Investment Research

3 January 2020

Nordic Outlook

Economic and financial trends

- Denmark: end of the recovery
  - After six years, the decline in unemployment is coming to an end

- Sweden: heading for a 2012 moment
  - We expect quarterly declines in GDP and rising unemployment

- Norway: weaker outlook on capacity limits
  - Growth has slowed, at least in part because of a lack of qualified labour

- Finland: structural barriers ahead
  - Growth is slowing as the economy faces both cyclical headwinds and a lack of spare capacity

Editor-in-Chief: Chief Economist, Las Olsen, +45 45 12 85 36, laso@danskebank.com

Analysts

Editorial deadline 2 January 2020 *Investment Research*

Editor-in-Chief:

Las Olsen	Chief Economist	+45 45 12 85 36	laso@danskebank.com

Macroeconomics:

Bjørn Tangaa Sillemann	Denmark	+45 45 12 82 29	bjsi@danskebank.com
Louise Aggerstrøm Hansen	Denmark	+45 45 12 85 31	louhan@danskebank.com
Anders Køhlert Larsen	Denmark	+45 45 13 76 14	anlars@danskebank.com
Michael Grahn	Sweden	+46 8 568 807 00	mika@danskebank.com
Frank Jullum	Norway	+47 85 40 65 40	fju@danskebank.com
Pasi Petteri Kuoppamäki	Finland	+358 10 546 7715	paku@danskebank.com
Jukka Samuli Appelqvist	Finland	+358 44 263 1051	app@danskebank.com

This publication can be viewed at https://research.danskebank.com.

Statistical sources: Refinitiv, Macrobond Financial, OECD, IMF, National Institute of Social and Economic Research, Statistics Denmark and other national statistical institutes as well as proprietary calculations.

Important disclosures and certifications are contained from page 35 of this report.

Contents

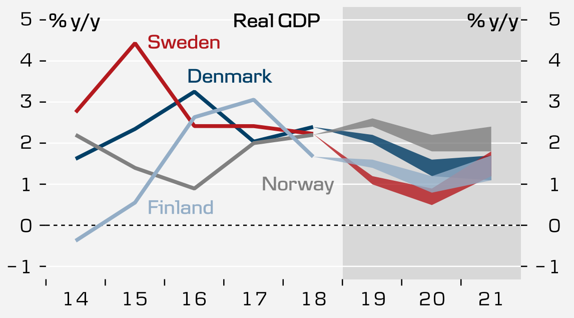
The ***Nordic Outlook*** is a quarterly publication that presents Danske Bank's view on the economic outlook for the Nordic countries. The semi-annual publication *The Big Picture* sets out our global economic outlook.

At a glance

Slowdown catches up with Nordics

Judging only from the headline quarterly GDP figures, the Nordic countries have for the most part done well in 2019 compared with the slow growth in Western Europe as a whole. But on closer inspection, there are already many signs of slowdown in the Nordics. Sweden is the clearest case, as the country has already seen an increase in unemployment and GDP growth has slowed significantly – despite what looks like temporary support from net exports. Denmark has been supported by a boom in pharmaceutical production and exports, Norway by surging investments in the oil sector, and Finland by ship exports and what looks like a temporary surge in private consumption in the third quarter of 2019. We do not expect these factors to continue to drive growth this year, and that will make the slowdown clear, before a slightly better global backdrop adds a bit more support in 2021.

2020 expected to be a low point

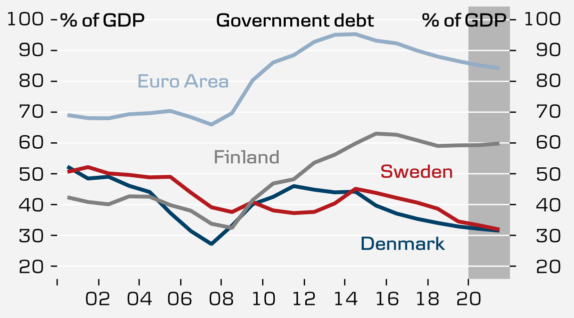


Source: Macrobond Financial, Danske Bank

Underlying strong economies

Sweden is the Nordic country that comes closest to a new economic crisis in our forecasts, as we expect outright GDP declines on a quarterly basis and a further increase in unemployment. That reflects the construction boom of earlier years, as declining housing investment is now a drag on growth. Of course, all of the Nordic countries are vulnerable to global recession, which clearly remains a risk in the coming years, even though progress over trade and better key figures from around the world have made us less worried. The Nordic countries in general are relatively well equipped to deal with recession risks, as Denmark, Sweden and Norway in particular have some of the healthiest public finances in Europe and ample space to ease fiscal policy if they decide to do so. We also do not see any of the Nordic economies as severely overheated, albeit with some local variations, such as the high prices in some metropolitan housing markets.

Room for manoeuvre

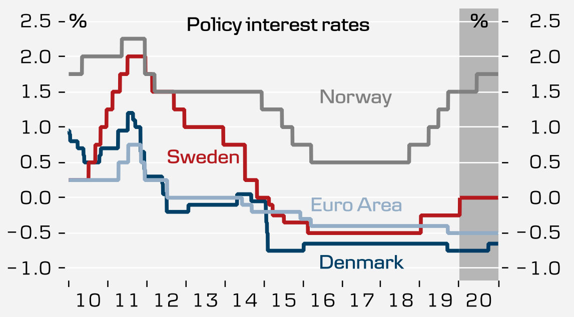


Source: Macrobond Financial, The European Commission
Note: Forecasts are from The European Commission

Hikers of the North

Sweden and Norway are among the few countries where official interest rates were increased in 2019. It is tempting to see a connection between the two, but the backgrounds are very different. Norway is simply one of the few countries where underlying inflation dynamics support the central bank's target, especially as wage growth is firmly above 3% and the labour market remains tight. Meanwhile, Sweden does not really fit the bill for a country where rates should be hiked, as core inflation is below target and heading lower as the economy cools. The Swedish Riksbank hiked rates at its December meeting to get away from negative interest rates, it seems. We expect the Riksbank to keep its policy rate at zero for a long time, but there is a good chance that it might have to take back the 2019 hike and return to negative. Norway, on the other hand, looks likely to hike once more in 2020 to keep inflation in check.

Going their own way



Source: Macrobond Financial, Danske Bank

Denmark

End of the recovery

- **After a period of relatively high growth and declining unemployment, the upswing appears to be ebbing out, although we do not foresee any impending crisis for the Danish economy.**
- **The global slowdown is visible in Danish economic data, albeit exports remain buoyant overall.**
- **Private consumption and house prices should support growth in the coming years, while the contribution from investment will decline.**
- **Higher cigarette prices are set to lift inflation considerably in the coming years, but underlying price growth remains very modest.**
- **We see Denmark as well prepared for any new crisis that might appear on the horizon, with ample ammunition to counter a crisis in the form of fiscal policy measures.**

Soft landing after a six-year upswing

With GDP growth looking set to come in at around 2%, Denmark has outperformed many other European countries in 2019. While Germany has suffered setbacks in the Auto and other industries, Denmark has been buoyed particularly by the pharmaceutical industry, which has experienced phenomenal growth in recent years. Although some of the problems Germany faces appear temporary and growth seems to be recovering slightly, we nevertheless expect that Denmark will be increasingly affected by the slowdown that is unfolding elsewhere. We expect growth to shift down a gear to just under 1.5% in the coming years, which also raises the prospect of slightly higher unemployment. Should our expectations pan out, Denmark will experience a so-called soft landing in the wake of an upswing that has lasted close to six years. There are many previous examples of hard landings, with noticeable downturns in employment, etc., and there is a risk of this happening again, with that risk emanating from abroad. However, we see the risk of a serious crisis in Denmark as lower than during previous slowdowns, as the economy has so far not overheated in terms of credit growth, house prices, competitiveness or inflation. Likewise, there is also a 'risk' of the upswing returning on the back of stronger consumption and investment growth.

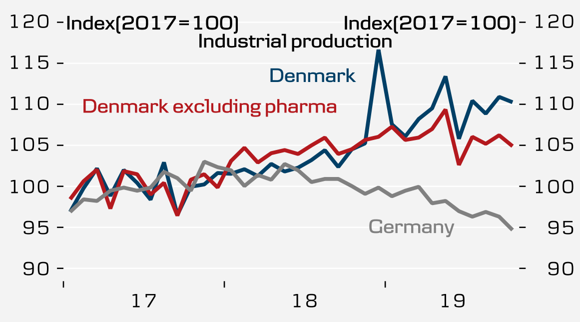
We have yet again seen a major upward revision to the Danish GDP figures; this time with the 2018 figure revised 1.5% higher, meaning that year had the second highest growth rate since 2006. Once again, the activities of Danish companies abroad were underestimated, this time especially construction, which was probably linked to the erection of wind turbines. More of these types of upward revisions are likely in the future, even though Statistics Denmark is working to improve its data collection. For now, though, we have not incorporated any expectations of revisions into our forecast, but instead have used Statistics Denmark's figures as they currently stand, including the growth figures for the first three quarters of 2019. As the revisions are often linked to companies' activities abroad, they typically do not have any great impact on the view of Denmark's domestic economy.

At a glance

Denmark	Current forecast			Previous forecast	
% y/y	2019	2020	2021	2019	2020
GDP	2.1	1.4	1.4	2.0	1.3
Private consumption	1.5	1.9	2.0	1.5	2.4
Public consumption	0.0	1.3	0.8	0.3	0.9
Gross fixed investment	-1.0	-0.2	1.4	-1.8	0.9
Exports	3.7	2.5	1.9	4.5	1.6
Imports	0.4	2.5	2.3	0.3	1.9
Gross unemployment (thousands)	104.1	105.6	105.6	104.4	106.9
Inflation	0.8	1.2	1.4	0.8	1.2
Government balance, % of GDP	2.6	0.2	-0.1	2.0	0.5
Current account, % of GDP	8.6	8.4	8.3	7.6	7.3

Source: Danske Bank

Danish industry remained buoyant in 2019

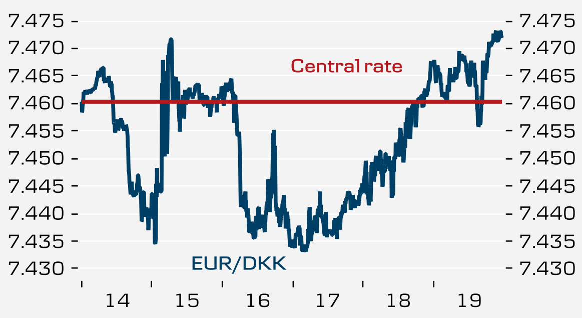


Source: Statistics Denmark, Macrobond Financial

Modestly fluctuating rates and yields

The likelihood of a unilateral Danish interest rate hike has risen as the Danish krone (DKK) has come under slight pressure against the euro (EUR). The European Central Bank (ECB) and Danmarks Nationalbank both cut their policy rates by 0.1 percentage points to -0.5% and -0.75%, respectively, in September. The current account surplus and a strong economy in general mean that a stable DKK can in fact be compatible with lower interest rates in Denmark, though the interest rate spread has perhaps grown a little too large. On the other hand, Danmarks Nationalbank has demonstrated a willingness to tolerate a slightly weaker DKK than previously – in fact the weakest since the EUR was launched in 1999 – while the bank also has ample resources to support the currency through intervention. Our main scenario is that Danmarks Nationalbank will ultimately raise the certificates of deposit rate by 0.1 percentage points during 2020. Long yields have been rising in recent months, in part because the risk of a global economic downturn has eased. We expect to see long yields rise slightly further in 2020, and in our view the 10Y government yield could well turn positive again in 2021.

Danmarks Nationalbank has tolerated a weaker DKK than previously

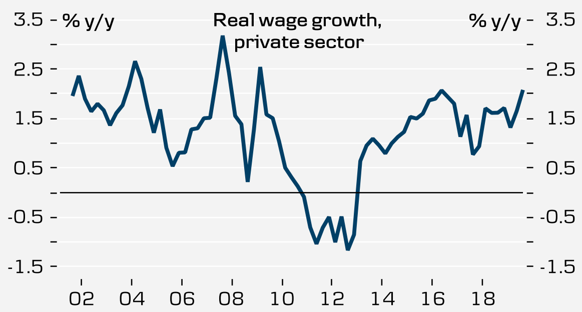


Source: Danmarks Nationalbank, Macrobond Financial

Stability rather than growth in the labour market

After falling for nearly six years, unemployment has been more stable in 2019. Job creation in the private sector has been less rapid than in previous years, while the labour force is continuing to grow, in part because the retirement age is set to rise by six months per year between 2019 and 2022. We expect unemployment to rise slightly in the coming years but still remain at a relatively low level. Low levels of unemployment have gone hand in hand with quite marked real wage increases in recent years for those already in work, while the overall level of wages (which also includes new employees and is what our forecast is based on) has grown somewhat more slowly. Much of the private sector is scheduled to commence a major round of collective bargaining in 2020, and experience tells us this tends to accelerate wage growth slightly. However, most of the details are thrashed out at a local level and depend on the situation of the individual companies. We expect to see wage growth roughly on par with recent years, even though higher inflation will tend to erode the value of pay increases somewhat.

Solid income growth

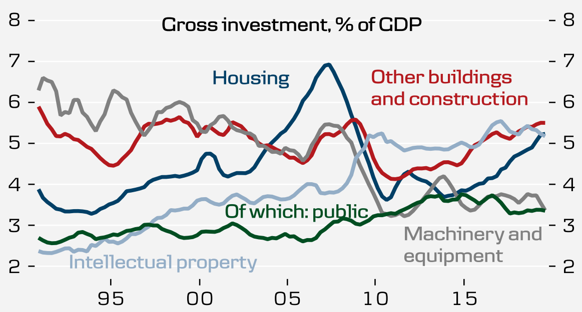


Source: DA's Wage statistic, Statistics Denmark, Macrobond Financial

Investment no longer a locomotive

We have pencilled in investment to pull growth lower in both 2019 and 2020. Business investment was greatly boosted in 2018 by investments in ships, so a fall is natural in 2019, when there was also apparently a negative contribution from a patent sold abroad – a negative investment in Denmark, as it were. Housing investment appears to be slowing after high levels of growth in 2019. Both business and housing investment are relatively high in historical terms, and it is only natural that they are not pulling overall growth higher in the way they did when they were in recovery mode during the upswing. Business investment is very much being driven by research and development in the pharmaceutical industry, while investments in machinery are lagging. With respect to housing, we expect to activity to slow after the surge in apartment building in recent years, though we still see a clear need for further apartment building in the longer term, as the number of single households looks set to rise substantially. Investments in

Investment rising again but composition altered



Note: 4 quarters moving average. Not all types of investment are show
Source: Statistics Denmark, Macrobond Financial

renovations and refurbishments, including energy efficiency, also offer growth potential.

Cigarettes pull inflation higher, but outlook is modest

Inflation in Denmark remains modest, with 2019 being the sixth year out of the past seven when inflation came in at less than 1%. There is nothing to suggest a serious increase in underlying price pressures in the Danish economy. Service inflation remains low, a reflection of the still relatively slow pace of nominal wage growth, while the tighter labour market of recent years has made no major contribution to wage pressures – and with our forecast's modest outlook for wage growth in mind, we can hardly expect more inflation from this area.

The government and its support parties agreed in the 2020 budget to raise the price of a packet of cigarettes by DKK15 in April. We estimate this will pull inflation up by 0.4 and 0.2 percentage points, respectively, this year and next.

Very modest rent increases have been a key reason for the low level of inflation over the past two years. Rents account for 20% of the consumer price index, so slower rent increases have a major influence on inflation. We know that the regulated part of the private rental market may not increase rents by more than the annual increase in the net price index from the previous summer. This was just 0.5% in July, so low inflation is self-reinforcing here. In the social housing sector, where rents are set according to costs, the low level of interest rates is helping to keep rents subdued. Hence, there is nothing really to indicate that upcoming rent increases should be particularly higher than has been the case in recent years. We expect inflation to come in at 1.2% this year and rise to 1.4% in 2021 on the back of rising energy prices.

