Research Reports

Effective policy responses with long-term risks

Upside surprises in the Nordics and Baltics

Nordic Outlook

September 2020

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Health crisis on two levels

Annus horribilis 2020

"It is always wise to look ahead, but difficult to look further than you can see," wrote Winston Churchill, the legendary British prime minister. The challenge feels especially big as we add a new forecast year: 2022.

No doubt 2020 will be a year for the history books. We are witnessing a health crisis for both humanity and the economy. Over the next couple of years, economic and financial market developments will be determined by our ability to sustainably slow the spread of COVID-19, as well as shape effective crisis and recovery policies.

The global recovery is in its fourth month but is steering through uncertain, treacherous waters. Crisis policies can rescue production capacity but do not necessarily lead to economic growth. There is great concern about lasting damage to the functioning of the economy, even as vaccines and virus suppressants seem within reach.

Reopening economies has proven at least as hard as locking them down, but in recent months households and businesses have shown a strong desire to return to normality. While COVID-19 holds the world economy in its iron grip, there is a tug-of-war between pessimism in the real economy and optimism in stock markets.

An unprecedented crisis response by governments and central banks – USD 19.5 trillion – has boosted asset prices. These public sector interventions dominate the outlook. The boundary between fiscal and monetary policies has blurred. A policy of "printing" new money is laying the groundwork for a recovery driven by capital spending that includes a focus on green transition.

After their free fall in the second quarter, economies have stabilised. The light at the end of the tunnel has grown stronger. There is potential for a long-awaited recovery. Where we end up will depend on how businesses, households, politicians and central bank governors react to the prevailing extreme situation.

This September 2020 issue of *Nordic Outlook* analyses the global consequences of COVID-19. We have included four in-depth theme articles on:

- Globalisation
- The Swedish krona
- The US elections
- Recessions and labour markets

We hope *Nordic Outlook* gives you new insights about today's challenging global prospects. Stay safe, and let us all help each other get the world back on its feet!

Robert Bergqvist
Chief Economist

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Head of Economic Forecasting

The global economy

Effective policy responses with long-term risks

The United States

The recovery has been faster than expected, despite widespread coronavirus outbreaks. But it will be a long way back to square one. Even if the US avoids large-scale new lockdowns, unemployment will remain high ahead.

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The euro area

GDP plunged last spring, but with north-south disparities. Household goods consumption is leading the rebound, while manufacturing growth is slower. The new EU recovery fund will stimulate growth and improve cooperation.

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China

The first country out of the crisis, China showed an unexpectedly strong GDP increase in Q2. However, its recovery is imbalanced and unsynchronised. Supply-side restrictions have eased, but the labour market will hamper growth.

Page 33

The United Kingdom

The UK saw a bigger downturn in Q2 than the euro area and the US. Recovery will be shaky, with both COVID-19 and Brexit creating uncertainty. The BoE is prepared for more quantitative easing as needed, but is avoiding key rate cuts.

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Despite increased virus spread, advanced economies have recovered faster than expected; GDP in the Nordics and Baltics will fall much less than feared. Above all, crisis responses have slowed the rise in unemployment. Public sector debt will climb, but not as sharply as earlier projections showed. Along with low inflation, this gives central banks and governments room to help sustain the next recovery phase, but ultra-loose monetary policy risks creating wider wealth gaps and easing pressure for change.

When we published the last *Nordic Outlook* (NO) in early May, lockdowns and restrictions were at their most widespread. Meanwhile, we were in the middle of a period when enormous government and central bank stimulus measures were being launched in rapid succession. Their effectiveness and actual size were hard to assess, but financial markets had begun to bounce back after the dramatic stock market downturn in March. The forecasting situation was extremely uncertain. Many observers drew the conclusion that only the 1930s depression was comparable in terms of severity. We were also in a phase when growth forecasts were being steadily revised downward, and since then international organisations have continued to outcompete each other in pessimism. As new statistics have been published, the picture has become a bit clearer and forecasts a bit less uncertain. If NO in May was dominated by the need to raise big issues and place the unique situation in a historical perspective, our focus this time is a bit more "down to earth". It is important to examine incoming data really closely and try to distinguish the most important errors and exaggerations in the initial conclusions and forecasts.

Positive surprises despite COVID-19 setbacks. The pandemic has in fact unfolded in a more negative direction than assumed in our previous main forecast. In spite of this, the economy has generally recovered slightly faster than anticipated in advanced economies, especially in terms of consumption and manufacturing. Yet preliminary GDP figures for the second quarter of 2020 show unexpectedly wide divergences, with the Nordic and Baltic countries in particular surprising analysts on the upside. Labour markets have not weakened as much as feared. Unemployment in the United States has fallen in recent months, while relief measures in Europe limited the upturn to a considerably greater extent than expected (see "Theme: Recessions and labour markets", p. 41). This is one reason why the recession and stimulus measures have not burdened public sector finances as much as anticipated, thereby creating room for additional programmes in the future.

Large upward revisions in the Nordics and Baltics. We have made small upward revisions in our 2020 forecasts for large developed countries. We now expect GDP among the 37 nations of the Organisation for Economic Cooperation and Development (OECD) to fall by 6.6 per cent, compared to 7.0 in our earlier forecast. In the Nordics and Baltics, however, our upward revisions are many times larger: in the 5-6 percentage point range for both regions. Yet we have revised our global GDP forecast about a point lower, since the spread of COVID-19 in many emerging market (EM) countries has caused more economic damage than expected. Changes in the outlook for India have played an especially large role. We have generally lowered our GDP forecasts for 2021 a bit, among other things since the pandemic looks set to impede some sectors for longer than expected. There will be a gradual recovery with above-trend growth, especially in 2021. But even at the end of 2022, resource utilisation will be lower than normal, with jobless rates in most countries well above pre-crisis levels.

Global GDP growth
Year-on-year percentage change

	2019	2020	2021	2022
United States	2.2	-5.5	4.0	3.5
Japan	0.7	-5.8	2.4	0.7
Germany	0.6	-6.1	5.0	2.8
China	6.1	2.0	8.0	5.6
United Kingdom	1.4	-11.6	7.0	1.0
Euro area	1.2	-8.8	6.6	3.4
Nordic countries	1.4	-3.5	4.0	2.8
Baltic countries	3.6	-2.9	3.7	3.4
OECD	1.6	-6.6	4.8	2.8
Emerging markets	3.9	-2.5	5.6	4.8
World, PPP*	2.9	-4.3	5.3	4.0

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

Goldilocks environment is benefiting asset prices. Risk appetite in financial markets has continued to improve. Corporate reports for Q2 generally surpassed low expectations, mainly due to resolute cost savings. Our macro forecast implies a continued relatively favourable environment for stock markets and risk appetite. Economic conditions will gradually move up to firmer ground. Meanwhile central banks are prepared to help sustain economies for a long time with record-low key interest rates, as well as to expand their asset purchases as needed. In such an environment, it is natural for stock market valuations to climb to levels that are high in a historical perspective. Central bank actions also enlarge the manoeuvring room for fiscal stimulus, which will assume an increasingly important role ahead. Although there are long-term drawbacks to ultra-loose monetary policy – in the form of widening wealth gaps and weak pressure for change in the economy – it is too early to begin speculating about future central bank exit strategies.

The US dollar continues to weaken. In recent months the convergence of key interest rates and bond yields at low levels has been an important foreign exchange (FX) market driver. We expect this trend to continue. This implies that the dollar will weaken now that it no longer enjoys a positive interest rate differential against other major currencies, while a more stable economic outlook also weighs down the dollar in its role as a defensive currency. Our forecast is that the EUR/USD exchange rate will be 1.25 at the end of 2021. We also expect the Swedish krona to keep regaining lost ground, in an environment where Riksbank no longer stands out among central banks like before (see "Theme: The Swedish krona – Lasting gains for an undervalued currency", page 18). At the end of 2021, we expect the EUR/SEK rate to stand at 9.75.

We expect the Swedish krona to keep regaining lost ground, now that the Riksbank no longer stands out like before

Unexpectedly large Q2 variations

The dramatic GDP nosedives during Q2 2020 were unprecedented in modern times. Unorthodox metrics indicated that as much as one third of the economies in countries like France and the UK were locked down in April. Now that we have preliminary GDP figures we can see that some things followed expectations, while others came as big surprises. The declines in the US and the euro area as a whole turned out about as expected. It was also logical that the UK recorded the biggest decline of all, more than 22 per cent, in light of the extent of its lockdowns, its indicators and Brexit. But the disparities between Germany and other large euro area countries were unexpectedly wide.

Unexpected resilience in Finland and Lithuania. But in the Nordics and Baltics, there were bigger surprises. GDP declines were generally milder than forecast, especially in Finland and Lithuania. In Norway, Q2 figures were published after our cut-off date but other indicators point to an unexpectedly fast recovery. Sweden's COVID-19 strategy of keeping the country more open than elsewhere attracted great international attention but did not result in a milder GDP decline than in neighbouring countries. During Q2, Sweden showed the largest drop in GDP in the region. But it is also relevant to keep in mind the first quarter, when the Swedish economy was the most resilient. As a result, its GDP decline in the first half of 2020 was about average for the Nordic and Baltic regions.

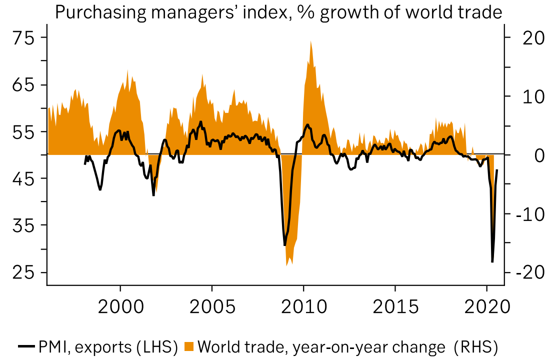
GDP, seasonally adjusted quarter-on-quarter changes
Per cent

	Q1 2020	Q2	Q3	Q4
United States	-1.3	-9.5	3.6	1.8
Euro area	-3.6	-12.1	6.0	3.5
Germany	-2.0	-10.1	6.0	3.0
Spain	-5.2	-18.5	10.0	6.0
United Kingdom	-2.2	-20.4	12.5	5.1
Sweden	0.1	-8.6	3.8	1.8
Norway	-2.1	-5.5	3.5	1.4
Denmark	-2.0	-7.5	4.0	2.0
Finland	-1.9	-3.2	2.4	0.2
Lithuania	-0.3	-5.1	2.9	0.5
Latvia	-2.9	-7.7	3.5	2.6
Estonia	-3.7	-7.4	4.5	4.1

Source: Eurostat OECD, SEB

Hard-hit countries will rebound. It is misleading to focus too much on a preliminary figure for a single quarter, but it is hard to ignore that we have seen a new "base level" that in some countries is well above expectations and will have a big impact on the full-year figures, assuming that we do not expect sharp setbacks ahead. As the level of restrictions converges, we foresee a stronger rebound in those economies that had the biggest negative figures in Q2. In spite of this, the revisions in our full-year 2020 GDP growth forecasts are very large. In our May report, for example, we predicted that overall GDP in the Nordics would fall by 8 per cent. Now we expect a decline of only 3.5 per cent. Our upward revision for the Baltics is even larger.

Challenging outlook for global trade
Purchasing managers' index, % growth of world trade



Source: Macrobond, SEB

Strong globalisation forces – after all

Global trade flows decreased sharply last spring when international supply chains were broken. Despite some recovery in June, world trade fell by 20 per cent year-on-year in Q2. Although the recovery is continuing during the second half, we expect a downturn of 10-12 per cent for this year as a whole. By late 2020, however, we believe that most of the loss will have been regained. In 2021 we expect an upturn of 8 per cent. In 2022, we believe that world trade will be back at about the same level as in 2019.

US-Chinese tensions even under Biden. The pandemic has focused attention on the increased importance of national boundaries, for example with governments having to re-assess their need for national emergency stockpiles. In a long-term perspective, it is not hard to conjure up threats of growing protectionism, a decline in democracy, weakened international organisations and perhaps even armed conflicts. Increasing tensions between China and the Western world, especially the US, are by far the most important issue. Unfortunately, US-Chinese conflicts have recently escalated. This raises questions about the bilateral trade agreement that was signed after exhaustive negotiations. By mid-year, China had met only one fourth of its stipulated import-expansion target for 2020. US-Chinese relations are unlikely to improve with Joe Biden in the White House, which currently seems like the most probable election outcome (see "Theme: The US elections", p. 25). A desire to slow China's global expansion is widespread in all US political camps.

US-Chinese relations are unlikely to improve with Joe Biden in the White House. A desire to slow China's expansion is widespread in all US political camps

Globalisation far from dead. It is not unusual for commentators to single out the risks to globalisation and free trade, but such threats must be balanced against other factors. Free trade has made progress in recent years, including various new trade agreements. There is still a widespread understanding of how vital trade has been in boosting prosperity and in waging the successful global struggle against poverty (see "Theme: Globalisation", p. 13). As a share of global GDP, world trade has stagnated since the global financial crisis. Among other things, this is because service sectors have boosted their share of GDP, financial market regulation has increased and EM economies – especially China – are trying to reduce their export dependence. There are also green arguments for slowing world trade expansion. Our conclusion is that world trade will grow slowly, or possibly stagnate, as various forces pull in opposite directions, but that globalisation is far from dead.

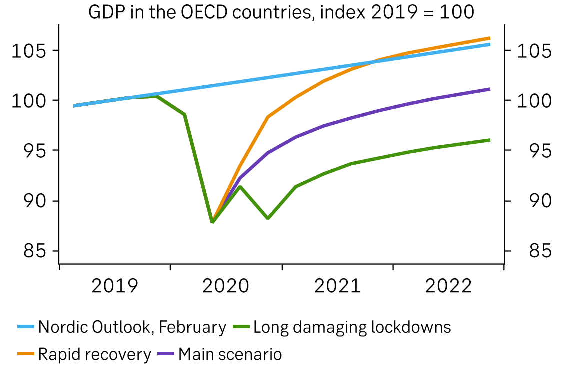
Increased virus spread leads to new tactic

The spread of COVID-19 has unfortunately continued at a disturbing pace. In North and South America, new cases are at record levels. In Asia and Europe, which were earlier in the pandemic cycle, we have seen new outbreaks in the past month. But instead of general lockdowns, , the tactic now seems to be to attack infection clusters in order to reduce their impact on the labour market and economic growth. Factors such as the capacity and preparedness of health care systems and the age structure of the population influence strategies, along with risks of political and social unrest.

Vaccine issue increasingly important. Given today's continued high level of virus spread at global level and flare-ups in hotspots around the world, it is increasingly obvious how important a vaccine will be to the normalisation process. It is hard to get a clear picture of when large-scale vaccinations can take place, since there are major disparities in the assessments of experts. Today six vaccine candidates have reached the final phase of clinical testing. This critical phase, which is expected to take 2-3 months, will determine whether one or more vaccines meet various requirements. In the best case, a vaccine may be in place by early 2021, which would be a major success for the world's medical researchers. Russia's early vaccination plans are creating both concerns and curiosity in other countries. If the Russian vaccine turns out to work and not lead to serious side effects, this will be a victory in the battle against COVID-19 but also an economic and political success for Moscow.

Various scenarios

GDP in the OECD countries, index 2019 = 100



Source: Macrobond, SEB

Many questions about the vaccination process. However, many other issues are being discussed about mass vaccinations: for example, how fast enough doses can be produced, the competition between countries for access, allocation of the vaccines, and their effectiveness and duration. Other factors contributing to uncertainty are the degree of anti-vaccine sentiment – especially in the US – and the economics of carrying out mass vaccinations in poorer countries. Our main scenario assumes that the world must "suffer through" the coming northern hemispheric winter without mass vaccinations. There is consequently a risk of a temperature-driven worsening of the pandemic situation, although this too is controversial. However, we assume that vaccinations during the second half of 2021 will reach such a scale that it will greatly reduce the need for restrictions.

Negative scenario

GDP growth, per cent

	2020	2021	2022
United States	-7.3	1.5	3.0
Euro area	-10.7	2.5	2.5
Sweden	-6.0	0.5	2.5
OECD	-8.5	1.5	2.5
World	-5.7	2.0	3.5

Source: OECD, SEB

Symmetrical risks. The great uncertainty about vaccines and the spread of COVID-19 is one reason why we are continuing to work with various alternative scenarios. On the downside, the dominant risk is that the pandemic will take off during the winter in such a severe way that large new lockdowns and tougher restrictions are absolutely necessary. Aside from direct effects on GDP, this would probably have a severe negative impact on confidence, both in the real economy and in financial markets. Large-scale vaccinations starting in early 2021 could generate a more positive scenario. It is also possible that we have underestimated the power of economic policy stimulus when it has better conditions to work in. We are sticking to a symmetrical probability for these alternative scenarios: a 60 per cent probability for our main scenario and 20 per cent each for the negative and positive scenarios, respectively.

Positive scenario
GDP growth, per cent

	2020	2021	2022
United States	-4.3	7.0	3.6
Euro area	-7.6	10.5	4.1
Sweden	-2.8	8.0	3.9
OECD	-5.4	8.0	3.1
World	-3.3	8.5	4.2

Source: OECD, SEB

Historic GDP decline for emerging markets

2020 will go down in history as the year when GDP in the emerging market (EM) economies as a group shrank for the first time since reliable statistics began to be published. No region will be spared from the COVID-19 pandemic, but there are major differences in how severely individual countries are being affected. It is hard to find any clear pattern, however, when it comes to successful strategies. For example, India introduced restrictions relatively early and then locked down the economy almost completely, while Brazil made decisions later and took less drastic steps. Brazil now has the world's second-largest number of confirmed infections after the United States, and India the world's third largest. The most important factor for EM countries has turned out to be institutional capacity: how well the authorities can handle challenges like food distribution and health care. Their ability to reach especially vulnerable and poor inhabitants with support is important. In general, there is a correlation between GDP per capita and institutional capacity, as indicated by countries like South Korea and Taiwan managing much better than Mexico and Brazil, for example.

EM countries are also being weighed down by weak international demand. Many economies are dependent on tourism and merchandise exports, while others are plagued by depressed raw material prices due to the global downturn. With the exception of China, GDP fell in all major EM economies during the second quarter, but a rebound seems to be on the way. Its strength will be determined by the extent to which restrictions need to be re-instated. For 2020 as a whole, we have revised our GDP growth forecast for the EM economies downward to -2.5 per cent from -0.6 per cent in May's *Nordic Outlook* (and -2.0 per cent in our June forecast). This adjustment is mainly due to a sharp downward revision for India and to some extent Mexico. We have downgraded our 2021 EM forecast to growth of 5.6 per cent (from 6.1 per cent in May).

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

	2019	2020	2021	2022
China	6.1	2.0	8.0	5.6
India	4.9	-5.6	4.0	7.4
Brazil	1.1	-7.0	3.0	2.5
Russia	1.3	-5.0	3.7	2.5
Emerging markets, total	3.9	-2.5	5.6	4.8

Source: IMF, SEB

Inflation risks further ahead. The deceleration in the EM countries has made room for additional monetary policy easing. Many central banks already cut their key interest rates during an earlier slowdown phase in 2018 and 2019, and key rates are now at record-low levels. Some central banks have also begun to buy government bonds, mainly in the secondary market. In the prevailing weak economic situation, this has hardly been inflationary. But there is an obvious risk of accelerating price increases in a more mature cyclical phase. In some countries, central banks will probably be subjected to political pressure to prop up growth.

Capital flows are hard to control. Although risk appetite has rebounded, EM currencies have not generally appreciated. Our EM currency index has instead fallen again and is now close to the level reached when the COVID-19 crisis was at its deepest. Most EM currencies have appreciated against the dollar but are instead losing ground against other world currencies like the euro, yen and pound. Partly due to falling interest rates and bond yields, returns have apparently become too low and rate differentials against mature economies too small to attract enough capital. Data from the Institute of International Finance (IIF) show that capital flows are positive, but less than in earlier periods of recovery and rising risk appetite. This will mean lower capital spending and falling growth potential, which are among the reasons why the EM economies face a long, bumpy way back.

Lower capital spending and falling growth potential are among the reasons why the EM economies will face a long, bumpy way back

Aggressive but unclear crisis programmes

Policy responses to the COVID-19 crisis were launched quickly and aggressively but were not always so transparent. Although international organisations and think tanks have devoted extensive resources to cataloguing these measures in a clear, comprehensible way, it is still uncertain how they should be interpreted. Overall, we believe that they total nearly 25 per cent of global GDP, with fiscal stimulus accounting for about two thirds. The table below shows the allocation of fiscal stimulus between immediate impulse, deferred payments and other liquidity provisions/guarantees.

Caution is advisable because of divergent definitions. Spending levels vary sharply between countries – it itself a signal that they should be interpreted with caution. One almost suspects that countries are competing to see who is the most decisive. Figures in some countries may be based on generous maximum levels, while other countries try to forecast probable outcomes. The trickiest is comparing "Other liquidity and guarantees". When discussing the size of a discretionary stimulus dose – how much impact these active decisions will have – we must also factor in how generous existing systems are. The basic protections found in Europe (unemployment benefits or the equivalent) are not reported as part of crisis responses but instead usually described as "automatic stabilisers". But in the US, these benefits are included among crisis responses. Discretionary measures and existing systems are also often interconnected, for example Swedish "short-time work" programmes relieve pressure on the unemployment benefit system.

Discretionary 2020 fiscal measures – COVID-19 crisis
Selected countries. August 5, 2020. % of 2019 GDP

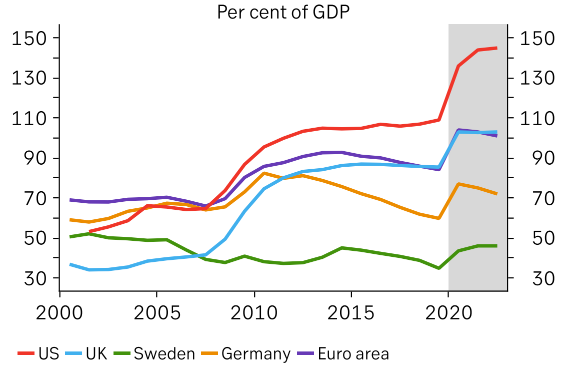
	Immediate fiscal impulse	Deferred payment	Other liquidity/ guarantees	Total
US	9.1	2.6	2.6	14.3
Japan	13.7	27.8	0.7	42.2
UK	8.0	2.3	15.4	25.7
Germany	8.3	7.3	24.3	39.9
France	4.4	8.7	14.2	27.3
Italy	3.4	13.2	32.1	48.7
Spain	3.7	0.8	9.2	13.7
Sweden	5.1	6.7	5.2	17.0
Norway	5.3	1.9	3.7	10.9
Denmark	5.5	7.2	4.1	16.8

Source: SEB, Bruegel, IMF

The upturn in debt is not as dramatic as previously feared. The estimates of public sector debt trends that are now being published by international organisations and national governments may serve as a more coherent metric of how generous the COVID-19 crisis responses actually are. So far, the main tendency is that the upturn has not been as strong as previously indicated. The debt ratio is climbing sharply in 2020 as large budget deficits are combined with falling nominal GDP (the denominator in the ratio), but as early as 2021 the debt ratio will level out, as deficits shrink slightly while nominal GDP rebounds. There are many indications that by 2022, the debt ratio will begin to fall in many countries, although this forecast is uncertain.

Systems are not being utilised as heavily as expected. There may be many reasons why public sector debt will not increase as much as the catalogue of COVID-19 responses leads us to believe. In some countries, the economic downturn does not appear likely to be as deep as had been feared, which is one reason why relief systems have not been utilised as heavily as expected. But a more important reason is that most programmes are not direct government expenditures. A large proportion of programmes consists of deferrals, with businesses merely postponing payment of taxes, social insurance fees and the like. It is thus simply a matter of rescheduling government revenues. In the case of guarantee programmes, these are sometimes stated at enormous gross amounts, but a debt only arises when a guarantee is utilised and becomes a part of the fiscal deficit. Making a lot of noise about the generous limits on guarantees, loans and deferred payments may also be a way of instilling courage in markets, businesses and households. One example is the Fed's emergency loan programme, which has been only marginally utilised so far, since its bold signals have had confidence-building effects that have instead made it possible to borrow in the market.

Higher government debt
Per cent of GDP



Source: IMF, SEB

Room for growth-promoting measures. Although the picture is mixed – with debt ratios soaring to new records in the US, Italy and elsewhere – in most countries the debt upturn does not seem so dramatic. For many, the debt ratio will end up on a par with levels after the global financial crisis, but due to low interest rates today's debt service costs are substantially lower and in some countries record-low. It is of course reassuring that their fiscal situation does not appear as strained as once feared. The objective of acute crisis policies was to rescue production capacity – businesses and jobs – but it could hardly prevent economies from shrinking as a result of lockdowns and restrictions. What countries need now is instead fiscal programmes that can stimulate growth and make restructuring easier. It thus makes sense to take advantage of the available manoeuvring room and hold off on reactivating restrictions like the EU's Maastricht criteria on budget deficits, debt and inflation or Sweden's fiscal policy framework. In that respect, the EU recovery fund agreement is a step in the right direction. It signifies that at least the EU will not repeat its mistakes from the euro crisis of a decade ago, when crisis-hit countries were forced to carry out immediate tightening measures amid an already weak economic situation. It is also a major success that Germany is finally leading the way with powerful stimulus measures.

Further QE more effective than negative key interest rates. There is also a growing consensus that fiscal policy makers should bear the main burden. Central banks are sending clear signals of their willingness to expand securities purchases if an upturn in long-term yields jeopardises the recovery. The Fed, European Central Bank (ECB) and Bank of Japan are expected to buy about USD 4 trillion worth of securities during the coming year. This would bring the balance sheets of central banks in the OECD countries to USD 26 trillion. Although the expansion of these balance sheets since the financial crisis has been more than 10 times larger than the upturn in nominal GDP, there are reasons to believe that this is preferable to cutting key interest rates to negative levels. Both the IMF's Article 4 analysis of the US and the Bank of England's studies on negative interest rates reach the conclusion that the disadvantages still outweigh the advantages.

Both the IMF's US analysis and the Bank of England's studies on negative interest rates reach the conclusion that the disadvantages still outweigh the advantages

Rapid recovery after oil price collapse

Oil price fluctuations due to the COVID-19 crisis have been historically large (see the box in *Nordic Outlook*, May 2020, p. 9). For example, in April the price of West Texas Intermediate oil collapsed to a negative USD 40 per barrel, among other things due to falling demand and the price war between Saudi Arabia and Russia. After that, the oil market stabilised once OPEC+ had agreed on production limits in order to deal with an expected downturn in demand during 2020 in the range of 8 per cent. We expect the average price of Brent crude oil in 2020 to be USD 45 per barrel.

Oil price will climb to USD 65/barrel. Next year we expect a rebound in global demand for oil to only 1 per cent below 2019 demand. Continued production limits and no clear turnaround in US oil production will shrink stockpiles. The price trend in 2021 and 2022 will depend greatly on how American energy producers react to shrinking stockpiles and higher prices. We believe it will take time before the US oil industry reacts to higher prices. Overall, we expect an average oil price of USD 55/barrel in 2021, climbing to USD 65 in 2022.

