Global Macro Forecast

Shelter from the trade war storm

- The trade war shock is stagflationary for the US, but disinflationary elsewhere
- In Europe, slowing growth is expected to be the dominant force, keeping central banks in easing mode
- Gradual policy rate cuts and elevated risk premiums imply still-high market interest rates ahead

Macro Research • Global Macro Forecast

21 May 2025

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Global backdrop

Shelter from the trade war storm

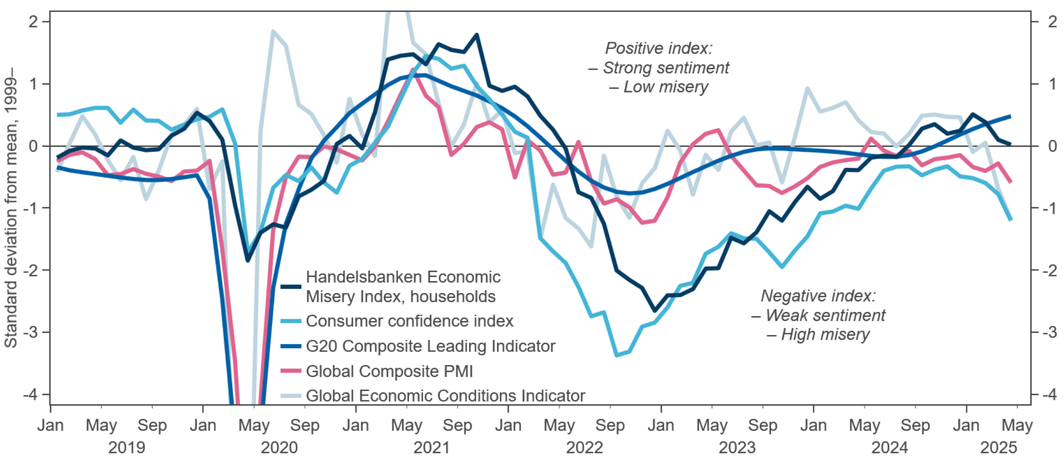
In the wake of trade conflict escalation, economic sentiment dropped while financial conditions tightened. Despite the recent de-escalation, we conclude that the damage is done, and forecast weakening growth and labour markets. Tariffs look set to end up relatively high, having a negative direct GDP effect and fanning growth-hostile uncertainty. For the US, the trade war stokes inflation, while a dampening of demand dominates in Europe, easing inflation. Against the backdrop, the Fed will hold off until September before resuming cautious policy rate cuts, while the ECB lowers rates at its coming meetings. Risks are balanced but wide - recession threat versus resilience, stock market gains versus capital outflow from the US - so renewed market turbulence cannot be excluded.

Growth impact of tariffs: Damage done

Trade conflict escalation has sunk economic sentiment; a more exact reading on the growth impact will emerge only gradually

Leading indicators of GDP growth should rebound somewhat in the coming months after the trade war de-escalation. However, having declined significantly in 2025 – especially due to the US administration's original 2 April announcement of dramatic tariff rises – the indicators will likely remain downbeat and signal a slowdown in global economic activity. So far, the decline has manifested mostly in sentiment surveys, such as consumer and business surveys. A more exact reading on the growth impact will emerge only gradually because 1) the first-order effect of tariffs works as a tax hike, with companies and households smoothing their spending and investment response over time, 2) businesses have been front-running the incoming tariffs (see below) to cushion the blow, making any near-term swings in the data tendency difficult to interpret, and 3) the hard data is published with a lag, often taking months to collect. Nevertheless, in a broad sense, we stand by our 9 April interim forecast update conclusion that the trade conflict is a broadside against global GDP, with weak growth in 2025 and a gradual recovery during 2026.

Global economic indicators



Sources: Macrobond, national sources, OECD, S&P Global, C. Baumeister et al. (2022) and Handelsbanken
Note: Misery index and CCI refers to the common factor in indices for the eurozone, Finland, Norway, Sweden, the UK and the US

Leading indicators signal a slowdown in global growth, but should partly rebound

Swift back-pedalling, but in the end far higher global tariffs than previously, which will take a toll on GDP

Admittedly, the partial de-escalation in the trade conflict has come more swiftly than we were assuming and a key question is if that matters or if the damage is largely already done? Reports and data show that goods volumes handled in ports have dropped but have recovered somewhat. Rather than early proof of a lasting economic downturn, for now, this is likely to partly be a rebound at the tail end of the shipment front-loading as businesses have been building inventories to cushion against the cost rises, supply chain disruptions and outright shortages that go hand in hand with tariff increases and a trade war. In the end, we forecast that the inventory buildup will help to smooth the impact of the tariff escalation on US supply chain strains, but cannot fully bridge the gap in the economy, since we assume that tariffs will remain significantly higher than before even after the recent de-escalation (see *Key trade conflict assumptions* box). Moreover, we expect trade policy uncertainty to remain elevated at least over the summer, as negotiations with major trading partners remain open. This will take a toll on global GDP.

Key trade conflict assumptions

• Our baseline assumption is for a partial de-escalation in the trade conflict over the course of 2025. The 12 May US-China back-pedalling from the previous gargantuan tariff escalations was a more substantial step on that journey than we foresaw in our April interim forecast, and helps avert crisis risks in their respective economies.

• Ahead, we essentially expect that the US' pause on the threatened highest "reciprocal" tariffs will either be extended or replaced by trade agreements, assuming that bilateral negotiations will largely succeed in appeasing the US with some lowering of trading partners' tariff- and non-tariff trade barriers, and other deals. See the *Risks to the outlook* box below for alternative scenarios.

• Still, the global tariff average is assumed to end up significantly higher than before the US started this year's escalation, as it is becoming clear that the US' global 10 percent baseline tariff is here to stay. The road to de-escalation will be bumpy with 1) the occasional bilateral standoff in negotiations to avert the US' "reciprocal" tariffs, 2) delivery of US-signalled additional sectoral tariffs on e.g. pharmaceuticals, semiconductors and electronics, and 3) trading partners not completely idly accepting US' tariff rises, but feeling forced to put in place at least partial countermeasures.

• For the US, we assume its average import tariff will end up in the region of 10–15 percent, close to the 13 percent we have at the time of writing, well below the brief mid-April peak at about 27 percent, and about a third of the level it has threatened (all statically calculated with 2024 import composition). If trading partners respond with proportionate tariff increases, tariffs on exports from the US would rise to the same extent. The final trade agreements are likely to differ across US trading partners with different types of sector-specific details, regulations, exemptions, quotas, etc. The average tariff level is therefore only a rough indication of how trade, value chains and consumers are affected.

• Towards the EU, we assume that the US will raise tariffs by about 10pp to about 11.5 percent. This is slightly higher than the level at the time of writing (about 10 percent), since we assume that tariffs will also be introduced on e.g. pharmaceuticals, which account for around a quarter of the EU's exports to the US. Together with current tariffs on cars and steel, sector-specific tariffs would then regulate around 40 percent of the EU's exports to the US. Overall, the average tariff on total EU exports (excluding intra-EU trade) increases by around 2pp, since about one fifth of EU exports go to the US. From the EU's side, we assume retaliatory tariffs of close to 10 percent on imports from the US, while the EU's tariffs on other trading partners are assumed to be largely unchanged. This means that the average tariff on total EU imports will be increased by just under 1.5pp, as imports from the US account for just under 15 percent of total imports into the EU.

• Towards China, we assume that the US will maintain higher tariffs, but with some further tapering from the current 40 percent to around 30 percent – still more than doubling the original level. Overall, the average tariff on China's total exports increases by about 2.5pp, as just under 15 percent of Chinese exports go to the US. From China's side, we assume roughly proportionate retaliatory tariffs. This means that the average tariff on China's total imports will be increased by just over 1pp, as imports from the US account for just under 7 percent of total imports to China.

• We also analysed the macroeconomic impact of the trade conflict in our interim forecast update on 9 April and in an article on tariffs in our January Global Macro Forecast report (see p. 9–14).

Europe will suffer less than the US, as only the latter raises tariffs on all trading partners

The European economy is forecast to suffer less than the US, via the direct trade channel. When the latter raises tariffs on all trading partners, not only imports fall. Exports will fall roughly as much, not least since US exports will face higher tariffs on most markets outside North America. In addition, US domestic resources need to shift from productive, competitive businesses, often exporters, towards less inefficient ones that fill the imports gap. And lastly, shortages and costs will rise throughout the supply chains. By contrast, our baseline scenario assumes that trading partners raise tariffs only on imports from the US, and their exports only face higher tariffs from the US.

Tighter financial conditions restrict household and business spending

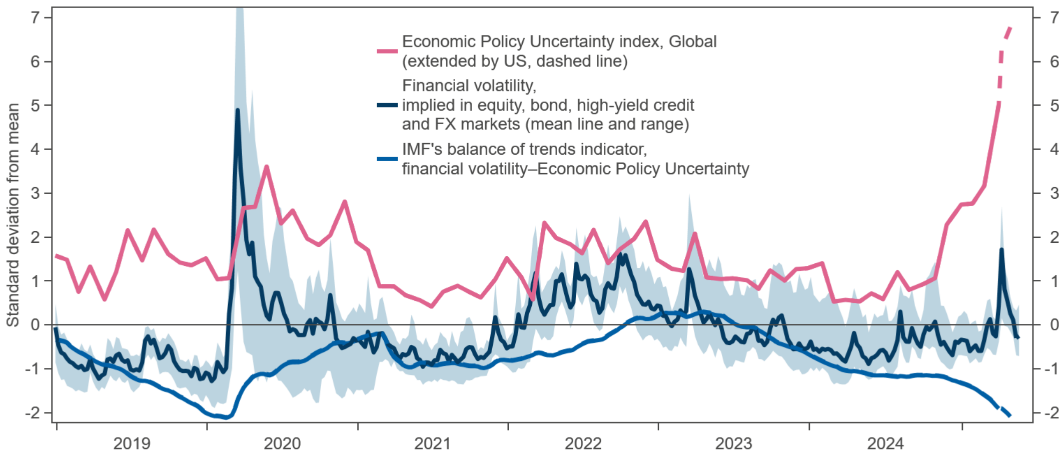
Another early warning is that market turbulence caused by the conflict escalation implies tighter financial conditions, rendering it more expensive and potentially more difficult for households and businesses to secure financing, thus slowing GDP growth. On the one hand, US public companies' Q1 reports suggest large businesses overall hope the storm will blow over and are trying to weather it by keeping their capital expenditure guidance roughly intact, albeit with Q2 investment looking set for some pullback at the same time as many US companies have opted not to issue guidance at all due to the elevated uncertainty. Small businesses are generally less resilient, and at least in the US, there are alarming signs of a negative rebound in investment intentions, after Donald Trump's election win initially boosted capex sentiment.

Uncertainty another key factor dampening consumption and investment

Heightened uncertainty and risk are driving the market turmoil and thus tighter financial conditions, but hurt consumer spending and business investment directly too. In some aspects, the uncertainty has started to recede compared to the shaky ground our outlook was resting on in January, for example, as the first round of the trade conflict is now behind us rather than being a known unknown. And market-priced uncertainty has come down since the April peak, as measured by implied volatility in the stock, bond, credit and FX markets. However, these two tentative improvements are poor comfort and may be short-lived as 1) the "increased certainty" overall is the result of a realisation of adverse economic developments, 2) the market uncertainty measures are still somewhat higher than in "normal" years (above the mode value), and 3) the market uncertainty measures remain well below what is consistent with the much more severe signals from indices of economic policy uncertainty and geopolitical risk, an imbalance that the IMF has previously highlighted (see graph). Hence, we forecast slower fixed investment and a delayed recovery in consumption, which will further dampen global GDP growth in 2025.

Economic policy uncertainty versus near-term future volatility priced in markets

Economic policy uncertainty is on the rise – market volatility responded belatedly, but the VIX and other measures are off their April peaks and underprice risks, says IMF indicator

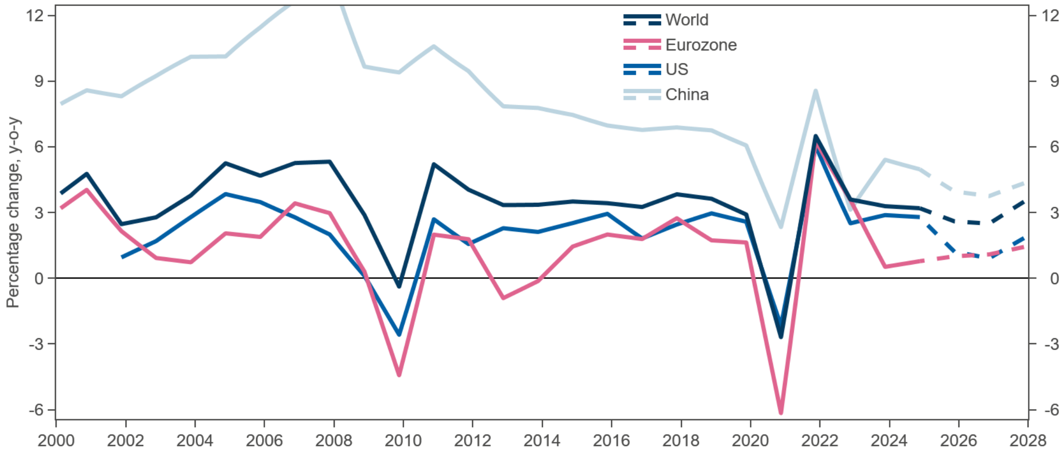


Sources: Macrobond, Bloomberg, CBOE, Economic Policy Uncertainty, ICE, J.P. Morgan, and Handelsbanken
Note: IMF indicator replicating analysis in GFSR October 2024. Trends are one year moving averages.

Gradual turnaround towards a global recovery in 2026-27, but world trade loss to linger

Starting gradually in 2026 and into 2027, the world economy should progressively recover. By then, the forecast gradual monetary policy easing should have reached full effect. Furthermore, we expect fiscal policy to turn somewhat more expansionary – cautiously defying worries about already-high public debt – supporting growth and underpinning defence ramp-up needs, particularly in Europe. Consumption and investment should pick up as households and businesses regain confidence and have pent-up demand from 2025. We also expect world trade to find its footing and resume growth, albeit without the prospect of a full recovery from the 2025 shock. All told, we forecast that annual average world GDP will grow by a weak 2.7 percent in both 2025 and 2026, but note the sharp contrast in growth momentum during these two years – slowing in the first, picking up in the second. The recovery continues with 3.3 percent growth in 2027.

Global GDP forecasts



Sources: Macrobond, IMF and Handelsbanken

Stagnant US growth, setback in challenged Chinese economy and delayed recovery in the eurozone spell a weak global outlook

Major economies overview

Eurozone – Refer to the *Eurozone* article later in this report.

China

• The first quarter delivered some favourable data outcomes, and in May, policymakers implemented additional stimulus measures – such as interest rate cuts by the People's Bank of China (PBOC) – to bolster economic growth.
• However, persistent domestic challenges, including subdued consumption, a distressed real estate sector and a negative demographic trend, have now been coupled with global trade conflict, posing a stronger threat to achieving the 5 percent GDP growth target. A trade war is economically unsustainable for both the US and China, and a 90-day pause to the large tariffs is now in effect.
• GDP growth is projected to decelerate in 2025, before gradually recovering in 2026 and into 2027. Export activity, a key growth driver, is expected to decline due to tariffs, from the strong frontloading-driven Q1 level. Domestic demand remains weak despite ongoing stimulus measures.

