Swedbank

Swedbank Economic Outlook

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Swedbank Economic Outlook

Swedbank Economic Outlook presents the latest economic forecasts for Sweden, the Nordic and Baltic countries and the major global economies. In this update, current issues that have a bearing on economic developments are analysed.

Swedbank Economic Outlook is a product made by Swedbank Macro Research.

Anna Breman
anna.breman@swedbank.se
Global Head of Macro Research/
Group Chief Economist
+46 70 314 95 87

Sweden

Andreas Wallström
andreas.wallström@swedbank.se
Head of Forecasting/
Deputy Head of Macro Research Sweden
+46 8 700 9307

Oscar Andersson
oscar.andersson@swedbank.se
Junior Economist
+46 8 700 92 85

Cathrine Danin
cathrine.danin@swedbank.se
Senior Economist
+46 8 700 92 97

Jana Eklund
jana.eklund@swedbank.se
Senior Econometrician
+46 8 5859 46 04

Josefin Fransson
josefin.fransson@swedbank.se
Assistant
+46 8 5859 03 05

Åke Gustafsson
ake.gustafsson@swedbank.se
Senior Economist
+46 8 700 91 45

Knut Hallberg
knut.hallberg@swedbank.se
Senior Economist
+46 8 700 93 17

Alexandra Igel
alexandra.igel@swedbank.se
Economist
+46 8 700 93 03

Matilda Kilström
matilda.kilstrom@swedbank.se
Senior Economist
+46 8 700 93 04

Estonia

Tõnu Mertsina
tonu.mertsina@swedbank.ee
Chief Economist Estonia
+372 888 75 89

Liis Elmik
liis.elmik@swedbank.ee
Senior Economist
+372 888 72 06

Marianna Rõbinskaja
marianna.robinskaja@swedbank.ee
Economist
+372 888 79 25

Latvia

Agnese Buceniece
agnese.buceniece@swedbank.lv
Acting Chief Economist Latvia
+371 6744 58 75

Linda Vildava
linda.vildava@swedbank.lv
Economist
+371 6744 42 13

Lithuania

Nerijus Mačiulis
nerijus.maciulis@swedbank.lt
Deputy Group Chief Economist/
Chief Economist Lithuania
+370 5258 22 37

Greta Ilekytė
greta.ilekyte@swedbank.lt
Ekonomist
+370 5258 22 75

Vytenis Šimkus
vytenis.simkus@swedbank.lt
Senior Economist
+370 6945 71 95

Norway

Kjetil Martinsen
kjetil.martinsen@swedbank.no
Acting Head of Macro Research Norway
+47 92 44 72 09

Marlene Skjellet Granerud
marlene.granerud@swedbank.no
Economist
+47 94 30 53 32

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Lower for longer

The global economic outlook remains muddy. The year has started with rising equity prices and falling interest rates. The drop in rates can be explained by lower growth prospects and dovish signals from central banks. The low rates seem to be here to stay.

Lower interest rates

Global trade stagnated in the last year and there is still a great deal of uncertainty surrounding the economy. Manufacturing indicators in Europe and the US gradually weakened in 2018 and have continued to falter at the start of this year. At the same time, other parts of the economies, such as the service sectors, are developing fairly well. Also, labour markets remain strong in most advanced countries.

Our main scenario in this forecast revision is that global growth will decline this year. Compared with the January forecast, GDP growth is adjusted slightly lower for the US and euro area, while emerging markets are mostly unchanged. For our neighbours, the Nordic and Baltic regions, growth is generally revised a bit higher for 2019 and is essentially unchanged next year.

Our interest rate projection has been revised down from the January forecast. The new forecast is that several central banks, including the Riksbank, will proceed much more cautiously with rate hikes, while, in the US, the Federal Reserve (Fed) has hit a ceiling. Yet, we stay somewhat hawkish compared with current market pricing, which suggests policy rate cuts from the Fed. Presumably, a lot of recession fear is currently discounted in markets, and, although acknowledging the recession risks, in our baseline we do not expect the U.S, the euro area, or China to enter a recession.

Both long- and short-term rates are expected to stay low for a while despite decent global economic development. Lower interest rates are a symptom of the deteriorating growth outlook, but can also depend on more structural, long-term, forces.[1/] In addition, central banks seem destined to support the economies. The more soft signals from the Fed and the ECB have dampened growth worries and boosted equity prices at the start of this year.

