

April 2010

# Nordic Outlook

## Economic and financial trends

- **Denmark: Upswing facing challenges**
  - Denmark's economy has begun to recover. The economy grew in H2 2009 - and we expect the pick-up to continue this year and next
- **Sweden: Waiting for the world to turn**
  - Together with a historically mild upturn in global demand and a prolonged weak global investment cycle Swedish growth is expected to pick up slowly
- **Norway: Weaker than expected**
  - The Norwegian economy has developed more weakly than we expected in our last quarterly report. Based on our forecast for oil consumption and production in the coming years, activity is expected to pick up and we estimate positive growth in this and next year
- **Finland: Slow recovery in the bullpen**
  - After an unprecedented fall in GDP in 2009, we expect the economy to return to modest growth in 2010, as export markets have continued to recover and the outlook for domestic consumption has improved

# Danske Research

*Investment Research*

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

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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 quarterly publication the *Global Scenarios* sets out our global economic outlook.

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- Denmark
- Sweden
- Norway
- Finland
- US
- UK
- Euroland
- Switzerland
- Central and Eastern Europe
- Asia

# Denmark

## Upswing facing challenges

- **Denmark's economy has begun to recover. The economy grew in H2 2009 – and we expect the pick-up to continue this year and next.**
- **That said the recovery looks set to be weak and fragile and there is still some doubt whether it can develop into a full-blown upswing, as an actual upswing would include falling unemployment.**
- **In our forecast we assume that the nascent upswing in Europe remains on track. There is, however, a risk of the European economy disappointing and if this happens the economic recovery in Denmark would be threatened.**
- **The government is set to tighten fiscal policy over the next three years and we would endorse the move. While tightening should of course take the state of the economy into account, there is no guarantee that the economic situation will be more favourable in 2012 or 2013 – which suggests that the tightening should start soon, so that it is not too abrupt. Irrespective of when the economy is tightened, there is a risk of over-medication.**
- **The housing market has turned – and we expect prices to rise during the forecast period – but the turnaround is being driven by unsustainably low interest rates, so the housing market may come under renewed pressure a few years down the line.**
- **Unemployment has developed more benignly over recent months than we previously expected. We therefore now expect that unemployment will remain below 145,000.**

### Further growth – but risk of a new downturn

Denmark's economy has begun to recover. The economy grew in both Q3 and Q4 last year – and extremely low interest rates have helped the housing market turn around. The labour market outlook also looks brighter – and so there is much to suggest that the Danish economy will both grow and create jobs in the years ahead. Until we reach that point, however, we will probably have to resign ourselves to a period of further increases in unemployment. The rise in unemployment comes, however, on the back of an expected recovery in Danish competitiveness – if competitiveness is not restored, the labour market could stabilise quite quickly, as growth is strong enough for this to happen, in our view.

There is though a risk that the economic recovery may never really develop into a real upswing with growth and job creation. If the budding European upswing ebbs out as a result of the major budget problems plaguing several European nations, the Danish economy will also be dragged down.

On top of this come Denmark's own budget problems, which will require a steady fiscal hand at the helm. With the budget deficit running at 5.5%, there

### Changes compared to previous forecast

	Current forecast			Previous forecast	
	2009	2010	2011	2010	2011
GDP	-4,9	1,8	1,9	1,7	2,0
Private consumption	-4,6	2,7	2,5	2,5	2,0
Public consumption	2,5	1,2	0,5	1,4	0,9
Gross fixed investment	-12,0	-2,3	1,3	-5,2	2,6
Exports	-10,3	2,7	3,5	4,6	3,5
Imports	-13,2	2,6	3,5	2,5	2,5
Unemployment (thousands)	98,1	128,3	138,6	148,2	159,2
Inflation	1,3	2,0	1,8	1,5	1,7
Public sector bal., % of GDP	-2,8	-5,6	-4,5	-6,1	-4,4
Current account, % of GDP	4,0	3,2	2,5	2,5	2,1

Source: Statistics Denmark and Danske Research

is clearly a need to tighten fiscal policy. Irrespective of the timing, fiscal tightening is always politically unpopular, and there is a risk of the measures being so severe that they undermine the recovery. The need for fiscal tightening in Denmark is relatively modest, but to avoid the measures being excessively concentrated, we believe it would make good sense to start as early as 2011. However, as 2011 is an election year we doubt that fiscal tightening will be on next year's agenda.

We have not made any major changes to our previous forecast for the Danish economy, although we have become more optimistic about when the labour market will turn – and our view on the housing market has also brightened. As a result, we have revised up our expectations for consumption growth in the coming years. Exports, on the other hand, have disappointed somewhat, and we have toned down our expectations here.

### Decent consumption potential

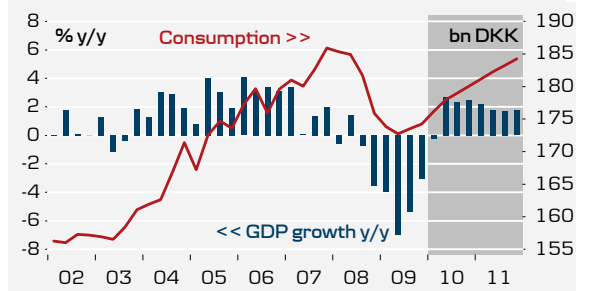
Private consumption beat a very hasty retreat during the crisis. According to the latest national accounts figures, private consumption (fixed prices) fell by 7.1% between Q4 2007 and Q2 2009. And while consumption has risen at a reasonable pace in Q3 and Q4 2009, the pick-up has been surprisingly weak considering that real household income has increased substantially over the period while household wealth – despite the pronounced drop during the crisis – remains at a relatively high level in historical terms. There is thus no doubt that consumers sharply increased their savings rates during the crisis.

The substantial growth in household disposable income is due to a generally high rate of wage growth, tax cuts for those in work in 2009 and 2010, a sharp fall in interest rates and very low inflation throughout the period. In addition, the paying out of SP pension savings from mid-2009 also increased consumption potential.

The considerable uncertainty generated by the crisis has been one of the reasons why consumers have been unwilling to convert higher real incomes into higher consumption. The risk of unemployment, for instance, has increased significantly. Moreover, many Danes have seen their wealth severely eroded by the crisis.

Finally, consumption was – especially in the latter half of 2009 – temporarily dampened by many Danes opting to make additional contributions to their pension schemes. This was prompted by a new tax reform scheduled to start in 2010. From 1 January 2010 the tax value of pension contributions would fall due to the marginal tax rate being cut. In other words, it was financially advantageous to bring forward planned pension contributions to 2009 rather than wait until 2010. In addition, a cap of DKK100,000 was introduced on the tax-deductible value of instalment pension payments. While there exists a very reasonable alternative in the form of life annuity pension payments for those wanting to save a lot, there is no denying that life annuities are rather less flexible – for example, it is not possible to have your pension savings paid out ahead of time. Many therefore opted to bring forward their planned

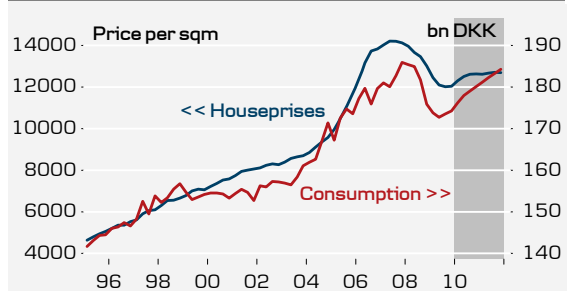
Consumption to lift growth during forecast period



Source: Statistics Denmark and Danske Research

Note: Grey background denotes forecast

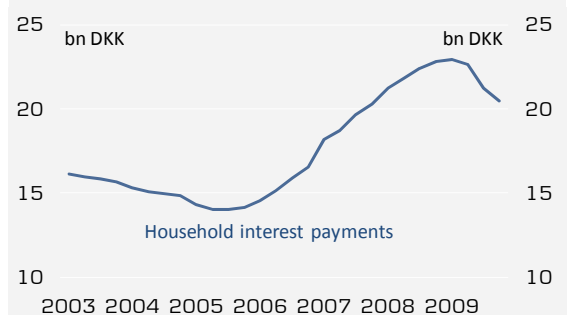
House prices to kickstart consumption



Source: Statistics Denmark and Danske Research

Note: Grey background denotes forecast

Households benefiting from falling interest rates



Source: Nationalbanken (Danish central bank)

pension contributions from 2010 to 2009 after the rule change was announced in March 2009.

However, these extraordinary pension contribution options have disappeared in 2010, which should help sink the savings ratio this year.

Moreover, the crisis in the labour market now seems more manageable and household wealth has risen considerably in the past year on the back of positive returns from the equity and housing markets.

Finally, it is important to remember that just as interest rates on adjustable-rate mortgages dampened consumption in 2009 as a result of the high rates at the end of 2008, Danish homeowners with adjustable-rate mortgages have enjoyed significant interest rate savings in 2010 as a result of the major declines in rates in 2009.

Thus there are solid arguments for why consumption should pick up over the forecast period. However, this would require consumer confidence being restored – if it is, the potential for a very substantial pick-up in consumption would be in place.

Overall, we estimate that consumption will grow by 2.7% in 2010. Looking ahead to 2011, some of the stimuli will gradually weaken; hence we expect consumption growth of 2.5% in 2011.

### Unemployment to turn in 2010

The latest figures from Statistics Denmark show that unemployment has remained relatively stable at around 115,000-180,000 over the past four months.

The stabilisation comes after 17 months of steeply rising jobless numbers, with 4,300 people losing their jobs, on average, every month between unemployment bottoming in summer 2008 and the recent stabilisation. One would have to look all the way back to the two oil crises to see unemployment rising at such a rapid rate.

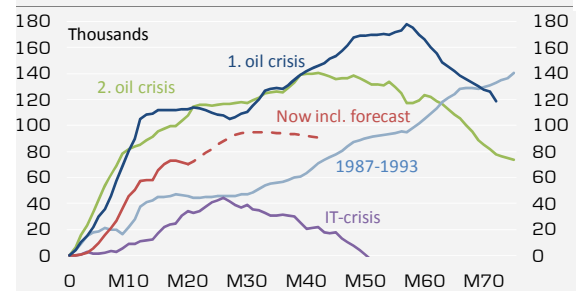
Hence, while the labour market is exhibiting signs of improvement, we are not fully convinced that an actual turnaround in unemployment is imminent.

This is first and foremost because we expect GDP growth to be relatively weak over the forecast period – especially compared to other recovery periods in the Danish economy. This means companies will remain reluctant to increase staff numbers, preferring instead to draw on existing employees to meet the slowly rising demand.

Moreover, productivity developments indicate that companies have not yet fully adjusted employee numbers to the very sharp downturn in sales suffered during the crisis. Hence, companies now have an opportunity to increase production as their sales prospects improve without having to hire more staff.

Thus there is much to suggest that the turnaround in unemployment could be some time in coming despite economic activity beginning to pick up.

Pace of unemployment growth historically high...



Source: Nationalbanken

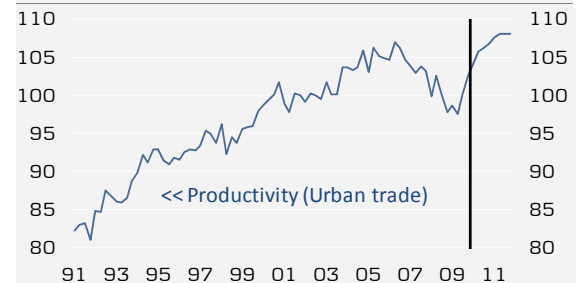
...but level of unemployment still low



Source: Statistics Denmark and Danske Research

Note: Grey background denotes forecast

Productivity continues to recover



Source: Statistics Denmark and Danske Research

Note: Vertical line denotes start of forecast period

On the other hand, companies now have a chance to restore the very considerable loss of productivity that occurred both before and after the financial crisis hit the Danish economy.

Productivity (GVA in private urban businesses per employee in such a business) fell by almost 9% between Q2 2006 and Q3 2009. And while it recovered a little in Q3 and Q4 2009, with the overall loss in productivity being reduced to 4.1%, productivity remains very low.

History shows that productivity normally declines as the economy peaks and recovers as the upswing takes hold. We therefore expect to see productivity pick up further during the forecast period.

Given that productivity has fallen as far as it has – and that economic growth looks set to remain relatively weak – the outlook is for productivity to take quite some time to recover. This means Denmark may face an extended period during which production will increase without – initially at least – resulting in rising employment and falling unemployment.

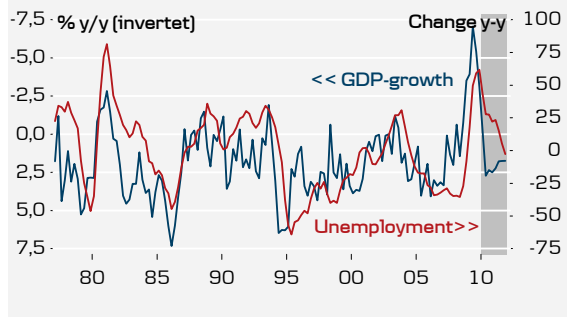
That said it is worth bearing in mind the considerable uncertainty associated with measuring productivity – especially given the current economic situation, where fluctuations in both production and employment have been very marked. It is therefore relevant to estimate how employment and unemployment are likely to develop assuming a different productivity scenario.

If we assume, for example, that productivity does not fully recover during the forecast period, but instead tracks the average rate of increase that applied during the period 1991-2007 – i.e. before the financial crisis struck Denmark – then the expected weak, but nevertheless positive, economic growth would suggest that unemployment should follow a relatively stable path during the forecast period (figure).

This is also why we would say our unemployment estimate is not carved in stone, and indeed we see a real chance that the turnaround in unemployment may gain a foothold earlier than we assume in our current forecast.

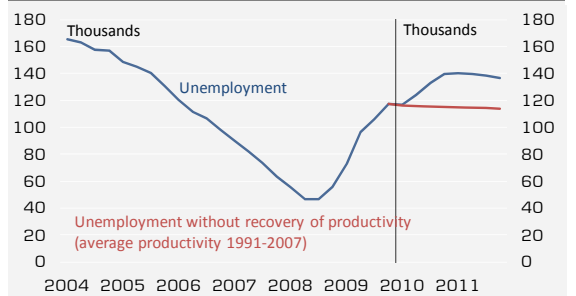
Overall, though, we expect that unemployment will rise to just above 140,000 in autumn 2010, after which it should gradually stabilise and then begin to fall slowly from Q4 2010 onwards.

**Growth upturn heralds unemployment turnaround**



Source: EcoWin and Danske Research  
Note: Grey background denotes forecast

**Productivity is the joker in the labour market**



Source: EcoWin and Danske Research  
Note: Vertical line denotes start of forecast period

### The jobs mystery

There is an unusually high degree of uncertainty about the true state of the Danish labour market. Registered unemployment rose by 61,800 between Q4 2008 and Q4 2009. This represents a major increase, but is nevertheless below what was seen in the early 1980s, for example. At the same time, the employment statistic reveals that 163,000 jobs were lost in Denmark over the same period, which is by far the largest drop in employment in at least 42 years.

