

Executive Briefing

Not so fast – market pricing for rate cuts seems excessive

As we enter 2024, focus is on when, how much and especially why central banks lower rates. Since our last update, interest rate markets have gone through a substantial repricing and markets now expect the Fed to cut rates to below 4% by end of 2024. Similarly, the ECB is expected to cut rates to below 2.5% from the current level of 4%. We acknowledge that inflation has fallen faster than initially expected but we also think market pricing has gone too far. We still think particularly core inflation could prove sticky as labour markets remain tight globally. Hence, we expect that the major central banks will rather adjust rates gradually lower to maintain a sufficiently restrictive real monetary policy stance, instead of opting for a full-on easing mode that the markets seem to suggest.

The euro area economy has lost steam much faster than the US economy, but overall, we are still set for a soft landing. Both manufacturing and service sector activity are now in recession territory in the euro area although December PMIs did not show further weakness. The US economy has been much more resilient thus far, but lower savings, cooling labour market and delayed pass-through of monetary policy will eventually hit consumption, in our view. On the other hand, in both regions, this could be a year of changing fortunes for households and businesses; households will feel relief as their real incomes recover and interest rates decline, while corporates still face rising labour costs that they most likely struggle to pass on to prices due to weakening pricing power.

Inflation could still prove stickier than expected, forcing central banks to keep rates higher for much longer than markets currently expect. Importantly, the recent rally in bond and equity markets implies looser financial conditions, which in itself supports growth and poses an upside risk to inflation. On the other hand, inflation could fall back faster than expected if the economy performs worse than expected. These risks are more pronounced in euro area compared to the US. In the US, fiscal policy is expected to remain supportive for growth which poses an upside risk to inflation, while EA countries will be required to tighten belt (see *Flash: New EU Fiscal rules – A realistic compromise*, 21 December).

Concerning inflation risks, we are closely monitoring tensions on the Red Sea that have disrupted seaborne trade through the Suez Canal route. Many commercial vessels are now opting for an alternative route around Africa that is longer, and hence, more costly. As a result, Shanghai container prices have increased by more than 70% since early December; yet, remain far from the highs seen during the pandemic. Same time oil and gas markets remain calm with prices barely moving despite a very cold weather in Northern Europe. Considering that global goods consumption is much less now than during the pandemic and that overall economic activity is declining, we think there is more leeway before any supply-side disruptions would start to disrupt the global economy and generate inflation.

More broadly, geopolitical risks will remain high on the agenda in 2024. As we wrote in our *Geopolitical radar – What to look out for in 2024*, 22 December, this will be a historically busy election year. Taiwanese election on 13 January will set the tone for China-Taiwan relations for the next four years, while the outcome of the US election in November could re-define the US stance to NATO and supporting Ukraine, their role in Middle East where a war is still raging, as well as their relations with China and the EU.

Key points

- Rate markets have gone through a massive re-pricing and markets now anticipate 5-6 rate cuts by the Fed by year-end 2024 and even more by the ECB. We acknowledge that inflation has fallen faster than initially expected but we also think that market pricing has gone too far.
- Lower interest rate expectations led to solid performance for bonds, equities, credit markets and currencies such as the SEK and NOK in December.
- Labour market strength continues to uphold wage pressures, which continues to feed into service inflation particularly, and we still think that the path to central banks 2% inflation targets could turn out to be a bumpy one.
- Economic data in the Nordic countries is very mixed, but Swedish inflation has started to surprise significantly on the downside.

Denmark

The GDP decline for Q3 was revised to 0.7%, following a similar decline in Q2 and hence on the face of it showing a quite severe contraction in the Danish economy. Apparently, the contraction in Q3 was driven by lower pharmaceutical production and export, which does not fit well with the impression from Novo Nordisk, so we expect either revisions or a boost to GDP and production later on. We do see a more or less stagnant economy outside of pharma, though. Bankruptcy numbers reached their highest level since 2010 in 2023, partly as a delayed effect from pandemic lockdowns but also reflecting higher costs and weaker demand in some industries, such as housing construction.

