

Weekly Focus

8 - 15 February 2008

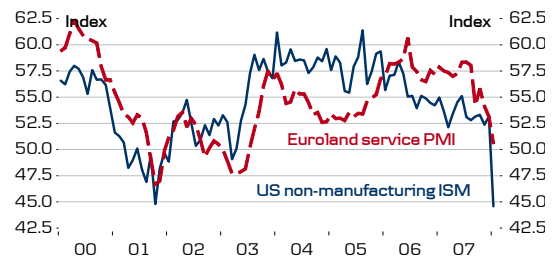
Service sector hit by stormy weather

Service sectors in both the US and Europe have been slowing recently. This was particularly evident in PMI confidence surveys released in the past week, which showed that the slowdown has even gathered pace in several countries. The US, Spain and Italy, in particular, saw significant declines in PMI numbers in January, pointing towards an outright fall in service industry activity.

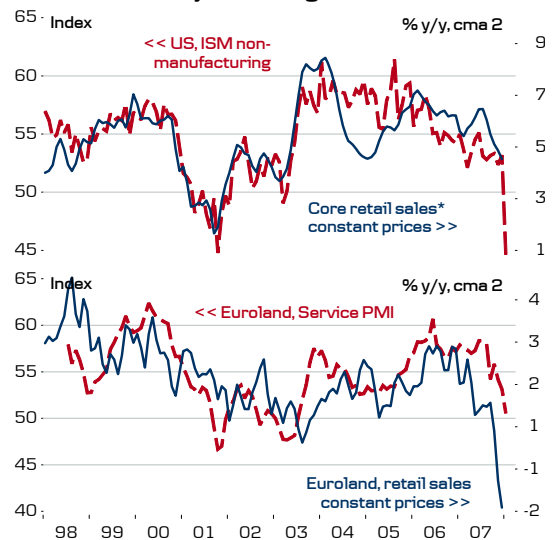
There are probably a number of reasons for the stormy weather that has hit the service industry. First of all, consumer demand has been hit hard as rising energy and food prices have eroded purchasing power. This has put a significant damper on retail sales (see discussion about the coming week's retail sales data in the US section) and, combined with the downturn in housing markets in several countries, has prompted a contraction in demand for services. Meanwhile, the credit crunch and the financial market turmoil have put the financial industry under pressure. As financial companies account for a large share of the service sector in most Western countries, some of the downturn in service PMIs is probably explained by the financial crisis (see *Research Global: A stalling service sector*).

The recent numbers have, naturally, contributed to the concerns surrounding the economic outlook in the West. While the numbers very much confirm the economic slowdown in the US, they also sow doubt on the robustness of the upswing in Europe. The more uncertain outlook for Euroland was highlighted at Thursday's monetary policy meeting at the ECB, when bank chief Trichet softened his tone more than expected. Not only did this reinforce our expectation of rate cuts from the ECB in H2 08; the risk has now increased of the ECB taking action as early as ahead of the summer recess (see Euroland and Fixed Income sections).

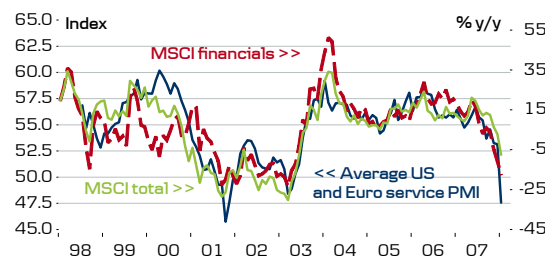
Marked fall in service sector indices ...



... driven by declining demand ...



... and financial turmoil



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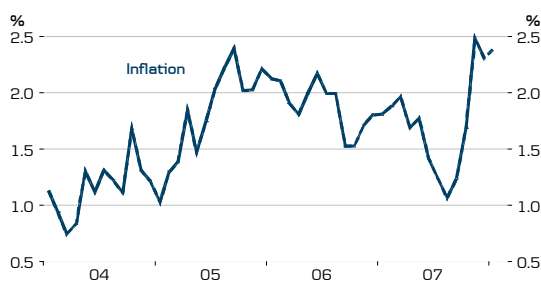
Draft budget for 2008

The government presented its proposed budget for 2008 on Tuesday. The coming year will be a little unusual from a fiscal policy perspective, in that the budget will not be passed until later in the year, but will also apply to the first couple of months of the year. It is also perhaps no great surprise that this proposal looks rather like the budget proposal that was presented in autumn 2007, but was not passed due to the snap election in November. There are, though, a few alterations to economic policy – changes that the government is using to signal greater fiscal prudence.

Perhaps the most notable change is the compulsory government saving of DKK 1bn. The compulsory saving, which represents 1% of the government’s budget, would be available for use in 2009 at the earliest, if there is less pressure on the economy at that time. The savings come on the back of concerns about economic overheating. As such, tightening fiscal policy by DKK 1bn will be more a signal rather than having a real effect on the Danish economy: given that government expenditure adds up to more than DKK 800bn, a compulsory saving of DKK 1bn is rather modest. The proposal should probably be interpreted as a signal, ahead of wage negotiations in the public sector, that the government is seriously concerned about the economy overheating, and therefore there is a need for prudent wage agreements.

Overall, the degree of economic tightening has not changed that much from the budget proposal in the autumn. Despite the tightening, fiscal policy remains slightly expansive. The current economic situation is characterised by a shortage of labour – which would suggest the need for a tight fiscal policy. On the other hand, it must also be said that there are a number of signs that the Danish economy is beginning to lose some momentum. This means that, in general, our fears of economic overheating have eased a little since the autumn. As the budget will not be passed until some time later in the year, we estimate that it will do a reasonable job of balancing the two opposing forces. Despite the slightly easing fiscal policy, there is still the prospect of an impressive general government surplus of DKK 66.6bn this year and DKK 51.2bn next year.

Inflation in focus



Key events of the week ahead

- Most important data release in the coming week will be the inflation numbers on Monday. We expect that inflation will rise to 2.4% in January from 2.3% in December. Among the factors pushing inflation higher are petrol, public transport and food prices.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Mon 11	8:45	FRF Industrial production	m/mly/y	Dec	0.8% 1.7%	-1.5% 2.5%
Tue 12	11:00	DEM ZEW economic sentiment	Index	Feb	-44.0	-43.5
Thu 14	8:00	DEM GDP	q/qly/y	4th quarter	0.3%	0.3% 1.8%
Thu 14	8:30	FRF Bank of France Bus. Sentiment	Index	Jan		103
Thu 14	8:45	FRF GDP preliminary	q/qly/y	4th quarter		0.3% 2.0%
Thu 14	9:00	ESP GDP Preliminary	q/qly/y	4th quarter		0.6% 3.3%
Thu 14	10:00	EUR ECB Publishes Feb. Monthly Report		Feb		
Thu 14	11:00	EUR GDP, s.a.	q/qly/y	4th quarter	0.4% 2.2%	0.4% 2.2%
Fri 15	8:00	EUR EU 25 New Car Registrations	%	Jan		1.3%
Fri 15	8:45	FRF Non-Farm Payrolls, preliminary	%	4th quarter		0.3%
Fri 15	9:00	ESP CPI- EU Harmonised	m/mly/y	Jan		-0.6% 4.4%
Fri 15	11:00	EUR Trade Balance, s.a.	EUR bn	Dec		2.7

Sweden

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Labour market showing first signs of weakness

For some time we have argued that the labour market will weaken during H1 2008. This would be an effect of the rapidly slowing demand from both external and domestic sectors. Logical as this might seem, it has not been the consensus among Swedish forecasters. Despite downward revisions of growth forecasts, market participants have failed to see a link to the labour market, and forecasts for the unemployment rate still show flat or even falling numbers.

