Handelsbanken

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Handelsbanken: Then will the economy pick up

Record-high inflation and soaring interest rates are already hitting households and companies hard. And despite fiscal initiatives, things will get worse, before they get better, says Handelsbanken's Chief Economist, Christina Nyman.
"We do not expect the economy to start recovering until the end of 2024, once inflation has fallen back and household purchasing power starts to improve."

Economic activity is slowing down globally, and Handelsbanken's analysts expect to see major economies enter a mild recession next year, with unemployment set to rise as a result. Looking at the US, the eurozone and China, the root causes behind the downturn vary. In both the US and the eurozone, high inflation and rapidly rising interest rates are the main culprits, with the downturn even more pronounced in the eurozone due to the energy crisis. In contrast, while China may not be affected to the same extent by inflation and rate hikes, its economy is still being hurt by the country's strict pandemic policies.

A delicate balancing act
The Swedish economy remains very strong, with employment rising and unemployment rates declining. However, household purchasing power is being rapidly undermined by high electricity prices, interest rate increases and falling real wages. The impact on households varies depending on the type of dwelling and the size of rainy day funds. Handelsbanken's economists expect households to manage the situation by cutting back on both consumption and savings. There is also growing pressure to push through bigger pay rises.
"Based on the figures we are seeing, we believe that households will receive around SEK 40bn in government support, which represented a third of household heating costs in 2021. This will mitigate the drop in consumption but also risks spurring further increases in inflation, which could trigger additional rate hikes by the Riksbank, depending on the kind of support provided", says Christina Nyman.

When will the recovery begin?
We expect to see a recession next year, with negative growth and rising unemployment. A downturn in the global business cycle will also result in lower demand for Swedish exports. Moreover, the decline in domestic consumption and exports, coupled with rising interest rates, will also curb investments. We expect housing investments to see a sharp decline, with house prices falling by almost 15 percent from their peak earlier this year. The weaker economic climate will gradually hamper jobs growth, leading to a slight rise in unemployment next year. Overall, Handelsbanken's economists expect GDP to slightly fall next year before rising by 1.6 percent in 2024, which is still slightly below the growth trend.
"We do not expect the economy to start recovering until the end of 2024, once inflation has fallen back and household purchasing power starts to improve", says Christina Nyman.

Modest pay rises despite high inflation

It looks like a difficult round of collective bargaining lies ahead. The inflation target has served as an anchor in the salary negotiations, but the extreme inflation currently means that real wages are taking a severe hit. A strong labour market, healthy profitability among businesses, high inflation and bigger salaries in Germany indicate that pay rises will be higher than usual. At the same time, the economic climate is deteriorating, which may have a restraining effect on this round of wage negotiations.
“Our assessment is that the various parties will stick to the prevailing model and reach an agreement by which we will see some compensation for the high inflation in year one, which then recedes in years two and three as inflation comes down again”, says Christina Nyman.
This means pay rises of just over 4 percent in 2023 and around 3.5 percent in 2024.

Inflation may decrease in 2023
Inflation is now at its highest in 30 years and it is expected to increase further during the autumn. However, several factors indicate that inflation may begin to slowly decline next year. The weaker economic climate will lead to subdued international price levels; many commodities prices have already fallen back. Subdued domestic demand and relatively modest wage growth will also keep inflationary pressure in check. For the full-year 2023, we expect CPIF inflation to stay at a high 6.1 percent, and we do not expect inflation to fall back towards the inflation target of 2 percent until around 2024.

Inflationary pressure to determine the key rate
The Riksbank will keep raising the key rate until it sees signs that inflationary pressure is decreasing. There is a risk that inflation will gain a real foothold, a scenario that all central banks wish to avoid.
“We can expect the Riksbank to raise the key rate even if it causes a downturn in the economy, although that could be just what is needed to curb inflation”, says Christina Nyman.
Our assessment is that a hike of 50 points will be made in November and that the Riksbank will continue down that route with a 25 point hike in February and one in April, taking the rate up to 2.75 percent. At this level, the rate will clearly lean towards austerity and we therefore expect the Riksbank to leave the rate unchanged for a while thereafter. As a consequence, we expect variable mortgage rates to climb towards 4.5 percent, while interest expenses as a percentage of household income will quickly creep up towards levels not seen since the mid-1990s.

