

ARTICLE – Alternative scenarios for the recovery

In the Riksbank's main scenario, growth picks up in the second half of 2021, primarily due to rising consumption. However, the economic outlook is more uncertain than during normal times. This is illustrated in this article with the help of two alternative scenarios.

In one scenario, it is assumed that the roll-out of vaccines will proceed more slowly than is expected in the main scenario, or that the vaccines will turn out to be less effective than expected against virus mutations. This would mean that effective immunity would be achieved later than in the main scenario with lower confidence among economic agents and a slower recovery as a result. In particular, this applies within sectors where it is common to have a lot of close contact between people.

In the other scenario, it is assumed that the recovery will take place more rapidly and be more powerful than in the forecast, for example if willingness to use the savings accumulated during the crisis for consumption and investment has been underestimated in the main scenario. This may mean that consumer and business confidence increase more rapidly than in the main scenario, with higher consumption, investment, employment and inflation as a consequence. At the same time, there may be limits to how quickly production can be adapted to a rapid rise in demand.

Still considerable uncertainty in the forecasts

The pandemic has impacted different sectors with varying severity

So far, the pandemic has hit companies and employees in the service sector the hardest. Sectors such as hotels, restaurants, various personal services, transport and physical shops have been particularly badly affected.^{44,45} Despite these sectors being relatively small in relation to total employment, they were responsible for almost 90 per cent of the total decline in the number of people employed in 2020 (see Figure 39). It

⁴⁴ The same sectors have also been hardest hit in other countries; see, for example, Economic Bulletin 2021:2, ECB. In both Sweden and the rest of the world, these sectors were particularly badly impacted during the first wave of the pandemic.

⁴⁵ This differs from the financial crisis of 2008-2009, for example, when goods manufacturing sectors were hit hardest.

is also in these sectors that confidence has fallen the most. On the contrary, production and confidence in the manufacturing sector are on a higher level now than before the pandemic.

The Riksbank's main scenario assumes that all people over the age of 18 will have been offered vaccination by the end of summer 2021 and that, helped by the warmer weather, the spread of infection will thereby slow down and restrictions can be phased out. In addition, the vaccinations are assumed to prevent the spread of infection gaining new impetus in the autumn. When restrictions are eased, growth in the Swedish economy is expected to pick up again, driven above all by increasing household consumption and rising employment in the sectors impacted most severely by the pandemic. Household saving has increased during the pandemic. This is not considered to be due primarily to increased precautionary saving, as in more normal recessions, but to households not having had the possibility to consume certain services. Neither have households fully compensated for this by consuming goods, for example. This also means that the recovery after the pandemic is expected to differ from a recovery from normal recessions.⁴⁶ Even if many people, following the authorities' advice and restrictions, have refrained from using hotels, restaurants, hairdressers, taxis and cultural services, there is an underlying demand for such services.⁴⁷ As these services as a rule imply physical contact, production of them can be automated or moved abroad to a lower degree than other production. It is therefore likely that production will recover rapidly when the pandemic subsides and households return to more normal consumption.

So far, inflation has not been affected as much by the pandemic as production and employment have.⁴⁸ In the main scenario, inflation is expected to be volatile this year due to energy prices and technological factors, but then rise towards 2 per cent as demand strengthens, wages increase more quickly and inflation abroad rises.

Alternative scenario – more rapid recovery

But forecasts are uncertain, especially in these times of constantly updated information on, for example, the spread of infection and vaccinations.⁴⁹ Not much is re-

⁴⁶ In normal recessions, households tend to postpone larger purchases when the economic outlook is uncertain. Recovery is then largely driven by a pent-up demand for these goods.

⁴⁷ See R. Chetty, J. Friedman, N. Hendren and M. Stepner, "How did Covid-19 and stabilization policies affect spending and employment? A new real-time economic tracker based on private sector data", NBER working paper no. 27431, 2020.

⁴⁸ For more information on the impact and expected impact of changed consumption patterns during the pandemic, see J. Johansson, M. Lóf and O. Tysklind, "Changed consumption during the pandemic affects inflation", Sveriges Riksbank, Economic Commentaries, No. 14, 2020.

