DNB Markets Economic Outlook 2018

6 December 2017

Main points, December 2017

Global:

- Global growth has firmed markedly this year, lifted by strong optimism and highly supportive financial conditions. We expect 2018 to be another good year for the world economy. Wage and inflation pressure looks set to remain muted despite continued labour market improvements in major advanced economies. This will limit the pace of Fed hikes, and delay the first steps toward policy normalisation in the euro zone, Japan and Sweden. Main (known) risks are an abrupt repricing in the financial markets as the age of extraordinary measures is coming to an end, a “hard landing” in China, a US recession and an escalation of geopolitical tensions.

Norway:

- 2017 has been a year marked by a smaller negative drag from oil investments, higher private consumption and a marked rise in housing investments. In 2018, growth may firm slightly further. Private consumption will be supported by higher income growth. Business investments and exports will continue to rebound, after several weak years, while housing investments will fall. Unemployment will edge down, but inflation will stay low due to continued moderate wage growth and a weak contribution from imported price growth. We expect Norges Bank to hike rates in September 2019, a little later than in Sweden and the euro zone.

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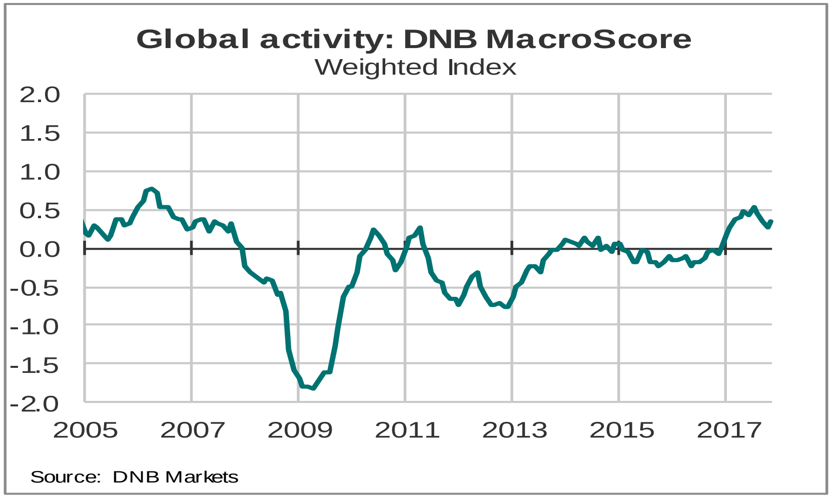
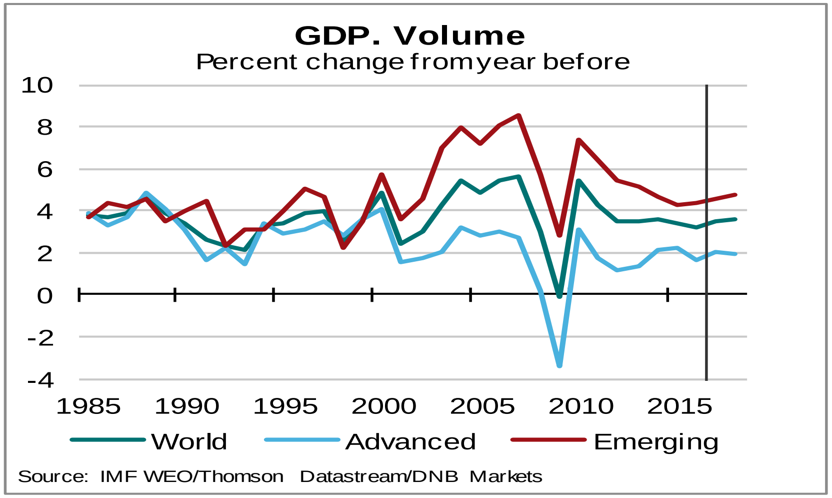
DNB

2018: Another good year in sight…

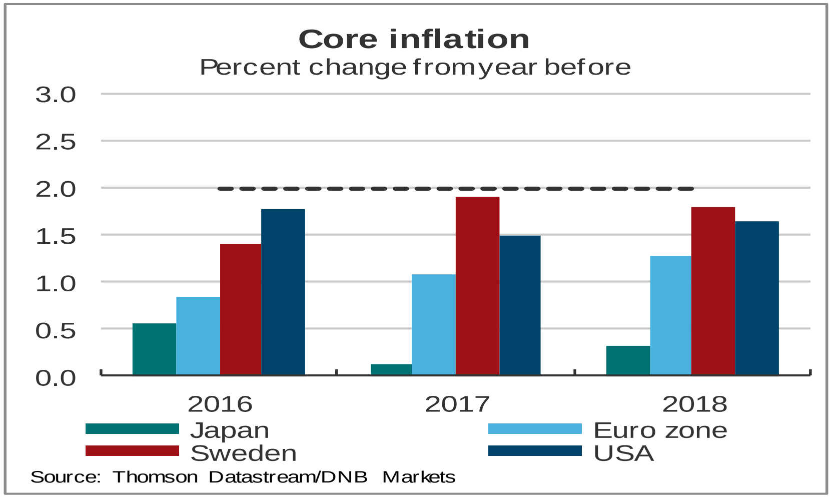
- Global growth has picked up by ½ percentage point to 3½% in 2017, supported by soaring optimism as political risks have faded and labour markets have improved further. DNB's MacroScore points to a continued strong momentum towards the end of the year, with firm data from the US and the euro zone.
- We expect global growth to edge up further in 2018, lifted by a positive trend for emerging markets as a whole. China is, however, likely to experience a government-induced, moderate slowdown. For advanced economies the growth pace is expected to be steady at 2.0%, which is solid, considering a low "normal" due to slow population and productivity growth.

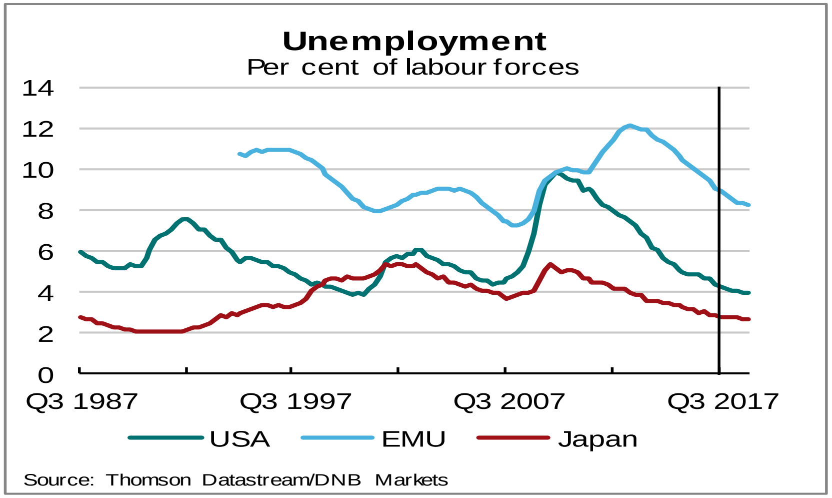




…but core inflation remains below target

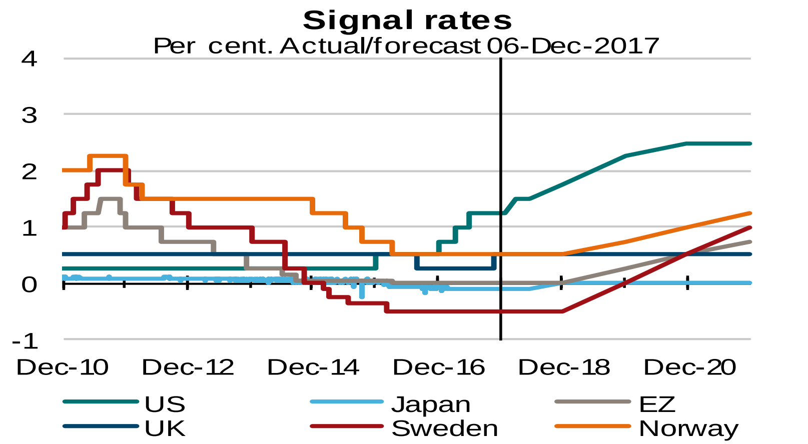
- Despite continued growth above trend in major advanced economies, and continued improvement in the labour markets, we expect the rise in wage growth to be moderate. Core inflation will remain below central banks' 2% targets.
- Why? Labour market slack is larger than signaled by the conventional unemployment figures. Importantly, the share of part-time jobs has increased significantly after the crisis. Also, labour market reforms in Europe have decreased workers' bargaining power. Generational effects on total wages are still at work in the US and Japan. Last, but, not least: Globalisation and digitalization continue to lay the ground for fierce competition, in labour and product markets.





Approaching the end of unconventional policy

- With continued strength in the US economy, the Fed is likely to raise its policy rate in December, and in June and December next year. In addition, the central bank's balance sheet is being slowly but surely reduced.
- Japan and the ECB are now the last of the major central banks to increase stimuli month by month, through asset purchasing programs. We expect the ECB purchases to be finalized by the end of 2018, but the policy rates to be left unchanged until the spring of 2019.
- Long-term swap rates are expected to rise somewhat, but a moderate growth and inflation outlook for advanced economies will curb the rise.



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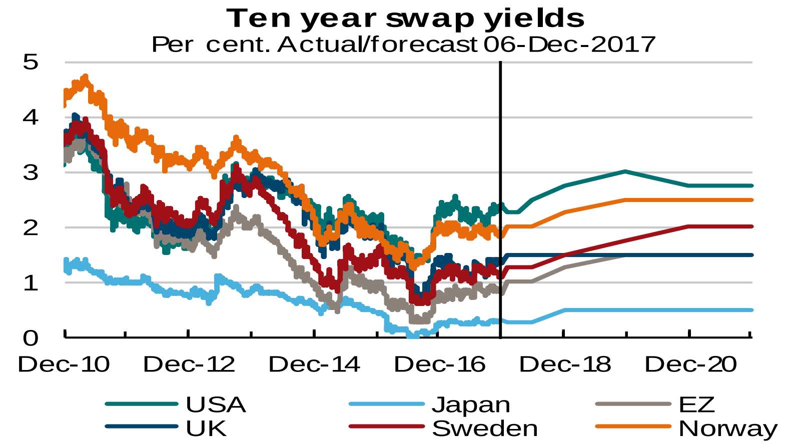


Source: Thomson Datastream/DNB Markets

Global

GDP forecasts, current and previous

GDP. Per cent change from preceding year

	2016	2017	2018	Change Aug 17 2017	Change Aug 17 2018	Consensus 2017	Consensus 2018
World	3.0	3.5	3.6	0.2	0.2		
Advanced economies	1.5	2.0	2.0	0.1	0.2		
USA	1.5	2.3	2.4	0.2	0.2	2.2	2.5
Eurozone	1.8	2.3	2.3	0.2	0.5	2.2	1.9
Sweden	3.2	2.7	2.5	-0.3	0.2	2.9	2.6
Mainland Norway	1.0	1.8	2.0	-0.2	0.0	1.9	2.1
UK	1.8	1.5	1.1	-0.1	0.1	1.5	1.4
Japan	1.0	1.5	0.9	-0.2	0.0	1.6	1.3
Emerging economies	4.1	4.5	4.7	0.2	0.2		
China	6.7	6.9	6.5	0.1	0.0	6.8	6.4
India	7.1	6.7	7.5	-0.3	0.0	6.8	7.5
Brazil	-3.6	1.0	2.0	0.5	0.5	0.8	2.4
Russia	-0.2	1.8	1.6	0.4	0.1	1.7	1.8

Source: DNB Markets and Consensus Forecast

DNB

Several serious (known) negative risk factors

Threats to the upturn in 2018 (I)

Risk factors	Δ since August report**	Probability*	Comment
Abrupt repricing in financial market	=	Medium	If investors' risk attitude sours substantially, we will see an abrupt tightening of financial conditions, falling stock markets with corresponding lower yields on safe haven bonds. The consequence will be a global economic downturn. The NOK is likely to weaken alongside other risk-sensitive currencies.
Hard landing in China	+	Medium	An abrupt unwinding of large imbalances in the Chinese economy would push the economy into a recession. A sharp drop in the Chinese GDP will lead to a global recession, with lower safe haven bond yields, and a commodity price plunge. The NOK is likely to weaken alongside other risk-sensitive currencies and a lower oil price.
Geopolitical tensions escalate	=	Medium	A more activist approach from the US in the Middle East and in North Korea could lead to higher global tensions. This is likely to result in increased appetite for financial market «safe havens», with lower US and German bond yields and a stronger yen. The effect on the NOK would depend on the impact on commodity prices.

* Low, medium and high probability indicate 0-15%, 15-30%, 30-45%.
** Our assessment of changed probability since August.

Several serious (known) negative risk factors

Threats to the upturn in 2018 (II)

Risk factors	Δ since August report**	Probability*	Comment
Steep wage growth	=	Low	If wage growth returns with a vengeance in advanced economies, central banks must tighten more rapidly. This will lead to a marked repricing in financial markets, an economic cooldown and inverted yield curves. If the shock applies to all advanced economies, the NOK is likely to be unaffected.
US recession	=	Low	Even a gradual tightening of financial conditions could lead to investment cuts for debt-laden US companies, creating a recession in the world's largest economy already in 2018. Consequences would be lower yields on safe haven bonds, lower equity prices and higher spreads. The NOK is likely to weaken alongside other risk-sensitive currencies.
"Hard" Brexit	=	Low	A breakdown of Brexit negotiations, with EU hardliners refusing to agree on a transition agreement, will point to an abrupt divorce between the UK and the EU in April 2019. An even higher level of uncertainty will lead to a marked economic slowdown for the UK, lower BoE rates and a weaker pound. The NOK would probably not be strongly affected in such a scenario.

* Low, medium and high probability indicate 0-15%, 15-30%, 30-45%.
** Our assessment of changed probability since August.