Swedbank's global GDP forecast

Annual % change	2018	2019F		2020F	
USA	2.9	2.1	(2.4)	1.7	(1.5)
Euro Area (calendar adjusted)	1.8	1.2	(1.3)	1.3	(1.3)
Germany	1.5	0.8	(1.2)	1.3	(1.3)
France	1.5	1.2	(1.2)	1.3	(1.3)
Italy	0.9	0.2	(0.5)	0.7	(0.7)
Spain	2.5	2.2	(2.1)	1.8	(1.8)
Finland	2.3	1.9	(1.9)	1.8	(1.8)
United Kingdom	1.4	1.1	(1.4)	1.5	(1.5)
Sweden	2.3	1.4	(1.3)	1.7	(1.8)
Denmark	1.0	1.8	(2.0)	1.5	(1.7)
Norway	2.5	2.6	(2.5)	1.6	(1.5)
China	6.6	6.1	(6.1)	5.9	(5.8)
India	7.4	7.4	(7.3)	7.3	(7.4)
Brazil	1.1	2.0	(2.3)	2.5	(2.5)
Russia	2.3	1.5	(1.5)	1.8	(1.8)
Global GDP (IMF PPP weights)	**3.6**	**3.2**	**(3.5)**	**3.5**	**(3.4)**

Previous forecast in parenthesis

Sources: IMF and Swedbank Research

[1/] See e.g. our Macro focus: Longer lives- lower yields

US growth moderates and Fed is in for a long pause

The US growth rate is expected to fall to 2.1% in 2019 and 1.7% in 2020. Modestly lower growth is natural since the US economy is entering a more mature stage. In addition, the stimulus from the big tax cuts in earlier years has faded. The labour market remains strong, however, with unemployment below 4% and jobless claims at the lowest level ever measured. The employment rate, i.e., the number of employed as a share of the population, in the age group 25–54 has now risen to nearly 80%, just as high as in 2006–2007. Wages have gradually climbed and are expected to continue a bit higher, while inflation is nearing the target of 2%.

Despite the favourable conditions in the economy, expectations of further rate hikes by the Fed have been dialled back. At the time of writing, futures contracts suggest that the Fed will cut rates, perhaps as soon as this year and once more next year. One reason is the growing fear of a recession. The US yield curve has inverted, i.e., the yield on the three-month treasury bill exceeds that of the ten-year bond; this has historically been a reliable indicator that a recession is close at hand. The most important reason for the reversal in market pricing is, however, that the Fed is now clearly signalling a long policy pause.

Our view is that the US economy will avoid a severe slump and that the Fed, therefore, won't have any reason to cut rates in the forecast period. On the other hand, we expect the Fed to stop reducing its balance sheet later this year and begin fully reinvesting the proceeds of its maturing bond holdings.

The trade conflict between the US and China persists

The trade conflict continues to affect global trade flows, especially between China and the US. There are incentives on both sides to reach an agreement in the coming months, however. In China, the economic slowdown has accelerated. In the US, the campaign leading up to next year's presidential election begins this fall. As it stands, many of the Chinese tariffs against the US are concentrated in sectors and geographic areas in the US that are important constituencies for the Republicans and President Trump. This puts pressure on Trump to find a solution before the campaign heats up, and our view is that an agreement will be signed by midyear.

A possible escalation of US tariffs on Chinese goods remains a threat, since the US wants to make sure that China lives up to the terms of an eventual agreement. At this point, an appropriate verification process remains to be negotiated as well as the lifting of US tariffs – the latter which China wants done immediately.

China has already made concessions in the form of lower tariffs on US goods, and further promises of increased imports from the US are expected in the agreement; this will also promise a more stable renminbi and measures to improve access to the Chinese market for foreign companies. Measures are also expected in the areas of intellectual property rights and preferential treatment of China's state-owned enterprises.

Regardless of when an agreement is signed, and what exactly it contains, more bilateral talks are expected on other geopolitical dimensions. In addition, the report on US auto imports and national security ordered by President Trump was completed in February, and a decision on import tariffs is expected before May. Any measures introduced subsequently would have significant consequences for European and Swedish automakers, and at this point the situation remains a risk. Our main scenario, however, assumes this outcome will not materialise.