An obvious explanation would be that the crisis had pushed considerably more people into taking early retirement or other forms of government benefits in addition to unemployment benefit, but as our table shows, this was in fact not the case. Thus there appear to be just over 107,000 people who apparently lost their jobs but did not receive any form of benefit, and therefore are not registered as unemployed.

#### Change Q4 2008 to Q4 2009

Employed	-163,000
Registered unemployed	61,800
Under coaching and retraining	8,750
Maternity leave benefit, etc.	-9,350
Invalidity pension	2,400
Early retirement	-7,200
Other benefit recipients (excl. student grants)	-790
Unexplained change in employment	-107,400

Source: Statistics Denmark

Many people opted not to pay unemployment benefit contributions during the good years when the risk of unemployment looked small. Many of these people now have no right to benefits when they lose their jobs and so they are not registered as unemployed. The questionnaire-based labour force survey shows a rise in unemployment that is around 40,000 higher for the period, and this can be explained in this way. Other important factors are probably students delaying completion of their studies due to the poor prospects of getting a job and foreigners working in Denmark leaving the country again - something we have no numbers for at present. Nevertheless, it is difficult to believe that employment has fallen so sharply when unemployment has risen so little. According to Statistics Denmark there is also unusually high uncertainty connected with the employment numbers due to changes in the data bases. On the other hand, nor is there any doubt that the number of registered unemployed underestimates the true extent of the crisis.

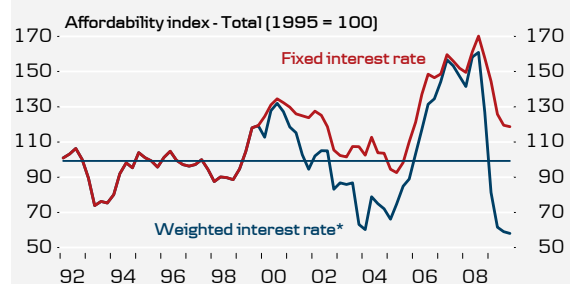
Source: Danske Research

### Housing market has turned for now

The latest data from Statistics Denmark show that house prices rose 1% from Q2 to Q3 2009. Furthermore, statistics from estate agent Home indicate that prices continued to appreciate in Q4 2009 and the first months of 2010. Historically, there has been a good correlation between the data from Home and Statistics Denmark's house price figures (figure). Therefore it looks like the housing market turned in summer 2009 and that the trend has continued into 2010.

The turnaround in house prices can largely be attributed to the sharp fall in interest rates seen in 2009. Interest rates are now at exceptionally low levels, reducing the housing burden - which measures the cost of financing a home

#### Housing burden hits historical low



Source: EcoWin and Danske Research

\*\*"Weighted interest rate" is calculated as a weighted average of the short and the long mortgage interest rate with total gross lending for short and long mortgage loans, respectively, used as weights

purchase relative to disposable income – to the lowest level seen since 1992. However, this also means there is a chance that house prices may eventually come under renewed pressure as Danish interest rates normalise.

That said we expect house prices to continue to appreciate over the forecast period – i.e. as far ahead as the end of 2011. This is in part because we expect to see just a modest increase in interest rates in the coming years and also because we have yet to see the full effect of the sharp falls in interest rates in the past year. Moreover, income growth looks set to be reasonable – not least due to the already enacted tax cuts.

However, while house prices should appreciate, the increase looks set to be fairly modest. The Danish economy is undergoing a slow and fragile turn-around and unemployment is expected to continue rising, though the crisis in the labour market certainly appears more manageable now. Unemployment will likely continue to dampen demand in the housing market going forward – the negative stimulus from this quarter will simply be less pronounced and will ease more quickly than previously expected.

Finally, it is worth remembering that there is still a significant number of properties on the market – also relative to the rising, though still low, rate of turnover. The current volume of single-family houses for sale – around 37,000 – equates to almost eleven months’ sales at current turnover rates. This will tend, all else being equal, to dampen price growth going forward.

Our general view is that house prices will appreciate by 3% in 2010 and 1.3% in 2011. However, price growth is expected to slow towards the end of 2011 as Danish interest rates begin to normalise. In the longer term, we see a (significant) risk of new falls in house prices as interest rates normalise.

### Exports growing – but risk of serious setback

Exports have remained flat for the past six months after falling sharply in the latter half of 2008 and the first half of 2009.

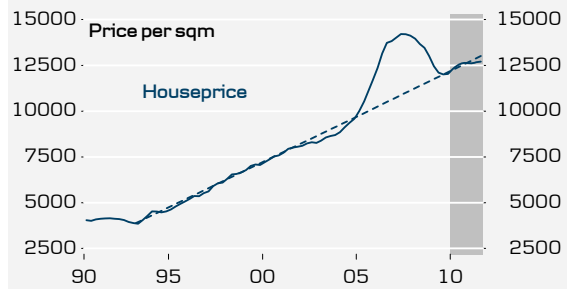
The stabilisation in exports can largely be attributed to the turnaround in activity seen in Denmark’s key export markets in the latter half of 2009.

The emerging stabilisation notwithstanding, exports have tumbled almost 11% over the past year – the largest year-on-year fall this side of World War Two.

Moreover, the stabilisation is largely the result of growing exports of services, as goods exports continue to struggle.

This dichotomy is presumably due to a relatively large share of Danish goods exports comprising agricultural and chemical products (medicine) and energy technology. These are sectors where demand is generally less sensitive to fluctuations in the global economy, meaning that Danish goods exports usually perform relatively well during a global slowdown, but also that the growth potential here is not as great as that of our neighbours when the economy begins to turn up again.

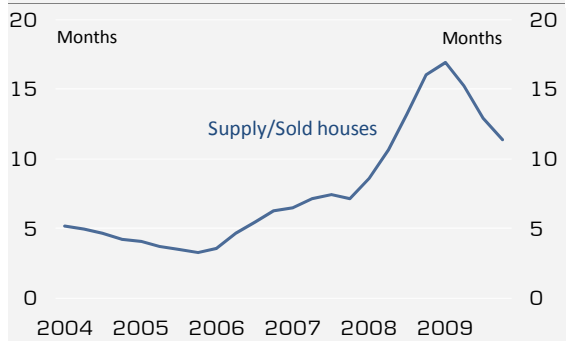
#### House prices to rise during forecast period



Source: EcoWin and Danske Research

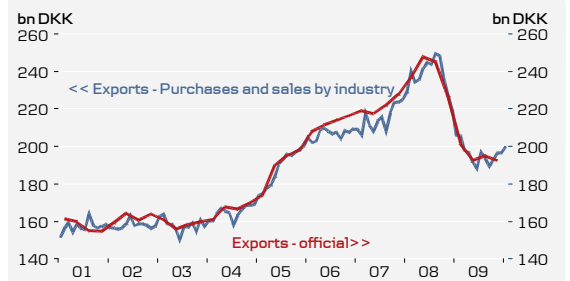
Note: Grey background denotes forecast

#### Supply of homes for sale still substantial



Source: EcoWin and Danske Research

#### Exports improving



Source: EcoWin and Danske Research

Service exports have, on the other hand, a greater sensitivity to the economic cycle and can therefore be expected to react more positively to the economic recovery in Denmark's export markets. Marine transport, including shipping, is one area in particular that is benefiting from the increase in global trade. Moreover, the Danish shipping industry is well represented in the Asian markets, where activity growth has been most pronounced in the latter half of 2009.

We expect exports will continue to grow during the forecast period, with service exports retaining the driving seat in the short term, although goods exports are also expected to increase as the nascent global upswing strengthens.

Unfortunately, however, exports will very probably continue to underperform for quite some time relative to what growth in Denmark's export markets would suggest. This is a result of the significant loss of competitiveness suffered by Denmark in recent years. Danish competitiveness has been blunted by relatively strong wage growth, very sluggish improvements in productivity and a substantially firmer Danish krone.

While Denmark has regained some of its competitive edge in recent months, history shows, unfortunately, that restoring competitiveness is a long, drawn out process. Hence competitiveness will be a key theme for the Danish economy for some time yet.

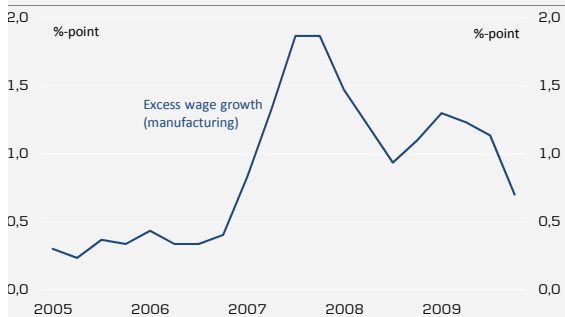
Nevertheless, we are reasonably confident about Danish exports and expect that export growth will pick up as the global economy shifts into a higher gear. Overall, we expect that total exports of goods and services will rise 2.7% in 2010 and 3.5% in 2011.

**Service exports show greater advance**



Source: EcoWin and Danske Research

**Danish excess wage growth is falling**



Source: EcoWin and Danske Research

### Budget problems in the EU could derail the upswing in Denmark

It is important to underline that there is considerable uncertainty attached to exports over the forecast period. The economies of Denmark's key export markets – especially Euroland – are expected to grow during the forecast period, but we also see a real risk that the nascent upswing in Euroland could be derailed.

Specifically, we see a risk that the current budget crisis in Greece could stoke more widespread scepticism about the sustainability of budget deficits across Europe. This would make the funding of national deficits more expensive and further undermine faith in the long-term credibility of fiscal policies. As a result, a number of countries could be forced to tighten fiscal policy ahead of schedule, meaning the fragile upswing would be replaced by a new economic downturn. The consequence would be that the current expected growth in Euroland of 1.8% in 2010 and 2.2% in 2011 would instead be zero (see Global Scenarios 9 March 2010 for details).

#### Modelled effect of negative export scenario

Current forecast:	2010	2011
- GDP (%)	1.8	1.9
- Exports (%)	2.7	3.5
Unemployment (1,000)	128.3	138.6
Employment (1,000)	2729.1	2733.1
<b>Negative export scenario:</b>		
- GDP (%)	0.6	-0.1
- Exports (%)	-0.8	-0.4
Unemployment (1,000)	146.8	190.6
Employment (1,000)	2706.1	2669.1

Source: ADAM and Danske Bank

Such a scenario would naturally have grave consequences for a small, open economy like Denmark, which is very much dependent on economic developments in Euroland.

An economic downturn in the eurozone of the above magnitude would cause the expected growth in exports of 2.7% in 2010 to become a contraction of 0.8%. The drop in exports would drag production down and GDP growth would be reduced to around 0.6% in 2010 and -0.1% in 2011 (see table). The prospect of unchanged production would cause a further loss of workplaces and unemployment numbers would be 18,500 and 52,000 higher in 2010 and 2011, respectively. The fall in employment would actually be greater, as the labour force is in fact expected to shrink.

This is of course an extremely gloomy scenario and fully illustrates just how vulnerable the Danish economy is to developments in Euroland. Moreover, such a scenario would leave Danish decision-makers little room to manoeuvre, as neither fiscal policy nor monetary policy would have the potential to steer Denmark clear of yet another economic crisis.

Source: Danske Research

## Business investment picking up

Business investment plummeted in H2 2008 and H1 2009. However, there has been some stabilisation in H2 2009 – albeit at a very low level. Business investment fell 11.5% overall in 2009 – the largest fall recorded since 1991.

The decline in business investment is due to the sharp fall in demand experienced by many companies for their products, which in turn seriously cut capacity utilisation and thus reduced the need for further investment.

The drop in business investment was probably further reinforced by the relative difficulty of obtaining funding in the wake of the financial crisis.

Looking ahead, we expect both the Danish and the global economy to pick up further. Naturally this will benefit companies' sales prospects. Moreover, interest rates have fallen to very low levels and are expected to remain low throughout the forecast period. Taken together these factors should tend to increase investment.

It is important to keep in mind, however, that companies still have considerable spare capacity. This is why we expect just modest growth in business investment in 2010. The pick-up should become more apparent in 2011 as sales prospects improve and the delayed effects of the decline in interest rates over the past year become more visible.

Turning to housing investment, we expect further falls in the coming quarters, but a turnaround should begin to gain traction in early 2011. Housing investment is very dependent on house price developments, i.e. housing investment normally rises when the price of existing homes increases relative to the cost of building new homes. While house prices have turned and are expected to increase further during the forecast period, we estimate that house price growth will only lift housing investment marginally.

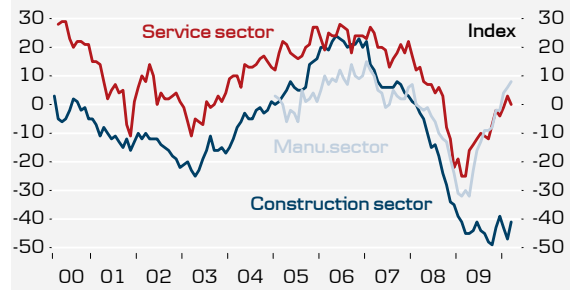
We base this on our view that housing investment needs to undergo a structural adjustment to a lower level following a period when it constituted a very large share of total economic activity. We believe that housing investment has for some time been at a higher level than is needed to meet the long-term demand for housing in Denmark. This would tend to delay the turnaround in housing investment that should follow the pick-up in the housing market.

Nevertheless, the very low level of interest rates and the turnaround in house prices should tend to stabilise housing investment.

The government's renovation fund has also helped support housing investment, though the main effect was felt in Q3 and Q4 2009. Moreover, the renovation fund very much contributed to bringing forward already planned investments. Therefore we expect that the renovation fund will affect housing investments negatively in 2010. Nevertheless, the renovation fund did generally boost activity in the construction sector – the effect was simply confined to 2009.

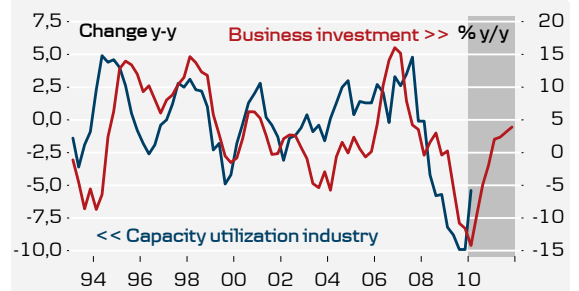
Overall, we expect housing investment to decline by 8.0% in 2010 and then rise by a weak 1.2% in 2011. This will reduce housing investment's share of

Optimism returning to the business sector



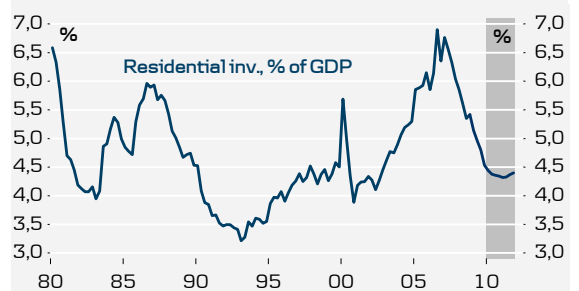
Source: EcoWin and Danske Research

Still plenty of spare capacity



Source: EcoWin and Danske Research

Residential investment down from a high level



Source: EcoWin and Danske Research

Note: Grey background denotes forecast

GDP to around 4.3%, which is the same as in the late 1990s and the early part of this decade.

