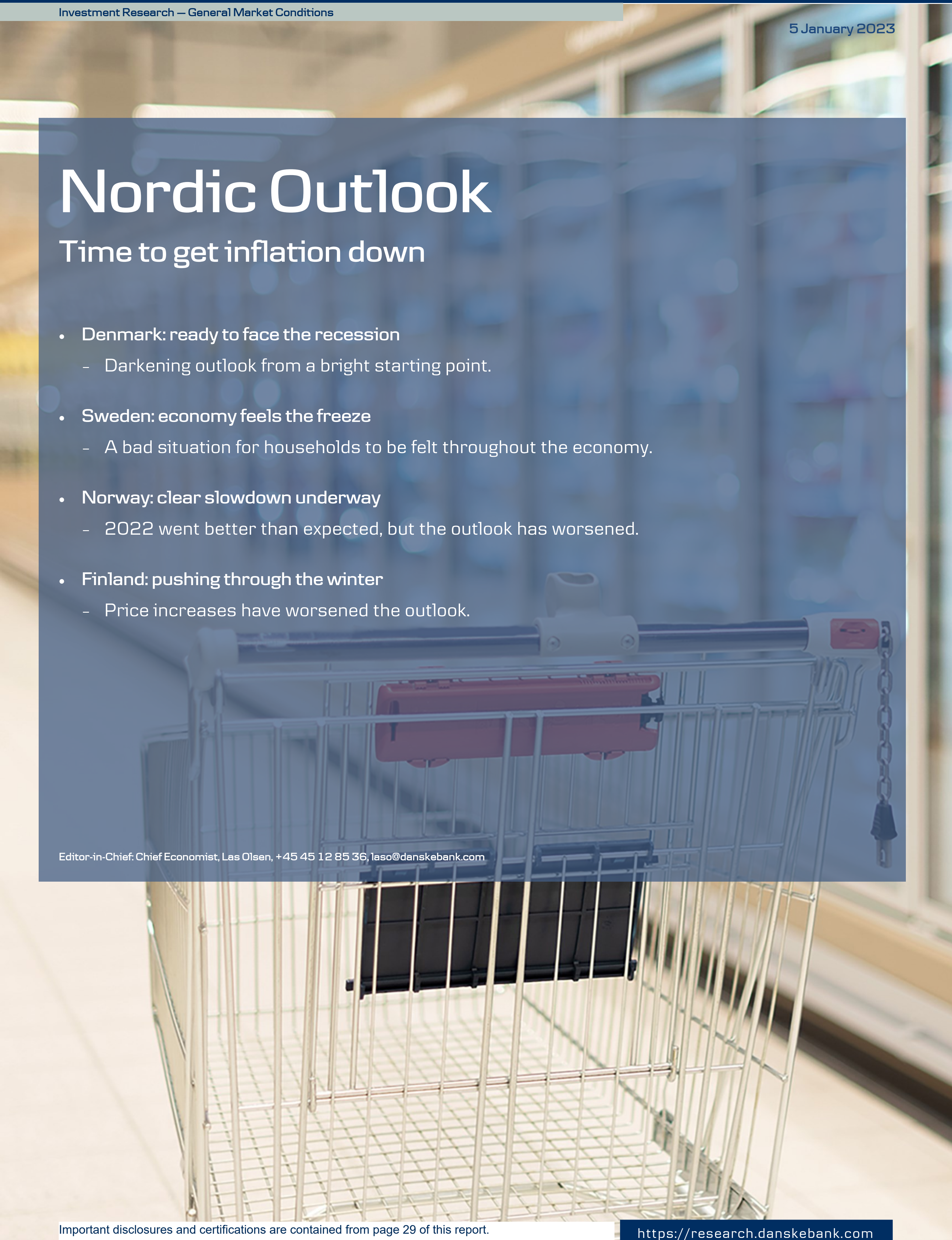
5 January 2023



Nordic Outlook

Time to get inflation down

- **Denmark: ready to face the recession**
  - Darkening outlook from a bright starting point.
- **Sweden: economy feels the freeze**
  - A bad situation for households to be felt throughout the economy.
- **Norway: clear slowdown underway**
  - 2022 went better than expected, but the outlook has worsened.
- **Finland: pushing through the winter**
  - Price increases have worsened the outlook.

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Important disclosures and certifications are contained from page 29 of this report.

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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 semi-annual publication *The Big Picture* sets out our global economic outlook.

At a glance

Time to get inflation down

Not a painless operation

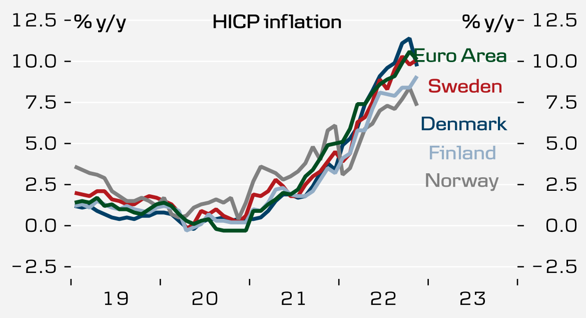
2022 was the year of inflation, also in the Nordics. This year and quite possibly the next will to a large extend be shaped by the efforts to bring inflation down again, and as last year's experience has clearly shown, inflation can be very difficult to predict. As we see it, we are approaching or already in a recession in both the Nordic countries and the wider euro area, as real incomes are being eroded by higher prices and higher interest rates are dampening demand. If all goes well, a mild recession should be enough to rebalance the economy and we can move on afterwards with somewhat higher unemployment but economies that are not seriously damaged. However, it is a very difficult task for central banks to achieve just the right amount of tightening, and there is a large risk that the recession will be either unnecessarily deep or that inflation will be drawn out and become more ingrained. Also in the coming years, it will be necessary to monitor economic data very closely to see where we are heading.

The Nordic countries have largely been hit by inflation to the same extent as other European countries, despite being much less reliant on natural gas. However, there is hope that inflation will decline faster in the Nordics than in the euro area, where utility companies seem to have been slower in passing higher gas and electricity prices on to consumers and hence have more energy inflation in store even if wholesale prices do not increase further. Still, also in the Nordics we are seeing elevated non-energy inflation as second-round effects from higher costs are pushing up prices of nearly all goods and services, and that process is far from finished. Central banks in Sweden and Norway are trying to strike the balance between a strong stand against inflation and the risk of harming domestic economies that are especially sensitive to short-term interest rates. Just as Norway was among the first to start hiking rates in 2021, it could very well be among the first to stop, as we expect no more hikes there.

Good Nordic starting point

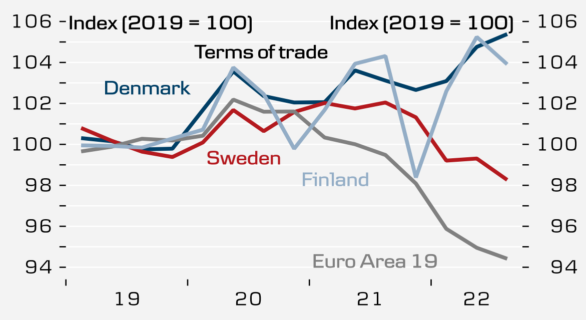
The Nordic countries have a strong starting point heading into this recession. Compared to most other European countries, they have been less damaged during the Covid crisis, and have recovered more quickly. Government finances are generally in good shape, and measures to help households and businesses cope with inflation are comparatively modest. Exploding natural gas prices have not been a big negative terms of trade chock for the Nordics, as it has for much of Europe. Gas is the heating source in 13% of Danish households and in very few households in the other Nordic countries. Norway is a large gas exporter. Denmark has significant gas production that is set to increase substantially this year. However, higher interest rates are a shock also to Nordic households and businesses, both directly through higher costs on existing loans especially in Sweden and Norway, and indirectly through the effect on asset prices, not least housing. How far prices fall will be an important thing to watch in the coming years.

Inflation surge also in the Nordics



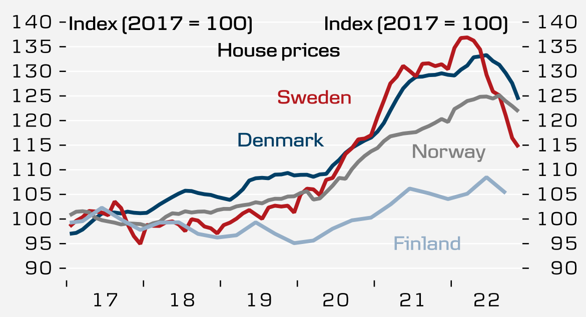
Source: Eurostat, Macrobond Financial

Less of a trade chock than in the Euro Area



Norway not shown, would be index 188.1 in Q3 2022. Export prices divided by import prices. Source: OECD, Macrobond Financial

Watch out for the housing market



Source: Macrobond Financial

Denmark

Ready to face the recession

- **Denmark's economy is facing recession, but it is well prepared after several years of personal and public financial consolidation.**
- **Getting inflation down again will take time, as last year's price increases will trigger new price rises this year on rents, etc.**
- **We are looking for a significant fall in private consumption, but expect this to correct again, as household finances are fundamentally solid.**
- **Denmark's huge current account surplus has been driven by freight rates and is set to shrink, but Denmark remains in a strong position compared to the euro area.**
- **House prices are under considerable pressure from higher interest rates, though general wage and price increases are providing uplift.**

At a glance

Denmark					
	Current forecast			Previous forecast	
% y/y	2022	2023	2024	2022	2023
GDP	2.9	-1.0	1.0	3.0	-0.6
Private consumption	-2.6	-2.3	1.8	-1.5	-1.0
Public consumption	-1.1	0.0	0.9	0.4	-0.2
Gross fixed investment	4.4	-3.3	-2.1	4.8	-2.1
Exports	7.4	1.3	1.2	5.3	-1.7
Imports	3.2	-0.7	0.4	3.7	1.5
Gross unemployment (thousands)	75.4	88.0	96.0	76.2	89.7
Inflation	7.8	4.9	2.0	7.5	3.4
Government balance, % of GDP	1.2	1.0	0.8	1.3	1.0
Current account, % of GDP	11.8	9.5	9.5	10.0	9.0

Source: Danske Bank

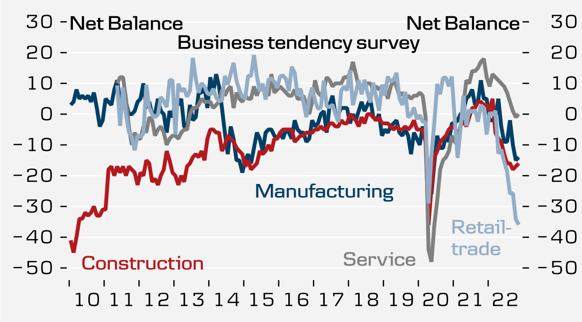
Tougher times ahead

We estimate Denmark is on the brink of an economic recession, with rising unemployment, declining GDP, more bankruptcies and generally tougher times ahead for many companies and households. Reduced purchasing power and higher interest rates point to lower demand at home and abroad, and this will leave its mark. However, Denmark is definitely not unique in this respect, and in our opinion the country is well prepared for the recession. Household and corporate finances are generally solid, while a tight labour market hopefully means unemployment need not rise unduly. Denmark has become less and less sensitive to the global industrial cycle, not least because of the increasing significance of the pharmaceutical industry. Government finances are strong, and in contrast to most European countries Denmark continues to run a large current account surplus.

We expect a recession in 2023 that reduces activity from an unsustainably high level to an approximation of an economy in balance. That also means there is little prospect of an upswing from 2024 onwards, but more something that could be termed normal growth. That being said, the recession in 2023 could well be deeper than we forecast, which would also provide greater potential for an upswing in its wake.

Economic data have generally surprised positively since our last forecast in October, and there is still not much evidence of a recession in 'hard' numbers like GDP or employment. On the other hand, inflation and interest rate expectations have risen, eroding household purchasing power and corporate finances in the process and dampening the outlook for the coming year.

