

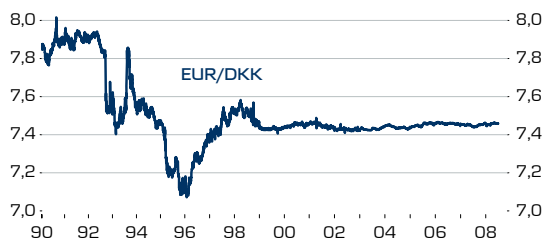
# Weekly Focus

27 June - 4 July 2008

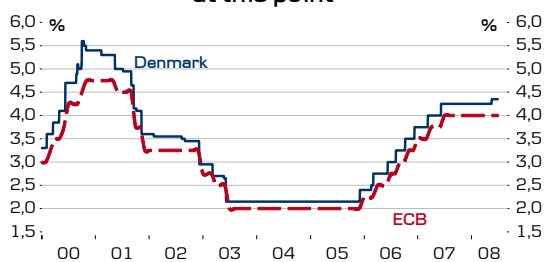
## Still majority for 'yes'...

Denmark: (%)	apr-08	mar-08
yes.....	41,7	42,8
maybe yes.....	9,9	9,6
maybe no.....	6,2	6,3
no.....	39,3	39,0
don't know.....	2,9	2,2
"yes" lead.....	6,1	7,2

## ..still stable currency ...



## ... still low yield spreads ... but no referendum at this point



## Danish referendum on EMU postponed

Until the Irish said No to the Lisbon treaty earlier this month, it seemed likely that two of the three Danish EU opt-outs would be put to the vote in early autumn.

However, the outcome of the Irish referendum has thrown a spanner into the works. Danish prime minister Anders Fogh Rasmussen was quoted on 24 June as saying that a decision on the timing of future referenda cannot be expected until at least October. Similarly, Social Democrat leader Helle Thorning-Schmidt has said that the Danish people cannot reach a decision on the opt-outs until the situation in relation to the treaty becomes clearer.

It would therefore be very difficult in practice to schedule a Danish referendum on EMU for this side of New Year - unless all three opt-outs are put to the vote at the same time, which we doubt will happen. It will also be difficult to find a good time in 2009, which is a very busy year politically, with elections to the European Parliament in June, local elections in November, and a climate summit in December. A decision on EMU would require its own space, and so we do not expect a Danish vote on the opt-outs until at least early 2010. This would be a good time (provided that the government makes it through 2009 unscathed), as there would still be a fair way to go before the next parliamentary elections, due no later than November 2011.

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# Denmark

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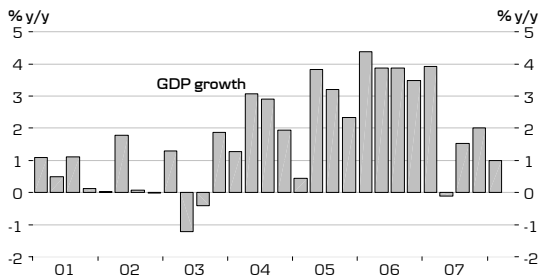
## Worrying dip in productivity

Statistics Denmark published figures on Thursday for business productivity in 2007. These showed that productivity fell by 1.1% last year, the first drop for five years.

It is a historically tight labour market that is sending productivity down. The general shortage of labour means that the employed portion of the labour force is working more hours – the number of hours worked increased by 4.2% in 2007. Economic growth, however, was just 2.7% in 2007, which means that all those extra hours did not result in a corresponding increase in output. This is because the individual worker is not nearly as productive at the end of the working day as at the beginning. In addition, otherwise marginalised groups were brought into the labour market as a result of the strong economic upswing. Their productivity will initially be below the average for the labour market, thus dragging down overall productivity. That said, the previously marginalised have considerable potential to increase their productivity, which could boost overall productivity in the future. Finally, we cannot rule out the possibility of the very tight labour market having caused companies to recruit even if they do not have an immediate need for more staff. It could also be that the downturn in the economy has caught companies by surprise. This is the case in construction, where activity is under pressure but companies may not have fully adjusted to the change in economic climate.

Rising productivity is essential for greater prosperity in the longer term, so it is not good news that productivity is now in decline – although we reckon that most of the dip is temporary. As the pressure on the labour market eases (and there is much to suggest that this will happen in the coming year), the number of hours worked should fall, pushing productivity up. On top of this, the groups that have been brought into the labour market in recent years have the aforementioned potential to increase their productivity as they gain experience in the labour market. Finally, we must not forget that productivity fluctuates widely from year to year.

Declining growth



### Key events of the week ahead

- The dominant event of the coming week is the release of the national accounts for Q1 on Thursday. Most economic indicators have pointed to low growth, but the labour market has continued to surprise on the upside, so it will be interesting to have more detailed information on Q1 developments.

Date	Time	Event	Period	DanskeBank	Consensus	Previous
Mon 30	9:30	DKK Confidence indicator, industry	Index Jun	-2.0		0.0
Tue 01	9:30	DKK Retail sales, volume	m/mly/y May			0.4% 2.1%
Tue 01	9:30	DKK GDP	q/qly/y 1st quarter	0.0% 1.0%		0.3% 1.9%
Wed 02	16:00	DKK Currency reserves	DKK bn Jun			-11.7
Fri 04	9:30	DKK Industrial production sa ex ships	m/m May			9.6%

# Sweden

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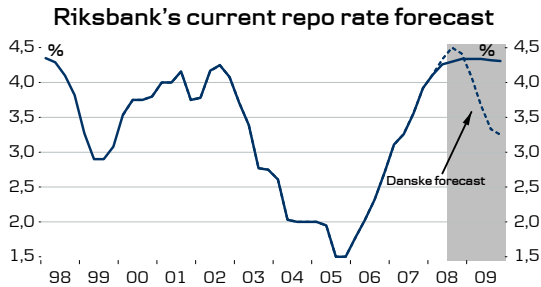
## What to expect from the Riksbank?

We expect the Riksbank to hike the repo rate by 25bp at the upcoming meeting (3 July). We believe that the repo rate path could also **suggest** an additional hike before year-end - i.e. a path that includes a 10-15bp higher repo rate in H2.

However, there are both upside and downside risks to this view:

- (1) Upside risks: In our view, a 50bp hike should be out of the question, but a more aggressive interest rate path is a real possibility. This could be demonstrated by a fully discounted hike at the October meeting, for instance.
- (2) Downside risks: The real economy is struggling, and signs of a weakening labour market are becoming more and more obvious. In addition, growth has come out considerably below Riksbank expectations.