### Fiscal tightening ahead

The economic crisis caused government balances to severely deteriorate over a very short period of time. The outlook is for a budget deficit of almost DKK100bn this year in Denmark – equivalent to 5.5% of GDP.

Hence the deficit will be greater than the 3% allowed for members of the EU. Denmark is therefore duty bound to improve the balance of its public finances. However, it is not only compliance with EU rules that makes trying to reduce the hefty deficit a sensible move. Denmark should really have a budget surplus at the moment. North Sea tax revenues remain substantial and demographic shifts are not yet weighing particularly heavily on public budgets. However, oil revenues will fall in the coming years, while the cost of providing for the elderly will rise. In other words, balancing the budget will not get any easier going forward.

Irrespective of when one tightens fiscal policy, it will always be a challenge politically. There will also, irrespective of the timing, be a risk of slowing economic activity excessively. There is already much debate on whether fiscal tightening in 2011 might be premature and if it would undermine the economic recovery before it had time to become self-perpetuating – but waiting until 2012 is no guarantee that a policy error can be avoided.

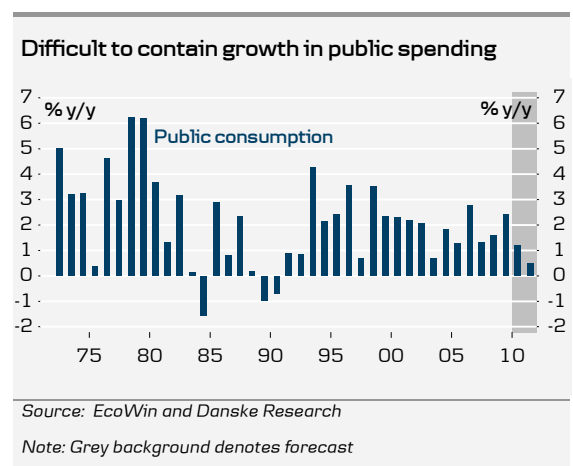
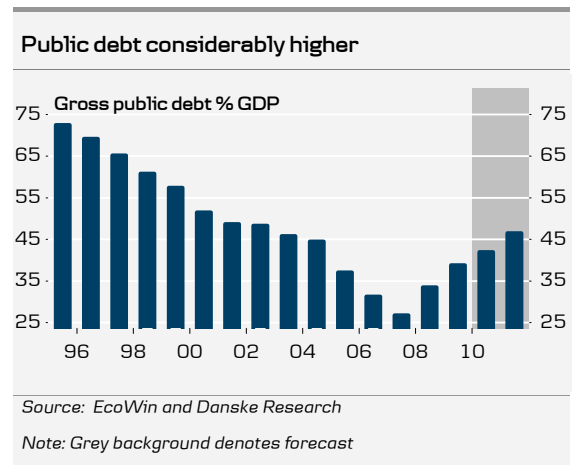
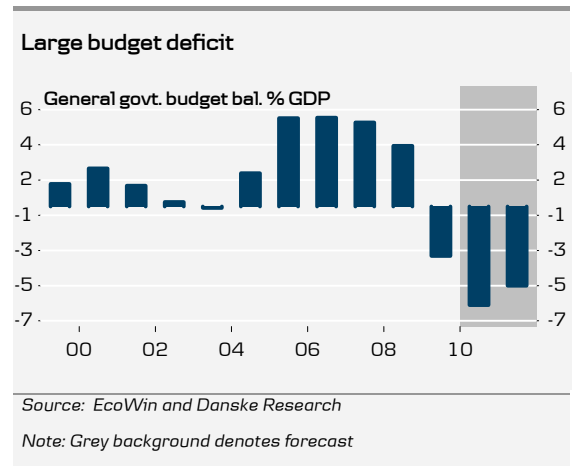
This is, first of all, because the tightening of fiscal policy would have to be more severe if one waits until 2012. Furthermore, the impact of rising interest rates would presumably be greater in 2012 than 2011. This would naturally make it more difficult to substantially tighten fiscal policy without the overall economic tightening being excessive.

As well as fiscal and monetary policy, Danish economic growth in the coming years will be affected by legislative initiatives that came as a natural consequence of the financial crisis. New regulations for the financial sector will have a negative effect on the economy in the short term. The changes are unlikely to have much impact in 2011 but could well have an effect in 2012.

Hence, delaying fiscal tightening until 2012 would definitely not be without its problems either – especially if the tightening were severe. There is no denying the necessity of fiscal tightening and getting started as soon as possible in order to avoid too dramatic an impact would seem the best approach.

There are of course other options than tightening fiscal policy. Certain reforms could reduce the need for fiscal tightening considerably. However, the political will for reform is limited and, moreover, phasing-in periods often mean that reforms take years to work. Thus reform would not necessarily bring the budget deficit down below 3% by 2013.

Instead the government has planned for zero growth in real public expenses. On the face of it this sounds perfectly feasible. The industrial sector has, for example, cut back by more than 20% during the crisis – while the public sector only has to aim for keeping expenses unchanged. Politically speaking,



this is a difficult task, however. There are basically two reasons for this: first, control of public spending has been demonstrably lacking, which is why actual spending growth has been greater than planned. It is a serious problem for an economy with a large public sector if spending cannot be precisely controlled. Basically the problem is that no solutions have been found to control demand for the services the public sector delivers. This means the politicians having to face enormous pressure from voters. Direct payment for services could be one way of avoiding excessive demand. However, there is also a lack of political will to introduce this.

Basically the government has said nothing in its so-called convergence programme about the profile of public spending over the coming three years – simply that it should be the same in 2013 as in 2010. We estimate that the outlook is for some growth in public spending in 2011. Next year is an election year, which tends to suggest there will be little in the way of unpopular cutbacks. Our forecast therefore assumes public spending growth of 0.5% in 2011. Naturally, this implies the prospect of an actual cut in public spending in 2012 and/or 2013. Hence there is a risk of the economy suffering a setback at that point.

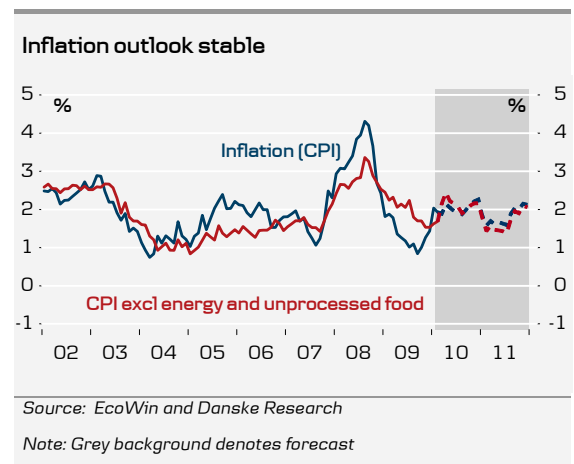
## Inflation outlook stable

Inflation has risen somewhat over the past six months. Since bottoming in September 2009 at 0.8%, inflation has climbed to just below 2% at present. The increase has been largely due to energy prices and a number of new taxes on beverages and tobacco plus energy introduced this year.

We expect that inflation will remain relatively stable at around 2% for the rest of the year. In 2011, we expect inflation to fall slightly to around 1.8%. The decline will come on the back of, among other things, the slowing pace of wage growth during the forecast period.

Wage growth is expected to slow further over the forecast period due to the negotiating strength of wage earners being severely dented as rapidly rising unemployment made it easier for companies to find alternative labour – while alternative job opportunities for wage earners at the same time shrank. Given this, we expect the rate of wage growth to be 1.75% in 2010 and 2% in 2011.

The forecast developments in inflation and wage growth also mean that the outlook for real wages in the private sector is slight falls in 2010 and 2011.



## Denmark: Forecast at a glance

National account	2005	2007	2008	2009	2010	2011
	DKK bn (current prices)			Vol growth in %		
Private consumption	745.1	2.4	-0.2	-4.6	2.7	2.5
Gross fixed investment	303.9	3.1	-4.6	-12.0	-2.3	1.3
Residential investment	92.4	4.1	-14.2	-16.8	-8.0	1.2
Business investment	184.4	3.8	-0.3	-11.5	-1.6	3.9
Public consumption	402.5	1.3	1.6	2.5	1.2	0.5
Public investment	27.1	-3.1	-2.8	21.3	14.8	-11.7
= Final domestic demand	1451.6	2.3	-0.8	-4.4	1.2	1.7
Growth contribution from stockbuilding	17.9	-0.3	0.3	-1.7	0.8	0.2
= Domestic demand	1469.5	2.0	-0.5	-6.0	2.1	1.9
Exports of goods	495.2	-0.3	-0.7	-10.5	3.0	3.2
Exports of services	261.8	6.7	7.4	-10.0	2.3	3.8
Exports, total	757.0	2.2	2.4	-10.3	2.7	3.5
= Total demand	2226.5	2.1	0.5	-7.6	2.3	2.4
Imports of goods	460.2	1.8	0.7	-14.9	2.7	3.5
Imports of services	221.0	4.5	8.4	-9.8	2.6	3.5
Imports, total	681.2	2.7	3.3	-13.2	2.6	3.5
Growth contribution from net exports	75.8	-0.2	-0.5	1.6	0.1	0.0
GDP	1545.3	1.7	-0.9	-4.9	1.8	1.9

Economic indicators	2007	2008	2009	2010	2011
Current account, DKK bn	25	38	66	52.8	45.3
- % of GDP	0.7	2.2	4	3.2	2.5
General govt. budget balance, DKK bn	80.6	59.8	-46.7	-97.1	-80.0
- % of GDP	4.8	3.4	-2.8	-5.6	-4.5
Gross public debt, DKK bn	453.2	580.3	643.2	723.0	830.0
- % of GDP	26.8	33.4	38.8	42.0	46.5
Employment (thousands)	2897.5	2922.5	2829.8	2771.5	2756.0
Unemployment (thousands)	78	51.6	98.1	128.3	138.6
Unemployment rate, %	2.8	1.8	3.5	4.6	5.0
Oil price - USD/Barrel	72.5	97.2	61.6	82.0	87.0
House prices	6.5	-4.3	-10.2	3.0	1.3
Hourly earnings in industry, % y/y	4	4.2	2.9	1.8	2.0
Consumer prices, % y/y	1.8	3.4	1.3	2.0	1.8

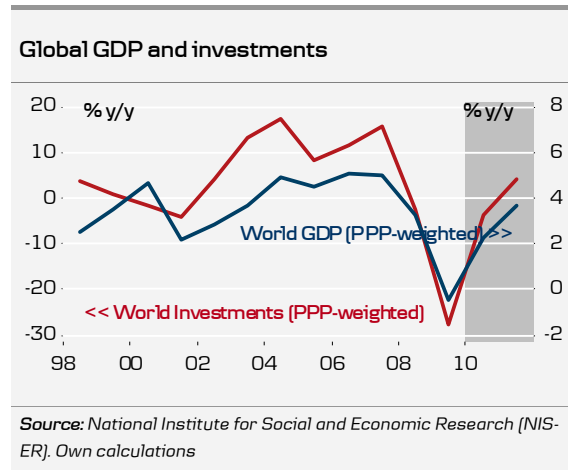
Financial figures	07.04.10	+3mths	+6mths	+12mths
Repo rate, % p.a.	1.05	1.05	1.05	1.30
2-yr swap yield, % p.a.	1.97	2.50	2.55	2.75
10-yr swap yield, % p.a.	3.56	3.80	3.95	4.05
DKK/EUR	744.3	744	745	746
DKK/USD	557.5	543	536	525

Source: Danske Markets

# Sweden

## Waiting for the world to turn

- The first few phases of the stabilisation process are nearing a close. Thanks to a never-before-witnessed stimuli from economic policy, the proverbial small open economy of Sweden, has managed to weather the global storm unexpectedly well.
- But stabilisation policy can only help for so long. The Swedish economy is in dire need of a decisive upturn on our main export markets. A global cyclical upswing is indeed our main scenario, but from a historical perspective the improvement is muted.
- And this also raises the question of economic structures. To what extent is the downshift in demand structural? Can and will the Riksbank identify such a shift and adjust its policy decisions accordingly? These questions are all near impossible to give a precise answer to, but we nonetheless have to attempt this in order to take the correct investment and allocation decisions.
- Our Swedish GDP-forecast reflects the undoubtedly negative forces that the above questions pose. Together with a historically mild upturn in global demand and a prolonged weak global investment cycle Swedish growth is estimated to be a meagre 1.5% y/y this year and a slightly more positive 2% y/y in 2011.
- Still on a high level, the rise in the unemployment rate has been surprisingly mild given the shortfall in production and demand levels. This is nonetheless expected to imply a longer period of weak labour market developments. Weighing the different forces affecting the employment and labour supply situation, we estimate that the unemployment rate will rise to 10.3% this year and remain at that level in 2011 as well.
- Despite difficulties when estimating the potential of the economy, resource utilisation cannot be said to be anything but low at the current juncture, implying domestic, core, inflation measures will remain subdued for a long period. In addition, imported prices have been muted and inter alia our forecasts for the Swedish krona imply that import prices will continue on a low note. All in all, inflationary pressures are thus expected to recede over the forecast horizon.
- For the Riksbank, this should eventually add up to a less disturbing inflation picture than it recently painted. Nonetheless, it has moved from a “crisis” policy stance to a more normal cyclical policy stance, which provides the Riksbank with quite a few degrees of freedom in setting rates up near-term.
- However, this means that should developments continue to come in according to our forecasts, the Riksbank will have no choice but to revise its interest rate path dramatically down.
- We expect the Riksbank to start hiking in September and to hike at each meeting going into 2011. Thereafter, the hikes will come at a considerably lower pace and by the end of 2012 reach a peak of 3%.



## World market growth

As mentioned in the Global section, we continue to be cautiously optimistic on the world economy and expect a road of sustained global recovery. It will, however, be moderate by historical standards. Global growth momentum is likely to peak in Q1 10 as strong cyclical tailwinds from stimuli and inventories taper off.

Despite the optimistic growth forecasts for global demand and even though Swedish companies are more present in growing markets than generally perceived, the strategy applied has been somewhat different than that of their competitors. Whereas companies in countries such as Germany and France seem to have relied more on domestic production and traditional exports, Swedish companies have chosen to invest directly – i.e. setting up production facilities, in growing economies. This means that the effect of strong growth in developing nations will be less visible in the domestically limited GDP aggregate and will only turn up via the current account as some type of return on investments. But it will not be as much of a help for domestic production.

The above is a more detailed way of describing that the import demand for Swedish export products (world market growth) is still heavily dependent on developments in advanced economies in western Europe and North America. The fact is that the EU and US together account for almost 70% of Swedish export markets. It is necessary for growth to pick up in these regions for Swedish export to pick up steam.

According to Danske Bank's demand forecasts even Swedish world market growth will pick up, albeit to a lesser extent than global demand suggests.

Another obstacle facing the Swedish export industry is the composition of demand. In Swedish export markets capacity utilisation has plummeted and is only slowly returning on the back of only moderate production growth. Global demand for consumption goods has on the other hand fared better, with strong help from economic policy initiatives. The Swedish export industry is heavily skewed toward input and investment goods, which we suspect will produce weak overall export growth for quite some time. This is different from previous upturns, where demand for input and investment goods normally pick up early on in the business cycle.

