



Stability and Sustainability Indicators Report

2023 Q1

Baltic and Swedish economies in doldrums



Sweden

Economic growth has weakened

- The economy showed more resilience than expected in the first quarter, although a substantial positive contribution also came from changes in inventories. But business investments, other than housing investments, and goods exports contributed as well. Household consumption has continued to weaken. However, the labour market has remained strong, with signs of an increase of labour hoarding.
- Due to too-high inflation, the Riksbank continued hiking the policy rate, by 50 basis points (bps), in April. We expect additional hikes of 25+25 bps in June and September. Rising mortgage rates and a cost-of-living shock have led to a 14% decline in housing prices since February 2022. We believe the overall price drop will accumulate to around 20% by end-2023.



Baltics

Insufficient demand and falling inflation

- Both Estonia and Lithuania are already in recession, while Latvia, after a short recession in mid-2022, has lately posted growth. Both manufacturing output and retail trade were falling at the start of this year. Real wages have already started growing in Lithuania and soon will grow in other Baltics as well – this will boost confidence and domestic consumption, but exports of goods are likely to remain weak throughout this year.
- Inflation has retreated from its peaks and is likely to continue falling – we forecast it to drop to close to 3% by the end of 2023 (slightly higher in Estonia). Although labour costs are still growing rapidly, weak domestic demand has also limited business's ability to transfer all costs to final consumers. Profit margins widened in most sectors last year and contributed to inflation, but now increasing number of companies report that insufficient demand constrains growth.
- Demand for loans and investments has been relatively resilient so far, but continued geopolitical tensions, the higher cost of capital, and some political decisions (such as an additional tax on banks' interest income in Lithuania) may further weaken foreign and domestic investments in the longer term.



Risks

Even weaker demand, higher unemployment, geopolitical pressures, deglobalisation

- Risks to the economic outlook are still tilted downwards. Energy prices have declined faster than expected, but supply shocks cannot be ruled out. However, new risk has emerged – the rapid increase in interest rates is creating stress for many leveraged households and companies. The full effect of tighter monetary policy is yet to be felt, banks across the euro area are tightening credit standards, and the credit impulse is already negative. Even if large credit events are avoided, shrinking loan portfolios could further dampen demand. Unemployment has remained very low, but prolonged contraction in exports and more negative sentiment could lead to more layoffs; this, in turn, could spill over into more negative effects in real estate markets. In Sweden, high indebtedness in households poses an additional risk for consumption, employment, and growth.
- The geopolitical risks are not easing. The end of the war in Ukraine is not in sight, and further tensions and sanctions are likely. Tensions between China and Taiwan (and the West) can intensify, further trade restrictions may be imposed, and globalisation is, at best, likely to pause.



Sustainability

Continued improvements are needed

- Governance and social inclusion issues are still most pressing in the Baltics; however, challenges remain also in Sweden. Governance indicators have improved, but the Baltic countries, especially Lithuania and Latvia, need a lot more progress towards these sustainable development goals. Higher minimum wages and other government support measures helped to mitigate inflationary shock; thus, social inclusion improved somewhat in most countries. The Baltic countries are catching up with respect to environmental protection goals, but Lithuania is lagging and needs to step up its game.

Authors:

Nerijus Mačiulis, nerijus.maciulis@swedbank.lt
Emma Paulsson, emma.paulsson@swedbank.se
Jana Eklund, jana.eklund@swedbank.se
Liis Elmik, liis.elmik@swedbank.ee

Līva Zorgenfreija, liva.zorgenfreija@swedbank.lv
Maria Wallin Fredholm, maria.wallin-fredholm@swedbank.se
Marianna Rōbinskaja, marianna.robinskaja@swedbank.ee
Vytenis Šimkus, vytenis.simkus@swedbank.lt

Early warning indicators (Q1 data unless stated otherwise)

Macro	Estonia	Latvia	Lithuania	Sweden
1. GDP, y/y %	-3.2	0.8	-2.5	0.8
2. Inflation, y/y % (May)	11.3	12.1	11.7	6.7
3. Unemployment rate, % (3yama)	6.2	7.4	7.2	8.3
4. Housing affordability index	↓ 104.0	154.0	99.7	81.0
5. Deflated apartment prices in capitals	↓ -7.0	-14.1	↓ -4.7	-22.2
6. Household lending and GDP growth diff., pp	0.6	↑ -6.2	-0.9	0.9
7. Household debt, % of GDP	31.3	14.3	20.2	80.2
8. Corporate lending and GDP growth diff., pp	1.7	-0.8	-0.8	9.1
9. Corporate debt, % of GDP	↓ 24.8	16.2	14.9	49.1
10. Current account, % of GDP (4qma)	-1.7	-6.1	-3.4	4.8
11. Real effective exchange rate, 3-year change %	10.5 *	↓ 8.2 *	11.5 *	-2.7 *
12. Export market share, 5-year change %	4.2 *	16.3 *	8.2 *	-11.8 *
13. Structural budget balance, % of GDP (2022)	↑ -0.2	-4.2	-0.4	0.6
14. Public debt, % of GDP (2022)	18.4	40.8	38.4	33.0
Financial sector	Estonia	Latvia	Lithuania	Sweden
1. Tier 1 capital ratio, %	21.9 **	26.1 **	19.6 **	19.9 **
2. Loan overdues >90 days, % of portfolio	0.2	1.1 *	0.5 *	0.2 *
3. Liquidity coverage ratio (LCR), %	154.0 **	277.0 **	422.0 **	151.0 **
4. Resident loans/deposits ratio, %	101.0	72.0	70.0	142.0 *
5. Non-residents' deposits, % of total portfolio	13.0	14.4	23.1	
6. Return on equity, % (4qma)	5.5 **	4.5 **	6.8 **	5.9 **

* Q4 data

** Q3 data

Note: change of colour to better – ↑, to worse – ↓ vs. previous quarter

Traffic lights signal the degree of concern. Cut-off values for traffic lights are assigned based on existing regulations, research, historical analysis, and expert judgement. Traffic light interpretation: ■ - no problem, ■ - cause for some concern, ■ - increased risk

The macroeconomic and financial stability indicators and their thresholds have been selected based on the work of such organizations as European Commission, IMF, European Systemic Risk Board and others.

