Macro Research

11 September 2024

Global Macro Forecast

Monetary Policy Endgame: Rate cuts to seal soft-landing win

- Sputtering economic growth with seemingly controlled inflation imply that the monetary policy endgame is underway
- Front-loaded rate cuts help household demand to seal soft-landing win
  - Fed to cut 75bp during H2, but slow down pace in the spring
  - Sticky service price inflation holds ECB back – cuts 50bp during H2
- Uncertain US presidential election risks hurting the economy
- Long-term: Population growth negative in several developed economies, risks eroding global welfare

Our view	Short term	Medium term
GROWTH	→	→
UNEMPLOYMENT	↗	↘
INFLATION	↘	→
POLICY RATES	↘	↘
LONG-TERM INTEREST RATES	→	→
EUR/USD	↗	↗

Note: The arrows illustrate our stylised overall direction compared with previous period. Short term refers to 1 year, medium term to 2–3 years.

Source: Handelsbanken

Table of contents

Global backdrop: Monetary policy endgame: Rate cuts to seal soft-landing win ……………………………………4

Theme article: Households' economic situation ……………………………………………………………………9

Theme article: Global demography……………………………………………………………………………………14

Eurozone: On a slow path to normality ……………………………………………………………………………17

United Kingdom: Bank of England rate setters divided on inflation ………………………………………………19

Sweden: On the road to recovery……………………………………………………………………………………21

Norway: Steady course for Norges Bank……………………………………………………………………………23

Finland: Slightly better outlook………………………………………………………………………………………25

Key ratios………27

Disclaimers………30

Monetary policy endgame: Rate cuts to seal soft-landing win

Despite rumbling growth worries during the summer months, we expect global economic expansion to continue. Signs of a sputtering recovery combined with seemingly controlled inflation imply that the monetary policy endgame is underway. Further front-loaded rate cuts will seal the soft-landing win, with rising household demand key to its success. In this scenario, longer-term interest rates are likely to remain elevated. US policy after the presidential election remains uncertain and could alter the outlook.

US recession and global hard landing?

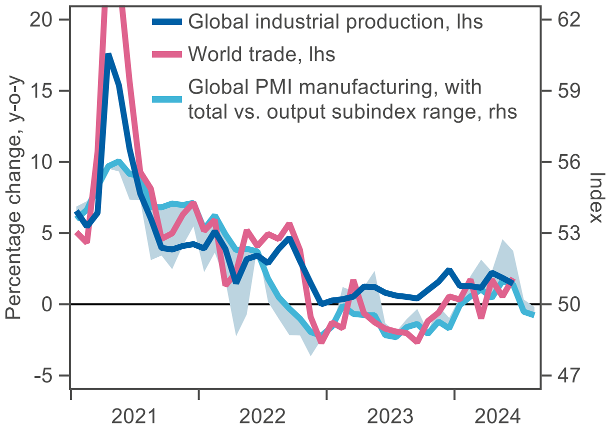
The global economy appeared to be tracking "the great normalisation" scenario we had previously outlined for 2024, but question marks were raised over the summer. Weak spots in the US economic data flow spooked economists and investors, stoking fears that the US economy could be facing a recession and generating turbulence in the financial markets in early August. The US's weak employment and PMI data even raised the prospect of a shift away from the consensus soft-landing base-line scenario for the world economy. Nonetheless, despite this backdrop, we forecast neither a US recession nor a global hard landing. Why?

Firstly, GDP growth outcomes suggest that our previous forecast of a normalisation of growth is intact, with a cooling of the US economy offset by a gradual recovery in the eurozone, although admittedly, GDP data seldom works as an early warning system for a recession. Secondly, when turning to leading indicators, most of our findings still indicate that aggregate global growth should continue to pick up.

Recovery needs a hand from policy

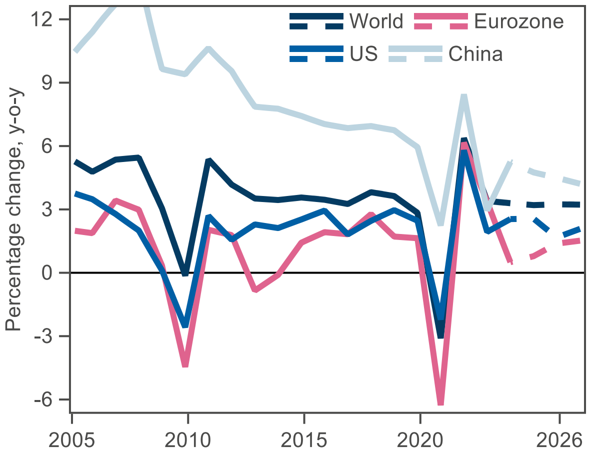
Growth is sputtering, however, with the manufacturing sector reappearing as a source of weakness in the economy. Due to weakening order intake, the global manufacturing PMI has declined for three consecutive months and threatens to bring the pickup in global industrial production and world trade to a premature end. Such a loss of momentum risks turning into a self-reinforcing negative circle, involving layoffs and a further drop in demand if the global economic recovery is not lent a hand by a loosening of the still-tight monetary policy. Hence, as inflation now seems to be under control, the long-awaited monetary policy endgame is underway to seal the soft-landing win that central banks have been striving for. On the whole, we now expect slightly more front-loaded policy rate cuts than we had flagged in our May Global Macro Forecast.

Global manufacturing output and goods trade



Sources: Macrobond, CPB and S&P Global and Handelsbanken

Global GDP will grow evenly; regional contrasts



Sources: Macrobond, IMF and Handelsbanken

Both investments and household consumption are demand-side GDP components that we believe will respond positively to the rate cuts.

Investment developments are sluggish, owing to weak housing construction and overall cautious business capital expenditure – factors that will turn around with the decreasing economic uncertainty and lower capital costs that follow the policy loosening ahead. Already today, there are pockets of strength in areas such as infrastructure, strategically important industries and AI- and tech-related capex.

Households: From “misery loves company” to driving the recovery

We believe that household consumption will be even more important to central banks’ efforts to lift final demand in the economy with continued rate cuts ahead. An assessment based on our “economic misery index” shows a turnaround to a cautiously optimistic consumer outlook across economies: see theme article *Households equipped to support demand*. Back in 2022, households suffered one blow after another, with surging inflation, falling asset prices and rising interest rates. From that state of “misery loves company”, households’ situations have improved over the past year, as easing inflation, improving asset prices and accelerating wage growth have begun to neutralise the continued negative contribution from high interest rates and, in some countries, the blow from rising unemployment. Going forward, households’ prospects to reclaim lost purchasing power are bolstered further by declining interest rates and we expect household consumption to drive the recovery. We forecast that in 2024–26 global GDP will grow evenly by 3.2 percent per year, masking regional contrasts that include recoveries in many economies but slowdowns in the US and China.

Labour market loosening after tight era

Unemployment has started to rise in the countries we cover, albeit mostly to a limited extent and from low levels. In some economies, job creation is now slowing, which means it takes longer to secure employment for workers moving on from a previous job, as well as for those from the outside who are being pulled into the labour market by its still-solid state. In other economies, the slowdown in economic activity has led all the way to fewer jobs. We forecast that employment growth will remain muted in the near term, which will create headwinds for the labour market, with an additional increase in unemployment. The transition from a tight labour market to more normal levels of slack in 2025–26 will help ease lingering labour cost pressures. In addition, recovering final demand growth in the global economy will help to reduce productivity slack after a period of labour hoarding.

Major economies overviews

Eurozone – see separate article

China

The crisis in the heavily indebted real estate sector continues to weigh on the economy, depressing investment, reducing local government revenues, and dampening consumption due to the negative wealth impact of falling housing prices.

Growth in the "three new" industries – electric vehicles, batteries and renewables – is in line with the authorities' long-term goal of high-quality growth, but the industries are too small to compensate for the slump in the real estate sector. Higher tariffs on Chinese products in the US and the EU, among others, are also a growing concern.

Weak domestic demand is also reflected in price developments, and there are concerns of a negative spiral with squeezed profits, lower wages and weaker demand.

Further measures from the authorities are to be expected, but the challenges are great, and are exacerbated by the negative demographic trend (despite an increase in the retirement age).

All told, this year’s 5 percent growth target is under threat after the sluggish Q2 outcome, and we expect growth to gradually slow to 4.2 percent in 2026.

US

A soft landing is still the main scenario, but recession risks have increased compared to our May forecast.

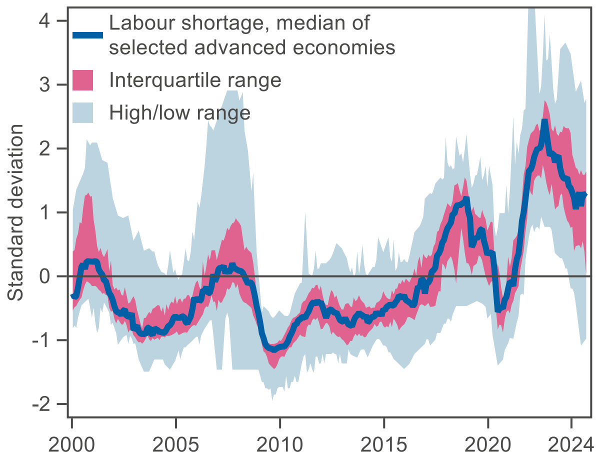
Unemployment is rising and will continue moderately higher in 2025, as surplus labour demand fades and job creation is slower than labour force growth.

The election year has been calm, but a contested result in November risks social and political instability, which could interact with fiscal and market fragilities.

Productivity growth supports GDP and mitigates cost pressures. It takes time, however, for businesses to compensate for pent-up costs, contributing to pricing plans that remain above normal. We forecast that inflation will reach the 2 percent target in 2025.

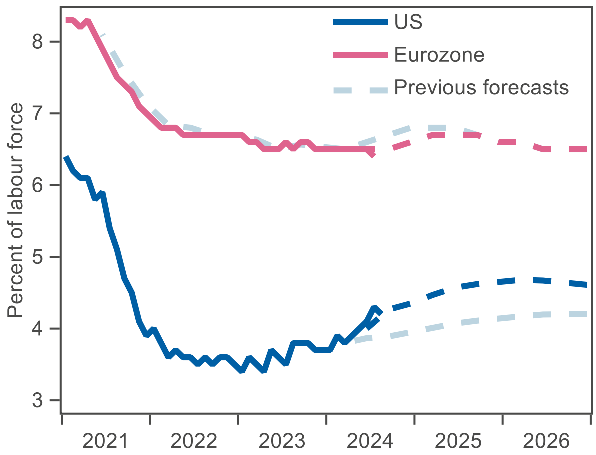
Rising unemployment risks and easing inflation risks should lead to successive policy rate cuts during autumn and winter, but in spring 2025, we expect the Fed to slow the cutting pace – partly due to unsound fiscal policy adding fuel to inflation (see box about the US election).

Labour market tightness gradually easing



Sources: Macrobond, Eurostat, national sources and Handelsbanken

Unemployment headwinds



Sources: Macrobond, BLS, Eurostat and Handelsbanken

Growth not reversing inflation progress

In some economies, notably the US, inflation has moderated, further closing in on central bank targets. In other economies, such as the eurozone, disinflation has more or less stalled since the spring. We forecast that sustained GDP growth, comparatively strong labour markets and policy rate cuts will not reverse the progress made towards inflation target achievement. There are three key reasons for this:

1) Demand and supply shocks and mismatches appear to have faded, leaving the economy in better balance, notably in the labour market.

2) Rate cuts from restrictive levels are gradual. Hence, we expect GDP to grow merely at a healthy rate – not at a clip fast enough to open up a positive GDP gap and create renewed overheating.

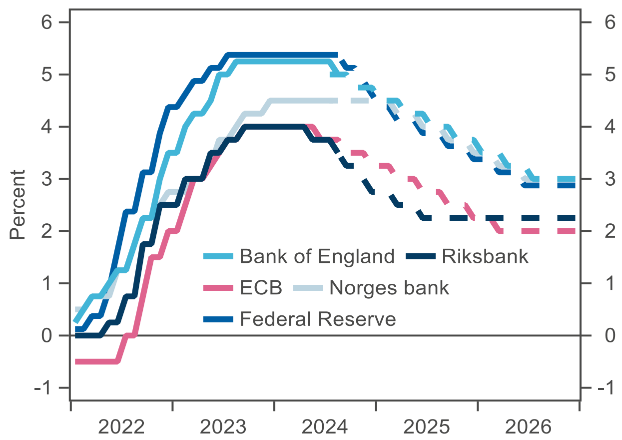
3) From the perspective of our "Gordian knot of disinflation" framework, there has been positive news in terms of improving productivity and a moderation in labour cost growth.

