Nordic Outlook

November 2021

Recovery, with speed bumps

Research Reports

SEB

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Recovery, with speed bumps

For a long time, the economic recovery went much faster than expected. But this autumn the situation took a turn for the worse. Old problems have lingered, and new ones have emerged. Although the recovery is continuing after a sharp economic downturn early in the pandemic, numerous and difficult speed bumps remain.

A tug-of-war is currently under way in the world economy. On the one hand, we have strong demand, solid growth and improved labour markets. On the other hand, there are major supply side problems, clear bottlenecks and rampant inflation that seems unwilling to subside quickly. This tug-of-war will be the main focus of economic drama in the coming months and quarters.

Supply side problems have not only persisted but in some cases have worsened. Shortages of components – most famously but not exclusively including semiconductors – continue to limit production capacity in many industries and countries. On top of this, an energy crisis has recently emerged. Energy shortages have led to higher costs for all energy-intensive production and in some cases have also led to actual rationing. In China, the factory of the world, production facilities have sometimes been forced to cut back operations or close down completely. Global transport chains also have continuing problems; once goods have been produced, it is still hard to get them where they are supposed to go. Transport times are long and prices still high, although some improvements are now discernible.

When demand in strong but supply cannot keep up, we expect prices to rise. And rise they do, as we know. The inflation upturn that began this summer has persisted and accelerated. It is now affecting both household purchasing power and the way various central banks view monetary policy. The focus of attention is the United States, where year-on-year inflation is now above 6 per cent: the highest in over 30 years. And it has not yet peaked. The US Federal Reserve is gently starting to ease its stimulus measures, but this is a delicate balancing act. The same liquidity reductions and key interest rate hikes that may be required to extinguish the fires of inflation also risks extinguishing a much-needed recovery. Looking ahead, central banks will probably remain in the spotlight as they weight the risks of inflation against threats to economic growth.

This November 2021 issue of *Nordic Outlook* includes five in-depth theme articles that discuss the following:

- The labour market
- Fossil fuels on fire
- COP26 in Glasgow
- Halts in production
- China

Nordic Outlook will hopefully give you new insights about a complicated and fascinating situation in the world economy, which is on the road to recovery but constantly faces both warning signs and speed bumps. We wish you pleasant reading and hope the rest of 2021 will bring many happy moments. Stay safe and keep on helping others in need!

Jens Magnusson
Chief Economist

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Head of Economic Forecasting

The global economy

The United States | page 22

The stimulus-driven recovery is showing signs of overheating. The labour supply is expected to increase as virus worries ease. Unexpectedly high, long-lasting inflation will still cause the Fed to begin a series of rate hikes in September 2022.

China | page 35

Risks to Chinese growth are deepening. Aside from domestic troubles in the credit and real estate markets, there is an energy crisis. Zero tolerance of COVID-19 is creating continued problems for both domestic supply and global value chains.

The euro area | page 28

Transport disruptions and component shortages are among short-term headwinds for industry. High energy prices will curb household purchasing power for some months. Inflation will fall in 2022. ECB key rates will be unchanged.

The United Kingdom | page 34

Brexit-related challenges and high energy prices are dampening economic growth. Inflation will be above target throughout our forecast period, and the Bank of England will hike its key interest rate several times, starting early in 2022.

International overview
Recovery will be resilient to inflation shock

The global economy is facing supply chain disruptions, renewed COVID-19 transmission and an energy crisis that is driving inflation higher. We expect these disruptions to ease during 2022 and our GDP forecasts are reliably positive. Inflation will fall but its stronger, broader impulse will force various central banks to hike key interest rates earlier than expected. Our main scenario is that policy mistakes will be avoided. Prospects of calmer inflation will dampen the upturn in long-term yields and provide support for risk appetite.

In recent months, the economic outlook has been dominated by growing uncertainty on multiple fronts. The manufacturing sector is increasingly hampered by transport problems and other supply disruptions. Rapidly rising energy prices are making inflation especially strong, undermining household purchasing power. In the United States, the phase-out of earlier household stimulus measures has also contributed to a consumption slowdown. Bottleneck tendencies in the labour market have recently become apparent in many countries. Today unemployment is not far from pre-pandemic levels. The share of businesses complaining about recruitment problems has rapidly climbed to historically high levels. In the US and the United Kingdom, this has also been manifested in accelerating pay increases. If the situation does not improve, this threatens central bank plans for a gentle normalisation process, while forecasts of above-trend GDP growth for a few more years will be hard to achieve.

Lingering pandemic-related disruptions. In various respects, today's challenges are connected to how post-pandemic reopening processes unfold. Despite rising vaccination rates, the spread of COVID-19 has again increased. Although restrictions and lockdowns no longer threaten the overall recovery, pandemic-related disruptions will persist for longer than expected. Continued depressed service consumption will create imbalanced demand, with overheating in many goods sectors. This puts heavy demands on transport capacity, while China's zero tolerance of virus transmission is hampering the global transport system, for example because key ports cannot be fully used. Renewed virus transmission is also holding back the labour supply. The main focus of this *Nordic Outlook* is on analysing the duration of these factors. This applies especially to our theme articles on China's challenges, threats to global value chains and labour supply problems. In addition, the current energy crisis – with its rising prices and power shortages – raises difficult questions about how fast the transition to fossil-free energy supplies can take place and what trade-offs must now be made. Various aspects of climate transition are addressed in theme articles on the energy market and COP26 in Glasgow.

Stable GDP forecasts. Despite the challenges that have emerged this autumn, GDP forecasts have been relatively stable over the past six months. Forecasts for major advanced economies have generally converged, with downward adjustments for the US and upward ones for Western Europe. In September's *Nordic Outlook*, we chose to distance ourselves to some extent from the optimistic tone that the International Monetary Fund (IMF) adopted in its July forecast. Now we are lowering our global GDP growth forecast for 2021 to 5.7 per cent from the previous 5.9, mainly due to slightly worse prospects for the US, China and India. We have also lowered our 2022 forecasts for the US and China a bit, but due to faster growth in Japan and elsewhere, we still foresee global GDP growth of 4.4 per cent. We have adjusted our 2023 global forecast marginally higher.

Global GDP growth

Year-on-year percentage change

	2020	2021	2022	2023
United States	-3.4	5.6	3.9	2.2
Japan	-4.6	2.5	2.7	1.2
Germany	-4.6	2.9	4.6	3.0
China	2.3	8.2	5.2	5.4
United Kingdom	-9.7	6.9	4.9	2.8
Euro area	-6.4	5.1	4.4	2.6
Nordic countries	-2.2	4.1	3.5	2.4
Baltic countries	-1.7	5.7	4.0	3.5
OECD	-4.6	5.2	3.9	2.4
Emerging markets (EM)	-2.1	6.2	4.8	4.3
World, PPP*	**-3.3**	**5.7**	**4.4**	**3.5**

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

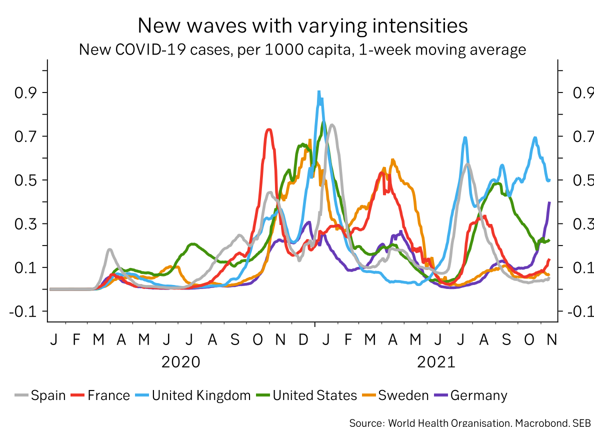
As for inflation, our revisions are bigger: it will be both more powerful and longer-lasting than projected earlier – especially in the US, where we expect it to peak around 7 per cent in January. In Western Europe, with the partial exception of the UK, the upturn will be milder and is highly focused on energy prices. Next spring, inflation will gradually begin to fall. But in the US, CPI will probably exceed 3 per cent throughout 2022.

Central banks are facing a classic dilemma, with a risk that interest rate hikes will amplify the tightening effect of an energy supply shock. But if they fail to act, there is a risk that inflation expectations will soar, especially in economies where price increases have broadened and pay hikes have accelerated. We now expect the US Federal Reserve to begin hiking its key interest rate in September 2022, then take gradual steps to a 1.50 per cent rate at the end of 2023. In the UK and Norway, we expect the key rate to end up fairly close to the Fed's level by the end of our forecast period. In the euro area and Sweden, central banks have a long way to go before hiking key rates; the European Central Bank will keep rates unchanged throughout the period, while a strong Swedish economy will persuade the Riksbank to finally implement a hike during the latter part of 2023.

The market trusts central banks. The bond market is dominated by a belief that central banks will succeed in fighting inflation without making policy mistakes and derailing the recovery. This implies a positive yield curve but still puts a lid on long-term bond yields. We have raised our 10-year Treasury yield forecast to 2.50 per cent by end-2023. The spread against European yields is widening. German and Swedish 10-year yields will reach only 0.40 and 0.95 per cent respectively. Changes in relative monetary policies will drive foreign exchange markets this coming year. Fed normalisation will strengthen the US dollar to 1.11 per euro by late 2022. The EUR/SEK exchange rate will remain relatively stable but reach 9.70 by late 2023. Stock markets have been very resilient to stresses this autumn. After a temporary slump, equities have climbed to new records in many places. Assuming that supply shocks subside in line with expectations, we foresee further potential in 2022. To some extent, strong earnings growth has lowered high valuations. Earnings forecasts have come down, adapting to a more mature cyclical phase.

New waves with varying intensities

New COVID-19 cases, per 1000 capita, 1-week moving average



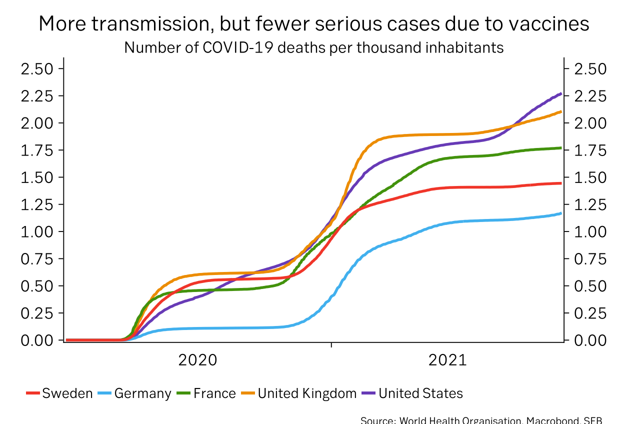
Source: World Health Organisation, Macrobond, SEB

The pandemic refuses to release its grip

Despite rising vaccination rates and improved vaccine availability in the world, infection rates are rising again. This is true not only in less developed economies, which are lagging in vaccinations for various reasons, but also among rich countries. Restrictions are on their way to being re-imposed in many countries, which may affect their economic outlook, but all indications are that these restrictions can increasingly be designed in a way that has limited financial consequences and emphasises encouraging people to get vaccinated instead of curbing their mobility. High vaccination rates and lessons learned from COVID-19 have also helped keep down the number of new deaths and serious illnesses, reducing the motives for drastic lockdowns. In addition, effective new medicines that lower the number of deaths and serious illnesses will be available next year.

More transmission, but fewer serious cases due to vaccines

Number of COVID-19 deaths per thousand inhabitants

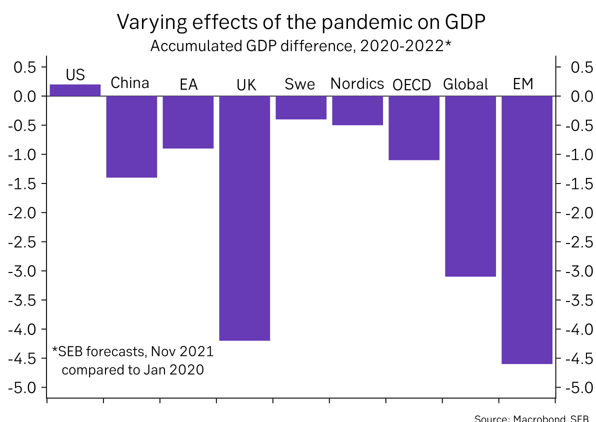


Source: World Health Organisation, Macrobond, SEB

Yet virus transmission will be felt in some ways. There is a risk that international travel restrictions will be extended or re-imposed. Long-distance travel will probably remain at a low level for quite some time. Infection curves in the world are unsynchronised, contributing to continued problems for global trade and transport systems, especially due to China's policy of zero tolerance for transmission. In the US, COVID-19 deaths have rebounded, delaying the return to a normal social life in some areas, for example by keeping labour supply down. But since the Delta variant wave has now culminated, we can hope for improvements soon.

Unexpectedly strong global demand for goods is creating extra-large bottleneck problems, since global transport capacity is already being hampered by the pandemic. Broken supply chains have led to increasing problems with deliveries of input goods, especially semiconductors – increasingly hurting industrial production. These problems are worsened by the European/Asian energy crisis. Disruptions in global value chains threaten economic recovery, while generating inflation and stressing monetary policy (see the theme

article on page 31). Our conclusion – based on historical comparisons, business surveys, anecdotal data and seasonal patterns – is that global supply problems will culminate in Q1 2022, then hamper world trade to a diminishing extent for another six months.



Risk outlook: Focus on role of supply side

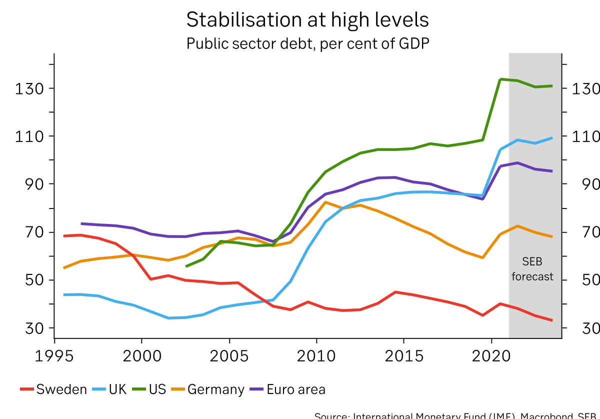
The pandemic is unlikely to paralyse the economy again, so downside risks in our forecast will increasingly deal with inflation and failures related to central bank exit strategies. If labour market shortages do not ease, wages may surge – showing that current macro forecasts and financial market pricing are based on an overly positive view of the supply side. Central banks would then probably choose to tighten their policies, triggering major stock market and home price declines. If they did not act, inflation expectations would instead take off, completely losing touch with inflation targets. An escalation of problems in China's real estate market, which authorities are failing to deal with, may also have far-reaching effects on the global economy.

Various scenarios for the OECD countries
GDP growth, per cent

	2021	2022	2023
Main scenario	5.2	3.9	2.4
Negative scenario	5.0	1.5	2.1
Positive scenario	5.3	5.6	2.8

Source: SEB

High consumption along with improved productivity. A combination of pent-up consumption needs and a high level of household savings represents upside potential. A robust increase in consumption may also lead to a positive spiral that drives broad-based capital spending. Ensuring that such a scenario is sustainable requires a highly favourable labour supply trend, but perhaps above all that new investments actually lead to clear productivity improvements. In view of increasing supply side uncertainty, we believe that upside potential has diminished and downside risks dominate.



Cautious headwind from fiscal policy

So far during the pandemic, fiscal stimulus measures have helped sustain economies on a broad front around the world. Our calculations indicate that in advanced (OECD) economies, the fiscal stimulus impulse – defined as the change in the cyclically adjusted budget balance – added up to the equivalent of 5 per cent of GDP in 2020. Recurring pandemic waves have prolonged the need for such support. Together with more traditional stimulus, fiscal policies look set to become even more expansionary again this year, with an additional dose equivalent to 0.5 per cent of GDP. After these historically very large stimulus measures, fiscal policies will inevitable tighten in 2022 as countries reduce their deficits and stabilise public sector debt. This fiscal headwind will total about 2.5 per cent of GDP in 2022 and will continue in 2023, though more gently. However, this will be a matter of phasing out crisis responses; there will be no austerity programmes like those that various euro area countries were forced to undergo after the global financial crisis a decade ago.

Fiscal stimulus impulse
Change in structural budget balance, per cent of GDP
Positive figures = stimulus effect, and vice versa.

	2020	2021	2022	Tot
United States	6.5	0.0	-4.0	2.5
Japan	5.0	-0.5	-2.0	2.5
Euro area	3.5	1.0	-1.5	3.0
United Kingdom	6.0	1.5	-5.0	2.5
Sweden	2.0	0.5	-1.0	1.5
OECD	5.0	0.5	-2.5	3.0

Source: OECD, SEB.

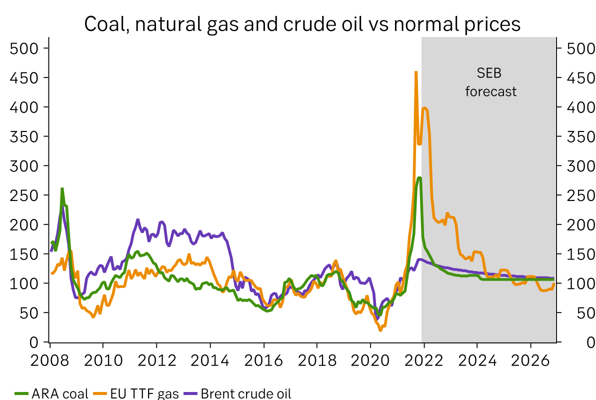
Structural policies will be given more room. Today the ambition is to support the economic recovery with stimulus programmes that are often structural in nature,

also aiming at improving long-term growth potential and facilitating climate transition. In the European Union we have the Next Generation EU programme, which will total 5-6 per cent of GDP over the coming years – an especially welcome injection for southern European countries. US spending programmes will also focus on investments, although President Joe Biden has had problems getting Senate approval for parts of his policy. Japan recently launched a new stimulus programme equivalent to 5 per cent of GDP, and negotiations to form a new German government are expected to result in a red-green-liberal coalition with a somewhat more expansionary policy than we have seen before. Sweden's tight fiscal policy framework is increasingly being questioned. Replacing its budget surplus target with a balanced budget target will be a likely first step, but the concept of separate accounting for certain types of investments also seems to be gaining ground.

Major challenges in the energy market

Developments in the energy market are especially important today in making forecasts. The trends are unusually divergent for different types of energy. However, the collapse in energy investments during the first phase of the pandemic was followed by a surge in demand, which generated widespread upward pressure on prices. A wave of hoarding ahead of the coming winter is also creating competition between China and Europe, causing coal and natural gas prices to soar to unforeseen heights. Despite a recent downward correction, these prices are now about 3 times higher than normal in some European countries. Oil prices have shown a calmer trend, and the current price of around USD 80 to 85 per barrel represents a level that is a moderate 35 to 40 per cent higher than the average price in real terms over the past 50 years. This indicates that oil prices may be the next to rise in an environment where there is reluctance to fund fossil fuel investments, although this is not our main forecast.

Coal, natural gas and crude oil vs normal prices

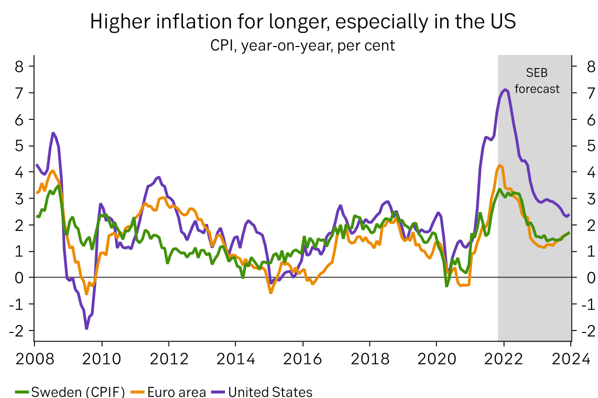


Source: Bloomberg, SEB

Energy prices will probably fall during 2022. Generally speaking, the energy transition is a huge challenge in a world that has been better at fighting fossil fuels than at building out new green alternatives. This means we have to get used to the fact that imbalances between supply and demand will become more common in the future, with greater price volatility as a consequence. This will also lead to major political tensions and challenges during the ongoing climate transition process. However, high CO_2 prices in Europe are helping keep electricity prices at a level that will make new investment projects in renewable energy very profitable. During the coming year, there is also potential for a general decline in prices. Chinese energy demand is falling due to the credit crunch, while Russia should be able to increase its gas exports to Western Europe following a domestic inventory build-up in October. Forward contracts in the northern European electricity market also point to a clear price decline in 2022. Despite long-term risks, we also believe oil prices will fall, reaching an average of USD 60/barrel in 2023.

Higher inflation for longer, especially in the US

CPI, year-on-year, per cent

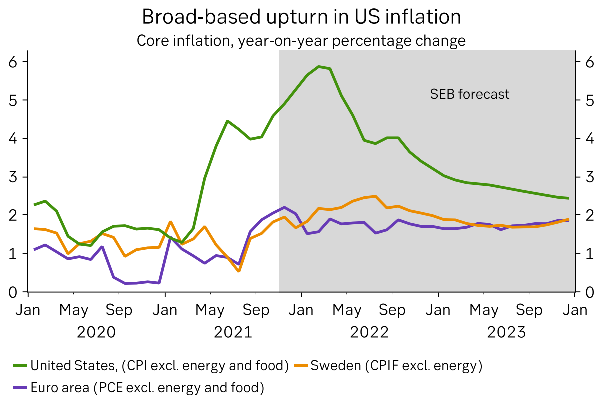


Source: Statistics Sweden, Eurostat, BLS, Macrobond, SEB

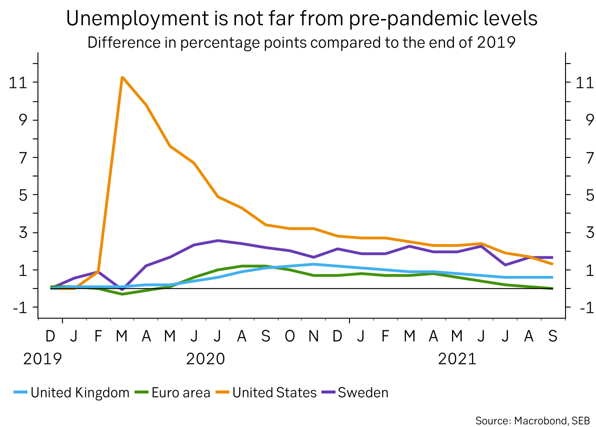
Despite everything, inflation will fall

We are currently in the midst of an inflation impulse that is becoming stronger and more long-lasting than had we previously expected. It is driven by many different kinds of forces, making it especially hard to assess. Rapidly rising energy prices have made the inflation surge more dramatic. In the US, the upturn also seems to be changing character. When inflation took off last spring, a few of its components – such as used cars and normalised prices for tourist services after the pandemic – accounted for much of the upturn. Today the upturn is broader-based, including rapid increases for rents and goods prices more generally. Yet so far service prices have been climbing at a modest pace, while goods inflation is the highest since February 1981. A broad-based rise in inflation suggests that price upturns are also being driven by generally strong demand after earlier household stimulus payments and blocked service consumption. Heavy demand for goods

has international consequences, by worsening bottleneck problems in the global transport system.

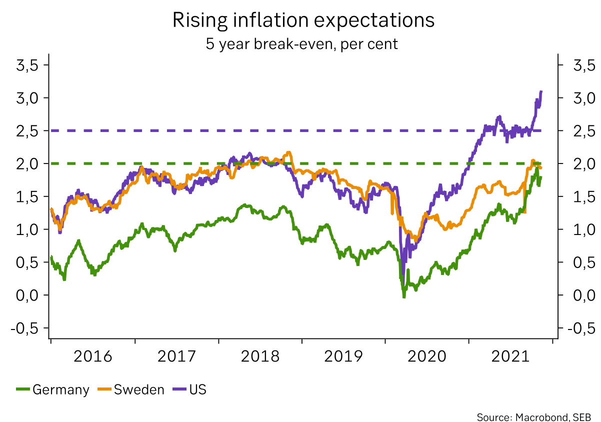


Stable core inflation in Europe. With the exception of the UK, the inflation upturn in Western Europe is still largely due to energy prices. This is illustrated in the above charts by differences with the US in various core inflation metrics being even greater than for overall CPI. The contribution of energy prices is significantly larger in the euro area than in Sweden due to differences in the use of natural gas, but we are likely to see some core inflation upturns in the euro area as well. At the producer level, we are now seeing a broader price upturn for consumer goods as well. After a lag, this should also have an impact on the CPI. We will probably also see an increase in underlying price and wage pressures as resource utilisation climbs.



Labour market bottlenecks have made themselves felt more clearly in the past year, which has also increased uncertainty. Unemployment has fallen rather quickly towards pre-pandemic levels, partly because many of those who left the labour market at the beginning of the pandemic have not returned. The theme article on page 13 analyses recruitment problems and their impact on wage formation. It is clear that bottleneck problems are greater in the US and the UK, where wages and salaries have accelerated quite clearly; broader political support for raising minimum wages is another factor. In the euro area and the Nordic countries, however, there are no clear signs of such a trend. In Sweden, multi-year collective labour agreements – including relatively low pay increases – are one reason we do not expect any significant acceleration, at least until the next national wage round in the spring of 2023. In the US, it is also likely that bottleneck problems will ease when social life normalises and the opportunities and motivations for working increase as government grants decrease.

Inflation will fall during 2022. Our main forecast is now that inflation will gradually fall as the post-pandemic situation normalises. Most of the price increases that are now pushing up inflation are one-off in nature and will hardly be repeated year after year. Although energy prices will probably be elevated in the future, compared with what we are accustomed to, they are likely to fall from current levels and make negative contributions to inflation during the latter part of our forecast period. Inflation expectations have risen but are not alarmingly high. After a new upside surprise in the US in October, 5-year expectations based on the inflation-linked bond market are now around 3 per cent. A level of around 2.5 per cent for this metric is in line with the Fed's operational targets. In Sweden and Germany, expectations do not indicate any distrust of inflation targets at all.