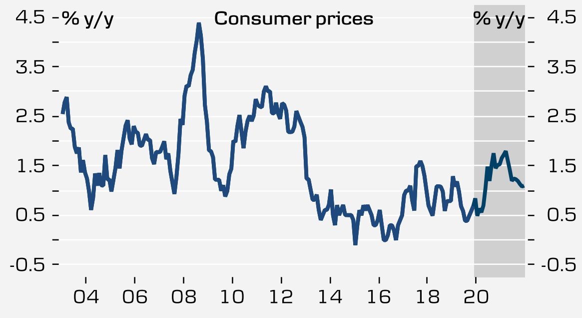
Housing market growing again, with apartments back onboard

We expect house prices to increase by around 3% nationwide this year and 2.25% next year. The reasons for the slightly weaker price growth next year include our outlook for more subdued growth in personal finances and slightly rising interest rates – though we expect that rise to be rather small and very slow. Naturally, the level of uncertainty is greater the further we look into the future, but we see little reason to believe the housing market – which continues to benefit from cheap financing and growth in personal finances – could be derailed in the coming years.

After having stagnated through most of 2018 and 2019, there are now signs that apartment prices are again beginning to increase, and whereas we previously expected apartment prices to fall slightly in the major cities in 2020 due to new property valuations and taxes, we now expect prices to rise a little this year, in part because the supply of apartments for sale has declined modestly.

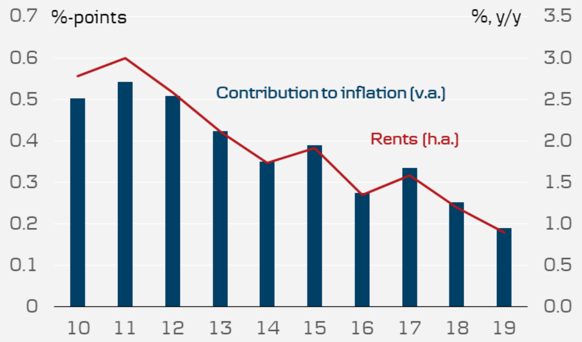
The postponement of property tax reforms until 2024 should help calm the apartment market for the immediate future. However, as new apartment valuations begin to appear from the end of 2020 onwards, we expect the market could react negatively. The impact will very likely be confined to apartments in the most expensive areas, and we generally do not expect the new valuations and

Duties and energy pulling inflation higher



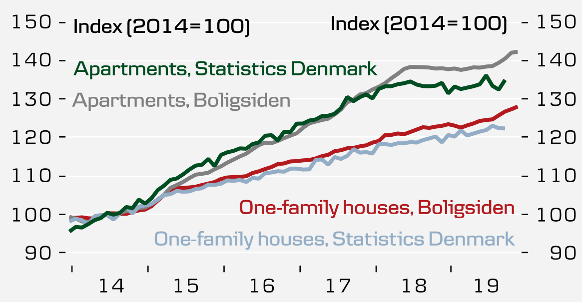
Source: Danske Bank, Statistics Denmark, Macrobond Financial

Modest rent increases keeping inflation subdued



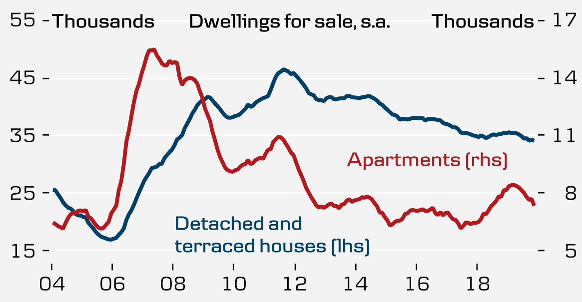
Source: Danske Bank, Statistics Denmark

House prices rising steadily and apartments getting more expensive again



Note: Own seasonal correction
Source: Statistics Denmark, Boligsiden and Macrobond Financial

Supply of homes no longer rising sharply



Source: Statistics Denmark and Macrobond Financial property tax reforms to cause any upset in house prices at a national level, as the taxation of most homes will only be affected to a limited extent.

Moderate consumption growth helped along by property tax refunds

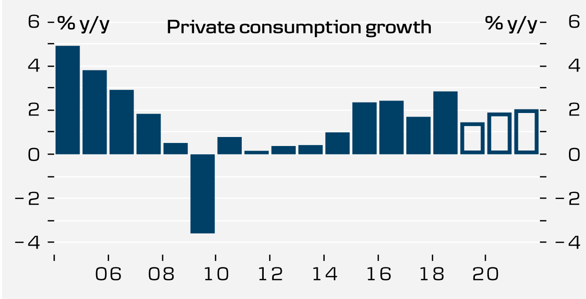
We expect private consumption to rise by around 2% this year and next. Consumption will continue to be supported by real wage growth and rising employment – even if the pace of employment growth is expected to slow compared with 2019. In addition, housing market growth means homeowners will have more economic potential that could be converted into consumption. While these factors are expected to gradually contribute less to consumption over the forecast period, we nevertheless expect consumption growth to pick up between 2019 and 2021 on the back of a substantial share of the property tax refunds paid to homeowners being converted into increased consumption. We expect this money to be paid out in late 2020 at the earliest, so the largest consumption effect should be in 2021. There are still a few unanswered questions regarding the refunding of property taxes, not least when exactly the money will be paid out and how large a share will be converted into consumption, which adds considerable uncertainty to consumption in 2021.

Consumption growth has been less than impressive compared to previous upswings, and we do not expect this to change in the coming years. Among other things, this reflects the tendency of Danes to capitalise on economic growth to increase their savings rather than increase their consumption, and to use the decline in interest rates in recent years to increase debt repayments. This is different to previous upswings, where consumption has tended to outstrip incomes. The consumption ratio – the share of disposable income spent on consumption – is therefore expected to remain low in the coming years. On the one hand this means a continuation of relatively subdued consumption growth despite the Danes having more money in their wallets, but it also means Danish households having more balanced finances and thus the Danish economy being more robust in the event of an economic slowdown.

Solid government finances – even if Denmark experiences a setback

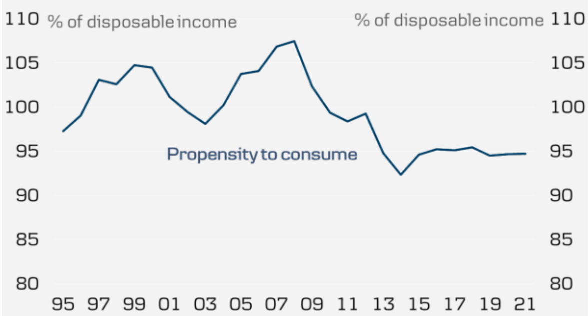
In contrast to many other European countries, government finances in Denmark are healthy and remain supported by general economic growth. Solid government surpluses are expected in both 2020 and 2021, although they will probably not be quite as large as in 2019. One reason for this is the likelihood of record-high income from pension return taxes, so-called PAL taxes, in 2019, which were boosted by higher prices of both equities and bonds. 2020 and 2021 are unlikely to be quite so strong, but with interest rates still low and pension contributions rising we can still look forward to a government surplus.

Consumption growth heading higher on the back of special factors



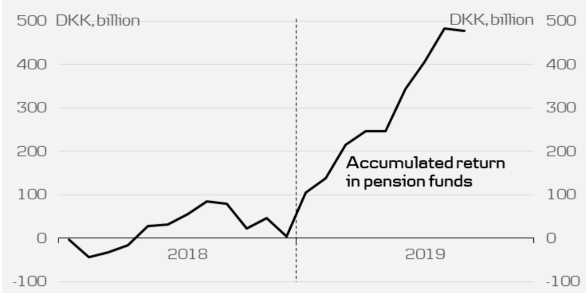
Source: Statistics Denmark, Macrobond Financial and own calculations

Consumption ratio remains low



Note: We have attempted to correct for the conversion of lump sum pensions in 2013-15.
Source: Statistics Denmark and own calculations

2019 has seen record-high pension returns, which means a hefty government surplus



Source: Danmarks Nationalbank, Macrobond Financial

The 2020 budget paves the way for a modest easing of fiscal policy due to increased growth in public consumption. Pulling in the other direction is the refunding of property taxes to those who have paid too much, which is now expected to happen more in 2021 than in 2020. While the refund payments may weaken government finances slightly, this does not change the fact that there is ample opportunity to ease further both this year and next if low levels of growth abroad trigger a slowdown in Denmark.

Historic export growth replaced by gathering headwind

Most of Denmark's key export markets weakened in 2019. Nevertheless, goods exports had an excellent year, and we estimate growth here was just under 10% – the largest growth spurt in 25 years. Industry, in particular, experienced steeply rising sales of goods, not least those produced outside Denmark's borders. Overall, Danish industry, which accounts for three-quarters of goods exports, has stood out, with production growth of 6% for the first 10 months of 2019. However, if we scratch below the surface, we can see that many of the cyclically-sensitive sectors, such as the machinery and metal industries, have begun to slow. Demand for such goods will also suffer from the weakness in European industry going forward and we will probably have to get used to significantly less growth here in 2020. Nor can we realistically count on the extraordinary growth in the pharmaceutical industry in Denmark continuing. However, as the global economy gradually regains momentum in 2020, this should also have a positive impact on Denmark.

In contrast to goods exports, selling Danish services abroad has been proving difficult for quite some time, and we estimate that service exports fell 2.5% in 2019, in part due to shipping feeling the pressure from the decline in global trade. Shipping companies have enjoyed something of a tailwind recently, but conditions remain tough. In addition, Denmark's three largest buyers of other services (than shipping), Sweden, Germany and the UK, are all experiencing pronounced economic headwinds at the moment, so the outlook here is not particularly favourable.

A very strong 2019 with expected total export growth of 3.7% will make its mark on the new year, and so we expect exports to grow by 2.5% in 2020 and 2.1% in 2021, even though we expect more momentum in 2021 than in 2020.

Current account surplus is structurally high

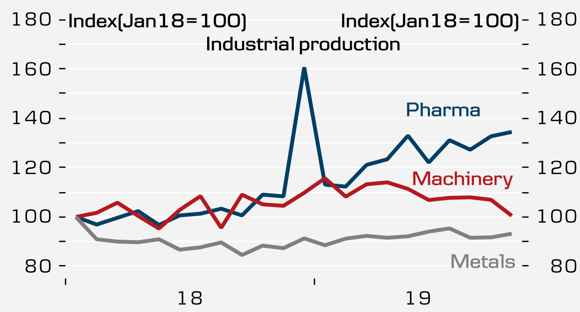
According to our estimates, the very strong export growth in 2019 resulted in the second-highest current account surplus to date – exceeded only by 2014. The goods balance, in particular, has grown strongly. The service balance surplus was revised significantly higher for 2018 following Statistics Denmark's latest revision to the current account in October. Exports of building and construction services and shipping had previously been particularly underestimated. The trend towards larger surpluses in these specific activities has continued into 2019.

While export growth is set to be modest, we expect subdued import growth will contribute to keeping the trade surplus elevated. This is due, in particular, to the modest prospects for further corporate investment, which typically includes a large import content. In addition, there should continue to be a substantial return on foreign wealth investments and thus also large capital income. Overall, we expect the current account surplus to come in at 8.6% of GDP in 2019. We expect it to be 8.4% this year and 8.3% in 2021.

Exports of goods produced abroad accounting for more and more

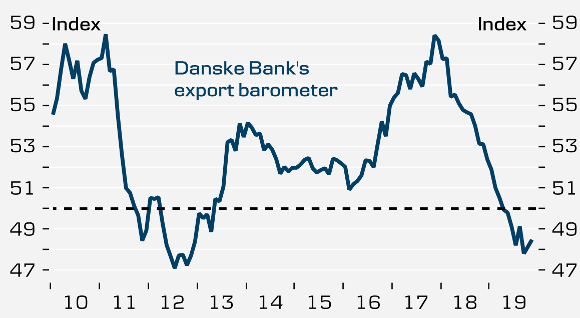
Note: Merchanting is the profit on goods bought and sold on abroad
Source: Statistics Denmark, own calculations

Cyclically-sensitive sectors feeling the global slowdown



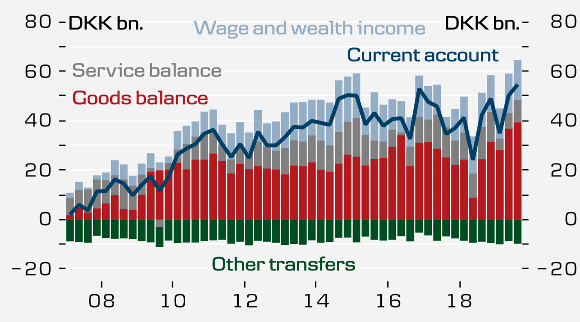
Source:: Danmarks Statistik, Macrobond Financial

Industry remains weak among Denmark's trading partners



Source: Markit Economics, Statistics Denmark, Danske Bank, Macrobo Financial

Huge trade surplus pulling higher



Note: Seasonally-corrected figures.
Source: Statistics Denmark, own calculations, Macrobond Financial

At a glance

			Forecast		
National account	**2018**	**2018**	**2019**	**2020**	**2021**
	DKK bn (current prices)		% y/y		
Private consumption	1017.0	2.8	1.5	1.9	2.0
Government consumption	546.8	0.4	0.0	1.3	0.8
Gross fixed investment	494.7	5.4	-1.0	-0.2	1.4
- Business investment	309.2	6.4	-5.1	0.3	1.1
- Housing investment	110.0	5.3	8.6	-2.1	0.8
- Government investment	75.4	2.0	1.9	0.6	3.3
Growth contribution from inventories		0.3	-0.1	-0.3	0.0
Exports	1249.7	2.4	3.7	2.5	1.9
- Goods exports	755.0	1.8	9.5	3.5	2.1
- Service exports	494.7	0.4	-2.5	0.9	1.7
Imports	1113.9	3.6	0.4	2.5	2.3
- Goods imports	682.3	2.6	2.7	2.7	2.6
- Service imports	431.6	5.1	-3.3	2.2	1.7
GDP	2246.0	2.4	2.1	1.4	1.4

Economic indicators	**2018**	**2019**	**2020**	**2021**
Current account, DKK bn	157.9	198.9	199.9	203.3
- % of GDP	7.0	8.6	8.4	8.3
General government balance, DKK bn	10.7	60.0	5.0	-2.0
- % of GDP	0.5	2.6	0.2	-0.1
General government debt, DKK bn	771.7	776.2	793.0	801.2
- % of GDP	34.4	33.5	33.4	32.9
Employment (annual average, thousands)	2963.3	2998.0	3016.2	3034.7
Gross unemployment (annual average, thousands)	108.0	104.1	105.6	108.0
- % of total work force (DST definition)	3.8	3.7	3.8	3.8
Oil price - USD/barrel (annual average)	71	65	60	65
House prices, % y/y	3.8	2.9	3.3	2.2
Private sector wage level, % y/y	2.2	2.0	2.2	2.1
Consumer prices, % y/y	0.8	0.8	1.2	1.4

Financial figures	**02/01/2020**	**+3 mths**	**+6 mths**	**+12 mths**
Lending rate, % p.a.	0.05	0.05	0.05	0.05
Certificates of deposit rate, % p.a.	-0.75	-0.75	-0.75	-0.65
2-yr swap yield, % p.a.	-0.17	-0.18	-0.18	-0.05
10-yr swap yield, % p.a.	0.34	0.32	0.42	0.65
EUR/DKK	7.47	7.47	7.47	7.46
USD/DKK	6.67	6.73	6.61	6.49

Source: Statistics Denmark, Danmarks Nationalbank, Macrobond Financial, Danske Bank

Sweden

Heading for a 2012 moment

- **A growth recession is coming, with the situation mirroring the 'euro crisis' in 2012.**
- **The business sector is clutching at straws – we see employment becoming gradually lower in 2020.**
- **Over time, actual inflation has been significantly below the 2% target and, in our view, the December rate hike will not be supportive for higher inflation in 2020.**
- **The Riksbank introduces a zero interest rate policy but the term premium remains negative. We expect the SEK to weaken in 2020.**
- **The government is foregoing the possibility of investing in public infrastructure, despite being paid to borrow.**

As set out in *Nordic Outlook – October 2019*, 1 October, Swedish economic growth remains in the doldrums. In several respects, the situation mirrors that in 2012 during the 'euro crisis', when quarterly GDP growth fell slightly below zero for a while. We expect a repetition of this in coming quarters. In the meantime, unemployment took another leap towards 8%. Underlying inflation CPIF excluding energy peaked in mid-2017 (slightly above 2% y/y), while target CPIF peaked at 2.5% in September 2018. Following a temporary rise in the autumn of 2019, we expect both to resume their downtrend to stabilise below 1.5% y/y in 2020.