However, already in Q4 we saw signs of weakness in labour market data. It is only one outcome, but it fits well with our general perception of future developments on the labour market. If anything, it is actually earlier than what could be expected given historical patterns.

Under any circumstances, all labour market data since the Riksbank's last report in December have come out worse than forecasted by the Riksbank (or could expect). This is true for employment plans in surveys, vacancies, employment growth and unemployment as well as wage data and other indicators of wage inflation.

Admittedly, Nyberg's and Öberg's speeches have not been as soft as we would have liked, but going through the data, not only labour market data, we will find anything but (at least) a postponement of the implied February hike totally incomprehensible.



Key events of the week ahead

- The labour force survey will be very interesting, since labour market developments hold the key to what the Riksbank will do.
- This week, the publication of the Riksbank's monetary policy decision and the monetary policy report will take centre stage, however.
- Industrial data will provide additional pieces to the Q4 GDP-puzzle.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Mon 11	9:30	SEK Activity index	Dec			124.0
Tue 12	10:00	SEK Nat. labour market board, Unemployment	Jan	3.5%	3.5%	3.5%
Wed 13	9:30	SEK Riksbank, Rate decision	Feb	4.00	4.00	4.00
Thu 14	9:30	SEK Unemployment	Jan	6.1%	6.3%	5.6%

Norway

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Inflation set to jump

The most important event for the Norwegian market in the coming week will be the inflation numbers for January. At its latest monetary policy meeting, Norges Bank said that the inflation data for January and February would be particularly important to follow, as many shops raise their prices during these months.

In our view, the January numbers will provide the first hint of this. We expect that underlying inflation will rise from 1.8% in December to 2.2% in January. However, some of the increase can be attributed to the effect of the VAT hike on food that took effect on 1 January 2007 falling out of the index and boosting the underlying inflation rate by 0.2 percentage points.

The general increase in the price of food is, though, also expected to contribute to higher inflation. In addition, there is great uncertainty with regard to how great the discount will be on clothing and shoes - a component that has often caused problems for economists in recent years. We have assumed that clothing and shoe prices will be cut by 11%, which was the average discount in 2007. This was, in fact, the largest January price cut ever for this component, which means the risk is to the upside, in our view.

We expect to see further price pressures in the Norwegian economy as the year progresses. Inflation is being pushed up by accelerating wage growth, rising housing rents and increasingly expensive food. Moreover, imported inflation is expected to contribute less and less to low inflation. We expect that underlying inflation will reach 2.5% in the course of the summer 2008. For more on the outlook for inflation in Norway, see "[Focus Norway: Era of low inflation is over](#)".

Besides inflation, the Norwegian market will be listening closely to the annual address by central bank chief Svein Gjedrem on 14 February. Previous annual addresses have included some very strong comments that were also relevant for the financial markets, though this has not been the case in the past two years. One possible theme might be how Norges Bank will balance the current global slowdown against the strong Norwegian economy.

Underlying inflation on the rise in Norway



Key events of the week ahead

- Underlying inflation expected to increase from 1.8% in December to 2.2% in January.
- Headline inflation expected to increase from 2.8% to 3.8% - mainly due to rising electricity prices.
- Central bank chief's annual address eagerly awaited by market. How will Norges Bank balance rising inflation against a weaker global economy?

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Mon 11	10:00	NOK Producer prices, incl oil	m/mly/y			0.2% 12.4%
Mon 11	10:00	NOK Consumer prices	m/mly/y	-0.3% 3.8%	-0.3% 3.8%	0.8% 2.8%
Mon 11	10:00	NOK Core inflation(CPI-ATE)	m/mly/y	-0.4% 2.2%	-0.3% 2.1%	0.3% 1.8%
Thu 14	18:00	NOK Annual address				
Fri 15	10:00	NOK Trade balance	NOK bn			39.6

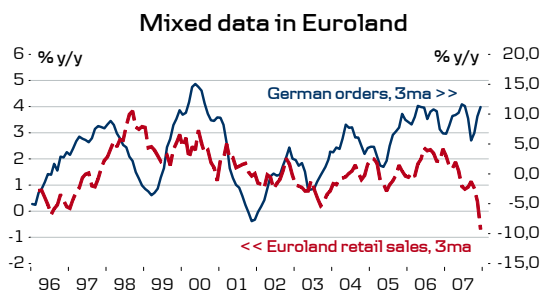
Euroland

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ECB getting flexibility for potential rate cut

In the press conference after the meeting Thursday ECB made some significant changes to its statement, which gave it more flexibility to change rates also in a downward direction (see [Flash Comment - ECB more dovish than expected.](#)). ECB increased the focus on downside risks to growth and suggested that the growth projection will be revised down in June. At the same time it made no attempt to change the current market expectations of rate cuts, which leaves the impression that it is leaning that way itself. With the quicker change in tone than we expected risk is now that ECB moves to cut rates before the summer instead of waiting until September.

In the statement ECB mentioned for the first time that actual data confirmed that risks to growth were on the downside. The weakening of data was evident also last week as numbers for retail sales and PMI service showed considerable weakness (see [Research Global - a stalling service sector](#)). Retail sales fell 2.0% y/y in December, which was the biggest decline in 13 years. The decline is probably exaggerated, but it does highlight the weakness in private consumption coming from the squeeze on incomes from higher oil and food prices. Much of the current slowdown is driven by domestic weakness from private consumption whereas the external drag is still rather muted. This was witnessed in the German orders data released last week, which still showed a fairly solid upward trend with orders rising 5% q/q in the fourth quarter. Looking ahead to next week focus turns to GDP data for the fourth quarter. It will most likely show that GDP growth slowed towards the end of the year dragged down by consumption.



Events this week

- Tuesday: We expect the German ZEW to decline further to -44 from -41.6 last month. Financial turmoil and weak data hit sentiment.
- Thursday: GDP for Euroland in Q4 is expected at 0.4% q/q, down from 0.8% last quarter. Risks are to the downside based on the soft retail sales last week.

