1 September 2022

Executive Briefing

Central banks double down on fighting inflation

Major central banks doubled down on their intention to fight high inflation in August. Fed Chair Powell struck a fairly hawkish tone in his speech at the Jackson Hole conference, signalling that Fed is committed to bringing inflation down even if it requires an extended period of below-trend growth and some weakening in labour market conditions. ECB officials echoed this view, with notably the influential member of ECB's executive board, Isabel Schnabel, stating that a recession and higher unemployment rates in the euro area may be needed to bring inflation lower. In light of these hawkish ECB officials' comments we changed our ECB rate call on 29 August, now expecting ECB to hike 75bp on its September meeting (up from 50bp), followed by 50bp in October and 25bp in December. In sum, we now see the end-point of the ECB deposit rate at 1.5% (up from 1% previously).

European inflation developments in August underscored the need for ECB action. The yearly headline and core CPI inflation was 9.1% and 4.3% in August, respectively, way above the ECB's 2% inflation target. Both service and non-energy industrial goods inflation ticked higher. With higher gas and electricity prices yet to fully feed through to consumers, we doubt that we have seen the inflation peak in the euro area yet, despite slowing demand and weakening pricing power. The surge in electricity and gas prices on fear of full cut-off of Russian gas led European policymakers proposed a price cap, although details will first be known mid-September. In the US, the July CPI figures showed moderating inflation pressures, as prices stalled compared with a month earlier due to the decline in gasoline prices. However, inflation pressures and labour markets still remain too strong for the Fed.

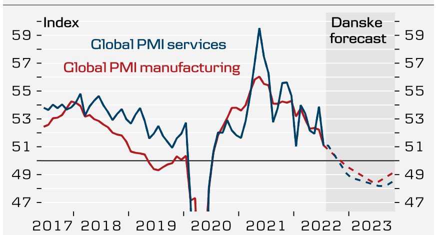
The global economy shows clear signs of slowing. In the euro area services activity stagnated and manufacturing slipped further into recession territory. New business was down in both the manufacturing and service sectors, suggesting little prospect of an improvement in production ahead Manufacturing PMIs. In the US, the manufacturing index declined more than expected though remaining above 50. Service sector growth also slowed faster than expected, as firms' expectations of incoming new business and employment growth ticked lower. On the positive side, consumer confidence rebounded slightly in the US and euro area, possible spurred by lower gasoline prices. Our recession model indicators for the US and Eurozone show that a recession is nearing, especially in the euro area, which we see falling into a mild recession in H2 this year (for more details see our new *Recession monitor - Closing in*, 26 August).

Over the last month, geopolitical tensions intensified between the US and China. The trigger was US House speaker Nancy Pelosi visit to Taiwan, which prompted a very strong reaction from China. While risks are rising, we still see a rather small probability of a Chinese invasion of Taiwan in the next couple of years (20%) as the costs for China are too high. However, the risk will increase over the coming years in our view and with that the risks of possible Western sanctions and restrictions. This will likely prompt companies to increasingly consider investment and production in China (for more details, see *Research China: The risk of a Taiwan war and what it implies - part 1*, 11 August and on the economic implications, *Research China - The risk of a Taiwan war and what it implies - part 2*, 19 August) .

Key points

- Inflation keeps increasing in many places, and so does central bank's willingness to hike interest rates, both in big economies and in the Nordics.
- Weaker purchasing power among consumers and higher interest rates make slowdowns and recessions more likely, and we are already seeing signs of that.
- Markets move back and forth in terms of risk willingness, with energy flows playing a big role in the currency markets.

Headwinds for global growth

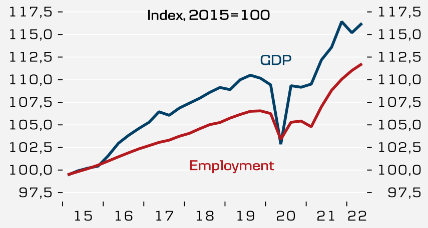


Source: S&P Markit, Macrobond Financial, Danske Bank

Denmark

GDP rebounded in Q2 after Covid restrictions pulled down in Q1, but overall, growth has slowed sharply in 2022. The unemployment rate has increased from 2.5% in April to 2.7% in July, with most of the increase coming from Ukrainian refugees. Inflation reached 8.7% in July and is set to rise further, as recent energy price increases have not yet passed through to consumers. House prices declined in July, according to early indicators. Business sentiment indicators have broadly declined, especially for retail trade and construction. We expect the economy to slow further, unemployment to rise and house prices to decline more in coming months, given the impact of higher interest rates and lower purchasing power. However, a record number of vacant positions point to an only moderate decline in employment, and household finances have a very strong starting point. We expect the Nationalbank to follow the ECB rate hikes, but with a risk that they hike slightly less.

