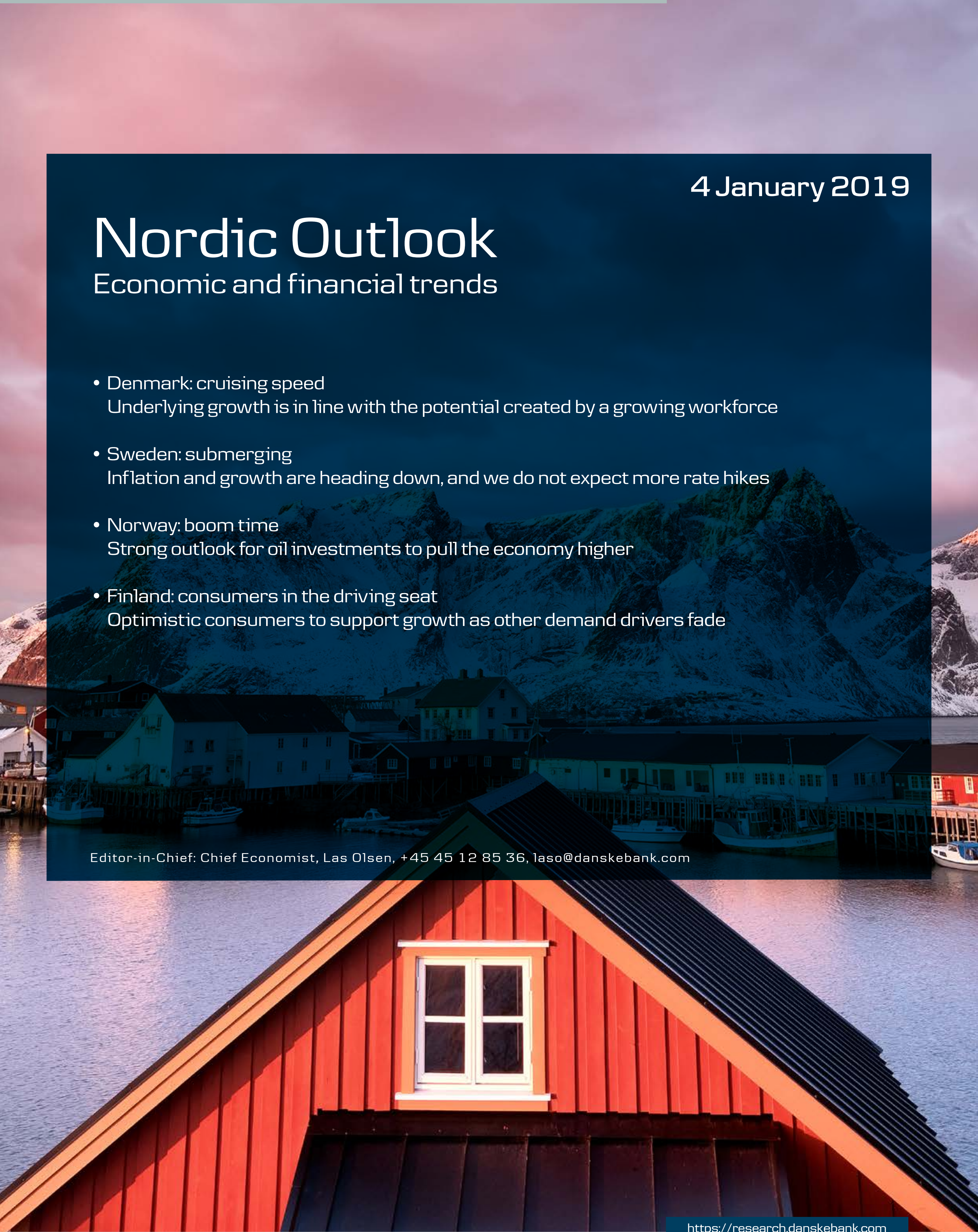

4 January 2019

Nordic Outlook

Economic and financial trends

- Denmark: cruising speed
  Underlying growth is in line with the potential created by a growing workforce

- Sweden: submerging
  Inflation and growth are heading down, and we do not expect more rate hikes

- Norway: boom time
  Strong outlook for oil investments to pull the economy higher

- Finland: consumers in the driving seat
  Optimistic consumers to support growth as other demand drivers fade

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Editorial deadline 3 January 2019 *Investment Research*

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Important disclosures and certifications are contained from page 38 of this report.

Contents

The ***Nordic Outlook*** is a quarterly publication that presents Danske Bank's view on the economic outlook for the Nordic countries. The semi-annual publication *The Big Picture* sets out our global economic outlook.

At a glance

Global risks and local strengths

The global economy is still strong in the sense that it is growing above its long-run potential, but it seems we are facing a period of declining growth, as the period of simultaneous recovery and low inflation and low interest rates is ending. The risk of a sharper global slowdown is also increasing. That is reflected in the outlook for the Nordic countries, which are highly dependent on external factors, but which are also in very different positions.

If we look though the noise created by volatile GDP numbers, Denmark is set to slow in line with the rest of Europe. If risks materialise and the global slowdown becomes more severe, Denmark would also suffer but we do not see the risk of an especially deep crisis, at least not for the country as a whole. Finland's remarkable recovery is already slowing down but growth rates remain high, and also here, concerns for the domestic situation are limited, even if there is a global crisis of some sort.

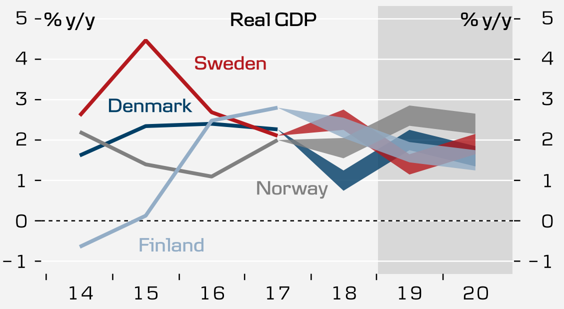
Sweden, on the other hand, is facing a more pronounced domestic slowdown, especially centred on the housing market where years of high investment growth are ending. Swedish manufacturers have maintained their optimism, but a more pronounced slowdown in Europe would further slow Sweden as well. Housing investment has also weakened in Norway, and other indicators have softened recently, but the outlook for oil investment growth has become even stronger. In light of that, it would take a lot of global trouble to make us pessimistic about Norway in the next few years.

Political risks on the agenda

Political events such as Brexit, trade wars and the Italian budget crisis are attracting significant attention and have the potential to seriously disrupt the global and European economies. In the Nordics, elections are due this year in Denmark, Finland and possibly Sweden, where it is proving very difficult to form a government after last year's election. As that illustrates, Nordic political divisions can also be hard to overcome, but fundamental changes to the economic framework do not seem to be on the agenda.

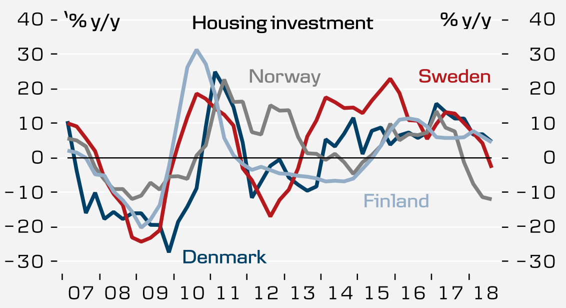
In terms of trade war risks, the tensions are mostly between China and the US, with limited direct effect on the Nordics, although sectors like Danish shipping are clearly affected, and lower global growth matters for all. A disorderly Brexit would create problems closer to home and affect many Nordic companies directly. If it triggers a short-term recession or at least a slowdown in the UK, that would be felt in the rest of Europe. In terms of direct effects, Nordic exporters would likely face tariffs on their UK exports, and all Nordic countries have a surplus against the UK in goods (but a deficit in services). Norway has the most exports, but 80% of that is oil and gas, which faces only 2.5% tariffs under WTO rules. In contrast, Denmark's substantial food exports could face tariffs of 15.5-35.9%. However, the total value of agricultural exports to the UK is only 0.46% of Danish GDP. The UK is not as important as it once was to the Nordics, and we do not expect a major economic impact.

Norway on top



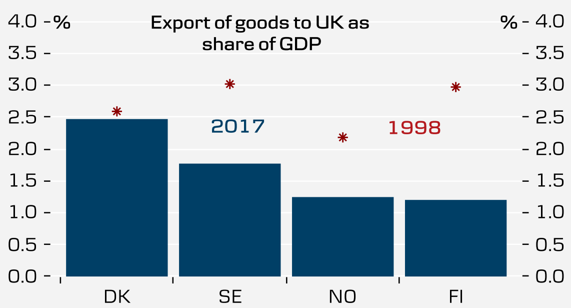
Source: Macrobond Financial, Danske Bank

Housing becoming a drag



Source: Macrobond Financial

Denmark most exposed to the UK



Note: Norway figures are mainland GDP and export
Source: Macrobond Financial

Denmark

Cruising speed

- **The Danish economy is growing at an underlying rate of close to 2% annually, with an expanding labour force giving it the capacity to do so.**
- **Risks are both upside and downside – with the downside risks stemming mainly from abroad, while the upside risks are from a domestic economy that could potentially overheat.**
- **House prices look set to continue rising, but at a slower pace and not in the most expensive areas.**
- **Wage growth and inflation are slowly picking up.**

Fluctuating growth figures conceal stability

In GDP growth terms, 2018 would appear to be the worst year for the Danish economy since the European debt crisis hit it in 2012. However, GDP figures alone give a considerably less than complete picture of the situation. In the past year, temporary factors pulled GDP sharply lower, so the apparent marked contrast to 2017 should not be taken at face value. For example, looking at registered unemployment excluding those in various activation schemes, the figures have fluctuated by just plus/minus 0.1 percentage points over two and a half years, which makes the period the most stable since at least 1970. That figure does not tell the whole story of the Danish economy but it comes closer. To say the economy is growing more or less in line with capacity is not far off the mark and that capacity is determined very much by the labour force.

In our view, there is a significant risk the stable picture will not last. We expect global growth to slow, which would also pull growth a little lower in Denmark. Moreover, the risk of a more serious slowdown abroad is growing, particularly when we look ahead to 2020. However, the Danish economy appears well prepared for this situation, as it is not currently overheating – credit growth is low, competitiveness is solid and house prices are not high, at least at the national level. On the other hand, the Danish economy could risk overheating in coming years, as households and companies have the potential to increase debt levels, while a tight labour market could trigger unsustainably high wage growth.

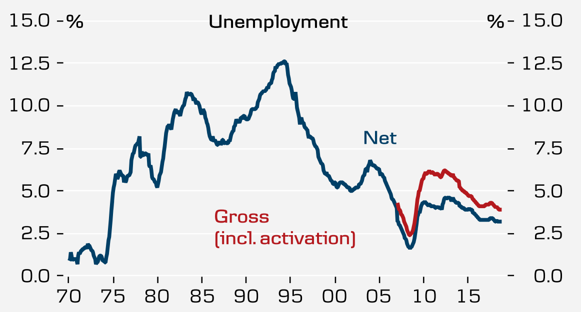
Low GDP growth in 2018 comes partly on the back of the poor harvest, which appears to have reduced GDP by around 0.3% but which we would then expect to raise GDP by an equivalent amount this year. Another factor is Statistics Denmark deciding to include a patent sale in 2017 as production that year, even though production was clearly over a long period preceding the sale. The artificially high GDP in 2017 gives a growth figure for 2018 that is around 0.4 percentage points too low. We had expected the decision to be reversed but this has not happened. The problems with calculating GDP are also underlined by yet another major revision of the figures so that GDP in 2017 is 1.3% higher than previously assumed, due mainly to significantly higher growth in the preceding years. Investment in particular had been undervalued previously, which means the potential for strong investment growth in coming years is not so significant. However, the new figures show significantly better productivity growth in recent years, which supports the growth outlook going forward.

At a glance

Denmark	Current forecast			Previous forecast	
% y/y	2018	2019	2020	2018	2019
GDP	1.0	2.0	1.6	1.6	2.0
Private consumption	2.4	1.9	2.3	2.5	2.3
Public consumption	0.4	0.4	0.4	0.6	0.5
Gross fixed investment	5.9	0.7	3.6	7.7	2.6
Exports	0.2	2.7	2.0	2.2	3.7
Imports	3.6	1.3	2.9	4.4	3.0
Gross unemployment (thousands)	108.3	104.7	103.0	108.0	100.7
Inflation	0.8	1.3	1.6	0.8	1.4
Government balance, % of GDP	0.3	0.1	-0.1	0.4	-0.1
Current account, % of GDP	5.6	6.0	5.9	5.4	6.1

Source: Danske Bank

Small fluctuations in recent years



Source: Statistics Denmark, Macrobond Financial

Low interest rates set to continue in 2019

The Danish krone (DKK) has weakened against the euro (EUR) in the past year within the limits of the fixed exchange rate policy. In our view, this is due, in particular, to low returns on Danish equity and bond investments abroad, combined with a slowdown in exports during much of 2018, which together have reduced demand for DKK. However, these are temporary factors, so we expect to see a renewed strengthening of the DKK this year, also without Danmarks Nationalbank having to raise interest rates. The government plans to withdraw around DKK50bn from its account at Danmarks Nationalbank in 2019, mainly to finance the redemption of mortgage loans to the social housing sector, which going forward will be financed by government loans. This may fuel downward pressure on yields in DKK and tend to weaken the DKK, which Danmarks Nationalbank will counter presumably by buying DKK.

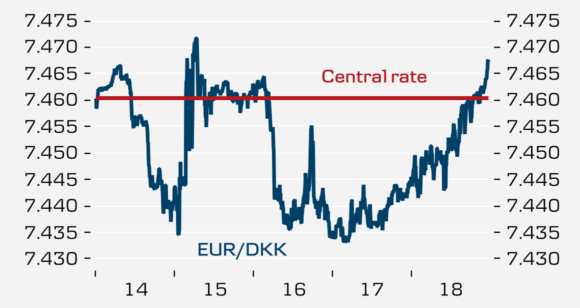
We expect the next rate hike to come alongside that of the European Central Bank's (ECB), which we expect in December 2019. However, we estimate that long yields will rise before then in expectation of the rate hike. Monetary policy should have only a minor dampening effect on the economy in the coming years, which is unusual so far into an upswing. This is not due to monetary policy being adjusted to a euro economy that is significantly different to the Danish economy – on key parameters like credit growth and inflation expectations Denmark fully resembles an average of the euro countries. During the crisis, however, inflation in the euro area (and in Denmark) has remained at a level considerably below the ECB's target, and a certain degree of heating in the economy could get inflation rising again.

Era of very low inflation has come to an end

Last year was yet another year of low inflation. Indeed, Denmark could boast the lowest inflation rates of all EU members for the most of H2 18. Extraordinary events have had a major influence. First came the reduction in car registration tax, then driving over the Great Belt bridge became notably cheaper, and lastly the increase in annual rents proved to be historically low. In the summer, district heating plants reduced their prices markedly, following strong earnings after a mild winter, and despite a drought and poor harvest, food has become cheaper in the past year, even though the opposite has been the case in Europe. Supermarkets appear to have intensified their price wars.