Recession ahead



Source: Statistics Denmark, Macrobond Financial. Own seasonal adjustment for retail trade.

Inflation begets more inflation

Consumer prices rose dramatically in 2022. Rising costs, particularly for energy, combined with production levels that could not keep up with demand, neither globally nor in Denmark, fuelled broad underlying price pressures in the economy. However, these pressures appear to have peaked on the back of declining demand and maybe also the normalisation of energy prices in the autumn. Substantially fewer companies expect to hike their prices and inventories have swollen markedly. This indicates a potential need to increase sales, and given the ever more modest level of demand, the result could be considerable price discounts.

On the other hand, the pronounced spike in energy prices in December once again upped costs for both consumers and companies, so a series of delayed effects will raise consumer prices in the first few months of this year. This applies to public transport, district heating to some extent and, most importantly, rents. The quarterly rent adjustments made in the course of 2022 indicate the major annual changes to rents in February's consumer price index will be substantially greater than we are used to. Hence, we should reckon on relatively high inflation in 2023 as well.

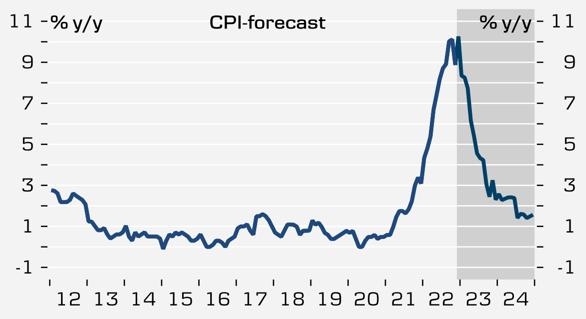
There still appears to be a lag in costs that has not yet been passed onto consumers. Wage pressures are also set to increase, indicating price pressures in the economy will remain significant. Pulling in the opposite direction are the large inventories and a slowdown in the economy and in demand, which will tend to gradually ease price pressures during the forecast period. We are expecting inflation of 4.9% in 2023, but note that inflation has proved very difficult to forecast. Hence, the level of uncertainty is also significant. In Denmark, energy market prices quickly feed through to energy bills, so our expectation of a gradual decline in energy prices should pull inflation lower, especially in 2024. That also means we expect inflation to again dip below 2% in the course of 2024, which is considerably faster than in the euro area, for example.

Wage battle ahead

After the dramatic decline in real wages in 2022, employees are clearly keen to see their pay increased at this year's collective bargaining rounds. In contrast, employers have pointed out that many companies are being squeezed by rising costs and that wage growth still appears to be subdued among Denmark's trading partners. Reaching an agreement will be difficult, and the risk of major industrial action in the spring is definitely present. In practice, a large proportion of an employee's pay is determined at the local, company level, and this has produced strikingly modest wage growth in 2022 despite the tight labour market and high inflation. Indicators like job ads and labour shortages suggest the labour market has become a tad less tight, and our forecast incorporates a further shift in this direction, which would point to lower wage growth, but we expect the collective agreements will tend to push wage growth higher, all in all.

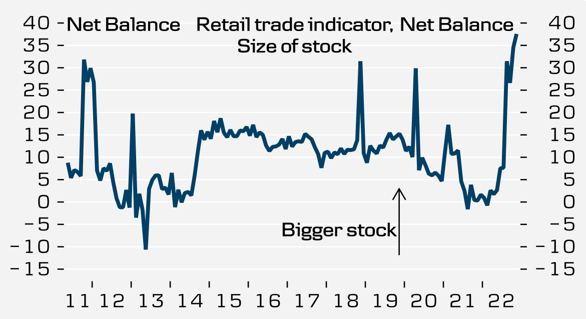
We expect employment numbers to fall by around 40,000 between now and the end of the year. That represents a relatively modest decline given our overall expectations for the economy. We estimate there is still an unfulfilled demand for labour, so those laid off in one sector will to some extent be able to find work in other sectors. Nevertheless, there is a clear risk the downturn in employment could be more pronounced. The recession may be more severe than expected,

Elevated levels of inflation for some time yet



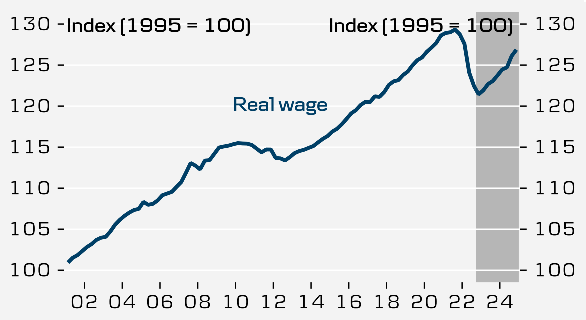
Source: Statistics Denmark, own calculations, Macrobond Financial

Inventories swelling



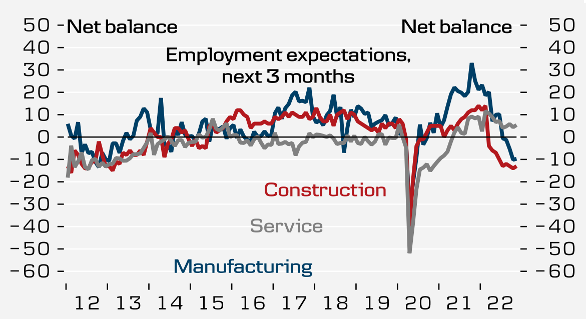
Source: Statistics Denmark, Macrobond Financial

Major decline in real wages in 2022



Based on DA's wage statistic deflated by the consumer price index.
Source: DA, Statistics Denmark, Macrobond Financial

Slightly less tight labour market ahead



Source: Statistics Denmark, Macrobond Financial. Own seasonal adjustment.

plus some employers may have hired too many workers during the post-pandemic upswing, when employment rose relatively steeply compared to the level of economic growth.

Consumption to fall, but rebound could be relatively swift in coming

Consumption looks set to fall further in 2023. Rising prices continue to erode purchasing power and there is no immediate prospect of real wage growth in Denmark until at least H2 23. Furthermore, increasing interest rates and declining house prices are beginning to seriously squeeze both the disposable income and wealth of homeowners. Moreover, uncertainty on disposable income trends is currently exceptionally high, both on the expense side, where interest rate growth and energy prices are difficult to forecast, and on the income side, as we expect the labour market to experience a setback. This points to a higher savings ratio in 2023.

We continue to expect that limited car sales and the major energy savings being made by Danes will pull consumption lower in real terms. Whereas 2022 saw a particular decline in the consumption of goods, which had generally performed well during the pandemic, we also expect consumption of services to weaken going forward. Reasons include the absence of any further reopening effect and the fact that rising uncertainty and reduced purchasing power also typically hit this area of consumption.

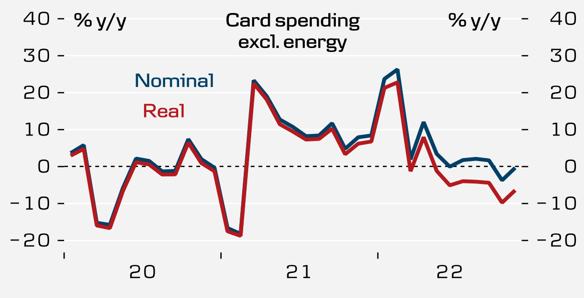
We expect the downtrend in consumption to end in 2024 as real wages rise once more and interest rate pressures slowly begin to ease. Lower inflation should also reduce uncertainty for consumers' finances, which together with a stabilisation of the labour market may result in less pressure for increased savings towards the end of our forecast period.

Our expectation that the downturn in private consumption will be relatively short-lived and replaced by modest growth is due, not least, to Danes generally entering the downturn with their finances well balanced. Households have not accumulated much debt in recent years and there has been no tendency for consumers to live beyond their means – in stark contrast to the years leading up to the financial crisis. Hence, fading price pressures coupled with real wage growth should be sufficient to once again spur modest consumption growth.

House prices set to fall further

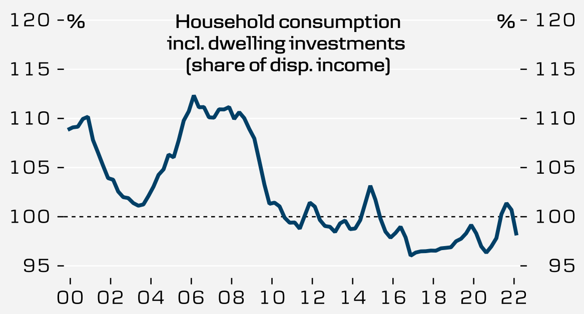
House prices are ailing and there is no obvious remedy. We expect the deteriorating economic outlook along with sharply rising interest rates and increased expenses to push house prices further south during our forecast period. While we see long-term mortgage rates as close to peaking, we expect further headwinds from rising short-term rates throughout 2023. High financing costs and increased uncertainty going forward have already severely dented activity levels in the Danish housing market. Meanwhile, supply has increased, as have sales times, and price discounts have become more common. We are expecting to see a noticeable decline in house prices of 14% between the past summer's peak and mid-2024. That equates to house prices retreating to mid-2020 levels. Adjusting for the considerable increase in the price of other goods and services and the expectation that this will continue, the real value of housing is set to fall to 2015 levels.

Consumption falling significantly in real terms



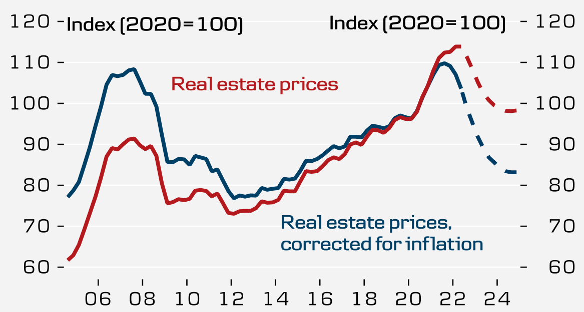
Source: Danske Bank, Statistics Denmark and Macrobond Financial

Danish household finances well balanced



Source: Statistics Denmark and Macrobond Financial

Noticeable decline in house prices expected



Note: Own seasonal adjustment

Source: Statistics Denmark, Boligsiden and Macrobond Financial

We expect the impact of rising interest rates to be greater on houses in the most expensive areas and on owner-occupied apartments in the major cities, as prices have clearly risen most here while interest rates were declining. This is now being reflected in a tendency towards greater price discounts in the more expensive areas compared to the rest of the country. Moreover, these areas will be hit relatively harder by the housing tax reforms and new property valuations, which should be rolled out during our forecast period.

Nevertheless, there are a number of mitigating factors at play in the housing market. Nominal income growth and high inflation are helping to support house prices. Moreover, Danes are generally well-cushioned and have used the period of low interest rates to reduce their housing debt to the extent that the average loan-to-value (LTV) ratio is currently at a multi-decade low. Furthermore, rising interest rates are not expected to fully feed through to prices in the expensive areas, as additional lending restrictions on top of disposable income levels have tended to limit how much prospective homebuyers could borrow in recent years.

No crisis in government finances

The government surplus in 2022 again looks set to be significantly higher than expected. The surplus has been maintained in part by Denmark only offering limited subsidies to help offset the high energy prices. However, the electricity tax is set to be largely but temporarily scrapped in H1 2023, which will cost the Treasury DKK3.5bn, or just over 0.1% of GDP. The most significant helping hand for energy costs is the option of borrowing an amount covering the increase in electricity, gas or heating prices. Interest in the scheme has been very limited since it opened on 1 November, but of course this could change and the media have speculated that the amount lent might reach DKK45bn. However, we doubt the scheme is attractive enough to reach such a high amount.