Longer-term sustainable economic development (progress towards UN SDGs), % of benchmark*

	Estonia	Latvia	Lithuania	Sweden
E: Environmental protection (SDGs # 6, 7, 11-15)	↗ 76	↗ 76	→ 67	→ 76
S: Social inclusion (SDGs # 1-5, 8, 10)	↗ 71	→ 66	↗ 66	↗ 82
G: Governance (SDGs # 9, 16, 17)	↗ 71	↗ 63	↗ 62	→ 88

Traffic lights: ■ <70 - significant challenges remain, ■ 70-90 challenges remain, ■ >90 green - very close to goal
Trends: ↑ on track, ↗ moderately improving, → stagnating, ↓ deteriorating

* Updated once a year. Based on Sustainable Development Goals' scores and trends provided in Lafortune, G., Fuller, G., Belmont-Diaz, L., Kloke-Lesch, A., Koundouri, P., Riccaboni, A. (2022). Achieving the SDGs: Europe's Compass in a Multipolar World. Europe Sustainable Development Report 2022. SDSN and SDSN Europe. France: Paris.

Estonia

Macroeconomic developments:

Economic situation has deteriorated

- GDP volumes continued to decline in the first quarter of 2023. Recession was widespread, and value added declined in most larger sectors. Retail sales and industrial production remained weak at the start of the second quarter. We expect GDP volumes to stabilise soon and start improving in the second half of 2023.
- Deteriorated purchasing power depressed private consumption, while weak foreign demand hit exports. Investment volumes also fell due to negative sentiment.
- The situation in the labour market is still relatively good. The number of employed remained record high in the first quarter. The registered unemployment rate has increased rather modestly so far. Wage growth is rapid, and real wages have started to recover. Inflation has started to decelerate. We expect inflation to decrease to single digits in the second half of the year.

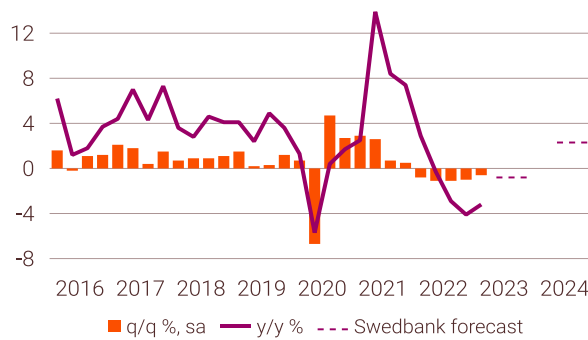
Main macroeconomic risks:

Longer recession

- Weaker demand and strong cost pressures have affected exporters' sales and competitiveness. Layoffs have been limited to some specific sectors so far but could increase if demand does not improve in the second half of this year, as we currently expect.
- The government has lifted public sector wages substantially and pushed business associations and labour unions to agree to a minimum wage increase from around 40% of the average wage this year to 50% of the average wage in 2027. This could add extra fuel to a possible wage-price spiral and dent the export sector's competitiveness.

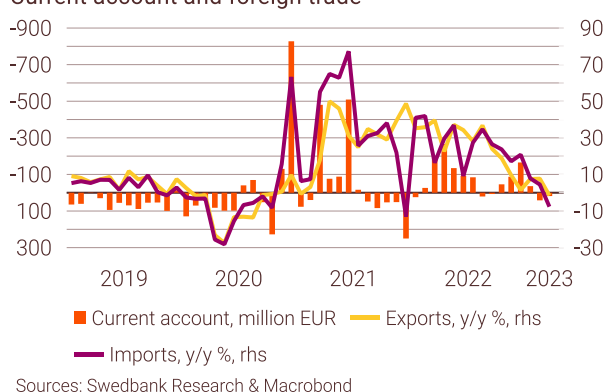
Long but mild recession

GDP, constant prices



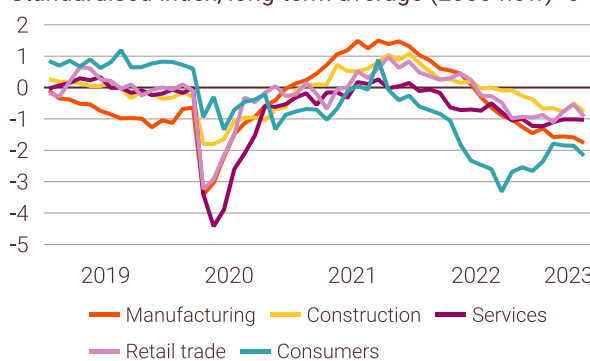
Current account close to balance

Current account and foreign trade



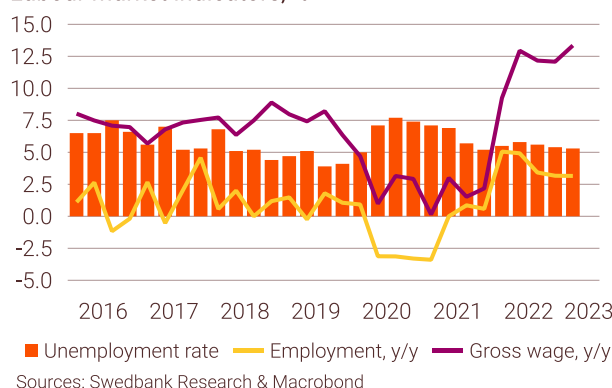
Consumers are still quite downbeat

Standardised index, long-term average (2000-now)=0



Wage growth still rapid

Labour market indicators, %



Financial sector issues:

The banking sector is resilient

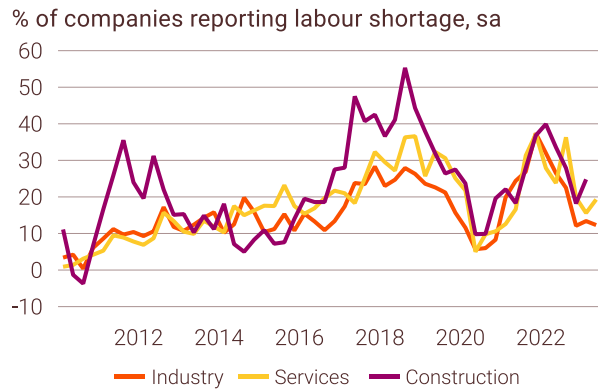
- Demand for loans has decreased somewhat in most sectors due to the weaker economic situation, deteriorated confidence, and higher interest rates. However, the stock of loans and leases to households and companies is still one-tenth above last year’s level. The quality of the loan portfolio of banks remains very good. However, some deterioration in credit quality should be expected.
- Loan margins have narrowed as competition in the market has grown, with smaller banks increasing their market share.
- Demand for dwellings has decreased, and the number of transactions has fallen substantially. House prices have stabilised this year. We expect house prices to decline only modestly as employment is unlikely to drop sharply.

Sustainable development goals:

Work in progress

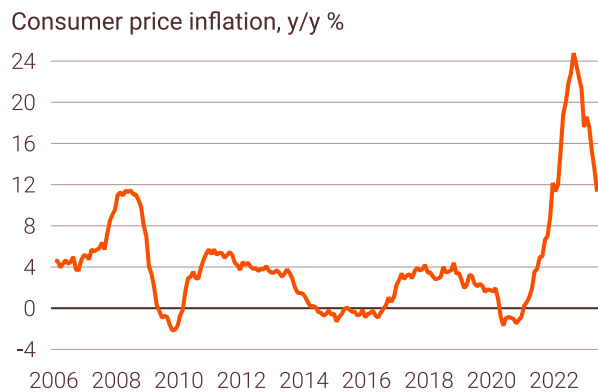
- Estonia will establish a Ministry of Climate by the start of 2024. The new Minister of Climate is already in place. One of his goals is to make transportation greener by introducing emission-based taxes on cars and trucks.
- Surging inflation has worsened the livelihoods of the most vulnerable parts of society. The government has increased the minimum wage, lifted social benefits, and provided energy subsidies to households. However, these measures are costly and, in some cases, not well targeted, and they do not encourage energy saving.

Demand for labour has decreased



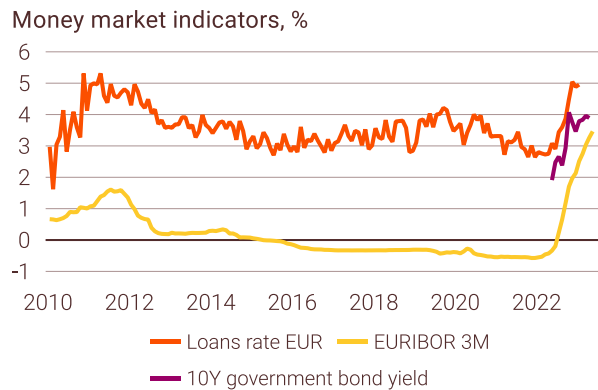
Sources: Swedbank Research & Macrobond

Inflation to decelerate



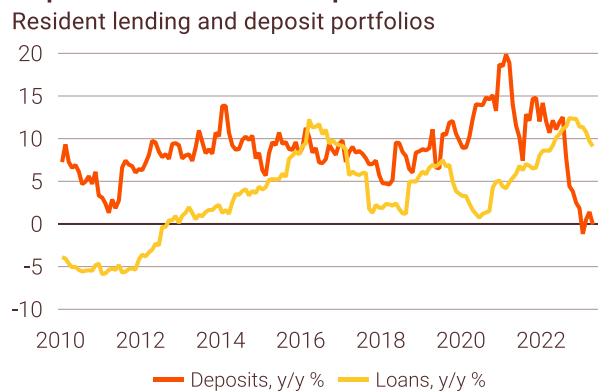
Sources: Swedbank Research & Macrobond

Interest rates on the rise



Sources: Swedbank Research & Macrobond

Deposits cushion the drop in real incomes



Sources: Swedbank Research & Macrobond

Latvia

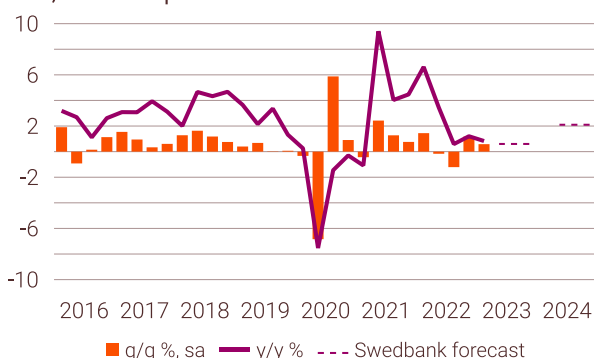
Macroeconomic developments:

Falling inflation, still-resilient economy

- The economy is faring better than expected – the start of the year saw growth. Investment is finally picking up, driven by construction of large projects. Household consumption was down from the very strong fourth quarter but was still up over the year. Net exports contributed negatively. Imports were still rising, while exports declined over the year, driven by a decline in goods exports. We expect GDP to be stagnant this year.
- The labour market remained strong, with the unemployment rate down to 6.4% in the first quarter and the decline continuing in recent months – helped by seasonal jobs. Nominal average wage growth accelerated, boosted by a minimum wage hike, while the real average net wage was down 6.1%. Wage growth will remain rapid, and unemployment is not expected to rise significantly going forward.
- Inflation decelerated to 12.1% in May. Energy-related prices are easing, and even food prices fell slightly in May over the month for the first time in almost two years. Services prices continued heading up, though. By year's end, inflation is expected to decline to about 3% due to retreating external cost pressures.
- Housing market activity declined further in the first quarter amid deteriorating housing affordability. The start of the year saw housing prices in Riga, after peaking in December 2022, fall by 2.7% over the previous quarter. Prices of older and less-energy- efficient apartments have been trending down for longer – since mid- 2022.