Policy rates down, long rates flat

We maintain our long-held view that central banks' cutting cycles will bring about a gradual normalisation of the policy stance, primarily aimed at calibrating the policy rate to the neutral rate of interest. However, in switching from inflation-fighting autopilot to manual control of the intended soft landing, central banks are largely poised to cut rates quicker than previously forecast. As described above, the slight front-loading of cuts follows on from weaker inflation and rising growth risks, particularly in the US and Sweden.

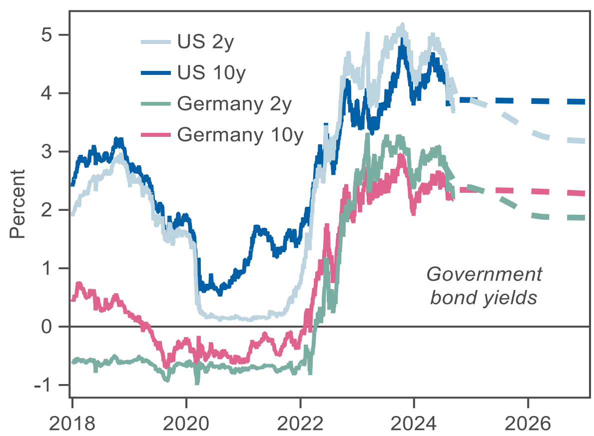
Market pricing of policy rates is currently tilted towards the risk of a hard-landing scenario whereby central banks are forced into making significantly faster rate cuts than in the baseline soft-landing scenario. Therefore, as the soft landing unfolds in line with our forecast, short rates will adapt to levels higher than those currently baked into longer market interest rates. All told, we forecast a continued decline in two-year rates, while ten-year rates remain roughly at today's level, given our assumption for the neutral rate of interest.

Policy rate cuts ahead



Sources: Macrobond, national sources and Handelsbanken

Long-term interest rates to stay quite high



Sources: Macrobond and Handelsbanken

Several factors to weaken the dollar

We expect the USD to weaken going forward. Firstly, the Fed has more room to cut than other major central banks, so interest rate differentials will drive USD depreciation. Moreover, as the soft landing unfolds and interest rates come down, we see risk appetite returning to the FX market, suggesting additional headwinds for the dollar while the riskier currencies stand to gain.

Our forecast scenario has already started to play out, but on top of this, the dollar also took a hit at the beginning of August as traders unwound some of their carry trade positions, meaning they bought low-interest-rate currencies such as the Japanese Yen and the Swiss Franc, and sold the high-yielding US dollar. Nevertheless, the speculative positions have largely been unwound, we judge, limiting the risk of further carry-trade-related corrections in the FX markets.

There are also several factors that put the brakes on forecasts of the dollar weakening. Geopolitical uncertainty and ongoing trade conflicts are typically associated with dollar strength. All told, we forecast a gradual depreciation of the dollar.

Downside risks despite policy response

We assess that the risks to the economy remain tilted to the downside, as materialising weak spots in the data flow serve to remind us of our long-standing view that the soft-landing main scenario is not a done deal. So, while central banks are now responding with rate cuts to counteract this risk imbalance, numerous potential triggers for a negative feedback loop remain. As discussed in our May report, it is crucial that households, businesses, markets and policymakers maintain confidence in continued disinflation, as well as demand growth.

Our main scenario assumes that geopolitical tensions and geoeconomic fragmentation neither improve nor deteriorate. Among the risks to this assumption, we note trade conflicts between the US and China and mounting transatlantic trade tensions (see also what we write on the US election overleaf), a further escalation of the Middle East conflict, and a deepening of the Russia-Ukraine conflict after recent developments. Economic prospects have already been dampened by the elevated uncertainty in Europe since Russia's full-scale invasion of Ukraine, and now the world faces additional triggers.

US election risks hurting economy

We assume that the policies of the next US president will drive larger deficits, higher GDP growth (albeit only initially), higher inflation, higher interest rates and a stronger dollar. The end result could be significantly better or worse depending on the exact outcome of this uncertain election.

Who will win the US presidential election?

It is impossible to tell at this stage. Recently, Vice President Kamala Harris has been leading former President Donald Trump in both an average of national polls and judging by betting odds. However, the margins are small and have historically proven sensitive even in the latter stages of campaigning, and so the election is essentially still a coin toss. Compared to popular opinion in the national polls, there could be a better chance for Trump thanks to his reportedly strong support in some of the key battleground states, where party allegiance tends to swing between elections and hence be a decisive factor for the overall outcome.

Our baseline assumption is a divided government, where both chambers of Congress and the presidency do not fall to one party. However, this assumption rests on shaky ground as the Republicans seem well-positioned for a "red sweep", at least on paper. A "blue sweep", i.e. Harris wins the presidency and the Democrats take majorities in both the House of Representatives and the Senate, currently appears to be quite unlikely.

National general election poll average

Sources: Macrobond, RealClearPolitics and Handelsbanken

How will economic policy be shaped by the potential incoming presidents?

The next president will need to tackle the 2025 expiration of expansionary measures included in the 2017 *Tax Cuts and Jobs Act* (TCJA). Neither of the candidate's policy platforms suggest an intention to use the expiration as an opportunity to consolidate the unsustainable US public finances, but rather to implement even larger packages than the TCJA.

Harris's "family-oriented" policy agenda: Harris wants to keep only parts of the TCJA, thereby shaping her partial extension as a "middle-class tax cut". High-income earners and businesses would see TCJA tax cuts expire. These tax increases would help finance Harris' biggest initiatives: expanded child tax credit and earned income tax credit; maintained tax credit for health insurance, as well as spending on, not least, childcare and education. All told, Harris claims to have a family-oriented policy agenda.

Trump's "business-oriented" policy agenda: Trump wants to extend all the personal TCJA tax cuts and strives not only to extend the business TCJA tax cuts but also cut the corporate tax rate further. On the spending side, Trump seeks to boost defence spending but also make some savings on social benefits and climate, although any repeal of the Inflation Reduction Act's climate-oriented policies now looks more limited than the larger cutbacks previously indicated. The bigger source of financing is Trump's proposal of sharp tariff increases.

Larger deficits, stronger growth, higher inflation and interest rates, and a stronger dollar

Macroeconomic outcomes of the two policy agendas?

Given that the election result is a coin toss and the policy agendas of Harris and Trump have vastly different macroeconomic effects, we choose to assume a probability-weighted average of these effects in our baseline forecast. The effects can be separated into the impact during our forecasting period until 2026 and the longer-term effects.

Larger deficits. Both Harris's and Trump's policy agendas are expected to increase the government budget deficit in 2025–26, although there is uncertainty regarding the longer term. A survey among economists signalled that the Trump agenda would increase deficits more, but in a "red sweep" some analysts expect the opposite, as sharp tariff rises would bring income to federal coffers. In a "blue sweep", more business tax increases could limit the longer-term deficits.

Stronger growth, but only initially. We assume a 0.3pp boost to 2026 GDP growth, and a marginally positive increase in 2025 GDP growth. Longer term, our assumption is a negative GDP effect, due to the severely growth-hostile Trump policies of stopping migration, i.e. a blow to labour supply and sharply raising import tariffs. In a "red sweep", these policy proposals risk being carried out in full, cancelling out the positives in the Trump agenda and yielding a net-negative GDP effect as early as 2026.

Higher inflation and policy rate, with large risks. The expansionary policies in the agendas of both candidates will be a boost to demand in 2025–26, and we add 0.2pp to our 2026 inflation forecast, conditional on a 25bp higher Fed policy rate than would have been the case without the fiscal stimulus. However, risks loom large, as there is a particularly stark contrast between the candidates' agendas in terms of inflation impact: Trump's tariffs and migration curbs are stagflationary by driving costs and hurting supply, which would force the Fed into pausing rate cuts or even restarting hikes. Meanwhile, Harris' family policies would – in the US context – be expected to unlock noticeably higher female labour force participation than today's ~57.5 percent, implying a disinflationary supply boost and an unchanged Fed outlook. Bear in mind, however, that the likelihood of a "blue sweep" seems limited.

Stronger dollar. We assume the EUR/USD will be 1 percent lower at year-end 2026, as our probability-weighted assumptions for the economic impact of the next presidency are for relatively higher US interest rates and more uncertainty about the global economic outlook, both favouring the dollar.

This box builds on research and articles by Oxford Economics, The Wall Street Journal, PIIE and Bloomberg.

Households equipped to support demand

Households have been portrayed as the losers in the wake of the inflation crisis, and returning consumption is key for a soft landing. We construct an economic misery index to assess and compare the consumer outlook across economies. The index shows a sharp rise in household economic misery during 2022 due to surging inflation, falling asset prices and rising interest rates. Over the past year, however, the situation has improved as easing inflation and accelerating wage growth have neutralised the negative contribution from high interest rates. Going forward, household consumption prospects should be bolstered further by declining interest, even with some cooling in wage growth.

Building on Okun's Misery Index

With inflation closing in on the target and central banks starting to loosen monetary policy, we are approaching a soft landing. Nevertheless, there are concerns that central banks are behind the curve, and that we should now worry more about weak demand than elevated inflation. In this article, we discuss the outlook for household consumption − a major component of overall economic activity − and hence critical to ensure a successful soft landing.

Household consumption is influenced by several key drivers, the importance of which vary over time and between countries. We identify six components that are essential when evaluating household finances, and aggregate them into an economic misery index, first prosed by Arthur Okun in the 1960s. While the name is inspired by an index adding two negative factors, inflation and unemployment, we focus more on the momentum in household finances, rather than the state of misery, and hence include drivers of a positive nature too.[1] Our composite misery index is constructed as the unweighted sum of the contemporaneous standardised variables.[2]

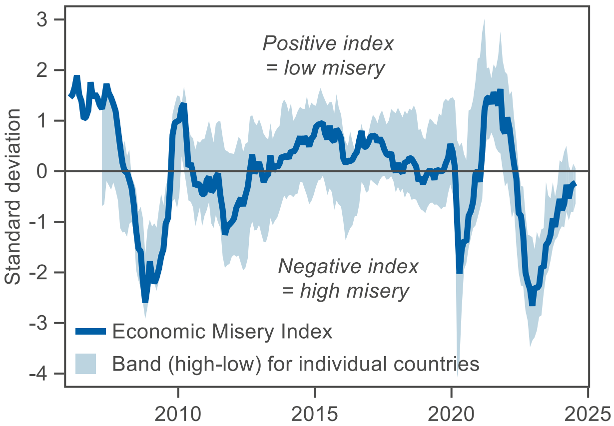
Economic Misery Index

Variable	Description
Inflation (-)	y-o-y percentage change
Unemployment (-)	Deviation from three-year moving average
Policy rate (-)	Deviation from three-year moving average
Stock market (+)	y-o-y percentage change
House price (+)	y-o-y percentage change
Wage (+)	y-o-y percentage change

Note: The data is collected from various national sources. The index is produced monthly. The original frequency of the individual variables varies from daily to quarterly. Missing data at the end of the sample is filled with the last non-missing (transformed and standardised) observation.

The timing and characteristics of business cycles, including the importance of the main drivers of household finances, vary between countries. Global shocks and spillovers between countries are extensive, however, which allows us to extract a common trend for each of the six index variables and construct an economic misery index representing all six markets. The common trend is particularly dominant around the large swings caused by the 2008–09 financial crisis, the reopening after the pandemic and the dynamics around the inflation crises.

Economic Misery Index



Note. The index represents US, EZ, UK, SE, FI, and NO
Sources: Macrobond and Handelsbanken

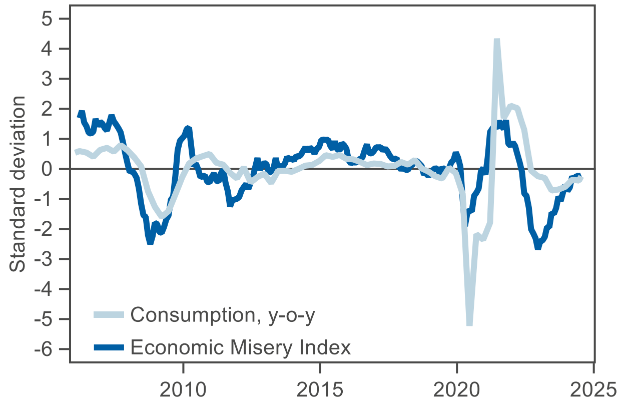
Misery mirrors confidence & consumption

Although the individual variables in our misery index represent standard factors in the analyses of household demand, our approach to aggregate them is novel and untested. In order to facilitate interpretation, we benchmark our misery index against consumption and survey-based consumer confidence. Overall, the comovement to both variables is striking.

[1] The original misery index was suggested to provide President Lyndon Johnson with an easily digestible snapshot of the health of the economy.

[2] For details and discussions about the index construction, see Macro Comments "After inflation misery – households once again equipped to support the recovery" available here.

