

December 2009

Nordic Outlook

Economic and financial trends

- Denmark: Fragile and jobless recovery
 - The Danish economy is working its way out of the worst crisis in recent history, but this looks to be a slow and fragile process
- Sweden: Behold the success of stabilisation policies
 - The Swedish economy is set for positive GDP growth, driven by fiscal stimuli and exceptionally loose monetary policies
- Norway: Step-by-step in the right direction
 - Norway's economy has climbed out of recession as low interest rates, expansionary fiscal policies and still high oil investment have helped counter the effects of the global crisis
- Finland: Stabilisation before weak recovery
 - Modest recovery taking off in Q4 09, but full-year GDP is likely to be more than 7% down from 2008

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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

Fragile and jobless recovery

- The Danish economy is working its way out of the worst crisis in recent history. However, it looks to be a slow and fragile process, with GDP growth expected at 1.7% in 2010.
- Although it is a good thing that GDP growth is no longer negative, growth of 1.7% is unimpressive, given the depth of this crisis and compared with previous recoveries. Indeed, Denmark is on course for its slowest recovery since 1970.
- Therefore, the recovery will initially be jobless. Although we saw positive growth in Q3 09 and also expect GDP to grow in Q4 09, the number of unemployed is likely to continue to increase until early 2011, peaking at around 160,000.
- The housing market has surprised on the upside and the very low level of interest rates has no doubt contributed greatly to stabilising it. Given the outlook for continued low interest rates and generally good income growth, we believe housing prices are about to bottom.

Weakest recovery in recent times

There is much to suggest that the Danish economy is on its way out of a very deep economic and financial hole, but it looks likely to be a very slow process. Growth is expected to be just 1.7% in 2010, which is very low given the scale of the crisis.

Growth of 1.7% is also far from impressive in comparison with previous recoveries in the Danish economy. Overall, we are looking at one of the weakest – if not the weakest – recoveries after a recession that we have seen since the early 1970s. There was also a relatively weak recovery following the recession of 2002-03, but on that occasion the economic downturn was rather more moderate than the current one.

That growth is expected at all needs to be seen in the light of the many temporary stimuli acting on the economy. There is the prospect of expansionary monetary and fiscal policy on an unprecedented scale in 2010 and the inventory cycle also points to rising output. But these will gradually ebb away, and so we are looking at not just a relatively slow recovery but also a fragile one.

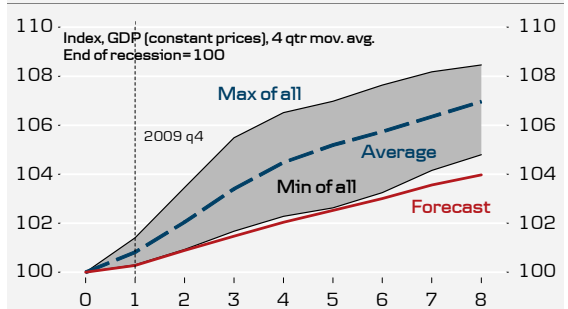
The reason why there is no prospect of a more marked upswing in the Danish economy is partly the sharp erosion of competitiveness seen in recent years. Wage growth has been higher in Denmark than abroad and competitiveness has been further undermined by a stronger effective exchange rate and unfavourable productivity growth. This means that Denmark is unlikely to feel the full benefit of improved global economic conditions. It will not be bypassed by the global upswing, but it is unlikely to reap all the rewards.

Changes from previous forecast

	Current forecast			Previous forecast	
	2008	2009	2011	2009	2010
GDP	-4,8	1,7	2,0	-4,5	1,6
Private consumption	-4,7	2,5	2,0	-5,0	2,3
Public consumption	2,2	1,4	0,9	2,2	1,4
Gross fixed investment	-12,2	-5,2	2,6	12,9	-2,1
Exports	-9,5	4,6	3,5	-10,0	2,8
Imports	-7,3	2,5	2,5	-13,6	5,0
Unemployment (thousands)	99,8	148,2	159,2	98,4	145,0
Inflation	1,3	1,5	1,7	1,5	2,1
Public sector bal., % of GDP	-3,0	-6,1	-4,4	-2,6	-5,2
Current account, % of GDP	3,5	2,5	2,1	1,4	1,0

Source: Statistics Denmark and Danske Research

Set for historically weak recovery



Source: EcoWin and own calculations

Note: The chart shows GDP growth in the quarters following the recessions that started in Q2 1975, Q2 1981, Q3 1993, Q2 2003 and Q3 2009, respectively

Weak productivity growth is also the reason why we do not expect the labour market to stabilise until 2011. We are therefore looking at a jobless recovery. Not until 2011 is there reason to expect more normal growth, and so not until 2011 is there reason to expect stabilisation in the labour market.

Although we are painting a picture of an economy in recovery, it is far from rosy. However, there is a not insignificant possibility that the Danish economy will perform better than we anticipate. If we compare the current crisis with previous ones, there is potential for higher growth. The stimuli applied have been very strong and if businesses and consumers can shake off their crisis mentality, we may very well see much stronger growth than outlined in this forecast. The GDP figures for Q3 might be an indication of a stronger recovery than we expect. The reason for our continued scepticism is that we have not seen any clear signs of such a change in sentiment in all the other economic indicators and so we assume that the household savings rate continues to climb and that businesses remain reluctant to invest.

By and large, we have not changed our view of the Danish economy since our previous forecast in October.

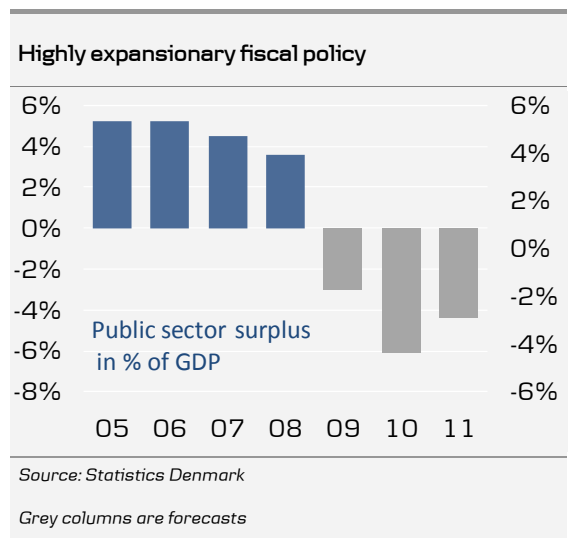
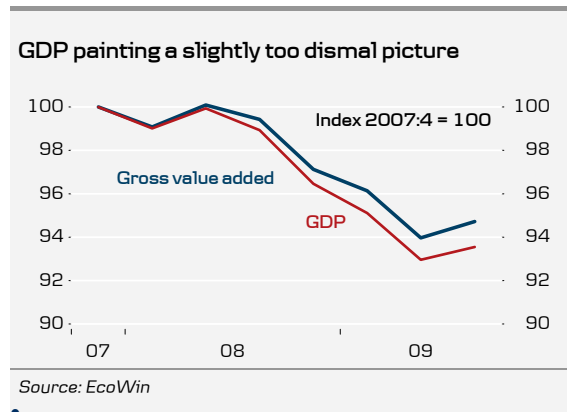
Booster rockets at full thrust

There is no question that the Danish economy has been hit by an economic crisis of historic proportions: over the past year GDP has fallen by more than 5%. However, there is a tendency for GDP to exaggerate the true fall in output. This is partly because private consumption has a major tax component. High car registration duties, for example, mean that a drop in car sales reduces GDP further in Denmark than in the countries where the cars are made.

This can best be illustrated by comparing movements in GDP and gross value added, which excludes indirect taxes etc. There is a clear tendency for GDP to fall further than GVA. Thus, there is no doubt that GDP is painting an overly bleak picture of the depth of the crisis in Denmark. That said, it is important to stress that the crisis has hit the Danish economy hard, whichever way we look at it.

The political response to the crisis has also been of historic proportions. The lesson from previous financial crises has been that it is crucial to react early and decisively to avoid a domino effect. Expansionary monetary and fiscal policy on an unprecedented scale has therefore been pursued both in Denmark and abroad. The effects of this expansionary economic policy are beginning to be seen in the global economy and the combination of tax cuts, increased public spending and record-low interest rates will also feed through to the Danish economy, especially next year. In isolation, expansionary economic policy is expected to boost growth next year by more than 2.5pp.

These are only temporary stimuli and as a result of the sharp economic downturn and the expansionary fiscal policy response, there is the prospect of substantial deficits in public finances, and there may be a need to tighten fiscal policy from as early as 2011. The ECB is also expected to commence the gradual normalisation of interest rates in 2010. In other words, the Danish economy had a real shot in the arm – but it will have only a temporary effect.



Besides expansionary economic policy, the inventory cycle should also help to bolster growth for a while. Companies have slashed their stocks, especially in H1 this year, enabling them to reduce output for a period beyond that which sales levels would dictate. This means that output can now rise for a period without there necessarily being any increase in sales. There is no reason to expect any actual stockpiling, but output needs to match sales more closely, which means an increase in output. The inventory cycle should therefore make a substantial, but temporary, contribution to growth, especially next year.

Overall, therefore, the economy should benefit from extensive stimuli in 2010 and in this light our growth forecast of 1.7% for 2010 is not particularly optimistic. However, it would be deeply pessimistic to assume much lower growth given such strong stimuli.

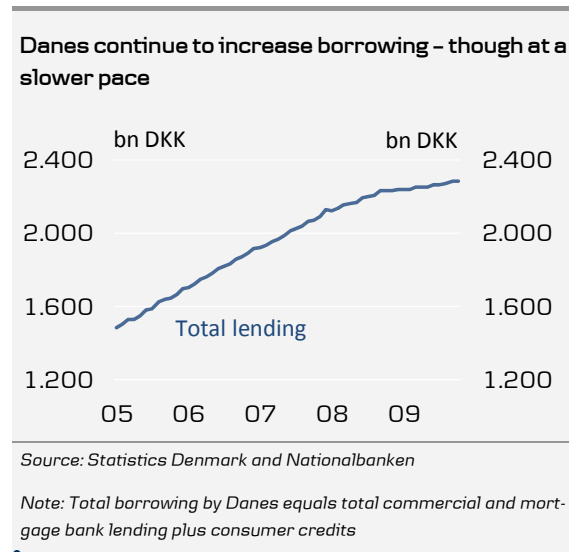
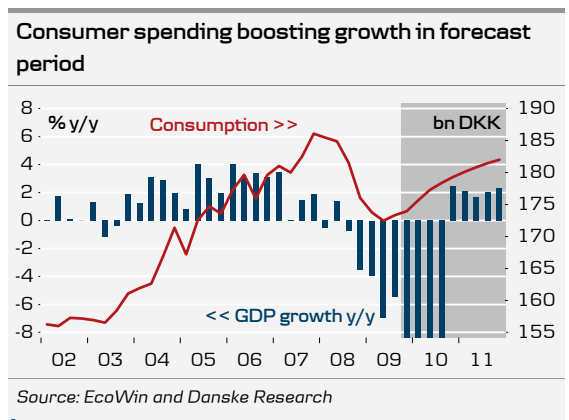
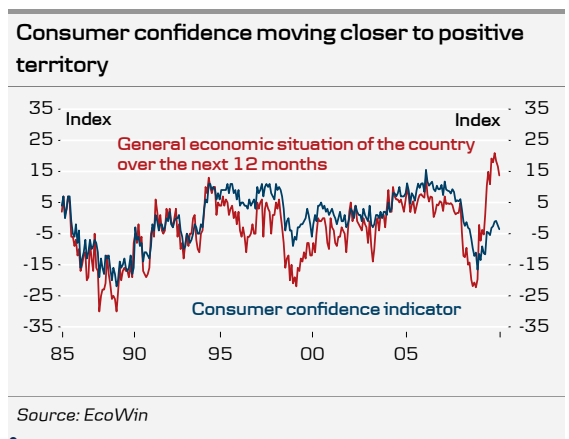
Consumption growth to return in 2010

Private consumption has reacted surprisingly strongly to the current crisis. According to the national accounts, private consumption fell by 7.4% in constant prices between the beginning of 2008 and Q2 09. In Q3 09 we saw modest consumption growth but overall we are looking at a huge drop considering that, during the same period, consumers benefited from rising incomes as a result of real wage growth and tax cuts. From mid-2009 consumers have also been able to withdraw their SP pension savings, giving them even more money to spend. In other words, there has been a very marked increase in the savings rate in a very short space of time.

This change in saving behaviour needs to be seen in light of the wave of economic uncertainty that engulfed the Danish economy when the financial crisis erupted in autumn 2008. Danes have also been hit by a marked decrease in wealth during the crisis, which has naturally also helped to drag down consumption. At its worst, housing wealth was down DKK450bn and losses on shares reduced financial wealth by more than DKK400bn. This has naturally led to an increased need to save.

On the other hand, Danish households have not begun to reduce their very considerable debt. Their borrowing from banks and mortgage institutions has actually increased during the crisis. In other words, the Danes have continued recent years' tendency towards inflating household balance sheets: households are simultaneously saving more and borrowing more. This makes Danish households relatively sensitive to movements in asset prices and, perhaps more importantly, the Danish economy highly interest-sensitive.

Consumption had already begun to fall before the financial crisis really began to bite, which needs to be seen in light of rising interest rates in 2006-08 digging a not insignificant hole in many families' finances. Rising interest rates hit consumption, both indirectly through lower house prices and directly through higher interest payments, and the latter effect is more significant today than a decade ago thanks to the growth in variable-rate mortgages. Households' annual interest payments after tax increased by more than DKK20bn between 2005 and 2008. Since the middle of last year, though, interest payments have begun to fall again. The reduction in the National



bank's interest rates has begun to show up in households' interest payments, but the main impact will not come until 2010 when the effect of record-low rates on interest reset loans feeds through. There is the prospect of a decrease in interest payments after tax of around DKK10-15bn from 2009 to 2010. The fall in interest rates should therefore have a similar impact on Danes' personal finances to the tax cuts also coming in at the beginning of the year.

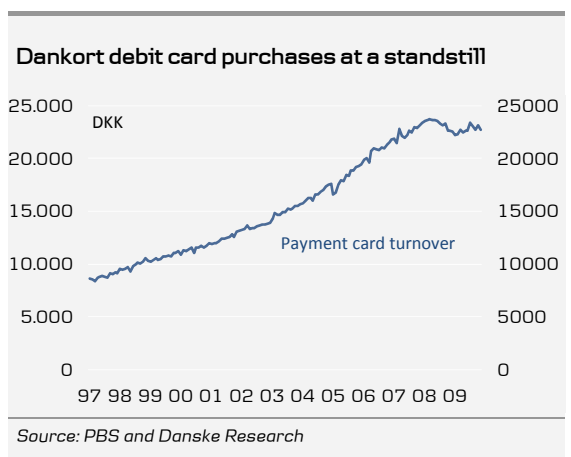
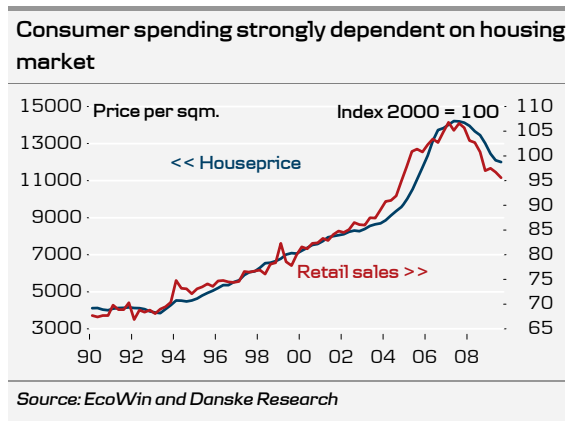
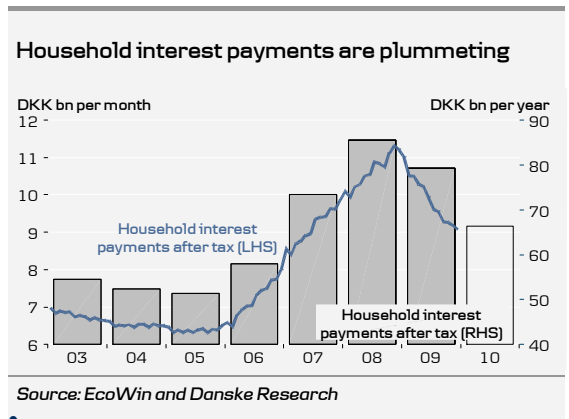
This combination of tax cuts and low interest payments is expected to be enough to drag private consumption out of the doldrums. That said, we do not expect consumption to grow at the same rate as incomes. Given the outlook for further unemployment growth and a fragile economic recovery, Danes are likely to remain cautious in the coming years.