⁴⁹ Approximately the same development in the spread of infection, immunity and restrictions is assumed in this scenario as in the main scenario.

quired to increase consumer and business confidence. This could lead to saving decreasing more rapidly and more than in the forecast and thereby to higher consumption and investment. In the scenario with more rapid recovery, consumption aimed at those service sectors hardest hit by the pandemic is expected to increase very substantially. This may also have spillover effects on other sectors. Similarly, demand abroad is also expected to increase and thereby drive up demand for Swedish exports.⁵⁰ Overall, this means that Swedish GDP will rise significantly more rapidly than in the main scenario (see Figure 59).⁵¹ The calculations presented in this article are based on the same assumptions of continued expansionary Swedish fiscal and monetary policy as in the main scenario.

It is also within the hardest-hit sectors that many have lost their jobs. For example, employment in the hotel and restaurant sector has fallen by more than 40,000 people between the fourth quarter of 2019 and the fourth quarter of 2020. Jobs in these sectors often require relatively short training and a large share of employees have temporary employment in services with a high staff turnover.⁵² This means that jobs can quickly be recreated when demand rises again and unemployment will therefore fall more rapidly than in the main scenario (see Figure 60).^{53,54} In this scenario, employment in the hotel and restaurant sector is expected to be back at approximately the same level as before the pandemic during the fourth quarter of this year. In the main scenario, the recovery is expected to take longer.

The highest price increases are expected in those sectors hardest hit by the pandemic.⁵⁵ In the main scenario, no extensive supply limitations are assumed due to a staff shortage or problems with goods deliveries. But in a scenario with faster recovery, competition may arise when many companies need to hire staff at the same time, something that could drive up wages and prices in these sectors and also spill over to

⁵⁰ The scenarios in “ECB staff macroeconomic projections for the euro area”, ECB, March 2021 have been used in this article for other countries.

⁵¹ The effects in this article are partly based on results from the Riksbank’s general equilibrium model, MAJA; see V. Corbo and I. Strid, “MAJA: A two-region DSGE model for Sweden and its main trading partners”, Working Paper Series 391, Sveriges Riksbank, 2020.

⁵² See “Development for temporary employees 2005-2019”, in Statistical news from Statistics Sweden, March 2020 and I. Häkkinen Skans and M. Mossfeldt, “Kort- och långsiktiga effekter av sänkt restaurangmoms” [Short and long-term effects of reduced VAT on restaurants], in Swedish only, Occasional Studies, no. 46, National Institute of Economic Research, 2015.

⁵³ Employees in the hotel, restaurant and transport sectors are on average younger, more often foreign-born and have a lower level of education than employees in other sectors, see the article “Arbetslöshet i covid-19-pandemin” [Unemployment in the COVID-19 pandemic] in the Swedish version of the Swedish Economic Report December 2020, National Institute of Economic Research.

⁵⁴ For more information on the effects of the pandemic on the labour market, see I. Häkkinen Skans “The corona crisis and the labour market - effects in the short and long term”, Sveriges Riksbank, Economic Commentaries no. 1, 2021.

⁵⁵ This is supported by, for example, the Riksbank’s Business Survey. If demand rises rapidly at pace with the roll-out of vaccines, restaurants will see greater opportunities to raise their prices. In the same survey, however, hotel and travel companies are more hesitant about the opportunity to raise prices. For example, one business leader says that “It isn’t the prices that stop people travelling”. See the Riksbank’s Business Survey ““Vaccine optimism” raises expectations”, Sveriges Riksbank, February 2021.

other sectors. The staff shortage might also force companies to hire less experienced workers with lower productivity, something that companies might need to compensate for by increasing prices. The pent-up need for, for example, eating out means that many consumers will also accept higher prices. In this scenario, inflation is also higher abroad, something which, via higher import prices, also spills over to consumer prices in Sweden. As global trade and industrial output is also expected to be higher in this scenario, there is a risk of delivery problems, for example caused by a shortage of semi-conductors or containers as a result of the strong demand.⁵⁶ Something like this could subdue output slightly but also drive up inflation in Sweden. In this scenario, it takes a shorter time for CPIF inflation to reach 2 per cent more permanently than in the main scenario (see Figure 61).

Alternative scenario – slower recovery

Even if some companies are optimistic now that vaccinations are underway, the pandemic is still creating great uncertainty.⁵⁷ Delays in vaccine distribution, mutated variants of the virus and increased spread of infection, all of which imply continued strict restrictions and risks for supply disruptions, are factors causing companies concern.

