufficient energy supplies. The ECB is tightening policy aggressively, but the rapidly cooling economy will force policymakers to stop early next year.

Sentiment indicators across sectors and countries have been flashing red over the past couple of months. The composite purchasing managers' index suggests a moderate GDP contraction already in the third quarter of this year. In the first half of 2022, growth was strongly supported by the an upswing in services activity, which has since faded. The manufacturing sector is in focus, as it is the most vulnerable to an energy squeeze and global slowdown. New orders in manufacturing weakened substantially, but the backlog of orders from the past couple of years is so large that orders might not be a problem. Not all is gloomy, even in manufacturing, as supply-chain issues are easing, and less-energy-intensive industries are still increasing production.

The ongoing energy crisis is still the primary problem for both the growth and inflation outlooks. Europe has successfully filled storage for the winter, and has managed to attract a lot of liquefied natural gas from other markets to replace most of the missing Russian gas flows. Natural gas prices spiked sharply to more than EUR 300/MWh when the flows through Nord Stream 1 pipes stopped, but they have since fallen more than 50%. However, further volatility and price spikes in energy prices are expected. There is enough natural gas incoming and in storage for an average European winter, but gas markets will remain very sensitive to weather and to any disruptions to the incoming gas flows and infrastructure.

Euro area PMI signals contraction

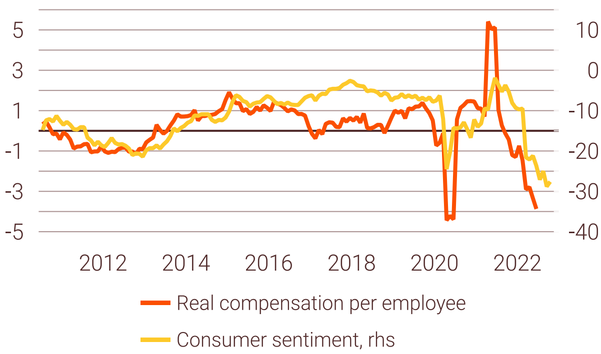
Index



Sources: Swedbank Research & Macrobond

Real incomes are devastated

y/y % (lhs); index (rhs)



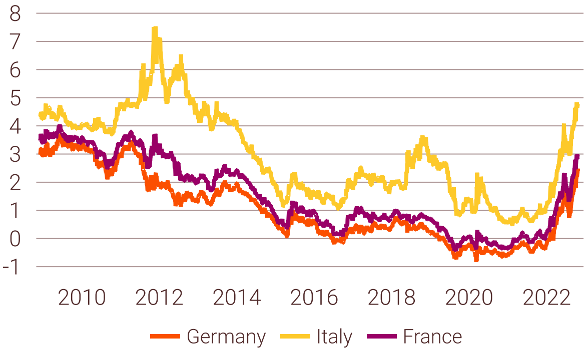
Sources: Swedbank Research & Macrobond

The labour market continued to improve, and unemployment in the euro area is at an all-time low of 6.6%. Nominal wages have picked up slightly but are far behind the 9.9% inflation currently observed in the euro area. The loss of purchasing power is weighing on consumer confidence and will lead to a contraction in consumption. However, governments will not sit idle. Support packages are being prepared across Europe to ease the energy costs for households and companies. Some of the measures will be financed through windfall taxes. In many cases, this will require additional borrowing, but, overall, these measures will add some needed support to household disposable income. Germany's announcement of a generous fiscal package amounting to more than 5% of GDP sparked divisions among other EU states, because not all countries have the fiscal space to match it and an uneven distribution of fiscal aid might distort the competitive environment in the single market.

Inflation will remain elevated during the coming months but will start easing gradually early next year. We expect average annual inflation to reach 8.3% this year and 5.1% in 2023. The easing of supply-chain issues and lowering of shipping costs ought to help reduce inflation substantially during the next 12 months.

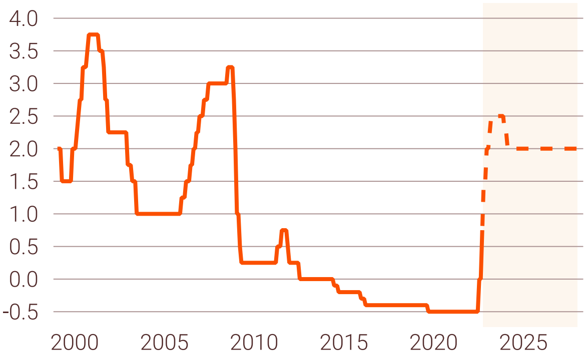
The euro area economy is likely to contract during the next couple of quarters. Because fiscal policy will support households and prevent a wave of bankruptcies, we expect the downturn to be shallow, without major negative consequences for the labour market. However, energy-supply problems could persist for a few years. This year, storage was filled, with Russian gas at least partly flowing; this will not be the case in 2023-2024. High energy prices in the medium term might spell economic weakness in the medium term.

10-year sovereign bond yields



Sources: Swedbank Research & Macrobond

ECB Deposit facility rate



Sources: Swedbank Research & Macrobond

In the most rapid tightening seen in two decades, the ECB has raised the deposit facility rate to 0.75% over the past couple of meetings. Currently, a hawkish mood prevails in the Governing Council, and the ECB is expected to continue hiking rates at an accelerated pace. We expect base interest rates to be increased by 75bps and 50bps in October and December 2022, respectively, followed by another two hikes of 25bps in February and March 2023. At this point, a neutral policy rate will have been reached or exceeded, while receding inflation and economic weakness are likely to warrant a pause in monetary tightening. Furthermore, we think that, against this economic backdrop, the ECB will have to make two 25bps cuts at the end of 2023 and early 2024.

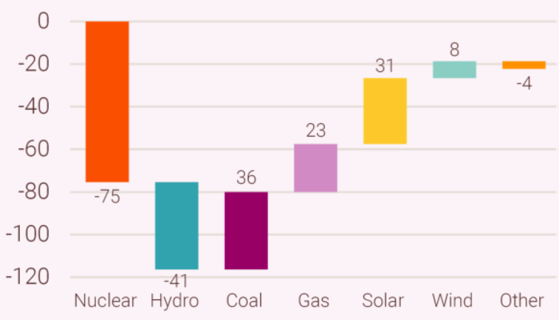
Admittedly, an expansionary fiscal policy will cushion the economic downturn and could give the ECB space to continue hiking interest rates longer (current market expectations are closer to 3%, compared with our forecast of 2.5%). However, an expansionary fiscal policy and monetary tightening could lead to financial stress in the euro area. In this environment, quantitative tightening would be very dangerous; thus, we do not see the ECB's balance sheet shrinking in our forecast horizon. It is quite likely that the ECB will have to use its balance sheet actively to ward off financial fragmentation risks in the sovereign bond market.

EU-electricity generation affected by extreme weather in an already sensitive situation

Europe has been in an energy crisis following Russia's invasion of Ukraine and the rapid decline in natural gas imports from Russia. In addition, over the course of the year, the situation has been aggravated by other factors that have led to reduced electricity generation. According to the energy organisation Ember, the EU had a 75 TWh decline in nuclear power generation between March and September 2022 compared to the same months in 2021. The lower generation was partly due to summer heat waves leading to drought and that river water has been too warm to cool nuclear power plants, in France in particular. As a result, some nuclear power plants have had to cut generation or to stop production. In addition, maintenance that was postponed during the pandemic has led to major shutdowns in France, and in Sweden, the annual maintenance has been extended, which has also contributed to the decline. The drought has also reduced hydropower's share of electricity generation. At the same time, we have seen an increased use of coal to meet energy demand, which leads to increased emissions.

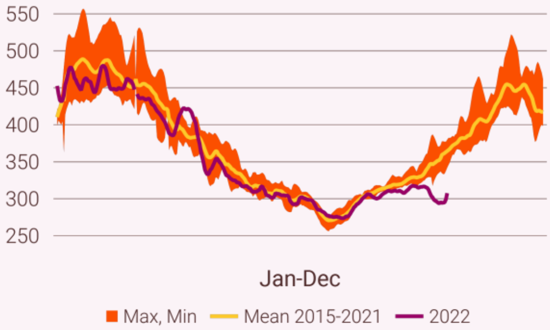
A few rays of hope are also visible, however. During the same period, solar and wind power grew at a record rate in the EU, resulting in a 39 TWh increase in March-September 2022 compared to the same months in 2021, and thus accounting for a larger contribution of TWh than coal. According to Ember, the EU saved more than EUR 11 billion in avoided gas costs on the increased solar and wind power. There are also indications that electricity consumption is decreasing. In Sweden, total electricity consumption decreased by about 4% in September (vs. Sep. 2021), according to Svenska kraftnät, but households reduced consumption by much more than that. If the decline continues even during the darker and colder months, the risk of forced power cuts becomes significantly smaller. The energy crisis has exposed several important challenges in the European and Swedish energy systems, which will not be solved in a year's time. At the same time, there are rays of light indicating that adaptation could be faster than first thought possible.

Change in EU electricity generation
March-September, 2022 vs 2021 (TWh)



Sources: Ember, Swedbank Research

Swedish energy consumption
TWh/day, 1wma



Sources: Swedbank Research & Macrobond

China – the economic slowdown intensifies

Economic activity continues to be held back by the zero-COVID policy and property sector downturn. Net exports will also likely weaken going forward, adding downside risks to growth. We expect that GDP will grow by just 3.5% this year.

COVID-19 outbreaks flared up again during the third quarter, leading to several lockdowns across the country. Despite this, economic activity recovered somewhat, with increases in retail sales and industrial production. Still, we do not expect any significant easing of the zero-COVID policy until well into next year, and this will continue to hamper growth.

There is also still no light at the end of the tunnel for the property sector downturn. Property investment has been 8% lower this year than last year, and housing prices have now fallen for 13 months in a row. The People's Bank of China has continued to cut interest rates recently, including the five-year loan prime rate (a reference for mortgages), and urged banks to boost loans to stabilise the property sector and promote growth.