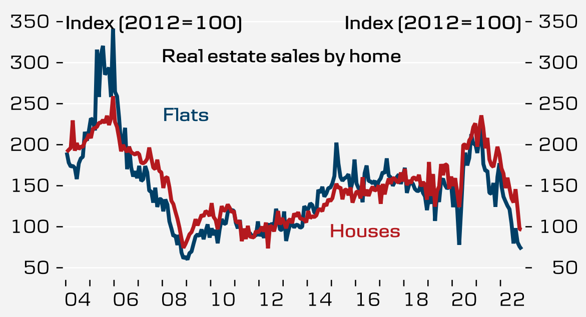
Strong DKK supportive of increased rate spread

When the European Central Bank (ECB) raised its key interest rates by 0.75 percentage points in October, Danmarks Nationalbank elected to hike by 0.15 percentage points less to counter the strengthening pressure on the Danish krone (DKK). However, this pressure remains in place, and we expect the rate spread to widen further when the ECB next raises interest rates. The euro is under pressure to weaken, in part due to higher energy prices in Europe, which Denmark is less exposed to because of domestic production and less dependency on gas. Moreover, high freight rates have pushed Denmark's current account surplus higher. 30-year mortgage borrowing costs have risen markedly in 2022, from around 1.8% to 4.5-5.0% plus administration margin. They have been pushed higher by both rising interest rates and by increased uncertainty and volatility. Further significant fluctuations, in either direction, could still be on the cards – though we do not have major overall increases in our forecast.

Very strong export sector set to slow

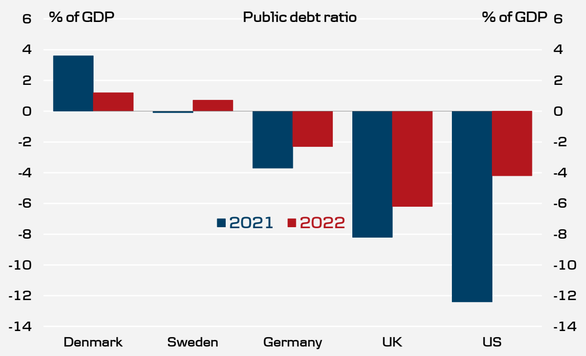
Danish manufacturing has performed remarkably well since the pandemic broke out. Production is up 25% compared to largely unchanged in the euro area, and that has been reflected in goods exports, which have grown faster since the onset of the pandemic than goods exports in any of the countries Denmark is normally compared with.

Sales activity dramatically lower from very high levels



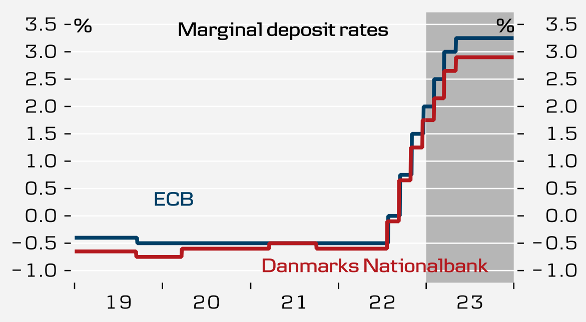
Source: home, own calculations, Macrobond Financial

Danish government finances in a class of their own



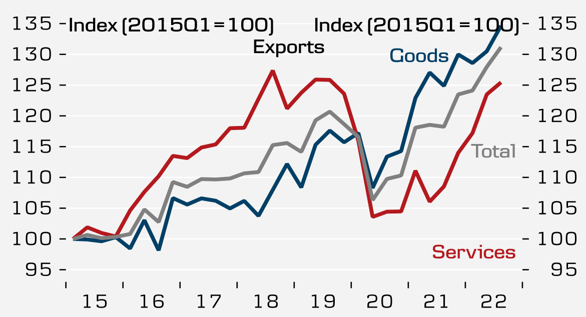
Source: Macrobond Financial, Danske Bank. 2022 is Danske Bank's estimate

Interest rates to rise by slightly less in Denmark



Source: Danmarks Nationalbank, ECB, Macrobond Financial. Shaded area is Danske Bank's forecast.

Exports have been very strong



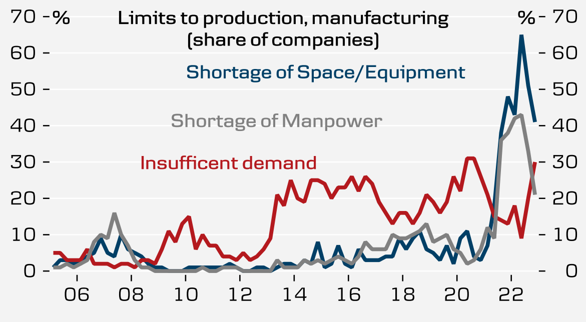
Source: Statistics Denmark, Macrobond Financial

That being said, headwinds have increased for exporters, and production has declined in recent months across cyclically sensitive sectors like the machinery and metal industries. Activity in Denmark's export markets has also fallen since the summer, and that will be increasingly felt by these industries. Lack of demand is once again more of a limit on production than the lack of labour – hence, order books are thinning. Denmark's competitiveness has deteriorated somewhat of late due to the strengthening of the EUR and hence DKK, but we expect the tendency towards a weaker effective DKK to return this year. While the challenges are mounting, we continue to expect exports to grow throughout this year and next, albeit rather modestly in the case of goods exports. Danish goods exports follow a decidedly different pattern than that dictated by the business cycle due to major exports of pharmaceuticals, wind turbines and food.

Denmark's current account surplus was almost 17% of GDP in Q3 22 despite the country's status as a net energy importer, which has had a considerable negative impact on the surplus. The surplus is on a scale previously unheard of and is due, in particular, to high freight rates, but also solid goods exports and a decline in imports as a result of weak domestic demand. This is reflected in terms of trade, which have increased by 32% for services since 2020, while rising energy prices, in contrast, have contributed to lowering the terms of trade for goods by 16% over the same period.

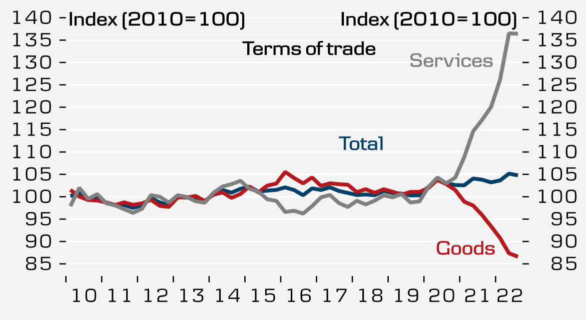
However, this extreme situation has shifted following the normalisation of freight rates, with the current account surplus falling DKK2bn in October. We expect this trend to continue, as the proceeds from shipping have clearly been the most important explanation for the growing surplus. The economic downturn in Denmark and globally will, however, contribute to increasing the surplus, as the demand for imports will be suppressed by limited domestic demand, while goods exports should be less affected by the business cycle. The reopening of the Tyra gas field in winter 2023-24 will also contribute considerably to net energy exports in 2024. The 29 million MWh of gas the Danish Energy Agency expects will be produced in 2024 had a market value of around DKK29bn in the first half of December, which equates to 1% of GDP, though we expect the price of gas will be lower by 2024.

Industry no longer overheating



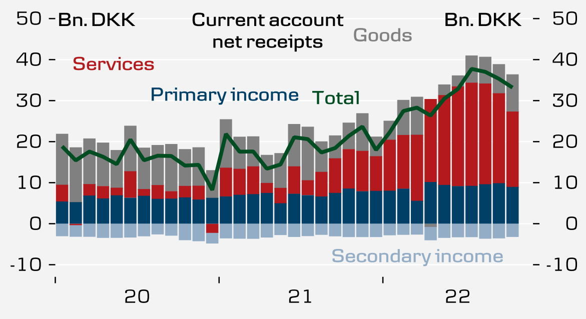
Source: Statistics Denmark, Macrobond Financial

Terms of trade shift dramatically



Source: Danmarks Statistik, Macrobond Financial

Record current account surplus receding



Source: Statistics Denmark, Macrobond Financial

At a glance

			Forecast		
National account	**2021**	**2021**	**2022**	**2023**	**2024**
	DKK bn (current prices)		% y/y		
Private consumption	1107.2	4.3	-2.6	-2.3	1.8
Government consumption	608.4	4.2	-1.1	0.0	0.9
Gross fixed investment	566.1	6.2	4.4	-3.3	-2.1
- Business investment	330.1	6.3	4.9	-1.0	-0.5
- Housing investment	150.7	9.9	6.8	-11.4	-10.1
- Government investment	85.3	0.4	-1.4	2.6	4.4
Growth contribution from inventories		0.0	0.6	-0.6	0.0
Exports	1494.0	8.0	7.4	1.3	1.2
- Goods exports	893.4	11.4	4.4	1.6	2.1
- Service exports	600.5	1.8	12.7	0.8	0.0
Imports	1315.2	8.0	3.2	-0.7	0.4
- Goods imports	814.4	10.5	0.5	-1.4	0.5
- Service imports	500.8	4.2	7.6	0.3	0.3
GDP	2504.2	4.9	2.9	-1.0	1.0

Economic indicators	**2021**	**2022**	**2023**	**2024**
Current account, DKK bn	206.2	330.8	276.9	284.1
- % of GDP	8.2	11.8	9.5	9.5
General government balance, DKK bn	91.0	34.0	30.0	25.0
- % of GDP	3.6	1.2	1.0	0.8
General government debt, DKK bn	917.0	835.0	820.0	810.0
- % of GDP	36.6	29.7	28.1	27.0
Employment (annual average, thousands)	3045.8	3164.3	3154.5	3142.0
Gross unemployment (annual average, thousands)	105.9	75.4	88.0	96.0
- % of total work force (DST definition)	3.6	2.6	3.1	3.4
Oil price - USD/barrel (annual average)	71	106	86	80
House prices, % y/y	11.2	0.8	-8.8	-3.6
Private sector wage level, % y/y	3.0	3.5	4.1	4.2
Consumer prices, % y/y	1.9	7.8	4.9	2.0

Financial figures	**04/01/2023**	**+3 mths**	**+6 mths**	**+12 mths**
Lending rate, % p.a.	1.90	2.80	3.05	3.05
Certificates of deposit rate, % p.a.	1.75	2.65	2.90	2.90

Source: Statistics Denmark, Danmarks Nationalbank, Macrobond Financial, Danske Bank

Sweden

Economy feels the freeze

- **Inflation and monetary tightening to send economy into brief recession**
- **Signals suggest clear fall in inflation in 2023**
- **Labour market resilient, but for how much longer?**
- **Housing market probably has yet to hit bottom**
- **Riksbank will need to raise policy rate again in the coming months**
- **Headed for budget deficit, but fiscal policy could be more proactive**

At a glance

Sweden	Current forecast			Previous forecast	
% y/y	2022	2023	2024	2022	2023
GDP, calendar adjusted	2.6	-1.2	1.2	2.4	-1.2
Private consumption	2.6	-1.3	2.0	3.4	-1.3
Public consumption	-0.2	1.1	1.2	-0.3	1.1
Gross fixed investment	5.6	-3.0	1.8	4.6	-2.2
Exports	4.6	1.3	2.8	4.9	2.4
Imports	7.9	0.2	2.6	8.7	1.8
Unemployment rate	7.5	8.2	8.1	7.4	8.2
Inflation	8.3	8.5	1.3	8.0	6.1
Government balance, % of GDP	0.7	-0.9	-0.4	0.7	-0.9
Current account, % of GDP	3.9	4.4	4.5	3.7	4.1

Source: Danske Bank

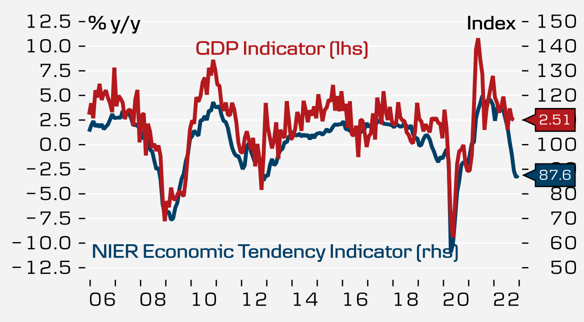
Inflation and monetary tightening to send economy into brief recession

Growth in the Swedish economy held up better than expected in the third quarter (0.7% q/q SA) and at the beginning of the fourth quarter, with the GDP indicator for October showing growth of 0.7% m/m SA. This is undeniably very positive on the face of it, but the underlying data for the third quarter reveal the composition of this growth to be problematic, with falling private consumption and a negative contribution from net exports. We also suspect that the biggest positive contribution to growth, from stockbuilding, was a result of dwindling demand, making it involuntary. This is therefore a negative factor in the outlook, as firms will eventually need to reduce production to bring their stocks back down again. Data indicate that investment, production and employment were the positive drivers in the Swedish economy over the summer and early autumn. In other words, Swedish firms continued to do really well, while consumers and the housing market struggled. This means that housing investment will continue to decline for at least the next year – more on this in the section on the housing market below.

