Economic Insights

Thursday, April 1, 2021

Increased economic resilience against COVID-19 restrictions

Early 2021 has been dominated by high COVID-19 transmissions and recurring extensions of lockdowns and restrictions, yet economic forecasts have recently been revised upward. For example, we now believe that global GDP will increase by 5.5 per cent this year, compared to 5.0 per cent in our latest *Nordic Outlook*. The main factor behind this change is higher expectations for the US economy, but the fact that Q1 2021 will not be as weak as once feared is contributing to stable forecasts for Western Europe as well. Now that a larger portion of this year looks likely to be hampered by restrictions, however, the recovery will boost 2022 GDP figures to a greater extent. Differences in the pace of vaccinations between countries will have some impact on forecasts, but the consequences of this will probably be rather small and transient.

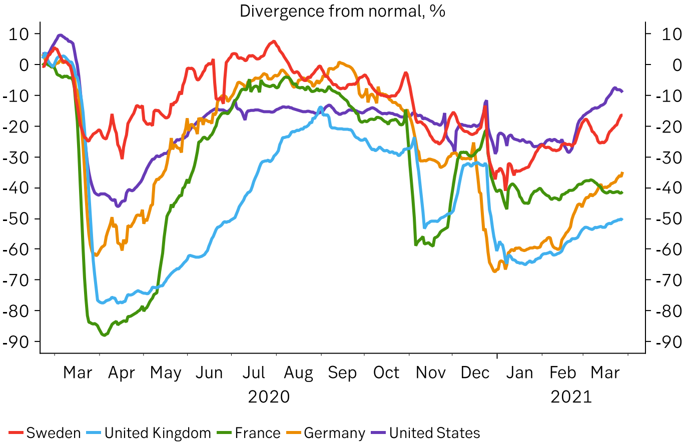
Håkan Frisén
Head of Economic Forecasting
+46 70 763 80 67
hakan.frisen@seb.se

Marcus Widén
Economist
+46 70 639 10 57
marcus.widen@seb.se

The impact of the COVID-19 pandemic on the economy continues to dominate macro analysis. But when the second transmission wave took off last autumn, it became evident rather quickly that its effects on the economy were much milder than in spring 2020. In general, restrictions were designed in a way that enabled work in most sectors to continue to a fairly large extent. Above all, this helped ensure that industrial production was much less affected than last spring. In addition, other parts of the economy have found new ways to maintain their level of activity even in an environment of ongoing restrictions. Our assessment in the February 2021 *Nordic Outlook* (*NO*, published January 26) was that the decline in GDP compared to pre-crisis level would end up at about a third of the plunge recorded in spring 2020. During this past winter, the degree of mobility in different countries has largely followed the spring 2020 pattern. The large economies in Western Europe have had clearly lower human mobility than the United States and the Nordic countries, for instance, although today the differences are narrower, especially compared to France. The link between mobility and economic activity also varies between countries. In large euro area countries and in the UK, retail sales follow mobility relatively well, while the link is significantly weaker in such countries as the US and Sweden.

Mobility index

Divergence from normal, %



Source: Google, Macrobond, SEB

Resilience against new lockdowns

Recent months have been dominated by new disappointments around the world in terms of COVID-19 transmission, leading to increased pressure on health care systems and rising death figures. The third wave has recently swept across Europe, resulting in continuous new decisions to extend or resume restrictions and lockdowns. The normalisation of the economic situation is thus taking longer than expected. Add to this the vaccine delivery problems that have affected European Union (EU) countries. Yet economic forecasts have generally been revised upward recently. The tendency for economies to become more resilient against restrictions has been confirmed and strengthened. As a result, GDP projections for the first quarter of 2021 are now being adjusted higher in most places. However, the recovery during the second quarter will be weaker because of the delay in normalisation. Differences in the pace of vaccinations will have some impact on forecasts, but the strident tone of media reporting makes it easy to exaggerate these effects. Estimates by the responsible authorities indicate a delay of one to two months. This especially affects the outlook for this summer and will thus have major consequences for the sectors primarily affected and for countries that are dependent on tourism. Yet the overall situation is still that well-functioning vaccines have been developed at an impressive pace, and that vaccination roll-outs generally seem to be working as planned in the developed countries. As a result, differences in the pace of vaccination will have relatively small and transient effects on economic activity.

