Nordic Outlook

Investment Research
4 April 2023

Unchartered territory

Highlights

- Economic activity held up better than feared, but modest growth outlook still ahead on the back of more monetary tightening
- Wage growth is picking up, delaying the slowdown in inflation
- Uncertainty looms large and recent financial turbulence is a reminder that we are in unchartered territory
- Nordic economies see diverging fortunes, with Norway and Denmark outperforming Sweden and Finland

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Where no other source is mentioned statistical sources are: Danske Bank, Macrobond, EC, IMF and other national statistical institutes as well as proprietary calculations.

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The Big Picture is focusing on the outlook for the global economy.
Read more about the prospects for Nordic economies in our Nordic outlook publication.

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

Unchartered territory

Global
We expect stagnation or decline in most Western economies, which have not yet felt the full effect of the very large interest rate increases over the last year, and where consumers and businesses have been squeezed by higher costs. In our forecast, the slowdown will be mild and not quite enough to bring inflation down to 2% within next year in general. However, the outlook is highly uncertain, and there is definitely a risk of a deeper economic crisis. The economic situation itself is difficult enough, and on top of that, we have war, a tense geopolitical climate and fears over financial stability.

Euro area
Despite a more upbeat near-term outlook, a strong recovery is not yet in sight, as monetary headwinds persist and fiscal support is fading. Challenging times lie ahead especially for Germany's economy, which is unlikely to return as the euro area's economic powerhouse anytime soon. Securing a leading position in the green transition race remains key, but growing political divisions in the EU pose a challenge. Despite the latest financial market jitters, elevated inflation pressures will keep ECB firmly in tightening mode. Following further rate hikes in the coming months, we expect the deposit rate to peak at 4.00% in early Q3 23 and look for rate cuts not before the summer 2024.

Denmark
The economy has proven more resilient than expected, with consumer spending stabilising or rebounding and with GDP reaccelerating thanks to higher pharmaceutical production. Still, also Denmark is facing a period of moderately higher unemployment, in our view. Inflation should decline in line with energy prices, but wage growth will feed through to consumer prices. The current account surplus is declining from extreme 2022 levels, but looks set to remain very large, supporting continued lower interest rates than in the euro area. House prices will likely continue to decline, especially in more expensive parts of the market.

Sweden
A two-track economy with, on the one side, households, retail trade, the housing market and construction under immense pressure from eroding real wages and soaring interest cost. On the other side, the manufacturing and services sectors are coping well with current conditions. Moreover, the labour market has been more sanguine than expected. On balance, we have raised the outlook for GDP growth in 2023 slightly. Core inflation has again surprised sharply to the upside at the beginning of the year, way above Riksbank's forecast, forcing it to continue to raise the repo rate sharply at the next two meetings. With that backdrop, house prices are likely to start falling sharply again.

Norway
Growth has been better than expected, particularly driven by a stronger growth in private consumption. As a result, the labor market has remained tight and wage and price growth has continued to rise. There are now signs that growth is slowing down, and most likely the economy is at a turning point where inflation decreases, while unemployment rises somewhat. The weak exchange rate may keep inflation higher for longer. House prices are likely to fall somewhat as Norges Bank raises interest rates to 3.5% in June.

Finland
Finnish economy entered a shallow recession in late 2022 and GDP will decrease slightly in 2023. Trade with Russia has fallen to a very low level. High inflation and rising interest rates weigh on consumers. The labour market looks stable and wages are rising faster than in recent years. Housing prices will fall and housing construction will slow down in 2023, but the unleashing of pent-up demand and the expected fall in interest rates will stimulate the housing market in 2024. A new government will be formed soon. We expect that the new government will gradually start to tighten fiscal policy. We forecast economic growth to pick up in 2024, as both domestic and export demand recover.

Sailing outside the map

- Persistent inflation and resilient economies suggest that monetary policy needs to be tightened more, but recent financial turbulence is a reminder that there can also be a high cost of tightening too much.
- We expect a period of stagnation or modest growth, where inflation will gradually decline, but this is a forecast with very large uncertainties in both directions – we are in a situation where history is not much of a guide.
- Unemployment has only increased a little or not at all. Wage growth is picking up, making it more difficult to get core inflation down.

Economic events over the last three years have been extreme. The Covid-19 crisis, the policy reaction to it, unexpected double-digit inflation, very rapid interest rate increases from negative or zero levels – these are not things that happen often. On top of that, we have a major war in Europe and a tense and unpredictable geopolitical situation. This is not only a difficult time for decision makers in households, businesses and investment management, it is also extremely challenging for central banks and politicians trying to avoid the most negative outcomes.

So far this year, we have gone from markets expecting a fairly rapid decline in inflation and interest rates, to fears that inflation would prove very sticky and interest rates have to be increased a lot more – and back again after problems were exposed in the banking sector. Some of the financial market fluctuations may seem excessive, but the uncertainty is real. We do not know how much monetary policy tightening is enough to stabilise inflation around 2%.

Here in the Nordic countries, like elsewhere in Europe and in the US, the economies have been remarkably resilient against the undermining of purchasing power and higher interest rates. In particular, unemployment has barely budged despite all the headwinds facing businesses. Lower energy prices have driven inflation down, but excluding that, inflation is not really decreasing yet – in some cases, like Sweden, quite the opposite. Across countries, we have increased our forecast for how high central banks will want to set policy rates to create enough of a slowdown to control the situation.

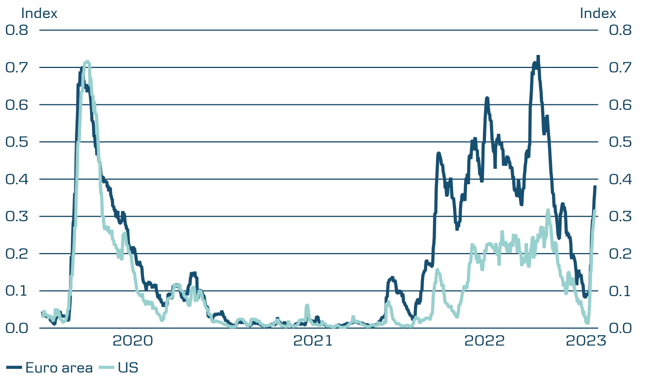
However, there was always also the risk that the slowdown would instead be a deeper crisis. Monetary policy affects the economy with delays and in magnitudes that are difficult to estimate even at the best of times, and unemployment and other economic variables can deteriorate rapidly and suddenly as history has often shown. One way this can happen is through a financial crisis. Higher interest rates are supposed to make it more expensive and difficult to borrow, but that process can spin out of control if the tighter financial conditions cause or expose problems in banks that lead to a wider loss of confidence.

The recent cases of bank problems are related to specific issues in those banks and probably do not foreshadow any wider crisis, especially given the measures that authorities have taken to reign in the problems. However, it is no coincidence that these problems appear now, where monetary tightening is really starting to be felt. For central banks, they are likely to tip the scales a bit in the direction of raising rates less, but only in a sense where they make an already complicated situation even more difficult. It remains very important to fight inflation and prevent inflation expectations from drifting too far.

Our main scenario for the US and Europe is that we face a prolonged period of modest growth where inflation will decrease. The US is a little ahead in the process and could reach 2% cores inflation in a year or so, while it will likely take longer in the euro area and countries like Denmark, where wage growth is set to be elevated for a period. Broadly speaking, this scenario would be a success for central banks, given the starting point we have now, although it would be painful for some businesses and individuals. We recognise that it will require some luck to achieve this outcome, though. Risks of both a deeper crisis and insufficient cooling, laying the ground for problems later, are large.

Markets have become nervous about the effects of monetary tightening

ECB's Composite Indicator of Systemic Stress (CISS)



Sources: ECB, Macrobond Financial, Danske Bank

> *Higher interest rates are supposed to make it more expensive and difficult to borrow, but that process can spin out of control.*

Las Olsen, Chief Economist at Danske Bank

US
The US economy has been more resilient than expected in early 2023, but recession still looms later in the year, as Fed sticks to restrictive monetary policy stance and the banking sector uncertainty poses further downside risks.

Euro area
More upbeat near-term outlook, but strong recovery not yet in sight, as monetary headwinds persist and fiscal support is fading. Despite the latest financial market jitters, elevated inflation pressures will keep ECB firmly in tightening mode.

China
China is rebounding from the zero-covid policy and we look for a decent recovery this year. While China faces many long-term headwinds, we still expect China's economy to grow a lot bigger in the coming decade.

Monetary headwinds persist

- Despite a more upbeat near-term outlook, we see few reasons that point to a strong euro area recovery any time soon, as monetary headwinds persist. With the economy growing below potential, we look for a moderate rise in unemployment over the coming years, but no large-scale labour market crisis.

- Despite the moderation in energy prices, high inflation will remain a worry for ECB for some time yet. Our forecasts show core inflation still above ECB's target by the end of 2024, with the green transition and higher than expected wage growth still presenting upside risks.

- Despite the latest financial market jitters, elevated inflation pressures will keep ECB firmly in tightening mode in our view. Following further rate hikes in the coming months, we expect the deposit rate to peak at 4.00% in early Q3 23 and look for rate cuts not before the summer 2024.

- Challenging times lie ahead especially for Germany's economy, which is unlikely to return as the euro area's economic powerhouse anytime soon. Securing a leading position in the green transition race remains key for Europe's long-term growth prospects, but growing political divisions pose a challenge.

		Forecast	
	2022	2023	2024
GDP Growth	3.5%	0.4% (0.1%)	0.6% (0.3%)
Inflation	8.4%	6.3% (5.6%)	3.5% (2.6%)
Unemployment	6.7%	6.9% (6.9%)	7.0% (7.0%)
Policy rate*	2.00%	4.00% (2.75%)	2.75% (2.00%)

Paranthesis are the old projections (From February 2023)
**End of period*
Source: Daske Bank, Eurostat, ECB

The euro area economy weathered the energy crisis and inflation shock of 2022 better than feared. Leading indicators have turned the corner, suggesting the worst of the economic downturn lies behind us for now and Chinese pent-up demand will likely give a boost to services activity in the near-term. However, despite the more upbeat near-term outlook, we see few reasons that point to a strong euro area recovery any time soon.

The economy has yet to feel the full impact of the ECB's monetary tightening. Higher mortgage rates have already started to cool construction and housing market activity and leave downside risks also for business investments. The fiscal tailwind that supported the economy last year will increasingly start to fade in 2023/24, as energy emergency measures are scaled back and sustainable public finances get renewed focus with the reinstatement of EU budget rules in 2024. A consensus on EU fiscal rules reform remains yet elusive and especially Germany remains sceptic about the proposal of countries striking individual deals on their public finances with the Commission. Should a reform fail to pass later this year, the old 3% deficit and 60% debt target would reapply. However, the

Commission might still apply some leeway in the interpretation of the rules, as a strict application could trigger a slump in public investments just at a time when demands from the green transition, digitalisation, energy and defense are piling up.

Labour markets remain on a strong footing and business surveys suggest firms remain in hiring mode. With the economy growing below potential, we still look for a moderate rise in unemployment over the coming years, but do not expect a large-scale labour market crisis, as high open vacancies also provide a cushion. Despite the moderation in natural gas and electricity prices, firms continue to pass-on higher input costs to consumers and 'stickily' high core inflation will remain a worry for ECB for some time yet. In light of still rising wages and strong corporate pricing power, we expect this process of cost-push inflation to extend into 2024, keeping price pressures elevated for longer. Our forecasts show core inflation still above ECB's target by the end of 2024, with the green transition and higher than expected wage growth still presenting upside risks.

Despite the latest financial market jitters, elevated inflation pressures will keep ECB firmly in tightening mode.

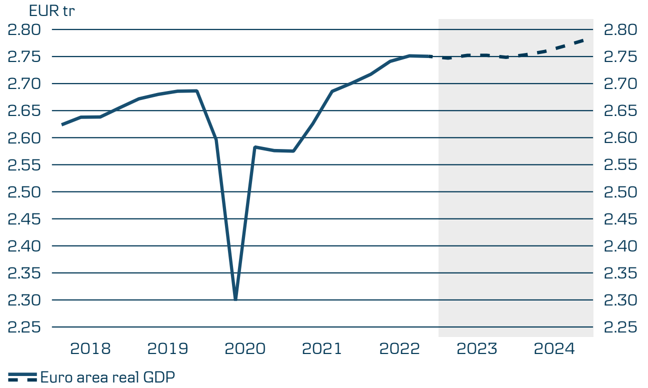
Aila Mihr, Senior Analyst at Danske Bank

Despite the latest financial market jitters, elevated inflation pressures will keep ECB firmly in tightening mode in our view. Following further rate hikes in the coming months, we expect the deposit rate to peak at 4.00% in early Q3 23. We expect rate cuts only in the summer 2024, but not in order to actively ease monetary conditions, but more to keep an unchanged monetary policy stance, considering declining inflation (expectations). Our forecast foresees the deposit rate at 2.75% by the end of 2024. Overall, the monetary policy outlook remains highly uncertain. Continued inflation upside surprises could require ECB to extend the hiking cycle into H2 23, postponing rate cuts further into late 2024. On the other hand, rising risks to financial stability could require a more cautious monetary policy response.

