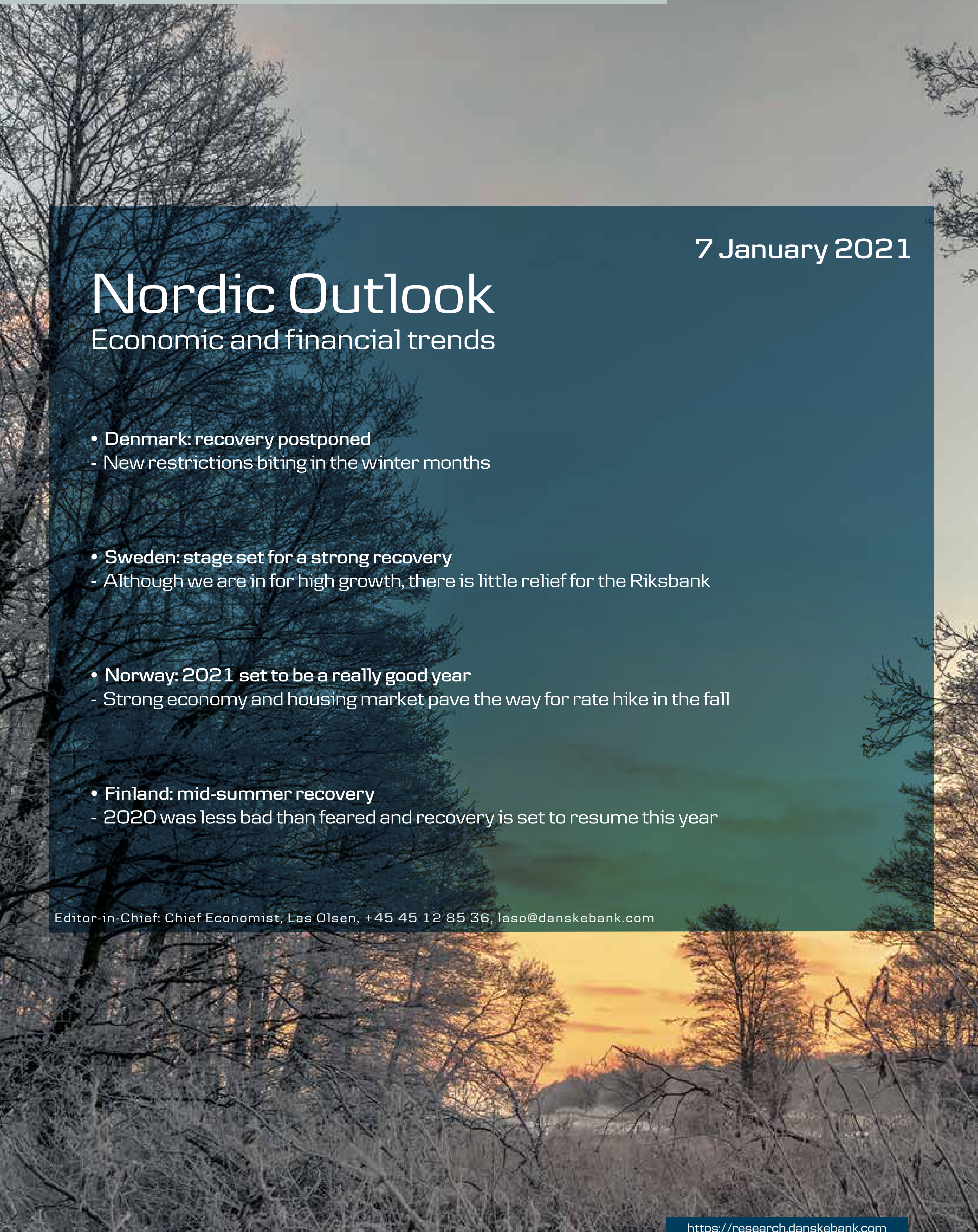


7 January 2021

Nordic Outlook

Economic and financial trends

- **Denmark: recovery postponed**
  - New restrictions biting in the winter months

- **Sweden: stage set for a strong recovery**
  - Although we are in for high growth, there is little relief for the Riksbank

- **Norway: 2021 set to be a really good year**
  - Strong economy and housing market pave the way for rate hike in the fall

- **Finland: mid-summer recovery**
  - 2020 was less bad than feared and recovery is set to resume this year

Editor-in-Chief: Chief Economist, Las Olsen, +45 45 12 85 36, laso@danskebank.com

Analysts

Editorial deadline 06 January 2021 *Investment Research*

Editor-in-Chief:			
Las Olsen, *Chief Economist*	Denmark	+45 45 12 85 36	laso@danskebank.com
Macroeconomics:			
Bjørn Tangaa Sillemann	Denmark	+45 45 12 82 29	bjsi@danskebank.com
Louise Aggerstrøm Hansen	Denmark	+45 45 12 85 31	louhan@danskebank.com
Anders Køhlert Larsen	Denmark	+45 45 13 82 87	anlars@danskebank.com
Michael Grahn, *Chief Economist*	Sweden	+46 8 568 807 00	mika@danskebank.com
Therese Persson	Sweden	+46 8 568 805 58	thp@danskebank.com
Frank Jullum, *Chief Economist*	Norway	+47 85 40 65 40	fju@danskebank.com
Pasi Petteri Kuoppamäki, *Chief Economist*	Finland	+358 10 546 7715	paku@danskebank.com
Jukka Samuli Appelqvist	Finland	+358 44 263 1051	app@danskebank.com

This publication can be viewed at https://research.danskebank.com.

Statistical sources: Refinitiv, Macrobond Financial, OECD, IMF, National Institute of Social and Economic Research, Statistics Denmark and other national statistical institutes as well as proprietary calculations.

Important disclosures and certifications are contained from page 34 of this report.

Contents

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.

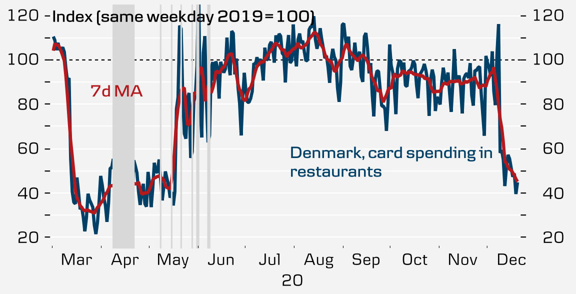
At a glance

Weakness before recovery

Virus set to be in charge for a while yet

In 2020, the Nordic countries followed a similar pattern to most other countries. Sharp contraction in the fall as the new coronavirus restrictions set in, a strong but partial rebound as restrictions were eased and renewed weakness towards the end of the year as infection rates rose. This year, we expect activity to remain subdued in the winter months, but to recover vigorously when the weather improves and vaccines make a difference. Most of the recovery will come simply as a result of opening up, with the remaining adjustments back to normal expected to happen more gradually and to be more or less completed in 2022. This is not like the great financial crisis when the economy took a long time to heal. Consumers have not chosen to spend less but are forced to do so and are partly compensating by spending much more on areas like housing. This is very different from previous crises and the recovery is expected to be different too.

New restrictions matter

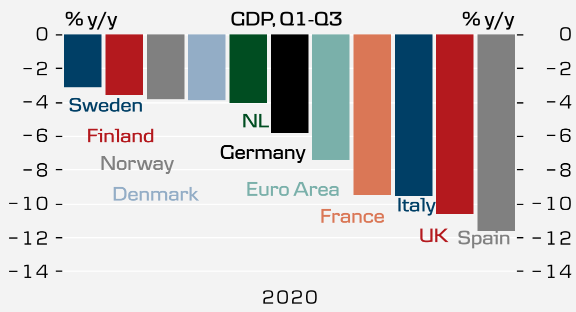


Source: Danske Bank

Nordics stand out

The circumstances are shared by many countries, but the Nordics have suffered significantly less, not only because they have relatively smaller hospitality sectors, but also due to the absence of travel. Only Denmark comes close to balanced trade in tourism. The Nordics also did better in manufacturing and construction, as they managed to avoid a lockdown of those sectors in the spring of 2020. There are important differences between the Nordic countries, though. At the time of writing, Denmark's lockdown includes schools and non-essential stores, which remain open in other countries. The recovery in Norway is so strong that, combined with the already strong state of the economy before the crisis, it could well be the first country in Europe to hike interest rates this year. Sweden, on the other hand, while also recovering, is battling with low inflation and could cut rates back into negative territory, although that is not our main scenario. Finland has been a big positive surprise given how dependent it usually is on the global business cycle.

Milder crisis in the Nordics

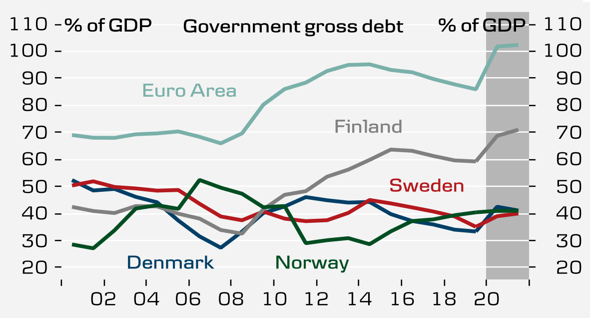


Source: Macrobond Financial

Risks remain

With the arrival of highly efficient vaccines the risk of a renewed crisis caused by the coronavirus has declined significantly. New trade wars look less likely following the US election result and the Brexit trade deal has also removed economic uncertainty. Risks now clearly run in both directions. The recovery may disappoint, but the Nordic countries are well equipped to support the economy if necessary. There is also the possibility that the upswing becomes significantly stronger than we expect, as large amounts of purchasing power are released together at a time of very accommodative economic policy. Concerns about overheating, not least of local parts of the housing market, could well resurface in the coming years.

Public finances still strong



Source: Macrobond Financial, Danske Bank

Denmark

Recovery postponed

- **New lockdown measures are expected to trigger further setbacks in early 2021, but the prospects for a subsequent recovery have strengthened and unemployment is set to return to pre-coronavirus levels in 2022.**
- **Consumption set to surge once restrictions are lifted.**
- **The groundwork has been laid for exports of both goods and services to grow, but the outlook for tourism remains uncertain.**
- **We expect house price appreciation to slow as the economy normalises.**

Recovery looks increasingly credible

We have revised down our expectations for growth in 2021 compared to our previous forecast in October. We had already pencilled in restrictions being placed on the economy to slow the spread of the coronavirus, but the lockdown measures have arrived earlier and are more extensive than we anticipated. Nevertheless, this does not mean we have turned more pessimistic. On the contrary, the imminent rollout of effective vaccines means a reduced risk of the recovery later in 2021 failing to materialise, while signs of a sound economy are in fact detectable beneath the risks of contagion and restrictions: the global industrial recovery has been surprisingly strong, unemployment has fallen faster than expected, corporate investment is shaping up quite well under the circumstances and rising house prices are strengthening the outlook for private consumption to quickly right itself when restrictions are eased. Economic policy is lending solid support via continuing low interest rates and bond buybacks from the European Central Bank (ECB), holiday allowance payouts and a rather expansive fiscal policy in Denmark. Overall, we feel more certain in our expectation that unemployment will decline to pre-coronavirus levels in the course of 2022, even though considerable uncertainty remains and progress could wax and wane.

More bankruptcies ahead

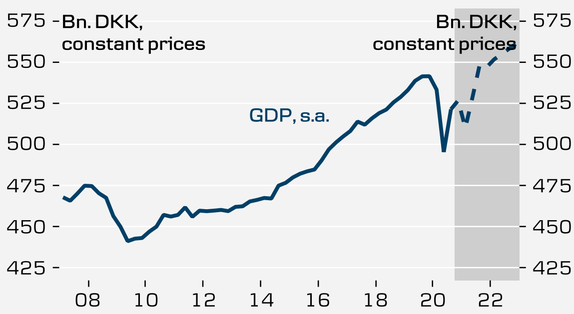
While 2020 looks set to have been the next-worst year ever in terms of GDP growth, there has been no increase in the number of bankruptcies. Companies were generally well cushioned ahead of the crisis and the low level of interest rates is keeping expenses down for companies with large debts. Compensation schemes and the opportunity to postpone tax payments have presumably also played a major role. We estimate that tax payments amounting to around DKK40bn (net) were postponed from 2020 to 2021 and will have to be paid during the first six months of the year. Overall corporate liquidity, measured as the difference between deposits and loans with the banks, has improved by more than DKK50bn since pre-coronavirus times. Nevertheless, we expect to see an increasing number of bankruptcies due to tax payments this year. The impact of the crisis has been very unevenly felt by the various sectors, with restaurants, hotels and the travel industry among the hardest hit.

At a glance

Denmark	Current forecast			Previous forecast	
% y/y	2020	2021	2022	2020	2021
GDP	-3.7	2.3	3.4	-3.5	3.0
Private consumption	-3.1	3.0	3.6	-1.8	4.6
Public consumption	-1.2	1.6	0.4	-0.6	2.9
Gross fixed investment	0.8	3.1	3.8	-1.7	0.4
Exports	-8.8	3.6	7.2	-12.4	4.6
Imports	-6.6	4.7	6.4	-10.2	4.6
Gross unemployment (thousands)	133.4	131.8	107.8	134.3	117.1
Inflation	0.4	0.8	1.2	0.5	1.2
Government balance, % of GDP	-2.6	-1.9	-1.2	-3.4	-2.2
Current account, % of GDP	7.4	6.9	7.7	7.5	7.5

Source: Danske Bank

Recovery set to return this year



Sources: Statistics Denmark, Macrobond Financial, Danske Bank

A very uneven crisis

Change in turnover, 2020 vs. 2019 (first ten months)	Change %	Contribution to total change, %-points
Total	-2,6	
Agriculture etc.	3,6	0,1
Mining and quarrying	-29,8	-0,2
Industry	-1,2	-0,2
Energy and water supply	-2,8	-0,3
Construction	-0,2	0,0
Trade	-1,9	-0,6
Transport	-7,9	-0,8
Hotels and restaurants	-29,6	-0,4
Information and communication	0,4	0,0
Knowledge-based services	-1,4	-0,1
Travel agencies	-61,4	-0,1
Other services	8,6	0,2
Other	-2,5	-0,1

Note: Current prices
Source: Statistics Denmark

Business mix supportive of corporate investment

Investment has surprised positively throughout the coronavirus crisis, with companies around the world pouring money into investments in Q3 to make up for the steep decline in the spring – a development that should be seen against the significant upswing in global manufacturing. In Denmark, investment volatility has been less pronounced than in many of its neighbours, in part due to the more cyclically robust mix of sectors, with pharmaceuticals and food accounting for a relatively large share. A survey of companies reveals that cyclically sensitive industries like metals and machinery have tended to plan for fewer investments, while the pharmaceutical and food industry have planned for more.