Economic Misery and Consumption

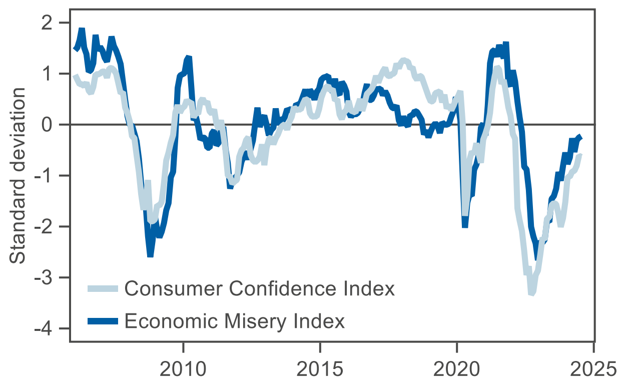


Note. Misery index and consumption represent US, EZ, UK, SE, FI, and NO
Sources: Macrobond and Handelsbanken

The deviation to consumption since 2019 is expected as our misery index does not include any variables reflecting the lockdown measures, nor the extraordinary governmental support measures launched during and after the pandemic. Nevertheless, our misery index is broadly back in line with consumption growth in the recent past.

The relationship between the variables in our misery index and consumption is complex, and comovements may be caused by external factors affecting more than one variable at the same time. The correlation is encouraging, however, and allows for a discussion regarding the outlook for, and tentative drivers of, consumption based on the breakdown by component.

Economic Misery and Consumer Confidence



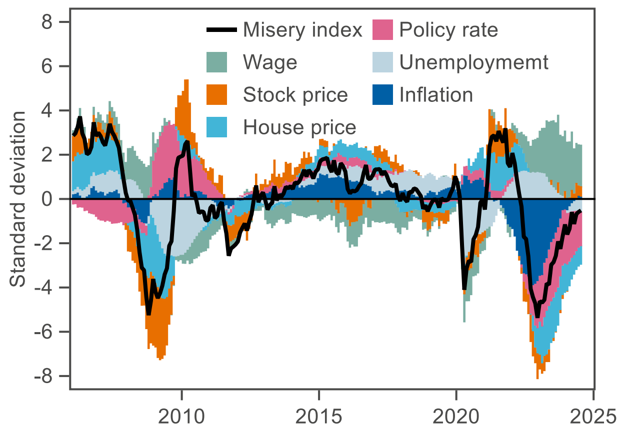
Note. Misey index and confidence represent US, EZ, UK, SE, FI, and NO
Sources: Macrobond and Handelsbanken

Consumer confidence reflects households' assessments of their personal finances and the general economy, including expectations and plans for consumption and savings. The strong correlation with our misery index is perhaps unsurprising given that variations in consumer confidence are commonly attributed to unemployment, inflation and interest rates. However, the fact that we are nearly able to replicate survey-based consumer confidence with hard data enriches the discussion around the drivers of households' spending plans.

A misery narrative of previous cycles

Turning our focus to the narrative suggested by the breakdown of our misery index, we find a plausible story for consumption cycles over the sample period.

Econmnic Misery Index



Note. The index represents US, EZ, UK, SE, FI, and NO
Sources: Macrobond and Handelsbanken

In the period just before the 2008–09 financial crisis, household economic misery was low (positive index reading) as the business cycle peaked with low unemployment and strong asset-price growth. Central banks gradually raised interest rates, but the direct impact on the misery index was moderate. In this period, economic misery in the US was relatively high as households felt the pinch from the evolving housing market slump.

The global financial crisis

Souring economic misery (negative index) during the first phase of the 2008–09 financial crisis was primarily a result of plunging asset prices followed by a steep increase in unemployment. The direct impact of the unprecedented support from central banks contributed to soften misery during the crisis. Moreover, in combination with recovering stock markets, it more than offset the misery caused by high unemployment and low wage growth in the recovery phase. This contributed to a sharp fall in economic misery (positive index), which was reflected also in improving confidence and consumption growth.

The eurozone debt crisis

Household economic misery rose again during 2011, partly due to the fading impact from monetary policy stimulus during the financial crisis. Deteriorating asset prices, as the European debt crisis fuelled mounting fears around the outlook of economic activity, also contributed to the increase in misery. In addition, high unemployment continued to inflict misery on households in the eurozone, while weak house prices and slow wage growth continued to weigh on American household misery in the aftermath of the financial crisis.

The low interest rate environment

For the period 2014–17, the misery index breakdown reflects the low inflation environment (prices as well as wages) with low interest rates supporting employment as well as asset prices. Overall, this was a period of little economic misery for households, which was reflected in positive confidence and elevated consumption growth. The subsequent increase in our economic misery index during 2018, largely driven by waning asset prices, was mirrored in slowing consumption growth, while consumer confidence remained positive.

The pandemic

The pandemic lockdown prompted a sharp rise in economic misery, as unemployment climbed while monetary policy easing was muted from a historical perspective. The close relationship with confidence is rather surprising as the direct concerns related to the pandemic itself probably added to uncertainty and pessimism among households. The close comovement with consumer confidence continued during the reopening as rising asset prices and falling unemployment were the primary drivers of easing economic misery, according to our index.

The inflation crisis

The reopening relief on economic misery was temporary, however, as supply and demand imbalances led to surging inflation and a sharp rise in interest rates as central banks tightened monetary policy. In addition, asset prices responded negatively to higher interest rates and the worsening economic outlook. House price developments differed between countries, with a more marked deterioration in Sweden, Finland and Norway, probably linked to shorter interest rate fixation on mortgages and a faster pass-through of monetary policy. Around the turn of the year 2022–23, household economic misery was at a similar level to that seen during the financial crisis, albeit with notable differences in the composition. The gradual easing of economic misery since the beginning of 2023 has been driven by falling inflation in combination with strong nominal wage growth, while interest rates have remained a significant drag on households. The contrast to the drivers in the recovery seen after the financial crisis is striking: the correlation between our misery index and consumer confidence is robust in both periods, apparently broadly unaffected by the composition of the index.

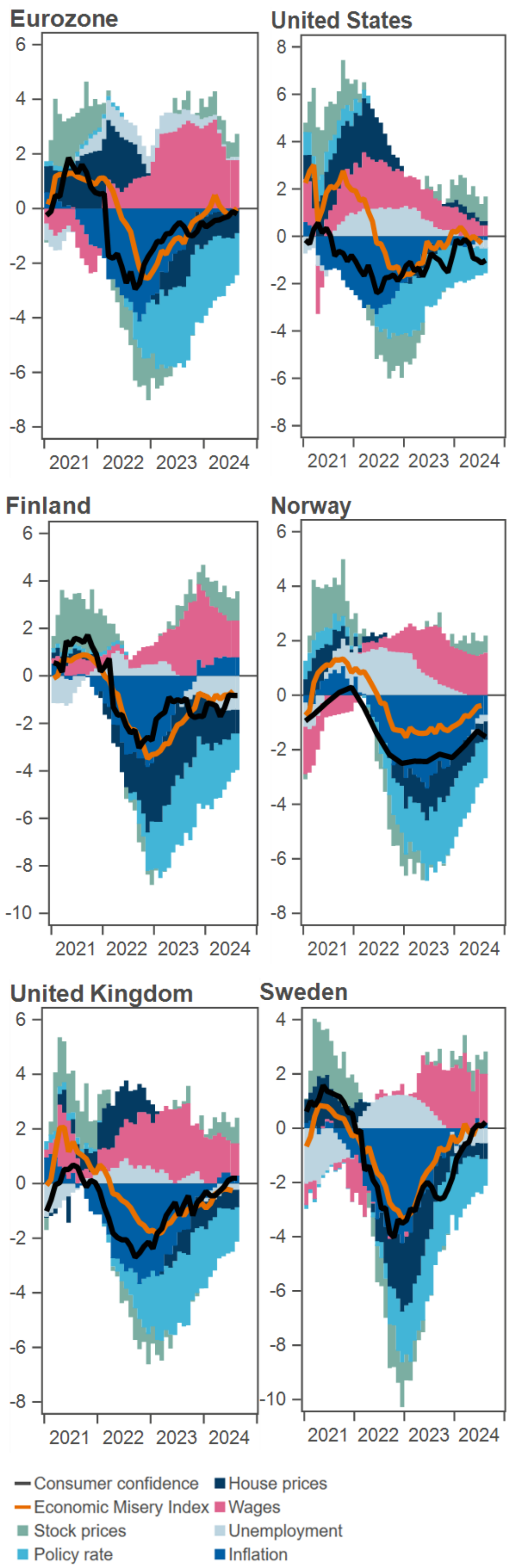
Economic misery has normalised

Overall, our misery index has returned to almost normal levels, suggesting that households, once again, are ready to support demand. We recognise that our index construction disregards the permanent loss of purchasing power due to past inflation, and that lower inflation drives real interest rates higher as nominal interest rates remain elevated. However, this should not overshadow the boost to real income growth as inflation has normalised, while nominal wage growth has remained strong and unemployment low. This is good news for the purchasing power of households' current cash flows.

Our misery index suggests that present outlook for household finances, including its drivers, is similar across the individual economies. In particular, inflation has broadly normalised, while the positive contribution from high nominal wage growth is largely offset by the negative from high interest rates.

Similar developments across countries

There is a range of structural differences between the various economies, which should affect the relative impact of the individual misery components on overall household misery. For example, the passthrough of policy rates depending on the household debt ratios and length of interest rate fixation period on mortgages, the level and composition of household assets should matter when it comes to the impact of asset price variations, and the impact of unemployment should be related to the generosity of unemployment insurance. Nevertheless, despite our approach using equal weights, the comovement between the misery index and consumer confidence is unmistakable in all countries, and the two different measures currently send broadly similar signals.



Sources: Macrobond and Handelsbanken

Studying the individual economies separately, there are some takeaways worth noting. In the eurozone, high nominal wage growth combined with record-low unemployment have been two important factors that have helped ease household economic misery. While labour cost pressure is a major concern for the ECB, it supports household confidence and consumption growth. Continued low unemployment, in combination with high wage growth, is also helping to ease misery among households in the UK. In the US, the positive contribution from wage growth is relatively moderate, while the impact of asset price growth is relatively positive, compared to the other countries. In Finland, low inflation is helping to ease household misery according to our index. However, the corporate sector may feel the pinch of the flipsides of high wage growth and low inflation. In turn, this may affect household misery through unemployment. In Norway, the continued negative contribution from high inflation stands out compared to the other economies. Wage growth contributes in the opposite direction, but not in a way that stands out in relative terms. Swedish households are feeling the pinch of rising unemployment, but also high wage growth in line with the other countries.

Misery to fall below normal levels

Going forward, we expect the contribution of interest rates on household misery to ease as monetary policy gradually normalises. At the same time, this is conditional on some easing in wage growth, which will work in the opposite direction. In our main scenario, this balancing of lower interest rates and easing wage growth is tuned to ensure the last mile of inflation, while containing the rise in unemployment. As inflation stabilises around the target, it has a neutral impact on households' economic misery. Overall, the relief from lower rates is expected to be the dominating effect, contributing to our household misery index climbing above balance (low misery) going forward.[3] The relief from gradually lower interest rates is broadly similar in the individual countries, although households in Norway will have to wait until the spring of 2025 before the first rate cut. In Finland and Sweden, households are also expected to benefit from a gradual decline in unemployment.

Consumption growth recovers

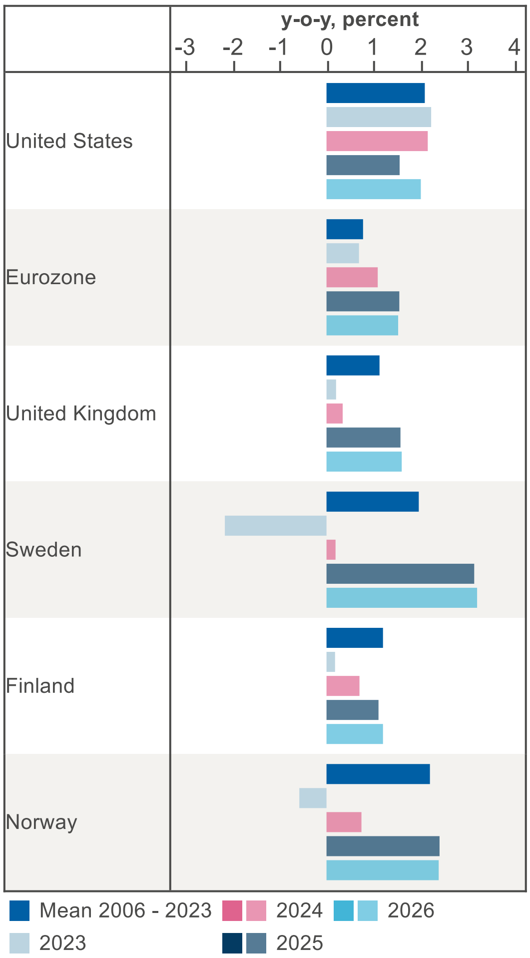
All in all, we expect the low level of misery according to our index to be reflected in above normal growth rate in consumption. For the eurozone, the UK,

[3] By construction, normal contributions from the individual components means a return to average growth for wages, inflation and asset prices and stabilisation at current levels (interest rates and unemployment).