Securing a leading position in the green transition race remains key for Europe's long-term growth prospects, but political divisions how to address climate change and protectionism are again on the rise in the EU. A renewed flaring up of the energy crisis or a full-scale banking sector crisis constitute the most prominent downside risks to the macro outlook, while pandemic-related savings buffers and accelerated investment spending on defense and the green transition pose upside risks.

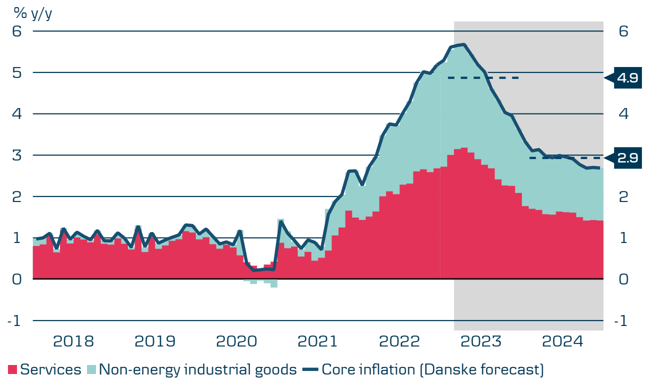
Challenging times lie ahead especially for Germany's economy, which is still in an adjustment phase. German industry remains pessimistic about its competitive position and although Chinese demand could give a welcome boost to exports in the near-term, structural issues such as 'slowbalisation' and a shrinking workforce set the scene for a muted growth outlook. Stepped up investments on infrastructure, digitalisation and the green transition provide a silver lining, but until the energy crisis is truly resolved, Germany is unlikely to return as the euro area's economic powerhouse anytime soon.

No strong rebound yet in sight for euro area economy



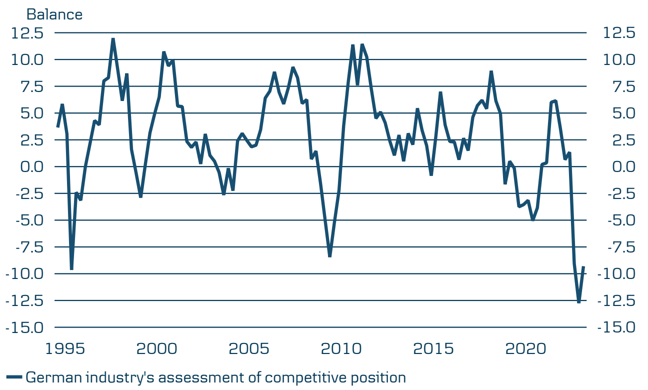
Source: Eurostat, Macrobond Financial, Danske Bank

Underlying inflation remains too high for too long



Source: Eurostat, Macrobond Financial, Danske Bank

Germany's industrial growth model is under pressure



Source: Eurorean Commission, Macrobond Financial, Danske Bank

Modest recession still on the horizon

- While the US economy has proven more resilient than we expected, the recession has merely been delayed. We have revised our forecast for 2023 GDP growth higher to +0.8% (from +0.3%), and 2024 lower to +0.3% (from +0.9%).
- The underlying inflation pressures have been even more persistent than we anticipated, underscoring that Fed will remain on a tightening bias even amid financial stability concerns.
- With rising negative base effects, disinflation in core goods prices and cooling shelter inflation, we expect headline inflation to ease to 4.2% in 2023 and 2.0% in 2024. Services sector will continue to support core inflation, which we expect to average 4.4% in 2023 and 2.3% in 2024.
- With strong liquidity measures now supporting the US banking sector, we remain cautiously optimistic that the financial stability concerns will be contained for now. We expect the Fed to hike the Fed Funds Rate for the final time to 5.00-5.25% in the May meeting, and only look for gradual rate cuts starting from Q1 2024.

	2022	Forecast 2023	2024
GDP Growth	2.1%	0.8% (0.3%)	0.3% (0.9%)
Inflation	8.0%	4.2% (4.2%)	2.0% (1.7%)
Unemployment	3.6%	3.7%	4.2%
Fed Funds*	4.50%	5.25% (5.25%)	4.25% (4.25%)

Paranthesis are the old projections (From January 2023)
**End of period*
Source: Daske Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Fed

While the US economy has proven resilient to the effects of monetary tightening and inflation during the winter, the future outlook still appears gloomy. The latest banking sector uncertainty adds an additional downside risk to our previous recession call. The combination of steady employment growth and elevated wage inflation has provided an important backbone for nominal consumption, while investments especially in the residential sector have already fallen into a recession.

We had anticipated that the US GDP could contract already during the 1st quarter, but the combination of warm weather and easing financial conditions lifted activity in January and February. Similarly, we had expected the growth slowdown to be accompanied with a gradual cooling in inflation, but as we noted in Global Inflation Watch - Central banks balance inflation and financial stability risks, 15 March, some measures of 'sticky' inflation have even accelerated.

The Fed needs either a prolonged period of stagnant growth or a modest recession to bring the economy back into equilibrium, and we see risks tilted towards the latter.

Cooling the overheated labour market remains a key objective for the Fed. While labour supply has recovered recently after stagnating through most of 2022, labour demand indicators remain consistent with 4-5% annual rise in employment costs – far too high for 2% inflation. While we expect only a gradual rise in unemployment rate to 4.2% in 2024, we emphasize that our forecast would still mark significant weakening in labour demand. Generally, our GDP and labour market forecasts are consistent with output gap turning from positive to slightly negative in 2024.

While timing recessions is always challenging, we are now seeing both short and longer-lead models lining up for a contraction around Q3. Our in-house 'growth tax' measure of financial conditions turned back to restrictive levels in Q1, and it has led developments in the real economy by 1-2 quarters. US real M3 growth turned sharply negative last summer, and over the past 50 years, a decline of over 5% has always been followed by a recession with the most common lag of 3-4 quarters. Real money gap suggests that there is still excess money in the system, which helps to explain the resilient growth and sticky inflation seen so far. But as households' savings buffers will run out during H2, the decline in real disposable income suggests private consumption will have to adjust lower.

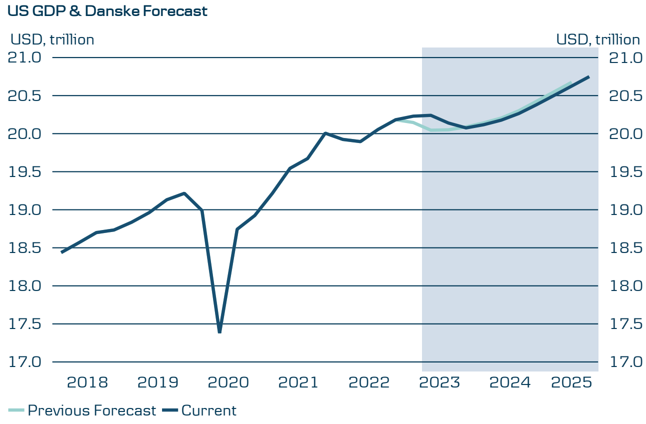
Inflation is bound to ease towards the end of 2023 due to negative base effects, disinflation in core goods prices and shelter inflation catching up with the downturn in housing prices. That said, the Fed focuses on core services inflation excluding shelter, which reflects prices most affected by wages. We pencil in core services inflation remaining above Fed's target well into 2024.

CBO's budget projections point towards public primary deficit averaging around 2.9% of GDP during the rest of the decade, up from the 2.1% average level seen over the five years leading up to the pandemic. Persistent labour shortages amid aging demographic combined with relatively expansionary fiscal policies point towards further risks of more prolonged inflation.

The sticky nature of current inflation drivers underlines, that Fed cannot turn its monetary policy stance supportive too early. Promisingly, longer-term inflation expectations have remained anchored near the target, illustrating confidence in Fed's ability to eventually restore price stability. We continue to forecast a gradual recovery for the US economy in 2024, driven by both private consumption and investments. But importantly, the Fed cannot allow a rapid rebound in activity without risking a renewed wave of inflation.

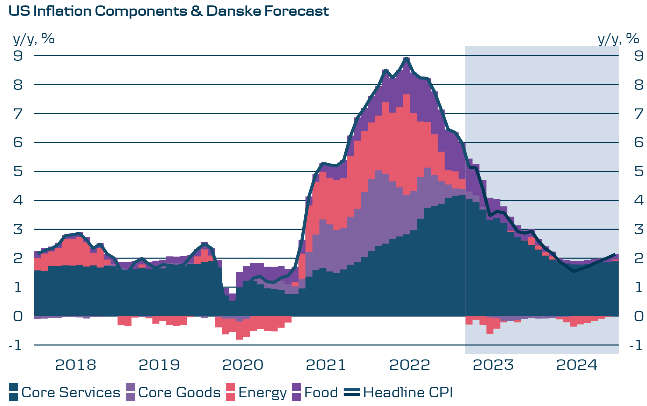
Nevertheless, markets have turned towards expecting rapid rate cuts from the Fed already this fall. As we discussed in Research US - Fed review: A cautious 25bp hike, 22 March, we remain cautiously optimistic that the risk of a broader systemic crisis could be contained for now. On aggregate, even small banks' liquidity buffers remain above pre-pandemic levels. Furthermore, lending growth remained stable during the weeks leading up to the collapse of SVB. Banks have actively utilized the emergency lending facilities provided by the Fed, and the total amount of bank reserves remains near the highest levels since spring 2022. As such, we expect the Fed to hike its policy rate by 25bp for the final time in the May meeting, and the only turn towards cutting rates in Q1 2024.

Modest recession delayed, but not cancelled



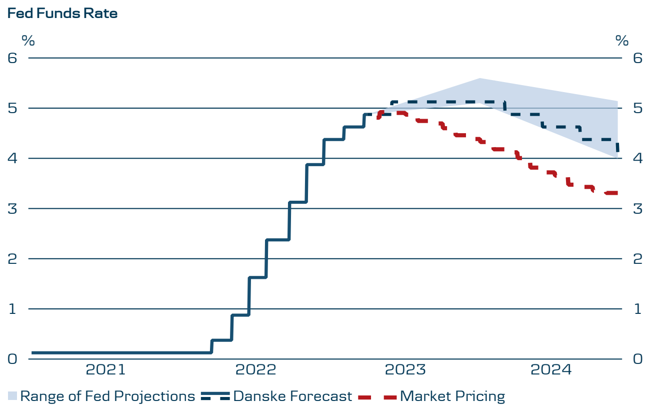
Sources: Macrobond Financial, U. S. Bureau of Economic Analysis (BEA), Danske Bank

2023 inflation drivers will be different from 2022, the Fed focuses on Core Services ex. Shelter & Health Care



Macrobond Financial, U. S. Bureau of Labor Statistics (BLS), Danske Bank

We think the Fed will maintain rates higher for longer than the market anticipates



Macrobond Financial, Chicago Board of Trade (CBOT), Danske Bank

A domestically driven recovery

- The Chinese economy has started to recover after leaving the zero-covid policy in late 2022. We look for GDP growth to rise to 5.5% in 2023 and moderate to 5.3% in 2024.
- While China faces many challenges, we believe the complete reopening of the economy is set to unleash pent-up demand in private consumption and housing. Employment growth is set to pick up and underpin household consumption. However, China still faces headwinds to exports from the weak outlook of the US and Europe.
- We expect only moderate further stimulus from here as local government finances are under pressure and China still has its eyes on deleveraging. Also stimulus in 2022 should have a sufficient impact this year to support the economic recovery.
- Geopolitical tensions between the US and China are likely to stay elevated but we do not expect a war to unfold on Taiwan, as the costs for all involved parties would be enormous.

		Forecast	
	2022	2023	2024
GDP Growth	3.0%	5.5% (5.5%)	5.2% (5.3%)
Inflation	2.0%	2.5% (2.2%)	2.5% (2.5%)
Unemployment	5.5%	5.3%	5.1%
Policy Rate*	2.75%	3.00%	3.50%

Paranthesis are the old projections (From January 2023)
**End of period (1-year Medium Lending Facility)*
Source: Daske Bank, Macrobond Financial

Domestic demand to recover further after the reopening

The zero-covid policy took a very sharp toll on China's economy in 2022. It created a big cloud of uncertainty for consumers and businesses and as a result, private consumption slumped, the housing crisis got worse and private investments took a hit. During the year, global manufacturing also entered recession, which shifted exports from a growth engine to a new headwind. However, after the removal of the zero-covid policy in November, China's economy is recovering. In January and February, PMI activity indicators for both the services and manufacturing sector rebounded sharply and home sales also saw a strong recovery. Retail sales have also moved back into positive territory, but are still running below the long-term trend growth potential.