Central banks face a historic dilemma

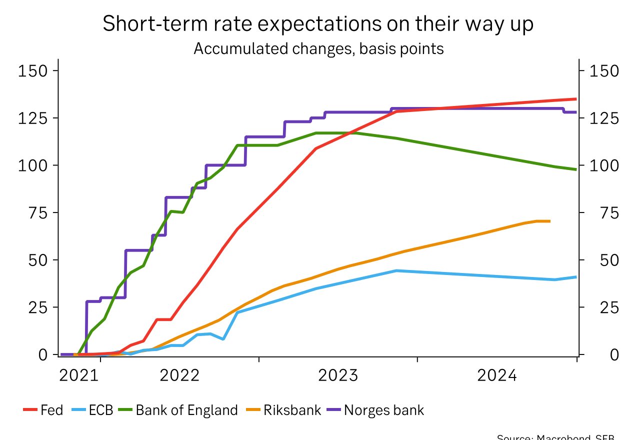
The Fed's new strategy of expanding its manoeuvring room to allow overshooting of its inflation target was launched in an environment where the previous bias against falling below the target had created stable low inflation expectations. The ECB, Sweden's Riksbank and other central banks in Europe have had even greater credibility problems in this respect. The sharp economic downturn due to the pandemic reinforced their motivation for signalling great tolerance for overshooting inflation targets. At first, it was thus quite natural for central banks to play down pandemic-driven inflation tendencies. The inflation impulse now appears

to be stronger and longer-lasting, and central banks thus face a balancing act. To clarify what is at stake, let us look at two extreme cases taken from history:

A clumsy response led to the 1970s stagflation era. After OPEC carried out major production cuts, oil prices soared in 1973-74. This happened soon after the collapse of the Bretton Woods system with its fixed exchange rates, anchored by the US dollar gold peg. This made the global economy especially vulnerable. There was no clear strategy for how to respond to the upturn in oil prices, but to varying degrees national fiscal policymakers tried to sustain economic activity. Monetary policymakers in most countries mainly accepted (accommodated) a general acceleration in price and wage increases. As a result, economies – especially the US, the UK and the Nordic countries – were plagued for a long time by high, volatile inflation that hampered investments and growth.

Exaggerated fear of contagion during 2008. Experiences during the 1970s oil crisis were one reason why for a long time, central banks were constantly worried that inflationary impulses from commodity prices, especially energy prices, would spread to other categories of goods and eventually also to wages and salaries. Central banks were, of course, aware of the dilemma of responding directly to a growth-curbing supply shock with key interest rate hikes, but they did not trust economic actors to refrain from passing on cost increases to customers. At the same time as the US subprime mortgage market collapse in August 2007 began to hamper the global economy, commodity prices rose sharply – mainly driven by large Chinese capital spending. In the spring of 2008, the inflation upturn broadened in the insidious way that often occurs at the beginning of a slowdown. Several central banks in Europe, led by the ECB, then chose to hike their key rates repeatedly. The Riksbank's final hike just a few months before the collapse of Lehman Brothers was the most spectacular example.

Monetary exit policies using various tools. Central banks are thus facing a dilemma, but so far their response to rising inflation has been modest. Continued but reduced asset purchases by central banks such as the Fed, the ECB and the Bank of Japan mean that overall global monetary policies will actually move in a more expansionary direction over the next six months. Our assessment is that the expansion of central bank balance sheets by USD 20 trillion since 2007 has been equivalent to downward pressure on global long-term interest rates of 120-160 basis points. Some months into 2022, when global monetary policy shifts towards tightening, we believe that central banks will choose to exercise restraint about liquidating assets and slimming balance sheets. Instead, key interest rates will be their most important monetary policy tool.



Overhyped rate hike expectations. Recently, the market has ratcheted up its expectations of central bank rate hikes, but we believe current pricing is generally a bit too aggressive. We have nevertheless adjusted our key rate forecasts higher, and we expect the Bank of England to be next in line after Norges Bank by hiking its key rate early in 2022. After that, we expect the Fed to carry out its initial rate hike in September, after having ended its bond purchases in June. Our forecast is that the Fed will then continue hiking its key rate to 1.50 per cent by the close of 2023. Where we end up during the upcoming hiking cycle will depend on the interest rate sensitivity of households and businesses and on the reaction of overall financial conditions in the form of credit spreads, share prices and exchange rates. Our assessment is that in many economies, a neutral nominal short-term interest rate is close to 2 per cent in the long run, but the pandemic and structural factors may have pushed it down to somewhat below 2 per cent in the medium term, which may be a benchmark for where key rates can peak.

The ECB and the Riksbank will be far behind the English-speaking countries and Norway in terms of key interest rate hikes. Because of central bank signalling, as well as the outlook for inflation and pay increases, the divergence in our forecast is greater than in market pricing. However, we expect the Riksbank to deliver its first hike during the second half of 2023. The ECB must constantly bear in mind the risk that even cautious rate hikes will lead to wider yield spreads between Germany and southern European economies. There is a risk that the end of the Pandemic Emergency Purchase Programme (PEPP) next spring may already contribute to higher yields in southern Europe. A new programme, with greater flexibility in the purchase allocation key

and a focus on the stability of spreads, would make it easier for the ECB to hike its key interest rates.

Central bank key interest rates
Per cent

	Nov 11	Dec 2021	Dec 2022	Dec 2023
Federal Reserve (Fed)	0.25	0.25	0.75	1.50
ECB (refi rate)	0.00	0.00	0.00	0.00
Bank of England (BoE)	0.10	0.10	0.75	1.25
Riksbank (Sweden)	0.00	0.00	0.00	0.25
Norges Bank (Norway)	0.25	0.50	1.50	1.75

Source: Central banks, SEB.

Lower EM growth forecast for 2021

In emerging market (EM) economies, the recovery has recently slowed somewhat. We have lowered our 2021 GDP growth forecast for the EM sphere from 6.5 to 6.2 per cent but have left our 2022 and 2023 forecasts unchanged. The change for 2021 is mainly due to downward adjustments for China and India, where energy shortages have forced rationing of electricity consumption. China's growth is also being slowed by problems in the real estate sector, which have been exposed by Beijing's ambition to bring down the high leverage ratios of many large property developers. Brazil's economy also looks set to grow somewhat more slowly than we previously thought. Right now Russia is going through its worst COVID-19 wave since the pandemic began, with new restrictions as a result, but more targeted restrictions and increased oil production will still help maintain economic activity. In general, EM economies are now also being hampered by disruptions in production chains and by rising inflation. Low vaccination rates, especially in the very poorest economies, are dampening activity among consumers and businesses. In addition, EM countries have only limited scope for prolonging fiscal stimulus measures. This year, some governments in major EM economies are already aiming at reducing their deficits.

High energy and commodity prices have varying effects among EM economies. Those benefiting most from higher energy prices are Russia and oil producers around the Persian Gulf, while oil-importing countries such as Turkey, Thailand, Chile and India tend to be on the losing end. But we should still be careful in drawing conclusions about winners. Producer countries are also adversely affected by rising energy prices in the form of higher inflationary pressures and production costs. Several central banks, including those in Brazil and Russia, have begun monetary tightening, which risks hampering their growth next year. Yet rising commodity prices are largely a sign of improvement in the world economy, which will benefit all emerging markets.

GDP growth, BRIC countries and EM sphere
Year-on-year percentage change

	2020	2021	2022	2023
China	2.3	8.2	5.2	5.4
India	-7.1	7.7	7.6	4.9
Brazil	-4.1	4.9	2.5	2.2
Russia	-3.0	4.3	2.8	2.0
Emerging markets, total	-2.1	6.2	4.8	4.3

Source: IMF, SEB.

Chinese challenges play a key global role. Various challenges facing China are now attracting widespread attention. After China's GDP growth of just over 8 per cent this year, the risks of a sharp slowdown next year have increased. The effects of the government's long-term goal of reducing the debt level in the economy have now begun to be felt, especially in the highly leveraged real estate sector (see theme article, page 35). We believe the authorities have enough resources to deal with individual companies that risk or enter into default, but there will be a difficult balance between saving financially sound companies and avoiding "moral hazard". Aside from tighter lending, China's growth will be hampered by external factors, such as higher energy prices that have led to rationing and lower production levels. Despite a vaccination rate of 75-80 per cent of the population, China is also sticking to its zero tolerance for COVID. Local outbreaks, even very small ones, still lead to lockdowns and imposition of quarantines, creating problems in production chains and hobbling the manufacturing sector. Since some of these lockdowns have affected transport hubs such as major container ports, zero tolerance is also adding to the transport and logistics chains problems the world is now experiencing.

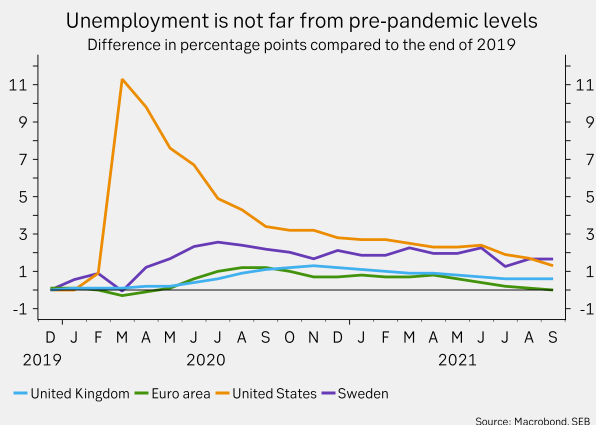
Theme:

The labour market

Early recruitment problems are threatening the recovery

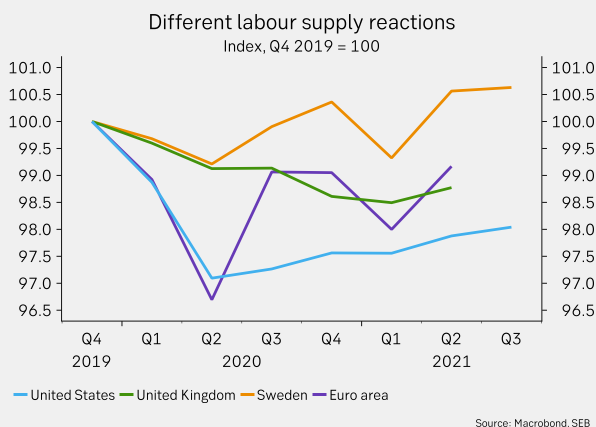
Unemployment has already fallen close to pre-pandemic levels in many countries. Meanwhile the share of businesses having difficulty recruiting employees has rapidly increased. This is partly because the labour supply has been depressed by various factors, some of them temporary in nature. In the US and the UK, pay increases have already accelerated, while no such clear trend can be discerned in the euro area or the Nordic region. The US labour shortage will probably ease as working life normalises and incentives to work become stronger again. Efficiency-improving business investments may possibly also give labour productivity a boost.

Early supply side constraints may change the playing field. When the pandemic crisis was at its deepest, economists predicted that it would take a very long time before we returned to normal resource utilisation. Such a view was also largely behind central bank signals that normalisation of monetary policy was far in the future. The prospect of a long period of extremely low interest rates, in turn, increased the manoeuvring room for fiscal policymakers. Due to an unexpectedly rapid recovery in demand, forecasters have gradually brought forward the time when economies are expected to return to the trend that prevailed before the pandemic. Recently, however, various kinds of supply side problems have worsened, prompting observers to question how much idle resources actually exist in the economy. This theme article analyses some key issues in the US and Western European labour markets, including the reasons why unemployment has fallen so quickly and why such a large percentage of companies already have major recruitment problems. The duration of these problems will be crucial to the ability of economic policymakers to continue supporting the recovery. It is also essential to ensure that these problems are not permanent if the growth and corporate earnings forecasts behind today's fairly high stock market valuations are to materialise.



Unemployment close to pre-pandemic

Actual unemployment is now relatively close to the situation at the start of the pandemic, indicating that we are not so far from normal resource utilisation. In the euro area, September unemployment was at exactly the same level as at the end of 2019. In the US, it is just over 1 percentage point higher than before the pandemic, after initially soaring more than 10 points in the spring of 2020.



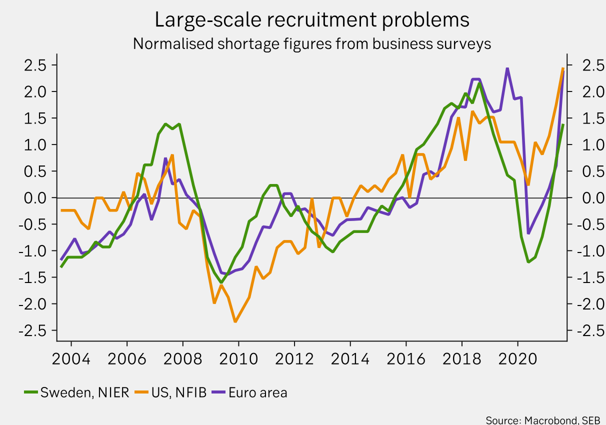
Depressed labour supply. We have seen a large decline in unemployment, even though the number of people with jobs has a long way to go before reaching pre-pandemic levels. This is because a relatively large share of those who left the labour force during the most dramatic lockdown period have not returned. There are several reasons for this, and dividing these into various categories can facilitate our analysis of how long the labour supply may conceivably remain depressed:

Statistical exaggerations: Because of certain crisis programmes, employees are still registered as being outside the labour force. In some countries, young people have left the labour force to an especially great extent, such as students with low average working hours. If you look only at changes in the number of people in the labour force, it is easy to overestimate the decline in the potential number of working hours.

Incentives/behavioural factors: US stimulus programmes – including relatively generous benefits for the unemployed and families with children – made it easier to give up working. The system of simple, low-paid, low-productivity jobs is increasingly being questioned, which may also reinforce this trend. Although most people now want to return to a normal working life, there are many who want to avoid returning to their old jobs. This applies, for example, to older age groups; those who can will retire to a greater degree. Partly due to the pandemic, younger age cohorts have also had to wait before entering the labour market, and some have instead continued their studies.

Pandemic-related factors: There are also lingering practical difficulties in returning to a normal working life. These include fear of becoming infected during travel to or at work, or the need to stay home with children until schools or day care centres reopen.

Structural factors: Ageing populations and declining immigration also lower labour supply. To some extent, the reasons for reduced mobility are pandemic-related, but they are also driven by underlying trends. The UK after Brexit is the clearest example. But in the US, too, there is a clear shift, especially in terms of the influx of labour into low-paid occupations.



Widespread recruitment problems

Generally speaking, labour market statistics are especially uncertain in the current situation, yet signals about recruitment problems in various business surveys show a robust pattern. We have created estimated normalised time series based on some of these surveys. In the US, we use a narrow metric – small businesses surveyed by the NFIB, which are now showing record labour shortages. Most of these shortages have increased exceptionally fast, which may be due to several factors. During almost all previous crises, manufacturing has been hardest hit. The sector has thus developed methods to bridge periods of weak demand. This is especially true in northern Europe, where

employer and employee organisations often collaborate with governments to ease the consequences of crises. Well-educated, skilled work forces have been strongly motivated to expect better times in their old sectors and have been given opportunities to further their education within their professions during crisis periods.

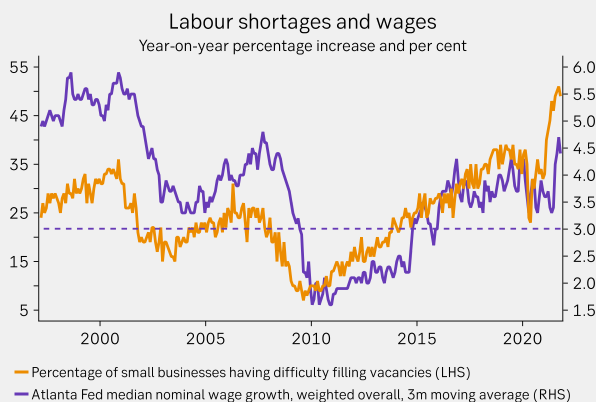
Unaccustomed crisis sectors and imbalanced demand. The pandemic has mainly affected service sectors that are historically less accustomed to dealing with economic crises. Their employees often have a weak position in the labour market. This makes them more mobile, and they have less incentive to return when demand has revived. In addition, there is a generally imbalanced demand situation. Many goods-producing companies bounced back quickly after the most acute pandemic phase in spring 2020, and their current recruitment problems are more similar to traditional overheating symptoms.

Accelerating wages in the US and UK

How rising labour shortages will affect short- and long-term wage formation will be an important question for central banks in the near future. In recent decades, the link between labour markets and price/wage formation has been weak (the "death of the Phillips curve"). But we are now seeing clear signs of acceleration in US and UK wage growth. In the US, various metrics now show annual wage growth of 4-5 per cent. However, it is hard to find clear indications of general acceleration in the euro area or in the Nordic countries – partly because bottleneck problems in the labour market are less prominent, but also because centralised pay agreements are more important, especially in Germany and the Nordic countries.

Labour shortages and wages

Year-on-year percentage increase and per cent



Percentage of small businesses having difficulty filling vacancies (LHS)

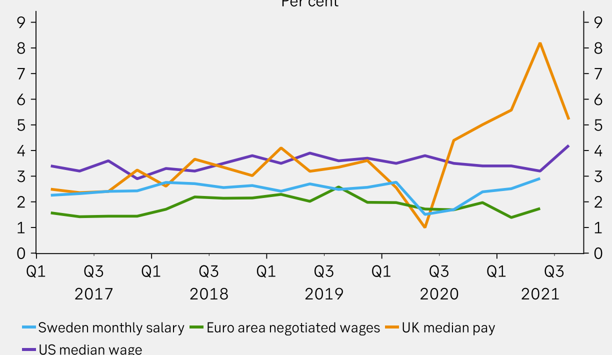
Atlanta Fed median nominal wage growth, weighted overall, 3m moving average (RHS)

Source: Federal Reserve Bank of Atlanta, National Federation of Independent Business, Macrobond, SEB

Distinctive features of the Swedish labour market. Sweden's mild pandemic-related restrictions in the spring of 2020 may have helped limit the decline in labour supply. The Swedish labour market is also characterised by a special combination of traditional and new features. In general, the collective agreements concluded late in 2020 – specifying relatively low annual pay hikes of around 2.2 per cent – seem to have set the pace, since additional pay increases appear to be small. Most agreements are valid until spring 2023. In addition, within the framework of its labour market policy, the government pays a large proportion of salaries in low-paid jobs for people with little formal education, who often have poor Swedish language skills. Within this system, market forces play only a minor role in wage formation. Parallel with this, there is a completely different type of market mechanisms. Very liberal labour immigration rules have contributed to increased competition in low-wage sectors. Downward wage pressure is exacerbated by the fact that enforcement of existing regulations is spotty and many employees have no opportunity to assert their rights.

Accelerating rates of pay increases in the US and UK

Per cent



Source: Federal Reserve Bank of Atlanta, U.K. Office for National Statistics (ONS), ECB (European Central Bank), National Me

Improvement on the horizon in the US

Our analysis thus shows that the supply side situation is now most acute in the US and the UK. Because of the UK's unique Brexit experiment, that country's problems will probably be quite long-lasting. In the US as well, there are long-term forces in play. For example, many older people who have left the work force will probably not return. In other areas, we are more optimistic. Pandemic-related problems should ease soon, since the Delta wave has now culminated. We should thus see a normalisation when it comes to commuting between homes and workplaces and the school and child care situation. The incentives to get a job are also gradually increasing as federal stimulus is phased out, and the weakness of US safety nets will have an effect. But it is important that we see a response to the labour supply situation before the end of 2021, now that conditions have changed. Another potential positive effect is that current labour shortages may accelerate productivity-enhancing investments. The potential for efficiency improvements and automation should be significant, since the share of simple jobs is higher in the US than in Japan and northern Europe, among other places.

Fixed income

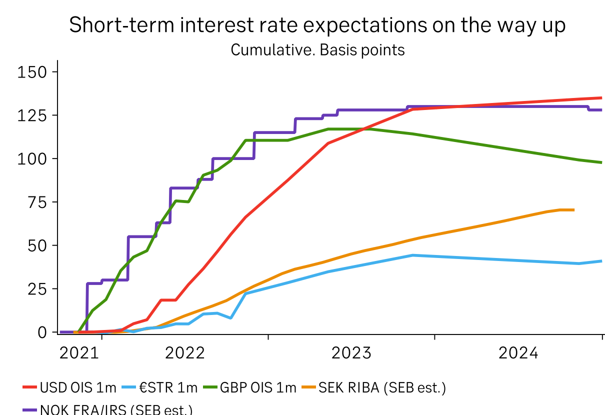
A feeling of stagflation

This autumn, high inflation and more hawkish major central banks have sharply increased expectations of higher global key interest rates. We believe long-term US and euro area yields will climb rather moderately in 2022. Expectations of aggressive key rate hikes over the next 2-3 years will hold down long-term inflation expectations, dampening upward pressure on long-term government bond yields. We expect Swedish and Norwegian long-term yields to follow global yields upward, with relatively small changes in yield spreads

High inflation is boosting rate hike expectations. Since August an energy crisis, rising inflation pressures and the monetary exit plans of central banks have contributed drastically to rising short-term interest rate expectations. The Bank of England and Bank of Canada have prepared the market for early hikes, while the European Central Bank's explicit link between its inflation forecast and the timing of rate hikes has also helped push up short-term euro rates. With signs of broader-based inflationary pressure and central bank concerns about long-lasting supply side bottlenecks, there are few indications that the market's inflation worries will ease in the near future.

Short-term interest rate expectations on the way up

Cumulative. Basis points



Source: Macrobond, SEB

Rate hikes will limit later rate and yield increases. Market pricing of key rate paths over the next 2-3 years has surged this autumn, but expectations further in the future have actually fallen. Pricing of US short-term rates now indicates a key rate peak of 1.70 per cent, down from 2.50 per cent in April. Relatively aggressive pricing in of rate hikes in 2022-23 is one reason why the market now expects US inflation to revert to the Federal Reserve's 2 per cent target within a couple of years. Moderate expectations of monetary tightening over a long-term also reflect uncertainty about the US growth outlook. Due to rising inflation pressures, the market is sticking to aggressive expectations of central bank hikes in the next 2-3 years. Our Fed forecast for 2023 is in line with market pricing (1.35 per cent), although Fed rate-hiking expectations may increase further in the next few months. Meanwhile we believe expectations of later rate hikes will rise more moderately. In such a scenario, we expect US 10-year Treasury yields to reach 1.80 per cent in June and 2.00 per cent by the end of 2022. As for the ECB, the market believes it will hike key rates as early as next year, while excess Eurosystem liquidity will fall sharply. Our forecast is that the ECB will keep its rate unchanged in 2022, with plenty of liquidity in the system. We thus foresee lower future short-term rates than are currently discounted, with German 10-year bond yields of -0.10 per cent in June 2022 and 0.00 per cent in December 2022.

Strong performance for Swedish government bonds. Expectations of a Riksbank rate hike in 2022 have increased, contributing to higher swap rates and a wider yield spread against the euro area. Meanwhile a reduced government bond supply over the next few years will support long-term yields. It will also limit the Riksbank's ability to continue its large bond purchases next year; due to its reinvestments of existing holdings, the Riksbank will absorb much of the supply. This will provide continued support for the long-term yield spread against Germany, which is expected to be 45 bps at the end of 2022. The spread is expected to widen in the end of 2023 when the Riksbank hikes.

Norwegian-German long-term yield spreads have reached their widest in decades (partly due to Norges Bank). Norwegian monetary policy has also contributed to far more movement in long-term yields than other markets. A very flat yield curve indicates that Norwegian long-term yields may rise, but since other central banks will eventually catch up with Norges Bank, the 10-year yield spread against Germany may narrow in 2023.

10-year government bond yield
Per cent

	Nov 11	Dec 2021	Dec 2022	Dec 2023
United States	1.56	1.50	2.00	2.50
Germany	-0.29	-0.20	0.00	0.40
Sweden	0.26	0,35	0,45	0,95
Norway	1.60	1.75	2.00	2.20

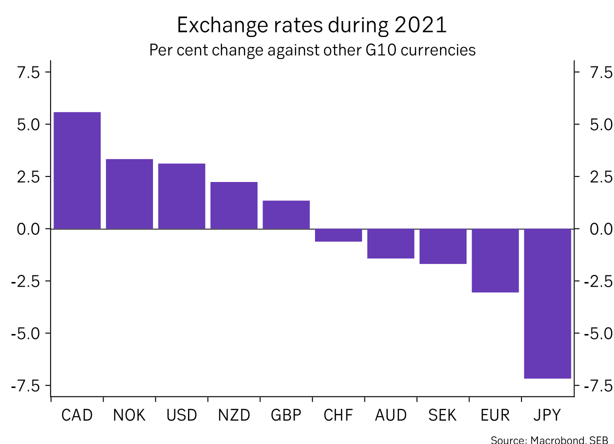
Source: National central banks, SEB

The FX market

The Fed's normalisation is strengthening the dollar

Volatility in the foreign exchange (FX) market is close to record-low levels. Historically, this has often been negative for the US dollar. The Federal Reserve recently began normalising its monetary policy, due to unexpectedly high inflation, giving the USD a tailwind. Central banks that responded to inflation early have seen their currencies climb. Changes in relative monetary policies will probably drive the FX market, as long as inflation remains high – well into 2022.

Central banks the strongest force. Changes in relative monetary policies, with the Fed in the driving seat, seem to explain more than half of FX market movements so far in 2021. The Canadian dollar, Norwegian krone and US dollar have climbed the most among G10 currencies. As these central banks have announced a normalisation of monetary policy, their currencies have appreciated. The CAD and NOK have been supported by rising oil prices as well. Risk appetite also explains some movements this year, especially where central banks have not signalled any major policy change – such as Sweden's Riksbank. Emerging market (EM) currency movements have been closely tied to risk appetite, although monetary policy changes are now gaining in importance. We expect this pattern to continue in the coming months, but we believe that relative growth will be more dominant in 2022.