Date	Time	Event	Period	Danske Bank	Consensus	Previous	
Mon 11	8:45	FRF Industrial production	m/mly/y		0.8% 1.7%	-1.5% 2.5%	
Tue 12	11:00	DEM ZEW economic sentiment	Index	Feb	-44.0	-43.5	-41.6
Thu 14	8:00	DEM GDP	q/qly/y	4th quarter	0.3%	0.3% 1.8%	0.7% 2.5%
Thu 14	8:30	FRF Bank of France Bus. Sentiment	Index	Jan		103	
Thu 14	8:45	FRF GDP preliminary	q/qly/y	4th quarter		0.3% 2.0%	0.8% 2.2%
Thu 14	9:00	ESP GDP Preliminary	q/qly/y	4th quarter		0.6% 3.3%	0.7% 3.8%
Thu 14	10:00	EUR ECB Publishes Feb. Monthly Report		Feb			
Thu 14	11:00	EUR GDP, s.a.	q/qly/y	4th quarter	0.4% 2.2%	0.4% 2.2%	0.8% 2.7%
Fri 15	8:00	EUR EU 25 New Car Registrations	%	Jan		1.3%	
Fri 15	8:45	FRF Non-Farm Payrolls, preliminary	%	4th quarter		0.3%	0.4%
Fri 15	9:00	ESP CPI- EU Harmonised	m/mly/y	Jan		-0.6% 4.4%	0.4% 4.4%
Fri 15	11:00	EUR Trade Balance, s.a.	EUR bn	Dec		2.7	

UK

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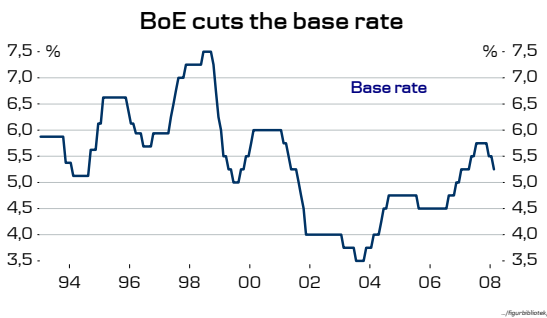
Focus on inflation report

As expected, the Bank of England cut its key policy rate, the base rate, by 25bp to 5.25% at its policy meeting in the past week. However, we will not have an insight into the background for the Bank's rate decision until the inflation report is released in the coming week.

We shall focus especially on how the BoE weighs the risks to growth against the already-high inflation rate in Britain and the outlook for even higher inflation in the months ahead.

Given the poor signals from both the UK and global economies, we expect the BoE to confirm market expectations of further policy easing this year in spite of the outlook for high inflation in the coming months.

As such, our expectation of additional rate cuts of 75bp from the BoE in 2008 still holds water. If anything, the risk to this estimate is to the downside.



Key events of the week ahead

- The inflation report due out on 13 February is the most important event of the week.
- But keep an eye also on the January inflation numbers. We expect the inflation rate to go up from 2.1% in December to 2.3% in January.
- The RICS housing market indicator might well fall further.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Mon 11	10:30	GBP PPI - Output	m/mly/y	Jan	0.4% 5.1%	0.5% 5.0%
Mon 11	10:30	GBP DCLG House Prices	y/y	Dec		9.5%
Tue 12	10:30	GBP CPI	m/mly/y	Jan	-0.6% 2.3%	0.6% 2.1%
Tue 12	10:30	GBP CPI core	y/y	Jan		1.4%
Tue 12	10:30	GBP RPI Inflation	m/mly/y	Jan	-0.6% 4.1%	0.6% 4.0%
Tue 12	10:30	GBP RPI Ex Mort Int Payments	y/y	Jan	3.3%	3.1%
Wed 13	1:01	GBP RICS House Price Balance	y/y	Jan		-49.1%
Wed 13	10:30	GBP Average Earnings ex bonus	3Ms/YoY	Jan	3.7%	3.6%
Wed 13	10:30	GBP Claimant Count Rate	%	Jan		2.5%
Wed 13	10:30	GBP Jobless claims change	'000	Jan	-5.0	-6.4
Wed 13	10:30	GBP Average Earnings incl bonus	3Ms/YoY	Dec	4.0%	4.0%
Wed 13	11:30	GBP BoE quarterly inflation report				

Poland

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Busy week ahead

It will be a busy week in terms of macroeconomic data in Poland. On top of the agenda will be inflation data for January, out on Friday.

Inflationary pressures remain strong driven by both supply-side factors – higher food and energy prices – and strong domestic demand and wage growth. Hence, we expect inflation to rise further to 4.2% y/y in January up from 4.0% y/y in December. Despite fairly strong inflationary pressures we are likely to be getting closer to the end of the monetary tightening due to the expected slowdown in domestic demand in Poland and the expected monetary easing from the ECB later in the year.

Polish wage growth data will be released on Friday as well. Labour markets remain tight in Poland and wage growth is likely to continue to accelerate in coming month. We expect wages to have grown by 9.7 % y/y in January up from 7.2% y/y in December.



Key events in the week ahead

- Inflation on Friday: We expect an increase to 4.2% y/y, slightly above consensus expectations of 4.1%.
- Both current account and trade balance data will be released on Tuesday; we expect a worsening of both.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Tue 12	14:00	PLN Current account	Euro mil Dec	-720		-351
Tue 12	14:00	PLN Trade balance	EUR mil Dec	-975	-1156	-793
Fri 15	14:00	PLN CPI	y/y Jan	4.2%	4.1%	4.0%
Fri 15	14:00	PLN Wages	y/y Jan	9.7%	9.2%	7.2%
Fri 15	14:00	PLN Employment	y/y Jan	4.9%	4.9%	4.9%

USA

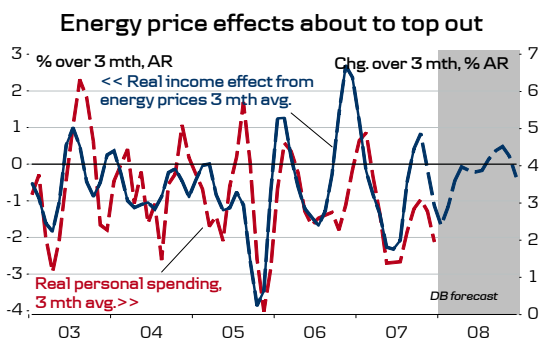
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More bad news

While the ISM's index of manufacturing activity rose from 48.4 in December to 50.7 in January, the past week has been dominated by more bad news from the US. The labour market report for January disappointed, with a small fall in employment of 17,000 and a decline of 0.3% m/m in the total number of hours worked. Meanwhile, the ISM's activity index for the service sector collapsed from 53.2 to 44.6 – a level in line with the recession of 2001. Thus both reports indicated a downturn in economic activity in January – making the deepening worry lines of the investors in recent weeks perfectly understandable. The bad news has warranted a further decline in interest rates, and the general expectation in the market is now that the Fed will cut to 2% by the middle of the year – which is in line with Danske Bank's forecast.