Looking ahead we expect to see a continued cyclical recovery during 2023 and into 2024, although the pace will likely slow after the initial strong bounce. We look for growth drivers this year to be pent-up demand in consumption, housing and private investments on top of stronger employment and profit growth providing tailwind to consumption and private investments. In addition, Chinese households saved more than usual over the past year and we look for a lower savings rate in 2023. We also look for the property crisis to ease further, as higher home sales provide more liquidity for developers to pay off running debt payments. Chinese leaders have been on a charm offensive towards the private sector lately, and the new premier Li Qiang has traditionally had a very business-oriented focus. If he manages to give more support to the private sector, it may underpin more investments.

Looking ahead we expect to see a continued cyclical recovery during 2023 and into 2024.

Allan von Mehren, Chief Analyst at Danske Bank

Long-term growth challenges, but economy still likely to get a lot bigger

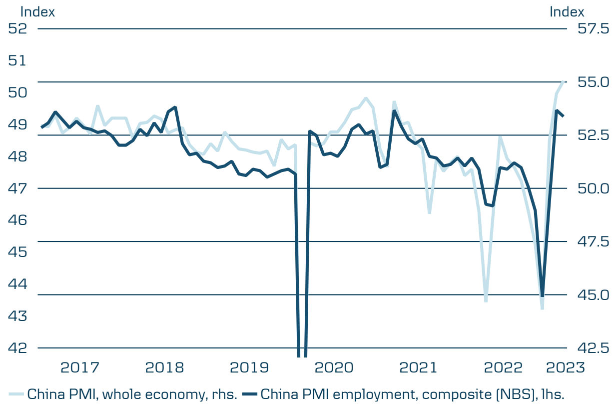
In the medium to long-term, China faces a number of challenges that work to dampen potential growth. First, debt levels are still high in certain sectors. Second, finances among local governments are under pressure. Third, the geopolitical tensions and rising US export restrictions on critical technologies hurt both domestic and foreign investments in China. Fourth, China struggles to see a more sustained move to the consumer as the main growth driver, which is key as construction and infrastructure is set to become a smaller share of the economy. Finally, China is facing a demographic headwind that started already 10 years ago.

Still, we see China's potential growth of around 4½-5%, over the coming 5 years - and not 2-3% as some analysts suggest. First, a move to 4½-5% is a decent decline coming from close to 10% a decade ago. China's strong focus on technology, innovation and education and a still large gap to Western living standards provides scope for continued catching up. Second, had it not been for the headwinds, we would expect China to grow around 6-7%. Also bear in mind, that China's economy is much larger today. Hence, despite lower percentage growth, China's economy is set to expand by around USD 1.500 bn per year over the next five years compared to around USD500 bn per year 10 years ago. Over the next 10 years, China is in our view likely to grow to USD35 trillion from USD20 trillion today.

Continued elevated US-China tensions

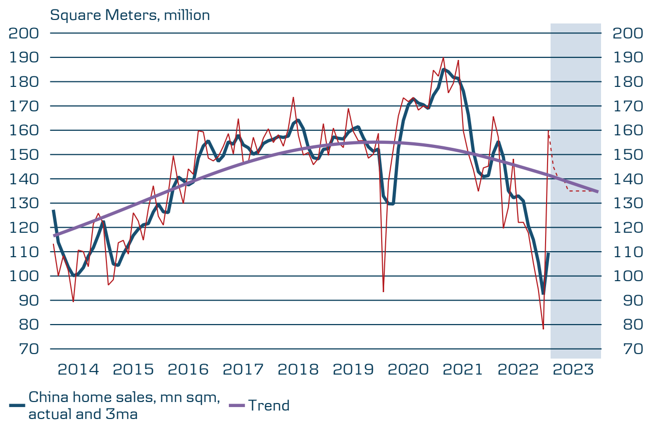
Tensions between US and China continued to escalate over the past year and we expect a new normal to prevail with Cold War sentiment and significant rivalry between the two super powers. Over the coming year, we look out for a new possible clash around a likely meeting between the new US speaker of the House Kevin McCarthy and Taiwanese President Tsai ing-Wen. Elections in Taiwan in early 2024 and the US Presidential election in November 2024 are also key events. We do not expect a war on Taiwan over the next 2-3 years as the cost for all countries would be enormous. But we worry it could come on a 10-15 years horizon.

PMIs point to strong rebound in both activity and employment



Sources: NBS China, Macrobond Financial, Danske Bank

China home sales recovered sharply after the reopening



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Allan von Mehren, Chief Analyst at Danske Bank

Diverging fortunes

Sweden

A two-track economy with, on the one side, households, retail trade, the housing market and construction under immense pressure from eroding real wages and soaring interest cost. On the other side, the manufacturing and services sectors are coping well with current conditions. Moreover, the labour market has been more sanguine than expected. On balance, we have raised the outlook for GDP growth in 2023 slightly. Core inflation has again surprised sharply to the upside at the beginning of the year, way above Riksbank's forecast, forcing it to continue to raise the repo rate sharply at the next two meetings. With that backdrop, house prices are likely to start falling sharply again.

Norway

Growth has been better than expected, particularly driven by a stronger growth in private consumption. As a result, the labor market has remained tight and wage and price growth has continued to rise. There are now signs that growth is slowing down, and most likely the economy is at a turning point where inflation decreases, while unemployment rises somewhat. The weak exchange rate may keep inflation higher for longer. House prices are likely to fall somewhat as Norges Bank raises interest rates to 3.5% in June.

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Finnish economy entered a shallow recession in late 2022 and GDP will decrease slightly in 2023. Trade with Russia has fallen to a very low level. High inflation and rising interest rates weigh on consumers. The labour market looks stable and wages are rising faster than in recent years. Housing prices will fall and housing construction will slow down in 2023, but the unleashing of pent-up demand and the expected fall in interest rates will stimulate the housing market in 2024. A new government will be formed soon. We expect that the new government will gradually start to tighten fiscal policy. We forecast economic growth to pick up in 2024, as both domestic and export demand recover.

Denmark

The economy has proven more resilient than expected, with consumer spending stabilising or rebounding and with GDP reaccelerating thanks to higher pharmaceutical production. Still, also Denmark is facing a period of moderately higher unemployment, in our view. Inflation should decline in line with energy prices, but wage growth will feed through to consumer prices. The current account surplus is declining from extreme 2022 levels, but looks set to remain very large, supporting continued lower interest rates than in the euro area. House prices will likely continue to decline, especially in more expensive parts of the market.

Slowdown concealed by pharmaceutical boost

- Danish GDP growth looks set to be considerably better than expected in our previous forecast, partly due to a boom in the pharmaceutical industry – minus that, a slowdown remains on the cards.
- Inflation is trending down thanks to lower energy prices, but core inflation remains high, and the prospect of quite substantial wage growth means getting inflation back down to 2% will likely be a drawn-out process.
- Consumption has been hit by a decline in purchasing power, but now seems to be on a modest upward trajectory despite house prices remaining under pressure.
- A huge current account surplus has contributed to widening the interest rate spread between Denmark and the euro area – and that spread may be here to stay.

	2022	Forecast 2023	2024
GDP Growth	3.8%	0.5% (-1.0%)	1.3% (1.0%)
Inflation	7.7%	5.1% (4.9%)	3.6% (2.0%)
Unemployment	2.6%	3.1% (3.1%)	3.6% (3.4%)
Policy rate*	1.75%	3.60% (2.45%)	2.35% (1.70%)

Paranthesis are the old projections (From January 2023)
**End of period*
Source: Daske Bank, Statistics Denmark, Nationalbanken

The Danish economy is in a relatively mild slump with modestly increasing unemployment and a variety of industries slowing at different rates. A loss of purchasing power and especially surging interest rates are dampening demand at home and abroad, though by just how much remains very uncertain. Danish households and companies are well cushioned, but have also experienced better growth rates than many other European countries in recent years, leaving Denmark with less catch-up potential. We see a clear risk of both an actual crisis materialising and an insufficient slowdown in the coming years.

We have revised our expectations for GDP growth considerably higher compared to our previous forecast and no longer expect a decline in 2023. This is partly due to dramatic production growth in the pharmaceutical industry at the end of 2022, which does not necessarily reflect production that physically occurred in Denmark. Even setting that side, however, private consumption, for example, is performing better than we expected, though overall we still expect unemployment to increase modestly during the remainder of 2023.

Inflation pulled lower by energy but higher by wages

As expected, inflation has fallen quite noticeably (from 10.1% to 7.6% so far) since peaking in October, mainly due to declining energy prices, while there is still not much sign of a more general slowdown in price growth. In our view, this is partly due to companies not yet having finished passing on higher input prices to consumers, so we should see more limited price increases, also ex. energy, in the time ahead. On the other hand, relatively high wage growth is pushing costs up, and we have revised our expectations for price growth higher overall. Naturally, the outlook for inflation is shrouded in a great deal of uncertainty, and not just because of energy prices, the raw materials situation and other global issues. The substantial overall demand pressure in the Danish economy has, in itself, so far not translated into significant pressure for higher prices, but that could well happen.

Wage growth looks set to be somewhat stronger than what we had based our previous forecast on. The recently concluded collective bargaining rounds will very likely provide a significant boost to the wage agreements that cover the bulk of the Danish labour market. Add to this that we also expect the labour market in general to only weaken slightly, and there is a solid foundation for high nominal pay increases. How that will translate into real wage growth will depend on price developments, though our current forecast points to real wages being restored by the end of 2024.

We see a clear risk of both an actual crisis materialising and an insufficient slowdown in the coming years.

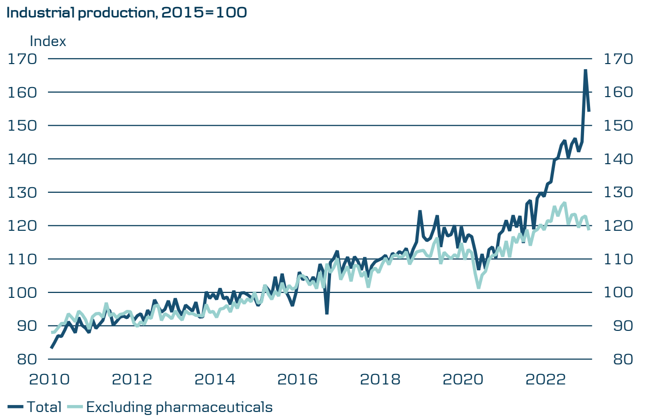
Las Olsen, Chief Economist at Danske Bankt

House prices set to fall further

Rising interest rates have had a noticeable impact on house prices, which are down almost 9% from their peak. While housing market activity has picked up slightly here at the start of 2023 after falling to extreme lows at the end of last year, we do not expect prices to have bottomed out yet. The pass-through from interest rates to prices is often subject to considerable delay, and with short rates in particular providing an upside surprise, we see further price falls ahead. We expect prices to decline most in the more expensive areas, as prices here are typically more interest-rate sensitive and also rose most during the pandemic years.

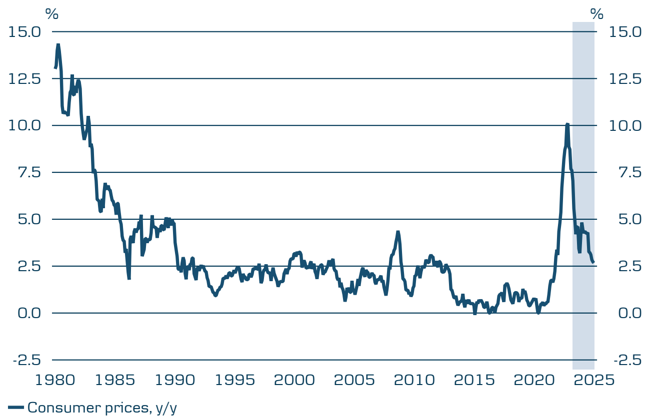
While higher interest rates will tend to pull prices lower, the general level of inflation and the prospect of a substantial jump in nominal incomes, not least driven by higher wage growth, will tend to push prices higher. Revised property valuations and the coming into force of a new property tax system can have negative repercussions for certain sections of the housing market, but this will generally be confined to, for example,

The pharmaceutical industry is driving growth



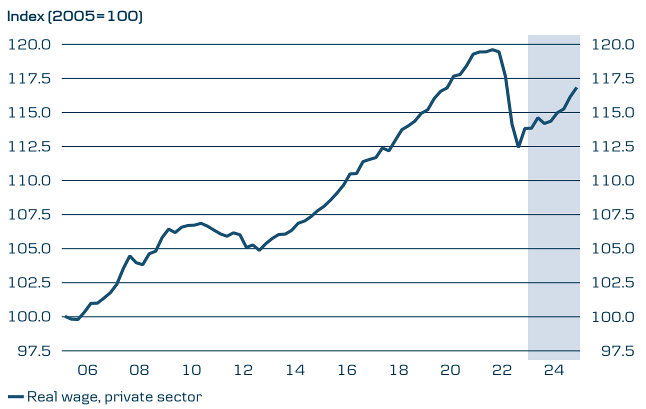
Source: Statistics Denmark, Macrobond Financial

Inflation will not fall to 2% again during forecast period



Statistics Denmark, Macrobond Financial and own calculations

Real wages on track to be restored towards the end of 2024



Source: Statistics Denmark, DA, Macrobond Financial and own calculations apartments in the most expensive areas, whereas overall the reform will provide tax benefits on houses across most of the country. This may also lend support to prices, although the short-term outlook is perhaps for increased uncertainty for both buyers and sellers.

