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ECONOMIC OUTLOOK

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Fragile growth

Uneven recovery

The world economy is heading for better times, driven by the advanced economies. However, the global recovery still seems to be fragile due to weakness in the emerging economies and serious geopolitical risks relating not least to the situation in Ukraine.

Sweden takes the lead

In the Nordic region Sweden appears to be best positioned for substantial progress over the coming years. Denmark and Finland are both in for a moderate recovery while the Norwegian economy dampens significantly after years of high growth.

Data overview

Editor

Helge J. Pedersen,
Global Chief Economist

helge.pedersen@nordea.com
Tel +45 3333 3126

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Fragile growth

The world economy is heading for better times, but the recovery still seems to be fragile. Key factors are the weakness in the emerging economies and the serious geopolitical risks relating not least to the situation in Ukraine as well as developments in the MENA region and East Asia.

In **the Nordic region**, **Sweden** appears to be best positioned for substantial progress over the coming years. The Swedish economy ended 2013 on a strong note and especially the domestic economy has successfully weathered recent years' problems in the export sector. With prospects of higher international growth, the traditionally very cyclical Swedish exports will also be poised for new gains. That also implies that the Riksbank will not need to cut rates further, although inflation at the moment is well below its target.

Following several years of stagnation there are better times ahead for the economy in **Denmark**. Especially the export sector could see quite decent gains driven by high growth in the important markets of Germany, Sweden and the UK. But domestic demand will also accelerate, albeit from low levels.

Finland has faced very considerable difficulties in shaking off the financial crisis and economic activity saw yet another sharp drop in 2013. As in the case of Sweden, more benign international growth prospects also bring hope of better times for exports. We expect a rebound in the Finnish economy over the forecast period.

While growth is set to accelerate in most Nordic countries, **Norway** is poised for a significant slowdown in the years ahead. The housing market shows signs of weakness and there are prospects of slowing activity in oil-related investment. But impressive public finances provide scope for easing fiscal policy and in this way support the economy. However, we do not expect Norges Bank to cut interest rates further. The main reason is that the NOK has weakened far more than foreseen by the central bank.

The pattern that has emerged over the past year or so is intact: the **advanced economies** are increasingly driving the acceleration in growth. And although recent US data have been fairly weak, we believe that the world's largest economy is headed for a self-sustaining recovery. In this light we attribute the recent bout of weakness to the extremely hard winter weather that hit the US and dragged down economic activity in December last year and the first two months of 2014.

Now the Euro zone has experienced three quarters of economic expansion led by a German economy in top shape. But the situation in Southern Europe is also gradually stabilising and turning into nascent growth. Meanwhile, the UK economy is like a phoenix rising from the ashes. And Japan still appears to be emerging from decades of deflation in light of the highly expansionary economic policy programme initiated at the end of 2012 – the so-called Abenomics programme.

However, there are more question marks over **the emerging economies**, which have been hit by capital outflows, the intensifying conflict between Ukraine and Russia and the growing investor focus on the serious structural problems in commodity-producing countries like Brazil, South Africa and Russia. In our baseline scenario, we have scaled back our growth forecasts for these countries and take a very cautious view on the near term.

The weakness of the emerging economies has the potential to impact growth also in the advanced economies, which have increasingly aimed their export and investment strategies at these regions. As long as the situation in Ukraine does not turn into a new East-West conflict and as long as China, by far the most important of the new economies, does not face a hard landing, we are not so nervous about the risk of contagion.

Admittedly, developments in Ukraine as well as China **do** involve considerable uncertainty and could trigger strong volatility in global financial markets. As regards China, these uncertainties relate to excess capacity in the manufacturing industry, financial sector stability, the implementation of the new growth strategy and political tensions with many neighbouring countries, especially Japan.

In our baseline scenario, the Chinese authorities are able to secure growth broadly in line with the target of 7.5% annually and diplomatic solutions are found to the territorial conflicts. Against this background, we forecast global economic growth at 3.7% this year after a comparatively modest expansion of 3% in 2013. Next year growth will accelerate further to just shy of 4%, see table.

Real growth, %

	2011	2012	2013	2014E	2015E
World	4.0	3.3	3.0	3.7	3.9
G3	1.4	1.4	1.0	2.1	2.4
BRIC	7.6	6.0	5.9	5.8	5.8
Nordics	2.2	1.0	1.1	1.9	1.8
Denmark	1.1	-0.4	0.4	1.3	1.7
Finland	2.8	-1.0	-1.4	0.3	2.0
Norway	2.6	3.4	2.0	1.5	1.2
Sweden	2.9	0.9	1.5	2.8	2.5

Less accommodative monetary policy

With prospects of global economic growth, we also continue to expect a gradual tightening of monetary policies in the major countries. And the initial steps have already been taken in the US, where the monthly purchases of Treasury and mortgage-backed securities have now been reduced from USD 85bn to USD 65bn. We expect the tapering process to be completed this year, but that the Fed, now headed by Janet Yellen, will not raise interest rates until 2015.

In Europe, the ECB has *its* focus on inflation, which over the past year or so has been markedly below the target – close to but below 2% – due to the crisis, falling commodity prices and EUR strength. In our baseline scenario, we do not see any real danger of deflation and expect the ECB to keep rates at the current level until the end of our forecast period in 2015. But bear in mind that falling prices of for instance energy and food help boost consumers' purchasing power and keep the costs of businesses in check. So the very low level of inflation observed at the moment in the Euro area could help to spur the recovery.

We also still expect relatively stable oil prices over the forecast period. But especially oil prices are highly sensitive to (geo)political tensions – not least in the Middle East but also in other large oil-producing countries, including Russia.

Notably expectations for monetary policy affect the long end of the yield curve. We look for slightly higher yields over the forecast period as signals of an imminent monetary tightening become increasingly clear. We see 10-year Treasury yields rising to nearly 4% over the forecast horizon whereas their European counterparts will stay below 3%.

Turbulence in currency markets

The considerable uncertainties over the political situation and economic instability in many emerging economies, combined with market expectations for monetary policy in the advanced economies, have hit several Emerging Markets currencies hard, mainly India, Turkey and most recently Russia. And as long as these factors are at play, the currencies of these countries could face turmoil. Meanwhile, the monetary policy authorities in these countries will likely adopt dramatic countermeasures also in future, including sharp rate hikes and capital restrictions, to prevent further marked falls.

But also the Nordic currencies react to monetary policy signals. We expect the SEK to strengthen against the EUR as the Riksbank raises rates sooner than the ECB. As the NOK has probably already weakened sufficiently against the EUR, we expect it to appreciate slightly longer term although Norges Bank, in contrast to the Riksbank, is not likely to raise rates over the forecast period.

We have long argued that economic fundamentals point to USD appreciation against the EUR. So far this appreciation has failed to materialise, perhaps because the US still injects billions of dollars into the economy every month. But as these amounts are reduced and the interest rate differential widens in favour of the US, we will come closer to the turning point. We thus see EUR/USD moving towards 125 over the forecast period. The historical link between the USD and the GBP as well as the current economic strength of the UK means that the GBP will also appreciate further against the EUR in our baseline scenario.

Risk scenarios

Several risks to our baseline scenario could affect the growth outlook in both a positive and negative direction. At this juncture we see the greatest risks on the dow side.

Upside risks:

- Higher growth in the US economy driven by a stronger-than-expected pick-up in investment activity when several years of pent-up investment is released.
- Lower oil prices – maybe as a result of increasingly larger shale gas production.
- An easier fiscal policy line is accepted in the Euro area to support growth; this could in turn result in better confidence indicators, higher investment activity and growth in bank lending.
- Successful implementation of the structural measures in Japan's reform programme.
- China benefits from stronger-than-expected growth, with positive effects on the rest of the world.

Downside risks:

- Monetary conditions in the US are tightened more than anticipated, hitting the housing market and financial markets hard.
- Tighter liquidity conditions lead to monetary tightening in the emerging economies and their growth dynamics fade.
- A burst credit bubble and problems in the shadow banking system lead to a hard landing in China.
- Geopolitical risks linked to the relationship between China and Japan, the conflict in Ukraine and unrest in the MENA region can trigger volatility in financial markets and a dramatic oil price rise.
- Failure to implement crucial structural reforms and deflation in the Euro area.

Helge J. Pedersen, Global Chief Economist
helge.pedersen@nordea.com +45 3333 3126

Growth, %

	2011	2012	2013E	2014E	2015E
World[1)]	4.0	3.2	3.0	3.7	3.9
USA	1.8	2.8	1.9	3.0	3.3
Euro area	1.6	-0.6	-0.4	1.2	1.5
China	9.3	7.8	7.7	7.4	7.0
Japan	-0.4	1.4	1.6	1.3	1.0
Denmark	1.1	-0.4	0.4	1.3	1.7
Norway	2.6	3.4	2.0	1.5	1.2
Sweden	2.9	0.9	1.5	2.8	2.5
UK	1.1	0.3	1.8	2.7	2.0
Germany	3.4	0.9	0.5	1.8	2.0
France	2.0	0.0	0.3	1.0	1.5
Italy	0.6	-2.6	-1.9	0.6	1.0
Spain	0.1	-1.6	-1.2	1.0	1.5
Finland	2.8	-1.0	-1.4	0.3	2.0
Estonia	9.6	3.9	0.7	2.8	3.8
Poland	4.5	1.9	1.6	3.6	4.2
Russia	4.3	3.4	1.4	1.5	2.0
Latvia	5.3	5.0	4.0	5.0	4.2
Lithuania	6.0	3.7	3.2	3.2	4.3
India	7.5	4.6	4.9	5.5	6.0
Brazil	2.7	1.0	2.3	1.6	1.9
Rest of World	4.5	3.7	3.1	3.9	4.2

Inflation, %

	2011	2012	2013E	2014E	2015E
World[1)]	4.9	3.9	3.6	3.6	3.7
USA	3.1	2.1	1.5	1.7	2.3
Euro area	2.7	2.5	1.4	1.0	1.5
China	5.4	2.6	2.6	3.0	3.5
Japan	-0.3	0.0	0.4	2.3	1.7
Denmark	2.8	2.4	0.8	1.3	1.7
Norway	1.2	0.8	2.1	2.0	2.0
Sweden	3.0	0.9	0.0	0.4	2.1
UK	4.5	2.8	2.6	2.1	2.2
Germany	2.5	2.1	1.6	1.4	1.8
France	2.3	2.2	1.0	1.0	1.3
Italy	2.9	3.3	1.3	0.8	1.4
Spain	3.1	2.4	1.5	0.7	1.0
Finland	3.4	2.8	1.5	1.4	1.6
Estonia	5.0	3.9	2.8	1.9	3.0
Poland	4.3	3.7	0.9	1.6	2.5
Russia	6.1	6.6	6.4	6.0	5.5
Latvia	4.4	2.3	0.0	2.0	2.5
Lithuania	4.1	3.2	1.2	1.6	3.4
India	9.5	7.5	6.2	6.0	5.8
Brazil	6.6	5.2	6.2	6.0	5.8
Rest of World	6.8	6.3	6.3	5.9	5.5

1) Weighted average of 184 countries. Weights for all countries and data for Rest of World are from the most recent World Economic Outlook, by the IMF. The weights are calculated from PPP-adjusted GDP-levels

Public finances, % of GDP

	2011	2012	2013E	2014E	2015E
USA	-8.4	-6.8	-3.9	-2.8	-2.2
Euro area	-4.1	-3.7	-3.1	-2.6	-2.5
China	-1.1	-1.7	-1.9	-2.0	-2.0
Japan	-9.6	-9.8	-10.1	-9.5	-9.5
Denmark	-2.0	-3.9	-1.2	-1.1	-1.8
Norway	13.6	14.7	12.0	11.6	11.6
Sweden	0.0	-0.7	-1.3	-2.0	-1.2
UK	-7.7	-6.1	-6.5	-5.0	-3.0
Germany	-0.8	0.1	0.0	0.3	0.2
France	-5.3	-4.8	-4.2	-4.1	-3.9
Italy	-3.7	-2.9	-3.0	-2.4	-2.1
Spain	-9.6	-10.6	-7.2	-5.5	-4.1
Finland	-0.7	-1.8	-2.0	-2.3	-2.2
Estonia	1.2	-0.2	-0.2	-0.5	-0.1
Poland	-5.0	-3.9	-4.4	4.5	-3.0
Russia	0.8	-0.2	-0.7	-0.8	-0.9
Latvia	-3.6	-1.4	-1.3	-1.0	-0.5
Lithuania	-5.5	-3.2	-2.7	-2.6	-2.3
India	-6.7	-5.5	-5.0	-4.5	-4.3
Brazil	-2.6	-2.1	-3.0	-3.8	-3.3

Current account, % of GDP

	2011	2012	2013E	2014E	2015E
USA	-2.9	-2.7	-2.5	-2.5	-2.5
Euro area	0.4	1.8	2.7	2.7	2.3
China	1.9	2.3	2.5	2.0	1.5
Japan	2.0	1.0	1.2	0.5	1.0
Denmark	5.9	6.0	7.2	6.6	6.1
Norway	12.8	14.3	11.1	11.8	12.1
Sweden	6.2	6.5	6.2	6.6	6.6
UK	-1.5	-3.7	-4.0	-4.2	-3.2
Germany	6.3	7.0	7.0	6.6	6.3
France	-2.5	-2.1	-1.9	-2.0	-2.2
Italy	-3.1	-0.5	0.9	1.3	1.2
Spain	-4.0	-1.2	1.1	1.6	1.8
Finland	-1.5	-1.4	-0.8	-0.2	0.0
Estonia	1.8	-1.8	-1.5	-1.7	-1.6
Poland	-5.0	-3.7	-1.5	-1.9	-2.1
Russia	5.4	4.3	3.0	2.5	1.9
Latvia	-2.3	-2.5	-1.6	-2.0	-2.5
Lithuania	-3.7	-0.2	0.9	-1.0	-3.0
India	-3.4	-5.1	-2.6	-2.5	-2.7
Brazil	-2.1	-2.6	-3.6	-3.5	-2.8

Monetary policy rates

	12.3.14	3M	31.12.14	30.06.15	31.12.15
US	0.25	0.25	0.25	0.75	1.25
Japan	0.10	0.10	0.10	0.10	0.10
Euro area	0.25	0.25	0.25	0.25	0.75
Denmark	0.20	0.20	0.40	0.50	1.00
Sw eden	0.75	0.75	1.00	1.25	1.50
Norw ay	1.50	1.50	1.50	1.50	1.50
UK	0.50	0.50	0.50	0.75	1.25
Sw itzerland	0.00	0.00	0.00	0.25	0.75
Poland	2.50	2.50	2.75	3.25	3.50
Russia	7.00	7.00	5.50	5.25	5.00
China	6.00	6.00	6.00	6.25	6.25
India	8.00	8.00	8.00	7.75	7.50
Brazil	10.75	11.00	11.00	12.00	12.00

For Russia, the forecast is made for the Key Rate, as opposed to the Refi Rate in earlier publications

Monetary policy rate spreads vs Euro area

	12.3.14	3M	31.12.14	30.6.15	31.12.15
US	0.00	0.00	0.00	0.50	0.50
Japan[1]	-0.15	-0.15	-0.15	-0.65	-1.15
Euro area	-	-	-	-	-
Denmark	-0.05	-0.05	0.15	0.25	0.25
Sw eden	0.50	0.50	0.75	1.00	0.75
Norw ay	1.25	1.25	1.25	1.25	0.75
UK	0.25	0.25	0.25	0.50	0.50
Sw itzerland	-0.25	-0.25	-0.25	0.00	0.00
Poland	2.25	2.25	2.50	3.00	2.75
Russia	6.75	6.75	5.25	5.00	4.25
China	5.75	5.75	5.75	6.00	5.50
India	7.75	7.75	7.75	7.50	6.75
Brazil	10.50	10.75	10.75	11.75	11.25

3-month rates

	12.3.14	3M	31.12.14	30.6.15	31.12.15
US	0.23	0.30	0.55	1.05	1.60
Euro area	0.29	0.30	0.30	0.30	0.80
Denmark	0.28	0.35	0.45	0.55	1.05
Sw eden	0.93	1.00	1.35	1.70	2.05
Norw ay	1.71	1.70	1.70	1.70	1.70
UK	0.52	0.55	0.60	0.90	1.40
Poland	2.71	2.75	3.00	3.50	3.75
Russia	8.40	6.65	6.65	6.55	6.55
Lithuania	0.41	0.40	0.30	0.30	0.80

3-month spreads vs Euro area

	12.3.14	3M	31.12.14	30.6.15	31.12.15
US	-0.05	0.00	0.25	0.75	0.80
Euro area	-	-	-	-	-
Denmark	-0.01	0.05	0.15	0.25	0.25
Sw eden	0.64	0.70	1.05	1.40	1.25
Norw ay	1.42	1.40	1.40	1.40	0.90
UK	0.23	0.25	0.30	0.60	0.60
Poland	2.42	2.45	2.70	3.20	2.95
Russia	8.11	6.35	6.35	6.25	5.75
Lithuania	0.12	0.10	0.00	0.00	0.00

10-year government benchmark yields

	12.3.14	3M	31.12.14	30.6.15	31.12.15
US	2.72	2.90	3.25	3.60	3.90
Euro area	1.65	1.75	2.20	2.45	2.65
Denmark	1.67	1.80	2.30	2.55	2.75
Sw eden	2.21	2.47	3.00	3.15	3.30
Norw ay	2.90	3.19	3.60	3.59	3.62
UK	2.77	2.90	3.25	3.45	3.70
Poland	4.24	4.35	4.70	4.85	5.00

10-year yield spreads vs Euro area

	12.3.14	3M	31.12.14	30.6.15	31.12.15
US	1.07	1.15	1.05	1.15	1.25
Euro area	-	-	-	-	-
Denmark	0.03	0.05	0.10	0.10	0.10
Sw eden	0.56	0.72	0.80	0.70	0.65
Norw ay	1.26	1.44	1.40	1.14	0.97
UK	1.13	1.15	1.05	1.00	1.05
Poland	2.59	2.60	2.50	2.40	2.35

Exchange rates vs EUR

	12.3.14	3M	31.12.14	30.6.15	31.12.15
EUR/USD	1.38	1.38	1.30	1.28	1.25
EUR/JPY	142.5	133.9	133.9	134.4	137.5
EUR/DKK	7.46	7.46	7.46	7.46	7.46
EUR/SEK	8.86	8.70	8.50	8.40	8.40
EUR/NOK	8.27	8.40	8.35	8.25	8.10
EUR/GBP	0.83	0.83	0.78	0.78	0.78
EUR/CHF	1.22	1.25	1.30	1.32	1.35
EUR/PLN	4.17	4.10	4.05	4.00	3.95
EUR/RUB	50.1	48.3	44.9	43.5	42.1
EUR/LTL	3.45	3.45	3.45	3.45	3.45
EUR/CNY	8.46	8.35	7.74	7.55	7.25
EUR/INR	84.5	82.8	75.4	70.4	66.3
EUR/BRL	3.19	3.31	3.25	3.26	3.25

Exchange rates vs USD

	12.3.14	3M	31.12.14	30.6.15	31.12.15
-					
USD/JPY	103.0	97.0	103.0	105.0	110.0
USD/DKK	5.39	5.41	5.74	5.83	5.97
USD/SEK	6.40	6.30	6.54	6.56	6.72
USD/NOK	5.97	6.09	6.42	6.45	6.48
GBP/USD	1.67	1.66	1.67	1.64	1.60
USD/CHF	0.88	0.91	1.00	1.03	1.08
USD/PLN	3.02	3.0	3.1	3.1	3.2
USD/RUB	36.2	35.0	34.5	34.0	33.7
USD/LTL	2.49	2.50	2.66	2.70	2.76
USD/CNY	6.12	6.05	5.95	5.90	5.80
USD/INR	61.1	60.0	58.0	55.0	53.0
USD/BRL	2.31	2.40	2.50	2.55	2.60

Economy firing on several cylinders

- Finally recovery
- Growth to moderate somewhat next year
- Below-target inflation means few rate hikes
- SEK to strengthen against EUR

Growth more broadly based
After a sluggish start to 2013 the Swedish economy began to recover in the latter part of the year. Domestic demand accelerated at a rapid pace whereas exports were subdued also towards the year's end.

