

23 June 2021

# Nordic Outlook

## We have lift-off

- **Denmark: too hot already?**
  - There are already signs of an overheating economy, but many of them should be temporary.
- **Sweden: sluggish recovery**
  - Recent data has disappointed a bit, but the recovery remains real.
- **Norway: here comes the upswing**
  - Reopening is lifting the economy, and a series of rate hikes is coming.
- **Finland: recovery is here to stay for a while**
  - Consumers, exports and investment all contribute to a benign outlook.

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*Statistical sources: Refinitiv, Macrobond Financial, OECD, IMF, National Institute of Social and Economic Research, Statistics Denmark and other national statistical institutes as well as proprietary calculations.*

*Important disclosures and certifications are contained from page 33 of this report.*

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The ***Nordic Outlook*** is a quarterly publication that presents Danske Bank's view on the economic outlook for the Nordic countries. The semi-annual publication ***The Big Picture*** sets out our global economic outlook.

# At a glance

## We have lift-off

### The recovery is happening

The Nordic countries have oscillated between restrictions and easing over the last 15 months as COVID-19 numbers have ebbed and flowed, but by now the direction is clearly towards reopening. The four countries are at slightly different stages but the economic results are clear. Consumer spending is fast approaching or even exceeding normal levels, and exports are benefitting from the very strong global demand for manufacturing goods. This is not surprising and we have only made small adjustments to our forecasts, but it is still positive to see it confirmed. In particular, we are seeing the labour markets improving much faster than in previous crises. There are of course still risks related to COVID-19, but with vaccinations progressing, we expect the recovery to continue and to have the economies back to their potential output and pre-crisis unemployment in 2022.

The very rapid recovery has led to clear signs of overheating, in particular rising input prices and a lack of materials and transportation. We expect these problems to be significantly eased as the world economy normalises and global demand shifts from goods to services, and we do not expect an inflation surge in the Nordics. However, given the uncertainty and pace of the recovery, it is well worth keeping an eye on also domestic signs of heating.

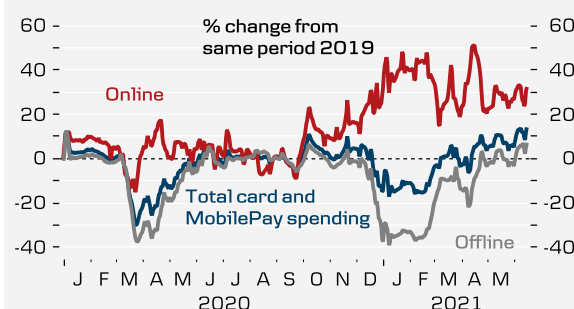
### House price surge to end

Like in many other parts of the world, house prices have surged in the Nordics during the COVID-19 crisis. We ascribe that in large part to consumers substituting from other kinds of spending and hence expect prices to level out now, also because some of the relevant interest rates are starting to move higher. It should be noted though that the uncertainty is significant, also since new regulation is being considered, see also our *Research Nordic – Housing boom coming to an end*, June 18 2021.

### Monetary policy on different paths

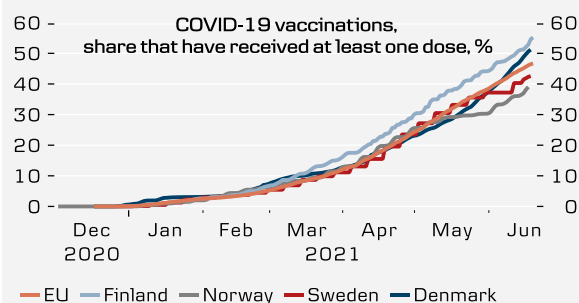
Norway is firmly on a path towards higher interest rates, and we expect the first rate hike in September, followed by four more before the end of 2022. Norway has not seen inflation and “natural” interest rates decline to the same extent as most other European countries, and a positive policy interest rate remains appropriate in a normal situation. In the other countries, however, we see little reason to expect a move away from current zero or negative rates. In fact, we expect a small rate cut in Denmark as a normalisation after the small hike to protect the exchange rate during the financial turmoil in March 2020. But also outside Norway, longer-term rates are edging up as the global and local economies improve.

#### Danish consumers spend more than in 2019



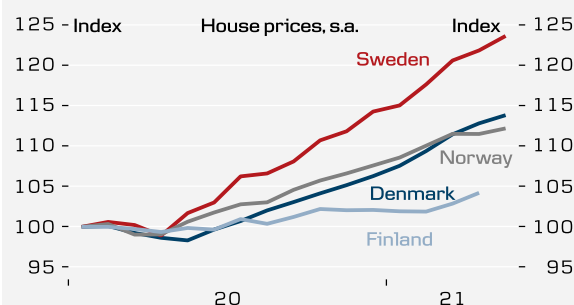
Source: Danske Bank

#### Vaccinations progressing with some variation



Source: Our World in Data, Macrobond Financial

#### COVID-19 effect on house prices?



Source: Macrobond Financial, boligsiden.dk

# Denmark

## Too hot already?

- The reopening has triggered a strong upswing and many companies are already experiencing shortages of labour and materials.
- We view many of these effects as temporary and do not expect a marked increase in inflation, though uncertainty is elevated.
- We expect steeply appreciating house prices to slow on the back of the reopening and the increase in long-term interest rates.
- The global reopening may put a damper on goods exports but boost tourism.
- Pent up consumption demand points to a high level of private consumption in the time ahead.

### Both crisis and upswing of historical proportions

The corona crisis was unprecedented, and so too is the upswing that is now fully under way. Especially the first lockdown in spring 2020 produced an extreme economic slump, but the rate of growth as society reopens is also extreme. Many years were required to recreate balance and trust in the economy following the financial crisis, for example, but this time around most of that is handled by suppressing the virus and lifting restrictions. This comes as no real surprise, and we have not significantly altered our forecast, though the pace of housing market, labour market and wage growth have outstripped our expectations. We expect much of the current pressure on the economy to prove temporary – be that the increase in house prices, shortage of materials or to some extent the labour shortages experienced by certain companies – but we are in an unparalleled situation. For example, we are uncertain whether consumption, as with previous reopenings, will simply more or less normalise. The plan is for fiscal policy to be tightened considerably from 2021 to 2022, which will help mitigate the risk of overheating.

### Increasing shortages of materials

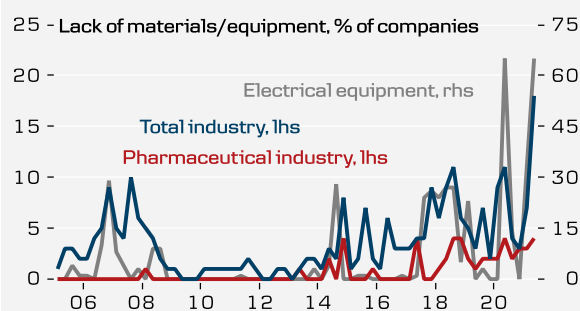
Manufacturing companies in Denmark report a general shortage of materials. Some 18% listed this as a limiting factor for production in April, which is around twice the level seen when the pace of economic expansion was at its highest just prior to the financial crisis in 2007. Producers of electronic goods are hardest hit, with 68% of electrical equipment manufacturers reporting shortages of materials as a limiting factor for production – the same as in April 2020, when global industry stalled and supply lines broke down. The exception is the pharmaceutical industry, where just 4% report materials shortages. Hence, Denmark's large pharmaceutical industry contributes to the robustness of the economy to supply problems, as we have also noted earlier here: *Nordic Research: Danish and Swedish exports relatively robust to supply problems* 31 March 2020.

Changes relative to previous forecast

Denmark				
% y/y	Current forecast		Previous forecast	
	2021	2022	2021	2022
GDP	3.0	3.5	3.0	3.4
Private consumption	3.0	4.0	2.5	4.0
Public consumption	0.9	0.2	1.5	-0.3
Gross fixed investment	3.0	3.5	4.4	3.5
Exports	9.7	7.0	5.1	6.8
Imports	8.1	6.4	5.7	5.9
Gross unemployment (thousands)	124.1	106.8	129.9	112.4
Inflation	1.2	1.2	0.9	1.2
Government balance, % of GDP	-2.1	-0.4	-2.5	-1.0
Current account, % of GDP	8.4	8.5	7.9	8.2

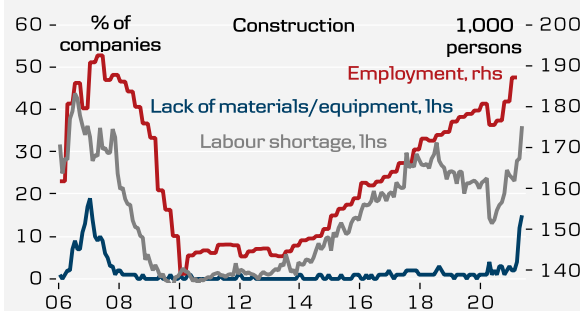
Source: Danske Bank

Shortages of materials in industry



Sources: Statistics Denmark, Macrobond Financial

Construction sector overheating?



Note: Labour shortage is seasonally adjusted.

Sources: Statistics Denmark, Macrobond Financial

Inputs of raw materials and electronics, of which there are particular shortages at the moment, are unsurprisingly hitting electronic goods producers hardest if we consider how production input was structured in 2019. Second hardest hit after electronic goods producers appears to be machinery manufacturers, as the level of electronic input is high here. Materials shortages risk rendering companies incapable of meeting the high demand for goods, and indeed the industrial sector is reporting the lowest inventories of finished goods in three years.

Construction is also increasingly reporting materials shortages, as reflected in the price of timber, which has risen almost five-fold compared to a year ago. We would have to go back to the overheating years in the run up to the financial crisis to find a period with greater shortages of both materials and labour.

This is due, not least, to lockdowns further stoking demand for homes and construction – a global phenomenon during the pandemic. Wage growth in the construction sector has also accelerated of late, up 3.5% (annualised) in Q1. Construction is clearly the sector with the fast growing wages.

### Labour market tightening

Certain pockets of the labour market also appear to face challenges supplying enough workers. Construction is again under pressure here, with construction companies in May reporting the most wide-reaching shortage of labour (seasonally adjusted) since 2007. The number of people working in the construction sector in Q1 was just over 6,000 up on the same period last year and close to the peak in 2007. Private sector wage growth surged in Q2 2020 but has already returned to around 2.5% annually, which was also the pre-corona level.

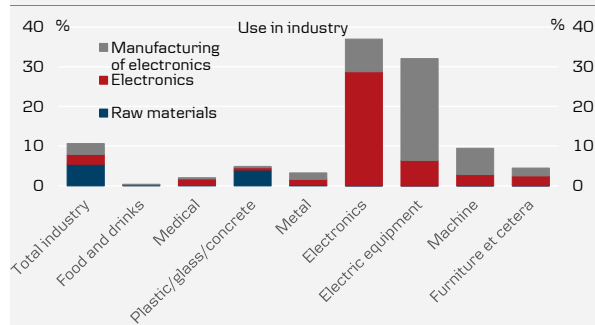
The service sector has also found itself in an unusual situation, transitioning in some areas from lockdown and layoffs to suddenly facing recruitment problems after reopening. Labour shortages were cited as a limiting factor for production across 19% of companies in May – the highest share to date along with a couple of similar surveys in 2018 and 2019. Low-wage sectors in particular, such as the restaurant industry with its loosely attached workforce, are encountering recruitment problems, as potential staff have been turning to other options, such as COVID-19 test centres, where wages are typically higher. The transport sector is also facing recruitment problems on the back of the current massive demand for goods, which is putting enormous pressure on freight services, including land-based.

We expect that the reopening and a fading requirement for test capacity will produce a better balance in the labour market over the summer. However, there are other factors at play in construction, where the activity level is unlikely to change so quickly. The substitution of consumption preferences away from housing, etc. should, however, contribute to easing some of the pressure here too.

### Limited consumer price inflation despite overheating

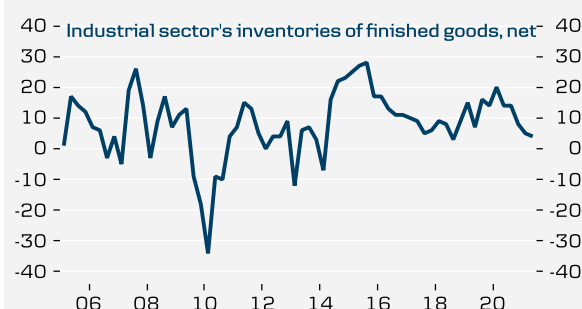
So far, we can see that manufacturers' sales prices have increased since the start of the year, while surging prices for raw materials will put pressure on manufacturers going forward, just as rising oil prices did in 2018 – and indeed, companies expect their sales prices to continue rising.