The Riksbank appears to have taken a step away from inflation targeting, similar to the 'leaning against the wind' years. The real rationale for the rate hike seems to us to be a concern for banks introducing negative rates on deposits and/or extending mortgage loans at negative rates, even though we cannot understand why this should be a problem now.

In coming years, fiscal policy has a unique chance to stimulate the economy without jeopardising the stability of public finances. However, it seems to us that neither the government and its allies nor the opposition is willing to shift focus from the surplus target to the debt anchor, despite the unique opportunity to borrow at close to zero or negative interest rates.

No light at the end of the tunnel – there's a growth recession coming

Over the past two years, domestic demand has remained almost flat and there is very little to suggest to us that this situation will change in the first half of 2020.

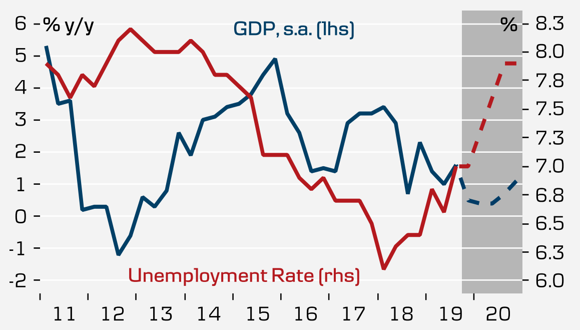
After the dip in the second half of 2017, residential property prices have been on a slow but steady increase. Recently, however, prices appear to have been reaccelerating. In our view, this probably relates to declining household rate expectations. Although the Riksbank sent a hawkish message about an imminent December rate hike, it also said that thereafter interest rates would remain unchanged for several years. In principle, this means that consumers expect mortgage rates to remain record low for a long time.

At a glance

Sweden					
	Current forecast			Previous forecast	
% y/y	2019	2020	2021	2019	2020
GDP, calendar adjusted	1.1	0.7	1.5	1.0	0.7
Private consumption	0.9	1.8	1.7	0.7	1.9
Public consumption	0.5	1.2	1.2	0.7	1.5
Gross fixed investment	-1.3	-1.5	0.9	-1.8	-2.2
Exports	4.7	3.1	2.8	4.2	2.7
Imports	2.2	2.2	2.5	1.7	2.1
	0.0	0.0	0.0	0.0	0.0
Unemployment rate	6.9	7.8	8.0	6.8	7.8
Inflation	1.8	1.5	1.2	1.7	1.1
Government balance, % of GDP	0.1	-0.5	-0.6	0.1	-0.5
Current account, % of GDP	4.8	5.2	5.2	3.7	3.7

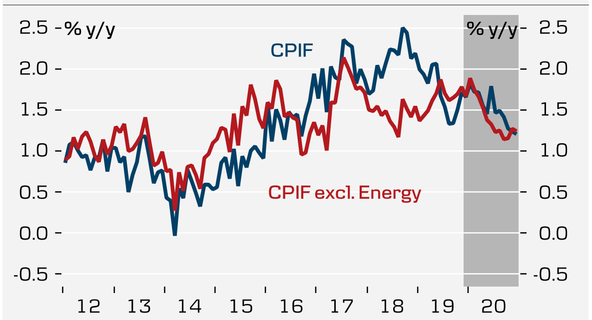
Source: Danske Bank

Revisiting 2012



Source: SCB, Danske Bank

Inflation falling to troubling levels



Source: SCB, Danske Bank

Rising prices may be supportive of residential construction but we doubt this will be the case over the short term. The most recent reading (Q3 19) of residential starts was running at a below 50,000 annual pace. To be in line with SCB's population growth estimates for the coming 10 years, residential starts need gradually to fall below 40,000 per year over the next couple of years. This suggests that the rise seen in dwelling investment in Q3 GDP was probably an aberration and that residential investment will remain a drag on GDP growth for some time yet.

Highly volatile fixed investment national accounts data did suggest a stabilisation in several categories of business investments such as machinery and ICT equipment. We find this hard to reconcile with recent negative manufacturing and services sector readings in both PMI and NIER's monthly confidence survey.

Households have a very favourable situation in terms of wealth. In Q3, net financial wealth amounted to slightly below SEK10.5trn, or close to 415% of disposable income. To these figures, we need to add at least another SEK9trn for the value of real estate. Hence, Swedish households' net wealth is probably about eight times greater than disposable income. This is an all-time high due partly to rising asset values but also to households' savings, which are also record high at 21% of disposable income. That said, the disturbing part is the outlook for income.

Real wage growth is currently the slowest since the Millennium with the exception of the 2011 dip but now it also coincides with negative growth in hours worked. This brings the combined growth in these two factors, the real wage sum, to the weakest seen on this side of the Millennium. As long as the labour market is deteriorating, we cannot see any major change to weak income growth. We expect slowing income growth to outweigh rising wealth when it comes to the impact on consumption.

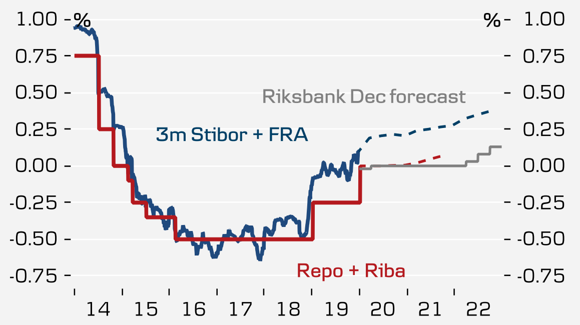
NIER's business survey and PMI manufacturing both suggest that goods exports are likely to start falling soon at a pace of around 5-10% y/y. However, overall exports are set to hold up better and growth may stabilise close to zero. The tricky part is the behaviour of imports and whether or not these can offset the decline in exports. After four quarters of positive contribution to GDP, there is a risk of a setback, i.e. net exports being a drag on GDP growth for a couple of quarters.

Overall, growth is set to slow gradually towards zero in H1 20, before resuming speed in H2 20.

Abundant signs of cooling labour market

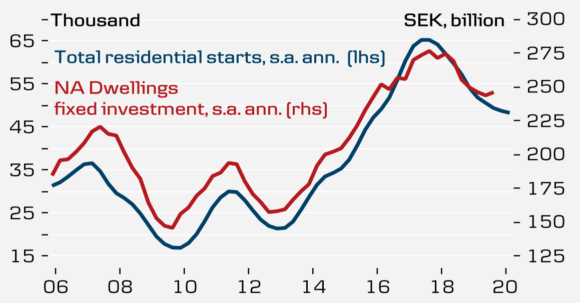
Since *Nordic Outlook – October 2019*, 1 October, it has emerged that LFS has had quality deficiencies since the middle of 2018, which has resulted in revisions. Thus, LFS no longer shows the steep rise in unemployment that we could see earlier; instead, the new figures indicate an increase in unemployment with a more balanced rise but still at a high level of unemployment rate (7.3% seasonally adjusted [s.a.] in November). However, we believe that the new LFS figures are very uncertain. Since the revision, volatility has increased significantly, mainly because the sample has been cut by half and the response rate has decline. In practice, this means that it is based on 25% of the original intended sample with an error margin of +/- 0.6. Therefore, we believe the new figures are, at best, of very low quality.

Unchanged repo rate path – zero rules for years now



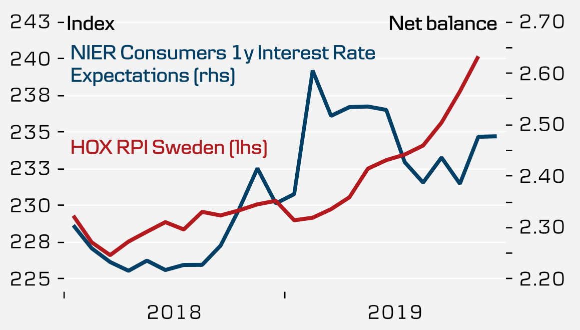
Source: Macrobond Financial, Riksbank, Danske Bank calculations

Housing set to remain a drag on GDP growth



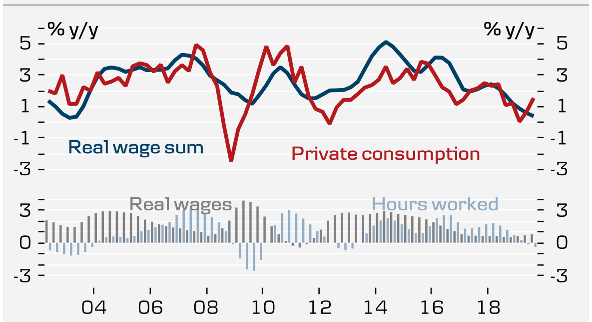
Source: SCB, Danske Bank calculations

Expected low rates (forever?) boost residential proper prices



Source: NIER, Valueguard

Underlying income growth is the weakest since 2003



Source: SCB, Danske Bank's calculations

Although uncertainty about the specific outcome has increased, the trend is still clear, our overall assessment is that the labour market continues to deteriorate and will reach 7.8% s.a. unemployment rate by the end of 2020. The supply of vacancies is reduced month on month, growth in hours worked is at the lowest level since the euro crisis and the business sector continues to indicate employment cuts. The Swedish Public Employment Service's (PES) measurement of unemployment also shows a clear rise in 2019, indicating we will continue to see a muted labour market in coming months. Contrary to rising unemployment, employment has not started to decline while hours worked remain fewer and fewer, indicating companies might still be hoping for a rise in demand. Still, vacancies have significantly fallen, giving the greatest difference ever between vacancies and employment. This gives the impression that the business sector is clutching at straws in order to retain staff, which may mean that in the near future we could also start to see a negative change in overall employment.

Data up to December suggest that the labour market has been subdued. However, the signals differ between sectors. Industrial companies continue to cut down together with personal cultural services, hotels/restaurants and retail trade, while the construction sector continues to hold up. This confirms to us, along with sub-indices from both NIER and PMI that it has generally weakened. Although we have seen nothing in the construction sector yet, we believe it is probably only a matter of time. The Riksbank's latest survey shows that companies in the construction sector also consider that their current workforce is too large in relation to demand, which we believe will result in cuts if no changes appear.

With this background, we expect the completion of a new wage round in the spring, including approximately 2.5 million employees. As it looks now, the starting position is not the best for raising wages. According to NIER's calculations, a wage increase of 3.5% would be required to reach the Riksbank's inflation target – a wage increase that we consider extremely difficult to achieve. Instead, we believe that wage increases will fall around similar levels to the latest central agreements, or slightly higher. This is probably not something that would please the Riksbank and would not be supportive for higher inflation in coming years.

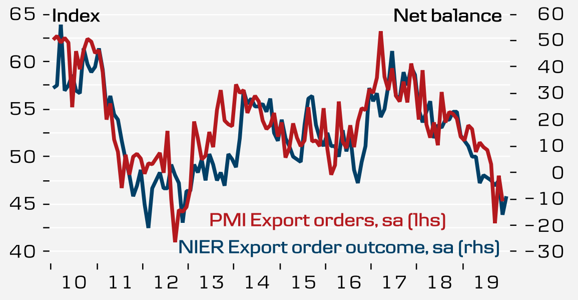
Inflation and expectations set to fall to multi-year low

There is no change to our long-standing call on inflation. In 2010, we launched an inflation model framework that has since been the workhorse in analysing the preconditions for the inflation outlook. In essence, the model says that nominal wage growth is the prime driver of inflation. Other factors, such as highly volatile SEK and energy, only occasionally affect inflation when trending. Nominal wage growth is a permanent inflation driver, while the SEK and energy are temporary, notwithstanding that these temporary factors can drag on for years.

The point is that in the absence of a strongly depreciating SEK or appreciating energy prices, wage growth is too slow to generate 2% inflation. Hence, we believe the inflation target is biased and it is **not** correct to expect inflation of 2%.

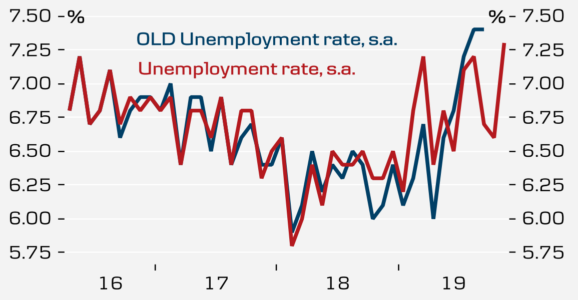
Average inflation has not changed much, whether you look at an average since 1995 or since 2010. Both CPIF and CPIF excluding energy have means below

Surveys suggest global weakness possibly a drag on GDP growth



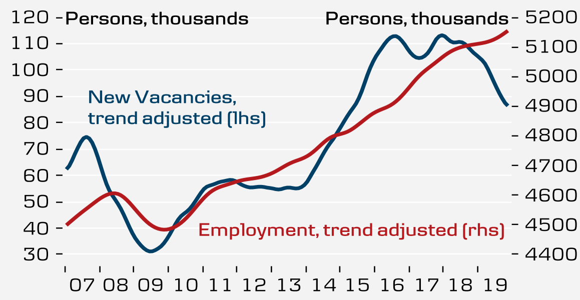
Source: NIER, Swedbank/SILF

Even the new LFS method says unemployment well above 7%



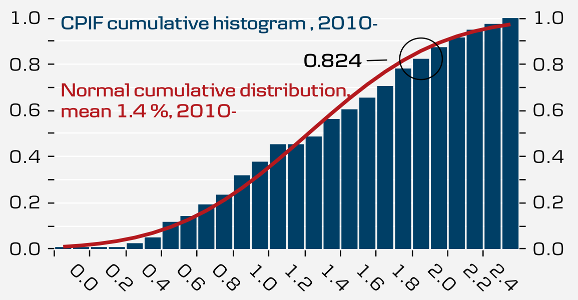
Source: SCB (LFS), Macrobond Financial

Vacancies keep falling and create the largest gap



Source: PES, SCB (LFS), Macrobond Financial

82% of actual CPIF inflation has been at or below the 2% target since 2010



Source: SCB

1.5% y/y (with low standard deviations). The cumulative distributions show that 82% and 98%, respectively, of the actual inflation prints have been **below** 2%.

A look at wage growth distribution shows that there was a quite significant shift in the mean between the 1995-2009 (3.8%) and post 2010 (2.5%) periods. A 'crisis' wage deal was struck in 2010, after which wage growth appears to have slowed permanently, in line with a decline in productivity growth. This has not been supportive in bringing inflation back to 2%.

In our view, as there are no strong reasons to believe that wage growth will shift up to a significant degree in the upcoming 2020 wage round, the task to push inflation towards 2% again falls on the SEK.

However, this is not an easy task. Historically, there has been a strong correlation between the means of year-on-year percentage changes in KIX and imported CPIF, both close to zero on average. However, since the Riksbank cut the repo rate below zero in 2014, the KIX has depreciated by 3% y/y on average, which is also very close to the mean for consumer goods prices at the producer level. Hence, SEK depreciation has been moved onto importers. As imported CPI is stuck at zero, this implies importers' margins have been squeezed, or that global export prices have fallen to a corresponding extent. Since 2014, this difference amounts to some 20% judging from the chart on the right.

