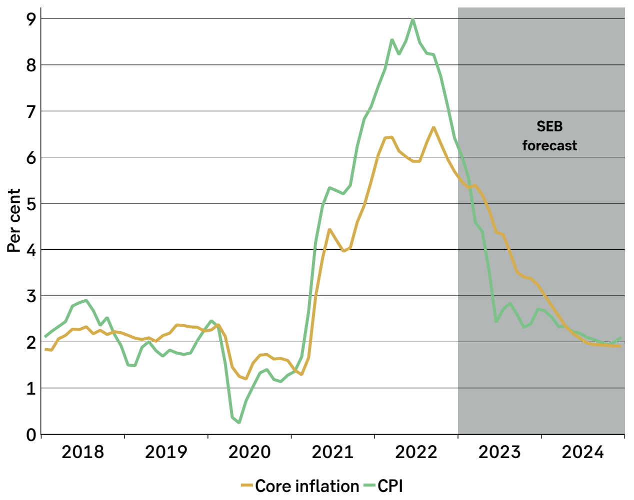
Theme: Inflation
Increased hopes of much lower inflation

After nearly two years of rising and surprisingly high inflation, the prospects of lower inflation are now much better. There are still many question marks as well as growing differences between regions. The clear downturn in inflation in the US, which was the first country to see the upturn, increases the likelihood that inflation will also fall globally.

US inflation has peaked



Source: BLS, Macrobond, SEB

The chart shows the consumer price index (CPI) and CPI excluding energy and food, so-called core inflation. Over the past three to six months, there have been signs that inflation may have peaked in the United States. Core inflation has fallen by 2.5 percentage points to about 6.5 per cent since June last year.

Strong demand for goods, alongside production and transport disruptions, drove up inflation

In our view, what triggered high inflation was extremely expansionary US fiscal policy. Large stimulus payments to households helped increase goods consumption by 15-20 per cent in just a few months. Supply and transport disruptions, both in the US and globally, helped accelerate the upturn. There were huge price increases for energy and commodities as well as manufactured goods. After a lag, the upturn in inflation became global, with the war in Ukraine helping to drive inflation even higher, especially in Europe.

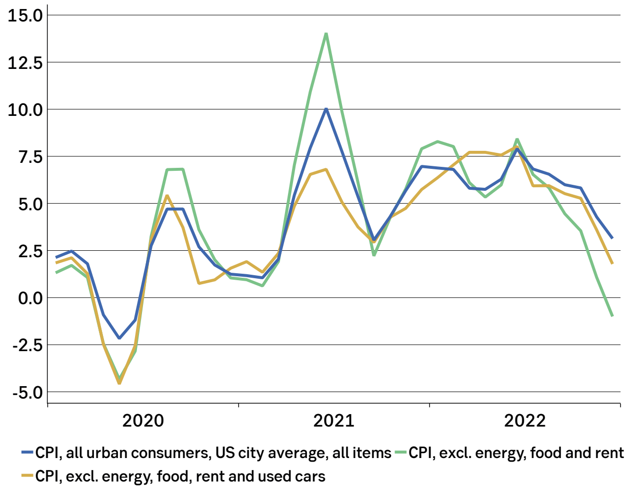
Much lower US inflation

Over the past three to six months, there have been signs that inflation may have peaked, especially in the US, where CPI inflation has fallen by 2.5 percentage points to about 6.5 per cent since June last year. Falling energy prices are the most important driver, but over the past three months core inflation (CPI excluding energy and food) also slowed by nearly one point to 5.7 per cent. While still well above the US Federal Reserve's 2 per cent target, there are many indications that inflation will continue to ease. Over the next three to six months, the big energy price hikes during the first six months of 2022 will disappear from rolling twelve-month figures. Unless there is a new energy price shock, CPI inflation looks set to fall below 2.5 per cent as early as this summer.

Lower core inflation in the US despite sharply higher rents

The core inflation trend is not as clear, but monthly changes over the past three months have averaged around 0.3 per cent, compared to the 0.5 per cent monthly increases posted during the first three quarters of 2022. The composition of price changes also indicates that an even greater slowdown in core inflation may be in store, since large rent hikes are currently adding nearly 0.3 percentage points a month to core inflation.

Lower US core inflation



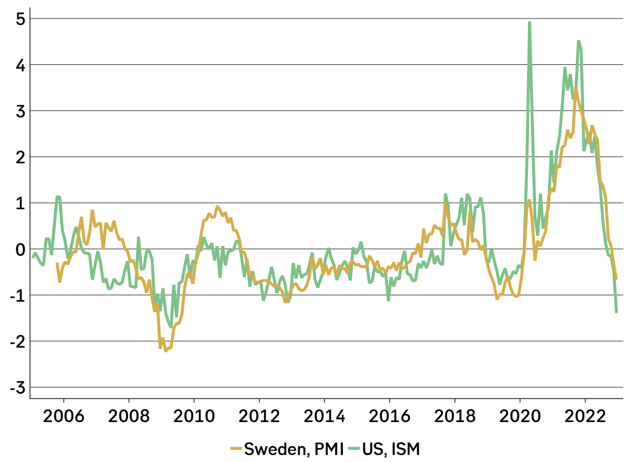
Source: BLS, Macrobond, SEB

Core inflation has been propped up by large rent hikes and used car prices. The latter component will fall, since comparative figures from spring 2022 were very high.

