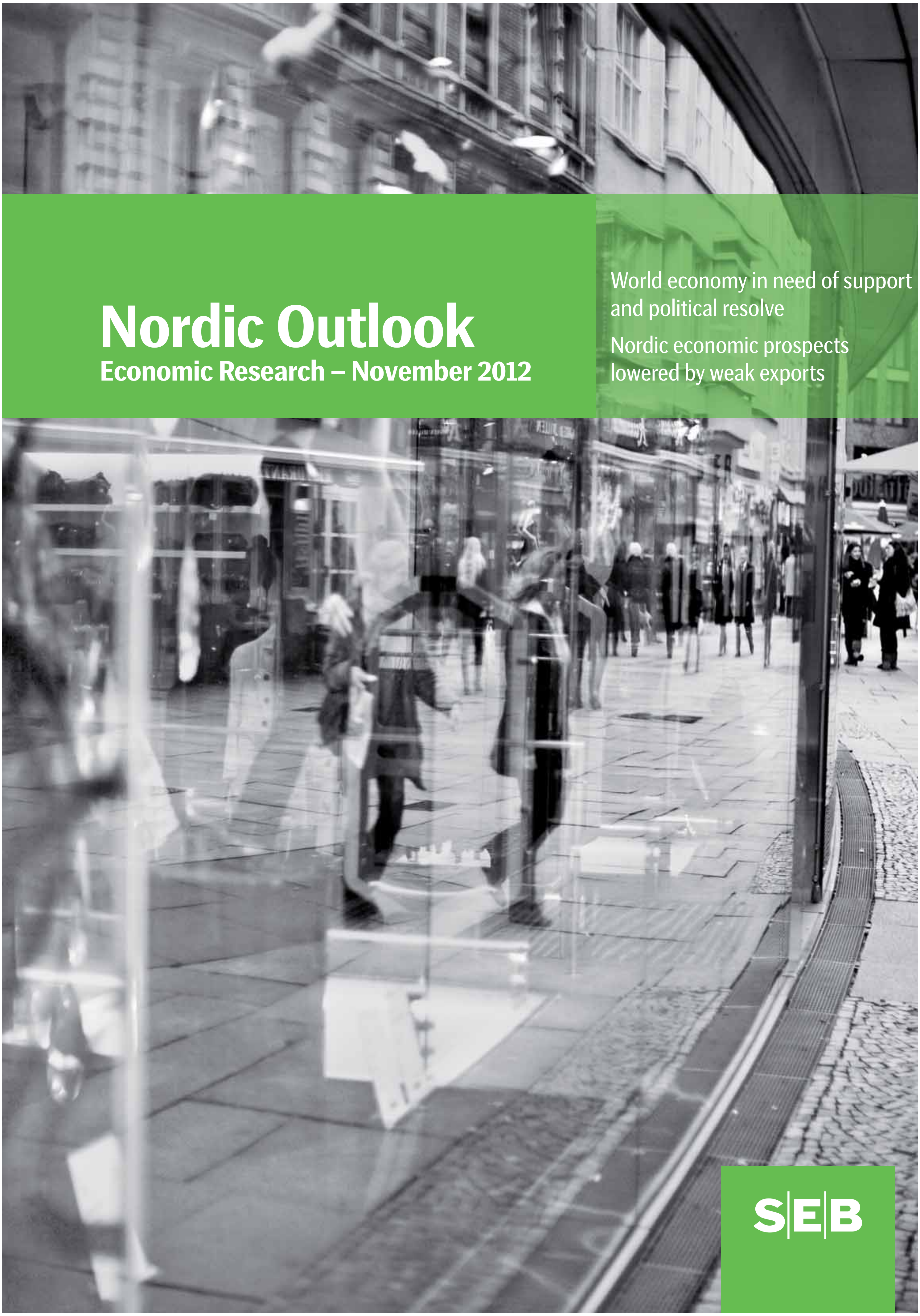

Nordic Outlook

Economic Research – November 2012

World economy in need of support and political resolve

Nordic economic prospects lowered by weak exports

SEB

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A divergent world economy in great need of support

- **US economy is on increasingly firm ground**
- **Continued negative euro zone dynamic, despite ECB support and smaller imbalances**
- **Emerging market growth has bottomed out**
- **Nordics held back by German slowdown**
- **Low interest rate environment will continue**
- **SEK and NOK will rebound, EUR/USD to 1.15**

The global economy is dominated by various competing forces right now. This autumn there has been a continued slowdown in many countries. A sharp inventory cutback seems to have occurred after the summer, primarily squeezing the investment and intermediate goods sectors. Many emerging economies have decelerated, while fiscal uncertainty is hampering growth in the United States. But especially worrying is the economic slump in Western Europe, where Germany and the Nordic countries are now also clearly losing momentum.

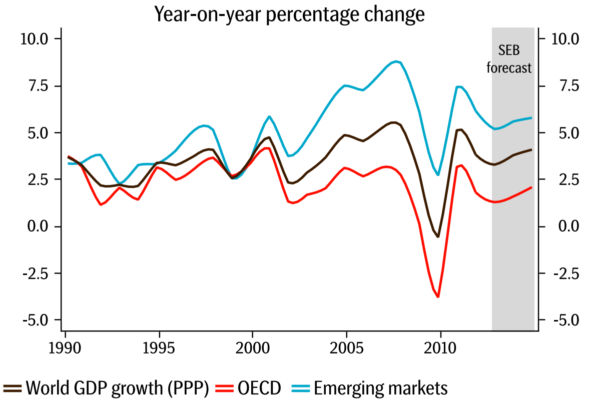
Meanwhile a number of ongoing processes point towards stabilisation. Leading indicators in many countries have shown bright spots, partly due to new programmes announced by central banks. US household deleveraging has come a long way. The housing market recovery seems to be continuing. In China, indicators predict a rebound in growth during the fourth quarter. Falling inflation has boosted purchasing power in many emerging economies, opening the way for looser economic policies. In the euro zone, the European Central Bank's announcement of its Outright Market Transactions (OMT) sovereign bond purchasing programme has pushed down borrowing costs for crisis-plagued countries like Spain and Italy. Imbalances in terms of competitiveness, government finances and foreign trade have also begun to ease, but major challenges remain both in the short and long term. Rising unemployment and an ever-broadening economic slowdown are impediments to the forces now trying to stabilise and eventually restore the euro system.

Our overall conclusion is that international growth will bottom out in the second half of 2012. At aggregated level our forecast adjustments are relatively small, compared to *Nordic Outlook* in August. **Total GDP in the 34 countries of the Organisation for Economic Cooperation and Development (OECD) will speed up from a modest 1.3 per cent in 2012 to 1.6 per cent in 2013 and 2.1 per cent in 2014. Global growth** (measured in purchasing power parities, PPP) **will climb gradually from 3.3 per cent in 2012 to 3.8 per cent in 2013 and 4.1 per cent in 2014**. But positive and negative forces in various parts of the world clearly have different emphases and risk profiles. We have revised our US growth forecast for 2013 upward. Meanwhile we foresee weaker performance in Japan and the euro zone, where economic expansion in Germany will be softer than expected.

The Nordic countries are now clearly affected by the international slump, especially the German slowdown. The Swedish, Finnish and Danish economies are stagnating. A deceleration has occurred in Norway, too, but the economy is still maintaining a good pace of expansion. Looking ahead, we expect modest recovery in line with other countries. In Sweden, both monetary and fiscal policy will provide support. Norway will continue growing more strongly than its neighbours, probably persuading Norges Bank to begin interest rate hikes before the summer of 2013.

Growth will bottom out late in 2012

Year-on-year percentage change



Source: SEB

Global GDP growth

Year-on-year percentage change

	2011	2012	2013	2014
United States	1.8	2.2	2.4	2.7
Japan	-0.7	1.7	0.8	1.3
Germany	3.0	0.8	0.6	1.5
China	9.2	7.7	8.1	7.7
United Kingdom	0.9	0.0	1.3	1.5
Euro zone	1.4	-0.4	-0.2	0.8
Nordic countries	2.3	1.4	1.6	2.2
Baltic countries	6.4	3.9	3.8	4.2
OECD	**1.8**	**1.3**	**1.6**	**2.1**
Emerging markets	6.2	5.2	5.6	5.8
World, PPP*	**3.8**	**3.3**	**3.8**	**4.1**
World, nominal	3.1	2.6	3.1	3.4

Source: OECD, SEB * Purchasing power parities

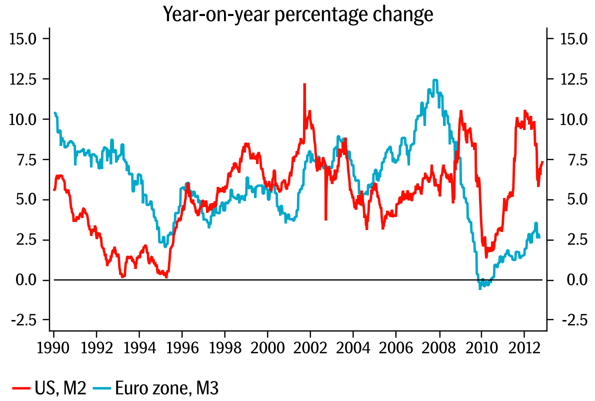
Central banks stepping up their efforts

Policy makers are continuing their balancing act amid the prevailing fragile economic situation. The restructuring of the financial sector, including major rule changes, will mean a continued tight credit environment. Meanwhile fiscal austerity in many countries is draining their economies of any growth dynamic. Central bank efforts to slow the pace of debt adjustment in order to prevent deflationary spirals from spinning dangerously out of control are increasingly important.

Central banks continue to employ drastic, unconventional methods when traditional interest rate policy has reached the end of the road. Quantitative easing (QE) will set new volume records over the next two years, due to large purchases of government securities and other asset classes. So far, central banks have been able to implement such policies without jeopardising their price and financial stability targets. Inflation expectations are entrenched close to central bank targets, and broad money supply measures are growing at a modest pace.

Money supply

Year-on-year percentage change



Source: Federal Reserve, ECB

The ECB in particular faces a difficult balancing act ahead. Its stimulus measures create room to carry out necessary fiscal actions, but ease pressure on politicians to implement planned restructuring and belt-tightening. In an increasingly precarious economic and social environment, the ECB will probably be under pressure to stretch the limits of its legal mandate. In addition, there will probably be mounting disagreement among central banks when it comes to assessing the promise and the potential risks of unconventional monetary policies.

The ECB is expected to activate its OMT programme in the coming months and thus begin buying Spanish government securities, but the amounts will be rather limited. No new Long-Term Refinancing Operation (LTRO) – with low-interest ECB loans to banks – is being considered in the short term. The liquidity situation looks satisfactory, though new problems may arise when the banking system shrinks its balance sheets. Since the ECB is likely to revise its economic outlook downward, this opens the door for one more cut in its main key interest rate, but at present unconventional policy is a more effective tool.

The US Federal Reserve will continue its monthly USD 40 billion purchases of mortgage-backed securities during our forecast period. We also expect the Fed to buy some USD 45 billion worth of government securities per month, once Operation Twist expires at the end of 2012. This implies that the Fed's balance sheet will grow by nearly 70 per cent by the end of 2014. We also expect the Bank of England and the Bank of Japan to expand their bond purchasing programmes.

Central banks in Norway and Sweden and not implementing any unconventional policies but instead still use interest rate policy as their main weapon. This difference creates a risk that their currencies will be pushed up to extremely high levels. Our forecast is that Sweden's Riksbank will lower its key interest rate in December and then once more in the first quarter of 2013. After that, the repo rate will remain at 0.75 per cent until the end of 2014. Norges Bank will begin hiking its key rate during the spring. By the end of 2013 the deposit rate will stand at 2.25 per cent, and by the end of 2014 at 3.00 per cent.

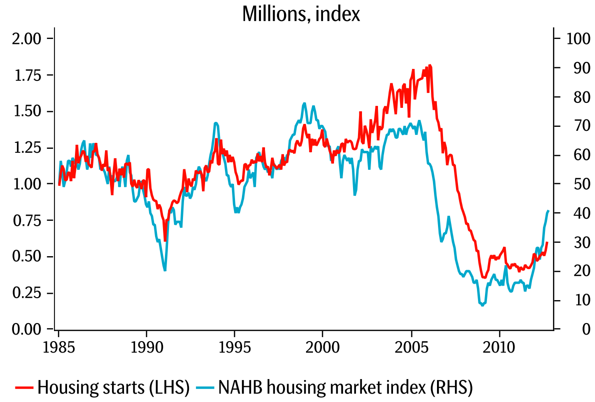
World economy in divergent phases

It is increasingly clear that there are divergences in how far different parts of the world economy have progressed in their post-crisis adjustment. **In the US, a housing market recovery is vital in generating a post-crisis dynamic**. Increased residential construction provides direct stimulus, but even more important is the impact on household balance sheets. Household debt has already fallen from 135 to some 115 per cent of disposable income, and rising home prices make room for more consumption by strengthening the wealth position of households. This will help boost GDP growth to 2.4 per cent in 2013 and 2.7 per cent in 2014, or slightly above trend.

But fiscal uncertainty will slow the upturn. Although we expect Congress to eliminate the acute risk that the US economy will plunge head first over the "fiscal cliff", the austerity effects of the expected compromises will still total 1.5 per cent of GDP in 2013. The need to restore order to US public finances and stabilise the national debt will also restrain growth and lead to strident political battles later as well.

US housing construction activity is accelerating

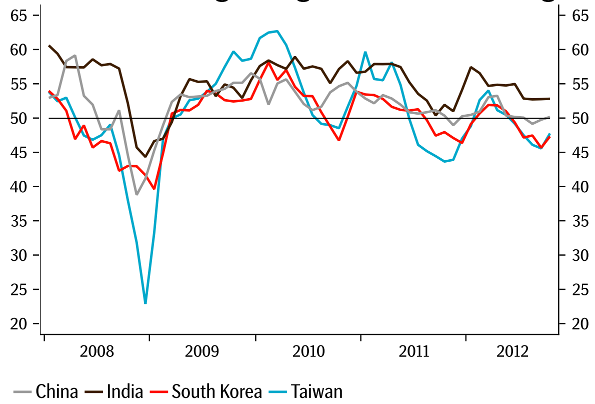
Millions, index



Source: Department of Commerce, NAHB, SEB

Asian emerging market (EM) countries continued to slow in the third quarter but are still expected to account for 40 per cent of global growth in 2012. We believe these economies will stabilise late this year, but their GDP growth will remain below trend in 2013. **In our assessment, the risk of a Chinese hard landing in 2013 has decreased**. Indicators show that growth has bottomed out. Stimulus programmes have also been used sparingly. There is thus manoeuvring room if the international economic situation should prove weaker than expected. Meanwhile imbalances in China's economy, reinforced in some respects by the government's exceptional support policies in 2009, undeniably entail long-term risks. The new Communist Party leadership thus faces major economic policy challenges.

Asia: Purchasing managers' indices stabilising



Source: Markit, National Bureau of Statistics China

Developments in the euro zone have been mixed in recent months. The ECB's announcement of its OMT programme has pushed down sovereign bond yields, especially in Italy and Spain. Hopes that a banking union will soon be in place and will become partly operational during 2013 are another reason why the crisis has moved into a less acute phase. Crisis-hit countries have also made good progress in dealing with underlying imbalances, such as competitiveness issues as well as internal and external deficits. Meanwhile there are some worrisome signs. Economic curves continue to point downward, and Germany is being more and more clearly affected by the crisis in southern Europe. We expect falling euro zone GDP in the fourth quarter. We have also adjusted our forecast for 2013 downward into negative territory. Unemployment will thus keep climbing, while economic and social tensions worsen. Only in 2014 will recovery begin as the euro zone, consistent with historical patterns, is aided by US growth. A probable shift towards an expansionary German fiscal policy will also help support the euro zone economy.

Alternative scenarios

Year-on-year GDP change

	2013	2014
Scenario with deepening euro zone crisis (25%)		
United States	1.0	1.0
Euro zone	-1.5	-1.5
OECD	**-0.5**	**-0.5**
EM economies	4.0	4.0
Scenario with US-led recovery (20%)		
United States	3.5	4.0
Euro zone	1.0	1.5
OECD	**2.5**	**2.5**
EM economies	6.3	6.5

Source: OECD, SEB

As earlier, a serious euro zone crisis is the most important risk factor in the world economy. Weak growth risks triggering renewed market worries about euro zone crisis management. We have revised the probability of such a scenario upward from 20 to 25 per cent. On the other hand, we have eased the projected GDP decline, since important steps have been taken to avoid a euro zone collapse. This crisis scenario implies an accumulated 3 per cent decline in GDP during 2013-14, compared to 5 per cent in our earlier forecast. The impact on other parts of the world economy would also be milder.

Near-term developments in crisis countries

Several crisis-hit countries in the euro zone are facing events in the near future that will affect the credibility of the euro project and ECB actions. Below is a brief summary of our assumptions.

Greece: A parliamentary majority has approved EUR 13.5 billion in further belt-tightening. In late November, the European Union and International Monetary Fund can thus approve their next bail-out loan payment of EUR 31.5 billion. We also assume that Greece will be granted a reduced interest rate plus two more years to meet fiscal balance targets. There will also probably be a debt write-down aimed at making Greece's long-term government debt target more realistic. Greece can thus avoid an immediate default, but there is a major risk of a snap election, and Greece is more likely than not to eventually leave the euro zone.

Spain: Spain is expected to apply for a government bail-out from the European Stability Mechanism (ESM) during the next several months. The situation is becoming more and more unsustainable, with a shrinking economy, rising unemployment and a continued decline in home prices. The ECB will thus begin buying Spanish government securities. We expect the regional election in Catalonia on November 25 to confirm opposition to greater federalism and centralisation in Europe.

