3 March 2023

Executive Briefing

Recession risks ease, but inflation fears resurface

Recession risks continue to ease as the global economy face easing headwinds and short-term leading indicators have turned higher. Chinese PMI data for February were even stronger than expected and point to a frontloaded recovery of both the service and manufacturing sector. We look for China's growth to rise to 5.5% this year from 3.0% in 2022 and the rest of the world should see a positive spill-over in both manufacturing as well as services (as Chinese tourists return).

On top of China's recovery, the energy crisis in Europe has calmed down a lot, at least for now. Mild winter weather and a reduction in energy demand from discretionary measures have pushed down gas and electricity prices significantly. Oil prices have not taken off despite the Chinese recovery, partly due to the lower European energy demand. **In the US, households raised consumption again in early 2023 and job growth stayed very solid** pushing the unemployment rate down to 3.4%, the lowest level since the 1960's. Mild weather may be part of the reason but even so, the overall picture looks stronger than anticipated a few months ago. Unemployment in Europe has also refrained from moving higher despite the economic slowdown, and the latest surveys suggest that consumers no longer expect unemployment to go up. There is widespread uncertainty on whether lagged effects from rate increases and eroding buffers as savings are drawn down will be enough to cool down the economies as much as needed.

Amid the stronger economic backdrop, inflation fears have resurfaced. It follows new upside surprises in inflation in both the US and the euro area, where core inflation is running at 5.6% and 5.3%, respectively. With labour markets tight and easing growth headwinds, it seems clear that central banks have more work to do. Rate markets have thus repriced expectations for rate hikes and now see another three 25bp hikes by the Fed taking the 'peak rate' to 5.4% and in the euro zone the market looks for another 150bp lift to the policy rate this year taking the 'peak rate' close to 4%. We broadly agree with the market pricing and have increased our forecast for rate hikes from the ECB to include a 50bp hike here in March, another 50bp in May, followed by two 25bp increases. However, there is clearly a high degree of uncertainty also within the ECB, and the outlook can quickly change in either direction if data starts to paint a different picture. Markets no longer price rate cuts later this year, which we always thought was premature.

On the geopolitical front, US-China tensions have flared up again, after the US shot down an alleged Chinese 'spy balloon' and White House officials stated they saw indications that China contemplated selling weapons to Russia. China has presented a peace plan including proposal for ceasefire on the war in Ukraine, but it has gained little traction and is unlikely to change much. We still see the conflict as frozen with no end in sight, unfortunately.

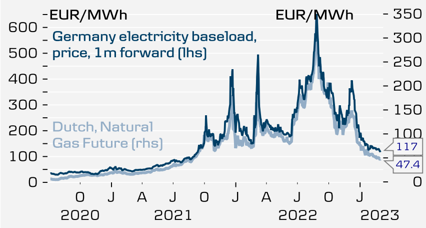
Key points

- Both we and especially markets have revised up interest rate expectations as data show persistent core inflation and stronger economies.
- In the Nordics, Sweden and Finland are contracting while growth has continued in Denmark and Norway.

China's economy bouncing back strongly in early 2023

Source: S&P Markit, Macrobond Financial and Danske Bank.

The European energy crisis has eased

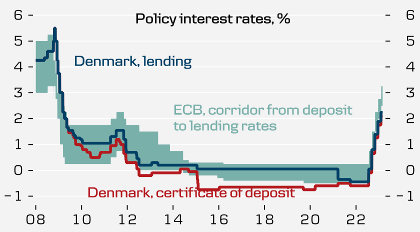


Source: Macrobond Financial, Bloomberg and Danske Bank. Note: Past performance is not indication of future performance.