We will be able to study the resolve of the Riksbank in the coming week. However, given that the Riksbank continues to argue for "second-round effects" from higher food and energy prices, we must admit that we are now more hesitant about calling a considerably more hawkish monetary policy stance over the coming 6-12 months. We do not believe that wage pressures will accelerate given the dire state of labour market indicators and the economy at large. Chances are still - at least in our book - that rates will eventually come down once labour market pressures start to ease.



### Key events of the week ahead

- PMI will be the most interesting release this week,
- But the event that everyone will be keeping an eye on is, of course, the Riksbank's rate decision. Given the diverging views of market participants, there could be rather strong market reactions either way.

Date	Time	Event	Index	Period	DanskeBank	Consensus	Previous
Tue 01	8:30	SEK Swedbank PMI Survey	Index	Jun			51.2
Thu 03	9:30	SEK Riksbank, Rate decision	%	Jul	4.50%		4.25%

# Norway

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## Sharper focus on inflation at Norges Bank

Norges Bank decided during the week to raise its key policy rate for the 16th time by 25bp to 5.75%. It was no surprise to see another rate increase in Norway - it was merely a question of whether it would come in June or August.

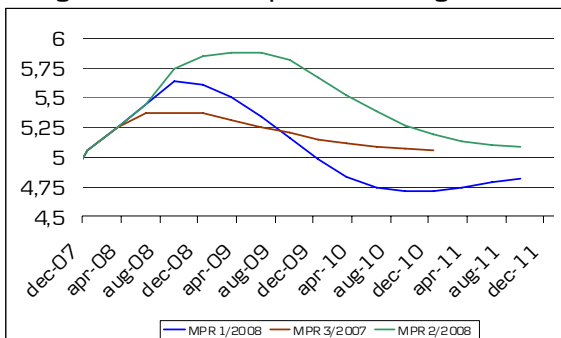
Focus was therefore on the accompanying monetary policy report and comments at the press conference. Starting with the report, Norges Bank made it clear that this hike in June would be the only rate increase during the current strategy period. In other words, no further hikes are on the cards before October. Based on its new interest rate path, Norges Bank sees a 50/50 chance of another 25bp hike in Q4 and expects its key rate to hold just below 6% in 2009. Despite this higher interest rate path, the fixed-income market found the report a tad dovish - many had been expecting the bank to set its sights on a rate of at least 6%.

However, we reckon the tone was much harder at the ensuing press conference. The bank made it clear that interest rates would have been raised further if the fixing spread had been smaller. It also stressed that inflation expectations had risen, which was one of the reasons why the bank chose to hike now rather than wait. We also sense clear concern at the bank over mounting inflationary pressures in Norway.

Since we expect the ECB to hike only one more time, we reckon that Norwegian interest rates have peaked for now, but the risk is clearly that there could be one or more hikes to come. If the ECB does raise its rates further in the autumn, Norges Bank will presumably follow suit. This was the second bit of news from the week's rate-setting meeting: Norges Bank is actually nervous about NOK weakening, as would happen if the policy rate spread narrowed. Things have therefore completely turned around compared to a few years ago, when the bank was worrying about NOK appreciating.

Confirmation that inflation is higher than Norges Bank expects could also trigger fresh rate hikes. In this context it is worth noting that the bank projects underlying inflation of just 2.5% in Q3, whereas we reckon it will be as high as 2.7%.

Higher interest rate path from Norges Bank



### Key events of the week ahead

- Retail sales are expected to fall by 0.2 % m/m in May.
- Credit indicator expected to drop to 14% y/y.

Date	Time	Event		Period	Danske Bank	Consensus	Previous
Mon 30	10:00	NOK Credit indicator (C2)	y/y	May	13.9	14.0	14.3
Mon 30	10:00	NOK Retail sales, s.a.	m/m y/y	May	-0.2% 3.8%	-0.1% 3.9%	0.4% 3.2%
Wed 02	9:00	NOK PMI	Index	Jun	53.0	52.1	53.0

# Euroland

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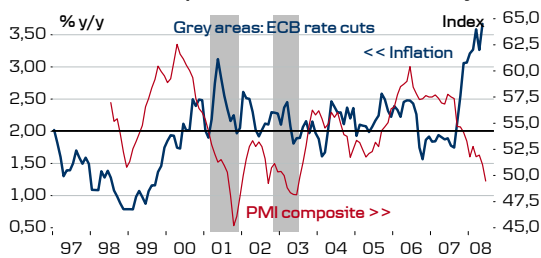
## ECB meeting in the light of weak growth indicators and high inflation

It has been an eventful week, with many of the remaining pieces falling into place in the run-up to the coming week's rate-setting meeting at the ECB. The PMI for Euroland as a whole fell quite sharply in June, which suggests only rather weak growth for the rest of 2008. The fall in the Euroland PMI reflects weak PMI figures for Germany and especially France, which were accompanied by a number of other weak indicators. For example, the Ifo index dropped sharply from 103.5 to 101.3, and French consumer confidence fell further to -46 from an already historically low -41 in May.

The coming week is also a busy one. The final pieces to fall into place ahead of the ECB's meeting on Thursday are June inflation, which we expect to be 3.8%, and final PMI data for Spain and Italy.

The highlight of the week is the ECB's rate-setting meeting. At the press conference in June, the bank surprised everyone by clearly signalling a 25bp rate increase to 4.25% at its next meeting. It would be very difficult for the ECB not to deliver the goods now without losing face. Although incoming data since then have almost unanimously painted a picture of a Euroland economy that is cooling very quickly, we do not think they have been sufficiently weak for the ECB to hold its fire. We therefore expect a rate increase of 25bp in July, but we also expect that growth will weaken sufficiently for the ECB not to raise rates further. Note, though, that this forecast is associated with usually high uncertainty. We have not previously seen the ECB raise interest rates when the economy is shifting down a gear. With the expected hike in July, the ECB is showing that it is ready to react if it sees signs of its credibility coming under pressure. Incoming information on inflation expectations will therefore be particularly important in the coming months.

Low PMI implies rate cuts – but not yet



### Key events of the week ahead

- Monday: Euroland inflation in June. We expect 3.8%.
- Tuesday: Final manufacturing PMI for the big four euro economies.
- Thursday: ECB rate-setting meeting. We expect a 25bp hike to 4.25%.
- Thursday: Services PMI and composite PMI for Euroland.