GDP growth has surprised on the upside

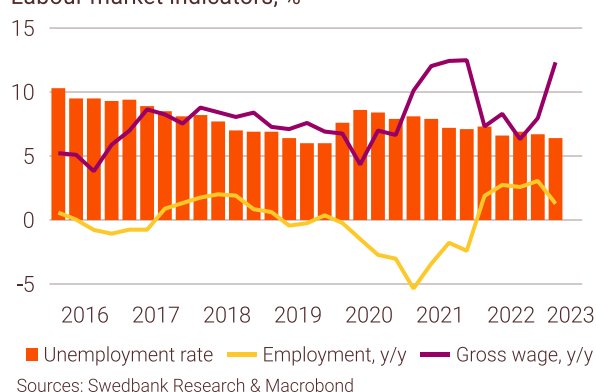
GDP, constant prices



Sources: Swedbank Research & Macrobond

Labour market still tight

Labour market indicators, %



Sources: Swedbank Research & Macrobond

Inflation retreating

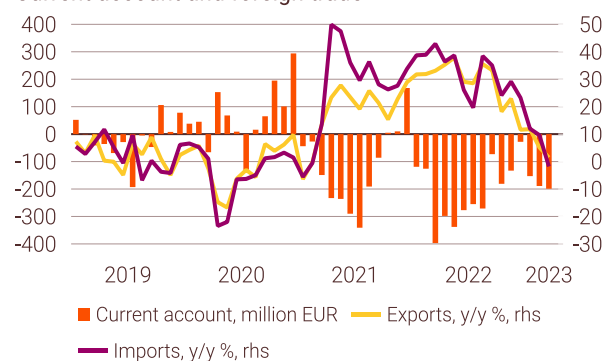
Consumer price inflation, y/y %



Sources: Swedbank Research & Macrobond

Deficit driven by higher services imports

Current account and foreign trade



Sources: Swedbank Research & Macrobond

Main macroeconomic risks:

Worse outlook, change in government

- Worse export market developments and/or a deterioration in external competitiveness due to faster-than-expected wage growth and insufficient investment could produce poorer economic outcomes, including lower GDP and higher unemployment. Rapid wage growth and the ill-timed fixing of costs by some companies could mean stickier inflation. A sharp increase of EU funds' absorption could lead to a capacity constraint in construction. There is a discussion on a potential change in government, which adds to uncertainty.

Financial sector issues:

Lending declines, bank tax discussed

- The banking system is well capitalised, and liquid. Indebtedness levels are low. The number of bankruptcies and the share of nonperforming loans remain low and stable. So far, the financial situation of companies is good, and profit margins – resilient. Lending growth declined amid high interest rates and uncertainty. Household deposit growth slowed materially, while non-financial company deposits accelerated as revenues still benefitted from high inflation.
- Politicians are discussing a bank tax. The central bank stresses the need for banks to raise deposit rates faster, increase credit to the economy in the coming years, and decrease lending rates, which are currently among the highest in the euro area.

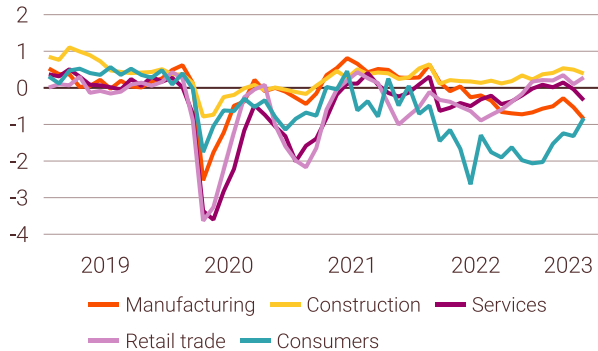
Sustainable development goals:

Inequality and populism

- Inequality of income has been high and stable, and social transfers do a very poor job correcting for it. The lately seen sharp minimum wage growth could be of some help in lowering income inequality, but the COVID-19 and the cost-of-living crises have likely made the matter worse and have proved a fertile ground for populism.

Sentiment seems to have bottomed out

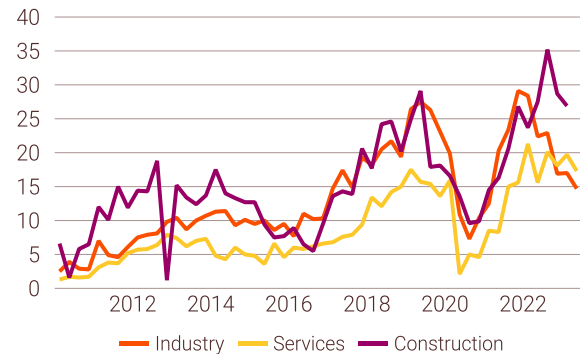
Standardised index, long-term average (2000-now)=0