The US dollar began its latest upward trend in June after May inflation came in higher than expected and speculation about a monetary policy shift took off. This trend looks set to continue, since high inflation is not expected to decline anytime soon. The Fed's tapering of asset purchases – starting in November 2021 – opens the way for an initial key rate hike in the second half of 2022. We believe the policy normalisation that has now begun will strengthen the dollar to 1.11 per euro by end-2022. The euro will bounce back a bit in 2023 as euro area growth recovers and the European Central Bank announces rate hikes.

Exchange rates

	Nov 11	Dec 2021	Dec 2022	Dec 2023
EUR/USD	1.15	1.15	1.11	1.15
USD/JPY	114	113	115	116
EUR/GBP	0.85	0.84	0.81	0.85
EUR/SEK	9.98	10.00	9.90	9.70
EUR/NOK	9.93	10.00	9.85	9.85

Source: Bloomberg, SEB

The British pound took a beating when the Bank of England surprisingly chose not to hike its key rate in November. Monetary tightening and the fact that the pound tends to follow the USD higher still suggest renewed GBP strength over the next 12 months. The EUR/GBP rate looks set to fall to 0.81-0.82 in 2022. After that, we believe that weak British fundamentals will take their toll and that the GBP will again lose ground.

The Swedish krona gained over two per cent against the euro in October, mainly due to rising short-term interest rates. The krona is likely to lose some ground in the near future, but we expect its upward trend against the euro since March 2020 to continue longer-term. The Swedish economy looks set to keep growing more strongly than the euro area, so the Riksbank will hike its key rate earlier than the ECB. The krona, which tends to be pro-cyclical, will thus appreciate due to normalisation of both the economy and monetary policy. At the end of 2023, we expect the EUR/SEK rate to be 9.70.

The Norwegian krone has been one of the strongest G10 currencies in 2021, but we expect it to fall slightly against the euro late in 2021 due to more moderate expectations of Norges Bank rate hikes. Moreover, there is a seasonal pattern in which the krone tends to weaken towards year-end. We also expect slightly lower oil prices late in 2021. Norges Bank is likely to implement further rate hikes in 2022, providing some support for the NOK. But we expect its movements against the euro to be relatively small, since the ECB will also probably tighten its monetary policy – though not as fast as Norges Bank.

The stock market

Resilience amid stronger headwinds

Stock market headwinds have undeniably intensified this autumn. Our forecast of resilient share prices has held up so far, but increased risks due to inflation, interest rates and production disruptions call for caution. There is still upside potential, supported mainly by continued positive growth and by the TINA argument. But if this potential is to materialise, supply side disruptions must subside (as expected) while inflation fades and rates/yields do not rise too quickly.

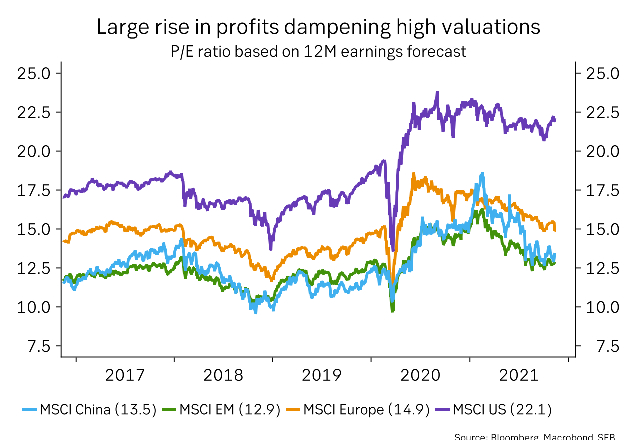
Showing strength. The stock market headwinds that we warned about in the last *Nordic Outlook* not only materialised, but proved even stronger than expected. Bottlenecks, rising commodity and input goods costs, problems in China, weaker macro statistics and especially higher, longer-lasting inflation contributed to a global price correction of around 5 per cent in September. But no autumn storm ensued. During October most major stock markets rebounded – with US indices setting new records.

Resilience, due to healthy demand. This shallow dip and rapid recovery may be interpreted as surprising signs of strength – given stock market worries – but we see a few explanations: Supply side problems can certainly make a short-term difference, but as long as there is demand, investors view these as temporary phenomena and stock markets tend to cope with them smoothly. Although asset manager surveys show lower expectations of future growth, this will probably be seen as a continued adjustment to the transition from economic recovery to normalisation. Most asset managers still expect relatively good growth over the next couple of years, and so do we.

Continued strong company reports. Q3 company reports also support equities. Positive surprises keep coming, though at a subdued pace. Supply side restrictions may have a clearer impact in the future, but given forecasts that they will subside next year, they can probably be managed by companies and absorbed by investors.

Worrisome costs. Rising costs are a potential threat to earnings growth. But the picture is not clear; higher input goods prices create both winners and losers. Nor does inflation at the consumer level necessarily create major profitability problems for the corporate sector, even if they are driven by rising wage and salary costs, which is not yet the case. Overall, however, supply side disruptions create a downside risk for corporate earnings growth.

Low bond yields are providing support. Inflation risks are also creating worries about interest rates and bond yields. Expectations of future key interest rate hikes have emerged earlier than anticipated. Central banks are starting to withdraw the strong liquidity support provided to markets in recent years. This is certainly expected and is a sign of healthy growth, but the market is usually sensitive to reductions in liquidity. What happens to long-term bond yields – the natural alternative to equities – is vital to stock markets. We expect long-term yields to rise, but not at a pace or on a scale that might cause problems for the stock markets, especially in the near term.



So far, the more uncertain growth outlook that has emerged this autumn has not adversely affected earnings forecasts. Global economic growth forecasts have been lowered but will remain well above trend in 2022.

Modest earnings forecasts. After this year's nearly 50 per cent earnings surge, increases of 5-10 per cent are expected next year. Given the growth outlook, this seems conservative: one interpretation is that forecasters are making allowances for a future squeeze on margins.

Earnings increases explain more than the stock market upturn so far this year. In 2021 forecasts have been revised upward more than share prices have climbed, pushing down valuations. This effect is clear in Europe and especially in emerging market (EM) indices, where China's problems have weighed heavily on prices (see chart).

Cyclicals will benefit. Assuming healthy economic growth, continued low rates/yields and a strong investment cycle, there are reasons to expect decent near-term stock market performance. This should benefit more cyclical sectors and stock markets in Europe, and potentially in EM countries, but given today's supply side worries and future growth and rate/yield risks, investors should be prepared for volatility and lower returns.

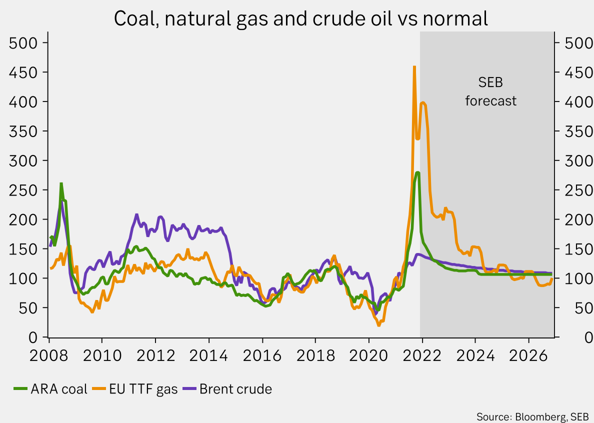
Theme:

Fossil fuels on fire

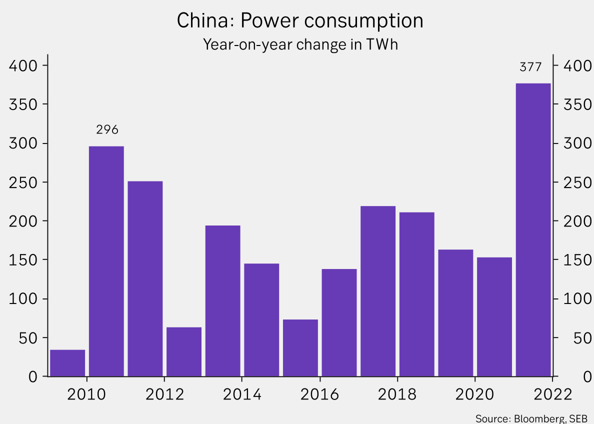
Coal and gas prices at unprecedented levels

Falling investments during the COVID-19 pandemic and a rapid rebound in demand have sent coal and gas prices soaring this year. The situation has been further worsened by fears of a cold winter, which have resulted in significant hoarding – thus increasing the competition between Asia and Europe for coal and gas supplies. There is scope for normalisation in prices next spring after a rough period for power consumers all over the world. Still, rising CO_2 prices will keep electricity prices elevated in the EU. Oil may be next in line to spike as investments suffer from a reluctance to finance fossil fuels. The energy transition is a huge challenge, since the world has been better at fighting fossil fuel production than at building new green alternatives.

Sharp waves in demand, prices and supply. This year, coal and gas prices have risen to levels we have never seen before. In early October, natural gas prices in the Netherlands were almost six times higher than normal. At this writing they have fallen sharply but are still three times higher than normal. Oil prices, on the other hand, are currently around USD 80-85/barrel, which is "only" 35-40 per cent higher than the 50-year real average price of approximately USD 60/bl. The pandemic is central to what has happened, since it has led to sharp fluctuations in supply, demand, and investment over the past year and a half. When the world stopped in the spring of 2020, the demand for most things plunged. Bloomberg's energy price index fell to its lowest since 2003. Average 2020 oil, coal, and gas prices were 30, 40, and 50 per cent lower than normal, respectively. As a result, investments in new production of these commodities fell to extremely low levels. For upstream oil and gas, investments in 2020 globally fell to an estimated USD 335 billion, or 40 per cent lower than what is assumed to be necessary to meet demand over time. Today's lower production of natural gas is one short-term consequence.



China and Europe are competing for coal and gas. Countries around the world stimulated their economies both monetarily and fiscally, with China in the lead. Total lending in China increased by almost 40 per cent in 2020, which is the largest credit expansion since the financial crisis in 2008/09. In China, this has meant more infrastructure and housing construction, requiring more steel, coal, gas and cement, and thus leading to higher electricity demand. From March to August this year, total Chinese power consumption rose by 377 TWh year-on-year: China's biggest-ever increase in absolute terms. Of course the amount will be even larger for the full year 2021. China has thus needed more coal and gas. With zero growth in Chinese coal production so far in 2021, all of China's increased demand for coal and gas has been directed towards the international market, with demand shocks and a price explosion for coal and gas as a result. Deep worldwide cuts in coal, gas and oil investments have accentuated this further.



Low inventories. Europe had a cold first quarter this year, lower wind power production than normal and a fall in UK gas production of 40 per cent year-on-year in Q2. There has also been limited access to spot volumes of gas from Russia. Overall, this has led to very low inventory levels for natural gas in 2021. Europe and Northeast Asia / China have consequently fought head to head for available spot cargoes of coal and liquefied natural gas (LNG) in the international market. Limited supplies have triggered a huge price spiral.

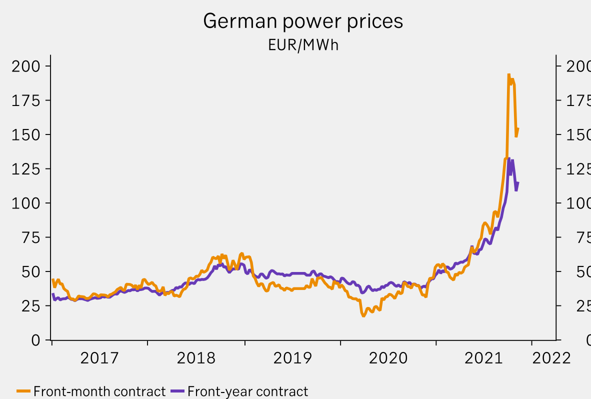
Cooling measures from China, but winter is still ahead. China is now doing what it can to counter the situation. Last year's hot credit expansion has been reversed to a credit cooling and contraction. Property developer Evergrande's problems are partly an expression of this. China has also imposed electricity rationing and ordered the maximisation of domestic coal production, even though it involves reopening unsafe mines. This has led to sharp worldwide declines in coal prices from record highs in early October. Russia has recently promised more gas to Europe in November after spending October filling its domestic inventories while also doing maintenance at several gas fields. Thus, Russia should now be able to export more gas to Europe – where gas prices have tumbled from record highs but are still 3-4 times above normal, since uncertainties about Russia's promises continue to linger in the market.

Price normalisation next spring. The fear of a cold winter has been a key driver behind the price explosion this autumn, and winter is still ahead. It is probably too early to fully de-risk coal and gas prices, since this winter is forecast to have an elevated risk of severe cold spells, which may lead to periods of very high gas prices. In March/April next year, however, both we and the rest of the market expect a sharp normalisation of international spot prices for both coal and gas as we leave winter behind us. As spot prices fall, longer-dated prices for 2023 and 2024 should fall as well.

Painful effects for power consumers around the world. Coal and natural gas are largely used to generate electricity. As prices for these fossil fuels rocketed this autumn, so did power prices all over the world. The normal price of electricity in Germany, the center of the European power market, has historically been around EUR 40/MWh, but this autumn, the front-month German power price has traded as high as EUR 330/MWh. Even more astonishing is that the full year 2022 traded up to a high of EUR 184/MWh, or 4.6 times the normal level.

Higher carbon prices. In the European Union, the CO_2 price is a factor cost in power production. Since this has tripled in a little more than a year, it has added greatly to the rise in EU power prices. While coal and gas prices are likely to normalise significantly by the end of winter, we do not expect more than temporary setbacks in the CO_2 price and instead expect it to rise towards EUR 75/tonne in 2022-2023. As a result, the new "normal" power price in Germany – and thus the EU – is likely to be around EUR 70-90/MWh rather than the previous normal of EUR 40/MWh. One important consequence is

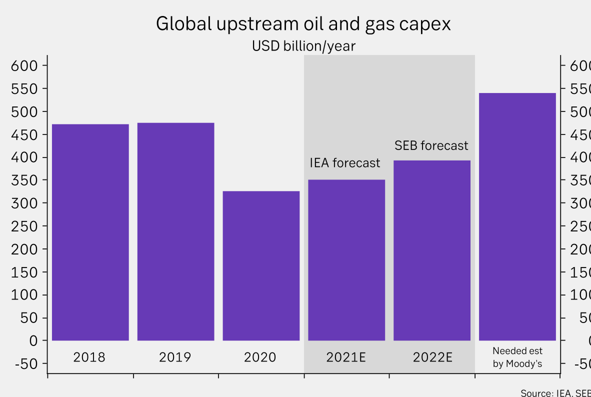
far higher profitability for renewable energy projects – helping to accelerate EU renewable energy expansion.



Oil prices may be next in line to spike

While we have seen coal and gas prices soar to record levels this autumn, oil prices have not reached anything near such multiples. At this writing, oil prices are around USD 80-85/bl, only 35-40 per cent above the long-term average of USD 60/bl. The main reason for the above-normal price level is restrained supply from OPEC+ since May 2020, rather than robust demand. Oil prices have not spiked like coal and gas prices have, because oil demand has been strongly affected by reduced aviation/travel and still is, to some degree.

More cautious investment behaviour. But oil demand is now moving closer to pre-pandemic levels as the world gradually reopens. In addition, there seem to be some fundamental changes in the oil market. Non-OPEC+ producers, typically Western countries, are not ramping up investments in new supply as quickly as we have seen in the past, especially US shale oil producers. Over the past 10 years, shale oil's mantra has been volume, volume, growth, growth, an approach that yielded no profits and led to widespread bankruptcies. Today's mantra is profits, profits, and no growth. At the moment it seems to be a successful recipe.



Less appetite for financing fossil fuels. It is not just US shale oil players who are seeing things a bit differently. Most fossil fuel producers in OECD countries are feeling deeply unloved by both politicians and investors. Financial institutions that have been their close allies for decades are now rapidly cutting ties, which means access to external capital is drying up. It is thus very natural that these companies are now much more careful with capital expenditures than before. Global capex in upstream oil and gas is rebounding after a deep trough in spending during 2020, but apparently at a more careful pace than in earlier cycles.

OPEC+ is in control. With no immediate volume threat from its Western competitors, OPEC+ is left to rule the oil world as it wishes, and that is all about maximising profits through restrained supply and high prices. But even OPEC countries like Kuwait, Nigeria, and Angola are experiencing production declines today due to subdued investments over the past few years.

A challenging energy transition

The energy transition is a huge, challenging and complex task. In simple terms, it is a balance between winding down the current fossil energy system while building alternatives at the same pace. Today the world seems to be better at fighting fossil fuel production than at building new, alternative green energy supplies. If so, the result can only be a wider energy crunch, with very high fossil fuel prices – enduring longer than the current pandemic-induced fluctuations and winter 2021/22 risks. Fossil fuel supplies will eventually rise in response to higher fossil fuel prices, and that is not what the doctor recommends for the environment. The only real medicine for the global environment is to build alternatives fast enough to displace fossil fuels and enable the necessary transition. Low wholesale fossil fuel prices for producers and high fossil fuel costs for consumers due to carbon penalties – together with a rapid build-out of the alternatives – are the solution.

The Hertz rental car moment. In October, Hertz ordered 100,000 electric Model 3 cars from Tesla to replace 20 per cent of its total car fleet with electric vehicles. This essentially means that EVs have come of age both cost- and technology-wise, rendering an increasing range of fossil fuel cars uncompetitive. Fossil fuel cars use 3-5 times more energy per kilometer than EVs and are much more expensive to maintain, due to the complexity of their engines and gearboxes. Petrol (gasoline) accounted for 27 per cent of global oil product demand from 2015 to 2019. There will be no growth in petrol demand once EVs reach a global new-sale market share of 20 per cent. China reached a market share of 17 per cent in September and will soon have zero growth and then a decline in petrol demand.

The United States

Fed rate hikes in 2022 after prolonged imbalance woes

After a rapid stimulus-driven recovery, the US economy is beginning to show signs of overheating. Some of its supply side problems are probably related to the COVID-19 pandemic, and we see prospects for a renewed influx into the labour market as virus worries ease. Unexpectedly high, long-lasting inflation and signs of wage and salary acceleration will still force the Fed to adopt a more cautious view of the supply side. Key interest rate hikes will occur in several stages starting during the autumn of 2022.

Biden's stimulus boom has run into problems

Strong federal stimulus has laid the groundwork for a historically rapid recovery but also worsened imbalances in an already complex post-pandemic reopening process. This has dampened the growth euphoria following the election of Joe Biden as president, although we still expect the US to grow at a faster pace than the euro area, for example. We are lowering our GDP growth forecast for this year to 5.6 per cent, compared to 6.0 per cent in September and 6.5 in May. We are cutting our 2022 growth forecast from 4.2 to 3.9 per cent, while leaving 2023 largely unchanged at 2.2 per cent. Weak Q3 2021 growth will be followed by renewed acceleration in Q4, and then a downshift to a more normal pace.

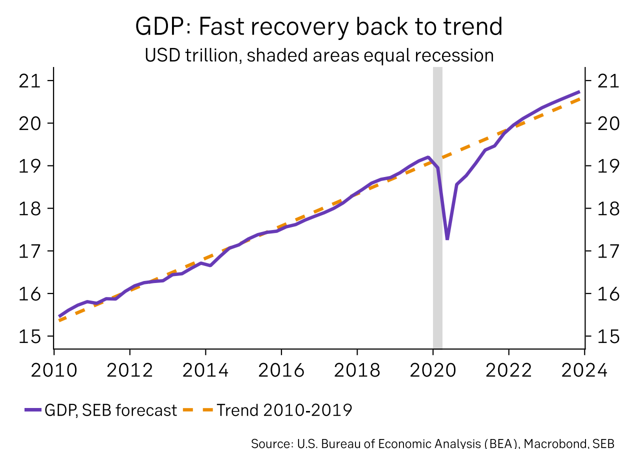
	2020	2021	2022	2023
GDP	-3.4	5.6	3.9	2.2
Unemployment*	8.1	5.4	3.7	3.4
Wages and salaries	4.8	4.0	4.3	4.1
Core PCE (Fed target metric)	1.4	3.2	3.6	2.4
Public sector balance**	-14.9	-11.0	-8.0	-6.0
Public sector debt**	127	128	127	129
Fed funds rate, %	0.25	0.25	0.75	1.50

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

Value chains remain stretched. Challenges related to the production problems of Chinese sub-contractors, component shortages and transport disruptions have lasted longer than expected and comments in business surveys indicate that problems remain. High energy prices are hurting corporate margins and household purchasing power. We believe supply side disruptions will persist for the next six months (see theme article, page 31) and strong demand due to stimulus measures early in 2021 will partly spill over into higher prices rather than increased production. Meanwhile signals from the labour market raise questions about economic growth potential.

Supply side constraints slowed Q3 growth. GDP grew by 0.5 per cent, down from about 1.5 per cent last spring (quarterly, non-annualised). Excluding inventory changes, the economy was completely stagnant. Consumption was expected to level off after the consumer shopping spree early in the year. This effect was amplified by a new wave of Delta variant transmission, which delayed the reopening of the service sector. But supply restrictions also appear to have been a factor behind weak growth. Lower auto purchases explain almost the entire decline in durable goods consumption, which we believe reflects production problems due to the global semiconductor shortage. Business investments in machinery and equipment also fell unexpectedly because of downturns in transport vehicles and IT hardware, which we can assume partly reflects similar obstacles.

Renewed acceleration as the latest COVID-19 wave recedes. Some of the problems that dominated Q3 should be about to fade. The number of new COVID-19 cases has fallen from an early September peak but remains above summer levels. We believe reduced worries about the virus will help jump-start service consumption in fields like entertainment and tourism but also encourage people to return to the labour market. This is vital in easing supply side problems, which have become increasingly clear.



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

Overheated corporate sector

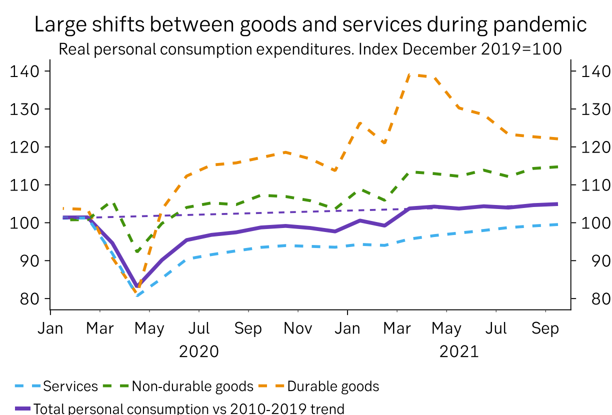
Sentiment indicators for large manufacturing and service sector companies (the ISM indices) are signalling a continued high level of activity in the economy, with a shift from industry to services. High index readings reflect strong order influx and well-stocked order books, but also long delivery times: normally a sign of high activity but now being driven by stretched value chains. Small

business sentiment (NFIB index) is in line with historical averages; meanwhile companies are reporting growing personnel shortages and rising prices/salaries. Production in the manufacturing sector is back at pre-pandemic levels, but has recently been hampered by the consequences of Hurricane Ida and continued setbacks in automotive production, which is now 13 per cent below late 2019 figures. Exports have levelled off well below pre-pandemic levels, reflecting subdued activity in other countries, especially China. A greater focus on meeting strong domestic demand may also have contributed.

Temporary dip in business investments. Because of strong order projections according to ISM surveys and growing bookings for capital goods, we remain optimistic about business investments. Difficulties in attracting low-skilled workers may also drive increased investments in automation and digitalisation, an idea that receives some support in the Fed's Beige Book. Commercial property construction has been depressed during the pandemic, while residential investments initially rose sharply and then fell in Q2-Q3 this year. We expect home building to start making positive contributions to growth again. Home sales rebounded in the middle of the year and sentiment among home builders has stabilised at high levels.

Cautious households still have ammunition

Household confidence fell during Q3, with a decline in the expectations index, which is usually more closely correlated with consumption. The mood of consumers has stabilised in recent surveys, which indicates that increased virus transmission has been important. Rising inflation expectations – even in the medium term – probably contribute to lower consumer confidence. Stimulus payments to households during Q1 led to an unparalleled surge in retail sales, but the sharp increase in goods consumption is offset by the earlier sharp decline in service consumption. Total consumption is back at its previous trend after the last round of cash payments.



Large shifts between goods and services during pandemic

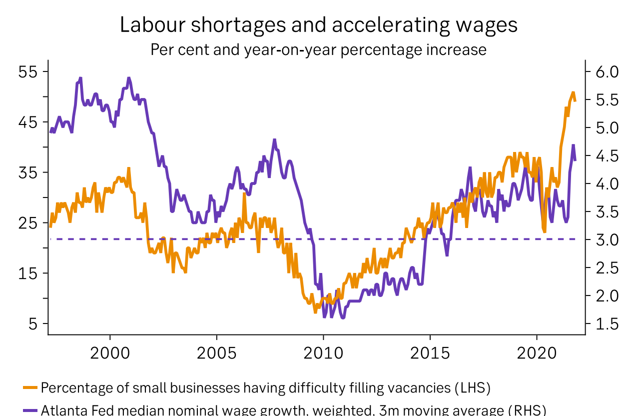
Real personal consumption expenditures. Index December 2019=100

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

Real incomes have begun to shrink. Generous stimulus programmes during the pandemic more than compensated households for rising unemployment, but federal jobless benefits expired in early September. Pay hikes have accelerated, but not enough to offset faster price increases. Yet a high level of saving during the pandemic – due to stimulus payments and the initial downturn in consumption during lockdowns – has provided households with a buffer estimated at nearly USD 2 trillion, or about 10 per cent of GDP. The Biden administration has also boosted support for low-income families with children through a form of child allowance that the welfare package now being negotiated among congressional Democrats would extend into 2022. We expect consumption to grow in line with the historical trend, with a shift from goods to services. We forecast that consumption growth will slow from 7.9 per cent this year to 3.0 per cent next year and 2.2 per cent in 2023.

