

Weekly Focus

11-18 January 2008

Frank words from Bernanke

US economic data have deteriorated sharply in recent weeks, and there is much to suggest that the pace of economic growth has slackened considerably in the closing months of the year. Now it is not just the housing market that is applying the brakes, industry and the labour market are also dragging the pace down. These developments have caused increasing concerns – both in the market and among analysts – that the US will slip into outright recession. While this is still not our main scenario, we see the risk of recession as having increased significantly: the US economy is balancing on a knife-edge (see “US” section).

That worries have also reached a critical level at the US central bank (Fed) was clearly apparent on Thursday evening, when Fed chief Bernanke spoke with unequivocal frankness. Bernanke signalled a shift in attitude on monetary policy in a speech that covered the problems in the housing market and the effect of the sub-prime crisis on the financial markets and the economy. Up to now, the Fed has been cautious about indicating whether there was a need for more rate cuts, but Bernanke’s speech left no doubt, stating that the Fed was ready to “take substantive additional action” and “act in a decisive and timely manner” to insure against a hard landing.

Combined with the latest weak data, Bernanke’s speech suggests that the Fed now fears being too slow to cut interest rates relative to the state of the economy. Given this, we are changing our forecast for the January rate meeting and now expect a 50bp cut to 3.75%. Our forecast profile thereafter is unchanged, with one 25bp rate cut per meeting for the rest of H1. This will bring the Fed funds rate down to 3.00% at the June FOMC meeting. Read more in [Flash Comment - US: Fed to cut by 50bp in January](#).

Downturn in US data

Housing market continues down



Industry slowing



Unemployment rising



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Denmark

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Denmark's economy has been motoring a little too fast

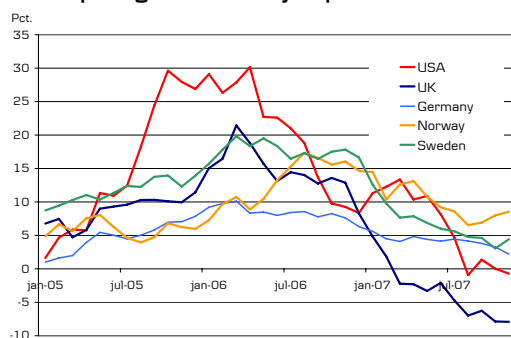
The past week has seen a string of data that underline that the Danish economy has been motoring a little too fast – and that speed has its price. Unemployment has dropped below 3% for the first time since 1974, which is great, but at the same time the current account surplus is being eroded fast, and core inflation is on the way up. The economy has been on the verge of overheating and this has squeezed Danish competitiveness. Signs are, however, emerging that the economy is beginning to gear down, so the opportunity to undertake timely fiscal tightening is almost gone.

One alarm bell was core inflation. Danish core inflation, measured as inflation minus unprepared foodstuffs and energy, has in just one year risen from 1.4% to 2.1% – the highest level since September 2003. The increase in core inflation has been very much driven by the pick-up in Danish wage growth and it highlights that wage growth is not being matched by substantial increases in productivity. We expect that growing domestic pressure price pressure combined with high food and energy prices will keep inflation above 2% throughout most of 2008 – possibly approaching 3% during the summer.

A second alarm bell was the current account surplus, which has fallen sharply. The current account surplus for the previous 12 months fell to DKK 21.3bn in November, compared with DKK 46.7bn just one year ago. The fall was largely due to a deterioration in the trade balance, which resulted from labour shortages and eroded competitiveness, undermining export growth, which has dropped markedly since its peak one and a half years ago. Export growth has declined across all major export markets.

Import growth has also slowed in the past year and a half, but not by quite as much as export growth. Should import growth continue to outstrip export growth by such a wide margin as has been the case since the start of 2005, the surpluses on both the trade balance and the current account will be gone in around a year's time. However, we expect that even though the erosion of competitiveness will put pressure on export growth, the slowdown in domestic consumer spending will help pull import growth lower and keep the current account positive – but perhaps only just.

Export growth to key export markets



Key events of the week ahead

- National account numbers on Wednesday. Following strong GDP growth in Q3, we expect a more subdued 0.4% in Q4, bringing GDP growth for 2007 to 1.7%.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Wed 16	9:30	DKK GDP, final	q/q	3rd quarter		1.3%

Sweden

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How about that Activity Index?

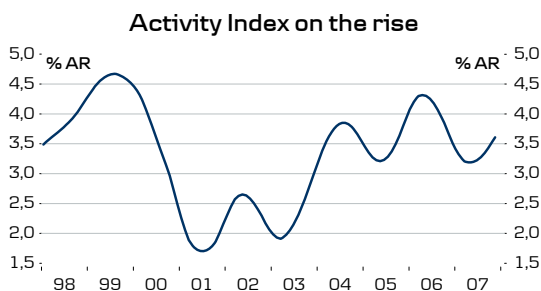
In the midst of all the negative input from both the global and the domestic economies, an important indicator – the Activity Index (AI), the GDP indicator, seems to be recovering and is now considerably above trend. What are we to make of this data?

– Well, we are indeed anticipating a mild recoil in Q4 GDP. But we do not expect anything near the 5.9% y/y (!) growth rate that the October and November AI are suggesting. However, a simple sensitivity test of the AI series indicates that a seasonally normal outcome in December would result in an AI in the vicinity of 3.5% y/y for Q4. However, this would still be a long way above our Q4 estimate.

Unfortunately, Statistics Sweden (SCB) does not provide us with details on the model that produces the monthly AI estimates. When trying to emulate the AI we have found that there is a large degree of interdependence among the variables, which gives rise to something the statisticians call ‘autocorrelation’. Autocorrelation makes parameter estimates uncertain and falsely inflates statistical tests of regression models. This might be controlled for using various statistical procedures, but we are uncertain as to what extent this is done by the SCB (and autocorrelation might still be present, despite correctional procedures).

This is especially true when checking the correlation between production (especially production of telecom products) and the trade balance. And now in November, when both the trade balance and industrial production were two of the main contributors, it is explicitly stated that the production of telecom products rose dramatically in November compared to October.