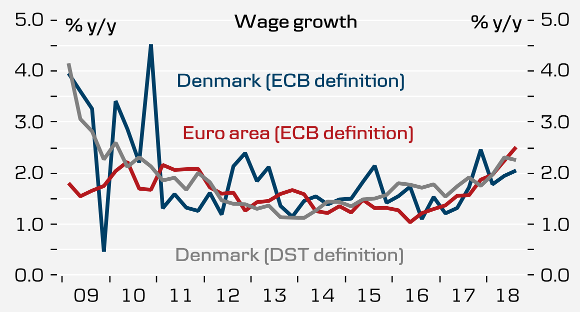
Extraordinary events looked set to keep a lid on Danish inflation again this year, as the media licence fee will be phased out over the next four years. However, as Eurostat has decided that the licence fee should be interpreted as a tax, it will fall out of inflation numbers in 2019 and will not be a significant drag on inflation in coming years. We expect inflation to edge up in 2019 as rents are set to rise at a more normal pace. Mounting wage pressures in Denmark will also start to feed into higher prices of services. We expect inflation to rise from 0.8% in 2018 to 1.3% in 2019 and 1.6% in 2020.

Weaker DKK



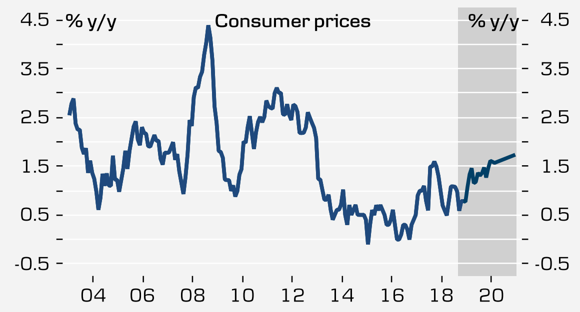
Note: DKK per EUR
Source: Danmarks Nationalbank, Macrobond Financial

Higher wage growth – not only in Denmark



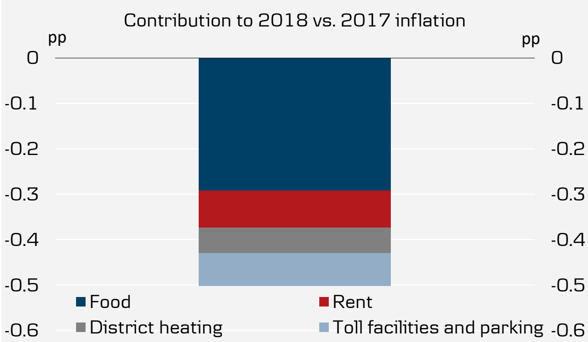
Source: ECB, Macrobond Financial

Period of very low inflation ebbing out



Source: Statistics Denmark, Macrobond Financial, Danske Bank

Several factors have pulled inflation down



Source: Statistics Denmark, Macrobond Financial, Danske Bank

Fairly tight labour market

Despite stable unemployment levels, the labour market has become tighter. Statistics Denmark's gauge of whether labour shortage curbs corporate output is close to pre-crisis levels. Other indicators such as the number of unsuccessful recruitments are, however, notably lower than at that time, albeit on the rise. Wage growth is trending up, and real wage growth is quite high, particularly when compared with productivity growth. This would seem to indicate that an increasing proportion of corporate earnings is spent on payrolls instead of being recognised as profits.

Over the past 12 months (to October), an average of 4,300 more wage earners have found work every month, while the registered unemployment has only fallen by 800 persons a month. This is a clear indication that job growth remains driven by foreign labour and higher labour market participation rates among Danish workers. Measured over the course of the recovery since 2013, about 40% of the employment increase was driven by foreign labour, while the remainder was due to lower unemployment and higher labour market participation rates, especially for the 60+ age group, students and people in flex jobs. As many of the newcomers have part-time jobs, the number of hours worked has risen substantially less than employment.

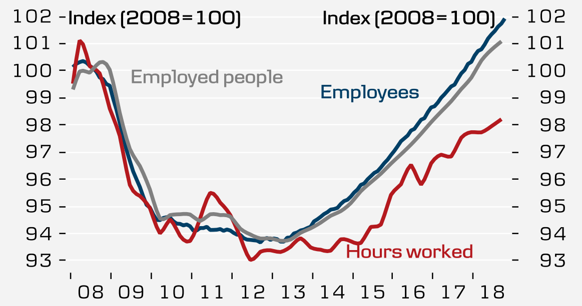
We also expect to see an expansion of the labour force in the coming years, among other things because the state pension age will increase by six months in both 2019 and 2020 (and the following two years), which by itself will probably expand the labour force by 10,000-15,000 people in each of the years. Part of the demand for labour may also be covered through longer working hours. Overall, we expect the labour market to remain tight with slightly higher wage growth and a risk of labour shortage restricting growth and resulting in unsustainably large wage increases.

Copenhagen no longer topping the Danish housing market

Across Denmark, we expect rising house prices in both 2019 and 2020 – also in real terms. Over the forecast period, however, we expect annualised growth in house prices will decline from about 3.5% in 2018 to 2.5% in 2020. One of the main reasons for the slowing price growth is that we expect short-term and long-term interest rates to rise over the forecast period. Rising income and persistently reasonable pricing in most parts of Denmark will still contribute to driving up prices, however.

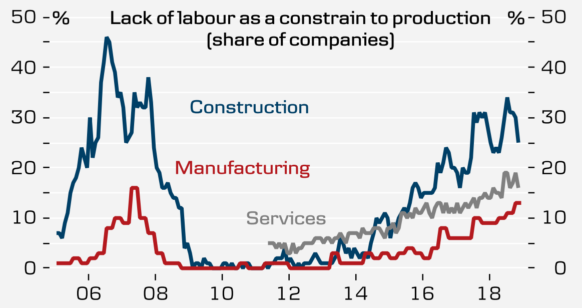
In the expensive areas, the picture is a bit more blurred, and Copenhagen in particular has witnessed more subdued price growth amid modest price falls in the market for owner-occupied flats. While these are by no means dramatic price falls but rather a question of prices moving sideways since spring 2018, there has been a noticeable shift in sentiment compared with 2017, when the market for owner-occupied flats experienced double-digit growth. The dampened buyer interest is also witnessed in a substantial increase in the number of apartments for sale. Price growth has also weakened for single-family houses in and around Copenhagen, a market that has seen much of the same price trend as for apartments.

More people in employment, but many of them part time



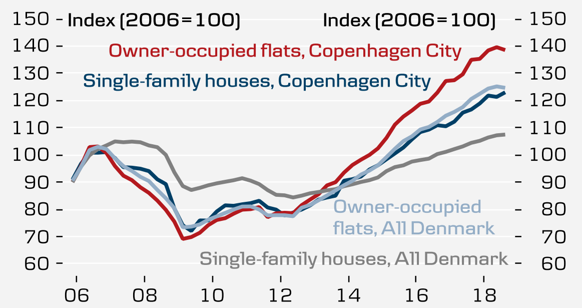
Source: Statistics Denmark, Macrobond Financial

More companies short of labour



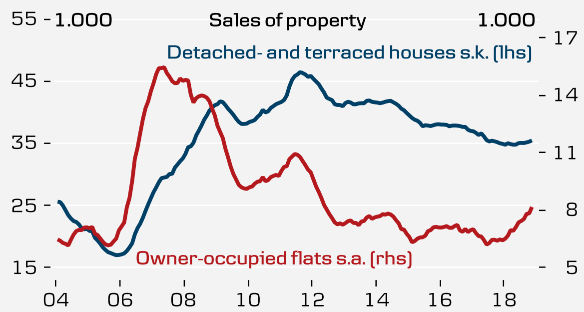
Source: Statistics Denmark, Macrobond Financial

House prices continue upwards across Denmark, but price increases ebbing out in Copenhagen



Source: Statistics Denmark, Macrobond Financial

The supply of flats has increased sharply, though from a low level



Source: Finans Danmark, Macrobond Financial

New property valuations for tax purposes are planned for the latter part of 2020. We do not expect this to give rise to any general volatility, as the majority of Danish homeowners will not experience any noteworthy tax changes. In areas that have experienced very sharp price increases in recent years and with many owner-occupied flats, the new valuations may push down prices.

Consumption rising steadily – but potential remains positive

Private consumption is trending upward and remains supported by a solid increase in real incomes. But in spite of growing by 2.00-2.25%, private consumption is growing at a fairly modest pace given the current economic upswing, reflecting the fact that Danes have become much more inclined to save their money than they were during the previous upswing. Among other things, this trend should be viewed in light of the fact that many borrowers capitalise on the falling interest rates to pay off more on their loans and also that some home owners are still suffering from the effects of the last crisis. In large parts of Denmark, home equity values have still not been restored after the large price falls during the crisis years, dampening the propensity to borrow among many households. That also explains why lending growth to households remains subdued, which is in sharp contrast to the boom years of the mid-noughties.

Going forward, we expect a small positive contribution to consumption from increased borrowing levels, but households are likely to remain reluctant to increase their debts. However, should consumers truly begin to increase their level of borrowing – for example if a prolonged period of rising house prices would result in greater home equity – that could mean considerably faster consumption growth than our current forecast indicates.

Overall, we expect consumption growth to decline in 2019 and to edge up again in 2020. The reason is partly the outlook for a slightly more modest real income increase than seen in 2018 and partly the fact that the boost expected in private consumption in 2019 from excess tax repayments to around 3/4 million homeowners has been deferred to the end of 2020.

Balanced government finances

Unlike in many other European countries, Danish government finances are in fine shape and remain supported by the overall economic recovery. In both 2019 and 2020, we expect more or less balanced government finances, with a small surplus in 2019 and a small deficit in 2020. One of the reasons is that the repayment of excess property taxes has been postponed from 2019 to 2020 and thus will weigh temporarily on public finances in 2020.

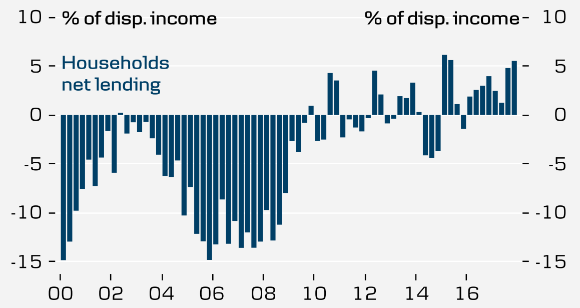
The reason that the sound economic situation in Denmark fails to translate into a larger government surplus is partly an expected decline in, particularly, PAL revenues (pension return tax) in the coming years, combined with rising interest rates.

The Danish fiscal policy will be more or less neutral in the coming years, largely reflecting the economic situation. However, the tight labour market may call for a tighter fiscal policy should growth surprise on the downside.

Exports defying global growth slump

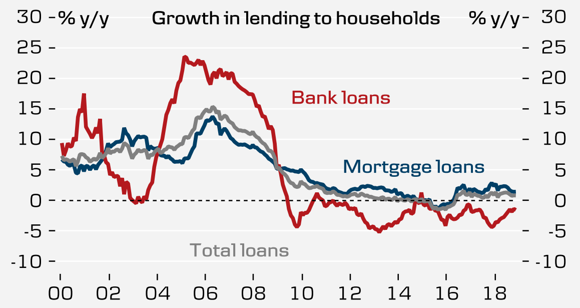
It has been difficult to interpret developments in exports recently. Exports have disappointed since the beginning of 2017 in spite of strong growth in key Danish

Before the crisis, we spent more than we earned – now we save our money



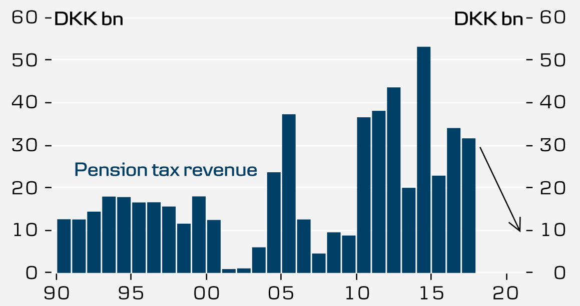
Note: Net financial saving is the difference between household net savings (incl. pension) and net borrowings
Source: Statistics Denmark, Macrobond Financial

A surge in borrowing would result in an upside consumption surprise



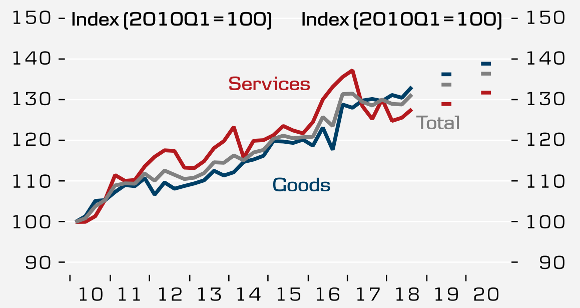
Source: Statistics Denmark, Danske Bank calculations, Macrobond Financial

Rising interest rates and weak financial markets to reduce revenue from pension return tax



Source: Statistics Denmark, Macrobond Financial

More exports expected



Source: Statistics Denmark, own calculations, Macrobond Financial export markets, which ought to have resulted in growing demand for Danish goods and services. Danish exports finally staged a comeback in Q3 18 amid sluggish growth in Sweden and the euro area and, particularly, Germany, Denmark's principal trading partner. It is not that easy to explain what is going on.

However, before giving up on finding any meaning in the export statistics, it is important to take a closer look at the numbers. Energy exports fell by nearly 11% in the first three quarters of 2018 compared with the year-earlier period, and food exports have only risen by about three-quarters of a percent after a difficult year for the agricultural sector with a long drought and a poor harvest. Exports of both energy and food are typically determined by factors other than the global business cycle, and it can be a good idea to disregard this data when assessing exports relative to growth in the export markets. Net of energy and food exports, it actually turns out that the rest of the goods exports, primarily made up of industrial products, rose by 2% year-on-year in the first three quarters of 2018, which, while not impressive, is not exactly bad.

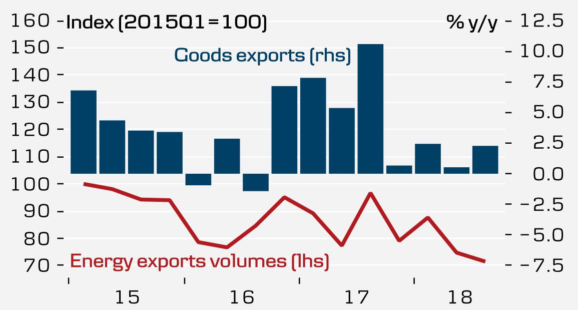
Although Danish exports are not likely to have better conditions than they had for the past year, we expect goods exports to make a greater contribution in 2019 than in 2018. The outlook ought to brighten for Danish exports after a year in which demand for Danish goods was lower than warranted by the circumstances. Also, the headwinds from a stronger Danish krone will start to wear off after a period in which the strength of the Danish krone against especially the Swedish krone and US dollar made Danish products more expensive in Sweden and the US. However, we expect export growth to subside in 2020 in step with the slowdown in the global recovery, and raw material extraction is also expected to slow, resulting in a negative contribution from energy exports.