A complex inflation and resource situation

Our forecast implies that GDP will surpass the previous growth trend by next spring. From this perspective, the US economy still has idle resources left, but such a view is challenged by signals of overheating in prices, wages and labour market indicators. This raises questions about the extent to which the pandemic has damaged long-term production potential. The ratio of vacancies to the number of unemployed people, labour shortages in the NFIB small business survey and anecdotal data all point rather consistently to growing labour shortages. Meanwhile, high levels of voluntary separations (quits) and consumer surveys indicate that employees regard their labour market situation as strong. Pay increases have not fallen during the pandemic, despite higher unemployment – probably because stimulus payments reduced the motivation to look for work. Metrics that adjust for changes in the composition of the labour force, such as the Atlanta Fed's median wage growth and the quarterly labour cost index, now show acceleration in wage growth to levels on a par with earlier peaks in 2000 and 2007.



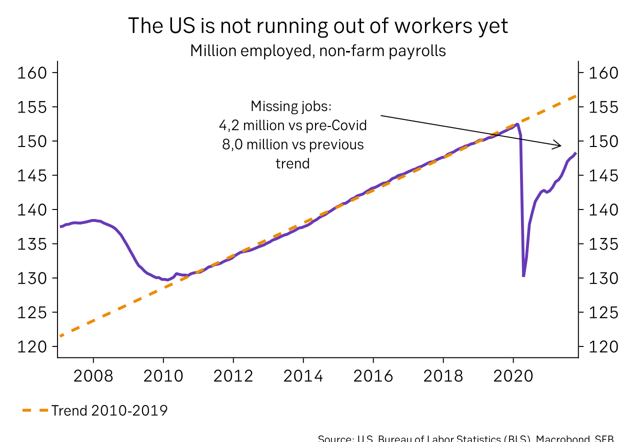
Labour shortages and accelerating wages

Per cent and year-on-year percentage increase

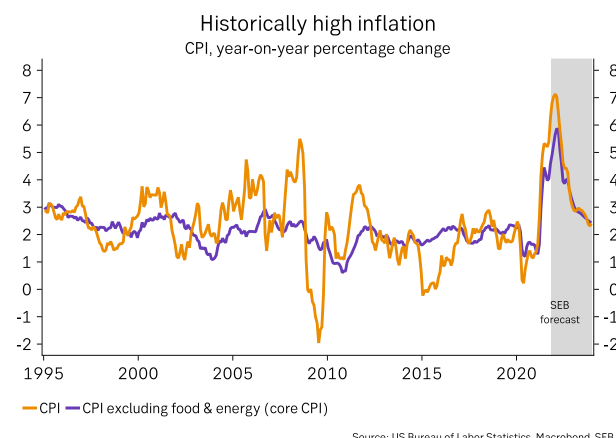
Source: Federal Reserve Bank of Atlanta, National Federation of Independent Business, Macrobond, SEB

Already full employment? Meanwhile it is hard to believe that the labour market has already peaked. The number of people with jobs is some 4 million fewer than before the pandemic and even lower compared to the previous trend, while unemployment is 1.0 percentage point above pre-pandemic levels. Factoring in the decline in labour force participation for people aged 25–54, the gap widens to about 3 points. We are seeing anomalies caused in part by the pandemic. Participation has declined most among older groups, people with less education and women of child-rearing age. We believe the downturn among the low-skilled may reflect a reluctance to engage in close-contact service jobs during the pandemic, while the downturn for women may partly be due to lingering childcare problems and erratic school reopenings.

Some of the decline is more permanent. The number of people over age 55 in the US labour force has decreased by almost 1 million and the participation rate has not recovered from the declines early in the pandemic. This age category has pushed the labour supply higher in recent decades – a trend that may eventually resume. But those who chose to retire early during the pandemic are unlikely to come back, which will delay a return to previous participation levels. Our forecast implies a return to a more normal labour market situation during the forecast period. Unemployment will fall to just over 3.5 per cent by the end of next year, in line with the 50-year low before the pandemic, and to just below 3.5 percent by the end of 2023.



Broad-based price increases. This spring's rapid increases were concentrated to a few products such as used cars and a normalisation of depressed prices for certain services. Recently, monthly price increases have been broadened. This challenges the Fed's thesis of "transitory" inflation. Faster rent increases are a new upside risk. Overall, however, prices of services are still rising at a moderate pace, while goods inflation is the highest since February 1981. We have revised our inflation forecast upward and now believe that prices, excluding food and energy, will continue to rise at a faster pace than normal for most of next year as well. Total CPI inflation will peak at just over 7 per cent early next year and core CPI inflation at close to 6 per cent.



Fed rate hikes next year. In November the Fed began the long-anticipated tapering of its bond purchases. Bond-buying is expected to end in June next year, opening the door to hiking interest rates. It took more than a year from the end of bond purchases to the beginning of rate hikes in the previous hiking cycle, but this reflected a very slow recovery. Given the need to respond to a prolonged period of above-target inflation, as well as signs of an accelerating rate of pay increases, the Fed will raise its key rate in September 2022 and again in December. During 2023, it will carry out three more rate hikes, also supported by an increasingly tight labour market situation. Our forecast implies a key rate of 1.50 per cent at the end of 2023 (the upper limit in the Fed's range).

Hurdles for Biden's agenda. On paper, the White House can rely on majorities in both houses of Congress, but Biden's reform policy has stalled in protracted negotiations between different Democratic Party factions. The infrastructure package worth about USD 1 trillion (including USD 550 billion in "new" money) that was hammered out by the Senate a few months ago was recently passed by the House of Representatives and signed into law. An agreement on Biden's climate and social welfare investment package has taken longer, however, with high inflation posing a new challenge. The latest proposal from the White House implies cutting such spending from the original USD 3.5 trillion to USD 1.75 trillion. Large portions of the previously planned tax increases on companies and high-income earners appear to have been scrapped. Our main scenario is that both bills will have been approved by Congress before year-end and – because of front-loaded spending – will help sustain growth in 2022-2023. But if the Democrats cannot reach an agreement, there is an increasing risk that fiscal policy will become a drag on growth.

Theme:

COP26

Climate negotiations in Glasgow

From October 31 to November 13, world leaders met at the United Nations Climate Change Conference (COP26) in Glasgow, Scotland. Their main purpose was to review the progress that countries have made on their pledges to help the world meet the target of the 2015 Paris Agreement to keep global warming well below 2 degrees Celsius compared to pre-industrial levels, and if possible limit it to 1.5 degrees. At the heart of the Glasgow negotiations was the issue of how much countries must raise their ambitions in order to achieve net zero emissions by mid-century.

COP26 is the 26th session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC). Since the Paris Agreement was reached in December 2015, 194 countries have signed it. One of the most important principles in the agreement is that countries set their own targets for contributing to the limitation of global warming. In these nationally determined contributions (NDCs), countries present their voluntary proposals on how they will help to curb the increase in global temperatures.

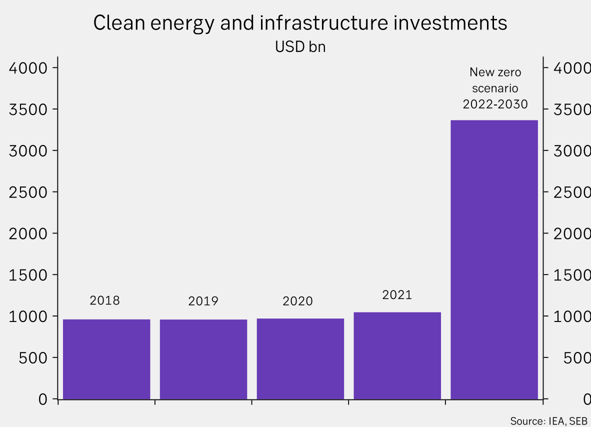
The Paris Agreement also requires that countries successively ratchet up their commitments and renew or update their NDCs every five years. A Global Stocktake of their overall commitments will also take place every five years, starting in 2023 – when the contributions pledged by all countries will be compiled and analysed to see how much their collective efforts will achieve.

Before the Glasgow meeting, the hope was that countries would live up to their commitments under the Paris Agreement by adopting more ambitious targets for cutting greenhouse gas emissions no later than 2030. In its latest report last August, the UN Intergovernmental Panel on Climate Change (IPCC) said the world must immediately, sharply and continuously lower emissions to curb global warming in line with the Paris Agreement.

Lofty ambitions before the conference

For the British government, which hosted the annual climate negotiations this year, the main goal of COP26 was for countries to agree to keep the more ambitious 1.5 degree target within reach. One week before the conference, the chances of achieving this goal appeared bleak. That is when the UNFCCC secretariat released its latest "synthesis report" on countries' NDCs. The report indicated that global greenhouse gas emissions will increase 16 per cent by 2030, compared to 2010. Such an increase, unless changed rapidly, may lead to a temperature rise of about 2.7 degrees by the end of this century – far above what scientists regard as a level with fairly manageable climate effects.

The International Energy Agency has provided answers to the question of how the world can still succeed in limiting global warming in line with the Paris Agreement. In its *World Energy Outlook*, released a few weeks before COP26, the IEA declared that coal power needs to be reduced by 55 per cent during the current decade. In addition, annual investments in renewable energy and energy infrastructure must increase from the current USD 1 trillion to USD 3.4 trillion by 2030. The IEA report also showed that current investments in oil and gas are among the very few areas that are reasonably in line with the Paris Agreement.



Although there is a strong consensus among experts about what technologies and investments are required to achieve the global climate target, it is unclear how responsibility for political implementation and financing will be allocated. Movements that work towards climate justice, such as Fridays for Future, point out that the countries that have largely caused climate change are not the ones that will suffer the most from its consequences. In addition, the quantity of greenhouse gases that can be emitted in order to achieve Paris Agreement targets is limited, and most of this has already been emitted by rich countries. According to the IPCC's latest report, only 500 gigatonnes of carbon dioxide remain to preserve a 50 per cent chance of limiting the global temperature increase to 1.5 degrees. In 2019, global CO_2 emissions were 33 gigatonnes.

> "Coal power needs to be reduced by 55 per cent during the current decade"

How to achieve a fair allocation of responsibility for emission reductions has also historically been one of the most controversial issues in international climate negotiations. Just two weeks before negotiations began in Glasgow, the British government was accused by China and India, among others, of trying to impose an unfair target of net zero emissions by 2050 on developing countries. At the same time, the latest IPCC report shows that emissions from both developed and developing countries must be reduced to net zero by mid-century in order to achieve the 1.5 degree target.

New pledges boost the chance of success

Just before COP26 began, the governments of Australia and Saudi Arabia announced their ambition to achieve net zero emissions in 2050 and 2060, respectively. These two countries have been criticised for years for slowing down the world's transition to fossil-free energy. In addition, the credibility of these net zero targets by the world's largest exporters of coal and oil, respectively, has been questioned since their targets do not include any plans to reduce fossil fuel production.

Prime Minister Narendra Modi's announcement at the beginning of COP26 that India's ambition is to achieve net zero emissions by 2070 was an unexpected and positive message. India had previously not wished to make any binding commitments, since it considers itself entitled to prioritise economic development. The world's fourth largest greenhouse gas emitter will increase its non-fossil energy capacity to 500 gigawatts by 2030, from today's 100 gigawatts. In addition, India will meet half its energy needs from renewable sources by the end of the current decade. This has been interpreted by climate economist Nicholas Stern as meaning that the country's emissions will peak before then. Modi's proposals put pressure on other countries and leaders, including both other emerging economies and the US.

An agreement by more than 70 countries to phase out coal-fired power production is another important outcome at COP26, since coal combustion is one of the absolutely biggest contributors to global warming. Coal-dependent countries such as Poland, Ukraine and Vietnam are included in the agreement. But several of the world's largest consumers and producers of coal-fired power – such as China, India and Australia – are not part of the initiative. The agreement also lacks a deadline for when coal-fired power will be phased out. According to the IEA, this should take place by 2040 globally in order to meet the world's climate goals.

An agreement among more than 100 countries to reduce methane emissions by 30 per cent has also been cited as a success for COP26. Methane has almost 100 times more capacity to capture heat in the atmosphere than carbon dioxide. Methane gas emissions are mainly caused by the exploitation of oil and natural gas, but agriculture is also a major source of methane emissions. The US was behind the initiative, while China and Russia are not involved.

A declaration aimed at ending deforestation and restoring felled areas is also regarded as an important step forward. The 105 countries behind this pledge account for 85 per cent of the world's forests, and they include such countries as Brazil, Indonesia and Congo. The initiative will receive initial funding of USD 14 billion. However, the declaration does not specify how much forest is to be protected, nor does it clearly define what is meant by sustainable forestry or provide a strategy for dealing with goal conflicts.

> “The 105 countries behind this pledge account for 85 per cent of the world’s forests, and they include such countries as Brazil, Indonesia and Congo”

In an initial analysis, the IEA estimates that the new promises, if they become a reality, may limit global warming to between 1.8 and 1.9 degrees. However, non-profit research group Climate Action Tracker which did its own analysis criticised that this would only be true under a best-case scenario – and that ambition must be raised further to limit global warming to 1.5 degrees.

From “Blah, blah, blah" to action

Thus, the IEA’s estimates should be interpreted cautiously. Jacob Werksman, the European Union’s top climate negotiator, warned that the organisation’s statements ignore the fact that none of the new pledges have been implemented yet.

A new analysis of national climate policy measures that was published by Climate Action Tracker before COP26 pointed to the wide gap between national pledges and actual behaviour. The group’s analysis of 40 countries showed that only one country – Gambia – has a climate policy framework consistent with the 1.5 degree target.

> “But another outcome would be that the transition to renewable energy would be much more unstructured, erratic and costly.”

There is a risk that empty promises were made in Glasgow. As a result, serious effects like those the UN Panel on Climate Change has long warned about could become a reality. But another outcome would be that the transition to renewable energy would be much more unstructured, erratic and costly. In its first climate-related macroeconomic stress test earlier this year, the European Central Bank warned of a "disorderly transition", in which extreme decisions are taken after 2030 in order to protect society and the economy from the worst consequences of climate change.

Simultaneously, COP 26 has also provided some momentum for improving the NDCs to accelerate emission reductions this decade. The declaration of the US and China – arguably the largest surprise of COP 26 – speaks of a joint commitment to raise ambitions in the 2020s to close the gap between current global efforts and what is needed to achieve the Paris Agreement.

The answer to the question if COP 26 was a breakthrough or a breakdown of international climate negotiations will not be found in the summit’s final declaration. It will be found in the actions that governments and the private sector take to promote rapid, lasting and science-based emission reductions.

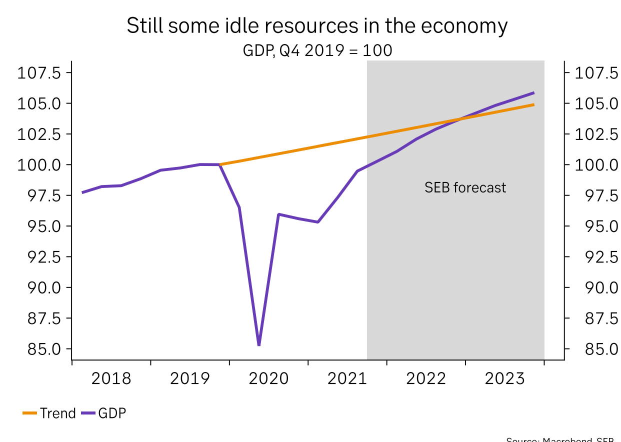
The euro area
High inflation is creating a new dilemma for the ECB

Recovery has continued at a reasonable pace in the past six months, but transport disruptions and component shortages are increasingly hampering manufacturers while high energy prices undermine household purchasing power. Growth will thus slow near term and GDP will gain 4.4 per cent in 2022 and 2.6 per cent in 2023. Rising inflation has boosted the likelihood of rate hikes, but if inflation falls in keeping with our main scenario, we believe the ECB will maintain its current key rates until the end of 2023.

Growth will decelerate in the fourth quarter
After the second pandemic recession last winter, the recovery has been a bit stronger than expected. Once again, the easing of restrictions has boosted service production and consumption in particular. Improved ability to manage the pandemic, combined with more widespread vaccination, have reduced sensitivity to renewed COVID-19 transmission. But post-pandemic problems including supply disruptions and high energy prices meanwhile continue to hamper the recovery. In the third quarter of 2021, GDP rose by 2.2 per cent, but we now expect a slowdown. The GDP forecast for this year has been raised to 5.1 per cent and thereafter we expect it to slow to 4.4 and 2.6 per cent respectively in 2022-2023.

Still some idle resources in the economy

GDP, Q4 2019 = 100

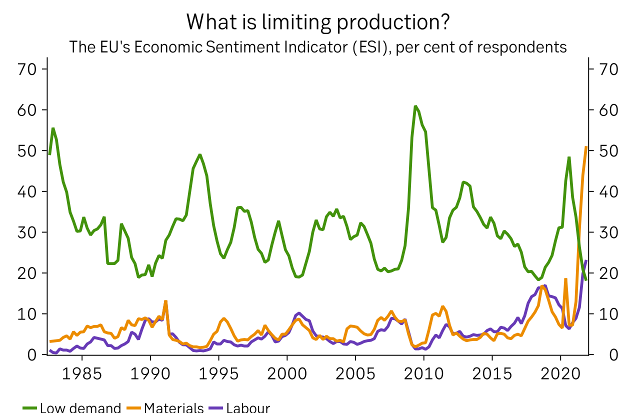


Source: Macrobond, SEB

Ambiguous sentiment indicators. According to indicators like the purchasing managers' index (PMI), companies have been highly optimistic since this past spring, but their mood has edged lower in recent months. Service sector sentiment has shifted higher as pandemic-related restrictions have eased. But indicators are divided: healthy order bookings as well as higher production and employment, at the same time as companies are suffering from extremely long delivery times and high input prices.

What is limiting production?

The EU's Economic Sentiment Indicator (ESI), per cent of respondents



Source: Eurostat, Macrobond, SEB

Post-pandemic difficulties are plaguing production. The headwinds facing manufacturers are also visible in hard data. Industrial production in some countries has had trouble regaining its losses from the pandemic. The upturn in production slowed in mid-2021, despite good order bookings. In August production fell, while manufacturing sector PMI moved clearly lower for the first time. In the euro area as a whole, output is largely back at pre-pandemic levels, but the trend is widely divergent. Highly industrialised Germany has found it harder than other major euro area economies to recover lost ground.

Key data

Year-on-year percentage change

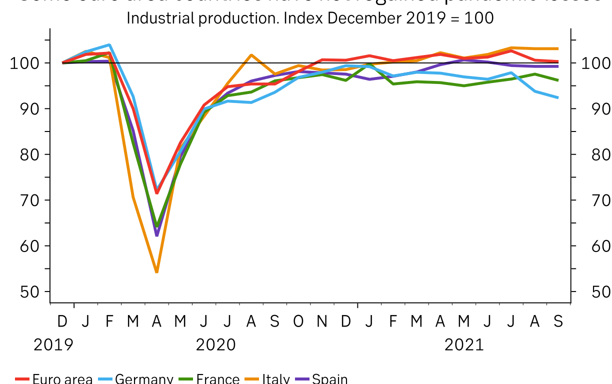
	2020	2021	2022	2023
GDP	-6.4	5.1	4.4	2.6
Unemployment*	7.9	7.7	7.2	7.3
Wages and salaries	-0.6	3.0	2.5	2.7
CPI	0.3	2.5	2.5	1.4
Public sector fiscal balance**	-7.2	-6.3	-3.6	-3.0
Public sector debt**	97.3	100.6	98.7	98.1
ECB deposit rate, %**	-0.50	-0.50	-0.50	-0.50

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

More supply side than demand side problems. Preliminary statistics for German truck tolls, which usually show a close co-variation with industrial production, point to a continued weak trend. But healthy order bookings indicate that the problems are more closely related to the supply side than to demand. Even if supply disruptions persist for longer than expected, there are many indications that they will ease early in 2022. Despite prevailing stagnation, due to the sharp upturn in 2020

industrial production will rise by 7 per cent for the full year 2021. This upturn will continue in 2022 and 2023, but at a more moderate yearly pace of 3 to 4 per cent.

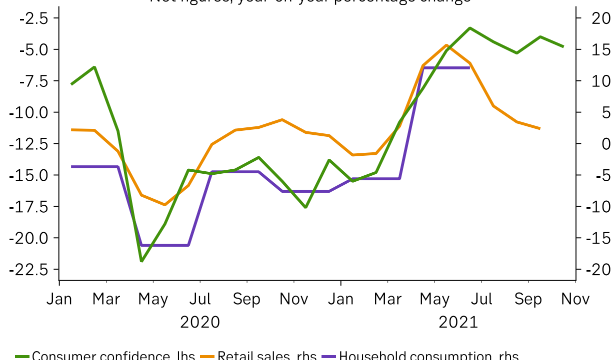
Some euro area countries have not regained pandemic losses
Industrial production. Index December 2019 = 100



Source: Eurostat, Macrobond, SEB

High savings and a good mood among households. Government stimulus measures helped avoid a sharp deterioration in consumer finances. Household incomes were largely unchanged in 2020 and will rise slightly this year. Goods consumption has now slowed after an earlier upswing, and retail sales have fallen in recent months. Service consumption will gradually regain lost ground as restrictions ease, but for some sectors it takes time to recover. Long-distance travel is still far from normal, and a continued low level of foreign tourism is very noticeable in southern European economies that are highly tourism-dependent. Next year, purchasing power will be greatly undermined by high energy prices. The upturn in real household income will be marginal in both 2021 and 2022, but a high savings level will leave room for surges in consumption. In both 2021 and 2022, we expect an increase of 5 per cent, slowing to 2.5 per cent in 2023.

Households are in a good mood
Net figures, year-on-year percentage change



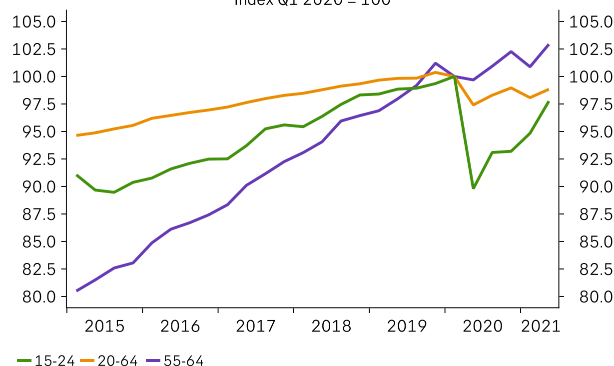
Source: Eurostat, European Commission (DG ECFIN), Macrobond, SEB

Unemployment already at pre-pandemic level. Unemployment fell to 7.4 per cent in September and is already back at the pre-pandemic level. Employment has regained about half of losses but is still about 2.5 million jobs short of its pre-pandemic level. Labour shortages have increased markedly, despite lower employment.

According to EU surveys, a record-high share of companies indicates that labour shortages are limiting production. Firms often have difficulty recruiting well-educated employees. But during the pandemic, employment has mainly declined among younger and low-skilled people. Many hard-hit sectors now seem to be having trouble attracting back employees who have left certain occupations. The trend towards higher employment in older age groups has also slowed.

Will the labour force recover? Resolving labour market mismatches in the long run will be important for both the economic growth outlook and wage formation. We are now seeing slightly higher pay increases, driven both by labour shortages and general upward pressure on minimum wages – in an environment where inequality issues have risen higher on the public agenda. But euro area pay hikes are not as strong as in the US and the UK. We also believe that labour force participation is largely being squeezed by temporary factors. The labour supply will thus rebound as demand increases (see theme article, page 13). As a result, unemployment will be essentially unchanged or fall slowly during the next couple of years. Annual average unemployment will fall from 7.8 per cent this year to 7.3 per cent in 2023. Wages and salaries will rise by about 3 per cent in 2022 and 2.5 per cent in 2023.

Employment in various age ranges
Index Q1 2020 = 100



Source: Eurostat, Macrobond, SEB

Continued fiscal stimulus

Lingering pandemic-related problems are creating a need for continued fiscal stimulus measures, but their scope is decreasing and they are changing character in order to manage shifting challenges. There seems to be a desire to avoid the mistakes made after the 2007-2009 global financial crisis, when premature austerity measures helped trigger the euro crisis. Some countries are now determined to ease the consequences of high energy prices by cutting taxes or boosting subsidies and grants. Because of reduced stimulus and a stronger economy, public sector deficits will gradually fall from 7.2 per cent of GDP in 2020 to just over 3 per cent in 2023. This year

public sector debt will exceed 100 per cent of GDP, then fall back to 98 per cent in 2023. Discussions are now underway to soften fiscal policy frameworks, but Germany is expected to slow this trend. The EU will probably ease requirements for how quickly government debt must be reduced to the target of 60 per cent of GDP, and it is also possible that this benchmark will be raised.

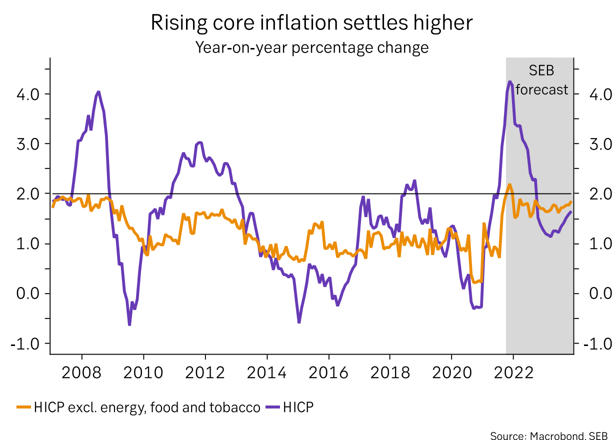
New investments at European Union level. At the same time as pandemic-related stimulus is being scaled back at national level, EU-wide initiatives are increasing through the NextGenerationEU (NGEU) package. The programme will add 6-7 per cent to GDP over a number of years, and many countries are investing heavily with a focus on structural spending that can support digitisation and the green transition. The programme will provide a welcome boost in investments, but it is important for the EU as a whole that this type of redistributive support really works by ensuring that the funds are used as intended.