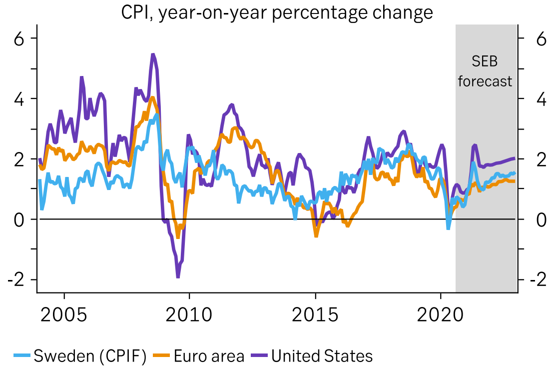
Challenges to stable inflation

The risk that exceptional monetary stimulus, combined with setbacks to globalisation, might eventually result in surging inflation has been a theme of recent public discourse. In the May issue of *Nordic Outlook*, we discussed such risks in more detail. Our conclusion was that the above-mentioned factors have changed the risk picture by decreasing the probability of deflation as well as increasing the probability of a significant upturn in inflation. But our main scenario was, and still is, that disinflationary forces will continue to predominate in an environment where low resource utilisation is exerting downward pressure on wages and salaries.

Low risk of a demand-driven inflation shock. The events of recent months have largely reinforced this picture. Consumer Price Index (CPI) inflation has admittedly climbed due to the oil price recovery, and base effects will intensify this impulse, especially early in 2021. Core inflation (CPI excluding energy and food prices) fell considerably in the spring, but in the past few months this movement has partially reversed. Prices of certain goods and services that were greatly affected by restrictions have climbed, and above all there has been increased volatility in these areas. CPI measurements have also become more uncertain, since it was impossible to establish prices for some items in the CPI basket due to businesses being almost entirely closed. These measuring problems peaked during the spring, especially in large euro area countries like France. Generally speaking, however, risks of a demand-driven inflation have diminished. Short-term effects, for example due to hoarding and broken supply chains, have faded. Looking ahead, we cannot rule out increased demands for national control of production, for example related to pharmaceuticals and food, yet it is unlikely that the world economy will generally shift especially far in a protectionist direction.

Energy prices will push CPI inflation higher

CPI, year-on-year percentage change



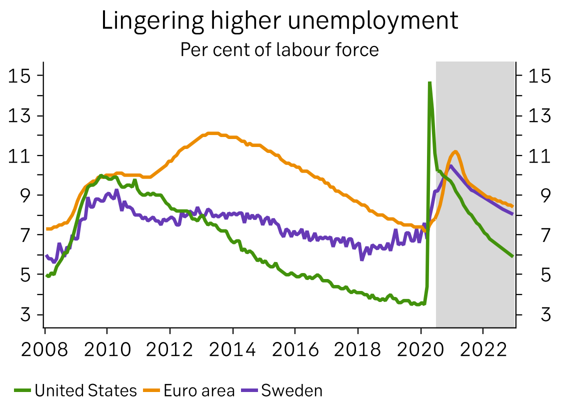
Source: Macrobond, SEB

Blurrier boundary between fiscal and monetary policies. So the question is whether further ahead, today's monetary policy expansion might trigger a raging inflation when resource utilisation begins to normalise. A little uncertainty on this point is actually something that central banks welcome at present. For example, the fact that inflation expectations have climbed a bit helps push down real interest rates further. Central banks will take advantage of this opportunity to signal acceptance of inflation that may overshoot their target, after a long period of bias towards excessively low inflation. Such a "commitment to being irresponsible" by central banks can help keep inflation expectations up. Further worsening the situation is that central bank holdings of government bonds will probably not be phased out within the foreseeable future, in line with the Japanese example.

We are thus approaching a monetisation of public sector debts, making the boundary between monetary and fiscal policies more blurry (see "Theme: Historic crisis policy" in *Nordic Outlook*, May 2020).

By all indications, governments and central banks will have plenty of time to withdraw stimulus programmes before signals of overheating become obvious

Low resource utilisation provides breathing room for exit policies. We can paint scenarios in which playing with the "fires of inflation" ends in a surge of inflation, for better or worse. But monetary expansion and swelling central bank balance sheets can only generate lasting inflation to the extent they really create an environment where demand exceeds supply in the economy. Even though the average pace of wage and salary increases in the short term seems to be holding up in many economies, since mainly low-paid people are losing their jobs, it is likely to take some time before we see any inflationary pay increases. By all indications, both governments and central banks will have plenty of time to withdraw stimulus programmes and liquidity before signals of overheating become unpleasantly obvious. So far it seems a bit far-fetched to say that advanced economies would deliberately like to use inflation as a way of sharply decreasing their real debt burden. In any event, our inflation forecast for the next 2-3 years implies that central banks must continue battling uncomfortably low inflation.



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

Hard to deal with gaps and environment

To summarise our analysis, it thus looks as if there is room for further fiscal and monetary policy stimulus measures, without serious debt burden and inflation consequences. But at the same time, there are a number of other challenges and risks that economic policy makers must now address and balance. In the long run, constant central bank actions and asset purchases help destroy the market's signalling system and promote unhealthy risk-taking. Chronically low interest rates also help to reduce pressure for change and create "zombie companies". This problem is now being exacerbated by various forms of guarantees to prevent bankruptcies. The most important problem, however, is that extremely low interest rates and bond yields help drive up share prices and housing prices in a way that worsens the problem of widening wealth gaps. This is especially serious in a situation where the pandemic has hit economically weak groups hardest.

Many challenges for fiscal policy makers. It would be reasonable if the existing fiscal manoeuvring room were used in ways that bridge wealth gaps to some extent. But while doing so, it is important not to weaken the driving forces for work and investment. Although there is now a broad political understanding of the need to narrow economic divides, we can expect fierce ideological battles over what funds should be used. Judging by recent public debate, there are no major signs of shifts in positions that might lead to compromises. Instead, most policy makers seem to interpret the crisis as a confirmation of the superiority of their own policies. There is also a broad consensus that reopening efforts must have a clear green focus. Here, too, vigilance is needed to ensure that these measures are truly effective and efficient in a longer perspective. There are many historical examples of failures when major investment programmes are designed in haste.

Theme:

Globalisation

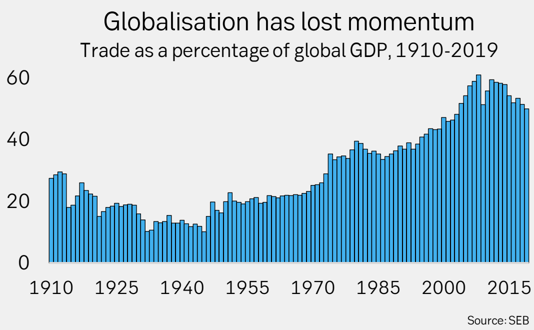
Rumours of its death are greatly exaggerated

Globalisation has benefited many, but not all. COVID-19 is raising questions about the role of national borders, the future of globalisation and its effects on growth, inflation and corporate profits. Trade conflicts in recent years have also persuaded companies and political leaders to consider steps to reduce their vulnerability, diversify risks and thereby boost their resilience to new disruptions. This will affect corporate value chains. Our conclusion is that the forces underlying globalisation are robust, and rumours of its death are exaggerated.

COVID-19 wiped out about 20 per cent of global trade during Q2 2020, compared to one year earlier. Political decisions included workplace shutdowns, limitations on mobility and new border controls. Some of the pandemic's adverse effects on growth have been due to broken global value chains – networks of companies including developers, producers, suppliers, investors and retailers. The future of globalisation will largely be determined by how much these value chains will be reshaped in order to boost resilience and diversification while reducing vulnerability to disruptions, such as new pandemics and protectionism.

Is the world moving towards de-globalisation in the wake of the COVID-19 crisis? In fact, globalisation – world trade (exports + imports) as a share of global GDP – is already past its peak. In 2008 it reached 61 per cent after 25 years of steady growth (see chart).

The decline in globalisation since 2008 has three rather undramatic explanations. *First*, emerging economies – led among others by China –have tried to become less export-dependent, boosting both domestic production and demand. *Second*, the expansion of the service sector and its increasing role in the world economy have decreased globalisation, as defined here. *Third*, export financing for globally active companies has become more expensive, due to increased regulation following the financial crisis. In addition, the global investment cycle as well as the automotive and tech cycle have shown some signs of weakness in recent years (see "Theme: Trade war & peace" in *Nordic Outlook*, September 2019).



The future of globalisation depends on several factors. First, global trade follows the **economic cycle** – recovery eventually leads to increased trade. Second, a prolonged period of high unemployment and economic inequality may lead to increased **public support** for trade barriers and protectionism. Third, **global and national security policies** imply that ongoing shifts in technology as part of the Fourth Industrial Revolution may cause governments and companies to want to protect their products from foreign countries.

COVID-19 has exposed systemic failings

The increased importance of national boundaries – even within the EU – is forcing countries and companies to rethink their policies. Governments need to review the need for national emergency stockpiles. Companies may also have to increase their storage capacity and/or ability to move or re-organise production to safeguard their value chains. "Just-in-time" deliveries of input goods have enabled firms to reduce inventories, thus helping to boost productivity and trim costs. Companies may now have to find a model that provides an optimal balance between delivery and production security, on the one hand, and cost-effectiveness on the other.

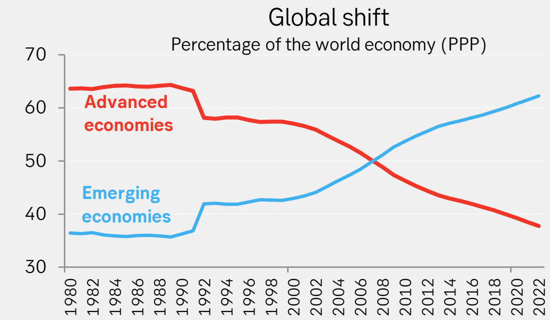
When China locked down in late January – and the world still believed that the virus outbreak would be confined to one country – many firms demonstrated an impressive and surprising talent for quickly re-organising and shifting production to factories in other countries. What products they needed to produce was also adapted to the prevailing situation. Such flexibility – admittedly coupled with higher costs – can provide valuable information to companies when it comes to both planning for and managing future crises.

Strong forces drive globalisation

Globalisation is best described as a strong, coherent underlying force behind actors in different countries within one shared system. This force arises when consumers, producers and investors are driven by a desire to benefit from price and cost differentials between markets for goods, services, labour and capital. Consumers want a wide product range at low prices. Companies want customers and low production costs. Investors want the highest possible return at the lowest possible risk. The chance to exchange ideas is also a major force behind new innovations. How strong these forces are allowed to be is ultimately determined by political decisions and interventions in the system.

The problems and potential of globalisation have been debated energetically in recent years. There is little doubt that free trade and technological progress enable the overall pie to grow. But globalisation and technological revolutions also have redistribution policy – and thus political – consequences. Economic policy makers thus need to focus their attention on people who have difficulty keeping up with ever-increasing demands, as well as ease the transition for those who become unemployed in shrinking sectors.

Globalisation has narrowed economic inequality between countries. Thirty-five years ago, emerging market countries accounted for 35 per cent of the world economy (using purchasing power parities, PPP). In 2019 their share was 60 per cent. Billions of people have been lifted out of poverty. The labour force in China and India, representing about 40 per cent of the global labour force, has been incorporated into the global system. Globalisation has enabled consumers to gain access to a wider range of products at low prices.



By specialising and leveraging their comparative advantages, countries achieve both higher efficiency and lower resource utilisation. The resulting conditions should be positive for the global climate. In addition, interest rates have been pushed down, strengthening household finances and stimulating business investments. Among the negative aspects of globalisation are that consumers and companies do not pay for all the negative effects of production and transport work on the environment and the climate.

But if economic inequality has narrowed between countries, it has instead widened within countries. An estimated one billion people in advanced economies have been affected by widening economic inequality, which has contributed to the emergence of anti-establishment forces. Yet before the COVID-19 pandemic, unemployment had fallen to its lowest level in 40-50 years in countries like the United States, Germany, Japan and the United Kingdom.

Free trade on the increase...until now?

The conventional picture of rising protectionism is flawed. In fact, over the past five years a number of economies and regions have taken important steps towards increasing – not decreasing – free trade. Although the recent US-Chinese Phase 1 deal was preceded by conflicts, a number of other new trade agreements were also signed: between the US and Japan; the US, Mexico and Canada (USMCA); the US and Mercosur; the EU and Japan; most African countries (AfCFTA); and between ASEAN and Australia, Japan, China, New Zealand and South Korea. Yet it is worth noting that because of COVID-19, around

120 new export restrictions have been introduced so far during 2020 according to World Trade Alert, for example on pharmaceuticals and medical products.

"Many of the problems troubling the world are not caused by economic globalisation"
Xi Jinping, President of China, January 17, 2017

Conflicts between China and other countries have increased, although relations with the US are at the epicentre. Aside from the huge economic assets, global jobs and poverty reductions that are at stake, these conflicts are also about political tactics and countries that have ended up on a collision course in areas like ideology, security policy and global/regional leadership in the era of the Fourth Industrial Revolution.

China is deeply integrated into many value chains and numerous companies cannot afford to become entirely independent of China. For a long time, many of them have invested in a presence in the world's largest – and fastest growing – consumer goods market, and they justifiably want to see a return on this investment.

Systemic reversals: the big picture

Globalisation is nothing new. It has been under way for hundreds of years, but what is unique about the past several decades is its speed and the fact that it includes enormously populous countries such as China and India. Globalisation has represented a major eastward economic shift. Increased global economic power will also lead to increased political power.

The emergence of a multipolar world – with an "infrastructure" to solve global problems and make decisions about the climate, refugee crises and the pandemic – has not happened in practice. The World Trade Organisation (WTO) needs reform and is now powerless as a global problem-solver. Its regulations have not kept up with changes in trade and the emergence of new economic superpowers. The WTO is viewed as treating areas like goods, services and data in separate silos. The G7, G10 and G20 have also lost influence in recent years. In an era of growing tensions on many levels, the shortcomings in the World Health Organisation (WHO) and in the leadership role of the United Nations (UN) are also clearer than before.

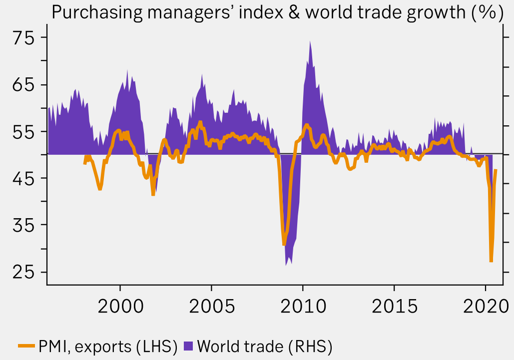
Calling for clearer national boundaries at the expense of multilateralism is counterproductive. The world needs constructive, not destructive, solutions to international problems. It is easy to paint future scenarios that include increased protectionism, setbacks for democracy and even armed conflicts.

Globalisation links together (at least) **three systems**: economic, financial and political. These systems thus need to evolve simultaneously. When economies have become interconnected via trade and value chains, the financial system is also globalised. A country's financial system is often described as the bloodstream that supplies oxygen to its economy. When the real economy is globalised, the same thing happens to the financial system. A failure to recognise the interdependence of the global financial system was probably a contributing factor behind the intensity of the 2008-2009 global crisis. Regulation without the restoration of national boundaries became the formula for increasing the resilience of the financial system.

Covid-19 is now testing the resilience of the economic system and global value chains. The Fourth Industrial Revolution has already begun; there are many indications that the COVID-19 crisis will speed up this wave of digitisation and automation. But to ensure greater resilience, systems may need even greater integration between network participants to achieve greater transparency – for example, an overview of inventories held by the participants in value chains.

The world wants to vaccinate the economic system, making it more resilient to both future pandemics and trade wars. But if countries and firms wish to decrease their vulnerability by bringing parts of the real world into the digital one, we must also be able to protect ourselves against computer viruses and cyberattacks. Otherwise the world has only won a Pyrrhic victory.

Challenging global trade outlook



Source: Macrobond, SEB

A world of predictable unpredictability

Companies need predictability and a long-term approach to global trade rules. A lack of predictability limits globalisations and capital spending, hampering growth and productivity. Uncertainty about how regulations will look may, in itself, also have dramatic negative effects on investments and production. Unpredictability in the international trade system accentuates structural and cyclical forces that inhibit both trade flows and economic growth. Yet there are many indications that the above-described forces underlying globalisation are strong enough to offset a counterproductive renaissance in national boundaries that hamper trade and exchanges of ideas. There are reasons to assume that trade as a share of GDP will not increase as fast as before 2008, but we see no reasons to believe that there will be a sharp decrease either.

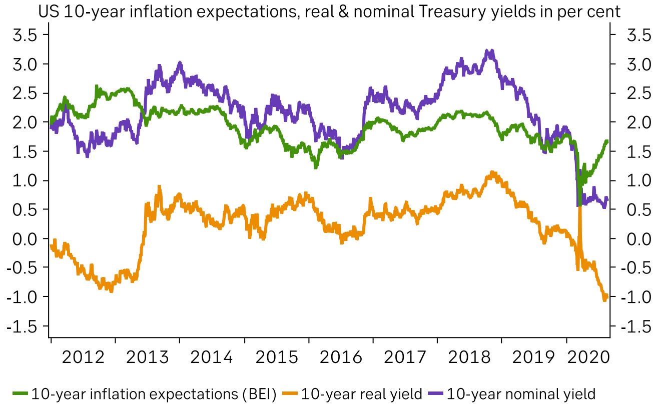
Fixed income

Central banks keep yields in steady grip

Central banks (CBs) are keeping global government bond yields in a steady grip. Despite increased risk appetite and rising stock markets, bond yields have remained extremely depressed. Meanwhile, real yields have fallen sharply amid rebounding inflation expectations. CB promises of low yields for many years indicate that today's situation may be long-lasting, although CBs are expected to allow some upturn in yields if this coincides with sustained economic recovery.

Large decline in US real yields

US 10-year inflation expectations, real & nominal Treasury yields in per cent



Source: Bloomberg, Macrobond, SEB

10-year government bond yields
Per cent

	Aug 19	Dec 2020	Dec 2021	Dec 2022
United States	0.68	0.80	1.00	1.20
Germany	-0.50	-0.40	-0.20	0.00
Sweden	0.00	0.00	0.20	0.50
Norway	0.69	0.70	0.80	0.95

Source: National central banks, SEB

After extremely large movements in early 2020, fixed income markets have largely been flat. Volatility in US Treasury yields has hit new record lows in recent weeks. Fixed income markets do not seem to have reacted to improved risk appetite in the past several months, rising stock markets or soaring fiscal deficits. The reason is that major CBs have said that there is essentially no upper limit to how much fixed income securities they can buy. Ten-year US Treasury yields are currently around 0.65 per cent after sinking to their lowest-ever closing level, 0.51 per cent, in early August.

The market's inflation expectations collapsed this spring, due to both plunging oil prices and widespread recession worries. After bottoming out at just below 0.6 per cent, US 10-year inflation expectations – measured as the difference between nominal and inflation-indexed yields – have soared. Expectations are now back almost where they were before COVID-19: 1.7 per cent. Since this upturn has occurred during a period of largely sideways movements in nominal yields, real yields have plunged. Negative real yields have been a long-time phenomenon in Japan and Europe. The shift in the US, where today's Treasury real 10-year yields are around -1 per cent, seems to have fuelled upturns in other asset classes. Aside from a stock market rally, gold prices have climbed to all-time highs.

Yet inflation expectations are relatively low in a historical perspective. Despite mixed inflation signals, CBs have emphasised that they will let inflation overshoot their targets. Monetary policy, both globally and in Sweden, is instead focusing entirely on propping up economies with promises of low key interest rates and liquidity support (which includes lending facilities, but mainly asset purchases). We expect markets to continue pricing in a certain probability of rate cuts. Given clear signals from the US Federal Reserve and other CBs that they do not wish to introduce negative key rates, we regard the downside for short-term rates as limited.

Looking at long-term yields, there is a continued tug-of-war between exploding supply and dedicated CBs. The US Treasury Department estimates that the government will need to borrow at least USD 5.4 trillion this year (around USD 2 trillion during the rest of 2020). This can be compared to USD 1.2 trillion in 2019. Having bought a maximum of USD 75 billion in government securities per day, the Fed has slowed its purchases to about USD 80 billion per month. This means the supply of US Treasury securities will balloon during the next few months, which indicates some upward pressure on yields. Our conclusion is that the Fed will allow long-term yields to climb gradually, as long as the upturn coincides with an improved economic outlook. Ten-year US Treasuries will climb to 0.8 per cent by the end of this year and to 1.0 per cent by the end of 2021. This is somewhat lower forecast compared to *Nordic Outlook* in May.

The EUR 750 billion EU recovery fund will open the market to large-scale European Commission borrowing for the first time. In addition – after many years of saving – Germany has unveiled large fiscal stimulus programmes that are expected to swell the bond supply in the coming years. But with the European Central Bank as a significant buyer, large upturns in yields will be less likely and the yield spreads between Germany and more indebted countries will shrink as joint EU support increases market confidence in the region.

The yield spread between Sweden and Germany has shown small movements this summer. After temporarily widening a bit beyond the range of recent years, the 10-year spread is now at 46 basis points, or about the same as in May. But after previously pointing to a widening spread due to increased supply, unexpectedly strong Swedish government finances in recent months combined with the Riksbank's expanded QE programme have reduced this trend. We thus foresee continued relatively small movements in the spread.

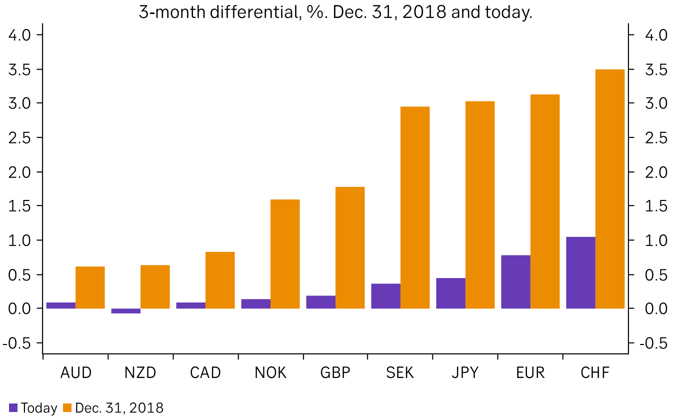
The FX market

New conditions require new exchange rates

In many cases, FX market movements have been very large since COVID-19 broke out earlier this year. After a successful period for such traditionally defensive currencies as the USD and CHF early in the crisis, pro-cyclical currencies have regained lost ground. Interest rate differentials between G10 currencies are the smallest in modern times. So far, exchange rates have not fully adjusted to the new environment. We thus believe that this summer's trend will continue but that narrow rate differentials will eventually also reduce FX market volatility.

Narrowing rate differential between USD and G10 currencies

3-month differential, %. Dec. 31, 2018 and today.



Source: SEB and Bloomberg

Exchange rates

	Aug 19	Dec 2020	Dec 2021	Dec 2022
EUR/USD	1.19	1.20	1.25	1.28
USD/JPY	106	110	113	113
EUR/GBP	0.90	0.87	0.83	0.81
EUR/SEK	10.30	10.00	9.75	9.60
EUR/NOK	10.53	10.35	9.90	9.80

Source: Bloomberg, SEB

The US dollar appreciated according to its traditional pattern when market stress peaked at the beginning of the COVID-19 crisis in March. An almost insatiable need for dollar liquidity and a large supply of liquid instruments make the dollar attractive during acute crisis phases, but the USD was already overvalued against many currencies when COVID-19 broke out. This was because higher American interest rates have attracted investors in recent years, but the Federal Reserve's key interest rate cuts down to zero – combined with its large-scale bond purchases – led to rapid rate convergence with other countries. This almost entirely eliminated one important dollar-positive force. Increased global risk appetite has also reduced the need for dollar liquidity, contributing to a sharp decline in the USD since April. We expect this trend to continue throughout our forecast period, provided that no unexpected new crisis emerges. Our EUR/USD exchange rate forecast is 1.20 at the end of 2020, 1.25 at the end of 2021 and 1.28 at the end of 2022.

The British economy was already in a vulnerable situation when the COVID-19 crisis struck. For example, it is still very uncertain whether any trade agreement with the European Union will be in place when the Brexit transition period expires on December 31, 2020. The outcome of the ongoing negotiations will be important to the future of the pound. Assuming an agreement is in place, we expect the pound to recover late in 2020 and in 2021. But the British economy has been harder hit than most countries by lockdowns. In order to ensure a lasting recovery for the pound, the British economy will probably need to regain lost ground during the next few quarters, enabling the Bank of England to take a step back. However, we expect the pieces of the puzzle to fall nicely into place, with the EUR/GDP exchange rate falling to 0.88 at the end of 2020 and then gradually continuing down to 0.80 by the end of 2022.

The Swedish krona has been undervalued against many currencies in the past few years but has rebounded strongly in recent months. Since mid-March, the SEK has appreciated by more than 8 per cent against the trade-weighted KIX exchange rate index. In fact, so far this year the krona has appreciated against all 21 currencies in the index, and this broad-based upturn has pushed the krona to its highest level in more than two years. Yet the krona remains undervalued. We expect it to appreciate further in the coming years. The main reason is that Swedish interest rates no longer diverge significantly from other countries. This changes the situation of many market players that have been underweighted in the krona during the past few years. At the end of 2020, the EUR/SEK rate will be 10.00. It will then fall to 9.75 by the end of 2021 and to 9.60 at the end of 2022 (see theme article, page 18).

The Norwegian krone continues to be squeezed by low oil prices. The NOK plunged when the bottom fell out of the oil market. Weak NOK liquidity also contributed to the currency's weakness during the COVID-19 crisis, with the EUR/NOK exchange rate peaking at above 13.00. In fundamental terms, the NOK is greatly undervalued, and a sizeable budget deficit this year – financed by the oil fund (Government Pension Fund Global) – is also creating a substantial capital influx that must be exchanged into NOK. Yet so far the krone has responded weakly, and the capital influx itself is apparently not enough to bring the EUR/NOK rate back to more reasonable levels. In a global environment of continued recovery, where risk premiums keep falling while oil prices are rising, we ultimately expect the NOK to appreciate. We are forecasting that the EUR/NOK rate will reach 10.35 at the end of 2020 and that the krone will gradually strengthen to 9.80 at the end of 2022.

Theme:

The Swedish krona

Lasting gains for an undervalued currency

The Swedish krona has been undervalued against many currencies in recent years but has recovered impressively over the past few months. Since mid-March, it has gained more than 8 per cent against the trade-weighted KIX exchange rate index. In fact, so far this year the krona has climbed against all 21 KIX currencies. In other words, what has occurred is a broad-based appreciation to its strongest position in over two years. Yet the krona remains undervalued. We expect further gains in the coming year. The main reason is that Swedish interest rates no longer diverge significantly from other countries.

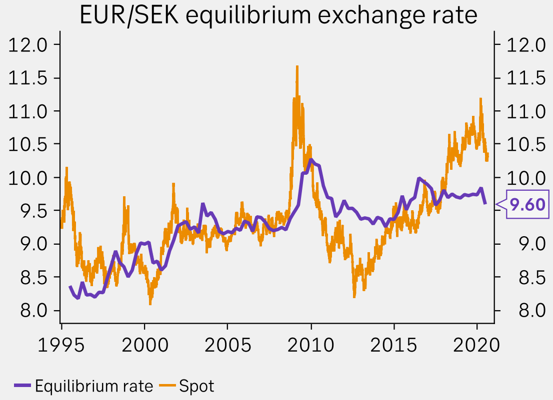
Major recovery for the krona

The impact of the COVID-19 crisis on economic activity seems to have peaked in March and April. This coincided with the beginning of krona appreciation: a trend that accelerated this summer. The krona has benefited from increased risk appetite and hopes of an economic turnaround after massive relief programmes by governments and central banks during the spring and summer. The value of the krona is often measured against the trade-weighted KIX exchange rate index, which consists of 21 currencies of importance to Swedish foreign trade. According to KIX, today the krona is at its strongest level for more than two years.