Government finances remain strong despite the crisis

The coronavirus crisis prompted a marked deterioration in government finances in 2020. This was partly due to the compensation schemes and wage subsidies, but most of the downturn was due to the normal consequences of lower activity levels and increased unemployment. The improved economic situation should dampen the deficit in the coming years, though there is considerable uncertainty about the cost of crisis measures in 2021 and the expenses associated with ending mink production. Payouts of the hitherto frozen holiday allowance will improve the government account in 2020 and 2021, as tax has to be paid on this money. Nevertheless, the government will initially fund the payouts, after which companies can choose to repay the amount right away or when employees retire, which also adds to the uncertainty surrounding the government's level of debt. From a historical perspective, government debt has only increased modestly as a result of the crisis, with the deficit in 2020 less than the surplus in 2019, according to our calculations. The amount of debt remains less than the value of the government's financial assets and, given the low level of interest rates, the government could easily continue to increase the deficit if necessary – due to a new crisis for example.

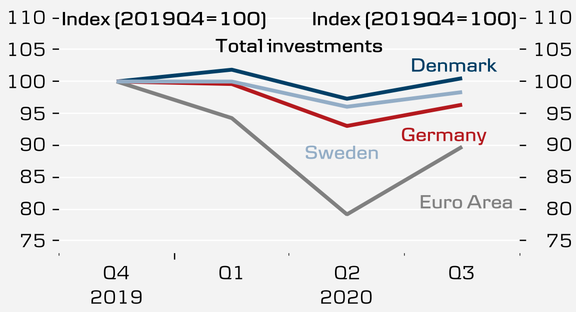
Little prospect of a change in interest rates

Danmarks Nationalbank sold FX reserves for DKK64.7bn and hiked interest rates by 0.15 percentage points in March to the DKK at a time of global financial turmoil. Sentiment has shifted since then, for example in the equity market, which the DKK is very affected by due to the scale of Danish equity investments abroad. The DKK has also strengthened against the EUR, though so far not to an extent that might prompt Danmarks Nationalbank to intervene against it. Factors countering a potentially stronger DKK include central bank negative rates feeding through more to actual interest rates in the Danish economy than is the case in the eurozone. FX reserves are at the same level as prior to the coronavirus crisis, but only because the government has taken up short-term loans in foreign currencies, which we expect will be redeemed in the course of 2021. If necessary, we expect Danmarks Nationalbank to focus heavily on FX purchases to prevent an excessively strong DKK – we see low probability of an actual rate cut. Long yields in Denmark track the eurozone and we expect to see a marginal increase here in 2021.

Impressive job growth after reopening

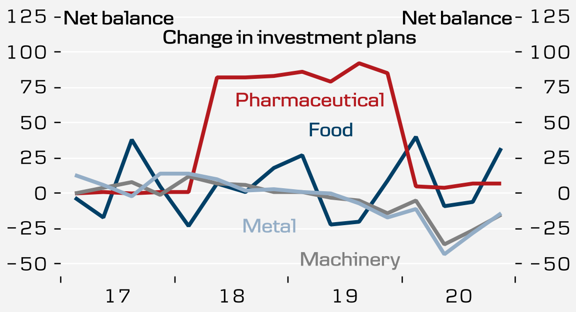
The spring 2020 lockdown cost around 80,000 jobs, while more than 280,000 employees were sent home over the year with employers partially compensated for wages.

Investment has been more stable in Denmark



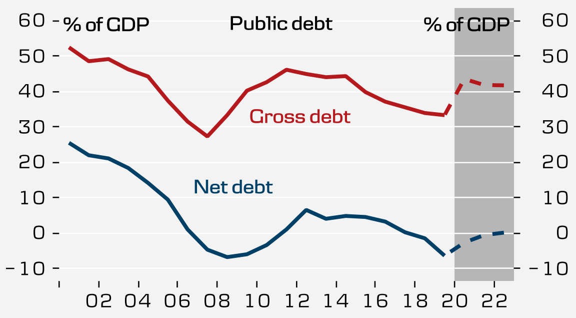
Sources: Statistics Denmark, Macrobond Financial

Investment boost from pharmaceutical and food industries



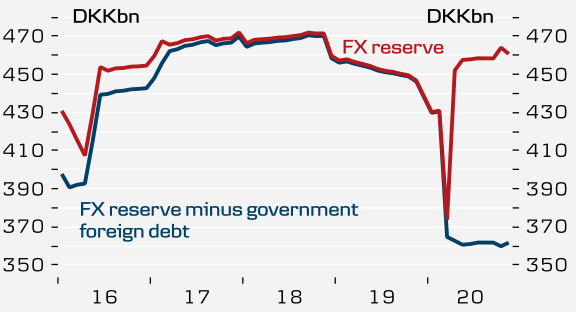
Sources: Statistics Denmark, Macrobond Financial

Modest government debt



Sources: Ministry of Finance, Danske Bank, Macrobond Financial

FX reserves buoyed by foreign debt



Sources: Danmarks Nationalbank, Macrobond Financial

Yet, employment was already up by 50,000 again in Q3 and the wage compensation scheme has largely been wound down.

We expect the remainder of the recovery to progress at a significantly slower pace, not least because the travel industry, for example, is still largely closed down and because new restrictions have been implemented since the autumn that will presumably continue in one form or other until the spring. On the other hand, labour is in high demand in certain sectors, not least construction. Our forecast points to a renewed uptick in employment from around Easter onwards and we expect to hit pre-coronavirus levels of unemployment again in 2022, even taking into account the growth in the labour force due to the increasing retirement age, etc. Wage growth slowed considerably in spring 2020 but was surprisingly strong in Q3 and with employment having generally recovered rather quickly, it now seems the coronavirus crisis will only feature as a minor slowdown in wage growth.

Reopening could trigger slightly higher inflation

Inflation excluding energy has been largely stable throughout 2020. However, the overall figure conceals significant price fluctuations. Tobacco prices have risen on the back of April's hike in duties, with a sudden 10% jump in the registered price in November indicating the new charge has been fully passed on, which increases inflation by 0.6 percentage points. In contrast, the coronavirus crisis has pulled some prices markedly lower, such as hotel stays. Housing equipment sales have also been ongoing for quite some time. It is still the case that not all prices are being registered due to the coronavirus crisis. This includes package holidays and international flights, which would presumably pull inflation lower if they were measured. Certainly, domestic flight prices, which are still being registered, have fallen very sharply.

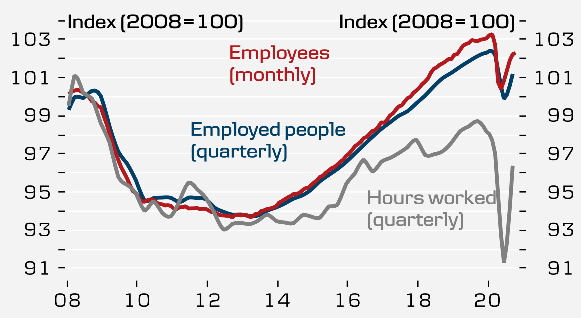
Rents, tobacco duties and tourism reopening will be decisive for inflation in 2021 and 2022. Rent increases have hit historical lows in the past two years and we see no reason for this to change in 2021. With a weighting of 21% in the consumer price index, rents will continue to put a damper on inflation. We expect tourism to gradually make a comeback this year, which could lend some support to hotel prices. In contrast, whether flight and charter holiday prices will increase or decrease at that point is uncertain, but we do not expect any marked increase here in 2021. Inflation will likely be more volatile in the coming years, as the pattern of consumption from 2020 will be reflected in consumer price weightings in 2021. This could translate into lower inflation in the coming year, especially over the summer (see *Research Denmark: Modest inflation pickup and choppy waters ahead*, 24 November 2020).

We expect inflation to rise from 0.4% in 2020 to 0.9% this year and 1.2% next year, when tobacco duties will provide an additional boost. In contrast, the phasing out of the PSO levy will tend to pull inflation lower in 2021 and 2022.

Consumption set to dip before picking up again

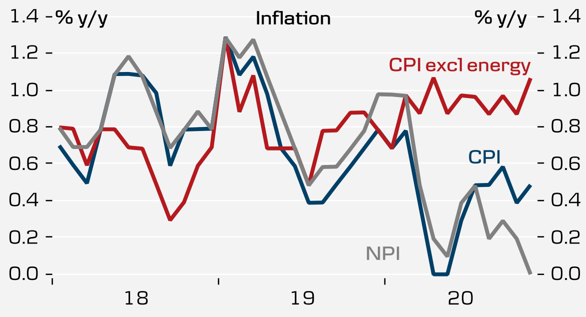
2020 brought a hitherto unseen shift in Danish patterns of consumption – and how restrictions, infection rates and the rollout of vaccines might unfold is creating great uncertainty about when consumption will fully recover.

Final leg of job growth still missing



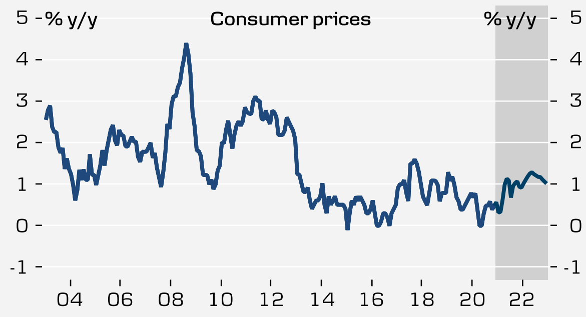
Sources: Statistics Denmark, Macrobond Financial

Tobacco duties have kept consumer price inflation above zero



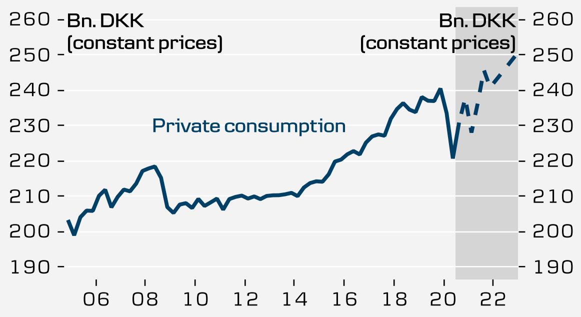
Source: Statistics Denmark, Danske Bank, Macrobond Financial

Higher but modest inflation ahead



Sources: Danske Bank, Statistics Denmark, Macrobond Financial

Strong recovery ahead for consumption after a weak start to 2021



Sources: Statistics Denmark, own calculations, Macrobond Financial

The opening months of 2021 will very likely still be marked by lockdown and there will be no boost to consumption from payouts of the previously frozen holiday allowance – unlike in the latter part of 2020. Moreover, car sales are expected to decline at the start of the year due to many motorists buying cars just before Christmas in anticipation of a hike in car taxes after New Year. The still comatose travel and holiday industry – where sales usually peak in January and February – is also a drag on consumption. Despite the ongoing rollout of vaccines, many Danes will probably delay their travel purchases until there is much more clarity on the opportunities for holidaying abroad. However, this could give a strong boost to travel-related purchases later in the year.

While the early part of the year looks somewhat grim for consumption, we expect it to bounce back as the summer holidays approach. One reason is that, as in the spring, retailers and enterprises like hairdressers, etc. should see a rapid resumption of business when they open again. Another reason is that there will presumably be an additional boost from a return to full capacity for the service sector, as even after the reopening in the spring many service businesses were subject to restrictions on opening hours, distancing, assembly and travel. When these restrictions are eventually lifted, we would expect to see a much stronger upswing in the affected industries than we saw in 2020.

On top of this comes the paying out of the final roughly DKK40bn in the hitherto frozen holiday allowance at the start of Q2 and the fact that Danes' savings have grown strongly in the past year. A gradual restoration of the consumption ratio – share of income spent on consumption – is also expected to help lift consumption growth in 2022.

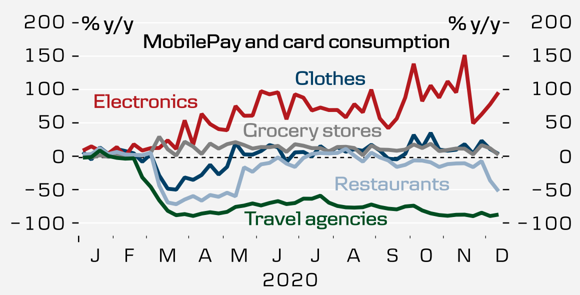
House price appreciation to slow as economy normalises

Following a historic fall in prices in March, the housing market has only gone one way – up. Supply remains extremely tight, sales activity is high and discounts are very limited. Everything indicates this is still a seller's market, as the low supply is due to properties being sold considerably faster than normal rather than homeowners being reluctant to put their properties on the market.

The strong performance of the housing market should be seen in light of several factors. First, 2020 has been characterised by people being at home much more than normal and this has increasingly caused Danes to reflect on whether their current dwelling lives up to their wishes and needs. Moreover, many Danes in the segment typically on the lookout to buy have had more money in their pockets, as spending on holidays and leisure activities has fallen drastically. This has freed up more funds to prioritise on a home. This situation could continue to some extent, but we generally expect price growth to slow as the economy and consumption patterns return to normal in the second half of 2021 and in 2022.

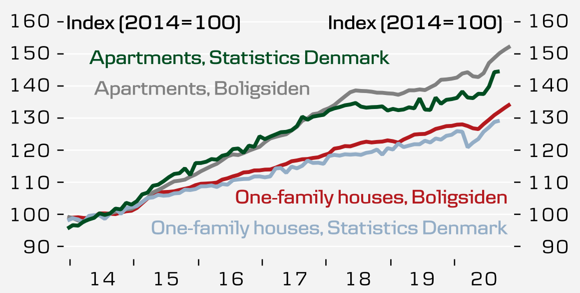
We expect house prices to appreciate by 4% in 2021. However, this conceals relatively modest growth over the year, with the strong starting point from 2020 pulling the average considerably up. We therefore expect a somewhat more modest annual rate of growth in 2022. A key uncertainty for the housing market is the postponed reform of property taxes and exactly when homeowners will receive their new property valuations.

Latest lockdown has also hit retailing, but to a much lesser extent than the service sector



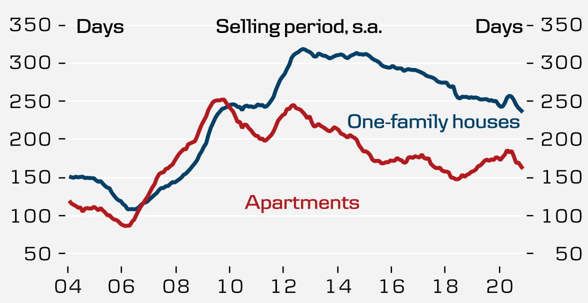
Sources: Danske Bank, Macrobond Financial

House prices were quick to recover and continue to increase



Note: Own seasonal correction
Sources: Statistics Denmark, Boligsiden, Macrobond Financial

Houses and apartments being sold more quickly



Source: Finance Denmark, Macrobond Financial

The current plan is to roll out the new property valuations around summer 2021. However, given the many postponements, a degree of scepticism is probably warranted on this schedule. The new valuations could well put downward pressure on properties in areas where prices have risen strongly in recent years, though there should be no significant impact at national level.

