January 2024

Swedbank Economic Outlook

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The final sprint is here

Inflation is on a fast downward path towards more sustainable levels and is in line with monetary policy targets. Consequently, as inflation was coming down during the winter, financial markets made a quick turnaround, pricing in aggressive cuts in central banks' policy rates starting in the spring and onwards. Risky assets benefited, equity markets gained in value, credit spreads compressed and yields on long-term government bonds fell. Lately, however, central banks have been trying to push back market pricing with hawkish rhetoric, and markets have adjusted somewhat. At the same time, the economic slowdown is expected to be a soft landing.

"The economic outlook looks a bit brighter"

Economic activity will come down in the near term; growth will be low, and, in some countries, it will stagnate. However, the economic outlook looks a bit brighter even though the inflation beast has not yet been tamed. Developments during 2024 will depend on whether the disinflation process that started last year can continue at full tilt, allowing central banks to be less restrictive. Currently, the inflation momentum remains stronger in the US than in the eurozone, and likewise the US economy is holding up rather well compared to the low growth in the eurozone. The final sprint of disinflation in the US could be bumpy, whereas inflation in other countries and regions appears to be more steadily on a downhill slope towards inflation targets.

> Inflation in some countries and regions appears to be more on a downhill slope

A risk in the current conjuncture is that central banks start cutting policy rates too late, and that monetary policy is not forward-looking enough. If this risk materialises, it could deepen and lengthen the economic slowdown as well as induce volatility in financial markets, resulting in a repricing of risk.

Risks to the outlook are more balanced – the probability of a hard landing seems to be declining – but at the same time, there are risks to the disinflationary process. The current conflict in the Red Sea cannot be compared to the opening effects after the Covid pandemic and the global disruptions it had on supply channels. However, an escalation in the conflict in the Red Sea or, more broadly, in the Middle East could potentially derail the downhill path of inflation. Geopolitical risks remain high and are a risk for the economic outlook, and we still have a war on European soil.

> But there are risks to the disinflationary process

Mattias Persson
Group Chief Economist

0.3%

GDP growth will be mediocre in 2024 in the euro area …

At a glance

1.4%

… and will decline in the US.

3.6%

US government bond yield at the end of 2025

1.5%

ECB deposit rate at the end of 2025

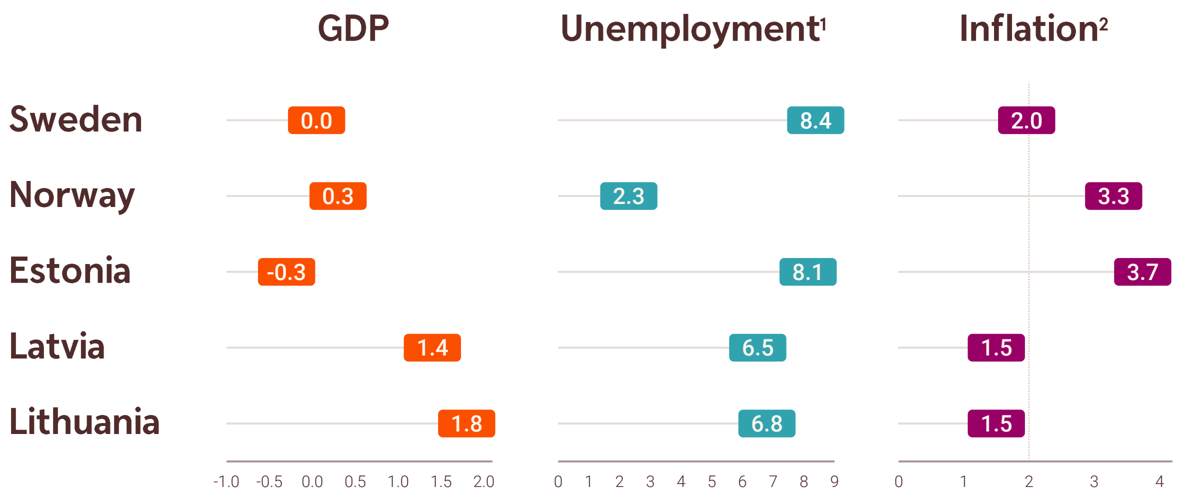
April

The ECB will make its first rate cut

1.14

EUR/USD, December 2024

2024 Outlook



[1] Refers to LFS except for Norway, where it refers to the registered unemployment rate (NAV).
[2] Refers to CPI except for Sweden, where CPIF is shown.

Global Outlook

1. **Lower inflation** and declining interest rates are expected to support the global economy this year and in 2025. But there are near-term headwinds and intensified **geopolitical tensions**, not least in the Middle East, pose a risk to the global economic recovery.

2. The current disruptions to trade flows in the Suez Canal are causing damage in the form of delayed production and higher prices. If this remains an isolated event, we do not deem it to be enough to reverse the downward trend in inflation.

3. The **US** economy is expected to land softly and grow more slowly going forward. Growth in the **euro area** economy has slowed down markedly, not least in Germany, but a recovery is expected in 2025. **China's** drawn-out property slump, together with demographic challenges, will lead to lower growth.

Financial Markets

1. The **European Central Bank (ECB)** will start slashing policy rates in April, followed by the US **Federal Reserve (Fed)** in May. In total, we forecast that both the ECB and the Fed will cut their policy rates by 2.5 percentage points, leaving the respective rates at 1.5% and 3.0% at the end of 2025.

2. The policy rate cuts are likely to put downward pressure on government **bond yields**, although increasing public debts and reduced central bank bond-buying are pulling in the other direction. Overall, we expect longer-dated bond yields to remain largely at current levels.

3. As global inflation normalises and interest rates fall, the US **dollar** is expected to **weaken** somewhat vis-à-vis the euro. The Swedish **krona** and Norwegian **krone** are expected to **gain** some lost ground during the forecast horizon.

Sweden

1. Falling inflation, lower interest rates and rising real incomes pave the way for a **rapid recovery** of the Swedish economy in 2025. However, the **near-term outlook is bleak,** and GDP is expected to be unchanged this year before growing by 3% next year.

2. The **labour market will weaken,** and the unemployment rate is expected to peak at 8.5% in the fourth quarter of 2024.

3. Price pressures are easing fast, and by summer, we expect **below-target inflation**. The Riksbank will start **cutting** the policy rate in **May** and then quickly lower it further to a long-term normal level, which we believe is 2%.

Baltics

1. We forecast that **GDP growth** will resume in 2024, especially in the second half of this year and mainly driven by stronger household purchasing power. Further growth acceleration is likely in 2025.

2. **Inflation** will be below 2% in Latvia and Lithuania this year, while Estonian inflation is expected to stay slightly higher, mainly due to increases in taxes.

3. **Wage growth** is likely to ease to 7–8% this year, while unemployment will remain stable or increase only slightly.

Global

Cautious optimism

Lower inflation and declining interest rates are expected to support the global economy this year and in 2025. However, there are near-term headwinds and intensified geopolitical tensions, not least in the Middle East, that pose a risk to the global economic recovery.

A soft landing

During the past few months, some encouraging signs for the global economy have been evident. Inflation in both the US and the euro area has fallen more rapidly than expected which in turn has pulled down market interest rates. Thus, the two major burdens on households, namely high inflation and expensive mortgages, are easing.

The rapid decline of inflation, together with falling interest rates, increases the likelihood of a soft landing for many economies this year. It also allows for a take-off next year. We do not, however, forecast an imminent global economic recovery. Monetary policy works with long lags, and the tightening seen in the past two years has yet to play out fully in the real economy.

Furthermore, geopolitical tensions seem to be building rather than abating, which poses a risk to the global economy. The situation in the Middle East has worsened, and the current disruption to trade flows in the Suez Canal could cause further damage by delaying production, harming supply chains and raising prices. Freight costs have already risen markedly in the past few weeks, but if this remains an isolated event, we do not deem it to be enough to reverse the downward trend in inflation. For high inflation to return, we would probably need to see a wider supply shock that also pulls up energy prices. So far, the prices for both crude oil and natural gas have stayed low.

Swedbank's GDP forecast

Annual % change	2022	2023F		2024F		2025F	
US	1.9	2.4	(2.4)	1.4	(0.8)	1.5	(1.6)
China	3.0	5.2	(5.0)	4.5	(4.8)	4.3	(4.5)
Euro area	3.4	0.5	(0.4)	0.3	(0.2)	1.5	(1.5)
Germany	1.9	-0.3	(-0.2)	0.2	(0.1)	1.5	(1.4)
France	2.5	0.8	(0.8)	0.5	(0.5)	1.5	(1.5)
Italy	3.9	0.7	(0.6)	0.3	(0.2)	1.2	(1.2)
Spain	5.8	2.3	(2.3)	1.0	(0.9)	2.1	(2.1)
Estonia	-0.5	-3.4	(-2.5)	-0.3	(0.7)	2.8	(2.3)
Latvia	3.4	-0.4	(-0.4)	1.4	(1.4)	2.7	(2.5)
Lithuania	2.4	0.0	(-0.3)	1.8	(1.2)	2.5	(2.0)
Sweden	2.9	-0.4	(-0.7)	0.0	(-0.4)	2.8	(1.7)
Norway	3.7	1.1	(1.3)	0.3	(0.4)	1.1	(1.0)
United Kingdom	4.3	0.2	(0.5)	0.5	(0.3)	1.3	(1.1)

Previous forecast in parentheses.
Source: Swedbank Research

Monetary policy about to change course

Massive rate cuts ahead…

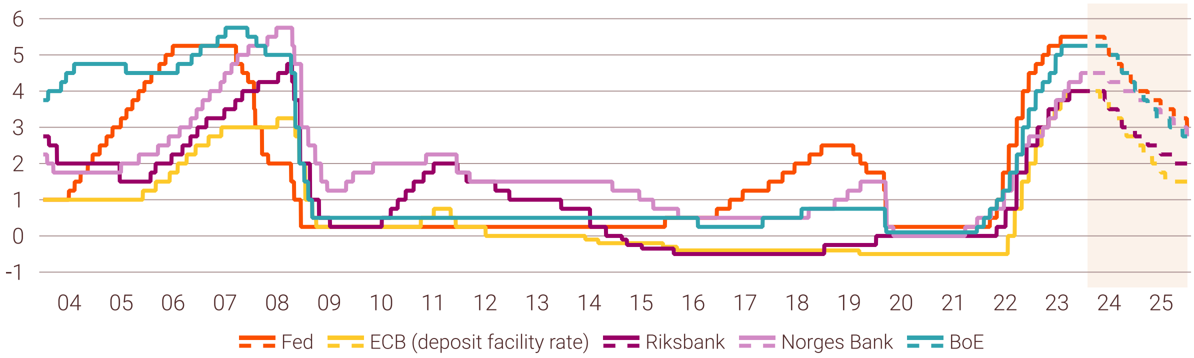
In recent months, it has become increasingly clear that we are at the peak of central banks' policy rates. Benign inflation developments have paved the way for markets to price in substantial rate cuts ahead, even though many central bankers have attempted to push back on those expectations.

We expect the first rate cut from the European Central Bank (ECB) in April, followed by the US Federal Reserve (Fed) in May, and then continued rate cuts through the rest of the year and in 2025. In sum, we are pencilling in rates falling by 2.5 percentage points from both the ECB and the Fed, leaving the respective policy rates at 1.5% and 3.0% at the end of the forecast horizon.

… but largely stable bond yields

Historically, bond yields have typically declined as central banks cut their policy rates. Thus, the substantial rate cuts that we expect to see in 2024 and 2025 are also likely to put downward pressure on longer-dated bond yields. However, there are also factors pulling in the other direction. Bond yields are already suppressed compared to short rates, and yield curves are even inverted. Also, public finances are under pressure in the US, as well as in many countries in Europe. Coupled with reduced central bank bond-buying, this is expected to increase bond supply, leading to upward pressure on yields. As a result, overall, bond yields are expected to stay largely at current levels in Europe, while declining somewhat in the US. The forecasts are surrounded by great uncertainty.

New direction of monetary policy
Outcome and Swedbank forecast, %



Sources: Swedbank Research & Macrobond

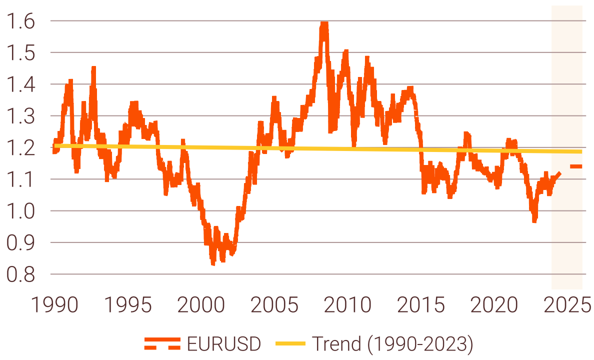
Weaker US dollar and stronger Scandies

As inflation normalises and interest rates fall, investor risk appetite is expected to strengthen. In such an environment, we typically see safe-haven currencies underperform. During the forecast horizon, the US dollar is expected to weaken somewhat from its current level, which is strong in a historical perspective. Should geopolitical tensions escalate further, or if financial worries related to the US election increase, the US dollar could remain strong.

