BUSINESS SWEDEN
THE SWEDISH TRADE & INVEST COUNCIL

TEMPORARY SLOWDOWN

GLOBAL ECONOMIC OUTLOOK
September 2022

BALANCING ACT AS GLOBAL ECONOMY SLOWS

The purchasing power of households is being hit hard by inflation, interest rate hikes, soaring electricity prices and falling asset prices. At the same time, companies are keeping their spirits high despite dampened optimism. High inflation has proven to be more persistent than expected and has now spread to large parts of the world. In response, central banks have urgently tightened monetary policy to safeguard confidence in their inflation targets. This comes at the expense of lower growth – a huge balancing act for central banks. It is an inevitable fact that the global economy will be heading into a downturn next year with growth barely reaching 2 per cent, which is lower than the historical average before the pandemic. It is above all the developed economies that will hamper global growth. Europe and North America are even at risk of falling into recession next year, which is worrying for Sweden and Swedish companies that have large part of their business in these regions.

Nonetheless, the slowdown is expected to be temporary. By next spring, the central banks will most likely be able to find relief as inflation is expected to fall back rapidly. Some central banks – particularly Federal Reserve – have probably increased interest rates too forcefully and may well face the need of lowering them at a later stage next year. That said, interest rates will for the foreseeable future be higher than before the pandemic and settle at around 2–3 per cent. The global economy will recover relatively quickly and grow at a more normal pace already by 2024.

But we must be mindful that forecasts are currently fraught with an unusual degree of uncertainty. Rising energy prices, geopolitical uncertainty, the war in Ukraine and inflation are all factors that affect global economic development and where any attempt to predict the outcome is difficult. If inflation does not fall back as we approach spring next year, there will be a growing risk of stagflation – meaning that the world will need to tackle rising inflation and weak growth at the same time. In this situation central banks have no policy tools to resort to.

When setting this risk aside, most indicators point to the fact that confidence in the central banks' inflation targets will continue to be sustained.

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REAL GDP GROWTH RATE

2021 5.9% | **2022f** 2.8% | **2023f** 1.7% | **2024f** 3.2% | **2015–2019** 3.0%

The global economy will be facing a temporary slowdown next year due to persistently high inflation and rising interest rates. The world is heading into a downturn but recovery is expected as soon as 2024. However, the forecasts are more uncertain than usual given the energy crisis, growing geopolitical tensions and the war in Ukraine, all of which have unpredictable consequences.

THE GLOBAL ECONOMY

TEMPORARY GLOBAL SLOWDOWN

A darker economic outlook became increasingly evident after the summer and the global economy is now clearly poised for slower growth. High inflation proved to be more persistent than expected and is sweeping large parts of the world. This has prompted central banks to rapidly tighten monetary policy to safeguard confidence in inflation targets which, in turn, comes at the cost of lower growth. Households' purchasing power is eroded when wages do not rise at the same pace as inflation and the room for consumer spending drops further when interest rates go up. At the same time, companies' investments are dampened when uncertainty around price developments is high and when the cost of borrowing increases.

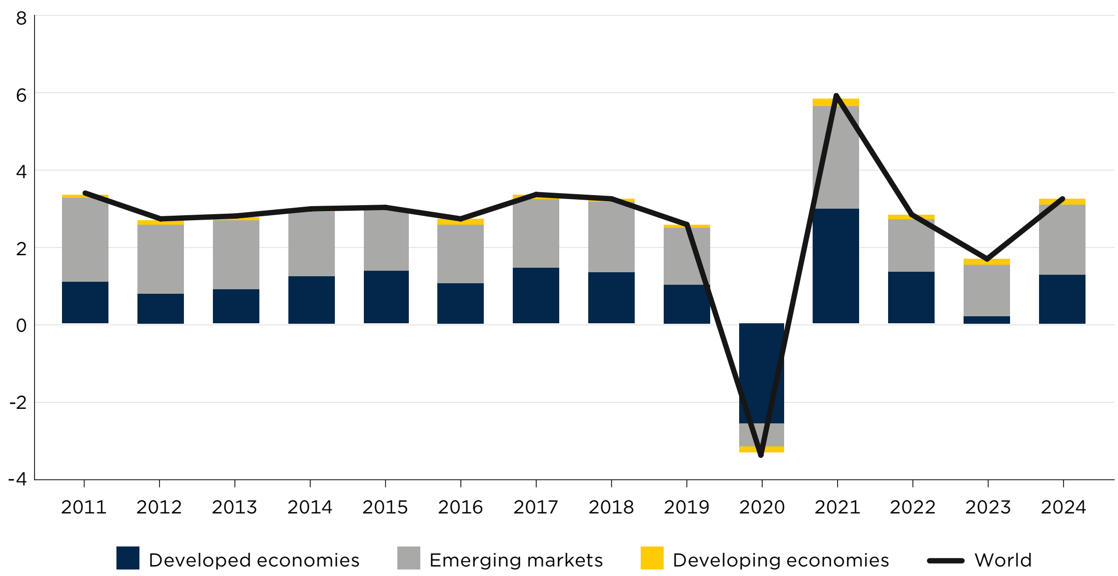
But the slowdown is expected to be short-lived. This forecast rests on the assumption that inflation will fall back next year and, in some cases, drop below the targets set by central banks as soon as early 2024. Sharp rises in inflation have historically been followed by a corresponding degree of inflation decreases. This means that central banks could be faced with the need to lower interest rates by the end of 2023, which the Federal Reserve (Fed) has already indicated. This would contribute to a recovery of growth during 2024.

Above all, weaker GDP growth is to be expected next year in the developed economies, particularly in North America and Europe. The slowdown was partly caused by the fact that many developed economies have been running at full steam since the pandemic, supported by massive stimulus which has, in some cases, led to overheated economies. Economic decline with low or negative growth typically follows an economic boom when GDP exceeds its trend level. But the principal factors causing the sharp slowdown are soaring energy prices (particularly in Europe) and high inflation, resulting in falling real wages and rapidly rising interest rates.

In the emerging markets, GDP growth will take a slightly different trajectory. China will be entering an economic slump already this year but is expected to recover in 2023, which contributes positively to global growth. But many emerging economies have not recovered to the same degree as the developed economies from the sharp downturn during the pandemic. GDP is approaching the trend level, but in many cases there is still available resources in the economy, which facilitates continued positive growth. However, the outlook differs between emerging markets. Economies that export

UNMISTAKABLE SLOWDOWN IN DEVELOPED ECONOMIES 2023

Real GDP growth, annual percentage change and contribution, constant prices and exchange rates



Sources: Oxford Economics and Business Sweden

GLOBAL SLOWDOWN

GDP forecasts, annual percentage change, constant prices

REGION	2019	2020	2021	2022f	2023f	2024f
Global	**2.6**	**-3.4**	**5.9**	**2.8**	**1.7**	**3.2**
Sweden	2.0	-2.3	4.8	2.8	-0.2	1.9
Asia and Oceania	3.8	-0.9	6.1	3.5	3.8	4.4
Europe	1.8	-5.8	5.4	2.5	-0.1	2.5
North America	2.1	-3.8	5.5	1.8	-0.1	2.2
South America	0.8	-6.4	7.5	3.3	0.7	2.8
Middle East	1.8	-5.5	3.5	6.2	3.8	2.8
Africa	3.2	-3.8	9.4	3.0	3.7	3.5

Sources: Oxford Economics and Business Sweden

raw materials benefit from higher prices, particularly in the Middle East, while countries that are importers of commodities are affected by deteriorating terms-of-trade.

The fast-growing economies of Asia are partly hampered this year by China's temporary slowdown but benefit, nonetheless, from a recovery in the services sector. For South America, weak demand from the US leads to a worsening outlook for exports at the same time as several economies of the region are facing major problems due to soaring inflation, political instability and aggressive interest rate hikes.

The global economy, which is propped up by strong consumption growth, is expected to grow by 2.8 per cent this year. A temporary slowdown will hit the global economy in 2023 resulting in just 1.7 per cent GDP growth. As such, the world is not facing a major collapse but this figure is clearly below the historical average of 3 per cent for the period 2015-2019. Following a relatively brief downturn the global economy will regain strength and GDP will grow by 3.2 per cent in 2024.

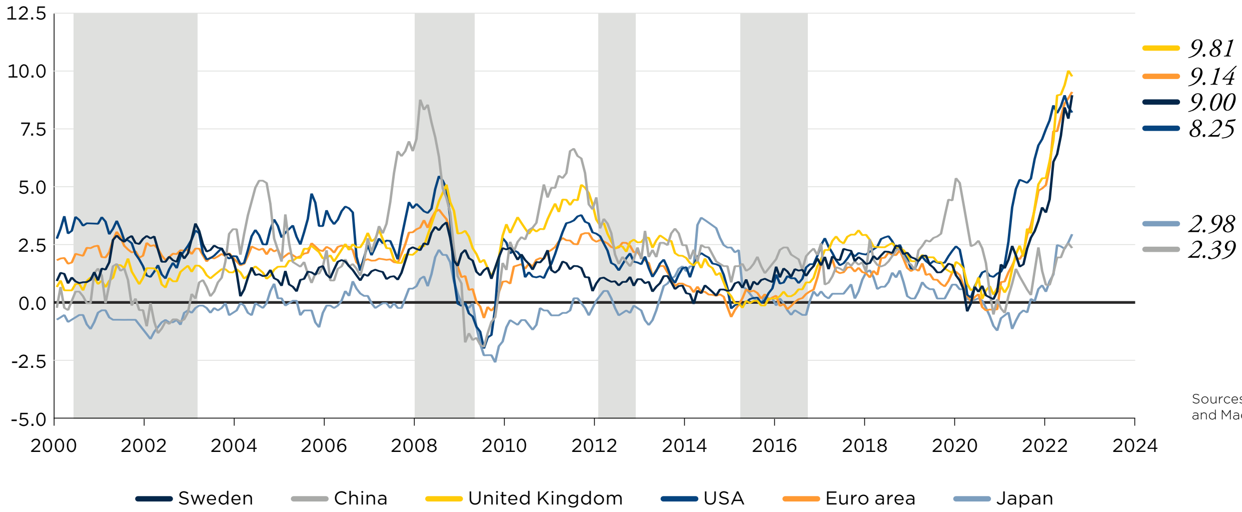
SOARING INFLATION

The recent rise in inflation can be explained by several factors, including global supply chain disruptions, rising transport costs and shortage of intermediate goods in the wake of the pandemic. The fact that disruption has continued to abate over the course of the year is good news, as this alleviates cost pressures and hence inflation. This has also benefited production conditions for manufacturers who have suffered from shortages of intermediate goods and components. World trade and global industrial production, which declined in the first two months after Russia's invasion of Ukraine, developed strongly during the summer. The level of disruption is still higher than normal but is fading as global demand slows down. Meanwhile, it cannot be ruled out that China's zero tolerance policy to Covid-19 will continue to cause problems in freight and container transport, leading to rising cost pressure.

Rising commodity prices have also contributed to inflation. After Russia's invasion of Ukraine the already high commodity prices rose further, but have begun to fall back in recent months as the economic outlook has deteriorated. Lower activity in the Chinese economy helps to push down commodity prices given that China is one of the world's largest importers of commodities. Prices for industrial metals and some food products are now lower than at the beginning of 2022, while prices for energy and energy-related commodities are still very high. The price of crude oil (Brent) has dropped to around USD 90 per barrel from the peak in March of approximately USD 130 per barrel, but the price has fluctuated considerably and volatility is expected to remain high. Despite the news that gas deliveries via Nord Stream 1 will be cancelled indefinitely, natural gas prices have fallen back during September but still remain very high. According to futures prices on natural gas and electricity in Europe, extremely high prices are expected this winter. Germany is expecting to see prices rise from EUR 400 per MWh in mid-September to almost EUR 700 per MWh in January 2023. This indicates that inflation will continue to rise in Europe for the remainder of the year.

PERSISTENT HIGH INFLATION

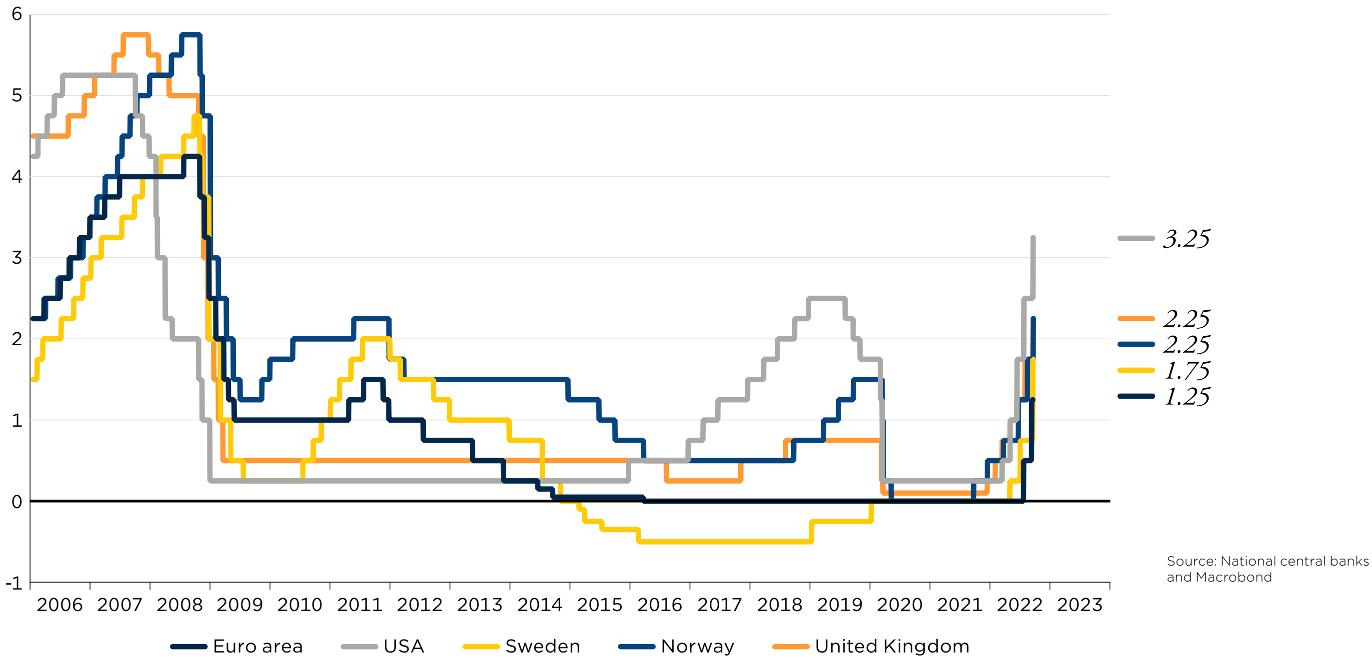
CPI inflation, annual percentage change



Sources: National sources and Macrobond

CENTRAL BANKS ARE RESPONDING URGENTLY

Policy rate, per cent



In all, we can observe signs of reduced cost pressure, but developments on energy markets will continue to dominate the short-term inflation outlook, especially in Europe.