Portugal: The country has systematically pursued a credible fiscal consolidation policy. But Portugal faces continued large economic and political risks. We expect the EU and IMF to grant some interest rate concessions on existing bail-out loans.

Italy: As for total debt levels, the outlook appears decent, which indicates that Italy will avoid having to seek an ESM/ECB bailout, but political uncertainty is growing as the country approaches the April 2013 parliamentary election that is supposed to replace Mario Monti's government of technocrats.

Ireland: Rising exports will keep growth above zero over the next couple of years but the economic slump will continue, causing major social and political strains. But we expect no new applications for international bail-outs.

Although we have adjusted our US growth outlook upward, an even faster recovery than projected is the most important upside risk in the world economy. A stronger US upturn would have contagious effects at global level, especially via financial channels. Although Europe's problems are of a long-term nature, crisis management there would benefit from US help.

Overall, risks on the downside dominate. This is true in the sense that the we have a higher probability of a worse development compared to the main scenario than a better one but also because the quantitative deviation from the main scenario is larger in the recession scenario than in the recovery scenario.

Commodity prices will stabilise

The oil and metal markets continue to be steered largely by global economic conditions, especially developments in China, and by changes in risk appetite. Oil prices thus remain sensitive to supply disruptions connected to geopolitical instability in the Middle East. **We have lowered our oil price forecast a bit**, because of a slight downward adjustment in the global growth outlook plus new additions to long-term oil supplies. However, we expect Brent crude to remain at relatively high levels: an average of **USD 107.50/barrel in 2013 and USD 110 in 2014**. Several conflicts in the Middle East are among the factors keeping prices up.

Prices of industrial metals have generally fallen markedly this autumn. We predict a **cautious recovery in 2013**, among other things due to gradually stronger Chinese demand. Prices of most metals are currently also so depressed that they are at or below reasonable marginal production costs. Looking at agricultural commodities, **grain prices** subsided this autumn after weather- and harvest-driven upturns in the summer. **We expect continued softness in prices** next year, but low inventories and steps towards greater protectionism will help limit price declines.

Lasting low inflation pressure

General inflation pressure in the world economy is low. Core inflation has decelerated more clearly than expected in most countries, especially the US and Sweden. We expect inflation to continue falling in the near term. Consumer food prices have stabilised after earlier upturns, and large petrol price declines will eventually push down Consumer Price Index (CPI) inflation. In the euro zone, inflation according to the Harmonised Index of Consumer Prices (HICP) will probably fall to 2 per cent as early as the fourth quarter, thus helping ease the downturn. Most indicators point to low and falling medium-term inflation as well. Low resource utilisation is holding back pay increases throughout the OECD. We thus assume that inflation will fall a bit below 2 per cent during our forecast period.

For a long time, our view has been that central bank monetary expansion poses no inflation threat, since resource utilisation is so low. The main purpose of such monetary stimulus policy

Tentative steps towards political union

The EU summit on December 13-14, 2012 will signify an important crossroads for the euro project. A final version of the "roadmap to a euro zone political union" (EPU) will be unveiled at that meeting. It will include a number of recommendations on necessary steps towards the eventual creation of a stable economic and monetary union. The roadmap is also raising questions about relations between euro zone countries and other EU countries such as the UK, Denmark and Sweden. The tough positions adopted by these three countries in recent EU budget negotiations indicate rising tensions.

Moves towards a federalist Europe will be a long-term project and will include various controversial issues. Yet the way that the roadmap is dealt with at the December meeting, and to what extent national political systems will back it up, will be important to the potential for strengthening confidence in the stability of the euro. There has been surprisingly little debate about the EPU since the "four presidents" (Herman van Rompuy of the European Council, José Manuel Barroso of the European Commission, Mario Draghi of the ECB and Jean-Claude Juncker of the Euro Group) unveiled a draft roadmap in late June. However, we believe that the project will be pursued systematically in the hope that support for these ideas among political leaders and the citizenry will gradually take hold. In a Europe plagued by economic crisis, however, public opinion seems to be moving in the opposite direction.

How the different approaches taken by Germany and France are dealt with will be important to the chances of making progress. Germany desires greater federalism and reliable mechanisms for controlling the economic policies of individual countries. France is more focused on making the political union a tool for collective risk and loss allocation. France, with its large bank exposure to southern Europe, has thus been a driving force in the creation of a banking union.

This autumn, efforts to create a banking union, one of the four building blocks of the EPU, has taken a step forward. Before January 1, 2013, heads and state and government are supposed to agree on the legal framework of a single supervisory mechanism (SSM). The ambition is to open up SSM for gradual operational implementation during 2013, thereby making direct support to banks from the ESM bail-out fund possible. The two other elements of the banking union – a single bank crisis resolution mechanism and a common deposit guarantee system – are more complex and will take longer to put in place.

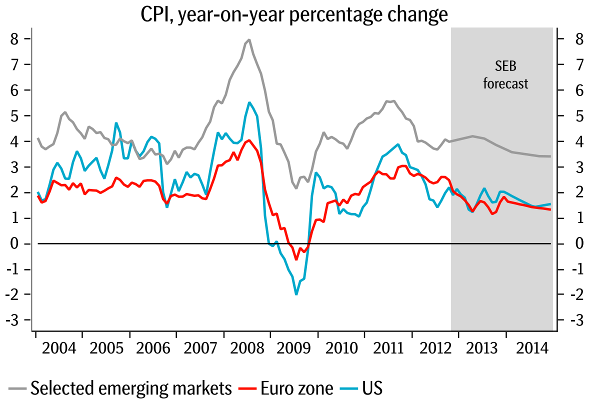
As for the other three EPU building blocks (fiscal, economic policy and democratic union) the question marks are even larger, and uncertainty about them is impeding economic growth. The ESM bail-out fund and the ECB will also bear a heavy burden in order to maintain the stability and credibility of the euro. In many respects, the ECB will be pressured to undertake actions that lie at the outer limit of the bank's constitutional mandate. Issues that cannot be resolved within the framework of ordinary cooperation between countries will thus be squeezed into the framework of the ECB's operations.

has also been to keep deflation expectations from growing too strong. So far, central banks have been successful in keeping inflation expectations close to desirable levels of around 2 per cent. In the wake of the third round of US quantitative easing (QE3), inflation expectations have risen slightly but remain at a comfortable level from a central bank perspective.

Differences in inflation between countries are nevertheless surprisingly small, in light of their divergent growth and unemployment levels. In the euro zone, for example, core inflation in crisis-hit countries is at roughly the same level as the average. Adjustments in the underlying cost situation are being offset by inflation-driving tax hikes as part of austerity policies. As the last *Nordic Outlook* discussed in greater detail, short-term rigidity in the inflation process may become a concern for central banks with inflation targets. For the euro zone as a whole and for countries like the United Kingdom, inflation has been high in recent years compared to the level of economic activity. Norway is the clearest example of the opposite. In spite of a tight labour market, a strong currency and other factors help hold down its inflation rate.

Falling CPI inflation

CPI, year-on-year percentage change



Source: Eurostat, BLS, SEB

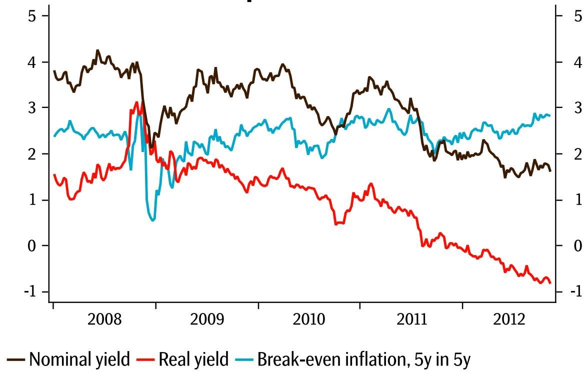
Persistent low-yield environment

Yield movements in bond markets have been small this autumn, with a slight downward drift since late October. Ten-year US Treasuries and their German equivalents are now about 20 basis points above their respective historical lows in July of 1.4 and 1.2 per cent. Predominantly weak economic data in Europe and Japan have kept long-term yields low. In Europe, the ECB's launch of OMT has also reinforced last summer's narrowing of yield spreads between crisis-hit countries and Germany.

Despite depressed nominal interest rates, inflation expectations are not especially low. In the US, for example, long-term expectations are not far below 3 per cent after climbing somewhat in the wake of QE3. These inflation expectations imply very low real yield, approaching -1 per cent. In this respect, today's situation in the Western world, especially the US, diverges from that of Japan in recent decades. In Japan, nominal rates have been pushed down by deflation expectations, while real yield has remained decent.

Looking ahead, the global low-yield environment will persist, although we foresee a modest upturn in bond yields over the next couple of years. This will fundamentally be driven by world economic growth, which will bottom out late in 2012 and then slowly gain strength. Continued ultra-loose monetary policies, falling inflation and stable inflation expectations will restrain the upturn. German 10-year yields will climb by a bit more than 80 bps during our forecast period, reaching 2.2 per cent at the end of 2014. The 25 bps US-German spread will widen gradually next year to 30 bps as a consequence of continued improvement in the American economic outlook. We also expect yields in the crisis-hit countries of Europe to fall somewhat further, among other things due to ECB purchases of Spanish sovereign bonds.

US: 10-year government benchmarks and inflation expectations



Source: Macrobond

Because of solid public finances in Sweden and Norway, their government securities will remain attractive in the market. Yield spreads on Swedish 10-year bonds against Germany will thus remain close to zero in 2013 and then rise to 20 bps in December 2014. However, we expect Norway's spread against Germany to widen next year when Norges Bank raises its key interest rate, but these movements will not be especially rapid at first; the 10-year spread against Germany will widen by 10 bps to 75 in 2013 and continue to 90 by the end of 2014.

Cheerier stock market environment in 2013

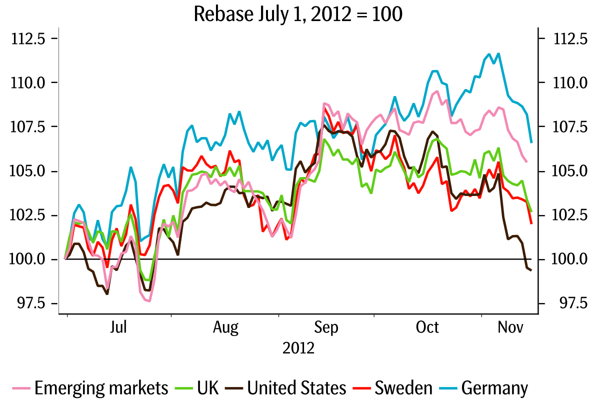
Since mid-year, stock markets have recovered a bit, mainly because the ECB has made the euro zone crisis situation less acute. In recent weeks, however, there has been a downward trend, with new worries connected to the Greek crisis, the escalation of various conflict issues in the Middle East and other factors. In the US, concerns about the fiscal cliff have led to a clearer downturn than in Western Europe. Since QE3 was launched, share prices have fallen by nearly 10 per cent. In the short term, it is difficult to foresee federal budget issues being resolved in a way that will interrupt this negative trend.

The outlook for 2013 seems brighter. Valuations are cautious, given persistently low interest rates. Our economic scenario, with GDP growth bottoming out in the fourth quarter of 2012, thus implies a potential for rising share prices. The budget agreements we are forecasting, combined with sizeable Fed purchase of government bonds when Operation Twist expires in December, will also make a positive contribution. GDP growth in China looks set to bottom out, which will also provide support. Meanwhile downside risks are not difficult to foresee. Policy disappointments related to US federal budget policy and euro zone crisis management may very well assume the upper hand. Expectations about company reports are fairly low for the next few quarters, but if the negative macro trend in Europe continues, they may turn out worse than expected.

The Nasdaq OMX Stockholm has climbed several percentage points since mid-year: a somewhat better performance than US stock markets, but clearly worse than Germany, for example. The rather strong krona has pushed down share prices in some sectors, while weaker capital spending has had a relatively big impact. In 2013 we expect stock exchanges in Stockholm and other Nordic capitals to track the global recovery. From a growth perspective, the Nordic exchanges have the potential to perform more strongly than Western Europe in general.

Equity indices

Rebase July 1, 2012 = 100



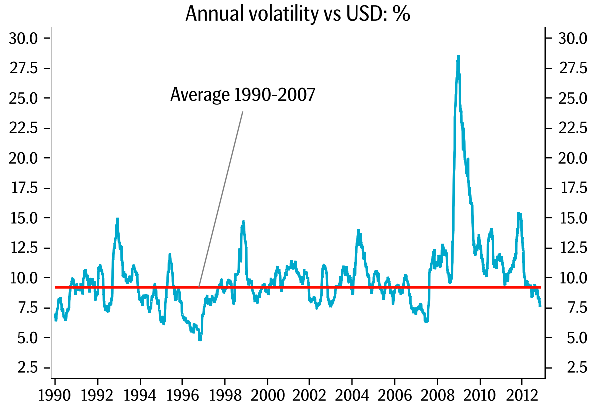
Source: Macrobond, SEB

Falling activity in the FX market

The global foreign exchange (FX) market has been characterised by lower activity and smaller fluctuations in major currencies, compared to recent years. The measure of the size of currency movements (actual volatility) has fallen to levels far below historical averages. Today's level is on a par with the extreme situation that prevailed just before the financial crisis was triggered.

FX markets: Lower volatility

Annual volatility vs USD: %



Source: Bloomberg

Normally, exchange rate fluctuations are small when developments appear relatively predictable and when trends are clear and easily identified. This was the case during 2006-2007, for example. Today's low volatility instead seems to be a consequence of repeated crises, regulatory zeal and interventions from many central banks in recent years. Since the FX market is perceived as so arbitrary and hard to manage, financial market players choose to reduce their exposure and activity as much as possible.

The search for new reserve currencies remains a driving force in the FX market, as global reserve managers increasingly look for alternatives to the US dollar (USD) and the euro (EUR). Such capital flows have caused a number of fundamentally strong currencies, including the Swedish krona (SEK) and Norwegian krone (NOK) to appreciate. Because of the big remaining political and economic challenges facing the euro zone, the US and other countries, this driving force will be important in the future as well, though not always dominant.

Since both the euro zone and the US are grappling with major problems, forecasting the EUR/USD exchange rate is uncertain. The fundamental problem of weak competitiveness in crisis-hit euro zone countries will persist, although the measures announced by the ECB will ease their acute crisis. In the US, worries about sharp fiscal tightening remain. In this environment, we expect the USD to weaken in the short term, with the EUR/USD rate climbing towards 1.30 before year-end. But our main scenario, in which US problems ease during 2013 while uncertainty about the EU integration process persists, implies a squeeze on the euro further ahead. Inter-regional growth rate differences will be another important force behind a weaker euro, with the EUR/USD rate reaching 1.22 by the end of 2013.

The Japanese yen and the British pound will also be held back by high debt, weak economic growth and unconventional monetary policy. We thus expect the JPY to successively weaken from today's high valuations. Our forecast is that by the close of 2013, the USD/JPY rate will stand at 88. The GPB, in contrast, is now being traded at fundamentally reasonable levels against the euro and the dollar, but the UK probably needs a weak currency in order to rebalance its economy in the long term towards a larger export sector. We thus anticipate a cautious weakening of the pound against the dollar. By the end of 2014, the GBP/USD rate will be 1.50.

The risk of a significant downward correction of Scandinavian currencies is relatively small, despite some recent worrisome signals about Swedish growth and exports. We thus expect the krona to strengthen against both the EUR and USD during the first half of 2013 and that the EUR/SEK rate will fall to 8.30 at the end of 2013. The present EUR/SEK level is thus attractive for exporters to increase their hedging levels.

Norway's dilemma with a strong currency is increasingly evident. We expect the krone to keep gaining strength in 2013 year as it becomes ever clearer that a tightening of monetary policy must begin before mid-year. Due to strong fundamentals, Norwegian assets will also continue attracting financial inflows from abroad, causing further appreciation pressure. We expect the EUR/NOK exchange rate to approach 7.00 during 2013.

Economic outlook a shade brighter

- **Housing market recovery will help drive consumption**
- **Fiscal uncertainty holding back companies**
- **Intensive, open-ended Fed stimulus**

Annualised American GDP rose by 2 per cent in the third quarter, or in line with the average since 2010. **The housing market is finally showing a viable recovery dynamic**, meaning that rising home prices will gradually stimulate private consumption via wealth effects and greater optimism. This positive effect will be partly offset, however, since fiscal worries and fading international demand are slowing business investment and hiring decisions. Foreign trade, which contributed positively to growth last year, will have a negative impact in 2012 and 2013. As earlier, we believe that the threat of fiscal tightening is the largest single risk to US recovery. Our forecast assumes that most pitfalls will be avoided but that congressional decisions will not occur until early 2013. Despite this, **the fiscal headwind will stiffen, totalling 1.5 per cent of GDP in 2013.** Overall, however, there are reasons to foresee a somewhat brighter economic outlook. We predict **GDP growth of 2.2 per cent this year, 2.4 per cent in 2013 and 2.7 per cent in 2014:** somewhat above consensus.

Unemployment earlier this autumn reached a four-year low and will continue downward to **7 per cent by the end of 2014**. Yet the amount of labour market slack is significantly larger than this jobless rate indicates. Our assessment is thus that deflationary forces will continue to predominate, contributing to **persistent ultra-loose monetary policy; the Federal Reserve will keep up its bond purchases during 2013 and 2014, according to our forecasts**.