This recovery continues at a good pace this year. Low interest rates and an expansionary fiscal policy line provide stimulus to the economy. Growth is strengthened further when global demand and exports regain momentum.

The period of tax cuts appears to be coming to an end. This year general government will show a deficit at 2% of GDP. Even though government debt is stable in relation to GDP, there is a political consensus that the budget ought to show a surplus again soon. That implies that fiscal policy will probably be tightened somewhat from next year. In addition, the Riksbank is set to raise interest rates somewhat by the end of 2014 while global demand remains historically weak. As a result GDP growth will moderate somewhat next year.

Stronger international demand
Exports of goods contracted in both 2012 and 2013. Indicators suggest that an improvement could be around the corner. Yet given the slowdown in Norway and major challenges in the Euro area, market growth and the recovery in exports will be relatively slow. Exports of services, which currently account for one-third of exports and represent an increasingly important part of the economy, expanded in both 2012 and 2013. And this favourable trend is set to continue.

Households a driver of growth running slowly
Households are the main growth driver of the Swedish economy. Apart from spending growth, the good financial position of households is also evident from rising home prices and a pick-up in residential construction.

Spending growth could, however, be even stronger considering all the favourable conditions. Inflation is low, incomes are growing rapidly and household wealth has improved via higher equity prices and rising home prices. Households' scepticism is chiefly reflected in the savings ratio which is at a multi-year high and also above the levels seen in many other countries. Consumer confidence is moreover fairly subdued and credit growth is stable.

There are probably several reasons why households are cautious. Consumers have probably been affected by the debate over the risks relating to the housing market and the increased debt burden, and they are saving more as a result. If additional macroprudential measures aimed at dampening household credit demand are implemented, the level of savings may rise even further. Also, the changes in unemployment benefits and in health insurance over the past ten years may have contributed to higher private savings. With higher incomes, there is

Sweden: Macroeconomic indicators (% annual real changes unless otherwise stated)

	2010 (SEKbn)	2011	2012	2013	2014E	2015E
Private consumption	1,617	1.7	1.6	2.0	2.6	2.2
Government consumption	890	0.8	0.3	2.0	1.0	0.9
Fixed investment	602	8.2	3.3	-1.3	3.6	4.1
- industry	74	17.1	8.3	-4.2	3.5	5.5
- residential investment	110	10.4	-11.2	5.8	9.4	4.7
Stockbuilding*	23	0.5	-1.2	0.2	0.3	0.0
Exports	1,651	6.1	0.7	-0.9	3.8	4.6
Imports	1,445	7.1	-0.6	-1.2	3.7	4.3
GDP		2.9	0.9	1.5	2.8	2.5
GDP, calendar adjusted		3.0	1.3	1.5	2.9	2.3
Nominal GDP (SEKbn)	3,338	3,481	3,550	3,634	3,790	3,945
Unemployment rate, %		7.8	8.0	8.0	7.9	7.6
Employment grow th		2.3	0.6	1.0	1.0	0.6
Consumer prices, % y/y		3.0	0.9	0.0	0.4	2.1
Underlying inflation (CPIF), % y/y		1.4	1.0	0.9	0.8	1.5
Hourly earnings, % y/y		3.2	2.8	2.2	3.0	3.0
Current account (SEKbn)		216	229	227	249	258
- % of GDP		6.2	6.5	6.2	6.6	6.6
Trade balance, % of GDP		2.2	2.4	2.2	2.5	2.7
General govt budget balance (SEKbn)		0	-26	-49	-74	-47
- % of GDP		0.0	-0.7	-1.3	-2.0	-1.2
Gross public debt, % of GDP		38.2	41.8	41.5	42.2	41.8

* Contribution to GDP growth, percentage points.

scope for a further increase in spending and housing investment. But spending is not likely to accelerate at the same strong pace as in previous periods with equally favourable conditions. According to our forecast, the savings ratio will thus remain at a high level in the years ahead.

Total investment fell last year but looks set to pick up from this year. Notably construction investment, and especially residential construction, will rise. Machinery investment will grow at a slower pace, partly because capacity utilisation in the manufacturing industry will only improve modestly.

Better labour market but low inflation

As GDP growth gained momentum last year, the growth in employment accelerated. Yet despite the rise, the jobless rate was stable around 8%. Employment is set to continue to increase whereas joblessness will only drop slowly to 7.7% by the end of this year. A strong inflow of labour and high structural unemployment contribute to persistent high jobless rates.

As improvements in the labour market take hold, inflationary pressures will increase, albeit slowly. Cost pressures are initially low. Unit labour costs in the business sector rose by a mere 0.4% last year. Given a recovery in productivity and the agreed pay rises, the increase in production costs will remain low also in future. The drop in import prices has already slowed, but price trends will remain subdued. That implies higher underlying inflation (CPIF) in future, but inflation will remain below the 2% target also in 2015.

Riksbank to raise rates this year, SEK to strengthen

With good growth in the economy and somewhat higher inflation, we expect the Riksbank to raise rates before year-end. However, persistent low inflation and soft central banks internationally will make the Riksbank proceed cautiously in raising rates. We see the repo rate at 1.5% by the end of 2015.

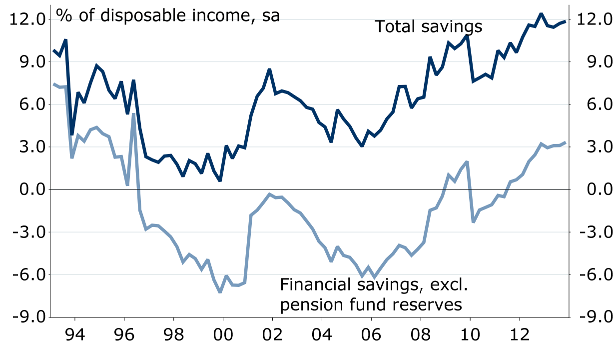
Swedish economic growth will likely exceed the level of most other countries, not least the level of the Euro area. With the Riksbank's fairly early rate hikes, the SEK will have additional support. The SEK will consequently gain ground and trade at 8.50 against the EUR by year-end, according to our forecast. But the SEK will weaken somewhat against the USD.

Torbjörn Isaksson
torbjorn.isaksson@nordea.com +46 614 8859

Better conditions for rising exports

Source: Nordea Markets and Reuters Ecowin

Household savings at record highs

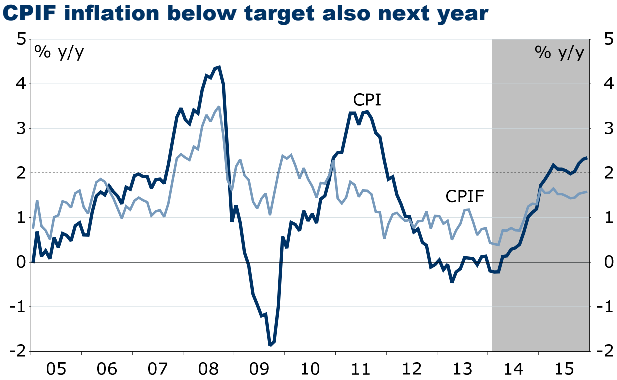


Source: Nordea Markets and Reuters Ecowin

Unemployment falling slowly

Source: Nordea Markets and Reuters Ecowin

CPIF inflation below target also next year



Source: Nordea Markets and Reuters Ecowin

Economic slowdown, but weak NOK and no rate cut

- Slow growth on weak domestic demand
- Weak NOK prevents rate cut
- Interest rates to remain low for a long period

Based on the preliminary national accounts data, growth in the mainland economy gradually gained momentum during H2 2013. The situation at end-year was better than we had expected. Still, we have not become more optimistic about the growth outlook. Growth in both domestic demand excluding inventories and in exports from the mainland was very weak, with inventory build-ups driving the higher momentum. To prevent the growth momentum from slowing again, demand will have to pick up quite considerably, which is not very likely. Residential construction looks set to decline, consumption growth should be moderate and oil investment seems to be peaking. In a weak macro environment business investment will likely also be very modest. Rising export growth and an expansionary fiscal policy are positives, though hardly enough to prevent a slowdown in coming years. In a weak growth scenario Norges Bank will come under pressure, but as the NOK looks set to weaken more than envisaged by the bank, no rate cuts appear to be in the pipeline. A rate hike is not realistic either.

Consumers less powerful drivers of growth

After a 3-month decline in home prices during the autumn the drop appears to have levelled out around year-end. But signals from the housing market suggest that the move down will be resumed. The number of homes for sale increased in 2013 and is now 30-40% higher than one year ago, while turnover is largely unchanged. Hence, the number of unsold homes has increased sharply. Also the time homes are on the market has increased. These trends will push home prices lower. We look for a price fall of some 10% towards end-2015.

The biggest signs of weakness are in the market for new homes, reflecting almost no sales activity. Against this backdrop we expect several new construction projects to be put on the backburner, resulting in lower housing investment and declining construction activity.

Consumer spending growth also showed signs of weakness in H2 2013. Uncertainty about the housing market situation and slightly higher unemployment may have dampened consumers' propensity to spend. We expect the economic slowdown to curb growth in disposable real incomes relative to recent years, and this coupled with higher unemployment and declining home prices will contribute to making consumers more cautious.

No boost from investment

After a strong pick-up the trend in oil investment is flattening and looks set to head south next year. Meanwhile, cost-trimming has become the name of the game in the oil sector. Consequently, the strong growth in oil services is about to come to an end, with both a direct and an indirect effect on the mainland economy in the form of lower wage and consumption growth and greater caution in relation to investment projects in mainland Norway.

Still , low interest rates, banks that are more eager to lend and fairly low investment activity in many sectors indicate that mainland business investment will accelerate somewhat going forward, albeit only moderately.

A few good factors hardly enough to boost growth

Mainland exports disappointed last year, but with expected stronger growth in Norway's export markets and a weaker NOK, export growth should pick up going for-

Norway: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010(NOKbn)	2011	2012	2013	2014E	2015E
Private consumption	1,090	2.6	3.0	2.1	1.7	1.8
Government consumption	558	1.1	1.8	1.6	2.5	3.5
Fixed investment	482	7.7	8.3	8.7	0.6	-3.9
- gross investment, mainland	340	6.3	4.5	4.7	-0.2	-1.2
- gross investment, oil	125	11.1	14.3	17.3	2.0	-10.0
Stockbuilding*	110	-0.1	-0.1	0.0	0.0	0.0
Exports	1,030	-0.7	1.1	-3.9	1.9	1.3
- crude oil and natural gas	471	-5.6	0.7	-7.3	2.0	0.0
- other goods	299	-0.1	1.7	0.8	2.0	3.0
Imports	776	3.8	2.3	2.5	1.8	0.7
GDP	2,544	1.3	2.9	0.6	1.6	1.0
GDP, mainland	1,987	2.6	3.4	2.0	1.5	1.2
Unemployment rate, %		3.3	3.2	3.5	3.8	4.2
Consumer prices, % y/y		1.2	0.8	2.1	2.0	2.0
Core inflation, % y/y		0.9	1.2	1.6	2.4	1.9
Annual w ages, % y/y		4.2	4.0	3.9	3.5	3.3
Current account (NOKbn)		351.0	417.2	333.7	373.5	395.0
- % of GDP		12.8	14.3	11.1	11.8	12.1
Trade balance, % of GDP		13.6	13.3	10.3	10.9	11.1
General govt budget balance (NOKbn)		374.1	426.5	359.0	365.0	380.0
- % of GDP		13.6	14.7	12.0	11.6	11.6

* Contribution to GDP growth (% points)

ward. Also fiscal policy will contribute to dampening the slowdown. And when the government budget for 2015 is due in October, clearer signs of economic weakness will likely induce the government to propose higher government expenditure and tax cuts. But this will not be enough to prevent mainland economic growth from staying at 1-1½% in coming years, half the level seen in 2011 and 2012. Employment growth will slow markedly, but empirical evidence suggests that labour supply growth will slow too in tandem with the weakening labour market, one reason being lower labour immigration. We look for a relatively modest rise in unemployment.

Lower wage growth and gradually rising prices

Less labour market pressure points to decelerating wage growth from last year's nearly 4%. This year's pay talks will likely ensure good real wage growth but result in overall nominal wage growth of 3½% from 2013 to 2014. Next year wage growth may decelerate further.

Core inflation has risen quite a bit over the past year on the back of a weaker NOK driving up imported inflation as well as higher domestic prices. This year inflation will likely be close to the 2.5% target. But in 2015 the effect of the NOK weakening will fade and this combined with the weaker macro environment should contribute to lower domestic inflation. We see inflation below 2% by the end of the forecast horizon.

Norges Bank will not cut rates

Even though Norges Bank revised down its growth forecasts sharply during 2013 our forecast is clearly less optimistic than the bank's. This might suggest that a rate cut was in the pipeline. However, the reason why we do not factor in a rate cut is that we foresee a far weaker NOK than Norges Bank. The lower growth outlook is also not likely to trigger a corresponding drop in capacity utilisation due to the expected deceleration of labour supply growth. Our projections for labour cost growth and core inflation are moreover not dramatically lower; this year core inflation may stay slightly above Norges Bank's forecast. Lastly, banks' lending margins seem to be under slight downward pressure.

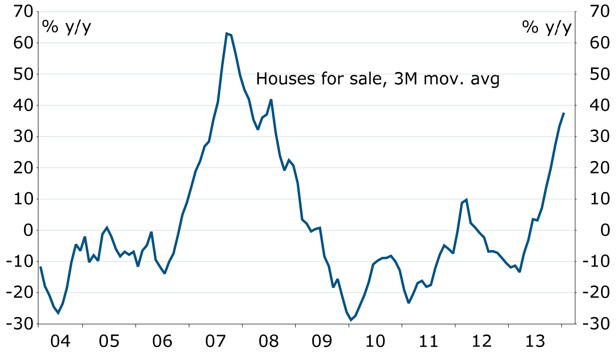
The NOK has weakened quite sharply in step with the weakening economy. With sustained low growth ahead EUR/NOK will likely stay around current levels for the remainder of the year and then strengthen slightly next year. Against the average exchange rate of the currencies of Norway's key trading partners, the NOK is expected to weaken on the back of a stronger SEK and USD.

With a policy rate on hold, short market rates will remain low in Norway. Meanwhile, rising long yields internationally will pull up their Norwegian counterparts.

Erik Bruce
erik.bruce@nordea.com +47 2248 4449

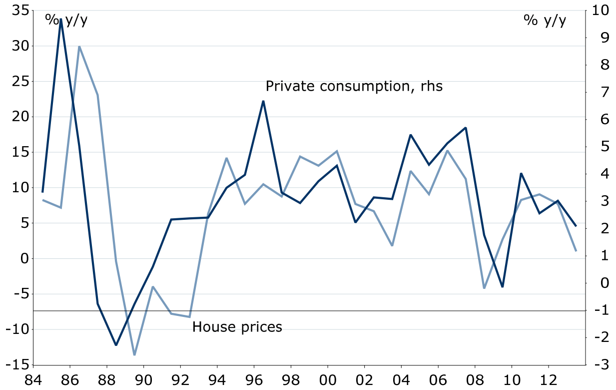
Joachim Bernhardsen
joachim.bernhardsen@nordea.com +47 2248 7913

Big increase in houses for sale



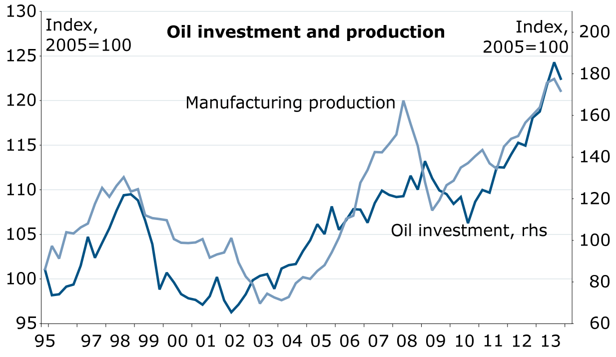
Source: Nordea Markets and Reuters Ecowin

Weaker housing market – lower consumption growth



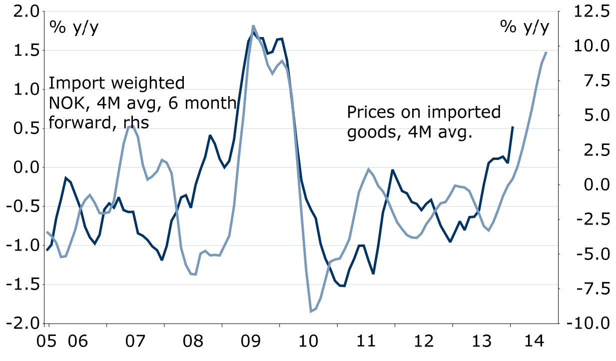
Source: Nordea Markets and Reuters Ecowin

Lower oil investments will hurt manufacturing



Source: Nordea Markets and Reuters Ecowin

Inflation rise due to higher import prices



Source: Nordea Markets and Reuters Ecowin

Measured pace

- Consumers key to growth
- Labour market a headache
- Maximum strain on public finances
- Many question marks over housing market

2013 will go down as yet another difficult year for the Danish economy. According to the preliminary figures the economy expanded by 0.4%. While this reflects a small improvement on the negative growth seen in 2012, it is still a long way away from the required long-term growth level.

The latest economic data point to a moderate pick-up in activity in the initial months of 2014. We expect this to continue over the year and help lift the economy by 1.3% in 2014, rising to 1.7% next year. So we keep our forecast unchanged compared with our view from December.