Behind this krona appreciation are several factors that are now pulling in the same direction: higher risk appetite and rising share prices; the krona's attractive valuation; foreign exchange (FX) market positioning, with market players having probably been underweighted in the krona over the past couple of years; narrowing interest rate differentials between Sweden and other countries; and the milder negative impact of the COVID-19 crisis on Swedish growth compared to similar economies, due to the use of guidelines rather than tough rules on social distancing. This theme article analyses the above factors. Our conclusion is that that the single most important reason why the krona has gained ground is the change in interest rate differentials and yield spreads.

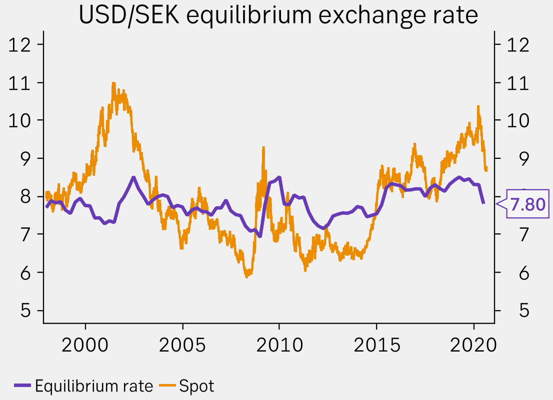
The krona has been weak for some time. Our long-term currency valuation model – based on a number of fundamental variables that usually determine a currency's equilibrium exchange rate – indicates that the Swedish currency has been greatly undervalued against both the euro and US dollar. According to our models, the krona's equilibrium exchange rate against the euro is between 9.50 and 10.00 kronor and against the dollar 7.50- 8.00 kronor. These levels have been relatively stable in recent years (see charts below). This means that at today's exchange rates the krona is still undervalued and should be able to appreciate further in the future against both the EUR and USD.

EUR/SEK equilibrium exchange rate



Source: SEB

USD/SEK equilibrium exchange rate



Source: SEB

Unfortunately we do not have equilibrium value estimates for all 21 currencies included in the KIX index. But if the index is adjusted to the ten currencies for which we do have such estimates (totalling 85 per cent of the total weight in the index) we discover that the equilibrium level should be between 109 and 110. Today the KIX index is just below 115 (a higher index number means a weaker krona), which implies that the krona is five per cent undervalued against our most important trading partners. This estimate also closely matches those made earlier by the Riksbank.

Krona less sensitive during COVID-19 crisis

For many years, Sweden has posted large current account surpluses. This has enabled the country to reduce its foreign debt. For the past decade, Sweden's assets abroad have been larger than the assets of foreign owners in Sweden. This is also true of equities, with Sweden's foreign shareholdings being larger than foreigners' shareholdings in Sweden. This serves as a cushion when there are large share price declines. In times of stock market turbulence, net flows related to equities are positive for the krona, since the value of the shares listed abroad that Swedish investors can be expected to sell will exceed the value of the shares listed in Sweden that foreign investors will sell. This factor helped to limit krona depreciation during the most acute phase of the COVID-19 crisis in February and March, although the krona lost ground against more liquid currencies like the dollar and euro.

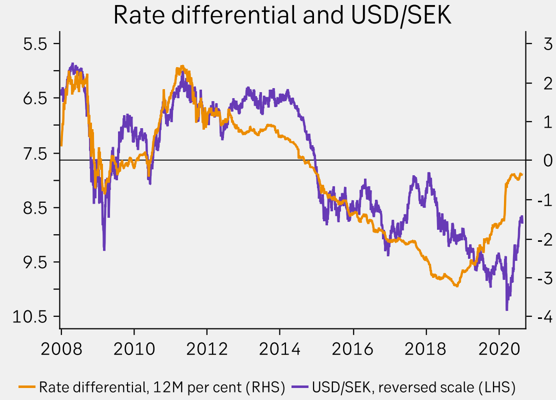
A low valuation and the fact that many market players were already underweighted in kronor may also have helped the SEK to perform better than many other small currencies.

Major change in relative interest rates

Because of an undervalued dollar and an overvalued krona, the cost of a dollar was less than six kronor in 2011. At that time, Sweden's key interest rate was substantially higher than that of the US. The 12-month rate differential between Sweden and the US was +2.4 percentage points (see chart below). After that, both the krona and Swedish interest rates trended lower against both the dollar and US interest rates until November 2018, when the differential was -3.2 points. The rate differential thus fell by 5.6 percentage points between 2011 and 2018. During the same period, the krona lost nearly half its value against the dollar.

Interest rates determine the forward purchase price of currencies. Companies participate in the FX forward contract market, among other things in order to hedge future revenue or cost flows. A change in interest rates has a huge impact on prices. The cost of a one-year USD/SEK currency hedge rose by about SEK 0.45 between 2011 and 2018. During this period the krona changed from being one of the currencies that could offer a positive rate differential against the dollar to one of the most attractive funding currencies.

Rate differential and USD/SEK



Source: SEB

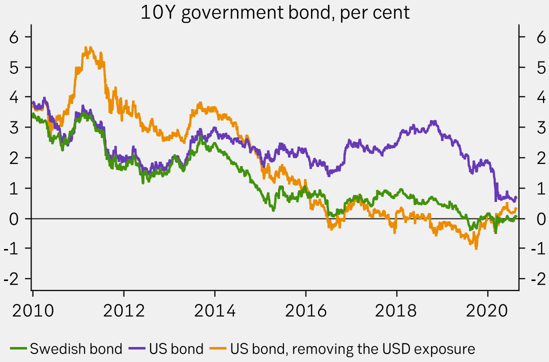
Until 2014, higher Swedish short-term interest rates enabled Swedish bond investors to earn far higher returns from US Treasury bonds (which paid the same yields as Swedish government bonds at the time) by simply eliminating the dollar exposure in these holdings. These conditions changed dramatically when the US Federal Reserve began hiking its key interest rate in late 2015, while the Riksbank did the opposite and slashed its key rate to -0.5 per cent.

The return on US Treasuries not only became higher, with an unchanged currency risk; since early 2016, currency-hedged holdings of US Treasury securities have generated a lower return than the equivalent Swedish bonds with the same maturities, even though US nominal bond yields have been substantially higher. In other words, since 2016 it has only been possible for Swedish financial institutions to take advantage of higher US Treasury yields if these holdings have had a currency exposure to the USD; otherwise it has been a better alternative from the standpoint of returns to buy Swedish government bonds. We have estimated the dollar exposure of Swedish institutions at the end of 2019 as being the equivalent of about SEK 500 billion.

Dramatic changes by the Fed and Riksbank this year. Since late 2019 – and as a result of the COVID-19 crisis – monetary policies have again changed dramatically. The Riksbank hiked its repo rate to 0 per cent, while the Fed cut its key rate to nearly 0 per cent and aggressively expanded its balance sheet. For Swedish export companies, this change implies that the cost of currency hedging has fallen greatly: to SEK 0.03-0.04 for a 12-month USD/SEK hedge, compared to a cost of nearly SEK 0.30 at the end of 2018.

Annual yield for Swedish investor

10Y government bond, per cent



Source: SEB

Conditions have also changed greatly for Swedish financial institutions. The yield spread between Swedish and US 10-year government bonds today is slightly above 0.5 percentage points, while a Swedish investor today can again earn somewhat higher yields by owning US treasury bonds without currency risk. This rapid, dramatic monetary policy change has created a need to reduce USD exposure by purchasing kronor and selling dollars. We believe it is the single most important reason why the krona has appreciated recently. This change, combined with an aggressive policy by the Riksbank – which took advantage of a krona depreciation to raise inflation expectations – probably forced Swedish investors to greatly increase the currency exposure on their foreign holdings, which helped to weaken the krona.

Because of narrow rate differentials, the krona is also no longer an obvious funding currency among more speculative FX market players, and Swedish export companies are likely to increase their currency hedging levels as the cost has fallen. Swedish institutional investors will probably continue to reduce their foreign exchange exposure. For good reasons, various FX market players have been underweighted in kronor in recent years, but this will probably not be the case in the future.

Swedish COVID-19 strategy also favourable

The milder impact of COVID-19 benefits the krona. This means there is good potential for the krona to continue appreciating from today's levels against many currencies, including the euro. Another factor that benefits the krona is Sweden's management of the COVID-19 outbreak, which seems to have had milder consequences for the economy than in other countries. During the second quarter of 2020, Swedish GDP preliminarily fell by 8.7 per cent compared to the same quarter of 2019. This was less than in both the US (-9.5 per cent) and the euro area (-15 per cent). If Sweden makes it through the COVID-19 crisis with somewhat less damage than other countries during the next few quarters as well, this may also benefit the krona.

Meanwhile Sweden's central government finances are considerably stronger than those of many comparable economies. Because of low central government debt at the outset and a degree of moderation during the COVID-19 crisis, there is still potential to stimulate demand in a sustainable way via fiscal policy if the need arises in the future. This can also be expected to benefit the krona.

Faster krona appreciation in our forecast

Even before the COVID-19 crisis, our forecast was that the krona would recover from its weak exchange rates as Sweden shifted to a less extreme monetary policy. Because of the COVID-19 outbreak, the adjustment in Swedish interest rates compared to those of other countries occurred in only a few months. The krona has consequently climbed faster than we previously expected. This summer, we thus revised our forecasts upward. We now foresee a faster krona appreciation. The EUR/SEK exchange rate is expected to drop to 10.00 by the end of 2020 and reach levels below SEK 10 per euro by the first half of 2021. After that we expect slower krona appreciation, with the EUR/SEK rate reaching 9.75 at the end of 2021 and 9.60 at the end of 2022. We anticipate a somewhat sharper krona appreciation against the dollar. We believe the USD/SEK rate will be 8.30 at the end of 2020, falling to 7.80 at the end of 2021 and 7.50 by the end of 2022.

The stock market

Digitisation winners are driving valuations

Corporate earnings are greatly surpassing market analysts' low expectations. The forward-looking nature of the stock market is becoming clear as extremely low growth coincides with historically high valuations. If forecasts of earnings, interest rates and yields prove correct, the stock market can maintain its rally, with the continued help of the companies that benefit the most from digitisation, or else aided by a comeback for cyclical companies in a benign recovery environment.

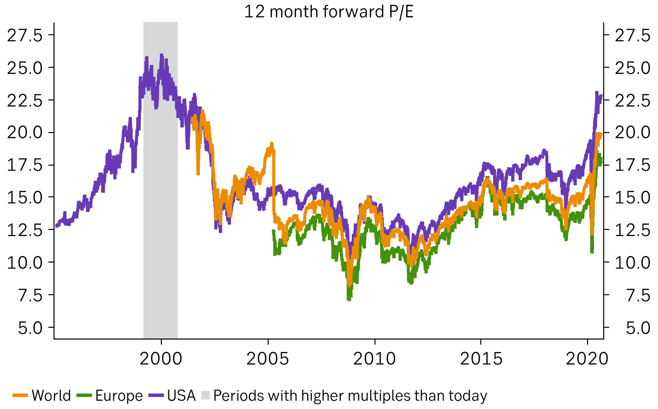
US equities: Giants dominate the upturn

YTD return, index Jan 2020 = 100

Source: Bloomberg, SEB

Stock markets are highly valued

12 month forward P/E



Source: MSCI, Macrobond, SEB

Better earnings than feared. It is encouraging but not so surprising that Q2 earnings greatly surpassed analysts' forecasts, considering how far these forecasts had been lowered. The relationship between sales and earnings was more remarkable. Unlike earnings, sales appear to have surpassed forecasts only marginally, which indicates surprisingly good profit margins. One possible explanation is that companies have benefited more than expected from stimulus packages. In addition, highly profitable digitisation companies represent a growing proportion of market capitalisation, which pushes the figures higher. Meanwhile companies have implemented extensive efficiency-raising programmes that reduce their costs. Stimulus measures will fade sooner or later, but both efficiency improvements and continued help from digitisation winners in driving up the overall market are likely in the next few quarters.

Stimulus measures are providing support. Since it bottomed out in late March, America's S&P 500 index has gained over 50 per cent and hit a new all-time high. Meanwhile the tech-heavy Nasdaq Composite has rebounded by an impressive 64 per cent since its March low and is up 26 per cent so far in 2020. Some observers are warning that a big correction is now due. This can never be ruled out, but we see reasonable explanations for the upturn. Unprecedentedly large stimulus programmes are providing support for growth forecasts and – importantly – giving investors reason to believe that governments will respond to growth disappointments with new fiscal stimulus. Central banks (CBs) are also aggressively helping, nowadays even buying corporate bonds. Letting CBs remove credit risk is pushing down companies' funding costs and spreading to the stock market. Such stimulus measures represent a sizeable transfer of capital from the public to the private sector. This is reflected in credit spreads, which after widening greatly during the crisis, have now nearly reverted to previous levels. This is especially true of relatively stable investment grade bonds, which have seen the largest supportive purchases, but also the high yield segment. Looking ahead, we expect more normal returns in the corporate credit market after several months of healthy recovery.

Higher valuations can be accepted. Not surprisingly, share prices and valuations have climbed in this environment. The difficult questions will be how long this environment will last and how high valuations can climb and remain acceptable. As indicated earlier, we expect relatively good growth and low interest rates in the foreseeable future. One important explanatory factor behind high valuations is the above-mentioned digitisation winners. The five biggest US listed companies in this category now account for around 22 per cent of S&P 500 capitalisation: a percentage exceeded only during the IT (dotcom) bubble two decades ago. But today's stock market giants are reporting both large and fast-growing earnings. They account for around 15 per cent of aggregate stock market profits. This shows that their valuations, while higher than the stock market average, are not sky-high. If their earnings forecasts prove correct, their valuations will grow rapidly.

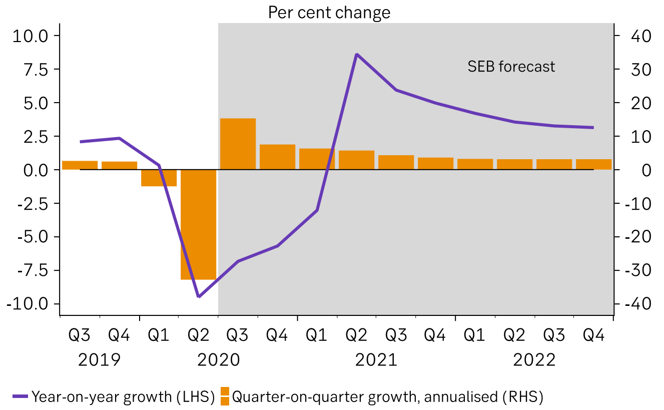
Will digitisation and sustainability produce winners? Yet it may be hard for the stock market giants to repeat the accelerating earnings growth of recent years, which may push down today's valuations. Looking at general valuations, the lion's share of reasonable increases is probably behind us. Today's level can be justified but requires a benign earnings trend. The TINA (There Is No Alternative) argument and a surplus of capital may well be enough to keep driving share prices upward, as long as there are no big negative surprises. Investments in digitisation and perhaps infrastructure appear likely. We expect efforts to create a more sustainable world will also intensify, benefiting companies that offer more sustainable products and services.

The United States

A long way back to square one

Recovery has been faster than expected. We are raising our GDP forecast to -5.5 per cent this year, with 4 per cent growth in 2021 and 3.5 per cent in 2022. Stimulus measures have buoyed households, while capital spending looks set to fall less than feared. Low interest rates are ending the housing market slump. But in 2021-22 the US will fall short of its earlier growth path, and unemployment will remain high. The Fed will stick to its zero-interest rate policy while awaiting above-target inflation.

Short-lived but historically sharp contraction



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

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.2	-5.5	4.0	3.5
Unemployment*	3.7	9.3	8.3	6.2
Wages and salaries	3.3	4.7	2.1	1.8
Consumer Price Index (CPI)	1.8	1.1	1.8	1.9
Core PCE (the Fed's target variable)	1.7	1.5	1.6	1.4
Public sector balance**	-5.9	-21.0	-11.0	-8,0
Public sector debt**	109	136	144	145
Fed funds rate, %***	1.75	0.25	0.25	0.25

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

Historic GDP decline, despite unusually fast recovery

The lockdowns in response to COVID-19 have had a severe impact on the US economy. Second quarter GDP fell by 9.5 per cent (32.9 per cent annualised), the most dramatic downturn in modern times. In April, unemployment reached nearly 15 per cent – the highest level since the 1930s – but unprecedented stimulus measures softened its secondary effects on the economy. The initial recovery has occurred faster than expected, especially in the labour market and some areas of private consumption, while foreign trade and manufacturing have remained weak. With the economy having already rebounded late in Q2, it will show good growth in Q3 growth despite signs of a levelling off during the summer. We are revising our 2020 GDP growth forecast from -6.5 per cent in the May issue of *Nordic Outlook* upward to –5.5 per cent but are instead lowering our 2021 forecast to 4.0 per cent. This forecast implies that GDP will be back at its pre-pandemic level by the end of 2021, but the gap compared to the earlier growth trend will not close even in 2022, when we expect GDP to increase by 3.5 per cent. Unemployment will remain high throughout our forecast period.

This summer's increased spread of the virus in previously less-affected states has forced them to impose new restrictions. Short-term indicators are pointing to a slowdown in economic activity during July and August, but because the virus curves have again begun to flatten during the past few weeks, the economic damage will probably be limited. Our main scenario is that the US will avoid large-scale new lockdowns, while the pace of reopening is likely to be calmer than it was during the spring.

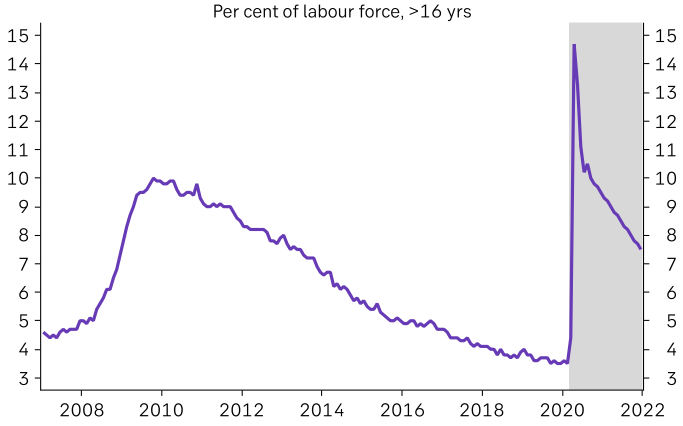
Unemployment fell rapidly when temporarily jobless employees were recalled to their workplaces during May and June. This positive trend partially continued during July, with a further downturn in unemployment to just above 10 per cent. Yet this still represents far higher jobless levels than previously. Less than half of the earlier decline has been reversed. The employment level among those of "prime age" (25-54) remains less than the lowest levels in 2009-2010. Judging from weekly statistics, the improvement seems to have levelled out during the summer, and we see a risk of a slower downturn in unemployment ahead. By year-end we expect the jobless rate to be just below 10 per cent. It will then continue falling to about 5.5 per cent in December 2022.

Generous support to households has boosted disposable incomes, so that at aggregate level they are now higher than when the crisis began. This was one reason why the second quarter GDP decline did not prove as dramatic as feared. Supply-side restrictions in areas like entertainment, travel and restaurants, rather than a lack of money, were the main obstacle to household demand during the spring. In late June, consumption of durable goods was nearly 10 per cent higher than in February. Total goods consumption was up about 5 per cent. Meanwhile service consumption remained 12 per cent short of its pre-crisis level. Demand for services will remain under pressure as long as the coronavirus threat persists, but we still see room for continued recovery in parts of the service sector. This applies, for example, to health care (about 30 per cent of total services), since resources for treating COVID-19 patients probably crowded out other care and contributed to the sharp decline (40 per cent) in March and April. Consumption of such services in June was still about 15 per cent below the February level. Continued coronavirus-related restrictions in the service sector and some saturation after earlier rapid recovery in goods sales are expected to slow the increase in private consumption ahead. This year's decline will be only 5.5 per cent, followed by increases of about 4.5 per cent during 2021 and 6.0 per cent in 2022.

Stimulus measures have been structured differently from those in Europe. Small businesses have been offered loans that turn into grants if they retain employees, but the focus of federal relief programmes has been on protecting household purchasing power. This has assumed two main forms – one-time payments of USD 1,200 per adult and USD 500 per child and extra unemployment benefits of USD 600 per week. The latter expired in July. Congressional negotiations aimed at extending benefits and issuing new cash payments to households appear, for the moment, to have collapsed. Instead, President Donald Trump has issued executive

Sharply higher unemployment followed by partial reversal

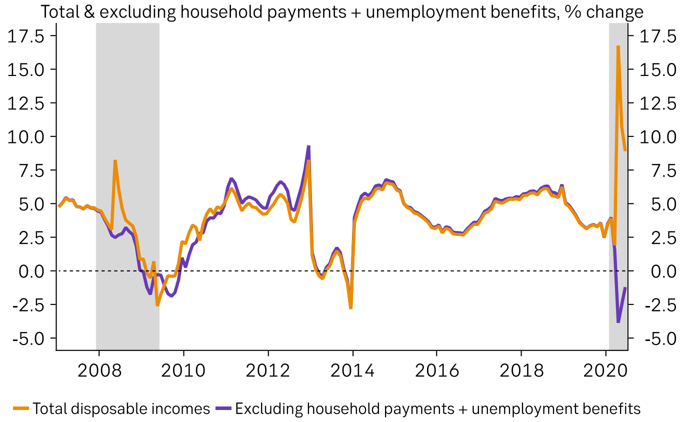
Per cent of labour force, >16 yrs



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

Household disposable incomes rose during COVID-19 crisis

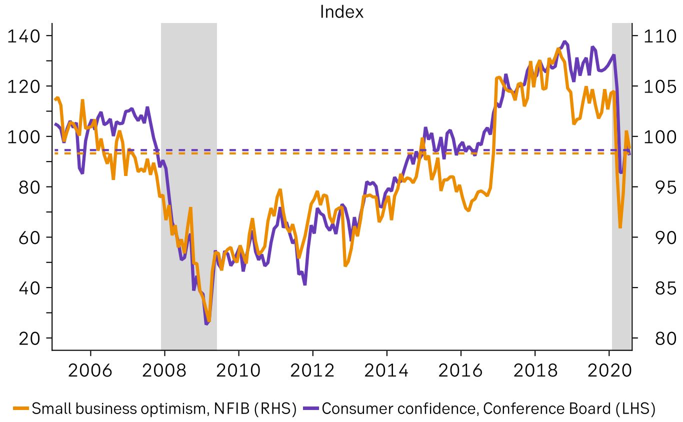
Total & excluding household payments + unemployment benefits, % change



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

Resilient sentiment among consumers and small businesses

Index



Source: Conference Board, National Federation of Independent Business, Macrobond, SEB

orders on federal jobless benefits and other relief measures. Aside from various practical challenges, however, these benefits will not add any new funds, but will only redirect existing federal money. Earlier support to households will help to bridge the gap until negotiations are resumed, probably not before September.

Our main scenario is that a new federal stimulus agreement will be reached. But the size of the package is uncertain, with a risk that it may be less than the USD 1-1.5 trillion we previously envisioned. Many Republicans are increasingly reluctant to add to burgeoning deficits. This will make negotiations difficult but will probably not be enough to stop new stimulus programmes. Yet the closer we get to the November 3 elections, the bigger the risk that further pandemic relief will be postponed until 2021. One possibility is that such programmes will instead be incorporated into this autumn's budget for the fiscal year starting October 1. Consumer confidence (especially as measured by the Conference Board) has been resilient, given the labour market situation, while small business sentiment has rebounded to historical averages due to continued optimistic forecasts. But in July, sentiment among both households and small businesses fell, which may signal increased worries related to both COVID-19 and stimulus programmes.

Major corporations are optimistic, despite weak exports and manufacturing. The Institute for Supply Management (ISM) purchasing managers' index for manufacturing has climbed to levels clearly signalling expansion, led by production and new orders. Yet this reflects optimism about the future outlook, not the current situation – which is underscored by still-depressed employment indicators. Weak foreign trade and major declines for transport equipment are important factors behind anaemic growth in manufacturing. Production of motor vehicles (5 per cent of the total) has now regained much of its earlier decline, but production of aircraft and aircraft parts (4 per cent) remains depressed, due to the double burden of earlier crashes/groundings and the general crisis affecting the world's airlines. Business investments were the second-largest driver of the Q2 GDP decline after private consumption, but indicators are pointing to limited effects compared to the two preceding recessions. The decline in order bookings was mainly concentrated in the transport sector, while other cyclical areas such as machinery showed relatively small changes and IT/electronic products performed strongly.

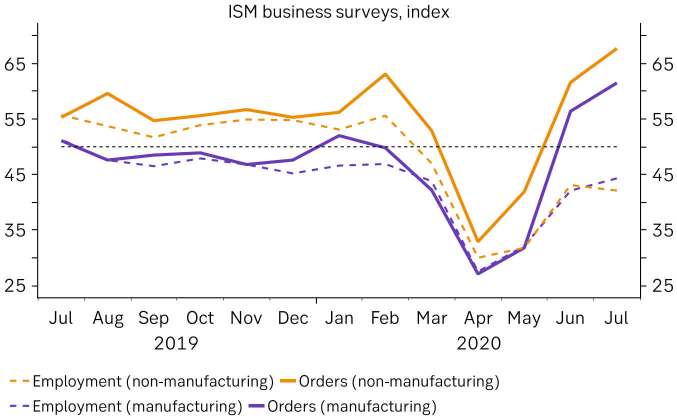
Brief slump in the housing market. The upswing in the housing market late in 2019 abruptly ended when the COVID-19 pandemic began. Since then, record-low home mortgage interest rates have led to a surge in mortgage applications. Home sales have rebounded, sustained in part by low inventory. Sentiment among home builders, according to the NAHB Index, is back at historically high levels, suggesting that new construction and residential investments will soon bottom out.

Low Fed rates while awaiting above-target inflation

Inflation fell sharply in the initial stage of the pandemic, but some of the extreme price declines were later reversed and this trend could continue in the short-term. Underlying inflation pressures are weak, however. We believe that the Federal Reserve will continue to have difficulty achieving its two per cent target for core inflation, using the personal consumption expenditures (PCE) deflator, but we still regard deflation risks as small. Changes in labour force structure – with mainly low-paid employees losing their jobs – have driven up the average rate of pay increases, but the low employment level should exert downward pressure on both wages and underlying inflation. Upward pressure from the USD weakening that we foresee is too small to markedly affect inflation. After aggressive actions during the spring aimed at stabilising financial markets and pushing down yields all along the yield curve, the Fed has largely left monetary policy unchanged at its recent meetings. Bond purchases will continue at a pace of at least USD 120 billion per month. Meanwhile, according to forecasts by members of the Federal Open Market Committee, the central bank will leave its key interest rate unchanged until 2022, as we have predicted. The focus of attention will be on the past year's review of the Fed's monetary policy framework, which will be unveiled at its September policy meeting. We believe that the Fed is moving towards average inflation target – allowing inflation to exceed its target for a period – after many years of downside misses. This may be clarified by a change in forward guidance, for example with the Fed promising to keep its key interest rate unchanged until inflation has stabilised above target, which would ease the Fed's monetary policy compared to earlier forward guidance and provide further support for its signals of zero interest rates lasting for the next several years. The Fed is also studying the possibility of emulating the Bank of Japan and the Reserve Bank of Australia by putting a ceiling on bond yields towards the far end of the yield curve (yield curve targeting, YCT). This technique enjoys only limited support among FOMC members and is unlikely to be considered until later in the recovery, as a way of supporting the Fed's interest rate guidance.