The coming week does not hold much prospect of a respite from the steady stream of bad news. Retail sales data will provide an important indication of the state of private consumption, which has lately been under pressure from declining levels of wealth, high energy prices, tighter credit terms and a softer labour market. This picture is very much expected to be confirmed in January, when the outlook is for retail sales to fall by 0.5% m/m. Some of this is due to a number of – presumably temporary – factors that will dampen retail sales in January. Car sales have been extraordinarily weak, and slightly falling petrol prices will have a negative nominal effect. But even when adjusting for these factors, there will still be signs of softness in underlying retail sales (ie, excluding cars, construction material and petrol) with a rise of just 0.1% m/m. In other words, there is not much prospect of recession fears easing in the coming week. On the contrary, retail sales will simply add fuel to the fire, which is why one cannot rule out the market revising its expectations on the Fed's interest rates further down.

Consumption therefore appears set to get off to a weak start this year, with a fall of 0.2% m/m in January in real terms. Our current forecast assumes consumer spending growth of 1.25% and GDP growth of only 0.25%. But, given the outlook for poor retail sales data, consumer spending – and hence GDP – might end up growing at an even softer rate. Nevertheless, there are good grounds for expecting an improvement in the household economy as the pressure from energy prices subsides, leaving more room in real incomes for spending. Combined with the planned tax cuts – due to take effect in early summer 2008 – we expect this to take consumer spending growth back up to a figure of a little more than 2% in H2.



Key events of the week ahead

- Wednesday: We expect retail sales to surprise on the downside, falling 0.5% m/m against the consensus expectation of 0.0%.
- Thursday: The December trade data will provide one of the last pieces in Q4's GDP growth puzzle.
- Thursday: Bernanke will report to the Senate budget committee.

Date	Time	Event	Period	Danske Bank	Consensus	Previous	
Tue 12	-	USD Fed's Poole (hawk, non-voter) speaks					
Tue 12	17:05	USD Fed's Yellen (dove, non-voter) speaks on economy					
Tue 12	20:00	USD Monthly budget statement	USD bn	Jan	33.0	38.2	
Wed 13	14:30	USD Retail sales	m/m	Jan	-0.5%	0.0%	-0.4%
Wed 13	14:30	USD Retail sales less autos	m/m	Jan	0.0%	0.2%	-0.4%
Thu 14	-	USD Fed's Bernanke (neutral, voter) and Paulson testify before state committee					
Thu 14	14:30	USD Trade balance	USD bn	Dec	-61.0	-63.1	
Thu 14	14:30	USD Initial jobless claims	1000	Feb	340	356	
Thu 14	19:30	USD Fed's Evans (neutral, non-voter) speaks					
Fri 15	1:30	USD Fed's Mishkin (dove, voter) speaks					
Fri 15	14:30	USD Import prices	m/mly/y	Jan	0.5% ..	0.0% 10.9%	
Fri 15	14:30	USD Empire Manufacturing	m/m	Feb	7.8	9.0	
Fri 15	15:15	USD Industrial production	m/m	Jan	0.0%	0.1%	0.0%
Fri 15	15:15	USD Capacity utilization	%	Jan	81.4%	81.4%	
Fri 15	16:00	USD University of Michigan Confidence	Index	Jan	77.0	77.3	78.4

Asia

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Not as bad as feared in Japan

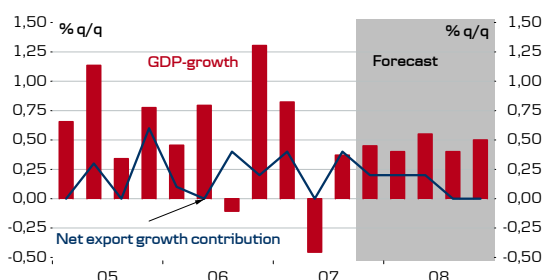
Fourth quarter GDP will be the focus of attention in Japan in the coming week. We expect growth of 0.5% q/q (1.9% q/q AR), which is a little higher than the consensus expectation of 0.4% q/q (1.6% q/q AR). We had initially forecasted growth of just about 0.2% q/q, meaning things do not look as bad as first feared for the Japanese economy in Q4. There are two main reasons for this. First, private consumption appears to have kept its head above water in Q4 despite lower employment growth and a sharp fall in consumer confidence. We now expect private consumption to grow 0.3% q/q in Q4 versus our initial forecast of 0.0% q/q. Second, the fall in construction activity is not proving such a drag as originally expected, as after collapsing following the tightening of building regulations, construction activity has begun to stabilise a little faster than expected. We now estimate that declining housing investments will only shave 0.2 percentage points from GDP growth in Q4 versus our original forecast of more than 0.3 percentage points.

Growth in Q1 of this year will probably be at about the same level as in Q4. Private consumption in Q1 will be hit by higher inflation, and we believe there will be some weakness in business investments. On the other hand, increasing housing investments will boost growth substantially in the coming quarters – by 0.3 percentage points in both Q1 and Q2. Hence, the normalisation of construction activity will lend considerable support to the economy, and an actual recession in the Japanese economy in H1 08 now seems unlikely. This is also why we expect the Bank of Japan to be on hold in H1.

China has gone from the year of the pig to the year of the rat, and is at the moment moving in low gear due to the New Year holidays and the unusually severe winter weather that has struck much of the country. The harsh weather will probably depress growth in Q1, but not by much. In contrast, we are seeing clear signs that the government’s tighter credit controls have begun to hit investment activity. Overall then, growth clearly seems to be heading down in Q1.

The greatest impact of the freezing weather conditions will be on inflation, which may well increase to around 7.5% in January and February. The longest lasting effect will most likely be on the already high food prices, as many winter crops and livestock have fallen victim to the harsh conditions. This means the “normalising” of food prices in China will take longer than originally expected.

Japanese GDP forecast



Key events of the week ahead

- Japanese Q4 GDP growth will be announced on 14 February. We expect a slight rise to 0.5% q/q (1.9% q/q AR) versus consensus expectation of 0.4% q/q (1.7% q/q AR).
- Japan’s central bank will hold a monetary policy meeting on Friday 15 February. Like consensus, we expect that the central bank will keep rates unchanged at 0.50%.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Thu 14	0:50	JPY GDP, q/q and q/q annualized	q/q q/q ann. 4th quarter	0.5% 1.9%	0.4% 1.7%	0.4% 1.5%
Thu 14	0:50	JPY Industrial production, final	m/m y/y Dec		0.7% 1.4%	0.7% 1.4%
Fri 15	-	JPY BoJ Monetary Policy Announcement	Feb		0.50%	0.50%
Fri 15 - 19	-	CNY Money supply M2	Jan			16.7