DNB

Risks are not one-sided

Upside risks

Risk factors	Δ since August report**	Probability*	Comment
Wage growth and inflation remain unchanged	=	Medium	Policy must be kept ultra-expansionary for longer, laying the ground for a stronger compression of term and credit premiums. Continued loose financial conditions would spur economic growth further in the short term, and lift stock markets and emerging market investments. The NOK would probably not be strongly affected in such a scenario.
China's authorities adds fuel the economy	=	Medium	The government could get cold feet when the economic effect of its policy aimed at curbing financial imbalances becomes evident. Policy-induced accelerating growth will be positive for risk investments, including stock markets, emerging market inflows and commodity prices. This would support the NOK.
The oil price rises to 100 dollar a barrel	=	Medium	If a steep rise in the oil price is due to supply side effects, the impact on the global economy is unclear. For Norway, however, the impact will be unambiguously positive, paving the way for stronger wage settlements, earlier rate hikes and a stronger NOK.

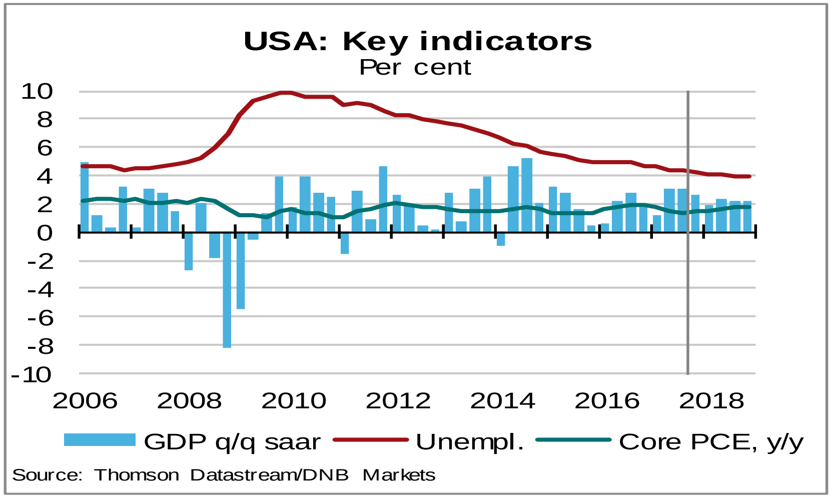
* Low, medium and high probability indicate 0-15%, 15-30%, 30-45%.
** Our assessment of changed probability since August.

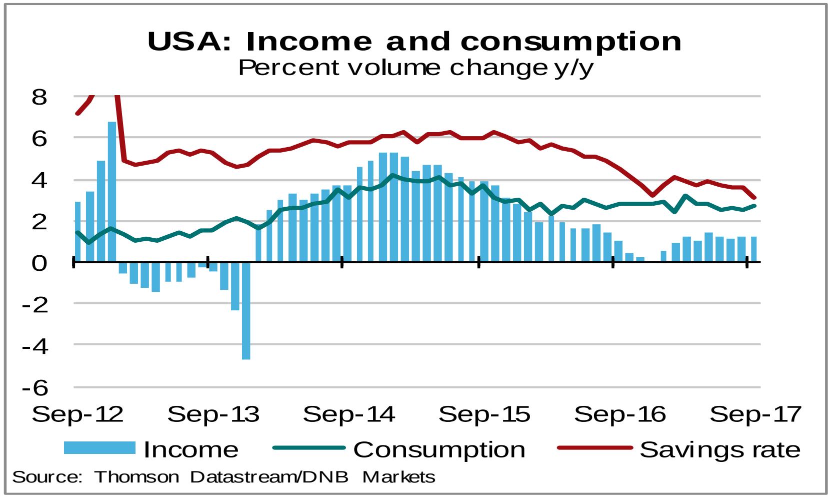
DNB

USA

Moderate growth despite tax reform

- We foresee only slightly higher growth next year. Consumer demand is likely to be hampered by continued weak real income growth as savings are already low. Tax reform is unlikely to boost consumer demand much, as high income earners will be main beneficiaries. However, tax cuts could lift business investments somewhat, in particular due to the full expensing of investments. The effects will likely be limited as the investment ratio is already high (in % of GDP) and the cycle is fairly mature.
- We expect GDP-growth at 2.4% next year, well above the potential. Hence, unemployment is forecast to drop further, albeit slowly. Core PCE-inflation will stay well below target for a while, but gradually approach the 2%-target.

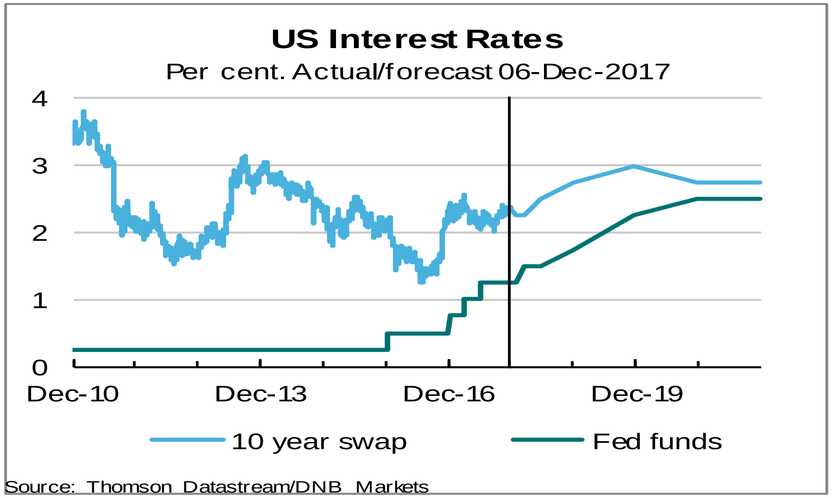


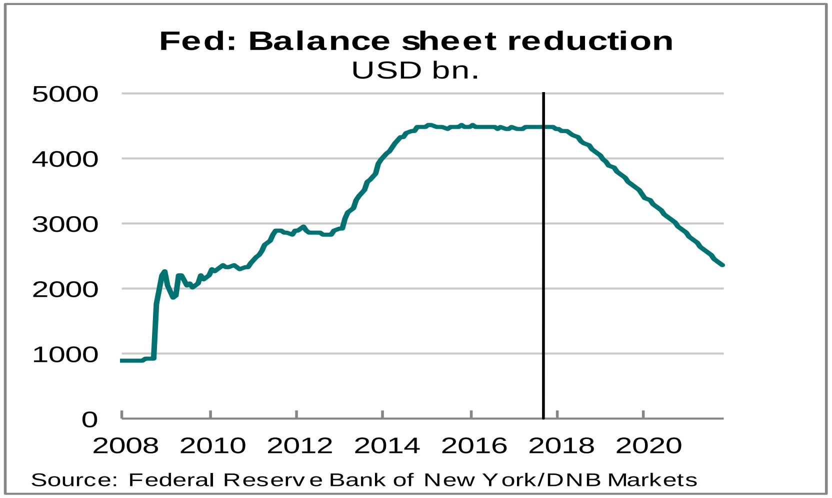


USA

Fed: Only two hikes in 2018

- We expect that Fed lifts the Fed funds target rate at the December-meeting. For 2018 we expect two hikes, in June and December. This is less than what the Fed's dot-chart from September indicated (three hikes).
- A tight labour market and higher expected inflation are the main reasons for continued tightening. Easy financial conditions adds to this argument. On the other hand, low actual inflation calls for a slower pace of rate hikes in 2018.
- We expect that Fed will continue the reduction of the balance sheet in line with the plan, ie. a gradual increase in the caps on reinvestments from 10 bn. USD per month now to 50 bn. USD per month in a years time.

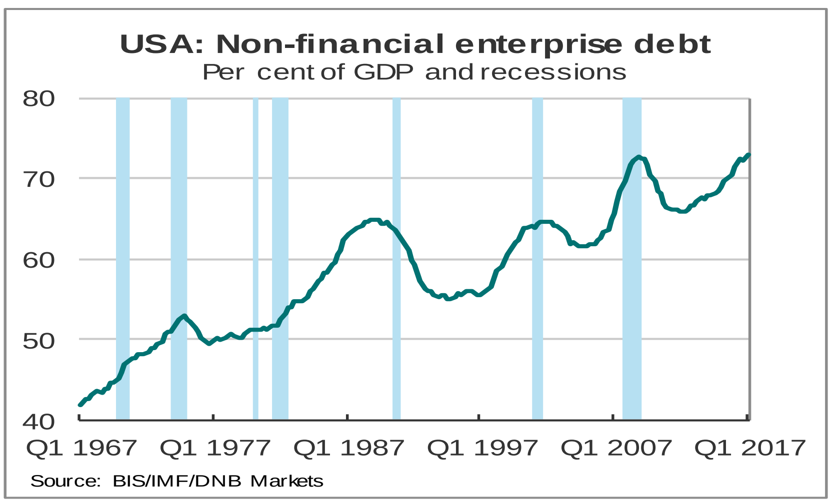


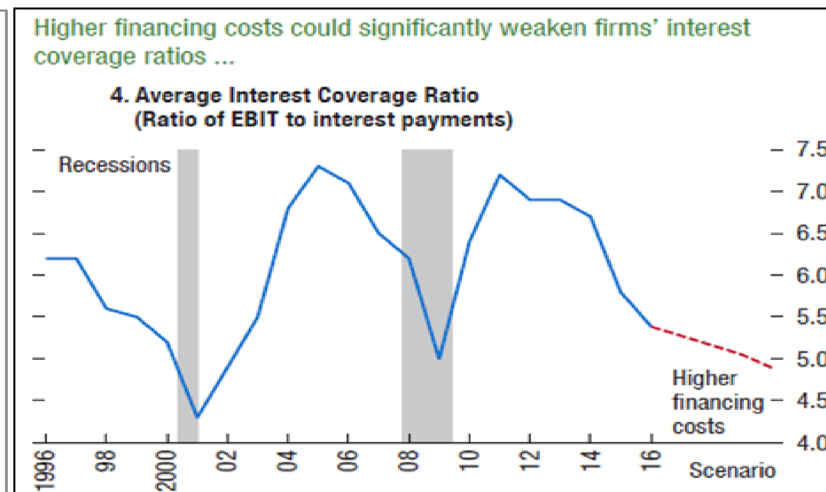


USA

Risk factor: High corporate debt

- The corporate debt level has been rising in recent years and is now at all time high in % of GDP. The average interest coverage ratio (ICR), ie. EBIT divided by interest expenses, has fallen to levels associated with previous recessions, and shows that the corporate sector is vulnerable to higher interest rates and credit spreads.
- The main downside risk to the economy seems to be an upside inflation surprise, which would imply more aggressive tightening from the Fed. Higher rates are likely to impact companies more than households as most mortgage loans have a fixed rate and as the household debt ratio is far below the pre-crisis level.



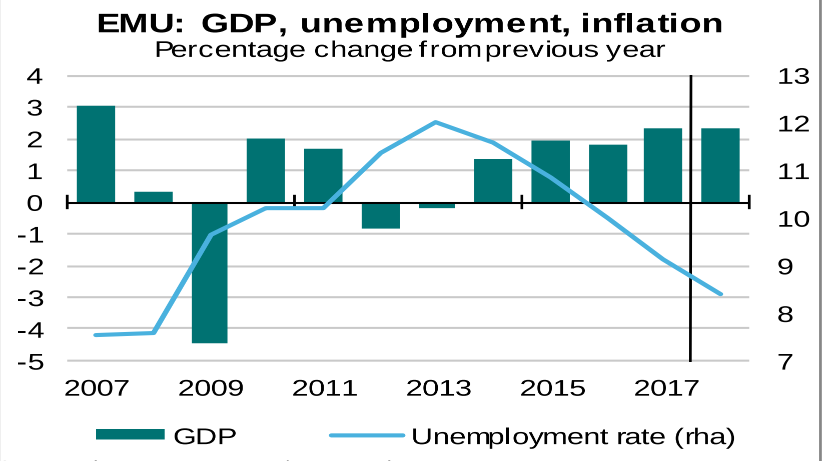


Source: IMF, GFSR April 2017, page 12.

Euro zone

Continued strong growth in 2018

- The economic upturn has been stronger than expected in 2017, and indicators are pointing to even stronger growth towards the end of the year. The positive trend is broad-based across regions and sectors. The strongest growth among the largest member countries is found in Germany and Spain (2.6 and 3.2%, respectively).
- We expect the growth pace to remain firm in the first half of 2018, but to slow down somewhat in the second half, as demand growth from China is decelerating.
- Unemployment may abate to 8.2% in Q4 2018, 0.7pp below the current level. A stronger labour market may lead to slightly higher wage growth and core inflation, but the effect of lower unemployment on wages is likely to remain modest.