In the scenario “Slower recovery”, it is assumed that the spread of infection does not slow as quickly as is expected in the main scenario and that it takes longer to build up immunity to COVID-19. This can be the result if vaccinations are delayed or virus mutations arise against which the vaccines are not as effective. This will in turn lead to restrictions remaining in place and will delay the recovery in demand, especially in sectors where people are in close contact with each other, something that will further damage consumer and business confidence. In such a scenario, it is also possible to imagine the currently high level of confidence in the manufacturing industry starting to fall.

It therefore takes longer for consumption and investment to increase. In the same way, consumption and investment abroad, and as a result demand for Swedish exports, also fall.⁵⁸ This means that Swedish GDP rises more slowly than in the main scenario (see Figure 59).

The lower demand also means that the recovery on the labour market, primarily in hard-hit service sectors, will be delayed with higher long-term unemployment as well

⁵⁶ See the article “Brist på halvledare hämmar produktionen första halvåret i år” [Shortage of semi-conductors putting a damper on output in the first half of this year] in the Swedish version of Swedish Economy Report March 2021, National Institute of Economic Research.

⁵⁷ See the Riksbank’s Business Survey ““Vaccine optimism” raises expectations”, Sveriges Riksbank, February 2021.

⁵⁸ Less favourable development in the spread of infection and vaccinations is also assumed in the more pessimistic scenario in “ECB staff macroeconomic projections for the euro area”, ECB, March 2021.

as more bankruptcies as a result.⁵⁹ In addition, the risk of long-term effects on confidence increases as pandemics change our assessment of the probability of new serious events of this kind occurring. This can lead to households increasing their precautionary saving, to permanently lower corporate investment and employment and to higher unemployment (see Figure 60).⁶⁰

In the scenario with slower recovery, more companies in the hardest-hit sectors are expected to be able to re-hire their staff in order to meet the more slowly rising demand. Competition for staff will thereby be less severe with lower wage pressures and lower inflation as a result, something which also risks spreading to other sectors. Imported inflation from abroad is also expected to be lower. In this scenario, CPI inflation is significantly lower than in the main scenario and does not even reach 2 per cent by the end of the forecast period (see Figure 61).

Economic policy may need adjustment

If economic developments do not turn out as expected in the main scenario, fiscal policy and monetary policy may need to be adjusted. However, the fact that inflation approaches 2 per cent more rapidly in the scenario with faster recovery need not be a reason for making monetary policy less expansionary in different ways. On the other hand, both fiscal policy and monetary policy would need to be made more expansionary in the scenario with slower recovery. The calculations in this article have not taken the effects of this into consideration, however.⁶¹

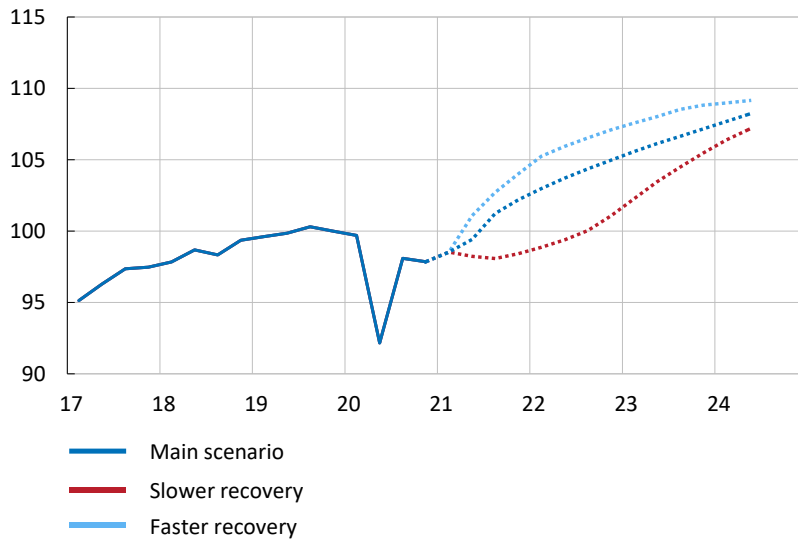
⁵⁹ The number of persons who have been without work for more than 12 months has increased by 30,000 since December 2019 and in March 2021 amounts to 182,000 people. About two-thirds of the increase is made up of persons with only compulsory school education, persons with functional impairments that reduce their capacity to work, unemployed people over the age of 55 and people born outside Europe. For more information, see "Långtidsarbetslöshetens utveckling i spåren av pandemin" [Development of long-term unemployment in the wake of the pandemic], in Swedish only, Swedish Public Employment Service, April 2021.