Fixed Income

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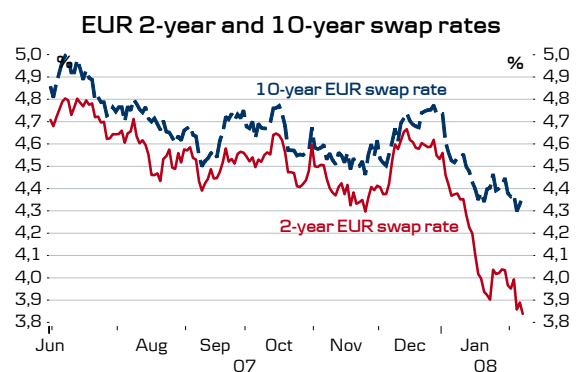
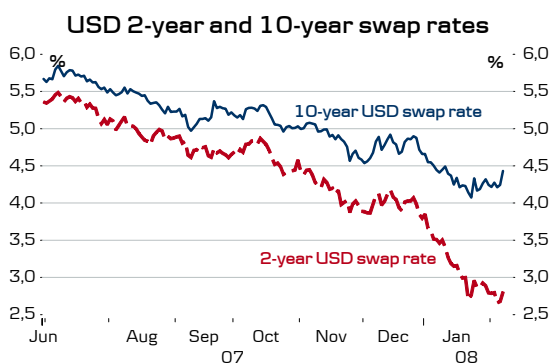
ECB softens stance

A softer tone regarding growth was heard following the European central bank's (ECB) monetary policy meeting on Thursday. While interest rates were kept unchanged at the meeting, a cut has moved further up the agenda. The bank remained hawkish on inflation, but markets focused more on the increased uncertainty surrounding economic developments and the deteriorating outlook – money market rates fell heavily as a result. The market is now pricing in a very aggressive path for monetary policy in Euroland, assigning a 50% probability to a rate cut as early as the next meeting, while an April cut is almost fully priced in. In our view, this is perhaps overly aggressive. True, the ECB did soften, but from a relatively hawkish position. We believe a rate cut from the ECB still remains some way off, but given recent data and the ECB's comments, a rate cut has certainly moved closer – a cut before the summer recess can certainly not be ruled out.

In terms of data, attention in the coming week will be focused on growth in Euroland and consumption in the US. Euroland's economy grew a respectable 0.8% in Q3 07, but the outlook is for a slowdown in Q4 – with growth being cut roughly in half. What might the financial markets make of a surprise? Stronger-than-expected growth would probably be ignored for being old data that says nothing about the outlook. Weak numbers, on the other hand, could be an excuse to send yields further down. This is, at any rate, the sentiment currently prevailing in the market.

There is the prospect of a weak outcome for US retail sales, and thus confirmation of the weak picture for growth that is forming at the moment. The next couple of weeks will probably deliver data that generally confirm the current sentiment in the fixed income markets. Developments in risk appetite and equities will continue to be important for fixed income – both in the US and here in Denmark. Also interesting to follow in the coming week will be Fed chief Ben Bernanke's report to Congress.

Poor demand at an auction of 30-year US Treasuries led to a significant increase in yields across the entire curve towards the end of the past week. Meanwhile, the US Congress has passed a USD 152bn fiscal package that is now only waiting for President Bush's signature. There are some signs of fatigue after a lengthy period of declining yields, and long yields, in particular, will find it hard to fall further, as they are already very low compared to historical levels and inflation. Pricing at the long end of the US yield curve and the short end of the European curve appears the most stressed.



Foreign exchange

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Has EUR/USD peaked?

Economic data have been surprisingly bad in the past week, with US employment down and a sharp fall in the activity indicator for the US service sector. Both outcomes increase the risk of a recession. The euro area has also seen sharp falls in the service sector activity indicator, especially in Germany, Spain and Italy, and yet another drop in retail sales. Retail sales have been falling for three months, and turnover is now 2% below the level of a year ago. Service PMI also usually provides a reliable signal about private consumption. In January, the so-called Eco-watchers survey, which focuses on consumption activity, fell steeply to its lowest level since the recession of 2001. The reasons we have mentioned all these data are, first, to point out that **the global economy is continuing to deteriorate** (and as we wrote last week, we believe it is too early to shift to an investment strategy based on an improving economy) and, second, we are keen to emphasise that **the economic slowdown is spreading fast** from the US.

EUR/USD reached a peak of 1.4967 on 23 November 2007. On two occasions since then - 15 January and 1 February - the market has attempted to extend this peak. There has been no lack of arguments for a weaker USD during this period, including two surprisingly weak labour market reports and the greatest easing of US monetary policy ever within eight days (125bp). That the dollar could not be weakened further on the back of this indicates a certain fatigue in the market with regard to poor US data. In contrast, the past week has witnessed a clear weakening of the euro on the announcement of disappointing data and in connection with a degree of softening from the ECB. The result is a pronounced asymmetrical reaction in EUR/USD to the data, depending on which side of the Atlantic they come from.

Our expectation has been that the dollar would weaken in the spring, based on a severe weakening of the US economy and on the continuation of the financial crisis. At the same time, we have also argued that the strengthening of the euro, which has continued for some years, would soon draw to a close. This led us to a forecast for EUR/USD of 1.52 in three months' time and 1.40 in twelve months. But after the past week, the question we are asking ourselves is: **has EUR/USD already peaked?**

There is little doubt that an economic slowdown is on its way for Euroland. Despite the protests of the ECB, we continue to expect that it will cut interest rates twice this year. We are also of the view that a shift in the monetary cycle will result in a significant weakening of the over-valued euro. Should we be correct in our call, EUR will fall against USD, but perhaps especially against JPY. However, we believe that it is still a little too early for a turn in EUR/USD based solely on cyclical factors, and we would emphasise that the movements of the past week probably have quite a bit to do with falling equity markets. From a technical perspective, the trend is still upwards until 1.4310 is broken.

G7 will meet in Japan this weekend (see *Is CNY still the biggest problem?*). We do not expect any major impact on the FX market. Japan's markets are, incidentally, closed on Monday.

Commodities

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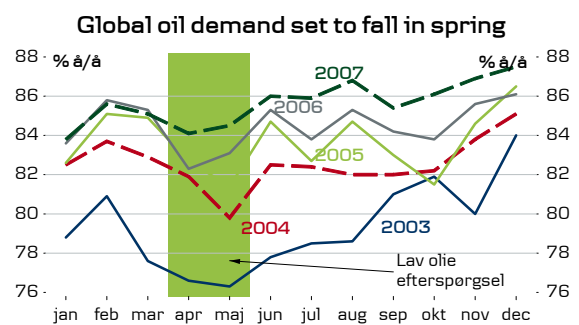
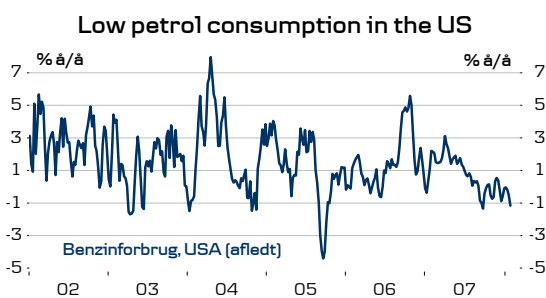
OPEC set to cut back on production

In the past week, OPEC chose to keep oil production unchanged at 29.7 million barrels a day for OPEC12 (Iraq has no quota). With the threat of recession in the US, one might have believed that OPEC would consider raising production a little to support global growth through lower oil prices. However, this is certainly not what OPEC has in mind. In fact, some OPEC delegates have already begun contemplating production cuts at the next OPEC meeting in March.