Geopolitics could keep the dollar strong

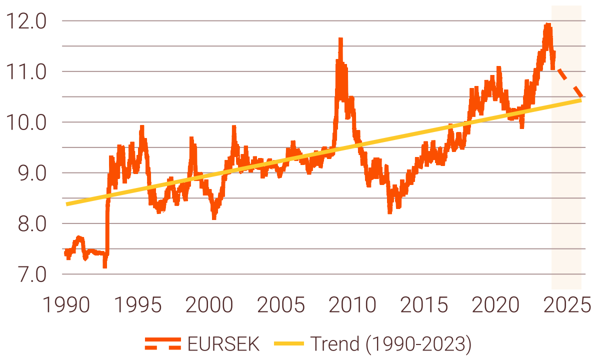
The Scandinavian currencies (NOK and SEK) are expected to gain as risk sentiment improves. A prerequisite for stronger Scandies is that global interest rates come down, given that both currencies are likely trading with a risk premium related to the real estate sector. The Norwegian krona is expected to appreciate somewhat more than the Swedish one, as Norges Bank will be more cautious in easing monetary policy.

Weaker USD starting next year
EURUSD



Sources: Swedbank Research & Macrobond

SEK strengthening towards trend
EURSEK



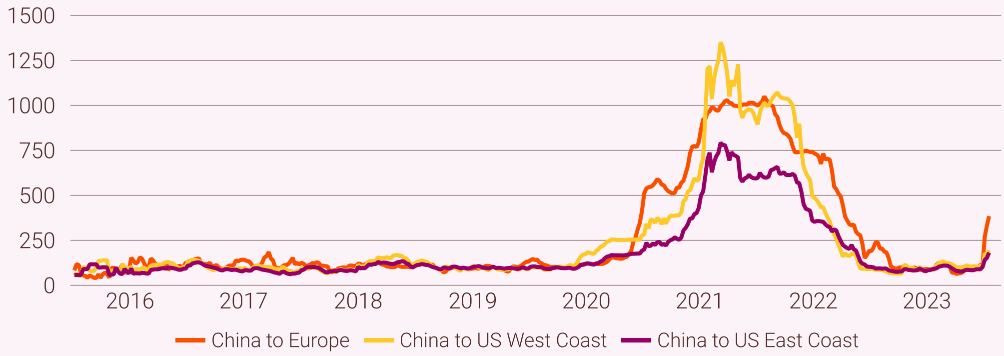
Sources: Swedbank Research & Macrobond

Canal woes

- The Red Sea and Suez Canal is an important shipping lane, facilitating around 11% of global maritime trade volumes according to the International Monetary Fund's Portwatch. The key goods passing via this route include oil, food products and most manufactured products. Traffic through the Suez Canal has been substantially reduced since Houthi attacks on commercial ships started in late November 2023.
- The world's largest shipping firms are rerouting ships around southern Africa, which has triggered delays and could potentially lead to rising goods prices. The reroute adds about 6,000 kilometres, or 10-14 days, for a route between Asia and northern Europe which typically takes about 30-40 days. For shorter distances, such as the Middle East to Europe, the re-route is even more expensive in relative terms.
- All else being equal, as long as the disruption is ongoing, freight rates will remain elevated, as more ships will be needed to transport the same number of goods given the longer sailing distance. Spot freight rates have risen significantly since the end of 2023, particularly to Europe, although they remain far below pandemic levels (see chart below). The impact on production costs is expected to be limited, as most larger shipping customers will not face immediate cost increases given that their rates are decided in longer contracts (but smaller customers may be exposed). Also, transport costs typically make up only a very small part of overall production costs.
- The Red Sea is not the only choking point that is being disrupted – due to a severe drought, the capacity of the Panama Canal has been gradually reduced during the past autumn and, instead of 38 vessels per day, the canal authority now allows 24 ships to pass. Under normal circumstances, the Panama Canal handles about 3% of global maritime trade volumes and 46% of container ships moving from Northeast Asia to the US East Coast. Now that the dry season is approaching, it is likely that the cap will remain in place.

Higher freight costs, but from a low level

Index (2019=100), shipping



Sources: Swedbank Research & Macrobond

United States – shifting to a lower gear

The surprising strength of the economy is dissipating, but recession is not on the cards. Though upside risks remain material, inflation is projected to continue heading down. The Fed will begin lowering interest rates in the spring.

The widely expected slowdown in the US economy has been pushed forward continuously amidst persistent upside surprises to growth. In fact, we estimate that in 2023 GDP rose by 2.4%, which is a higher growth rate than in 2022.

Landing softly

Despite this, signs that the economy is heading for a downshift are beginning to show, and the slowdown is expected to speed up as the lagged effects of tight monetary policy feed through the economy and as fiscal policy effectively becomes more restrictive. However, given that the economy has held up better than expected despite soaring prices and high interest rates, we no longer expect GDP to contract in the near term. Rather, we see it growing at a below-trend pace throughout the year; clearly, a soft landing.

Overall, we expect GDP in 2024 to grow by 1.4%, which is not too bad in comparison to many European countries, but still markedly lower than last year. After a weak development during the course of 2024, GDP is expected to grow 1.5% next year on the back of less restrictive monetary policy and lower inflation.

Consumption accounts for around 70% of US GDP, and surprisingly resilient consumer spending was key to last year's strong growth. This year, less pent-up demand and lower pandemic-era savings should entail more muted consumption. However, a strong labour market is supporting incomes and real wages are growing, which will dampen the fall. We forecast that the labour market will deteriorate somewhat going forward, but this is not expected to be drastic enough to cause consumption to decline, just to grow at a slower pace.

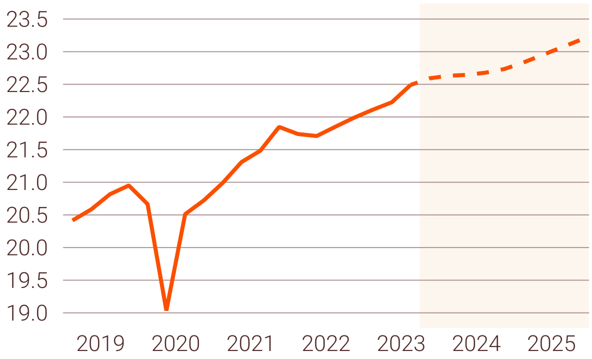
Additionally, there are some weak spots in the overall resilience. The ISM manufacturing index has been in contractionary territory for almost one and a half years, and manufacturing production has also declined. Demand for housing has been strained by lower demand resulting from high mortgage rates. Residential investments have contracted by around 20% since their peak in the first quarter of 2021, and a sustained recovery is not expected until interest rates have started declining. Going forward, business fixed investment is expected to slow down on the back of lower demand and high borrowing costs.

The unemployment rate, now 3.7%, has remained at historically low levels, but scratching the surface of the labour market data reveals a softer picture. Not only has the pace of job gains trended down since 2022, but most of the gains have also recently been concentrated within education & healthcare and government, while more cyclically sensitive sectors of the economy have grown much more slowly. Also, fewer job openings and declining employment for temporary help point to a continued softening of the labour market. If a recession is avoided, the unemployment rate will nevertheless be prevented from rising too far beyond 4%.

Both headline and core inflation trended down last year, and we are optimistic about the inflation path going forward. Shelter disinflation has further to run, and softer consumer demand will dampen corporates' scope to raise prices. At the same time, continued strong wage growth is a risk to services inflation, while tensions in the Middle East could cause both energy prices and costs to rise as shipping continues to be rerouted. Overall, we expect it will take until next year before inflation has come all the way down to the Fed's 2% target.

Slower growth expected this year

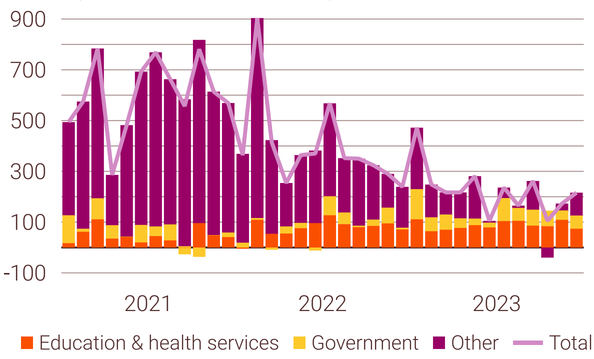
Annualised GDP, USD trn, constant 2017 prices



Sources: Swedbank Research & Macrobond

Job gains mostly in non-cyclical sectors

Monthly change in nonfarm payrolls, thousands



Sources: Swedbank Research & Macrobond

Fed shifts dovish

Our overall impression from the Fed's latest monetary policy meeting, in December, is that the central bank currently has a rather dovish reaction function. The key evidence suggesting a shift in the Fed's thinking is the rate path (dot plot), which now indicates a total of three rate cuts by the end of this year. This was a surprise for us, given that data up to that point had still come in relatively strong and the market was already pricing in aggressive rate cuts. Nevertheless, we expect the Fed to cut more than it has signalled, not because the data warrants it (we are revising our growth forecast up, after all) but because of the Fed's current soft stance. We are looking for the Fed to start cutting rates at its May meeting and thereafter at every subsequent meeting this year, for a total of 150 basis points. These rate cuts should be seen as policy normalisation rather than as a reaction to a weak economy. Because of this, we expect the Fed to lower its rate-cutting pace next year to every other meeting, ending 2025 with a federal funds rate of 2.75–3.00%. We also expect the Fed to end its quantitative tightening during the second half of this year.

Fed expected to start cutting rates at its May meeting

Outcome of the US presidential election: potential impacts on the economy

Even though the primaries have only just started, current polls indicate that the upcoming presidential election will most likely be a race between Biden and Trump. We have not made an explicit assumption about who the next President will be, as we judge that the election outcome will not have a major impact on the economy during our forecast horizon. In the longer term, however, the differences in policy as well as the effects on the US and the world economy could potentially be vast.

Economic policy is in focus as the US continues to wrestle with a growing budget deficit with no long-term solution in sight. A Trump victory is expected to entail a permanent extension of the tax cuts that the former President enacted in 2017 and that are set to expire next year. Biden has proposed extending the tax cuts for households making under USD 400 000 annually but letting the rest expire. Beyond that, Biden will likely strive to increase taxes on the wealthy to reduce the deficit.

The need to take a tough stance against China is one of the few areas where Democrats and Republicans agree. However, the risk of increased global economic fragmentation will be higher if Trump wins. One reason is that he has proposed a new 10% tariff on all imported goods. If this were imposed, trading partners would likely retaliate. Such a tariff would distort global trade and would likely have broad negative consequences for the US economy, including lower GDP and higher inflation.

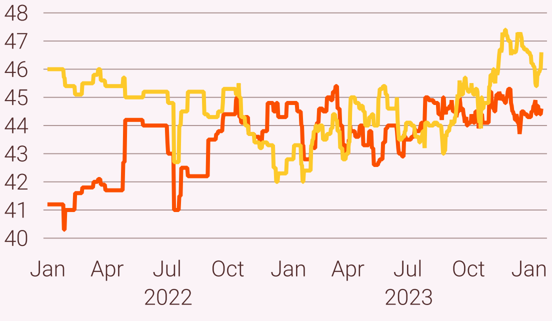
Less than 40% approve of Biden

Biden's approval rating, %

Sources: Swedbank Research & Macrobond

Tight race

Presidential election polls



Sources: RealClearPolitics, Swedbank Research & Macrobond

Euro area – stagnation is not over yet

It is likely that the European economy was in a shallow recession at the end of 2023. Considering all the headwinds, most of the euro area fared well enough, although the economy will continue to struggle this year. Inflation will fall below 2% in the middle of this year, and monetary easing is coming, yet growth will remain sluggish.

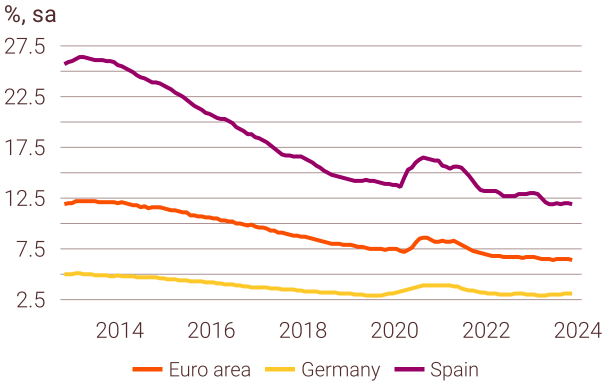
Current conditions in the euro area remain quite poor. It is highly likely that the economy has contracted for two consecutive quarters, while sentiment indicators continue to suggest that economic activity is falling in many countries. Industrial output remains the key source of weakness – it is almost 6% lower than a year ago. Although energy-intensive sectors are being affected the most, the manufacturing recession is broad. Intensive manufacturing subsidies in China are causing competition to stiffen and making the medium-term prospects of the European industrial recovery much dimmer.

Despite the rather weak economy, the labour market has been holding up very well. The unemployment rate remains at an all-time low of 6.4%, and overall labour market dynamics resemble a soft-landing scenario, where job openings fall while the unemployment rate is stable. Furthermore, as inflation has retreated, real wages in the third quarter of 2023 were 1% higher than in the third quarter of 2022 (although still below 2021 levels). Real wage growth will accelerate further this year, supporting household consumption, although unemployment may start increasing in some of the sectors that have been affected the most.

Policy will not provide support for growth in the near term. Credit flows remain very weak across Europe as a result of high interest rates and tighter credit conditions. Rates are expected to start falling soon, but monetary policy will remain restrictive. Thus, demand for credit will likely recover and will boost the economy only towards the end of this year and in 2025. Fiscal policy will also be restrictive. The newly agreed update of the fiscal rules in the European Union offers only a marginal improvement over the previous ones. Depending on their enforcement, fiscal overtightening is a potential risk in several countries. For example, in Germany a constitutional court ruling at the end of 2023 led to significant spending cuts that will contribute to underperformance. Fiscal overtightening is a risk not only to near-term growth, but to strategic EU objectives.