This expectation of a measured increase in private consumption is supported by indicators of retail sales and consumer confidence. Consumer confidence fell to record-low levels at the end of 2008 but has rebounded significantly since and has been heading for the magic zero mark over the past six months. This suggests that the initial shock of the economic and financial crisis has worn off somewhat, but that there is still a considerable amount of concern. Looking at Dankort debit card purchases, there are no clear signs of improvement. Dankort purchases fell in November after rising in October, but are reasonably stable. Car sales have picked up slightly since the end of 2008, but it has been a relatively slow recovery.

It is not just tax cuts, interest rates, economic uncertainty and decreased wealth that are impacting consumption. It has also been held back by an extraordinarily strong incentive to top up pension savings in 2009. From the end of the year, the marginal rate of income tax will be reduced by 7.5pp, which means that the tax relief on pension contributions will decrease. In other words, it may be worth topping up pension savings this year rather than waiting until next year. This has given pension contributions an extraordinary boost in 2009, which is helping, temporarily, to curb consumption. In the very short term, therefore, the tax cuts are pulling in the opposite direction to that intended.

Once we get to New Year, many of these effects on consumption will reverse. While interest rates on interest reset loans pulled consumption down in 2009 due to the high level of interest rates at the end of 2008, there is the prospect of a record-strong interest rate stimulus from 1 January 2010. The incentive to top up pension savings will also be markedly reduced. Overall, therefore, we predict that consumption will climb 2.5% in 2010. This is not a particularly high level of growth, but it is the highest rate since 2007.

Looking ahead to 2011, some of these stimuli will gradually ebb away. Interest rates on interest reset loans at the end of 2010 are likely to be around 1pp higher than at present, which means that interest payments will rise by around DKK600 a month after tax for a homeowner with borrowings of DKK1m. This will naturally reduce expendable income. On the other hand, there is reason to expect a turnaround in the labour market at the beginning of 2011, so on balance we anticipate consumption growth of 2% in 2011.



Housing market picking up

The past year's sharp fall in interest rates, combined with a general improvement in the economic outlook and further strong income growth, have had a stabilising effect on the housing market.

The latest figures from the Danish Mortgage Banks' Federation reveal that prices for single-family houses continued to fall in Q3, but at a much slower rate. Prices for these houses fell by 0.8% in Q3, compared with 4.3% and 2.8% in Q1 and Q2 respectively.

There are not yet any official statistics for the period beyond Q3, but price statistics from estate agent home indicate that the fall in house prices has slowed further in Q4. Historically there has been a close correlation between home's property price statistics and the official price statistics.

This deceleration in house price deflation is also reflected in a fall in the number of homes on the market, which is due partly to a general increase in turnover in the housing market.

According to figures from Statistics Denmark, sales of single-family houses increased by no less than 11.9% in Q2 (seasonally adjusted). Data from home indicate that this growth continued into Q3 and Q4, so it seems that turnover is recovering after trending downwards since the end of 2005.

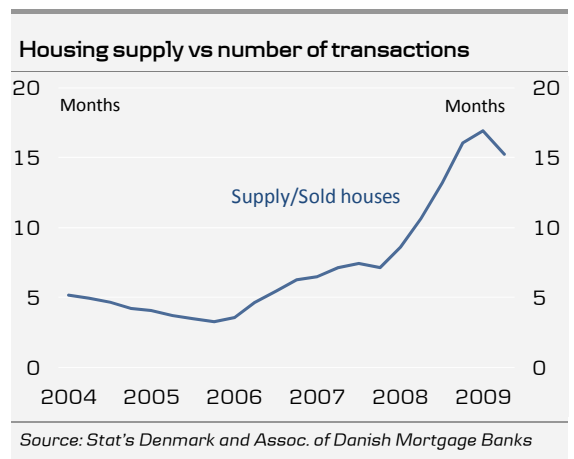
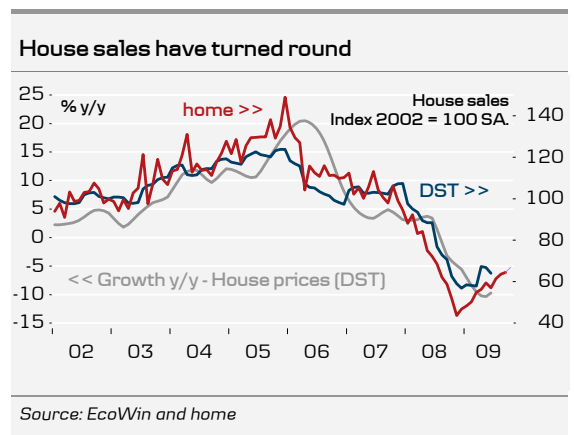
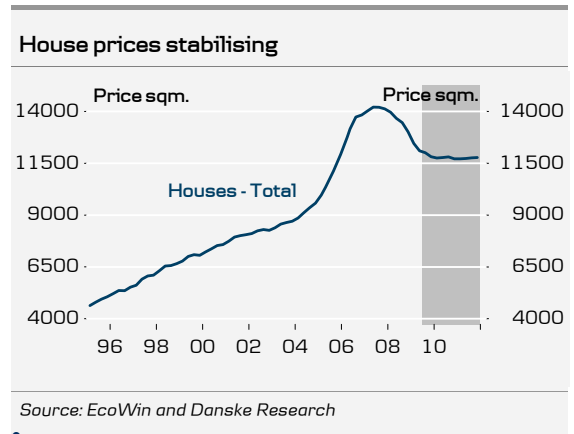
We expect the housing market to continue to stabilise. This should be seen in light of our expectation of only a moderate rise in interest rates in the coming years, as well as the fact that we have yet to see the full impact of the past year's sharp fall in interest rates. Further tax cuts are also due in 2010, which should contribute to healthy income growth.

All things considered, though, it will be a weak and fragile recovery, as there are still a number of factors that will be pulling the housing market the wrong way.

First and foremost, the number of jobless has risen by around 68,000 since summer 2008 and is expected to continue to climb during the course of 2010. Such a sharp increase in unemployment not only impacts on demand for housing from those affected but also results in increased uncertainty and caution on the part of the average homebuyer, which should tend, in isolation, to put a damper on demand for housing.

In addition, a significant imbalance has emerged between a large supply of housing on the market and low, albeit rising, turnover. At the current level of turnover, the number of single-family houses currently on the market – more than 38,000 – corresponds to almost 15 months of property sales. This will put a damper on any recovery in house prices.

It is also important to remember that the current improvement in the housing market is largely attributable to the very sharp fall in interest rates over the past year. Interest rates are currently at extraordinarily low levels; therefore we cannot rule out the possibility of house prices coming under renewed pressure in the longer term when Danish interest rates normalise.



Overall, we estimate that house prices will fall by a further 2.5% from their current levels and then begin to climb again slowly during the course of next year, resulting in largely unchanged prices in 2011.

Unemployment to peak in early 2011

According to Statistics Denmark, the number of jobless has increased by around 68,000 since plunging to a record low of just under 46,000 in summer 2008.

This translates into an average increase of just over 4,500 people a month during the period. This is a big rise, even in comparison with previous crises in the Danish economy. We need to go right back to the oil shocks of the 1970s to find similar rates of unemployment growth.

This rapid growth in unemployment can be attributed mainly to the abrupt slowdown in the Danish economy in H2 last year and H1 this year.

Given the positive growth in the Danish economy in Q3, the economic crisis now seems to have subsided. Therefore we expect the crisis in the labour market to ease.

However, it is important to remember that the labour market typically reacts to economic conditions with a certain delay. Unemployment does not normally peak until two to three quarters after a turnaround in output. Unfortunately, though, there are a number of factors in the current situation that may serve to postpone the turnaround in unemployment.

First and foremost, the economic recovery is expected to be relatively weak, especially in comparison with previous recoveries in the Danish economy.

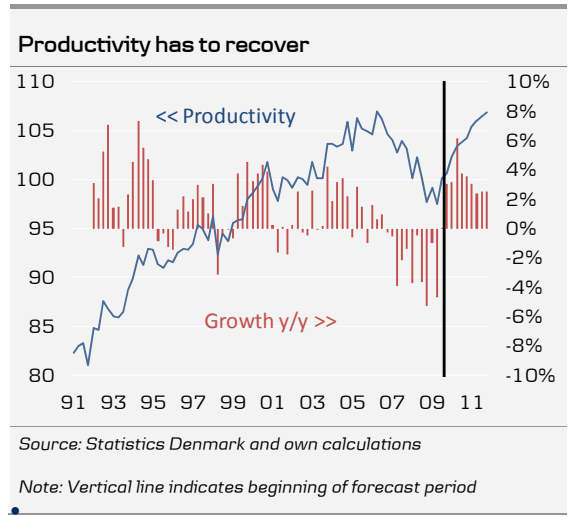
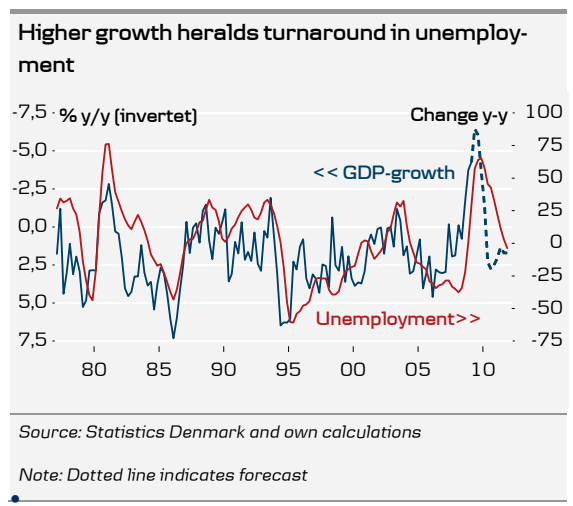
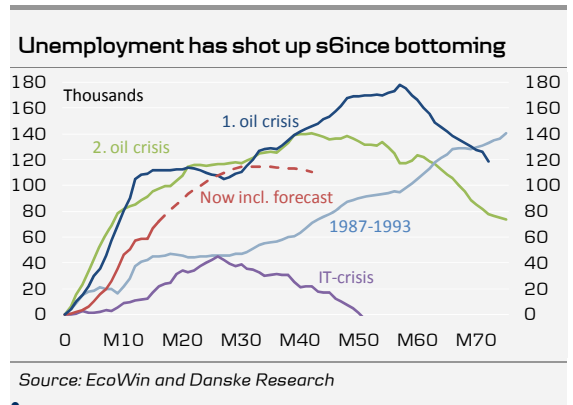
In addition, the previous very tight labour market, combined with the dramatic fall in output during the current crisis, has contributed significantly to a very sharp drop in productivity in recent years. Since peaking in Q2 06, productivity has dropped by almost 6.5%, taking it right back down to the levels of early 2000.

We therefore expect productivity to recover in the coming years – and we already saw the first tendencies to a recovery in productivity in Q3. This means that, although activity is now expected to pick up, it will take longer than usual for this to be reflected in rising employment and falling unemployment.

Overall, we expect the number of jobless to climb to almost 130,000 at the end of this year and 160,000 at the end of 2010, before gradually stabilising and beginning to fall again gently from Q2 11.

Growing exports – but still major challenges

Exports fell sharply as a result of the rapid, deep economic downturn that hit Denmark’s export markets in the wake of the financial crisis. Despite minor growth from Q2 to Q3 exports have dropped by 11.4% from Q3 08 to Q3 09, which is among the largest drops in exports seen in the post-war period.



The decline in exports has been exacerbated by the significant deterioration in Danish competitiveness in recent years due to much faster wage growth in Denmark than abroad, weak productivity growth and strong appreciation of the DKK.

Unfortunately this suggests that Denmark could be facing a lengthy period when exports fare less well than growth in its export markets would otherwise suggest. Thus Danish exports will probably not feel the full benefits of the recovery now beginning in the most important export markets. This is, of course, unfortunate in a situation where global recovery is one of the most important growth engines for pulling Denmark out of the current crisis.

One mitigating factor is that Danish exports include a high proportion of upmarket goods, which have a relatively high value in the export market. Therefore some of the decrease in wage competitiveness can probably be justified by Denmark exporting products of ever higher relative value. In addition, demand for upmarket products is generally less sensitive to changes in relative prices in the export market, so lessening the impact of the decline in wage competitiveness and the stronger DKK.

That said, we still believe that competitiveness should be a major challenge for the Danish economy in the years ahead.

In the short term, though, we are relatively optimistic about Danish exports. As the global upswing moves up a gear, we expect export growth to edge back into positive territory in Q4 this year. Overall, we expect exports of goods and services to fall by 9.5% in 2009 before climbing again by 4.6% in 2010 and 3.5% in 2011.

Business investment hobbling along

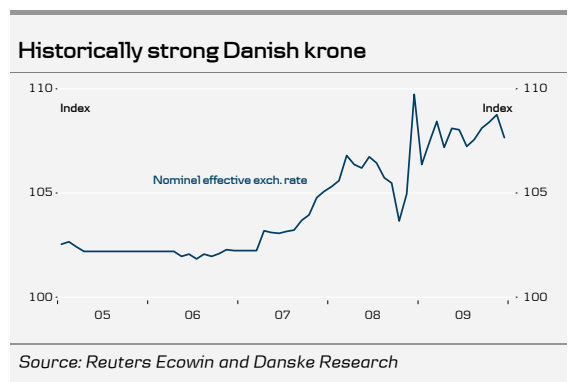
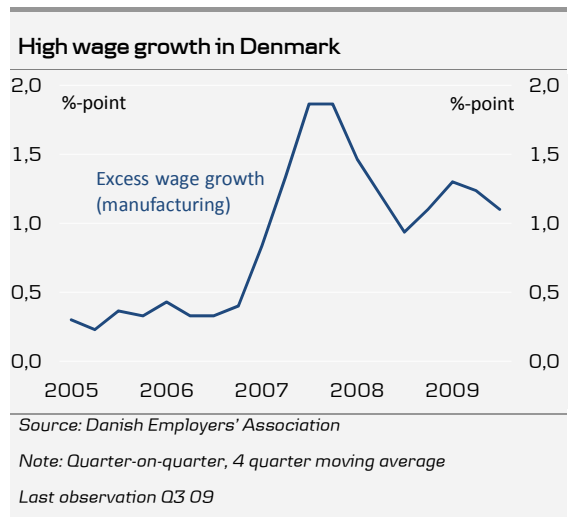
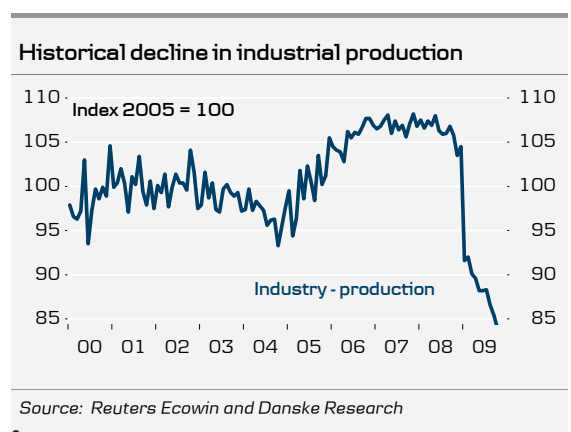
Business investment has fallen back sharply as a result of the severe downturn in both the global and the domestic economies. Many businesses have seen a general decline in demand for their products, resulting in a sharp decrease in capacity utilisation and, therefore, a reduced need for further investment.

The fall in business investment has probably been exacerbated by the relatively difficult credit conditions in the wake of the financial crisis.