These hard numbers have led us to revise up our growth forecast for 2022, but we are not changing our narrative on the economic outlook. It is still clear that the Swedish economy is facing probably its most severe shock since the early 1990s. We therefore remain negative about growth in 2023, which is supported by the NIER's Economic Tendency Indicator.

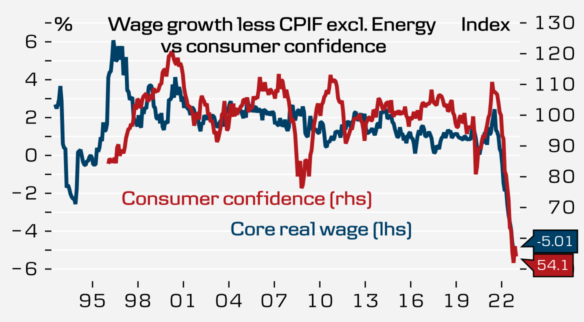
The outlook for Swedish consumers cannot be described as anything other than bleak. Workers lost at least four years of real wage growth in one fell swoop in 2022, even if we exclude the effects of rising interest rates and power prices. Real wages also look likely to continue to trend down in 2023, albeit at a decreasing rate. Not until the second half of the year will the situation begin to normalise. The Riksbank's rate increases will not have their full effect until during the first half of the year as they are fully incorporated into mortgage rates and firms' borrowing costs, and the outlook for power prices is very uncertain.

Economic Tendency Indicator points to recession in 2023



Source: Swedish National Institute of Economic Research (NIER), Statistics Sweden

Collapse in real wages sends consumer confidence to record low



Source: NIER, Statistics Sweden, Swedish National Mediation Office

Although there is reason to believe that power prices will drop back in spring with rising temperatures and less need for heating, there is much to suggest that price levels will now be permanently higher, partly because of the war in Ukraine and European gas shortages, and partly because the heavy investment expected in industry in the coming years will require greatly increased electricity production. All of these factors point to a substantial erosion of purchasing power, with subdued consumption and weak prospects for the housing market.

Soaring interest rates and power prices are also affecting many firms, of course, and at a time when customer demand is also ailing. It is clear that many manufacturers are being hit hard by rising production costs, primarily for electricity.

The Government's proposed power price subsidy will alleviate the economic stress somewhat. However, the subsidy is relatively small given the still high price of electricity, and all we know is that the subsidy for households will begin to be paid out at the beginning of February. It is not yet known when the subsidy for firms will start to be paid, and there is naturally a risk of bankruptcies rising in the meantime. In a worst-case scenario, unemployment will rise as a result. The section on the labour market below fleshes out our view of the outlook there.

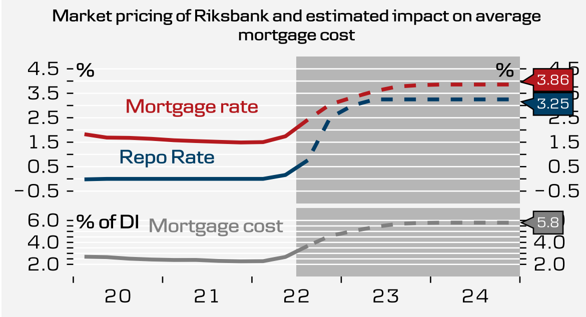
Signals suggest clear fall in inflation in 2023

The inflation outlook has deteriorated in the near team, due mainly to record-high power prices and the Riksbank's rate increases pushing up mortgage costs and hence consumer price inflation. November brought slightly lower core inflation (CPIF ex energy) than expected, and it was a very broad-based improvement. It is too early to declare the danger over, however, because the high rate of inflation during the autumn has increased the need for firms, municipalities and housing associations to raise their prices and charges.

For example, we expect that bank charges, electricity transmission charges, district heating prices, water and wastewater charges, housing association service charges and the ceiling for kindergarten prices will all go up in January. This will bump up the monthly rate of inflation by around 1pp. Only after that is there the prospect of inflation peaking and heading back down.

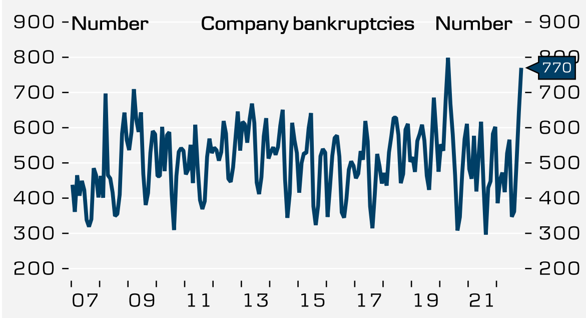
We assume that inflation will subside comparatively quickly in 2023, but the outlook is very uncertain, and there is a risk of it coming down more slowly. We are basing our forecast primarily on international factors such as falling container freight rates and prices for industrial inputs, such as base metals, semiconductors, sawn timber, oil, petrol and chemicals. Prices here came down in 2022 and should therefore put a damper on consumer price inflation in 2023. It is worth noting in this context that global PMIs are signalling loud and clear that delivery times have returned to normal, thanks partly to softer new orders (demand) and partly to reduced supply chain problems.

Riksbank trebles mortgage costs



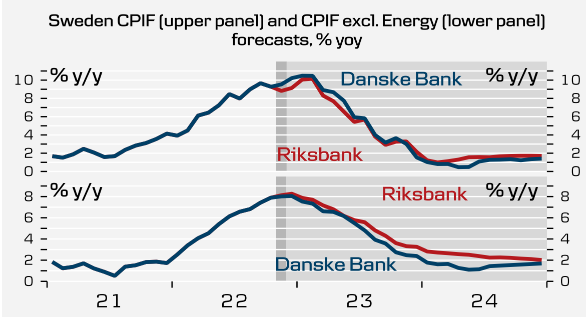
Source: Statistics Sweden, Sveriges Riksbank

Bankruptcies picking up



Source: UC, Creditsafe, Danske Bank calculations

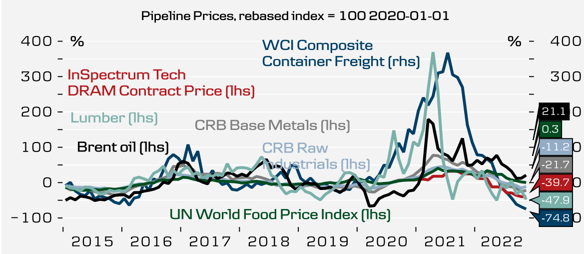
Inflation to head back down in the first quarter



Source: Statistics Sweden, Sveriges Riksbank, Danske Bank

Exchange rates and wage growth are normally the two key drivers of inflation. Historically, a 10% decline in the SEK (KIX index) has increased the rate of inflation by around 0.5pp. When inflation is around the target level, this is a significant factor. Now that inflation is up around 10%, it pales into insignificance. It is primarily international prices for goods that have driven up imported consumer inflation, not the weaker SEK. Around half of the rate of wage growth has historically fed through into consumer prices – in other words, wage inflation of 2% has, on average, pushed up price inflation by around 1pp (although this varies somewhat depending on which measure we use). The unions have called for a one-year deal of 4.4%, which is very high by historical standards. Employers have responded with an offer of 2%, which would point to a settlement in the range of 3-3.5%. We find it hard to see this triggering significant inflationary problems and a wage-price spiral. From workers' perspective, it is simply a matter of softening the decline in real wages. Not until 2024 will real wage growth turn positive again.

Falling global input prices point to lower inflation in 2023

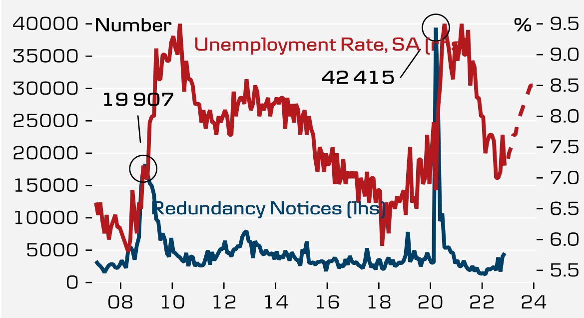


Source: WCI, CRB, InSpectrum, Macrobond Financial, Bloomberg, UN

Labour market resilient, but for how much longer?

The labour market has proved very resilient: employment has continued to grow, and hours worked have held at good levels. Unfortunately, we consider it only a matter of time before things take a turn for the worse here as well. Hiring plans in the business sector are clearly trending down, and both construction and retail expect to reduce the workforce in the coming months. New vacancies are still at high levels but have fallen appreciably, and redundancies and bankruptcies have risen, which also points towards unemployment to start to rise from here. We are therefore sticking with our previous forecast for the unemployment rate of 8.5% at the end of 2023.

Rising unemployment in 2023



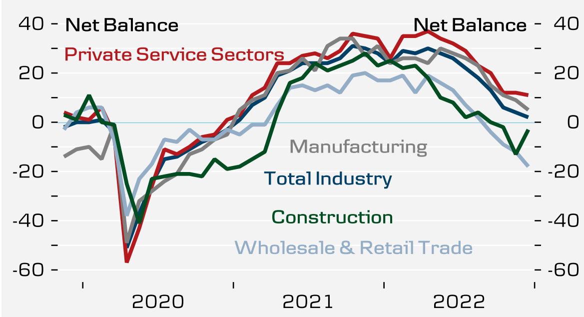
Source: Public Employement Service, Statistics Sweden, Macrobond Financial

Housing market has probably yet to hit bottom

Since peaking in February/March, housing prices have fallen 12% SA overall, with houses down 13.6% and apartments down 10.7%. Geographically, house prices in Malmö stand out with a drop of 15.3%, while apartment prices have come down more consistently across the big cities. The decline in house prices accelerated particularly in the second half of 2022, presumably driven by higher interest rates and living costs, including power prices.

Surprisingly, housing prices seem to stabilise somewhat in November and December despite the Riksbank raising its policy rate by a further 75bp during the same period. We think this is only a temporary reprieve, however, partly because these hikes have not yet had their full impact on the economy, and partly because we expect the policy rate to go up at least another 50bp. We are therefore sticking to our expectation that housing prices will decrease by a total of 20% from the peak, meaning that there is another 8pp to go from current levels. Housing prices will probably not stabilise until late spring, when the focus should have shifted from rate increases to rate cuts, and inflation will have begun to come down.

Firms' employment plans suggest demand for labour will fall



Source: NIER, Macrobond Financial

According to Hemnet, the supply of housing is still much higher than in previous years. Despite this, turnover is around the same levels as before the pandemic.

According to the NIER's Economic Tendency Survey, consumers expect mortgage rates to be around 5.1% in a year's time, compared to today's average list rate of 4%. These mortgage rate expectations imply a somewhat higher policy rate than we are expecting from the Riksbank, which points to a degree of resilience in housing prices. Pulling in the other direction is how consumers view the risk of becoming unemployed, which has increased in the NIER survey since last spring and can be expected to climb further as the labour market deteriorates. In addition, other than during the pandemic, the share of consumers responding that they are not interested in buying a new home in the next 12 months is at its highest since the question was added to the survey in 2003.

