Danske Bank

Investment Research

5 January 2017

Nordic Outlook

Economic and financial trends

- Denmark: from crisis fears to risk of overheating
  - The recovery looks set to continue in coming years, but keep an eye on the labour market
- Sweden: the business cycle: dead or dormant?
  - Growth is set to continue above trend without causing a spike in inflation
- Norway: moderate growth
  - Growth is set to pick up but more slowly than previously expected
- Finland: growth gains a better footing
  - The economy surprises positively but with challenges

Important disclosures and certifications are contained from page 34 of this report.

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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

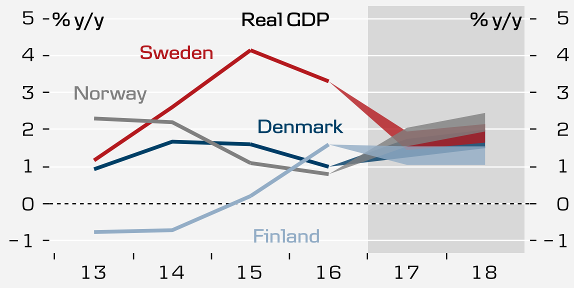
Synchronised recovery

Global growth is supporting the Nordics

In terms of the economic cycle, the world is entering 2017 in a rather upbeat mood. Indicators are pointing to higher growth in all major regions at the same time, which is unusual, and very good news for small, open economies such as the Nordics. This is one reason why we also expect to see a version of synchronised recovery among the Nordic countries. There has been an unusual divergence in growth rates between them in recent years but in 2017, GDP growth ranges from 1.3% in Finland to 1.8% in Norway, according to our forecasts. With the exception of Sweden, we are also seeing moderately higher growth than in 2016. In Sweden's case, the high 2016 growth rate mostly reflected developments in 2015.

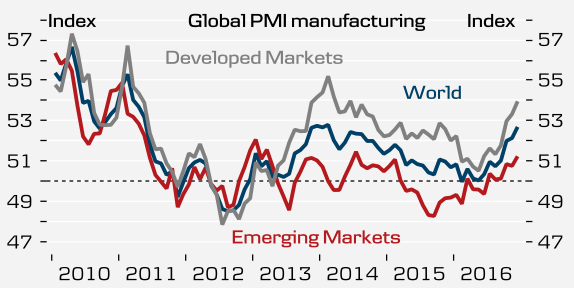
Growth rates below 2% might not seem like much of a recovery by historical standards. However, as elsewhere in the world, potential growth rates have declined as productivity growth disappoints. The growth we forecast is enough to see employment rise, and in most cases unemployment decline. We hope we will also see more of a recovery in business investment, which has been mostly absent since the crisis years. This should help raise productivity growth both in the Nordics and globally and lead to more demand for Nordic investment goods and sea transport, among other things. The fact that we expect Nordic growth rates to diverge a little again in 2018 also reflects that underlying growth in the four Nordic countries is not the same, owing to very different demographic situations, among other things.

A more normal picture this year



Source: National statistics, Danske Bank

Global recovery is helpful



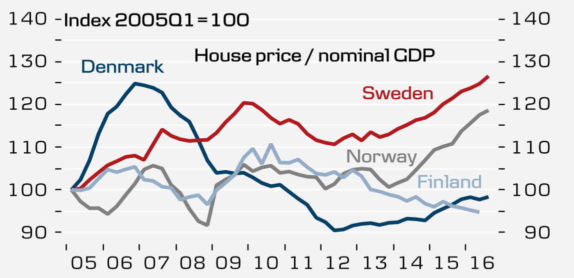
Source: Markit Economics

Synchronised and unsynchronised risks

The global cyclical situation might be good, but it is also fraught with risk. The new US administration looks set to increase protectionism and that could be negative especially for the Nordic countries, with their very open economies. The political situation in Europe is difficult with important elections on their way at the same time as Brexit negotiations. China could face a debt crisis as some point with serious global implications and the process of hiking US interest rates from virtually zero has not been tried before.

Although the growth outlook is fairly synchronised this year, there are many differences between the Nordic countries in the underlying state of the economy. Sweden is slowing down more than recovering, following several years of very high growth, supported by rapidly rising house prices, which now seem to be fading. Norway is coming back after a slump, induced by the fall in oil prices but not from recession, and there is not a lot of slack in the economy, especially not in the housing market, which is seeing very high price rises. Finland, on the other hand, is just starting to recover from the long recession of 2012-14, at the same time as it is restoring competitiveness. The Danish recovery might be modest but it has been running for four years and there is not much left in terms of unused resourses there.

Unsynchronised house prices



Source: National statistics

Denmark

From crisis fears to risk of overheating

- **We expect the Danish economic recovery to remain on track, supported by a growing labour force and stronger global and domestic demand.**
- **There is a risk of the economy overheating within the next few years, although it could also take the opposite course.**
- **Consumption is set to continue being underpinned by growing income, higher house prices and low interest rates, although inflation is likely to pick up.**
- **Exports were a disappointment in 2016, but stronger global GDP growth should pave the way for a recovery in exports.**
- **Public consumption rose by more than expected and will probably not dampen GDP growth in 2017. Fiscal policy is likely to be tightened in 2018.**

Prospect of strong upswing in coming years

Denmark is entering its fifth year of economic recovery. Until now, the recovery has been one of relatively moderate economic growth and rising employment growth. In our main scenario, economic growth will gather momentum, while employment growth will slow down because businesses will be scaling up production increasingly by means of an increase in capex and not merely by employing more people. Compared to previously, however, we now see a more distinct possibility of a more robust recovery, which would also involve a risk of the economy overheating – not right away, but over the course of the next few years. The global economy is on the cusp of a synchronous recovery and if sentiment truly turns positive, Denmark could be witnessing significantly stronger increases both in consumer spending and investment than our forecast would suggest. As interest rates are set to remain low in coming years, a shift in sentiment could swiftly and strongly feed through to the economy. However, as always, there is also a risk that things will turn for the worse. The global recovery is threatened by political instability and debt accumulation in China, US rate hikes may cause renewed volatility and the latest business and consumer confidence indicators actually point to a slump in consumption and investment.

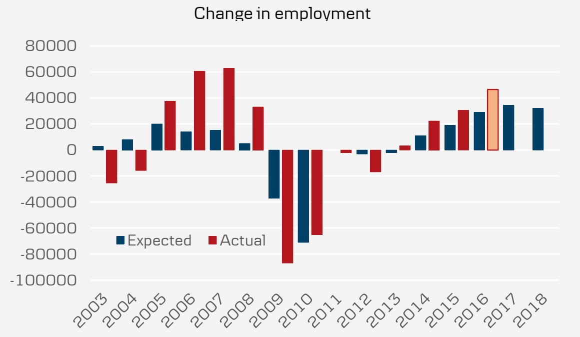
Statistics Denmark has carried out a comprehensive revision of the national accounts, which are now showing far more positive GDP and productivity figures for Denmark. Production per working hour in private-sector non-farm and non-oil industries grew 1.8% annually in 2012-2015 instead of 0.4% as previously indicated. Based on these new figures, Denmark can no longer be said to suffer from particularly poor productivity compared with other countries, especially considering the fact that prices of Danish imports have fallen relative to the price of exports. This improvement in the terms of trade has the same effect as higher productivity. However, overall economic growth in Denmark is impaired by declining North Sea energy output, and output per capita is affected by the shrinking working age share of the population. Importantly, productivity levels in the rest of the world have by no means been impressive in recent years. Wealth per capita has been largely unchanged in Denmark for the past ten years.

Changes vs previous forecast

Denmark					
	Current forecast			Previous forecast	
% y/y	2016	2017	2018	2016	2017
GDP	1.0	1.5	1.8	1.1	1.7
Private consumption	1.8	1.6	2.0	1.6	1.7
Public consumption	1.3	1.0	0.5	1.0	0.7
Gross fixed investment	3.9	3.2	3.7	1.0	2.9
Exports	0.1	2.2	2.7	0.6	2.8
Imports	1.3	3.4	3.4	0.7	3.5
Gross unemployment (thousands)	112.3	107.9	103.8	112.8	107.0
Inflation	0.3	1.3	1.5	0.3	1.3
Government balance, % of GDP	-1.7	-1.3	-0.7	-0.6	-1.2
Current account, % of GDP	7.4	7.3	7.3	6.4	6.6

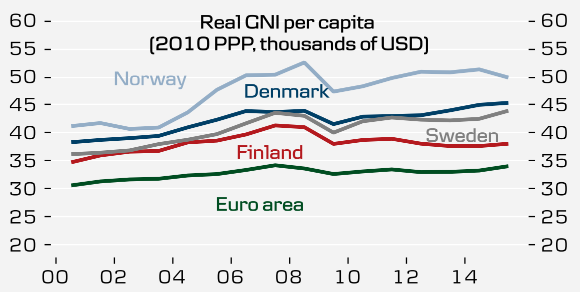
Source: Danske Bank

Recovery surprising on the upside – and it may do so again



Note: 'Projected' is the government's expectations in December of the preceding year, except 2017-2018, which is Danske Bank's projection.
Source: Statistics Denmark, Economic Survey, Danske Bank

Denmark and peers experience stagnant incomes



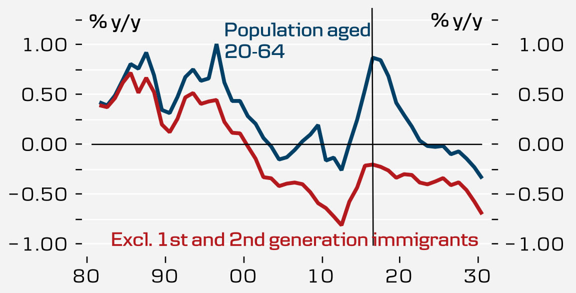
Source: OECD, national statistics

More labour needed for employment growth

Our forecasts assume an increase in employment by some 66,000 persons over the next two years. As unemployment is already low, the employment increase would require an almost equally large increase in the labour force. We believe this is realistic given demographic developments in Denmark and the potential for bringing a greater proportion of the population into the labour market. However, the lack of job-ready unemployed individuals increases the likelihood that growing demand for labour will cause bottlenecks and increased wage pressure. Wage growth in Denmark is already higher than in peer countries, and wages as a proportion of total outputs is at a historical high.

New wage deals are due to be negotiated in large parts of the private labour market in coming months. The latest wage settlements, in 2014, resulted in modest wage increases but owing to the unexpectedly low inflation since then, real wages have surged. Therefore, we factor in relatively moderate wage increases of some 2% annually in coming years despite the labour market having tightened significantly since 2014. There is no doubt that wages could rise faster than this.

Improved integration could pave the way for stronger growth

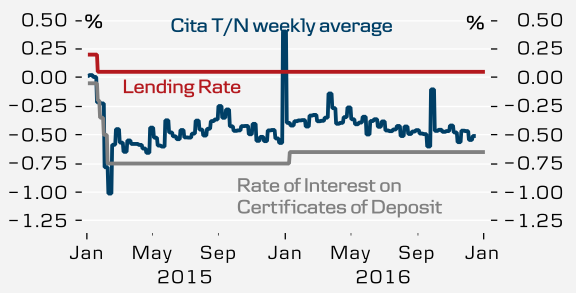


Source: Statistics Denmark's population projection

Low rates for longer

There are no monetary policy changes on the cards from the ECB in 2017, and we do not expect any rate adjustments from the Danish central bank (Danmarks Nationalbank – DN). History shows that political instability in Europe may drive pressure up to strengthen the krone – a scenario that may well repeat itself in 2017. We believe that DN would respond in the form of currency intervention instead of rate cuts, but such intervention may also push down market rates somewhat. The ECB is expected to taper its asset purchases some time in 2018 and, all else being equal, that would indicate higher interest rates in Denmark. While we do not expect de facto rate hikes from the ECB until 2019 at the earliest, DN may hike rates before that given that its lowest official interest rate is lower than the ECB's lowest rate. Danish long yields have climbed on the back of higher yields in the US and this trend may well continue. How much yields will increase depends on global economic developments, inflation in particular. In 2017, we expect 10Y yields to rise by about half a percentage point.

Market rates may rise without a formal rate hike

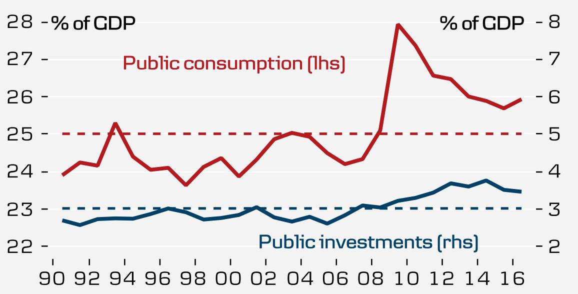


Source: Nasdaq OMX, Danmarks Nationalbank

Public consumption exceeding budgets

There was an unexpectedly strong increase in public consumption in 2016, which rose by 1.4% in Q3 alone. Unless there was a major decline in spending in Q4, it will be difficult for the Danish government to achieve its consumption growth targets of 0.4% in 2016 and 0.7% in 2017. The increase in public consumption occurred despite fewer public employees and was due to an increase in purchases of goods and services. The government had already planned on a deficit on the structural balance of close to 0.5% of GDP, which is the normal maximum permitted deficit, according to the Danish Budget Act. The budget does not incorporate any fiscal policy tightening from 2016 to 2017. Although public consumption has risen by more than expected, the actual public sector deficit should shrink, especially because rising employment means fewer expenses and higher income for the government.

Public consumption and investment are high from a historical perspective



Note: 2016 reflects Q1-Q3 16; dotted lines are historical averages since 1990
Source: Statistics Denmark

The current cyclical trends and the outlook for low rates for longer could trigger a distinct tightening of fiscal policy in 2018. Tax cuts were one of the components on which the current Danish coalition government was formed in November. Tax cuts are feasible within the framework of a tighter fiscal policy provided public consumption grows at a slower pace than the economy as a whole. The government platform builds on capping growth in public spending at 0.3% annually, and if this is achieved it would provide ample space for tax cuts. The revised national accounts data shows much stronger productivity growth in the public sector than previously, which means that it takes less growth in public spending to achieve a given increase in public consumption.

Inflation trending upward

Inflation is finally making a comeback. We expect it to hit the 1% mark at the beginning of 2017 for the first time in three years. Consumer price inflation remained very low throughout 2016, due initially to low energy prices and subsequently because of a plunge in prices of mobile phone services and clothing. Indeed, inflation in 2016 was at its lowest level since 1953. We expect inflation to rise to 1.3% in 2017, and while this is much higher than the levels of the past few years, inflation remains subdued. This should be seen in the context of low inflation globally, which contributes to low prices of imported goods but also to modest wage increases in Denmark (in nominal terms) and that, in turn, keeps a lid on prices of domestic services. In addition, there is a certain inertia in Danish inflation, as rent increases in large parts of the residential rental market are linked to the previous year's inflation numbers. As such, we expect last year's low inflation level to keep a lid on inflation in 2017.

