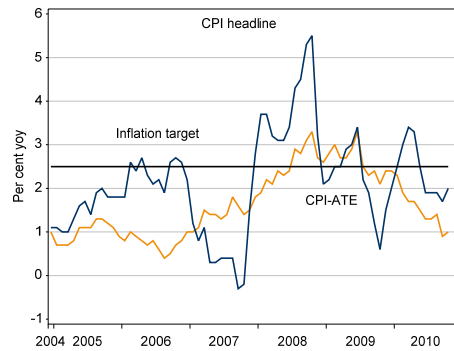


Norges Bank's dilemma resurging?

Norway: headline and core inflation



Source: Reuters Ecowin

Business cycle view

	3m	6-9m
US		
Core inflation	↘	↗
Growth	→	↗
FED	→	→
Eurozone		
Core inflation	↘	↘
Growth	↘	↘
ECB	→	→
Sweden		
Core inflation	↘	→
Growth	→	↘
Riksbank	↗	↗
Norway		
Core inflation	↗	→
Growth	↗	→
Norges Bank	→	→

Source: Handelsbanken Capital Markets

Financial forecast

	10-Nov	3 months	6 months	12 months	24 months
Base rates					
USA	0.125	0.125	0.125	0.125	1.50
EMU	1.00	1.00	1.00	1.00	1.50
Sweden	1.00	1.25	1.50	2.00	2.50
Norway	2.00	2.00	2.00	2.25	3.50
10 year government bond yields					
USA	2.64	2.65	2.75	3.25	4.00
EMU	2.46	2.55	2.55	2.75	3.30
Sweden	2.78	2.90	3.00	3.35	3.50
Norway	3.19	3.35	3.35	3.45	4.50

Source: Handelsbanken Capital Markets

US: Many homeowners unable to cash in as rates fall

Many homeowners are unable to benefit from the decline in mortgage rates as they are ineligible for refinancing and cannot roll over their existing mortgages into new lower-cost loans. Foreclosure uncertainty continues to weigh on house prices, but in our view the most likely outcome is that house prices will recover gradually in the coming years as the economy recovers.

Norway: Norges Bank's dilemma resurging?

With the October consumer price figures at hand, core inflation has negatively surprised Norges Bank for the fourth consecutive month and we expect core inflation to remain low for some time. On the other hand, there are some signs of rising domestic demand pressure. The former advocates lower interest rates, whereas the latter suggests higher interest rates: Is Norges Bank's dilemma from the pre-crisis period resurging?

	10-Nov	3 months	6 months	12 months	24 months
Versus EUR					
EURUSD	1.38	1.45	1.25	1.15	1.15
EURSEK	9.29	8.90	8.90	8.90	8.90
EURNOK	8.08	8.00	7.90	7.80	7.90
EURGBP	0.855	0.920	0.900	0.850	0.800
Versus USD					
USDSEK	6.74	6.14	7.12	7.74	7.74
USDNOK	5.86	5.52	6.32	6.78	6.87
USDGBP	1.61	1.58	1.39	1.35	1.44
USDJPY	82	79	82	85	85

Source: Handelsbanken Capital Markets

Key events

Date	Indicator	Our FC	Cons	Previous	Comment
15 Nov					
10:00 Norway	Trade balance, Oct			23.4bn	
14:30 US	Retail sales, Oct		0.6/	0.6/	Sales are likely holding up
16 Nov					
11:00 Germany	ZEW current, Nov		74.0	72.6	Likely to remain positive
	ZEW expectations balance, Nov		-3.0	-7.2	Likely to remain positive
15:15 US	Industrial production, Oct		0.3/	-0.2/	Soft on the back of slowing investment
16:00	NAHB Housing Mkt Index, Nov		16.0	16.0	Housing activity remains on a low levels
17 Nov					
14:30 US	Housing starts, Oct		0.6mn	0.61mn	Housing activity remains on a low levels
	CPI ex. food and energy, Oct		0.1/0.8	0.0/0.8	Core inflation remains low
	CPI, Oct		0.3/1.2	0.1/1.1	Rising due to food and energy prices
18 Nov					
09:30 Sweden	Unemployment, Oct			7.8	Continued labour market strengthening
19 Nov					

Figures are reported in percentage change month over month/year over year unless otherwise noted.