Recovering demand but no need to hire

ISM business surveys, index

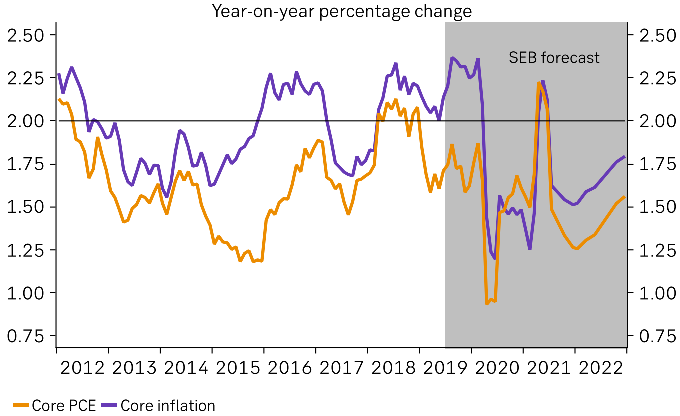


Source: Institute for Supply Management (ISM), Macrobond, SEB

Average inflation targeting would open the way for inflation to climb above target for a period

Fed's favourite measure will remain below target

Year-on-year percentage change



Source: Macrobond, SEB

Record-low long-term yields will ease the pressure to increase bond purchases. Our main scenario is that bond purchases will continue at current levels or higher, which implies that the Fed's securities portfolio will climb to a new peak of USD 7 trillion (more than 30 per cent of GDP) by year-end. A possible escalation of bond purchases may occur, however, if the Fed needs to offset upward pressure on yields caused by bond issues connected to new fiscal stimulus programmes. But the Fed's total balance sheet looks unlikely to grow as large as previously assumed. This is due to low utilisation of its loan facilities, with the Fed's announcement of planned corporate bond purchases in itself proving sufficient to stabilise the market.

Continued deficit policy after the elections

Fed stimulus measures played a crucial role in avoiding an acute financial crisis last spring, but they are creating new risks by pumping up asset prices and accommodating a continued deficit spending policy even after the acute COVID-19 crisis. The Trump administration has shown yearly federal deficits around 5 per cent of GDP, at the height of an economic boom. During the crisis year 2020, the deficit will climb to 17 per cent of GDP. The outcome of the presidential election is still uncertain, but we believe there is a high probability that Joe Biden will win. A change of president is unlikely to end the deficit policy, however. Aside from addressing lingering needs due to the pandemic, the left wing of the Democratic Party is pushing hard for higher spending on behalf of disadvantaged groups. All this can probably be only financed in part by higher taxes (see the theme article on page 24).

US-Chinese conflicts have escalated in recent months due to sanctions related to the effects of China's new security law on Hong Kong and to its suppression of the Uighur minority. The country's geographic claims in the South China Sea and Taiwan, as well as security risks and strategic competition in information technology, have also contributed to the escalation. This also raises questions about the US-Chinese trade agreement, which was signed in January after exhausting negotiations. As part of the agreement, China promised to increase its imports from the US by USD 200 billion during 2020 and 2021 compared to their 2017 level. By mid-year, China had met only about one fourth of this year's target but pledged to speed up future imports. The importance of these purchases has increased, given the general weakness of US exports, but China's weak adherence to its promises will mean that the agreement will not be the proud achievement that Trump had expected in the run-up to the presidential election. The risk that the agreement will be rescinded is growing as the election approaches, especially if Trump continues to trail Biden in the opinion polls. A Biden administration would adopt less confrontational rhetoric, but we do not believe its policies towards China would represent any dramatic shift.

Theme:

The US elections

Green left turn with Biden, or four more years of Trump?

Green investments, tax hikes for high income earners and companies as well as less trade-related drama are among the policy changes that can be expected if Joe Biden – who leads in the opinion polls – takes over the US presidency. This time around, there is uncertainty not only about the candidates but also the election process itself. Assuming a high percentage of postal votes, it might take weeks before the election is decided. The final winner may not be the candidate who leads the race on election night. This creates a risk of financial market volatility and increased political tensions.

A historic election, in the shadow of a pandemic. COVID-19 and the economic crisis have changed the circumstances surrounding the US presidential election on November 3. It is highly probable that Democratic candidate Joe Biden will win, but the outcome might remain uncertain for some time. The coronavirus situation, the pace of economic recovery and the outlook for a vaccine are three factors that may determine who wins. The economy is viewed as the most important factor among voters (79 per cent according to Pew Research). This is the area where President Donald Trump enjoys the highest confidence. But the most important issue for Biden supporters is the coronavirus (82 per cent). The polarised election landscape increases the risk of conflicts in case of a close outcome, which may threaten the legitimacy of the election among the losing side. This is especially true since postal voting is expected to be record-high. It may thus take weeks before the final outcome is known. The Republicans have announced no 2020 election platform, but refer to their 2016 platform. The president may throw in promises of payroll and capital gains tax cuts, for example, but another term for Trump can largely be expected to be a continuation of his policies of the past four years. The potential for change is instead tied to Biden's campaign promises and the prospect of another sharp US policy shift. This article examines the conditions surrounding the election and what changes a Biden victory might make in the economic policy field.

What does Joe Biden want?

Joe Biden was Barack Obama's vice president from 2009 to 2017 and belongs to the mainstream of the Democratic Party. But both the United States and the Democrats have been influenced by four years of Donald Trump. Biden will need to follow his party towards the left and adapt to a changed approach to the climate issue and globalisation. Just like the Republicans after Obama, bitter Democratic core voters – after the past four years of setbacks – want to see a radical shift in policies and a president who, like Trump, is not afraid to test boundaries. Since the winner of the primaries emerged, a task force with representatives of the Biden and Sanders campaigns have developed joint policy proposals. In addition to Biden's earlier campaign promises, these proposals provided input for the election platform approved by the virtual Democratic convention in mid-August.

Bidenomics: from Wall Street to Green Street. Green industrial policies, tax increases for high income earners and companies, support for union rights, an expanded social safety net and stopping the outsourcing of American industrial jobs are among the main points in Biden's economic policy. Some of the factors that have benefited the stock market under Trump – corporate tax cuts and deregulation – would be reversed under Biden. "Green" sectors such as renewable energy would enjoy higher priority, at the expense of "brown" sectors like oil. As for stimulus measures, we foresee fewer differences compared to the Trump era. Because of the need to continue stimulating the economy after the pandemic, federal fiscal policy will remain expansionary in 2021. Congressional Democrats have proposed more than USD 3 trillion in coronavirus-related stimulus, compared to USD 1 trillion for the Republicans. If Biden wins, parts of the Democratic package – such as more money for state and local governments – will probably be enacted in 2021 instead. Biden's climate agenda and social welfare promises make it hard to expect any return to tight fiscal policy after that. We expect yearly federal deficits of around 5 per cent of GDP during the rest of Biden's term, roughly the same as before the pandemic.

Biden's message – buy green and do it in the US. Biden's own version of Congress's "Green New Deal" combines market solutions with green industrial policies and quantifiable emission targets. Over a four-year period, Biden promises to invest USD 2 trillion – equivalent to nearly 2.5 per cent of GDP annually – in green infrastructure and green jobs, with a special focus on communities more exposed to pollution and climate change. US electricity production should be free of carbon dioxide emissions by 2035, and greenhouse gas emissions eliminated by 2050. Climate, environmental and health regulations from the Obama era that were scrapped by Trump would be restored, and the US would stay in the Paris Agreement on climate change. Unlike Sanders, Biden does not want to prohibit fracking (hydraulic fracturing), which is used to extract shale oil, or to scrap the use of natural gas and nuclear power. Biden's environmental policy is not as radical as the Sanders wing's, but still far-reaching. But the need to support the recovery from the coronavirus crisis makes it easier to justify massive clean energy investments. Linking climate policy to an economic agenda may also broaden its appeal. For many voters, climate change is not high on their priority list.

Biden's green agenda

USD 2 trillion in green infrastructure, jobs & R&D over 4 years
Carbon-pollution free electricity by 2035
Net-zero emissions no later than 2050
Build 500,000 charging stations within 4 years
Add 500 million solar panels & 60,000 wind turbines over 5 years
Energy make-over of 4 million buildings
Build 1.5 million new energy-efficient homes
Convert government vehicle fleet to electric vehicles
Rebates to swap to new clean American-made vehicles and and energy upgrades of appliances and windows
Rejoin the Paris Climate Agreement
Reverse roll-backs of 100 public health and environmental rules

Source: Joe Biden campaign, SEB

Tax hikes for high income earners and companies. During his primary campaign, Biden promised to reverse Trump's tax cuts for high income earners and boost payroll taxes on high incomes. Individuals who earn more than USD 1 million should also pay the same tax on capital gains as on work income. The corporate income tax would be raised to 28 per cent. The tax on foreign subsidiaries would be doubled. Biden would also like to introduce a minimum tax of 15 per cent to force highly profitable companies like Amazon to pay taxes. It remains to be seen whether this idea, which is based on taxing profits based on external accounting instead of a company's reports to tax authorities, can actually be implemented. Critics point out that the discrepancy is due to the availability of deductions that were created to encourage capital spending and other desired actions. In any event, the proposal signals a more confrontational approach towards information technology giants. Last spring, it was estimated that Biden's tax proposals could generate about USD 3.8-4.0 trillion in additional tax revenues over a ten-year period, about evenly divided between individuals and companies, of which 1/3 would come from the higher corporate tax. Since these tax hikes are also expected to have certain negative effects on growth, annual increases in revenue are expected to total about 1.5 per cent of GDP – well below the costs of Biden's climate-related investments.

Biden's tax hikes

Restore top income tax rate to 39.6 from 37%
12.5% payroll tax on high incomes (above USD 400,000)
Tax capital gains as income for those earning above USD 1 million
Corporate income tax hike (from 21 to 28%)
15% minimum tax on corporations with 100M in book profits
Doubling of tax on foreign subsidiaries (from 10.5 to 21%)
Deductions for renewable energy and an end to fossil fuel subsidies

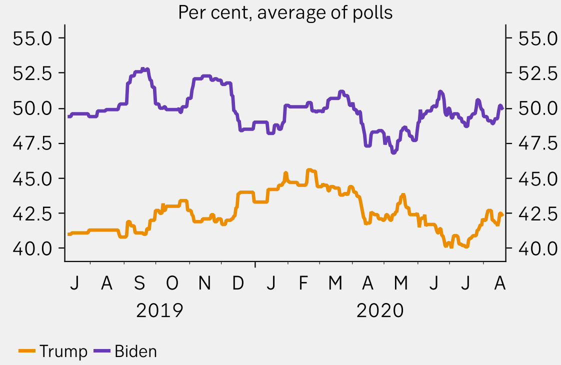
Source: Tax Foundation, Tax Policy Center, SEB

No return to Obama's trade policy. Trump's first term of office was characterised by an aggressive foreign trade policy, in sharp contrast to the pro-free trade philosophy of the Obama administration and Biden himself. But the picture of Democratic trade policy is more divided today. One of the slogans in the campaign is "Buy American". Rhetoric towards China has been stepped up. Biden is critical of Trump's unilateral tariffs, which in his view have harmed American industrial workers and farmers. Instead, the US should act jointly with allies and partners to isolate China in terms of trade policy. Whether this means that Biden also wants to abolish Trump's remaining tariffs on Chinese goods is unclear, however. Biden's message is that they will be reviewed. The party is proud of the labour and environmental provisions it helped to include in the new North American free trade agreement (USMCA). Biden has said that environmental and labour representatives will be involved in the task of negotiating new trade pacts and has proposed carbon fees or quotas to level the playing field within climate change. At the same time, investments in domestic labour should be prioritised before new trade agreements are signed. The rhetoric surrounding US contacts with traditional G20 and NATO allies will be changed, but the practical consequences are harder to judge. Overall, we believe that under Biden, the business community and stock markets can expect less drama related to trade policy, but without new breakthroughs.

Minimum wage, but no universal health insurance. Biden will not follow up on the demands of the Sanders wing regarding Medicare for All. One of the reasons is that many Americans apparently do not want to let go of their private health insurance. Instead, Obama's health care reform will be supplemented with a "public option". Another proposal that may have a major impact on the business community is Biden's promise to more than double the federal minimum wage from USD 7.25 to USD 15 per hour. In practice, the increase will be less in many places, since 30 out of 50 states have already boosted the minimum wage: from about USD 8.50 in Florida to USD 13.50 in Washington state. Today only Washington, D.C. has a minimum wage of USD 15 per hour. Many large companies, including retailers, have also raised their minimum wages at their own initiative, sometimes to exactly USD 15 per hour.

Can Biden enact his agenda? In 2018 the Democrats regained control of the House of Representatives, and they appear to have a good chance of retaining control after 2020, even if Trump is re-elected. Control of the Senate will be crucial. A divided Congress would make it very hard for Biden to enact his policies. It is common for presidents to begin their terms with their own party in control of both houses, but then lose ground in the midterm election two years later. This may give Biden a short window to push through the most important parts of his agenda, during which he must strike a balance between keeping up enthusiasm and not alienating centrist voters. One key issue is how the party will act on the issue of ending a "filibuster": a supermajority (60 out of 100 votes) is needed in the Senate to force a vote. This rule does not apply to budgets or approval of presidential appointments, but filibusters can stop economic initiatives that cannot be squeezed into the budget (and bills in a number of other areas). Abolishing the filibuster would require only a simple majority, but the party that takes this step will lower the future threshold for the opposition to push through controversial bills, also reducing the chances of holding radical internal opinions at bay and, above all, reducing need to reach agreement across party lines on reforms. The result may be an even more polarised, short-sighted political environment and more frequent major shifts on important matters of policy.

Presidential elections: Biden remains in the lead



Source: RealClearPolitics (RCP), Macrobond, SEB

Postal voting a new challenge. A polarised population, coronavirus concerns and an increased number of postal votes may turn the 2020 election into a cliff-hanger. In the 2016 election, 21 per cent voted by mail; ahead of the 2020 election, figures of up to 70 per cent have been mentioned. Because many states lack the infrastructure to count all these ballots, it may take weeks before final election outcomes are clear. Postal voting has also become a political issue: 58 per cent of Biden's voters plan to vote by mail, compared to only 17 per cent of Trump's. The president has attacked postal voting and earlier tried to block further money for the under-financed US Postal Service.

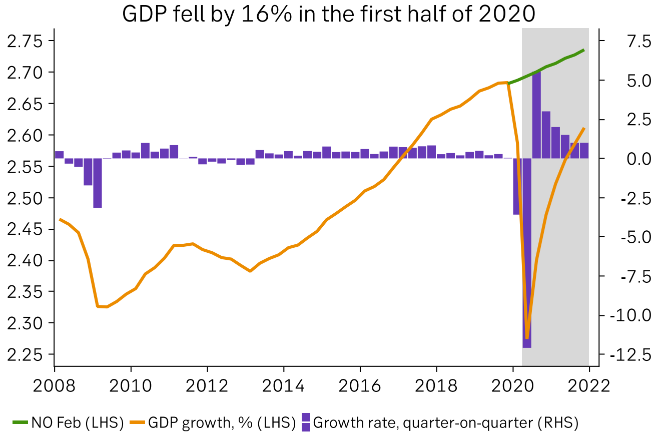
Can a blue shift enable Biden to win? Because Democrats vote by mail to a greater extent, this means that election outcomes can change during the vote counting. A new phenomenon in the 2018 midterm election was the "blue shift", in which Republican candidates initially seemed to have picked up more support than predicted, only to lose against Democrats in the final vote count. One scenario is that Trump proclaims himself the winner on election night, but Biden wins in the final count. Will Trump voters accept such an outcome after Trump has warned for years about postal voting fraud? On the other hand, a final victory for Trump may be hard for Democrats to accept if they suspect that problems with delivery of postal votes – or other obstructions aimed at Democratic voter groups – played a part. For voters, a lot is riding on this election. According to a study by Pew Research, the most common reason why voters support Biden (56 per cent) is that he is *not* Trump. The risk that election outcomes will lack legitimacy among the losing side's supporters may fan the flames of conflict even further in the US, making constructive cooperation in Congress more difficult.

The euro area

Clear north-south gaps in size of GDP declines

GDP has fallen sharply throughout the region, but the gaps between countries are striking. In Spain the decline was 24 per cent in the first half of 2020 compared to Germany's 12 per cent. The rebound now on its way will be led by households, while manufacturing recovery will occur more sedately. Large-scale crisis packages – including the new EU recovery fund – will provide support, but high unemployment and weak pay hikes will limit room for consumption. The ECB will rely on its QE policy.

GDP fell by 16% in the first half of 2020



Source: Eurostat, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.3	-8.8	6.6	3.4
Unemployment*	7.6	8.5	10.0	8.7
Wages and salaries	2.0	1.5	1.0	2.0
CPI	1.2	0.6	0.9	1.2
Public sector fiscal balance**	-0.6	-11.5	-5.8	-2.8
Public sector debt**	84,1	104,1	103,1	101,3
Deposit rate, %***	-0.50	-0.50	-0.50	-0.50
EUR/USD***	1.12	1.14	1.25	1.28

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

Rebound in indicators is hard to interpret

Indicators crashed to historical lows when lockdowns aimed at limiting the spread of COVID-19 swept across Europe in March and April. The subsequent rebound has been powerful as economies have reopened. Index levels are now above those we saw early in 2020. This suggests a clear third quarter upturn in production and demand, but sentiment data are unusually difficult to interpret since survey questions are often based on the direction rather than the strength of changes. Since some sectors were totally shut down in April and May, it is not surprising that a majority of businesses now view the outlook as improved. It is also mainly future expectations that are positive, while assessments of current conditions are more cautious. The PMI also abated in August, in particular in the service sector. This accentuates the risk that any re-imposition of restrictions in response to new virus outbreaks may limit the delicate recovery. Even assuming a more upbeat main scenario, it will take a long time to revert to pre-crisis GDP levels. We expect overall euro area GDP to fall by nearly 9 per cent this year: a somewhat milder downturn than we predicted in May. Our 2021 forecast has also been adjusted marginally higher to a 6.7 per cent rebound. The recovery will slow in 2022 to just below 3 per cent.

EU recovery fund: stimulus and closer cooperation

Rapid policy responses are providing both direct and indirect support. These measures help to ease the short-term economic downturn, while enabling many businesses to survive a period of production shutdowns, which in some sectors will be followed by a long period of weakened demand. Germany accounts for the most aggressive measures, with more than 8 per cent of GDP in direct stimulus during 2020, while this year's stimulus packages in the three other biggest euro area economies (France, Italy and Spain) are about 3-4 per cent of GDP. Postponed taxes, guarantees and loans account for an additional 10-30 per cent of GDP. These stimulus measures, combined with the new recovery fund, will enable the European Union to avoid the mistakes made during the euro crisis about a decade ago. At that time, countries that received support were forced to enact immediate large-scale cutbacks despite underlying weak demand. The reforms will deeply affect government finances, and even if crisis packages are followed by recovery policies, it will not be possible to maintain the current stimulus level. Overall public sector deficits in the euro area will climb sharply, reaching more than 10 per cent of GDP this year, but then fall in 2021-2022 as costly crisis packages fade. Public sector debt will soar, especially in 2020, and will remain above 100 per cent of GDP throughout our forecast period.

EU recovery fund will help calm tensions. For many years, we have become accustomed to major tensions and delays in EU negotiations about joint actions. But this summer, after Germany and France unveiled a joint proposal for post-pandemic recovery programmes, it was only a matter of time before EU heads of state and government reached a unanimous agreement, despite resistance by the "frugal four" (Austria, the Netherlands, Sweden and Denmark). The recovery package that leaders finally approved in mid-July is an important step, both in the short term and long term. It totals EUR 750 billion, or nearly 6.5 per cent of European Union GDP, and payments will begin in 2021. EUR 390 billion will consist of grants and the rest will be in the form of loans.

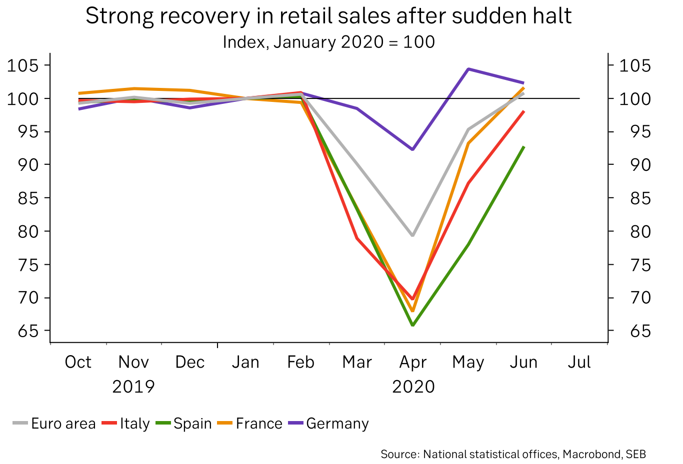
Clearer German support an important piece of the puzzle. In itself the package is a strong indication that the euro project is here to stay, giving the fund more weight than its actual size implies. Also confirming the solidarity within the euro area is the convergence of government bond yields between countries. Most importantly, Germany is now clearly signalling that it is not only increasing its own stimulus measures but is also prepared to help support the whole region financially. The recovery package also represents joint borrowing, and Brussels will now gain access to its own income channels. The EU has thus achieved a breakthrough on key issues that had previously encountered fierce resistance from some members. But major challenges meanwhile remain. Although the grants are relatively large, the fundamental difficulties facing highly indebted countries with chronic growth problems – such as Italy – still persist. The euro area has again bought itself time, but the remaining question is how it will manage the large economic and political differences between member countries.

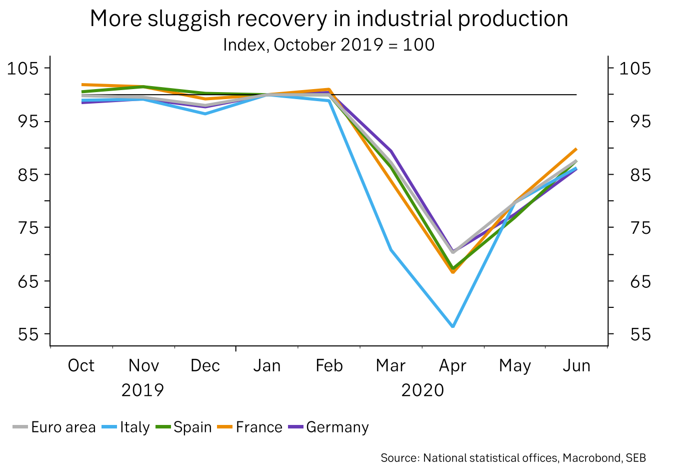
GDP growth forecasts

Quarter-on-quarter, Q1 and Q2 2020, and year-on-year, per cent

	Q1	Q2	2020	2021
Germany	-2.0	-10.1	-6.1	5.0
France	-5.9	-13.8	-11.3	9.2
Italy	-5.4	-12.4	-10.5	7.4
Spain	-5.2	-18.5	-12.7	10.0
Euro area	-3.6	-12.1	-8.8	6.6

Source: Eurostat, SEB





Major north-south differences in growth

All euro area economies saw dramatic GDP declines during the first half of 2020, but the gaps between countries were wider than expected. So far, the scale and duration of lockdowns have been the most important explanation, but sectoral structure and the size of rescue packages and fiscal stimulus programmes will play a larger role ahead. Of the four largest euro area countries, Spain was hardest hit. Meanwhile Italy sustained a somewhat less dramatic downturn than France (see table). The countries that have seen the biggest declines in growth so far this year will probably show the strongest upturns this autumn, but southern European countries are more dependent on services in general and tourism in particular. Recurrent regional restrictions due to new COVID-19 outbreaks and household caution suggest a slow recovery in the hospitality sector. This is one reason why Germany's GDP will regain its pre-crisis level faster than Spain, France and Italy. Our forecast implies that by the end of 2022 most countries in the region will have recovered to the point where the GDP level is higher than at the end of 2019. But not even towards the end of our forecast period will they be back at their potential growth trend. This means that resource utilisation will remain lower than before the pandemic broke out.

Slower recovery in manufacturing than in consumption. Due to its large share of GDP, falling household consumption has been the demand component that has contributed the most to GDP declines. Second quarter details have not yet been published in all countries, but in France consumption contributed 3 and 6 negative percentage points, respectively, to the respective total GDP declines of 6 and 14 per cent in Q1 and Q2. On the other hand, consumption has recovered significantly since economies began to reopen. This is partly due to pent-up demand after the lockdowns, especially for goods, which is clear from retail sales statistics. As expected, service sector consumption has meanwhile not recovered to the same extent. Retail sales are benefiting because people are buying more goods, whereas opportunities for consumption of services are still limited in many areas. In several countries, June retail sales surpassed pre-crisis levels (in Germany, this was already true in May). The substitution effect may continue to benefit retailers this autumn, but further ahead an upturn in employment will be needed in order to offset fading stimulus programmes and slow pay increases. Household saving has climbed in recent years, however, so there is a buffer even if employment growth is weak. Despite weak service consumption, households will be a major growth driver in 2021 and 2022.

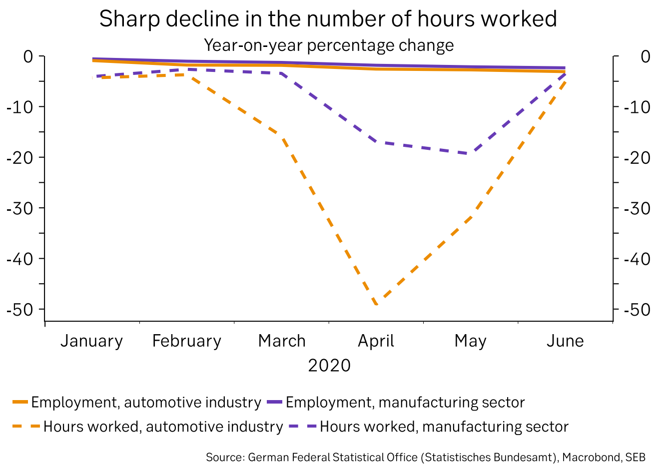
More sluggish manufacturing upturn. Industrial production fell very steeply in March-April. After a later rebound, large euro zone countries remain 20-25 per cent below earlier levels. We expect the upturn to continue at a cautious pace as manufacturers reconnect with global supply chains. The order situation has improved but in Germany, for example, it is still 10 per cent below pre-crisis level. According to sentiment indicators, global demand will remain weaker than domestic demand. Together with a stronger currency – the EUR/USD rate is already at its highest in more than two years – this will hamper exports. Capital spending has already fallen, and lingering uncertainty will continue to inhibit activity and contribute to weaker manufacturing growth. We expect investments to fall in 2020 and not rebound appreciably until 2022.

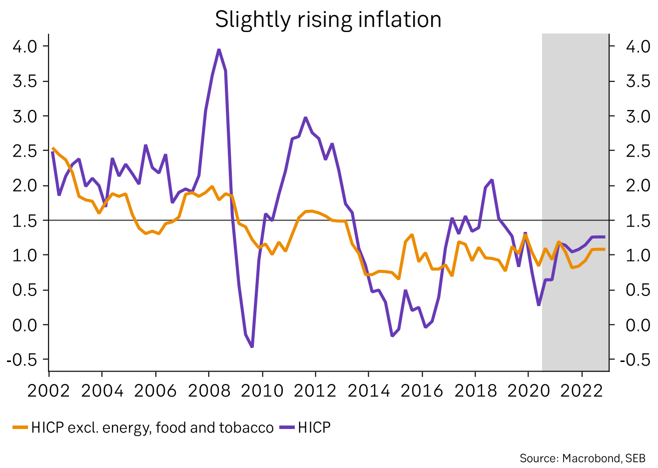
Unexpectedly smaller upturn in unemployment

The sharp downturn in GDP obviously hurt the labour market, but the increase in registered unemployment was less than expected (see Theme: Recessions and the labour markets). In the euro area as a whole, unemployment rose from 7.2 per cent in March to 7.8

per cent in June: a very small upturn, given dramatic GDP declines. The most important reason is that "short-time work" programmes have helped maintain the number of jobs. For example, the number of employees in German manufacturing during May was only 2 per cent lower than in the same month of 2019, while the number of hours worked was a full 19 per cent lower. In the automotive industry, the corresponding downturns were 3 and 32 per cent, respectively. In addition, many people left the labour force when the outlook for landing a job dramatically worsened due to the COVID-19 crisis. In Spain, for example, unemployment climbed by 1.5 percentage points in Q2, while employment fell by 4-5 per cent.