Exports looking good and prerequisites for further recovery in place

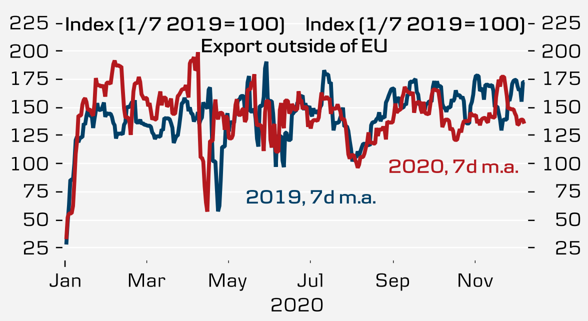
Goods exports have had a tough 2020. When totting up the figures for the year, the significant setbacks due to the coronavirus crisis will mean the worst year for growth in goods exports since the horror show that was 2009. Yet, Danish exporters have performed better than most during the crisis. Goods exports shrunk by 2.3% over the first three quarters of the year compared to 2019, which is much less than in Germany and the UK, for example, and also in Sweden and Finland. The trend can be partially explained by a large share of Denmark's export markets being located in northern Europe, which has been less affected by the crisis, and Denmark's large pharmaceutical industry, which has proved to be very robust. That being said, there are indications that activity in the pharmaceutical industry slowed towards the end of the year, while exports to the US, where pharmaceutical products are overrepresented, declined in November and December, according to figures from the Customs and Excise system for trade outside the EU.

Service exports fell by a whopping 15.0% over the same period – pulled lower, in particular, by the very pronounced slowdown in tourism, marine and air transport and the export of building and construction services, which were extraordinarily high in 2019. Other services, meanwhile, such as business services, have performed well during the crisis.

The prerequisites for growth are in place, and the new year bodes well for Danish exports. The global manufacturing upswing is clearly reflected in activity levels in Denmark's key export markets and in manufacturers' expectations for new export orders. The upswing in the manufacturing sector has also resulted in a substantial recovery in investment in Europe, which should help support Denmark's cyclically sensitive machinery exports. All these goods have to be transported between the different continents, so there has been a positive impact on global container freight, which has experienced significant growth since the setbacks in the spring. Danish shipping is also a beneficiary of this. However, not everything is rosy, as companies still have to battle with a DKK whose strength is close to a 10-year high, while tourism is unlikely to reach 2019 levels anytime soon. This is also why a full recovery in service exports is still a long way off.

Danes have been able to maintain more normal levels of consumption during the crisis than consumers in many of Denmark's trading partner countries. Corporate investment has also bounced back reasonably well after plunging in Q2, and both these factors are reflected in goods imports, which rebounded to near normal levels in Q3. This has left its mark on the balance of goods surplus, which eased in 2020. However, a large deficit in the services trade is very much what is pulling the current account surplus lower in 2020, driven, in particular, by the above-mentioned decline in the export of services. Nevertheless, in our view, the conditions for a recovery are in place. We therefore also expect that an improvement in the balance of services will help push the current account surplus a little higher next year

Pharmaceuticals a drag on exports ex-EU

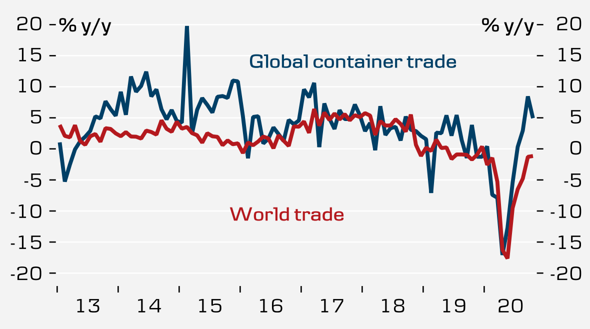


Sources: Statistics Denmark, Danske Bank

Pickup in Danish export market activity and new order expectations

Note: Index 50 delineates between growth and contraction, see our Export Barometer. RH axis indicates difference in percentage points of companies expecting more orders relative to how many expect fewer. Source: Danske Bank, IHS Markit, Statistics Denmark, Macrobond Financial

Shipping companies busy again



Sources: CPB Netherlands Bureau for Economic Policy Analysis, CTS, Macrobond Financial

At a glance

National account	2019	2019	2020	2021	2022
			Forecast		
	DKK bn (current prices)		% y/y		
Private consumption	1044.3	1.4	-3.1	3.0	3.6
Government consumption	556.8	1.2	-1.2	1.6	0.4
Gross fixed investment	512.5	2.8	0.8	3.1	3.8
- Business investment	320.9	2.3	-3.3	3.4	4.8
- Housing investment	115.0	6.2	6.3	3.9	2.0
- Government investment	76.7	0.3	9.4	0.9	2.5
Growth contribution from inventories		-0.3	-0.1	0.1	0.0
Exports	1361.8	5.0	-8.8	3.6	7.2
- Goods exports	804.7	6.9	-2.3	2.8	4.1
- Service exports	557.1	-1.5	-15.0	5.2	12.4
Imports	1190.2	2.4	-6.6	4.7	6.4
- Goods imports	701.2	1.5	-2.9	4.0	4.5
- Service imports	489.0	3.9	-11.9	5.7	9.2
GDP	2335.0	2.8	-3.7	2.3	3.4

Economic indicators	2019	2020	2021	2022
Current account, DKK bn	206.8	170.0	162.9	190.1
- % of GDP	8.9	7.4	6.9	7.7
General government balance, DKK bn	88.3	-60.0	-45.0	-29.0
- % of GDP	3.8	-2.6	-1.9	-1.2
General government debt, DKK bn	778.7	970.0	968.0	1003.0
- % of GDP	33.3	42.5	41.1	40.7
Employment (annual average, thousands)	3002.8	2981.4	2977.4	3027.2
Gross unemployment (annual average, thousands)	104.2	133.4	131.8	107.8
- % of total work force (DST definition)	3.7	4.7	4.7	3.8
Oil price - USD/barrel (annual average)	64	38	50	60
House prices, % y/y	3.8	3.4	4.0	1.5
Private sector wage level, % y/y	2.5	2.2	1.9	2.1
Consumer prices, % y/y	0.8	0.4	0.8	1.2

Financial figures	06/01/2021	+3 mths	+6 mths	+12 mths
Lending rate, % p.a.	0.05	0.05	0.05	0.05
Certificates of deposit rate, % p.a.	-0.60	-0.60	-0.60	-0.60

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

Sweden

Stage set for strong recovery

- **After a temporary slowdown at the turn of the year, the stage is set for a strong recovery in 2021 on the back of significant economic stimulus.**
- **The labour market has stabilised after a rapidly rising unemployment rate. Looking forward, we expect gradual improvement.**
- **Property prices have surprised on the upside; the 'work from home trend' that has spilled over into higher prices is expected to be intact in 2021, but a slower pace.**
- **Inflation fundamentals are dire. Record low wage growth and the delayed impact of the SEK's strength keep inflation depressed.**
- **Should long-term inflation expectations decline further, we cannot rule out the possibility of a rate cut back into negative territory.**

At a glance

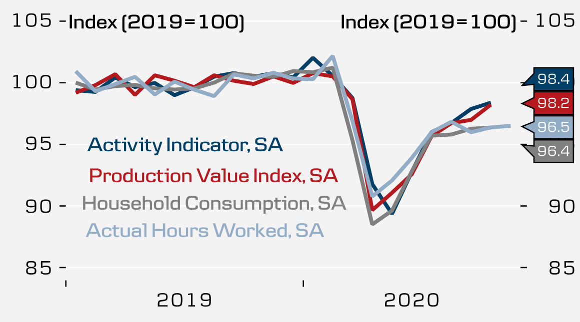
Sweden	Current forecast			Previous forecast	
% y/y	2020	2021	2022	2020	2021
GDP, calendar adjusted	-3.2	3.3	2.6	-3.3	3.8
Private consumption	-4.7	3.8	3.0	-5.1	4.2
Public consumption	-0.2	2.4	1.5	-0.3	2.8
Gross fixed investment	-1.4	4.1	2.7	-3.7	2.5
Exports	-5.5	6.9	3.9	-6.1	6.2
Imports	-6.8	7.6	3.9	-7.1	4.6
Unemployment rate	8.3	8.3	7.3	8.7	9.0
Inflation	0.6	1.2	0.8	0.6	1.1
Government balance, % of GDP	-3.0	-2.8	-1.0	-5.8	-1.0
Current account, % of GDP	5.3	5.1	5.1	4.9	4.6

Source: Danske Bank

Economic growth in Q4 will most likely be slower than what we expected in the previous Nordic Outlook, despite signs of a good start. It remains unclear to what extent the second wave of the coronavirus slowed growth in Q4 20. Consumer prices approached deflation in late 2020 and inflation expectations remained at record-low levels. The Riksbank added more stimulus via QE and the government extended measures to keep businesses afloat.

Against this backdrop, the stage is set for a strong recovery this year. As the population gets vaccinated, the sectors worst hit by the pandemic such as hotels, restaurants and travel should recover at the same time as manufacturing, business services and residential construction gather speed. Unemployment peaked last year and is set to improve, albeit gradually.

Recovery slowed in Q4 ...



Source: Statistics Sweden

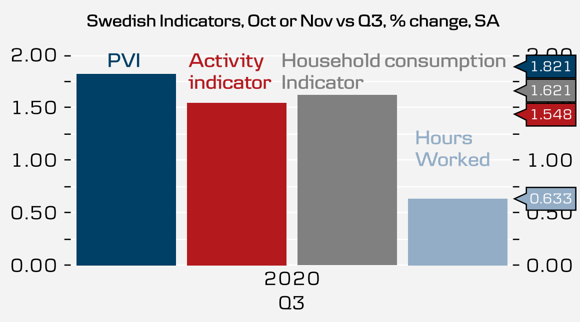
Q4 second wave just a temporary slowdown

A limited amount of reliable October data suggested a good start to Q4 economic growth. However, as in many other countries a surge in COVID-19 cases

struck the economy from late October/early November. Less accurate diffusion and confidence data for November and December point to renewed deterioration in consumer-related services and durable retail trade, following tighter restrictions for social distancing and mobility from health authorities. These are likely to remain in place for at least the first half of Q1, possibly longer.

After a strong bounce in Q3, private consumption has entered a much flatter growth path. Actually, the decline in turnover in consumer services, such as hotel accommodation, eating out, holiday travel, concerts, sports events etc., appears to have resumed in November and most likely extended into December. Durable retail trade, such as clothing and shoe sales, shows a similar drop in sales. Hence, it is unclear to what extent higher demand in the 'stay at home'-related parts of consumption, such as spending on food, furniture, home appliances, cars, DIY building materials etc., will balance the weakness. Note that the housing market remained very strong up until November, largely based on the COVID-19 induced demand for bigger living space.

... but still growth looks to be positive



Source: Statistics Sweden

Manufacturing back in business

A striking feature of economic developments in the second half of 2020 was that the second wave of COVID-19 seems to have had a much smaller impact on manufacturing production than the first wave did. This is not a unique Swedish experience, but perhaps more important for Sweden than most other countries as this is an extremely export-dependent economy. The supply disruptions that rippled through the economy in the first half of 2020, have largely been absent in the second half of the year. As far as can be seen in PMI data, manufacturing export orders are rising at the same strong pace as after the Great Recession in 2009-2010 and in line with what is seen in Germany. According to NIER, manufacturing export orders are recovering at a slower pace than what the PMI suggests, but this is as it should be as NIER usually lags the PMI. We do not expect the SEK to appreciate further, but if it does, then obviously that could be a mitigating factor. That said, this sets the stage for a further recovery in goods exports, which were still about 5% below the average 2019 level by October 2020. Hence, the fundamentals for a continued, strong recovery in the export-oriented manufacturing industry are in place.

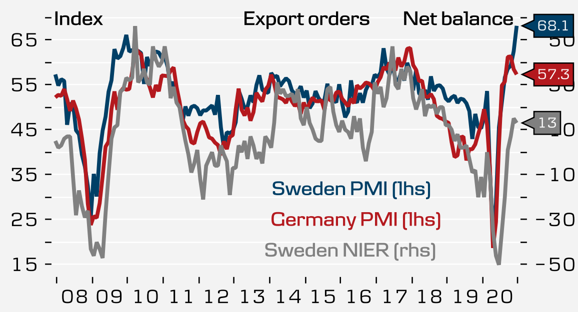
Services industries a mixed bag

Turning to services industries, the picture is much more mixed. Like manufacturing, the business-related branches of services appear to have coped with the second wave better than the consumer-related. That said, December NIER data showed a moderate setback for business-related services, albeit still in positive territory. This is mainly the result of a strong performance by financial and insurance and employment agencies, while most other sectors have levelled off slightly. Looking at consumer-related services, however, the situation is much worse. For hotels, restaurants and travel agencies the situation in December was almost as bad as at the trough in April and May, while transportation, a bit surprisingly, appears to have managed better.

Consumption down, but retail sales up

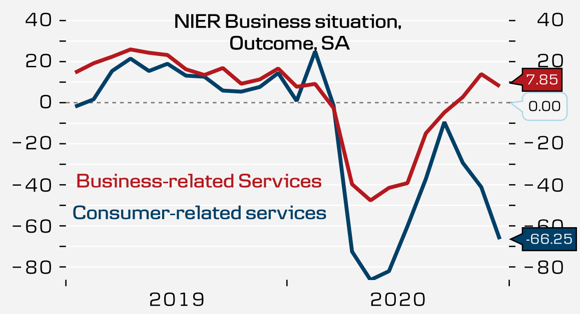
There is a similar split when looking at what is happening in retail trade. Actually, November overall retail sales rose by a significant 5.5% y/y in calendar adjusted volume terms, the highest print since September 2015. Unfortunately, NIER's confidence survey implies a significant drop in December. Nonetheless, this overall positive tendency masks a very strong non-durable goods development (accompanied by DIY goods, home furnishings, car hire etc.) and a counterbalancing very weak development for durables (especially clothing). Hence, the new consumer spending pattern unleashed by COVID-19 is also visible in retail trade. Under normal circumstances the growth rates of retail sales and household consumption are very close. The impact of COVID-19 is clearly visible in the chart on the right: overall it has been good for retail sales but detrimental for total consumption.

New industrial orders are soaring



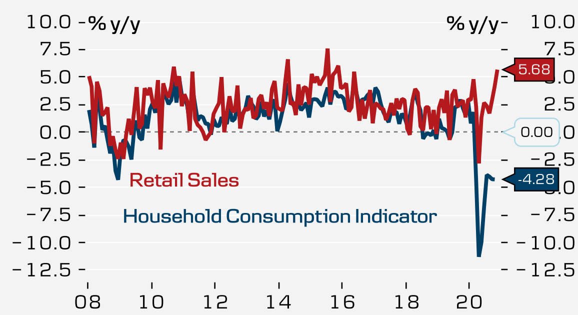
Source: NIER, Swedbank, Markit

Second COVID-19 wave impact is very different from first



Source: NIER

Strong retail sales, but plunging consumption



Source: Statistics Sweden

COVID-19 had very different impacts

Households were hit very differently by COVID-19. To a large extent it is an 'insider/outsider' story. Many householders have lost their jobs and hence income and may not have had much financial or property wealth. These are the obvious losers or 'outsiders'. Others are much better off due to the fact that they still have their jobs and, very importantly, their financial and property wealth soared in 2020 on the back of the strong rebound in stock and property prices. Just to get a feeling for these numbers, note that households' aggregated nominal disposable income rose by SEK6.5bn in the first three quarters of 2020, while net financial wealth rose by SEK532bn. The factor is almost 1 to 100.