Sweden

Inflation is slowing down quickly as all standard inflation measures were below the market November forecast. A relatively small discrepancy versus CPI and CPIF was due to electricity prices surprising to the upside (rising 25% m/m), but there was a big downward surprise in core CPIF excluding energy. The core inflation measure turned out 0.4 p.p. below the Riksbank's forecast, printing 5.4% y/y. Different measures of bankruptcies are at their highest since the Swedish banking crisis in the 90s. However, the numbers should be interpreted with caution as the share of companies in bankruptcy has only returned to levels before the pandemic. Manufacturing PMI were more or less unchanged and remains in contraction territory. However, Q4 as a whole saw PMI's rising, which might indicate that the worst now lies behind us, further indicated by the rise in the sub-index "production plans".

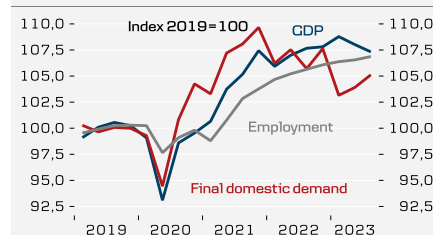
Norway

Short-term data paint a less negative picture of the Norwegian economy than suggested by leading indicators. Retail sales moved moderately upwards towards the end of the year, the manufacturing PMI rose into expansionary territory and the number of new vacancies seems to be improving slightly again. As monetary policy remains contractive, global growth is slowing and real wage growth is barely positive, we are not looking for a significant improvement until well into 2024. On the contrary, Norges Bank's surprise rate hike in December should imply further headwind in the first half of the year.

Finland

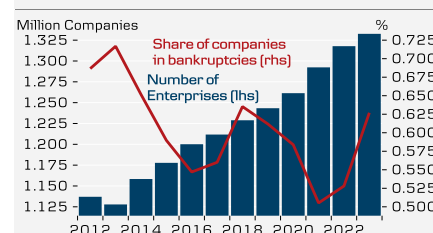
The Finnish economy is in a shallow recession. Foggy outlook and headwinds from high interest rates have cooled consumption, postponed manufacturing investment and frozen construction in H2 2023. 2024 is likely to get a weak start, but the outlook should gradually brighten with lower inflation and interest rates. Unemployment rises in some industries, like construction, while others, like healthcare, suffer from labour shortage. We expect wage rises of nearly 4% in 2024. Consumer confidence is well below average and purchase intentions low. Housing construction is going to fall significantly and stay low in 2024, which has repercussions in other industries like transportation and wholesale trade. Housing market has remained quiet but stable. The tax exemption for first-time home purchases was abolished at year-end. This increased the number of housing transactions in Q4, but a stronger improvement is not expected for a while yet. However, there exists plenty of pent-up demand and lower interest rates help to activate the housing market in 2024.

A volatile and slowing economy



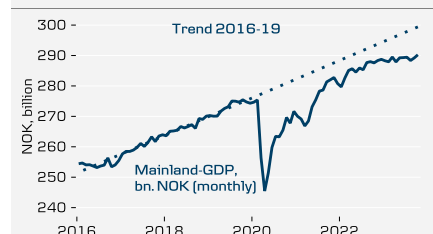
Source: Statistics Denmark, Macrobond Financial

Bankruptcy share is back to levels before the pandemic



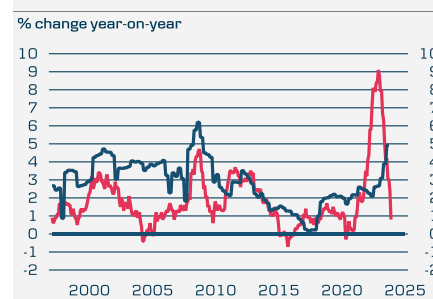
Source: Statistics Sweden, UC, Macrobond Financial