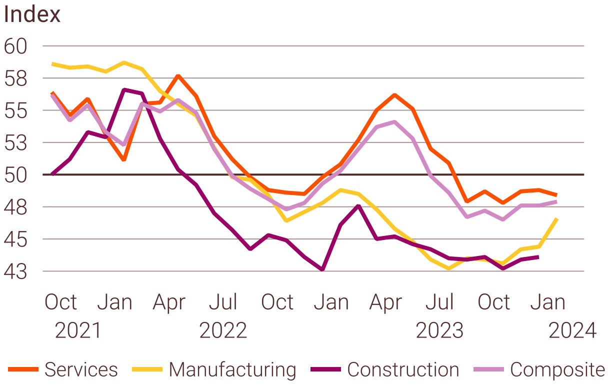
Overall, the euro area is expected to stagnate for the first half of the year. Then, as household purchasing power grows, rates start to drop and global trade picks up, growth is expected to normalise. Our estimate is that euro area GDP growth will amount to 0.3% this year and 1.5% in 2025.

EA unemployment rate is lowest on record



Sources: Swedbank Research & Macrobond

Euro area PMIs signal continued contraction



Sources: Swedbank Research & Macrobond

The ECB is almost ready to cut rates

The ECB governing council is trying to maintain its hawkish façade, but rapidly falling inflation and weak growth are likely to justify rate cuts sooner rather than later. At the end of 2023, both core and headline inflation readings surprised on the downside several times, and the current inflation trajectory is significantly below the latest ECB forecasts. We forecast that headline inflation will fall below 2% in the second quarter of 2024 and that underlying price pressures will follow with a short lag.

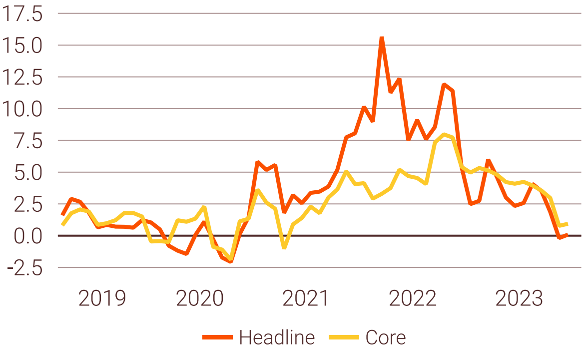
Risks to the inflation outlook are quite balanced; on the one hand, expiring state aid may lead to a higher-than-expected rise in administered prices, while on the other hand, weak demand could lead to more muted annual price revisions and larger sales discounts. The supply side could pose some risks to the inflation outlook in the near term. On the one hand, the energy markets remain calm, the winter season and its impact on heating costs has been mild, and gas storage tanks are full, leading to a further moderation of gas prices. However, Houthi rebel attacks in the Red Sea are affecting Europe-Asia trade, leading to a spike in transportation costs; this could lead to an inflation tick-up in Q2. This unwelcome, albeit temporary higher inflation could spark ECB hawkishness and postpone expected rate cuts. Not only could this prolonged monetary tightness further dampen economic growth, it could also increase the probability of credit events in most leveraged sectors.

While hawks are emphasising the increase in labour costs, which remain high, leading wage indicators point to slowing wage growth, and there is little evidence of a wage-price spiral. Instead, we are seeing wages trying to catch up with the shifted price level.

We are keeping our ECB forecast unchanged and expect the ECB to start cutting rates in April, and to do so six times this year, amounting to 150 basis points worth of cuts by year-end. Balance-sheet reduction will continue at a moderate pace, and the ECB's asset holding could fall by EUR 400 billion this year. So far, quantitative tightening in Europe has had no tangible effect, and a continued moderate pace is unlikely to cause stress in the sovereign markets.

Inflation momentum

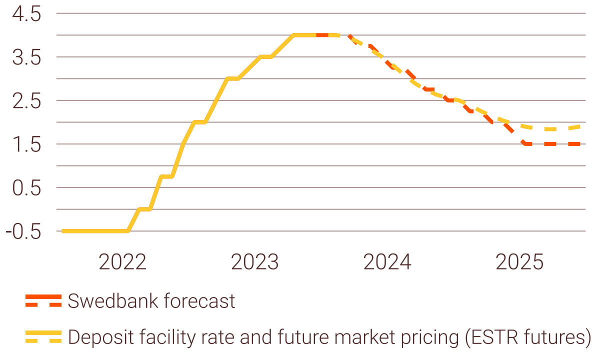
%, 3-month inflation, annualised rate, sa



Sources: Swedbank Research & Macrobond

ECB rate: market expectations and forecasts

%



Sources: Swedbank Research & Macrobond

Europe – an energy race on two fronts

Inflation is falling in most western economies, and much of the decline can be explained by falling energy prices. Two reasons for the fall in energy prices are that gas storage facilities in Europe are full and that renewable energy capacity has increased. Indeed, the EU's renewable energy capacity reached an all-time high in 2023, according to the International Energy Agency (IEA) and in July, the EU raised its binding renewable energy target for 2030 from 32% to a minimum of 42.5% of the total energy consumption. Thus, the EU is taking crucial steps towards a more sustainable economy.

On top of the EU's own targets, almost 200 nations (including EU member states) declared their global ambition to triple renewable energy capacity from 2022 levels by 2030 at the COP28 climate conference in December 2023. Based on current policies and market conditions, the IEA forecast is that the global capacity will reach 2.5 times its current level by 2030. Tripling the current level is within reach, if e.g., policy uncertainties are reduced (like sudden government interventions in energy markets) and that investments in grid infrastructure are increased.

With the world investing record amounts in renewable energy and thus in the green transition, there is one "but". Expanding renewable energy is not the only energy race that is underway. EU member states, especially those previously more dependent on Russian gas, have also invested billions of euros in building new liquefied natural gas (LNG) terminals and have experienced a significant increase in LNG imports. This energy race on two fronts may delay the transition.

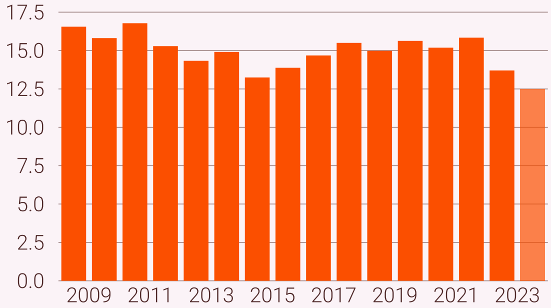
Even before the Russian invasion of Ukraine in 2022, natural gas was the fastest-growing fossil fuel, and the war has accelerated the global growth of natural gas further. While the EU experienced a 60% surge in LNG imports in 2022, it also agreed to long-term contracts with the US and Qatar, extending until 2050. This means emissions from usage of natural gas will continue.

In contrast to coal, gas has positioned itself as a less carbon-intense fossil fuel. However, more recently detected leaks of the invisible gas indicate a significantly greater climate impact from the gas sector than earlier emphasised. Methane, the main component of natural gas, emerges as a highly potent greenhouse gas when released without burning, capturing over 80 times more heat than carbon dioxide in the first 20 years after it is emitted. Consequently, a record increase in demand for natural gas is bad news for climate targets. In Sweden, the synonym "fossil gas" has been officially introduced and is recommended to make it clear that the gas is fossil and to reduce mixing it up with biofuels. Similar discussions are ongoing at the international level.

EU imports of LNG have increased sharply, and the trend looks set to continue going forward. However, gaseous fossil gas still makes up a larger share of EU imports and is on a falling trend. The total consumption of natural gas in 2023 will likely be somewhat lower than the total consumption in 2022. This is probably partly due to the weak economic development, not least in the manufacturing industry, that has certainly temporarily reduced the demand for gas.

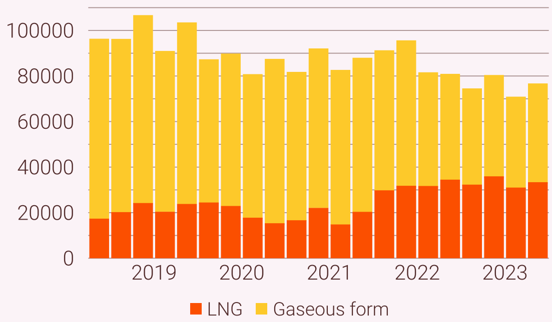
Taken together, investing heavily in the fossil gas makes it more lucrative; thus, there is a substantial risk that fossil gas will become a more permanent rather than transitional fuel. While fossil gas, admittedly, is now a crucial source of energy, it is not a long-term solution to a greener economy. Investments should therefore be considered in a way that supports energy security, lowers dependency on other countries and supports the green transition. Investing in renewable energy and storage is the best way to accomplish these objectives, although still involving some challenges with storage solutions and weather dependency.

EU consumption of natural gas
Million terajoule, annually, liquid and gaseous



Note: Latest outcome for 2023 is September, rest of months imputed
Sources: Eurostat & Swedbank Research

EU imports of natural gas
Million cubic metres



Sources: Bruegel & Swedbank Research

United Kingdom – domestic challenges

Despite the stagnant economy, the Bank of England is expected to delay policy rate cuts until June as both service inflation and wage growth are too high. A general election is expected later this year where the Tories are likely to hand over power to Labour.

The British economy is stagnating as domestic demand is constrained by the cost-of-living shock and increased interest rates. Indicators of economic activity within the manufacturing and construction sector remain low, while the service sector, which makes up the largest share of the British economy, has improved in recent months. As overall price pressures subside, households' real wage growth has entered positive territory. Later this year, household purchasing power and confidence will be further boosted by the lower interest rates that are on the cards, and consumption is expected to start to rebound. We estimate that GDP will grow around 0.5% and 1.3% in 2024 and 2025, respectively.

Weak economy with indications of brighter days ahead

The low domestic and global demand is expected to lead to a deterioration of the labour market going forward. So far, the labour market has remained fairly resilient, but there are some signs of a cooling as the number of job vacancies has decreased, especially in the services sector, and redundancies have started to rise. Furthermore, pay growth, which has been increasing at almost the highest pace on record, has recently started to slow somewhat. However, unemployment remained unchanged in the second half of 2023, according to labour market data.

Although inflation has fallen during the past year, it has remained stubbornly higher than in many other large economies. However, in recent months inflation has declined a little faster than the Bank of England had expected, mainly driven by lower prices for energy and core goods. Core and services inflation, on the other hand, remain sticky at 5.1% and 6.4%, respectively, although it is trending downwards, particularly for core inflation, where the three-month annualised rate is about 2.5%.

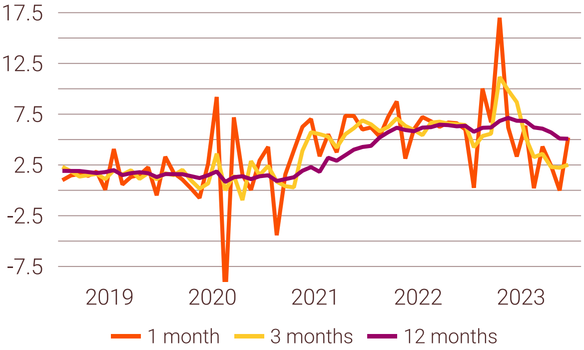
Bank of England will cut the policy rate in June

We expect that the Bank of England will abandon the higher-for-longer mantra sooner than its own forecast. This is supported by the inflation momentum slowdown, the stagnating economy, and the signs of a cooling labour market, such as slower wage growth. We therefore continue to expect that the British central bank will feel confident enough to start cutting the policy rate in June, especially given that both the Fed and the ECB will have made their first rate cuts by then.

Another important event for the United Kingdom is the upcoming general election which is expected to be held during the second half of this year. Will Prime Minister Rishi Sunak and the Conservative Party manage to win over Sir Keir Starmer and the Labour Party? Right now, the Tories are about 20 percentage points behind Labour, and so far, Sunak has only delivered on one of the five pledges that he made in January 2023, namely that inflation has been (more than) halved. The remaining pledges are to grow the economy, reduce the national debt, shrink National Health Service waiting lists, and stop migrants from crossing the English Channel in small boats. The last of these is the pledge where he seem to make some progress. Looking at our forecast, Sunak might also be able to deliver on growing the economy, but getting re-elected will be a tough race against the clock.

Momentum in core inflation trending down

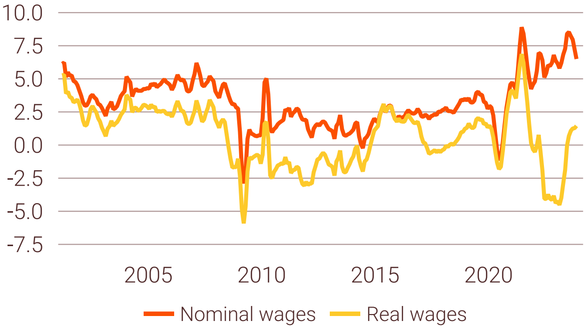
Core inflation, %, annualised rate, sa



Sources: Swedbank Research & Macrobond

Positive real pay growth

y/y %, sa, 3mma



Note: Real wages have been adjusted for CPI inflation.
Sources: Swedbank Research & Macrobond

China – staying afloat

China's economy continues to suffer the scars of the pandemic and a drawn-out property slump. Going forward, structural factors will mean an inevitable downshift in long-term growth potential. GDP growth is expected to slow to 4.5% this year and 4.3% next year.

In the midst of a cyclical and structural slowdown

China's GDP rose by 5.2% in 2023. Although this is a clear upshift from the prior year, the economy failed to gain solid traction following its re-opening early last year. Scarring effects from the pandemic such as damaged balance sheets and low economic confidence, as well as the property downturn, continue to weigh on the economy.