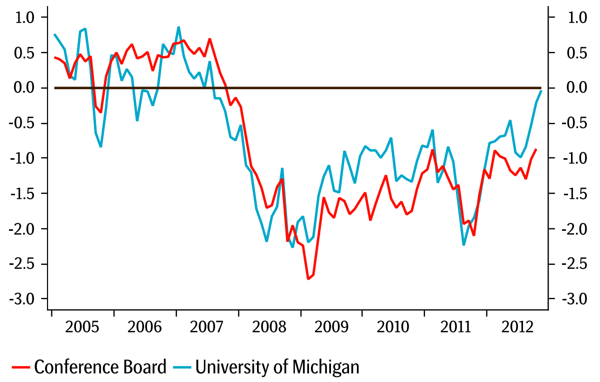
The damage caused by Hurricane Sandy in densely populated areas of the US east coast late in October increases the likelihood of a weak fourth quarter; 60 million Americans in 23 states were affected. But as with hurricanes Gloria (1985), Hugo (1989), Andrew (1992), Katrina (2005), Ike (2008) and Irene (2011) the effects will be temporary and the economy will catch up with lost output during the early months of 2013.

Budding optimism at the consumer level

In recent months, household optimism has improved unexpectedly fast. Confidence indicators such as the Conference Board index and especially the University of Michigan consumer sentiment survey have climbed sharply. The retail sector has performed robustly this autumn. Lower unemployment and rising net worth may partly explain the shift in mood, but another likely factor is that the intensive media focus on the presidential election has overshadowed fiscal risks. **Meanwhile there are fundamental reasons for optimism.** According to a study by the Fed and the US Commerce Department, consumers spend only 28 per cent of after-tax income on food, energy and housing expenses such as rent and mortgage payments. This is the lowest figure since measurements began in 1980. Given such low basic outlays, it indicates **major potential for higher consumption if a positive recovery spiral takes hold**. In light of the large role of consumption in GDP, this implies an upside risk in our forecast.

Consumer confidence: Better but still not good

Standard deviations

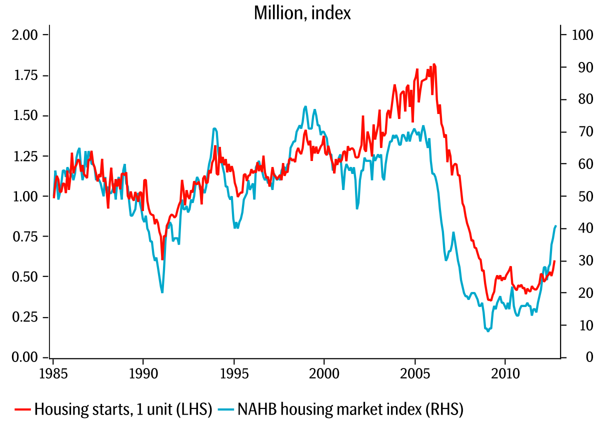


Source: Bloomberg, Conference Board, SEB

Yet our main forecast calls for a rather cautious acceleration in consumption. Household debt deleveraging will continue, hampering growth. **We forecast that household consumption will grow by 2.4 per cent in both 2013 and 2014**: a tad higher than the 2010-2012 average.

Accerlerating home building activity

Million, index



Source: Department of Commerce, NAHB, SEB

Housing market will boost growth

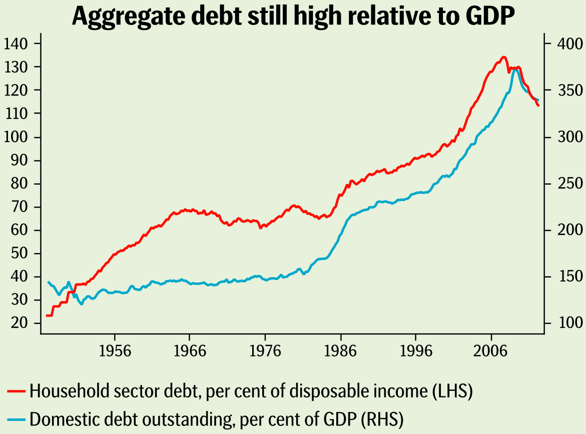
The housing market upturn is the main reason behind our brighter economic scenario. According to the National Association of Home Builders (NAHB), construction sector confidence fluctuated at near-record lows as recently as 2011, but has now rebounded sharply and is approaching historical averages. Housing starts have not yet risen equally fast, but an acceleration is in our forecast. Sales of both new and existing homes are up by around 40 per cent since bottoming out. Housing investments have increased six quarters in a row; in the third quarter, the rate of increase was a full 14 per cent, contributing 0.3 percentage points to GDP. **In 2013, too, we expect housing investments to contribute an average of 0.3 points to GDP**; the risk is on the upside. The effect is relatively small because housing investments only account for some 2 per cent of GDP after a sharp decline in recent years.

Partly due to tight supply conditions, home prices have now begun to rise. This will greatly stimulate the economy, especially because of wealth effects. Homes are often mortgaged, leading to an extra leveraging effect. More and more **households will now be able to refinance their home loans and expand their room for consumption**. Meanwhile nearly 65 per cent of households own a home, while only about 50 per cent invest in the stock market. Furthermore, the median value of homes is seven times larger than that of share portfolios. Yet a large shadow inventory of homes is not visible in the official figures. These homes are now likely to move gradually into the market, boosting the supply of homes for sale. Taken together, this indicates rather **modest home price increases in 2013-2014**. We foresee a 5 per cent annual price rise in both years, as measured by the Case-Shiller Index.

Continued deleveraging

Total debt in the US economy has fallen from a peak of 370 per cent of GDP in 2009 to 340 per cent today. Today's debt level is the same as in late 2007. At the turn of the millennium it was 260 per cent of GDP. Household debt has fallen relatively faster and is now 113 per cent of disposable income, compared to a peak of 135 per cent. Debt retirement has been the most important reason why **the recovery to date has been the weakest on record in the post-war period**. In our assessment, debt retirement will continue in the next few years, though at a decelerating pace due to the housing market recovery.

Aggregate debt still high relative to GDP



Source: Federal Reserve, BEA, SEB

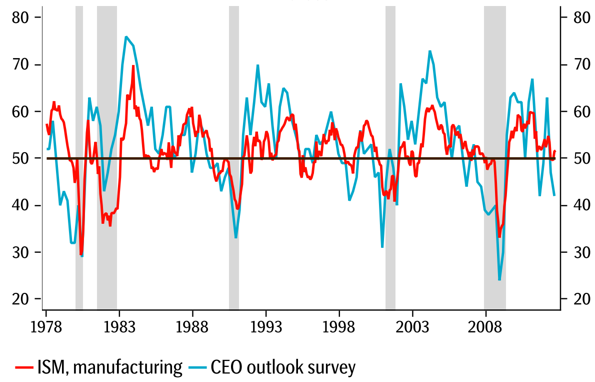
Companies are facing headwinds

Unlike households, companies are worried about both the "fiscal cliff" and weak international demand. This is reflected, for example, in the Business Roundtable's CEO Economic Outlook Survey Index, which has fallen to recession levels. However, more established indicators such as the ISM index of purchasing managers in manufacturing have crept back to firmer ground after sliding this past summer, when actual US industrial production fell.

The decline in short-term indicators like order bookings implies that corporate expenditures on machinery and software – one of the most cyclical elements of GDP– will weaken in the near future. Overall, however, weaker company investments will be offset by robust housing investments. **We predict that capital expenditures by businesses will grow by an average of 7.7 per cent in 2013-2014**. Such indicators as the ISM export order index meanwhile point towards a continued slowdown in export growth, especially to major Asian economies. Exports will grow by an average of 4 per cent in 2012-2014, and the US current account deficit will gradually widen during our forecast period.

Weak corporate indicators

Indices



Source: Business Roundtable, ISM, SEB

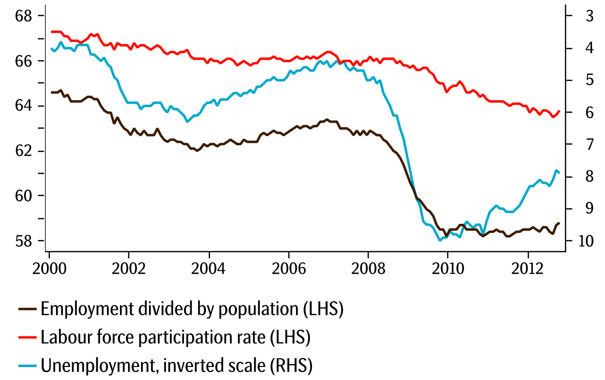
Plenty of slack in the labour market

Unemployment has fallen unexpectedly fast this year. It stood at 7.9 per cent in October, one percentage point below the year-earlier level. Unemployment will continue downward to 7 per cent at the end of 2014, according to our forecast. The quantity of idle resources in the labour market is nevertheless far bigger than is evident from the official jobless rate, as indicated by weak wage and salary increases and other factors. Average hourly wages have risen by 1.1 per cent in the past year, which is less than inflation and thus means a decline in real wages. Alternative measures of resource utilisation such as the labour force participation rate are still falling, and the employment rate (employment divided by population) has treaded water since 2010. Once the recovery gains momentum, more people are likely to join the labour market. The downturn in unemployment will thus be very slow. Instead, labour market improvement will primarily be reflected in a reversal of the worrisome downward trend in labour force participation.

As long as fiscal uncertainty persists, employment will probably continue to increase at a modest pace. We foresee upturns of around 100,000 jobs per month for the rest of 2012. The short-term risk is on the downside. Since about 4.4 million people are hired each month, while 4.3 million leave their jobs, a small percentage hiring downturn may have dramatic effects on the job creation figure. In 2013 we foresee employment increases averaging 150,000 per month. Assuming such a job creation rate, the previous employment peak, from January 2008, will not be surpassed until the spring of 2015.

Different labour market metrics, different messages

Per cent



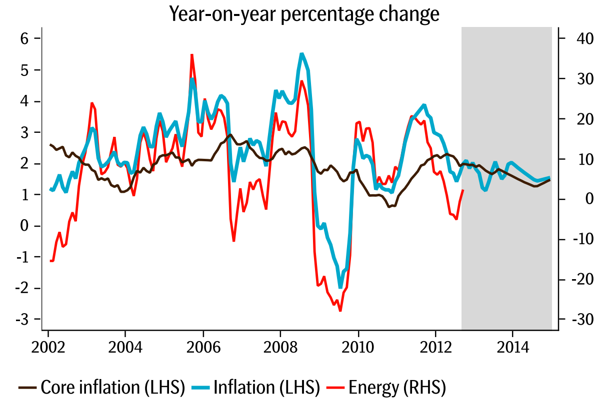
Source: BLS, SEB

Inflation pressure will remain weak

Falling petrol (gasoline) prices will be the dominant near-term inflation factor. For consumers, petrol prices have fallen by 40 US cents or 10 per cent since October. For each cent that they fall, household purchasing power increases by USD 1.5 billion. The decline in petrol price thus contributes to our brighter economic outlook. US price formation is also generally sensitive to oil price changes. **Annual average inflation will reach 2.1 per cent this year and 1.6 per cent in 2013-2014.** Core inflation, which excludes food and energy, has also been modest this autumn. Core inflation will fall below the 2 per cent target throughout our forecast period. Inflation will thus not create any obstacles to continued ultra-loose monetary policy.

No inflation threat in sight

Year-on-year percentage change



Source: BLS, SEB

Post-election fiscal policy

As expected, President Barack Obama was re-elected, while Democrats and Republicans each continue to control one house of Congress. Intensive negotiations are now under way on how to ease and manage the fiscal tightening that is due at year-end. The president wants to extend earlier tax cuts for most households but stubbornly refuses to do this for households with annual incomes above USD 250,000. Since the Republicans have promised voters not to raise taxes, there is a short-term deadlock. One conceivable opening will come after New Year, when the "fiscal cliff" takes effect and taxes are raised for all households. At that time, the question will be which taxes to cut, thus opening the way to compromises. So our main scenario is that the fiscal cliff will be avoided, but not until early 2013. The resulting **fiscal headwind will be 1.5 per cent of GDP in 2013**, which the economy can handle. **The budget deficit will continue to shrink gradually**, reaching 5 per cent of GDP in 2014. In 2009 the deficit peaked at a massive 13 per cent.

Obama's re-election also means that the Federal Reserve can continue its work without disruption. It is assumed that Fed Chairman Ben Bernanke will choose to step down from his hot seat when his term expires in January 2014. The president must then nominate his successor, preferably someone with dovish leanings. One oft-recurring name is Fed Vice Chair Janet Yellen. This would ensure the continuation of current monetary policy.

Fed paying more attention to labour market

The launch of a third round of quantitative easing (QE3) confirmed the change in the Fed's reaction function, with the central bank paying greater attention to the labour market and less to inflation. The main purpose of QE3 is to speed the healing process in the labour market before cyclical unemployment ends up being structural. There are some disturbing signs that high unemployment has already caused structural damage. The "Beveridge curve", which illustrates the ratio between the number of job vacancies and unemployment, has shifted outward, indicating poorer labour market matching. Yet we foresee a rather minor upturn in structural unemployment; current Fed forecasts show it at 5.6 per cent.

New target figures for monetary policy have recently been discussed, for example continuing monetary stimulus programmes for as long as unemployment exceeds 7 per cent and inflation stays below 3 per cent. Since the official jobless rate understates the amount of idle labour market resources (as discussed above), an explicit target has obvious disadvantages. We thus believe that the Fed will want to avoid such targets, considering the risk that financial markets may discount an excessively early shift in monetary policy.

The Fed's purchases of mortgage-backed securities are likely to proceed during 2013 and 2014 at a rate of USD 40 billion per month. In addition, we believe that the Fed will decide to buy Treasury securities at a rate of USD 45 billion per month when Operation Twist expires at the end of 2012. **The Fed's balance sheet**, which has remained stable just below USD 3 trillion since last year, **will approach USD 5 trillion or 30 per cent of GDP in the next couple of years**. We also expect the central bank to maintain its zero key interest rate throughout our forecast period, that is, until at least the end of 2014.

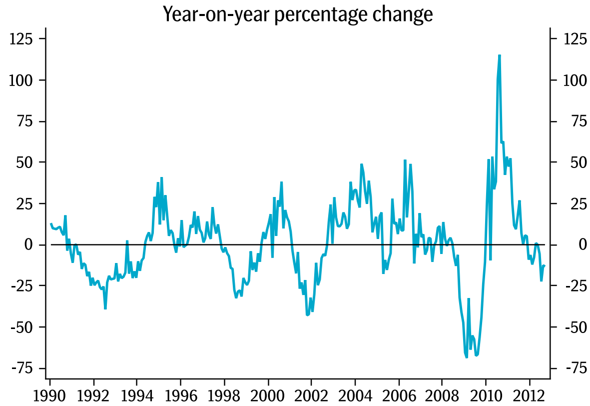
Tense foreign policy situation infecting the economy

- **Falling GDP in second half of 2012**
- **Election will lead to change of power**
- **New BoJ easing due to below-target inflation**

The Japanese economy is sputtering alarmingly. After an upturn earlier this year, both corporate capital spending and foreign trade are making large negative contributions to growth. Quarter-on-quarter GDP will fall in the second half. We predict that **the economy will grow by 1.7 per cent this year and 0.8 per cent in 2013**, somewhat below consensus. In 2014, GDP will grow by 1.3 per cent, which is close to trend. The weak growth outlook is opening the way for **new stimulus measures from the Bank of Japan**, especially since inflation will remain below target next year according to the central bank's own forecasts. At its monetary policy meeting in late October, the BoJ decided to expand its asset purchase fund from JPY 55 trillion to JPY 66 trillion. It also introduced a new credit facility to stimulate lending. The government and central bank made a joint statement on ways to overcome deflation. **The BoJ is subject to strong political pressures**, and its independence is gradually being undermined.

Falling machinery orders

Year-on-year percentage change



Source: Cabinet Office

Industrial output fell sharply in September, and production plans indicate further weakness. Low manufacturing activity is reflected in fewer hours worked and lacklustre income growth. Business surveys like the BoJ's Tankan index and PMI are down, and **corporate capital spending will contribute negatively to growth in the second half**. After a consumption surge earlier in 2012 when low-energy car subsidies boosted growth, household indicators are also pointing downward. Car sales have stalled and retail sales growth is showing large negative figures. Indicators like the Economic Watchers survey show a weak consumption outlook. **Unemployment**, which has fallen to a low 4.2 per cent, **will climb in the next couple of years** to annual averages of 4.4 per cent in 2013 and 4.6 per cent in 2014. Unemployment peaked at 5.4 per cent in July 2009.

Worries about Japan's government finances have grown larger recently. According to the IMF, **sovereign debt will reach a huge 237 per cent of GDP this year**, compared to 198 per cent in Greece and 126 per cent in Italy. Since most of this debt is owned by domestic investors, there is little risk of a euro zone-style debt crisis soon. Meanwhile the unstable political situation is causing concern. A **consolidation of Japan's government finances seems increasingly remote**. The consumption tax hike planned for 2014 may be shelved. Meanwhile, for four straight years the government has raised more money via bond sales than from taxation. **The deficit**, projected at 10.5 per cent of GDP this year, **will climb further in 2013**. In 2014, we expect some fiscal tightening, but deficits will remain large and Japan's **credit rating is in jeopardy**.

An election has been called for December 16. Opinion polls indicate a change of power, with Shinzo Abe (LDP) becoming prime minister. A more expansionary economic policy appears likely at that time. Abe has advocated greater coordination of fiscal and monetary policy to stimulate the economy and push up inflation to 2-3 per cent. A change of power thus not only implies fiscal stimulus, but also increases the probability that the Bank of Japan will lower its key interest rate below zero.

After Japan nationalised three disputed islands in the East China Sea, political and military tensions between Asia's two largest economies have escalated, leading to Chinese protests, tense trade relations and falling exports to China, especially for Japanese car companies. Since **China is Japan's most important trading partner**, the dispute is impacting Japan's trade balance, which has been negative since last year's natural disasters. In September, exports fell by more than 11 per cent year-on-year and a record-sized trade deficit was recorded. **Foreign trade is thus providing a strong negative contribution to GDP**, which is the main reason for lowering our forecast. Judging from Abe's tough rhetoric and focus on stronger defence, Japanese-Chinese relations are hardly likely to improve after the election. Negotiations on a free trade agreement between Japan, China and South Korea also recently broke down.