Fiscal policy limitations
Sweden’s low public debt means that there is considerable scope to alleviate the effects of the economic slowdown. Handelsbanken’s economists believe that fiscal policy measures will mainly focus on offsetting the high electricity prices, funded by the extra tax income that the electricity price generates for the government and electricity producers. On top of this, there is believed to be headroom in the region of around SEK 40bn that will almost certainly be used.
“A too expansionary fiscal policy runs the risk of backfiring, given that it would drive up inflation, thus forcing the Riksbank to raise the key rate even further”, says Christina Nyman.

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For the full report in Swedish, see Konjunkturprognos and in English, Global Macro Forecast
For more information about Handelsbanken, visit www.handelsbanken.com

Real GDP forecast

	Annual average			
	2021	**2022**	**2023**	**2024**
Sweden, actual	5.0 (4.8)	3.0 (2.4)	-0.3 (0.8)	1.6 (1.6)
Denmark	4.9 (4.7)	2.3 (3.8)	-0.7 (0.5)	1.1 (1.0)
Finland	3.0 (3.5)	2.3 (1.8)	-0.2 (1.3)	1.0 (1.5)
Norway. mainland economy*	4.2 (4.1)	2.9 (3.6)	0.7 (1.9)	1.3 (1.0)
Eurozone	5.2 (5.4)	3.1 (2.4)	-0.5 (0.9)	1.5 (1.5)
United Kingdom	7.4 (7.4)	3.7 (3.2)	0.4 (1.2)	1.3 (1.8)
United States*	5.7 (5.7)	1.8 (3.0)	0.2 (1.6)	1.3 (1.6)
China	8.1 (8.1)	3.7 (5.1)	5.2 (5.3)	5.1 (5.1)

*Calendar adjusted

Interest rate forecast

	End of year			
Policy rates	**2021**	**2022**	**2023**	**2024**
United States	0.125 (0.125)	3.875 (2.625)	4.125 (2.625)	3.375 (2.375)
Eurozone	0.50 (-0.50)	2.00 (0.50)	2.00 (0.75)	1.50 (0.75)
Sweden	0.00 (0.00)	2.25 (1.25)	2.75 (1.75)	2.25 (1.75)
Denmark	-0.60 (-0.60)	1.90 (0.50)	1.90 (0.75)	1.40 (0.75)
United Kingdom	0.25 (0.25)	3.00 (1.50)	3.00 (1.50)	2.75 (1.50)
Norway	0.50 (0.50)	2.75 (1.75)	3.25 (2.25)	3.00 (2.25)

Exchange rate forecast

	End of year			
	2021	**2022p**	**2023p**	**2024p**
EUR/SEK	10.23 (10.23)	10.85 (10.10)	10.50 (9.80)	10.30 (9.80)
USD/SEK	9.03 (9.03)	11.07 (9.44)	10.50 (8.83)	10.00 (8.60)
GBP/SEK	12.18 (12.18)	12.62 (11.61)	12.35 (11.67)	12.12 (11.67)
NOK/SEK	1.02 (1.02)	1.07 (1.00)	1.06 (0.98)	1.05 (1.01)
DKK/SEK	1.37 (1.37)	1.46 (1.35)	1.41 (1.31)	1.38 (1.31)
CHF/SEK	9.49 (9.49)	11.19 (9.71)	10.82 (9.33)	10.62 (9.33)
JPY/SEK	8.13 (8.13)	7.91 (7.61)	7.72 (7.12)	7.35 (6.93)
CNY/SEK	1.42 (1.42)	1.60 (1.47)	1.57 (1.38)	1.52 (1.33)
EUR/USD	1.13 (1.13)	0.98 (1.07)	1.00 (1.11)	1.03 (1.14)
EUR/GBP	0.840 (0.840)	0.860 (0.870)	0.850 (0.840)	0.850 (0.840)
USD/CNY	6.35 (6.35)	6.90 (6.40)	6.70 (6.40)	6.60 (6.45)

Source: Handelsbanken
In brackets: Handelsbanken Global Macro Forecast May 18, 2022.