Inflation is a bigger problem in the developed economies as a result of high resource utilisation and, in some cases, overheated economies. This year, it is estimated that inflation in the developed economies will hit 7 per cent, which can be compared to the pre-pandemic period when inflation was below 2 per cent. Inflation in emerging markets is expected to reach 9.6 per cent this year, which is higher than the pre-pandemic average of approximately 4 per cent. Next year, inflation in emerging markets is expected to hit 6.4 per cent while reaching 3.7 per cent in developed economies. Global inflation will remain high in the short-term but is expected to fall over the course of next year as demand in the global economy declines markedly.

CENTRAL BANKS ARE TAKING URGENT ACTION

In beginning of last year, central banks in the large, developed economies were expecting to be able to gradually tighten monetary policy. Their assessment at that time was that inflation was driven by an unusual combination of supply shocks linked to the pandemic and, at a later stage, Russia's invasion of Ukraine. The consensus was that inflation would fall back when these shocks abated. However, massive stimulus policies resulted in a significant increase in demand which added to price pressure. Today, inflation has risen to historically high levels in several major economies which has caused broad-based price increases. Central banks have recognised the need to tighten monetary policy faster to prevent the long-term inflation expectations from deviating away from inflation targets. It is increasingly clear that central banks are taking measures to achieve, partially at least, a neutral interest rate, meaning the policy rate level which has neither stimulating nor tightening effect on the economy. In developed economies, the neutral interest rate is most likely around 2–2.5 per cent according to most central banks and international organisations, but these estimates are uncertain and difficult to make.

In September, the Fed continued with a third triple hike in the policy rate for this year with an interval of 3.0–3.25 per cent and the Bank of Canada continued its rate hike cycle by 75 basis points to 3.25 per cent, following a walloping 100 basis point hike in July. Bank of England and Norges Bank raised their interest rates from 1.75 per cent to 2.25 percent.

Similarly, the European Central Bank (ECB) raised the interest rate by 75 basis points to 1.25 per cent, while Sweden's Riksbank decided to raise the interest rate by 100 points to 1.75 per cent in September after inflation rose to 9 per cent in August, the highest level since 1991.

The central banks have indicated that more interest rate hikes will be forthcoming this year. The Riksbank's forecast points to a policy rate of 2.5 per cent by the end of 2022, where it will remain for the rest of 2023. Market expectations suggest that the ECB will raise the policy rate to 1.8 per cent by the end of 2022 and 2.8 per cent by the middle of 2023. After that, the policy rate will stabilise at around 2.5 per cent. The Federal Reserve indicates an interest rate range of

4.25–4.50 per cent by the end of 2022 and 4.50–4.75 per cent by the end of 2023.

In most emerging markets, the central banks have also raised interest rates as a result of higher and more persistent inflation. The exceptions are China, Russia and Turkey, where the central banks have lowered interest rates in order to stimulate the economies. Inflation in Asia now exceeds the central banks' inflation targets in most economies, and in recent months the central banks in Indonesia, Thailand, Malaysia, the Philippines and India have begun a normalisation of monetary policy. In Latin America, where inflation has been high for a while, central banks in Colombia, Chile, Brazil and Mexico have forcefully raised interest rates and referred to concerns that inflation expectations may grow.

CHALLENGING INTERPLAY

The interplay between fiscal and monetary policy is becoming more and more challenging. Governments around the world are currently introducing support measures in the form of tax cuts, lowered tariffs, subsidies and price caps, to mention a few, in order to cushion the blow of soaring costs for households and businesses. Among the EU member states, these measures are estimated to correspond to 1–1.5 per cent of GDP on average, but the share could go up. The United Kingdom's newly appointed Prime Minister Lizz Truss is planning to dedicate GBP 150 billion, approximately 6.5 per cent of GDP, mainly by the introduction of an energy price cap for this winter and next. There is a major risk that support measures and fiscal policy stimulus will drive up demand and counteract monetary policy, which only causes inflation to increase further. In such a scenario the central banks will need to raise interest rates even higher. In all, however, stimulus measures are expected to be relatively moderate in scope compared to the pandemic years, but fiscal policy will nonetheless continue to be somewhat expansive during 2023 and 2024.

TRICKY FORECASTS

The forecast are currently characterised by an unusual degree of uncertainty as a result of soaring energy prices, geopolitical uncertainty, the war in Ukraine and the persistently high inflation. The inflation development is particularly hard to assess given that price developments in the energy market are steered by the war in Ukraine and the geopolitical situation. Regardless of how quickly Europe can replace Russian gas with alternative sources, prices will still be affected. There is a risk of overestimating the future development of inflation, just like many underestimated inflation in the past year. But even the real economic effects of the rapid tightening of monetary policy around the world remain uncertain. Monetary policy always has a delayed effect on the real economy and inflation. So there is a risk that inflation and economic activity will fall back more quickly than expected, which means that central banks will be forced to lower interest rates in late 2023. For example, the Fed has already signalled that reduced interest rates may become necessary. If inflation continues to rise we will be facing a challenging situation as the risk of stagflation goes up, meaning rising inflation and weak growth.

REAL GDP GROWTH RATE

2021	2022f	2023f	2024f	2015–2019
4.8%	2.8%	-0.2%	1.9%	2.6%

Following a very strong recovery last year, we are expecting a marked slowdown in the Swedish economy in the wake of weakened purchasing power due to inflation and higher interest rates. Inflation will continue to reveal surprises on the upside and it is therefore expected that the Swedish Riksbank will raise the policy rate at a faster pace this year. The economy is now being cooled down on several fronts.

SWEDEN'S ECONOMY AND EXPORT

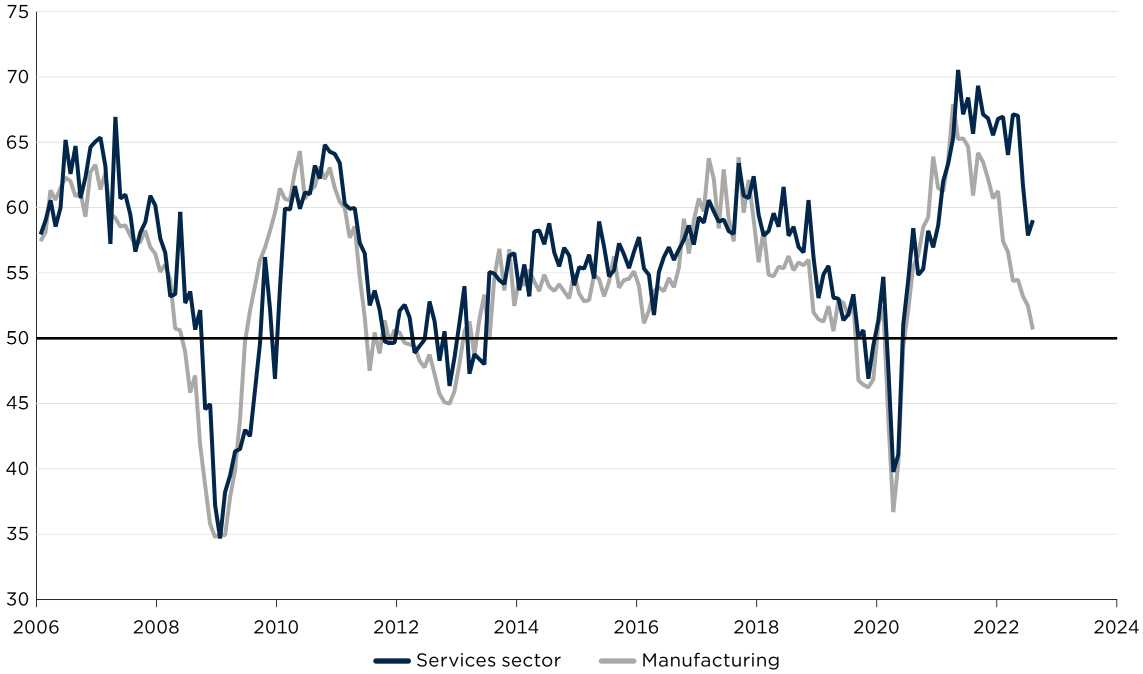
UNMISTAKABLE SLOWDOWN

The Swedish economy is still going full steam ahead with a GDP growth of 3.4 per cent in the first half of 2022 compared to the same period last year. Following a strong start of the year, most indicators now point to an unmistakable slowdown in the growth rate. The purchasing managers' index has fallen back considerably trend-wise since its peak in the spring of 2021. In August, the index for the services sector dropped to 59.4 and the index for manufacturing to 50.6, significantly lower than the record levels of 71.3 and 68.7 respectively. This indicates continued growth in the services sector while sentiment in manufacturing is now more balanced. Widespread concerns around economic development and soaring energy prices signal weak investment growth in Sweden and around the world, which will put a damper on the Swedish economy. Investments in the construction sector fell back at the beginning of the year following the major upswing of last year, and they are now back at the pre-pandemic level. Rising interest rates and increased construction costs will contribute to the downward trend in housing construction. As such, housing investments are expected to hamper investment growth over the next two years.

Households' confidence has fallen to record low levels due to higher costs of living following higher energy and food prices, rising interest rates and falling asset prices. A strong labour market and increased government support alleviates the situation somewhat. But the development of wages continues to be far weaker than the pace of inflation, which means that real wages are falling and purchasing power is dwindling. The labour market has proven resilient and labour demand remains high. More people are employed today than before the pandemic and unemployment has fallen back to the pre-crisis level of 7 per cent. Labour market indicators such as employment plans and number of vacancies are at historically high levels. Meanwhile, a large number of companies confirm that they are facing labour shortages. Gradually fading demand in Sweden and around the world will dampen the need for workers, but we are only expecting a marginal rise in unemployment.

MARKED DOWNTURN IN THE PRIVATE SECTOR

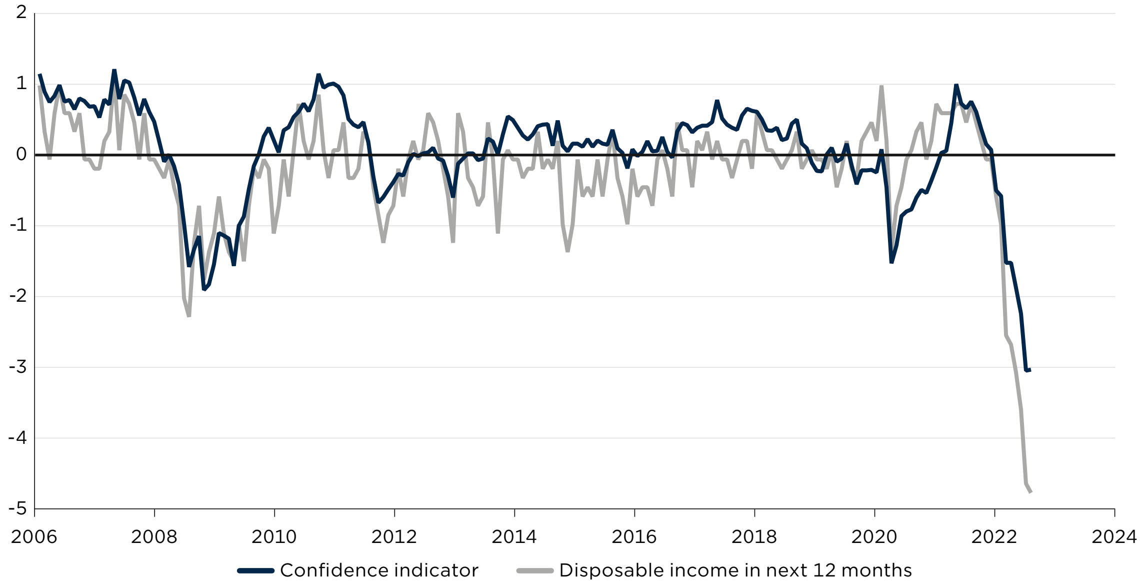
Purchasing managers' index, index > 50 indicates expansion



Sources: SILF/Swedbank

SWEDISH HOUSEHOLDS PRESSURED FROM SEVERAL DIRECTIONS

Households' confidence indicators, standardised median value



Source: The National Institute of Economic Research, NIER

Households will continue to feel pressure on their real incomes. Wages rose by 2.5 per cent during the first half of the year while inflation increased by 6.1 per cent, which means that real wages fell by approximately 4 per cent. Wage trends in the Swedish labour market are to a large extent driven by the centrally-agreed wage increases, which were relatively low in the most recent negotiations. New agreements must be in place by April 2023, but the negotiations are likely to be tough given the uncertain economic prospects and weak productivity development, and as workers want to be compensated for the rise in inflation. Most forecasters are expecting total wage increases of 3.5–4.5 per cent in 2023 which would appear reasonable. Despite this, real wage development will continue to be negative next year.

Growth prospects are dampened, above all, by weak consumption development and a decline in housing construction but also by reduced export growth and private sector investments, which typically shrink when global demand declines. GDP growth is expected to be 2.8 per cent this year but will decrease by 0.2 per cent next year. After that, the economy will stabilise, but the recovery will be relatively moderate with a growth rate of 1.9 per cent in 2024 which is lower than the historical average before the pandemic.