To conclude, we believe that the Activity Index indeed highlights potential upside risks to our GDP estimate for Q4 07. However, given that other variables – even including those used as input to the AI calculations – are weak and/or weakening further, we will await December data before drawing any stronger conclusions as to the outcome for the Activity Index.



Key events of the week ahead

- Inflation out on Monday: It will be interesting to see how the outcomes compare to the Riksbank’s forecasts.
- House price barometer should also prove interesting given the discussions on slowing house prices during the autumn/winter.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Mon 14	9:30	SEK CPI	m/mly/y	0.4% 3.7%	0.3% 3.6%	0.6% 3.3%
Mon 14	9:30	SEK Underlying inflation	m/mly/y	0.3% 2.2%	0.3% 2.2%	0.5% 1.9%
Tue 15	10:00	SEK Nat. labour market board, Unemployment	%		3.5%	3.1%

Norway

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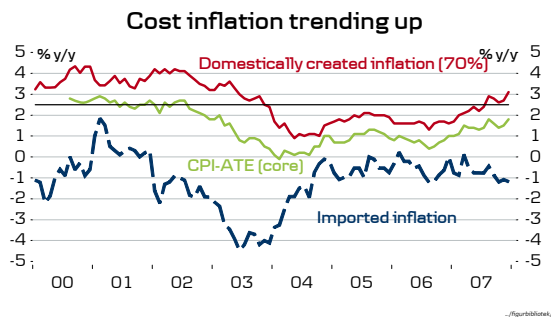
All set for another rate hike

The past week supplied solid ammunition for our expectations of another rate hike in Norway. Firstly, inflation now seems to be rising. Core inflation came out at 1.8% y/y for December. This was well over the estimate included in the November central bank policy report. The increase in core inflation was broadly based on goods and services produced in Norway, illustrating that Norway's rapid cost growth is beginning to make itself felt.

Secondly, higher inflation should be viewed in the context that other indicators for the Norwegian economy are showing no signs at all of easing off. For instance, labour market data indicated job growth of close to one per cent in Q4. With normal productivity growth, this suggests mainland GDP expanded by roughly 1.5% (excluding power production) during the same period. Therefore, we have raised our growth estimate for 2007 to 5.8%, which is well over Norges Bank's November estimate of 5.25%.

As we know that manufacturing industry is beginning to feel the effects of lower global demand - and the construction industry the effects of higher interest rates - the strong growth outlook indicates considerable momentum in consumer spending, which is not that strange, considering the significant growth in household income. The November retail sales data confirmed this impression. Retail sales grew 1.0% on the month (7.5% y/y), which suggests consumer spending may have expanded by roughly 7% (!) in 2007.

As Norges Bank is now underestimating both the rate of growth in the economy and inflation, we believe the stage is set for another rate hike. It will most likely come at the central bank's policy meeting on 23 April, but we do not rule out a hike as early as 13 March.



Key events of the week ahead

- No important indicators due out.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Tue 15	10:00	NOK Trade balance	Dec		32.5	31.3

Euroland and Switzerland

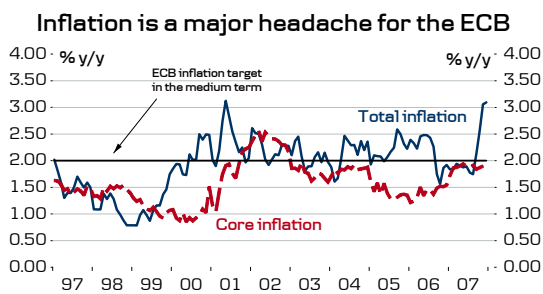
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Can the ECB cut interest rates when inflation is so high?

We changed our forecast for the ECB last Friday, calling for the central bank to ease monetary policy by 50bp in H2 08. This was due to a combination of the credit crisis looking set to continue, an earlier-than-expected slowdown in US manufacturing, Euroland private consumption appearing to soften, Euroland's exports no longer receiving so much support from eastern Europe and, finally, credit terms having presumably been tightened more in Euroland over the past year than in other regions, such as the US and Japan.

However, there are a number of risks to our scenario. First, the US economy may bounce back strongly before the weakness in Europe becomes severe enough for the ECB to cut. Second, it is not certain that global growth will soften sufficiently to seriously dent export growth (emerging markets still look strong). Third, inflation is high, and there is a risk of elevated wage agreements in the spring – especially in Germany. Euroland inflation was 3.1% y/y in December, and while the German VAT hike will fall out of the annual inflation rate in January 2008, rising oil and food prices will probably keep inflation at 3.1% this month. Can the ECB, which has a target of keeping inflation below 2% in the medium term, really ignore such a high inflation rate?

No, of course not. Furthermore, rising oil and food prices will have some knock-on effect on other goods, and there is a real risk that wage growth will accelerate. However, we expect that wage growth will only pick up a little, though German wages may see significant increases. Meanwhile, the outlook is for just a temporary increase in underlying inflation (excluding food and energy), and only to a little above 2%. One should also remember that the last time the ECB embarked on a rate-cutting course, inflation was at 3.1% and core inflation was rising sharply. Finally, it is typically the case that global inflationary pressures (oil and food) ease when global growth slows. The big question with regards to both global growth and global inflation is whether growth in the emerging markets will ease enough to cause a major slowdown in Euroland's exports and in global commodity prices. This is one of the key issues that will influence whether or not our forecast of rate cuts from the ECB in the course of the autumn will be proved correct.



Key events of the week ahead

- ZEW, financial investors' expectations for the German economy, will probably fall further.
- Final inflation numbers for Euroland. We expect the preliminary estimate of 3.1% to be confirmed. Rising food inflation will neutralise falling energy price inflation, keeping the figure constant at 3.1% y/y.
- ECB's monthly report, which will contain a number of signals on the ECB's view on the inflation outlook.