Looking ahead, we expect to see a relatively healthy recovery in both the global and the domestic economies. This should boost businesses' sales potential. In addition, interest rates have fallen to very low levels and are expected to remain low for some time. The combination of low interest rates and the coming improvement in businesses' sales potential should, in isolation, help to increase investment.

However, the recovery in both the global and the domestic economies will probably be slow and so businesses should continue to have plenty of capacity.

We therefore expect business investment to fall further during H2 this year and Q1 next year, but at a decreasing rate, and to climb slowly from Q2 next



year as businesses' sales potential improves and the delayed effects of the past year's slide in interest rates feed through.

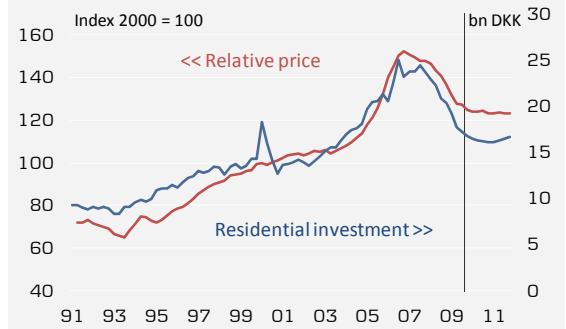
Turning to housing investment, a continued decline is expected. Movements in housing investment are heavily dependent on the state of the housing market. Housing investment normally falls when the price of existing homes decreases relative to the cost of building new ones. With prices down by around 15% from their peak, there is no doubt that the incentive to build new homes is greatly reduced. The latest national accounts figures show that housing investment has fallen by almost 30% since peaking in 2007.

That said, it is worth bearing in mind that housing investment has fallen from very high levels. At the peak of the economic boom in 2006, housing investment amounted to no less than 6-7% of GDP and we have to go right back to the late 1970s and 1980s to find similarly high levels. It would therefore appear that housing investment has been higher than necessary to meet demand for housing in the economy in the long term.

Partly as a result of this, we expect to see a further decline in housing investment during the forecast period, but at a decreasing rate. Low interest rates and the expected stabilisation of the housing market will, in isolation, help to stabilise housing investment, but will not change the fact that housing investment needs to make a structural shift to lower levels after a period of having accounted for a very high proportion of aggregate economic activity.

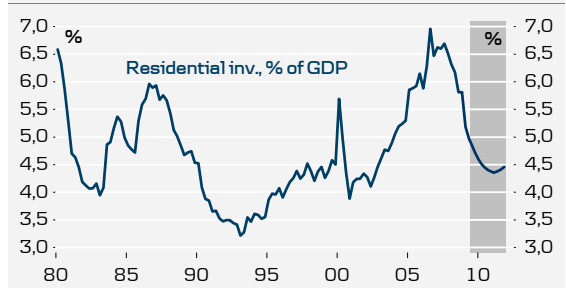
Overall, we expect housing investment to fall by 7.6% in 2010 and to remain more or less unchanged in 2011, taking its share of GDP down to around 4.5%, which is the level of the late 1990s and the early part of the current decade.

Housing investment tracking housing market



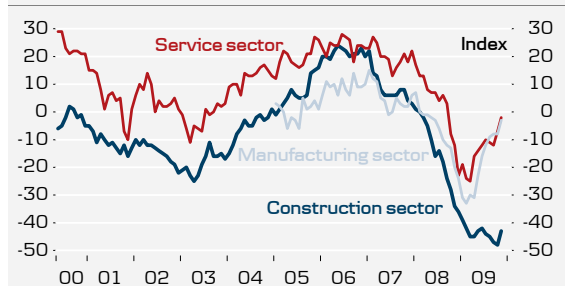
Source: Reuters Ecowin and Danske Research

Housing investment declining from high level



Source: EcoWin and Danske Research

Businesses have become slightly more optimistic



Source: EcoWin

Inflation to climb slowly

There is much to suggest that inflation has bottomed out and should rise steadily going forward. We expect inflation to climb slowly from its current level of 1.2% to just less than 2% in 12 months' time.

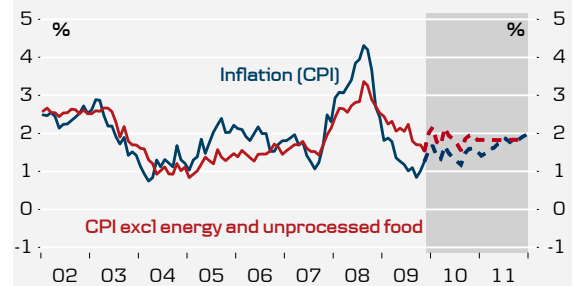
However, this increase can be attributed largely to energy prices having fallen very sharply in autumn 2008 and climbed gently since. This means that energy prices today are higher than last year's very low levels. Looking at core inflation, which excludes movements in energy prices, the annual rate of inflation is actually still falling. The increase in duties as part of the tax reform will also serve to push up inflation in 2010.

However, there is no doubt that rising unemployment, combined with generally low capacity utilisation in industry and continued modest growth in private consumption, should continue to keep Danish inflation in check.

Wage growth is expected to slow further during the forecast period. Employees' bargaining power has deteriorated considerably as rapidly rising unemployment has made it easier for employers to find alternative labour and harder for employees to find alternative employment.

We predict wage growth of 2.9% in 2009 and 2.5% in 2010 and 2011.

Inflation rising from low level



Source: EcoWin and Danske Research

Denmark: Forecast at a glance

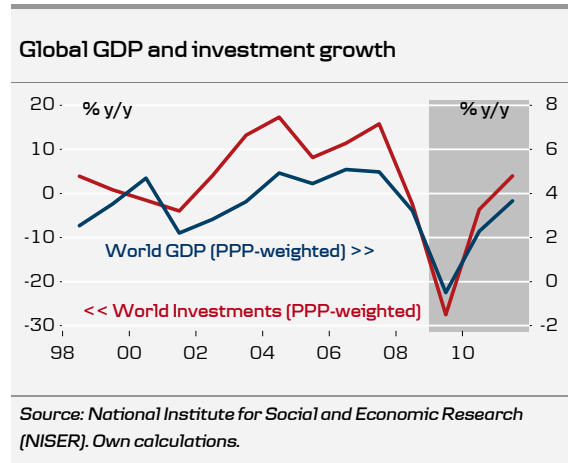
National accounts	2005	2007	2008	2009	2010	2011
	(2005-prices)					
	DKK bn	Vol growth in %				
Private consumption	745.1	2.4	-0.1	-4.7	2.5	2.0
Gross fixed investment	303.9	3.3	-5.0	-12.2	-5.2	2.6
Residential investment	92.4	5.2	-9.8	-15.9	-7.6	0.7
Business investment	184.4	4.4	-3.9	-10.0	-4.9	3.4
Public consumption	402.5	1.3	1.5	2.2	1.4	0.9
Public investment	27.1	-9.9	4.8	7.9	15.4	1.8
= Final domestic demand	1451.6	2.3	-0.9	-4.6	0.5	1.8
Growth contribution from stockbuildi	17.9	-0.3	0.2	-1.6	0.7	0.2
= Domestic demand	1469.5	2.0	-0.7	-6.1	1.3	2.0
Exports of goods	495.2	-0.4	-0.5	-8.8	6.8	3.6
Exports of services	261.8	6.9	6.8	-10.2	1.6	3.4
Exports, total	757.0	2.2	2.3	-9.5	4.6	3.5
= Total demand	2226.5	2.1	0.3	-7.3	2.5	2.5
Imports of goods	460.2	2.2	0.9	-14.5	6.3	3.5
Imports of services	221.0	4.3	8.5	-10.5	0.5	3.8
Imports, total	681.2	2.9	3.4	-13.2	4.1	3.6
Growth contribution from net exports	75.8	-0.3	-0.6	2.1	0.4	0.0
GDP	1545.3	1.7	-1.2	-4.8	1.7	2.0
Other items						
Current account, DKK bn		25.0	38	58.0	43.0	40.0
- % of GDP		0.7	2.2	3.5	2.5	2.1
General govt. budget balance, DKK bn		80.6	59.8	-50.0	-97.0	-79.0
- % of GDP		4.8	3.4	-3.0	-6.1	-4.4
Gross public debt, DKK bn		453.2	580.3	642.9	723.5	828.2
- % of GDP		26.8	33.4	38.0	42.1	46.4
Employment (thousands)		2897.5	2922.5	2834.3	2780.5	2765.0
Unemployment (thousands)		78.0	51.6	99.8	148.2	159.2
Unemployment rate, %		2.8	1.8	3.6	5.3	5.7
Oil price - USD/Barrel		72.7	99.0	77.0	82.0	-
House prices		6.5	-4.3	-10.6	-2.7	0.0
Hourly earnings in industry, % y/y		4.0	4.2	2.9	2.5	2.5
Consumer prices, % y/y		1.8	3.4	1.3	1.5	1.7
Financial figures						
		21.12.2009	+3 mths	+6 mths	+12 mths	
Repo rate, % p.a.		1.2	1.15	1.15	1.20	
2-year interest rate, % p.a.		1.5	1.60	2.00	3.00	
10-year government bond, % p.a.		2.3	2.40	2.55	3.15	
DKK/EUR		744.2	745.0	745.0	746.0	
DKK/USD		517.3	481.0	497.0	514.0	

Source: Danske Markets

Sweden

Behold the success of stabilisation policies

- Thanks to unparalleled measures by economic policy makers, a tidal wave of liquidity is rolling back and forth over the global economy, and countries with a benign starting position – such as Sweden – are experiencing the ride of a life time.
- For countries with fiscal and monetary muscle at the onset of the financial crisis, the past year has demonstrated the potency of modern-day stabilisation policies. Despite suffering immensely from a short-fall in global demand, Sweden has managed to keep domestic demand firmer than anyone could have dreamed a year ago.
- However, for a small, open economy, stabilisation policies are only viable as long as structural changes in demand are taken into account: i.e. there is a limit to how long and how much such policies can counteract adversity without becoming misaligned with fundamentals.
- *Inter alia*, given the success of stabilisation policies in Sweden, the Riksbank will probably hike earlier and/or swifter than is the case for many other developed economies. We believe that the first Riksbank hike will take place in September.
- We have downgraded our repo rate forecast, as there now seems to be less need to lean against the wind that has reflat and inflated Swedish credit volumes and housing markets. We expect the Riksbank repo rate to reach a peak of 3.5% in winter 2011/12.
- At 1.5% y/y, Swedish GDP-growth remains below potential in 2010, and it is only in 2011 (2% y/y) that resource utilisation increases in any meaningful sense.
- Despite feeling reasonably comfortable with our growth forecasts, we are juggling our inflation and hence repo rate forecasts and the upcoming wage negotiation round do not make our deliberations any easier. Anecdotal evidence suggests a completely different direction than economic logic. Companies and industry organisations seem surprisingly toothless in their arguments, which could be a hint at structural changes taking place in the Swedish labour market.
- The large age cohort born in the late 1940s are heading for retirement and transforming from being a saving and productive part of the labour market to becoming a consuming and inflationary group of the population.
- Significant uncertainties still surround the outlook, in terms of effects of exit strategies being implemented during the forecast horizon, *inter alia*. In many ways, 2010 should provide a first shot at the sustainability of the economic rebound.



Still optimistic on international demand

Danske Bank's optimistic take on international demand is becoming more and more a consensus view: both IMF and OECD have recently made large upward revisions to their growth forecasts. This means that while we retain our positive stance on Swedish export markets we are becoming relatively less so as other forecasters catch up.

As before, some weakness is expected in 2010, when some of the most acute economic policy measures designed to combat the financial crisis are withdrawn. This is, however, not expected to derail the upturn in global demand but may stir financial markets during the course of next year.

Swedish export industry losing market share

It is, therefore, reasonable to expect a gradual recovery in Swedish world market growth during the forecast horizon. This should of course leave a positive mark on the export-laden Swedish economy. However, this time around, the impact is estimated to be weaker than normal – the Swedish export industry is estimated to lose market share. The reason for this more sombre outlook is that global resource utilisation is expected to remain low for an extended period of time and demand for investment goods is therefore likely to be subdued. Investment goods, together with input goods, are the Swedish export industry's most vital branches.

Nonetheless, in our forecasts, exports are still one of the main reasons for a pick-up in consecutive GDP growth rates over the forecast horizon. Exports are forecast to fall by more than 16% y/y this year but rebound to above 6% y/y in 2010. In 2011, Swedish exports are expected to lose some of their momentum and grow by a more moderate 4% y/y.

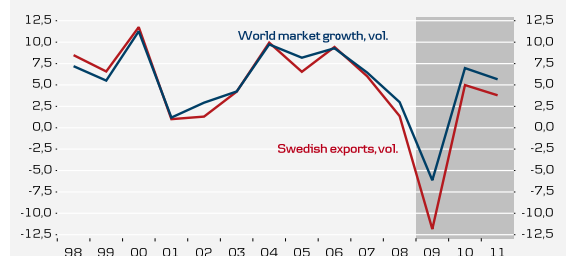
The hazardous life of a small, open economy

Developments in financial conditions are now at the whim of inflation

The deterioration in growth prospects has been accompanied by dwindling inflation in most countries, and Sweden is no exception. The upside is a steady improvement in the purchasing power of households and companies alike. The downside is, however, that, in real terms, financial conditions worsen – i.e. this is an effect of interest rates already at an all-time low combined with falling inflation, which actually serves to tighten real financial conditions.

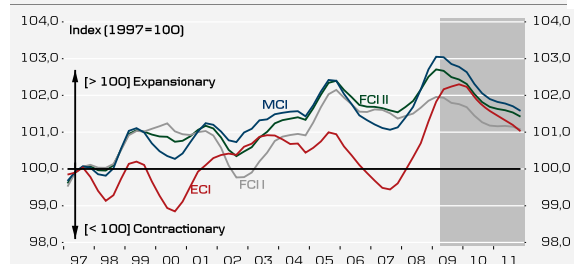
In fact, despite apparent risks to the contrary, inflation is expected to trend downwards for the forecast horizon and beyond, implying that financial conditions are very much the result of changes in the inflation outlook. The Riksbank – having stabilisation policy as a secondary target – must feel very uneasy about such prospects, especially with the upcoming wage round in mind.

Swedish export market and export growth



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

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 of growth, whereas a number below 100 indicates that financial conditions and/or economic policy are contractionary. All measures are adjusted for inflation and are quoted in volume terms.

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

Inventory cycle paramount for short-term growth outlook

Like many of its export markets and competitor nations, Sweden experienced the negative workings of the inventory cycle during the latter half of 2008 and the beginning of 2009. However, the latest quarterly national accounts (Q3) imply that the pace of inventory liquidation has lost momentum. In GDP growth terms, this translates into a positive contribution to growth. This process should continue for a couple of quarters more and – given the size of the liquidation – could provide a very strong short-term push to Swedish growth. Whether or not international and domestic demand returns to pre-crisis levels, the exact impact of any positive impetus from stocks on growth is blurred. Danske Bank foresees almost a 2 percentage points (pp) negative contribution to growth in 2009. Next year this should be reversed and stocks should add nearly 1pp to GDP growth. In 2011, the inventory cycle should have passed and we therefore expect a 0pp contribution.

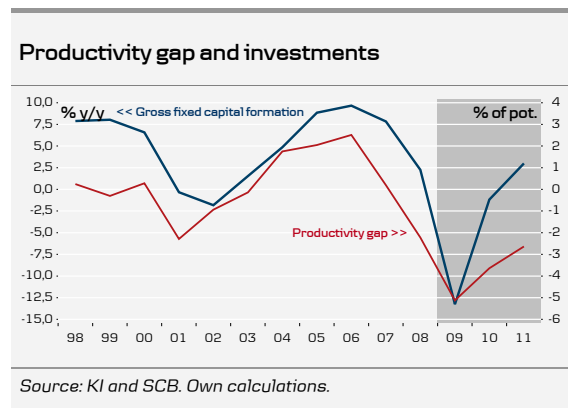
An immense rise in spare capacity

Industrial production has continued to surprise negatively despite being revised in a more positive direction. October even saw a new low in this cycle. Without any swift rebound in demand, the sharp drop in production means that spare capacity remains abundant. The need to expand capacity, or even to replace obsolete capital, should therefore be very low. According to Statistics Sweden's (SCB's) investment survey, companies foresee a staggering drop in investments – in some sectors even by as much as 50% compared to the investment levels seen before the crisis. Public investments are, nonetheless, expected to grow quite strongly, due both to announced and to upcoming initiatives on improving Swedish infrastructure. Nevertheless, overall investment growth should contract by more than 13% y/y in 2009 and by approximately 1% y/y in 2010. It is not until 2011 that investment growth returns to positive territory, and then only by a modest 3%

The implications of such weak developments are likely to be felt in all parts of the economy, but nowhere as much as in labour markets. The impact from changes in investment levels on the labour market has always been very direct and very strong in Sweden.