UNUSUALLY DIFFICULT BALANCING ACT FOR THE RIKSBANK

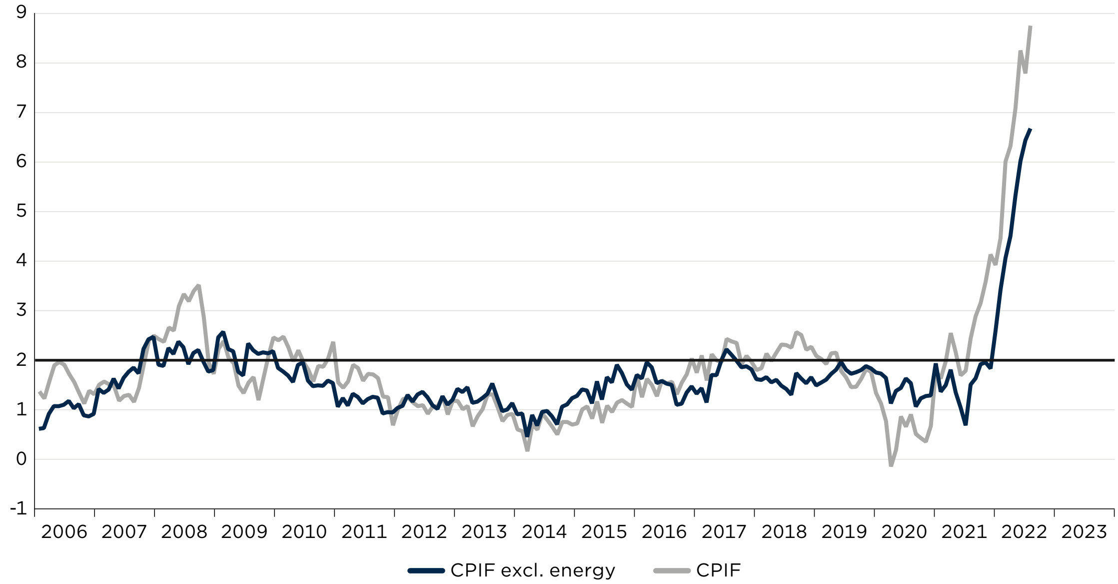
Inflation has continued to rise in Sweden this year and amounted to 9 per cent in August, measured as CPIF (consumer price index with fixed interest), up from 8 per cent in July. The inflation increase was largely driven by soaring energy prices which rose by 29 per cent in August compared to the previous month. The underlying inflation, that is to say inflation adjusted for energy prices, rose from 6.6 per cent in July to 6.8 per cent in August. Besides increased electricity prices, sweeping price increases were seen in the CPI basket. Food prices increased for the ninth consecutive month. We are expecting that inflation will continue to rise over the remainder of the year. Inflation is estimated to hit 7.4 per cent in 2022 and is likely to drop to 4.5 per cent on average next year. Risks related to inflation will dominate in the short term. Above all, the development of energy prices and the Swedish krona are difficult to forecast.

The Riksbank continues to emphasise the importance of combating inflation, by ensuring that the long-term inflation expectations do not lose touch with inflation targets, despite it being painful for many households and businesses. The Riksbank has already raised the key interest rate by 175 percentage points since the beginning of the year, from 0 to 1.75 per cent. The trajectory set during the September meeting means that the policy rate will reach 2.5 per cent by the end of 2022.

With deteriorating economic prospects and falling prices on the housing market, there is a growing risk that demand will stagnate, which could lead to an inflation level that is too low. The high interest rate sensitivity in the Swedish economy due to the high levels of debt among households, as well as the high proportion of variable rate loans, means that a tightening of monetary policy will affect the real economy to a greater degree and faster than in the US and in many European countries. The tightening of monetary policy could cause the economy to cool off more than expected. To ease the blow, the government has announced that Svenska Kraftnät (Sweden's national grid operator) must reimburse Swedish households and businesses to the amount of SEK 90 billion, taken from the increased revenue generated during 2022 and 2023. Svenska Kraftnät has been asked to present a proposal by no later than 15 November for how payments will be made.

CONTINUED HIGH INFLATION

CPIF and CPIF excluding energy, annual percentage change



Source: Statistics Sweden

The parliamentary election on 11 September resulted in an even result as 48.8 per cent of the electorate voted for the red-green coalition and 49.5 per cent for the centre-conservative opposition. Most likely, the process of forming a new government will be protracted and it is possible that Sweden will once again have a minority government, which means that it will be difficult for the government to get policy bills passed in parliament. Although Sweden has strong public finances and government revenues benefit from high inflation and high electricity prices, the new government will need to tackle a range of long-term challenges that require major investments, for example in defence, energy supply, integration, education and healthcare.

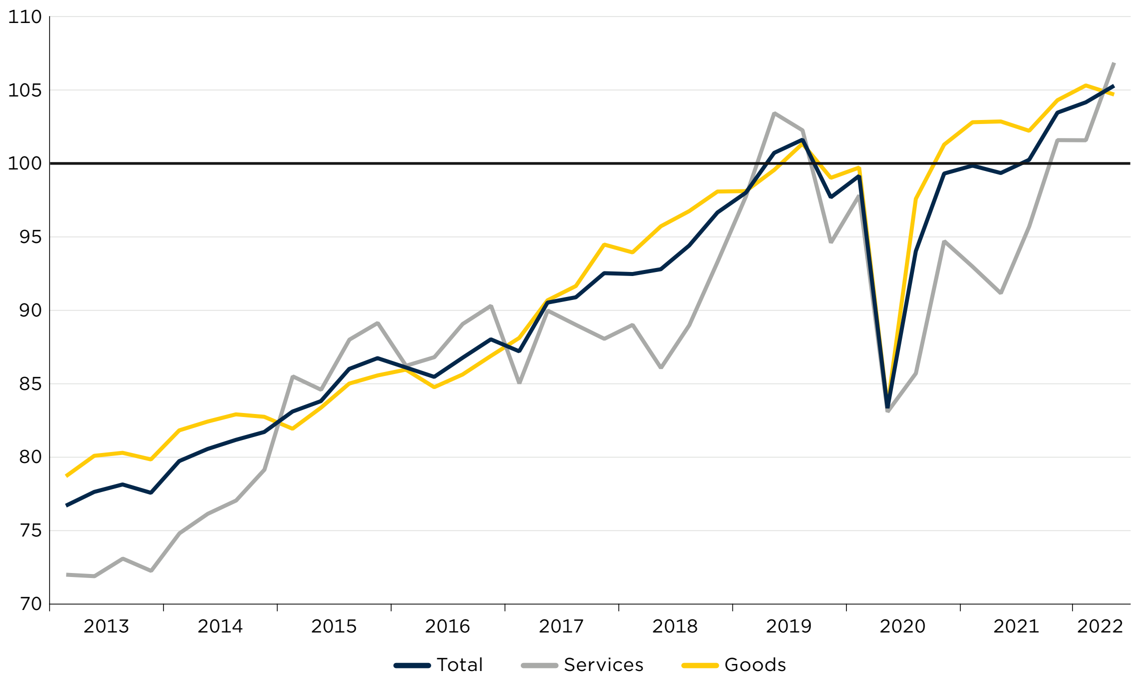
EXPORTS LOSING STEAM

Declining global demand means that Swedish exports will lose momentum going forward. Swedish exports developed well during the first half of 2022 when export volumes increased by 5.4 per cent compared to the first half of 2021. The growth of services exports was particularly driven by travel, transport and other business services (including R&D services, administrative services and marketing services). The growth in exports of goods was driven by an increase in exports of pharmaceuticals, metals, minerals and foodstuffs while the export of manufactured goods decreased.

Business Sweden's Export Managers' Index (EMI), which monitors views and reflects

STRONG SERVICES SECTOR

Index 2019 = 100, constant prices



Source: Statistics Sweden

sentiment among Swedish exporters of goods and services, fell back slightly in the third quarter but remains at a high level which indicates growth. Companies continue to be strongly optimistic about export sales and export stocks, as well as about the profitability of export sales. But dampened views on export development in the next three months contributed to the decline of EMI in the third quarter, particularly as companies are expecting the profitability of export sales to worsen.

Nonetheless, companies had a positive outlook on expected export sales in the next three months and many were expecting shorter delivery times. Shorter delivery times indicate that disruptions in companies' supply chains are abating, but could also be a sign of dampening demand.

Swedish exports of goods are expected to grow by just under 2 per cent this year and by 0.7 per cent in 2023. The slowdown can be explained by reduced import demand next year, especially from Europe, which is Sweden's most important export market, but also from North and South America. Investment growth will slow down particularly in the euro area which will negatively impact Swedish export of goods, as they largely consist of intermediate and investment goods.

The export of goods to Asia, Africa and the Middle East will be increasing at a faster rate than in other regions during 2023. During 2024, Sweden's export of goods is expected to increase by 2.8 per cent. Services exports – which saw weak development during the pandemic – will witness a major upswing this year with expectations of 10.5 per cent growth. This will fall to a more moderate growth rate of 2.5 per cent in 2023. In 2024, services exports are expected to grow by 4.4 per cent.

Overall, the total export of goods and services is expected to grow by 4.3 per cent this year and 1.2 per cent next year. The growth rate in 2024 will amount to 3.3 per cent, which is slightly lower than the historical average.

SWEDISH EXPORTS LOSING STEAM

Sweden's export of goods, constant prices, annual percentage change

REGION	2022f	2023f	2024f	Share of Sweden's export of goods 2021, %
Europe	1.6	0.5	2.7	74.1
Asia and Oceania	1.5	3.3	3.7	11.7
North America	3.7	-1.8	2.1	9.8
South America	0.1	-2.5	3.3	1.2
Africa	2.4	2.1	2.1	1.5
Middle East	3.9	3.9	3.3	1.7
Global	**1.8**	**0.7**	**2.8**	**100**

Sources: Oxford Economics, Statistics Sweden and Business Sweden

REAL GDP GROWTH RATE

2021	2022f	2023f	2024f	2015–2019
5.4%	2.5%	-0.1%	2.5%	2.1%

– *Energy crisis and inflation dampen the economy*
– *Tightened monetary policy slightly relieved by government support*
– *Major uncertainty and risks in the forecast*

EUROPE

MAJOR ECONOMIC TRHEAT

By the end of 2021, most of Europe's economies had reached or exceeded their own pre-pandemic GDP levels. The recovery was mainly driven by a rise in private consumption, strong export development and high rates of investment, but also by government consumption linked to national crisis measures and the European Union's recovery package Next Generation EU.

With Russia's invasion of Ukraine on 24 February and continued war of aggression, Europe's economic outlook worsened. Europe's strong dependence on Russian gas for its energy supply proved to be a weak spot. The outbreak of war also escalated a range of underlying imbalances and circumstances that became evident during the pandemic, with potential adverse effects for the European economy and business community. The shockwaves from the pandemic caused demand in global markets to plunge and then make an impressive recovery. This resulted in shortages of commodities, food and intermediate goods which, in turn, pushed up inflation. Europe's dependence on Chinese suppliers became abundantly clear following the acute shortage of medical equipment, at the same time as declining demand in China had severe repercussions for Germany's exports, which are heavily weighted toward the Chinese market. Disruption in international freight and container transport as ports were closed, coupled with the undercapacity of ships and containers revealed the vulnerabilities of just-in-time production and delivery to Europe's manufacturing industries and retail trade.

Europe's economy grew at a relatively strong pace during the first half of 2022 which saw a minor upswing for private consumption and investments, despite price increases primarily in energy and food and disruption in industrial

THE ENERGY CRISIS BECOMES FACT

The European economy is affected by the war in Ukraine mainly through its heavy dependence on Russian natural gas, which currently meets just under 10 per cent of the Europe's energy supply. Due to uncertainty around Russian gas supplies, European gas prices have multiplied. The situation worsened with the Russian energy company Gazprom's decision on 2 September to suspend indefinitely all gas supplies to Europe via the North Stream 1 pipeline. A few days later, Russia announced that the halted deliveries should be seen as a response to the EU's economic sanctions, and that gas supplies will not resume until the sanctions are lifted.

Gas shortages and possible energy rationing may therefore become necessary in several Western European countries such as Germany, Italy and in parts of Eastern Europe. At the same time, gas storage facilities in the EU have been almost completely filled during the autumn while gas consumption has dropped. In August, the stores were filled to 80 per cent, two months before the EU agreed deadline of 1 November.

The high gas prices, which have an automatic impact on electricity prices on the common European energy market, is a threat to both industry and households' purchasing power. Inflation in the euro area rose faster than expected and reached a record level of 9.1 per cent in August. Energy prices rose by 40 per cent in the same month. Food prices are also soaring along with prices in the services sector. The forecast is that prices will continue to rise this autumn causing negative socio-economic consequences that may force governments to intervene with various types of support for consumers and businesses.

Different models are being discussed within the EU to disconnect the price of gas from the electricity prices, while the entire European energy market is also being reviewed. This is to protect businesses and consumers from electricity price fluctuations that have caused the current shortages and uncertainty around future gas deliveries. It is still unclear how such a pricing model would be set up. The potential transfer of energy producers' excess profits to the most vulnerable households will also be reviewed.

supply chains. Activity in the economy could draw strength from the continued opening up of the services sector as the spread of coronavirus infections decreased, coupled with an early start of the tourist season. Parts of Europe, particularly the countries of southern Europe, benefited from an almost full-scale resurgence of tourism which grinded to a complete halt during the pandemic.

Russia's fading role as a trading partner and supplier of raw materials and intermediate goods caused only limited disruption to industrial production. Even the partial loss of suppliers in Ukraine due to the war had little impact on European industry.

The labour market continued to develop strongly in the spring and unemployment in the EU fell to a record low of 6 per cent in July. In most European countries, unemployment remains lower than the pre-pandemic level. Despite the strong labour market, there has so far been no noticeable upward pressure on wages, but high inflation will most likely lead to increased demands for compensation from both workers and major trade unions.

The summer's widespread drought in Europe, with record temperatures in many places, worsened the economic situation as the prices of energy, animal feed and fertilisers increased for the agricultural sector. Ruined crops and small harvests have put further upward pressure on food prices, which together with the rising price of energy account for most of the European inflation.

SLOWDOWN HITS ZERO GROWTH IN EUROPE

The purchasing managers' index compiled by IHS Markit for the euro area fell slightly to 48.9 in August, from 49.9 in July. The latest surveys indicate that the economy is in a decline phase, primarily in manufacturing but also in the services sector, which is slowing down considerably as households start to feel the increased cost of living and hence cut back on their consumption. The forward-looking results in the index indicate a significant loss of economic momentum. The euro has weakened in recent months and is now on par with the USD for the first time in two decades. The weakening of the euro contributes further to inflation through higher prices on imports which, in turn, hits consumption.

