

# Baltic macro outlook

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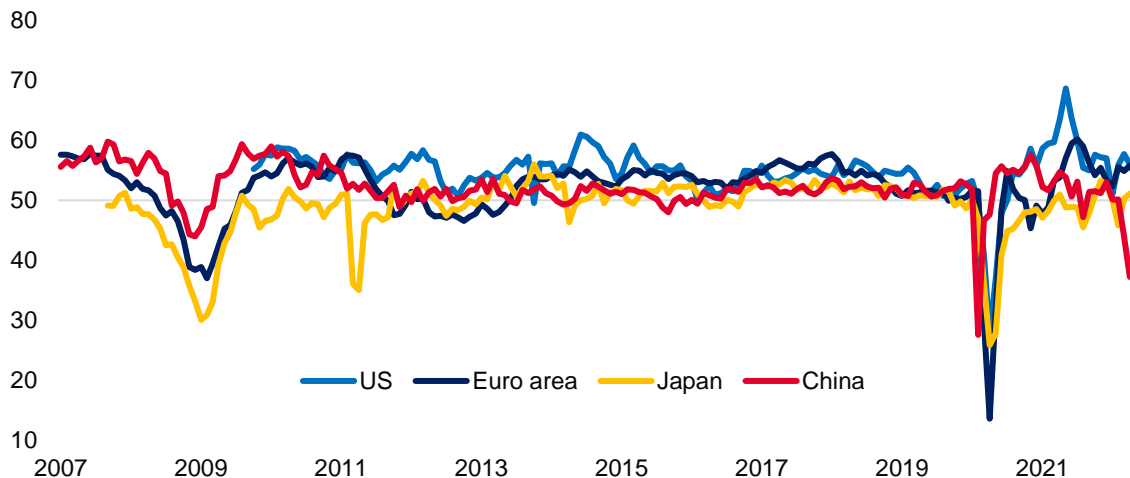
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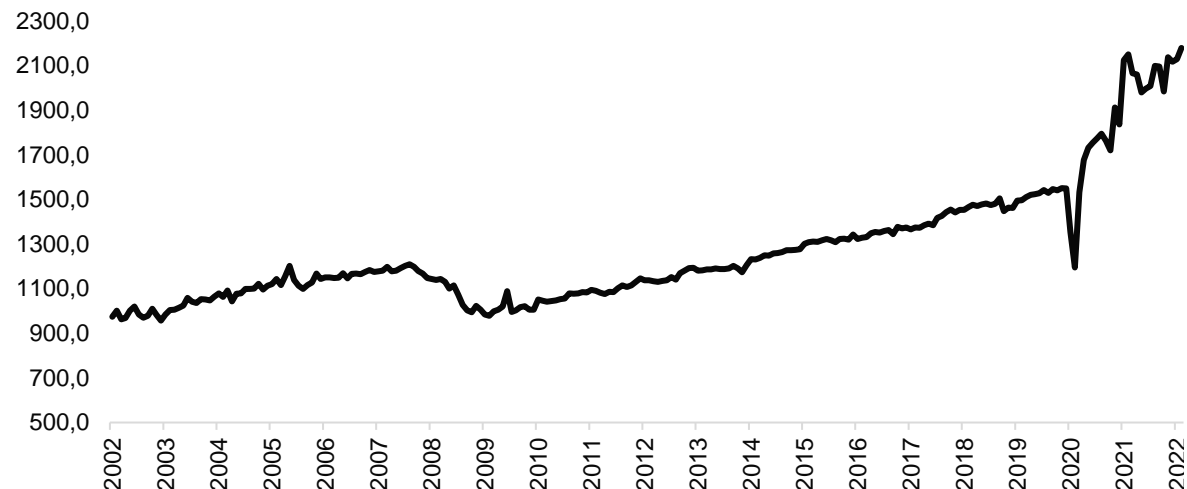
# Global economy

The global economy continues to grow, but high inflation has created new challenges

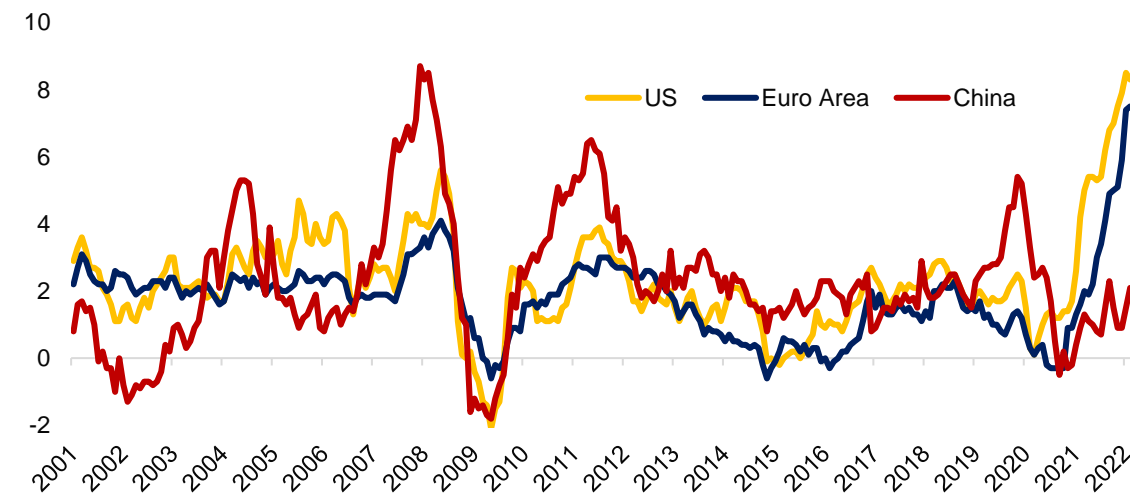
**IHS Markit Composite PMI** (values above 50 indicate expansion)



**US consumption expenditures** (durable goods, nominal terms)



**Consumer price inflation (% YoY)**



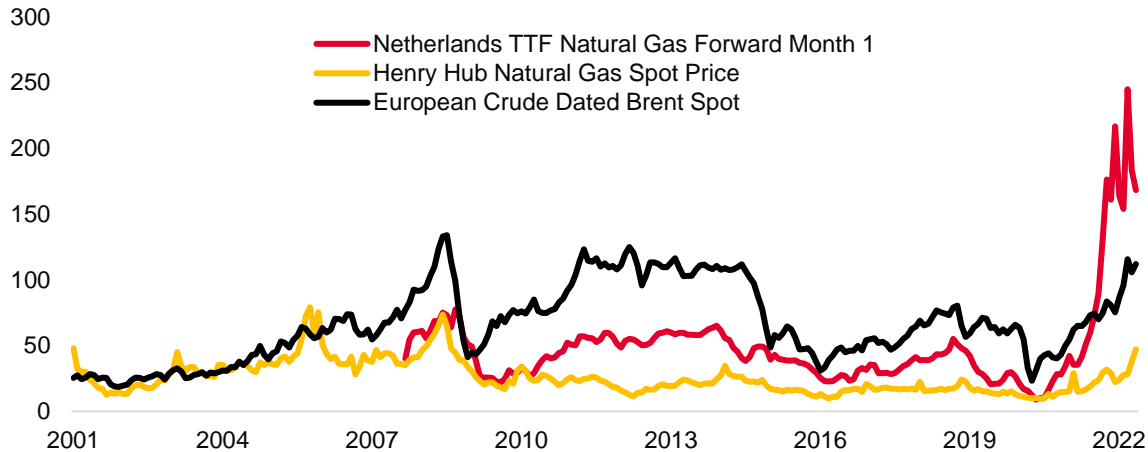
## Comments

- Business sentiment in the US, the eurozone and the world as a whole remains positive, with the global economy continuing to grow and recover from the COVID-19 pandemic.
- Russia's invasion of Ukraine and the highest inflation in recent decades have created new challenges for the global economy.
- Although the economic recovery is incomplete, the unexpectedly sharp rise in inflation has become a major political issue, forcing governments to implement measures to reduce prices and for central banks to raise interest rates.

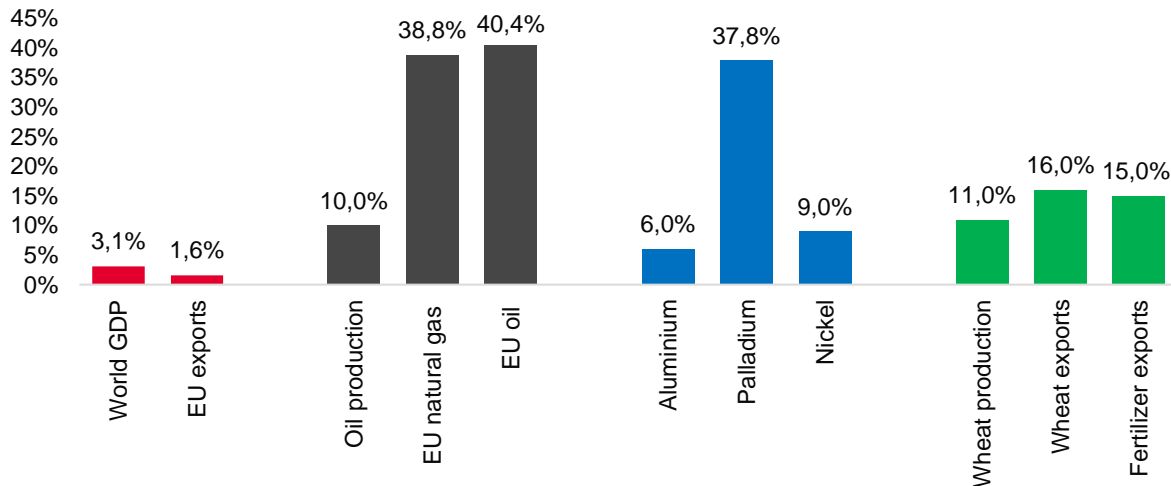
# Commodities

The unexpectedly sharp rise in inflation is the biggest challenge facing the global economy