After a dismal 2022, consumption is starting to pick up

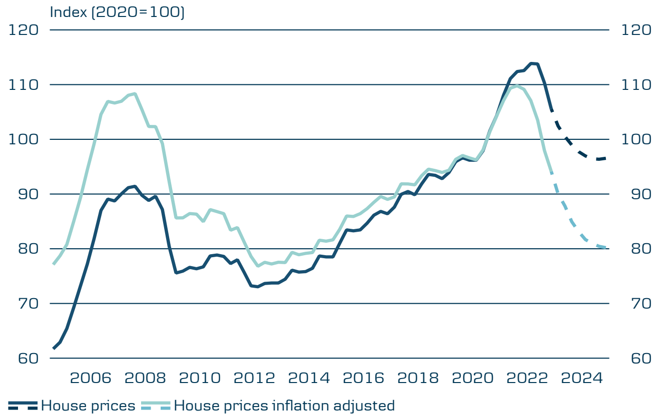
Private consumption took a tumble in 2022, but now there is much to suggest it bottomed out at the end of last year. The retail trade was particularly hard hit due to both an erosion of purchasing power and a normalisation of consumption patterns in the wake of the pandemic, when a great deal of service consumption was rerouted to the consumption of goods. Given higher prices and the massive pressure on purchasing power, we have seen major upheavals within the various types of consumption in 2022, driven by households efforts to make ends meet. Gas consumption in Denmark fell by close to 40%, for example, with much of that due to lower consumption among households. Grocery purchases also clearly reacted, not least to the surge in food prices. Despite an increase in food prices of almost 15% between December 2021 and December 2022, nominal grocery consumption did not budge. Hence, real consumption in terms of grocery purchases saw a major decline over the period, reflecting a massive shift in shopping habits to discount stores, fewer branded goods, lower quality, etc.

Recent data indicates the decline has for now been replaced by modest growth here at the start of the new year. Less uncertainty on energy prices and moderate real wage growth have begun to support consumption, and we expect this trend to continue over the forecast period. Higher-than-expected pay increases and a labour market that continues to demonstrate considerable resilience will help support incomes, even if inflation is not falling as quickly as earlier expected.

> *Rising interest rates are generally synonymous with lower consumption, but we should not exaggerate this effect.*
>
> Louise Aggerstrøm Hansen, Chief Analyst at Danske Bank

Rising interest rates are generally synonymous with lower consumption, but we should not exaggerate this effect. First, those homeowners most negatively affected are relatively well cushioned and typically have savings to draw on as well as a lower-than-average propensity to consume. Moreover, the high level of remortgaging activity seen over the past year has freed up liquid funds that provide a considerable buffer for both consumption and the payment of higher interest expenses. Interest rates also influence consumption via falling house prices and thus lower levels of home equity. However, whereas home equity loans to finance consumption were hugely popular ahead of the financial crisis, that has not been the case in recent years, so the impact from this quarter will also be significantly less.

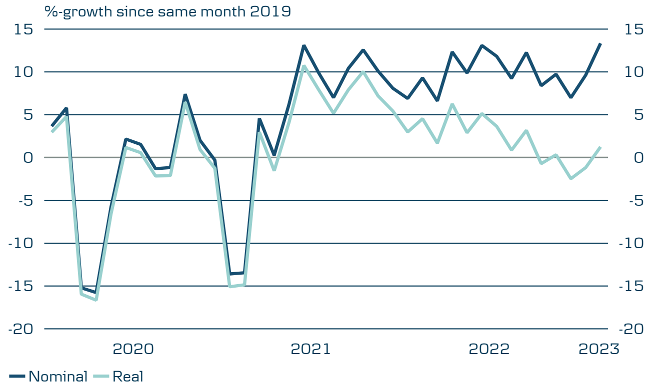
House prices have not finished falling



Source: Statistics Denmark, Boligsiden, Macrobond Financial and own calculations

Consumption appears to have bottomed out at the end of 2022

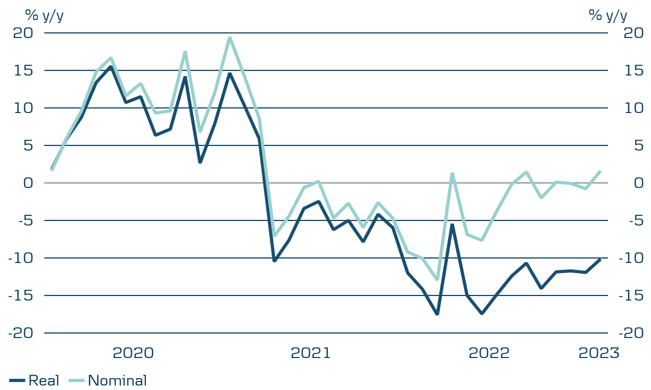
Card spending ex energy



Source: Danske Bank, Statistics Denmark and Macrobond Financial

Higher prices let to lower real grocery consumption

Spending in grocery stores



Source: Danske Bank

The uncertainty around consumption developments remains elevated. Factors that could potentially pull consumption lower include further significant rises in interest rates, and while energy prices are relatively low right now, they could well increase again. On the positive side is the fact that Danes still have substantial savings, and should inflation fall faster than expected, then recent significant pay increases could give a solid boost to real wages, which could quickly translate into increased consumption. Car sales recovering after a period of stagnation would also lend a considerable helping hand to consumption.

Another source of uncertainty for household finances is the future direction of the labour market. Employment has tended to surprise positively so far, and unemployment has only risen marginally. However, we expect the labour market to be buffeted by the headwinds of the slowdown this year, though predicating the precise extent of the impact is difficult. To date, most workers who have lost their jobs have been able to find other employment. After a period of massive labour shortages, many companies are presumably reluctant to let employees go out of concern that finding replacements could be difficult if the slowdown proves temporary.

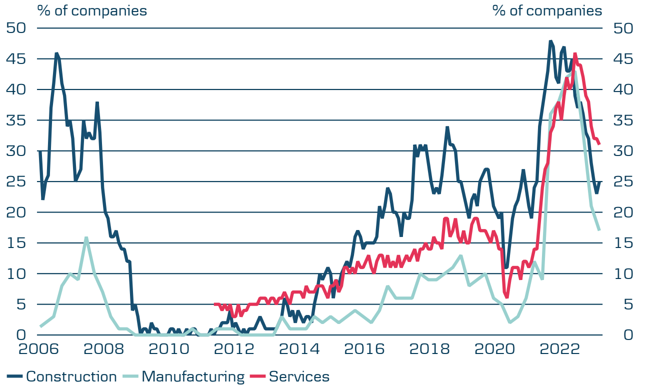
Large current account surplus acts as a damper on Danish interest rates

The Danish current account surplus set a new record in 2022, reaching 13.2% of GDP, largely on the back of high freight rates, which greatly added to the export of services in the form of shipping. Pulling in the opposite direction were higher prices on imported energy. However, while freight rates normalised towards the end of 2022 and into this year, the current account surplus continued to hover at a level equivalent to roughly 12% of GDP.

In other words, there are other industries than shipping contributing to the surplus, including the pharmaceutical industry and returns on ever increasing investments abroad, which are generally rising. Danish exports have been growing strongly in recent years, even after adjusting for price changes, but we do not expect this to continue given, for example, that wage competitiveness looks set to deteriorate slightly. On the other hand, slower demand growth in Denmark will also limit imports, plus there is the prospect of a significant rise in Danish gas production as the Thyra field gradually reopens over the coming year. Gas production from this area alone is expected to amount to approximately 0.5% of GDP in 2024, so in our view there is no reason to expect any major decline in the current account surplus overall.

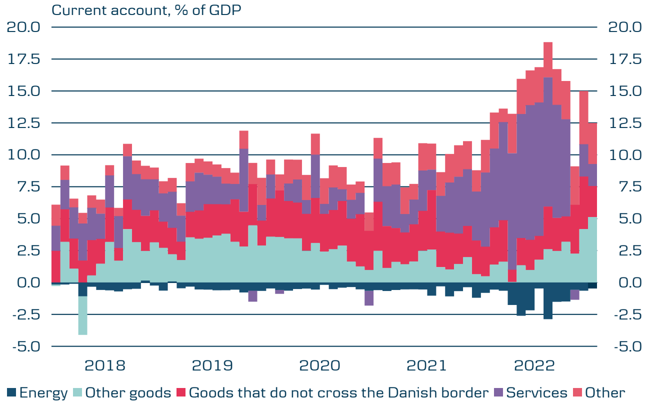
The surplus is a key reason behind the upward market pressure there has been on the Danish krone (DKK) over the past year. Pressure that has twice prompted Danmarks Nationalbank to widen the interest rate spread to the euro area, causing the Danish central bank's deposit rate to trail 0.4 percentage points below that of the European Central Bank (ECB). The actions of Danmarks Nationalbank appear to have stabilised the exchange rate and we expect that future Danish rate changes will track the ECB's and that we will therefore maintain the historically wide rate spread.

Labour shortages continuing make companies reluctant to lay off workers



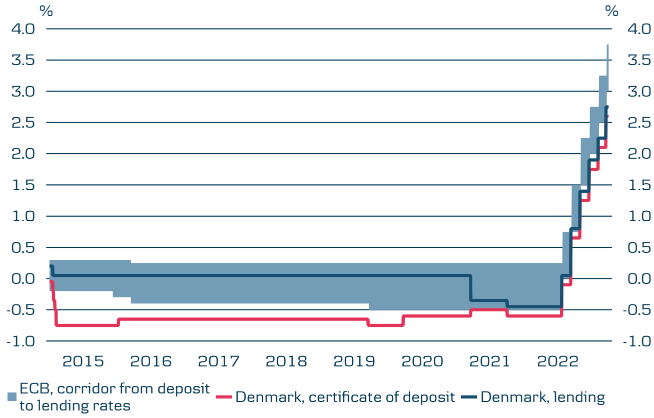
Source: Statistics Denmark and Macrobond Financial

Shipping not the only source of uplift for current account surplus



Note: Figures up to January 2023. Deficit for services in November 2022 due to import of a patent.
Source: Statistics Denmark and Macrobond Financial

Danish central bank rates clearly below those of the ECB



Source: Macrobond Financial

Diverging trends in a limping economy

- Two-track economy with weaker consumption and housing market, but more stable manufacturing, services and labour market.
- Unexpectedly high and accelerating core inflation at the start of the year dims the outlook for when peak inflation is reached. There are, however, signs that inflation should turn lower in the coming quarter in the form of lower selling price expectations and lower price pressure at the producer level.
- Substantially higher core inflation than forecast by Riksbank will trigger further sharp interest hikes at the coming two policy meetings.
- Housing market seems to have stabilised in recent months, but we expect this to be short-lived and prices to plunge further given the prospect of further rate hikes.

	2022	Forecast 2023	2024
GDP Growth	2.7%	-1.0% (-1.2%)	1.7% (1.2%)
Inflation	8.4%	9.6% (8.5%)	2.3% (1.3%)
Unemployment	7.5%	8.0% (8.2%)	7.9% (8.1%)
Policy rate*	2.50%	4.25% (3.00%)	3.25% (2.00%)

Paranthesis are the old projections (From January 2023)
**End of period*
Source: Danske Bank, Statistics Sweden, Riksbanken

The Swedish economy has performed better than feared in recent months. GDP did not fall as far as expected in the fourth quarter, and the few indicators released to date show a decent start to 2023. That said, there is no doubt that parts of the economy – households and the housing market – could come under renewed pressure from the Riksbank continuing to raise interest rates sharply, assuming that the turmoil in the global banking system blows over. This bleaker picture is offset by the business sector and the labour market coping better with the slowdown than we had anticipated. All in all, we expect to see a two-track economy which continues to limp along, but less slowly than before.

Wage negotiations have finished and the industry's "mark" struck a 7.4 % 2-year deal (4.1 % year1 and 3.3 % year 2). It is on average slightly higher than expected, but it is clear that the decline in real wages will be both larger and more prolonged than we previously assumed. This is largely because core inflation has risen further than expected. It also appears that households will need to battle with even higher interest rates, as we expect the Riksbank to step up its rate increases during the spring and summer. One ray of light is falling power prices. While still expensive by historical standards, electricity has traded in the first quarter at levels well below the extreme highs of November and December last year.