Sources: Swedbank Research & Macrobond

Labour shortage-somewhat eased, but still high

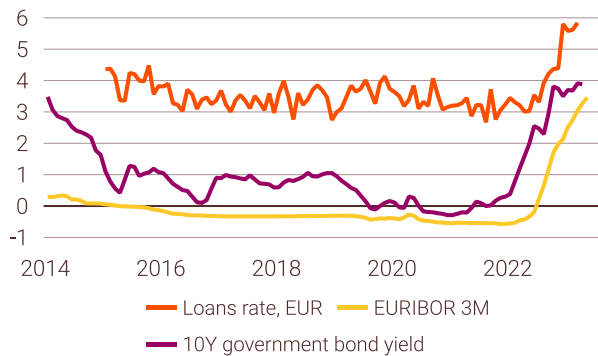
% of companies reporting labour shortage, sa



Sources: Swedbank Research & Macrobond

Interest rates are rising

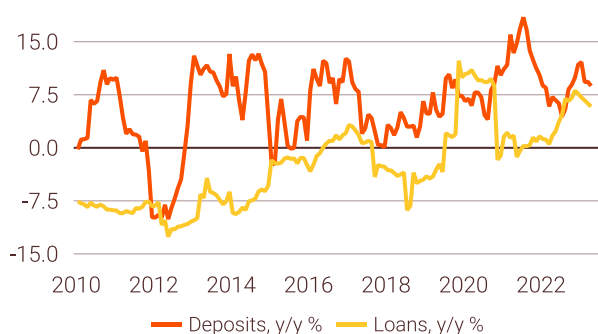
Money market indicators, %



Sources: Swedbank Research & Macrobond

Lending slows amid high rates and uncertainty

Resident lending and deposit portfolios*



*Lending portfolio is adjusted for structural changes in the banking sector
Sources: Swedbank Research & Macrobond

Lithuania

Macroeconomic developments:

Economy is in recession

- The Lithuanian GDP contracted 2.5% annually in the first quarter of the year. Weaker household consumption and a rundown of inventories (a reflection of weaker production) were the primary drivers of contraction; meanwhile, investment remained robust. There are signs that economic activity is stabilising, but recovery will be slow and gradual.
- The labour market is showing some signs of weakness. The unemployment rate rose to 7.7% at the start of the year. Part of this rise reflects an increase in the labour force due to the influx of refugees. However, hiring has slowed, and the increase in unemployment reflects weak demand as well.
- Inflation continued to fall rapidly, declining to 11.7% in May. Deceleration mainly comes from energy, but there is potential for further disinflation from food and other goods. Producer and import prices indicate that inflation will continue falling, although services inflation is expected to be rather sticky.

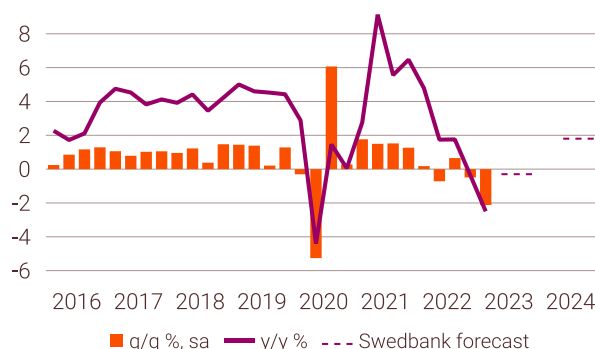
Main macroeconomic risks:

Energy dependence is still a vulnerability

- Higher interest rates and worsening credit conditions across export markets could further dent demand for Lithuanian exports. This could spill over into services and have even more adverse effects on the labour market.
- Energy prices have fallen, but price volatility is still likely going forward. Furthermore, many businesses hedged their risks last year by entering long-term contracts and now cannot reap the benefits of lower market prices – this poses a risk to their cost competitiveness.

GDP continued declining

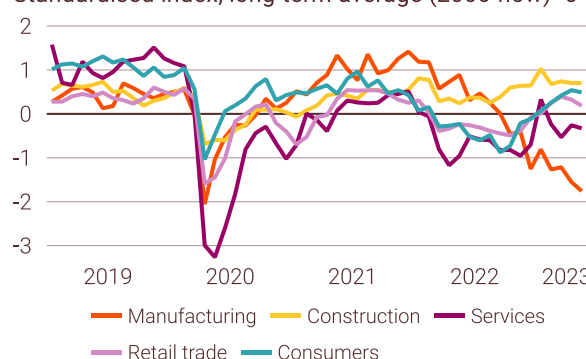
GDP, constant prices



Sources: Swedbank Research & Macrobond

A modest rebound in confidence

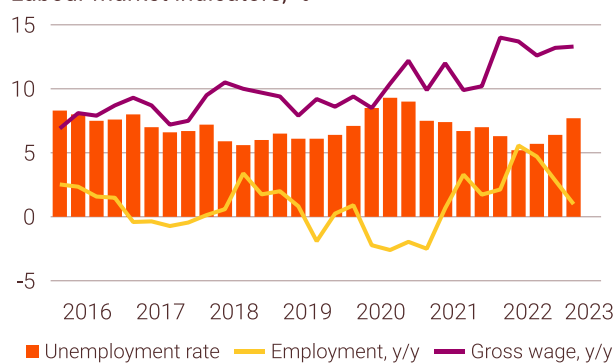
Standardised index, long-term average (2000-now)=0



Sources: Swedbank Research & Macrobond

Rapid wage growth

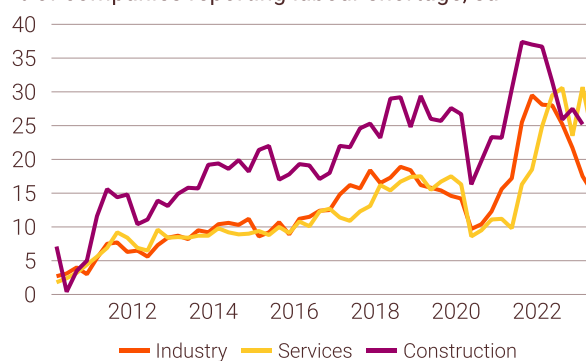
Labour market indicators, %



Sources: Swedbank Research & Macrobond

Labour shortages on the decline

% of companies reporting labour shortage, sa



Sources: Swedbank Research & Macrobond

Financial sector issues:

Lending is slowing

- Credit growth slowed further but remains positive. Corporate credit has expanded by 6.8% annually, a sharp slowdown from the 20% growth of a couple of quarters ago. Household lending is also slowing, primarily due to lower activity in the housing market.
- So far, the banking system has proved to be resilient despite the slowing economy. Nonperforming loans remain very low; however, the weakening macroeconomic environment might increase the share of financially distressed firms and households.
- A windfall profit tax for banks was introduced. In the near term, the macroeconomic effects are likely to be muted. However, the tax will negatively affect the capital ratios, could weaken banking in the longer term, and have a negative effect on foreign direct investment flows.

Sustainable development goals:

Long road ahead

- In the area of environmental protection, Lithuania still has the most work to do of the three Baltic countries. The near-term priorities should be to decrease energy intensity in manufacturing and to adopt economy-wide energy-saving measures.
- An ambitious investment programme hopes to massively boost renewables production. However, the offshore wind and green hydrogen projects are still in the early stages.
- The good news is that, across both social and governance categories, most indicators showed improvement over the last year. In addition, Lithuania managed to avoid an erosion of democratic standards and to strengthen its institutions. Lithuania's rankings are improving both in terms of democratic institutions and freedom of the press.

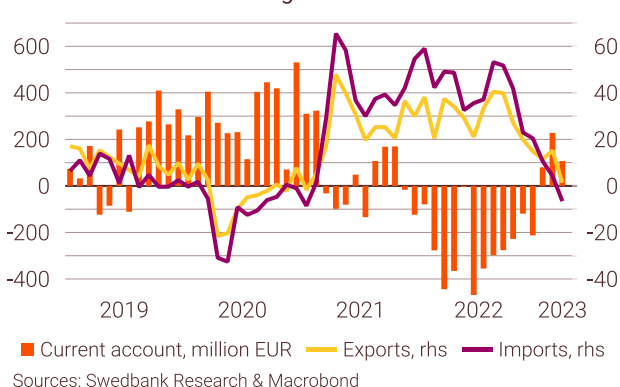
Inflation is falling rapidly

Consumer price inflation, y/y %



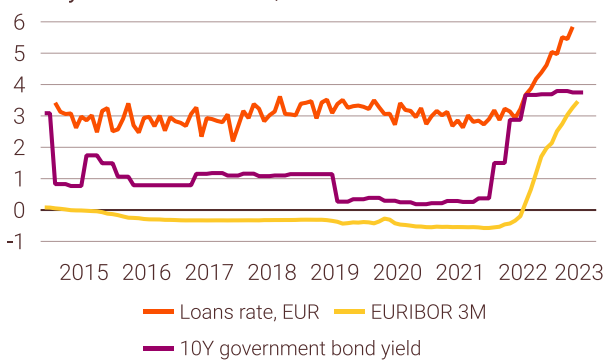
Foreign trade in surplus again

Current account and foreign trade



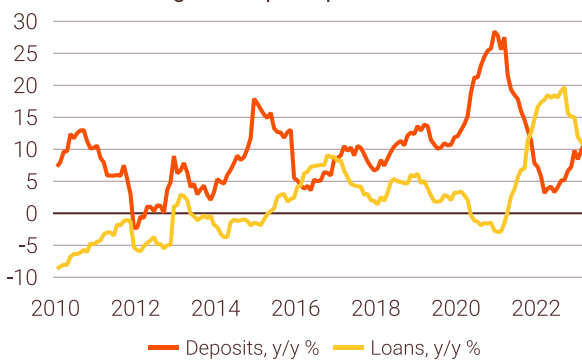
Borrowing costs are rising

Money market indicators, %



Loan growth slows

Resident lending and deposit portfolios



Sweden

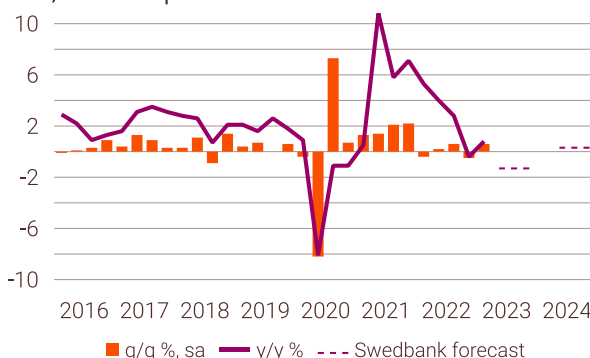
Macroeconomic developments:

Surprisingly resilient Swedish economy

- New data show that economic growth was surprisingly resilient and increased by 0.6% in the first quarter (QoQ). Goods exports and changes in inventories contributed the most, but investments also rose. Household consumption, however, declined more than expected, by 1.2%, as consumption of food, transport, and non-resident consumption weakened further. Going forward, we expect growth to continue to be weighed down by lower housing investments and household consumption.
- The labour market continued to be surprisingly resilient in the first quarter, as the employment rate increased to record-high levels and the unemployment rate fell. However, after summer, as the economic downturn broadens and consumers cut back on all non-necessary consumption, we expect the employment rate to fall.
- Inflation started to slow in the first quarter, although from high levels. In May, core inflation was down to 8.2% (YoY) and the consumer price index to 9.7%. With declining energy prices and large base effects, we expect inflation to continue to fall in June, but on a volatile and slow path.
- The Riksbank hiked the policy rate by 50 bps, to 3.5%, in April. As inflation is still at very high levels, the krona exceptionally weak, and the economy resilient, we expect hikes of 25 bps in June and in September, lifting the policy rate to 4.00%.
- Prices of one-family houses continued to decline in the first quarter, while prices of tenant-owned flats recovered somewhat. Prices have on average declined by 14% since February 2022. We expect prices to continue to fall during 2023, with a total fall of 20% from the peak in February 2022 to the trough in 2023.