GDP stalls, employment to follow

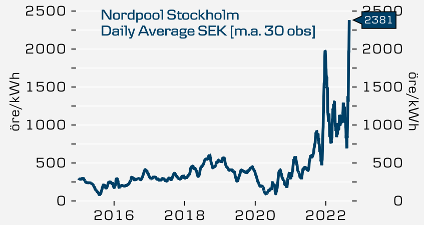


Sources: Statistics Denmark, Macrobond Financial

Sweden

Inflation in July (CPIF 8.0%, CPIF ex. Energy 6.6%) was significantly higher than Riksbank's forecasts, and we have revised our repo rate call to 2*75bp for the September and November meetings, taking it to 2.25%. Money market is pricing another 100 bps at the April 2023 meeting. Q2 GDP rose 0.9 % q/q, as Covid restrictions were abolished and there was strong capital spending. That said, consumers and firms are increasingly squeezed by falling real income, skyrocketing electricity prices (counter-measures coming) and soaring rate expectations. Business confidence is heading lower and consumer confidence is at a 30-year low. Labour market remains strong but there are signs hiring will slow down. Stockholm flats prices rebounded in August but we expect another 5-10% decline. Government formation is likely to be tricky after the September 11 election.

Extreme electricity prices

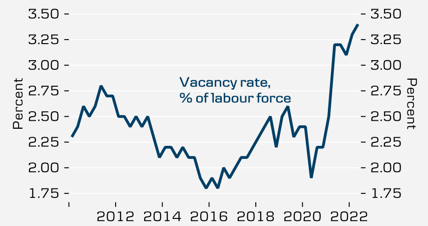


Source: Macrobond Financial, Nordpool

Norway

Core inflation continues to climb. In seasonally-adjusted terms, prices were rising by around 0.3-0.4% m/m in recent months, but accelerated to 0.7% in July. Hence, core inflation increased from 3.6% y/y in June to 4.5% y/y in July. Given the time it takes for global price drivers to feed through into domestic inflation, core inflation will probably remain high or even climb further in the coming months. As a result, Norges Bank raised its policy rate by 50bp to 1.75% in August and signalled that 'the policy rate will most likely be raised further in September', without giving any signals whether it hikes by 25bp or 50bp. The tightness of the labour market continues, and the vacancy rate climbed to 3.4 % in Q2, which of course speaks in favour of another 50 bp. rate hike in September. The housing market holds up well, as low supply implies a tight market.

Many vacant jobs in Norway

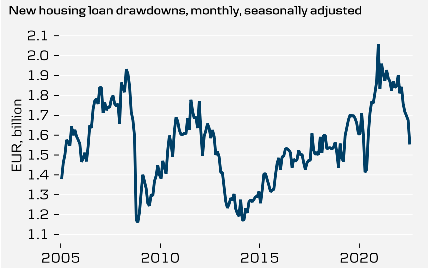


Source: Norges Bank, Macrobond Financial

Finland

In Finland, GDP growth continued in Q2 at 3% y/y, but we expect activity to cool down in H2. Consumers spend more money in retail trade, but due to high inflation (7.8% in July) less goods have been bought. Consumer confidence is very weak. Inflation and rising interest rates worry consumers. Housing market activity and demand for housing loans has decreased, but housing prices are stable. The FIN-FSA recommends that mortgage borrowers' total loan-servicing costs should be no more than 60% of their net income. This DSTI cap may limit lending especially in growth centers. Construction outlook has weakened and activity is going to fall. Business confidence has fallen during summer especially in retail trade. Sanctions and voluntary boycotts have halted most of the foreign trade with Russia. There will be additional investment into domestic energy and national security. Lack of electricity is a worry during next winter. Open job vacancies are plentiful in many industries, which gives a buffer against the economic adversities.