Stagnating rents in 2024?

If rents are excluded, core inflation has been negative for three straight months. Except for the price declines during the pandemic, this is the lowest core inflation during a three-month period since at least 1980. As part of CPI, rents will continue to increase at a rapid pace at least for the next three to six months, but rents in new leases look set to stabilise. If this trend continues, it means that in 2024 rents as part of CPI will fall below their historical trend. Falling prices for goods, especially used cars, are one key explanation for low core inflation in recent months, and there are indications that goods prices will continue to fall, reversing some of their increases. Goods consumption has fallen gradually since mid-2021, and the production bottlenecks that contributed to the upturn in inflation have eased significantly. Both delivery times and price changes in the purchasing managers index (ISM) are now well below normal levels. US hourly earnings are still probably increasing at a faster pace than is compatible with the Fed's inflation target in the longer term, but there are some deceleration tendencies here as well. If the labour market weakens in line with our forecasts, slower wage and salary growth is also likely.

Bottlenecks have eased



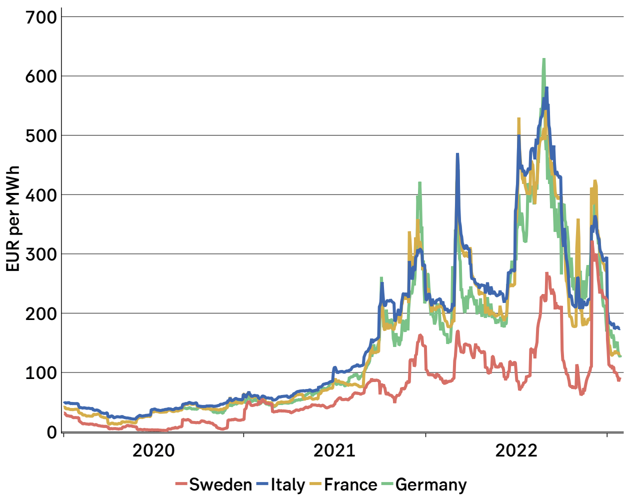
Source: Swedbank, ISM, Macrobond, SEB

The chart shows delivery times based on purchasing managers' indices (PMIs) for Sweden and the US (the ISM Manufacturing and Non-manufacturing surveys), which have now fallen below normal levels.

European energy prices have fallen significantly but are still high

Steep falls in electricity and natural gas prices suggest that inflation in the euro area is heading downward. However, the inflation outlook in Europe is more complicated and, unlike in the US, electricity and natural gas prices are still much higher than before the pandemic. Many countries have used subsidies, taxes and price controls to keep prices down for households and businesses. Energy prices as part of the consumer price index (CPI) will probably not follow market prices downward to any great extent. Given high energy prices, there is still a great risk that core inflation will be much higher in Europe than in the US, when businesses try to compensate for increased costs.

European energy prices still high



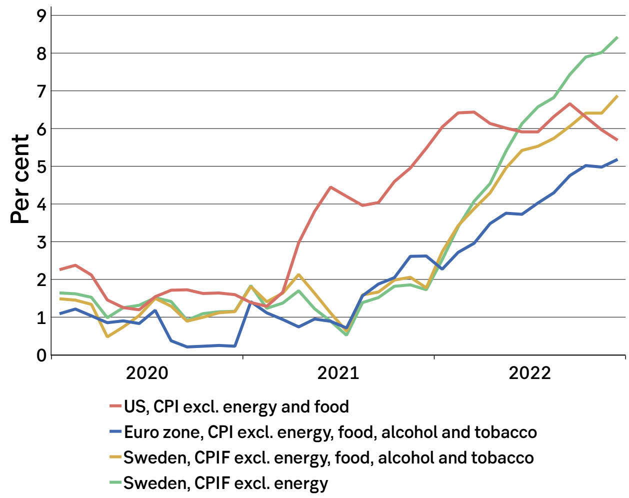
Source: Macrobond, SEB

European energy prices have plunged but are still far higher than historically.

Core inflation is still rising in Europe

Core inflation in the euro area continued to rise late in 2022, and a very large percentage of companies in retail and other consumer-oriented sectors plan to raise their prices over the next few months. In Sweden, CPIF excluding energy, food, alcohol and tobacco – a core inflation metric that aligns with the most common such metric in the euro area – rose to 6.9 per cent in December after remaining unchanged at 6.4 per cent in November. The weak Swedish krona is contributing to relatively higher inflation in Sweden, but core inflation in the euro area also hit a new high in December: 5.2 per cent.