Electronics and machinery production most affected by shortage of electrical components



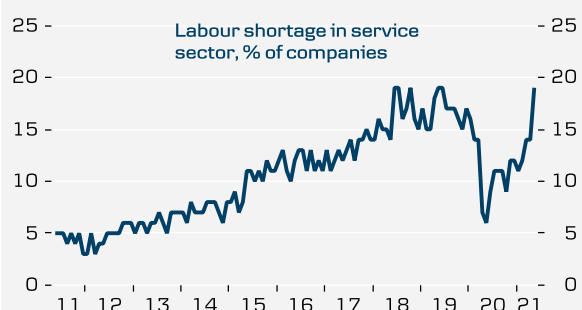
Sources: Danske Bank, Statistics Denmark

Industrial inventories at 3-year low



Note: Chart shows how many percentage points more have reported too large than too small inventories. Sources: Statistics Denmark, Macrobond Financial

Service sector also experiencing labour shortages



Sources: Statistics Denmark, Macrobond Financial



The question is to what extent rising raw material prices will be passed on to consumer prices. Companies often prefer to keep the prices consumers see relatively stable, with their mark-up typically acting as a shock absorber for short-term fluctuations in materials costs. Nevertheless, higher costs for an extended period would likely mean a full or partial passing on of costs to consumers, though we have not really seen any sign of this yet. Moreover, the risk of permanently higher inflation will not materialise until households raise wage expectations to compensate for higher consumer prices, thus potentially causing a price-wage spiral. Experience shows, however, that increasing raw material and commodity prices do not have knock-on effects on wages, but only produce temporary price increases (see *Danmarks Nationalbank*<sup>1</sup>).

Consumer prices in Denmark are generally quite robust to fluctuations in raw material and commodity prices compared to other countries, as the materials input accounts for less in an economy with high wages and generally high price levels, and because fuel accounts for a relatively small share of consumption. So, while Danes are already experiencing rising prices at the pumps, fuel costs have much less significance for budgets than in other countries. In 2021, fuel has a 2.2% weighting in the Danish consumer basket compared to 3.7% in the eurozone.

Like fuel, heating oil is very closely linked to the price of oil, but the number of households that still have oil-fired heating is now rather limited and heating oil accounts for a rather modest 0.3% of the consumer price index compared to 0.6% in the eurozone's HICP. Gas prices are to some extent affected by oil prices, but an increase in oil prices of 10% typically produces not much more than a 1% increase in gas prices. Gas is a much more common means of heating in the eurozone, accounting for 2% of HICP (compared to 0.4% in Denmark). The main source of heating in Denmark, district heating, (which accounts for 1.5%) is, conversely, not really affected by oil prices.

We expect inflation has already peaked for now at 1.7% in May, and that it will decline a little again as the base effects from energy prices fade. Nevertheless, energy and more expensive cigarettes will keep inflation above 1%. Cigarette prices are set to rise by a further DKK5 next year, but we are expecting just modest inflation, albeit slightly higher than we have long been used to.

## Consumers quick to return

Private consumption has quickly recovered on the back of the reopening. As expected, Danes were happy to return to previously closed businesses, and while certain segments of the service industry are still waiting for a return to full capacity, the signs are also pointing in the right direction here.

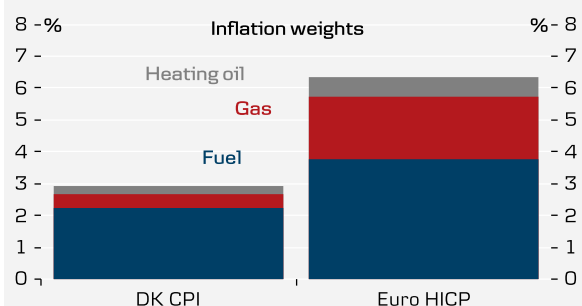
As restrictions are increasingly lifted in Q3, we expect the economy to receive a further boost from a full return to the service industries – not least the travel business. So far, retailing does not appear to have experienced a drop in consumption as a result of the recovery in the service sector, although a considerable share of consumption does appear to have more permanently shifted from brick and mortar shops to online shopping.

### Companies reporting higher sales prices



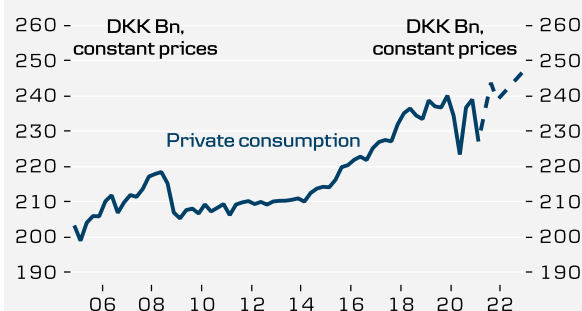
Note: 3-month moving average. Shows how many have reported rising prices minus how many have reported prices. Sources: Statistics Denmark, Macrobond Financial

### Oil-related energy weighs twice as much in the eurozone as in Denmark



Sources: Statistics Denmark, Eurostat, Macrobond

### Prospect of strong recovery in consumption



Sources: Statistics Denmark, own calculations, Macrobond Financial

<sup>1</sup> Spange, Morten (2011), Commodity prices and inflation in Denmark, Danmarks Nationalbank, Monetary review, 2nd quarter 2011, part 1.

Danes generally have good prerequisites for increasing their consumption to above average – not least, due to payouts in the past year of the hitherto frozen holiday allowance, and because the consumption ratio – the share of income spent on consumption – has been very low due to the lockdown. This means there is both a pent up consumption demand and money to spend. The recovery in the consumption ratio should also mean higher consumption growth in 2022 than would have been the case without COVID-19.

## Housing market on course for a soft landing

The housing market has been thundering ahead for more than a year now, in part because Danish consumption patterns have shifted as a result of the corona crisis and also because Danes have had more disposable income, while home financing has remained inexpensive. Incidentally, this trend has been seen across the Western world.

We expect house prices to climb 11.5% in 2021. However, this steep increase conceals relatively modest expected growth in H2, but with the strong starting point in 2020 and early 2021 pulling the average substantially higher. Rising interest rates and a gradual return to more normal patterns of consumption are expected to slow the pace of house price appreciation, and there is much to indicate that the pressure on the housing market has begun to ease. The number of property showings peaked in March and sales activity has also declined since the winter, though prices are continuing to increase significantly and homes are getting sold very quickly.

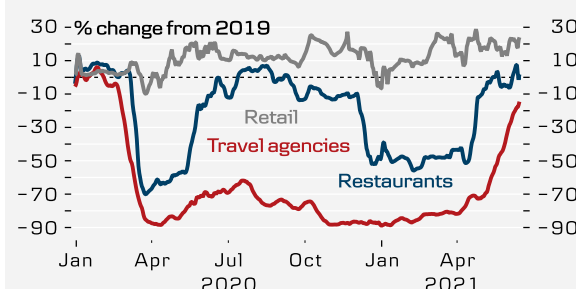
More subdued price growth would be welcome. The longer prices rise as strongly as they have in the past year, the greater the risk of a sudden shift in the housing market. A sharp increase in interest rates, or an overtightening of the lending rules could at worst produce a hard rather than a soft landing for the housing market – particularly if this coincides with a general decline in activity as we put the corona crisis behind us.

At the same time, the upcoming reform of property taxes and new valuations present a significant uncertainty factor for the housing market. Prices could already begin to fall in connection with the publication of the new property valuations – which according to the very uncertain timetable should happen this year – in those areas where prices have risen strongly in recent years. However, on a national level, neither the reforms nor the new property valuations should prompt significant price changes.

## No crisis for public finances

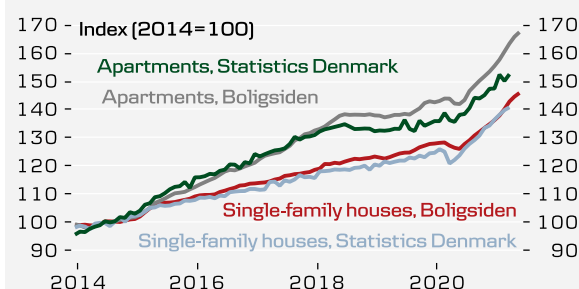
The public deficit in 2020 has been revised down again to just DKK14bn, and a further revision could well be on the cards. Hence, the corona crisis has far from knocked the bottom out of government coffers, though it has produced a marked deterioration relative to the DKK94.2bn surplus in 2019. Part of the story is also that holiday allowance payouts produced additional tax revenues of around DKK21bn. The deficit is likely to be somewhat larger this year, in part due to expected compensation payments to mink farmers. Nevertheless, this does not change the fact that public finances are fundamentally strong and that income, in particular, continues to surprise positively year after year. The government has lent companies DKK40-50bn as a consequence of the corona crisis, with the longest term loans falling due in 2023. We should probably reckon on an increase in the number of bankruptcies as companies under

### Consumption of services normalising, but retail activity still solid



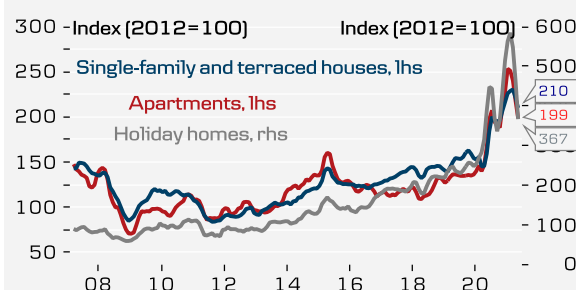
Note: MobilePay and card transactions, 2-week moving average  
Source: Danske Bank

### House prices continue to rise



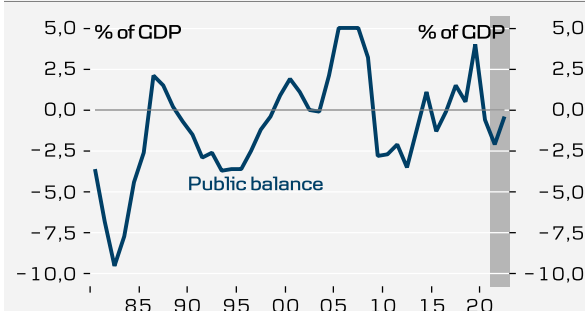
Note: Own seasonal adjustment  
Sources: Statistics Denmark, Boligsiden and Macrobond Financial

### Property showings peaked this winter



Note: 3-month moving average, seasonally adjusted  
Sources: Home, Macrobond Financial and own calculations

### Deterioration, but from a high level



Sources: DØRS, Statistics Denmark, Danske Bank



pressure in, for example, the hotel and restaurant sectors have to repay these loans. The government has also opened up for the early payment of taxes, which is attractive compared to incurring negative interest on bank accounts, and will reduce the need to borrow the money through other channels.

### Slightly higher long and slightly lower short yields

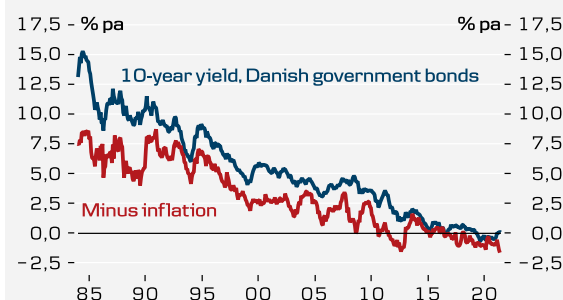
Long rates and yields have generally been increasing this year due to the improved economic outlook in Europe, and we expect this trend could continue for a little time yet, although we see no real prospect for any decisive shifts in the coming year. The overriding pattern is of small fluctuations around the long-term trend towards still lower real interest rates. The Danish krone (DKK) has been trading on the strong side against the euro (EUR) throughout most of 2021, and Danmarks Nationalbank has purchased foreign currencies for DKK41.8bn so far to weaken the DKK. We expect Danmarks Nationalbank will lower its benchmark rates by 10bp in the coming months to ease the pressure. Denmark unilaterally raised interest rates by 15bp during the financial turmoil in 2020, and a cut now could be seen as a normalisation. Current yields and money market rates in Denmark are, in practice, slightly higher than in the eurozone, which there is no need for when the goal is a stable exchange rate and Denmark has a large current account surplus.

