Danske Bank

Investment Research

20 June 2018

Nordic Outlook

Economic and financial trends

- Denmark: Boring but in a good way
  - Growth is high enough to create new jobs, without creating major signs of overheating, at this point at least.

- Sweden: Manufacturing slowdown too?
  - The housing market is affecting construction and consumption and now manufacturing companies are starting to report fewer export orders.

- Norway: All set for oil-driven upswing
  - Growth will gain a further boost from oil investments and house prices are growing again.

- Finland: Broad-based growth continues
  - This year began with very high growth and, while it is likely to decline from this, we believe it will still be clearly above trend.

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Important disclosures and certifications are contained from page 36 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.

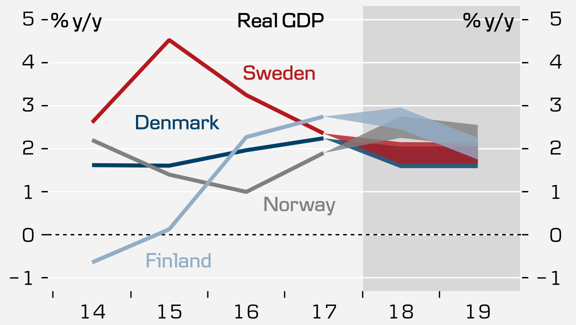
At a glance

Recovery continues despite headwinds

External risks have increased

Global news has not sounded positive for the Nordic growth outlook recently. The increasing risk of trade wars is not in the interest of small open economies and of Nordic businesses that are integrated into global value chains. Lower growth indicators in the euro area dampen the prospects for the most important markets for Nordic exports, and the political uncertainty in Italy also risks undermining European growth. However, while trade disputes can have large consequences for individual companies, they are unlikely to have a large GDP effect in the short run and even with the slowdown, the euro area is still growing above trend in line with our previous forecasts. Hence, we have not made major adjustments to Nordic growth based on the international backdrop. A sharper slowdown is a risk more than a reality at this point, but a serious risk, as for example lower manufacturing growth in Germany also affects countries like Sweden and Denmark. Of course, there are also factors pulling in the other direction. A higher oil price supports oil investments in Norway, while Finland's improved competitiveness is visible in the trade figures.

Trading places



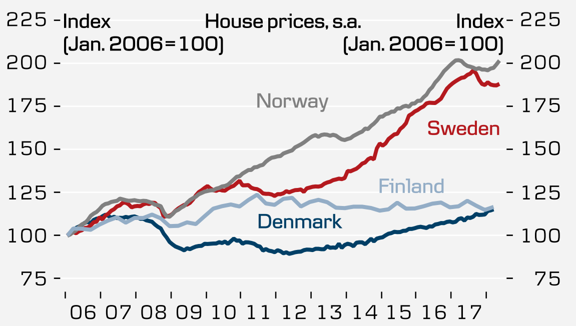
Note: Danish growth in 2017 is likely to be revised down. Source: Macrobond Financial, Danske Bank

Sweden slowing, Norway speeding up

While Denmark is well aligned with the European business cycle, other factors play crucial roles currently in other countries. Growth in Sweden has been higher than elsewhere in Europe for some time, increasingly driven by housing investment, and we expect that to change in the near future. Lower house prices could also affect domestic consumption. In Norway, on the other hand, we see a marked increase in growth this year for the mainland economy, because of the oil investments, but also because the decline in house prices is over, and domestic demand is growing briskly. This is part of the reason why Norway will begin hiking interest rates shortly, while Sweden's first hike is likely to be more than a year away.

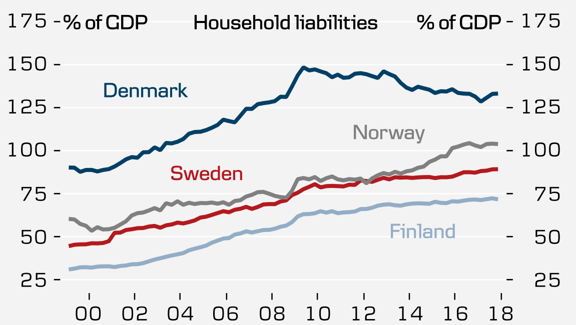
The domestic risk factor most in focus in the Nordic countries is probably household debt. High debt levels make households sensitive to interest rate changes. However, stress tests show that household finances will remain sound even if interest rates increase sharply, also in Denmark, which has the highest debt level but also the highest share of mortgage loans where the interest rate is fixed for the duration. Another concern is that economies where demand is supported by increasing debt are more at risk of a sharp slowdown when credit growth slows, for example because of higher interest rates. In any case, the high and in many cases rising debt of Nordic households should be seen in the context of large pension savings, as to some extent they are invested in mortgage products, and as they reduce the need for individual household saving. Well-developed pension systems are an important part of the high long-run stability of the Nordics, broadly speaking.

House prices also in different directions



Source: Macrobond Financial, Danske Bank

Household debt has increased



Source: Macrobond Financial, Danske Bank

Denmark

Boring but in a good way

- **The absence of dramatic headlines is usually good news for an economy, and Denmark is experiencing a dearth of dramatic headlines at the moment.**
- **Private consumption is growing faster than previously expected and exports and investment less, so our growth forecast is largely unchanged overall.**
- **Neither political turmoil in Europe nor the ECB ending its bond purchases are likely to trigger unilateral Danish interest rate changes, in our view.**
- **Tighter lending practices have dampened the market for apartments somewhat, but there is no slowdown in the broader property market.**
- **Government finances look set to outperform official forecasts this year, although the surplus in 2017 will become a slight deficit.**
- **The current account surplus will be somewhat lower in 2018, in part due to substantial ship imports.**

At a glance

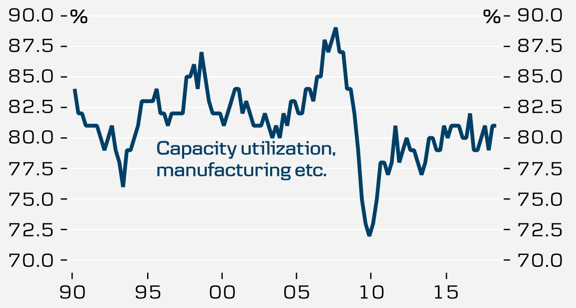
Denmark	Current forecast		Previous forecast	
% y/y	2018	2019	2018	2019
GDP	1.8	1.8	1.8	1.9
Private consumption	2.3	2.4	1.9	2.6
Public consumption	1.1	0.5	1.0	0.5
Gross fixed investment	5.0	1.5	5.8	4.2
Exports	0.5	2.7	2.5	2.9
Imports	3.6	2.4	4.2	3.6
Gross unemployment (thousands)	108.9	102.7	107.9	102.7
Inflation	0.9	1.5	0.6	1.3
Government balance, % of GDP	-0.2	-0.2	-0.2	-0.1
Current account, % of GDP	6.5	7.2	7.5	7.5

Note: Forecasts exclude effect of patent sale in 2017.
Source: Danske Bank

No crisis, no overheating

The Danish economy is currently balanced between boom and bust. Denmark has clearly left the crisis behind, unemployment is low and considerably fewer companies than previously are citing lack of demand as an obstacle to growth, especially in the domestic market. On the other hand, there are few signs of overheating that might herald a new crisis. Overheating could occur if the level of consumption and investment by households and companies was unsustainably high and financed by ever growing debt. Credit-fuelled demand often comes to an abrupt halt. However, the pace of debt growth is still rather low in Denmark, and both consumption and investment are running at modest levels relative to incomes. Overheating can also become apparent through strong wage growth that erodes competitiveness and leads to a subsequent decline in exports. However, while a shortage of qualified labour is an increasing problem for many companies, wage growth is only picking up slowly and is not ahead of other countries. A third obvious place to look for potential problems is the housing market, where we have in fact seen substantial price increases at a local level, but looking at the average for the country as a whole, then owner-occupied dwellings generally seem to be priced low rather than high.

Out of crisis, but room for more growth



Source: Statistics Denmark, Macrobond Financial

Given the above we can take comfort from the rather undramatic state of the Danish economy, although risks do of course exist. Among them is the upswing accelerating and becoming unsustainable, which is probably the biggest risk in the short term. From a more structural perspective, however, one concern could be that the current upswing is only generating GDP growth of less than 2%. The underlying growth in incomes is probably higher, but productivity growth has been disappointing during this upswing and still is.

We disregard misplaced patent sale

Denmark's GDP figures are unfortunately marked by substantial and partly inexplicable fluctuations. The figures for Q1 18, for example, show a fall of 0.5% compared to the year before. This was not due to Denmark suddenly relapsing into crisis once again, but rather Statistics Denmark including the sale of a patent for roughly DKK9bn as exports and production in Q1 17, even though production in reality occurred over a much longer period prior to the sale. The artificially high figure for Q1 17 means the growth figures for 2018 are artificially low. Our forecast assumes the GDP figure for last year will be revised down again, but if that does not happen, then our GDP growth figure for this year is 0.4 percentage points too high – all else being equal.

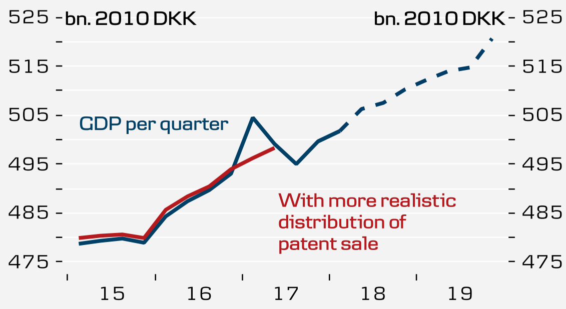
Interest rates to remain low

The Danish krone (DKK) strengthened during May's financial market turmoil prompted by the political crisis in Italy, just as it did previously when concerns surfaced about the stability of the eurozone. This time, however, the inflows to Denmark were very limited, and Danmarks Nationalbank did not need to intervene in the FX market to prevent the DKK strengthening by more than the 0.4% or so relative to the central parity rate against the euro that Danmarks Nationalbank has in practice accepted in recent years. Even if the crisis were to deepen and the inflow to Denmark become considerably greater, we expect Danmarks Nationalbank would refrain from cutting interest rates and instead react by intervening if necessary. Likewise, we do not expect a unilateral Danish rate hike even when the European Central Bank (ECB) ceases its bond buyback programme, which will equate to a tightening of monetary policy in the eurozone. The DKK is well supported by Denmark's large current account surplus and by solid interest in Danish bonds from abroad. The Danish bond market is also being supported by the government's very low need to issue bonds. The next Danish rate hike in our forecast is alongside the ECB's in December 2019, though we expect long yields will rise slightly over the coming year.

Inflation set to increase in 2019

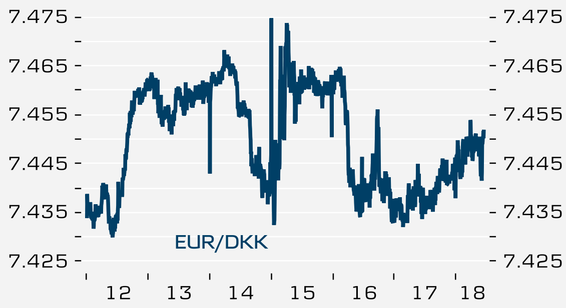
Danish inflation normally follows developments in the eurozone, though occasionally with major fluctuations. So far in 2018 Danish inflation has been markedly lower due, in particular, to lower price increases on food and beverages. However, price pressures are fundamentally in line with the rest of Europe, so we expect inflation to gradually rise. We have revised up our expectations for this year and next, in part because the reduction in the duty on electric heating from May 2018 turns out not to be included in the consumer price index. The normal duty on electricity, which the government plans to cut, is included. If the government implements the cut, it could reduce the consumer price index by 0.23%, though the proposal is for the cut to be spread over a period of six years, so the impact on the 2019 figures will be limited. Inflation has, however, been pulled higher by a rise in oil prices and in the price of holiday home rentals, perhaps influenced by the unusually warm weather in May.

Patent sale distorts growth picture



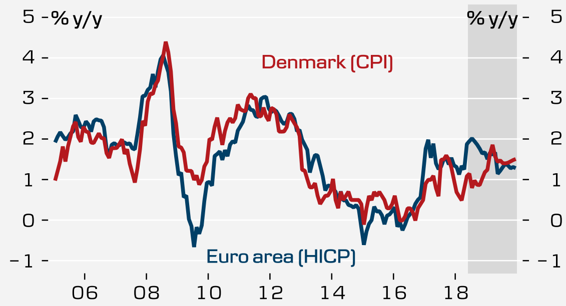
Source: Statistics Denmark, Macrobond Financial, Danske Bank

Impact of Italian turmoil on DKK was limited



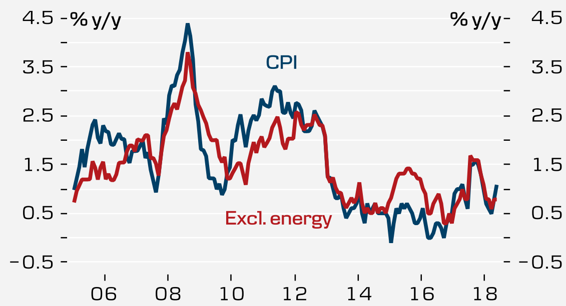
Source: Macrobond Financial

Extremely low Danish inflation is temporary



Source: Statistics Denmark, Macrobond Financial, Danske Bank

Energy prices behind higher inflation in May

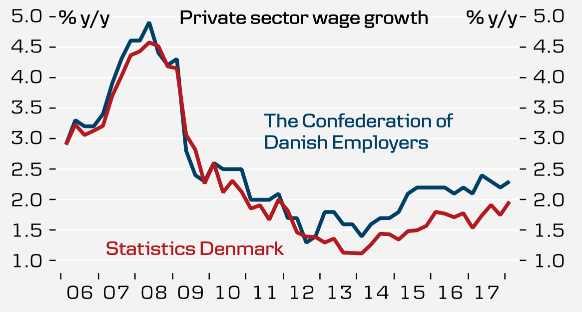


Source: Statistics Denmark, Macrobond Financial

Wage growth not as low as it looks

Private sector wage growth has increased by less than one percentage point over the past four years to 2-2.3%, depending on which statistic you look at. That is remarkably modest growth given that employment among wage-earners has increased by 6.5% over the same period and that a significant number of companies are citing lack of qualified labour as a limiting factor for production. This suggests companies are still marked by the crisis and stiff competition, and apparently often choose to say no to an order rather than bid wages higher and increase prices. However, the trend also has to be seen against the low level of inflation and low productivity growth. If our forecast for 2018 proves correct, consumer prices will have risen by 4.1% over six years. The low level of inflation means that modest nominal wage growth equates to a quite decent increase in real wages, historically speaking, while the long period of slow price increases has also probably depressed expectations on future price increases among both companies and employees.