China's strong net exports were – last year and until recently – one of its economic drivers. We expect that export volumes will weaken going forward, adding further downside risks to growth. Demand for Chinese exports is likely to wane due to the global economic slowdown and the spending cutback by consumers in China's important trading partners on account of high inflation and their shift in consumption away from goods to services.

The 20th National Congress of the Chinese Communist Party took place on 16–22 October. As widely expected, Xi Jinping was confirmed as leader of China for an unprecedented third term, and the new Politburo Standing Committee, China's top governing body, will be made up of members who are close to him. This cements Xi Jinping as the country's most powerful leader in decades, and will likely entail more policies closely associated with him, such as Common Prosperity. Hence, we do not foresee any major changes to overall economic policy, including the zero-COVID policy.

United Kingdom – political turmoil and a credibility crisis add pressure to the BoE

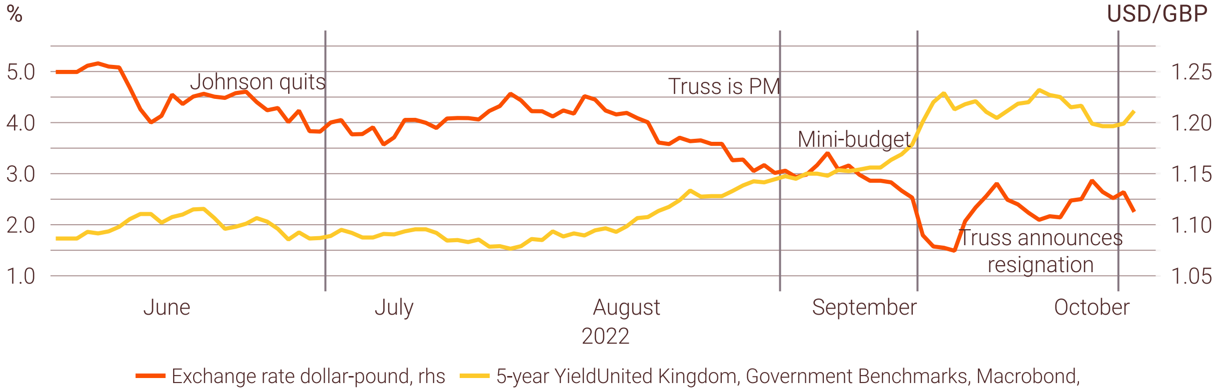
The pressure is high on both the incoming political leadership and the BoE to regain credibility and stability for the economy after weeks of political turmoil. Growth is being dragged down by a shrinking labour force and weak household consumption. The shape of fiscal policy will continue to be a balancing act going forward and is a risk to the outlook and monetary policy.

The UK has seen plenty of political turmoil in the last couple of months and, especially, weeks. Rishi Sunak was recently elected as new leader of the Tory party and will thereby succeed Liz Truss as Prime Minister. Truss, who delivered her resignation as a result of falling political support, made a steep U-turn in mid-October by reversing almost all tax cuts previously presented in a fiscal package, the "mini-budget", in order to stabilise financial markets and prevent the situation from turning into a financial crisis. The energy support package was also limited to run for a shorter period. The BoE had previously stepped in to ensure financial stability and announced temporary bond purchases, barely a week after its latest monetary policy decision in which active gilt sales were announced and the policy rate hiked. The credibility of the political leadership, and of the BoE, is hanging by a thread. But the situation also highlights how, in some situations, monetary policy depends on fiscal policy–a challenge we believe more countries will face going forward.

The UK economy grew by 0.2% in the second quarter, but GDP is still below the pre-COVID level. A shrinking labour supply, caused by Brexit and the pandemic, together with high energy prices, is part of the explanation. Moreover, the outlook for the third quarter looks grim, and the monthly GDP for August indicates that the economy contracted. Going forward, we expect a higher interest rate, weak household consumption, and falling investments to further drag on growth.

Inflation has increased to 10.1%. The price pressure is broad, and for 80% of the UK, consumer basket annual price increases exceed 4%–a far larger share than in, e.g., the euro area and the US, according to the OECD's latest *Economic Outlook*. The UK economy is more directly exposed to wholesale gas prices than many other economies, but there are also signs of domestically generated inflation, with steep price increases in services and core goods prices, among others. We expect continued tightening throughout this year from the BoE, which needs to protect its credibility as a guarantee of financial and price stability. We foresee a lifting of the policy rate from 2.25% to 3.50% by end-2022, and then expect the policy rate to be unchanged until end-2023, when the BoE will start cutting rates to gradually approach the neutral rate by end-2024.

Political turmoil weakens the pound; 5-year yield curve surge



Sources: Swedbank Research & Macrobond

Nordics – interest-rate sensitive households

The Nordic countries are expected to enter a recession in the coming year. Households are interest-rate sensitive, while public finances remain solid.

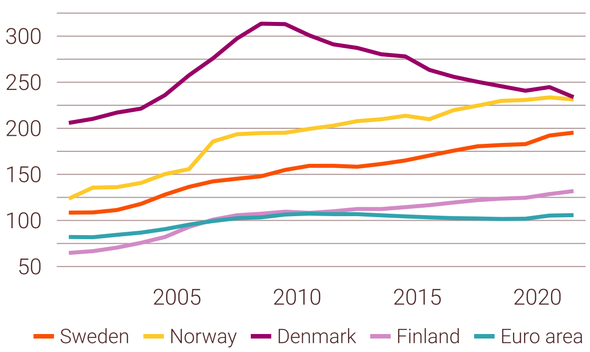
High inflation and increasing interest rates are affecting household consumption, the housing market, and business investments. The monetary transmission mechanism is expected to work quickly due to the high household debt and large share of flexible-rate mortgages, especially in Norway and Sweden. The Riksbank and Norges Bank are expected to end the hiking cycle at 3% and then start cutting rates in about a year, when growth has slowed and inflation has started to ease.

The housing market will take a hit. In Sweden, housing prices peaked already in February and have dropped by close to 10% since. Recently, the housing market has cooled down in the rest of the Nordics as well. In Norway, housing prices started to decline in September, and in Denmark monthly price indicators suggest that prices have started to fall. In Finland, prices of old dwellings were muted in August. We expect housing prices to continue to fall as long as mortgage rates are increasing. The largest fall from top to bottom is expected in Sweden, one reason being the faster price increase during the pandemic.

The labour market has continued to show resilience, and labour shortages remain large. The slowdown in the economy will, however, have an impact going forward. We expect rising unemployment, although to a lesser extent than during the pandemic and to different degrees across the Nordic countries.

Household debt higher in the Nordics

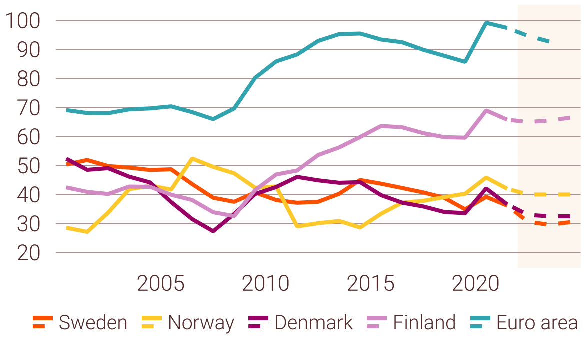
% of disposable income



Sources: Swedbank Research & Macrobond

Government debt lower in the Nordics

% of GDP



Note: Forecast for Euro area from European Commission
Sources: Swedbank Research, AMECO & Macrobond

For better or worse, the Nordic countries have presented less expansionary support measures to mitigate high energy costs than those presented in several other European countries. Public finances remain strong in the Nordics. Most notably, the electricity support package that has been in place since December 2021 in Norway is reducing headline inflation by about 3 percentage points. In Sweden, the new government will soon present the budget for next year, and, although we expect considerable support measures, most of these will be financed by the government's extra income from the high energy prices. The support schemes in Denmark are also financed, while in Finland, the general government budget deficit is expected to amount to 2% of GDP next year.

Sweden – awaiting a chilly winter

The Swedish economy is slowing markedly. We expect consumption to decline as households' purchasing power falls. The number of housing starts will drop substantially on the back of higher interest rates. The labour market is still showing resilience, but the situation will deteriorate as employment-intensive industries, such as retail trade and construction, suffer. The Riksbank will continue to fight inflation in the near term. When inflation falls back down next year, the Riksbank is expected to soften monetary policy and to start lowering its policy rate by the end of 2023.

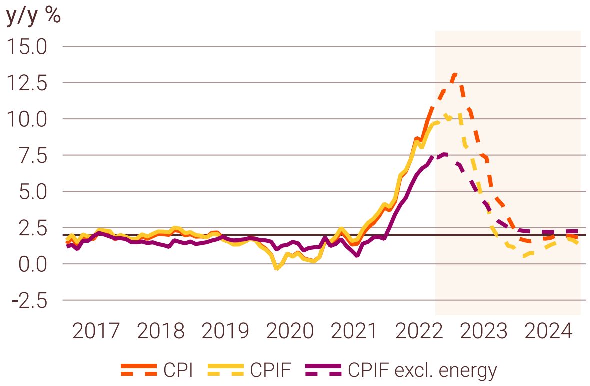
Inflation to fall back in 2023

The high inflation rate continues to have a major impact on the Swedish economy. In September, inflation rose to a new height, at an annual rate of around 10%. We expect inflation to continue to rise, and to peak in early 2023, but volatile electricity prices mean that the forecast is more uncertain than usual. In addition to energy components, price pressures remain broad-based, covering both goods and services. However, there are signs of some deceleration, with smaller price increases than in the first half of the year.

Looking ahead, the outlook for inflation is mixed. In the short term, the weak krona is contributing to higher prices for imported goods and services. The weakening of the krona, together with rising energy prices, also adds to firms' production costs. In addition, new price increases in the form of rising rents and fees in tenant-owner associations are in the cards. Higher wage growth is also expected to lift inflation somewhat, going forward. At the same time, global supply disruptions have eased, and shipping costs are falling significantly. Non-energy commodity prices are falling as well. The sharp slowdown in economic activity limits the scope for new price increases, especially in the consumer durables sector, which is already suffering from weak demand and large inventories. There are also reasons to assume a more moderate price development for different types of services, such as hotels & restaurants and leisure.