OPEC has no doubt chosen to continue its hawkish stance. Hence, they will accept no responsibility for global growth and how it is affected by oil prices. Not surprisingly, OPEC's aim is to act as a cartel and, as such, to optimise prices and volume.

And, in fact, it will be a challenging task for OPEC to keep up oil prices going forward. *Firstly*, indicators suggest the US - the world's largest oil consumer - might be heading towards a recession. Petrol consumption is down by 1% from the same period of last year. Also, the market assessment of the consequences of lower US growth is changing. Until now, the general belief has been that the downturn would have only a modest impact on Europe because of high domestic demand in Europe and because European exports would benefit from strong growth on Emerging Markets. However, it no longer seems likely that Europe will escape the slowdown unscathed. The latest PMI data are pointing downwards, and in the past week even the ECB admitted that there is a downside risk to Euroland growth. *Secondly*, we are heading for spring, when global oil demand usually falls. Historically, demand in April and May has been running about 1.5 million barrels below the annual average. Hence, the continuing run-down in stocks that has taken place over a relatively long period might give way to re-stocking, which would be another negative for oil prices.

Against this background, we now expect OPEC to cut down production in March. However, the OPEC quota will probably be reduced only by a modest 0.5 million barrels. Note in this connection that OPEC takes a rather negative view on global oil demand in 2008. OPEC expects demand for oil to be significantly lower than, for instance, the IEA is expecting. Also, as OPEC is no doubt still concerned that the dollar might weaken, members want to be compensated via higher oil prices. However, all things considered, we still expect a modest downward pressure on oil prices in the coming months that will take the price of a barrel of oil down to roughly USD 80/bbl. Nevertheless, as spring approaches and the US economy begins to show signs of stabilisation - while seasonal demand for oil increases - oil prices will again begin to point upwards. We would not be surprised to see the price of a barrel of oil increase to above USD 100/bbl. Should the price of oil fall towards USD 80/bbl in the coming months, we would therefore recommend taking advantage of this to position for higher oil prices/hedge future oil expenses.



Equities

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What sectors are better prepared for a US recession

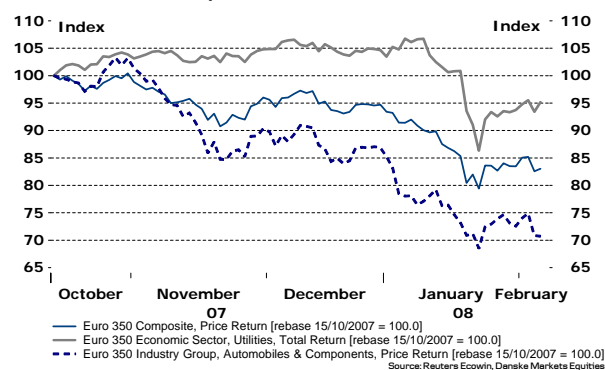
This month, the equity market has again been exposed to a steady stream of bad economic data and global equity markets have again turned negative. In particular data on the American labour market and the global service sector have shown signs of weakness to a degree that was not expected by the market. Today we look at how the corporate earnings are typically affected by a US recession - just in case.

One way of measuring how European corporate earnings are typically affected by a US recession, is to measure the revisions in 12 months forward earnings over the period of a US recession. To get more data than from just the 2001 US recession, we include the 1990/91 recession to increase the reliability of the results. Both the 1990/91 and the 2001 recession were around nine months long, if we follow the NBER [National Bureau of Economic Research] definition, and we use the average of the two recession periods as the expected recession effect on corporate earnings if a US recession should occur.

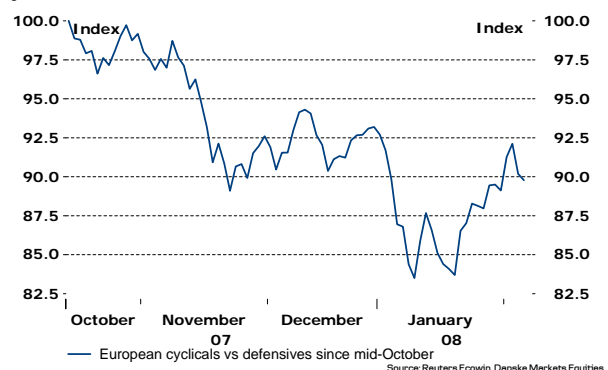
Following the technique above, we measure the earnings sensitivity of the European sectors and industry groups, and expect there to be a positive relationship between earnings revisions and performance in the respective sectors and industry groups. The industry group with the largest negative revisions in 12 months earnings expectations in Europe during US recessions is Automobiles & Components. In the middle of October, 2007, the equity markets had already started to discount a possible US recession into the economic scenario, which was also reflected in prices. This is a good explanation of why Automobiles & Components have underperformed the general market strongly since mid-October last year. On the other hand, earnings estimates in the Utilities sector have actually been revised to the positive during the two last recession periods. Looking at the Utilities sector, since mid-October it has outperformed the general market by more than 10 percentage points (as of February 7).

Looking ahead, we continue to expect the traditional defensive stocks to outperform the cyclical sectors as uncertainty surrounding the global economic outlook continues to put pressure on equities. We overweight Consumer Staples, Health Care, Telecommunication and Utilities, while we would underweight Consumer Discretionary, Industrials and Materials. In our opinion investors are in a challenging market where the right sector bets are more important than regional or style bets.

Utilities have outperformed the market



Cyclicals vs. Defensives since mid-October



Macroeconomic forecast

Macro forecast, Scandinavia

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Stock build. ²	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Unem-ptym. ³	Public budget ⁴	Public debt ⁴	Current acc. ⁴
Denmark	2007	1,9	2,1	1,7	5,1	-0,1	3,1	4,2	1,7	3,5	4,4	25	1,2
	2008	1,7	1,7	2,0	2,5	-0,1	4,3	4,5	1,7	3,3	3,8	20	1,1
	2009	1,3	1,6	1,8	2,4	0,0	4,1	4,9	1,9	3,7	3,2	16	0,8
Sweden	2007	3,0	3,1	0,5	8,0	0,8	5,7	8,9	2,2	6,2	2,3	43,8	6,5
	2008	1,9	2,0	0,9	-0,9	-1,2	3,7	-0,4	2,6	7,1	2,3	41,1	7,7
	2009	2,4	1,7	1,4	-2,9	-0,4	5,1	1,3	1,1	7,9	1,7	39,4	9,0
Norway	2007	3,7	6,2	3,2	6,9	-0,4	2,7	6,2	1,0	2,7	12,0	26	17,5
	2008	3,9	4,3	3,1	5,7	0,8	1,6	4,3	2,4	2,6	13,9	24	20,2
	2009	3,2	4,2	3,0	3,6	0,8	1,0	5,3	2,5	2,5	15,0	20	18,1

