Danske Bank

3 September 2024

Executive Briefing

From fear of inflation to fear of slowdown

Over the Summer, market focus has turned from concerns about persistently high US inflation, that would force the Fed to keep rates restrictive, to fears over a slowdown in the US economy, that points to more rate cuts. The fears of a US slowdown have been fuelled by weaker labour market data, particularly an increase in the US unemployment rate to 4.3% in July and a slowdown in non-farm payroll growth to 114,000 from an average of 225,000 in the first half of the year. We still think the US economy remains on a solid footing and estimate the risk of a recession as low. The increase in the unemployment rate is mainly due to growth in the labour force, and many other indicators still point to robust economic growth, albeit with more slack in the labour market. See our latest economic projections in *Nordic Outlook – Normalising economies, with risks*, 3 September.

We agree with markets that slowing US inflation over the summer has cleared the path for a faster "normalisation" of policy rates in the US. Especially the broader services price pressures have eased, and the last three inflation prints have shown annualized core inflation in line with or below the 2% target. Recent comments from Fed Chair Jerome Powell saying that "*the time has come for policy to adjust"* and *"we do not welcome any further labour market cooling"* have contributed to a change in our Fed call, and we now expect the Fed to cut rates by 25bp in every meeting from September until June 2025, followed by two final 25bp cuts in H2 2025. As such, we see a terminal policy rate at 3.00-3.25% (prev. 3.75-4.00%) by the end of 2025, instead of during 2026.

In Europe, we expect a less aggressive cutting cycle by the ECB compared to Fed due to limited slack in the labour market, more persistent inflation and a lower starting point. The unemployment rate declined to an all-time low of 6.4% in July. Headline inflation declined to a three-year low at 2.2% y/y in August due to energy base effects, while core inflation remained sticky at 2.9% y/y like in July. Underlying inflation in the euro area is driven by services inflation where the monthly price increases have been high in the entire year. This dynamic continued in August at 0.4% m/m, seasonally adjusted, which is far from compatible with annual inflation at 2%. With sticky services inflation and headline inflation close to the target, we expect the ECB to proceed gradually with quarterly rate cuts until September next year, leading to a policy rate of 2.50% by end of 2025.

In spring, we saw encouraging signs of a rebound in the global manufacturing cycle, but over the summer data has softened. The US manufacturing PMI declined to 48.0 in August, the lowest level seen in a year, while the euro area remained far below the 50-mark at 45.8, despite eased financial conditions. The weaker manufacturing picture fits with the recent loss of manufacturing momentum witnessed in China where industrial production growth slowed in July and manufacturing PMIs softened in July and August. The Chinese economy continues to struggle with weak domestic demand and problems in the housing market that spills over to construction. The Chinese manufacturing and construction weakness has led to falling metal prices lately as well as lower oil prices. We have thus become less optimistic about the prospects of a rebound in global manufacturing and instead foresee a muddling through scenario. On the other hand, this means that China and global manufacturing are disinflationary forces in the world.

Today's key points

- Our updated economic forecasts (see *Nordic Outlook – Normalising economies, with risks*, 3 September) are much the same as 3 months ago, but the balance of risk is different.
- The risk of a resurgence in inflation has dropped, while the risk of slowdown has increased, clearing the path for interest rate cuts to come sooner than previously anticipated.
- Concerns over slowdown risks caused significant volatility in financial markets in early August, but markets have since calmed down.

Editor-in-chief
Las Olsen

(see page 4 for list of all authors)

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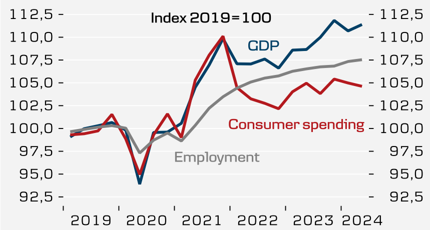
Denmark

GDP grew 0.6% q/q in Q2, partly reversing a decline of 1.0% in Q1. Hence, Danish GDP remains very volatile and likely affected by problems in periodising pharmaceutical production. For the first half of the year, GDP was 2.2% up y/y, so the overall picture remains positive and employment growth continues (0.2% q/q in Q2). Consumer spending disappoints despite strong wage growth. We expect some more growth from this and form investments over the coming year, also supported by lower interest rates. The government budget proposal for 2025 calls for a fiscal easing of around 0.4% of GDP. The economy does not really need this extra demand, but on the other hand, inflation is low, and we are not seeing a dangerous overheating, and there will still be a large fiscal surplus.