Activity is levelling off



Source: Macrobond Financial

Inflation falling and earnings growing



Source: Macrobond Financial, Statistics Finland

Currency markets

FX markets in December were characterised by strong Scandies performance and a weaker USD. The biggest outperformer over the last month was the NOK which gained more than 4% vs the EUR and hence DKK. The Norwegian currency was aided by a surprise interest rate hike by Norges Bank and changes to the fiscal NOK FX sales in the end of December. The rally in equities extended the SEK rally while the sharp decline in global yields supported the notoriously yield-sensitive JPY with USD/JPY reaching the lowest levels since July. In the other end of the spectre, year-end rebalancing flows alongside weaker-than-expected US data weighed on the USD. Also, a dovish Fed vis-à-vis the ECB contributed to sending EUR/USD more than two figures higher. GBP underperformed peers amid a very soft inflation release while the CNY suffered from the weaker USD and weak domestic releases. Finally, EUR/DKK range traded just north of 7.4500 throughout the month.

Bond markets

In December, the market continued the trend from November to price in more easing from central banks. Short end swap rates dropped 40bp during December to new lows for the year and the drop in the long end of the yield curve was only marginally smaller. Looking at fundamentals, it seemed that the continued lower yields was a result of market sentiment/momentum and particular comments from the Fed. Our view is that EUR rates have dropped too much, and we expect fewer rate cuts from ECB than the market is currently pricing – and thereby we see a potential for higher short end and also 10Y rates. From an issuance perspective, December is typical a dull month and this was again the case this time. Hence, little impact on EGB pricing and Supra/Agency ASW spreads. In Danish mortgage bonds, 30Y 5% bonds mostly trades just above 100 and thereby closed for new issuance with borrowers then taking up loans in 30Y 4% bonds at a modest pace. The main aspect to take note of regarding borrower behaviour now is that we expect more borrowers to focus on 5Y flex loans rather than 1Y flex loans / floating rate loans / bank loans due to the sharply inverted yield curve that makes 5Y flex loans look cheap.

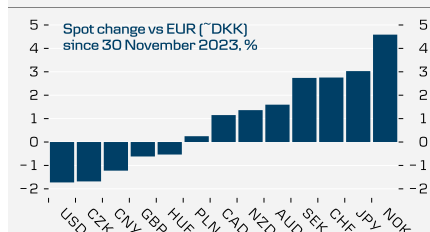
Credit markets

Credit had a very strong December, with significant spread tightening amidst the overall positive backdrop for risk assets. While the rally was most pronounced for CDS indices, cash bonds also saw meaningful performance. This led credit spreads (except for IG) to finish 2023 at the lowest seen during the year. For 2023 as a whole, cash bonds have tightened notably less than CDS indices, with HY spreads approximately 90bp tighter for the year and IG c.10bp, whereas their CDS counterparts have tightened 164bp and 32bp, respectively. We expect January to be very busy from a primary market perspective, as the December rally will probably lure out some issuers to take advantage of the positive market backdrop in addition to the usually high issuance pace in January.

Equities

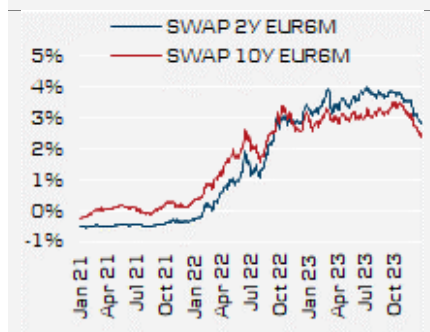
December became yet another month with strong equity performance, but leadership changed as the fundamentals did. The cyclical leadership change into a small cap driven rally. Macro figures are still benign but no longer surprising strongly to the upside. Instead, the massive drop in yields have led to rethinking of the discounting factor. Hence, long duration equities like small caps outperformed in December and started to regain some of the lost ground. Taking the full 2023, the group of cyclical stocks outperformed defensives by 30% primarily driven by continuous upgrade of the US economy. In 2024, we do not expect the same macro upgrades and hence do not expect the same cyclical outperformance.