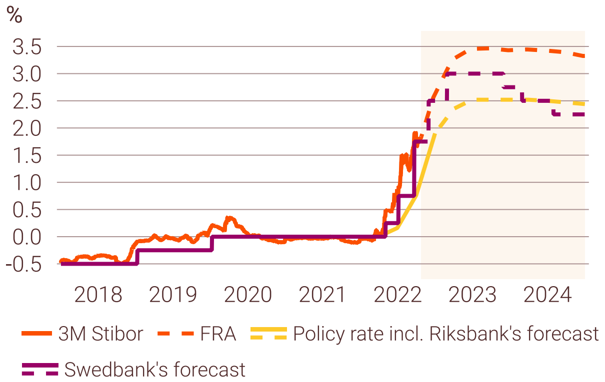
We expect inflation to decline over the course of 2023 and 2024. However, underlying inflation, measured as the annual rate of CPIF (the price index at a fixed interest rate) excluding energy, will

Inflation rises for now, but eventually declines



Sources: Swedbank Research & Macrobond

The Riksbank will lower rates already next year



Sources: Swedbank Research & Macrobond

remain higher than 2%, according to our forecast. Over the course of 2024, we believe that the situation in the energy market will stabilise somewhat, slightly lowering electricity prices; this means that CPIF inflation will fall below the 2% target.

The Riksbank is moving faster but will soften its approach next year

The sharp and broad rise in inflation means that the Riksbank will tighten monetary policy significantly in the near future. We expect the Riksbank to raise its policy rate by 75 basis points (bps) to 2.5% in November, and by 50bps to 3.0% in February (the latter under the new Governor of the Riksbank, Erik Thedéen). The Riksbank's securities holdings, which increased sharply during the pandemic, will decline at a rapid pace during the next few years; this will also contribute to monetary policy tightening. However, as activity and inflation decline, the Riksbank's priorities will shift slightly. Households are under severe pressure, and the need to tighten monetary policy is subsiding. In just over a year, the Riksbank will, therefore, begin a series of interest rate cuts totalling 75bps, which will ultimately result in a policy rate of 2.25%. This is roughly what the current Riksbank Governor, Stefan Ingves, has described as a neutral interest rate for economic activity. However, there is great uncertainty about this level.

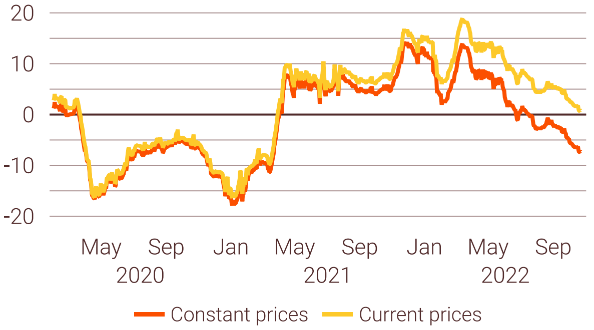
Economic activity will shrink next year as households tighten the purse-strings

High inflation and rising interest rates mean that households and businesses face significantly higher costs. For households, the deterioration of purchasing power, including falling real wages, at the same time as the sharp decline in the stock market has led to record-low sentiment. Now the confidence among companies is also beginning to deteriorate. For both households and businesses, the burden will be partly alleviated by the promised cost ceiling for high electricity prices. But the large debt held by households and some companies, together with many of them having floating interest rates on their debt, means that interest expenses are now rising rapidly.

Since the lifting of the pandemic restrictions last winter, household consumption patterns have become increasingly normalised, and services consumption has risen rapidly. Households are now spending less on durable goods, such as home electronics, home furnishings, and building materials. We foresee that the weaker purchasing power will mean that households will continue to spend less on durable goods and, eventually, less on, restaurant services and other entertainment-related services, for example. As inflation falls, purchasing power will improve, but we still expect the recovery in consumption to be weak in 2024. All in all, this means that household consumption will fall by just over 1% next year and will grow only by a little more than 1% in 2024.

Consumption drops due to high inflation

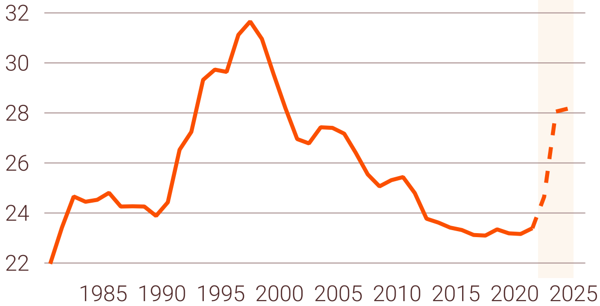
Transaction turnover, y/y %, 4wma



Note: Deflated by CPIF excl. electricity. Swedbank's forecast is used in Oct.
Sources: Swedbank Pay & Swedbank Research

Housing costs increase to 1990s level

% of disposable income



Note: Households' expenditures on rents & fees, mortgage rates, electricity and other housing costs. Assumes unchanged usage.
Sources: Swedbank Research & Macrobond

The chill in the housing market continues. All indicators point to further price falls, e.g., there is now a large number of unsold homes, which has generated unusually long times on the market; at the same time, homebuyers are likely to feel uncertain about how high mortgage rates will rise. In addition, the anticipated weak income developments will contribute to a wait-and-see mood among homebuyers. But, in the long run, there are some factors to suggest that the price decline will subside, and that the growth rate will level off. For example, in the long run, there will not be as much newly produced housing, as housing investments will be almost halved during the forecast period; this, together with demographic factors and slightly lower mortgage rates at the end of the forecast period, may contribute to a somewhat balanced situation in the housing market. Overall, housing prices in Sweden are expected to fall by 15-20% from the peak in February 2022 to the bottom in the first half of 2023.

Investments are falling sharply in the wake of increased construction costs, higher interest rates, and reduced demand. This applies to both new production and renovations, where household renovations have probably contributed. Many companies will experience higher rents and rising interest expenses at the same time as a deterioration in their sales numbers. We expect that this will result in business investments falling slightly throughout the forecast period. Lockdowns during the pandemic led to major disruptions in global supply chains, and, in order to avoid future shortages of components or goods, many companies have built up inventory. In some cases, stocks may have become too large, especially as demand is faltering in sectors such as retail trade, and we therefore expect that these stocks will need to be sold off.

Indicators such as the purchasing managers' index, the economic tendency survey from the National Institute of Economic Research (NIER), and Business Sweden's export managers' index show that expected new orders have slowed during the past six months. Given the increasingly gloomy global outlook and the energy crisis in Europe, we expect that the Swedish export industry will generally face worse times ahead, with reduced demand. On the other hand, we expect that, e.g., the Swedish defence industry and the industry related to the green transition will develop better and partially compensate for lost demand in other industrial sectors. Public consumption is also expected to contribute slightly more than usual to Swedish GDP in the coming years. This boost in public consumption is explained by demographic factors, such as the larger proportion of older and younger people, as well as by the increased spending on defence.

All in all, we expect Swedish GDP to shrink by almost 1% next year and to recover somewhat over the course of 2024, when it will instead grow by 1%.

The labour market is gradually deteriorating, and some industries stand out

The labour market has shown great resilience, but, going forward, we expect it to deteriorate as the economy slows. We believe that industries such as consumer durables, construction, and hotels & restaurants will be hit extra hard when households spend less on nonessential consumption. We foresee a relatively moderate rise in unemployment, as global demand will not deteriorate as dramatically as during the pandemic. However, the recovery in 2024 will be slow and protracted, as many employers will be cautious.

The need for increased employment in the public sector is significant as a result of, among other things, the expected increased demand for health care and investments in defence. At the same time, there are major mismatching problems, which is preventing the needed increase in the number of new employees. In addition, the finances of regions and local governments will deteriorate in the coming years. Larger government subsidies are necessary for the realisation of employment plans.

Ahead of this winter's round of collective agreements negotiations, the situation is unusually complicated. Inflation is high, which has resulted in a large drop in real wages. We believe that the negotiated wage increases will be higher than the current agreements because workers held back during the pandemic and the high-cost situation is now affecting households with the smallest margins the most. Wages in Norway, Denmark, and Germany, e.g., have risen more than usual, which suggests greater wage increases in Sweden as well. If it becomes very difficult to reach agreement, lump sums paid for the current year may come into the picture; there is also the risk that the agreements will be shorter than the three years that are usually sought.

Fiscal policy supports without compromising public finances

Fiscal policy is an important piece of the puzzle for future development; in the short term, it is all about supporting vulnerable households and companies without creating new problems, such as what has happened in the UK. The newly appointed government will soon present the budget for next year, and details of the high-cost protection scheme for electricity will most likely not be announced before then. We expect fiscal policy to be supportive, but without jeopardising Swedish public finances.

The high-cost protection scheme for electricity is expected to amount to SEK 100 billion, which will be paid out retroactively next year and distributed evenly between households and companies. Most of the support is financed. According to our calculations, households' electricity costs will increase by SEK 40–60 billion and total housing costs by around SEK 140 billion during the second half of 2022 and first half of 2023, compared with the corresponding period the year before. A support payment of SEK 50 billion to households is thus significant in relation to the cost increase, but the effectiveness of this support will depend largely on how it is distributed. In addition to subsidies on electricity bills, the new government has announced, among other things, that fuel prices will be reduced and that the temporary hike in unemployment benefits during the pandemic will be made permanent. We also expect that grants to the municipal government sector will be increased next year and in 2024 as a result of the sharply rising cost situation and demographic developments. We believe that the announced tax cuts on employment income and for pensioners will be delayed until later.

In total, we expect unfunded measures to amount to SEK 50 billion in 2023 and SEK 20 billion in 2024. This means that public finances will, in principle, be in balance next year and will show a minor deficit in 2024. The public debt as a share of GDP will reach around 30% of GDP in 2024, which corresponds to the lower end of the debt anchor.