### Lockdown clearly visible in exports, but trend could soon shift

Goods exports sprinted from the starting blocks this year on the back of the massive global demand for goods. Since the pandemic struck in spring 2020 and global industry stalled, goods exports have gone only one way – up – hitting a level in Q1 that was almost 8% above their previous peak in 2019. Cyclically sensitive exports like machinery have performed very well of late, and there is nothing to immediately indicate a slowdown in momentum. On the contrary, Danske Bank's export barometer is at an all-time high as a result of soaring growth in Denmark's key export markets. In the near term, increasing shortages of materials could result in a slowdown that might shave the top off export growth. As outlined above, however, this is where the pharmaceutical industry can benefit the Danish economy. As the service economy reopens across Denmark's export markets, we would expect the demand for goods to moderate and the rate of growth in goods exports to settle at a more modest level.

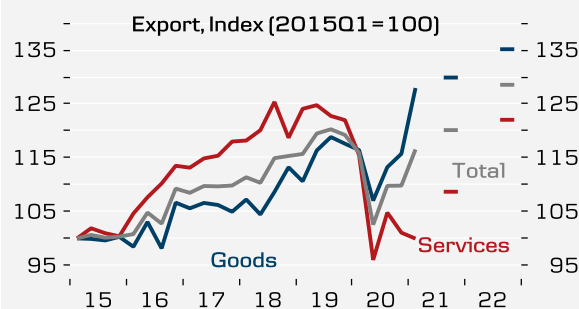
Service exports remain almost 20% below their peak in 2019. In part, this is due to the tourism industry shutting down, which produced a decline of DKK11bn in Q1 compared to before the pandemic. Nevertheless, German tourists being allowed to enter Denmark again without having to go into quarantine from the start of June means that conditions for the Danish tourist industry have improved. Last year, Germans accounted for 45% of total Danish tourism exports and around 30% in a normal year, equivalent to DKK17bn. Exports of building and construction services can explain the rest of the decline in service exports, as exports here in Q1 were DKK12bn below the peak in 2018. Developments here are often affected by large, individual construction projects, and we can probably count on a recovery here as postponed projects are resumed.

#### Small fluctuations in the big picture



Sources: Macrobond Financial, Statistics Denmark

#### Comeback for service exports ahead



Sources: Statistics Denmark, Danske Bank, Macrobond Financial

#### Record growth across Denmark's export markets



Note: Index 50 delineates between growth and contraction, see our Export Barometer. RH axis indicates difference in percentage points of companies expecting more orders relative to how many expect fewer.  
Source: Danske Bank, IHS Markit, Statistics Denmark, Macrobond Financial.

## At a glance

			Forecast	
National account	2020	2020	2021	2022
	DKK bn (current prices)		% y/y	
Private consumption	1026.3	-2.0	3.0	4.0
Government consumption	575.7	-0.1	0.9	0.2
Gross fixed investment	527.5	2.1	3.0	3.5
- Business investment	319.3	-1.2	1.4	4.8
- Housing investment	124.1	6.9	10.9	2.6
- Government investment	84.1	8.3	-2.4	0.0
Growth contribution from inventories		-0.2	-0.2	0.0
Exports	1262.8	-7.7	9.7	7.0
- Goods exports	773.5	-2.4	14.8	4.1
- Service exports	489.4	-17.6	4.2	12.3
Imports	1112.0	-4.8	8.1	6.4
- Goods imports	674.3	-0.8	13.3	4.3
- Service imports	437.8	-10.4	0.2	10.2
GDP	2323.7	-2.7	3.0	3.5

Economic indicators	2020	2021	2022
Current account, DKK bn	191.9	203.5	213.9
- % of GDP	8.3	8.4	8.5
General government balance, DKK bn	-14.0	-50.0	-10.0
- % of GDP	-0.6	-2.1	-0.4
General government debt, DKK bn	981.3	935.0	945.0
- % of GDP	42.2	38.7	37.3
Employment (annual average, thousands)	2981.2	2995.5	3039.0
Gross unemployment (annual average, thousands)	132.3	124.1	106.8
- % of total work force (DST definition)	4.6	4.4	3.8
Oil price - USD/barrel (annual average)	42	65	73
House prices, % y/y	4.3	11.5	2.5
Private sector wage level, % y/y	2.3	2.7	2.5
Consumer prices, % y/y	0.4	1.2	1.2

Financial figures	22/06/2021	+3 mths	+6 mths	+12 mths
Lending rate, % p.a.	-0.35	-0.45	-0.45	-0.45
Current account rate, % p.a.	-0.50	-0.60	-0.60	-0.60

Source: Statistics Denmark, Danmarks Nationalbank, Macrobond Financial, Danske Bank

# Sweden

## Sluggish recovery

- Growth has disappointed slightly but recovery is expected to gain pace in second half of the year on the back of fading Covid-19. We keep our GDP forecast unchanged. Large differences in labour market, but optimistic hiring plans are expected to be reflected in lower unemployment rate.
- House prices have continued at an unsustainable pace, we expect a slowdown but no decline unless there is a reduction of interest rate tax deduction as currently under political deliberation.
- Inflation peaked in April, looking forward we expect inflation to fall towards 1 percent soon. Inflation expectations are likely to turn down too. Hence Riksbank is framed with its usually low inflation environment.
- Riksbank is expected to continue to signal an unchanged repo rate for a long time. In effect has already started to taper its QE-programme, a trend that will continue into next year. The political turmoil might add a short-term risk premium to the SEK.
- Central government budget deficit has been smaller than expected. Meaning Sweden's public finances still in very good shape. Short-term risks for higher interest rate volatility related to the political turmoil should be very limited.

### Growth underperforming slightly

Q1 GDP expanded by 0.8 % qoq sa which was slightly less than our March NO forecast. The interpretation of the outcome is a tricky due to a skewed mix of drivers. Inventory build-up was the main contributor adding 0.5 percentage points to GDP growth. Taking a positive view on this suggests firms are in the process of restocking as demand is expected to rise sharply ahead at the same time as there are supply disruptions holding back current production. This view is supported by strong manufacturing new order and long delivery time prints in PMI and NIER surveys, noting that these appear to have peaked.

However, exports expanded by a mere 1.3 % qoq sa and imports rose even more. Hence, net exports added nothing to GDP in Q1. Likewise, there are no evident signs yet that manufacturing is boosting capital spending as demand is recovering.

Turning to consumption, households added 0.2 p.p. to growth in Q1 as mainly "stay away" consumption recovered from the 2<sup>nd</sup> Covid19 wave that gradually hit spending in Q4. The April consumption indicator, however, took another dive as "stay away" components weighed down. It is very hard what to make of this just yet as the NIER May survey flagged a continued improvement in business situation in restaurants/hotels, transportation and travel agencies, all being positive for the first time since February 2020. Hence, data is a bit inconclusive in this respect.

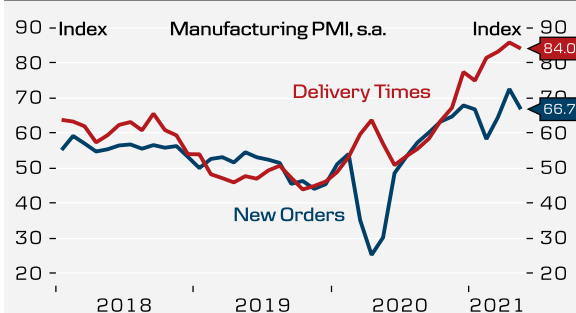
At glance at our overall growth indicators, then, implies a weak and quite modest start to Q2 GDP growth. In the March NO we expected Q2 growth at 0.5 % qoq sa slowing on the back of supply disruptions, in principle half of the

### Changes relative to previous forecast

	Sweden			
	Current forecast		Previous forecast	
% y/y	2021	2022	2021	2022
GDP, calendar adjusted	3.7	3.4	3.4	3.3
Private consumption	3.4	4.1	3.2	4.2
Public consumption	1.7	1.4	1.6	1.5
Gross fixed investment	2.5	3.7	3.6	3.2
Exports	8.8	4.0	7.5	4.1
Imports	7.0	4.1	7.3	4.1
			0.0	0.0
Unemployment rate	8.5	7.3	8.5	7.3
Inflation	1.3	0.7	1.2	0.8
Government balance, % of GDP	-0.6	0.1	-1.7	-0.4
Current account, % of GDP	6.6	6.4	5.1	5.1

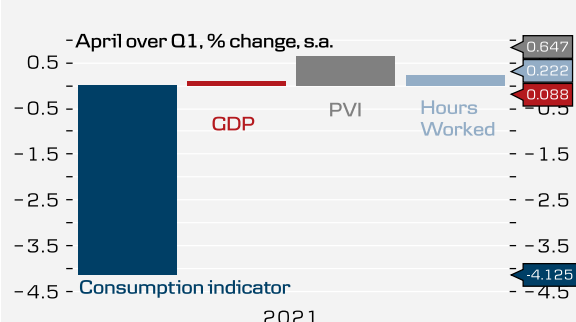
Source: Danske Bank

### Manufacturing momentum turning lower now



Source: Swedbank

### Indicators suggest weak start to Q2 growth



Source: SCB

Q1 pace. The April GDP indicator, however, was only 0.1 % above Q1, being dragged down by the plunge in consumption (down 4.2 % vs Q1). Negative consumption developments was being balanced by higher production (+0.6 % qoq) and more working hours (+0.2% qoq).

Evaluating the current situation, there is no reason to revise up the 2021 growth outlook at this instance. Q1 was weaker than forecast and Q2 has also started weaker than we assumed in the March NO. To get back on track for Q2, the GDP indicator need to rise 1.5 % sa in May and June. This will be quite hard to achieve, but we stick to our previous forecast noting risks are probably skewed to the downside.

## Red hot housing market likely to cool

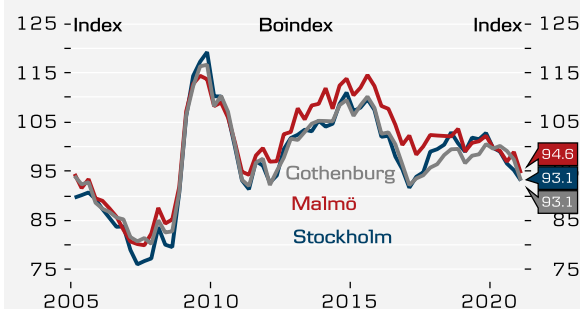
By April 2021, the average property price had risen by 18 % vs December 2019, driven mainly by a 23 % increase in single-family house price and leaving the increase in owner-occupied apartments well behind with a 9 % gain. This divergence illustrates well the hunt for bigger living space caused by Covid19. Our own Boprisindikator measuring owner-occupied apartment prices in Stockholm, shows a similar picture within apartment: it is the bigger ones that have gained the most. Despite the staggering price developments last year, affordability (Boindex) was well above the norm in Q1 in Sweden on average (at 111). However, the indices for single-family houses in the three major cities were all below the 100 index level, implying more than 30 % of DI was used to buy a house. This is actually close to the average since the survey started in 2005. The difference now is that mortgage rates are lower and prices have outpaced incomes.

Prices have so far been bolstered by declining mortgage rates and a lack of housing supply. Most likely, however, these have reached a bottom in the past few months. Hence, it seems quite likely that the price gains will moderate going forward. We do not expect prices drop unless there is an unexpected event such as a stock market crash or a change in housing taxes. The reinstated amortization requirement on August 31 is likely to have a dampening although not detrimental effect on prices. Currently, the biggest threat to house prices is a possible Government proposal to gradually reduce the 30 % interest rate tax reduction over a number of years, starting next year. Both the speed and the size of the reduction is unclear. Such a reduction has been proposed by several authorities such as Riksbank, FSA and the Debt Office with the aim of slowing credit growth, household indebtedness and eventually house prices. The Government also appears to see this as a source of funding part of the welfare system.

## Labour market

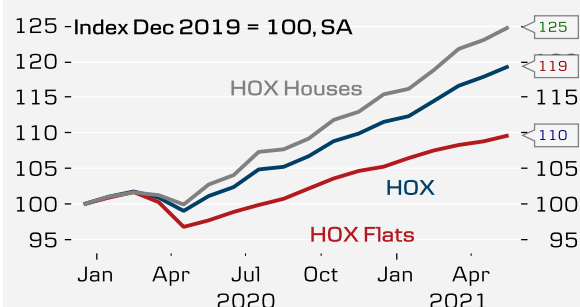
Initially of the Covid-19 pandemic, the unemployment rate rose sharply but as soon as the short-term furlough system came into place the labour market stabilized. Now, a year later, the overall picture of the labour market is optimistic but there are large differences in the recovery between sectors and groups. Short term unemployment is lower than one year ago, layoffs have continued to be low during 2021, the number of short-term furloughs is about 38 000, which can be compared with 270 000 a year ago and also new vacancies is back at pre-covid levels.