Source: Handelsbanken Capital Markets

US

Many homeowners unable to cash in as rates fall

Many homeowners are unable to benefit from the decline in mortgage rates as they are ineligible for refinancing and cannot roll over their existing mortgages into new lower-cost loans. Foreclosure uncertainty continues to weigh on house prices, but in our view the most likely outcome is that house prices will recover gradually in the coming years as the economy recovers.

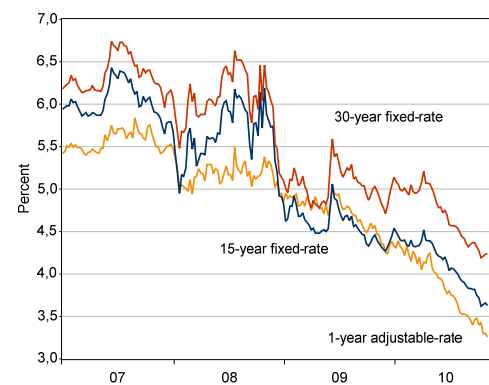
Many homeowners do not meet lending guidelines

Many homeowners cannot benefit from the decline in mortgage rates due to the restart of the Fed's asset purchases. Millions of borrowers are unable to take advantage of low mortgage rates by rolling over their existing mortgages into new lower-cost loans because they do not meet the more stringent lending guidelines.

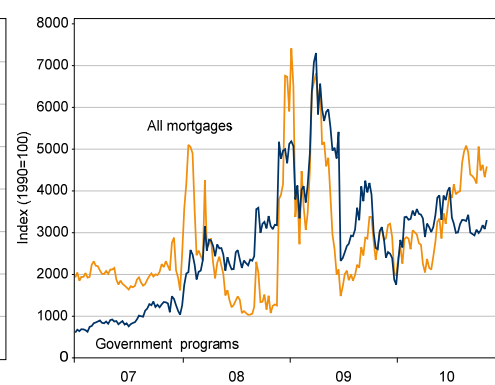
Refinancing activity could fall further in coming years

Many either owe more than their homes are worth, have lost their jobs or have their credit impaired in other ways, making them ineligible for refinancing. Others refinanced their mortgages in 2009, when mortgage rates first began to dip, and are unwilling to bear the additional costs and hassle of going through the process again. The Mortgage Bankers Association predicts that refinancing activity will fall further in the coming years as the pool of eligible borrowers continues to shrink.

Mortgage rates (Freddie Mac)



Mortgage refinancing



Source: Reuters Ecowin

A house price recovery would boost refinancing activity

If house prices were to dip further, more homeowners would become ineligible for refinancing as their homes would then be worth less than they owe. On the other hand, if house prices were to recover more, homeowners would become eligible for refinancing and be able to roll over their existing mortgages into new lower-cost loans.

Foreclosure uncertainty weighing on house prices

Fear of a flood of foreclosures

Many banks have suspended foreclosures after it emerged that staff had rubberstamped thousands of documents without checking their accuracy. At this point there is a lot of uncertainty about how the moratoriums will play out. In the short run, the bank-imposed foreclosure freeze could boost house prices because of a smaller proportion of distressed sales. In a longer perspective, a flood of foreclosures once the moratoriums are lifted might increase the supply of homes, triggering a slide in house prices.

House prices to recover gradually

In our view, the most likely outcome is that house prices will recover gradually in the coming years as the economy recovers and unemployment drops. The valuation of homes relative to income is very low in an historical perspective, indicating that house prices will likely rise in the longer term, unless the recovery derails.

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NORWAY

Norges Bank's dilemma resurging?

With the October consumer price figures at hand, core inflation has negatively surprised Norges Bank for the fourth consecutive month and we expect core inflation to remain low for some time. On the other hand, there are some signs of rising domestic demand pressure. The former advocates lower interest rates, whereas the latter suggests higher interest rates: Is Norges Bank's dilemma from the pre-crisis period resurging?

Core inflation still low....

Falling core inflation since mid 2009

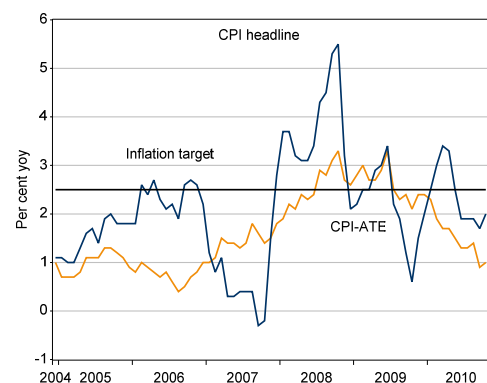
Core inflation (CPI ATE) started to decline from mid 2009, dampened by the financial crises. Since then, it has not only stayed low, but the trend has continued to decline, dragged down by prices for domestically produced and imported goods and services being effected by subdued domestic demand and contracting international price pressure.