The enigmatic behaviour of Swedish labour markets

We have made only small revisions to the Swedish forecasts we made in the autumn. However, we revise one area drastically – we speak of course of the labour market. There has been a dramatic rise in unemployment over the past year and this is expected to continue well into 2010. However, considering the unrivalled drop in GDP, the rise in unemployment has actually been rather muted. Domestic sectors have held up well due to the “Tidal wave of liquidity” and other forceful economic policy measures implemented over the past year. 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. Consequently, our labour market forecasts are considerably more upbeat. Instead of seeing unemployment rates surpassing 12%, we now see a peak of 10.3%, a revision of almost two full percentage points.



However, these more positive developments on the labour market come at a 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, profits bear 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 regularly questioned these developments and stated that this should sooner or later transform into an increased focus on profits from companies and therefore additional lay-offs; but this has not materialised. Instead it seems that share holders are prepared to keep the cost base high, probably in order to take advantage of an expected upturn in demand.

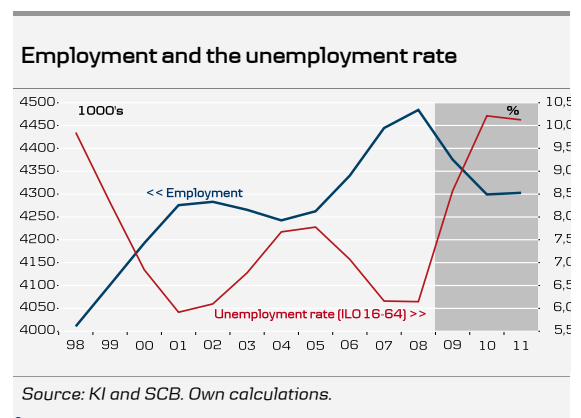
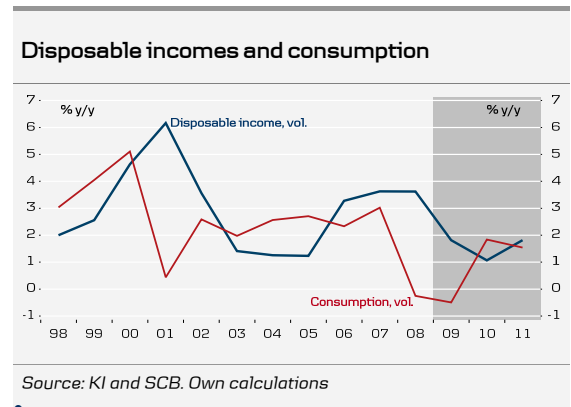
There are, perhaps, other explanations for this rather unconventional behaviour. Anecdotal evidence points to a couple of other factors that could help to explain developments:

1. Indivisibles. Swedish labour, particularly within the manufacturing industry, is carrying an ever-increasing amount of capital, meaning that the production process would rapidly come to a complete halt if too much labour were laid off.
2. Demographics. The large age cohort of people born between 1945 and 1950 are approaching retirement and Statistics Sweden estimates that the number of retirees will increase from around 100k today to 850k by 2015. In order to preserve competence, companies are therefore forced to hoard labour.

An unemployment rate of above 10% is under any circumstances unusually high and, if anything, the risks are that companies will demonstrate a renewed focus on profits should the expected upturn in demand disappoint. In short, despite a considerably less pessimistic view on the labour market, there is no evidence of an improving labour market any time soon. The fact is, 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. This is also visible in our forecasts, where the improvement in employment is hardly distinguishable despite the growth outlook becoming more optimistic.

Consumption buckling under the weight

Our forecasts are built on an assumption of moderate wage growth, which, together with very strong automatic stabilisers and a broad welfare system, serves to support disposable incomes throughout the forecast period. Disposable incomes are therefore expected to rise by almost 4% y/y this year, despite the strong cutback in hours worked. Next year, the adjustment of hours worked should level off but wage growth should become more subdued. This



adds up to a still strong 2% y/y growth in disposable incomes for both 2010 and 2011.

The very benign developments in disposable incomes, especially in comparison to the overall drop in national incomes, are a measure of the success of stabilisation policies. For the typical household – homeowners with two children and one car – a back-of-the-envelope calculation suggests that purchasing power increased by some SEK6,000 per month between September 2008 and July 2009. Another important factor explaining the rather strong developments in disposable incomes is related to the demographic situation: the wage sum is supported by the relatively minor lay-offs taking place, which also strengthens the negotiation power of employees vs employers. This is an important factor, especially as the outcome of the wage negotiation round this spring will probably be decisive for the Riksbank’s next steps.

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 – should mean that once the Riksbank starts 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 fall by 0.5pp this year, and increase by almost 2% y/y in 2010. In 2011, due to the Riksbank hiking rates, consumption growth slips back to 1.5% y/y despite ameliorating labour markets.

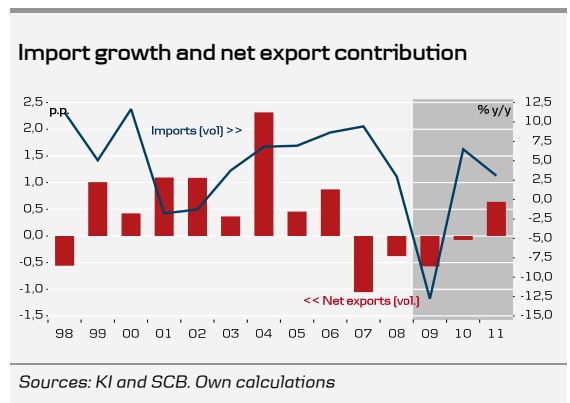
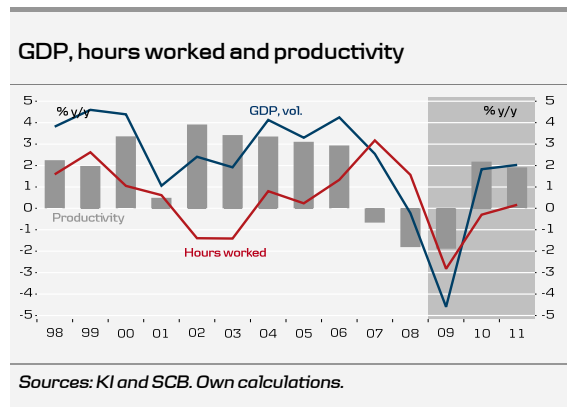
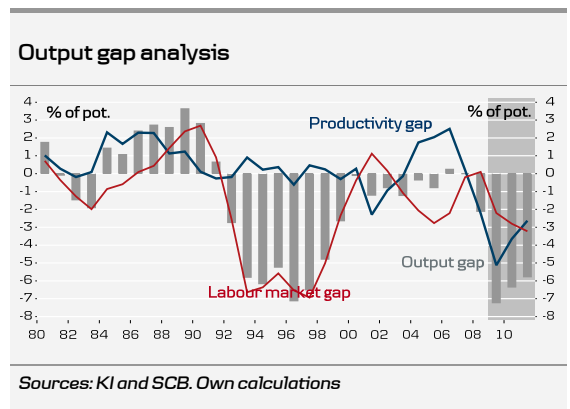
Imports weaken in 2009 and net exports contribute to GDP growth over the forecast horizon

The cutback in imports has been dramatic and has to some extent even outpaced the very weak developments in exports. Nevertheless, strong household consumption growth has meant that retailers’ inventories need to be replenished, something that became apparent in the latest release of national accounts data. Nonetheless, when international demand eventually returns, the Swedish export industry should react and net exports are indeed expected to contribute positively over the forecast horizon. To sum up, we calculate a negative contribution of 0.5pp to GDP-growth from net exports in 2009, a flat contribution in 2010 and – once exports are on a sustainable upwards trajectory again – a positive contribution of more than 0.5pp in 2011.

The second leg of economic policy response to the financial crisis

A daunting output gap remains the Riksbank’s main concern

We have now gone through all the main developments in the Swedish business cycle; and the impression of a severe recession is lingering. Summing up the various GDP components only serves to confirm these impressions. In 2009 GDP should drop by some 4.5% y/y. In 2010, growth 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 again sees



growth at 2% y/y, taking more decisive steps towards a balanced resource utilisation.

Resource utilisation should by any standard be extremely low. According to our calculations this admittedly abstract measure reaches a nadir of a shocking 7% – even worse than 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, as 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 admit to having been too optimistic on this measure. This has also been the main reason for our overestimating of the unemployment rate. However, over the past quarters, companies have begun to scale down not only production but also hours worked. But, and as mentioned above, it so far has not sufficed to balance the drop in demand, and has therefore resulted in continued negative productivity growth. Nevertheless, 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. In 2010, Danske Bank expects productivity to rise by approximately 2.5% y/y, only to recede somewhat in 2011 when we calculate it to increase by 2% y/y.

A rise in productivity should be sorely missed by companies that saw their costs rise dramatically throughout 2008 and the first quarters of 2009. Unit labour costs (ULC), which adjusts for wage earners' share of productivity gains, rose 6.2% y/y in 2008 and is set for another big rise in 2009 (we do not have access to the full data needed to estimate ULC on a quarterly basis), and 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 should 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 an expected high unemployment rate, representatives from employers and trade unions will convene to start the wage negotiations for the period 2010 and a few years onwards. Suffice to say that the prospects for wage increases have seldom been as weak as now. Should wage settlements end in only slight increases, or even no wage rises in some sectors, the threat of deflation is likely. At the same time, we think it is important to underline that this is also the consensus and – more importantly – the Riksbank view. The risks are therefore that wage agreements could result in higher wages than currently expected. Contrary to common belief there are actually a couple of factors that, despite their more anecdotal character, could very well produce a higher outcome at the wage negotiations:

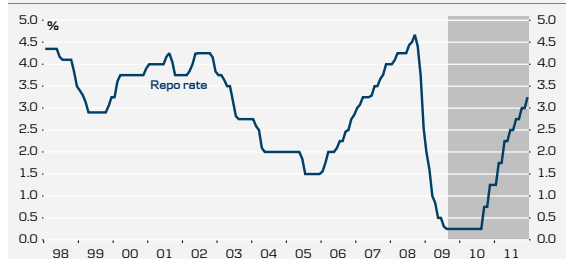
1. Financial viability of corporates. Of course not all corporations are experiencing troubles or feel financially strained. But for those hardest hit by the crisis – probably many companies in the wage-leading export industry – demand has dropped by some 20% or even more. This has wiped out much of the financial flexibility that companies may have had. And even though some cushion has been provided by the liquidation of inventories, many companies express an inability to fight excessive wage demands – they simply cannot afford it.
2. Demographics – for many companies the coming few years should be extremely challenging as a large part of their work force is approaching retirement. In the absence of more flexible hiring and firing rules, companies are left with little choice but to keep “youngsters” on their roster to be able to keep competence up and bridge the gap between the outgoing labour and the hiring need foreseen in a not too distant future.
3. Related matching problems. In tandem with the demographic situation the outgoing labour pool leaves open work tasks that require a certain combination of competences and/or education. These prerequisites are not necessarily met by the available pool of labour.

Inflation returns short term, but core inflation is on a downbound train

We have never faced such multifaceted inflation prospects as we do now. To touch briefly upon upward risks: our main global scenario, in which 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. At the other extreme, there are 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, the risks remain contained and the credibility of economic policy remains high. Growth as well as inflation returns in the medium to long term, but in a more controlled fashion. Therefore, prices for internationally traded goods and Swedish import prices gradually normalise. Domestic inflation and so-called ‘core inflation’ (CPI inflation minus food, energy, interest rates) are both derivatives principally of 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 in 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 in economic policy is sufficiently strong to keep expectations from following suit.

Repo rate at the nominal interest rate floor



Source: Riksbank. Own calculations.

Monetary policy outlook

Resource utilisation is extremely low and should remain so for an extended period of time. In addition, there are a number of near-term risks for deflation – *inter alia* the upcoming wage negotiations. However, as the risks are mainly tilted to the upside in terms of monetary policy, we take into account what would happen should the wage process – for any reason at all – take another direction than currently expected.

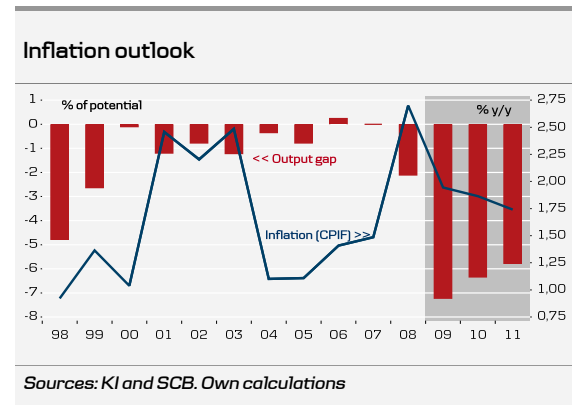
The Riksbank has already lowered rates to what it regards as the zero interest rate floor, 0.25%, and has committed to hold rates low for a long period of time. This has been underlined by three SEK100bn fixed-rate repo facilities instigated at the executive board meetings in July (and terminated at the December meeting).

Thanks to these and other measures, not to mention the apparent stabilisation of global developments, credit has started to flow freely in the Swedish economy again. In fact, the credit contraction feared has turned into a credit boom, where first and foremost the household sector has taken on more debt, and house prices have risen.

Deputy Governor and fool proof Professor Lars E O Svensson probably has no second thoughts on the reflation of domestic house prices and credit growth. But a few other Riksbank members are showing apparent signs of anxiety about the increased leverage in the household sector, especially since it is mainly going into an already strained housing market. We do feel some sympathy with those worries. In a small, open economy, it is always a bit difficult to adhere in all faith to the effects of monetary policy. If global demand does not recover it does not matter much how expansionary domestic monetary policy is. An overly expansionary policy could instead risk jeopardising the long-term trust in the inflation target itself. Or, it could also create unwanted effects on domestically confined asset markets, such as the housing market.

We have tried to reconcile the somewhat differing views on the conduct of monetary policy in two arbitrary policy stages: the first phase is the response to the financial crisis. Here, deflationary and depression and systemic risks are fought back by all means necessary. We believe that we are at the end of this phase, as indicated by statements and actions from both the Riksbank and other central banks. Nonetheless, due *inter alia* to the low utilisation of resources, it should be another 6 to 12 months before economic policy goes into reverse.

In the second phase, once financial markets have managed to shrug off the effects of the crisis and the real economy has stabilised, the withdrawal of stimuli commences. For Sweden this is probably an easier task than for many other economies, since there were no apparent imbalances to begin with and the measures implemented here are of a more traditional form. However, the increased leverage in the household sector and the shortening of duration has made households very susceptible for interest rate changes. Our own simulations show that an interest rate of 3% in a couple of years time would subtract just as much household purchasing power as a 4.75% interest rate in 2008



(For further information see *Reading The Markets: Scandinavia published 4 December*).

Given our optimistic forecasts for international demand, the economic ground should be sufficiently solid for the Riksbank to start hiking the repo rate by the end of summer next year. The initial hikes are expected to be quite aggressive since the Riksbank will need to normalise interest rates rapidly when deflationary risks have petered out. However, thanks to early indications of more subdued housing market developments, the increased interest rate sensitivity among households and the sought-after assistance from the Swedish Financial Supervisory Authority on household credit growth, our earlier call for an extended hiking cycle has lost some weight. We now foresee the Riksbank hiking to a peak level of 3.5% in winter 2011/12 (compared to 4% by year-end 2012 previously), but this is under the vital assumption of more subdued household credit growth rates.