Macron is headed towards a new election victory. After the German election in September, the Social Democrats, the Greens and the liberal FDP are now trying to form a coalition government. Even if the FDP succeeds in slowing down some of the other parties' stimulus plans, we expect a slightly more expansionary German fiscal policy over the next couple of years. The focus of attention will soon shift to the French presidential election in April 2022. The left has lost ground, and at present Marine Le Pen and President Emmanuel Macron will most likely face off again in the second election round. However, Le Pen is being challenged by another candidate from the nationalist right (Éric Zemmour), which may open the way for traditional rightist Xavier Bertrand. Although Macron's popularity has declined somewhat, he leads in opinion polls and most indications are that he will be re-elected.

Higher inflation but unchanged ECB key rate

Inflation has again surprised on the upside, reaching 4.1 per cent in October and equalling the previous record from 2008. We expect inflation to rise slightly further in the next few months, peaking at 4.3 per cent around year-end before falling again. As in 2008, high energy prices are the dominant driver. In October, they were up more than 30 per cent compared with a year earlier, contributing more than two percentage points to CPI. The difference between total CPI and core inflation is also far wider than in other economies, but there are also signs of a broader upturn. Both goods and service inflation was just above 2 per cent in September; for service prices, this was a new record. Base effects from previous VAT cuts in some countries also helped to boost inflation. The outlook for the near future is entirely dependent on energy prices, but we expect inflation to fall to 2 per cent in mid-2022, when the recent energy price surge disappears from 12-month figures. Our main forecast is therefore that annual average inflation will end up at 2.5 per cent in 2022 and 1.4 per cent in 2023.

Rising core inflation settles higher
Year-on-year percentage change



Source: Macrobond, SEB

The ECB will wait until its December policy meeting. The announcement following the European Central Bank's October meeting was that it would await future developments and leave policy unchanged. Asset purchases will decrease slightly in Q4, and at the December meeting we will learn more about ECB plans when the Pandemic Emergency Purchase Programme (PEPP) expires in March 2022. We believe the ECB will either temporarily extend its Asset Purchase Programme – buying EUR 20 billion worth of bonds per month – or set up a temporary mechanism that will ease the effects of sharply lower bond purchases when PEPP expires.

Key rate hikes are still remote. Rising inflation risks are among the reasons why the market is now pricing in almost a full 25 basis point hike in ECB's key interest rates as early as 2022. Rate hikes by other central banks such as the Fed and Bank of England are approaching, which certainly affects market expectations, but at present neither the ECB's nor our own inflation forecast points to any rate hikes in the foreseeable future. We are thus sticking to our forecast that the ECB's key rates will remain stable during the next couple of years. There is a risk that ECB hikes would lead to wider bond yield spreads between Germany and weaker southern European economies. This is currently raising the threshold for the ECB to hike interest rates, but new programmes with expanded opportunities to concentrate purchases on weaker economies might lower the threshold for interest rate hikes. If it turns out that higher inflation persists for longer than expected, it is thus likely that the ECB's strategy may include cautious interest rate hikes.

Theme:

Halts in production

Between demand heaven and production hell

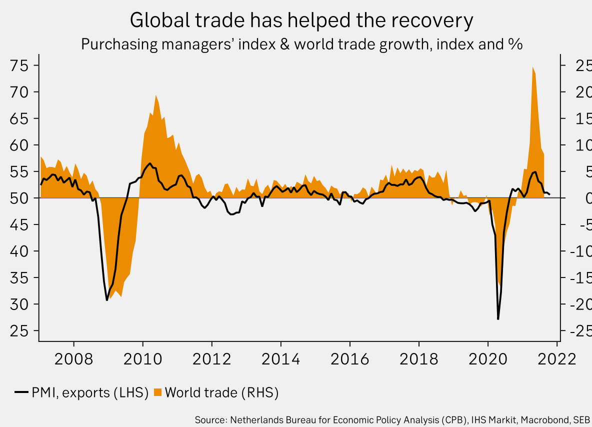
Unexpectedly strong global demand for goods right now is faced with mounting production disruptions. These are largely pandemic-related but can also be connected to a European and Asian energy crisis. Disruptions in the global value chains of companies threaten the economic recovery, help drive inflation and put pressure on monetary policy. Our conclusion – based on historical comparisons, national business surveys, anecdotal data and seasonal patterns – is that this global "production crisis" will culminate in the first quarter of 2022, but that the challenges will persist until the second half of the year.

Although the world – helped by vaccines – is now taking decisive steps to master the COVID-19 pandemic, more and more companies face growing production problems. Many goods-producing companies are encountering serious disruptions in their global value chains. Input goods are in short supply, the global logistics network is out of balance and costs are rising. Problems also arose when the pandemic began early in 2020, when first China and then the rest of the world locked down. Through impressive creativity, flexibility and interaction between various market players, however, companies unexpectedly managed to quickly restore their value chains. Production resumed and was able to meet the subdued demand prevailing in the spring of 2020.

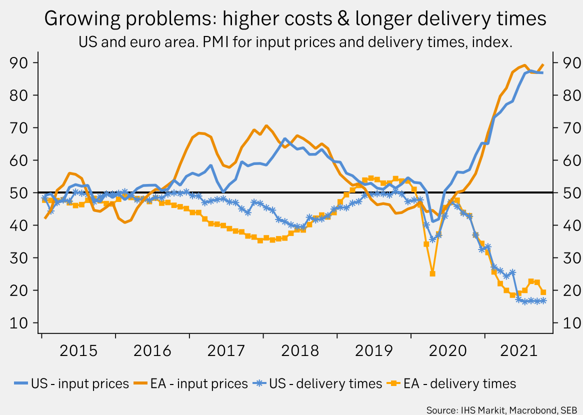
Today's "production crisis" actually has nothing to do with concerns about vulnerability in global value chains and the debate on strategic autonomy (SEB, October 11, 2021: "Globalisation & value chains – on the threshold of a new world?"). Companies are describing the pandemic as the ultimate stress test for global value chains, saying these chains have shown surprising resilience. The recovery from the pandemic, combined with an energy crisis, is proving significantly more complicated than many had expected.

Growth engine will lose momentum

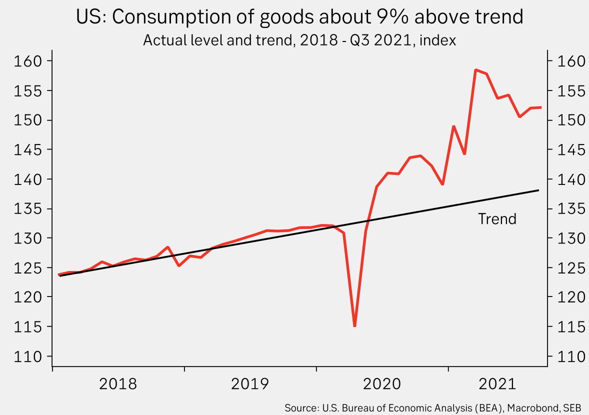
Global trade has recovered faster than expected after the pandemic. The resilience shown by manufacturers and traders has softened the economic impact of the pandemic and helped propel the recovery. The International Monetary Fund (IMF) estimates that global trade will grow by 10 per cent in volume this year, then slow marginally to 7 per cent; trend growth is estimated at close to 3.5 per cent. However, we see clear downside risks for global trading volume during the first half of 2022 – and thus for the full year 2022 – even if value continues to grow because of price increases.

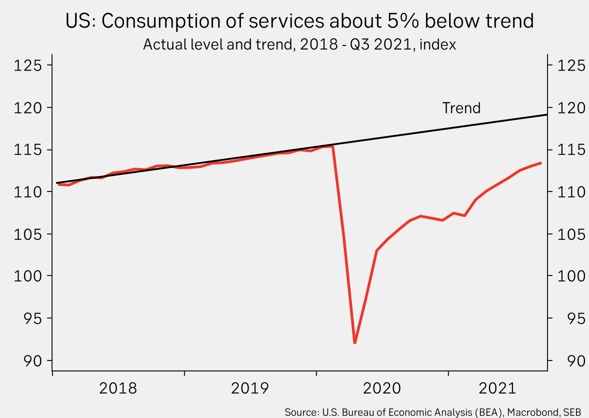


Mounting production concerns. Corporate surveys conducted by the US Federal Reserve, the Bank of Canada, Sweden's Riksbank and others show rapidly growing and widespread concerns about production disruptions. During the autumn of 2021, this concern was confirmed by final statistics, third quarter reports and corporate "guidance" for the final quarter of 2021. Anecdotal information and conversations with companies also confirm this worrying situation.



Protracted consumer rotation. The recent increase in disruptions is due to several unprecedented and interacting forces. We have seen an unexpectedly sustainable and strong consumer rotation between sectors: normalisation in demand for services has been delayed, while demand for goods has remained strong (see chart below). Government stimulus has helped lift consumption. In retrospect, fiscal measures aimed at fuelling demand may have been too extensive. Today, US households still have a savings surplus of about USD 2 trillion, equivalent to 9 per cent of GDP (2021). Household goods consumption is about 9 per cent above trend – and service consumption about 5 per cent below trend – which confirms the picture of global bottlenecks.



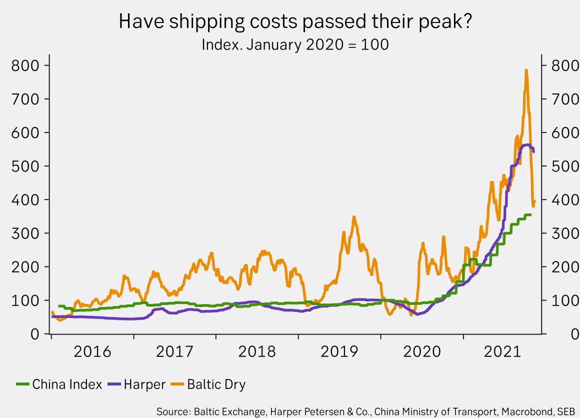


Several reasons behind the semiconductor shortage. Strong, imbalanced demand is not the only challenge. The world has also faced various constraints on the supply of production-critical inputs, such as semiconductors. Early in the pandemic, global semiconductor sales fell by about 5 per cent. In the past 18 months, sales have climbed nearly 40 per cent. Rapidly rising demand for semiconductors in particular is due to shifts in behaviour, such as an increased need for technical equipment to enable people to work remotely. Production takes place in Asia, among other locations, and the deteriorating geopolitical situation in the region may also have given rise to hoarding.

Energy crisis with seasonal effects

Natural gas prices have climbed to record levels, which has also pushed up other energy prices. Commodity markets often undergo large cyclical fluctuations (see theme article, page 19). When commodity prices are low, capital spending on production capacity normally

declines, and vice versa. Last year, for example, natural gas prices were at their lowest in 13-14 years. When production capacity cannot meet a rapidly rising short-term demand, prices often surge. The winter of 2020-2021 was unusually cold and the summer of 2021 unusually warm, which are other reasons why stocks of coal, natural gas and other fuels are far below normal.



Weather is crucial in the short term. There is great uncertainty about some of the most important driving forces behind energy markets: global economic strength, geopolitical events and the expansion of green energy. How cold the winter of 2021-2022 turns out to be will determine short-term supply and price changes. Countries like China are rationing their energy supplies, contributing to disruptions and production stoppages in factories – and thereby risking further disruptions in global value chains.

China's many-faceted problems

The value chains of international corporations are deeply integrated with China's production structure. Many companies are likely to have difficulty making themselves entirely independent of China, for example. Over long periods they have invested in their presence in the world's largest, fastest-growing market for consumer goods. China's ever-increasing advances in research fields are also likely to encourage collaboration with Chinese companies.

China's manufacturers are being adversely affected today by several interacting factors that have an impact far beyond their country's borders. Chinese companies are also suffering from shortages of input goods, such as semiconductors. They are facing energy rationing and virus outbreaks. The government's zero tolerance COVID-19 policy is creating production stoppages while making strategic thinking and planning harder. Pandemic-related production disruptions and political tensions between China and the rest of the world have put pressure on companies to reduce their dependence on Chinese value chains. But doing so would be a long-term process and would not solve the problems that the world currently faces.

What can the global financial crisis teach us?

The world economy suffered similar disruptions in global value chains and production problems as a result of the financial crisis of 2007-2008. This period has also been called the Great Trade Collapse; see the first chart on page 31). Just as the financial crisis more or less simultaneously struck economies worldwide, global trade was similarly affected. Driving this trade collapse were rapidly falling demand and reduced opportunities for companies – due to a weakened financial system and credit supply restraints – to obtain trade finance.

These disruptions in global value chains ended relatively fast, however, and world trade bounced back. In the same way that value chains have contributed to global recovery after the COVID-19 pandemic, they also contributed to the recovery following the global financial crisis of 2007-2008. But whereas the financial crisis was mainly due to demand falling below supply, the pandemic has lifted demand above supply at the same time as production constraints have appeared.

A repeat of 2008, with overestimated demand? Surveys show that companies around the world are responding to strong international demand and limited sales opportunities by planning to boost investments and expand production capacity. Meanwhile customers' global search for various goods runs a risk of creating an exaggerated picture of total demand. Further ahead, this may create an oversupply of certain goods, which may push down future production and prices.

Demand heaven and production hell. Goods-producing companies are in heaven when it comes to strong customer demand. At the same time, many companies are in production hell when it comes to component (and labour) shortages, logistics problems and rising production costs. Our conclusion – based on historical comparisons, national business surveys, anecdotal data and seasonal patterns – is that this global "production crisis" will culminate during Q1 2022 but that the challenges will persist until the second half of the year.

The United Kingdom
An expensive winter will dampen economic growth

High energy prices will not only lower purchasing power but confront households with direct choices between comfort and cost. Weaker consumption will delay the recovery, but by the end of 2023 we expect GDP to be back at its pre-pandemic trend. The inflation surge will be stronger and lengthier than expected; CPI will climb by 4.7 per cent in 2022. The Bank of England will start raising the bank rate gradually and will reach a level of 1.25 per cent by the end of 2023. Trade issues with the EU remain a clear risk.

Slowdown after reopening. After the final step was taken to reopen the British economy in June, activity has clearly slowed. During most of the third quarter, GDP was largely flat. Energy prices are higher than elsewhere in Europe, and the UK uses expensive natural gas not only to produce electricity but also for heating houses and cooking. Although households will probably reduce their comfort level in order to slow the rise in their energy spending, consumption will be subdued on a broad front during the winter months. This will delay the recovery by a few quarters. We have lowered our 2022 GDP growth forecast by nearly one percentage point to 4.9 per cent, but we expect growth to pick up again from mid-2022. GDP will thus be back at its pre-pandemic trend by 2023.

Key data

Year-on-year percentage change

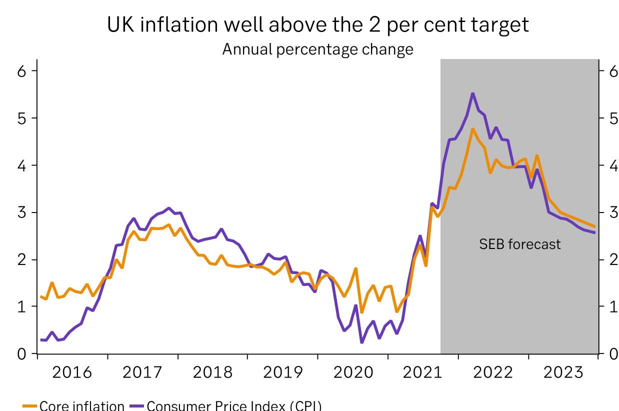
	2020	2021	2022	2023
GDP	-9.7	6.9	4.9	2.8
Unemployment*	4.5	4.6	4.3	4.1
Wages and salaries	1.8	5.3	1.8	2.4
CPI	0.9	2.5	4.7	2.9
Public sector balance**	-12.5	-12.0	-5.0	-4.0
Public sector debt**	104.5	107.0	106.0	107.0
Key interest rate, %***	0.10	0.25	0.75	1.25

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

The large savings buffers that households have built up will soften some of the negative impact of high energy prices on consumption. In addition, the government will provide direct compensation for rising costs and is proposing higher minimum wages to help sustain the most vulnerable groups. Private consumption will thus still increase by 5.3 per cent during 2022 as a whole.

UK inflation well above the 2 per cent target

Annual percentage change



Source: DNS, Macrobond, SEB

Many job openings and a shrinking labour supply. The number of new vacancies has risen markedly since the reopening. In addition, matching problems due to Brexit are helping to boost pay increases. The labour supply has also decreased because of early retirements and greater interest in studies. Acute shortages in some occupational categories will ease in the long term, although we will see significant transition problems caused by Brexit over the next few years. Despite recruitment problems, the labour supply is not rebounding fast enough. Unemployment has fallen steadily this year but remains about 1.5 percentage points above its pre-pandemic level. Towards the end of our forecast period, we expect it to reach 4.1 per cent.

Higher and more persistent inflation. Due to several factors, inflation now looks set to remain more clearly and persistently above the 2 per cent inflation target. CPI is expected to peak at 5.8 per cent in March 2022 and then fall to 3.5 per cent towards year-end. High energy prices will have a clear impact. Various types of bottleneck problems, rising global prices and higher pay increases will also contribute to higher underlying inflation. The situation is now temporarily worsening as the economy reopens and companies compete with pay hikes to resolve their imbalances. Due to Brexit-related problems, high inflation is likely to persist longer than in many other countries.

The Bank of England will start hiking its key rate. Due to a higher inflation path, the BoE has shifted rapidly from wait-and-see mode to plans for a key rate hike soon. We expect an initial hike to 0.25 per cent in February 2022 and then 0.50 per cent in May. The BoE can thus allow its securities holdings to mature, which will have some tightening effect. After a short pause to assess the extent to which the economy is affected, we expect the BoE to raise the key rate three more times during the remainder of our forecast period to 1.25 per cent at the end of 2023.

Theme:

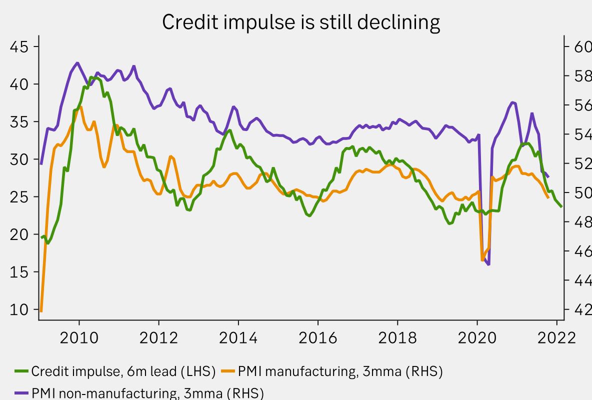
China

Growth is taking a back seat to structural reforms

Near-term downside risks to China's growth are deepening. Aside from persistently lower lending growth, a combination of shocks will slow GDP growth to 8.2 per cent in 2021 and further to 5.2 per cent in 2022. Some steps will probably be taken to partially offset the slowdown, but the overall official focus will be on limiting structural risks. We will thus hardly see any major shift in current policies. Despite challenges to growth, the USD/CNY exchange rate will likely remain resilient, ending 2021 at around 6.40 with room for modest declines towards 6.30 by end-2022.

Downside risks to China's growth go beyond the problems created by more restrictive lending. While favourable base effects are fading from annual growth figures, the pullback in economic momentum has been deeper than expected. Yet the government's focus remains on reforming policies to mitigate structural risks as China nears a significant Communist party congress in 2022. While the direction of the reforms and the reasoning behind them are familiar, their speed and scale in some places have resulted in some painful consequences. Policymakers are steering between a need to help sustain the economy and concerns that too extensive an arsenal of supportive tools might undo some of the successes achieved in their reform work. We thus expect modest stimulus measures that may help somewhat but will not be enough to generate a strong rebound. Base effects from depressed GDP growth in 2020 will provide enough of a buffer for 2021 GDP to rise by 8.2 per cent year-on-year, but lingering problems will then pull down the growth rate to 5.2 per cent in 2022.

A combination of shocks is now evident in monthly activity indicators. The official manufacturing PMI continues to slump, with the production sub-index at its lowest except at the onset of the pandemic and during the 2008-2009 global financial crisis. Hard-to-predict supply chain issues are clouding the outlook. Meanwhile, recurring domestic infection waves are dampening the recovery in the services sector.



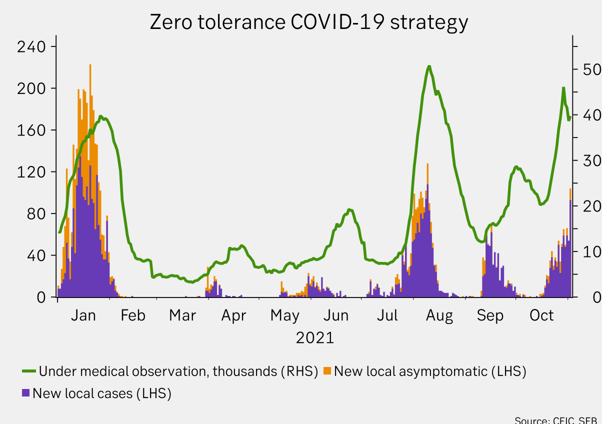
The persistent deterioration in the credit impulse (i.e. lending) reflects the caution of policymakers in relying on more debt creation to engineer a growth rebound. Growth in aggregate credit continues to head lower. Aside from a modest pullback in bank loans, the expansion of local government bond issuance has dropped to an estimated 13 per cent year-on-year in September, from almost 21 per cent at the end of 2020. Aside from lower bond issuance this year, following large-scale issuance in 2020, local governments have also been more cautious about tapping the onshore government bond market. Provincial authorities have struggled to find revenue-generating infrastructure projects. Part of the deleveraging drive has been aimed specifically at instilling financial discipline among local and provincial governments. The effect has been to exacerbate the tightness in financial conditions from this direction as well. In an attempt to provide some easing in fiscal constraints given the current situation, Beijing has instructed local governments to sell the remaining quotas of special bonds by end-November. About CNY 1.14 trillion of this year's CNY 3.65 trillion quota had yet to be sold by October. In our view, the incoming bond supply will warrant more liquidity injections from the central bank, but declining fiscal efficiency and rising input prices will likely dampen the impact on infrastructure investment.

Key data
Year-on-year percentage change

	2020	2021	2022	2023
GDP	2.3	8.2	5.2	5.4
CPI	2.2	0.9	2.3	2.1
Public sector fiscal balance*	-3.7	-3.2	-2.8	-2.8
Bank reserve req, %**	12.50	12.00	11.50	11.00
1-year Loan Prime Rate, %**	3.85	3.85	3.85	3.85
7d Reverse Repo rate, %**	2.20	2.20	2.20	2.20
USD/CNY**	6.53	6.40	6.30	6.15

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

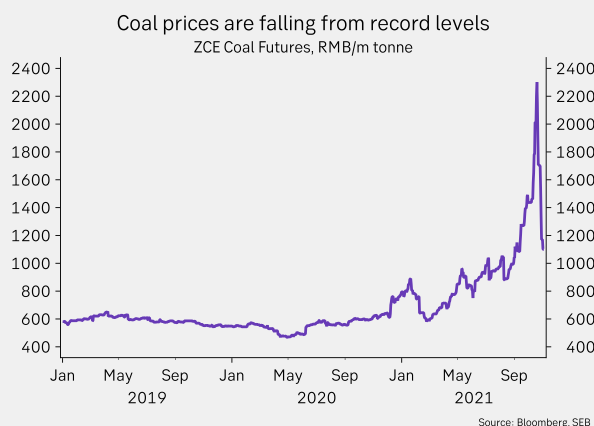
China is holding on to its zero-tolerance policy towards COVID-19. Since declaring victory against the virus in September 2020, China has continuously refined its "internal and external" pandemic policies with the aim of eliminating all domestic transmission. The latest infection wave, which started in mid-October, had spread to 20 of 31 mainland provinces as of early November. Although the Delta variant has shown brief periods of zero domestic transmission, authorities are showing no signs of abandoning the current strategy. A combination of strict international border controls, widespread testing, quarantining of arriving travellers and targeted lockdowns at the slightest outbreak has been successful in containing local outbreaks within four to six weeks of confirmation of the first case.



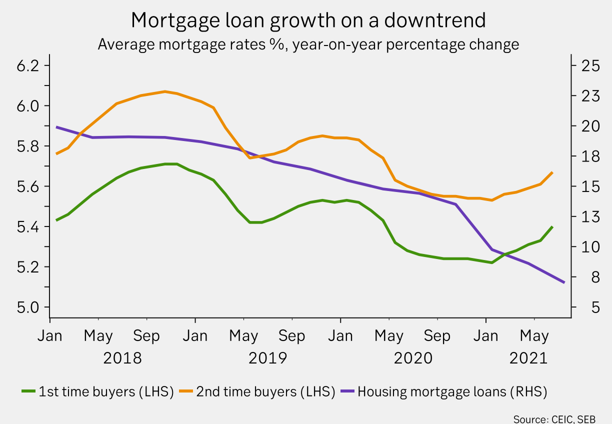
Although this strategy is obviously dampening the economic recovery, the government continues to view widespread transmission as even more costly. The authorities continue to develop and refine methods for limiting transmission, like minimising geographical restrictions after each new outbreak. Yet households remain cautious. The travel and retail sectors are still sensitive to outbreaks. And since this domestic strategy is regarded as successful, imported transmission is seen as the big threat and there is popular support for maintaining tight border controls. Thus, it is likely that

extensive quarantine requirements for international travellers will persist for another 12 months. Chinese organisers of the upcoming Winter Olympics in February have decided to hold the Games in an isolated bubble around Beijing. Organisers, competitors and other participants will have no contact with local residents.