Rising core inflation in Europe

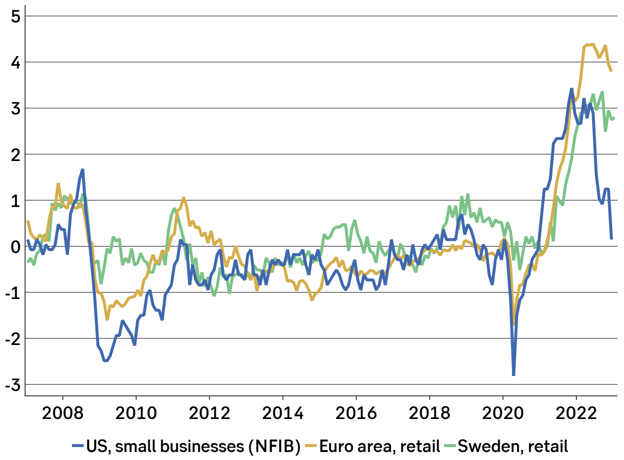


Source: BLS, Eurostat, Statistics Sweden, Macrobond, SEB

The downturn in US inflation, like the expected downturn in the euro zone and Sweden, is being slowed by high core inflation. Core inflation is still rising in the euro zone and Sweden, but subdued pay increases are pointing in a favourable direction.

There are some encouraging signs of decelerating inflation in the euro area as well, with reduced delivery times and decreasing price pressure on input goods and in manufacturing. However, unlike in the US, companies say that prices are still rising faster than normal. Base effects of high price hikes in 2022 also suggest that core inflation will gradually slow, but signals of falling inflation are much weaker than in the US so far. However, one favourable factor for long-term inflation is that wage inflation has accelerated much less than in the US. This is especially true in Sweden, where wage and salary growth is still just below three per cent, despite high inflation expectations and a tight labour market. There is also an increasing probability of moderate pay increases in the current national collective bargaining negotiations, though some uncertainty remains.

Easing price pressure in Europe, but far behind the US



Source: NFIB, European Commission, NIER, Macrobond, SEB

Price expectations according to business surveys have peaked. As with overall inflation, the US is leading the way. Levels remain high in the euro area and Sweden.

Lower inflation in the euro area, too, is the likeliest scenario

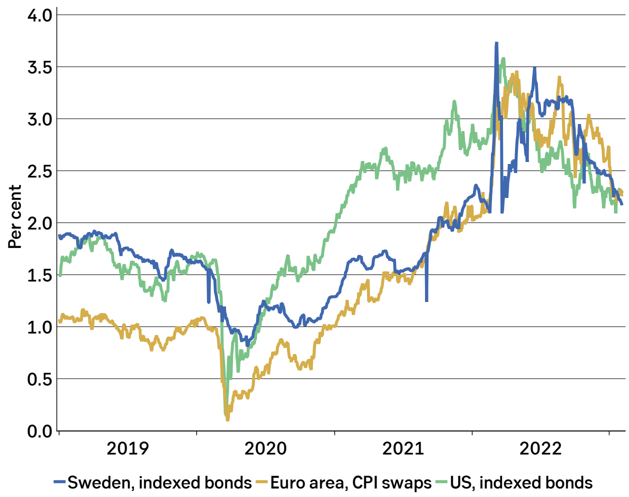
Clearly decelerating US inflation increases the likelihood that our forecasts of falling euro area inflation will prove accurate, although there are greater upside risks for core inflation over the next six months. In most countries, the post-pandemic inflation upturn was by far the biggest since the early 1980s, and forecasts are still much more uncertain than usual. Because of the war in Ukraine, new energy and commodity price surges are possible, and given the geopolitical situation the outlook for supply chains and globalisation remains uncertain. The green energy transition and wage developments are other upside risks, especially if economic growth does not slow in line with the forecasts of SEB and others. Although the risks of a repeat of 1970s-style inflation have decreased, it may be important to remember that inflation during the 1970s was not only high but also highly volatile.

Not all risks are on the upside

On the other hand, not all inflation risks are on the upside. One not entirely improbable scenario is that some price increases from recent years will be reversed, which could cause inflation to fall below target or be followed by a period of deflation. Apart from commodities, no clear signs of widespread price decreases are as yet discernible, but container freight prices, which increased sevenfold during the pandemic, have nearly fallen back to their 2019 levels. Some big US price hikes for used cars have been reversed, and certain manufacturers of new cars have announced that they are now lowering their prices. Historic inflation upturns have often been followed by periods of low inflation, but it is unusual for prices to fall, except for energy and in some cases food.

Our forecast is that inflation will fall below central bank targets in 2024, though this is partly due to some normalisation in energy prices. Market inflation expectations based on inflation-indexed bond yields and CPI swaps gradually eased in 2022, and these expectations are now in line with inflation targets, although they are higher than pre-pandemic levels.

Expectations in line with the inflation target



Source: Bloomberg, Macrobond, SEB

The chart shows that market inflation expectations based on inflation-indexed bond yields and CPI swaps fell gradually in 2022, and levels are now in line with central bank inflation targets, although they are higher than before the pandemic.