Short-time work programmes are maintaining employment, though the number of hours worked has plunged





Euro area unemployment will climb to 11 per cent by year-end. The strength of the recovery will determine future unemployment trends. Sentiment has improved in various sectors, but it will take time before the demand for labour reaches earlier levels. In particular, the continued focus on social distancing will hamper recovery in labour-intensive services. Some of the businesses using short-time work programmes are also likely to reduce their headcounts in the future when these programmes end. Although short-time work programmes have helped to stabilise national economies, further ahead they may adversely affect labour market mobility. We predict that unemployment will keep climbing during the next six months, peaking at 11 per cent early in 2021. After that it will start to fall, reaching around 8.5 per cent by the end of 2022. By way of comparison, unemployment peaked after the global financial crisis and euro crisis at about 12 per cent in 2013.

Core inflation will remain around 1 per cent

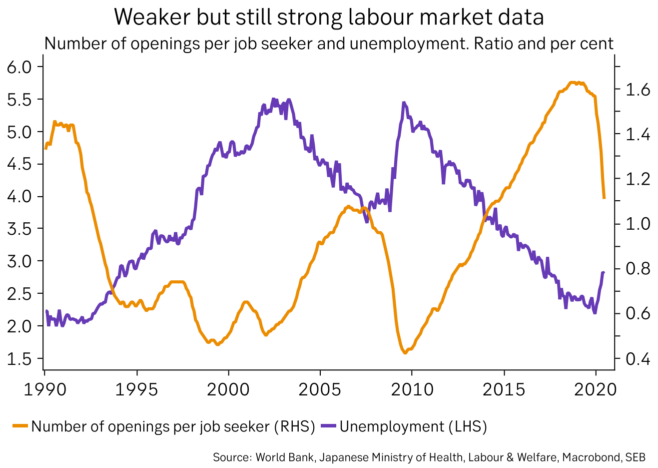
Core inflation has been around 1 per cent for some time. We believe it will stay there during the next couple of years. In the short term, inflation will vary more than usual, partly due to measuring problems. When sectors have partly or entirely shut down their operations, it has been difficult and sometimes impossible to record price trends. In France, the national statistics office abstained from trying to measure as much as 40 per cent of prices in the CPI basket between March and June. Other crisis management factors also affect inflation. In Germany, inflation fell in July because the impact of a temporary value-added tax cut proved somewhat larger than expected. But in France, customary seasonal sales could not take place. Price increases thus proved significantly higher than expected. In the overall euro area, inflation rose during July. Since this was clearly driven by temporary factors, it was nothing that the European Central Bank (ECB) needed to worry about. Looking ahead, conflicting forces will affect inflation. Weak demand will slow price increases, and low resource utilisation is likely to hold back pay increases for quite some time, though they have shown unexpected resilience so far. On the other hand supply-side disruptions, for example limitations on transport and mobility, will push up some prices. The ECB believes that disinflationary forces will be stronger during the foreseeable future. And although we see some risk that the ECB is playing down the effects of supply-side disruptions, they will hardly have any perceptible impact on future monetary policy.

ECB in a holding pattern, but prepared to buy more. Due to low inflation, there is nothing to prevent the ECB from continuing its expansionary policy in the next couple of years. Large public sector deficits more or less require its presence in the bond market. Like other central banks, it is also likely to show tolerance if inflation unexpectedly climbs above target. As for key interest rates, though, the ECB is already close to its lower bound, so the focus of attention will continue to be on actions involving its balance sheet, by means of asset purchases. It has only recently activated large asset purchase programmes (about 30 per cent) that will continue until the end of 2021. But the ECB is prepared to take further action as warranted. While it welcomed the EU's recent recovery package agreement, the bank continues to urge fiscal policy makers to be more active both at the national level and as part of EU cooperation – preferably with an emphasis on grants rather than loans. This year the ECB was forced to postpone its ambitious plan to undertake a review of its strategy and had to focus instead on crisis responses.

Japan

New problems being added to old ones

The COVID-19 crisis is lifting public sector debt to new record levels, but the BoJ will "guarantee" continued low interest rates. We expect a slow recovery, with downside risks predominating for growth and inflation and with inflation expectations at about 1 per cent. The inflation target will thus not be met during our forecast period. An ageing population will continue to impede growth, but faster digital transformation will help inspire hope.



Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	0.7	-5.8	2.4	0.7
Unemployment*	2.4	3.4	2.9	2.7
CPI excluding food prices	0.5	0.1	0.1	0.5
Public sector fiscal balance**	-3.3	-14.7	-6.1	-3.5
Public sector debt**	238	268	265	266
Repo rate***, %	-0.10	-0.10	-0.10	-0.10
USD/JPY***	109	110	113	113

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

Japan entered the COVID-19 crisis with a weakened economy and worryingly low inflation pressure. Manufacturers have been hard pressed by structural changes in the tech sector and elsewhere. The economy is vulnerable to stalled globalisation and increased protectionism. Temporary improvements in GDP growth last year due to factors such as preparations for the 2020 Tokyo Olympics and the installation of Emperor Naruhito have faded; if the Olympics are again delayed past 2021, demand will fall further. Added to this are the constant challenges posed by an ageing population. According to the Bank of Japan (BoJ), potential growth has fallen sharply during the past 5-10 years. The latest estimate before the COVID-19 outbreak was ±0 per cent.

Structural reforms are needed in order to raise potential output by boosting both labour supply and productivity. Creating some light at the end of the tunnel is the Shinzo Abe government's decision – a direct response to the crisis – to speed up Japan's digital transformation. This may help lift productivity through greater labour flexibility (teleworking) and access to digital care services.

COVID-19 management has been successful so far. The number of deaths has been low, totalling about 0.0001 per cent of overall population. But new virus outbreaks in recent weeks have raised questions about the "Japan Model". Partly due to a lockdown from mid-April to mid-May and tough social distancing rules, private consumption in the late spring was down 20 per cent compared to the same period of 2019. Mobility in large cities is still low. In Tokyo it stands at 10 per cent of normal, which points to a slow economic recovery. Unemployment climbed about 1 percentage point to nearly 3 per cent at the peak of the crisis but is expected to fall gradually as a result of decreased labour supply.

The government and BoJ have responded with aggressive economic policies to alleviate the acute crisis phase and stimulate growth. The government's two crisis packages totalling USD 2.2 trillion – more than 42 per cent of GDP – have also included cash payments to households and businesses. Given the traditionally high savings in the Japanese private sector, there is a substantial risk that this capital transfer from the public to the private sector will not help drive economic growth. Fiscal support measures are larger than the G20 average (12 per cent of GDP). Japan's public sector debt, which in early 2020 was expected to reach 240 per cent of GDP, is now projected to climb by some 30 points to 270 per cent.

The large corporate cash reserves that were built up over many years will give Japanese industry global competitive advantages, provided that the economy recovers this autumn. The BoJ has also offered low-interest loans totalling about USD 1 trillion to businesses. In addition, the central bank is carrying out practically unlimited purchases of securities, aimed at stabilising the entire yield curve ("yield curve control"). The government and BoJ are trying to reduce the risk that businesses and households will lower their long-term growth and inflation expectations. How companies choose to set their prices is being affected by weak demand and by production constraints. The downside inflation risk will persist.

We do not believe the BoJ will achieve its 2 per cent inflation target during our forecast period. Long-term inflation expectations among households and businesses have trended downward for the past five years and stand at about 1 per cent today (looking ahead 5-10 years). In the short term, corporate earnings have been boosted by lower oil prices and the government's support policy, but this is unlikely to help boost wages and thus inflation pressure. A falling US dollar also poses a downside inflation risk. We expect the USD/JPY exchange rate to be 110 at the end of this year, 113 at the end of 2021 and 113 at the end of 2022.

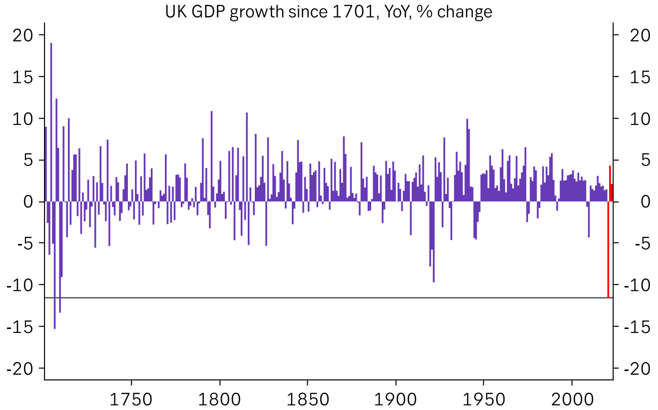
The United Kingdom

Uncertain future, due to Covid-19 and Brexit

Aside from the COVID-19 crisis, uncertainty about Brexit (withdrawal from the EU) has contributed to a fragile economy that risks being harder hit than other countries. A recovery is under way, but it is shaky. Capital spending and exports are hampered by the Brexit worries, while service sector is burdened by lockdowns and cautious households. Crisis policies are powerful, but unemployment is stuck at around 6 per cent. The outlook will greatly worsen if the UK ends up in a no-deal situation with the EU.

Sharpest GDP decline in more than 300 years

UK GDP growth since 1701, YoY, % change



Source: Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.5	-11.6	8.0	1.0
Unemployment*	3.8	4.9	6.2	5.9
Wages and salaries	3.5	-0.6	0.2	1.2
CPI	1.8	0.7	1.8	1.6
Public sector balance**	-2.1	-13.5	-7.7	-2.0
Public sector debt**	85.4	103.0	102.7	103.0
Key interest rate, %***	0.75	0.10	0.10	0.10
EUR/GBP***	0.85	0.87	0.83	0.81

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

British households were already vulnerable due to low savings when the COVID-19 pandemic struck. Lockdowns during the spring have now boosted the household savings ratio from 5.5 to nearly 8.5 per cent because of increased precautionary saving, limited mobility and government stimulus measures, which have supported household incomes relatively well. During the first half of 2020, GDP fell by 22 per cent, compared to an EU average of 15 per cent. Our full-year GDP forecast is -11.6 per cent. The recovery now under way will continue into 2021, when we expect GDP to climb by 8.0 per cent. We predict GDP growth of 1.0 per cent in 2022.

The government has implemented extensive measures to soften the impact of the pandemic. Fiscal stimulus programmes total an estimated 8 per cent of GDP, which is far more than the EU average, but they are causing already high public sector debt to grow rapidly. According to an OECD forecast, the government's 2020 borrowing requirement is expected to reach 23 per cent of GDP, thus pushing public sector debt to above 100 per cent of GDP this year. Such heavy debt is expected to constrain future growth.

Aside from COVID-19, Brexit is hurting the economy. Negotiations on a trade agreement with the EU are under way, but time is starting to run short. Manufacturers may be hard hit if an agreement – eliminating tariffs and trade barriers – is not in place when the transition period ends on December 31. The EU accounts for 46 per cent of goods exports and is thus the UK's most important export market. A no-deal situation would heavily penalise exporters.

The service sector has been much more severely affected by COVID-19 and this spring's lockdowns. The purchasing managers' index for services fell to a record-low 13.4 in April but has rebounded sharply, reaching 56.5 in July. In light of these dramatic fluctuations, it is hard to interpret such figures in terms of growth. There is thus a great risk that the pandemic will continue to hamper activity in the service sector while a failed EU withdrawal hurts the manufacturing sector. Our conclusion is that the cost of not reaching a UK-EU deal would be too high for both sides. We thus expect a trade agreement to be in place by the end of 2020.

The labour market was record-strong when the pandemic struck. Although the number of jobs has shrunk by about 730,000 since March, unemployment remained below 4 per cent in the second quarter. This is because most of the unemployed had not yet searched for new jobs. As many as 7.5 million people remain on furlough or temporarily away from their jobs, which explains the record-high downturn in hours worked this spring and summer. The government's Coronavirus Job Retention Scheme expires on October 31 and has protected more than 9 million jobs during the pandemic. There is an obvious risk that some of the people now on furlough will end up unemployed. We expect the jobless rate to climb rather quickly to 6.5 per cent towards the end of 2020 and to remain at around 6 per cent during the rest of our forecast period.

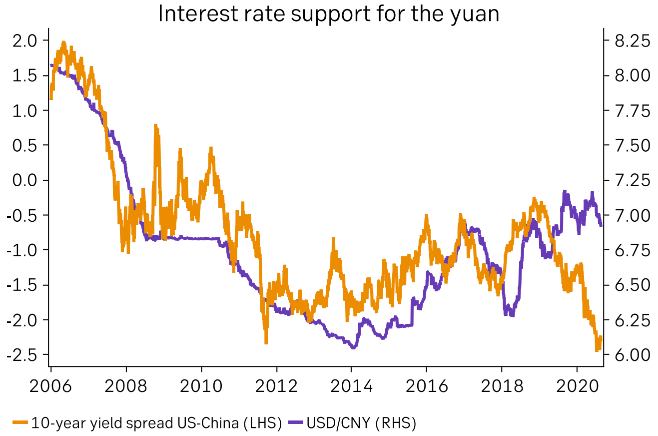
The British central bank (Bank of England) has reacted quickly and decisively during the pandemic. It has used essentially its entire arsenal, with cuts in the key interest rate to 0.10 per cent, bond purchases and a number of programmes to ensure the supply of liquidity to businesses and banks. Although BoE representatives have opened the door to negative interest rates, we expect the key rate to remain at its current level throughout our forecast period. The BoE is also likely to continue mainly using bond purchases if the economy needs more monetary policy support during the next couple of years. We expect further bond purchases of GBP 100 billion to be announced in November. A large GDP (or output) gap will hold back inflation and might force the BoE to carry out further rate cuts towards the end of our forecast period.

China

First in – first out...

The recovery continues. We are keeping our 2020 GDP growth forecast unchanged at 2.0 per cent, though the improvement is unevenly distributed among sectors. Labour market conditions remain weak. Private consumption is thus improving more slowly than investments and industrial production. The recovery has enabled China's central bank to ease liquidity injections into the banking system.

Interest rate support for the yuan



Source: Macrobond, SEB

Key data
Year-on-year percentage change

	2019	2020	2021	2022
GDP	6.1	2.0	8.0	5.6
CPI	2.9	2.9	2.2	2.2
Public sector fiscal balance*	-2.8	-3.6	-2.8	-2.8
Bank reserve requirement, %**	13.0	12.0	12.0	12.0
1-year lending rate**	4.15	3.75	3.65	3.65
Deposit rate, %**	1.50	1.50	1.50	1.50
7-day reverse repo rate, %**	2.50	2.10	2.00	2.00
USD/CNY**	6.96	7.03	6.95	6.75

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

China's economic recovery is continuing. Second quarter GDP growth of 11.5 per cent (3.2 per cent year-on-year) surpassed market expectations, but this recovery is uneven in various respects. Beijing's crisis policies have contributed to a sizeable supply-side improvement, but lingering challenges – for example, in the labour market – continue to hamper demand. We foresee a rebound to 8.0 per cent GDP growth from this year's 2.0 per cent, followed by 5.6 per cent growth in 2022.

After successfully halting the spread of COVID-19 in Wuhan, China has seen three new but far smaller virus outbreaks. Beijing now seems to have developed effective methods for halting the spread. Local, limited lockdowns around infection clusters have enabled the authorities to discover asymptomatic cases early, without negative impacts at national level. This approach is making it possible for China to continue its gradual recovery, even though it will be a while before an effective vaccine becomes available.

The labour market is showing signs of weakness. According to survey data, unemployment in urban areas stood at 5.7 per cent in June. This is close to the 6 per cent target set by the National People's Congress in May. Although the official jobless rate has fallen from its February peak, we believe that the figure underestimates the weakness of China's labour market. As new graduates now prepare to start their first jobs, the situation will deteriorate further. We thus expect private consumption to lag fixed investment and industrial production during the recovery. In the first half of 2020, retail sales were down 11.4 per cent compared to the same period of 2019.

The return to growth in Q2 has enabled the People's Bank of China (PBoC) to roll back some of its policy support. Since April, when it implemented a key interest rate cut and stepped up liquidity support, the central bank has resisted market pressures to lower both the bank reserve requirement and key rates. Since May, the PBoC has tightened liquidity to nudge interbank rates back to their "corridor". We foresee some further monetary easing with a lower Loan Prime Rate before the end of 2020. However, the PBoC's reluctance to take this accommodative step is understandable as long as interbank rates are not sustainably back above the 7-day repo rate.

We expect economic fundamentals to buoy the Chinese yuan. The decline in the US dollar since late March has strengthened emerging market Asian currencies overall, though they have appreciated less than G10 currencies. Since March, the yuan has climbed nearly 3 per cent against the USD. Support from interest rates is now providing a further buffer for the Chinese currency. Yield spreads between Chinese and US government bonds with various maturities are currently record wide. Meanwhile the PBoC has signalled that it no longer plans any additional major monetary easing. Unlike the US Federal Reserve, the PBoC has instead indicated a hawkish bias, which we expect to continue to bolster the yuan exchange rate against the USD.

Due to increased tensions with the US, the yuan will be unable to take full advantage of China's better real economic performance and its positive yield spreads against the USD. Although the yuan has appreciated against the USD, the RMB index – based on a basket of 24 currencies – has remained at a weak 92.1 (August). President Donald Trump's executive order to ban the Chinese apps TikTok and WeChat in the United States signifies an escalation of US-Chinese conflicts in the technology field. We expect further escalation of anti-Chinese rhetoric ahead of the US presidential election in early November.

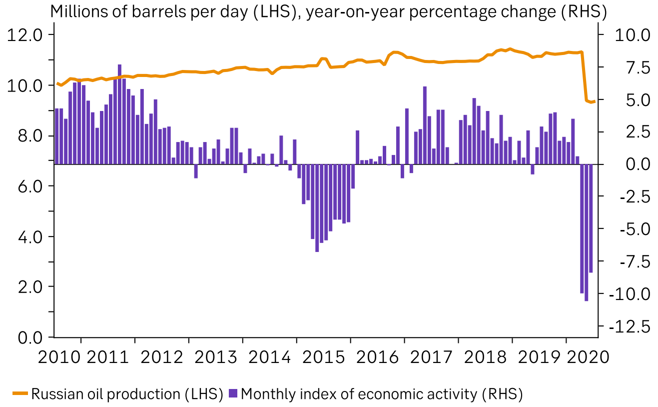
Russia

Hard hit by the pandemic

The Russian economy has been hit by lower domestic demand because of coronavirus-related restrictions, as well as a sharp drop in oil prices. Accompanying cutbacks in oil production have also decreased the room for fiscal stimulus measures. President Vladimir Putin's popularity has fallen, and local protests have broken out, but constitutional amendments that have been implemented will enable him to remain in office until 2036.

Covid-19 and lower oil production weigh on the economy

Millions of barrels per day (LHS), year-on-year percentage change (RHS)



Source: Russian Federal State Statistics Service (Rosstat), Energy Intelligence Group, Bloomberg, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.3	-5.0	3.7	2.5
CPI	4.5	3.2	4.1	3.5
Government debt*	14.0	17.9	17.0	15.5
Current account surplus*	5.8	1.5	3.0	4.0
Wages and salaries (nominal)	7.3	4.5	6.0	7.5
Key interest rate, %**	6.25	3.75	4.25	6.00
USD/RUB**	61.9	72.0	70.0	70.0

*Per cent of GDP **At year-end.
Source: IMF, Rosstat, Central Bank of the Russian Federation (CBR), SEB

Sluggish, uneven recovery. Like the global economy, the Russian economy is in a recovery phase after authorities have begun to ease pandemic-related restrictions. This recovery is anaemic and unevenly distributed. Auto sales are back at pre-crisis levels, but other retail sales continued to weaken in June, along with industrial production. Second quarter GDP fell by 8.5 per cent year-on-year. Large-scale coronavirus-related restrictions and relatively small fiscal stimulus measures contributed to the large decline. Another major explanation is the oil production ceiling that Russia and OPEC agreed on after oil prices fell to their lowest level in 18 years. We expect the economy to begin recovering in the second half of 2020 and believe GDP will fall by 5.0 per cent during the year as a whole, but the slow implementation of already announced policy measures aimed at boosting potential growth and living standards will hamper growth and contribute to a relatively weak recovery; we foresee 3.7 per cent GDP growth in 2021 and 2.5 per cent in 2022.

Inflation climbed to 3.4 per cent in July and is expected to rise a bit further in Q3 but remain at around the central bank's 4.0 per cent target. The upturn is mainly due to base effects and temporarily higher fuel and food prices. The CBR was already in an easing cycle in 2019 due to weak growth and falling inflation, but it speeded up the pace of key interest rate cuts when the pandemic struck. Since April the CBR has cut its key rate by 175 basis points to 4.25 per cent. We foresee further cuts to 3.75 per cent before year-end. The bank will continue pursuing its orthodox monetary policy and will stick to its inflation target. Once demand recovers and inflation shows signs of rising during the second half of 2021, we expect interest rate hikes, with the key rate reaching 4.75 per cent in 2021 and 6.00 per cent in 2022.

The rouble weakened by nearly 25 per cent against the US dollar when global demand for oil fell soon after the COVID-19 outbreak, as Saudi Arabia began aggressively pushing down the price level in order to expand its market share. The rouble recovered once expectations of a production ceiling within the framework of OPEC+ again started to climb. Yet in spite of rising oil prices, the rouble has weakened by more than 7 per cent since June – mainly due to worries about new American and European sanctions. If Joe Biden wins the US presidency, the risk of sanctions will increase, but we regard measures like those that have been imposed on Iran as unlikely, since they would hurt both American and European companies. We expect the rouble to stabilise after the US elections and to trade at 72 per dollar at the end of 2020, then strengthen along with oil prices to 70, where it will remain in 2022.

On May 11 the Kremlin declared its nationwide lockdown over. Since then, however, regional authorities have been able to make decisions on specific measures depending on local conditions. Various restrictions remain in place, but the relaxation of the national lockdown made it possible to carry out Moscow's traditional and symbolically important Victory Day Parade on June 24. This was followed by a national advisory referendum (June 25-July 1) which – by a wide margin – approved constitutional amendments that will allow President Putin to be re-elected for two more terms of office and stay in power until 2036. For better or worse, this means that only small changes in economic policy can be expected in Russia over the next 16 years. The Kremlin will prioritise Russian independence from other countries (mainly the US and the EU) by keeping the national debt and inflation low, while making gradual changes to improve health care, schools, infrastructure and the investment climate in certain fields such as information technology.

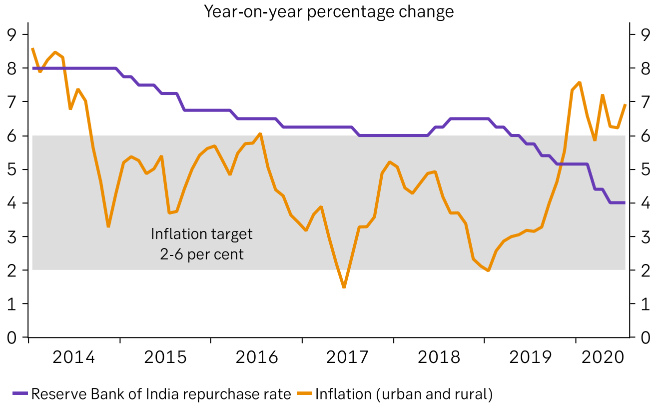
India

Slow growth after extensive lockdowns

The COVID-19 pandemic, which struck an already weak economy, has severely affected India. During Q2, GDP appears to have shrunk by 20 per cent year-on-year. The government has approved a relief package totalling 10 per cent of GDP and is discussing another package, but India cannot avoid recession in 2020, with GDP falling by 5.6 per cent. Continued restrictions will make recovery slow.

Central bank awaiting lower inflation before next rate cut

Year-on-year percentage change



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

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	4.9	-5.6	4.0	7.4
CPI	3.7	5.8	3.8	4.3
Public sector fiscal balance*	-7.4	-11.0	-7.3	-5.0
Current account balance*	-1.1	-0.6	-1.5	-1.8
Key interest rate, %**	5.15	3.50	3.50	3.75
USD/INR**	71.4	75.0	73.0	74.0

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

Ineffective lockdown. The government in New Delhi imposed one of the world's most far-reaching economic lockdowns on March 25. Everyone except members of essential occupational groups was ordered to stay home, which eliminated the livelihoods of millions of employees. The implementation of this home quarantine did not work, however, and India has still not overcome the spread of COVID-19. The country is now third in the world in terms of reported cases, but the actual figure is probably much higher. After a total reversal in May – with Prime Minister Narendra Modi urging everyone to go back to their jobs – it has been difficult to resume production. Many migrant workers who lost their incomes and homes moved back to rural areas and have not yet been able to return. Some states and major cities have retained or re-imposed travel restrictions after their hospitals became overwhelmed.

The COVID-19 pandemic struck at a time when the Indian economy was already weak. At 3.1 per cent, first quarter growth was the lowest since the global financial crisis. During Q2, GDP appears to have shrunk by a full 20 per cent compared to the same quarter of 2019. But not everything is gloomy. Many of the people who returned to rural areas have been able to benefit from unemployment programmes. Some have also been able to work in agriculture, which looks set to have a good year since the monsoon rains have been favourable so far.

Room for further stimulus measures. In May, the government unveiled a relief package equivalent to about 10 per cent of GDP. Discussions are now under way on a second package, since there is some room in government finances to temporarily increase spending, despite relative high public sector debt totalling 72 per cent of GDP in 2019. The budget deficit will probably far exceed 10 per cent of GDP, and the government is now gradually easing restrictions in order to attract foreign lenders. PM Modi has promised productivity-raising reforms, but the COVID-19 crisis seems to be leading the government to lose its focus on long-term strategy. We expect GDP to shrink by 5.6 per cent in calendar 2020 and then recover slowly – with growth of 4.0 per cent in 2021 and 7.4 per cent in 2022.

Inflation reached 7.4 per cent in December 2019. Although it has fallen a bit since then to 6.9 per cent in July 2020, inflation is above the central bank's target of 2-6 per cent. July inflation was mainly driven by disruptions in food distribution, but core inflation is also climbing. This relative high level poses a challenge to the Reserve Bank of India (RBI), but we expect inflation to fall in the coming months due to weak demand. This will allow a further key interest rate cut from the current 4.00 per cent to 3.50 per cent late in 2020. The key rate will remain unchanged until late 2022, when it will be raised to 3.75 per cent. The RBI will probably abstain from directly financing large portions of the budget deficit due to the inflation risk, but further politicisation of the bank's decision making cannot be ruled out.

The Indian rupee has weakened since the outbreak of the pandemic. During the rest of 2020 we foresee a flat trend for the INR against the US dollar, followed by some appreciation in 2021 as growth accelerates and the intensity of the COVID-19 pandemic fades. However, there is a major risk of reversals and a continued depreciation of the rupee, especially in 2021, due to relatively high inflation and negative real interest rates.