Are there any reasons to expect the historical distribution to shift up? No, not really. As the Swedish and global economy is weakening, the risk is probably that the next wage round will produce an outcome at or below the post 2010 mean. Moreover, we cannot really see what would take the pressure off Swedish importers of consumer goods in terms of price competition. Swedes are used to and increasingly rely on online purchasers from global vendors.

The conclusions are that inflation is likely to undershoot the 2% target in 2020 and, given historical distributions, that the target is biased by around 0.5 percentage points. As a result, in the absence of any surge in energy prices, we believe the SEK is set to be hit again.

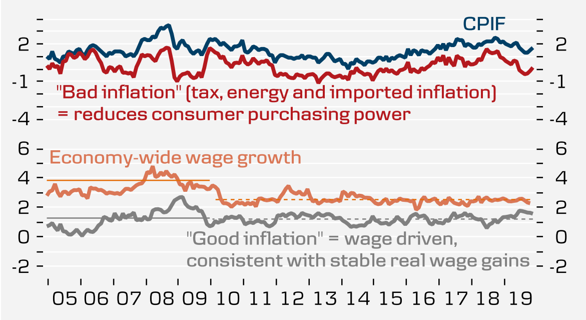
To put it simply, if there is no change to either the inflation target (lowered), wage formation (higher growth) or global consumer goods inflation (higher), then the SEK is likely to be under constant depreciation pressure.

Riksbank goes ZIRP but the term premium remains negative

The Riksbank delivered on its 'promise' to hike to zero, probably the most expected move ever, in our view. The new rate path is identical to the one in October, meaning an unchanged rate at zero through to end-Q1 22. The endpoint (Q4 22) is unchanged at 13bp (unchanged). Two board members – Per Jansson and Anna Breman – voted against.

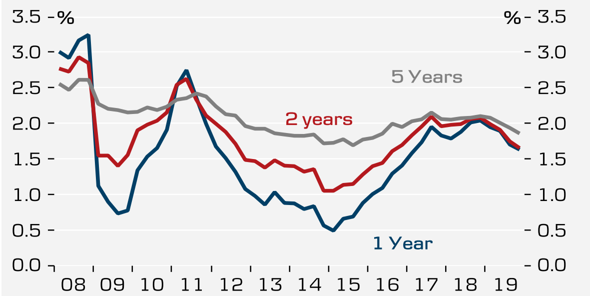
We find it hard to rationalise the hike even with the Riksbank's more optimistic take on growth, unemployment and inflation versus most other forecasters. Instead, it appears to us as though the Riksbank's real justification is a concern that Swedish banks are about to introduce negative rates on deposits for retail clients, which, together with the risk of negative mortgage rates, could lead to 'negative effects'. If this happened, it would be an awkward situation. However, we find it hard to believe that we have been close to such a situation. Nonetheless,

Wage growth is too slow and the weaker SEK impact i waning



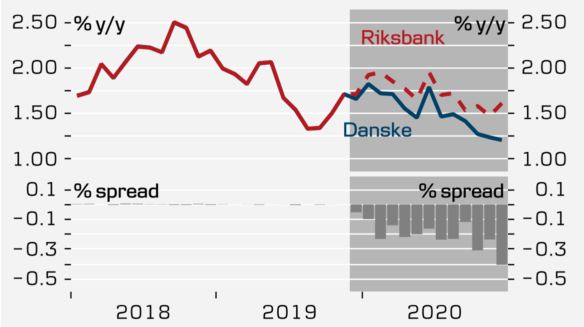
Source: SCB, Mediation Office, Danske Bank calculations

Prospera inflation expectations grinding lower



Source: Prospera

CPIF inflation will remain well below target in 2020



Source: SCB, Riksbank, Danske Bank

it appears as though the Riksbank has taken a step back from 'inflation-nutting' towards something similar to 'leaning against the wind'. Anyway, we believe it would be detrimental to the credibility of the Riksbank's inflation target. This is just what Deputy Governor Per Jansson has been concerned about, pointing to the years when deflation fears surfaced.

As we have a more pessimistic outlook than the Riksbank, we retain the view that the risk is that it may have to take back the hike. Surprisingly, the Riksbank did not signal any concern about the recent 5% appreciation of the SEK, the second biggest in the past five years. However, we would be cautious about interpreting this as the Riksbank being comfortable with such a development, as it could easily derail the inflation forecast.

In trying to judge the stance of monetary policy, we look at the so-called natural interest rate, R star. In theory, this is the equilibrium real repo rate associated with an economy in balance and should be determined by potential GDP growth and other hard to catch factors such as demographics and savings/investment behaviour. In practice, these factors are likely to be global rather than domestic Swedish factors. Actually, it turns out that the Riksbank's real repo rate correlates strongly with estimates of the US natural interest rate. However, the chart above right suggests that the Swedish natural rate started to diverge in 2014 when Riksbank went NIRP and it launched the QE programme. Is this a coincidence or have the Riksbank's actions affected R star?

Estimates seem to suggest that the natural interest rate is lower in Swedish than in both the US and the eurozone, around -2% or perhaps slightly higher. Such estimates of an unobserved variable must be taken with a big pinch of salt. However, Swedish linkers of different maturities trade close to this level, giving some support for this idea. Most forecasters today, including us and the Riksbank, expect the real repo rate to stay in the -1.5 to -2% range over coming years.

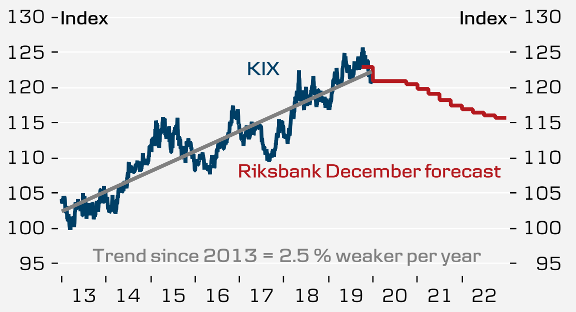
Adding the Riksbank's inflation target to this number leads us to conclude that the Swedish *nominal* natural interest could be close to zero, i.e. exactly where the Riksbank is currently. Unless the natural rate shifts up, this would mean that Swedish monetary policy is close to neutral despite the obvious perception that zero is indeed a low number.

Another, possibly related issue is that bond/swap term premiums are sharply negative. Part of this may be related to NIRP policies but it seems more 'logical' to point to very large QE programmes as a more plausible explanation. Indeed, flatter curves have been one objective of central banks. However, that term premiums remain negative (note even in the US) is not only a problem for bond investors, as it continues to underpin risk taking and boosts risky assets. It remains to be seen how the Riksbank will handle its QE programme. Currently, it plans to keep the size of the portfolio intact up to summer 2020. After this, it needs to take a new decision.

An outdated fiscal rule

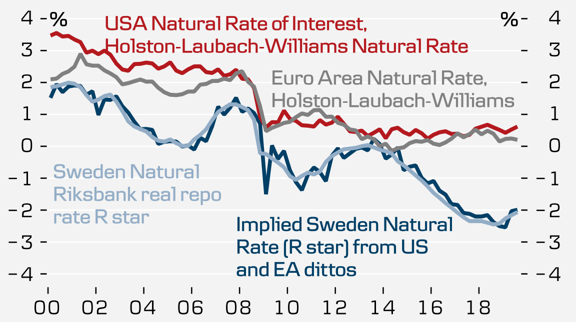
Sweden has, in an international comparison, an extremely beneficial position for fiscal policy. In 2019, a new 35% debt anchor, which applies to the Maastricht (public sector) debt, was introduced and, very importantly, also attained. The framework stipulates that not until actual debt deviates by 5 percentage points from the target does something need to be done. The problem is that the anchor

SEK likely to continue weakening with no change in fundamentals



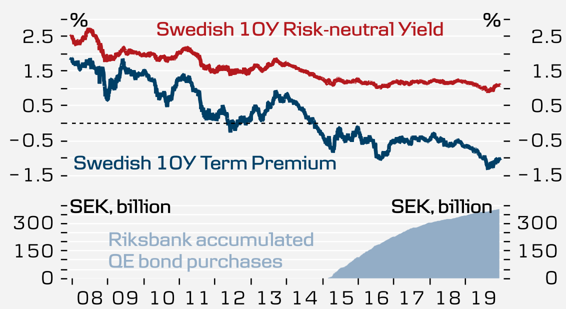
Source: Riksbank, Danske Bank

Is Riksbank's natural rate lower than Feds and ECB's?



Source: New York Fed, Riksbank, Danske Bank

Negative term premiums as Riksbank started QE



Source: Riksbank, Danske Bank

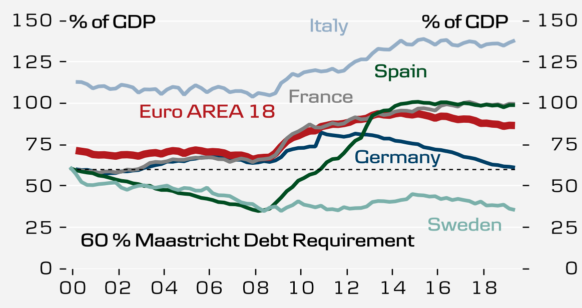
plays the second fiddle. The government, as well as, in principle, all political parties, is still sticking to a public sector 0.3% of GDP surplus target as the main objective. This leads to a gradual undershooting of the 35% debt anchor. In our view, it might be better to aim at keeping the 35% ratio intact and plan for a budget that is compatible with this.

The Swedish Association of Local Authorities and Regions (SALAR) recently said that despite serious efforts to make cost reductions and increase efficiency many municipalities will not be able to keep their budgets in balance, so are planning for tax hikes. The problem is that the dependency ratio is rising as Sweden enters a slowdown: the resources needed to keep welfare intact are increasing more quickly than tax revenues. The government's 2020 budget bill presented in September does not include transfers sufficient to cover projected deficits in coming years.

The strange thing is that government does not seem to take into account the current unique and very favourable borrowing conditions that are available. Negative bond yields and term premiums are the opposite of the conditions plaguing investors. It is an enigma why this opportunity is not being used better, as the government is paid to issue bonds. Furthermore, there is no strong reason why there should be a bigger buffer for, say, financial instability. Historically, financial crises have been considerably more costly than ordinary crises, so this is indeed a valid argument. However, Swedish banks are currently more regulated than ever before, so, in our view, this risk should be quite limited.

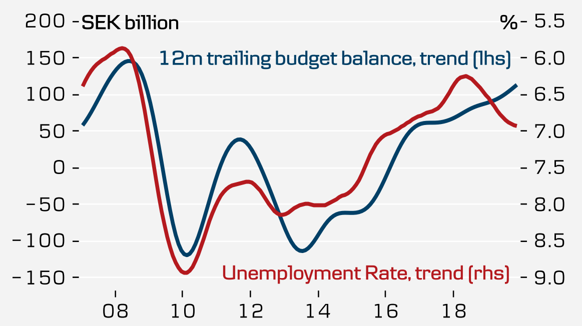
Looking ahead to 2020, we expect a rising government budget deficit along historical patterns as automatic stabilisers start to work. As we have a slightly more pessimistic view of the economic outlook and unemployment than the Debt Office, there is a risk that bond issuance may be higher than planned. Note also that the Riksbank's repo rate hike has made the 0% interest rate on the tax account less competitive and could lead to significant outflows, which could increase bond issuance.

Maastricht debt comparison



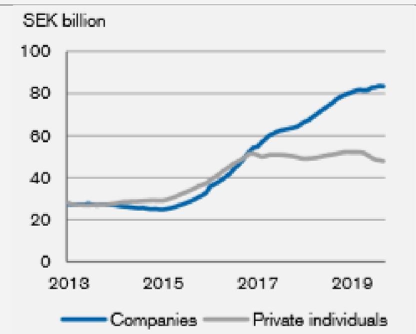
Source: Macrobond Financial

Automatic stabilisers set to push government budget into deficit in 2020



Source: Debt Office, SCB

Risk of tax account outflows following Riksbank repo rate hike



Source: Debt Office

At a glance

National account	2018	2018	2019	2020	2021
			Forecast		
	SEK bn (current prices)		% y/y		
Private consumption	2178.9	1.7	0.9	1.8	1.7
Government consumption	1263.9	0.4	0.5	1.2	1.2
Gross fixed investment	1232.8	4.2	-1.3	-1.5	0.9
Growth contribution from inventories	29.9	0.4	-0.3	-0.3	0.0
Domestic demand	4705.6	2.0	0.2	0.8	1.3
Exports	2318.2	3.2	4.7	3.1	2.8
Aggregate demand	7023.8	2.6	1.4	1.3	1.8
Imports	2138.0	3.6	2.2	2.2	2.5
Growth contribution from net exports	150.9	-0.1	1.2	0.5	0.2
GDP	4885.7	2.2	1.1	0.9	1.5
GDP, calendar adjusted	4892.3	2.3	1.1	0.7	1.5

Economic indicators	2018	2019	2020	2021
Trade balance, SEK bn	120.88	180.2	205.7	246.8
- % of GDP	2.5	3.7	4.2	4.9
Current Account, SEK bn	128.6	234.1	256.6	261.1
- % of GDP	2.7	4.8	5.2	5.2
Public sector savings, SEK bn	43.0	4.8	-24.7	-30.0
- % of GDP	0.7	0.1	-0.5	-0.6
Public debt ratio, % of GDP*	39.0	35.0	34.0	33.0
Unemployment, % of labour force	6.3	6.9	7.8	8.0
Hourly wages, % y/y	2.6	2.6	2.4	2.4
Consumer prices, % y/y	2.0	1.8	1.5	1.2
House prices, % y/y	-2.9	2.0	2.0	3.0

* Maastricht definition

Financial figures	02/01/2020	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	-0.25	0.00	0.00	0.00
2-yr swap yield, % p.a.	0.23	0.20	0.20	0.20
10-yr swap yield, % p.a.	0.72	0.70	0.80	1.00
EUR/SEK	10.46	10.60	10.80	10.80
USD/SEK	9.33	9.55	9.56	9.39

Source: Danske Bank

Norway

Weaker outlook on capacity limits

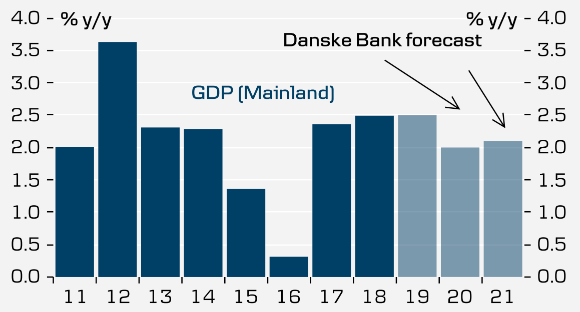
- **Growth has disappointed but remains above trend and there is the prospect of lower growth next year.**
- **The slowdown is broad based but the weakness in retail trade is more pronounced and the abrupt halt in construction took us by surprise.**
- **Unemployment has bottomed out and employment growth has peaked.**
- **However, wage growth seems to be picking up and may actually be higher than we previously expected.**
- **Inflation has slowed as expected.**
- **Norges Bank kept rates at 1.50% in December and appears to be on hold for a time. We still expect a rate hike in 2020.**
- **The NOK has weakened since we published *Nordic Outlook*, 1 October, mainly on higher global risk. As risk has turned, we expect the NOK to strengthen in 2020.**

At a glance

Norway	Current forecast			Previous forecast	
% y/y	2019	2020	2021	2019	2020
GDP (mainland)	2.5	2.0	2.1	2.6	2.2
Private consumption	1.7	2.0	2.2	2.0	2.4
Public consumption	2.2	1.7	2.0	2.0	1.7
Gross fixed investment	5.0	3.0	1.3	4.8	3.0
Exports	1.8	6.0	3.4	3.0	4.0
Imports	5.0	2.5	2.5	3.5	2.5
Unemployment (NAV)	2.3	2.3	2.2	2.3	2.2
Inflation	2.3	2.2	2.0	2.2	2.2

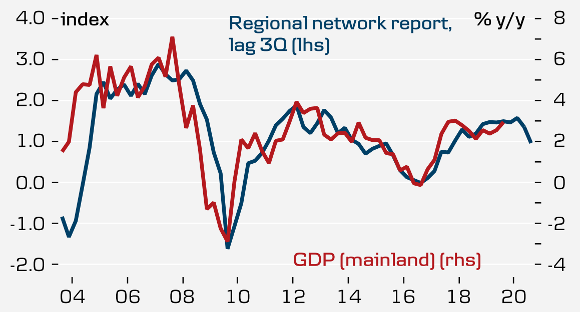
Source: Danske Bank

Only minor tweaks to our growth forecasts



Source: Macrobond Financial, Danske Bank

GDP growth likely to slow towards trend



Source: Macrobond Financial, Danske Bank

Growth is stalling but pressure remains

There have been clear signs of slower growth since *Nordic Outlook*, 1 October. The GDP figures indicate that mainland GDP has moved more or less sideways for three months and the regional survey from Norges Bank signals annual growth will move below 2% in the first half of 2020. Albeit still above trend, this is a bit lower than we expected in October. Hence, we believe unemployment will probably stabilise, wage growth will peak and core inflation will remain under control.