The BoJ prefers to focus on inflation excluding fresh food. After a -0.3 per cent year-on-year rate last year, core inflation is predicted to increase slightly, but the **inflation rate will be well below the BoJ's target** during the next couple of years. **Further monetary stimulus measures are thus likely**. A combination of weak real economic conditions and aggressive monetary policy, not least if opposition leader Abe has his way, has weakened the yen to six-month lows against the dollar. We expect this trend to continue, and **in December 2013 the USD/JPY exchange rate will stand at 88**.

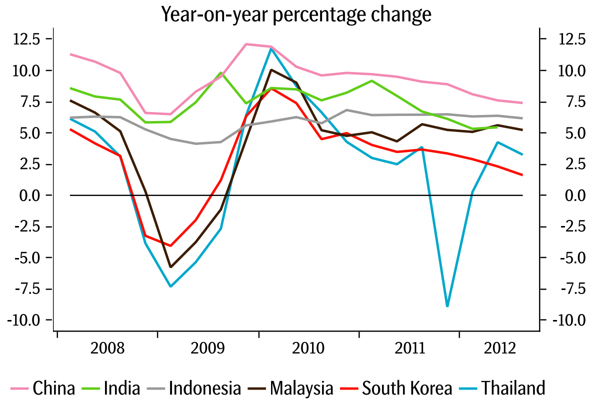
Below-trend growth, but still support to world economy

- **Economic deceleration in the third quarter**
- **China: reduced risk of hard landing**
- **India: reform proposals a step in the right direction, but more needed**

GDP growth in Asian emerging economies decelerated in most places during the third quarter of 2012, not only in China but also in such places as South Korea and Malaysia. Despite this slowdown, growth was still significantly faster than in Europe and the United States. Asia's emerging economies will contribute an estimated 40 per cent of global growth this year. Looking further ahead, the region will continue to provide substantial support to the world economy. Growth will stabilise during the next few quarters and solid domestic demand will maintain decent growth in 2013, but we expect GDP growth to remain below trend next year.

Asia: GDP growth

Year-on-year percentage change



Source: National statistical offices

Purchasing managers' indices indicate that the region's manufacturing sector is still struggling, though October statistics point to a slight improvement. In addition, export figures for many countries in the region brought upside surprises. Exports to the euro zone continue to weigh down the totals, while exports to the US and within the region itself are more expansionary.

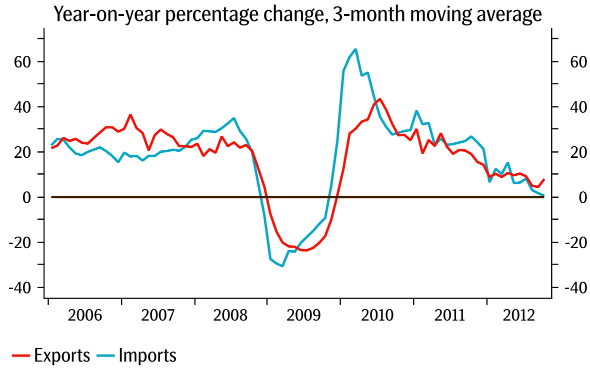
Inflation is expected to climb somewhat in the coming months, driven by rising food prices. Generally speaking, however, **inflation pressure is low**, with depressed core inflation and with producer prices falling year-on-year in many countries. Inflation thus poses no obstacle to looser monetary policy. However, we anticipate **no far-reaching shift in monetary policy during 2013**, although many economies are expected to start normalising key interest rates during the fourth quarter.

China: Growth is close to bottoming out

During the third quarter, GDP growth slowed to 7.4 per cent year-on-year and the growth rate has thus weakened for seven straight quarters. However, quarter-on-quarter growth accelerated. **Our long-held assessment that China will be able to avoid a hard landing has been reinforced.** Purchasing managers' indices have begun to recover, and **hard data also strengthened late in the third quarter**, with exports as a positive surprise. Industrial production and retail sales accelerated in October compared to September. Activity in the construction sector remains weak but there are signs of improvement and home prices have begun moving cautiously upward month-on-month. Bank lending has been weaker than expected in recent months, but total social financing, a measure that includes other forms of credit than bank lending, indicates relatively strong demand for credit. **We expect China's GDP to grow by 7.7 per cent in 2012. GDP will grow by 8.1 per cent in 2013 and 7.7 per cent in 2014**.

Exports provided a positive surprise in September and October

Year-on-year percentage change, 3-month moving average



Source: National Bureau of Statistics of China

The official **policy response to the economic slowdown has been limited**. State investments in infrastructure projects approved this autumn had been planned for a long time and thus do not indicate a policy shift. Looking ahead, their stimulus effect will also be spread over several years and will only have a marginal impact on growth in the next few quarters. **The main explanation for the cautious fiscal policy is that the imbalances** – including higher local debt and overcapacity in the manufacturing sector – **that resulted from the big 2008-2009 stimulus programme have contributed to more prudent fiscal policy this time around.** Another reasonable explanation is that the authorities have been less worried about the economic slowdown this time since exports have performed much better than during the 2008-2009 crisis, despite a marked deceleration. Also, the labour market has been resilient to the economic slump and wages are still continuing to rise at a healthy pace, removing the risk for labour market unrest. Since growth has bottomed out no further major stimulus is expected.

Chinese leadership changes without surprises

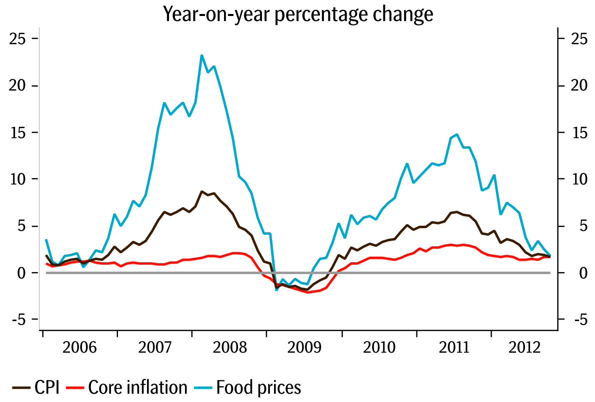
The 18th National Congress of the Communist Party of China confirmed that Xi Jinping and Li Keqiang are assuming the two top positions in the Politburo Standing Committee. Xi was appointed general secretary of the Communist Party and will also become president of China next March, while Li was appointed prime minister. The Politburo Standing Committee was reduced from nine to seven members to facilitate decision making. Two of the most reformist candidates were not elected to the Committee, so the Standing Committee is not expected to be as reform-minded as many had hoped. Its decision making is consensus-based, however, so one should not exaggerate the importance of individual members' commitment to reforms. The main thing is for the Standing Committee to be collectively capable of pursuing reform efforts. Our assessment is that there will be numerous reforms over the next five years.

Monetary policy has also been unexpectedly cautious this autumn, and the key interest rate has remained at 6.0 per cent since being cut in early July. Nor have bank reserve requirements been eased. Concerns that housing prices could soar once again are probably holding back a loosening of monetary policy. Instead of lowering its key rate and reserve requirements, the People's Bank of China has begun to use reverse repos to supply credit to financial markets. **Repo transactions** have thus become the **central bank's main monetary policy tool**. Our assessment is that the **key interest rate will remain at 6.0 per cent during our forecast period**, as long as there is no radical deterioration in the economic outlook.

The rate of CPI inflation decelerated to 1.7 per cent in October. **We expect inflation to climb in the next few months**, driven by food prices and base effects, but we foresee a limited increase. Inflation will remain below the maximum official target of 4 per cent during our forecast period.

Continued low inflation pressure

Year-on-year percentage change



Source: National Bureau of Statistics of China

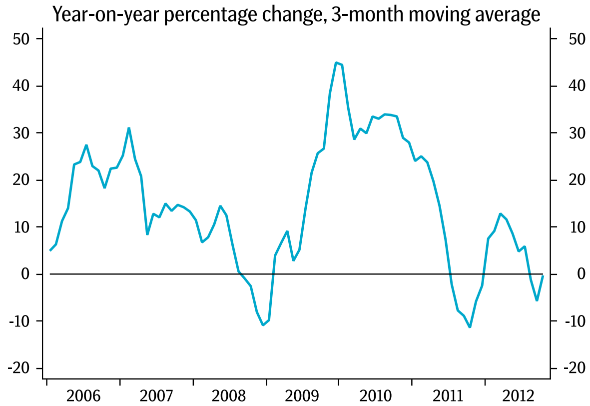
The yuan recently resumed its rise against the US dollar after a mid-year depreciation period. The occasionally harsh tone towards China in the US presidential election campaign, along with signs of export stabilisation, may have speeded up this appreciation. Yet since 2012 began, the yuan has strengthened by a modest 1 per cent or so. **In our assessment, the USD/CNY exchange rate will stand at 6.25 at the end of 2013 and 6.15 at the end of 2014**.

India: Reform proposals a promising step

India's economic performance remains weak, although the growth rate accelerated slightly to 5.5 per cent year-on-year in the second quarter. **Growth was probably weak during the third quarter as well**, since both the manufacturing and agricultural sectors were in a sluggish period, but there are signs of stabilisation. Purchasing managers' indices for both manufacturing and services have stopped falling, and industrial production has started to show signs of stabilising. Exports continue to perform poorly, however, and car sales indicate weak domestic demand. **We expect GDP to increase by 5.5 per cent in 2012 and then rise 5.9 per cent in 2013 and 6.2 per cent in 2014**.

Weak car sales indicate sagging domestic demand

Year-on-year percentage change, 3-month moving average



Source: SIAM

In mid-September the government unveiled several **reform proposals**, including a hike in administratively set diesel fuel prices, to reduce state subsidy expenses. This is part of attempts to come to grips with the large budget deficit. Foreign investments will also be liberalised in retailing and other sectors. These proposals are a step in the right direction and had a positive impact on both the stock market and currency, but are still **not far-reaching enough**. There is still a very great need for structural reforms. It will also take time to implement market liberalisation. The reform proposals have increased political tensions, and further proposals will be difficult to push through.

Inflation remains stubbornly above the Reserve Bank of India's comfort zone and was 7.4 per cent in October. **There is thus only limited room for key interest rate cuts in the near term**. We expect the central bank to leave the key rate at 8.0 per cent at its December policy meeting, but we foresee inflation cooling a bit to 7.0 per cent in 2013. Because of the expected slowdown in inflation along with weak economic growth, we believe **the central bank will cut its key rate by one percentage point during the first three quarters of 2013**.

Despite appreciating at the time of the reform proposals, the rupee will remain squeezed by India's large current account deficit. **We expect the USD/INR rate to be 51 at the end of 2013 and 49 at the end of 2014**.

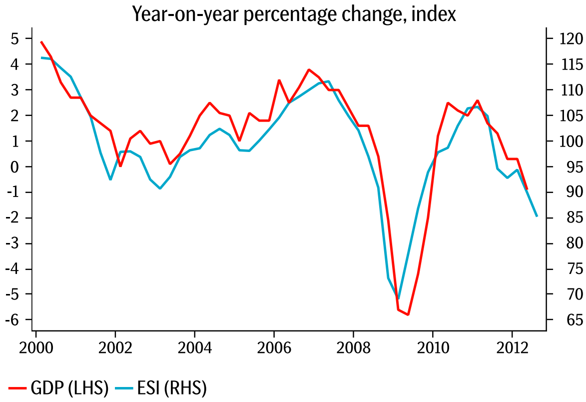
Continued negative growth, despite new ECB stimulus

- **Rising unemployment squeezes households**
- **More expansionary fiscal policy in Germany**
- **Better external balance in crisis countries**
- **Stubborn inflation on the way down**
- **OMT may provide temporary relief**

Economic performance remains weak in the euro zone. During the third quarter, GDP in the region fell by 0.1 per cent compared to the preceding quarter. The euro zone as a whole is now technically in recession. **Indicators point towards persistent weakness**. The Economic Sentiment Indicator (ESI) for the euro zone continued downward in October, a signal that GDP will drop significantly in the fourth quarter. Purchasing managers indices also show falling activity, but indicators have tended to exaggerate the force of the downturn in recent quarters. At present, hard data are more stable. Exports have continued to chug along at a healthy pace during the autumn, while retail sales have recently presented upside surprises. We thus expect the GDP downturn to be only 0.2 per cent, quarter-on-quarter. As an annual average, **we expect euro zone GDP to fall by 0.4 per cent in 2012**.

ESI indicates GDP decline

Year-on-year percentage change, index



Source: Eurostat, European Commission

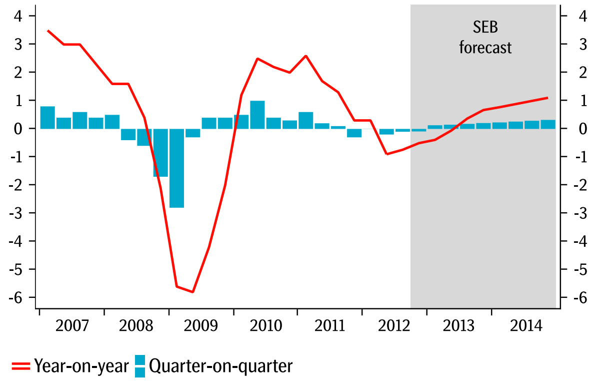
The euro zone growth outlook for the next two years remains gloomy. Households are squeezed by rising unemployment. Due to uncertainty about the future of the euro system, companies are postponing capital spending. However, export demand is holding up decently, mainly benefiting countries like Germany and Ireland. Even the crisis-plagued countries of southern Europe are slowly improving their competitiveness. **In 2013, we expect GDP growth to end up at just below zero, followed by modest 0.8 per cent growth in 2014**.

The euro zone financial crisis became somewhat **less acute** in early September when the European Central Bank unveiled its **Outright Monetary Transactions (OMT) programme**. Under this new support programme, the ECB will be prepared to buy government securities in the secondary market if certain conditions are met. **The OMT programme** has not yet been used, yet has still **helped push down borrowing costs for crisis-hit countries**. The recent EU summit also took a further step towards a **banking union** by setting a deadline of January 1, 2013 for reaching agreement on the legal framework of a banking supervision mechanism. The ambition is for the ECB to gradually begin implementing such monitoring in 2013.

The euro project still faces major challenges. Developments in Greece are turbulent, and the country must continue its reform process to ensure disbursements from its bail-out package. In countries like Spain, Italy, and Portugal rising unemployment is also contributing to greater social tensions. Major differences of opinion between Germany and France on key issues related to the banking union, financial supervision and shared debt-related commitments are creating uncertainty. **Although the outlook has improved, it remains uncertain whether the euro project will survive in its current form**.

GDP growth in the euro zone

Per cent



Source: Eurostat, SEB

Faltering German resilience

In Germany, too, **the trend of economic indicators is gloomy**. The IFO business sentiment index fell in October for the sixth straight month and now stands below its long-term average. The purchasing managers' index (PMI) is also depressed. Yet actual hard data have shown decent resilience so far, and third quarter GDP growth ended up at 0.2 per cent compared to the preceding quarter. We nevertheless expect the fourth quarter to be weak, like the end of the third quarter.

Partly as a result of Germany's decent sovereign finances, the government has now finally opened the way for a **somewhat more expansionary fiscal policy in 2013**. Tax cuts and smaller pension contributions representing at least EUR 15 billion

(0.6 per cent of GDP) has been unveiled in order to boost private consumption. This is a welcome step towards a rebalancing of euro zone growth forces, but it is too small to have any major impact on German growth. **We expect Germany's GDP to grow by 0.8 per cent this year and 0.6 per cent in 2013. In 2014**, growth will accelerate to **1.5 per cent**.

France has so far managed to avoid a major decline in GDP. Instead the economy has stagnated, showing zero growth in the past three quarters. The outlook has dimmed recently, however. Although industrial production has remained resilient, this autumn there has been a wave of lay-off notices and dismissals in the manufacturing sector. Unemployment continues to climb and reached 10.7 per cent in September, its highest level since 1999. President François Hollande's regime has been passive towards this economic deterioration, and the government's forecast of 0.8 per cent GDP growth in 2013 seems far too optimistic. Our assessment is that **growth will end up close to zero, both in 2013 and 2014**. In addition, further belt-tightening will probably be required in order to achieve the targeted budget deficit of 3 per cent of GDP next year.

The French economy has some fundamental strengths, among them leading global companies, good infrastructure and low energy costs. Yet the long-term trend also looks gloomy. France has suffered a large decline in competitiveness during the past decade and will require far-reaching reforms in both the labour market and the tax system to turn around this negative trend. The government seems to lack a clear strategy for tackling the great need for reforms. **Increased business sector opposition** to official policies in recent months may possibly contribute to an eventual change of course.