Reduced current account surplus both good and bad

The modest increase in exports has also left its mark on the current account surplus, which fell considerably in 2018. This is mainly due to the balance of trade shrinking. The surplus from shipping more or less evaporated as shipping companies have struggled with a weaker dollar and lower freight rates. In 2019, the trade war may continue to weigh on shipping companies, at least until the US and China reach a trade agreement, hopefully later in the year. This would provide better conditions for maritime transport.

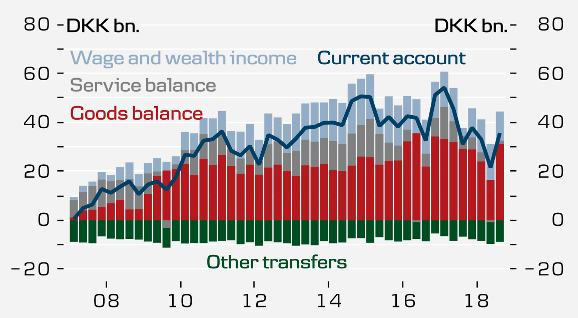
However, the reduced surplus is also driven by an increase in domestic investment levels, which contributed to an increase in imports. This is a positive development as more corporate investments are crucial for the sustainability of the economic recovery. Indications from Danish businesses are that this development will continue – at least in the industrial sector – and that will contribute to keeping the trade balance down. Conversely, we expect exports to contribute more to the current account, and the high level of savings in Denmark should continue to provide high net investment income and hence large capital incomes Overall, we expect the current account surplus to rise from 5.6% of GDP in 2018 to 6.1% in 2019 and 5.9% in 2020.

Energy exports a detractor



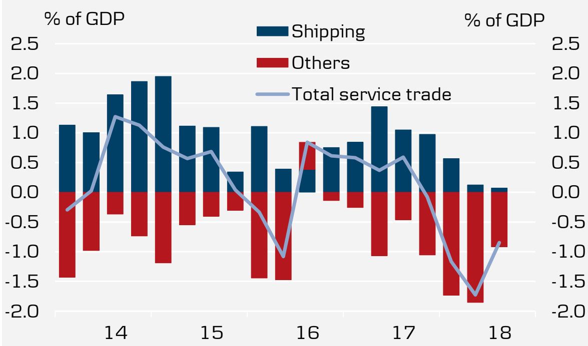
Note: Goods exports from the national accounts, energy is a quantum index
Source: Statistics Denmark, Macrobond Financial

Reduced current account surplus reflects disappointing exports but also an increase in investments



Note: Seasonally adjusted figures
Source: Statistics Denmark, own calculations, Macrobond Financial

Surplus turned into deficit on balance of services in 2018



Note: Shipping surplus includes bunkering; data is not seasonally adjusted
Source: Statistics Denmark

At a glance

National account	2017	2017	2018	2019	2020
			Forecast		
	DKK bn (current prices)	% y/y			
Private consumption	985.0	2.1	2.4	1.9	2.3
Government consumption	535.6	0.7	0.4	0.4	0.4
Gross fixed investment	462.1	4.6	5.9	0.7	3.6
- Business investment	286.3	5.0	7.1	-0.9	3.8
- Housing investment	102.8	12.9	5.6	4.4	4.0
- Government investment	73.0	-6.2	1.7	1.8	1.9
Growth contribution from inventories	-0.1	-0.1	0.1	0.0	0.0
Exports	1188.0	3.6	0.2	2.7	2.0
- Goods exports	746.8	6.0	2.2	3.0	1.9
- Service exports	441.2	0.0	-3.4	2.1	2.2
Imports	1033.4	3.6	3.6	1.3	2.9
- Goods imports	640.6	6.1	3.9	0.5	2.7
- Service imports	392.9	-0.3	3.1	2.8	3.2
GDP	2178.1	2.3	1.0	2.0	1.6

Economic indicators	2017	2018	2019	2020
Current account, DKK bn	173.3	122.6	137.8	138.1
- % of GDP	8.0	5.6	6.0	5.9
General government balance, DKK bn	25.6	7.0	3.2	-2.0
- % of GDP	1.2	0.3	0.1	-0.1
General government debt, DKK bn	775.1	740.0	755.0	780.5
- % of GDP	35.6	33.5	33.1	33.2
Employment (annual average, thousands)	2918.9	2971.4	3004.9	3034.4
Gross unemployment (annual average, thousands)	116.0	108.3	104.7	103.0
- % of total work force (DST definition)	4.2	4.0	3.9	3.8
Oil price - USD/barrel (annual average)	54	72	73	80
House prices, % y/y	4.0	3.4	2.7	2.5
Private sector wage level, % y/y	1.7	2.3	2.5	2.8
Consumer prices, % y/y	1.1	0.8	1.3	1.6

Financial figures	03/01/2019	+3 mths	+6 mths	+12 mths
Lending rate, % p.a.	0.05	0.05	0.05	0.05
Certificates of deposit rate, % p.a.	-0.65	-0.65	-0.65	-0.45
2-yr swap yield, % p.a.	-0.05	0.05	0.15	0.25
10-yr swap yield, % p.a.	0.90	1.15	1.35	1.55
EUR/DKK	7.47	7.46	7.46	7.46
USD/DKK	6.57	6.60	6.32	5.96

Note: Forecasts for 2018 are based on an expectation of a downwards revision of GDP and exports in 2017 (see text).
Source: Statistics Denmark, Danmarks Nationalbank, Macrobond Financial, Danske Bank

Sweden

Submerging

- **Riksbank December hike probably a ‘one and done’.**
- **Core inflation to undershoot Riksbank forecast again.**
- **House prices likely to drop another 5-10% as transactions slow.**
- **Stagnant real wage growth a headache for households.**
- **Strong labour market – how long will it last?**

Riksbank’s December hike probably a ‘one and done’

On 20 December, the Riksbank used its ‘window of opportunity’ to raise the repo rate by 25bp as expected. It was the first hike in seven years. It also postponed the next 25bp hike to “the second half” of 2019. Thereafter it expects fewer than two 25bp hikes per year according to the repo rate forecast. For the reasons laid out below, however, we believe the December hike is likely to be a ‘one and done’.

Some might consider the downward shift in the repo rate path as soft. However, the money market expects an even slower tightening path.

There are no significant differences between our growth outlook for 2019 and the Riksbank’s, with both of us expecting about 1.5% GDP growth. However, we remain more bearish on inflation.

There is a peculiarity in the Riksbank’s inflation forecasts, which makes us sceptical about its repo rate forecast. As can be seen in the two charts in the section on inflation, we have roughly the same CPIF forecast as the Riksbank for the majority of 2019. The Riksbank has it at 1.4 % in September, the last print ahead of the October meeting when it next intends to raise the repo rate. It seems odd to us that the Riksbank would be considering another hike at a time when it expects inflation to fall well below the target and growth to be well below trend. The only rationale we can find is that the Riksbank expects core CPIF excl. Energy to be closer to 2% (1.8% in September, which is a temporary dip) at that time. As can be seen, we believe core inflation will be quite a bit lower, gradually converging at 1.5% rather than the 2% target. If we are right, there is unlikely to be any hike in 2019.

If CPIF and CPI drop as the Riksbank expects, we would be surprised if inflation expectations do not fall as a result, becoming detached from the target. Expectations are strongly correlated with the most recent inflation print. This means the whole foundation for further rate hikes will probably erode in the coming year.

We expect the Riksbank to make a decision about how to handle its QE bond portfolio, which will probably be in April.

Inflation – slowing to sub-target ‘equilibrium’

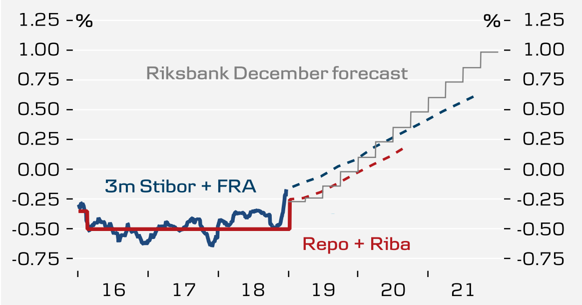
CPIF inflation has been on a slow but steady upward trend over the past five years. Still, over the last two years, the rise has moderated and the average has been close to the targeted 2%. Looking at core CPIF excl. Energy paints a slightly different picture: inflation has been around 1.5% for the past four years

At a glance

Sweden					
	Current forecast			Previous forecast	
% y/y	2018	2019	2020	2018	2019
GDP, calendar adjusted	2.2	1.4	1.9	2.0	1.6
Private consumption	1.2	0.8	1.9	2.2	1.9
Public consumption	0.6	0.3	1.8	0.8	0.4
Gross fixed investment	4.6	1.7	1.7	3.1	1.3
Exports	2.3	2.3	3.1	2.7	2.3
Imports	2.4	1.3	2.5	3.7	2.2
Unemployment rate	6.3	6.5	6.9	7.1	7.6
Inflation	1.9	1.9	1.6	1.9	1.6
Government balance, % of GDP	0.9	0.5	0.8	1.0	0.8
Current account, % of GDP	3.3	4.0	4.0	2.8	2.8

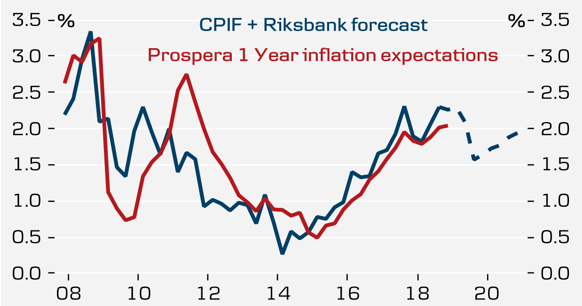
Source: Danske Bank

December hike most likely a ‘one and done’



Source: Riksbank, Macrobond Financial, Danske Bank calculations

Expectations likely to fall back with inflation



Source: Prospera, SCB, Riksbank

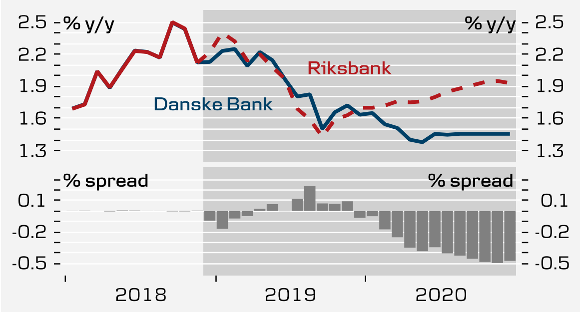
and only occasionally breached 2%. This suggests that the very volatile energy component has been an important driver of CPIF. Currently, global oil/petrol prices are in freefall and if recent levels prevail for some time, it will have a significant negative impact on CPIF inflation in 2019. This illustrates how fragile the inflation outlook is when looking at broad measures.

That said, we think it is worth emphasising that core inflation has also been exposed to a 'temporary' factor: the SEK weakening. Some might consider it daring to call the past five years of SEK weakening temporary, but in a sense we believe it is. There is no fundamental reason to expect the SEK to continue to weaken unless we expect Swedish monetary policy to remain more accommodative than its peers' also going forward. However, over the past five years it was more accommodative than others, as the Riksbank embarked on a sub-zero policy rate and large-scale QE. Consequently, the SEK weakened considerably. That weakening drove import prices higher and in turn pushed consumer import prices higher (these constitute 30% of CPIF and even more of CPIF excl. Energy). Hence, part of the gradual rise in Swedish inflation in the past years was temporary, as we do not expect the SEK to continue to weaken. Should CPI imports follow the Riksbank's KIX forecast this time, then we could expect some deflation (see chart on the right).

Some discretionary factors have added to inflation during this period, such as annual energy tax increases (indexation), a tax on international airline tickets and higher electricity grid fees, to mention a few. These will be non-recurring or abolished in the coming year. This summer's drought has also been a major issue as the food industry has warned about soaring input prices. As a result, non-durable retail goods price expectations surged throughout the fall, only to collapse in December. This may suggest it will be hard for producers to get the necessary price hikes through at the consumer level in the coming months.

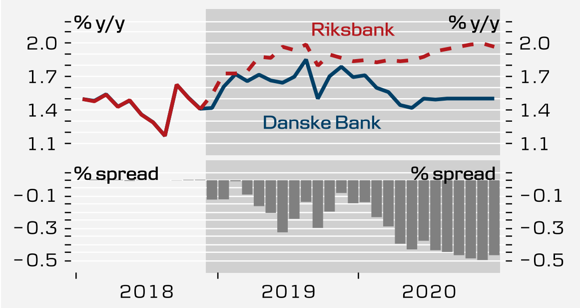
Some of the taxes will be reversed in 2019. The Moderate/Christian Democrats' budget proposal that won support in the Riksdag contains an abolition of the above-mentioned tax on airline tickets (1 July) and a reduction of the annual overindexation of fuel taxes. Both changes are likely to have a slightly negative impact on inflation.

Common view on CPIF inflation in 2019



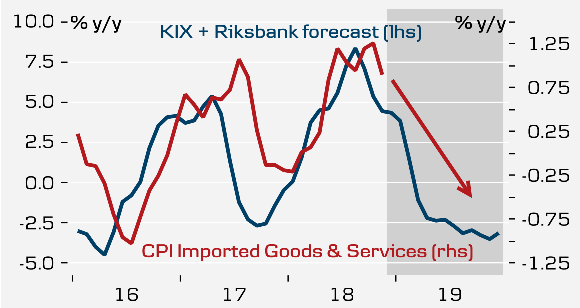
Source: Riksbank, Danske Bank

But we differ on core CPIF excl. Energy inflation



Source: Riksbank, Danske Bank

Expect import deflation if Riksbank's KIX forecast proves correct



Source: Riksbank, SCB

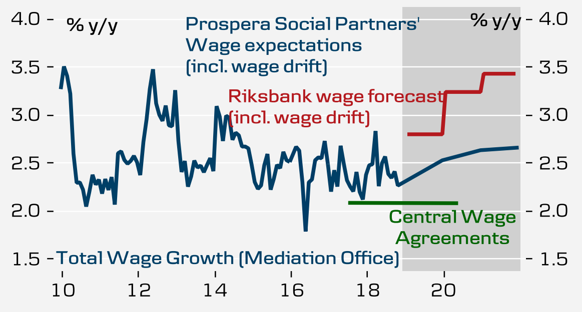
Main inflation driver still missing

The main inflation driver, as we have explained in several previous *Nordic Outlooks*, is wage growth. As central agreements will still run at just above 2% until March 2020 and there are no signs of sufficient wage drift, we do not expect any change to underlying, sustainable inflation fundamentals in 2019.

Putting the pieces together, we believe the stage is set for a slowdown in inflation back to just shy of 1.5%, determined by wage growth (equilibrium) as oil prices and the SEK stabilise. The view that fundamentals imply sustainable inflation significantly below the Riksbank's target remains our long-standing view.