Euro area – the puzzle pieces that hold it together

The slowdown in global manufacturing has also affected growth in the euro area. But development differs greatly among countries and sectors. Germany has surprised on the downside, and significantly weaker development is now expected for 2019. The forecast for Italy, despite already low expectations, has been adjusted sharply downwards, and the economy is expected to stagnate this year. The French economy keeps chugging along, although concerns related to the Yellow Vest protests have temporarily slowed development. Spain is expected to drive the euro area in 2019 with GDP growth of over 2%. Taken together, euro area growth is estimated at 1.2% this year and 1.3% in 2020.

We still see several reasons for economic conditions in the euro area to remain fairly favourable. First, the ECB is expected to support the economy by maintaining an expansionary monetary policy. We expect the ECB to leave the refi rate unchanged in 2019 and 2020, though lifting the deposit rate from -0.40% to -0.25% in September next year. Also, the ECB will maintain major presence/repurchases in the bond market. The ECB has also announced that it intends to offer loans to banks at favourable rates for a "longer term" (TLTRO). Given this, rates should remain very low in the forecast period.

Second, we expect fiscal policy to be more expansionary in several countries. The OECD and IMF have encouraged countries with sufficient fiscal space to take advantage of the situation and invest in their production capabilities for the long haul. Third, a resilient labour market is expected to lead to further wage growth, supporting household income and spending.

Europe still faces political risks that could jeopardise economic development. In the UK, the Brexit logjam is dragging on and the outcome remains in doubt. The likelihood that the UK will leave without an agreement remains; such an outcome would weigh on the entire European economy. We expect an EU exit to be further delayed, causing uncertainty for the rest of 2019, and that there will eventually be a soft landing- a transition period with about the same relations holding between the UK and the EU in 2020.

We don't expect the upcoming EU parliamentary election to be that big a risk for the European economy in the near term. Even if support for populist parties rises, it is hard to see that these parties will come to agreement and exert much influence. In addition, the EU Parliament's influence on the European economy is very limited. The EU budget for 2019 amounts to nearly 1% of GDP, which is much lower than the budgets in the individual countries. In Sweden, the central government budget is around 20% of GDP. Indirectly, increased support for populist parties could, however, pressure national governments to implement a more expansionary fiscal policy.

Slightly brighter outlook for emerging markets in 2019

In the larger emerging market economies, the growth outlook remains divergent. In the Chinese economy, small signs that the fiscal and monetary stimulus have begun to take effect, have emerged. Households remain cautious, however, and there is a risk that consumption will continue to slow growth this year. Infrastructure spending is lifting investment, but there is a risk that investments in general will still be dampened by weaker investments in housing and manufacturing. Manufacturing profits are being squeezed by the trade conflict, and lower producer prices indicate a risk of deflation this year. This deflation risk will be important, since the debt build-up in the Chinese economy remains significant. In general, China's slowdown is expected to continue at a reasonable pace, but the risks remain high on the downside.

In India the election is underway, and the economic outlook is largely dependent on how much support the current government receives. The level of support is still uncertain even though Prime Minister Narendra Modi has recently regained support in the polls. Confidence in Brazil's new president, Jair Bolsonaro, seems to have already begun to fade; this could hamper growth in the short term as investors retreat and the labour market stays sluggish. The Russian economy is expected to perform decently in 2019 and 2020, given the higher oil price and the strong public finances. We expect Russian GDP to grow at 1.5–2.0% per year during 2019 and 2020.

Sweden

So far, the Swedish economy has remained resilient in the face of the slowdown in global trade and lower growth in several EU countries, especially Germany. Exports and industrial production have continued to rise. Total export volume is up 26% in the last five years and has now reached record levels.

On the other hand, the development of domestic demand (household consumption and housing investment) has been weak over the last year. The decline in housing investment, which will continue this year, should be seen against the backdrop of the high investment levels in the period 2014–2017 and subsequent price drop in the fall of 2017, especially for new housing. We expect the stable price development seen during the last year to continue and investment to gradually rise again later during 2020. Underlying housing demand is still high.

The uncertainty surrounding the housing market may also be a reason for lower consumer spending. We expect a slight recovery of household spending in the forecast period, however. Households benefit from a stable labour market, rising wages, and mortgage rates remaining low. Some households also benefit financially from income tax cuts this year. Next year, a special tax on high-income earners (värnskatten) is expected to be eliminated and the tax on pensioners to be further reduced as well.

