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Nordea Economic Outlook

01 / 2016

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Nordea

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"In Germany, companies report 600,000 vacant positions. Most of the refugees will have to improve their qualifications to succeed on the labour market."

Holger Sandte
Nordea chief analyst

“An economic crisis in Emerging Markets – China particularly – is the foremost risk for 2016”

Helge J. Pedersen
Nordea group chief economist

Editorial

We are delighted to present Nordea Economic Outlook in a completely new design, with radical changes to the format. We hope that you will find it more accessible and insightful. At the core, though, are still economic forecasts for our home markets and an overview of the global economy. You will also find articles covering some of the most important themes for the economy and the financial markets.

In this issue of Nordea Economic Outlook you can read about the influx of refugees to the Nordic countries, monetary policy in Norway and Sweden, as well as the current situation in Germany. We also give our assessment of what will happen in Emerging Markets economies once the Federal Reserve embarks on its next tightening cycle.

Turning to the Nordic economies, our economic forecasts are largely unchanged from September. **The Nordic countries are still on diverging courses**, with Sweden leading the race for growth followed by Denmark, which is back on the growth track after several years of stagnation.

The Norwegian economy is hard hit by the decline in oil prices, but economic policy easing coupled with sharp weakening of the krone have prevented the downturn from becoming as severe as might have been feared. Finland still lags far behind in the Nordic race for growth, but now seems to be entering a period of modest recovery.

Internationally, the picture is also largely the same. Generally, we see that **the advanced economies, headed by the US, are entering a self-sustaining recovery** supported by highly accommodative monetary policies and sharply lower commodity prices. The latter is especially benefiting commodity-importing countries.

For the commodity-producing countries, however, the situation has changed for the worse and the slowdown in China adversely affects activity in the Asian economies in particular.

In 2016, we see the decline in commodity prices and the dire situation of the Emerging Markets turning around. Against this backdrop, **we expect more robust growth of 3.5%**, against 3.1% in 2015. In this scenario, world trade, which is currently much weaker than normally, should start to pick up again.

The decline in commodity prices is one of the main factors behind the low level of inflation globally. It also means that **the low interest rate regime will persist for a long time**, even if the Federal Reserve is on the brink of raising rates.

Hence, US monetary policy will remain supportive of economic activity for some time, while any tightening measures by the ECB in Europe seem a long way off. Also monetary policies in the Nordic countries will remain very loose in the year ahead despite the different economic trajectories of the Nordic countries.

The very low interest rate level notwithstanding, **global investment activity remains very subdued**. One reason might be persistent excess capacity following the big recession, but also uncertainties about the future play a role. These uncertainties relate to the economic growth outlook and geopolitics.

The conflict between Ukraine and Russia remains unresolved and the war against ISIS has reached alarming proportions with the terror attacks in Paris and the refugee influx in Europe. Finally, one should not ignore the severe security tensions in South East Asia, where the Chinese territorial aggression has brought the Middle Kingdom on a collision course with neighbouring countries in the region and the US. So all in all, the scene is set for an interesting 2016.

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"The large migration flows may have huge effects on the economy over the coming years"

Torbjörn Isaksson
Nordea chief analyst

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The economy has shifted into a higher gear. The refugee crisis gives a fiscal stimulus through increased spending.
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Growth is gaining momentum. External developments present the biggest risk. House prices will go higher, but at a slower pace.
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NORDIC HIGHLIGHTS • Swedish growth keeps surprising in the positive • Denmark is staging a solid recovery • Norway is managing through the sharp downturn in oil prices • Finland is in dire need of reforms to turn a new page on years of stagnation

The Nordics in brief

The Nordic countries are still on diverging courses. Sweden is leading the race for growth, followed by Denmark. The Norwegian economy is hard hit by the decline in oil prices, but economic policy easing has prevented a sharp downturn. Finland still lags far behind.

SWEDEN

Asylum seekers in 2015

160k

The Swedish economy has shifted into a higher gear with GDP growth accelerating to around 3.5% 2015 and 2016. Domestic demand is the main driving force. The refugee crisis gives fiscal stimulus through increased government spending. Exports have started to pick up as an effect of Euro-area growth. Inflation will rise, but not stabilise at the 2% target. Strong growth and rising inflation make further monetary policy easing unlikely.

DENMARK

Expected GDP growth in 2016

1¾%

A broadly-based recovery is emerging, driven mainly by consumer spending. In 2016, we expect the recovery to gain more momentum as also investment activity will start to pick up. More progress on housing market and labour market will support domestic growth. Developments outside Denmark present the biggest risk with stagnant world trade a threat to exports and business investment.

NORWAY

Oil projects investment in 2015

-15%

The slowdown in the oil services industry is not over. Consumer spending growth will help moderate the economic setback. Mainland exports are currently benefiting strongly from the krone's weakness. Norges Bank's rate cuts will put a damper on any NOK appreciation. And should the NOK strengthen markedly, the bank will respond by cutting rates more to curb the strengthening.

FINLAND

Economic growth since 2007

-5%

The economy is set to expand very slowly, suggesting that the country is in need of reforms. Exports are expected to pick up only slightly. The problems faced by exports, lack of confidence and a weak growth outlook, spell difficulties for domestic demand. Investments will pick up slowly and unemployment will continue to rise. Households' disposable income and private consumption will increase only a little.

HIGHLIGHTS • GDP growth 3.5% both 2015 and 2016 • Rising immigration boosts growth but weighs on public finances • Recovery in industry boosts productivity • Stronger SEK pulls down inflation

SWEDEN

Population and growth boom

The Swedish economy is on a sharp upward trend, and in the years ahead it will be further boosted by the refugee crisis. Meanwhile, budget deficits will rise over the forecast horizon, and unemployment will remain at the current high level. Inflation should pick up, but not reach the 2% target.

Accelerating growth driven by productivity

The Swedish economy has shifted into a higher gear, with GDP growth rising from a modest 1.2% in 2013 to 2.4% last year. We expect GDP growth to be around 3.5% this year and next year.

Employment continues to show a steady increase, so the higher GDP growth will be driven by rising productivity after several years of erosion. Since the financial crisis, activity in the private services sector has recovered at a steady pace, which is expected to continue thanks to sustained domestic demand growth. The higher growth and productivity will therefore mainly be due to the improvement in the manufacturing industry.

Around 75% of manufacturing output is exported. For many years the manufacturing sector has been hit hard by subdued demand from export markets. But about a year ago, demand started to pick up, driven mainly by Euro-area growth. This means that growth in Sweden will be more broadly based, and it underpins a recovery in productivity.

Booming population

While the supply of Swedish-born labour declines, the supply of non-Swedish labour increases. This is also reflected in the employment data as the latter group accounts for the bulk of the past years' employment growth.

160k

Number of asylum seekers in 2015.

90%

Average employment rate for Swedish-born residents for the age group 25-54.

11.5%

The annual growth rate for exports of services the first three quarters of 2015. Exports of services now stand for 14% of GDP.

Sources: Nordea Markets and Macrobond

The unexpected strong increase in the number of asylum seekers during the autumn will provide another boost to the labour supply in future. At this juncture it is difficult to quantify the effect of this as it will depend on political decisions taken in both Sweden and the EU. It is simply not possible to say now how many refugees will seek asylum in Sweden.

The prolonged asylum application process means that refugees coming to Sweden now will likely not be able to start applying for jobs until 2017. In step with accelerating growth in the labour supply, unemployment should also rise as it takes longer for immigrants to get a job. The employment rate among people born outside of Sweden is only 60% – nearly 10% points lower than for Swedish-born people.

The refugee crisis will provide an extra boost to GDP growth in both 2016 and 2017. This could be seen

SWEDEN: MACROECONOMIC INDICATORS

Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP (calendar adjusted), % y/y	1.2	2.4	3.5	3.5	2.6
Underlying prices (CPIF), % y/y	0.9	0.5	0.9	1.6	1.7
Unemployment rate, %	8.0	7.9	7.4	6.8	6.9
Current account balance, % of GDP	6.1	5.5	6.4	6.8	6.7
General gov. budget balance, % of GDP	-1.4	-1.7	-1.0	-1.3	-1.6
General gov. gross debt, % of GDP	39.8	44.9	43.5	42.1	41.1
Monetary policy rate (end of period)	0.75	0.00	-0.35	0.00	0.00
EUR/SEK (end of period)	8.85	9.48	9.27	8.80	8.80

as fiscal stimulus through increased government expenditure. In addition, transfer payments will increase, which in turn will further boost the already fairly high household consumption growth. Despite reprioritisation, expenditure reductions and rising tax receipts, the public deficit seems set to increase by SEK 10-15bn per year over the forecast period. We see the budget deficit at 1.6% of GDP in 2017.

Inflation close to target

Inflation will mainly be influenced by two other – opposite – trends. On the one hand, domestic inflation should rise driven by high resource utilisation, labour market tightness and higher taxes in some areas. On the other hand, we expect the Swedish krona to strengthen and imported inflation to decline.

Combined, these trends suggest that inflation as measured by the CPIF index will rise going forward, but not sufficiently so to permanently meet the 2% target in the years ahead. However, the upswing is assumed to be enough for the Riksbank not to take further action.

The SEK remains a source of concern for the Riksbank. However, the ECB will not launch any additional measures and the Fed will hike rates, which reduces the probability for a sharp SEK appreciation. Consequently, we don't expect the Riksbank to take any further stimulus measures but the bank will stick to the announced government bond buying programme for H1 2016. We see a first rate hike in Q4 2016.

In the absence of further monetary policy stimulus, the strong Swedish economy favours a strengthening of the krona versus the euro next year. According to our projections, the trade-weighted exchange rate index (KIX) will be 108, corresponding to a SEK rate of 8.80 versus the euro as well as versus the dollar by end-2016.

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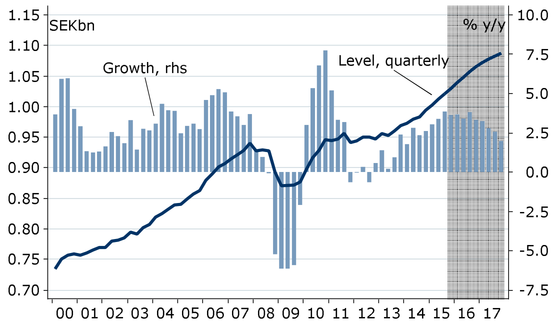
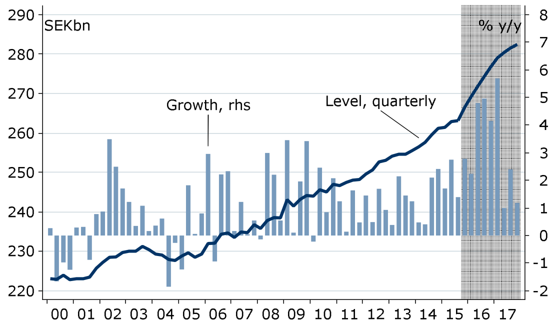
A / Robust GDP growth driven by domestic demand
Quarterly real GDP



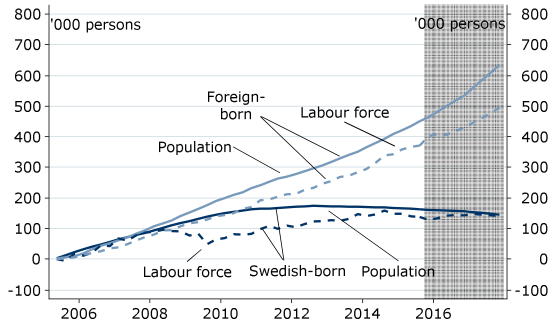
Source: Nordea Markets and Macrobond

B / Government consumption booming
Quarterly government consumption



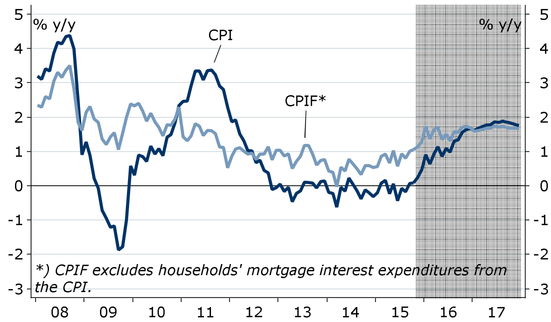
Source: Nordea Markets and Macrobond

C / Immigration accelerating
Change in population and labour force since April 2005



Source: Nordea Markets and Macrobond

D / Higher inflation
Inflation with and without mortgage interest expenditures



Source: Nordea Markets and Macrobond

A /
GDP growth broad-based. Resource utilisation is rising and bottlenecks are increasing on the labour market

B /
More elderly people and growing population increase demand for health care, education and social services. Government consumption lifts GDP growth by 1 percentage point in 2016.