Taken together this means that the Swedish exports industry is set to lose market share, on a market that is growing rather slowly. In our forecasts, exports are set to grow by a moderate 3.1% y/y in 2010 and a slightly better 4.4% y/y in 2011.

## Financial conditions tighten as inflation recedes

The dramatic fall in demand has been accompanied by dwindling inflation in almost all countries, and Sweden is not one exception. On a more positive note, this implies increasing purchasing power for households and companies alike. However, it is troublesome from a stabilisation policy perspective, since it actually serves to tighten real financial conditions and in a situation where nominal interest rates are at, or close to, the zero interest rate bound the monetary authority needs to tread with extreme caution.

World markets and Swedish exports



Source: NISER, National Institute for Economic Research (KI) and Statistics Sweden (SCB). Own calculations.

Nonetheless, the Riksbank is poised to hike interest rates in the second half of this year, and the combined effect is that real financial conditions will trend lower toward and into contractionary territory.

### Inventories to decide short-term growth dynamics

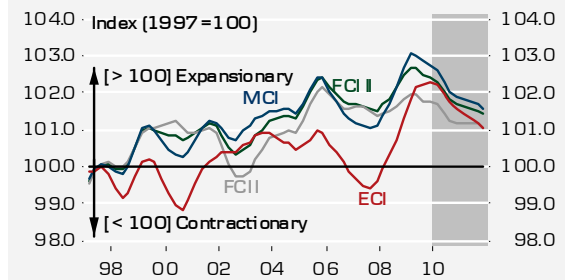
After a strong negative contribution to growth from inventories in the beginning of the crisis we have begun to expect the reverse – a strongly positive contribution from inventories. Remember that the contribution from inventories is not decided by changes in the inventory level, but rather by the pace of inventory build up or cutbacks – the second derivative if you want to be more formal.

Somewhat surprisingly, the receding pace of inventory liquidation has not materialised up until recently – and not in a very convincing manner. But somewhere inventory levels must reach a trough and production start to pick up. Browsing survey data and other indicators we get impression that this is finally about to happen. For 2010 we foresee a contribution to growth amounting to 0.5% percentage points (pp) and in 2011 a zero-contribution.

### Investments held back by low capacity utilisation

The stabilisation of inventory levels and mild upturn in exports are expected to push production in a more positive direction. Capacity utilisation is therefore expected to increase, especially since *corporate are currently not even replacing obsolete or worn down capacity*. At some point this process has run up capacity utilisation to a level where investments will again start rising. But we do not see this happening any time soon and the recent investment survey from Statistics Sweden indeed underlines the very weak prospects for investments going forward. One of the few sectors where growth is expected to rise throughout the forecast horizon is the public sector. Taken together, we foresee zero-growth this year and a mere 2.2% y/y rise in gross fixed capital formation for 2011.

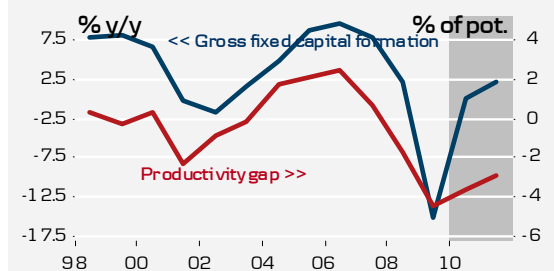
Real financial conditions



Note: MCI is FX and interest rates. FCI I is MCI plus the stock market. FCI II is FCI I plus house prices. ECI is MCI plus the cyclically adjusted government balance. A number above 100 implies that financial conditions and/or economic policy are supportive to growth, whereas a number below 100 indicates that financial conditions and/or economic policy is contractionary. All measures are adjusted for inflation and are quoted in volume terms.

Source: Reuters Ecowin, NIESR and KI. Own calculations.

Productivity gap and investments



Source: KI and SCB. Own calculations.

## The enigmatic behaviour of Swedish labour markets

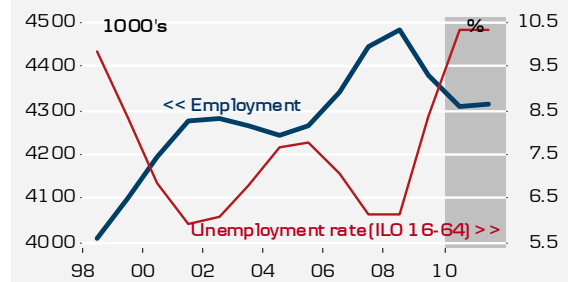
Throughout the crisis, which we have captured quite well in terms of GDP and inflation, we have at the same time failed utterly when it comes to labour market developments. We have continuously been forced to revise labour market developments stronger

A dramatic rise in unemployment rates has indeed taken place over the last year. And the deterioration is expected to continue well into 2010. However, and especially considering the unrivalled drop in GDP, the rise in unemployment rates have actually been rather muted. We can of course see that domestic sectors have held up well due to the “Tidal wave of liquidity” and other forceful economic policy measures implemented over the past year. But, even the industries hardest hit by the crisis, construction and manufacturing, have not shed nearly as many people as was expected by us and others. All in all, we believe that the unemployment rate will average 10.3% in both 2010 and 2011. These seemingly stable numbers, however, mask both additional weakness near term, as well as a longer term improvement toward the end of 2011.

The overall more positive developments on the labour markets nonetheless come at a high cost – weak productivity. In 2007, the once admired strong productivity gains turned in a more negative direction. And ever since, productivity growth has posted negative readings. Low productivity is worrisome since it pertains to growth in value added. Value added is basically what is divided between the production factors labour and capital (i.e. wages and earnings) when other input costs are paid for. Since wage growth – especially in the regulated Swedish labour market – seldom enters negative territory the profit share bears the brunt of the loss of productivity. Indeed, when adjusting the productivity for labour costs, we also find that developments in so called unit labour costs have been even more negative from a corporate perspective. We have continuously questioned these developments and stated that this will sooner or later transform into an increased focus on profits from companies and therefore additional lay-offs. Admittedly, this has not materialised. Instead it seems as if shareholders are prepared to keep the cost base high, probably in order to take advantage of a perceived upturn in demand.

Nonetheless, an unemployment rate of above 10% is under any circumstances an unusually high number and, if anything, risks are that companies will demonstrate a renewed focus on profit shares should the expected upturn in demand disappoint. In short, despite a considerably less pessimistic view on the labour market outlook, there is no evidence of an improving labour market any time soon. If the above arguments for hoarding labour are valid, we should also expect opposite developments – i.e. a slower improvement phase, once demand picks up steam again. This is also visible in our forecast where the improvement in employment is rather mild despite the rather optimistic consecutive growth rates.

Employment and unemployment rate



Source: KI and SCB. Own calculations.

### Consumption craves a new driving factor

Our forecasts are built on an assumption of moderate wage growth, which together with very strong automatic stabilisers and a broad welfare system serve to support disposable incomes throughout the forecast period. Disposable incomes are therefore expected to rise by 2.3% y/y this year. Next year wage growth become even more subdued, which results in a still strong 1.7% y/y growth in disposable incomes for 2011.

The very benign developments of disposable incomes, especially in comparison to the overall drop in national incomes are measures of the success of stabilisation policies. The fact is that for the typical household – homeowners with two children and one car – a back of the envelope calculation suggests that purchasing power increased by net some SEK6,000-7,000 a month between September 2008 and now.

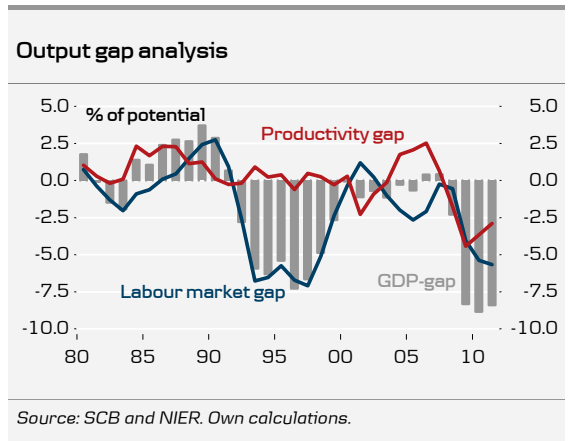
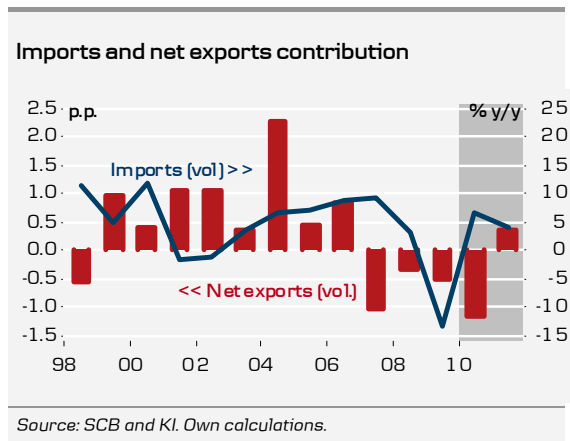
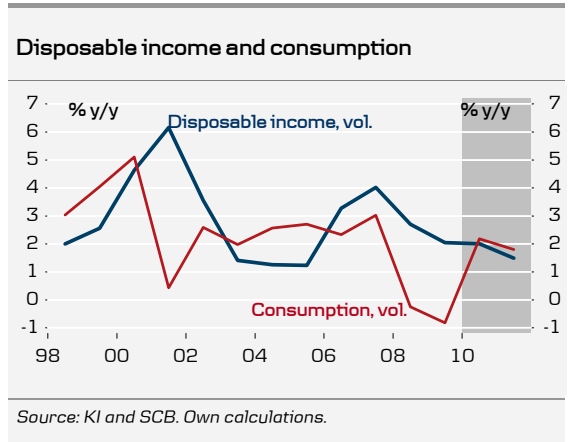
However, it is also important to notice that the increased interest rate sensitivity of Swedish households – due to increased leverage and the shorter duration of debt – will mean that once the Riksbank start hiking rates a larger part of disposable incomes will be subtracted. This is why we believe that household consumption should hold up well over the forecast horizon, but will probably not show the same vigorous response to the improving labour market as in previous upturns. All in all, Danske Bank expects consumption growth to increase by 2.1% y/y in 2010. In 2011, due to the Riksbank hiking rates, consumption growth slips back to 1.8% y/y despite ameliorating labour markets.

### Imports still strong, hence net exports less vigorous

The cutback in imports was indeed dramatic in 2008/09 and to some extent even outpaced the very weak developments in exports. Nevertheless, strong household consumption growth and an inventory cycle drawing to an end has meant that imports have kept up during the last few quarters, keeping the contribution from net exports to growth at bay. Nonetheless, when international demand eventually returns, the Swedish export industry will react and net exports are indeed expected to contribute positively over the forecast horizon. To sum up, we calculate with a negative contribution of 1.2pp to GDP-growth from net exports in 2010 and – once exports are on a sustainable upward trajectory again, slight positive contribution of circa 0.3pp in 2011.

### Dauntingly low resource utilisation will keep the Riksbank from hiking swiftly

We have now gone through all the main elements of the Swedish business cycle. And the impression of a severe but alleviating recession is lingering. Summing up the various GDP components only serves to confirm these impressions. In 2009 GDP posted a preliminary drop of some 4.7% y/y. In 2010, growth, thankfully, is expected to return. But only to a fraction (1.5% y/y) of what would be needed to increase resource utilisation more swiftly. In



2011 the Swedish economy is again, with growth at 2% y/y, taking more decisive steps toward a balanced resource utilisation.

Resource utilisation will by any standard be extremely low. According to our own calculations this admittedly abstract measure is calculated to a nadir of a shocking 7% – even worse than back in the days of Sweden’s own home-brewed financial crisis.

From a policymaking perspective, an output gap of that size is cause for concern, since it risks pushing wage and inflation expectations too low, maybe even to deflationary levels.

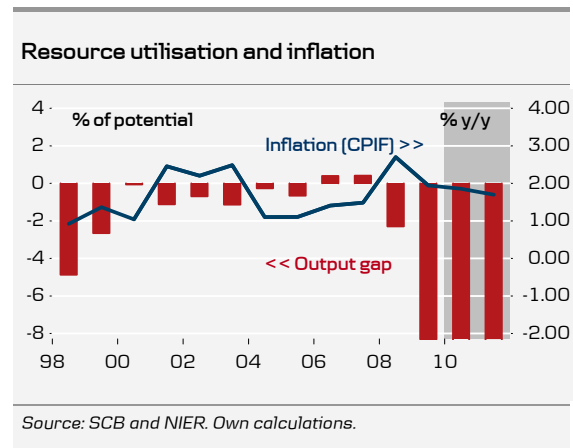
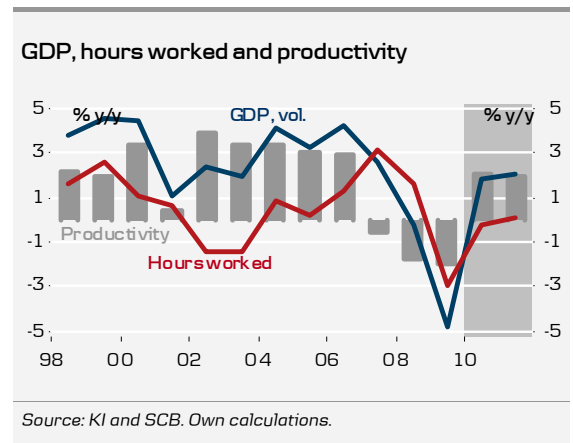
Productivity (output per hours worked) has been surprisingly weak for a very long period and we have continuously been too optimistic on this measure. This has also been the main reason for our simultaneous overestimating of the unemployment rate. However, over the past quarters, companies have begun to scale down not only production but also hours worked. But as mentioned above, it so far has not sufficed to balance the drop in demand, and has therefore resulted in a continued negative productivity growth. But a rise in productivity should be close, if nothing else because demand is expected to start posting positive consecutive growth rates in the near term. All in all, Danske Bank expects productivity to rise by about 2% y/y, in both 2010E and 2011E.

And a rise in productivity should be sorely missed by companies who saw their costs rise dramatically throughout 2008 and 2009. Unit labour costs (ULC), which adjusts for the wage earners share of productivity gains, rose above 6% y/y in both 2008 and 2009 diminishing the profit share in non-financial companies has diminished even more since financial companies (creditors) are demanding a noticeably larger share of corporate cash flows. Stationary, or even rising, costs together with a never before seen drop in corporate incomes will dramatically increase the pressures on companies and we suspect that arduous cost control measures will continue to be in place.

Against this background, with low demand, continuing high cost pressures, deteriorating profit shares, and a foreseen high unemployment rate, representatives from employers and trade unions have convened in wage negotiations for the period 2010 and a few years on. Suffice to say that the prospects for wage increases have seldom been as weak as they are now and with conflict measures already announced from the union side the centralised wage negotiation round risk becoming one of the most uneasy since the current set up was launched in the mid-1990s. However, when the dust settles we expect the centralised wage agreement will result in agreements somewhere between 1% and 1.5% y/y.