Sweden: Forecast at a glance

National accounts	2008	2009	2010	2011
		Vol growth in %		
Private consumption	-0.2	-0.5	1.8	1.6
Government consumption	1.4	1.3	2.0	0.7
Fixed gross cap formation	2.6	-13.1	-1.3	5.9
Stocks*	-0.6	-1.4	1.2	0.1
Domestic demand	0.1	-4.2	2.7	2.3
Exports	1.9	-12.0	5.5	3.8
Aggregate demand	0.8	-7.1	3.6	2.8
Imports	3.0	-12.8	6.5	3.0
Net exports*	-0.4	-0.5	-0.1	0.6
GDP	-0.2	-4.4	1.2	2.0
- GDP, Calendar adjusted	-0.5	-4.5	1.5	2.0

* contribution to GDP growth

Other items	2008	2009	2010	2011
Trade balance, SEK bn	127	121	118	137
in % of GDP	4.0	3.9	3.7	4.1
Current Account, SEK bn	304	232	224	255
in % of GDP	9.6	7.5	7.0	7.7
Public sector savings, SEK bn	78	-39	-77	41
in % of GDP	2.5	-1.3	-2.4	1.3
Public debt ratio, % of GDP*	37.5	39.5	43.1	46.0
Unemployment, % of labour force	6.1	8.5	10.4	11.2
Hourly wages, % y/y	3.4	3.2	1.8	2.2
Consumer prices, % y/y	2.2	-0.3	0.9	2.6

* Maastricht definition

Financial figures	21.12.2009	+ 3 mths	+ 6 mths	+ 12 mths
Repo-rate	0.25	0.25	0.25	1.25
2-yr swap yield	1.53	1.60	2.00	3.00
10-yr swap yield	3.50	3.75	3.90	4.30
SEK/EUR	1042	1010	980	960
SEK/USD	729	652	653	662

Source: Danske Markets

Norway

Step by step in the right direction

- Norway's economy has climbed out of recession. Low interest rates, an expansive fiscal policy and still high levels of oil investment have helped counter the effects of the global crisis. The global economy has also made a considerable contribution to economic growth in Norway since our previous quarterly report. In contrast, uncertainty has increased in some areas of the oil-related industry.
- Unemployment looks set to be lower than expected. This is due to both stronger growth and a decline in the supply of labour. Gross unemployment continues to rise, but much more slowly than earlier this year. Wage growth 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 settlements may therefore be more modest than we expected.
- Norges Bank has hiked interest rates by 25bp twice since our previous report, though the bank has indicated that rates will only increase gradually. We believe a lengthy period of significant rate increases lies ahead, although low rates in other countries and the NOK exchange rate will restrain central bank actions somewhat in the first half of 2010. Higher yield spreads and increased risk appetite will likely cause NOK to strengthen.

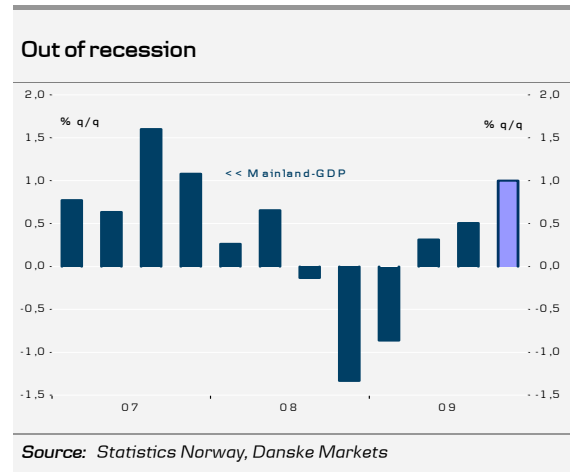
The Norwegian economy has developed largely as expected since our previous quarterly report. The most important development is that exports are now making a significant contribution to overall growth as the global economy continues to pick up.

Steep cuts in interest rates combined with lower inflation have increased household incomes significantly. This is why annual private consumption growth was a little over 4% during the summer – despite a still elevated savings rate. This has been the key factor to pulling Norway out of recession.

House prices, meanwhile, continue to rise. Following a drop in construction costs, we are now approaching the point where the cost of building a new home is cheaper than house prices on the secondary market, especially when taking quality improvements into account. This suggests that the building industry may soon begin to recover in Norway.

In contrast, uncertainty remains high in some areas of the oil supply industry. While oil investment will probably remain high next year, order books are shrinking fast and new orders show no sign of stabilisation.

Unemployment, on the other hand, does appear to have stabilised. This will help reduce much of the downside risk to the housing market, private consumption and the commercial property market. However, nascent signs of



unemployment retreating stem mainly from a decline in the supply of labour and only to a lesser extent from increased employment.

Inflation continues to trend down. A stronger NOK and slowing wage growth will continue to pull core inflation down well into 2010, while low energy prices will pull headline inflation down. Periodical wage statistics suggest that overall wage growth could be somewhat lower than previously thought.

As expected, Norges Bank elected to hike interest rates at its October meeting – the second Western bank to do so. However, there was nothing to suggest we are entering a period of frequent rate changes. Still weak international growth and low interest rates among Norway’s neighbours will limit Norges Bank’s room to manoeuvre with interest rates. We have therefore not changed our forecasts from earlier and are of the opinion that rate hikes will become more frequent from the second half of next year.

After strengthening considerably over the autumn, NOK has retreated a little in recent weeks. The most important cause is probably that many players are now selling ahead of the year-end to secure gains. At the same time, more mixed economic data from Norway and Dubai’s woes have also affected both yield spreads and risk appetite. Given our own yield forecast and the fact that Norges Bank is unlikely to be a major seller of NOK in 2010, we still look for NOK to strengthen after New Year.

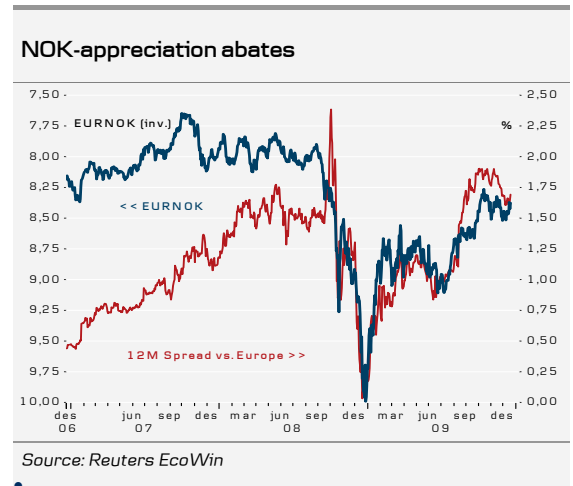
Handsome income growth

Mainland GDP grew 0.5% in Q3 after increasing 0.3% in the previous quarter. Hence Norway is definitely out of recession. As expected, it was an increase in both private and public consumption that supported growth. Considerable fiscal leeway, low interest rates, falling inflation and rising housing and equity markets are the main reasons behind the growth pick-up.

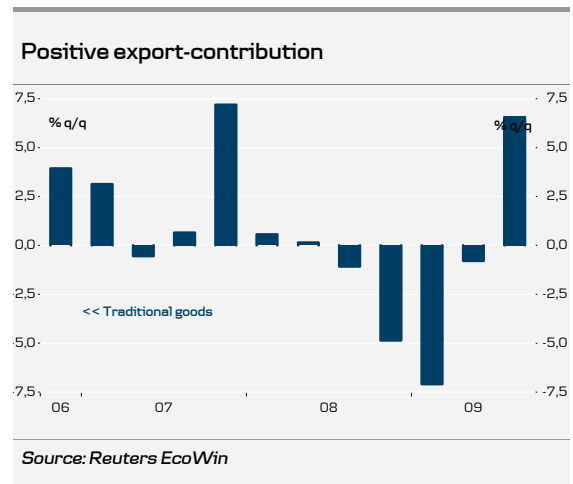
The big news in Q3, however, was the considerable contribution to growth from net exports. Traditional exports increased by 6.6% q/q, while imports actually fell. One might be tempted to think that net exports would make a negative contribution given that domestic demand has been much stronger than growth in the countries surrounding Norway. The positive effect from net exports is probably due to the import content of investments being fairly large and also that the share of imports in Norway always tends to be very high at the peak of an upswing. When growth eases there is thus more spare production capacity in Norway, so imports slow. Nevertheless, the strong level of export growth shows that the recovery in the global economy is now being clearly felt by Norwegian exporters.

Meanwhile, the latest national accounts data show that the household savings rate has increased by more than expected over the past year. The savings rate now stands at 8%, which is a little higher than the historical average. Given higher home and equity values and a stable level of unemployment, the savings rate will very likely ease somewhat over the next few years.

The deep rate cuts from Norges Bank towards the end of last year and during this year have contributed to more than halving average household mortgage



Source: Reuters EcoWin



Source: Reuters EcoWin

interest rates from more than 6.2% in 2008 to well below 3% in 2009. Moreover, lower inflation is helping to boost purchasing power despite wage growth slowing from more than 6% in 2008 to around 4% this year due to the weaker labour market. Declining energy prices will pull inflation lower still in 2010, and together with a gradual improvement in the labour market, a significant increase in purchasing power should be on the cards for next year as well. We estimate that growth in real disposable income will be between 4% and 5% in both 2009 and 2010, which should mean similar growth in consumption, assuming a roughly unchanged savings rate.

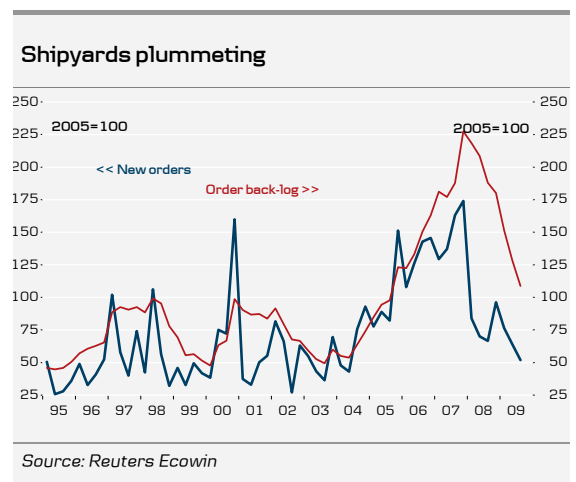
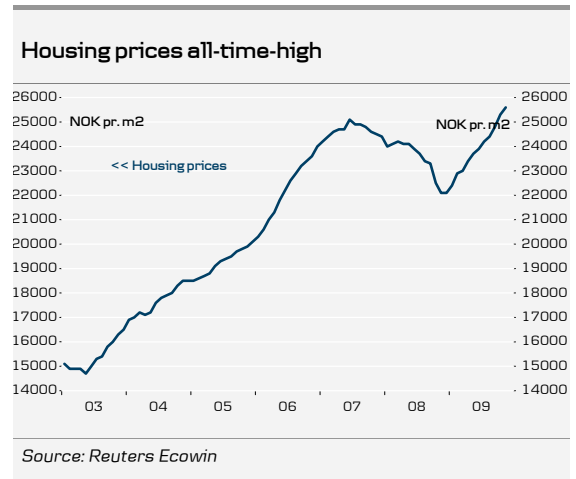
While interest rates have begun to increase and are expected to increase further, there is no sign of house price growth slowing. Seasonally adjusted house prices have risen by 16% so far this year, and the average price per square meter for all housing types is now at the highest level ever.

Meanwhile, the number of unsold homes has remained more or less stable, while turnover has increased sharply: the ratio of unsold housing units to turnover is the lowest since summer 2007. Given that new housing starts are still falling, that interest rates will only increase gradually in 2010 and that unemployment is very probably peaking, there is every reason to believe in a limited downside for house prices.

It has been reported that construction costs have fallen sufficiently for new home prices to be lower than house prices on the secondary market. So far this has not led to much in the way of new home starts, but new housing orders are now increasing for the first time in two years. Anecdotal evidence also suggests that a turnaround in residential construction is close – several housing suppliers report they are now ready to commence new projects. At the same time, increased household purchasing power has resulted in an upswing in the refurbishment of existing homes. This, together with the refurbishment of public buildings in connection with the crisis package in February, is sufficient, we believe, to suggest that the bottom has now been reached for the building and construction industry.

Apart from the improvement in exports, growing pessimism in the oil supply industry is the most important shift in the Norwegian economy since our previous quarterly report. It would appear that the order flow for new ships and platforms completely dried up over the summer. Production remains high thanks to fat order books, but if new orders do not soon pick up, activity will slow dramatically in 2010 and 2011. Investment figures for the oil industry in November showed that the oil companies now reckon on a lower level of investment in 2010 than this year.

Uncertainty is evident in e.g. the regional network that reports to Norges Bank. Expectations in the oil supply industry now suggest that production in H1 2010 will be the lowest in the network's history (since autumn 2002). The trend is also reflected in the PMI, which despite a slight improvement remains below 50, indicating falling activity levels. The Norwegian PMI is, in fact, rising much more slowly than equivalent indices in other countries. One positive aspect, however, is that the order index in November's PMI was actually above 50 – for the first time since July.



We are rather uncertain about the reason for the weak development in oil investment. With oil trading at close to USD80 a barrel, the marginal costs of investing in new production should not be the problem. Perhaps the oil companies are keen to both cut costs in the industry and at the same time put pressure on the authorities to grant access to new production areas. We are convinced that production capacity in the oil industry will have to increase in the longer term, but recent developments carry a downside risk in the short term.

Labour market stabilisation

Unemployment in Norway has grown by less than expected. Employment was largely stable from summer 2008 until June this year, but has now fallen for three months in a row. That unemployment can nevertheless show signs of stabilisation is due to the labour supply shrinking. In our view, the decrease in the labour supply is due to the youngest members of the workforce increasingly completing or seeking further education and the oldest members choosing or being forced to retire earlier when job

opportunities diminish. It is important to remember that the fantastic labour market situation that has prevailed in Norway in recent years has led to a record participation rate among the youngest and oldest workers, suggesting that trend growth is falling.

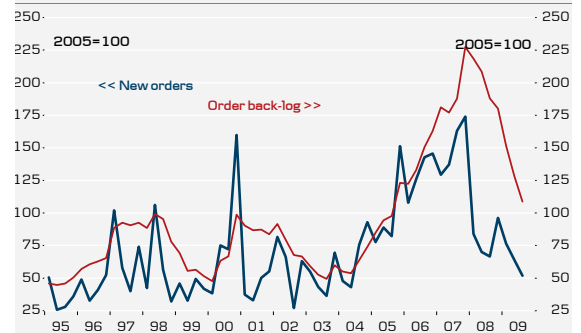
At present our preferred measure of labour market developments is therefore the number of unemployed plus the number of people on government labour market schemes. Measured in this way, unemployment continues to rise, though at a slower pace than earlier this year.

The number of registered job vacancies shows, meanwhile, that the demand for labour remains solid. True, the number of job vacancies is somewhat lower than in the same month in 2007 and 2008, but it remains higher than in 2006. Furthermore, the leading employment indicators from the PMI, Business Tendency Survey, etc. also show signs of improvement, though they still do not indicate rising employment.

Even if the labour market tightens more than expected, we believe this will have less impact on wage growth than one might think. The quarterly wage statistics show somewhat weaker wage growth during 2009 than we had expected, and we have therefore revised down our forecast for wage growth this year from 4.0% to 3.8%. In terms of supplements, this will give a lower wage overhang into 2010. We also note that the employee side signals a pronounced willingness for wage moderation at the spring negotiations.

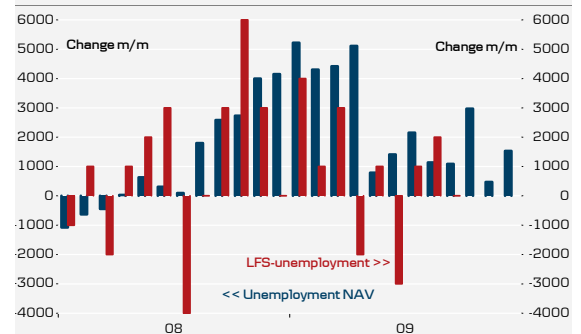
So far we have not revised down our wage growth forecast of 3.7% for 2010, but as employer-side lobbyists gain support for their arguments highlighting the cost-competition problems facing the Norwegian export sector, wage growth might be lower. Pulling in the other direction is a somewhat stronger improvement in profitability than expected. The critical issue will likely be how employment in the oil-related industry develops over the winter.