FX. Sorted spot returns vs EUR



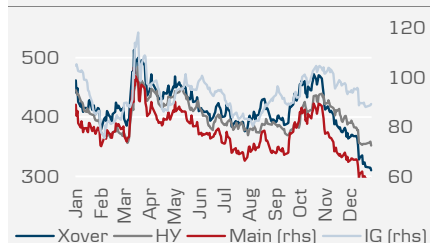
Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial

Significant drop in yields



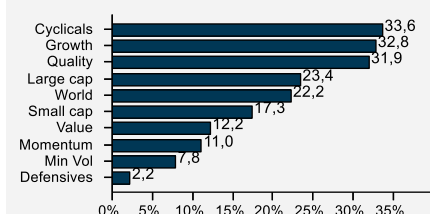
Past performance is not a reliable indicator of current or future results. Source: Danske Bank

Spreads ended 2023 lower



Past performance is not a reliable indicator of current or future results. Source: Bloomberg

Cyclicals best performing style in 2023



Past performance is not a reliable indicator of current or future results. Source: Refinitiv and Danske Bank

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Macroeconomic forecast

Macro forecast. Scandinavia

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Wage growth ¹	Unem-ploym ²	Public budget ³	Public debt ³	Current acc. ³
Denmark	2023	1.1	1.0	1.2	-4.6	10.3	8.7	3.3	4.1	2.8	2.0	29.7	10.5
	2024	1.0	1.8	2.0	-0.4	3.6	5.4	2.0	5.7	3.1	1.0	27.9	11.5
	2025	1.6	1.7	1.6	2.2	1.6	1.8	1.9	3.6	3.3	0.7	26.5	11.5
Sweden	2023	-0.2	-1.7	2.3	-1.0	2.6	0.7	8.6	4.0	7.6	-0.4	29.0	4.7
	2024	1.3	1.1	0.9	1.3	2.9	2.9	2.3	3.3	8.2	-0.8	29.0	4.8
	2025	1.8	2.0	1.5	2.3	3.2	3.6	1.0	2.5	8.0	-0.8	29.0	4.6
Norway	2023	1.1	-1.0	2.0	0.5	4.0	3.0	5.6	5.4	1.8	-	-	-
	2024	1.1	1.2	1.3	4.0	2.0	1.8	3.0	4.4	2.3	-	-	-
	2025	2.1	2.5	1.6	4.0	2.0	1.8	2.0	3.5	2.5	-	-	-

Macro forecast. Euroland

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Wage growth ¹	Unem-ploym ²	Public budget ³	Public debt ³	Current acc. ³
Euro area	2023	0.5	0.4	0.0	0.9	0.2	-0.3	5.5	5.6	6.5	-3.2	90.6	2.5
	2024	0.5	0.6	0.7	0.6	1.7	2.0	2.4	4.6	6.8	-3.0	89.9	2.0
	2025	1.2	1.1	0.8	1.5	2.7	2.6	2.1	3.7	7.1	-2.8	88.8	2.4
Finland	2023	-0.5	-0.5	3.0	-5.5	-0.5	-4.5	6.2	4.0	7.3	-2.8	73.8	-0.7
	2024	0.3	0.5	0.2	0.0	1.0	1.5	1.9	3.4	7.8	-3.0	75.3	-0.3
	2025	1.9	1.2	0.2	4.0	3.0	2.0	1.5	2.5	7.2	-2.7	75.4	0.0

Macro forecast. Global

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Wage growth ¹	Unem-ploym ²	Public budget ³	Public debt ³	Current acc. ³
USA	2023	2.4	2.1	3.9	0.4	1.7	-2.1	4.1	4.3	3.7	-5.8	124.6	-3.0
	2024	1.1	0.2	3.3	3.1	-1.7	0.4	2.4	3.2	4.4	-5.8	126.8	-2.8
	2025	1.6	0.7	2.0	5.4	3.8	4.2	2.5	2.5	4.4	-5.8	128.6	-2.6
China	2023	5.4	6.6	-	4.6	-	-	0.5	-	5.3	-7.5	83.0	1.5
	2024	4.5	5.5	-	3.8	-	-	1.0	-	5.2	-7.2	87.4	1.4
	2025	4.5	5.5	-	3.8	-	-	1.5	-	5.2	-7.0	91.8	1.1
UK	2023	0.5	-	-	-	-	-	7.4	-	4.2	-	-	-
	2024	0.0	-	-	-	-	-	2.8	-	4.6	-	-	-
	2025	1.0	-	-	-	-	-	1.9	-	4.9	-	-	-