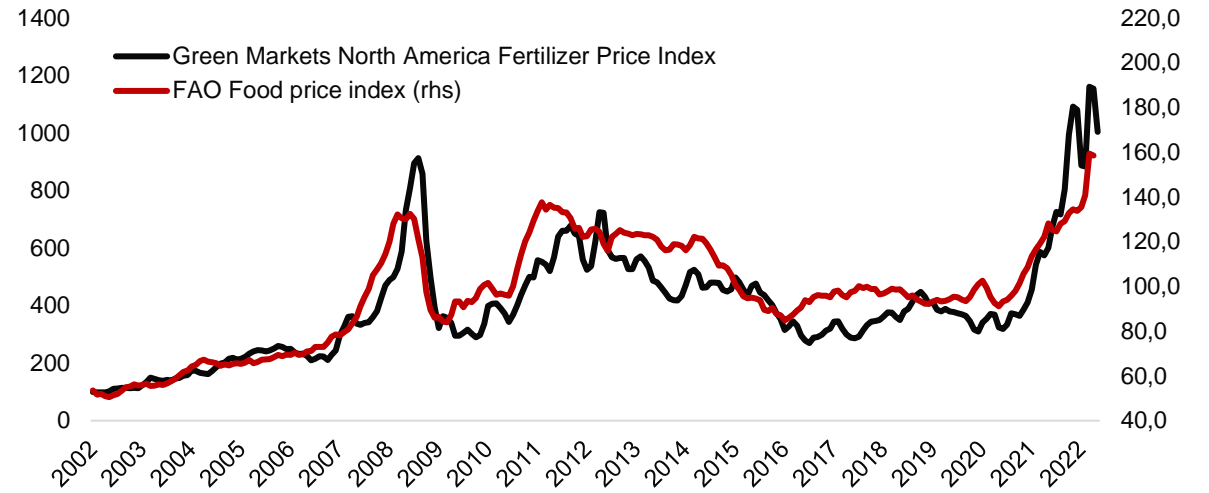
## Oil and natural gas prices (USD/Barrel of Oil Equivalent)



## Russia in the global economy (%)



## Food and fertilizer prices



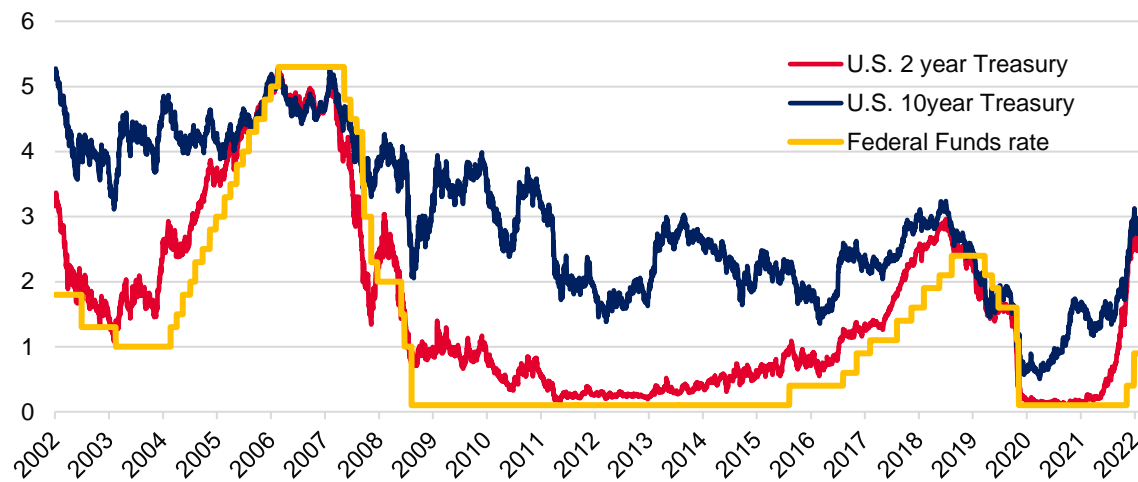
## Comments

- For the first time since the 1980s, strong inflation has returned in the developed world and prices have risen much faster than expected over the past year.
- Inflation in the world, Europe and Latvia is currently mainly driven by rising prices for food, energy, metals and various other natural resources.
- Lockdowns, the wide-ranging COVID-19 restrictions, unexpected swings in consumption, extra barriers to crossing borders, and more frequent and prolonged sick leaves of workers have disrupted the global production system. Inflationary pressures in the global economy are not over.

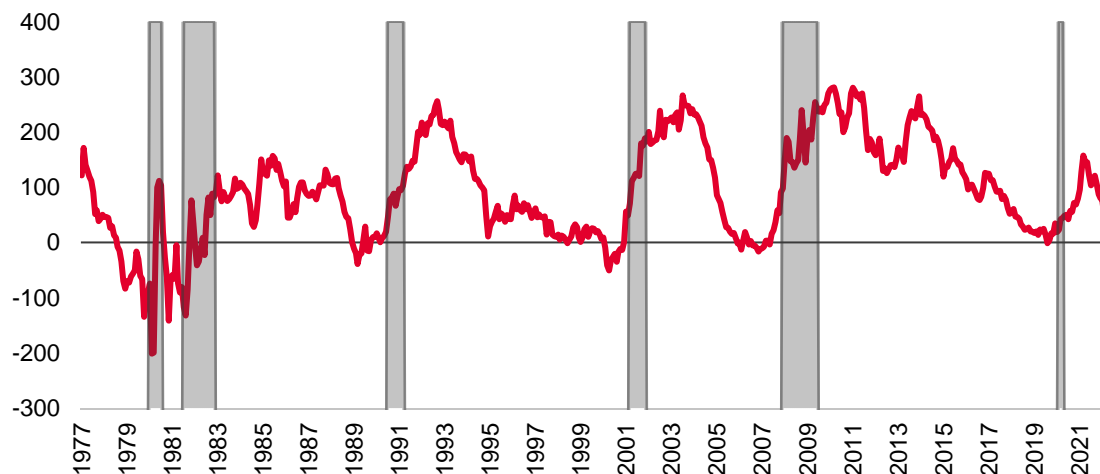
# Global economy

Signs of recession in the global economy are increasing

## U.S. interest rates (%)

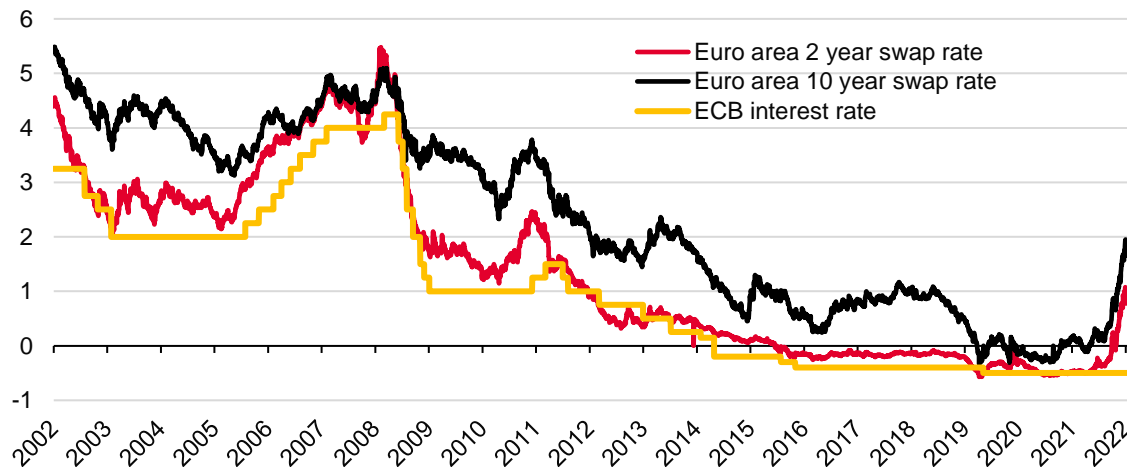


## 10-2 Year US Treasury Yield Spread



Source: Bloomberg

## Euro area interest rates (%)



## Comments

- According to the financial market, the US could raise interest rates as much as 10 times this year and the base rates could approach 3% at the end of the year, while in the eurozone interest rates could exceed 1% in 2023.
- In the last 80 years, the United States has only a few times managed to implement a so-called soft landing and raise interest rates without causing a recession.
- Financial markets are concerned not only about inflation, but also about growth, as indicated by the convergence of short-term and long-term interest rates. In the US over the past 50 years, whenever short-term government bond yields have been higher than long-term rates, the recession has followed in a year or two.