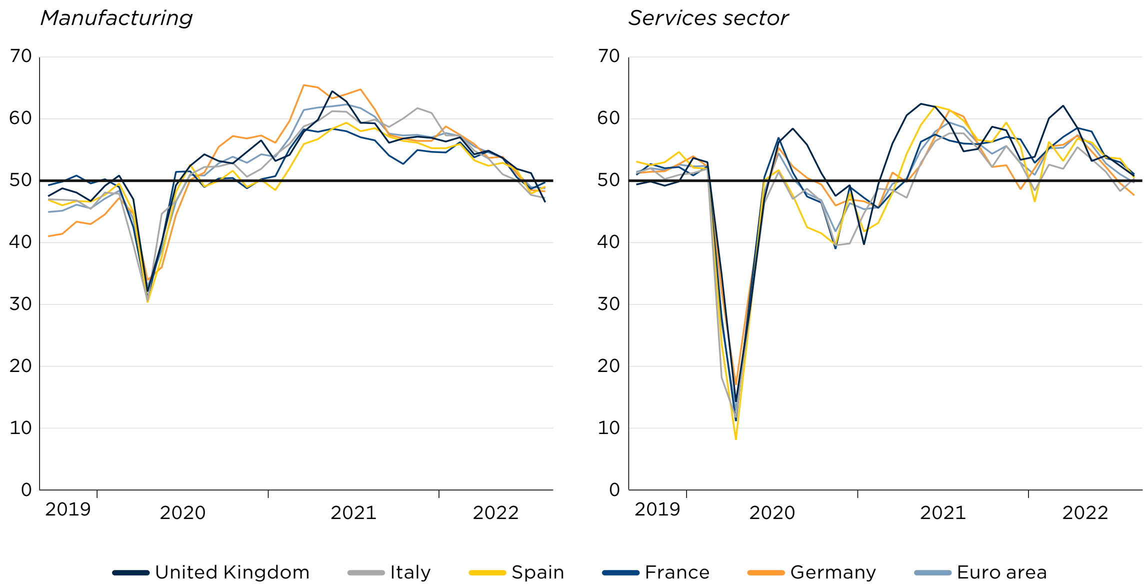
The European Central Bank (ECB) raised the policy rate by 50 basis points in July to 0.5 per cent, in the first interest rate hike of nearly a decade. In September, the ECB raised the interest rate by another 75 basis points to 1.25 per cent, and markets are expecting an interest rate of around 2 per cent by the end of the year. Data from the ECB published in August shows no weakening so far of credit growth, but instead indicates continued robust lending to both households and businesses.

Activity in the economy is expected to slow down over the next six months at least, with private consumption and investment increasingly being scaled back. Industrial production is heading towards zero growth. The scale of government support which is likely to be needed to deal with the European energy crisis is an uncertainty factor in the forecasts.

Europe's economy is expected to grow by 2.5 per cent this year but will enter a mild recession in 2023 as GDP falls marginally by 0.1 per cent. The slowdown is expected to be temporary and during 2024, GDP will bounce back and grow by 2.5 per cent.

SLOWDOWN IN THE EUROPEAN BUSINESS SECTOR

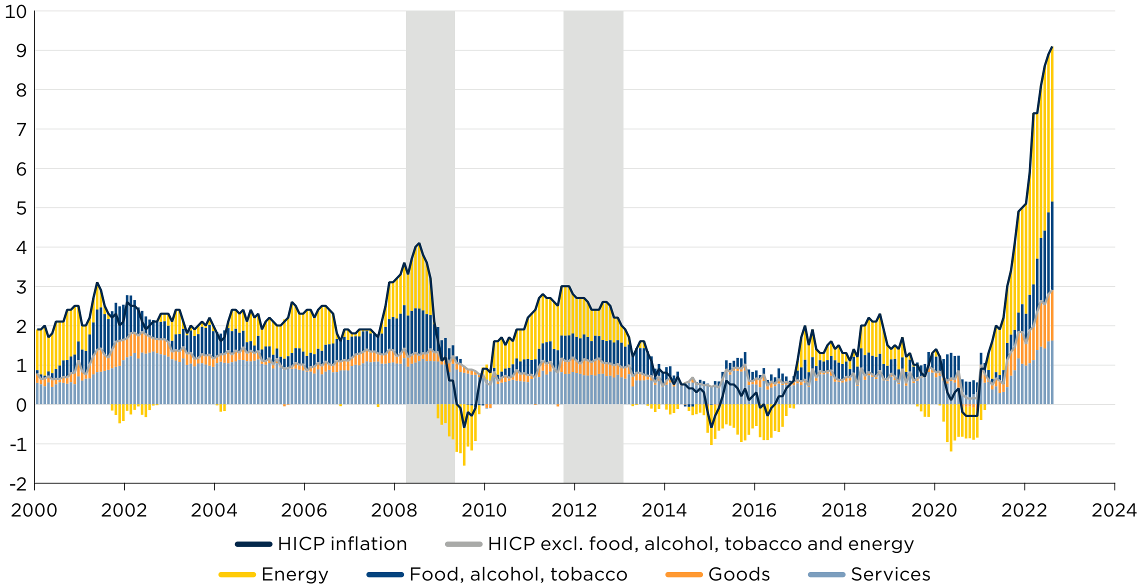
Purchasing managers' index in manufacturing and services, index >50 indicates expansion



Source: IHS Markit

ENERGY-DRIVEN INFLATION

Harmonised index of consumer prices (HICP) in the Euro area, annual change, contribution in percentage points



Source: ECB

Germany. The German economy has so far been resilient in 2022 and expanded albeit moderately. Growth was driven mainly by private consumption and households' pent-up needs in the wake of the pandemic. However, a slowing down in the retail sector and and a 20 per cent drop in new car sales was noted in early summer. Private consumption is still expected to grow by 4.3 per cent for the full year thanks to strong demand for services. But inflation, which amounted to the high level of 8.8 per cent in August, is putting more and more pressure on households, and so consumption is expected to slow considerably this autumn and stagnate next year.

A downturn for manufactured goods exports is expected following the high gas and electricity prices and the slowdown in global markets, particularly China which is Germany's largest export market. According to the forecasts, industrial production will decline by just over 1 per cent this year, while the limited growth in exports of just 1.3 per cent means altogether that 2022 will have become a lost year for the export industry. And investments are stagnating against the backdrop of the economic uncertainty.

The government has launched a number of economic support measures including government loans to energy producers, tax breaks on energy and compensation to vulnerable households. These support plans are valued at a whopping EUR 95 billion, but are probably only enough to cushion the worst effects on the economy. Germany's economy is expected to grow by 1.3 per cent this year and then fall into recession with a GDP loss of 0.8 per cent next year, in a broad economic decline. A recovery of mainly private consumption and investment facilitates growth of 2.9 per cent in 2024.

France. The French economy performed significantly better than expected in the first half of 2022, particularly during the early summer. Weak private consumption was partially offset by a strong rise in services exports, which benefited from a bustling tourist season. High inflation, rapidly declining confidence in the economy among businesses and consumers, coupled with the gloomy outlook for the energy supply this winter has, however, worsened the growth prospects.

Inflation reached 6.6 per cent in August, a marginal decline from 6.8 per cent in July which was the highest recorded level since the 1980s. While energy and food are driving the price hikes, prices for services have also risen considerably, even if this can partly be explained by the increased demand seen since restrictions were lifted. The extremely hot summer had a negative impact on France's electricity production, as the cooling water at several nuclear power plants was too hot and forced the operators to reduce output. Electricity production is also lower due to maintenance work at 32 of the country's 56 nuclear reactors. Nuclear power accounts for 65 per cent of France's electricity production.

The government has announced a new package amounting to EUR 20 billion to support vulnerable households. Coupled with previous promises of public support, the total crisis package amounts to EUR 64 billion. This crisis support remains unfunded and will put a further drain on France's public finances, with a deficit that is expected to be one of the biggest in the euro area. The country's GDP growth is expected to amount to 2.6 per cent this year and then drop significantly to 0.2 per cent in 2023, with stagnant private consumption and investments being the main cause of the decline.

In 2024, a slight uptick in domestic demand and increased exports will contribute to a 1.7 per cent expansion of the French economy.

United Kingdom. The growth prospects for the UK economy are gloomy due to rising inflation, falling demand from key export markets, a weak investment climate, dampened confidence in the future and falling company revenues. Inflation fell back to 9.9 per cent in August after exceeding 10 per cent in July, the highest figure for 40 years and a level that greatly undermines households' purchasing power and consumption. The new prime minister Liz Truss plans to invest GBP 150 billion, the equivalent of 6.5 per cent of GDP, to primarily introduce a cap on energy prices. The forecast points to an average inflation of 8.9 per cent in 2022 and a drop in households' real incomes of as much as 5 per cent.

The economy is still expected to expand by as much as 3.5 per cent this year, fuelled by private consumption and a high rate of investment, mainly in the construction industry. Next year, the economy is expected to stagnate with a growth of 0.1 per cent, primarily as a result of reduced domestic consumption and a slowdown for investments. Industrial production is expected to increase by just 0.8 per cent in 2023. GDP growth will make a moderate recovery of 2.1 per cent in 2024.

Italy. The forecast for Italy's economy in 2022 points toward an economic expansion of 3.3 per cent due to robust private consumption and a high rate of investment, followed by zero growth next year. 2022 started off slow, followed by a second quarter with strong growth driven by household consumption. The economy is expected to slow in the second half of 2022 due to high inflation and particularly high gas prices and potential gas rationing as winter approaches. Inflation stands at record levels and reached 9.1 per cent in August, fuelled by rising prices for food and services.

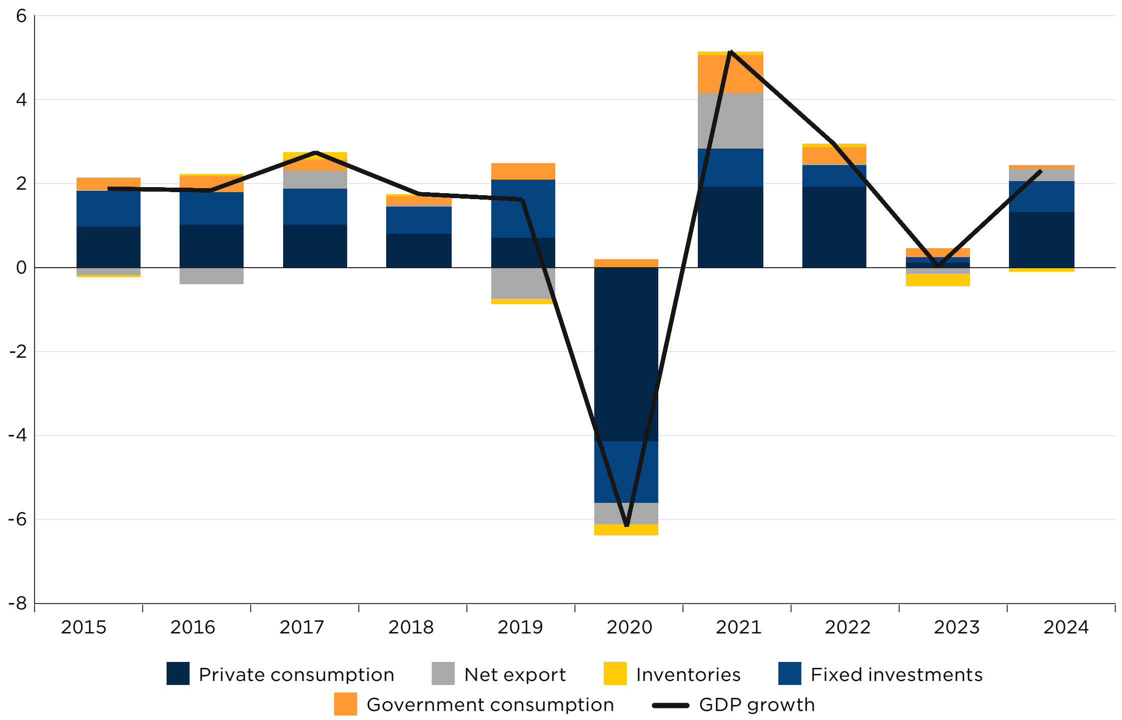
Spain. The Spanish economy performed unexpectedly well during the first half of the year with strong export development and a continued strong rate of investment. The booming tourism sector played an important part and is set to regain its former role as a key sector in the economy. At the same time, inflation in July and August hit the highest levels seen in 40 years and soaring prices are expected to threaten households' purchasing power. But the labour market has remained strong. The growth forecast for Spain indicates a robust 4.3 per cent expansion this year and 1 per cent growth in 2023. The economy is expected to pick up again in 2024 and deliver GDP growth of 3 per cent.

STEEP DECLINE ON THE HORIZON

Russia. Despite the enormous costs of the war in Ukraine and economic sanctions from the Western allied nations, the Russian economy has fared relatively well so far. Oil exports, a pillar of the economy, have been sustained by diverting deliveries to Asia and primarily China and India. The higher oil price, which in recent months amounted to approximately USD 100 per barrel, has kept government revenues afloat. The economic decline is expected to continue in 2023, and shortages of components and spare parts for industrial production and transport due to sanctions are expected to cause major problems across society in the next year. Russia's GDP is expected to fall by 4.4 per cent this year and 3.4 per cent next year.

EURO AREA SET TO STAGNATE NEXT YEAR

Real GDP growth, annual percentage change and contribution, constant prices



Sources: Business Sweden and Oxford Economics

Central and Eastern Europe. The war in Ukraine and the refugee flows it has caused has overshadowed all other issues on the political agenda in neighbouring Central and Eastern European countries, which for many years were vassal states to the Soviet Union and are now observing Russia's ambitions to reclaim its former empire with great concern. This has prompted the formation of a united front in the otherwise often split world views between the EU's Western and Eastern European member states. The governments of Hungary and Poland, otherwise largely hostile to Brussels, have joined in the EU's economic sanctions against Russia.

The conflict over the EU' s migration policy has temporarily simmered as Ukraine's neighbouring countries opened up their borders to accommodate millions of refugees fleeing the war. Before the outbreak of war, the conditions for economic development in the region were looking promising for this year, as well as next year. Several of the countries are major beneficiaries of the EU's recovery package Next Generation EU and its long-term budget for 2021–2027. Several of the EU's Eastern European member states – particularly Lithuania, Slovakia, Hungary, Poland and Latvia – are dependent on gas imports from Russia for their energy supply. Russia is also a significant export market for some of these countries, although their exports are mainly oriented towards Germany and the larger Western European markets.