US

• The US economy is slowing, but Q1's negative headline GDP misrepresented what was still underlying growth. Headwinds will increase in 2025–26. Larger tariff rises than anticipated, not only on strategic rival China, but on all other trading partners too, will hurt growth. A declining foreign trade outlook and rising uncertainty have led to sharply falling business investment plans.
• Consumption growth is forecast to slow, due to declining real incomes as inflation rises in the wake of tariffs. Incomes and consumption will also be dragged down by the weakening labour market. In addition, the low saving rate will rise, as uncertainty makes consumers cautious. All told, we forecast somewhat weaker GDP growth and somewhat higher unemployment than the consensus.
• The Fed is expected to focus on the inflation side of its dual mandate, seeing a new difficult inflation episode as a bigger risk than recession. Inflation expectations among households, businesses and investors are on the rise, and we forecast inflation will pick up ahead. Hence, we see the Fed holding off the next rate cut until September and only cutting slowly in 2026–27. The federal budget looks set to markedly increase the deficit, but deliver only moderate GDP stimulus.

Inflation resurgent in the US, but in check globally

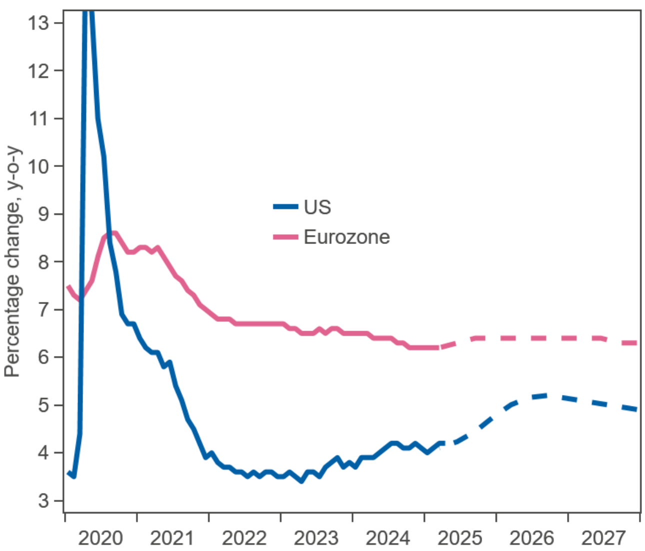
In general, we expect labour market conditions to weaken. In the US, labour shortages linger, and we therefore forecast only a moderate rise in unemployment, as businesses are expected to partly hoard labour given the mild nature of the GDP downturn that we forecast. In Europe, the economy is not materially slowing, but the delayed recovery is costly because businesses have already been hoarding labour in recent weak years. Hence, we expect some job losses ahead, but mostly through attrition rather than layoffs. All told, we forecast a near-term rise in unemployment, followed by stabilisation, and overall some resumed decline in the medium term.

Unemployment is forecast to rise in the near term

Inflation is forecast to pick up again in the US this year, while disinflation continues in Europe. This is in contrast to the evidence of synchronised global inflation patterns, but caused by the trade war which is expected to have opposite effects on inflation in the US and the rest of the world (see theme article on inflation). In the US, rising import prices and supply disruptions push inflation up. In Europe and elsewhere, the shock is disinflationary, primarily due to heightened uncertainty weakening demand, dampening labour market cost pressures and profit margins. The inflation impact of retaliation tariffs and the indirect effects of high US–China tariffs are likely limited and more than offset by increased global competition and the dollar depreciation that we forecast. In 2026, US inflation is forecast to cool, while the eurozone is expected to see inflation falling slightly below the ECB's target. By 2027, however, we forecast inflation to stabilise close to 2 percent.

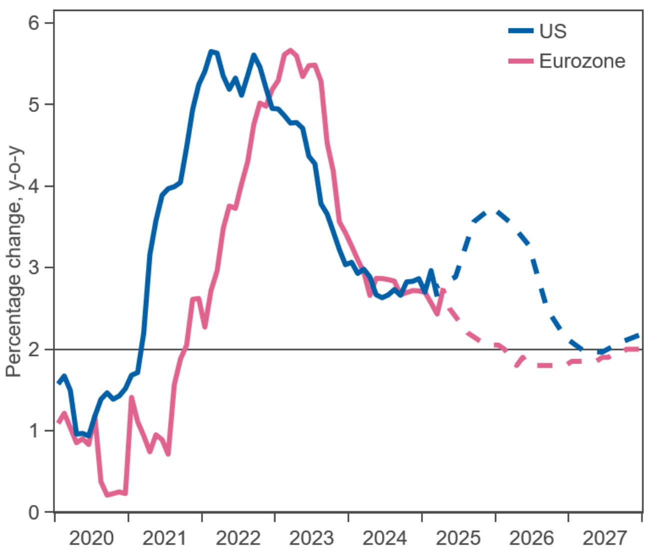
The trade war is disinflationary outside the US

Unemployment



Sources: Macrobond, Eurostat, BLS and Handelsbanken

Inflation



Sources: Macrobond, Eurostat, BEA and Handelsbanken

Policy rate cuts counteracted by risk premiums in market interest rates

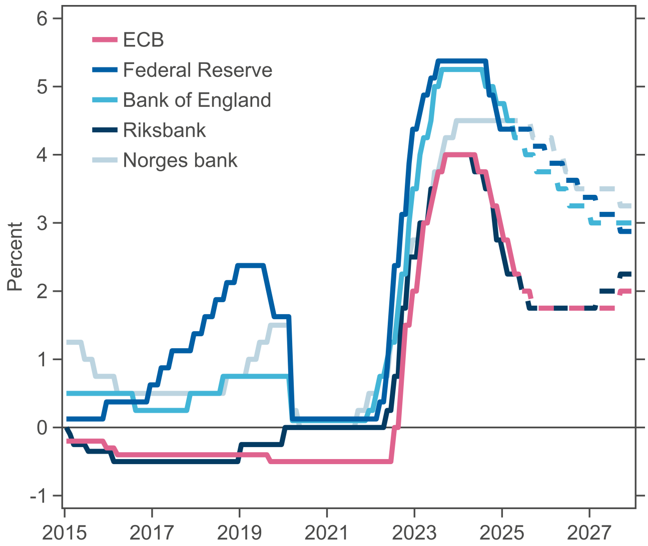
Central banks are forecast to cut policy rates more than we had expected before our April interim forecast update. This implies that we judge central banks will partly "see through" risks of any tariff-driven inflation impulse, and that for most of them – the US Fed is the exception (see *Major economies overview* box) – the growth risks will instead be the dominating policy factor of the global shock from the trade war.[1] However, central banks will need to stay alert to the threat of renewed inflation pressures, and we therefore forecast that they will cut rates more slowly than they have, on average, during historical economic downturns. A prerequisite for such a measured approach by central banks is that financial markets keep functioning normally even when the economic downturn materialises. A first such test has been passed, when the turbulence in the wake of 2 April did not cause markets to spin out of control into outright financial stress.

Central banks set to cut rates further to mitigate growth drop, but more slowly than is usual during downturns, due to the heightened inflation risks

Our long-standing call that bond market term premiums are on the rise has proven correct, but given the sharp rise leading up to our January report, we had forecast a partial retreat.[2] That conclusion may have been premature, because instead of premiums being mitigated by overall dissipating risk and uncertainty, the market is experiencing the opposite with new worries around growth, inflation and government borrowing needs (fiscal policy).[3] All told, our forecast for longer-

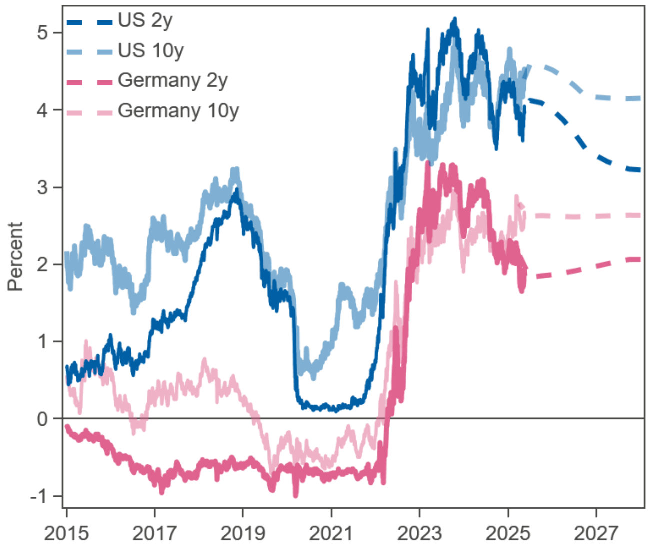
Long rates to decline slowly, but remain significantly higher than in the last decade term market interest rates assumes a gradual decline ahead, driven by central bank cuts. Towards the end of 2027, we expect longer-term market interest rates to remain significantly higher than in the last decade, mainly due to higher policy rates owing to higher neutral interest rates, but also due to a higher term premium.

Policy rates



Sources: Macrobond, ECB, Federal Reserve, Bank of England, Norges Bank, Riksbank and Handelsbanken

Government bond yields



Sources: Macrobond and Handelsbanken

Down, but not out: Dollar to weaken further amid stagflationary pressure

The USD has depreciated quicker than expected

The balance of key USD drivers has shifted and new drivers have come into focus, together resulting in a sharp depreciation since the beginning of the year. This has rendered the dollar weaker versus e.g. the euro than we have previously forecast, even compared to our April interim forecast update. However, we have previously highlighted the risk of deeper dollar depreciation amid rising doubts about its status as the world's no.1 currency.[4] We continue to find the *de-dollarisation* fears overblown (see *The dollar has temporarily lost its shine – not its status* box), but still forecast that the dollar will continue to weaken. This is mostly driven by US stagflationary pressures and a fading trust in the Trump administration's ability to conduct solid economic policies.

Several factors signal more dollar weakness ahead...

Factors favouring a weaker dollar in general and, in some cases, a stronger euro (EUR/USD up):

• A relative weakening of the US economic outlook. This tendency has further to run, given that our below-consensus forecast for US GDP materialises and impacts markets.

• The stagflationary impulse from the trade war is also difficult for policymakers to navigate and raises the risk of policy mistakes by the Fed, but also from fiscal policy. This adds to risk premia, leading to capital outflow pressure from US markets as lower risk-adjusted returns drive down allocations in global asset allocation.

• Confidence in the US administration's ability to manage sound policy – across economics, foreign relations, trade, defence, and so on – is likely to weaken further as incoming data validates the concerns about the policies. This contributes to a gradual decline in the dollar's safe haven appeal, but also to the debate about the dollar's role as the world's reserve currency – even if we think the latter is overblown (see above).

• European growth outlook shored up, not least by the pivotal change in German fiscal policy which lifts the GDP outlook somewhat. In addition, the more acute need to ramp up defence spending jolts economic activity in the short- to medium run.

• Public finances are fragile on both sides of the Atlantic, but more clearly unsustainable in the US, especially as the upcoming budget looks set to increase the deficit significantly, raising bond market risks. In Europe, by contrast, the problem is smaller with France being an unfortunate exception.

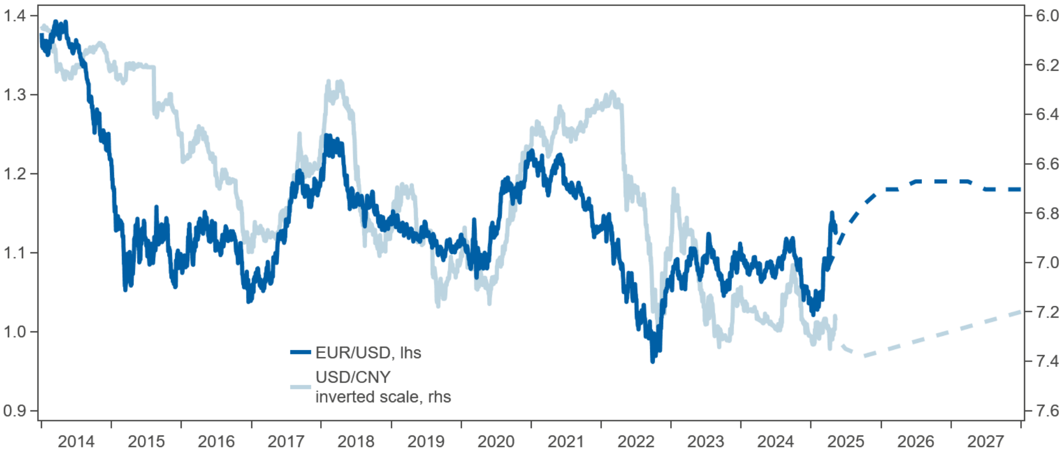
• Stability in value, a key safe haven property, of the euro and other European currencies was on full display in the March-April global markets turbulence, proving that investors and central bank reserve managers can diversify further away from the dollar. One reason is likely credibility in European democracies' policy-making, for example the cool-headed, economically sound response in the trade conflict, so far at least.
• The US' positive interest rate differential is forecast to decrease over the coming years.

Factors favouring a stronger dollar and a weaker euro (EUR/USD down):
• Part of the "US exceptionalism" narrative is still alive and well, as the outlook for US productivity growth still looks somewhat stronger than that of peers, even after factoring in the growth-hostile parts of the White House's economic policy agenda.

...although productivity growth in the US still provides some support

All told, we see EUR/USD reaching 1.19 – close to our estimate of the long-term EUR/USD equilibrium. Our forecasts for other key global currencies include a short-term weakening of the Chinese yuan, which helps soften the tariff rise blow to Chinese exports.

Key major FX forecasts



Sources: Macrobond and Handelsbanken

The US dollar forecast to depreciate on all fronts

The dollar has temporarily lost its shine - not its status

The dollar has lost some of its safe haven appeal in recent months, following its depreciation and signs of capital outflows from US assets. On several occasions, the dollar has weakened even during risk-off episodes – an unusual pattern for what is typically the world's premier safe haven currency.

It is nevertheless important not to conflate the dollar's tactical role as a safe haven with its structural role as the world's dominant currency. The latter is far more entrenched and rests on several pillars:

- **Reserve currency**: The dollar accounts for roughly 58 percent of central bank FX reserves globally, while the corresponding share of the second-placed euro accounts for 20 percent (IMF).
- **Funding currency**: Approximately 64 percent of world debt is denominated in dollars, compared to 23 percent in euros (BIS).
- **Invoicing currency**: Global trade, especially in commodities like oil, is overwhelmingly priced in dollars. As of 2022, the dollar was used to price about 54 percent of global trade invoicing (Brookings).
- **Settlement currency**: Cross-border payments and trade flows are largely settled in dollars. In March 2025, the dollar accounted for 49 percent of global payments processed via SWIFT, surpassing the euro's share of 22 percent (SWIFT).

These functions are deeply intertwined. For example, because the dollar dominates funding, pricing, and settlement, the global banking system is heavily reliant on access to dollars. As a result, central banks hold dollar reserves not just for trade or intervention purposes, but to ensure they can backstop their domestic financial systems in times of stress.

While the safe haven role can fluctuate with sentiment, policy, or geopolitics – and may return just as quickly as it disappeared – the dominant currency role is deeply embedded in the global financial infrastructure. Displacing it would take many years and would require a credible alternative, which does not currently exist. The euro comes closest, but remains limited by institutional constraints. The renminbi is even further behind, lacking convertibility and global trust.

This context helps clarify what may seem like a contradiction in US policy. The White House administration speaks of a "strong dollar policy", yet also signals that it would welcome a *weaker* dollar. However, the "strong dollar policy" refers to maintaining the dollar's global dominance across reserves, funding, invoicing, and settlement – not necessarily supporting a strong exchange rate.