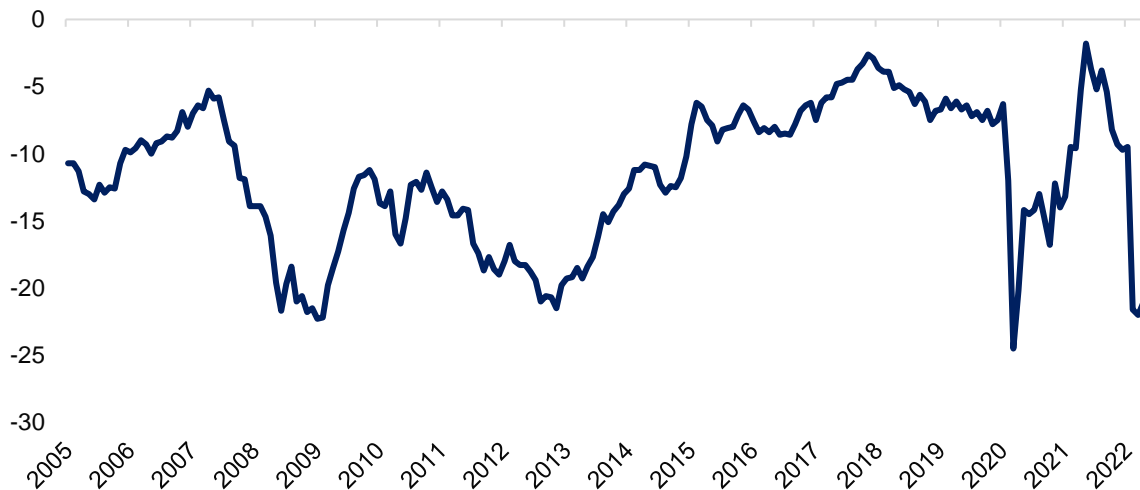
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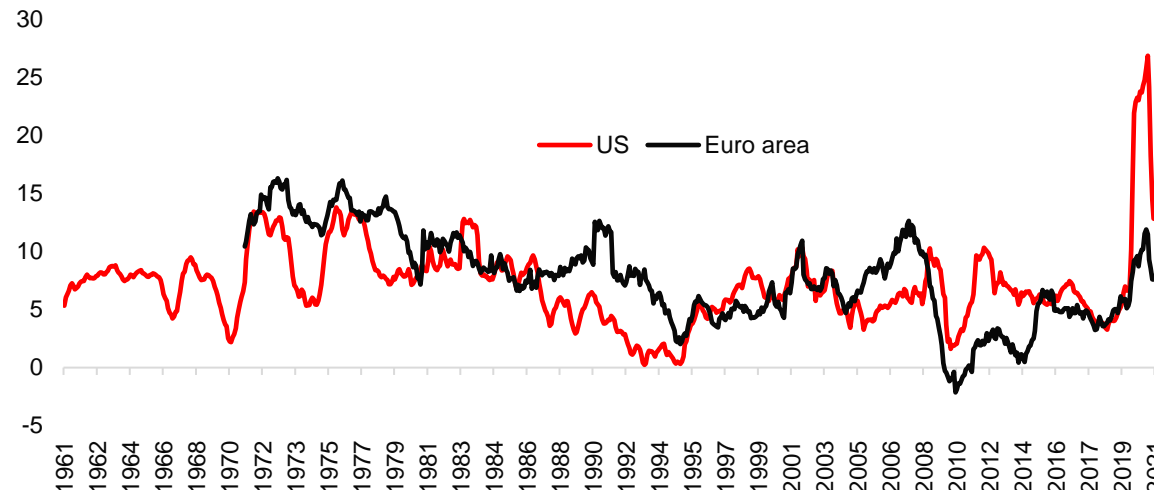
# Global economy

Signs of recession in the global economy are increasing

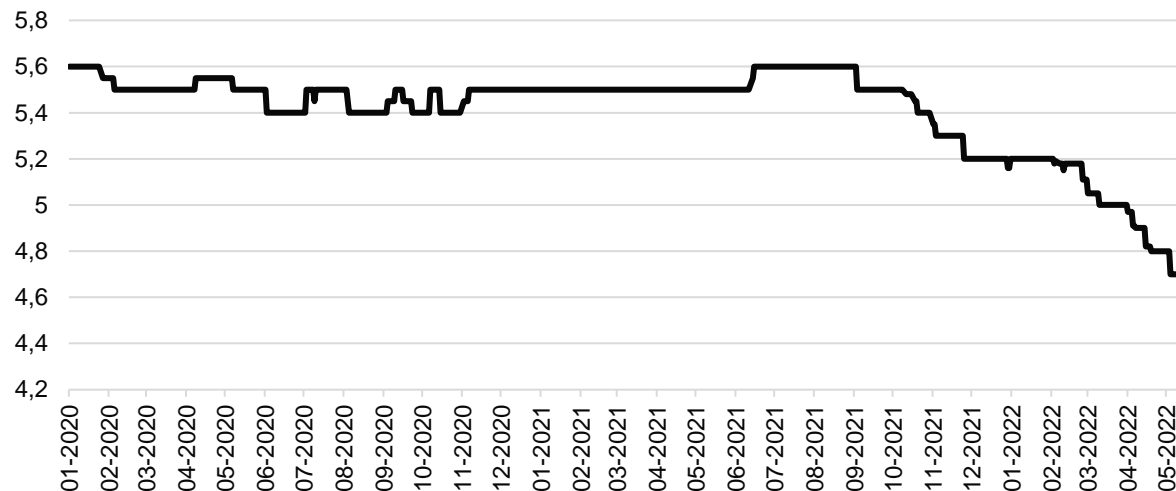
### Euro area consumer confidence



### M3 money supply (% YoY)



### China GDP growth forecast in 2022 (%)



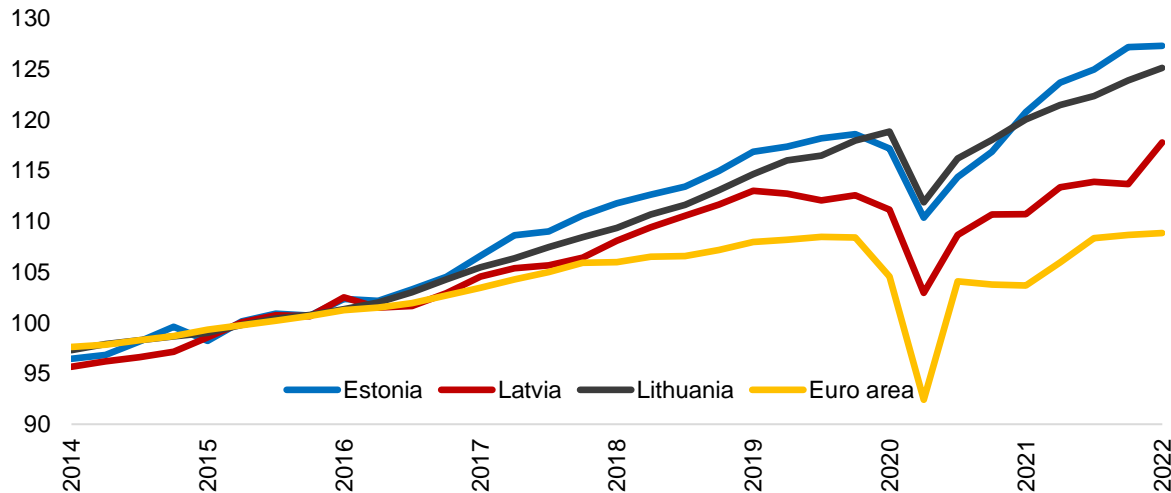
### Comments

- Growth in new industrial orders in the global manufacturing is slowing, consumer sentiment has deteriorated significantly in many places, and the sharp rise in mortgage rates has begun to cool the US housing market.
- In Europe, very expensive energy sources pose a significant risk to the economy. Natural gas prices in Europe are currently 4-5 times higher than in the US.
- Strict restrictions on COVID-19 and measures to cool the real estate market are having a negative impact on China's economic growth prospects.

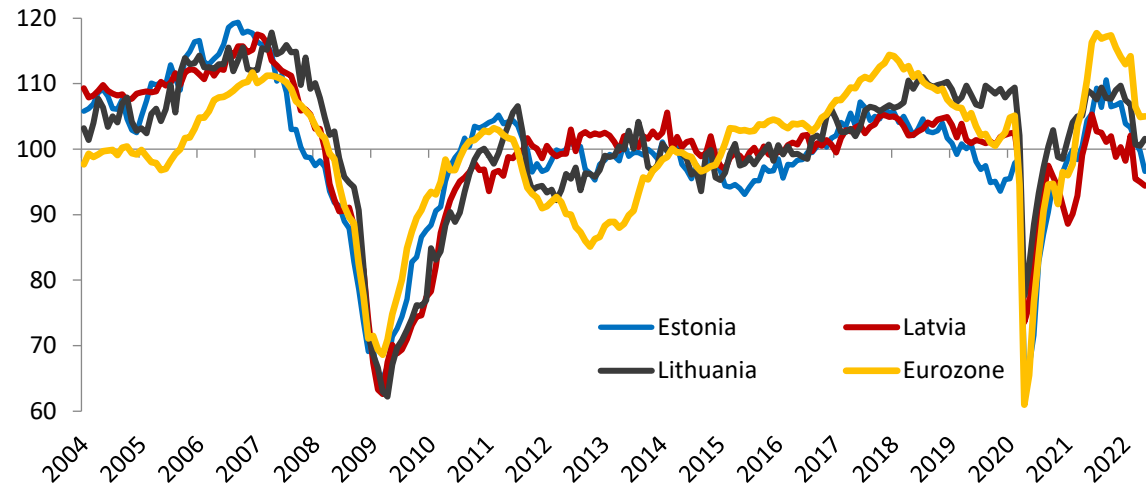
# Baltic region

The economic recovery in the Baltics has been faster than the euro area average

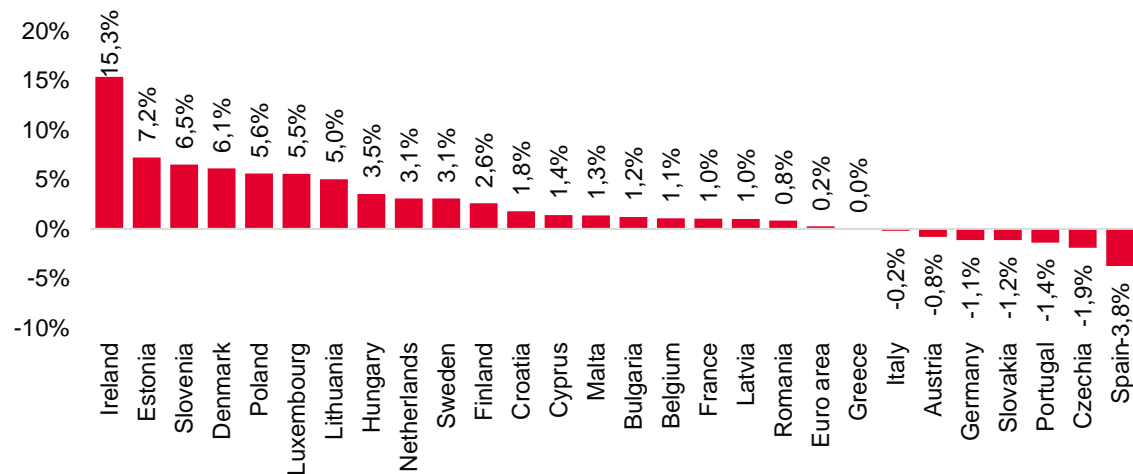
GDP in constant prices (2015=100)