The economy will likely power through 2024 without much noise – a kind of continuation from the end of last year. Although pandemic scarring effects should gradually fade, consumer confidence is not expected to rebound quickly, putting a damper on consumption. The property sector downturn has yet to bottom out; property sales and prices continue to fall. We do not foresee a quick recovery, if any, this year; the situation will continue to hold back investments in this previously important growth engine.

Overall trade is expected to remain subdued this year as a result of lower global demand, but some sectors could see continued high growth. For example, China has become the world's largest exporter of cars thanks to a surge in demand for electric vehicles and increased sales to Russia.

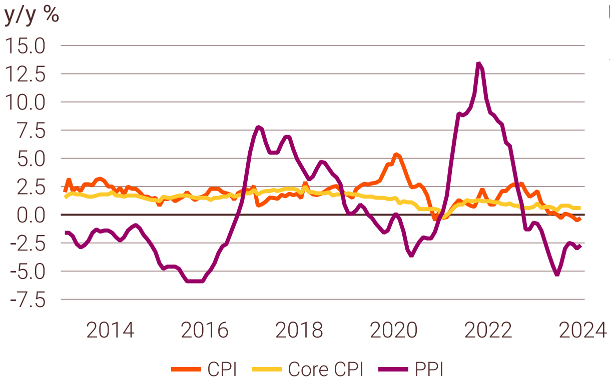
For the first time since records began, China recorded an outflow of foreign direct investments (FDI) in the third quarter of last year. If this marks a turning point with much lower FDI going forward or even continued outright outflows, the near-term effect on growth will likely be limited, but it could hurt China's competitiveness in the longer run.

Late last year, China made an unusual mid-year revision to its general budget deficit target, raising it from 3% of GDP (a target it traditionally sets and rarely exceeds) to 3.8%. The added fiscal support may indicate that policymakers felt more needed to be done to bolster the economy. While monetary policy is expected to remain accommodative, fiscal policy will continue to play a prominent role in propping up the economy this year. As such, investments in parts of the economy other than the property sector, mostly infrastructure but also advanced manufacturing, will continue to rise.

We forecast that China's GDP will grow by 4.5% this year. Downside risks dominate and include a further worsening of the property slump and geopolitical tensions. The economy is ultimately facing a structural slowdown driven by factors such as the need to rebalance away from investments towards consumption and by an ageing population. This lowers China's long-term growth potential. As such, we expect a further downshift in growth in 2025, to 4.3%.

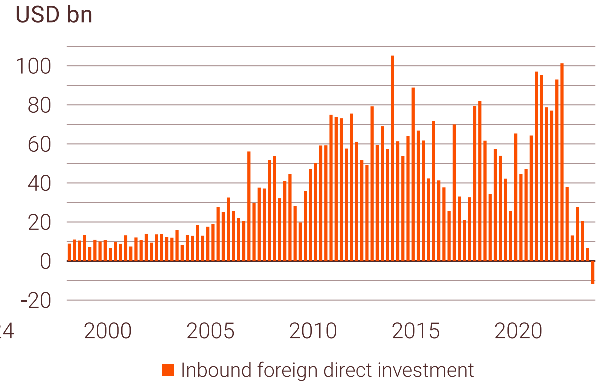
Structural headwinds lower the long-term growth potential

Deflation points to weak domestic demand



Sources: Swedbank Research & Macrobond

Foreign direct investment is exiting China



Sources: Swedbank Research & Macrobond

Sweden

Not as bad as feared

Falling inflation, lower interest rates and rising real incomes will pave the way for a rapid recovery of the Swedish economy in 2025. However, the near-term outlook is bleak, and the labour market will weaken during the year. The Riksbank will start cutting the policy rate in May.

Bleak near-term outlook, but rapid recovery in 2025

Parts of the Swedish economy are developing very poorly, particularly housing investment, but household consumption is also shrinking. However, a competitive export sector and high investment in the business sector are among the reasons that GDP growth has not declined as much as feared. We expect growth to remain subdued during the next six months before falling inflation, rising real incomes and lower interest rates contribute to a rapid recovery in the Swedish economy in 2025.

Sweden (%)	2023	2024	2025
Real GDP	-0.1	0.1	3.0
Inflation	6.0	2.0	1.3
Unemployment	7.7	8.4	8.4
Policy rate	4.00	2.75	2.00

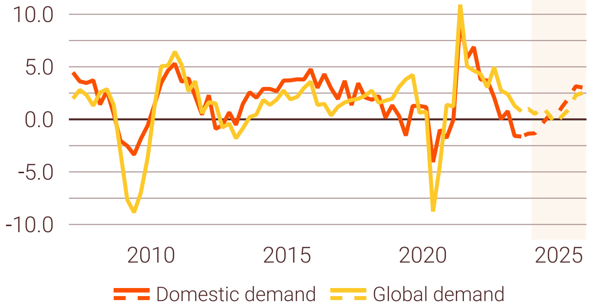
Swedish export has continued to grow despite weak demand in several partner countries, including Germany. Lower wage growth relative to many other countries and the weakening of the krona have contributed to Swedish competitiveness, while global demand for defence and green technology products has remained high. A rapid increase in exports to the United States, which has been Sweden's largest export market for the past year, probably also contributed to export growth. With a stronger krona and a slowdown in the US, we expect weaker export growth this year. We also expect a slowdown in business investments due to high interest rates and tighter margins. The outlook will improve towards the end of the year, and in 2025 we expect a rapid upturn in mainly domestic, but also global, demand. Although a soft landing seems increasingly likely, there are still risks to the outlook. In particular, the labour market could weaken more than expected, which would lead to lower domestic demand and weaker growth.

3%

GDP growth in 2025

Export growth has counteracted falling GDP ...

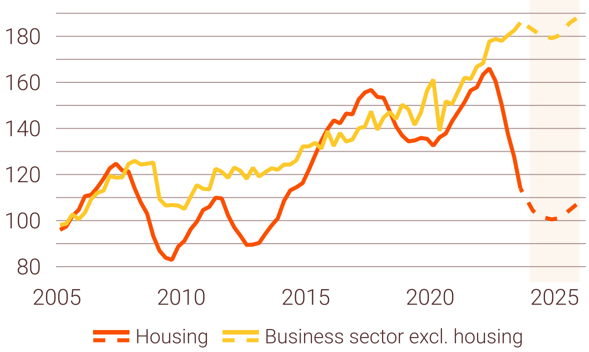
Contribution to annual real GDP growth, pp



Note: Domestic demand includes consumption and investment, and global demand includes exports. Contributions not adjusted for imports.
Sources: Swedbank Research & Macrobond

... and high investment in the business sector

Index (2005=100), constant prices, sa



Sources: Swedbank Research & Macrobond

Below-target inflation by summer

Inflation in Sweden was close to the Riksbank's target at the end of 2023 for the first time since 2021. In December, the annual rate in the CPIF, i.e. CPI with fixed interest rate, was 2.3%. Underlying inflation has also fallen significantly, and the annualised three-month change in CPIF excluding energy fell below 2% at the end of last year.

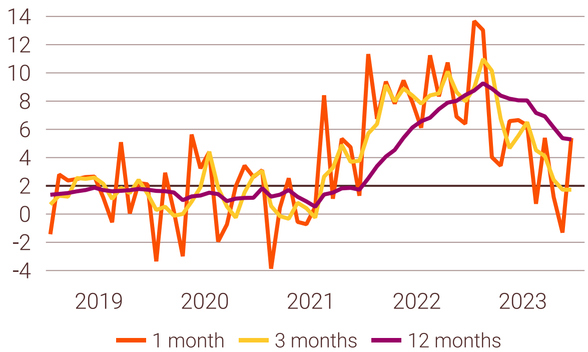
Less favourable base effects and delayed price increases, such as for rents and tenant-owner fees, will cause inflation to rise temporarily at the beginning of the year. However, the underlying trend is disinflationary and is supported by a stronger krona and by low input and commodity prices, as well as weak demand that is making it more difficult for companies to raise prices. Our assessment is that inflation will continue to fall for most of the year. CPIF inflation will fall below the 2% target by the summer and remain there for the rest of the forecast period. When the Riksbank begins to cut the policy rate, mortgage rates will follow, and CPI inflation will quickly approach CPIF inflation in late 2024. During 2025, global price pressures will rise in line with the improvement in economic activity, meaning that inflation will begin to rise towards the 2% target.

1.3%

CPIF inflation, December 2024

The underlying inflation trend has reversed...

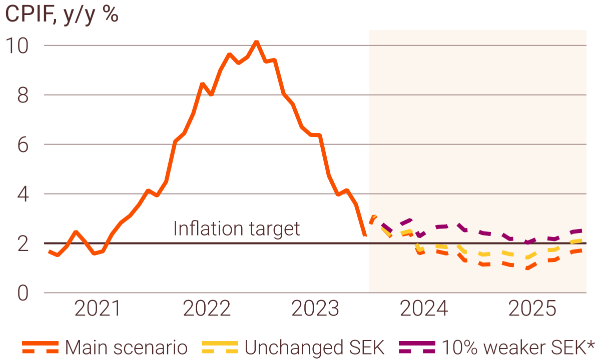
CPIF excl. energy, %, annualised rate, sa



Sources: Swedbank Research & Macrobond

... for the better, although upside risks exist

CPIF, y/y %



Note: *The scenario denotes permanent 10% SEK depreciation in Feb 2024
Sources: Swedbank Research & Macrobond

However, our forecast is subject to risks, one of them being another depreciation in the Swedish krona, contrary to our forecast. According to Swedbank's estimates, a krona that is permanently 10% weaker than the current level would leave inflation close to, or above, the 2% target in the next few years.[3] On the other hand, a weaker economic development than our baseline could put greater downward pressure on inflation going forward.

Increasing income and consumption

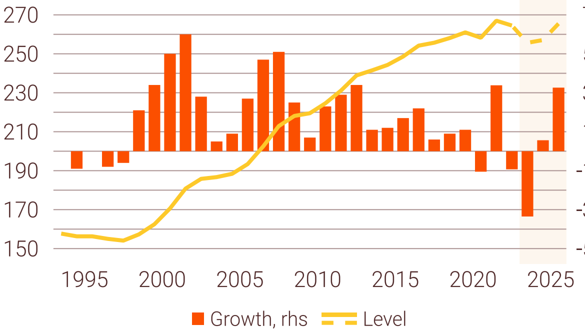
After two years of falling incomes, real disposable household income is expected to rise this year and next as inflation falls and public transfers increase. However, the increase in 2024 will be subdued as a result of the weakening of the labour market and the delayed impact of last year's rising interest rates, meaning that average interest expenditures will continue to rise this year. Next year, disposable income will rise much faster thanks to the recovery of the labour market and a decline in interest expenditure, meaning that real income per capita will return to the peak noted in 2021.

Households have so far reduced both consumption and savings in response to their weakened purchasing power. We expect consumption to remain subdued during the next six months as households act cautiously and increase their savings as the labour market weakens. This is supported by a pessimistic sentiment among households noted in the results of the Economic Tendency Survey, although households' expectations on their own financial situation have improved. In addition, more respondents than normal see an increased risk of becoming unemployed themselves.

We expect households to become increasingly optimistic and consumption to start rising in the second half of this year as real incomes increase. In addition, lower interest rates are expected to contribute to a recovery in the housing market, which will further strengthen optimism and a willingness to consume among households. Next year, consumption is expected to rise by 3.4%.

Improvement in real disposable incomes

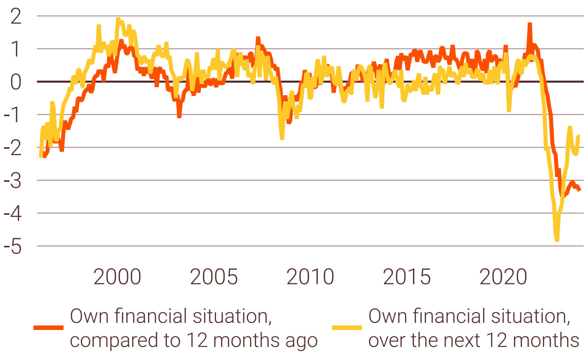
Real disposable income/capita, SEK thousand, % (rhs)



Note: Reference year is 2022
Sources: Swedbank Research & Macrobond

Households' expectations are improving

Standardised net percentage



Sources: Swedbank Research & Macrobond

[3] See Swedbank Macro Focus, "SEK and inflation: new estimates show a more rapid effect", 12 January 2024.

A weakening labour market, but some sectors maintain momentum

30 000

Decline in the number of employed people throughout the downturn

The labour market is gradually deteriorating. The employment rate has declined since the peak in the second quarter of last year, and the unemployment rate was 7.9% in November. We expect the situation to continue to deteriorate in 2024 as economic growth remains subdued, and the unemployment rate is expected to peak at 8.5% in the fourth quarter. Wage growth will slow in 2024 and 2025 to 3.7% and 3.5%, respectively. Adjusted for CPI inflation, real wages will increase from June 2024.

The outlook differs across sectors. Subdued domestic demand is weighing on employment in retail trade and the hospitality sector, as well as on residential construction and related industries such as architectural services. On the other hand, demand for labour is surging in the defence industry and in industries related to civil and public emergency preparedness, while green technology and services, as well as the IT sector, continue to see steady demand for labour. In the public sector, employment is increasing in the judicial system, while the largest employer – the local government sector – is struggling. Overall, we expect the public sector to maintain employment levels, but risks dominate on the downside.