Single-house affordability is very stretched in the three major cities



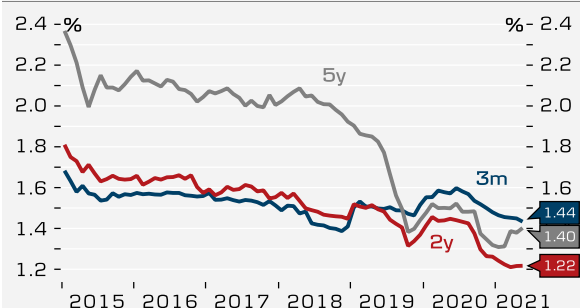
Source: Swedbank

Soaring prices as buyers pay up for bigger space



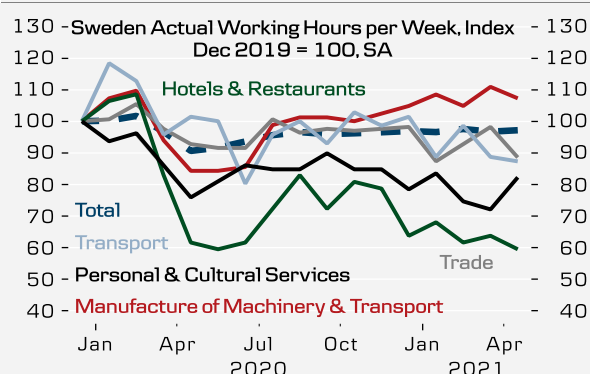
Sources: Valueguard, Danske Bank calculations

Mortgage rates has probably bottomed



Source: Average of major housing credit institutions in Macrobond

Hours worked should pick up also in Hotels and Restaurants



Source: SCB, Macrobond

Against this encouraging picture, long-term unemployment rate is at historical high level and hours worked (up to April) shows that production in consumer related services still lags behind. Especially hotels & restaurants gives a gloomy picture, where no improvements have been seen since last summer. However, the vaccination process have speeded up, restrictions are gradually lifted, which is reflected in optimistic hiring plans in also these hard hit sectors. This indicates a demand for labour in near term and long-term unemployment should decline too.

We expect unemployment rate to continue to gradually decline from here, albeit at a quite slow pace.

## Inflation has peaked, now heading for 1 %

Swedish inflation has peaked. Core inflation CPIF excl. Energy actually peaked already in January after partially being boosted by the annual re-weighting of the basket. Being lifted by energy prices, it took another few months for CPIF to peak in April. By May, however, both these measures had fallen back, CPIF and CPIF excl. Energy printing 2.1 % yoy and 1.2 % yoy respectively. This is only marginally above Riksbank's latest forecast. We expect a further steep decline over the summer with both these measures stabilizing around 1 % in the second half of 2021, turning below Riksbank's projections.

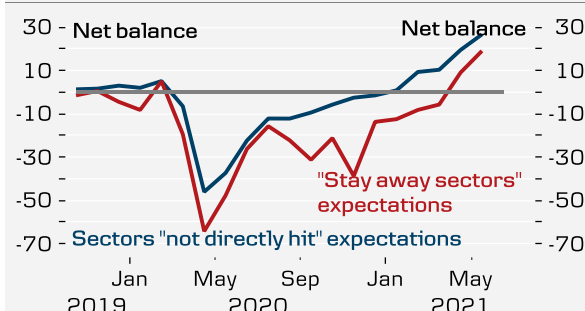
The swing in Swedish CPIF inflation between the trough in April 2020 and the peak in April 2021 has largely been driven by energy prices, mainly electricity. The Corona pandemic has also had a strong impact on prices in the "leisure" industry such as hotels, restaurants, transportation and charter packages to mention a few. In retail trade, clothing appears to be most affected.

The impact from global supply disruptions such as semiconductors or lack of containers is largely absent in Swedish data. To be sure, producers of consumer goods in Swedish manufacturing has raised their price expectations significantly lately. However, price expectations has simultaneously been cut among retailers. The same is true looking at consumer-related services. In any case, we view the impact on prices of these disruption as a temporary phenomenon since this requires input prices to soar at the same pace as over the past year to keep inflation high. This appears highly unlikely.

Instead, it seems more reasonable to expect inflation fundamentals to come into play again. That means wage cost pressures and SEK developments impacting consumer import prices. Wage cost pressures are set to remain low for the next two years as central wage agreements are record low and wage drift is basically absent. Furthermore, the SEK appreciation over the past year has already pulled down imported consumer goods prices at the producer level to the lowest since April 2010 in the aftermath of the financial crisis. Over the coming months this is likely to add downward pressure to imported prices in CPI too.

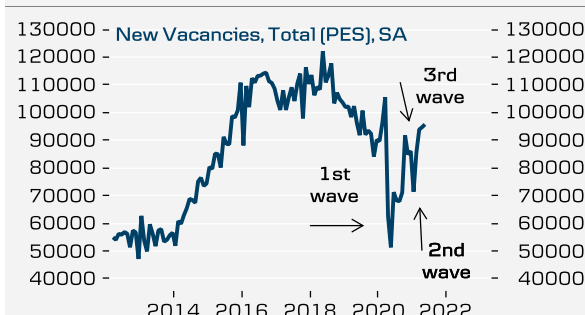
Inflation expectations have risen lately, however, we don't give these developments much attention as expectations are basically adaptive i.e. they follow the most recent inflation outcome. Hence, as inflation gradually decline we should see inflation expectations do the same.

Demand for labour in coming months according to NIER



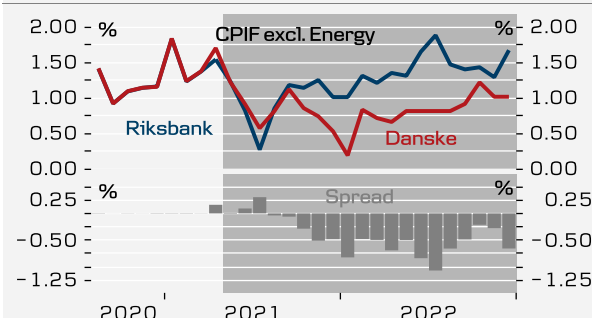
Source: NIER, Macrobond

No signs of the 3rd wave in new vacancies



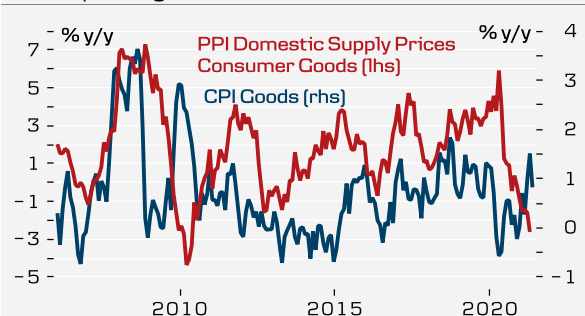
Source: PES, Macrobond

Core inflation peaked, toward 1% or lower now



Source: SCB, Riksbank and Danske Bank

Consumer prices in PPI falling at fastest pace since 2010, pushing CPI lower



Source: SCB



## Riksbank to face same old headache

As mentioned above, we expect Riksbank to run into trouble again in the sense that inflation is likely to undershoot its forecasts. We don't expect Riksbank to react on that, however, unless there is a sharp drop in long-term inflation expectations say closer to 1.5 %.

Hence, the base case is as previously that Riksbank will stick to its current repo rate forecast signalling an unchanged repo rate into mid-2024. At some point, Riksbank will need to consider raising the end-point above zero, but such a step is unlikely to occur as long as economic developments are not on a solid footing. In the meantime, risks are probably slightly tilted to the downside.

Theoretically, an extension of Riksbank's SEK 700 bn QE program could be used if needed but we find that quite unlikely under the current circumstances. Actually, as seen in the withstanding table, Riksbank has reduced the pace of purchases from SEK 120 bn in Q1 to about SEK 100 bn in Q2 and further down in H2 2021. The overwhelming part has been in covered bonds and then considerably less in munis and government bonds and very small amounts in corporates.

In 2022 Riksbank aims at keeping the portfolio intact at the end-2021 level. To do that Riksbank need to buy about SEK 145 bn that matures in 2022, about SEK 36 bn on average per quarter. The allocation is roughly expected to remain the same as in 2021.

In essence, Riksbank has already started a gradual reduction of bond purchases that will continue into next year. This may be seen as a slight tightening of QE, but to gauge the impact on interest rates it is necessary to take into account net supply of different bonds. Without going into details, we expect Riksbank's purchases to keep a lid on longer-dated rates and spreads going forward.

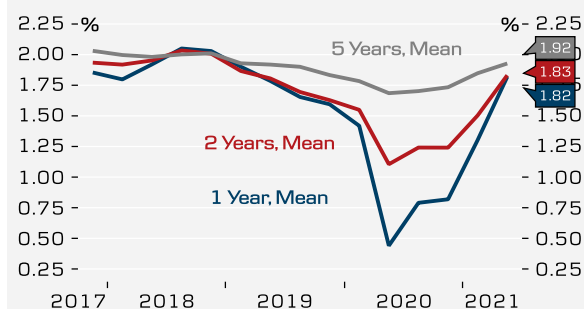
We perceive most members of the Executive Board to be quite cautious not to signal any unwarranted tightening

So far, Riksbank has been quite relaxed about the, by now, quite significant appreciation of the SEK. We find it hard to see that the krona can continue to strengthen much more without having a detrimental impact on inflation. On the contrary, the SEK needs to weaken from here on to increase the chance for pushing inflation toward 2 % in coming years. The recent political turmoil in which PM Lofven received a vote of no confidence is likely to induce a short-term political risk premium weakening the Krona, at least until the political outlook becomes less opaque. This might take several months.

## Solid public finances unaffected by politics

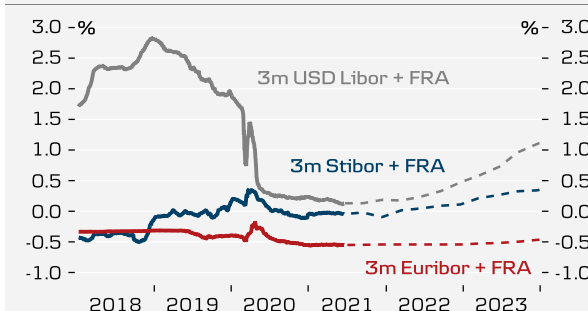
Despite the largest stimulus packages in modern history, the impact on government finances has been significantly less than first anticipated. The Debt Office have done significant revisions of the projected budget balance and now expects the central government budget to be close to balance this year (deficit of 4bn), with a surplus next year (61bn). The main reason for this 'better-than-expected trend' is that the downturn in the Swedish economy was smaller than first expected which also is reflected in much higher tax revenues. However, the difference between the DO's and the government's aggregated budget balance for 2021-22 is very large with a gap of more than 120bn, and it is hard to understand why. But with only a year to next general election in Sweden (Sep 2022), one explanation could be that the government plans to announce

Inflation expectations higher, but set to fall back again



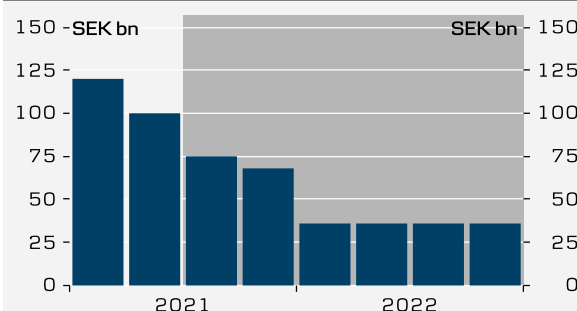
Source: Prospera

Market prices Riksbank hikes, we see none for a long time



Source: Macrobond, Danske calculation

Riksbank to continue to "taper" purchases



Source: Riksbank, Danske Bank calculations

Large gap between DO and government forecast

Budget forecast, bn	2021	2022	Total
Debt office (May)	-4	65	61
Government (Apr)	-140	77	-63

Source: Debt Office

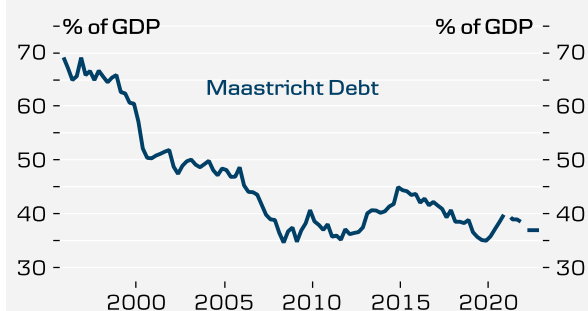


more stimulus close to that. Which might be a risk to the DO budget balance forecast.