Surprise rise in property prices likely to slow

Property prices rose 9.6% in the year to November, measured on a seasonally adjusted basis, with houses up a substantial 12.2% and flats left behind with a mere 4.8% advance. Apparently, this is also an effect of COVID-19, with households looking for bigger space anticipating more working at home in the future. This is also mirrored in household lending, where mortgages to single-family dwellings show the strongest increase in SEK terms. Overall housing credit growth still falls short of the 2016-2018 years, but the growth is slowly accelerating. Looking at the residential market from the construction/fixed investment side, multi-dwelling starts and completions (which make up the bulk of the market) appear to have stabilised at a quarterly rate of about 10,000 units. This is probably a bit below what is needed on a long-term demographic basis. Going forward, with the 'stay at home' trend probably still intact, price gains may remain elevated in 2021, but long term we expect a moderation to so as to get in line with nominal income growth.

Business investment turning higher

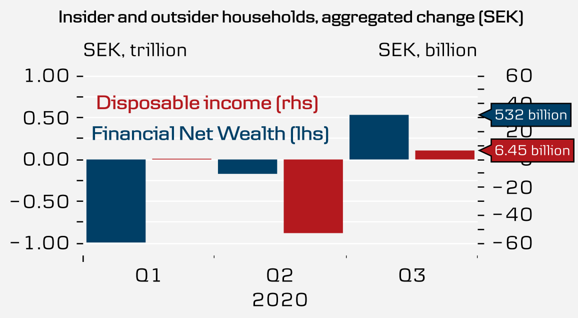
Turning to the other parts of gross fixed investment demand, it seems business investment turned decidedly for the better in Q3 20. Overall GFI bounced back 3.8% q/q sa, driven by a 23% and close to 4% increase in machinery and intellectual property investments, respectively. As the recovery gains speed, so should business investment. As business confidence in general returns to normal in 2021, so should capital spending.

Several drivers for the recovery

To sum up, the second wave in Q4 does not appear to have caused a double dip and with vaccination starting already late that quarter, growth may remain positive in Q1 too. That said, we have reduced, compared to earlier forecasts, growth in both these quarters.

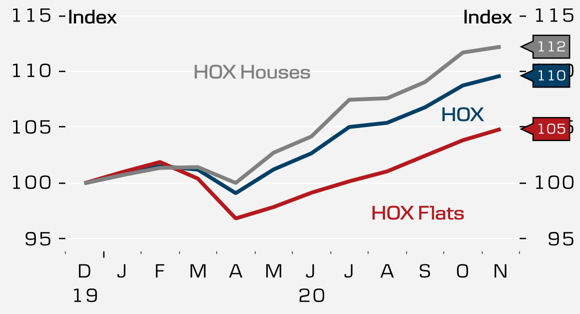
We think the fundamentals for a strong recovery in 2021 look very good: (1) vaccines are being distributed, which should cause demand to return to depressed sectors; (2) governments are adding significant fiscal stimulus, both internationally and domestically, which should support growth in general; (3) monetary policies, again internationally and domestically, are at full throttle, ensuring financing remains cheap for a long time and thereby giving a further boost to asset prices and (4) pent-up demand in depressed sectors, such as hotels, restaurants, travel and parts of retail trade, should be a significant driver for a strong rebound in private consumption

Rich households became (much) richer in 2020



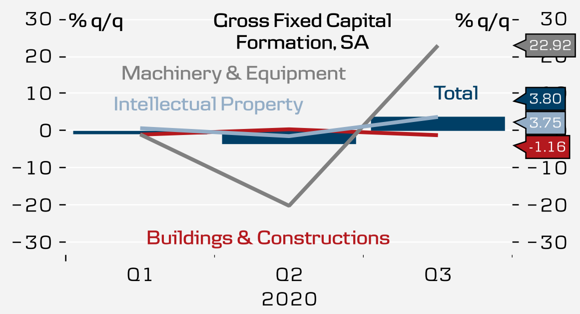
Source: Statistics Sweden

Strong COVID-19 impact on house prices



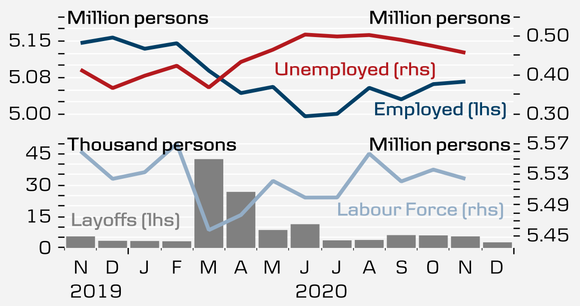
Source: Valueguard, Danske Bank seasonal adjustment

Machinery showed a record comeback in Q3



Source: Statistics Sweden

Gradual improvement is expected during 2021-22

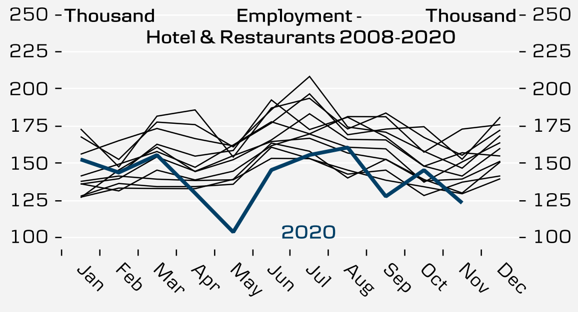


Source: SCB, Macrobond

Labour market is overall showing resilience

The labour market has shown more resilience than expected. The spring was characterised by a rapidly rising unemployment rate, from 7.2% sa in January to 9.2% sa in June (the top so far), but since the short-time work allowance system in particular came into effect, the labour market has stabilised. In November unemployment fell further, despite the increasing spread of infection and greater restrictions imposed at the end of October. In terms of weekly statistics, there is a slightly rising alert level among hotels and restaurants and in the cultural sector, however, in industries such as transport and retail, there is no direct rise despite being directly affected by the new restrictions. Given that the monthly total of lay-offs has not risen, this has been counteracted by fewer layoffs in the remaining sectors. However, the recovery in the labour market seems to have stalled somewhat, but the fact that there is no renewed concern can still be seen as a sign of the strength of the Swedish economy. Our thesis is that the labour market has peaked for this time and that we will see gradual improvement in 2021 as an economic recovery picks up again. The fact that the redundancy system was extended until June 2021 will probably also help to keep the labour market stable.

Hotels and restaurants – one of the worst hit sectors



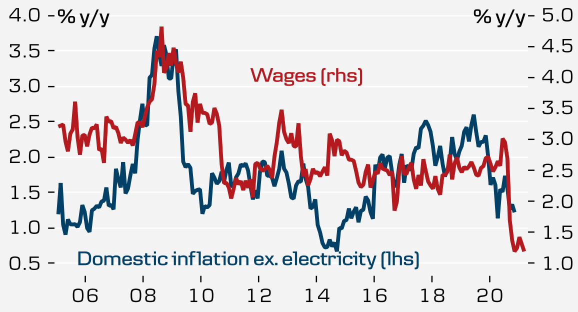
Source: SCB, Macrobond Financial

Low inflation amid changing consumption pattern

After a postponement from the end of March 2020 due to the pandemic, social partners in industry finally agreed in late October to put the central wage agreement 'mark' at 5.4% over 29 months. Other sectors have as usual followed and struck the same deal. On paper, this is a 'fair' 2.2% per year. However, taking into account that the wage level was frozen for seven months, which was not compensated for, in effect the wage deal is worth only 1.8% per year measured over the entire 36-month period. This is actually the lowest recorded wage increase seen over the past couple of decades. It has a major implication: the major inflation driver, domestic wage cost, will be growing slower than ever, reducing core domestic inflationary pressures to new lows.

On top of that, the Riksbank's unwillingness to combat the detrimental economic impact of COVID-19, by cutting rates back to negative again, has been a boost for the SEK. The SEK700bn pandemic QE programme has not been an obstacle for the SEK, which has strengthened sharply since March last year, especially against the USD. Looking at the KIX-index, its 12-month % change currently suggests that there will be significant downward pressure on the prices of imported consumer products and services.

Record-low wage deals put lid on domestic inflation

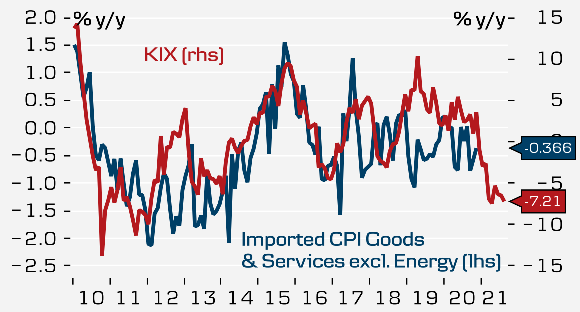


Source: Mediation Office, Statistics Sweden

At the same time, there are alleviating factors. Statistics Sweden has announced that CPI weights and the annual January basket effect will be calculated based on 2020 Q1-Q3 consumption instead of 2019 consumption. This because the consumption pattern has been changed considerably by COVID-19. During the pandemic people have been consuming more of food, housing and DYI goods and less of travel, holiday, hotels, restaurants and clothing. The first set of prices have been going up, the latter down or changes have been non-existent. The implication is that inflation in 2020 has been higher than what the CPI tells us.

Hence, the shift in methodology will adjust for that in 2021, adding a couple of tenths of a percentage point to inflation.

KIX strength pushed import prices into deflation



Source: Riksbank, SCB

Even so, inflation is set to remain below the Riksbank's 2% target on average. The real problem for the Riksbank is if this also causes a further dip in expectations of long-term inflation. It views Prospera's 5y inflation expectations as a proxy for credibility in the inflation target. Currently, these expectations stand at 1.7% and should they move closer to or even break 1.5%, we are certain the Riksbank will react.

Riksbank approaching a cut?

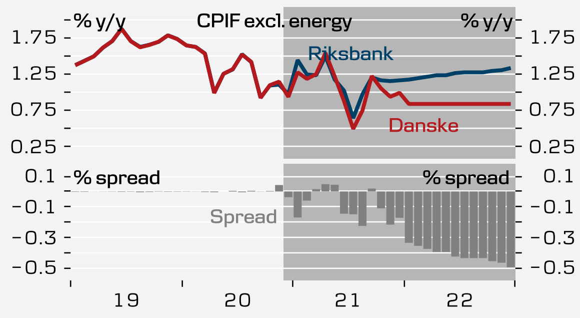
According to the November Monetary Policy meeting's minutes, several Riksbank board members have hinted that a rate cut may come into play again. It is obvious to us that both Deputy Governors Jansson and Flodén would prefer a rate cut before a further expansion of QE, if additional stimulus is needed. Of the remaining four, at least Governor Ingves and Deputy Governors Skingsley and Breman have not closed the door to rate cuts, although they appear open to use 'the whole toolbox'.

Previously, many members have been arguing that as long as the pandemic reduces demand, a rate cut is not effective. A second, less emphasised and implicit reason, may be that growing interbank liquidity caused by the soaring QE programme will result in a considerable cost for the banking system if the repo rate is cut markedly into negative. We estimate that a -0.5% repo rate would cost about SEK8bn in terms of interbank deposits. Hence, the size of the Riksbank's balance sheet is a factor to consider when assessing the possibility of the Riksbank going NIRP again (i.e. performing a negative interest rate policy). In this respect, it is worth noting Governor Ingves in particular pointing to the fact that the Riksbank's balance sheet is small relative to GDP in comparison with other central banks, such as the Fed or the ECB, implying the Riksbank could expand further.

So, what could trigger a rate cut from the Riksbank? It seems to us that prerequisites for a cut are that: (1) the COVID-19 pandemic is easing; (2) the lingering depressed state continues, with core inflation below the lower variation band and long-term inflation expectations creeping to record lows, say 1.5 %, and (3) a further quick and forceful appreciation of the SEK. We argue that the last two are currently close to being fulfilled. Hence, the piece that is lacking is a more solid footing for sectors struck by COVID-19, mainly consumer services such as tourism, travel, leisure and parts of retail trade. We expect these sectors to recover as vaccination comes on board.

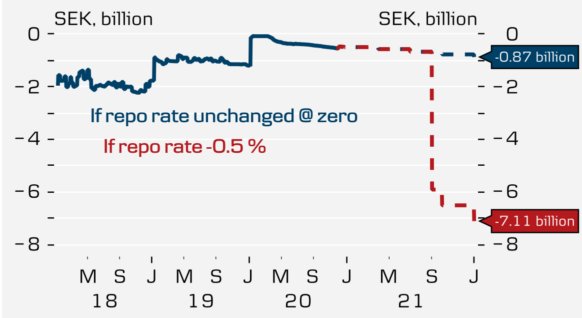
As we see it, the negative cost for banks that would follow from a negative repo rate could be dealt with by either (1) introducing negative deposit rates for SMB/households or by (2) wider lending margins. A 10bp margin adjustment in either of these would cover most of the cost for banks, as both household bank deposits and lending stocks are bigger than total interbank liquidity (see table on the right). This suggests even bigger repo cuts, to say -1.0%, would be manageable.

Depressed core inflation with a downside



Source: SCB, Riksbank,

Higher depo cost for banks if Riksbank goes NIRP again



Source: Debt Office

Note that this is not our base case, which is still for an unchanged repo rate, but it is hard to escape the conclusion that the probability for a rate cut has increased. Not least as some board members appear to be questioning the efficacy of additional QE in terms of its impact on rates and spreads. There are also question marks to what extent QE depresses yield term premiums and credit spreads, to the extent that it herds investors into risky assets and hence raises financial fragility instead of reducing it (just the opposite of what the Riksbank/FSA want). An additional, much bigger question concerns how QE impacts the future returns for the pension system.

Shifting fiscal stimulus into 2021

Despite the largest stimulus package in modern history, the 2020 budget deficit has been revised down. This can be attributed to the fact that the downturn in the Swedish economy was smaller than first expected, together with an extremely strong recovery during Q3. This has led to higher tax revenues, as well as crisis measures not being utilised to the same extent as first feared (e.g. subsidised short-time working, reorientation support for companies with substantial losses of sales turnover and reimbursement of sick pay). In May, the Debt Office forecast a deficit for 2020 of SEK402bn, a forecast that was then significantly reduced to SEK256bn in October. This ‘better than expected trend’ has continued, with October and November together being SEK30bn better than forecast, and it is expected to be intact also in December, meaning, the 2020 deficit will most likely be revised down further. We believe a deficit close to SEK210bn is more realistic. In the first place, the Debt Office’s strategy for matching shorter-term fluctuations of the borrowing requirement is to make adjustments in short-term instruments (T-bills and commercial papers), while only making gradual adjustments in the supply of long-term debt instruments (bonds).