C /
The labour force of foreign-born persons will increase by around 100 000 over the forecast horison, boosting total labour supply by 2%.

D /
CPIF-inflation is rising but will stabilise somewhat below the 2% target, something the Riksbank is expected to accept.

Sources: Nordea Markets and Macrobond

HIGHLIGHTS • Consumers are back and driving the economy • Exports are the biggest issue at the moment • Labour and housing markets moving upwards • Growth to accelerate in 2016 and 2017

DENMARK

Recovery on solid track

A broadly-based recovery is emerging, driven by consumer spending. Exports are hit by a slowdown. In 2016, we expect the recovery to gain momentum, with a GDP growth of 1¾%. External developments present the biggest risk, with stagnant world trade a threat to exports and business investment.

Consumer spending again driving growth

Consumer spending is again a key growth engine. Over the past year household consumption has grown by 2.5% and is approaching the pre-crisis level. The increase in consumer spending shows through especially in higher retail sales data, and sales in shops related to the housing market show strong growth. This suggests that the positive housing market trend is spilling over to the rest of the economy.

Exports hard hit

Over the past six months, the Danish export sector has been hard hit by the marked slowdown in global trade. Moreover, exports remain adversely affected by the trade sanctions against Russia; because of them exports to Russia have more than halved. Even so, the current account surplus remains substantial, among other things due to subdued domestic investment activity. The surplus generates underlying pressures for a strengthening of the Danish krone and thus contributes to keeping Danish interest rates at low levels versus the Euro area.

Investment drought almost over

A weak trend in business investment has so far prevented the recovery from becoming self-sustaining. In future, however, business investment should pick up again. Capacity utilisation in the manufacturing industry has been on a steady increase and is now approaching the long-term average level. Also, businesses' cash reserves are abundant, which coupled with the increase in employment and sustained low funding costs should foster investment growth. This projection is supported by manufacturers' investment plans for 2016, which are at a post-2012 high.

1¾%

Expected growth in 2016 – would be the highest since 2006.

25k

Asylum seekers will be adding pressure to the budget.

Sources: Nordea Markets and Macrobond

Inflation has bottomed

2015 will be described in history books as yet another year of exceptionally low inflation in Denmark. A closer analysis of Danish inflation data shows, however, that things are changing, which should soon start to push inflation higher. The expected uptick in inflation will be driven by factors relating to the computation methodology used especially with regard to energy prices and rents and by slightly rising underlying inflation pressures as idle capacity in the economy is gradually reduced. On

DENMARK: MACROECONOMIC INDICATORS

Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP, % y/y	-0.2	1.3	1.4	1.7	1.9
Consumer prices, % y/y	0.8	0.6	0.5	1.1	1.9
Unemployment rate, %	5.8	5.0	4.6	4.0	3.6
Current account balance, % of GDP	7.1	7.7	7.4	7.0	6.3
General gov. budget balance, % of GDP	-1.0	1.8	-2.9	-2.7	-2.3
General gov. gross debt, % of GDP	43.1	44.6	39.5	41.0	42.4
Monetary policy rate, deposit (end of period)	-0.10	-0.05	-0.75	-0.50	-0.30
USD/DKK (end of period)	5.41	6.15	6.88	7.46	6.77

average we expect Danish inflation to reach 1.1% in 2016, up to 1.9% in 2017.

Full employment in sight

Employment has increased steadily since early 2013, driven by the private sector as public sector employment has been largely unchanged. With prospects of rising economic activity, employment should continue to grow in coming years. However, this means that unless the labour supply grows similarly, perhaps through qualified labour from abroad, the risk of bottlenecks also increases.

Public budgets stretched to breaking point

In recent years, changing governments have stretched budgets as far as they possibly could without violating the Danish budget law. As a result of this strategy, the structural budget deficit has exceeded the maximum limit of 0.5% for two consecutive years.

Going forward, government deficit will probably be reduced only very slowly. One reason is that revenues from taxation of pensions will likely be considerably lower than in previous years. Moreover, the government has revised up its estimates of the number of asylum seekers in 2015 and 2016 from 15,000 to 25,000 each year; however, as part of the additional costs will be funded through a reduction of foreign aid, this will hardly bring the structural deficit for 2016 above the maximum limit again.

Rising home prices spreading like ripples in a pond

Danish home prices have increased sharply over the past year, and the reason is simple: historically cheap financing has significantly boosted home affordability in Denmark. Meanwhile, employment and consumer confidence are rising, while the number of housing starts nationwide is very low. Seen from a structural view the current pricing at the housing market is close to equilibrium. So the scene is set for the pick-up in home prices to spread across the country like ripples in a pond.

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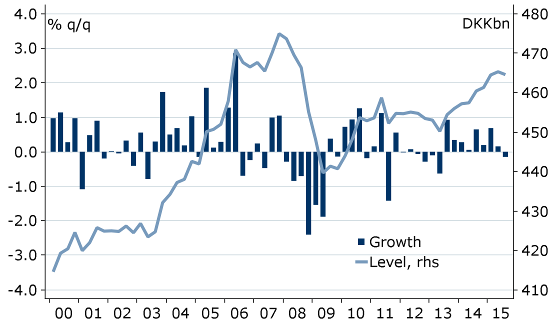
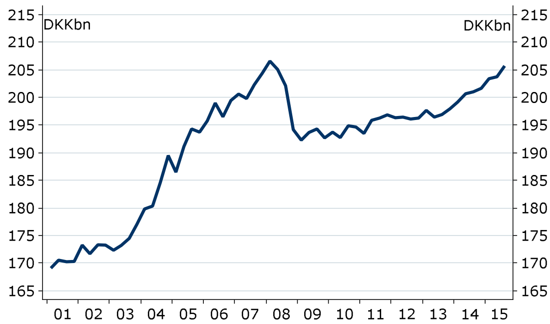
A / Danish economy is growing in a higher gear
Quarterly real GDP



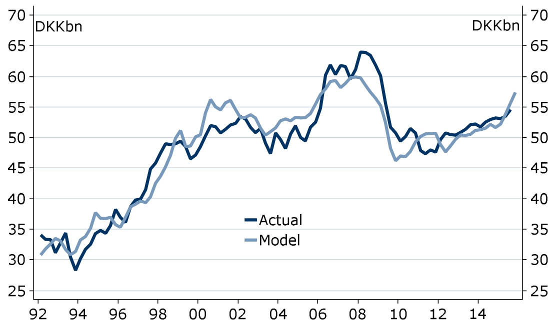
Source: Nordea Markets and Macrobond

B / Underlying consumption is gaining momentum
Quarterly household consumption excluding energy



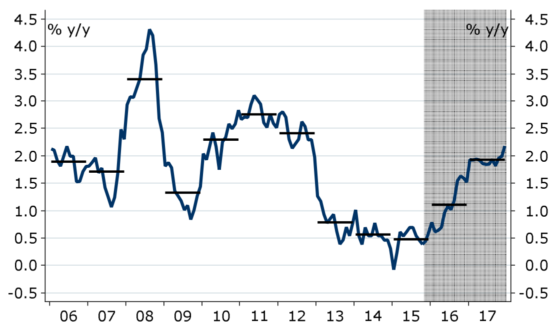
Source: Nordea Markets and Macrobond

C / Business investments are picking up again
Quarterly real gross fixed capital investment



Source: Nordea Markets and Macrobond

D / Inflation has bottomed and will soon start to rise:
Consumer price index, y/y change %



Source: Nordea Markets and Macrobond

A /
Danish economy has for more than two years been on a steady higher growth path. But the level is still below the peak in 2008.

B /
Consumer spending was for several years a key concern for the Danish economy. Now this has turned and domestic consumption is again a major driver for growth.

C /
Leading indicators point to a modest upswing in investment activity. A higher capacity utilisation and a tighter labour market will push investments up.

D /
For several years Danish inflation has stayed at unusual low levels. This is about to turn as both technical factors and higher domestic demand will push inflation higher.

Sources: Nordea Markets and Macrobond

NORWAY

Consumers will decide

The slowdown in the oil services industry is not over, but strong growth in exports and public consumption will underpin growth. Consumers will realise that the oil sector downturn does not threaten most people's jobs. Consumer spending growth will also help moderate the economic setback.

Declining investment – both offshore and mainland
Oil investment is declining sharply and oil companies' investment plans suggest that this trend will continue next year, albeit at a slower pace. Not only offshore investment shows a weak trend. Also mainland business investment looks set to decline slightly both this year and next year – despite plans in the manufacturing and energy sectors of relatively sharp growth in investment next year. We will likely have to wait until 2017 before an improved macro outlook boosts investment in other sectors as well.

Weak NOK and expansionary fiscal policy supportive
Mainland exports are currently benefiting strongly from the krone's weakness and growth in mainland exports may be as high as 6% this year. Exports will most likely continue to be underpinned by improved competitiveness, so going forward we expect strong, albeit gradually slowing, export growth.

The government's draft budget from September included relatively strong expenditure growth. Parliament's budget compromise envisages even higher expenditure growth due partly to the stronger-than-expected influx of refugees. This will trigger steady growth in government consumption, which accounts for one-third of demand in the mainland economy.

Consumption helped by lower rates
So far, consumer spending has withstood spill-over effects from the oil sector downturn. But recent consumer confidence data reflect increased pessimism and may be an early warning of a slowdown in consumer spending growth. Still, we expect private consumption to remain a growth driver in coming years because despite low real wage growth, lower interest rates will put a floor under overall income growth. Also the savings ratio is high, and any pick-up in unemployment will after all be moderate.

Lower interest rates will also contribute to rising house prices despite a flattening trend in price growth. A benign housing market will keep residential construction activity at a high level and boost growth in 2016.

Consumers will decide
Unemployment in oil-dependent regions is rising and further layoffs in the oil services industries are

1.2%
Expected inflation at year-end 2017

-15%
Investment in oil-related projects in 2015.

Source: Nordea Markets and Macrobond

NORWAY: MACROECONOMIC INDICATORS
Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP (Mainland), % y/y	2.3	2.3	1.4	1.4	1.7
Core consumer prices, % y/y	1.6	2.4	2.7	2.4	1.4
Unemployment rate, %	3.5	3.5	4.4	4.8	4.9
Current account balance, % of GDP	10.2	9.7	6.3	5.6	6.5
General gov. budget balance, % of GDP	10.8	9.0	7.0	5.4	6.0
Private consumption	2.7	1.7	2.3	1.6	2.0
Monetary policy rate, deposit (end of period)	1.50	1.25	0.75	0.25	0.25
EUR/NOK (end of period)	8.36	9.07	9.23	8.80	8.50

likely. But in other sectors we see good growth in the demand for labour. So in the overall economy unemployment should rise only moderately. But some labour market weakness, cost reductions in the oil services industries and seemingly overall agreement on wage moderation suggest sustained low wage growth in coming years. As a result, company cost growth will be lower than normally. At this juncture, inflation is still high due to the krone weakening, and it will probably take a while before importers are done passing on their higher costs to consumers. But from H2 2016 we expect inflation to drop markedly.

More cuts and a relatively weak NOK
Our expectations for growth, unemployment and inflation in 2017 paint a weaker picture than Norges Bank's projections. As early as in 2016 we expect clear signs to emerge, showing that the recovery in 2017 projected by the central bank will not materialise. Against this backdrop, we look for two rate cuts in 2016. The risks are tilted to the downside. Banks' funding costs have increased sharply recently, and this could prevent Norges Bank's rate cuts from feeding through to lower lending rates. In that case, Norges Bank will cut rates further. Recent consumer confidence readings have been rather weak, and if consumer spending growth undershoots our forecasts by a wide margin, it could trigger more rate cuts.

The NOK is currently very weak. Over time we look for some normalisation, helped by rising oil prices. But Norges Bank's rate cuts will put a damper on any NOK appreciation. And should the NOK strengthen markedly, the bank will respond by cutting rates more to curb the strengthening.

With rising unemployment and declining inflation, Norges Bank will do much to prevent excessive NOK appreciation. In the event of a turnaround in the currency market, Norwegian rates may move into negative territory.