Indeed, by most measures, the dollar remains overvalued. A somewhat weaker exchange rate would help US exporters without threatening the dollar's international role. The White House administration appears to be aiming for exactly that: a cheaper dollar, but one that continues to anchor the global financial system. However, the recent depreciation has largely been driven by a deteriorating outlook for the US economy and mounting fear of stagflation – developments that are hardly welcome news for the administration.

Risks to the outlook: Balanced but wide after our baseline downgrade

We assess that the risks to the economy are more in balance, after the larger downsides described in our January forecast report partly materialised, prompting us to downgrade our baseline forecast in our April interim update. We also assess that the confidence band around our baseline is wider than average – while we have more certainty about the initial phases of the trade conflict, there is abundant uncertainty regarding future phases and, perhaps more importantly, the macroeconomic effects of an escalation of this unprecedented scale.

• On the downside, our negative alternative scenario assumes that trade negotiations stall, the US reintroduces a significant part of its paused "reciprocal" tariffs and that the rest of the world escalates by retaliating fully. In this trade war scenario, the decline in international trade is more severe, renewed market turbulence tightens financial conditions, and worsening household and business confidence cause an outsized blow to consumption and investment. The weaker economy hurts the labour market, with clearly higher unemployment, which in turn further deepens and prolongs the economic downturn. Most central banks “see through” the risks of initial inflation impulses and cut policy rates sharply to mitigate the downturn, which otherwise would give deep disinflation in the medium term. However, the US Fed faces a stagflationary shock of such magnitude that it is instead forced to raise its policy rate to curb inflation and safeguard anchoring of inflation expectations. Fiscal policy adds stimulus to the economy, but all told the scenario results in a recession globally, including in Europe.

• On the upside, our positive alternative scenario assumes that households and businesses remain resilient in the face of the tariff shock, that trade negotiations yield further de-escalation than our baseline forecast and that the uncertainty channel in the economy is fairly muted, not accentuating the effect of the direct negative effect on trade. In this scenario, exports will still decline, but the knock-on effects on household consumption, investment and the labour market will be far smaller. Inflation turns out more sticky, driven by better pricing power as well as some second-round effects and worries about de-anchoring of inflation expectations. Hence, central banks would keep policy more restrictive, with the Fed not cutting at all in 2025, nor reaching its neutral rate level during our forecast period 2025–27, and the ECB merely normalising its policy rate to 2 percent.

• Lastly, several other factors pose upside as well as downside risks. Geopolitical tensions and geo-economic fragmentation are assumed to deteriorate somewhat further through the trade conflict tensions, but given a wide array of pressure points around the world, both improvement and deterioration are possible overall. Renewed market turbulence and tighter financial conditions could go as far as a credit crunch (corporate lending standards tightened in Q1 2025), but stress in financial markets is unlikely and central banks have tools to safeguard market functioning. Conversely, more buoyant markets and looser financial conditions could boost credit growth.

Theme article - Inflation

US trade war supports disinflation abroad

In contrast to the evidence of synchronised inflation patterns, the trade war is expected to have opposite effects on inflation in the US and the rest of the world. In the US, rising import prices and supply disruptions are pushing inflation up. Elsewhere, the shock is disinflationary, primarily due to heightened uncertainty weakening demand, dampening labour market cost pressures and margins. The inflationary impact of retaliation tariffs and the indirect effects of high US-China tariffs are likely limited and more than offset by increased global competition and dollar depreciation. How the trade war evolves remains a key uncertainty. Price setting behaviour poses a risk to disinflation, while bottlenecks could add price pressure as demand recovers.

Inflationary in the US and disinflationary elsewhere

In our baseline scenario, we anticipate that the ongoing trade conflict will exert upward pressure on inflation in the US, while exerting a disinflationary influence on the rest of the world. This outlook contrasts with the well-documented trend of increasing synchronisation of inflation across advanced economies. For instance, an ECB working paper estimates that common global factors explain approximately 70 percent of inflation variation among OECD countries.[5] These findings underscore the influence of global shocks – such as commodity price fluctuations and the COVID-19 pandemic – on convergent inflationary trends. Moreover, increasingly synchronised business cycles and a shared orientation among central banks towards inflation targeting have further contributed to this convergence. In the current environment, however, we identify limited transmission channels through which US tariff-induced inflation could spill over to trading partners.

The outlook contrasts with the well-documented trend of increasing synchronisation of inflation across advanced economies

For most economies, the trade dispute is expected to act as a disinflationary demand shock. The primary transmission channel operates through heightened global trade uncertainty, which weighs on business and consumer sentiment, ultimately dampening economic activity and exerting downward pressure on inflation. This channel is reinforced by global trade prices, partly due to slowing global activity, but also by the ambiguous, yet still net disinflationary, impact of raised tariffs, which is linked to reduced US demand for imports.

The primary transmission channel operates through heightened global trade uncertainty

How the trade war evolves remains a major source of uncertainty

Nonetheless, hard evidence of a broad-based downturn in activity or meaningful downward pressure on inflation remains limited at this stage, and central banks are likely to remain vigilant of the potential for renewed or persistent inflationary pressures. A key source of risk is the outcome and duration of the trade war, which carries implications in both directions. In our baseline scenario, policy uncertainty remains elevated – both around tariffs and other areas of global cooperation – though it is expected to ease gradually in the second half of the year. Successful negotiations accompanied by only a modest increase in tariffs could still avert a pronounced slowdown in activity and, by extension, its disinflationary effects. Conversely, an escalation involving a broader set of countries and deeper global economic fragmentation would raise the risk of a global stagflation scenario. In the case of inconclusive negotiations marked by extended pauses and recurring threats, uncertainty would remain high, reinforcing a wait-and-see approach among companies and households and further delaying recovery while amplifying disinflationary pressures.

Policy uncertainty remains elevated though it is expected to ease gradually in the second half of the year

Cost pressures dominate in the US

A key distinction between the US and most of its trading partners lies in the scope and structure of the trade dispute. For the US, the trade war is global in nature, encompassing multiple trading partners simultaneously. In contrast, for most other economies, the conflict is bilateral – primarily limited to their trade relations with the US. Under a scenario in which the US imposes tariffs unilaterally, with no (or mild) reciprocal measures from its trading partners, the primary economic effects unfold through a rise in import prices and potential supply disruptions. Higher import prices translate into increased input costs for producers and reduced purchasing power for consumers.

For the US, the trade war is global in nature, encompassing multiple trading partners simultaneously

In parallel, elevated uncertainty surrounding trade policy weighs on business investment and consumer spending, leading to a moderation in domestic economic activity. While the slowdown in activity exerts downward pressure on labour costs and corporate margins, these disinflationary forces are more than offset by rising import prices and product shortages, resulting in a net increase in headline inflation. The potential transmission channel to global prices via US export prices depends on the pricing behaviour of US exporters and the degree of pricing power they possess in international markets.

Slowing activity dominates in the rest of the world

For US trading partners, the predominant transmission channel is through reduced real activity, driven by heightened uncertainty and declining external demand. US tariffs directly reduce demand for exports from trading partners, while the broader weakening of global economic activity – stemming from diminished confidence and trade flows – further suppresses export demand from the rest of the world. As in the US, the slowdown in domestic activity exerts downward pressure on labour costs and profit margins. Moreover, in contrast to the US, the inflationary impulse from higher import costs seen in the US does not materialise elsewhere, in the absence of (high) retaliatory tariffs. Instead, the weaker global demand environment places downward pressure on global import prices, reinforcing the disinflationary trend.

For US trading partners, the predominant transmission channel is through reduced real activity, driven by heightened uncertainty and declining external demand

Retaliation tariffs have limited impact on average import tariffs

When trading partners impose retaliatory tariffs on US exports, the overall effect on average tariff levels and import prices for most economies remains limited, and is unlikely to generate significant supply shortages or broad-based inflationary pressures. Moreover, retaliatory tariffs are likely to focus on final consumer goods to minimise broader cost effects transmitted through global value chains. For example, the EU's tariff response has targeted products such as beverages, food, and home appliances. Nonetheless, at the margin, retaliatory tariffs may exert modest upward pressure on inflation. For the US, however, retaliatory tariffs by a broad set of trading partners results in a more pronounced increase in the average tariff burden on US exports. As a consequence, US export competitiveness deteriorates, threatening to reinforce the slowdown in activity.

Retaliatory tariffs are likely to focus on final consumer goods to minimise broader cost effects

Stylized example - direct pass-through from tariffs

The pass-through from tariffs to import prices, and subsequently to consumer prices, is complex and depends on multiple factors, including the price elasticity of imports, the types of goods targeted by tariffs, and the degree of (cross-border) value chain integration. However, a simple back-of-the-envelope calculation assuming a universal tariff can still provide useful insights.

Import price and consumer prices

A country where goods from the US account for 8 percent of total goods imports – corresponding to the global share of US goods exports – imposes a uniform 10 percent retaliation tariff on US imports (a plausible assumption for trading partners other than Canada, Mexico and China). This would raise the average tariff rate – and the total import price – by approximately 0.8 percent. In a country where imported goods make up 25 percent of consumer consumption (a plausible estimate for a European economy), full pass-through would lead to an increase in consumer prices of around 0.2 percent.

In the case of the US, assuming a 15 percent increase in the average tariff level and an import content of 10 percent in consumption, full pass-through would imply a rise in consumer prices of about 1.5 percent.

Export prices

US exports face larger tariff hikes than its trading partners' exports. The pass-through of US import tariffs to the overall tariff rate faced by an average trading partners' exports is approximately 13 percent – reflecting the share of US imports in global imports. A 15 percent increase in US tariffs would therefore raise the average tariff faced by partner country exports by about 2 percent. By contrast, symmetric retaliation – whereby trading partners impose equivalent tariffs on US exports – would raise tariffs on US exports by the full 15 percent.

Muted indirect tariff effects through global supply chains

Tentative short-run risks include transition costs for the reshaping of global supply chains

There is a risk that the trade war generates inefficiencies or even shortages spreading across the world through integrated value chains. We consider this risk to be primarily linked to an escalation of the conflict to include more countries and increased global fragmentation (see *Global backdrop*), even if bilateral tariffs also imply tentative efficiency losses in global values chains, raising production costs across countries, in particular in the longer run. Tentative short-run risks include transition costs for the reshaping of global supply chains and costs for maintaining larger inventory levels to avoid higher tariff costs and/or mitigate the impact of tentative disruptions.

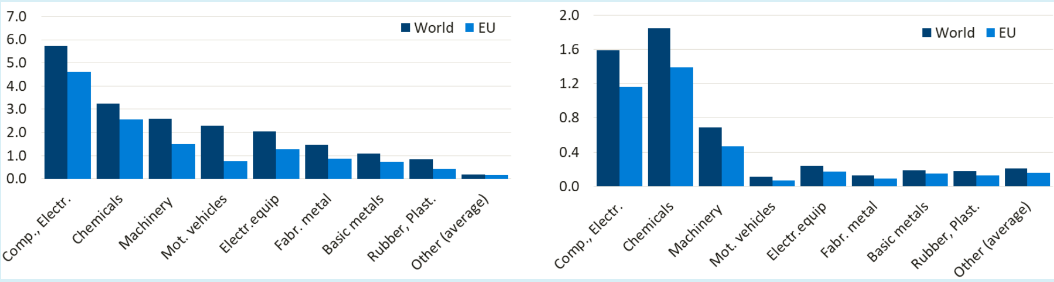
Third countries are also indirectly affected by relatively high US–China tariffs. For example, higher US tariffs on Chinese imports would raise US export prices, creating an indirect tariff burden on US export markets. However, we believe that this effect is limited, provided that the trade crisis between the US and China does not escalate again (see box below).

Indirect tariff burden of high bilateral tariffs between the US and China

The indirect tariff burden of bilateral tariffs between the US and China has been analysed in a report in The World Economy. The authors use input-output data and illustrate the effects with an example whereby tariffs between the US and China are increased to 100 percent in both directions. In the electronics sector, which depends heavily on imported intermediate goods, the indirect tariff effect of the US tariff on China (left chart) is estimated at roughly 5 percent in both the EU and globally. In addition, the impact of the Chinese tariff on the US is estimated at roughly 1 percent in the EU and 1.5 percent globally (right chart). Hence, the total tariff burden on computers and electronics from a 100 percent bilateral tariff between the US and China would be 6.5 percent.

The impact on most other products is much less pronounced, with the weighted indirect tariff burden for the EU estimated at about 1.2 percent – a 0.9pp contribution from US tariffs on China and 0.3pp from Chinese tariffs on the US. Assuming 30 percent tariffs between the US and China – roughly in line with our baseline scenario – the indirect tariff burden on all manufactured imports to the EU would be around 0.4 percent. In our view, this suggests that the inflationary impact of high bilateral tariffs between the US and China is relatively muted for most other countries.

Indirect tariff burden due to 100% higher bilateral tariffs between US and China



Note: Based on Mao, H. and Görg, H. (2020), "Friends like this: The impact of the US–China trade war on global value chains", The World Economy, Vol. 43, No 7 – The left chart shows the indirect effect of US tariffs on China and the right chart shows the indirect effect of Chinese tariffs on the US

Export opportunities and intensified competition

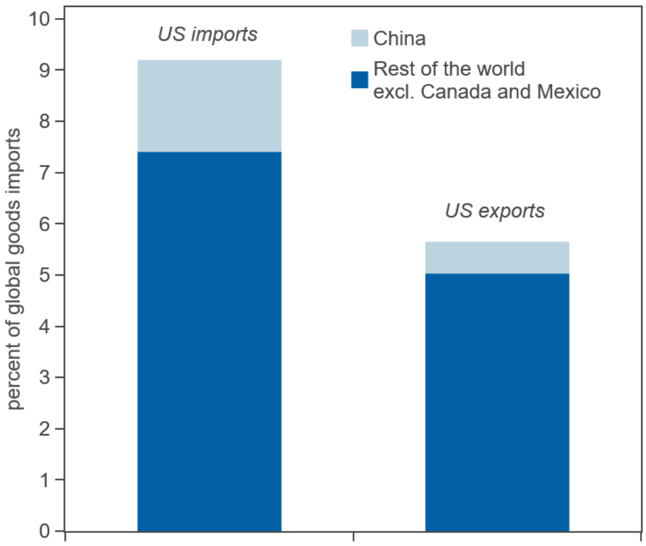
The trade war has significant implications for relative competitiveness and is likely to reshape global trade flows. In particular, US imports are expected to decline as a result of import tariffs, posing significant challenges for its trading partners. After all, US imports account for approximately 13 percent of global goods imports and around 3 percent of global GDP. At the same time, US exports are likely to decrease due to retaliatory tariffs. Trade flows between the US and China are expected to be especially affected, reflecting the relatively large increase in tariffs between the two countries. Overall, this creates both challenges and opportunities for US trading partners, with some countries likely to lose more than others.

US imports account for about 13 percent of global goods imports and around 3 percent of global GDP

An illustration of aggregate trade flows provides a useful reference point for assessing the competition for market shares. US trading partners face a loss in export demand due to the decline in US imports, while they also have the potential to gain market shares as a result of reduced US exports. However, as US imports substantially exceed US exports, the net effect for trading partners outside Canada and Mexico is a smaller aggregate export market. For instance, a 10 percent decline in US imports (lost market share) corresponds to roughly 0.9 percent of global imports, whereas a 10 percent decline in US exports (market share opening up) corresponds to less than 0.6 percent. For one country to emerge as a net winner, there must also be a net loser. US imports from China – representing roughly 2 percent of total global imports – are expected to decline relatively more due to tariffs. While this creates opportunities for other exporters to expand their US market share, China is likely to intensify efforts to redirect exports to (or through) alternative destinations, thereby increasing competition both in third markets and domestically.