Unfortunately, however, the spread of infection has flared up again, which also makes the uncertainty about the budget’s actual development unusually high. Since the latest 2021 reforms were published at SEK105bn, the government has already extended and presented more measures and more may be required, especially if the government uses the pandemic law, which is expected to be in effect on 10 January (making it possible to temporarily close specific venues, such as shopping malls or public transport). Central government debt (Maastricht) is expected to grow in both 2020 and 2021, but much less than first feared. In an international perspective, Sweden will still continue to have very strong central government finances

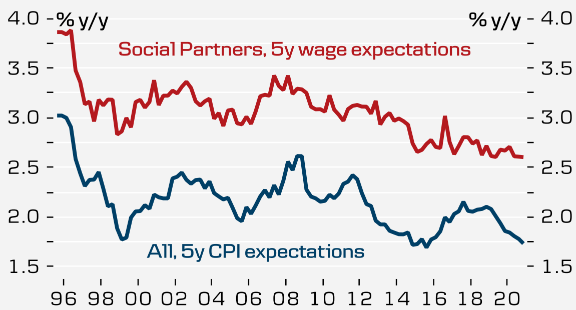
.

A 10bp margin adjustment on household deposits and lending would compensate for a 50bp rate cut

	Stock (SEKbn)	10bp margin adjustment (SEKbn)
Household deposits	2278	2.3
Household lending	4395	4.4
- of which housing	3604	

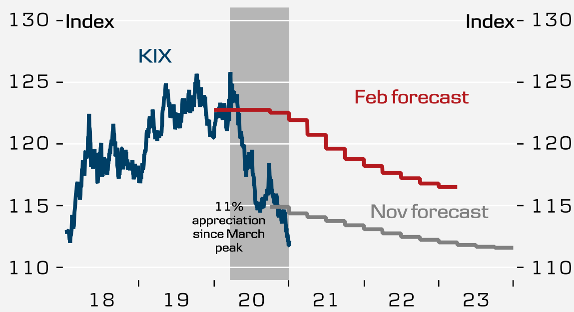
Source: SCB, Danske Bank

Overwhelming signs inflation target losing credibility



Source: Prospera quarterly survey

SEK strength now below Riksbank’s long-term target



Source: Riksbank

At a glance

National account	2019	2019	2020	2021	2022
			Forecast		
	SEK bn (current prices)		% y/y		
Private consumption	2277.6	1.2	-4.7	3.8	3.0
Government consumption	1298.2	0.4	-0.2	2.4	1.5
Gross fixed investment	1263.0	-1.2	-1.4	4.1	2.7
Growth contribution from inventories		-0.3	-0.7	0.0	0.0
Domestic demand	4840.8	0.4	-3.3	3.5	2.5
Exports	2368.2	4.2	-5.5	6.9	3.9
Aggregate demand	7208.9	1.4	-4.1	4.6	3.0
Imports	2184.8	1.8	-6.8	7.6	3.9
Growth contribution from net exports		1.1	0.4	0.0	0.2
GDP	5024.2	1.2	-2.9	3.4	2.6
GDP, calendar adjusted	5027.6	1.3	-3.2	3.3	2.6

Economic indicators	2019	2020	2021	2022
Trade balance, SEK bn	176.331	202.3	202.1	209.9
- % of GDP	3.6	4.1	4.0	4.1
Current Account, SEK bn	224.8	262.3	257.1	259.9
- % of GDP	4.6	5.3	5.1	5.1
Public sector savings, SEK bn	4.8	-150.0	-140.0	-50.0
- % of GDP	0.1	-3.0	-2.8	-1.0
Public debt ratio, % of GDP*	35.0	39.0	40.0	39.0
Unemployment, % of labour force	6.8	8.3	8.3	7.3
Hourly wages, % y/y	2.6	2.0	1.9	1.9
Consumer prices, % y/y	1.8	0.6	1.2	0.8
House prices, % y/y	2.2	7.4	4.0	3.0

* Maastricht definition

Financial figures	06/01/2021	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	0.00	0.00	0.00	0.00

Source: Statistics Sweden, Macrobond Financial, Danske Bank

Norway

2021 set to be a really good year

- **The economic recovery has been stronger than expected.**
- **Increased infections and new restrictions have put a damper on growth, but Norway will avoid another recession by some margin.**
- **A gradual reopening of the economy this year due to vaccinations is set to push up growth, which could also be boosted by pent-up demand.**
- **Temporarily laid-off staff is set to largely return to work and unemployment is set to approach normal levels.**
- **The housing market is set to remain tight.**
- **The NOK is set to appreciate gradually in the wake of increasing risk appetite, stronger oil prices and higher interest rate expectations.**
- **We now expect Norges Bank to raise its policy rate by 25bp in September this year.**

At a glance

Norway					
	Current forecast			Previous forecast	
% y/y	2020	2021	2022	2020	2021
GDP (mainland)	-3.3	4.0	3.3	-3.6	3.7
Private consumption	-7.5	8.0	5.5	-6.8	6.3
Public consumption	1.7	2.0	2.0	1.7	2.0
Gross fixed investment	-5.6	1.0	2.0	-5.6	-0.8
Exports	-3.0	5.8	4.5	-4.3	4.5
Imports	-12.0	5.0	6.0	-10.5	3.8
Unemployment (NAV)	5.0	3.3	2.6	5.0	3.3
Inflation	1.3	2.5	2.1	1.5	2.8

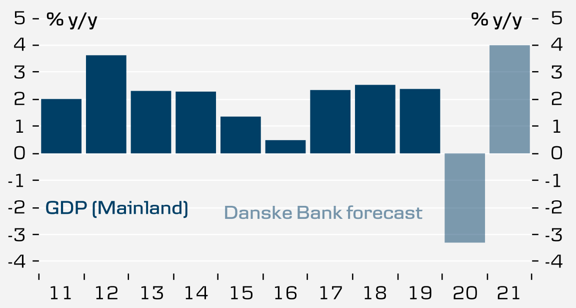
Source: Danske Bank

Better than expected

The economic recovery in Norway during the autumn was stronger than expected. Mainland GDP climbed 5.1% in the third quarter and a further 1.2% in October to just 1.5% below where it was in February, before the pandemic hit the Norwegian economy. This means that 85% of the ground lost in March and April has now been regained, making it the most brutal but also the most short-lived recession we have seen.

It was mainly private consumption that fuelled growth over the summer, but there have also been signs of a broader-based upswing in recent months. Mainland exports in particular have picked up and are now higher than before the pandemic. Oil investment has also begun to rise, and both mainland investment and housing investment have bottomed out. Rising infections from mid-October, followed by fresh restrictions both nationally and locally, probably resulted in a moderate decline in activity in November, but the weekly unemployment figures suggest that activity headed back up again in December. It is, of course, mainly parts of the service sector, such as hospitality, that have been hit hard by the second wave of infections.

Revised forecast



Source: Macrobond Financial, Danske Bank

There is no escaping the fact that it will land some firms in financial difficulties, despite the government support scheme being renewed and expanded. Bankruptcies will therefore rise during the course of the year, but probably not to the extent that this has serious repercussions.

We still expect 2021 to deliver a solid rebound in growth driven by an upswing in the sectors hit hardest by the pandemic, but also perhaps by some pent-up demand. The probability of vaccinations having progressed sufficiently for activity levels to normalise as early as the summer has increased substantially of late.

On the other hand, we expect a gradual reversal of the shift seen in 2020, when reduced consumption of services and lower retail leakage gave retailers a record year.

We can therefore see retail sales falling by around 10% in 2021 and consumption of services rising by 15-20%. All in all, we anticipate solid growth in private consumption, driven partly by base effects. There is also some upside risk to our forecast for private consumption. Thanks to extensive income compensation measures for those who have been laid off whether temporarily or permanently, coupled with interest rate cuts totalling 1.5pp, the decline in household incomes in 2020 was relatively limited.

As mentioned above, mainland investment has stabilised, although firms are reporting limited investment plans. This may be a result of increased investment in technology and green production capacity, i.e. investments to increase efficiency rather than expand capacity. This is a trend that will probably continue over the next couple of years. On the other hand, overall business investment is at relatively high levels, so the economy cannot expect the usual boost from investment as it heads into the upswing.

Oil investment has also begun to rise, driven by slightly higher oil prices and the changes to the taxation of the oil companies agreed in the summer. This will limit the decline in oil investment, but we still have to expect another fall in the region of 6-7% in 2021, as a number of major projects have been completed in the past couple of years.

Mainland exports is set to continue to benefit from a substantial upswing in the global economy, not only because demand will pick up but also because stock levels are relatively low and will therefore boost production as they normalise. We do not expect the limited appreciation of the NOK that we are predicting to counteract this trend.

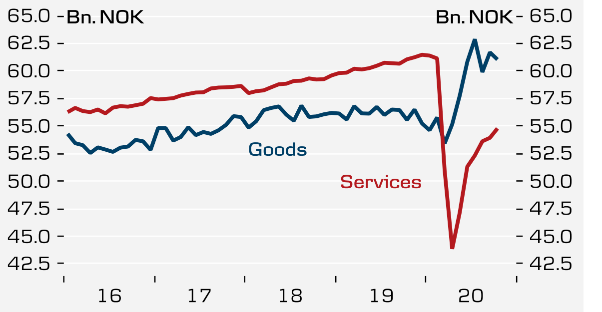
Housing investment has also stabilised. With limited supply in the market for existing homes, we have seen rising sales of new homes. This should bring a substantial increase in housing investment in 2021, which will help maintain activity levels not only in the construction sector but also in the economy as a whole. On the other hand, there are signs of capacity constraints on the regulation side, which presents a slight downside risk to our expectations.

We have revised up our forecast for the Norwegian economy slightly since our previous forecast. Because the economy performed better than expected through to October, we now expect mainland GDP to fall by 3.3% rather than 3.5% this year, even though November and December will be somewhat weaker than we had anticipated. A slightly earlier vaccine rollout both in Norway and abroad means that we now expect economic activity to normalise somewhat earlier than we previously assumed. We therefore now forecast mainland GDP growth of 4.0% rather than 3.7% in 2021.

Short-lived rise in unemployment

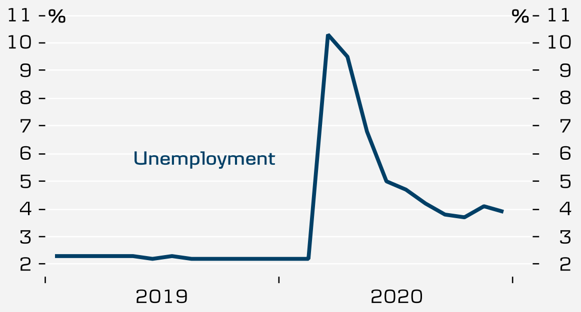
Due to the increase in infections and new restrictions, unemployment began to climb again at the beginning of November after falling steadily since April. Total unemployment, including temporary layoffs, climbed to 7.1% in November but dropped back again to 6.9% in December. Some 80-90% of the rise in unemployment in November was in hospitality, mostly in the form of temporary layoffs. The rise in unemployment in the second wave has thus been both smaller and less broad-based.

Large twist in consumption



Source: Macrobond Financial, Danske Bank

Short-lived rise in unemployment in the second wave



Source: Macrobond Financial, Danske Bank

As the countermeasures begin to have the desired effect and the vaccination rate increases, we expect the economy to be reopened gradually, with the hardest-hit sectors bringing many of the staff they previously laid off back to work. This means that we expect unemployment to fall steadily during the course of this year, although there will also be some industries where activity levels do not return to pre-crisis levels in 2021/22, if ever. We expect that registered (full-time) unemployment, which stood at 2.3% in February 2020, will drop back towards 3% by the end of 2021.

At the same time, there is reason to believe that the increase in unemployment is a result of structural changes due to new travel patterns, online meetings and so on, which will push up equilibrium unemployment in the economy. We have seen a substantial increase in the number of vacancies advertised, which is a sign of growing demand for labour, despite high unemployment in the overall economy.

Higher wage growth despite higher unemployment

Historically, there has been a strong relationship between unemployment and wage growth in Norway, even in the years after the financial crisis. The current high jobless levels should therefore spell moderate wage growth for the next few years. As mentioned earlier, however, the current crisis is different, with a much faster expected recovery than from previous crises, which means that much of the unemployment is in the form of temporary layoffs.

Our forecasts nevertheless show unemployment remaining higher than normal for a long period, partly because some of the effects of the crisis are likely to be permanent, such as reduced business travel and more working from home. As noted above, these effects can be seen as structural – they are not a result of weak aggregate demand but of structural changes on the supply side. There is therefore reason to assume that they will push up structural unemployment for a period, in which case wage growth will start to accelerate at a higher level of unemployment than in the past.

In theory, the system of centralised wage bargaining in Norway should help keep wage growth down in periods such as this, but it is questionable whether areas with high levels of activity (such as the public sector, construction, services, parts of manufacturing and the whole of the health sector) will show sufficient solidarity with low-paid part-timers in the hospitality sector.

We therefore expect wage growth to accelerate from 2.0% in 2020 to around 2.3% in 2021. This allows for distortions resulting from the bulk of those who have been laid off, whether temporarily or permanently, having been in low-paid jobs.

The slower wage growth means that domestic inflationary pressures will gradually ease over the course of 2021. Imported inflation will also fall further as the NOK continues to strengthen. On the other hand, demand in the retail trade in particular has been stronger than expected, globally as well as domestically, which could result in higher cost pressures but also greater pricing power than history would suggest. All in all, therefore, we expect core inflation to slow to around 2% at the end of the year.

Wage growth higher than during the oil crisis

Source: Macrobond Financial, Danske Bank

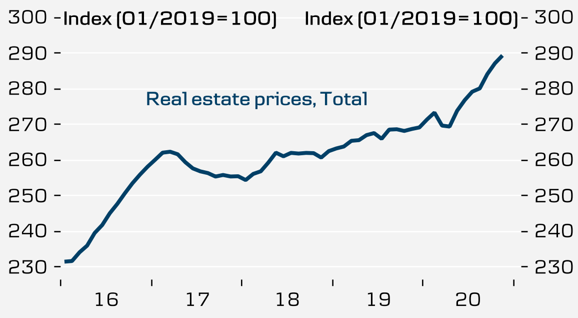
Limited supply pushing up housing prices

The housing market tightened further during the autumn. Since bottoming out in April, housing prices have climbed more than 7%. The most important reason for this strong rebound is, of course, that Norges Bank's rate cuts have more or less halved mortgage rates from around 3% to around 1.5%.

However, it is worth remembering that the rise in housing prices is also due to there being relatively few properties on the market when the crisis struck, and little in the pipeline after low housing starts in the preceding year. This illustrates very clearly how different the coronavirus crisis is to, say, the financial crisis or the oil crisis. Only four months into the current crisis, sales of new homes had picked up and housing starts had begun to climb. This trend came to an end during the autumn, however, with excess demand beginning to rise again.