The inflation mix is currently of the 'bad' variety, i.e. still to an excessive degree caused by higher energy prices and/or a depreciating krona. Both factors eat into consumers' purchasing power. We dwell further on that subject in the sections below, but in essence, we are moving from a situation where energy price increases and SEK weakening have eroded consumers' purchasing power in 2018 to a gradual turn in the opposite direction in 2019 where inflation falls back as these factors reverse.

Wage growth to remain within past years' range

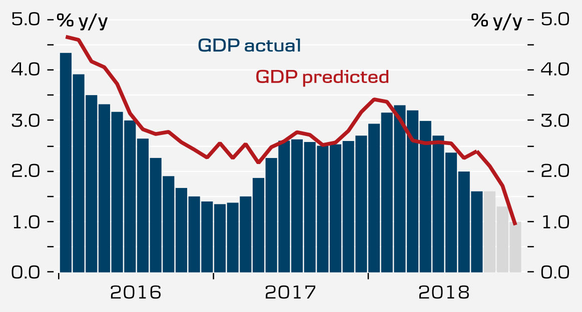


Source: Riksbank, Mediation Office, Prospera

Mounting signs of a slowdown well below trend

Let us start with the worries first. Swedish Q3 GDP turned out at -0.2% q/q s.a./1.6% y/y cal adj, the latter being a tad below our estimate. This was the first time since 2013 that we had a quarterly GDP print in Sweden. Besides the obvious, i.e. that the Swedish housing market is finally becoming a drag on economic growth (and will remain so for the next year or so), private consumption fell considerably as car sales plunged after the introduction of the new bonus-malus car tax/subsidy system in July. This is of course a temporary effect, but underlying fundamentals are also deteriorating.

Our GDP indicator suggests growth heading for 1% in Q4



Source: Statistics Sweden, Danske Bank calculations

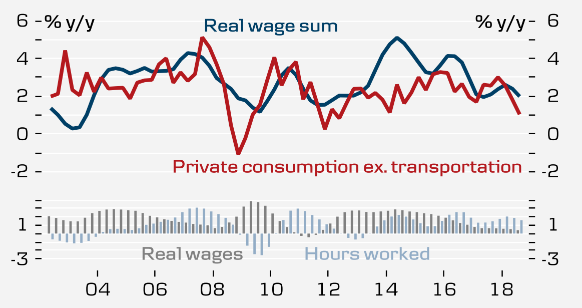
Real wage stagnation slows consumer spending

As argued above, rising inflation has pulled down Swedish economy-wide real wage growth to about 0.5% on average for the past two years. This is in stark contrast to the roughly 2.5% annual average in the previous five years. The most recent print is close to zero. As inflation slows in 2019 and wage growth remains in the 2.0-2.5% range, real wage growth will improve, but only modestly. Hence, we do not have much hope for a significant improvement in households' individual disposable incomes. Tax cuts in the M/CD budget are probably too small to have any meaningful impact. Hence, real wage growth would remain muted in 2019, keeping a lid on spending. Falling stock markets and house prices are also likely to be negative for consumer sentiment. We already see that consumer confidence has dropped below its long-term 'normal' level.

There are of course positive aspects, such that households' aggregated net wealth and savings ratio are both high. However, net wealth is currently falling, with stocks and residential property prices and savings normally counter-cyclical, i.e. they rise as the economy sours.

The still-strong labour market is our primary reason for not being outright bearish on private spending. Employment and activity rates have risen to multi-decade highs. Employment and hours worked are still growing at close to 2% per year and the unemployment rate has been stabilising at just above 6%. There are vague signs that job vacancies may be about to decline.

Consumption slowdown is not temporary but follows from stagnant real wage growth



Source: SCB, Mediation Office, Danske Bank calculations

Housing and construction in steep correction

Residential property prices, or more specifically prices of tenant-owned flats, have, contrary to our expectations, shown a miniscule upward trend in 2018 after the decline in the second half of 2017. That said, we stick to the view that prices are more likely to take another leg down in 2019 rather than stabilise or move higher. Why? Because we cannot simply see what stimulus would keep them unchanged or push them higher.

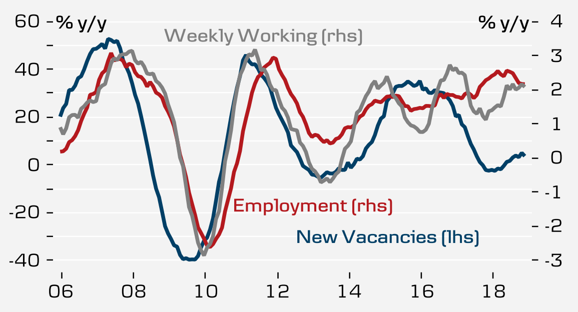
The housing market has slowed less than we expected in 2018, both in terms of house price correction and its impact on GDP. Q3 data, however, suggests that multi-dwelling starts were aligned with completions for the first time in five years, a clear sign that housing developers are pulling the handbrake Q3 also showed residential investment in GDP starting to fall in a slightly more pronounced way. Hence, the process that we have been arguing for, but also misjudged the timing of, is now underway. As developers get rid of the estimated 50k pent-up supply of flats, they need to cut prices on new production to balance the market. Current prices around SEK80-90,000 per square metre in Stockholm are too high for most households and need to be reduced further. These price cuts will have spillover into the successions market too. We stick to our call that prices are likely to drop another 5-10% in 2019 before bottoming out.

This likely means that starts will decline further as demand for the new flats is limited. Furthermore, the FSA's mandatory amortisation requirements in 2016 and 2017 have made it more expensive to switch housing as most households probably cannot avoid getting hit. Banks checking households' ability to pay using the so-called KALP (left to live on) calculations, where rates are assumed to be about 5 percentage points higher than today, keeps financing possibilities in check. Currently, it remains uncertain to what extent the Riksbank will lift rates going forward. All these factors are important aspects of the change in financing for flats that has taken place over the past two years. Previously, as a buyer you bought a ticket for a flat about two years in advance and both the ticket and the house prices rose in a positive trend. Today, this price process has completely reversed. The ticket may mean you have bought something that will lose value at the same time as your current dwelling is losing value. Demand is suffering, developers cannot no longer find financing and sales are dropping.

This means that the slowdown is still to come. A 30-40% decline in residential investments still appears reasonable on a two-year horizon in our view. This barely started to impact GDP growth in 2018, and we expect most of it to come in 2019.

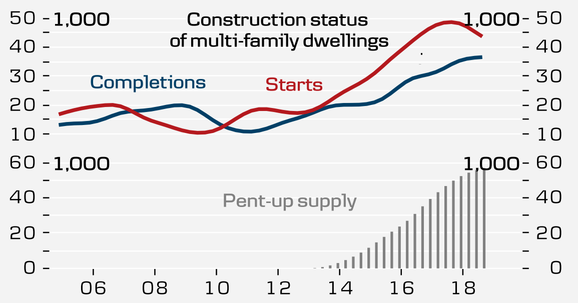
This will have a decidedly negative impact on growth going forward, albeit nothing out of the ordinary.

Still strong labour market but new jobs have stopped growing



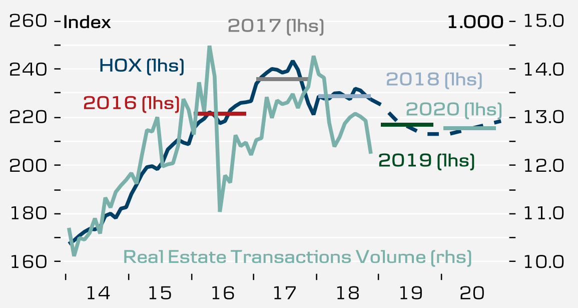
Source: SCB, Public Employment Service

Starts are slowing, but pent-up supply still rising



Source: Statistics Sweden, Danske calculations

Declining transaction volume suggests prices are likely to decline somewhat again



Source: Valueguard, Mäklarstatistik

Manufacturing upbeat, but why should it be?

A very peculiar aspect of the Swedish economy is that manufacturing still appears to be doing fine, despite the apparent slowdown in Euro Area industry. The Swedish manufacturing PMI has been closely correlated with that of the Euro Area (or German). However, over the past three months we have witnessed a divergence. It is hard to understand this difference as Swedish export orders show some improvement, both in terms of manufacturing PMI and in NIER's manufacturing confidence survey. For now, we cannot reconcile this apparent paradox.

All other business sectors are showing a negative confidence trend. Construction is no surprise given the state it is in, and neither is retail trade. The most surprising is that private services appears to be the weak spot, with confidence dropping below normal.

An April snap election?

The complicated political situation in Sweden has not been resolved. The Riksdag has dismissed both the current PM, the Social Democrat Stefan Löfvén, and the Moderate party leader Ulf Kristersson. Two more attempts remain before the speaker can announce a snap election.

Both the Liberals (L) and the Centre Party (C) i.e. the middle of the political spectrum, have voted down both candidates. They are unwilling to accept the outgoing Red/Green government with support from the former Communists (current Left Party) as well as their previous Alliance partners, the Moderates (conservative) and the Christian Democrats, as they argue it would need support from the anti-immigration Sweden Democrats.

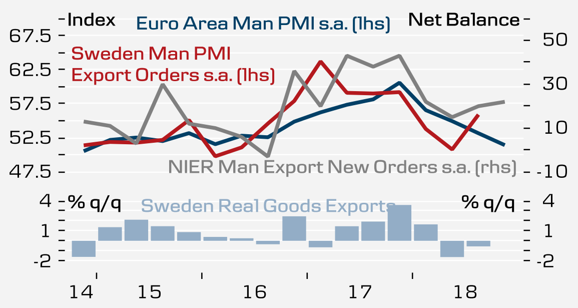
The speaker has set the date for the next vote for party leader at 14 January and the final two votes of no confidence on 16 January and 23 January.

The situation is further complicated by the fact that the Moderate/Christian Democrats' budget proposal, with support from the Sweden Democrats, won support in the Riksdag.

Hence, currently, there is no new government, but there is a right-wing budget, which includes mostly income tax cuts. It is slightly expansionary but still based on an expected 0.9% budget surplus in 2019.

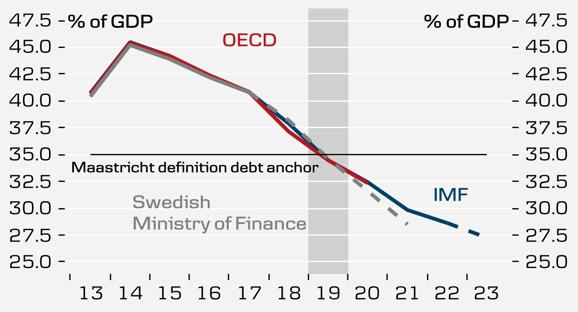
It is worth emphasising in our view that Sweden has a very rigid budget framework: (1) a 0.3% budget surplus target, (2) a 35% Maastricht definition public debt anchor to be introduced and attained in 2019, (3) three-year expenditure ceilings for the central government finances and (4) budget balance requirements for municipalities. Hence, even if government formation becomes cumbersome, the risk of budget difficulties appears minimal as current policies will continue to apply.

Goods exports have slowed but surveys are mixed



Source: Markit, Swedbank, NIER, SCB

Public debt expected to hit debt anchor at introduction in 2019



Source: OECD, MoF, IMF

At a glance

			Forecast		
National account	**2017**	**2017**	**2018**	**2019**	**2020**
	SEK bn (current prices)	% y/y			
Private consumption	2041.0	2.2	1.2	0.8	1.9
Government consumption	1196.2	0.0	0.6	0.3	1.8
Gross fixed investment	1142.6	6.0	4.6	1.7	1.7
Growth contribution from inventories	30.3	0.1	0.2	0.0	0.0
Domestic demand	4410.1	2.6	1.9	0.9	1.8
Exports	2076.3	3.2	2.3	2.3	3.1
Aggregate demand	6486.4	2.9	2.2	1.3	2.2
Imports	1907.6	4.8	2.4	1.3	2.5
Growth contribution from net exports	168.7	-0.6	0.1	0.5	0.4
GDP	4578.8	2.1	2.1	1.4	2.1
GDP, calendar adjusted	4579.2	2.4	2.2	1.4	1.9

Economic indicators	**2017**	**2018**	**2019**	**2020**
Trade balance, SEK bn	168.7	171.7	194.8	213.8
- % of GDP	3.7	3.7	4.1	4.4
Current Account, SEK bn	170.3	154.1	191.0	191.7
- % of GDP	3.7	3.3	4.0	4.0
Public sector savings, SEK bn	68.7	41.2	23.9	39.7
- % of GDP	1.5	0.9	0.5	0.8
Public debt ratio, % of GDP*	41.0	37.0	34.0	33.0
Unemployment, % of labour force	6.3	6.3	6.5	6.9
Hourly wages, % y/y	2.6	2.6	2.6	2.7
Consumer prices, % y/y	1.8	1.9	1.9	1.6
House prices, % y/y	6.0	-3.0	-5.0	-1.0
* Maastricht definition				

Financial figures	**03/01/2019**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	-0.25	-0.25	-0.25	-0.25
2-yr swap yield, % p.a.	0.03	0.25	0.35	0.55
10-yr swap yield, % p.a.	1.05	1.35	1.30	1.45
EUR/SEK	10.26	10.10	10.00	10.00
USD/SEK	9.03	8.94	8.47	8.00

Source: Danske Bank

Norway

Boom time

- **The Norwegian economy is booming and we believe it will continue to grow above trend in 2019, a year with no headwinds.**
- **We expect growth to be driven by higher oil investment, higher real wage growth and higher infrastructure investment.**
- **Unemployment is set to fall more slowly due to an increased labour supply and emerging bottlenecks.**
- **Inflation has picked up but we expect it to hold at 2.0-2.5%.**
- **Wages have risen less than expected but we believe they will take off in 2019.**
- **Norges Bank is set to raise its policy rate in March and September and is signalling two further hikes per year in 2020-21.**
- **We expect higher oil prices and larger interest rate differentials to boost the Norwegian krone.**

At a glance

Norway					
	Current forecast			Previous forecast	
% y/y	2018	2019	2020	2018	2019
GDP (mainland)	2.2	2.6	2.4	2.4	2.5
Private consumption	1.9	2.2	2.3	2.3	2.5
Public consumption	1.9	1.7	1.8	1.9	1.8
Gross fixed investment	0.6	4.7	2.0	-0.4	4.4
Exports	-0.5	3.5	3.0	0.8	2.4
Imports	1.5	3.0	3.3	3.3	3.0
Unemployment (NAV)	2.4	2.3	2.2	2.4	2.1
Inflation	2.7	1.6	1.7	2.8	1.6

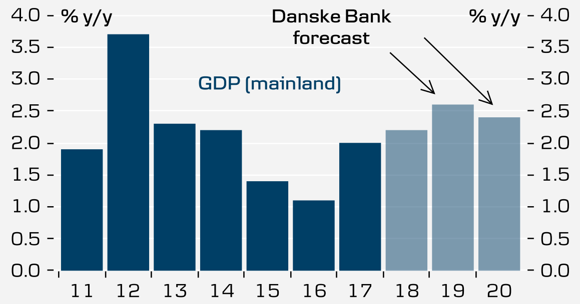
Source: Danske Bank

Stronger turnaround in the oil sector

We expect growth to remain above trend, unemployment to fall, and capacity utilisation to rise over the next couple of years. Stronger growth and fewer jobless have caused wages and inflation to accelerate and we expect this trend to continue.