Macro forecast, Euroland

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Stock build. ²	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Unem-ptym. ³	Public budget ⁴	Public debt ⁴	Current acc. ⁴
Euroland	2007	2,6	1,5	2,0	4,7	-0,1	6,5	5,7	2,1	7,4	-0,8	67	-0,8
	2008	1,6	1,4	2,0	2,5	-0,1	4,0	4,0	2,5	7,0	-0,8	65	-0,3
	2009	1,8	1,7	1,9	2,0	0,1	5,5	5,0	2,0	6,8	-0,8	64	-0,5
Germany	2007	2,7	-0,1	1,8	5,5	-0,1	9,0	6,0	2,2	9,1	-0,5	65	5,8
	2008	1,8	0,8	1,5	2,5	0,0	6,0	4,0	1,6	8,3	0,2	64	5,8
	2009	1,7	1,3	1,5	2,0	0,0	6,5	4,0	1,5	8,0	0,4	64	6,0
France	2007	1,9	2,0	1,9	4,0	-0,2	4,0	7,1	1,3	8,0	-2,3	63	-2,3
	2008	1,8	1,8	1,7	3,0	0,0	4,0	4,7	1,5	7,7	-2,2	62	-2,3
	2009	1,8	2,0	1,7	2,5	0,0	4,0	4,0	1,5	7,5	-2,3	61	-2,3
Italy	2007	1,8	1,8	0,7	2,7	0,0	3,0	2,3	1,9	5,9	-2,6	105	-1,7
	2008	1,2	1,1	1,3	1,7	0,0	2,0	3,0	2,0	5,7	-2,0	103	-1,7
	2009	1,2	1,1	1,2	1,7	0,0	2,0	2,5	1,9	5,7	-2,2	102	-1,7
Spain	2007	3,9	3,5	5,2	6,3	-0,4	6,0	7,3	2,7	8,0	1,5	37	-9,0
	2008	2,9	2,5	4,0	4,5	0,0	4,5	5,0	2,9	8,2	1,0	35	-9,5
	2009	2,7	2,0	3,5	3,0	0,0	4,0	4,0	2,3	8,8	0,0	35	-9,0
Holland	2007	3,0	1,9	3,1	4,7	-0,1	6,5	6,0	1,7	3,3	0,0	60	7,0
	2008	2,4	1,9	1,4	4,0	-0,1	5,5	5,5	2,0	2,9	0,0	59	6,5
	2009	2,2	2,0	0,8	3,3	0,0	5,0	5,5	1,8	2,8	0,0	60	6,5
Finland	2007	4,2	3,0	1,4	4,6	0,3	9,0	4,0	2,5	6,6	4,0	38	6,0
	2008	3,0	2,5	1,6	3,3	0,0	6,0	5,5	2,6	6,3	4,4	37	6,0
	2009	2,7	2,3	1,8	2,5	0,0	5,0	4,0	2,0	6,1	4,2	36	6,0

Macro forecast, Global

	Year	GDP ¹	Private cons. ¹	Public cons. ¹	Fixed inv. ¹	Stock build. ²	Ex-ports ¹	Im-ports ¹	Infla-tion ¹	Unem-ptym. ³	Public budget ⁴	Public debt ⁴	Current acc. ⁴
USA	2007	2,2	2,9	2,1	-1,8	-0,3	7,9	2,0	2,9	4,6	-1,2	60	-5,6
	2008	1,8	1,8	2,5	-2,9	-0,1	8,5	1,7	3,1	5,1	-2,6	60	-4,3
	2009	2,4	2,2	2,0	1,6	0,1	6,7	3,7	2,3	5,4	-1,5	59	-4,2
Japan	2007	1,7	1,6	0,8	-3,1	-0,1	7,4	2,4	0,1	3,8	-2,7	179	5,0
	2008	1,6	1,5	0,9	3,0	-0,1	5,5	4,2	0,4	3,6	-3,0	178	5,0
	2009	2,1	1,9	1,2	3,4	0,0	5,7	5,3	0,7	3,3	-2,7	178	4,8
UK	2007	3,0	3,1	1,9	5,5	0,3	-4,0	-2,0	2,8	3,0	-2,5	43	-3,3
	2008	2,2	2,1	2,1	2,0	0,0	6,0	5,0	3,0	3,2	-2,5	43	-4,1
	2009	2,3	2,1	2,1	3,0	0,0	5,0	5,0	2,3	3,3	-2,5	43	-4,0
Switzer-land	2007	2,7	1,9	-0,5	3,8	0,1	10,1	9,8	1,1	3,3	-0,2	55	16,0
	2008	2,4	2,3	0,1	2,7	0,0	7,5	6,6	0,5	2,7	0,0	54	16,5
	2009	1,9	1,9	0,0	3,3	0,0	4,7	4,5	1,1	2,5	0,0	53	17,0

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

Financial forecast

Bond and money markets							
		Key int. rate	2-yr swap yield	10-yr swap yield	Currency vs EUR	Currency vs USD	Currency vs DKK
USD	08-feb	3,00	2,76	4,36	144,9	-	514,4
	+3m	2,50	2,65	4,15	152	-	491
	+6m	2,00	2,70	4,20	150	-	497
	+12m	2,00	3,05	4,45	140	-	533
EUR	08-feb	4,00	3,78	4,35	-	144,9	745,3
	+3m	4,00	3,95	4,30	-	152	746,0
	+6m	4,00	3,60	4,15	-	150	746,0
	+12m	3,50	3,40	4,15	-	140	746,0
JPY	08-feb	0,50	0,85	1,62	155,8	107,5	4,78
	+3m	0,50	0,80	1,60	158	104	4,72
	+6m	0,50	0,90	1,65	150	100	4,97
	+12m	0,75	1,25	1,85	147	105	5,07
GBP	08-feb	5,25	4,81	4,97	74,3	194,9	1002,9
	+3m	5,25	4,90	4,90	77,0	197	969
	+6m	5,00	4,80	4,80	78,0	192	956
	+12m	4,50	4,50	4,60	74,0	189	1008
CHF	08-feb	2,75	2,44	3,23	160,2	110,6	465,3
	+3m	2,75	2,55	3,20	160	105	466
	+6m	2,75	2,45	3,10	158	105	472
	+12m	2,50	2,60	3,20	157	112	475
DKK	08-feb	4,25	3,98	4,47	745,3	514,4	-
	+3m	4,25	4,10	4,40	746,0	491	-
	+6m	4,25	3,75	4,30	746,0	497	-
	+12m	3,75	3,60	4,30	746,0	533	-
SEK	08-feb	4,00	4,12	4,59	943,9	651,5	79,0
	+3m	4,00	4,00	4,55	945	622	78,9
	+6m	4,00	3,55	4,35	935	623	79,8
	+12m	3,50	3,45	4,35	935	668	79,8
NOK	08-feb	5,25	5,46	5,30	803,8	554,8	92,7
	+3m	5,50	5,60	5,40	780	513	95,6
	+6m	5,50	5,40	5,30	775	517	96,3
	+12m	5,50	5,20	5,30	775	554	96,3
PLN	08-feb	5,25	5,85	5,70	361,9	249,8	205,9
	+3m	5,50	6,20	5,60	365	240	204
	+6m	5,50	5,90	5,75	370	247	202
	+12m	5,50	7,05	6,85	370	264	202