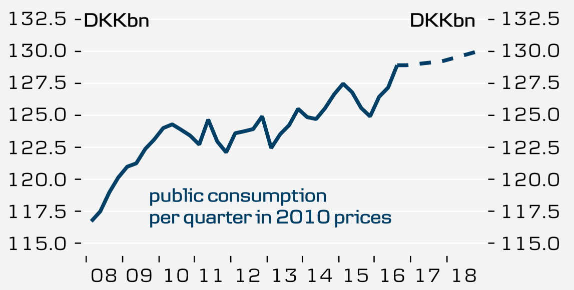
Housing market set to improve for many years to come

Denmark is witnessing nationwide housing market improvements. The highest price increases are still seen in and around the large cities but all parts of Denmark are taking part in the recovery. The housing market is fanned by an overall economic recovery, rising incomes and very low interest rates. On one hand, we expect these factors to drive prices up over our forecast period. On the other, we expect some downward pressure on house prices as long-term rates start to rise during the forecast period and because increasing building activity is set to drive supply up. However, this will by no means derail the housing market and we expect house prices to continue to outpace general prices.

In its proposal for a new property tax system, Denmark's former liberal government proposed that property taxes should once again track price developments, the intention being to stabilise the housing market. If adopted, this would have an impact only from 2021. We now await the new tripartite coalition government's adjusted proposal for property taxes. Until 2021, the 2017-20 freezing of the land tax, which was a component of the new government's platform, is set to help push house prices up.

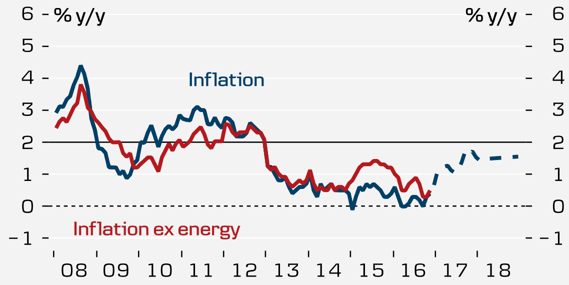
With prices set to rise for many years to come, this may cause fears of a housing bubble, especially in the more expensive residential areas, where prices may be pushed up by persistently low interest rates and property taxes that do not rise in step with house prices. Credit growth remains weak, however, and we are still nowhere near the appreciation levels witnessed in the mid-2000s. The current price levels do not give rise to concerns as the price increases are rooted in economic fundamentals. Still, if lending growth starts to surge in the years ahead, it could cause concerns about a de facto expectations-driven housing bubble. While economic fundamentals can explain price increases, this does not rule out prices falling again; for example, if interest rates were to rise – especially in the expensive residential areas.

Our forecast calls for weak growth in public consumption



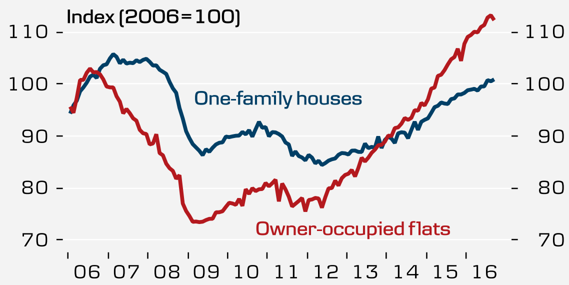
Source: Statistics Denmark, Danske Bank

Inflation trending upward



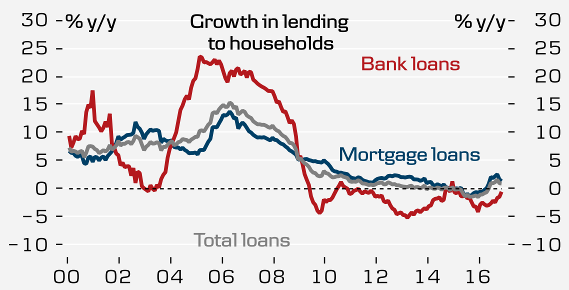
Source: Statistics Denmark, Danske Bank calculations

House prices continue to appreciate



Source: Statistics Denmark, Danske Bank calculations

Access to credit starting to ease, but far from the growth rates of the 2000's



Source: Statistics Denmark, Danske Bank calculations

Consumption outgrowing income slightly

Private consumption has been one of the principal drivers of recent years' economic recovery. The increase in private consumption is testament to the stronger spending power among Danish consumer owing to the fact that wages are outgrowing inflation. The extremely low rate of inflation boosted this effect extensively in 2016 but it will also remain in effect in coming years. Continuing labour market improvements also contribute to lifting salary incomes in Denmark, not least because more people should find employment and so will no longer receive social security benefits.

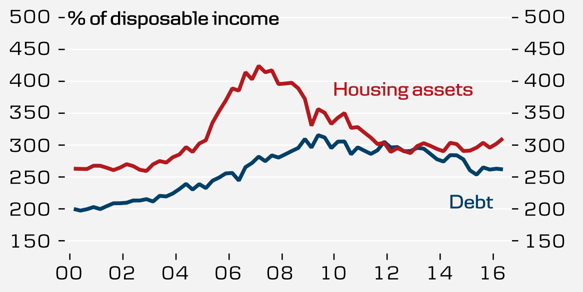
In 2017 and 2018, we expect consumption to start outgrowing incomes following an extensive period during which Danish consumers will have spent less than they have earned. We do not expect consumption to grow much faster than incomes the way they did in the mid-2000s, when consumption was fuelled by increasing debt. Instead, we expect a modest increase in borrowing to help lift consumption. This is now possible because the Danes have come a long way in balancing their finances after a long period of spending their extra income on reducing debts rather than on consumption. Another reason why borrowings may also help fund part of private consumption is that home equity has been restored in many parts of Denmark owing to recent years' house price appreciation.

Weak global trade and slump in North Sea oil production weighed on exports in 2016

Danish exports had a sluggish year in 2016, and we estimate zero growth relative to 2015. The sluggish trend is attributable partly to weak goods exports throughout 2016. This is due in part to the sharp drop in energy exports, which is explained in part by oil and natural gas production having declined in recent years. Energy exports may fluctuate heavily in step with production stoppages and starts at various North Sea oil fields, which may have a large impact on overall exports. We should not expect energy exports to make any positive contribution to export growth for some time to come. However, there is still some degree of uncertainty attaching to future North Sea oil production. In economic terms, commodity exports were a detractor in 2016, especially because of a large drop in mink prices. Still, goods exports were largely flat in 2016, partly because of an increase in pharmaceutical exports, whereas agricultural exports and the more cyclical exports were more or less flat.

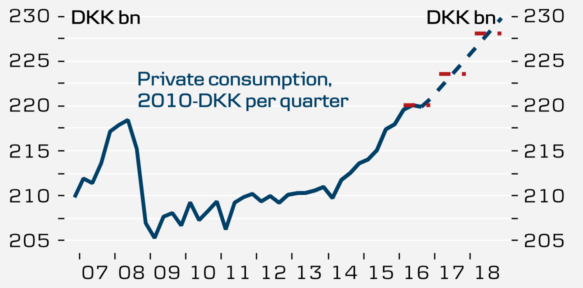
Service exports were less than impressive in 2016, due partly to a decline in exports of sea transportation services. Sea transportation depends on an expansion of global trade. However, global trade has been very subdued lately, partly due to limited global economic growth, but also because growth has become less trade-intensive in recent years. We expect Danish exports to gather momentum in the upcoming period. Our key export markets are thriving currently and we expect these buoyant trends to continue, providing a sound foundation for selling more goods in future.

Household debt falling and housing wealth once again trending upward



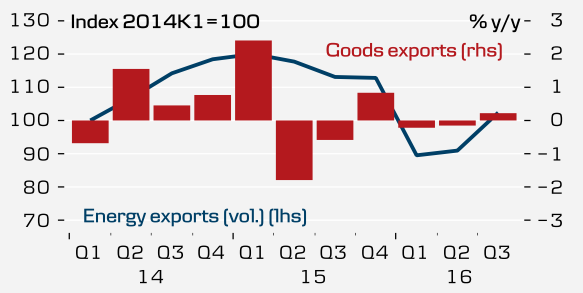
Source: Statistics Denmark, Association of Danish Mortgage Banks and Realkredit Danmark

Private consumption set to grow further



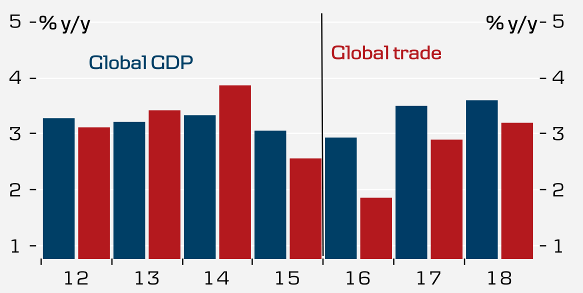
Source: Statistics Denmark, Danske Bank

Energy weighed on goods exports in 2016



Source: Statistics Denmark

Small improvement in global economy bodes well for Danish exports



Source: OECD, Danske Bank estimate for global GDP growth

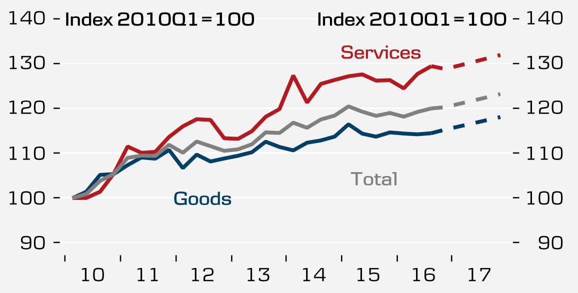
We expect global GDP growth to pick up a bit from here and once output gaps around the world begin to close, more investment will be required to keep the wheels in motion. As investments are typically quite import-intensive, this may help boost global trade. It would also lead to greater demand for Danish industrial goods and sea transportation. Combined with recent years' strong expansion of the Danish commercial fleet, this could pave the way for a recovery in exports. However, there is some uncertainty attached to US president-elect Donald Trump's highly protectionist agenda, which could potentially jeopardise global trade.

Very large current account surplus set to decline due to recovery

The current account surplus declined by a fair margin in 2016, due in particular to a sharp decline in sea transportation. A slump in activity levels and plunging freight rates contributed to pushing down the current account surplus by nearly DKK17bn during the first ten months of 2016 compared with the same period in 2015. A drop in net capital income from a very high level was another detractor. However, Denmark maintains a large current account surplus – not least after the October revision, when the 2015 surplus was lifted by DKK46bn, corresponding to 2.3% of GDP.

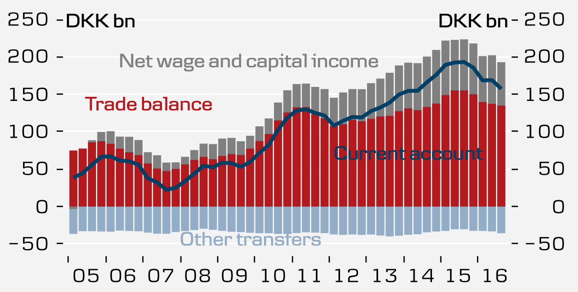
We expect normalising cyclical trends to push down Denmark's current account surplus in the coming years. There is still a decent potential for corporate investments to pick up, both among our trading partners and at home. This would gradually lead to more foreign trade, although we see a higher probability of an increase in Danish demand for foreign goods than in foreign demand for Danish goods. We expect the lower current account surplus to be offset partly by a higher return on net wealth. This is partly because current account surpluses inherently result in a greater need for Danish overseas investment, but also because the composition of net wealth indicates a higher return on Danish overseas investment than on foreign investment in Denmark. We expect the two opposing effects to lead to a slightly lower current account surplus going forward. For more details, see *Research Denmark: Large current account surplus is here to stay*, 2 December 2016.

Modest outlook for exports, but better times ahead



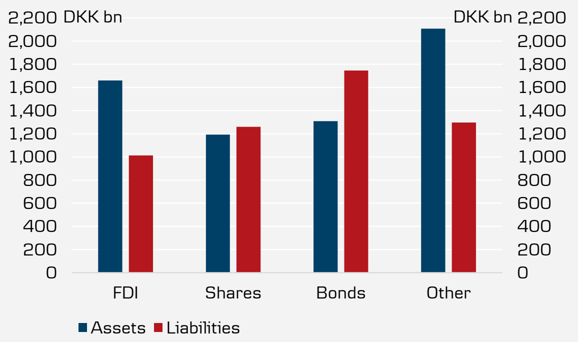
Source: Statistics Denmark, Danske Bank

Very large current account surplus in 2016 driven by sharp drop in sea transportation



Source: Statistics Denmark

Foreign direct investment generates large return from Denmark's net foreign wealth



Note: The chart shows wealth as at Q2 16
Source: Statistics Denmark

Denmark: forecasts at a glance

			Forecast		
National account	**2015**	**2015**	**2016**	**2017**	**2018**
	DKK bn (current prices)		% y/y		
Private consumption	926.5	2.0	1.8	1.6	2.0
Government consumption	520.8	0.6	1.3	1.0	0.5
Gross fixed investment	389.9	2.5	3.9	3.2	3.7
- Business investment	236.7	4.1	2.3	3.7	3.6
- Housing investment	82.0	3.8	11.5	4.0	6.9
- Government investment	71.3	-3.9	0.5	0.5	-0.4
Growth contribution from inventories	-0.3	-0.3	-0.4	0.2	0.1
Exports	1119.5	1.8	0.1	2.2	2.7
- Goods exports	690.3	2.1	-0.2	2.1	2.7
- Service exports	429.2	1.4	0.6	2.5	2.8
Imports	969.5	1.3	1.3	3.4	3.4
- Goods imports	604.7	1.7	1.2	4.4	3.5
- Service imports	364.8	0.5	1.6	1.7	3.2
GDP	2027.2	1.6	1.0	1.5	1.8

Economic indicators	**2015**	**2016**	**2017**	**2018**
Current account, DKK bn	185.6	153.1	155.3	158.8
- % of GDP	9.2	7.4	7.3	7.3
General government balance, DKK bn	-27.2	-34.3	-28.1	-14.8
- % of GDP	-1.3	-1.7	-1.3	-0.7
General government debt, DKK bn	801.8	781.7	788.0	790.6
- % of GDP	39.6	38.0	37.2	36.2
Employment (annual average, thousands)	2828.7	2875.2	2909.6	2941.6
Gross unemployment (annual average, thousands)	123.0	112.3	107.9	103.8
- % of total work force (DST definition)	4.6	4.2	4.1	3.9
Oil price - USD/barrel (annual average)	52	43	53	58
House prices, % y/y	6.1	3.9	4.1	3.7
Private sector wage level, % y/y	1.5	1.8	2.0	2.1
Consumer prices, % y/y	0.5	0.3	1.3	1.5

Financial figures	**04/01/2017**	**+3 mths**	**+6 mths**	**+12 mths**
Lending rate, % p.a.	0.05	0.05	0.05	0.05
Certificates of deposit rate, % p.a.	-0.65	-0.65	-0.65	-0.65
2-yr swap yield, % p.a.	0.03	0.00	0.10	0.20
10-yr swap yield, % p.a.	0.93	1.05	1.20	1.60
EUR/DKK	7.44	7.44	7.44	7.44
USD/DKK	7.07	7.15	6.89	6.65

Source: Statistics Denmark, Danish central bank (Danmarks Nationalbank), Macrobond Financial, Danske Bank

Sweden

The business cycle: dead or dormant?