GDP, selected countries

Year-on-year percentage change

	2011	2012	2013	2014
Germany	3.0	0.8	0.6	1.5
France	1.7	0.1	0.2	0.5
Italy	0.4	-2.0	-0.7	0.3
Spain	0.4	-1.4	-1.3	0.0
Greece	-7.1	-6.5	-4.5	-0.9
Portugal	-1.7	-3.0	-1.6	0.1
Ireland	1.4	0.3	0.8	1.5
GIPS countries	-0.9	-2.2	-1.6	0.0
Euro zone	**1.4**	**-0.4**	**-0.2**	**0.8**

Source: Eurostat, SEB

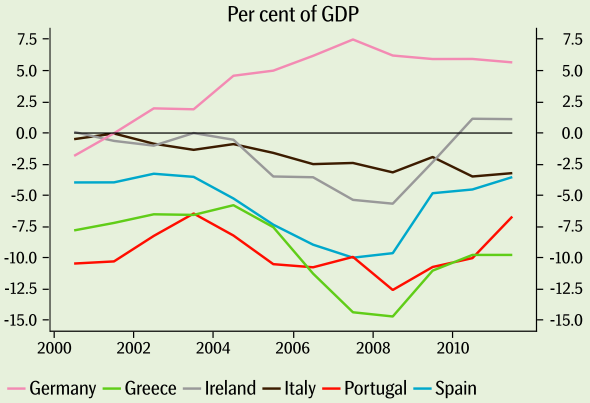
Shrinking imbalances in crisis countries

Crisis-hit countries in the euro zone have made progress towards shrinking their external and internal imbalances. All these countries have greatly reduced their foreign trade deficits since 2008. Ireland already boasts a current account surplus, and only Greece is expected to show a deficit of more than 3 per cent of GDP in 2012. The main factor behind this improvement is a downturn in imports, driven by sharply weakened domestic demand. But the competitiveness of some countries has also improved, benefiting exports. Unit labour costs have begun to fall in crisis-hit countries, although the trend is occurring slowly because of dysfunctional labour markets. In Greece, labour costs have fallen by more than 15 per cent since they peaked in 2009. In Germany, the adjustment is moving in the opposite direction; labour costs have begun a clear rise in recent years. Looking ahead, this trend is expected to continue and help ease the imbalances in the euro zone.

Except for Spain, budget deficits in crisis-hit countries have also greatly decreased due to tough belt-tightening measures. The overall euro zone budget deficit is also decreasing: from 4.1 per cent of GDP in 2011 to 3.1 per cent in 2012. By 2014, we estimate that this deficit will fall to 2.0 per cent, but it is increasingly evident that austerity measures are hampering economic activity to a greater degree than expected. Tax hikes, dismissals and public sector pay cuts are hurting private consumption. GDP will thus keep falling in all of the crisis-hit countries of southern Europe in 2013, and 2014 will be another very weak year. Unemployment will thus continue to climb, with a risk of mounting social unrest as a consequence.

Current account balance

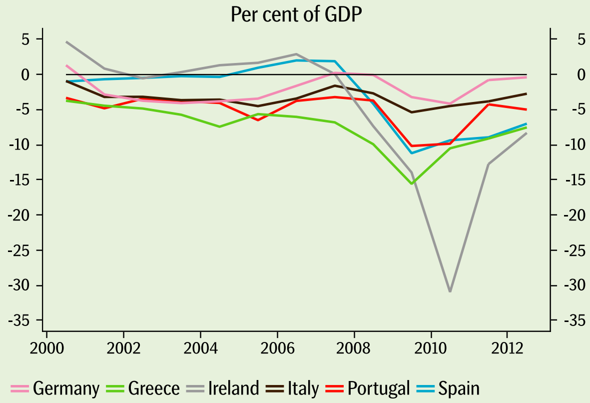
Per cent of GDP



Source: OECD

Budget balance

Per cent of GDP

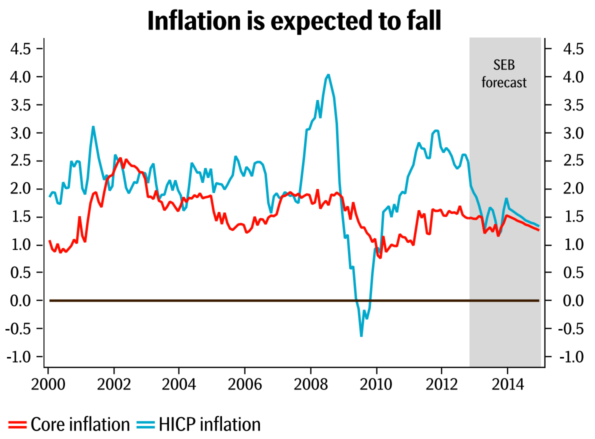


Source: IMF

Stubborn inflation is squeezing households

Euro zone households are being squeezed by a combination of austerity measures, weak labour markets and relatively high inflation. **Unemployment** reached a **new record** of **11.6 per cent** in September. This increase is still being driven by worsening conditions in crisis countries; Spain's jobless rate is now close to 26 per cent. Measured as annual averages, euro zone **unemployment** will be **11.4 per cent this year**, rising to **12.0 per cent in 2013** and to **12.4 per cent in 2014**.

Inflation is currently well above the ECB's target, but in October, HICP inflation fell somewhat to 2.5 per cent. We expect this slowdown to continue for the rest of 2012 and during 2013. **Measured as annual averages, inflation will fall from 2.5 per cent in 2012 to 1.5 per cent in 2013 and 2014. Core inflation** will fall further, driven by low capacity utilisation, and **will stand at 1.3 per cent at the end of our forecast period**. Although inflation is now slowing, private consumption will remained squeezed in the future, which is one important reason behind the dismal growth outlook for the next two years.



Source: Eurostat, SEB

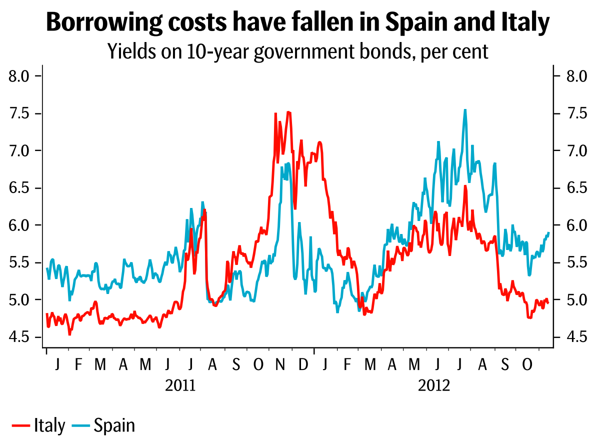
ECB back in wait-and-see mode

Since it unveiled the new OMT bond purchasing programme in September, the ECB has not taken any policy initiatives. The central bank seems satisfied that OMT has pushed down borrowing costs in crisis-hit countries and has now reverted to the wait-and-see mode of last spring. Meanwhile listless economic performance is putting pressure on the ECB to act. Bank lending, especially to companies, remains weak, but the ECB's latest *Bank Lending Survey* indicates that weak lending is still mainly driven by low demand for loans rather than by a shortage of liquidity. Further three-year LTRO loans are not likely at present. Generally speaking, **it is difficult to foresee the ECB launching any major new policy initiatives in the short term**. The bank also left the key interest rate unchanged at its November meeting, and our assessment is that **the refi rate will remain at 0.75 per cent during our forecast period**. Although the ECB has signalled that it is not ruling out future rate cuts, we believe that further cuts would have little stimulus effect and would risk disrupting the functioning of the interbank market.

OMT programme provides breathing room

Even though the ECB has not yet carried out any **OMT** bond purchases, the **programme** has already had **positive effects** by increasing demand for the government securities of crisis-hit euro zone countries. The OMT programme's most important contribution thus far is that it has created some **breathing room** for crisis countries to continue implementing structural reforms and improving their government finances.

If OMT purchases do not begin, there is a risk of renewed instability and rising bond yields. The potential for actually starting such purchases is thus of great interest. According to the ECB, a country must first have applied and been approved for an EFSF/ESM bail-out programme before OMT bond purchases can begin. A bail-out programme implies mandatory economic reforms and IMF monitoring. In addition, the country itself may borrow money in the financial market to some extent. **No country currently meets the requirements for the ECB to start buying its government securities through OMT:** Spain has access to market funding but has not applied for ESM aid, while the situation is the reverse in Greece, Ireland and Portugal. There is also **uncertainty about how the ECB will act once a country has met its conditions**. This applies both to what yields are required in order for purchases to begin and what volume of bonds the ECB will buy.



Source: Macrobond

Spain is the country that is ripest for potential purchases of government securities by the ECB. Our assessment is that **Spain will apply for a bail-out package during the next several months and the ECB will thus begin bond purchases**. An application will imply mandatory reforms that will limit national sovereignty, which is one reason why Spain has hesitated so far. Spain's borrowing costs have recently fallen, decreasing the pressure to apply for a bail-out. In addition, Germany has opposed a Spanish application. Germany wants a clear indication of the magnitude of a future application, as well as a solution to the Greek situation in order to avoid having to contribute money for yet another bail-out. This autumn's local elections may also have helped persuade the government to postpone the issue. But because of weak macroeconomic growth, the prospects of achieving the established budget targets are steadily worsening, which will increase pressure on the Spanish government.

Is the British economy stuck in a low-growth rut?

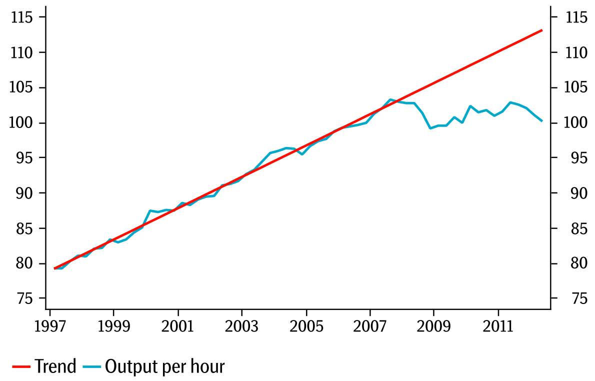
- **Olympics provided temporary growth surge**
- **Low inflation will increase purchasing power**
- **Fiscal headwinds will intensify in 2013**

After declining earlier this year, **British GDP growth topped the EU charts** during the third quarter. Underlying growth was far weaker, though; the Olympic Games and calendar effects provided a sharp quarter-on-quarter surge. Our forecast is that **GDP will stagnate this year and grow by 1.3 per cent in 2013 and 1.5 per cent in 2014**. Fiscal austerity remains in place. Combined with weak export demand, this will hold back the recovery. Nearly half of British exports go to the euro zone. After peaking at 5 per cent as recently as last year, inflation is headed towards levels somewhat below the Bank of England's target. We expect the BoE to increase its dose of stimulus in 2013 but to abstain from further interest rate cuts.

Although GDP is at its year-ago level, job creation has been rapid and unemployment has fallen. However, **productivity growth has been weak**, especially in services, accentuating **worries about structural growth problems in the British economy**. Since the Second World War, productivity has climbed steadily at around 2 per cent yearly, but since 2007 there has been a total stagnation. This means the gap between actual productivity and the long-term trend is a full 11 per cent. Conceivable causes are dwindling North Sea oil production and the problems of the banking sector. Looking ahead, we expect a degree of normalisation in productivity growth, leading to an **increase in unemployment from 8.2 per cent in 2012 to 8.4 per cent in 2014**, measured as annual averages.

Poor productivity growth

Index



Source: ONS, SEB

Manufacturing faces headwinds. A weighted average of purchasing managers' indices for construction, services and manufacturing is compatible with economic stagnation. After sharp declines during the 2008-2009 crisis, the recovery in corporate capital spending has been weak in historical terms. The euro zone crisis has spread to British industry, but exceptionally weak trade figures in August (the second-highest deficit recorded) reflected a broad-based export slide. The CIPS export order bookings index is showing weakness, and **foreign trade will contribute negatively to growth next year**.

Household indicators show a divided picture, with stronger retail sales and weaker consumer confidence. The BoE's new Funding for Lending Scheme is expanding the supply of cheap loans; mortgage rates have fallen and the number of approved mortgage applications is rising. **Home prices have stabilised and will probably climb cautiously in 2013**. Nearly a million households will be affected by the child allowance reform early in 2013, when this benefit will be withdrawn from relatively high-income households. The impact on individual households will be significant, but the aggregate income effect will be only 0.2 per cent on an annual basis. Offsetting this, wages and salaries will rise faster than inflation in 2013, which will boost purchasing power. The household savings ratio will remain close to its historical average and **private consumption will increase by 1.5 per cent in 2013 and 1.8 per cent in 2014**.

After exceeding 5 per cent in 2011, inflation dropped to a three-year low in September, squeezed by the UK's sizeable output gap, which among other things is holding back pay increases. Another factor has been falling commodity prices. **Inflation** will be **in line with BoE's target in 2013 and well below the target in 2014**. More favourable inflation will increase purchasing power and ease the effects of the government's austerity programme. Chancellor George Osborne's plan for increasing the pace of budget tightening in 2013-2014 remain in place, and the deficit will fall from 7.7 per cent of GDP in 2012 to 5.2 per cent in 2014. Public consumption will thus account for a large negative contribution to growth in the next couple of years. The **fiscal tightening effect will be equivalent to 1-1.5 per cent of GDP in 2013 and 2014**. The government's ambition is to achieve a structural budget balance within five years, thereby ensuring that the UK will keep its AAA sovereign credit rating.

Offsetting this tighter fiscal policy, our forecast is that the **BoE will increase its government bond purchases by another GBP 50 billion** early in 2013. When BoE Governor Sir Mervyn King's term of office expires in June 2013, the game plan may change, however; one alternative would be additional steps to ease credit. The most important key interest rate will remain at 0.50 per cent during the next couple of years. According to our models, the pound is correctly valued against both the euro and the dollar, as reflected in our rather cautious exchange rate forecasts. The **EUR/GBP exchange rate will stand at 0.77 at the end of 2014**, that is, close to today.

Russia and Poland will climb out of their growth slump

- **Continued divergence in the region**
- **Ukraine weak despite expected devaluation**
- **Credit situation approaching normality**

The dominant economies in Eastern (including Central) Europe – Russia and Poland – are now affected by the global economic slowdown but continue to cope with the euro zone crisis better than most countries in the region. This is especially different from central and southern parts of the region, where countries like the Czech Republic, Hungary, Croatia and Slovenia will see weak growth after the 2012 recession. In 2013-2014, Russia will grow by a yearly average of 3.7 per cent and Poland by 3.2 per cent. We have slightly lowered our forecasts compared to *Eastern European Outlook*, October 2012. Russia and Poland **will perform better than other countries in the region** largely because they are less export-dependent and their public finances are under control. They are also less dependent on bank financing via the euro zone; although the lion's share of Poland's banks are owned by EU-based parents, they have been robust and well-capitalised for some years.

But since last spring, **GDP growth has clearly decelerated in Poland and to some extent in Russia**. This autumn, the Russian purchasing managers' index in manufacturing has remained a bit above the expansion threshold of 50 (rising to 52.9 in October), while Poland's PMI is below 50 (47.3 in October). Russian growth has cooled mainly due to sagging exports and rapidly rising inflation. Poland's slowdown has been more broad-based, with consumption hurt by weakening real wages; construction and other capital spending have fallen since the summer's European football championships.

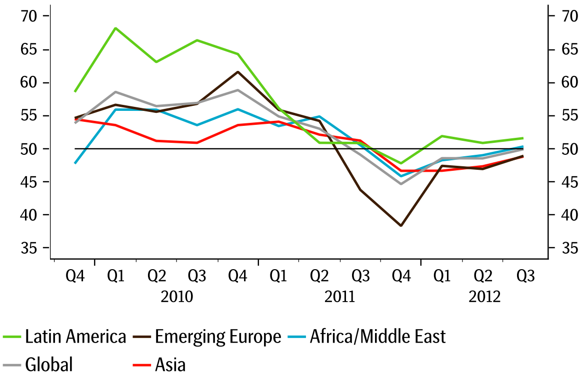
Poland and Russia have good potential to climb out of their slump and show decent growth. Russia's will continue to be sustained by **high oil prices, expansionary fiscal policy** (though with less stimulus than this year), a **strong labour market and high credit demand**. Inflation has surged from a record-low 3.5 per cent last spring to 6.5 per cent and will be stuck close to this level next year. In Poland, a continued **decline in inflation will help sustain growth. Lower interest rates will also contribute**. In the past six months, market interest rates have plunged and this trend will now be reinforced by a monetary policy shift. The central bank will slash the key rate by a total of 75 basis points in the next six months after its first cut from 4.75 to 4.50 per cent in early November. Capital spending will rebound, partly due to **extra infrastructure investments** over the next couple of years. A new state fund is being formed in order to arrange market financing without burdening the government budget. Fiscal policy must remain slightly contractive in order to further push down the budget deficit to less than 3 per cent of GDP and, above all, to keep public debt below its ceiling of 55 per cent of GDP. The government unveiled its stimulus measure in October in response to the slowdown and Poland's financial regulator announced looser consumer and home mortgage loan terms in order to stimulate continued good credit demand.

Ukraine has decelerated clearly more than expected. Lower steel prices have hampered exports, and political uncertainty has held back investments. A **sluggish recovery** will occur in 2013, with inflation surging from this year's extremely depressed level. Despite the resulting squeeze on current high real wage increases, growth will still be driven by private consumption. There will also be a slight rebound in exports, helped by higher steel prices and a **devaluation of the hryvnia by at least 10 per cent against the USD** this winter. This will help ease Ukraine's large current balance deficit. As for political direction, there will be no major change after the recent parliamentary election. The government will probably apply for a new IMF loan; the current, suspended agreement will soon expire.

Better risk appetite since last summer has greatly strengthened **many Eastern European currencies**. Looking ahead 1-2 years, we predict a **slight appreciation** in the Russian rouble, Polish zloty, Hungarian forint and other regional currencies, due to growth advantages compared to the West (except Hungary), interest rate gaps and long-term valuations.

EM Bank Lending Condition Indices

Index 50 = neutral



Source: IIF

Eastern European **credit conditions thawed a bit further in** the third quarter, according to the latest Institute of International Finance emerging market loan survey. Today "Emerging Europe", which also includes countries outside Eastern Europe, is not far from neutral levels and close to levels in other fast-growing regions. The ECB's low-interest LTRO loans to euro zone banks in December 2011 and February 2012 greatly helped ease the severe financial tensions prevailing in both Western and Eastern Europe in the second half of 2011.