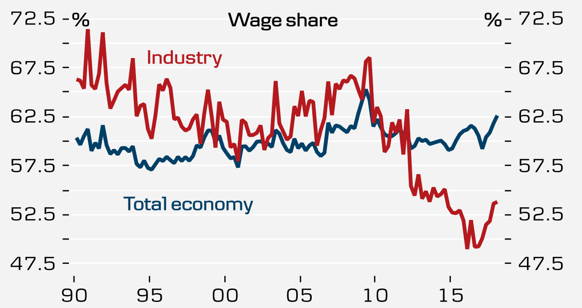
Wage growth only slightly up



Source: Statistics Denmark, DA, Macrobond Financial

Low productivity during this upswing also means fewer resources for wage increases. The wage share, which is the employees' share of the total production value, is in fact on the high side of the historical average – and this despite a substantial fall in the wage share in manufacturing, where production value has risen without involving many more employees, not least in the pharmaceutical industry. That the overall wage share has nevertheless risen is in part due to much of the growth in new jobs occurring in the service sector, where the wage share is relatively high.

Larger share of the cake for employees, but not in manufacturing



Note: Payroll as % of GDP at factor cost
Source: Statistics Denmark, Macrobond Financial

Slowly tightening labour market

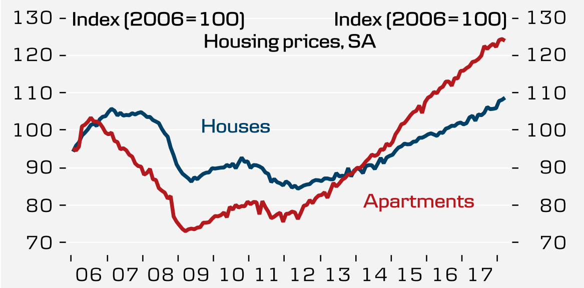
Despite the tighter labour market we are not necessarily facing a period of significantly higher wage increases. We expect that wage growth and inflation will only gradually return to more normal levels as inflation expectations slowly rise in both Denmark and the eurozone. But given that unemployment is low, the labour force will have to expand if employment is to continue to rise. While we expect this will be the case, in part due to the rising retirement age, the labour market is also tightening in other parts of northern Europe, so the risk is that a more serious shortage of labour could lead to unsustainable wage growth or to the economy slowing.

Rising house prices, but the apartment market has lost steam

The housing market is in fine shape with rising prices across most of the country. The opening months of the year saw sharp increases in the price of houses on the back of general economic growth, rising household incomes and very low interest rates.

Following significant price increases in the first few months of the year, we expect growth to slow somewhat going forward. This should be seen against the tightening of lending practices on 1 January this year seemingly having the desired effect, as far fewer borrowers with high levels of debt are now taking out adjustable rate or interest-only loans compared to last year. There is also some indication that housing market activity has slowed a little this year, for example in the Copenhagen apartment market. This suggests a slowdown in price growth, and actual price falls cannot be ruled out in that market. However,

House prices rising steadily, but slower growth for apartments



Source: Statistics Denmark, Macrobond Financial we do not expect the slowdown to be particularly pronounced, and a more subdued pace of growth in the apartment market would be welcome after several years of soaring prices.

Gradually rising long-term interest rates in 2019 will put something of a damper on price growth compared to this year. However, there is little prospect of the rise in interest rates being significant enough to derail housing market growth. Further down the line we expect those areas where prices have increased most will also be the ones that react most strongly to increases in interest rates.

New construction will also eventually put a damper on price growth. The number of new homes has accelerated in recent years, with the number of apartments completed in 2017 matching that in 2007. Construction is most buoyant in the major towns and cities, with many new apartments, in particular, being built. We expect the pace of construction to remain high despite the latest new home start figures pointing to a slowdown in construction activity. This is likely due to major data quality issues, as other indicators indicate continued growth.

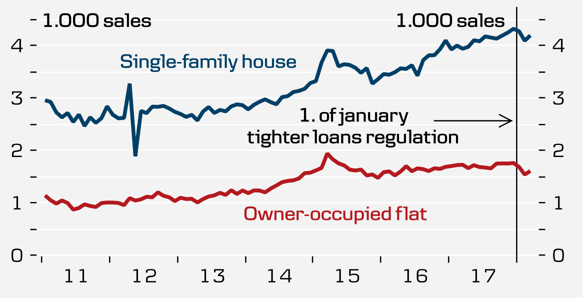
Consumption picking up

Private consumption got off to a flying start in 2018 after a lacklustre performance in 2017. Consumers received a helping hand at the start of the year from higher real wage growth on the back of low inflation. We expect this will continue to support consumption this year and to a lesser extent next year too.

Despite the outlook for a pick-up in consumption this year, there is little sign of this being out of step with underlying developments in household incomes – given rising real wages and continued employment growth. Nor is there any indication that households have begun to finance consumption with increased borrowing. Should borrowing seriously take off, there would be significant potential for stronger consumption growth, but we have no real expectations of this happening during our forecast period.

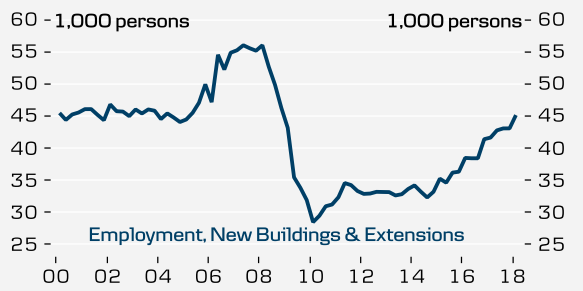
We also expect consumption to receive a boost from payouts of early retirement contributions (to employees who opt out of the early retirement scheme) and the repayment of excess property taxes. That being said, we have revised down our expectations for how much will be paid out in early retirement contributions this year, and as the new property valuations have been delayed from the start of 2019 to later in the year, tax repayments to around ¾ million homeowners are also expected to take place later. All this adds up to a lesser boost to consumption in 2019 than previously expected.

Still decent sales activity despite decline after tighter lending practices



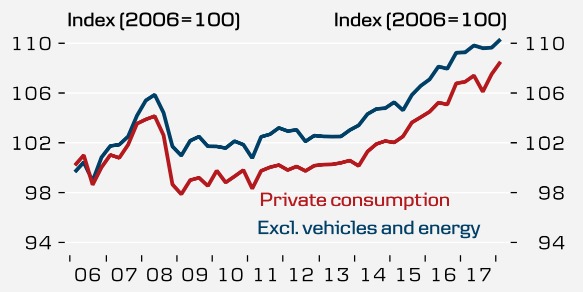
Source: Statistics Denmark, Macrobond Financial

Construction activity rising



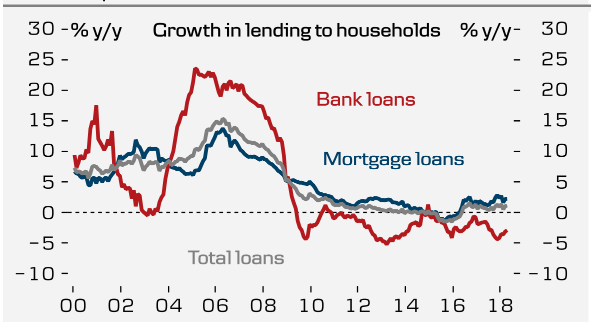
Source: Statistics Denmark, Macrobond Financial

Private consumption picks up after disappointing 2017



Source: Statistics Denmark, Danske Bank calculations, Macrobond Financial

Credit barely rising – in sharp contrast to consumption boom in 2000s



Source: Statistics Denmark, Danske Bank calculations, Macrobond Financial

Government finances continue to outperform expectations

We expect the general government finance surplus will become a minor deficit during our forecast period despite the current economic expansion. This is partly due to temporary factors, such as the paying out of early retirement contributions and the repayment of excess property taxes. However, both factors are shrouded in a degree of uncertainty, as we still do not know how many will request their early retirement contributions be paid out or exactly when payouts in connection with the new property valuations will be made. Also likely to pull the surplus lower will be less income from the tax on pension returns (so-called PAL tax).

We are generally more optimistic than the government about its finances, as we expect the labour market to develop more favourably and also estimate that the decline in PAL taxes will be less pronounced – in part because we expect more subdued growth in interest rates over the forecast period. This also means we expect a slightly smaller net financing requirement than the government projects. That being said, we expect the government's net financing requirement will be greater overall in 2018 than in 2017, in part due to buybacks of the bonds underlying social housing loans.

Exports and investment disappoint

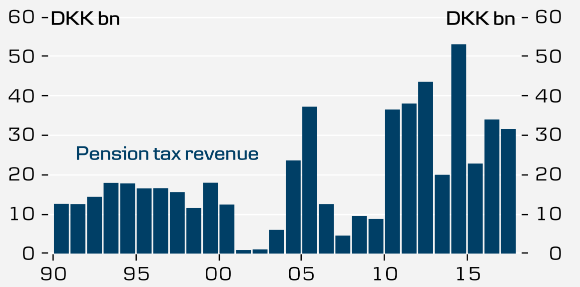
Export growth continues to disappoint given the solid economic growth rates in export markets and Denmark's improved competitiveness. One explanation could be the strengthening of the DKK against the US dollar and a number of other currencies over the past one and a half years, though even corrected for this we would have expected a higher level of exports. Within goods exports, the machinery industry appears to be one of the areas losing market share. Service exports failed to grow last year if you disregard the patent sale, and declined further in Q1 18 – possibly triggered by China's ban on the import of scrap, which has reduced the need for shipping services. Our forecast is based on the premise that some of the export losses will be recouped, even though we are facing a period of slightly lower growth in certain markets, particularly Sweden.

Imports soared in April 2018 when ships and aircraft worth DKK8.7bn were imported. This was because the Danish merchant shipping fleet grew particularly strongly, and this will also be reflected in the figures for corporate investment. However, if we disregard shipping, then corporate investment remains remarkably low given the high level of employment. This is especially true for physical investments in machinery and buildings, while investments in intellectual property rights are higher than pre-crisis levels.

Current account surplus less impressive in 2018

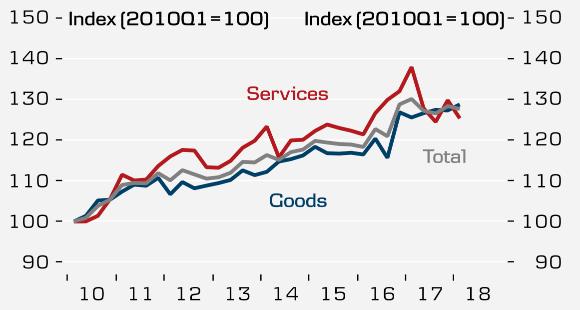
The major investment in ships will pull the current account surplus lower in 2018, but it also provides the foundation for an even greater surplus in the future. The 2018 surplus is also weighed down by the disappointing growth in exports, especially when calculated in DKK terms rather than volume. However, we expect the current account surplus to increase again in 2019, as underlying consumption and investment growth is not high enough to seriously dent the surplus, which will continue to remain buoyant on the back of growing pension savings in Denmark.

Government revenue from pension return tax expected to fall from a high level



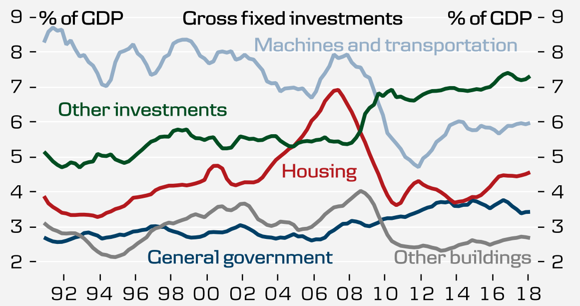
Source: Statistics Denmark, Macrobond Financial

No export growth since 2016



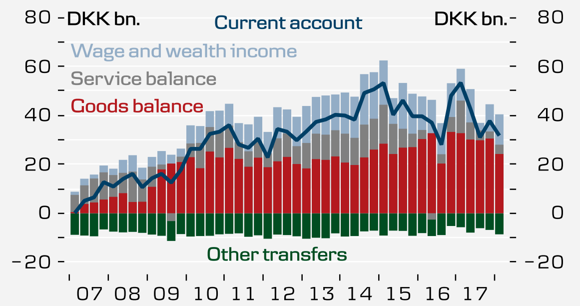
Source: Statistics Denmark, Danske Bank calculations, Macrobond Financial

Building and machinery investments still low



Note: 4-quarters moving average
Source: Statistics Denmark, Macrobond Financial

Current account surplus still very large



Note: Seasonally adjusted data
Source: Statistics Denmark, Danske Bank calculations, Macrobond Financial

At a glance

National account	2017	2017	2018 (Forecast)	2019 (Forecast)
	DKK bn (current prices)	% y/y		
Private consumption	976.8	1.5	2.3	2.4
Government consumption	535.9	1.2	1.1	0.5
Gross fixed investment	437.1	3.7	5.0	1.5
- Business investment	266.8	5.6	6.3	-0.1
- Housing investment	96.8	6.2	6.2	6.8
- Government investment	73.6	-5.5	-1.3	0.1
Growth contribution from inventories	0.1	0.1	0.0	-0.1
Exports	1,184.3	4.4	0.5	2.7
- Goods exports	748.2	5.7	1.9	2.5
- Service exports	436.1	2.0	0.0	3.1
Imports	1,032.9	4.1	3.6	2.4
- Goods imports	641.8	5.3	4.9	2.1
- Service imports	391.1	2.1	1.4	3.0
GDP	2,145.1	2.2	1.8	1.8

Economic indicators	2017	2018	2019
Current account, DKK bn	168.1	143.0	162.3
- % of GDP	7.8	6.5	7.2
General government balance, DKK bn	21.5	-3.7	-5.6
- % of GDP	1.0	-0.2	-0.2
General government debt, DKK bn	780.9	771.2	779.5
- % of GDP	36.4	35.1	34.4
Employment (annual average, thousands)	2,920.9	2,967.7	2,999.4
Gross unemployment (annual average, thousands)	115.9	108.9	102.7
- % of total work force (DST definition)	4.2	4.0	3.8
House prices, % y/y	4.0	4.5	2.5
Private sector wage level, % y/y	1.7	1.9	2.3
Consumer prices, % y/y	1.1	0.9	1.5

Financial figures	19/06/2018	+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.	-0.05	0.00	0.05	0.25
10-yr swap yield, % p.a.	1.06	1.20	1.40	1.70
EUR/DKK	7.45	7.45	7.45	7.44
USD/DKK	6.43	6.36	6.20	5.95

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

Sweden

Manufacturing slowdown too?