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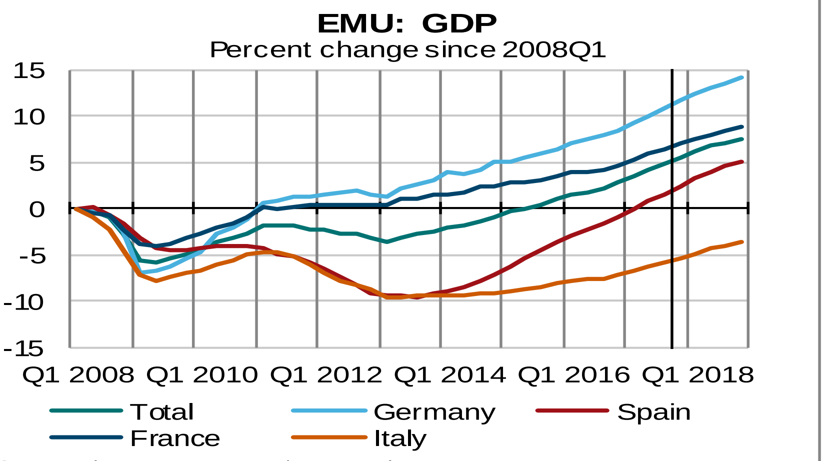
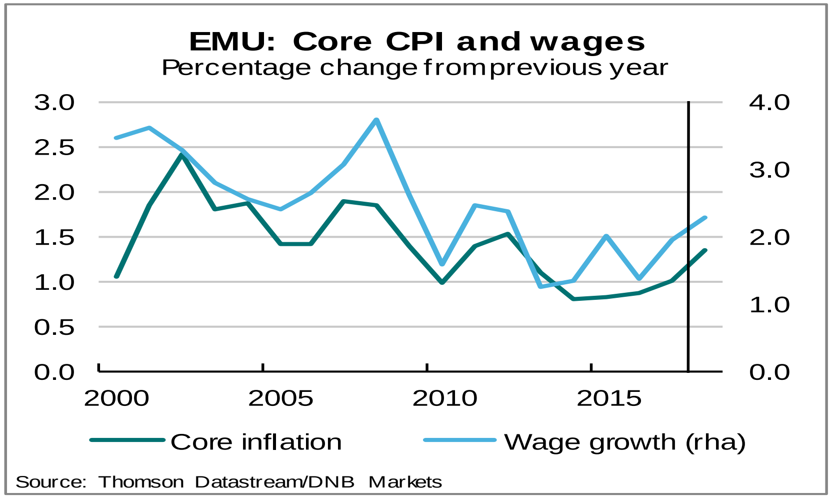


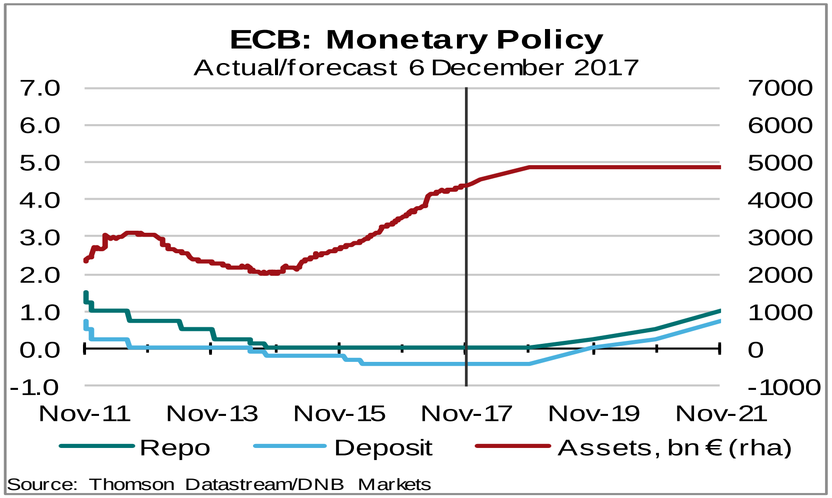
Source: Thomson Datastream/DNB Markets

Euro zone

QE to be ended by end-2018

- With continued strong growth – by euro zone standards – and slightly higher wage growth, the ECB will be ready to stop its extension of monetary policy stimulus by the end of 2018.
- We expect the central bank to buy assets for EUR30bn a month until September 2018, in line with their current plan, and thereafter taper purchases gradually to zero in Q4.
- In Q2 2019 we expect the ECB to be ready to lift the deposit rate to -0.25. In Q3 negative rates may be history, with the ECB lifting the deposit and the refi rate simultaneously, to 0 and 0.25%, respectively.

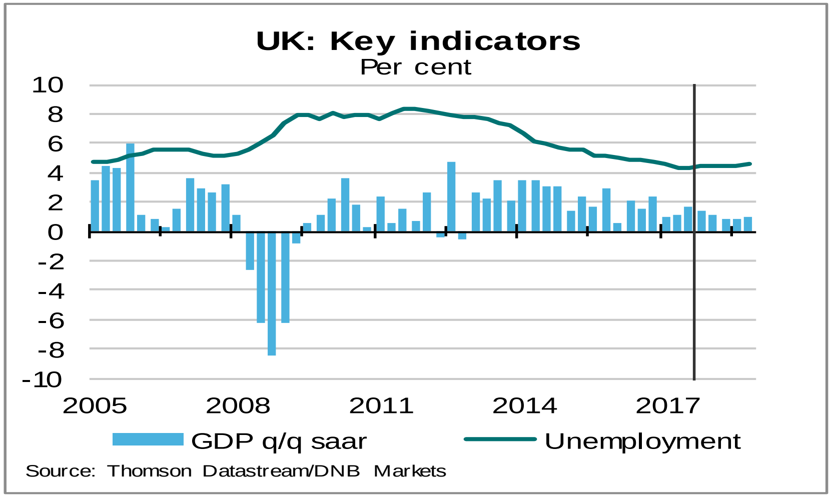


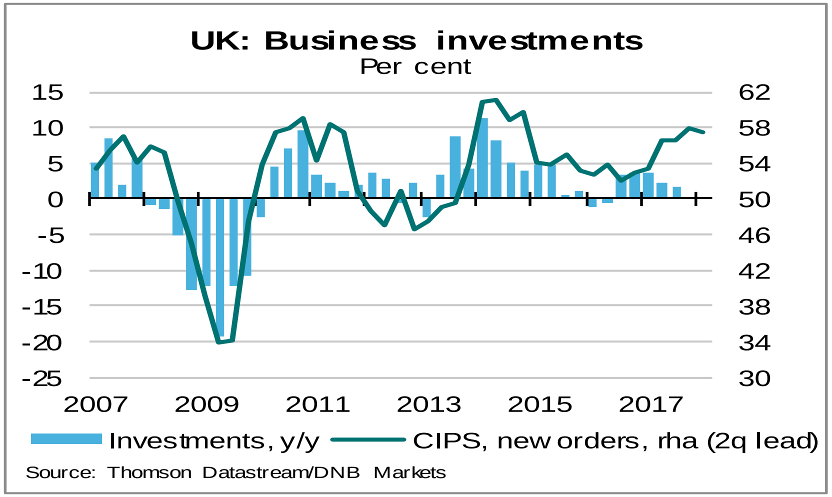


UK

Weak outlook due to Brexit-uncertainty

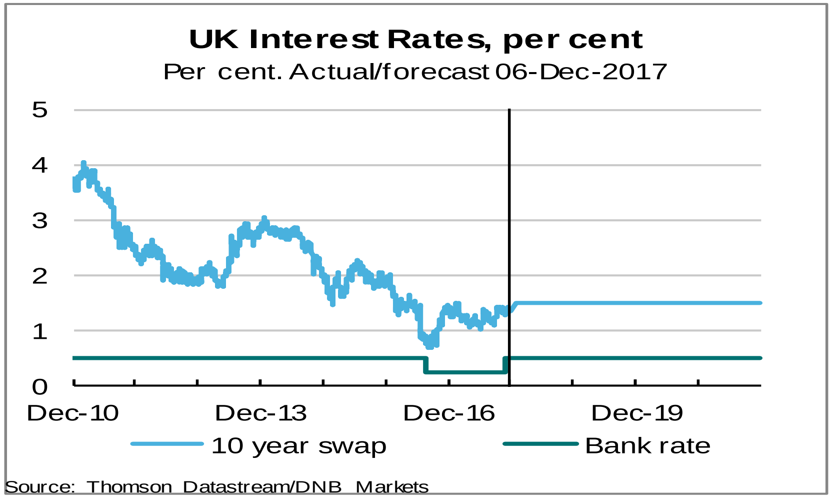
- Economic growth has slowed this year and we forecast continued weakness going forward. Household demand will continue to be held back by low income growth, given that the savings rate is already low. Business investments will likely remain weak due to Brexit-uncertainty. The latter is reinforced by limited progress in Brexit-negotiations so far.
- We forecast GDP-growth at 1.1% in 2018. Inflation is expected to fall to 2.5% next year before falling further towards the 2%-target. The unemployment rate will likely reach a trough early next year and start rising gradually, as GDP-growth is falling below potential.

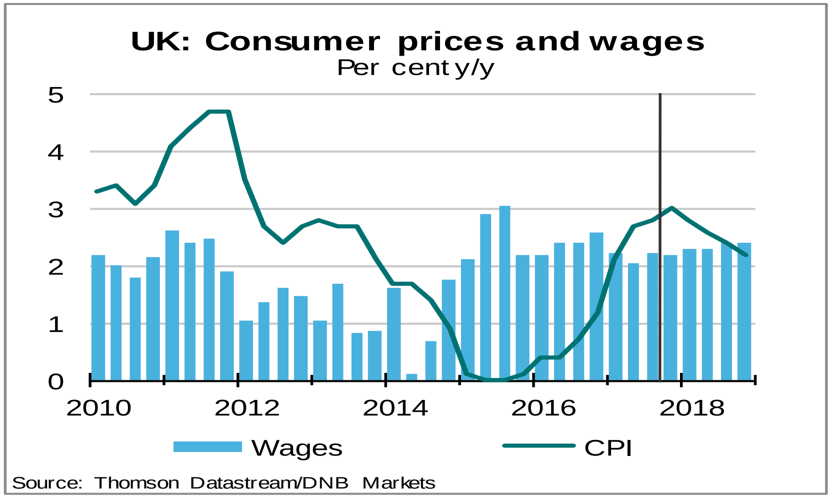




«One and done» from Bank of England

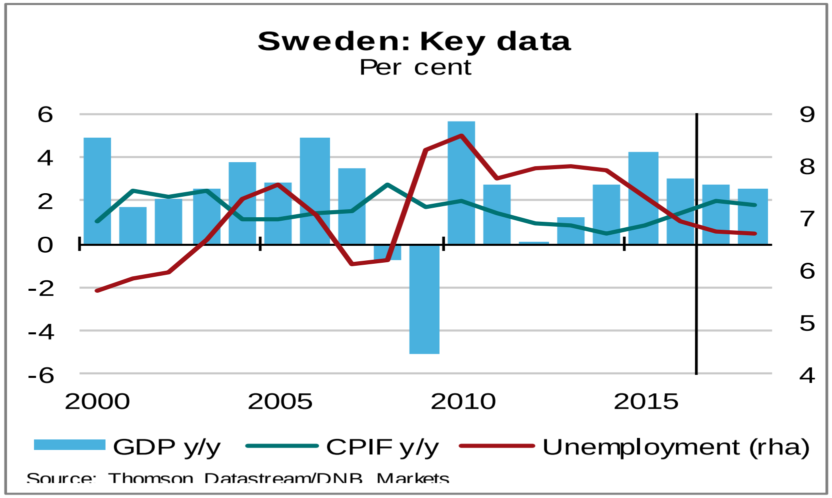
- BoE hiked the Bank Rate by 25bps. at the meeting in November, but indicated that the continued tightening would be “at a gradual pace and to a limited extent”, in other words a very cautious approach. Based on our below consensus forecasts for GDP and inflation in 2018, we do not believe that BoE will hike at all next year.
- Our view is supported by the fact that the inflation overshoot is primarily caused by the GBP-weakening and is hence temporary. Most likely inflation will fall substantially during the course of 2018. Furthermore, wage growth is still very low and stable despite the low unemployment rate. The market is not prising in another hike until the autumn of 2018.

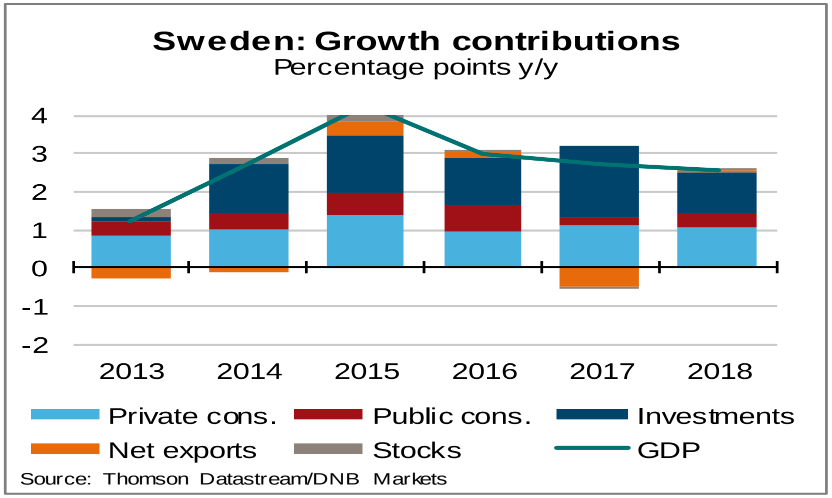




Swedish economy still booming

- GDP-growth remains solid, primarily due to strong investment growth, especially for housing. Weaker housing investments are set to slow investment growth somewhat in 2018. Private consumption is growing at a stable rate, while public consumption growth is expected to increase somewhat in the election year 2018. Export growth is decent, but net exports are pulled down by strong import growth.
- GDP-growth is projected to slow from 2.7% this year to 2.5% in 2018. Unemployment will remain at 6.7%, as the natural unemployment rate is increasing due to a larger share of immigrants in the labour force. Inflation is expected at 1.9% in 2017, but is likely to edged down to 1.8% in 2018.

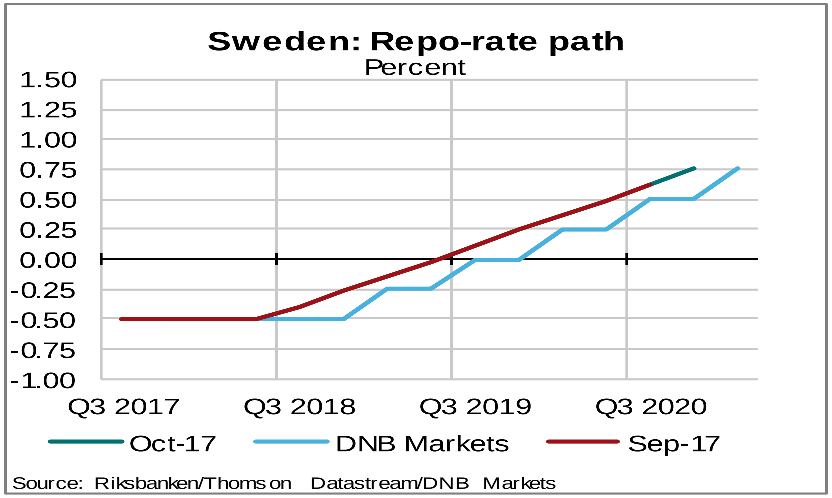


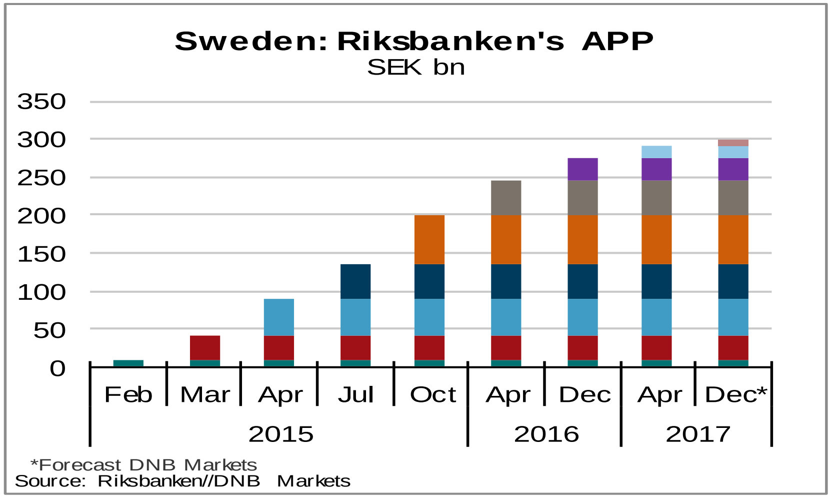


Sweden

Riksbanken to extend QE in H1 2018

- Wage growth is slowly picking up with higher resource utilisation, but will remain moderate going forward. The positive contribution to inflation from the SEK depreciation and higher energy prices will be smaller in 2018 than in 2017, hence inflation will fall from 1.9% in 2017 to 1.8% in 2018.
- Riksbanken is likely to extend QE by 10bn SEK in H1 2018 despite booming economy and inflation close to target. The Riksbank is unlikely to deviate too much from ECB's policy unless inflation overshoots target. We expect a first rate hike in February 2019, somewhat before the ECB.