The US pulls ahead of Western Europe

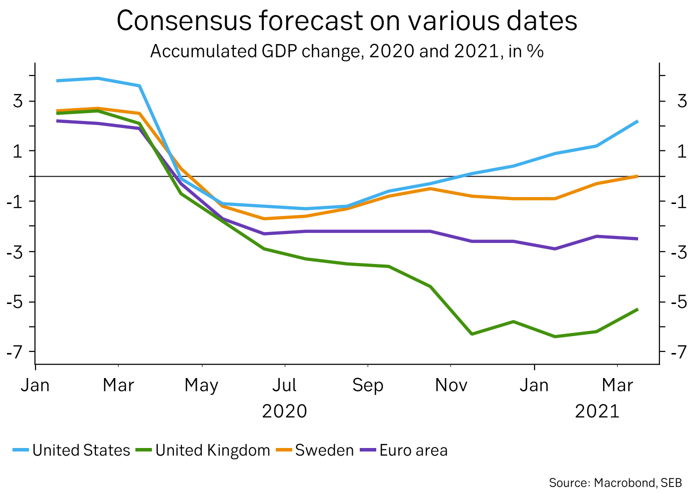
We have recently published updated analyses of various parts of the world economy. Looking at 2021, we have end up with a clear upward revision of our global GDP growth forecast to 5.5 per cent, up from our earlier figure of 5.0 per cent (measured in purchasing power parities, PPP). Our upward adjustment for 2022 is only 0.1 percentage point, but our new forecast of 4.4 per cent is clearly above the global trend growth of around 3.5 per cent. The dominant change is in the US, where recent economic performance has been unexpectedly strong despite continued widespread virus transmission. Our forecast is now that US GDP will grow by 6.5 percent this year and by 4.0 per cent in 2022. In February's *Nordic Outlook*, the corresponding estimates were 4.5 and. 3.6 per cent, respectively. It is clear that US lockdowns have been less extensive than in Europe, as illustrated by higher mobility. Differences in the overall dose of fiscal stimulus have also widened, now that Congress has approved the Biden Administration's American Rescue Plan, which is equivalent to more than 8 per cent of GDP. The fact that US stimulus measures have largely focused on direct support to households has also contributed to their faster impact via a sharp recovery in household consumption, US here and Euro area here.

SEB's forecasts of GDP growth

Year-on-year percentage change

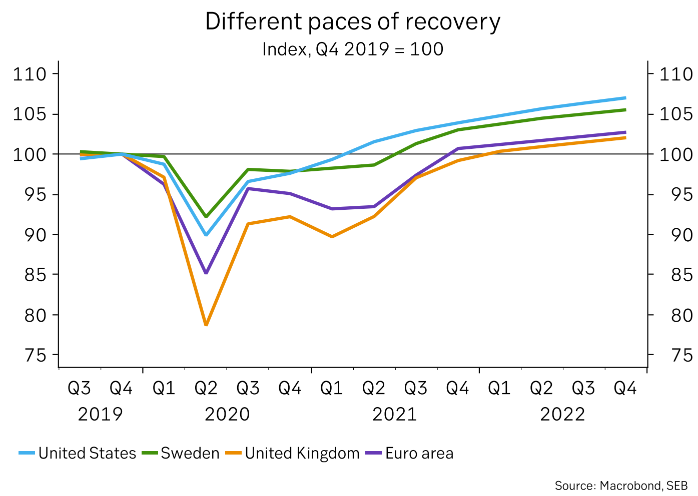
	2020	2021	2022	Diff from *NO* Feb** *2021*	*2022*
United States	-3.5	6.5	4.0	*2.0*	*0.4*
Japan	-4.8	2.4	1.4	*0.3*	*0.4*
China	1.9	8.0	5.6	*0.0*	*0.0*
United Kingdom	-9.9	5.3	7.0	*1.8*	*-1.2*
Euro area	-6.6	3.0	5.1	*-0.1*	*0.2*
Sweden	-2.8	3.5	4.4	*0.7*	*-0.4*
Denmark	-3.3	2.5	5.0	*-0.5*	*0.5*
OECD	-4.8	4.5	3.8	*0.8*	*0.1*
Emerging markets	-3.5	6.3	4.9	*0.1*	*0.1*
Globally*	**-4.1**	**5.5**	**4.4**	***0.5***	***0.1***

Source: OECD, IMF, SEB. *PPP=Purchasing power parities. **Percentage points.