Economic sentiment indicator



GDP in constant prices (Q4 2022 compared to Q4 2019, %)



## Comments

- Economic growth in the Baltics remained strong in the first months of 2022, and the effects of Russia's invasion of Ukraine are currently largely felt only by rising inflation.
- In the 1st quarter of 2022, the GDP in Latvia grew by 6.7%, compared to the 1st quarter of 2021, in Estonia the GDP grew by 4.3%, while in Lithuania the GDP grew by 4.6%.
- Short-term economic performance in the Baltics remains positive. Payment card turnover has increased since February 2022, unemployment is decreasing, the number of vacancies and job advertisements is increasing.

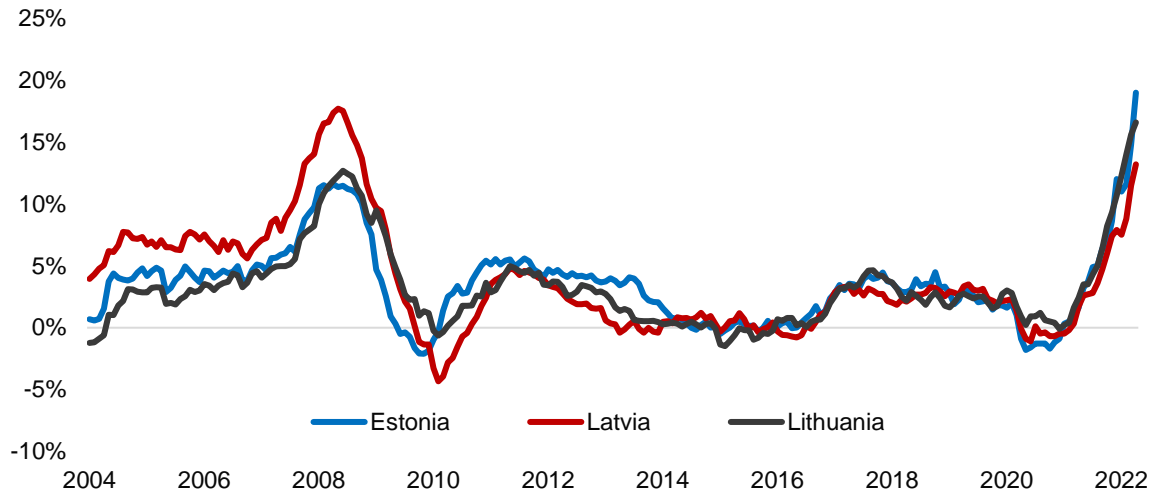
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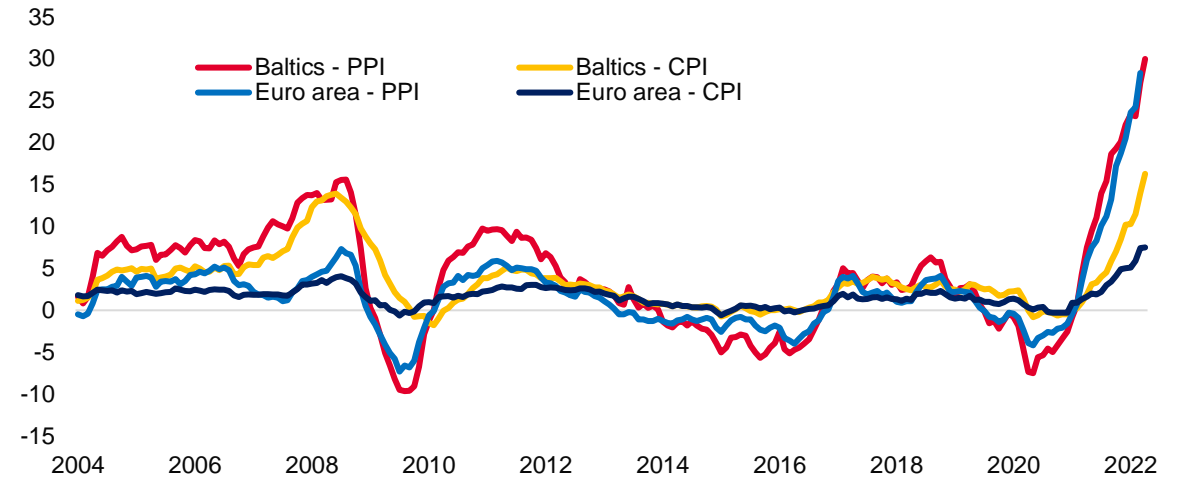
# Inflation

Prices in the Baltics are growing faster than in Europe

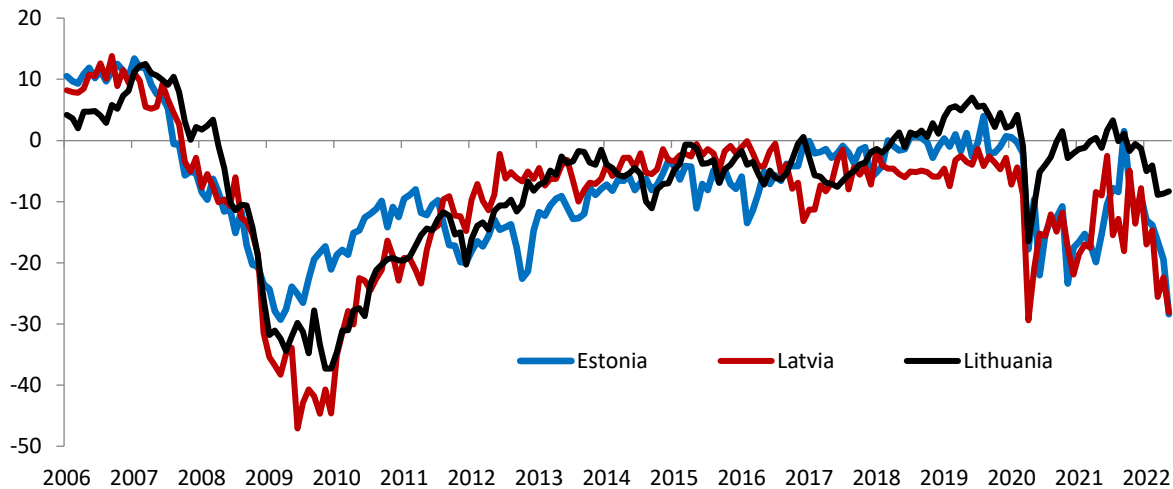
### Consumer prices (% YoY)



### Consumer and producer price inflation (% YoY)



### Consumer sentiment



### Comments

- Inflation in the Baltic States has exceeded 10% for the first time since 2008, while in Estonia it reached 19% in April. The sharp rise in inflation in the Baltics is mainly due to rising global commodity prices, which will not diminish in the coming months.
- Government support measures will help dampen price rises, but producer price inflation in the Baltics has reached 30% and pressure on consumer prices remains strong.
- Producer prices in the Baltics have risen as fast as in the euro area as a whole, consumer price inflation in the Baltics is almost two times higher than in euro area.

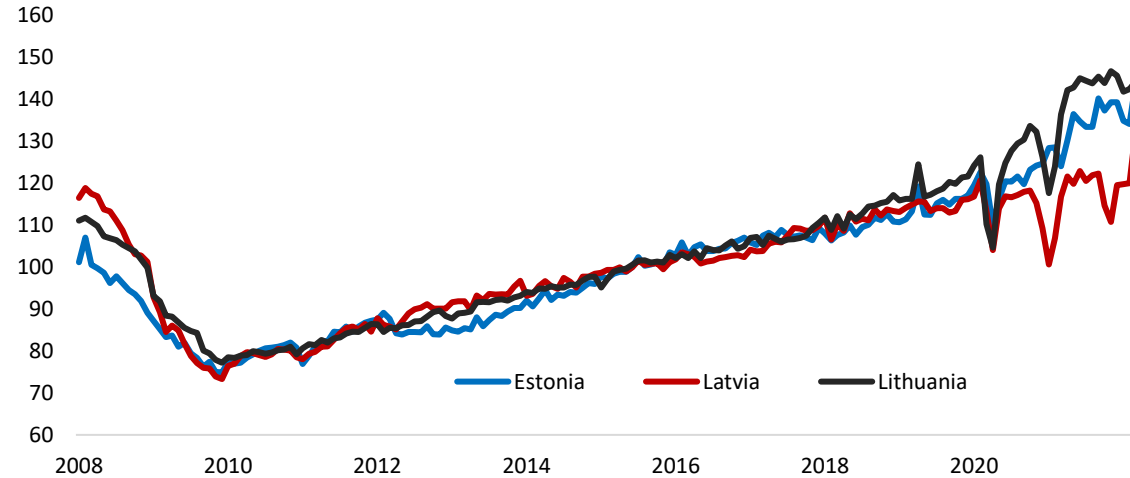
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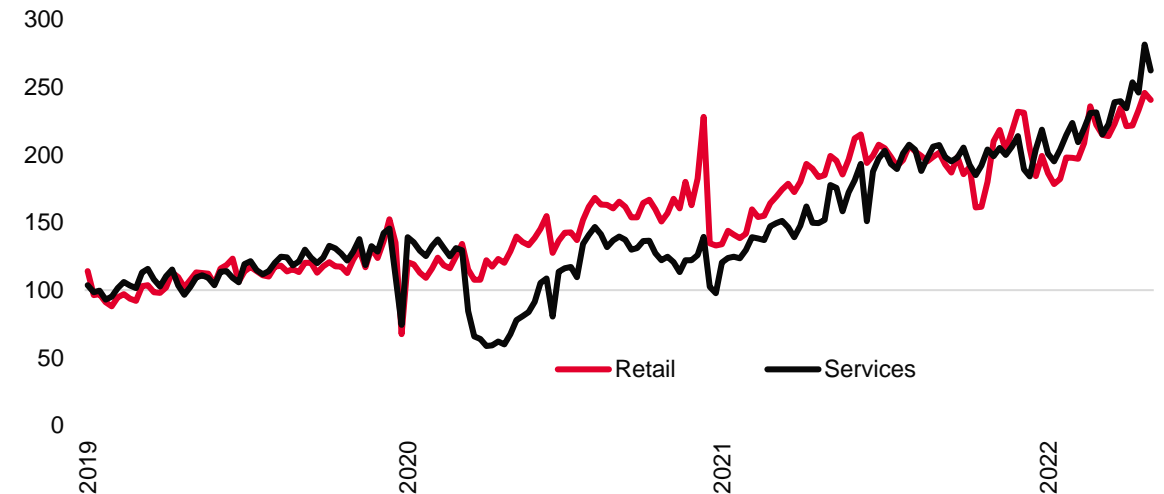
# Retail trade

