2 May 2022

Monthly Executive Briefing

Inflation risks trump growth risks for central banks

The Russia/Ukraine war has entered its third month, without any signs that the conflict will be resolved any time soon. After failing to capture Kyiv, Russian forces are now focussing their attacks on the Donbass region in the Southeast. But despite broad-based devastation, Ukrainian resistance remains strong and we see a risk of further escalation in the coming weeks (see also *Research Russia-Ukraine - Several signals point to an escalation in the war in Ukraine as Victory Day looms*, 26 April). The war continues to create severe disruption to global supply chains, which is stoking "stagflation" fears. Food price inflation remains high, and oil and gas prices increased after Russia halted gas deliveries to Poland and Bulgaria and stories that EU countries might sanction Russian oil.

The combination of higher energy prices and a weaker growth outlook puts central banks in a tough spot. In particular, China's economy is faced with renewed headwinds from Covid-19 lockdowns in Shanghai and Beijing, which are weighing on consumer spending and production. Economic activity in the US remains resilient despite the Ukraine war, thanks to ongoing strong consumer spending. However, a tight labour market and stubbornly high inflation (40-year high of 8.5% in March) remain the Achilles' heel of the US economy, and to address this, we expect the Fed to front-load rate increases and deliver 50bp rate hikes in May, June, and July, and 25bp in September, November, and December (a total of 225bp). Aggressive tightening of financial conditions also increases the risk of recession, especially in 2023, and US mortgage rates have seen a significant rise since the beginning of the year.

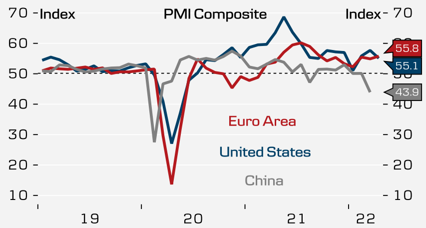
Business surveys suggest that the Eurozone economy has weathered the fallout from the war better than expected. Services activity continued to build momentum during April after the lifting of pandemic restrictions and increased spending on travel and recreation. However, growth in manufacturing output nearly stopped as bottlenecks, rising prices, and heightened uncertainty took their toll, especially in Germany. While the economic repercussions from the Ukraine war remained limited in Q1, sharp declines in business and consumer confidence still point to downside risks ahead. With inflation reaching ever new record highs (7.5% in April), a growing number of ECB governing council members are advocating a faster policy normalisation pace, especially amid signs of de-anchoring inflation expectations, which now stand above the 2% goal. With the possibility of further disruptions to Russian gas and oil supply looming as the EU readies another sanctions package, the risks to Eurozone inflation remain firmly on the upside in our view. We now expect a first 25bp hike from the ECB in July, followed by continued hikes in September, December, and March, taking the deposit rate back to 0.5% in Q1 23. Markets are pricing in further 115bp of rate increases for 2023, which we see as too aggressive in light of the fragile state of the global economy and aggressive Fed tightening.

Incumbent French President Emmanuel Macron secured another five-year term. His re-election supports further EU integration, but he is also facing increasing economic and political headwinds. With only 59% of voters endorsing him for a second term, he has to govern a divided country and the weaker mandate could make it challenging to push ahead ambitious reforms of the pension, health, and education systems. To what degree Macron can implement his plans will depend on parliamentary elections held in June.

Key points

- Inflation, the ongoing war in Ukraine, and sharp slowdown in China are threatening the demand outlook, while consumer confidence has dropped.
- However, business surveys in the US and Europe are holding up well.
- High inflation is adding to pressure for higher interest rates, and both the markets' and our expectations are increasing.
- In April, higher yields were a significant contributor to weakness in equity and credit markets, and large movements in FX markets.