Norway – the peak policy rate is near

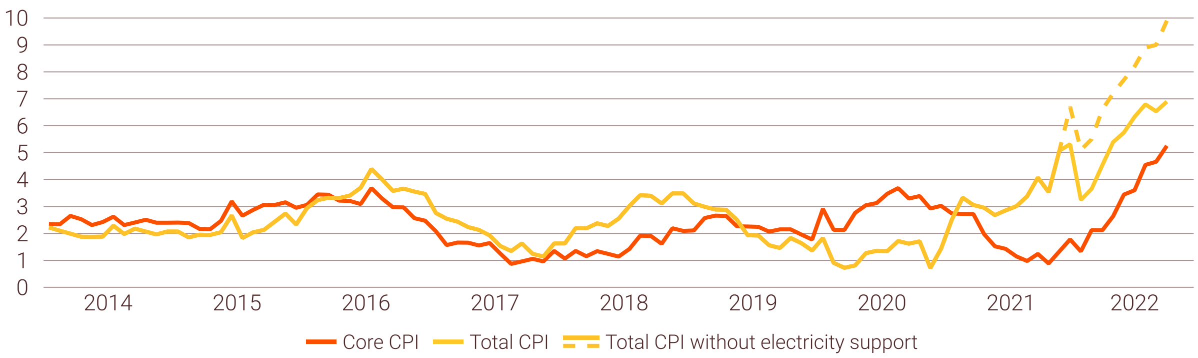
We expect economic activity in 2023 to be weak, led particularly by a deteriorating situation for households. Norges Bank is expected to end its hiking cycle at 3.00% this year, and we forecast rate cuts to start already in September 2023.

The Norwegian economy has been on full throttle during the past few quarters but will likely hit the brakes hard over the coming year. The Regional Network Survey from September painted a picture of a divided economy, with oil and business services likely to continue expanding, while the more household-oriented industries will face tougher times ahead. The outlook for households is weakening, with higher interest rates, reduced purchasing power, and record-low consumer confidence. Precautionary savings cannot be ruled out in light of heightened uncertainty and pessimism going forward, which could lead to an abrupt and sharp fall in consumption. An anticipated solid increase in petroleum investments and fiscal spending will cushion the fall next year.

The labour market remains resilient for now, although a slowly rising unemployment rate should be expected going forward, in line with slower growth. Registered unemployment has fallen to 1.6%, matching the lowest level ever recorded, last seen in 2008. With bleaker growth prospects ahead, and companies struggling with large electricity bills, a rise in the unemployment rate is inevitable going into the winter months. The number of new vacancies continues to fluctuate around a record-high level but has so far not started to decline markedly. Labour shortages are moderating somewhat. We expect wage growth to come in at 4.1% this year and to moderate to 3.8% in 2023.

Inflation keeps beating expectations, and prices are increasing materially across all product groups, as higher electricity and financing costs propagate through pricing behaviour and companies protect their margins. Headline CPI rose by 6.9% on an annual basis in September. It would have been 9.9% without the electricity support package that has been in place since December 2021. Core CPI, excluding energy and taxes, came in at a record-high 5.3% in September, while other measures of core inflation are even higher. Imported price growth is affected by the elevated global inflation, and the weakening krone will also contribute to keeping imported goods' price growth high. Domestic price pressures will remain strong in the short term amid the tight labour market and a continued surge in financing, food, and energy prices. We estimate that core inflation will stay above 5% for the remainder of this year, and probably remain above 4% for the majority of next year.

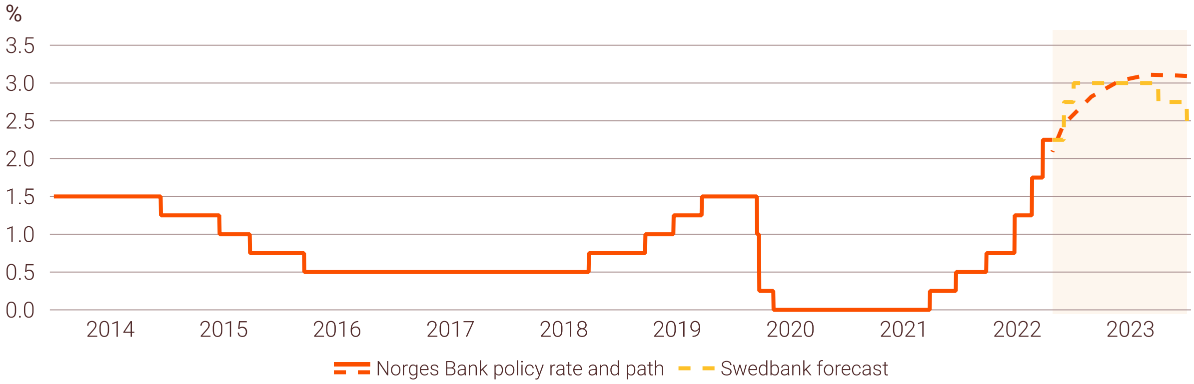
High inflation but the electricity support eases the burden



Sources: Swedbank Research & Macrobond

Monetary policy will be tightened further ahead, but we expect Norges Bank to start cutting rates already next year. Norges Bank delivered a third 50bps hike in September, leaving the policy rate at the current 2.25%. A 25bps hike at the November interim meeting is signalled by the rate path, but we foresee a fourth consecutive 50bps hike due to several factors. Inflation coming in higher than expected and on a broad base with very few signs of slowing, a lower unemployment rate and stronger GDP growth than anticipated, a less contractionary fiscal budget, a weaker krone, and higher oil prices are all arguments speaking in favour of a necessitated continued hawkishness by the central bank. Whether or not we will get another hike in December, and what the size of that potential hike might be, will be highly data-dependent. Norges Bank has hiked much faster than normal, and the effects on the economy are seen to be both larger and faster than during previous hiking cycles. Thus, we would like to see Norges Bank take its time to assess the lagged effects of higher rates on the economy. Norwegian households are among the most rate-sensitive in the world, with 95% of mortgages having floating rates. Although we forecast a 25bps hike in December, which would leave the peak policy rate at 3.00%, the important Regional Network Survey, to be published in early December, could send such a weak signal that Norges Bank would end its hiking campaign already in November, at 2.75%. As the economy will be slowing fast during the first half of next year, we expect Norges Bank to start cutting rates in September 2023.

Policy rate will reach 3% but rate cuts will begin already in September 2023



Sources: Norges Bank, Swedbank Research & Macrobond

Housing prices started to decline in September amid mortgage-rate hikes and a rapidly increasing supply side. In addition to a market balance in which demand is cooling and supply is rising, the expectation of more rate hikes, along with somewhat slower household credit growth, reduced purchasing power, and a weaker growth outlook, speaks in favour of a continued decline in housing prices in the coming months. However, we do not expect a decline in such a manner as we are seeing in, e.g., Sweden, as long as the credit channel is not negatively affected. The Norwegian Financial Supervisory Authority (FSA) has recommended that mortgage requirements be tightened, but we do not expect the Minister of Finance to follow this advice. A still-strong labour market and decade-low construction completions, as well as increasing immigration, could contribute to cushioning declines in housing prices.

Denmark – incoming election and recession

The Danish economy is expected to contract after an exceptional recovery from the pandemic. Higher interest rates will cause housing prices to fall.

Prospects are for a considerable slowdown in the Danish economy for the coming year. Inflation will increase further this winter, eroding household purchasing power, while residential investments are expected to contract. However, exports will continue to grow, as well as government consumption. Overall, GDP is expected to decline by 0.9% in 2023 and to grow by 0.7% in 2024.

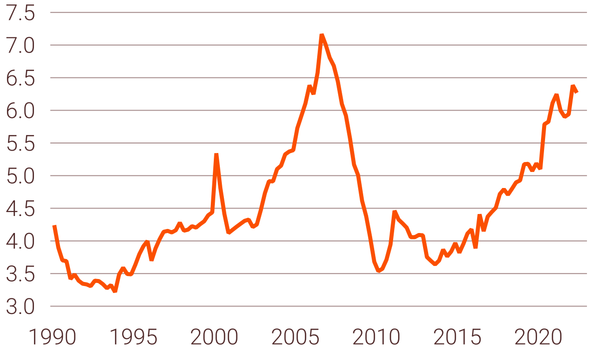
The construction sector thrived during the pandemic, and residential investments have increased to their largest share of GDP since 2006, after which they fell markedly. The sector is now again losing momentum on the back of rising interest rates and costs, as well as lower demand. Housing starts are declining, and residential investments are expected to deteriorate in the coming years, although not to the extent of the downturn after 2006. Although lower supply could support prices, the steep increase in mortgage rates works in the opposite direction. There are clear indications that a slowdown is under way, especially in trading activity. Prices of houses and flats have also started to drop recently. We expect housing prices to decline going forward, although remaining above pre-pandemic levels.

Households' purchasing power is being eroded by the high inflation. We expect inflation to increase further this winter due to high electricity prices, before starting to ease next year. In addition to lower global commodity prices, a temporary reduction in the levy on electricity and a new ceiling on housing rent increases will contribute to the slowdown. The housing rent ceiling will cap increases to 4% per year over the next two years and replaces the current rules that landlords are allowed to increase rents in line with inflation. The cap eases the situation for households, while worsening the outlook for property owners. The election to Parliament is set to 1 November, and opinion polls suggest a close race. During the election campaign, few promises of additional support schemes have been made, and most parties agree on the need for a contractional fiscal policy, due to a very tight labour market and high inflation.

Danish industrial production has grown by around 10% since the turn of the year. Although we expect a slowdown as global demand decreases, production is expected to continue to grow as Danish exports are less cyclical, due to large shares for pharmaceuticals, wind turbines, and food.