Date	Time	Event	Period	Danske Bank	Consensus	Previous	
Mon 14	10:00	EUR Industrial production	m/mly/y	Nov	-0.5% 2.9%	-0.7% 2.7%	0.4% 3.8%
Tue 15	8:45	FRF CPI	m/mly/y	Dec	0.2% 2.5%	0.3% 2.5%	0.5% 2.4%
Tue 15	9:00	ESP CPI EU-harmonized	y/y	Dec			4.3%
Tue 15	10:00	ITL CPI (NIC incl tobacco), final	m/mly/y	Dec	0.3% 2.6%	0.3% 2.6%	0.3% 2.6%
Tue 15	11:00	DEM ZEW economic sentiment	Index	Jan	-40	-39.0	-37.2
Tue 15	11:00	DEM ZEW current situation	Index	Jan	56	58.0	63.5
Tue 15	11:00	EUR ZEW economic sentiment		Jan	-39		-35.7
Wed 16	8:00	DEM Consumer prices, final	m/mly/y	Dec		0.5% 2.8%	0.5% 2.8%
Wed 16	8:00	DEM CPI EU-harmonized, final	m/mly/y	Dec		0.7% 3.1%	0.5% 3.1%
Wed 16	12:00	EUR Inflation	m/mly/y	Jan	0.4% 3.1%	0.4% 3.1%	0.5% 3.1%
Wed 16	12:00	EUR Inflation core	y/y	Dec	2.0%	2.1%	1.9%
Thu 17	12:00	EUR Trade Balance	EUR bn	Nov			6.1

Poland

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Inflation continues to rise

It will be a busy week in terms of economic data for Poland. At the top of the agenda will be December's inflation figures. Inflation continues to rise in Poland driven by both supply-side factors - higher food and energy prices - and strong domestic demand.

While we expect domestic demand to ease somewhat during 2008, the lagged impact from strong wage growth and especially higher energy prices will keep inflation well above the Polish central bank's (NBP) inflation target of 2.5% during 2008. In December, we expect inflation to have risen to 4.0% y/y from 3.6% y/y in November.

The continued rise in Polish inflation will undoubtedly keep the NBP in a hawkish mood for some time to come and we continue to expect that the NBP will hike its key policy rate by another 25bp at the end of January. One rate hike should be expected in March or April. However, looking into the second half of 2008, the challenges to monetary policy should be expected to increase as inflation is expected to remain above the NBP's inflation target, but at the same time we expect domestic demand to begin to ease somewhat, and concurrently the ECB is expected to start cutting interest rates. This will surely make it harder for the hawks on the NBP's monetary policy council to convince the doves that further monetary tightening will be needed.



Key events of the week

- We expect Polish inflation to have risen to 4.0% y/y in December - up from 3.6% y/y in November.
- We expect a current account deficit of EUR 1.0bn in November.

Date	Time	Event	Period	Danske Bank	Consensus	Previous	
Tue 15	14:00	PLN CPI	y/y	Dec	4.0%	4.0%	3.6%
Wed 16	14:00	PLN Exports growth	y/y	Nov	14.1%		15.7%
Wed 16	14:00	PLN Imports growth	y/y	Nov	16.1%		17.0%
Wed 16	14:00	PLN Current account	m. EUR	Nov	-1000	-930	-1302
Wed 16	14:00	PLN Trade balance	m. EUR	Nov	-750	-700	-587
Wed 16	14:00	PLN Wages	y/y	Dec	12.0%	11.8%	12.0%
Wed 16	14:00	PLN Employment	y/y	Dec	5.0%	5.0%	5.0%
Fri 18	14:00	PLN Producer prices	y/y	Dec	2.9%	2.9%	2.6%
Fri 18	14:00	PLN Industrial production	y/y	Dec	8.6%	8.9%	8.3%

USA

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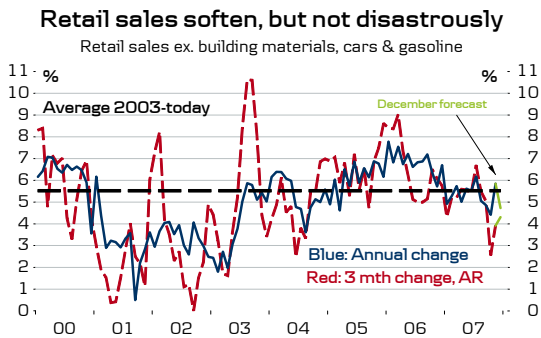
Last man standing: the US consumer

Several important figures on activity and price developments in December are due in the coming week. Given the outlook of weak retail sales and a further slump in housing market, data combined with a rise in annualised core inflation, the recent trend of higher inflation and lower growth looks set to continue.

Last week's surprisingly negative signals from both industry and the labour market indicated a substantial growth slowdown in the supply side of the economy in December. It is still uncertain whether this is due to a real slowdown in household demand or if the soft numbers are the result of a dent in corporate confidence occasioned by the financial crisis. While there is no doubt that the economy faces serious weakness in the short term, the duration and depth of the downturn will be very dependent on the robustness of the US consumer. The coming week's retail sales data may present some measure of this.

Meanwhile, it is also important to remember that Thanksgiving falling early last year - ie, in November - distorted the monthly retail sales figures. This means that the November data were artificially strong and, similarly, that December's data will be artificially low - because a greater share of the Christmas trade than normal occurred in November. To assess the state of the consumer, one should therefore look at the average over both months. Given our expectation of a minor increase in retail sales of 0.1% m/m in December, the average over the final two months of the year should tally up to 0.65% m/m. Some of this can, though, be ascribed to the nominal effect of higher petrol prices. Looking at underlying retail sales excluding petrol, cars and construction material, the average drops to 0.45%, corresponding to an annualised growth rate of 5.5%, which is close to "normal". Hence it is still too early to count the US consumer out, even if there is a small decline in retail sales.

We are, nevertheless, concerned about the latest data. There is little doubt that the risk of a self-perpetuating negative dynamic in the economy has increased significantly given the weakening of the labour market and industry, combined with the ongoing housing market downturn. Hence, the US consumer appears to be the last man standing in the US economy.