Expectations rising



Source: Reuters Ecowin

Moderate weakness in the labour market



Source: Reuters Ecowin

The price of imported products will soon begin to fall again as a result of the stronger NOK exchange rate. Given lower wage growth than expected and a cyclical upswing in productivity, we believe that cost-driven price growth will also ease in H1 next year. Together with low energy prices, this should ensure consumer price growth of a little below 1% in 2010.

Rate hikes have started

Norges Bank hiked interest rates by 0.25 percentage points at its meetings in October and December. The central bank has signalled that rate increases will most probably happen gradually, but suggested that rates would approach 5% towards the end of 2012.

As outlined elsewhere in this publication, we expect to see a fairly strong global upswing that will reinforce the growth impulses in the Norwegian economy. This is why we still hold the view that interest rates will approach more normal levels somewhat earlier than Norges Bank has suggested. In any case, we now stand on the threshold of a period of significant rate hikes.

As we do expect any signals of imminent rate hikes from Norway's neighbours, we believe Norges Bank will tread carefully in H1 2010. However, if we are proven correct with respect to the ECB not hiking until early summer and the US central bank at best starting towards the end of the year, the rate spread to other countries will nevertheless increase. This will most likely lead to NOK strengthening (see below), which will in turn limit the actions of Norges Bank. Inflationary pressures continuing to ease well into next year will also act as a restraint on the bank.

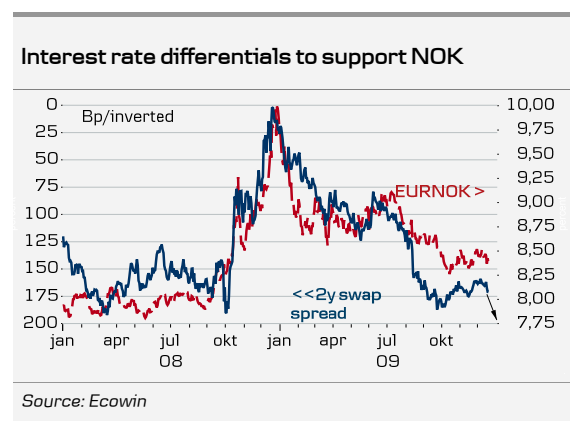
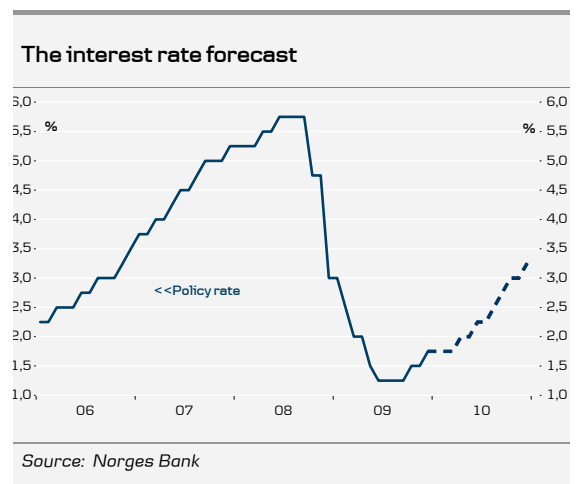
We expect the key interest rate to increase from its current 1.75% to 3.25% by the end of 2010. At this pace, Norway will approach a more normal level of interest rates towards the end of 2011.

Value in the NOK

We believe the currency market in 2010 will reward currencies with a strong cyclical situation and currencies with a large potential for monetary policy unwinding. Furthermore, we believe that the currency market will continue to buy the currencies that are undervalued from a valuation point of view.

The Norwegian mainland economy is expected to expand close to 3% in 2010 and as Norway has one of the smallest output-gaps (spare capacity) in the OECD area the fundamental case for a stronger NOK is quite good.

We also note that the fiscal budget for 2010 is very supportive for the NOK. It seems unlikely that Norges Bank will have to purchase any foreign currency (sell NOK) in the market in 2010 on behalf of the Government Pension Fund – Global (Petroleum Fund). The oil taxes paid in NOK and the dividend from the government's stake in Statoil will likely not be enough to cover the government need for Norwegian krone in 2010. Hence, we might end up in a situation, where the proceeds in foreign currency from the government's stake in the oil sector will have to be exchanged into krone. If that happens



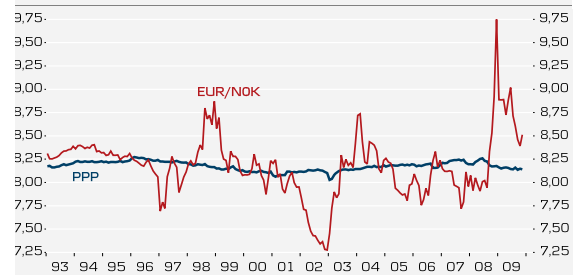
Norges Bank could end up in a situation, where it has to buy NOK in the market instead of the normal selling. In other words, the FX flows in 2010 are expected to lend support to NOK.

Interest rate differentials, or carry, have played a minor role in the FX market in 2010, as rates have all been close to zero. However, looking into 2010 we argue that carry will become a very important driver in the FX market. Considering that Norges bank is expected to hike an accumulated 150bp on top of the 50bp this year the interest rate spread to Euroland is expected to widen significantly. We only expect a modest 50 basis points tightening of the ECB policy rate in 2010.

Finally, we still argue that NOK offers value from a valuation point of view. A simple purchasing power parity (PPP) model points to a EUR/NOK level of 8.15. In respect of valuation we also believe the NOK will benefit from outstanding government balances. Few countries can compete with huge budget surpluses and a huge sovereign wealth fund.

We forecast that EUR/NOK will drop to 8.20, 8.10, and 8.00 on a three-, six- and 12-month horizon.

PPP model points to a stronger NOK



Source: Ecowin, Danske Markets

Norway: Forecast at a glance

National accounts	2008(2006-prices)	2007	2008	2009	2010
	NOK bn			Vol growth in %	
Private consumption	947.5	5.3	1.1	0.1	4.6
Public consumption	443.4	3.0	4.1	6.0	4.3
Gross fixed investment	477.6	12.5	1.3	-7.7	0.3
Petroleum activities	132.2	4.3	2.7	2.5	-1.6
Mainland Norway	345.34	15.6	0.8	-11.2	1.0
Dwellings	87.5	3.2	-12.3	-18.7	-2.0
Enterprises	187.7	17.0	-0.1	-15.3	-1.0
General government	70.2	9.9	4.6	5.6	7.6
Mainland demand	1920.2	8.1	2.9	-2.7	4.6
Total domestic demand	1868.5	5.2	2.4	-2.3	4.2
Growth contribution from stockbuilding	51.7	-1.0	0.5	-1.5	0.6
Exports	1042.0	2.1	0.9	-5.0	0.5
Crude oil and natural gas	478.0	-2.7	-2.2	-2.2	-1.6
Traditional goods	309.2	7.7	4.4	-8.6	5.7
Total demand	2962.2	4.1	1.9	-3.3	2.9
Imports	687.5	8.7	2.3	-11.2	3.6
Traditional goods	446.1	8.3	-0.4	-12.8	3.6
Growth contribution from net exports	354.5	-1.6	-0.3	1.1	-0.8
GDP	2274.7	2.7	1.7	-0.8	2.7
GDP Mainland Norway	1719.891	5.5	2.5	-1.1	2.7
Other items					
		2007	2008	2009	2010
Employment, % y/y		4.1	3.1	-0.3	-0.1
Labour force, % y/y		3.1	3.1	0.2	0.3
Unemployment (LFS), %		2.5	2.6	3.1	3.4
Annual wages, % y/y		5.6	5.8	4.0	3.6
Consumer prices, % y/y		0.8	3.8	2.1	1.7
Core inflation		1.4	2.6	2.6	1.7
Financial figures					
		21.12.09	+ 3 mths	+ 6 mths	+ 12 mths
Deposit rate		1.75	2.00	2.25	3.25
2y swap rate, %		3.37	4.05	4.50	5.30
10y swap rate, %		4.56	4.85	5.00	5.30
EUR/NOK		835.1	820	810	800
USD/NOK		5.8	539	544	556

Source: Danske Markets

Finland

Stabilisation before weak recovery

Output has fallen exceptionally fast in Finland. During the first nine months of 2009 GDP was 8.6 percent lower than a year earlier, at par or even exceeding Iceland and Ireland. Encouragingly, the decline stopped during the third quarter compared to the second quarter. We forecast a modest recovery to have started during the fourth quarter, but full-year GDP is likely to be more than 7 percent lower than in 2008. Given the challenging export outlook and retirement boom, we expect the recovery to continue as a weak one with 1.5 percent growth in 2010 and 2.5 percent in 2011. A weak recovery will not create enough jobs and the unemployment rate is projected to exceed 10 percent in 2010, before moderating in 2011. Inflation is set to rise from zero in 2009 to over 1 percent in 2010. Expansionary fiscal policy creates a wide budget deficit, but trade balance should continue to show a surplus.

Exports reached the bottom

Volume of goods and services exports was a staggering 28 percent lower during January-September than a year ago. Exports of goods fell more than services, as all manufacturing industries suffered from weak global demand. Exports accounted only for 36 percent of GDP during the first nine months, while a year ago the ratio stood at a record-high 48 percent. Exports stopped falling during the third quarter compared to the second quarter, but signs of any recovery remain weak.

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. 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 6 percent in 2010 and faster in 2011. Yet, given the depth of the fall it will take some years to reach the 2008 peak figures in exports.

Investment slump to continue

Investments fell already in the last quarter of 2008, and the fall has steepened to 13 percent during the first nine months of 2009 from year earlier. Housing construction has decreased by 12 percent; other construction and machinery & equipment have shrunk 17 percent. The decline derives entirely from the private sector, because public investments have been reported to have increased 5 percent.

Manufacturing has plenty of capacity and the office vacancy rate has increased in many service industries, spelling quiet times for construction of business premises. Supported by the government and rising apartment prices, housing construction shows an improving outlook. We expect a total decline

of 15 percent in investments in 2009 and a further fall of 4 percent in 2010. Recovery and pent-up demand for new technology are likely to re-vive investment activity in 2011.

Anaemic outlook for private consumption

After rising for 15 years, private consumption growth halted mid-2008 due to a peak in inflation and a deteriorating outlook. In January-September 2009 recession closed wallets and the volume of private consumption fell 2.7 percent year-on-year. Purchases of durable goods plunged by 14 percent, especially car sales have stalled, but expenditure on services fell only 1 percent.

Hourly earnings and pensions have risen 4-5 percent during the first nine months of 2009 and inflation has fallen below zero. Rising unemployment, reduced over-time pay and bonuses have worked the opposite way and purchasing power has been roughly flat. Weak employment, slower growth in hourly earnings, flat pensions, rising municipal taxes, VAT increase late 2010 and return of inflation will limit personal expenditure, even if consumer confidence has made a remarkable recovery. Given the historical correlation between consumer expectations and retail sales, we expect private consumption to be flat year-on-year, after falling 2.5 percent in 2009. Public consumption has risen moderately in 2009, but especially tight budgets in municipalities are likely to stem growth in public spending in 2010. A debate about exit from large budget deficits points to tax increases and spending cuts in 2011 also in the central government.

GDP bottoming out to a permanently slower growth path

Output fell sharply during the first half of 2009 and GDP was 8.6 percent lower in January-September from a year earlier, despite stabilisation during the third quarter. Output has declined in all industries except agriculture. The decline is comparable to Iceland or Ireland, but the recessions are still not alike. The shock is almost fully external from exports, while Iceland and Ireland suffer from excesses in banking and construction. The unemployment rate in Finland has risen less than feared; our forecast for 2009 had to be revised to a smaller figure. Low interest rates mitigate the shock in domestic markets and a recovery in export markets should revive the economy from Q4 onwards.

We expect the recovery to be a weak one with 1.5 percent growth in 2010 and 2.5 percent in 2011, which would still leave the total output significantly behind potential derived from the outlook in 2008. The future potential output is unlikely to return to previous trend, because closures in paper & pulp have destroyed capacity and deteriorating demographic structure yields less growth. Under our growth projections, total output would not reach the earlier 2008 peak before 2012 or 2013.

Employment was 2.7 percent lower in January-October than a year ago. While the number of employed has shrunk in all industries, manufacturing jobs were hardest hit by a fall of 9 percent. All hours worked dropped 7 per-

cent and in manufacturing a staggering 17 percent. At the same time, supply of labour was reduced only by one percent forcing a rise in unemployment.

The number of unemployed in January-October was 222,000 on average, that is 48,000 more than a year earlier. Unemployment rate rose by nearly 2 percentage points to 8.3 percent and the full-year average is likely to reach 8.4 percent. There has been some slowdown in the loss of jobs during autumn, but despite a downward revision in 2009 estimate we forecast a 10.2 percent unemployment rate for 2010. Without immigration, the Finnish workforce is starting to decline due to demographic factors.

Headline inflation reaching positive numbers in 2010

A quick fall in oil and other raw material prices, decreasing interest rates, moderation in housing costs and a reduction of food VAT from 17 percent to 12 percent in October have pushed consumer prices below 2008 figures during the second half of 2009. We expect full-year average inflation to be zero in 2009 and to rise to above 1 percent in 2010 mainly on the back of oil and other raw materials. Also a VAT increase from 22 to 23 percent in late 2010 will raise the price level. Low cost pressure from the labour market and excess capacity in some industries imply modest inflation outlook up to 2011, but raw material prices can create larger changes.

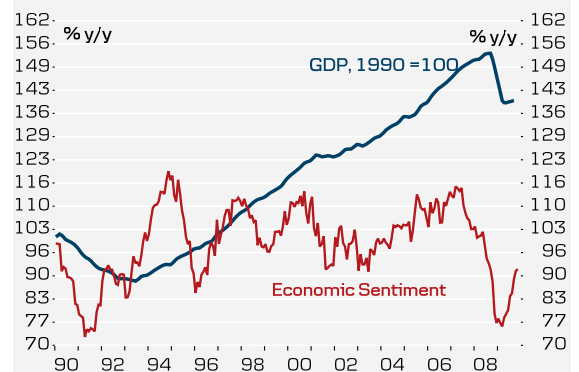
Employee earnings rose 5.5 percent in 2008, more than in several years. State salaries rose more than average, fuelled by previous labour agreements. The rise has continued at excess of 4 percent in January-September, but we expect it to moderate to clearly below 3 percent in 2010.

Apartment prices fell marginally in the fourth quarter of 2008 and first quarter of 2009, roughly 5 percent from a year earlier. Lower interest rates and improving consumer confidence surprisingly turned the market and prices regained the fall by third quarter 2009. Trade volumes have continued to rise, but limited supply is starting to create a bottleneck and push prices higher. Prices might still rise marginally, before new construction adds to supply. House prices have decreased more than 10 percent from year earlier, but stabilisation would seem to have taken place during late 2009. We expect fairly stable prices in 2010-2011.

Public sector balances deteriorating

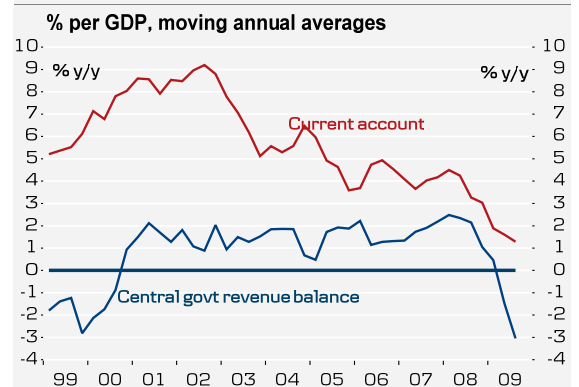
Finland has maintained a general government surplus for several years and the State is not highly indebted. The positive current account balance during the past 16 years and also during forecast period 2010-2011 highlight the savings orientation, even if there are differences between sectors. General government balance has turned into a clear deficit in 2009 and debt will rise significantly in 2010-2011. The public sector faces falling tax income, rising unemployment costs and a need to stimulate the economy. We expect the public debt-GDP ratio to rise to nearly 50 percent in 2010. Despite the rise, Finland remains one of the least indebted countries in the euro area. Soon after the recession ends, taxation is likely to be raised in order to close the deficit and keep pension systems adequately funded. Government plans to build new buffers against future shocks.