Interest rates are therefore on their way up, making monetary policy gradually less expansionary. Nevertheless, we believe there will be a solid improvement in households' purchasing power due to higher real wage growth and continued job creation. We expect further strong growth in public infrastructure investment and a gradual levelling off of the decline in housing investment to prop up construction activity. Last, but not least, we have recently revised up our forecast for oil investment in 2019.

Growth is accelerating



Source: Macrobond Financial, Danske Bank

As expected, the strong rise in housing prices at the beginning of 2018 slowed towards the end of the year. This was a result of continued growth in the number of properties for sale bringing better balance to the market. Together with signals of higher interest rates ahead, we still expect this to mean only moderate increases in housing prices over the forecast period.

No headwinds this year

Economic developments since we published *Nordic Outlook – Economic and financial trends*, 2 October, have been a more mixed bag. Consumption of goods has been weak, homebuilding has fallen, unemployment has stopped falling, and GDP growth in Q3 was sluggish but we think this downturn is only temporary.

Starting with GDP, mainland output climbed just 0.3% q/q in Q3 but was pulled down by weak growth in the agricultural sector caused not by some structural drop-off in demand but simply by a record-dry summer. Allowing for this, GDP growth was just over 0.5%. We also think that the background to the weak growth in consumption was high inflation eroding purchasing power in the quarter. This probably also had to do with the dry summer, which led to high electricity prices.

Norges Bank's latest regional network survey indicates that growth in the Norwegian economy is still well above trend. The aggregated output index climbed to 1.49, corresponding to growth in mainland GDP of around 0.75% q/q in H1 19. As expected, it was oil-related industries, services and construction that pushed the index up, while other manufacturing and retail made a slight negative contribution. Capacity utilisation rose to 36.27, the highest since January 2013, and indicates that the output gap has already closed. These results confirm that economic growth is set to remain above trend and that the weakness in Q3 was probably only a temporary blip.

As mentioned above, we expect above-trend growth in 2019 too. We expect this growth to be broad based, with strong contributions from oil investment, public infrastructure investment, private consumption and investment and exports. Indeed, we cannot see any headwinds for the Norwegian economy in 2019.

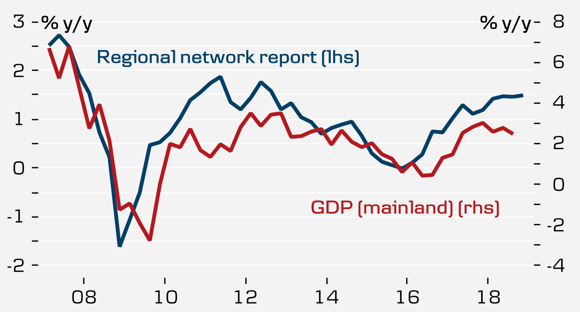
In the latest investment survey, the oil companies expected to invest NOK155.6bn in 2018 and NOK175.3bn in 2019. While the survey suggests investment growth of 21% next year, this needs to be adjusted for the submission of the plan for the development and operation of phase 1 of the Johan Sverdrup field in December 2017. Even then, the survey indicates an increase in investment of around 13% in 2019, which is slightly higher than our previous forecast of 10-12%.

Therefore, we have revised up our forecast for oil investment this year despite the fall in oil prices. Cost cutting in the Norwegian sector has pushed the average breakeven price for investments down to USD21 per barrel. So, although spot prices have fallen towards USD50 per barrel, we expect this to have little impact on investment levels. Prices for delivery in three to four years have also fallen by only USD5-6 per barrel. All this therefore supports our expectation that oil investment will contribute more than 0.5pp to mainland GDP in 2019. This said, the risk is now on the downside, because there is a slight chance of the decline in oil prices reducing the oil companies' cash flows to a point where they cut back on exploration activity. However, we do not consider this risk to be strong enough to alter our conclusions in this document.

As mentioned above, we believe that the weak retail sales at the end of 2018 were due partly to higher energy prices. Therefore, we do not see any great risk of a serious downturn in private consumption, unless interest rates rise much further than we expect. Our calculations suggest that, with electricity prices more or less normalising over the course of this year, headline inflation will fall well below 1.5% by the end of the year, taking growth in household real disposable income in 2019 to more than 2.5%. With a moderate rise in the savings rate, this means that private consumption will increase by more than 2% this year. The trend towards stronger growth in consumption of services and relatively weaker growth in consumption of goods means we expect retail sales to increase somewhat more slowly than that.

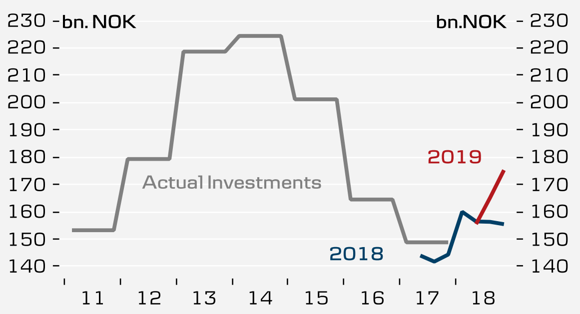
We expect private investment (excluding housing investment) to strengthen further. We believe higher capacity utilisation, stronger growth, growing optimism and still favourable credit conditions will support investment. The regional network survey also showed that firms still expect strong investment growth, although their expectations are slightly more subdued than in the

No signs of weakness in leading indicators



Source: Macrobond Financial, Danske Bank

Marked rise in oil investment



Source: Macrobond Financial, Danske Bank

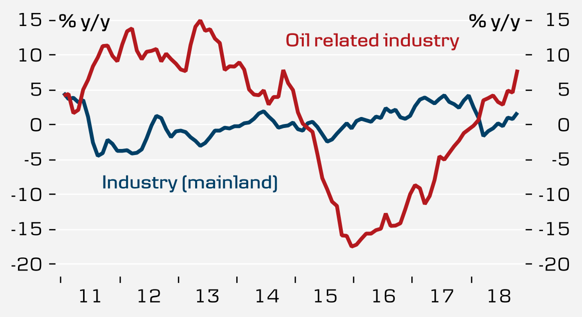
previous survey. However, the investment survey suggests that manufacturing investment will grow much more quickly than in 2017.

On the other hand, overall investment in the construction sector looks set to be much higher than in 2018. This is due to the combination of a slightly slower decline in the construction of new housing, stronger growth in commercial construction, and, not least, further strong growth in infrastructure investment due to projects in both the public sector and the power sector.

At the same time, we now anticipate much stronger export growth in the mainland economy, partly because traditional mainland manufacturing is benefiting from a weak krone and continued healthy global growth, but mainly because we can now see the upswing in oil investment beginning to reach the global market.

The dry summer probably held GDP growth back in 2018 but we expect much of this ground to be made up in 2019. We have therefore revised down our estimate of GDP growth in 2018 to 2.2% but revised up our forecast for 2019 to 2.6%. This is again well above trend and means that capacity utilisation will continue to rise and unemployment will continue to fall. For 2020, we now expect growth of 2.4%, which is also some way above trend.

Oil upswing beginning to show



Source: Macrobond Financial, Danske Bank

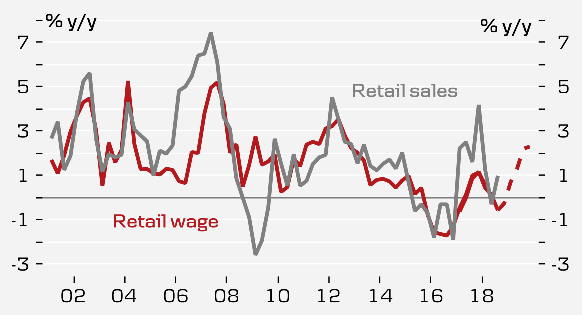
Clear improvement in labour market, even in the longer term

Unemployment has fallen less far than expected since our October forecast. In principle, this could be a sign that the labour market is deteriorating, as might result if growth were slowing. However, we do not believe this to be the case. As mentioned earlier, all growth indicators suggest that growth is holding up, and a number of technical factors affecting NAV's collection methodology pushed unemployment up artificially towards the end of the year. NAV itself reckons that this may have inflated the jobless rate by 0.1-0.2pp without this reflecting any real change in the labour market.

Allowing for this, it would seem that unemployment has moved more or less as expected. Meanwhile, there have again been signs of considerable divergence between the jobless figures from NAV and Statistics Norway. LFS unemployment has been largely unchanged over the past three months, but this appears to be a result of stronger growth in the labour supply rather than slower employment growth. Although it has decreased slightly, employment growth is still above 2% y/y. Meanwhile, the labour supply has begun to grow significantly, with the result that the jobless rate has been unchanged.

What is more, almost all labour market indicators point to demand for labour holding up. Data from Statistics Norway also show that the number of vacancies in Norway climbed to 71,500 in Q3, up more than 12,000 on a year earlier. If we compare this with gross unemployment (which includes job creation schemes), the UV ratio in Norway is now 1.15, which is its lowest since the series began in 2010.

Lower power prices spell higher real wage growth

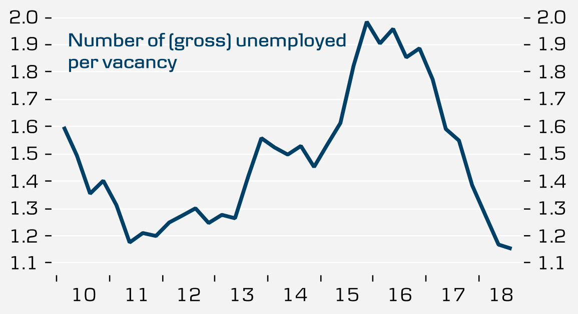


Source: Macrobond Financial, Danske Bank

The latest regional network survey also suggests that labour shortages are increasingly becoming an issue, with 20.27% of firms now reporting problems sourcing labour as a constraint on production, the highest since August 2013. It is actually the construction sector that has seen the biggest change in terms of labour constraints, which confirms our suspicion that activity in the sector is high despite weaker residential construction, thanks to strong growth in public infrastructure investment (civil engineering) and to some extent commercial construction.

Based on our expectation that growth will stay above trend, we expect employment growth to remain high. A growing labour supply and emerging bottlenecks would, however, mean that unemployment does not fall to the same extent. We expect registered unemployment to fall to 2.3% in 2019 and 2.2% in 2020.

Tight labour market



Source: Macrobond Financial, Danske Bank

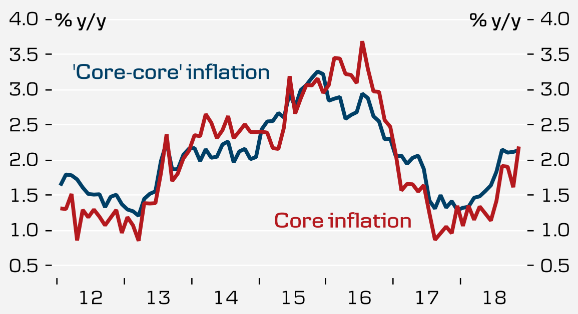
Normalisation of electricity prices set to bring lower inflation

Inflation has been much higher than expected since our September forecast. Core inflation hit 2.2% y/y in November, driven by higher prices for domestically produced goods and services and slightly higher import prices than expected. Domestic inflation climbed to 2.8% in November, while imported inflation was stable around 1.2%.

There was also an abnormal increase in airfares and prices for domestically produced foods. Our measure of “core-core” inflation, which ignores these volatile components, has been more stable at just over 2% in recent months, and shows how underlying inflation is clearly heading up.

We expect this trend to continue in 2019. We believe higher capacity utilisation and lower unemployment will continue to push up wage growth. Domestic inflation will therefore climb towards 3% during the year. With the krone depreciating somewhat further in the latter part of 2018 than we expected, imported inflation will also fall less far than we previously thought. However, as we expect the krone to recover gradually towards the end of the year, we believe import prices will peak mid-year and then ease back.

Tight labour market



Source: Macrobond Financial, Danske Bank

All in all, we expect core inflation to climb towards 2.5% again through to the summer, before dropping back towards the 2% inflation target as import prices head back down.

Due to abnormally high electricity prices, headline inflation has been much higher than core inflation, reaching 3.5% in November. Based on forward prices in the power market, we expect electricity prices to remain much higher than normal well into 2019. This means that inflation will fall back towards 2% somewhat later than we previously expected but it will still fall well below 1.5% in H2 and remain there well into 2020.

We are continuing to see clear signs of wage growth picking up, but perhaps rather more slowly than we anticipated. The quarterly statistics show overall wage growth of just over 2.5% in the first three quarters of 2018. With a continued rising trend in Q4, this suggests a rate of around 2.7% for 2018 as a whole. In the latest regional network survey, firms anticipated wage growth of 2.8% in 2018. We have therefore revised our estimate of wage growth in 2018 down to 2.8% from 3% in our September forecast.

We expect a tighter labour market and healthy profitability again both this year and next. The firms in the regional network anticipate wage growth of 2.9% this year, which is about 0.3pp more than they predicted for 2018 at the same time last year. This points to wage growth this year of just over 3%. On the other hand, the regional network report reveals signs of bottlenecks emerging in the labour market, and such periods have often produced higher national settlements and, not least, higher wage drift. Figures from engineering union Tekna show average wage growth in 2018 of 2.3% for its membership as a whole, but 4.2% for engineers in the oil sector.

We are therefore sticking to our forecast of wage growth of 3.5% this year, rising to 3.8% in 2020.

Wage growth rising, but a little more slowly than expected

Source: Macrobond Financial, Danske Bank

Well-balanced housing market

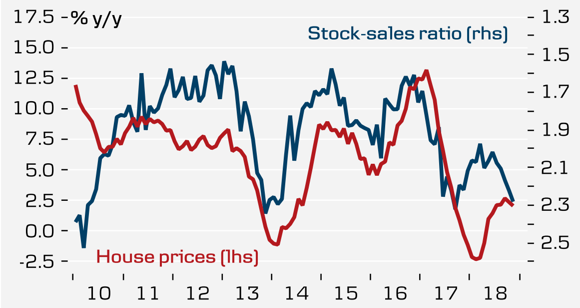
After rising rapidly in H1, housing prices levelled off towards the end of 2018. This seems to have been the result of a growing supply of properties for sale despite turnover holding up well.

There has been a particular slowdown in Oslo, which has helped put the brakes on prices nationally. This probably has to do with a big increase in the number of properties on the market following the completion of various developments. So, although turnover in the housing market has been record high, the stock-to-sales ratio – the number of properties on the market divided by monthly turnover – climbed from 1.17 in May to 1.55 in November.