The squeeze is clear from both real disposable income and consumption falling by around 2.5% y/y in the fourth quarter. The financial accounts also show that households sold financial assets during the quarter to fund their spending. Our calculations show that, in real terms, households sold liquid assets (excluding interests in housing associations) of more than SEK 1bn, something not seen since the fourth quarter of 2006. We expect households to remain under pressure until the Riksbank is done raising interest rates. As we have explained in previous reports, Swedish households are extremely sensitive to movements in rates due to a high share (50%) of variable-rate and short-term fixed-rate mortgages. Rate increases will therefore be felt quickly by international standards.

Persistently high core inflation and substantial further rate increases will exacerbate the shift towards a two-track economy.

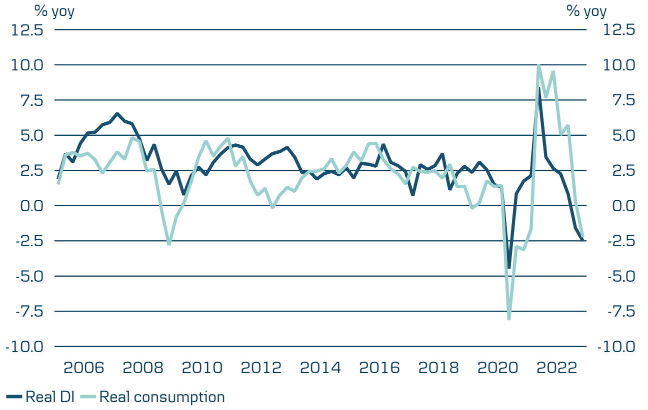
Michael Grahn, Chief Economist Sweden

The housing market has proven surprisingly resilient in recent months after toppling in spring 2022. Prices are currently down by 12% s.a from the peak in February last year, and we do not believe that the bottom has been reached yet. Given that previous hikes have not yet had their full effect, and that we expect the Riksbank to raise the policy rate by another 125bp, we have revised our forecast to a drop of 25% from the top compared to our previous forecast at -20% which means that prices are still only half-way to the bottom. Historically, it has normally taken two to three years for prices to return to previous levels after a tumble, but much longer to get back on trend. It took five years after the euro crisis. Our view is that housing prices will stabilise over the summer once the Riksbank reaches the end of its hiking cycle, and then develop sideways for some time. It will probably then be a couple of years before housing prices return to the previous trend seen in 2005-2019.

It is also likely that homebuilders will find life harder and harder. This is particularly evident from the big drop in multi-dwelling starts. Production costs for such construction are rising at more than 15% a year, which will scarcely help builders adapt to the decrease in demand. It is therefore not at all surprising to see confidence in the industry at record-low levels.

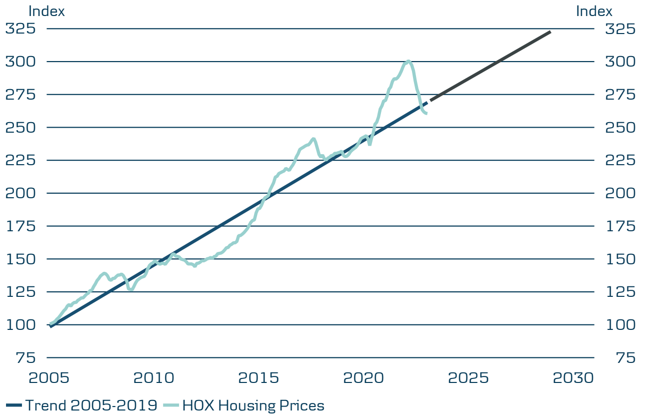
The outlook for the business sector as a whole, however, seems much brighter. Retailers are understandably having a tough time, and plenty are battling with dwindling sales volumes, but many parts of the retail trade have been able to raise prices sufficiently to more or less offset the drop in volumes. Stockbuilding also appears to have petered out.

Disregarding Covid era, income and consumption is falling at the fastest pace in at least the past two decades



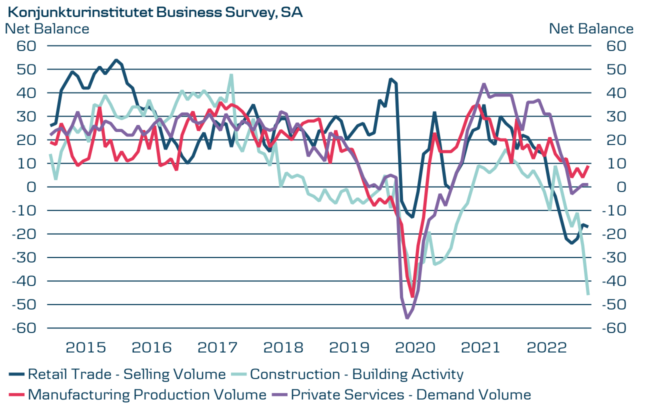
Source: Statistics Sweden

House prices have dropped below long-term trend – and more is to come



Source: KTH-Valueguard

A split economy – activity differs sharply among business sectors



Source: Konjunkturinstitutet

Manufacturing is the sector that appears to have fared best. The rate of production seems to have slowed considerably, but has not begun to fall. Both the PMI and the NIER's confidence survey show new orders/order books stabilising, and stock-building appears to be over. New orders from both the export market and the domestic market show a positive turn. Manufacturing is also the only sector where confidence is still above normal levels. In the service sector, sentiment has improved somewhat in recent months from well below normal. Demand seems to have stabilised, but there has not yet been any clear upswing in orders. Construction output has continued to rise, which is a surprise given the bleak outlook for the housing market. Even with activity in the sector as a whole in decline, there is no doubt that builders have drawn the short straw. All in all, the picture is of an economy that has coped very well on the production side.

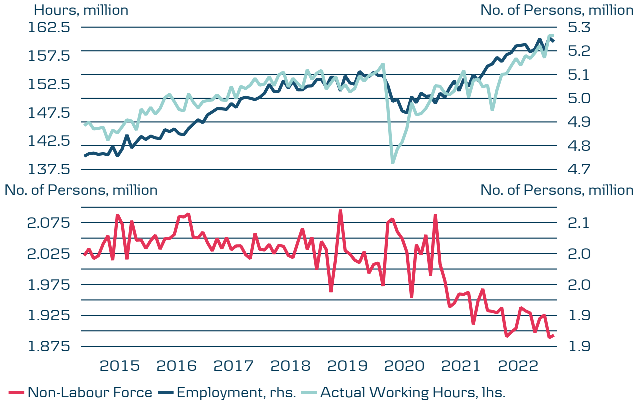
> *Housing prices have stabilized during the previous months, but we expect this to be temporary. As we project another 125bp from the Riksbank from here, we expect housing prices to drop another 12 percentage points.*
>
> Therese Persson, Macro Analyst

The labour market has also done much better than we anticipated. We previously assumed that there would be clear signals by now of unemployment rising. There are, of course, a number of worrying signs: bankruptcies are rising rapidly, employment plans in the business sector are heading down, and consumers are increasingly worried about becoming unemployed. However, the bankruptcies seem to be mainly among small firms, and the rise in redundancies in February was due largely to a single company being denied a licence, so these would seem to be a minor concern. Instead, we can look to positive factors such as weekly redundancies in March being surprisingly low, there still being major labour shortages, and employment and hours worked not showing any clear signs of dropping off their stable upward trend. A strong labour market provides a foundation for growth and consumption in the sense that households can maintain their income from employment. We believe that the risk of collapse is now smaller than before.

The inflation outlook has deteriorated in the short-term. Over the past two months, core inflation (CPIF ex energy) has come out much higher than forecasters expected. In fact, it seems to have accelerated in recent months, which is very worrying.

In normal circumstances, we know that core inflation is determined largely by a handful of fundamentals, such as wage costs and fluctuations in the exchange rate. During the pandemic and since the Russian attack on Ukraine, however, sudden disruptions of supply chains and soaring commodity prices

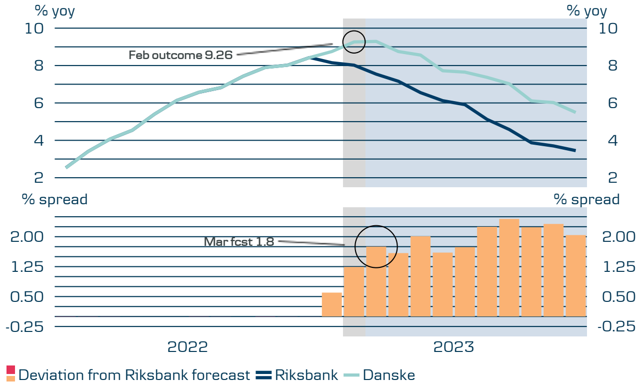
Employment is surprisingly resilient – a backbone supporting the economic outlook



Source: Statistics Sweden

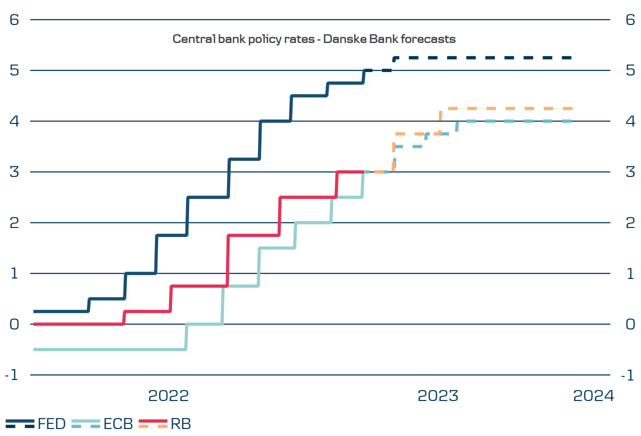
Core inflation probably close to peak – but Riksbank is far off the forecast

Sweden CPIF excl. Energy



Source: Statistics Sweden, Riksbank, Danske Bank

Riksbank is forced to continue to tighten fiercely



Source: Federal Reserve, ECB, Riksbank, Danske Bank became much more important for inflation. What concerns the former, it should be emphasized that the new wage deal should not cause an inflation driving cost pressure. Rising prices for container freight, energy, commodities, semiconductors, food and so on put clear upward pressure on prices for many consumer goods, which is clear from last year's surge in inflation. Most of these factors have now eased considerably, but we still expect substantial downward pressure on Swedish goods inflation, and not just food as the media focus might suggest.

Rising services inflation has also become a growing concern and shows no signs of abating. We suspect that much of this persistence can, paradoxically, be explained by the Riksbank's own rate increases. These do not just act directly via rising rents and housing association fees (as housing companies and housing associations encounter higher interest costs) – there is also an indirect and much more broad-based effect in that offices, shops and hotels/restaurants too are also adversely affected. This latter effect means that prices of many goods and services need to go up to compensate for higher interest costs. The magnitude of this effect is unclear, but it is difficult to see any other factor that could explain so clearly the persistent late-cycle pressure on services inflation and/or domestic inflation. The upshot of this is that the Riksbank's rate hikes are putting a damper on inflationary pressures via demand on the one hand, but fuelling inflationary pressures via rising costs on the other, so to some extent the bank's rate increases are counterproductive.

Our view is that the Riksbank will react aggressively to core inflation exceeding its forecast by almost 2 whole percentage points, especially as the risk of the international bank crisis spreading to Sweden still seems very small at the time of writing. Given that the bank previously planned to raise the policy rate by 25bp or 50bp in April, we think a 75bp hike is on the cards. We can also see the Riksbank adding another 50bp at the end of June. One might think that, having raised the policy rate so quickly and so far (from 0% in April 2022 to 3% in February 2023), the Riksbank would now be able to take some time to assess what impact these increases are having. However, the bank probably feels under immense pressure from inflation not showing any signs of peaking and actually accelerating. It should be noted that the Riksbank will also be tightening monetary policy by selling government bonds (starting in April) and greatly reducing liquidity in the money market, which will further increase the cost of variable-rate loans. We do not see the Riksbank lowering the policy rate again until inflation returns to the 2% target level in the first half of next year, or unless Sweden heads into a deep recession, which we do not currently anticipate.

Clear turning point

- Economy approaching clear turning point, with lower inflation, but higher unemployment
- Households propping up consumption ¬– and so growth – by drawing on savings, but not for much longer
- NOK at the mercy of global risk appetite
- Policy rate likely to peak at 3.25% in June, but uncertainty has increased

	2022	Forecast 2023	2024
GDP Growth	3.8%	1.0% (0.6%)	1.5% (1.5%)
Inflation	5.8%	4.8% (4.8%)	2.5% (2.1%)
Unemployment	1.8%	2.1% (2.2%)	2.4% (2.4%)
Policy rate*	2.75%	3.25% (2.50%)	2.75% (2.25%)

Paranthesis are the old projections (From January 2023)
**End of period*
Source: Daske Bank, Statistics Norway,
Norwegian Labour and Welfare Organization (NAV), Norges Bank

The Norwegian economy is approaching a clear turning point, where inflation has peaked but activity has levelled off and unemployment is climbing. While economic growth has been stronger than expected, capacity utilisation is falling and unemployment has bottomed out. Leading indicators such as Norges Bank's regional network survey also point to flat growth in the period ahead. Inflation is also still high, but lower global commodity prices and expectations of lower wage growth make it highly likely that inflation is about to peak. The risk, of course, is a protracted decline in the NOK.