### The inflation and monetary policy outlook

We have never faced inflation prospects as multifaceted as we do now. To briefly touch upon upward risks: our global main scenario, where financial markets regain their vitality, could quite rapidly turn into one extreme with both growth and inflation taking off with a bang due, inter alia, to the tremendous economic-political stimuli that has been, and is being, implemented.



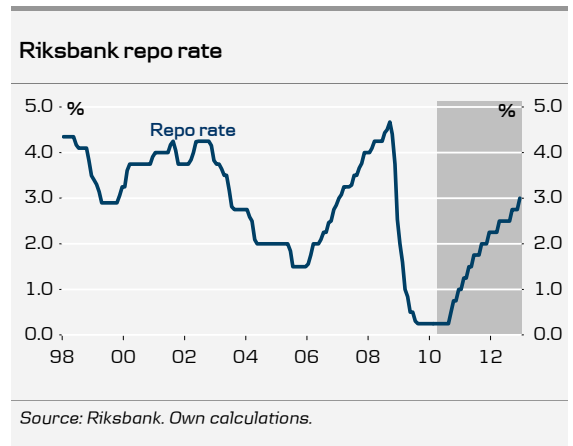
On the other extreme, there are of course downward risks that could most easily be described as a depression, a deflationary spiral combined with a dysfunctional financial sector unable to transfer any economic policy stimuli.

But, in our main scenario, risks remain rather contained, and credibility for economic policy continues to be high. Growth as well as inflation returns in the medium- to long-term, but in a more controlled fashion. Therefore, prices on internationally traded goods, and Swedish import prices gradually normalise. Domestic inflation and so-called ‘core inflation’ (CPI inflation minus food, energy and interest rates) are both derivatives of principally wage developments. And as stated above, wage pressures are expected to be low, but positive, for a number of years. Unfortunately, and despite rather benign developments of international demand, resource utilisation could be too low to generate any wage or inflation pressure for a long period of time. Core inflation measures are therefore expected to trend lower for the remainder of the forecast horizon. Hopefully, confidence for economic policy is sufficiently strong to keep expectations from following suit.

The Riksbank plans to move away from a crisis policy stance to a more normal monetary policy stance and hence hike rates in September and gradually onwards up to 4%. In addition, the three SEK100bn fixed rate repo facilities will mature in July, September and October, which can be expected to add to the upward pressures on interest rates and interest rate spreads.

This fits very well with our long-held view of the Riksbank hiking the repo rate in September and only gradually thereafter. In fact, given our view of inflation, labour markets, domestic growth and the household’s interest rate elasticity, our view differs from the Riksbank’s from 2011 onward, since we believe that hiking to around 3% will suffice to dampen any inflationary pressure.

Nonetheless, and with an increasing focus on economic fundamentals, the Swedish krona could very well continue to strengthen over the coming quarters. On a 12-month horizon we believe that the EUR/SEK strengthens to around 9.40, and we currently see no reason to why it should underperform the euro on an even longer perspective.



## Sweden: Forecast at a glance

	2008	2008	2009	2010	2011
	SEK bn		Vol growth in %		
Private consumption	1466.9	-0.2	-0.8	2.2	1.8
Government consumption	833.3	1.4	2.1	4.6	1.5
Fixed gross cap formation	614.5	2.6	-15.3	0.4	2.2
Stocks*	5.2	-0.6	-1.5	0.5	0.0
Domestic demand	2920.0	0.1	-4.7	3.2	1.8
Exports	1711.5	1.9	-12.5	3.5	4.4
Aggregate demand	4631.4	0.8	-7.6	3.3	2.7
Imports	1476.8	3.0	-13.4	6.8	4.2
Net exports*	234.7	-0.4	-0.5	-1.1	0.4
GDP	3154.6	-0.2	-4.9	1.8	2.0
- GDP, Calendar adjusted		-0.5	-4.7	1.5	2.0
* contribution to GDP growth					
		2008	2009	2010	2011
Trade balance, SEK bn		126.9	109.1	73.7	89.9
in % of GDP		4.0	3.6	2.3	2.8
Current Account, SEK bn		303.6	231.2	186.1	220.4
in % of GDP		9.6	7.6	5.9	6.8
Public sector savings, SEK bn		78.3	-38.2	-86.2	32.4
in % of GDP		2.5	-1.3	-2.8	1.0
Public debt ratio, % of GDP*		37.5	39.5	43.1	44.0
Unemployment, % of labour force		6.1	8.4	10.3	10.3
Hourly wages, % y/y		3.4	3.7	1.3	2.0
Consumer prices, % y/y		2.2	-0.3	1.4	2.4
* Maastricht definition					
		07.04.10	+ 3 mths	+ 6 mths	+ 12 mths
Repo-rate		0.25	0.25	0.50	1.25
2-yr swap yield		1.60	2.10	2.30	3.30
10-yr swap yield		3.30	3.60	3.90	4.40
SEK/EUR		967.0	960.0	950.0	940.0
SEK/USD		722.2	700.7	683.5	662.0

Source: Danske Markets

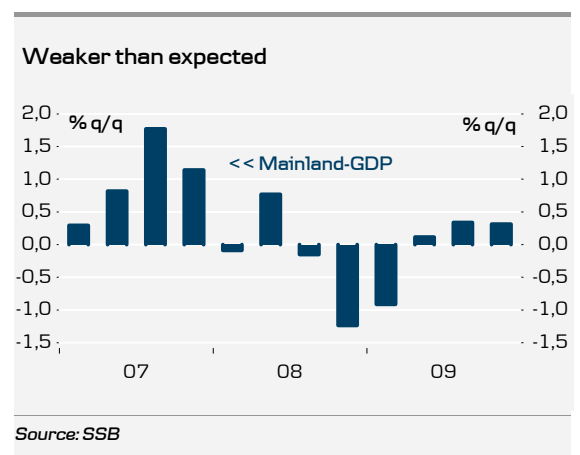
# Norway

## Weaker than expected

- Despite an extremely stimulative economic policy, developments in the Norwegian economy have been weaker than expected since our previous quarterly report. Low interest rates and low unemployment have meant a significant increase in household disposable income. However, a sharp increase in the savings rate has helped keep consumption growth at sensible levels.
- Developments in the industrial sector have been a particular disappointment. Stronger global growth and higher oil prices caused us to expect an upswing in industrial activity in Q1. A quite high level of activity to begin with could explain the delay – and we still believe that the order situation will improve as early as the current quarter.
- Unemployment looks set to be lower than forecast. This is due to productivity growth being lower than normal and the supply of labour slowing more than expected. This indicates that capacity utilisation in Norway is relatively high, which means economic policy makers will have limited room to manoeuvre in the next couple of years. Wage growth, on the other hand, looks set to be lower than forecast this year, and signals from the employee side suggest a pronounced willingness for moderation in order to save threatened jobs. This spring's wage adjustment will be modest but improved profitability will increase the risk of higher wage drift.
- Norges Bank revised down its interest rate projection by 0.3-0.6 percentage points in its March Monetary Policy Report. The downward revision was almost entirely due to NOK exchange rate considerations given the low interest rate expectations among Norway's neighbours. While we appreciate the good intentions, we are very sceptical about whether rates in Norway can be kept as low as in other Western countries.

The Norwegian economy has developed more weakly than we expected in our last quarterly report. We were particularly surprised by the weak contribution to growth from traditional exports. Given the strong global upswing, zero growth here seems something of a mystery, especially as the short-term indicators had seen decent gains.

Deep cuts in interest rates and low levels of unemployment have significantly boosted household incomes. However, high energy prices due to the cold weather have pushed inflation higher, which meant lower growth in real disposable incomes than expected. Furthermore, the savings rate rose to 10% in Q4, which has helped keep private consumption growth under control.



Given lower unemployment, higher asset prices and low interest rates, it is uncertain how long this trend in savings will last. In our opinion, the savings rate is close to peaking, and a decline could cause private consumption to pick up as the summer approaches.

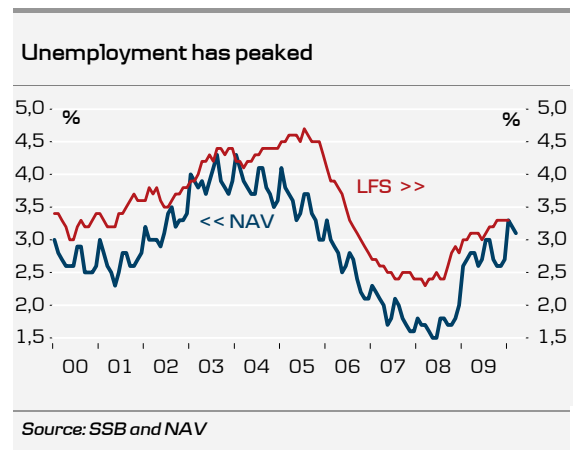
House prices continue to rise. Following the fall in construction costs, we are approaching the point where building new homes will be cheaper than the prices on the secondary market, especially if improvements in quality are taken into account. This suggests that construction in Norway is beginning to bottom out – something also visible in the order statistics for the construction sector, as orders for both housing and commercial property are now growing again.

Signs that the global economy is beginning to enter a phase of self-perpetuating growth have reduced the downside risk connected with the global economy. Together with the associated higher oil prices, this removes much of the downside risk for the Norwegian economy via the effect on oil investments. Activity levels have been high in recent years and this has affected both growth momentum and costs. Based on our forecast for oil consumption and production in the coming years, we are nevertheless in no doubt that the world will need more production capacity going forward, which will in turn generate higher activity throughout the supply industry in Norway.

Unemployment appears to have peaked. Indeed, the revised figures for NAV (Norwegian Labour and Welfare service) unemployment indicate that unemployment is beginning to fall. This reduces much of the downside risk for the housing market, private consumption and the market for commercial property – information from the commercial property market suggests that rents are bottoming out and are expected to increase going forward.

The trend of declining core inflation continues. A stronger NOK and slowing wage growth will help core inflation to keep falling well into 2010. Moreover, both the regular wage statistics and signals from the wage negotiations suggest that total wage growth will be somewhat lower than previously thought. On the other hand, productivity growth appears set to be lower than normal during an economic turnaround. Furthermore, the very cold weather during the winter has helped increase electricity prices sharply, meaning headline inflation is now rising steeply.

Norges Bank elected to keep interest rates unchanged at its March meeting. Moreover, the central bank's interest rate projection was revised down by 0.3-0.6 percentage points over the forecast period. The downward revision was entirely due to the stronger NOK and lower interest rate expectations in other countries than envisaged in the Monetary Policy Report from October. Put simply, Norges Bank wishes to avoid further NOK strengthening, both out of consideration for inflation and out of consideration for Norwegian industry, which is operating in a very competitive market.



While we very much applaud Norges Bank's intentions, we seriously doubt whether it can pull it off – particularly considering that the need for fiscal tightening is very limited compared to other countries.

After strengthening significantly during the autumn, the NOK exchange rate has been largely stable since October. Major fluctuations in international exchange rates have, however, meant large movements in NOK against individual currencies such as the US dollar, euro and GB pound. As mentioned, we believe rate spreads to other countries will increase more than the market currently expects, which would support a stronger NOK. On the other hand, a lower oil-corrected deficit (higher tax revenues and lower spending growth) and a higher net cash flow from the oil industry mean that Norges Bank will soon have to restart buying foreign currency on behalf of the Government Pension Fund (Petroleum Fund). This could pull in the opposite direction.

### Savings and inflation to slow growth

Mainland GDP grew 0.3% in Q4, after growing at the same rate in the previous quarter. Hence growth was considerably weaker than expected. Growth was pulled higher by private and public spending. Considerable fiscal leeway, low interest rates, declining inflation and strengthening housing and equity markets were the main reasons behind the economic expansion. In contrast, the growth impulses from traditional exports were much weaker than expected, while inventory investments fell more than forecast.

The latest national accounts numbers show, moreover, that household savings have increased more than expected over the past year. The savings rate is now 10%, which is higher than the historical average. Given the higher values of homes and equities and stable unemployment, the savings rate will very probably ease somewhat in the coming couple of years.

Thus much of the financial consolidation that was absolutely necessary in the household sector has already been completed. This is also reflected in debt levels, which have been falling continuously since the end of 2008 and are now at their lowest since Q1 2007.

After rising for 13 months in a row, house prices fell unexpectedly in February. However prices rose by 1% m/m in March, meaning house prices appear to be approximately unchanged in Q1. It is natural that price growth should ease somewhat after prices rose so strongly in 2009, especially as price levels were already high. We therefore do not expect that price growth will continue at the same pace as last year, but that prices in 2010 will, nevertheless, grow by around 10%.

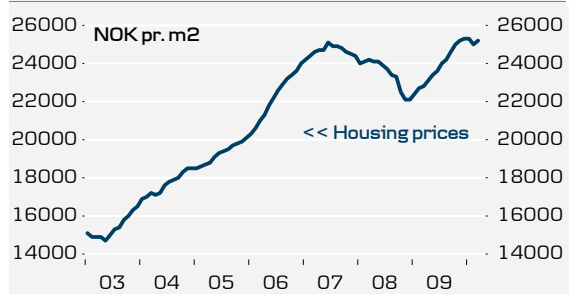
We can also see that the number of unsold homes has remained more or less stable while turnover has increased sharply. The stock of unsold homes relative to turnover is the lowest since summer 2007. Given that new housing starts remain modest, that interest rates will only rise gradually in 2010 and that unemployment is again peaking, there is reason to believe that house prices have a limited downside.

Savings rate to slow the pace of growth



Source: SSB

Housing prices all-time-high



Source: NEF

It is now being reported that construction costs have fallen sufficiently for new home prices to be lower than prices on the secondary market. New home orders rose steadily in 2009 to reach their highest level (in Q4) since the start of 2008 – and there are signs that this is now beginning to result in more new housing starts. Together with the renovation of public buildings and the major civil engineering investments linked to the crisis package from last February, we believe this will be sufficient for the construction industry to bottom out for now.

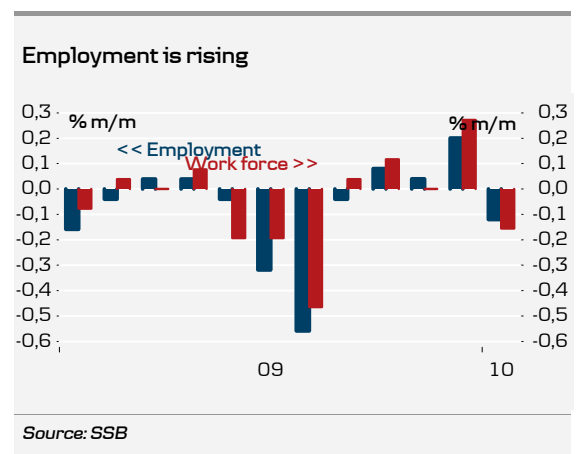
We have on several occasions emphasised that the greatest downside risk for the Norwegian economy is a potential fall in oil investments. Last summer saw the flow of orders for new ships and platforms dry up completely. Thanks to thick order books, production remained high, but the outlook was for a levelling off and downturn. Investment figures for the oil industry in February 2010 showed that oil companies now expect to invest less this year than last year. This has led to, for example, Norges Bank revising down its estimate for oil investment growth from zero to -4.5% – or the equivalent of around NOK6bn.