Key events of the week ahead

- Tuesday - Core producer prices look set to rise by 0.2% m/m or 2.1% y/y in December.
- Tuesday - Retail sales growth in December will be weak at 0.1% m/m. The risk is for a weaker number.
- Wednesday - Core producer prices rising by 0.2% m/m in December will mean annual core inflation creeping up to 2.4%.
- Wednesday and Thursday - Both construction confidence from the NAHB and new housing starts are set to fall further.

Date	Time	Event	Period	Danske Bank	Consensus	Previous	
Tue 15	14:30	USD Retail sales less autos	m/mly/y	Dec	0.2% 6.3%	0.1%	1.8% 7.4%
Tue 15	14:30	USD PPI	m/mly/y	Dec	0.0% 6.9%	0.2% 7.6%	3.2% 7.2%
Tue 15	14:30	USD PPI core	m/mly/y	Dec	0.2% 2.1%	0.2% 2.0%	0.4% 2.0%
Tue 15	14:30	USD Retail sales	m/mly/y	Dec	0.1% 5.2%	0.1%	1.2% 6.3%
Tue 15	14:30	USD Empire State Manufacturing Index	Index	Jan		10.0	10.3
Wed 16	13:00	USD MBA Mortgage Applications					
Wed 16	14:30	USD CPI ex. food & energy	m/mly/y	Dec	0.2% 2.4%	0.2% 2.4%	0.2% 2.3%
Wed 16	14:30	USD CPI	m/mly/y	Dec	0.3% 4.2%	0.2% 4.1%	0.8% 4.3%
Wed 16	15:00	USD TICS international capital flow, Net inflow	USD bn	Nov			
Wed 16	15:15	USD Industrial production	m/m	Dec	-0.2%	-0.1%	0.3%
Wed 16	15:15	USD Capacity utilization		Dec		81.3%	81.5%
Wed 16	19:00	USD NAHB Housing Market Index	Index	Jan	18	19	19
Wed 16	20:00	USD Beige Book					
Thu 17	14:30	USD Initial jobless claims	1000				
Thu 17	14:30	USD Housing starts	m	Dec		1148	1187
Thu 17	14:30	USD Building Permits		Dec		1140	1162
Thu 17	16:00	USD Philadelphia Fed.	Index	Jan	-2.3	-2.0	-5.7
Thu 17	16:00	USD Fed's Bernanke (voter, neutral) speaks to House Budget Committee					
Thu 17	18:30	USD Fed's Fisher (voter, neutral) speaks					
Thu 17	19:15	USD Fed's Lockhart (non-voter, neutral) speaks					
Fri 18	14:00	USD Fed's Lacker (non-voter, hawk) speaks					
Fri 18	16:00	USD Leading indicator		Dec			
Fri 18	16:00	USD University of Michigan Confidence, preliminary	Index	Jan	76	74.9	75.5

Asia

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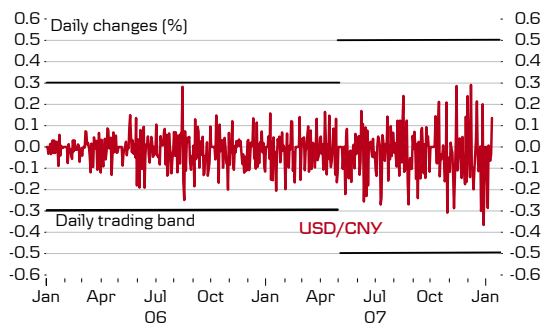
Still no signs of a slowdown in the Chinese economy

The first important economic data from China for December will start to come in during the week, and it is possible that the initial estimate of Q4 GDP growth will be published at the end of the week. To date, there have been few signs of any slowdown in Chinese economic growth. In fact, most indicators suggest that growth accelerated once again at the end of 2007. We expect GDP growth to climb from 11.5% y/y in Q3 to 11.7% y/y in Q4. Our expectation of stronger growth in Q4 is based on both investment and private consumption having been very strong in recent months. The contribution to growth from net exports has fallen back slightly, due to higher import growth, and the overall picture seems to be that Chinese growth is increasingly being driven by domestic demand. As export growth has not fallen dramatically, one might question whether this situation is compatible with stable inflation. We have previously argued that lower export growth due to weaker global economic growth will not necessarily be such a bad thing for the Chinese economy, as it will reduce the need for action within China to cool the economy down.

Since the latest US-China Strategic Economic Dialogue (SED) concluded on 13 December, the rate at which CNY has appreciated against USD has increased. Altogether, CNY has gained more than 1.7% against USD since mid-December. It is not only from abroad that there is growing pressure for a stronger CNY: more and more independent economists inside China are arguing the case for a stronger CNY. We reckon that the gap between Chinese and American standpoints narrowed at the December SED, and that the latest CNY appreciation can be taken as a sign that China is delivering the goods. Not only is CNY strengthening more quickly, but the People's Bank is making increasing use of the daily trading band of +/- 0.5% against the USD (see chart below). So we cannot rule out the possibility of the bank deciding to widen the daily trading band in the coming months and so meeting American calls for increased flexibility.

The market has also sharply adjusted its expectations for CNY appreciation over the last couple of months. 12M USD/CNY NDFs are now trading at 6.72, which is roughly on a par with our expectation of a USD/CNY of 6.75 on a 12-month view. This corresponds to CNY appreciation of around 7.5% over the next year. Although we are now more or less in line with market expectations, we would stress that the risk is very much biased towards CNY strengthening even further. For example, a major revaluation cannot be completely ruled out.