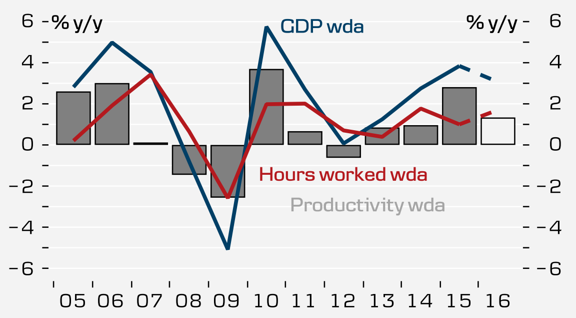
- **In Sweden, demand growth has remained on a solid footing. In the first three quarters of 2016, GDP growth was 3.5% y/y on average. Despite this, due to a very strong comparative Q4 15, we expect the full-year average to be closer to 3% y/y.**
- **In 2017 and 2018, we expect GDP to grow around 2% y/y, which is a little above our estimate of potential GDP growth post crisis (1.5% y/y). Given apparent domestic and international perils, this reflects our view of an economy in a state of Riksbank-induced real interest rate unconsciousness.**
- **Swedish labour markets continue to show steady improvement, despite some deceleration in employment growth being visible throughout 2016. Concurrently, the improvement in the unemployment rate seems to have ground to a halt. Our forecasts indicate the unemployment rate will continue to hover just above 7% over the forecast years.**
- **At face value, there is an apparent inconsistency between strong demand and employment growth but a rather high and stable unemployment rate. Looking into details, we can nevertheless explain most of these differences with a very strong inflow of immigrants over the past few years. We expect these flows to build over the coming two years as newcomers exit basic language and vocational training programmes and enter the labour force.**
- **Despite the 'core labour market' (domestically born persons between 25 and 54 years of age) demonstrating among the lowest unemployment rates since the early 1990s, wage inflation is still very weak. Even accounting for historical upward revisions to data and wage drift, we estimate that wage inflation is currently below 2.5% y/y.**
- **Looking ahead, we do not forecast a material change to the wage outlook. First, the profit share is rather subdued from a historical perspective; second, companies refer to stark competition and troublesome developments in demand; third, real wage growth has been very strong in Sweden, finally, employers and employees are posting subdued expectations on future wage growth. In our view, this implies only a gradual ascent from the current 2.5% y/y hourly wage growth towards 3% y/y in 2018.**
- **Historically, CPI inflation has been half of wage inflation. Hence, our forecast of peak 3% wage inflation is not sufficient to push inflation sustainably much closer to the inflation target than its current point.**
- **That said, the renewed push in oil and other commodity prices seen recently as well as a weak SEK can, at least temporarily, cause higher inflation. In our forecast, we expect commodity prices to rise slightly from here and a modest strengthening of the SEK. This last one is, however, not enough to balance fully the inflationary impulse, implying a small rise in inflation from summer 2017 onwards.**
- **Thus, we expect the Riksbank to increase stimuli with another prolongation of at least SEK30bn over the next six months, to lower rates by 0.1pp and then to hold still.**

Changes vs previous forecasts

Sweden	Current forecast		Previous forecast	
% y/y	2017	2018	2017	2018
GDP, calendar adjusted	2.0	2.0	2.0	-
Private consumption	1.5	2.0	1.1	-
Public consumption	2.0	1.3	2.1	-
Gross fixed investment	1.9	2.1	2.3	-
Exports	3.5	4.1	3.0	-
Imports	3.4	4.4	3.4	-
Unemployment rate	7.2	7.1	6.8	-
Inflation	1.3	1.4	0.8	-
Government balance, % of GDP	-0.7	-0.5	-0.5	-
Current account, % of GDP	4.5	4.5	5.0	-

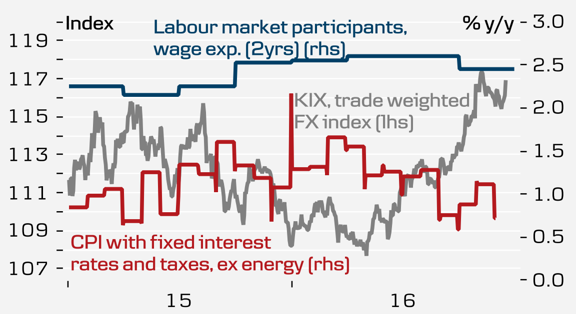
Source: Danske Bank

GDP, hours worked and productivity



Source: National Institute for Economic Research (KI) and Statistics Sweden (SCB), Danske Bank calculations

All there is to weighing the Riksbank's next steps



Source: National Institute for Economic and Social Research (NIESR), National Institute for Economic Research (KI) and Statistics Sweden (SCB), Danske Bank calculations

Light at the end of the global tunnel?

Danske Banks' recently updated global forecasts paint a more positive view of global demand. In particular, it is the US and euroland that we expect to grow faster than in previous years, while we expect emerging markets and to revert to a higher growth rate. As advanced economies are the main share of Swedish export markets, this is unambiguously positive. That said, we must also consider that we forecast global investment growth to be quite weak whereas we expect global consumption to accelerate. From a Swedish industrial perspective, this is less benign, as the Swedish export industry is geared heavily towards input and investment goods.

We expect import growth on Swedish export markets, or Swedish world market growth if you prefer, to grow by 3.5% in both 2017 and 2018, following a rather weak 2.5% y/y in 2016. After winning market share in both 2014 and 2015, we expect the Swedish export sector to maintain its market share over the forecast horizon. In 2016, exports should have grown by at least 2.7% y/y (volume and working-day adjusted). In 2017 and 2018, they should accelerate to 4.0% y/y (vol, wda) and 4.1% y/y (vol, wda), respectively.

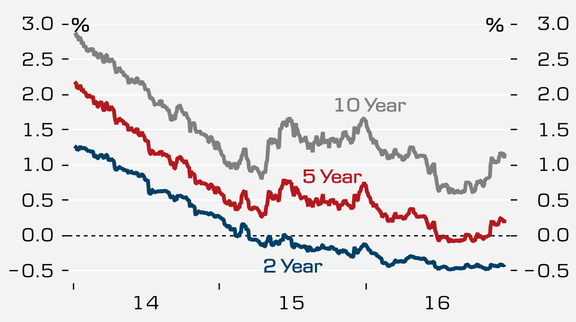
Exports aligning to strong world market growth

Source: National Institute for Economic and Social Research (NIESR), National Institute for Economic Research (KI) and Statistics Sweden (SCB), Danske Bank calculations

Financial conditions are a one-way bet

Ever since the global financial crisis of 2007/08, our call has been for ever lower nominal and real rates – at least as long as it was possible to engineer with economic policy. Given that the Riksbank and other central banks are quite openly talking about 'monetary policy fatigue', the notion that central banks cannot carry on indefinitely with QE and ever lower policy rates, we suspect that the unconventional monetary policy of today is coming to an end. Additional, and even more controversial, measures are of course still possible but are probably reserved for a potential recession or a similar situation.

Interest rates are on the rise again



Source: Macrobond Financial, Danske Bank calculations

Considering the relatively strong developments in the Swedish economy, we expect the Riksbank to be leading rather than lagging these developments. Less central bank distortion of market pricing should under any circumstances imply reflating term and risk premiums. The crux is whether this increase will outpace growth in incomes and eventually supress any form of demand growth. Our base case is that it will not but it is a subject to which we will have to pay much attention over the coming months and years.

In terms of market interest rates, this implies higher long-term interest rates but short rates that are anchored around current levels, i.e. a steepening of the interest rate curve from already conspicuously high levels. Credit premiums should also swell, tightening financial conditions further.

In nominal terms, the SEK is undoubtedly weak. From a truly fundamental perspective, we are also of the view that the SEK has the potential to strengthen. That said, we have some caveats to the omnipresent view of a very weak SEK. These caveats are strongly related to the export industry's competitiveness and unsustainable fiscal balances and central bank actions distorting price discovery in the currency markets. Therefore, we have a very modest strengthening of the SEK in our forecast.

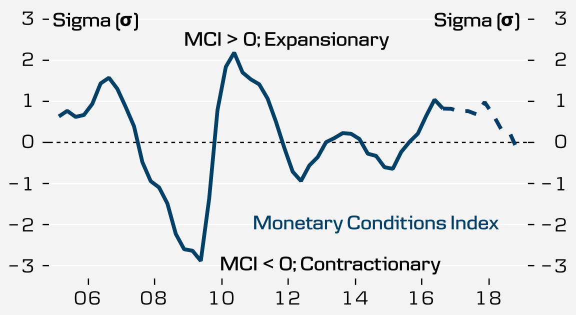
After posting an impressive rise over the past few years, we expect Swedish equity markets to realign themselves with overall nominal GDP growth, as it is likely the impetus for further cost-based improvements in profits is more or less exhausted.

The housing market has recovered after the introduction of the forced amortisation rules in June 2016. Yet, since the start of 2015, house price inflation seems to have decelerated, which coincides with a very strong boost to residential investments. Looking ahead, we expect this deceleration to continue and for prices to align more with fundamental income prospects. After rising c.4% this year, prices should remain stable as incomes catch up with house market developments. This view is underlined by the apparent resolve among regulatory authorities to keep house prices and household credit growth in check.

Swedish public finances are in good shape, especially in comparison with many other countries'. Tax incomes have grown strongly over the past few years, due mainly to solid employment and consumption growth.

A crude but effective way to summarise the financial prerequisites to our forecast is in a Financial Conditions Index (FCI). As can be seen, financial conditions are currently relatively benign for growth and are set to remain supportive until 2018, when financial conditions become more balanced.

Economic conditions becoming more balanced

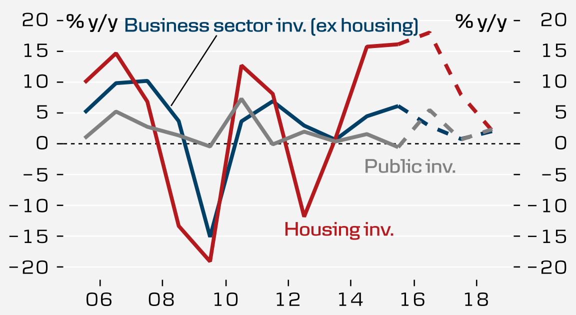


Note: MCI is calculated as the deviation from a filtered trend of different interest rates and an exchange rate index (all variables are normalized and adjusted for inflation)
Source: Macrobond Financial. Danske Bank calculations

Disappointing investment growth

Over the past couple of years, Swedish investment growth has been remarkably strong, due mainly to soaring housing investments. At times, quarterly growth rates in housing investments have even exceeded 30% AR (vol, wda). Housing investments growth was elevated in the first three quarters of 2016, exceeding 20% AR (vol, wda) Outside of housing, however, developments have been much less benign and the main source of information regarding the investments outlook – Statistics Sweden's investment survey – has actually deteriorated with each new edition.

Investments growth by sector (and type)

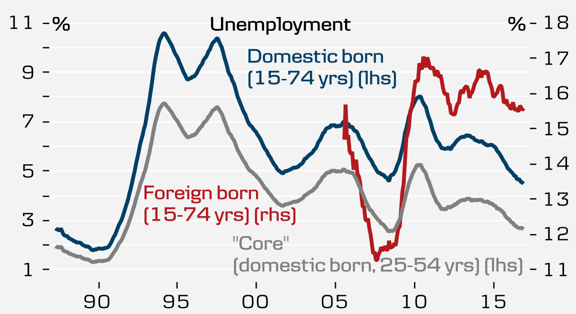


Source: National Institute for Economic Research (KI), Statistics Sweden (SCB), Danske Bank calculations

For the full-year 2016, we estimate that housing investments growth will average 18% y/y (vol, wda) and that growth will be a still solid 8% y/y (vol, wda) in 2017. However, as the housing market settles and major projects are completed, we expect a swift deceleration to 2.1% y/y (vol, wda) in 2018. Admittedly, especially given still low supply and low financing costs, there are some upside risks to this forecast.

'Underlying' investment growth, business sector investment growth, is nonetheless uncannily weak and has rarely averaged above 5% y/y (vol, wda). According to our calculations, we believe this to be below replacement rates, meaning that the Swedish business sector capital stock has been depleted over the past few years. Unfortunately, we see no evidence of a more buoyant investment cycle over the forecast horizon.

'Core' labour market is as strong as it's ever been



Source: SCB, Macrobond Financial, AMS, Danske calculations

Overall investments, or gross fixed capital formation if you will, is therefore expected to grow a sombre 2.3% y/y (vol, wda) in 2017 after a still solid 6.2% y/y (vol, wda) in 2016. In 2018, and following Statistics Sweden's investment survey closely, we expect investments to grow 2.1% y/y (vol, wda).

Divided labour market, tepid consumption growth

For the ‘core’ labour market – domestically born persons between 25 and 54 years of age – unemployment is currently at levels not achieved sustainably since the early 1990s. The share of population employed is likewise among the highest we have on record and employment growth continues on a strong note. That said, youth unemployment and, in particular, foreign-born persons have a very hard time finding a matching job in Swedish labour markets. This goes some way to explaining why the unemployment rate has remained elevated throughout 2016.

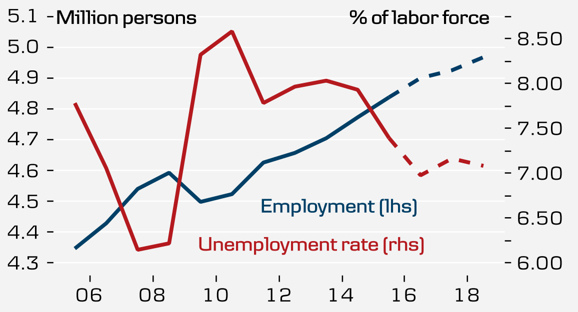
Looking ahead, challenges persist. The high influx of immigrants over the past couple of years is set to continue feeding into the labour force as the newcomers exit vocational and language trainings. Taken together with large numbers of young cohorts entering the labour market, it is plausible that labour force growth will be in line with, or even above, employment growth. This illustrates why we have a bifurcated almost conflicting view on labour market developments. In 2017, we expect employment growth to be quite low, only 0.5% y/y, while in 2018 we think it will pick up steam again and reach 0.9%. Meanwhile, unemployment rates are elevated and it is only past the forecast horizon we expect any pronounced progress towards our estimate of the non-accelerating inflation rate of unemployment (NAIRU) at 6.5%.