The Nordics

Sweden

The economy is recovering nicely after last spring's GDP decline. The housing market is resilient, but employment will remain chronically weak. New stimulus will arrive in the autumn budget. The Riksbank prefers QE to negative rates.

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Norway

The recovery has been faster than expected. Exports and the oil industry face headwinds, but domestic demand has been supported by fiscal stimulus. Norges Bank will shift policy direction, with a key rate hike in late 2022.

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Denmark

The country's broad, rapid reopening and relatively mild virus outbreak have limited the downturn in consumption. Full recovery is likely to take time, but Denmark will continue to perform better than most European countries.

Page 46

Finland

The second-quarter GDP decline was among the smallest in the euro area. Households have remained optimistic, leading to a rapid recovery in consumption after restrictions were lifted, but exports have been hard hit.

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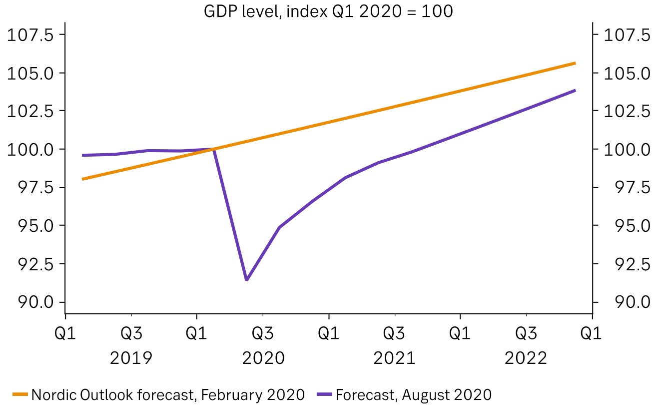
Sweden

Continued rebound

The second quarter of 2020 finally proved better than feared. Since then, the recovery has been healthy in most sectors. Various service sectors are the exceptions; due to a sluggish upturn in labour-intensive businesses, it will take time for the labour market to recover. Since costly reforms seem to turn out cheaper than expected, new fiscal stimulus is likely in 2021. Low pay increases and an even stronger krona will help to ensure low inflation. The Riksbank prefers quantitative easing to rate cuts.

GDP still below trend at year-end 2022

GDP level, index Q1 2020 = 100



Source: Statistics Sweden, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.2	-3.8	4.2	3.1
Unemployment*	6.8	9.0	9.6	8.4
Wages and salaries	2.5	1.2	2.2	2.5
CPIF (CPI excl. interest rate change)	1.7	0.5	1.2	1.5
Net lending**	0.5	-5.0	-4.0	-3.0
General government debt**	35.1	41.0	43.0	44.0
Repo rate, %***	0.00	0.00	0.00	0.00
EUR/SEK***	10.51	10.00	9.75	9.60

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

A decent second quarter after all. Partly due to more lenient COVID-19 restrictions, GDP fell by only 8.3 per cent during the first half of 2020, compared to 15.3 per cent in the euro area. Although the GDP rebound in the second half will be more modest than in countries that implemented more far-reaching lockdowns, we expect full-year 2020 GDP to decline by only 3.8 per cent: less than half the expected downturn in the euro area. But despite differences in lockdown strategies, Sweden does not stand out in a comparison with other Nordic economies. We anticipate 4.2 per cent Swedish GDP growth in 2021 and 3.1 per cent in 2022.

Some service sectors will suffer from abnormally low demand for a rather long time, forcing many small businesses to close permanently. Because this largely includes labour-intensive sectors, unemployment will remain at high levels throughout our forecast period. The relief programmes launched during the crisis have been utilised to a smaller degree than expected, which has decreased the burden on public sector finances. This creates more room for further stimulus measures. The Riksbank will end up under pressure, as low pay increases and a stronger krona result in continued below-target inflation, but we believe that the Executive Board's threshold for reverting to negative key interest rates is relatively high and that the central bank will instead continue to focus on its balance sheet.

Continued rebound for manufacturing and exports

Industrial production and merchandise exports fell by a total of 15-20 per cent during March and April, but during May and June they recouped nearly half of their downturn. The purchasing managers' index (PMI) in manufacturing has climbed to 51: a level normally associated with a very modest upturn in production. Despite weak international economic conditions, we believe that the recovery in industrial production will continue at a healthy pace during the third quarter. German industrial production in June showed record-high growth, despite a PMI at about the same level as in Sweden, which indicates that historical correlations do not apply today. Strong industrial production is one important reason why we have revised our 2020 GDP forecast higher since *Nordic Outlook* in May.

Moderate downturn in capital spending. So far this year, capital spending has remained largely flat. A slight downturn in business investments has been offset by a weak upturn in public sector investments. Falling business investments in manufacturing as well as in the service sectors hardest hit by the coronavirus crisis – for example transport and tourism – will contribute to an overall 7.5 per cent drop in capital spending this year. Home prices have already shown signs of recovery, indicating that the housing market is more resilient than feared. This will help to stabilise construction. Continued heavy demand for core public sector services – such as health care and schools – suggests a continued upturn in public sector investments. This is one reason why the total downturn in capital spending will not be as dramatic as previously feared.

Historic drop in consumption, but upturn has begun

Private consumption normally shows low volatility, since even during deep crises, households adjust consumption very gradually. In March and April, however, we saw a decline of nearly 13 per cent and the downturn in the second quarter is 9 per cent. The closest comparable period is the early 1990s crisis, when the decline was 5 per cent during a longer timeline. Durable goods and cars normally show the largest cyclical fluctuations, but the current downturn has been driven by consumption of services. Very low consumption in areas like restaurants, hotels, transport and cultural events accounts for almost the entire downturn.

Gradual recovery in consumption. In May and June, consumption rose by a total of 5 per cent, or less than half the decline in March and April. Looking ahead, the recovery will be determined in part by how much household consumption patterns change. It will probably take a long time before cross-border tourism is back at its 2019 level, when consumption abroad by Swedish households accounted for 6.5 per cent of total consumption. Portions of domestic service consumption are also likely to be hampered by restrictions for longer than expected. Consumption of goods and available services has instead risen, and retail sales are now 2.5 per cent higher than at the end of 2019. Consumption of goods and domestic services is expected to increase further, but the question is where the saturation levels are and how long substitution to these areas of consumption can continue.

Strong recovery for manufacturing orders

New orders, manufacturing sector, index January 2020 = 100

Source: Macrobond, Statistics Sweden, SEB

Household incomes and savings ratio

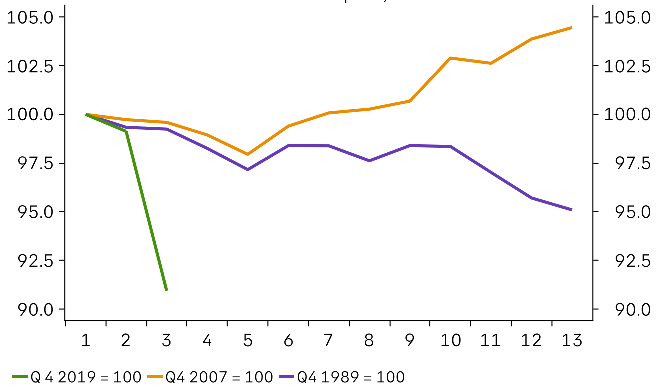
Year-on-year percentage change

	2019	2020	2021	2022
Real disposable income	3.4	-0.8	2.6	2.3
Private consumption	1.2	-3.5	3.5	2.7
Savings ratio, per cent of income	15.1	17.1	15.7	15.8

Source: Statistics Sweden

Unprecedented collapse in consumption

Private consumption, index



Source: Statistics Sweden, SEB

The housing market is stabilising. After falling by nearly three per cent during the spring, home prices have recovered and shown new record levels during the summer. SEB's Housing Price Indicator suggests that prices will continue to climb during the next few months, but we believe that rising unemployment during the autumn will cool off the market and that prices will fall slightly late this year and in 2021. We do not believe that the overall downturn will be larger than 5 per cent, which is significantly milder than we foresaw in our May report.

Fiscal stimulus measures are propping up purchasing power. Household incomes are now being squeezed by job losses and weak real wage increases, but fiscal stimulus measures – including higher unemployment and health insurance benefits – are helping to limit the decline in real household purchasing power to less than one per cent in 2020. The government's September budget bill for 2021 is likely to include further programmes, some of them presented as tax cuts. Fiscal stimulus measures are expected to boost total household incomes by nearly one per cent in 2021. Overall, real incomes will increase by around 2½ per cent both in 2021 and 2022, but high unemployment and lingering uncertainty about the future suggest that the household savings ratio will continue to climb to new record levels. Measured as full-year averages, we are forecasting that consumption will decrease by 3.5 per cent this year and then rebound by 3.5 per cent in 2021 and 2.5 per cent in 2022.

Public sector consumption also fell in the second quarter, among other things because education and non-coronavirus-related health care declined substantially, with higher absences due to illness among health care employees as one reason. Our estimate is that total public sector consumption fell by about 5 per cent. The burden of care for COVID-19 patients has decreased greatly, which is now helping to normalise the situation in the health care system. The same applies to education and other public services that shrank during the most acute phase of the crisis. A normalisation of public sector consumption is expected to contribute more than one percentage point to GDP during the second half of 2020.

Unemployment will peak at more than 10 per cent

The number of jobs fell by three per cent between February and June as a result of declining GDP. During the same period, unemployment rose by about two points to just above 9 per cent. During the summer, labour market indicators have greatly improved. For example, the number of lay-off notices during July fell to levels below those prevailing before the COVID-19 outbreak. The wage subsidy scheme introduced in March, which now covers more than 500,000 people or 10 per cent of the workforce, has probably played a major role in stabilising the labour market. This is confirmed by the number of hours worked, which has fallen far more than overall employment. Instead of cutting the number of employees, their working hours have been reduced with the help of wage subsidies. Increased sick leaves have also contributed.

New wave of employee cutbacks. Companies in sectors where no major improvement is discernible in the near future will probably begin to terminate employees. Our forecast implies that the number of jobs will fall by another two per cent, equivalent to 85,000 employees, during the second half of 2020. The phase-out of the wage subsidy system will lead to a gradual normalisation of average working hours after the previous large declines. Early next year a recovery in job numbers will begin, and by the end of 2022 we expect employment to be back at the same level as at the beginning of 2020. Unemployment will climb to 10.5 per cent by the end of 2020 and then fall to 8.0 per cent by late 2022: about one point higher than in the last quarter of 2019.

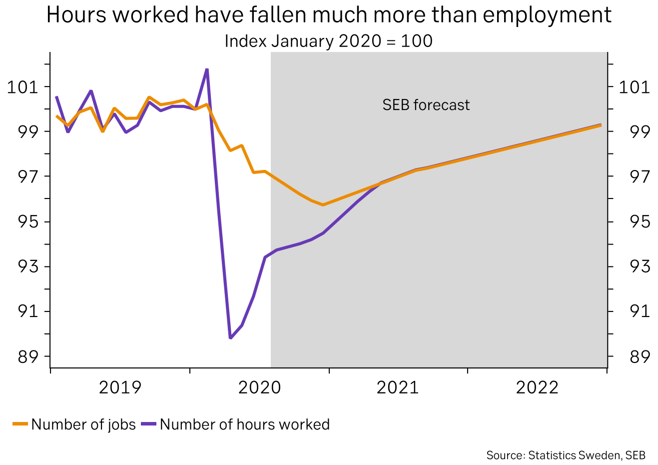
Record-low pay increases. Because of the dramatic outbreak of the crisis, employer and employee organisations cancelled their pay negotiations, which had been scheduled for completion in March. Industrial negotiations will resume in October, aimed at reaching collective bargaining agreements by the end of the month. Once industry has established a "benchmark", other sectors will probably reach agreements by around year-end. Ahead of negotiations, the two sides have positioned themselves according to traditional patterns, with employees seeing little room for nominal pay hikes while unions demand enough to give their members an increase in real wages. Yet both sides seem to agree that 2020 is a lost year and that wages and salaries should not be raised retroactively.

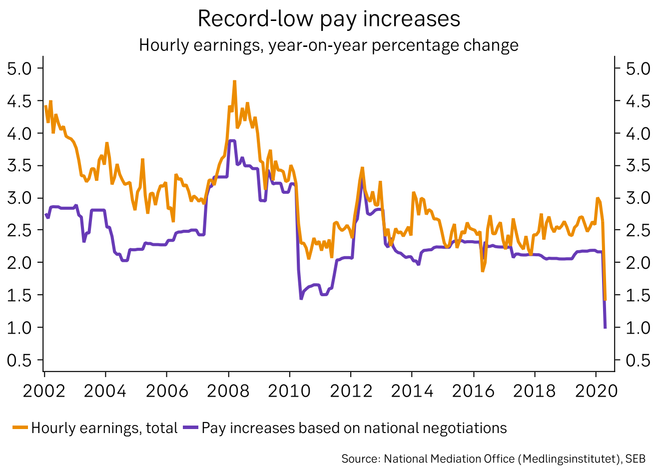
GDP, the labour market and productivity

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.2	-3.8	4.2	3.1
Employment, people	0.6	-2.3	-0.7	1.7
Employment, hours	-0.3	-6.5	2.5	2.4
Productivity (hours)	1.5	2.8	1.7	0.7
Labour force	1.1	-0.1	-0.1	0.4
Population	0.5	0.4	0.4	0.4
Unemployment	6.8	9.0	9.6	8.4
Labour force, % of population	68.3	66.4	65.6	66.4

Source: Statistics Sweden, SEB





In April, the rate of pay increases had fallen to 1.4 per cent: the lowest level since the current time series began in the early 1990s. The contractual portion of these increases was 1.0 per cent in April and will approach zero during the summer. Total pay increases are expected to fall below 0.5 per cent during the second half, and the average pay hikes for 2020 will be 1.0 per cent. This year's record-low wage and salary increases will probably be a major union argument in negotiations for future pay. We expect contractual pay increases to end up at about two per cent yearly in 2021 and 2022, despite the weak economic situation. Total pay increases will be 2.2 per cent in 2021 and 2.5 per cent in 2022.

Inflation well below the 2 per cent target

After falling below zero per cent during the spring, inflation rebounded this summer. However, CPIF fell to 0.5 per cent in July, mainly due to a temporary downturn in electricity prices. CPIF excluding energy prices fell from just over 1.5 per cent during the spring to slightly above one per cent, but during the summer a large part of this downturn was reversed. Weak demand for travel, hotels and other services has contributed to large price fluctuations. Prices of goods – for example, food and clothing – have also been affected by shifts in demand, and to some extent also by supply disruptions. In addition, certain prices have been imputed (estimated) in areas where restrictions almost completely halted consumption, for example international air travel and charter tours.

Exchange rate shift is pushing down inflation. The big price movements that the crisis has caused in some portions of the CPI basket are increasing the uncertainty of forecasts. But on the whole, it is still clear that inflation risks have diminished. Over the past five years, gradual krona depreciation helped push inflation higher, but now we foresee the opposite trend – with the currency helping to lower inflation for the next 12-18 months. For some time, food price increases have been higher than usual – especially last spring – but they have now begun to fall, due to low international prices and a stronger krona. A clear slowdown in pay hikes will also help ease inflation pressure during the next couple of years. We expect CPIF excluding energy to stabilise at a bit below 1.5 per cent this year and then climb a few tenths of a point during the spring of 2021 due to base effects. CPIF will increase a bit more noticeably until spring 2021 due to higher energy prices. International trends will be important to inflation further ahead. As in other countries, there are hard-to-assess supply side or demand effects due to the pandemic, which will pull in different directions. But our main forecast is that inflation will remain well below target in 2022 too.

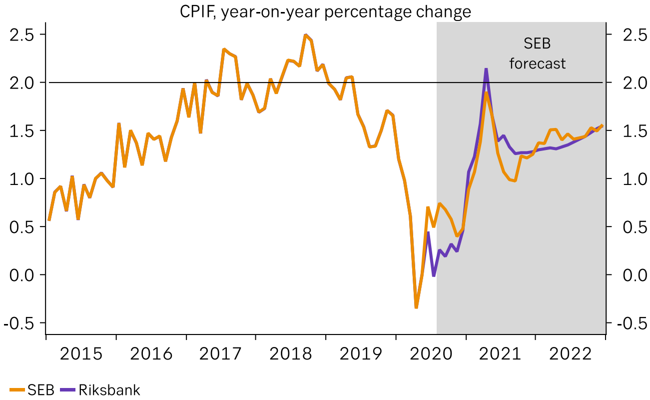
High bar for key rate cuts, lower for QE

Like the ECB, in July the Riksbank renewed its quantitative easing (QE) programme until mid-2021, while expanding its planned purchases to SEK 500 billion from the previous 300. The Riksbank also decided to start buying corporate bonds starting in September, in addition to the mortgage-backed, municipal and government bonds it already buys. Because of weak economic conditions and below-target inflation, the Riksbank is still under pressure to do more, but our main scenario is that the Board will hold off in the near future. The Riksbank's measures have already had their intended effect of squeezing credit spreads and general interest rates, while growth is about to rebound. The Riksbank is already forecasting that inflation will remain well below target until the end of 2023.

A strong krona and low contractual pay hikes are putting pressure on the Riksbank. The bar for expanding and/or extending bond-buying is probably rather low, however. Low inflation is already increasing sensitivity to downside surprises, especially if inflation expectations begin to fall. Disappointments about the strength of the recovery will probably also lead to QE expansion. As for new key interest rate cuts, the bar is much higher. All Board members are signalling that future rate cuts are conceivable. But as long as restrictions rather than demand are limiting growth, they are not effective. This argument will probably weaken as the pandemic fades and the focus shifts to the weak economic situation, but several Board members – including Governor Stefan Ingves – have maintained that the risk of negative side effects from rate cuts has risen as the balance sheet has swelled. Some have also expressed concerns that dramatic SEK depreciations like those seen in recent years may adversely affect confidence.

Below-target inflation

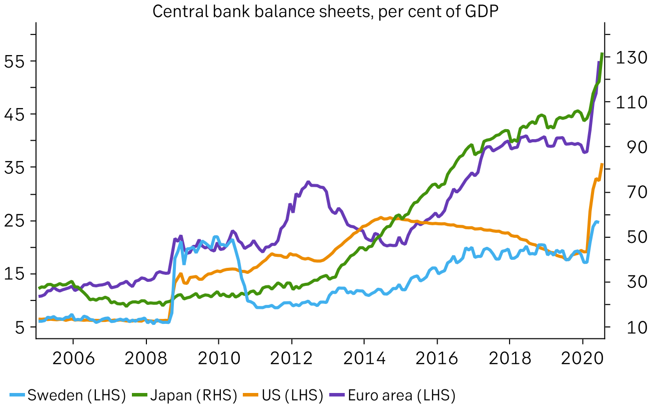
CPIF, year-on-year percentage change



Source: Riksbank, Macrobond, SEB

Modest increase in Riksbank balance sheet

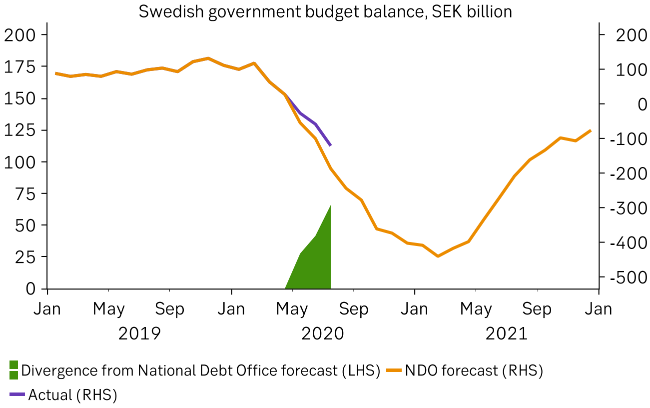
Central bank balance sheets, per cent of GDP



Source: Macrobond, SEB

Increasing budget deficit, but less than feared

Swedish government budget balance, SEK billion



Source: Swedish National Debt Office (Riksgälden), Macrobond, SEB

Continued strong krona appreciation might cause the Board to cut the key rate, but we believe that the krona will not climb all the way back to its equilibrium level and will thus not be a big enough problem to trigger rate cuts. The national wage round may also increase pressure for rate cuts, since contractual pay hikes look set to be at such low levels that the inflation target will be hard to achieve in the foreseeable future. Nor are employers and unions likely to press harder for new monetary stimulus, especially in an environment where the krona continues its upward march.

From crisis policy to reopening policy

Relief measures aimed at easing the impact of the pandemic have come thick and fast in recent months. Instead of the usual system of a spring and autumn budget, we have seen a total of nine extra amended budgets since mid-March. Aside from direct stimulus programmes, the authorities have launched far-reaching liquidity reinforcement measures and guarantees. During the summer, the government estimated that direct fiscal stimulus was equivalent to about 5 per cent of GDP, but recent data on unusually low utilisation of some programmes – especially related to short-term work – indicate a somewhat lower level. Other measures are more than twice as extensive, but they also have a lower utilisation level than anticipated. Further programmes can be expected, however, in order to strengthen the recovery and focus to a greater extent on sectors that are still facing an uphill battle. Due to strong underlying government finances, and since some programmes have proved far “cheaper” than expected, room for future actions will also increase.

As usual, crisis policies have been characterised by a political truce, with a laid-back opposition, but during the summer the temperature of political discourse has risen. The budget bill for 2021 (to be unveiled on September 21) will probably be a mix of extended crisis measures and more traditional stimulus programmes. We will probably see more long-term and ideologically coloured programmes, but they will be described as necessary crisis policy. To ensure that the January 2019 budget agreement remains in place, the Social Democratic-Green Party minority government must allow room for initiatives designated as vital by the other signatories, the Centre and Liberal Parties. The Liberals have already proposed SEK 30 billion in tax cuts, and the Centre will probably demand tax cuts and support for small businesses in the negotiations. Municipal and regional programmes as well as infrastructure and educational spending can also be expected. Some form of spending aimed at further stimulating residential construction is also likely.

Budget framework on hold. We expect a total of SEK 100 billion worth of extra spending in 2021. Due to the current focus on the COVID-19 crisis, the official fiscal policy framework – with its surplus target and debt anchor – is temporarily on hold. Because of the government’s extensive reform agenda, combined with a low level of economic activity, the budget deficit will remain relatively high throughout our forecast period. Although the burden on government finances will not be as heavy as feared, we estimate that the net lending deficit will reach about 5 per cent of GDP this year, then fall to about 4 per cent of GDP in 2021 and 3 per cent in 2022. As a result of the deficit and shrinking GDP, the public debt ratio will climb by nearly 10 percentage points in 2020 to almost 45 per cent of GDP. When nominal GDP recovers, the debt ratio will increase much more slowly to around 45 per cent of GDP in 2021-2022.

Theme:

Recessions and labour markets

COVID-19 a mix of financial and 1990s crises

The magnitude of medium-term consequences of a crisis is largely determined by labour market developments. Differences in European and US responses to the GDP decline have partly followed historical patterns, though unemployment has risen less than expected in Europe. In Sweden, the COVID-19 crisis carries traces of both the 1990s and global financial crises. The rapid policy response is reminiscent of the financial crisis, but labour-intensive service sectors are now also affected as in the 1990s.

This past spring, the main challenge to economists was to try to predict the size of GDP declines that lockdowns and other pandemic-related disruptions would cause. We are now entering a phase where labour market developments are of growing importance. More concretely, this phase will determine how big the damage will be further ahead, for example in terms of permanent job losses, household income trends and optimism. It will ultimately also determine how big the strains will be on public finances, and thus how much room there will be for fiscal stimulus to help sustain the recovery and respond to the next downturn.

Every crisis has its special characteristics. There are many factors that determine how deep the downturn will be and how its pattern will diverge from earlier crises. How severe the underlying imbalances are, and how rapid and forceful the economic policy response is, are of great importance to the general depth and duration of the GDP downturn. How unemployment reacts to a given GDP downturn also varies significantly between different countries and crises. For example, the subsequent upturn may be smoother because many people have completely left the labour market, or because productivity falls when companies retain employees while awaiting a recovery.

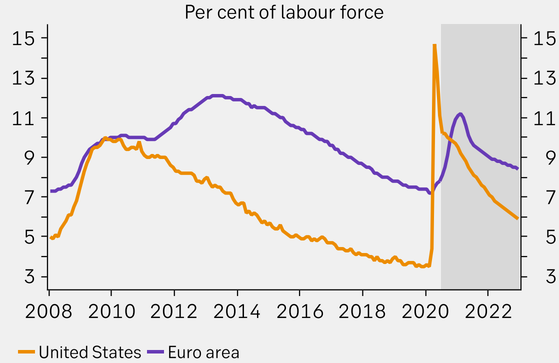
Rapid responses and minor imbalances

Early in the COVID-19 pandemic, it was possible to identify some positive factors compared to earlier crises in modern times. Relief measures could be launched rapidly, without decision makers having to worry very much about negative side effects, for example in the form of distorted incentive structures. Underlying imbalances also seemed minor. Both the early 1990s crisis and the global financial crisis are usually classified as "balance sheet recessions". In such recessions, it takes economic actors a long time to restore balance between liabilities and assets, which hampers demand. In the prevailing situation, there were instead reasons to be relatively hopeful about the strength of the recovery and the effectiveness of stimulus measures, once restrictions began to ease.

Unemployment is harder to predict than GDP. Looking back, we can certainly say that forecasts of GDP growth during 2020 have been reasonably stable since May, in particularly for large advanced economies. Meanwhile the downturn in regions like the Nordics and Baltics now appears to be milder than previously feared. Despite this, the unemployment outlook has undergone major revisions, reflecting new factors changing the relationship between GDP and unemployment.

Different time profiles for unemployment

Per cent of labour force



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

Major disparities between US and Europe

The differences between how labour markets work in the US and Europe are a recurring theme when discussing recession dynamics. In the most intensive phase of the global financial crisis, the unemployment in the US rose by about 5 percentage points. The upturn in the euro area during the same period was about half as large, although GDP fell more than in the US. After that unemployment declined in the US, while in the euro area unemployment was more persistent before the euro crisis pushed unemployment higher again.

The differences in GDP declines we are now seeing between the US and Europe are strongly reminiscent of the pattern from the financial crisis, but the differences in unemployment today are substantially larger. In little more than a month, US unemployment soared from 4 to almost 15 per cent. Since then it has fallen to 10 per cent in July. In the euro area, the upturn so far has been a very modest 0.6 percentage points. In Europe, employees who left the labour force reduced the upturn in unemployment. In addition, underlying systemic differences play a role, but the big difference is also explained by the structure of relief programmes and the definitions of metrics. In the US, people are registered as unemployed immediately after losing their job, even if the situation is temporary. Most "short-term work" programmes in Europe have been designed for people to retain their jobs, helped by a sizeable government subsidy, but work far fewer hours.

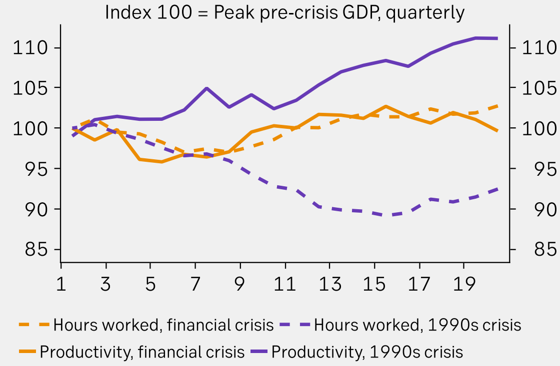
Job numbers stay high, but hours worked plunge. The ECB has estimated that in May, half of the people in short-term work programmes were not working at all. In Germany, the number of hours worked in manufacturing in June was down 19 per cent from a year earlier, but the number of employees fell by only 3 per cent. In France, unemployment would triple if people in programs were included among the unemployed. However, the significance of these differences will gradually fade, and our forecast of unemployment further ahead will be dominated by more underlying factors. In Europe, unemployment will probably keep climbing as these programmes end and as companies adapt to a situation of long-lasting relatively weak demand in many sectors.