Good domestic demand providing decent GDP growth

- **Exports are recovering slowly**
- **High but falling unemployment**
- **Latvia is on its way into the euro zone**

Continued healthy domestic demand is sustaining the Baltic economies as exports recuperate only slowly after their sharp deceleration since early 2011. GDP growth in Estonia, the most export-sensitive of the three countries, will strengthen from 3.1 per cent this year to 3.3 per cent in 2013. Lithuania's GDP will increase by 3.5 and 4.0 per cent, respectively, during the same years. Latvia, previously the hardest hit by the financial and economic crisis, has so far been the most resilient to the global slowdown; we expect growth of 5.3 per cent this year, followed by a small dip to 3.8 per cent in 2013. The forecasts for Estonia and Latvia have been raised after unexpectedly strong growth in the third quarter of 2012. **During 2014, all three Baltic countries will achieve growth around their potential of some 4 per cent** (4.5 per cent in Latvia). Our GDP forecasts are above consensus, as they were earlier this autumn.

Inflation will remain low in Latvia and relatively low in Lithuania, but will get stuck at a high 4 per cent in Estonia, where the impact of wages and later money supply will be larger. Current account deficits will become relatively high in Latvia (4.5 per cent of GDP in 2014) and Lithuania (6 per cent), but we foresee no threats to financing or economic stability. Estonia and Latvia will continue to show small public budget deficits in 2013: some 0.5 and 1.5 per cent of GDP, respectively. In Lithuania, the budget deficit will grow from just above 3.0 per cent to 3.5 per cent of GDP. **Only Latvia, which is aiming at euro zone accession in 2014, is continuing to tighten fiscal policy slightly**. Lithuania's austerity policies will probably be scrapped as a consequence of the change of government after the late October parliamentary election. A leftist-led coalition will replace the previous centre-right government. Another effect of the election outcome will be that the question of euro adoption will not be a priority; in our judgement, the previous government's 2014 target date was over-ambitious.

Growing private consumption and capital spending in the Baltics have softened the impact of the shift from an export boom to tepid export growth. Capital spending will continue to benefit from increased construction (although Lithuania has performed sluggishly so far) as well as the use of EU funds for infrastructure projects. But in the near term, capital spending in the region will be hampered by the euro zone crisis, which is affecting foreign-based market players in particular. Consumption will be fuelled by higher real income and **gradual labour market improvements**. Lithuania, Estonia and Latvia showed the largest drop in unemployment in the EU between September 2011 and September 2012, when the jobless rate actually rose in 20 of 27 countries. But unemployment is still high, at 12.9, 10 and 15.9 per cent, respectively. We predict a continued gradual decline in 2013-2014, but only Estonia will show levels below 10 per cent (9 per cent in 2014).

Export growth will remain relatively weak due to lethargic global demand. Because of good competitiveness after earlier internal devaluations, incursions into new markets and robust Russian demand, exports will nevertheless slowly strengthen. Competitiveness will remain good – with certain warning signs in Estonia, with its high pay growth (6 per cent year-on-year in the first half of 2012, climbing towards 7-8 per cent for 2013 as a whole) and inflation.

Growing signs that Latvia will adopt the euro 2014

There are more and more indications that Latvia will meet the quantitative Maastricht criteria in next spring's evaluation of its euro zone application by the EU and ECB. Latvia can thus adopt the euro in 2014 as planned. We believe it will **fulfil the criteria by ample margins, although its inflation margin may be close**; Latvia would have qualified based on annual average EU figures for September 2012-September 2011. But this spring, Latvia must also get EU/ECB certification that its **downshift in inflation and budget deficit is lasting**. This is a more qualitative assessment. For a long time, the European Commission was cautious in commenting on Latvia's chances, but on October 19 Olli Rehn, Commissioner for Economic and Monetary Affairs, suddenly provided a clear positive signal: *"Latvia has pretty good prospects of joining the euro if it maintains momentum and I would encourage Latvia to meet all the conditions,"* he told Reuters.

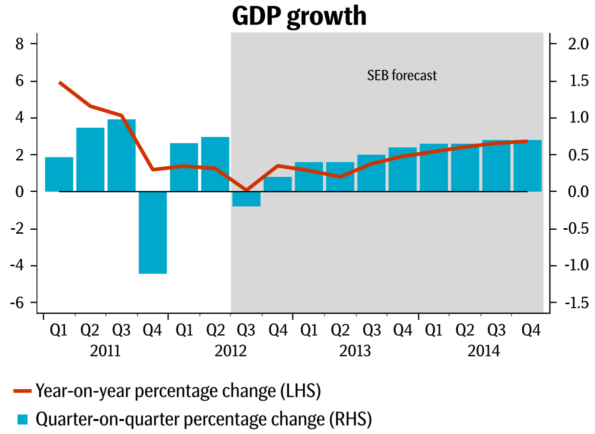
According to our analysis, approval of Latvia's euro zone application in the coming months is also one way for the EU and ECB to **show that the euro zone process is still alive** and that new members can be handled despite the severe crisis in countries like Greece and Spain. It is also worth noting that financial turbulence related to the current euro zone crisis countries had already begun to emerge at the time Estonia was being evaluated in the spring of 2010 and received approval to join the euro zone in 2011. One qualification is that Estonia was able to show a clearly more stable historical trend in its public finances than Latvia. Another factor indicating that Latvia will be admitted to the euro zone is that **convergence towards future euro zone accession was an important aim of the IMF/EU-led international bail-out loan programme** during December 2008 - December 2011.

Faltering exports testing the resilience of the economy

- **The Swedish economy is stagnating**
- **CPI inflation will drop below zero**
- **Riksbank will lower key rate to 0.75 per cent**
- **Expansionary fiscal policy despite deficits**

Earlier signals of Swedish resilience have now completely been reversed. Growth will clearly be very weak in the near future. **GDP will increase by 0.7 per cent in 2012** as a whole, implying stagnation in the second half. The resilience of the economy is now being severely tested by falling exports, rising unemployment and risks of price declines in the housing market. But we still believe that a recession can be avoided and that growth will keep pace with the stronger countries in northern Europe, sustained among other things by expansionary fiscal policy. We predict **1.3 per cent growth in 2013 and 2.5 per cent in 2014**. Our forecasts for 2012 and 2013 have been revised downward compared to the August issue of *Nordic Outlook*.

GDP growth



Source: Statistics Sweden, SEB

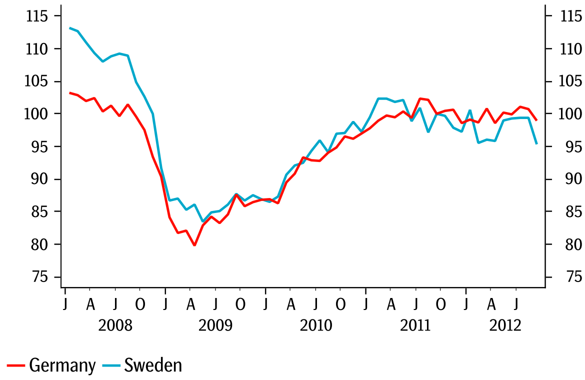
Falling merchandise exports in second half

Economic indicators for the manufacturing sector have rapidly weakened in recent months and are now at their lowest levels since spring 2009. A deceleration in German manufacturing, combined with weakening trends in many emerging markets, is hampering exports. On the other hand, decent growth in other Nordic countries is providing support, especially because of the strong expansion in Norway, which is now Sweden's most important export market.

Signals of a slightly stronger manufacturing trend in the US and China will gradually also provide support to export demand in Sweden and Germany in the next few months. The correlation between Swedish and German exports and industrial output has been very strong for a long time, despite rather large variations in exchange rates. We believe that this strong association will persist and expect **Swedish merchandise and service exports** to be largely unchanged in 2012, **then rise by nearly 3 per cent in 2013 and more than 4 per cent in 2014**. Still, the recent steep decline in export volume and sentiment indicators implies that the risks in 2013 are on the downside.

Industrial production

Index 100 = 2011



Source: Statistics Sweden

Rising consumption, despite uncertainty

Household optimism has fallen since the summer as the downturn in manufacturing and construction has affected the labour market, but consumption is being sustained by rising income. Because of surprisingly low inflation, due among other things to falling petrol prices, we have adjusted our real income forecast upward. A sharp downturn in mortgage interest rates, driven by a lower repo rate and lower interbank rates as well as by falling risk spreads for mortgage bonds, will also encourage consumption. We are thus sticking to our forecast of continued household consumption growth, though at a slower pace.

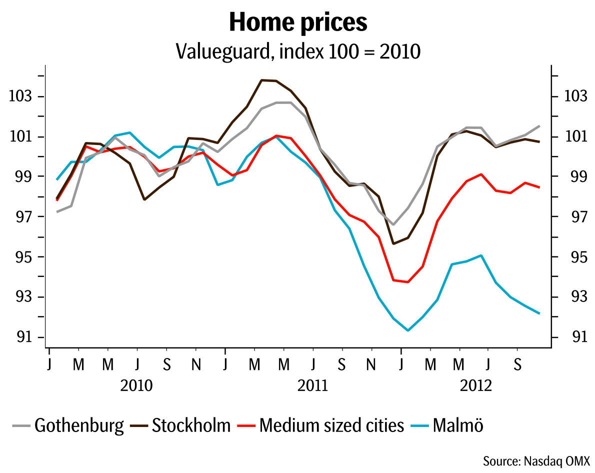
Household income and consumption

Year-on-year percentage growth

	2011	2012	2013	2014
Consumption	2.1	1.5	2.0	2.3
Income	3.0	2.8	2.6	2.8
Savings ratio, % of disp. income	9.3	10.3	10.9	11.3

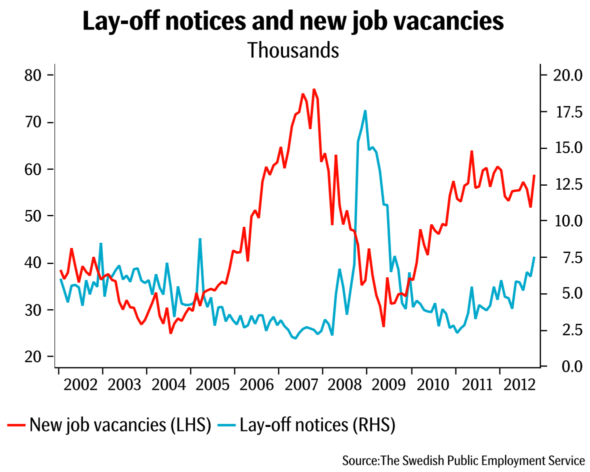
Source: Statistics Sweden, SEB

Housing market indicators continue to be stable, although there are major regional differences. In particular, prices are now falling in southern Sweden, influenced in part by weak economic performance in Denmark. **Falling home prices remain the biggest risk to the domestic economy**, but unexpectedly good resilience in prices during the past year shows that the long period of very low residential construction is an important stabilising factor for home prices.



Unemployment up earlier than expected

The number of lay-off notices has gradually risen since early 2011 and is now at about the same level as during the 2003-2004 slowdown, but is far from the levels reached during the lay-off wave triggered by the 2008-2009 crisis. Indications from company quarterly reports and other sources point towards a **continued increase in lay-offs later this year**.



The economic slowdown is one reason why **unemployment has begun to climb** somewhat earlier than we predicted in our August forecast. So far, **the upturn in unemployment has been driven by a strong increase in the labour force, while job creation has actually also been marginally stronger** than expected. Indicators are showing that employment will soon level out. Weak GDP growth signals a slight decline in 2013. We are still predicting that unemployment will climb a bit above 8 per cent next year, but there is a risk that the upturn will be even larger.

Labour market

Year-on-year percentage change

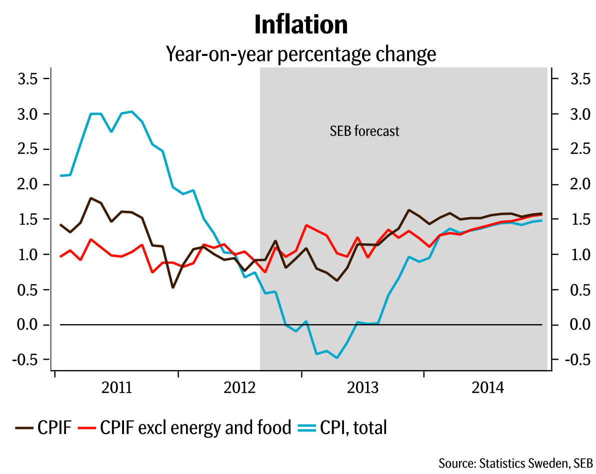
	2011	2012	2013	2014
Employment	2.1	0.6	0.0	0.2
Labour supply	1.2	0.7	0.6	0.2
Unemployment, %	7.5	7.6	8.2	8.2
Average hours worked	0.2	-0.2	-0.1	0.1
Productivity, GDP	1.6	0.5	1.4	2.4

Source: Statistics Sweden, SEB

The weakening of the labour market also means that resource utilisation has fallen significantly. Both our own indicator and the Riksbank's continued to fall in the third quarter. Their level is now on a par with the lows during the 2003-2004 slowdown and not especially far from their record decline in 2009. There is thus no doubt that unemployment today is well above its equilibrium level.

Pay negotiations approaching

Pay negotiations for about 2.5 million employees are now about to begin. Major industrial collective agreements expire late in March 2013, which means that negotiations will enter their most intensive phase during January and February. Ever-shorter contract periods are an indication of rising tensions between the two sides. Various groups, especially in the public sector, have signalled dissatisfaction with prevailing pay levels and great readiness for labour disputes, but negotiations will take place in an environment of growing unemployment and major concerns about the future. We thus expect contractual pay increases of only slightly above 2 per cent and **total increases of just above 3 per cent**, that is, a bit lower than in the preceding contract period. Due to the uncertain economic situation, agreements are likely to run for only one year.



CPI will fall below zero

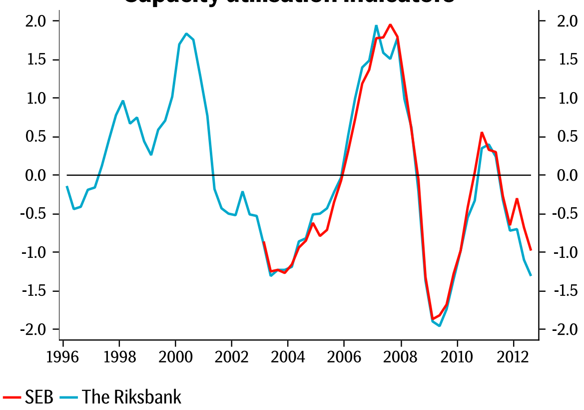
Inflation pressure remains low. In recent months, core inflation (CPIF excluding energy and food) has been less than 1 per cent, which is lower than expected. Because of pay increases and the fading effects of earlier krona appreciation, core inflation will climb slightly in 2013 and 2014. A rapid downturn in petrol prices is helping keep down CPIF inflation, which will stay around 1 per cent during most of 2013. CPI inflation is also affected by falling mortgage rates, which will cause it to fall to as low as -0.5 per cent in the first half of 2013.

Riksbank will cut repo rate to 0.75 per cent

In its October *Monetary Policy Report*, the Riksbank adjusted its key interest rate path slightly downward in line with our expectations. Since then, weak economic indicators combined with falling resource utilisation have further increased the likelihood of a **December interest rate cut to 1.00 per cent,** which we expect. We also expect the combination of low inflation and rising unemployment to persuade the Riksbank to **cut the repo rate one more time early in 2013 to 0.75 per cent**. Our main forecast is that the second cut will come in February, but there is some likelihood that the bank will wait until April. After that, we foresee an unchanged key interest rate during the rest of our forecast period.

Despite disagreement among Executive Board members, the Riksbank's October report took another step towards explicitly taking rising household debt into account. The report declared that stabilisation of the ratio of debt to disposable income is essential to continued interest rate cuts. We believe that lending growth will slow somewhat from today's 4.5 per cent and will thus not prevent continued rate cuts. Stefan Ingves' statement to Parliament that a conceivable debt ceiling might be 200 per cent of income came as a surprise. Such a high level could be compatible with a fairly rapid debt build-up for some years to come. Our conclusion is that the Riksbank governor probably cited this figure spontaneously as a conceivable example in response to a direct question, and that the Riksbank has no plans to formalise this.

Capacity utilisation indicators



Source: The Riksbank, SEB

Renewed krona appreciation early in 2013

This past summer's krona appreciation, especially against the euro, was corrected in September and October. The most important reasons are the ECB's OMT programme, which strengthened the euro against most currencies, and a sharp deceleration in the Swedish economy. This has helped fuel worries, especially among foreign investors, that in keeping with historical patterns the krona will weaken when the global economy slows. Increased expectations of interest rate cuts by the Riksbank, among other things because of unexpectedly low inflation figures, have also pushed down the krona.

Yet we are sticking to our view that, to a greater extent than before, new driving forces will make it possible to regard the krona as a safe haven amid mounting global risk aversion. We also believe that given today's positioning of the investor community, **the potential for further krona depreciation is small**. Domestic investors are under-weighted in the krona in a historical perspective due to unusually low currency hedging and large foreign currency account balances. We expect Swedish exporters and institutions to regard the prevailing slightly weaker krona as an argument for increasing their degree of currency hedging, though they will probably wait until the business cycle shows signs of stabilisation or improvement. Overall, we believe that the EUR/SEK will trade towards 8.75 at year-end when the RIksbank will cut the repo rate in December at the same time as the euro temporary strengthens. Assuming better global economic conditions and rising risk appetite, we expect the **EUR/SEK rate to stand at 8.30 at the end of both 2013 and 2014**. The USD/SEK rate will be 6.80 at the end of 2013 and 7.22 at the end of 2014.

Further stimulus despite weaker finances

Swedish public finances are now deteriorating as the economy slows. In October, for example, the National Debt Office adjusted its forecast of the 2013 and 2014 budget deficits upward. We expect a **central government budget deficit of SEK 48 billion in 2014** (1.3 per cent of GDP). This is more than SEK 80 billion weaker than the government's forecast. Nearly half the difference is due to divergent assumptions about fiscal policy and privatisation revenue. But divergent assumptions about economic performance and GDP growth are behind most of the difference in public sector financial forecasts.