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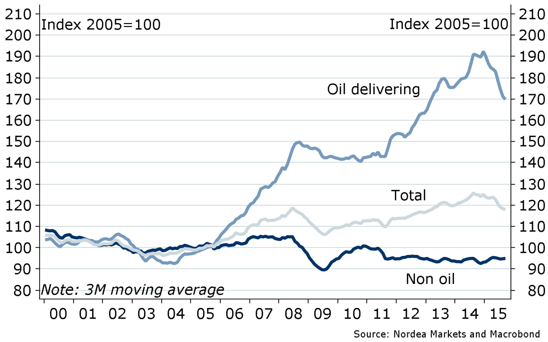
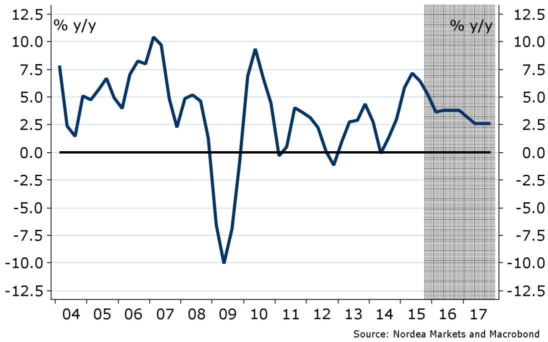
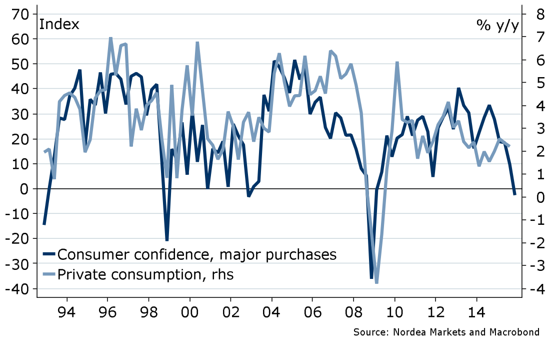
A / Oil related industries hard hit
Manufacturing production



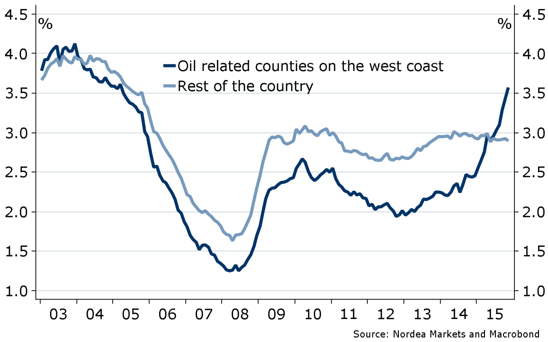
B / Exports benefit from weak NOK
Growth in mainland exports



C / Consumers are worried
Consumption growth and consumer confidence



D / Unemployment an oil story
Registered unemployment rate



A /
The good times are over in the oil-related industry due to falling oil investment.

B /
A weaker NOK softens the blow from lower oil-related activity.

C /
Consumption growth is still strong, but could soften somewhat due to lower consumer confidence.

D /
Unemployment is increasing, but only in areas with above-average employment in oil-related industries.

Sources: [Source]

HIGHLIGHTS • Finland falling behind the rest • Reforms need quick implementation • Exports stagnating • Domestic demand is weak • Inflation will surprise as early as January

FINLAND

In need of a reformed lifestyle

The Finnish economy is set to grow 0.5% in 2016 and 0.7% in 2017. We have maintained our forecast for next year while slightly raising the forecast for 2017.

The divergence in economic growth in Finland and the rest of the western world is striking, and the gap only seems to be widening. Whereas other western countries have enjoyed a moderate growth cycle for several years, Finland has stagnated. Looking past the forecast period, Finland's growth will be outpaced by its peers. The euro area will see growth of 1.5% this year, but the Finnish economy will continue to shrink slightly for the fourth consecutive year.

The "sick man of Europe" is in need of major change. Solutions must be found in structural reforms and a cheaper cost level versus the euro area. Traditional stimulus through government spending will not work, as it maintains growth in costs and halts the ongoing process of internal devaluation.

Reforms must be implemented without delay, as the boost received from the global economy will begin to wear off after the forecast period. By then, the global economy will be past its cyclical peak and the ECB will begin to hike its policy rate. Although work on reforms is already under way, they are lacking quick execution to bolster long-term growth and put public finances on a sustainable path.

Exports stagnating

Global economic growth will accelerate in 2016 once the problems faced by the emerging markets subside. This time, though, the pick-up won't be based on rapid growth in industry, investments and global trade, but on growth in consumption. This is bad news for commodity-producing countries and Finland, whose exports largely consist of investment goods and other production inputs.

-5%

Economic growth in Finland since 2007

Russia accounts for

5.9%

of Finnish goods exports

Sources: Nordea Markets and Macrobond

We estimate that exports will pick up only slightly in the coming years, topping just 2%, because their structure is currently unfavourable. The picture will change dramatically if global industry and investments experience a higher than expected recovery. In such a scenario, demand for production inputs and investment goods would inevitably perk up. However, there are no signs of such a turn of events.

Domestic demand will remain subdued

The problems faced by exports, coupled with a lack of confidence and a weak growth outlook, spell difficulties for domestic demand.

FINLAND: MACROECONOMIC INDICATORS

Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP, % y/y	-1.1	-0.4	-0.2	0.5	0.7
Consumer prices, % y/y	1.5	1.0	-0.2	0.8	1.0
Unemployment rate, %	8.4	8.7	9.5	10.0	10.3
Hourly earnings, % y/y	2.1	1.4	1.2	0.8	0.7
General gov. budget balance, % of GDP	-2.5	-3.3	-3.2	-3.1	-2.9
General gov. gross debt, % of GDP	55.6	59.0	62.5	65.5	68.4
Monetary policy rate (end of period)	0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)	1.38	1.21	1.08	1.00	1.10

If there is a silver lining, it is that the drop in exports to Russia is in the rear-view mirror. The dragging effect of Russian exports will subside. Industrial production, however, is recovering meekly and investments will pick up slowly following their 15-year trough. Construction investments are expected to increase in 2016. Investments in machinery and equipment will also recover slightly, but investments in intangible assets will remain weak.

Unemployment will rise throughout the forecast period. We have maintained our forecast at 10% for 2016 and 10.3% for 2017. Wages and pensions will increase moderately, which will translate to a very modest rise in households' disposable income, especially with inflation picking up. Real incomes and private consumption will increase moderately. The influx of refugees will increase public spending, boosting growth. On the other hand, the repayment-free periods for housing loans, which have proven popular in Finland, will expire next year, putting a damper on consumption growth.

Inflation set to surprise in January

According to the national inflation barometer, consumer price inflation has been negative throughout 2015. In October, prices fell by 0.3% year-on-year. Talk of deflation and its dangers has already started, just as we predicted a year ago. Prices have been depressed especially by food and energy. Consumer prices have highly divergent trends. According to the latest data, goods are 2% cheaper than a year ago, but services are 2% more expensive. Core inflation, however, has remained firmly in positive territory (0.3% in October).

As early as January, however, inflation data will surprise. If there is no further drop in the price of oil (as we expect), the negative impact of energy on inflation will disappear. With price hikes in tobacco products and the fees charged by health care and social services, we expect January inflation to be at least 0.7%, possibly reaching even 1.0%. We see full-year inflation for 2016 at 0.8%.

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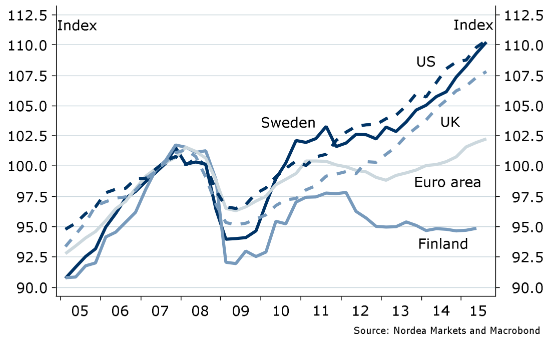
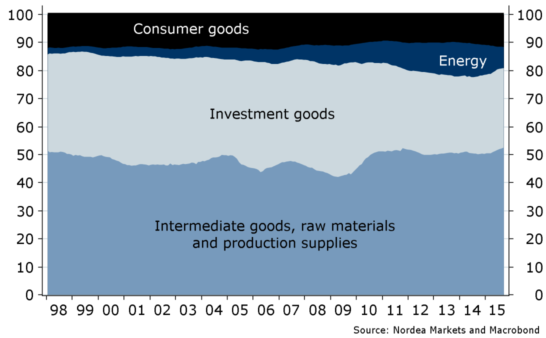
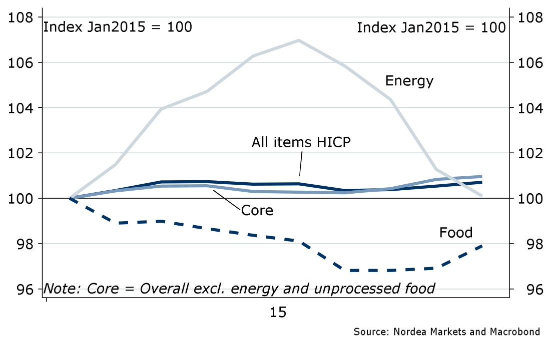
A / Finland falling behind its competitors
GDP index, 2007 = 100



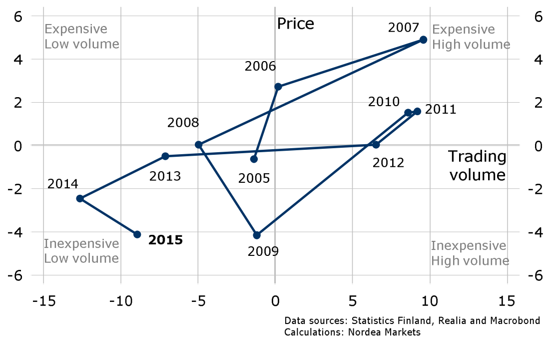
B / Unfavourable structure of exports
Share of exports, %,



C / Consumer price inflation will pick up in January
CPI breakdown



D / There is no housing bubble
Trading volume and relative price of real estate transactions



A /
The gap between Finland and the rest of the world is widening. This is due to structural problems.

B /
This time growth in the global economy is not based on growth in industry, investments and global trade.

C /
Inflation will be clearly positive, putting a stop to talk of deflation.

D /
The housing market clock indicates the distance between prices in relation to incomes and the number of transactions from the long-term average (origin).

Sources: Nordea Markets and Macrobond

“In Russia, a recession driven by the downturn in commodities is giving way to stabilisation”

Dmitry Savchenko
Nordea chief economist, Russia

ESTONIA
Exports are suffering, but a drop in unemployment will keep consumers spending and bodes for a broad-based tepid recovery.
/ page 18

LATVIA
Caught between growing wages and continued emigration, Latvia may in fact reveal itself to be a sleeping beauty.
/ page 19

LITHUANIA
The country would be hot hot hot - if it were not for a collapse in exports to Russia.
/ page 20

RUSSIA
Green shoots was Bernanke's term for the flicker of light in the US economy in 2009. Now the term fits Russia, writes Dmitry Savchenko.
/ page 21

HIGHLIGHTS • Estonian employment at record lows • Latvia battling emigration • Lithuania weathering drop in exports to Russia • The recession in Russia is heading to a close. 2016 may end with positive GDP growth

Baltics and Russia in brief

The Russian recession took its toll on Baltic economies in recent years, but the bear is finally waking up from a long winter. Domestic issues vary significantly. If immigration is a challenge elsewhere, Latvia is battling with emigration. Riga's population has declined 10% in 10 years. Lithuania, on the other hand, is starting to look overheated and 2016 is an election year. Estonian consumers will get help from a material drop in unemployment.

ESTONIA

Unemployment has dropped to

5.2%

Slow trade, low energy demand and an uneven recovery in Europe will dampen the strength of the export-led recovery in Estonia. Prospects will brighten up in 2017. However, there are good reasons to believe that consumers will remain in the driver's seat, especially as unemployment has decreased substantially.

LATVIA

Low youth unemployment

14.6%

Brain drain is real: the population in Riga dropped by 10% in 10 years. Latvia is racing against time to change this trend or it will be a strain on public finances that in turn could force fiscal tightening – adding further pressure on emigration. The latest data gives some hope and the Latvian labour market is becoming more attractive to young workers.

LITHUANIA

GDP growth in 2016 could hit

4%

"One side hot, one side cold" is the most accurate description of the Lithuanian economy at present. But contrary to the post-crisis period, it's the domestic economy (over)heating – not exports. Indeed, exports to Russia dropped 47% y/y in Q3 2015. Still, if investment activity does not lose momentum, overall GDP growth could well accelerate to 4% in 2016.

RUSSIA

GDP with plus sign at end 2016

+0.3%

After a recession driven by the massive drop in commodity prices, the economy is finally close to stabilisation. Growth could be close to zero in 2016 and we see potential upside surprises in investment over the coming years. Consumer spending too should recover as inflation will decrease sharply in the beginning of 2016.

ESTONIA

Broad-based tepid recovery

Commensurate with resurfaced risks in the external sector, the Estonian economy is experiencing a temporary soft patch with only 1.2% y/y growth on average from Q1 to Q3. Investment and trade will remain a drag on growth in Q4 before the recovery sets in. As expected, growth last year was revised up to a decent 2.9%.