Daily trading band is being used more and more



Key events of the week ahead

- China's Q4 GDP figures may also be released at the end of the week. We predict a slight increase in GDP growth to 11.8% y/y.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Thu 10 - 16	-	CNY Trade balance	USD bn	Dec	24.50	26.28
Fri 11 - 16	-	CNY Money supply M2	%	Dec	18.2	18.5
Fri 11 - 16	-	CNY Foreign Exchange Reserves	bn. Usd	Dec	1510.00	1433.61
Fri 11 - 17	-	CNY Wholesale prices		Dec		7.4%
Wed 16	0:50	JPY Machinery orders	m/m	Nov	-4.5%	12.7%
Wed 16	0:50	JPY Domestic CGPI	m/m/y/y	Dec	2.3% 2.3%	0.2% 2.3%
Wed 16	0:50	JPY Current Account Total	JPY bn	Nov	1860.9	2229.1
Wed 16	7:00	JPY Machine tool orders, prelim.	y/y	Dec		13.0%
Thu 17 - 24	-	CNY GDP Constant Price	y/y	4th quarter	11.7%	11.3%
Thu 17 - 24	-	CNY PPI	y/y	Dec	4.7%	4.6%
Thu 17 - 24	-	CNY CPI	y/y	Dec	6.5%	6.3%
Thu 17 - 24	-	CNY Retail sales value	y/y	Dec	18.6%	18.8%
Thu 17 - 24	-	CNY Industrial production	y/y	Dec	17.2%	17.3%
Thu 17 - 24	-	CNY Fixed assets investments	y/y	Dec		26.8%
Fri 18	0:50	JPY Tertiary Industry Index	m/m	Nov	-0.4%	1.1%
Fri 18	6:00	JPY Consumer confidence		Dec		40.0

Foreign exchange

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New year diet!

The new year has delivered a stark wake-up call after the indulgence of Christmas. Equity markets have fallen across the board, yields are down and economic data from both sides of the Atlantic have been worryingly weak. Our FX views have, since the summer, been based on an assumption of uneasy capital markets and slowing growth, and we are still not ready to alter our bets. Basically, there are three things we do not like at this juncture of the global upswing: canine yoga in Stockholm, bespoke chocolates in London and charity consultants in New York. Enough is enough! Recent years have seen ample expansion into abundance and hence a good call for 2008 is that we will have to lose a few pounds. We have lately witnessed a drastic re-pricing of housing markets, structured products, and now economic expectations as well. That B&O (Denmark's upmarket audio/video producer) was forced to downgrade its earnings expectations is, given this perspective, a little less surprising.

Last week's comment on equities highlighted the risk of a price fall on the back of an economic slowdown. While the second half of 2008 may bring some cheer, one cannot rule out a hard landing, and this uncertainty is now being priced in. **A tumble on equity markets is anything but trivial for the FX market**, as there has been an unusually high correlation between currencies and equities since spring 2007. The day-to-day correlation between changes in the S&P500 and USD/JPY is now some way above 70%. This means that a 10% fall in the S&P500 will, *ceteris paribus*, occasion a fall in USD/JPY of 7%. The same high correlation can be found for EUR/JPY and, more surprisingly, for EUR/CHF. Based on today's spot rates, **a 10% slide in equities could translate into a fall to USD/JPY 100, EUR/JPY 150 and EUR/CHF 1.52, or a solid 10 figures all round.** A similarly high correlation is to be found for AUD and NZD, which would also suffer from a decline in equity prices. Both SEK and NOK have a somewhat weaker correlation with equities, but both would be dragged down by falling prices. There is no guarantee that the current correlations will remain unchanged, and other factors may come into play too, but, if like us, you see the potential for a further fall in equities, this would suggest a rise in JPY and CHF against EUR, USD, AUD and NZD.

What about EUR/USD? Generally speaking, we expect this to rise in the coming months (see [FX forecast update](#), 7 January 2008), although we are aware that not even a dramatic shift in expectations for the US recently has been able to weaken the dollar. Relative rates and rising oil prices point to a stronger EUR, while sliding equity prices and a decline in expectations for Euroland (we expect rate cuts from the ECB this year) point the other way. From a technical perspective, the uptrend is intact so long as it stays above 1.4310, and we expect that the current downward correction will be over and done with before long.

We remain positive on the **Norwegian krone**, not least because this week's data support our expectation of a rate hike in the spring. The **Danish krone** has also continued to rise in the past week. The privatisation of DONG (energy) is expected to give a one-off capital inflow of less than DKK 10bn, which will have no significant impact on exchange rates in today's market, but the effect will, nonetheless, be positive for DKK.

Fixed income

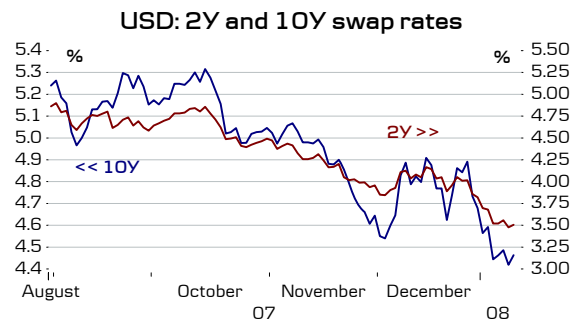
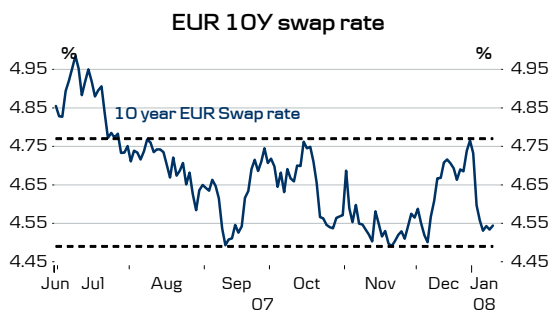
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Yields to rise slightly in the short term

Tactically we look for a modest short term rebound in US yields in the next couple of weeks. Yields have fallen significantly since Christmas and there are some signs of saturation. Last time US 10Y government bond yields went much lower than current levels, many people were comparing the US economy to Japan's in the 1990s and talking about deflation. This is hardly the case today, and the potential for further decreases in long US yields is limited. Markets have had to absorb a range of negative news recently. This leaves little scope for further declines in US yields short term, as it will be difficult to price in more gloom in the near term. Combined with the large drop in yields the last two weeks, these points to a modest short-term rebound in US yields.