This trend can also be seen in Norges Bank’s regional network. However, after a sharp decline in the outlook for the oil supply industry in November 2009, the February numbers showed that the industry now has a slightly less gloomy view of the future. This trend was also visible in the PMI, which despite a slight recovery remains around 50, indicating largely unchanged activity levels in Norwegian industry. The Norwegian PMI is, moreover, strengthening much more slowly than equivalent indices in other countries, which can hardly be due to anything other than the oil supply industry’s significant share of Norwegian industrial activity.

We are rather uncertain about the reason for the weak development in oil investment. However, based on the estimates in this report, we are in no doubt that oil demand will exceed oil production going forward. Everything therefore indicates that global oil production will have to increase in one way or another, which should support a new upswing in large parts of the Norwegian oil supply industry. The signals we have seen in recent months have increased the likelihood of the global upswing becoming self-perpetuating, which would clearly reduce the downside risk for the Norwegian economy.

### Labour market stabilising

Unemployment appears to have peaked in Norway. The various labour market sources differ slightly – however, the general impression is that unemployment was increasing towards the end of last year but has been falling steadily in Q1. Employment appears to have been rising slowly since as far back as September, although the January numbers (December-February) showed a fall of 3000. The cold weather in February may have been the reason for this. The declining participation rate in the labour market among the oldest and youngest workers has to be viewed against the exceptionally good labour market in recent years that led to record-high participation rates. The just modest rise in unemployment is also due to much of the labour



needs in the shipbuilding and construction sectors being met by labour imported from abroad in recent years.

While the labour market will tighten more than expected, we believe that this will as such have less significance for wage growth than one might think. The quarterly wage statistics show somewhat weaker wage growth in 2009 than we had expected. This gave a lower wage overhang into 2010 than we had previously counted on. At the same time, the employee side appears to be signalling a pronounced willingness for moderation in connection with this spring's collective wage bargaining.

So far we have refrained from revising down our wage growth estimate of 3.7% for 2010, but as the employers' lobbyists advance their arguments of a cost-competition problem for Norwegian exporters, wage growth may end up being lower. Pulling in the other direction is a somewhat greater increase in profitability than expected.

### Interest rate hikes postponed

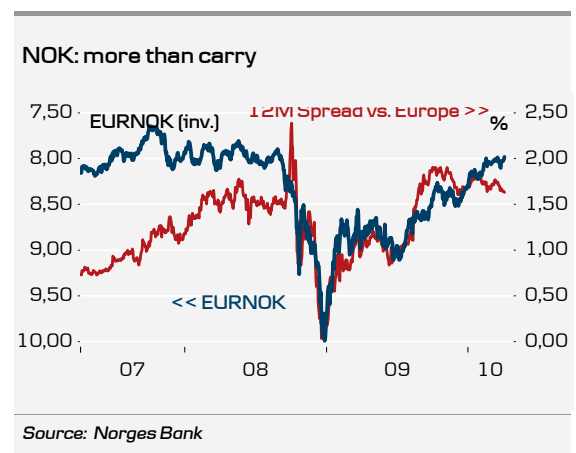
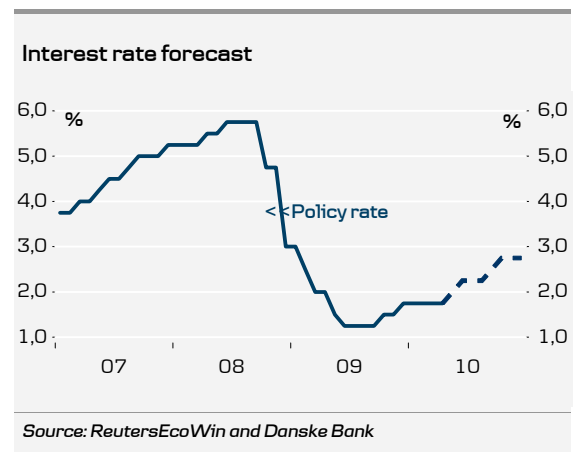
Norges Bank elected to keep interest rates unchanged at its March meeting. Moreover, the central bank's interest rate projection was revised down by 0.3-0.6 percentage points over the forecast period. The downward revision was entirely due to the stronger NOK and lower interest rate expectations in other countries than envisaged in the Monetary Policy Report from October. Put simply, Norges Bank wishes to avoid further NOK strengthening, both for the sake of inflation and for the sake of Norwegian industry, which is operating in a very competitive market.

While we very much applaud Norges Bank's intentions, we seriously doubt whether it can pull it off. The combination of floating mortgage interest rates and the swap facility for mortgages at the central bank has meant a far greater fall in mortgage rates in Norway than in other Western countries. As a result, house prices have appreciated by 10-15%, private consumption has increased by almost 4%, while the savings rate at the same time has already reached 10%. Given that unemployment appears to be peaking at less than 3.5% and that the impulses from global growth on traditional exports and the oil business will probably increase, keeping interest rates at the same level as other countries will be a huge challenge. Making the situation even more problematic is that the need for fiscal tightening is very limited in Norway compared with other countries.

### NOK: Bulk of firming over and done

The import-weighted NOK exchange rate (I-44) strengthened almost 14 % in 2009. Greater risk appetite, higher oil prices and widening yield spreads to other countries were the key drivers behind this. In addition, an estimated oil-corrected deficit of more than NOK150bn meant that Norges Bank has not sold NOK in the market since last August.

NOK is now back at a level that in our opinion better reflects fundamentals. We therefore are of the view that the potential for further strengthening is considerably more limited than was the case last year. Nevertheless, given



the increasingly solid outlook for a sustainable global upswing, conditions should be right for NOK to remain firm. Both risk appetite and commodity prices should support NOK, while the focus on government finances in many countries could make Norwegian securities look attractive. And finally, as mentioned, it would seem difficult for the rate spread to other countries to go any lower.

On the other hand, it appears that the oil-corrected deficit for 2010 could be lower than previously assumed, as tax revenues have been higher than expected and public spending has increased less than anticipated due to the downturn being less severe than the Finance Ministry had forecast. At the same time, higher oil prices and a stronger dollar mean that the net cash flow from the oil industry will probably be greater than originally reckoned. Overall, this suggests that Norges Bank will have to restart buying foreign currency on behalf of the Government Pension Fund in a few months' time. In itself, this would point to a weaker NOK, but we believe that on the contrary it could give Norges Bank the leeway to increase interest rates in order to dampen domestic economic growth.

## Norway: Forecast at a glance

Demand and output	2008	2007	2008	2009	2010	2011
	NOK bn (2006 prices)		Vol growth in %			
Private consumption	947.5	5.3	1.1	0.1	5.0	4.4
Public consumption	443.4	3.0	4.1	5.0	3.1	2.5
Gross fixed investment	477.6	12.4	1.3	-7.9	-0.5	0.0
Petroleum activities	132.2	4.3	2.7	4.2	-0.2	4.1
Mainland Norway	345.3	15.5	0.8	-12.1	-0.7	3.2
Dwellings	87.5	3.2	-12.3	-18.7	-3.1	5.9
Enterprises	187.7	17.0	-0.1	-15.7	-3.1	6.5
General government	70.2	9.7	4.6	2.5	7.5	-6.5
Mainland demand	1920.2	8.1	2.8	-3.4	4.7	3.7
Total domestic demand	1868.5	5.1	2.3	-2.9	4.4	4.4
Growth contribution from stockbuilding	51.7	-1.0	0.4	-1.8	1.0	0.0
Exports	1042.0	2.1	0.9	-4.2	2.3	1.4
Crude oil and natural gas	478.0	-2.7	-2.1	-1.3	-2.7	-4.3
Traditional goods	309.2	7.7	4.4	-7.8	9.6	7.2
Total demand	2962.2	4.0	1.8	-3.4	3.6	2.9
Imports	687.5	8.7	2.2	-9.6	5.6	7.3
Traditional goods	446.1	8.2	-0.5	-13.0	2.5	7.1
Growth contribution from net exports	354.5	-1.5	-0.3	1.0	-0.6	-1.5
GDP	2274.7	2.7	1.7	-1.4	3.1	1.7
GDP Mainland Norway	1719.9	5.4	2.0	-1.4	2.7	3.0
<b>Economic indicators</b>		2007	2008	2009	2010	2011
Employment, % y/y		4.1	3.1	-0.3	0.4	0.9
Labour force, % y/y		3.1	3.1	0.2	0.7	1.0
Unemployment (LFS), %		2.5	2.6	3.1	3.3	3.4
Annual wages, % y/y		5.6	5.8	4.0	3.7	4.0
Consumer prices, % y/y		0.8	3.8	2.2	2.5	1.9
Core inflation		1.4	2.6	2.6	1.8	2.0
<b>Financial figures</b>		7.4.10	3 mths.	6 mths.	2 mths.	
Deposit rate		1.25	2.00	2.25	3.25	
2y swap rate, %		2.76	4.05	4.50	5.30	
10y swap rate, %		4.61	4.85	5.00	5.30	
EUR/NOK		898	820	810	800	
USD/NOK		637	539	544	556	

Source: Danske Markets

# Finland

## Slow recovery in the bullpen

- **After an unprecedented 7.8% fall in GDP in 2009, we expect the economy to return to modest growth in 2010, as export markets have continued to recover and the outlook for domestic consumption has improved.**
- **GDP is forecast to rise 1.5% in 2010 and 2.5% in 2011. So far signs of a recovery are tentative, but GDP has been remarkably stable since the second half of 2009.**
- **The weak recovery will not create enough jobs and the unemployment rate is projected to reach 10% in 2010, before moderating in 2011. Inflation is set to rise from zero in 2009 to over 1% in 2010.**
- **The fiscal stimulus policy creates a wide budget deficit, but the trade balance should remain in surplus. Given the initially low level of state debt and the narrow spread compared with the German benchmark, Finland is expected to manage an orderly exit from its public deficit, although not in the forecast period 2010-11.**

### Exports returning to growth

Volume of goods and services exports was a staggering 24% lower in 2009 than a year ago. Exports of goods fell more than services, as all manufacturing industries suffered from weak global demand. Exports only accounted for 36% of GDP, while a year ago the ratio stood at a record-high 47%. Exports stopped falling during the third quarter compared to the second quarter, but signs of an actual recovery remain weak. The two-week long stevedore strike at harbours in March 2010 made a large but temporary dent in exports.

The economic outlook has improved in most of the important export markets for Finnish goods. Nevertheless, the structure of Finnish exports could cause a lagged recovery. Most export industries have reported an improving outlook for the first half of 2010, but a recovery in metal engineering and other investment goods requires an expansion of CAPEX in the export markets. Given faster bottoming out in other industries and services, we expect exports to grow 4% in 2010 and faster in 2011. Yet, given the depth of the fall it takes some years to reach the 2008 peak figures in exports.

Despite the huge fall in exports, Finland maintained a current account surplus in 2009. We forecast a EUR2-3bn surplus to persist in 2010-2011.

### Investment activity hibernates to 2011

Investments fell 13% during 2009 from a year earlier. Housing construction decreased by 12%; other construction and machinery & equipment shrunk 14%. The decline derives entirely from the private sector, because public investments have been reported to have increased 5% in 2009.

Supported by the government and rising apartment prices, housing construction has an improving outlook. Housing starts doubled from the last quarter of 2008 to the last quarter of 2009, implying noticeable growth figures also for 2010. Manufacturing has plenty of capacity and the office vacancy rate has increased in many service industries, spelling quiet times for construction of business premises. We expect a total decline of 4% in investments in 2010. CAPEX is forecast to rise again in 2011 on the back of the general recovery and pent-up investment plans.

### Confident consumer but anaemic income growth

After rising for 15 years, private consumption fell 2% in 2008, while real income rose 1% generating a rise in the savings rate. Purchases of durable goods plunged by 12%, especially car sales have stalled, but expenditure on services fell only 1%. Wage earners' regular income and pensions rose 4-5%, but total earnings fell due to lower employment, overtime and bonuses. Private consumption had stabilised by the end of the year and the outlook is improving. Consumer confidence rose to normal levels, which reflects the development in other Nordic countries and a more optimistic view than in most other EU countries.

Higher unemployment and the tough competition in export markets is leading to a slower rise in hourly earnings. Pensions hardly rose at the beginning of the year, because of partial inflation indexation. We expect higher oil prices and rising VAT to push inflation above 1% in 2010. Together with higher municipal taxes, the outlook of more stringent fiscal policy and still rising unemployment, we expect the rise in real disposable income to be close to zero. Despite the limited income growth, the remarkable recovery in consumer confidence leads us to forecast a modest increase in consumer expenditure. Public spending has risen moderately in 2009, but especially tight budgets in municipalities are likely to stem growth in public spending in 2010. The debate about exit from large budget deficits points to tax increases and spending cuts in 2011 also in the central government.

### Jobless recovery until 2011

GDP volume fell nearly 8% in Finland in 2009, making the recession deeper than in any other euro area country. The shock is almost fully external from exports, while in many other countries excesses in banking and construction contributed to the crisis. Low interest rates and buffers both in private and public sector have helped to cushion the impact on the general feeling of security and welfare. Output fell sharply during the first half of 2009, but third quarter GDP was marginally higher already. Output has declined in all industries except agriculture. Leading indicators both in consumer and industrial surveys point to recovery during the first half of 2010. Given limited scope for domestic demand and exit from fiscal stimulus, the recovery is likely to be export-led. We forecast a 1.5% rise in output in 2010 and 2.5% in 2011.

Employment was 2.9% or 74,000 persons lower in 2009 than a year ago. While the number of employed has shrunk in all industries, manufacturing

jobs were hardest hit by a fall of 9%. The fall is less than our and consensus expectation earlier in 2009. Temporary lay-offs, reduced overtime and labour hoarding have all helped to limit the rise in official unemployment figures. All hours worked dropped 6%, which is more in line with the fall in GDP. At the same time, supply of labour was reduced only by 1% forcing a rise in unemployment. The unemployment rate rose by nearly 2 percentage points to 8.2% in 2009, which is 221,000 unemployed persons.

Given a slow recovery and a decline in weekly hours, a significant number of new jobs are likely to be created only when the recovery gains speed and retirement of large generations continues in 2011. We expect the full-year average unemployment rate to reach 10% in 2010 before falling in 2011. Without immigration, the Finnish workforce is starting to decline due to demographic factors. The decline limits future growth speed of potential output to roughly 2%.