The Chinese economy is weakening, while US and Europe are more resilient

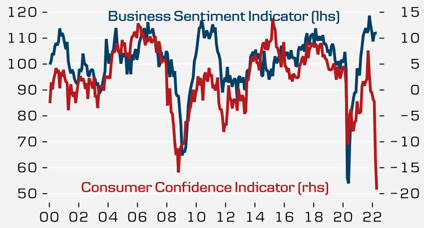


Source: Markit, Macrobond Financial, Danske Bank

Denmark

Consumer confidence has dropped to its lowest level since 1988 as inflation continues to increase. However, actual consumer spending is not declining in nominal terms, and business sentiment remains strong, with lack of materials and labour the predominant concerns of companies. Despite the widespread consumer pessimism, we do not expect any large economic setback or increase in unemployment. The government has suspended its target for the structural budget deficit due to the “exceptional circumstances” of the war in Ukraine and is working for a fiscal easing of 0.2-0.3% of GDP for defence and income support, on top of the expense to help Ukrainian refugees.

Mixed sentiment in Denmark

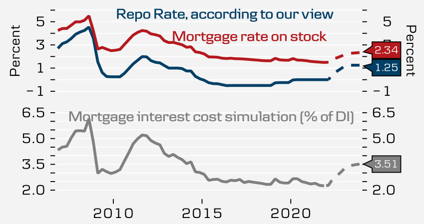


Sources: Statistics Denmark, Macrobond Financial

Sweden

The Riksbank felt no need to wait and hiked by 25bp in April. We have revised our call for the Riksbank and we now expect that it will deliver the June, September, and November hikes we previously expected. We also add one more hike in February 2023. Hence, our end-point for the policy rate is lifted from 0.75% to 1.25% in 2023. We forecast moderating inflation in 2023 and we do not expect hikes after that point. However, the inflation forecast is highly uncertain. The Riksbank is clearly on a path to fight inflation and the economy will feel it. Household real wage growth has dipped to its lowest level since the 90s and consumer sentiment is lower than during the pandemic lows, which should become apparent in household consumption. The GDP indicator for Q1 was -0.4% q/q, slightly lower than our forecast. The monthly indicators suggest that household consumption, production, and net exports dragged GDP down. However, the economy indicator from the National Institute of Economy Research held up well among all sectors and order inflow remains above normal, implying divided signals in the economy.

Rate hikes will be felt by households

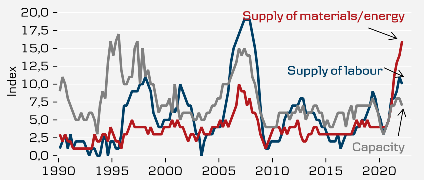


Source: Macrobond Financial, Danske Bank

Norway

Leading indicators, especially in the manufacturing sector, suggest acceleration in growth, despite global turmoil and intensifying capacity constraints. Activity in oil related industries is clearly picking up on a combination of tax effects and higher energy prices. Retail trade is also surprisingly strong given that high inflation is eroding household purchasing power. The first wage negotiations ended around 3.7%, in line with expectations. We still expect these developments to support the case for another rate hike in June, but the risk of a more aggressive Norges Bank still seems limited. A lack of available houses keeps the housing market tight, but demand is starting to be negatively affected by higher mortgage rates. Capacity constraints and higher costs (energy, materials, freight, wages, interest rates) create a challenging environment for non-energy businesses.

Limitations on manufacturing increase

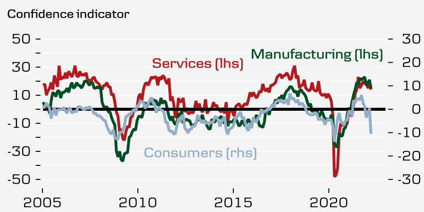


Source: Macrobond Financial, Danske Bank

Finland

In Finland, the Russia-Ukraine War is a major risk to the outlook. Russia accounted for around 5% of goods exports and 10% of imports in 2021. Sanctions and voluntary boycotts have halted most of the trading outside energy. There are not only negative effects, as industries like sawmills could benefit from lack of competition from Russia, and there will be additional investment in domestic energy and national security. Consumer confidence indicators dropped in March and April, but business confidence remains relatively stable. Companies have started to adapt and seek new markets. Open job vacancies are plentiful in many industries, which gives a good buffer against the economic fallout from the war. Covid-19 restrictions have been reduced and service businesses can operate relatively freely. Inflation has risen close to 6% this spring, which limits consumer purchasing power. NATO membership application looks likely soon.