Despite the tax cuts and slightly slower economic development, public debt is expected to fall this year and stay low next year. We think it would be appropriate to allow for a more expansionary fiscal policy in order to invest and better prepare Sweden for the future. This recommendation is motivated from a long-term structural standpoint rather than for the sake of stabilisation or for business cycle needs.

Inflation outcomes at the start of 2019 were surprisingly low and because of this the inflation path for all of 2019 has been adjusted downwards slightly compared to the January forecast. We still think that underlying inflation will gradually rise going forward, however. The Riksbank is expected to raise its benchmark rate to 0.0% in September and then stay on hold throughout next year.

Nordic and Baltic regions resist global slowdown

In Norway, growth is rising again, as domestic demand is strong and oil investments are boosting growth this year. The housing market has recovered, and Norges Bank has begun raising rates and signals continued gradual rate hikes. The growth rate in both Denmark and Finland is expected to reach around 2% in the coming years. Households are benefitting from the strong labour market; meanwhile, companies are investing more as the business cycle is maturing and interest rates remain low.

So far, the Baltic countries have also been resilient in the face of the global manufacturing slowdown. Growth projections are down slightly for 2019 and 2020, but not as much as we had expected at the beginning of this year. Household income and domestic demand remain strong. Labour shortage is still one of the main stumbling blocks for manufacturers and if rapid labour cost growth continues there is a risk of weakening external competitiveness.

Interest rates and currencies

The fixed-income markets are still wrestling with uncertainty due to political developments and mixed economic signals. In addition, the markets are affected by recent monetary policy signals, as leading central banks are adopting an increasingly cautious approach. We expect the US Fed funds rate and the ECB refi rate to stay unchanged for the entire forecast period. The ECB is, however, expected to lift the deposit rate from -0.40% to -0.25% in September 2020.

Looking ahead, we see the Riksbank raising the repo rate this fall, but, due to the cautiousness of other central banks, the Riksbank will then stay on hold throughout 2020. The euro will strengthen against the dollar in the medium term as the ECB takes its first cautious steps towards a slightly less accommodative monetary policy, but this strengthening is expected to proceed slowly.

The Swedish and Norwegian currencies are both expected to strengthen against the euro, with Norges Bank and the Riksbank raising rates ahead of the ECB. A dovish international monetary policy, coupled with political uncertainty and restrained global growth, has us expecting very little movement in bond yields. At the same time, we stress that the genuine uncertainty and unpredictability looming over the political arena may lead to significant temporary swings in the fixed-income and FX markets.

Appendices

Interest and exchange rate forecasts

	Outcome 2019 9 APR	Forecast 2019 30 JUN	2019 31 DEC	2020 30 JUN	2020 31 DEC
Policy rates (%)					
Federal Reserve, USA (upper bound)	2.50	2.50	2.50	2.50	2.50
European Central Bank (refi rate)	0.00	0.00	0.00	0.00	0.00
Bank of England	0.75	0.75	0.75	0.75	1.00
Riksbank	-0.25	-0.25	0.00	0.00	0.00
Norges Bank	1.00	1.25	1.50	1.50	1.50
Government bond rates (%)					
Sweden 2y	-0.48	-0.45	-0.20	-0.10	0.10
Sweden 5y	-0.22	-0.20	-0.05	0.05	0.25
Sweden 10y	0.40	0.40	0.45	0.45	0.50
Germany 2y	-0.57	-0.55	-0.50	-0.35	-0.15
Germany 5y	-0.44	-0.40	-0.20	-0.10	0.05
Germany 10y	0.01	0.00	0.10	0.10	0.20
US 2y	2.36	2.25	2.30	2.45	2.50
US 5y	2.33	2.25	2.35	2.50	2.55
US 10y	2.52	2.40	2.30	2.35	2.45
Exchange rates					
EUR/USD	1.13	1.13	1.14	1.14	1.15
EUR/GBP	0.86	0.86	0.86	0.84	0.85
EUR/SEK	10.42	10.25	10.10	10.00	9.90
EUR/NOK	9.62	9.67	9.71	9.62	9.57
KIX (Trade weighted SEK)	120.7	118.9	117.1	116.3	115.0
NOK/SEK	1.08	1.06	1.04	1.04	1.04
USD/SEK	9.25	9.05	8.85	8.80	8.60
USD/CNY	6.71	6.80	6.85	6.85	6.80
USD/JPY	111.34	112.00	112.00	111.00	110.00
USD/RUB	64.73	65.00	64.00	63.00	61.70