Job openings over the past few years have been distinguished by a relatively high share of low value added – low paying – jobs This is one reason behind the rather low nominal hourly wage growth, but strong growth in hours worked and low inflation have nevertheless implied that real incomes have been growing handsomely. We see little reason to believe the next couple of years will be much different, as many entering the labour force are taking their very first few career steps and trying to amass experience and knowledge. In all, we expect disposable incomes to grow 2% (vol, wda) in both 2017 and 2018.

Developments in the savings ratio have been rather unusual, almost counterintuitive, over the past few years. After making a leap in conjunction with the global financial crisis, as precautionary savings increased, we and most other forecasters expected the savings ratio to recede towards its historical averages. However, this has not materialised but instead the savings ratio has continued to climb and is currently around 16% of disposable income. One could make the case that this time it is different and that the savings ratio is about to start its descent, opening up for increased consumption. We remain hesitant. Instead, marked by previous errors, we have – fingers crossed – chosen to keep the savings ratio more or less intact over the forecast horizon.

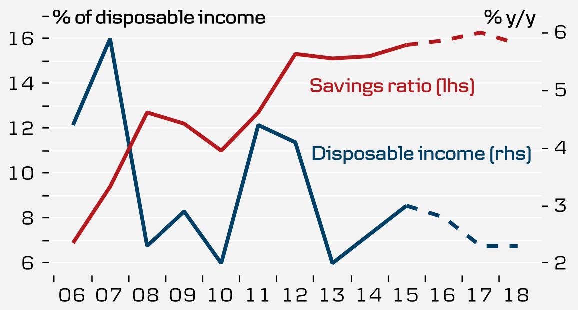
Turning to the consumption outlook, considering the outlook for incomes and weighing the near-term propensity to save among households, we believe that consumption growth in 2017 will be a slightly disappointing 1.6% y/y (vol, wda) but this is due mainly to weak developments towards the end of 2016. In 2018, consumption growth is again close to its historical average, at 2.1% y/y (vol, wda).

Labour market ‘running hot’ is set to help detached worker groups



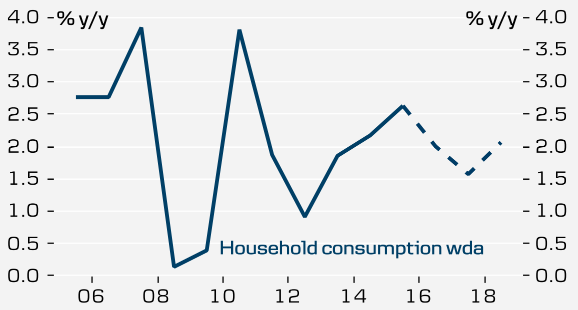
Source: KI, SCB, Danske Bank calculations

Disposable incomes and savings ratio



Source: SCB, NIER, Danske Bank calculations

Consumption outlook stable



Source: KI, SCB, Danske Bank calculations

Subdued inflationary pressures, Riksbank pushing on a string

We have already commented on our main assumptions and discussed our forecasts for different sectors of the Swedish economy. Aggregating the components of GDP together, a familiar story emerges: that of a flat-lining Swedish economy. After growing 3% y/y (vol., wda) in 2016, GDP growth is expected to recede to 2% y/y (vol, wda) in 2017 and remain there also in 2018. Albeit uninspiring, it is still somewhat above our estimate of potential GDP growth (1.5% y/y). Bear in mind that actual growth has often been higher than this over the past years, with domestic demand or rather household consumption and housing investments being the sole drivers of GDP growth. In our view, this is almost exclusively the result of unprecedented economic policy stimuli. As the scope for further stimuli is exhausted and reversed, we expect overall demand growth to recede towards fundamentals. The lopsided nature of growth has also resulted in weaker productivity than historical experiences suggest, while nominal rigidities have managed to keep wage growth at more normal levels.

Eventually, we expect Sweden to behave as the proverbial small open economy it is. In short, suffering from weak international demand and low domestic productivity, paired with high real wage growth, the profit share has been depressed (in particular in the manufacturing industry). In order to restore the profit share to its relatively stable historical average, companies need to claim a larger part of the expected low productivity gains, to the detriment of wage growth. We expect this to play out over coming years, which is why we believe that hourly wage growth will remain subdued.

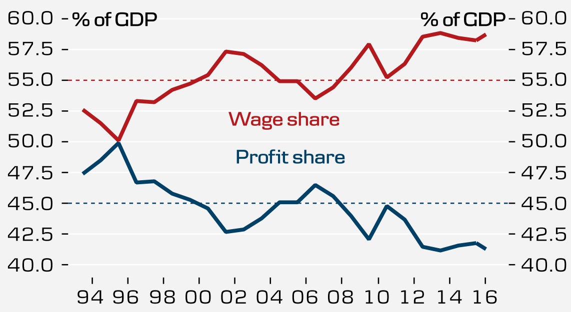
Put another way, we expect a strong cost focus, from both companies and households, implying continued very low inflation pressure.

There are some risks to this view, in particular if labour market unions in, for example, the buoyant construction sector or the demographically squeezed public sector, fail to adhere to the wage-setting ‘mark’ of the export industry. However, we believe such fears are overblown, as the export industry’s wage-setting mark is considered widely to be an instrumental part of Sweden’s economic success over the past few decades.

Hence, we expect inflation to run below both the Riksbank’s current forecasts and, more importantly, below the inflation target. We expect (CPI) inflation to average a sub-par 1.3% y/y in 2017 and a still measly 1.4% y/y in 2018. This, masks even worse underlying inflation developments.

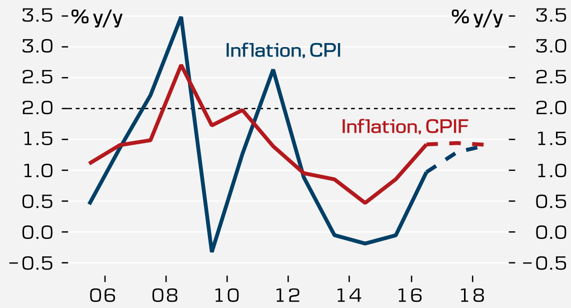
In conclusion, from a monetary policy perspective, the Riksbank will have no other option than to continue supporting the economy, lowering the repo rate to -0.6% and prolonging the bond purchasing programme by at least another six months and at least another SEK30bn. For now, we have not added further stimuli to our forecasts but as we move deeper into 2017, we are certain that we will return to this subject again if real development should disappoint, or inflation expectations turn south again. Considerably more aggressive policy measures are still available to the Riksbank. Just saying.

Poor Swedish capitalists



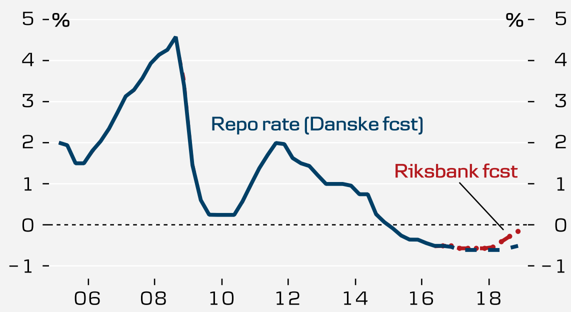
Source: KI, SCB, Danske Bank calculations

Inflation becoming entrenched below target



Source: SCB, Riksbank, Macrobond, Financial, Danske Bank calculations

Hikes are still a long way hence



Source: Riksbank, Macrobond Financial, Danske Bank calculations

Sweden: forecasts at a glance

National account	2015	2015	2016	2017	2018
			Forecast		
	SEK bn (current prices)		% y/y		
Private consumption	1884.2	2.7	2.1	1.5	2.0
Government consumption	1086.4	2.5	3.5	2.0	1.3
Gross fixed investment	988.7	7.0	6.5	1.9	2.1
Growth contribution from inventories	23.4	0.3	0.2	-0.1	0.1
Domestic demand	3982.6	3.7	3.6	1.7	1.9
Exports	1906.2	5.6	3.1	3.5	4.1
Aggregate demand	5888.8	4.0	3.8	1.6	2.0
Imports	1707.7	5.5	4.3	3.4	4.4
Growth contribution from net exports	198.5	0.3	-0.3	0.2	0.1
GDP	4181.1	4.1	3.3	1.7	1.9
GDP, calendar adjusted		3.8	3.0	2.0	2.0

Economic indicators	2015	2016	2017	2018
Trade balance, SEK bn	125.5	78.0	79.6	78.1
- % of GDP	3.0	1.8	1.8	1.7
Current Account, SEK bn	195.5	198.0	201.6	209.2
- % of GDP	4.7	4.6	4.5	4.5
Public sector savings, SEK bn	-4.2	-26.1	-31.4	-20.9
- % of GDP	-0.1	-0.6	-0.7	-0.5
Public debt ratio, % of GDP*	43.4	42.0	41.8	40.7
Unemployment, % of labour force	7.4	7.0	7.2	7.1
Hourly wages, % y/y	3.0	2.5	2.8	3.0
Consumer prices, % y/y	0.0	1.0	1.3	1.4
House prices, % y/y	10.8	4.0	0.0	0.0
* Maastricht definition				

Financial figures	04/01/2017	+3 mths	+6 mths	+12 mths
Repo rate, % p.a.	-0.50	-0.50	-0.50	-0.50
2-yr swap yield, % p.a.	-0.35	-0.45	-0.40	-0.45
10-yr swap yield, % p.a.	1.10	1.20	1.20	1.40
EUR/SEK	9.56	9.40	9.30	9.20
USD/SEK	9.10	9.04	8.61	8.21

Note: The national account figures relate to actual growth rates (i.e. not calendar adjusted or wda)
Source: Statistics Sweden, Danske Bank

Norway

Moderate growth

- **All indicators point to growth picking up but somewhat more slowly than previously expected.**
- **There are still no signs of serious second-round effects from the oil downturn, sectoral or geographical. Quite the opposite, it seems that growth outside the oil sector is accelerating.**
- **While we believe activity in the oil sector will continue to decline, much of the fall is behind us. The headwinds are easing and we expect them to ease further. However, developments during the autumn suggest the danger is far from over.**
- **High homebuilding activity and expansionary fiscal policy are propping up growth, while private demand remains weak.**
- **While we expect oil-related headwinds to ease somewhat in 2017, we also expect the fiscal policy stimulus to ease. Nevertheless, we believe economic growth will be higher this year, due to stronger growth in private consumption and investment.**
- **Unemployment has risen moderately and vacancies increased somewhat more slowly in the autumn than earlier in the year. However, leading indicators point to employment picking up during the course of 2017.**
- **Inflation has come down more quickly than we expected but this is due solely to a faster pass-through of the krone's appreciation. The underlying rate of inflation has been more or less unchanged.**
- **In our view, lower inflation will gradually enhance purchasing power, even if real wage growth remains moderate.**
- **The housing market has become very tight but there are signs of the supply side reacting. Together with new credit restrictions, we expect this gradually to rein in growth in housing prices.**
- **Norges Bank left its policy rate unchanged in December and we do not expect it to fall further; nor do we believe it is likely to increase in 2017.**
- **Higher oil prices and better growth have resulted in a stronger krone and we believe this trend is set to continue in 2017.**

Brighter outlook

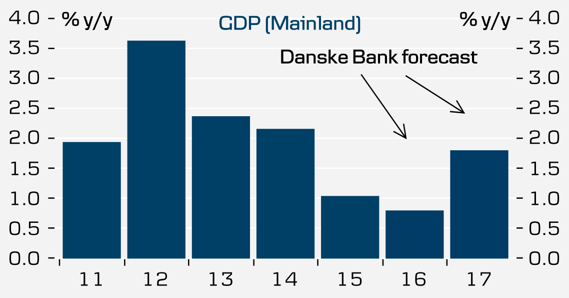
Growth in the Norwegian economy seems to be slowly but surely picking up again but has been somewhat weaker than expected. Mainland GDP grew 0.2% q/q in Q3 16 and we now expect it to grow by 0.8% in 2016 as a whole, which is 0.2pp lower than we forecast in *Nordic Outlook: September 2016*, 23 September 2016. This downward revision is due mainly to slightly weaker growth in private consumption and to mainland exports performing substantially less well than expected. The latter effect is largely a result of a steep fall in exports from oil-related mainland firms.

Changes vs previous forecasts

Norway				
	Current forecast		Previous forecast	
% y/y	2017	2018	2017	2018
GDP (mainland)	1.8	2.2	2.3	-
Private consumption	2.0	2.2	2.2	-
Public consumption	2.0	2.3	3.0	-
Gross fixed investment	1.0	2.5	-1.4	-
Exports	1.3	1.3	1.3	-
Imports	1.9	2.3	1.9	-
Unemployment (NAV)	3.0	3.0	3.3	-
Inflation	2.2	2.1	2.2	-

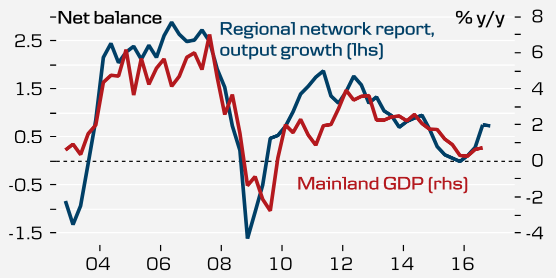
Source: Danske Bank

Looking up



Source: Macrobond Financial, Danske Bank

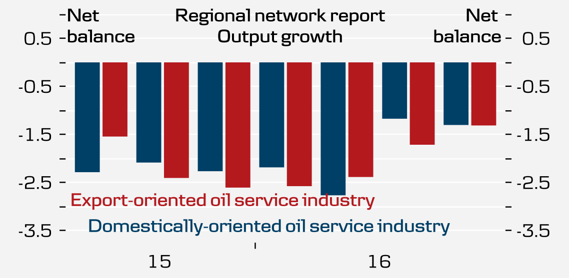
Growth outlook brighter



Source: Macrobond Financial

Oil investment continues to fall but much more slowly than a year ago. The fall in oil investment in Q3 was the smallest for almost three years. Nevertheless, industrial activity was much weaker than expected in Q3 and leading indicators have also deteriorated, increasing the risk of a fresh downturn in manufacturing. Statistics Norway's manufacturing confidence indicator fell sharply in Q3, due entirely to weaker order books. This may be because new orders are not rising fast enough to compensate for projects being completed. If so, it could be that activity is set to fall. However, there was little sign of any big drop-off in activity in the November round of Norges Bank's regional network survey, which may reflect a somewhat stronger end to the year than feared.