We expect housing prices to continue to rise more slowly in 2019. Due to strong growth in homebuilding in 2016 and 2017, there will still be a large number of new properties coming onto the market. We also expect mortgage rates to rise during the autumn and homebuyers to begin to factor in further rate increases over the next couple of years.

In contrast, we do not see any great risk of a serious downturn in the housing market, unless interest rates rise much further than we expect. Our calculations indicate that, even with debt at five times income, housing purchasing power will decrease by only 1pp with three rate hikes in 2019. There has also been a clear decrease in housing starts, which means that the excess supply will gradually be absorbed.

Increase in supply has pushed up stock-to-sales ratio



Source: Macrobond Financial, Danske Bank

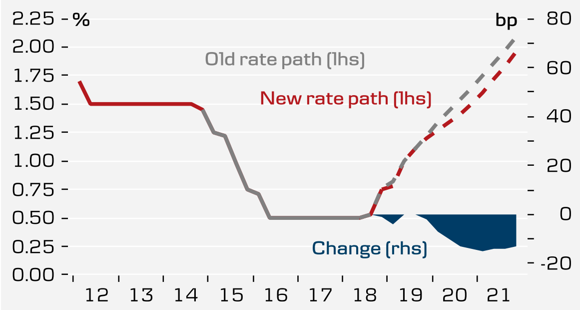
Gradual rate increases still on the cards

As expected, Norges Bank left interest rates alone at its meeting in December but continued to signal that its policy rate will go up in March and then once more later in the year, most likely in September. Given somewhat mixed data for the Norwegian economy, global concerns and lower oil prices, this may have come as something of a surprise to some.

The interest rate path in the new monetary policy report also revealed slightly more moderate interest rate expectations further out than in the September report but the central bank is still projecting just over five rate increases by the end of 2021, taking the policy rate to around 2%.

There were no major surprises in the bank's analysis, where it was mainly global uncertainty and the resultant weaker outlook for interest rates among Norway's trading partners that pulled its interest rate projections down. Otherwise, Norges Bank painted a picture of a Norwegian economy that ties in well with our own expectations, with growth remaining above trend for the next couple of years and

Marginal downward revisions – gradual increases still the order of the day



Source: Macrobond Financial, Danske Bank

causing capacity utilisation to rise, unemployment to fall further and wage and price inflation to accelerate.

As we are slightly less concerned about the global outlook, we believe this means that Norges Bank will raise its policy rate twice a year in 2019-21, with the risk here actually being slightly on the upside.

Will krone finally recover?

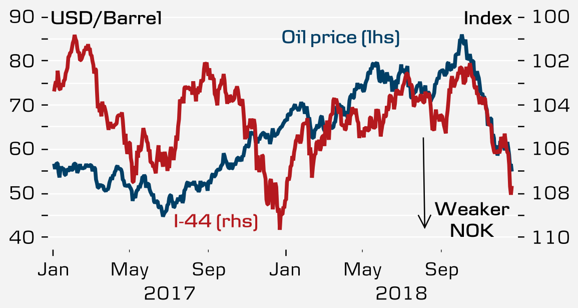
Once again, the krone has been much weaker than we expected. This time, however, there is a clear link with the steep fall in the price of oil since our October forecast. Spot prices have fallen more than USD20 per barrel. As can be seen from the chart on the right, there is a close correlation between the fall in oil prices and the decline in the import-weighted krone exchange rate (I-44) during the period.

Our oil analysts expect oil prices to head back towards USD70 per barrel over the course of the year. Higher oil prices, combined with a substantial downward revision of market expectations for rate increases from Norges Bank since September, mean that we expect the krone to strengthen significantly in 2019.

A simple cross-check shows that the krone has depreciated somewhat further than the decline in the terms of trade resulting from the slide in oil prices over the past quarter would warrant.

Therefore, we forecast an exchange rate of 9.10 to the euro in a year's time.

Lower oil prices have undermined the krone



Source: Macrobond Financial, Danske Bank

At a glance

			Forecast		
National account	**2017**	**2017**	**2018**	**2019**	**2020**
	NOK bn (current prices)	% y/y			
Private consumption	1471.8	2.3	1.9	2.2	2.3
Public consumption	797.4	2.5	1.9	1.7	1.8
Gross fixed investment	824.6	3.6	0.6	4.7	2.0
Petroleum activities	155.1	-3.8	1.8	13.0	4.0
Mainland Norway	669.5	7.0	0.4	2.6	1.5
Dwellings	198.6	7.0	-9.7	-1.0	2.0
Enterprises	295.8	9.3	1.7	3.1	1.5
General government	175.1	3.6	9.0	5.0	1.5
Mainland demand	2938.6	3.3	2.3	2.5	2.0
Growth contribution from stockbuilding		0.1	0.6	0.2	0.0
Exports	1196.9	-0.2	-0.5	3.5	3.0
Crude oil and natural gas	459.5	1.5	-4.0	0.0	2.0
Traditional goods	381.3	1.7	1.5	3.7	3.0
Imports	1092.7	1.6	1.5	3.0	3.3
Traditional goods	635.6	2.7	2.0	3.0	3.0
GDP	3304.4	2.0	1.8	2.5	2.5
GDP Mainland Norway	2798.1	2.0	2.2	2.6	2.4

Economic indicators	**2017**	**2018**	**2019**	**2020**
Employment, % y/y	1.1	1.5	1.2	0.9
Unemployment (NAV), %	2.7	2.4	2.3	2.2
Annual wages, % y/y	2.3	2.8	3.5	3.8
Consumer prices, % y/y	1.9	2.7	1.6	1.7
House prices, % y/y	5.0	1.0	2.0	3.0
Core inflation	1.4	1.5	1.9	1.9

Financial figures	**03/01/2019**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	0.75	0.75	1.00	1.25
2-yr swap yield, % p.a.	1.49	1.65	1.95	2.20
10-yr swap yield, % p.a.	2.03	2.45	2.70	2.85
EUR/NOK	9.94	9.40	9.20	9.10
USD/NOK	8.75	8.32	7.80	7.28

Source: Danske Bank

Finland

Consumers in the driving seat

- **The Finnish economy continued to perform well in 2018 but the growth outlook is weakening. In Q3 18, GDP rose 2.4% y/y (wda) but growth was based mainly on inventories as other demand components were weak. Leading indicators have peaked but they are still above long-term average levels. We have lowered our 2018 GDP growth forecast.**
- **Consumer confidence has consistently stayed at a high level and improving employment will boost private consumption in 2019.**
- **The outlook for the export industry is subdued. Finland is relatively modestly exposed to Brexit and the ongoing trade war.**
- **The Finnish housing market is stable and bubble-free but the market is strongly divided geographically. Construction is cooling down.**
- **Rapid GDP growth has increased tax revenue and continues to improve public finances. However, higher labour force participation will be needed to deal with the deteriorating old-age dependency rate in the future. The rating outlook is getting brighter, but rating agencies need further evidence of successful structural reforms. Rating changes are unlikely before the next parliamentary elections in April 2019.**

At a glance

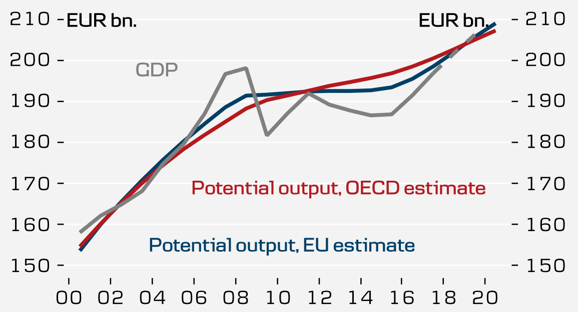
Finland					
	Current forecast			Previous forecast	
% y/y	2018	2019	2020	2018	2019
GDP	2.3	1.7	1.5	2.7	2.0
Private consumption	1.5	1.6	1.3	2.1	1.6
Public consumption	2.0	0.5	0.5	2.0	0.5
Gross fixed investment	2.5	1.5	2.0	4.0	3.5
Exports	1.1	2.5	2.0	3.2	4.0
Imports	2.5	2.3	1.5	3.0	3.5
Unemployment rate	7.5	7.0	6.9	7.6	7.3
Inflation	1.1	1.5	1.5	1.2	1.5
Government balance, % of GDP	-0.3	0.0	0.1	-0.3	0.1
Current account, % of GDP	-0.9	-0.4	-0.2	-0.6	-0.2

Source: Danske Bank

Growth rate slowing down

After a strong start in Q1 18, the growth of the Finnish economy has slowed down considerably. All main demand components are turning out to be weaker than anticipated. The growth rate of exports and investments has slowed down, and even private consumption has not been as impressive as one might expect based on the underlying rise in wages and employment. All in all, the economy is still performing reasonably well even if the pace has slowed from 2017. Leading indicators continue to indicate a reasonably solid outlook for the coming months. Order books still look good in both the manufacturing industry and construction. The business cycle is past its peak but there is nothing too alarming on the horizon and the domestic risk outlook is fairly neutral.

GDP reaching towards potential



Source: Macrobond Financial data, Statistics Finland

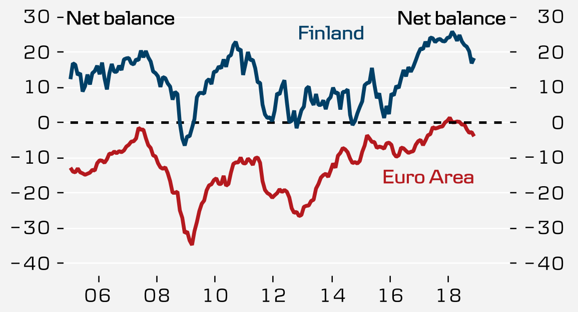
The output gap of the Finnish economy has basically been closed and the period of rapid cyclical recovery is now over. In Q3 18, the economy grew 0.4% q/q and 2.4% y/y. The numbers still look quite good but their interpretation is somewhat challenging. Most of the growth in Q3 came from inventories while other demand components fell short of expectations. Expanding inventories probably partly reflect timing factors related to export industries. However, large inventories raise the worry that production may slow in the future due to a rebalancing of inventory levels. Finnish GDP finally surpassed the pre-financial crisis peak production level in Q2 18, although GDP per capita is still considerably below its previous record. In 2019, growth in GDP is likely to rely increasingly on domestic factors, especially private consumption.

We have revised down our GDP forecast to reflect the current growth trend. Our current forecast for 2018 is 2.3% (was 2.7%). In 2019, we expect the economy to grow 1.7% (was 2.0%). In 2020, we expect growth to slow down to 1.5%, which is close to the potential long-term growth rate of the Finnish economy. Going forward, maintaining growth will become increasingly difficult due to demographics. Improving growth potential depends partly on structural policies and the labour participation rate, which is well below other Nordic countries. Investment in R&D has stayed low compared to history, which may imply a lacklustre rise in productivity.

Households take centre stage

A combined effect of improving employment, rising wages and low inflation should continue to support private consumption in 2019. Consumer confidence has decreased a little in recent months but continues to be considerably above the long-term average level. Households are confident about their personal finances and employment security but are more reserved about the general macroeconomic outlook. The unemployment rate is decreasing and nominal wage growth exceeds inflation into the foreseeable future. The interest rate burden is set to remain extremely low, at least in 2019.

Consumer confidence is very high

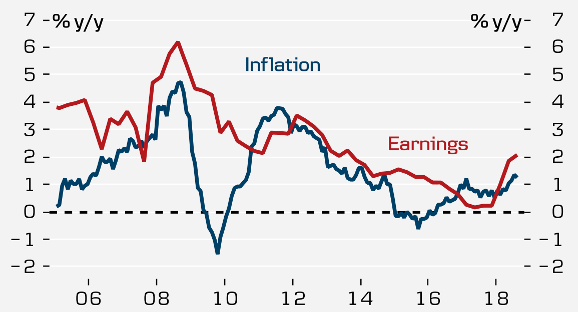


Source: Macrobond Financial data, Statistics Finland

Private consumption has not quite seen the increase expected in 2018. In 2017, private consumption surprised on the upside despite a decline in average real earnings. This year, earnings have rebounded but some of the growth has been used to restore the negative savings rate and consumption has been weaker than otherwise expected. A reversal in the decreasing savings rate is welcome considering that an increasing share of household consumption has been financed using debt. So far, the household debt compared to disposable income is not exceptionally high in an international comparison and due to low interest rates, the interest-rate burden on households is very low. Consequently, we believe that the risks in household sector finances are still moderate. In principle, exposure to rising rates may become a more significant factor later on given that in Finland, most loans for households are linked to variable Euribor rates.

The Fin-FSA has been worried about the growing household debt. To combat this issue, they tightened the maximum loan-to-collateral (LTC) ratio as of 1 July 2018. The maximum amount of housing loan was capped at 85% of the current value of the collateral posted at the time of loan approval. The new regulation will not apply to first-time buyers for whom the LTC ratio remained unchanged at 95%. As for consumer lending, which is growing considerably faster than housing loans, Fin-FSA has few tools. A positive credit register is one tool under consideration but progress is going to take some time.

Earnings growth is recovering



Source: Macrobond Financial data

In 2019, we expect solid growth in private consumption to continue and domestic demand is set to support the Finnish economy. Wage growth is still somewhat modest but relatively low inflation and a rise in employment is helping consumers. In the future, we expect private consumption to follow the development in earnings more closely. The net effect of changes in income taxes is roughly neutral in 2019.

Exports expected to pick up moderately in 2019

Global trade weakening is beginning to take its toll and export growth has been slower than expected this year. In Q3 18, exports contracted by 1.8% q/q. In 2017, the export of goods and services grew by 7.5%, the highest annual rate seen in Finland after the financial crisis. For 2018, we estimate considerably more modest growth of 1.1%. In 2019, we expect exports to pick up again partly as a result of two medium-sized ship deliveries. Export industries continue to benefit from improved domestic price competitiveness and the global demand environment is expected to remain reasonably solid. However, capacity utilisation is at a high level and after a strong upswing in production, exports growth has returned closer to the long-term trend. The rapid recovery for export industries is behind us and we expect exports and imports to be fairly balanced going forward, with net exports playing a minor role for growth.

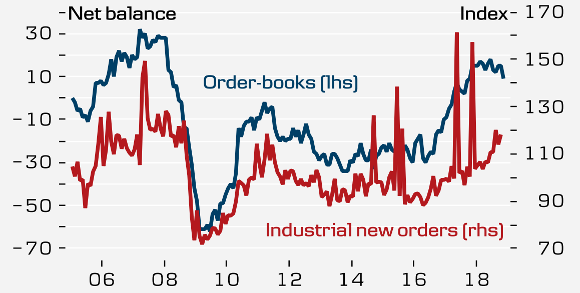
Despite weak numbers from Q3, the outlook for exports remains reasonably good. Business confidence has declined a bit but is still above average. Order books look very promising and production expectations have stayed high. For the manufacturing industry, the capacity utilisation rate is running at 90%. According to the customs reports, the value of goods exports rose by approximately 6.7% y/y in the January-October period. The figure is fairly good considering the equivalent period in 2017, which was quite high, although much of the growth was driven by rising export prices rather than volumes. The best performing item in goods exports has consistently been motor vehicles.