Since housing projects take around 18 months to two years to be completed, this means that the housing market will remain tight in terms of the stock-to-sales ratio well into 2021. Over the summer, however, we expect stronger interest rate signals to combine with rising sales of new homes to help stabilise the housing market. We have nevertheless revised up our forecast for housing prices and now anticipate an increase of 4.4% last year and 6% this year, the latter figure due largely to a high degree of price overhang into 2021.

Housing prices have climbed further than expected



Source: Macrobond Financial, Danske Bank

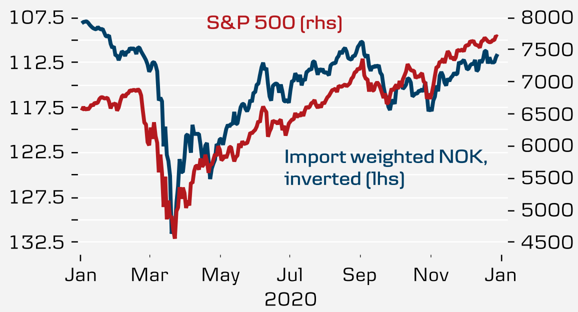
NOK buoyed by positive vaccine news

Movements in the NOK since the coronavirus crisis erupted show that it is mainly global factors that are determining the exchange rate. Since the initial downturn when risk appetite collapsed in March, the NOK has gradually moved with general risk appetite.

Since positive vaccine news began to come in at the beginning of November, risk appetite has picked up again. The import-weighted NOK exchange rate has strengthened by almost 6% in the same period. That said, it has fluctuated considerably from day to day, caught in a tug-of-war between good and bad news on the global stage.

We anticipate a gradual increase in risk appetite in 2021, fuelled by rising vaccination rates in many countries, a fiscal support package in the US, and a Brexit deal. Together with slightly higher oil prices and stronger signals of a rate increase from Norges Bank towards the end of the year, we expect this to produce a gradual rise in the NOK over the course of year.

NOK exchange rate at mercy of global risk appetite



Source: Macrobond Financial, Danske Bank

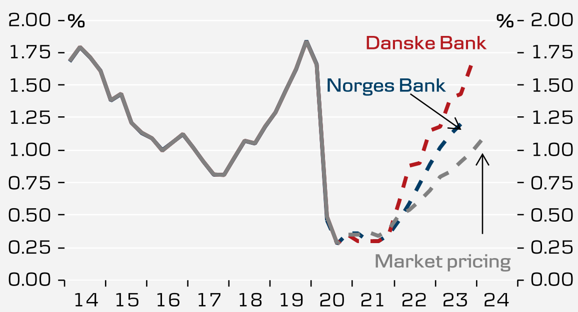
Norges Bank to hike in September

As expected, Norges Bank left its policy rate at 0% in December and reiterated that it will 'most likely remain at today's level for some time ahead', but it also added that its 'policy rate forecast implies a rate at the current level for over a year ahead'.

The rate-setting committee emphasised that the growth outlook is now somewhat brighter, and the risk somewhat lower, than in September, due presumably to a combination of growth having been stronger than expected and medium-term prospects having improved as a result of the positive news about vaccines.

In the accompanying monetary policy report, the bank presented a policy rate path showing a roughly 70% chance of a first rate hike in March 2022, as

Market not convinced by Norges Bank



Source: Macrobond Financial, Danske Bank opposed to the third quarter of 2022 last time around. The rate path now shows two hikes in 2022 and the equivalent of 1⅔ hikes in 2023.

The central bank's economic projections are largely in line with our own expectations, although we believe that current activity levels are somewhat higher and that the bank's interest rate signals are coloured by there still being some risk around vaccination deployment and the recovery. In this context, it is interesting to note that Norges Bank is working with three different scenarios for economic developments during the projection period depending on how the vaccination programme goes.

In the baseline scenario presented above, it assumes that 'vaccination of risk groups begins in 2021 Q1 and that the general population both of Norway and of its main trading partners is largely vaccinated by the end of 2021'.

The bank also presents a downside scenario where there are production and distribution bottlenecks and where current containment measures need to be retained well into 2022. In this scenario, the output gap remains negative throughout the period, and interest rates hold at current levels "through much of the projection period".

Finally, an upside scenario assumes that a 'sufficient vaccination rate' is achieved as early as summer 2021. Unfortunately, the bank does not present any alternative interest rate projections, but the output gap closes two to three quarters earlier here than in the baseline scenario. The timing of the first rate hike would then logically move forward by a similar amount, i.e. to September (or even June) this year rather than March 2022 as in the baseline scenario. We should stress that our own forecasts are based on roughly this view of the vaccination rate, which is also supported by the Norwegian Institute of Public Health. It is also worth bearing in mind that there could be less risk of contagion when temperatures rise, as we saw last spring. This may help keep the infection rate down from April/May onwards.

Since this scenario is the best match for our own expectations, we forecast that Norges Bank will raise its policy rate in September this year

At a glance

National account	2019	2019	2020	2021	2022
			Forecast		
	NOK bn (current prices)	% y/y			
Private consumption	1497.6	1.4	-7.5	8.0	5.5
Public consumption	868.1	1.9	1.7	2.0	2.0
Gross fixed investment	914.6	4.8	-5.6	1.0	2.0
Petroleum activities	177.4	12.6	-4.0	-6.5	-2.5
Mainland Norway	733.7	4.0	-6.0	1.5	2.5
Dwellings	47.7	1.0	2.0	2.3	2.3
Enterprises	49.0	5.5	2.0	1.5	1.5
General government	213.5	3.0	1.0	1.5	1.5
Mainland demand	3184.9	2.3	2.0	2.0	2.0
Growth contribution from stockbuilding		0.0	0.0	0.0	0.0
Exports	1296.2	0.5	-3.0	5.8	4.5
Crude oil and natural gas	463.7	-4.5	11.0	3.5	3.5
Traditional goods	432.3	4.6	-3.5	3.7	4.0
Imports	1238.8	4.7	-12.0	5.0	6.0
Traditional goods	736.2	5.3	2.3	2.4	2.4
GDP	3568.5	0.9	-2.7	4.3	3.3
GDP Mainland Norway	3068.4	2.3	-3.3	4.0	3.3

Economic indicators	2019	2020	2021	2022
Employment, % y/y	1.6	-1.7	0.7	1.6
Unemployment (NAV), %	2.3	5.0	3.3	2.6
Annual wages, % y/y	3.5	2.0	2.3	2.9
Consumer prices, % y/y	2.2	1.3	2.5	2.1
Core inflation	2.2	3.0	2.2	1.8
Housing prices, % y/y	2.5	4.4	6.0	3.0

Financial figures	06/01/2021	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	0.00	0.00	0.00	0.25

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

Finland

Midsummer recovery

- **The Finnish economy has been resilient in facing the coronavirus crisis. In Q2 20, GDP in Finland contracted less than in any other EU country. The epidemic situation become more difficult towards the end of 2020 but lockdown remained moderate enough to keep economic damage limited.**
- **However, the near-term outlook is difficult. Private consumption is suffering from the epidemic and external demand for export industries remains weak. In our view, growth is unlikely to pick up substantially until H2 21. On average, we expect GDP to grow 2.2% in 2021 (was 2.5%).**
- **Unemployment has not risen as much as we had feared and retail sales grew in late 2020 but the service sector is suffering from the second wave and construction is slowing down. On average, we expect the unemployment rate to be slightly higher in 2021 than in 2020.**
- **The Finnish housing market performed well in 2020. In spring, the market adjusted mainly through less trade rather than through prices. Transactions normalised in summer and household buying intentions remained high at the end of 2020.**
- **Public support for companies hurt by the coronavirus and the blow from the recession have widened the public deficit significantly. The government is slowly shifting from crisis mode towards more targeted stimulus. Gross issuance rose to around EUR40bn in 2020. Even with a recovery, the deficit is still likely to be large in 2021 and we expect the debt-to-GDP ratio to rise to above 70%. We believe costs related to an ageing population should push debt higher in the 2020s and a more austere fiscal policy looks likely to us.**

At a glance

Finland	Current forecast			Previous forecast	
% y/y	2020	2021	2022	2020	2021
GDP	-3.3	2.2	2.8	-4.5	2.5
Private consumption	-4.0	3.5	2.7	-4.0	3.5
Public consumption	0.0	1.5	1.0	1.0	1.5
Gross fixed investment	-2.5	2.0	3.0	-5.0	2.0
Exports	-10.0	5.0	6.0	-12.0	5.0
Imports	-8.0	5.0	5.0	-9.0	5.0
Unemployment rate	7.8	8.0	7.2	8.2	8.2
Inflation	0.3	1.0	1.5	0.3	1.0
Government balance, % of GDP	-8.0	-4.1	-2.4	-8.4	-3.7
Current account, % of GDP	-0.6	-0.6	-0.6	-0.9	-0.6

Source: Danske Bank

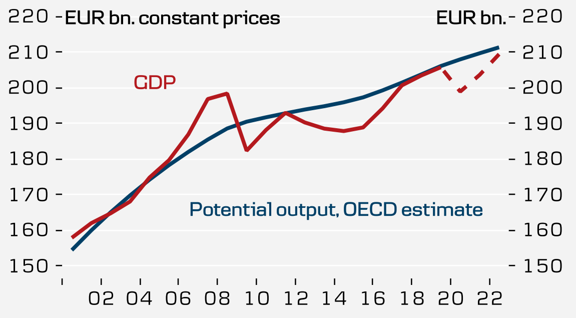
Better than expected

The Finnish economy has survived the coronavirus pandemic and its economic consequences better than we had expected. In spring, Finnish GDP contracted less than in any other EU country. In Q3 20, GDP increased 3.3% q/q following the rebound in private consumption, leaving the economy only 2.7% below the 2019 level. Relatively speaking, Finland survived the first wave of the coronavirus crisis with limited economic damage. However, the second wave constitutes a strong headwind for the economy and the outlook for early 2021 is difficult.

During the COVID crisis, five main factors have supported the Finnish economy. First, the pandemic itself has been relatively mild and the objective risk of catching the virus low. Second, and partially related, lockdown measures have been less stringent than in many countries. Third, industrial production did not plummet in spring. Factories did not close and the industrial structure, with a focus on investment goods with long production times, provided work. Fourth, already existing good capabilities for remote work have helped to maintain productivity. Fifth, tourism plays a less significant role for the Finnish economy than for many of the worst hit countries, especially in southern Europe.

The shock to the labour markets has been sizeable but unemployment has not risen us much as we had feared. In spring, approximately 170,000 workers were laid off but many of them were able to return to work over summer. In any case, public finances suffered a substantial blow in 2020 from crisis aid to businesses and

Output gap closing at the end of forecast horizon



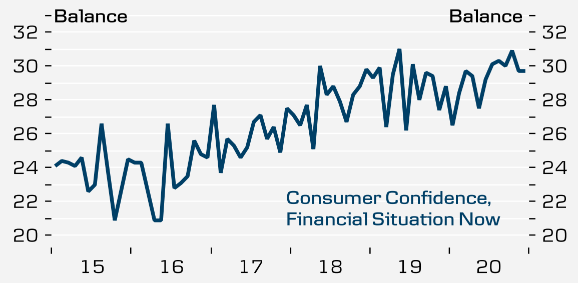
Source: Macrobond Financial, Statistics Finland decreasing tax revenue. The fiscal measures together with low interest rates have helped to avoid bankruptcies, which remain at a very low level. However, despite a relatively good performance so far, the outlook is not great and we expect the recovery to be sluggish. Even though business surveys have recovered from their very weak levels in spring, the outlook remains below average for all main industries, especially services, which we do not expect to recover in the winter due to the second wave of the epidemic. So far, the situation is reasonably well under control but escalation of the epidemic remains a large domestic risk. In addition, export industries continue to suffer from weak external demand and a lack of new orders.

We revise our GDP growth forecast to -3.3% for 2020 (was -4.5%) following a better-than-expected recovery in Q3 and upward revisions in some earlier data. In our view, the first months of 2021 are likely to be difficult but we expect a gradual recovery to begin in spring and to gather strength in H2. We believe fiscal policy response and a rebound in global trade should boost the recovery. We forecast a 2.2% increase in GDP (was 2.5%) in 2021 and 2.8% increase in 2022. The growth path would take Finnish GDP close to potential output by the end of 2022.

Private consumption drives the business cycle

Finland is a small open economy and changes in external export demand typically drive the business cycle. This time is different and fluctuations in domestic private demand have been unprecedented. In Q2 20, private consumption fell over 5% q/q and over 10% y/y due to lockdown measures and the reaction to the risk of catching the virus. In Q3, we saw a similar swing in the other direction, when private consumption grew 3.3% q/q. Despite the recovery, consumption remains depressed and is below the pre-coronavirus level. In the autumn, Finland reinstated some lockdown restrictions but restaurants, schools and stores remained open and stricter restrictions concentrated mostly on the travel industry, mass gatherings and public spaces. Grocery sales and, especially, online sales have been winners now that people are spending more time at home and eating less in restaurants and office cafeterias. Advice for office workers is to continue remote working.

Most consumers are not financially stressed



Source: Macrobond Financial data

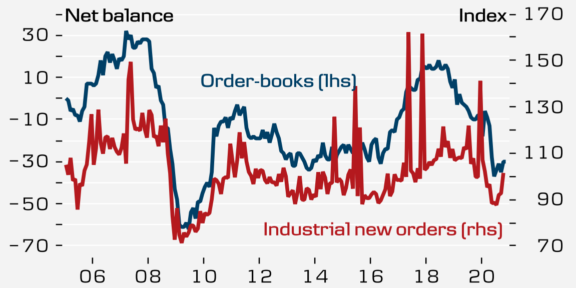
Before the coronavirus epidemic began, we based our growth forecast on the assumption that the household sector would be the backbone of the Finnish economy, shielding it from weak export demand. This premise changed dramatically in spring, although in some respects it remains true. Private consumption fluctuated more than expected following the spread of the virus but, broadly speaking, households remain in good shape. The labour market has not collapsed, average wages are still rising and inflation remains nearly non-existent, supporting purchasing power. Reduction in employment is set to lead to a smaller aggregate wage sum but, so far, the effect seems to be modest. Unemployment benefits, steady pension payments and wage increases are helping to maintain purchasing power.

Households are likely to remain cautious in coming months but we expect consumers to return to their important role in supporting the recovery in H2 21. Once the vaccination process has advanced enough, the boost from pent-up consumer demand is likely to be substantial. The household savings rate rose in 2020, which means households have the means to boost consumption, if they wish to do so. We expect private consumption to shrink by 4.0% in 2020 and make a 3.0% recovery in 2021. In our forecast, growth in private consumption continues at a rate of 2.7% in 2022.