Major structural changes are conceivable.

The consequences of the coronavirus crisis are also raising new questions about how labour markets are affected and what categories of people are most affected. One important dividing line concerns the connectivity of different jobs and whether people have the option of working from home, or whether their occupation requires a physical presence. The IMF recently published an analysis showing that differences of this kind during the coronavirus crisis are much bigger than during the financial crisis. The option of working from home often coincides with higher incomes, which means that weak groups in the labour market are hard hit to an even greater degree than in normal recessions. This adds a further dimension to the problem of widening economic gaps, which are now also being compounded by the way central bank stimulus measures drive up home and share prices.

Different productivity patterns during crises

Index 100 = Peak pre-crisis GDP, quarterly



Source: Statistics Sweden (SCB), Macrobond, SEB

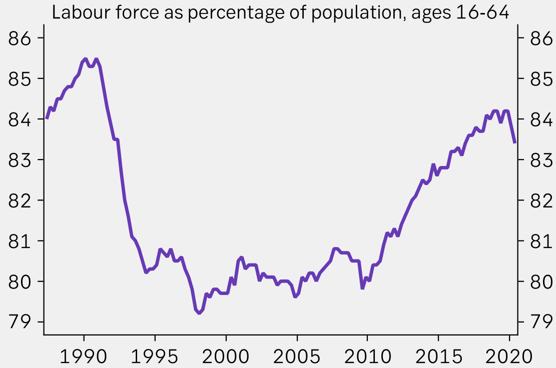
Swedish productivity surged during the 1990s crisis. It is not unusual for crises to trigger or at least coincide with major structural shifts in the economy that affect the labour market during the recovery. Sweden's

1990s crisis included several such phenomena. During the first phase of the crisis in 1990-92, manufacturers were pressed by a combination of international recession and an overvalued currency, for as long as Sweden could manage to defend its fixed exchange rate system. This forced them to enact tough efficiency-raising measures that marked the beginning of a period of high productivity growth in the entire economy. In the short term, this intensified job losses. The financial crisis showed a completely different pattern, with falling productivity and a modest downturn in hours worked, mainly attributable to manufacturing. Economic policy stimulus helped reduce the secondary effects on the labour-intensive service sector.

Lasting change, or back to the same old rut? We now see people hoping that the changes in behaviour patterns that the pandemic has forced on us will lead to a new surge in productivity, for example that we can now finally make large-scale use of the progress achieved in digitisation over a rather long period. The most obvious changes are related to our travel patterns and where we can work, for instance allowing us to decrease our use of various auxiliary services around our workplace by working more at home. It is possible the pandemic will change our travel patterns in ways that the climate debate has not yet managed to do. But we must not underestimate people's desire to return to the way things were. Humans are social creatures and will want to meet each other and experience other cultures in the future. So far, labour market forecasts are based on relatively cautious assumptions about future productivity trends.

Labour force downturn, but no exclusion

Labour force as percentage of population, ages 16-64

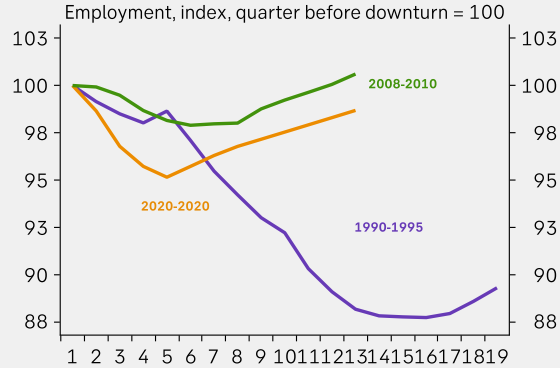


Source: Statistics Sweden (SCB), Macrobond, SEB

Temporary downturn in labour force participation. Another question concerns labour force mobilisation. The Swedish labour force decreased sharply during the 1990s crisis. Higher educational requirements, demographic changes and chronically weak demand for labour led to large-scale exclusion, among other things via early retirements. Overall, this slowed the upturn in unemployment. So far during the COVID-19 crisis, the decline in labour force participation is roughly on a par with what we saw during the financial crisis, although the current process has been faster. We expect a further decline in the short term, but a downturn like that of the 1990s is unlikely. The options for leaving the labour market have gradually decreased during the 21st century, partly due to lower benefit levels in social insurance systems. Low pension levels for various occupational categories and underlying demographic pressures are contributing factors.

Short-term drop in employment

Employment, index, quarter before downturn = 100

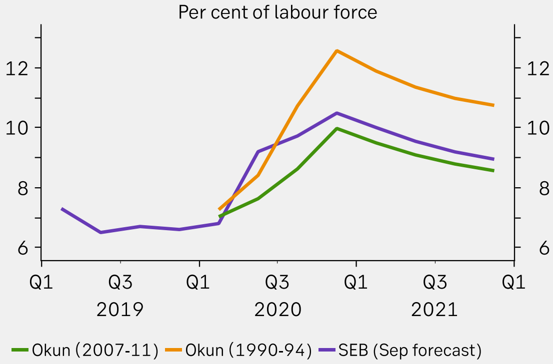


Source: Macrobond, SEB

Danger of long-term damage. Both productivity and participation rate trends underscore the importance of distinguishing between short- and long-term perspectives. When economic policy makers try to slow the upturn in unemployment, they must accept that production per hour worked may fall, or that university students will take a bit longer to complete their education, with lower labour supply as a consequence. The challenge to policy makers today is to avoid letting these side effects become permanent, for example because perpetually low interest rates reduce pressure for change in the economy and enable "zombie companies" to survive. Lasting low demand for labour also risks increasing chronic unemployment and permanent exclusion from the labour market.

Unemployment in different crisis environments

Per cent of labour force



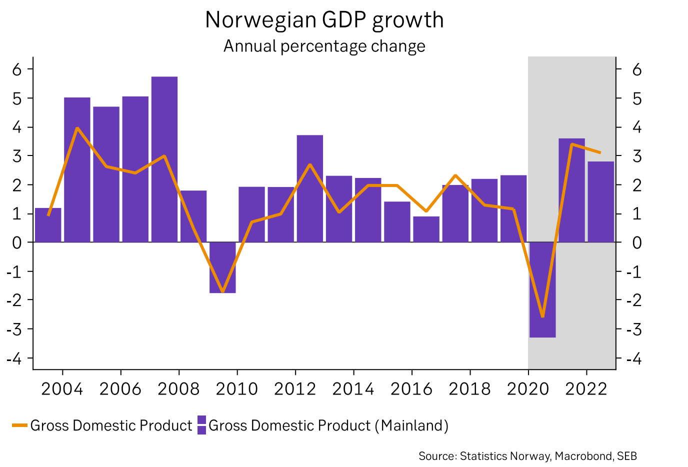
Source: Macrobond, SEB

More like the global financial crisis than the 1990s. The current Swedish labour market situation has features in common with both the 1990s crisis and the financial crisis. As in the financial crisis, economic policy ammunition was available and was also quickly used. However, as in the 1990s this crisis is having a broad impact on the entire labour market, including the service sector. We let the relationship between GDP and unemployment (Okun's Law) illustrate the differences. If the correlation were identical with the 1990s, registered unemployment based on our GDP projection would peak at 12.5 per cent instead of the 10.5 per cent in our main forecast. Assuming the reaction pattern during the financial crisis, on the other hand, unemployment would not exceed 9.5 per cent.

Norway

Better than feared

Though uncertainty remains high and downside risks have risen due to a resurgence in COVID-19 infections, we now predict a less deep contraction in mainland GDP in 2020. Economic activity spurred by household demand has picked up earlier than envisaged, and the policy response has been unprecedented. The recovery will nonetheless be dented by weak oil sector activity. Low interest rates are fuelling home price gains, so Norges Bank will start lifting its key interest rate late in 2022.



Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.2	-2.6	3.4	3.1
Mainland GDP	2.3	-3.3	3.6	2.8
LFS unemployment*	3.7	5.4	4.5	3.9
Annual wage and salary increases	3.5	1.9	2.5	2.7
CPI-ATE inflation	2.2	2.9	2.1	1.7
Key interest rate, %	1.50	0.00	0.00	0.25
EUR/NOK**	9.84	10.35	9.90	9.80

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

The trough in economic activity has been passed

Activity in the Norwegian economy came to an abrupt halt in mid-March when the government implemented extensive containment measures to combat the pandemic outbreak. Mainland GDP posted a sequential drop of 2.1 per cent in Q1 and a combined 11.0 per cent fall from February to April. The country gradually reopened starting in late April. Most restrictions were eased in the following month, aside from some related to foreign travel and social distancing. Economic activity thus picked up somewhat earlier than we had projected in May's *Nordic Outlook*, but the recovery has so far been moderate. Mainland GDP rose by 2.4 per cent in May, dented by a further decline in oil and commercial services as well as in portions of manufacturing. This underpins our assessment that the recovery will be hampered by weak external demand and low oil prices. It will take time for economic growth to recover fully from the pandemic crisis and the resurgence in infections since late July adds downside risks. The government has responded by halting reopenings, and tightening travel restrictions and opening hours for some restaurants and bars. The risk of more extensive lockdowns on a regional basis cannot be ruled out but is not our main scenario.

The economic outlook remains uncertain and dependent on the outcome of Q2 GDP growth (the national accounts will be published on Aug 25). However, we are now predicting a smaller contraction in 2020 due to the earlier pick-up in economic activity and the stronger scope of policy response supporting household demand. We forecast that mainland GDP will fall by 3.3 per cent in 2020, followed by a 3.6 per cent increase in 2021. Total GDP will fall by 2.6 and rebound by 3.4 per cent in 2020 and 2021, respectively.

Norway's way out of the crisis is being smoothed by broader fiscal support, which will stimulate demand in the recovery phase. The fiscal response has been unprecedented, since the government has utilised the flexibility offered by the "fiscal policy rule". For the first time since 1995, Norway is running an overall deficit and is using capital from Government Pension Fund Global (GPFG) to fund the budget. The fiscal contribution amounts to 5.3 percentage points of mainland GDP, and petroleum spending equals 4.2 per cent of GPFG. We expect fiscal policy to remain expansionary in 2021.

Clear split within manufacturing

The manufacturing sector has been hard-hit by infection control measures, a sharp fall in external demand and lower oil prices. Production fell 7.5 per cent from February to May, driven by a 13 per cent fall in petroleum-related industries. Meanwhile production of traditional goods only declined by 5 per cent. Shipments of traditional goods will nonetheless fall substantially this year. There is high uncertainty attached to the recovery trajectory, but we have assumed a gradual normalisation in such exports from 2021.

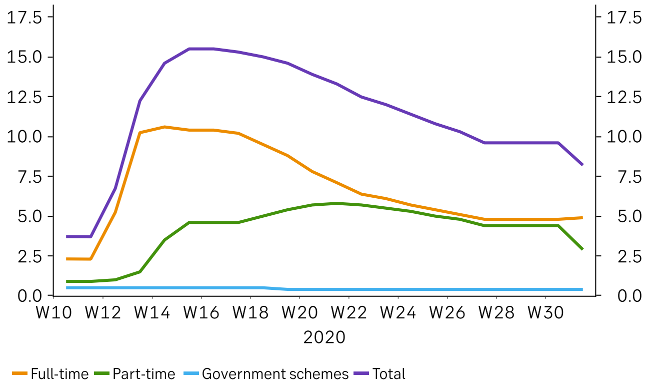
Manufacturing sentiment rebounded in Q2, but the petroleum-heavy capital goods sector was a drag on sentiment which signals a sluggish recovery in manufacturing. The outlook for petroleum investment was gloomy even before the virus outbreak, and the collapse in global oil prices will accelerate the spending downturn. A fiscal support package to the industry was approved in May and included temporary changes to the tax system aiming to improve companies' liquidity and ability to complete already planned projects. Statistics Norway's Oil Investment Survey for Q3 was therefore better than feared due to larger capacity expansions and a new development project. We now forecast a cumulative decline of 10 per cent in petroleum capital spending in 2020-2021 compared to 16.5 per cent in May. Growth in mainland business investment is expected to correct lower this year due to low capacity utilisation and sturdy growth in recent years. We forecast that gross fixed capital spending to subtract 2.2 percentage points from GDP in 2020, while being broadly neutral in 2021.

A revival in private consumption

The various infection control measures and travel restrictions have led to changed consumption pattern; households are spending less on services in favour of certain retail goods. Increased jobless benefits and record-low interest rates have also mitigated the effects on consumption. Household goods consumption, which gained a modest 0.1 per cent in 2019, rose 12.4 per cent from March to June. Spending on services should rebound this autumn but will be a drag on overall private consumption in 2020. We forecast that private consumption will fall by 4.1 in 2020 and rebound by 4.4 per cent in 2021.

Registered unemployment rates

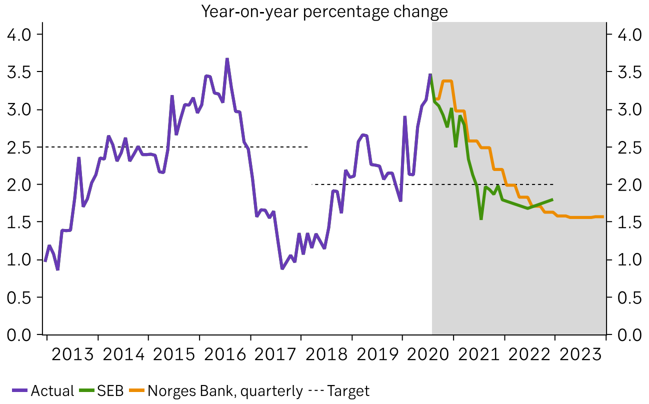
Per cent of labour force



Source: NAV, Macrobond, SEB

CPI-ATE inflation at the peak

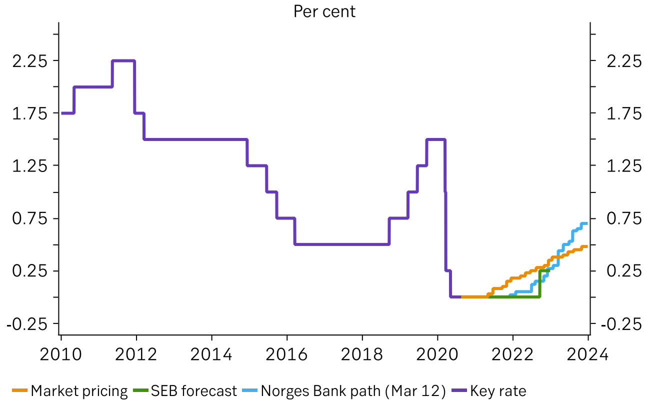
Year-on-year percentage change



Source: Bank of Norway (Norges Bank), Statistics Norway, Macrobond, SEB

Expectations for Norges Bank

Per cent



Source: Bank of Norway (Norges Bank), Macrobond, SEB

Low interest rates fuel home prices

Norges Bank's rate cuts have greatly lowered household borrowing costs, since almost 95 per cent have floating rate mortgages. The government has temporarily eased mortgage regulations, allowing banks greater flexibility in their lending. This has caused existing home prices to soar; the year-on-year increase was 4.9 per cent in July, and average prices so far this year were up 2.9 per cent compared to the same period in 2019. Sales in July were record-high, and a rapidly declining inventory ratio suggests that short-term price momentum will stay positive. We forecast an annual increase in existing home prices of 3.9 per cent in 2020 and 4.7 per cent in 2021.

Unemployment driven by furloughs

The registered unemployment rate surged from 2.3 to 10.7 per cent in March, of which 90 per cent reflected furloughs. The easing of business restrictions has led to more employees being called back to work, and the full-time jobless rate has declined to 4.9 per cent. The rapid decline suggests that businesses may have exaggerated the fall in demand, but still nearly half of full- and part-time unemployment represent furloughs. In August the government extended the period an employer can furlough staff from 26 to 52 weeks. Redundancies have so far been moderate, but companies have stated that they will assess the situation this autumn. We forecast an average Labour Force Survey jobless rate of 5.4 per cent in 2020, which will gradually fall to 4.5 per cent in 2022.

Inflation will fall below target in 2021

Inflation has been volatile in recent months. Signals that CPI-ATE (excluding taxes and energy) was about to culminate in the spring were defied by a renewed rise during the summer. The year-on-year rate rose to 3.5 per cent in July, which is in line with peak levels from the past 20 years. The weak krone is an important driving force and the exchange rate is expected to continue to exert upside pressure on inflation during the second half of 2020. The recent strengthening of the krone will, however, contribute to a decline in CPI-ATE to below Norges Bank's target in 2021. Service prices, which are normally less affected by exchange rate movements, have also risen significantly since the end of 2018 despite muted wage pressures. Unusually large price increases for services such as health care are a partial explanation, but the acceleration is relatively broad-based. Some temporary driving forces in combination with moderating wage growth suggest that service inflation will ease, but uncertainty is unusually high. Falling electricity prices will weigh on CPI this year, but futures prices indicate that electricity prices will normalise by the end of this year. We expect CPI to increase by 2.3 and 2.1 per cent in 2021 and 2022, respectively, which is faster than the rise in CPI-ATE.

Norges Bank eyeing policy normalisation

Norges Bank has acted forcefully during the pandemic, delivering two emergency rate cuts and a total 150 basis points worth of key interest rate cuts to 0 per cent. In June the bank ruled out further rate cuts and shifted its focus towards policy normalisation. Norway's flexible inflation target, allowing for temporary inflation deviations and leaning against the wind, makes Norges Bank once again stand out from its peers. The central bank is signalling a first rate hike around year-end 2022, followed by two more during 2023. The strong transmission mechanism means that keeping the rate too low for too long will fuel a build-up in financial imbalances. We believe such considerations are likely to justify a rate hike in autumn 2022, despite the output gap remaining negative. We forecast a key rate of 0.25 per cent by year-end 2022.

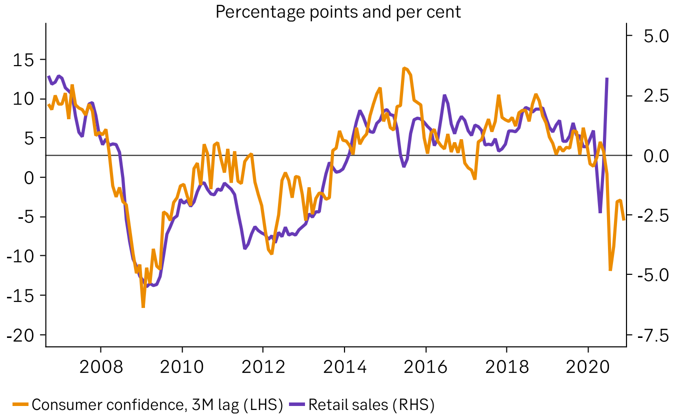
Denmark

Ahead of the pack

Denmark's reopening was faster and more comprehensive than expected, and the relatively mild virus outbreak had little lasting effect on consumer behaviour. We are thus raising our GDP forecast for 2020 to -4.5 per cent. A full recovery is still likely to take time, but strong fundamentals suggest Denmark will be among the leaders in the recovery.

Consumers are driving normalisation

Percentage points and per cent



Source: Statistics Denmark, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.3	-4.5	5.0	2.5
CPI	0.8	0.4	0.9	1.3
Wages and salaries	2.0	2.0	1.0	1.0
Public sector fiscal balance*	2.0	-10.0	-6.0	-5.0
Public sector debt*	33.5	42.0	44.0	44.0
Current account*	8.0	6.0	8.0	8.0
Key interest rate (CD rate),%	-0,75	-0,60	-0,60	-0,60
EUR/DKK**	7.45	7.45	7.45	7.45

*Per cent of GDP. **At year-end. Source: Statistics Denmark, DØRS, SEB

Historical hit to growth, but it could be worse. After the release of *Nordic Outlook* in May, we raised our Danish GDP growth forecast from -10.0 per cent to -6.5 per cent due to a faster and more comprehensive reopening than planned. We are now upgrading it further to -4.5 per cent, followed by an increase of 5.0 per cent in 2021. In 2022 we expect GDP to grow by 2.5 per cent. The recently published GDP indicator from Statistics Denmark points to a historically large quarter-on-quarter decline of 7.4 per cent in Q2, significantly worse than the 2.1 per cent downturn in Q1. Although this is the largest decline in Denmark's GDP on record and it will take a few years before growth is back on trend, the impact has been smaller than in most other European economies and the reopening strategy is looking more effective. The main risks to the forecast are weaker global demand and a renewed virus outbreak.

Some restrictions remain. The lockdown in March was fast and aggressive, but as noted in our update from June 5, the normalisation process was also faster than expected and this has continued throughout June and July. The virus still has a presence; some restrictions remain in place and the government has just announced that 'phase 4' of the reopening will be significantly scaled back after local outbreaks this summer. However, consumers appear unaffected, most likely due to the low level of virus cases.

Consumers are driving normalisation. The reopening has led to a fast return to normal spending patterns. Retail sales jumped 9.4 per cent in May and the positive trend continued into June with a further 1.4 per cent increase, mainly driven by apparel. Consumer confidence worsened in August. Consumers remain sceptical of major purchases and have become less optimistic on the economic situation over the next 12 months. On the other hand, there is surprisingly little impact on the housing market; after a few months of stagnation, prices have started to pick up again. This is better than expected in the early stages of the crisis, reflecting the impact of effective income support and very low mortgage rates. We expect consumption to lead the economy out of the crisis, with 5.3 per cent growth in 2021.

Unemployment masked by furlough schemes. The fast reopening has led to a swift return to the labour market for the majority of those under the furlough scheme (reduced considerably from 200,000 to 60,000 over the summer) without a significant spike in unemployment. This suggests that secondary effects will likely be more limited. The latest weekly unemployment numbers also show signs of improvement. However, because the furlough schemes expired on August 8, the question is how income and the propensity to consume will be impacted during the autumn. We expect unemployment to peak at 9 per cent by year-end, declining to 6 per cent in 2022. This is still a bit above the pre-COVID-19 level, and we think the economy has enough slack to grow above trend even beyond 2022.

Lower deficit than expected. The government overestimated the cost of the rescue packages. Compared with its assessment in May, the actual outcome over the summer has been almost DKK 50 billion (more than 2 per cent of GDP) better than expected. This year is still expected to see a relatively large deficit due to deferred tax payments, but the funding requirement is likely to be smaller next year, at least if we avoid a further spike in unemployment. Meanwhile, the pressure on the DKK that forced Danmarks Nationalbank (DNB) to hike rates in March was quickly reversed and the DKK is now stronger than its parity rate against the euro.

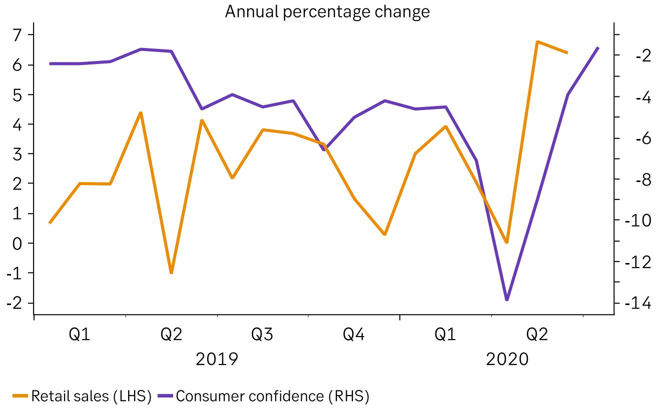
Finland

Surprising resilience

On the back of dramatic economic data coming from other parts of Europe, Finland looks almost untouched by the crisis. Consumer confidence now exceeds even last year's level, which has greatly benefited domestic demand. On the other hand, Finnish exports have been severely hampered, causing GDP to decline by 2.9 per cent this year. The economy will return to a moderate growth path in 2021, supported by a broad-based global upturn.

Strong consumer sentiment supports sales

Annual percentage change



Source: Eurostat, Statistics Finland, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	1.1	-2.9	3.2	2.2
Private consumption	0.9	-1.3	2.1	1.6
Exports	7.5	-9.7	5.5	3.6
Unemployment*	6.7	8.6	8.2	7.6
Wages and salaries	2.2	1.5	1.8	2.3
HICP inflation	1.1	0.1	1.5	1.8
Public sector fiscal balance**	-1.1	-7.6	-4.5	-3.0
Public sector debt**	59.4	70.2	72.0	71.5

* Per cent of labour force ** Per cent of GDP. Source: Eurostat, SEB

Relatively spared from the crisis. Finland has, at least in relative terms, been spared from the crisis both in economic terms as well as from a public health perspective. The number of COVID-19 deaths per million inhabitants has been among the lowest in Europe. Furthermore, the economy has been surprisingly resilient. The flash estimate showed only a 3.2 per cent GDP decline in Q2, making Finland one of the best performers in the euro area. This enables us to improve our outlook for the Finnish economy this year. We now expect the decline in GDP to be limited to 2.9 per cent.

Slight downturn for manufacturing. In Q2, the drop in industrial production was the smallest in the EU, just 5 per cent. In important sectors such as the forest industry, food processing and metals, production clearly declined, but large gains in the production of electrical appliances and electronics helped to offset some of the losses. Merchandise exports dropped by 22 per cent in Q2, however, also suffering from a 7 per cent decline in prices. New orders remain in a steep decline, leading to a not-so-optimistic scenario for the second half of the year. On the whole, exports should fall by 9.7 per cent in 2020. In 2021 more favourable trends will return, lifting exports by 5.5 per cent.

Retail sales remained strong during a tumultuous spring. A small decline in sales was recorded in April. By June, retail sales were already surging by more than 7 per cent compared to a year ago. Even car sales have recovered, coming close to year-earlier volume in July. Household consumption has declined, since bars and restaurants remained closed until June and have operated under strict limitations after that. Yet the decline in private consumption will probably be among the lowest in the EU in 2020: only 1.3 per cent. A high comparative base and an increasing propensity to save will limit its growth to 2.1 per cent in 2021 and 1.6 per cent in 2022.

Stable construction but falling business investments. The good condition of the Finnish economy is also reflected in sentiment indicators. After the first shock in April, consumer confidence quickly recovered. In July it was already higher than in the summer of 2019. This has helped to stabilise the real estate market, and construction activity remains relatively stable. However, the uncertain outlook and the possible reintroduction of restrictions have stirred unease in the business sector, which remains sceptical about undertaking new investment projects. This will cause gross fixed capital formation to drop by 7 per cent this year followed by a 5.8 per cent recovery in 2021.

No quick recovery in the labour market. Registered unemployment quickly shot up from 9.4 per cent in February to 15.8 per cent in June. However, there are also methodological reasons behind this surge and for many, staying away from work will be temporary. The unemployment rate based on the Labour Force Survey has remained at a low 6.7 per cent. In the second half of the year, we should still see this figure increase. We forecast an average unemployment rate of 8.6 per cent in 2020. Structural competitiveness issues and a slow recovery in the service sector will prevent a quick drop in unemployment during 2021, and we expect the jobless rate to remain above 7 per cent during our forecast period.

Government debt to reach 70 per cent of GDP in 2020. Finland's strong public finances were turned upside down after the global financial crisis, when public debt soared from 30 per cent to 60 per cent of GDP. During the past several years, Finland has tried hard to contain its debt and recently managed to bring it below the 60 per cent level. Given this year's new circumstances, the debt ratio will again start to rise and reach new highs of more than 70 per cent.