In the autumn budget bill for 2013, the government abandoned its cautious fiscal strategy and committed itself to stimulus measures equivalent to SEK 23 billion (0.7 per cent of GDP). We expect **the 2014 budget to contain fiscal expansion of equivalent size**. Due to weaker public finances, however, such a policy will cause the cyclically adjusted balance (which determines the room for reforms) to show negative figures for a number of years. The opposition can thus intensify its arguments to the effect that Finance Minister Anders Borg has given up on the official surplus target. This would force the finance minister to use new types of reasoning to defend the government's new stimulus measures.

Public finances
Per cent of BNP

	2011	2012	2013	2014
Net lending	0.1	-0.4	-0.8	-0.9
Gen. gov't gross debt	38.3	38.1	38.2	38.1
Central gov't debt	33.1	33.2	33.5	33.5
Borrowing req., SEK bn	-68	29	39	48

Source: Statistics Sweden, SEB

As earlier, we believe that **an expansionary budget is entirely consistent with established stabilisation policy principles**. The economic slowdown has proved deeper than expected, and resource utilisation is well below normal. The labour market outlook now appears so much worse than before that a passive policy is indefensible. The deficits we are forecasting are rather small and roughly in line with those that arose during the 2001-2004 slowdown. Sweden's public finances are also very strong in an international comparison. We expect **central government debt to remain at a low level, around 33 per cent of GDP at the end of our forecast period**. An expansionary fiscal policy is also entirely in line with recommendations by the IMF, OECD and other bodies about the allocation of international responsibility in a situation where many countries are forced to pursue dramatic belt-tightening. The pedagogical problems facing the Finance Ministry are instead a result of the political success of its earlier strict interpretation of the fiscal policy framework, which thus became a fixture of Swedish political discourse.

Domestic weakness lingers, fiscal policy supportive

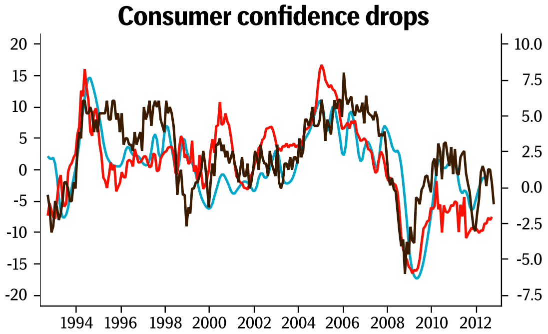
- **Households continue facing headwinds**
- **Fiscal policy turning increasingly supportive**
- **Current account surplus sets new record**
- **Central bank supports krone marginally**

The first half of 2012 saw zero growth, with a positive first quarter being offset by a negative second quarter. We expect growth of 0.5 per cent in 2012 as a whole as public consumption rises in the second half of the year. **Growth** is set to gradually recover to **1.4 per cent in 2013 and 1.7 per cent in 2014** as the global backdrop improves. These GDP estimates are unchanged from the last *Nordic Outlook*. We expect inflation to reach 2.4 per cent in 2012, dropping to 1.6 per cent in both 2013 and 2014. The recovery is weak as households continue to deleverage on the back of the housing bust.

Domestic economy under pressure

The cyclical pressure on consumers also continues. Pay negotiations are **entrenching negative real wages**, while unemployment has risen. Home prices have stabilised, but with mortgage institutions raising fees and restricting access to loans with variable rates and no amortisation it is most likely that home prices will continue declining. After recovering in early 2012 to a neutral level, consumer confidence has dropped again. Despite this retail sales have recovered, which could be related to a one-off transfer from an early retirement scheme.

Consumer confidence drops



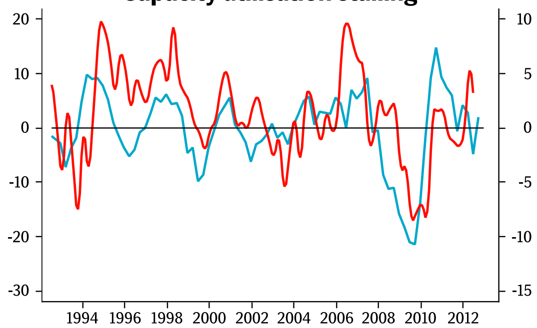
— Consumer confidence (LHS)
— Retail sales, year-on-year % change (3 month average) (RHS)
— Private consumption, year-on-year % change (RHS)

Source: Statistics Denmark

Corporate capital spending started the year strongly but reversed in the second quarter. Business surveys suggest that companies are still in a wait-and-see mode as uncertainty about the global recovery lingers, while muted growth has resulted in stalled capacity utilisation rates. Meanwhile, housing investments are drifting lower.

On the other hand, public consumption rose in the first half of the year as the austerity of 2011 was reversed. We expect public spending to pick up further in the second half of the year (although it will continue to lag budgets). **The budget for 2013 is estimated to be marginally growth positive.**

Capacity utilisation stalling



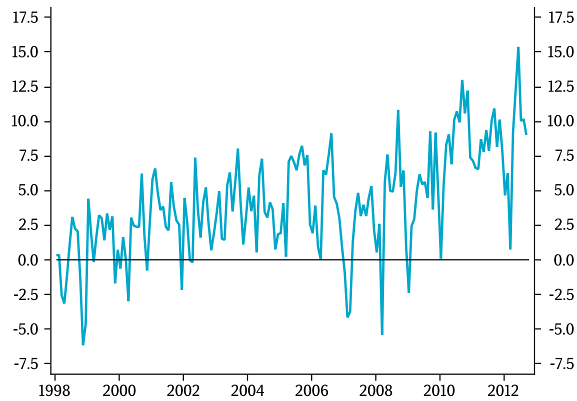
— Non-residential investments, year-year (LHS)
— Capacity utilisation, year-year (RHS)

Source: Statistics Denmark

External demand surprisingly strong

The current account surplus set a record in June and has since remained at an elevated level. Exports held up surprisingly well in light of the global economic slowdown before taking a hit in September. The weakening of the trade-weighted krone due to its peg to the euro is a positive factor.

Current account in new record



Source: Statistics Denmark

Despite the large external surplus, the krone has weakened against the euro. The central bank's unilateral interest rate cuts in May and June and subsequent lowering of the deposit rate to negative territory in August thus seem to have had a large effect. The central bank has purchased kroner over the last two months to counter this trend. However, the size of interventions has been limited and therefore **the second line of defence in the shape of a unilateral interest rate hike does not seem imminent**.

Markedly slower growth should prove transitory

- **Momentum downshifted in the summer**
- **Norges Bank to lift key rate by mid-2013**

Momentum in the economy has downshifted quite a bit after very strong growth in the first half of 2012. The third quarter thus saw stagnating private consumption of goods and, according to foreign trade statistics, declining merchandise exports both overall and excluding oil and gas. On the supply side of the equation, oil and gas extraction plunged in the third quarter as did electricity production. Finally, employment stalled between the second and the third quarter, ending a period of continuous gains.

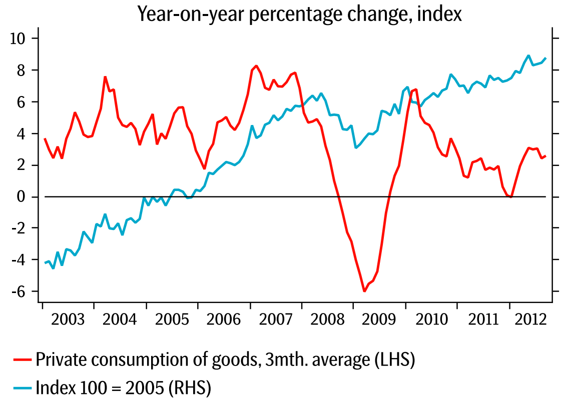
Part of this **weakness should prove transitory**, though the peak in terms of the maximum rate of acceleration has been passed for now. Relative to the August issue of *Nordic Outlook*, we are shaving our forecasts only marginally, expecting **overall GDP to expand by 3.4 per cent in 2012 and 2.6 per cent in 2013**, while **mainland GDP** – excluding oil, gas and shipping – **should be up 3.4 per cent and 3.1 per cent**, respectively.

Fundamentals support solid consumption

Private consumption has moderated since the first half, as seen in the monthly indicator for goods consumption. Here, the level was unchanged from the second to the third quarter, the weakest quarterly outcome since the start of 2010.

Rising consumption trend remains intact

Year-on-year percentage change, index



Source: Statistics Norway

However, the stall in average spending on goods for the quarter was all about a drop in June, and **the solid 1.1 per cent gain over the three months to September is more indicative of the underlying trend**. Fundamentals thus remain favourable on balance. Household income is very solid and continued to run stronger than consumption during the summer on healthy nominal wage growth and lower overall inflation. Growth in private consumption should be **3.5 per cent in 2012 and moderate slightly to 3.3 per cent in 2013**.

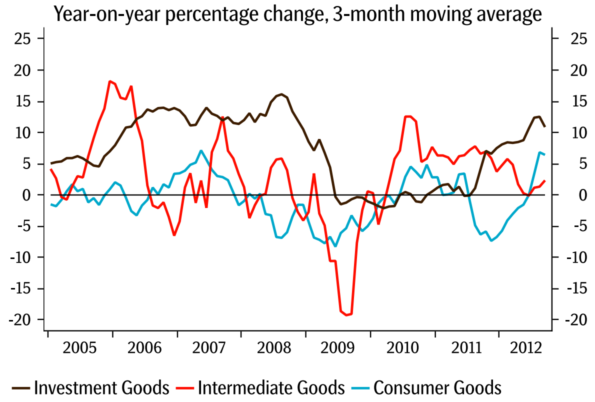
The labour market is not as strong as before. The Labour Force Survey (LFS) unemployment rate ticked up a notch to 3.1 per cent on average in the third quarter, which is low by any standard. However, while employment was still up a solid 1.6 per cent year-on-year, the 0.1 per cent decline from the second quarter marked the first sequential decline since the end of 2009. This weakness might resemble slower momentum in the economy, but it is worth noting that the latest report from Norges Bank's regional network saw respondents in all sectors expecting ongoing job growth, though at a slightly slower pace.

Manufacturing to slow in the near term

Industrial production showed a sharp sequential drop in the third quarter as oil and gas extraction plunged, hit by a strike at mid-year and then by maintenance stoppages, as did electricity production (weather-related after a surge in the first half). Output in the petroleum sector should recover in the near term.

Manufacturing has been surprisingly firm

Year-on-year percentage change, 3-month moving average



Source: Statistics Norway

In contrast, manufacturing output – i.e. excluding energy – has on balance been surprisingly firm since spring. Despite some payback in September, the 1.8 per cent gain from the second to the third quarter was the strongest on any quarter since spring 2008. Leading the upturn were investment goods, up 10.9 per cent for the quarter from the year-earlier period and fuelled by the very strong investment cycle in the petroleum sector which has lifted production of machinery, ships and oil platforms to record-high levels. More surprising was the upturn in the more export-oriented intermediate goods sector from a decline in the second quarter to show a sequential gain in the third.

Surveys suggest a **moderation in manufacturing**, however. The manufacturing sentiment indicator thus dropped five points to a below-average net balance of 1.2 in the third quarter, the weakest since late 2009, as a slight decline in the order stock caused an increase in inventories. Production expectations slipped as well. In addition, the PMI (not a very good predicator) eased slightly to 48.7 in October. Surveys have not been consistent, though. Manufacturers in Norges Bank's regional network thus remained more upbeat in the October report, expecting healthy growth in output over the winter.

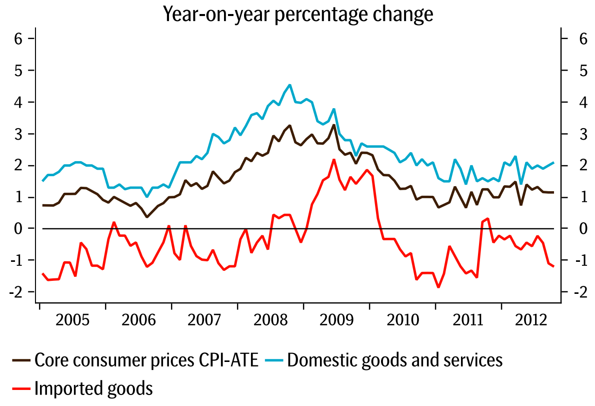
Meanwhile, construction activity should continue to run strong. In particular, approved housing starts in the third quarter were the highest for any three-month period since early 2007 and 24 per cent higher than a year earlier. The cycle has further to run, reflecting a persistent supply-demand imbalance due to strong population growth and under-supply in recent years.

Domestic inflation slowly rising

Core CPI inflation has moved nowhere over the past year: the 1.1 per cent year-on-year rate in October on the CPI-ATE measure – excluding taxes and energy – was thus marginally below the average rate over the previous 12 months. Overall inflation has been even lower but shifted markedly upward from 0.5 to 1.1 per cent in the year to October, spurred by a 15 per cent jump on the month for electricity prices (though still declining on a year-ago basis).

Stable core inflation masks a split

Year-on-year percentage change



Source: Statistics Norway, SEB

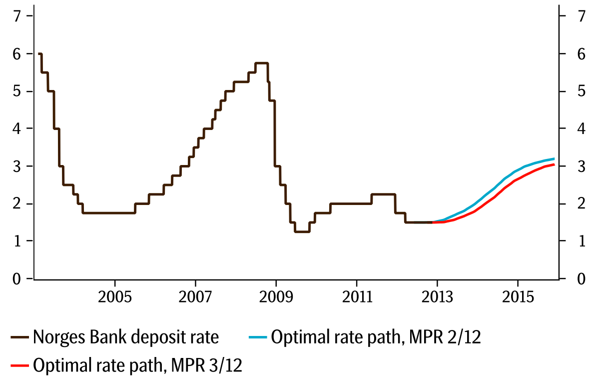
Broadly stable core inflation over the past year hides a split. Imported deflation has intensified as prices for imported goods (almost 30 per cent of the core CPI basket) were 1.2 per cent lower in October than a year earlier. Meanwhile, **core domestic inflation has trended higher**: from 1.5 per cent on average in the final quarter of 2011 to 2.1 per cent in October, on our calculation. This fits with rather healthy domestic demand for a period of time and continuing cost pressure. Here, the acceleration has been led by services while the trend for domestically produced consumer goods has actually been softer recently than in the first half of 2012. More puzzling is the trend in rents, i.e. actual rents paid by tenants and imputed rents for homeowners. Intuitively, one would expect some effect from a red-hot housing market and the relentless home price increase of the past 3-4 years, and anecdotal evidence suggests as much. However, while rent inflation as measured in the CPI has picked up slightly recently, the 1.8 per cent year-on-year rate in October was still only slightly more than half the pace of late 2010.

Norges Bank still walking the tightrope

Norges Bank's end-October monetary policy meeting and new *Monetary Policy Report* broke no new ground in terms of guiding policy going forward. The optimal rate path was revised slightly lower but **a key interest rate hike before mid-2013 remains more likely than not**, with a 64 per cent probability of a move by next June while fully factoring in a 25 basis point hike by September 2013. Although the rate path was lowered some 25 bps further out, it still implies a deposit rate of 2.00 per cent at the end of 2013, 2.75 per cent by the end of 2014 and 3-3.25 per cent at the end of 2015. Hence, the deposit rate will remain well below "normal" over the forecast horizon.

Norges Bank to start hiking mid-2003

Per cent



Source: Norges Bank, SEB

The somewhat lower rate path was all about a stronger-than-assumed exchange rate and even lower global interest rate expectations. Norges Bank thus noted that "very low interest rates abroad are limiting how quickly the key policy rate in Norway should be raised." (Put differently, apart from still-low inflation, domestic factors warrant higher rates already.) However, in a subtle shift, the bank acknowledged that at least part of recent currency appreciation was due to factors outside its control – i.e. very strong fundamentals (relative growth and the twin surpluses of the fiscal and current account balances) and diversification flows.

The bank is also giving more weight to avoiding financial instability. Thus a long period of low interest rates "can induce households and businesses to take excessive risk and accumulate excessive debt", with potential repercussion on the economy.

Norges Bank is still dependent on peer central banks and their key rates. As such, we recognise the risk that the bank may keep deferring its first rate hike. However, we are making only small changes to the forecast, expecting a first 25 bps hike next May (instead of March) while still foreseeing the **deposit rate ending 2013 at 2.25 per cent and at 3.00 per cent by the close of 2014**. The earlier start of the hiking cycle than among peers should see EUR/NOK moving to 7.00 by the end of 2013 and staying at that level also 2014.

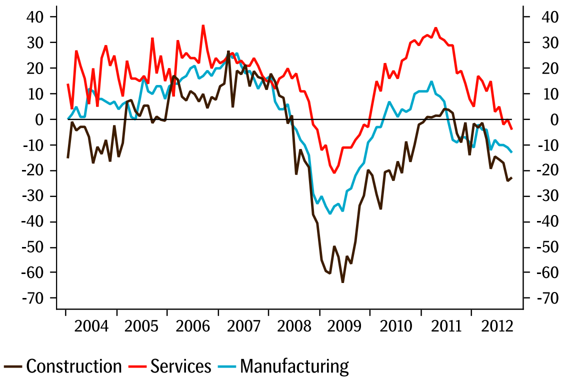
Cyclical sectors are hampering economic growth

- **Zero growth in the second half of 2012**
- **Falling inflation will sustain real income**
- **Continued confidence in sovereign bonds**

After a decent start early in 2012, GDP fell 1.1 per cent in the second quarter compared to the first. GDP growth in the second half looks set to end up around zero as dwindling international demand hampers exports, while consumption and capital spending are being held back by a continued uncertain economic outlook. **In 2012 as a whole, GDP growth will be only 0.2 per cent**. Then it will improve a bit to 0.8 per cent in 2013 and 2.0 per cent in 2014. Despite low rates of increase, household consumption and capital spending will be the main drivers of economic growth over the next couple of years.