Households key to growth

Stagnating household spending is still the Achilles heel of the Danish economy. Retail sales have been hit the hardest with sales in volume terms close to a 10-year low. By contrast, households' car purchases are surging and this has helped to stabilise the trend in total consumer spending. One of the reasons for the lack of consumer spending growth is that households focus more on deleveraging. After reaching an absolute peak in mid-2009, households have gradually reduced their debt burden by around 20% points relative to disposable incomes. Mainly lending from banks has been reduced, whereas the domestic lending of mortgage institutions has seen a steady rise throughout the period. At this point it is very difficult to predict how long this deleveraging process will last, as it partly depends on the political regulation of the financial sector. Looking ahead, though, we think the headwinds from households' debt reduction will be gradually offset by record-high financial wealth, slightly positive real wage growth and an optimistic view on the future, making consumers more inclined to spend. Against this backdrop we expect consumer spending to grow by 1.3% in 2014 followed by a higher growth rate in 2015.

Rising exports and historical surplus

While domestic demand is under pressure, the trend in exports is much more favourable. Notably a significant improvement in the vital German market has helped to lift foreign trade. Given our expectations of an overall demand pick-up in the most important export markets, the upward trend in exports is set to continue over the coming years. With a combination of export growth, limited domestic demand and growing net wealth, the current account surplus is now at more than 7% of GDP.

Labour market trends a source of concern

There are many question marks over labour market trends. Gross unemployment has seen a steady decline since the middle of 2010, even though the Danish economy has moved in and out of recession during the same period. One reason is a reduction of the labour force during the same period – for instance as a result of the reforms made in the unemployment benefit and cash welfare benefit systems. But another factor behind the drop in joblessness is a slight upward trend in employment putting downward pressure on productivity. The setback in productivity coincides with slowing wage growth among Denmark's trading partners, implying that the pace of Danish wage increases is no longer slower than in other countries. So Danish companies no longer gain ground in terms of international wage competitiveness. Meanwhile there are well-founded fears that the economic crisis of recent years in Denmark has increased struc-

Denmark: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (DKKbn)	2011	2012	2013	2014E	2015E
Private consumption	855	-0.7	-0.1	0.0	1.3	2.0
Government consumption	510	-1.4	0.4	0.9	0.7	0.5
Fixed investment	301	3.3	0.8	0.7	0.6	2.2
- government investment	39	4.4	7.7	-0.7	-4.2	-0.7
- residential investment	67	17.8	-8.0	-5.0	1.0	1.4
- business fixed investment	194	-1.7	2.8	3.2	0.8	2.8
Stockbuilding*	-3	0.4	-0.3	0.1	0.2	0.0
Exports	888	7.0	0.4	1.0	3.1	3.4
Imports	790	5.9	0.9	1.5	2.4	3.4
GDP		1.1	-0.4	0.4	1.3	1.7
Nominal GDP (DKKbn)	1,760	1,792	1,826	1,848	1,895	1,965
Unemployment rate, %		6.0	6.1	5.8	5.6	5.5
Gross unemployment level, '000 persons		160	162	153	147	145
Consumer prices, % y/y		2.8	2.4	0.8	1.4	1.6
Hourly earnings, % y/y		1.8	1.5	1.2	1.6	1.7
Nominal house prices, one-family, % y/y		-2.8	-3.3	2.6	1.9	2.9
Current account (DKKbn)		107	109	134	123	116
- % of GDP		5.9	6.0	7.2	6.6	6.1
General govt. budget balance (DKKbn)		-36.6	-71.9	-21.5	-20.0	-35.0
- % of GDP		-2.0	-3.9	-1.2	-1.1	-1.8
Gross public debt, % of GDP		46.4	45.4	46.0	45.5	44.8

* Contribution to GDP growth (% points)

tural unemployment – and thus ultimately reduced the underlying growth potential of the Danish economy. Once again this underlines the need for structural reforms aimed at boosting productivity and labour market flexibility.

Maximum strain on public finances

At first glance the trend in public budgets is really impressive. In 2013 the deficit was reduced to the lowest level since the onset of the crisis. The same pattern is evident for this year, which even holds potential for a surplus if the extraordinary revenues from the changed taxation of capital pension schemes exceed the official estimate of DKK 20bn. Adjusted for these one-off revenues, the pattern is not quite as favourable with a projected structural deficit of 0.5%, which is the maximum allowed within the framework of the budget law. That also means public budget deficits are set to increase again from 2015.

Inflation edging higher

After reaching a historical low last summer, inflation has started to climb. This rise is mainly driven by a number of technical factors, as for example the abolition of the fat and sugar tax no longer pushes inflation lower. At the same time the massive weight of the housing component contributes to a relatively stable trend in the Danish inflation index. We expect the slight upward pace of increase to continue over the year, with consumer prices on average rising 1.4% this year and 1.6% in 2015.

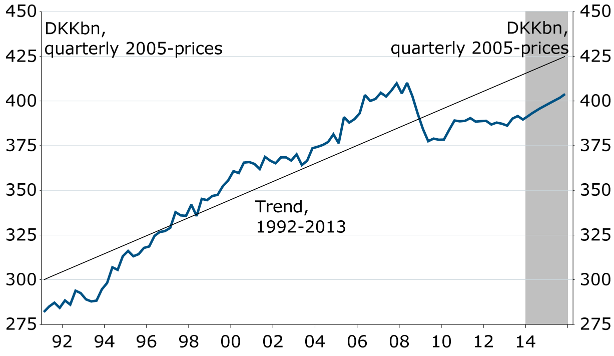
Many question marks over housing market

The housing market is still the biggest unknown factor in terms of the Danish economy. On the positive side prices continue to paint a relatively optimistic picture. Over the past year the price for owner-occupied flats has increased by 8.1% on average, with single-family houses rising 2.4%. But these rises mask wide geographical variations and a very low number of transactions. That reflects a market under pressure which has still not emerged from the crisis despite mortgage rates at historical lows. Another factor highlighting this is that residential construction is very low, still dragging the overall activity level lower.

Helge J. Pedersen
helge.pedersen@nordea.com +45 3333 3126

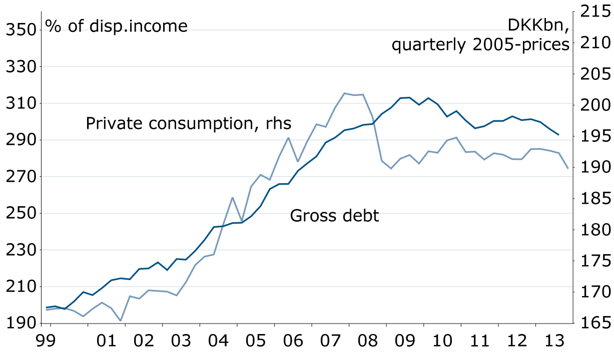
Jan Størup Nielsen
jan.storup.nielsen@nordea.com +45 3333 3171

Economic growth is about to pick up



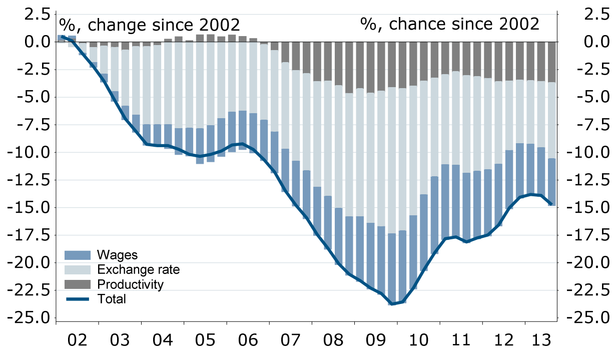
Source: Nordea Markets and Reuters Ecowin

Deleveraging is restraining consumption



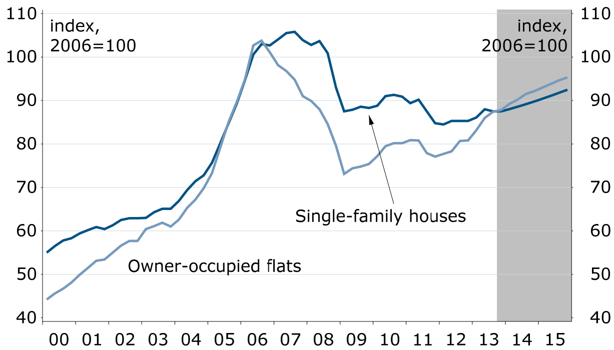
Source: Nordea Markets and Reuters Ecowin

Wage competitiveness still under pressure



Source: Nordea Markets and Reuters Ecowin

Fragile stabilisation of housing market



Source: Nordea Markets and Reuters Ecowin

Barely growing

- Exports will continue as the only growth driver
- Third year in a row with decreasing investment
- Private consumption will continue to contract in 2014
- Public sector deficit will remain significant

A long downhill

The Finnish economy has contracted for two years in a row. The drop was 1.0% in 2012 and 1.4% in 2013. Total production has declined to the level seen in the first half of 2010 after seven consecutive quarters of decline or unchanged performance. Thus Finland's starting point is weaker this year than anticipated in our previous forecasts, even though our prediction was one of most pessimistic ones. After a long downhill, the economy must pick up somewhat in order to reach even zero growth this year.

We have lowered our estimate of economic growth in Finland to 0.3% for 2014 (from 0.8%) and kept the estimate for 2015 unchanged at 2%. In 2015, the economy will be boosted not only by exports but also by domestic demand. The latter will gather more speed, as employment gradually improves, for instance.

Exports will continue as the only growth driver

The global economic outlook has become much brighter, as anticipated by several indicators. For example, growth in both world trade and global industrial production has accelerated. Most importantly, however, economic activity has clearly picked up in markets that are important for Finland, such as the United States, the euro area, Sweden and the United Kingdom. It is only a matter of time before the improved international demand will start to propel Finnish exports. We assume in our forecast that this will happen in the second half of this year at the latest. This will of course require that imports of the key trading partners will start to increase and that the current dispute between Russia and Ukraine will not continue for long. For the time being, the imports of our trading partners have increased very modestly or even decreased further. Another factor restricting growth in Finnish exports is the rather large share of investment goods.

We estimate exports to grow faster than imports and the trade balance to retain a small surplus. This would make foreign trade a significant and, in fact, the only driver of economic growth, which was the case last year, too. At the same time weak domestic demand puts a considerable damper on the economy. Private consumption and investment decreased for the major part of 2013. Due to weaker employment and decreased total production, the outlook for both is also subdued in 2014. We estimate both consumption and investment to continue to decrease compared to last year, but we expect the downhill to gradually turn into moderate growth in both cases.

Third year in a row with decreasing investment

The decline in construction, machinery and equipment investment will continue for the majority this year due to the weak economic outlook. The bottom will probably be reached sometime this year. Investment will not, however, have enough time to recover significantly, but will contract from last year for the third year in a row.

Budding signs of a pick-up are mainly visible in construction. New building permits decreased sharply last year, but late in the year, we saw a small increase. Based on data on accrued permits, construction will remain subdued for at least the early part of the year.

Finland: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (EURbn)	2011	2012	2013	2014E	2015E
Private consumption	99	2.5	0.3	-0.8	-0.4	1.5
Government consumption	44	0.5	0.5	0.8	0.4	0.5
Fixed investment	34	5.8	-0.8	-4.6	-2.5	4.8
Stockbuilding*	-1	1.5	-1.4	-1.1	0.5	-0.1
Exports	72	2.8	-0.2	0.3	3.4	5.5
Imports	70	6.2	-0.7	-1.8	2.2	4.9
GDP		2.8	-1.0	-1.4	0.3	2.0
Nominal GDP (EURbn)	178.7	188.7	192.4	193.4	196.7	204.6
Unemployment rate, %		7.8	7.7	8.2	8.4	8.1
Industrial production, % y/y		-0.6	-5.3	-2.6	1.5	3.0
Consumer prices, % y/y		3.4	2.8	1.5	1.4	1.6
Hourly w ages, % y/y		2.7	3.2	2.0	1.4	1.4
Current account (EURbn)		-2.7	-2.7	-1.6	-0.5	0.0
- % of GDP		-1.5	-1.4	-0.8	-0.2	0.0
Trade balance (EURbn)		-1.3	0.1	0.3	1.0	1.3
- % of GDP		-0.7	0.0	0.2	0.5	0.6
General govt budget balance (EURbn)		-1.4	-3.5	-3.9	-4.5	-4.4
- % of GDP		-0.7	-1.8	-2.0	-2.3	-2.2
Gross public debt (EURbn)		93.1	103.2	110.2	118.0	125.9
- % of GDP		49.3	53.6	56.9	60.0	61.5

* Contribution to GDP growth (% points)

Private consumption will continue to contract

It is rare to have private consumption decrease from the previous year. It is even rarer to have it decrease two years in a row. Nevertheless, this seems to be the case at hand. In 2013, private consumption decreased 0.8% and this year we expect it to decrease another 0.4%.

Consumption is hampered by many factors that continue to reduce purchasing power: employment will continue to weaken a bit further and the income level will rise modestly. Pensions will also rise less than in the past few years. Another factor reinforcing this development is the fact that taxes have been raised. Income taxation was tightened at the beginning of this year with more than half of municipalities raising their tax rate. Also, commodity taxes were raised selectively.

Purchasing power is further eroded by the rise in consumer prices. We estimate consumer prices to rise 1.4% in 2014 and 1.6% in 2015, which is more or less in line with the rise in the income level. With income taxes taken into account, this means that the purchasing power of an average earner will decrease. This will force households to be cautious and to consider carefully any larger acquisitions and borrowing despite the fact that interest rates are expected to remain exceptionally low for a long time.

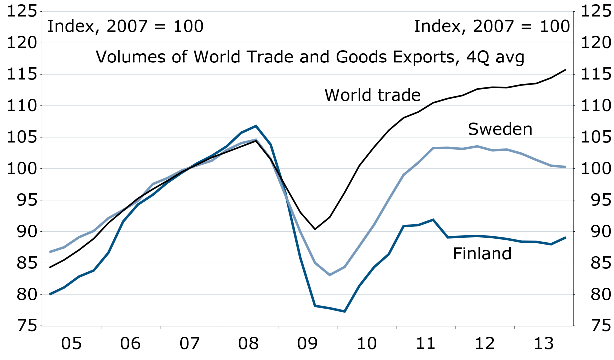
According to Eurostat, Finland was, along with the UK, the EU country with the fastest rising (harmonised) consumer prices in January (1.9%). This is extraordinary, as rising expenses cannot cause much upward pressure on prices in Finland at the moment, as evidenced by contracting economy, weaker employment, unused production capacity, industrial producer and wholesale prices that have decreased from last year and a strong currency that should make imported goods more affordable. Consequently, the most likely reasons behind the price rise outpacing the other EU countries are loose competition and tighter commodity taxes. Another round of commodity tax hikes would be devastating for consumer prices and household purchasing power, especially when the upward pressure on expenses will start to increase.

Public sector deficit to remain significant

Zero growth will hinder tax income accrual and maintain the public sector deficit at around 2% of GDP. Public debt will unavoidably rise above 60% of GDP, and it will not start to decrease within the forecast horizon without further fiscal austerity measures of billions of euros.

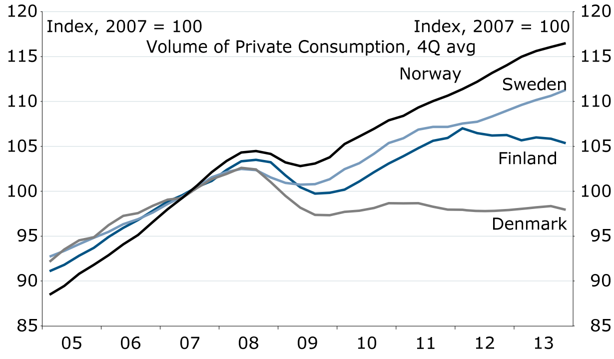
Pasi Sorjonen
pasi.sorjonen@nordea.com +358 9 165 59942

Exports fall while world trade expands



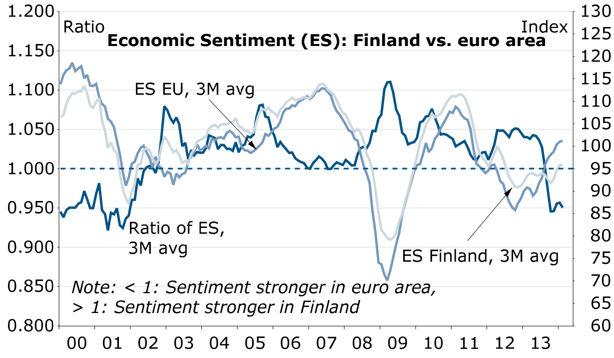
Source: Nordea Markets and Reuters Ecowin

Private consumption has been weak for a long time



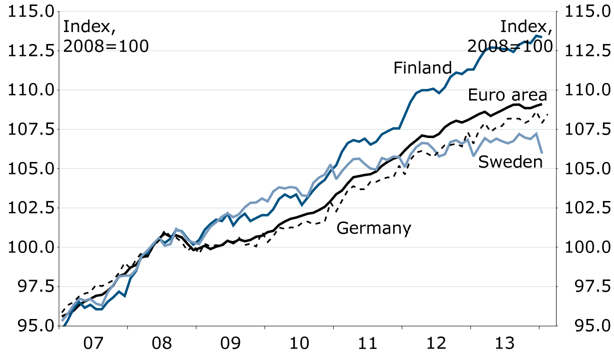
Source: Nordea Markets and Reuters Ecowin

Economic sentiment is unusually low



Source: Nordea Markets and Reuters Ecowin

Consumer prices are rising faster than elsewhere



Source: Nordea Markets and Reuters Ecowin

Spring will bring better times

- Bad weather mainly to blame for recent weakness
- Strong fundamentals: expect much stronger growth
- Less slack in the economy will push up wage gains
- QE to end in late 2014 – first rate hike in early 2015

A string of disappointing US data has recently sparked concerns that the economic acceleration seen in the second half of 2013 has lost steam. These concerns are misplaced, in our view. We believe the weakening is largely – although not entirely – related to the exceptionally cold weather in the past three months. After the weather turns more seasonal, economic activity is therefore expected to snap back, but unfortunately it could still take some weeks before that shows through in key monthly indicators due to the usual reporting lags.

Consumer confidence indicators have recently generally remained stable, and this increases our confidence that the underlying trend in economic growth has not suddenly deteriorated.

More importantly, with economic fundamentals as good as they have been for decades, preconditions are still in place for much stronger growth in 2014.

Households have significantly reduced their debt loads. The average share of after-tax income that households devote to servicing debt is as low as it has been since at least 1980. Households are also locking in extraordinarily low interest rates: only a fifth of liabilities are tied to rates that adjust from year to year.