Soft, but more broad-based recovery ahead

Slow trade, low energy demand and an uneven consumption-led recovery in Europe will dampen the strength of the export-led recovery. Estonian exports will see mediocre growth next year, but with prospects brightening in 2017. The turnaround in global investment and the manufacturing cycle remain tame. Export revenues in Estonia remain depressed by slowly abating deflation in producer and commodity prices. However, there are good reasons to believe that consumers will still remain in the driver's seat.

Unemployment in Estonia has crashed to as low a level as 5.2% in Q3, putting the metric at par with the US. Moreover, the labour participation rate has hit an all-time high of 70.9%, and there is not going to be a lift-off in EUR rates anytime soon! As a caveat, the underlying trend in labour demand has not been as rosy as headline figures might suggest. Labour market statistics have been partly affected by Estonia's progress with digitalisation measures to enhance tax reporting and collection. The short-term unemployment measure, which is more prone to cyclical demand, has fallen considerably less than the long-term unemployment rate.

The economy is expected to pick up speed next year as exports and investment add to moderating consumption growth. Consumption will be affected by rising inflation and real wage growth, which is expected to halve from the current over 6% y/y pace.

5.2%

Unemployment rate in Q3

A /
The labour market continues to tighten, but the successful measures to enhance tax collection have also helped to shrink the share of the shadow economy.

Sources: Nordea Markets and Macrobond

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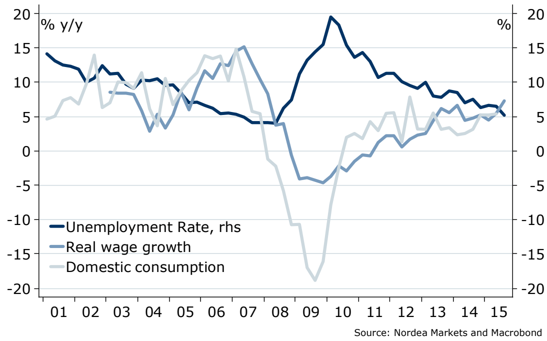
A / Softer real-wage growth ahead
Y/y unemployment rate, wage and consumption change, %



ESTONIA: MACROECONOMIC INDICATORS
Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP, % y/y	1.6	2.9	1.3	2.7	2.9
Consumer prices, % y/y	2.8	-0.1	-0.4	1.7	2.9
Unemployment rate, %	8.6	7.3	6.1	6.1	7.0
Current account balance, % of GDP	-0.1	1.1	2.4	1.4	1.1
General gov. budget balance, % of GDP	-0.2	0.8	0.2	-0.3	-0.2
Gross wages, % y/y	7.8	5.6	5.8	4.6	5.7
Monetary policy rate (end of period)	0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)	1.38	1.21	1.08	1.00	1.10

LATVIA

A sleeping beauty

The Latvian economy continues to be the best performer in the Baltics, but 2.5% growth is not enough to ensure long-term sustainability and continued convergence with EU average income levels. In fact, the Latvian economy is between a rock and a hard place, that is, growing wages and continued emigration.

A race against time

With fewer and more expensive employees, the only escape for businesses is to invest heavily in productivity-enhancing measures and climb up the value-added chain. This will not be an easy task as Latvia at present is one of the least innovative EU countries.

Riga has not been very successful at retaining and attracting migrants: over the last 10 years the population of Riga declined by 10%, while Tallinn saw 3% growth and population growth in Vilnius remained fairly stable. Rising wages should contribute positively to stymieing emigration.

However, if Latvia does not succeed, the declining working-age population will be a strain on public finances and may result in tax increases even in times of economic stability, such as the currently proposed "solidarity tax". Such a development would, in turn, further accelerate emigration and brain drain.

The latest data gives some hope, with investment growth accelerating to 6.4% in Q3 after a meagre 0.3% in 2014. In addition, employment growth accelerated to 2.1% in Q3. The growing number of employed youth (15-24 years) is very promising, indicating that the Latvian labour market is becoming more attractive and has something to offer to young people. Youth unemployment fell to 14% - below the EU average of 20% - while overall unemployment rate (9.8%) remains above the EU average (9.3%).

7.3%

Increase in wages in Q3 2015

14.6%

Youth unemployment, well below the EU average

A /
Rising wages stimulate productivity-enhancing investments

Sources: Nordea Markets and Macrobond

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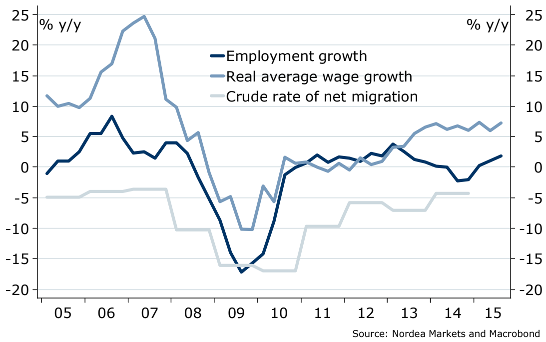
A / Wages and employment to stem emigration

Year-on-year change in income and employment growth



LATVIA: MACROECONOMIC INDICATORS

Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP, % y/y	3.5	2.5	2.4	3.0	3.5
Consumer prices, % y/y	0.0	0.6	0.3	1.3	2.6
Unemployment rate, %	11.8	10.8	9.8	9.0	8.0
Current account balance, % of GDP	-2.3	-1.9	-1.2	-2.0	-2.0
General gov. budget balance, % of GDP	-0.9	-1.5	-1.7	-1.2	-1.0
Gross wages, % y/y	4.7	6.9	6.7	5.0	5.0
Monetary policy rate (end of period)	0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)	1.38	1.21	1.08	1.00	1.10

HIGHLIGHTS • Growth will accelerate in 2016 • Russia to blame for dismal export performance • Investment is back at double-digit growth levels • Record-high activity in residential real estate market

LITHUANIA

"Yes we can" hit 4% growth

"One side hot, one side cold" is the most accurate description of the Lithuanian economy at present. But contrary to the post-crisis period, it's the domestic economy (over)heating – not exports.

Domestic economy is driving growth

Private consumption growth accelerated to 6.4% in Q3, fuelled by rapid wage growth (5.5%), falling unemployment, subdued inflation, strong consumer confidence and record-high activity in the residential real estate market. Public consumption is also set to increase after years of harsh austerity measures, with nearly 4% expenditure growth planned for 2016 - the election year. However, the overall GDP performance has been cooled down by a dismal export performance.

Exports to Russia fell by as much as 47% y/y in Q3 2015, pushing overall export growth into negative territory (-8%). However, the negative Russian effect is forecast to fade in 2016. Firstly, the share of exports to Russia already went from 21% in 2014 to a mere 11%. Secondly, exports to the EU countries are expected to continue growing at 5-7%. Hence, even assuming the economic sanctions stay, the negative Russian effect will be significantly less pronounced in 2016 compared to 2015.

Investment growth is back at double-digit levels. After a temporary slowdown at end-2014, investment (GDCF) growth accelerated to 12% in Q3 primarily driven by rising investment in machinery and equipment (+27%). As a result, the investment-to-GDP ratio increased to above the EU average level for the first time since the drop in 2009. If investment activity does not lose momentum, overall GDP growth could well accelerate to 4% in 2016

-47%

Year-on-year drop in exports to Russia (to Q3 15)

12.4%

Increase in fixed investment in Q3

A /
Investment growth is accelerating in spite of much reduced exports

Sources: Nordea Markets and Macrobond

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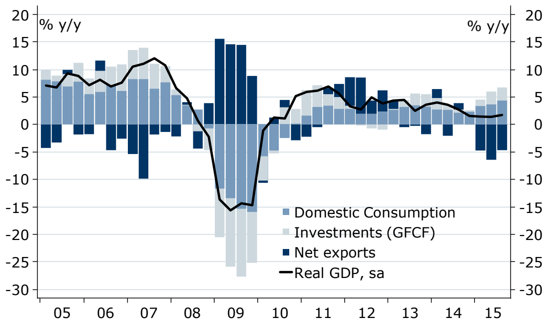
A / Net exports are the major drag on the economy
Year-on-year change in investments, exports and GDP



Source: Nordea Markets and Macrobond

LITHUANIA: MACROECONOMIC INDICATORS
Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP, % y/y	3.7	3.0	1.8	4.0	3.5
Consumer prices, % y/y	1.0	0.1	-0.8	1.8	2.6
Unemployment rate, %	11.9	10.7	9.4	8.5	7.5
Current account balance, % of GDP	1.5	3.6	-2.0	-1.0	-1.0
General gov. budget balance, % of GDP	-2.2	-0.7	-0.9	-1.2	-0.5
Gross wages, % y/y	5.0	4.5	5.0	6.0	6.0
Monetary policy rate (end of period)	0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)	1.38	1.21	1.08	1.00	1.10

RUSSIA

Towards stabilisation

After recession driven by commodity market downturn, the economy is finally close to stabilisation. We expect GDP growth to close 2016 with a positive sign and possible upside surprises in investment activity over the forecast horizon.

The Russian economy seems close to bottoming out. September was the first month of industrial output growth (+1.5% m/m) since the beginning of the recession. In 2015 we expect GDP to decline by 3.7% and the year-end performance may become crucial for any further recovery. In 2016 we expect +0.2% GDP growth by the year-end with more potential for acceleration in 2017.

Household consumption will be the major drag on the recovery over the forecast horizon. Relatively high inflation and negative trends in real wages will put pressure on consumption. On the other hand, inflation may sharply decrease in the beginning of 2016 thanks to high base effects. This may have some positive impact on consumption. In 2016 and 2017 we expect inflation to continue declining.

+0.3%

Estimated GDP growth at year-end 2016

58

Our USDRUB forecast for end 2016

A /
The government will be the major investor during the coming years.

Sources: Nordea Markets and Macrobond

Capital investment will suffer due to the weak commodity markets, limited access to western capital markets and tough lending conditions. However, investment activity may surprise on the upside given government support of state-owned companies.

The rouble may remain volatile and will follow the oil market. Geopolitics and CBR policies will remain secondary factors. We do not expect FX liquidity shortage as companies have accumulated enough liquidity in 2015. We see USDRUB at 58 by the end of 2016 supported by oil market stabilisation, positive current account balance and ample reserves.

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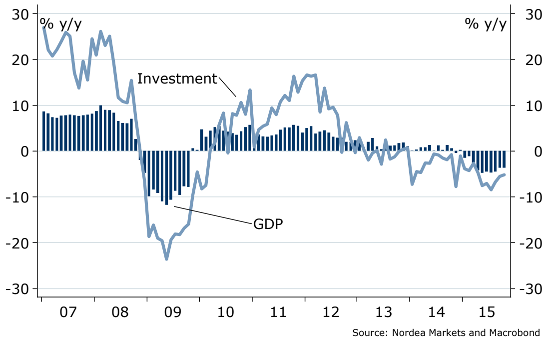
A / Economy needs stimulus to spur investment
Year-on-year change in investment activity and GDP



RUSSIA: MACROECONOMIC INDICATORS
Monetary policy rate refers to the refi rate unless otherwise stated

	2013	2014	2015E	2016E	2017E
Real GDP, % y/y	1.3	0.6	-3.7	0.3	1.1
Consumer prices, % y/y	6.8	7.8	15.5	8.8	6.6
Unemployment rate, %	5.5	5.2	5.5	6.2	6.1
Current account balance, % of GDP	1.6	2.9	3.5	2.5	2.0
General gov. budget balance, % of GDP	-0.8	-0.7	-4.0	-3.0	-2.0
Private consumption	5.0	1.3	-7.0	-0.2	1.5
Monetary policy rate (end of period)	0.00	17.00	10.86	8.00	7.00
USD/RUB (end of period)	32.9	58.1	66.8	58.0	56.0

“Employment, income gains and low rates will drive growth in Germany”

Holger Sandte
Nordea chief analyst

GERMANY
The China slowdown, "Dieselgate" and extraordinary refugee influx are great challenges that will reshape the engine of Europe.
/ page 24

INFLATION TARGETING
Are there any alternatives to inflation targeting? Andreas Wallström gives an update on a review being carried out in Sweden and Norway.
/ page 26

REFUGEE CRISIS
Is the unprecedented influx of refugees in the Nordics a challenge or an opportunity? Both, argues Joachim Bernhardsen.
/ page 28

EMERGING MARKETS & FED
Emerging Markets have seen five years of slowdown in a row. Will 2016 bring better times or will Fed hikes add to the trouble?
/ page 30

HIGHLIGHTS • Germany export woes offset by strong internal demand • Swedish population up 1.7% in 2015 driven by refugee influx • EM less vulnerable than in 1980s and 1990s

Economic themes in brief

Two immediate challenges to the economic outlook for Europe – for the Nordics in particular – are external: the unprecedented refugee influx and economic vulnerability in the Emerging Markets. We analyse these issues separately, and also how Europe's largest economy – Germany – is coping with them. We also look at a review of inflation targeting goals being carried out in Sweden and Norway.