Weaker headwinds in oil-related industries



Source: Macrobond Financial

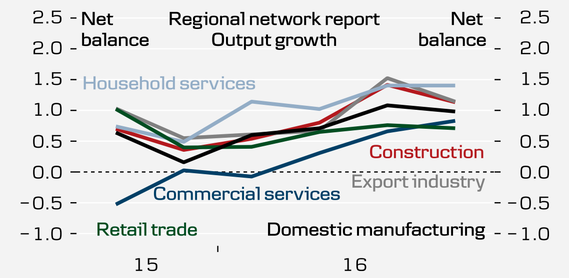
Growth in private consumption has disappointed since our September forecast. Consumption of goods in particular is still weak, which should be seen in the light of high inflation eroding purchasing power through negative real wage growth. Consumer confidence improved towards the end of the year and the savings rate has come down, which suggests that it is not caution and fear that are holding households back. The annual rate of growth in consumption of goods is holding above 3% in nominal terms but only around zero in real terms, which also suggests that purchasing power is the real problem. Consumption of services is continuing to grow strongly, to some extent a result of higher tourist numbers.

Growth in mainland exports has been a big disappointment since our September forecast. The main reason is probably that some oil-related exports count as mainland exports in the GDP data and that these industries have undergone a fresh downturn since the summer.

As already mentioned, it is primarily strong growth in government demand and housing investment that has been driving growth in the Norwegian economy. The fiscal policy stimulus in 2016 is estimated at 1% of mainland GDP, which means, in isolation, that GDP growth would otherwise have been negative. In such a scenario, however, interest rates would probably have been lower and the krone weaker, pulling somewhat in the other direction. We have also revised up our estimate of growth in housing investment in 2016 from just over 7% to almost 9%, with ever-higher prices for existing homes boosting sales of new housing and increasing the expected return on newbuilds.

It is also very encouraging that business investment has now risen for four successive quarters. There was strong growth in industrial investment in 2016, driven partly by several big projects in the process industry but it is mainly the power sector that is pushing up investment at present.

Slightly more mixed picture of late



Source: Macrobond Financial

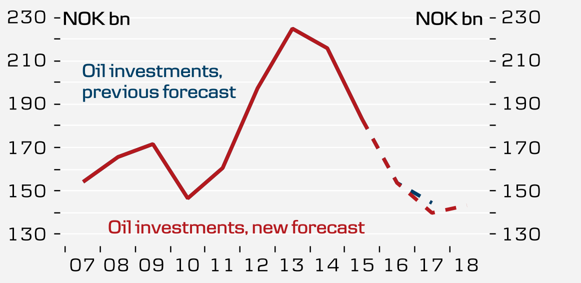
Norges Bank's regional network still expects growth to accelerate further over the next six months but somewhat more slowly than we had expected. The aggregated output index came out at 0.73 in November, down marginally on August. Factoring in growth in government demand, this points to GDP growth of just under 0.5% q/q in Q1 and Q2.

The underlying survey data show the decline in oil-related industries continuing at roughly the same rate as in the previous survey, which is somewhat more slowly than in H1 16. This ties in well with our belief that oil investment is about to bottom out after falling since 2013.

Equally important, however, are the clear signs that growth outside the oil sector is still accelerating. Firms in all sectors reported similarly strong growth expectations to those in August. This may indicate that the danger of second-round effects from the oil shock sending the Norwegian economy into a deep and protracted recession is now evaporating, with the positive growth effects of lower interest rates, a weak krone and, in particular, expansionary fiscal policy outweighing the negative effects of dwindling oil activity.

Firms are also expecting jobs growth for the first time in almost two years. Although expectations in November were slightly weaker than in August, it would appear that employment will rise over the next two quarters for the first time in two years. Firms also reported in November that capacity utilisation increased throughout 2016. The combination of higher capacity utilisation and slightly lower growth may, unfortunately, indicate that trend growth is slightly weaker than previously assumed.

Oil investment revised down but about to bottom



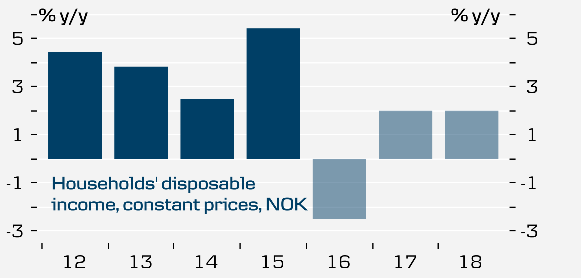
Source: Macrobond Financial, Danske Bank

Private demand to take over in 2017

In our view, higher oil prices and heavy cost cutting in the Norwegian sector mean oil investment will bottom during the course of this year. The oil downturn's negative effects on mainland growth will therefore be greatly reduced. Nevertheless, we have revised down our forecast for oil investment in 2017 from -6% to -9% in the light of the November oil investment survey, due mainly to lower investment in exploration. While oil prices are naturally a source of uncertainty, we do not expect investment levels to be greatly affected unless there is a surge in prices at the start of the year.

This downward revision of oil investment is the most important reason we have reduced our GDP forecast for 2017, due to the effect it has on activity in the supply sector. We also expect fiscal policy to be much less expansionary than in 2016, with the government's budget translating into a fiscal stimulus of around 0.4%, down from 1.0% last year.

Purchasing power set to improve



Source: Macrobond Financial, Danske Bank

At the same time, we expect inflation to slow gradually as the effects of the Norwegian krone's depreciation fade and, along with a stronger labour market, we expect this to provide more support for private consumption. We expect growth in private consumption to accelerate from 1.5% in 2016 to 2.0% in 2017 and this is the most important reason we expect growth in 2017 to be higher than in 2016. In addition, we now expect much stronger growth in business investment in 2017, fuelled by greater optimism, stronger profitability and higher capacity utilisation. We also expect a substantial contribution from investment in the power sector, both in traditional hydroelectric production and in other types of renewable energy.

On balance, we forecast mainland GDP growth of 1.8% in 2017.

Labour market showing signs of stabilising

It appears that the worst of the downturn in the labour market is behind us. This is partly because the main waves of redundancies in the oil sector came from Easter through to late summer 2015. Nevertheless, we have seen signs of unemployment rising again in recent months. As the increase has been concentrated largely in typical oil-dominated industries and regions, it is natural to assume that it is the result of another round of downsizing in the sector.

However, the number of redundancies and layoffs reported to the Norwegian Labour and Welfare Administration (NAV) has fallen over the past two months, which could mean that this fresh round of downsizing is drawing to a close, with the result that unemployment will fall again from early 2017.

The two sources of labour market data – NAV and the Labour Force Survey (LFS) – have continued to paint rather different pictures. This may be due to more young people having problems finding a job and so counting as out of work in the LFS data but not being included in the NAV data because they have not registered as unemployed. However, the two measures have begun to converge again in recent months and are now presenting more or less the same trend over the past year.

We have long argued that the rapid rise in vacancies published by NAV means that demand for labour has, after all, been relatively healthy. The increase has stagnated rather over the past couple of months but the level remains relatively high.

We are also now seeing leading employment indicators clearly signalling an increase in employment. Employment expectations in Norges Bank's regional network survey, for example, have been at their highest for two years in the past two rounds.

We still expect oil-related industries to downsize further in 2017 but at a much slower rate than in 2016. Therefore, we expect unemployment to peak around the current level of just over 3% (NAV) as growth picks up. On the other hand, we are seeing signs that productivity growth is accelerating again and that the supply of labour may also be increasing, both of which would temper the fall in unemployment even with stronger economic growth.

Inflation set to fall

Inflation has fallen much further than expected over the past four months. After peaking at 3.7% y/y in July, core inflation slowed to 2.6% in November, which is more than half a point less than Norges Bank projected in the September monetary policy report. It is mainly imported inflation that has fallen unexpectedly far: domestic inflation has been more or less as predicted, holding at just over 2.5% y/y. Therefore, we believe that the underlying picture has changed little and that the pass-through from the exchange rate to import prices has simply happened more quickly than we expected.

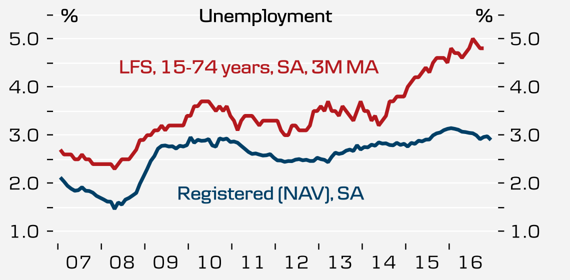
We expect the underlying price drivers – lower wage growth and higher productivity growth – to put something of a dampener on domestic inflation. We also expect a gradually higher oil price to result in a slightly stronger krone. Therefore, import prices are likely to fall further. We still believe that core inflation has peaked and will slow during the year, approaching 2% at the end of 2017.

Lower unemployment and higher corporate earnings point to higher levels of wage growth. However, recent surveys indicate that wage expectations among both employers and unions are somewhat lower than we anticipated. Therefore, we have revised down our wage growth forecast for 2017 to 2.8%.

Housing market buoyant

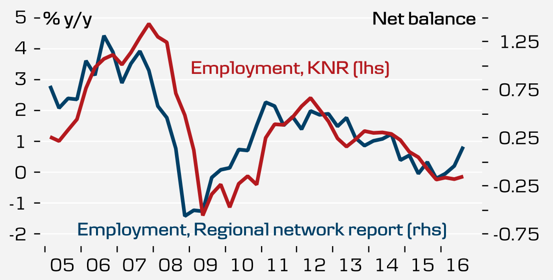
The housing market tightened significantly during the autumn. Prices climbed much more quickly than expected, especially in the big cities, and turnover was high in relation to the number of homes on the market. Prices in November were up 11.5% y/y, the highest rate of growth for almost seven years. Prices in Oslo climbed 22%, the biggest increase since 2000.

Unemployment stabilising



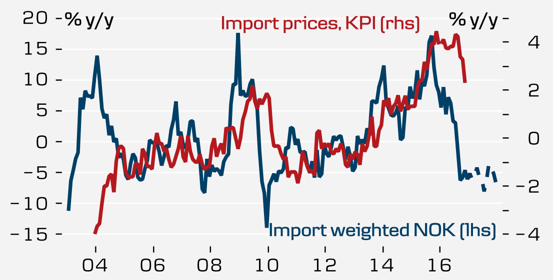
Source: Macrobond Financial, Danske Bank

Employment set to increase



Source: Macrobond Financial, Danske Bank

Krone will continue to put pressure on inflation



Source: Macrobond Financial, Danske Bank

The underlying reasons for these soaring prices are a surge in demand, due to population growth and increased borrowing capacity on the back of low mortgage rates and the supply side's failure to keep up.

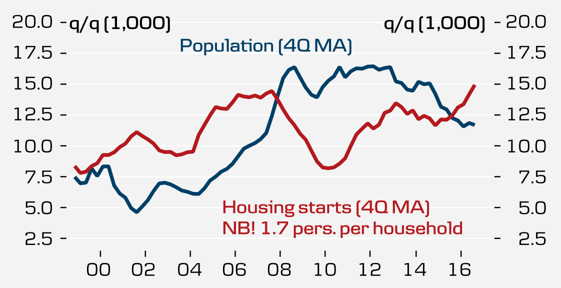
Therefore, there is growing concern that the rapid rise in prices and associated increase in debt in the household sector could pose a risk of financial imbalances building up. The FSA has duly proposed further steps to tighten banks' lending practices, this time including measures specifically targeting mortgages in Oslo. Higher equity requirements for purchases of second homes and a maximum LTI of 5 are probably those that will have the greatest impact.

We think these measures could well help curb the rise in prices in Oslo by making it harder to fund purchases of second homes. According to Norges Bank, 6.9% of new mortgages in 2014 had an LTI above 5 and the percentage has probably risen slightly since.

On the other hand, borrowing rates have stopped falling, population growth has slowed and homebuilding activity is rising. Homebuilding is actually now outpacing growth in the number of households, so we expect a better balance in the housing market during the course of 2017 and 2018. However, homebuilding activity in Oslo is still insufficient, so the market there may tighten further in 2017 unless the aforementioned credit restrictions are more effective than we expect.

Despite all this, we do not expect any major correction of housing prices while interest rates remain low and unemployment is stabilising.

Headed for a better balance in the housing market



Source: Macrobond Financial, Danske Bank

Interest rates have hit bottom

As expected, Norges Bank left its key rate unchanged at 0.5% at the meetings in October and December. Clear signs of economic growth picking up mean that there is less of a need to cut rates further. Soaring housing prices over the summer also underlined the growing cost of extremely expansionary monetary policy.

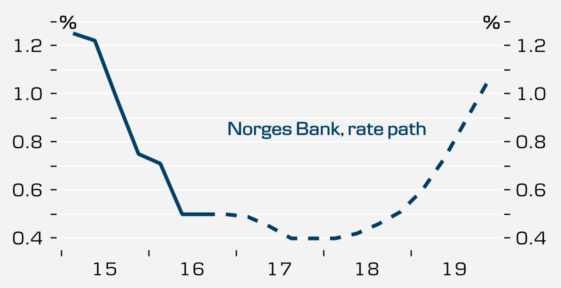
This is now explicitly reflected in Norges Bank including financial stability (i.e. developments in housing prices and debt) directly in its interest rate projections. Without this adjustment, a rate cut would actually have been on the cards in the not-too-distant future.

Further rate reductions are therefore to be avoided. The interest rate path presented in Norges Bank's latest monetary policy report still includes a roughly 40% chance of a further rate cut by summer 2017. Based on the forecasts presented in this edition of *Nordic Outlook*, we expect Norges Bank to leave its policy rate unchanged at 0.5% throughout 2017. As we see it, only a major strengthening of the krone could trigger a new rate cut and this is probably also the main reason the central bank's interest rate projections include the possibility of a further reduction.

Although oil prices have been fairly stable since our September forecast, the krone has, as expected, strengthened somewhat. This has to be seen in the light of the Norwegian economy performing better than many may have feared. Expectations of further rate cuts have receded and much of the downside risk to the Norwegian economy has evaporated.

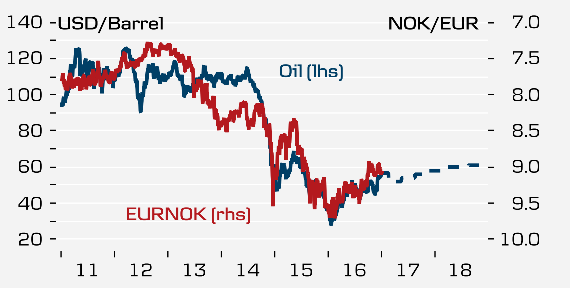
Based on our expectation of a higher oil price and gradually accelerating domestic growth, we therefore expect the Norwegian krone to strengthen further over the next 12 months. However, we do not expect significant appreciation, as the interest rate differential to Norway's trading partners will be largely unchanged and the rise in oil prices will be only moderate. We predict an exchange rate of 8.80 kroner to the euro at the end of this year.