Denmark

GDP growth was extremely strong at 0.9% q/q in Q4, almost only driven by a somewhat mysterious increase in pharmaceutical production – revisions are likely. Also excluding that, however, the picture is stronger than expected, also in the current quarter, where we are seeing signs of higher consumer spending and less negative business sentiment. Nationalbanken hiked rates 15bp less than the ECB in February, and that seems to have finally been enough to remove the pressure for a stronger DKK. We expect Danish rate changes to shadow ECB going forward. Wage agreements indicate 10-12% wage growth over 2 years, likely enough to return real wages to 2021 levels but likely high compared to trading partners. In manufacturing and some other industries, the final outcome will be determined by local negotiations. The housing market improved slightly in February, perhaps reflecting lower long term mortgage yields which have since increased again.

Low rates reflect strong economy

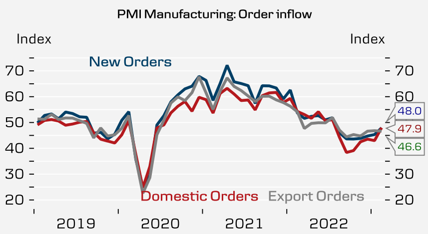


Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial

Sweden

Sweden entered a recession in Q4 as GDP dropped 0.9 % q/q, despite domestic household consumption surprising on the upside. We expect another negative GDP growth print for Q1, but as PMI new orders improve and the labour market is resilient, the recession might be mild. The Riksbank hiked 50bp to 3% as expected, but as January core inflation came out at 8,7%, 0.5 p.p above their new forecast, we expect another 50bp rate hike in April (revised from 25bp) followed by a final 25bp hike in June (new). We still see risk tilted to the upside. The housing market has surprised on the upside with an increase in prices during January and flat in February (according to our Housing price indicator). We do expect prices to drop coming months, our earlier forecast of -20% from the top is still likely in our view, which would mean another -8% from here. We expect prices to stabilize during the summer, when the Riksbank hopefully have come to the end of the hiking cycle.

Order inflow has improved

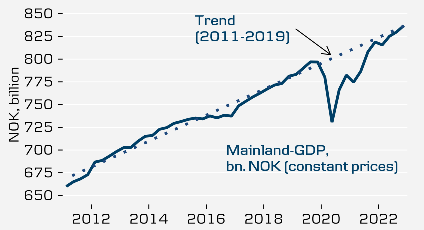


Source: Macrobond Financial

Norway

Growth was stronger than expected in Q4, up 0.8 % q/q, driven by both private consumption and business investments. Core inflation surprised to the upside again after some months of a downward trend, probably driven by some one-offs but inflation is nevertheless uncomfortably high. Fortunately, both price and wage expectations remain fairly well anchored, and shows signs of peaking. The labour market remains tight even though leading indicators point to some weakness in labour demand. Finally, housing prices were basically flat in January, probably due to some easing in the lending regulations.

Activity back at long-term trend

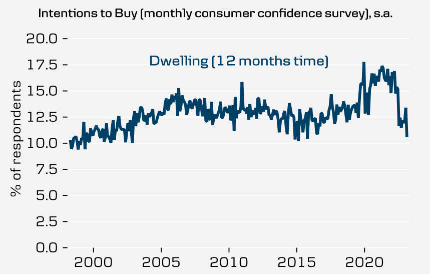


Source: Macrobond Financial

Finland

The Finnish economy fell into a shallow recession in H2 2022. GDP shrank 0.6% q/q in Q4. Consumer and business confidence indicators are still weak, although early 2023 brought some rebound. Labour market is tight and open job vacancies continue to be plentiful in many industries, which gives a buffer against the economic adversities. Inflation (8.4% in January) and rising interest rates worry consumers, but inflation fears have eased with lower energy prices. Demand for housing loans has decreased a lot. Housing prices have fallen over 5% from the peak in June. Prices are likely to fall slightly more, but there is no pressure for a large price movement. Housing construction activity is likely to fall. Stock of unsold new apartments has risen. Trade with Russia has been reduced to a very low level, but companies have been able to divert most trade elsewhere. There will be additional investment into domestic energy and national security. Political parties prepare for parliament elections on 2nd April.