- **Core inflation steady at around 1.5% for the past five months and expected to remain below the Riksbank's forecast, increasing signs of a slowing Swedish economy and, not least, a European Central Bank that argues for its first rate hike in H2 19 at the earliest suggest that the Riksbank will move by mid-2019 at the earliest. However, due to soaring energy prices and possibly a lagging impact from the previous SEK weakening, we expect CPIF to remain above the Riksbank's forecast this year. This may trigger a hike or two but in our eyes it would be a mistake. In a fundamental sense, the Riksbank is trapped in a Catch 22 situation with the SEK.**
- **Our bearish outlook for residential construction is basically playing out as expected, being a drag on GDP growth. We expect prices on new flats to fall sharply, as very few can afford them and as supply is significant. On the back of this, there may be a second leg down in prices on existing flats.**
- **We have not changed our economic forecast to any meaningful extent but new dark clouds, in the form of what appears to be a sharp slowdown in the eurozone manufacturing business cycle, are now approaching. This constitutes a downside risk to our GDP forecast.**

Riksbank in a Catch 22 situation

In April, the Riksbank kept the repo rate unchanged but shifted the repo rate path forward in time, now signalling a first rate hike in October or December this year (previously 'mid-2018'). This caused some upheaval in the markets as many investors had pointed to the repo rate path being unchanged for several meetings up to April as suggesting it intended to start hiking rates soon. In particular, the FX market reacted fiercely, pushing the EURSEK above 10.60 in the weeks after that meeting. The backdrop for the Riksbank's decision to postpone rate hikes was that inflation had again turned out to be on the low side of its forecast.

Subsequently, the SEK has rebounded strongly, after Riksbank board members pointed out that it forecasts a stronger SEK. In addition, CPIF inflation has turned out close to the Riksbank's forecasts and close to the 2% target itself. However, as laid out below, CPIF excluding energy was only 1.5% y/y in May.

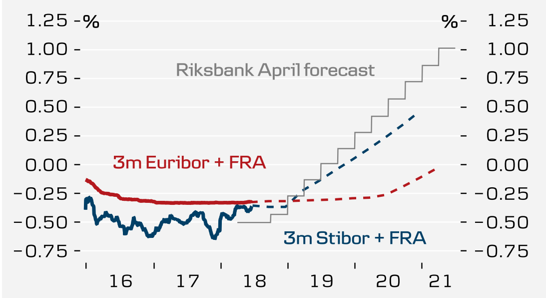
This puts the Riksbank in a tricky situation. Should it point to CPIF, which we forecast will remain above the Riksbank's forecasts until year-end, or should it look at CPIF excluding energy for guidance about where 94% of the CPIF basket is heading? We believe most of the Executive Board members will argue that it is core that sets the trend and that headline is boosted to an exceptional extent by energy prices. In addition, the board is aware that if its language is too hawkish, it risks strengthening the SEK, which would put downward pressure on imported inflation. This is what we mean by the 'Catch 22' in the heading above: higher inflation leads to a hawkish Riksbank leads to a stronger SEK leads to slowing inflation and a dovish Riksbank. It is a circular reference. Some board members seem to disregard or ignore how inflation is composed. These members, who constitute a minority, may very well argue that CPIF has

At a glance

Sweden	Current forecast		Previous forecast	
% y/y	2018	2019	2018	2019
GDP, calendar adjusted	2.0	1.9	1.7	2.0
Private consumption	2.0	1.8	1.6	1.8
Public consumption	0.6	0.8	1.3	0.8
Gross fixed investment	3.0	0.4	-1.1	0.4
Exports	3.8	4.7	5.6	4.7
Imports	4.2	3.8	4.8	3.8
Unemployment rate	7.1	7.6	7.1	7.6
Inflation	1.7	1.4	1.6	1.3
Government balance, % of GDP	1.0	0.8	1.0	0.8
Current account, % of GDP	2.8	3.2	3.5	3.9

Source: Danske Bank

Soft ECB will most likely delay Riksbank hikes too



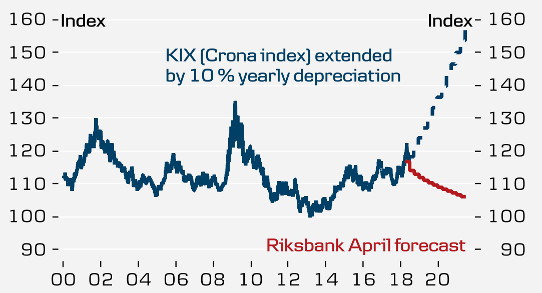
Source: Riksbank, Macrobond Financial

Riksbank needs a 'crawling depreciation' to reach 2 % target

Source	Increase	Impacts	Passthrough	Weight	Contribution
Wages	2.5	Domestic inflation ≈ Services inflation	0.6	65	1.0
Currency	10.0	Imported inflation ≈ Goods inflation	0.2	30	0.5
Energy	7.5	Energy	1	5	0.5
One-off's: tax hikes, public charges, bank fee's etc					
CPIF				100	2.0

Source: Danske Bank calculations

What Riksbank needs and what it says



Source: Riksbank, Danske Bank calculations, Macrobond Financial been, and will be, close to the target and, hence, argue that it is time to lift rates, in particular as inflation expectations are close to the target.

These considerations suggest there is a high probability the Riksbank will wait with any rate hikes until mid-2019 at the earliest. If you add to the inflation outlook that (1) Swedish data suggest economic growth is slowing markedly and (2) the ECB now argues it will start hiking rates by mid-2019, then this case becomes even more compelling. This said, we allow just a small chance – smaller following the ECB's soft June statement – that the Riksbank will trigger a rate hike or two later this year. Such a step would, in our eyes, be a policy mistake.

We expect no change to the Riksbank's reinvestment plans for the QE programme. We expect it to continue buying government bonds worth some SEK11bn per quarter for six consecutive quarters (to mid-2019) from the start at the beginning of January 2018. This is the sum of around SEK15bn in coupon payments and the redemption of the SGB1052 bond in early 2019. These reinvestments are front-loaded compared with maturing bonds. Riksbank reinvestments will absorb the nominal issuance from the Debt Office, which will retain downward pressure on longer dated bonds. Net issuance was further reduced as the Debt Office understated tax revenues and had to reduce bond funding.

Headline and core CPIF to move separately for a while yet

The sharp fall in core CPIF excluding energy that we expected in April as a result of base effects did not really kick in to the extent we expected. Still, it is worth recalling that core inflation remained stuck in the range of 1.4-1.5% y/y between January and May. Inflation took a multi-step leap in the first half of 2017 on the back of several factors that we deem temporary and that are now gradually fading out of the statistics. Some of these, such as electricity companies' grid fees and the methodological change to charter holiday prices, will still be in play for a few months.

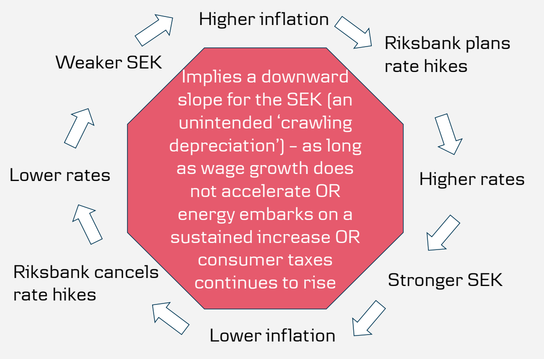
Comparing our forecasts with those of the Riksbank reveals that we expect

CPIF to overshoot the Riksbank's current forecast for the remainder of the year. The reason for this is because we have a more bullish assumption about energy prices than the Riksbank. This said, there is really no particular strategic idea behind it. Our assumption on both car fuels and electricity prices is that they have a seasonal pattern every year that will be repeated but that the average assumed annual price gain is zero. In our view, this is a neutral assumption. Apparently, the Riksbank has a more bearish view on energy prices. How do we come to this conclusion? Well, our CPIF excluding energy forecast is lower than the Riksbank's.

Both measures will be affected by the SEK. We raised our core CPIF excluding energy as EUR/SEK soared towards 10.60. Since then, the SEK has recovered strongly, which means that there may be a slight downside risk to our core forecast. But we stick to it for now, as the SEK is very volatile.

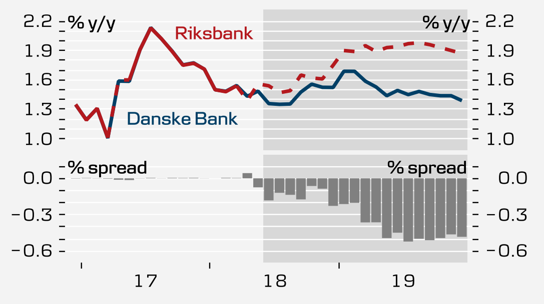
Our inflation analysis boils down to three things: 1) wage growth is too low to generate domestic cost pressures consistent with 2% CPIF inflation, 2) current CPIF inflation is boosted to an extreme, unsustainable extent by energy prices

It's a Catch 22 situation or circular reference for Riksbank



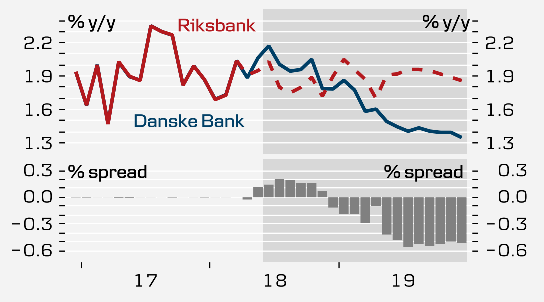
Source: Prospera, Riksbank, Mediation Office

Core CPIF excl. energy set to undershoot Riksbank's forecast going forward



Source: Riksbank, Danske Bank, Macrobond Financial

However, unless energy drops back soon, CPIF will instead overshoot Riksbank's forecast



Source: Riksbank, Danske Bank, Macrobond Financial and 3) the SEK needs to embark on a chronic weakening path if it is to help raising CPIF inflation. The first point is illustrated by services (excluding housing) inflation which has more than halved since the peak of 4.0% y/y in July last year. The third point stands in contrast to the Riksbank's KIX forecast, which assumes an appreciating SEK.

Clearly, the CPIF inflation target is not calibrated according to economic fundamentals.

Fearing an imminent downturn in export markets

In March's Nordic Outlook we focused on the negative implications of falling residential property prices' negative impact on household wealth and hence consumer spending. Although that threat is still very much alive and kicking as we expect another leg down in property prices, another threat is rapidly emerging: a downturn in the global manufacturing business cycle. More specifically, the main threat seems to stem from a weakening eurozone market (see Global Overview).

Looking at Swedish data, it is clear that manufacturing's new export orders are slowing in general. A few sectors – motor vehicles, intermediaries and wood/wood products – are actually showing outright declines. The latter may be more related to the Swedish domestic housing market though. But the overall impression is that it is probably more business-oriented (B2B) demand that is slowing Swedish manufacturing new orders.

In May, NIER's confidence survey showed manufacturing new orders on the export market dropping to just 7. That is a level that historically seems to suggest no goods export growth, being just on the verge of positive. Actually, the Engineering Industry's Q2 business barometer (which comprises more than 500 Swedish firms of different sizes, of which 80% are exporters) confirmed that new orders dropped significantly and that the eurozone market was mainly responsible for the decline. The decline was visible in all but one branch (machinery).

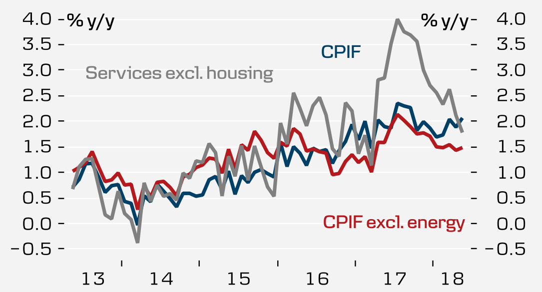
Hence, it appears that Swedish foreign trade has deteriorated much faster than we expected in the March outlook. Instead of being an average contributor to growth in 2018, it now appears it could become a drag instead.

This is also partly what appears to be showing up in our GDP indicator. Currently it suggest Q2 GDP growth at 2.4% y/y, not far off our 2.1 % y/y forecast.

Abundant signs now that residential investment declining

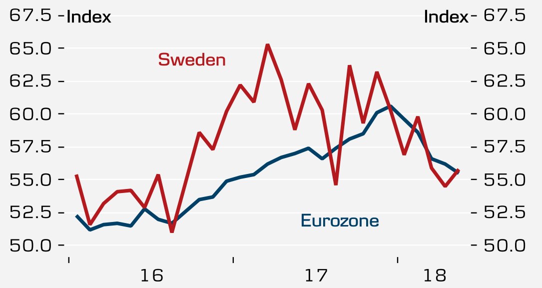
2017 GDP growth was generally revised down slightly. Calendar adjusted Q4 GDP, previously at 3.3% y/y, was reduced to 2.9% y/y. Instead Q1 18 now appears to be the peak at 3.3% y/y. Given that Statistics Sweden has generally revised down GDP data for 2017, it seems reasonable that Q1 18 is overstated too. Gross fixed investments seems to be the prime candidate for that, both software and new dwellings are pointed out.

Plunging services inflation is going to be a major worry for Riksbank



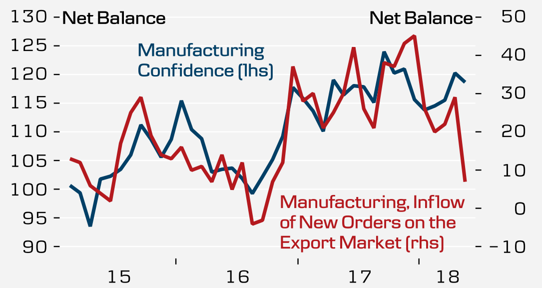
Source: Statistics Sweden, Macrobond Financial

Weaker manufacturing PMI can be traced to the eurozone



Source: Markit, Swedbank, Macrobond Financial

Plummeting orders stem from the export markets



Source: NIER, Macrobond Financial

The latter has been the factor we have been focusing on for the past couple of quarters. Q1 data is a bit mixed in the sense that it shows an outright decline in new residential investment in Q1 (-4.9% q/q), while overall residential investment rose (2.4% q/q). New construction makes up two thirds of total dwellings investments and the rest consists of reconstruction, cost of ownership transfer and holiday homes. Hence, to gauge developments in the residential construction market, we should look at construction of new dwellings. As can be seen in the chart, it did start to decline in Q1 18, as we predicted in the previous Nordic Outlook. In essence, this means that out forecast for this part of GDP is on track.