### Modest rise in inflation not a major problem

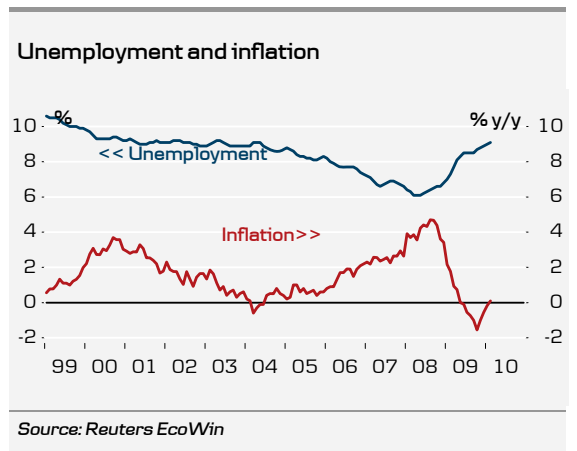
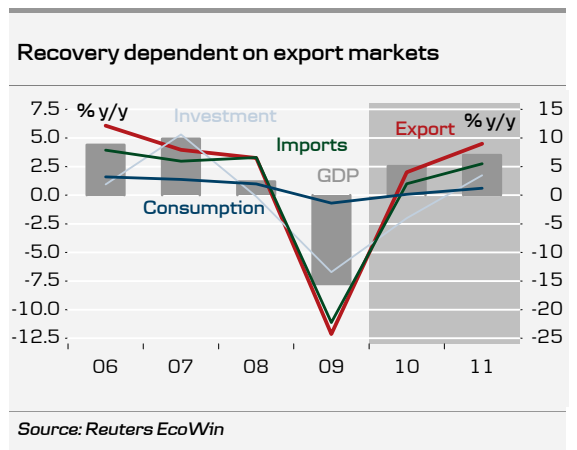
Inflation fell to negative territory temporarily in 2009, but as an annual average there was no change from a year earlier. Consumer prices have started to rise again and the national CPI inflation rose back to positive territory in February 2010, mainly on the back of housing, oil and other raw materials. We expect full-year average inflation to be 1.4% in 2010 and to rise to about 2% in 2011. The VAT increase from 22 to 23% in late 2010 will shift the price level upwards. Low cost pressure from the labour market and excess capacity in some industries imply low cost inflation pressure up to 2011, but raw material prices can create larger changes.

Employee earnings rose 3.9% in 2009, while the carryover from 2010 shrank towards the end of the year. State salaries rose more than average, 5.8%, fuelled by previous labour agreements. We expect the earnings growth to fall towards 2% in 2010 and 2011. New wage agreements have been more moderate and the current outlook does not favour pay rises much over productivity.

Apartment prices fell marginally in the first quarter of 2009, but lower interest rates and improving consumer confidence surprisingly turned the market and prices regained the fall by third quarter. In the fourth quarter, apartment prices were 8% higher than a year ago. Trade volumes have continued to rise, but limited supply is creating a bottleneck and pushing prices higher. Prices might still rise marginally, before new construction adds to supply at the end of 2010 and the expected rise in interest rates cools demand. Overall, we expect fairly stable prices in 2010-2011.

### Talk about exit

General government balance fell to a deficit for the first time in 12 years in 2009. The central government deficit was over EUR8bn and the local government deficit was almost EUR1bn. Social security funds' surplus exceeded EUR5bn, reducing the general government deficit to EUR3.7bn or 2.2% of GDP. Our forecast produces a deficit in excess of 3% both in 2010 and in 2011. State debt was EUR65bn and the total public debt EUR75bn at year-



end, which was 44% of GDP. We expect the public debt-GDP ratio to rise to over 50% in 2011. Despite the rise, Finland remains one of the least indebted countries in the euro area. The public sector still faces falling tax income and rising unemployment costs. Especially the municipal sector is facing tight fiscal conditions. Soon after the recession ends, taxation is likely to be raised in order to close the deficit and keep the pension systems adequately funded. Despite the very large fall in GDP and weak growth outlook, the government already talks about exit and plans to build new buffers against future shocks. Parliamentary elections in 2011 are unlikely to change the drive towards fiscal sustainability.

## Finland: Forecast at a glance

National accounts	2007	2008	2009	2010	2011
GDP	4.9	1.2	-7.8	1.5	2.5
Imports	6.0	6.6	-22.3	2.0	5.5
Exports	7.9	6.5	-24.3	4.0	9.0
Consumption	2.7	2.0	-1.3	0.1	1.2
- Private	3.4	1.7	-2.1	0.2	1.5
- Public	1.1	2.7	0.7	0.0	0.5
Investments	10.6	-0.2	-13.4	-4.0	3.5

Other indicators	2007	2008	2009	2010	2011
Unemployment rate, %	6.9	6.4	8.2	10.0	9.2
Earnings, %	3.4	5.5	4.0	2.6	2.5
Inflation, %	2.5	4.1	0.0	1.4	2.0
Current account, Bn euro	7.6	5.6	2.4	2.5	4.0
Current account / GDP, %	4.2	3.0	1.4	1.4	2.2
Public deficit / GDP, %	5.2	4.2	-2.2	-3.8	-3.3
Public debt / GDP, %	35.2	34.2	44.0	49.0	52.0

Financial figures	07.04.10	+3 month	+6 month	+12 month
Repo rate, %	1.00	1.00	1.00	1.25
2 year sw ap rate	1.48	1.75	1.95	2.30
10 year sw ap rate	3.28	3.50	3.70	3.90
EUR/USD	133	137	139	142

Source: Danske Markets

# Global

## Strong lift-off but gravity still heavy

- 2010 will be the moment of truth for the global economy: it will become apparent whether the recovery is sustainable or whether a double-dip scenario will materialise. Since 2010 is effectively a ‘make or break’ year, the markets are expected to be more volatile than in 2009.
- We continue to be cautiously optimistic and expect a road of sustained recovery. It will, however, be moderate by historical standards. Global growth momentum is likely to peak in Q1 as strong cyclical tailwinds from stimuli and inventories taper off.
- We leave our growth forecasts for the US and Asia broadly unchanged. We have revised down our projections for Euroland slightly in 2010 based on the growth disappointment in late 2009. Our projections are still slightly above consensus in all regions.
- Key for sustainability will be a return of US job growth. We expect the strong US economic growth in the second half of 2009 to translate into decent gains in employment of around 200-250k per month. This should lead to sustained growth in US final demand of 2.5-3.0% in the coming years.
- We expect the Euroland recovery to continue in 2010 mainly driven by exports. The Asian upswing is one step ahead and we already see strong growth in final demand. Focus is changing to policy tightening to avoid inflation and bubbles in asset markets.
- Monetary exit strategies in the US and Euroland are likely to be slow as inflation is not yet an issue and the recovery is moderate. We look for a first hike from the Fed in November while the ECB is expected to hike in early 2011. In China we expect a resumption of the gradual CNY appreciation in Q2.

### Recovery broadly on track

The global recovery has continued broadly on track over the past three to six months. The US delivered a positive surprise in Q4 with growth close to 6% q/q annualised and growth in H2 09 has been in line with our expectations of 4.0-4.5% growth. Although the inventory cycle has provided some of the boost, it is encouraging that final demand has also picked up (see chart). In particular, investment in equipment and software grew strongly in Q4.

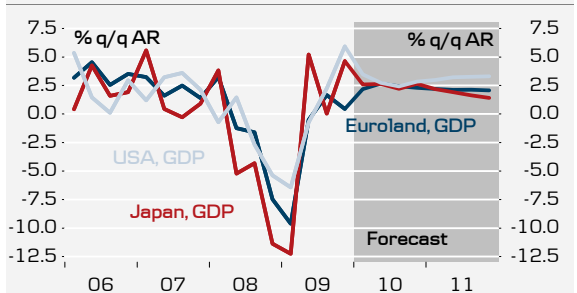
While the US recovery is on track, Euroland disappointed in late 2009. GDP only grew 0.5% annualised in Q4. In particular Germany posted a negative surprise with GDP stagnating in late 2009. However, factory orders for January suggest that activity has picked up again in early 2010. This is also signalled by continued increases in the German ifo expectations index and PMI new orders which tend to give good signals on Euroland growth.

### Growth forecasts: Still slightly above consensus

% y/y	2010				2011			
	Danske Bank	Consensus	IMF	OECD	Danske Bank	Consensus	IMF	OECD
USA	3.2	3.0	2.7	2.5	3.0	3.0	2.4	3.0
Euroland	1.8	1.2	1.0	1.2	2.2	1.5	1.6	2.0
Japan	2.7	1.8	1.7	1.4	2.1	1.8	2.2	2.2
China	9.5	9.6	10.0	10.2	9.5	8.9	9.7	9.3
Global	4.2		3.9		4.4		4.3	
Asia (ex Japan and China)	6.6				6.1			
CEE and CIS	0.8				3.5			
<i>Change from previous fcst</i>								
USA	0.0				0.0			
Euroland	-0.4				+0.1			
Japan	-0.2				-0.2			
China	-0.1				+0.3			

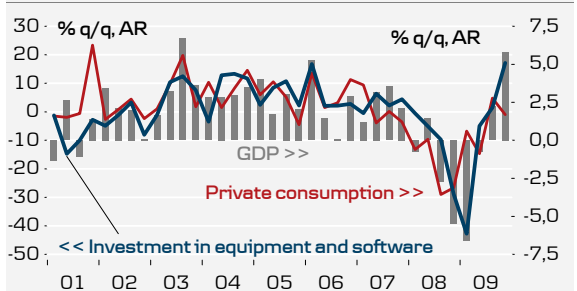
Source: Danske Markets, Bloomberg, OECD, IMF

### G3 growth profiles



Source: Reuters Ecowin and Danske Markets

### US final demand picking up



Source: Reuters Ecowin and Danske Markets

In Asia, economic data have continued at a strong pace into 2010. Asia continues to be ahead in the cycle and has already reached the phase of self-sustained recovery with declines in unemployment rates throughout the region. Exports are performing again and private domestic demand has also picked up nicely.

### The next phase is critical

While the global recovery has been broadly on track so far, it is too soon to break open the champagne. The next six months will prove critical for the global economy as the baton in the Western economies has to be delivered from massive stimulus and inventory correction to job growth and sustained recovery in final demand.

In *Global Scenarios* in December, we compared the global recovery to a space ship. In order to fight gravity and get lift-off, we need a massive amount of fuel. At some point though, the fuel will taper off, and the rocket should by then have escaped gravity in order to continue the path upwards. If not, it will crash.

We are now at the stage in the global economy where the fuel will taper off. It will therefore become increasingly obvious whether the global economy will manage to escape the gravity pull. The task is quite big since gravity is particularly strong this time due to the damage to the banking sector, high debt levels and massive wealth losses that are still lingering.

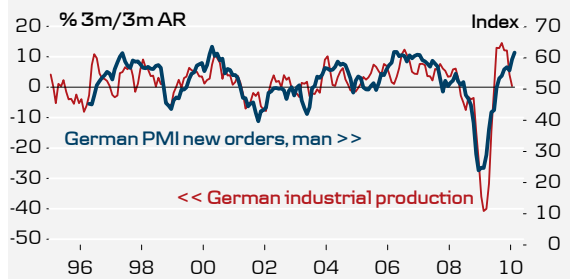
Another reason why this phase is so critical is that we do not have much fuel left to use should it be needed again if the economy falters. Fiscal policy is more or less maxed out everywhere and there is also a limit as to how much more can be done through monetary policy – although more money can be printed. Indeed, 2010 is likely to prove to be a ‘make or break’ year.

### Encouraging signs of real lift-off...

Fortunately, we see increasing signs that labour markets are improving globally which is the main precondition for a real lift-off. Unemployment rates have either fallen or stabilised in most Western economies and in Asia unemployment is already on a clear downward path. A short-term model for US non-farm payrolls suggests decent job gains over the next three to six months and our expectation is monthly job growth of around 200-250k over this horizon.

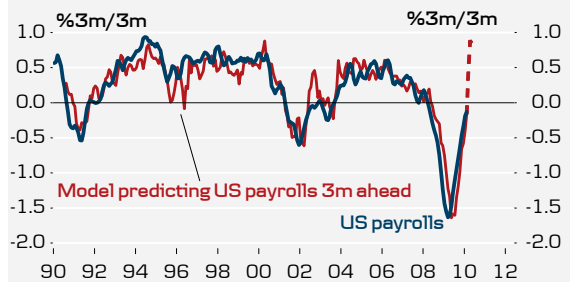
All evidence suggests that once unemployment starts to go down it normally continues to decline for a considerable period: it becomes a sustainable recovery that feeds on itself. The process works through a variety of channels. First, employment gains increase disposable income growth for households and support consumption growth. Second, the decline in unemployment gives rise to higher job security and therefore reduces the need for precautionary savings. Third, the improvement in consumer demand triggers companies to scale up investment plans as the uncertainty over demand fades and focus shifts from crisis management to strategic management. Finally, as this is a

Mixed signals in Germany: Hard data weaker while soft data point to strengthening recovery



Source: Reuters Ecowin and Danske Markets

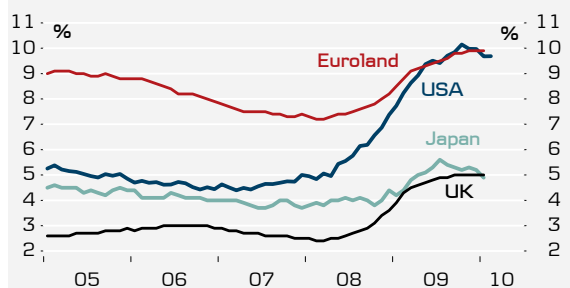
Strong signs of US job recovery coming soon



Source: Reuters Ecowin and Danske Markets

Note: US payrolls is modelled on temporary help workers, weekly jobless claims, hours worked, ISM new orders, NFIB small bus. Optimism and “jobs plentiful minus jobs hard to get”

Looks like global unemployment is peaking earlier than expected



Source: Reuters Ecowin and Danske Markets

process taking place in most of the world economy, it will improve external demand as well and give a lift to export growth and world trade will benefit.

It is still too early to conclude that we have entered this positive spiral. The global economy is still fragile during this transition phase and in the past we have seen double-dip recoveries because new shocks have hit the economy during this critical period when sentiment is vulnerable. It is therefore important that we don't get hit by new shocks over the next 6-12 months. By definition, shocks are difficult to forecast but there are a number of candidates to watch out for: an acceleration of the public debt crisis, renewed significant bank losses damaging market confidence, a spike in oil prices or a rise in protectionism.

### ... but going from acceleration to cruising speed creates jitters in the markets

Although growth is probably becoming more sustainable, we expect the global economy to lose some speed after reaching a growth peak in the first half of 2010. The global economy currently has maximum fuel from stimulus and the inventory cycle and this effect is about to taper off. We already see signs of the growth peak in some leading indicators. For example, global PMI new orders fell in January and momentum in OECD's leading indicator has been on a downward path for some months now.

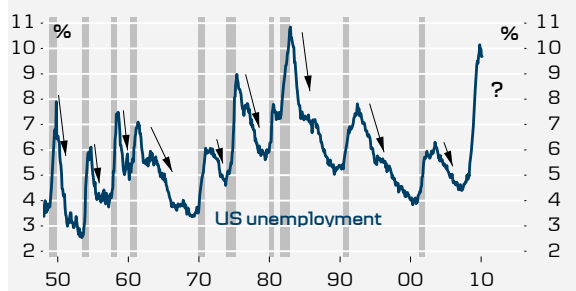
The transition from acceleration to cruising speed is likely to create more (realised) volatility in financial markets in 2010. Indeed, we have already witnessed this in early 2010 where equity markets saw the biggest correction since early 2009 when equity markets bottomed. Markets will be caught between (a) slowing speed which tends to spur fears that growth will slow too much and cause a double-dip scenario, and (b) rising signs of sustainability from improving labour markets which should work as comfort that a double-dip scenario will not materialise. At the same time, expectations for earnings growth are quite high, leaving scope for disappointments.