October reading for core inflation surprised Norges Bank again on the downside

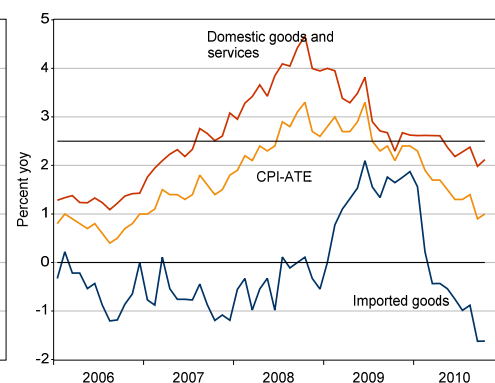
Subdued international price pressure also contributed in keeping the core inflation for October low: Despite an upward pushing base effect (i.e. the m-o-m decline in October last year was quite prominent, pushing up the y-o-y figure) the core inflation increased to only 1.0 percent y-o-y from 0.9 percent in September. This was in line with our forecast, but 0.1 percentage points lower than the market consensus and more importantly; 0.2 percentage points below Norges Bank's forecast from its latest Monetary Policy Report (MPR).

With this October reading, core inflation has been lower than the central bank's forecast for four consecutive months. This is also the case for CPI adjusted for taxes and excluding temporary changes in energy prices (CPIXE), which is an alternative core inflation gauge closely watched by Norges Bank.

Headline and core inflation



Core inflation, domestic and imported



Source: Reuters Ecowin

Core inflation might continue to surprise Norges Bank on the downside....

In its latest MPR, Norges Bank forecasts average core inflation (CPI ATE) to remain near 1 percent in Q4 2010 and Q1 2011. Thereafter it expects core inflation to rise to 1.3 and 1.5 percent on average for next year's Q2 and Q3. However, Norges Bank models for short-term forecasting (SAM), forecasts CPI ATE to be 0.2 and 0.3 percentage points lower than forecasted in the latest MPR for next year's Q2 and Q3, respectively. Based partly on these SAM forecasts, we see downside risk to Norges Bank's core inflation forecasts.

....suggesting postponed interest rate hikes

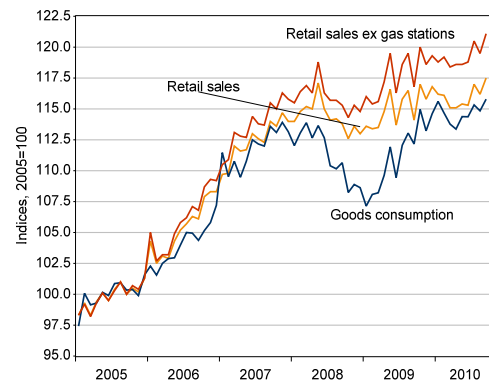
Lower than expected inflation was the main contributing factor behind the downward revision of Norges Bank's interest rate path in the most recent monetary policy report. If inflation remains lower than the Bank's expectations in the coming months, this could cause the central bank to postpone the planned interest rate hikes next summer.

On the other hand, domestic demand is picking up somewhat....

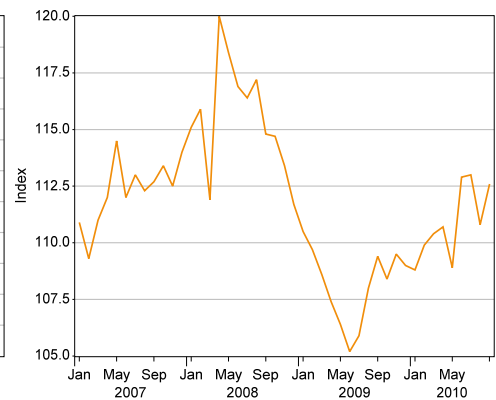
....but domestic demand picking up somewhat

In our semi-annual macro forecast, which was published on October 26, we described the development in domestic demand as less upbeat than the initial recovery stage. More specifically, we described what seems to be a flattening out of household consumption after a period of growth. Since then, however, we have seen some signs of stronger domestic demand pressure. For example, retail sales and goods consumption for September soared, more than revising the August decline and pushing the trend upwards. Also, the manufacturing production for September surprised on the upside. Based on the upward trend in manufacturing orders, we expect this sector's production to continue its recovery. Also, the trend in housing prices continues to rise, with an especially strong rise in the October reading.