The pricing in Euroland is somewhat different than that of the US. The hawkishness of the ECB, better growth prospects and a stronger focus on headline inflation has held a hand under European yields and limited the spillover effect from US yields in recent months. We expect the tug-of-war between high inflation and a hawkish ECB on the one side and a deteriorating economic outlook on the other side to continue to be the key going forward. There is not much that can change the inflation picture in the short term, and Euroland inflation is expected to remain at or just above 3% in January. The positive effect from last year's hike in German VAT is likely to be offset by higher food and fuel prices. This leaves the growth outlook and ECB's interpretation of wage developments as the key factors going forward.

Important data releases this week are: US retail sales (Jan 15), NAHB (Jan 16), US CPI inflation (Jan 16), and final estimate of Euroland CPI inflation (Jan 16). Further, JP Morgan Q4 earnings release (Jan 16) and the results of the Fed's and ECB's USD auctions (Jan 15) can get the market's attention.



Equities

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Danish equities take a severe beating from US recession fears

The Danish equities market has been hit hard by the downturn in global equity markets. The benchmark Danish stock index, OMXC20, is down by 7.7%, while European equities have lost only 5.2%. The Danish stock index has shed 16% since early Q4 07 against Europe's 8%. Several years of growth in the Danish equity market has now given way not only to an absolute, but also to a relative equity market downturn.

On international equity markets what might, at first glance, look like an excessive reaction in prices is unfortunately not excessive, in our opinion. We have been surprised to see how close the US economy has moved to the brink of recession, and with statistics showing an average drop in Wall Street equity prices of 23% during the past six recessions (since 1969) from the start of a recession until the market bottomed out, this obviously gives rise to concern. The US equity market is down by only 9% from its peak in summer 07, so there might be more in store for the US if data in the coming weeks and months tells us that recession has, in fact, become a reality.

For several years, we have held the view that low valuation has been a key driver of global equities. This argument is now losing value, as history shows that corporate earnings, for instance in the USA and Europe, have dropped by 10%-30% in the recessions since the 1970s. Hence, for valuation to become a market driver again there would need to be more certainty about 2008/2009 earnings than is currently the case. In other words, we do not know if the market P/E is 14, 16 or 19, and although we expect a mild slowdown in earnings that will leave good value for the equity market, this is not the time for seemingly attractive, but also more uncertain, valuation to drive equity markets.

There are several reasons for the relative fall in Danish equities, and below we give a brief overview of the conditions affecting the Danish equity market, which, since 2003, has been one of the absolute top performers among European country markets: **1)** Several years of earnings-driven growth for a number of small and medium-sized Danish industrial and financial companies has made the OMXC20 index more sensitive to swings in the business-cycle. **2)** Valuation in the Danish equity market has increased significantly relative to European markets. While, in 2002, the price of Danish stocks was about 75% of that of European stocks generally (in terms of 12M Forward P/E), the Danish market today costs 15% more than its European peers. **3)** The Danish stock market has lost one of its historical virtues, *ie*, being a defensive market. Due to 1) and 2) (see above), the market is more sensitive to fluctuations in international prices today than, for instance, in 2003. **4)** The supply of Danish stocks has fallen in recent years due to buybacks (William Demant, Lundbeck, etc.) and, not least, delistings (ISS, TDC, Copenhagen Airports, etc.). During the same period, Danish retail investors developed a strong appetite for stocks relative to bonds. But this picture has now turned around. Retail investor appetite for Danish equities has again decreased, and the DONG issue will raise the supply of Danish stocks in 2008. **5)** Since 2002 international investors have been looking for Small Cap rather than Large Cap exposure. This has, for a number of years, lent good support to the Danish market, which has an overweight of small/mid cap stocks. Small caps are now generally more expensive than large caps, and we expect international investors to continue finding more value in large than in small cap stocks/markets.

We expect to see large fluctuations in the Danish equity market in 2008. Right now, support for Danish equities is modest, both in absolute terms and relative to the European stock market. We also expect the stock market to be very nervous, with a potential for further falls in prices, until we know more about the length and the depth of the US growth crisis.

Commodities

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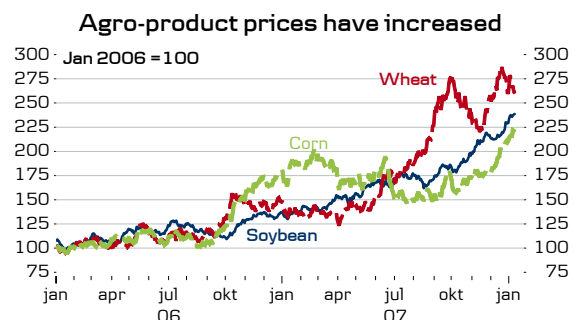
Recession is bad news, but the Fed will rescue commodities

A string of economic commentators have in recent weeks warned that the US economy faces recession – and that it may even have already started. In our view, the US economy will not sink that far, though we do expect that a slow-down in H1 08 will be difficult to avoid. Metals normally react strongly to lower growth in the US, but this is less certain this time around. The connection between the global – or more correctly the OECD and not least the US – industrial cycle and metal prices is well known. Thus, in our view, the correction in metal prices in October and November was, in reality, the market anticipating lower growth. But even more important, emerging markets are not exhibiting the same signs of weakness as the US, and EM demand for metals is undiminished, not least in China. We expect EM demand for metals will continue. In addition, expectations of aggressive interest rate cuts by the Fed provide some hope that US growth can again pick up – and commodities are quick to react to good news.

One important thing to note is that the expected aggressive rate cuts from the Fed will presumably weaken the dollar further. In 2007 there was a very close correlation between, in particular, oil and agricultural prices and the weakening of the dollar. As we have written earlier, dollar-denominated commodities have a tendency to increase in price when the dollar falls. We have already seen record-high gold prices this year, and agricultural prices are continuing to rise.

We expect investor interest in commodities to remain healthy despite the gloomier outlook for the US economy. Investors view commodities as a safe haven of sorts, which offers a hedge against further dollar weakness and a partial hedge against increasing inflation worries. Rising commodity prices are in themselves an important source of inflation in the global economy.