With a quick recovery in sight in 2025, employers will try to maintain staffing levels in 2024. The expected decline in employment – just over 30,000 employees – will therefore be relatively mild compared to the decline in GDP. When growth picks up in 2025, employment will grow more slowly than GDP, as it will initially be possible to meet the upturn with existing staff.

Employment will grow more slowly than GDP in 2025

Sources: Swedbank Research & Macrobond

The Riksbank will start cutting the policy rate in May

Inflation is clearly on a downward trend and is expected to reach 2% by the summer – CPIF inflation in June and CPIF excluding energy in July. Meanwhile, the labour market continues to weaken, and outside Sweden, central banks are preparing for rate cuts. Given these conditions, we believe that the Riksbank will cut the policy rate to 3.75% at its meeting in early May. However, there is a significant risk that the first cut will not come until June, for example if the ECB does not cut as expected in April or the krona weakens again.

Regardless of when the first cut comes, the Riksbank is then expected to quickly lower the policy rate further to a long-term normal level, which we believe is 2% (see the in-depth analysis on page 27). The rate path is motivated by the fact that inflation is continuing to fall and that, in 2025, it is expected to be lower than the inflation target. The policy rate will then need to be cut quickly for inflation to stabilise around 2%. Given that the economic downturn is expected to be fairly mild and we estimate that fiscal policy will be somewhat expansionary in 2025, the policy rate does not need to be lowered below normal levels for inflation to start rising towards the target next year.

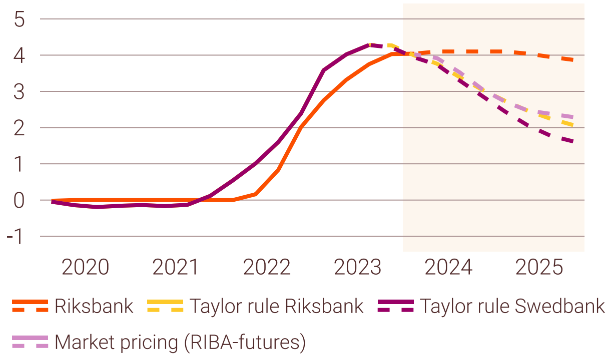
Our assessment is supported by what is known as the Taylor rule for the policy rate.[4] Central banks' interest-rate setting can often be described by simple policy rules, and these estimations are also an important input to monetary policy decisions. Such policy rules describe the Fed's interest-rate setting surprisingly well, and to some extent also the Riksbank's behaviour.[5] Considering the Riksbank's latest forecast for inflation and unemployment, the Taylor rule indicates that the policy rate should be cut as early as the second quarter of this year and then further to just over 2% in the last quarter of 2025. This is significantly lower than the Riksbank's own policy rate forecast, and almost perfectly in line with current market pricing as well as our forecast.[6] With our lower forecast for core inflation, the Taylor rule indicates an even lower policy rate in 2025.

2%

Normal policy rate

The Taylor rule indicates rate cuts soon

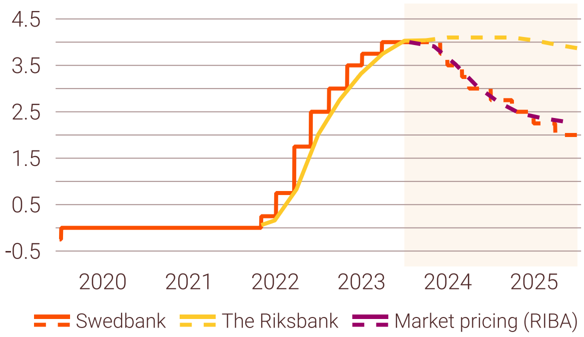
Policy rate, % quarterly averages



Sources: Swedbank Research & Macrobond

Policy rate cuts will start in May

%



Note: The Riksbank's forecast refers to quarterly averages.
Sources: Swedbank Research & Macrobond

Interest rate cuts will pave the way for housing market recovery

Housing construction has slowed markedly and will continue to weigh on growth through 2024 before the outlook slowly improves. Housing starts have fallen by more than 70% since their peak in late 2021, while the number of

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[4] In its simplest form, the Taylor rule implies that the policy rate is set equal to the long-term (normal) level plus 1.5 times the deviation of inflation from the inflation target minus the deviation of unemployment from the equilibrium unemployment rate. Here, inflation is measured with CPIF excl. energy and the long-term policy rate is set to 2%. Equilibrium unemployment is the assessment of the Swedish National Institute for Economic Research. In practice, central banks do not move the policy rate as quickly and as much as the Taylor rule suggests, and policy is better described by a smoothed rule.

[5] See Jonsson and Katinic (2017), "Is the Swedish monetary policy in line with the Taylor rule?", Economic Commentary, Sveriges Riksbank.

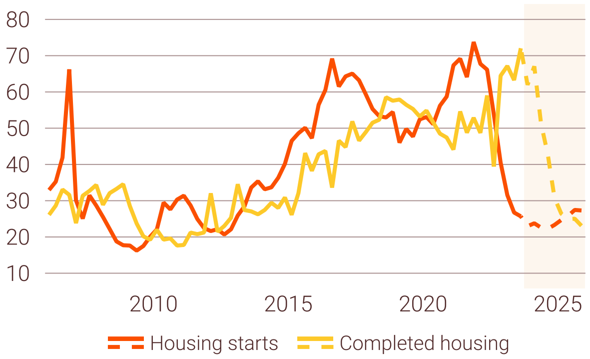
[6] Swedbank's forecast for the policy rate is almost identical to the policy rate indicated by the Taylor rule with the Riksbank's forecasts for inflation and unemployment.

completed homes has remained high so far. However, later this year, housing completions will fall sharply, and total residential investment is expected to fall by 16% in 2024, weighing on GDP growth. As interest rates decline and real household incomes start to rise, the housing market outlook is expected to improve, with a cautious recovery starting in 2025.

The continued large supply of homes for sale, together with the high pace of new housing completions and high interest rates, suggests that the housing market will remain cautious in the first half of 2024. Last year, housing prices remained broadly unchanged after their decline in 2022, but we expect prices to fall by up to 5% in the first half of 2024.

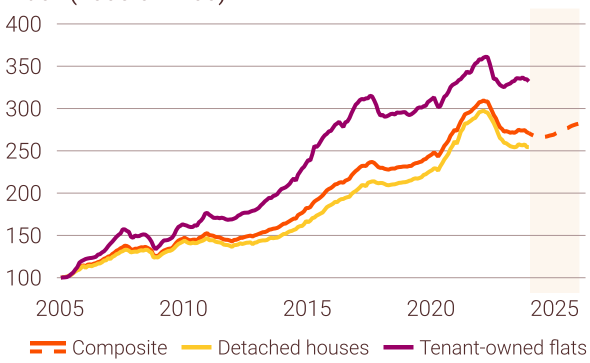
A recovery will begin in the second half of this year with modest price increases. Next year, the housing market will gain a little more momentum, with prices expected to rise by 5%. This is mainly explained by the fact that uncertainty about mortgage rates is likely to fade and that households' financial situations will have clearly improved while housing construction will remain low.

Sharp drop in completed homes in 2024
Thousands, annualised rate, sa



Sources: Swedbank Research & Macrobond

Swedish housing prices will rise in 2025
Index (2005-01=100)



Sources: Booli, Valueguard, Swedbank Research & Macrobond

Surplus target will be abandoned after the forecast period

Public finances quickly returned to a surplus after the pandemic, but a deficit is forecasted this year, as the economy will remain weak and a capital injection to restore the Riksbank's equity capital will weigh on government net lending.[7] However, the budget deficit is almost negligible compared with, for example, the levels seen in the euro area and the United States. The Maastricht debt is rising slightly but will remain well below the debt anchor of 35% of GDP in 2025.

Fiscal policy will continue to focus on bringing down inflation in the near term, but we assume a slightly more expansionary policy by 2025. By then, we expect SEK 50 billion in unfinanced measures in the government budget, of which a significant part will be tax cuts aimed at households. Given that several social insurance benefits are linked to last year's inflation, transfers to households as a share of GDP will increase slightly this year. Despite permanently higher government transfers to the municipal sector, the outlook presents challenges, and the public consumption growth in 2024 and 2025 will

[7] We expect the capital injection to amount to SEK 45 billion. Read more here.

mainly be driven by higher central government consumption, while the growth in the municipal sector will be limited.

A review of the fiscal policy framework has been initiated, and an appointed parliamentary committee will present its findings later this year. No new framework will come into effect during the forecast period, but the debate is likely to be heated in the coming year. Judging from the discussions so far, the surplus target will be abandoned, but whether it will be replaced by a balanced target or a benchmark for the government deficit remains to be seen.

The Riksbank's policy rate – 2% in the long run

Now that central banks, including the Riksbank, are finished with policy rate increases and a lowering cycle is approaching, the question arises: what is a normal level for policy rates? The level is driven above all by inflation expectations and by the global equilibrium real interest rate, which has been falling for several decades. However, the downward trend in long-term bond yields that began in the 1980s appears to have been broken after the pandemic. The question is, where might interest rates go in the future?

The global equilibrium interest rate is determined by the relationship between supply and demand for savings. Demographic development, with a high percentage of the population saving for an increasingly longer period as pensioners, has meant a high level of savings. The slowdown in the growth of the global labour force is reducing the need for investment at the same time as the relative price of investment has fallen. In addition, global incomes have increasingly accrued to groups with a high propensity to save. Another factor that affects the equilibrium interest rate is trend-wise lower productivity growth. These factors have contributed to driving down the equilibrium interest rate. In the extreme long term, the demographic development may speak for reduced savings which, together with necessary climate investments, could drive up the equilibrium interest rate. The majority of studies conclude, however, that the equilibrium interest rate will remain low for at least the next decade.[8]

The Riksbank's most recently published assessment of the long-term normal level for the policy rate is from February 2017, and it was then 2.5–4.0%.[9] Already at that time, market pricing and survey expectations were at a lower level. The Swedish National Institute of Economic Research (Konjunkturinstitutet) regularly publishes scenarios, and in its latest, from December 2023, the policy rate is 2.25% for the next 3–10 years. During the pandemic, market pricing and survey expectations fell sharply to below 1%, but have bounced back to levels between 2 and 3% in recent years.[10]

[8] See, eg. Lundvall, Henrik (2023), "Drivkrafter bakom globala trender i den neutrala räntan", , appendix to Långtidsutredningen 2023, only in Swedish.
[9] See "The repo rate in the long run", article in the Monetary policy report, February 2017, The Riksbank.
[10] Market pricing can be illustrated with the calculated 5-year swap rate in 5 years' time. This measure probably contains a certain positive term premium and is thus probably an overestimate of the expected average policy rate in 5 years. Expectations for the policy rate in 5 years have been included in the Prospera survey of money market participants since the third quarter of 2005. The two measures show approximately the same development over time.

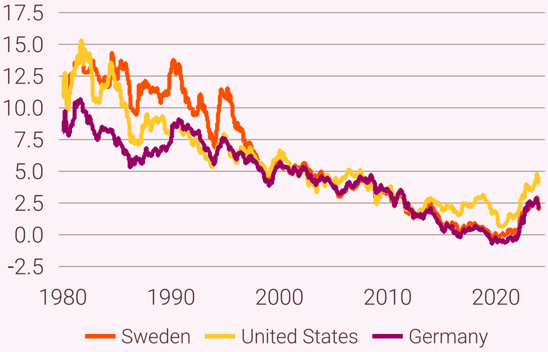
The Federal Reserve Bank of New York continuously publishes model estimates of the real natural policy rate for the US and the euro area based on the Holston-Laubach-Williams model.[11] This model uses inflation, GDP and policy rate data to extract trends in economic activity and natural interest rates based on the estimated relationship between the deviation of interest rates from the natural level and economic activity. These estimates of the natural rate also show a downward trend. Armelius et al. (2023) have made estimates for Sweden with a similar method that uses more data series to better identify the trend in economic activity.[12] Common to these estimates is that they now point to a very low natural real interest rate, and this rate has not risen much in recent years despite the rapid rise in inflation and policy rates. By adding the model's expected inflation to the estimated natural real interest rate, a measure of the normal nominal policy rate can be obtained. The estimate for Sweden with data up to and including the third quarter of 2023 indicates that the normal policy rate has risen from about -0.5% during the pandemic to barely +0.5% at the end of 2023.

Swedbank's overall assessment is that the global equilibrium interest rate has fallen for a long time and that, since 2015, a normal policy rate in Sweden has been around 2%. Demographic factors may well contribute to rising global equilibrium interest rates in the very long run, but most models, surveys and market pricing indicate at most marginal effects in the next 5-10 years. During the pandemic, many estimates of the normal policy rate were pushed down even lower and then rose, as the actual policy rate has been raised. The levels of these estimates are now, however, roughly the same as in 2015-2019, despite significantly higher interest rates. This provides support for the assessment that the normal level in the longer term is still low.

Our forecast is that the Riksbank will gradually lower the policy rate to 2% by mid-2025, which means that monetary policy will remain tight, albeit to a lesser degree. If inflation were to persistently fall below the inflation target, or if the economy's performance worsened, the Riksbank would have to lower the policy rate below 2%.

Long trend with falling interest rates

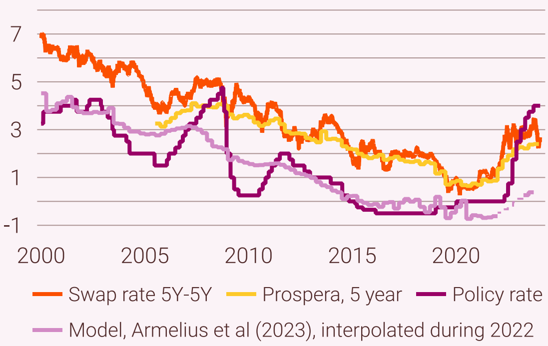
%, 10-year government bond yield, monthly data



Sources: Swedbank Research & Macrobond

Long-run normal policy rate in Sweden

%, actual policy rate and estimates of normal level



Sources: Swedbank Research & Macrobond

[11] See Measuring the Natural Rate of Interest – Federal Reserve Bank of New York (newyorkfed.org).