Retail sales and goods consumption



Manufacturing production



Source: Reuters Ecowin

....suggesting higher interest rates

Norges Bank back in the splits?

In the years before the financial crisis, Norges Bank faced a dilemma of low inflation on one hand and strong domestic demand on the other. The former advocates lower interest rate, whereas the latter suggests the opposite. During the financial crisis and the initial recovery stages, this has not been the case, as inflation and demand have contracted. Now, however, it might seem that the dilemma is resurging, although it is still too early to claim this with certainty.

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Macro indicators

US

	2008	2009f	2010f	2011f	2012f
Household consumption	-0.3	-1.2	1.5	1.9	2.0
Public spending	2.8	1.6	0.3	-0.9	1.2
Non-residential investment	0.3	-17.1	6.2	8.8	7.4
Residential investment	-24.0	-22.9	3.2	10.5	9.1
Inventory investment*	-0.5	-0.6	1.2	-0.2	0.1
Net exports*	1.1	1.1	-0.3	0.1	0.2
GDP	0.0	-2.6	2.7	2.2	3.0
Unemployment rate	5.8	9.3	9.6	9.6	9.2
Consumer prices (Core PCE)	2.4	1.6	0.9	1.0	1.3

EMU

	2008	2009	2010f	2011f	2012f
Household consumption	0.3	-1.2	-0.1	-0.1	0.3
Gross fixed investment	-0.9	-10.8	1.7	2.2	1.7
Exports	na	na	na	na	na
Imports	na	na	na	na	na
GDP	0.4	-4.1	1.7	0.7	1.2
Unemployment rate	7.6	9.4	10.0	10.2	10.3
Consumer prices	3.3	0.3	1.6	1.4	1.6

Sweden

	2008	2009	2010f	2011f	2012f
Household consumption	-0.1	-0.8	2.8	2.3	2.4
Public consumption	1.3	1.7	1.2	1.0	0.8
Gross fixed investment	1.7	-16.0	5.4	5.5	5.8
Exports	1.4	-12.4	10.0	5.1	5.8
Imports	2.9	-13.2	11.8	6.1	6.0
GDP calendar-adjusted	-0.4	-5.1	4.1	2.4	2.7
Unemployment rate	6.1	8.4	8.6	8.0	7.9
Consumer prices	3.4	-0.3	1.1	1.6	1.9
CPIF	2.7	1.9	2.0	1.3	1.6

Norway

	2008	2009	2010f	2011f	2012f
Private consumption	1.3	0.2	2.6	3.2	3.1
Public consumption	4.1	4.7	2.7	2.1	1.9
Gross fixed investments	1.4	-9.1	-3.1	5.5	4.2
Exports	0.9	-4.0	-0.6	0.0	0.8
Imports	2.2	-11.4	6.6	5.3	4.3
GDP mainland	2.2	-1.4	1.7	2.5	2.7
Unemployment rate	2.5	3.1	3.5	3.6	3.6
Consumer prices, core	2.6	2.6	1.5	1.5	2.0

Finland

	2008	2009	2010f	2011f	2012f
Private consumption	1.7	-1.9	2.6	2.4	2.3
Public consumption	2.4	1.2	0.5	0.5	0.5
Gross fixed investment	-0.4	-14.7	0.9	5.3	5.6
Exports	6.3	-20.3	11.0	5.8	6.6
Imports	6.5	-18.1	8.0	5.7	5.6
GDP	0.9	-8.0	3.4	2.7	3.0
Unemployment rate	6.4	8.2	8.2	8.0	7.6
Consumer prices	4.1	0.0	1.0	2.2	2.4

Denmark

	2008	2009	2010f	2011f	2012f
Household consumption	-0.2	-4.6	1.8	1.3	1.1
Public consumption	1.6	3.4	1.2	0.0	0.0
Gross fixed investment	-4.7	-13.0	-7.9	0.9	1.6
Exports	2.4	10.2	4.6	2.1	1.5
Imports	3.3	-13.2	3.9	2.4	1.8
GDP	-0.9	-4.7	1.1	0.9	0.9
Unemployment rate	1.8	3.5	4.4	4.8	4.7
Consumer prices	3.4	1.3	2.2	1.8	1.7

Source: Handelsbanken Capital Markets

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