Home buying intentions still low

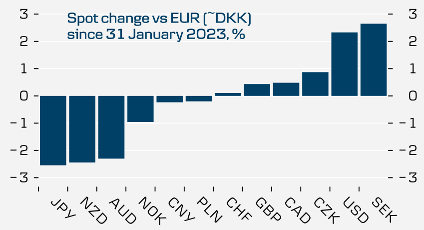


Source: Macrobond Financial, Statistics Finland

Currency markets

We will remember FX markets in February for four things. First, that the SEK made a remarkable rebound from the year-lows leaving it the top performer among majors amid not least a sharp repricing of the Riksbank. Secondly, also the USD had a strong month given several factors including the repricing of the Fed and a general retightening of global financial conditions amid prospects of the "high and/or higher rates for longer"-narrative gaining traction. Third, both the NZD and AUD rallies reversed amid the China reopening story losing steam with losses only surpassed by the JPY that suffered from the rise in US yields and markets second-guessing the prospects of a near-term end to Bank of Japan's yield curve control. Fourth, and finally, we will remember February as the month where EUR/DKK reacted to Danmarks Nationalbank widening the rate spread to the ECB further with spot temporarily moving above 7.4500 before settling close to 7.4430 by end-month.

FX. Sorted spot returns vs EUR

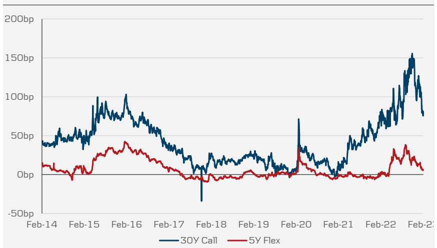


Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial

Bond markets

During February, yields rose 50-65bp in both the long and short end of the curve. The move seems to be driven by the solid economic data lately and inflation data surprising to the upside, which support the case for further rate hikes from central banks and keeping rates higher for a longer period. Danish mortgage bonds have continued spread tightening trend during most of February and our call is that spreads are close to a 'neutral' level compared to EUR markets on both callable as well as flex and floating rate bonds. The 30Y 6% interest-only bond has just opened for issuance and this reflects the higher yields across the curve that is resulting in increased borrowing cost for borrowers – and this should keep low (and perhaps decrease even further) the incentive to do extra borrowing the coming period.

Spreads may have topped in Denmark

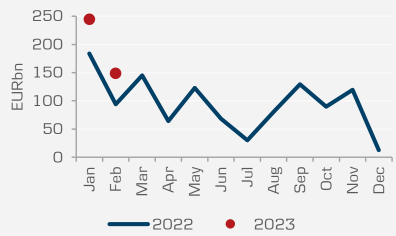


Past performance is not a reliable indicator of current or future results. Source: Danske Bank

Credit markets

Market sentiment has been mixed in February. Both iTraxx Xover and Main are more or less at the same level as where they closed in January. The same goes for IG cash bonds, but HY bonds have managed to tighten during February and the spread between Xover and cash HY is currently around 40bp, which is quite elevated and something seems to have to give (we think cash bonds will eventually cave in). Despite the somewhat less upbeat secondary market as well as continued large volume of new issues coming to the market, primary continues to absorb new issues quite well. Issuance pace in February was significantly above the level from last year, with all sorts of issuers ranging from SSAs to corporates bringing more deals to the market.

Issuance still elevated compared to 2022

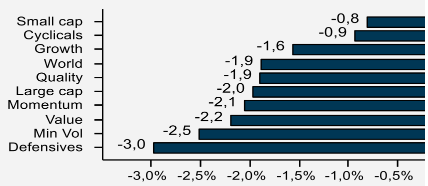


Past performance is not a reliable indicator of current or future results. Source: Bloomberg

Equities

February gave an end to the strong rally in equities that started back in October 2022. While equities were lower during the month of February it does not change the fact of positive returns year to date. The main reason for the retracement is the strong set of inflationary data across the western world that led to a sharp reprising central banks. As macro data have continued to surprise on the upside this has led to a narrative of either soft landing or overheating. Hence, despite that we saw a retracement in equities, we still saw cyclicals outperforming defensives while banks continued their strong run. As long as yields are reprised higher while macro improving at the same time, we expect to see further cyclical and financial outperformance. Earnings revisions are still negative which is quite unusual given the macro and financial market circumstances. However, this is due to bottom-up analysts being way too optimistic around profit margins. This is something that we have been flagging since summer last year and that is now materializing. Lower profit margins is also the reason why we continue to argue for negative earnings growth in 2023.