Consumer sentiment is deteriorating, but spending continues to rise

Retail trade excluding fuel (constant prices, 2015=100)

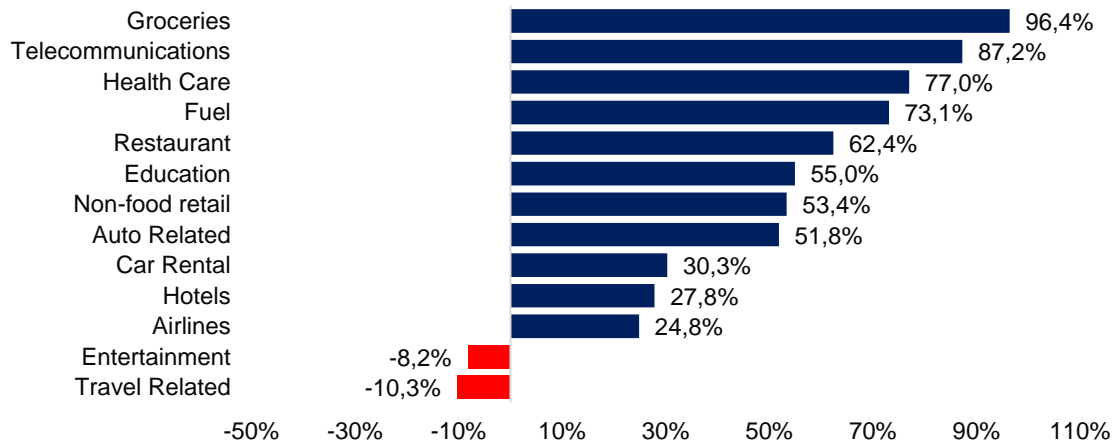


Credit card turnover by Citadele clients in the Baltics (2019 jan=100)



Weekly credit card turnover by Citadele clients in Baltics

(2022 compared to 2019, %)



## Comments

- Retail sales in the Baltics have recovered quite well from the COVID-19 restrictions, and the Russian invasion of Ukraine has not yet had a significant impact on consumer spending.
- Consumer sentiment has deteriorated markedly since early February and was only slightly better in April than in the first months of the COVID-19 pandemic. However, consumer spending continues to rise.
- The lifting of COVID-19 restrictions means greater opportunities to consume services, but inflation in the Baltics is currently outpacing wage growth, and economic uncertainty is high in the second half of the year.

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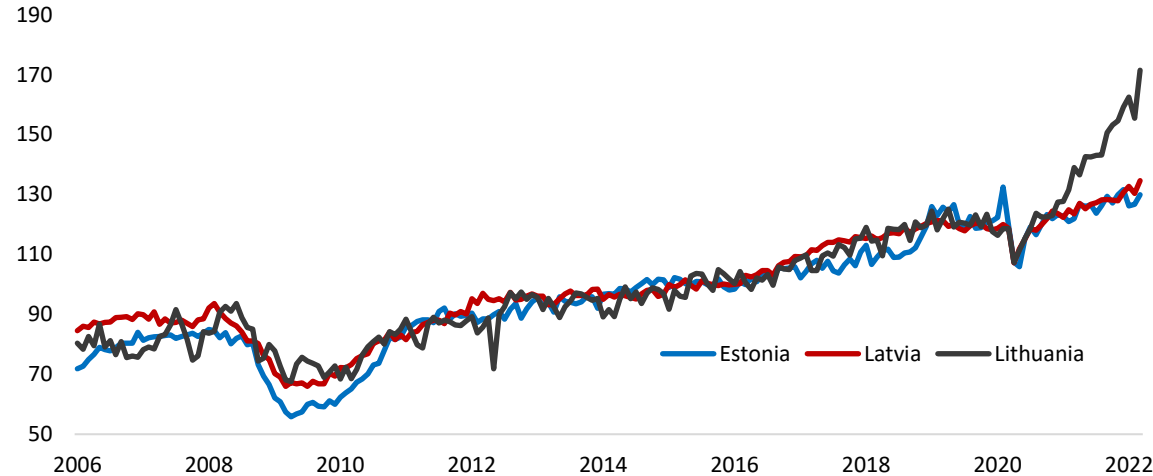
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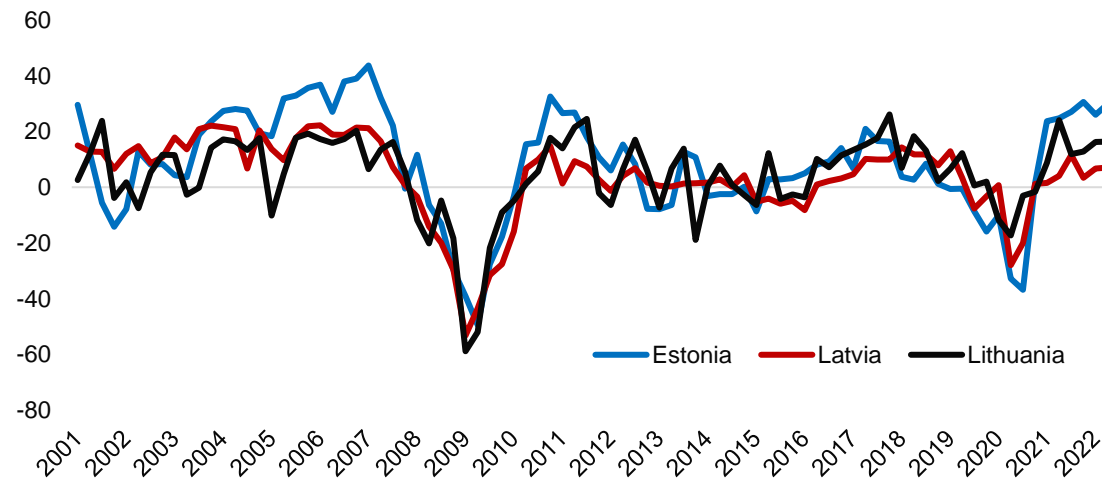
# Manufacturing

Demand in the manufacturing remains strong

### Manufacturing output (constant prices, 2015=100)

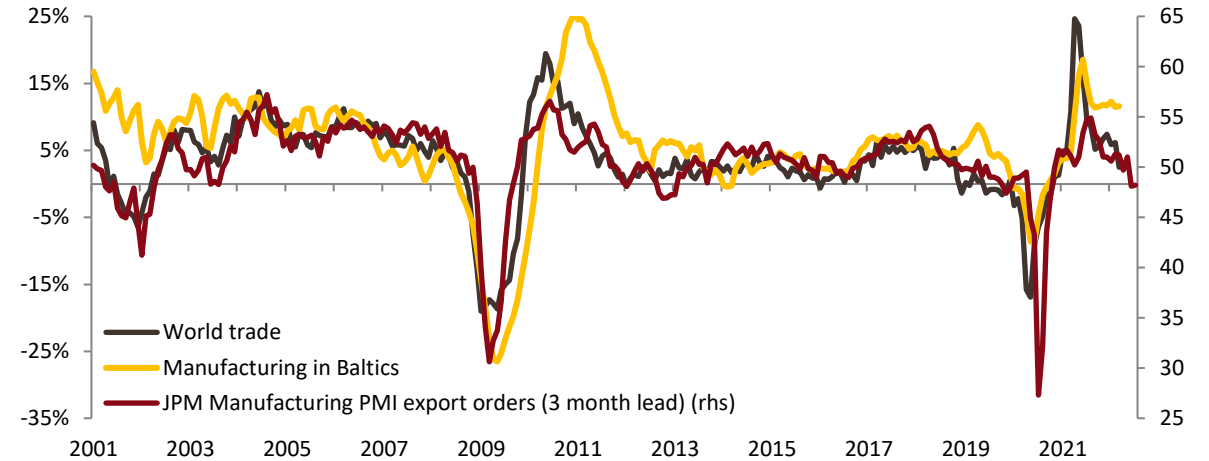


### New industrial orders



Source: Eurostat, DG ECFIN, Bloomberg, CPB

### World trade and manufacturing (% YoY)



### Comments

- For the Baltic manufacturing COVID-19 pandemic has been successful period and strong external demand has allowed companies to significantly increase production.
- In March 2022, manufacturing output in Estonia increased by 6.6% compared to March 2021, while growth in Latvia reached 9% and in Lithuania even more than 23%.
- High energy prices are having a negative impact on the competitiveness and growth potential of European industry, and this is a risk for Baltic producers. New orders in global industry are no longer growing, and the lifting of COVID-19 restrictions will increase demand in the services sector.