Riksbank will need to raise policy rate again in the coming months

In some ways, the Riksbank seems to have shifted its focus from CPIF inflation to core inflation ex energy. There is nothing odd about this, because the bank cannot do anything about energy prices with its policy rate. That said, we do not believe the Riksbank is ignoring energy prices, as they can have second-order effects that could push up core inflation in turn. For example, higher fuel prices can mean higher transport costs, which in turn push up prices for many goods. Rising power prices function in the same way and could push up prices for both goods and services, in the latter case via rents and/or service charges. This kind of spillover effect on core inflation cannot be overlooked.

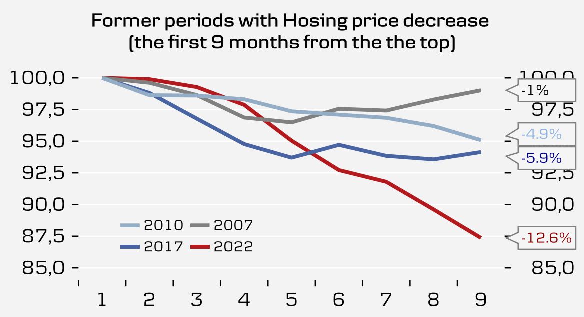
We have recently adjusted our forecast for the Riksbank and now expect the policy rate to rise by 50bp in February to 3.0%, which is slightly more than the bank signalled at its November meeting. The reason for this is not that core inflation has surprised to the upside, but more that the ECB has announced a much more aggressive stance than before, with clear signals that larger rate increases are needed. The Riksbank will probably feel that it needs to keep its policy rate in step with the ECB so as not to prompt a further fall in the SEK. We consider this unlikely to be a real risk, but the Riksbank seems to think so.

Depending on how inflation moves in the first quarter of 2023, we think the Riksbank may then need to hike one last time by 25bp in April, taking the policy rate to 3.25%.

The risk of doing so is, of course, that the bank slams the brakes on too hard. There is often talk of there being a neutral interest rate, whereas we think the discussion should be more about what would be a "neutral interest cost", because levels of debt and income (or revenue in the case of firms) are important parameters in this context. When it comes to households, it is easy to show that interest costs as a share of disposable income are well above the average for 2006-2014 (i.e. before the past decade's extreme situation with negative policy rates and heavy intervention in the bond market). We can only conclude that the policy rate will have a strong contractionary effect during the spring.

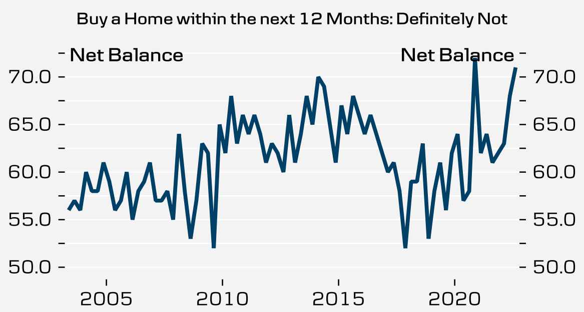
When the Riksbank will start to lower the policy rate again is, of course, very uncertain. The market is currently pricing in cuts from as early as the November meeting, but we do not anticipate a first move until 2024, when we expect the policy rate to come down by a total of 100bp.

Deflation in 2022 stands out, but previous surge in prices must be borne in mind



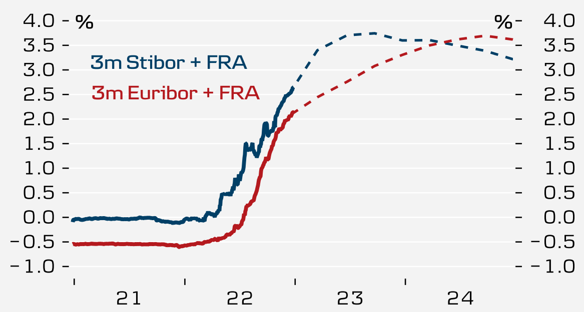
Source: NIER, Macrobond Financial

Households have little interest in buying a new home



Source: NIER, Macrobond Financial

Riksbank cannot allow gap to the ECB to grow too wide



Source: Macrobond Financial, Danske Bank calculations

Headed for budget deficit, but fiscal policy could be more proactive

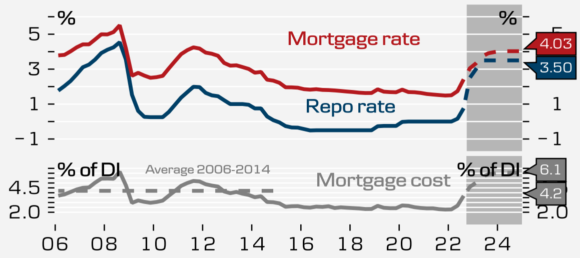
Fiscal policy seems rather deliberately cautious, and maybe overly cautious in our view. We are not among those who see a significant risk of the power price subsidy acting as a stimulus for households and fuelling inflation, because the households and firms that have paid high bottleneck charges will only be getting around half of this back. The government, however, appears keen not to feed this risk, if there is any.

Rather than extensive discretionary fiscal measures in 2023, we expect it to be the coming recession that causes a budget deficit, with central government expenditure rising and tax revenue falling – i.e. the automatic stabilisers coming into play. As an extension of this, we expect that central government (and local government for that part) will need to borrow more money and step up bond issuance.

In the longer term, we would like to see discussion on a new target for fiscal policy that would release resources for government investment that would benefit the entire economy. As Maastricht debt looks set to drop below 30% in 2023, which is outside the permitted band of 5 percentage points either side of the 35% debt anchor, the government will need to report to the Riksdag on how it plans to remedy this. We would have liked to have seen budget deficits being given the green light in future on the condition of compliance with the debt anchor. Unfortunately, there has been no hint of such a discussion among the parties in the Riksdag.

3.5% policy rate would make monetary policy record-tight

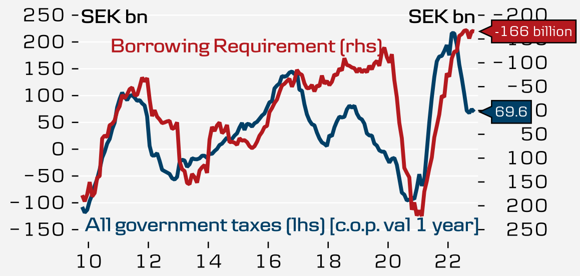
Market pricing of Riksbank and estimated impact on average mortgage cost



Source: Statistics Sweden, Sveriges Riksbank, Danske Bank calculations

Slower growth in tax revenue points to increased borrowing requirement in 2023

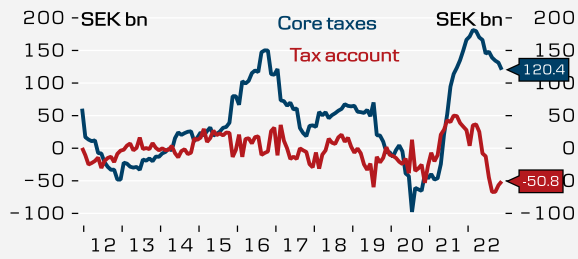
Central Government Finances, 12m trailing sum, yoy SEK bn



Source: Swedish National Financial Management Authority (ESV), Swedish National Debt Office

Continued growth in tax revenue, but substantial outflows from tax account

Swedish Budget Management Authority (ESV), yoy SEK change in 12m trailing sum



Source: ESV, Danske Bank calculations

At a glance

			Forecast		
National account	**2021**	**2021**	**2022**	**2023**	**2024**
	SEK bn (current prices)		% y/y		
Private consumption	2393.5	5.9	2.6	-1.3	2.0
Government consumption	1411.3	2.4	-0.2	1.1	1.2
Gross fixed investment	1413.4	6.1	5.6	-3.0	1.8
Growth contribution from inventories		0.3	0.6	-0.8	-0.6
Domestic demand	5216.5	5.3	3.9	-2.0	1.1
Exports	2479.3	7.6	4.6	1.3	2.8
Aggregate demand	7695.9	6.0	4.1	-0.9	1.7
Imports	2246.3	9.4	7.9	0.2	2.6
Growth contribution from net exports		-0.3	-1.2	0.5	0.2
GDP	0.0	4.8	2.6	-1.4	1.2
GDP, calendar adjusted	5436.3	4.6	2.6	-1.2	1.2

Economic indicators	**2021**	**2022**	**2023**	**2024**
Trade balance, SEK bn	228.6	165.4	193.6	203.1
- % of GDP	4.2	3.0	3.5	3.7
Current Account, SEK bn	283.6	215.4	243.6	253.1
- % of GDP	5.2	3.9	4.4	4.5
Public sector savings, SEK bn	-5.0	40.0	-50.0	-25.0
- % of GDP	-0.1	0.7	-0.9	-0.4
Public debt ratio, % of GDP*	37.0	31.0	29.0	29.0
Unemployment, % of labour force	8.8	7.5	8.2	8.1
Hourly wages, % y/y	2.7	2.5	3.2	2.7
Consumer prices, % y/y	2.2	8.3	8.5	1.3
House prices, % y/y	14.0	0.0	-13.0	1.5

* Maastricht definition

Financial figures	**04/01/2023**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	2.50	3.00	3.00	3.00

Source: Statistics Sweden, Macrobond Financial, Danske Bank

Norway

Clear slowdown under way

- **Growth is slowing, and the outlook is deteriorating further**
- **Capacity utilisation is now falling fast, albeit from high levels**
- **The labour market remains tight, but there are signs of the tide turning**
- **The housing market is clearly reacting to higher interest rates**
- **Norges Bank is signalling another rate increase, but we have our doubts**
- **The NOK remains volatile as uncertainty has grown, which spells a further period of pressure on the currency, but 2023 could see it rally**

Stronger than expected to date, but bleaker outlook

The revised national accounts showed stronger growth over the summer and into the autumn than we previously assumed. Business investment in particular surprised to the upside, but consumption of services and mainland exports were also better than expected. Mainland GDP grew by 0.8% q/q in the third quarter, well above our forecast in September. The revised figures are thus a better fit with signals from the labour market, where unemployment was largely unchanged during the autumn.

However, all leading indicators show things taking a turn for the worse, and more quickly than three months ago. The results of Norges Bank's regional network survey in December point to a clear slowdown. The aggregated output index fell from -0.16 to -0.57, which corresponds to annualised growth of around -1.1% over the next six months. This suggests that the combination of weaker global growth, faster inflation and higher interest rates is eroding demand, and that the output gap is closing. The slowdown is broad-based, with the exception of oil-related industries, and the outlook is weakest in retail and construction.

Most interesting, perhaps, is that only 44% of firms are now operating at full capacity, down from 58% in the September survey and the lowest since May 2021. This comes despite actual GDP growth being very solid in the third quarter, which could mean that there was a significant deterioration towards the end of the year. Either way, the survey results suggest that pressures in the economy are easing, and that growth is now below normal. This should gradually help put a damper on price and wage inflation in the Norwegian economy.

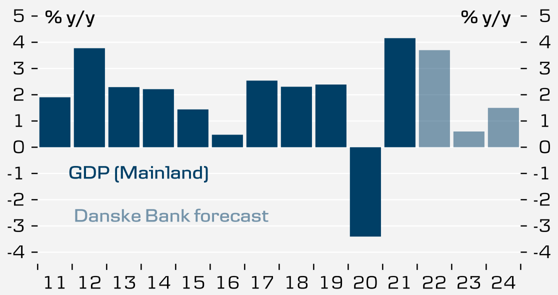
Firms' expectations for profitability in the coming year were revised down considerably once again. This is a clear indication that demand growth is slowing, which will make it harder for firms to pass on cost increases to their customers. This leads us to two clear conclusions. First, inflationary pressures will gradually ease, reducing the risk of price-price spirals. Second, we are seeing a sea-change in the economy where firms are being forced to switch comparatively quickly from expansion mode to contraction mode as costs have to be cut to maintain or improve profitability. This was partially confirmed by other data from the regional network survey, with firms now expecting zero growth in both investment and employment. Employer organisation NHO's

At a glance

Norway	Current forecast			Previous forecast	
% y/y	2022	2023	2024	2022	2023
GDP (mainland)	3.7	0.6	1.5	2.8	0.9
Private consumption	6.6	-0.5	0.9	4.6	0.9
Public consumption	0.3	1.3	1.5	0.9	1.3
Gross fixed investment	4.0	0.5	4.0	1.0	4.0
Exports	3.0	3.5	2.0	3.0	3.0
Imports	12.1	2.5	2.0	8.0	3.5
Unemployment (NAV)	1.8	2.2	2.4	1.8	2.4
Inflation	5.8	4.8	2.1	5.5	3.4

Source: Danske Bank

Mild recession expected



Source: Macrobond Financial, Danske Bank

quarterly survey has showed a similar trend, only with negative expectations for investment and employment.