All in all, the overall picture is that the public finances continues to be strong despite the Covid-19 pandemic. The central government debt (Maastricht) is expected to be hold below 40% which in an international perspective is low.

We believe that the budget outlook will escape quite unscathed from the recent political turmoil. Spending plans have already been decided and authorities act according to plans. Hence, at least short-term the situation appears stable. Longer-term, it is more a question of how a future government runs the overall economic priorities, either towards the left or the right.

Not much signs of a world pandemic in Sweden's public finances



Source: Government, World bank

## At a glance

			Forecast	
National account	2020	2020	2021	2022
	SEK bn (current prices)		% y/y	
Private consumption	2193.9	-4.7	3.4	4.1
Government consumption	1326.7	-0.5	1.7	1.4
Gross fixed investment	1237.1	0.6	2.5	3.7
Growth contribution from inventories		-0.8	0.2	0.1
Domestic demand	4747.2	-3.0	2.9	3.4
Exports	2221.4	-5.2	8.8	4.0
Aggregate demand	6968.6	-3.7	4.8	3.6
Imports	1991.2	-5.8	7.0	4.1
Growth contribution from net exports		0.0	1.1	0.2
GDP	4977.4	-2.8	3.8	3.4
GDP, calendar adjusted	4975.0	-3.1	3.7	3.4
Economic indicators	2020	2021	2022	
Trade balance, SEK bn	211.203	286.2	294.3	
- % of GDP	4.3	5.5	5.5	
Current Account, SEK bn	271.2	341.2	344.3	
- % of GDP	5.3	6.6	6.4	
Public sector savings, SEK bn	-166.0	-40.0	10.0	
- % of GDP	-3.2	-0.6	0.1	
Public debt ratio, % of GDP*	40.0	38.0	35.0	
Unemployment, % of labour force	8.3	8.5	7.3	
Hourly wages, % y/y	2.0	1.9	1.9	
Consumer prices, % y/y	0.5	1.3	0.7	
House prices, % y/y	7.5	13.0	2.0	
* Maastricht definition				
Financial figures	22/06/2021	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	0.00	0.00	0.00	0.00

Source: Statistics Sweden, Macrobond Financial, Danske Bank

# Norway

## Here comes the upswing

- The reopening plan is on course thanks to more vaccinations, and optimism has returned across sectors and regions
- We expect a further rebound in H2, boosted by pent-up demand and global growth
- Laid-off workers will largely return to work, and unemployment will approach normal levels
- The housing market is calming down, and we expect prices to level out
- The NOK is being driven mainly by global factors, and we still expect a moderate fall towards the end of the year
- We expect Norges Bank to raise its policy rate by 25bp in September, and again in December, March and June.

### Recovery ahead

As expected, higher infections and new restrictions put the brakes on growth in Q1 and into April. But with rising vaccinations and falling infections, both national and local authorities have gradually been able to relax restrictions. There are early signs that this is seriously beginning to boost growth in the Norwegian economy, and in particular it has meant that optimism is returning.

According to Norges Bank's regional network survey, firms now anticipate annualised growth of around 3.75% over the next six months, in what appears to be a broad-based upswing across both sectors and regions. The figures show particularly strong sentiment in consumer services, the sector hit hardest by the pandemic. As we had hoped, there has also been a clear improvement in the outlook for construction, driven by public infrastructure projects and possibly also higher homebuilding. Strong activity is also expected in manufacturing (for both the domestic market and the export market) and oil-related industries.

The survey shows that the proportion of firms reporting capacity constraints is now slightly above the historical average. This points to activity levels in the Norwegian economy already being close to normal.

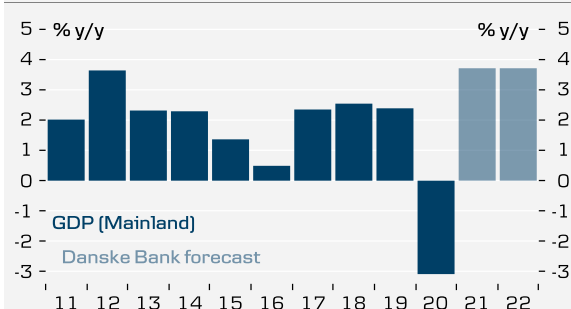
The clearest sign that the economy is already improving can be found in unemployment, which fell sharply in May and the first part of June. The number of jobless has fallen furthest in parts of the service sector, such as hotels and restaurants, and in the Oslo/Viken region. This shows that the easing of coronavirus restrictions has begun to have an effect, and the drop in unemployment could be a sign that the upswing has been somewhat stronger than anticipated.

We have not revised our forecast a great deal this time around, as we had assumed that the economy would largely reopen from the summer, and the latest vaccination plan from the Norwegian Institute of Public Health indicates that the government's reopening plan is realistic. We therefore forecast a solid rebound in growth in May-July, compensating for the slightly weaker performance than expected in March/April (including the downward revisions of GDP). We therefore still predict mainland GDP growth of 3.7% this year. Based on slightly higher projections for global growth, and slightly larger

### Changes relative to previous forecast

Norway				
	Current forecast		Previous forecast	
% y/y	2021	2022	2021	2022
GDP (mainland)	3.7	3.7	3.7	3.4
Private consumption	5.0	7.4	6.0	7.0
Public consumption	2.5	1.8	2.0	2.0
Gross fixed investment	1.0	2.0	1.0	2.0
Exports	2.7	6.5	2.6	6.0
Imports	3.5	7.0	5.0	6.0
Unemployment (NAV)	3.3	2.5	3.3	2.5
Inflation	3.1	1.7	2.8	1.4

### Strong recovery



Source: Macrobond Financial, Danske Bank

increases in both consumption and investment next year, we have revised our growth forecast for 2022 up from 3.4% to 3.7%.

As mentioned above, we still expect growth to bounce back strongly in H2, driven by an upswing in the sectors hit hardest by the pandemic. We also expect growth to be boosted by pent-up demand. The extension of coronavirus restrictions meant that savings grew further in the first four months of the year, and households now have almost NOK 150bn more in the bank than they did in February 2020. We assume that some of these savings will be spent in H2 and into 2022. How much is naturally very difficult to say, which means that our forecast for private consumption this year and next is very uncertain.

## Unemployment falling fast

As mentioned above, unemployment has already started to come down with the reopening of sectors previously locked down and a return to work for many of those temporarily laid off. We obviously expect this pattern to continue into H2. At the same time, we can see that ordinary unemployment is falling too, which supports the impression that there has also been relatively strong growth in the sectors less affected by the virus. Clear confirmation of this can be found in the data for job vacancies, which were 2% higher in Q1 than at the end of 2019. In fact, we have to go right back to Q2 2019 to find as many jobs advertised in Norway.

This picture is supported by the firms in the regional network survey now expecting a substantial increase in employee numbers in the coming months, although it is difficult to distinguish between genuine new recruits and the return of staff previously laid off in such a survey. This is a clear sign of growing demand for labour in the sectors not directly affected by the coronavirus restrictions.

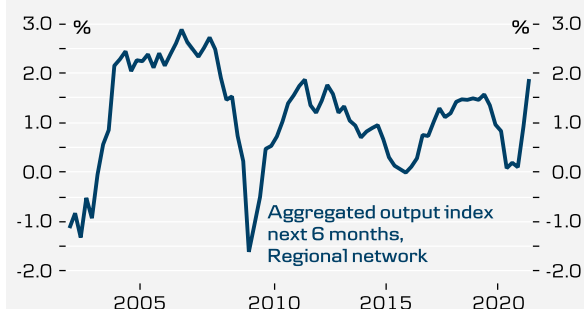
We still expect unemployment to continue to come down over the rest of the year, with the registered rate heading down towards, and maybe even below, 3% at the end of 2021. As the strongest rebound effects fade, and part of the coronavirus boost to retail etc. reverses, we expect the decline in unemployment to slow, but we still think it could move below 2.5% in the course of next year.

## Wage growth higher than expected, inflation very uncertain

Last year, there were signs of higher wage growth than expected given the massive shock to the labour market. Part of the increase was due to the distorting effect of a larger share of low-paid workers being made redundant or temporarily laid off, and so no longer being included in the wage statistics. But even when drilling down into the data for different professional groups and sectors, wage growth seemed to be higher.

In our last report in April, we wrote that it looked as though this trend was influencing the two sides going into this year's pay talks, and that wage growth could be higher than many anticipated. The final outcome is still unknown, since parts of the public sector remain on strike after the two sides failed to reach a deal. In the private sector, agreement was reached on wage growth this year of around 2.7%. However, this assumes that local supplements and other changes result in wage drift of only around 1%, which would be the lowest since the oil crisis in 2016. Given that activity levels across much of the private

Renewed optimism in the business sectors



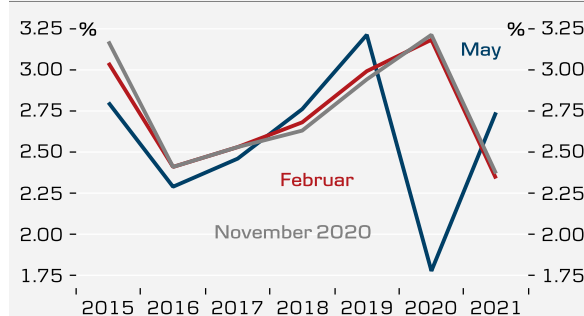
Source: Macrobond, Danske Bank

Unemployment dropping as restrictions are removed



Source: Macrobond, Danske Bank

Wage growth revised up



Source: Macrobond, Danske Bank

sector other than the parts hit particularly hard by the coronavirus is already more or less back to normal, this would seem an optimistic assumption.

We have therefore revised wage growth up slightly from 2.6% to 2.7% this year once account is taken of average wages falling as low-income groups return to work.

This slightly higher wage growth also means that domestic cost pressures will be marginally stronger than previously assumed, which will impact on inflation via domestic prices. Imported inflation, however, will fall further, as the NOK has strengthened so far this year. This disinflationary pressure will be amplified through to August by negative base effects (high inflation in the corresponding months last year). We are therefore assuming that inflation will drop well below 2% towards the end of the year.

On the other hand, we are now seeing more examples of rising costs for commodities and freight, and there are increasingly local and global bottlenecks that could result in stronger price pressures than we have assumed. Norges Bank's expectations survey shows a clear move towards higher inflation expectations, and firms are reporting both higher purchase prices and higher selling prices. This presents an upside risk to our inflation forecast. It was therefore a big surprise when core inflation dipped to 1.5% y/y in May, driven by lower imported inflation.

## Signs of housing prices levelling out

Housing prices have slowed over the past two months, and the annual rate of increase has fallen. As we wrote in our previous report, our forecast assumes that much of the increase in prices has already taken place, and we expect prices to slow considerably in H2. Sales of new homes have picked up, and housing starts have begun to climb, which will gradually bring a better balance to the market during the autumn. At the same time, we expect interest rates to begin to rise gradually from September, and together with the prospect of further rate increases in the coming years, this is likely to put a damper on prices through the expectations channel. This view is supported by Eiendom Norge's price expectations survey.

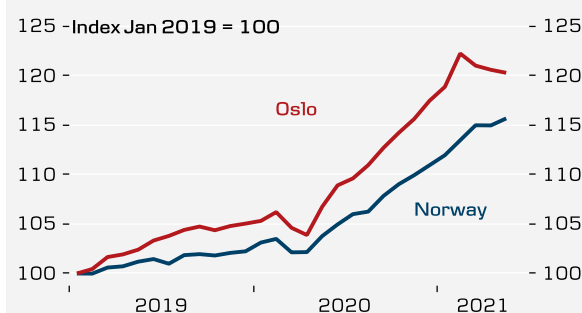
It is also worth noting that this trend is strongest in Oslo, where prices have actually fallen in seasonally adjusted terms for three months on the trot. We therefore expect housing price inflation to finish up just below 9% this year and then slow to just over 2% next year. It is important to stress that the risk of a strong supply-driven decline in housing prices is only moderate. While the supply of properties has improved somewhat, and there is now a better balance in the market, it remains relatively tight in terms of the stock-to-sales ratio. And while homebuilding activity has picked up, it is still too low to create future imbalances.

## NOK mostly dependent on global factors

In our previous report, we stressed that movements in the NOK since the coronavirus crisis erupted show that it is mainly global factors that have been determining the exchange rate, rather than expectations for the Norwegian economy and Norwegian interest rates. We have since had clear confirmation of this.