Date	Time	Event	Period	DanskeBank	Consensus	Previous
Wed 28 - 08	-	DEM CPI - EU Harmonised, preliminary	m/mly/y		0.4% 2.8%	-0.2% 2.6%
Fri 20 - 30	-	EUR ECB Euro-Zone current account	EUR bn			-7.8
Mon 30	8:00	DEM Retail sales, real s.a.	m/mly/y	0.5% 1.0%	0.5% -1.0%	-1.7% -1.0%
Mon 30	11:00	ITL HICP, preliminary	m/mly/y		0.3% 3.8%	0.6% 3.7%
Mon 30	11:00	ITL CPI (NIC incl. tobacco), preliminary	m/mly/y		0.3% 3.6%	0.5% 3.6%
Mon 30	11:00	EUR CPI estimate	m/mly/y	↓3.8%	↓3.8%	↓3.6%
Tue 01	8:00	DEM ILO Unemployment rate	%			7.4
Tue 01	9:15	ESP PMI Manufacturing (June)	Index		47.5	48.0
Tue 01	9:45	ITL PMI Manufacturing	Index		49.2	49.2
Tue 01	9:50	FRF French PMI manufacturing, final	Index		49.2	49.2
Tue 01	9:55	DEM Unemployment, change	1000		-15	4
Tue 01	9:55	DEM Unemployment rate	%		7.9	7.9
Tue 01	10:00	DEM PMI Manufacturing, final	Index	52.3	52.3	52.3
Tue 01	10:00	EUR PMI Manufacturing, final	Index	49.1	49.1	49.1
Tue 01	11:00	EUR Unemployment	%		7.1%	7.1%
Wed 02	11:00	EUR Euroland PPI	m/mly/y			0.8% 6.1%
Thu 03	9:50	FRF French PMI service, final	Index	49.2	49.2	49.2
Thu 03	10:00	ESP Consumer Confidence	Index			56.4
Thu 03	10:00	EUR Euroland PMI, final	Index	49.5	49.5	49.5
Thu 03	10:00	EUR Euroland Service PMI, final	Index	49.5	49.5	49.5
Thu 03	10:00	DEM PMI Service, final	Index	53.3	53.3	53.3
Thu 03	11:00	EUR Retail sales	m/mly/y			-0.6% -2.9%
Thu 03	13:45	EUR ECB Meeting	%	4.25	4.25	4.00
Fri 04	12:00	DEM Factory Orders	m/mly/y		0.6% 1.7%	-1.8% 15.0%

# Switzerland

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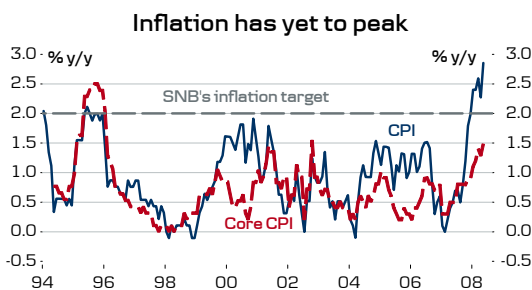
## Is the high inflation only temporary?

The main event of the week in Switzerland will be the publication of inflation figures for June on Thursday – not least because inflation continuing at a high level will be needed for the SNB to respond to the ECB’s expected interest rate hike in July. Inflation has been gathering pace in Switzerland since mid-2007, and hit 2.9% y/y in May, its highest level since 1993. However, the latest rise in inflation has been primarily driven by higher food and energy prices, and can therefore to some extent be expected to be temporary, assuming that oil prices do not continue to rise. The SNB has in fact communicated that it considers the current breaching of its inflation target to be only temporary, and its latest projections indicate that inflation is expected to drop back below 2% in Q2 next year.

However, the producer and import prices (PPI) for May released on 20 June were not exactly encouraging. The increase in PPI was 3.9% y/y, slightly above the consensus expectation of 3.6% y/y. While some of the increase was driven by higher import prices due to higher oil prices, the data also showed that producer prices actually rose more than import prices. Looking at the components of producer prices, these generally indicate increased domestic price pressure, as was also clear from the SNB’s latest core inflation data. Nevertheless, the second-round effects from high oil prices can be expected to be relatively modest, as is also assumed in the latest forecasts from the major Swiss research units.

For example, the past week brought an updated economic forecast from the State Secretariat for Economic Analysis (SECO). Like the SNB, SECO expects inflation to drop back early next year. This is also our main scenario, as favourable base effects coupled with dwindling domestic demand can be expected to pull down inflation. However, risks are on the upside. We still expect inflation to remain lower in Switzerland than in Euroland, which will put downward pressure on EUR/CHF in the longer term. In the short term, though, it will be the central bank’s reaction to the high rate of inflation that dominate. If the ECB hikes in July and the SNB does not follow suit in September this would (other things being equal) result in temporary pressure on the CHF.

Besides the inflation report, the coming week brings the PMI figures for June (SVME). The Swiss PMI has closely mirrored movements in the KOF leading indicator, and has trended down since autumn 2006. The KOF indicator for June was published on Friday, and showed a drop from 1.08 to 1.01, which is a deceleration compared to the falls in previous months.



Source: Reuters EcoWin

### Key events of the week ahead

- Tuesday brings the PMI for June.
- Thursday brings the week’s most important data from Switzerland – June inflation figures.

Date	Time	Event	Period	Danske Bank	Consensus	Previous
Thu 03	7:45	CHF CPI	m/mly/y Jun	0.3%	3.0%	0.8% 2.9%

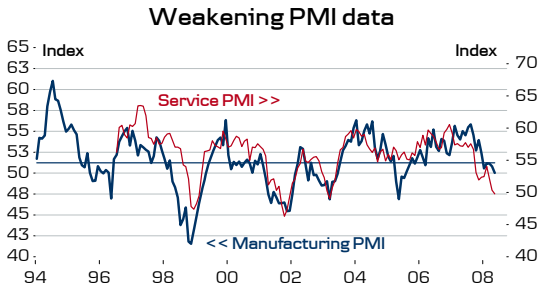
# UK

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## PMI data – further weakness?

The past week has been more of the same. The CBI distributive trades survey rebounded a little on reported sales, but expected sales fell back. So overall there is still a very large divergence between actual retail sales showing sales up 7% while a range of surveys indicate retail sales growth of 1%. Fundamentals are very poor for UK consumers, with rising inflation, a weakening labour market and declining house prices. The woes in the housing market were yet again highlighted this week with the release of BBA mortgage approvals, which were down 56% y/y, declining to the lowest level since 1997. Adding to the headwinds are rising signs that Euroland – one of the UK’s largest export markets – is slowing more rapidly. Hence exporters will likely face a more pronounced trimming of order books than was initially anticipated.