Residential investment close to historical high

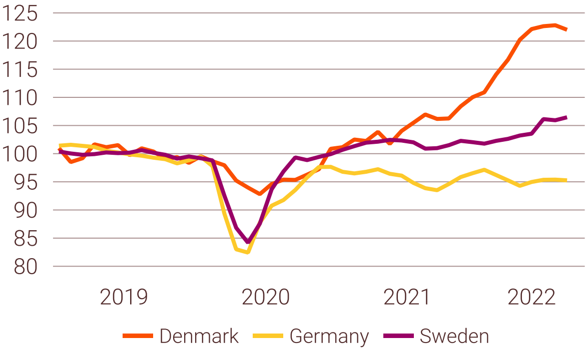
% of GDP



Sources: Swedbank Research & Macrobond

Industrial production is resilient

Index (2019=100), 3mma



Sources: Swedbank Research & Macrobond

Finland makes a soft landing

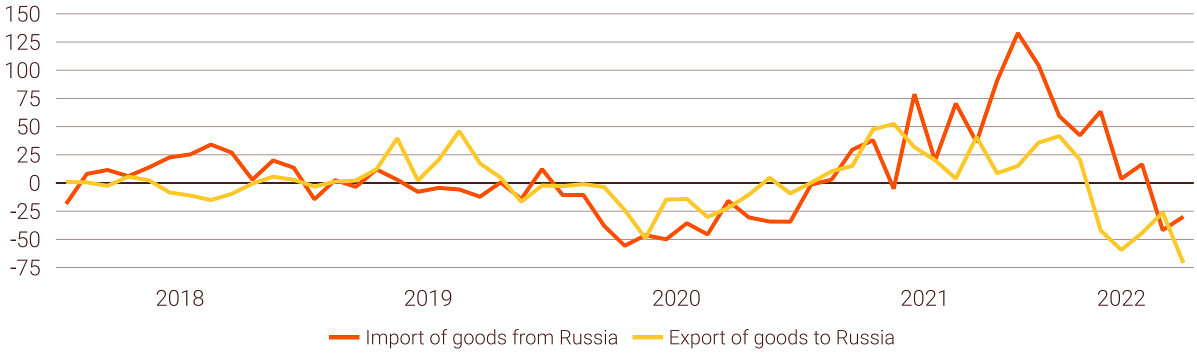
Weakening demand is slowing Finnish economic growth, and we expect a mild and temporary recession next year. Consumer price inflation will ease in 2023, but it will take time before it returns to more normal levels.

Economic growth in Finland was strong in the first half of the year, and GDP increased by 3.5% year on year. The growth was quite broad; only wholesale and retail trade and agriculture and forestry contracted. However, the second half of the year is considerably weaker. Deteriorating demand is worsening the outlook, and we expect that GDP will drop slightly next year. We forecast a recovery of 1.3% in 2024 as purchasing power will start to increase gradually and foreign demand improves.

Foreign demand from Finnish trade partners will worsen in 2023, which will limit export growth. Like those in many other European countries, Finnish enterprises have substantially increased their inventories due to uncertainties in supply chains. Inventories picked up to 4.7% of GDP in nominal terms in the second quarter this year–the highest ratio in at least 32 years. Thus, the gap between production and sales, including exports, has been particularly large. We expect that enterprises will run down their inventories as supply bottlenecks are easing and demand is weakening. Finland has substantially reduced trade with Russia. In August, exports of goods to Russia decreased 71% and imports decreased 57% on a yearly basis, in nominal terms. This has reduced the share of goods imports from Russia from 13.7% in February to 4% in August, while the share of goods exports to Russia has decreased from 5.3% to 1.2%.

Trade between Finland and Russia has dropped substantialy

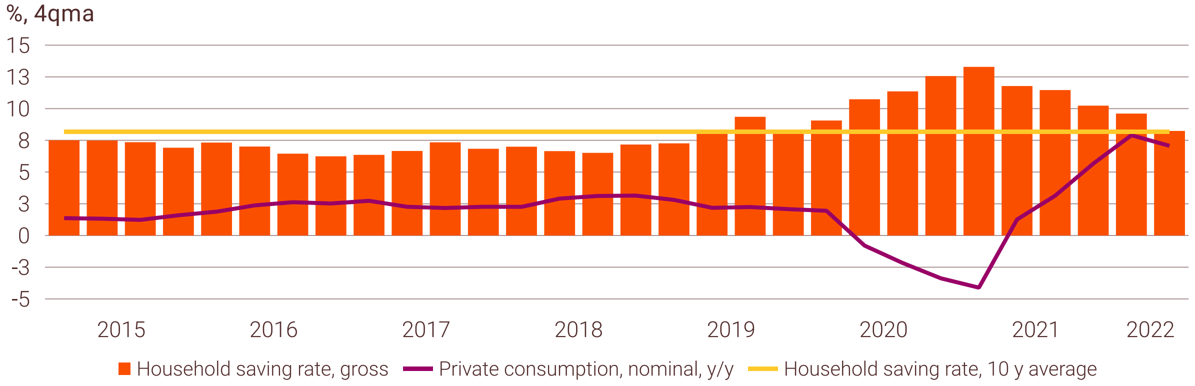
y/y %, nominal



Sources: Swedbank Research & Macrobond

Consumer price inflation is expected to remain high in the coming months, but weaker demand and slower growth in energy and global commodity prices, as well as supply bottlenecks, are expected to ease inflation in 2023. We forecast that consumer price inflation will slow from 6.9% this year to 4% in 2023. High inflation has reduced households' purchasing power, while consumer confidence has dropped to the lowest level in at least 27 years. At the same time, an increasing number of employees and large savings have contributed to consumption growth. The robust growth of private consumption has reduced the household savings rate closer to the long-term average. The worsening economic conditions and outlook have slowed employment growth, and we expect employment to expand only very modestly in 2023. In line with the continued drop in purchasing power, private consumption growth will be substantially limited next year. Even though enterprises are facing hard times in the economy, we do not forecast a very high climb in the unemployment rate, as labour, especially skilled labour, is in shortage.

Households' savings have dropped to the long-term average rate



Sources: Swedbank Research & Macrobond

The Finnish government has proposed several initiatives to soften the impact of high energy prices. The government has planned to offer up to EUR 10 billion in liquidity guarantees to the Finnish energy sector. This would be a last-resort financing option for companies that would otherwise be threatened by insolvency. In the beginning of September, the European Commission approved a plan to support the Finnish fishing industry. In addition, the government has worked out a household compensation scheme for high energy bills, including VAT reduction on electricity. Unfortunately, this support will come at the price of extra costs on the government budget, which we had already projected to be in deficit during the forecast period.

Baltics – turning the corner

The Baltic economies have remained on a steady footing so far, but declining purchasing power, weak confidence, and falling external demand are likely to push them into recession this winter. We still expect a relatively mild and short-lived contraction, with limited lasting damage to labour markets. Inflation is peaking, but annual inflation is expected to return to normal levels late next year.

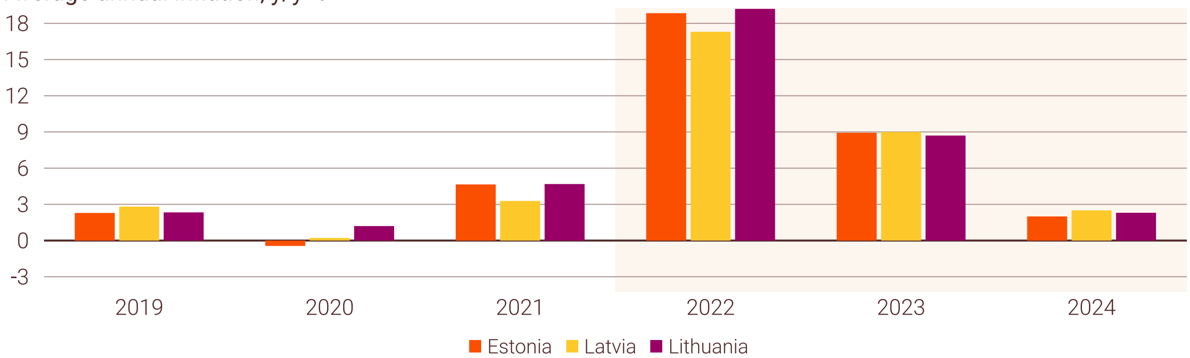
Annual inflation increased to 22-24% in September, the highest level in at least a quarter of a century. Three-fourths of this inflation is driven by higher housing costs (energy), and transportation and food prices. Energy prices paid by households and businesses have not peaked yet, but other external sources of inflation are ebbing. Energy prices are likely to remain high throughout the forecasting period, but households and businesses will at least be partially compensated. On the other hand, an expected increase in the minimum wage (10.8% in Estonia, 24% in Latvia, and 15% in Lithuania) will continue to push up labour costs and may prove to be at least somewhat inflationary. We forecast that average annual inflation will drop to slightly below 10% in 2023, before falling farther to a healthy level of 2-3% in 2024.

Real wages are expected to shrink by 6-8% this year; naturally, this has already affected household consumption. Retail trade has been flat or shrinking slightly since spring, although there were pockets of boosted expenditure – during the summer, households were still spending more on travel, restaurants, and other recreational services. Consumer confidence has fallen to the lowest level since the start of the pandemic; this is likely to be reflected in even weaker consumption, especially once the energy bills are paid. Households with mortgages will also feel the pinch from the higher Euribor, which has risen from 0% to 2% and may reach 3% if market expectations are right and the ECB does not change its plans. However, we do not expect a collapse in household consumption – it is expected to decline only slightly later this year and during the first half of 2023. Among the reasons for this relative resilience are the expected government support and continued strength in labour markets. Unemployment is expected to drop to 6-7% this year and to increase only by around 1 percentage point in 2023.