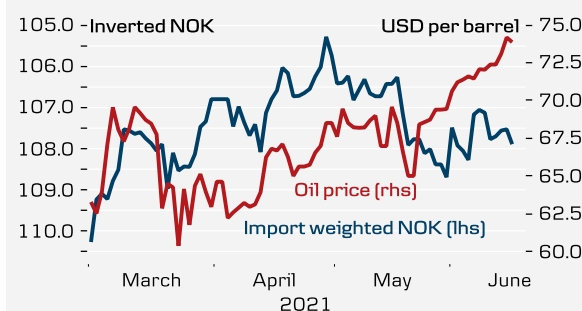
The market now considers it most likely that there will be a rate increase in Norway in September, and the price of a barrel of oil is USD 7-8 higher than

Housing prices starting to level out



Source: Macrobond, Danske Bank

NOK weaker than oil prices would have suggested



Source: Macrobond, Danske Bank

three months ago. The NOK is nevertheless around the same level, both against the EUR and on an import-weighted basis, as when our last report was published. We have also seen examples of these drivers on a daily basis during the period.

We expect the global industrial cycle to peak during the course of this year, due to tightening in China and a reversal of the sharp growth in global consumer spending. On top of this, we expect markets increasingly to price in policy rate hikes and a scaling down of quantitative easing in the US, which will push up global real rates, boost the dollar and slow/reverse the rise in inflation expectations. All of these factors will act as headwinds for commodities and commodity-based currencies such as the NOK. We therefore still expect the NOK to weaken somewhat during the autumn despite signals of higher interest rates.

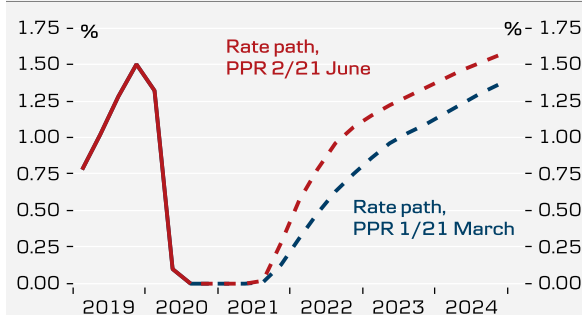
### Norges Bank to hike in September and December

As expected, Norges Bank left its policy rate unchanged at 0.0% at its meeting during the week but signalled that it will most likely be raised in September.

The accompanying monetary policy report presents interest rate projections showing not only a first hike in September but also a very high chance of a second in December. The background to this upward revision of the interest rate path is a combination of stronger wage growth, more expansionary fiscal policy, higher oil prices and oil investment, stronger global growth and growing optimism among firms in Norway. The bank now expects activity to return to normal levels as early as Q3 this year, and its projections actually show four rate increases in the next four quarters, one more in 2023 and almost another in 2024, taking the policy rate to between 1.50% and 1.75% at the end of 2024.

We therefore still expect Norges Bank to raise its policy rate in September. Given that its projections are more or less in line with our own forecasts, we now expect a second rate increase in December, a further three next year, one in 2023 and one in 2024, taking the policy rate to 1.75% at the end of 2024.

Norges Bank signalling two hikes this year



Source: Macrobond, Danske Bank



At a glance					
			Forecast		
National account	2020	2020	2021	2022	
	NOK bn (current prices)		% y/y		
Private consumption	1417.5	-7.6	5.0	7.4	
Public consumption	905.6	1.7	2.5	1.8	
Gross fixed investment	907.0	-3.9	1.0	2.0	
Petroleum activities	180.3	-4.9	-1.5	-4.0	
Mainland Norway	720.7	-3.9	1.0	3.3	
Dwellings	46.2	-4.0	3.5	5.5	
Enterprises	44.7	-6.3	0.0	3.0	
General government	216.4	-0.3	0.8	1.3	
Exports	1110.0	-0.9	2.7	6.5	
Traditional goods	408.5	-2.3	5.5	4.0	
Imports	1125.3	-12.2	3.5	7.0	
Traditional goods	747.1	2.3	4.0	3.5	
GDP	3413.5	-1.5	3.5	3.8	
GDP Mainland Norway	3043.0	-3.1	3.7	3.7	
Economic indicators		2020	2021	2022	
Employment, % y/y		-1.3	0.6	1.8	
Unemployment (NAV), %		5.0	3.3	2.5	
Annual wages, % y/y		3.1	2.7	3.1	
Consumer prices, % y/y		1.3	3.1	1.7	
Core inflation		3.0	2.0	1.9	
Housing prices, % y/y		4.5	8.9	2.5	
Financial figures		22/06/2021	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.		0.00	0.25	0.50	1.00
Source Statistics Norway, Norges Bank, Macrobond Financial, Danske Bank					

# Finland

## Recovery is here to stay for a while

- Finnish economy is quickly recovering from the corona crisis now that vaccinations have helped to bring down the epidemic and lockdown measures are being lifted. In 2020, GDP contracted only 2.7% and there is little sign of permanent deterioration of potential output.
- Private consumption was still weak in Q1 2021 but it will support the recovery for the rest of the forecast period. External demand for export industries is also strong, which is expected to speed up investment activity. On average, we expect GDP to grow 2.6% in 2021 (was +2.3%) and 2.9% in 2022 (was 3.0%).
- Labour market has endured the corona pandemic with considerable resiliency. Employment will increase as the lockdown measures are removed from service sector. We forecast the average annual unemployment rate to fall from 7.8% in 2020 to 7.7% in 2021 and to 7.1% in 2022, which is close to full employment.
- The Finnish housing market performed well and households' intentions to buy housing and withdraw loans remain at a very high level. Increasing housing construction should reduce price pressures.
- Public debt will continue to grow significantly in 2021. Debt-to-GDP ratio is set to rise above 70%. Age-related costs will push debt higher in the latter part of 2020s and structural reforms are needed.

### Changes relative to previous forecast

	Finland			
	Current forecast		Previous forecast	
% y/y	2021	2022	2021	2022
GDP	2.6	2.9	2.3	3.0
Private consumption	4.0	3.0	4.0	3.0
Public consumption	1.5	1.0	1.5	1.0
Gross fixed investment	4.0	3.0	2.0	3.0
Exports	3.5	6.0	3.5	6.0
Imports	5.0	5.0	5.0	5.0
Unemployment rate	7.7	7.1	8.0	7.2
Inflation	1.7	1.6	1.4	1.5
Government balance, % of GDP	-4.7	-2.3	-3.5	-2.3
Current account, % of GDP	-0.2	-0.2	-0.2	-0.2

Source: Danske Bank

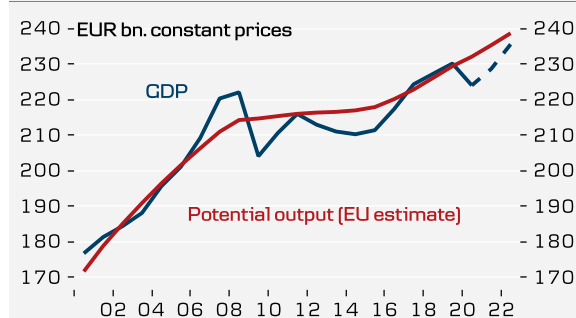
### Lockdown being phased out

It seems that the Finnish economy survived the corona pandemic with limited long-term economic damage. The second wave of Covid-19 has been a consistent headwind for the economy during winter but the economy contracted only modestly. According to preliminary figures, the Finnish GDP grew 0.4 % q/q in Q4 2020 and contracted 0.1% q/q in Q1 2021. In 2020, the annual Finnish GDP contracted 2.7%, which is also considerably less than in most EU countries. Now the epidemic is fading, the vaccinations have progressed as planned, and the reopening of the economy is well on its way.

During the COVID crisis, the Finnish economy has been relatively stable and many industries have continued to operate without interruptions. The pandemic itself has been relatively mild compared to most countries. Consequently, the lockdown measures have been less stringent. Good capabilities for remote work have helped to maintain productivity. Relatively large share of manufacturing and small share tourism industries have structurally supported the economy, especially compared to the worst hit countries in Southern Europe. Again this summer, many Finns are likely to spend their money domestically instead of traveling abroad.

The shock to the labour markets has been sizeable but the unemployment rate has not risen as much as feared. In spring 2020, approximately 170,000 workers were laid off but roughly 2/3 of them were able to quickly return to work over summer. Layoffs have stayed elevated over winter but lockdown restrictions did not lead to an additional increase in layoffs like we feared. The fiscal measures together with low interest rates, interest only periods and temporary modification of the insolvency legislation have helped to avoid bankruptcies, which still remain at a relatively low level. Public finances suffered a massive

### Output gap closing



Source: Macrobond Financial, Statistics Finland

blow in 2020 from crisis aid to businesses and decreasing tax revenue. Public deficit remains large in 2021 and the public debt will continue to grow significantly.

The reopening of the economy will free pent-up consumer spending on services and encourage businesses to invest in H2. Export industries will benefit from the on-going global recovery and continuing fiscal stimulus in export markets, which will bring more new orders.

We have revised our GDP growth forecast to 2.6% in 2021 (was 2.3%) given the strong outlook for both manufacturing and services, as well as a promising vaccination campaign. The gradual recovery is progressing well and it is set to gather strength in H2. We forecast a 2.9% increase in GDP (was 3.0%) in 2022. The projected growth path will take Finnish quarterly GDP above to pre-crisis level at the end of 2021 and reach potential output in 2022.

## Private consumption drives the business cycle

For a small open economy like Finland, changes in external exports demand typically drive the business cycle. However, during the corona crisis, changes in domestic private consumption have been the main driver of short-term demand fluctuations. After a strong but relatively brief rebound last fall, private consumption started to contract again towards the end of 2020 due to worsening epidemic situation. The contraction continued in Q1 2021 and the private consumption decreased 0.7% q/q from an already somewhat weak starting point and ended 4.1% below the 2020 level. The bright side is that there is much room for private consumption to recover now that the epidemic has improved.

During spring 2021, many lockdown restrictions have still been in place. However, as the vaccinations have progressed, the restrictions have become less stringent. The exact list of restrictions keeps changing all the time and it depends regionally on the local epidemic situation. Typically, more stringent restrictions have been in place in the Helsinki region. Restaurants and sports facilities still operate at reduced capacity and limited opening hours. Likewise, office workers are still advised to continue remote work. On the other hand, stores and many services, like hairdressers, have remained open at all times, unlike in many countries.

In 2020, household income developed more steadily than consumption. The main reason is that employment has fallen less than expected. At the same time, unemployment benefits, steady pension payments and wage increases have helped to maintain purchasing power. Consequently, savings rate rose and households on average have more deposits, which serves as a buffer against risks and makes it easier to increase consumption now that the economy is opening. Broadly speaking, household finances remain in good shape. The labour market is also recovering and open vacancies are at a high level. Increase in employment should give rise to a larger aggregate wage sum during the forecast period. Inflation accelerated to 2.2% in May. Rising inflation restricts the growth of purchasing power temporarily but there is little sign of persistent price pressures.

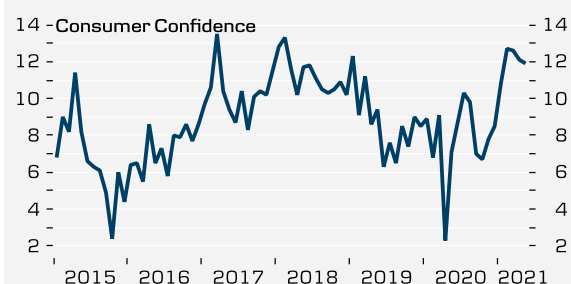
Households are expected to return to an important role in supporting the recovery in H2 21 and beyond. Now that the vaccination process has advanced enough, the boost from pent-up consumer demand is likely to be substantial.

Pent-up consumption on the horizon



Source: Macrobond Financial data, Statistics Finland

Consumers confident about the future



Source: Macrobond Financial data, Statistics Finland

However, the process will be gradual and extra saving will be spent over an extended time period. Consumption of services is likely to increase significantly, but retail trade could suffer a modest setback as consumers return back to restaurants from eating at home.

Private consumption shrank by 4.8% in 2020. We expect private consumption to make a +4.0% recovery in 2021. In our forecast, the growth of private consumption continues at 3.0% in 2022.

## Outlook for manufacturing remains bright

The strength of global manufacturing cycle has supported Finnish exports during winter months. The outlook going forward is quite good: maybe not fantastic, but certainly above average. In addition, Finnish factories did not close at any point in 2020 due to corona restrictions or lack of components which helped to avoid additional economic damage. In any case, there is some way to go to reach full recovery and exports were still 5.0% below the pre-corona level in Q1 2021. Especially service exports remain depressed. One obvious factor suppressing service exports is tourism, although its general equilibrium effects are less clear due to Finland's negative tourism account. Domestic travel supports the tourism industry. Also imports have fallen and the net contribution from foreign trade remains positive.