[12] Armelius, Hanna, Martin Sohlberger, Erik Spånberg and Pär Österholm (2023), "The evolution of the natural rate of interest: evidence from the Scandinavian countries", Empirical Economics (springer.com) Thanks to Erik Spånberg for updating the estimates with data up to and including the third quarter of 2023.

Norway

Core inflation is still running too hot

Inflation momentum is still too strong for Norges Bank, forcing continued sensitivity to cost pressures in the economy. The economy will remain clearly divided, at least until the first policy rate cut that we expect to see towards the summer.

A technical recession excluding oil

The Norwegian economy continued to expand only moderately at the end of last year. While the overall mainland economy has so far avoided any quarters of contracting activity, most of the strength is driven by interest rate-insensitive oil and gas investments. Excluding this sector, the Norwegian mainland economy has already encountered a technical recession of two quarters of declining activity. Looking ahead, we expect the mainland economy to remain at a standstill in the short term, with a potential decline in activity during the first half of this year and a slight recovery during the second half. This is also conditional on somewhat lower policy rates.

Norway (%)	2023	2024	2025
Real GDP	1.1	0.3	1.1
Inflation	6.2	3.3	2.0
Unemployment	1.8	2.3	2.5
Policy rate	4.50	3.75	2.75

The outlook for households remains mixed as higher interest rates are biting, while real wage growth has improved markedly and employment growth has only recently started to taper. Nevertheless, there are clear signs that households have been forced to prioritise their expenditure more than normal, as consumption of large durable goods such as cars, boats and white goods remains sluggish, while services consumption is holding up. We also expect that the boost from the excess pandemic savings has been exhausted following the five consecutive quarters of negative household savings and three quarters of decline in household demand reported in national accounts. Despite anticipated solid growth in petroleum investments, household demand remains below trend, which may contribute to slower overall activity growth in the coming year.

The labour market has been on a weakening trend in the past year, albeit only very slowly. The number of unemployed people has increased, as unemployment within the construction sector has risen. However, at 1.9%, the unemployment rate is staying close to historically low levels. A further increase in the unemployment rate is, however, expected this year as growth remains slow and uneven, especially within construction and retail trade. Labour shortages are also moderating somewhat, as the number of new vacancies has decreased from elevated levels. Wage growth is seen remaining high in the coming year, but slowly receding going forward. From the current rate of above 6%, we expect nominal wage growth to stand at a little below 5% this year, resulting in some real wage growth for households.

Inflation has been trending down from the peak levels seen during the first half of last year, both for headline and core. At 5.5%, core inflation remains far too high, and it will take time before we see clear signs that it will converge more permanently towards the inflation target of 2%. A continued weak Norwegian krone (NOK) and high expected wage growth remain the most important drivers of the current inflation momentum, together with companies' ability to take home margins. While slowing global inflation is affecting imported price growth, the past weakening of the NOK has delayed the impact of these impulses on Norwegian prices. Domestic price pressures are expected to remain elevated in the short term as a result of high unit labour costs and a weak NOK. However, core inflation is expected to slow more markedly towards the summer, and we project that core inflation will be below 3% already in June.

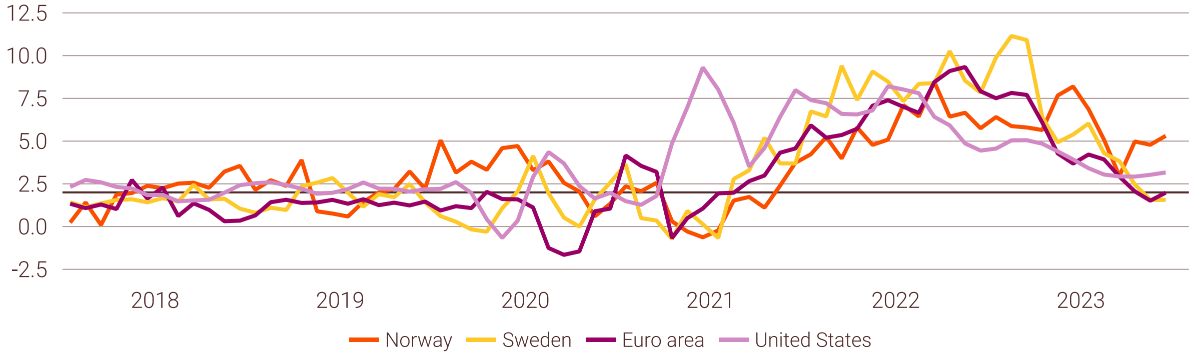
CPI-ATE in June 2024

2.9%

Norges Bank hiked the policy rate to 4.5% in December but signalled that the rate would likely remain at this level for some time, effectively signalling that the peak had been reached. Regardless, the central bank is seen maintaining a hawkish stance due to higher-than-target inflation, a fragile NOK, and limited signs of weakening labour markets. Hence, we expect Norges Bank to be on hold, not signalling any intentions of cutting the policy rate in the near term. However, given that we project a faster slowdown in core inflation than Norges Bank, our baseline scenario is for a

Norwegian inflation momentum remains higher than in peer economies

m/m %, 3m ma, annualised rate, sa (CPI ex energy)



Sources: Swedbank Research & Macrobond

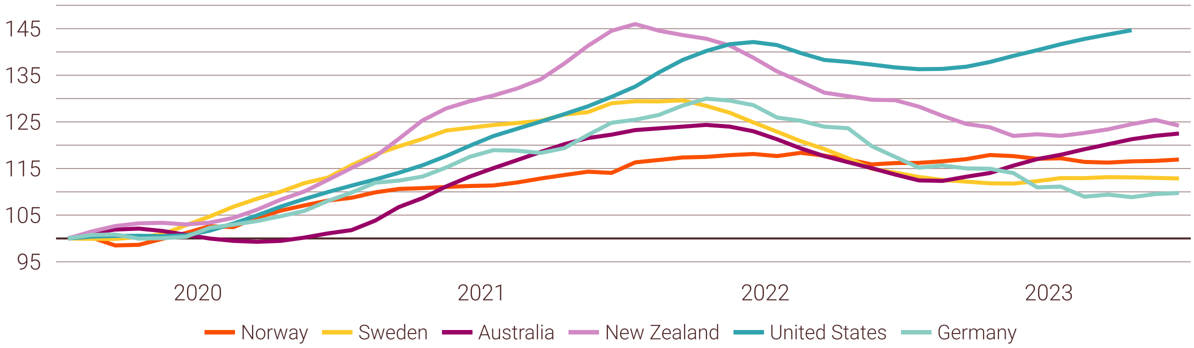
first rate cut in June. The risk to that outlook, however, is mainly concentrated on the hawkish side. We expect Norges Bank to remain highly sensitive to the inflation outlook, so it could take more time before the central bank starts cutting the policy rate. On the other hand, the lagged effects of Norges Bank's faster-than-normal rate hikes could be greater on the economy, as pandemic savings may now have been exhausted. Credit growth is already weak, both for households and non-financial corporates, a sign that higher policy rates are already having an impact. In the near term, inflation will likely remain the key variable for Norges Bank to monitor. As such, we expect that Norges Bank will cut the policy rate only gradually during the second half of this year and through next year, to reach a level of 2.75%, close to a normal level.

3.75%

Norges Bank's policy rate by December 2024

Housing prices in Norway have remained close to their all-time highs in the past few months, despite higher and mostly floating mortgage rates and high household leverage. This more sideways development contrasts with that of several peers, where house prices rose strongly during the pandemic years and declined more thereafter. However, looking ahead, it is anticipated that housing prices in Norway will see a flat to slightly negative development during the first half of this year, but recover more strongly during the second half, as interest cuts commence. Moreover, given a strong decline in construction of new homes during the past few years, there could be a ketchup effect on house prices and investment activity once interest rates start fading. Overall, we expect nominal house prices to increase by 4% this year, implying roughly unchanged real house prices.

Real estate price development: more sideways in Norway than in peer economies
Index (2020-01=100)



Sources: Swedbank Research & Macrobond

Three years in recession

The Estonian economy will remain in mild recession in 2024, and the labour market will worsen temporarily. We expect moderate growth next year, as demand will improve.

Estonia (%)	2023	2024	2025
Real GDP	-3.4	-0.3	2.8
Inflation	9.2	3.7	2.7
Unemployment	6.5	8.1	6.9

In real terms, the Estonian economy fell 3.5% year-on-year in the first three quarters of 2023. As the population increased, GDP volume per capita dropped by nearly 6% in the same period. The Estonian economy has contracted since the beginning of 2022, and by the third quarter of last year, GDP had fallen by 5.7% below the pre-recession peak.

The largest negative influence on the decline in GDP volume in the first three quarters of 2023 came from energy production and transportation, which together accounted for more than half of the decline. Electricity production, which remains largely based on non-renewables, has become less competitive in Estonia, while the contraction of economic activity and more efficient use of energy has reduced its consumption. The transportation sector was affected by weaker demand and by discontinued transit from Russia.

Weak foreign demand has led to a further drop in goods exports. Service exports, which increased in the first half of the year, also began to decline in the third quarter. The large contraction of imports of intermediate goods shows that the decline in production volumes and in the export of goods will continue, at least in the next few months. However, the expected improvement in the economies of Estonian trading partners and gradual recovery in their demand will provide opportunities to increase exports in the second half of 2024.

Continued decline in production volumes going forward

Although nonfinancial corporates' profits fell in the second half of 2023, the level remained high in a historical comparison. The same applies for their profitability (profit share in turnover), which remained high compared to the last six years. This makes it easier to understand why the labour market has been so resilient in the protracted economic recession. Employment continued to increase, the unemployment rate picked up only moderately, and wage growth was highly robust last year. However, economic confidence continued to worsen in the fourth quarter. Unemployment is set to rise, as real labour productivity has already been declining for a long time, while demand and economic activity are expected to remain weak in the first half of this year. Although we forecast that the unemployment rate will pick up and nominal wage growth will slow, we do not expect anything very dramatic. Earnings growth will remain strong in 2024, supported by a 13% increase in the minimum wage and an 11% increase in pensions.

Pensions will be increased by

11%

The economic recovery in 2025 is expected to generate lower unemployment, and it will support strong wage growth. Real wages have already been increasing since the middle of last year, but given that household confidence remains weak, there will be a delay in the expansion of consumption volumes. Households have shifted more of their savings to term deposits, which could limit their consumption spending in the next few months, at least. Although income tax will be increased next year, we forecast a strong pick-up in net wages in real terms, given that the minimum for non-taxable income will be raised for a large share of households. We forecast a modest increase in private consumption this year, while next year households will be able to consume considerably more.

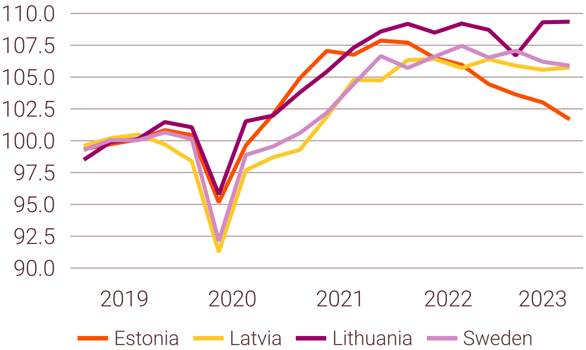
The Estonian economy is expected to rebound to quarter-on-quarter growth in the first half of this year, but for the full year, a decline will be seen. We forecast moderate growth in 2025, fuelled by stronger domestic demand and the return of export growth. Only in 2026 is Estonia's GDP volume expected to exceed the pre-recession peak of the fourth quarter of 2021 – thus, the economy will lose more than four years.

Estonian economy will lose more than four years to the recession

Despite the tax hikes that will be implemented in 2024 and 2025, government expenditures will increasingly exceed revenues and the budget will fall into a larger deficit. As a result, the government will have limited options to expand spending and to stimulate the economy. Government debt will pick up, although as a share of GDP, it will remain one of the lowest in Europe.

A contracting economy since Q1 2022

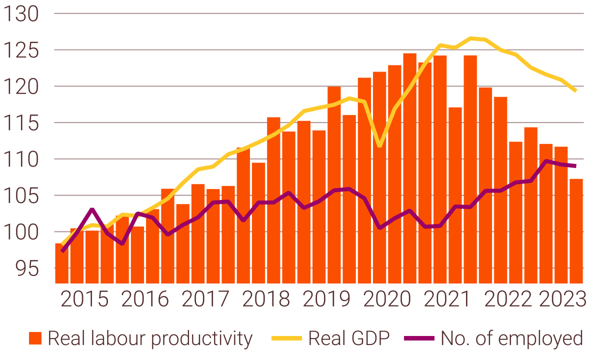
GDP index (2019=100), at constant prices, swda



Sources: Swedbank Research & Macrobond

Underutilisation of employees is increasing

Index (2015=100)



Sources: Swedbank Research & Macrobond

Stagnation will not last forever

The Latvian economy is coping rather well with the challenges posed by a high price level, high interest rates and weak external demand. With inflation low, economic growth will return this year. Declining interest rates will boost recovery in 2025.