The weak economy has also been highlighted by soft PMIs, and the next is scheduled for release in the coming next week. The service sector, in particular, has shown marked weakness (see chart). PMI price components are rising strongly, however, adding to the Bank of England’s dilemma. At the moment, the bank is not in a position to support growth due to high inflation pressures. Inflation went above 3% last month, triggering a letter from the MPC governor Mervyn King to the chancellor of the exchequer to explain why inflation had broken the 3% upper limit of the MPC’s range of 1-3% (target at 2%). After a period of pricing up to 75bp of hikes over the next year from the Bank of England, the market has now scaled back its expectations to less than 50bp. Financial jitters and weak growth data are again leading to lower yields, and we think this could continue. We also continue to look for a weakening of GBP vs EUR.



### This weeks events

- Monday: Nationwide house prices
- Tuesday: PMI manufacturing likely to fall further
- Thursday: PMI service is also on the decline
- Thursday: Bank of England credit survey should be interesting. Banks may have tightened credit conditions even further.

Date	Time	Event	Period	DanskeBank	Consensus	Previous
Mon 30	1:01	GBP Gfk Consumer confidence	Index Jun		-31	-29
Mon 30	10:30	GBP Net Consumer Credit	GBP bn May		1.1	0.9
Mon 30	10:30	GBP Net Lending Secured on Dwellings	GBP bn May		6.0	6.4
Mon 30	10:30	GBP Mortgage Approvals	1000 May		50	58
Mon 30	10:30	GBP Index of services	q/q Apr			0.5%
Tue 01	8:00	GBP Nationwide House Prices	m/mly/y Jun		-1.0% -6.4%	-2.5% -4.4%
Tue 01	10:30	GBP PMI Manufacturing	Index Jun	49.8	49.8	50.0
Wed 02	10:30	GBP BoE Housing Equity Withdrawal	bn. £ 1st quarter			7.3
Wed 02	10:30	GBP PMI Construction	Index Jun			43.9
Thu 03 - 11	10:30	GBP HBOS House Prices	m/m/q/y Jun		-1.0%	-2.4% -3.8%
Thu 03	10:30	GBP BoE Credit Conditions Survey	2nd quarter			
Thu 03	10:30	GBP PMI Services	Index Jun		49.6	49.8

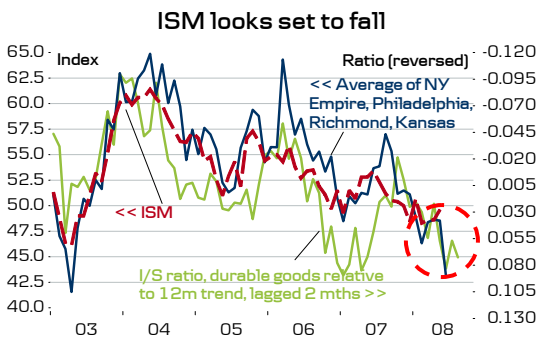
# USA

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## Manufacturing faces further slowdown

The Federal Reserve rate meeting set the agenda for the past week. For the first time since August last year the US central bank did not cut interest rates, which thus remained at 2%. At the press conference afterwards, the Fed noted that the economy did not appear as distressed as previously feared. At the same time, increasing concern was expressed about the high level of inflation and inflation expectations. Overall though, the tone was relatively balanced, and thus did not indicate a hike anytime soon. Clearly the bank remains very uncertain about the prospects for both growth and inflation. While the chances of a rate hike in the near term have diminished as a result of the meeting, the market is still pricing in a more than 50% probability of monetary policy tightening in September (see [Flash Comment: FOMC – Neutral, with rising inflation concerns](#)).

We still believe that rates will be left unchanged for an extended period, as the general picture of a stagnating economy does not look likely to change in the foreseeable future. Indeed, this picture will probably be reinforced in the coming week by manufacturing ISM and the jobs report. So far, the manufacturing sector has remained relatively buoyant, held afloat by low inventories and solid export performance. In recent weeks, however, there have been a number of signs suggesting that the sector is on the edge of a more pronounced slowdown. Local manufacturing indices for June, for example, have so far fallen. The four indices currently available, for New York, Philadelphia, Richmond and Kansas, together indicate an ISM at 43.4 in June versus 48.6 in May. Furthermore, the latest order data demonstrated a deterioration in the ratio of inventories to sales for consumer durables. That said, the ISM has tended to surprise positively in recent months, which is why we expect a more moderate fall to 48 (consensus 49). Friday's jobs report is expected to present a largely unchanged picture of the labour market, with a modest decline in employment of about 50,000, and a temporary dip in unemployment to 5.4% after last month's sharp increase.



### Key events of the week ahead

- Monday - Like consensus, we expect the Chicago PMI to fall to 48.0 from 49.1.
- Tuesday - ISM expected to fall to 48 in June from 49.6 in May. We are a little below the consensus forecast of 49.
- Thursday - Jobs report will show employment falling by 50,000 and unemployment dipping temporarily to 5.4 %.
- Thursday - Service ISM for June almost unchanged at 51.5.

Date	Time	Event	Period	DanskeBank	Consensus	Previous	
Mon 30	15:45	USD Chicago PMI	Index	Jun	48.0	48.5	49.1
Tue 01	-	USD Total Vehicle Sales	m	Jun		14.2	14.3
Tue 01	16:00	USD ISM Manufacturing	Index	Jun	48.0	49.0	49.6
Tue 01	16:00	USD Construction spending	m/m	May		-0.6%	-0.4%
Tue 01	16:00	USD ISM prices paid	Index	Jun		86.0	87.0
Wed 02	-	USD Fed's Lockhart (non-voter, neutral) speaks					
Wed 02	13:00	USD MBA mortgage applications	%				-9.3
Wed 02	16:00	USD Factory Orders	m/m	May		0.5%	1.1%
Wed 02	18:00	USD Fed's Mishkin (voter, dove) speaks					
Thu 03	14:30	USD Change in nonfarm payroll	1000	Jun	-50	-54	-49
Thu 03	14:30	USD Unemployment	%	Jun	5.4	5.4	5.5
Thu 03	14:30	USD Average hourly earnings, non-farm	m/m	Jun	0.3%	0.3%	0.3% 3.5%
Thu 03	14:30	USD Initial jobless claims	1000				384
Thu 03	16:00	USD ISM (NAPM) non-manufacturing	Index	Jun	51.5	51.4	51.7
Fri 04	-	USD Independence Day - Market closed					

# Asia

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## Japanese inflation jumps as growth stalls

A string of economic data in the past week suggests, on the one hand, that inflation is rising more than expected and, on the other, that GDP growth will stall in Q2 after surprising positively in previous quarters.