China is likely to intensify efforts to redirect exports to (or through) alternative destinations

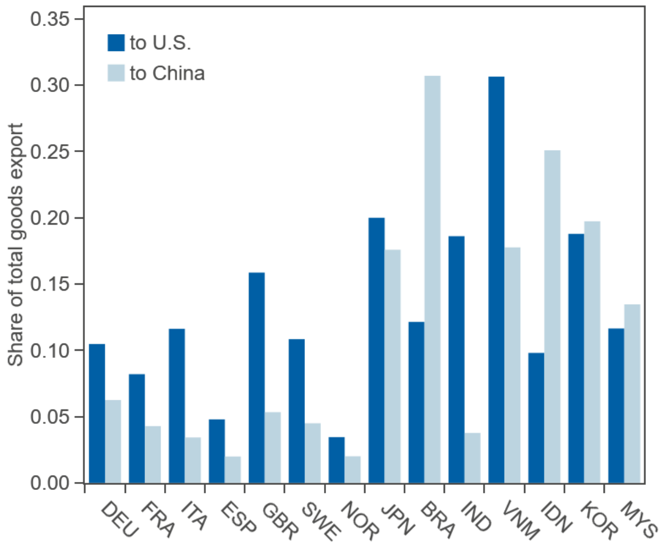
Market shares affected by shifts in competition



Sources: IMF and Handelsbanken

Note: The chart illustrates the size of trade flows most likely to be affected by tariffs – US exports to countries other than Mexico and Canada, and Chinese exports to the US

Export to US and China



Sources: IMF, Macrobond and Handelsbanken

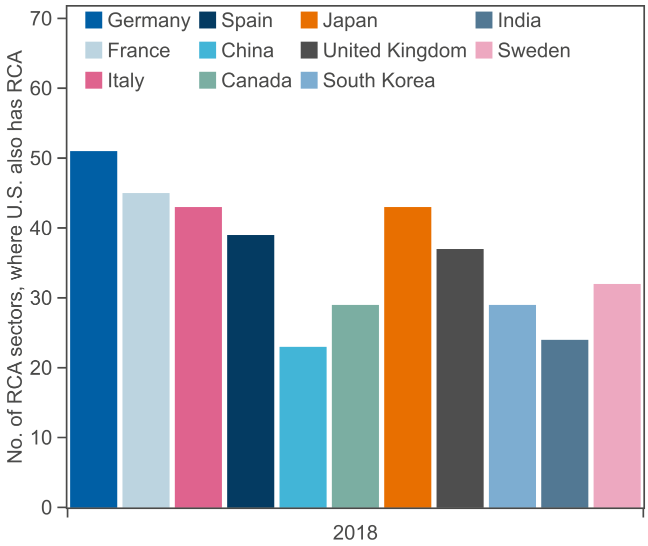
Advanced economies to compete for lost US exports

One gauge of how well trading partners are positioned to compete for the export gaps arising from the trade war is the degree of overlap in comparative advantages – specifically, similarities with China's exports to the US and with US exports to the rest of the world (excluding Canada and Mexico). The revealed comparative advantage (RCA) index measures a country's relative advantage or specialisation in exporting a particular good or service.[6] By comparing RCA values across countries, we can identify the number of sectors with overlapping comparative advantages, providing a rough estimate of the extent to which individual countries may be affected by changes in the competitiveness of their trading partners.

Looking first at the potential to replace US exports, Germany has the greatest overlap in comparative advantages, but the number of overlapping sectors is similar for other European countries and Japan, suggesting a close race to compete for lost US market shares among advanced economies. The overlap between the US and China, however, is relatively low. Turning to a comparison with China, a high degree of overlap may be a double-edged sword. On the one hand, it signals potential to replace lost Chinese market shares in the US. On the other hand, it also indicates increased Chinese competition in third-country markets as China looks elsewhere to recover lost US market shares. Italy stands out with a relatively high overlap, while the UK and Canada have a low degree of overlap (see *Eurozone* article for more discussion).

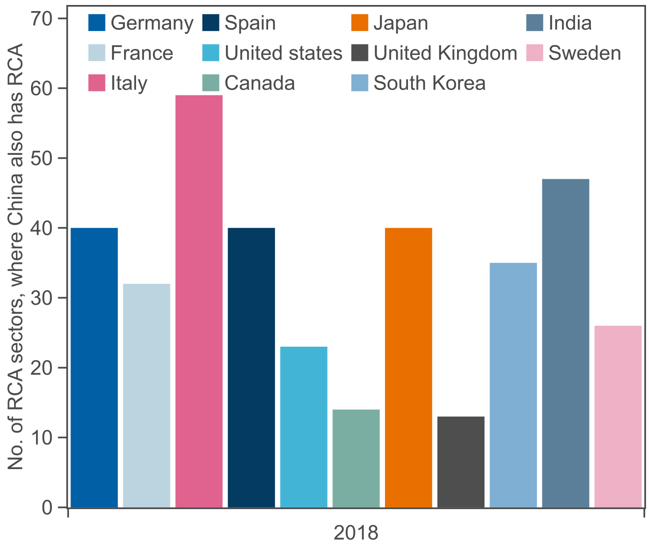
A high degree of overlap with Chinese exports may be a double-edged sword

Comparative advantage overlap with the US



Sources: UNCTAD and Handelsbanken

Comparative advantage overlap with China



Sources: UNCTAD and Handelsbanken

Chinese exports replaced by neighbouring Asia

Trade patterns following the 2018-19 US-China tariff hikes show that Chinese exports previously destined for the US found alternative markets, including neighbouring Asian countries and, notably, the eurozone. While increased Chinese exports to the eurozone reflect structural similarities – as captured by an Export Similarity Index (ESI) – the rise in Chinese exports to neighbouring Asia is less attributable to such overlap with exports to the US. Instead, the latter likely reflects supply chain reconfiguration, partly aimed at circumventing US tariffs. Supporting this view, Federal Reserve analysis indicates that US import substitution away from China was accompanied by increased imports from countries that, in turn, imported more of the same goods from China. ECB analysis similarly finds that Asian neighbours expanded exports to the US, while no significant increase was observed from other regions, including the eurozone, with exports to the US the least similar to China’s. Recent trade data supports this view with Vietnam's imports from China and exports to the US both reaching a post-pandemic record in April.

The rise in Chinese exports to neighbouring Asia reflects supply chain reconfiguration, partly aimed at circumventing US tariffs

Overall downward pressure on global trade prices

Overall, the 2018-19 tariff hikes episode suggests that neighbouring Asian economies are best positioned to replace declining Chinese exports to the US, while regions such as the eurozone may absorb redirected Chinese exports. The net effect on export demand and export performance across individual countries remains uncertain. In general, countries with limited exposure to the US market and to Chinese competition in third-country markets, will be less directly affected by tariff measures. Similarly, economies with a high share of differentiated exports are better positioned to maintain market share in both the US and third-country markets.

The net effect on export demand and export performance across countries remains uncertain

Nonetheless, the smaller global export market for trading partners outside North America increases competition, putting downward pressure on global trade prices as US trading partners – particularly China – seek to recover lost US market shares. This pressure is further reinforced by the broader sentiment-driven slowdown in global demand, which also contributes to weaker pricing dynamics. Thus far, this has been most evident in the decline of oil and other commodity prices, although the recent drop in oil prices is partly driven by supply factors. While demand for differentiated goods tends to be relatively price inelastic, these products are not fully insulated from the broader slowdown, and downward price pressure is expected to be felt across sectors and countries.

Increased competition puts downward pressure on global trade prices

Port congestion could cause price pressure as demand resumes

Less global trade reduces demand for freight and should exert downward pressure and reduce the risk of congestion. At the same time, shifts in capacity from transpacific to other lanes risks generating congestion in ports, with implications for delivery times and the availability of goods. At this point there is little evidence of tariff-related disruption in ocean supply chains or upward pressure on freight rates. However, uncertainty has generated spot rate volatility in freight rates, which may reflect risks of capacity constraints if and when the US-China trade dispute is resolved and demand resumes, and shippers begin to diversify supply chains across regions.

At this point there is little evidence of tariff-related disruption in ocean supply chains or upward pressure on freight rates

Price setting behaviour remains a concern

There are growing concerns that renewed, albeit tentative, cost pressures from trade tensions could have a relatively strong pass-through to inflation. Research on the post-pandemic inflation surge pointed to a non-linear Phillips curve, suggesting that price and wage-setting behaviour is influenced by prevailing economic conditions rather than remaining constant over time.[7] In particular, when marginal costs rise sharply, companies tend to increase prices more frequently to safeguard profit margins, while tight labour markets encourage more flexible wage adjustments as companies compete to attract and retain workers. Also, the recent period of elevated inflation may have heightened the responsiveness of inflation expectations to new inflation shocks.[8]

In most countries, we assess resource utilisation to be supportive of disinflation

In our baseline inflation scenario, we include some remaining challenges in the final phase of disinflation, including elevated service prices, persistently high price expectations among companies and households, and, in some regions and sectors, still tight labour markets. Nevertheless, in most countries, we assess resource utilisation to be supportive of disinflation, admittedly at different speeds, and we do not see any obvious cost-push shocks in the pipeline that would interact with post-pandemic price setting behaviour and induce a renewed rise in inflation.

Dollar depreciation moderates trading partners' inflation pressures

During the 2018–19 trade war, the dollar appreciated and the Chinese renminbi depreciated. Similarly, under normal circumstances, recent widening interest rate differentials and safe haven capital flows due to heightened uncertainty would be expected to contribute to dollar appreciation. In the current environment, however, the dollar has actually weakened, which helps to moderate the transmission of inflationary pressures from the US to the rest of the world. Moreover, the weaker dollar amplifies the negative impact on US import demand.

Eurozone

Trade policy uncertainty delays the recovery

The eurozone economy has been navigating towards a soft landing, with a recent pickup in growth and continued disinflation despite record-low unemployment. However, the trade war escalation implies mounting headwinds as trade policy uncertainty hurts both global and domestic demand and Chinese overcapacity pressures domestic manufacturing. The slowdown is likely to lead to a mild increase in unemployment and contain domestic inflation, supported by easing imported inflation. We believe the ECB will see through the April spike in service prices and deliver two rate cuts to 1.75 percent in September. We expect growth to slowly improve again during the second half of this year as policy uncertainty recedes, and domestic demand is supported by economic policy easing.

Recovery on track for a soft landing...

The eurozone economy has been on a trajectory towards a soft landing, with momentum gradually building. Growth has picked up, unemployment remains historically low, and inflation has closed in on the ECB's target, although elevated service prices have remained a concern. GDP expanded by 1.2 percent over the past four quarters, and households appear well-positioned to sustain further growth. Alongside the resilient labour market, households' purchasing power is being underpinned by solid wage gains, cooling inflation and easing monetary policy.

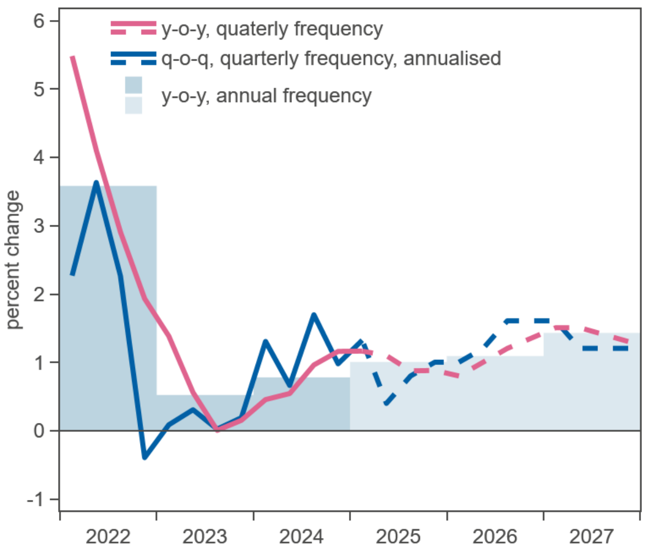
Growth has picked up and unemployment remains historically low

...but delayed by the escalated trade war

This relatively benign domestic outlook now stands in contrast to mounting external headwinds. In light of this shift, we now anticipate a delay in the eurozone recovery. The downturn is primarily being driven by increased uncertainty, but also weaker export demand, due to the trade war (see *Global backdrop*). At this point, however, there is little evidence of imbalances that would generate a deeper and more durable downturn. In particular, we note that households are still equipped with strong balance sheets, which should support a recovery as uncertainty fades. We expect the recovery to regain traction during the course of next year, as new trade agreements are concluded and policy uncertainty recedes, supported by monetary policy easing and fiscal stimulus. Hence, we forecast GDP growth of around 1 percent in 2025–26, rising to 1.4 percent in 2027.

Trumps tariff announcements on 2 April dealt a significant blow to global trade confidence

GDP forecast



Sources: Macrobond, Eurostat and Handelsbanken

Selected survey indicators

Sources: Macrobond, S&P Global, European Commission and Handelsbanken

Uncertainty around US tariffs on EU exports remains high

The escalation of trade tensions has broad global repercussions

Eurozone exports to the US are subject to an average tariff rate hike from about 1.5 percent to 10 percent based on 2023 trade volumes. Should the currently paused additional reciprocal tariffs be implemented, the effective average tariff rate would rise to around 15 percent. Among the threatened sectoral tariffs, those announced for pharmaceuticals would be of particular importance for the EU. The US is the main destination for extra-EU exports of pharmaceuticals (38 percent in 2024) and pharmaceuticals accounted for roughly a quarter of all EU exports to the US. It is noticeable that US pharmaceutical imports surged in March – to the equivalent of 20 percent of all pharmaceutical imports in 2024 – signalling that the industry stocked up ahead of potential tariffs.

A 10 percent increase in the tariff on exports to the US implies that the average tariff on all exports from a typical EU country – including intra-EU trade – increases by approximately 0.7 percent. By the same logic, a 10 percent retaliatory tariff by the EU on imports from the US would raise the average import tariff towards all countries by about 0.5pp.

Chinese competitiveness challenges eurozone industries

The share of eurozone imports from China increased notably in the wake of the 2018 trade tensions

Of particular concern is the potential for Chinese overcapacity – fuelled by diminished access to the US market – to exert pressure on eurozone manufacturing. In the wake of the 2018 trade tensions, Chinese exports to the US slumped, prompting Chinese exporters to reorient towards alternative markets, including the eurozone. Analysis by the ECB shows that the share of eurozone imports from China increased notably in product categories affected by US tariffs, reflecting that China's export structure to the eurozone is highly aligned with that of the US. Conversely, the composition of the eurozone export basket to the US is among the least similar to China's, and eurozone exports to the US remained largely unchanged, failing to fill the gap left by Chinese exports.

The number of sectors in which both China and the eurozone exhibit a revealed comparative advantage has risen steadily

Meanwhile, limited overlap between Chinese and eurozone exports to the US also suggests that direct competition from China may not be a major concern for eurozone manufacturing on an aggregate level. However, as Chinese exporters move up the value chain, the degree of overlap with high value-added sectors traditionally dominated by European firms – such as automotive and machinery – has increased. Recent trends reinforce this concern. The number of sectors in which both China and the eurozone exhibit a revealed comparative advantage (RCA) has risen steadily (see *Inflation* theme article). Moreover, eurozone export market shares have declined, particularly in sectors in which relative price increases have outpaced those of Chinese competitors. These developments suggest that sector-specific pressures are intensifying, with implications for industrial competitiveness in the eurozone.