Looking down the road, there is more to come. There is really no need to change our previous assumption that residential investment will fall by close to 20% this year and another 10% in 2019. Why? Because recently, there has been a lot of data and anecdotal information suggesting that forecast is credible.

Firstly, Q1 data on multi-dwelling permits and flats confirms the turnaround in residential construction. Permits and starts have been falling for four and three quarters respectively, implying falling activity is in the cards.

Secondly, developers of multi-family flats, mainly in Stockholm, showed sharp declines in sales. In Q1, sales were down some 60% y/y on average. And the situation has hardly got any better. In response to that, for the first time in many years, developers started to cut prices on new production in April by some 10-12% according to Hemnet. There have been reports saying that big developers are slashing prices by 5-20% and in some cases by some 30%. The problem is that there are no statistics to back these indications. But they seem quite reasonable, as we know that production is still running high in comparison to sales. As we see these prices come down, sales should respond positively and gradually construction activity will stabilise. However, we are far from such a situation yet. Actually, we have recently witnessed the first signs that developers are shedding labour. It seems likely that we will see more of this.

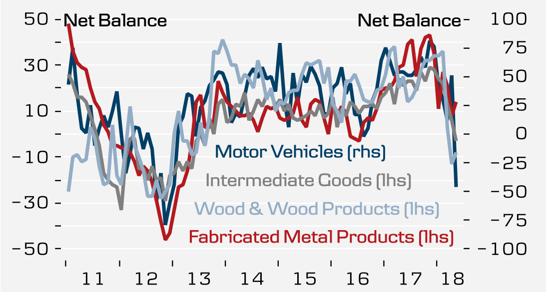
The back drop is really that there is a mismatch between – probably quite ample – demand for cheap flats and the – likewise ample – supply of expensive flats. Not necessarily a general over-supply.

Prices on existing flats in Stockholm have basically been flat since December. We had anticipated prices would start to decline after the new amortisation requirement introduced on 1 March. Looking forward, we still see a high probability that declining prices on new flats will spill over onto existing flats. Presumably, prices could fall another 5-10% before bottoming out.

Consumers remain vulnerable to a decline in house prices

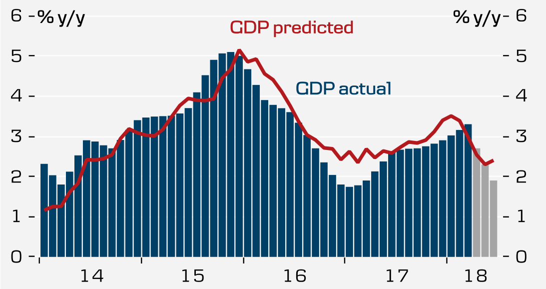
As laid out in the previous NO, Swedish households operate from a strong position. Employment growth remains strong and unemployment is falling. The employment and activity rates remain at the highest levels in decades. Recently employment growth by foreign born labour has receded somewhat, but still makes up about half total employment growth. The most pronounced change is that public job growth has slowed significantly over the past six months, partly being off-set by rising job growth in manufacturing industry. Despite the lacklustre growth in nominal wages, nominal disposable income growth has remained in the 3-4% range

Weakening orders seen in many industrial sectors – bad news for the economy



Source: NIER, Macrobond Financial

Our GDP indicator on track with slowing Q2 GDP forecast



Source: SCB, Danske Bank, Macrobond Financial

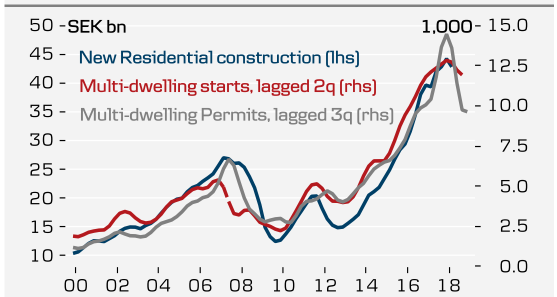
Sharp decline in developers' sales of new flats

Residential developers

	Flats sold			Flats started		
	Q1 2018	Q1 2017	% change	Q1 2018	Q1 2017	% change
JM Stockholm	117	354	-67	215	300	-28
JM Riks	244	321	-24	286	343	-17
Bonava Sweden	42	155	-73	61	116	-47
Skanska Sweden	241	458	-47	452	357	27
Oscar Properties	12	102	-88	0	0	0
Tobin propertyies	3	146	-98	0	95	-100
Veidekke	59	238	-75	0	221	-100
Total	718	1774	-60	1014	1432	-29

Source: Quarterly reports, News agency Direkt

Permits, starts and new residential construction all pointing down now



Source: Statistics Sweden, Macrobond Financial

Households save a lot: the savings ratio is close to 17% and roughly half of that is in equities, funds or bank accounts, giving some flexibility to react to worsening conditions if needed. Indeed, if necessary, households could at least partially offset any distractions with savings. The crux of the matter though is that savings usually are negatively correlated to spending.

Looking at households' balance sheets, about 45% of their assets are caught up in residential properties – houses, land and tenant-owned flats – and part of the financial assets are fixed in pensions, both public and private. Nonetheless, households on average appear to have some flexibility in terms of possible adjustments of financial assets.

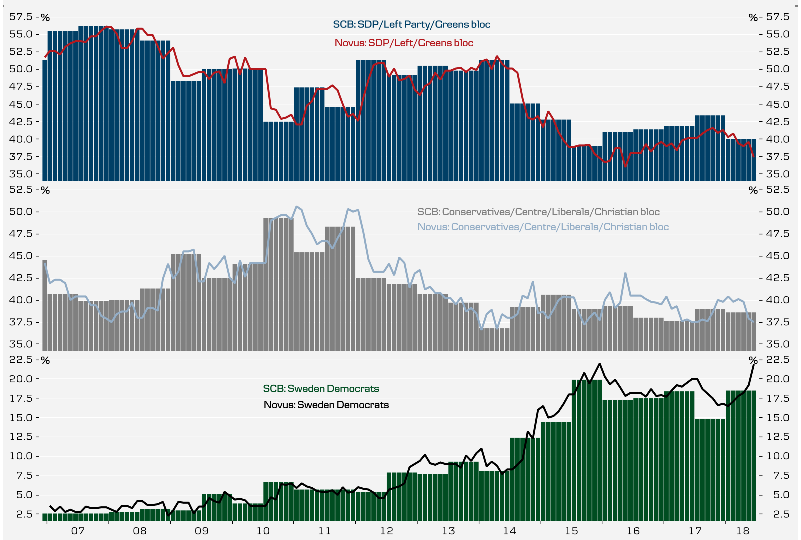
If the labour market deteriorates, there is a risk of a more pronounced slowdown in GDP growth. A further decline in house/condo prices could also hit wealth and consumer confidence, causing a more marked slowdown in retail sales and consumer spending.

Longer term, this poses a risk that the long-standing rise in Swedes' real income and wealth, a 'feel-good' factor, may start to level off in 2018.

Heading for a tricky parliamentary situation

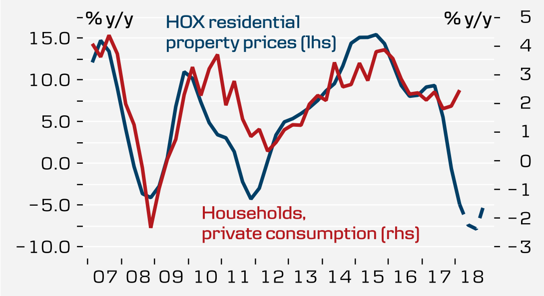
The outcome of the general election remains very blurred. The chart below can be used to show the trends in political opinions over the past decade. It is obvious that the anti-immigration Sweden Democrats (SD) have become a major player in Swedish politics, but outside the traditional two blocs. In 2010-14 when the centre-right coalition Alliance was in power, it lost votes not only to the left-green bloc, but also to the SD. Since then, over the past four years, SD has taken another leap in polls, taking voters from the current SDP/Green coalition (which is backed by the Left Party), while the support for the Alliance has been fairly unchanged. Recent polls suggest Sweden now has three parties with support in the 20-25% range: the SDP, The Conservatives (C) and the SD. Although the first two have toughened up their immigration policies, they are still losing votes to SD. The latter appears more inclined to support a new centre-right coalition rather than a left-green. But it will not do that without getting something back.

Recent trends: SDP loses out to SD



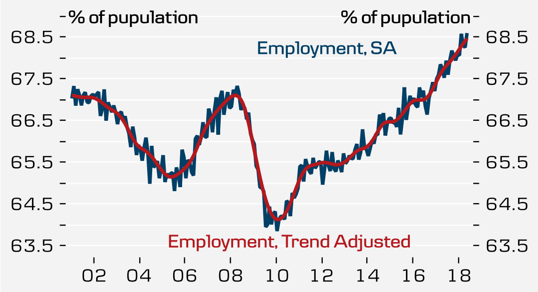
Recent trends: SDP loses out to SD

Spending holding up well so far – but may weaken if house prices decline again



Source: Statistics Sweden, Valueguard, Macrobond Financial

No signs of weakening labour market



Source: Statistics Sweden, Macrobond Financial

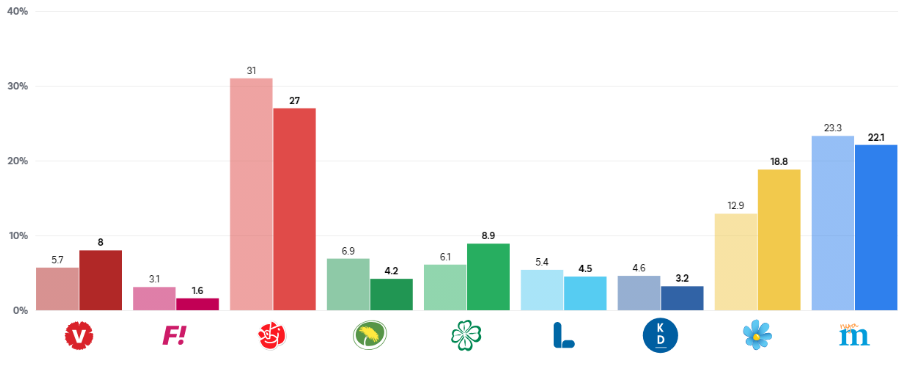
It seems inevitable that there will be a minority government. But these are vulnerable. In the left bloc, the Greens are close to the 4% threshold. If below that level in the September elections, a left-oriented government is out of the question. In the Alliance coalition, the Christian Democrats (CD) are currently running below that level and the Liberals are not much above. To complicate the situation further, both the Centre Party and the Liberals have said they do not want to be part of a coalition that relies on the SD, as they do not share SD views on immigration policies. The CD and conservatives, however, are closer to SD on that subject.

Parties and coalitions

- Feministic Party - left wing, outside parliament
- Left Party - left wing, supports SDP + Green government coalition
- Social Democrats -in government coalition with Greens
- Greens - in government coalition with SDP
- Centre Party - middle/right party with rural roots, in Alliance coalition
- Liberals - in Alliance coalition
- Christian Democrats - in Alliance coalition
- Moderates (Conservatives) - in Alliance coalition
- Sweden Democrats - anti-immigration party

Source: Parties, Danske Bank

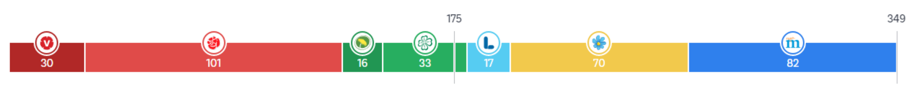
Poll of polls suggests new minority government coming



Source: Mämä, Datastory

The latest result of the poll of polls (consisting of a weighted average of the six biggest probability-based opinion surveys) compared to the 2014 election is illustrated in the chart above. The SDP is the big loser and SD the big gainer. The Alliance bloc is hampered by the fact that CD is below the threshold, which reduces the Alliance's mandates in the Riksdag (chart below). 175 out of 349 mandates are needed to form a majority government.

Distribution of Riksdag mandates with latest polls



Source: Mämä, Datastory

There seem to be no viable majority alternatives. A 'grand coalition' between SDP and Conservatives seems unrealistic as this would imply cooperation between sworn enemies. Most likely there will be a minority right-wing government, which will seek support from both SD and the left-green bloc depending on the question.

At a glance

National account	2017	2017	2018	2019
			Forecast	
	SEK bn (current prices)	% y/y		
Private consumption	2,027.0	2.2	2.0	1.8
Government consumption	1,197.9	0.4	0.6	0.8
Gross fixed investment	1,146.4	5.9	3.0	0.4
Growth contribution from inventories	34.9	0.1	0.2	0.2
Domestic demand	4,406.1	2.6	1.9	1.2
Exports	2,084.8	3.6	3.8	4.7
Aggregate demand	6,490.9	3.0	2.6	2.5
Imports	1,891.3	4.8	4.2	3.8
Growth contribution from net exports	193.5	-0.3	0.0	0.6
GDP	4,599.6	2.3	1.9	1.9
GDP, calendar adjusted	4,600.0	2.5	2.0	1.9

Economic indicators	2017	2018	2019
Trade balance, SEK bn	193.5	191.9	219.1
- % of GDP	4.2	4.1	4.6
Current Account, SEK bn	192.0	131.1	151.5
- % of GDP	4.2	2.8	3.2
Public sector savings, SEK bn	55.2	47.8	39.7
- % of GDP	1.2	1.0	0.8
Public debt ratio, % of GDP*	41.0	37.0	35.0
* Maastricht definition			
Unemployment, % of labour force	6.7	7.1	7.6
Hourly wages, % y/y	2.5	2.6	2.7
Consumer prices, % y/y	1.8	1.7	1.4
House prices, % y/y	-2.0	-10.0	2.0

Financial figures	19/06/2018	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	-0.50	-0.50	-0.50	-0.50
2-yr swap yield, % p.a.	-0.18	-0.15	-0.15	-0.05
10-yr swap yield, % p.a.	1.14	0.95	1.15	1.40
EUR/SEK	10.16	10.20	10.40	10.20
USD/SEK	8.76	8.72	8.67	8.16

Source: Danske Bank

Norway

All set for oil-driven upswing

- **Growth in the Norwegian economy has been largely as expected.**
- **Capacity utilisation is continuing to rise. Oil-related industries are clearly on the up and will be an important growth engine over the next couple of years.**
- **Unemployment is set to fall further and wage growth is picking up.**
- **Core inflation has been stable since autumn and is likely to be pushed up by higher wage growth going forward.**
- **Despite global political uncertainty and somewhat more mixed data, we still expect a rate hike in September. The market expectation of interest rates rising less than 25bp per year over the next three to four years seems highly optimistic.**
- **Housing prices have now climbed for four months in a row. An increased supply of properties and higher interest rates will bring more balance and stabilise the market in H2.**
- **The short-term outlook for the krone is uncertain due to global factors, but we still expect it to strengthen over the rest of the year.**

More self-sustained growth

Growth in Norway has been largely as expected since our previous forecast in March, but with slightly greater variations and hence uncertainty in the data. Still, economic growth has held above trend, unemployment is falling and capacity utilisation is rising. Stronger growth and lower unemployment mean that inflation is picking up, and we expect a first rate hike in September.