We still anticipate a significant slowdown in the global economy, much weaker growth in consumption due to strong inflation, higher interest rates and rising unemployment, and a more moderate upswing in investment as profitability in the business sector comes under pressure and financing options narrow. We therefore expect a further slowdown in growth in Norway in late 2022 and well into 2023.

In the light of the revised GDP figures, we have raised our growth forecast for 2022 to 3.7%. Slightly weaker consumption and lower housing investment mean that we have lowered our forecast for 2023 to 0.6%, while we expect growth of 1.5% in 2024.

Mixed picture of the labour market

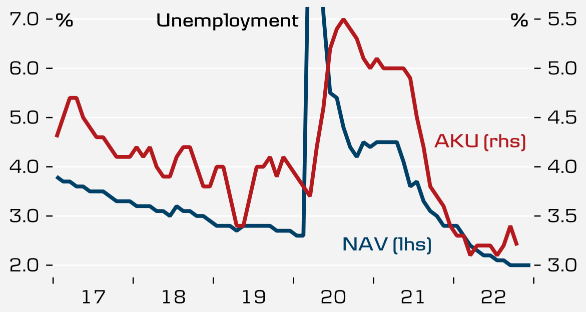
The labour market appears to be very tight, and registered unemployment is still at its lowest levels since before the financial crisis – just 1.6% in November. The national accounts showed further strong employment growth of 0.5% q/q in the third quarter, meaning that employment is now 3.4% higher than before the pandemic.

The LFS, on the other hand, paints a slightly different picture. Its jobless measure climbed from 3.1% to 3.4% during the autumn and was at its highest since December last year in October. The LFS has also shown employment falling continuously since April, albeit moderately. We normally set slightly less focus on the LFS numbers, partly because of the methodology and partly because the results can fluctuate considerably, it being a survey. However, we saw in both 2008 and 2014 that joblessness in the LFS began to climb before NAV's figures for registered unemployment. This may reflect firms putting the brakes on recruitment to adjust the workforce, but not having gone as far as actual redundancies. Those outside the labour market will then find it increasingly difficult to find work, but may not register as unemployed if they are not entitled to unemployment benefits. These people would be captured as unemployed by the LFS but not by NAV.

There are also other signs that the tide is turning. The monthly figures for new job openings peaked in May and have trended slowly down since, reaching levels last seen in spring 2021 in November. The number of job vacancies also fell from 107,000 to 100,000 in the third quarter.

Our unemployment forecast is unchanged at 1.8% for 2022, while we now expect a gradual rise to 2.2% in 2023 and 2.4% in 2024.

Labour market could be turning



Source: Macrobond Financial, Danske Bank

Wage and price pressures to ease

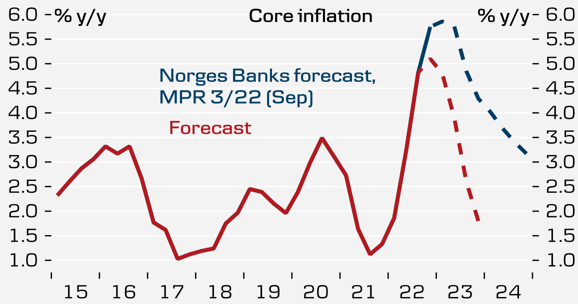
Inflation has been much higher than expected since our September forecast. A combination of strong cost increases throughout the value chain and rampant demand has resulted in a stronger cost pass-through than expected. Core inflation hit an annual rate of 5.9% in October but eased slightly to 5.7% in November. There is the prospect of inflation remaining high for a period, but we have probably passed the peak measured on a monthly basis. Inflation is still broad-based, but there were signs in November that prices for hotels, restaurants and furniture/interiors have started to come down. This could be a sign that weaker demand is beginning to put a damper on prices.

Although cost pressures will persist for a while, we expect the pass-through to consumer prices to become gradually more muted. Private consumption is likely to perform poorly for a period, and weaker demand will make it much harder for firms to pass on cost increases to customers.

We therefore expect core inflation to finish up at 3.9% for 2022 as a whole, before rising to 4.4% in 2023 and dropping back over the course of 2024 to an average of 2.8%.

The trouble, of course, is that this will put pressure on firms' profitability, and we expect this to increase their interest in cost-cutting when it comes to labour too. As mentioned above, we therefore expect unemployment to rise, and the combination of rising unemployment and pressure on profitability will result in more moderate wage growth further ahead. In 2023, however, relatively high inflation expectations mean that we expect wage growth to climb to 4.3% before slowing to 3.8% in 2024.

Core inflation approaching peak



Source: Macrobond Financial, Danske Bank

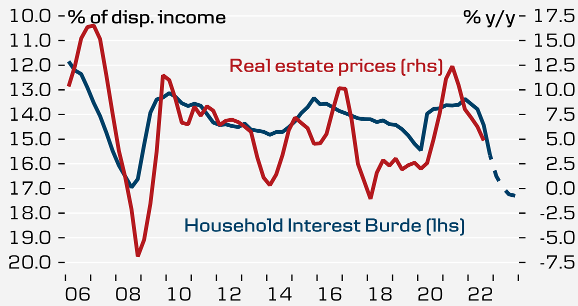
Housing prices to fall further but bottom out during the year

We have long predicted that housing prices would soften as a result of rising interest rates, already high (real) prices and a growing supply of housing. Housing prices outperformed our expectations for some time, but the aggressive monetary policy pursued since summer 2022, with the policy rate climbing 2 percentage points in six months, made it only a matter of time before things changed.

Seasonally adjusted housing prices have now fallen by almost 3% since late summer, and the number of homes on the market has risen considerably. This probably spells continued weakness, exacerbated by the rate increases in November and December.

We therefore now expect housing prices to fall by 3.5% in 2023 as a whole, further than previously predicted. However, if we are right in our take on the policy rate, a levelling off of interest costs combined with low homebuilding activity will mean that prices stabilise over the summer and perhaps rise moderately at the end of the year. We therefore expect housing prices to increase by 1.5% in 2024.

Higher interest rates pulling down housing prices



Source: Macrobond Financial, Danske Bank

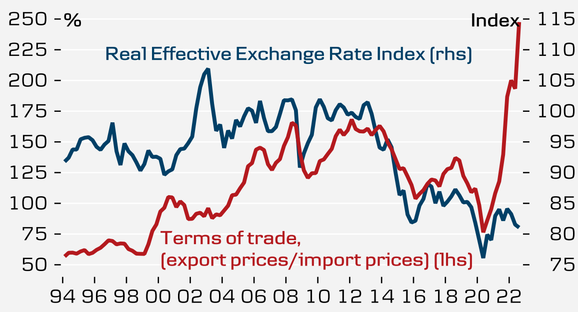
NOK could be popular later this year

The outlook for the NOK through to the end of 2023 is uncertain. In our base scenario, we expect the currency to weaken in the first part of the year in the wake of weaker global growth and a general deterioration in risk appetite in global financial markets.

However, we reckon 2023 could be a turning point for the currency. We see a good chance of the structural challenges in the energy market, especially in Europe, leading to persistently high prices and a need for further investment in the oil and gas sector. Persistently high energy prices will support the NOK in the medium term, and our models suggest that the currency is now underpriced for the first time for many years.

The biggest risk factor is the global investment climate. Whether the global economy performs better/worse and inflationary pressures ease more quickly/slowly than expected will be pivotal in terms of the need for tighter global monetary policy. Reduced pressure from central banks would bring an increased appetite for risk and gradual appreciation of the NOK, while increased pressure would have the reverse effect.

Will terms of trade boost the NOK?



Source: Macrobond Financial, Danske Bank

Policy rate may have peaked

Norges Bank raised its policy rate by 25bp to 2.75% as expected at its December meeting but indicated that there will probably be a further hike in the first quarter of 2023: "Based on the Committee's current assessment of the outlook and balance of risks, the policy rate will most likely be raised further in the first quarter of next year."

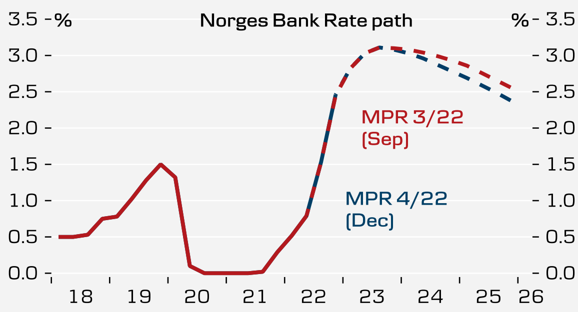
This is more hawkish than we anticipated and means that the downturn in the economy will need to be sharper than Norges Bank anticipates for the policy rate to peak at its current level. The bank's policy rate path was revised marginally up in the short term and slightly down further out (2024-2025), and now shows a roughly 50% probability of a rate increase in the first quarter of 2023 and a slim chance of a further hike after that, with a first rate cut in the course of 2024. The bank then anticipates a policy rate of around 2.25% at the end of 2025.

Norges Bank is signalling a continued rise in the policy rate even though we are now beginning to see previous rate increases making their mark on the economy. This naturally has to do with inflation being higher than expected and wage growth being expected to pick up. Together with a tight labour market, this means that the bank is looking for insurance against inflation becoming embedded at a high level. This is illustrated partly by the bank using "discretion" in its policy rate projections to signal a further rate increase.

The bank's risk assessment seems fairly balanced: "If the pressures in the economy persist, and signs emerge that inflation will remain high for longer than currently projected, a higher policy rate may be needed than currently envisaged. If inflation falls faster or unemployment rises more than projected, the policy rate may be lower than projected."

Given that we still expect economic activity to fall quite sharply in the first part of 2023, we are sticking to our expectation that the December rate hike will be the last in the cycle, and that we could see a rate cut by the end of the year.