GERMANY

The slowdown in Emerging Markets primarily hits exporters of investment goods. Fortunately other important export destinations like the US are holding up well. And most of all, consumers and not exporters have become the prime growth engine. The large influx of refugees leads to more expansionary fiscal policy and will support consumption and construction over the medium term. "Dieselgate" will most likely not be visible in GDP numbers.

INFLATION TARGETING

The most appropriate inflation measure to target may not be the same for Sweden and for Norway. Moreover, inflation targeting is not the only game in town for central banks in small open economies with flexible exchange rates. Financial stability or growth and employment could be targets, too. The reviews undertaken in Norway and Sweden offer the chance to improve the framework for monetary policy.

REFUGEE CRISIS

From a sheer numbers perspective, the present influx of asylum seekers in the Nordics is the largest registered since WWII. From the strain on the infrastructure of receiving countries comes the short term opportunity for government spending and expansionary fiscal policy. Down the line, a positive outcome depends on each country's ability to integrate newcomers in the workforce.

EMERGING MARKETS & FED

Emerging Markets as a whole are less vulnerable to higher US rates than in the 1980s or 1990s. After all, flexible exchange rate regimes have allowed currencies to depreciate and current account positions could be much worse. What could go wrong relates to debt, in China and elsewhere. Countries with a managed currency and a large share of debt denominated in foreign currency are the most likely candidates for a crisis.

Germany will rise to the challenge

In our view, Germany will weather the China slowdown because the economy is now being driven by domestic demand and other export destinations. “Dieselgate” will likely not go from being a severe company to a macro issue. And the additional government expenditure linked to the influx of more than 1m refugees this year is the reason why we have recently raised our forecast for GDP growth 2016 to 1.8% (from 1.6%).

Three topics are dominating the economic debate in Germany right now: 1) the slowdown in China and other emerging markets that hurts German exports; 2) the “Dieselgate” scandal, who some see as a threat to a key industrial sector; and most of all 3) the large influx of refugees that, as in others countries, raises the question of how many immigrants society can integrate and what they entail for the economy.

China is important but not decisive for exporters

In recent years, China has become Germany’s fourth largest export partner with a share of almost 7%. **This year, German exports to China will probably shrink**, the first decline since 1997. However, exports to important destinations such as the US and the UK are performing well, and demand from the Euro-area countries – which take 37% of German exports – is recovering, too.

So, not everything on the export side looks bleak. Since spring 2014, the euro has weakened by some 11%, and although German exports are generally less price sensitive than French or Italian exports, they should still benefit. For next year, we expect exports of goods and services to rise by 4% in real terms, compared to 5% this year.

No doubt, the German growth model based on a high share of manufacturing, especially investment goods, and a strong export orientation, is vulnerable to shocks from the outside. However, on the demand side, a rebalancing of the economy has clearly taken place. The recent stability of sentiment indicators despite external headwinds signals that **domestic demand is robust enough to keep growth going** at an above-trend pace.

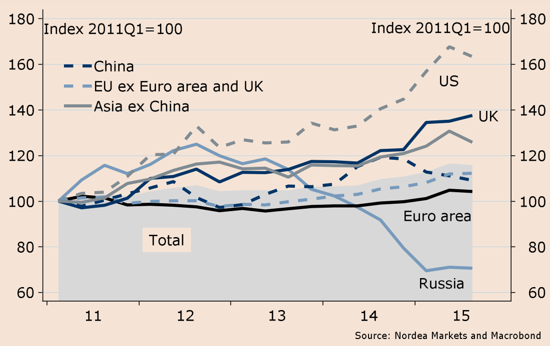
Private consumption will remain the main engine of growth, supported by employment and income gains and very low interest rates. Not least, the **more than 20m pensioners in Germany can look forward to an increase in their public pensions by 4-5% next year**. This will be decided by the federal government based on a formula where the general wage development is the most important factor.

Dieselgate: A VW issue, not a macro problem

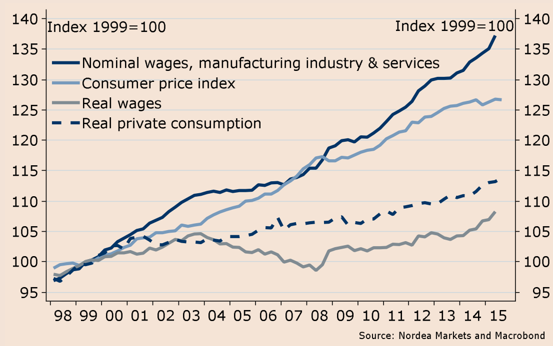
Moving on to the emissions scandal, there can be no doubt that it has a big impact on the Volkswagen group, one of the largest German companies – it accounted for almost half of the 5.6m cars produced in Germany last year. However, there are simply no indications that demand for German cars has declined as a result of a loss of trust.

“There will be bumps on the road ahead, but we feel comfortable with our growth forecast of 1.8% for next year.”
Holger Sandte
Nordea chief analyst

A / Divergent trends in goods exports
Index Q1 2011 = 100



B / Private consumption well supported
Wages, prices and consumption, index 1999 = 100



A /
Exports to Asia and Russia are declining, but demand from important destinations such as the US, the UK and the Euro area is holding up well

B /
The years of wage restraint are over, so domestic demand is now the prime growth engine.

VW's woes may benefit its competitors. That said, we will of course keep an eye on the development as automotive is the largest industrial sector in Germany in terms of sales and no 2 in terms of employment (machine building is no 1).

More refugees, more government spending

Between January and October of this year 758,000 registered refugees came to Germany, compared to a population of 82.1m. Unofficial reports talk about a further 193,000 until 24 November. To put things into perspective: The highest number of asylum applications so far (440,000) was filed in 1992. So what is happening now is unprecedented – and it makes forecasting difficult.

The main short-term impact is the increase in government spending on accommodation, assistance, language classes etc. It takes several months after arrival until refugees can file their request for asylum and then again several months until asylum or refugee status is granted (or rejected). That means that most of the newcomers in 2015 will still be in the country next year. We expect some EUR 10bn in additional expenditure this year and at least EUR 20bn next year, which means that the budget surplus originally planned will disappear. Fiscal policy will be more expansionary as the government has no plans to cut other expenditure or hike taxes.

Refugees receive mostly allowances in kind, so any significant positive effects on private consumption and construction activity will only kick in late in 2016 and in subsequent years.

Given 600,000 officially reported unfilled vacancies, the immigrants can be a huge benefit for the economy – if the integration into the labour market succeeds. That will take several years. The immigration authorities estimate that only about 10% of the asylum seekers have qualifications that allow them to take up a job quickly. To reap the benefits of immigration and to increase its growth potential, **Germany clearly has to get better at integrating people from non-European countries**. For example, the employment ratio of Syrians living in Germany is only 16%. It is close to two-thirds for Germans and about 50% for immigrants from former Yugoslavia. Next year, we expect employment to rise by roughly 0.5% and the unemployment rate to pick up to 6.5% (from 6.4%).

Summing up, there is no lack of challenges for Europe's largest economy. Growth is partly driven by benign factors such as low oil prices and interest rates. **The subdued outlook for global growth prevents Germany from attaining growth beyond 2%**, but fiscal policy will be more expansionary. There will be bumps on the road ahead, but we feel comfortable with our growth forecast of 1.8% for next year. So, although not at very high speed, Germany remains a growth engine for neighbouring countries and the Nordics with their close trade relations to Germany.

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600k

German companies report 600,000 vacant positions. Most of the refugees will have to improve their qualifications to succeed on the labour market.

16%

The employment ratio of Syrians living in Germany, less than a third than that of immigrants from former Yugoslavia.

Sources: Bundesagentur für Arbeit, Macrobond

Inflation targeting: any alternatives?

Norges Bank and the Riksbank focus on bringing consumer price inflation up to 2.5% and 2% respectively. However, there are drawbacks related to a narrow focus on consumer prices for small, trade-oriented countries. A broader measure such as nominal GDP might be preferable. The ongoing reviews of the inflation targeting regimes in both countries may bring light on those matters.

In the beginning of the 1990s, all Nordic countries had pegged their currencies to the European Currency Unit (ECU). But times were turbulent, and as the Bundesbank pushed through with monetary policy tightening, other countries had a hard time defending their currencies. In September 1992 Finland left the peg, followed by Sweden and Norway just a few months after. Finland and Sweden announced that as from 1995 they would start targeting price stability, while Norway did not formally decide on an inflation target until 2001. Finland joined the Exchange Rate Mechanism (ERM) already in 1996 and thus abandoned inflation targeting. Denmark managed to keep its peg during 1990s and has done so until this day.

In both Norway and Sweden, consumer price inflation works as operational targets. While Norges Bank strives for inflation to increase to 2.5% per year, the Riksbank's target is 2%.[1] The average inflation rates in Norway and Sweden over the past 15 years have been 1.8% and 1.5%, respectively. Thus, **in hindsight, both central banks' policies seem to have been too tight**. The bigger picture, however, is that inflation clearly has moderated compared to earlier decades and, in this perspective, monetary policy seems to have been successful in both countries.

Sweden and Norway have so called **flexible inflation targeting** regimes, which mean that besides inflation other factors, such as GDP or financial stability should be taken into account. Norges Bank has explicitly taken financial stability into account for many years. Previously this was also the case for the Riksbank but the policy was heavily criticised, also by dissidents within the governing board. And when both inflation and inflation expectations started to trend down, the Riksbank saw no other option than to return its focus to bring up inflation.

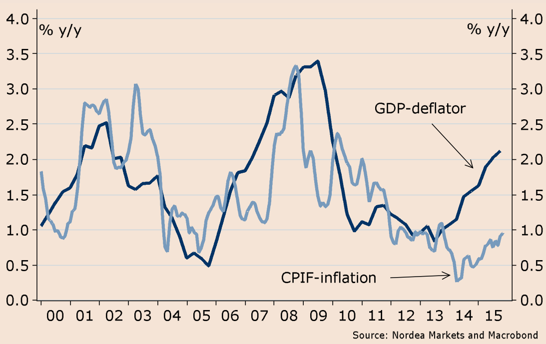
The inflation-targeting regimes are currently under review in both Sweden and Norway. The Swedish parliament has commissioned a review, due in January 2016, to "examine the formulation of the Swedish inflation target". The reviewers, Mervyn King and Marvin Goodfriend, seem to support inflation targeting so no radical changes to the existing

"Monetary policy cannot just 'mop up' after a crisis. Risks must be dealt with beforehand"

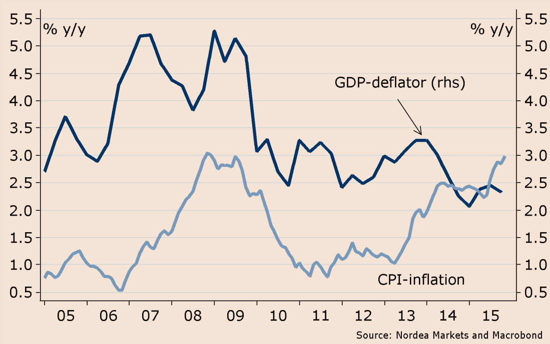
Mervyn King
Ex-governor of the BoE

[1] In Sweden, 2% was chosen because inflation at the time of the introduction of the inflation target was some 2%. Also, it was in line with that selected by other central banks. Norway set the target somewhat above its trading partners in order to allow for a real appreciation of the krona taking the form of a higher inflation differential rather than nominal appreciation. This, in turn, was linked to the government's decision to increase the non-oil fiscal deficit as a sustained fiscal expansion should lead to an appreciation of the real exchange rate.

A / Swedish inflation – perhaps not that low after all
CPIF inflation and GDP deflator, y/y change %



B / Norwegian core inflation above target:
CPI inflation and GDP deflator, y/y change %



A /
Swedish inflation is on a clear upward trend. A broader measure on inflation, the so-called GDP-deflator, shows that inflation even runs somewhat above 2% currently.

B /
Due to the weakening of the NOK, consumer price inflation has temporarily risen to 3%. However, a broader measure of inflation suggests that inflation now stands at record lows.

regime should be expected. More likely is that they will recommend a broader focus within the current framework, with greater weight on the real economy and perhaps financial stability. Mervyn King seems to support flexibility in monetary policy-making. For example, he called central bankers who focus on inflation only "inflation nutters". King also has said that "Monetary policy cannot just 'mop up' after a crisis. Risks must be dealt with beforehand".[2]

The Norwegian review has less formal status but may nevertheless be of high importance. REFIT (Review of Flexible Inflation Targeting) is a research project that has been going on since 2013 and the final report is scheduled for 2016. The project focuses on whether monetary policy should take into account financial stability and if so, how this should be done. **Another important issue is how monetary policy should be conducted in a small, open and commodity-exporting country.**

The ongoing reviews will hopefully elaborate not only on financial stability matters but also on the pros and cons of alternative inflation measures. There's surprisingly little research on which inflation measure to prefer.[3] In small and open economies consumer price inflation will to a large extent be imported from abroad. The central banks can still influence domestic inflation, and import prices will also be affected via currencies, but monetary policy may have to be more extreme than in larger, and less open, economies in order to bring inflation to target. Focusing on consumer price inflation only may entail a greater risk, for instance to financial stability, in small and open economies.