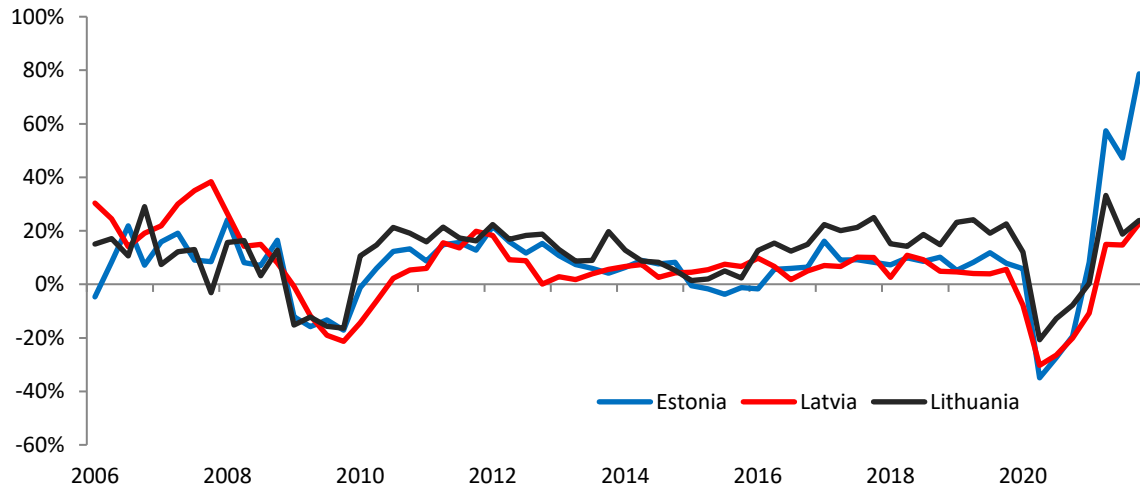
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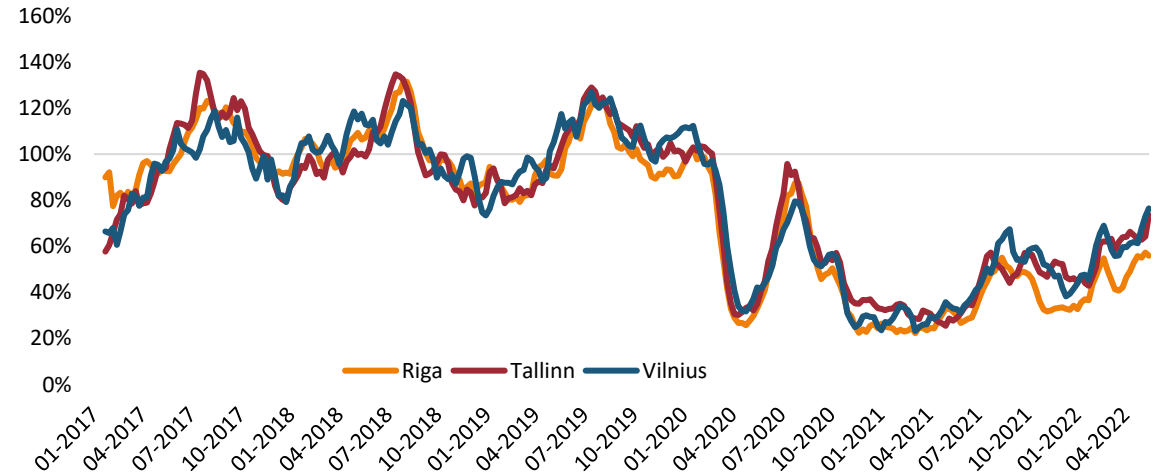
# Services

The removal of COVID-19 restrictions will once again allow the service sectors to operate

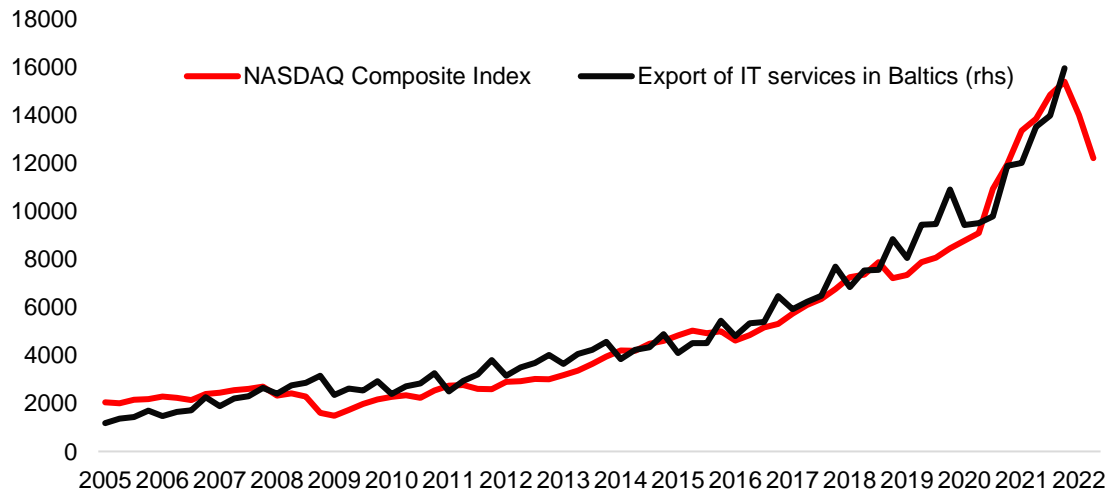
Export of services (% YoY)



Google trends (Hotels in Baltic capitals, 2017-2019 average=100)



Export of IT services in the Baltics (MEUR)



## Comments

- In catering, hotel and entertainment, the removal COVID-19 restriction will allow to resume operations, and our customers' payment card spending in the service industries has grown significantly since the start of the year.
- The war in Ukraine is a new shock to the tourism industry. The number of tourists in the Baltics is still half as low as in 2019, and caution is being exercised after the Russian invasion of Ukraine. . Tourism sector is not expected to return to the level of 2019 this year.
- Exports of IT services in the Baltics have been growing by more than 10-15% for 12 years, but rising interest rates are starting to cool the US technology sector, and the number of redundancies in start-ups has been growing since April.

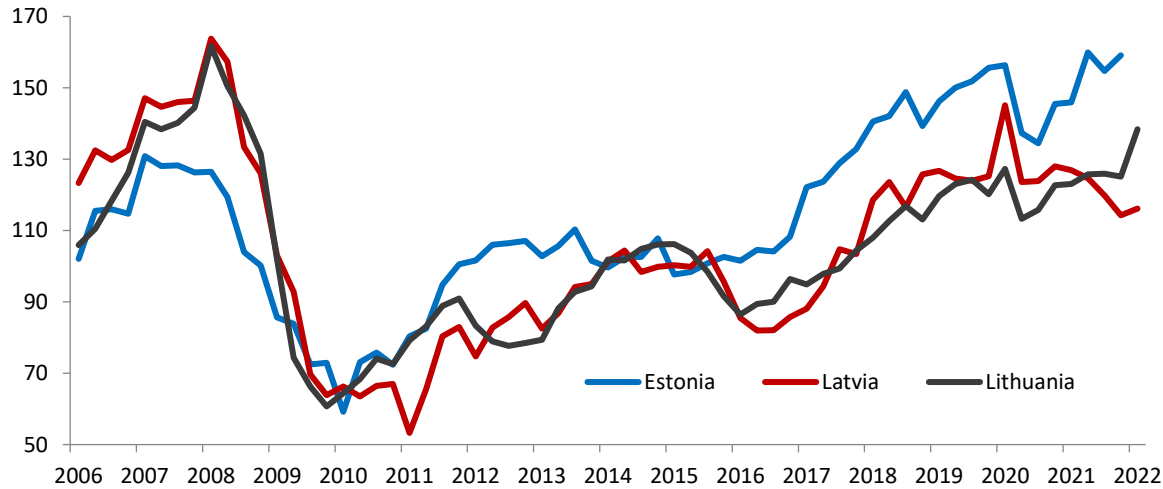
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# Construction

Demand is still strong in construction, but prices are rising sharply

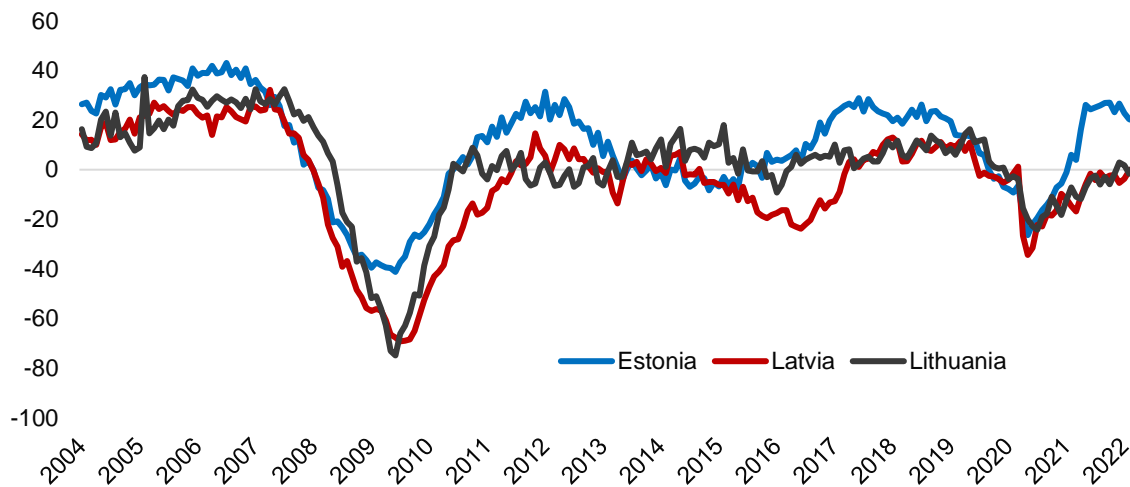
### Construction in constant prices (2015=100)