We expect GDP growth to remain above trend for the next couple of years, so this picture should remain unchanged. We nevertheless expect significant growth rotation, with government demand and housing investment making less of a contribution, and private consumption and investment contributing more. Oil-related industries could also perform better than expected and make a greater contribution to growth in the mainland economy.

The housing market has been the main risk, but we are now seeing clear signs of stabilisation. The risk now relates primarily to high levels of household debt, which make the economy vulnerable if interest rates rise faster than expected.

Growth much as expected

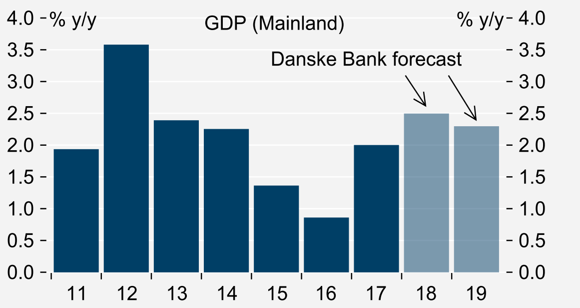
Growth in the Norwegian economy has been largely as expected, but more uneven than last year. Mainland GDP climbed 0.6% q/q in Q1, but the underlying data were slightly disappointing, with weak growth in private demand and oil investment. Growth was propped up instead by higher net exports and stock building. We believe, however, that part of the weakness in private demand is only temporary, a result of calendar effects and cold weather in March/April. Strong growth in both employment and hours worked confirm this impression.

Growth to remain above trend

Norway				
	Current forecast		Previous forecast	
% y/y	2018	2019	2018	2019
GDP (mainland)	2.5	2.3	2.5	2.3
Private consumption	2.3	2.5	2.5	2.3
Public consumption	1.9	1.9	1.8	1.8
Gross fixed investment	2.0	3.5	3.0	2.0
Exports	2.0	2.4	2.0	2.0
Imports	2.5	2.3	2.0	2.0
Unemployment (NAV)	2.4	2.2	2.3	2.2
Inflation	2.4	1.6	2.0	1.9

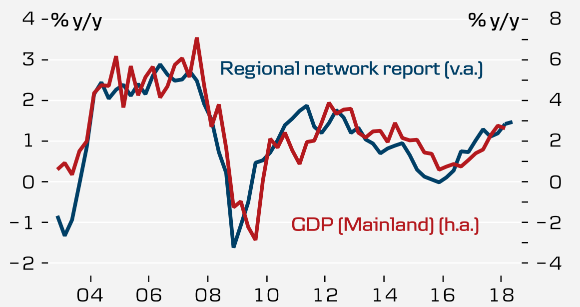
Source: Danske Bank

Above-trend growth despite higher interest rates



Source: Macrobond Financial, Danske Bank

Growth to remain above trend



Source: Macrobond Financial, Danske Bank

The results of Norges Bank's regional network survey for May also bear this out, indicating that growth will remain above trend over the next six months. The aggregated output index climbed from 1.42 in February to 1.47, its highest since September 2012.

This corresponds to mainland GDP growth of 0.7% q/q for the next two quarters. The survey shows big improvements in oil-related industries, construction and parts of the service sector. On the other hand, there was slightly weaker growth elsewhere in the manufacturing sector and in retail and consumer-oriented services.

We expect growth to remain above trend next year too, driven by a process of growth rotation where private demand and oil investment gradually take over as the main growth engine as the contributions from government demand and housing investment fade. Our expectation of stronger private consumption is due to faster growth in households' real disposable income. Higher wage growth, lower inflation and stronger job growth will all help growth in real disposable income to hold around 2.5% this year and climb towards 2.8% next year, partly cancelling out the effect of higher interest rates.

We also expect private investment (excluding housing investment) to strengthen further. Higher capacity utilisation, stronger growth, growing optimism and further favourable credit conditions should support investment, and it was particularly encouraging to see growth in business lending accelerating from around 2% y/y early last year to more than 7% y/y in April this year, the highest rate of growth since 2012. The regional network survey also shows that firms anticipate much stronger investment growth. In fact, investment expectations have not been higher since March 2007. The investment survey, on the other hand, suggests that investment growth in both manufacturing and the power sector will be slightly lower next year than in 2018, and investment is still below the long-term trend.

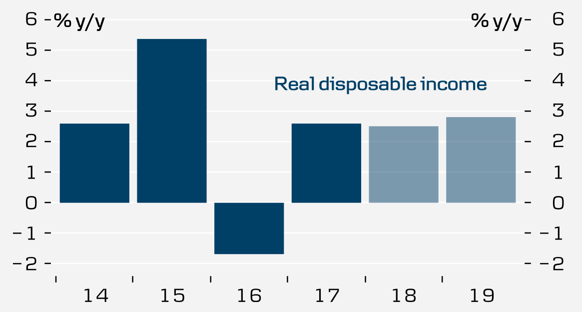
As mentioned above, we expect a solid contribution to growth from oil investment in 2018 and 2019. Cost-cutting on the Norwegian shelf has pushed the average breakeven price for investments well below USD 30 per barrel. Meanwhile, spot prices have climbed above USD 75, and prices for delivery in three to four years have hit USD 70.

We therefore expect oil investment to rise by close to 15% in 2018-19. It is particularly encouraging to see that exploration investment is estimated at NOK 33bn next year, more than 25% up on this year. This is the first sign that the upturn in the oil sector is entering a new phase where investment in new projects increasingly complements the development of existing fields. This means that there is increasingly a not insignificant upside risk to our forecast for oil investment – and so also for the Norwegian economy.

To date, the turnaround in oil-related industries is mostly only visible in expectations surveys and order books. This will presumably translate into a significant increase in activity in these industries in H2 and 2019.

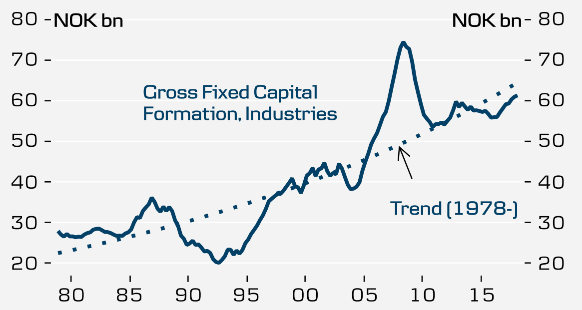
Nor do we see any great risk of a serious downturn in private consumption, unless interest rates rise much further than we expect. Our calculations show that even households with debt at four times income will see an improvement in their real purchasing power with interest rates raised twice annually in 2019-21. Overall, households' real disposable income after interest costs will climb

Growth in incomes to accelerate despite higher interest rates



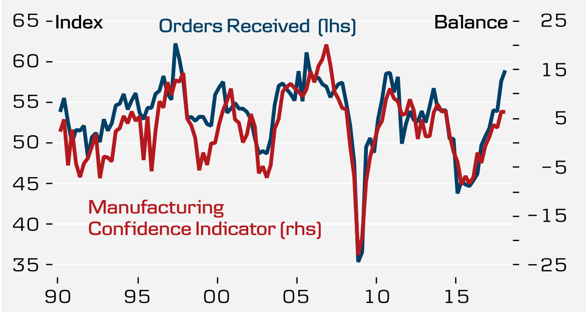
Source: Macrobond Financial, Danske Bank

Investment still below trend



Source: Macrobond Financial, Danske Bank

Manufacturing upswing only visible in order books



Source: Macrobond Financial, Danske Bank

by more than 2% per year even with two hikes per year. This will be enough to keep growth above trend during the period.

We have made no changes to our growth forecast this time around and still anticipate an increase in mainland GDP of 2.5% in 2018 and 2.3% in 2019. This is well above the trend growth rate and means that capacity utilisation should rise further and unemployment should continue to fall.

Unemployment to fall further

As expected, unemployment has continued to fall in 2018. However, the picture has been much more uneven than last year. After decreasing by 1500-2000 people per month for most of 2017, gross unemployment (which includes labour market measures) fell by just 200-400 per month in February to April, before falling sharply again in May to return to a trend of about 1,500 fewer jobless each month. Unemployment in May was the lowest since 2009.

This ties in well with all leading labour market indicators: the employment section of Norges Bank's regional network survey, the expectations survey, Manpower, the Confederation of Norwegian Enterprise barometer and Statistics Norway's business tendency survey for the manufacturing sector all point to further strong growth in demand for labour. According to Statistics Norway, the number of vacancies has increased by more than 10,000 in the past year despite over 45,000 more people in work.

In fact, we are starting to see signs of the fall in unemployment lagging slightly behind what would be expected from the rise in vacancies. This could mean that firms are having bigger problems finding the sufficient skills in the dole queue. Historically, this has often been a sign that the labour market is beginning to tighten. The fact that unemployment is falling more slowly is therefore not necessarily a sign that economic growth has slowed, but perhaps more that capacity utilisation is increasing.

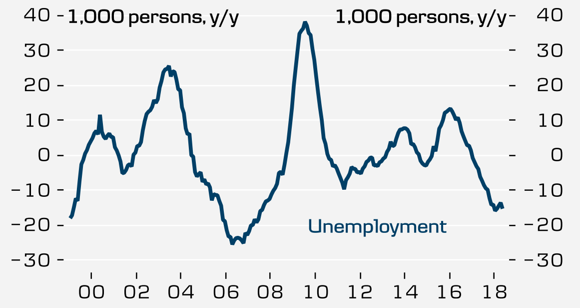
What is more, the LFS suggests that the labour force is growing more quickly, which will also slow the fall in unemployment. This in itself is also an indication that trend growth is on the up, which is very good news in the slightly longer term. In particular, the ever stronger growth in employment among the under-24s is a clear sign that the labour market is improving even though unemployment is not falling as fast.

On balance, we anticipate slightly stronger growth in the labour supply, causing the fall in unemployment to slow slightly towards the end of this year and in 2019.

Inflation and wage growth set to rise

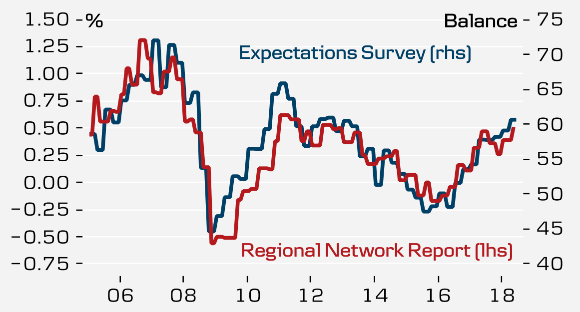
Inflation has been lower than expected since our March forecast. Core inflation came out at 1.2% y/y in May, well below our expectations. Inflation is nevertheless showing clear signs of picking up, and we expect the upward trend to last the year, with the core rate closing on 2% by Christmas. This is a downward revision from our previous forecast, due partly to import prices having risen less than we anticipated given the krone's depreciation late last year and early this year. Our target for 'core-core' inflation – which excludes ever-volatile airfares and food prices – is slightly higher than for core inflation. But this is also partly because the increase in sugar taxes, which ought to push inflation up 0.3pp, has almost completely failed to feed through to prices,

Fall in unemployment has stabilised



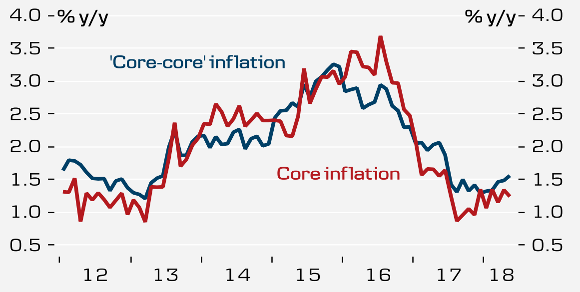
Source: Macrobond Financial, Danske Bank

Firms anticipate higher employment



Source: Macrobond Financial, Danske Bank

Core inflation on the way up



Source: Macrobond Financial, Danske Bank

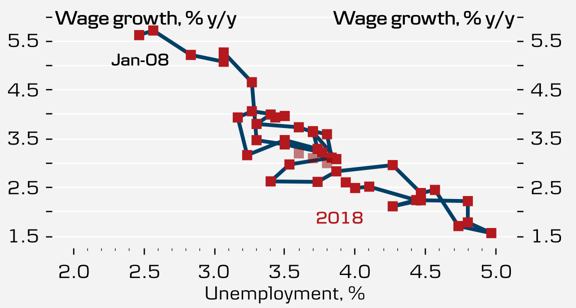
whereas Statistics Norway assumes a complete and immediate feedthrough in its computation of the CPI adjusted for taxes and energy (CPI-ATE).

On the other hand, the krone has been weaker than expected since our March forecast. This will bring slightly stronger growth in import prices late this year and early next year than we previously anticipated.

We are also seeing clear signs of wage growth beginning to pick up. This year's pay settlements supposedly set a limit of 2.8%, but we think this assumption is on the low side. The estimate is based on a wage overhang of 1.2% and a national wage increase of around 0.5%, and therefore assumes wage drift in manufacturing of just 1.1%. That would be in line with wage drift last year, which seems rather optimistic given that the labour market is tighter and profitability in the business sector is higher. Wage drift, which includes everything from locally agreed pay rises to wage increases when changing jobs, has historically been closely linked to economic activity. We therefore expect wage drift to be around 1.3% this year, which will push wage growth in the manufacturing sector up to around 3%.

This year's pay settlements tie in well with the historical relationship between unemployment and wage growth described by the Phillips curve, as mentioned in our March forecast. We assume that this relationship will continue to apply. We have not therefore made any changes to our forecasts for wage growth and still assume a rate of 3.0% in 2018 and 3.5% in 2019.