Outlook for manufacturing remains fragile

Finnish exports did not see much recovery in Q3 20. Exports grew by 2.6% q/q but remained 12.7% below the level in Q3 19. In particular, service exports remain depressed, with a significant 30.9% y/y decline. However, Finnish factories did not close in spring due to coronavirus restrictions, so there is less room or need for a rebound in manufacturing industries. In our view, one obvious factor supressing service exports is tourism, although its general equilibrium effects are less clear due to Finland's negative tourism account. Domestic travel also supports the tourism industry in Lapland but some bankruptcies may still be unavoidable despite government aid.

Industrial orders improving



Source: Macrobond Financial data

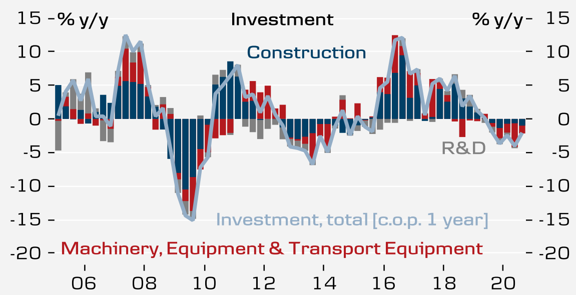
Imports saw a somewhat faster recovery of 3.7% in Q3 20, turning the net contribution from foreign trade negative. Finnish industrial manufacturing has seen only a relatively small contraction compared with the situation in many other European countries. The main worry has been the lack of new orders and the possibility of larger export-driven companies experiencing difficulties, layoffs or bankruptcies. So far, the worst has been averted and the outlook for manufacturing improved in December, although it is still below average. There has also been some recovery in new orders since the summer but order books remain thin. The structure of Finnish export industries with a relatively large share of long-term projects, such as passenger ships, is more robust against quick shifts in the business cycle. However, the headwind may continue to be strong for Finnish export industries for an extended period and until the global recovery strengthens, which we expect to be in H2 21.

The expected global recovery in 2021 should improve the outlook for exports markedly but Finland produces a lot of investment goods and intermediate goods that are not the fastest to recover. Consequently, external demand is likely to remain weak for some time. The EU recovery fund should bring a boost in 2022. We estimate exports declined by 10.0% in 2020. For 2021, we forecast a modest recovery with exports growing by 5.0%. In our forecast, the recovery continues in 2022, with exports growing by 6.0%.

Investments contracted less than expected

Investment demand had already decreased in 2019 and the outlook was not particularly great for 2020 given declining capacity utilisation. During the coronavirus crisis, the volume of investment has contracted further but less than we had expected. In Q3 20, investment fell only 0.3% from spring, leaving the volume 2% below Q3 19. Industrial investment has fallen more rapidly, as expected, but construction has supported the overall level of investment. There has not been any sign of delays to construction projects and we even saw a small uptick in new starts for apartment construction.

Industrial investment remains weak



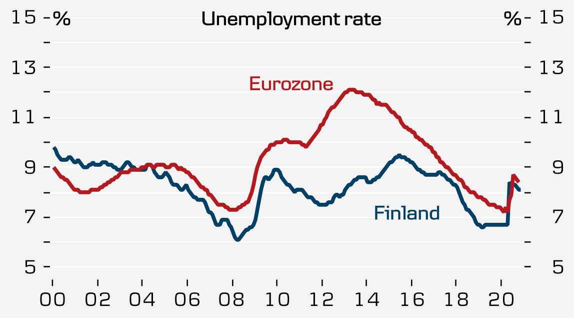
Source: Macrobond Financial data, Statistics Finland

In any event, the coronavirus crisis is likely to affect investment demand in many ways. News about future vaccinations improves morale but, in our opinion, it would be too optimistic to think that investment will get going quickly. A lack of demand, as well as the high level of uncertainty, is still holding back business investment. As a positive contributor, the government intends to spend more on infrastructure, which should stimulate construction in the medium term. In total, we estimate fixed investment shrunk 2.5% in 2020 (was -5.0%). For 2021, we expect investment to grow 2.0%, following a modest recovery in construction and manufacturing investment. For 2022, we expect only a modest acceleration in investment growth to 3.0%.

Job market remains resilient against headwinds

The labour market improved in the summer in the sense that many people returned to work after being laid off temporarily in the spring. At the same time, real unemployment is increasing, as some jobs have been permanently lost and it has become more difficult to find jobs. Jobs in the service industry were hit hardest in the early phase of the crisis but nearly all industries, from manufacturing and construction to the public sector, are affected. Despite clear headwinds from the second wave of the COVID-19 pandemic, the Finnish labour market stayed stable in late 2020 and unemployment increased less than we expected in our previous forecast. The economy, including restaurants, has remained more open than in the spring, which lowers the need for reductions in staff. Open vacancies have fallen less than in most previous crises. Companies probably prefer to keep skilled labour in anticipation of a recovery in demand for goods and services in 2021.

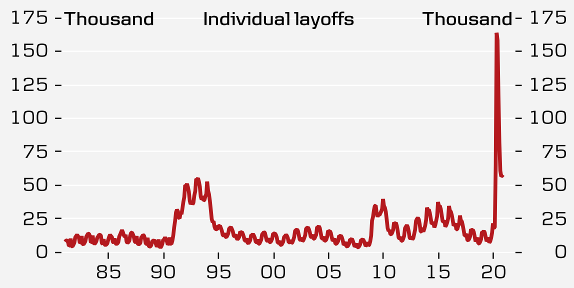
Official unemployment rate up modestly



Source: Macrobond Financial data, Statistics Finland

We expect lay-offs to stay elevated as tourism-related service businesses continue to suffer from the crisis. Manufacturing and construction companies are also reacting to lower business volumes. We forecast the average annual unemployment rate will rise from 6.7% in 2019 to 7.8% in 2020 and rise further to 8% in 2021. We expect a recovery to create more jobs and the unemployment rate to begin to fall in late 2021. Employment has already started to recover from the spring plunge. The employment rate trend number rose to 72.2% in November. The official target rate for employment set by the government is 75% and, recently, there has been discussion about possibly raising the target to as high as 78%. It is clear to us that it will not hit these ambitious targets any time soon. The need for labour market reforms has not disappeared. Quite the contrary, the inevitable rise in public debt makes it all the more important that Finland is able to maintain a high employment rate in the longer term to cope with the rising public expenditure following on from demographics. The government has proposed some reforms that aim to activate job seeking and reduce possibilities for early retirement but a major part of the possible reforms is left to further preparation.

Lay-offs have more than halved from the peak in May

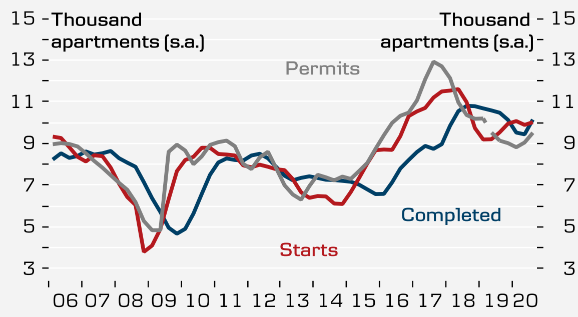


Source: Macrobond Financial data, Ministry of Employment and the Economy

Housing market upbeat

The coronavirus crisis has had only a modest impact on the housing market. Adjustment came mostly through temporary lower sales volumes in the spring. Prior to the lockdown, the Finnish housing market was performing quite well. In April-May, transaction volumes fell by approximately one-third but they bounced back to normal in the summer. Relevant information is available online and even sales can be done digitally, which helps to maintain the market even in times of pandemic. The number of housing transactions was normal in the autumn and demand for housing loans was higher than in 2019. We expect the average price of old dwellings to rise by 1.0% in 2020 and 1.5% in 2021. Household buying intentions are surprisingly high and private investors continue to buy apartments as well. However, higher unemployment and plentiful supply of new housing should keep a lid on the market. The housing market is getting support from low interest rates. Supply of old apartments has diminished in e-channels in 2020 but the construction of new apartments is maintaining a good pace in growth centres, where demand is high.

Permit data indicates stable housing construction



Source: Macrobond Financial, Statistics Finland

For several years, average house prices in Finland have risen only modestly, with wide variations according to location. Prices have risen in growth centres and fallen in locations with shrinking population. We expect a similar pattern to continue in the long run. Construction has been one of the key drivers for the

Finnish economy for the past few years. Before the coronavirus crisis, the boom was fading as seen in the number of housing permits. Latest data from permits indicates that housing construction is maintaining a reasonably good rate, especially in the Helsinki region.

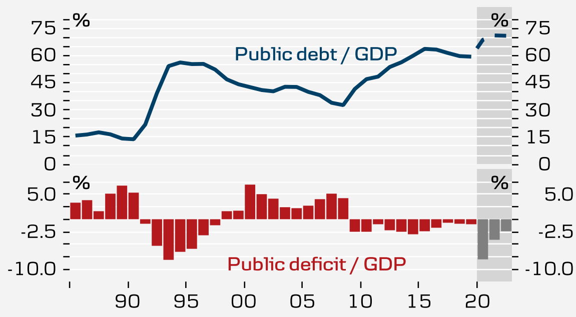
Fiscal policy to stay loose

The Finnish government announced seven extra budgets for 2020, which totalled nearly EUR20bn of new net debt in 2020. Substantial public support for companies struggling with the effects of the coronavirus has helped to avoid bankruptcies. Recovery is easier with economic structures intact. Wider unemployment benefits (covering also entrepreneurs and dropping the waiting period), support to municipalities, healthcare-related purchases and reduced revenues all contribute to the significant deficit. Active fiscal stimulus measures also widen the public deficit. The government aims to increase infrastructure spending and education. Social spending is also getting some additional funding. Together with the need to fund redemptions, central government gross issuance rose to above EUR40bn in 2020. The Ministry of Finance estimates that net central government borrowing will total EUR11.7bn in 2021. It expects government debt to total approximately EUR138bn at the end of 2021. In our opinion, this could turn out to be slightly too pessimistic if the recovery gains speed as we forecast. As an extraordinary item, the Finnish air force is set to acquire new fighter jets, with the upcoming cost set to add around EUR1bn annually to public debt over the next decade, starting in 2021. We estimate the public debt-to-GDP ratio will rise to above 70%.

Given the unusual times, rating agencies are patient about the growing debt burden but we still expect structural reforms. Sizable guarantee liabilities pose an additional risk to public finances. Finland has the highest ratio of public loan guarantees to GDP in the EU. Finnvera's (state-owned financing company, the official export credit agency) capacity to guarantee loans has increased by EUR10bn, up to around EUR12bn.

The Finnish central government has been running a long-standing deficit since the financial crisis but strong growth in employment brought public finances closer to balance before the coronavirus crisis. In addition, municipalities have been financing their spending with debt and an ageing population is often behind weaker local government budgets. The surplus in social security funds, which consist mostly of statutory pension companies, has narrowed the general government deficit. In our view, Finland will need to address the sustainability of public finances from a whole new position once the coronavirus pandemic has gone. In the future, a high level of employment is set to remain important for healthy public finances. Finland needs structural reforms to boost potential growth and improve labour participation in order to deal with the rise in age-related expenditure caused by an ageing population and a rising dependency rate. The coronavirus pandemic will not make the old issues go away.

Debt-to-GDP set to rise sharply



Source Macrobond Financial, Statistics Finland

At a glance

			Forecast		
National account	**2019**	**2019**	**2020**	**2021**	**2022**
	EUR bn (current prices)	% y/y			
GDP	240.6	1.1	-3.3	2.2	2.8
Imports	95.9	2.4	-8.0	5.0	5.0
Exports	96.7	7.7	-10.0	5.0	6.0
Consumption	181.7	0.9	-2.8	2.9	2.2
- Private	126.0	0.8	-4.0	3.5	2.7
- Public	55.6	1.1	0.0	1.5	1.0
Investments	57.4	-1.0	-2.5	2.0	3.0

Economic indicators	2019	2020	2021	2022
Unemployment rate, %	6.7	7.8	8.0	7.2
Earnings, % y/y	2.1	1.9	2.5	2.5
Inflation, % y/y	1.0	0.3	1.0	1.5
Housing prices, % y/y	0.6	1.0	1.5	1.5
Current account, EUR bn	-0.5	-1.4	-1.5	-1.5
- % of GDP	-0.2	-0.6	-0.6	-0.6
Public deficit, % of GDP	-1.0	-8.0	-4.1	-2.4
Public debt/GDP, % of GDP	59.2	68.6	71.0	70.8

Financial figures	06/01/2021	+3 mths	+6 mths	+12 mths
Leading policy rate, % p.a.	-0.50	-0.50	-0.50	-0.50

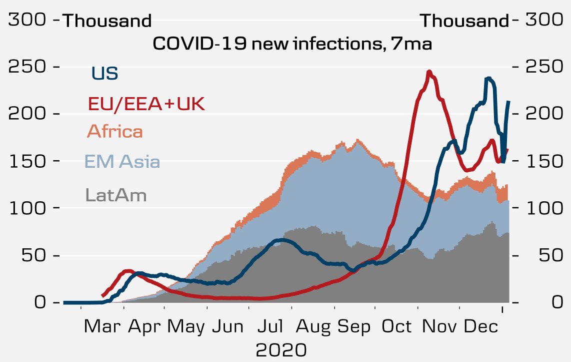
Source: Statistics Finland, Macrobond Financial, Danske Bank

Global overview

Darkest before dawn

- **Continuing high numbers of COVID-19 cases mean restrictions are likely to remain throughout Q1.**
- **After a strong recovery, the global economy is likely to see a soft patch in Q4 20 and Q1 21 due to the new restrictions, slowing momentum in China's economy and delays in new fiscal stimulus in the US.**
- **However, as vaccines are distributed widely in H1 21, we see brightening prospects for the global economy taking hold in Q2 and strengthening further in Q3 before levelling off late in the year.**
- **Overall, we look for a smaller effect from fiscal and monetary stimulus in 2021 than in 2020.**
- **The balance of risks to our global scenario has shifted to the upside due to the positive vaccine outlook, reducing at the same time negative tail-risks for the global economy.**

US and Europe still struggling with high levels of new infections

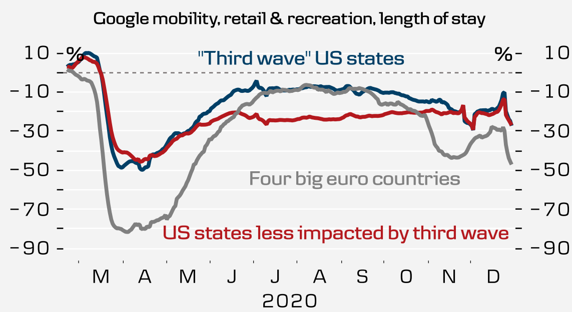


Source: Macrobond Financial, Danske Bank

Corona restrictions set to stay through winter...