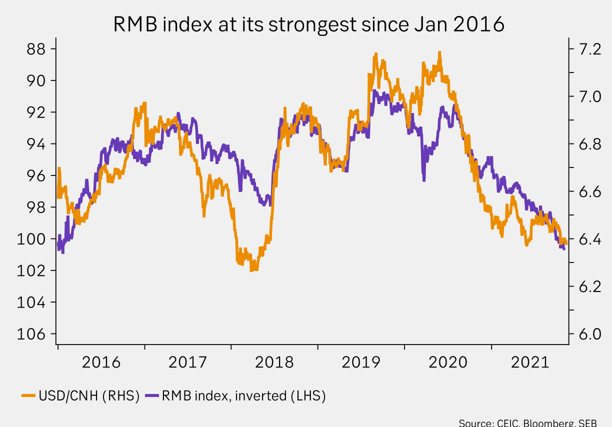
Amidst the surge in global energy prices, China's government is trying to balance the domestic coal market. Regulations promoting cleaner energy have led to lower imports of coal and crude oil in the last year. However, weather conditions and other factors have disrupted the supply of renewable energy. This has created energy shortages, leading to a jump in domestic coal prices and to power rationing in September and October. Since authorities prioritise stabilising energy supply to households, energy-intensive sectors like steel, cement and aluminium are forced to reduce their production. The government has also taken steps to raise domestic coal production in order to offset energy shortages and lower coal imports. Tighter market monitoring and regulation have recently pushed down domestic coal prices again. Even so, the recent energy crunch illustrates how coal-dependent the economy remains. China has a great need to balance and stabilise its energy supply even as it pursues its environmental targets. This will mean power rationing will become more common in the foreseeable future. Short-term steps are being taken to help companies weather the crisis: for example, deferring payment of Q4 taxes for three months for specific small and medium manufacturing enterprises, as a way of offsetting high energy prices.



The challenges of the property sector will persist in 2022. Although worries of contagion beyond this sector have eased, risk appetite for China's offshore bond markets remains weak. As long as authorities hold on to the "*three red line policies*" for lending to the property sector, we expect developers' liquidity challenges to persist – especially for weaker-rated names. Controls on pre-selling activities, as well as government land auctions, remain in place. Growth of mortgage loans continues to decline. Although authorities have signalled marginal easing in mortgage processing, this will not be enough to completely offset tightening factors. In particular, low-rated developers rely heavily on off-balance sheet financing. Default risks remain high, with some USD 84 billion of debt maturing in onshore and offshore markets in the next 18 months.



Despite growth headwinds, the yuan will remain resilient. Even though the Federal Reserve is starting to normalise US monetary policy, we expect USD/CNY to trade around 6.40 by end-2021, with modest declines to 6.30 by end-2022. External balances are strong, with the trade surplus beating expectations. Bond inflows will pick up with the inclusion of Chinese government bonds (CGBs) in the FTSE World Government Bond Index (WGBI). With the trade-weighted RMB Index for the yuan now above 100, we believe the authorities will continue to limit USD/CNY downturns – with state-owned banks propping up purchases of the dollar in the onshore market as needed.



India

Low vaccination rate weakens confidence

India's economy is growing again, after shrinking in the second quarter of 2021 when the pandemic was at its worst. However, the recovery in industrial production is being held back by an energy crisis and supply disruptions. Low vaccination rates also increase the risk of new COVID-19 waves. Signs of higher inflation point to likely normalisation of monetary policy in early 2022. The rupee is expected to weaken somewhat in the next couple of years as rising domestic demand weakens the current account.

COVID-19 transmission in India is falling after a sharp increase in the second quarter of 2021, when the government was suddenly forced to re-impose many pandemic-related restrictions. The economic slowdown was significant, but not as sharp as in the first half of 2020. Available short-term statistics indicate that the recovery following this year's wave of infections was strongest in June and slowed down after that. One reason is low household confidence; another is disruptions in global and domestic production chains. India, like China, has been hit hard by an energy crisis, mainly due to a shortage of coal. These problems should ease gradually during the first half of 2022. Overall, we expect GDP to grow by 7.7 per cent this year, followed by 7.6 per cent in 2022. In 2023, growth will slow to just below 5 per cent.

Key data
Year-on-year percentage change

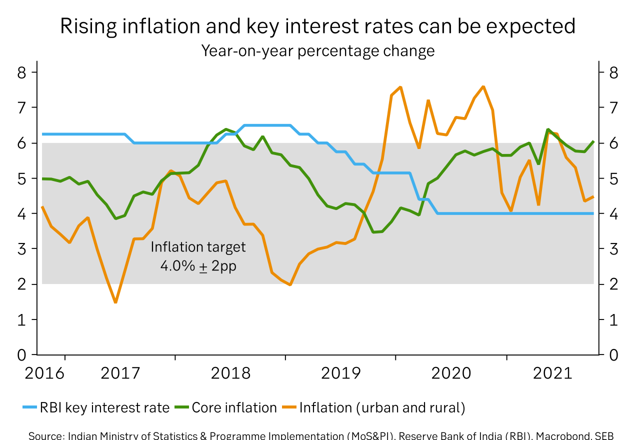
	2020	2021	2022	2023
GDP	-7.1	7.7	7.6	4.9
CPI	6.6	5.2	5.2	4.6
Public sector fiscal balance*	-12.8	-11.3	-9.7	-8.8
Public sector debt*	89.6	90.6	88.8	88.1
Key interest rate, %**	4.00	4.00	4.50	5.00
USD/INR**	73.1	74.0	75.0	75.0

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

Low vaccination rate. One source of concern is that only about 25 per cent of the population has received two doses of COVID-19 vaccine. The authorities have nevertheless quickly eased restrictions, despite the risk that transmission will accelerate again. However, the pace of vaccinations has increased to around 6.6 million doses per day, and we estimate that 70 per cent of the population will be fully vaccinated by March 2022.

Increased inflation pressure. Headline inflation has been volatile in 2021 primarily due to swings in vegetable and other food prices. Core inflation, which has been higher than headline inflation this year, was almost 6.1 per cent in October: just above the upper limit of the Reserve Bank of India's 2.0-6.0 per cent tolerance range. In light of the shaky recovery, the RBI is not expected to tighten monetary policy this year, despite the risk of rising inflation due to recent energy price increases. However, a normalisation of monetary policy is likely during Q1 2022. We expect inflation to end up averaging 5.2 per cent both this year and next.

Rising inflation and key interest rates can be expected
Year-on-year percentage change



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

Less expansionary fiscal policy. The government of India plans to reduce pandemic-related stimulus measures. Unexpectedly large tax revenues over the past six months have made the administration hopeful about achieving its budget target of -6.8 per cent of GDP this fiscal year, but this goal looks optimistic. The economic slowdown, rising interest costs and difficulties in selling state-owned companies are likely to squeeze public finances. Central government finances are also under pressure from extensive infrastructure investments. The National Infrastructure Pipeline (NIP) programme for 2020–2025 contains investments equivalent to about 50 per cent of 2019 GDP. This is positive for both short- and long-term development, even if the government is unlikely to be able to implement the entire program.

The Indian rupee is now mainly managed by the RBI. India has received sizeable capital inflows over the past 12 months, yet the rupee is weaker than it was before the outbreak of the pandemic, when the RBI replenished its foreign exchange reserves. We expect the rupee to remain stable for the rest of 2021 and then weaken a bit in 2022 and 2023 when domestic demand increases – generating a moderate current account deficit.

Russia

Increased energy exports, but weak domestic demand

High energy and commodity prices as well as increased exports will lift the Russian economy in 2022, but the authorities have not gained control of the pandemic and recurring waves of COVID-19 transmission will hamper domestic consumption. Geopolitical tensions are likely to provoke further sanctions, but a total halt to trading in Russian government bonds is unlikely unless new information emerges about threats to US security.

Since mid-2020 the economy has been in a recovery phase, driven by higher government spending and rising exports. Russia's high GDP growth for the full year 2021, 4.3 per cent, is mainly a consequence of economic lockdowns during parts of 2020 and of a reduction in oil output under an agreement between Russia and OPEC.

Key data
Year-on-year percentage change

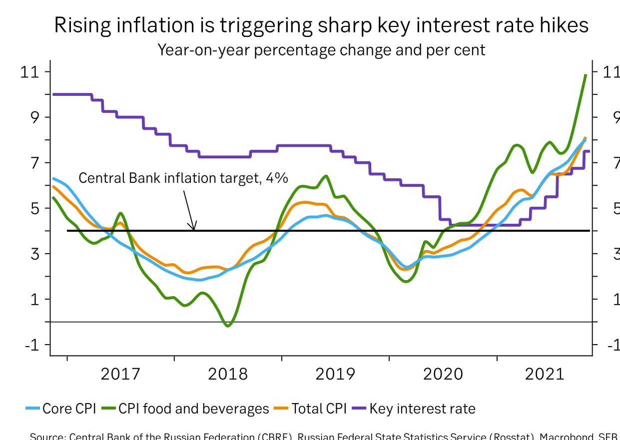
	2020	2021	2022	2023
GDP	-3.0	4.3	2.8	2.0
Unemployment*	5.9	4.2	4.5	4.5
Wages and salaries	5.8	8.7	7.0	6.0
CPI	3.4	6.7	5.0	4.0
Public sector fiscal balance**	-4.0	0.3	-1.0	-0.5
Government debt**	19.3	17.5	17.0	17.0
Key interest rate, %**	4.25	8.25	7.50	6.50

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

A low vaccination level is holding back the economy. COVID-19 transmission has recently increased sharply, reaching record levels in October. New restrictions will now dampen domestic demand over the next six months. So far only a third of the population has been fully vaccinated, but the authorities have now tightened vaccination requirements for various occupational groups and certain types of activities. However, there is widespread suspicion of vaccines. It will probably take until the end of 2022 before Russia reaches herd immunity. Recurring transmission waves will pose a risk to growth next year. A continued increase in oil and gas production, high energy prices and investments in the mining industry will help sustain growth in 2022 and 2023. Overall, we believe GDP will grow by 2.8 per cent in 2022, followed by 2.0 per cent in 2022.

Improved public finances. Rising energy prices have provided much-needed government revenue. The 2020 budget deficit, 4.0 per cent of GDP, looks set to turn into a small surplus in 2021 despite higher spending ahead of September's State Duma election, but the Kremlin plans to tighten fiscal policy over the next couple of years. Infrastructure project investments until 2024 are an exception, but they total less than 1 per cent of GDP.

Rising inflation is triggering sharp key interest rate hikes
Year-on-year percentage change and per cent



Source: Central Bank of the Russian Federation (CBRF), Russian Federal State Statistics Service (Rosstat), Macrobond, SEB

Key interest rate hikes will slow inflation. Year-on-year inflation rose to 8.1 per cent in October, from 7.4 per cent in September. The increase was broad-based, although volatile factors such as food and energy prices set the tone. Inflation looks set to slow in the near term due to reduced demand growth and base effects. After that there will be a continued gradual decline in 2022 and 2023, partly as a consequence of tighter monetary policy. The central bank hiked its key interest rate by 0.75 percentage points to 7.50 per cent in October and is likely to raise it sharply in December. Low unemployment and rapid household credit growth pose a risk of higher inflation. We expect the central bank to raise the key rate again early in 2022 to 8.50 per cent, where it will remain until the fourth quarter and then be reduced gradually.

High energy prices and increased exports should strengthen the rouble in the near future, but we foresee a rouble depreciation further ahead driven by relatively high inflation. There is a major risk of US and EU sanctions. President Joe Biden is under pressure from Congress to react to cyberattacks emanating from Russia. Sanctions against Russian organisations and individuals are likely, but a complete ban on trading in Russian government bonds is improbable. President Vladimir Putin has pledged to achieve carbon neutrality by 2060, which may provide foreign companies with investment opportunities, but changes in Russian climate policy will occur only slowly.

The Nordics

Sweden | page 41

Due to production disruptions, growth will slow in the next six months before the recovery regains momentum. Inflation will climb further but fall again in 2022. The Riksbank will take small steps towards tightening, then hike its key rate in 2023.

Norway | page 45

Increased consumption and mainland capital spending will boost 2022 growth. A tight labour market and above-trend GDP growth will increase price pressures. As planned, Norges Bank will gradually hike its key rate to 1.50 per cent in 2023.

Denmark | page 47

Machinery investments and consumption have contributed to a solid recovery. The re-imposition of some restrictions will only have minor negative effects. Denmark will reach full employment in 2023. A key rate cut has not eased pressure on the krone.

Finland | page 48

Capital spending and consumption will keep driving growth. Next year exports – which enjoy healthy demand and full order books – will contribute more to GDP. Inflation is well below that of Nordic neighbours and the euro area as a whole.

Sweden

Growth to gain speed again later this year

Due to production disruptions and rising commodity prices, the recovery will lose strength in the coming quarters. When disruptions ease and energy prices fall, growth will speed up again, with GDP surpassing its pre-pandemic trend late in 2022. Inflation will climb more sharply than expected, but towards the end of 2022 it will decline significantly. The Riksbank will take small steps towards tighter monetary policy. The first step will be to trim its balance sheet, but we believe that an initial key rate hike will come in 2023.

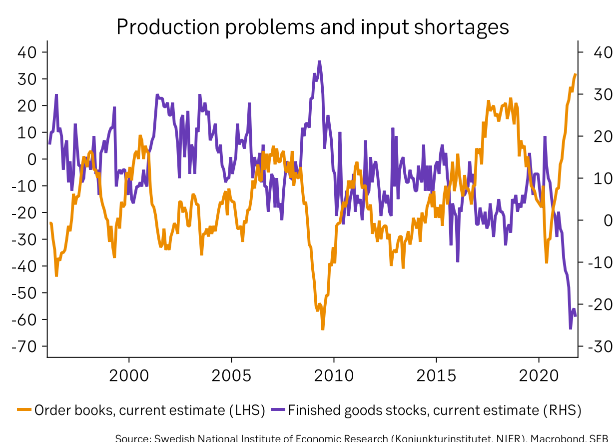
Temporary slowdown this winter and spring

Swedish GDP rose 1.8 per cent in the third quarter, about two percentage points faster than peak pre-pandemic growth. Slightly weaker international demand, production disruptions and a minor slowdown in consumption due to rising energy prices will contribute to more sedate growth in the coming quarters. However, this deceleration will be temporary, and GDP growth will surpass its earlier trend towards the end of next year. We have lowered our full-year 2022 growth forecast from 3.9 to 3.6 per cent but raised our 2023 figure by 0.2 points to 2.5 per cent.

	2020	2021	2022	2023
GDP	-2.8	4.6	3.6	2.4
Unemployment*	8.8	8.8	7.7	7.3
Wages and salaries	1.9	2.9	2.6	3.2
CPIF	0.5	2.3	2.6	1.5
Net lending**	-2.8	-1.0	0.0	0.7
General gov't debt**	39.7	37.6	34.0	32.0
Repo rate, %***	0.00	0.00	0.00	0.25

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

Input goods shortages are hampering industry. Manufacturers remain optimistic despite a deterioration in their increasingly obvious supply problems with key inputs. Industrial production fell by 3.7 per cent in August. It rebounded slightly in September, but the positive trend has probably ended. Although manufacturing sector optimism is close to historical peaks, according to the National Institute of Economic Research (NIER) sentiment survey, its current drivers are mainly record-sized order books and low inventory levels rather than order flow and production. Signals of increased production disruptions in the latest quarterly reports confirm that manufacturing is losing momentum. We have lowered our export and production forecasts for the next six months and expect production problems to ease in mid-2022. The downgrade in our 2022 export forecast is offset by an almost equal upward adjustment for 2023. Service exports, which have only recovered a small share of their 2020 decline, will help boost total exports in 2022-2023. Part of the decline, especially for travel services, is structural. At the end of 2023 period, service exports will be far below their previous trend.

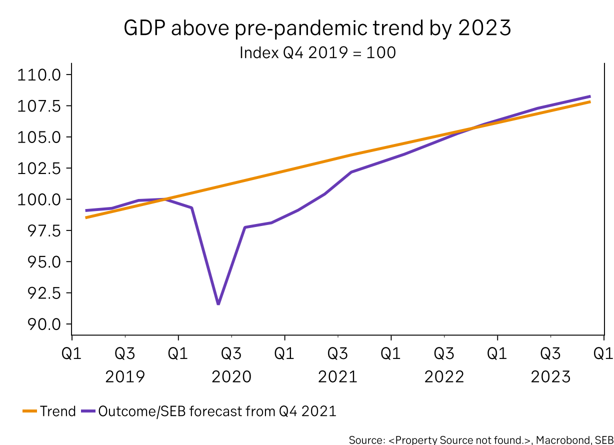


Source: Swedish National Institute of Economic Research (Konjunkturinstitutet, NIER), Macrobond, SEB

Rising capital spending. Machinery investments fell by almost 25 per cent during the first half of 2020. Despite a strong recovery, we are not yet back to pre-pandemic levels. High capacity utilisation and full order books indicate that investments in the manufacturing sector will accelerate significantly over the coming year. A clear recovery in home construction is also contributing to a brighter capital spending outlook. Housing starts are now on a par with 2017 peaks, an indication that the rate of increase in residential investments may rise by 10 per cent in both 2021 and 2022. After falling by 0.4 per cent in 2020, total capital spending will climb by 6.0 per cent this year and by 7.0 per cent in 2022. In 2023, the rate of increase will slow to 5.0 per cent. The threat of a cement shortage if Cementa's limestone quarry on the island of Gotland must close is a hard-to-assess risk. Given its large impact on the economy, we still see an overwhelming likelihood that a solution will be found that allows operations to continue.

Calmer housing market trend. After sharp increases during almost the entire pandemic, the price trend in the housing market is now entering a new and calmer phase, in line with our expectations. This is because the special conditions that prevailed during the pandemic – with a strong focus on living space, remote work, staycations and mortgage rates that seemed destined to remain low forever – are now fading. The result is a return to more

normal conditions, even though home sales volume is still high. We also see tendencies towards greater interest in flats compared to detached homes and smaller flats compared to larger flats, after the reverse situation prevailed during the pandemic. We expect most home prices to move only slightly higher the rest of this year. Price increases in 2021 will total around 10 per cent. The upward trend will continue in 2022, and we expect price increases of a moderate 3-5 per cent for the full year.



Strong households, cautious recovery in consumption. Household consumption has also recovered strongly, without returning to pre-pandemic levels. But the trend has been divided – with a strong upturn for retail, while service consumption has been depressed for a long time. After restrictions were lifted this summer, however, restaurants, hotels and cultural services have recovered significantly. According to Statistics Sweden's monthly consumption index, in September they rose above their previous peak in 2019. Consumption is still well below the earlier trend while household finances are strong and the labour market situation is improving, which points to a continued robust upturn. We expect consumption to increase by 3.7 per cent in 2022 and 2.2 per cent in 2023.

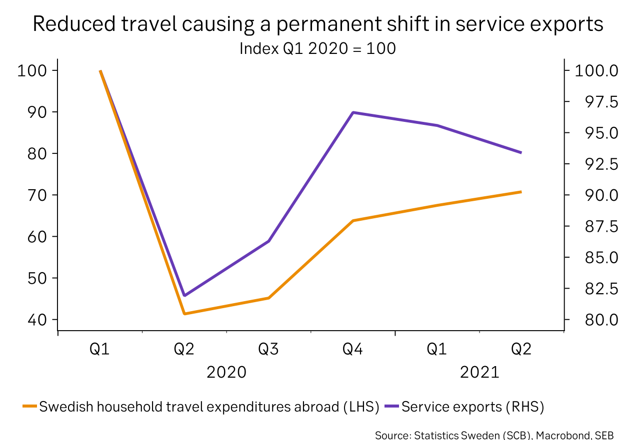
Household incomes and savings ratio

Year-on-year percentage change

	2020	2021	2022	2023
Real disposable income	-0.8	5.3	2.9	3.2
Private consumption	-4.7	4.9	3.7	2.2
Savings ratio, % of income	17.1	17.7	16.8	18.0

Source: Statistics Sweden, SEB

Travel is still depressed. However, there are areas that continue to lag behind. Despite a recovery this autumn, the number of travellers is less than half as many as in 2019. Large declines in business travel are the main reason, but during Q2 both Swedish consumption of travel services abroad and foreigners' consumption in Sweden were 30-40 per cent lower than in 2019. Car sales are also low, which is partly related to delayed deliveries, but tax changes in recent years have contributed to large variations in new car registrations that make the underlying trend difficult to assess.



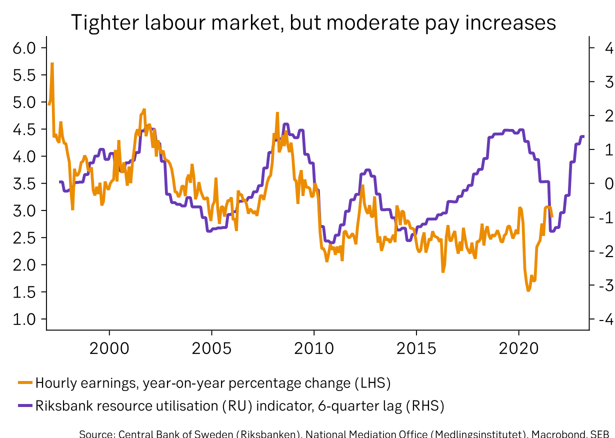
Rapid labour market improvement

The recovery in GDP is reflected in an improved labour market, although a restructuring of the Labour Force Survey starting in January 2021 makes the statistics hard to interpret. According to the LFS, unemployment has remained relatively high, but we believe Swedish Public Employment Service statistics currently provide a more accurate picture. They indicate that unemployment has fallen significantly this past year and is approaching pre-pandemic lows. According to our own estimates, employment has recovered almost its entire decline. Short-term indicators such as business sector hiring plans point to a continued upturn. We believe unemployment as measured by the LFS will also decline, approaching its pre-pandemic level of about 7.2 per cent. Compared to many countries, labour force participation was relatively stable during the pandemic. Having climbed for a long time, the participation rate seems to be stabilising. Together with slower population growth, this means the labour force is growing much more slowly than before.

Resource utilisation is approaching historical peaks. Indicators of resource utilisation in the economy have also recovered rapidly. The Riksbank's RU indicator is close to its 2018-2019 peaks. Shortage figures in the NIER economic tendency survey are still a bit lower than at that time but are expected to climb to historical peaks soon.

Weak wage response, due to long-term agreements. The collective agreements concluded in the autumn of 2020, specifying annual pay increases of around 2.2 per cent, do not expire until the spring and summer of 2023. Pay increases above such agreements have been very low since 2015, and so far there are no clear signs that this trend has been interrupted. Although a strong labour

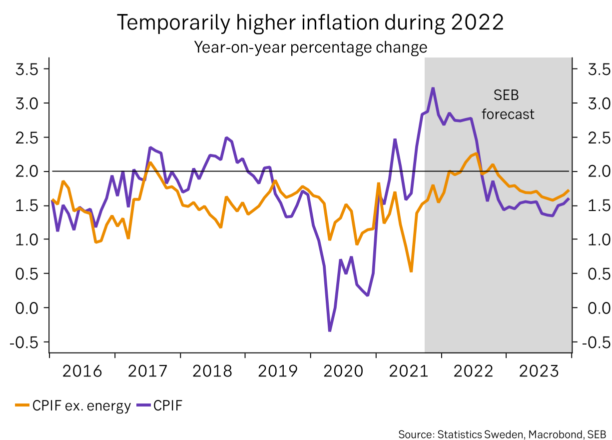
market will lead to some pay increases in Sweden, this is unlikely to be comparable to what we are now seeing in countries like the US and the UK (see theme article, page 13). The next centralised wage round is far in the future, and it is hard to assess how the situation will look then in various respects. Strong economic conditions, high inflation over the coming year and faster pay hikes in other countries suggest higher pay increases. On the other hand, our forecast indicates that Swedish inflation will slow before negotiations enter their most intensive phase. Pay increases in important nearby competitor countries are also expected to remain fairly restrained. We thus believe the increase in contractual pay hikes will be relatively small. Overall, we have raised our wage growth forecast to 2.6 per cent in 2022 and 3.2 per cent in 2023; only a few tenths higher than our earlier forecast.



Temporarily higher core inflation during 2022. As in many other countries, inflation has climbed unexpectedly fast this autumn. In October, year-on-year CPIF (CPI less interest rate changes) was 3.1 per cent. This is the highest since 2008, but moderate compared to the US and the euro area. So far, energy prices are the dominant driver; if they are excluded, October CPIF was a moderate 1.8 per cent. Due to rising international prices for food and other goods, core inflation will gradually rise over the next year. Indirect effects from higher input goods prices will also contribute to higher inflation. We expect CPIF excluding energy of 2.5 per cent by mid-2022. After that, inflation will gradually fall to close to 2 per cent by year-end. We believe CPIF will climb to 3.4 per cent in November, but then fall. At first the decline will be driven by base effects, but electricity futures will also plunge starting in spring 2022. We thus expect CPIF to drop below CPIF excluding energy late in our forecast period.

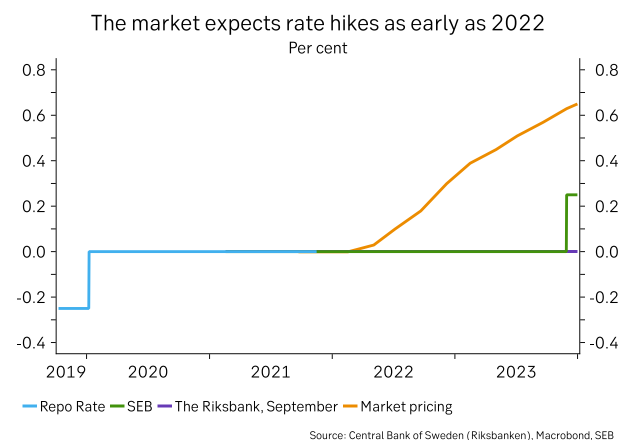
Changing conditions for the Riksbank

So far, the Riksbank has insisted that key rate hikes will not happen in the foreseeable future. Nearly all Executive Board members have signalled that it is acceptable, and also desirable, for inflation to exceed the bank's target for a period. Per Jansson, the most dovish board member, has emphasised that inflation of around 3 percent for one year can be accepted without a rate hike being needed. In light of this, it was logical that the Monetary Policy Report in September foresaw an unchanged repo rate well into 2024. If electricity prices fall as we forecast, this will provide further room to hold off on rate hikes.