However, the pressure in the labour market still appears to be strong. The UV ratio – the number of unemployed per vacancy –is still close to the all-time low at 1.10. Wage growth has also accelerated more than we expected at the time of our September forecast but wage expectations remain moderate. Core inflation has slowed as we expected but is still above the 2% target. In our view, stronger wage growth and a weaker NOK will probably push inflation up again in the first half of 2020.

Norges Bank kept its policy rate at 1.5% in December and signalled that interest rates are likely to stay unchanged for a time. We still expect a rate hike in 2020, most likely in June.

Abrupt halt in construction due to capacity problems

Growth in the Norwegian economy has apparently held up well since September. Mainland GDP grew 0.7% q/q in the third quarter, taking annual growth to 2.9%. Strong increases in oil investment and business investment were the main drivers. There were moderate increases in housing investment but private consumption disappointed. However, these figures mask a significant slowdown on a monthly basis following strong July figures. In the period from August to October, mainland GDP moved more or less sideways, indicating a clear slowdown towards year-end.

More importantly, Norges Bank's latest regional network survey indicates that growth will slow to around 1.9% over the next six months, i.e. the first half of 2020. This is significantly lower than indicated in the previous survey but still around trend growth (1.75-2.0%).

The slowdown is broad based, as all sectors except the export-oriented oil sector have lowered their growth prospects since August. We had expected slower growth in oil-related sectors, as growth in oil investments on the Norwegian shelf are peaking. The weaker outlook for the retail trade was no surprise, neither was the mild slowdown in the service (to business) sector. However, the abrupt halt in the construction sector took us completely by surprise.

Actually, close to half of the decline in expected growth from 2.7% in August to 1.9% in November was due to a weaker outlook for the construction sector. Interestingly, the respondents partly blame the postponement of several, rather large public infrastructure projects for the more negative outlook. Even more interestingly, the postponements seem to be due to lack of skilled workers, especially project managers. These details raise the suspicion that capacity constraints rather than lack of demand have caused much of the sudden stop in the construction sector. The big uncertainty for our forecasts is whether these projects restart later in 2020 or are postponed even further. In this document, we assume there will be no effect from these projects in 2020.

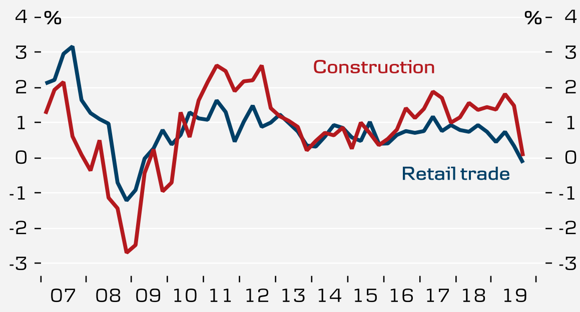
The increase in the number of respondents reporting that a shortage of labour is constraining growth to 24.5% in November, the highest since May 2013, confirms our impression that the economy is increasingly suffering from capacity constraints.

As mentioned, we have seen a slowdown in oil-related sectors, as growth in oil investments has peaked. However, we still expect oil investments to increase in 2020 and see limited risk for a more pronounced slowdown in this sector.

In the latest investment survey, the oil companies estimated investment of NOK182.9 bn in 2019, which is NOK1.2bn more than in the previous survey. The survey still suggests investment growth of almost 20% this year but we expect something more like 15% in reality given the rise in capacity utilisation. The oil companies' estimate for 2020 is now 4% higher than the estimate for 2019 at the same point in 2018. We tentatively forecast that oil investment could rise another 3% in 2020. The big risk is the level of oil investments in 2021, as some larger projects are finished and we do not expect the start-up of some new larger projects until 2022. A careful approach suggests oil investments will fall 4% in 2021.

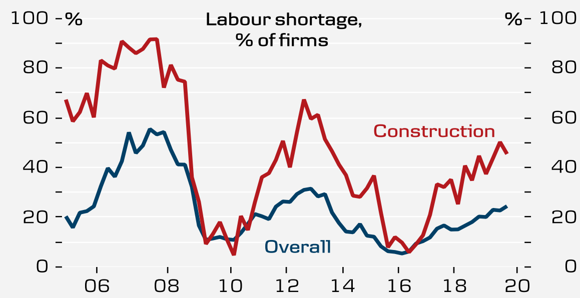
Looking through the monthly volatility, it appears to us that the underlying trend in retail sales has picked up again since the spring. Stronger wage growth, lower inflation due to lower power prices and solid growth in employment mean that household income is absorbing higher interest costs relatively well. We have also seen a rise in consumer confidence recently and fears of a housing crash appear to be receding. Therefore, we do not expect any major increase in the savings rate and we expect spending to rise with income, i.e. by around 2.0-2.5%.

Sharp slowdown in domestic sectors



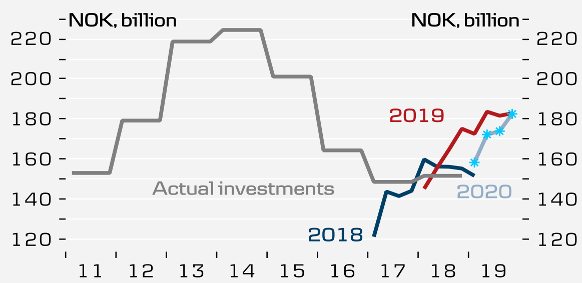
Source: Macrobond Financial, Danske Bank

Capacity problems in the construction sector



Source: Macrobond Financial, Danske Bank

Oil investments to increase in 2020



Source: Macrobond Financial, Danske Bank

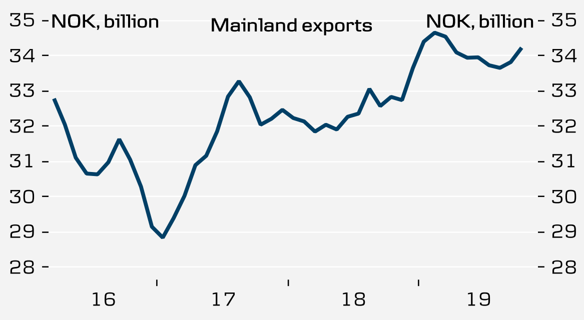
We expect private investment growth to continue but at a slower pace. We expect high capacity utilisation, favourable credit conditions and continued focus on digitalisation to support investment but currently business investments are 11% of GDP, close to an all-time high. The regional network survey also shows that firms still expect strong investment growth and their expectations are actually slightly higher than in the previous survey.

As mentioned, some large public infrastructure projects have been postponed and we have no information on the time schedule for restarts. As a result, we now expect investment in the construction sector to be considerably lower than previous expectations.

Following a slowdown over the summer, mainland exports now seem to be picking up again. This could confirm our impression that the global cycle has stabilised or even improved and the NOK weakening could be reinforcing this effect. The regional network also pointed to a stabilisation in export growth ahead.

Overall, we have revised down our growth forecast for 2020, due mainly to the weaker outlook for the construction sector. We now expect mainland GDP growth of 2.5% in 2019 and revise down our estimate for 2020 to 2.0%, which should be around trend growth. We expect growth in 2021 to pick up marginally to 2.1% despite a decline in oil investments, based on stronger growth in construction.

Mainland exports have turned around



Source: Macrobond Financial, Danske Bank

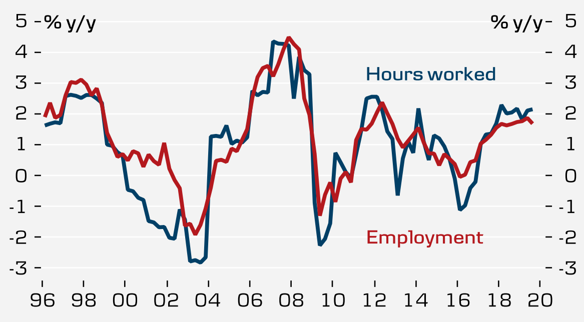
Labour market still relatively tight

Unemployment seems to have started bottoming out after falling almost continually for three years. The registered unemployment rate in December was 2.2%, unchanged from April.

Meanwhile, only 24.5% of firms in the regional network reported labour shortages as a constraint on production, which is the highest since May 2013. This is at odds with reports of slower growth in the past three months and supports our view that the slowdown is due partly to capacity constraints, in this case labour. Bear in mind that the details conceal major variations between industries: more than 55% of firms in oil-related industries and 45% of those in the construction sector are having recruitment problems, while the figure is only 1.3% in the retail trade.

This is supported by hours worked still increasing more rapidly than employment, which implies that average working hours are on the up. This could be a result of companies struggling to recruit the necessary amount of skilled labour, 'forcing' the existing stock of labour to put in extra hours to meet demand.

Increasing working hours



Source: Macrobond Financial, Danske Bank

Wage growth picking up further

The clearest sign that the labour market is continuing to tighten is what is happening to wages. The LO (Trades Union Congress) and the NHO (Confederation of Norwegian Enterprise) agreed on a pay target this year of 3.2% but this assumes lower wage drift than in 2018, which we find ambitious given a tighter labour market and slightly improved profitability in the business sector.

This is supported by Statistics Norway's quarterly data showing wage growth of 3.5% y/y in Q3. This is the highest since 2013 and confirms other indications that the labour market was about as tight in the first half of this year as it was in 2013. In addition, including variable factors such as bonuses and so on, wage growth was actually 3.8% y/y in Q3. Therefore, we revise up our wage growth forecast for 2019 marginally to 3.5% but lower our forecast for 2020 to 3.5%.

Inflation has been more or less as expected since we published *Nordic Outlook*, 1 October, with the core rate slowing to 2.0% y/y in November.

We expect inflation to head up into 2020. Higher capacity utilisation and lower unemployment are set to continue keeping wage growth elevated. Therefore, we expect domestic inflation to be in the range of 2.75-3.00%. With the NOK clearly weaker than we had expected, imported inflation looks likely to climb a fair way in the coming months.

Overall, we expect core inflation of 2.3% in 2020, and 2.1% in 2021 if the NOK strengthens as we expect.

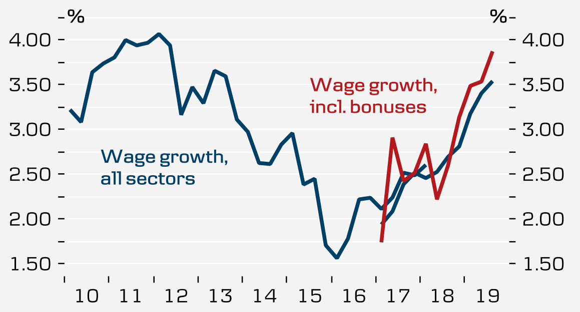
Housing market still nicely balanced

After levelling off towards the end of 2018, housing prices have picked up again in 2019. There are still plenty of properties in the market, driven by strong growth in housing starts over the past two to three years. However, demand has been strong enough to absorb this supply and the stock-to-sales ratio has not risen appreciably. Therefore, it seems to us that the risk of a collapse in the housing market hitting the economy has decreased considerably in recent months. In Oslo, there are actually signs of a decline in the stock-to-sales ratio, which could bring a risk of housing prices turning out stronger than expected.

Pulling in the other direction, however, are the past year's interest rate increases. There is also the new debt register, which could mean that some borrowers face greater restrictions.

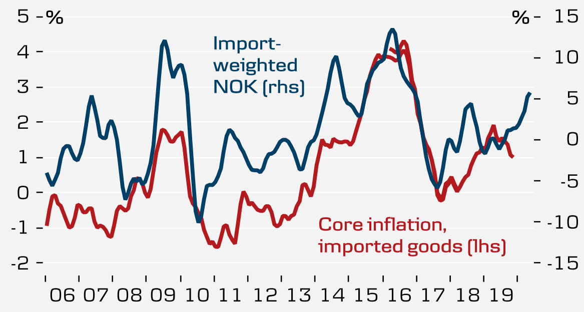
Therefore, we expect housing prices to continue rising moderately in 2020 and 2021, which should continue to push real house prices (deflated by wages) downwards. We still do not see any great risk of a serious downturn in the housing market, unless interest rates rise much further than we expect.

Wage growth slightly stronger than expected



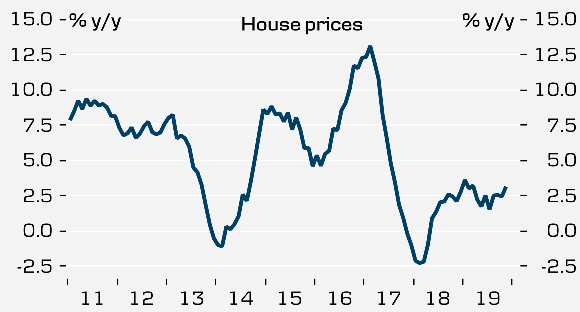
Source: Macrobond Financial, Danske Bank

NOK depreciation in 2019 set to raise imported inflation



Source: Macrobond Financial, Danske Bank

Moderate price growth in the house market



Source: Macrobond Financial, Danske Bank

Norges Bank on hold for a long time

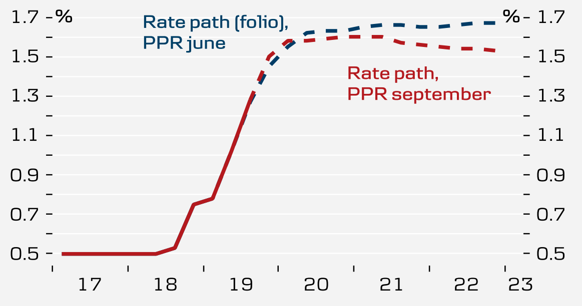
As widely expected, Norges Bank kept policy rates unchanged at 1.50% at the December-meeting. It adjusted the rate path downward marginally in the short end to reduce the possibility of a hike in H1 20 but adjusted it marginally higher in the long end. We believe the intention is to be on hold in the near term but Norges Bank kept the tightening bias and was a little bit more hawkish than we had expected.

The executive board concluded that '*the Executive Board's current assessment of the outlook and balance of risks suggests that the policy rate will most likely remain at this level in the coming period*'. The rate path implies a 40% probability of a rate hike in 2020. The long end of the rate path was adjusted marginally higher to 1.55% (from 1.53%).

According to Norges Bank, the NOK has been weaker than expected, oil prices have been slightly higher, global interest rates have been higher and global growth prospects brighter – all of which points to an upward revision of the policy rate path. However, growth in the domestic economy seems to have been weaker than expected and is set to slow as expected.

We share most of the views presented in the MPR but we are a bit more optimistic about the global outlook and suspect the slowdown domestically is due partly to capacity problems. Hence, we still expect Norges Bank to hike rates by 25bp to 1.75% in 2020 but we now expect this to happen in June rather than in March, as previously expected.