⁶⁰ This phenomenon is sometimes referred to in academic literature as "belief scarring", see the discussion in the article "The long-term economic effects of the pandemic are uncertain", Sveriges Riksbank, Monetary Policy Report, November 2020 and J. Kozłowski, L. Veldkamp and V. Venkateswaran, "Scarring Body and Mind: The Long-Term Belief-Scarring Effects of COVID-19", National Bureau of Economic Research (NBER), Working Paper 27439, 2020.

⁶¹ However, monetary policy is not well suited to providing targeted support to different parts of the economy. Fiscal policy has an important role to play in this.

Figure 59. GDP in Sweden

Index, 2019 Q4 = 100, seasonally-adjusted data

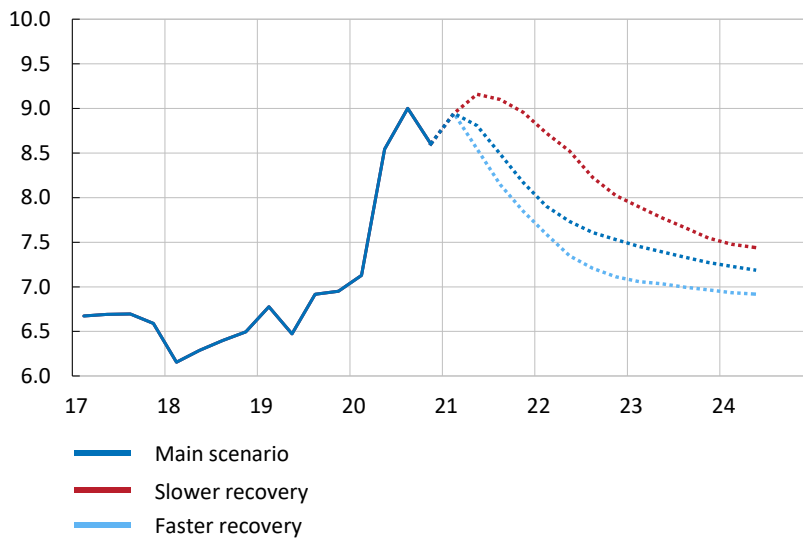


Note. Unbroken line refers to outcomes, broken line to the Riksbank's forecast.

Sources: Statistics Sweden and the Riksbank.

Figure 60. Unemployment in Sweden

Percentage of labour force, 15–74 years, seasonally-adjusted data.

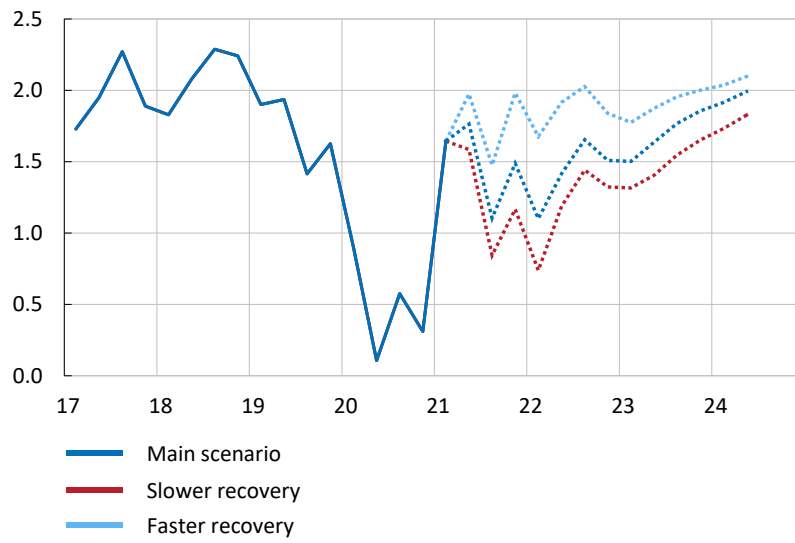


Note. Unbroken line refers to outcomes, broken line to the Riksbank's forecast.

Sources: Statistics Sweden and the Riksbank.

Figure 61. CPIF

Annual percentage change, quarterly data



Note. Unbroken line refers to outcomes, broken line to the Riksbank's forecast.

Sources: Statistics Sweden and the Riksbank.