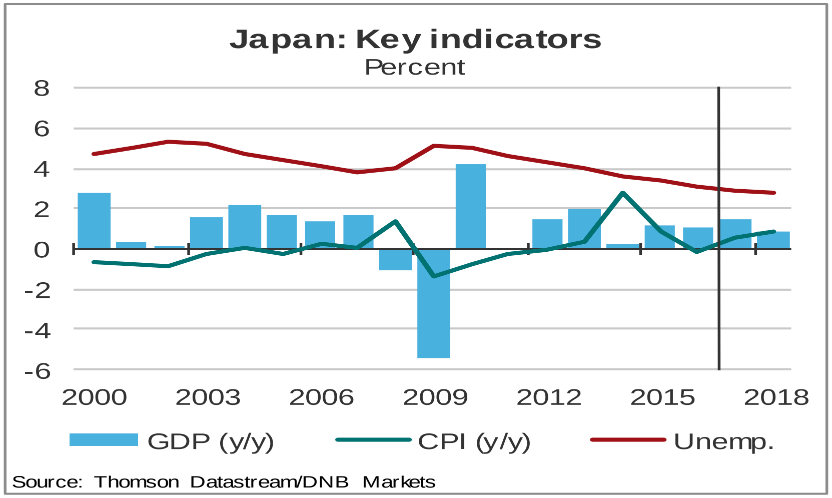


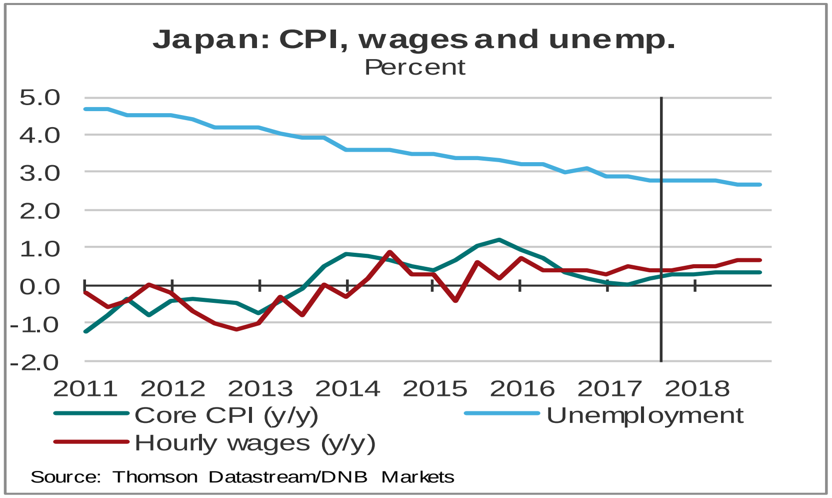


Japan

Growth to slow, inflation well below target

- Strong economic growth in 2017, driven by solid rise in household consumption and a positive contribution from exports. The latter due to both high growth in China and improved demand from the US and the euro zone.
- The labour market has tightened, with unemployment down to 2.8%. Still, wage growth is weak, reflecting demographic factors, rising part-time employment and adaptive inflation expectations. Hence, core inflation has remained low at 0.1%.
- We expect GDP to rise by 0.9% in 2018. The slowdown owes to weaker growth in China and somewhat lower growth in household demand. Core inflation is expected to edge up by 0.2pp to still-low 0.3% in 2018.

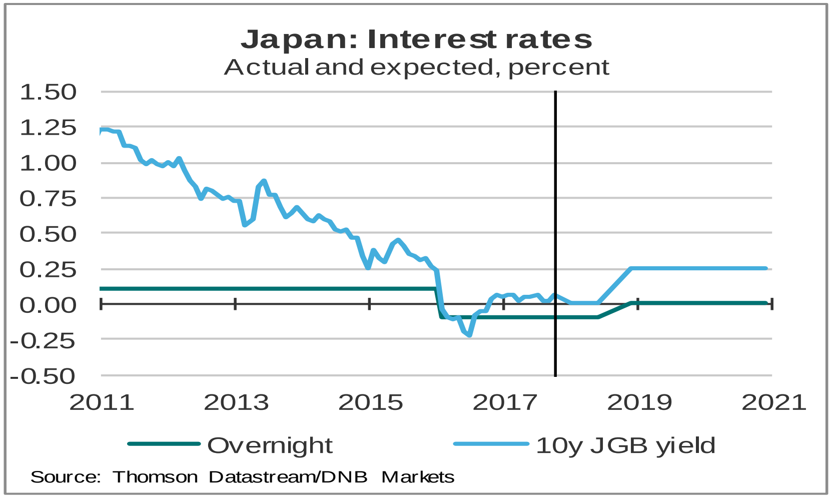


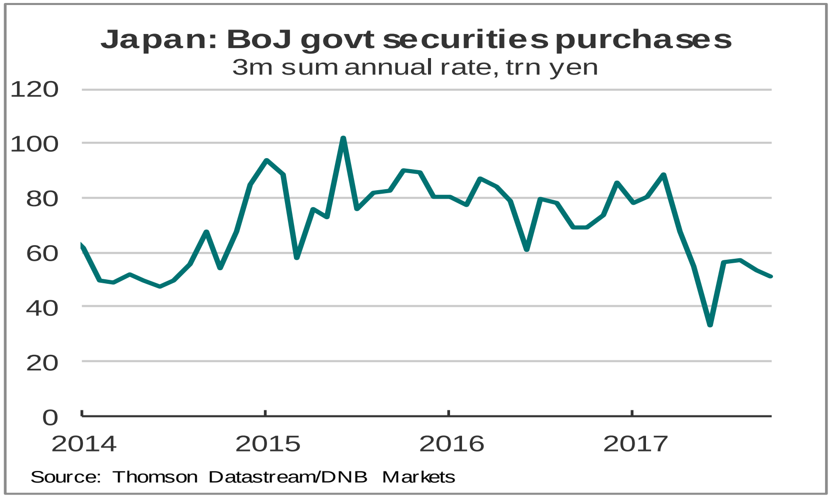


Japan

Bank of Japan to adjust monetary policy in 2018

- With inflation well below target at 2% we expect monetary policy to remain highly accommodative in the foreseeable future.
- However, in light of recent signals from the BoJ about the existence of a “reversal rate” – that is the rate at which accommodative monetary policy reverses its intended effect and becomes contractionary for lending – we now expect the BoJ to hike interest rates once in October 2018. QE expected to unwind in H2-2019.
- The short-term rate is expected up 10bps. to 0% while the target for the 10y yield is expected up from ~0% to ~0.1%. Thereafter interest rates are expected to remain unchanged. QE will go on until 2019, but in a gradually decreasing pace.

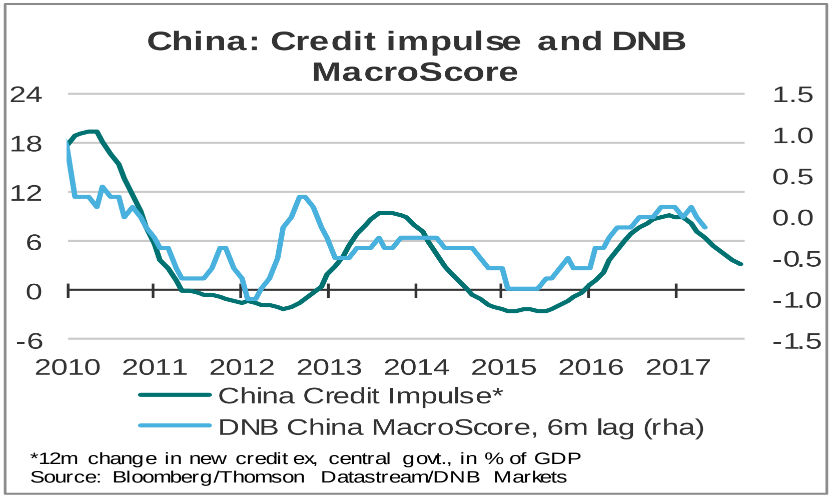


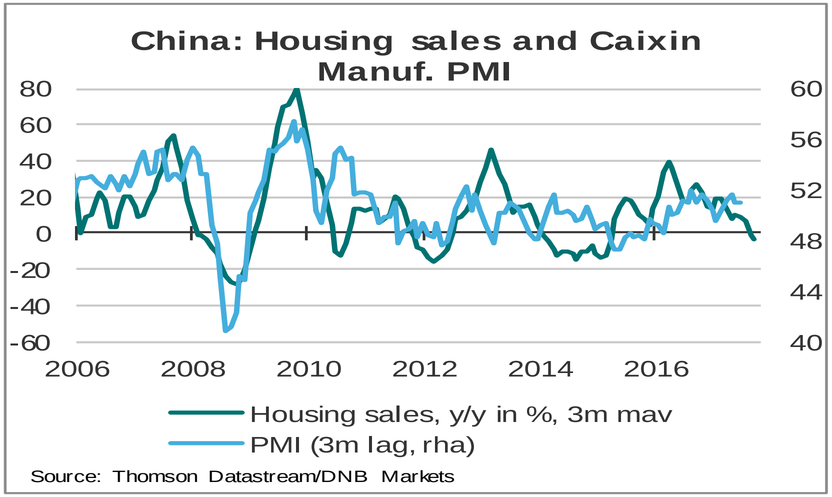


China

Credit-driven slowdown in 2018

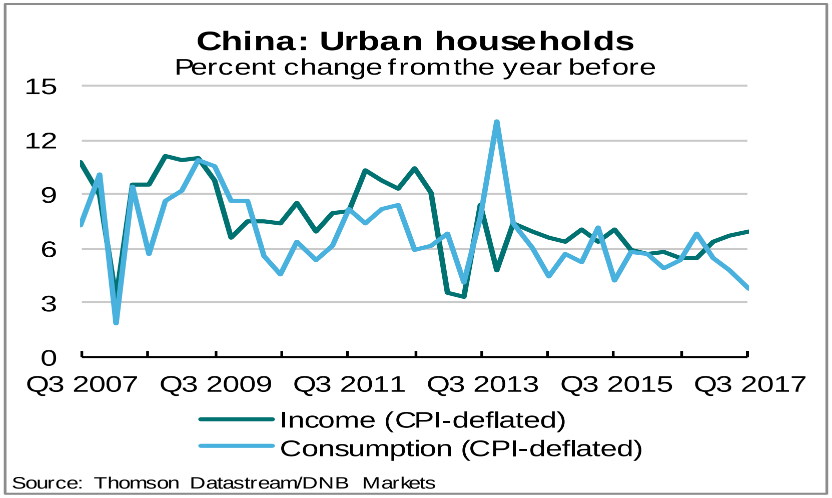
- The cyclical recovery that has taken place since 2015 has come to and end, and there are clear signs that the economy have started to slow. The main driver behind the slowdown is tighter credit policy, which combined with stricter home purchase restrictions, has led to a slowdown in the real estate sector. However, investments in other sectors are also slowing, with fixed asset investment growth at its slowest ever in the 2000s.
- The slowdown in real estate is starting to make an impact on other sectors, but the spill-over effects are likely to amplify in 2018. Consequently, underlying GDP growth is expected to slow to around 5% in 2018, down from around 6.3% in 2017.





No further tightening of monetary policy

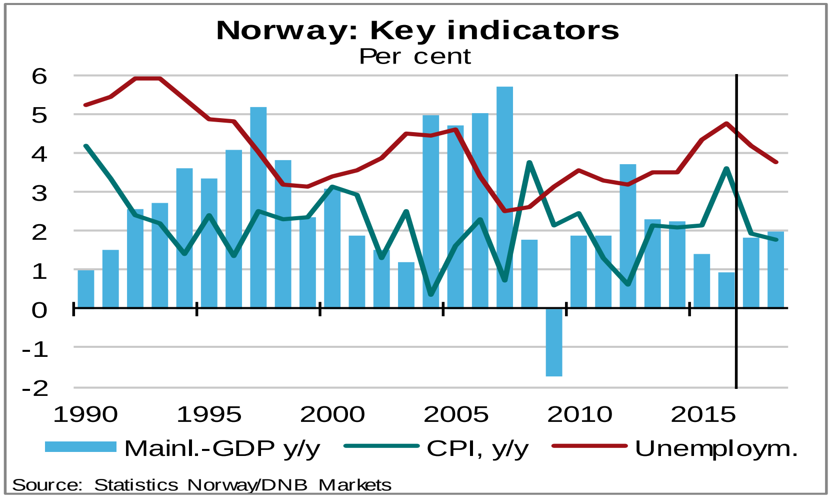
- The risk to our forecast is somewhat skewed to the downside. Firstly, there are signs that the household sector is slowing down, with both retail sales and NBS' household survey indicating weaker growth in consumer demand. Secondly, the government has intensified its effort to improve the environment, partly by freezing production in heavy industries and partly by suspending new investments.
- On the other hand, we no longer expect further tightening of monetary policy, as the housing market is already showing clear signs of a slowdown. Moreover, with credit growth slowing and new regulations being implemented in the financial sector, there is less need for monetary policy tightening to curb financial risks.