Finnish industrial manufacturing only saw a relatively small contraction last year compared to the situation in many other European countries. During initial months of the corona crisis, the main worry was the lack of new orders and the possibility of larger export driven companies experiencing difficulties, layoffs or bankruptcies. The worst has been avoided and the confidence in manufacturing has improved noticeably in 2021. During spring months, business surveys have indicated above average production outlook and order books. The structure of Finnish export industries with a relatively large share of long-term projects like passenger ships has been more robust against quick shifts in the business cycle during the corona crisis.

The expected global recovery in 2021 will support the outlook for Finnish exports during the forecast horizon. The EU recovery fund as well as CAPEX in the US should bring a boost next year. Exports declined 6.6% in 2020. For 2021, we are forecasting a modest recovery with exports growing 3.5%. In our forecast, the recovery continues in 2022 with exports growing 6.0%.

## Investment outlook improving

Investment demand decreased already in 2019 and the outlook was never particularly great for 2020. During the corona crisis, the volume of investments contracted further but less than we had feared and much less than, for example, during the financial crisis. In 2020, the investments fell by 3.3%. Industrial investment has fallen more sharply, as expected, but construction has supported the overall level of investment. In recent months, especially apartment construction has been on the rise following strong housing demand.

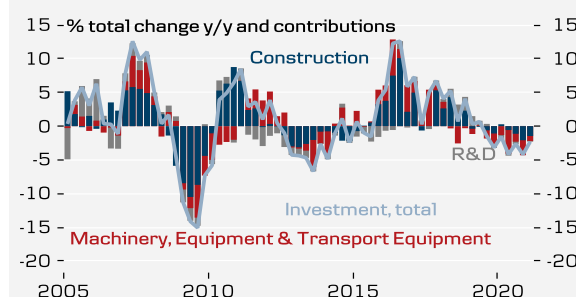
In Q1 2021, one of the bright spots during an otherwise difficult period was the increase in industrial investment. Investments in machinery, equipment and transport equipment rose by 4.3% from the previous quarter. Strong external demand for exports and on-going vaccinations boost investment demand. Also business surveys indicate strong growth for investments in 2021. Construction investment, apart from housing, remains weak and there is little need for office

Industrial orders continue to rise



Source: Macrobond Financial data, Statistics Finland, EK

Investment activity surprised positively in Q1 21



Source: Macrobond Financial data, Statistics Finland

or hotel construction anytime soon. SME companies are likely to remain more cautious in the coming months, while larger companies intend to invest more in 2021. Forest industry companies have announced sizable projects spanning over next few years. Energy sector companies plan to invest more after a weak 2020. As a positive contributor, the government intends to spend more on infrastructure, which should stimulate construction in the medium term.

In total, we expect investments to grow 4.0% in 2021. The previous forecast was 2%. In other words, the outlook is considerably more upbeat. For 2022, we are expecting some moderation but still reasonably strong investment growth at the rate 3.0%.

## Labour market tightening ahead

Labour market has endured the corona pandemic with considerable resiliency. Unemployment rose, but not as much as many feared. Temporary layoffs surged to a new record in spring 2020, but situation improved significantly in H2 2020. Layoffs remained elevated in spring 2021, but further weakening was avoided. Despite several months of headwinds from the second wave of Covid-19, the labour market remained stable and unemployment rate fell during spring 2021. Open vacancies are plentiful considering the severity of the crisis. Total wages and salaries rose by 2.9% year-on-year in February to April.

Service industry jobs recover when the epidemic is under control and people start traveling more. Restaurants and tourism-related service businesses have suffered the most, but their situation has started to improve together with the health situation and lesser restrictions. The second half of 2021 will likely see a considerable rebound in employment. Manufacturing and construction have faced less challenges. We forecast the average annual unemployment rate to fall from 7.8% in 2020 to 7.7% in 2021 and to 7.1% in 2022. Higher inflation and tighter labour market push wages up.

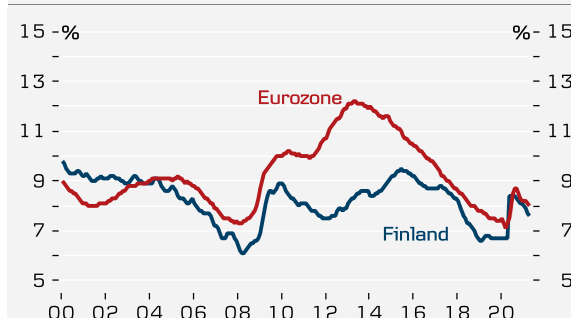
Many companies report that they suffer from lack of skilled labour already. Structural issues and skills mismatch imply that 7% unemployment rate is close to full employment in Finland. Full employment could be reached in 2022, and more education and reforms are needed to increase labour participation and push down the structural unemployment. Otherwise lack of labour will become an obstacle to growth.

## Housing market remains active

The Finnish housing market performed very well in 2020. Generally speaking, the corona crisis has had only a modest impact on the housing market. In some ways, it even seems to have supported active sales. When people spend a lot of time at home, and also work from home, it can lead to an increased need to find new housing. In surveys, households' intentions to buy housing and withdraw loans has risen to very high levels. Remote working arrangements and travel bans related to Covid-19 have caused a temporary boom in second homes in the countryside, which we expect to calm down.

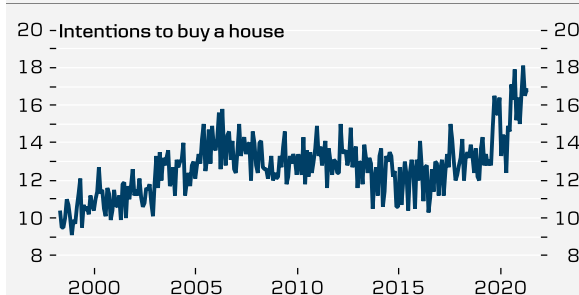
Prices of old apartments per square meter in Finnish housing companies rose 4.9% year-on-year in April 2021. Prices in Greater Helsinki were up by 6.1%. For several years, the average house prices have seen only modest rise in Finland with very much geographical variation. Prices generally rise in small number of growth centres and fall in locations with shrinking population.

Unemployment rate has started to fall



Source: Macrobond Financial data, Statistics Finland

Households interested in home purchase



Source: Macrobond Financial, Statistics Finland

Finland is behind many other EU countries in terms of urbanisation, which makes it likely that a similar main trend will continue.

In recent surveys, households' intentions to buy housing and withdraw loans has risen to very high levels. The result is probably partly related to a new life situation where much time has been spent at home because of Covid-19. Institutional and private investor interest into real estate investment has also increased demand of housing property. The stock of housing loans stood at EUR 104.0 bn in April, and the annual growth increase was 4.0%. Buy-to-let mortgages accounted for 7.9% of the total housing loan stock, while the share of new drawdowns was 9.1% in April. Construction permits indicate increasing housing supply. At the same time, many of the buy-to-let apartments are empty without tenants. We expect price development to moderate, once people start to spend more time outside homes and housing supply increases.

The average interest rate on housing loans stood at 0.81% in April. Many customers have hedged their interest rate risk, and we do not expect interest rates to rise much in the medium term.

The Financial Supervisory Authority (FIN-FSA) kept the maximum loan-to-collateral (LTC) ratio, and banks' capital requirements unchanged in March. Maximum LTC ratio stands currently at 90%, except that for first time buyer it is 95%. FIN-FSA is closely monitoring the housing market and household indebtedness, and urges banks to take particular care when assessing borrowers' ability to pay, especially in the case of large and long-term loans. According to Bank of Finland, vulnerabilities related to housing finance have increased in Finland during the COVID-19 pandemic. Long housing loans are being taken out more than before and a larger proportion of new mortgages are being granted to borrowers with high loan-to-income (LTI) ratio. Bank of Finland proposes a debt-to-income cap and a limit on the maturity of housing loans to stop the loosening of credit standards. A Ministry of Finance working group has proposed similar ideas.

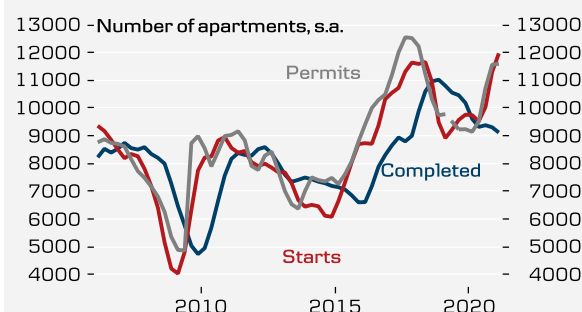
Housing loans have performed well through the Covid-19 recession. Many customers took interest only periods in 2020, but most of these have expired without any problems. Bank of Finland states that the Finnish financial system has remained stable despite the pandemic. In our view, the good economic outlook makes things stable in the medium term.

## Public deficit will not go away

Public deficit remains large despite the economic recovery. Central government net borrowing stands at over EUR 14 bn in 2021, according to the third supplementary budget, which implies no real improvement from 2020. Debt is projected to rise to over EUR 139 bn. This looks slightly pessimistic if the economy recovers and the cash holdings from last year are used. The government has also announced that the earlier expenditure framework would be exceeded by 900 million euros in 2022. We expect public debt-to-GDP ratio to exceed 70%. This will narrow fiscal policy space in coming years, even if Finland stays well below euro area average debt ratio. Sizable guarantee liabilities (roughly 25% per GDP) pose an additional risk to public finances. Rating agencies are patient but expect structural reforms.

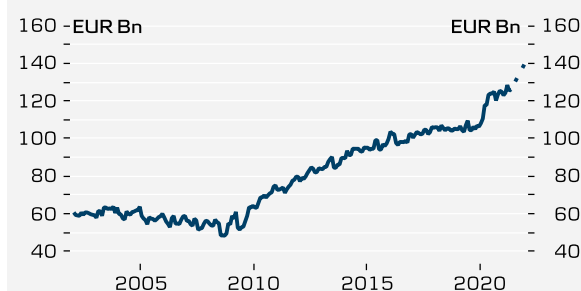
Finland expects to receive approximately EUR 2.9 billion out of the EU's 750 billion euro recovery package over the next few years. A large share of the funds will be used on "green transition" and digitalization. On the other hand,

Permit data indicates active housing construction



Source: Macrobond Financial, Statistics Finland

Central government debt projection



Source: Macrobond Financial, State Treasury



Finland's own contribution to the fund will be around EUR 6.6 billion. On top of more typical public spending, the Finnish air force is set to acquire new fighter jets, with the upcoming cost set to add roughly EUR1 billion annually to public debt over the next decade, starting in 2021.

The Finnish central government has been running a long-standing deficit since the financial crisis but strong growth in employment brought public finances closer to balance before the corona crisis. Also municipalities have been financing their spending with debt, ageing population is often behind weaker local government budgets. Ageing population implies significant increase in age-related costs, and a reform to move social and health care burden from municipalities to higher level of government is under way. The general government deficit has been narrowed by the surplus in social security funds, which consist mostly of statutory pension companies. Finland will need to address sustainability of public finances from a whole new position once the corona crisis is over. In the future, high employment rate remains important for healthy public finances. Structural reforms are needed to boost potential growth and improve labour participation in order to deal with the rise in age-related expenditure caused by an ageing population and rising dependency rate. Corona virus has not made the old issues go away.

## At a glance

			Forecast	
National account	2020	2020	2021	2022
	EUR bn (current prices)	% y/y		
GDP	237.5	-2.8	2.6	2.9
Imports	84.2	-6.6	5.0	5.0
Exports	85.2	-6.6	3.5	6.0
Consumption	178.4	-2.7	3.2	2.4
- Private	120.3	-4.9	4.0	3.0
- Public	58.1	2.3	1.5	1.0
Investments	56.0	-3.1	4.0	3.0
Economic indicators	2020	2021	2022	
Unemployment rate, %	7.8	7.7	7.1	
Earnings, % y/y	1.8	2.5	2.7	
Inflation, % y/y	0.3	1.7	1.6	
Housing prices, % y/y	1.4	2.2	1.5	
Current account, EUR bn	0.7	-0.5	-0.5	
- % of GDP	0.3	-0.2	-0.2	
Public deficit, % of GDP	-5.4	-4.7	-2.3	
Public debt/GDP, % of GDP	69.2	70.8	70.5	
Financial figures	22/06/2021	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	-0.50	-0.50	-0.50	-0.50

Source: Statistics Finland, Macrobond Financial, Danske Bank

# Global overview

## Brightening up

- Despite an intensification of the corona pandemic during the winter and spring, global economic activity continued its recovery.
- The global recovery from the pandemic crisis remains uneven. Especially emerging markets are lagging behind, while the US and euro area should recoup their pre-pandemic GDP levels by 2022.
- Chinese growth will continue to moderate as the boost to exports from US fiscal stimulus fades.
- Inflation and virus mutations remain the key risks to the outlook.