Growth last year ended up at 3.7%, marginally less than we anticipated in our previous forecast in December, and mainland GDP fell 0.2% m/m in January. As mentioned above, firms in Norges Bank's regional network anticipate unchanged output in the coming quarter. This is a clear improvement from the very bleak picture the survey painted in December, but still means that growth will remain well below trend in the coming period.

This is best illustrated by 41% of firms in the survey reporting that they are operating at full capacity, down from 44% in December. This decrease in capacity utilisation is a clear sign that pressures in the economy are easing – in other words that growth is now lower than normal. This should gradually help put a damper on price and wage inflation in the Norwegian economy.

On the plus side, firms in the survey reported an improvement in profitability (over the past year) for the first time since February last year. This could mean that firms are now in a better position to pass on cost increases to customers, suggesting that price pressures could persist, but it could also mean that we are now beginning to see the effects of lower energy prices, freight costs, metal prices and so on in the value chain, suggesting that price pressures are set to ease. Firms themselves are reporting that they plan to raise their selling prices further, which could mean that the former effect is still very important.

The slightly less pessimistic outlook is also illustrated by firms now anticipating positive employment growth in the coming quarter and slightly higher investment growth next year than in the previous survey in December. That said, these employment expectations are probably not strong enough for the economy to avoid a moderate increase in unemployment. The expectations for investment growth are also much more moderate than they would be in an economic upswing. All in all, the survey points to a less pronounced slowdown in the Norwegian economy than we had feared, but there are still no signs of any significant rebound.

> *Unusually wide variations in growth make it particularly difficult to gauge the strength of the economy.*
>
> Frank Jullum, Chief Economist Norway

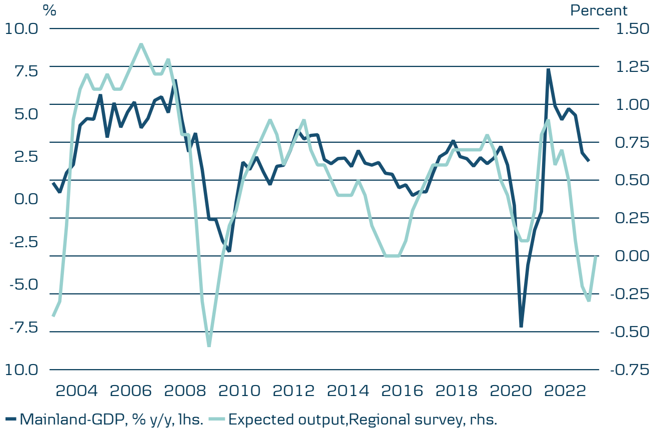
There are, however, unusually large variations in the growth outlook. While the oil service sector is at its most optimistic since before the oil crisis, and the service sector is also now slightly more upbeat, manufacturers anticipate more or less flat growth, and retailers and the construction sector in particular remain deeply pessimistic. There are also significant regional variations, with growing optimism in the south and south-west of the country, and the greatest pessimism in the east. All of this points, of course, to the rise in interest rates impact on demand, but in different ways.

We have revised up our growth forecast slightly and now expect mainland GDP to grow 1.0% rather than 0.6% this year, and 1.5% next year.

Households feel the squeeze

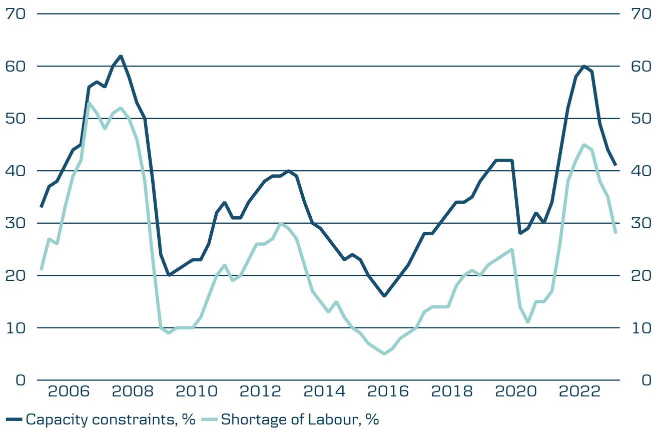
Much of the reason why growth has been surprisingly strong is that Norwegian households have drawn on their savings to keep up their spending as incomes have fallen. High inflati-

Leading indicators point to a slowdown



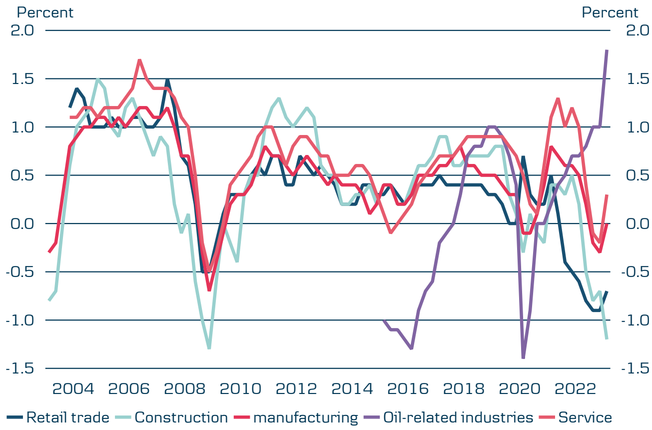
Sources: Macrobond Financial, Danske Bank

Capacity utilisation is coming down



Sources: Macrobond Financial, Danske Bank

Very mixed picture



Sources: Macrobond Financial, Danske Bank

on brought a marked decrease in real wages, and the rise in interest rates has naturally also hurt given high levels of debt. Real disposable income fell 2.5% last year, yet spending rose almost 7%. The reason, of course, is that households spent some of the extraordinary savings accumulated during the pandemic. The savings rate fell throughout last year and ended up as low as -11% in the fourth quarter!

We now expect real wage growth this year to be around zero, and Norges Bank to deliver two further rate increases, in May and June. We therefore see real disposable income falling almost 3% this year. For households to maintain their spending for the rest of this year and so prevent a clear slowdown in the economy, the savings rate would need to come down even further. With cash (in real terms) already below the long-term trend, we seriously doubt that this is possible. We therefore expect spending to slow sharply in the coming months, with a clear risk to the downside of our forecast.

Labour market still tight

Unemployment has been more or less unchanged since summer 2022 despite the slowdown in the economy and lower capacity utilisation. Demand for labour has remained very strong into 2023, with record-high job vacancies in the fourth quarter last year. Leading indicators such as the regional network survey and employer organisation NHO's quarterly survey do, however, show that demand growth is now slowing, and the number of new job openings is falling, albeit still high. Hard employment data are a little tricky to interpret, with the LFS showing a slight downward trend since summer 2022, but the monthly job statistics not beginning to slow until the very end of the year.

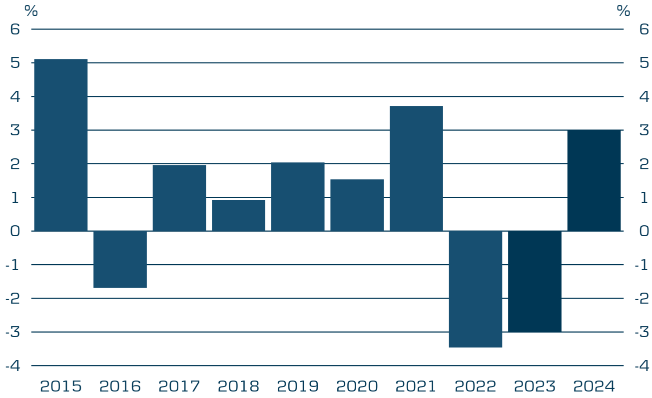
A deeper look at the jobless figures suggests that unemployment has gradually now begun to rise. If we include both the part-time unemployed and those on various job creation schemes, there were almost 3,000 more people out of work in February than in November, and the rate of increase accelerated from month to month, although it is still modest. We believe that this trend will continue as the effects of the rate increases since summer 2022 become more and more tangible. We therefore expect to see 10-15,000 more jobless at the end of this year than at the end of last year.

> *Wage and price expectations are peaking, so the risk of wage-price spirals is still low.*
>
> Frank Jullum, Chief Economist Norway

Wage and price expectations on the way down

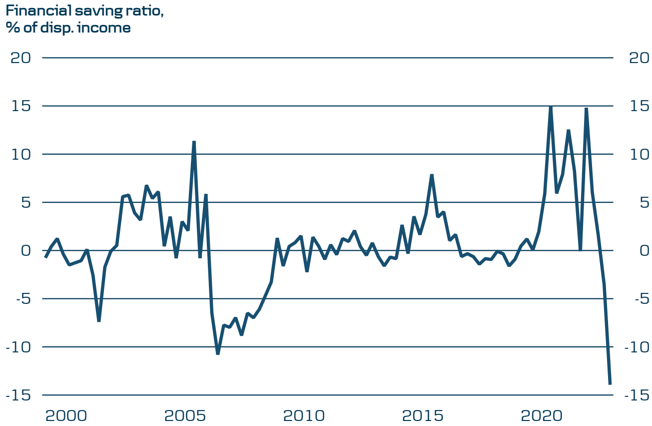
Wage growth ended up at 4.1% last year, well above our forecast of 3.7%. Higher inflation and especially a tighter labour market than we anticipated mean that we have also revised up our wage forecast for this year. With the unions calling for a restoration of purchasing power which would point to wage growth of almost 5%, and employers referring to profitability

Household income is taking a hit



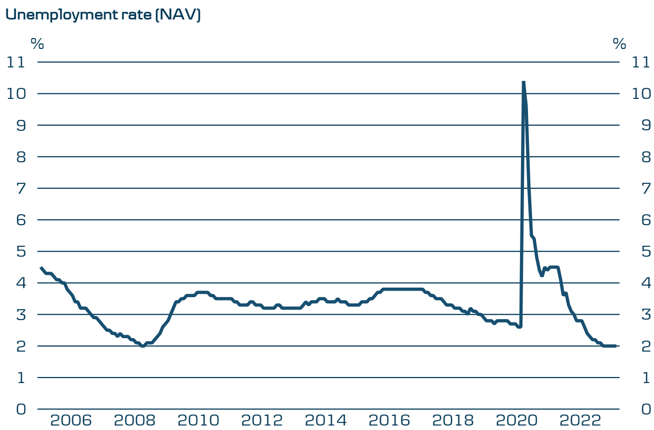
Sources: Macrobond Financial, Danske Bank

Consumption driven by a sharp drop in savings



Sources: Macrobond Financial, Danske Bank

Unemployment lowest in 15 years



Sources: Macrobond Financial, Danske Bank

being under pressure in many industries, this year's pay talks could be fractious. That said, Norges Bank's expectations survey shows that the unions anticipate much lower wage growth next year of 4.3%, which suggests that the risk of more protracted wage and price spirals is still low.

Inflation is still high, even when we ignore base effects. A combination of rapid cost growth and brisk demand has brought strong inflation at consumer level. We expect the effects of lower costs for energy, materials and freight to ease cost pressures gradually, and weaker demand may make it harder for firms to pass on higher costs. We therefore believe that inflation is about to peak, and that we will see much lower rates after the summer. All in all, we forecast core inflation of 5.2% this year, but with the annual rate well below 4% in December. We predict core inflation next year of just under 3%.

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NOK weakens further

The NOK has fallen further since our last forecast, thanks to a combination of lower oil and gas prices, turmoil in financial markets and aggressive central banks in other countries. Central banks' battle to get inflation under control will probably contribute to further uncertainty in financial markets through the summer. The failure of Silicon Valley Bank has also illustrated the risk of parts of the financial system crumbling under the weight of higher interest rates. This indicates that the NOK will remain relatively weak for a while.

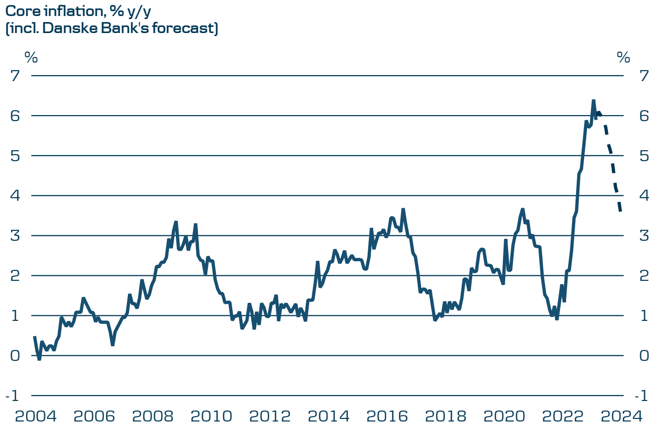
We think the picture could change after the summer, however, by which time we expect inflation to have begun to come down and central banks to be signalling that rates have peaked. There will still be a focus on relative growth differentials, but we also expect more interest in the global energy situation. Put simply, we envisage a divide between energy importers and energy exporters, and Norway as part of the latter club can look forward to its currency strengthening considerably in the medium-term.