An alternative measure of inflation could be the GDP-deflator. **One merit of the GDP-deflator is that it reflects price development for the whole economy**, not just a narrow consumer basket.[4] The plunge in oil prices in late 2014, for instance, had different effects on oil-producing Norway and oil-consuming Sweden. Such effects are more visible in the broader GDP-deflator.

Another potential target would be **nominal GDP**, which takes into account both price inflation (GDP-deflator) and real economic developments. An attractive feature of this target is that it naturally rhymes well with the overall target of monetary policy-making, namely a stable development of the real economy.

The reason for choosing

2%

as a target was that inflation was around that level when the target was introduced. Also, it was in line with inflation targets in other countries.

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[2] Twenty years of inflation targeting (BoE speech, 9 October 2012)

[3] Perhaps this reflects that most of the research comes from a rather closed economy, namely the U.S. One exception is "The death of inflation targeting" (Frankel, 2012).

[4] The GDP-deflator incorporates price developments for all the components of GDP: households, public consumption, investments, exports and imports.

Economics of the refugee influx

Europe is experiencing the largest refugee crisis since the Second World War, with close to 250.000 asylum seekers arriving in the Nordic countries in 2015. The initial economic effects of this on the Nordic economies will be more expansionary fiscal policy, leading to a deterioration of public finances, but also higher economic growth. Longer term, the economic consequences depend solely on successful integration of the refugees in the labour markets.

More than a million asylum seekers are expected to arrive in the European Union, Norway and Switzerland before end of 2015. This corresponds to 0.2% of the population in those countries, not in itself an unmanageable number. But the refugee flows to the individual European countries are uneven. **Most of the refugees arrive in the south, but move north** to countries such as Germany and Sweden that traditionally have had a relatively open door to refugees. Among the Nordic countries, Finland and Norway are also experiencing an extraordinarily large inflow this year.

Refugee inflow calls for higher public expenditure

The total inflow of refugees to the Nordic countries in 2015 is expected to be around 250,000 corresponding to almost 1% of the population. However, also among the Nordic countries the refugee influx is uneven and a lion's share of the refugees is coming to Sweden. **The Swedish immigration authorities estimate asylum seekers could reach 165,000 by year-end** and an additional 135,000 in 2016. In Norway, it is estimated that 33,000 refugees will arrive both this year and next year. In Finland, 30,000 are estimated to arrive this year and 15,000 next year. In Denmark, 25,000 refugees are expected to arrive in both 2015 and 2016.

It marks a significant increase in the number of asylum seekers compared to 2014 when 81,185 applied for asylum in Sweden, 14,675 in Denmark, 11,415 in Norway and just 3,630 in Finland.

The number of refugees arriving in the Nordic countries these years is much higher than the asylum infrastructure can handle, and the countries are now changing regulations to limit the influx of asylum seekers. The increase in the number of asylum seekers is nevertheless driving increased public spending and more expansionary fiscal policies to handle the inflows, including local government expenditure on schools, social services and healthcare which will increase in line with the population.

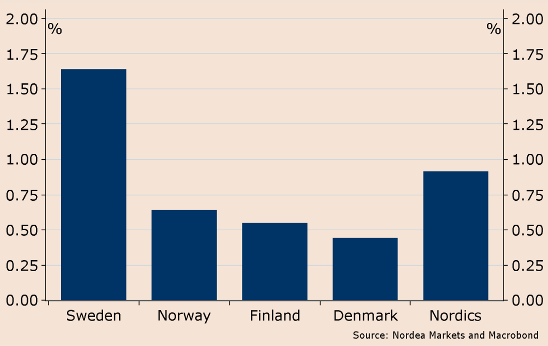
The Nordic countries are in a much better position than most other countries in Europe to handle the extra expenditure. Norway is sticking out with its NOK 7,400bn (EUR 800bn) sovereign wealth fund, but also Sweden and Denmark have solid public finances. Only Finland is currently experiencing problems with its public finances due to the long-lasting economic slowdown.

The Swedish Migration Agency estimates that government expenditure will increase by SEK 29bn

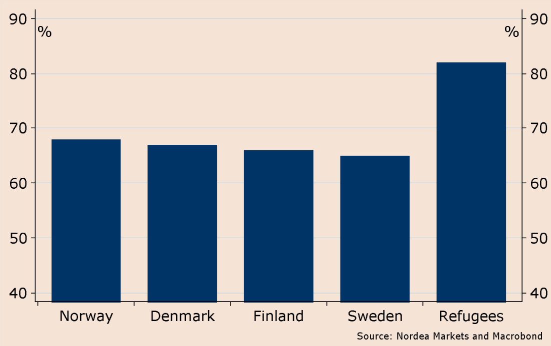
"The refugee influx calls for increased public spending, which will work as a demand shock on the Nordic economies."

Joachim Bernhardsen
Nordea analyst

A / Significant inflow of refugees to the Nordics
Refugee inflow as % of population in 2015, by country



B / Refugee influx is an opportunity in the long run
Share of population of working age (14-65 years)



A /
The Nordics are experiencing a sharp increase in asylum seekers, with the lion's share coming to Sweden

B /
Asylum seekers are to a bigger extent of working age. This represents an opportunity for the Nordic countries through increased supply of labour.

(EUR 3.1bn) next year, most of which will be funded through government borrowing. Part of the expenditure will be in the form of higher government consumption, with a direct impact on GDP. Another part will be in the form of transfers directly to the refugees, which indirectly will increase activity in the private sector. In total, **we expect the increased government expenditure to boost GDP growth by 0.5 % in both 2016 and 2017**.

Positive short term effects on Nordic GDP

Short term, the refugee influx can be seen as a demand shock which could put upward pressure on inflation. That should be welcomed by the Riksbank who has eased monetary policy to extreme levels to fight low inflation. On the other hand, an increase in the supply of labour and growing pressure to lower the barriers to entry in the labour market in the longer term have the opposite effect on inflation. The effect should be negligible at least in 2016.

In Norway, the government already had presented an expansionary 2016 budget. An addition to the budget was presented in November, increasing the estimated expenditure on refugees by NOK 9.5bn (EUR 1bn) in 2016. About 10% of the extra costs will be financed through higher transfers from the sovereign wealth fund. The rest is financed by higher dividends from state-owned companies, reduced foreign aid, expenditure cuts and tax increases. The expansionary effects will probably not be significant enough to prevent Norges Bank from cutting rates to 0.25% during next year. However, the timing of the rate cuts could be affected.

The increase in asylum seekers in Finland implies that public spending on asylum seekers will increase by 235% to EUR 460m in 2016. Almost all of this will be funded through increased borrowing, while in Denmark most of the DKK 10bn (EUR 1.3bn) increase in spending in 2015 and 2016 will be financed by reductions in foreign aid. Therefore, the consequences for Danish public balances are fairly limited in the short term. Assuming that the proportion of costs on refugees is the same across the Nordics, **GDP is estimated to rise by 0.1-0.2% over the coming years** in Denmark, Norway and Finland.

Long term effects depend on successful integration

In the long run, the inflow of refugees also represents an opportunity as it potentially increases the supply of labour. Many countries in Europe, including Finland and Denmark, suffer from an ageing population, and increased immigration could dampen such negative demographic effects. However, history tells us that this is a challenge as labour market participation rates for non-EU immigrants are lower than for both EU migrants and the native population.

To succeed in this particular field seems to be one of the biggest challenges for today's policymakers in all of the Nordic countries.

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1%

The expected flow of refugees to the Nordics in 2015 amounts to close to 1% of the population.

3.1bn

The expected increase in government expenditure (in EUR) in Sweden next year due to the refugee influx.

Emerging Markets risk: Fed hikes

2016 is likely to bring interest rate hikes from the Fed. Fed tightening cycles are widely seen as bad news for Emerging Markets (EM) and this one comes at a time when EM has already been hit by the slowdown in China and the massive drop in commodity prices. Can the Fed really make 2016 even worse for EM?

Higher interest rates from the Fed need not be bad news for EM. After all, the Fed initiates a tightening cycle because it views the US economy strong enough to cope. Moreover, the Fed has been warming up for this tightening cycle for so long that most of the adverse effect on EM may have happened already.

Indeed, our baseline scenario sees EM growth picking up modestly in 2016 after five consecutive years of slowdown. A key risk to this EM baseline is the Fed tightening cycle. In this note we take a closer look at the current vulnerabilities of EM. What can go wrong? And what are the reasons not to expect the worst?

Crucial current accounts

What could go wrong is most easily measured using the current account. **During the major EM crises of the 80s and the 90s, most EMs ran large current account deficits** and thus relied on Advanced Economies (AE) to finance part of their economic activities. Foreign financing vanished as these crises unfolded and sharp contraction in economic activity became inevitable.

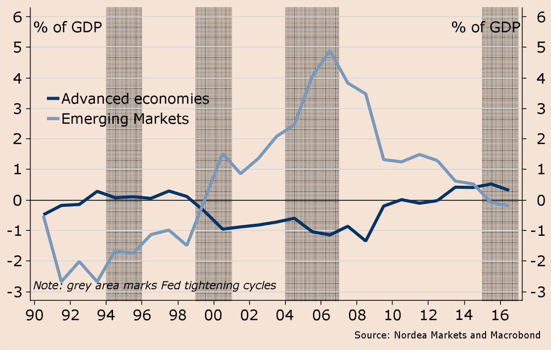
The Global Financial Crisis of the 00s that followed the most recent Fed tightening cycle did not trigger major EM crises. That might have been the case because EMs had built up large current account surpluses that acted as a cushion to absorb parts of the external shock when AEs went into recession and commodity prices collapsed. One region that ran large current account deficits during the Global Financial Crisis was Central and Eastern Europe (CEE), which ended on the brink of a banking crisis.

This time, the Fed can make foreign financing scarce once again, prompting serious economic adjustment in EMs with large current account deficits. Therefore **it is somewhat comforting that EM as a whole are running a balanced current account**, though the overall EM current account balance masks significant differences between regions and countries. Large EMs like Colombia, Turkey, South Africa, Brazil, Egypt, Saudi Arabia, Kazakhstan and Venezuela are all expected by the IMF to end up with current account deficits greater than 3% of GDP in 2015, making them more exposed to a potential worsening of foreign financing conditions. Emerging Asia still runs a current account surplus, and has done so since the Asian crisis.

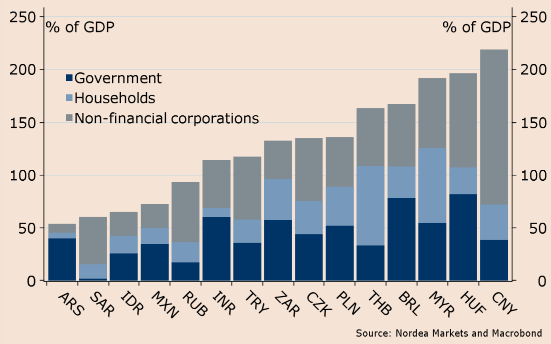
"Emerging Markets are much less vulnerable today than during the crisis of the 1980s and 1990s."

Anders Svendsen
Nordea chief analyst

A / EM run a balanced current account
Current account balance (IMF WEO estimate 2015)



B / Gross debt could be a problem, mostly in China
Gross debt by sector as of Q1 2015



A /
This time is different. EM run a balanced current account.

B /
Debt is too high, but in local currency and with corporates.

Focus on flexibility

Another comforting factor and major "this time is different" is **the exchange rate regime changes towards greater flexibility.** Foreign financing need not vanish and prompt real economic adjustments when a country has a flexible exchange rate. Instead, the price of foreign currency, the exchange rate, adjusts to prevent a shortage of foreign currency. **More EM FX weakening could thus be in store.**

Not all EMs have flexible exchange rates and several EMs with managed exchange rate regimes have in fact already run into foreign liquidity problems. Countries like Nigeria, Egypt, Argentina and Venezuela have chosen not to allow their currencies to weaken and currently suffer from a shortage of foreign currency. Pressure for more devaluations and more real-economic adjustment are likely.