### North Europe Steel Rebar (euro per ton)



### Construction activity in the last 3 months



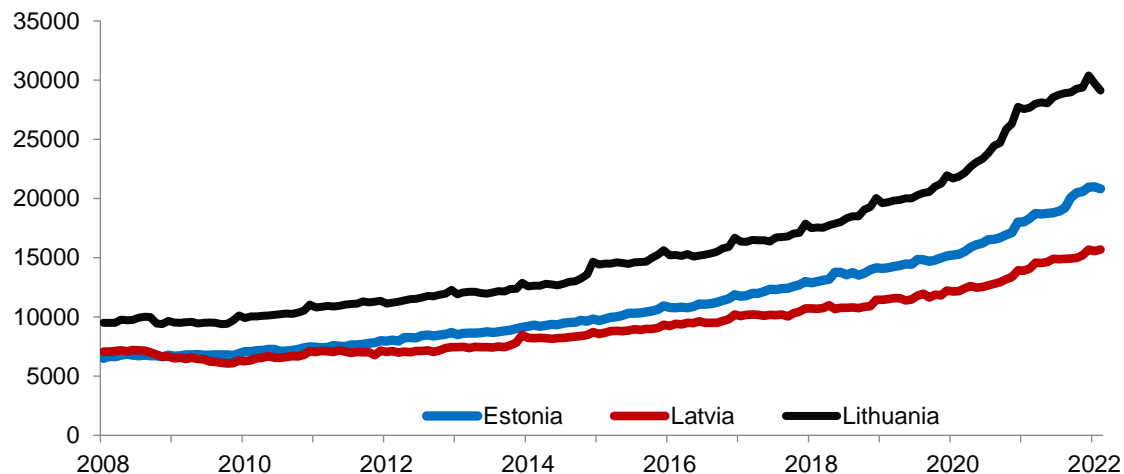
### Comments

- An active real estate market, stable private sector investment and the inflow of EU economic recovery funds are creating strong demand in the construction sector.
- In construction, as in other sectors, the biggest challenge now is the sharp rise in prices, and in recent months the situation in the building materials market has been exacerbated by the Russian invasion of Ukraine.
- There are signs that the rise in prices and investor caution is revising investment plans and the implementation of some projects is being suspended. However, demand in the construction is strong and the sector is expected to grow in 2022.

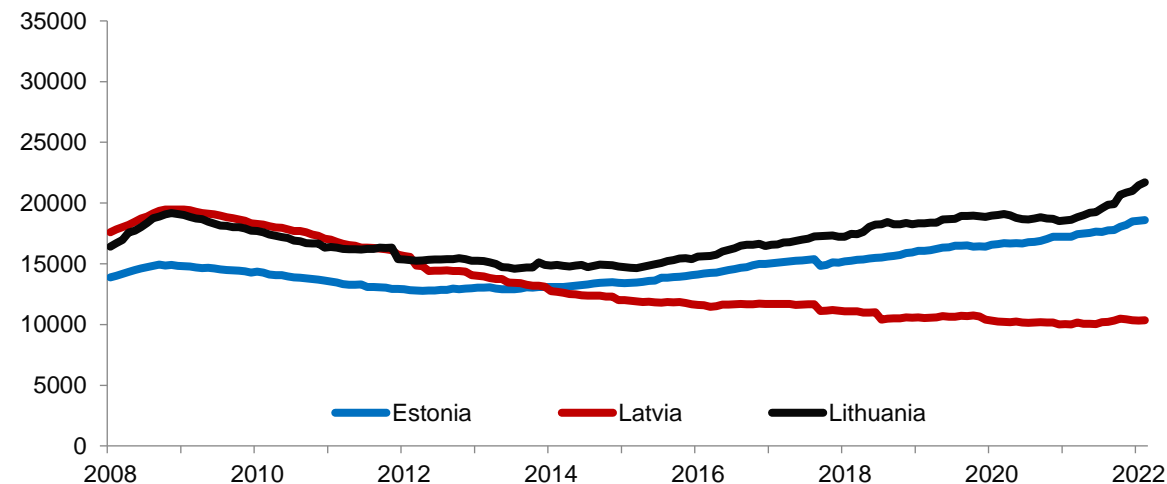
# Banking sector

Low debt and prudent lending bring stability to the economy

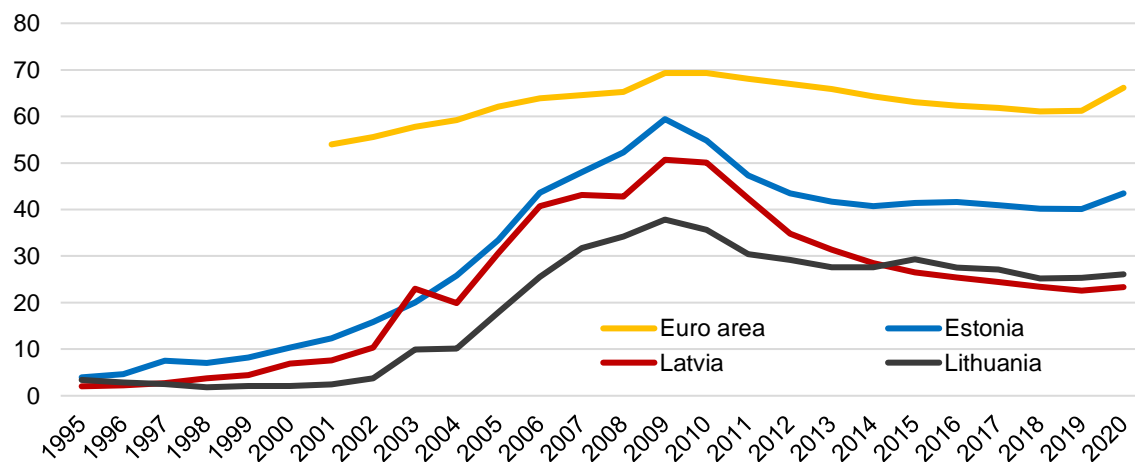
## Resident deposits (MEUR)



## Resident loan portfolio (MEUR)



## Household liabilities – loans (% of GDP)



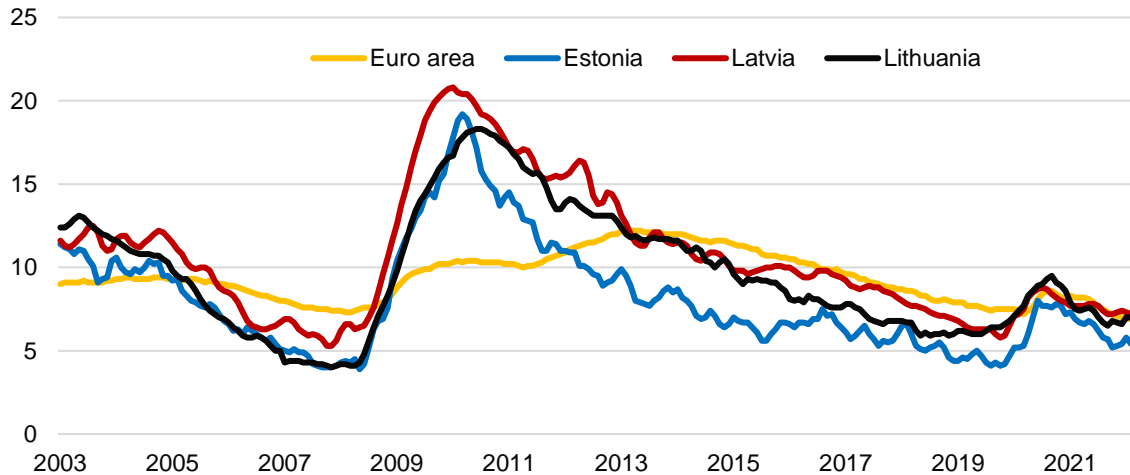
## Comments

- The economies of the Baltic States are in good shape. Government, household and corporate debt is low, lending is driven by local resources and foreign trade is balanced.
- During the COVID-19 pandemic, businesses and households have grown rapidly, providing additional security.
- The level of household debt in the Baltics is significantly lower than the euro area average.