We expect the volume of exports to rise by 2.5% in 2019 and 2.0% in 2019. Export price competitiveness has been a problem for Finnish industries since the financial crisis, as productivity growth has not kept up with wage growth. Because Finland cannot devalue its currency, the government has pursued a policy of 'internal devaluation' together with the central labour organisations. The policy has been successful in helping Finland improve its competitiveness and cut unit labour costs relative to other EU countries.

Investment boom fading

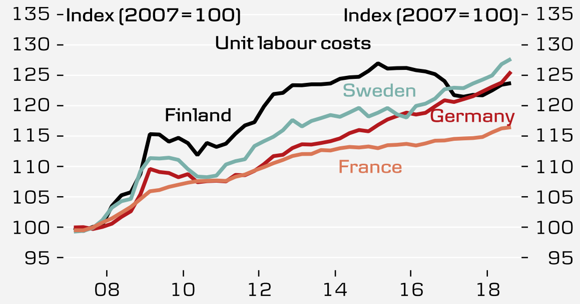
In Q3 18, investments contracted 1.4% q/q. Especially industrial investment fell short of expectations last year. Currently, there are no large scale industrial investments underway but we still expect industrial capex to improve at a reasonably pace in 2019-20 due to a high capacity utilisation rate, growth in exports and the low level of investment during the past decade. There are also several substantial, and quite promising, investment projects under consideration in forest industry but it will take time before any of these still uncertain projects are started.

Industrial orders looking good



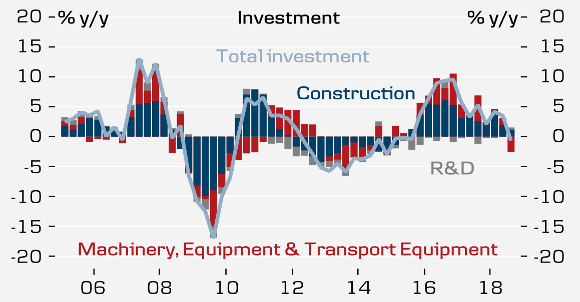
Source: Macrobond Financial data

Internal devaluation restored price competitiveness



Source: Macrobond Financial, Statistics Finland

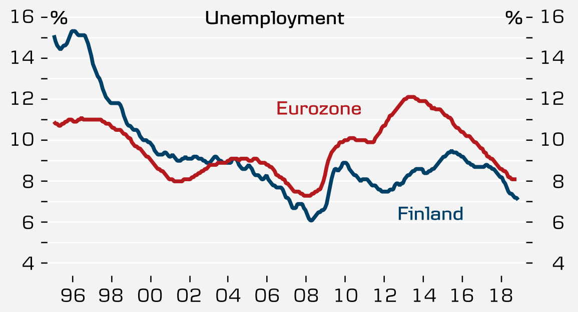
Investment activity



Source: Macrobond Financial data, Statistics Finland

The housing boom has been one of the main drivers of recovery in the Finnish economy. The investment boom in 2016 and 2017 began from a surge in housing construction but later on it spread to industrial investment, as well as transportation equipment. Even after the recent slowdown, the volume of industrial investment is close to the pre-financial crisis record high level. In 2016, construction investment in housing grew at a rate of 10.5%. In 2017, the growth had slowed down but still remained close to 6%. Strong growth has continued in 2018 but the amount of new housing permits has started to decline markedly. The level of new permits is still high and indicates robust apartment construction in growth centres, especially the Helsinki region. The peak for housing starts is likely to be in 2018, leading to a peak in completed apartments in 2019. Given the high level of permits granted in the past, housing investment is likely to cool down gradually. We expect investments to continue to grow by 2.5% in 2018, 1.5% in 2019 and 2.0% in 2020.

Unemployment rate falling towards 7%

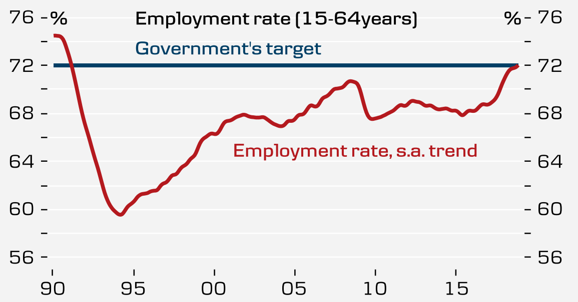


Source: Macrobond Financial data, Statistics Finland

Unemployment falling towards structural rate

In Finland, the labour market has improved markedly over the past year and the unemployment rate has fallen to 7.1% in November 2018. Estimates of structural unemployment or NAIRU are typically between 7-8%, meaning that the labour market is tight already. An improvement in employment has been rapid in the past but the pace seems to be slowing down. Corporate surveys indicate that a lack of skilled labour is the biggest obstacle to growth and that it has become more difficult to fill vacancies in lower-skilled occupations as well. The number of open vacancies has increased significantly, indicating that employment should continue to improve in the future. Given the difficulty in filling the vacancies and lower growth trajectory, we forecast only a slow improvement in 2019 and 2020. We expect the annual unemployment rate to have fallen to 7.5% in 2018 and to 7.0% in 2019.

Employment rising towards government target



Source: Macrobond Financial, Statistics Finland

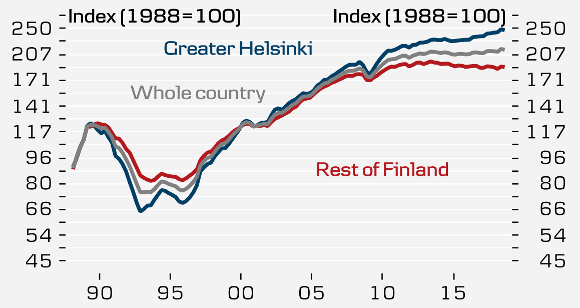
The government has aimed to lift the employment rate to 72%, which was reached, measured by the trend indicator of employment rate in November 2018. So far, much of the progress has taken place for older groups of workers, with employment seeing little improvement for the younger workforce. Some past policy changes are only gradually taking effect, which provides some reassurance for continuing improvement in the future. In the long run, an employment rate above 75%, similar to other Nordic countries, would help a lot in achieving long-term budget sustainability as the population ages rapidly. The ageing population is starting to have an impact on the supply of labour and public expenditure.

Wage growth dropped to a historically low level in 2017. Even nominal earnings growth was close to zero and labour costs fell more than anywhere else in the EU. In 2018, earning growth is returning to a more typical range. Together with wage drift, we expect average earnings to rise 1.9% in 2018 and 2.5% in 2019. This level is still quite tolerable and lower than in some export competitors like Sweden or Germany. However, difficulties in filling vacant positions clearly increase the risk of higher wage drift in some industries like ICT and construction.

Strong supply of housing cooling price pressure

Better employment opportunities and a growing interest in an urban lifestyle continue to drive an increasing number of Finns into cities. Most immigrants end up in larger cities as well. Consequently, the Finnish housing market has become segregated geographically, as well as by the type of housing in question. Growth in housing demand has raised prices and caused a construction boom in Helsinki and a few other towns, while the real estate market in the rest of the country has remained more of less flat or is even declining. In some scarcely populated parts of the country, the housing market does not function well and part of the housing stock is worthless. Migration to growth centres has created especially strong demand for compact apartments, and construction companies have increased the supply reasonably quickly. Consequently, even if Helsinki is fairly expensive, the price rise has not been anything like that seen in other Nordic growth hubs such as Stockholm or Oslo.

Diverging housing prices

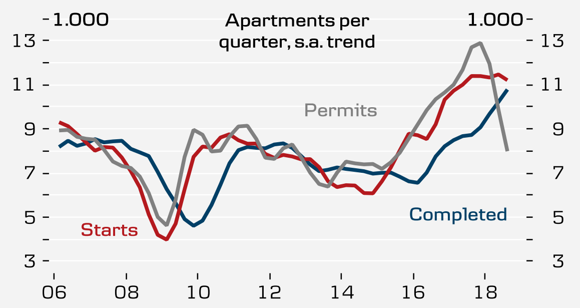


Source: Macrobond Financial, Statistics Finland

Renting has become more popular among younger generations and the buy-to-let market has grown. More than half of new apartments end up being bought by professional or private investors, which has led to a boost in housing construction. For the most part, there are no signs of oversupply, at least not yet. The rise in rents has exceeded the rise in housing prices or wages for some years, but recently the rise in market rents has moderated to roughly 2%. Supply of new housing is increasing significantly into 2019 and this weighs on both prices and rents. |The number of construction permits fell to the pre-construction boom figure in Q3 and supply of new housing is likely to follow in late summer 2019. Construction companies have spotted a saturation in demand and are clearly cautious on new projects. Urbanisation is likely to continue for some time, however, and demand for some amount of new housing is not going away.

Prices of old dwellings rose 1.6% in 2017. On average, house prices have been nearly flat in Finland for approximately the past five years and real prices have fallen. However, the average price development does not capture the situation in full, as it is calculated from decreasing prices in some regions and rising prices in others, such as Helsinki and its surrounding municipalities. Prices of old dwellings grew on average 2.2% y/y in the Helsinki region and decreased by 0.7% elsewhere in Q3. A similar main trend is likely to continue. In Helsinki, new apartments in particular have been in strong demand and construction has followed demand. Prices of new apartments rose by 4.3% in the Helsinki region in Q3 18.

Supply of new housing set to peak in H1 19



Source: Macrobond Financial, Statistics Finland

Low interest rates, plentiful jobs and relatively high consumer confidence support the housing market and we still expect prices to grow modestly. Given the significant rise in supply, however, we forecast housing prices to increase only by 0.5% in the whole country on average in 2019.

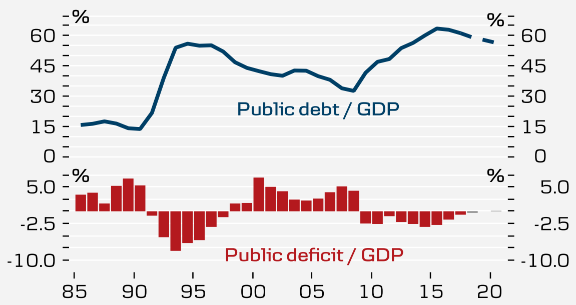
Public finances close to balance in the short run

Every budget for the Finnish central government has had a significant deficit since the financial crisis. Thanks to surplus in social security funds, which consist mostly of statutory pension companies, the general government deficit is smaller. Deficits have helped to maintain the welfare state with fairly generous social security, even if some benefit cuts have been made. As a consequence, public debt has grown quite fast. Municipalities have also been running a deficit on average. Some timing issues and one-off income from the sale of assets caused a surprise in central government finances in Q4: the government debt may fall year-on-year. The positive event is not likely to be sustained, however, because the central government keeps running a small deficit in 2019 and 2020.

Thanks to the economic recovery, improving tax revenue and austerity measures, the general government debt-to-GDP ratio is already down quite a bit from its peak level in 2015. The ratio is forecast to fall below 60% in 2018. The fall in the debt ratio has surprised positively in late quarters and may do so again. Even with the central government deficit, the general government is very close to reaching a balanced budget in 2019. The government has been able to maintain a fairly austere fiscal policy also in the parliamentary election year 2019. Measured by the change in the cyclically-adjusted primary balance, the 2019 budget looks modestly contractionary.

Structural reforms are still needed to boost potential growth and improve labour participation in order to deal with the rise in age-related expenditure caused by an ageing population and rising dependency rate. Otherwise, the debt ratio is likely to rise again in the 2020s. The rating outlook is getting brighter. Fitch changed the outlook to positive in August, but rating agencies are likely to need further evidence of sustained economic growth and successful structural reforms. A successful social and healthcare reform (SOTE) could be one way of regaining an ‘AAA’ sovereign credit rating. At the moment, the fate of the SOTE project is still quite unclear and its true potential to reduce healthcare costs are hotly debated. This government may fail to enact and get approval for the law needed for the reform. Parliamentary elections are due to be held in April 2019 and the next governing coalition is likely to be different.

Debt-to-GDP levelling down



Source Macrobond Financial, Statistics Finland

At a glance

			Forecast		
National account	**2017**	**2017**	**2018**	**2019**	**2020**
	EUR bn (current prices)		% y/y		
GDP	223.8	2.8	2.3	1.7	1.5
Imports	85.4	3.5	2.5	2.3	1.5
Exports	86.3	7.5	1.1	2.5	2.0
Consumption	173.1	0.8	1.7	1.3	1.1
- Private	121.9	1.3	1.5	1.6	1.3
- Public	51.2	-0.5	2.0	0.5	0.5
Investments	49.6	4.0	2.5	1.5	2.0

Economic indicators	**2017**	**2018**	**2019**	**2020**
Unemployment rate, %	8.6	7.5	7.0	6.9
Earnings, % y/y	0.2	1.9	2.5	2.5
Inflation, % y/y	0.7	1.1	1.5	1.5
Housing prices, % y/y	1.6	1.1	0.5	1.0
Current account, EUR bn	-1.5	-2.0	-1.0	-0.5
- % of GDP	-0.7	-0.9	-0.4	-0.2
Public deficit, % of GDP	-0.6	-0.3	0.0	0.1
Public debt/GDP, % of GDP	61.3	59.2	57.9	56.5

Financial figures	**03/01/2019**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	-0.40	-0.40	-0.40	-0.20
2-yr swap yield, % p.a.	-0.19	-0.05	0.05	0.15
10-yr swap yield, % p.a.	0.75	1.00	1.20	1.40
EUR/USD	1.14	1.13	1.18	1.25

Source: Danske Bank

Global overview

Slower momentum but no recession yet

- **The growth momentum in the global economy is set to continue to moderate toward its potential growth rate, but a recession is not around the corner.**
- **A trade agreement between China and the US is likely in mid-2019.**
- **The monetary policy outlook will continue to diverge, with the US seeing further tightening while Europe and Japan will proceed more cautiously given muted inflation pressures.**
- **Political risks from Brexit and Italy will continue to dominate headlines but the economic impact should stay muted.**

The global economy is losing momentum...

Over the past months, the global growth momentum has clearly moderated. Manufacturing PMI has fallen back in both advanced economies and emerging markets. Tightening of financial conditions, particularly in the US, uncertainty about the future trade relations between the US and China and distress in the most vulnerable emerging markets has weighed on global sentiment. Europe has hit a weak spell on the back of a rougher external environment, while the bright spot in the global economy has been the US, where fiscal stimulus has held up economic momentum.

...but no recession is in sight yet

While global growth might be decelerating, we do not expect it to turn into a marked downturn over the next two years – rather, growth in the world economy should moderate back to its potential. After growing by 3.8% in 2018, we expect the growth pace for the global economy to slow to 3.6% and 3.5% over the course of 2019-20 (see also *The Big Picture*: *No recession yet,* 4 December 2018*).*

This lower global growth trajectory compared to our previous Nordic Outlook reflects mainly the escalation of the trade war between the US and China. We believe this will create headwinds especially for the Chinese economy until an agreement is found between the two sides possibly around mid-next year (see more below). Furthermore, the tensions could also affect sentiment in countries exposed to the global cycle such as the euro area, Japan and emerging markets.