Uncertainty weighing on domestic demand

Households' concerns about future employment and income prospects are prompting a shift toward precautionary savings

We believe the primary impact on eurozone economic activity will stem from heightened uncertainty regarding the global trade policy environment, and note that this uncertainty is already weighing on sentiment. Notably, expectations regarding future activity – in particular among households and within the services sector – deteriorated sharply in April. We expect the lack of clarity to be reflected in companies deferring investment and hiring decisions. In parallel, households' concerns about future employment and income prospects are prompting a shift towards precautionary saving, pausing the ongoing recovery in consumption. Admittedly, hard data on economic activity and more timely survey data on output and new orders have shown limited signs of a pronounced slowdown thus far.

Current developments do not suggest higher financial stress

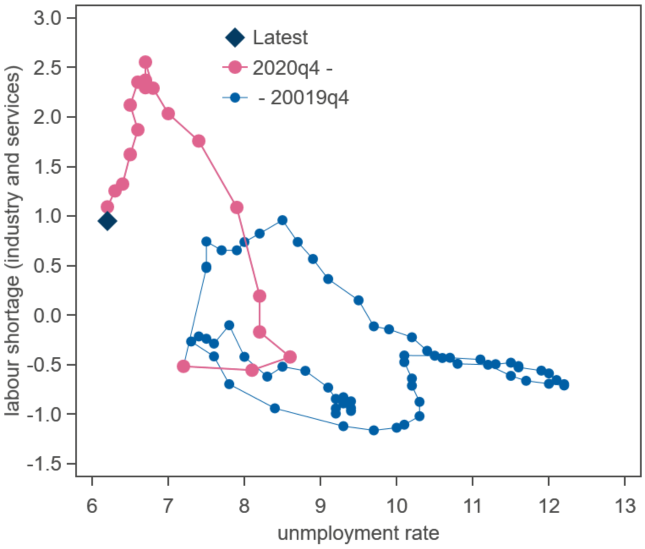
Financial conditions have tightened in response to rising uncertainty. Equity markets have declined and risk premia on corporate credits have widened. However, although these developments have contributed to a deterioration in overall confidence, current developments do not point to an escalation in financial stress.

Easing wage growth despite record-low unemployment

The eurozone labour market has exhibited remarkable resilience throughout the recent inflationary episode. Unemployment has remained at or near historical lows in recent months, reflecting robust employment amid slowing output growth. At the same time, reported labour shortages have declined markedly, suggesting an ongoing easing of labour market tightness and wage pressures have also begun to moderate, as negotiated wages indicate further wage growth easing in 2025.

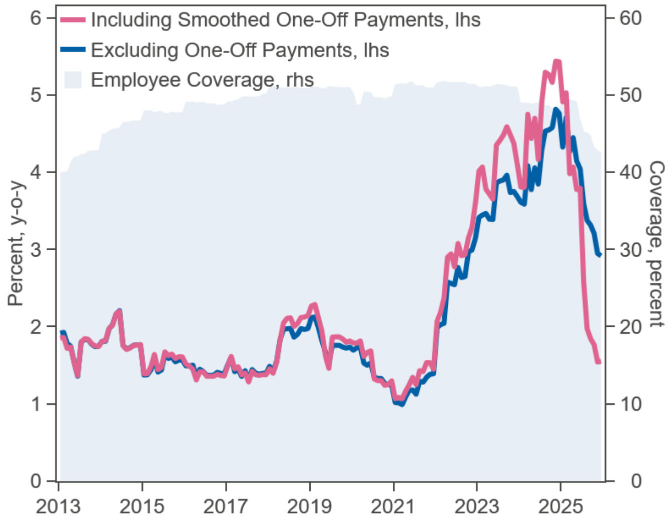
The eurozone labour market has exhibited remarkable resilience

Labour shortages and unemployment



Sources: Macrobond, European Commission and Handelsbanken

ECB wage tracker



Sources: Macrobond, ECB and Handelsbanken

A mild rise in unemployment as demand slows

The strength of the labour market has coincided with persistently weak labour productivity. Output per worker has fallen below its already modest pre-pandemic trend, contributing to rising unit labour costs and exerting pressure on corporate profit margins. More recently, the recovery in economic growth has been accompanied by a rebound in labour productivity, which has helped moderate unit labour cost increases. Nevertheless, the anticipated slowdown in demand may prompt renewed pressure on companies to adjust employment or absorb rising unit labour costs through further compression of profit margins, as weakening demand should make it difficult to pass on rising costs to final prices. While companies are likely to remain cautious about shedding staff – particularly in the absence of clear evidence of a sustained downturn – we expect to see a modest deterioration in labour market conditions. With profit margins already under pressure and demand softening, some degree of labour market adjustment appears likely. Hence, unemployment is projected to edge up from 6.2 percent to 6.4 percent before falling back again during 2027.

The anticipated slowdown in demand may prompt renewed pressure on companies to adjust employment

Cost pressures to ease - domestic as well as imported

We expect softening demand and a cooling labour market to contain domestic inflation – both wages and margins. In parallel, we believe easing global trade prices (see theme article), coupled with more a stronger euro exchange rate, will exert downward pressure on imported inflation. Overall, this should support the ongoing disinflation. We expect the EU to respond with retaliatory tariffs on US goods, but deem that the inflationary impact will likely be limited (see theme article).

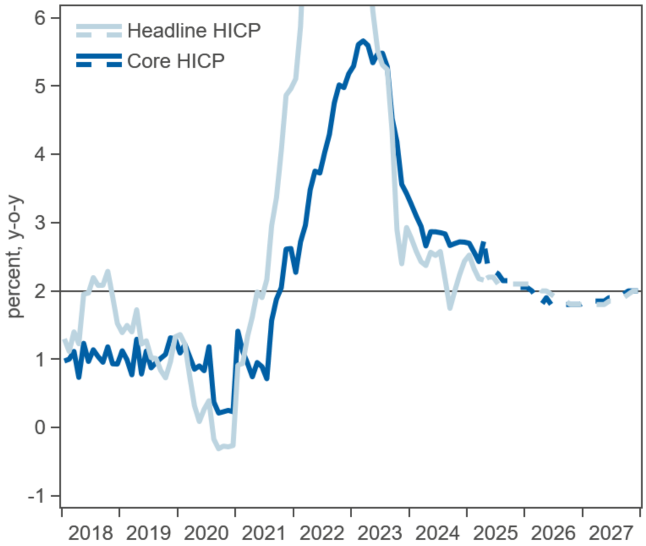
Softening domestic activity, easing imported inflation and a stronger euro support the ongoing disinflation

High service inflation remains a concern

Headline HICP inflation eased to 2.2 percent in April, driven largely by a decline in energy prices. Looking ahead, inflation is expected to continue its gradual descent, falling below the ECB's 2 percent target over the course of 2026. However, elevated services inflation remains a near-term concern. In April, services inflation rose to 3.9 percent, pushing core inflation up to 2.7 percent and effectively reversing the downward trend observed in the previous two months. We assess that

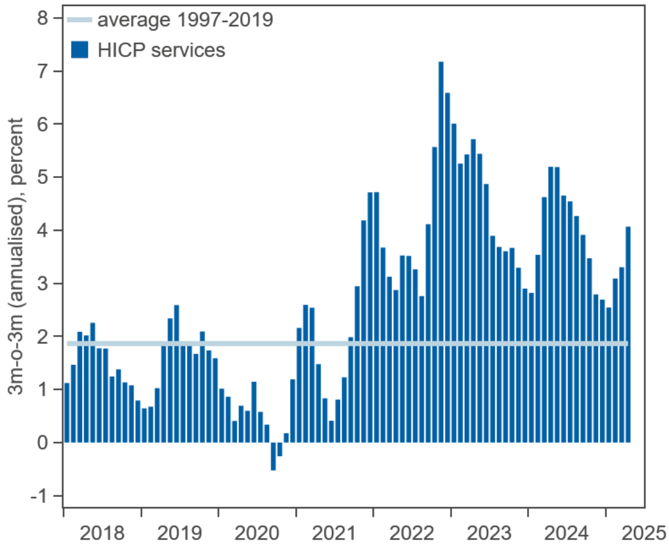
Underlying momentum in service prices has been on an upward trajectory since the beginning of the year much of this spike is likely due to temporary calendar effects related to the timing of Easter holidays, rather than a renewed build-up in underlying price pressures. Nonetheless, near-term service sector price expectations remain elevated and momentum in service prices has been on an upward trajectory since the beginning of the year, signalling that the last mile of disinflation is not yet a done deal.

Inflation forecast



Sources: Macrobond, Eurostat and Handelsbanken

Service inflation momentum



Sources: Macrobond, ECB and Handelsbanken

Note: Seasonally adjusted

The trade war strengthens the case for rate cuts

The adverse impact of escalated trade tensions on the economic outlook strengthens the case for a more accommodative monetary policy stance. With post-pandemic disinflation broadly progressing, and inflation expectations well anchored, and the policy rate remaining in restrictive territory, there is room for further rate reductions without jeopardising price stability. However, hard data confirming the scale of the slowdown will become available only gradually and the April HICP print adds a degree of uncertainty to the near-term inflation outlook. We expect the ECB to adopt a careful approach with a rate cut in June, a pause in July, and one additional cut in September, leaving the policy rate at 1.75 percent.

We expect the ECB to make cuts in June and September, leaving the policy rate at 1.75 percent

German fiscal expansion supports growth

In our forecast, we assume that the German structural deficit widens by about 2 percent to around 3.5 percent in 2027. This boosts GDP in Germany by around 1.5 percent by 2027, the end of our forecast period, spilling over to roughly half a percentage point higher GDP in the eurozone. The effect will be gradual with muted impact this year as it takes time to implement new spending.

Significant uncertainty around the size and impact of the stimulus

The the size and timing of the fiscal boost, as well as its effect on GDP, is shrouded in uncertainty. Friedrich Merz's failure to secure the chancellorship in a first vote in the Bundestag highlighted the slim majority in parliament, which could complicate agreement on the details of the economic policy agenda. The size and timing of the stimulus also depend on the effectiveness of reform implementation, with planning for defence strengthening and infrastructure improvement projects likely to take time. Moreover, although the national fiscal framework no longer restricts running larger deficits, the costs and risks of higher debt remain, and there is limited room for fiscal expansion under the current EU fiscal framework.

The national fiscal framework is no longer the main restriction

The German debt brake reform effectively removes the domestic legal framework as the main restriction on debt-financed expenditure reforms. The reform has four main pillars:

- The limit for a Federal government structural deficit of -0.35 percent of GDP remains in place.
- Defence spending above 1 percent of GDP is freed from the 0.35 percent limit.
- A EUR 500bn off-budget fund for infrastructure investment over 12 years, around 1 percent of GDP per year.
- Federal states are allowed to run structural deficits of -0.35 percent of GDP.

Since the rules require that 1 percent of defence expenditure be financed, the non-defence federal surplus – including interest payments – must be at least 0.65 percent of GDP. However, there is no cap on defence spending. Assuming military expenditure was set to reach, for example, 3.5 percent of GDP even in the absence of the reform, the debt brake would effectively free up 2.5 percent of GDP for other spending. Adding 1 percent of GDP per year in spending from the off-budget infrastructure fund and the 0.35 percent deficit permitted at federal and state levels allows debt-financed structural borrowing to exceed 4 percent of GDP.

Costs associated with higher government debt remains a constraint

The relaxed fiscal framework does not change the costs associated with higher government debt, including increased interest expenses and concerns about fiscal sustainability. In theory, the debt level remains sustainable after the reform, as the criteria are defined in terms of a structural balance – including interest payments – rather than a primary balance. However, a sustained deficit of 4 percent would raise the debt level to between 80 and 92 percent of GDP by 2036, and to between 110 and 200 percent in the long run, depending on GDP growth (see chart). To keep the debt-to-GDP ratio near 70 percent by 2036 with a safety margin, the average deficit should likely not exceed 2.5 percent of GDP. Fitch Ratings notes that a debt-to-GDP ratio approaching 70 percent by 2027 would be the highest among 'AAA'-rated peers. While Germany's status as the eurozone's benchmark issuer with a large, diversified economy enhances its debt-carrying capacity, the rating agency flags that a shift towards more spending could increase pressure on the rating over the longer term.

German debt-to-GDP in 2036 under different assumptions

Source: Handelsbanken
Note: Scenarios for debt-to-GDP under different assumptions about (constant) nominal growth (g) and deficits (d)

The EU fiscal framework requires public debt to be below 60 percent of GDP

The EU fiscal framework requires EU member states keep their budget deficits within 3 percent of GDP, and their public debt below 60 percent of GDP. Under the new rules, which entered into force in April 2024, the German structural primary balance would need to strengthen marginally, according to Bruegel calculations. Activating the national escape clause could ease the required consolidation. Nevertheless, the EU fiscal framework still limits the overall increase in German debt-financed general government expenditure – excluding interest payments – to less than 1.5 percent of GDP, and requires a gradual consolidation after 2028. This would impose a considerable restriction on the German government's ability to spend the EUR 500bn off-budget fund on infrastructure investments, without consolidation in other areas.

With several countries, including France and Italy, committed to significant budgetary consolidation in line with the new rules, it will be difficult for the Commission to grant Germany an exception. At the same time, the German government is unlikely to retreat from its pledged reforms to boost infrastructure investment. Our assumption that the structural deficit will rise from around 2 percent of GDP to around 3.5 percent of GDP by 2027 implicitly reflects a compromise involving reforming or bending the rules under the EU fiscal framework. Similarly, the structural deficit is likely to remain above 1.5 percent – a level we estimate to be broadly consistent with a debt-to-GDP path towards 60 percent – even after 2028, unless trend growth surprises on the upside.

Fiscal multipliers range from 0.5 to 1.0

Estimates of the impact of government expenditures on GDP – so-called fiscal multipliers – vary widely across countries and studies, and a more precise assessment is difficult without details on the type of spending. That said, a plausible rough generic fiscal expenditure multiplier would range from 0.5 to 1.0, and we have assumed the midpoint of this range.[9] While defence spending is generally associated with lower multipliers, other factors work in the opposite direction, including Germany's perceived strong debt-carrying capacity, sufficient slack in the economy to absorb higher demand, and the expected long duration of the stimulus package over the next decade. For the eurozone, we assume spill-over effects proportional to Germany's share of the eurozone economy, which is about one third.

Norway

Robust growth outlook

The outlook for the mainland economy remains robust, in our view. At the same time, wage and price pressures are still strong, leaving Norges Bank in no hurry to lower its key policy rate. We maintain our view that the first rate cut will come in no earlier than September – and that it will likely be the only cut this year. This puts us at odds with the interest rate market, which currently anticipates two cuts in 2025. If our view proves correct, it could pave the way for further appreciation of the Norwegian krone.

Mainland GDP hovering around trend

The outlook for the mainland economy remains robust

The outlook for the Norwegian economy remains robust, in our view. We assume that Norway will be relatively unaffected by the ongoing conflicts, which have also recently moderated, allowing growth in the mainland economy to remain close to trend. We expect mainland GDP to grow by 1.5 percent this year, up from 0.6 percent last year. For next year, we forecast growth of 1.4 percent – in line with the economy's potential growth rate. Our projections imply that unemployment may edge slightly higher from current levels, but stabilise just below pre-pandemic levels. Meanwhile, underlying wage and price pressures remain strong, suggesting that Norges Bank is in no hurry to cut rates. We expect the first rate cut to come no sooner than September this year.