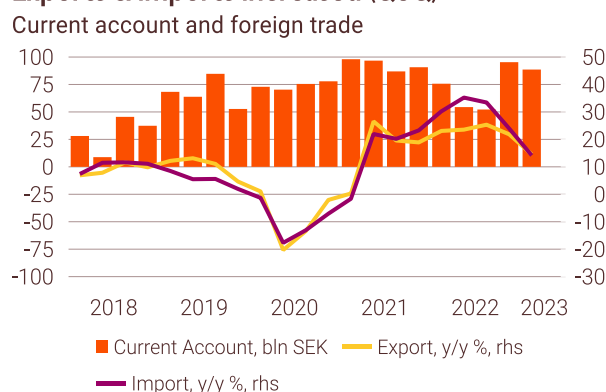
Surprisingly strong growth in the first quarter

GDP, constant prices



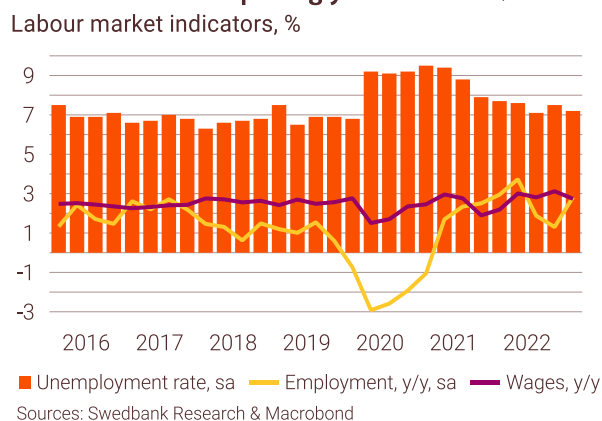
Sources: Swedbank Research & Macrobond

Exports & imports increased (QoQ)



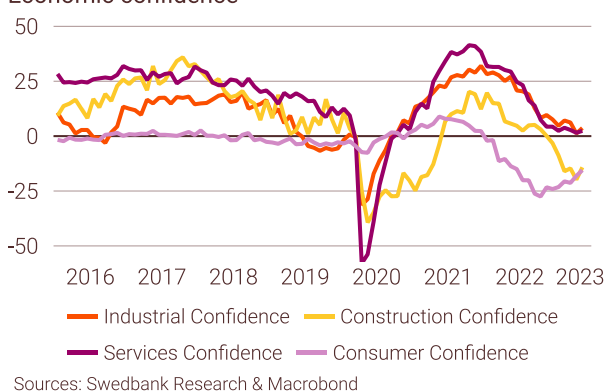
Sources: Swedbank Research & Macrobond

Labour market surprisingly resilient in Q1



Sources: Swedbank Research & Macrobond

Prices and interest rates weigh on consumers



Sources: Swedbank Research & Macrobond

Main macroeconomic risks:

Tense central banks, geopolitical risks

- As inflation is still at high levels, although on a slow and lagging downward path, the risk of the central banks' hiking rates excessively is clear. So far, economic activity has been more resilient than expected in most economies, but the risk that central banks might go too far is still there, which could take out demand completely. The financial turmoil in the US banking sector has moderated, and the risk of a similar event in Sweden is assessed to be smaller than in the US: deposits in the smaller Swedish banks are to a large extent covered by the deposit insurance scheme. The geopolitical tensions between global superpowers remain, and there is a risk of escalating barriers to trade.

Financial sector issues:

Commercial property debt main concern

- Too much debt among CRE companies, coupled with tightening credit conditions, are creating spillover effects on the krona. The krona has weakened substantially during the second quarter and is at its lowest level since 2009. The potential for further tightening by the Fed and the ECB is putting additional downward pressure on the krona. However, as the Riksbank also pointed out, it is important to distinguish between the few CRE companies that have taken on too much risk and the ones that in fact have solid business models. Household lending growth continues to slow rapidly, but household debt is mainly a macro-related risk.

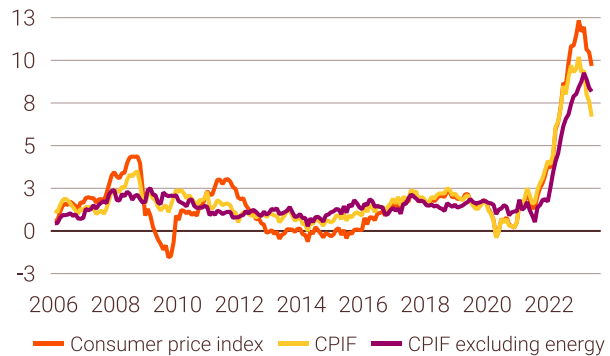
Sustainable development goals:

EU presidency and green coordination

- During H1, Sweden has had the presidency of the Council of the European Union, and climate and long-term competition have been high on the agenda. Also, Business Sweden has been appointed as coordinator of large establishments in the automotive industry's green transition.