Moreover, business balance sheets are about as strong as ever, the banking system is well-capitalised and highly liquid, credit conditions are improving and overall financial conditions are still very lenient.

As the drag from fiscal policy tightening fades, from around 1½% of GDP in 2013 to around ½% of GDP in 2014, the US recovery therefore seems likely to evolve into a self-sustaining expansion, with stronger growth, more jobs, lower unemployment and higher wage increases.

On the political side, Congress' recent suspension of the federal debt ceiling through 15 March 2015 resolves the last important source of fiscal policy uncertainty for the foreseeable future. Once the ceiling is reinstated, we estimate that the Treasury will be able to borrow funds until sometime in late 2015. Thus the debt deal, which illustrates the waning influence of the Tea Party-backed conservatives, suggests that we now may have at least 1½ years of fiscal certainty after several years of seemingly non-stop budget crises.

With the prospect of more fiscal calm, we are more confident that revived business investment growth will emerge as a key bullish theme for 2014.

Against this background, GDP growth is projected to strengthen from 1.9% last year to 3% in 2014 and 3.3% in 2015, unchanged from our December forecast.

Less slack in the labour market

Payrolls growth is expected to accelerate to an average 225k per month once the weather normalises later this year, up from last year's trend of 194k. The expected pace is more than enough to lead to a further decline in the unemployment rate, which is estimated to be down to 6.0% by end-2014 and 5.5% by end-2015, assuming a roughly unchanged labour force participation rate. Ac-

USA: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (USDbn)	2011	2012	2013	2014E	2015E
Private consumption	10,202	2.5	2.2	2.0	2.6	3.0
Government consumption and investment	3,174	-3.2	-1.0	-2.3	-0.6	-0.1
Private fixed investment	2,039	6.2	8.3	4.5	6.0	8.0
- residential investment	381	0.5	12.9	12.1	6.0	12.8
- equipment and softw are	732	12.7	7.6	3.1	6.3	7.4
- non-residential structures	362	2.1	12.7	1.4	6.4	7.2
- intellectual property products	564	4.4	3.4	3.4	5.4	5.7
Stockbuilding*	62	-0.2	0.2	0.2	0.1	0.0
Exports	1,844	7.1	3.5	2.7	7.1	5.7
Imports	2,362	4.9	2.2	1.4	4.3	5.3
GDP		1.8	2.8	1.9	3.0	3.3
Nominal GDP (USDbn)	14,958	15,534	16,245	16,797	17,592	18,528
Unemployment rate, %		8.9	8.1	7.4	6.3	5.6
Industrial production, % y/y		3.4	3.6	2.6	3.5	3.8
Consumer prices, % y/y		3.1	2.1	1.5	1.7	2.3
Consumer prices ex. energy and food, % y/y		1.7	2.1	1.8	1.9	2.4
Hourly earnings, % y/y		2.0	1.9	2.1	2.3	2.8
Current account (USDbn)		-457.7	-440.4	-419.9	-439.8	-463.2
- % of GDP		-2.9	-2.7	-2.5	-2.5	-2.5
Federal budget balance (USDbn)		-1,295.6	-1,087.0	-650.0	-500.0	-400.0
- % of GDP		-8.4	-6.8	-3.9	-2.8	-2.2

* Contribution to GDP growth (% points)

cording to our estimations, the economy needs to create only about 125-150k jobs per month net to keep the unemployment rate steady.

With continued diminishing slack in the labour market we expect to see a clear upturn in wage gains in the second half of 2014 at the latest, to 2¼-2½% y/y, up from 1.9% over the past year.

After a drop back to around 1% in February, headline CPI inflation is forecast to see a renewed gradual move up to reach 2% in late 2014. The pickup is expected to be driven by rents and, with a lag, some pressure from stronger wage increases.

Especially signs of labour market pressures are expected to cause markets to price in significantly more tightening by the Fed in 2015 and 2016. The result will likely be further increases in bond yields and a stronger USD in 2014.

Fed to end QE in late 2014

In December the Fed started to reduce its monthly bond purchases from USD 85bn, and Janet Yellen, who recently replaced Ben Bernanke as chairman, has indicated that it would likely require a “notable” change in the economic outlook for the central bank to pause or increase the pace of tapering. The Fed therefore seems likely to continue reducing its monthly bond purchases by USD 10bn per FOMC meeting, bringing its quantitative easing (QE) to an end in October or December 2014.

When the Fed’s 6.5% unemployment threshold is soon breached, we believe the Fed will simply switch to qualitative forward guidance, indicating that rates won't rise as long as inflation remains well below target.

We continue to expect the first Fed rate hike in Q1 2015, with the fed funds rate reaching 1.25% by end-2015.

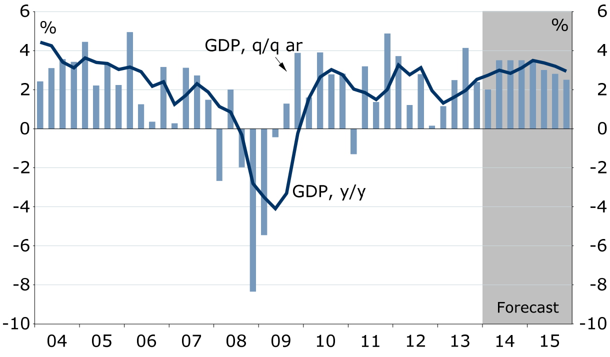
Risks to the US outlook

In addition to global downside risks to the US outlook, a disorderly response from financial markets to the Fed’s reduced bond buying remains a concern. This includes the risk that higher interest rates curb demand more than we anticipate. Another key domestic risk is that US political/regulatory uncertainty continues to hold back business investment. With respect to upside risk factors, we could see a stronger-than-expected rebound in US business investment as pent-up demand is released. Also lower energy prices, possibly as a result of increasing shale gas production, is seen as a positive risk factor for our baseline scenario for the US economy.

Overall, risks to the US outlook are viewed as roughly balanced.

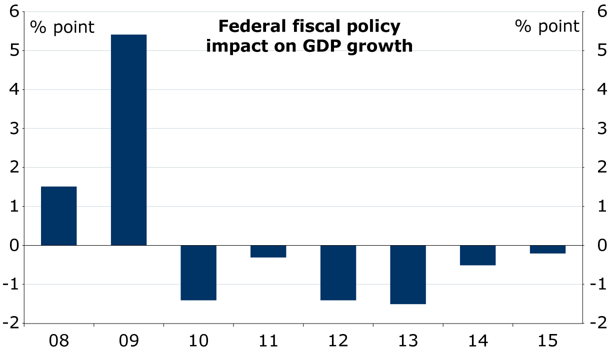
Johnny Bo Jakobsen
johnny.jakobsen@nordea.com +45 3333 6178

2014: a breakout year for the US economy



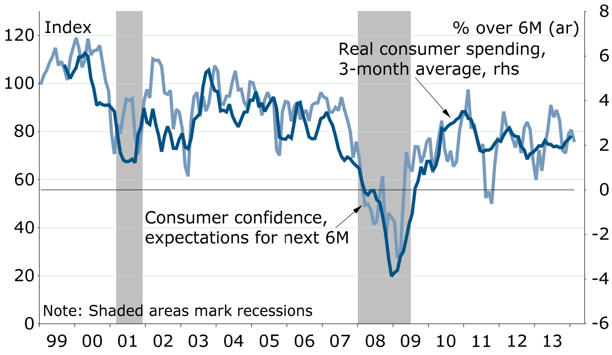
Source: Nordea Markets and Reuters Ecowin

Fiscal drag is sharply fading in 2014



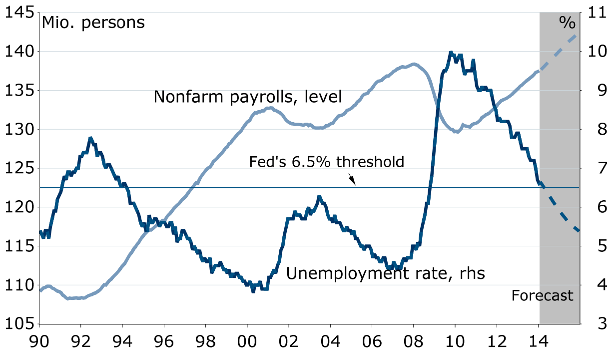
Source: Nordea Markets, CBO and Reuters Ecowin

Consumer confidence has held up



Source: Nordea Markets and Reuters Ecowin

Less slack in the labour market



Source: Nordea Markets and Reuters Ecowin

Recovery on a broader basis

- Domestic demand firming
- Less divergence between countries
- Low risk of a Japan-style deflation scenario
- No more easing from the ECB

The Euro area is advancing broadly as expected on its path of gradual recovery. Going forward, growth will probably not be fast, as the crisis' legacy – most of all excessive debt and a weakened banking sector – is acting as a drag. However, there are many signs of progress both on the economic and the financial side. Consumer and business confidence has improved significantly over recent months. Employment is no longer shrinking and unemployment seems to have peaked, which supports future private consumption. On the financial side, the fragmentation between strong and weak countries is less of an issue. Yields on long-term bonds in Italy and Spain, for example, are down to 3.6%, ie to multi-year lows. Despite progress, however, the recovery will probably need support from a very lenient monetary policy for a long time to come.

No major country in recession any more

GDP increased by 0.3% over the quarter in Q4. No major country remained in recession. That said, growth was still very weak in Italy, and also France is not out of the woods yet. On the other hand, the German economy looks quite robust, and growth is firming in Spain and the Netherlands. Sentiment indicators are pointing to sustained growth of roughly the same magnitude. Private consumption and investment spending should be the main growth drivers. We fine-tuned our GDP forecast for this year, raising it to 1.2% (from 1.0%). All in all, we still see the main forecast risk as being tilted to the downside, especially in the near term.

Structural reforms must go on

The return of confidence is good for growth, as less consumers and investors will take a wait-and-see attitude. Domestic demand should also benefit from a less restrictive fiscal policy. The public debt to GDP ratio will probably peak this year. However, still there is hardly any room for boosting the economy. Structural reforms will have to go on and be sped up in France and Italy. In that respect, we find it promising that the new Italian Prime Minister announced far-reaching reforms. Actual implementation is key, of course.

On the external side, European exporters are benefiting from the pick-up in global trade. The most important export destinations are the US and the UK – two economies that we expect to expand at a healthy pace. Among Emerging Markets (and apart from China), Turkey and Russia are the most important ones for Euro-area exporters. A mild slowdown there would not threaten the recovery of the Euro area as a whole, but could affect single countries.

Two issues to keep an eye on are the elections to the European Parliament in late May and the ECB's Asset Quality Review (AQR) of the largest Euro-area banks. Euro-sceptics and "populists" will probably score a very strong election result, possibly getting around 25% of the votes. However, we don't expect break-up fears to resurge or the parliament to become dysfunctional, as the moderates will probably cooperate more closely. Likewise, we are confident that the AQR and stress tests will not cause a systemic banking crisis. Several banks will probably have to raise capital, some might even have to close down. But as long as backstops are in place, it is a necessary exercise to restore confidence in the banking sector and ultimately to make the recovery more robust.

Low risk of deflation ...

Deflation risks are mentioned ever more often in the Euro area. Deflation refers to a persistent fall in the general price level. The *persistent* part is why deflation is very negative for economic activity.

The key to prevent deflation is that economic policies are loosened enough to prevent expectations of falling prices to take hold. In that way, deflation can be seen as a policy error, ie not loosening policies enough.

Euro area: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (EURbn)	2011	2012	2013	2014E	2015E
Private consumption	5,283	0.3	-1.4	-0.4	0.7	1.2
Government consumption	2,020	-0.1	-0.6	0.3	0.3	0.4
Fixed investments	1,741	1.8	-3.8	-2.8	2.8	4.0
Exports	3,794	6.7	2.7	1.3	4.0	5.0
Imports	3,673	4.7	-0.8	1.3	3.8	5.3
Net exports*	121	0.9	1.5	0.5	0.3	0.1
GDP		1.6	-0.6	-0.4	1.2	1.5
Nominal GDP (EURbn)	9,186	9,444	9,506	9,596	9,809	10,105
Unemployment rate, %		10.2	11.4	12.1	11.9	11.6
Consumer prices, % y/y		2.7	2.5	1.4	1.0	1.5
Current account, % of GDP		0.4	1.8	2.7	2.7	2.3
General government budget balance, % of GDP		-4.1	-3.7	-3.1	-2.6	-2.5
General government gross debt, % of GDP		88.0	92.7	95.6	96.0	95.6

* Contribution to GDP growth (% points)

Given policymakers' massive attention on (the lack of) inflation, we still see little risk of outright deflation or a Japan-like scenario in the Euro area.

… but low inflation …

Inflation has fallen gradually from almost 3% at the end of 2011 to below 1% at the end of 2013 and is still falling. Several countries in the Euro area, such as Greece and Cyprus, are even experiencing negative inflation (falling prices) due to the severity of the recessions and the need to substantially improve competitiveness in these countries.

However, inflation has developed roughly in line with our December inflation projection and we maintain the view that inflation will be below 1% until the April reading, around 1% until autumn, and only gradually rising thereafter. If we are right that inflation will have passed the bottom in a few months' time, deflation fears should gradually abate during this year.

The main reason why we expect inflation to start rising gradually in the last months of the year is that by then the recovery will have been going on for long enough to have substantially reduced the slack in the economy.

… and a risk to the ECB outlook

We believe the ECB is done easing monetary policy. The recovery is taking hold and inflation is expected to be close to the low in this cycle.

The ECB has long recognised that inflation will remain well below the inflation target for some years. However, low inflation for too long would risk adversely affecting inflation expectations. Therefore, the ECB will want to show its readiness to act if the inflation outlook deteriorates further. This could be done by cutting its already low key interest rates a bit further.

Mr Draghi and his fellow Governing Council members are still not overly concerned about outright deflation. However, we have little doubt that any signs of inflation expectations being less than well-anchored will prompt more decisive monetary policy easing in some form.

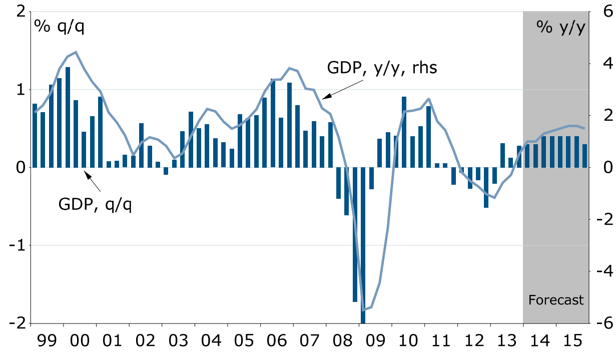
Market rates to rise gradually

We expect market rates to start rising gradually later this year. By then expectations of more ECB easing should have faded due to the strength of the recovery and gradually rising inflation. We expect the ECB to hike rates towards the end of 2015 and still expect a moderate weakening of the EUR vs the USD over the forecast horizon. A stronger EUR is a clear downside risk to our growth outlook.

Holger Sandte
holger.sandte@nordea.com +45 3333 1191

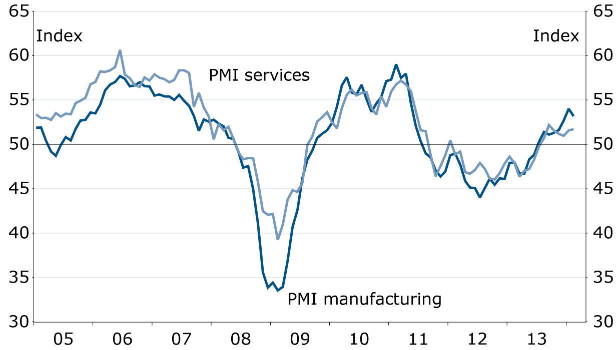
Anders Svendsen
anders.svendsen@nordea.com +45 3333 3951

Gradual recovery



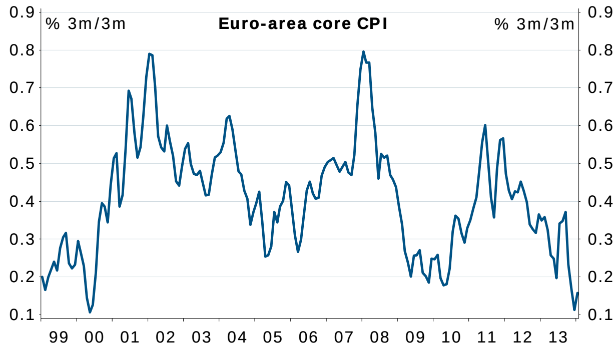
Source: Nordea Markets and Reuters Ecowin

Indicators pointing to ongoing growth



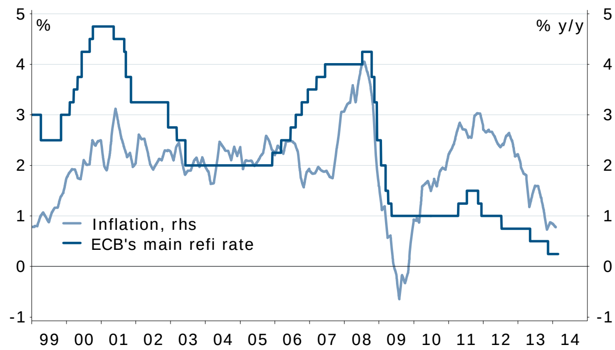
Source: Nordea Markets and Reuters Ecowin

Lower core price increases



Source: Nordea Markets and Reuters Ecowin

Low inflation and low ECB rates



Source: Nordea Markets and Reuters Ecowin

Broadly-based growth ahead

The German economy is in good shape and will probably grow by around 2% this year and next. Private consumption should again be a major growth driver. Full employment is not that far away and wage increases are picking up. Real disposable income should rise by slightly more than 1% this year. That leaves room for an expansion of private consumption by about the same order of magnitude, and maybe a bit more if the savings ratio continues to decline.

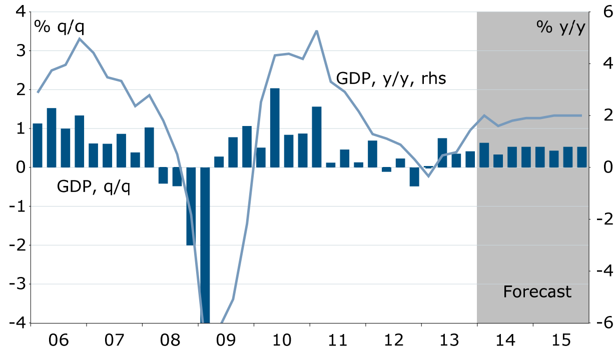
Nominal GDP increased by 2.7% last year. That gives an indication of what an appropriate Bundesbank policy rate for Germany would be – around 3%, maybe higher. In reality, rates are much lower and will support especially the construction sector for a longer period of time. House prices in large cities continue to rise, with no sign of a bubble for the whole economy, according to the Bundesbank.