The Norwegian economy is not very exposed to the US, and trade signals from the EU remain positive

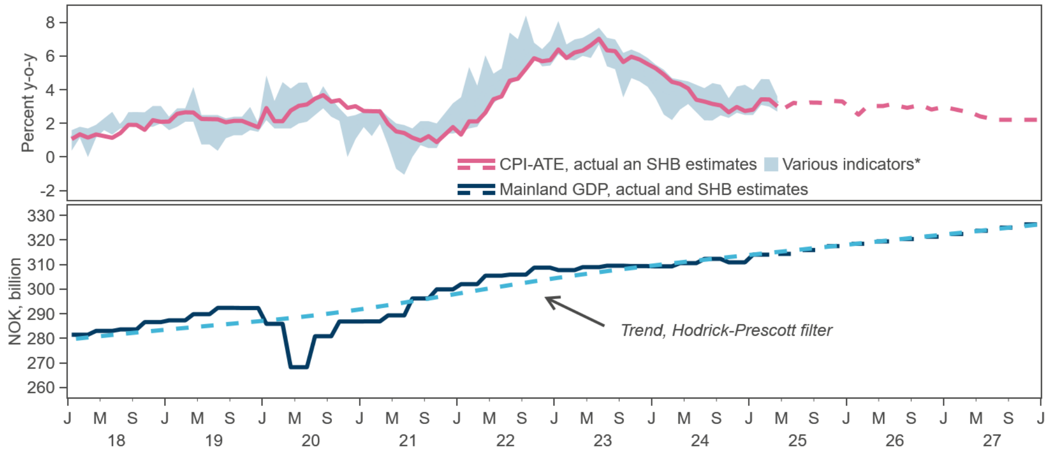
The medium-term outlook for the Norwegian economy, given the ongoing trade conflicts (which have eased recently), still suggests that the downside scenarios outlined by Statistics Norway have become more relevant. However, these scenarios still do not appear that severe from a Norwegian perspective. The US has stated that it will raise tariffs on Norwegian goods to 15 percent. At present, a 10 percent rate is effective, as many of the "reciprocal" tariffs remain on hold. Ultimately, we assume that 10 percent will serve as a lower band for US tariffs on Norwegian exports.

Importantly, only 3 percent of Norwegian exports are to the US. By contrast, three quarters of Norwegian exports go to European countries, with the eurozone accounting for roughly half of all exports. This means the Norwegian economy will be only marginally affected by US trade measures. A more critical risk would be if the EU were to implement general protectionist measures that might also impact Norway. While there are no guarantees, signals from the EU have been positive. Recently, European Commission President Ursula von der Leyen stated that it is “crystal clear” that Norway is part of the EU's internal market.

Unemployment expected to settle below pre-pandemic levels

The mainland economy had a solid start to 2025, growing by 1.0 percent q-o-q. While some of the growth can be attributed to volatile factors, underlying demand remained robust. Further ahead, we believe the negative trade effects on the Norwegian economy will be relatively limited. At most, we expect a reduction in GDP growth of about 0.1 percentage points *relative to the baseline.* According to a simple rule of thumb – Okun's Law, estimated on Norwegian data over time – this would imply an additional increase in the unemployment rate of just 0.03 percentage points. All told, the unemployment rate is still expected to settle below pre-pandemic levels.

Core inflation and mainland GDP



Sources: Macrobond and Handelsbanken
Note: Trimmed mean, weighted median, seasonally adjusted annual rate (CPI-ATE), three- and six-month moving average

Mainland GDP expected to continue to hover around trend

Price pressures remain solid - no rate cut until September

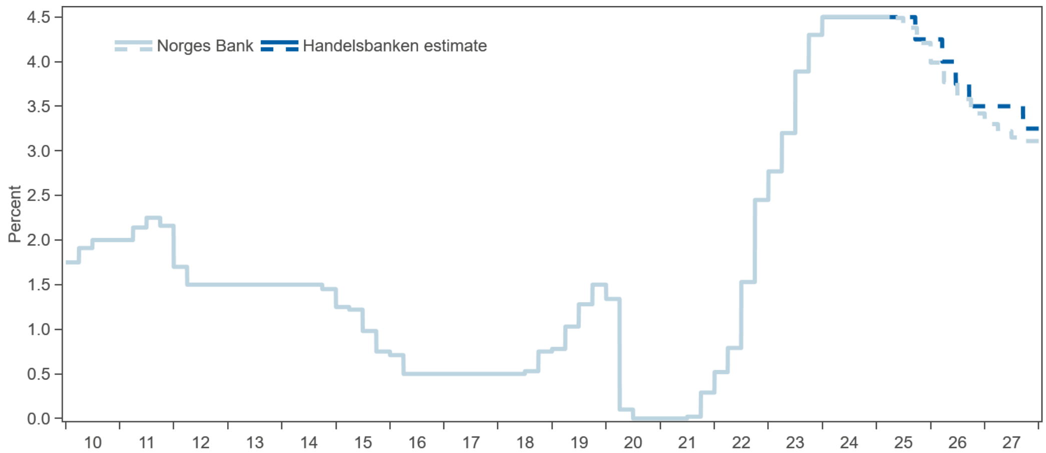
Unexpectedly strong inflation pressure caused Norges Bank to cancel the rate cut that was long-planned for March

Unless we see a surprising rise in unemployment – which we do not expect – Norges Bank is likely to hold off on further cuts for quite some time. This is because underlying inflation remains high. Core inflation (CPI-ATE) surprised significantly on the upside this winter, before moderating again in April. However, the gap to the inflation target remains wide. Other indicators of underlying inflation, such as trimmed mean and weighted median, also suggest that the decline in inflation has slowed. Wage growth continues to contribute significantly to high core inflation. This year's negotiated wage norm of 4.4 percent remains well above levels consistent with the inflation target over time – note that trend productivity growth in Norway is around 0.5–1.0 percent. This means wage growth would need to fall to around 3.0 percent to be more in line with the inflation target, which still seems a long way off. The wage share in Norwegian manufacturing remains low, implying scope for continued strong wage settlements aimed at restoring income distribution in the sector. This forms the basis for wage settlements elsewhere in the economy, prompting companies in more sheltered sectors to raise prices in response. This dynamic has characterised Norwegian wage and price behaviour in recent years, and these mechanisms have yet to fully play out. As a result, we believe that wage and price pressures are unlikely to ease back towards target until late in our forecast period.

We stick to our call that Norges Bank will wait until September to make the first rate cut – and that it will be the only rate cut this year

It was the unexpectedly strong inflation pressure that caused Norges Bank to cancel the rate cut long-planned for March. Given the dynamics just described, we are also sticking to our call that Norges Bank will wait until September to make the first rate cut, and that it will be the only rate cut this year. We therefore diverge from the interest rate market, which is currently expecting two to three rate cuts from Norges Bank this year. If we are right about the outcome, this also opens the door for some appreciation of the Norwegian krone in the period ahead. We estimate that the EUR/NOK will trade at around 11.30 by the end of this year.

Expectations for Norges Bank's key policy rate path



Sources: Macrobond and Handelsbanken

The market is too optimistic regarding the number of rate cuts expected this year, in our view - if we are right about the outcome, this opens the door for appreciation of the NOK

Sweden

Setback – uncertainty delaying the recovery

Uncertainty in the wake of recent US trade policy is weighing on the Swedish economy, hampering household consumption, investments and exports. As a consequence, we expect subdued growth and slightly higher unemployment this year. However, with rate cuts, expansionary fiscal policy, rising real wages and gradually reduced uncertainty, we believe that the necessary conditions are in place for the recovery to resume next year. Core inflation remains elevated, but is expected to ease as the economy weakens and the krona strengthens. We expect the Riksbank to cut rates in June and August to 1.75 percent to support a recovery. Long-term government bond yields are expected to rise slightly, partly reflecting relatively expansionary fiscal policy.

Weak growth outlook this year, but growth will pick up next year

Uncertainty dampens household consumption and business investment

The Swedish economy began to show signs of recovery last year as rising real wages and lower interest rates contributed to an upturn in household consumption and housing investment. In the first quarter of this year, however, the recovery had a setback. The flash GDP estimate for the first quarter showed zero growth compared to the previous quarter and households have now become significantly more pessimistic about both their own economic situation and the general outlook for the Swedish economy. The deterioration in household sentiment and the slowdown in the Swedish economy can probably be linked to the increased uncertainty about the global economy in the wake of the new US trade policy and higher inflation. However, recent signs that the trade war is de-escalating and the recovery in the stock market suggest that households will be less pessimistic going forward. Nonetheless, we expect households to continue to be more pessimistic than normal as a result of heightened uncertainty about both their own and the Swedish economy in general. This suggests that households will hold on tightly to their wallets in the near future and that a recovery in household consumption is postponed, while business investment is also dampened by uncertainty and weaker growth prospects.

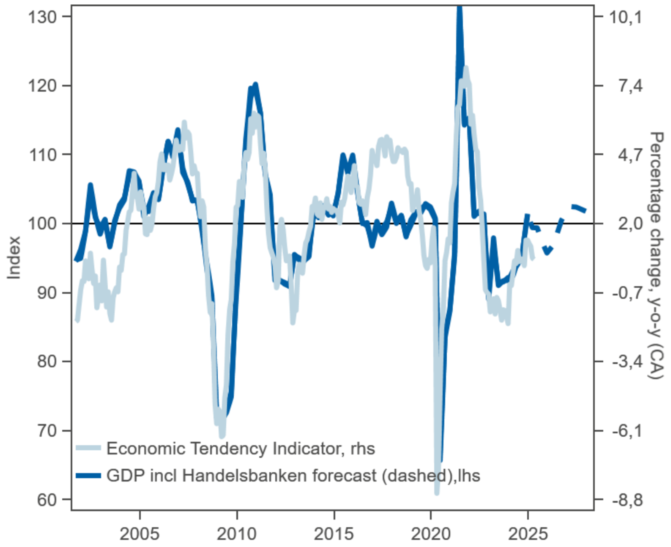
Higher tariffs and weaker global demand dampen exports

Higher tariffs and weaker global demand will suppress demand for Swedish exports. However, given that Swedish exports of goods to the US account for only 9 percent of total exports of goods, the direct effect on Swedish GDP of the assumed overall effective average tariff hike of around 10 percent on exports to the US – including general tariffs and sectorial tariffs on steel, cars and likely also pharmaceuticals (see *Global Backdrop* for EU tariff assumptions) – will be relatively limited. Exports of goods to the US will be subject to an average tariff rate hike from about 1.5 percent to 13 percent, based on unchanged trade volumes. Should the currently paused additional reciprocal tariffs be implemented, the effective average tariff rate would rise to around 18 percent, while threatened sectoral tariffs on pharmaceuticals would lift the average to around 22 percent. Over 80 percent of Swedish exports go to the EU's internal market or to markets with which the EU has free trade agreements. Overall, we expect GDP growth to land at 1.5 percent this year, compared with our forecasts from January of 1.9 percent for 2025.

Growth will pick up next year as uncertainty subsides and economic policy becomes more expansionary

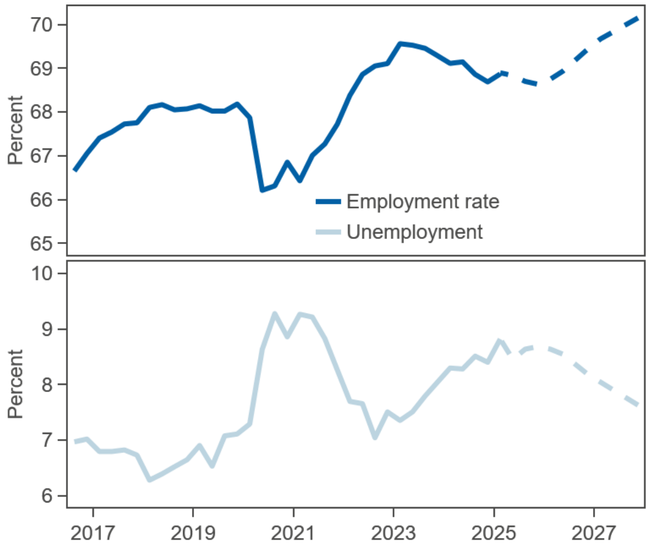
As the Riksbank cuts rates, uncertainty subsides and households' real wages continue to rise, we believe economic activity will pick up next year. More expansionary fiscal policy, with large unfunded defence investments and more money to households, is also excepted to contribute to higher growth next year and in 2027. Increased defence investments in the rest of the EU and a slight pickup in global growth will also contribute to increased exports. Furthermore, households' currently high saving rate – partly driven by precautionary saving – is expected to decline slightly, as the economic situation brightens. In combination with rising real disposable incomes, this will result in households increasing consumption relatively rapidly in the coming years. Overall, we forecast that GDP will increase by 2.1 percent next year and rise by 2.6 percent in 2027, and that resource utilisation returns to normal levels by the end of 2027.

GDP and NIER survey



Sources: Macrobond, NIER and Handelsbanken

Unemployment and employment rate



Sources: Macrobond, Statistics Sweden and Handelsbanken

A weak labour market for a while longer

Labour demand stabilised at the beginning of the year, after previously weakening for more than two years. Employment and hours worked increased in the first quarter, and some forward-looking indicators such as layoffs have normalised. However, in the coming quarters, we expect unemployment to increase somewhat as demand weakens, and some companies postpone hiring due to high uncertainty. The slowdown is being mitigated by the defence industry expanding at a rapid pace and public sector employment continuing to grow. As the growth outlook improves over the next year, this will also be reflected in the labour market, with rising employment and lower unemployment next year and in 2027.

Rising real wages strengthens households' purchasing power

Wage growth was 4.1 percent last year, implying that real wage growth picked up after declining sharply in 2022. The labour market parties have agreed on a new collective agreement that extends over two years from April 2025, with 3.4 percent wage-related cost increases in the first year and 3.0 percent wage-related cost increases the second year. We believe the new agreement will mean total wage growth (both centrally agreed wage increases and including wage drift) of around 3.7 percent this year and 3.6 percent in 2026. The relatively high wage increase means that real wages will rise in line with the historical trend since 2000, despite inflation being somewhat higher than normal. We also expect an expansionary fiscal policy next year, with tax cuts and other increased contributions to households totalling around SEK 30bn, further strengthening households' real disposable income. Together with lower interest rates and the turnaround in the labour market, this strengthens households' purchasing power and creates good conditions for a recovery in household consumption once uncertainty eases.

Underlying inflation remains stubbornly above the 2 percent target

Inflation is broad-based

In April, inflation stood at 2.3 percent according to the Riksbank's target variable CPIF. Excluding energy prices – which have contributed negatively to inflation for two years – inflation stood at 3.1 percent. Inflation is broad-based – food prices have accelerated again (up 4.7 percent in April), goods prices have stopped falling (up 0.4 percent), and service prices continue to rise faster than normal (up 3.8 percent).

Weaker economic activity should dampen inflation

Going forward, we expect the trade war to gradually dampen Swedish inflation through both weaker economic activity and lower global prices overall (see theme article on inflation). In addition, the krona has strengthened significantly, which is also expected to ease inflationary pressures.

CPIF excluding energy is expected to peak at around 3 percent this summer

Forward-looking indicators are increasingly divergent – some are now below their historical averages, while others remain significantly above – in contrast to the synchronised upturn in indicators seen in 2021–22. Overall, companies' price plans remain unusually high in relation to both historical averages and the subdued business cycle. However, there are no signs of a renewed inflation surge, and the new wage agreements are assessed to be consistent with real wage growth, a solid labour market, and the inflation target.

