Danske Bank

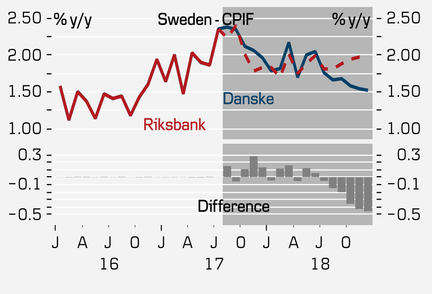
10 September 2017

Scandi Markets Ahead

Inflation week and general election and regional survey in Norway

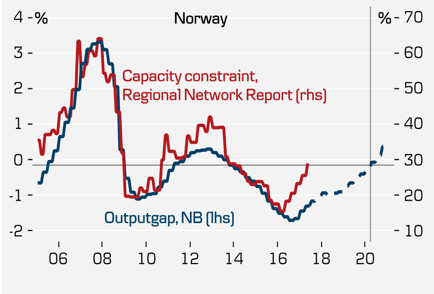
- In **Sweden,** we get August CPIF and CPIF excluding Energy. We expect them to turn out 0.2 and 0.1 percentage points *higher* than the Riksbank's new forecasts at 2.4% y/y and 2.1% y/y, respectively. Actually, our current forecasts are on the upside of the Riksbank's until summer next year, when our forecasts depart. That said, inflation is likely to peak in the short term and then embark on a downward trend. That trend is driven by weak fundamentals, i.e. modest wage cost pressures and a gradually dampening impact from the krona.
- There is also the quarterly Prospera inflation survey. Based on the monthly survey, we expect a further rise in Q3. The final estimate for Q2 GDP is also on the agenda. The preliminary print at 4.0 % y/y wda was much higher than expectations. We have no reason to expect significant revisions.
- The regional network survey is **Norges Bank's** preferred measure of economic activity. Going by recent data, it seems that the growth outlook is even brighter than at the time of the last survey, so we expect the index to climb from 1.29 to around 1.4-1.5.
- Norwegian core inflation has been slightly higher than expected in the past two months due partly to a surprisingly strong rise in airfares, which have displayed considerable monthly volatility over the past couple of years. This means that there is a certain risk of a correction to airfares in August, but we have seen no indication of any abnormally strong change. We therefore expect base effects (abnormally weak inflation last year) to push the annual rate of core inflation up from 1.2% in July to 1.5% in August. That would be 0.4pp higher than Norges Bank projected in June.
- Monday sees parliamentary elections in **Norway**, and it looks to be a very close race. Not only is it unclear which bloc will have a majority, but there is considerable uncertainty about what the governing coalition will look like.
- In **Denmark**, August inflation figures are released on Monday. There was a big jump in July, with many subcomponents unexpectedly showing relatively large increases. We expect a correction in August. We predict -0.7% m/m and 1.1% y/y.

Sweden: Inflation trending lower from here



Source: Macrobond Financial, Danske Bank

Norway: Still healthy turnover in the Norwegian housing market



Source: Macrobond Financial

Financial and macro forecasts for the Nordic area

- *See our monthly Yield Outlook that covers Scandi and core markets (August 2017)*
- See *FX Forecast Update* for our latest FX Forecasts (August 2017)
- See *Nordic Outlook* (June 2017) for updated Macro forecasts.

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Sweden – temporarily higher inflation and soft Riksbank

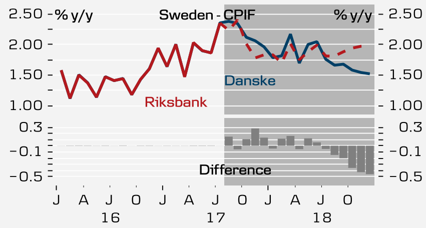
In **Sweden,** we get August CPIF and CPIF excl. Energy. We expect them to turn out 0.2 and 0.1 percentage points *higher* than the Riksbank's new forecasts at 2.4% y/y and 2.1% y/y, respectively. Actually, our current forecasts are on the upside of the Riksbank's until summer next year, when our forecasts depart. That said, inflation is likely to peak in the short term and then embark on a downward trend. That trend is driven by weak fundamentals, i.e. modest wage cost pressures and a gradually dampening impact from the krona.

Short term, the big issue concerns the extent to which prices of charter packages will fall back in August (and possibly September) after an unprecedented string of price increases in April-July as measured by the new Eurostat-aligned technique. According to Statistics Sweden, there should not be any shift in measured charter prices due to the change; however, we have actually assumed that there is. This effect will eventually fade out in January.

To be sure there is also uncertainty regarding the size of the rise in clothing prices in August as the seasonal pattern has changed over the past couple of years. There are now bigger price increases in August and smaller ones in September. Clothing is the major contributor to price increases this month.