Finland and Norway, this implies that consumption growth will recover from low levels. In the US, we expect consumption to slow in 2025 but remain close to average. Our forecast for consumption in Sweden stands out with strong growth. This is partly explained by expansionary fiscal policy, including tax cuts for households, and Swedish households being relatively sensitive to interest rates. Neither of these two effects is directly reflected in our economic misery index.

The swings in consumption during the pandemic lockdown and the extraordinary fiscal support measures during the reopening were only partly captured by our misery index (and by consumer confidence). There is still uncertainty around remaining effects related to, for example, excess household savings. However, we believe the ripple effects of these extraordinary events have largely faded and that we can once again expect our misery index to be informative for the outlook for consumption.

Consumption



Sources: Macrobond and Handelsbanken

Too early to claim victory

The lagging nature of the labour market suggests that it is too early to claim victory in terms of a soft landing. However, according to our index, a more severe unemployment scenario may not necessarily imply greater economic misery, as a rise in unemployment would likely be partly offset by more aggressive policy rate cuts (although it could take time for this to feed through to households). At the same time, in a scenario with rising unemployment, there is a risk that falling asset prices and lower wage growth could also add to economic misery, outweighing the tentative positive contributions from lower interest rates and inflation. This was evident as stock markets were hit by a global sell-off at the beginning of August as weak jobs growth stoked fears of a sudden downturn in the US economy. Markets have since recovered as other data releases shifted the narrative back to a goldilocks scenario. Nonetheless, the turbulence was a reminder that the economic outlook remains fragile.

Theme article: Global demography

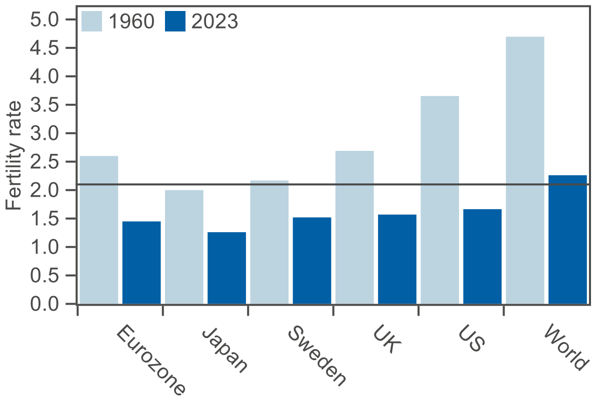
Negative population growth challenges welfare

Populations have already peaked in several advanced countries and the UN's recent forecast indicates that the global population could peak around 2080. Japan's population peaked in 1995 and is at the forefront of this global transition. Furthermore, we also see population growth turning negative in the eurozone and flattening out in US. In order to prevent the erosion of global welfare systems due to an ageing population, the smaller working-age population will have to work more and possibly longer. If the working population is unable to do so, productivity growth will have to come to the rescue. This global trend stresses the importance of structural reforms and is likely to lead to labour shortages, lower GDP and higher public debt. We assume the effect on neutral interest rates from demographics to be close to zero and argue that much depends on the difficult-to-predict productivity growth.

Demographic transition towards...

Economic development and improved living standards have led to longer life expectancy, a higher average childbearing age, lower child mortality and smaller families. Initially, lower mortality rates lead to higher population growth, but as fertility rates decrease, growth decelerates. We have now reached the stage at which the population of many countries (63 out of 237) has already peaked and population growth is expected to turn negative over the coming decades in several other regions (48 countries). According to the UN's recently published forecasts, the world's population will peak around 2080, and as soon as 2025 in western Europe.[4]

Significant drop in fertility rates



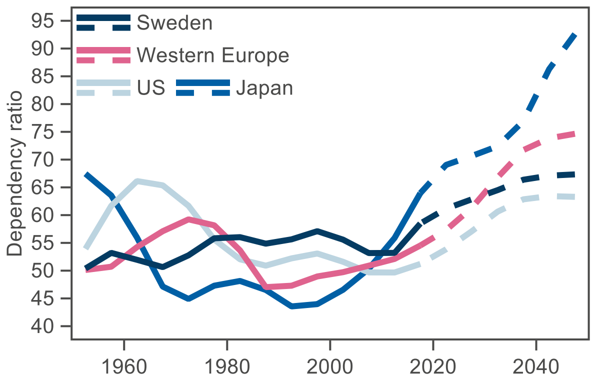
Note: Number of births per woman, 2.1 imply stable population growht according to UN.
Sources: Macrobond and Handelsbanken

One reason for falling population growth is the decrease in fertility rates. According to the UN and the OECD, and assuming no migration, a fertility rate of 2.1 children per woman ensures a broadly stable population. In 2024, the global fertility rate has plummeted to 2.3 births per woman down from 3.3 in 1990 and 4.7 in 1960. Moreover, while the global rate is still above what is assessed to be equal to a stable population, in the eurozone and the Nordic countries, the fertility rate is roughly 1.5.

...a shrinking working-age population...

Longer lives and reduced fertility rates mean that the share of elderly in the population is increasing, while the working part of the population is decreasing. Hence, dependency ratios are increasing. In Japan, for example, almost half of the population will be under 15 or over 65 years old around 2050.

Dependency ratio on the rise



Note: Share of people in age 0-14years and 65+ per 100 in 15-64 years.
Sources: United Nations and Handelsbanken

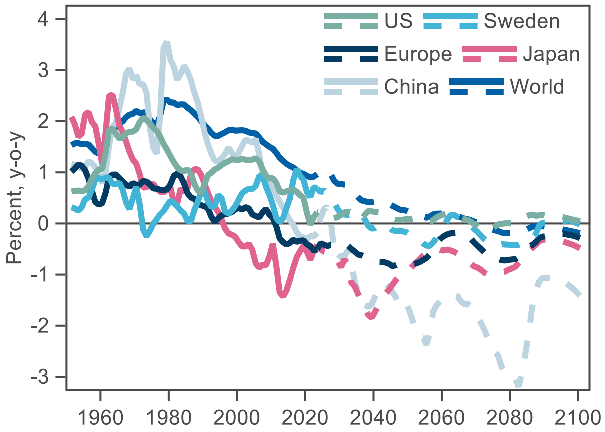
Despite this common global trend, population growth can be vastly different between countries. The evident differentiator is the aforementioned economic development, but a country's policy measures and cultural differences also play a vital role. While China has scrambled to reverse the effects of its long-held one-child-policy over the last ten years, migration has shaped populations and

[4] https://www.un.org/development/desa/pd/world-population-prospects-2024

greatly influenced politics in European countries during the same decade.

Although the world's population is yet to peak, many developed nations are already experiencing shrinking working populations. Europe had its largest working-age population in 2011, at just over 503 million, and this figure is expected to total 476 million this year, and according to the UN, Sweden's working population will peak in 2037. In contrast, the US is one of few developed countries in which the population is projected to continue to grow throughout the UN's forecast period.

Working-age population trending downwards



Note: Population growth, 15-64 years
Sources: Macrobond, UN and Handelsbanken

On a global level, migration is a zero-sum game, but plays a vital role in slowing the decline in certain developed countries and regions. From Europe's peak to today, the eurozone averaged a net 1.4 million migrants per year. The US has had almost twice the migration rate per capita and is projected to sustain a steady and high net migration rate over the forecast period.

...comes with challenging consequences

Looking ahead, a shrinking working-age population could affect economic development in several ways, such as:

- **Economic growth:** In general, the ageing population is expected to hamper economic growth owing to a decrease in labour supply and slower productivity growth resulting in a decrease also in GDP per capita.[5] Overall, fewer people in the workforce results in a reduced need for investments through the direct effect on housing and public infrastructure. Furthermore, lower investments could have a negative effect on productivity growth although this could be offset by positive effects from policy measures, adaptation to new technology and AI development.
- **Labour demand:** Reduced employment growth and a greater proportion of elderly people could lead to an increase in labour shortages and higher relative demand for services (e.g. healthcare), causing a sectoral shift towards the more labour-intensive service sector.
- **Savings behaviour:** While an elderly population means that there will be fewer people saving into their pensions, longer life expectancy means that people should save more, which leads to diverse effects on neutral interest rates. Moreover, taking the effect of a reduced need for investments into account, we assume that the demographics total net effect on neutral interest rates will be approximately zero over the coming decades.[6]
- **Fiscal sustainability:** Lower tax revenue and increased costs for welfare could, in the absence of high productivity growth, lead to policy measures that increase public debt or to a less ambitious level of welfare.
- **ESG perspectives:** An ageing population is generally known to exacerbate income inequality, meaning we should expect the Gini-coefficient to increase. The redistributive role of fiscal policy, through taxes and transfers, might thus become more in focus.[7] However, even though older generations have lower incomes, they have – on average – higher wealth.[8]

[5] See for example, https://www.nber.org/system/files/working_papers/w22452/w22452.pdf
[6] Read more about how demographics could affect neutral interest rates in our Macro comment "Rising r* revisited – Phoenix or Icarus?" from 5 June 2024
[7] Even though the IMF questions how efficient fiscal transfers could be to tackle inequality, see Sustainable Path to Inclusive Growth in Japan: How to Tackle Income Inequality?, IMF, July 2024
[8] See Japan: Selected Issues, IMF, 27 November 2018

Is Japan leading the way?

Japan is leading the demographic transition to an ageing population. Its dependency ratio is surging due to longer life expectancy and the fact that the post-war baby boom was short relative to other G7 members. Japan has also had exceptionally low immigration.

The shrinking and ageing population could have had a significant negative impact on economic growth as well as the neutral interest rate. See for example Han, F. (2019). However, concerning neutral interest rates, the research comes to divergent conclusions, and it is difficult to pinpoint both this unobservable rate level and what is due to demographics.

Japan's high debt-to-GDP ratio reached 230 percent at the start of 2024. The Japanese government has been able to borrow cheaply and invest abroad in high-return assets and has thus been able to sustain a high level of debt – and welfare. Yet, Morikawa (2018) and other surveys show that the quality of services is eroding as a result of labour shortages.

Japan has invested in a number of fiscal policies aimed at increasing women's labour-force participation rate. For women aged 15-64 this rate has risen to 75 percent from 65 percent ten years ago. However, a large proportion of the female workforce is employed in low-paid, part-time, non-regular jobs.

Japan's economy has been characterised by wage stagnation and low inflation since the burst of the bubble at the end of 1990 and is not solely a consequence of demographics. Companies avoided wage rises since it was difficult to pass the costs on to consumers, which fed through to wage and price expectations. In 2023, wage negotiations were the highest in 30 years and the frequency of companies' price revisions has soared from exceptionally low levels.

Productivity growth has been low in parallel with real wages, not least in the service sector. However, the number of robots per capita in manufacturing is one of the highest in the world partly due to government initiatives as the "New Robot Strategy" from 2015 and the Society 5.0 initiative, which is a concept for future society including investments in AI and big data.

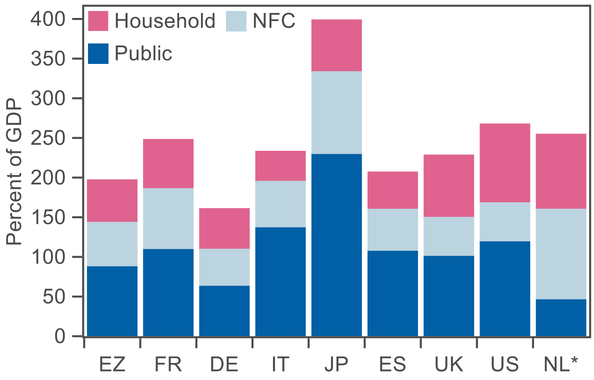
Policy measures to mitigate the effects

So, what could politicians do to mitigate these negative effects on welfare? For individual countries, labour migration can be a partial solution, but the trend towards negative population growth is global and thus labour migration is not a solution on a broader level. Measures to compensate for the negative demographic effects include extending working life by, for example, improving incentives to work longer and offering a more flexible approach to retirement, and incentives for higher employment rates among women, such as raised child-care benefits and review the incentives in the tax system.

However, these types of structural changes to get more people to work are often difficult to implement. Over the past year, we have seen that a higher retirement age has been a very contentious issue in France, despite the country's relatively low retirement age. It underlies the importance of measures to increase productivity. But even here, there are challenges, such as the fact that high indebtedness in many countries might put a lid on productivity-enhancing investments.

Perhaps we can learn a couple of lessons from Japan, which has implemented policy measures to increase labour supply and also boost the rate of innovation. However, one hard lesson is that this global trend is hard to escape and Japan has the majority of the increase in the dependency ratio ahead of it and thus has much still to prove.