The Riksbank will finally raise its key rate. Meanwhile higher international inflation – along with accelerated and larger rate hikes by various other central banks – has increasingly led markets to question the Riksbank's interest rate path. Given strong economic growth and a tightening Swedish labour market, the question is whether the Riksbank will actually choose a completely different path than most other central banks. Although historical experience shows that the Riksbank is not afraid to stand out, our main forecast is that its policies will be affected to some extent by changing conditions. We are sticking to our forecast that in November the bank will indicate a certain probability of a rate hike in 2024. After that, it will begin more clearly signalling monetary policy normalisation, then deliver an initial rate hike in 2023.

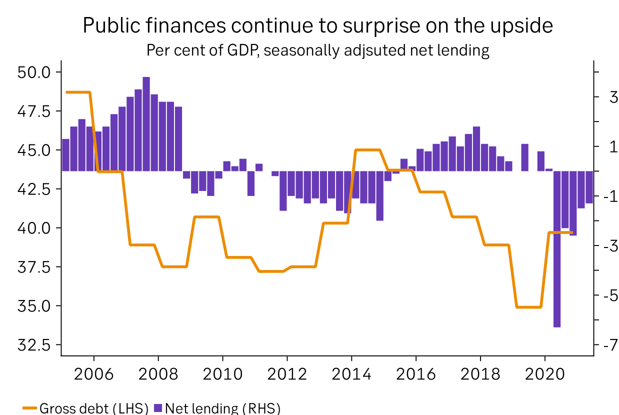
Trimming the balance sheet will be the first step. In the last *Nordic Outlook* we predicted that during 2022 the Riksbank will buy bonds more slowly than its holdings mature. Since then the National Debt Office has reduced the government bond supply, further decreasing market liquidity. This has boosted the likelihood that the Riksbank will taper its purchases in 2022. Reduced bond purchases will probably be the first step towards tightening monetary policy. The Riksbank may also withdraw some of the surplus liquidity in the payments system by increasing the allocation of certificates in its weekly auctions. This would push up the Stockholm Interbank Offered Rate (Stibor) from its current -0.1 per cent or so to about or slightly above zero – which is the repo rate – thus carrying out a soft form of rate hike.



Public finances have strengthened further

Sweden's public finances have remained strong throughout the pandemic, with moderate deficits and debt increases. Compared to most other countries, both the decline in GDP during 2020 and the scale of crisis responses were relatively limited. Government finances have continued to surprise on the upside, mainly in terms of tax revenues but also on the expenditure side. This is one reason why the Debt Office recently and unexpectedly lowered its forecast of 2022 bond issues. Net lending looks set to reach balance faster than expected, despite major spending in 2021 and an expansionary 2022 budget bill. The fiscal deficit will shrink from 2.8 per cent of GDP in 2020 to 1.0 per cent this year. As early as 2022, we expect to achieve a balanced budget and in 2023 a surplus of nearly 1 per cent of GDP. Due to the improved budget situation and rising GDP, public sector debt will probably fall below its benchmark (or "anchor"), 35 per cent of GDP, by 2022.

Changes in the fiscal framework are again being considered. Public sector debt is now approaching the "debt anchor", again raising the question of whether the fiscal framework needs adjusting. The finance minister recently supported such a step in an op-ed article. Although a political consensus will be needed, the next step is probably to introduce a balanced budget target during Parliament's next term (2022-2026). Such a step is reasonable but will "free up" only SEK 15-20 billion for stimulus measures. With a balanced budget target, the debt ratio would continue to fall, assuming that nominal GDP increases. There is also growing support for introducing an investment budget alongside the regular government budget. This would make it easier to borrow more money for long-term investments such as infrastructure and green transition, without being hampered by the fiscal policy framework. But such restructuring would have bigger consequences than a change in balance target and is unlikely to be implemented in the near future. There are also various demarcation problems, since many urgent spending programmes do not fit into areas normally defined as investments.



Exciting political year. Stronger economic conditions and public finances increase the government's freedom of action but also make economic policy more unpredictable. There are also uncertainties about the 2022 budget process and the formation of a new government. Our view is that current negotiations on the budget and the selection of a new prime minister to succeed Stefan Löfven, who has resigned, should be seen as a package. If a majority of Parliament agrees on the budget, they will likely agree on the prime minister, and vice versa. Despite louder opposition rhetoric, most indications are that the Social Democratic-Green minority government's budget will pass and that Parliament will approve Magdalena Andersson, the new Social Democratic leader, as prime minister. At present, it is uncertain if opposition parties will launch a joint counter-proposal or will be content with minor criticisms of individual proposals. The opposition appears to be focusing its energy on the September 2022 election, rather than trying to force the government to rule on the basis of an opposition budget until then.

Norway

Closed output gap justifies rate hikes

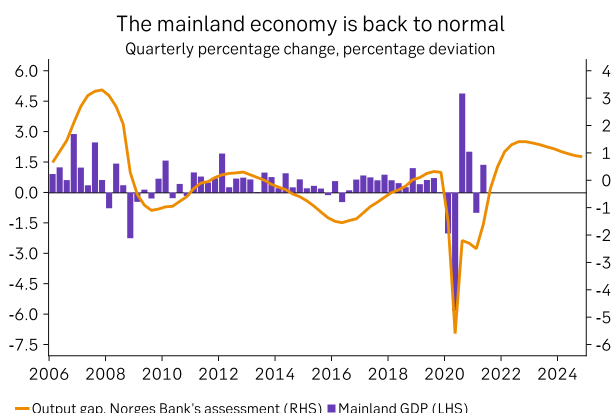
Activity in the mainland economy has normalised and growth is now higher than before the pandemic. Sharply higher private consumption and rising mainland investment will boost mainland GDP growth in 2022, but gradually higher interest rates will dampen growth further out. A tight labour market and a widening output gap will create domestic price pressures. Core inflation is nonetheless expected to remain below the target, but Norges Bank will move forward with speedy rate hikes.

Mainland GDP is above its pre-pandemic level

The mainland economy has recovered fully from the pandemic, helped by strong monetary and fiscal stimulus and by the unwinding of restrictions. Since the government finalised its reopening plan in September, infection rates have surged and reached new daily highs. With almost 90 per cent of the adult population fully vaccinated, we do not expect widespread retightening of restrictions. Some local measures aimed at slowing the spread of COVID-19 while keeping society open are likely though the economic impact should be limited. Normalisation of consumption patterns and activity in sectors hardest hit by the pandemic is thus expected to lift mainland GDP further. Q3 data will be published on November 19, but monthly data indicate a solid quarterly increase of nearly 2.5 per cent.

The mainland economy is back to normal

Quarterly percentage change, percentage deviation



Source: Statistics Norway, Norges Bank, Macrobond, SEB

A normal economy justifies normal fiscal policy. Capacity utilisation has increased, resulting in a closed output gap. Unwinding of fiscal stimulus measures and a return to the 3 per cent limit set by the fiscal policy rule are thus sensible. The amended budget from the new centre-left government represents a fiscal contribution of -2.6 per cent of mainland GDP in 2022, following an accumulated 4.4 percentage point boost in 2020-2021. Domestic demand is nonetheless expected to be strong due to solid financial buffers, high capacity utilisation and an improving labour market. This will contribute positively to mainland GDP growth, while net trade in traditional goods will be a drag due to rising imports. We forecast mainland GDP growth of 3.7 per cent and 3.9 per cent in 2021 and 2022, respectively. A normalised consumption pattern and higher interest rates are expected to slow growth towards trend: 1.3 per cent in 2023. Total GDP growth will rise from 2.8 per cent in 2021 to 3.7 per cent in 2022 before moderating to 2.6 per cent in 2023.

Key data

Year-on-year percentage change

	2020	2021	2022	2023
GDP	-0.8	2.8	3.7	2.6
Mainland GDP	-2.5	3.7	3.9	1.3
LFS unemployment*	4.6	4.4	3.8	3.7
Wages and salaries	3.1	3.0	3.2	3.4
CPI-ATE inflation	3.0	1.7	1.6	1.7
Key interest rate, %				

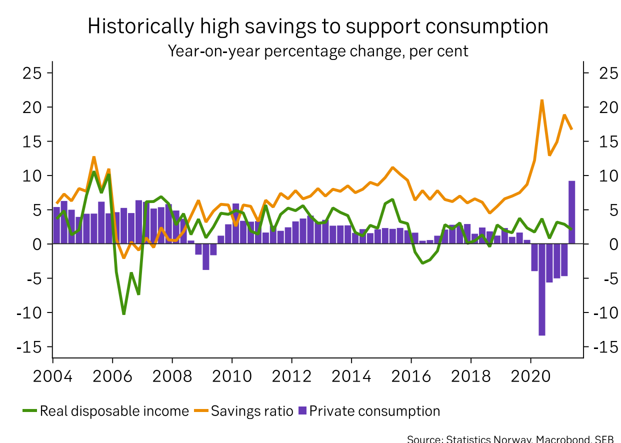
*Per cent of labour force. Source: Macrobond, SEB

Private consumption leading the upturn

Since the reopening of society started in April, private consumption has increased by 9.7 per cent. Spending on services previously limited by restrictions has increased the most but remains well below its pre-pandemic level. We expect a clear shift in the consumption pattern, with a continued sharp rise in spending on services while goods consumption should moderate ahead. Low interest rates and fiscal stimulus measures have upheld households' real disposable income growth during the pandemic. Combined with limited consumption opportunities, this enabled the savings ratio to surge from 8.7 per cent in 2019 to 16.7 per cent in mid-2021. Moreover, the labour market has improved sharply, and the high number of job vacancies suggests strong employment growth ahead. Registered unemployment should revert to pre-pandemic levels in early 2022. Measured by the Labour Force Survey, the average jobless rate is expected to decline to 3.7 per cent in 2023 from 4.6 per cent in 2020.

Tight labour market conditions and the solid outlook for mainland GDP have put pressure on available resources. According to Norges Bank, the output gap closed this autumn and is expected to widen in 2022. Wage pressure

in the economy is thus rising, and we forecast annual pay increases will accelerate from 3.1 per cent in 2020 to 3.4 per cent in 2023. This will provide a solid buffer for households, enabling strong private consumption growth despite gradually higher interest rates ahead. In the near term, higher electricity prices will weigh somewhat on household purchasing power, but we forecast that overall private consumption will rise 3.2 per cent in 2021 and 8.6 per cent in 2022 before moderating in 2023.



Capacity constraints will fuel investments

Manufacturing production is now higher than its pre-pandemic level, and resource utilisation has risen sharply. Input goods shortages, delivery problems and shortages of skilled and foreign labour are limiting production. Because of strong growth in order bookings, however, manufacturers have maintained their positive outlook, while both hiring and investment plans have increased markedly. We expect the growth in business investments to rise from 0.8 per cent in 2021 to 4.0 per cent in 2022. Recent strong housing market activity and home price growth should support residential investments next year. Higher interest rates are expected to slow annual increases in existing home prices from 9.1 per cent in 2021 to 1.6 per cent in 2023, putting a lid on residential investment growth. Overall, mainland capital spending should contribute solidly to mainland GDP in 2022-2023.

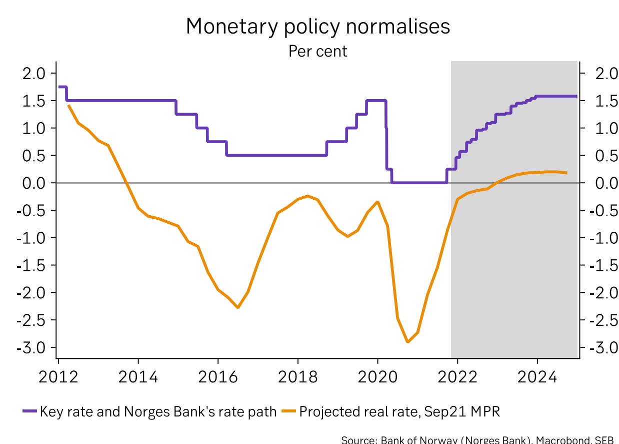
The outlook for petroleum investments remains bleak despite higher oil and gas prices. Following a 4.1 per cent fall in 2020, capital spending is expected to record an accumulated decline of 9.4 per cent in 2021-2022. New development projects will lead to a 10.0 per cent recovery in petroleum capital spending in 2023. Strong growth in exports of petroleum products will mitigate part of the drag from lower capital spending on total GDP.

Inflation – less affected by global prices

CPI-ATE inflation (CPI excluding taxes and energy) has trended lower over the past year, driven by the stronger krone. Core inflation fell to 0.9 per cent in October, on a par with the lows during the global financial crisis. Although this mainly reflected an incomplete pass-through from normalisation of taxes on hospitality services, underlying inflation pressures remain subdued. We still believe that CPI-ATE is at a trough and predict the inflation rate will rise faster than projected by Norges Bank over the next 12 months. Although Norway tends to be less sensitive to international price movements than other countries, some upward pressure on goods prices from supply disruptions are likely, but more important is a normalisation of unusually low food prices. Rising wages imply that core inflation will increase gradually in 2023, but CPI-ATE is expected to stay below target throughout our forecast period. High energy prices will keep headline inflation around 3.5-4.0 per cent this winter, but electricity futures prices have declined markedly. We have lowered our near-term forecast for headline CPI and expect a sharp fall to below 1.0 per cent late in 2022.

Norges Bank is on the go

Norges Bank initiated its hiking cycle in September by raising the key interest rate to 0.25 per cent. Prospects for higher capacity utilisation and inflation justified another upward revision of the rate path, which now indicates somewhat faster hikes from the second half of 2022 and key rate of 1.70 per cent by end-2024. This implies that monetary policy will turn close to neutral next year, and the key rate will reach a normal level in 2024.



Economic data pointed to an even faster hiking trajectory in September, but Norges Bank advocated a cautious approach due to the uncertainty surrounding the effects of higher interest rates. Rising domestic price pressure and the risk of a build-up in financial imbalances still suggest a slightly faster pace of rate hikes than we have previously assumed. A hike in December should be a done deal, and we now forecast four hikes in 2022 to 1.50 per cent. In the last hiking cycle, the key rate peaked at 1.50 per cent. We believe Norges Bank may deliver a final hike to 1.75 per cent in 2023, but it all depends on households' response to higher interest rates.

Denmark

Approaching full employment

Consumption and machinery investments contributed to Denmark being among the first to recover its GDP decline during the pandemic. The outlook is for a continued strong economic performance in the next couple of years. Growth will gradually slow from 5.0 per cent to 2.5 per cent over our forecast period, at which point Denmark will be close to full employment.

Return to pre-pandemic GDP level. The Danish economy started the second half of 2021with a stronger than expected GDP growth of 2.0 per cent in Q3, primarily driven by the reopening of the service sector. Denmark was thus among the first countries in the world to surpass its pre-pandemic GDP level, and the rapid reopening thus continued into the second half of the year, as the government removed all restrictions related to the pandemic as of September 10. The recent re-introduction of some containment measures following a spike in virus cases was less invasive than expected and will, in our view, have a limited effect on Q4 growth. We have thus increased our GDP growth forecast for 2021 from 3.6 per cent to 5.0 per cent, while lowering our forecast for 2022 from 4.1 to 3.5 per cent and keeping 2023 unchanged at 2.5 per cent.

Key data

Year-on-year percentage change

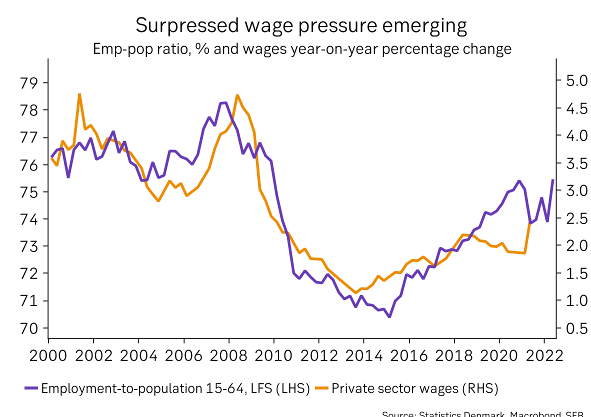
	2020	2021	2022	2023
GDP	-2.1	5.0	3.5	2.5
CPI	0.4	1.9	2.9	2.1
Wages and salaries	1.9	2.6	3.4	3.7
Public sector fiscal balance*	-3.0	0.5	2.0	4.0
Public sector debt*	44.0	40.0	36.0	32.0
Current account*	7.5	7.5	7.5	7.0
Key interest rate (CD rate),%	-0.50	-0.60	-0.60	-0.60

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

Consumption and investment will drive growth. Rising disposable incomes continue to be the main driver for consumption, now supported by sharply rising employment in Q2. Private consumption, while more volatile, has lagged incomes, resulting in a high savings ratio of close to 12 per cent of disposable income. The combination of negative interest rates, high home prices and relatively strong job security will likely reduce savings going forward, supporting spending while rising energy costs undermine real incomes and crowd out other spending over the winter. We expect private consumption to grow 4.0 per cent in 2021 and then rise by 5.0 per cent in 2022. Meanwhile, business investment has rebounded sharply along with capacity utilisation.

Slower increase in home prices. The housing boom continued moderating into the autumn, but this should be seen in context: average selling prices in the Danish housing market are still rising at a 10 per cent clip. The more moderate increases are mostly due to an increase in mortgage rates during 2021, while the tighter lending rules called for by the central bank, among others, did not get political backing. A more modest pace is likely to be more sustainable. We expect a rising wealth-to-income ratio to continue supporting household balance sheets.

Economy set to hit full employment in 2023. The labour market continues to recover faster than expected. Unemployment is now at its lowest in more than a decade: around 4.5 per cent. Some sectors such as restaurants are experiencing difficulties recruiting labour. There is still some distance to the historical low of just above 3 per cent. We forecast a jobless rate close to this level. Denmark will thus essentially be at full employment by the end of 2023. As a result, we expect wage inflation to rise from 2.6 per cent in 2021 to 3.7 per cent in 2023.



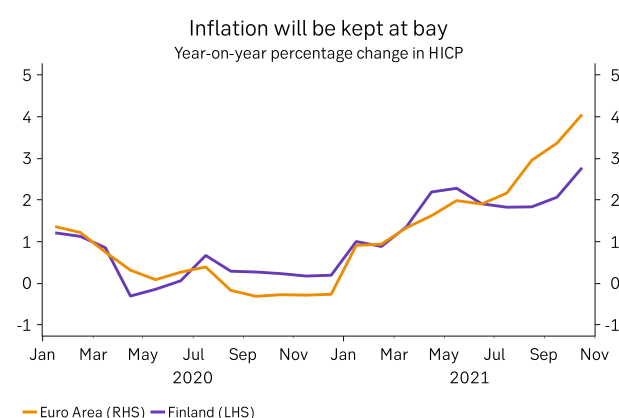
Rate cut fails to ease DKK pressure. Continued intervention led Danmarks Nationalbank to cut its deposit rate unilaterally by 10 basis points effective from October 1, a bit faster than we had expected. Following the cut, the Danish krone moved a little away from the intervention zone, but it has now come back to this range. We think intervention is the preferred path for now, both because lower rates may work against stabilisation in the housing market and because they allow liquidity to move higher.

Finland

Households on a spending spree

A quick labour market recovery and strong increases in household consumption as well as capital spending have been the key drivers of growth this year, resulting in a 3.5 per cent increase in GDP. The same factors will continue to support the economy in 2022, but with exports and business investments playing a gradually larger role. After the two-year sprint, GDP growth will fall back to 1.6 per cent in 2023.

Surprisingly quick labour market recovery. In the second quarter of 2021, the employment rate reached 62.9 per cent, very close to its pre-pandemic peak. The government is likely to continue its efforts to push up labour force participation, which remains below that of Nordic peers. Boosting employment in older age groups is crucial since according to the latest projections, the effects of an ageing population will be even worse than previously expected. For now, the labour market will continue to strengthen. The number of vacancies has almost doubled in a year. This will support wage and salary negotiations that are likely to produce a 2.5 per cent rise in pay in 2022 and a 2.2 per increase in 2023.



Inflation less of a concern than elsewhere. While inflation has accelerated, it has remained relatively mild compared to many other countries. In September HICP increased by 2.1 per cent, far below the 3.4 per cent euro area average. Energy as a share of household expenditures is lower than in many countries, but Finland's relative strength in producing energy from nuclear and renewable sources has had its impact too. We expect inflation to remain well below the euro area average during our forecast period. HICP will increase by 1.9 per cent in 2021, 1.6 per cent in 2022 and 1.4 per cent in 2023.

Private consumption to remain strong. Since the negative impact of inflation on household spending will be limited, the current surge in private consumption will continue next year. In addition to rising employment and wages, it will be supported by high savings and pent-up demand. The current rapid growth in household deposits will slow somewhat as a result, but we expect the savings ratio to remain higher than before the pandemic. After a 3.7 per cent upturn in 2021, private consumption will increase by 3.5 per cent in 2022 and then slow to 1.7 per cent growth in 2023.

Exports to contribute more. High demand and full order books have driven manufacturing sector sentiment to its highest level since early 2007. In 2022 the growth in exports will amount to 5.6 per cent. Manufacturers will enjoy good fortune at least until 2023, when we forecast that exports will increase by 3.8 per cent.

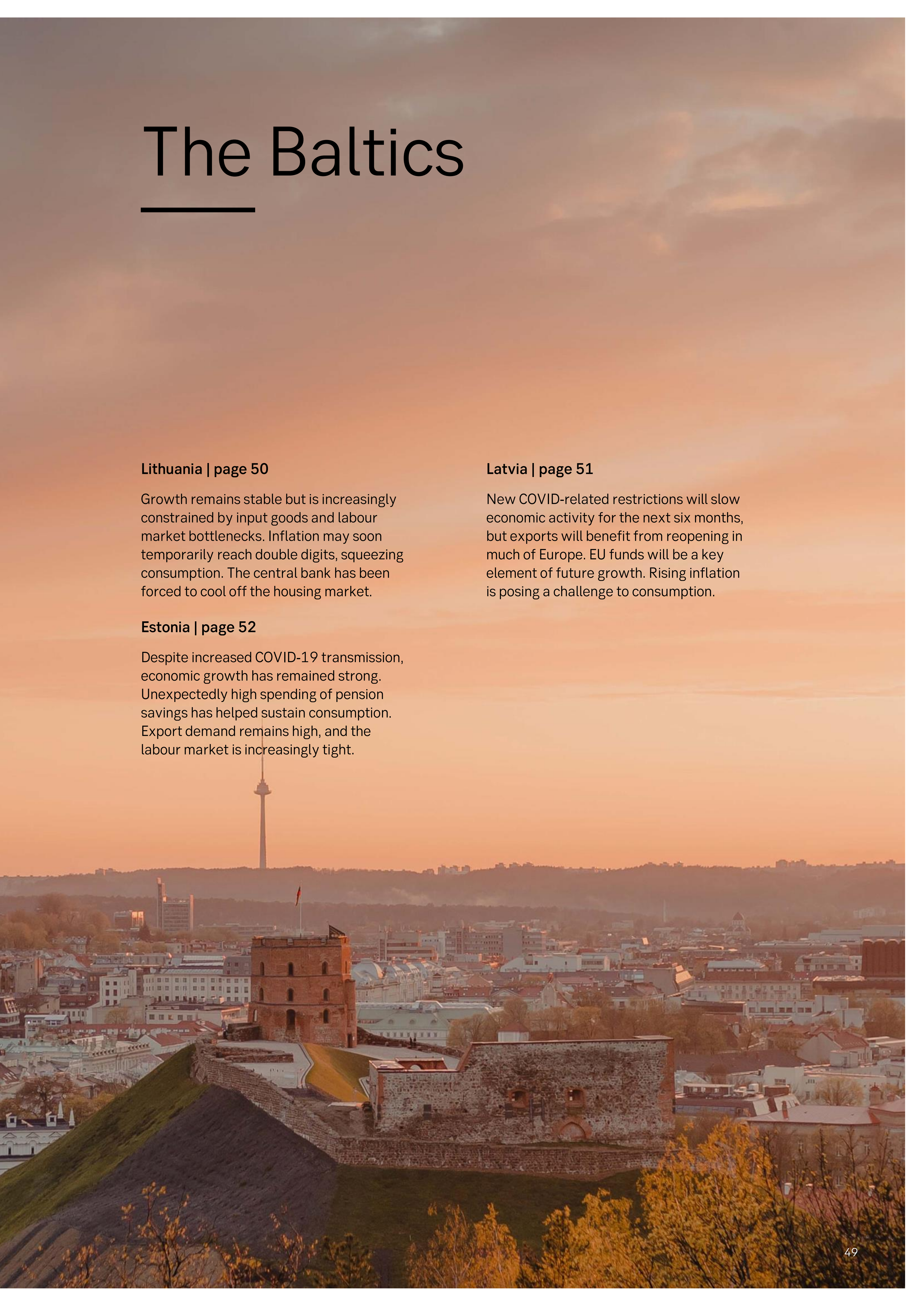
Growth in capital spending will be driven by households. Current era has favoured private investments in housing. The total volume of new home mortgage loans has increased by 16 per cent this year. Construction volume remains high, and residential investments will be the key driver of capital spending next year as well. Investment appetite will also slowly improve in the corporate sector.

Stronger labour market will improve public finances. Rapid economic growth and lower health care spending will reduce the deficit in 2021 and 2022. Balancing the budget remains a long-term problem that needs to be addressed, but we expect the deficit to fall below the EU's benchmark – 3 per cent of GDP – as early as next year.