GDP volatile, job growth steady

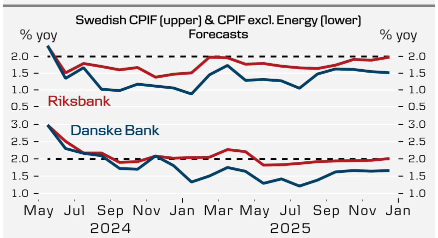


Source: Statistics Denmark, Macrobond FInancial

Sweden

The Swedish economy seems to have fared quite well during the first half of this year. However, with weaker consumption and fewer hours worked. Housing construction, on the other hand, is showing signs of turning around and housing prices are rising, albeit slowly. Business investments and foreign trade increases. Going forward, we expect that a pro-cyclical monetary and fiscal policy will give proper support to the growth outlook. Inflation has continued to fall in recent months. The target variable of CPIF inflation has dug in below 2%, and core inflation is only a shade above the target. We expect inflation to continue to fall and park below the target level in the coming years. The Riksbank has taken the lead, and we expect a cut by 25bp at each meeting until March next year. Followed by one more cut in June which would mean a policy rate of 2% by the summer of 2025.

We expect lower inflation

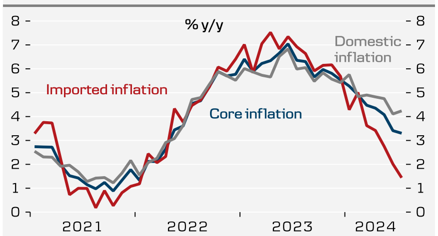


Source: Statistics Sweden, Riksbank, Danske Bank, Macrobond Financial

Norway

Although activity has been more or less unchanged over the past year, there were signs of improvement late last year and heading into this year, with mainland GDP climbing 0.1% in both the first quarter and the second. While growth has picked up, it is still well below the trend rate of around 0.35-0.4% q/q. We have revised down our growth forecast for 2024 from 1.1% to 0.7% on account of the weaker-than-expected start to the year. We still anticipate a more substantial upswing heading into next year and have revised down our growth forecast for 2025 only marginally from 2.1% to 2.0%. Inflation is continuing to fall, and not just the annual rate. Headline inflation was 2.8% in July, while the core rate fell to 3.3%, down from 5.3% in January and more than 7% at its peak in June last year. Employment seems to have levelled off again after a slight upswing before the summer, but new job openings seem to be holding up well.

Disinflation continues

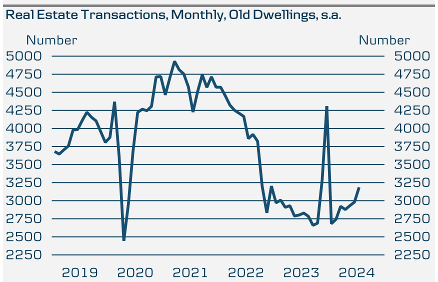


Source: Macrobond Financial

Finland

The Finnish economy is a making a slow exit from a shallow recession. Low inflation, falling interest rates and a gradually improving Global manufacturing cycle support recovery. Headwinds from tight fiscal policy slow growth down, and higher unemployment makes consumers cautious in the short term. Consumer confidence, on the other hand, improved during summer. The government implements expenditure cuts and VAT was hiked to 25.5% in September. Fitch lowered sovereign rating outlook to negative, implying that additional measures to reduce budget deficit are expected. Housing construction is bottoming and housing market transactions increased in July. There exists plenty of pent-up demand for apartments and lower interest rates help to activate the housing market. Economic growth is expected to become more broad-based and speed up in 2025.

Housing market improved in July

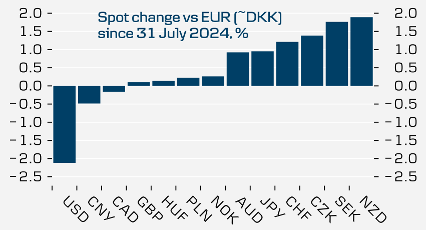


Source: Macrobond Financial, Statistics Finland

Currency markets

The predominant move in August has been the weakening of the US dollar. The USD sell-off should be seen in light of the shift in rhetoric from the Fed which seems to have paved the way for a string of interest rate cuts in the coming quarters. This means easier global monetary conditions which in turn initially paved the way for EUR/USD moving from 1.08 to 1.12 before markets - on the back of stronger US data releases - retraced to slightly above 1.10. Among the other underperformers are the CNY and the CAD which have suffered from weak domestic macro momentum and more accommodative economic policies. In the other end of the spectrum, the likes of NZD and SEK have outperformed, being both resilient to the early August sell-off in risk and benefitting from easier monetary conditions in the subsequent weeks. The CHF and JPY have both enjoyed lower global yields while the NOK is little changed compared to one month ago despite some considerable intramonth volatility. Finally, EUR/DKK has moved back below the 7.46 level.