The opening days of the new year have seen precious metal prices rise sharply, and gold has hit an all-time high. Traded commodity prices are also at an elevated level. However, in our view, it is still too early to say that either group has peaked – uncertainty and dollar-weakness are good for both. As regards agro-products, there is also the ethano/China factor and, furthermore, agro-products are also the least sensitive to the economic cycle. Metals will probably meet resistance now and again in the coming months, and high levels of volatility should be expected, though a new tailwind will likely come as the US economy stabilises. Energy prices may also come under some pressure in the spring, but towards the end of the year there is a distinct risk that oil will again breach the magical \$100 a barrel mark.



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	2,8	2,5	1,3	9,1	0,4	3,8	6,0	2,2	4,6	2,0	36,0	6,4
	2008	2,8	2,4	0,8	1,5	-0,4	4,6	1,9	2,3	6,9	2,4	31,7	6,2
	2009	2,8	2,4	0,8	1,5	-0,4	4,6	1,9	1,8	7,5	2,0	27,5	7,7
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	2,3	2,9	2,0	-1,7	-0,2	7,8	1,9	2,9	4,6	-1,2	60	-5,5
	2008	2,0	2,1	2,3	-2,7	-0,2	8,3	1,4	3,1	5,1	-1,1	58	-4,2
	2009	2,5	2,4	2,0	1,4	0,1	6,7	3,7	2,3	5,4	-1,4	57	-4,1
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	11-jan	4,25	3,40	4,49	147,9	-	503,6
	+3m	3,50	3,40	4,45	152	-	491
	+6m	3,00	3,15	4,30	150	-	497
	+12m	3,00	3,75	4,70	140	-	533
EUR	11-jan	4,00	4,33	4,54	-	147,9	744,6
	+3m	4,00	4,30	4,50	-	152	746,0
	+6m	4,00	4,15	4,45	-	150	746,0
	+12m	3,50	3,95	4,40	-	140	746,0
JPY	11-jan	0,50	0,84	1,60	161,3	109,1	4,62
	+3m	0,50	0,95	1,65	160	105	4,66
	+6m	0,50	1,00	1,70	150	100	4,97
	+12m	0,75	1,35	1,90	147	105	5,07
GBP	11-jan	5,50	5,00	4,89	75,7	195,2	983,1
	+3m	5,00	4,90	4,90	75,5	201	988
	+6m	4,75	4,90	4,75	74,0	209	1008
	+12m	4,50	4,90	4,80	72,0	201	1036
CHF	11-jan	2,75	2,77	3,23	162,8	110,1	457,4
	+3m	2,75	2,80	3,20	163	107	458
	+6m	2,75	2,70	3,20	162	108	460
	+12m	2,50	2,60	3,15	160	114	466
DKK	11-jan	4,25	4,51	4,66	744,6	503,6	-
	+3m	4,25	4,50	4,65	746,0	491	-
	+6m	4,25	4,35	4,60	746,0	497	-
	+12m	3,75	4,20	4,55	746,0	533	-
SEK	11-jan	4,00	4,53	4,78	937,5	634,0	79,4
	+3m	4,00	4,30	4,60	935	615	79,8
	+6m	4,00	4,00	4,45	930	620	80,2
	+12m	3,50	4,30	4,60	940	671	79,4
NOK	11-jan	5,25	5,71	5,50	781,3	528,4	95,3
	+3m	5,25	5,50	5,60	780	513	95,6
	+6m	5,50	5,50	5,60	775	517	96,3
	+12m	5,50	5,25	5,60	775	554	96,3
PLN	11-jan	5,00	6,11	5,75	358,2	242,1	207,9
	+3m	5,00	6,20	5,60	370	243	202
	+6m	5,25	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	Lower than -5%	-5% to +5%	Neutral
Japan	Average	Lower than -5%	-5% to +5%	Overweight
Emerging markets (USD)	High	Lower than -5%	-5% to +5%	Underweight
Pan-Europe (EUR)	Low	Lower than -5%	-5% to +5%	Overweight
Nordics				
Sweden	High	Lower than -5%	-5% to +5%	Neutral
Norway	High	Lower than -5%	-5% to +5%	Neutral
Denmark	High	Lower than -5%	-5% to +5%	Neutral

Key data and events (1)

Monday, January 14, 2008					Period	Danske Bank	Consensus	Previous
9:30	SEK	CPI	m/mly/y	Dec	0.4% 3.7%	0.3% 3.6%	0.6% 3.3%	
9:30	SEK	Underlying inflation	m/mly/y	Dec	0.3% 2.2%	0.3% 2.2%	0.5% 1.9%	
10:00	EUR	Industrial production	m/mly/y	Nov	-0.5% 2.9%	-0.7% 2.7%	0.4% 3.8%	
10:30	GBP	DCLG House Prices	y/y	Nov		10.7%	11.3%	
10:30	GBP	PPI - Input	m/mly/y	Dec		0.5% 10.5%	1.7% 10.3%	
10:30	GBP	PPI - Output	m/mly/y	Dec		0.4% 4.7%	0.5% 4.5%	

Tuesday, January 15, 2008					Period	Danske Bank	Consensus	Previous
8:45	FRF	CPI	m/mly/y	Dec	0.2% 2.5%	0.3% 2.5%	0.5% 2.4%	
9:00	ESP	CPI EU-harmonized	y/y	Dec			4.3%	
10:00	NOK	Trade balance	NOK bn	Dec		32.5	31.3	
10:00	ITL	CPI (NIC incl tobacco), final	m/mly/y	Dec	0.3% 2.6%	0.3% 2.6%	0.3% 2.6%	
10:00	SEK	Nat. labour market board, Unemployment	%	Dec		3.5%	3.1%	
10:30	GBP	CPI	m/mly/y	Dec		0.5% 2.0%	0.3% 2.1%	
10:30	GBP	CPI core	y/y	Dec		1.5%	1.4%	
10:30	GBP	RPI Inflation	m/mly/y	Dec		0.6% 4.1%	0.4% 4.3%	
10:30	GBP	RPI Ex Mort Int. Payments	y/y	Dec		3.1%	3.2%	
11:00	DEM	ZEW economic sentiment	Index	Jan	-40	-39.0	-37.2	
11:00	DEM	ZEW current situation	Index	Jan	56	58.0	63.5	
11:00	EUR	ZEW economic sentiment		Jan	-39		-35.7	
14:00	PLN	CPI	y/y	Dec	4.0%	4.0%	3.6%	
14:30	USD	PPI	m/mly/y	Dec	0.0% 6.9%	0.2% 7.6%	3.2% 7.2%	
14:30	USD	Retail sales less autos	m/mly/y	Dec	0.2% 6.3%	0.1% .	1.8% 7.4%	
14:30	USD	PPI core	m/mly/y	Dec	0.2% 2.1%	0.2% 2.0%	0.4% 2.0%	
14:30	USD	Retail sales	m/mly/y	Dec	0.1% 5.2%	0.1% .	1.2% 6.3%	
14:30	USD	Empire State Manufacturing Index	Index	Jan		10.0	10.3	