Policy rate set to bottom out at 0.5%



Source: Macrobond Financial, Danske Bank

Oil price will continue to drive Norwegian krone



Source: Macrobond Financial

Norway: forecasts at a glance

			Forecast		
National account	**2015 (2014 prices)**	**2015**	**2016**	**2017**	**2018**
				% y/y	
Private consumption	1254,1	2,1	1,5	2,0	2,2
Public consumption	652,3	2,1	2,3	2,0	2,3
Gross fixed investment	717,4	-3,8	-0,3	1,0	2,5
Petroleum activities	213,3	-15,0	-16,0	-9,0	2,5
Mainland Norway	503,1	0,6	4,5	4,2	3,0
Dwellings	152,3	1,6	8,8	6,1	2,0
Enterprises	219,1	-1,6	2,0	3,0	3,5
General government	131,7	3,0	4,5	4,0	2,5
Mainland demand	2742,9	1,8	2,6	2,3	2,3
Growth contribution from stockbuilding		0,2	0,2	0,0	0,0
Exports	1203,7	3,7	-1,5	1,3	1,3
Crude oil and natural gas	581,3	3,2	1,0	-0,3	-0,6
Traditional goods	321,8	5,8	-4,9	2,8	2,8
Imports	875,5	1,6	1,0	1,9	2,3
Traditional goods	510,7	1,9	0,2	1,8	2,5
GDP	3071,1	1,6	0,6	1,5	1,5
GDP Mainland Norway	2418,8	1,1	0,8	1,8	2,2

Economic indicators	**2015**	**2016**	**2017**	**2018**
Employment, % y/y	0,3	0,0	1,0	1,0
Unemployment (NAV), %	3,0	3,0	3,0	3,0
Annual wages, % y/y	2,8	2,4	2,8	3,0
Consumer prices, % y/y	2,1	3,5	2,2	2,1
House prices, % y/y	2,7	8,0	7,0	1,0
Core inflation	2,7	3,1	2,3	2,0

Financial figures	**04-01-2017**	**+3 mths**	**+6 mths**	**+12 mths**
Repo rate, % p.a.	0,50	0,50	0,50	0,50
2-yr swap yield, % p.a.	1,28	1,20	1,30	1,40
10-yr swap yield, % p.a.	1,95	1,80	2,00	2,30
EUR/NOK	9,07	9,10	9,00	8,80
USD/NOK	8,63	8,75	8,33	7,86

Source: Statistics Norway, Danske Bank

Finland

Growth gains better footing

- **The Finnish economy surprised positively in 2016, although GDP continues to be well below pre-crisis levels. We have revised our forecast slightly higher and expect Finnish GDP to grow 1.3% annually in 2017-18. Growth has been driven mainly by consumption and construction in 2016 while improved competitiveness and expectations should help to boost exports and investments in 2017.**
- **Private consumption has continued to revive the economy. It is hard to believe that consumption could grow as strongly incoming years without a pickup in exports and employment. While low interest rates and falling unemployment support consumers, inflation is set to turn positive again and low wage and pension growth will challenge purchasing power.**
- **Exports have performed badly in recent years. The outlook for 2017 is promising due to growth in export markets and better competitiveness. Russia is expected to resume growth and show increasing demand for Finnish exports. Tourism from Russia started to recover in late 2016.**
- **Construction has risen significantly and we forecast manufacturing investment will follow in 2017.**
- **Prime Minister Juha Sipilä's government is reform-oriented and aims to adjust public finances by EUR10bn (5% of GDP) in four years of power. The budget for 2017 is less austere than expected and aims to boost domestic private demand. Public debt continues to grow and Finland has lost its status as a triple 'AAA' country. Reforms should continue in order to maintain the 'AA' ratings. However, government bond yields are set to remain low in 2017.**

Changes relative to previous forecast

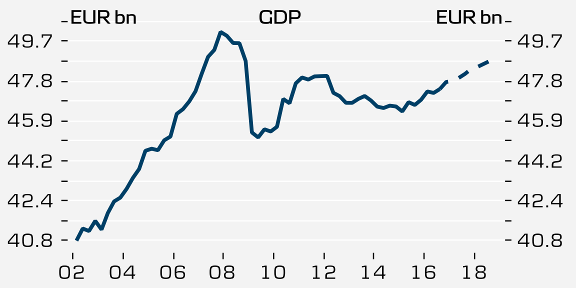
Finland	Current forecast		Previous forecast	
% y/y	2017	2018	2017	2018
GDP	1.3	1.3	1.0	-
Private consumption	0.8	1.0	0.7	-
Public consumption	0.0	0.2	-0.5	-
Gross fixed investment	3.5	2.5	3.0	-
Exports	3.0	3.5	2.5	-
Imports	2.5	3.0	2.0	-
Unemployment rate	8.3	8.0	8.6	-
Inflation	1.3	1.5	1.0	-
Government balance, % of GDP	-2.4	-2.2	-2.4	-
Current account, % of GDP	-0.7	-0.7	0.0	-

Source: Danske Bank estimates

Growth surprised positively this time

According to the latest national account figures, GDP rose 1.5% in January-September 2016. Year-on-year growth for the first half of the year was revised higher (1.5%) than we used as a baseline in our previous forecast (0.8%). Despite improving growth figures, the level of GDP is still roughly 5% lower than before the recession in 2008 and the economy is crawling below potential output. In 2016, domestic demand has continued to grow but foreign trade has disappointed again. Corporate investment has been subdued because of weak demand compared to existing capacity and an uncertain outlook. The situation in the labour market has stabilised and the trend in unemployment has improved modestly. Although we expect a continued recovery in 2017-18 and a positive surprise cannot be ruled out, the growth outlook as a whole remains moderate. An ageing population limits supply of labour and productivity growth has slowed down. Reforms in the labour market could increase participation rates and boost growth, yet the growth potential is likely to be below 2% per annum.

More than a lost decade in Finland's GDP



Source: Macrobond Financial, Statistics Finland

We expect GDP growth to peak at 1.6% in 2016 and then slow to an annual speed of 1.3% in 2017-18. Households have fuelled consumption and construction, but weak growth in real earnings will slow down private consumption growth significantly in 2017. At the same time, the competitiveness pact together with growth in global economy is beginning to lift exports. Headwinds will abate as we expect Russia, an important export market, to recover in 2017. The government budget for 2017 is modestly supportive of private demand, while municipalities seek savings. The main risks are external, relating to global demand.

Consumers moving into the background

Taking into account the prolonged weakness of the Finnish economy, private consumption has been surprisingly resilient. In addition, in 2016 private consumption continued its relatively strong performance and grew by 2.1% y/y in Q3. Low interest rates, moderate inflation and declining unemployment have been supporting consumers. Consumer confidence is very high in Finland – the highest in the whole of the EU.

Part of the consumption is financed by debt. Indebtedness of households has continued to grow, reaching all-time highs. Despite the growing indebtedness, the interest-rate burden paid by households is at an all-time low due to the low interest rates. The household indebtedness ratio in Finland is a bit higher than the euro area average, but lower than in other Nordic countries.

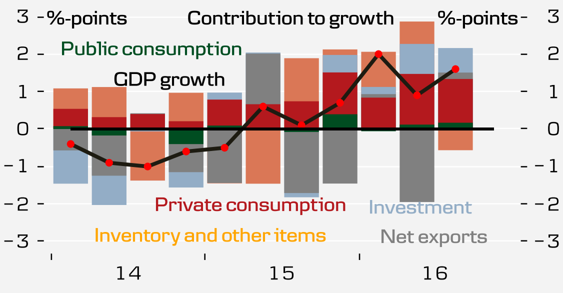
Looking ahead, we find it hard to believe that consumption could grow as strong in coming years without a pickup in exports and employment. Low interest rates and a lowering unemployment rate are supporting consumers. However, due to the competitiveness pact agreed in June, wages are set to be frozen in 2017 and employees' share of social security payments will be increased. To compensate for this, the government has introduced tax concessions in income taxes starting in 2017. Inflation will turn positive again (1.3% in 2016) and thus rising prices will eat up most of the growth in purchasing power. Taking into account these factors, we expect growth in private consumption to moderate from 2.2% in 2016 to 0.8% this year and 1.0% in 2018.

Exports set to rise in 2017 for many reasons

The volume of exports rose 1.2% in January-September 2016. Exports were boosted by a large ship delivery, while goods exports in general could be described flat at best. According to customs statistics, the value of goods exports diminished by 5% in January-October. The volume of imports increased by 1.6% in January-September and net exports contributed negatively to GDP growth. Customs statistics for October were downbeat without any indication of improvement, except for trade with Russia, which has bottomed out.

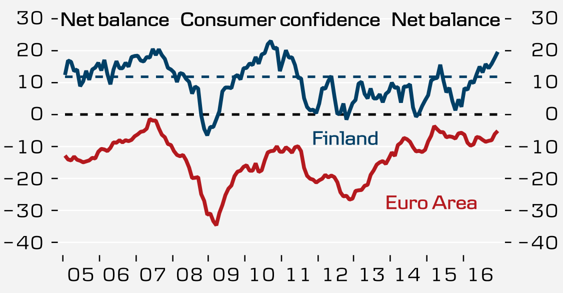
Among euro area economies, Finland continues to be a rare example of a country that has not seen much real growth in exports over the past three years. The volume of exports is about 20% below the 2008 level, even if the global economy has been recovering nicely. Exports of goods suffered badly from the descent of Nokia, but the development has been weak even without Nokia, which was old news by 2016. Falling demand for newsprint is a chronic issue but the forest industry strives to restructure and invent. Exports have also suffered from a high share of investment goods, which have been in short demand globally during this recovery.

Consumer driven growth (in 2016)



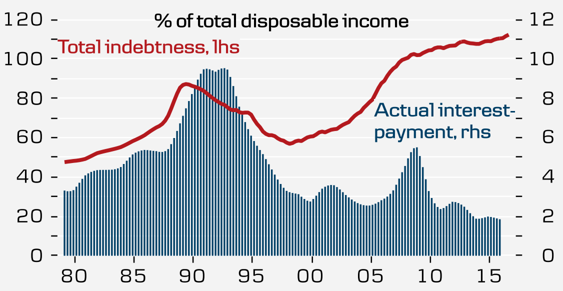
Source: Macrobond Financial

Consumer confidence is very high



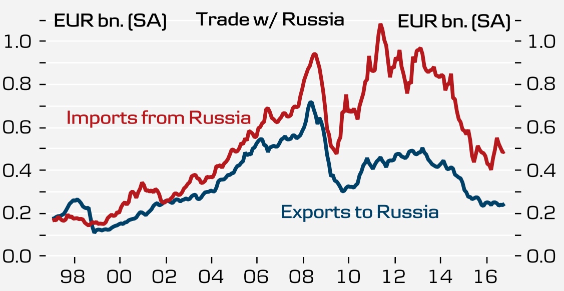
Source: Macrobond Financial, Statistics Finland

Indebtedness and interest rate burden



Source: Macrobond Financial, Bank of Finland

Exports to Russia stabilising

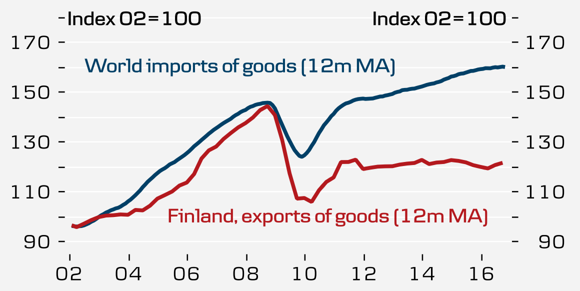


Source: Macrobond Financial

Finland's worsened cost competitiveness also plays a role here. Finland has seen its price competitiveness weaken compared with Germany and Sweden over the past 10 years. Finland's relative position is improving slowly due to wage moderation in Finland, higher wage rises in Germany and 'creative destruction', making output more efficient. In many earlier big cycles, a devaluation of currency or a significant structural change in industries resolved the problem within a few years. However, this time the process has been unusually slow.

Competitiveness is a core issue in the government's plan to boost growth. Because Finland cannot devalue its currency, the government pursued an 'internal devaluation'. After a year of intensive negotiations, a new competitiveness pact was signed in June. The pact freezes wages for a year (mainly 2017), makes employees liable for a larger share of social security payments, increases annual working hours by 24 without any impact on wages, cuts public sector holiday bonuses and adds some flexibility to local agreements. The Ministry of Finance estimates that the competitiveness pact will cut unit labour costs by 3.7%, which together with higher wage increases in other countries like Germany should boost price competiveness a fair amount by the end of 2017. We expect a modestly positive impact on exports and capex.

Finland's exports are still lagging



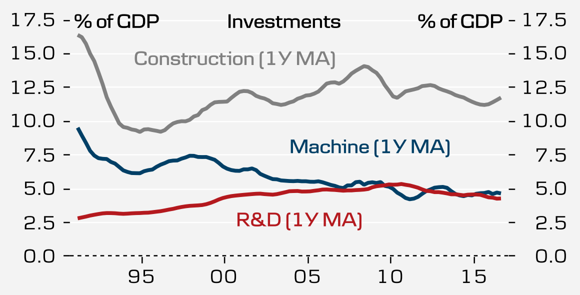
Source: Macrobond Financial, Finnish Custom

Meanwhile, the export outlook depends largely on demand from main markets. The outlook for the main Finnish export markets has remained relatively good (Germany, Sweden, the US) and Russia is expected to stage a modest recovery in 2017. Tourism from Russia has started to recover already. Exports of forest industry goods and cars should rise due to new production lines. Orders for new cruise ships will improve export figures in 2018. Surveys indicate investment plans in the SME sector. Brexit is clouding the export outlook in the medium term but the impact in 2017 is less adverse than expected initially. We expect exports to rise by 3.0% in 2016 and 3.5% in 2017.

Investment atmosphere improving

Due to the prolonged recession and poor export performance, manufacturing investments have been subdued in Finland for some time. Investments have decreased for four consecutive years and the volume in 2015 was roughly the same as in 2003. Total investment started to rise in 2016, due largely to construction. Housing construction volume rose by 6.5% and other construction by 4.2% in January-September, while investments in machinery and equipment fell by 1.4% and investment in intellectual property products like research and development fell by 1.9%. This slump in industrial investments erodes future growth potential. Surveys conducted by the Confederation of Finnish Industries and the Federation of Finnish Enterprises also show some tentative positive signals in the investment intentions of Finnish companies. Given higher growth expectations, improving cost competitiveness, relative ease of funding and ageing equipment, we expect industrial capex to gain speed in 2017. A similar turn in R&D expenditure is not in sight yet, which means that Finland risks falling behind other top innovators. Finland has lost its position as the most innovative country in the World Economic Forum ranking, for example. The ability to turn innovations into major commercial success seems to have been missing in recent years too.