Fewer housing loans in Finland

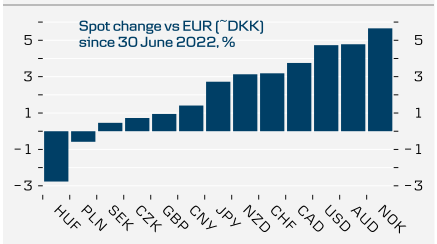


Source: Macrobond Financial

Currency markets

Summer FX markets have seen energy exporter strength and energy importer weakness. NOK has appreciated the most following the combination of more aggressive Norges Bank rate hikes and not least surging natural gas prices lifting the exchange demand from Norwegian oil and gas companies. The USD has also had a strong set of months as the combination of relative rates, relative growth prospects and – again – higher energy prices have all favoured the greenback at the expense of most other currencies. In the other end of the spectre, we find currencies the most vulnerable to Russian gas supplies. While PLN and not least HUF have been the biggest underperformers in recent months the sharply deteriorating growth backdrop for the Eurozone has also weighed strongly on the EUR (and hence DKK). EUR/USD has moved below parity and has temporarily reached the lowest levels since 2002. EUR/DKK remains stuck in the low end of the historic trading range.

FX. Sorted spot returns vs EUR over the last 2 months

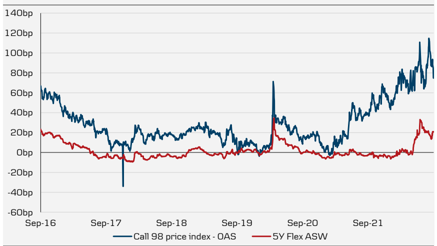


Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial

Bond markets

Inflation and central bank response remain central in fixed income markets with push for higher yields. Danish 4-5% callable bonds have performed lately, and with 5% bonds as issuance coupon, we expect little supply in callables and borrowers focusing issuance in floating rate loans. Buybacks are still a large driver for callables and the recent higher yields have pushed buybacks up – however, we expect gradually lower buybacks the next months due to burnout effects. Another important factor for mortgage bonds is selling pressure from foreign investors. This year, we expect that buybacks in the lower coupons leads to a negative net supply that nearly matches that – the big challenge may be later this year and next year if foreign investors keep reducing positions in the lower coupons since buybacks will be much lower. We do expect that foreign selling pressure will also dampen, but uncertainty is high – potentially a negative driver for callable bonds.

Still high spreads on Danish callables

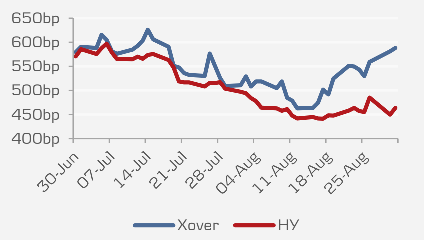


Past performance is not a reliable indicator of current or future results. Source: Danske Bank

Credit markets

July/August have been characterised by the usual summer lull, which has kept primary market activity very low despite a mostly positive market backdrop. Between mid-July and Mid-August, HY and IG spreads contracted 135 and 30bp, respectively, providing what would have been a positive window for issuance had it not been for the holiday period. Towards the middle of August (where the market usually reopens), sentiment took a turn for the worse. Until now, this has primarily affected CDS indices while cash bonds have held up better. The less favourable backdrop has likely kept some issuers from bringing transactions to the market and we would expect to see some pent-up issuance if/when sentiment improves. Combined with cash bonds probably having some catch-up with CDS indices to do, it seems like there is further widening in store for credit markets.