Winners and losers over the last year



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

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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	2022	3.6	-2.6	-2.8	8.4	7.9	3.8	7.7	3.5	2.6	1.2	29.7	11.8
	2023	-1.0	-2.3	0.0	-3.3	1.3	-0.7	4.3	4.1	3.1	1.0	28.1	9.5
	2024	1.0	1.8	0.9	-2.1	1.2	0.4	2.0	4.2	3.4	0.8	27.0	9.5
Sweden	2022	2.6	2.6	-0.2	5.6	4.6	7.9	8.4	2.5	7.5	0.7	31.0	3.9
	2023	-1.2	-1.3	1.1	-3.0	1.3	0.2	8.5	3.2	8.2	-0.9	29.0	4.4
	2024	1.2	2.0	1.2	1.8	2.8	2.6	1.3	2.7	8.1	-0.4	29.0	4.5
Norway	2022	3.8	6.8	0.1	4.4	5.9	9.3	5.8	3.9	1.8	-	-	-
	2023	0.6	-0.5	1.3	0.5	3.5	2.5	4.8	4.3	2.2	-	-	-
	2024	1.5	0.9	1.5	4.0	2.0	2.0	2.1	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[3]	Public budget[4]	Public debt[4]	Current acc.[4]
Euro area	2022	3.5	4.0	1.2	4.4	7.5	8.6	8.4	4.2	6.7	-3.9	93.7	1.5
	2023	0.1	-0.3	0.8	1.7	3.5	5.2	6.1	4.9	6.9	-4.0	92.5	1.9
	2024	0.3	0.9	1.0	0.0	3.6	4.6	2.6	3.6	7.0	-3.5	91.6	2.4
Germany	2022	1.9	4.4	1.2	0.6	3.0	6.1	8.7	4.1	3.1	-2.3	67.4	3.7
	2023	-0.4	-0.6	0.9	-0.7	3.3	4.4	6.6	5.4	3.3	-2.7	65.5	4.6
	2024	0.1	0.8	1.2	0.0	3.2	4.6	2.6	4.3	3.5	-1.9	66.2	4.9
Finland	2022	1.8	2.3	2.5	4.5	1.5	7.0	7.1	2.6	6.8	-1.8	70.7	-3.3
	2023	-0.7	-0.3	1.5	-1.0	-1.5	-2.0	4.8	4.0	7.3	-2.5	71.0	-2.7
	2024	0.5	0.4	1.0	0.5	1.5	1.0	2.2	3.5	7.2	-2.0	71.7	-2.1

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	2022	2.1	2.8	-0.6	-0.2	7.2	8.2	8.0	5.2	3.6	-4.2	124.0	-3.9
	2023	0.3	0.3	1.5	-5.2	1.0	-5.7	3.8	4.0	4.0	-3.8	121.0	-3.1
	2024	0.9	0.8	1.3	1.5	1.2	1.7	1.6	2.1	5.6	-3.9	120.5	-2.8
China	2022	3	2.8	-	4.5	-	-	2.0	3.0	-	-8.9	76.9	1.6
	2023	5.5	5.1	-	5.2	-	-	2.2	5.0	-	-7.2	84.1	1.0
	2024	5.2	5.5	-	5.5	-	-	2.5	5.5	-	-7.5	89.8	0.8
UK	2022	4.2	-	-	-	-	-	8.9	-	3.8	-	-	-
	2023	-0.7	-	-	-	-	-	6.2	-	4.4	-	-	-
	2024	0.8	-	-	-	-	-	2.6	-	5.0	-	-	-
Japan	2022	1.4	3.0	1.6	-0.8	4.7	8.0	2.2	-	2.6	-	-	-
	2023	0.7	0.9	0.6	1.3	2.5	3.2	2.4	-	2.8	-	-	-
	2024	0.9	0.8	0.5	0.6	1.5	0.5	1.4	-	2.8	-	-	-