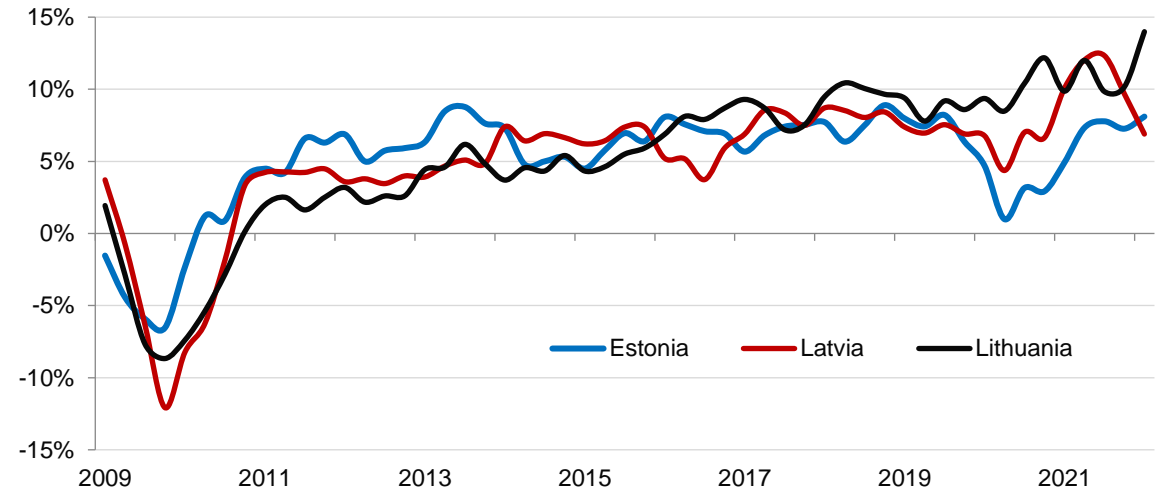
# Labour market

Labour market in the Baltics remains in good shape

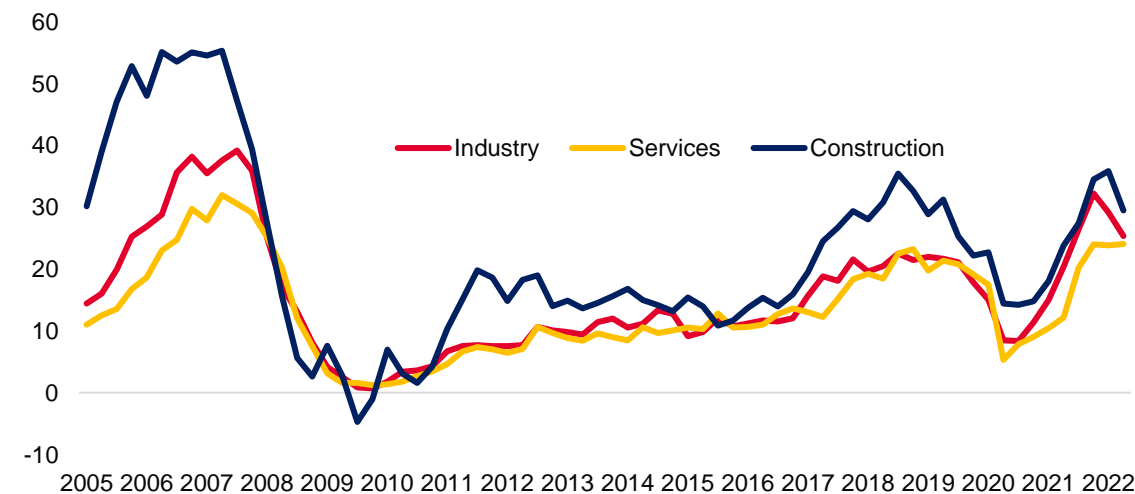
### Unemployment rate (%)



### Average gross wage (% YoY)



### Lack of labour by sectors (Baltic average, % of companies)



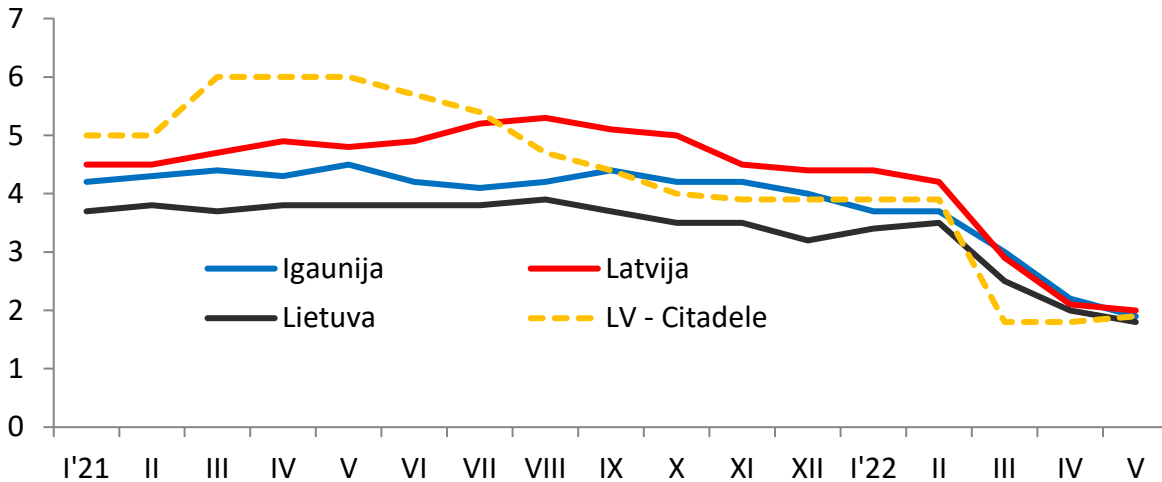
### Comments

- Unemployment is falling in the labor market, wages are rising and the impact of the war on unemployment in Ukraine is not yet felt.
- In almost all sectors, entrepreneurs cite labour shortages as a major constraint on growth, although the scarcity of raw materials is also increasingly cited.
- Wages in the Baltics are growing more slowly than prices and the purchasing power of the population is declining.

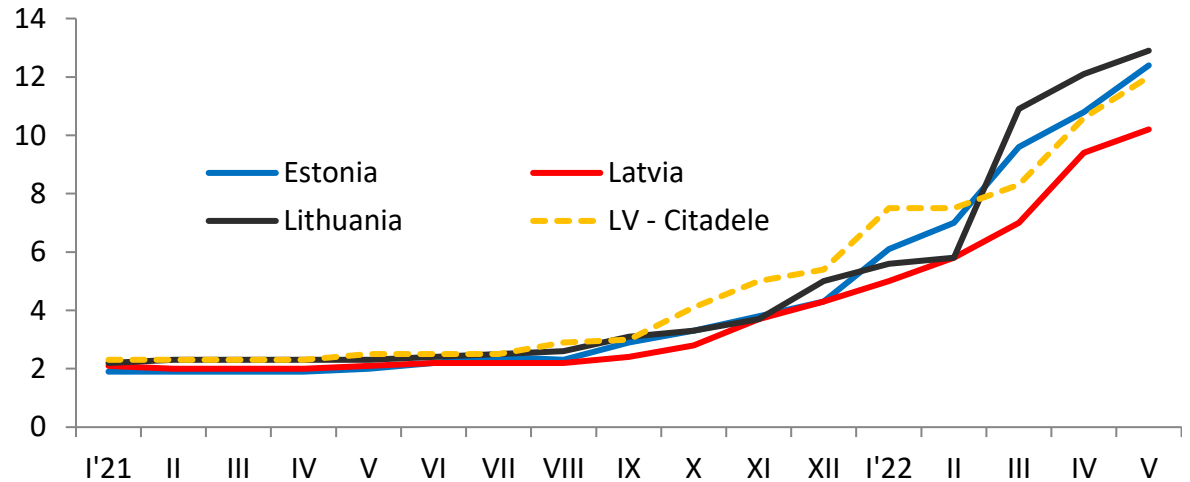
# Forecasts

Real growth forecasts are falling, but inflation is rising

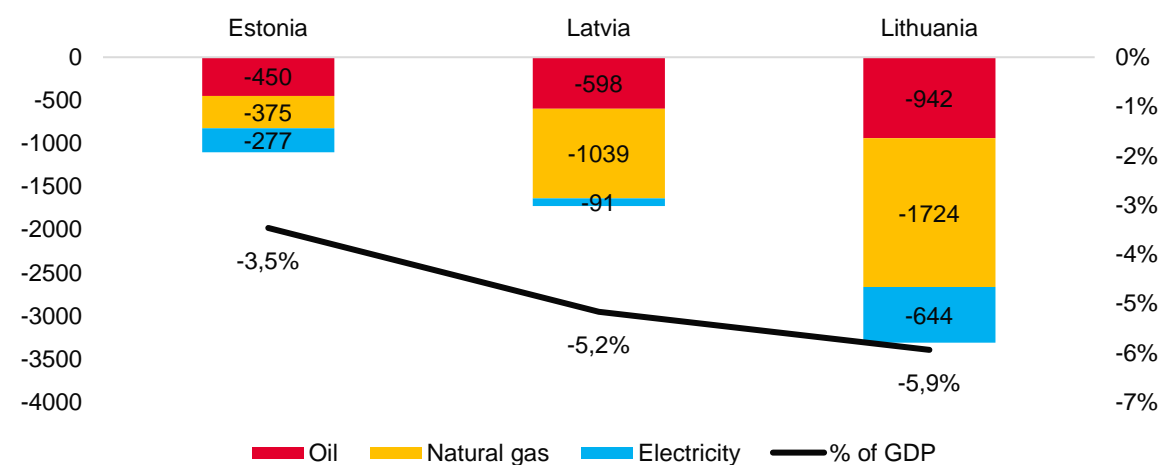
GPD forecast - 2022 (% YoY)



Inflation forecast – 2022 (% YoY)



Extra energy import costs (MEUR relative to 2016-2019 average)



## Comments

- Short-term data do not show a deterioration in the economic situation. For the time being, the impact of war in Ukraine on prices and GDP growth in all three Baltic countries in 2022 could be in the range of 2-3%. However, it will be difficult for the economy to grow with falling real incomes.
- The risks of a recession in the Baltics in the next year or two are high. Consumer sentiment is pessimistic, prices are rising faster than wages and purchasing power is declining, while the effects of Russia's actions are only partially felt. At the end of the year, the economy will increasingly feel the impact of expensive energy.
- Consumer price inflation in the Baltics is likely to exceed 12% this year, and could be in the range of 4-5% in 2023.

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