Pay settlements in line with Phillips curve



Source: Macrobond Financial, Danske Bank

Housing market tightening again

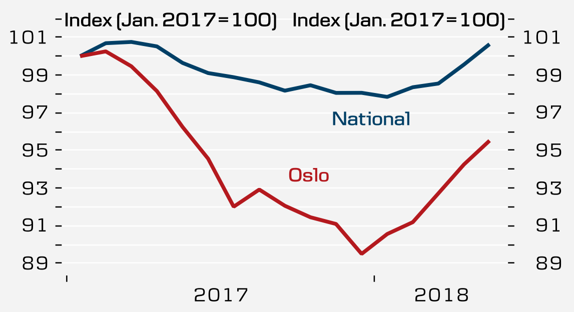
Housing prices have now risen for four months in a row and will soon be back to the levels seen before the drop in H2 last year. The turnaround in the housing market is due primarily to a better balance between supply and demand. For one thing, turnover is slowly but surely picking up. For another, the number of properties coming onto the market has been lower than turnover for a while, which means that the stock of unsold properties has fallen sharply.

The improvement has been particularly marked in Oslo. Prices there have climbed almost 7% so far this year in seasonally adjusted terms, and demand has been strong enough for the excess supply almost to have halved since peaking in the autumn. This may be because more homebuyers have come off the fence now that prices have begun to climb, after adopting a wait-and-see approach last year.

We expect the growth in housing prices to slow in H2. Due to strong growth in homebuilding in 2016 and 2017, a large number of new properties will be coming onto the market. We also expect mortgage rates to rise during the autumn, and homebuyers to begin to factor in further rate increases over the next couple of years.

On the other hand, we do not see any great risk of a serious downturn in the housing market unless interest rates rise much further than we expect. Our calculations indicate that, even with debt at four times income, housing purchasing power will decrease by only 0.7pp next year with two rate hikes.

Housing prices have begun to rise again



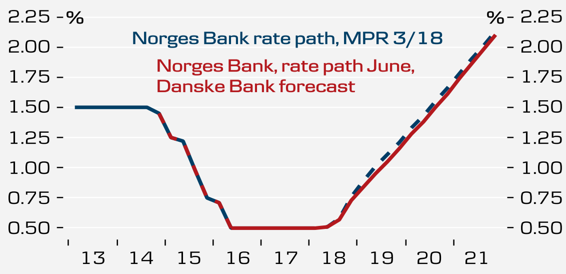
Source: Macrobond Financial, Danske Bank

Norges Bank to raise rates faster than indicated previously

As expected, Norges Bank left its policy rate unchanged at the May meeting and repeated the message from March of a first hike in September. As mentioned above, economic developments since March have been rather a mixed bag. Lower inflation and interest rates among Norway's trading partners are expected to drag the bank's interest rate projections down, with a weaker krone and higher oil prices pulling in the other direction, and other factors making only minor contributions.

On the other hand, Norges Bank has applied an element of discretion in its policymaking since December 2016. This is intended to capture both financial stability considerations (debt levels and housing prices) and the uncertainty associated with interest rates already being extremely low, and gives the bank much greater flexibility when preparing the interest rate paths in its monetary policy reports.

Rate hike inching closer



Source: Macrobond Financial, Danske Bank

Our view of the interest rate outlook is relatively straightforward. Norges Bank acknowledges that monetary policy is currently expansionary. This is clear from growth being above trend, unemployment falling, capacity utilisation rising and wage growth having begun to climb. The risk of deflation, or even just disinflation, is therefore relatively low. Housing prices are also now increasing again from relatively high levels.

This means that Norges Bank wants to start normalising monetary policy as soon as possible, since high household debt levels spell a significant risk of the bank being caught on the back foot and having to raise interest rates a long way in a short time. This shift in the central bank's risk assessment has been clear from its communications since last summer. As governor Øystein Olsen said in his annual address in February:

'In its conduct of monetary policy, Norges Bank weighs the outlook for inflation against developments in output and employment. In an environment of low inflation, solid economic growth and low unemployment, a conflict may arise between inflation considerations and considerations relating to the real economy. In that situation, we would be less worried about low inflation than if real economic prospects were also weak. We can then choose to bring inflation up to target over a longer horizon, particularly if interest rates are already low and there are signs that financial imbalances are building up'.

Our interpretation of this is relatively simple. For as long as growth remains above trend, with rising capacity utilisation and wage growth, there will be less of a focus on current inflation – especially with housing prices and debt rising more rapidly than household incomes.

We therefore believe that the threshold for postponing the long-signalled rate increase in September is unusually high. As a result, we expect Norges Bank to be relatively specific in its mention of the probability of a hike in September at its June meeting.

All in all, we expect the bank to revise down the interest rate path in the new monetary policy report by around 5-6bp to show interest rates rising by just over 40bp per year in 2019-21.

We also expect the key rate to be raised to 0.75% at the September meeting, and that somewhat higher capacity utilisation will ultimately necessitate two hikes per year in 2019-21.

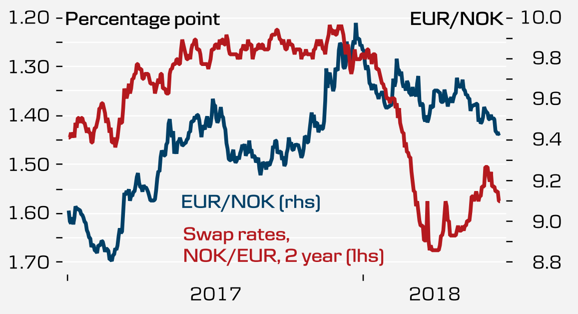
Krone constrained by global factors

Contrary to our expectations, the krone has actually weakened marginally since our March forecast. Rather more mixed data from Norway, including lower-than-expected inflation, have fed uncertainty about the signalled rate increases, but the most important reasons for the weaker krone can probably be found outside the country's borders. Greater uncertainty about global economic developments and various sources of political uncertainty have eroded risk appetite in global markets, which has a tendency to weaken illiquid assets such as the krone, and the persistent rise in oil prices has not been enough to counter these forces.

In the short term, market expectations now seem to be closely in tune with our own. This suggests that domestic factors will give the krone slightly more of a helping hand in the coming weeks. On the other hand, developments in Italy, the ongoing trade war and relations between the US and North Korea will probably put a damper on risk appetite.

We nevertheless expect the krone to gain against most currencies in H2 and into 2019. For example, we can see the EUR/NOK cross pushing down towards 9.30 at the end of the year.

Relative interest rates have not taken the krone with them



Source: Macrobond Financial, Danske Bank

At a glance

National account	2017	2017	2018	2019
			Forecast	
	NOK bn (current prices)	% y/y		
Private consumption	1,474.7	2.3	2.3	2.5
Public consumption	790.6	2.0	1.9	1.9
Gross fixed investment	784.2	3.5	2.0	3.5
Petroleum activities	149.5	-4.0	6.0	7.0
Mainland Norway	637.3	5.9	0.8	2.2
Dwellings	203.4	7.1	-5.5	-2.0
Enterprises	255.3	5.1	5.2	5.3
General government	178.6	5.8	2.0	2.2
Mainland demand	2,902.6	3.0	2.8	2.0
Growth contribution from stockbuilding		-1.6	0.2	0.0
Exports	1,148.2	0.8	2.0	2.4
Crude oil and natural gas	441.8	1.9	-1.0	0.0
Traditional goods	381.5	2.2	3.8	3.2
Imports	1,082.2	2.2	2.5	2.3
Traditional goods	635.1	3.2	3.0	2.6
GDP	3,279.4	1.8	2.1	2.0
GDP Mainland Norway	2,803.8	1.8	2.5	2.3

Economic indicators	2017	2018	2019
Employment, % y/y	1.1	1.2	1.1
Unemployment (NAV), %	2.7	2.4	2.2
Annual wages, % y/y	2.3	3.0	3.5
Consumer prices, % y/y	1.8	2.4	1.6
House prices, % y/y	5.9	0.7	2.0
Core inflation	1.5	1.7	1.9

Financial figures	19/06/2018	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	0.50	0.50	0.75	1.00
2-yr swap yield, % p.a.	1.38	1.55	1.65	2.00
10-yr swap yield, % p.a.	2.17	2.40	2.55	2.75
EUR/NOK	9.43	9.30	9.30	9.20
USD/NOK	8.13	7.95	7.75	7.36

Source: Danske Bank

Finland

Broad-based growth continues

- **In Q1 2018, GDP growth accelerated to 1.2% q/q, boosted by strong domestic demand from manufacturing investment and private consumption.**
- **Due to the better than expected start in Q1, we have revised our forecast and now expect Finnish GDP to grow 2.7% in 2018. However, the fastest growth spurt is probably already behind us and we see no reason to change our 2.0% growth forecast for 2019.**
- **Consumer confidence has consistently stayed at a record high level and improving employment continues to boost private consumption.**
- **The outlook for the export industries is strong thanks to growth in export markets, improved price competitiveness, and new production facilities in forest and automotive industries.**
- **The Finnish housing market is stable and bubble-free but the market is strongly divided geographically. We expect the average price level to rise by 1.2% in 2018.**
- **Fast GDP growth has increased tax revenue and continues to improve public finances. However, higher labour force participation will be needed to deal with the deteriorating old-age dependency rate in the future.**

At a glance

Finland	Current forecast		Previous forecast	
% y/y	2018	2019	2018	2019
GDP	2.7	2.0	2.4	2.0
Private consumption	2.1	1.6	2.1	1.6
Public consumption	0.9	0.5	0.5	0.5
Gross fixed investment	4.0	3.5	3.5	3.5
Exports	4.2	4.5	4.5	4.5
Imports	4.2	4.0	4.5	4.0
Unemployment rate	8.0	7.7	8.0	7.7
Inflation	1.0	1.4	1.0	1.4
Government balance, % of GDP	-0.3	-0.1	-0.2	-0.2
Current account, % of GDP	0.5	0.7	0.6	0.8

Source: Danske Bank

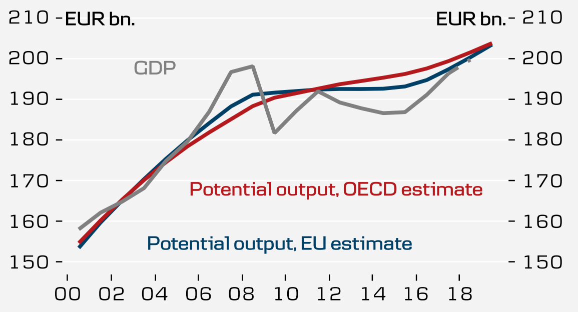
Output gap closing soon

In Finland, GDP increased by 2.7% in 2017 and we expect similar growth this year. At the beginning of 2018, growth accelerated to 1.2% q/q and 3.1% y/y, boosted by strong domestic demand. This was faster than expected. In general, outlook for the next couple of years remains good, although we see that the quarterly growth rate will slow already in Q2 18. We now expect GDP growth to be 2.7% in 2018 (was 2.4%) and slow down to 2.0% in 2019 (unchanged). In Q2 18, the Finnish GDP has probably finally surpassed the pre-financial crisis peak production level, although we won't know this for sure until official figures are published.

All the main components of GDP continue to support the economy in 2018. A combined effect of improving employment, rising wages and low inflation will lead to an acceleration of private consumption. However, the main drivers for fast economic growth are private investment and exports. Export industries benefit from continued strong global demand and improved domestic price competitiveness. Recent depreciation of euro provides additional support. High capacity utilisation rate and low interest rates are likely to boost manufacturing investment. Despite continued upswing, growth rates for both investment and exports should return to more typical territory after peak levels seen last year.

Consumer confidence has remained at a record high level for over a year now. Households continue to be extremely confident about both their personal finances and the general macroeconomic outlook. Rewards from the on-going recovery are slowly starting to benefit consumers more. The unemployment rate is finally decreasing and nominal wage growth surpasses inflation for the first time since 2016.

GDP reaching towards potential



Source: Macrobond Financial data, Statistics Finland

Leading indicators continue to indicate robust growth across industries. However, the current growth rate is well above the long run potential and the economy is closing the output gap quickly. Maintaining growth will become increasingly difficult in the future due to demographics. Improving growth potential depends partly on structural policies and labour participation rate, which is well below other Nordic countries.

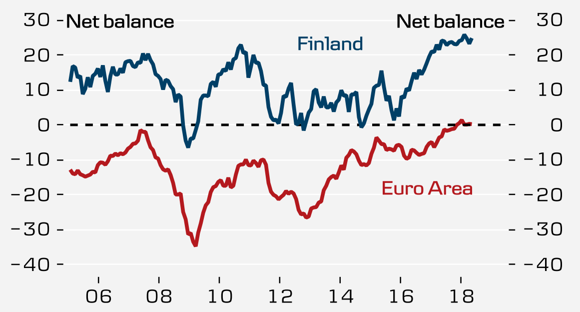
Consumers stay confident

With the help from tax cuts and low inflation, private consumption grew 1.7% in 2017 despite negative real earnings growth. In 2018, the growth in private consumption is expected to accelerate to 2.1%. Wage growth is still somewhat modest but low inflation and a rise in employment are helping consumers. All in all, the total wage sum for the whole economy is growing at a healthy rate of 4-5% with the help of rising labour participation. The net effect from changes in income taxes is roughly neutral in 2018.

Private consumption has been surprisingly robust in Finland during an extended period of weak economic growth. However, an increasing share of consumption has been financed using debt. In 2016, the net savings rate turned negative and it decreased further in 2017, reaching -0.9%. This is the lowest level of savings since 1988. So far, the household debt compared to disposable income is not exceptionally high in international comparison and, thanks to low interest rates, the interest-rate burden paid by households is very low. Improving employment and wage growth is likely to reverse the pattern of a shrinking savings rate. Consequently, we see that the risks in the household sector finances are still moderate. In principle, exposure to rising rates may become a more significant factor later on given that most Finnish housing loans are linked to variable Euribor rates.

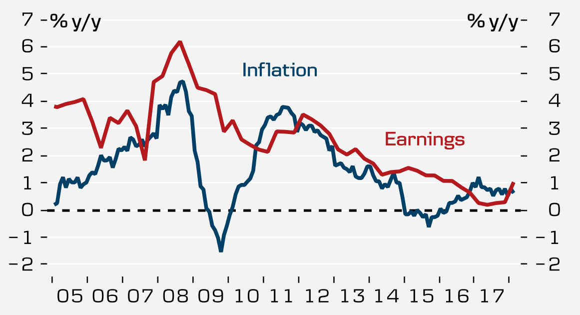
The Fin-FSA has been worried about the household debt growth rate and recently announced its decision to tighten the maximum loan-to-collateral (LTC) ratio for loans other than housing loans for first-time buyers. Beginning from 1 July 18, the maximum amount of housing loan will be capped to 85% of the current value of the collateral posted at the time of loan approval. The new regulation will not apply to first-time buyers for whom the LTC ratio will remain unchanged at 95%. There is some risk that the new legislation might actually encourage first-time buyers to take larger loans, which is unlikely to be the aim of the regulation. It remains to be seen whether this actually happens. As for consumer lending, Fin-FSA has very little tools. A positive credit register is one tool under consideration but progress is going to take some time.