Inflation excluding fresh food rose to 1.5% y/y in May from 0.9% y/y. Some of this jump was due to the government reintroducing a petrol duty that was temporarily lifted in April. The increase in petrol duties explains around 0.3 percentage points of the increase in inflation. Preliminary inflation numbers for the Tokyo area in June suggest surprisingly strong price increases on food. Together with increasing energy prices, this means that inflation in June could reach as high as 1.9% y/y. Thus, a breach of the Bank of Japan's target for price stability (0%-2%) in the coming months can no longer be ruled out, in contrast to what we had previously assumed.

It is first and foremost the increasing rate of inflation that means the outlook for private consumption is very weak in Japan. Rising inflation coupled with slowly falling employment means that overall real income growth is currently less than -1% y/y, as can be seen in the graph below. By way of comparison, real incomes were growing by more than 0.5% y/y in early 2008. Weak real income growth means we now expect a considerable fall in private consumption of -0.5% q/q in Q2. Given that export growth has also slowed sharply, GDP growth looks set to slow significantly in Q2. We currently forecast zero growth in Q2 (revised down from 0.3% q/q), but negative growth can certainly not be ruled out.

In light of the outlook for a significant slowdown in growth, we believe that the BoJ will continue to have a relaxed view about the recent rise in inflation. Furthermore, core inflation (excl. energy and food) is still just 0% y/y, and there is as yet no sign of second-round effects from rising energy and food prices. While inflation may rise more than we previously expected (and temporarily breach the price stability target), we do not believe it will have any noticeable effect on monetary policy. The BoJ may begin to focus a little more on inflation expectations, but we still expect that it will not hike interest rates until H2 09.

Contributions to real income growth, Japan



### Key events of the week ahead

- Monday sees the release of Japanese PMI manufacturing for June and housing starts for May.
- On Tuesday, the Bank of Japan will publish the important Tankan survey for Q2. Business confidence is expected to deteriorate significantly.
- Also Tuesday, Chinese manufacturing PMI for June. So far there has been no suggestion of a slowdown in industrial production,

Date	Time	Event	Period	DanskeBank	Consensus	Previous
Mon 30	1:15	JPY Nomura/JMMA Manufacturing PMI	Index Jun			47.7
Mon 30	7:00	JPY Housing starts	y/y May		-3.2%	-8.7%
Mon 30	7:00	JPY Construction orders	y/y May			-8.4%
Tue 01	1:50	JPY Tankan Lge Manufacturer's Index	Index 2nd quarter	1	3	11
Tue 01	1:50	JPY Tankan Lge Mfg Outlook	Index 2nd quarter	0	2	7
Tue 01	1:50	JPY Tankan Non-Manufacturing	Index 2nd quarter	5	8	12
Tue 01	1:50	JPY Tankan Non-Mfg Outlook	Index 2nd quarter	4	7	13
Tue 01	3:30	JPY Labour Cash Earnings	y/y May		0.7%	0.6%
Wed 02	1:50	JPY Monetary Base	y/y Jun			-0.9%
Fri 04	7:00	JPY Leading Economic Index, preliminary	% May		93.0	92.8
Fri 04	7:00	JPY Coincident Economic Index, preliminary	% May		103.4	101.7

# Foreign Exchange

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## Dismal maybe, boring never

If you have ever wondered why economics is regularly referred to as “the dismal science”, just cast a glance over the data of the past week. We are currently witnessing an unheard of collapse in consumer confidence (in Denmark, consumer confidence fell to its lowest level since 1999, in the US to the lowest level since 1992, in New Zealand to the lowest level since 1991, and in France to the lowest level since 1987 - to name just four). At the same time, purchasing managers' expectations (PMI and ISM) show that industry is now contracting in the US, Euroland, the UK and Japan. Further, US housing market indicators this week show that the situation here continues to deteriorate. On top of all this comes a jump in inflation. This is perhaps most visible in countries such as Vietnam (consumer prices up 26.8% y/y this week), Iceland (12.7% y/y) and South Africa (11.7% y/y), but inflation is also making its mark closer to home: Belgian inflation is running at 5.8% y/y, the highest rate since the mid-1980s. Central banks are, of course, under pressure from rising inflation, and Norway, Poland, Rumania, Mexico and Taiwan all hiked in the past week.

The events of the past week lie well within our strategic framework centred on an economic slowdown and a financial crisis. However, as we wrote two weeks ago (see [An era gone by](#)), inflation must now be added as a third leg, which does not make the challenges any easier: inflation erodes consumer purchasing power, and central bank hikes tighten the liquidity cycle above and beyond that resulting from banks tightening their lending standards. We definitely see the glass as half empty rather than half full.

On FX markets, the euro is setting a pace that few other currencies can match. The top performing currency of the past week was HUF, which rose to its strongest against EUR since 2002. A shift in interest rate expectations that benefited Hungary was part of the story, but even the central bank's decision to leave rates unchanged this week could not prevent further strengthening. However, the Hungarian economy does not impress either in terms of strength or balances, and we do not expect the rise to be sustained. In second place was NOK. Norges Bank's rate hike and impressive fundamentals make the Norwegian krone a much more likely candidate for further appreciation. After these two, EUR came in a solid third. Bottom of the league were KRW and NZD, both falling around 2% against EUR. USD and JPY did not do much better. ISK started the week with a sharp fall to a new all-time low, but later corrected.

The euro appears to be drawing most of its strength from a shift in relative rate expectations, but an indirect effect from rising oil prices is also at play. As we show in the current [FX Crossroads](#), the latest rise in oil prices left behind it a risk of EUR/USD and EUR/JPY increasing, and USD/CAD and EUR/NOK falling. EUR/USD should be able to rise further in the coming week, towards 1.5850 at first, though technically a break here would indicate a new top around 1.63. The ECB meeting on Thursday 3 July could be critical: Trichet has said several times that one cannot expect a series of rate hikes, but so far neither the fixed income nor the FX markets have listened. Should he really carve this out in stone, a downward correction may result. The strength of the euro was also reflected in an increase in EUR/JPY to a new record high. The movement is in line with both rates and oil prices, but does not sit well with falling equity prices. We do not expect the fall in JPY to be sustained, and currently recommend selling USD/JPY.