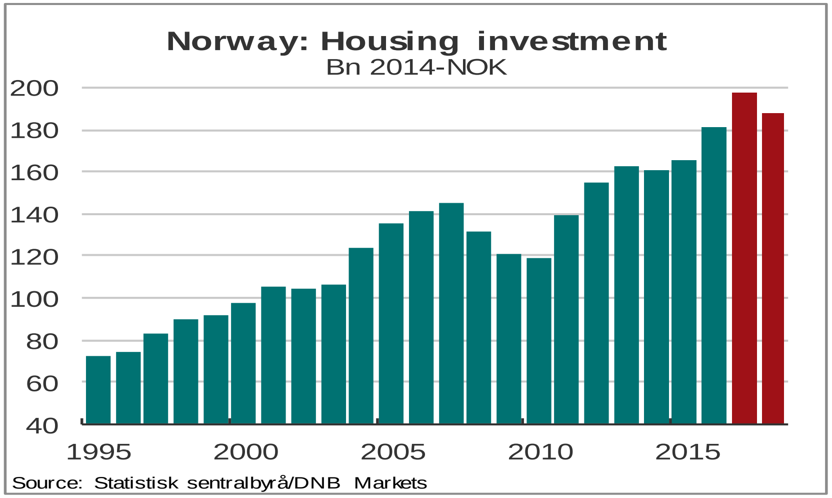


Norway (I): Main points

Growth is picking up, but remains moderate

- Growth picked up in 2017 due to a smaller drag from oil investments, higher private consumption and a marked rise in housing investments. Private consumption is expected to hold up in 2018 due to higher income growth and business investments are rebounding after several years of weak growth. A slowdown in housing investments will dampen growth in 2018.
- In sum, we forecast mainland GDP growth at 1.8% in 2017 and 2.0% in 2018. Unemployment is likely to edge further down while wage growth will pick up somewhat. Inflation will stay low due to continued moderate wage growth and a weak contribution from imported price growth.

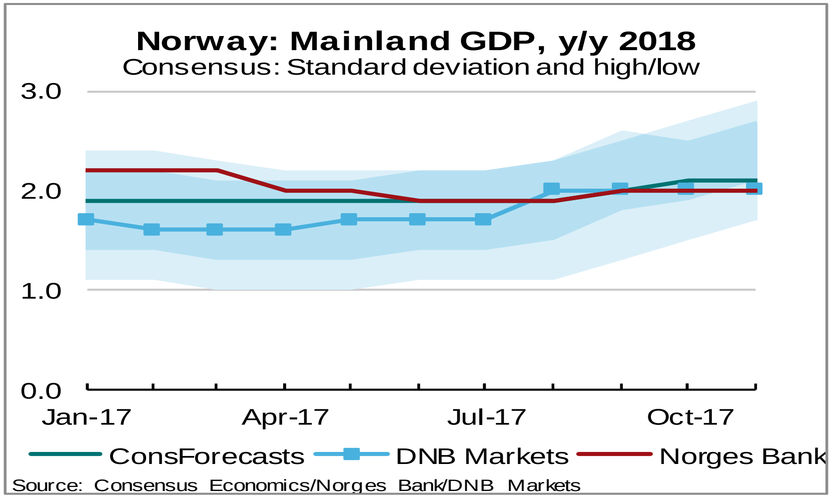


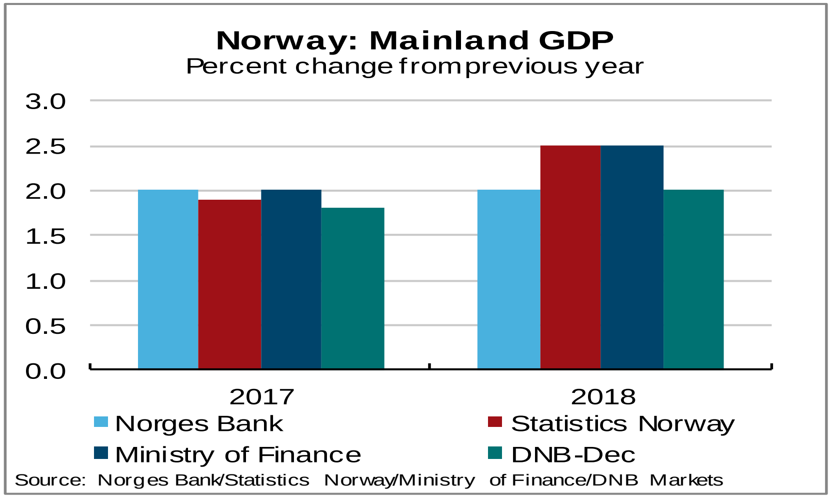


Norway (II): Main points

Growth projection for next year unchanged

- Forecast for mainland GDP growth in 2017 is adjusted down from 2.0% (Aug. forecast) to 1.8%, mainly due to data received so far this year. The Consensus' forecasts for 2017 are more or less unchanged.
- The growth forecast for 2018 is unchanged at 2.0%. We have revised down our estimates for housing investments and public investments. On the other hand, we have lifted our forecast for private consumption, oil investments and business investments.
- Our 2018 forecast is more negative than Statistics Norway and the Ministry of Finance, but in line with Norges Bank and slightly below consensus.

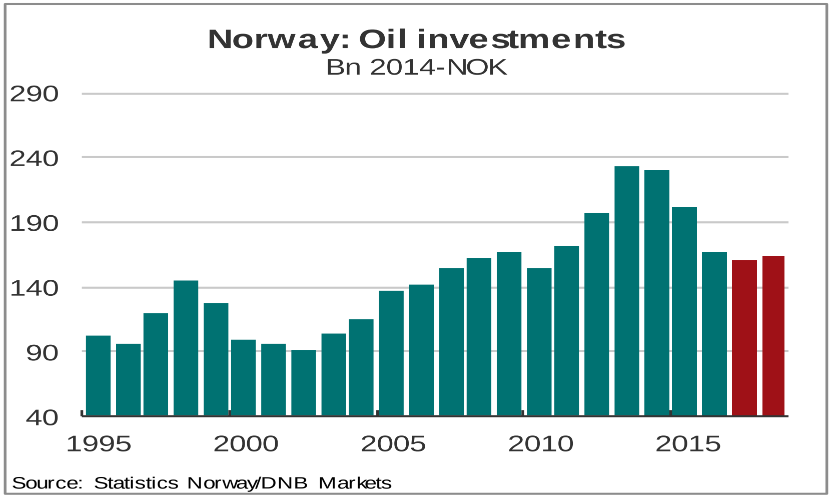


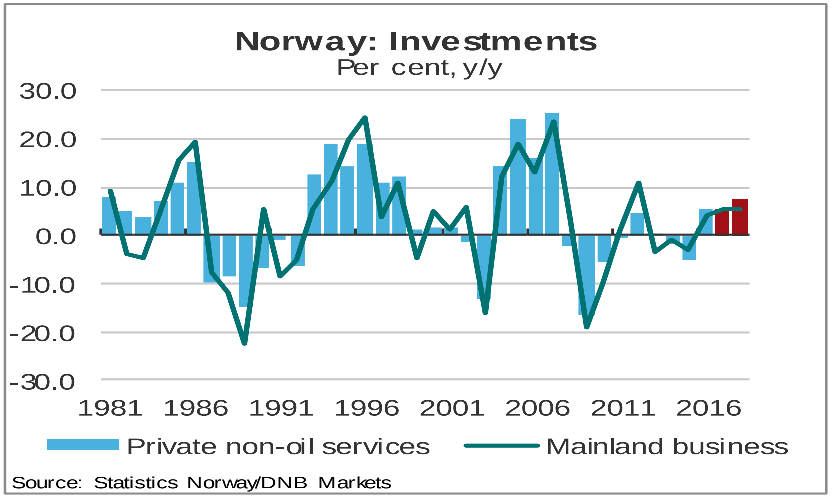


Norway (III): Growth drivers

Investments in oil and businesses to pick up

- Oil investments will likely reach a trough in 2017, after falling markedly from high levels in 2015 and 2016. In 2018 oil investments are projected to increase slightly.
- Mainland businesses' investments have been weak for several years and their share of GDP is relatively low. We expect these investments to pick up with stronger prospects for demand.
- Private consumption is projected to increase by 2.4% in 2017 and 2.2% in 2018.
- Momentum in private consumption has slowed somewhat lately, and a weak housing marked poses a downside risk to consumption ahead.

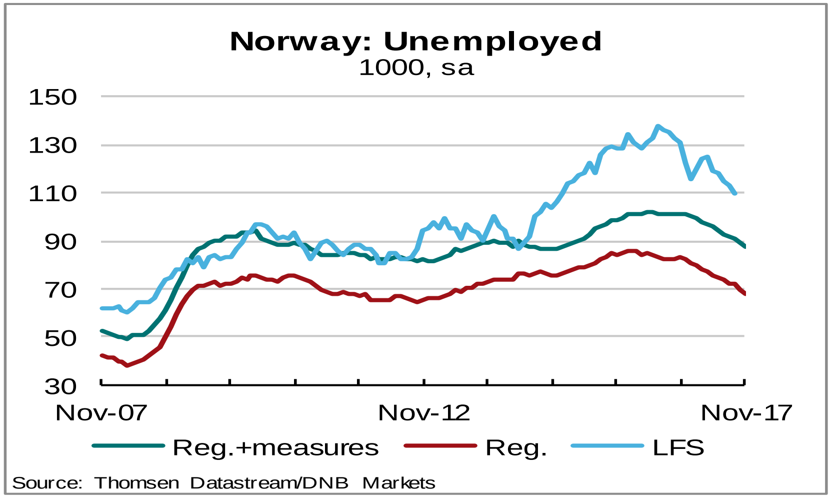


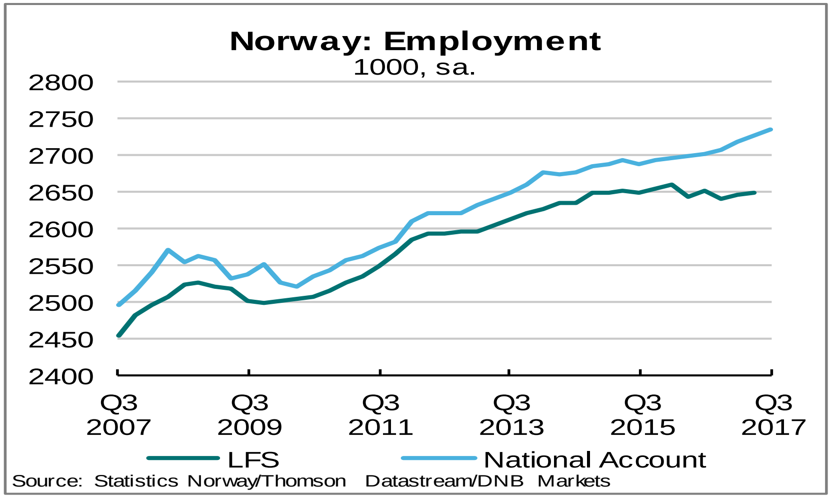


Norway (IV): Labour market

Unemployment to edge further down

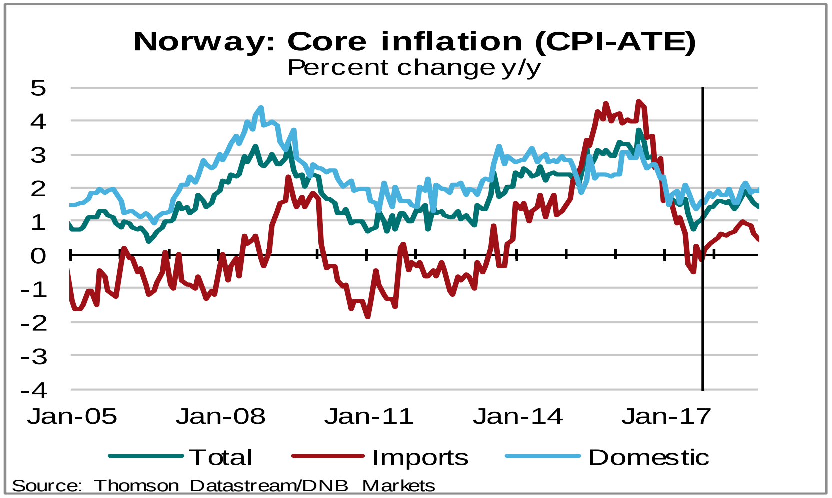
- Unemployment has decreased substantially from mid-2016, both measured by the labour force survey (LFS) and registered unemployment from the unemployment benefit office (NAV). Employment has picked up the last three quarters according to National Accounts, while LFS-employment is weaker. We put more emphasis on the National Accounts due to potential measurement errors in the LFS survey.
- We expect employment to continue up in 2018 and LFS unemployment to fall from 4.2% in 2017 to 3.8% in 2018. We forecast registered unemployment at 2.7% in 2017 and 2.5% in 2018.

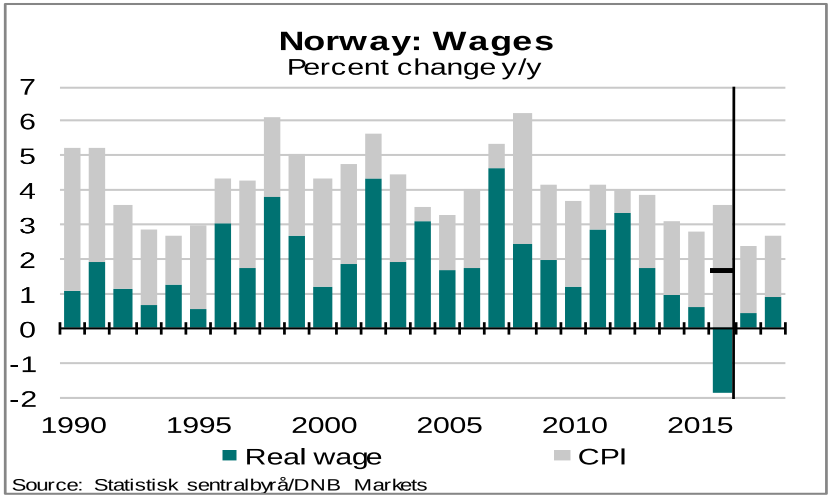




Inflation to remain below target

- Inflation has fallen more than expected in 2017. However, during the autumn the NOK has fallen substantially, a development that improves the outlook for 2018 inflation. As these two effects cancel each other out, our forecast for core inflation in 2018 is unchanged from the August report, at 1.5%.
- Very low wage growth last year was partly caused by structural changes. We expect wage growth to increase in line with this year's agreed benchmark, and believe that the social partners will aim at wage growth in line with the trading partners in the coming years. A tighter labour market might contribute to lift wage inflation 0.2pp to 2.7% in 2018 compared to our previous forecast.