Mixed sentiment in Finland



Source: Macrobond Financial, Danske Bank

Currency markets

The outlook for monetary policy tightening, Chinese lockdowns, and commodity price volatility were the key drivers in April. Most notably, the USD has strengthened by 4.5% vs the EUR (and DKK) with EUR/USD hitting the lowest level since 2017, due to a range of fundamental factors including the outlook for relative growth, relative rates, and relative terms of trade. Among other majors, JPY has weakened and Bank of Japan remains one of the few central banks that have not tightened monetary policy. Towards the end of the month, CNY showed a large decline, but it still trades stronger vs EUR than one month ago. In the Scandies, NOK has suffered from a weaker global growth outlook, a setback to energy prices, and a reversal in commercial flows. Neighbouring SEK has done better, supported by the recent Riksbank rate hike. EUR/DKK has moved above 7.4400.

Bond markets

Market pricing of the ECB is still more aggressive than our revised outlook and expect 30bp higher leading interest rate by end of Q1 2023. April resulted in further rise in yields by some 20bp in 2Y segment and 35bp in 10Y segment. For Danish callable bonds, April started with 25bp lower credit spreads (large move) until mid-April, where spreads re-widened some 30bp and performance again 10bp in late April. Hence, volatility in callables has been high in a historical perspective both relatively speaking (credit spreads) as well as in outright price terms (3-4 price point lower prices). Buybacks still a significant factor for low coupon callables, but have reduced since March. Liquidity has been poorer in callables and intraday volatility high, a concern to many investors. New 3.5% bonds are now the issuance coupons. Danish government bonds have seen small underperformance to German government bonds (which are currently expensive).

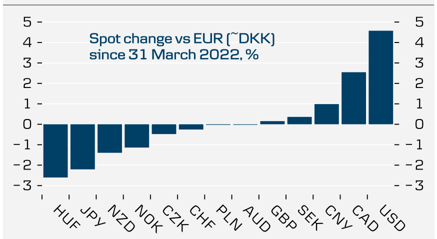
Credit markets

Credit market strength extended into the first week of April where both CDS indices and cash bonds continued to grind tighter, but sentiment has changed significantly since then. HY spreads were almost 50bp wider during April and IG around 12bp wider. CDS indices have sold off even more dramatically, with Xover 90bp wider for the month and Main 17bp wider. The worsening sentiment is also visible in the new issue market (although it was also impacted by many issuers in silent period during April). While corporate/financials (excl. covered) issuance in EUR totalled almost EUR70bn in March, in April it declined to EUR25bn (around 33% below 2021). Meanwhile, both SSA and sovereign issuance also came to an almost complete stop. This should imply that investors have plenty of cash available for buying in secondary markets and this rhymes with the impression we have from investors. However, investors remain reluctant to add risk.

Equities

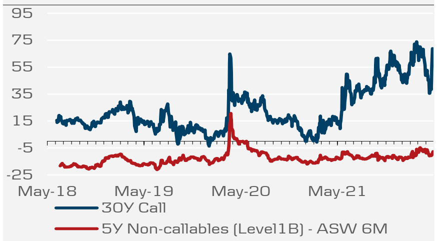
After a strong March, equities retraced in April with some areas experiencing the worst month since 2008. All Nordic markets performed better than global peers. The trigger was the sharp move higher in yields across the curve. Hence, it was no surprise to see cyclical value stock sharply underperforming value defensive and low vol stocks. As the majority of macro data is holding up much better than indicated by the weak performance in equities, there is now a large pool of reality gaps that are positive for the equity outlook. The Q1 earnings season is now 50% complete and results are solid. In S&P500, earnings surprises are running at 6% and revenue surprises running 2.2%. Both revenue and earnings surprises are above the long-term average while margins are disappointing. Earnings revisions are still pointing higher with bottom up consensus looking for 10.3% earnings growth in 2022, compared with expectations of 6.8% earnings growth at Jan-1.