The closure of the Russian market did limited damage to the Baltic manufacturers and transport sector. New suppliers of energy and commodities have been found without major disruptions. Most exports have been booming during the pandemic, but the first signs of weakness have started emerging. During

The worst is (almost) behind us

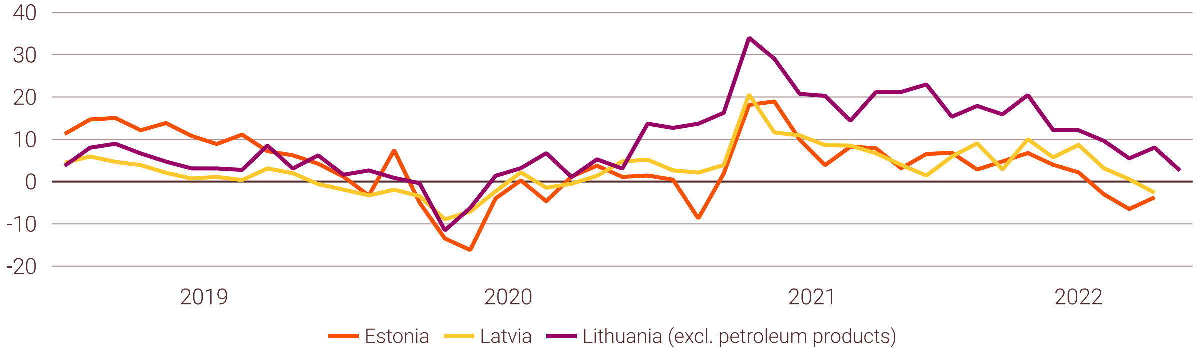
Average annual inflation, y/y %



Sources: Swedbank Research & Macrobond

Manufacturing output

y/y %, sa



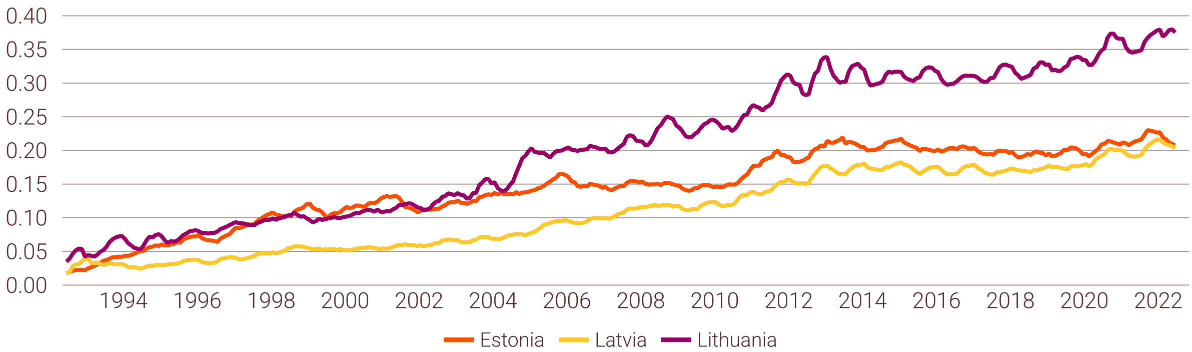
Sources: Swedbank Research & Macrobond

the third quarter, manufacturing shrank in Estonia and Latvia, but was still growing in Lithuania, albeit at a much slower pace. Export orders have started falling and are now at or below the long-term average. We expect this weakness to continue for a few quarters, as households' real income is shrinking, and the energy crisis is continuing across Europe. Many Baltic export markets are expected to enter at least a brief recession. Public sector investments are expected to continue growing, and the private sector will also have plenty of incentives to invest in renewable energy generation and efficiency. Construction of housing, however, may suffer a period of stagnation, given the falling housing affordability and weak confidence.

In the short term, anti-cyclical fiscal policy will help soften the blow; thus we do not expect a deep or lasting downturn. In the medium and longer term, the Baltic countries are likely to emerge from this crisis more resilient and with higher energy security. However, there are also risks related to cost competitiveness, especially if wages continue growing at an elevated pace while productivity starts stagnating.

Exporters remain competitive within the EU

Export market shares in EU27, %, 6mma



Sources: Swedbank Research & Macrobond

Estonia – harder times ahead

The second economic crisis in two years is causing households' standard of living to deteriorate, draining businesses and presenting a serious challenge for the public finances. Weakening demand will contribute to the slowdown of high inflation, while the labour market is likely to remain resilient and unemployment is expected to pick up only moderately.

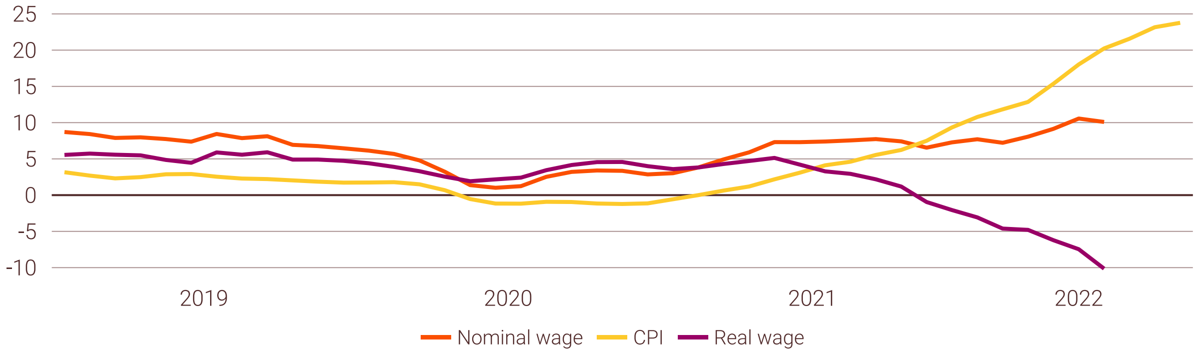
Estonian GDP increased by 2.4% in real terms in the first half of the year, but the second half will be worse. Economic sentiment has dropped sharply, weakening foreign demand has reduced the volumes of export goods and manufacturing output, while households' falling purchasing power has slowed down the growth of consumption volumes in retail. Increasing costs, including higher energy prices, have put greater pressure on enterprises' liquidity and competitiveness. Despite the expected mild recession in the second half of this year and the first half of 2023, we have projected 0.5% GDP growth this year and that the economy will stagnate next year.

Very rapid price increases will continue in the coming months, although the peak in annual growth rates was probably in August. In October, monthly inflation is expected to be negative due to the overnment's energy subsidies which are lowering electricity, gas, and heating prices for households. Energy subsidies amounting to 0.5% of GDP will alleviate the cost-of-living crisis for households. Consumer prices are expected to grow by 19% this year and another 9% next year. The slowdown in price growth comes from a higher base effect, but also from the slowing demand locally and globally. The unemployment rate is expected to grow in winter and spring but then fall again gradually once the economy starts to recover. Wage growth is supported by labour shortages, higher minimum wage, pay rises in the public sector, and a strong push from employees who do not want to see their standard of living drop so significantly due to skyrocketing inflation. After a 9% drop in 2022, it would take five years for the standard of living to return to last year's level. The influx of Ukrainian refugees has done little to alleviate labour shortages.

The government will substantially increase spending on softening the impact from the energy crisis and on defence because of the higher geopolitical risks. The general government budget will remain in deficit, while the debt will gradually pick up. This will bring about larger interest payments, less room to manoeuvre in case of the need for more fiscal stimulation, and possibly a higher tax burden.

High inflation has reduced purchasing power despite robust wage growth

y/y %, 3 mma



Sources: Swedbank Research & Macrobond

Latvia – sub-zero economic temperature

The economy is slowing, and sentiment, especially among households, has dropped. We still expect a mild and short-lived recession in Latvia, with a gradual recovery starting in the second half of 2023 as inflation retreats to single digits.

The economy expanded by a decent 4.5% in the first half of the year. However, quarter-on-quarter GDP growth stalled in the second quarter, with household consumption and goods exports declining from the first quarter in a sign that the soaring inflation has started to dent both domestic and foreign demand. More recent data point to further weakness. Retail sales volumes have eased from their March peak, and they were only a tad above last year's level in August. Commercial bank card spending, including cash withdrawals and adjusted for inflation, fell by about 4% year on year in the third quarter. The producing sectors of the economy have so far managed to replace Russian imports of production inputs with alternative sources. Nevertheless, higher costs and waning demand have weighed on production volume. Manufacturing output slid below last year's level in August, led by a downturn in wood processing. Export orders have come down and are currently at the long-term average. Construction value-added has been declining for the past four quarters, possibly due to hesitation about contract indexation. So far, the decline in construction investment has been compensated by investments in transport and machinery.

The economy likely contracted already during the third quarter. We forecast two additional quarters with small quarter-on-quarter declines in GDP. This year's growth, at 2.8%, is supported by the strong start of the year. For 2023, we forecast no growth, with a decline early in the year followed by a gradual recovery. GDP will return to a more stable growth of 2.9% in 2024. The downturn will be driven by a decline in private consumption amid the plunging purchasing power of households and, to a lesser extent, by weaker exports on the back of waning global demand. Private investment activity will remain cautious, except in energy-related improvements, while public investment activity will be boosted by accelerated EU funds inflows in 2023-2024.

Inflation likely peaked at 22.2% in September, with food, housing, and transport categories accounting for about 85% of overall price increases. It will, however, hover around an uncomfortable 20% until the spring, given further increases in energy prices and second-round effects. Government support will partly compensate for the extreme rise in heating and electricity prices from October through April, removing almost 1 percentage point off this and next year's inflation. Receding external price pressures and weakening demand will help bring down inflation over the next year. In 2022, inflation will average about 17.3%, before retreating to 9% in 2023 and 2.5% in 2024.

The labour market continued to tighten, with the unemployment rate falling to 6.3% in September. Given the labour shortages and our forecast of a mild recession, we expect only a slight uptick in the unemployment rate. It will exceed 7% at the beginning of next year and gradually come down thereafter. Wage growth will remain rapid, boosted by a 24% hike in the minimum wage in 2023 and an additional 13% hike in 2024. Currently, about 17% of workers earn a minimum wage or less. The minimum wage is the second-smallest in the EU and needs to be increased. However, such a steep and rushed rise could lead to losses in employment and a bigger shadow economy. The envisaged minimum wage hike will lift the average wage by an additional percentage point next year. Despite rapid nominal wage growth, real net wages will remain subdued next year, delaying the recovery in private consumption.

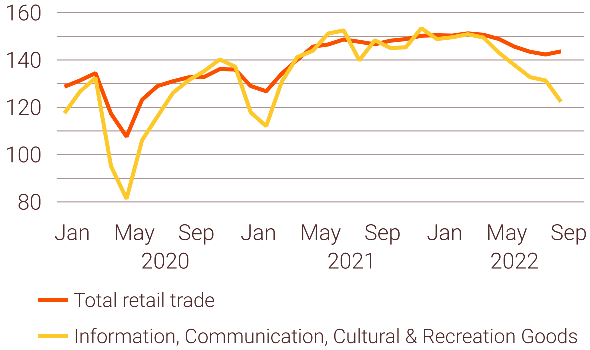
Lithuania – fiscal support to soften the blow

GDP growth remained positive during the first half of this year, but we do not expect this trend to continue – Lithuania, like many European countries, is likely to be in recession during the coming quarters. The downturn is likely to be contained, not least because of the relatively large positive fiscal impulse. Inflation increased slightly more than expected this year, but we forecast average annual inflation to drop to 8.7% next year.