On the export side, the gradual recovery of economies such as France, Italy and Spain is good news for German companies, compensating for a loss of momentum in Emerging Markets. Less uncertainty about the future of the Euro area should also support spending on machinery and equipment. Q4 probably marked the starting point for a stronger trend in capital spending. Once the investment cycle starts, it usually goes on for a few quarters, also creating jobs. On that note, continued immigration should ease capacity constraints. In 2012 and 2013 combined, Germany saw net immigration of almost 800k people, compared to a total population of 80.8m.

A bigger risk than a resurgence of the euro crisis currently seems to be a marked weakening of important Emerging Markets. Over the medium to long term, high energy prices remain a challenge for parts of German industry. It also remains to be seen whether and how minimum wages can be introduced without major job losses.

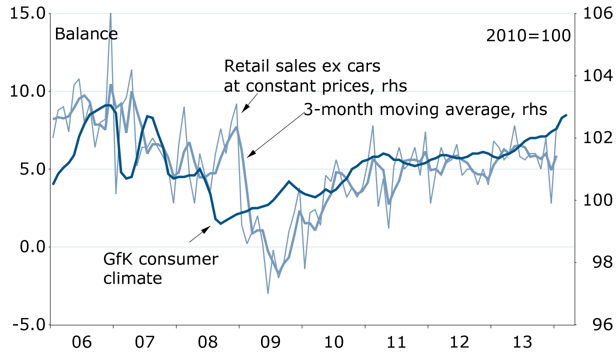
Holger Sandte
holger.sandte@nordea.com +45 3333 1191

Stable growth ahead



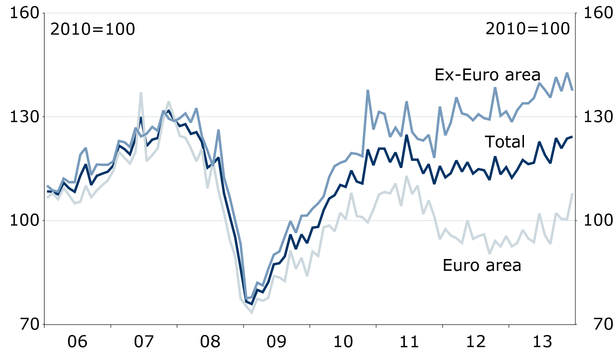
Source: Nordea Markets and Reuters Ecowin

Consumer confidence steadily rising, sales not yet



Source: Nordea Markets and Reuters Ecowin

Manufacturing orders from the Euro area picking up



Source: Nordea Markets and Reuters Ecowin

Germany: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (EURbn)	2011	2012	2013	2014E	2015E
Private consumption	1,435	2.3	0.7	1.0	1.3	1.7
Government consumption and investment	487	1.0	1.0	0.7	0.8	1.0
Fixed investment	435	7.1	-1.3	-0.5	4.6	5.3
Exports	1,189	8.1	3.8	1.0	4.6	6.0
Imports	1,048	7.5	1.8	1.0	5.2	6.5
Net exports*	140	0.7	1.1	0.0	0.2	0.1
GDP		3.4	0.9	0.5	1.8	2.0
Nominal GDP (EURbn)	2,495	2,610	2,666	2,738	2,788	2,899
Unemployment rate, %		7.1	6.8	6.9	6.7	6.6
Consumer prices, % y/y		2.5	2.1	1.6	1.4	1.8
Current account, % of GDP		6.3	7.0	7.0	6.7	6.3
General government budget balance, % of GDP		-0.8	0.1	0.0	0.3	0.2
Gross public debt, % of GDP		80.0	81.0	79.6	77.3	74.5

* Contribution to GDP growth (% points)

"It's on the supply side we must act." Still so true

Our view on the French economy is unchanged: very slow growth in 2013 will likely be followed by slightly higher momentum this year, mainly driven by private consumption as fiscal policy becomes less tight. France will probably continue to lag behind Germany, and progress on growth-enhancing reforms is still slow.

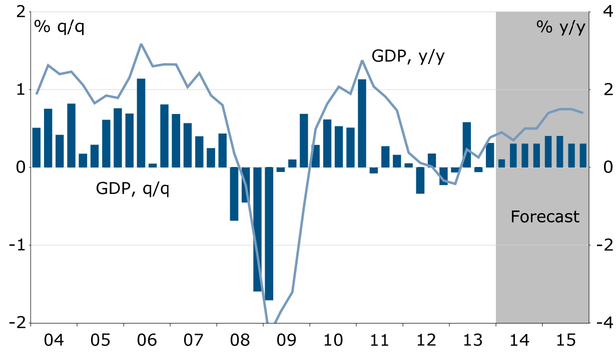
The main driver behind the GDP growth rate of 0.3% q/q for Q4 2013 was private consumption. A small hike in VAT led to home maintenance expenditure being brought forward, resulting in a setback in Q1. Consumer confidence is still low by historical standards but has increased significantly since mid-2013. Unemployment seems to be about to peak. Supported by the tax credit for competitiveness and employment (CICE), employment should rise a bit this year, but probably not by enough to allow unemployment to fall significantly.

The outlook for the industrial sector is mixed. Forward-looking indicators are somewhat contradictory, but in any case do not indicate strong momentum. France should continue to benefit from stable growth in Germany, the US and the UK. All in all, though, French companies continue to lose market share. One reason is that wages are high compared to the level of product sophistication. At the same time, competitiveness is improving in Spain and Portugal. In a sense, companies in France should be happy that Italy is lagging in terms of reforms, too. However, this might change with the new Prime Minister Matteo Renzi. President Hollande still has to deliver on his reform speech from mid-January when he said: "It's on the supply side we must act. Supply itself creates demand. We must continue to reduce the cost of labour."

One risk to the outlook relates to fiscal policy. More tightening may be needed for France to meet the 3% deficit criterion in 2015. On the positive side, French exports are not very exposed to Emerging Markets, and hence a major slowdown here would not hurt much.

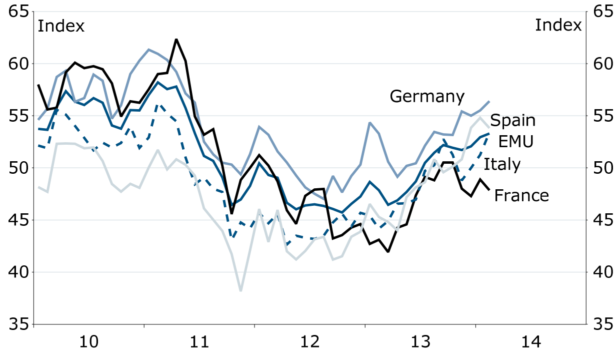
Holger Sandte
holger.sandte@nordea.com +45 3333 1191

Growth: moderate expectations



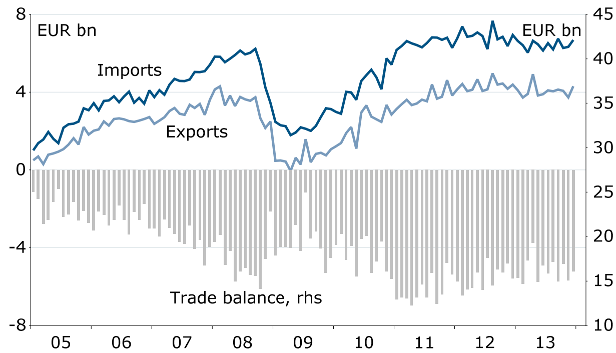
Source: Nordea Markets and Reuters Ecowin

PMI composite index: France lagging



Source: Nordea Markets and Reuters Ecowin

No momentum in exports



Source: Nordea Markets and Reuters Ecowin

France: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (EURbn)	2011	2012	2013	2014E	2015E
Private consumption	1,045	0.5	-0.3	0.4	0.6	0.9
Government consumption and investment	444	0.4	1.4	1.7	1.2	1.0
Fixed investment	334	3.0	-1.2	-2.1	2.0	3.0
Exports	466	5.6	2.5	0.6	3.5	4.5
Imports	509	5.3	-0.9	0.8	3.0	3.5
Net exports*	-43	0.0	1.0	-0.1	-0.1	0.1
GDP		2.0	0.0	0.3	1.0	1.5
Nominal GDP (EURbn)	1,936	2,000	2,032	2,060	2,091	2,133
Unemployment rate, %		9.6	10.2	10.8	10.8	10.6
Consumer prices, % y/y		2.3	2.2	1.0	1.0	1.3
Current account, % of GDP		-2.5	-2.1	-1.9	-2.0	-2.2
General government budget balance, % of GDP		-5.3	-4.8	-4.2	-4.1	-3.9
Gross public debt, % of GDP		85.8	90.2	93.9	96.1	97.3

* Contribution to GDP growth (% points)

The end of forward guidance

- Strong growth momentum for the rest of this year
- Employment at record high and rising
- The first rate hike remains some time away

We revise our GDP forecast up a tad to 2.7% for this year (from 2.5%) and keep our 2.0% for 2015. We see risks mainly skewed to the upside.

The labour market improvements are impressive with 400,000 new jobs having been created during 2013. Housing market activity is increasing and prices are rising faster. Exports to the Euro area are flattish in value terms, but exports to other destinations have increased at close to double-digit pace in recent years. Only investment is lagging, but will probably pick up during 2014.

The economy has been doing much better than expected. The Bank of England (BoE) sees growth at 3.4% in 2014 or almost 1% point higher than in August 2013 when forward guidance was introduced and at 2.7% in 2015.

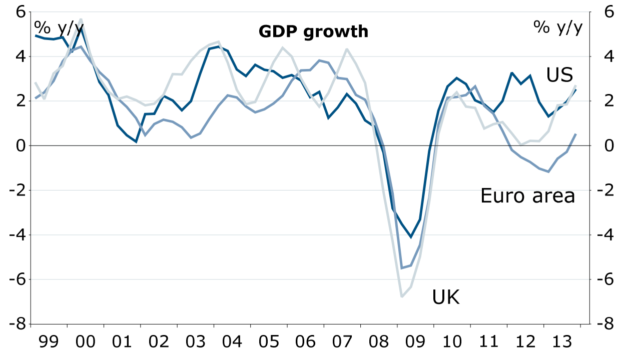
The BoE has scrapped threshold-based forward guidance just six months after its introduction. Governor Carney has given clear signals that the first rate hike remains some time away still and we expect the first rate hike around the middle of 2015 – a bit later than current market pricing.

We remain a bit more sceptical on growth compared with the BoE due to the potential for more GBP strengthening and a general belief that employment growth will be unable to keep up the current pace for very long given that the level is already at a historical high.

The GBP is likely to continue strengthening over the forecast horizon given its weak starting point and the relatively strong economic recovery, especially relative to the Euro area.

Anders Svendsen
anders.svendsen@nordea.com +45 3333 3951

Catching up with the Joneses

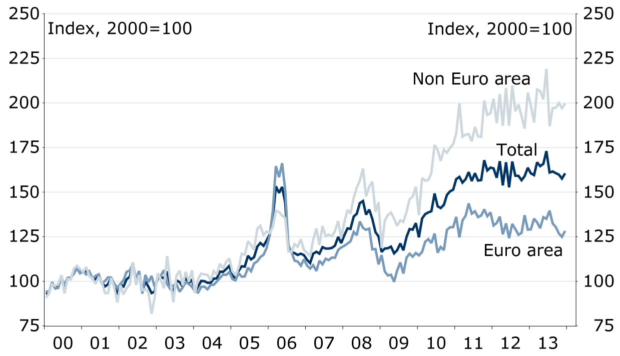


Source: Nordea Markets and Reuters Ecowin

Impressive labour market performance

Source: Nordea Markets and Reuters Ecowin

Export redirection



Source: Nordea Markets and Reuters Ecowin

United Kingdom: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (GBPbn)	2011	2012	2013	2014E	2015E
Private consumption	959	-0.4	1.5	2.3	2.0	1.8
Government consumption	337	0.0	1.6	0.9	1.5	0.0
Fixed investment	221	-2.4	0.7	-0.5	8.1	4.3
Stockbuilding*	2	0.5	-0.2	0.3	-0.1	0.0
Exports	447	4.5	1.1	0.8	2.2	5.4
Imports	480	0.3	3.1	0.4	2.3	4.2
GDP		1.1	0.3	1.8	2.7	2.0
Nominal GDP (GBPbn)	1486	1537	1567	1621	1711	1788
Unemployment rate, %		8.1	8.0	7.6	7.0	6.6
Consumer prices, % y/y		4.5	2.8	2.6	2.1	2.2
Current account, % of GDP		-1.5	-3.7	-4.0	-4.2	-3.2
General govt budget balance, % of GDP		-7.7	-6.1	-6.5	-5.0	-3.0
Gross public debt, % of GDP		84.3	88.8	91.8	92.5	91.4

* Contribution to GDP growth (% points)

Reality check ahead

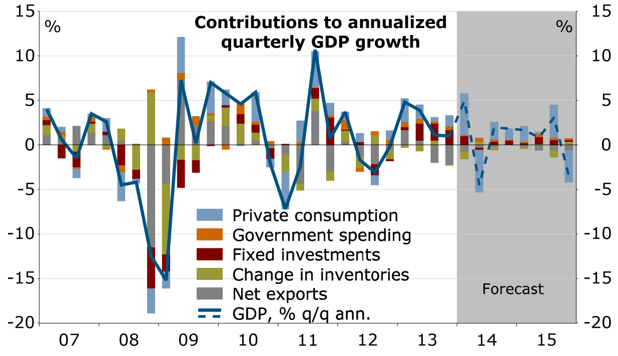
Japan's economy has improved dramatically since Prime Minister Shinzo Abe took office in December 2012 with promises to end two decades of deflation and tepid growth. Following the 2012 recession Japan saw GDP growth of around 1½% last year, a pace well above the economy's estimated long-term growth potential of around 1% per year. The expansion, supported by strong monetary and fiscal stimuli, is being driven by consumer spending, a rebound in business investment and exports.

The expansion is expected to continue, but fiscal consolidation in the form of consumption tax hikes in 2014 and 2015 is expected to slow GDP growth to around 1.3% in 2014 and 1% in 2015. In order to secure funds to cover swelling social spending due to the aging population the government has decided to raise the consumption tax from 5% to 8% in April 2014, which amounts to a fiscal tightening of around 1½% of GDP. The tax increase is likely to cause quarter-on-quarter contraction in the economy in Q2 this year following a consumption-led acceleration in Q1. However, with the offsetting JPY 5.5trn (1.1% of GDP) fiscal stimulus passed in February we expect to see recovery in the second half of 2014.

A key uncertainty to the outlook is whether the dramatic improvement in corporate earnings in 2013, supported by the sharp JPY depreciation, will spill over to wages. Real wage growth is currently negative as higher import prices have boosted CPI inflation, but for the recovery to become more self-sustaining we would need to see higher wages. If not, the recovery will stall. Another still missing key ingredient in a sustained recovery is structural reform, where progress remains slow partly due to strong resistance to deregulation among vested interests. For now, we don't expect the Bank of Japan to expand its quantitative easing programme, but more stimulus is likely if growth disappoints. Risks include disorderly market reactions to Fed tapering, a spike in energy costs, a China hard landing, and escalating tensions with China.

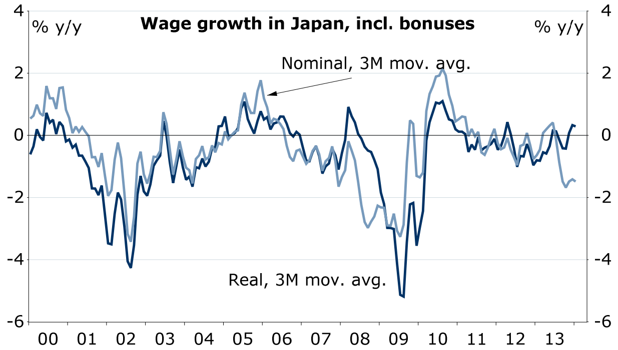
Johnny Bo Jakobsen
johnny.jakobsen@nordea.com +45 3333 6178

Bump ahead: consumption tax hike



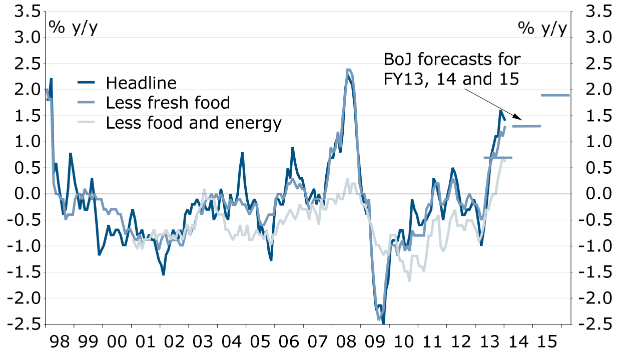
Source: Reuters Ecowin and Nordea Markets

Negative real wage growth ...



Source: Nordea Markets and Reuters Ecowin

... due to stronger consumer price increases



Source: Reuters Ecowin and Nordea Markets

Japan: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (JPY bn)	2011	2012	2013	2014E	2015E
Private consumption	279,848	0.3	2.1	2.0	1.5	1.4
Government consumption	95,194	1.2	1.7	2.0	1.4	1.2
Gross fixed capital formation	96,407	1.5	3.2	2.8	4.5	1.9
Stockbuilding*	-772	-0.2	0.1	-0.3	-0.2	-0.1
Exports	73,270	-0.4	-0.1	1.6	2.2	4.8
Imports	67,470	5.9	5.4	3.3	8.1	7.3
GDP		-0.4	1.4	1.6	1.3	1.0
Nominal GDP (JPY bn)	482,471	471,543	473,919	478,516	492,872	507,658
Unemployment rate, %		4.6	4.4	4.0	3.5	3.0
Consumer prices, % y/y**		-0.3	0.0	0.4	2.3	1.7
Current account, % of GDP		2.0	1.0	1.2	0.5	1.0
General government budget balance, % of GDP		-9.6	-9.8	-10.1	-9.5	-9.5

* Contribution to GDP growth (% points)

Outperformer again

Recovery of the Polish economy in the second half of 2013 proved even stronger than indicated in our above-consensus forecasts. We expect it will be continued in 2014-2015. Crucial driver of the economic revival is improvement in external environment (over half of Polish exports go to the Euro-area, which has entered a recovery path). Rebound in fixed investments is fuelled by stronger investment activity in the private sector (improved confidence, record-low interest rates, easier lending conditions) and revived activity in public investment (fresh EU funds). Consumption growth is fostered by strengthening improvement in labour market conditions and rising consumer confidence. Potential impact of events in Ukraine on the Polish economy should be limited as the country's share in Poland's exports is a mere 2.8% while Polish FDIs in Ukraine have been less than EUR1bn.