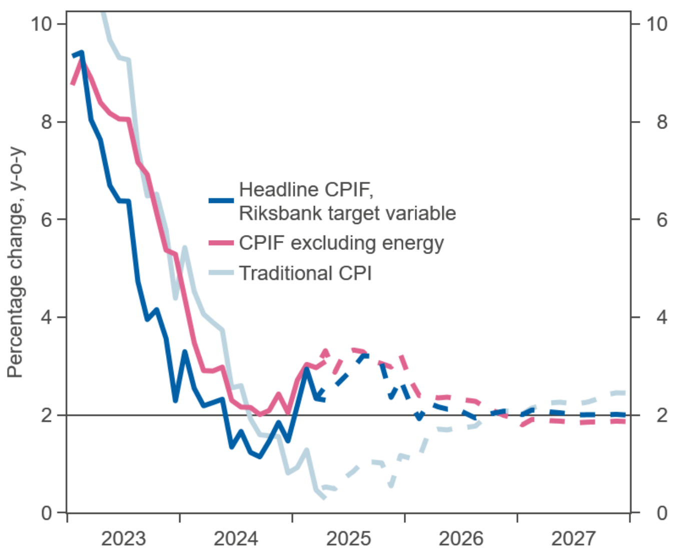
Overall, underlying inflation – measured by CPIF excluding energy (CPIFXE) – is expected to peak at around 3 percent this summer, reflecting goods price increases and broader price pressures evident in early 2025. Slowing economic activity, with support from lower global prices and the stronger krona, supports a decline in inflation during the second half of the year and convergence around the Riksbank's 2 percent target by 2026, somewhat later than we anticipated in January.

The sharp rise in household inflation expectations poses a risk

Rising household inflation expectations could influence wage formation and firms' scope for price hikes

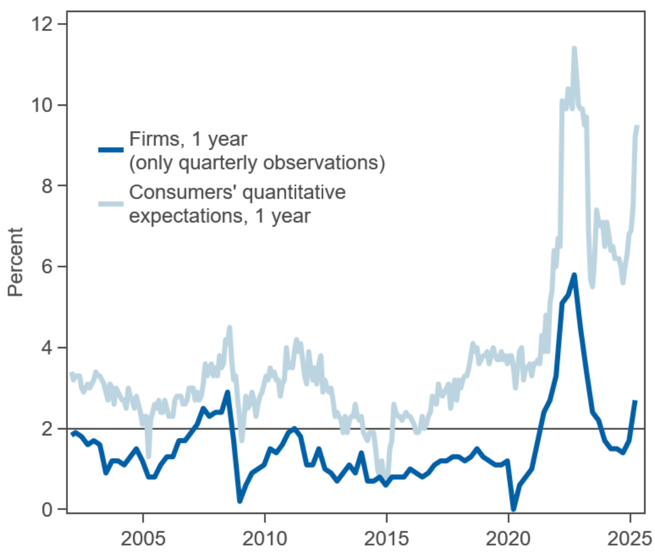
One risk to the inflation outlook is that inflation expectations among Swedish households have risen sharply in recent months – much more rapidly than historical relationships would suggest – which could influence wage formation and companies' scope for raising prices. However, other measures of inflation expectations, such as those among companies, have not risen to the same extent (see charts). This is assessed to limit the risk via the central bank credibility channel, though inflation expectations will continue to be closely monitored.

Inflation forecast



Sources: Macrobond, Statistics Sweden and Handelsbanken

Inflation expectations



Sources: Macrobond, NIER and Handelsbanken

The Riksbank opens the door to rate cuts - we expect two this summer

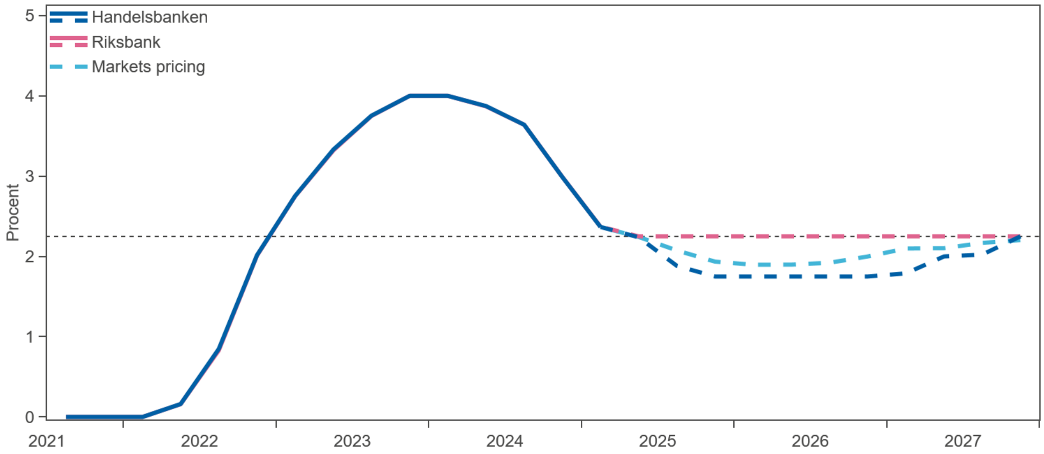
Weakening growth prospects

As expected, the Riksbank kept its policy rate unchanged at the May meeting. This was an interim meeting without updated forecasts. However, the Riksbank opened the door to further rate cuts, noting that growth prospects have worsened slightly since March and that trade tensions are likely to dampen inflation over time. According to the press release, this "could suggest a slight easing of monetary policy going forward".

We expect the Riksbank to cut rates in June and August, bringing the policy rate down to 1.75 percent – below our estimate of the neutral level. A lower rate could lend some support to households, who are currently very pessimistic about the economic outlook, according to the Economic Tendency Survey, and support the weak labour market. That said, further easing is contingent on inflation remaining subdued – in line with both our own and the Riksbank's forecast – without signals of renewed cost pressures.

A lower rate could lend some support to households

Riksbank policy rate



Sources: Macrobond, Handelsbanken and Riksbank

While signalling a potential cut, the Riksbank also highlighted uncertainty – both around inflation and the outlook, which could shift quickly. In our view, the timing and scale of rate cuts will depend on incoming data and the evolution of the trade conflict.

While signalling a potential cut, the Riksbank also highlighted uncertainty

Key data we believe will support a cut:

- Persistently low consumer confidence (even without further declines)
- The Riksbank's business survey indicates a wait-and-see approach and postponed investments
- Price plans are flat or weakening
- Inflation in line with or below the Riksbank's March forecast

Since our 9 April forecast, we have removed one rate cut. Since then, financial markets have stabilised somewhat and US-China negotiations have progressed faster than we expected. As a result, we nudge up our GDP forecast and now expect two, rather than three, rate cuts.

US-China negotiations have progressed at a faster pace than expected

Stronger krona despite a challenging environment

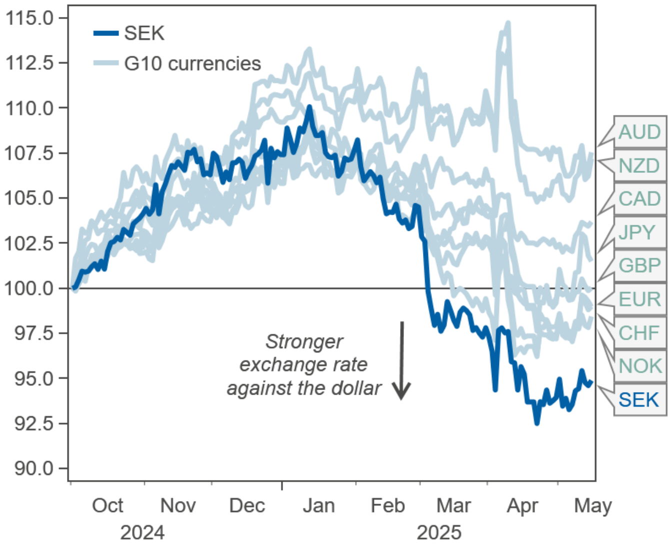
The Swedish krona has strengthened notably since the start of the year – a move that caught many by surprise given the high level of global uncertainty, a setting in which the krona typically struggles. The shift was triggered by growing concerns that Trump's tariff policies might hit the US economy harder than others, prompting investors to reduce their US exposure.

US growth concerns caused a shift out of US assets...

As capital flowed out of the dollar, the krona stood out among the G10 currencies – not because of a single domestic driver, but thanks to a broad set of underlying strengths. For example, the SEK remains clearly undervalued, Sweden's economic recovery from both the pandemic and recent trade-related turbulence is expected to be relatively strong, and the country benefits from exceptionally sound public finances. This last point is particularly important in uncertain times, as it gives the government fiscal room to support the economy if needed.

...and the krona came out on top driven by a long list of relative strengths

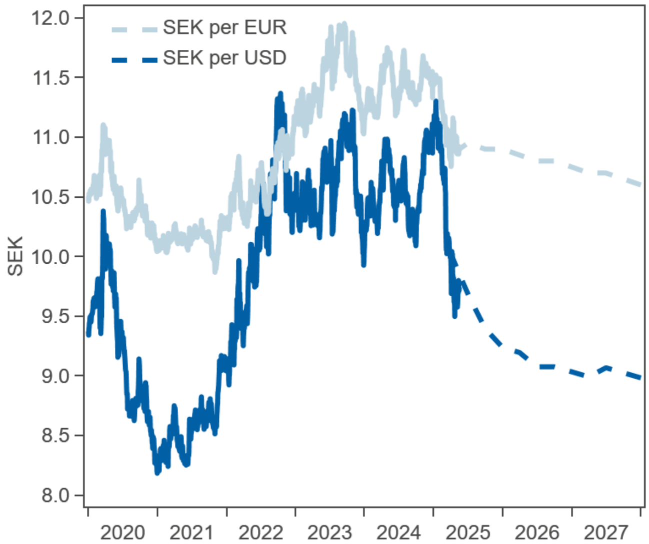
SEK has outperformed the other G10 currencies



Sources: Macrobond and Handelsbanken

Note: Index 100 = 2024-10-01. Higher values imply weaker currency against the USD

SEK appreciation expected to continue



Sources: Macrobond and Handelsbanken

Further SEK strength ahead

Looking ahead, we continue to see support for the krona from both cyclical and structural factors. However, the pace of appreciation is expected to be slower than in the early part of the year. Against the euro, gains are likely to be gradual, while a faster strengthening is expected versus the USD – mainly due to broader dollar weakness rather than SEK-specific drivers.

United Kingdom

Gliding to a halt

The UK remains set for a spell of lethargic growth, with GDP remaining essentially flat through the middle of 2025 and only gradually recovering over the course of the next three years. While the international trade situation and a poor investment outlook have been contributing to this malaise, much of the challenge is also home-grown, with record-high taxes draining consumer spending power and increased regulation dampening business confidence. Still, the subdued economic outlook points to inflationary pressures easing, and interest rates will continue to decline as a result.

This will not feel like growth

Recession averted, but get set for lethargic growth through 2026

Economic growth remains lethargic, and while our forecast for 2025 sees the UK avoiding two quarters of negative growth, and thus a recession, what growth there is will not be sufficient to substantially drive up confidence and thus business investment. Looking beyond the remainder of this year, we forecast only a slow recovery in 2026 and 2027 as tax hikes hinder consumer spending and consumer and business confidence continue to languish in light of domestic and political uncertainties.

April saw a flurry of growth-negative developments as consumer confidence and expenditure have been hit by tax increases. These rises had been set out in October 2024's budget, but only came into effect in April. Specifically, these taxes represented a 2p rise to 13.8p for employers' National Insurance (essentially an income tax), as well as increases in local council property taxes. Alongside these higher tax rises, the cost of doing business has also risen with the National Living Wage increasing by 6.7 percent for adults and 18 percent for young workers. Looking further ahead, the details of the Employment Rights Bill are far from clear, but expectations are that the legislation will be drawn up in favour of workers rather than employers, leaving the latter cautious. Combined, these factors have constrained our expectations for growth in both consumer expenditure and business investment.

As for government expenditure driving growth, overall government expenditure has continued to rise and has now reached an all-time high of just under GBP 1.29 trillion. While taxes have also risen to record levels as a percent of GDP, the government is still set to run a budget deficit of 4.8 percent in 2025. Our expectation is that – at least in the short term – government expenditure continues to grow through 2027. The Chancellor has set out two Golden Rules to retain credibility with financial market investors. The first is the "investment rule", which is only just being met, looks to have government debt to GDP falling over a rolling five-year horizon. The second is the "sustainability rule", which pledges that the government will only borrow to invest, not to meet day-to-day expenditure requirements; the challenge here, however, is that rising Gilt yields have pushed up debt-servicing costs. The real test of these rules is set to come about in this autumn's budget, and there is a general expectation that there will be some constraints on the scale of spending rises, accompanied by further rises to taxation.

Looking beyond 2026, there is scope for a more substantive recovery dependent upon a reversal in languishing consumer and business confidence. The role of savings is key, the household saving rate bottomed out in mid-2022 at 4.5 percent, and over the last three years has steadily increased to 12 percent, which, excluding the pandemic, is a level that has not been seen since 2010. This increase in the saving rate has pushed up accumulated savings for both residents and businesses to a combined GBP 3.6 trillion. When there is sufficient consumer and business confidence to start spending and investing, the money is there, but we do not anticipate this to come about before the latter half of 2026.

Productivity's absence matters

Expectations of surging productivity growth are unlikely to be met

Poor productivity has been the bane of the British economy for more than a decade. In her Spring Statement of 26 March, the Chancellor outlined a growth plan, which was substantially based on a building boom being triggered by the centralising of planning resulting in 300,000 new homes being built annually over the coming years. This building surge anticipates productivity swinging back to its pre-pandemic trend rate of 0.8 percent growth per annum, rising to more than 1.2 percent per annum by 2028. However, this house-building target is similar to the (unmet) target of the previous Conservative government, and notably these levels of house building have not been seen since the 1970s. Beyond these measures, the challenge remains that public sector productivity, in particular, remains 4.6 percent below its 2019 level. Disappointingly, the public sector pay settlements (agreed when the new government came into office in the summer of 2024) did not demand reciprocal efficiency improvements and our expectation is that wider productivity growth targets are likely to be missed.

Trade wars bypass the UK

The UK's service-oriented economy will sidestep the worst of the trade wars

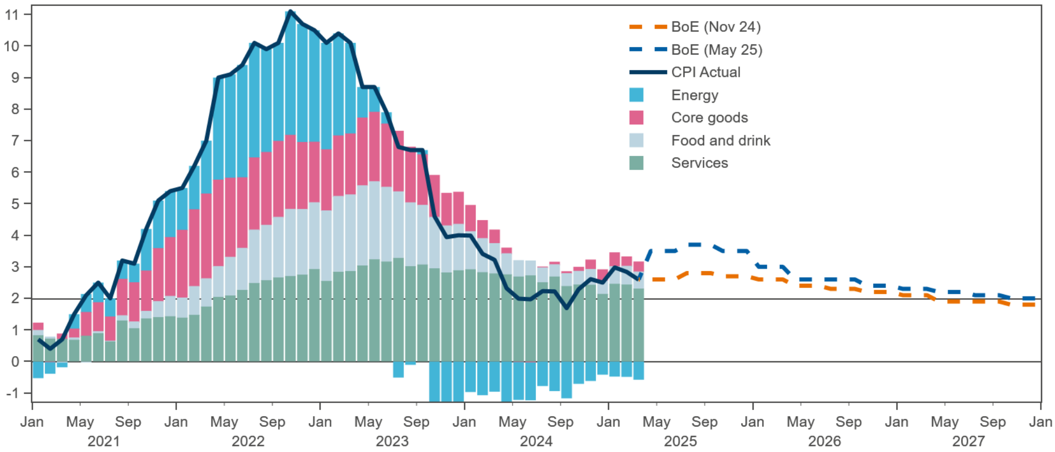
Today's trade landscape is more uncertain than it has been in years, but there is at least some scope for optimism. The US and the UK have announced a comprehensive trade agreement, an extensive trade agreement has just been reached with India, and there are ongoing discussions about how UK-EU trade might be improved. The US remains the single most important trading partner for the UK. Importantly, goods trade between the UK and the US is roughly in balance, and while the UK has a services trade surplus of GBP 75.8bn with the US, the focus of recent trade friction relates to goods trade. For a limited number of areas, such as steel and aluminium, tariffs are set to be zero-rated; although notably these are not particularly crucial, since UK steel exports were only worth GBP 350m in 2024. More critically, an agreement has been reached over cars, exports being worth GBP 9bn, where the first 100,000 units are only subject to base tariffs, this limit will cover the vast majority of UK exports. Tariffs on other sectors, such as pharmaceuticals, worth GBP 6.6bn, are still being negotiated. The trade agreement with India opens up new possibilities in what is clearly a fast-growing market. The reduction of tariffs on items such as whisky are of a scale that, in reality, new markets are opening up for the first time. In the short term, it looks unlikely that any of these agreements are going to result in a substantial lift in trade volumes, and while they may improve business confidence, they have only a marginal impact on our overall economic growth forecast.