Policy rate about to peak



Source: Macrobond Financial, Norges Bank, Danske Bank

At a glance

			Forecast		
National account	**2021**	**2021**	**2022**	**2023**	**2024**
	NOK bn (current prices)	% y/y			
Private consumption	1529.1	4.5	6.6	-0.5	0.9
Public consumption	971.9	4.9	0.3	1.3	1.5
Gross fixed investment	974.0	-1.2	4.0	0.5	4.0
Petroleum activities	176.0	-2.1	-7.0	4.0	10.5
Mainland Norway	796.0	1.1	6.7	-0.8	0.5
Dwellings	42.8	3.0	-2.8	-5.0	1.0
Enterprises	46.4	4.3	14.0	0.1	0.0
General government	215.6	-5.7	1.3	0.5	1.5
Exports	1753.7	5.5	3.0	3.5	2.0
Traditional goods	486.2	4.6	1.0	4.0	3.0
Imports	1213.3	1.7	12.1	2.5	2.0
Traditional goods	820.2	5.7	3.5	1.5	1.5
GDP	4209.5	3.9	3.2	1.2	1.2
GDP Mainland Norway	3286.3	4.1	3.7	0.6	1.5

Economic indicators	**2021**	**2022**	**2023**	**2024**
Employment, % y/y	1.2	3.8	-0.2	0.1
Unemployment (NAV), %	3.1	1.8	2.2	2.4
Annual wages, % y/y	3.5	3.9	4.3	3.8
Consumer prices, % y/y	3.5	5.8	4.8	2.1
Core inflation	1.7	3.9	4.4	2.8
Housing prices, % y/y	9.1	4.8	-3.5	1.5

Financial figures	**04/01/2023**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	2.75	2.75	2.75	2.50

Source Statistics Norway,: Norges Bank, Macrobond Financial, Danske Bank

Finland

Pushing through the winter

- **Finnish economy was stable during the first half of 2022, but headwinds grew during the autumn and the economy falls into a recession over the winter 2022/23. We have lowered our GDP forecast to -0.7% in 2023 (was -0.2)**
- **Persistently high inflation, tighter monetary conditions and weaker Global outlook take the wind out of consumption, investment and exports. Trade with Russia stays at a very low level. Relatively strong labour market shields the economy from a bigger impact.**
- **We expect housing markets to cool down with fewer transactions. Housing prices are likely to fall slightly, but there is no major pressure for larger price movements.**
- **The economic slowdown together with the energy crisis aid, investment into energy infrastructure and national defence put pressure on public finances. The debt-to-GDP ratio remains relatively flat thanks to a large increase in nominal GDP. Ageing related expenditure rise significantly this decade.**

At a glance

Finland	Current forecast			Previous forecast	
% y/y	2022	2023	2024	2022	2023
GDP	1.8	-0.7	0.5	2.0	-0.2
Private consumption	2.3	-0.3	0.4	2.0	0.1
Public consumption	2.5	1.5	1.0	3.0	1.0
Gross fixed investment	4.5	-1.0	0.5	3.5	0.5
Exports	1.5	-1.5	1.5	0.5	-0.5
Imports	7.0	-2.0	1.0	4.0	0.5
Unemployment rate	6.8	7.3	7.2	6.8	7.3
Inflation	7.2	4.8	2.2	6.6	3.7
Government balance, % of GDP	-1.8	-2.5	-2.0	-3.1	-2.6
Current account, % of GDP	-3.3	-2.7	-2.1	-2.6	-1.4

Source: Danske Bank

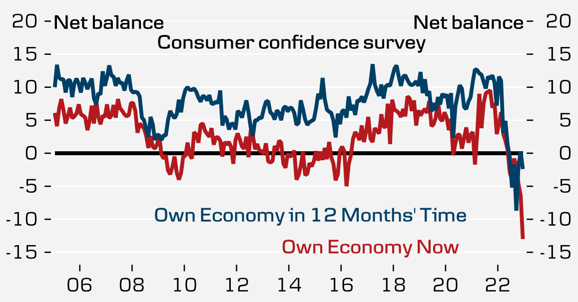
Weathering the headwinds

The Finnish economy was stable during the first half of 2022, but headwinds grew during the autumn and the economy is falling into a recession. GDP fell 0.3% q/q in Q3 and Q2 growth was revised lower. Persistently high inflation, tighter monetary conditions and weaker global outlook take the wind out of consumption, investment and exports. Relatively strong labour markets shield the economy from a bigger impact. We have lowered our GDP forecast to -0.7% in 2023 (was -0.2). Risks are on the downside, especially if the energy crisis does not ease during the year. Lower inflation would boost consumption.

General uncertainty increased a lot during the year, which can be observed from leading indicators like weak consumer confidence, falling business confidence and a volatile stock market. Consumer confidence stayed at a very weak level at the end of 2022, and consumers' views on their own economy at present were gloomiest in measuring history. Consumers are very worried about how to make ends meet during the high inflation period. Geopolitical uncertainty has also increased in 2022, which Finland aims to mitigate by joining the NATO. The membership waits for the ratification by Hungary and Turkey. We expect this to happen in 2023.

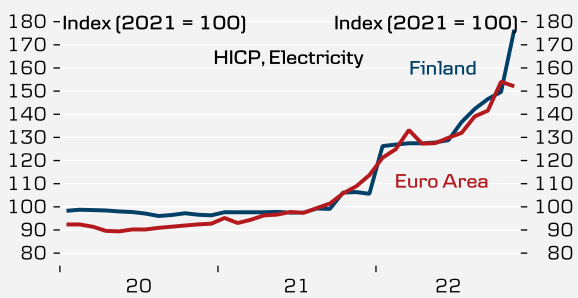
Trade with Russia has plummeted to marginal levels. Exports to Russia have fallen to a very low level, existing orders are still being delivered. Imports have fallen as well, natural gas and electricity imports have ended. The remaining imports include nickel used in production of stainless steel. Trade relations are unlikely to improve in the near future, which creates a need to find new markets for goods and sources for energy. The Olkiluoto 3 nuclear reactor launch has been delayed again. The reactor is expected to start regular electricity production in February, which would replace earlier electricity imports from Russia. Demand for electricity can hit production and transfer capacity limits in cold windless winter days, which implies a risk of electricity rationing. Investment into energy production grows in the medium term.

Consumers very worried about current situation



Source: Macrobond Financial data, Statistics Finland, Danske Bank

Consumer electricity bill has nearly doubled



Source: Macrobond Financial data, Statistics Finland, Danske Bank

Inflation will be higher for longer also in Finland, which takes goods consumption volumes down. Finland is less reliant on natural gas than many other countries in Europe, but the energy crisis is a major worry in Finland. Electricity prices have risen, and a cold winter coupled with shortcomings in production could lead to further price increases. Many fixed price contracts will be updated gradually to higher pricing. The government has announced measures like a temporary electricity VAT reduction, higher social benefits for lower income people, a tax deduction for large electricity bills and direct aid for people with large electricity bills during winter months. These measures will not fully save the purchasing power, but will help to avoid some problems for people especially reliant on electricity as the main source of heating.

High inflation has a big impact on earnings-related pensions, which are linked through an index to both inflation (70%) and earnings (30%). These pensions rise 6.8% in 2023. Shrinking purchasing power has already hit retail trade, where sales value has grown, but sales volume has fallen. The durable goods sector is going to see less demand, because consumers need to use more on daily necessities and delay home improvements. Services consumption still grows in 2023, because it benefits from pent-up demand, increasing post-lockdown possibilities and relatively has seen less inflation. Tight budgets may, however, cut consumer travel plans.

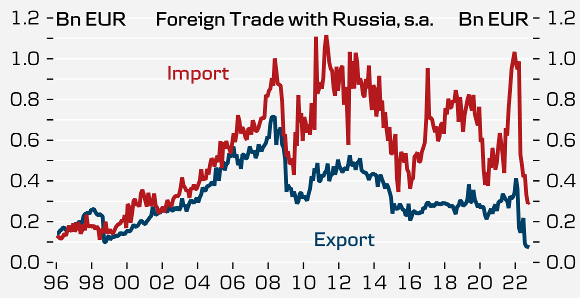
Rising interest rates dampen the housing market

Interest rates have risen fast and we expect that the peak is ahead. Rising rates feed into corporate and household finances with a lag. Finnish housing loans are typically linked to variable euribor rates. The 12 month rate is the most common. Less than half of the mortgages have been hedged. We expect less construction and corporate investment as financing costs rise. Housing construction has boomed, but falling demand and rising costs are putting many new projects on hold. Higher interest rates also seem to have a dampening impact on consumer credit.

The housing market has cooled significantly. The number of transactions and drawdowns of new housing loans fell roughly 1/3 below average during the autumn. Prices of used apartments fell by 5% from June peak to November.

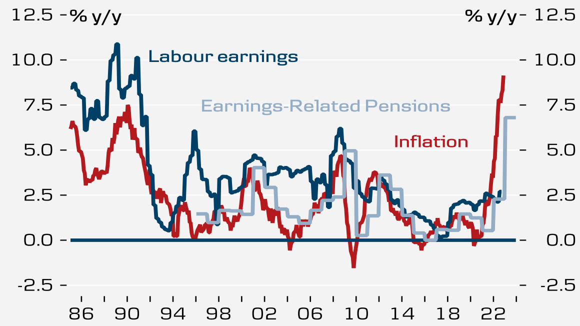
We expect the housing market to stay cool with fewer transactions in 2023. Housing prices keep falling slightly, but there is no major pressure for a large price movement as long as people are able to service their loans, sometimes with the help of interest only periods. Deteriorating labour market would weaken the housing market. Plentiful supply of new housing puts pressure on the prices. So far the number of unsold new apartments has stayed moderate.

Trade at the eastern border remains quiet



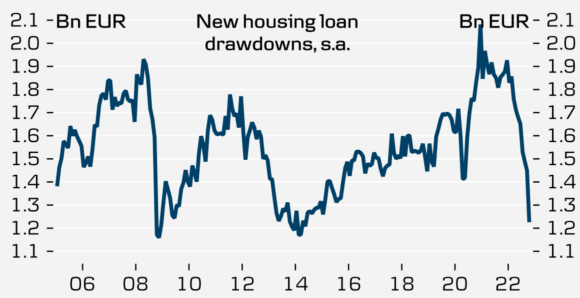
Source: Macrobond Financial data, Finnish Customs, Danske Bank

Inflation lifts earnings related pensions in 2023



Source: Macrobond Financial data, Statistics Finland, Danske Bank

Housing loan drawdowns fall at quick pace

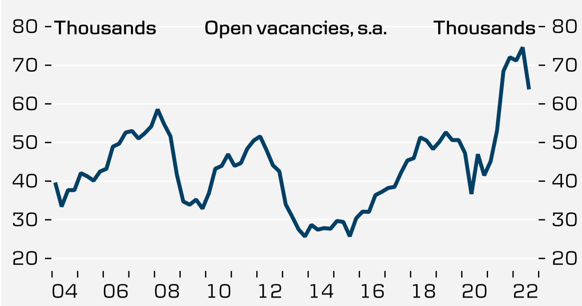


Source: Macrobond Financial data, Bank of Finland, Danske Bank

A recession with labour shortages

The employment rate rose to a new record in November and the unemployment rate has remained at a low level, albeit slightly higher than in late spring. All the headwinds combined have had an unusually small impact on unemployment. Open vacancies fell seasonally adjusted during the autumn, but the number of open vacancies is still high and many companies continue to report lack of skilled labour as a barrier to growth. Staff is needed for example in health care, IT services, parts of manufacturing and restaurants. Mismatch in education, experience, language skills and geographical location as well as inadequate incentives to accept low paid work are preventing unemployed to find and take jobs. Labour market could stay tight even during a shallow recession, because companies try to keep skilled staff. We expect employers to use temporary layoffs as a way to lower labour costs, if necessary. We expect the strong labour market to absorb the economic shocks without a significant rise in unemployment. The consumer confidence survey shows weak general expectations, but fear of personal unemployment is at roughly average level. When the recession is over, labour shortages continue as the working age population shrinks without higher immigration. At the same time, ageing population implies that a larger share of the labour force works in healthcare.

New job opportunities are still plentiful

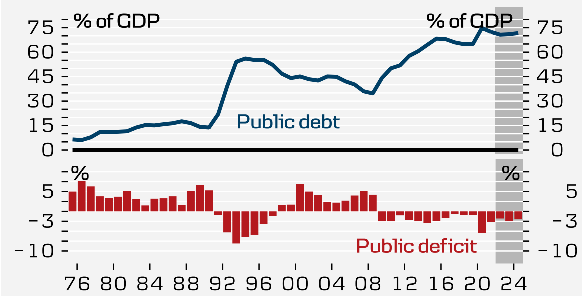


Source: Macrobond Financial data, Statistics Finland, Danske Bank

Public finances mitigate several shocks

The economic slowdown together with investment into energy infrastructure and national defence put pressure on public finances. According to the budget proposal for 2023, the central government net borrowing need is over EUR 8 bn. We expect a slightly larger deficit. The debt-to-GDP ratio is on a rising trend, and population ageing increases health care expenditure over the next decade. Bond yields move largely in line with the European peers. Finland holds parliamentary elections in April 2023 and the next government needs to address the sustainability of public finances. According to the MoF, the need to adjust public finances is EUR 9 bn over the next 8 years. In our view, an adjustment of that size is difficult to achieve, but the debt should grow slower.