The Baltics

Lithuania

Unexpectedly strong resilience in the first half of 2020 will limit the full-year GDP decline to 1 per cent. A relatively small tourism sector and successful measures to strengthen household incomes are important explanations.

Page 49

Latvia

Effective government responses have helped keep Latvia's GDP downturn relatively mild compared to the overall euro area. A quick recovery in new car registrations shows that household optimism has bounced back.

Page 50

Estonia

As in the other Baltic countries, Estonia's downturn has been relatively modest, especially in domestically oriented sectors. Positive signals from important trading partners like Sweden and Finland will help sustain growth ahead.

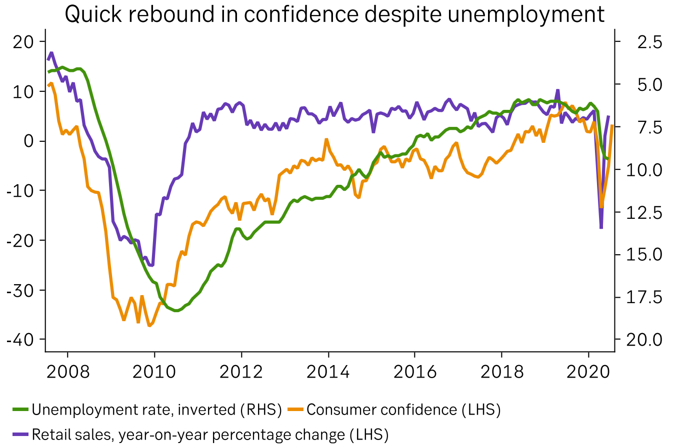
Page 51

Lithuania

Surprisingly resilient

The minor importance of the tourism industry in the economy and the successful containment of the COVID-19 outbreak have so far helped prevent GDP from falling as much as in the rest of the euro area. Recovering consumer and business confidence indicate that the economic decline in 2020 will be limited if Lithuania avoids a sharp resurgence of new cases in the autumn. However, it will take time before the labour market can revert to its pre-crisis level.

Quick rebound in confidence despite unemployment



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

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	3.9	-1.3	3.0	3.0
Private consumption	3.2	-2.5	4.3	3.3
Exports	9.6	-4.5	4.4	2.8
Unemployment*	6.3	8.5	8.1	7.5
Wages and salaries	8.8	5.5	5.0	6.0
HICP inflation	2.2	1.2	2.2	2.4
Public sector fiscal balance**	0.3	-6.8	-2.7	0.3
Public sector debt**	36.2	46.9	49.5	48.5

*Per cent of labour force **Per cent of GDP. Source: Eurostat, SEB

Lithuania's GDP fell by 5.1 per cent in the second quarter and was 3.7 per cent lower year-on-year. The result was well above the forecast we presented in early May, when we predicted a double-digit quarterly loss. The outbreak of COVID-19 in Lithuania was quickly contained, allowing various restrictions to be lifted from the middle of April. This contributed to a decent rebound in private consumption. Moreover, the slump in exports of goods and services was smaller than we feared and less substantial than the decline in imports, which led to a sharp increase in net exports and the current account surplus.

Consumer and business confidence continued to rebound. In Lithuania, as in other countries, tourism-related businesses were hurt the most. There is little optimism in this sector regarding a recovery in the near future. We assume that external demand will keep rebounding both in 2020 and the next two years. We also believe that the Lithuanian government will manage to avoid the reintroduction of last spring's harsh containment measures. Overall, we forecast that GDP will drop by only 1.3 per cent this year and increase by 3.0 and 3.0 per cent in 2021 and 2022, respectively.

Unemployment was 8.5 per cent in the second quarter, 2.4 per cent higher than a year earlier. The number of jobs fell by 2.2 per cent. The number of employed people started to recover in June, even eliminating seasonality factors, but registered unemployment continued to increase in July and August. This is mainly due to the introduction of a temporary universal monthly job seeker allowance for all unemployed people. We expect unemployment to peak at the end of 2020 and start decreasing at an accelerating pace in the second half of 2021. Average unemployment will drop from 8.5 per cent to 8.1 per cent in 2021 and 7.5 per cent in 2022.

Wage growth stagnated in April and May but recovered in June to its pre-COVID pace. The average public sector salary is around 10 per cent higher this year and remained stable during the recent months of economic downturn. Wages and salaries in the private sector suffered much more, but the recovering demand for labour indicates that pay levels will increase more than we forecast earlier. We believe that the monthly minimum wage will be increased in 2021, but considerably less than this year. The growth in public sector pay in 2021 will be smaller, too.

Temporary decline in the inflation rate. Sharply lower energy prices are the main reason why inflation has decelerated this year. Food price inflation also declined recently and was around 1 per cent in July. Meanwhile, core inflation advanced during the summer on higher service prices, indicating improving economic conditions.

Home prices have been resilient despite plummeting residential property market activity. The decline in economic activity was too brief to have a significant effect on home prices, especially since the housing market was healthy before the COVID-19 outbreak. Home price expectations recovered quickly.

The government's fiscal stimulus package was comprehensive and helped to mitigate the decline in disposable income. According to our calculations, the immediate impact of the package in the second quarter was around 5 per cent of GDP. A similar level of support by means of tax deferrals has been added. However, some fiscal stimulus measures seem excessive and were influenced by the upcoming parliamentary election in October. We forecast that the budget deficit will expand to 6.8 per cent of GDP in 2020 but will fall to 2.7 per cent in 2021.

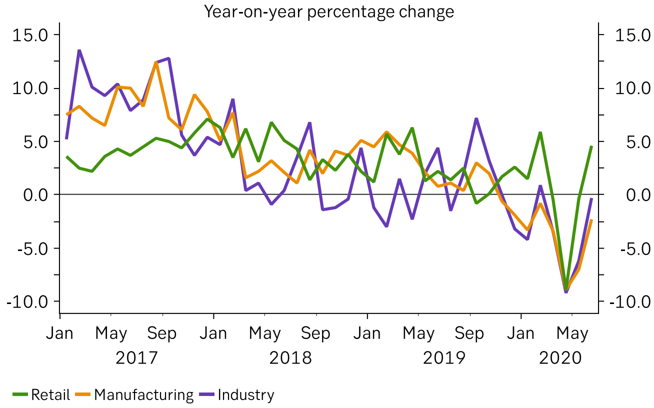
Latvia

Recovery on the way

Largely due to its effective containment policy, Latvia has been able to limit the economic damage caused by COVID-19. Since May, the economy has demonstrated a healthy pace of recovery, improving the outlook. We expect GDP to decrease by 4.6 per cent this year. Unemployment will peak by the end of the year at just above 10 per cent. Despite better prospects and a low infection rate, the economy will most likely not return to its pre-pandemic level before 2022.

Industry and retail recovering

Year-on-year percentage change



Statistics Latvia, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	2.2	-4.6	4.3	3.5
Private consumption	3.0	-5.3	4.5	3.5
Exports	1.9	-4.5	3.5	4.0
Unemployment*	6.3	9.1	9.0	7.9
Wages and salaries	7.2	2.0	3.5	4.5
Consumer price index (CPI)	2.8	0.3	1.9	2.3
Public sector financial balance**	-0.2	-8.8	-5.0	-3.7
Public sector debt**	36.9	48.8	51.5	52.5

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

Economic sentiment is improving but remains negative. In the second quarter, Latvia's GDP contracted by 9.8 per cent year-on-year. Output dropped by 3.8 per cent in goods production sectors and 11 per cent in service sectors, of which retail trade by 1.6 per cent. This was the most difficult stage for the economy, when the introduction of restrictions choked economic activity. Since May, there have been strong recovery trends in industrial output, consumption and exports. In July, economic sentiment increased further by 3.9 points to 87.6. Government relief measures will provide a significant stimulus to economic activity, but the question is how much the current uncertainty will translate into delayed capital spending. Our GDP forecast for 2020 has been revised from -8.3 per cent to -4.6 per cent, Latvia will continue its recovery in 2021, but the growth rate will slow somewhat in 2022.

Consumption is rising but will remain the biggest drag on the economy. Since May the mobility of the population has recovered very rapidly, which has also revived spending. In June, retail trade surged by 4.6 per cent year-on-year. Retail is one of the fastest-growing sectors, since many other consumption options such as travel and entertainment will remain partly restricted. New car registrations in July were only 3.1 per cent lower than a year earlier, compared to a 59 per cent drop in April. Towards autumn, the rebound in consumption could slow due to lingering uncertainty and sentiment that might weaken if restrictions are tightened again.

The outlook for manufacturing is improving. In June, industrial production volume was only 0.3 per cent lower than a year earlier, in manufacturing 2.3 per cent lower. In July, sentiment in industry climbed from -12.1 in June to -7, indicating an improving outlook. The wave of global recovery is boosting Latvian industry and allows it to compensate for the decline of previous months. It is very likely that manufacturing might return to growth in the second half of 2020, supported by exports. Exports of goods in June were down 1.4 per cent year-on-year compared to -16.8 per cent in May. However, going forward the outlook is quite muted.

Unemployment will peak by the end of the year. Between early March and late July, registered unemployment rose from 6.3 to 8.6 per cent. Job seekers are even more numerous, reaching 9.8 per cent in June. For the first time, there was a slight decline in registered unemployment in July. There was also a small increase in registered vacancies. Yet the jobless rate may rise towards autumn, since some furlough schemes and seasonal patterns will end. We expect it to peak late this year at just above 10 per cent before falling, but in 2022 it will remain higher than before the COVID-19 crisis. We believe that support measures should be in place to avoid a sharp rise in unemployment later this year. Despite this, average wages and salaries will increase this year by 2 per cent.

Inflation will accelerate modestly. The 0.2 per cent increase in inflation in July was somewhat atypical for the price cycle. Annual inflation returned to positive territory in July at 0.5 per cent. As the economy began to move convincingly away from the grip of COVID-19, price pressure revived, especially in services. The rapid recovery has allayed concerns about a disinflationary environment. In the coming months, favourable conditions for disinflation will remain, but they will abate by the end of 2020. Due to labour market improvement and wages, inflation will rise from 0.3 per cent this year to 1.9 per cent in 2021.

The budget deficit will surge. Government revenue in the first seven months of 2020 was 1.2 per cent lower than in the same period of 2019. We expect the budget deficit to increase to 8.8 per cent of GDP in 2020 and improve to 5 per cent next year.

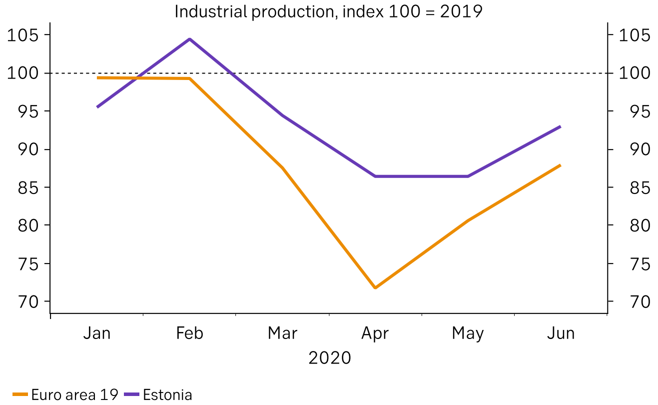
Estonia

Disaster averted

After the summer holidays, the general mood in the economy has improved, supported by favourable data and the better-than-expected economic performance of Estonia's main export partners. This enables us to revise our GDP forecast sharply higher. We now expect the economy to contract by only 4.7 per cent in 2020. The main hit will be to exporters and the hospitality sector, while the impact will be less dire for businesses oriented towards domestic consumers.

Manufacturers have fared better than the euro area average

Industrial production, index 100 = 2019



Source: Eurostat, Macrobond, SEB

Key data

Year-on-year percentage change

	2019	2020	2021	2022
GDP	4.3	-4.7	4.0	3.5
Private consumption	3.2	-3.4	3.6	3.2
Exports	5.2	-7.5	6.5	5.0
Unemployment*	4.7	7.9	7.5	6.7
Wages and salaries	7.4	1.5	2.8	5.0
HICP inflation	2.4	-0.5	1.8	2.3
Public sector fiscal balance**	-0.3	-9.3	-4.2	-2.2
Public sector debt**	8.4	21.6	23.2	21.8

* Per cent of labour force ** Per cent of GDP. Source: Eurostat, SEB

Just a few months ago, the economic picture in Estonia looked grim to say the least. Exports, which the country very much depends on, fell by nearly a quarter in April-May. At the same time, the number of Finnish tourists, who have traditionally had a significant impact on the hospitality and retail sectors, dwindled to almost zero. This caused registered unemployment to shoot up from 5.7 per cent in February to 7.8 per cent in May. Even worse than the actual economic data was the outlook painted by various sentiment indicators. Business sentiment in the service sector declined to the lowest level ever recorded, while confidence among manufacturers came very close to the depths last seen in 2009.

However, the most recent figures have reflected positive changes. Both real economic data and forward-looking indicators have markedly improved, while Estonia's main trade partners have managed to withstand the crisis better than previously expected. We have thus adopted a more optimistic scenario, where GDP will contract by only 4.7 per cent in 2020 – much less than the euro area average. In 2021 the economy will rebound by 4 per cent, taking economic output to almost the same level as in 2019. In 2022 growth will ease to 3.5 per cent.

With exports having a strong impact on the economy, Estonia's fate has largely been in the hands of its main trade partners. Although the two most important destination countries for Estonian goods – Finland and Sweden – took different paths in fighting the coronavirus, both economies have performed comparatively well, thus avoiding a larger drop in demand. The earlier decline in Estonia's exports came to a halt in June, and improving industrial confidence hints that the worst could now be over. Instead of the previously forecast double-digit decline, we now expect exports to drop by 7.5 per cent in 2020, followed by a strong rebound in 2021.

So far, household consumption has held up relatively well despite the COVID-19 crisis. There was a steep 16 per cent decline in retail sales in April, but in June sales grew by 5.7 per cent. Household purchasing power is supported by low energy prices, which have pushed the economy into deflation. We predict that private consumption will decrease by 3.4 per cent this year, while the consumer price index (HICP) will fall by 0.5 per cent.

A steeper decline in household consumption will be avoided thanks to the continuing strength of the labour market. After its initial jump, registered unemployment has remained at 7.8 per cent for the third month in a row. This figure would have been higher without the government-funded furlough scheme, which helped to pay wages and salaries until the end of June. Without this government aid, unemployment may increase somewhat in the coming months, but it now appears that double-digit figures can be avoided. We expect the average unemployment rate for 2020 to be only 7.9 per cent, followed by a gradual decline in 2021 and 2022.

Forecasting volatile capital spending is tricky even in normal times, and the virus outbreak has only made it worse. In the construction sector, feelings are mixed. The housing market has largely recovered, but even before the COVID-19 crisis new public sector projects were becoming scarce. While most previously planned investment projects will be carried out in 2020, the recovery in 2021 could be more limited than some observers expect.

As in many countries, the government has gone on a borrowing spree to finance a looming budget deficit. With a very low existing public debt level, Estonia has room to borrow more, but the crucial question is how well it will be put to use. In 2020, the fiscal deficit will swell to 9.3 per cent and debt will soar to 21.6 per cent of GDP.

Global key indicators

Yearly change in per cent

	2019	2020	2021	2022
GDP OECD	1.6	-6.6	4.8	2.8
GDP world (PPP)	2.9	-4.3	5.3	4.0
CPI OECD	2.1	1.3	1.7	1.9
Oil price, Brent (USD/barrel)	64	45	55	65

US

Yearly change in per cent

	2019 level, USD bn	2019	2020	2021	2022
Gross domestic product	21,433	2.2	-5.5	4.0	3.5
Private consumption	14,545	2.4	-5.5	4.6	4.0
Public consumption	2,995	1.8	1.7	2.1	1.6
Gross fixed investment	4,455	2.4	-5.3	2.2	3.7
Stock building (change as % of GDP)	49	0.0	-1.4	0.4	0.0
Exports	2,515	-0.1	-12.7	8.4	3.5
Imports	3,125	1.1	-12.4	8.7	4.4
Unemployment (%)		3.7	9.3	8.3	6.2
Consumer prices		1.8	1.1	1.8	1.9
Core CPI		2.2	1.6	1.7	1.7
Household savings ratio (%)		7.9	15.5	10.5	8.0
Public sector financial balance, % of GDP		-5.9	-21	-11	-8
Public sector debt, % of GDP		109.0	136.0	144.0	145.0

Euro area

Yearly change in per cent

	2019 level, EUR bn	2019	2020	2021	2022
Gross domestic product	11,920	1.3	-8.8	6.6	3.4
Private consumption	6,210	1.3	-10.0	8.0	3.0
Public consumption	2,364	1.8	2.0	1.0	2.0
Gross fixed investment	2,429	5.7	-12.0	8.0	5.0
Stock building (change as % of GDP)	0	-0.5	0.1	0.0	0.0
Exports	5,565	2.5	-12.0	10.5	5.2
Imports	5,091	4.0	-10.0	10.0	5.0
Unemployment (%)		7.6	8.5	10.0	8.7
Consumer prices		1.2	0.6	1.0	1.2
Core CPI		1.0	1.0	0.9	1.1
Household savings ratio (%)		6.0	6.5	6.0	6.0
Public sector financial balance, % of GDP		-0.6	-11.5	-5.8	-2.8
Public sector debt, % of GDP		84.1	104.1	103.3	101.3

Other large countries

Yearly change in per cent

	2019	2020	2021	2022
GDP				
United Kingdom	1.5	-11.6	8.0	1.0
Japan	0.7	-5.8	2.4	0.7
Germany	0.6	-6.1	5.0	2.8
France	1.5	-11.3	9.2	3.5
Italy	0.3	-10.5	7.4	4.3
China	6.1	2.0	8.0	5.6
India	4.9	-5.6	4.0	7.4
Brazil	1.1	-7.0	3.0	2.5
Russia	1.3	-5.0	3.7	2.5
Poland	4.1	-4.5	4.5	3.0
Inflation				
United Kingdom	1.8	0.7	1.8	1.6
Japan	0.5	0.1	0.1	0.5
Germany	1.5	0.8	1.5	1.5
France	1.3	0.5	1.0	1.5
Italy	1.1	0.0	0.8	0.9
China	2.9	2.9	2.2	2.2
India	3.7	5.8	3.8	4.3
Brazil	3.7	2.4	3.0	3.5
Russia	4.5	3.2	4.1	3.5
Poland	2.3	3.2	2.7	2.5
Unemployment (%)				
United Kingdom	3.8	4.9	6.2	5.9
Japan	2.4	3.4	2.9	2.7
Germany	3.2	4.2	4.4	4.2
France	8.3	9.8	10.2	9.0
Italy	9.9	10.5	11.0	10.5

Financial forecasts

Official interest rates		19-Aug	Dec-20	Jun-21	Dec-21	Jun-22	Dec-22
US	Fed funds	0.25	0.25	0.25	0.25	0.25	0.25
Japan	Call money rate	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro zone	Refi rate	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	Repo rate	0.10	0.10	0.10	0.10	0.10	0.10
Bond yields							
US	10 years	0.68	0.90	1.00	1.10	1.20	1.30
Japan	10 years	0.03	0.05	0.05	0.05	0.10	0.10
Germany	10 years	-0.50	-0.30	-0.20	-0.10	0.00	0.10
United Kingdom	10 years	0.28	0.45	0.55	0.65	0.75	0.85
Exchange rate							
USD/JPY		106	110	112	113	113	113
EUR/USD		1.19	1.20	1.23	1.25	1.27	1.28
EUR/JPY		126	132	138	141	144	145
EUR/GBP		0.90	0.87	0.85	0.83	0.82	0.81
GBP/USD		1.32	1.38	1.45	1.51	1.55	1.58

Sweden

Yearly change in per cent

	2019 level, SEK bn	2019	2020	2021	2022
Gross domestic product	5,026	1.2	-3.8	4.2	3.1
Gross domestic product, working day adjustment		1.3	-4.1	4.1	3.1
Private consumption	2,227	1.2	-3.5	3.5	2.7
Public consumption	1,307	0.4	-0.7	1.2	0.8
Gross fixed investment	1,263	-1.2	-7.5	6.0	3.0
Stock building (change as % of GDP)	36	-0.3	-0.3	0.1	0.1
Exports	2,385	4.2	-8.2	8.4	5.6
Imports	2,192	1.8	-9.3	7.3	4.3

Unemployment, (%)	6.8	9.0	9.6	8.4
Employment	0.6	-2.3	-0.7	1.7
Industrial production	1.0	-5.6	6.0	4.5
CPI	1.8	0.6	1.2	1.5
CPIF	1.7	0.5	1.2	1.5
Hourly wage increases	2.5	1.2	2.2	2.5
Household savings ratio (%)	15.1	17.1	15.7	15.8
Real disposable income	3.4	-0.8	2.6	2.3
Current account, % of GDP	4.2	5.4	4.5	4.0
Central government borrowing, SEK bn	118	260	230	100
Public sector financial balance, % of GDP	0.5	-5.0	-4.0	-3.0
Public sector debt, % of GDP	35.2	41.0	43.0	44.0

Financial forecasts	19-Aug	Dec-20	Jun-21	Dec-21	Jun-22	Dec-22
Repo rate	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate, STIBOR	0.01	-0.10	0.00	-0.05	0.00	-0.05
10-year bond yield	0.00	0.10	0.15	0.30	0.45	0.60
10-year spread to Germany, bps	50	40	35	40	45	50
USD/SEK	8.66	8.33	8.01	7.80	7.64	7.50
EUR/SEK	10.31	10.00	9.85	9.75	9.70	9.60
KIX	114.9	111.7	110.0	108.8	108.2	107.1

Finland

Yearly change in per cent

	2019 level, EUR bn	2019	2020	2021	2022
Gross domestic product	241	1.1	-2.9	3.2	2.2
Private consumption	126	0.9	-1.3	2.1	1.6
Public consumption	55	1.2	3.3	1.7	1.3
Gross fixed investment	57	-1.0	-7.0	5.8	3.5
Stock building (change as % of GDP)	1	0.3	0.3	-0.1	0.0
Exports	96	7.5	-9.7	5.5	3.6
Imports	95	2.4	-6.3	4.5	3.0

Unemployment, OECD harmonised (%)	6.7	8.6	8.2	7.6
CPI, harmonised	1.1	0.1	1.5	1.8
Hourly wage increases	2.2	1.8	1.8	2.3
Current account, % of GDP	-0.5	-1.6	-1.4	-1.4
Public sector financial balance, % of GDP	-1.1	-7.6	-4.5	-3.0
Public sector debt, % of GDP	59.4	70.2	72.0	71.5

Norway

Yearly change in per cent

	2019 level, NOK bn	2019	2020	2021	2022
Gross domestic product	3,376	1.2	-2.6	3.4	3.1
Gross domestic product (Mainland)	2,920	2.3	-3.3	3.6	2.8
Private consumption	1,522	1.5	-4.1	4.4	3.2
Public consumption	816	1.7	3.5	2.3	1.8
Gross fixed investment	883	6.1	-8.9	0.1	1.6
Stock building (change as % of GDP)		0.0	0.0	0.0	0.0
Exports	1,212	1.5	-4.1	3.8	3.9
Imports	1,160	5.2	-6.5	1.5	1.7
Unemployment (%)		3.7	5.4	4.5	3.9
CPI		2.2	1.3	2.3	2.1
CPI-ATE		2.2	2.9	2.1	1.7
Annual wage increases		3.5	1.9	2.5	2.7

Financial forecasts	**19-Aug**	**Dec-20**	**Jun-21**	**Dec-21**	**Jun-22**	**Dec-22**
Deposit rate	0.00	0.00	0.00	0.00	0.00	0.25
10-year bond yield	0.69	0.70	0.75	0.80	0.85	0.95
10-year spread to Germany, bps	119	110	105	100	95	95
USD/NOK	8.85	8.63	8.13	7.92	7.76	7.66
EUR/NOK	10.53	10.35	10.00	9.90	9.85	9.80

Denmark

Yearly change in per cent

	2019 level, DKK bn	2019	2020	2021	2022
Gross domestic product	2,315	2.3	-4.5	5.0	2.5
Private consumption	1,062	2.2	-4.4	5.3	2.8
Public consumption	557	1.3	3.0	-3.0	0.8
Gross fixed investment	512	2.7	-6.6	9.5	4.7
Stock building (change as % of GDP)		-0.3	0.0	0.0	0.0
Exports	1,300	1.9	-2.7	11.8	3.7
Imports	1,147	0.6	-1.7	11.8	4.7
Unemployment, OECD harmonised (%)		5.1	9.0	7.0	6.0
CPI, harmonised		0.8	0.4	0.9	1.3
Hourly wage increases		2.0	2.0	1.0	1.0
Current account, % of GDP		8.0	6.0	8.0	8.0
Public sector financial balance, % of GDP		2.0	-10.0	-6.0	-5.0
Public sector debt, % of GDP		33.5	42.0	44.0	44.0

Financial forecasts	**19-Aug**	**Dec-20**	**Jun-21**	**Dec-21**	**Jun-22**	**Dec-22**
Deposit rate	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
10-year bond yield	-0.36	-0.19	-0.10	0.00	0.10	0.20
10-year spread to Germany, bps	14	11	10	10	10	10
USD/DKK	6.26	6.21	6.06	5.96	5.87	5.82
EUR/DKK	7.45	7.45	7.45	7.45	7.45	7.45

Lithuania

Yearly change in per cent

	2019 level, EUR bn	2019	2020	2021	2022
Gross domestic product	48	3.9	-1.3	3.0	3.0
Private consumption	29	3.2	-2.5	4.3	3.3
Public consumption	8	0.7	4.5	-4.0	0.5
Gross fixed investment	10	7.4	-4.0	4.0	5.0
Exports	38	9.6	-4.5	4.4	2.8
Imports	35	6.0	-5.3	4.5	3.2
Unemployment (%)		6.3	8.5	8.1	7.5
Consumer prices		2.2	1.2	2.2	2.4
Public sector financial balance, % of GDP		0.3	-6.8	-2.7	0.3
Public sector debt, % of GDP		36.2	46.9	49.5	48.5

Latvia

Yearly change in per cent

	2019 level, EUR bn	2019	2020	2021	2022
Gross domestic product	30	2.2	-4.6	4.3	3.5
Private consumption	18	3.0	-5.3	4.5	3.5
Public consumption	6	2.6	3.7	3.5	2.9
Gross fixed investment	7	3.1	-5.0	4.5	4.0
Exports	18	1.9	-4.5	3.5	4.0
Imports	18	2.3	-7.0	2.3	4.5
Unemployment (%)		6.3	9.1	9.0	7.9
Consumer prices		2.8	0.3	1.9	2.3
Public sector financial balance, % of GDP		-0.2	-8.8	-5.0	-3.7
Public sector debt, % of GDP		36.9	48.8	51.5	52.5

Estonia

Yearly change in per cent

	2019 level, EUR bn	2019	2020	2021	2022
Gross domestic product	28	4.3	-4.7	4.0	3.5
Private consumption	14	3.2	-3.4	3.6	3.2
Public consumption	6	2.8	2.8	2.0	2.0
Gross fixed investment	7	13.4	-9.0	6.2	5.0
Exports	20	5.2	-7.5	6.5	5.0
Imports	19	3.9	-6.5	5.2	4.5
Unemployment (%)		4.7	7.9	7.5	6.7
Consumer prices		2.4	-0.5	1.8	2.3
Public sector financial balance, % of GDP		-0.3	-9.3	-4.2	-2.2
Public sector debt, % of GDP		8.4	21.6	23.2	21.8

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One of the key publications from the SEB Macro & FICC Research unit is the quarterly Nordic Outlook, which presents analyses covering the economic situation in the world as well as Europe and Sweden.

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