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

Financial forecast

Bond and money markets

		Key interest rate	3m interest rate	2-yr swap yield	10-yr swap yield	Currency vs EUR	Currency vs USD	Currency vs DKK	Currency vs NOK	Currency vs SEK
USD*	04-Jan	5.50	-	4.21	3.59	0.91	-	6.81	10.31	10.21
	+3m	5.25	-	4.15	3.75	0.91	-	6.78	10.64	10.36
	+6m	5.00	-	4.05	3.85	0.93	-	6.96	11.31	10.84
	+12m	4.50	-	3.95	3.85	0.95	-	7.10	11.52	11.05
EUR	04-Jan	4.00	3.88	2.88	2.57	-	1.10	7.4577	11.30	11.19
	+3m	4.00	3.84	2.85	2.55	-	1.10	7.4550	11.70	11.40
	+6m	3.75	3.64	2.70	2.70	-	1.07	7.4500	12.10	11.60
	+12m	3.25	3.17	2.55	2.75	-	1.05	7.4500	12.10	11.60
JPY	04-Jan	-0.10	-	-	-	0.006	0.007	4.71	7.13	7.06
	+3m	0.00	-	-	-	0.007	0.007	4.88	7.65	7.46
	+6m	0.00	-	-	-	0.007	0.007	5.16	8.38	8.03
	+12m	0.00	-	-	-	0.007	0.008	5.38	8.73	8.37
GBP*	04-Jan	5.25	-	4.15	3.49	1.16	1.06	8.64	13.10	12.97
	+3m	5.25	-	4.25	3.50	1.14	1.25	8.47	13.30	12.95
	+6m	5.00	-	4.10	3.55	1.12	1.20	8.37	13.60	13.03
	+12m	4.50	-	3.95	3.60	1.12	1.18	8.37	13.60	13.03
CHF	04-Jan	1.75	-	-	-	1.07	1.18	8.01	12.14	12.02
	+3m	1.75	-	-	-	1.05	1.16	7.85	12.32	12.00
	+6m	1.50	-	-	-	1.06	1.14	7.93	12.87	12.34
	+12m	1.00	-	-	-	1.06	1.12	7.93	12.87	12.34
DKK	04-Jan	3.60	3.88	3.01	2.73	0.134	0.147	-	1.52	1.50
	+3m	3.60	3.80	2.96	2.67	0.134	0.148	-	1.57	1.53
	+6m	3.35	3.56	2.80	2.80	0.134	0.144	-	1.62	1.56
	+12m	2.85	3.04	2.65	2.85	0.134	0.141	-	1.62	1.56
SEK	04-Jan	4.00	4.07	2.97	2.44	0.089	0.098	0.67	1.01	-
	+3m	4.00	4.12	2.70	2.50	0.088	0.096	0.65	1.03	-
	+6m	3.75	3.91	2.50	2.60	0.086	0.092	0.64	1.04	-
	+12m	3.25	3.41	2.50	2.75	0.086	0.091	0.64	1.04	-
NOK	04-Jan	4.50	4.77	3.99	3.43	0.089	0.097	0.66	-	0.99
	+3m	4.50	4.68	3.80	3.20	0.085	0.094	0.64	-	0.97
	+6m	4.25	4.26	3.60	3.25	0.083	0.088	0.62	-	0.96
	+12m	3.25	3.45	3.40	3.30	0.083	0.087	0.62	-	0.96

*Notes: GBP swaps are SONIA, USD swaps are SOFR

Commodities

	04-Jan	2023				2024				Average		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2023	2024	
ICE Brent	78	82	78	86	83	80	80	80	80	82	80	

Source Danske Bank

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