Nominal GDP growth slows down rise in debt ratio



Source: Macrobond Financial data, Statistics Finland, Danske Bank

A reform to move the social and health care burden from municipalities to higher level of local government (wellbeing services counties) takes place in January 2023. The wellbeing services counties are autonomous, and the highest decision-making power in each county will be exercised by a county council. This will change the way public finances are managed, but not the big picture in terms of total debt and deficit. At the initial stage we expect the reform to incur some extra costs in terms of additional office hours and changes to the wage setting system. We do not expect the reform to achieve costs savings soon, because the number of counties is too large (21) to create costs synergies.

At a glance

			Forecast		
National account	**2021**	**2021**	**2022**	**2023**	**2024**
	EUR bn (current prices)	% y/y			
GDP	251.5	3.0	1.8	-0.7	0.5
Imports	98.5	6.0	7.0	-2.0	1.0
Exports	98.5	5.4	1.5	-1.5	1.5
Consumption	189.8	3.9	2.4	0.3	0.6
- Private	128.2	3.7	2.3	-0.3	0.4
- Public	61.6	2.9	2.5	1.5	1.0
Investments	59.5	1.5	4.5	-1.0	0.5

Economic indicators	**2021**	**2022**	**2023**	**2024**
Unemployment rate, %	7.7	6.8	7.3	7.2
Earnings, % y/y	2.3	2.6	4.0	3.5
Inflation, % y/y	2.2	7.2	4.8	2.2
Housing prices, % y/y	3.7	1.0	-4.0	3.0
Current account, EUR bn	2.3	-9.0	-7.5	-6.0
- % of GDP	0.9	-3.3	-2.7	-2.1
Public deficit, % of GDP	-2.6	-1.8	-2.5	-2.0
Public debt/GDP, % of GDP	72.3	70.7	71.0	71.7

Financial figures	**04/01/2023**	**+3 mths**	**+6 mths**	**+12 mths**
Leading policy rate, % p.a.	2.00	3.00	3.25	3.25

Source: Statistics Finland, Macrobond Financial, Danske Bank

Global overview

Inflation sticks and recession comes

- **We expect recessions in both the euro area and in the US, as real incomes are undermined and monetary policy is tightened.**
- **The situation is worse in the euro area which is hit by higher energy costs, while the US is facing a more traditional recession.**
- **Inflation will decline during 2023 but remain at elevated levels throughout the year. Central bank easing could be on the agenda for 2024.**
- **China reopening could be a boost to global demand in 2023.**

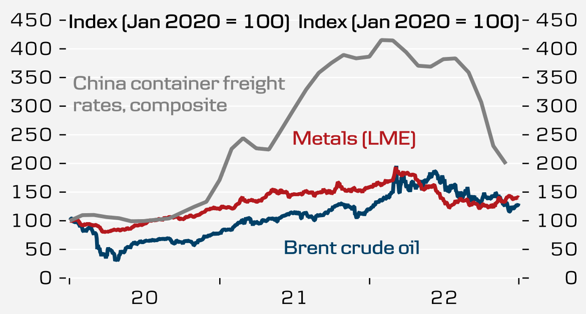
Not one global story, but many

The global economy is responding to many different chocks at the same time, creating a volatile and unpredictable situation with large differences between the major economies. Western countries face high inflation and are tightening monetary policy to reduce demand, but inflation in the euro area is more related to higher energy prices, whereas concerns in the US centre much more on wage growth. In China, demand has been held back by the zero Covid policy, but that policy is now changing, which is likely to mean economic recovery later in 2023, while many other countries are facing slowdown and recession. The level of inflation and the pace of interest rate increases in the euro area and the US are unlike what we have seen in many years, creating uncertainty on top of Russia's war against Ukraine, political tensions between the US and China, and an unclear outlook for fiscal policy in many countries.

The euro area is likely in a recession or close to it. Energy shortages and very high energy prices challenge companies and households, pushing down both production and consumption. The energy-related problems are not a one-winter struggle for Europe, but a structural hurdle that will take years to clear. Supportive fiscal policies, aiding companies and households struggling with high energy costs, combined with rapidly tightening monetary policy create an in-optimal policy mix. The US economy is in a somewhat simpler situation with something resembling a classical policy tightening cycle likely triggering a recession, but if all goes well, a shallow one.

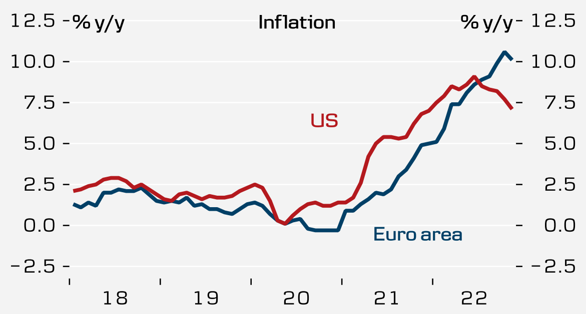
Inflation, and how central banks tackle it, continues to be central for the global outlook. Many of the initial inflation drivers, such as shipping costs, the inventory cycle and raw material costs, have fallen back considerably lately, pointing towards significant global deflationary pressures going forward. However, the second-round effects from the initial drivers to consumer prices have not finished. In many European countries, even the retail prices of energy do not yet reflect the full effect of last year's price increases, and on top of that, producers and retailers are far from finished in passing their cost increases on to consumers. For those reasons alone, we expect euro area inflation to remain much higher than the ECB's 2% target for all of 2023 and well into 2024. On top of that, energy prices could easily rise again in Europe, where the supply situation for gas and electricity remains fraught.

Price pressures coming down...



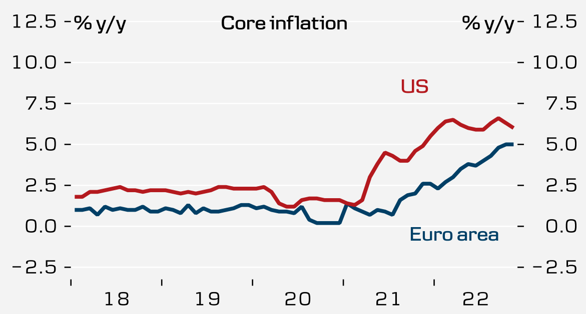
Past performance is not a reliable indicator of current or future results. Source: Macrobond Financial

...with visible effects on headline inflation...



Source: Macrobond Financial

...but it will take time for core inflation to normalise



Source: Macrobond Financial

Key forecast: recession

The key building blocks of our global forecast are that both the euro area and the US are in or will enter a recession during the coming quarters, inflation will prove sticky but gradually recede over the forecasting period and energy related problems in Europe will be with us for at least 3-4 years.

We forecast euro area GDP decline of 0.9% in 2023 and zero growth in 2024. Our forecast builds on the assumption that energy-related issues will become smaller during the summer, but will again resurface when the cold season closes in next autumn. Delayed effects of ECB monetary tightening as well as spill-overs from US recession through the export channel also drive our expectation of a double-dip recession during the winter of 2023/24. Even with the weak growth outlook, we expect the ECB to hike interest rates by a further 125bp over the coming months to keep inflation expectations down for the longer run and to avoid a wage-price spiral taking off.

We expect US GDP to decline 0.2% in 2023 but to grow 0.5% in 2024. In contrast to Europe, we do not foresee similar structural headwinds for the US from energy shortages and higher energy prices. One risk to look out for, though, is the sharp slowdown in the housing market, with house prices now falling from elevated levels. Even so, we expect a further 75bp of rate hikes from the Fed over the coming months to dampen demand in the US economy.

We expect growth in China to accelerate later this year as pend up demand from the long period of zero-Covid policy is released. However, the weaker outlook for demand in the US and Europe will be a significant headwind for Chinese exports.

A complex risk picture

In a sense, the big economic chock of 2022 was the surge in inflation. Not many forecasters had expected that, and so inflation is an obvious candidate for new surprises over the coming years. It is easy to imagine a scenario where inflation again is higher than expected, leading to more loss of purchasing power and/or further tightening of monetary policy, with further negative consequences for asset prices and the real economy. A trigger could be new disruptions to energy markets, a resurgent pandemic causing new supply problems, accelerating wage growth or a major loosening of fiscal policy, which could again be caused by spending related to the war in Ukraine or other conflicts. Depending on the source of the disruption, such a high inflation scenario could quite easily reduce global growth by a percentage point or more in 2023, compared to our baseline forecast.

There is of course also a chance for surprises in the opposite direction. Given the fall in commodity prices and the fact that inflation expectations seem to remain anchored, actual inflation could decline more rapidly than expected, paving the way for less restrictive policy and in turn higher growth. A less benign route to lower inflation could be that the recession is deeper and unemployment surges, following the sharp increase in interest rates we have seen.

For our full view of the global economy, see *The Big Picture – Recession with different undercurrents*, November 28, 2022

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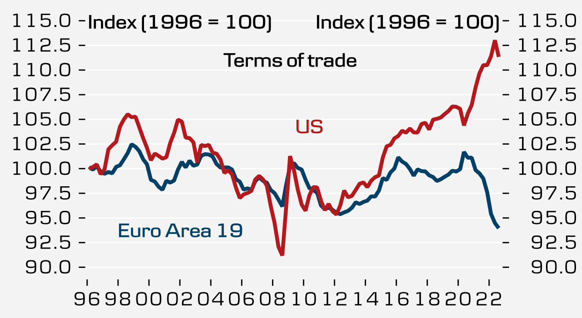
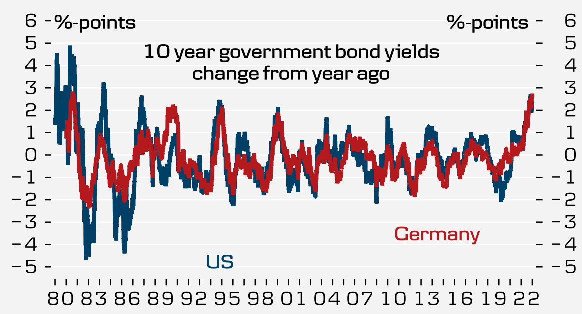
A major price chock to Europe



Export prices divided by import prices. Source: OECD, Macrobond Financial

Big increase in interest rates



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

Forecast for real GDP growth, %

	2023	2024
US	1.6	2.2
Euro	-0.9	0.0
China	4.9	5.3
Japan	0.7	0.9
UK	-0.7	0.8

Source: Danske Bank

Economic 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	2.9	-2.6	-1.1	4.4	7.4	3.2	7.8	3.5	2.6	1.2	29.7	11.8
	2023	-1.0	-2.3	0.0	-3.3	1.3	-0.7	4.9	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	8.3	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	3.7	6.6	0.3	4.0	3.0	12.1	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	3.3	3.9	1.1	4.4	7.4	8.6	8.4	4.2	6.7	-3.9	93.7	1.5
	2023	-0.9	-1.6	1.3	0.7	2.9	4.5	6.8	4.9	7.4	-4.0	92.5	1.9
	2024	0.0	0.7	1.7	-0.1	1.3	2.7	2.9	3.6	8.3	-3.5	91.6	2.4
Germany	2022	1.8	4.6	1.6	0.4	3.2	6.7	8.6	4.1	3.0	-2.3	67.4	3.7
	2023	-1.4	-2.1	1.9	-1.2	2.4	3.7	7.9	5.4	3.8	-2.7	65.5	4.6
	2024	-0.5	0.9	2.3	0.2	-0.1	3.0	3.9	4.3	4.2	-1.9	66.2	4.9
Finland	2022	1.8	2.3	2.5	4.5	1.5	7.0	7.2	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	1.9	2.6	-0.9	-0.4	7.9	8.5	8.0	5.2	3.6	-4.2	124.0	-3.9
	2023	-0.2	-0.2	1.1	-5.4	1.1	-4.4	3.3	4.4	4.0	-3.8	121.0	-3.1
	2024	-0.2	0.8	1.8	2.8	3.8	4.8	5.8	6.8	5.6	-3.9	120.5	-2.8
China	2022	3.3	2.8	-	4.5	-	-	2.0	3.0	-	-8.9	76.9	1.6
	2023	4.9	5.1	-	5.2	-	-	2.2	5.0	-	-7.2	84.1	1.0
	2024	5.3	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	-	-	-

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

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