The world has been struggling with the coronavirus pandemic for almost a year. Hot spots have been moving back and forth between regions and countries, underscoring the difficulty in getting to grips with the virus. After dealing with a severe first wave in the spring, Europe opened up over the summer but has seen a sharp rise in new cases in the autumn and into the winter, triggering new restrictions in most countries. A new more contagious variant of the virus starting in the UK has also started to spread lately. The US is witnessing a third wave, seeing a sharp acceleration in new cases and record-high hospitalisation rates, which is more widespread across states than the first and second waves were. In response, many states have taken additional measures to stem the contagion. However, restrictions are more targeted on service sectors than in the spring, while the manufacturing sector has been left more or less untouched, limiting the damage to the economy.

Service sector activity is taking a hit in the euro area and the US



Source: Google, Macrobond Financial, Danske Bank

...creating headwinds in the short term

As the US and Europe have tightened restrictions, service sector activity has been particularly hit, although not to the same degree as in the first wave. As a result, private consumption in Europe and the US is facing headwinds, as more consumers stay at home to avoid shopping and travel. Furthermore, China's recovery is set to peak in Q1 21, as the government is keen on scaling back stimulus to continue its deleveraging process. Due to COVID-19 pandemic restrictions, we expect the euro area to see negative growth in Q4 20 and only a small expansion in Q1 21 (hitting service PMIs in particular, while manufacturing may hold up better due to external demand). We believe the US will also see headwinds in coming months due to its worsening COVID-19 pandemic situation.

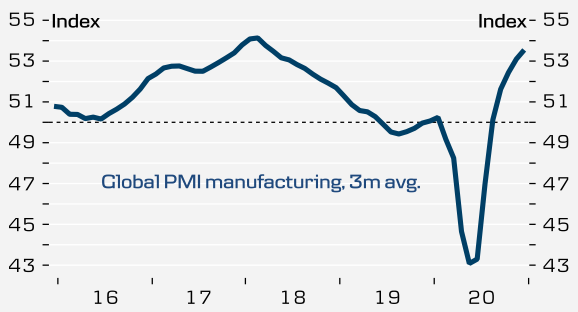
Roll-out of vaccines set to pave the way for a global recovery

Many countries have rolled out the first vaccines now and, although there are still many unknowns about the vaccines, we assume a wider rollout will gain speed in Q1. The most vulnerable groups and frontline health officials are the first to receive the vaccination. Other groups are set to get access to vaccinations in Q2-Q4. It is uncertain how many will be vaccinated but we assume it will be enough for things to get close to normal by the end of Q2 or early Q3 (hence reducing the need for restrictions in autumn 2020). We expect that continued improvement in the treatment of the coronavirus also to help to lower the mortality rate of those who are infected, easing fears over the disease.

In summary, we expect the US and Europe to recover gradually from Q2 on due to (1) restrictions related to COVID being lifted gradually; (2) improving sentiment from a vaccine rollout starting to unleash pent-up demand and (3) our expectation that growth in export markets will remain slightly above potential throughout 2021, despite China slowing down. In the middle of 2021, we look for the biggest effect of pent-up demand to drive a robust recovery, with growth slightly above potential and unemployment falling globally. We expect the service sector to benefit the most but also believe manufacturing should gain due to higher investment and more purchases of consumer durables as employment increases.

Overall, we expect G4 growth to rebound to around 6% in 2021, from -2.4% in 2020. In our opinion, the main driver of global growth will continue to be China but we believe Europe and the US will also see strengthening growth momentum throughout 2021. In 2022, we expect global GDP growth to fall to trend growth as economies have normalised.

Global manufacturing is recovering briskly



Source: Markit PMI, Macrobond Financial, Danske Bank

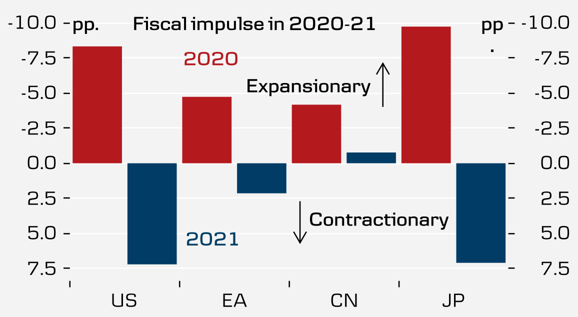
Additional policy stimulus would be limited in 2021

Overall, we look for a smaller effect from fiscal stimulus in 2021 than in 2020, which implies fiscal policy will have a slightly negative to neutral impact on growth compared with 2020. In December, the US agreed on a new package of around 4% of GDP but it will mostly be an extension of existing measures and not provide a new boost to the economy.

In the euro area, we still expect an expansionary fiscal policy in 2021 but less so than in 2020. The focus is on backstop measures to limit bankruptcies, while most countries have already extended employment schemes throughout 2021. The effects of the Recovery Fund will be gradual in 2021, as it will take time to roll out the green and digital investments planned. In China, fiscal policy is set to dampen growth in 2021, as publicly driven investments will be scaled back and focus returns to deleveraging the economy after a necessary break in 2020. Japan is planning a third fiscal stimulus package but it is likely to be smaller than the previous ones.

On the monetary policy side, the probability of the Fed scaling up asset purchases has come down but tightening is far away. The ECB will be keen to avoid any tightening of financial conditions, so we look for more liquidity operations (TLTROs) and an extension of the PEPP programme to be announced at the December meeting. However, we expect only a modest growth impact from these measures. We expect the People's Bank of China to be on hold for now but higher money market rates and bond yields indicate a de facto tightening is already taking place, as China's focus is shifting to deleveraging the economy. In our view, this means credit growth will start to decline.

Fiscal policy turning more neutral in 2021



Note: The fiscal impulse is calculated as the change in the primary fiscal structural balance
Source: IMF World Economic Outlook October 2020, Macrobond Financial, Danske Bank

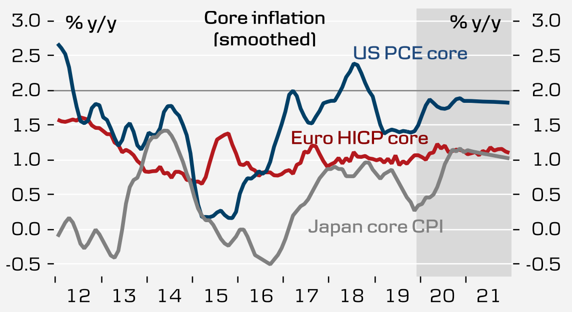
While we expect headline inflation to move higher in both Europe and the US, as the drag from energy prices abates, we expect core inflation to increase only modestly, averaging 0.9% in the euro area and 1.5% in the US in 2021.

Prospect of an effective vaccine reduces downside risks for global economy

In comparison with *The Big Picture – Darkest before dawn*, 1 December 2020, the downside risks to our global economic forecasts have declined following the positive news about a vaccine for the coronavirus (15% probability of downside versus 25% before). Furthermore, while a Joe Biden administration in the US is set to maintain a tough stance towards China, the risk of new trade wars is significantly lower than under Donald Trump. The last-minute Brexit deal between the EU and UK in December removed another downside risk.

In contrast, the upside risks to the global economy have increased (25% probability now versus 15% before). Among the key upside risks is stronger-than-expected pent-up demand as companies and households look through new coronavirus waves, spurred by the early approval, distribution and take-up of an effective vaccine against the virus. We expect this to propel the normalisation of economies in the first half of 2021, lifting investment amid easy financial conditions and increasing capacity utilisation. We expect the rebound to be strong and persistent, so unemployment rates could reach pre-COVID-19 levels in China, the Nordic countries, the US and the eurozone in 2021

Core inflation set to stay rather muted in 2021



Source: Macrobond Financial, 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	2020	-3.7	-3.1	-1.2	0.8	-8.8	-6.6	0.4	2.5	4.7	-3.5	43.4	7.4
	2021	2.3	3.0	1.6	3.1	3.6	4.7	0.8	2.0	4.7	-1.9	41.9	6.9
	2022	3.4	3.6	0.4	3.8	7.2	6.4	1.2	1.8	3.8	-1.2	41.5	7.7
Sweden	2020	-3.2	-4.7	-0.2	-1.4	-5.5	-6.8	0.6	2.0	8.3	-3.0	39.0	5.3
	2021	3.3	3.8	2.4	4.1	6.9	7.6	1.2	1.9	8.3	-2.8	40.0	5.1
	2022	2.6	3.0	1.5	2.7	3.9	3.9	0.8	1.9	7.3	-1.0	39.0	5.1
Norway	2020	-3.3	-7.5	1.7	-5.6	-3.0	-12.0	1.3	2.0	5.0	-	-	-
	2021	4.0	8.0	2.0	1.0	5.8	5.0	2.5	2.3	3.3	-	-	-
	2022	3.3	5.5	2.0	2.0	4.5	6.0	2.1	2.9	2.6	-	-	-

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	2020	-7.0	-8.8	-0.8	-13.7	-9.1	-10.5	0.3	-1.0	8.0	-8.8	101.7	2.6
	2021	4.9	4.5	3.2	-1.2	13.1	10.6	1.1	1.0	8.9	-6.2	102.1	2.6
	2022	3.4	5.3	1.8	2.1	3.5	4.3	1.1	1.0	8.6	-4.4	102.3	2.8
Germany	2020	-5.3	-5.9	4.5	-3.7	-10.2	-8.8	0.5	-0.1	4.2	-6.0	71.2	6.0
	2021	4.0	3.2	4.1	2.8	13.8	10.9	1.2	1.5	4.2	-4.0	70.1	6.3
	2022	2.2	3.3	1.4	2.1	3.3	4.3	1.3	0.0	3.7	-2.5	69.0	6.1
Finland	2020	-3.3	-4.0	0.0	-2.5	-10.0	-8.0	0.3	1.9	7.8	-8.0	68.6	-0.6
	2021	2.2	3.5	1.5	2.0	5.0	5.0	1.0	2.5	8.0	-4.1	71.0	-0.6
	2022	2.8	2.7	1.0	3.0	6.0	5.0	1.5	2.5	7.2	-2.4	70.8	-0.6

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	2020	-3.4	-3.8	0.9	-2.4	-13.7	-10.7	1.2	4.6	8.1	-16.0	126.4	-2.1
	2021	3.3	4.6	1.4	4.6	1.7	6.6	1.6	2.0	6.5	-12.2	132.3	-2.1
	2022	3.8	4.3	2.1	4.3	2.0	3.8	1.6	2.3	5.3	-7.2	131.9	-2.1
China	2020	1.7	1.5	-	3.0	-	-	3.0	7.5	-	-11.9	-	0.6
	2021	9.2	9.0	-	10.0	-	-	2.0	7.0	-	-11.8	-	0.4
	2022	5.5	7.0	-	4.0	-	-	2.5	7.0	-	10.9	-	0.4
UK	2020	-11.1	-14.4	-9.9	-12.8	-12.5	-21.1	0.9	2.0	4.4	-19.0	109.1	-2.0
	2021	5.2	4.2	4.0	6.2	6.4	6.1	1.6	1.2	4.9	-7.7	109.3	-3.8
	2022	6.9	8.3	2.1	11.9	5.9	8.2	1.9	1.6	4.6	-4.5	108.3	-3.6
Japan	2020	-5.6	-7.0	1.9	-5.7	-12.8	-7.5	-0.2	-	2.8	-	-	-
	2021	2.7	2.4	1.8	-1.0	9.1	1.5	0.3	-	2.7	-	-	-
	2022	2.5	2.7	-1.1	3.7	5.3	3.0	0.6	-	2.5	-	-	-

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

Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this report are listed on page 2 of this report.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Quarterly.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 06 January 2021, 14:00 CEST

Report first disseminated: 07 January 2021, 06:00 CEST

Danske Bank Research

Global Head of FICC Research, Thomas Harr, +45 45 13 67 31, thhar@danskebank.com

International Macro

Chief Analyst & Head of
Jakob Ekholdt Christensen
+45 45 12 85 30
jakc@danskeban.com

Aila Evchen Mihr
+45 45 13 78 67
amih@danskebank.com

Allan von Mehren
+45 45 12 80 55
alvo@danskebank.com

Bjørn Tangaa Sillemann
+ 45 45 12 82 29
bjsi@danskebank.com

Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.com

Piet P.H. Christiansen
+45 45 13 20 21
phai@danskebank.com

Fixed Income Research

Chief Analyst & Head of
Jan Weber Østergaard
+45 45 13 07 89
jast@danskebank.com

Daniel Brødsgaard
+45 45 12 80 83
dbr@danskebank.dk

Jens Peter Sørensen
+45 45 12 85 17
jenssr@danskebank.com

Cross Scandi Strategy

Chief Analyst & Head of
Arne Lohmann Rasmussen
+45 45 12 85 32
arr@danskebank.com

Foreign Exchange

Jens Nærvig Pedersen
+45 45 12 80 61
jenpe@danskebank.com

Kristoffer Kjær Lomholt
+45 45 12 85 29
klom@danskebank.com

Lars Sparresø Merklin
+ 45 45 12 85 18
lsm@danskebank.dk

Credit Research

Chief Analyst & Head of
Jakob Magnussen
+45 45 12 85 03
jakja@danskebank.com

Bendik Engebretsen
+47 85 40 69 14
bee@danskebank.com

Brian Børsting
+45 45 12 85 19
brbr@danskebank.com

David Andrén
+46 8 568 80602
davia@danskebank.com

Henrik Renè Andresen
+45 45 13 33 27
hena@danskebank.com

Louis Landeman
+46 8 568 80524
llan@danskebank.com

Mads Rosendal
+45 45 14 88 79
madros@danskebank.com

Mark Thybo Naur
+45 45 12 85 19
mnau@danskebank.com

Niklas Ripa
+45 45 12 80 47
niri@danskebank.com

Sverre Holbek
+45 45 14 88 82
holb@danskebank.com

Sweden

Chief Analyst & Head of
Michael Boström
+46 8 568 805 87
mbos@danskebank.com

Chief Economist
Michael Grahn
+46 8 568 807 00
mika@danskebank.com

Carl Milton
+46 8 568 805 98
carmi@danskebank.com

Filip Andersson
+46 8 568 805 64
fian@danskebank.com

Jesper Jan Petersen
+46 8 568 805 85
jesppe@danskebank.com

Stefan Mellin
+46 8 568 805 92
mell@danskebank.com

Therese Persson
+46 8 568 805 58
thp@danskebank.se

Denmark

Chief Economist & Head of
Las Olsen
+45 45 12 85 36
laso@danskebank.com

Bjørn Tangaa Sillemann
+ 45 45 12 82 29
bjsi@danskebank.com

Louise Aggerstrøm Hansen
+ 45 45 12 85 31
louhan@danskebank.com

Norway

Chief Economist & Head of
Frank Jullum
+47 85 40 65 40
fju@danskebank.com

Emerging Markets

Chief Analyst & Head of
Jakob Ekholdt Christensen
+45 45 12 85 30
jakc@danskeban.com

Finland

Chief Strategist & Head of
Valtteri Ahti
+358 (0)10 546 7329
vah@danskebank,com

Chief Economist
Pasi Kuoppamäki
+358 10 546 7715
paku@danskebank.com

Jukka Samuli Appelqvist
+ 358 44 263 1051
app@danskebank.com