Norges Bank sticking to plan



Source: Macrobond Financial, Danske Bank

Currency markets dominated by global risks

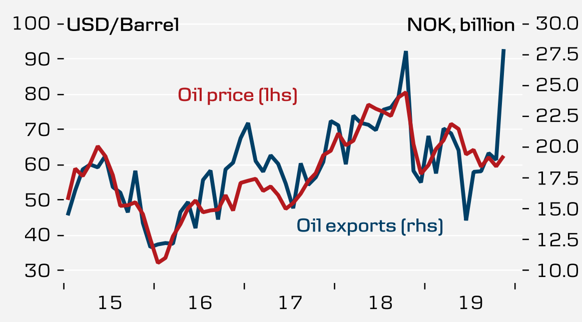
Once again, the NOK has been much weaker than we expected. We have seen signs of a reduced appetite for cyclical risk in global financial markets undermining the NOK.

However, we currently expect a moderate pickup in global growth and reduced downside political risks. We expect this to be supportive for the NOK into 2020 and believe higher rates will support this by if our call for a rate hike in June proves right.

Our oil analysts expect the price of oil to hold around the current level in 2020, together with the prospect of a significant pickup in oil production and exports as the Johan Sverdrup field achieves full production. This would contribute to a major improvement in the trade balance in 2020 compared with 2019.

Therefore, we forecast an exchange rate of 9.90 to the euro in three months and 9.80 in a year.

Trade surplus to improve on higher oil production



Source: Macrobond Financial, Danske Bank

At a glance

			Forecast		
National account	**2018**	**2018**	**2019**	**2020**	**2021**
	NOK bn (current prices)	% y/y			
Private consumption	1533.6	2.3	1.7	2.0	2.2
Public consumption	826.8	2.5	2.2	1.7	2.0
Gross fixed investment	851.5	3.6	5.0	3.0	1.3
Petroleum activities	154.1	-3.8	15.0	3.0	-4.0
Mainland Norway	697.2	7.0	3.7	1.3	1.8
Dwellings	193.5	7.0	1.0	2.0	2.3
Enterprises	311.0	9.3	5.5	2.0	1.5
General government	192.7	3.6	3.0	1.0	1.5
Mainland demand	3057.5	3.3	2.3	2.0	2.0
Growth contribution from stockbuilding		0.1	0.0	0.0	0.0
Exports	1357.3	-0.2	1.8	6.0	3.4
Crude oil and natural gas	569.4	1.5	-4.5	11.0	3.5
Traditional goods	681.8	1.7	4.8	3.5	3.0
Imports	1152.2	1.6	5.0	2.5	2.5
Traditional goods	681.8	2.7	5.3	2.3	2.4
GDP	3530.9	2.0	1.3	3.3	2.2
GDP Mainland Norway	2906.9	2.0	2.5	2.0	2.1

Economic indicators	**2018**	**2019**	**2020**	**2021**
Employment, % y/y	1.1	1.7	1.0	1.0
Unemployment (NAV), %	2.7	2.3	2.3	2.2
Annual wages, % y/y	2.3	3.5	3.5	3.3
Consumer prices, % y/y	1.9	2.3	2.2	2.0
House prices, % y/y	5.0	2.3	2.0	2.5
Core inflation	1.4	2.3	2.3	2.1

Financial figures	**02/01/2020**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	1.50	1.50	1.50	1.75
2-yr swap yield, % p.a.	1.99	2.05	2.10	2.20
10-yr swap yield, % p.a.	2.08	2.05	2.15	2.45
EUR/NOK	9.84	9.90	9.80	9.80
USD/NOK	8.78	8.92	8.67	8.52

Source:' Danske Bank

Finland

Structural barriers ahead

- **The Finnish economy surprised positively in Q3 19 with the help of a surge in private consumption. We have made an upward correction to our forecast. However, the revision does not change the projected growth path and we still expect slower growth this year.**
- **Business surveys indicate subdued growth going forward and the near-term outlook for both exports and investments remains weak. Exports are expected to pick up again in 2021, when global demand improves.**
- **Consumer confidence continued to deteriorate in autumn 2019 but the purchasing power of households will grow during the forecast period driven by rising wages and low inflation. We expect private consumption to be the main growth driver in 2020.**
- **The labour market is stable, but unemployment is close to structural levels and further improvement in employment faces headwinds.**
- **The Finnish housing market is stable but the market is strongly divided geographically. Construction is cooling down in 2020, but activity remains high in growth centres.**
- **The public deficit looks larger and local government finances in particular have been hit by lower tax income and increasing ageing-related expenditure. The new government led by PM Sanna Marin is running an expansionary fiscal policy. The debt-to-GDP ratio, which has improved in the past three years, is likely to resume a rising trend. Sovereign credit ratings are likely to remain unchanged in 2020.**

At a glance

Finland					
	Current forecast			Previous forecast	
% y/y	2019	2020	2021	2019	2020
GDP	1.5	1.0	1.4	1.2	0.8
Private consumption	1.2	1.5	1.2	0.8	1.0
Public consumption	1.5	1.5	1.0	1.5	1.5
Gross fixed investment	0.6	0.6	2.0	0.5	0.6
Exports	4.5	1.7	3.0	3.5	1.5
Imports	3.2	2.2	2.5	2.0	2.0
Unemployment rate	6.7	6.7	6.5	6.6	6.6
Inflation	1.0	1.2	1.5	1.1	1.4
Government balance, % of GDP	-1.2	-1.3	-1.2	-0.4	-0.4
Current account, % of GDP	-0.6	-0.6	-0.6	-0.8	-0.8

Source: Danske Bank

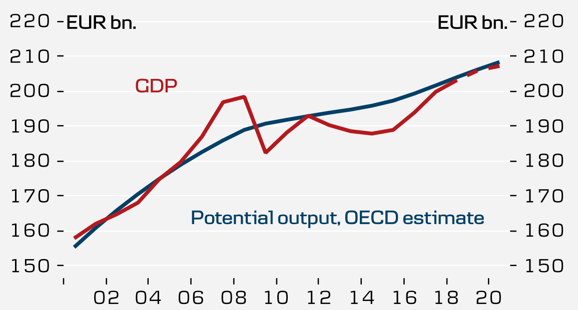
So far so good

In Finland, the growth of the economy has surprised positively in 2019 and we have revised our forecast accordingly. However, brisk growth in Q3 19 has not changed the overall economic outlook. We still think that the Finnish economy is gradually slowing down after an expansionary period. The fastest boom year was 2017, when the economy expanded 3.1%. In 2018, the growth slowed down to 1.7%. It now seems that nearly the same pace continued last year. In our revised forecast, we estimate that Finnish GDP grew by 1.5% in 2019 (was 1.2%).

We are still expecting a slowdown in the near term due to the weak export demand and fading construction boom. In 2020, we expect growth to be 1.0% (was 0.8%). During the end of the forecast period, in 2021, the growth is expected to pick up again with the help of improved global demand and settle at 1.4%.

In Q3 19, quarterly GDP grew at the rate of 0.7% q/q. This is slightly faster than we anticipated. The main driver was private consumption that accelerated to 1.5% q/q. Fast growth is partly explained by tax refunds that were mostly paid in Q3 this year. Going forward, both private and public consumption continues to support the economy. However, we should not get too optimistic despite robust growth so far, since business surveys indicate a relatively weak outlook for next year. Economic sentiment has cooled noticeably for both consumers and businesses, especially in export industries. We have to note that Statistics Finland has decided that two exceptionally large investments in intellectual property products, which were

Output gap has been closed



Source: Macrobond Financial, Statistics Finland included in the strong Q3 figures, are going to be revised away. Therefore, the final estimate for Q3 GDP is likely to be less strong.

However, there is nothing too alarming on the horizon either. Overall, the economy is still performing reasonably well. Leading indicators have declined, but they are still close to long-term average levels. In 2020, consumption demand should continue to be the steady but slow engine for the economy, while investment and exports are expected be weaker. In the short run, the largest domestic risks come from the on-going wage negotiations and related strikes that threaten export industries. Otherwise, domestic risks are modest and the largest risks are still to be found in external factors such as the trade war despite recent progress in the external risk outlook.

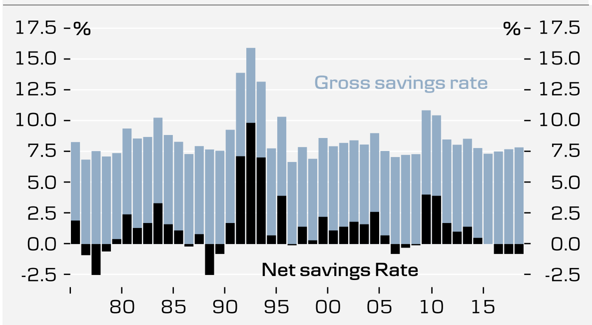
The output gap of the Finnish economy has been closed and the period of rapid cyclical recovery is over. The current unemployment rate is close to, or even below, the estimated structural rate or NAIRU. Finland lost potential output from the demise of Nokia´s mobile phone business and structural change in the forest industry. Forest industry companies have announced the closure of two paper mills in 2019, which reflects the ongoing structural change. New large-scale investment projects are on the horizon, but they will take some time.

In 2020, growth in GDP is likely to rely increasingly on domestic factors, especially private consumption. In our opinion, the risks are fairly balanced. Growth could easily turn out to be slightly faster, but downside risks have potential for larger upsets. In the future, consistently maintaining growth above 1.5% will become increasingly difficult due to demographics. The working age population is shrinking. Improving growth potential depends on investments in productivity and structural labour market policies. The possibility of increased tax deductions for corporate investment expenditure, as planned by the government, may speed up some investment plans but the effect is unlikely to be very large.

Consumers support the economy

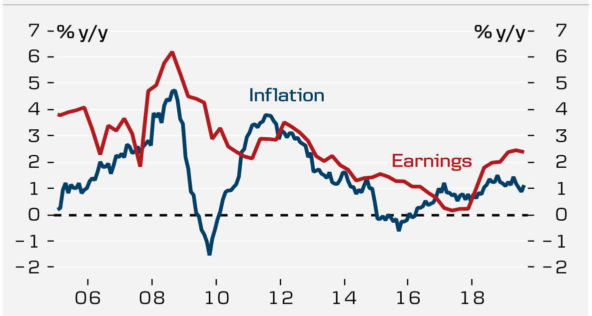
The next round of wage increases is still being negotiated, but it seems likely that real wages will increase given the persistently low inflation. Rising wages continue to support households. On the other hand, nearly non-existent employment growth implies less of a boost for purchasing power and consumption in 2020 and 2021. The unemployment rate is low and there has not been a further decrease since last January. Consumer confidence has decreased in recent months regarding both the general macroeconomic outlook and personal finances and employment security for households. However, objectively speaking households are still doing fine. In addition to wage growth, households are getting support from low interest rates that help to keep the interest rate burden low despite historically high rate of household indebtedness.

Household savings rate set to rebound



Source: Macrobond Financial data, Statistics Finland

Solid real earnings growth



Source: Macrobond Financial, Danske Bank

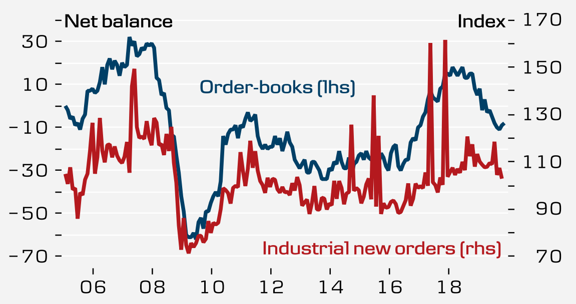
The Fin-FSA has been worried about growing household debt in recent years. Payment difficulties have indeed increased but they are mostly related to payday loans and affect only a relatively small minority. More generally, we believe that the risks in household sector finances are moderate. The net savings rate was negative in Finland for three consecutive years but it returned back to positive territory in 2019. A reversal in the decreasing savings rate was welcome, even though household debt is not exceptionally high when compared with other Nordic countries. In theory, exposure to rising rates could become a more significant factor given that in Finland most loans for households link to variable Euribor rates. However, during the forecast horizon this type of risk does not seem relevant.

In 2020, we expect private consumption to follow the development in earnings and continue to support the Finnish economy, although we cannot rule out a further rise in the savings rate. Domestic demand is important, but wage increases staying modest would help to maintain manufacturing industry price competitiveness in tough export markets.

Exports face headwinds

Finnish exports seem to have had a fairly good year in 2019 compared with some other European countries. The structure of Finnish export industries, with a relatively large share of investment goods and long-term projects like passenger ships, has been robust against the general industrial weakness in the euro area. Finland entered the on-going difficult period of European manufacturing industries with exceptionally healthy order books and that has provided support, at least so far. However, global trade continues to be weak and it will gradually begin to have a larger impact in the future. In 2019, some unusually large items, such as two large cruise ships being delivered, gave a boost to exports.

Industrial orders past their peak



Source: Macrobond Financial, Danske Bank

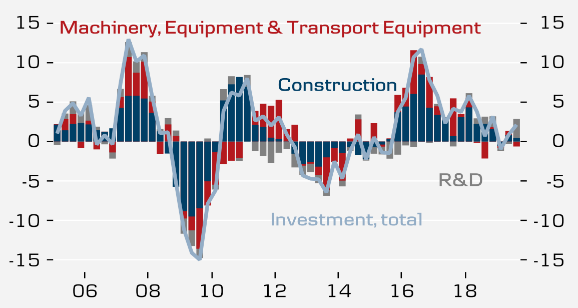
The volume of exports increased by 4.8% in Q1-Q3 19. At the same time, the volume of imports increased 3.4%. Thus, net exports are expected to once again have some positive impact on GDP in 2019 after a weak period in 2018. Service exports in particular have been booming, with ICT service rates growing in double digits. Customs statistics from October 2019 indicate that the value of Finnish goods exported has increased by 2.2% ytd, while the value of imports has declined by 0.9%. Export growth has been much faster to non-EU countries. Finland's main export markets in the EU, such as Germany and Sweden, remain weak going forward.

Finnish export industries continue to benefit from improved price competitiveness. However, new industrial orders saw some decline in 2019. In the autumn, capacity utilisation also dropped. We expect net exports to play a slightly negative role for growth in 2020. Service exports have more potential given the fast rise in ICT service exports but their magnitude is difficult to estimate. In total, we expect the volume of exports to have risen by 4.5% in 2019, but to slow down to 1.7% in 2020. In 2021, we expect exports to pick up again, while the slowdown in the euro area is improving. In 2021, we anticipate the growth in exports will be 3.0%. The main risks are a more pronounced slowdown in the euro area growth or an unfavourable development in the trade war.

Cautious investment outlook

Industrial investment remained sluggish in Q1-Q3 19. The weak global outlook has probably contributed to the slowdown and the decreasing capacity utilization rate implies that difficulties are not over. Investment activity has been relatively weak for many years. Surveys for both larger and SME companies still show interest in investment projects but uncertainty about the economic outlook continues to be high, making it attractive to postpone investment projects. The largest recent industrial investment project seems to have been the EUR600m data centre Google is planning in Hamina.

Investment activity



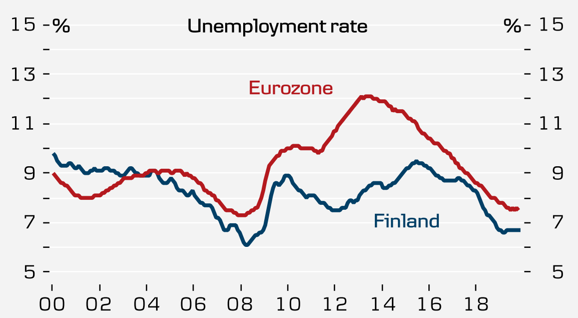
Source: Macrobond Financial data, Statistics Finland

We still expect industrial capex to improve at a modest pace in 2020 but speed up a little in 2021 when global growth improves. There are several substantial and promising investment projects under consideration in the forestry sector. However, it will take time before any of these still uncertain projects are launched and the investment decisions hang in part on the new government's decision on to what extent forest resources can be tapped, while still maintaining ambitious environmental goals. Forests are growing more than the total felling but forest net growth could potentially play a big role in climate change policy as a significant carbon sink.