Consumer confidence is very high



Source: Macrobond Financial data, Statistics Finland

Earnings growth is recovering



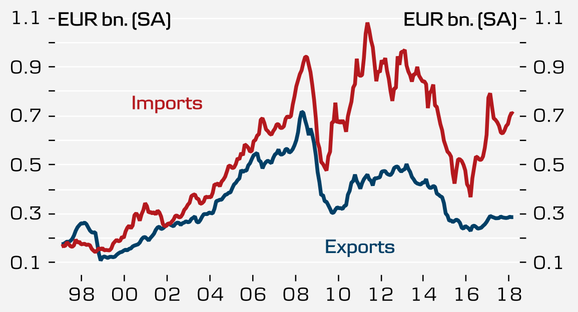
Source: Macrobond Financial data

Exports are expected to pick up after slow start

Exports of goods and services rose by 7.8% in 2017. The first quarter of 2018 was surprisingly weak for the export industry: exports decreased 1.1% q/q and only grew at the rate of 0.3% y/y. The contraction is likely to be temporary. Industrial new orders have remained robust and the order books are better than in a long time. It should also be noted that the weak export performance comes from the service sector, which is notorious for large statistical revisions.

Generally speaking, the outlook for export industries has improved considerably from last autumn, when it seemed for a while that the growth would come to a halt. According to the customs reports, the value of goods exports has risen by approximately 10% y/y in the January-April period. The figure is quite good considering that the level of comparison from last year is already quite high. The growth in the value of goods exports has been fast especially to the euro area. However, the growth profile is diverse and goods exports have risen in all main industries and areas. The outlook continues to be good thanks to growth in export markets, improving price competitiveness and new production facilities in forest and automotive industries, which are starting to operate at full capacity this year.

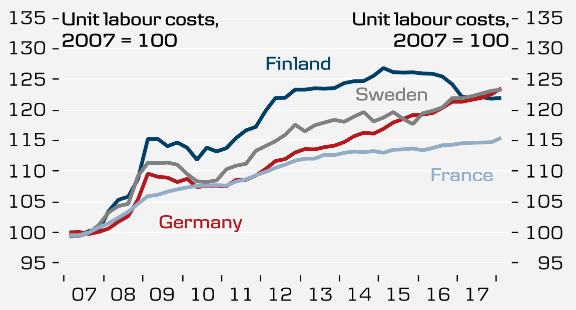
Exports to Russia stable but modest



Source: Macrobond Financial data

Export price competitiveness has been a hotly debated issue in Finland. Because Finland cannot devalue its currency, the government has pursued a policy of 'internal devaluation' together with the central labour organisations. The policy has been successful in helping Finland improve its competitiveness and cut unit labour costs relative to other EU countries. Even though the most significant tailwind at the moment is clearly stronger global demand, it seems that improved price competitiveness is contributing positively to export performance.

Internal devaluation restored price competitiveness



Source: Macrobond Financial, Statistics Finland

The outlook for most of the main Finnish export markets has remained good and business surveys show considerable signs of optimism. An increasingly large share of exports come for services. One of the bright spots in service exports has been the tourism industry, which has benefited from larger inflows of foreign visitors especially from Asia and Russia. Exceptionally fast exports growth in 2017 was to some extent explained by large individual items such as large ship deliveries. Given that there will fewer large ship deliveries this year, some slowdown is likely but we expect exports to rise by 4.2% in 2018 and 4.5% in 2019.

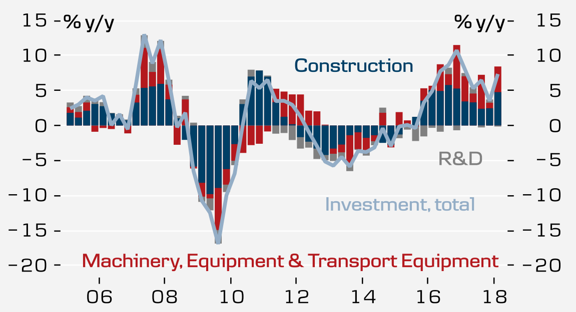
Private investment back on the growth track

Investment development was a little disappointing at the end of last year, but Q1 18 surprised on the upside and investments grew 3.7% q/q and 7.9% y/y. We expect industrial capex to improve at a reasonably rapid pace in 2018–2019 due to solid growth and a low level of investment in recent years. However, the unusually fast investment growth is set to slow down, when construction is starting to cool down. In 2017, investments increased by 5.8%, which is already considerably less than 8.0% seen in 2016. We expect investments to grow by 4.0% in 2018 and 3.5% 2019.

The investment boom in 2016 and 2017 began from a surge in housing construction but later on it spread to industrial investment, as well as transportation equipment. Growing exports demand, strong domestic demand, and low interest rates have boosted investment to the fastest growth since the pre-financial crisis levels. In 2017, the growth in investment was solely driven by the private sector, as public investment decreased by 4.3% and private investment grew 8.1%. We still forecast growth in investment but the growth rate is likely to slow down when the construction boom slows down and some larger industrial investments such as the Äänekoski bio-product mill are finished. There are several substantial new investment projects under consideration in forest industry but it will take time before any of these still uncertain projects get started, let alone show up in statistics.

Housing investment is expected to remain at reasonably high at high level in 2018–2019 but there is not much room for additional growth. There are already some signs of the housing boom ending but the process will be gradual. Construction investment grew 9.6% in 2016 but already slowed down to 5.2% in 2017. Housing permits and new starts continue to indicate robust apartment construction in growth centres, especially the Helsinki region. Compared to previous years, the number of completed apartments is also rising, which helps to cool down the market. Investment in non-residential buildings is driven partly by demand from the industrial sector for new production capacity. In 2017, R&D expenditure also finally started to increase after many years of decline. This is good news for the future development of potential output, although current levels of R&D investment are still not that impressive.

Investment activity



Source: Macrobond Financial data, Statistics Finland

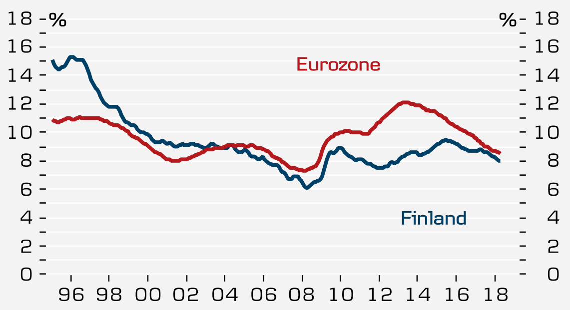
Unemployment still high but improving

In Finland, the unemployment rate is still high despite the strong business cycle. During recent months, we have finally seen some improvement in unemployment but it is too early to tell how far this will go. In April 2018, the trend estimate for unemployment from Statistics Finland fell to 8.0%, which is only 0.9pp lower than at the same time two years ago. The slow decrease in the unemployment rate seems to indicate that much of the current unemployment is structural.

In 2017, the employment rate rose through increasing labour force participation. Growth has encouraged people previously outside the labour force to come back and seek employment. In April, the trend estimate for the employment rate was 71.0% (up by 2.4 pp in two years). Somewhat alarmingly, the growth in employment has slowed down considerably in recent months. Government's target of 72% is still possible to reach in the spring 2019, when this government's term ends, but it is by no means guaranteed. Luckily, some past policy changes are only gradually taking effect which provide some reassurance for continuing improvement in the future. In the long run, an employment rate above 75%, similar to other Nordic countries, would help a lot in achieving long-term budget sustainability as the population ages rapidly.

The number of open vacancies has increased significantly. We expect that the annual unemployment rate will fall to 8.0% in 2018 and 7.7% in 2019. An increasing share of open vacancies are reported by employers as being 'hard-to-fill' which may indicate that we are not as much above the NAIRU level as we would like to think. Consequently, the unemployment rate could be sticky in the future as well.

Sticky unemployment rate



Source: Macrobond Financial data, Statistics Finland

Wage growth dropped to a historically low level in 2017. Even nominal earnings growth was close to zero and labour costs fell more than anywhere else in the EU. Progress towards higher employment would benefit from modest wage increases also going forward. In 2018, earning growth is returning to a more typical range. Together with wage drift, we expect average earnings to rise 2% in 2018 and 2.3% in 2019. This level is still quite tolerable and lower than in some export competitors like Sweden or Germany, for example. However, difficulties in filling vacant positions clearly increase the risk of higher wage drift in some industries like construction. Going forward, we expect the Finnish labour market to develop towards more local agreement.

Strong demand continues to support the housing market

Better employment opportunities and growing interest in an urban lifestyle are driving an increasing number of Finns into cities. Most immigrants end up in cities as well. Consequently, the Finnish housing market has become segregated geographically, as well as by the type of housing in question. Growth in housing demand has raised prices and caused a construction boom in Helsinki and a few other towns, while the real estate market in the rest of the country has remained more of less flat or is even declining. Migration to growth centres has created especially strong demand for compact apartments. In some scarcely populated parts of the country, functioning housing markets may not even exist.

Renting has become more popular among younger generations and the buy-to-let market has grown. Both real estate funds and private investors have been flocking into residential property, which has led to a boost in housing construction. For the most part, there are no signs of oversupply, however. Rise in rents continues to exceed the rise in housing prices or wages. Rents are rising approximately at the annual rate of 2.5%. Supply of new housing is increasing significantly in 2018, which provides downward pressure for prices: both rents and housing prices are likely to rise only moderately during the forecast period.

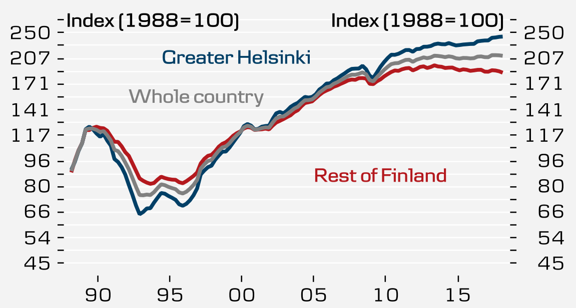
Prices of old dwellings rose 1.6% in 2017. On average, house prices have been nearly flat in Finland for approximately past five years. However, the average price development does not capture the situation in full, as it is calculated from decreasing prices in some regions and rising prices in others, like Helsinki and its surrounding municipalities. The same main trend is likely to continue: in Q1 18 prices of old dwellings grew on average by 2.1% y/y in Helsinki Region and decreased by 1.9% elsewhere. On average, the prices did not change. In Helsinki, new apartments in particular have been in strong demand, and construction has followed demand. Prices of new apartments rose by 5.0% in Helsinki Region in 2017. The prices of new apartments fell in Q1 18, but this may reflect temporary factors. In any case, the price rise of new apartments is likely to be considerably slower in the future due to increasing supply.

Low interest rates and high consumer confidence support the housing market, and we still expect prices to grow modestly, and there seems to be only a small risk of overheating in the future. Supply of new city apartments will be high in 2018 and probably also in 2019. On average, housing prices are expected to increase by 1.2% in 2018 and 1.5% 2019. Even slightly more peripheral areas may benefit from the current economic upswing.

Employment rising toward government target

Source: Macrobond Financial, Statistics Finland

Diverging housing prices



Source: Macrobond Financial, Statistics Finland

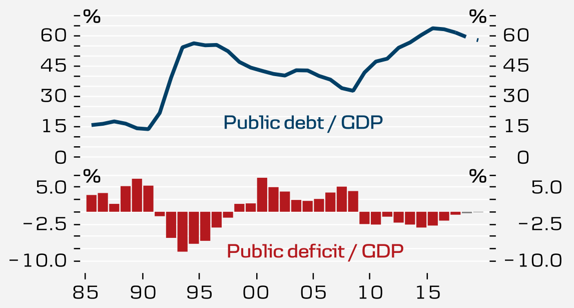
Debt level to fall soon to reach 60% of GDP

In Finland, every budget for the central government has had a significant deficit since the financial crisis. As a consequence, the public debt has grown quite fast. Deficits have helped to maintain the welfare state with fairly generous social security, even if some benefit cuts have been made. Municipalities have also been running a deficit on average. Social security funds still have surplus from earning-related pension funds, albeit a decreasing one.

Thanks to economic recovery, improving tax revenue and austerity measures, general government debt to GDP ratio is already down quite a bit from its peak level in 2015. The ratio is likely to fall below 60% in 2018. This is noticeably earlier than what was expected still six months ago. General government is very close to reaching a modest surplus in 2019, but forthcoming parliamentary elections may lead to more lax budget and smaller social security fund surplus could keep the balance in red.

Structural reforms are still needed to boost potential growth and improve labour participation in order to deal with the rise in age-related expenditure caused by an ageing population and rising dependency rate. Otherwise, the debt ratio is likely to rise again in the 2020s. The rating outlook is getting brighter, but rating agencies are likely to need further evidence of sustained economic growth and successful structural reforms. Successful social and health care reform (SOTE) could be one way of regaining AAA sovereign credit rating. At the moment, the fate of the SOTE project is still quite unclear and its true potential for reducing health care costs hotly debated.