Equity markets				
Regional	Risk	Price trend 3 mth.	Price trend 12 mth.	Regional recommendations
USA	Low	-5% to +5%	-5% to +5%	Neutral
Japan	Average	-5% to +5%	-5% to +5%	Neutral
Emerging markets (USD)	High	-5% to +5%	-5% to +5%	Underweight
Pan-Europe (EUR)	Low	-5% to +5%	-5% to +5%	Overweight
Nordics				
Sweden	High	-5% to +5%	-5% to +5%	Neutral
Norway	High	-5% to +5%	-5% to +5%	Neutral
Denmark	High	-5% to +5%	-5% to +5%	Neutral

Key data and events (1)

Monday, February 11, 2008				Period	Danske Bank	Consensus	Previous
1:30	AUD	Home loans	m/m	Dec		-1.0%	4.0%
8:45	FRF	Industrial production	m/m y/y	Dec		0.8% 1.7%	-1.5% 2.5%
9:30	SEK	Activity index		Dec			124.0
10:00	NOK	Producer prices, incl oil	m/m y/y	Jan			0.2% 12.4%
10:00	NOK	Consumer prices	m/m y/y	Jan	-0.3% 3.8%	-0.3% 3.8%	0.8% 2.8%
10:00	NOK	Core inflation(CPI-ATE)	m/m y/y	Jan	-0.4% 2.2%	-0.3% 2.1%	0.3% 1.8%
10:30	GBP	PPI - Output	m/m y/y	Jan		0.4% 5.1%	0.5% 5.0%
10:30	GBP	DCLG House Prices	y/y	Dec			9.5%
14:30	CAD	New housing price index	m/m	Dec		0.3%	0.5%

Tuesday, February 12, 2008				Period	Danske Bank	Consensus	Previous
-	USD	Fed's Poole (hawk, non-voter) speaks					
10:00	SEK	Nat. labour market board, Unemployment	%	Jan	3.5%	3.5%	3.5%
10:30	GBP	CPI	m/m y/y	Jan		-0.6% 2.3%	0.6% 2.1%
10:30	GBP	CPI core	y/y	Jan			1.4%
10:30	GBP	RPI Inflation	m/m y/y	Jan		-0.6% 4.1%	0.6% 4.0%
10:30	GBP	RPI Ex Mort Int Payments	y/y	Jan		3.3%	3.1%
11:00	DEM	ZEW economic sentiment	Index	Feb	-44.0	-43.5	-41.6
14:00	PLN	Current account	Euro mil	Dec	-720		-351
14:00	PLN	Trade balance	EUR mil	Dec	-975	-1156	-793
17:05	USD	Fed's Yellen (dove, non-voter) speaks on economy					
20:00	USD	Monthly budget statement	USD bn	Jan		33.0	38.2

Wednesday, February 13, 2008				Period	Danske Bank	Consensus	Previous
1:01	GBP	RICS House Price Balance	y/y	Jan			-49.1%
9:30	SEK	Riksbank, Rate decision	%	Feb	4.00	4.00	4.00
10:30	GBP	Average Earnings ex bonus	3Ms/YoY	Jan		3.7%	3.6%
10:30	GBP	Claimant Count Rate	%	Jan			2.5%
10:30	GBP	Jobless claims change	'000	Jan		-5.0	-6.4
10:30	GBP	Average Earnings incl bonus	3Ms/YoY	Dec		4.0%	4.0%
11:30	GBP	BoE quarterly inflation report					
14:30	USD	Retail sales	m/m	Jan	-0.5%	0.0%	-0.4%
14:30	USD	Retail sales less autos	m/m	Jan	0.0%	0.2%	-0.4%

Thursday, February 14, 2008				Period	Danske Bank	Consensus	Previous
-	USD	Fed's Bernanke (neutral, voter) and Paulson testify before state committee					
0:50	JPY	GDP, q/q and q/q annualized	q/q q/q ann.	4th quarter	0.5% 1.9%	0.4% 1.7%	0.4% 1.5%
0:50	JPY	Industrial production, final	m/m y/y	Dec		0.7% 1.4%	0.7% 1.4%
1:30	AUD	Unemployment rate	%	Jan		4.3%	4.3%
8:00	DEM	GDP	q/q y/y	4th quarter	0.3% ..	0.3% 1.8%	0.7% 2.5%
8:30	FRF	Bank of France Bus. Sentiment	Index	Jan			103
8:45	FRF	GDP preliminary	q/q y/y	4th quarter		0.3% 2.0%	0.8% 2.2%
9:00	ESP	GDP Preliminary	q/q y/y	4th quarter		0.6% 3.3%	0.7% 3.8%
9:30	SEK	Unemployment	%	Jan	6.1%	6.3%	5.6%
10:00	EUR	ECB Publishes Feb. Monthly Report		Feb			
11:00	EUR	GDP, s.a.	q/q y/y	4th quarter	0.4% 2.2%	0.4% 2.2%	0.8% 2.7%
14:30	USD	Trade balance	USD bn	Dec		-61.0	-63.1
14:30	USD	Initial jobless claims	1000	Feb		340	356
14:30	CAD	International merchandise trade	CAD bn.	Dec		3.5	3.7
18:00	NOK	Annual address					
19:30	USD	Fed's Evans (neutral, non-voter) speaks					

Key data and events (2)

Friday, February 15, 2008			Period	Danske Bank	Consensus	Previous
-	JPY	BoJ Monetary Policy Announcement	Feb		0.50%	0.50%
1:30	USD	Fed's Mishkin (dove, voter) speaks				
8:00	EUR	EU 25 New Car Registrations	%	Jan		1.3%
8:45	FRF	Non-Farm Payrolls, preliminary	%	4th quarter	0.3%	0.4%
9:00	ESP	CPI- EU Harmonised	m/m y/y	Jan	-0.6% 4.4%	0.4% 4.4%
10:00	NOK	Trade balance	NOK bn	Jan		39.6
11:00	EUR	Trade Balance, s.a.	EUR bn	Dec		2.7
14:00	PLN	CPI	y/y	Jan	4.2%	4.1%
14:00	PLN	Wages	y/y	Jan	9.7%	9.2%
14:00	PLN	Employment	y/y	Jan	4.9%	4.9%
14:30	USD	Import prices	m/m y/y	Jan	0.5% ..	0.0% 10.9%
14:30	USD	Empire Manufacturing	m/m	Feb	7.8	9.0
15:15	USD	Industrial production	m/m	Jan	0.0%	0.1%
15:15	USD	Capacity utilization	%	Jan	81.4%	81.4%
16:00	USD	University of Michigan Confidence	Index		77.0	77.3

During the week			Period	Danske Bank	Consensus	Previous
Fri 15 - 19	CNY	Money supply M2	%	Jan		16.7

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