Sources: Swedbank Research & Macrobond

SWEDEN: Key economic indicators, 2018-2020

Annual % change unless stated otherwise	2018	2019F		2020F	
Real GDP (calendar adjusted)	2.4	1.4	(1.3)	1.5	(1.5)
Real GDP	2.3	1.4	(1.3)	1.7	(1.8)
Household consumption	1.2	1.7	(1.5)	2.0	(1.8)
Government consumption	0.9	0.8	(1.1)	1.1	(1.7)
Gross fixed capital formation	3.3	-0.2	(-0.3)	1.0	(1.1)
Change in inventories, contribution to GDP growth	0.4	-0.3	(0.0)	0.0	(0.0)
Exports of goods and services	3.5	3.6	(3.0)	3.3	(3.3)
Imports of goods and services	2.9	2.0	(2.5)	2.9	(3.1)
CPI (average)	2.0	1.6	(2.0)	2.2	(2.7)
CPI (dec-dec)	2.0	1.8	(2.2)	2.3	(2.9)
CPIF (CPI with fixed mortgage rate, average)	2.1	1.5	(1.9)	1.9	(2.1)
CPIF (CPI with fixed mortgage rate, dec-dec)	2.2	1.4	(1.7)	2.0	(2.2)
Riksbank policy rate (dec)	-0.25	0.00	(0.00)	0.00	(0.50)
Unemployment (% of labour force, 15-74)	6.3	6.2	(6.2)	6.2	(6.3)
Labour force (15-74)	1.4	1.2	(1.1)	0.7	(0.7)
Employment (15-74)	1.8	1.3	(1.2)	0.7	(0.6)
Number of hours worked (calendar adjusted)	2.4	1.1	(1.1)	0.5	(0.6)
Nominal hourly wage (NMO), whole economy	2.6	2.8	(2.8)	3.1	(3.2)
Household real disposable income	1.7	3.2	(3.2)	1.4	(1.4)
Household nominal disposable income	4.2	4.7	(4.7)	3.8	(3.8)
Household savings ratio, % of disposable income	16.2	17.4	(17.6)	17.1	(17.3)
General government budget balance, % of GDP	0.9	0.1	(0.3)	-0.1	(0.3)
General government debt (Maastricht), % of GDP	38.8	34.6	(34.7)	34.8	(34.3)

Previous forecast in parenthesis

Source: Statistics Sweden and Swedbank Research

ESTONIA: Key economic indicators, 2018-2020

Annual % change unless stated otherwise	2018	2019F		2020F	
Real GDP	3.9	3.0	(3.0)	2.7	(2.7)
Household consumption	4.7	3.8	(3.7)	3.2	(3.3)
Goverment consumption	0.3	1.5	(2.0)	1.5	(2.0)
Gross fixed capital formation	3.3	5.0	(6.0)	4.0	(4.5)
Exports of goods and services	4.3	3.0	(3.0)	3.0	(2.5)
Imports of goods and services	6.1	4.0	(4.0)	3.5	(3.0)
CPI (average)	3.4	2.4	(2.9)	2.4	(2.4)
Unemployment (% of labour force)	5.4	5.1	(5.1)	5.3	(5.3)
Employment	0.9	0.4	(0.6)	0.0	(0.0)
Gross monthly wage	7.3	6.7	(6.3)	5.8	(5.5)
Nominal GDP, billion euro	25.6	27.3	(27.4)	29.0	(29.0)
Exports of goods and services (nominal)	6.8	5.2	(5.4)	5.1	(4.5)
Imports of goods and services (nominal)	8.2	6.2	(6.4)	5.5	(5.0)
Balance of goods and services, % of GDP	3.4	2.7	(3.5)	2.4	(3.1)
Current account balance, % of GDP	1.7	1.1	(1.8)	0.7	(1.3)
Current and capital account balance, % of GDP	2.9	2.2	(2.7)	1.9	(2.2)
FDI inflow, % of GDP	3.4	3.3	(3.3)	3.3	(3.3)
General government budget balance, % of GDP	-0.5	-0.1	(0.4)	0.2	(0.2)
General government debt (Maastricht), % of GDP	7.9	8.1	(7.3)	7.8	(6.6)