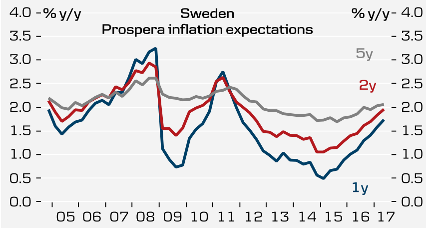
There is also the quarterly Prospera inflation survey. Based on the monthly survey, we expect a further rise in Q3. The final estimate for Q2 GDP is also on the agenda. The preliminary print at 4.0 % y/y wda was much higher than expectations. We have no reason to expect significant revisions.

Inflation at a peak



Source: Riksbank, Danske Bank

Prospera 'big' inflation expectations



Source: Prospera

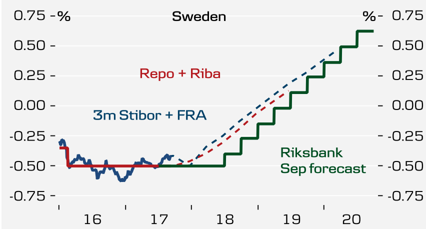
Soft tone from the Riksbank

The Riksbank has announced an unchanged policy stance and the repo rate path is the same as in July, with the first hike (some 10bp) indicated in Q3 18. The Riksbank lowered the KIX path but kept the end point more or less intact. As an effect, the Riksbank now expects a looser SEK appreciation than in July: 1.3% until the end of 2018 versus 2.6% in July. Asset purchases continue according to plan. This outcome was generally expected; however, the money market showed a minor decline and the SEK weakened slightly.

On inflation, the Riksbank says that recent outcomes have been higher than expected but underlines that this is due primarily to higher services prices (airfares), which should be temporary. However, strong growth and stimulatory monetary policy should help to hold inflation close to the target it says. The Riksbank revised its inflation forecast up somewhat over the forecast horizon. Note, the message here is that the inflation forecast suggesting inflation is close to the target is conditioned partially by a sustained strong monetary stimulus as expressed in the repo rate forecast. The Riksbank repeated that as inflation has been undershooting for such a long period, inflation being above target temporarily does not justify tighter policy near term.

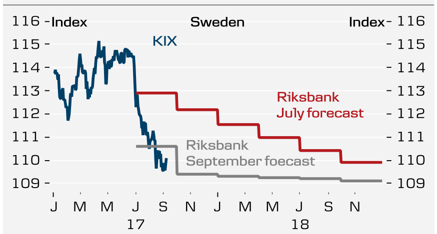
On growth (the GDP forecast has been revised up), the Riksbank stresses that recent high GDP figures have been driven mainly by strong productivity, which dampens cost pressure. In addition, nominal wage growth is moderate and the Swedish krona has appreciated faster than expected. It reiterated that Riksbank policy cannot deviate too much from that of other central banks.

Money market still frontloaded



Source: Macrobond, Danske Bank, Riksbank

SEK on the strong side of new forecast



Source: Riksbank

Hence, the bottom line is that, despite higher inflation, the Riksbank is holding its policy stance intact. This illustrates that it is in a way asymmetric in the sense that it is prepared to tolerate inflation above target for a while without responding. It is still restricted by other central banks' (read ECB) ultra-light policy and it stresses that the inflation forecast (CPIF close to 2%) is conditioned partially by continued stimulatory policy.

The Riksbank announced that from here on in, CPIF will be the formal target variable and it reintroduced a +/-1 percentage point variation band. Neither has any implication for actual policy making.

We expect the Riksbank to end the QE programme by year-end, but to keep the repo rate unchanged as long as fundamental inflation drivers imply CPIF inflation is close to the target on a sustainable basis.

Norway – inflation, regional survey and general election

In **Norway**, the coming week brings two key pieces of information ahead of the central bank's rate-setting meeting the following week.

The regional network survey is Norges Bank's preferred measure of economic activity, and the aggregated output index (for the next six months) has shown a clear upswing in recent quarters. Going by recent data, it seems that the growth outlook is even brighter than at the time of the last survey, so we expect the index to climb from 1.29 to around 1.4-1.5, which would be somewhat higher than the interval of 1.35-1.45 that would be neutral for Norges Bank based on its June forecast for GDP growth of 0.7% q/q for the rest of the year.

On the other hand, we are also very interested in firms' take on capacity constraints. To our mind, recent reports from the regional network have indicated that capacity utilisation in the Norwegian economy is a fair bit higher than Norges Bank's estimates of the output gap would suggest. In plain English, this means that interest rates ought to go up earlier than projected by the central bank, all else equal.