Japan has the highest debt ratio



Note: EZ=Eurozone, NFC=Non-financial corporations.
* The size of NFC debt in The Netherlands is largely held by multinational companies for tax-related purposes.
Sources: Bank of France and Macrobond.

Eurozone

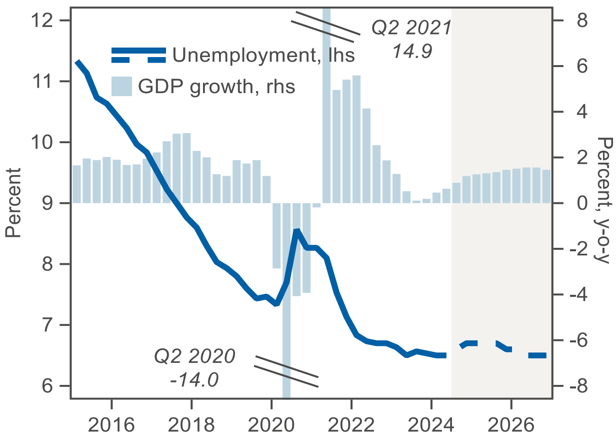
On a slow path towards normality

Our baseline scenario implies that the ECB manages a soft landing of the economy with the support of households using their recovering purchasing power. Inflation is closing in on the ECB's target, there are early signs of easing unit labour costs, and unemployment remains record low. Nevertheless, a soft landing is not yet a done deal, as labour cost pressures and service prices remain elevated, delaying a normalisation of policy rates. While consumers should be encouraged by low unemployment and improved purchasing power, a recent deterioration in expectations of future activity among purchasing managers raises some concerns about growth. We maintain our view that the risks are tilted to the downside as the ECB remains focused on prices and cost pressures, with more tolerance for weaker signals regarding activity.

Slow recovery underway…

The case for a soft-landing scenario is supported by the remarkable disinflation process, which has paved the way for gradual rate cuts, with unemployment still close to record lows. In combination with strong nominal wage growth, this should imply that households are equipped to support demand going forward. We illustrate this with our 'economic misery index' and note a similar improvement in consumer confidence, albeit from low levels (see theme article). However, the ECB is expected to go slow on rate cuts, and we find little support for a rapid recovery in the various business surveys. In particular, the August PMI confirmed the weak signals from the two previous months, albeit partly masked be a temporary Olympic effect boosting the service sector in France.

GDP forecast



Sources: Eurostat, Macrobond and Handelsbanken

Overall, we expect a slow recovery, with GDP growth in the second half of the year broadly unchanged from the first half at 0.3 percent q-o-q. This implies y-o-y growth of 1.1 percent at the end of 2024, up from 0.2 percent over the previous four quarters. We expect growth to accelerate somewhat in 2025, as monetary policy continues to normalise, and reach 1.6 percent y-o-y at the end of 2025.

…with a mild rise in unemployment

Unemployment has remained record low, as companies are hesitant to shed staff, with difficulties recruiting still a problem for many employers. According to the commission business survey, the share of eurozone companies reporting labour shortages remained markedly above normal, in particular in the service sector. Going forward, we expect productivity slack in companies to hold back employment growth, leading to a mild rise in unemployment to 6.7 percent, where we expect it to stay during most of next year before it gradually falls back towards 6.5 percent.

Early signs of easing unit labour costs

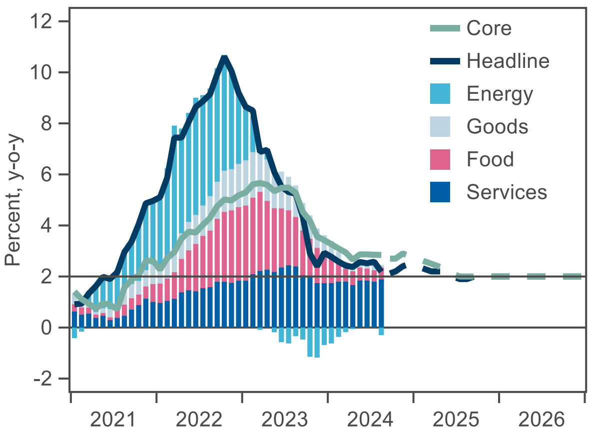
Over the past year, productivity per person has fallen by around half a percentage point, which in combination with elevated wage growth, implies unit labour cost growth of around five percent. The trend in quarterly productivity growth has taken small steps in the right direction, with a positive reading in the second quarter. The ongoing acceleration in growth supports a cyclical recovery in productivity, which is a key condition for a sustainable disinflation process, while allowing profit margin growth and improving real household purchasing power.

Even with improving productivity, wage growth still needs to decelerate. The ECB should find support for this in recent wage indicators. Eurozone wage growth according to compensation per employee as well as the ECB's indicator of negotiated wages eased more than expected in the second quarter, adding to the evidence of easing wage pressures from wages in job postings (Indeed), the ECB Corporate Telephone Survey (CTS) and SAFE wage expectations.[9] Nevertheless, the sharp deceleration in negotiated wages was driven by one-off payments in Germany, and the ECB wage tracker even indicates a re-acceleration in the short term. Overall, we think wages will remain elevated into 2025, contributing to slow progress in the last mile of disinflation.

Service price inflation is key

Headline inflation in the eurozone has eased considerably and, at 2.2 percent, was close to target in August, supported by falling energy prices. However, the ECB is not yet ready to declare victory. The progress in core inflation has stalled in recent months, as the contribution from falling goods inflation has faded, and service inflation has remained remarkably sticky hovering at around 4 percent since the end of last year. Going forward, we think the last mile of disinflation will boil down to service inflation easing to around 3 percent. This in turn is closely related to the development of domestic price pressures and labour costs in particular. With limited slack in the labour market and demand growing once again, we expect this to be a gradual process, with inflation stabilising around the target towards mid-2025

Inflation and contributions by components



Note: Food includes alcohol & tobacco.
Sources: Eurostat, Macrobond and Handelsbanken

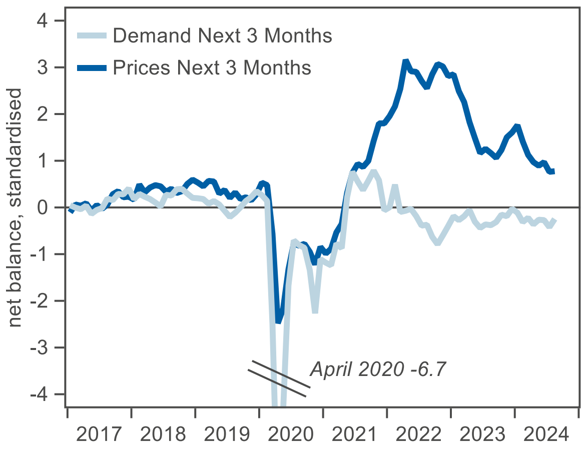
ECB to deliver two rate cuts in H2 2024

So far, the ECB's strategy to safeguard the inflation target has focused on past price and cost developments, with wages and service prices the key variables. While this is partly lagging data, as long as unemployment remains low, the ECB should be patient when gathering evidence that the risks of above-target inflation have passed. At the same time, today's policy rate of 3.75 percent is well above the neutral level, and gradual progress in disinflation should be sufficient to motivate two rate cuts during the second half of this year, and two more in the first half of 2025, leaving the policy rate at 2.75 percent in June next year. As we move into the second half of next year, the monetary strategy will be more about preventing unemployment from becoming entrenched above neutral levels, and inflation falling below target. This suggests that decisions are increasingly guided by forward-looking indicators, inflation expectations and the assessment of the neutral interest rate. We forecast that eurozone policy rates will reach 2.0 percent – our assessment of the neutral rate – in the beginning of 2026.

A soft landing is not a done deal

There is still considerable uncertainty about the outlook for economic activity, and the billion-euro question continues to be how to safeguard the inflation target without crashing the economy. The remaining challenge is well illustrated by the gap between service companies' demand and price expectations in the eurozone's business surveys. There is still a lack of evidence of a full normalisation of price plans without weakening demand.

Total Service Sector



Sources: Macrobond, DG ECFIN and Handelsbanken

We maintain our view that the risks of economic activity are tilted to the downside, as the ECB remains focused on prices and cost pressures, with more tolerance for weaker signals regarding activity. There is a risk of a negative feedback loop whereby slowing demand leads to an acceleration in unit labour costs via sluggish productivity, forcing companies to shed labour, which reinforces a weakening in demand. In such a scenario, the ECB would probably respond with more aggressive rate cuts but would find it hard to avoid a hard landing.

[9] Compensation per employee eased from 4.8 percent y-o-y in the first quarter to 4.3 percent in the second quarter, and negotiated wages eased from 4.7 to 3.6 percent.

United Kingdom

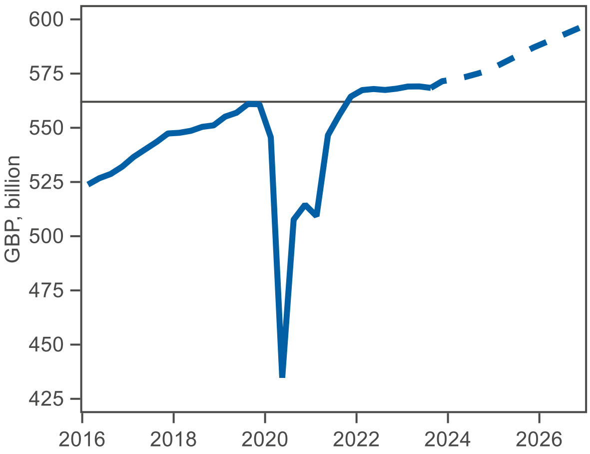
Bank of England rate setters divided on inflation

Given that the UK has shown a reasonably robust recovery from last year's recession, we now expect to see stronger growth in 2024. The election of a new government in July brings political stability in parliament for up to five years. However, although this is much welcomed by financial markets, it is unlikely to alter our projection of modest growth in the medium term. In August, interest rates were cut for the first time in this cycle, but rate setters at the Bank of England (BoE) remain firmly divided regarding the likely persistence of inflation. Our base-case scenario is still that there will be one further cut this year, with the BoE base rate gradually falling to a nominal level of 3 percent by the end of 2026.

Short-term outlook improves; medium-term remains unchanged

Our previous forecast of meagre growth of just 0.4 percent in 2024 now appears to be too pessimistic. Growth in Q1 (0.7 percent) and Q2 (0.6 percent) has exceeded expectations, and fundamentals will aid economic growth in H2 2024. Real wage growth has now been positive for over a year, and we expect this to continue to be the case throughout the remainder of the calendar year. In the meantime, there is more uncertainty around the pathway of real earnings in 2025 given the prospect of additional taxation measures. It is notable that the household saving rate for Q1 2024 averaged 11.1 percent[10], the highest level since the Global Financial Crisis (excluding the pandemic). We expect the saving rate to ease towards year-end, particularly as consumer confidence has been picking up from its previous lows. As a consequence, we upgrade our 2024 UK growth forecast to 1.1 percent.

UK Quarterly GDP



Sources: Macrobond, ONS and Handelsbanken

[10] Households (S.14): Households' saving ratio (percent): Current price: GBPm: SA - Office for National Statistics (ons.gov.uk)

Since the previous edition of the GMF, the UK has elected a new government. The Labour Party has a comprehensive parliamentary majority of over 170 seats, which provides political stability in parliament for up to the next five years. This has been interpreted positively by financial markets, although the impact on the UK's medium- to longer-term growth prospects remains unclear. We forecast that GDP will grow by 1.6 percent in 2025 and 2026, up marginally from our previous forecast of 1.4 percent in 2025 and 1.5 percent in 2026.

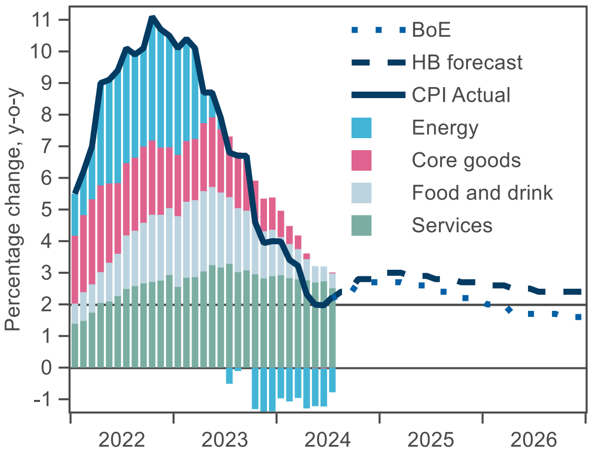
Recent announcements will have a somewhat mixed impact on forecasted growth. The Chancellor of the Exchequer has identified what she describes as a GBP 22bn 'black hole' that requires imminent action to fill, meaning that additional tax rises are likely to be announced in conjunction with the Autumn Budget. These will dampen consumer expenditure and growth prospects, but other proposed measures – particularly those that could render the prevailing planning system more conducive to higher levels of housebuilding – could boost the productive potential of the economy.