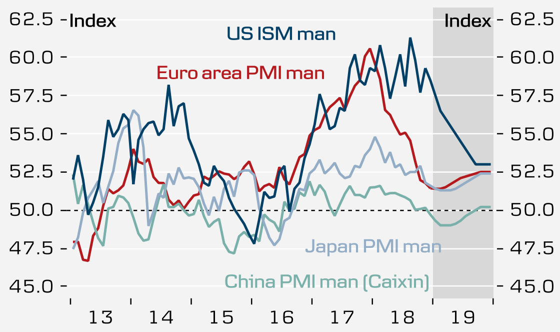
However, we think domestic demand in most economies will be supported by high levels of employment and increasing wage growth. In Europe, expansionary fiscal measures in some countries will also compensate for some of the external headwinds. In the US, the current expansion will soon be the longest in US history and the fiscal stimulus will be a positive factor for US economic growth at least until Q3 19. Still muted inflation pressures mean that central banks do not have to step too hard on the brakes, especially in the eurozone and Japan.

Global GDP forecasts

% y/y	2017	2018F	2019F	2020F
Global	3.7	3.8	3.6	3.5
Developed markets	2.2	2.2	2.0	1.6
USA	2.2	3.0	2.7	2.0
Euro area	2.5	1.9	1.6	1.5
Germany	2.5	1.6	1.7	1.6
Japan	1.7	0.9	0.9	0.5
UK	1.7	1.3	1.6	1.5

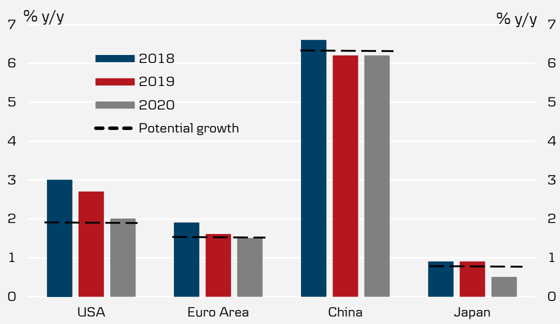
Source: Bloomberg, IMF, Danske Bank

Global manufacturing PMIs have declined from high levels



Source: Markit, Macrobond Financial, Danske Bank

Economic growth is slowing to potential growth levels



Source: Macrobond Financial, Danske Bank

Inflation and central bank divergence

Amid further tightening of labour markets, wage growth continues to gradually pick up speed in major economies given the fall in the unemployment rates. The pickup in wage growth is supporting underlying inflation in most advanced economies, albeit more slowly than anticipated, especially in the euro area and Japan. Signs that the euro area Phillips curve has re-awakened lead us to expect a pickup in euro area core inflation to 1.5% by end-2019, but it will be a gradual process (see *Euro Area Research: Is the Phillips curve finally coming alive in 2019?,* 18 December 2018). Similarly, we expect US core inflation to move gradually higher in 2019 with PCE core inflation reaching 2.1% by the end of the forecast horizon, but lower inflation expectations and oil prices mean that inflationary pressures should remain in control.

While we expect a gradual tightening of monetary policy in both the US and EU, the differing inflation outlook means that monetary policy divergence between the US and other advanced economies will persist in 2019. Following the December hike, where the Fed sent a more cautious signal than we had expected, we expect two more hikes next year and that is it. In the euro area, after ending the QE programme in December 2018, the ECB is expected to embark on a ‘dovish tightening’ strategy, and deliver a first rate hike in December 2019. However, at the same time it will continue to reinvest its maturing assets and may offer new liquidity operations (TRTLO) in mid-2019. Meanwhile, the Bank of Japan is likely to proceed extremely cautiously given the still weak inflationary pressures in the economy and we therefore expect it to stay on hold throughout 2020 at least. In contrast, in light of tighter financial conditions, we see further scope for monetary policy easing in China, especially if a trade agreement is not reached.

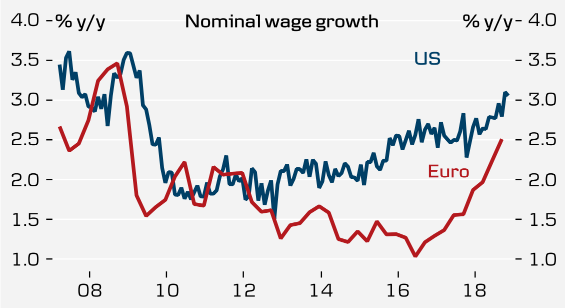
Political risks will continue to attract headlines in 2019

Over the past years, we have witnessed heightened political uncertainty both in Europe, the US and other parts of the world following the rise of populist parties and also in 2019 there will be no shortage of political risk factors. However, so far the impact on the global economy of these has been limited.

The trade war between the US and China has been a major source of uncertainty for the global economy in recent months. At the G20 meeting in Argentina in early December, China and US leaders agreed to a 90-day ceasefire period in which the two sides will seek agreement on a permanent deal (see also *US-China trade - Ceasefire paves the way for the real deal in 2019,* 2 December 2018). While negotiations will be bumpy, both sides seem very committed to reaching a trade deal this time and we think an agreement could come in mid-2019. Such a deal would not only remove uncertainty for companies and help boost global trade, but also underpin a recovery in China next year and thus remove a significant drag from the biggest contributor to global growth.

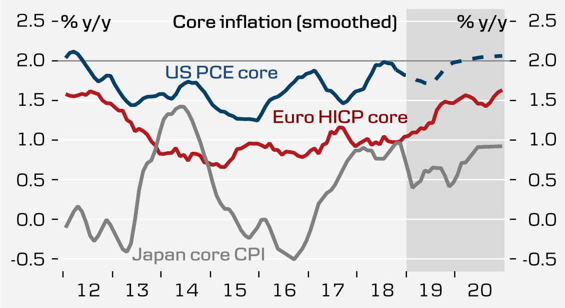
Apart from the trade negotiations between China and the US, the Brexit process will be a key event for Europe, especially if the UK and EU fail to come to an agreement on the terms of the exit, which would have a material economic impact on both the UK and the rest of Europe. In our main scenario, we still expect a ‘decent’ Brexit, i.e. that the deal eventually passes the House of Commons (although it might not in the first attempt), but uncertainty remains high and the likelihood of some of the other options materialising, including a second referendum and a ‘no deal’ Brexit, has increased.

Nominal wage growth catches up speed in the eurozone



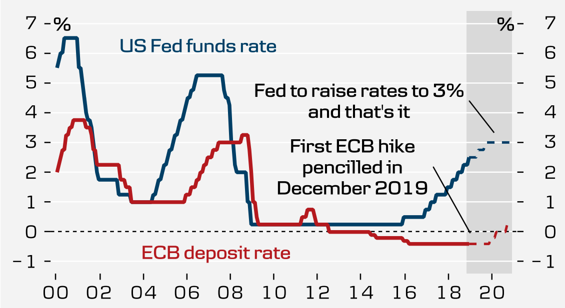
Source: Macrobond Financial, Danske Bank

Underlying inflation pressures nowhere near target in Japan and the eurozone



Source: Macrobond Financial, Danske Bank

Monetary policy set to diverge further between the US and Europe in 2019



Source: Macrobond Financial, Danske Bank

A disorderly Brexit is not the only risk for the European growth outlook. Following the Yellow Vest protests, clouds are increasingly gathering over France and Italian risks also linger in the background. Although the Italian government has recently reached a compromise with the EU on the 2019 budget, many fundamental questions remain unresolved, including the weak economic outlook as well as the durability of the governing coalition (see *Italian Politics Monitor - Budget balancing act,* 19 December 2018).

Financial forecast

Bond and money markets

		Key interest rate	3m interest rate	2-yr swap yield	10-yr swap yield	Currency vs EUR	Currency vs USD	Currency vs DKK
USD	03-Jan	2.50	2.81	2.64	2.65	113.6	-	657.2
	+3m	2.50	2.99	3.30	3.35	113.0	-	659.7
	+6m	2.75	3.15	3.40	3.55	118.0	-	631.8
	+12m	3.00	3.46	3.60	3.55	125.0	-	596.4
EUR	03-Jan	-0.40	-0.31	-0.19	0.75	-	113.6	746.7
	+3m	-0.40	-0.33	-0.05	1.00	-	113.0	745.5
	+6m	-0.40	-0.33	0.05	1.20	-	118.0	745.5
	+12m	-0.20	-0.12	0.15	1.40	-	125.0	745.5
JPY	03-Jan	-0.10	-0.07	0.01	0.18	122.4	107.8	6.10
	+3m	-0.10	-	-	-	127.7	113.0	5.84
	+6m	-0.10	-	-	-	134.5	114.0	5.54
	+12m	-0.10	-	-	-	143.8	115.0	5.19
GBP	03-Jan	0.75	0.91	1.10	1.37	90.5	125.6	825.2
	+3m	0.75	0.82	1.30	1.70	87.0	129.9	856.9
	+6m	1.00	1.07	1.40	2.00	83.0	142.2	898.2
	+12m	1.00	1.08	1.60	2.20	83.0	150.6	898.2
CHF	03-Jan	-0.75	-0.71	-0.58	0.25	112.2	98.8	665.3
	+3m	-0.75	-	-	-	113.0	100.0	659.7
	+6m	-0.75	-	-	-	116.0	98.3	642.7
	+12m	-0.75	-	-	-	120.0	96.0	621.3
DKK	03-Jan	-0.65	-0.28	-0.05	0.90	746.7	657.2	-
	+3m	-0.65	-0.30	0.05	1.15	745.5	659.7	-
	+6m	-0.65	-0.30	0.15	1.35	745.5	631.8	-
	+12m	-0.45	-0.17	0.25	1.55	745.5	596.4	-
SEK	03-Jan	-0.25	-0.20	0.03	1.05	1026.1	903.1	72.8
	+3m	-0.25	-0.20	0.25	1.35	1010.0	893.8	73.8
	+6m	-0.25	-0.20	0.35	1.30	1000.0	847.5	74.6
	+12m	-0.25	-0.20	0.55	1.45	1000.0	800.0	74.6
NOK	03-Jan	0.75	1.25	1.49	2.03	993.7	874.6	75.1
	+3m	0.75	1.35	1.65	2.45	940.0	831.9	79.3
	+6m	1.00	1.41	1.95	2.70	920.0	779.7	81.0
	+12m	1.25	1.66	2.20	2.85	910.0	728.0	81.9

Commodities

		2018				2019				Average	
	03-Jan	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2019	2020
ICE Brent	54	67	75	76	69	65	70	75	80	73	80

Source: Bloomberg, Danske Bank

Economic forecast

Macro forecast, Scandinavia

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Wage growth[1]	Unem-ploym[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Denmark	2018	1.0	2.4	0.4	5.9	0.2	3.6	0.8	2.3	4.0	0.3	33.5	5.6
	2019	2.0	1.9	0.4	0.7	2.7	1.3	1.3	2.5	3.9	0.1	33.1	6.0
	2020	1.6	2.3	0.4	3.6	2.0	2.9	1.6	2.8	3.8	-0.1	33.2	5.9
Sweden	2018	2.2	1.2	0.6	4.6	2.3	2.4	1.9	2.6	6.3	0.9	37.0	3.3
	2019	1.4	0.8	0.3	1.7	2.3	1.3	1.9	2.6	6.5	0.5	34.0	4.0
	2020	1.9	1.9	1.8	1.7	3.1	2.5	1.6	2.7	6.9	0.8	33.0	4.0
Norway	2018	2.2	1.9	1.9	0.6	-0.5	1.5	2.7	2.8	2.4	-	-	-
	2019	2.6	2.2	1.7	4.7	3.5	3.0	1.6	3.5	2.3	-	-	-
	2020	2.4	2.3	1.8	2.0	3.0	3.3	1.7	3.8	2.2	-	-	-

Macro forecast, Euroland

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Wage growth[1]	Unem-ploym[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Euro area	2018	1.9	1.3	1.0	3.0	2.7	2.6	1.8	1.6	8.2	-0.6	86.9	3.8
	2019	1.6	1.7	2.0	2.4	2.5	3.6	1.8	2.3	7.8	-0.8	84.9	3.6
	2020	1.5	1.6	2.4	2.0	2.7	3.5	1.6	2.2	7.5	-0.7	82.8	3.6
Germany	2018	1.6	1.1	0.9	3.3	2.2	3.6	1.9	2.6	3.4	1.6	60.1	7.8
	2019	1.7	1.8	2.2	3.7	2.6	5.1	2.0	3.0	3.1	1.2	56.7	7.3
	2020	1.6	1.9	2.2	3.1	3.1	4.6	1.7	3.2	2.9	1.1	53.7	6.9
Finland	2018	2.3	1.5	2.0	2.5	1.1	2.5	1.1	1.9	7.5	-0.3	59.2	-0.9
	2019	1.7	1.6	0.5	1.5	2.5	2.3	1.5	2.5	7.0	0.0	57.9	-0.4
	2020	1.5	1.3	0.5	2.0	2.0	1.5	1.5	2.5	6.9	0.1	56.5	-0.2

Macro forecast, Global

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Wage growth[1]	Unem-ploym[3]	Public budget[4]	Public debt[4]	Current acc.[4]
USA	2018	3.0	2.7	1.7	5.2	4.3	4.7	2.4	2.8	3.9	-4.0	106.0	-3.2
	2019	2.7	2.7	1.8	3.6	2.9	3.7	1.8	3.1	3.6	-4.6	107.0	-3.6
	2020	2.0	2.1	1.0	2.9	2.4	2.6	2.4	3.5	3.5	-4.6	108.0	-3.7
China	2018	6.6	8.2	-	5.0	-	-	2.2	8.5	-	-4.1	50.1	0.7
	2019	6.2	8.0	-	4.7	-	-	2.0	8.3	-	-4.5	53.9	0.7
	2020	6.2	7.8	-	4.6	-	-	2.2	8.0	-	-4.3	57.1	0.7
UK	2018	1.3	1.7	0.5	0.2	1.5	0.4	2.5	3.0	4.1	-1.3	85.0	-3.3
	2019	1.6	1.7	0.6	1.3	2.8	1.6	1.6	3.7	3.9	-1.5	84.1	-3.2
	2020	1.5	1.6	0.4	1.9	2.4	2.0	1.5	3.8	3.9	-1.3	83.2	-3.0
Japan	2018	0.9	0.3	0.5	1.8	3.1	2.7	0.9	-	2.8	-	-	-
	2019	0.9	1.0	0.8	1.5	2.0	2.1	1.4	-	2.4	-	-	-
	2020	0.5	0.0	0.8	-0.3	2.8	1.2	2.0	-	2.4	-	-	-

Source: OECD and Danske Bank. 1) % y/y. 2) % contribution to GDP growth. 3) % of labour force. 4) % of GDP.

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Date of first publication

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