Key data
Year-on-year percentage change

	2020	2021	2022	2023
GDP	-2.9	3.5	3.0	1.6
Private consumption	-4.7	3.7	3.5	1.7
Exports	-6.8	5.5	5.6	3.8
Unemployment*	7.8	7.7	7.0	6.6
Wages and salaries	1.8	2.4	2.5	2.2
HICP inflation	0.3	1.9	1.6	1.4
Public sector fiscal balance**	-5.4	-3.5	-2.5	-2.0

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



The Baltics

Lithuania | page 50

Growth remains stable but is increasingly constrained by input goods and labour market bottlenecks. Inflation may soon temporarily reach double digits, squeezing consumption. The central bank has been forced to cool off the housing market.

Estonia | page 52

Despite increased COVID-19 transmission, economic growth has remained strong. Unexpectedly high spending of pension savings has helped sustain consumption. Export demand remains high, and the labour market is increasingly tight.

Latvia | page 51

New COVID-related restrictions will slow economic activity for the next six months, but exports will benefit from reopening in much of Europe. EU funds will be a key element of future growth. Rising inflation is posing a challenge to consumption.

Lithuania

Inflation is approaching double digit level

The economy is demonstrating a solid growth pace in 2021 after a 0.1 per cent decline in GDP last year. However, growth is increasingly constrained by bottlenecks in materials supply and the labour market. Inflation greatly exceeded our projections in the past few months. We now expect it to climb above 9 per cent in early 2022 and have its strongest impact on private consumption in the first quarter. Capital spending is recovering since companies are operating at record-high capacity utilisation rates.

GDP expanded by 4.9 per cent in the first nine months of 2021, slightly above our previous forecast. Both private consumption and exports performed well during Q3. We are revising our 2021 GDP growth forecast upward from 4.3 to 4.9 per cent but leaving our projections of 3.6 per cent growth in 2022 and 3.3 per cent in 2023 unchanged. We expect the negative output gap to close this year. The economy will expand at close to potential growth over next two years.

Capital spending is already above pre-pandemic level. Strong external demand, the need to increase labour productivity and healthy balance sheets are allowing companies to accelerate their investments. Capacity utilisation in the manufacturing sector remains record-high. However, companies with greater dependence on Belarus and China have a more cautious attitude towards the near-term outlook.

Key data
Year-on-year percentage change

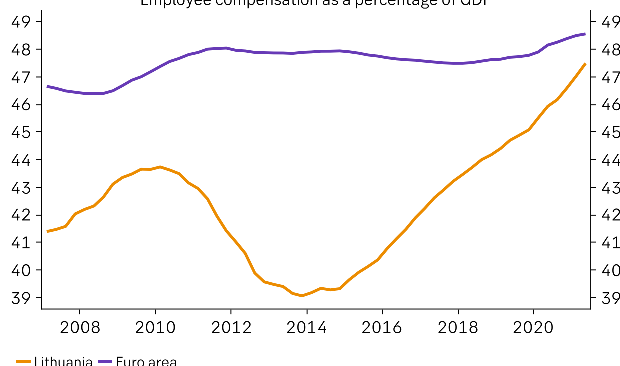
	2020	2021	2022	2023
GDP	-0.1	4.9	3.6	3.3
Private consumption	-2.1	4.9	4.2	3.4
Exports	0.4	11.3	4.6	4.3
Unemployment*	8.5	7.1	6.5	6.1
Wages and salaries	10.1	9.8	8.7	6.5
HICP inflation	1.1	4.5	5.4	2.3
Public sector fiscal balance**	-7.2	-4.0	-2.8	-1.1

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

The labour market is tightening. The share of companies complaining about recruitment difficulties is historically high. We assume that labour force participation will improve and unemployment will edge lower over the next couple of years, but businesses cannot avoid unfavourable demographic trends. The number of people aged 18-24 shrank by 20 per cent over only 5 years.

Wages as a share of GDP have finally reached the euro area average. But this means lower potential for wages to grow faster than labour productivity. We expect average wages to increase by 8.7 per cent in 2022 and 6.5 per cent in 2023. Due to a sharp increase in minimum wages and a higher non-taxable income amount, after-tax income will increase more for lower paid employees.

Wages as a share of GDP have reached the euro area average



Source: Eurostat, Statistics Lithuania, Macrobond, SEB

Inflation will peak in early 2022. Headline HICP inflation jumped to 8.2 per cent in October, mainly due to much higher energy prices. In addition, price increases for services also accelerated on strong growth in labour costs and higher economic activity. We assume that inflation will peak in January, when higher household electricity and natural gas charges will be set. In 2022 inflation will average 5.4 per cent and in 2023 it will fall to 2.3 per cent.

Central bank to cool property market. In order to curb the housing market, the central bank has proposed a reduction in the maximum LTV ratio from 85 to 70 per cent on second and subsequent home mortgages. Home prices are around 15 per cent higher than a year ago, and in 2022 we expect price increases to slow to 10 per cent.

Fiscal impulse will be slightly expansionary in 2022 excluding one-off expenses. The 2021 budget deficit is expected to be 4.0 per cent of GDP or significantly smaller than projected due to surprising growth in tax revenue. The deficit will shrink to 2.8 per cent of GDP in 2022, but excluding expenses related to COVID-19 and a new border fence with Belarus, it will be closer to 2 per cent. We expect government debt to remain stable at 45 per cent of GDP.

Latvia

Economy will slow because of new restrictions

Economic growth slowed in the third quarter to 4.8 per cent. Activity will shift to a lower gear in late 2021 and remain subdued until the second quarter of next year, but we foresee sustained restrictions. Our GDP forecast for this year is 4.5 per cent and we expect a rebound to 5 per cent in 2022. The labour market will improve further. The biggest risk is surging inflation putting pressure on households, though wage and salary growth will outpace it.

New measures will dampen short-term growth. GDP rose by 4.8 per cent in the third quarter, with the manufacturing sector growing by 1.3 per cent and services by 6.1 per cent. However, due to the worsening coronavirus situation a curfew and other restrictions were reintroduced on October 21. Economic activity will remain subdued until mid-2022 as the infection risk falls. Restrictions will likely be targeted mainly towards the unvaccinated, limiting their ability to consume, while those who have been vaccinated will be more cautious in their mobility and spending. Thus consumption will slow, driven by weaker household sentiment and surging inflation, although the latest overall indicator suggests some improvements. As long as COVID-19 risks are present, the economy will be even more cyclical, but we foresee a rebound to 5.0 per cent next year as infection rates come down, following 4.5 per cent growth in 2021.

Key data

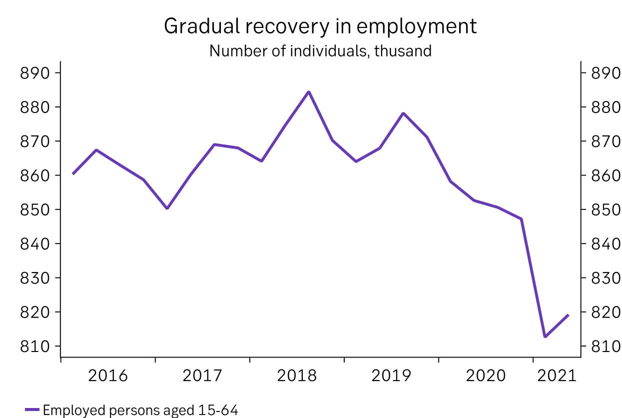
Year-on-year percentage change

	2020	2021	2022	2023
GDP	-3.6	4.5	5.0	4.2
Private consumption	-10.0	5.5	5.8	4.7
Exports	-2.7	5.2	4.8	4.3
Unemployment*	8.1	7.3	6.6	6.2
Wages and salaries	6.2	7.0	7.5	7.5
HICP inflation	0.1	3.1	4.6	2.0
Public sector fiscal balance**	-4.5	-9.0	-5.1	-3.5

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

European recovery supporting production. Among important growth pillars will be manufacturing and exports, supported by more favourable epidemiological situation in most of Europe. There has been a significant increase in manufacturing output in high and medium-high technology sectors: pharmaceuticals, motor vehicles, trailers and chemical products. Exports grew by 22.8 per cent from January to August. Due to component shortages, supply disruptions and energy prices, exports may lose some momentum but will remain at a robust 10 per cent growth rate for the next two years.

Government support and EU funds are key in order to stabilise the impact of risks and provide good prospects for growth. Construction will be one of the critical sectors facilitating investment. One major challenge will be to effectively manage public investments, reduce construction overheating risks in particular and make progress towards achieving climate and digitisation goals. The first payment from the EU Recovery and Resilience Facility, EUR 237 million, was received in September.



Labour market in transformation. In September, unemployment was 6.4 per cent, or 0.5 percentage points lower than in August. Despite shrinking joblessness, it will take some time for employment to recover. The labour market has undergone adjustments as it transforms towards a higher share of remote work, with demand shifting towards manufacturing, construction, transport, IT and shared service centres. Many have adopted a wait-and-see attitude, withdrawing from the labour market. It will take time and effort to get them back.

Surging inflation will pose a serious challenge, with higher housing, transport and food costs accounting for more than half of household expenses. Vaccinated seniors will receive 20 euros to help pay their electricity and gas bills, but we believe this subsidy should be broadened. Producer prices for manufacturing and services are rising rapidly and will inevitably push up consumer prices – by an average of 3.1 per cent this year and 4.6 per cent in 2022 before subsiding to 2 per cent in 2023.

Estonia

Robust recovery despite another COVID setback

The risks of a relatively low vaccination rate highlighted in the last *Nordic Outlook* have materialised and hospitals are overburdened with COVID-19 patients. The negative impact of the ensuing restrictions will not offset rapid growth in the previous months, and we now expect the economy to expand by 8.8 per cent in 2021. Strong forward-looking indicators suggest continued brisk and well-balanced growth in 2022. After a long spending spree, growth will fall more in line with its long-term path in 2023.

High inflation was foreseen, but its strength has been a surprise. In October inflation surged to 7.4 per cent. For now, high inflation is being caused by soaring energy prices, but a greater concern is the global increase in food prices, which account for 20 per cent of household expenses in Estonia. We now expect HICP inflation to reach 4.1 per cent in 2021, followed by 3.7 per cent in 2022. Inflation will start to ease from the second half of 2022 and slow to 2.5 per cent in 2023.

Key data
Year-on-year percentage change

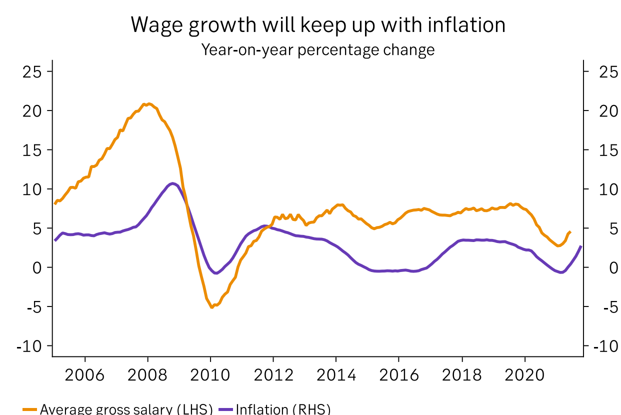
	2020	2021	2022	2023
GDP	-3.0	8.8	3.8	3.0
Private consumption	-2.5	7.7	3.8	3.5
Exports	-5.0	15.5	6.0	5.0
Unemployment*	6.8	6.7	5.8	5.2
Wages and salaries	2.9	7.1	8.5	7.0
HICP inflation	-0.6	4.1	3.7	2.5
Public sector fiscal balance**	-4.8	-3.2	-2.0	-1.0

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

Strong domestic demand. Despite inflation, the rapid growth in household consumption has continued almost undeterred. A speedy recovery in wage growth – paired with high savings — has given households solid spending power. An additional boost came from the pension reform as households who opted to withdraw their pension savings received approximately EUR 1 billion in their bank accounts in early September. The speed with which this money is being spent has exceeded expectations, and we have thus shifted some of the consumption we previously forecast for 2022 to this year. After swelling by 7.7 per cent in 2021, private consumption will increase by 3.8 per cent in 2022 and then ease to 3.5 per cent in 2023.

High export demand balances the books. Together with domestic demand, industrial production and exports have continued to surge. Forward-looking indicators suggest high export demand will continue for some time. Exports will increase by 15.5 per cent in 2021, followed by a 6 per cent upturn in 2022.

Corporate sector to play a greater role in capital spending. High demand in manufacturing has driven capacity utilisation to its highest level since 2007. New investments are needed, but the boost in capital spending will not be confined to industry. Meanwhile residential investments by households will start to play a somewhat lesser role towards the end of our forecast horizon. Due to a large base effect, capital spending will rise by only 0.5 per cent in 2022, followed by a 4 per cent increase in 2023.



The labour market is tightening further. Although unemployment will not fall to its pre-crisis level for some time, the number of vacancies is likely to have set a new record as early as Q3 2021. Mismatches are worsening, since high demand for labour in industries such as IT will not be met by the oversupply of employees previously engaged in the tourism or entertainment industries. These trends will push average gross salary up by 8.5 per cent in 2022, while unemployment will decline to 5.8 per cent. We expect tight labour market conditions to persist in 2023, when wages and salaries will increase by 7 per cent and unemployment will fall to 5.2 per cent.

Robust growth will support public finances. Fast economic growth has made balancing the budget easier, and the deficit will fall to 2 per cent as early as 2022. This will also reduce the need for debt financing and limit public sector debt to less than 20 per cent of GDP.

Global key indicators

Yearly change in per cent

	2020	2021	2022	2023
GDP OECD	-4.6	5.2	3.9	2.4
GDP world (PPP)	-3.3	5.7	4.4	3.5
CPI OECD	1.4	3.6	3.9	2.5
Oil price, Brent (USD/barrel)	43	71	73	60

US

Yearly change in per cent

	2020 level, USD bn	2020	2021	2022	2023
Gross domestic product	20,894	-3.4	5.6	3.9	2.2
Private consumption	14,048	-3.8	7.9	3.0	2.2
Public consumption	3,078	2.0	1.4	1.9	1.3
Gross fixed investment	4,479	-2.0	6.2	3.6	3.2
Stock building (change as % of GDP)	-60	-0.6	-0.2	0.7	0.0
Exports	2,123	-13.6	4.1	5.5	4.8
Imports	2,775	-8.9	13.2	4.0	4.5
Unemployment (%)		8.1	5.4	3.7	3.4
Consumer prices		1.3	4.7	4.9	2.7
Core CPI		1.7	3.5	4.4	2.7
Household savings ratio (%)		16.6	14.0	8.0	7.5
Public sector financial balance, % of GDP		-14.9	-11.0	-8.0	-6.0
Public sector debt, % of GDP		127	128	127	129

Euro area

Yearly change in per cent

	2020 level, EUR bn	2020	2021	2022	2023
Gross domestic product	11,400	-6.4	5.1	4.4	2.6
Private consumption	5,902	-7.9	5.0	4.7	2.6
Public consumption	2,573	1.3	3.0	1.0	1.0
Gross fixed investment	2,495	-7.0	6.5	4.5	3.8
Stock building (change as % of GDP)	0	-0.5	0.1	0.0	0.0
Exports	5,173	-9.1	10.0	6.0	4.0
Imports	4,749	-9.1	10.0	5.0	4.0
Unemployment (%)		7.9	7.7	7.2	7.3
Consumer prices		0.3	2.5	2.5	1.4
Core CPI		0.7	1.4	1.7	1.7
Household savings ratio (%)		19.5	17.8	14.2	13.4
Public sector financial balance, % of GDP		-7.2	-6.3	-3.6	-3.0
Public sector debt, % of GDP		97.3	100.6	98.7	98.1

Other large countries

Yearly change in per cent

	2020	2021	2022	2023
GDP				
United Kingdom	-9.7	6.9	4.9	2.8
Japan	-4.6	2.5	2.7	1.2
Germany	-4.6	2.9	4.6	3.0
France	-7.9	6.8	4.3	2.2
Italy	-8.9	6.4	4.7	2.4
China	2.3	8.2	5.2	5.4
India	-7.1	7.7	7.6	4.9
Brazil	-4.1	4.9	2.5	2.2
Russia	-3.0	4.3	2.8	2.0
Poland	-2.7	5.2	4.7	4.0
Inflation				
United Kingdom	0.9	2.5	4.7	2.9
Japan	0.0	-0.2	0.8	0.6
Germany	0.4	3.1	2.4	1.3
France	0.5	2.0	2.2	1.4
Italy	-0.1	1.8	2.3	1.4
China	2.5	0.9	2.3	2.1
India	6.6	5.2	5.2	4.6
Brazil	3.2	8.5	5.5	3.5
Russia	3.4	6.7	5.0	4.0
Poland	3.4	4.9	5.0	3.0
Unemployment (%)				
United Kingdom	4.5	4.6	4.3	4.1
Japan	2.8	2.8	2.6	2.5
Germany	3.8	3.7	3.6	3.7
France	8.0	8.0	7.5	7.6
Italy	9.3	10.0	9.8	9.5

Financial forecasts

Official interest rates		11-Nov	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23
US	Fed funds	0.25	0.25	0.25	0.75	1.25	1.50
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro area	Refi rate	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	Repo rate	0.10	0.10	0.50	0.75	1.00	1.25
Bond yields							
US	10 years	1.56	1.50	1.80	2.00	2.30	2.50
Japan	10 years	0.06	0.05	0.05	0.05	0.10	0.10
Germany	10 years	-0.29	-0.20	-0.10	0.00	0.20	0.40
United Kingdom	10 years	0.93	1.00	1.20	1.40	1.50	1.60
Exchange rate							
USD/JPY		114	113	114	115	115	116
EUR/USD		1.15	1.15	1.13	1.11	1.13	1.15
EUR/JPY		131	130	129	128	130	133
EUR/GBP		0.85	0.84	0.82	0.81	0.84	0.85
GBP/USD		1.35	1.37	1.38	1.34	1.35	1.35

Sweden

Yearly change in per cent

	2020 level, SEK bn	2020	2021	2022	2023
Gross domestic product	4,977	-2.8	4.6	3.6	2.5
Gross domestic product, working day adjustment		-3.0	4.5	3.6	2.6
Private consumption	2,187	-4.7	4.7	3.7	2.2
Public consumption	1,332	-0.6	1.9	1.2	1.2
Gross fixed investment	1,234	-0.4	6.0	7.0	5.0
Stock building (change as % of GDP)	0	-0.7	0.6	0.2	0.0
Exports	2,221	-4.6	8.9	6.3	5.2
Imports	1,991	-5.7	10.1	7.7	5.8

Unemployment, (%)	8.8	8.8	7.7	7.3
Employment	-1.3	1.5	2.0	0.7
Industrial production	-3.9	7.0	6.0	3.0
CPI	0.5	2.0	2.5	1.5
CPIF	0.5	2.3	2.6	1.5
Hourly wage increases	1.9	2.9	2.6	3.2
Household savings ratio (%)	17.1	17.7	16.8	18.0
Real disposable income	-0.8	5.3	2.9	3.2
Current account, % of GDP	5.7	5.5	5.0	4.5
Central government borrowing, SEK bn	-221	20	90	100
Public sector financial balance, % of GDP	-2.8	-1.0	0.0	0.7
Public sector debt, % of GDP	39.7	37.6	34.0	32.0

Financial forecasts	11-Nov	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23
Repo rate	0.00	0.00	0.00	0.00	0.00	0.25
3-month interest rate, STIBOR	-0.10	-0.10	-0.05	-0.10	-0.05	-0.05
10-year bond yield	0.26	0.35	0.40	0.45	0.65	0.95
10-year spread to Germany, bps	55	55	50	45	45	55
USD/SEK	8.67	8.70	8.81	8.92	8.67	8.43
EUR/SEK	9.98	10.00	9.95	9.90	9.80	9.70
KIX	113.0	113.4	113.5	113.2	111.5	109.8

Finland

Yearly change in per cent

	2020 level, EUR bn	2020	2021	2022	2023
Gross domestic product	236	-2.9	3.5	3.0	1.6
Private consumption	121	-4.7	3.7	3.5	1.7
Public consumption	58	0.5	2.5	1.0	1.0
Gross fixed investment	57	-0.7	2.0	3.5	1.0
Stock building (change as % of GDP)	0	0.2	0.4	0.0	0.0
Exports	85	-6.8	5.5	5.6	3.8
Imports	85	-6.5	5.0	4.5	3.0

Unemployment, OECD harmonised (%)	7.8	7.7	7.0	6.6
CPI, harmonised	0.3	1.9	1.6	1.4
Hourly wage increases	1.8	2.4	2.5	2.2
Current account, % of GDP	0.8	0.3	0.1	-0.2
Public sector financial balance, % of GDP	-5.4	-3.5	-2.5	-2.0
Public sector debt, % of GDP	69.2	70.3	70.5	71

Norway

Yearly change in per cent

	2020 level, NOK bn	2020	2021	2022	2023
Gross domestic product	3,557	-0.8	2.8	3.7	2.6
Gross domestic product (Mainland)	2,929	-2.5	3.7	3.9	1.3
Private consumption	1,441	-6.9	3.2	8.6	3.4
Public consumption	856	1.7	3.0	1.6	0.9
Gross fixed investment	857	-3.8	1.1	1.7	2.8
Stock building (change as % of GDP)		-1.0	0.7	0.0	0.0
Exports	1,350	-0.5	2.3	5.6	3.8
Imports	1,057	-11.9	3.6	9.2	3.7
Unemployment (%)		4.6	4.4	3.8	3.7
CPI		1.3	3.3	2.0	1.8
CPI-ATE		3.0	1.7	1.6	1.7
Annual wage increases		3.1	3.0	3.2	3.4

Financial forecasts	11-Nov	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23
Deposit rate	0.25	0.50	1.00	1.50	1.75	1.75
10-year bond yield	1.60	1.75	1.90	2.00	2.10	2.20
10-year spread to Germany, bps	189	195	200	200	190	180
USD/NOK	8.60	8.70	8.76	8.87	8.72	8.57
EUR/NOK	9.93	10.00	9.90	9.85	9.85	9.85

Denmark

Yearly change in per cent

	2020 level, DKK bn	2020	2021	2022	2023
Gross domestic product	2,330	-2.1	5.0	3.5	2.5
Private consumption	1,042	-1.4	4.0	5.0	2.5
Public consumption	574	-1.7	4.0	0.3	0.8
Gross fixed investment	521	5.1	9.2	7.0	5.4
Stock building (change as % of GDP)		-0.1	-0.3	0.3	0.0
Exports	1,278	-6.9	4.1	4.1	4.1
Imports	1,128	-4.1	4.4	6.0	4.9
Unemployment, OECD harmonised (%)		6.0	4.2	3.6	3.2
CPI, harmonised		0.4	1.9	2.9	2.1
Hourly wage increases		1.9	2.6	3.4	3.7
Current account, % of GDP		7.5	7.5	7.5	7.0
Public sector financial balance, % of GDP		-3.0	0.5	2.0	4.0
Public sector debt, % of GDP		44.0	40.0	36.0	32.0

Financial forecasts	11-Nov	Dec-21	Jun-22	Dec-22	Jun-23	Dec-23
Deposit rate	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
10-year bond yield	-0.03	0.06	0.14	0.22	0.40	0.60
10-year spread to Germany, bps	26	26	24	22	20	20
USD/DKK	6.46	6.47	6.58	6.70	6.59	6.48
EUR/DKK	7.44	7.44	7.44	7.44	7.45	7.45

Lithuania

Yearly change in per cent

	2020 level, EUR bn	2020	2021	2022	2023
Gross domestic product	49	-0.1	4.9	3.6	3.3
Private consumption	29	-2.1	4.9	4.2	3.4
Public consumption	9	-0.4	0.3	0.1	0.1
Gross fixed investment	11	-1.8	11.0	7.0	8.0
Exports	36	0.4	11.3	4.6	4.3
Imports	32	-4.4	13.6	5.7	5.5
Unemployment (%)		8.5	7.1	6.5	6.1
Wages and salaries		10.1	9.8	8.7	6.5
Consumer prices		1.1	4.5	5.4	2.3
Public sector financial balance, % of GDP		-7.2	-4.0	-2.8	-1.1
Public sector debt, % of GDP		46.6	45.3	43.5	44.4

Latvia

Yearly change in per cent

	2020 level, EUR bn	2020	2021	2022	2023
Gross domestic product	29.3	-3.6	4.5	5.0	4.2
Private consumption	16.1	-10.0	5.5	5.8	4.7
Public consumption	5.9	2.6	3.5	2.8	2.2
Gross fixed investment	6.9	0.2	3.4	4.7	5.1
Exports	17.7	-2.7	5.2	4.8	4.3
Imports	17.3	-3.3	5.6	5.0	4.7
Unemployment (%)		8.1	7.3	6.6	6.2
Wages and salaries		6.2	7.0	7.5	7.5
Consumer prices		0.1	3.1	4.6	2.0
Public sector financial balance, % of GDP		-4.5	-9.0	-5.1	-3.5
Public sector debt, % of GDP		43.5	49.4	49.6	47.5

Estonia

Yearly change in per cent

	2020 level, EUR bn	2020	2021	2022	2023
Gross domestic product	27	-3.0	8.8	3.8	3.0
Private consumption	13	-2.5	7.7	3.8	3.5
Public consumption	6	3.0	3.5	0.8	1.5
Gross fixed investment	8	19.9	12.5	0.5	4.0
Exports	19	-5.0	15.5	6.0	5.0
Imports	19	0.9	22.0	2.0	4.0
Unemployment (%)		6.8	6.7	5.8	5.2
Wages and salaries		2.9	7.1	8.5	7.0
Consumer prices		-0.6	3.2	2.7	2.3
Public sector financial balance, % of GDP		-4.8	-3.8	-2.5	-2.0
Public sector debt, % of GDP		18.2	20.8	24.2	27.5

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This report was published on November 16, 2021.
Cut-off date for calculations and forecasts was November 11, 2021.

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