Norges Bank

Norges Bank raised its policy rate by 25bp to 3.00% as expected at its March meeting, but also signalled that it will most likely go up further in May. The projections in the monetary policy report now show that the policy rate will probably peak in June at 3.5%.

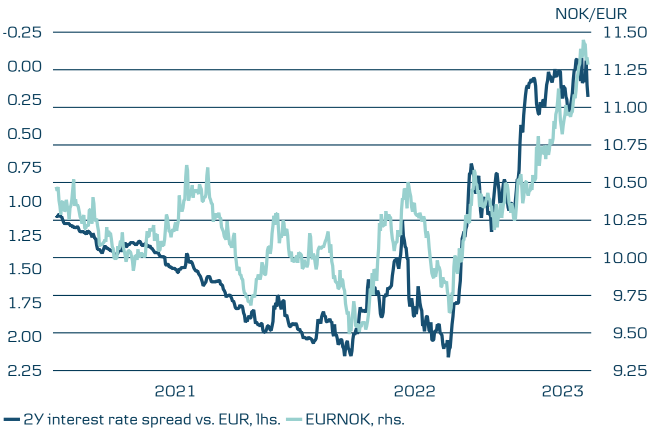
We still believe that the effects of the rise in rates over the past year are not yet fully reflected in the economy, and that both growth and inflation will fall. However, we recognise that this is unlikely to be plain to see by June, and so expect the bank to hike in both May and June. On the other hand, we are sticking to our view that Norges Bank will deliver a first rate cut in December.

Inflation is most likely about to peak



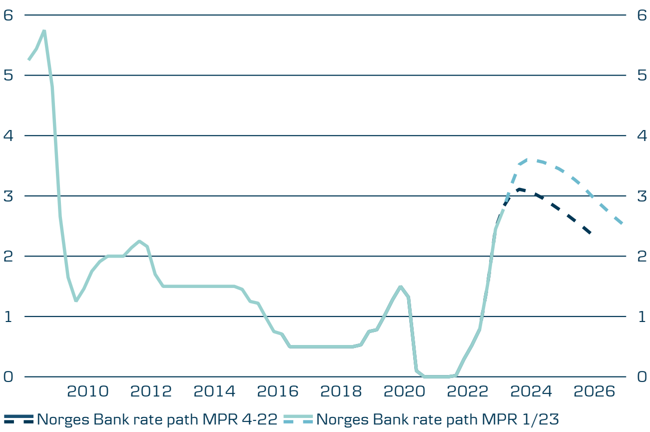
Sources: Macrobond Financial, Danske Bank

Higher global rate expectations are hurting the NOK



Sources: Macrobond Financial, Danske Bank

Norges Bank signaling two more hikes



Sources: Macrobond Financial, Danske Bank

Economic frost slowly thawing

- Finland's GDP will decrease slightly in 2023, but economic growth will pick up in 2024 as a result of recovering private consumption supported by falling inflation and the reinvigoration of export demand.
- In some industries, labour markets will weaken somewhat, but many companies are still struggling with labour shortages and wages are rising faster than in recent years.
- Housing prices will fall and housing construction will slow down in 2023, but the unleashing of pent-up demand and the expected fall in interest rates will result in housing markets picking up in 2024.
- We expect that the new government will start to take fiscal adjustment measures aimed at balancing public finances, but there is a risk that the debt ratio will nevertheless take an upward turn again.

	2022	Forecast 2023	2024
GDP Growth	2.1%	-0.2% (-0.7%)	0.9% (0.5%)
Inflation	7.1%	5.5% (4.8%)	2.1% (2.2%)
Unemployment	6.8%	7.0% (7.3%)	6.8% (7.2%)
Policy rate*	2.00%	4.00% (2.75%)	2.75% (2.00%)

Paranthesis are the old projections (From January 2023)
**End of period*
Source: Danske Bank, Statistics Finland, ECB

Finland's economy slipped into mild recession in the second half of 2022. Inflation weighed on private consumption and GDP decreased, but labour markets remained rather steady. The economic headwinds weakened during the winter, as the energy crisis was not as deep as expected due to the milder winter and successful adjustment measures related to energy consumption. At the same time, recession did not take a hold of the euro area and China's economy was lifting COVID-19 restrictions, which resulted in an improved export outlook for Finnish companies. Investments in the green transition and national defence grew. However, the economy is still affected by multiple factors delaying an upturn. Persistent inflation continues to weaken the purchasing power of consumers, rising interest rates are holding back the economy with long-term effects, housing construction slows down and the flow of export orders remains sluggish in the short-term. We have slightly improved the forecast for Finnish economy due to the improved macro environment, but we still expect GDP to decrease in 2023.

The slowdown in inflation, rapid increase in earnings and falling interest rates will alleviate consumers' worries in 2024, when private consumption together with export and investments will again turn the economy around. However, growth in demand will remain modest, and labour shortages will dampen companies' possibilities to expand their business. Fiscal adjustment measures related to public finances curb public spending.

Rapid inflation weakened the purchasing power of consumers to an exceptional extent in 2022, and the decrease in real earnings will continue during this year, albeit at a somewhat more moderate level. At the same time, the good employment situation and savings accumulated during the COVID-19 crisis have

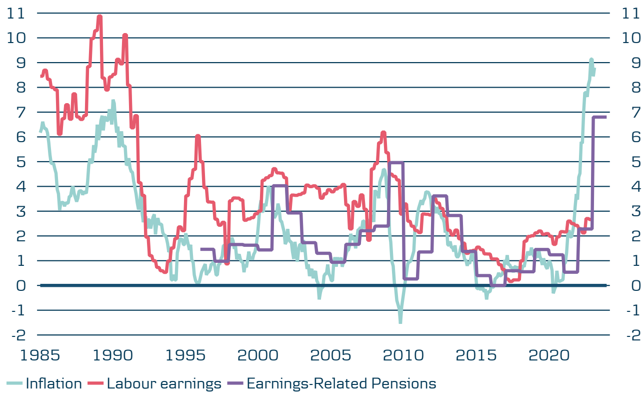
> *A dim growth outlook, higher interest rates and the easing of capacity constraints are weighing on industrial investments in the short-term. However, investments in the energy sector and national defence support aggregate demand.*
>
> Pasi Kuoppamäki, Chief Economist Finland

made it possible to maintain the standard of living. A growing number of households have been forced to resort to their savings and find ways to balance their finances. The savings ratio fell to an exceptionally low level in the fourth quarter of 2022, and the stock of households' deposits decreased in early 2023. Not all excess savings were used, but as interest rates rise, an increasing share of the income of debt-ridden households goes to interest expenses. Consumers adjust, for example, by purchasing fewer consumer durables. The payment of electricity subsidies to households that are within scope for the support will gradually revive consumers' purchasing power. We expect consumer demand to recover in 2024.

Finland's harmonised inflation rate has remained at a level that is slightly lower than the average inflation rate in the euro area. The situation was made easier by the fact that consumers are less dependent on natural gas compared to the rest of Europe. Underlying inflation has increased in Finland as well, and it will take a long time for inflation to fall, even though the price of energy will gradually fall below the previous year's level. The growth of income will accelerate to around 4%, which is likely to maintain inflation caused by cost pressures. The high inflation rate in the euro area combined with the tighter labour market situation will also be problematic to central banks. We expect the ECB to gradually increase the deposit facility rate to 4% this summer. Our forecast means that the 12-month Euribor rate will go up from its current level. A decrease in the key interest rates may be possible in 2024, provided that inflation falls and there is no large-scale increase in wages. A decline in interest rates would make the situation easier for debtors and it would support the housing market.

Inflation strongly reduces consumer real earnings

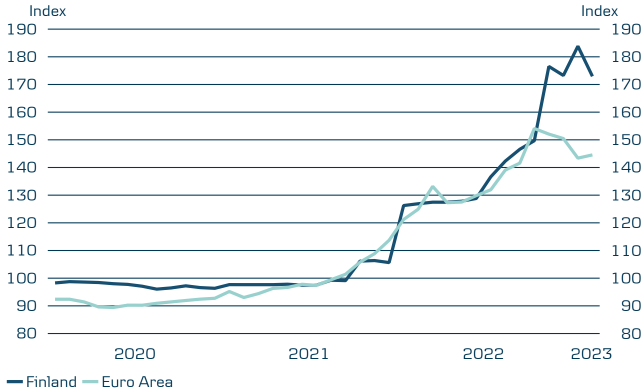
% change year-on-year



Sources: Macrobond Financial, Statistics Finland, Danske Bank

Electricity prices went up more than average in Finland

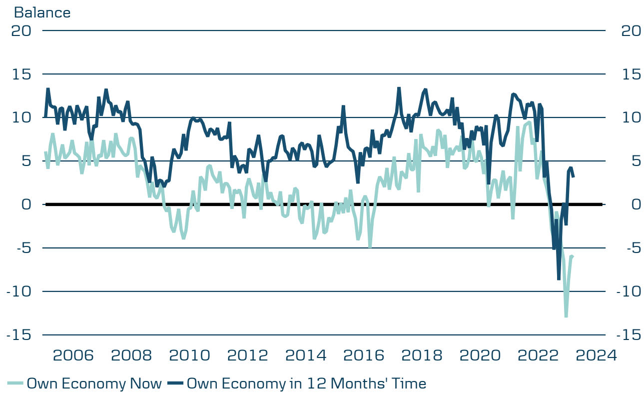
HICP, Electricity, 2021=100



Sources: Macrobond Financial, Eurostat, Danske Bank

Consumer confidence recovered modestly in early 2023

Consumer confidence



Sources: Macrobond Financial, Statistics Finland, Danske Bank

During the first months of the year, the number of housing transactions was roughly 40% below last year's level and, in February, the prices of re-sold apartments fell by 7% compared to the peak figure in June 2022. The rise in the interest rate level continues to weigh on the market, and consumers' planned housing purchases are at an exceptionally low level, so we are still expecting to see a slight decline in prices. Most people with housing loans can still manage their loans, and it seems that there is no significant increase in the number of enforced sales, so any major changes in the price level seem unlikely. Recovering economic growth, the predicted fall in interest rates and the unleashing of pent-up demand will stimulate the market

We expect the public debt ratio to rise, unless economic growth picks up more than forecast or the new government front-loads fiscal adjustment measures.

Pasi Kuoppamäki, Chief Economist Finland

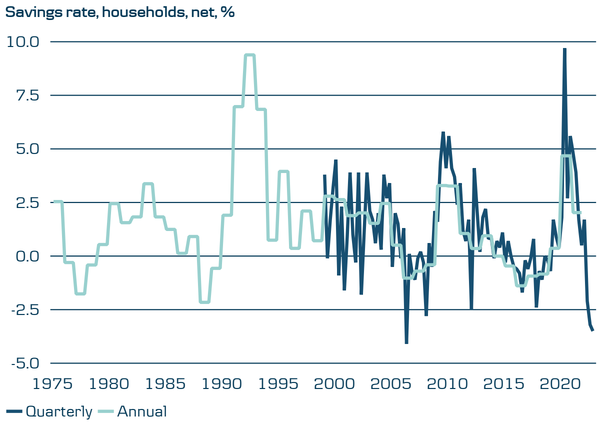
at a rather rapid pace in 2024. Sluggish demand, increased construction costs and the increase in interest rates lead to a downward trend in housing construction in 2023. The stock of unsold new apartments will increase on a temporary basis, but pent-up demand will turn new construction around in 2024.

Export demand took a hit due to the collapse of Russian trade, but many companies with export to Russia have found other markets. Export to the US and China has increased. However, the volume of export orders has been low in the past months and we expect a decline in the export of goods this year. The development of service export is looking more positive. A dim growth outlook, higher interest rates and the easing of capacity constraints are weighing down industrial investments in the short-term. However, investments in the energy sector and national defence support aggregate demand. In the next few years, investments in the green transition will increase to billions of euros.

The slowdown of export demand, increased costs, the increasing interest rate burden and the more cautious buying behaviour of consumers will weaken business opportunities of many companies, which will result in a slight increase in layoffs and redundancies. On the other hand, companies have faced labour shortages, which encourages them to hold on to their skilled employees. There are still plenty of job opportunities, even though the number of open vacancies has decreased over the past few months. We expect the labour market to remain stable throughout the year, despite the fact that a slight increase in unemployment seems likely.