Poland's economic performance in the first half of the year exceeded expectations, but there are clear signs of a slowdown this autumn. Foreign trade is being hit by the weakening development in the EU market. Wages have rapidly gone up and so the purchasing power of households remains intact, at least in the short term. But Polish households are being threatened by high inflation of nearly 14 per cent this year. The GDP forecast for 2022 shows growth of 4.4 per cent, which will drop to zero in 2023. A similar trend can be seen in Hungary where the recovery continues this year, despite the war in Ukraine, resulting in no less than 5.7 per cent GDP growth. Private consumption shows signs of strong growth and manufacturing is benefiting from investments in the battery sector and electrification in the automotive industry. However, growth is expected to fall to 0.2 per cent in 2023. In the Czech Republic, growth is limited to 2.6 per cent this year followed by a GDP loss of 0.4 per cent in 2023.

The Nordic countries. The political agenda in the Nordics has also focused on the war in Ukraine and its consequences, primarily highlighting the acute question of soaring electricity prices. Finland has to tackle the issue of depending on Russian fossil fuels for 45 per cent of the country's energy supply, while also dealing with the loss of Russia as an important export market, accounting for 5 per cent of the country's total exports of goods. The economy is expected to grow by 2.3 per cent this year and drop to zero growth in 2023.

Denmark's economy is expected to expand by 2.3 per cent this year following a boost in manufacturing and investments. Next year GDP is expected to grow by 0.5 per cent. Norway's economy is expected to grow by 2 per cent this year, underpinned by robust private consumption. An anticipated rise in the rate of investment next year will compensate for the likewise expected slowdown in household consumption, resulting in 0.8 per cent growth. Following a very strong recovery last year, the Swedish economy is set to cool considerably on several fronts. GDP will grow by 2.8 per cent this year but will fall by 0.2 per cent in 2023.

REAL GDP GROWTH RATE

2021	2022f	2023f	2024f	2015–2019
5.5%	1.8%	-0.1%	2.2%	2.3%

NORTH AMERICA

– Continuation of tight labour market and high inflation
– Aggressive monetary policy dampens growth outlook
– Mild recessions awaits in 2023

SOFT SLOWDOWN

USA. The US economy slowed in the first half of 2022, primarily as a result of dampened private consumption due to the high inflation and the Federal Reserve's interest rate hikes. Manufacturing and exports also faced headwinds as global demand weakened. Despite reduced activity in the economy, job growth remains strong and unemployment fell to a low of 3.5 per cent in July. The claim that the economy would be in recession on the basis of GDP having fallen during the first two quarters is therefore not entirely clear.

The assessment pointing to a downward trend in the growth rate is supported by the development of IHM Markit's purchasing managers' index which has gradually fallen back in the past six months. The index for manufacturing fell from 58 in March to 51.5 in August, indicating that the economy is balancing the line between expansion and contraction. The outlook for the services sector is looking bleak with the index falling to a low of 43.7 in August.

At the same time, other monthly indicators, like the OECD's Business Confidence Index (BCI), show that the business community's confidence in the US economy's development has gradually fallen to a level indicating economic decline. Consumers' confidence in the economic outlook is even weaker.

The total index in the Conference Board's latest survey rose, nonetheless, in August following a three-month decline which testifies to modest expansion in the economy. But the subindices for the current situation and the future paint two different pictures:

THE POLITICAL SITUATION

During the spring, the political debate between Democrats and Republicans focused primarily on concerns around high inflation and a slowing economy, rising crime and immigration. Following the successful launch of a massive federal aid package (The American Rescue Plan) and major infrastructure investment plans (The Infrastructure Investment and Jobs Act) last year, president Biden's climate action package stalled in Congress when certain Democratic senators opposed the plan.

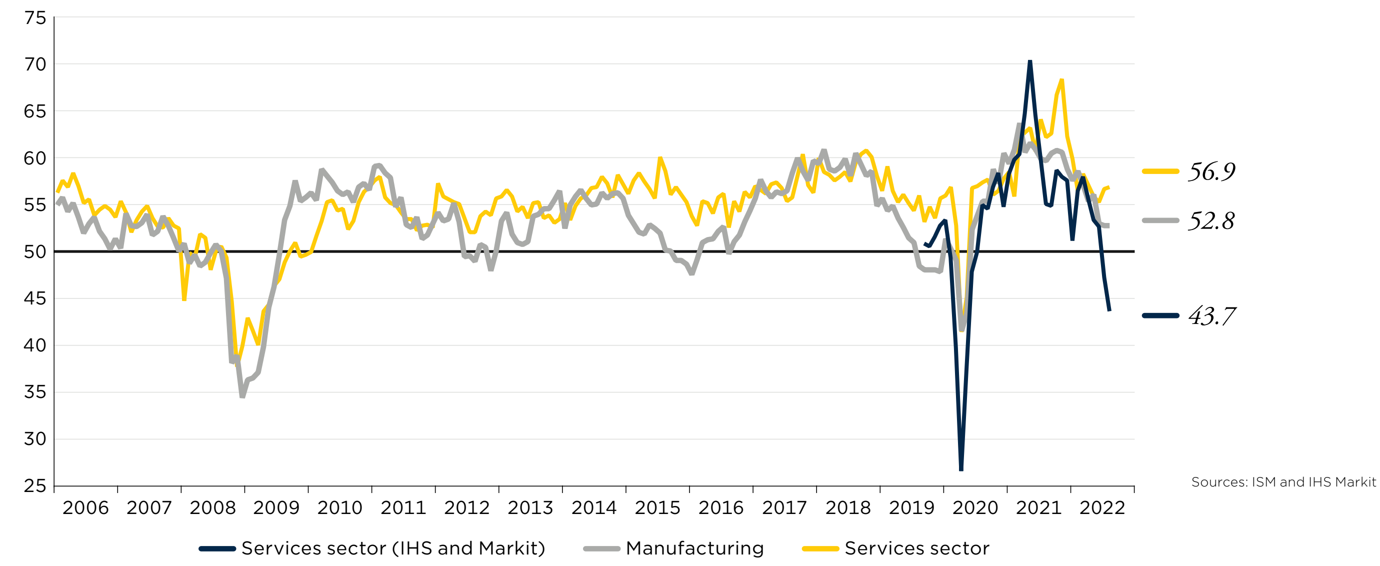
Biden's chances of getting his policies passed in the remainder of his term will be determined by the result of the mid-term elections on 8 November, when all 435 seats in the House of Representatives and 35 out of 100 seats in the Senate will be up for grabs. Historically speaking, the party holding the presidency has tended to lose ground in the mid-term elections, and with today's totally divided Senate, where each party has 50 seats but where vice president Kamala Harris has a deciding vote, the Republicans are deemed to stand a good chance of winning a stable majority. Biden's low popularity figures have also contributed to the Republicans' favoured prospects in the election.

However, the Supreme Court's decision in June to pass the issue of abortion rights into the hands of states has resulted in political mobilisation among women and Democrats, while gun violence, the threat to democracy and climate change have climbed the political agenda. When to comes to foreign policy there is political consensus on the measures taken to support Ukraine in Russia's war of aggression, but the shift in the debate towards other pressing social issues is considered to have weakened the Republicans' advantage. Former president Trump's successful endorsement of Republican candidates on the fringes has also worsened the Republicans' chances of winning a majority in the Senate.

Biden has also managed to retake the initiative in Congress. In August, the Democrats surprisingly managed to agree on the contents of the new climate bill, The Inflation Reduction Act, which includes USD 800 billion in investments and savings until 2031. That same month, Democrats and Republicans agreed in Congress on federal investment for the development and manufacture of semiconductors in the US, The CHIPS and Science Act, a support package amounting to USD 52 billion over 10 years. And in early September, Biden signed a presidential order regarding student loan write-offs for 40 million Americans who have completed their studies at colleges and universities. The legality, however, of the president's action will be challenged by Republicans in court so it is doubtful whether the programme can be implemented.

SLOWER MOMENTUM IN US BUSINESS SECTOR

Purchasing managers' index in the US, index >50 indicates expansion



while consumers have confidence in the economy today, their views of future economic development suggest a downward trend in the next few months.

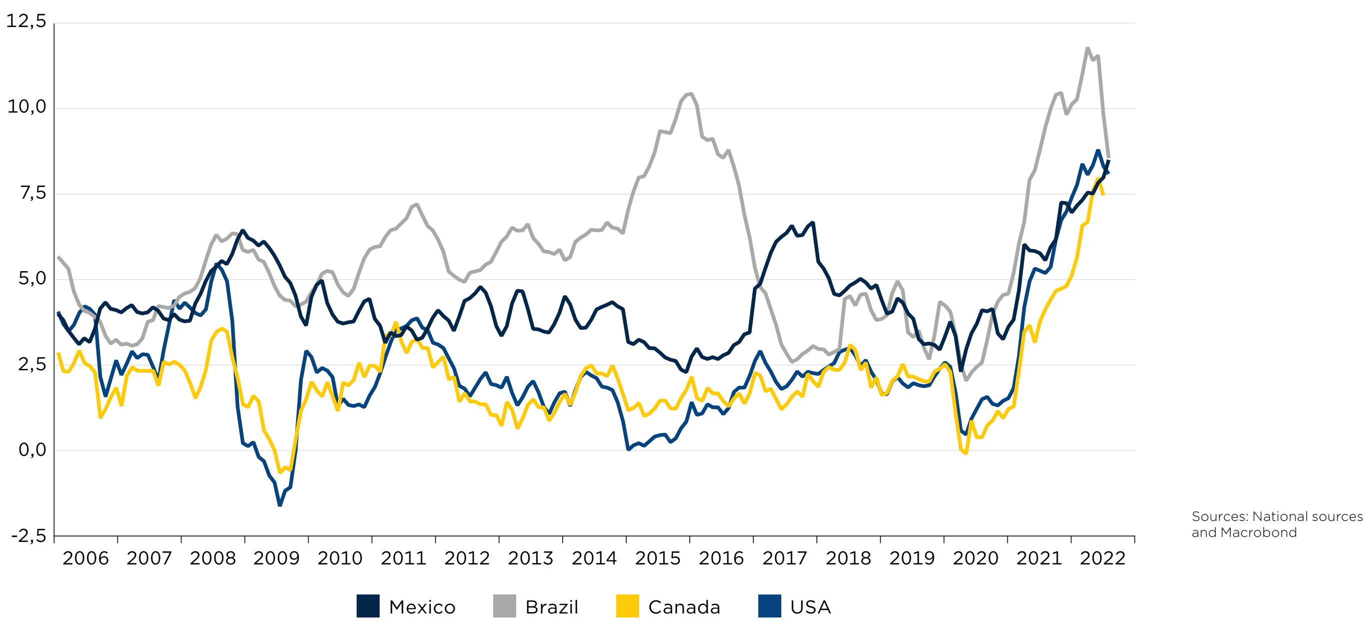
At its September meeting, the Federal Reserve raised the interest rate by a further 75 points resulting in an interest rate range of 3.0–3.25 per cent. It was the third time in a row that the Fed announced an interest rate hike of this magnitude. But a continued tight labour market and high inflation, which fell back slightly from 8.5 per cent in July to 8.2 per cent in August, means that the Fed will continue to raise interest rates to cool the economy. According to our assessment, the US interest rate will be raised to the range of 4.25-4.50 by the end of 2022.

The GDP forecast for the US suggests a significant drop in the growth rate to 1.7 per cent this year, followed by stagnation and zero growth in 2023, following weak development for private consumption and investments.

Canada. The Canadian economy performed well in the first half of the year. Pent-up consumption needs in the wake of the pandemic and households' shift in focus toward services gave private consumption a significant boost, while the industrial sector demonstrated a continued strong pace of investments. But the expected downward turn for the Canadian economy has now arrived. The purchasing managers' index for manufacturing has fallen three months in a row and hit 48.7 in August, which indicates decline in the industrial sector.

HIGH INFLATION ACROSS THE REGION

Consumer price index, annual percentage change



Housing prices have fallen by almost 20 per cent between the price peak in February and July. A weakening of the labour market, high inflation and falling real wages are expected to put a damper on household consumption this autumn and beyond. The Bank of Canada's announcement that the policy rate would be increased by no less than 100 basis points to 2.50 per cent came as a surprise in July, and in September a further 75 point-rise was announced, putting the interest rate at 3.25 per cent. The Bank of Canada is the first central bank in the OECD that has raised interest rates by as much as 100 basis points.

Canada's economy is expected to grow by 2.9 per cent this year and then go into recession with a GDP loss of 1.1 per cent in 2023, as private consumption and investments both go into decline. Strong export development is the only bright spot in the forecast.

Mexico. Having showed certain momentum in the first half of this year, monthly data now indicates declining activity in the Mexican economy. With high inflation, which reached 8.7 per cent in August, private consumption has taken a hit and falling demand from the all-important US export market is affecting the industrial sector, resulting in a drop in both exports and investments. Unemployment fell to 3.4 per cent in July, and the rise is expected to be only marginal reaching an average of 3.7 per cent during 2023. The economy is expected to expand by 1.9 per cent this year and 0.6 per cent 2023, in a broad downturn where only public consumption makes any noteworthy contribution to growth.

Overall, the North American economy is expected to grow by 1.8 per cent in 2022 and then stagnate during next year.

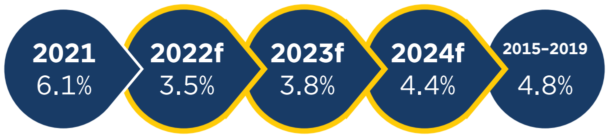
BRAZIL

Following an economic recovery last year, Brazil's growth rate has fallen back. High inflation and the central bank's most recent interest rate hike to 13.75 per cent have both undermined households' purchasing power and dampened consumption. The government's tax breaks on energy and telecom services as well as extra grants to vulnerable households ahead of the presidential election in October are expected to have only a short-term positive effect on demand.

President Bolsonaro's popularity fell during the pandemic and he risks losing the election, with the former president Lula as the most likely contender in the race. Many analysts warn of unrest in the country resulting in negative consequences for economic development in the event of a narrow loss for the incumbent.

The GDP forecast for this year shows growth of 2.5 per cent underpinned by an increase in government and private consumption and strong export growth, while investments and industrial production stagnate. In 2023, GDP growth of no more than 0.3 per cent is expected.