Wednesday, January 16, 2008					Period	Danske Bank	Consensus	Previous
0:50	JPY	Machinery orders	m/m	Nov		-4.5%	12.7%	
0:50	JPY	Domestic CGPI	m/mly/y	Dec		2.3% 2.3%	0.2% 2.3%	
0:50	JPY	Current Account Total	JPY bn	Nov		1860.9	2229.1	
1:30	AUD	Home loans	m/m	Nov		1.0%	-0.7%	
7:00	JPY	Machine tool orders, prelim.	y/y	Dec			13.0%	
8:00	DEM	Consumer prices, final	m/mly/y	Dec		0.5% 2.8%	0.5% 2.8%	
8:00	DEM	CPI EU-harmonized, final	m/mly/y	Dec		0.7% 3.1%	0.5% 3.1%	
9:30	DKK	GDP, final	q/q	3rd quarter			1.3%	
10:30	GBP	Jobless claims change	'000	Dec		-5.0	-11.1	
10:30	GBP	Average Earnings incl. Bonus	3Ms/YoY	Nov		3.9% 3.6%	4.0% 3.6%	
10:30	GBP	ILO Unemployment rate	%	Dec		5.3%	5.3%	
12:00	EUR	Inflation	m/mly/y	Jan	0.4% 3.1%	0.4% 3.1%	0.5% 3.1%	
12:00	EUR	Inflation core	y/y	Dec	2.0%	2.1%	1.9%	
13:00	USD	MBA Mortgage Applications						
14:00	PLN	Current account	m. EUR	Nov	-1000	-930	-1302	
14:00	PLN	Trade balance	m. EUR	Nov	-750	-700	-587	
14:00	PLN	Wages	y/y	Dec	12.0%	11.8%	12.0%	
14:00	PLN	Employment	y/y	Dec	5.0%	5.0%	5.0%	
14:00	PLN	Exports growth	y/y	Nov	14.1%		15.7%	
14:00	PLN	Imports growth	y/y	Nov	16.1%		17.0%	
14:30	USD	CPI ex. food & energy	m/mly/y	Dec	0.2% 2.4%	0.2% 2.4%	0.2% 2.3%	
14:30	USD	CPI	m/mly/y	Dec	0.3% 4.2%	0.2% 4.1%	0.8% 4.3%	
15:00	USD	TICS international capital flow, Net inflow	USD bn	Nov				
15:15	USD	Industrial production	m/m	Dec	-0.2%	-0.1%	0.3%	
15:15	USD	Capacity utilization		Dec		81.3%	81.5%	
19:00	USD	NAHB Housing Market Index	Index	Jan	18	19	19	
20:00	USD	Beige Book						
22:45	NZD	CPI	q/qly/y	4th quarter			0.5% 1.8%	

Key data and events (2)

Thursday, January 17, 2008			Period	Danske Bank	Consensus	Previous
1:30	AUD	Unemployment rate	Dec		4.4%	4.5%
12:00	EUR	Trade Balance	Nov			6.1
14:30	USD	Initial jobless claims				1000
14:30	USD	Housing starts	Dec		1148	1187
14:30	USD	Building Permits	Dec		1140	1162
16:00	USD	Philadelphia Fed.	Jan	-2.3	-2.0	-5.7
16:00	USD	Fed's Bernanke (voter, neutral) speaks to House Budget Committee				
18:30	USD	Fed's Fisher (voter, neutral) speaks				
19:15	USD	Fed's Lockhart (non-voter, neutral) speaks				
22:45	NZD	Retail sales	Nov			-0.7%

Friday, January 18, 2008			Period	Danske Bank	Consensus	Previous
0:50	JPY	Tertiary Industry Index	Nov		-0.4%	1.1%
6:00	JPY	Consumer confidence	Dec			40.0
10:30	GBP	Retail Sales	Dec		0.2% 3.5%	0.4% 4.4%
12:00	LVL	Current account	Nov			-296.7
14:00	PLN	Producer prices	Dec	2.9%	2.9%	2.6%
14:00	PLN	Industrial production	Dec	8.6%	8.9%	8.3%
14:00	USD	Fed's Lacker (non-voter, hawk) speaks				
16:00	USD	Leading indicator	Dec			
16:00	USD	University of Michigan Confidence, preliminary	Jan	76	74.9	75.5

During the week			Period	Danske Bank	Consensus	Previous
Thu 10 - 16	CNY	Trade balance	Dec		24.50	26.28
Fri 11 - 16	CNY	Money supply M2	Dec		18.2	18.5
Fri 11 - 16	CNY	Foreign Exchange Reserves	Dec		1510.00	1433.61
Fri 11 - 17	CNY	Wholesale prices	Dec			7.4%
Thu 17 - 24	CNY	GDP Constant Price	4th quarter	11.7%	11.3%	11.5%
Thu 17 - 24	CNY	PPI	Dec		4.7%	4.6%
Thu 17 - 24	CNY	CPI	Dec	6.5%	6.3%	6.9%
Thu 17 - 24	CNY	Retail sales value	Dec		18.6%	18.8%
Thu 17 - 24	CNY	Industrial production	Dec		17.2%	17.3%
Thu 17 - 24	CNY	Fixed assets investments	Dec			26.8%

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