Sentiment consistent with weak recovery



Source: Reuters Ecowin

Recession weighs on budget and current account



Source: Reuters Ecowin

Finland: Forecast at a glance

National accounts	2007	2008	2009	2010	2011
			Vol growth in %		
GDP	4.2	1.0	-7.2	1.5	2.5
Imports	6.5	7.0	-21.0	2.0	3.5
Exports	8.1	7.3	-25.0	6.0	7.0
Consumption	2.6	1.9	-1.6	0.1	0.9
Private	3.3	1.9	-2.5	0.2	1.0
Public	0.8	2.0	1.0	0.0	0.5
Investments	8.7	0.3	-15.0	-4.0	3.5
Other items	2007	2008	2009	2010	2011
Unemployment rate, %	6.9	6.4	8.4	10.2	9.2
Earnings, %	3.4	5.5	4.0	2.8	2.5
Inflation, %	2.5	4.1	0.0	1.2	2.0
Current account, Bn euro	7.3	5.6	1.0	2.5	4.5
Current account / GDP, %	4.1	3.0	0.6	1.1	1.5
Public deficit / GDP, %	5.2	4.5	-3.4	-4.6	-4.6
Public debt / GDP, %	35.1	34.1	43.0	49.5	53.5
Sampo Bank economists					
Financial figures	22.12.09	+3 mths	+6 mths	+12 mths	
Repo rate, %	1.00	1.00	1.00	1.50	
2 year swap rate	1.73	1.95	2.10	2.80	
10 year swap rate	3.49	3.70	3.85	4.15	
EUR/USD	142.49	152.00	149.00	144.00	

Source: Danske Markets

Global

Fighting gravity

- Our forecasts for the global economy are left broadly unchanged. We continue to look for strong growth in the short term and expect business surveys to continue higher. Our growth forecast is still slightly higher than consensus – but less so than three months ago.
- From Q2 10 we project a gradual slowdown in growth as the boost from the inventory cycle and policy stimulus fades. The global recovery should prove sustainable, though, with growth slightly above trend into 2011.
- Labour market improvement is key for restoring confidence and sustaining the recovery. We look for a peak in unemployment in both the US and Euroland in Q1 10. If confidence takes hold there is a lot of pent-up demand to be unleashed – especially in the US.
- A key risk to our scenario is a setback in confidence that takes the economy back into a negative feedback loop in which employment and investment fail to come through. Testing times are approaching for sustainability and hence markets may become more jittery.
- Deflationary pressures in the developed world will continue to be stronger than inflationary pressures.
- Monetary policy will stay loose for a long time. Liquidity measures will start to be phased out gradually. The ECB will hike before the Fed as ECB is more concerned about sowing the seeds for new excesses in the financial system. China is expected to resume CNY appreciation in spring 2010.

Recovery on track

The global recovery has been broadly on track and most regions left recession in Q3. US growth disappointed, but mainly because inventories continued to be depleted at a very fast pace. This means that some of the boost from inventory changes will be pushed to Q4 09 and Q1 10 instead. On a positive note, US consumers have staged a small revival. Even outside cars (temporarily boosted by the cash-for-clunkers scheme), consumption has shown signs of life. The US housing market has moved from a major drag to a decent boost as housing starts have started to recover from record-low levels.

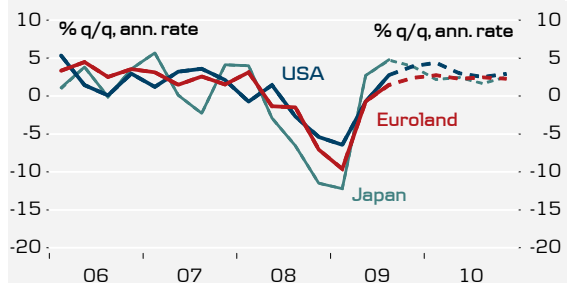
Asia has continued to surprise on the upside with buoyant activity in the second half of 2009. Euroland has witnessed a recovery broadly in line with our expectations driven by rising exports and a smaller reduction in inventories. There is a strong division within Euroland, though, with Germany and France outperforming while the ‘bubble economies’ of Spain, Ireland and Greece are still suffering quite badly. Central and Eastern Europe are also lagging in the recovery, although they are also showing some signs of stabilisation.

Global forecasts

% y/y	2009				2010			
	Danske Bank	Consensus	IMF	OECD	Danske Bank	Consensus	IMF	OECD
USA	-2.5	-2.4	-2.7	-2.5	3.2	2.6	1.5	2.5
Euroland	-3.9	-3.9	-4.2	-4.0	2.2	1.2	0.3	0.9
Japan	-5.1	-5.7	-5.4	-5.3	2.9	1.3	1.7	1.8
China	8.5	8.3	8.5	8.3	9.6	9.5	9.0	10.2
Global	-0.9		-1.1		3.9		3.1	
Asia (excl. Japan and CEE and CIS)	2.3				5.8			
	-7.4				0.9			
	Change from previous forecast							
USA	-0.1				0.0			
Euroland	-0.2				0.0			
Japan	0.0				-0.1			
China	0.0				+0.1			

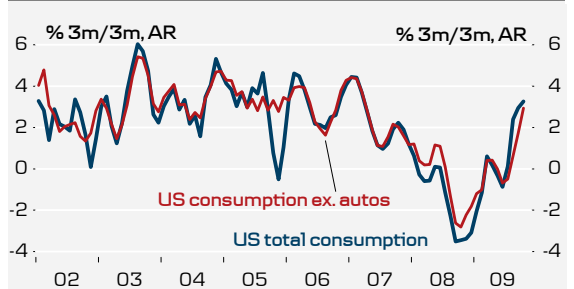
Source: Danske Markets, Bloomberg, OECD, IMF

Growth profile in G3



Source: Reuters Ecowin

US consumers showing signs of life again



Source: Reuters Ecowin

Continued strength in the short term – peak in Q1

We expect global growth to continue to remain strong in the short term as the current drivers behind the recovery will be with us for a few more quarters:

1. *Inventories* have been depleted in most sectors and the gap between production and demand has yet to be closed.
2. The effect of *policy stimulus* is still strong as tax cuts are working their way through the system and infrastructure projects will come through in early 2010. Rate cuts will have an increasing impact on the economy – especially through a positive effect on the housing market.
3. *Financial healing* will increasingly underpin investment. While small businesses are still struggling to get loans, large corporations now have strong access to capital in corporate credit markets.
4. *Asia* continues to be a strong support for exports in the developed countries and commodity exporters in Emerging Markets outside Asia.

We believe the effect of these factors will peak in Q1 10 and that growth will slow down during the rest of 2010. Business confidence is likely to rise further over the next three or four months but is expected to level off after that reflecting the slowing of growth.

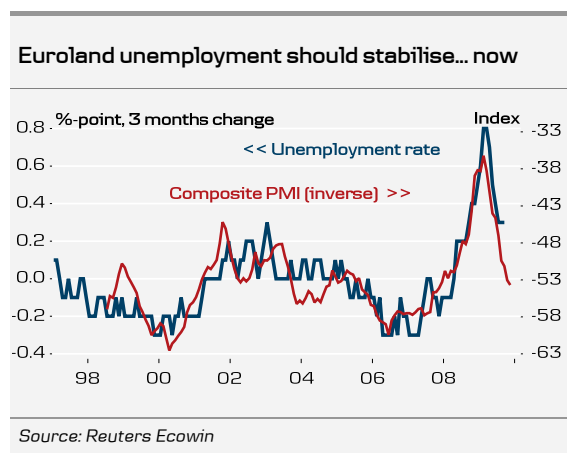
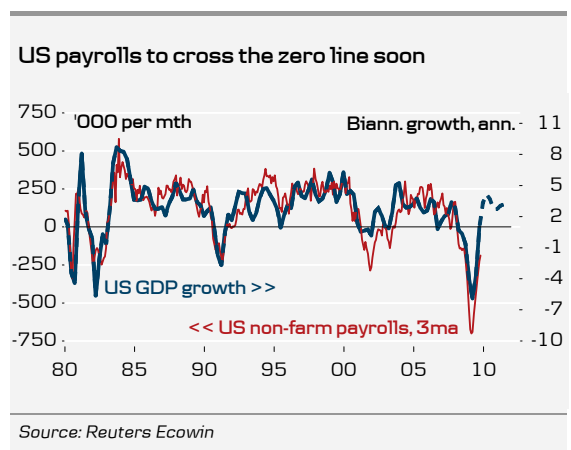
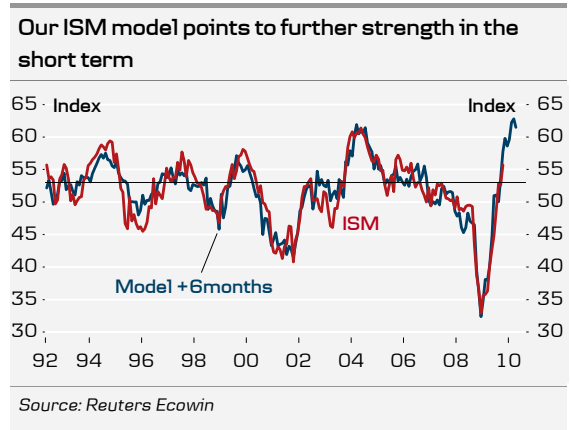
The exact timing is uncertain but it is likely to be important for financial markets as slowing growth could easily reignite concerns that growth is faltering and that we are headed for a double-dip recession.

Can we defeat gravity and get real lift-off?

As the growth momentum starts to fade in 2010, it is crucial that we see signs that the recovery will be sustainable. It is still uncertain whether the short-term boost is strong enough to jump-start the economy.

It is comparable to a rocket ship that needs lift-off. Massive power is needed in the beginning to fight gravity and get the ship going. Once it is in the air and moving, it is probably safe to assume that gravity has been defeated and that it will continue. On the other hand, if the initial power is not strong enough, there is the risk that the rocket ship will lose momentum too early and crash. The stronger the gravity, the more power is needed. And gravity is strong in the world economy at the moment. It is still uncertain whether enough fuel has been added, but we believe it is the case.

Most critical for sustainability is improvement in the labour market. **If the current improvement in US private consumption is to be sustained, we need job growth to kick in early 2010. We believe this is what we will see** as also argued in our *Research – US: Job recovery ahead*. Massive cutbacks in employment during the crisis have left the companies lean and with growth expected around 4% in coming quarters this should prove sufficient to create employment growth. We also expect unemployment in Euroland to peak in early 2010 as the current growth pace is normally enough to turn the labour market (see *Research – Euroland: Imminent labour market stabilisation*).



Testing times getting closer – confidence critical

We will probably know over the next three to six months whether the rocket ship gets real lift-off and continues on the path of moving up – or whether it loses momentum too early and crashes. Key indicators to track are employment and confidence data. Financial market developments will also be important as renewed setbacks can become self-fulfilling if they derail confidence. Other potential risk factors include a spike in oil prices or a debt crisis leading to a loss of confidence in the sustainability of public finances in G7 countries.

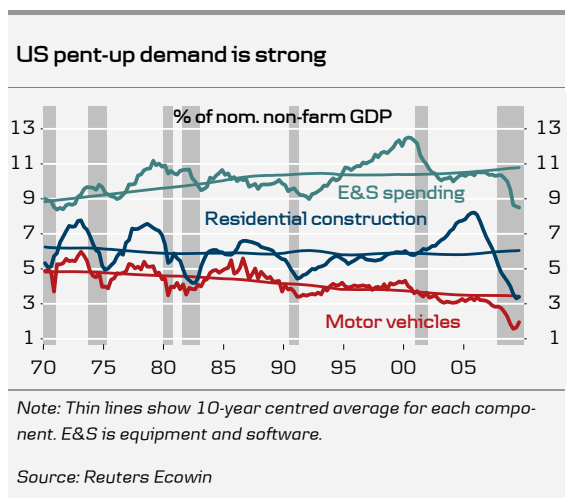
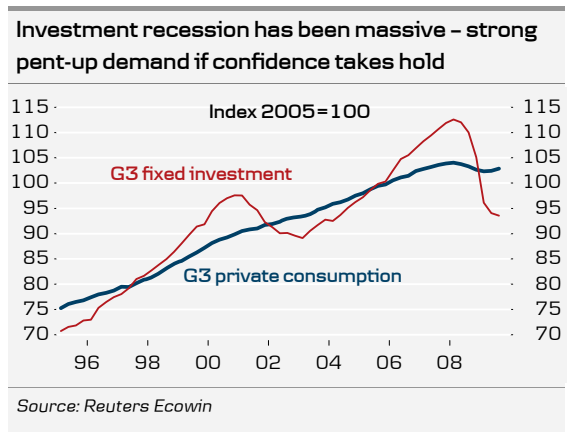
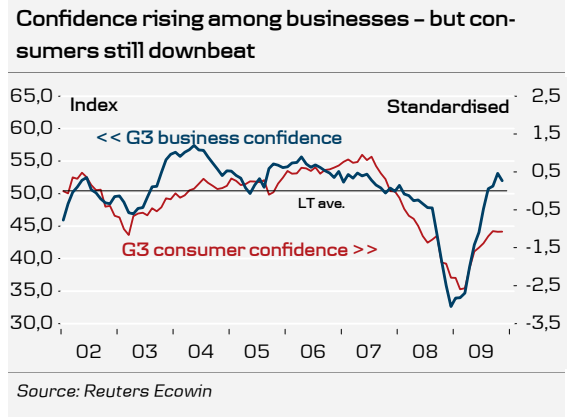
We believe Asia is in the strongest position for a sustained recovery. There are increasing signs of a recovery in private domestic demand and Asia also has more firepower if needed, should the global recovery derail.

Given the initial strong boost, the US and Euroland are also in a good position to get traction and sustain the recovery, albeit at slower growth rates than in the initial phase. Central and Eastern Europe and some countries within Euroland (Spain, Ireland, Greece) will be suffering from further strong need to deleverage and tighten policy and will be strongly dependent on growth elsewhere to avoid a long depression in their economies.

Massive pent-up demand if confidence is restored

If policymakers actually succeed in jump-starting the economy, there is the potential of a continued positive feedback loop in which rising confidence unleashes a lot of pent-up demand that has built up as an effect of the crisis. So where is this pent-up demand? There are three strong cases:

1. *Housing investment* in the US has been reduced to historically low levels, which has been necessary to get rid of inventories of new houses. This process is very far progressed, though, and inventories of new houses are at historically low levels. This means housing starts have to catch up with home sales again, leaving a lot of pent-up demand in residential construction.
2. *Global private investment* is at a record low when compared with the level of GDP. If confidence is restored, long-term investment plans that had been shelved will slowly emerge again. The usual argument against a pick-up in investment is large spare capacity in the overall economy. However, capacity utilisation has never been a good predictor of investment *growth* as it fails to take into account the low starting point for investments and it looks at the economy on average. If we move from a situation where no companies invest to a situation where just 10-15% of companies start investing, we will see a recovery in overall investment. We are seeing signs of this currently as capital goods orders are recovering from record low levels.
3. *US car sales* are also at a record low which is unsustainable in the long run given the rise in the number of households and the write-downs on cars. At some point car sales will have to rise again – and probably quite a bit.



As mentioned the main risk to our scenario is that confidence fails to take hold and pent-up demand continues to be just that – pent-up. You don't buy a car if you are afraid of losing your job. You postpone necessary investment further if you don't know if the company can survive another downturn. And you don't build any new houses if consumers stop looking for a house again because the recovery has been derailed.