REAL GDP GROWTH RATE



– *Lower growth in China hits the region hard*
– *Inflation has caught up with Asia*
– *Central banks are tightening their policies to keep pace with the West, except China and Japan who take their own path*

ASIA

Asia is facing several challenges when it comes to economic growth. The Chinese economy has slowed sharply as a result of its far-ranging restrictions and shutdowns of large cities in dealing with Covid-19, leading to negative spill-over effects on the global economy but also for regional trading partners. The war in Ukraine continues to affect global commodity markets and pushes up prices especially for energy and food, although the slowdown in China contributes to weaker price pressure. Next year, growth in Asia will be hampered due to weaker demand from the region's major export markets, the US and Europe.

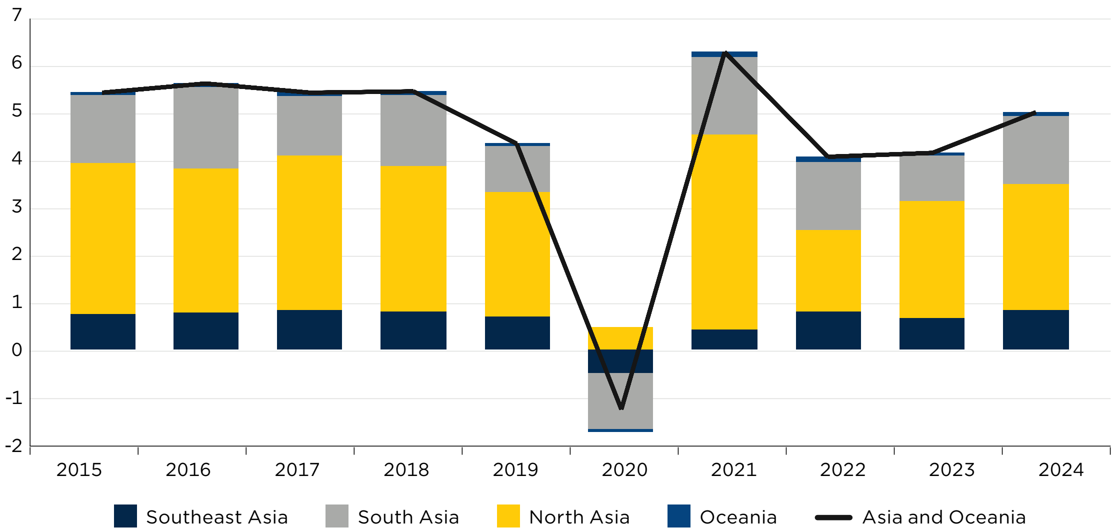
At the same time, many commodity-importing nations have been burdened by worsening terms-of-trade and by weakening currencies against the increasingly strong USD, as US monetary policy has tightened. This has led to large capital outflows from Asia's emerging markets, not least from India. Overall, GDP growth for Asia and Oceania is expected to slow to 3.5 per cent this year and then increase to 3.8 per cent in 2023, and 4.4 per cent in 2024. This is slightly below the average growth rate of 4.8 per cent during the period 2015–2019.

VARYING GROWTH CHALLENGES IN THE REGION

The differences in GDP growth across the region's markets are quite significant. In North Asia, the heavily industrialised economies such as China, South Korea and Taiwan, with the exception of Japan, have advanced further in their recovery and the growth rate for GDP returned to its trend level already last year. The Chinese economy continues to be hampered by strict Covid-19 restrictions as well as challenges in the real estate sector, which have put a significant damper on growth this year, despite continued efforts by the authorities to stimulate the economy. The consumption outlook in South Korea reflects the pressures being felt by rising inflation, which has hit around 6 per cent, higher interest rates, at the same time as the export-heavy economy is facing lower global demand. In Japan, investment growth has been negative since the start of the pandemic and further setbacks are now imminent as global demand drops and dampens export growth. The economies of Southeast Asia have grown at a relatively robust pace this year due to the fact that domestic demand still has some catching up to do in the wake of the pandemic. With free resources in the economy, GDP growth is accelerating rapidly as Covid-19 restrictions are eased and more people are entering employment. In South Asia, India is tackling worsening conditions for trade as well as growing risks of rising oil prices, which forces the central bank to raise the interest rate so as not to further burden the current account balances.

DAMPENED GROWTH IN ASIA

GDP growth in Asia, annual percentage change and contribution from different areas of the region, constant prices, PPP weighted



Sources: Business Sweden and Oxford Economics

Note: North Asia (China, Japan, South Korea and Taiwan), South Asia (India, Pakistan, Afghanistan, Sri Lanka, Nepal, Bangladesh, Bhutan), South East Asia (Singapore, Indonesia, Cambodia, Thailand, Myanmar, Malaysia, Vietnam, Laos, The Philippines and Brunei), Oceania (Australia and New Zealand).

China. China' domestic market problems are growing more severe and a slowdown in the economy is now notable. GDP fell by 2.6 per cent during the second quarter of this year. The principal short-term factor which is dampening growth is China's zero tolerance policy against Covid-19. This has contributed to weaker results than expected in output data such as industrial production, investment and retail sales. When the restrictions in Shanghai were lifted in the spring, subsequent shutdowns in Shenzhen, Chengdu and Dalian were introduced. The summer also brought on the worst heatwave in 60 years which led to energy shortages in the country, not least in Sichuan province where hydropower accounts for the largest share of the energy mix, which has further weighed on the economy. At the same time, the real estate sector remains shaky which has dampened both investment and revenues. Given that the highly indebted real estate sector accounts for around 30 per cent of China's GDP, a collapse of the real estate sector would pose considerable risks for the economy.

President Xi Jinping's set growth target of 5.5 per cent for 2022 is now out of reach, which could pose challenges during China's National Congress this autumn, as Xi Jinping aims to be re-elected for another five-year term. Fiscal stimulus has been promised to sustain growth in the economy. Support in the form of monetary policy has been modest despite weaker economic development and an inflation which hovers around the set target. But in August this year, China's central bank, The People's Bank of China (PBOC), lowered its policy rates by 10 points to stimulate the economy. Unfortunately, increased monetary policy stimulus does not solve the problems being faced as long as Covid-19 restrictions are in place and as consumption is held back. While admitting that zero tolerance entails great economic costs, the government is sticking to the strategy nonetheless, probably until the communist party congress in October, if not beyond this date.

GDP growth is expected to reach 3.2 per cent this year, fuelled by increased investments. It is widely expected that China's zero tolerance approach to Covid-19 will be abandoned next year, by which point household consumption will regain momentum and drive up growth to around 5 per cent where it is likely to remain in 2024. There are several downside risks in the forecast for the Chinese economy, including growing geopolitical risks and deteriorating relations with the United States, particularly with regard to increased tensions around Taiwan. In addition, China is facing many structural challenges that could negatively affect long-term growth (read more in the special section *China's painful transformation*).

Japan. Japanese GDP figures for the second quarter of the year confirm a recovery in economic activity after a weak first quarter. It was primarily household consumption which increased rapidly when restrictions across society were lifted. Households have a large savings surplus to spend in the coming years which means that consumption will be the main driver of growth this year. Investments are also expected to recover after several years of negative growth and, as such, will be the main driver of economic growth in 2023 and 2024. Investment growth remains overall negative 2022 but with bright spots in the private sector where investments are expected to develop positively already this year, which companies' extensive investment plans testify to. Inflation in Japan continues to be relatively low despite rising producer and commodity prices globally. Japan's inflation increased to 3 per cent in August, but the underlying inflation (excluding food and energy) amounted to just 0.7 per cent. This means that the Japanese central bank, the Bank of Japan, will continue to pursue an expansive monetary policy in the next few years and interest rates will remain low. In 2024, GDP will grow by 1.6 per cent – a significantly higher level than normal.

India. Domestic activity in the Indian economy has developed well. GDP increased overall by a total of 8.4 per cent during the first half of 2022 compared to the same period last year. Indicators such as the purchasing managers' index point to strong growth in both manufacturing and the services sector. Households' confidence is rising but is still at low levels which indicates a continuous gloomy outlook among households, while the corporate sector is showing optimism. As in many other countries, high inflation has hit the Indian economy hard. In August, inflation reached 7 per cent, well above the target range of 2-6 per cent, but lower than this year's record level of 7.8 per cent in April. Consumers' purchasing power is being eroded by the high inflation and consumption growth has already begun to slow down. The negative effects on consumption are being mitigated somewhat by the fiscal policy measures that have been introduced including tax cuts and subsidies for energy, fuel and food.

Private investment is gradually recovering but is slightly dampened this year due to the prevailing uncertainty around the protracted war in Ukraine, rising commodity prices, volatile financial markets and tighter financial conditions. Net exports contribute negatively to GDP growth this year as a result of worsened terms-of-trade and lower global demand. The central bank has already raised the policy rate by 140 points this year to 5.65 per cent and is expected to continue to tighten monetary policy to curb inflation and stave off a continuation of the weakening currency and capital outflows. In all, this means that GDP will grow by 7 per cent in 2022 and a more moderate 4.4 per cent in 2023. Growth will then bounce back and hit 7.1 per cent in 2024, which is in line with India's average GDP growth of 6.9 per cent in over past decade.

Southeast Asia. The economies of Southeast Asia, which are characterised by a delayed recovery from the pandemic, have witnessed an upswing in private consumption following easing Covid-19 restrictions this year and consumption is thereby the main driver of GDP growth. The tourism-dependent economies such as Thailand and the Pacific Islands have opened up again for international visitors who are slowly finding their way back to holiday hotspots, but they are coming in far fewer numbers than normal.

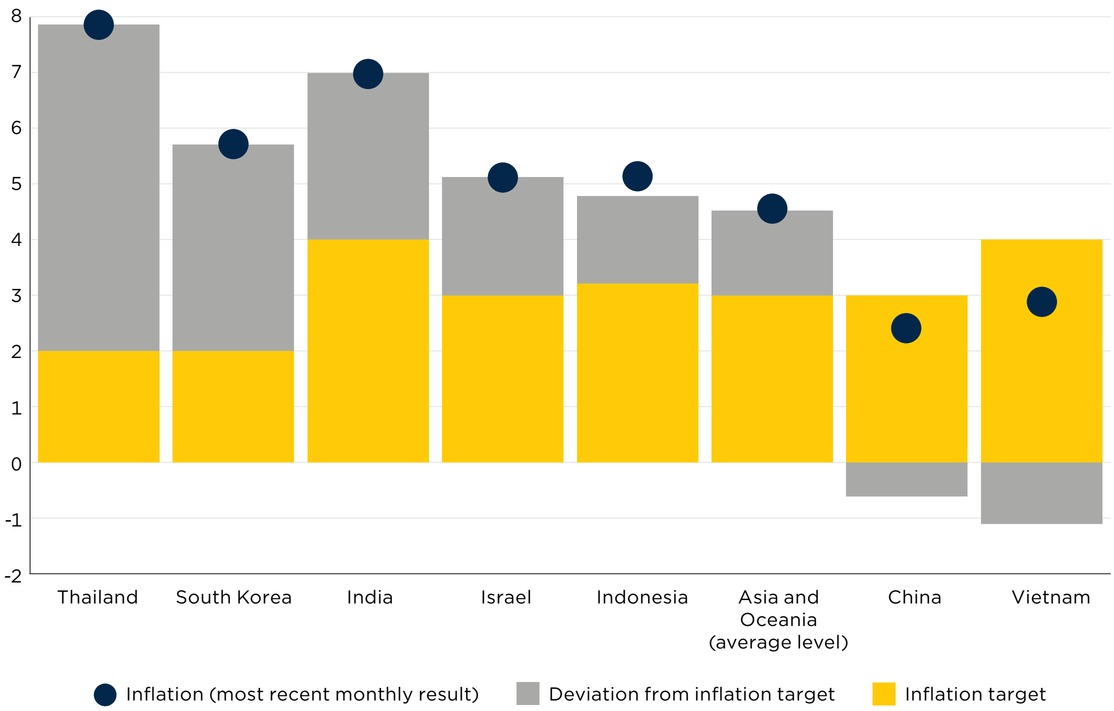
It is expected that households' purchasing power will be eroded even more, which dampens household consumption in the coming year and puts a spanner in the works of the tourism sector as it attempts to recover. The resilient manufacturing sector and strong export growth will both contribute positively to growth this year, despite the fact that the Chinese economy is slowing down. But as global demand dampens, export growth will also be weaker in the future. The commodity-exporting countries Malaysia and Indonesia will benefit from stronger export revenues creating more room for fiscal stimulus measures such as tax subsidies for food, fuel and electricity. Countries such as the Philippines and Thailand are negatively impacted by higher commodity prices as they are net importers. Government consumption continues to rise this year but at a significantly slower pace, but is set to make a stronger contribution to the economy in 2023 and 2024. Investments across Southeast Asia will continue to grow a gradually faster rate in the next few years following a modest recovery last year. Overall, GDP in Southeast Asia will grow by 5.5 per cent this year and 4.4 per cent next year, bouncing back to 5.5 per cent growth again in 2024.