The housing boom was one of the main drivers of recovery in the Finnish economy in 2015-18. A gradual slowdown in construction has been going on for quite some time and we expect it to continue in 2020 before an improvement towards the end of the forecast period. The number of new housing permits dropped significantly in 2018. More recently, new starts and the number of finished apartments have started to decline. However, the level of ongoing housing construction is still high, giving rise to strong supply of apartments in growth centres, especially the Helsinki region. The number of unsold apartments has not risen much so far, indicating that demand has also held up. Construction companies are being cautious in the near term but the caution will probably lead to only a minor slowdown, because growth of the urban population is still creating consistent demand for new housing. The new government intends to spend more on infrastructure, which should stimulate construction in 2020-23. In total, we expect fixed investment to grow by only 0.6% in both 2019 and 2020. For 2021, we expect a slightly faster pace of 2% driven by both industrial capex and construction.

Labour market enters tough negotiations

Unemployment rate has reached structural barriers

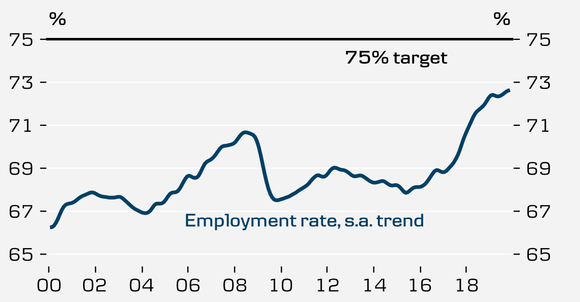


Source: Macrobond Financial, Statistics Finland, Danske Bank

The past couple of years have seen a strong improvement in the Finnish labour market. Unfortunately, the rise in employment has slowed down in 2019. The economic slowdown has already forced some companies to reduce staff, but employment opportunities are relatively plentiful. The labour market is still strong in terms of open vacancies, but we have not seen much further decrease in unemployment or rise in employment during recent months. In November, the trend estimate for unemployment rate was 6.7%, which was a bit higher than the 6.6% observed at beginning of the year. The figure is high considering that we are already late in the business cycle, but the Finnish unemployment rate has been lower than this only once in recent history, in 2008, just before the financial crisis. Estimates of structural unemployment or NAIRU have typically been above 7%, meaning that the labour market is already tight. Consequently, a lack of skilled labour continues to be a major obstacle to growth. At the same time, it has become more difficult to fill vacancies in some lower-skilled occupations. We expect the annual average unemployment rate to have fallen to 6.7% in 2019 and to stay there in 2020. The number of open vacancies is high enough to maintain good employment, but cyclical headwinds and structural barriers make further improvement unlikely.

The employment rate rose significantly in 2018 and surpassed the official target level of 72% set by the previous government in late 2018. The largest increase took place among older groups of workers. In November 2019, the trend indicator of employment rate stood at 72.6%, only marginally higher than at the beginning of the year. In our view the improvement has more or less stalled. The new government raised the target to a 75% employment rate, but weaker cyclical outlook has taken the tailwind away. The new left-leaning government has planned to cancel some reforms, aimed to activate job seeking and extend working hours, done by the previous government. Proposed new reforms are mostly soft tools from increased job seeking services to some kind of earned income tax credit. These measures, which are still in the early discussion phase, increase public expenditure and are unlikely to be enough to reach the 75% target. 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 already.

Employment rate has a long way to go



Source: Macrobond Financial, Statistics Finland

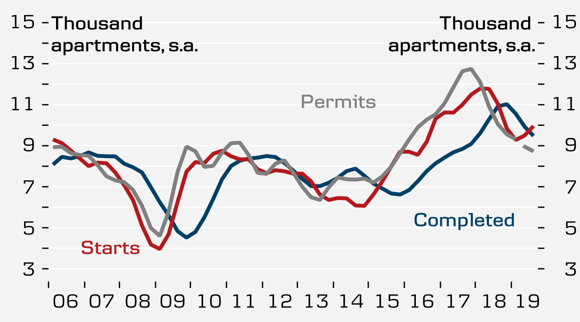
Nominal earnings growth was close to zero and labour costs fell more than anywhere else in the EU in 2017. This restored cost competitiveness, which had become a major problem. In 2018, earnings growth accelerated. Together with wage drift, we expect average earnings to have risen 2.5% in 2019.

Many key industry labour contracts expire this winter, and negotiations continue well into 2020. Industrial workers had a strike in early December 2019, and more strike announcements could follow suit in the coming months in Finland. As a countermove, The Finnish Forest Industries Federation held a six-day lockout closing half of the sawmills and plywood factories, aiming to put pressure on unions in pay negotiations. After tough negotiations, we expect earnings to rise 2.7% in 2020. This level would be sustainable from the cost competitiveness perspective and offers more purchasing power to households. However, difficulties in filling vacant positions clearly increase the risk of higher wage drift in some industries such as ICT and construction.

Housing market still interesting to investors

Prices of old dwellings rose marginally y/y in Q3 19. On average, prices grew 1.5% in the Helsinki region and declined by 0.8% in the rest of the country. For approximately the past five years, average house prices have seen only modest rises in Finland 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 the largest cities. In 2018, prices of old dwellings grew on average 2.5% y/y in the Helsinki region and decreased by 1.3% elsewhere. A similar main trend has continued in 2019 and is likely to continue also in 2020, although a strong supply of new housing in the Helsinki region is also likely to lead to some cooling of the housing market in the capital region. Household interest in buying continues to be supported by good

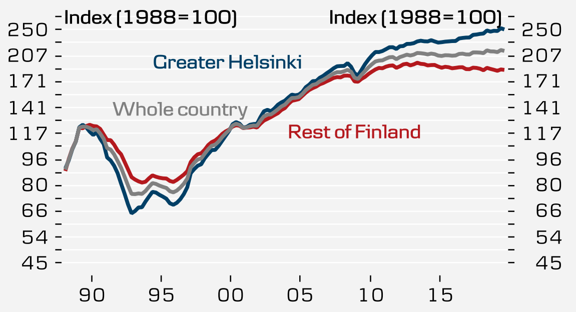
Housing construction set to slow down in 2020



Source: Macrobond Financial, Statistics Finland employment and low interest rates. Investor interest in real estate is fairly strong, while interest rates stay low and the economic outlook stable.

Construction has been one of the key drivers for the Finnish economy for the past three years. 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. Growth in housing demand has raised prices and caused a construction boom in Helsinki and a few other cities, while the real estate market in the rest of the country has remained flat or declining. In some sparsely populated parts of the country, the housing market does not function well and part of the housing stock is nearly worthless, which makes moving expensive and adds to labour market rigidities. 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 nearly as fast as in some 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 migrants. Consequently, the professional renting business and private buy-to-let market has grown. Strong demand from both professional and private investors has led to a boost in housing construction. For the most part, there are no signs of oversupply, at least not in most locations. The rise in rents has exceeded the rise in housing prices or wages for some years, but the rise in market rents has moderated recently and was 1.4% in Q3 19. The supply of new housing is increasing significantly at the moment and this weighs on both prices and rents. Construction companies have spotted a saturation in demand and are clearly cautious on new projects. Based on the number of housing permits and starts, the supply of new housing is likely fall somewhat in 2020. Despite slowdown the volume of construction is likely to stay at a historically high level in growth centres, especially in the Helsinki Region. Urbanisation will continue in the future and the demand for new housing is not going away. On average, we expect the prices to increase only by 0.5% in 2020, which is considerably slower than the rise in other consumer prices or earnings.

Debt ratio on the rise again

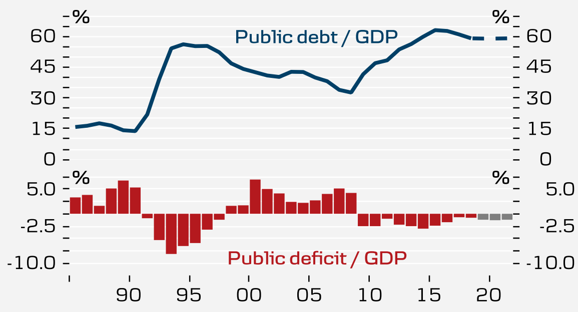
The Finnish central government has been running a long-standing deficit since the financial crisis but strong growth in employment has brought public finances closer to balance in recent years. Also municipalities have been financing their spending with debt, but the general government deficit is much smaller thanks to a surplus in social security funds, which consist mostly of statutory pension companies. Deficits have helped to maintain the welfare state with fairly generous social security. Public debt grew quite fast after the financial crisis and the debt rose to over 60% of GDP in 2014, but the economic boom since 2016 helped drag the debt ratio below 60% again.

Finland got a new government in December 2019, after previous PM Rinne lost the confidence of the governing coalition parties. New PM Sanna Marin (Social Democrat) leads the same five party coalition with the same programme. The government had earlier announced its budget plan, which expands expenditure and leaves many key reforms to further planning.

We forecast a slightly larger deficit than before. The central government budget deficit is set to rise to roughly EUR3bn in 2020 and 2021. The deficit is planned to be partly funded by asset sales, but net borrowing will be significant. Gross issuance in all maturities will top EUR20bn, because a large amount of long- and short-term debt will mature. A surplus in social security lends some support to the overall public finances, but the local government deficit has been growing more than we expected. Many municipalities with ageing populations and shrinking tax bases struggle, and may require central government action. Measured by the change in the cyclically-adjusted primary balance, the 2019 budget now looks modestly expansionary, especially because of the large local government deficit. Fiscal policy is moving towards a more expansionary stance and, simultaneously, the GDP growth is slowing down.

The debt ratio is likely to resume a rising trend, but higher GDP growth should keep the ratio below 60% in 2021. A further slowdown in the economy, however, could send the ratio well above 60%. The ageing of the population will hit public finances hard during the 2020s. In addition, air force fighter replacement may add roughly EUR10bn to debt during 2020s. The sovereign rating outlook has improved in recent years, but rating agencies need further evidence of sustained growth and successful structural reforms. Sovereign ratings are likely to stay the same for a while. Rating agencies need further evidence of sustained growth and successful structural reforms, which are progressing slowly. Structural reforms are 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. Labour market reforms look unconvincing so far and social and health care reform is not high on the agenda.

Debt-to-GDP improving slowly



Source Macrobond Financial, Statistics Finland

At a glance

			Forecast		
National account	**2018**	**2018**	**2019**	**2020**	**2021**
	EUR bn (current prices)	% y/y			
GDP	234.5	1.7	1.5	1.0	1.4
Imports	92.1	5.0	3.2	2.2	2.5
Exports	90.4	1.8	4.5	1.7	3.0
Consumption	176.8	1.7	1.3	1.5	1.1
- Private	123.7	1.8	1.2	1.5	1.2
- Public	53.1	1.5	1.5	1.5	1.0
Investments	55.5	3.3	0.6	0.6	2.0
Economic indicators		**2018**	**2019**	**2020**	**2021**
Unemployment rate, %		7.4	6.7	6.7	6.5
Earnings, % y/y		1.7	2.5	2.7	2.8
Inflation, % y/y		1.1	1.0	1.2	1.5
Housing prices, % y/y		0.6	0.4	0.5	1.0
Current account, EUR bn		-3.2	-1.4	-1.5	-1.4
- % of GDP		-1.4	-0.6	-0.6	-0.6
Public deficit, % of GDP		-0.8	-1.2	-1.3	-1.2
Public debt/GDP, % of GDP		58.6	58.9	58.9	59.0
Financial figures		**02/01/2020**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.		-0.50	-0.50	-0.50	-0.50
2-yr swap yield, % p.a.		-0.29	-0.30	-0.30	-0.20
10-yr swap yield, % p.a.		0.23	0.20	0.30	0.50
EUR/USD		1.12	1.11	1.13	1.15

Source: Danske Bank

Global overview

Risk of a global recession has declined

- **Following significant headwinds over the summer, the global economy is showing tentative signs of stabilisation.**
- **This stabilisation comes on the back of sizeable monetary policy stimulus in both advanced and emerging markets in addition to an expansionary fiscal policy in China.**
- **Despite the stabilisation and expectations of a modest recovery in the global manufacturing sector in early 2020, we have revised down our outlook for the global economy amid continued trade uncertainty and waning stimulus measures.**
- **However, the risk of a global recession over the next year or so has declined to 25% (from 30%) on the back of an improving chance of a trade deal and the receding risk of a no-deal Brexit, on the back of the UK election.**
- **The outcome of the US-China trade talks is a key risk to the global economy in 2020. The discussions could go in either direction, prompting considerable uncertainty for our global forecasts.**

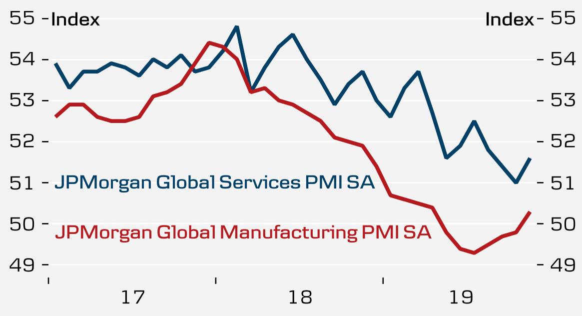
Decline in global manufacturing sector has eased…

Following a notable slowdown in the global manufacturing sector, there are signs of stabilisation. As predicted in *Global Economic Update: Stuck in the mud but no hard landing yet, 22 August*, the global manufacturing sector has witnessed further headwinds from the uncertainty prompted by the US-China trade war, which escalated further over the summer, and Brexit. However, there are now signs of stabilisation in the global manufacturing sector, especially in China, where sizeable fiscal and monetary policy stimulus is aiding the economy. The US manufacturing sector is also seeing stabilisation and even for the beaten German manufacturing sector, indicators are pointing to nascent improvement. The weakness in the manufacturing sector has been threatening to spill over to the service sector but there also appears to be some robustness in that sector due to continuing sound employment and wage growth.

…due to sizeable policy easing globally

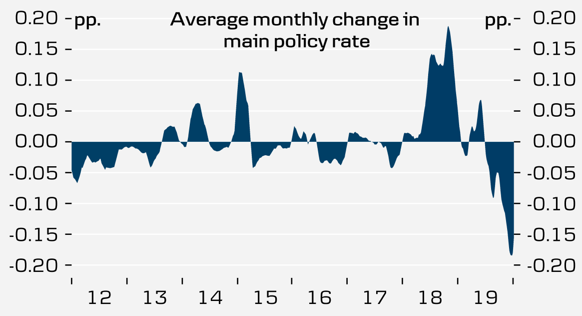
In response to weak global inflation pressures and expectations and the sizable slowdown in the global manufacturing sector, central banks around the world have eased monetary policy considerably in 2019 (see figure). The Fed has cut its policy rate three times since the summer, while the ECB restarted its QE programme and cut its policy rate by 0.1pp in September (though the impact on the euro area economy is probably small). In the biggest emerging markets (accounting for 30% of global GDP), policy easing has also been significant, with policy rates being cut at the fastest pace since the global financial crisis in 2009. On the fiscal side, China has cut taxes and boosted infrastructure spending amounting to 1.3% of GDP in 2019.

Global manufacturing sector is stabilising, while the service sector is under pressure



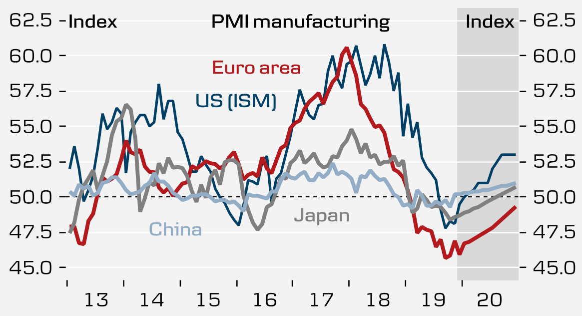
Source: Macrobond Financial, Danske Bank

Forceful monetary policy easing set to support a global recovery



Note: Three months moving GDP weighted average of G4 countries, G10 currencies and 18 biggest EM countries (excluding Turkey).
Source: Macrobond Financial, Danske Bank

We expect a modest rebound in the global manufacturing sector



Source: Macrobond Financial, Danske Bank

A phase-one US-China trade deal alone is unlikely to be a game-changer…

Following the escalation of the trade war between China and the US in August, the two sides are finalising a phase-one deal. The idea is to put all the parts that the two sides can agree on in phase one and leave the stickier points to phase two. While we still believe the two sides will eventually sign a phase-one deal, this has proven more difficult than expected. While a phase-one deal will provide an important boost to global risk sentiment, removing some of the tail risk of an abrupt escalation of the trade war, we do not believe it will be a game-changer for the global economy in terms of raising investments, as uncertainty is likely to still linger as the two sides move to the more difficult phase-two negotiations in the spring. We see a 50-50 chance of the two sides agreeing on a phase-two trade deal ahead of the US presidential election.