Revised data show that GDP grew better than previously estimated during the first half of this year, and, so far, there was no quarterly contraction. In the second quarter, GDP was still 0.3% higher than in the first, and 2.8% higher than a year ago. Yet, our nowcasting models suggest that GDP was already shrinking during the third quarter, and we forecast that this contraction will continue until the second quarter of 2023. We are keeping our GDP forecast for 2022 and 2023 unchanged, which means that the economy is expected to grow by 2.0% and 0%, respectively. However, we are lowering the GDP growth forecast for 2024 to 2.1% (from 2.5%), as the still-high energy prices, higher interest rates, and still-weak external demand are likely to drag down the recovery.

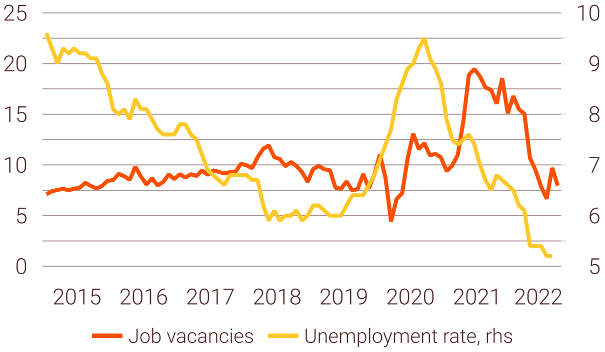
Inflation increased further in September, to 24.1%, but there are encouraging signs that the peak has been reached (retreating commodity, transportation, and producer prices). Nevertheless, we are revising up next year's inflation forecast to 8.7%, mainly due to larger carryover effects and higher expected wage growth. As the minimum monthly wage is going to be increased by 15% next year, this will also push average wage growth up to 8.5% – even though a growing number of companies are signalling that they have no room to increase labour costs that much. We assume that some of the companies will try to control labour costs, not by freezing wages, but by cutting the number of employees. Labour shortages remain elevated across many sectors, but falling job vacancies indicate that businesses are becoming more wary. Manufacturing has held up relatively well so far, but export orders are falling, and we expect shrinking demand in export markets to catch up later this year and, especially, in 2023. The government has drafted a budget for next year with the deficit amounting to 5% of GDP. Among other measures, gas and electricity price compensations for households and businesses are likely to soften the blow and help avoid a hard landing. Fingers crossed.

Consumers cut spending on non-necessities
Index, 2015=100, sa



Sources: Swedbank Research & Macrobond

Strong labour market but vacancies are falling
15-74, sa, thousands; % (rhs)



Sources: Swedbank Research & Macrobond

Appendix

Interest and exchange rate forecasts

	Outcome	Forecast				
	2022	2022	2023	2023	2024	2024
	21 Oct	31 Dec	30 Jun	31 Dec	30 Jun	31 Dec
Policy rates (%)						
Federal Reserve, USA (upper bound)	3.25	4.50	4.75	4.25	3.25	3.00
European Central Bank (refi rate)	1.25	2.50	3.00	2.75	2.50	2.50
European Central Bank (deposit rate)	0.75	2.00	2.50	2.25	2.00	2.00
Bank of England	2.25	3.50	3.50	3.00	2.50	2.00
Riksbank	1.75	2.50	3.00	2.75	2.50	2.25
Norges Bank	2.25	3.00	3.00	2.50	2.00	2.00
Government bond rates (%)						
Sweden 2y	2.28	2.75	2.85	2.60	2.30	2.10
Sweden 5y	2.54	2.60	2.70	2.60	2.40	2.20
Sweden 10y	2.31	2.40	2.50	2.50	2.40	2.20
Germany 2y	2.18	2.20	2.30	2.20	2.20	2.00
Germany 5y	2.34	2.35	2.40	2.30	2.30	2.10
Germany 10y	2.48	2.50	2.50	2.50	2.40	2.20
US 2y	4.49	4.80	4.60	4.40	4.00	3.50
US 5y	4.34	4.60	4.40	4.30	4.00	3.60
US 10y	4.21	4.25	4.20	4.10	4.00	3.70
Norway 2y	3.64	3.40	3.10	2.40	2.10	1.90
Norway 5y	3.73	3.30	2.80	2.50	2.30	2.10
Norway 10y	3.72	3.20	2.70	2.60	2.50	2.30
Exchange rates						
EUR/USD	0.98	0.97	1.00	1.05	1.07	1.10
EUR/GBP	0.87	0.89	0.88	0.87	0.87	0.87
EUR/SEK	11.03	11.00	10.75	10.50	10.50	10.50
EUR/NOK	10.43	10.60	10.40	10.20	10.00	10.00
USD/SEK	11.26	11.34	10.75	10.00	9.81	9.55
USD/CNY	7.24	7.20	7.00	6.80	6.80	6.80
USD/JPY	150.1	150.0	147.0	140.0	135.0	135.0
NOK/SEK	1.06	1.04	1.03	1.03	1.05	1.05
KIX (Trade-weighted SEK)	125.8	125.5	122.4	118.9	118.6	117.9

Sources: Swedbank Research & Macrobond

SWEDEN: Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP (calendar-adjusted)	4.9	2.7	(2.2)	-0.9	(0.4)	1.0	(1.5)
Real GDP	5.1	2.7	(2.2)	-1.1	(0.2)	1.0	(1.5)
Household consumption	6.0	3.7	(3.4)	-1.3	(0.7)	1.1	(1.3)
Government consumption	2.8	0.2	(0.8)	2.0	(1.6)	2.2	(1.2)
Gross fixed capital formation	6.3	4.9	(-0.8)	-3.6	(-1.8)	-0.8	(1.4)
Change in inventories, contr. to GDP growth	0.3	1.1	(0.7)	-0.5	(-0.4)	0.0	(0.0)
Exports of goods and services	7.9	3.8	(4.0)	0.0	(-0.5)	3.2	(3.4)
Imports of goods and services	9.6	7.5	(4.6)	-1.0	(-1.3)	3.1	(3.1)
CPI (average)	2.2	8.4	(8.2)	7.4	(6.6)	1.5	(2.1)
CPI (Dec.-Dec.)	3.9	12.1	(11.0)	2.3	(2.9)	1.5	(1.7)
CPIF (CPI with fixed mortgage rate, average)	2.4	7.8	(7.6)	5.1	(4.8)	1.2	(1.6)
CPIF (CPI with fixed mortgage rate, Dec.-Dec.)	4.1	9.9	(8.9)	1.2	(2.1)	1.4	(1.4)
CPIF ex. energy (average)	1.4	5.8	(5.7)	4.5	(4.1)	2.2	(2.3)
CPIF ex. energy (Dec.-Dec.)	1.7	7.5	(7.3)	2.6	(2.5)	2.3	(2.2)
Riksbank policy rate (Dec.)	0.00	2.50	(2.00)	2.75	(2.25)	2.25	(2.00)
Unemployment (% of labour force, 15-74)	8.8	7.3	(7.6)	7.6	(7.7)	8.2	(7.6)
Labour force (15-74)	1.2	1.1	(1.4)	0.1	(0.4)	0.1	(0.6)
Employment (15-74)	1.0	2.8	(2.8)	-0.2	(0.3)	-0.6	(0.8)
Number of hours worked (calendar-adjusted)	2.3	2.0	(2.0)	-0.3	(0.7)	0.1	(0.6)
Nominal hourly wage (NMO), whole economy	2.6	2.8	(2.8)	3.7	(3.6)	3.7	(3.7)
Household real disposable income	3.1	-0.8	(-1.0)	-1.8	(-1.8)	1.6	(2.1)
Household nominal disposable income	5.0	6.3	(6.2)	4.0	(3.5)	2.8	(3.6)
Household savings ratio, % of disposable income	15.5	10.6	(10.7)	11.0	(9.2)	11.5	(9.9)
General government budget balance (% of GDP)	-0.1	0.8	(0.4)	-0.1	(0.0)	-0.5	(-0.5)
General government debt (Maastricht), % of GDP	36.2	30.6	(31.7)	29.6	(31.1)	30.5	(31.4)

Previous forecast in parentheses
Source: Statistics Sweden & Swedbank Research

ESTONIA: Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP	8.0	0.5	(1.7)	0.0	(0.5)	2.5	(2.5)
Household consumption	6.4	3.5	(3.0)	0.0	(1.0)	3.0	(2.5)
Government consumption	4.0	1.0	(2.0)	2.0	(1.5)	2.0	(1.5)
Gross fixed capital formation	2.8	-15.0	(-15.0)	5.0	(5.0)	7.0	(8.0)
Exports of goods and services	19.9	3.5	(4.0)	0.5	(0.5)	3.0	(4.0)
Imports of goods and services	21.0	2.0	(0.5)	-0.5	(1.0)	4.0	(5.0)
CPI (average)	4.6	18.8	(18.5)	8.9	(7.1)	2.0	(2.0)
Unemployment (% of labour force)	6.2	6.1	(6.0)	7.3	(6.8)	6.0	(5.8)
Employment	-0.5	3.2	(3.2)	-1.0	(-1.1)	0.5	(0.3)
Gross monthly wage	6.9	9.5	(10.0)	8.5	(7.5)	6.7	(6.7)
Nominal GDP, billion euro	31.4	36.6	(37.0)	39.0	(39.4)	40.9	(41.4)
Exports of goods and services (nominal)	29.4	22.7	(23.8)	6.5	(6.6)	6.1	(7.1)
Imports of goods and services (nominal)	30.2	21.9	(20.6)	6.4	(8.0)	7.1	(8.2)
Balance of goods and services, % of GDP	0.2	0.2	(2.3)	0.2	(1.2)	-0.5	(0.4)
Current account balance, % of GDP	-1.6	-0.2	(0.7)	-0.3	(-0.3)	-1.3	(-1.2)
Current and capital account balance, % of GDP	7.3	5.2	(6.8)	4.9	(5.5)	3.8	(4.5)
FDI inflow, % of GDP	19.0	2.0	(3.3)	4.0	(3.3)	4.0	(3.3)
General government budget balance, % of GDP	-2.3	-2.5	(-2.2)	-3.3	(-2.5)	-3.0	(-1.9)
General government debt (Maastricht), % of GDP	17.6	18.6	(19.8)	19.4	(22.3)	21.9	(22.2)