FX. Sorted spot returns vs EUR over the last month



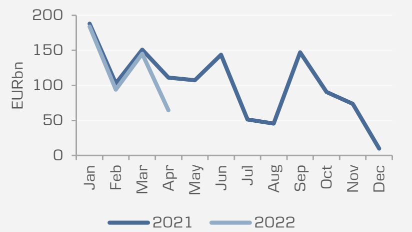
Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial, Danske Bank

High spreads on Danish callables



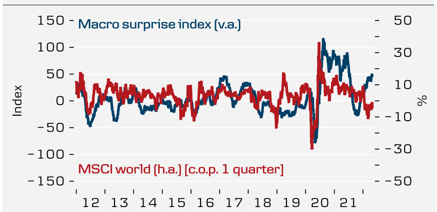
Past performance is not a reliable indicator of current or future results. Source: Danske Bank

Low issuance activity in April



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

Macro outlook challenge the equity outlook as well



Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial, 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[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Denmark	2021	4.7	4.3	3.7	5.6	7.8	8.2	1.9	3.0	3.7	2.4	36.7	8.3
	2022	3.5	2.2	0.6	2.0	6.0	4.0	4.5	3.7	2.4	1.7	32.6	7.5
	2023	1.3	2.5	0.5	1.1	3.1	4.1	1.2	4.0	2.5	1.8	30.3	7.7
Sweden	2021	4.5	5.7	2.5	5.9	7.2	9.1	2.2	2.7	8.8	-0.2	37.7	1.4
	2022	2.5	3.3	1.3	2.8	5.1	5.6	4.0	2.0	7.0	0.8	33.0	4.8
	2023	2.0	1.9	1.2	2.2	3.9	3.4	1.3	2.1	6.8	0.8	30.0	5.1
Norway	2021	4.2	5.0	3.9	-0.3	4.8	2.0	3.5	3.5	3.2	-	-	-
	2022	3.8	6.5	1.3	3.1	6.0	7.5	3.3	3.7	2.0	-	-	-
	2023	2.0	2.5	1.3	2.0	4.0	4.0	1.8	3.7	1.9	-	-	-

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[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Euro area	2021	5.4	3.5	3.9	4.2	11.0	8.7	2.6	4.1	7.7	-5.1	95.6	3.1
	2022	2.5	2.8	3.9	3.7	7.3	9.4	7.0	2.5	6.7	-3.6	97.6	3.2
	2023	2.8	1.2	3.7	4.5	5.3	4.9	2.0	3.4	6.5	-2.1	96.7	3.4
Germany	2021	2.9	0.1	3.1	1.3	9.8	9.1	3.2	3.4	3.6	-3.7	69.3	7.5
	2022	1.0	2.8	2.6	0.2	6.2	8.8	7.4	3.2	3.1	-2.1	69.2	6.6
	2023	3.6	1.6	4.1	4.0	6.4	4.9	2.7	3.8	2.9	-0.5	68.1	6.8
Finland	2021	3.5	3.1	3.2	1.2	4.7	5.3	2.2	2.3	7.7	-2.6	65.8	0.7
	2022	1.7	2.3	1.0	3.0	3.0	4.0	4.4	2.8	7.0	-3.0	66.1	0.2
	2023	2.0	2.5	1.0	3.0	3.0	3.5	2.0	2.6	6.6	-1.8	65.5	0.4

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[3]	Public budget[4]	Public debt[4]	Current acc.[4]
USA	2021	5.7	7.9	0.5	7.8	4.5	14.0	4.7	4.0	5.4	-13.4	129.7	-3.5
	2022	2.8	2.5	0.1	2.9	4.9	5.5	7.2	5.0	4.0	-4.7	125.6	-3.5
	2023	2.0	1.9	1.0	3.5	1.5	1.8	3.0	4.6	3.8	-3.1	124.0	-3.3
China	2021	8.0	10.2	-	5.2	-	-	0.7	5.0	-	-5.6	68.9	3.0
	2022	4.7	6.0	-	3.0	-	-	3.0	5.5	-	-7.0	72.0	1.0
	2023	5.3	6.0		4.5			2.5	5.5		-6.8	74.5	0.7
UK	2021	7.4	6.2	14.3	5.9	-1.3	3.8	2.6	4.9	4.5	-8.1	95.6	-3.0
	2022	5.1	6.1	3.3	6.5	3.3	4.8	5.2	3.2	4.0	-3.9	95.5	-4.6
	2023	2.4	2.5	0.8	4.8	3.4	3.7	2.9	3.9	3.7	-1.9	94.1	-4.2
Japan	2021	1.7	1.1	2.1	-1.3	11.8	5.2	-0.2	-	2.8	-	-	-
	2022	2.1	3.3	1.5	-2.2	4.6	1.4	1.6	-	2.6	-	-	-
	2023	1.0	1.4	0.7	-0.6	3.2	2.0	1.1	-	2.5	-	-	-