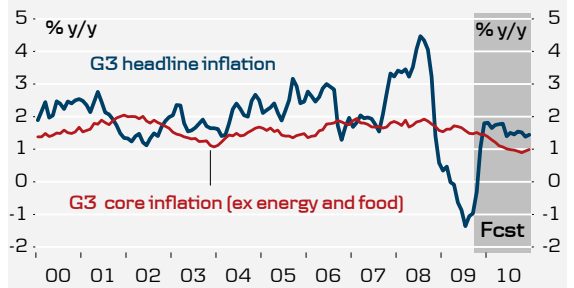
Deflationary pressures and gradual policy exit

Although headline inflation is likely to rise globally due to the rise in commodity prices, underlying pressures on inflation are still on the downside. High unemployment will lead to very low wage growth and pricing power will be limited for a long time as demand will be very vulnerable to price rises. Hence core inflation will probably move lower into next year.

A key issue in 2010 will be exit strategies regarding both monetary and fiscal policy. We believe the exit will take place very slowly as the recovery will be very fragile for some time. Too early tightening and the recovery risks stalling with confidence faltering again. This could mean starting all over again – and with very limited firepower given ballooning public deficits.

We expect the Fed to stay on hold for most of 2010 but think the ECB will start to lift rates slowly from summer 2010. The ECB is more concerned about sowing the seeds for new bubbles and does not like extremely low rates for extended periods. Monetary policy in Asia is expected to be tightened earlier and more than in Europe and the US. Only in Japan with inflation expected to remain negative for most of 2010 do we expect monetary policy to be on hold. In China, we expect the central bank to start tightening monetary policy in Q1 10 and resume the gradual appreciation of CNY.

Headline inflation to turn higher – but core inflation to continue lower



Source: Reuters Ecowin

Road map for sustainability

Our expectations for key drivers to judge sustainability:

1. US payrolls to show job growth in early 2010. Unemployment peaks in Q1. Similar pattern in Euroland.
2. Business confidence to stay high while consumer confidence climbs gradually.
3. Oil prices should rise only slowly. If it spikes higher on rising demand we could face new downturn – especially in the US and Euroland.
4. Equity markets hang on to gains. If sentiment falters and equities drop we could see hit to confidence hitting consumption and investment.
5. Asian growth to stay robust.
6. Confidence in public finance sustainability in G7 does not deteriorate further. If it does it could hit sentiment and derail recovery.

Macroeconomic forecast

Macro forecast, Scandinavia

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Stock build. ²	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Unem-ploym. ³	Public budget ⁴	Public debt ⁴	Current acc. ⁴
Denmark	2009	-4.8	-4.7	2.2	-12.2	-1.6	-9.5	-13.2	1.3	3.6	-3.0	38.0	3.5
	2010	1.7	2.5	1.4	-5.2	0.7	4.6	4.1	1.5	5.3	-6.1	42.1	2.5
	2011	2.0	2.0	0.9	2.6	0.2	3.5	3.6	1.7	5.7	-4.4	46.4	2.1
Sweden	2009	-4.4	-0.5	1.3	-13.1	-1.4	-12.0	-12.8	-0.3	8.5	-1.3	39.5	7.5
	2010	1.2	1.8	2.0	-1.3	1.2	5.5	6.5	0.9	10.4	-2.4	43.1	7.0
	2011	2.0	1.6	0.7	5.9	0.1	3.8	3.0	2.6	11.2	1.3	46.0	7.7
Norway	2008	2.5	1.1	4.1	0.8	0.5	-2.2	2.3	3.8	2.6	8.0	26.0	19.0
	2009	-1.1	0.1	6.0	-11.2	-1.5	-2.2	-11.2	2.1	3.1	12.0	26.0	24.9
	2010	2.7	4.6	4.3	1.0	0.6	-1.6	3.6	1.7	3.4	13.9	26.0	24.8

Macro forecast, Euroland

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Stock build. ²	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Unem-ploym. ³	Public budget ⁴	Public debt ⁴	Current acc. ⁴
Euroland	2008	0.6	0.3	2.2	-0.7	0.1	1.1	1.1	3.3	7.6	-1.9	69.3	-0.8
	2009	-3.9	-0.5	2.5	-9.8	-0.5	-14.2	-12.1	0.3	9.4	-6.1	78.0	-0.8
	2010	2.2	0.8	2.1	2.8	0.3	6.1	5.1	1.1	9.9	-6.5	83.5	-0.4
Germany	2008	1.0	0.2	2.0	5.0	0.0	2.4	3.9	2.9	7.4	-0.5	63.0	7.1
	2009	-4.8	0.5	2.5	-11.8	0.4	-14.4	-8.5	0.3	8.2	-3.5	67.0	5.2
	2010	2.6	0.7	1.8	5.6	0.0	8.7	7.5	1.1	8.5	-5.5	72.0	5.4
France	2008	0.8	0.8	1.4	0.5	0.0	2.0	1.8	3.3	7.8	-2.9	66.0	-1.6
	2009	-1.8	-0.4	1.6	-3.8	-0.3	-0.3	-0.4	0.4	8.6	-5.0	71.0	-1.4
	2010	2.1	1.6	1.4	2.1	0.2	2.9	2.9	1.3	9.1	-6.0	78.0	-1.6
Italy	2008	-0.3	-0.6	1.2	-1.5	0.0	0.3	-1.5	3.6	7.0	-2.6	103.0	-2.6
	2009	-4.5	0.2	1.2	-4.8	-0.3	-0.6	-0.9	0.8	8.5	-4.0	107.0	-2.1
	2010	1.7	0.3	1.0	2.0	0.2	2.0	2.4	1.9	9.1	-4.5	111.0	-2.5
Spain	2008	1.2	0.1	5.3	-3.0	0.0	0.7	-2.5	4.1	11.3	-3.8	38.0	-10.0
	2009	-3.5	-4.7	3.4	-12.0	-0.2	-19.0	-21.0	0.0	18.9	-9.5	47.0	-6.0
	2010	0.3	-1.0	2.0	-2.4	0.1	10.8	4.1	1.4	21.0	-9.0	56.0	-6.0
Finland	2008	1.0	1.9	2.0	0.3	-0.6	7.3	7.0	4.1	6.4	4.5	34.1	5.6
	2009	-7.2	-2.5	1.0	-15.0	0.0	-25.0	-21.0	0.0	8.4	-3.4	43.0	1.0
	2010	1.5	0.2	0.0	-4.0	0.0	6.0	2.0	1.2	10.2	-4.6	49.5	2.5

Macro forecast, Global

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Stock build. ²	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Unem-ploym. ³	Public budget ⁴	Public debt ⁴	Current acc. ⁴
USA	2008	0.4	-0.2	3.1	-5.1	-0.3	5.4	-3.2	3.8	5.8	-3.2	69.0	-4.9
	2009	-2.5	-0.6	2.2	-18.3	-0.7	-10.0	-13.8	-0.3	9.3	-14.0	82.8	-4.9
	2010	3.2	2.0	2.4	5.4	0.9	10.8	10.4	2.4	10.3	-9.0	88.4	-2.7
Japan	2008	-0.7	0.6	0.8	-5.1	-0.2	2.0	0.9	1.5	4.0	-5.6	196.0	3.3
	2009	-5.1	-0.8	1.0	-13.0	-0.2	-24.6	-14.6	-1.3	5.2	-9.8	212.0	1.9
	2010	2.9	1.6	1.1	-0.7	0.4	17.8	1.1	-0.7	4.8	-8.0	220.0	2.0
UK	2008	0.7	1.7	3.3	-4.0	0.0	0.5	1.2	3.7	2.8	-2.5	50.1	-3.6
	2009	-2.7	-0.3	1.5	-0.3	0.0	-3.6	0.0	2.3	5.0	-8.8	60.0	-3.4
	2010	1.0	1.6	2.0	2.2	0.0	4.6	4.9	1.5	6.4	-9.6	68.0	-2.9
Switzer-land	2008	1.6	1.7	0.0	-1.7	-0.4	2.3	-0.2	2.4	2.6	0.9	42.0	9.2
	2009	-2.7	0.2	2.3	-6.4	1.2	-11.7	-7.4	-0.5	3.9	-1.5	40.7	7.6
	2010	1.0	0.5	1.5	-0.5	-0.2	1.3	-1.1	0.7	5.1	-2.5	43.5	8.1

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	22-Dec	0.13	0.25	1.25	3.93	142.7	-	521.5
	+3m	0.13	0.30	1.35	3.85	152	-	490
	+6m	0.13	0.30	1.70	4.20	149	-	500
	+12m	0.75	1.00	2.40	4.40	144	-	518
EUR	22-Dec	1.00	0.71	1.72	3.49	-	142.7	744.2
	+3m	1.00	0.90	1.95	3.70	-	152	745.0
	+6m	1.00	1.20	2.10	3.85	-	149	745.0
	+12m	1.50	1.80	2.80	4.15	-	144	746.0
JPY	22-Dec	0.10	0.28	0.47	1.38	130.9	91.7	568
	+3m	0.10	0.30	0.50	1.45	137	90	544
	+6m	0.10	0.30	0.65	1.65	142	95	525
	+12m	0.10	0.30	1.00	1.90	144	100	518
GBP	22-Dec	0.50	0.60	1.89	3.99	89.4	159.6	832.3
	+3m	0.50	0.65	1.80	3.90	88.0	173	847
	+6m	0.50	0.75	2.00	4.00	85.0	175	876
	+12m	1.25	1.50	2.75	4.40	82.0	176	910
CHF	22-Dec	0.25	0.25	0.80	2.44	149.7	104.9	497.1
	+3m	0.25	0.35	0.90	2.45	151	99	493
	+6m	0.25	0.35	1.15	2.65	152	102	490
	+12m	0.75	0.75	1.60	2.85	154	107	484
DKK	22-Dec	1.20	1.55	2.29	3.76	744.2	521.5	-
	+3m	1.15	1.55	2.40	3.90	745	490	-
	+6m	1.15	1.70	2.55	4.05	745	500	-
	+12m	1.65	2.10	3.15	4.35	746	518	-
SEK	22-Dec	0.25	0.48	1.53	3.53	1043.4	731.2	71.3
	+3m	0.25	0.50	1.60	3.75	1010	664	73.8
	+6m	0.25	0.50	2.00	3.90	980	658	76.0
	+12m	0.75	1.00	3.00	4.30	960	667	77.7
NOK	22-Dec	1.75	2.13	3.44	4.63	839.2	588.1	88.7
	+3m	2.00	2.60	4.05	4.85	820	539	90.9
	+6m	2.25	2.90	4.50	5.00	810	544	92.0
	+12m	3.25	3.90	5.30	5.30	800	556	93.3
PLN	22-Dec	3.50	4.16	5.07	5.77	418.4	293.2	177.9
	+3m	3.50	4.10	5.00	5.85	415	273	180
	+6m	3.50	4.10	5.20	6.10	400	268	186
	+12m	3.75	4.10	5.80	6.35	390	271	191

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

Commodities											
	22-Dec	2009				2010				Average	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010
NYMEX WTI	73	43	60	68	78	82	83	83	85	62	83
ICE Brent	73	78	76	75	77	81	82	82	84	77	82
Aluminium	2,269	2,203	1,526	1,836	1,950	1,900	2,000	2,000	2,100	1,879	2,000
Copper	6,935	6,810	4,685	5,856	6,600	6,700	6,800	6,900	7,200	5,988	6,900
Zinc	2,438	2,270	1,503	1,780	2,150	2,100	2,200	2,200	2,400	1,926	2,225
Nickel/1000	18	16	13	18	18	19	20	21	21	16	20
Gold	1,085	1,216	1,208	1,161	1,100	1,300	1,200	1,150	1,100	1,171	1,188
Matif Mill Wheat	129	130	129	128	130	130	145	143	148	129	142
CBOT Wheat	518	629	636	530	550	575	600	600	625	586	600
CBOT Corn	400	429	443	346	400	425	450	450	475	404	450

Source: Danske Markets

Disclosure

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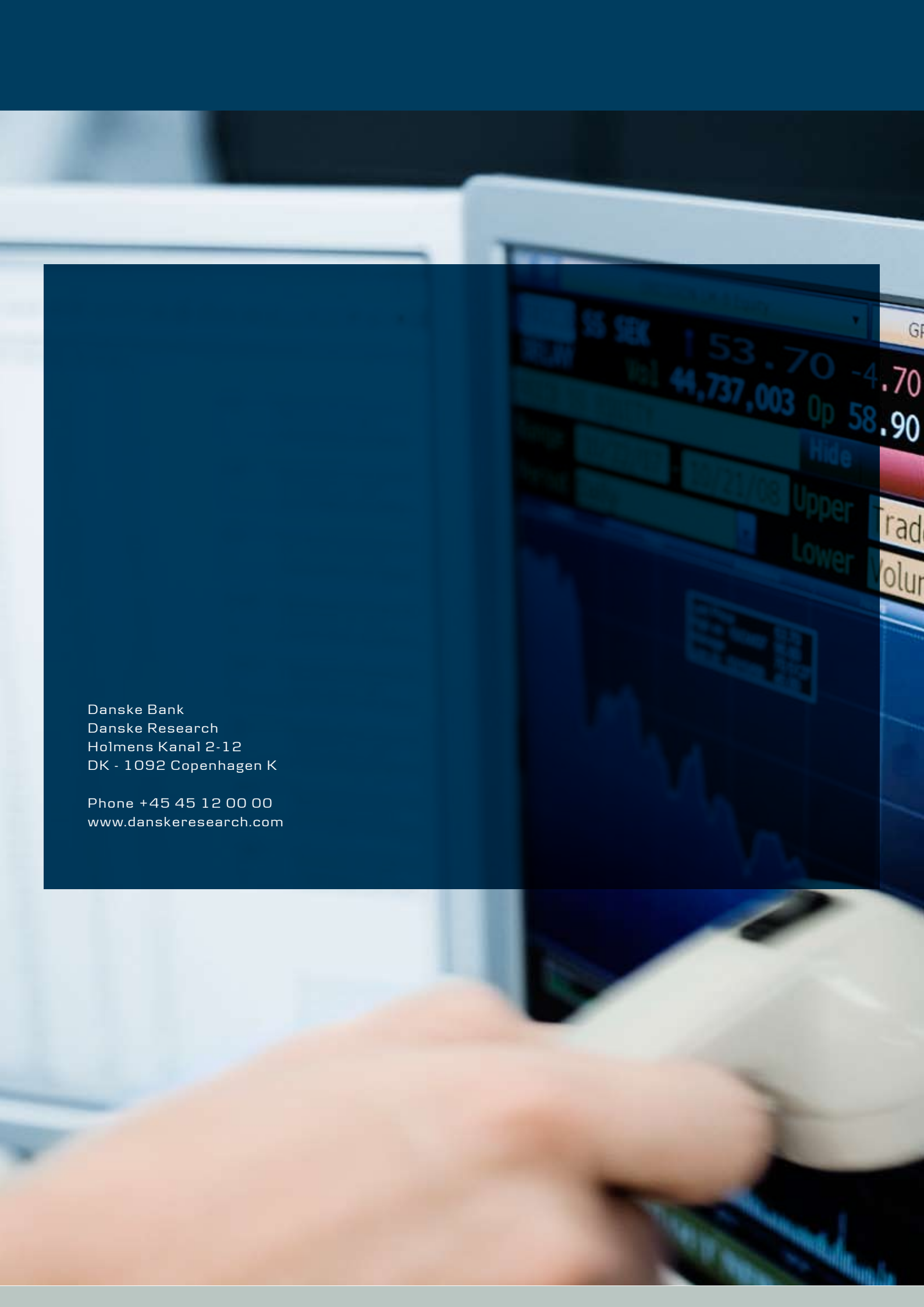
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First date of publication

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A close-up photograph of a person's hand holding a white computer mouse. The mouse is positioned over a computer monitor. The monitor displays a financial data interface with a dark blue background. The interface includes a table of data with columns for 'SEK', 'Vol', and 'Op'. The 'SEK' column shows '153.70' and '-4.70'. The 'Vol' column shows '44,737,003'. The 'Op' column shows '58.90'. Below the table, there are labels for 'Upper' and 'Lower' with corresponding values. A line graph is visible at the bottom of the screen. The overall scene is dimly lit, with the primary light source being the monitor's display.

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