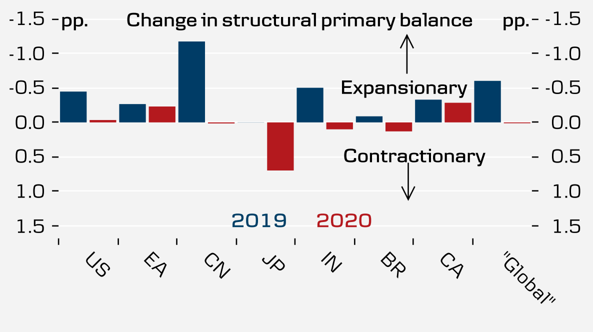
…meaning the global economy will probably experience only a modest growth rebound

While the economic policy easing and a possible phase-one trade deal will support a modest pickup in the global economy, the continued elevated uncertainty about global value chains and trade relations means we have downgraded our outlook for global growth. We expect the global economy to grow by 2.9% in 2019, picking up speed slightly to 3.0% in 2020 (3.2% previously), as some of the headwinds for the global economy such as trade war fade. This will give a slight boost to private consumption and investment. The pick-up in growth is in part driven by a rebound in several key emerging markets, including India, Russia, Brazil and Turkey as they benefit from easier monetary policy and stronger domestic demand. While economic growth is moderating in the US, Japan and the euro area, a big part is due to negative carry over from 2019. In many countries, fiscal policies are projected to tighten, although this will probably remain conditional on the economic outlook.

Central banks set to keep an easing bias amid modest inflation pressure

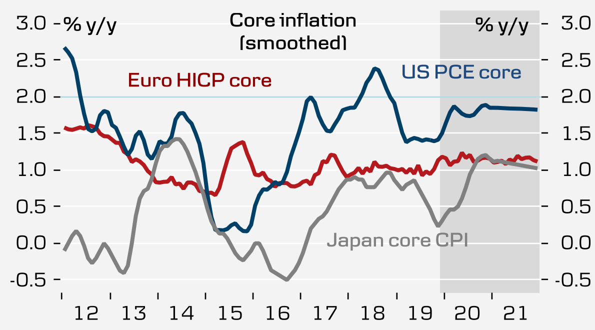
Although the economic expansion has been record long in the US and euro area countries such as Germany, inflation pressures remain muted. Also market-based inflation expectations are at a low level. Core inflation remains low in the euro area and is projected to rise to only 1.1% by 2021, significantly below the ECB's 2.0% target. While economic growth is higher in the US, PCE core inflation continues to run below the Federal Reserve's 2% target and despite higher wage increases, it does not seem to us that underlying inflation pressure is rising. One reason is probably that low inflation is quite persistent. As a result, we believe both the ECB and the Fed will maintain a slight easing bias. While the Fed's message has switched to a 'wait-and-see' approach, we still expect one more cut in 3-6M (down from three additional cuts previously). Although we expect the ECB to be on pause amid growing divisions in the Governing Council, we believe the bias is towards further easing in the event of significant deterioration in the growth or inflation outlook.

Fiscal policy goes from expansionary to neutral in many countries in 2020



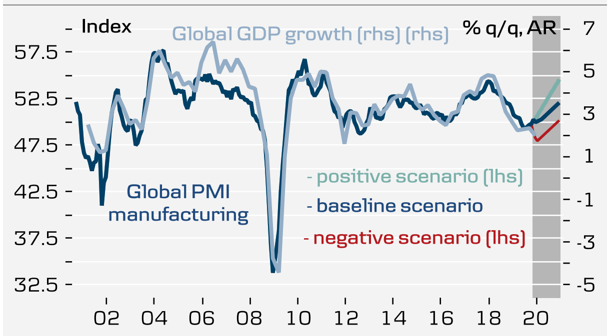
Note: "Global" is GDP-weighted average of the countries in the chart.
Source: IMF WEO October 2019 Database, Macrobond Financial, Danske Bank

Underlying inflation still at modest levels globally



Source: Macrobond Financial, Danske Bank

US-China trade talks hold key to global manufacturing sector outlook



Source: Macrobond Financial, Danske Bank

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	02-Jan	1.75	1.91	1.70	1.92	112.1	-	666.5	877.5	933.2
	+3m	1.75	1.73	1.60	1.85	111.0	-	673.0	891.9	955.0
	+6m	1.50	1.65	1.55	1.85	113.0	-	661.3	867.3	955.8
	+12m	1.50	1.65	1.55	2.05	115.0	-	648.7	852.2	939.1
EUR	02-Jan	-0.50	-0.38	-0.29	0.23	-	112.1	747.1	983.5	1046.0
	+3m	-0.50	-0.41	-0.30	0.20	-	111.0	747.0	990.0	1060.0
	+6m	-0.50	-0.41	-0.30	0.30	-	113.0	747.3	980.0	1080.0
	+12m	-0.50	-0.41	-0.20	0.50	-	115.0	746.0	980.0	1080.0
JPY	02-Jan	-0.10	-0.05	0.02	0.11	120.5	108.8	6.2	8.2	8.7
	+3m	-0.10	-	-	-	122.1	110.0	6.1	8.1	8.7
	+6m	-0.10	-	-	-	126.6	112.0	5.9	7.7	8.5
	+12m	-0.10	-	-	-	128.8	112.0	5.8	7.6	8.4
GBP	02-Jan	0.75	0.79	0.82	1.06	84.8	132.1	880.6	1159.4	1233.0
	+3m	0.75	0.58	0.80	0.95	83.0	133.7	900.0	1192.8	1277.1
	+6m	0.50	0.54	0.70	0.95	85.0	132.9	879.1	1152.9	1270.6
	+12m	0.50	0.54	0.80	1.15	86.0	133.7	867.4	1139.5	1255.8
CHF	02-Jan	-0.75	-0.69	-0.60	-0.09	108.7	97.0	687.1	904.7	962.1
	+3m	-0.75	-	-	-	110.0	99.1	679.1	900.0	963.6
	+6m	-0.75	-	-	-	110.0	97.3	679.3	890.9	981.8
	+12m	-0.75	-	-	-	112.0	97.4	666.1	875.0	964.3
DKK	02-Jan	-0.75	-0.40	-0.17	0.34	747.1	666.5	-	131.7	140.0
	+3m	-0.75	-0.42	-0.18	0.32	747.0	673.0	-	132.5	141.9
	+6m	-0.75	-0.42	-0.18	0.42	747.3	661.3	-	131.1	144.5
	+12m	-0.65	-0.32	-0.05	0.65	746.0	648.7	-	131.4	144.8
SEK	02-Jan	-0.25	0.15	0.23	0.72	1046.0	933.2	71.4	94.0	100.0
	+3m	0.00	0.15	0.20	0.70	1060.0	955.0	70.5	93.4	-
	+6m	0.00	0.15	0.20	0.80	1080.0	955.8	69.2	90.7	-
	+12m	0.00	0.15	0.20	1.00	1080.0	939.1	69.1	90.7	-
NOK	02-Jan	1.50	1.84	1.99	2.08	983.5	877.5	76.0	100.0	106.4
	+3m	1.50	2.19	2.05	2.05	990.0	891.9	75.5	-	107.1
	+6m	1.50	2.28	2.10	2.15	980.0	867.3	76.3	-	110.2
	+12m	1.75	2.29	2.20	2.45	980.0	852.2	76.1	-	110.2

Commodities

		2019				2020				Average	
	02-Jan	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2019	2020
ICE Brent	66	64	68	62	65	60	60	60	60	72	60

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	2019	2.1	1.5	0.0	-1.0	3.7	0.4	0.8	2.2	3.7	2.6	33.5	8.6
	2020	1.4	1.9	1.3	-0.2	2.5	2.5	1.2	2.0	3.8	0.2	33.4	8.4
	2021	1.4	2.0	0.8	1.4	1.9	2.3	1.4	2.1	3.8	-0.1	32.9	8.3
Sweden	2019	1.1	0.9	0.5	-1.3	4.7	2.2	1.8	2.6	6.9	0.1	35.0	4.8
	2020	0.7	1.8	1.2	-1.5	3.1	2.2	1.5	2.4	7.8	-0.5	34.0	5.2
	2021	1.5	1.7	1.2	0.9	2.8	2.5	1.2	2.4	8.0	-0.6	33.0	5.2
Norway	2019	2.5	1.7	2.2	5.0	1.8	5.0	2.3	3.5	2.3	-	-	-
	2020	2.0	2.0	1.7	3.0	6.0	2.5	2.2	3.5	2.3	-	-	-
	2021	2.1	2.2	2.0	1.3	3.4	2.5	2.0	3.3	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	2019	1.2	1.1	1.6	6.9	2.4	4.6	1.2	2.1	7.6	-0.8	86.4	3.3
	2020	0.9	1.4	1.8	2.6	1.5	3.2	1.1	2.3	7.5	-0.9	85.1	3.2
	2021	1.3	1.4	1.4	1.6	2.5	2.8	1.1	2.1	7.4	-1.0	84.1	3.1
Germany	2019	0.5	1.6	2.1	2.8	1.1	2.4	1.3	3.1	3.1	1.0	59.2	6.0
	2020	0.6	1.2	2.5	1.2	1.2	2.4	1.5	2.8	3.0	0.8	56.8	5.9
	2021	1.3	1.2	2.4	1.9	2.6	3.3	1.4	3.0	3.0	0.7	55.0	5.8
Finland	2019	1.5	1.2	1.5	0.6	4.5	3.2	1.0	1.0	6.7	-1.2	58.9	-0.6
	2020	1.0	1.5	1.5	0.6	1.7	2.2	1.2	1.2	6.7	-1.3	58.9	-0.6
	2021	1.4	1.2	1.0	2.0	3.0	2.5	1.5	1.5	6.5	-1.2	59.0	-0.6

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	2019	2.3	2.6	2.2	1.3	-0.3	1.6	1.8	3.2	3.7	-4.5	105.0	-2.5
	2020	1.7	2.4	0.8	0.9	0.1	1.7	2.1	3.1	3.5	-4.5	106.0	-2.6
	2021	1.9	2.0	0.4	2.7	2.0	1.8	2.1	3.3	3.4	-4.5	107.0	-2.5
China	2019	6.6	8.2	-	5.0	-	-	2.2	8.5	-	-4.1	50.1	0.7
	2020	6.2	7.5	-	5.0	-	-	2.5	8.0	-	-6.1	53.9	0.0
	2021	6.0	7.8	-	4.6	-	-	2.2	7.5	-	-5.5	57.1	-0.1
UK	2019	1.3	1.2	3.0	0.6	1.4	3.4	1.8	3.5	3.8	-1.4	83.8	-3.5
	2020	0.7	1.4	0.8	-1.2	2.0	-0.7	1.4	3.4	3.7	-1.1	82.9	-3.7
	2021	1.1	1.4	0.6	0.9	2.0	2.0	1.6	3.7	3.6	-1.1	82.2	-3.7
Japan	2019	1.0	0.4	2.2	1.7	-1.8	-0.5	0.7	-	2.4	-	-	-
	2020	0.5	-0.3	1.9	0.4	1.7	0.8	0.7	-	2.4	-	-	-
	2021	0.5	0.8	0.4	-0.5	2.1	1.2	0.9	-	2.4	-	-	-

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

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this report are listed on page 2 of this report.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Quarterly.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research report has been prepared by Danske Bank (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided herein.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/A, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Report completed: 2 January 2020, 16:00 CET

Report first disseminated: 3 January 2020, 06:00 CET

Danske Bank Research

Global Head of FICC Research, Thomas Harr, +45 45 13 67 31, thhar@danskebank.com

International Macro

Chief Analyst & Head of
Jakob Ekholdt Christensen
+45 45 12 85 30
jakc@danskeban.com

Aila Evchen Mihr
+45 45 13 78 67
amih@danskebank.com

Allan von Mehren
+45 45 12 80 55
alvo@danskebank.com

Bjørn Tangaa Sillemann
+ 45 45 12 82 29
bjsi@danskebank.com

Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.com

Piet P.H. Christiansen
+45 45 13 20 21
phai@danskebank.com

Fixed Income Research

Chief Analyst & Head of
Jan Weber Østergaard
+45 45 13 07 89
jast@danskebank.com

Daniel Brødsgaard
+45 45 12 80 83
dbr@danskebank.dk

Jens Peter Sørensen
+45 45 12 85 17
jenssr@danskebank.com

Cross Scandi Strategy

Chief Analyst & Head of
Arne Lohmann Rasmussen
+45 45 12 85 32
arr@danskebank.com

Foreign exchange

Chief Analyst & Head of
Christin Kyrme Tuxen
+45 45 13 78 67
tux@danskebank.com

Jens Nærvig Pedersen
+45 45 12 80 61
jenpe@danskebank.com

Kristoffer Kjær Lomholt
+45 45 12 85 29
klom@danskebank.com

Lars Sparresø Merklin
+ 45 45 12 85 18
lsm@danskebank.dk

Credit Research

Chief Analyst & Head of
Jakob Magnussen
+45 45 12 85 03
jakja@danskebank.com

Bendik Engebretsen
+47 85 40 69 14
bee@danskebank.com

Brian Børsting
+45 45 12 85 19
brbr@danskebank.com

Christopher Hellesnes
+46 8 568 80547
cahe@danskebank.com

David Andrén
+46 8 568 80602
davia@danskebank.com

Henrik Renè Andresen
+45 45 13 33 27
hena@danskebank.com

Louis Landeman
+46 8 568 80524
llan@danskebank.com

Mark Thybo Naur
+45 45 12 85 19
mnau@danskebank.com

Natasja Cordes
+45 45 14 38 54
naco@danskebank.com

Niklas Ripa
+45 45 12 80 47
niri@danskebank.com

Nicolai Pertou Ringkøbing
+45 45 12 80 56
nrin@danskebank.com

Sverre Holbek
+45 45 14 88 82
holb@danskebank.com

Sweden

Chief Analyst & Head of
Michael Boström
+46 8 568 805 87
mbos@danskebank.com

Carl Milton
+46 8 568 805 98
carmi@danskebank.com

Filip Andersson
+46 8 568 805 64
fian@danskebank.com

Jesper Petersen
+46 8 568 805 85
jesppe@danskebank.com

Michael Grahn
+46 8 568 807 00
mika@danskebank.com

Stefan Mellin
+46 8 568 805 92
mell@danskebank.com

Therese Persson
+46 8 568 805 58
thp@danskebank.se

Denmark

Chief Economist & Head of
Las Olsen
+45 45 12 85 36
laso@danskebank.com

Bjørn Tangaa Sillemann
+ 45 45 12 82 29
bjsi@danskebank.com

Louise Aggerstrøm Hansen
+ 45 45 12 85 31
louhan@danskebank.com

Norway

Chief Analyst & Head of
Frank Jullum
+47 85 40 65 40
fju@danskebank.com

Emerging Markets

Chief Analyst & Head of
Jakob Ekholdt Christensen
+45 45 12 85 30
jakc@danskeban.com

Finland

Chief Strategist & Head of
Valtteri Ahti
+358 (0)10 546 7329
vah@danskebank,com

Chief Economist
Pasi Kuoppamäki
+358 10 546 7715
paku@danskebank.com

Jukka Samuli Appelqvist
+ 358 44 263 1051
app@danskebank.com