### An uneven global recovery

Despite an intensification of the corona pandemic during the winter and spring, global economic activity continued its recovery. Especially emerging markets such as India and Brazil have been hard hit by second and third waves, while the more rapid vaccination pace helped developed countries limit COVID-19-related fatalities and paved the way for a quicker relaxation of containment measures and economic rebound. Especially US and Chinese activity remained stronger than expected during the spring, due to the large fiscal stimulus approved by the Biden administration. We expect the recovery in the global economy to pick up further pace during H2 21, as both a faster pace of vaccinations and seasonality limit the spread of the virus and improving sentiment unleashes pent-up demand. Even though the exact timing of vaccination progress remains uncertain, we do not expect new restrictions to be necessary in the autumn. That said, the projected global recovery from the pandemic crisis remains uneven. Especially in emerging markets (excluding China) the recovery is expected to progress more sluggishly due to the slower vaccination rollout, while the US and euro area should recoup their pre-pandemic GDP levels already by Q3 21 and Q1 22, respectively.

### US economy firing on all cylinders

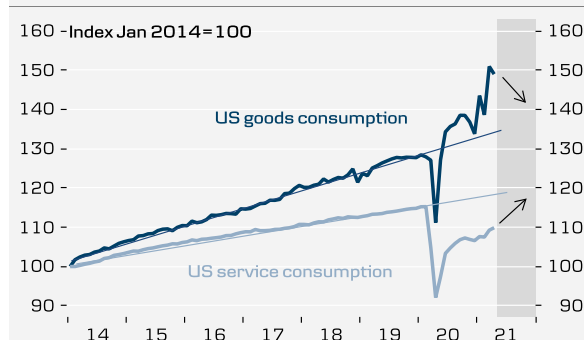
Thanks to forceful fiscal support and an earlier vaccine roll-out, the US economy continues to fire on all cylinders. While the fiscal boost will likely start to fade somewhat in H2 21, moderating high US goods demand in favor of services, we expect the labour market recovery to be fairly strong this year. This should induce the Fed to turn more hawkish the coming months, where we expect discussions on tapering to start in earnest. We expect actual tapering of asset purchases to begin in Q4 21, with a first rate hike coming in H2 2022. Furthermore, President Biden's economic agenda also creates upside potential for growth in 2022-24 (see also *Research US: Biden's economic agenda means upside potential for growth in 2022-24*, 9 April), leaving a risk that the Fed might have to tighten monetary policy even sooner. Higher inflation expectations suggest that inflation will be higher on a sustained basis compared to the years before the pandemic hit, but we do not expect US inflation to spiral out of control (see also *Research US - Higher inflation but not spinning out of control due to still well-behaved expectations*, 14 June).

Danske global GDP forecasts

	Real GDP growth (%)		
	2020	2021	2022
US	-3.5	7.5	5.3
Euro area	-6.7	4.7	4.1
Germany	-5.1	3.2	4.0
UK	-9.8	5.2	6.9
China	2.3	9.0	5.4
Japan	-4.9	3.1	2.0

Source: Danske Bank

High US goods consumption should start to normalize



Source: BEA, Macrobond Financial, Danske Bank

## Euro area preparing for take-off

With the increasing vaccination pace and gradual re-opening observed in many European countries, a recovery took shape in the euro area during the spring, which we expect to strengthen further during H2 21. Excess savings accumulated during the pandemic and increasing consumer confidence leave room for pent-up demand to boost consumer spending (especially on services). While moderating external demand could dampen manufacturing growth over the latter half of the year, ample monetary and fiscal support still provides a cushion to growth. Especially the latter will play a crucial role in alleviating the risk of an asymmetric recovery and we expect the first 'Next Generation EU' (NGEU) payments to start flowing in H2 21 (see also *Research Euro Area - Decoding Europe's recovery plans*, 17 May). Job retention schemes still cushion developments in the labour market, but we expect more workers to re-join the labour force as fiscal support measures are increasingly scaled back during 2021 and 2022. Continued slack in the labour market should keep wage pressures at bay and beyond the temporary rise in inflation in 2021, we doubt that euro area core inflation is about to return to the highs preceding the Global Financial Crisis on a sustained basis (see also *Research Euro Area - Mind the inflation gap*, 8 June). This should ensure a continued patient stance from the ECB with regard to monetary stimulus. Although we look for the ECB's PEPP programme to be phased out around March 2022 as a first step to exit its crisis response tools, policy rate hikes are not on the horizon.

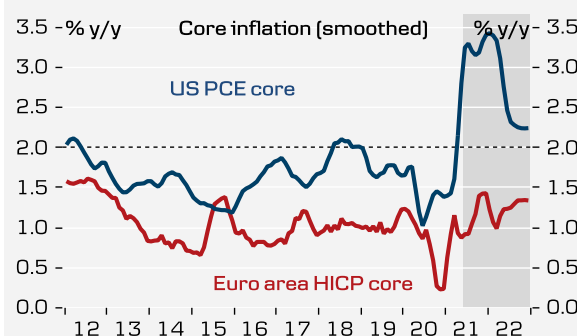
## Chinese growth is moderating

The Chinese economy has continued its strong recovery for longer than previously expected during the spring, not least thanks to strong US goods consumption boosting Chinese exports. However, declining PMI levels and a sharp decline in credit growth suggest that underlying growth has started to moderate and the fading boost from US fiscal stimulus combined with a renewed deleveraging push by Chinese authorities will dampen GDP growth going forward in our view. Reduced investments in infrastructure and construction is set to drive the slowdown and dampen demand for commodities. We expect relations between China and the US to remain tense with regard to trade and technologies, but increased cooperation seems likely on climate policies.

## Inflation and virus mutations are the key risks

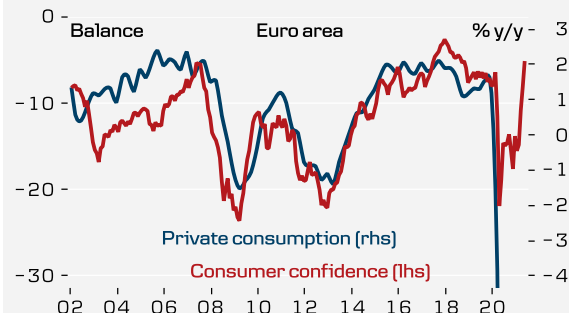
In our baseline scenario (50%), a solid recovery from the corona pandemic will take the global economy back to normal levels during 2022. An upside scenario (25%) would see a stronger than expected rebound in activity, especially in the euro area, as private consumption is boosted by sharp falls in unemployment when economies reopen. Inflation pressures would rise quickly, especially in the US, forcing the Fed to hike rates already in 2022, while the ECB ends net PEPP purchases around October 2021. In a downside scenario (25%), the recovery is slower than expected, either because new virus mutations and a slow vaccine roll-out require restrictions to remain in place in the fall and winter of 2021, or because unemployment fears undermine the recovery in consumption. Uncertainty would also weigh on investments. In this case we would expect global central banks to keep a dovish stance, as inflation is only very slowly picking up.

### Euro inflation jump will be temporary



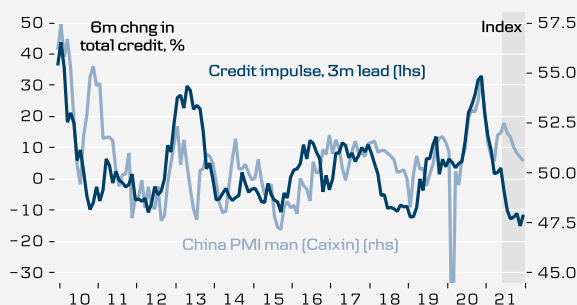
Source: BEA, Eurostat, Macrobond Financial, Danske Bank Bank

### Ample room for pent-up demand in Europe



Source: Eurostat, EU Commission, Macrobond Financial, Danske Bank

### Chinese policy tightening slowing the cycle this year



Source: Markit, People's Bank of China, Macrobond Financial, Danske Bank

## Economic forecast

## Macro forecast. Scandinavia

	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Wage growth <sup>1</sup>	Unem-ploym <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
Denmark	2020	-2.7	-2.0	-0.1	2.1	-7.7	-4.8	0.4	2.3	4.6	-0.6	42.2	8.3
	2021	3.0	3.0	0.9	3.0	9.7	8.1	1.2	2.7	4.4	-2.1	38.7	8.4
	2022	3.5	4.0	0.2	3.5	7.0	6.4	1.2	2.5	3.8	-0.4	37.3	8.5
Sweden	2020	-3.1	-4.7	-0.5	0.6	-5.2	-5.8	0.5	2.0	8.3	-3.1	37.9	1.4
	2021	3.7	3.4	1.7	2.5	8.8	7.0	1.3	1.9	8.5	-0.6	38.0	6.6
	2022	3.4	4.1	1.4	3.7	4.0	4.1	0.7	1.9	7.3	0.1	35.0	6.4
Norway	2020	-2.5	-6.9	1.7	-3.8	-0.5	-11.9	1.3	3.1	5.0	-	-	-
	2021	3.7	5.0	2.5	1.0	2.7	3.5	3.1	2.7	3.3	-	-	-
	2022	3.7	7.4	1.8	2.0	6.5	7.0	1.7	3.1	2.5	-	-	-

## Macro forecast. Euroland

	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Wage growth <sup>1</sup>	Unem-ploym <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
Euro area	2020	-6.7	-8.0	1.4	-8.4	-9.6	-9.1	0.3	-0.6	8.0	-7.2	98.0	3.0
	2021	4.7	2.6	3.3	5.0	10.0	8.2	1.9	3.1	8.4	-7.8	102.2	3.1
	2022	4.1	5.7	1.8	2.1	4.6	4.3	1.5	2.0	8.3	-4.4	102.3	3.1
Germany	2020	-5.1	-6.2	3.7	-3.5	-10.2	-9.0	0.4	0.0	4.2	-4.2	69.8	6.9
	2021	3.2	-0.7	1.8	3.2	12.0	9.9	2.5	1.2	4.3	-7.5	73.0	7.5
	2022	4.0	5.1	1.4	2.1	5.0	4.3	1.6	1.8	3.8	-2.5	72.1	6.9
Finland	2020	-2.8	-4.9	2.3	-3.1	-6.6	-6.6	0.3	1.8	7.8	-5.4	69.2	0.3
	2021	2.6	4.0	1.5	4.0	3.5	5.0	1.7	2.5	7.7	-4.7	70.8	-0.2
	2022	2.9	3.0	1.0	3.0	6.0	5.0	1.6	2.7	7.1	-2.3	70.5	-0.2

## Macro forecast. Global

	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Wage growth <sup>1</sup>	Unem-ploym <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
USA	2020	-3.5	-3.9	1.1	-1.8	-12.9	-9.3	1.2	4.6	8.1	-16.0	126.4	-2.1
	2021	7.5	8.4	1.6	8.9	5.6	11.2	3.9	2.0	4.7	-12.2	132.3	-2.1
	2022	5.3	6.7	3.1	3.7	2.0	4.4	2.7	2.3	3.5	-7.2	131.9	-2.1
China	2020	2.3	1.5	-	3.0	-	-	3.0	7.5	-	-11.9	-	0.6
	2021	9.0	9.0	-	10.0	-	-	2.0	7.0	-	-11.8	-	0.4
	2022	5.4	7.0	-	4.0	-	-	2.5	7.0	-	10.9	-	0.4
UK	2020	-9.8	-10.6	-6.5	-8.8	-15.8	-17.8	0.9	2.0	4.5	-12.3	104.5	-2.0
	2021	5.2	4.2	4.0	6.2	6.4	6.1	1.5	1.2	4.9	-7.7	109.3	-3.8
	2022	6.9	8.3	2.1	11.9	5.9	8.2	1.8	1.6	4.6	-4.5	108.3	-3.6
Japan	2020	-4.9	-6.4	2.7	-4.2	-12.4	-6.8	-0.2	-	2.8	-	-	-
	2021	3.1	1.3	3.3	3.3	10.5	2.5	0.3	-	2.7	-	-	-
	2022	2.0	2.4	-1.1	3.2	4.1	3.5	0.6	-	2.5	-	-	-

Sources: OECD and Danske Bank. 1) % y/y. 2) % contribution to GDP growth. 3) % of labour force. 4) % of GDP.

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