# Fixed Income

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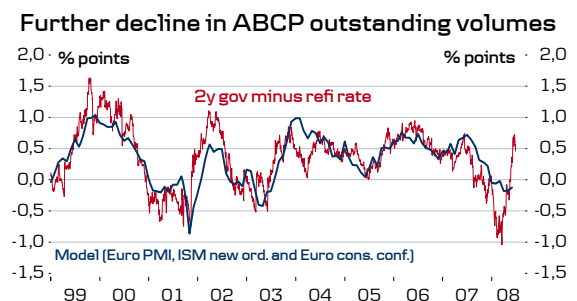
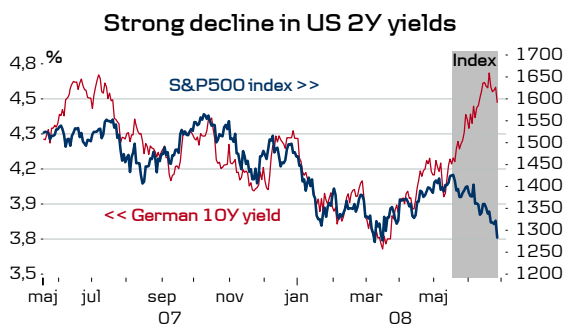
## Financial fears are back

Inflation has been name of the game in bond markets for some time. Further increases in oil prices, inflation rates close to 4% and rising inflation expectations in several countries shifted focus dramatically from financial fears to an inflation scare. The ECB reinforced this shift when they signalled a July hike. The change in dynamics is illustrated in the chart below, which shows how close bond yields were correlated with equities when financial fears dominated. The “decoupling” of the two markets happened when inflation fears took over and hit both markets. Residuals were very negative until March, as risk appetite drove yields much lower than was warranted by growth. This rapidly turned around as inflation fears gripped the market and sent yields to much higher levels than explained by the growth picture.

More recently, however, financial fears have resurfaced and reached a point where they could no longer be ignored by bond markets. Rumours about US automaker Chrysler having financial problems and renewed fears of rising banks losses have taken a firm grip on the market in recent days. This has to some extent been reinforced by very soft Euroland growth numbers (PMI, Ifo, consumer confidence) – raising fears of a pronounced slowdown – and by the Fed being less hawkish than expected. Worryingly, oil prices are not showing any signs of levelling off despite all the bad news. Oil prices hit a new high yesterday above USD 140/bbl. Hence the inflation picture is not likely to improve – and could even worsen. German CPI data point to a rise in Euroland HICP to 3.9% in June, and perhaps breaking the 4% mark in the coming months if oil prices remain elevated.

This development heightens the dilemma of the ECB. The bank has signalled a rate hike next week – which we think they will deliver, despite the recent jitters in the market – but the question is what happens after that. We think it is fair to price in some chance of a further hike, but the current pricing of close to 3 hikes seems a little too much.

In the short run we also see scope for a further decline in risk appetite and more weak growth data, which will put a further dampener on yields levels. The big joker in the pack is inflation expectations. The ECB has made it clear that it will not tolerate a rise in inflation expectations – hence, if this happens it could ruin the outlook for slightly lower yields at the short end of the curve. The longer end might still manage to come down a bit, though, as more ECB hikes could lead to a further twisting of the yield curve, as seen recently.



# Macroeconomic forecast

Macro forecast, Scandinavia													
	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Stock build. <sup>2</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Unem-ptym. <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
Denmark	2007	1,8	2,5	1,7	6,7	-0,2	3,7	6,1	1,7	2,9	4,1	25	1,1
	2008	1,4	2,4	1,7	2,6	-0,1	3,4	4,5	3,1	2,0	3,2	20	0,6
	2009	1,3	1,4	1,6	0,6	0,1	2,8	2,8	2,4	2,5	2,3	17	0,6
Sweden	2007	2,7	3,2	1,0	8,3	0,7	5,8	9,7	2,2	6,2	3,1	42,0	8,3
	2008	1,8	1,7	1,0	3,5	-0,7	5,3	4,5	2,9	6,2	2,9	37,7	8,2
	2009	1,6	1,0	1,8	0,4	-0,4	3,8	2,4	1,5	6,8	2,3	35,5	8,3
Norway	2007	3,5	6,4	3,2	9,6	-1,3	3,2	8,6	0,8	2,5	8,0	26	19,3
	2008	3,5	4,6	2,8	10,9	-0,2	3,7	9,2	4,4	3,3	12,0	26	20,6
	2009	2,9	4,1	2,8	2,6	0,0	3,4	4,8	2,2	3,4	13,9	26	18,2

Macro forecast, Euroland													
	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Stock build. <sup>2</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Unem-ptym. <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
Euroland	2007	2,6	1,4	2,1	4,8	-0,1	6,0	5,2	2,8	7,4	-0,8	67	-0,8
	2008	1,4	1,2	1,2	1,7	0,1	3,1	3,3	2,8	7,1	-0,8	65	-0,3
	2009	1,5	1,5	1,5	1,5	0,0	4,0	4,9	1,9	7,4	-0,8	64	-0,5
Germany	2007	2,7	-0,2	1,9	5,6	-0,1	8,5	5,5	2,9	9,1	-0,5	65	5,8
	2008	1,6	0,6	0,7	1,7	0,2	5,1	3,3	1,9	8,3	0,2	64	5,8
	2009	1,4	1,1	1,1	1,5	-0,1	5,0	3,9	1,4	8,0	0,4	64	6,0
France	2007	1,9	1,9	2,0	4,1	-0,2	3,5	6,6	2,0	8,0	-2,3	63	-2,3
	2008	1,6	1,6	0,9	2,2	0,2	3,1	4,0	1,8	7,7	-2,2	62	-2,3
	2009	1,5	1,8	1,3	2,0	-0,1	2,5	3,9	1,4	7,5	-2,3	61	-2,3
Italy	2007	1,8	1,7	0,8	2,8	0,0	2,5	1,8	2,6	5,9	-2,6	105	-1,7
	2008	1,0	0,9	0,5	0,9	0,2	1,1	2,3	2,3	5,7	-2,0	103	-1,7
	2009	0,9	0,9	0,8	1,2	-0,1	0,5	2,4	1,8	5,7	-2,2	102	-1,7
Spain	2007	3,9	3,4	5,3	6,4	-0,4	5,5	6,8	3,4	8,0	1,5	37	-9,0
	2008	2,7	2,3	3,2	3,7	0,2	3,6	4,3	3,2	8,2	1,0	35	-9,5
	2009	2,4	1,8	3,1	2,5	-0,1	2,5	3,9	2,3	8,8	0,0	35	-9,0
Holland	2007	3,0	1,8	3,2	4,8	-0,1	6,0	5,5	2,4	3,3	0,0	60	7,0
	2008	2,2	1,7	0,6	3,2	0,1	4,6	4,8	2,3	2,9	0,0	59	6,5
	2009	1,9	1,8	0,4	2,8	-0,1	3,5	5,4	1,7	2,8	0,0	60	6,5
Finland	2007	4,4	3,7	0,8	7,6	0,1	4,8	4,1	2,5	6,9	5,3	35	4,6
	2008	2,6	2,5	1,5	3,0	0,0	2,5	2,0	3,3	6,5	4,7	33	4,5
	2009	2,5	2,5	1,5	2,0	0,0	3,0	2,5	2,2	6,2	3,9	31	4,5