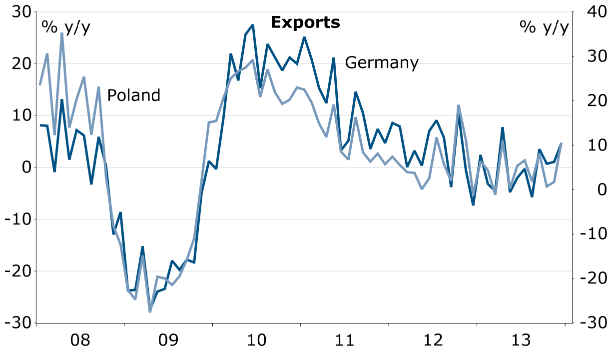
The sharp inflation drop in late 2012 and during 2013 should gradually reverse in the course of 2014. We expect that recovery of domestic demand (relatively small output gap should start to close in early 2014) as well as low base effects will push the headline inflation rate towards the target of 2.5%.

While the Polish MPC has pledged that the key policy rate will remain at record-low of 2.5% at least until mid-2014, we expect that economic recovery and gradual build-up of underlying inflationary pressures should induce Polish central bankers to start policy normalisation in the second half of this year. We bet on the first rate hike in Q4 2014 and we think the policy tightening will be very cautious with the total scale of hikes up to 100 bps until the end of 2015.

In the medium term the PLN should gain on the back of cyclical recovery of the Polish economy and considerably improved balance of payments position, but in the short term it should remain broadly stable amid concerns about negative effects of QE3 tapering.

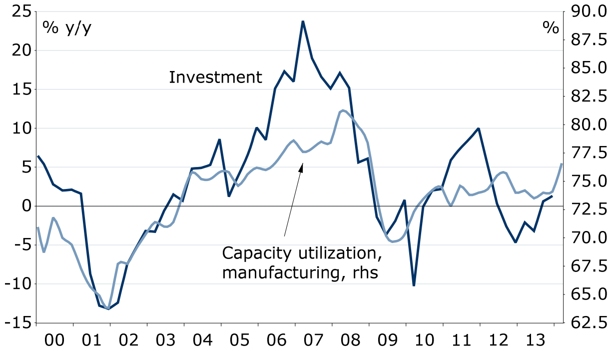
Piotr Bujak
piotr.bujak@nordea.com +48 521 3651

Polish exports strongly linked to German exports



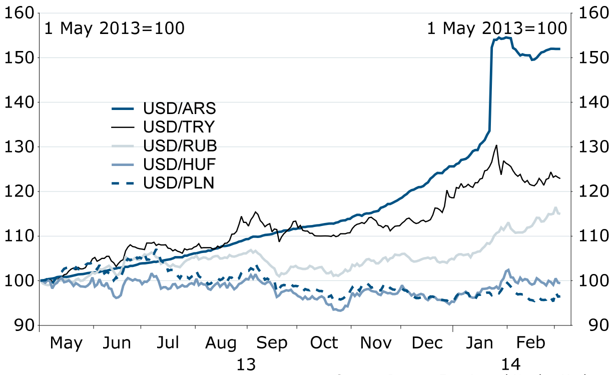
Source: Reuters Ecowin and Nordea Markets

Fixed investment recovery on the way



Source: Reuters Ecowin and Nordea Markets

PLN resilient to EM rout



Source: Reuters Ecowin and Nordea Markets

Poland: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (PLNbn)	2011	2012	2013	2014E	2015E
Private consumption	856	2.6	1.2	0.8	2.7	3.6
Government consumption	268	-1.7	0.2	2.0	1.2	3.0
Gross fixed capital formation	281	8.5	-1.7	-0.4	6.0	8.5
Exports	689	7.7	3.9	4.3	4.1	4.5
Imports	706	5.5	-0.7	0.7	3.6	4.5
GDP		4.5	1.9	1.6	3.6	4.2
Nominal GDP (PLNbn)	1,417	1,528	1,595	1,632	1,708	1,814
Unemployment rate, %		12.5	13.4	13.4	12.6	11.8
Consumer prices, % y/y		4.3	3.7	0.9	1.6	2.5
Current account, % of GDP		-5.0	-3.7	-1.5	-1.9	-2.1
General government budget balance, % of GDP		-5.0	-3.9	-4.4	4.5	-3.0

Slowdown – new reality

- Slowdown continues
- Investment activity is frozen
- Consumption is the only driver
- The rouble no longer follows trends in the commodity markets

Economic growth continues to decelerate in Russia. After excellent years in 2011-2012 the economy started to misfire and a gradual slowdown led to GDP growth of just 1.4% in 2013. Hopes for some acceleration at the end of 2013 were multiplied by zero after growth in December appeared to be only insignificantly higher due to unsustainable seasonal factors (20% of total annual investments and government spending are allocated in December). Thus, the perspectives for a revival of economic activity appear more than uncertain. The overall economic weakness forces us to cut our 2014 and 2015 forecasts to 1.5% and 1.8%, respectively. The major drag will be the same – low investment activity.

The major drag is low investment activity

Investment activity has seen a negative trend since the beginning of last year. Commodity market trends do not signal high growth, monetary policy is restrictive and fiscal stimuli are uncertain. The government's inflation-targeting policy threatens to freeze tariff hikes for natural monopolies, such as Gazprom (which accounts for approximately one-third of all investments in Russia), leading to even lower investment activity. Also the monetary policy has put a strain on the investment activity. The Bank of Russia was forced to issue a hawkish statement at the beginning of 2014 given the increased inflation threat from the weakening rouble – leaving no hope for the desperately needed key rate cut. However, we do not see a further drop in capital investment growth in 2014. This is due to the government's strict control over big companies' investment plans. The government has announced a reassuring investment programme of domestic blue chips, which account for up to 80% of total investments.

Hopes for government support are alive

However, not everything is that gloomy and there is a ray of sunshine in the darkness. The government has both the will and the resources to fight a slowdown. A major source of hope in 2014-2015 is government investment. Ample reserves provide some cushion for the economy and the government has prepared a USD 40bn (2% of GDP) package to invest in infrastructure. However, the mechanism of such injections is not ready and hence we do not anticipate the market to see this lump sum shortly. Furthermore, the Sochi Winter Olympics may add extra points to overall growth in 2014, but it certainly will not provide sustainable support.

Driving force under question

On the other hand, household consumption – which is still strong – remains the only bright story. Real wage growth, a healthy labour market and high credit activity support consumer confidence. However, there are worries over the pace of retail sales growth. The foundation is shaky, taking into account lower forecasts for retail credit growth and that corporate earnings may continue to be at least stagnant against the background of flat commodity markets, with a spillover effect on household income. Also the pace of wage growth may decrease due to the government's decision to cancel salary indexations in some segments of the public sector. Thus, consumption growth may appear under pressure in 2014, eliminating hopes for higher-than-expected (ie 2%) GDP growth.

Bank of Russia pursues inflation-targeting policy

The Bank of Russia acknowledges the low economic growth rates and of course weak investment activity. However, inflation is still in the focus and the regulator is not going to step back from its inflation-targeting policy. The weakened rouble added uncertainty and increased inflationary risks, forcing the Bank of Russia to increase its key rate from 5.50% to 7.00% The measures, as the regulator said, were temporary, but we do not exclude that the CBR will increase rates for a longer period if the rouble continues to weaken and inflation rises above 7%. The current target of the Bank of Russia for CPI growth for the end of the year is 5.5%, which is a rather reasonable

Russia: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (RUBbn)	2011	2012	2013	2014E	2015E
Private consumption	23,618	6.4	6.6	3.4	3.3	3.2
Government consumption	8,671	1.2	0.0	0.2	0.4	0.6
Fixed investment	10,014	8.3	6.7	-0.3	0.1	1.6
Exports	13,529	0.3	1.8	2.9	2.8	2.5
Imports	9,790	20.3	8.7	5.0	4.1	4.7
GDP		4.3	3.4	1.4	1.5	2.0
Nominal GDP (RUBbn)	46,322	55,799	62,357	66,689	72,837	79,792
Unemployment rate, %		6.6	5.5	5.6	5.7	5.7
Consumer prices, % y/y		6.1	6.6	6.4	6.0	5.5
Current account, % of GDP		5.4	4.3	3.0	2.5	1.9
Central govt budget balance, % of GDP		0.8	-0.2	-0.7	-0.8	-0.9

level given the projected decline in food price growth and the possible freeze of tariffs for some natural monopolies. However, all will depend on the currency market.

The rouble can find its bottom

Also the global negative sentiment surrounding all EM currencies hit the rouble. The turmoil in the Ukraine and devaluation in Kazakhstan also added ‘two cents’ in the overall picture. The geopolitical tensions around Crimea between Russia and Ukraine can continue to weigh on the rouble and cannot be solved quickly. The possibility of EU and US economic sanctions against Russia can continue to weigh on the rouble. However, neither Moscow nor the western world wants an escalation, and we expect diplomats to resolve the conflict over the coming weeks. Until then, however, investors should be prepared for a period of high volatility in the Russian currency and money markets.The low pace of economic growth, worsening current account balance and accelerated capital outflow have made the rouble more vulnerable to external factors and during January-February 2014 the RUB lost ~10%, ie more than many other peer EM currencies. The overall trend in the FX rate of the rouble since the beginning of 2013 is much more promising and is not worse than the average trend for other EM currencies. Thus, the rouble’s weak start to 2014 can be partially explained by its catching up with the peer group.

The most notable thing is the fact that the fundamental correlation of the rouble with world commodity markets has gone. Petroleum prices are high, and our 2014-2015 commodity market forecast remains RUB-supportive. However, today the rouble is completely out of touch with petroleum prices and follows external sentiment. We think that the current situation will not be sustainable in the long term as geopolitical risks around Crimea will fade and Russian exporters, the major market participants, will finally bring the rouble back to historically justified levels versus the oil market.

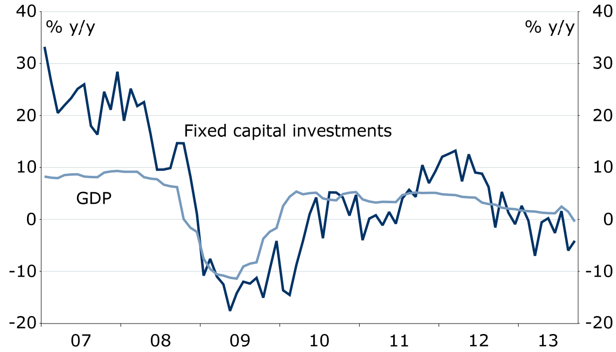
Of course growth problems in Russia put some pressure on the rouble but the fundamental picture in Russia is better than in many other EM countries. A still positive current account balance in 2014-2015, ample reserves and sound public finances will support the Russian currency in the long run, where we see a relatively stable rouble versus the USD. Weaker GDP growth will put some pressure on the rouble but Russian exporters with high revenues will remain market makers in the domestic currency market, supporting the RUB.

On the negative side the accelerated capital outflow from Russia can cause a rebound of the rouble exchange rate, and its ’comeback’ may take some time.

Dmitry Savchenko
dmitry.savchenko@nordea.ru +7 495 777 34 77 4194

CBR shift target basket band upward

Investment activity is dragging growth down



Source: Nordea Markets and Reuters Ecowin

Consumption is still robust

Source: Nordea Markets and Reuters Ecowin

Inflation near target

Source: Nordea Markets and Reuters Ecowin

Looking for a gradual turnaround

After two years of robust recovery the Estonian economy finally experienced a temporary stagnation on the back of the Euro-area recession. Stalling export volumes and exceptionally strong (state) investment from the previous year translated into a meagre 0.7% y/y GDP growth rate in 2013. Growth in Q4 was close to zero as consumption did not offset contracting investment and exports. We expect that consumption remained vibrant at year-end as suggested by 5% y/y growth in retail trade.

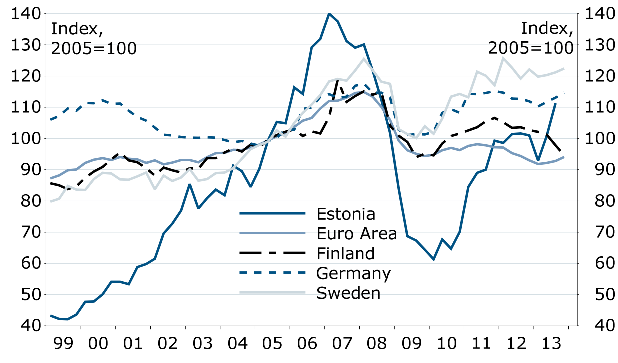
GDP growth slowed mainly due to the decrease in value added in the transportation and storage sector as well as the building sector, the latter being affected by state investment. The value-added contribution was the strongest in the manufacturing sector and wholesale and retail trade. Risks to the speed of recovery will remain tilted to the downside for 2014 with weak investment appetite in key export markets (including Scandinavia and Russia). Credit growth remains slow. Nevertheless, we expect that Q4 marked a turning point for the Estonian economy with gradual acceleration in growth to follow.

The recovery will be underpinned by robust private consumption and gradually improving export prospects from the second half of the year. Consumption will be supported by broad-based income growth and a notable deceleration of inflation in the first half-year. Moderating price pressures will help to contain the high GDP deflator, which depressed growth last year. Furthermore, the labour market continues to tighten. Unemployment will reach 7.5% by 2016.

The ongoing recovery of the property market (apartment prices up more than 10% y/y in Tallinn) will be an important ingredient for the sustainability of the turnaround. The building sector will recover as EU structural funds will lift investment next year. Overall, the open Estonian economy is expected to re-accelerate in the course of the year as export demand and investment appetite gradually return although the market remains challenging with weak export orders and uneven growth in the Euro area.

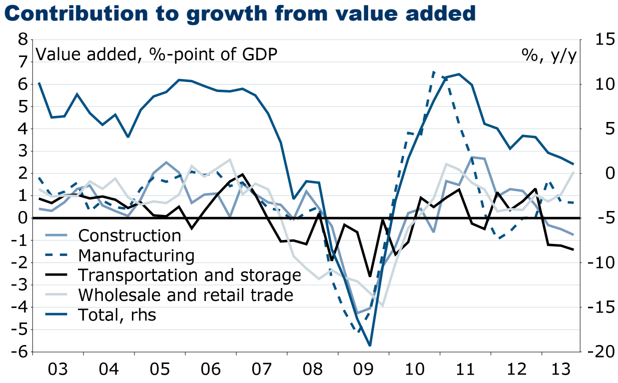
Tönu Palm
tonu.palm@nordea.com + 372 628 3345

Investment volumes slow to recover



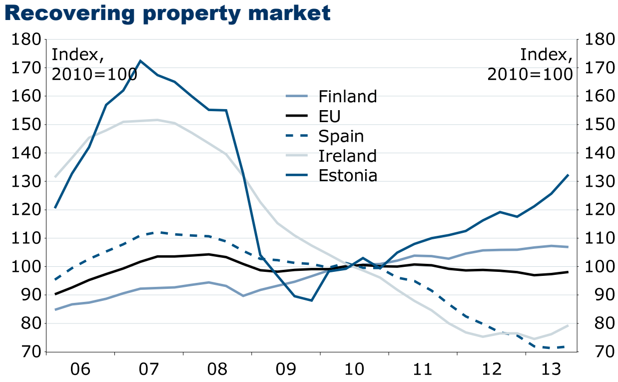
Source: Nordea Markets and Reuters Ecowin

Contribution to growth from value added



Source: Nordea Markets and Reuters Ecowin

Recovering property market



Source: Nordea Markets and Reuters Ecowin

Estonia: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (EURbn)	2011	2012	2013	2014E	2015E
Private consumption	7.50	3.8	4.9	4.6	4.3	4.5
Government consumption	2.99	1.3	3.8	1.1	1.0	1.0
Fixed investment	2.73	38.0	10.8	-0.2	2.4	5.7
Exports	11.38	23.4	5.6	1.9	2.1	5.2
Imports	10.41	28.4	8.8	3.1	2.2	5.4
GDP		9.6	3.9	0.7	2.8	3.8
Nominal GDP (EURbn)	14.37	16.20	17.4	18.4	19.4	21.0
Unemployment rate, %		12.3	10.0	8.6	8.4	7.6
Consumer prices, % y/y		5.0	3.9	2.8	1.9	3.0
Current account, % of GDP		1.8	-1.8	-1.5	-1.7	-1.6
General govt budget balance, % of GDP		1.2	-0.2	-0.2	-0.5	-0.1

From ugly duckling to beautiful swan

The Latvian economy is like a rubber ball: the harder it falls, the faster it rises afterwards. Indeed, over the last five years, the Latvian economy has transformed itself from an ugly duckling to a beautiful swan. Having experienced the largest GDP drop in the EU just five years ago, Latvia can now boast of having the fastest growing economy in the EU in 2012 and 2013. Moreover, Latvia has high chances of extending this leadership into 2014.

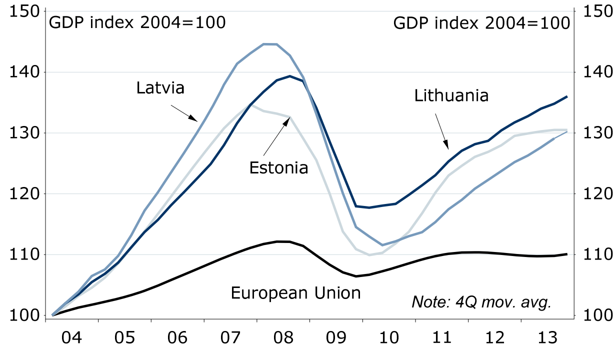
Even though Latvian GDP has not reached pre-crisis levels yet, it should be noted that Latvia made an impressive task in rebalancing its economy. First, Latvia managed to reduce its public deficit from hazardous 9.8% in 2009 to just 1.3% in 2012. This signifies that the "belt-tightening" period in Latvia is over, with higher public expenditures and tax cuts moving to the top of the agenda (1% reduction in social security contributions from 2014 is just one example). Secondly, the Latvian economy is far more balanced with an estimated current account deficit to GDP ratio of 1.6% in 2013 (compared to 15.7% in 2007). Thirdly, Latvia became the 18th member of the Euro zone in 2014, which will give extra stability and improved access to international financial markets.

Private consumption will remain the key economic growth driver, while the improving confidence of manufacturing companies coupled with capacity utilisation at record-high levels will boost investment volumes. Deleveraging in the private sector is also slowing: the private credit to GDP ratio in Latvia fell from 143% in 2009 to an estimated 85% in 2013, which is comparable to the levels observed in 2004.

The major threat comes from the slowdown of the Russian economy, which is an important export partner not only for Latvia itself, but also for the whole Baltic region (including Finland). Another challenge is to control inflation expectations fuelled by the euro adoption and rapid rise in private as well as public consumption.