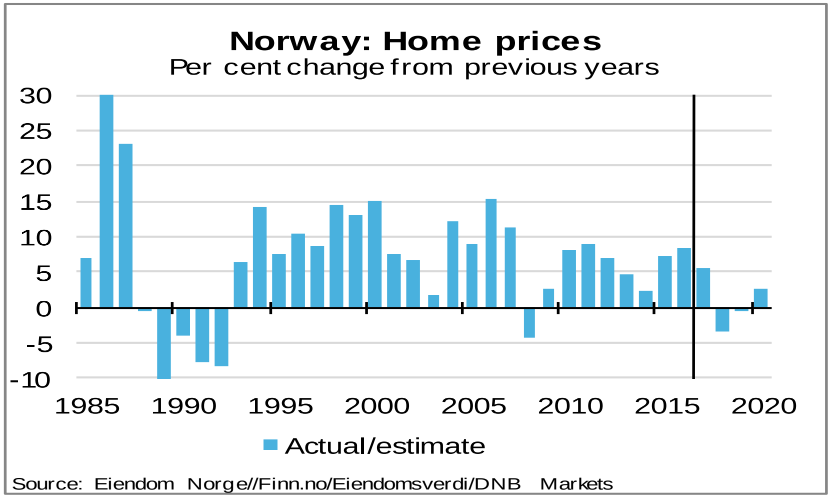


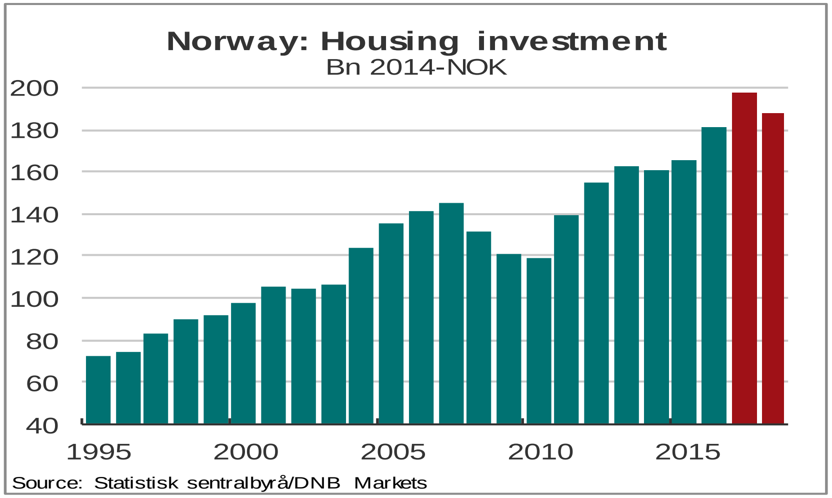


Norway (VI): Housing market

Home price growth abates as expected

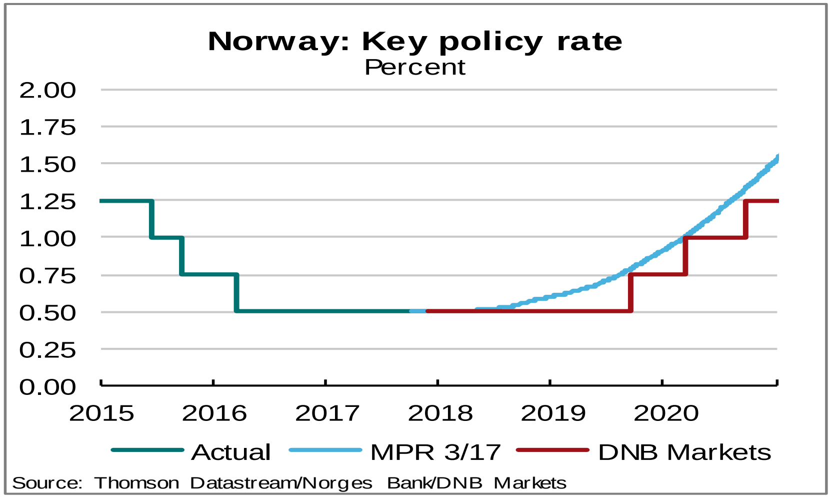
- Home price growth has dampened so far this year in line with our August forecasts. A very rapid growth in 2016 and tighter regulations from beginning of 2017 contributed to the turnaround.
- A strong increase in unsold homes indicates that prices may fall for a longer time than previously expected. We now expect home prices to fall throughout 2018. Which such a development, home prices will decline by 3.5% from 2017 to 2018.
- Improved income growth, improved labour market, stable interest rates and falling housing investments prevent prices from falling more. Moreover, taxation for home owners remains favourable.

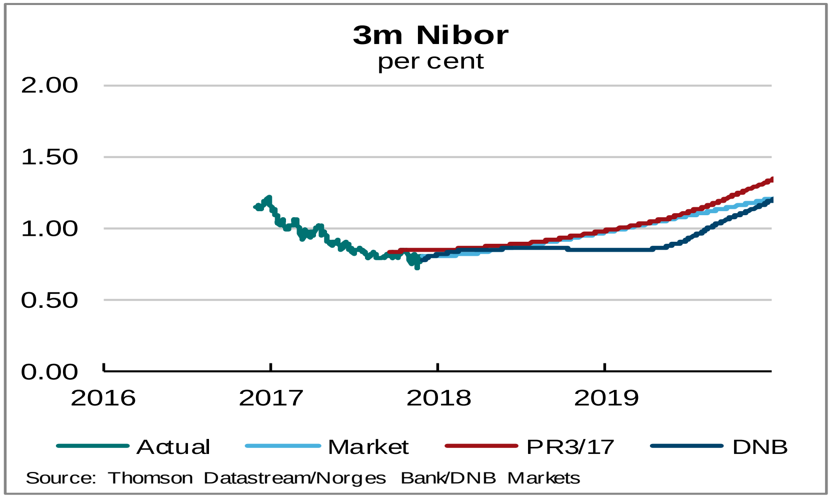




Unchanged rates the whole forecast period

- Norges Bank's rate path from September indicated a first rate hike in June 2019. The fall for NOK during this autumn will probably contribute to a higher path in the monetary policy report in December indicating first rate hike in March 2019.
- With a slightly stronger NOK, low inflation and moderate wage growth domestic conditions will not call for a near-term hike. Neither will external conditions, with unchanged ECB and Riksbanken rates until Q2 2019.
- In such a setting we think Norges Bank will lag behind the ECB. Thus we expect the first rate hike in September 2019.





Norway (VIII):Monetary Policy

Factors that can trigger a rate hike in 2018

Risk factors	Probability	Probability of 2018-hike	Comment
Weak NOK lifts inflation	High	Low	EURNOK at 10.0 in 2018 will, according to our model, lift inflation by 0.3-0.7pp in 2018-2020. It is a temporary effect, and core inflation will remain below target. Hence Norges Bank is unlikely to respond with a rate hike.
ECB hikes in 2018	Low	High	ECB might end QE by September witch could open for at rate hike late in 2018. This would require a substantial pick-up in wage growth, which we do not consider to be likely. A 2018 ECB hike is likely to trigger a Norges Bank hike, in the absence of other negative surprises,
Housing prices turns upwards	Low	Medium	If housing prices move upwards again, the consideration of financial imbalance risks will favour a rate hike. Norges Bank would still need to se inflation and capacity utilization improving before hiking.
Wages increase substantially	Low	High	The labour market might tighten more than we assume, and this could trigger higher wage growth. We consider it quite unlikely that wages pick up already in 2018. But if they do, Norges Bank could definitely hike in 2018.

* Low, medium and high probability indicate 0-15%, 15-30%, 30-45%.

DNB

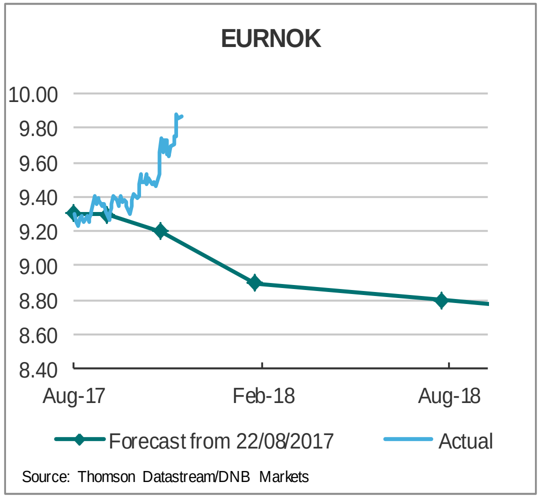
Norway (IX):

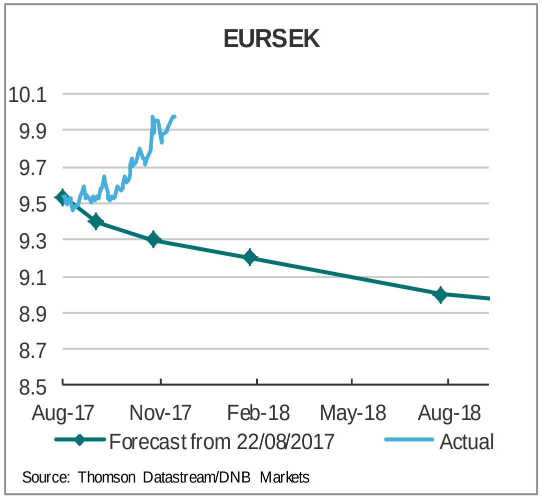
Economic Forecasts for Norway

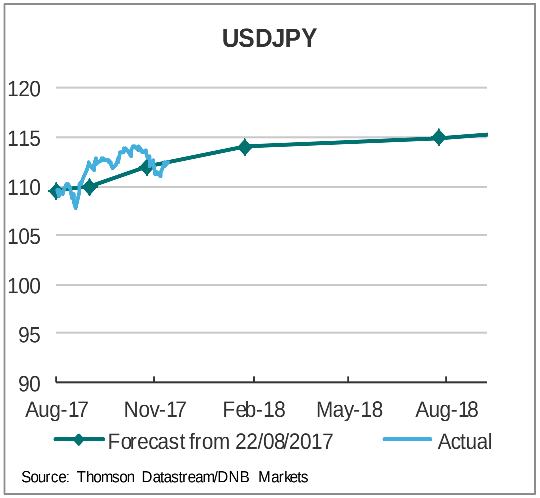
Norway: Economic Outlook. Annual growth, per cent					Difference from August pp.		
	2015	2016	2017	2018	2016	2017	2018
Private consumption	2.6	1.5	2.4	2.2	-0.1	0.3	0.1
Public consumption	2.4	2.1	1.9	1.8	-0.1	-0.2	0.1
Offshore investments	-12.2	-16.9	-4.0	2.0	-0.5	0.7	2.1
Mainland investments	-0.2	6.1	5.6	1.0	-0.1	0.7	-1.0
Private companies	-2.8	4.1	5.4	5.3	1.0	3.1	0.6
Housing	3.2	9.0	9.3	-5.0	-0.9	0.2	-2.5
Public	0.2	5.9	1.7	2.0	-1.0	-2.3	-1.5
Traditional goods exports	6.9	-8.2	2.0	3.6	0.0	0.8	0.3
Traditional goods imports	3.2	-0.4	2.8	2.0	0.7	-0.7	-0.1
GDP	2.0	1.1	2.1	1.9	0.0	0.6	0.4
- Mainland-Norway	1.4	1.0	1.8	2.0	0.1	-0.2	0.0
Employment	0.5	0.3	1.1	1.1	0.0	0.7	0.2
Unemployment rate (LFS), %	4.4	4.8	4.2	3.8	0.0	-0.1	-0.4
Wages	2.8	1.7	2.4	2.7	0.0	0.0	0.2
Inflation	2.1	3.6	1.9	1.8	0.0	-0.2	0.2
… Core inflation (CPI-ATE)	2.7	3.1	1.4	1.5	0.0	-0.2	0.0
Saving ratio, %	10.7	7.2	7.0	7.3	0.0	-0.2	-0.1
Existing home prices	7.2	8.3	5.4	-3.5	0.0	-0.3	-0.9
3m NIBOR, %	1.3	1.0	0.9	0.9	0.0	0.0	0.0
Oil price, USD/Brl	53	45	55	61	0.0		
EURNOK		9.3	9.3	9.5	0.0	0.1	0.6
USDNOK	8.1	8.4	8.3	7.9	0.0	0.1	0.5

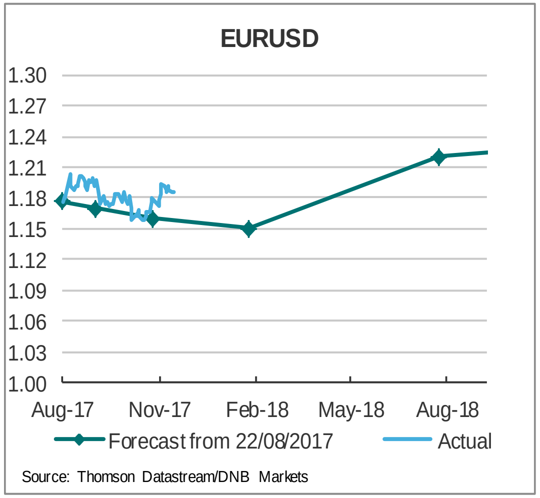
Source: Statistics Norway/DNB Markets December 2017