RISING INFLATION ACROSS THE REGION – BUT TO A VARYING EXTENT

Inflation has caught up with Asia despite price pressures being considerably more moderate across the region than in other parts of the world. This is partly because the Asian economies were not hit as hard by the supply disruptions last year, but also because the recovery of domestic demand has not been as strong as, for example, in the US which has seen greater monetary and fiscal stimulus measures and a stronger labour market. In Singapore and South Korea, the central banks began the fight against inflation already towards the end of 2021, but inflation has now regained momentum in more and more Asian countries. While the rate of inflation in China and Japan remains relatively limited, the upward trend is unmistakable. Thailand, the Philippines and India have been particularly affected by large increases in food prices, which account for a major share of consumer spending. Rising energy and food prices have prompted some Asian governments

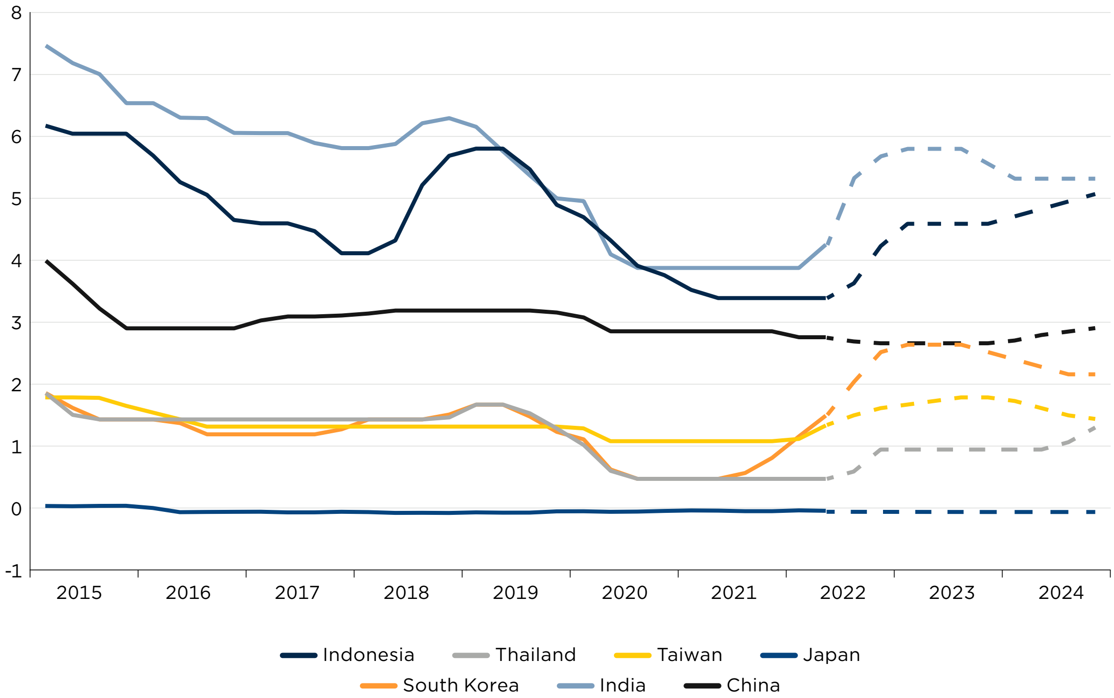
VARYING INFLATIONARY PRESSURE IN THE REGION

Consumer price index and deviation from central bank target, annual percentage change, percentage points



Sources: National sources and Business Sweden

TIGHTENING OF MONETARY POLICY
Policy rate, per cent



Source: Oxford Economics

to introduce subsidies and other forms of support to ease the burden on households. Within the region, inflation has increased the most in relation to inflation targets in Thailand, South Korea and India. A common trend for these economies is that their currencies have weakened considerably, which is not unusual for small open economies in uncertain times. In addition, the exchange rate typically weakens in countries that are net importers of commodities when commodity prices rise overall.

The increasingly higher inflation figures have prompted most of the central banks in Asia's emerging markets, with the exception of China, to start tightening monetary policy sooner than what had been hoped to sustain economic recovery. As the Federal Reserve has tightened monetary policy more rapidly, most emerging markets in Asia have experienced large capital outflows on par with the period following the global financial crisis, when the Fed tightened monetary policy in 2013.

Capital outflows have been particularly severe for India, but significant outflows have also occurred in advanced economies such as South Korea and Taiwan. As such, large capital outflows and weakened currencies put pressure on central banks to tighten monetary policy at a faster pace which, in turn, may jeopardise the economic recovery. China and Japan are the two exceptions where inflation is considerably lower. China's central bank even lowered its policy rate in August to stimulate a weaker economy, while Japan's central bank has stuck to its policy of zero interest rate. Overall, we expect that the Asian central banks, except those of China and Japan, will tighten their policies more rapidly during the remainder of 2022.

CHINA'S PAINFUL TRANSITION

China has steadily increased its role on the world stage and has long been a locomotive of the global economy. Today, China's economy is facing a critical phase involving huge challenges. What are the prospects for the Chinese economy going forward?

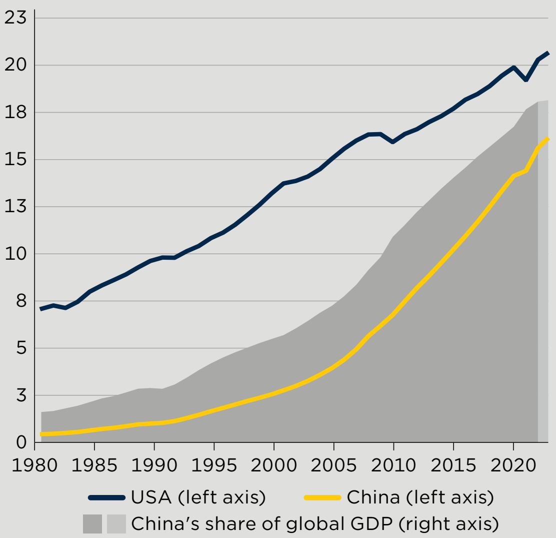
China's economic development has been nothing less than an unparalleled success story. Following the first economic reforms implemented in 1979 until 2011, the economy has grown by almost 10 per cent per year on average – faster than any other country. China's share of global GDP increased from less than 2 per cent in 1979 to 18 per cent in 2021. The surge in growth took place primarily when China opened up to foreign trade and foreign investments. China's economy grew by approximately 550 per cent since it became a member of the World Trade Organization in 2001. In 2010, China became the world's largest exporter and in 2013 it became the largest trading nation, currently accounting for 15 per cent of global trade in goods. Many forecasters around the world have long expected China to overtake the US as the world's largest economy by around 2030, which would require an average GDP growth rate of 5.5 per cent as of next year. But as China's economy has matured, growth has gradually slowed since the 2010s. Growth of 5 per cent today is roughly equivalent to a 10 per cent increase a decade ago due to the fact that the economy has doubled in size. But this year, the considerable downturn has become a major problem. Over the past decade, a range of challenges have also emerged in sectors that were previously expansive – not least the real estate sector. The country's growing importance on the world stage has tangible consequences, not only in China but also globally due to ongoing trade and financial transactions.

CHINA'S GROWTH MODEL LED TO IMBALANCES

China's unique growth journey was largely based on two driving factors: large domestic investments, primarily in infrastructure, as well as basic industrial production for export based on the principle of low wages. The large-scale capital investments were financed by high levels of domestic savings and foreign investments. In the early stages of economic development it is possible to achieve significant productivity leaps by investing in infrastructure and industrialisation. In this case, the returns on invested capital are high and can be reinvested in the economy, but when the infrastructure needs of a country are met these returns will dwindle. The rapid rate of investment in China is now linked to lower returns and a declining GDP growth rate. Despite the falling returns on invested capital, investments still account for 42 per cent of China's economic activity today.

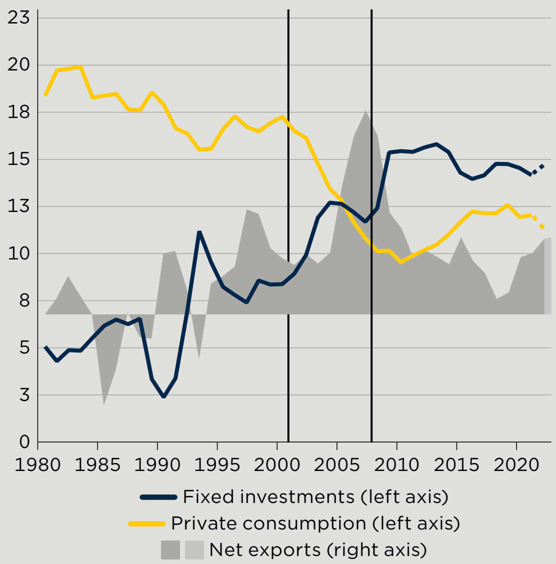
Over the past decade, Chinese has greatly expanded its investments overseas. In the autumn of 2013, Xi Jinping launched the concept of a new silk road – The Belt and Road Initiative (BRI) – which aims to connect western parts of China with, originally Asia and Europe, but now all the world's continents via investments in new transport routes. The initiative is clearly linked to China's domestic imbalances. By lending money to recipient countries and by letting Chinese companies build roads, railways and other infrastructure using Chinese

CHINA'S GROWTH DEVELOPMENT
GDP trillion USD and % of global BNP



Note: GDP in USD, constant prices and exchange rates

IMBALANCES IN THE ECONOMY
% of GDP, current prices, CNY



Source: Oxford Economics and Business Sweden intermediate goods, China reduces the problem of overcapacity in many industries and increases the return on invested capital. At the same time, the initiative is a way of raising incomes and living standards in western China through increased trade, investments and business establishments.

When studying the Chinese economy, it is important to consider the high level of savings used to finance investments. In the past five-year period, total savings have amounted to 45 per cent of GDP which is one of the highest savings ratios in the world. The absence of a functioning social welfare system means that households save a large share of their income for unforeseen expenses. As a consequence of the structurally high savings, private consumption remains relatively low. China has grappled with this economic imbalance since the early 2000s – as households contribute less and less to GDP growth through consumption. At the same time, the investments that have been financed by a high level of savings become less productive and export companies are facing increasingly fierce competition as wages increase and geopolitical tensions grow.

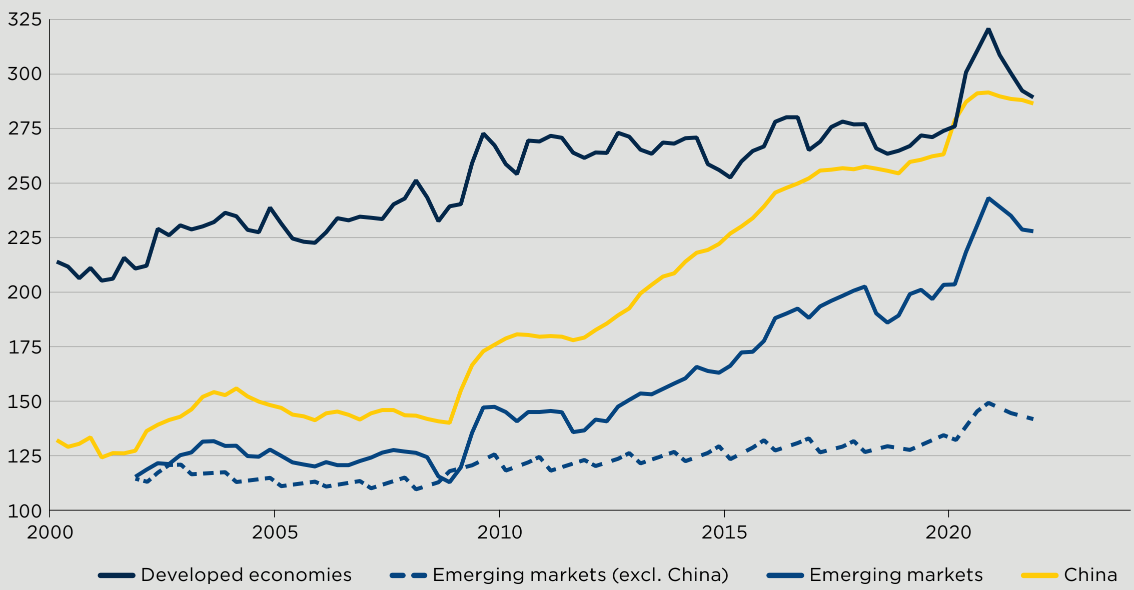
Already during the spring meeting of the National Congress of the Chinese Communist Party in March 2007, China's then Premier Wen Jiabao declared that the Chinese economy is "becoming increasingly unbalanced, instable, uncoordinated and unsustainable". The rapidly growing investment rate accumulated debts in the economy and caused concern around the financial stability of the country. Since the current President Xi Jinping came to power in 2012, economic policies have changed through a range of initiatives. China's economy would to a larger extent be driven by domestic consumption, it would become more self-sufficient in the high-tech sector and less dependent on export.

REAL ESTATE SECTOR AN OVERHANGING RISK

A downside of the booming Chinese economy and large capital investments is overcapacity in large parts of China's business sector, not least in the real estate sector. The large-scale construction of housing and infrastructure – which nonetheless paved the way for a massive urbanisation process – has meant that the real estate sector now accounts for about 30 per cent of GDP, almost twice that of most other countries. Another severe consequence of China's growth model is the enormous accumulation of debt. The large savings in the country are converted by the banks into lending, not least to property companies that are taking on more and more debt. The Chinese economy has grown rapidly, but debt has increased faster and now stands at around 280 per cent of GDP. The build-up of debt is particularly large for non-financial companies where debt amounts to 155 per cent of GDP, while household and and public sector debt amounts to just above 60 per cent of GDP.

The red-hot real estate market and high levels of debt pose considerable risk to the Chinese economy. The government has taken measures to reduce the risk level by introducing debt ceilings, especially in the real estate sector. During 2020, the "three red lines policy" was introduced which made it more difficult for property developers to secure financing. These "lines" meant that the loan-to-value ratio is not allowed to exceed 70 per cent of the property's value and net debt must not exceed 100 per cent of owned capital. In addition, liquid assets must be as large as the short-term liabilities. The credit crunch resulted in a sharp decline in the property sector already last year and several property developers have run into financial difficulties, not least the property giant Evergrande which has debts of more than USD 300 billion.

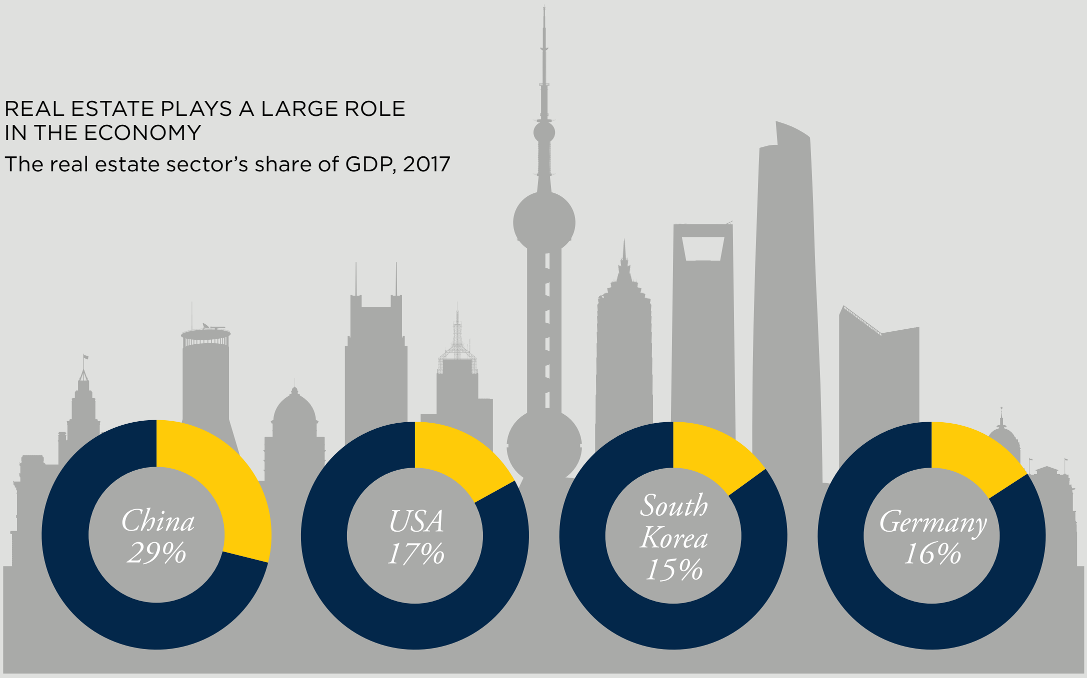
CHINA'S DEBT HAS GROWN RAPIDLY
Total non-financial debt, share of GDP



Source: Oxford Economics and Business Sweden

REAL ESTATE PLAYS A LARGE ROLE IN THE ECONOMY

The real estate sector's share of GDP, 2017



Source: Rogoff and Yang, 2021

The negative news reports surrounding China's real estate sector have continued this year. With falling housing prices and a wave of boycotts on mortgage amortisations, confidence in construction companies has deteriorated further and they risk getting into payment difficulties. The authorities have therefore once again increased lending and eased credit terms to reduce the risk of a liquidity crisis. With so much of the economic activity linked to continued large investments in the real estate sector, the question is how China will be able to govern its economy without ending up in a deep financial crisis.