Latvia (%)	2023	2024	2025
Real GDP	-0.4	1.4	2.7
Inflation	8.9	1.5	2.5
Unemployment	6.4	6.5	6.1

The good news is that Latvia's inflation story has changed dramatically from a year ago. Last year started with inflation at more than 21%, but by the end of the year the level had reached a meagre 0.6%. That being said, the consumer price level is 30% higher than it was in 2020, which helps to explain the downbeat consumer sentiment. Barring major geopolitical turbulence, inflation will be much less of a focus this year, averaging 1.5%. The effects of lower global input costs and energy prices will be a notable drag on average inflation figures throughout 2024. The only area where inflation will be rather stubborn is services, given that the cost of labour in Latvia continues to grow rapidly.

Inflation no longer causing headache

The less positive news is that Latvia's GDP declined in the first three quarters of 2023. However, given the weakness among trade partners and the high price level faced by households and firms, an estimated contraction of 0.4% in 2023 overall is not a bad result. Both net exports and private consumption declined last year. GDP was supported by strong investment and government consumption.

The weakness in goods exports that has been observed for more than a year has turned out to be contagious – in the third quarter of 2023, services exports also fell below the level seen a year ago. Travel and air transport are still on the rise, while road transport is declining, and income from exports of business services stagnated in 2023. Exports will continue to disappoint for a large part of 2024. A recovery will begin once the changing interest rate path re-ignites the economic growth of Latvia's trade partners.

On the back of a notable loss in purchasing power, private consumption was the other weak link in 2023. The tide is turning, though; retail trade has risen in the last few months, and deflated bank card data shows a year-on-year increase in the final quarter of 2023. Although on the road to recovery, private consumption growth is likely to remain slow at the start of this year. With inflation low and wages growing by 8% in 2024, purchasing power will continue to rebound, boosting consumption growth down the road.

Labour market to weaken just slightly

Consumption will also be supported by a resilient labour market. Despite the stagnant economy, unemployment was lower last year than in 2022. Labour market conditions deteriorated somewhat in the third quarter – unemployment edged up and employment dropped below the prior year's level. Given the sluggish economy and the decline in seasonal jobs, we expect further weakening. However, unemployment will peak at just 6.7% in the first half of 2024 before gradually coming down later in the year.

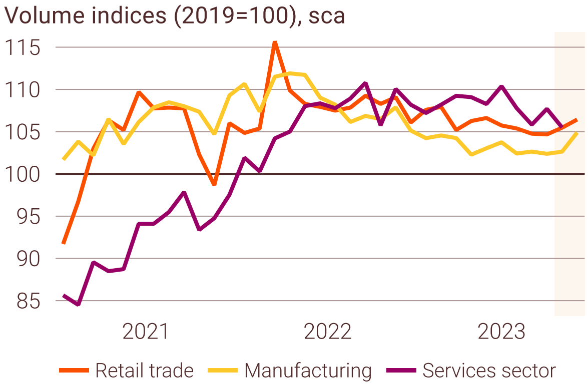
Investment was up in 2023 largely thanks to public and EU fund-linked projects, and the trend will continue this year. Private investment will continue to struggle in the high interest rate environment, especially in the first half of 2024. Declining rates and an improving economic outlook will help revive the drive to invest, but a stronger recovery will take time.

Regulatory uncertainty an obstacle to strong medium-term growth

Overall, a pick-up in economic growth is on the cards only for the second half of 2024. Growth will average just 1.4% this year. A more pronounced recovery is expected in 2025, fuelled by lower interest rates, higher purchasing power and recovering trade partner economies. For Latvia to step up the pace of convergence with average EU income levels, medium-term economic growth needs to be far above the 2.7% expected in 2025. A key prerequisite is a stable and predictable business and regulatory environment. The recently approved bank levy, aimed at supporting mortgage-takers by effectively lowering the interest rate they pay, is a step backwards in achieving this objective. It was a rushed and poorly handled legislative process that disregarded data and resulted in the state regulating prices in the financial sector. Such an approach to policy-making increases uncertainty for businesses by adding another facet of risk at a time when there is no shortage of challenges.

Latest indicators for Q4 signal GDP growth

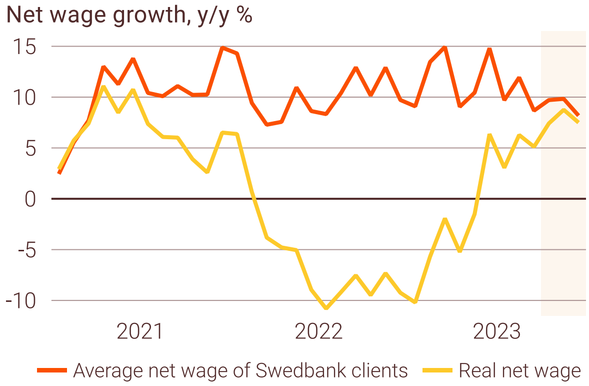
Volume indices (2019=100), sca



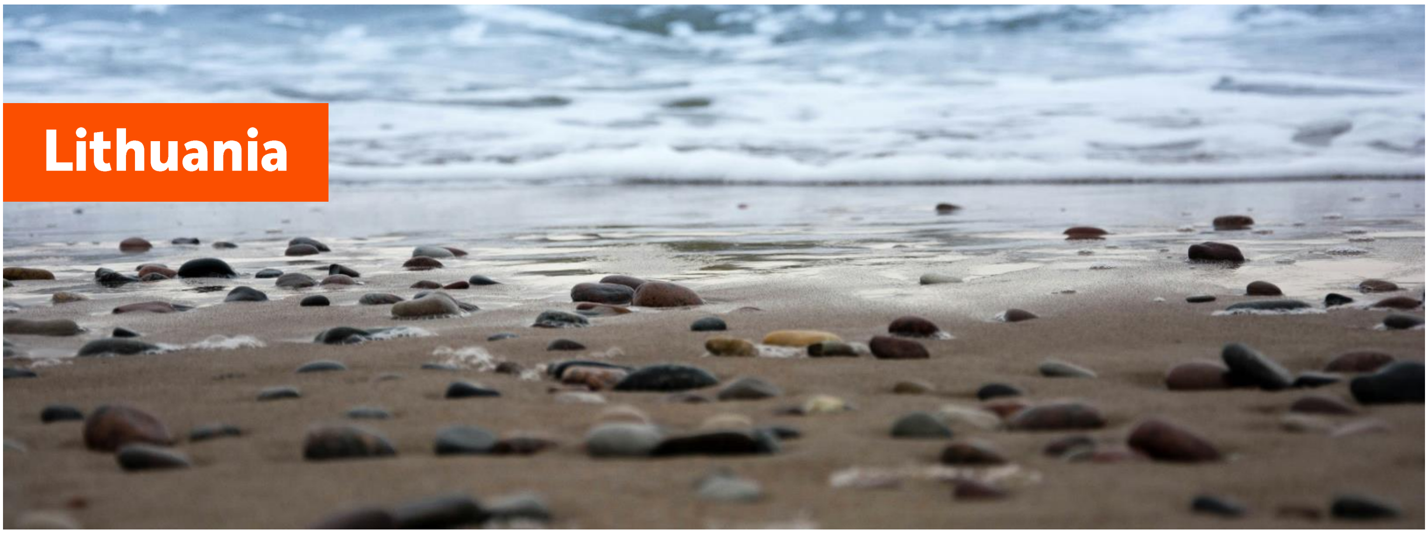
Sources: Swedbank Research & Macrobond

The return of purchasing power

Net wage growth, y/y %



Sources: CSB, Swedbank Research & Macrobond



Saved by investments

GDP growth rebounded at the end of last year, and the momentum is likely to continue in 2024. Inflation fell faster than most expected, and retail trade and manufacturing output are no longer shrinking. Investments, especially public, significantly boosted economic growth. We are revising GDP growth for this year and next year up to 1.8% and 2.5%, respectively.

Lithuania (%)	2023	2024	2025
Real GDP	0.0	1.8	2.5
Inflation	9.3	1.5	2.5
Wage growth	11.7	8.5	6.5

A recovery of economic activity in the final quarter of last year probably means that GDP contraction was avoided in 2023. Despite a fall in household consumption and exports, the year was saved by 10% growth in investments. The Lithuanian government distributed a record amount of EU funds for investments in infrastructure, energy generation, defence, R&D, and ICT development. The sum distributed was 35% more than in 2022 and is expected to continue increasing this year.

Inflation fell to 1.2% at the end of last year and is likely to stay at low levels throughout 2024. We forecast that average annual inflation will drop to 1.5% this year before picking up to 2.5% in 2025. Although some excise taxes and VAT for restaurants increased at the start of this year, the change will have very limited impact on overall inflation. On the contrary, we estimate that prices of some consumer goods have increased more than what is justified by commodity and energy costs, so they could fall further or at least stagnate this year. The only inflationary source that remains is rapid wage growth, but this is likely to be reflected only in a slightly elevated increase in prices of services.

We forecast that wage growth will decelerate to 8.5% this year and ease further in 2025. We have already seen large divergences across sectors, where exporters and real estate

GDP growth will accelerate to
1.8%

“Only”
8.5%
wage growth this year

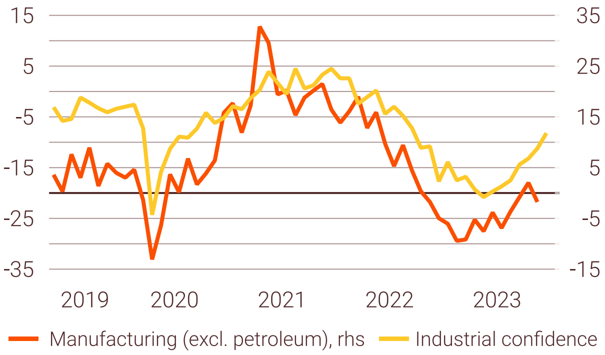
developers were affected the most and had fewer opportunities to increase wages at the same pace as other sectors. Admittedly, we have been forecasting slower wage growth for the past six years, but wages kept increasing by close to 10% every year for several reasons – labour shortages, a rapid increase in minimum wage, a decline in the share of wages paid under the table, and an increasing share of employment in higher value-added jobs and sectors. Nevertheless, we are sticking to our deceleration forecast – we expect global demand to remain weak and fragmented, while the competition will intensify, leaving less room for unchecked labour cost growth.

For now, the benefits will be reaped by consumers – real wage growth will be close to 7% this year. Minimum net wages and average pensions will increase by 12% this year, providing a strong boost to purchasing power and, consequently, household consumption. This is the main reason why we are less pessimistic about 2024 and are increasing our GDP growth forecast. At the same time, we do not expect an imminent rebound in manufacturing and exports, although stable export orders and a rebounding industrial confidence indicator suggest that the worst may be behind us.

This year, growth will be further supported by public spending and a positive fiscal impulse. We estimate that the budget deficit will increase to 2.5% of GDP and provide broad-based stimulus to the economy – from higher pensions and public sector wages to a continued increase in public investments. In 2025, the budget deficit is likely to fall, but the private sector will take over as a driver of growth – through larger exports of goods and recovering investments in housing.

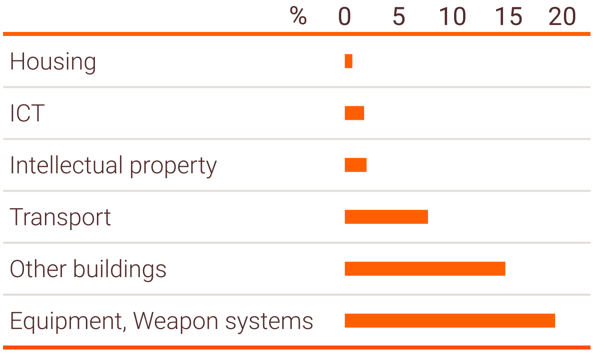
Recovering output and confidence

balance %; y/y % (rhs)