Debt to GDP levelling down



Source Macrobond Financial, Statistics Finland

At a glance

National account	2017	2017	2018 Forecast	2019 Forecast
	EUR bn (current prices)	% y/y		
GDP	224.1	2.7	2.7	2.0
Imports	85.2	3.7	4.2	4.0
Exports	86.3	7.8	4.2	4.5
Consumption	173.6	1.5	1.6	1.3
- Private	122.1	1.7	2.1	1.6
- Public	51.5	1.6	0.9	0.5
Investments	50.5	5.8	4.0	3.5

Economic indicators	2017	2018	2019
Unemployment rate, %	8.6	8.0	7.7
Earnings, % y/y	0.2	2.0	2.3
Inflation, % y/y	0.7	1.0	1.4
Housing prices, % y/y	1.1	1.2	1.5
Current account, EUR bn	1.6	1.2	1.7
- % of GDP	0.7	0.5	0.7
Public deficit, % of GDP	-0.6	-0.3	-0.1
Public debt/GDP, % of GDP	61.3	59.1	57.6

Financial figures	19/06/2018	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	-0.40	-0.40	-0.40	-0.40
2-yr swap yield, % p.a.	-0.17	-0.15	-0.10	0.10
10-yr swap yield, % p.a.	0.92	1.05	1.25	1.55
EUR/USD	1.16	1.17	1.20	1.25

Source: Danske Bank

Global overview

From boom to cruising speed

- **After a strong end to 2017, we see clear signs that the global business cycle is losing momentum in early 2018.**
- **While the global cycle is softening, we still expect growth to stay above potential in 2018 and 2019, led by the US, China and Emerging Markets.**
- **Inflation pressures will rise modestly, implying a gradual withdrawal of monetary policy support in advanced economies.**
- **The main risks to our forecast are an escalation of trade tension into a full-blown trade war and inflation increasing faster than expected, prompting sharper monetary policy tightening.**

Global forecasts

% y/y	2017	2018	2019	2020
Global	3.7	3.8	3.7	3.6
Developed markets	2.2	2.1	1.9	1.6
USA	2.3	2.6	2.4	2.0
Euro area	2.6	2.1	1.7	1.6
Japan	1.7	1.0	1.1	0.5
UK	1.8	1.1	1.2	1.2
Emerging Markets of which	4.7	4.9	5.0	4.9
China	6.9	6.6	6.4	6.2
India	6.3	7.0	7.2	7.0

Source: Bloomberg, IMF, Danske Bank

The global manufacturing cycle peaked in early 2018...

After a strong synchronised upturn in the global industrial cycle since early 2016, the global economy has seen a rocky start to 2018. This comes amid signs that the global manufacturing cycle is losing momentum, with PMIs falling back (albeit from high levels) and signals from our medium-term business cycle model. Furthermore, market sentiment was hit by inflation concerns in early February and rising yields in the US, which has hurt EM assets. Recently, trade tensions between the US and its major trading partners, notably China, have added to the wobbly market sentiment.

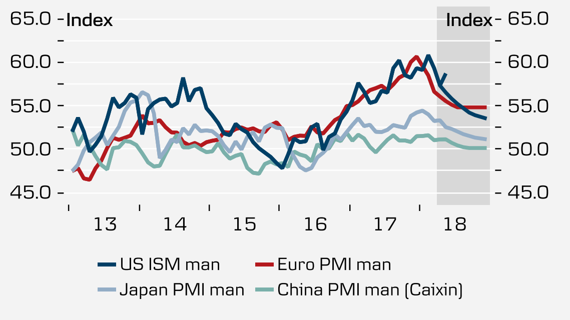
...but the global economy should still grow above potential

While global growth might be decelerating, we do not expect it to turn into a marked downturn over the next two years — rather, growth in the world economy should go from boom to cruising speed in line with its potential. As a result, we expect the global economy to grow 3.8% in 2018, falling to 3.7% and 3.6% over the course of 2019-20 as major central banks tighten monetary policies and capacity constraints weigh on production.

We have become slightly more upbeat on US economic growth, mainly because of the sizeable fiscal expansion approved over the winter. Furthermore, China's economic growth has held up better than we expected as external demand has offset the negative impact of financial tightening. In the euro area, our December forecast remains unchanged: a pick-up in real GDP growth to 2.1% in 2018, but slowing to 1.7% and 1.6% in 2019 and 2020, respectively, as the stronger euro and global growth moderation weigh on net exports, offsetting modest investment growth.

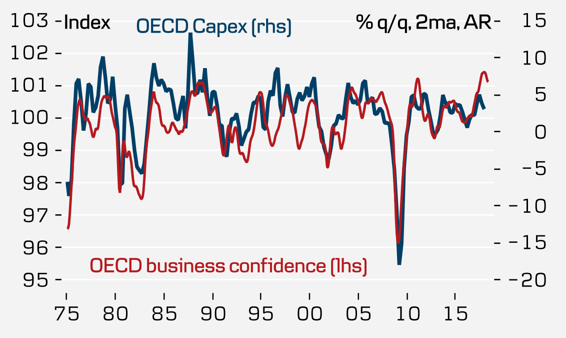
A pertinent question, in our view, is how long the recovery can go on for, with our forecast suggesting that the current US expansion is the longest since the Second World War. We do not see the trigger for a recession over the forecast period. The flat US yield curve can be said to be a danger sign of markets expecting a recession, but again, not likely within our forecast horizon.

Global manufacturing from acceleration to deceleration across regions



Source: Markit, Macrobond Financial, Danske Bank

Global capex boom not kicking off



Source: Macrobond Financial, Danske Bank

Gradual monetary policy tightening amid muted inflation pressures

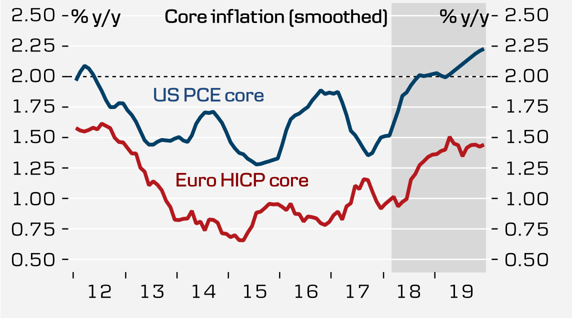
Typically, a recovery ends when central banks have to step on the brakes if inflation threatens permanently to exceed the central bank's target. However, despite solid economic growth and a tightening of labour markets in many countries, we are still not seeing a rapid rise in inflation pressures. Of course, headline inflation is being boosted by the rise in oil prices, but in our base case that the rise in oil prices is temporary, the impact on inflation should fade. Core inflation is rising only modestly as wage growth is still subdued even in economies with low unemployment rates, such as the US, Germany and Japan, due to limited wage demands, driven by relatively muted inflation expectations and globalisation pressures. Hence, we see core inflation only reaching 1.4% in the euro area and 2.2% in the US by 2019. We believe the biggest upside risk to inflation is in the US, given its sizeable fiscal expansion and limited slack in the economy.

Given the muted inflation outlook, we continue to expect a gradual tightening of monetary policy in the G3. The Federal Reserve is widely expected to raise its interest rate two to three times more this year, followed by three hikes next year, still marking a very gradual hiking cycle compared with the past. In the euro area, the ECB is expected to gradually end its bond buying programme in Q4 18 as the economic growth outlook has strengthened, and along with its own expectations. However, given the muted inflation outlook, we recently postponed our call for the first ECB hike from June 2019 to December 2019. The same goes for Bank of Japan, which is also struggling to get inflation back towards its 2% target. This will only happen very slowly and therefore we expect BOJ to raise its yield target cautiously in 2019 by 0.10% as a first step towards removing the unprecedented policy support.

Trade war and European politics the main risk

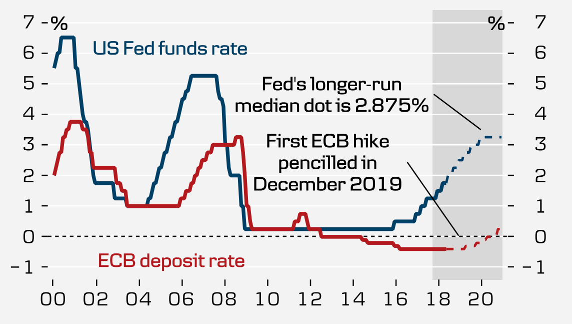
The risks to our forecast are tilted to the downside. One clear risk for the eurozone is the new Italian government and a flaring up of the European debt crisis. The government has presented a policy programme envisaging a sizeable fiscal expansion and calling for euro area reforms. This could push Italy into a conflict with the EU, which could increase market wariness about the eurozone outlook. Another significant downside risk is further escalation of the trade conflict between the US and major trading partners such as EU and China. Such an escalation will weigh on global trade and investor sentiment.

Global inflation pressures rising gradually...



Source: Macrobond Financial, Danske Bank

..implying only gradual tightening of global monetary policies



Source: Macrobond Financial, Danske Bank

Financial forecast

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	19-Jun	2.00	2.34	2.83	2.98	115.9	-	642.7
	+3m	2.00	2.42	2.80	3.05	117.0	-	636.3
	+6m	2.00	2.62	3.00	3.15	120.0	-	620.4
	+12m	2.50	2.95	3.30	3.35	125.0	-	595.4
EUR	19-Jun	0.00	-0.32	-0.17	0.92	-	115.9	745.0
	+3m	0.00	-0.33	-0.15	1.05	-	117.0	744.5
	+6m	0.00	-0.33	-0.10	1.25	-	120.0	744.5
	+12m	0.00	-0.33	0.10	1.55	-	125.0	744.3
JPY	19-Jun	-0.10	-0.04	0.05	0.26	128.0	110.5	5.82
	+3m	-0.10	-	-	-	128.7	110.0	5.78
	+6m	-0.10	-	-	-	134.4	112.0	5.54
	+12m	-0.10	-	-	-	140.0	112.0	5.32
GBP	19-Jun	0.50	0.63	1.00	1.52	87.4	132.6	852.3
	+3m	0.75	0.82	1.15	1.70	86.5	135.3	860.7
	+6m	0.75	0.82	1.45	1.90	84.0	142.9	886.3
	+12m	1.00	1.07	1.70	2.15	83.0	150.6	896.7
CHF	19-Jun	-0.75	-0.73	-0.54	0.42	115.5	99.6	645.1
	+3m	-0.75	-	-	-	116.0	99.1	641.8
	+6m	-0.75	-	-	-	119.0	99.2	625.6
	+12m	-0.75	-	-	-	122.0	97.6	610.0
DKK	19-Jun	0.05	-0.30	-0.05	1.06	745.0	642.7	-
	+3m	0.05	-0.30	0.00	1.20	744.5	636.3	-
	+6m	0.05	-0.30	0.05	1.40	744.5	620.4	-
	+12m	0.05	-0.30	0.25	1.70	744.3	595.4	-
SEK	19-Jun	-0.50	-0.38	-0.18	1.14	1015.8	876.3	73.3
	+3m	-0.50	-0.45	-0.15	0.95	1020.0	871.8	73.0
	+6m	-0.50	-0.40	-0.15	1.15	1040.0	866.7	71.6
	+12m	-0.50	-0.40	-0.05	1.40	1020.0	816.0	73.0
NOK	19-Jun	0.50	1.02	1.38	2.17	942.8	813.3	79.0
	+3m	0.50	1.15	1.55	2.40	930.0	794.9	80.1
	+6m	0.75	1.30	1.65	2.55	930.0	775.0	80.1
	+12m	1.00	1.50	2.00	2.75	920.0	736.0	80.9

Commodities

		2018				2019				Average	
	19-Jun	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2018	2019
NYMEX WTI	65	63	68	68	68	69	69	70	70	67	70
ICE Brent	75	67	75	72	72	72	72	74	74	72	73

Source: Bloomberg, Danske Bank

Economic forecast

Macro forecast, Scandinavia

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Wage growth[1]	Unem-ploym[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Denmark	2017	2.2	1.5	1.2	3.7	4.4	4.1	1.1	1.7	4.2	1.0	36.4	7.8
	2018	1.8	2.3	1.1	5.0	0.5	3.6	0.9	1.9	4.0	-0.2	35.1	6.5
	2019	1.8	2.4	0.5	1.5	2.7	2.4	1.5	2.3	3.8	-0.2	34.4	7.2
Sweden	2017	2.5	2.2	0.4	5.9	3.6	4.8	1.8	2.5	6.7	1.2	41.0	4.2
	2018	2.0	2.0	0.6	3.0	3.8	4.2	1.7	2.6	7.1	1.0	37.0	2.8
	2019	1.9	1.8	0.8	0.4	4.7	3.8	1.4	2.7	7.6	0.8	35.0	3.2
Norway	2017	1.8	2.3	2.0	3.5	0.8	2.2	1.8	2.3	2.7	-	-	-
	2018	2.5	2.3	1.9	2.0	2.0	2.5	2.4	3.0	2.4	-	-	-
	2019	2.3	2.5	1.9	3.5	2.4	2.3	1.6	3.5	2.2	-	-	-

Macro forecast, Euroland

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Wage growth[1]	Unem-ploym[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Euro area	2017	2.6	1.7	**1.2**	**3.5**	5.5	4.5	1.5	1.6	9.1	-0.9	86.7	3.5
	2018	2.1	2.1	**1.8**	**3.4**	4.1	3.3	1.6	1.9	8.4	-0.7	86.0	3.4
	2019	1.7	2.1	**2.4**	**2.1**	3.3	3.8	1.4	2.1	8.0	-0.6	85.5	3.4
Germany	2017	2.5	2.0	1.5	4.0	5.3	5.6	1.7	2.6	3.7	1.3	64.1	8.0
	2018	2.1	1.5	0.8	4.3	3.6	3.4	1.8	2.8	3.4	1.2	60.2	7.9
	2019	1.9	2.3	2.1	3.3	3.8	5.3	1.7	3.0	3.3	1.0	56.3	7.6
Finland	2017	2.7	1.7	1.6	5.8	7.8	3.7	0.7	0.2	8.6	-0.6	61.3	0.7
	2018	2.7	2.1	0.9	4.0	4.2	4.2	1.0	2.0	8.0	-0.3	59.1	0.5
	2019	2.0	1.6	0.5	3.5	4.5	4.0	1.4	2.3	7.7	-0.1	57.6	0.7

Macro forecast, Global

	Year	GDP[1]	Private cons.[1]	Public cons.[1]	Fixed inv.[1]	Ex-ports[1]	Im-ports[1]	Infla-tion[1]	Wage growth[1]	Unem-ploym[3]	Public budget[4]	Public debt[4]	Current acc.[4]
USA	2017	2.3	2.8	0.1	4.0	3.4	4.0	2.1	2.5	4.4	-3.5	105.0	-2.5
	2018	2.6	2.4	1.3	5.2	4.2	4.4	2.5	2.6	3.9	-4.0	106.0	-3.0
	2019	2.4	2.3	1.1	4.0	3.1	3.0	2.0	2.8	3.6	-4.6	107.0	-3.4
China	2017	6.9	-	-	-	-	-	2.0	9.0	4.1	-3.7	47.6	1.4
	2018	6.6	-	-	-	-	-	2.3	8.7	4.3	-3.4	50.8	1.1
	2019	6.4	-	-	-	-	-	2.3	8.5	4.3	-3.4	53.9	1.2
UK	2017	1.8	1.7	0.1	4.0	5.7	3.2	2.7	2.2	4.4	-1.9	87.7	-4.1
	2018	1.1	1.1	1.1	2.9	1.3	1.2	2.5	2.5	4.2	-1.8	85.4	-4.4
	2019	1.2	1.2	0.4	1.3	2.6	2.0	1.5	2.9	4.1	-1.7	85.3	-4.0

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

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Date of first publication

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