UK headline inflation will rise by year-end

UK y-o-y CPI was at 2 percent in both May and June. However, inflation rose above target in July to 2.2 percent, primarily due to a base effect in the energy component of inflation. We expect inflation to increase again by year-end since energy prices are due to rise in October, and a further base effect will show up in the headline rate.

With respect to domestically generated inflation, data releases show some cooling in nominal wage growth and services inflation, although recent public sector wage settlements are an area of concern. For the private sector, both wage and inflation expectations are showing signs of moderating. We therefore expect overall annual wage growth to ease from 5.4 percent[11] currently to roughly 4.5 percent by the end of 2024, although this is unlikely to make a material dent in services inflation by year-end. Stubborn services inflation, along with base effects in the energy component of inflation, will likely mean y-o-y CPI will end the year at roughly 2.8 percent.

Inflation outlook and component breakdown



Sources: Macrobond, Pantheon, BoE and Handelsbanken

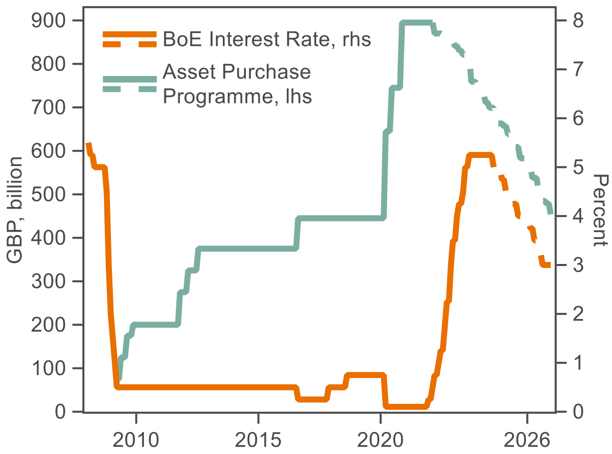
What next after first cut of the cycle?

An interest rate cutting cycle began in August with the base rate falling from 5.25 percent to 5 percent. The BoE's current modal inflation forecast indicates that y-o-y CPI inflation will hit 1.5 percent by 2027[12], (assuming that market expectations for interest rates in the run up to the decision are followed). This is considerably below target and indicates that the collective opinion of the Bank of England rate setters, the Monetary Policy Committee (MPC), is that market interest rate expectations are too hawkish. Recent turbulence in global financial markets, prompted by concerns about the prospect of a US recession, have led some to reinforce their view that the BoE base rate may come down faster than they had previously thought.

We would urge some caution with respect to this scenario. There is a divergence of views on the MPC, with four out of nine members on the committee backing a rate freeze in August on the basis that inflation persistence remains a concern. These members are likely concerned about inflation persistence that results in fewer interest rate cuts in the medium term should, for example, earnings prove stickier or recent increases in UK inactivity levels persist into the future.

However, our base-case scenario on interest rate expectations remains similar to that in our previous edition of the GMF. Assuming a cooling in wage settlements, the MPC is set to initiate one further interest rate cut this calendar year – most likely in November – with the base rate gradually returning to 3 percent by the end of 2026. Note that, along with the usual decision on rates, at its next meeting in September, the MPC will vote on the level of quantitative tightening (QT) for the following twelve months. Given the preponderance of passive QT in the coming year, we expect the pace of QT to continue at the same pace as in the previous two years (GBP 100bn per annum).

Monetary policy outlook



Sources: Macrobond, Bank of England and Handelsbanken

GBP/EUR may settle at 0.84 by year-end

There are two key reasons for our relatively bullish view on GBP/EUR for the rest of 2024. The first is due to interest rate differentials; our forecast is for just one interest rate cut in the UK for the remainder of 2024 versus current market expectations of two cuts. Secondly, the comparatively stable political situation in the UK should provide a moderate tailwind for Sterling. We therefore forecast that EUR/GBP will end the year at 0.84 with GBP/USD ending the year at 1.31.

[11] Based on regular pay settlements (April–June 2024)

[12] Bank of England, Inflation Report, August 2024

Sweden

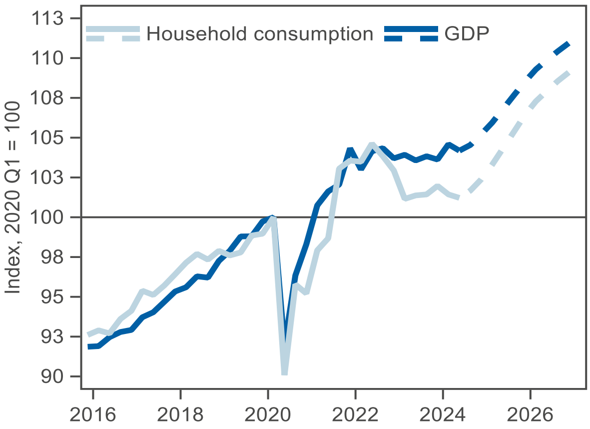
On the road to recovery

Economic activity remains weak, but forward-looking indicators are on the way up. Lower inflation and a clear shift in economic policy with lower interest rates and more stimulus from the government pave the way for a recovery from the end of 2024. The krona will continue to strengthen gradually.

Domestic demand remains weak

The Swedish economy has stagnated since 2022 due to high inflation and a restrictive monetary policy. Interest-sensitive areas of the economy such as household consumption and housing investment have declined significantly. The slowdown has continued in the first half of 2024 and we assess that the economy currently is in a mild recession. GDP fell in Q2 due to weak domestic demand, and both business and consumer confidence remain at levels that suggest slow growth in Q3. However, the outlook for the Swedish economy is beginning to brighten. Lower inflation is paving the way for a clear shift in economic policy with both lower interest rates and more stimulus from the government.

Household consumption will drive the recovery

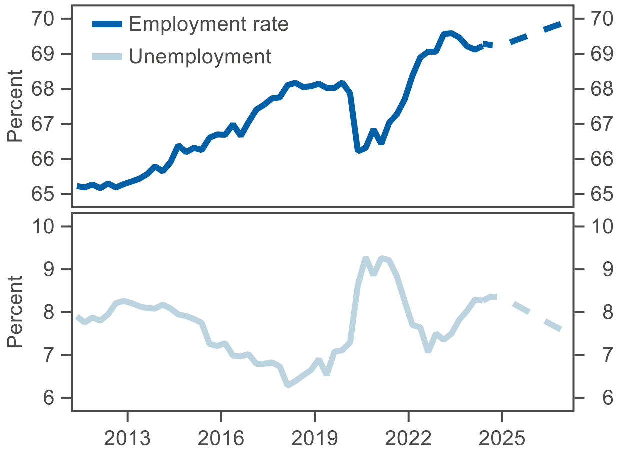


Sources: Macrobond, Statistics Sweden and Handelsbanken

The brighter outlook is reflected in many survey-based indicators that are on the way up. Above all, households have become significantly less pessimistic. After two years of sharply falling real wages, households' purchasing power is starting to improve again. We expect that rising real wages and lower interest rates will lead to a cautious recovery of household consumption in the second half of this year. However, our assessment is that the economic recovery will not get any real wind in its sails until 2025, when we see a move to an expansionary fiscal policy, a further normalisation of monetary policy and a brighter labour market.

Overall, we forecast that GDP will increase by 0.9 percent this year and rise by 2.5 percent in 2025 and by 2.7 percent in 2026. Growth in 2025 and 2026 is stronger than in most other European countries. Important reasons for this are Sweden's greater fiscal stimulus and stronger response to lower policy rates, coupled with more slack in the labour market and higher trend growth.

Employment rate and unemployment



Sources: Macrobond and Handelsbanken

Recovery in sight for the labour market

The labour market has weathered the downturn relatively well. The rise in unemployment can mainly be attributed to an increase in labour supply and is thus not as bad as when taken at face value. Furthermore, the decline in employment has been entirely driven by fewer temporary employees. This suggests that companies have been able to meet weaker demand by reducing new hires and cutting back on temporary employees rather than having to lay off permanent staff. There are also signs that the outlook for the labour market is beginning to brighten and note that employment increased in the second quarter of this year. Forward-looking indicators for the labour market are, however, mixed. Employment plans for the business sector are weakly positive and indicate that employment will increase in the autumn. On the other hand, redundancy notices and the number of newly registered vacancies signals a more muted labour demand in the near term. Overall, we expect employment to remain almost unchanged in the autumn. At the end of the year, we expect a recovery in the labour market to begin, mainly driven by higher domestic demand.

The new normal: 2 percent inflation

Inflation in Sweden turned out lower than forecast and currently appears to have been tamed. The underlying inflation trend is cooling, and in the near term, our forecast for CPIF excluding energy (CPIFXE), indicates that inflation will be slightly above the Riksbank's 2 percent target.

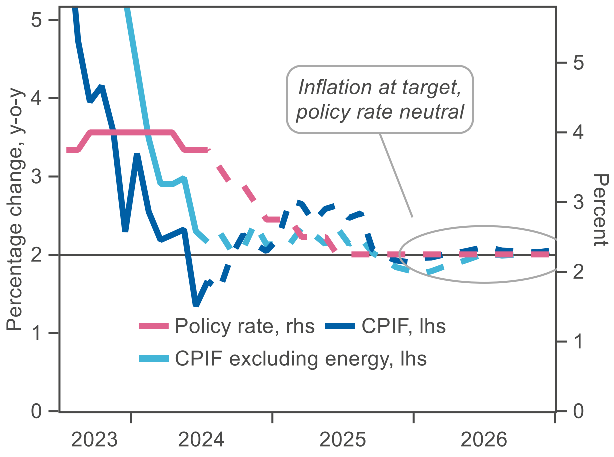
For the most part, forward-looking indicators have returned to levels close to those seen in the pre-inflation-crisis years – relatively rapidly rising wages and unit labour costs are examples of above-normal indicators, while some raw material and intermediate goods prices are examples of below-normal indictors. We do not believe that this should be interpreted as signalling a return to past standards, with inflation undershooting the Riksbank's target. Instead, the "new normal" is also based on, among other things, globally higher inflation and inflation expectations as well as lingering changes in price and wage-setting behaviour. In Sweden, the latter is reflected, not least, in the fact that companies' pricing plans and wage expectations have not fallen in line with demand in the economy. As demand strengthens in 2025–26, we therefore expect a somewhat more robust pass-through to inflation than we observed during the lowflation period in the 2010s, in addition to a normal strengthening of companies' pricing power.

Our forecast is that CPIFXE inflation will land at close to 2 percent during 2025. Total CPIF inflation will temporarily be slightly higher, as we assume that the price of electricity will rise to a normal level next year. All in all, a clear blue inflation sky in the short term, but further into 2025–26, the outlook naturally becomes rather foggy: the Riksbank's expected policy rate cuts may have a greater or a smaller impact on inflation and inflation expectations while geopolitics and other global developments may alter the outlook for energy and other prices.

Riksbank on course for more cuts

In light of inflation stabilising close to target and dampened economic activity, the Riksbank has continued to cut its policy rate and signalled that additional cuts will come faster than previously forecast. A key part of the Riksbank's forward guidance has been kept, however: "gradual" cuts. We interpret this as an intention to stick to steps of 25bp. All told, for the remainder of 2024, we forecast the policy rate to be lowered in September, November and December, reaching 2.75 percent.

Front-loaded rate cuts as inflation cooled



Sources: Macrobond, Statistics Sweden and Handelsbanken

This assessment is at risk if inflation starts rising again, coupled with a broader surge in price pressures through renewed krona weakening and pickup in key leading indicators like pricing plans. Then the Riksbank could pause cuts. On the other hand, our assessment is that a renewed sharp slowdown in the economy would be required before the Riksbank resorts to any outsized 50bp cuts.

We assume that the nominal neutral rate of interest in Sweden will be about 2.25 percent in a few years' time[13]. During 2025, we expect the Riksbank to continue to cut the policy rate to this level.

Krona to continue gradual strengthening

After weakening during much of the summer, following falling Swedish interest rates, the krona took a new turn at the end of July and started appreciating. In the driver's seat, we now found falling US interest rates, and some general dollar depreciation. At the other end, riskier currencies stood to gain – not least the krona.

We forecast that the krona will continue to strengthen driven by several factors. First and foremost, as the expected Fed policy rate cuts become reality it will become increasingly clear that both the US and Swedish economies are on track for a soft landing, boosting risk appetite in the FX market and hence strengthening the SEK vs. the USD and the EUR. In the medium term, improving interest rate differentials compared to the eurozone and the US will further add to the krona's appreciation. However, it will likely be a bumpy ride in this unusually jittery FX market, sensitive to macroeconomic data and geopolitical risk developments.