FX. Sorted spot returns vs EUR

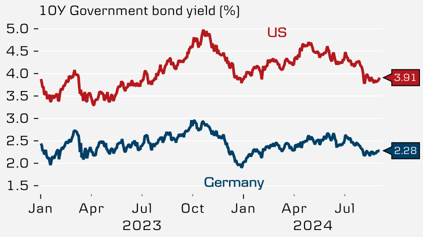


Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial

Bond markets

A significant decline in US rates, especially in the short end, has dominated fixed income markets in August. The Fed is now priced to deliver cuts of 220bp until end-2025, relative to 125bp priced in July. This has had a material spillover to EUR rates, where the pricing of ECB cuts until end-2025 has increased from roughly 100bp to 160bp. The 10-year US Treasury yield has declined by 35bp, while the 10-year German yield is down 10bp. These declines have added tailwinds to the Danish callable bond market, where the benchmark 4% 2056 bond price has periodically traded slightly above 99. Should we see another decline in global rates, issuance could soon shift towards a potential 3% or 3.5% coupon. We expect long-end European rates to move slightly higher over the next 12 months, but the risk to our forecast seems tilted to the downside, should the recent softening of US data trigger a more aggressive US monetary policy response than what we currently pencil in.

Long end rates lower through the summer



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

Credit markets

Despite the dramatic start to the month, where HY spreads widened 40bp during just a few trading days, credit markets have overall been quite strong in August. HY spreads are 14bp below end-July though IG spreads have yet to recoup the damage from the early part of the month. Following the usual summer lull, the primary market was back at full speed by the middle of the month and issuance activity has been very high since then as issuers are taking advantage of the highly receptive market conditions for new issues. Funding levels have improved (seen from the perspective of issuers) significantly during the summer and BBB-rated issuers have on average been able to issue EUR debt in intermediate maturities at around 3.6% relative to 4.3% in May as underlying interest rates have declined materially. Funding levels are thus the most attractive they have been for these issuers since mid-2022, which may also have lured in some opportunistic issuers.

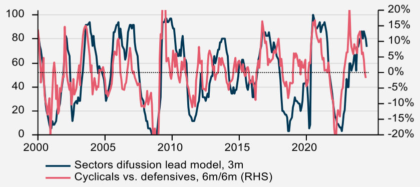
Funding yields the most attractive since mid-2022

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

Equities

Equity markets have stabilized following an extremely volatile start to August, where the VIX spiked to 65 before settling back down to 15 by month's end. The risk-adjusted outlook for equities has weakened, following strong market returns, fading macro tailwinds, and stretched positioning. August also marked the end of a very long streak of cyclical growth outperforming. While there are good chances of this trend continuing, we are now more focused on accurately predicting the cyclical vs. defensive sectors. Although we still observe solid macro data, we are not ready to favour outright defensive over cyclicals; instead, we are closely monitoring the balance between macro data and cyclical performance.

Cyclicals less strong versus defensives



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

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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	2.5	1.3	0.2	-6.6	10.4	3.7	3.3	4.1	2.8	3.3	33.6	9.8
	2024	1.8	1.0	1.7	-1.8	3.7	0.8	1.5	5.1	2.9	2.1	32.0	10.1
	2025	2.0	2.1	2.6	3.8	2.6	3.3	1.9	3.5	3.1	1.1	30.5	10.9
Sweden	2023	0.1	-2.2	1.1	-1.1	3.5	-0.8	8.6	3.8	7.7	-0.5	32.0	4.8
	2024	1.2	0.1	0.8	-1.8	2.4	0.8	2.8	3.5	8.4	-0.8	33.0	5.6
	2025	2.4	2.6	1.9	1.6	3.5	3.3	0.6	2.5	8.2	-0.2	33.0	5.7
Norway	2023	1.1	-0.8	3.4	0.0	1.4	0.7	5.5	5.3	1.8	-	-	-
	2024	0.7	1.3	2.2	4.0	3.0	1.5	3.2	5.1	2.1	-	-	-
	2025	2.0	2.9	1.8	4.0	3.0	2.0	2.0	3.8	2.4	-	-	-

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	0.7	1.0	1.2	-0.4	-1.1	5.4	4.5	6.6	-3.6	90.2	2.9
	2024	0.7	0.8	1.2	-0.5	1.3	-0.2	2.4	4.3	6.5	-3.0	90.1	2.8
	2025	1.2	1.3	0.8	1.3	3.0	3.1	2.1	3.4	6.6	-2.9	90.7	2.9
Finland	2023	-1.2	0.2	3.4	-8.8	-0.1	-6.6	6.3	4.2	7.2	-2.7	76.6	-1.1
	2024	-0.4	0.2	0.5	-5.0	-1.0	-1.5	1.9	3.0	8.3	-4.1	80.3	-0.7
	2025	1.8	1.2	0.2	5.0	3.0	3.5	1.5	3.0	8.0	-3.5	81.8	-0.5