Diverging CDS and cash bonds

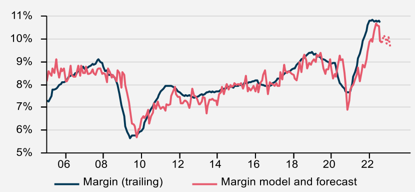


Past performance is not a reliable indicator of current or future results. Source: BondRadar

Equities

Equities are ~5-10% off their June lows but also ~5-10% off their August highs. This highlights how volatile equity markets have been over summer, but it also highlights the uncertainty currently dominating investors. Q2 earnings season on the surface looks okay but underneath there is a more worrisome story. Revenue surprises came in very strong but earnings surprises just in line with historical average. Hence, the underlying message is that profit margins are disappointing and that is typically a negative signal for future earnings growth and for the business cycle. Looking 12 month ahead, the current bottom up consensus expectations of close to 11% profit margins are too optimistic in our opinion. We are arguing for 1-3%-point drop in margins and hence a up to 30% cut to current consensus earnings estimates. This is one of the key reasons why we took equities to underweight in August.

Global profit margins to weaken



Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial, Refinitiv and Danske Bank securities

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Macroeconomic 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	2021	4.9	4.3	4.2	6.2	8.0	8.0	1.9	3.0	3.7	2.6	36.7	8.3
	2022	3.5	2.1	-0.3	3.3	4.1	1.9	7.5	3.7	2.5	1.0	31.9	8.8
	2023	0.7	1.3	0.9	-0.4	2.2	2.5	3.4	4.0	2.7	0.7	29.9	8.1
Sweden	2021	4.8	6.1	2.6	5.9	7.6	9.3	2.2	2.7	8.8	-0.2	37.3	5.2
	2022	1.1	2.6	0.1	-0.3	5.4	6.3	6.4	2.0	7.4	-0.3	33.0	4.9
	2023	1.6	1.7	1.2	1.3	3.9	3.4	3.5	2.1	7.2	0.3	31.0	5.2
Norway	2021	4.1	4.9	3.8	-0.9	4.7	2.3	3.5	3.5	3.2	-	-	-
	2022	3.6	6.7	1.3	3.1	6.0	7.5	4.6	3.7	1.8	-	-	-
	2023	1.6	2.5	1.3	2.0	4.0	4.0	2.0	3.7	2.1	-	-	-

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	2021	5.3	3.6	3.9	3.9	10.4	8.1	2.6	4.1	7.7	-5.1	97.4	3.2
	2022	2.8	2.5	1.4	3.1	5.6	7.0	8.5	3.2	6.7	-3.7	94.7	2.4
	2023	0.3	0.3	2.4	2.2	2.6	4.8	4.9	3.4	6.8	-2.5	92.7	2.9
Germany	2021	2.6	0.4	3.8	1.0	9.5	8.9	3.2	3.4	3.6	-3.7	69.3	7.4
	2022	1.3	2.4	0.7	2.6	1.8	6.8	7.9	3.3	2.9	-2.5	66.4	6.4
	2023	-0.2	-0.1	2.8	2.5	2.1	4.8	4.8	3.9	3.0	-1.0	64.5	6.8
Finland	2021	3.0	3.6	2.7	1.1	5.6	5.6	2.2	2.3	7.7	-2.6	72.3	0.9
	2022	1.5	1.6	1.5	4.0	1.0	2.5	6.0	2.8	6.4	-2.8	65.0	-0.6
	2023	1.6	2.5	1.0	2.5	2.0	3.5	2.5	2.6	6.3	-2.3	64.8	-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	2021	5.7	7.9	0.5	7.8	4.5	14.0	4.7	4.2	5.4	-12.4	126.9	-3.5
	2022	1.6	2.4	-1.4	1.4	5.8	9.5	7.9	5.2	3.6	-4.2	124.0	-3.5
	2023	-0.2	-0.1	0.9	-2.9	-1.4	-3.4	3.7	4.2	3.9	-3.8	121.0	-3.2
China	2021	8.0	10.2	-	5.2	-	-	0.7	5.0	-	-5.6	68.9	3.0
	2022	2.8	4.8	-	3.0	-	-	2.5	5.0	-	-7.7	77.8	1.1
	2023	5.7	6.5		5.0			2.5	5.5		-7.1	81.8	1.0
UK	2021	7.4	6.2	14.3	5.9	-1.3	3.8	2.6	5.1	4.5	-5.4	95.6	-2.6
	2022	4.0	4.8	1.3	8.1	0.7	14.7	8.4	4.4	3.6	-3.9	95.5	-4.8
	2023	-0.2	-0.3	1.2	-1.9	-2.4	-2.4	5.6	3.3	4.1	-1.9	97.0	-3.7
Japan	2021	1.7	1.1	2.1	-1.3	11.9	5.1	-0.2	-	2.8	-	-	-
	2022	1.7	3.3	1.4	-1.8	3.6	4.1	1.6	-	2.5	-	-	-
	2023	1.8	1.6	0.7	1.7	2.9	1.1	1.1	-	2.5	-	-	-