[13] See our Macro Comment "Rising r* revisited – Phoenix or Icarus?", June 2024.

Norway

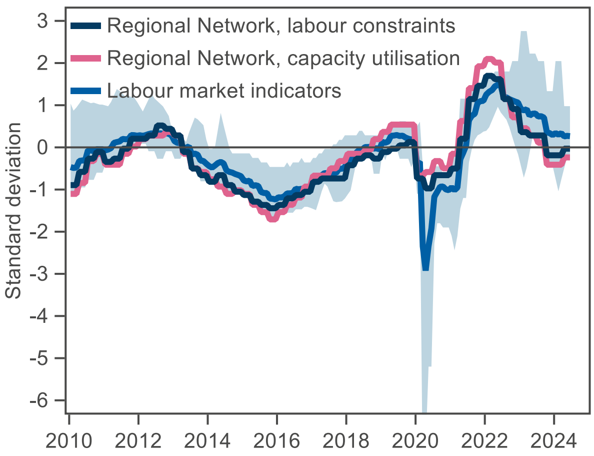
Steady course from Norges Bank

Mainland GDP has underperformed slightly compared to our expectations in May, but the deviation is minor. Recent indicators support our view that growth will gradually pick up from this autumn. However, inflation has decreased faster than expected, and global interest rate expectations have been revised down, indicating downside risks to Norges Bank's rate path. Despite this, due to concerns about the NOK exchange rate, we still believe Norges Bank will delay its first rate cut until March next year.

Activity has levelled out...

Recent data show that the mainland economy increased by 0.1 percent q-o-q in the second quarter, just slightly weaker than our estimate of 0.2 percent from our previous report. Growth in the first quarter was also revised down, indicating a fairly flat development in the Norwegian economy throughout the first half of the year. This has also impacted employment, which levelled off in the second quarter, suggesting that capacity utilisation in the Norwegian economy has decreased further. Our assessment, based on various indicators, is that the Norwegian economy has eased further down to neutral levels.

Capacity utilisation



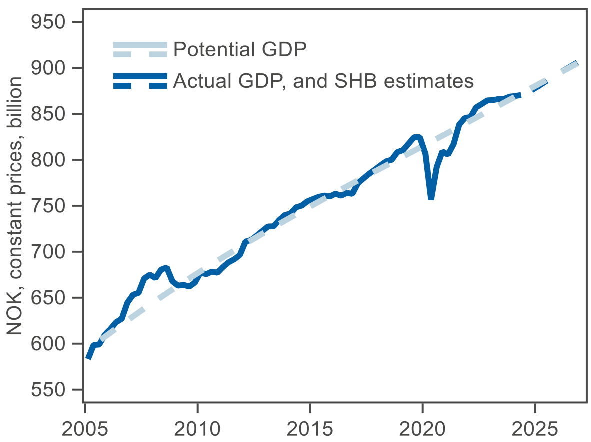
Sources: Macrobond and Handelsbanken

...but is likely to pick up from this fall

Looking ahead, we expect growth to gradually pick up from the fall and continue through the forecast period. This outlook is supported by recent signals from Norges Bank's latest Expectations Survey, where companies' expectations for net employment and profitability plans were slightly adjusted upwards. Key drivers include a further decline in inflation, improving household purchasing power, a peak in interest rates, and expectations of future rate cuts. However, the stimulus from rising oil investments is about to face, as these investments are expected to decline again from next year. On the other hand, the trough in residential construction has likely been reached, and we anticipate a significant rise in residential investments over the next couple of years; stimulated in particular by housing prices rising more than 20 percent over the forecast period.

However, we believe it will take some time before the economy fully reaches its trend growth again, so we expect a slight increase in unemployment, which has been rising modestly so far. We anticipate that unemployment will peak at levels similar to those before the pandemic, however.

Mainland GDP has slowed in 2023

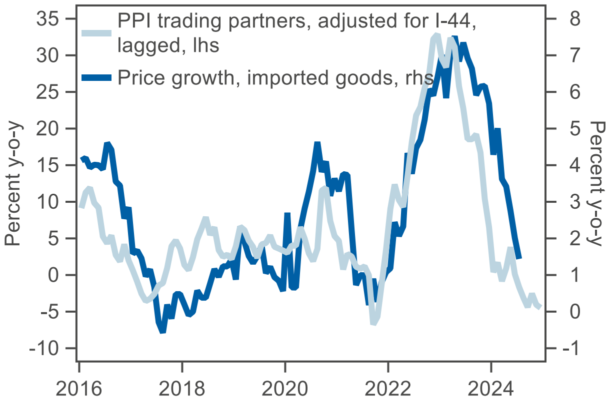


Sources: Statistics Norway and Handelsbanken

Inflation has dropped faster

Underlying inflation, measured by CPI-ATE, has decreased faster than expected since May. The continued decline in the annual CPI-ATE growth rate can largely be attributed to a faster drop in price inflation of imported goods. The NOK exchange rate has hovered around our estimates, however, and typically it also takes time before currency changes affect core inflation. This suggests that price impulses in foreign currency have likely been weaker than expected. However, the decline in imported goods' inflation may now be levelling off, as shown in the chart below. While price growth for domestically produced goods and services continues to slow, it remains elevated, and wage growth is still high. The recent national accounts report indicates that productivity growth in the Norwegian economy remains weak, meaning that high nominal wage growth will continue to feed directly through to business costs.

Imported price impulses

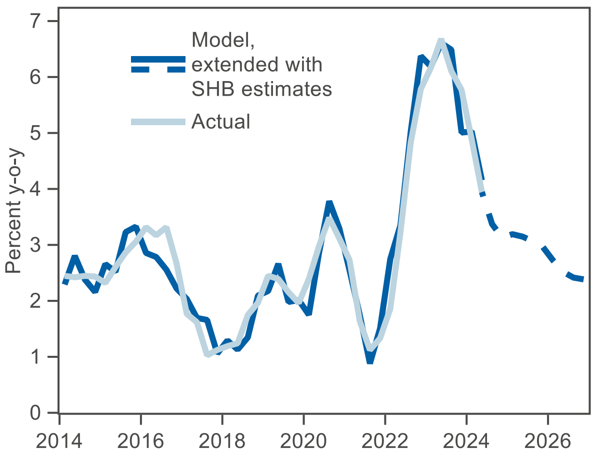


Note: PPI trading partners, after adjustment for changes in the krone exchange rate, versus imported goods price inflation
Sources: Macrobond and Handelsbanke

Norges Bank's latest Expectations Survey shows that expectations for both price and wage growth among labour market participants have declined further in the third quarter. This could potentially be due to the faster-than-expected drop in actual inflation, but it could also lead to lower wage demands, which may help curb inflation. However, it would take time before nominal wage demands decrease significantly. Overall, our wage forecasts remain relatively unchanged in this report.

That said, core inflation estimates have been revised down slightly. However, since our forecasts for key drivers, such as wages, labour productivity, and the krone exchange rate, have not been significantly changed, the downward revision of our inflation forecast is smaller than recent forecast deviations might suggest. We still do not expect inflation to fall completely to the target within the forecast period.

CPI-ATE: Actual and expected



Sources: Macrobond and Handelsbanken

Probably no rate cut this year

Since May, we have argued that Norges Bank will keep interest rates steady for the rest of this year, with the first cut expected in March next year. Norges Bank's June projections aligned closely with these forecasts. We maintain this expectation but note that downside risks to the interest rate path have increased, meaning the rate cut could come as early as the end of this year. Rate forecasts for major central banks have been revised down, inflation has fallen more than expected, and the momentum in the Norwegian economy has been slightly weaker than expected recently.

However, the krone's exchange rate remains a concern. The worst of the krone's weakening seems to be behind us for now, but there is still a considerable risk premium in the krone that Norges Bank will have to consider.

Overall, we maintain our call that the first rate cut will not come before March next year and we forecast a total of four rate cuts next year, compared to three previously. By the end of the forecast period, we expect the policy rate to have decreased further, to 3.00 percent, implying a slower rate decline than currently priced into the market, where the key policy rate is expected to be cut by the end of this year. Consequently, we expect the Norwegian krone to strengthen further, with EUR/NOK moving towards 11.50 over the next three to six months.

Finland

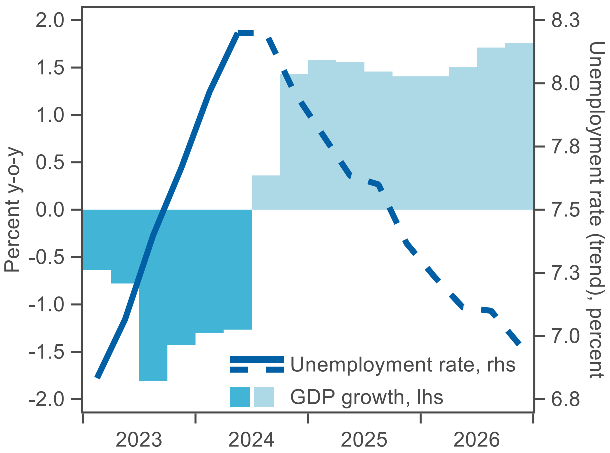
Better growth next year

The Finnish economy has performed broadly in line with our May forecast and we thus leave our GDP forecasts for 2024–26 unchanged. We believe the economy will continue to grow in the second half of this year, but due to weak carryover from 2023, GDP is set decline by 0.2 percent in 2024. For 2025–26, we forecast around 1.5 percent GDP growth per year, driven by exports and domestic demand. We expect that the unemployment rate will peak this year and then gradually decline as economic activity improves. The modest inflation will spike temporarily this autumn thanks to a one-off correction of the electricity price index and the increase in value-added tax. Public finances are in dire straits and the government has taken action to put them on a more solid footing. It will take time, however, before this trickles through to the actual data.

Quarterly growth throughout the year

The Finnish economy enjoyed some growth during the first of half of 2024. In the second quarter, GDP grew by 0.3 percent versus the previous quarter, led by exports and public consumption. During the summer, the economy performed broadly in line with our May forecast, and so we leave our GDP forecasts for 2024–26 unchanged. Due to the weak carryover from 2023, GDP is set to decline by 0.2 percent in 2024 despite positive quarterly growth numbers throughout the year. For 2025–26, we forecast around 1.5 percent in GDP growth per annum.

Better prospects ahead



Sources: Macrobond, Statistics Finland and Handelsbanken

Export prospects moderate

Industrial production was quite weak during the first half of the year, with only a few bright spots. Luckily, it seems that industrial new orders have past the trough. Moreover, manufacturing confidence has strengthened in recent months and production expectations have improved. The growth outlook for Finland's main export markets is currently modest, but we expect it to improve during the forecast period, which should bolster Finnish exports.

Lower interest rates and a need for investment should also support Finnish goods exports. Meanwhile, the digitalisation trend continues to underpin the potential for growth in service exports although the latter has stagnated somewhat in recent years.

We forecast that exports will decline by 1.2 percent in 2024 and return to an average growth rate of more than 3 percent in 2025–26. We expect imports to outgrow exports, and thus the contribution from net exports will be negative. We believe that the current account will remain in deficit during our forecast period.

Modest growth in private consumption

Consumer confidence is still quite weak. Modest inflation, lower interest rates and improving real disposable income underpin the growth in private consumption. However, unemployment has also increased this year and, short-term, we expect a soft labour market, followed by a gradual improvement as economic growth picks up. We expect the government's 1.5 percent VAT hike in September to have a marginal effect on private consumption growth and forecast that private consumption will grow by 0.4 percent in 2024 and accelerate in 2025–26.

Investments to return to growth in 2025

Investments declined markedly during the first half of the year, with residential and non-residential construction investments being particularly weak. The decline in building permits stabilised in recent months, although it will be some time before we see a real upturn in construction. For 2024, we expect growth in machinery and equipment investments as well as public investments. Overall, we forecast that total investments will decline by 3 percent in 2024 due to the weakness in private investments.

For 2025–26, we expect solid investment growth thanks to lower interest rates and a less uncertain economic outlook. We project a gradual recovery in construction investments. Furthermore, machine and equipment investments and other investments should see solid growth thanks to the green transition, digitalisation and artificial intelligence. In addition, investments in security, border control and national defence, in particular the delivery of the new multirole fighter aircrafts from 2025, will significantly boost public investments during our forecast period. We believe that total investments will grow by around 4 percent in 2025–26.

Housing market in recovery

The housing market is gradually recovering. The number of house sales has marginally increased and house prices have bottomed out. We expect house prices to decline by 2.5 percent in 2024 and increase by 2.5 percent in 2025. This year, households' intentions to buy a dwelling have been clearly below normal levels. We expect that households' buying intentions will pick up as interest rates decline further and economic activity gathers momentum.