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	2.5	2.2	4.1	0.6	2.6	-1.7	4.1	4.3	3.6	-6.3	122.3	-3.0
	2024	2.5	2.1	3.4	4.1	2.0	4.1	3.2	3.2	4.1	-6.7	123.1	-2.8
	2025	1.5	1.2	2.6	3.5	1.9	4.5	2.5	2.5	4.7	-6.5	125.1	-2.6
China	2023	5.2	6.6	-	4.6	-	-	0.2	-	5.2	-7.1	83.6	1.5
	2024	4.8	4.5	-	5.0	-	-	0.3	-	5.2	-7.4	88.6	1.3
	2025	4.8	5.6	-	4.5	-	-	1.5	-	5.2	-7.6	93-+	1.4
UK	2023	0.1	-	-	-	-	-	7.3	-	4.0	-	-	-
	2024	1.1	-	-	-	-	-	2.8	-	4.6	-	-	-
	2025	1.4	-	-	-	-	-	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*	02-Sep	5.50	-	3.71	3.47	0.90	-	6.74	10.59	10.25
	+3m	5.00	-	3.60	3.45	0.92	-	6.84	10.64	10.46
	+6m	4.50	-	3.45	3.45	0.93	-	6.97	11.12	10.93
	+12m	3.75	-	3.25	3.50	0.94	-	7.03	11.51	11.04
EUR	02-Sep	3.75	3.47	2.68	2.57	-	1.11	7.4583	11.72	11.35
	+3m	3.50	3.20	2.65	2.65	-	1.09	7.4575	11.60	11.40
	+6m	3.25	2.95	2.55	2.65	-	1.07	7.4550	11.90	11.70
	+12m	2.75	2.50	2.45	2.65	-	1.06	7.4550	12.20	11.70
JPY	02-Sep	0.25	-	-	-	0.006	0.007	4.59	7.21	6.98
	+3m	0.25	-	-	-	0.006	0.007	4.78	7.44	7.31
	+6m	0.50	-	-	-	0.007	0.007	4.98	7.94	7.81
	+12m	1.00	-	-	-	0.007	0.007	5.21	8.53	8.18
GBP*	02-Sep	5.00	-	4.12	3.71	1.19	1.07	8.86	13.93	13.49
	+3m	4.75	-	3.80	3.65	1.20	1.31	8.98	13.98	13.73
	+6m	4.50	-	3.60	3.65	1.19	1.27	8.88	14.17	13.93
	+12m	3.50	-	3.25	3.65	1.18	1.25	8.77	14.35	13.76
CHF	02-Sep	1.25	-	-	-	1.06	1.17	7.91	12.44	12.04
	+3m	0.75	-	-	-	1.04	1.14	7.77	12.08	11.88
	+6m	0.75	-	-	-	1.05	1.13	7.85	12.53	12.32
	+12m	0.75	-	-	-	1.06	1.13	7.93	12.98	12.45
DKK	02-Sep	3.35	3.41	2.77	2.71	0.134	0.148	-	1.57	1.52
	+3m	3.10	3.10	2.75	2.80	0.134	0.146	-	1.56	1.53
	+6m	2.85	2.85	2.65	2.80	0.134	0.144	-	1.60	1.57
	+12m	2.35	2.45	2.55	2.80	0.134	0.142	-	1.64	1.57
SEK	02-Sep	3.50	3.28	2.27	2.35	0.088	0.098	0.66	1.03	-
	+3m	3.00	2.83	2.30	2.60	0.088	0.096	0.65	1.02	-
	+6m	2.50	2.38	2.40	2.75	0.085	0.091	0.64	1.02	-
	+12m	2.00	2.05	2.40	2.85	0.085	0.091	0.64	1.04	-
NOK	02-Sep	4.50	4.77	3.85	3.51	0.085	0.094	0.64	-	0.97
	+3m	4.50	4.75	3.75	3.50	0.086	0.094	0.64	-	0.98
	+6m	4.50	4.55	3.65	3.55	0.084	0.090	0.63	-	0.98
	+12m	4.00	4.05	3.55	3.60	0.082	0.087	0.61	-	0.96

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

Commodities

		2024				2025				Average	
	02-Sep	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2024	2025
ICE Brent	77	82	85	80	80	85	85	85	85	82	85

Source Danske Bank

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