Previous forecast in parentheses
Sources: Statistics Estonia & Swedbank Research

LATVIA: Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP	3.9	2.8	(2.4)	0.0	(0.4)	2.9	(3.5)
Household consumption	7.4	5.0	(7.0)	-3.8	(0.3)	4.6	(5.0)
Government consumption	4.4	2.7	(2.5)	1.7	(2.0)	2.0	(2.3)
Gross fixed capital formation	2.9	1.5	(1.5)	4.0	(6.0)	8.0	(8.0)
Exports of goods and services	5.9	6.0	(6.5)	0.0	(1.0)	3.8	(4.5)
Imports of goods and services	15.3	8.2	(9.3)	-0.5	(2.7)	5.8	(6.0)
CPI (average)	3.3	17.3	(17.5)	9.0	(7.5)	2.5	(2.0)
Unemployment (% of labour force)	7.6	6.8	(7.0)	7.0	(7.1)	6.3	(6.3)
Employment	-3.2	1.7	(1.5)	0.2	(0.2)	0.9	(1.1)
Gross monthly wage	11.7	8.2	(8.0)	8.5	(7.5)	8.0	(7.0)
Nominal GDP, billion euro	33.6	40.0	(38.2)	42.9	(41.1)	45.8	(44.3)
Exports of goods and services (nominal)	17.9	24.3	(24.1)	3.0	(5.0)	3.3	(4.5)
Imports of goods and services (nominal)	26.3	28.3	(29.0)	1.0	(5.6)	3.7	(3.9)
Balance of goods and services, % of GDP	-3.4	-5.8	(-5.0)	-4.2	(-5.3)	-4.4	(-4.7)
Current account balance, % of GDP	-4.2	-5.9	(-5.5)	-3.9	(-5.0)	-3.7	(-4.0)
Current and capital account balance, % of GDP	-2.8	-4.5	(-4.3)	-2.3	(-3.3)	-2.3	(-2.5)
FDI inflow, % of GDP	8.3	3.0	(2.7)	3.0	(2.7)	3.0	(2.7)
General government budget balance, % of GDP	-7.0	-7.2	(-4.9)	-3.8	(-2.4)	-0.8	(-1.6)
General government debt (Maastricht), % of GDP	43.7	41.9	(44.7)	42.8	(43.4)	42.3	(41.4)

Previous forecast in parentheses
Sources: Statistics Latvia & Swedbank Research

LITHUANIA: Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP	6.0	2.0	(2.0)	0.0	(0.0)	2.1	(2.5)
Household consumption	8.0	1.8	(1.0)	1.2	(1.5)	2.5	(3.8)
Government consumption	0.9	1.5	(1.5)	1.8	(1.0)	1.0	(1.0)
Gross fixed capital formation	7.8	3.5	(7.2)	4.5	(4.5)	6.0	(6.0)
Exports of goods and services	17.0	8.5	(8.0)	0.0	(0.0)	3.5	(4.0)
Imports of goods and services	19.9	11.5	(10.5)	-1.0	(1.0)	4.0	(5.3)
CPI (average)	4.6	19.2	(17.8)	8.7	(6.0)	2.3	(2.5)
Unemployment (% of labour force)	7.1	5.6	(5.7)	6.6	(6.6)	6.0	(5.9)
Employment	0.3	1.1	(0.9)	0.0	(0.3)	0.6	(0.7)
Gross monthly wage	10.5	12.6	(10.7)	8.5	(7.5)	6.6	(5.7)
Nominal GDP, billion euro	56.2	68.2	(65.5)	73.6	(69.5)	76.7	(73.0)
Exports of goods and services (nominal)	24.0	27.0	(16.5)	1.5	(2.5)	4.5	(4.5)
Imports of goods and services (nominal)	34.1	39.0	(26.5)	2.0	(3.2)	2.5	(2.0)
Balance of goods and services, % of GDP	4.5	-2.8	(-2.3)	-3.0	(-2.8)	-1.5	(-0.9)
Current account balance, % of GDP	1.1	-6.0	(-6.4)	-4.6	(-4.2)	-2.8	(-2.1)
Current and capital account balance, % of GDP	2.6	-5.0	(-5.2)	-3.4	(-2.9)	-1.5	(-0.7)
FDI inflow, % of GDP	4.5	2.0	(5.0)	2.5	(2.5)	2.5	(2.5)
General government budget balance, % of GDP	-1.0	-1.5	(-3.2)	-4.5	(-2.5)	-1.7	(-1.2)
General government debt (Maastricht), % of GDP	43.7	37.4	(40.7)	39.1	(40.8)	39.2	(40.1)

Previous forecast in parentheses
Sources: Statistics Lithuania & Swedbank Research

NORWAY (Mainland): Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP	4.2	3.0	(3.2)	-0.5	(1.0)	1.4	(1.4)
Household consumption	4.7	5.6	(6.1)	-1.5	(0.5)	1.8	(1.9)
Government consumption	3.8	-0.3	(1.6)	1.7	(1.5)	1.2	(1.0)
Gross fixed capital formation	-0.9	0.4	(1.4)	1.6	(2.5)	1.8	(2.0)
Exports of goods and services	5.2	4.7	(4.0)	1.5	(1.5)	0.9	(1.0)
Imports of goods and services	1.9	10.4	(7.5)	-5.2	(1.5)	1.0	(1.0)
CPI (average)	3.5	5.5	(5.1)	4.6	(3.1)	1.7	(1.9)
CPI-ATE (average)	1.7	3.8	(3.8)	3.5	(2.9)	2.1	(2.1)
Unemployment (% of labour force, registered)	3.1	1.8	(1.8)	2.4	(2.2)	2.2	(2.1)
Employment (15-74)	1.2	3.2	(2.7)	-0.8	(0.2)	0.5	(0.4)
Employment rate (15-74)	69.0	70.3	(70.5)	69.0	(70.0)	69.5	(70.0)
Nominal hourly wage, whole economy	3.5	4.1	(4.1)	3.8	(3.5)	3.0	(3.0)
General government budget balance, % of GDP	-3.0	0.3	(0.3)	1.0	(1.0)	1.0	(1.0)
General government debt (Maastricht), % of GDP	42.0	40.0	(40.0)	40.0	(40.0)	40.0	(40.0)

Previous forecast in parentheses
Source: Statistics Norway & Swedbank Research

DENMARK: Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP	4.9	3.0	(3.2)	-0.9	(-0.9)	0.7	(0.7)
Household consumption	4.1	-1.2	(1.5)	-0.3	(0.4)	1.2	(0.8)
Government consumption	4.2	0.2	(-0.2)	1.0	(0.9)	1.0	(1.0)
Gross fixed capital formation	6.2	5.0	(5.6)	-7.1	(-7.2)	-2.2	(-2.2)
Exports of goods and services	8.0	5.6	(3.5)	2.6	(4.0)	2.5	(2.9)
Imports of goods and services	8.0	4.2	(4.4)	2.2	(4.0)	2.1	(2.3)
CPI (average)	1.9	8.2	(7.2)	4.3	(4.0)	1.8	(2.0)
Unemployment (% of labour force, 15-74)	5.2	4.3	(4.6)	5.2	(5.1)	5.2	(5.1)
Employment (15-74)	2.4	3.2	(2.0)	-1.0	(0.0)	0.5	(0.5)
Employment rate (15-74)	66.5	67.8	(67.3)	66.8	(66.8)	66.8	(66.8)
Nominal hourly wage, private sector	3.0	3.6	(3.8)	4.0	(3.8)	3.5	(3.5)
General government budget balance, % of GDP	3.7	0.5	(0.5)	0.5	(0.5)	0.5	(0.5)
General government debt (Maastricht), % of GDP	36.6	33.0	(33.0)	32.5	(32.5)	32.5	(32.5)

Previous forecast in parentheses
Source: Statistics Denmark & Swedbank Research

FINLAND: Key economic indicators, 2021-2024

Annual % change unless stated otherwise	2021	2022F		2023F		2024F	
Real GDP	3.0	2.3	(1.8)	-0.3	(0.5)	1.3	(1.5)
Household consumption	3.6	2.5	(1.7)	0.0	(0.5)	1.2	(1.2)
Government consumption	2.7	3.5	(1.8)	0.5	(0.0)	0.5	(0.5)
Gross fixed capital formation	1.1	3.5	(3.5)	-1.0	(1.5)	2.0	(2.0)
Exports of goods and services	5.6	0.0	(1.5)	1.0	(2.0)	3.0	(3.5)
Imports of goods and services	5.6	8.5	(3.0)	0.5	(1.5)	2.0	(2.0)
CPI (average)	2.2	6.9	(6.7)	4.0	(3.0)	2.0	(2.0)
Unemployment (% of labour force, 15-74)	7.7	6.9	(6.6)	7.0	(6.7)	6.5	(6.5)
Employment (15-74)	2.4	2.2	(2.4)	0.2	(0.2)	0.6	(0.6)
Employment rate (15-74)	62.0	63.4	(63.5)	63.2	(63.6)	63.5	(64.0)
Nominal hourly wage, whole economy	2.4	2.3	(2.8)	2.4	(2.9)	2.2	(2.5)
General government budget balance, % of GDP	-2.7	-2.2	(-2.1)	-2.0	(-1.9)	-1.7	(-1.6)
General government debt (Maastricht), % of GDP	65.8	65.0	(65.0)	65.5	(66.0)	66.5	(66.5)

Previous forecast in parentheses
Source: Statistics Finland & Swedbank Research

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