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

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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	03-Mar	4.75	4.98	5.21	4.02	106.1	-	701.8	1042.9	1049.8
	+3m	5.25	5.40	5.10	3.85	104.0	-	715.6	1019.2	1057.7
	+6m	5.25	5.40	4.90	3.65	102.0	-	729.9	1019.6	1098.0
	+12m	5.25	5.06	4.70	3.45	102.0	-	730.4	1000.0	1098.0
EUR	03-Mar	2.50	2.85	3.81	3.28	-	106.1	744.2	1106.1	1113.4
	+3m	3.50	4.04	3.35	3.00	-	104.0	744.3	1060.0	1100.0
	+6m	4.00	4.16	3.20	2.85	-	102.0	744.5	1040.0	1120.0
	+12m	4.00	4.14	2.90	2.55	-	102.0	745.0	1020.0	1120.0
JPY	03-Mar	-0.10	-0.03	-	-	120.5	136.2	6.18	9.18	9.24
	+3m	-0.10	-	-	-	130.0	125.0	5.73	8.15	8.46
	+6m	-0.10	-	-	-	127.5	125.0	5.84	8.16	8.78
	+12m	-0.10	-	-	-	127.5	125.0	5.84	8.00	8.78
GBP*	03-Mar	4.00	-	4.49	3.77	88.5	119.8	840.8	1249.5	1257.8
	+3m	4.25	-	4.10	3.40	87.0	119.5	855.5	1218.4	1264.4
	+6m	4.25	-	4.10	3.40	85.0	120.0	875.9	1223.5	1317.6
	+12m	4.00	-	3.90	3.30	85.0	120.0	876.5	1200.0	1317.6
CHF*	03-Mar	1.00	-	1.85	2.01	99.6	93.9	747.5	1110.9	1118.3
	+3m	1.25	-	-	-	98.0	94.2	759.4	1081.6	1122.4
	+6m	1.25	-	-	-	97.0	95.1	767.5	1072.2	1154.6
	+12m	1.25	-	-	-	97.0	95.1	768.0	1051.5	1154.6
DKK	03-Mar	2.10	3.04	3.94	3.40	744.23	701.76	-	148.62	149.60
	+3m	3.10	3.10	3.50	3.15	744.25	715.63	-	142.43	147.80
	+6m	3.60	3.10	3.35	3.00	744.50	729.90	-	139.69	150.44
	+12m	3.60	3.10	3.05	2.70	745.00	730.39	-	136.91	150.34
SEK	03-Mar	3.00	3.19	3.81	3.25	1113.4	1049.8	66.8	99.3	100.0
	+3m	3.50	3.70	3.35	2.85	1100.0	1057.7	67.7	96.4	-
	+6m	3.75	3.85	3.15	2.80	1120.0	1098.0	66.5	92.9	-
	+12m	3.50	3.60	2.80	2.75	1120.0	1098.0	66.5	91.1	-
NOK	03-Mar	2.75	3.26	3.85	3.47	1106.1	1042.9	67.3	100.0	100.7
	+3m	3.00	3.40	3.35	3.15	1060.0	1019.2	70.2	-	103.8
	+6m	3.25	3.42	3.20	2.85	1040.0	1019.6	71.6	-	107.7
	+12m	3.00	3.20	3.05	2.70	1020.0	1000.0	73.0	-	109.8

*Notes: GBP swaps are SONIA and CHF swaps are SHARON.
We have updated our Norges Bank forecasts after yesterday's Norges Bank meeting but not yet our Norwegian yield outlook

Commodities

		2023				2024				Average	
	03-Mar	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2023	2024
ICE Brent	84	90	90	85	80	80	80	80	80	86	80

Source Danske Bank

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this report are listed on page 4 of this report.

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