Inflation slows but core remains sticky

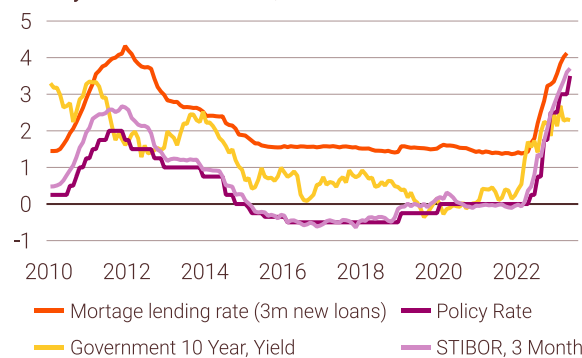
Consumer price inflation, y/y %



Sources: Swedbank Research & Macrobond

Short-term rates to rise more than long term

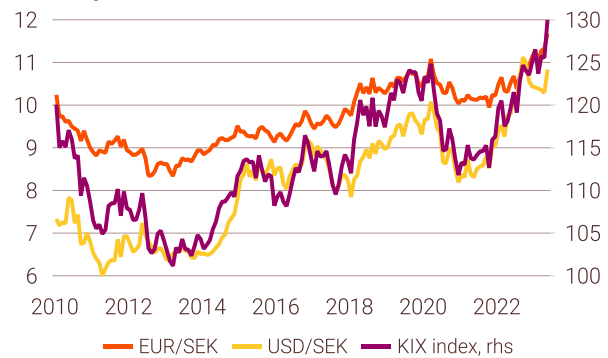
Money and credit market, %



Sources: Swedbank Research & Macrobond

SEK at weakest levels since 2009

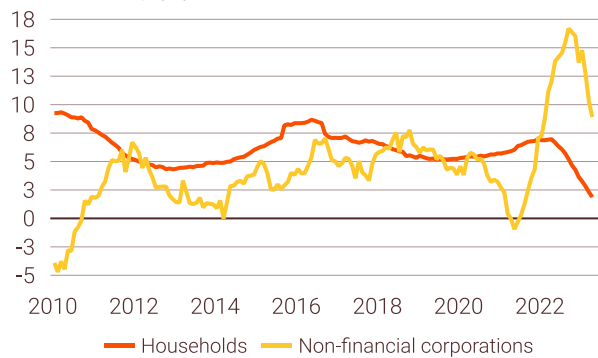
Exchange rates



Sources: Swedbank Research & Macrobond

Households' credit growth keeps falling

Bank lending, y/y %



Sources: Swedbank Research & Macrobond

Progress on sustainable development goals

	Estonia	Latvia	Lithuania	Sweden
E: Environmental protection				
GOAL 6: Clean Water and Sanitation	🟡 ↗ 84	🟡 ↑ 83	🟡 ↑ 83	🟢 ↑ 94
GOAL 7: Affordable and Clean Energy	🟡 ↗ 70	🟡 ↑ 84	🔴 → 35	🟢 → 97
GOAL 11: Sustainable Cities and Communities	🟡 ↗ 82	🔴 ↑ 66	🟡 ↗ 80	🟡 → 78
GOAL 12: Responsible Consumption and Production	🔴 ↗ 62	🔴 ↓ 52	🔴 → 43	🔴 → 58
GOAL 13: Climate Action	🔴 ↗ 54	🔴 ↓ 63	🔴 ↓ 58	🔴 → 60
GOAL 14: Life Below Water	🟡 ↗ 86	🟡 ↑ 85	🟡 → 80	🟡 ↗ 70
GOAL 15: Life on Land	🟢 ↗ 96	🟢 ↗ 98	🟢 ↗ 92	🟡 → 75
Average score	🟡 ↗ 76	🟡 ↗ 76	🔴 → 67	🟡 → 76
S: Social inclusion				
GOAL 1: No Poverty	🟡 ↗ 70	🔴 ↗ 59	🔴 ↗ 63	🟡 → 76
GOAL 2: Zero Hunger	🔴 ↓ 59	🔴 → 63	🔴 → 61	🔴 → 69
GOAL 3: Good Health and Well-being	🟡 ↗ 78	🟡 ↗ 70	🟡 ↗ 73	🟢 ↗ 90
GOAL 4: Quality Education	🟡 ↑ 88	🟡 ↗ 80	🟡 ↗ 76	🟡 ↗ 87
GOAL 5: Gender Equality	🔴 → 50	🔴 ↓ 52	🔴 ↗ 58	🟡 ↗ 77
GOAL 8: Decent Work and Economic Growth	🔴 → 63	🔴 ↗ 66	🔴 ↗ 64	🟡 ↗ 79
GOAL 10: Reduced Inequality	🟡 ↑ 89	🟡 ↓ 71	🟡 ↗ 71	🟢 ↑ 98
Average score	🟡 ↗ 71	🔴 → 66	🔴 ↗ 66	🟡 ↗ 82
G: Governance				
GOAL 9: Industry, Innovation and Infrastructure	🔴 ↗ 64	🔴 ↗ 53	🔴 ↗ 53	🟢 ↗ 95
GOAL 16: Peace and Justice Strong Institutions	🟢 ↗ 90	🟡 ↗ 79	🟡 ↗ 83	🟡 → 83
GOAL 17: Partnerships to Achieve the Goal	🔴 → 60	🔴 → 56	🔴 ↗ 52	🟡 → 85
Average score	🟡 ↗ 71	🔴 ↗ 63	🔴 ↗ 62	🟡 → 88

Traffic lights: 🟢 <70 - significant challenges remain, 🟡 70-90 challenges remain, 🟢 >90 - very close to goal

Trends: ↑ on track ↗ moderately improving, → stagnating, ↓ deteriorating

Updated once a year. Based on Lafortune, G., Fuller, G., Bermont-Diaz, L., Kloke-Lesch, A., Koundouri, P., Riccaboni, A. (2022). Achieving the SDGs: Europe's Compass in a Multipolar World. Europe Sustainable Development Report 2022. SDSN and SDSN Europe. France: Paris.

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Swedbank C&I, Swedbank AB (publ), SE-105 34 Stockholm.

Visiting address: Malmskillnadsgatan 23, 111 57 Stockholm.

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