Indicators have deteriorated

Net balance



Source: DG ECFIN

Indicators point to weak near-term growth, especially in manufacturing and construction, but the service sector is also slowing. Export volume fell in the second quarter, and preliminary figures indicate a continued downturn in the third quarter. The export decline is being softened by a still-expansive Russian economy (Finland's third largest export market), while the cool-off in the two biggest markets – Sweden and Germany – is noticeable. Because the Finnish economy is dependent on machinery, electronics and forest products, its large cyclical exposure is noticeable in the current environment of falling global demand. **Overall, we expect zero growth in exports during 2012, followed by modest increases: 3.7 per cent in 2013 and 5.8 per cent in 2014.**

In a structural perspective, the downturn in the information and communications technology (ICT) sector has been striking. As a share of GDP, exports have fallen from nearly 50 per cent to less than 40 per cent, contributing to a rapid decline in the country's previously large current account surplus. The current account will weaken further, among other things due to unfavourable terms of trade as export prices fall while import prices of commodities are unchanged or higher. But generally, Finland's competitiveness is good. Since 2008 the real effective exchange rate has weakened by about 10 per cent.

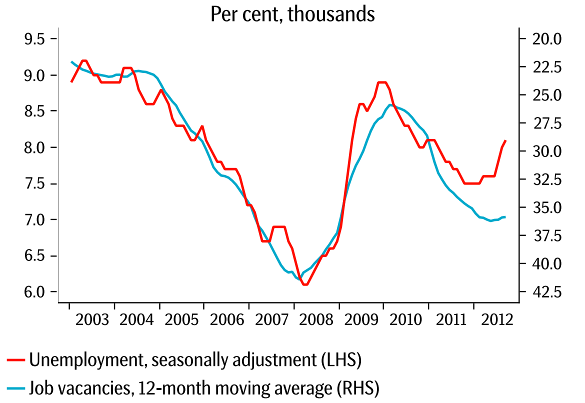
Capital spending fell during the second quarter, but continued relatively high capacity utilisation and expanded bank lending to companies and individuals point to a **modest upturn in fixed investment ahead**. We expect capital spending to increase by 2.0 per cent in 2013 and 3.5 per cent in 2014.

Consumer confidence has stabilised at positive levels. Changes in the taxation of car sales contributed to a temporary drop in consumption during the second quarter. A weaker labour market and a temporary inflation spike (HICP 3.4 per cent in September, CPI is lower at 2.6 per cent in October) are squeezing households, but inflation (HICP) will fall to 2.3 per cent in 2013 and 2.1 per cent in 2014, contributing to higher real income. Home prices have not increased as much as in countries like Sweden and Norway, reducing the risk of a sharp correction. Overall, we predict that **household consumption will increase by 1.0 per cent in 2013 and 2.0 per cent in 2014**.

The labour market, after showing resilience, has now begun to weaken. There are fewer job vacancies. In recent months, unemployment has climbed from 7.5 per cent to 8.1 per cent. We estimate that **unemployment will continue climbing and will average 8.3 per cent in 2013 and 2014**.

Unemployment is rising

Per cent, thousands



Source: Statistics Finland

Tight fiscal policy is helping to restrain demand. This year's budget deficit will end up at 0.8 per cent of GDP. In 2013 it will increase to 1 per cent due to weak economic performance. This deterioration is small, however, and will not affect market confidence in the country; despite euro zone worries, Finland's sovereign debt is still AAA-rated, and we expect the yield spread of about 30 basis points above Germany to persist.

Economic data

DENMARK

Yearly change in per cent

	2011 level, DKK bn	2011	2012	2013	2014
Gross domestic product	1,783	0.8	0.5	1.4	1.7
Private consumption	865	-0.8	0.5	1.0	1.5
Public consumption	510	-1.3	0.5	0.8	0.8
Gross fixed investment	308	0.2	2.0	2.0	4.0
Stockbuilding (change as % of GDP)		0.3	-0.1	0.0	0.0
Exports	959	7.0	2.0	2.8	3.2
Imports	863	5.2	2.5	2.5	3.5
Unemployment (%)		4.1	4.9	5.0	4.6
Consumer prices, harmonised		2.8	2.4	1.6	1.6
Hourly wage increases		1.7	1.5	1.5	2.0
Current account, % of GDP		6.7	7.0	7.5	7.0
Public sector financial balance, % of GDP		-1.8	-3.0	-1.5	-0.5
Public sector debt, % of GDP		46.5	48.0	48.0	47.0

FINANCIAL FORECASTS	Nov 15th	Dec 12	Jun 13	Dec 13	Jun 14	Dec 14
Lending rate	0.20	0.20	0.20	0.20	0.20	0.20
10-year bond yield	1.24	1.40	1.60	1.70	1.90	2.10
10-year spread to Germany, bp	-10	-10	-10	-10	-10	-10
USD/DKK	5.83	5.78	5.87	6.11	6.31	6.48
EUR/DKK	7.46	7.45	7.45	7.45	7.45	7.45

NORWAY

Yearly change in per cent

	2011 level, NOK bn	2011	2012	2013	2014
Gross domestic product	2,407	1.4	3.4	2.6	2.2
Gross domestic product (Mainland Norway)	1,957	2.4	3.4	3.1	2.9
Private consumption	1,091	2.4	3.5	3.3	3.1
Public consumption	548	1.5	1.8	2.5	2.2
Gross fixed investment	520	6.4	6.9	5.5	4.4
Stockbuilding (change as % of GDP)		0.3	-0.3	0.0	0.0
Exports	932	-1.4	1.9	1.8	1.7
Imports	751	3.5	1.6	4.3	4.3
Unemployment (%)		3.3	3.1	3.2	3.2
Consumer prices		1.3	0.7	1.6	2.0
CPI-ATE		1.0	1.2	1.4	1.9
Annual wage increases		4.2	4.3	4.1	4.4

FINANCIAL FORECASTS	Nov 15th	Dec 12	Jun 13	Dec 13	Jun 14	Dec 14
Deposit rate	1.50	1.50	1.75	2.25	2.50	3.00
10-year bond yield	1.97	2.10	2.45	2.55	2.85	3.10
10-year spread to Germany, bp	63	60	75	75	85	90
USD/NOK	5.75	5.66	5.59	5.74	5.93	6.09
EUR/NOK	7.35	7.30	7.10	7.00	7.00	7.00

SWEDEN

Yearly change in per cent

	2011 level, SEK bn	2011	2012	2013	2014
Gross domestic product	3,503	3.9	0.7	1.3	2.5
Gross domestic product, working day adjusted		3.9	1.0	1.3	2.6
Private consumption	1,673	2.1	1.5	2.0	2.3
Public consumption	926	1.7	0.9	0.8	0.8
Gross fixed investment	646	6.7	2.0	2.5	3.0
Stockbuilding (change as % of GDP)	40	0.5	-0.7	-0.2	0.1
Exports	1,748	7.1	0.0	2.0	4.3
Imports	1,532	6.3	-0.2	2.6	3.7
Unemployment (%)		7.5	7.6	8.2	8.2
Employment		2.1	0.6	0.0	0.2
Industrial production		6.8	-2.5	1.5	3.5
Consumer prices		3.0	0.9	0.1	1.4
CPIF		1.4	1.0	1.1	1.5
Hourly wage increases		2.6	3.3	3.1	3.1
Household savings ratio (%)		9.3	10.3	10.9	11.3
Real disposable income		3.0	2.8	2.6	2.8
Trade balance, % of GDP		2.6	2.3	2.2	2.5
Current account, % of GDP		7.0	6.9	6.3	6.4
Central government borrowing, SEK bn		-68	29	39	48
Public sector financial balance, % of GDP		0.1	-0.4	-0.8	-0.9
Public sector debt, % of GDP		38.3	38.1	38.2	38.1

FINANCIAL FORECASTS	Nov 15th	Dec 12	Jun 13	Dec 13	Jun 14	Dec 14
Repo rate	1.25	1.00	0.75	0.75	0.75	0.75
3-month interest rate, STIBOR	1.45	1.30	1.10	1.10	1.10	1.10
10-year bond yield	1.43	1.50	1.70	1.80	2.10	2.40
10-year spread to Germany, bp	9	0	0	0	10	20
USD/SEK	6.75	6.78	6.61	6.80	7.03	7.22
EUR/SEK	8.64	8.75	8.40	8.30	8.30	8.30
TCW	119.2	120.4	115.9	115.4	116.4	116.9

FINLAND

Yearly change in per cent

	2011 level, EUR bn	2011	2012	2013	2014
Gross domestic product	187	2.7	0.2	0.8	2.0
Private consumption	105	2.4	1.0	1.0	2.0
Public consumption	46	0.4	0.2	0.0	0.2
Gross fixed investment	37	6.8	0.7	2.0	3.5
Stockbuilding (change as % of GDP)		1.2	0.0	0.0	0.0
Exports	77	2.0	0.5	3.3	5.8
Imports	78	5.0	1.7	4.0	6.0
Unemployment (%)		7.8	7.8	8.3	8.3
Consumer prices, harmonised		3.3	3.2	2.3	2.1
Hourly wage increases		2.4	2.9	3.0	3.0
Current account, % of GDP		-1.6	-1.3	-1.2	-1.0
Public sector financial balance, % of GDP		-0.6	-0.8	-1.0	-0.8
Public sector debt, % of GDP		49.0	47.6	45.0	44.0

EURO ZONE

Yearly change in per cent

	2011 level, EUR bn	2011	2012	2013	2014
Gross domestic product	8,598	1.4	-0.4	-0.2	0.8
Private consumption	4,855	0.1	-1.1	-0.7	0.5
Public consumption	1,837	-0.1	-0.3	-0.4	0.2
Gross fixed investment	1,626	1.6	-3.4	-0.5	2.1
Stockbuilding (change as % of GDP)		0.1	-0.2	0.0	0.0
Exports	3,769	6.4	2.3	3.1	4.1
Imports	3,530	4.2	-0.3	2.4	3.6
Unemployment (%)		10.2	11.4	12.0	12.4
Consumer prices		2.7	2.5	1.5	1.5
Household savings ratio (%)		9.3	9.1	9.2	9.0

US

Yearly change in per cent

	2011 level, USD bn	2011	2012	2013	2014
Gross domestic product	15,321	1.8	2.2	2.4	2.7
Private consumption	10,874	2.5	1.9	2.4	2.4
Public consumption	3,051	-3.1	-1.3	-0.4	-1.0
Gross fixed investment	1991.1	6.6	8.0	6.7	8.8
Stockbuilding (change as % of GDP)		-0.2	0.1	-0.1	0.0
Exports	2,120	6.7	3.5	4.3	5.5
Imports	2,715	4.8	3.0	3.9	5.0
Unemployment (%)		9.0	8.1	8.0	7.4
Consumer prices		3.1	2.1	1.7	1.6
Household savings ratio (%)		4.2	4.0	5.1	5.6

LARGE INDUSTRIAL COUNTRIES

Yearly change in per cent

	2011	2012	2013	2014
GDP				
United Kingdom	0.9	0.0	1.3	1.5
Japan	-0.7	1.7	0.8	1.3
Germany	3.0	0.8	0.6	1.5
France	1.7	0.1	0.2	0.5
Italy	0.4	-2.0	-0.7	0.3
Inflation				
United Kingdom	4.5	2.8	2.1	1.4
Japan	-0.3	0.1	0.3	0.5
Germany	2.5	2.0	1.8	1.7
France	2.7	2.1	1.6	1.4
Italy	2.9	3.2	2.1	1.7
Unemployment (%)				
United Kingdom	8.2	8.2	8.3	8.4
Japan	4.6	4.2	4.4	4.6
Germany	6.0	5.5	5.7	5.7
France	9.6	10.5	11.4	11.5
Italy	8.4	10.6	11.3	11.5

EASTERN EUROPE

	2011	2012	2013	2014
GDP, yearly change in per cent				
Estonia	8.4	3.1	3.3	4.0
Latvia	5.5	5.3	3.8	4.5
Lithuania	5.9	3.5	4.0	4.0
Poland	4.4	2.4	2.7	3.7
Russia	4.3	3.5	3.4	4.0
Ukraine	5.2	0.8	2.0	3.7
Inflation, yearly change in per cent				
Estonia	5.1	4.0	4.3	3.3
Latvia	4.2	2.5	2.1	3.0
Lithuania	4.1	2.5	3.0	3.0
Poland	3.9	3.8	2.8	2.6
Russia	8.5	5.0	5.8	6.0
Ukraine	8.0	2.5	6.0	7.5

FINANCIAL FORECASTS

		Nov 15th	Dec 12	Jun 13	Dec 13	Jun 14	Dec 14
Official interest rates							
US	Fed funds	0.25	0.25	0.25	0.25	0.25	0.25
Japan	Call money rate	0.10	0.10	0.10	0.10	0.10	0.10
Euro zone	Refi rate	0.75	0.75	0.75	0.75	0.75	0.75
United Kingdom	Repo rate	0.50	0.50	0.50	0.50	0.50	0.50
Bond yields							
US	10 years	1.58	1.75	1.95	2.10	2.30	2.50
Japan	10 years	0.73	0.75	1.00	1.10	1.20	1.20
Germany	10 years	1.34	1.50	1.70	1.80	2.00	2.20
United Kingdom	10 years	1.73	1.90	2.10	2.20	2.40	2.60
Exchange rates							
USD/JPY		81	81	84	88	90	94
EUR/USD		1.28	1.29	1.27	1.22	1.18	1.15
EUR/JPY		104	104	107	107	106	108
GBP/USD		1.59	1.58	1.55	1.52	1.51	1.50
EUR/GBP		0.81	0.82	0.82	0.80	0.78	0.77

GLOBAL KEY INDICATORS

Yearly percentage change

	2011	2012	2013	2014
GDP OECD	1.8	1.3	1.6	2.1
GDP world	3.8	3.3	3.8	4.1
CPI OECD	2.5	2.0	1.5	1.4
Export market OECD	5.7	3.1	4.9	6.3
Oil price, Brent (USD/barrel)	112.3	112.0	107.5	110.0

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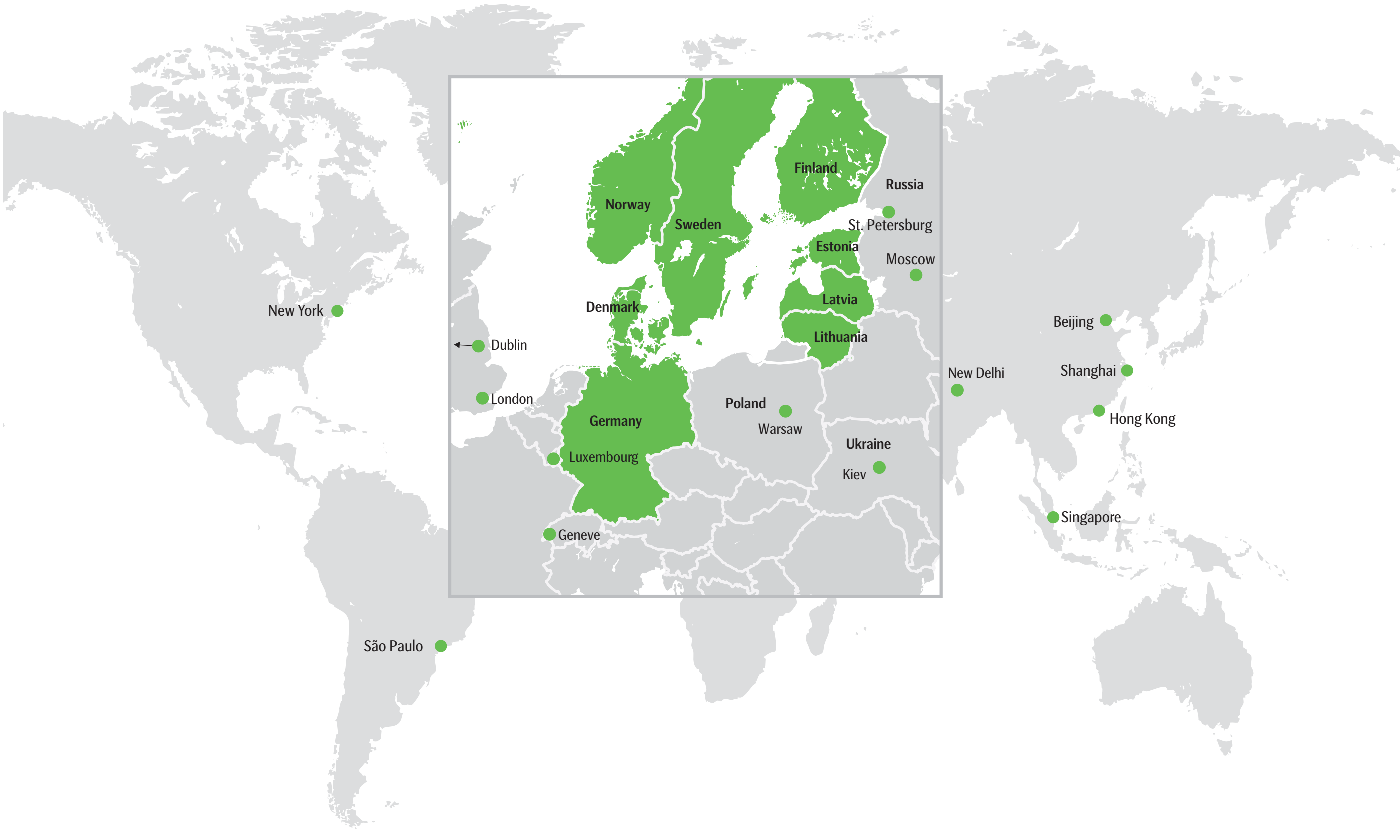

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