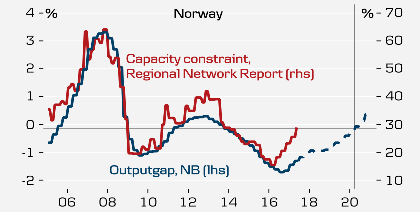
Also coming up during the week is August inflation data. Core inflation has been slightly higher in the past two months than Norges Bank forecast in June, due partly to a surprisingly strong rise in airfares, which have displayed considerable monthly volatility over the past couple of years. This means that there is a certain risk of a correction to airfares in August, but we have seen no indication of any abnormally strong change. We therefore expect base effects (abnormally weak inflation last year) to push the annual rate of core inflation up from 1.2% in July to 1.5% in August.

That would be 0.4pp higher than Norges Bank projected in June and, in isolation, push up the interest rate path in the new monetary policy report on 21 September.

Monday sees parliamentary elections in Norway, and it looks to be a very close race. Not only is it unclear which bloc will have a majority, but there is considerable uncertainty about what the governing coalition will look like. As there are still only relatively minor differences in economic policy between the parties, and the fiscal rule for the spending of oil money imposes clear limits on fiscal leeway, we do not expect any market reaction to the election results. The exception would be if there is surprisingly strong support for the environmental parties, as this could cast doubt on future conditions in the oil sector.

For more on the election see *Reading the Markets Norway*, 4 September.

Capacity utilisation seems to be higher than Norges Bank is estimating

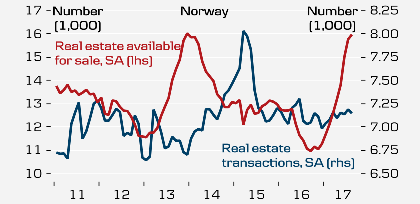


Source: Macrobond Financial, Norges Bank, Danske Bank

Housing market – correction, not a crash

Housing prices have now fallen for five months on the trot, and the decline is becoming more broad-based geographically. The reason is probably a combination of tighter bank lending practices on the back of new regulations, and a much improved balance between supply and demand. The number of properties on the market has therefore risen sharply, especially in Oslo. This will probably put a damper on prices in the coming months. While many are focusing on the rise in unsold properties, we would stress that turnover is holding up relatively well, which tells us that observed prices are, at the very least, clearing the market. The reason why we still believe the drop in prices to be a correction, rather than a crash, is the prospect of continued low unemployment and moderate interest rate increases in the coming years.

More properties on the market, but turnover stable



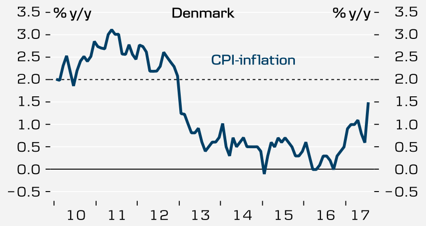
Source: Macrobond Financial, Danske Bank

Denmark – inflation data

In **Denmark**, August inflation figures are released on Monday. There was a big jump in July, with many subcomponents unexpectedly showing relatively large increases. We expect a correction in August, with prices for food, package holidays and holiday homes creeping back down again. We predict -0.7% m/m and 1.1% y/y.

Tuesday brings unemployment figures for July from Statistics Denmark. We expect an unchanged jobless rate of 4.3%. The next day, the Nationalbank unleashes its latest economic forecast. Finally, Friday brings Finance Denmark's housing market statistics for Q2. We already have Statistics Denmark's figures for how prices have moved on a nationwide basis, but it will be interesting to see what has been happening at a local level.

Inflation to correct in August after big jump in July

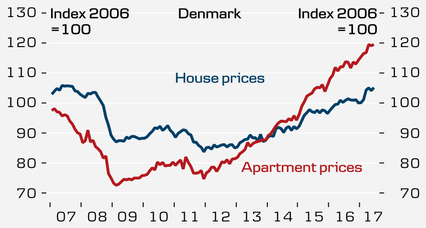


Source: Statistics Denmark, Macrobond Financial

Housing market still in good shape

The past week has brought good news from the housing market. House prices climbed 1.0% in June and apartment prices 0.3% and the number of transactions hit a 10-year high. This goes to show what good shape the housing market is in at the moment, as is also confirmed by the number of repossessions holding at a nine-year low with just 195 in August, down 13 on July. Meanwhile, industrial production fell 0.8% in July. This statistic does have a tendency to be volatile, however, so we should not read too much into a single month's reading, and it currently ties in very poorly with the national accounts. Finally, the number of bankruptcies fell by nine to 189 in August, which is low, continuing the recent trend.

Housing prices have trended up ever since late 2011



Source: Statistics Denmark

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This research report has been prepared by Danske Bank A/S (‘Danske Bank’). The author of this research report is Arne Lohmann Rasmussen, Chief Analyst.

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Report completed: 10 September 2017, 19:33 GMT

Report disseminated: 10 September 2017, 20:45 GMT