Macro forecast, Global													
	Year	GDP <sup>1</sup>	Private cons. <sup>1</sup>	Public cons. <sup>1</sup>	Fixed inv. <sup>1</sup>	Stock build. <sup>2</sup>	Ex-ports <sup>1</sup>	Im-ports <sup>1</sup>	Infla-tion <sup>1</sup>	Unem-ptym. <sup>3</sup>	Public budget <sup>4</sup>	Public debt <sup>4</sup>	Current acc. <sup>4</sup>
USA	2007	2,2	2,9	2,0	-1,8	-0,3	8,0	1,9	2,9	4,6	-1,2	60	-5,5
	2008	1,2	1,4	2,4	-6,1	-0,4	7,2	-2,2	3,9	5,3	-3,5	61	-3,7
	2009	1,5	1,2	2,0	-2,8	0,0	7,4	1,0	2,2	6,0	-2,5	61	-2,0
Japan	2007	2,1	1,4	0,8	-3,1	-0,2	7,8	1,8	0,0	3,8	-3,3	180	5,0
	2008	1,4	1,1	0,9	2,0	0,1	5,0	3,8	1,2	3,8	-3,8	182	4,8
	2009	1,7	1,5	1,2	2,5	0,0	5,4	4,4	0,6	3,6	-3,5	183	5,0
UK	2007	3,1	3,1	1,9	4,1	0,0	4,2	-2,0	2,3	3,0	-2,5	43	-3,3
	2008	1,6	1,3	2,3	4,2	-0,2	3,8	3,5	2,6	2,8	-2,5	43	-4,1
	2009	1,6	1,3	2,4	3,0	0,0	3,4	3,0	2,1	3,0	-2,5	43	-4,0
Switzer-land	2007	3,1	2,1	0,1	2,7	0,1	10,0	5,2	0,7	2,8	-0,2	55	15,1
	2008	1,7	1,8	0,5	0,4	0,0	3,8	4,5	1,9	2,6	0,0	54	13,9
	2009	1,6	1,6	0,6	1,7	0,0	4,7	5,2	1,1	2,7	0,0	53	14,9

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	27-jun	2,00	3,62	4,74	157,8	-	472,8
	+3m	2,00	3,30	4,60	155	-	481
	+6m	2,00	3,05	4,50	150	-	497
	+12m	2,00	3,40	4,65	150	-	497
EUR	27-jun	4,00	5,23	4,99	-	157,8	745,8
	+3m	4,25	5,20	4,80	-	155	746,0
	+6m	4,25	4,95	4,70	-	150	746,0
	+12m	4,25	4,80	4,60	-	150	746,0
JPY	27-jun	0,50	1,23	1,87	167,7	106,3	4,45
	+3m	0,50	1,15	1,90	160	103	4,66
	+6m	0,50	1,05	1,85	150	100	4,97
	+12m	0,50	1,30	2,05	150	100	4,97
GBP	27-jun	5,00	6,22	5,58	79,4	198,7	939,2
	+3m	5,00	5,80	5,30	82,0	189	910
	+6m	4,75	5,50	5,20	80,0	188	933
	+12m	4,50	5,00	5,00	75,0	200	995
CHF	27-jun	2,75	3,41	3,77	160,6	101,8	464,3
	+3m	2,75	3,20	3,60	160	103	466
	+6m	3,00	3,10	3,50	158	105	472
	+12m	3,00	2,60	3,35	156	104	478
DKK	27-jun	4,35	5,66	5,21	745,8	472,8	-
	+3m	4,60	5,55	4,95	746,0	481	-
	+6m	4,60	5,30	4,85	746,0	497	-
	+12m	4,60	4,95	4,70	746,0	497	-
SEK	27-jun	4,25	5,39	5,25	940,8	596,4	79,3
	+3m	4,50	5,40	5,00	925	597	80,6
	+6m	4,50	5,00	5,00	920	613	81,1
	+12m	4,00	4,40	4,65	920	613	81,1
NOK	27-jun	5,75	6,78	5,86	798,2	505,9	93,4
	+3m	5,75	6,50	5,60	780	503	95,6
	+6m	5,75	6,10	5,50	775	517	96,3
	+12m	5,75	6,00	5,30	775	517	96,3
PLN	27-jun	6,00	6,80	6,30	337,0	213,6	221,3
	+3m	6,25	6,60	6,20	345	223	216
	+6m	6,25	6,50	6,10	350	233	213
	+12m	6,25	6,40	6,00	355	237	210

Equity markets				
Regional	Risk	Price trend 3 mth.	Price trend 12 mth.	Regional recommendations
USA	Low	-5% to +5%	+5% to +10%	Overweight
Japan	High	-5% to +5%	+5% to +10%	Neutral
Emerging markets (USD)	High	-5% to +5%	+5% to +10%	Underweight
Pan-Europe (EUR)	Low	-5% to +5%	+5% to +10%	Neutral
Nordics				
Sweden	Average	-5% to +5%	+5% to +10%	Neutral
Norway	High	-5% to +5%	+5% to +10%	Overweight
Denmark	High	-5% to +5%	+5% to +10%	Neutral

# Key data and events (1)

Monday, June 30, 2008				Period	Danske Bank	Consensus	Previous
-	RUB	Current account	USD bn	1st quarter			
0:45	NZD	Building permits	m/m	May			82.1%
1:01	GBP	Gfk Consumer confidence	Index	Jun		-31	-29
1:15	JPY	Nomura/JMMA Manufacturing PMI	Index	Jun			47.7
3:30	AUD	Private sector credit	m/m/y/y	May		0.6% 13.4%	0.4% 14.1%
5:00	NZD	NBNZ Business Confidence	Index	Jun			-49.7
7:00	JPY	Housing starts	y/y	May		-3.2%	-8.7%
7:00	JPY	Construction orders	y/y	May			-8.4%
8:00	DEM	Retail sales, real s.a.	m/m/y/y	May	0.5% 1.0%	0.5% -1.0%	-1.7% -1.0%
9:30	DKK	Confidence indicator, industry	Index	Jun	-2.0		0.0
10:00	NOK	Credit indicator (C2)	y/y	May	13.9	14.0	14.3
10:00	NOK	Retail sales, s.a.	m/m/y/y	May	-0.2% 3.8%	-0.1% 3.9%	0.4% 3.2%
10:30	GBP	Index of services	q/q	Apr			0.5%
10:30	GBP	Net Consumer Credit	GBP bn	May		1.1	0.9
10:30	GBP	Net Lending Secured on Dwellings	GBP bn	May		6.0	6.4
10:30	GBP	Mortgage Approvals	1000	May		50	58
11:00	ITL	HICP, preliminary	m/m/y/y	Jun		0.3% 3.8%	0.6% 3.7%
11:00	ITL	CPI (NIC incl. tobacco), preliminary	m/m/y/y	Jun		0.3% 3.6%	0.5% 3.6%
11:00	EUR	CPI estimate	m/m/y/y	Jun	.3.8%	.3.8%	.3.6%
14:00	PLN	Current account	Euro m.	1st quarter		-3870	-3221
14:30	CAD	GDP	m/m	Apr		0.2%	-0.2%
15:45	USD	Chicago PMI	Index	Jun	48.0	48.5	49.1