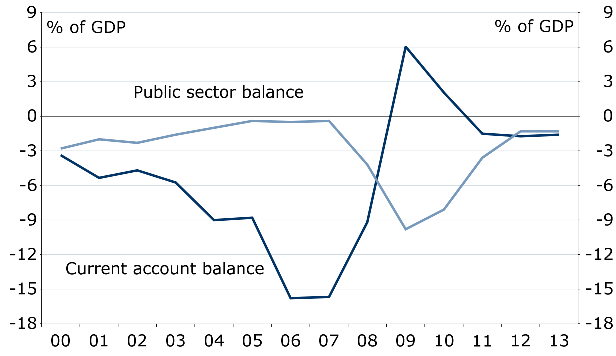
Žygimantas Mauricas
zygimantas.mauricas@nordea.com +370 612 66291

Economic roller-coaster



Source: Nordea Markets and Reuters Ecowin

Rebalancing the economy: internally and externally



Source: Nordea Markets and Reuters Ecowin

Confident consumers are ready for shopping

Source: Nordea Markets and Reuters Ecowin

Latvia: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (LVLmn)	2011	2012	2013	2014E	2015E
Private consumption	11,484	4.9	5.8	5.6	5.2	4.6
Government consumption	3,342	1.1	-0.2	2.7	3.0	2.0
Fixed investment	3,315	27.9	8.7	-0.2	6.0	4.5
Exports	9,742	12.4	9.4	0.9	3.5	4.2
Imports	9,989	22.3	4.5	-0.3	4.5	4.5
GDP		5.3	5.0	4.0	5.0	4.2
Nominal GDP (LVLmn)	18,190	20,312	22,082	23,319	25,021	26,472
Unemployment rate, %		16.2	15.0	11.9	9.5	8.5
Consumer prices, % y/y		4.4	2.3	0.0	2.0	2.5
Current account, % of GDP		-2.3	-2.5	-1.6	-2.0	-2.5
General govt budget balance, % of GDP		-3.6	-1.4	-1.3	-1.0	-0.5

Ready to embrace the euro

Lithuanian GDP increased by 3.2% in 2013, making Lithuania the third fastest growing economy in the EU. The Lithuanian economy will remain among the top performers in the EU in 2014 and 2015. However, contrary to the post-crisis period (2009-2012), the key economic growth drivers will be domestic consumption and investment, whereas the role of exports will decline.

The Russian economic slowdown and continued depreciation of the rouble (25% since May 2013) presents the greatest challenge to Lithuanian exporters, since Russia is by far the most important export partner (19% of total exports in 2013). However, the recovering EU economy will to a large extent counterbalance the negative developments in the East. As a result, export growth will slow down, but nevertheless remain positive.

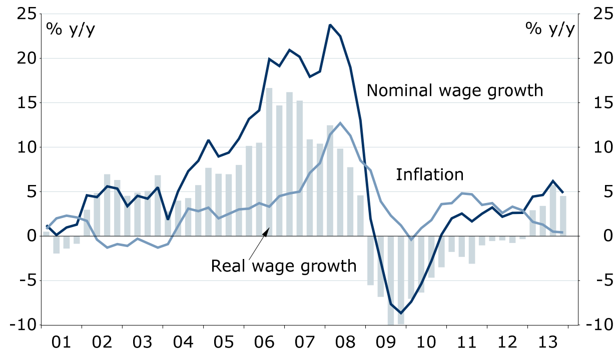
Private consumption growth will be supported by the rising real purchasing power of households. Accelerating nominal wage growth (5.0%) and falling inflation (1.2%) kick-started the real wage growth in 2013 – a trend not seen since 2008. Rising wages, subdued inflation and steadily falling unemployment create a “perfect trio” that will keep supporting domestic consumption growth in 2014 and 2015.

Investment volumes are gradually recovering, but growth comes to a large extent from investments in transport, real estate and the public sector, while manufacturing companies are still hesitant to implement longer-term investment projects. Rising activity in the housing market (transactions increased by 31% in 2013) will provide further support for housing investment.

Lithuania has a close to 100% chance of becoming the 19th member of the Euro zone in 2015. Lithuania meets all the Maastricht criteria and is showing strong commitment to keeping budget expenditures in check. The final decision by the EU will be announced in June 2014.

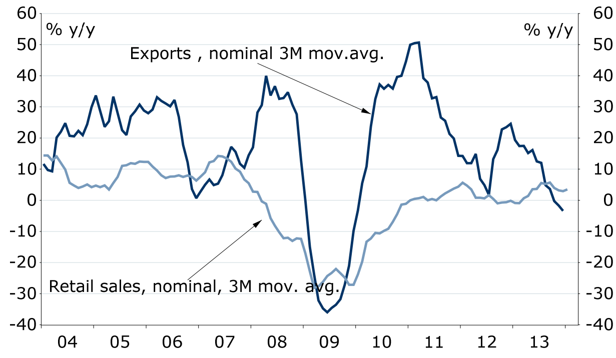
Žygimantas Mauricas
zygimantas.mauricas@nordea.com +370 612 66291

Exports are slowing down, but retail trade is rising



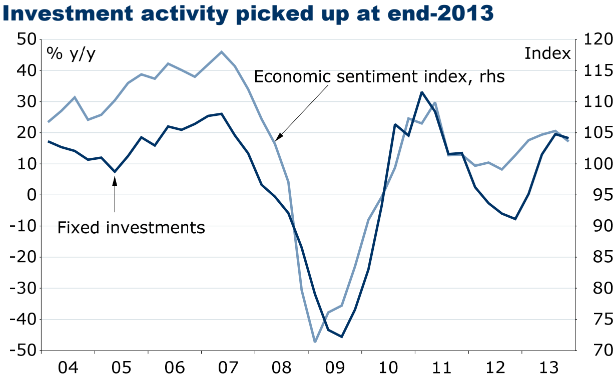
Source: Nordea Markets and Reuters Ecowin

Real wage growth turned positive in 2013



Source: Nordea Markets and Reuters Ecowin

Investment activity picked up at end-2013



Source: Nordea Markets and Reuters Ecowin

Lithuania: Macroeconomic indicators (% annual real changes unlss otherwise noted)

	2010 (LTLmn)	2011	2012	2013	2014E	2015E
Private consumption	61,285	4.8	3.9	4.4	4.0	4.2
Government consumption	19,475	0.3	0.6	1.6	2.0	2.0
Fixed investment	15,589	20.7	-3.6	12.0	10.0	8.0
Exports	64,792	14.1	11.8	8.5	3.5	5.0
Imports	66,655	13.7	6.1	9.1	5.0	5.0
GDP		6.0	3.7	3.2	3.2	4.3
Nominal GDP (LTLmn)	95,676	106,893	113,735	119,305	126,105	135,311
Unemployment rate, %		15.4	13.4	11.8	9.8	8.6
Consumer prices, % y/y		4.1	3.2	1.2	1.6	3.4
Current account, % of GDP		-3.7	-0.2	0.9	-1.0	-3.0
General govt budget balance, % of GDP		-5.5	-3.2	-2.7	-2.6	-2.3

Chasing the Chinese dream

- The new economic strategy entails lower growth
- Pace of deleveraging determines growth rate
- Reforms to promote consumption will be prioritised
- CNY on the way as a global reserve currency

The Chinese dream

The Chinese dream, after all, is the dream of the people. We must realise it by closely depending on the people. We must incessantly bring benefits to the people. This is a quote from President Xi Jinping, who has campaigned on the slogan since he came to power in the autumn of 2012. It is essentially his promise to lift the average standard of living. After all, the phrase 国富民穷 (a wealthy nation with poor people) expresses one of the key dissatisfactions of ordinary people.

To realise this dream, China needs to rebalance its economy. It implies lower investment in the industrial sector, deleveraging among local governments and the state-owned enterprises (SOEs), and weaker export competitiveness followed by ongoing currency appreciation. It is a shift away from the traditional drivers that were behind the decade-long growth miracle.

Instead, China must adopt a new strategy, as formulated after the Communist Party's third plenum in November, with the emphasis on eliminating income gaps and improving living conditions. Deregulation in the financial markets is also crucial to support the consumers.

This structural shift will occur gradually over the coming decade and will, in our opinion, lead to lower but more sustainable growth. In some areas, such as the financial sector, radical changes could begin as early as this year and provide grounds for our expectation of a fall in GDP growth in 2014 and 2015. However, Beijing will not tolerate growth below 7% as it is perceived as the threshold for maintaining stable employment.

The end of investment and credit mania

With a share of GDP at nearly 50%, there is little dispute about the need for a slowdown in overall investment. However, a large difference in regional development means that investment will not disappear altogether. Infrastructure spending will go on in the central and western provinces, where transport facilities and power and water supply systems are extremely poor. Overall investment growth will not exceed 20% in 2014, a sizable drop from 34% in 2009.

Credit expansion is another traditional growth driver in which the marginal cost has now exceeded the marginal benefit. In 2012, total credit outstanding was estimated at 220% of GDP, much higher than most other Emerging Markets countries. Deleveraging is at the top of the agenda for 2014, but it may happen too slowly due to the government's fear of the negative impact on growth. Despite Beijing's verbal pledge last year, official bank lending reached an almost all-time high of CNY 8.9trn (16% of GDP). The amount is expected to stay unchanged this year.

Too much investment and credit expansion will boost GDP growth this year but adds to the risk of a hard landing in the longer run.

The consumption boom has just started

Thanks to rapid wage growth in the past decade and the prospect of continued rising income, the urban middle class has already begun to consume. During early October about 430 million people decided to spend the week-long National Day holiday on leisure travel, up 15% compared to the same period in 2012. During the same time, Chinese visitors in London spent on average GBP 8,000 on purchasing goods. The travel fever has repeated during the Lunar New Year holiday in February this year.

As the middle class is expanding fast and the starting point for consumption is low (accounting for only 37% of GDP), this only marks the beginning of China's consumption boom, which will continue for years to come. Nonetheless, a number of challenges need to be overcome for private spending to fulfil its full potential. For this reason, private consumption will not become the

China: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (CNYbn)	2011	2012	2013E	2014E	2015E
Private consumption	14,076	11.1	7.8	7.8	8.0	8.2
Government consumption	5,336	9.6	9.1	9.0	8.5	8.5
Fixed investment	18,362	9.1	10.1	9.0	8.5	8.0
Stockbuilding*	999	0.4	-0.5	-0.3	-0.2	0.1
Exports	11,803	4.0	2.8	3.5	4.0	3.0
Imports	10,293	5.1	3.8	5.0	6.5	7.5
GDP		9.3	7.8	7.7	7.4	7.0
Nominal GDP (CNYbn)	40,151	47,310	51,932	56,885	61,720	66,657
Unemployment rate, %		4.1	4.1	4.1	4.1	4.1
Consumer prices, % y/y		5.4	2.6	2.6	3.0	3.5
Current account, % of GDP		1.9	2.3	2.5	2.0	1.5
General government budget balance, % of GDP		-1.1	-1.7	-1.9	-2.0	-2.0

* Contribution to GDP growth (% points)

dominant growth driver until the end of the current decade.

First of all, social security has to rise. Even though China boasts a health care coverage rate of 95%, the out-of-pocket costs for medical bills are very high. In addition, the 270 million migrant workers are poorly covered. Only 17% of them have medical insurance. Income inequality between urban and rural areas also hampers spending.

Secondly and perhaps more importantly, the sky-high and rising house prices in the large cities have to be curbed. The down payment (30% for first-time home-buyers) cannot be easily borrowed anywhere. For people born in the 1970s, there are estimated to be three unmarried men for each unmarried woman. This gender imbalance intensifies the pressure on young men and their families to save for an apartment to increase their chance obtaining an eligible marriage partner.

Finally, CNY appreciation needs to go on to enhance Chinese purchasing power abroad. This triggers the willingness to buy and can help to change the saving/consumption culture.

Financial liberalisation continues

As part of the Chinese dream, Xi Jinping wishes the CNY to become a global reserve currency in about ten years. This requires the yuan to become fully convertible, which is supported by the top leaders. This is precisely the message that Beijing sent by keeping Zhou Xiaochuan, a well-known liberalist, as the central bank governor. It was also revealed that the party leadership insisted on bold experiments within the Shanghai Free Trade Zone. In this supportive environment, the CNY could be freely floating at the end of 2016 in our view.

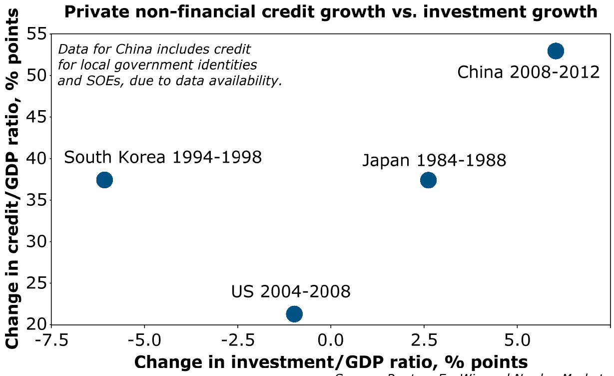
Thus, we expect the most radical reforms this year to be undertaken within the financial sector. First of all, the CNY trading band, in which the spot rate is allowed to deviate from the central bank fixing, is likely to be widened in the first part of 2014. This will lead to more volatility but also a freer currency. The yuan will likely become stronger versus the dollar for the reason cited above. Secondly, capital restrictions will be further lifted, boosting bilateral capital flows. Finally, deregulation of the deposit rate, currently fixed at a maximum 3.3%, removes the financial repression of the households. This will be a crucial step to fulfil the Chinese dream.

Amy Yuan Zhuang
amy.yuan.zhuang@nordea.com +45 3333 5607

Lower but more balanced growth

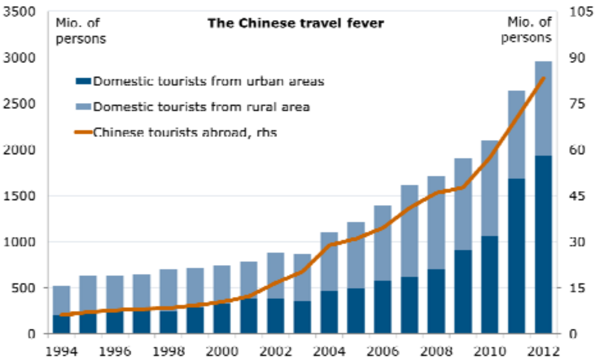
Source: Reuters Ecowin and Nordea Markets

Growth previously fuelled by credit and investment



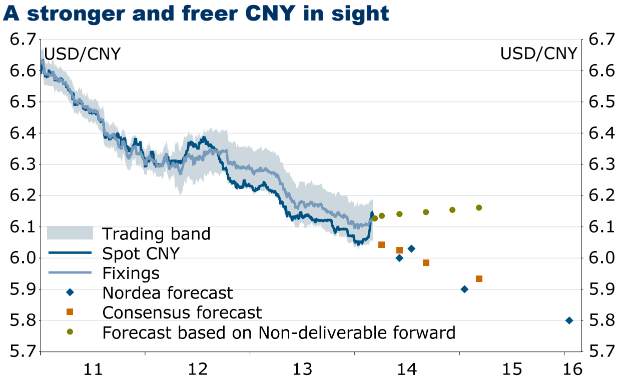
Source: Reuters EcoWin and Nordea Markets

The consumption boom has just started



Source: China National Bureau of Statistics and Nordea

A stronger and freer CNY in sight



Source: Reuters Ecowin and Nordea Markets

Growing at slowest pace in a decade

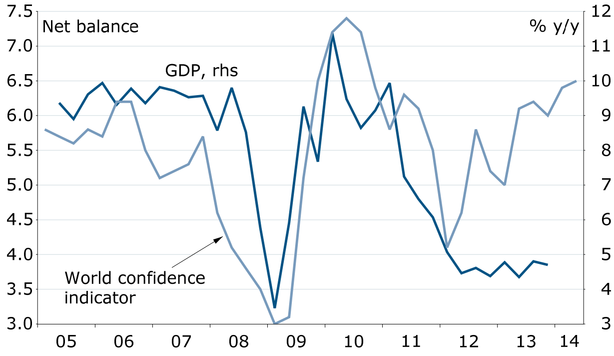
India's economic growth has slowed markedly and well beyond what can be explained by external developments. Failure to reform the economy in the boom years of 2003-08 has left India with supply-side bottlenecks and stubbornly high inflation. 2013 will post the lowest GDP growth since the global financial crisis of 2008-09. Looking ahead, we expect economic activity to gradually pick up to 5.5% this year against a backdrop of better export growth and some rebound in the investment cycle. Headwinds will, however, come from fiscal constraints and the recent tightening of monetary policy.

A toxic combination of elevated inflation and high fiscal/current account deficits meant that India was particularly vulnerable to the Emerging Market sell-off in the summer of 2013, where especially the Indian rupee was hit hard. Since then, however, the Indian authorities have taken several steps to reverse the situation. Tough restrictions on gold imports have effectively reduced India's current account deficit to just 1.2% of GDP in Q3, the lowest level in more than four years. More recently, the Reserve Bank of India (RBI) is contemplating moving to inflation targeting based on headline CPI. The target for the CPI should be set at 4% with a band of +/- 2%. This is another encouraging step for the Indian economy, as the new policy framework would be more rule-based and thus help enhance the credibility of the RBI and provide a transparent setting to obtain low and stable inflation. The CPI is currently around 10% y/y, so the target is not planned to be met before end-2015.

On the 16 May, the result of the 16th general election will be published. If polls are any guide, Narendra Modi from the main opposition Bharatiya Janata Party (BJP) is likely to become the next prime minister. Modi has strong credentials as chief minister of Gujarat and has wide support in the business community. He is likely to push for structural reforms that deregulate and open up the economy..