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 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-May	0,50	1,33	3,04	3,03	105,3	-	706,6	944,6	989,6
	+3m	2,00	2,30	3,10	3,20	107,0	-	695,6	915,9	953,3
	+6m	2,25	2,76	3,40	3,25	106,0	-	702,4	943,4	952,8
	+12m	3,25	3,30	3,50	3,25	105,0	-	709,5	933,3	971,4
EUR	02-May	-0,50	-0,43	0,95	1,73	-	105,3	743,9	994,5	1041,9
	+3m	-0,25	-0,11	0,95	1,75	-	107,0	744,3	980,0	1020,0
	+6m	0,00	0,16	1,15	1,80	-	106,0	744,5	1000,0	1010,0
	+12m	0,50	0,57	1,35	1,85	-	105,0	745,0	980,0	1020,0
JPY	02-May	-0,10	-0,02	0,10	0,42	120,5	130,1	6,17	8,25	8,65
	+3m	-0,10	-	-	-	133,8	125,0	5,56	7,33	7,63
	+6m	-0,10	-	-	-	130,4	123,0	5,71	7,67	7,75
	+12m	-0,10	-	-	-	125,0	119,0	5,96	7,84	8,16
GBP*	02-May	0,75	-	2,23	1,93	83,7	125,8	888,6	1187,9	1244,5
	+3m	1,00		2,25	2,10	84,0	127,4	886,0	1166,7	1214,3
	+6m	1,25		2,35	2,10	84,0	126,2	886,3	1190,5	1202,4
	+12m	1,50		2,40	2,20	84,0	125,0	886,9	1166,7	1214,3
CHF*	02-May	-0,75	-	0,33	1,29	102,4	97,3	726,2	970,7	1017,0
	+3m	-0,75	-	-	-	101,0	94,4	736,9	970,3	1009,9
	+6m	-0,50	-	-	-	100,0	94,3	744,5	1000,0	1010,0
	+12m	0,00	-	-	-	99,0	94,3	752,5	989,9	1030,3
DKK	02-May	-0,60	-0,19	1,24	1,99	743,94	706,60	-	133,68	140,05
	+3m	-0,35	0,13	1,20	2,00	744,25	695,56	-	131,68	137,05
	+6m	-0,10	0,39	1,40	2,05	744,50	702,36	-	134,32	135,66
	+12m	0,40	0,80	1,60	2,10	745,00	709,52	-	131,54	136,91
SEK	02-May	0,00	0,36	1,88	2,38	1041,9	989,6	71,4	95,5	100,0
	+3m	0,50	0,73	1,65	2,20	1020,0	953,3	73,0	96,1	-
	+6m	0,75	1,00	1,65	2,15	1010,0	952,8	73,7	99,0	-
	+12m	1,25	1,50	1,75	2,10	1020,0	971,4	73,0	96,1	-
NOK	02-May	0,75	1,27	2,58	2,94	994,5	944,6	74,8	100,0	104,8
	+3m	1,00	1,49	2,70	3,10	980,0	915,9	75,9	-	104,1
	+6m	1,25	1,76	2,90	3,15	1000,0	943,4	74,5	-	101,0
	+12m	1,75	2,26	3,05	3,25	980,0	933,3	76,0	-	104,1

*Note: GBP swaps are SONIA and CHF swaps are SHARON

Commodities

		2022				2023				Average	
	02-May	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2022	2023
ICE Brent	105	98	125	115	100	95	95	95	95	110	95

Source Danske Bank

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