Political symbolism in the UK vaccination campaign

In Western Europe, the changes in our GDP forecasts are relatively small, especially for the euro area. Comparisons between euro zone countries and the UK are extra noteworthy since we can now measure the impact of Brexit on the British economy. In this situation, the pace of vaccinations has gained a lot of symbolic value, especially for Boris Johnson and his Tory government. The UK has imposed severe restrictions throughout the pandemic, and its 10 per cent GDP decline in 2020 was far deeper than in the euro area as a whole. The "UK variant" of the COVID-19 virus has put extra pressure on the health care system, and during the third wave, metrics of the degree of lockdowns indicate that the UK is one of the countries that has gone the furthest. The UK's lead in the vaccination process is now creating opportunities for its economy to recover lost ground. In late February, Prime Minister Johnson presented a step-by-step plan for how to restart the economy, aiming for it to be fully open by the end of June. But at the same time, the Brexit process is entering a critical phase. On June 30, a number of temporary transitional rules for trade with the EU will end, which might cause new disruptions. These risk distracting attention from the success of UK vaccinations, where the government can point to the benefits of having full national control. A high vaccination rate and an unexpectedly small GDP decline during Q1 are contributing to our fairly clear upward revision of British GDP growth in 2021, but this reduces the potential for 2022. Looking at our entire forecast period, we still believe that UK and euro area performance this year and next will be relatively similar, as the UK economy recovers the ground it lost in 2020 (see chart). In general, we believe that due to the protracted course of the pandemic, GDP growth in Europe – unlike the US and Asia, for example – will be higher in 2022 than in 2021, measured as annual averages. We disagree on this point with organisations like the OECD, which foresees a much smoother growth curve.

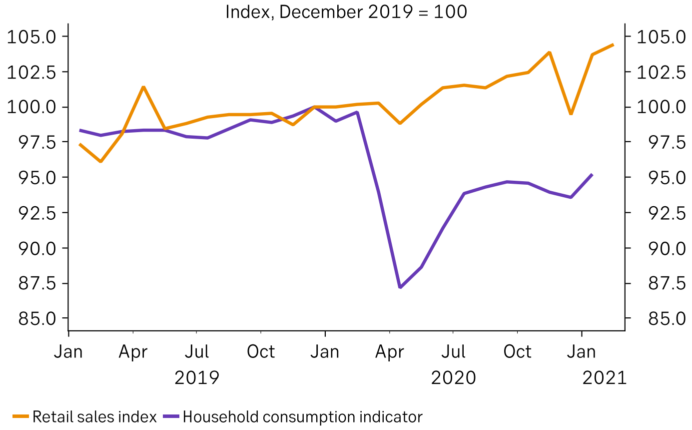


Delayed Swedish recovery

Last year's GDP decline in Sweden and the other Nordic countries was on a par with that of the United States, and thus significantly milder than elsewhere in Western Europe. The Swedish economy continued to show resilience in early 2021 but because of the remaining pandemic-related restrictions and a more cautious fiscal policy, it cannot keep up with the pace of US recovery. Production in the Swedish business sector rose by a marginal 0.1 per cent in January, and merchandise exports were weaker than expected during the early months of the year, yet Statistics Sweden's monthly GDP estimate (activity index) rose by 0.9 per cent in January. This is one reason why we now believe that GDP will grow by 0.4 per cent in the first quarter; in *NO*, our forecast was instead a decline of 0.4 per cent. Early in 2021, sentiment indicators improved more markedly than hard data. This applies, above all, to purchasing managers' indices, which are now at or near historic peaks in both the manufacturing and service sectors. Despite this optimism, we are unlikely to see a clear recovery in the second quarter. The upturn in Swedish manufacturing will continue, among other things due to strong demand from the US and China, but household consumption will continue to be held back by the remaining restrictions. Despite strong retail sales, total consumption has been largely flat since August. Most indications are that we are now facing another lost quarter in such sectors as tourism, cultural services and sporting events. Once the economy can be reopened on a broader front, there is potential for a strong recovery in consumption, since households have increased their savings during the COVID-19 crisis. In addition, underlying strong government finances provide greater scope for new fiscal stimulus measures in the future. Despite extended restrictions, due to the unexpectedly strong start to the year we have adjusted our 2021 GDP growth forecast to 3.5 per cent, from the earlier 2.8 per cent. We have adjusted our forecast for 2022 downward from 4.8 to 4.4 per cent, read more here.