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

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	Currency vs NOK	Currency vs SEK
USD	01-Sep	2.50	3.08	3.85	3.29	100.2	-	742.7	1003.6	1070.5
	+3m	3.50	3.97	3.90	3.35	98.0	-	758.9	1061.2	1081.6
	+6m	3.75	4.00	3.90	3.45	96.0	-	775.5	1062.5	1125.0
	+12m	3.75	3.99	3.65	3.25	95.0	-	784.2	1031.6	1157.9
EUR	01-Sep	0.00	0.65	2.23	2.47	-	100.2	743.8	1005.1	1072.1
	+3m	1.25	1.54	2.30	2.65	-	98.0	743.8	1040.0	1060.0
	+6m	1.50	1.62	2.35	2.50	-	96.0	744.5	1020.0	1080.0
	+12m	1.50	1.62	2.25	2.45	-	95.0	745.0	980.0	1100.0
JPY	01-Sep	-0.10	-0.01	0.12	0.49	120.5	139.3	6.17	8.34	8.90
	+3m	-0.10	-	-	-	131.3	134.0	5.66	7.92	8.07
	+6m	-0.10	-	-	-	127.7	133.0	5.83	7.99	8.46
	+12m	-0.10	-	-	-	118.8	125.0	6.27	8.25	9.26
GBP*	01-Sep	1.75	-	3.90	2.97	86.4	115.9	860.4	1162.7	1240.1
	+3m	2.50		2.55	2.30	86.0	114.0	864.8	1209.3	1232.6
	+6m	2.50		2.55	2.35	85.0	112.9	875.9	1200.0	1270.6
	+12m	2.50		2.35	2.05	84.0	113.1	886.9	1166.7	1309.5
CHF*	01-Sep	-0.75	-	1.21	1.76	97.8	97.8	760.2	1027.3	1095.7
	+3m	0.25	-	-	-	95.0	96.9	782.9	1094.7	1115.8
	+6m	0.75	-	-	-	94.0	97.9	792.0	1085.1	1148.9
	+12m	0.75	-	-	-	93.0	97.9	801.1	1053.8	1182.8
DKK	01-Sep	-0.10	1.02	2.54	2.74	743.77	742.68	-	135.13	144.14
	+3m	1.15	1.73	2.60	2.95	743.75	758.93	-	139.83	142.52
	+6m	1.40	1.80	2.65	2.80	744.50	775.52	-	137.00	145.06
	+12m	1.40	1.80	2.55	2.75	745.00	784.21	-	131.54	147.65
SEK	01-Sep	0.75	1.29	3.05	2.89	1072.1	1070.5	69.4	93.8	100.0
	+3m	1.50	1.95	2.70	2.40	1060.0	1081.6	70.2	98.1	-
	+6m	2.25	2.50	2.65	2.50	1080.0	1125.0	68.9	94.4	-
	+12m	2.25	2.50	2.50	2.40	1100.0	1157.9	67.7	89.1	-
NOK	01-Sep	1.75	2.60	3.95	3.58	1005.1	1003.6	74.0	100.0	106.7
	+3m	1.75	2.57	3.05	3.35	1040.0	1061.2	71.5	-	101.9
	+6m	2.25	2.60	2.95	3.40	1020.0	1062.5	73.0	-	105.9
	+12m	2.25	2.60	2.85	3.20	980.0	1031.6	76.0	-	112.2

*Notes: GBP swaps are SONIA and CHF swaps are SHARON.
We have updated our Norges Bank forecasts after yesterday's Norges Bank meeting but not yet our Norwegian yield outlook

Commodities

		2022				2023				Average	
	01-Sep	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2022	2023
ICE Brent	95	98	112	115	100	95	95	95	95	106	95

Source Danske Bank

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Date of first publication

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