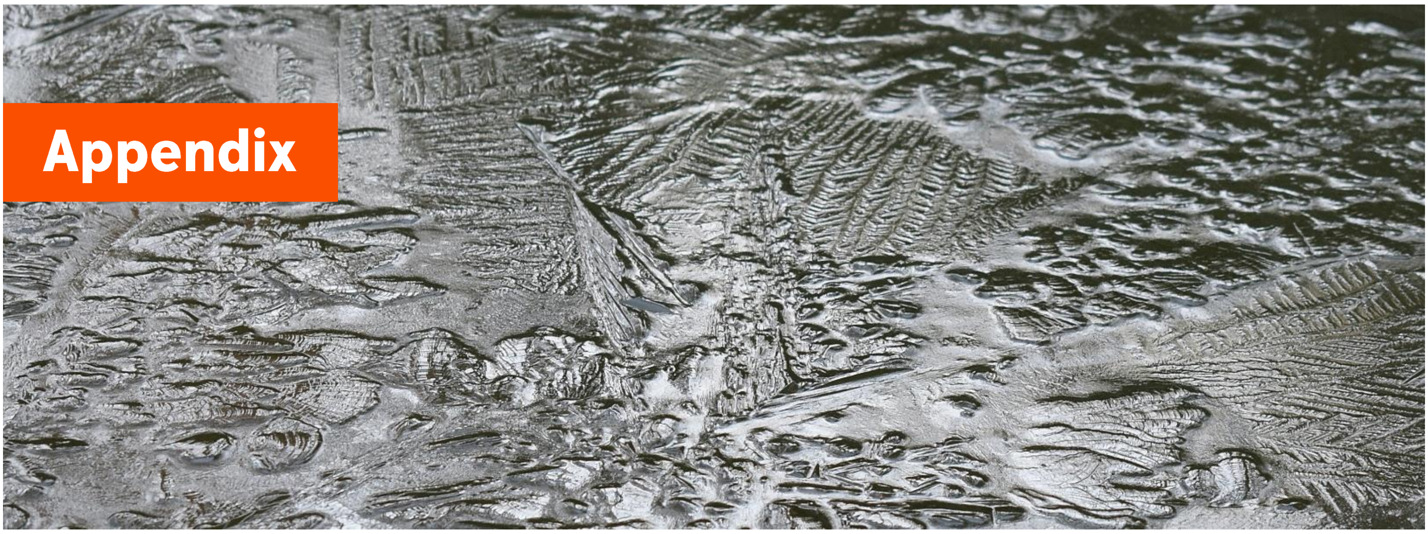
Sources: Swedbank Research & Macrobond

Investments increased last year, not least because of public efforts



Sources: Swedbank Research & Macrobond

Appendix



SWEDEN: Key economic indicators, 2022-2025

Annual % change unless stated otherwise	2022	2023F		2024F		2025F	
Real GDP growth (average, calendar-adjusted)	2.9	-0.1	(-0.5)	0.1	(-0.4)	3.0	(2.0)
Real GDP growth (Q4-Q4, calendar-adjusted)	-0.3	-0.2	(-0.7)	0.7	(0.8)	3.9	(2.1)
Real GDP growth	2.9	-0.4	(-0.7)	0.0	(-0.4)	2.8	(1.7)
Household consumption	1.8	-2.5	(-2.0)	0.2	(0.2)	3.4	(2.3)
Government consumption	-0.1	2.0	(1.9)	1.3	(1.4)	1.5	(1.6)
Gross fixed capital formation	6.0	-1.3	(-2.1)	-2.8	(-3.1)	2.0	(0.0)
private, excl. housing	8.4	4.3	(1.7)	-1.5	(-2.2)	1.5	(-1.1)
public & NPISH	-1.0	3.7	(5.9)	3.8	(4.2)	4.0	(3.3)
housing	4.8	-23.9	(-21.3)	-16.4	(-15.6)	1.7	(0.5)
Change in inventories (contribution to GDP)	1.0	-1.4	(-0.6)	-0.1	(-0.3)	0.2	(0.0)
Exports, goods and services	7.3	2.6	(1.6)	0.8	(0.4)	2.8	(2.1)
Imports, goods and services	9.2	-1.2	(-0.1)	-0.1	(-0.2)	2.5	(1.6)
Domestic demand (contribution to GDP)	2.3	-1.0	(-1.0)	-0.3	(-0.4)	2.3	(1.4)
Net exports (contribution to GDP)	-0.6	2.0	(0.9)	0.5	(0.3)	0.3	(0.3)
CPI (average)	8.3	8.6	(8.6)	3.1	(3.8)	0.7	(1.4)
CPI (Dec.-Dec.)	12.3	4.4	(4.7)	1.3	(2.3)	0.9	(1.1)
CPIF (average)	7.7	6.0	(6.1)	2.0	(2.4)	1.3	(1.4)
CPIF (Dec.-Dec.)	10.2	2.3	(2.6)	1.3	(1.7)	1.7	(1.4)
CPIF ex energy (average)	5.9	7.5	(7.6)	2.5	(3.1)	1.5	(1.7)
CPIF ex energy (Dec.-Dec.)	8.4	5.3	(5.7)	1.7	(2.3)	1.9	(1.6)
Riksbank policy rate (Dec.)	2.50	4.00	(4.00)	2.75	(3.50)	2.00	(2.50)
Unemployment (% of labour force, 15-74)	7.5	7.7	(7.7)	8.4	(8.5)	8.4	(8.4)
Change in labour force (15-74)	1.5	1.7	(1.6)	0.3	(0.2)	0.7	(0.5)
Change in employment (15-74)	3.1	1.4	(1.4)	-0.4	(-0.7)	0.6	(0.6)
Number of hours worked (calendar-adjusted)	2.3	1.2	(1.5)	-0.7	(-1.2)	1.3	(0.9)
Nominal hourly wage (NMO), whole economy	2.7	3.8	(3.8)	3.7	(3.7)	3.5	(3.4)
Household real disposable income per capita	-0.9	-3.4	(-4.1)	0.6	(-0.2)	3.4	(2.8)
Household nominal disposable income	6.8	3.5	(2.9)	3.2	(2.7)	5.1	(5.1)
Household savings ratio, % of disposable income	13.0	12.5	(11.6)	13.5	(11.8)	13.4	(12.0)
General government budget balance (% of GDP)	1.3	-0.1	(0.0)	-1.6	(-1.0)	-0.9	(-0.8)
General government debt (Maastricht), % of GDP	32.8	31.2	(31.4)	32.4	(32.1)	33.2	(32.7)

Previous forecast in parentheses
Source: Statistics Sweden & Swedbank Research

ESTONIA: Key economic indicators, 2022-2025

Annual % change unless stated otherwise	2022	2023F		2024F		2025F	
Real GDP	-0.5	-3.4	(-2.5)	-0.3	(0.7)	2.8	(2.3)
Household consumption	2.0	-2.0	(-2.2)	0.5	(1.5)	3.0	(3.5)
Government consumption	0.1	0.5	(1.0)	2.0	(1.5)	1.5	(2.0)
Gross fixed capital formation	-3.7	-5.5	(-13.0)	-1.5	(3.0)	5.0	(5.0)
Exports of goods and services	3.0	-8.0	(-4.5)	-2.0	(1.0)	3.0	(3.0)
Imports of goods and services	3.2	-7.0	(-6.0)	-1.5	(0.7)	3.0	(4.0)
CPI (average)	19.4	9.2	(9.5)	3.7	(3.8)	2.7	(2.4)
Unemployment (% of labour force)	5.6	6.5	(6.8)	8.1	(7.6)	6.9	(6.3)
Employment	4.1	2.5	(2.0)	-0.9	(-0.4)	0.5	(0.3)
Gross monthly wage	11.6	11.4	(11.2)	7.3	(7.4)	6.9	(7.1)
Nominal GDP, billion euro	36.0	37.6	(38.2)	38.9	(39.8)	41.0	(41.6)
Exports of goods and services (nominal)	23.5	-6.1	(-1.6)	-1.0	(3.0)	5.1	(5.1)
Imports of goods and services (nominal)	22.7	-7.0	(-4.6)	-0.6	(2.7)	5.1	(6.1)
Balance of goods and services, % of GDP	-0.6	0.3	(2.0)	-0.2	(2.1)	-0.2	(1.4)
Current account balance, % of GDP	-2.9	-3.0	(-1.4)	-2.2	(-0.5)	-2.1	(-1.4)
General government budget balance, % of GDP	-0.9	-2.8	(-2.6)	-3.4	(-3.0)	-3.2	(-2.5)
General government debt (Maastricht), % of GDP	18.5	19.8	(19.6)	21.3	(21.1)	22.7	(22.5)

Previous forecast in parentheses
Source: Statistics Estonia & Swedbank Research

LATVIA: Key economic indicators, 2022-2025

Annual % change unless stated otherwise	2022	2023F		2024F		2025F	
Real GDP	3.4	-0.4	(-0.4)	1.4	(1.4)	2.7	(2.5)
Household consumption	6.0	-1.8	(-2.1)	1.7	(1.3)	3.5	(3.4)
Government consumption	2.8	6.1	(4.4)	2.7	(1.6)	2.0	(2.0)
Gross fixed capital formation	0.6	5.6	(6.0)	4.5	(4.2)	3.6	(3.6)
Exports of goods and services	10.3	-6.1	(-4.0)	-1.5	(0.5)	4.5	(4.4)
Imports of goods and services	11.1	-3.4	(-2.4)	-0.5	(0.5)	4.7	(4.8)
CPI (average)	17.3	8.9	(9.0)	1.5	(1.8)	2.5	(2.5)
Unemployment (% of labour force)	6.9	6.4	(6.5)	6.5	(6.6)	6.1	(6.1)
Employment	2.6	0.0	(0.0)	0.0	(0.0)	0.5	(0.5)
Gross monthly wage	7.5	11.8	(11.5)	8.0	(8.0)	7.5	(7.5)
Nominal GDP, billion euro	38.9	41.0	(41.8)	42.3	(43.6)	44.8	(46.1)
Exports of goods and services (nominal)	29.9	-7.7	(-5.9)	-2.9	(1.6)	5.7	(5.6)
Imports of goods and services (nominal)	31.7	-8.2	(-6.5)	-1.5	(0.5)	5.4	(5.5)
Balance of goods and services, % of GDP	-4.5	-3.6	(-3.6)	-4.3	(-2.7)	-4.2	(-2.7)
Current account balance, % of GDP	-4.7	-3.4	(-2.8)	-3.8	(-2.0)	-3.5	(-2.0)
General government budget balance, % of GDP	-4.6	-2.8	(-2.5)	-3.6	(-3.4)	-3.2	(-1.7)
General government debt (Maastricht), % of GDP	41.0	42.0	(40.4)	43.3	(41.6)	43.8	(41.5)

Previous forecast in parentheses
Sources: Statistics Latvia & Swedbank Research

LITHUANIA: Key economic indicators, 2022-2025

Annual % change unless stated otherwise	2022	2023F		2024F		2025F	
Real GDP	2.4	0.0	(-0.3)	1.8	(1.2)	2.5	(2.0)
Household consumption	2.0	-1.0	(-1.0)	3.7	(2.8)	4.2	(4.2)
Government consumption	0.4	0.5	(0.5)	0.8	(1.0)	0.5	(0.5)
Gross fixed capital formation	3.6	10.0	(8.5)	5.5	(3.2)	6.0	(5.5)
Exports of goods and services	12.2	-4.2	(-2.8)	2.5	(2.5)	4.4	(4.4)
Imports of goods and services	12.4	-5.5	(-3.0)	4.5	(4.0)	5.4	(5.4)
CPI (average)	19.6	9.3	(9.4)	1.5	(1.8)	2.5	(2.5)
Unemployment (% of labour force)	5.9	6.6	(6.7)	6.8	(7.1)	6.6	(6.7)
Employment	3.8	1.1	(1.0)	-0.6	(-0.7)	-0.1	(0.1)
Gross monthly wage	13.3	11.7	(11.7)	8.5	(8.5)	6.5	(6.2)
Nominal GDP, billion euro	67.4	73.6	(73.4)	76.3	(75.6)	80.1	(79.0)
Exports of goods and services (nominal)	29.4	-4.4	(-4.6)	4.2	(4.2)	5.8	(5.5)
Imports of goods and services (nominal)	40.3	-10.5	(-10.5)	5.0	(5.0)	7.0	(6.5)
Balance of goods and services, % of GDP	-2.0	3.2	(3.1)	2.7	(2.5)	1.8	(1.8)
Current account balance, % of GDP	-5.5	1.7	(1.4)	1.3	(1.1)	0.7	(0.7)
General government budget balance, % of GDP	-0.7	-0.7	(-1.3)	-2.5	(-2.6)	-2.2	(-2.2)
General government debt (Maastricht), % of GDP	38.1	36.8	(37.5)	37.8	(38.8)	40.0	(41.3)

Previous forecast in parentheses
Sources: Statistics Lithuania & Swedbank Research

Interest and exchange rate forecasts

	Outcome 2024 23 Jan	Forecast 2024 30 Jun	2024 31 Dec	2025 30 Jun	2025 31 Dec
Policy rates (%)					
Federal Reserve, USA (upper bound)	5.50	5.00	4.00	3.50	3.00
European Central Bank (refi rate)	4.50	4.00	3.00	2.25	2.00
European Central Bank (deposit rate)	4.00	3.50	2.50	1.75	1.50
Bank of England	5.25	5.00	4.00	3.25	2.75
Riksbank	4.00	3.50	2.75	2.25	2.00
Norges Bank	4.50	4.25	3.75	3.25	2.75
Government bond rates (%)					
US 2y	4.31	3.80	3.40	3.30	3.20
US 5y	4.06	3.60	3.50	3.50	3.50
US 10y	4.14	4.00	3.70	3.60	3.60
Germany 2y	2.70	2.15	2.00	1.90	1.80
Germany 5y	2.26	2.10	2.10	2.00	2.00
Germany 10y	2.31	2.15	2.15	2.10	2.10
Exchange rates					
EUR/USD	1.08	1.12	1.14	1.14	1.14
EUR/GBP	0.86	0.88	0.88	0.87	0.85
EUR/SEK	11.35	11.00	10.80	10.70	10.50
EUR/NOK	11.43	10.90	10.60	10.50	10.30
USD/SEK	10.44	9.82	9.47	9.39	9.21
USD/CNY	7.09	7.10	6.90	6.90	6.90
USD/JPY	148.4	138.0	130.0	130.0	125.0
NOK/SEK	0.99	1.01	1.02	1.02	1.02
KIX (Trade-weighted SEK)	125.4	120.9	118.8	117.9	116.0

Sources: Swedbank Research & Macrobond

Swedish interest rate forecasts (%)

	Outcome 2024 23 Jan	Forecast 2024 30 Jun	2024 31 Dec	2025 30 Jun	2025 31 Dec
STIBOR 3m	4.09	3.60	2.85	2.35	2.10
Government bond yields					
2y	3.02	3.00	2.70	2.50	2.20
5y	2.30	2.40	2.30	2.30	2.30
10y	2.27	2.40	2.40	2.50	2.50
Swap rates					
2y	3.12	3.30	3.00	2.80	2.50
5y	2.67	2.70	2.60	2.60	2.60
10y	2.66	2.70	2.70	2.80	2.80

Sources: Swedbank Research & Macrobond

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