Sweden: Retail sales stronger than total consumption

Index, December 2019 = 100



Source: Statistics Sweden (SCB), Macrobond, SEB

Wide divergences in recovery pace of EM economies

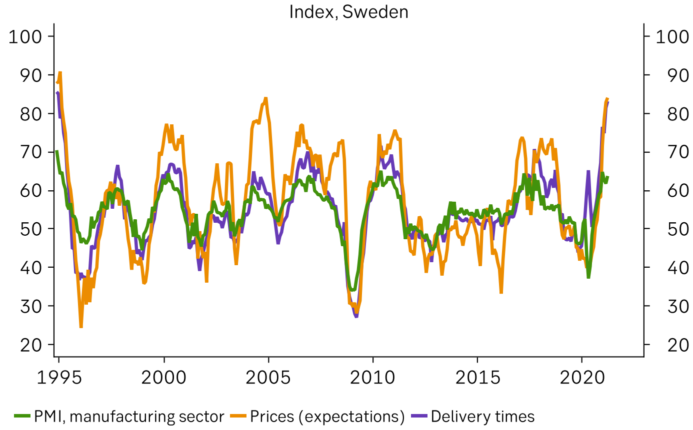
The effects of the pandemic on emerging market (EM) economies are showing wide variations. But despite continued serious COVID-19 transmission in many countries, our forecast for the EM sphere as a whole has remained largely unchanged since February's *Nordic Outlook*. We expect GDP growth to exceed 6 per cent in 2021. This would be the fastest in more than a decade – which is not so surprising given last year's record-sized GDP decline. Because the pace of ongoing vaccinations varies, the recovery will be even less synchronised than the spring 2020 slowdown. Since China has made it through the pandemic in such a good way, it will also provide support for other economies in Asia. The recovery will be more protracted and weaker in the economies of Latin America and Africa, partly due to poorer governance. The preconditions for vaccination roll-outs also differ markedly from advanced economies. Because of resource constraints, health care systems are under significantly greater strain, but those countries with younger populations enjoy an advantage. The World Health Organisation has emphasised the risk of far-reaching virus mutations if the vaccination process takes too long in poorer countries. This, in turn, poses risks to the whole world – putting extra pressure on rich countries to share vaccines. If the US achieves its ambition of offering vaccinations to all adults by the end of April, we believe the country will be both highly able and willing to help poorer countries, especially in its vicinity. Other factors also contribute to divergence among the EM economies. Over the past year, rising commodity prices have benefited a number of these economies, for example through rising investments. Meanwhile, EM economies that depend heavily on tourism and spending by travellers from China and advanced economies are under pressure, read more here.

Sizeable upside – as well as downside – risks

The above analysis has focused on slightly narrow questions about how economic forecasts have been affected by the conflicting forces that have characterised early 2021. There are, of course, other important aspects associated with this. As for the risk picture, we cannot rule out that medical experts will still have difficulty predicting the course of the pandemic. For example, we cannot eliminate the possibility that COVID-19 mutations and other complications will delay normalisation, leading to a situation where restrictions remain in effect for so long that it will seem doubtful that normalisation will ever materialise. This will not necessarily have such dramatic effects on the general level of activity, given the adaptability to pandemic conditions we have witnessed. But it might have major consequences for vulnerable industries and thus also create stress in the financial system. There are also significant upside risks if restrictions were eased at the pace that most people are now expecting. Household consumption behaviour may be the most crucial factor. Savings are now very high in most countries, since fiscal stimulus has helped in varying degrees to maintain income while large areas of consumption have been blocked. There is thus room for a major consumption boom when opportunities have broadened.

Rising prices and delivery problems are driving PMI

Index, Sweden



Source: Swedbank, Macrobond, SEB

Inflation threats in various time perspectives

The inflation issue has become increasingly crucial to financial markets. In our next *Nordic Outlook*, to be published in early May, inflation risks will be a major theme. In the short term, we are now seeing inflationary impulses from rising commodity prices and problems on the supply side of the economy, for example when it comes to transport. Sector-specific bottlenecks are likely to become even more important for a while, once economies have reopened. The above chart illustrates some of the various challenges that economists are discussing now. Manufacturing sentiment indicators are close to historical highs in many countries, partly due to underlying strengths such as order bookings. But the overall index is also driven by high price expectations and long delivery times. High levels for these PMI sub-components should normally reflect strong demand, but if it is instead supply problems, such as disruptions in value chains – for example a semiconductor shortage– we understand why it may be tricky to rely on historical correlations between sentiment data and actual production figures.

New conditions for economic policymakers

Central banks do not seem especially worried about the kind of inflationary impulses we are now seeing. But with upgraded US growth prospects, traditional cyclical inflationary forces are also becoming interesting to analyse. Our new forecast implies that full-year 2022 GDP will be 7 per cent above the 2019 pre-crisis level, which is actually a bit above the previous growth trend. Although we do not believe this will necessarily lead to any serious inflationary pressures, economic policy conditions may change faster than expected. This week's Reflections, *"New challenges for fiscal policymakers"*, discusses the various phases as COVID-19 crisis policies transition to recovery policies and are eventually phased out at a suitable pace (exit policies). The conversation about new conditions for interaction between fiscal and monetary policymakers will also become increasingly intense as the situation normalises, read more here.