WIDENING INCOME GAPS POSES CHALLENGES

China is facing a unique challenge when it comes to scaling up private consumption. China now belongs to the upper tier of the world's middle-income countries according to the World Bank's definition, but consumption in the country is comparable to significantly poorer countries. This is partly due to the fact that income gaps have increased sharply since the mid-1980s, which has made China one of the most unequal countries in the world. Another important reason is the absence of a social welfare system which leads to high precautionary savings among households.

For China's economy to grow rapidly with private sector consumption as the locomotive of growth, significant resources need to be shifted from the state and the wealthy elite to the wider population. Xi Jinping's campaign "Common prosperity" has received a lot of attention in the past year. During a meeting with the Central Financial and Economic Affairs Commission (CFEAC) in August 2021, he underlined that prosperity for all is a "cornerstone of the socialist system and necessary to balance growth and financial stability".

The campaign aims to reduce income gaps and distribute wealth more equitably between citizens. Everyone must have access to education and development opportunities but also fundamental public services such as healthcare and elderly care. The objective is also to strengthen the social insurance and pension systems and encourage high income earners and businesses to contribute more to society and welfare. An important measure within the framework of the programme are regulations that aim to limit debt ("unlawful expansion of capital") in the real estate sector. Speculation in real estate has been a big source of wealth growth and inequality. The cost of living has increased rapidly in recent years and buying a home is impossible for many families as this requires a lifetime of savings. Chinese families spend the majority of their income on their homes, with exception of food and education.

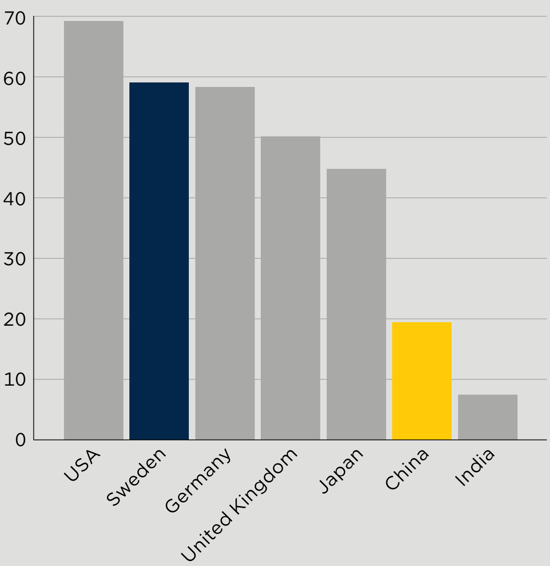
The programme paves the way for favourable economic development as better access to education leads to increased human capital and higher productivity. A stronger social security safety net can also help to increase the birth rate and reduce precautionary savings, especially among the young, which would contribute to a more consumption-driven economy.

"Productivity isn't everything, but in the long run, it's almost everything."

Paul Krugman,
Nobel Prize laureate

CHINA IN THE TOP LEAGUE OF THE WORLD'S MIDDLE-INCOME COUNTRIES

GDP per capita, thousand USD (PPP weighted), 2021



Source: Conference Board TED

DEMOGRAPHY – ANOTHER ECONOMIC OBSTACLE

Another major challenge facing China's future prosperity is its aging population and shrinking workforce. This is largely a consequence of the one-child policy that was pursued between 1979 and 2016 as a way of dampening the rapid population growth in China at the time. While nativity levels have decreased, the average life expectancy in China has also increased in tandem with the increasingly higher standard of living in the country.

While the government has liberalised the one-child policy in an attempt to increase the birth rate, other forces are pushing in the opposite direction, for example rising costs for childcare, housing and education. Another consequence of the one-child policy is that there are significantly more men than women in China which also negatively affects the nativity.

China's working-age population is expected to be greatly reduced in the coming years and the burden of supporting the elderly is becoming increasingly difficult. Apart from the fact that an aging population requires more resources in healthcare and elderly care, as well as an overhaul of the pension system, it also affects long-term GDP growth negatively.

TECHNOLOGY INVESTMENTS A POTENTIAL KEY

Another way forward for Chinese growth is to move up the global value chain. Innovation and technological development, an advanced services sector and greatly improved education are all keys. Technological development and innovation contribute to increased productivity – often measured by what is called "total factor productivity". China's total factor productivity was only around 40 per cent of the US equivalent in 2019, which indicates considerable room for improvements. China's investments in R&D, advanced manufacturing and innovation partly reflect the need for increased productivity but also its desire to become a high-tech superpower. The Chinese business sector is characterised therefore by a large state presence. Although the share of state-owned companies has decreased in recent years, they play a significant role in strategically important sectors such as energy and infrastructure, commodities, banking and finance, telecom and electronics, as well as the defence industry. The state-owned companies are often less profitable than private sector companies, which account for most of the country's increased productivity.

The stricter regulations and crackdowns recently on the internet and technology sectors in China has attracted much attention. The stated justification has been to prevent abuse of market forces and avoid risks to data privacy and national security.

In addition, the Chinese state, in line with its "Common prosperity" strategy, has decided to "adjust excessively high incomes" and urged companies and private individuals to "give back to society", which has resulted in more companies now allocating billions of dollars to charity. This onslaught coupled with increased state governance has resulted in major stock market losses which has prompted heightened concerns around the conditions for foreign investors, as well as the issue of competent labour fleeing the country and that innovation and entrepreneurship are inhibited.

PAINFUL TRANSITION AWAITS

China's economy is in a critical situation and is facing enormous tasks. For the economy to become driven by higher business activity and private consumption, a painful economic and political transformation will be required. The current "Common prosperity" strategy contributes in several ways to the structural changes that are needed for China's economy to successfully transform. But tensions remain regarding the state's dominating presence in the economy. On the one hand, this enables rapid and much-needed structural changes, but on the other, the state's dominating role coupled with strict regulations risks inhibiting the development of innovation and efficient capital allocation. Meanwhile, the pursuit of technology leadership will continue to characterise trade relations around the world, and lies at the heart of the tension between the two superpower rivals the US and China (see Business Sweden's report *Technologies of Power* 2022).

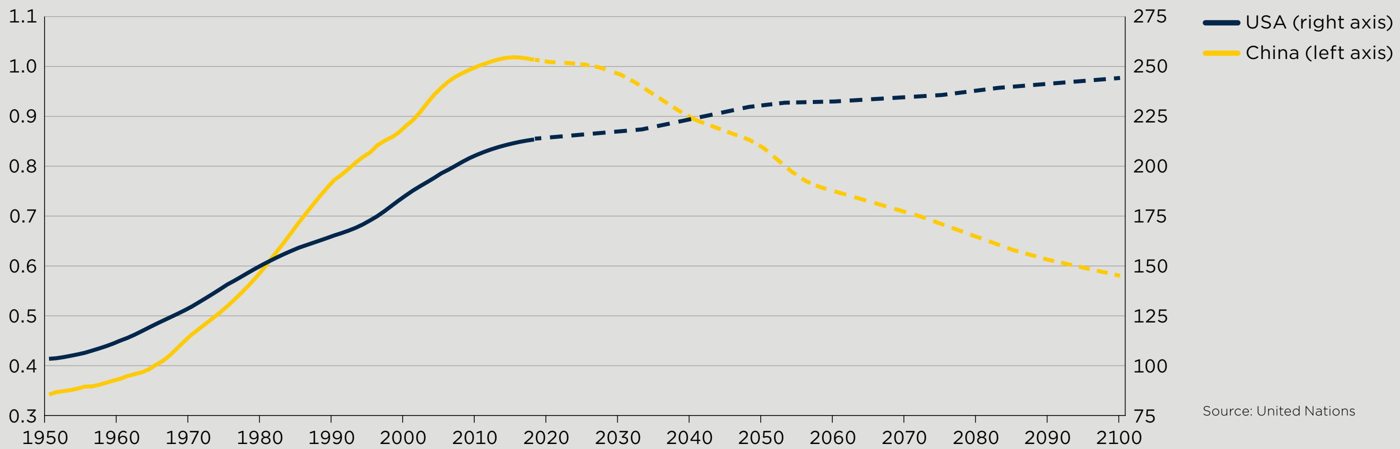
There is a tangible risk that the Chinese economy will not succeed in its transition. China's economic growth will decline in the future, but how rapidly and by how much is more difficult to answer. Although China will contribute less to global GDP growth going forward, it will nonetheless remain one of the world's biggest economies and continue to wield immense influence in the world.

"Despite a slowdown the Chinese economy remains huge and important for many Swedish companies. The market has become more complex and uncertain. That's why it is more important than ever to adapt your strategy to navigate successfully."

Joakim Abeleen, Market Area Director and Trade & Invest Commissioner, Greater China, Business Sweden

CHINA'S WORKING AGE POPULATION IS RAPIDLY FALLING

Billion people



Source: United Nations

APPENDIX

COUNTRY	Swedish goods exports, current prices			GDP growth, constant prices, %				Inflation, %	
	Exports 2021, SEK bn	Change 2020–2021, %	Share of Swedish exports 2021, %	2021	2022f	2023f	2024f	2022f	2023f
Europe									
Sweden				4.8	2.8	-0.2	1.9	7.4	4.5
Austria	14.8	13.8	0.9	4.9	3.5	-0.5	3.2	7.6	1.7
Czech Republic	14.6	29.4	0.9	3.5	2.6	-0.4	3.8	15.3	4.2
Denmark	126.7	17.3	7.8	4.9	2.3	0.5	3.8	7.6	3.3
Finland	115.9	15.5	7.1	3.0	2.3	0.0	1.9	7.1	3.8
France	66.8	14.7	4.1	6.8	2.6	0.2	1.7	6.0	4.4
Germany	170.5	12.4	10.5	2.6	1.3	-0.8	2.9	7.5	4.4
Italy	48.0	24.8	3.0	6.6	3.3	-0.1	1.5	7.8	4.4
The Netherlands	82.6	12.1	5.1	4.9	4.7	0.9	1.6	10.3	3.9
Norway	175.4	15.3	10.8	4.0	2.0	0.8	2.7	6.3	5.2
Poland	62.7	30.9	3.9	5.9	4.4	0.0	4.2	13.6	11.3
Russia	22.5	20.9	1.4	4.7	-4.4	-3.4	2.2	13.9	5.0
Spain	32.0	22.3	2.0	5.1	4.3	1.0	3.0	8.6	3.8
United Kingdom	91.7	24.8	5.6	7.4	3.5	0.1	2.1	8.9	5.4
Americas									
Brazil	10.3	2.6	0.6	4.9	2.5	0.3	2.9	9.7	6.6
Canada	10.3	-0.8	0.6	4.5	2.9	-1.1	2.8	6.7	3.3
Chile	3.5	15.1	0.2	11.9	2.0	-1.7	2.4	11.5	7.7
Colombia	1.2	7.4	0.1	10.7	6.9	-1.4	3.1	9.8	7.4
Mexico	6.8	18.5	0.4	5.0	1.9	0.6	2.5	7.9	5.4
USA	137.5	14.0	8.5	5.7	1.7	0.0	2.1	7.9	3.7
Asia and Oceania									
Australia	14.5	-10.1	0.9	4.9	3.8	2.0	3.3	6.4	4.9
China	67.5	-13.5	4.2	8.1	3.2	4.9	5.2	2.3	2.3
Hong Kong	0.0	0.0	0.0	6.3	-0.8	4.0	3.6	2.1	2.6
India	11.5	19.1	0.7	8.3	7.0	4.4	7.1	6.9	5.4
Indonesia	3.4	20.9	0.2	3.7	5.5	4.7	6.2	4.8	5.2
Japan	24.4	6.0	1.5	1.7	1.6	1.8	1.6	2.1	1.1
Malaysia	3.4	30.9	0.2	3.1	8.8	3.6	4.2	3.4	2.5
The Philippines	1.7	25.7	0.1	5.7	6.1	4.5	6.3	5.8	4.2
Singapore	10.9	25.2	0.7	7.6	3.6	1.5	3.0	6.0	3.1
South Korea	14.7	2.9	0.9	4.1	2.7	1.6	2.7	5.2	3.4
Taiwan	5.9	10.7	0.4	6.6	2.7	1.8	2.8	3.0	1.8
Thailand	5.3	-2.8	0.3	1.5	3.6	4.5	4.2	6.0	0.8
Vietnam	2.1	7.7	0.1	2.6	7.7	6.3	6.4	3.3	3.8
Middle East, Türkiye and Africa									
Kenya	0.3	-24.5	0.0	7.5	4.2	3.9	4.1	7.4	6.8
Morocco	2.8	15.4	0.2	7.9	-1.4	4.0	3.6	6.6	3.6
Saudi Arabia	10.4	8.3	0.6	3.2	7.6	3.3	1.8	2.3	2.8
South Africa	7.7	17.1	0.5	4.9	1.8	1.2	1.7	6.8	5.5
Türkiye	15.2	2.3	0.9	11.4	4.8	0.8	2.2	73.0	39.4
United Arab Emirates	6.8	-24.0	0.4	3.8	7.0	5.4	3.2	4.5	2.8

Sources: Oxford Economics, Statistics Sweden, Business Sweden

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