Managed exchange rates can be a problem

What could go wrong also relates to debt. External debt and government debt are generally lower with respect to major EM crises of the past and predominantly in local currency. Managed exchange rate regimes tend to have a higher share of external debt denominated in foreign currency, perhaps as FX risks are perceived to be smaller. The latter could pave the way for EM crises in 2016 similar to the crises of the 80s and the 90s. The countries with largest FX-denominated external debt are countries like Kazakhstan, Chile, Turkey and Colombia.

China also manages its exchange but does not seem to have a significant share of its external debt in foreign currency. Moreover, **China also has a huge FX reserve** to defend any level of the renminbi for quite some time or even replace FX-denominated debt with local-currency debt.

Chinese debt levels are a problem, but not right now

China's problem is new to EM. The largest part of Chinese debt is taken up by non-financial companies in local currency. China's gross debt-to-GDP ratio is 225 % of GDP, of which 150% points is owed by non-financial corporates. China will most likely be in crisis over its debt-level at some time, but that need not be in 2016 given the current account surplus and large FX reserves. When it happens it could look more like a crisis in AEs.

To sum up, the Fed tightening is a key risk to our EM baseline as it could trigger economic and FX weakness. **EM is much less vulnerable today than during the major EM crises of the 80s and the 90s** with an overall balanced current account, flexible exchange rates and local-currency debt as the most important changes. However, countries with managed currencies could face a difficult 2016.

The gross debt in China is

225%

of GDP

The gross debt of the non-financial corporate sector in China is

150%

of GDP

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GLOBAL OVERVIEW

A world stumbling forward

The year 2015 will mark for the global economy its weakest expansion since 2009. However, thanks to an expected moderate cyclical recovery in Emerging Markets and continued gradual progress in advanced economies, global growth is forecast to pick up in 2016 and 2017. But the pace of the recovery is likely to remain below pre-crisis levels for both advanced economies and particularly Emerging Markets.

Six years after the end of the Great Recession, a return to a robust, synchronised global recovery is still rather distant. Thus, 2015 marked another year with weaker global growth and sharply diverging trends. While the recovery in advanced economies gained further momentum for the second straight year, activity in Emerging Markets (EM) slowed for the fifth year in a row, primarily driven by China and commodity-producing countries.

Because the gradually stronger recovery in advanced economies is not strong enough to offset the sharp slowdown in EM, this year the global economy is heading for its weakest expansion since 2009. Thus, global GDP growth is expected to slow from 3.4% in 2014 to 3.1% in 2015.

However, because the downturn in growth in EM is expected to bottom out in 2015, while the cyclical recovery in the advanced economies is projected to continue strengthening, global growth is forecast to pick up to 3.5% in 2016 and 3.4% in 2017. This is ½% point below the average growth recorded during 1995-2007. The 2015-2017 forecasts for global GDP are only little changed compared to our September projections.

Despite the anticipated improvement, the pace of the recovery is forecast to remain below pre-crisis levels for both advanced economies and particularly Emerging Markets. With growth in advanced economies generally projected to remain a little above potential, while EM growth is believed to remain well below potential, global spare capacity is expected to remain roughly steady over the next two years. The estimated potential growth rate for the global economy is around 3½% annually, according to the OECD.

Continued gradual pick-up in advanced economies

Among the advanced economies, growth is set to remain significantly stronger in the US and the UK than in the Euro area and Japan. This gap reflects stronger potential growth rates as well as more advanced business cycles in the US and the UK.

Thanks to domestic strength, the **US economy** is on track for two more years of moderate growth around 2½%, supported by low energy prices, reduced fiscal drag, robust wage income growth, favourable labour market conditions and an improving housing market. As the economy is fast approaching full employment, wage growth is expected to pick up significantly in 2016, offsetting a projected increase in consumer price inflation. These forces will likely

3.5%

The expected global growth in 2016 – half a percent point lower than what recorded between 1995 and 2007.

1.7%

Our forecast – revised higher – for the Euro area GDP growth for both 2016 and 2017 more than offset a continued drag on net exports coming from a stronger USD and weak foreign demand. Still, growth looks set to settle on a gentle downward trajectory in coming years as slack in the labour market is eliminated and the Federal Reserve (Fed) gradually normalises monetary policy.

Also in the **UK** economy a self-sustaining recovery continues to unfold. Growth is projected at 2¼-2½% in 2016 and 2017, driven by continued robust growth in private consumption more than offsetting the impact of significant fiscal tightening and a stronger GBP. The labour market has improved remarkably and consumer confidence remains at high levels, supported by continued recovery in wage growth and low oil prices.

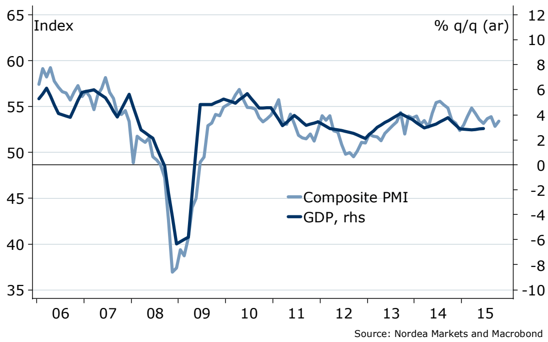
The **Euro area** is entering its third year of recovery. The pace has slowed down somewhat during this year due to weaker external demand. However, powerful drivers for domestic demand like low oil prices and easier bank lending conditions remain in place. With continued labour market improvement, private consumption will remain the prime engine of growth. Also capital spending should pick up somewhat, not least due to extremely lenient monetary policy. In addition, the stance of fiscal policy is expected to change from neutral to slightly expansionary as governments will spend more money on refugees and for security purposes in the wake of the tragic Paris attacks. On the other hand, we cannot be completely sure that there will be no "uncertainty shock" holding back investment and/or private consumption. Against this backdrop, we have raised our GDP growth forecasts for both 2016 and 2017 to 1.7%. Weakness in Emerging Markets will continue to be a drag on a more substantial recovery.

The outlook for **Japan** remains softer than in other advanced economies, reflecting weaker demographics, weaker foreign demand and strong fiscal headwinds. In 2015 the economy entered a new recession, the fifth since 2008, as uncertainty over the global outlook hurt activity. Growth, however, is expected to firm up to 1% in 2016, supported by higher real wages and front-loaded demand in anticipation of the planned sales tax hike in 2017. In 2017, by contrast, growth will likely decline again due to fiscal tightening.

"Weakness in the Emerging Markets will be a drag on a more substantial recovery in the Euro area"

Johnny Bo Jakobsen
Nordea chief analyst

A / Global economy stumbling forward
Global real GDP growth and global composite PMI



B / Looking for a turnaround
Manufacturing PMIs

A /
Still no signs of a return to a robust, synchronised global recovery

B /
Cyclical weakness in Emerging Markets, while advanced economies are performing somewhat better

Sources: Nordea Markets and Macrobond

GDP GROWTH FORECAST, % Y/Y

	World		G3		BRIC		US		Euro area		China		Japan		UK	
	New	Old	New	Old	New	Old	New	Old	New	Old	New	Old	New	Old	New	Old
2014	3.4	3.4	1.5	1.5	5.8	5.8	2.4	2.4	0.9	0.9	7.4	7.4	-0.1	-0.1	3.0	3.0
2015	3.1	3.1	1.9	1.9	4.9	5.0	2.5	2.5	1.5	1.3	6.8	6.8	0.5	0.7	2.6	2.6
2016	3.5	3.5	2.1	2.1	5.4	5.6	2.7	2.8	1.7	1.6	6.6	6.6	1.0	1.2	2.4	2.4
2017	3.4	3.3	2.0	2.0	5.6	5.7	2.5	2.5	1.7	1.5	6.2	6.2	0.6	0.6	2.2	2.2

Modest cyclical recovery in Emerging Markets

Following a decade of rapid growth, Emerging Markets have slowed down sharply in recent years, with some economies currently going through deep recessions. Because the slowdown is partly driven by structural, more permanent, factors, the strong growth momentum of the 2000s is unlikely to repeat.

The projected modest cyclical acceleration in Emerging Markets in 2016 and 2017 reflects a gradual normalisation of conditions in distressed countries like Russia and Brazil, assuming a stabilisation in commodity prices, and positive spill-overs from advanced economies. China is projected to gradually slow further due to a declining working-age population and weaker productivity gains.

While the EM outlook remains bleak, it has recently stopped worsening. The fear of a significant near-term slowdown in **China** has abated due to the massive economic policy easing this year. Growth is expected to slow only modestly over the next two years. The authorities have room to ease policies further if necessary. The government's commitment to sustain high growth is confirmed by the official target of at least 6.5% real GDP growth for the coming five years.

Falling commodity prices are still hurting commodity producers. In the biggest EMs like **Russia, Brazil and Mexico,** flexible exchange rates have absorbed a large part of the shock. Indeed, weaker currencies have partly shielded profits of exporters while temporarily eroding the purchasing power of consumers through higher import prices. This effect is gradually fading, leading to lower inflation and stabilising growth going into 2016. Some commodity exporters, mainly in the Middle East, Africa and Latin America, that manage their exchange rates will continue to suffer as the shock is gradually absorbed by the real economy. More crises and devaluations are a risk in these countries, but should not matter much for the overall EM growth outlook.

Monetary policy divergence

The episode of falling headline inflation in advanced economies is now over, if commodity prices stabilise. Thus, over the next few months fading base effects from falling energy prices a year ago will push 12-month inflation rates higher, assuming oil prices develop in line with our forecast. Core inflation rates have already started to rise and are expected to track slightly higher during 2016.

Nevertheless, central banks are generally believed to maintain extraordinary levels of monetary support. After all, disinflation concerns are unlikely to disappear any time soon given the amount of spare capacity in the global economy. Although wage pressures should start to build in advanced economies as labour markets tighten, the pick-up is generally likely to be slow.

Still, because the business cycle is more advanced in the US, the **Fed** is likely to start hiking rates in December this year for the first time since 2006. We currently expect the Fed to raise the funds rate by 100 bp in both 2016 and 2017. The **Bank of England** should start raising rates in Q2 2016.

By contrast, a projected modest pick-up in Euro-area wage inflation and core inflation will give the **ECB** ample room to continue its easy policy stance. We have pencilled in the first ECB rate hike in H1 2018. The **Bank of Japan** is also expected to continue its aggressive quantitative easing.

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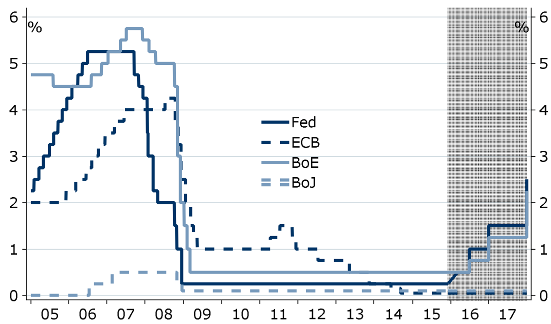
C / Monetary policy divergence
Key central bank interest rates



Source: Nordea Markets and Macrobond

6.5%
China's official GDP growth target confirms the government's commitment to sustain high growth

1.50%
Our fed funds rate forecast for end 2016

C /
Fed and BoE expected to start raising rates before long, while ECB and BoJ are likely to continue their easy policy stance

Sources: [Source]

OIL

Hard times not over for oil

Oil prices remain under pressure as oil production growth continues to outpace a formidable growth in oil demand. Inventories are at a record high leaving the market with a healthy cushion in case of unexpected supply disturbances. If OPEC continues to stick to its market share strategy, we don't expect to see a sharp upswing in oil prices in the forecast period.

OPEC will force low prices for a long time

OPEC is drowning the market with cheap oil to try to squeeze out the more costly producers, but the process has been more painful and longer lasting than expected. Despite a year with punitively low prices, non-OPEC production has remained stubbornly high as the US shale production has been more resilient to lower oil prices and Russia is producing at the highest level since the breakup of the Soviet Union. We expect to see a sharper fall in US oil production next year, but the effect will be outbalanced by the return of large volumes of Iranian oil after the sanctions are removed. Oil prices have to stay low for an extended period for OPEC to reap its reward and win back market share.

Low oil prices and ten years with ballooning costs have forced oil companies to put new projects on hold. Global investments have been cut by 20% in 2015 and more cuts are expected in 2016. Oil demand has surged as lower oil prices have triggered above-trend growth especially in India and from motorists in US and China. This will abate next year.

The transport sector accounts for 55% of the world's oil consumption, and oil-based fuels have in effect been shielded from competition. OPEC's production control has contributed to a decade of rising oil prices. In addition, climate change and growing pollution in metropolises around the world have increased the pressure for new energy efficiency standards and emission cuts from transport. This has in turn triggered development of new sources and new battery technology – ultimately a dampener for oil demand.