### A moderate recovery with strong regional differences

Seen in a historical context, the recovery in the western world is expected to be quite moderate (see chart on the US). There are several reasons for this. First, there will be a need for significant tightening of fiscal policy already in 2011 and 2012 as countries need to reduce unsustainably high budget deficits. Plans for this have already been outlined. Second, considerable financial regulation is expected, which will dampen banks' ability to increase lending. Finally, private consumption growth in the western world will probably be more moderate as high unemployment rates put downward pressure on wage gains and there may be further need to repair household balance sheets.

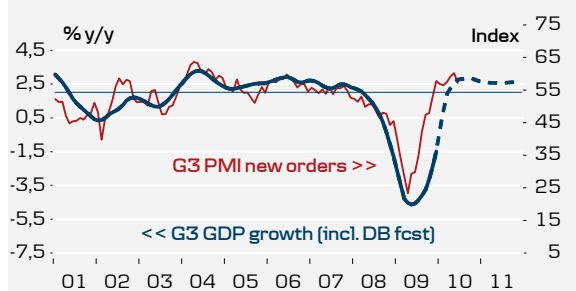
On the other hand, the Asian recovery has already proven quite strong and a recovery in final demand is starting to take hold. In particular China and India have proven very strong and this has significant positive spill-over to the whole region. The Asian recovery also has significant positive effects on commodity exporters such as Russia and Latin America. Asia has proven to

When unemployment starts falling it normally continues for a longer period



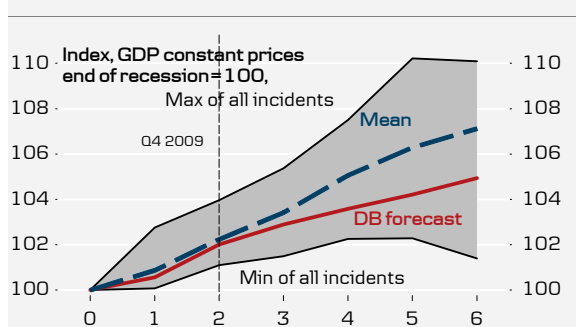
Source: Reuters Ecowin and Danske Markets

Global growth close to a peak but expected to stay above trend growth



Source: Reuters Ecowin and Danske Markets

A moderate US recovery in a historical context



Source: Reuters Ecowin and Danske Markets

be a considerable stabilising force in the global economy, providing an important engine of demand for other regions including the Western countries.

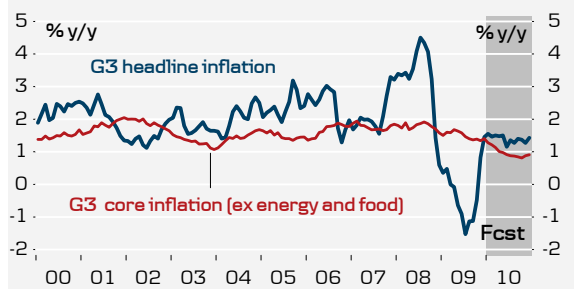
### Monetary exit will be slow

Although the global economy is recovering, central banks are likely to move slowly in their exit strategies. Inflation is expected to stay at moderate levels in the Western economies as wage pressures are low and pricing power poor. In the US, unemployment has risen to very high levels and there will be plenty of slack in the economy for a long time. Non-standard measures will be scaled out gradually during 2010 but we don't expect the Fed to hike before late 2010 (see *Research US: A roadmap for the Fed's exit*).

In Euroland, the jitters around fiscal sustainability have postponed the ECB's exit and we do not foresee the first hike until early 2011 (see *Flash Comment Euroland: ECB will not hike before early 2011*).

In Asia the situation is a bit different. Here focus has shifted rapidly to fighting inflation and new bubbles and some tightening has already started in China. In Q2 we expect most Asian central banks to raise their leading interest rates and China is expected to resume its gradual appreciation of the CNY versus the USD.

### Inflation to stay at moderate levels



Source: Reuters Ecowin and Danske Markets

### Road map for sustainability

Our expectations for key drivers to judge sustainability:

- 1. Labour market:** US payrolls to show job gains of 200-250k in mid 2010. Unemployment to decline in most economies during Q2.
- 2. Confidence:** Business confidence should stay high and moderate only slightly during spring/summer. Consumer confidence to climb gradually.
- 3. Oil prices:** Should rise only slowly. If it spikes higher on rising demand, we could face new downturn.
- 4. Fiscal sustainability:** Although fiscal issues will probably stay high on the agenda, an escalation of the confidence crisis involving the US and the UK should be avoided.
- 5. Equity markets:** Should hang on to gains although no strong performance is expected. If sentiment falters and equities drop strongly, we could see hit to confidence affecting consumption and investment.
- 6. Asian growth:** Should continue at robust pace as it is important demand engine for the world economy - not least Euroland and commodity exporters

## Macroeconomic forecast

## Macro forecast, Scandinavia

	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Stock build. <sup>2</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Unem-ploym. <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
Denmark	2009	-4.9	-4.6	2.5	-12.0	-1.7	-10.3	-13.2	1.3	3.5	-2.8	38.8	4.0
	2010	1.8	2.7	1.2	-2.3	0.8	2.7	2.6	2.0	4.6	-5.6	42.0	3.2
	2011	1.9	2.5	0.5	1.3	0.2	3.5	3.5	1.8	5.0	-4.5	46.5	2.5
Sweden	2009	-4.9	-0.8	2.1	-15.3	-1.5	-12.5	-13.4	-0.3	8.4	-1.3	39.5	7.6
	2010	1.8	2.2	4.6	0.4	0.5	3.5	6.8	1.4	10.3	-2.8	43.1	5.9
	2011	2.0	1.8	1.5	2.2	0.0	4.4	4.2	2.4	10.3	1.0	44.0	6.8
Norway	2009	-1.4	0.1	5.0	-7.9	-1.8	-4.2	-9.6	2.2	3.1	8.0	26.0	19.0
	2010	3.1	5.0	3.1	-0.5	1.0	2.3	5.6	2.5	3.3	12.0	26.0	24.9
	2011	1.7	4.4	2.5	0.0	0.0	1.4	7.3	1.9	3.4	10.0	-	17.0

## Macro forecast, Euroland

	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Stock build. <sup>2</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Unem-ploym. <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
Euroland	2009	-3.9	-0.6	2.2	-10.9	-0.7	-13.0	-11.7	0.3	9.6	-7.0	79.8	-0.7
	2010	1.8	0.3	1.7	-0.1	0.5	6.8	4.9	1.0	9.8	-7.2	83.7	-0.4
	2011	2.2	1.5	1.6	4.7	0.1	5.3	5.4	1.5	9.5	-6.1	87.4	-0.6
Germany	2009	-5.0	0.5	2.5	-12.3	0.4	-14.5	-8.5	0.2	7.5	-3.5	73.0	4.0
	2010	2.8	0.7	1.7	5.7	0.1	8.9	7.5	1.0	8.1	-5.0	76.5	3.7
	2011	2.3	2.1	1.4	5.5	0.0	6.4	7.4	1.2	7.6	-3.0	79.0	3.2
France	2009	-2.4	0.6	1.6	-7.0	-1.6	-10.7	-9.8	0.1	9.4	-8.3	78.0	-2.3
	2010	2.0	0.8	1.7	1.5	0.5	7.5	5.5	1.2	10.0	-8.5	82.0	-2.5
	2011	1.8	1.2	1.0	3.5	0.3	6.2	6.2	1.5	9.7	-7.0	87.0	-2.2
Italy	2009	-4.8	-1.6	1.6	-13.1	-0.3	-19.2	-15.2	0.7	7.8	-5.3	114.6	-2.2
	2010	1.5	0.9	1.3	0.1	0.2	8.0	6.0	1.9	8.6	-5.0	116.0	-2.0
	2011	2.2	1.0	1.0	5.2	0.1	8.4	7.2	2.0	8.3	-4.5	117.5	-1.7
Spain	2009	-3.7	-5.1	5.0	-15.5	0.0	-12.0	-18.2	-0.3	18.1	-11.2	54.3	-5.2
	2010	-0.9	-0.5	1.8	-5.6	0.0	7.2	4.6	0.9	20.1	-10.0	66.0	-4.1
	2011	0.9	0.7	0.2	0.2	0.0	6.1	4.1	1.9	19.8	-8.5	73.0	-3.2
Finland	2009	-7.8	-2.1	0.7	-13.4	0.0	-24.3	-22.3	0.0	8.2	-2.2	44.0	1.4
	2010	1.5	0.2	0.0	-4.0	0.0	4.0	2.0	1.4	10.0	-3.8	49.0	1.4
	2011	2.5	1.5	0.5	3.5	0.0	9.0	5.5	2.0	9.2	-3.3	52.0	2.2

## Macro forecast, Global

	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Stock build. <sup>2</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Unem-ploym. <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
USA	2009	-2.4	-0.6	1.9	-18.3	-0.6	-9.6	-13.9	-0.3	9.3	-9.9	83.8	-3.0
	2010	3.2	2.1	1.5	3.1	0.9	13.6	10.1	2.0	9.5	-10.6	93.2	-3.4
	2011	3.0	2.4	0.2	7.9	0.0	8.6	5.7	1.7	8.7	-8.3	98.3	-3.2
Japan	2009	-5.2	-1.1	1.6	-19.3	-0.3	-24.2	-17.1	-1.3	5.2	-9.8	212.0	1.9
	2010	2.7	1.9	1.3	1.3	-0.1	18.7	1.1	-0.7	4.8	-8.0	220.0	2.0
	2011	2.1	1.6	1.0	5.3	0.0	5.1	4.7	0.3	-	-	-	2.5
UK	2009	-4.9	-3.0	2.8	-16.2	0.0	-10.6	-13.3	2.2	7.5	-8.6	68.6	-2.6
	2010	1.3	0.2	3.0	-5.2	0.0	4.4	0.9	2.5	8.1	-11.5	80.3	-2.4
	2011	2.1	2.0	2.2	2.6	0.0	6.9	5.0	1.7	7.9	-8.7	88.2	-2.0
Switzer-land	2009	-1.4	1.3	2.1	-1.5	1.3	-10.9	-6.4	-0.5	3.7	-0.7	39.3	8.7
	2010	1.6	1.2	1.4	1.5	-1.0	5.2	2.9	0.5	4.8	-2.4	41.9	10.2
	2011	1.7	1.4	0.7	1.0	0.1	4.1	3.7	0.9	4.6	-2.9	41.0	10.9

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

Financial forecast

Bond and money markets								
		Key int. rate	3m interest rate	2-yr swap yield	10-yr swap yield	Currency vs EUR	Currency vs USD	Currency vs DKK
USD	07-Apr	0.13	0.30	1.25	3.94	133.5	-	557.5
	+3m	0.13	0.25	1.40	3.95	137	-	543
	+6m	0.13	0.50	1.70	4.15	139	-	536
	+12m	1.00	1.15	2.20	4.25	142	-	525
EUR	07-Apr	1.00	0.64	1.48	3.28	-	133.5	744.3
	+3m	1.00	0.75	1.75	3.50	-	137	744.0
	+6m	1.00	1.20	1.95	3.70	-	139	745.0
	+12m	1.25	1.55	2.30	3.90	-	142	746.0
JPY	07-Apr	0.10	0.24	0.48	1.46	125.2	93.8	5.95
	+3m	0.10	0.30	0.45	1.45	128	92	5.81
	+6m	0.10	0.30	0.65	1.65	135	97	5.52
	+12m	0.10	0.30	1.00	1.90	145	102	5.14
GBP	07-Apr	0.50	0.65	1.60	3.87	87.9	152.0	847.3
	+3m	0.50	0.65	1.80	3.95	92.0	149	809
	+6m	0.50	0.75	2.00	4.15	85.0	164	876
	+12m	1.00	1.50	2.40	4.60	82.0	173	910
CHF	07-Apr	0.25	0.25	0.86	2.38	143.2	107.3	519.8
	+3m	0.25	0.25	0.85	2.50	144	105	517
	+6m	0.25	0.25	1.10	2.65	142	102	525
	+12m	0.75	0.75	1.55	2.90	146	103	511
DKK	07-Apr	1.05	1.30	1.97	3.56	744.3	557.5	-
	+3m	1.05	1.40	2.50	3.80	744	543	-
	+6m	1.05	1.65	2.55	3.95	745	536	-
	+12m	1.30	1.90	2.75	4.05	746	525	-
SEK	07-Apr	0.25	0.50	1.62	3.31	968.7	725.7	76.8
	+3m	0.25	0.50	2.10	3.60	960	701	77.5
	+6m	0.50	0.75	2.30	3.90	950	683	78.4
	+12m	1.25	1.50	3.30	4.40	940	662	79.4
NOK	07-Apr	1.75	2.33	3.20	4.44	797.2	597.2	93.4
	+3m	2.00	2.60	3.95	4.75	790	577	94.2
	+6m	2.50	3.15	4.40	4.90	780	561	95.5
	+12m	3.50	4.15	5.20	5.20	780	549	95.6
PLN	07-Apr	3.50	3.93	4.60	5.44	383.4	287.2	194.2
	+3m	3.50	4.10	5.00	5.85	380	277	196
	+6m	3.50	4.10	5.20	6.10	385	277	194
	+12m	3.75	4.10	5.80	6.35	395	278	189

Equity markets				
Regional	Risk	Price trend 3 mth.	Price trend 12 mth.	Regional recommendations
USA	Low	-5% to +5%	0% to +10%	Underweight
Japan	High	-5% to +5%	0% to +10%	Neutral
Emerging markets (USD)	High	-5% to +5%	0% to +10%	Overweight
Pan-Europe (EUR)	Low	-5% to +5%	0% to +10%	Neutral
Nordics				
Sweden	Average	-5% to +5%	0% to +10%	Neutral
Norway	High	-5% to +5%	0% to +10%	Neutral
Denmark	High	-5% to +5%	0% to +10%	Neutral

Commodities											
	07-Apr	2010				2011				Average	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2010	2011
NYMEX WTI	87	80	80	82	84	85	86	87	88	82	87
ICE Brent	86	79	79	81	83	84	85	86	87	81	86
Aluminium	2,355	2,200	2,200	2,300	2,200	2,300	2,350	2,400	2,450	2,225	2,375
Copper	7,972	7,400	7,500	7,700	7,900	8,100	8,200	8,300	8,400	7,625	8,250
Zinc	2,428	2,300	2,300	2,350	2,400	2,450	2,500	2,550	2,550	2,338	2,513
Nickel/1000	25	19	20	20	21	21	22	22	23	20	22
Lead	2,305	2,350	2,350	2,400	2,450	2,500	2,550	2,600	2,650	2,388	2,575
Gold	1,142	1,100	1,050	1,000	950	900	900	900	900	1,025	900
Matif Mill Wheat	127	123	119	119	118	119	119	120	120	120	120
CBOT Wheat	474	500	490	495	500	505	505	510	510	496	508
CBOT Corn	345	375	400	425	450	475	480	490	500	413	486
CBOT Soybeans	943	960	975	1,000	1,010	1,020	1,030	1,040	1,050	986	1,035

Source: Danske Markets

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### **First date of publication**

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