Previous forecast in parenthesis

Sources: Statistics Estonia and Swedbank Research

LATVIA: Key economic indicators, 2018-2020

Annual % change unless stated otherwise	2018	2019F		2020F	
Real GDP	4.8	3.3	(3.0)	2.5	(2.5)
Household consumption	4.5	4.0	(4.6)	3.2	(3.2)
Goverment consumption	4.0	2.8	(2.8)	2.8	(2.8)
Gross fixed capital formation	16.4	8.0	(7.0)	5.0	(5.5)
Exports of goods and services	1.8	2.0	(2.8)	2.0	(3.2)
Imports of goods and services	5.1	3.7	(4.5)	2.7	(3.8)
CPI (average)	2.5	2.5	(2.5)	2.3	(2.3)
Unemployment (% of labour force)	7.4	6.7	(6.7)	6.6	(6.6)
Employment	1.6	0.4	(0.6)	-0.8	(-0.8)
Gross monthly wage	8.4	7.0	(7.0)	5.5	(5.5)
Nominal GDP, billion euro	29.5	31.4	(31.3)	33.2	(33.1)
Exports of goods and services (nominal)	5.2	4.0	(4.9)	4.0	(5.3)
Imports of goods and services (nominal)	6.5	4.7	(5.5)	3.9	(5.1)
Balance of goods and services, % of GDP	-0.6	-1.0	(-1.1)	-0.9	(-1.0)
Current account balance, % of GDP	-1.0	-0.7	(-0.6)	-0.7	(-0.5)
Current and capital account balance, % of GDP	0.8	1.0	(1.1)	1.1	(1.3)
FDI inflow, % of GDP	2.5	2.4	(.)	2.3	(.)
General government budget balance, % of GDP	-0.7	-0.5	(-0.8)	-0.4	(-0.6)
General government debt (Maastricht), % of GDP	38.1	37.2	(37.1)	37.9	(37.8)

Previous forecast in parenthesis
Note: FDI previous forecast unavailable due to change in methodology
Sources: Statistics Latvia and Swedbank Research

LITHUANIA: Key economic indicators, 2018-2020

Annual % change unless stated otherwise	2018	2019F		2020F	
Real GDP	3.4	3.0	(2.7)	2.0	(2.0)
Household consumption	3.9	4.2	(4.0)	3.0	(3.0)
Goverment consumption	0.6	0.5	(0.5)	1.0	(1.0)
Gross fixed capital formation	6.5	7.0	(7.0)	5.0	(5.0)
Exports of goods and services	4.9	3.5	(3.0)	2.0	(2.0)
Imports of goods and services	4.3	4.5	(4.0)	3.0	(3.0)
CPI (average)	2.7	2.5	(2.7)	2.5	(2.5)
Unemployment (% of labour force)	6.2	6.2	(6.2)	6.3	(6.3)
Employment	0.7	0.4	(0.4)	0.0	(0.0)
Gross monthly wage	9.7	8.5	(8.0)	5.0	(5.0)
Nominal GDP, billion euro	45.1	47.7	(47.5)	49.8	(49.7)
Exports of goods and services (nominal)	9.3	5.0	(5.0)	3.0	(3.0)
Imports of goods and services (nominal)	9.0	6.5	(6.5)	4.0	(4.0)
Balance of goods and services, % of GDP	3.1	1.9	(1.7)	1.1	(0.9)
Current account balance, % of GDP	1.6	0.4	(0.2)	-0.3	(-0.5)
Current and capital account balance, % of GDP	3.1	1.9	(1.7)	1.1	(0.9)
FDI inflow, % of GDP	1.6	2.0	(2.0)	2.0	(2.0)
General government budget balance, % of GDP	0.7	0.3	(0.3)	0.1	(0.1)
General government debt (Maastricht), % of GDP	34.2	37.5	(37.5)	37.2	(37.2)

Previous forecast in parenthesis
Sources: Statistics Lithuania and Swedbank Research

Swedbank Research's disclaimer

What our research is based on
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Address
Swedbank LC&I, Swedbank AB (publ), SE-105 34 Stockholm.
Visiting address: Malmskillnadsgatan 23, 111 57 Stockholm

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