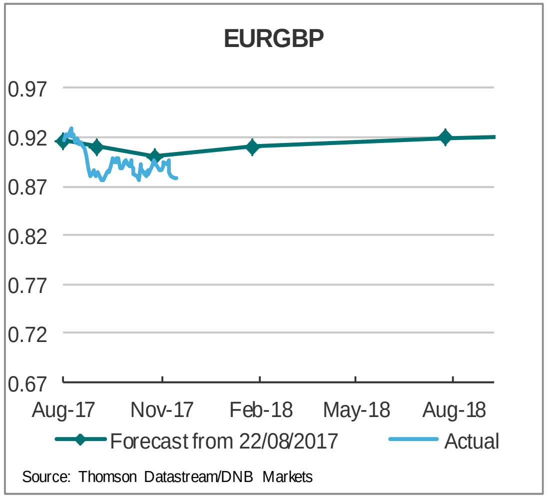
FX development since August report

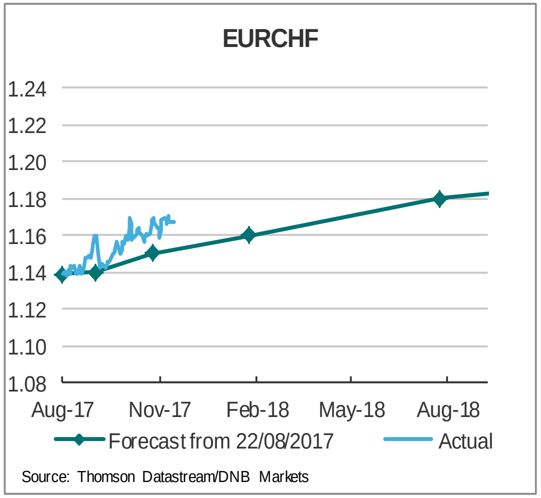








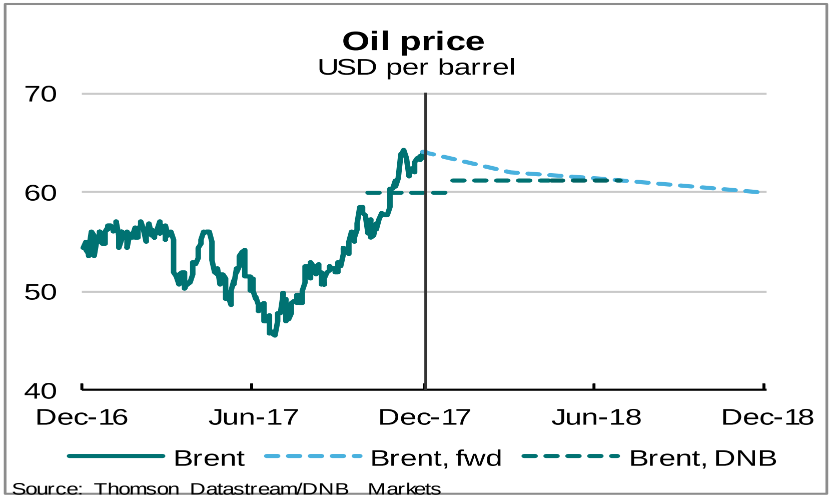


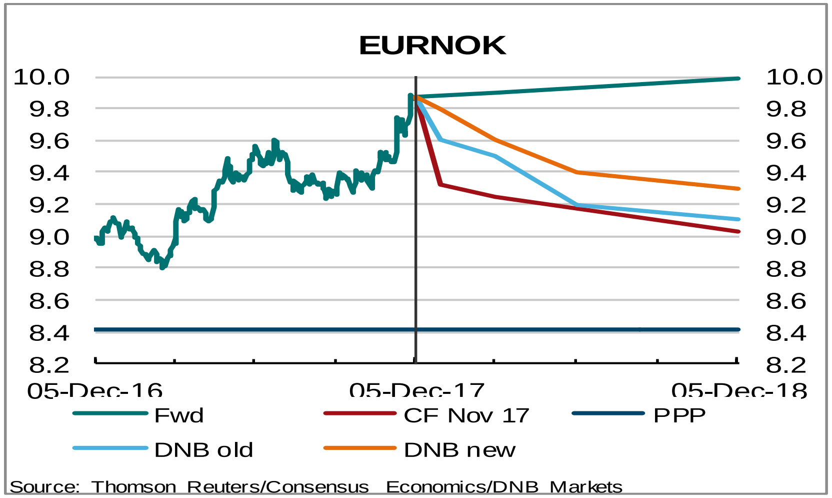


NOK (I)

Limited NOK support from fundamentals…

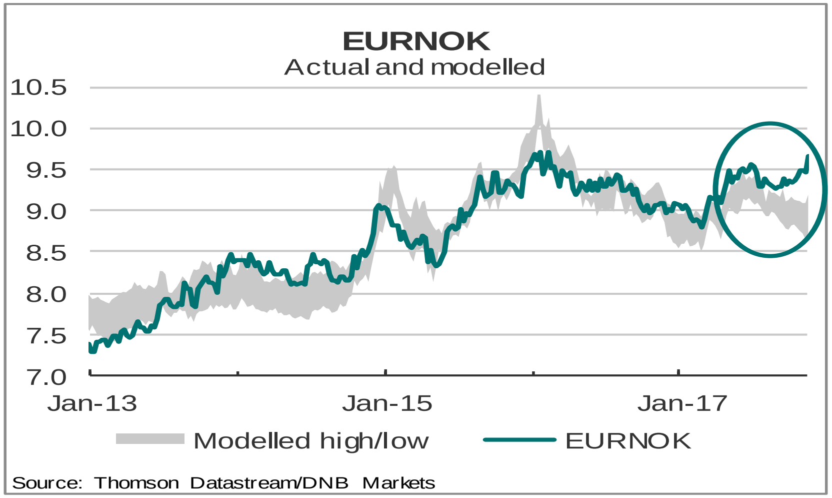
- Macro momentum remains soft, and we expect moderate growth ahead.
- We see a tendency for NOK to reconnect to oil, but see limited support ahead.
- Housing market worries will remain, but will weigh less on the NOK into next year.
- Speculative accounts looks to be short NOK into year-end, while commercials should have limited ammunition to take advantage of weak NOK.
- Valuation remains NOK positive, with an upwards revision of the Norges Bank interest rate path next week a likely catalyst.
- We lift forecast for EURNOK, seeing EURNOK @9.60 in 3M and @9.30 in 12M.

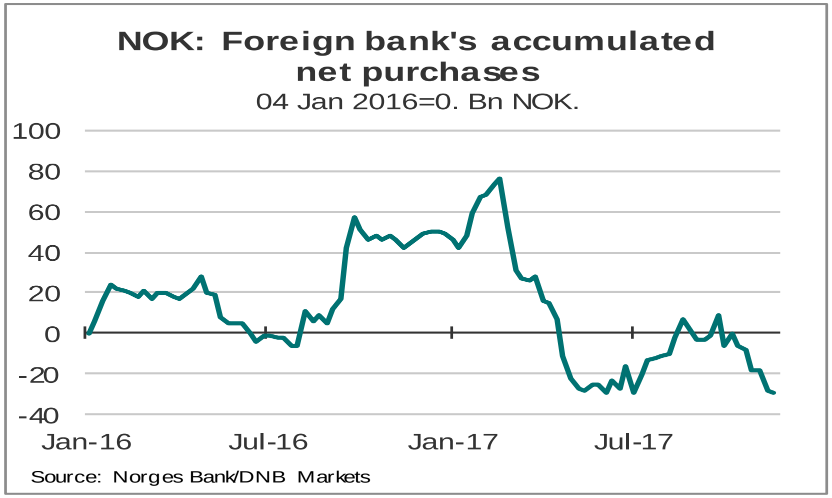


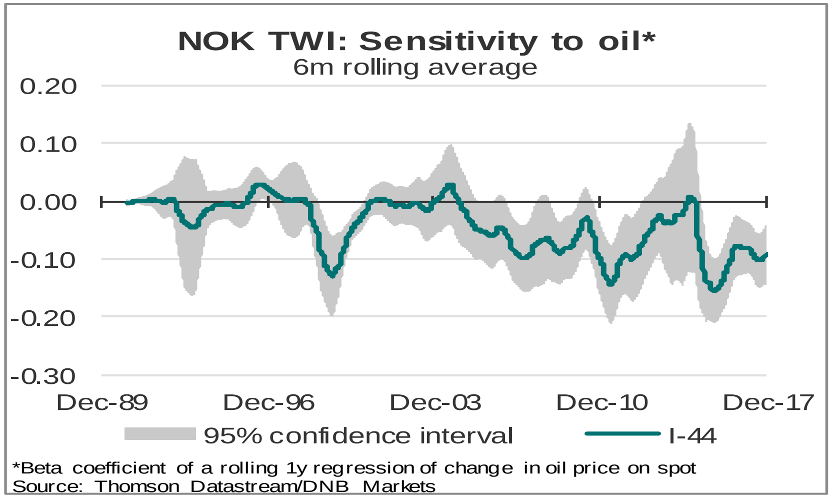


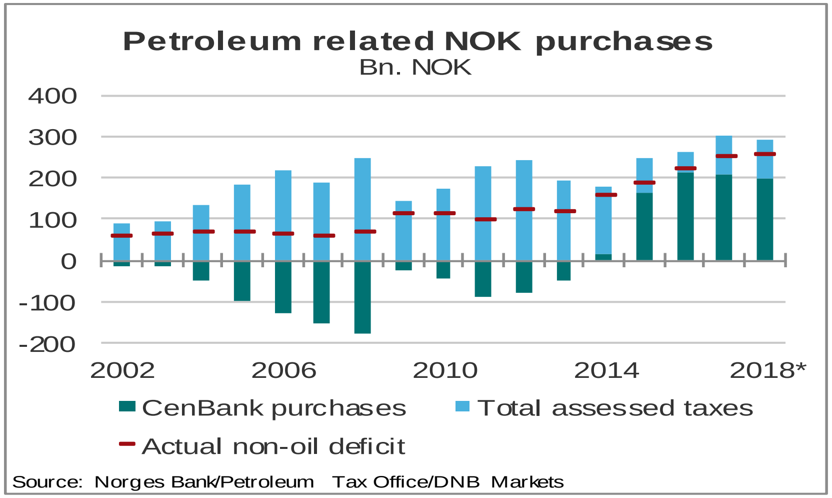
NOK (II)

…but valuation attractive





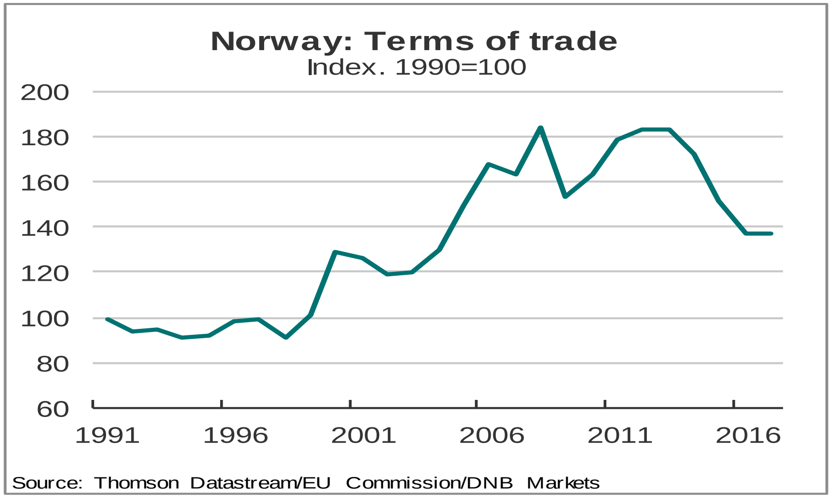


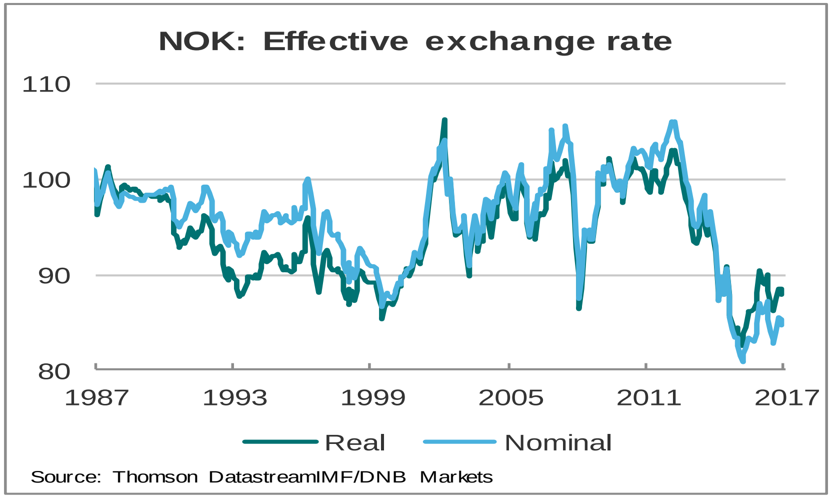


NOK (III)

A weaker new normal for the NOK

- The real NOK exchange rate (REER) has depreciated since 2014, mainly due to a nominal depreciation as terms of trade has deteriorated.
- Should incentivize investments in non-sheltered sector, lifting productivity and thus lead to a REER appreciation, of magnitude depending on relative productivity.
- We do however expect mainland investments to outperform non-sheltered in coming years, as subdued petroleum activity weigh on related industries.
- However, as per our 12M forecast, some of the nominal depreciation is seen as overdone. Thus, we lift our 4y target for EURNOK by 5% to 8.80.