A short-term inflation bump

Inflation has slowed this year and was 1.0 percent in July. The decline in inflation has been broad based − transport and food prices have moderated and lower interest rates have impacted inflation. However, the contribution of interest rates to CPI inflation is still above the long-term average.

Overall price pressure is modest at the moment. We expect less pressure on food prices and moderate electricity prices. Housing inflation should also subside as interest rates decline further. Lower crude oil prices will dampen transport fuel prices.

However, as the correction of the electricity price index will no longer affect the annual change of the consumer price index as of August, we see a rise in inflation. Also, we believe the 1.5 percent VAT hike to 25.5 percent in September will have a 0.7 percentage point impact on inflation, if fully passed through to consumer prices. We forecast that inflation in Finland will slow down to 1.8 percent in 2024 and 1.7 percent in 2025–26.

Near-term labour market weakness

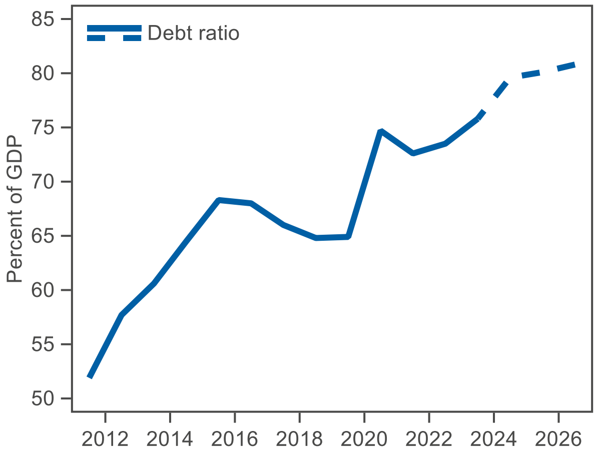
Thus far in 2024, employment has decreased and unemployment has increased. As a result, the trend figure for the unemployment rate rose to 8.3 percent in July. Compared to our May forecast, we are raising our unemployment rate assumptions. Thus far this year, employment has increased the most within the fields of health and social work, while it has decreased the most within construction. The employment expectations of companies improved during the summer but are still below normal and the number of job vacancies has decreased. We expect the unemployment rate to peak this year, then gradually decline as economic activity improves. We forecast that the unemployment rate will average 8.1 percent in 2024, 7.6 percent in 2025 and 7.1 percent in 2026.

Public finances remain weak

In 2023, the general government deficit was 2.7 percent of GDP, while the debt-to-GDP ratio rose to 75.8 percent. In spring, the government introduced measures to further improve public finances. Due to modest tax accrual, higher interest rate expenses and bigger-than-expected deficits in wellbeing services counties the general government deficit will widen further this year. The wellbeing services counties are self-governing regions that took over responsibility for organising healthcare, social welfare and rescue services as of 1 January 2023. These duties were previously the responsibility of municipalities. The government's ongoing consolidation measures should improve public finances in 2025 and 2026. However, costs related to an ageing population, higher defence expenditures and the elevated financial cost of public debt mean that Finland's public finances will remain in deficit.

We expect the deficit in public finances to shrink at the end of the forecast period. and the debt-to-GDP ratio to increase from 75.8 percent in 2023 to 80.8 percent in 2026.

Public debt ratio increasing



Sources: Macrobond, Statistics Finland and Handelsbanken

Key figures

GDP		Annual average		
	2023	2024p	2025p	2026p
Sweden*	0.0	0.9 (0.4)	2.5 (2.8)	2.7 (2.4)
Finland	-1.0	-0.2 (-0.2)	1.5 (1.5)	1.6 (1.6)
Norway, mainland*	1.1	0.7 (0.8)	1.6 (1.2)	1.7 (1.5)
Eurozone	0.5	0.6 (0.7)	1.4 (1.3)	1.5 (1.5)
United Kingdom	0.1	1.1 (0.6)	1.6 (1.4)	1.6 (1.5)
United States*	2.5	2.6 (2.5)	1.7 (1.8)	2.1 (1.6)
China	5.2	4.8 (5.0)	4.5 (4.5)	4.2 (4.2)

*Calendar adjusted

Inflation		Annual average		
	2023	2024p	2025p	2026p
Sweden. CPI	8.5	3.1 (3.3)	1.7 (1.8)	1.8 (1.8)
Sweden. CPIF	6.0	2.1 (2.2)	2.3 (2.1)	2.0 (2.0)
Finland	6.2	1.8 (2.3)	1.7 (2.3)	1.7 (1.8)
Norway, CPI	5.5	3.7 (3.8)	3.2 (3.1)	2.4 (2.7)
Norway, CPI-ATE	6.2	3.8 (4.1)	3.1 (3.6)	2.5 (2.8)
Eurozone	5.4	2.4 (2.3)	2.1 (2.1)	2.0 (2.0)
United Kingdom	7.3	3.0 (2.7)	2.9 (2.3)	2.6 (2.2)
United States. PCE Core	4.1	2.7 (2.8)	2.2 (2.3)	2.2 (2.0)

Unemployment		Annual average		
	2023	2024p	2025p	2026p
Sweden	7.7	8.3 (8.3)	8.1 (8.1)	7.7 (7.7)
Finland	7.2	8.1 (7.8)	7.6 (7.3)	7.1 (6.9)
Norway*	1.8	2.0 (2.0)	2.2 (2.2)	2.2 (2.2)
Eurozone	6.6	6.5 (6.7)	6.7 (6.7)	6.5 (6.5)
United Kingdom	4.3	4.5 (4.9)	4.8 (5.1)	4.6 (4.8)
United States	3.6	4.1 (3.9)	4.6 (4.1)	4.7 (4.2)

Source: Handelsbanken *Registered unemployment NAV

In brackets: Handelsbanken Global Macro Forecast 22 May 2024

Exchange rate forecast

	End of year			
	2023	**2024p**	**2025p**	**2026p**
EUR/SEK	11.10	11.15 (11.35)	10.75 (10.90)	10.55 (10.60)
USD/SEK	10.04	10.14 (10.51)	9.60 (9.91)	9.25 (9.46)
GBP/SEK	12.75	13.27 (13.35)	12.95 (12.82)	12.71 (12.47)
NOK/SEK	0.99	0.97 (0.99)	0.96 (0.98)	0.96 (0.97)
CHF/SEK	11.98	11.49 (11.35)	10.64 (10.69)	10.14 (10.19)
JPY/SEK	7.12	7.14 (7.35)	7.06 (7.23)	6.96 (7.06)
CNY/SEK	1.42	1.42 (1.46)	1.39 (1.44)	1.38 (1.41)
	2023	**2024p**	**2025p**	**2026p**
EUR/USD	1.11	1.10 (1.08)	1.12 (1.10)	1.14 (1.12)
USD/JPY	141.02	142.00 (143.00)	136.00 (137.00)	133.00 (134.00)
EUR/GBP	0.87	0.84 (0.85)	0.83 (0.85)	0.83 (0.85)
GBP/USD	1.27	1.31 (1.27)	1.35 (1.29)	1.37 (1.32)
EUR/CHF	0.93	0.97 (1.00)	1.01 (1.02)	1.04 (1.04)
USD/CNY	7.08	7.15 (7.20)	6.90 (6.90)	6.70 (6.70)
	2023	**2024p**	**2025p**	**2026p**
EUR/NOK	11.24	11.50 (11.50)	11.15 (11.15)	10.95 (10.95)
SEK/NOK	1.01	1.03 (1.01)	1.04 (1.02)	1.04 (1.03)
USD/NOK	10.17	10.45 (10.65)	9.96 (10.14)	9.61 (9.78)
GBP/NOK	12.92	13.69 (13.53)	13.43 (13.12)	13.19 (12.88)
CHF/NOK	12.14	11.86 (11.50)	11.04 (10.93)	10.53 (10.53)
JPY/NOK	7.21	7.36 (7.45)	7.32 (7.40)	7.22 (7.30)

Source: Handelsbanken

In brackets: Handelsbanken Global Macro Forecast 22 May 2024

Interest rate forecast			End of year	
Policy rates	**2023**	**2024p**	**2025p**	**2026p**
United States	5.375	4.625 (4.875)	3.375 (3.875)	2.875 (3.125)
Eurozone	4.00	3.25 (3.25)	2.25 (2.25)	2.00 (2.00)
Sweden	4.00	2.75 (3.25)	2.25 (2.25)	2.25 (2.25)
United Kingdom	5.25	4.75 (4.75)	3.75 (4.00)	3.00 (3.00)
Norway	4.50	4.50 (4.50)	3.50 (3.75)	3.00 (3.25)
Interbank rates	**2023**	**2024p**	**2025p**	**2026p**
United States. SOFR	5.59	4.875 (5.04)	3.54 (4.04)	2.875 (3.08)
Sweden. STIBOR	4.05	2.73 (3.23)	2.25 (2.25)	2.25 (2.25)
Eurozone. EURIBOR	3.91	3.17 (3.30)	2.17 (2.30)	2.00 (2.05)
Norway. NIBOR	4.73	4.70 (4.85)	3.70 (4.00)	3.20 (3.50)
2 year govt. bond yield	**2023**	**2024p**	**2025p**	**2026p**
United States	4.23	3.88 (4.51)	3.36 (3.70)	3.18 (3.37)
Eurozone (Germany)	2.38	2.39 (2.65)	1.92 (1.98)	1.87 (1.96)
Sweden	2.88	1.97 (2.66)	2.01 (2.22)	2.08 (2.22)
Finland	2.41	2.45 (2.75)	2.05 (2.10)	1.95 (2.03)
United Kingdom	3.98	3.75 (4.00)	3.45 (3.86)	3.10 (3.77)
Norway	3.54	3.90 (4.10)	3.50 (3.70)	3.10 (3.30)
5 year govt. bond yield	**2023**	**2024p**	**2025p**	**2026p**
United States	3.84	3.69 (4.32)	3.56 (3.89)	3.47 (3.71)
Eurozone (Germany)	1.93	2.22 (2.40)	2.10 (2.13)	2.01 (2.15)
Sweden	2.03	1.85 (2.50)	1.97 (2.43)	2.17 (2.44)
Finland	2.33	2.50 (2.70)	2.30 (2.35)	2.20 (2.30)
United Kingdom	4.62	3.85 (4.09)	3.60 (4.08)	3.33 (4.09)
Norway	3.23	3.60 (3.80)	3.40 (3.60)	3.40 (3.60)
10 year govt. bond yield	**2023**	**2024p**	**2025p**	**2026p**
United States	3.88	3.88 (4.39)	3.87 (4.23)	3.85 (4.14)
Eurozone (Germany)	2.02	2.34 (2.50)	2.32 (2.42)	2.28 (2.44)
Sweden	2.02	2.06 (2.59)	2.19 (2.71)	2.42 (2.75)
Finland	2.57	2.80 (2.85)	2.80 (2.80)	2.75 (2.75)
United Kingdom	3.60	3.95 (4.18)	3.75 (4.29)	3.55 (4.40)
Norway	3.24	3.60 (3.80)	3.50 (3.70)	3.40 (3.60)
2 year swap rate	**2023**	**2024p**	**2025p**	**2026p**
United States	4.07	3.68 (4.39)	3.16 (3.55)	2.98 (3.18)
Eurozone	2.80	2.66 (3.00)	2.20 (2.30)	2.16 (2.26)
Sweden	2.91	2.27 (3.04)	2.31 (2.55)	2.38 (2.52)
United Kingdom*	4.28	4.22 (4.47)	3.92 (4.33)	3.57 (4.24)
Norway	3.95	4.10 (4.30)	3.70 (3.90)	3.30 (3.50)
5 year swap rate	**2023**	**2024p**	**2025p**	**2026p**
United States	3.53	3.39 (4.04)	3.26 (3.60)	3.17 (3.41)
Eurozone	2.43	2.51 (2.73)	2.37 (2.43)	2.26 (2.41)
Sweden	2.38	2.19 (2.79)	2.28 (2.70)	2.44 (2.69)
United Kingdom*	4.98	4.15 (4.39)	3.90 (4.37)	3.62 (4.38)
Norway	3.43	3.80 (4.00)	3.60 (3.80)	3.60 (3.80)
10 year swap rate	**2023**	**2024p**	**2025p**	**2026p**
United States	3.47	3.44 (4.00)	3.44 (3.84)	3.44 (3.74)
Eurozone	2.49	2.57 (2.74)	2.54 (2.64)	2.49 (2.64)
Sweden	2.35	2.35 (2.82)	2.45 (2.93)	2.64 (2.95)
United Kingdom*	3.54	4.07 (4.30)	3.87 (4.41)	3.67 (4.52)
Norway	3.33	3.80 (4.00)	3.70 (3.90)	3.60 (3.80)

Source: Handelsbanken
* Note that our forecasts for UK swap rates are based on the historical measure that referenced LIBOR
In brackets: Handelsbanken Global Macro Forecast 22 May 2024

Disclaimers and contact page to be added to the pdf