Investment activity per GDP



Source: Macrobond Financial, Statistics Finland

Housing construction is expected to be strong also in 2017 but growth figures are set to peak already. The number of completed apartments is still rising, which helps to cool down housing prices and rents. Housing permits and new starts continue to indicate robust apartment construction in growth centres, especially the Helsinki region, while construction of detached houses is slow. Demographic changes as well as financial limitations favour smaller apartments. We expect investments as a whole to grow 3.5% in 2017 and slow down to 2.5% in 2018, when construction is past its peak levels.

Unemployment continues to decline

The official unemployment rate has been decreasing gradually for 1.5 years, which is good news for the Finnish economy. The seasonally-adjusted unemployment rate declined to 8.7% in November. The number of employees in the private sector has increased y/y but has slightly declined in the public sector. Youth unemployment has also started to decline, especially among young men. Unemployment in Finland is lower than the eurozone's average but above NAIRU estimates.

The employment rate has increased slightly (67.7% in November) but is still well below the government’s target of 72%. The employment rate in Finland is lower than in other Nordic countries, so the target could be even higher in the long run. During this government’s term, it will be hard to reach the target.

Despite a decline in unemployment, there are some worrisome underlying trends: the number of long-term unemployed and persons in disguised unemployment is high. There are now over 120,000 long-term unemployed persons in Finland, which is the highest since 1997. The number of disguised persons (people who would like gainful work but have given up searching for one) has doubled since the start of the recession. These facts indicate that structural unemployment is on the increase. Luckily, the undesired trend in the long-term unemployed and disguised persons is slowing.

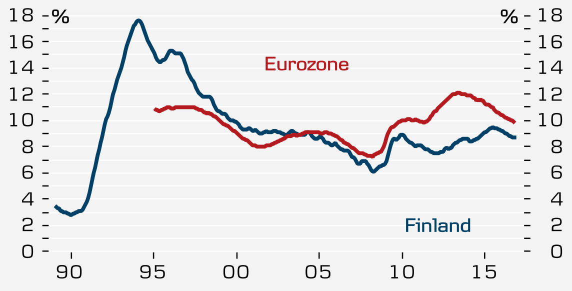
We forecast the average unemployment rate will fall to 8.3% in 2017 and continue to reach 8.0% in 2018, assuming that the economy recovers.

Divergence in housing market is here to stay

The house prices have stagnated in Finland during the last five years. This development is new for many as prices used to increase relatively evenly after the big depression in the 90’. The development in the different regions has diverged; prices in Greater Helsinki and other growth centres have held up better than prices in other places. This phenomenon is here to stay in our opinion, as demographic shift and better employment opportunities are driving people into cities.

However, there are signs that the overall situation is picking up in parallel with the overall economy. In Q3 16, prices for old dwellings increased by 1.4% y/y. In Greater Helsinki, prices grew 2.8% and in the rest of Finland by only 0.2%. On average, we expect housing prices to increase by 1.0% in 2017 and by 1.5% in 2018.

Unemployment decreasing

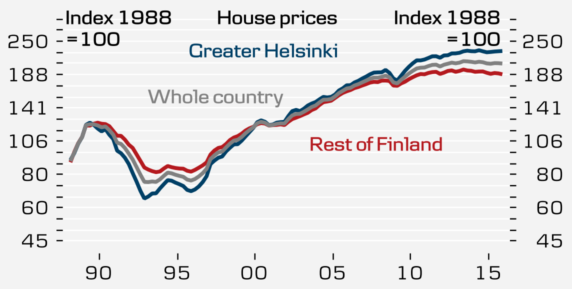


Macrobond Financial, Statistics Finland

Employment rate still below target

Source: Macrobond Financial, Statistics Finland

Diverging housing prices

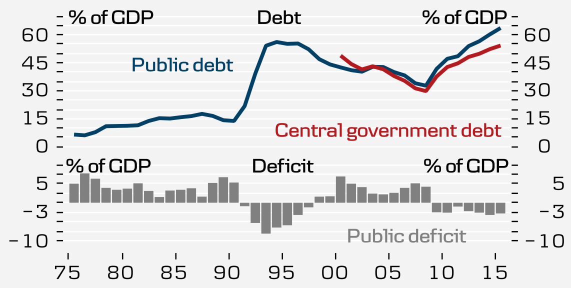


Source: Macrobond Financial, Statistics Finland

Slow growth not a panacea for public finances

Finland's public debt has grown fast over the past few years and, according to the latest data, the debt-to-GDP ratio exceeded the 60% limit by rising to 63.6% in 2015 – officially for the first time during Finland's EU membership, although 2014 was later revised above 60% as well. General government debt (EDP debt) was around EUR133bn at the end of the year. We expect debt to continue to accumulate and the debt ratio to reach 67% in 2018. Even if the level of the debt-to-GDP ratio is still moderate by international standards, its growth is worrisome. Because economic growth remains slow, the government's aim to stop the debt ratio from growing is a challenging task. The budget balance also deteriorated in the recession and 2016 is going to be the eight consecutive year for the budget to be in deficit. However, as a small positive surprise, the EU's 3% budget deficit limit was not broken in 2015. Revenues rose more than previously estimated and the deficit seems to have stayed within the 3% limit in 2016 as well.

Debt level inching up even if economy grows

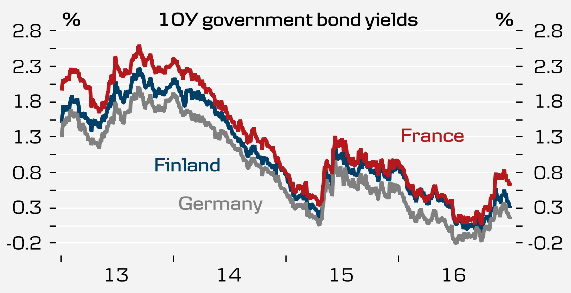


Source Macrobond Financial, Statistics Finland

The conservative three-party government led by Prime Minister Juha Sipilä is reform-oriented and the fiscal policy was tightened initially. The government plans to adjust public finances by a total of EUR10bn with a combination of short-term and long-term measures including expenditure cuts. The budget for 2017, however, does not include additional austerity measures and is aimed at maintaining domestic demand largely through tax cuts and deduction possibilities. Cuts to holiday bonus pay and staff reduction may lower the staff expenditure in 2017. Going forward, economic growth does not seem fast enough to resolve the debt spiral alone. The government needs to implement either new austerity measures or further structural reforms, which would increase private employment or slow public cost growth.

All major credit rating agencies have downgraded Finland to the 'AA+/Aa1' category since the announcement by Moody's on 3 June 2016. The rating outlook is stable with all three big agencies since S&P changed the outlook from negative to stable in September. Given higher debt and slow potential growth, the Finnish economy would be less resilient in the face of a new crisis. We expect continued structural reforms and recovering growth to help Finland maintain the current ratings. Return to 'AAA' ratings would require ample evidence of sustained growth and a declining debt-to-GDP ratio, which is unlikely before 2019. Despite downgrades, we have seen little impact on government borrowing costs. Finland still has a good reputation and the ECB purchase programme helps. Spreads to German government 10-year bond yields have returned close to 20bp after some widening seen before summer 2016.

10Y government bond yields



Source Macrobond Financial

Finland: forecasts at a glance

			Forecast		
National account	**2015**	**2015**	**2016**	**2017**	**2018**
	EUR bn (current prices)			% y/y	
GDP	209.1	0.2	1.6	1.3	1.3
Imports	77.5	1.9	1.5	2.5	3.0
Exports	76.6	-0.2	0.8	3.0	3.5
Consumption	166.7	1.1	1.6	0.6	0.8
- Private	115.7	1.5	2.2	0.8	1.0
- Public	51.0	0.4	0.2	0.0	0.2
Investments	42.7	0.7	3.0	3.5	2.5

Economic indicators	2015	2016	2017	2018
Unemployment rate, %	9.4	8.8	8.3	8.0
Earnings, % y/y	1.4	1.2	0.6	0.8
Inflation, % y/y	-0.2	0.4	1.3	1.5
Housing prices, % y/y	-0.6	1.0	1.0	1.5
Current account, EUR bn	-0.9	-1.5	-1.5	-1.5
- % of GDP	-0.4	-0.7	-0.7	-0.7
Public deficit, % of GDP	-2.8	-2.5	-2.4	-2.2
Public debt/GDP, % of GDP	63.6	65.0	66.5	67.0

Financial figures	04/01/2017	+3 mths	+6 mths	+12 mths
Repo rate, % p.a.	0.00	0.00	0.00	0.00
2-yr swap yield, % p.a.	-0.16	-0.20	-0.10	0.00
10-yr swap yield, % p.a.	0.66	0.75	0.95	1.35
EUR/USD	1.05	1.04	1.08	1.12

Source: Statistics Finland, Danske Bank

Global overview

Recovery, reflation and political uncertainties

- **We revise our global growth estimate for 2017 slightly to 3.5%, from 3.4%, due to a small lift in our US and euro area growth forecasts.**
- **In our view, the global economy is set for a synchronised rebound into 2017, driven by a lift in global investment activity from very weak levels. However, economic growth is set to remain moderate and fragile.**
- **The US and euro area are gaining momentum, while we believe Chinese growth is likely to slow somewhat in 2017, following this year's recovery. Russia and Brazil are out of recession but we still project growth will be soft.**
- **Reflation is coming to the US but is not yet in the euro area. A slow hiking cycle has been kicked off by the Fed as the ECB extends QE, though at a slightly slower pace.**
- **We expect political uncertainty to keep haunting Europe in 2017. China could face a pickup in outflows as growth slows again.**

GDP outlook: moderate global recovery

% y/y	2017 Danske Bank	2017 Consensus	2018 Danske Bank	2018 Consensus
USA	2.2	2.2	2.8	2.2
Euro area	1.5	1.3	1.5	1.5
Japan	0.8	0.8	0.7	0.7
China	6.6	6.4	6.3	6.0
Global	3.5	3.4	3.6	3.4

Source: Bloomberg, Danske Bank

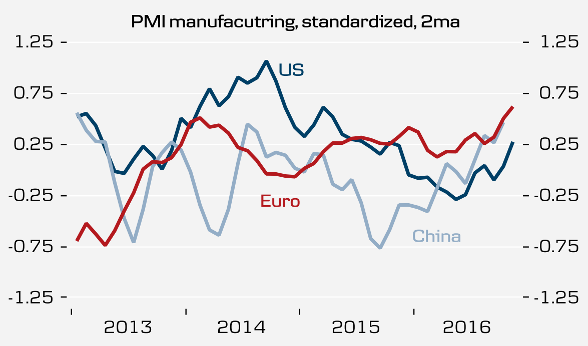
2017 starts with synchronised recovery

The global economy was on a soft and diverging path in 2015 and most of 2016. The US faced headwinds from the collapsing oil price, while Europe has been stuck in the mud because of political uncertainty and the emerging market turmoil in Q1. China recovered from the beginning of 2016, as housing staged a rebound and infrastructure investment got a boost to fend off a hard landing due to capital outflows.

However, as we enter 2017 all regions are showing positive developments. The US has ended the 1.5-year slowdown related to a marked decrease in energy investments. Private consumption is growing at a healthy rate, housing looks robust and there are signs that investment growth is starting to bottom from the negative rates seen over the past year. While we expect Donald Trump to give a boost to fiscal policy, we believe most of this effect will be felt in 2018. It should help sustain the US recovery for a couple of years, barring any new shocks and we look for 2.8% GDP growth in 2018. While this is a bit above consensus of 2.2% our feeling is that real consensus is higher but that it will take time to feed into official consensus numbers.

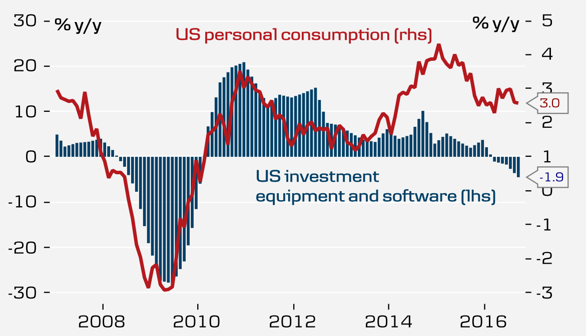
In Europe, the effects of Brexit have so far been far less than expected and both the UK and the euro area saw a rebound in growth indicators in Q3. This was probably helped by stronger activity in China and consumers not changing their behaviour and keeping a healthy pace of spending. Europe is set to face new challenges soon, with some important elections coming up, especially in France. Eurosceptic parties are gaining pace currently and if they gain power, Europe could be confronted by new and possibly harder challenges in keeping the EU and the euro together in coming years (see more below).

PMIs point to synchronised recovery going into 2017



Source: Macrobond Financial, Danske Bank

US economy set to see lift as drag from investments fades



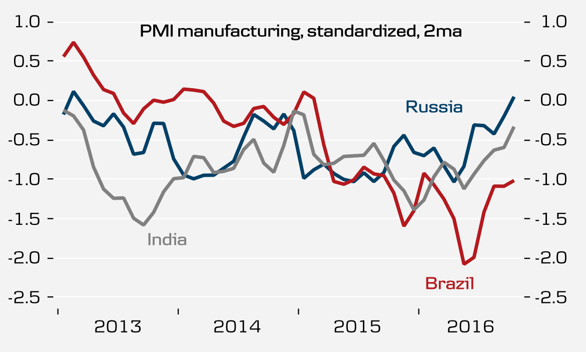
Source: Macrobond Financial, Danske Bank

China has gained strength throughout 2016 and is still not showing any signs of a peak in the current data. However, some leading indicators for construction and infrastructure – the two growth engines in 2016 – point to slower growth in 2017. We look for a peak in Q1 but do not expect a hard landing, rather a moderate slowdown – partly because housing inventories have fallen quite significantly and partly because exports should serve as a buffer given a 10% weakening of the CNY and recovering export markets in the US and Europe.

Structurally, the Chinese economy is looking more fragile as financial risks keep rising due to a very rapid rise in corporate debt and there are clear signs of misallocation of credit, a rapid growth in shadow banking and increasing leverage in financial markets. We do not expect an imminent crisis but we are concerned that China could face some sort of financial crisis within three to five years (50% probability scenario). As growth slows down in 2017, attention could turn back to the structural challenges and risks of China and a pickup in capital outflows could very well be in the pipeline in 2017.

In other emerging markets, Brazil and Russia have recovered somewhat from the deep recessions in which they have been mired since early 2015. PMIs in both countries are at the highest level in four years pointing to stronger activity. Part of the economic lift is related to stronger demand for commodities from China.