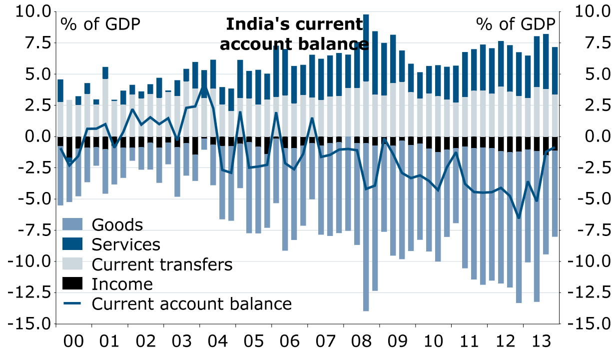
Deanie Marie Haugaard Jensen
Deanie.haugaard@nordea.com +45 3333 3260

Growth is lagging behind



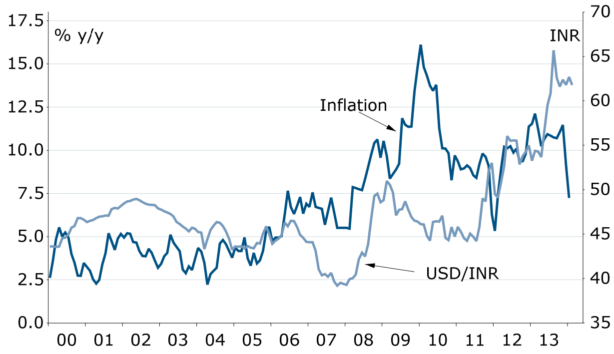
Source: Reuters Ecowin and Nordea Markets

Improved external imbalances



Source: Reuters Ecowin and Nordea Markets

The cost of a weaker currency



Source: Nordea Markets and Reuters Ecowin

India: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (INRbn)	2011	2012	2013	2014E	2015E
Private consumption	43,499	9.4	5.0	5.0	6.0	6.5
Government consumption	77,115	6.9	6.2	4.0	5.0	4.0
Fixed investment	24,071	11.1	0.8	9.0	9.0	10.0
Exports	17,102	12.3	0.8	3.0	5.0	8.0
Imports	20,502	20.8	6.6	7.0	7.5	9.0
GDP (production approach)		7.5	4.6	4.9	5.5	6.0
Nominal GDP (INRbn)	77,953	89,750	100,206	111,298	124,097	138,741
Wholesale prices, % y/y		9.5	7.5	6.2	6.0	5.8
Current account, % of GDP		-3.4	-5.1	-2.6	-2.5	-2.7
General government budget balance, % of GDP		-6.7	-5.5	-5.0	-4.5	-4.3

Sluggish growth – again!

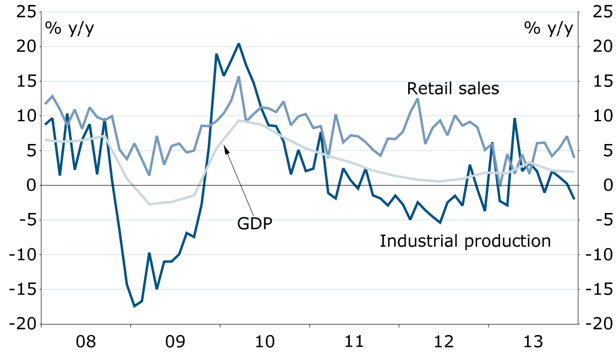
Brazil's growth scenario appears ever so bleak. We expect the Brazilian economy to decelerate in 2014 to 1.5%, reflecting softer domestic demand only partly offset by improvements in the external sector, where net exports are expected to contribute positively to growth due to a pick-up in demand from the advanced economies and import substitution stemming from the weaker currency. China remains a down-side risk to economic activity. Investment will be key. On the one hand, the government is fast moving forward with its infrastructure concessions together with investments related to the 2014 FIFA World Cup. On the other hand, investment activity will likely be negatively affected by higher interest rates, a slowdown in subsidised lending and sour business confidence.

Two new developments outside of Brazil's control also contribute to the bleak outlook. First, the Argentine devaluation and imminent recession will likely pose downside risks for the Brazilian manufacturing industry. Second, a looming energy crisis threatens economic activity, as one of the worst droughts ever has depleted the reservoirs of Brazil's crucial hydroelectric power plants. Being an election year, risks are that a higher energy bill will be picked up by the government, thereby jeopardising the health of already stretched public finances, raising risks of a sovereign credit rating downgrade.

The central bank is nearing the end of a tightening cycle that has seen the policy rate raised by 350 bp to 10.75%. Inflation and especially inflation expectations are still running high, but a looming growth slowdown together with somewhat promising prospects of tighter fiscal policy, should give the central bank some breathing room. We expect the central bank to end its tightening cycle in March with a 25 bp hike, before going on hold until after the October elections – as a courtesy to President Dilma Rousseff, who stands a strong chance of being re-elected.

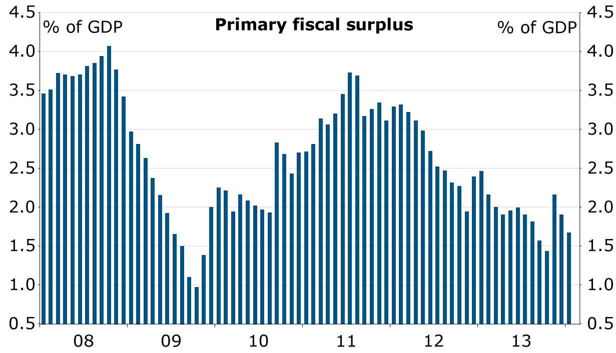
Deanie Marie Haugaard Jensen
Deanie.haugaard@nordea.com +45 3333 3260

Fourth year with below-trend growth



Source: Nordea Markets and Reuters Ecowin

Public finances are key



Source: Nordea Markets and Reuters Ecowin

Don't underestimate Argentina's importance

Source: Nordea Markets and Reuters Ecowin

Brazil: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2010 (BRLbn)	2011	2012	2013	2014E	2015E
Private consumption	1,816	4.1	3.2	2.3	1.9	2.0
Government consumption	541	2.0	3.2	1.9	4.0	2.5
Fixed investment	580	4.8	-1.9	6.2	2.0	2.0
Exports	342	4.5	0.7	2.3	3.3	6.8
Imports	413	10.0	4.0	8.5	4.1	4.3
GDP		2.7	1.0	2.3	1.6	1.9
Nominal GDP (BRLbn)	3,770	4,143	4,403	4,777	5,140	5,536
Unemployment rate, %		6.0	6.0	5.4	5.7	6.0
Consumer prices, % y/y		6.6	5.2	6.2	6.0	5.8
Current account, % of GDP		-2.1	-2.6	-3.6	-3.5	-2.8
General government budget balance, % of GDP		-2.6	-2.1	-3.0	-3.8	-3.3

Geopolitics cast dark shadows over the oil market

Oil prices continue to move sideways in Q1 2014 as commercial inventories are low, the global supply/demand balance remains tight and political unrest has cut oil supply in major oil-producing countries. Oil prices are expected to weaken in Q2 as global refinery runs will reach a seasonal low. In H2 oil prices are expected to move higher as demand picks up and the oil market tightens again. In 2015 we expect to see some of the politically related lock-in volumes return to the market and the supply/demand balance will become softer. It is a considerable risk that further supply outages can move oil prices above our forecast.

A sharp rise in oil prices over the past decade has contributed to a golden dawn for the oil industry. With stagnating oil price growth, high costs and focus on dividends to shareholders, oil companies have started to rebalance their production portfolios and put new projects on hold. Over time, it is a risk that a sharp cut in investments could lead to a significantly tighter market as the growth in new production capacity will not be adequate to meet future supply growth. The shale oil/tight oil boom in North America is expected to continue at a formidable rate. North America will remain the centre of gravity of non-OPEC supply growth. In 2015 we expect that some of the production losses in the MENA region will return to the market forcing Saudi Arabia to cut production to balance the market. However, supply outages have remained severe after the Arab Spring and have outbalanced the growth in North America. Worries are rising that the tight market situation will persist. Global spare capacity is low and political unrest continues to trouble production in Libya, Nigeria, South Sudn and Iraq. Instability in Venezuela is mounting and it may take time before the nuclear negotiations between Iran and the West will materialise in higher production volumes.

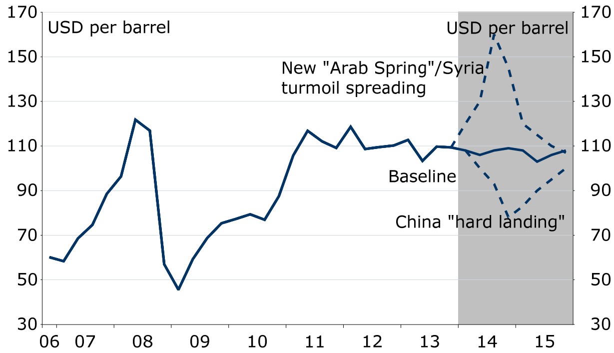
The global economic recovery led by the US is expected to continue and will be the main driver of oil demand growth in the forecast period. Non-OECD countries will account for the lion's share of the increase in oil demand as population growth, income growth and urbanisation will push energy consumption higher. Downside risk will prevail for the next half-year for some Emerging Market countries due to economic weakness and political risk. This could dampen economic activity and thereby the demand for oil. Especially the risk of significantly weaker economic growth in China due to a credit bubble bursting and the shadow banking system could potentially have a major impact on the oil market as China is now the biggest oil-importing country in the world. Chinese oil demand is expected to gain some support from the fulfilment of the country's ambitious SPR programme.

Thina M. Saltvedt
thina.margrethe.saltvedt@nordea.com +47 2248 7993

Oil price forecasts Brent – baseline (USD/barrel)

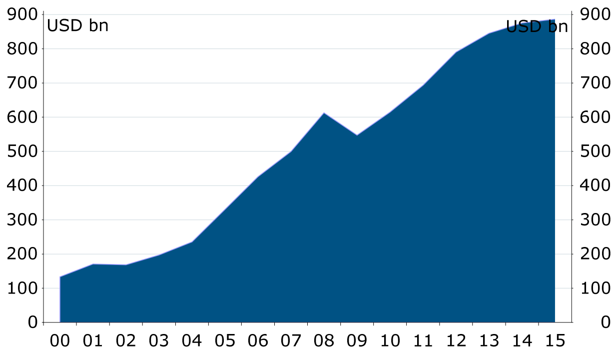
	Q1	Q2	Q3	Q4	Year
2012	118	109	109	110	**112**
2013	113	103	108	107	**108**
2014E	108	106	108	109	**108**
2015E	108	103	106	108	**106**

Oil price forecast



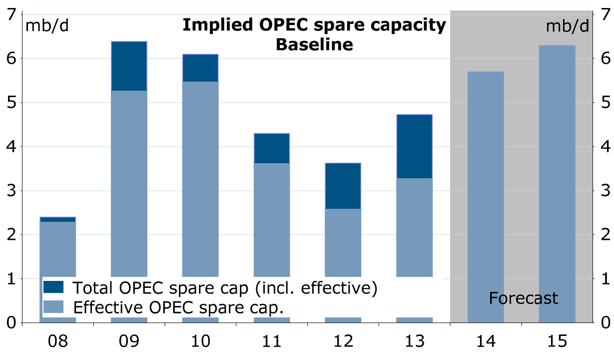
Source: Nordea Markets and Reuters Ecowin

Investment growth slowing



Source: Rystad energy

Global spare capacity still at low levels



Source: Nordea Markets and IEA

Well supplied in general, but tighter zinc market ahead

Base metal prices have declined in tandem with slower demand growth from the Chinese industrial and construction sectors and solid mine supply growth, but prices have stabilised since the second half of 2013. Over the forecast horizon we still expect the metals markets to remain well supplied, with the exception of zinc, where planned mine closures and deferrals of new projects are expected to tighten the zinc market.

We expect the primary aluminium market to be well supplied in the coming three to five years. Consumption growth is expected to be higher than the planned output growth, implying that the market prospects look fairly tight. Producers have cut costs and curtailed production amid poor profitability. A material share of curtailed capacity could re-enter the market if prices return to above USD 2,000 per tonne. We forecast slightly higher prices ahead in our baseline scenario.

The copper market is expected to show a slight surplus until 2016. Delayed ramp-ups and continued moderate consumption growth will limit the size of this surplus to around 1-2% on an annual basis. This implies a fairly tight market and a price slightly above industry marginal cash cost plus overhead and sustainable capex is reasonable, ie around USD 7,300 per tonne over the forecast period. Copper prices have the largest downside among the four metals covered if growth in the Chinese and global economies disappoints significantly.

The nickel market continues to be heavily oversupplied and there are few fundamentals capable of boosting prices in the short term. As nearly half of the mining capacity is unprofitable on gross profit level, current prices are unsustainable in the long run. Hence, we expect high-cost suppliers to eventually take out excess capacity from the market in the coming years and anticipate nickel prices to gradually gain ground going forward.

Several zinc projects are being deferred, and we continue to see planned closures materialising. Even though demand grows at a modest rate, lower forecast supply pushes the market into balance this year and deficit for 2015. Prices are forecast to rise towards our long-term real price assumption of USD 2,500 per tonne during 2015, in line with the average project development incentive level.

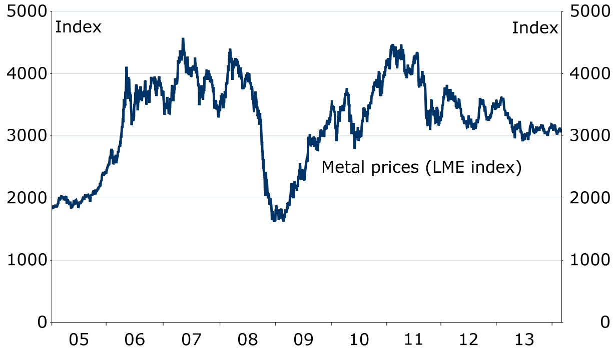
Bjørnar Tonhaugen
bjornar.tonhaugen@nordea.com +47 2248 7959

LME base metals price forecast (USD/tonne)

	2013	2014E	2015E
Aluminium	1,845	1,745	1,860
Copper	7,322	7,275	7,300
Nickel	15,003	14,750	16,000
Zinc	1,909	2,125	2,300

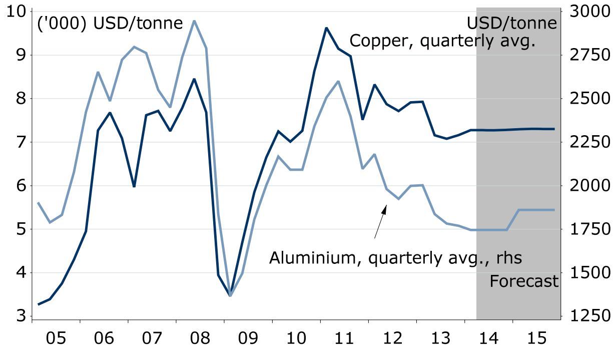
Source: Nordea Markets

Base metals prices



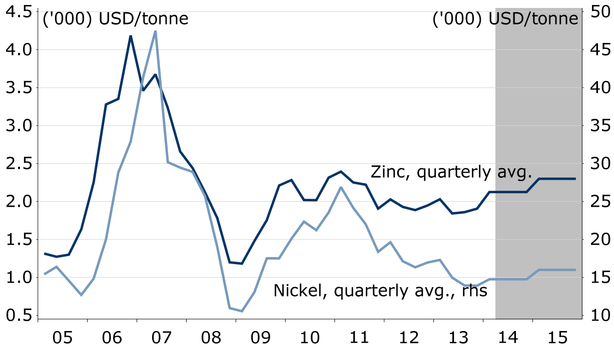
Source: Nordea Markets and Reuters Ecowin

Copper and aluminium forecast



Source: Nordea Markets and Reuters Ecowin

Nickel and zinc forecast



Source: Nordea Markets and Reuters Ecowin

Economic Research Nordea

Denmark:

Helge J. Pedersen, Global Chief Economist
helge.pedersen@nordea.com, +45 3333 3126

Johnny Bo Jakobsen, Chief Analyst
johnny.jakobsen@nordea.com, +45 3333 6178

Anders Svendsen, Chief Analyst
anders.svendsen@nordea.com, +45 3333 3951

Holger Sandte, Chief Analyst
holger.sandte@nordea.com, +45 3333 1191

Jan Størup Nielsen, Senior Analyst
jan.storup.nielsen@nordea.com, +45 3333 3171

Amy Yuan Zhuang, Senior Analyst
amy.yuan.zhuang@nordea.com, +45 3333 5607

Aurelija Augulyte, Senior Analyst
aurelija.augulyte@nordea.com, +45 3333 6437

Deanie Haugaard Jensen, Assistant Analyst
deanie.haugaard@nordea.com, +45 3333 3260

Henrik Lorin Rasmussen, Assistant Analyst
henrik.l.rasmussen@nordea.com, +45 3333 4007

Daniel Freyr Gustafsson, Assistant Analyst
daniel.freyr.gustafsson@nordea.com, +45 3333 5115

Finland:

Aki Kangasharju, Chief Economist, Finland
aki.kangasharju@nordea.com, +358 9 165 59952

Pasi Sorjonen, Chief Analyst
pasi.sorjonen@nordea.com, +358 9 165 59942

Norway:

Steinar Juel, Chief Economist Norway
steinar.juel@nordea.com, +47 2248 6130

Erik Bruce, Chief Analyst
erik.bruce@nordea.com, +47 2248 4449

Thina M. Saltvedt, Chief Analyst
thina.margrethe.saltvedt@nordea.com, +47 2248 7993

Bjørnar Tonhaugen, Senior Analyst
bjornar.tonhaugen@nordea.com, +47 2248 7959

Joachim Bernhardsen, Assistant Analyst
joachim.bernhardsen@nordea.no, +47 22487913

Marte Andresen, Assistant Analyst
marte.andresen@nordea.com, +47 2248 7969

Sweden:

Annika Winsth, Chief Economist Sweden
annika.winsth@nordea.com, +46 8 614 8608

Torbjörn Isaksson, Chief Analyst
torbjorn.isaksson@nordea.com, +46 8 614 8859

Andreas Wallström, Chief Analyst
andreas.wallstrom@nordea.com, +46 8 534 910 88

Bengt Roström, Senior Analyst
bengt.rostrom@nordea.com, +46 8 614 8378

Lena Sellgren, Senior Analyst
lena.sellgren@nordea.com, +46 8 614 88 62

Rickard Bredeby, Assistant Analyst
rickard.bredeby@nordea.com, +46 8 614 80 03

Sofie Andersson, Assistant Analyst
sofie.b.andersson@nordea.com, +46 8 614 80 03

Vera Batyalova, Assistant Analyst
vera.batyalova@nordea.com, +46 8 614 80 03

Estonia:

Tõnu Palm, Chief Economist Estonia
tonu.palm@nordea.com, +372 628 3345

Lithuania:

Zygimantas Mauricas, Chief Economist Lithuania
zygimantas.mauricas@nordea.com, +370 5 2657 198

Russia:

Dmitry A. Savchenko, Chief Economist Russia
dmitry.savchenko@nordea.ru, +7 495 777 34 77 4194

Dmitry S. Fedenkov, Head of Research, Russia
dmitry.fedenkov@nordea.ru, +7 495 777 34 77 3368

Poland:

Piotr Bujak, Chief Economist Poland
piotr.bujak@nordea.com, +48 22 521 36 51

Nordea, Markets Division
Nordea Bank Norge ASA
17 Middelthuns gt.
PO Box 1166 Sentrum
N-0107 Oslo
+47 2248 5000

Nordea AB (publ)
10 Hamngatan
SE-105 71 Stockholm
+46 8 614 7000

Nordea Bank Finland Plc
Aleksis Kiven katu 9, Helsinki
FIN-00020 Nordea
+358 9 1651

Nordea Bank Danmark A/S
3 Strandgade
PO Box 850
DK-0900 Copenhagen C
+45 3333 3333