Tuesday, July 1, 2008				Period	Danske Bank	Consensus	Previous
-	USD	Total Vehicle Sales	m	Jun		14.2	14.3
1:50	JPY	Tankan Lge Manufacturers Index	Index	2nd quarter	1	3	11
1:50	JPY	Tankan Lge Mfg Outlook	Index	2nd quarter	0	2	7
1:50	JPY	Tankan Non-Manufacturing	Index	2nd quarter	5	8	12
1:50	JPY	Tankan Non-Mfg Outlook	Index	2nd quarter	4	7	13
3:30	JPY	Labour Cash Earnings	y/y	May		0.7%	0.6%
6:30	AUD	Reserve Bank of Australia (cash rate target decision)			7.25%	7.25%	7.25%
6:30	RUB	PMI Manufacturing		Jun			
8:00	GBP	Nationwide House Prices	m/m/y/y	Jun		-1.0% -6.4%	-2.5% -4.4%
8:00	DEM	ILO Unemployment rate	%	May			7.4
8:30	SEK	Swedbank PMI Survey	Index	Jun			51.2
9:15	ESP	PMI Manufacturing (June)		Jun			
9:30	DKK	Retail sales, volume	m/m/y/y	May			0.4% 2.1%
9:30	DKK	GDP	q/q/y/y	1st quarter	0.0% 1.0%		0.3% 1.9%
9:45	ITL	PMI Manufacturing	Index	Jun		47.5	48.0
9:50	FRF	French PMI manufacturing, final	Index	Jun		49.2	49.2
9:55	DEM	Unemployment, change	1000	Jun		-15	4
9:55	DEM	Unemployment rate	%	Jun		7.9	7.9
10:00	DEM	PMI Manufacturing, final	Index	Jun	52.3	52.3	52.3
10:00	EUR	PMI Manufacturing, final	Index	Jun	49.1	49.1	49.1
10:30	GBP	PMI Manufacturing	Index	Jun	49.8	49.8	50.0
11:00	EUR	Unemployment	%	May		7.1%	7.1%
16:00	USD	ISM Manufacturing	Index	Jun	48.0	49.0	49.6
16:00	USD	Construction spending	m/m	May		-0.6%	-0.4%
16:00	USD	ISM prices paid	Index	Jun		86.0	87.0

## Key data and events (2)

Wednesday, July 2, 2008			Period	Danske Bank	Consensus	Previous
-	USD	Fed's Lockhart (non-voter, neutral) speaks				
1:50	JPY	Monetary Base	y/y			-0.9%
3:30	AUD	Building approvals	m/m y/y		-3.4% 7.2%	7.8% 5.2%
3:30	AUD	Retail sales	m/m		0.1%	-0.2%
8:00	EEK	Industrial production WDA	y/y	-0.8%		-0.2%
9:00	NOK	PMI	Index	53.0	52.1	53.0
10:30	GBP	BoE Housing Equity Withdrawal	bn. £			7.3
10:30	GBP	PMI Construction	Index			43.9
11:00	EUR	Euroland PPI	m/m y/y			0.8% 6.1%
13:00	USD	MBA mortgage applications	%			-9.3
16:00	USD	Factory Orders	m/m		0.5%	1.1%
16:00	DKK	Currency reserves	DKK bn			-11.7
18:00	USD	Fed's Mishkin (voter, dove) speaks				

Thursday, July 3, 2008			Period	Danske Bank	Consensus	Previous
6:30	RUB	PMI Services				
7:45	CHF	CPI	m/m y/y		0.3% 3.0%	0.8% 2.9%
9:30	SEK	Riksbank, Rate decision	%	4.50%		4.25%
9:50	FRF	French PMI service, final	Index	49.2	49.2	49.2
10:00	DEM	PMI Service, final	Index	53.3	53.3	53.3
10:00	EUR	Euroland PMI, final	Index	49.5	49.5	49.5
10:00	EUR	Euroland Service PMI, final	Index	49.5	49.5	49.5
10:00	ESP	Consumer Confidence	Index			56.4
10:30	GBP	BoE Credit Conditions Survey				
10:30	GBP	PMI Services	Index		49.6	49.8
11:00	EUR	Retail sales	m/m y/y			-0.6% -2.9%
13:45	EUR	ECB Meeting	%	4.25	4.25	4.00
14:30	USD	Change in nonfarm payroll	1000	-50	-54	-49
14:30	USD	Unemployment	%	5.4	5.4	5.5
14:30	USD	Average hourly earnings, non-farm	m/m	0.3 .	0.3 .	0.3% 3.5%
14:30	USD	Initial jobless claims	1000			384
16:00	USD	ISM (NAPM) non-manufacturing	Index	51.5	51.4	51.7

Friday, July 4, 2008			Period	Danske Bank	Consensus	Previous
-	USD	Independence Day - Market closed				
-	RUB	CPI	m/m		1.1%	1.4%
-	RUB	CPI Core	m/m		1.1%	1.1%
7:00	JPY	Leading Economic Index, preliminary	%		93.0	92.8
7:00	JPY	Coincident Economic Index, preliminary	%		103.4	101.7
9:30	DKK	Industrial production sa ex ships	m/m			9.6%
12:00	DEM	Factory Orders	m/m y/y		0.6% 1.7%	-1.8% 15.0%
16:00	CAD	lvey PMI	Index		62	62.5

During the week			Period	Danske Bank	Consensus	Previous
Wed 28 - 08	DEM	CPI - EU Harmonised, preliminary	m/m y/y		0.4% 2.8%	-0.2% 2.6%
Fri 20 - 30	EUR	ECB Euro-Zone current account	EUR bn			-7.8
Thu 03 - 11	GBP	HBOS House Prices	m/m q/y		-1.0% .	-2.4% -3.8%

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