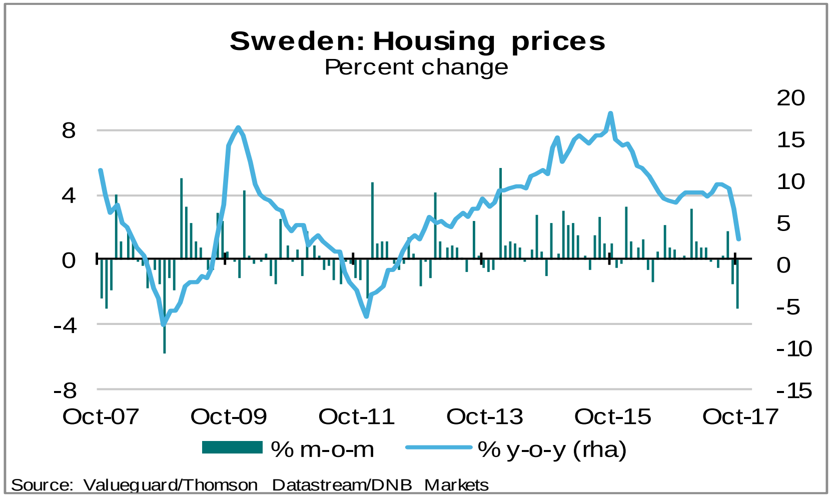


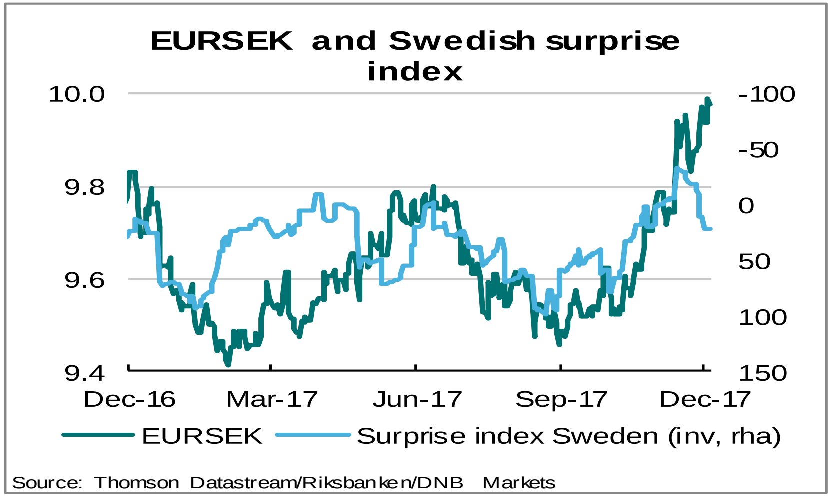


EURSEK (I)

Fear over housing market weigh on SEK

- EURSEK looks to be ending 2017 higher, against all odds. Strong fundamentals and inflation close to target have supported SEK through 2017, but not enough to resist fear of a housing market slowdown and a dovish Riksbanken.
- SEK has weakened more than fundamentals and valuation argues in favour of stronger SEK. Still, we see few drivers turning sentiment for SEK any time soon.
- Riksbanken: We expect QE to be extended in December until H1 2018, and forecast first rate hike in February 2019. This is more dovish than market expects, with pricing indicating a 30% chance of a rate hike by July 2018.

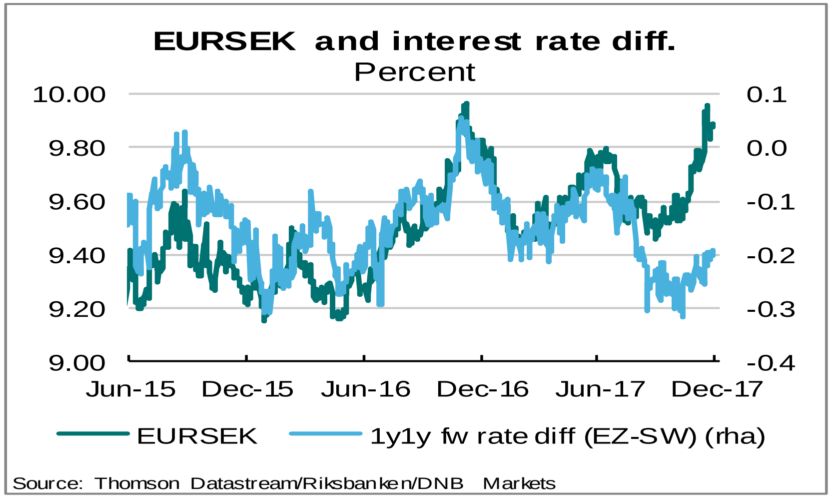


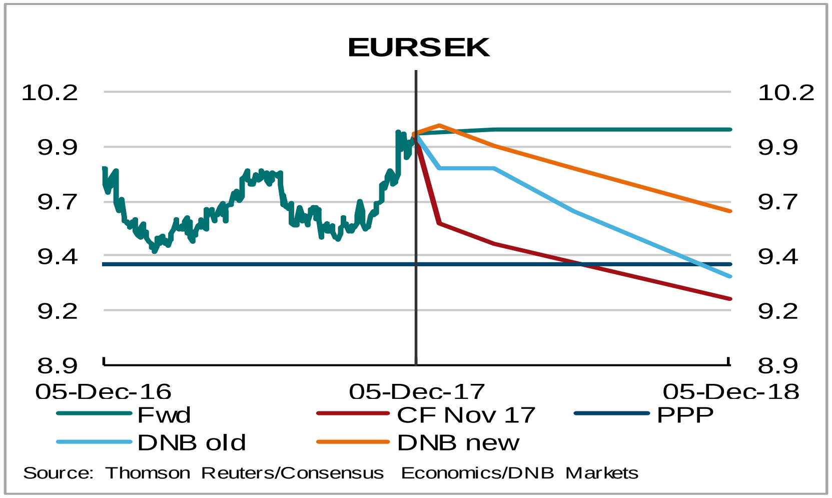


EURSEK (II)

Expect SEK weakness to persist

- Housing market: We don't expect the housing market to collapse, but see potential for further slowdown. Concern will probably not be disproved any time soon.
- Short term, EURSEK @10.00 in 1M: See increased risk for higher EURSEK into year-end, with lower house prices (14 Dec.) and dovish Riksbanken (20 Dec.).
- Forecast 2018, EURSEK @9.60 in 12M: Room for SEK to strengthen somewhat in H2 2018 when Riksbanken ends QE, but still revise year-end forecast higher.
- Due to large currency moves driven not just by fundamentals, but in large by a shift in sentiment we see increased uncertainty for SEK going forward. See table.





Increased uncertainty for scandies going forward

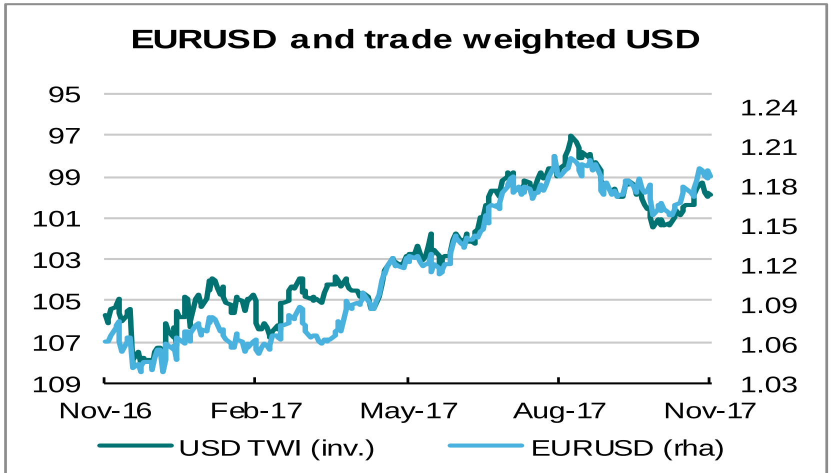
Risk factors	Δ EURSEK	Δ EURNOK	Probability*	Comment
Collapse in house prices	**↑**	**↑**	Low	We expect housing prices to slow further in 2018 (both in Sweden and Norway), but predict a soft landing and small repercussions to the rest of the economy. In our view, the risk of a collapse is low. A small upside risk to our forecast.
House price fear blows off	↓	↓	Medium	The housing market has gotten (too) much attention and could explain some of the risk premium that prevails in scandies. Fear could easily blow off into 2018 and we view this as a potential downside risk to our forecast.
Riksbanken more hawkish	**↓**	↓	High	We expect Riksbanken to extend QE in Dec. and eventually delay first rate hike until Feb. 2019 (7 months later than indicated by the last rate path). The risk of a more hawkish Riksbanken is high. A potential downside risk to forecast.
ECB hike rates in 2018	**↓**	↓	Low	We expect ECB to extend QE until end of 2018, and a rate hike in Q2 2019. Earlier tightening opens up for market to price an earlier normalization from Riksbanken. We regard this risk as low. A small downside risk to our forecast.
Norges Bank hiking rates in 2018	↓	↓	Low	Developments since last Norges Bank meeting points to a higher interest rate path in Dec. Still, we see risk for a rate hike in 2018 as low, more details here. A small downside risk to forecast.

* Low, medium and high probability indicate 0-15%, 15-30%, 30-45%. Downward arrow indicates stronger SEK/NOK. The size of the arrow indicates the magnitude of potential currency moves.

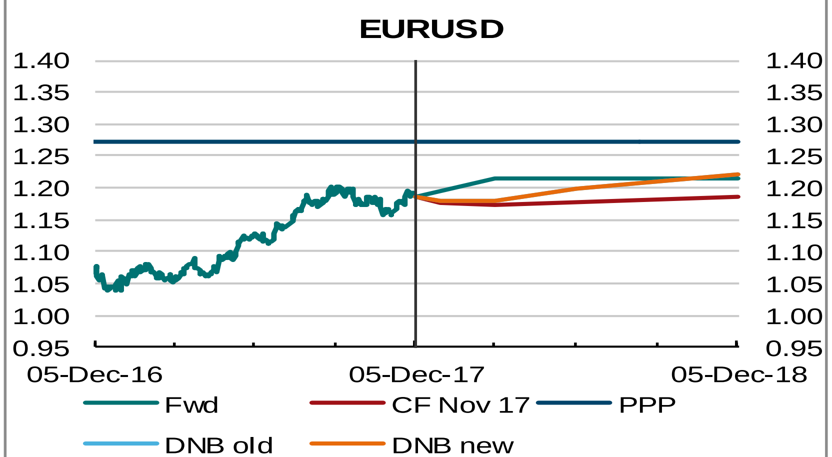
EURUSD

EUR expected to edge higher in H2 2018

- EUR is ending the year as the best performer among G10 currencies and EURUSD is back up above 1.18. We see EUR sentiment holding up in 2018.
- We still see potential for dips in EURUSD going into year-end, but expect the upward trend to hold up in 2018, with potential for further EUR strength in H2 2018.
- ECB has locked in policy until Sept. 2018, but market will eventually start pricing a rate hike when QE ends in H2 2018. We forecast first rate hike in Q2 2019.
- We view Fed's hiking cycle as increasingly mature, giving less support to the USD. Forecast unchanged, expecting EURUSD @1.18 in 3M and 1.22 in 12M.



Source: Thomson Datastream/DNB Markets



Source: Thomson Reuters/Consensus Economics/DNB Markets

Interest rates forecasts, new and old

Policy rates	06-Dec-17	1 mnd	Mar-18	Jun-18	Dec-18	1 mnd	Nov-17	Feb-18	Aug-18
	06-Dec-2017					22-Aug-2017			
USA: Fed Funds	1.25	1.25	1.50	1.50	1.75	1.25	1.25	1.50	1.75
Japan: Day-to-day	-0.10	-0.10	-0.10	-0.10	0.00	-0.10	-0.10	-0.10	-0.10
Euro: Repo	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK: Base rate	0.25	0.50	0.50	0.50	0.50	0.25	0.25	0.25	0.25
Sweden: Repo	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.25
Norway: Folio	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Switzerland: 3M Libor CHF	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75

3-month money market rates

Country	06-Dec-17	1 mnd	Mar-18	Jun-18	Dec-18	1 mnd	Nov-17	Feb-18	Aug-18
USA	1.52	1.55	1.55	1.85	2.10	1.35	1.50	1.75	2.00
Japan	0.06	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Euro	-0.33	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30
U.K.	0.52	0.55	0.55	0.55	0.60	0.30	0.30	0.30	0.35
Sweden	-0.61	-0.50	-0.40	-0.40	-0.15	-0.40	-0.40	-0.40	-0.15
Norway	0.77	0.80	0.85	0.90	0.90	0.80	0.85	0.85	0.85
Switzerland	-0.76	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75

10-year swap rates

Country	06-Dec-17	1 mnd	Mar-18	Jun-18	Dec-18	1 mnd	Nov-17	Feb-18	Aug-18
USA	2.37	2.25	2.25	2.50	2.75	2.25	2.25	2.50	2.75
Japan	0.31	0.25	0.25	0.25	0.50	0.25	0.25	0.25	0.25
Euro area	0.80	1.00	1.00	1.00	1.25	1.00	1.00	1.00	1.25
U.K.	1.34	1.50	1.50	1.50	1.50	1.25	1.50	1.50	1.50
Sweden	1.09	1.25	1.25	1.25	1.50	1.25	1.25	1.50	1.75
Norway	1.85	2.00	2.00	2.00	2.25	2.00	2.00	2.00	2.25
Switzerland	0.22	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

Source: DNB Markets

FX forecasts, new and old

Exchange rates		06-Dec-2017				22-Aug-2017			
	06/12/2017	1 mnd	Mar-18	Jun-18	Dec-18	1 mnd	Nov-17	Feb-18	Aug-18
EURNOK	9.79	9.80	9.60	9.40	9.30	9.30	9.20	8.90	8.80
USDJPY	112.1	112	112	114	115	110	112	114	115
EURUSD	1.18	1.18	1.18	1.20	1.22	1.17	1.16	1.15	1.22
EURGBP	0.88	0.89	0.90	0.91	0.92	0.91	0.90	0.91	0.92
EUR/DKK	7.44	7.44	7.44	7.45	7.46	7.44	7.44	7.45	7.46
EURSEK	9.91	10.00	9.90	9.80	9.60	9.40	9.30	9.20	9.00
EURCHF	1.17	1.16	1.16	1.17	1.18	1.14	1.15	1.16	1.18
USDCNY	6.61	6.65	6.70	6.75	6.85	6.68	6.70	6.75	6.85

Exchange rates (calculated)	06/12/2017	1 mnd	Mar-18	Jun-18	Dec-18	1 mnd	Nov-17	Feb-18	Aug-18
SEKNOK	98.77	98.00	96.97	95.92	96.88	98.94	98.92	96.74	97.78
USDNOK	8.28	8.31	8.14	7.83	7.62	7.95	7.93	7.74	7.21
GBPNOK	11.09	11.01	10.67	10.33	10.11	10.22	10.22	9.78	9.57
JPYNOK	7.39	7.42	7.26	6.87	6.63	7.23	7.08	6.79	6.27
DKKNOK	131.5	131.72	129.03	126.17	124.66	125.00	123.66	119.46	117.96
CHFNOK	839.2	844.83	827.59	803.42	788.14	815.79	800.00	767.24	745.76
TWI	115.2	117.00	114.50	112.00	111.00	111.50	110.50	107.00	105.00

Source: DNB Markets

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