Sticky inflation persists

Earnings remaining well above productivity suggests that inflation will remain sticky

Vigilance when considering UK inflation remains valid. The energy price spike of 2022 may now have subsided, but service sector inflation is an ongoing concern with earnings-driven service sector inflation currently at 5.4 percent, while goods inflation is running at 0.6 percent. We judge that to hit the Bank of England's two percent overall target, services inflation should be 3.0 percent, while goods inflation should be -1.0 percent. Our forecast, driven by a belief that earnings continue to run ahead of productivity, is that sticky inflation will only fade very slowly over our forecast period.

UK inflation



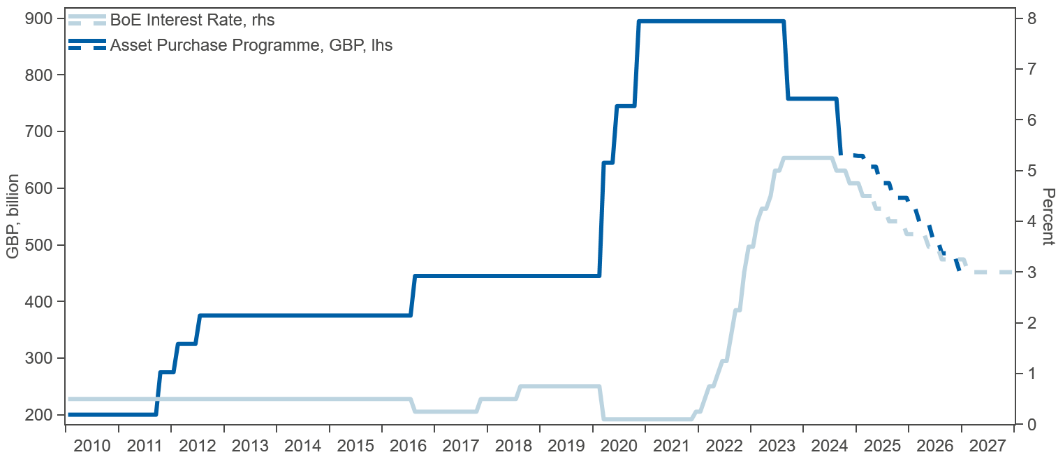
Source: UK Office for National Statistics, BoE, Handelsbanken

Interest rates to decline slowly

Two more reductions are set to come, with interest rates reaching 3.0% in late 2026

Over the past year, the question on interest rates has been how quickly they could be reduced and where those rates might settle in the longer term. On the first issue, our forecast is that the two 25bp rate reductions seen in February and May look set to be joined by two more 25bp cuts in August and December, taking interest rates to 3.75 percent at the end of 2025. As to where interest rates will be at the end of 2026, given our view on the sticky nature of inflation, we are forecasting two more interest rate reductions in April and July 2026, which would take interest rates to 3.0 percent, slightly above our estimate of the neutral rate. With regards to Gilt yields, our view is that the Chancellor is likely to find adhering to her Golden Rules a challenge, and she will be borrowing more than she anticipates. Hence, we expect the 10-year Gilt yields to be 4.5 percent in 2028, implying a widening spread between base rates and the 10-year Gilts rate.

UK monetary policy



Source: Macrobond

Interest rate differentials will support Sterling over the coming two years

For the past few years, the most significant driver of Sterling has been interest rate differentials, a trend we expect to continue. We believe that both UK and eurozone interest rates are set to see further declines over the course of 2025 and 2026, but marginally higher UK interest rates will boost GBP/EUR to 0.82. Looking at Sterling's value on a purchasing power parity (PPP) basis against the dollar, it is clear that the dollar remains overvalued by approximately 15 percent, although we readily accept that valuation variance against a PPP can persist for extended periods of time. Our view is that, with dollar uncertainty driven by both monetary policy and questions around trade strategies, the GBP/USD will reach 1.45 by late 2026.

Data appendix

Key forecasts

The interim macro forecast update from 9 April 2025 is shown in parentheses.

Gross domestic product, annual percentage change, y-o-y

	2024	2025	2026	2027
World	3.2 (3.2)	2.7 (2.6)	2.7 (2.5)	3.3 (3.5)
Advanced economies	1.8 (1.8)	1.2 (1.0)	1.1 (0.7)	1.6 (1.9)
Emerging economies	4.1 (4.2)	3.7 (3.8)	3.8 (3.6)	4.1 (4.3)
China	5.0 (5.0)	4.2 (4.0)	3.8 (3.3)	4.1 (4.3)
Eurozone	0.8 (0.8)	1.0 (0.8)	1.1 (0.9)	1.4 (1.5)
Norway, mainland economy	0.6 (0.6)	1.5 (1.1)	1.4 (1.2)	1.4 (1.3)
Sweden	0.9 (0.9)	1.5 (1.4)	2.1 (1.8)	2.6 (2.6)
United Kingdom	1.1 (1.1)	1.0 (0.2)	1.1 (0.7)	1.4 (1.6)
United States	2.8 (2.8)	1.2 (1.1)	1.0 (0.4)	1.8 (2.1)

Sources: Macrobond, IMF, national sources and Handelsbanken

Headline consumer price index, annual percentage change, y-o-y

	2024	2025	2026	2027
Eurozone	2.4 (2.4)	2.2 (2.2)	1.9 (1.9)	1.9 (1.8)
Norway	3.1 (3.1)	2.8 (3.1)	2.7 (2.8)	2.4 (2.4)
Sweden, CPIF	1.9 (1.9)	2.6 (2.8)	2.0 (2.2)	2.0 (2.1)
United Kingdom	2.5 (2.3)	3.4 (3.7)	3.4 (3.4)	3.1 (3.3)
United States, PCE deflator	2.5 (2.5)	3.1 (3.8)	2.9 (3.1)	2.0 (2.0)

Sources: Macrobond, national sources and Handelsbanken

Policy rate and longer-term swap rates, year-end, percent

		2024	2025	2026	2027
Eurozone					
–	Policy rate	3.00 (3.00)	1.75 (1.50)	1.75 (1.50)	2.00 (1.75)
–	2y	2.2 (2.2)	2.0 (1.7)	2.1 (1.9)	2.2 (2.0)
–	5y	2.3 (2.3)	2.3 (2.1)	2.4 (2.2)	2.4 (2.3)
–	10y	2.4 (2.4)	2.6 (2.4)	2.6 (2.5)	2.6 (2.6)
Norway					
–	Policy rate	4.50 (4.50)	4.25 (4.25)	3.50 (3.50)	3.25 (3.25)
–	2y	4.2 (4.2)	4.1 (4.0)	3.7 (3.7)	3.7 (3.7)
–	5y	3.9 (3.9)	4.0 (4.0)	3.9 (3.9)	3.9 (3.9)
–	10y	3.9 (3.9)	4.1 (4.1)	4.0 (4.0)	3.9 (3.9)
Sweden					
–	Policy rate	2.50 (2.50)	1.75 (1.50)	1.75 (1.50)	2.25 (2.00)
–	2y	2.4 (2.4)	2.0 (1.8)	2.3 (2.1)	2.4 (2.2)
–	5y	2.5 (2.5)	2.3 (2.2)	2.5 (2.4)	2.6 (2.5)
–	10y	2.7 (2.7)	2.6 (2.6)	2.8 (2.7)	2.8 (2.7)
United Kingdom					
–	Policy rate	4.75 (4.75)	3.75 (4.00)	3.25 (3.50)	3.00 (3.50)
–	2y	4.3 (4.3)	4.1 (4.3)	3.6 (3.8)	3.5 (3.8)
–	5y	4.1 (4.1)	4.1 (4.4)	4.0 (4.2)	4.0 (4.2)
–	10y	4.1 (4.1)	4.2 (4.6)	4.4 (4.7)	4.6 (4.7)
United States					
–	Policy rate	4.38 (4.38)	4.13 (3.88)	3.38 (2.88)	2.88 (2.63)
–	2y	4.1 (4.1)	3.8 (3.3)	3.2 (2.9)	2.9 (2.9)
–	5y	4.0 (4.0)	3.7 (3.3)	3.3 (3.2)	3.2 (3.1)
–	10y	4.1 (4.1)	4.0 (3.6)	3.6 (3.5)	3.5 (3.5)

Sources: Macrobond, Bloomberg, national sources and Handelsbanken

Government bond yields, year-end, percent

		2024	2025	2026	2027
Germany					
–	2y	2.1 (2.1)	1.9 (1.6)	2.0 (1.7)	2.1 (1.9)
–	5y	2.2 (2.2)	2.2 (2.0)	2.3 (2.1)	2.3 (2.2)
–	10y	2.4 (2.4)	2.6 (2.5)	2.6 (2.5)	2.6 (2.6)
Norway					
–	2y	4.1 (4.1)	3.8 (3.7)	3.4 (3.4)	3.4 (3.4)
–	5y	3.8 (3.8)	3.8 (3.8)	3.7 (3.7)	3.7 (3.7)
–	10y	3.8 (3.8)	4.0 (4.0)	3.9 (3.9)	3.8 (3.8)
Sweden					
–	2y	2.1 (2.1)	1.8 (1.4)	2.0 (1.8)	2.1 (1.9)
–	5y	2.2 (2.2)	2.0 (1.9)	2.3 (2.1)	2.3 (2.3)
–	10y	2.4 (2.4)	2.3 (2.3)	2.5 (2.4)	2.6 (2.5)
United Kingdom					
–	2y	4.4 (4.4)	4.1 (4.1)	3.4 (3.6)	3.1 (3.6)
–	5y	4.2 (4.2)	4.3 (4.3)	3.9 (4.1)	3.8 (4.1)
–	10y	4.6 (4.6)	4.6 (4.6)	4.5 (4.6)	4.5 (4.5)
United States					
–	2y	4.3 (4.3)	4.0 (3.6)	3.4 (3.1)	3.2 (3.1)
–	5y	4.4 (4.4)	4.1 (3.7)	3.7 (3.5)	3.6 (3.5)
–	10y	4.6 (4.6)	4.5 (4.1)	4.2 (4.0)	4.2 (4.0)

Sources: Macrobond, national sources and Handelsbanken

Exchange rates, year-end

	2024	2025	2026	2027
EUR/USD	1.04 (1.04)	1.18 (1.10)	1.19 (1.11)	1.18 (1.12)
EUR/GBP	0.84 (0.84)	0.83 (0.82)	0.82 (0.82)	0.82 (0.82)
GBP/USD	1.24 (1.24)	1.42 (1.34)	1.45 (1.35)	1.44 (1.37)
USD/JPY	157.00 (157.00)	142.00 (144.00)	134.00 (136.00)	126.00 (128.00)
USD/CNY	7.30 (7.30)	7.27 (7.47)	7.18 (7.35)	7.10 (7.23)
EUR/CHF	0.94 (0.94)	0.95 (0.95)	0.96 (0.96)	0.97 (0.97)
EUR/NOK	11.60 (11.60)	11.30 (11.70)	11.10 (11.40)	10.90 (11.20)
EUR/SEK	11.48 (11.48)	10.80 (10.90)	10.65 (10.75)	10.50 (10.60)

	2024	2025	2026	2027
USD/SEK	11.05 (11.05)	9.15 (9.91)	8.95 (9.68)	8.90 (9.46)
EUR/SEK	11.48 (11.48)	10.80 (10.90)	10.65 (10.75)	10.50 (10.60)
CHF/SEK	12.19 (12.19)	11.37 (11.47)	11.09 (11.20)	10.82 (10.93)
NOK/SEK	0.99 (0.99)	0.96 (0.93)	0.96 (0.94)	0.96 (0.95)
GBP/SEK	13.66 (13.66)	13.01 (13.29)	12.99 (13.11)	12.80 (12.93)
JPY/SEK	7.04 (7.04)	6.45 (6.88)	6.68 (7.12)	7.06 (7.39)
CNY/SEK	1.51 (1.51)	1.26 (1.33)	1.25 (1.32)	1.25 (1.31)

	2024	2025	2026	2027
USD/NOK	11.17 (11.17)	9.58 (10.64)	9.33 (10.27)	9.24 (10.00)
EUR/NOK	11.60 (11.60)	11.30 (11.70)	11.10 (11.40)	10.90 (11.20)
CHF/NOK	12.32 (12.32)	11.89 (12.32)	11.56 (11.88)	11.24 (11.55)
GBP/NOK	13.81 (13.81)	13.61 (14.27)	13.54 (13.90)	13.29 (13.66)
SEK/NOK	1.01 (1.01)	1.05 (1.07)	1.04 (1.06)	1.04 (1.06)
JPY/NOK	7.11 (7.11)	6.74 (7.39)	6.96 (7.55)	7.33 (7.81)
CNY/NOK	1.53 (1.53)	1.32 (1.42)	1.30 (1.40)	1.30 (1.38)

Sources: Macrobond, national sources and Handelsbanken

Footnotes

1 For more on monetary policy in the face of tariff shocks, see theme article p. 9–14 in our January Global Macro Forecast report. ↩

2 Term premium is the compensation investors demand for bearing growth and inflation risks. Since today's challenged public finances situation in many countries cause risks to for example future lending needs, this too may drive the term premium. ↩

3 See the term premium analysis on p. 6–7, in our January Global Macro Forecast report. ↩

4 For more analysis on the radical and internally conflicting policy goals of the US White House Administration, and its impact on the dollar, see *'Mar-a-Lago Accord' or 'Have-the-cake-and-eat-it-too' plan?*, our 3 April Macro Comment. ↩

5 Ciccarelli. M and Benoît Mojon. B (2005), "Global inflation" ECB Working Paper series, no 537 ↩

6 It is calculated by comparing the share of a product in a country's exports to the share of that product in global exports. If the RCA is greater than 1, the country is said to have a revealed comparative advantage in that product. UNCTADstat Data Centre ↩

7 Malmendier, M. and Nagel, S. (2016), "Learning from inflation experiences", The Quarterly Journal of Economics, Vol. 131, No 1 ↩

8 Hobijn, B. et al. (2023), "The Recent Steepening of Phillips Curves", Chicago Fed Letter, No 475 ↩

9 Kilponen, et al. (2015), Comparing fiscal multipliers across models and countries in Europe, ECB Working Paper Series, No 1760 March 2015. Comparing fiscal multipliers across models and countries in Europe ↩

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