Emerging markets outside China also seeing recovery



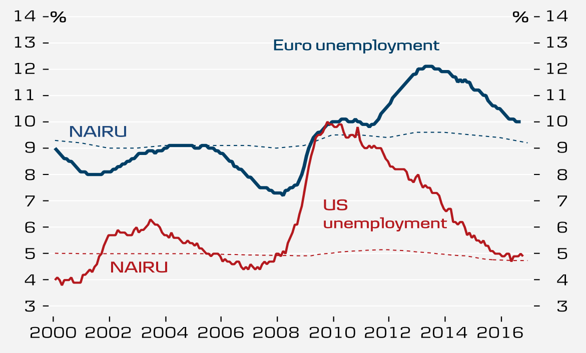
Source: Macrobond Financial, Danske Bank

Reflation in the US – not yet in the euro area

Reflation has become a market theme lately and we see a good case for reflation happening in the US. The economy is gaining momentum, the output gap is almost closed, global commodity prices are rising and we expect the Fed to keep policy accommodative by hiking only very gradually (see also *Strategy: The case for reflation – what it means and what to watch*, 18 November 2016). We look for only two hikes by the Fed in 2017, a historically slow hiking pattern in a situation with economic recovery and rising inflation. However, the neutral rate has declined significantly in the US and a stronger pace of hiking would lead to too much USD strength, undermining the recovery and reflation.

When it comes to the euro area the case for real wage driven reflation is weaker: being further behind in the recovery than the US, there is still plenty of slack in our view. There are no signs of wage pressure and the increase in inflation that we look for over the next six months will relate mostly to an increase in commodity prices and not due to domestic price pressures. We project core inflation of 1.1% at the end of 2017 – still far below the ECB's target of just below 2% inflation.

US close to 'full employment' – still more slack left in the euro area

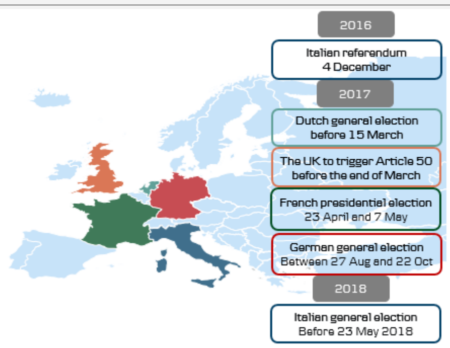


Source: Macrobond Financial, Danske Bank. NAIRU is structural unemployment rate

Political uncertainty set to keep haunting the world in 2017

A string of very important elections is coming up in the euro area over the next year, which we expect to keep uncertainty high. The Italians voted 'No' to constitutional changes that would have reduced the power of the Senate at a referendum on 4 December 2016. Prime Minister Matteo Renzi has subsequently resigned and new elections may be called. Italy has three very eurosceptic parties: the Five Star movement, Forza Italia and Liga Nord. A change of government could suddenly throw Italy's membership of the euro into question again. However, our base case is that Italy will remain in the euro despite the 'No' vote on 4 December (see *Research Italy: No 'Italexit' in the case of a 'No' in the referendum*, 22 November 2016).

Time line for European elections

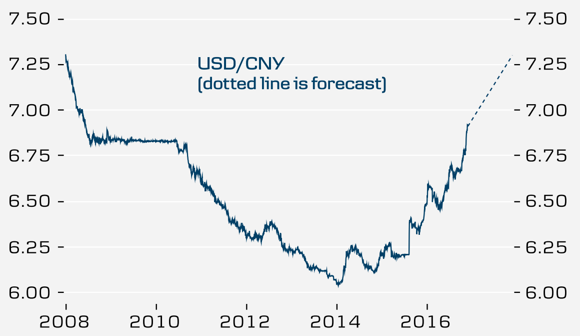


Source: Macrobond Financial, Danske Bank

France is scheduled to hold another important election in April next year, when the French people will elect their next president. While polls currently do not point to a majority supporting the eurosceptic leader of Front Nationale Marine Le Pen, there were also very few polls that projected that Britain would leave the EU or that Trump would be the next US president. The Netherlands and Germany will also hold elections in 2017: The Netherlands before 15 March and Germany between 27 August and 22 October. On top of elections, the focus in Europe will be on the UK's two-year Brexit negotiations with the EU as Article 50 should be triggered by end-March.

Finally, a source of policy uncertainty in 2017 is the policies of Donald Trump as he takes his seat as the next US president. How much protectionism will we see? Will he build a wall? Will he deliver on promised fiscal easing? There are many unknowns when it comes to the actual policies of Donald Trump. We do not believe he will dare to pick a fight with China (see *Flash Comment: What does Trump mean for China*, 9 November 2016) but we will not actually know until he has been in office for some time. A continued weakening of the CNY versus the USD is likely to be a red flag for Trump. While it has mainly reflected overall USD strength, it is still hurting US businesses competitiveness against China and he could very well label China as a currency manipulator in 2017 (see also *FX Strategy: Rise in USD/CNY reflects stronger USD – more to come*, 17 November 2016). Trump's first 100 days will give the initial impression of what kind of president we can expect for the next four years. Hence, in the early months of 2017, markets are likely to pay close attention to US policy and the French election in April.

Rise in USD/CNY to be a red flag for Trump



Source: Macrobond Financial, Danske Bank

Economic forecasts

Macro forecast, Scandinavia

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Stock build.[2]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Unem-ploym.[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Denmark	2016	1.0	1.8	1.3	3.9	-0.4	0.1	1.3	0.3	4.2	-1.7	38.0	7.4
	2017	1.5	1.6	1.0	3.2	0.2	2.2	3.4	1.3	4.1	-1.3	37.2	7.3
	2018	1.8	2.0	0.5	3.7	0.1	2.7	3.4	1.5	3.9	-0.7	36.2	7.3
Sweden	2016	3.3	2.1	3.5	6.5	0.2	3.1	4.3	1.0	7.0	-0.6	42.0	4.6
	2017	1.7	1.5	2.0	1.9	-0.1	3.5	3.4	1.3	7.2	-0.7	41.8	4.5
	2018	1.9	2.0	1.3	2.1	0.1	4.1	4.4	1.4	7.1	-0.5	40.7	4.5
Norway	2016	0.8	1.5	2.3	-0.3	0.2	-1.5	1.0	3.5	3.0	-	-	-
	2017	1.8	2.0	2.0	1.0	0.0	1.3	1.9	2.2	3.0	-	-	-
	2018	2.2	2.2	2.3	2.5	0.0	1.3	2.3	2.1	3.0	-	-	-

Macro forecast, Euroland

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Stock build.[2]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Unem-ploym.[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Euroland	2016	1.7	1.7	1.9	3.0	-	2.3	3.0	0.2	10.1	-1.8	91.6	3.7
	2017	1.5	1.1	1.2	2.7	-	3.0	3.1	1.3	9.5	-1.5	90.6	3.5
	2018	1.5	1.1	1.1	3.6	-	3.6	4.0	1.2	9.1	-1.5	89.6	3.3
Germany	2016	1.8	1.7	4.2	2.1	-	2.3	3.0	0.4	4.3	0.6	68.1	9.0
	2017	1.9	1.4	2.2	2.0	-	3.3	3.1	1.7	4.1	0.4	65.7	8.7
	2018	1.9	1.4	1.8	4.0	-	4.0	4.8	1.5	4.1	0.3	63.1	8.5
France	2016	1.1	1.7	1.5	2.8	-	0.8	3.5	0.3	10.1	-3.3	96.4	-2.1
	2017	1.0	0.8	1.2	2.1	-	2.8	3.6	1.1	10.0	-2.9	96.8	-2.3
	2018	1.2	1.0	1.1	3.0	-	3.0	3.5	1.3	9.8	-3.1	97.4	-2.6
Italy	2016	0.9	1.4	0.6	2.0	-	1.3	1.7	-0.1	11.6	-2.4	133.0	2.8
	2017	1.0	0.7	0.6	2.1	-	3.3	3.3	1.1	11.5	-2.4	133.1	2.5
	2018	1.3	0.8	0.7	3.6	-	3.5	3.5	1.2	11.4	-2.5	133.1	2.1
Spain	2016	3.2	3.0	1.3	3.6	-	4.0	3.0	-0.3	19.7	-4.6	99.5	1.7
	2017	2.3	2.1	1.4	2.9	-	2.6	2.1	1.7	18.3	-3.8	99.9	1.5
	2018	2.3	2.0	1.3	4.7	-	3.6	4.6	1.1	17.1	-3.2	100.0	1.5
Finland	2016	1.6	2.2	0.2	3.0	-	0.8	1.5	0.4	8.8	-2.5	65.0	-0.7
	2017	1.3	0.8	0.0	3.5	-	3.0	2.5	1.3	8.3	-2.4	66.5	-0.7
	2018	1.3	1.0	0.2	2.5	-	3.5	3.0	1.5	8.0	-2.2	67.0	-0.7

Macro forecast, Global

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Stock build.[2]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Unem-ploym.[3]	Public budget[4]	Public debt[4]	Current acc.[4]
USA	2016	1.6	2.6	0.8	0.4	-0.4	0.7	0.7	1.3	4.9	-2.6	105	-2.7
	2017	2.2	2.2	0.6	2.8	0.1	3.2	2.3	2.4	4.7	-2.9	105	-2.9
	2018	2.8	2.0	2.9	6.1	0.0	3.0	3.0	2.5	4.4	-2.8	103	-3.3
China	2016	6.7	-	-	-	-	-	-	2.3	4.1	-3.0	46.3	2.4
	2017	6.6	-	-	-	-	-	-	2.0	4.3	-3.3	49.9	2.1
	2018	6.3	-	-	-	-	-	-	2.0	4.3	-3.0	53.3	1.5
UK	2016	2.0	2.8	0.8	0.9	0.5	1.0	2.7	0.6	4.9	-3.6	88.7	-5.0
	2017	1.2	1.7	0.2	0.3	0.3	1.7	2.4	2.3	5.0	-2.9	89.2	-4.9
	2018	1.0	1.0	0.4	0.7	0.0	2.8	2.0	2.6	5.3	-2.2	88.7	-3.3

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

Financial forecasts

Bond and money markets

		Key int. rate	3m interest rate	2-yr swap yield	10-yr swap yield	Currency vs EUR	Currency vs USD	Currency vs DKK
USD	04-Jan	0.75	1.00	1.47	2.34	105.1	-	707.2
	+3m	0.75	1.08	1.35	2.40	104.0	-	715.1
	+6m	1.00	1.24	1.55	2.60	108.0	-	689.1
	+12m	1.25	1.50	1.85	2.90	112.0	-	664.5
EUR	04-Jan	0.00	-0.32	-0.16	0.66	-	105.1	743.5
	+3m	0.00	-0.30	-0.20	0.75	-	104.0	743.8
	+6m	0.00	-0.30	-0.10	0.95	-	108.0	744.3
	+12m	0.00	-0.30	0.00	1.35	-	112.0	744.3
JPY	04-Jan	-0.10	-0.05	0.02	0.22	123.4	117.4	6.03
	+3m	-0.10	-	-	-	123.8	119.0	6.01
	+6m	-0.10	-	-	-	127.4	118.0	5.84
	+12m	-0.10	-	-	-	132.2	118.0	5.63
GBP	04-Jan	0.25	0.37	0.61	1.23	85.2	123.4	872.5
	+3m	0.25	0.40	0.55	1.40	87.0	119.5	854.9
	+6m	0.25	0.40	0.55	1.50	86.0	125.6	865.4
	+12m	0.25	0.40	0.60	1.75	86.0	130.2	865.4
CHF	04-Jan	-0.75	-0.73	-0.60	0.15	107.2	102.0	693.7
	+3m	-0.75	-	-	-	107.0	102.9	695.1
	+6m	-0.75	-	-	-	110.0	101.9	676.6
	+12m	-0.75	-	-	-	113.0	100.9	658.6
DKK	04-Jan	0.05	-0.23	0.03	0.93	743.5	707.2	-
	+3m	0.05	-0.17	0.00	1.05	743.8	715.1	-
	+6m	0.05	-0.17	0.10	1.20	744.3	689.1	-
	+12m	0.05	-0.17	0.20	1.60	744.3	664.5	-
SEK	04-Jan	-0.50	-0.59	-0.35	1.10	956.2	909.6	77.8
	+3m	-0.50	-0.60	-0.45	1.20	940.0	903.8	79.1
	+6m	-0.50	-0.60	-0.40	1.20	930.0	861.1	80.0
	+12m	-0.50	-0.60	-0.45	1.40	920.0	821.4	80.9
NOK	04-Jan	0.50	1.17	1.28	1.95	907.4	863.1	81.9
	+3m	0.50	1.00	1.20	1.80	910.0	875.0	81.7
	+6m	0.50	0.90	1.30	2.00	900.0	833.3	82.7
	+12m	0.50	0.90	1.40	2.30	880.0	785.7	84.6

Equity Markets

Regional		Risk profile 3 mth	Price trend 3 mth	Price trend 12 mth	Regional recommen-dations
USA (USD)	Growth boost: fisc. expansion, tax cuts, infl./growth-impulse	Medium	5-10%	10-15%	Overweight
Emerging markets (local ccy)	Hurt by stronger USD and increased protectionism	Medium	-5-0%	-5-+5%	Underweight
Japan (JPY)	Valuation and currency support	Medium	5-10%	10-15%	Overweight
Euro area (EUR)	Weaker growth and EPS momentum than USA	Medium	0-5%	0-5%	Underweight
UK (GBP)	Currency support, stronger infl. exp. off-set Brexit negativity	Medium	3-8%	5-10%	Neutral
Nordics (local ccy)	Currency support on earnings, continued domestis demand	Medium	3-8%	5-10%	Neutral

Commodities

		2017				2018				Average	
	04-Jan	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2017	2018
NYMEX WTI	52	53	55	57	59	60	60	61	61	56	61
ICE Brent	56	53	55	57	59	60	60	61	61	56	61
Copper	5,500	5,850	5,900	5,950	6,000	6,025	6,050	6,075	6,100	5,925	6,063
Zinc	2,521	2,400	2,300	2,200	2,200	2,225	2,250	2,275	2,300	2,275	2,263
Nickel	9,910	11,200	11,300	11,400	11,500	11,600	11,700	11,800	11,900	11,350	11,750
Aluminium	1,687	1,750	1,760	1,770	1,780	1,790	1,800	1,810	1,820	1,765	1,805
Gold	1,165	1,100	1,120	1,140	1,160	1,170	1,180	1,190	1,200	1,130	1,185
Matif Mill Wheat (€/t)	169	164	166	168	168	169	169	170	170	167	170
Rapeseed (€/t)	417	420	410	410	410	415	420	425	430	413	423
CBOT Wheat (USd/bushel)	407	450	475	500	510	520	530	540	550	484	535
CBOT Soybeans (USd/bushel)	990	1,150	1,100	1,100	1,100	1,125	1,125	1,150	1,150	1,113	1,138

Source: Danske Bank

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of the research report are Las Olsen (Chief Economist), Bjørn Tangaa Sillemann (Analyst), Louise Aggerstrøm Hansen (Analyst) and Mark Thybo Naur (Assistant Analyst), Roger Josefsson (Senior Analyst), Frank Jullum (Chief Analyst), Pasi Kuoppamäki (Chief Economist), Henna Mikkonen (Economist) and Minna Kuusisto (Economist).

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Expected updates

None.

Date of first publication

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