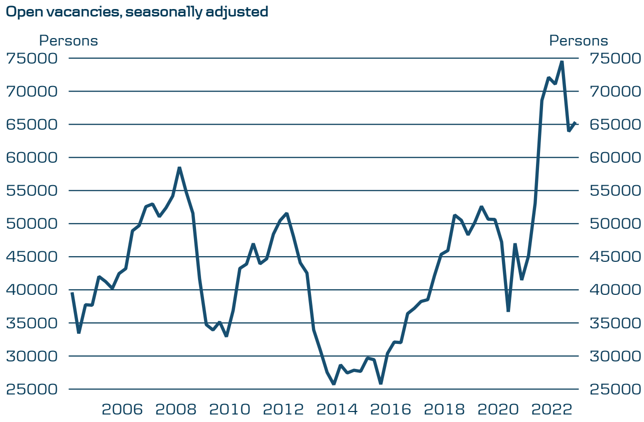
The parliamentary elections in early April most likely mean that the composition of the government will change this spring. The largest parties agree on Finland's NATO membership being promoted, but there are significant differences in the parties' objectives related to economic policies. According to the Minis-

Households use savings to maintain living standard



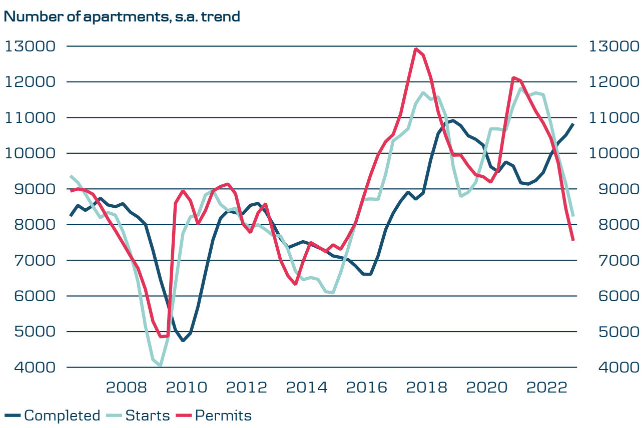
Sources: Macrobond Financial, Statistics Finland, Danske Bank

Plentiful open vacancies help to stabilise labour market



Sources: Macrobond Financial, Statistics Finland, Danske Bank

Housing construction is going to fall in 2023



Sources: Macrobond Financial, Statistics Finland, Danske Bank

try of Finance's calculations, Finland's public finances should be balanced through expenditure cuts, tax increases or by means of structural reforms accelerating growth at the level of EUR 6bn in the upcoming parliamentary term and at the level of EUR 3bn in the subsequent parliamentary term. Implementing such major measures seems challenging, so we expect that the public sector will continue to incur debt.

Public debt has increased at a rapid rate and it continues to grow. According to the latest official estimate, in 2022, the government incurred new debt amounting to nearly EUR 12bn. The margin requirements related to the managing of the government's debts increased the debt by approximately EUR 5bn and new debt amounting to nearly EUR 2bn was incurred for the financing of the new wellbeing services counties, but this financing will not be used until 2023. Said items are not reflected in the public deficit, which decreased as a result of economic growth. In 2023, weakened economic growth, energy subsidies, higher interest rates and the increase in the national defence budget will increase the public deficit. Furthermore, the healthcare and social welfare reform will have an impact on the calculations for public finances in 2023. For example, over 170,000 employees in healthcare, social welfare and rescue services from municipalities and joint municipal authorities transferred to become employees of the wellbeing services counties. The wages of employees who worked for various municipalities and joint municipal authorities will be harmonised, which will result in additional costs.

According to the government's supplementary budget proposal, the net borrowing of the state is estimated to amount to approximately EUR 10.4bn in 2023. The growth in the interest expenses for the national debt increases the deficit by nearly EUR 2bn. The fall in the price of electricity will likely reduce the actual expenditure compared to the budget. The total deficit for the public sector will increase compared to 2022. The public debt to GDP ratio will decrease due to the growth in nominal GDP, but we expect the ratio to rise in 2024, unless economic growth picks up more than expected or the new government front-loads fiscal adjustment measures.

The 10-year interest rate for Finland's national debt has fallen slightly compared to the beginning of March, as markets' expectations regarding the general rise of interest rates have grown more moderate. Compared to Germany, the difference in interest rates has remained rather stable during this year. Credit rating institutions have taken a calm approach to the incurrence of debt, but they are still waiting for structural reforms, which would narrow the sustainability gap, and for the fiscal adjustment measures related to public finances. We expect Finland's credit ratings to remain unchanged in 2023.

Public debt ratio going to rise slowly in 2024

Sources: Macrobond Financial, Statistics Finland, Danske Bank

Macro forecasts - Denmark

			Forecast	
	2022	2022	2023	2024
National Accounts	**DKK bn (Current prices)**	y/y	y/y	y/y
Private consumption	1162.4	-2.4%	0.0%	1.8%
Government consumption	615.4	-3.5%	-0.4%	1.6%
Gross fixed investment	651.7	8.6%	-5.0%	-1.7%
- Business investment	391.0	11.9%	-6.1%	0.4%
- Housing investment	174.0	7.8%	-7.6%	-8.2%
- Government investment	86.7	-2.7%	4.9%	1.8%
Growth contribution from inventories		0.8%	-0.6%	0.0%
Exports	1939.4	8.6%	1.3%	1.3%
- Goods exports	1045.2	5.7%	4.0%	1.9%
- Service exports	894.2	12.9%	-2.0%	0.5%
Imports	1642.0	4.2%	-2.0%	0.6%
- Goods imports	981.4	-2.2%	-2.9%	0.8%
- Service imports	660.6	14.7%	-0.8%	0.3%
GDP	2797.9	3.8%	0.5%	1.3%
Economic indicators				
Current account, DKK bn		367.2	340.0	350.0
- Share of GDP		13.1%	11.5%	11.3%
General government balance, DKK bn		93.0	60.0	35.0
- Share of GDP		3.3%	2.0%	1.1%
General government debt, DKK bn		834.8	800.0	780.0
- Share of GDP		29.8%	27.1%	25.1%
Employment (annual average, thousands)		3163.5	3173.1	3150.6
Gross unemployment (annual average, thousands)		75.7	88.7	101.7
- Share of total work force (DST definition)		2.6%	3.1%	3.6%
House prices, y/y		-0.1%	-9.5%	-3.5%
Private sector wage level, y/y		3.5%	4.7%	5.0%
Consumer prices, y/y		7.7%	5.1%	3.6%
Financial figures	**03/04/2023**	**+ 3 months**	**+6 months**	**+12 months**
Lending Rate	2.75%	3.50%	3.75%	3.75%
Certificates of deposit Rate	2.60%	3.35%	3.60%	3.60%

Source: Daske Bank, Statistics Denmark, Nationalbanken

Macro forecasts - Sweden

	2022	2022	Forecast 2023	2024
National Accounts	**SEK bn (Current prices)**	**y/y**	**y/y**	**y/y**
Private consumption	2628.7	2.1%	-2.3%	1.8%
Government consumption	1486.4	0.0%	1.1%	1.2%
Gross fixed investment	1589.7	5.2%	-2.8%	2.3%
Contribution from invetory change	77.7	0.5%	-0.7%	-0.1%
Domestic demand	5782.5	3.4%	-2.3%	1.6%
Exports	3116.4	6.6%	2.0%	2.8%
Aggregate demand	8898.9	4.4%	-0.8%	2.0%
Imports	2972.6	8.7%	-0.1%	2.6%
Contribution from net exports	143.9	-0.6%	1.0%	0.2%
GDP	5926.3	2.6%	-1.2%	1.7%
GDP, calendar adjusted	5914.6	2.7%	-1.0%	1.7%
Economic indicators				
Trade Balance, SEK bn		206.9	264.0	274.1
- share of GDP		3.7%	4.8%	4.9%
Current Account, SEK bn		256.9	314.0	324.1
- share of GDP		4.6%	5.7%	5.8%
Public budget, SEK bn		40.0	-50.0	-50.0
- share of GDP		0.7%	-0.9%	-0.9%
Public debt ratio*		31.0%	29.0%	29.0%
Unemployment rate		7.5%	8.0%	7.9%
Consumer prices, y/y		8.4%	9.6%	2.3%
CPIF, y/y		7.7%	6.8%	2.3%
CPIF excl. Energy, y/y		5.9%	7.7%	2.4%
Hourly Wages, y/y		2.5%	4.1%	3.3%
House prices, y/y		-1.2%	-14.0%	2.0%
*Maastricht definition				
Financial Figures	**03/04/2023**	**+3 months**	**+6 months**	**+12 months**
Leading policy rate	3.00%	3.75%	4.25%	4.00%

Source: Danske Bank, Statistics Sweden, Valueguard, Sveriges Riksbank

Macro forecasts - Norway

	2022	2022	Forecast 2023	2024
National Accounts	**NOK bn (Current prices)**	**y/y**	**y/y**	**y/y**
Private consumption	1805.0	6.8%	-1.0%	0.9%
Government consumption	1036.1	0.1%	1.2%	1.7%
Gross fixed investment	1096.2	4.4%	0.5%	4.0%
Petroleum activities	177.9	-5.5%	4.0%	6.0%
Mainland Norway	917.5	6.6%	0.5%	1.0%
Dwellings	232.1	-1.4%	-4.0%	1.0%
Enterprises	448.4	14.5%	1.0%	-1.0%
General government	237.1	0.9%	1.0%	3.0%
Exports	3100.6	5.9%	4.0%	2.0%
Crude oil and natural gas	1972.9	0.3%	3.5%	3.5%
Traditional goods	626.0	-0.3%	4.0%	3.0%
Imports	1521.8	9.3%	3.0%	2.0%
Traditional goods	991.7	2.5%	-0.5%	1.5%
GDP	5569.2	3.3%	1.2%	1.5%
GDP Mainland Norway	3569.3	3.8%	1.0%	1.5%
Economic indicators				
Employment, y/y		3.9%	0.3%	0.1%
Unemployment rate (NAV)		1.8%	2.1%	2.4%
Annual wages, y/y		4.3%	5.0%	4.0%
Core inflation, y/y		3.9%	5.2%	2.8%
Consumer prices, y/y		5.8%	4.8%	2.5%
House prices, y/y		4.9%	-3.0%	0.5%
Financial figures	**03/04/2022**	**+3 months**	**+6 months**	**+12 months**
Leading policy rate	3.00%	3.50%	3.50%	3.25%

Source: Daske Bank, Statistics Norway, Real estate Norway, Norwegian Labour and Welfare Organization (NAV), Norges Bank

Macro forecasts - Finland

	2022	2022	Forecast 2023	2024
National Accounts	**EUR bn (Current prices)**	**y/y**	**y/y**	**y/y**
GDP	266.7	2.1%	-0.2%	0.9%
Imports	127.1	7.5%	-1.0%	2.0%
Exports	119.7	1.7%	-0.5%	1.5%
Consumption	203.1	2.3%	0.2%	0.8%
- Private	138.3	2.1%	-0.2%	1.0%
- Public	64.8	2.9%	1.2%	0.5%
Investments	65.7	5.0%	-2.0%	2.0%
Economic Indicators				
Unemployment rate		6.8%	7.0%	6.8%
Earnings, y/y		2.4%	4.1%	3.7%
Inflation, y/y		7.1%	5.5%	2.1%
Housing prices, y/y		0.6%	-5.5%	4.0%
Current account, EUR Bn		-10.0	-4.0	-3.0
- share of GDP		-3.7%	-1.4%	-1.0%
Public deficit, share of GDP		-0.8%	-2.5%	-1.7%
Public debt, share of GDP		73.0%	72.1%	72.4%
Financial Figures	**03/04/2023**	**+3 months**	**+6 months**	**+ 12 months**
Leading Policy Rate	3.00%	3.75%	4.00%	4.00%

Source: Danske Bank, Statistics Finland, ECB

Macro Forecasts - Euro area

	2023 Q1	Q2	Q3	Q4	2024 Q1	Q2	Q3	Q4
GDP, q/q	-0.1%	0.2%	0.0%	-0.1%	0.2%	0.2%	0.4%	0.4%
Unemployment rate	6.7%	6.8%	6.9%	7.0%	7.0%	7.0%	7.0%	7.0%
HICP, y/y	8.0%	6.7%	5.6%	4.9%	4.1%	3.6%	3.2%	3.0%
Core HICP, y/y	5.5%	5.4%	4.7%	3.9%	3.2%	3.0%	2.9%	2.7%
ECB deposit rate*	3.00%	3.75%	4.00%	4.00%	4.00%	3.75%	3.25%	2.75%

**End of period*
Source: Daske Bank, Eurostat, ECB

Macro Forecasts - United States

	2023 Q1	Q2	Q3	Q4	2024 Q1	Q2	Q3	Q4
GDP, q/q	0.2%	0.1%	-0.5%	-0.3%	0.2%	0.3%	0.4%	0.6%
Unemployment rate	3.5%	3.6%	3.7%	3.9%	4.1%	4.2%	4.3%	4.3%
CPI, y/y	5.8%	4.4%	3.6%	3.0%	2.4%	1.7%	1.7%	2.0%
Core CPI, y/y	5.6%	5.0%	4.0%	3.2%	2.6%	2.2%	2.3%	2.4%
Fed Funds target rate*	5.00%	5.25%	5.25%	5.25%	5.00%	4.75%	4.50%	4.25%

**End of period*
Source: Daske Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Fed

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