-19%

Drop in global oil investment projects between 2014 and 2016

A /
In spite of surging demand, especially from the US and China, the world will be oversupplied well into 2017

Sources: Nordea Markets, Rystad Energy, IEA and Macrobond

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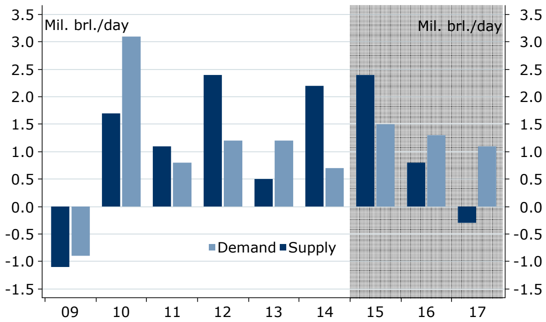
A / Supply will be outstripping demand until 2017:
Year on year change in production/supply (mm. barrels/day)



Source: Nordea Markets and Macrobond

BRENT OIL PRICE FORECAST
USD/barrel

	Q1	Q2	Q3	Q4	Year
2013	113	103	110	109	109
2014	108	110	103	77	100
2015E	55	64	51	47	54
2016E	50	53	56	59	55
2017E	60	63	67	70	65

Risk scenarios

In our baseline scenario, we expect a modest pick-up in global growth as the cyclical recovery in advanced economies should strengthen and the downturn in Emerging Markets is bottoming out (read more in the global overview section).

We outline here what we see as the main macro-related and financial market risks to the baseline that could affect the global growth outlook in both a positive or negative direction. All in all, at this juncture we continuously consider the risks to our baseline scenario as **balanced**.

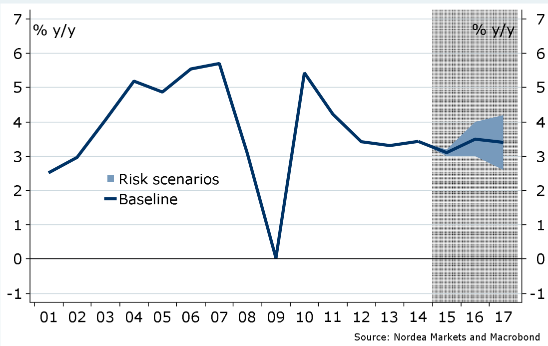
Upside risks:

- Stronger than expected growth in **commodity-importing countries** due to the decline in commodity prices
- The current negative growth outlook for China may turn out to be too pessimistic. The authorities might find ways to stimulate growth, though probably increasing longer-term downside risks
- **Less than expected** tightening by the Fed
- **Growth in the Euro aread might pick up** more than expected – for example owing to easier fiscal policy, positive wealth effects, a weaker euro or pent-up demand being released
- Convincing **structural reforms** in countries such as France, Italy, Brazil and India
- The situation in the **Middle East** could calm down, and **sanctions against Russia** could be lifted.

Downside risks:

- The downturn in **Emerging Market economies** may run further, e.g. triggered by a further drop in commodity prices or structural changes in China.
- A hawkish repricing of upcoming Fed hikes or excessive risk-taking by investors hunting for yield may lead to **financial market instability.**
- **Europe** could be hit by an **uncertainty shock** in the wake of the Paris attacks and the strong influx of refugees holding back investments and / or private consumption.
- Also, the EU is struggling to find common answers to thorny issues like the refugees crisis. **EU break up fears may rise** also in the wake of the "Brexit" referendum to be held in the UK.
- **Geopolitical tensions** (e.g. in the Middle East, Ukraine and South East Asia) might escalate, with negative repercussions on confidence

Baseline and risk scenarios for global growth
Year on year growth in real world GDP



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Growth, %

	2013	2014	2015E	2016E	2017E
World[1]	3.3	3.4	3.1	3.5	3.4
Advanced economies	1.1	1.8	2.0	2.2	2.1
USA	1.5	2.4	2.5	2.7	2.5
Euro area	-0.2	0.9	1.5	1.7	1.7
Japan	1.6	-0.1	0.5	1.0	0.6
Denmark	-0.2	1.3	1.4	1.7	1.9
Norway	2.3	2.3	1.4	1.4	1.7
Sweden	1.2	2.3	3.7	3.8	2.4
UK	1.7	3.0	2.6	2.4	2.2
Germany	0.4	1.6	1.5	1.8	1.6
France	0.7	0.2	1.2	1.4	1.6
Italy	-1.8	-0.4	0.7	1.2	1.3
Spain	-1.7	1.4	3.1	2.7	2.5
Finland	-1.1	-0.4	-0.2	0.5	0.7
Estonia	1.6	2.9	1.3	2.7	2.9
Latvia	3.5	2.5	2.4	3.0	3.5
Lithuania	3.7	3.0	1.8	4.0	3.5
Emerging economies	4.9	4.6	3.9	4.6	4.9
China	7.7	7.4	6.8	6.6	6.2
Russia	1.3	0.6	-3.7	0.3	1.1
India	6.4	7.1	7.3	7.5	7.6
Brazil	3.0	0.1	-3.7	-2.4	1.1
Poland	1.5	3.4	3.6	3.5	3.3
Rest of World	3.6	3.3	2.8	3.6	4.0

Inflation, %

	2013	2014	2015E	2016E	2017E
World[1]	4.1	3.8	3.6	4.1	4.1
Advanced economies	1.4	1.4	0.3	1.6	2.2
USA	1.5	1.6	0.2	2.2	2.8
Euro area	1.4	0.4	0.1	1.1	1.6
Japan	0.4	2.7	0.8	0.5	1.4
Denmark	0.8	0.6	0.5	1.1	1.9
Norway	2.1	2.0	2.2	2.4	1.5
Sweden	0.0	-0.2	0.0	1.2	1.8
UK	2.6	1.5	0.0	1.1	1.9
Germany	1.6	0.8	0.2	1.1	1.7
France	1.0	0.6	0.1	1.4	1.6
Italy	1.3	0.2	0.2	1.1	1.4
Spain	1.5	-0.2	-0.6	0.7	1.6
Finland	1.5	1.0	-0.2	0.8	1.0
Estonia	2.8	-0.1	-0.4	1.7	2.9
Latvia	0.0	0.6	0.3	1.3	2.6
Lithuania	1.0	0.1	-0.8	1.8	2.6
Emerging economies	6.1	5.5	5.9	5.9	5.4
China	2.6	2.0	1.5	2.0	2.6
Russia	6.5	11.4	11.5	8.0	6.5
India	10.7	6.6	4.7	5.0	2.8
Brazil	6.2	6.3	8.4	7.0	4.9
Poland	1.2	0.2	-0.8	0.6	1.9
Rest of World	6.2	6.0	7.3	7.6	7.2

1) Weighted average of 186 countries. Weights for all countries and data for Rest of World are from the most recent World Economic Outlook, by the IMF. The weights are calculated from PPP-adjusted GDP-levels

Public finances, % of GDP

	2013	2014	2015E	2016E	2017E
USA	-4.1	-2.8	-2.5	-2.2	-2.1
Euro area	-3.0	-2.6	-2.0	-2.0	-1.7
Japan	-10.1	-7.7	-7.5	-7.2	-6.8
Denmark	-1.0	1.8	-2.9	-2.7	-2.3
Norway	10.8	9.0	7.0	5.4	6.0
Sweden	-1.4	-1.9	-1.0	-1.3	-1.6
UK	-5.7	-5.7	-5.2	-4.1	-2.7
Germany	-0.1	0.3	0.6	0.1	0.2
France	-4.1	-3.9	-3.8	-3.8	-3.4
Italy	-2.9	-3.0	-2.6	-2.3	-1.6
Spain	-6.9	-5.9	-4.5	-3.5	-2.5
Finland	-2.5	-3.3	-3.2	-3.1	-2.9
Estonia	-0.2	0.8	0.2	-0.3	-0.2
Latvia	-0.9	-1.5	-1.7	-1.2	-1.0
Lithuania	-2.2	-0.7	-0.9	-1.2	-0.5
China	-1.1	-1.1	-1.3	-1.1	-0.8
Russia	-0.8	-0.7	-4.0	-3.0	-2.0
India	-7.6	-7.0	-6.5	-6.0	-6.0
Brazil	-3.1	-6.2	-7.9	-7.5	-5.8
Poland	-4.3	-3.3	-2.9	-2.8	-2.5

Current account, % of GDP

	2013	2014	2015E	2016E	2017E
USA	-2.3	-2.2	-2.4	-2.4	-2.5
Euro area	2.5	3.0	3.5	3.4	3.0
Japan	0.8	0.5	2.0	2.0	2.0
Denmark	7.1	7.7	7.4	7.0	6.3
Norway	10.2	9.7	6.3	5.6	6.5
Sweden	6.1	5.5	6.4	6.8	6.7
UK	-4.5	-5.9	-5.1	-4.7	-4.2
Germany	6.9	7.6	7.9	8.2	8.0
France	-2.6	-2.3	-1.3	-1.6	-2.2
Italy	0.9	2.0	2.2	1.9	1.9
Spain	1.5	1.0	1.4	1.3	1.4
Finland	-1.8	-2.2	-1.0	-0.1	-0.1
Estonia	-0.1	1.1	2.4	1.4	1.1
Latvia	-2.3	-1.9	-1.2	-2.0	-2.0
Lithuania	1.5	3.6	-2.0	-1.0	-1.0
China	1.9	2.0	2.0	1.5	2.0
Russia	1.6	2.9	3.5	2.5	2.0
India	-1.7	-1.5	-1.0	-1.3	-1.0
Brazil	-3.3	-4.5	-3.9	-3.6	-3.4
Poland	-1.3	-1.3	-1.0	-1.5	-2.0

Monetary policy rates

	9.12.15	3M	30.06.16	31.12.16	31.12.17
US	0.25	0.50	1.00	1.50	2.50
Japan	0.10	0.10	0.10	0.10	0.10
Euro area	0.05	0.05	0.05	0.05	0.05
Denmark	-0.75	-0.75	-0.65	-0.50	-0.30
Sweden	-0.35	-0.35	-0.35	0.00	0.00
Norway	0.75	0.75	0.50	0.25	0.25
UK	0.50	0.50	0.75	1.25	2.25
Switzerland	-0.75	-0.75	-0.75	-0.75	-0.75
Poland	1.50	1.50	1.50	1.00	1.50
Russia	11.00	10.50	9.00	8.00	7.00
China	4.35	4.10	4.10	4.10	4.10
India	6.75	6.75	6.75	6.75	6.50
Brazil	14.25	14.25	14.25	13.50	11.50

Monetary policy rate spreads vs Euro area

	9.12.15	3M	30.06.16	31.12.16	31.12.17
US	0.20	0.45	0.95	1.45	2.45
Japan[1]	-0.15	-0.40	-0.90	-1.40	-2.40
Euro area	-	-	-	-	-
Denmark	-0.80	-0.80	-0.70	-0.55	-0.35
Sweden	-0.40	-0.40	-0.40	-0.05	-0.05
Norway	0.70	0.70	0.45	0.20	0.20
UK	0.45	0.45	0.70	1.20	2.20
Switzerland	-0.80	-0.80	-0.80	-0.80	-0.80
Poland	1.45	1.45	1.45	0.95	1.45
Russia	10.95	10.45	8.95	7.95	6.95
China	4.30	4.05	4.05	4.05	4.05
India	6.70	6.70	6.70	6.70	6.45
Brazil	14.20	14.20	14.20	13.45	11.45

1) Spread vs USA

3-month rates

	9.12.15	3M	30.6.16	31.12.16	31.12.17
US	0.44	0.60	1.10	1.65	2.65
Euro area	-0.12	-0.15	-0.15	-0.15	-0.10
Denmark	-0.18	-0.10	-0.05	0.00	0.10
Sweden	-0.44	-0.30	-0.25	0.10	0.10
Norway	1.15	1.00	0.90	0.65	0.65
UK	0.57	0.60	0.85	1.65	2.65
Poland	1.72	1.65	1.50	1.25	1.75
Russia	11.82	11.70	10.50	9.50	8.50

3-month spreads vs Euro area

	9.12.15	3M	30.6.16	31.12.16	31.12.17
US	0.56	0.75	1.25	1.80	2.75
Euro area	-	-	-	-	-
Denmark	-0.06	0.05	0.10	0.15	0.20
Sweden	-0.31	-0.15	-0.10	0.25	0.20
Norway	1.27	1.15	1.05	0.80	0.75
UK	0.70	0.75	1.00	1.80	2.75
Poland	1.84	1.80	1.65	1.40	1.85
Russia	11.94	11.85	10.65	9.65	8.60

10-year government benchmark yields

	9.12.15	3M	30.6.16	31.12.16	31.12.17
US	2.20	2.30	2.60	2.90	3.50
Euro area	0.67	0.50	0.65	0.90	1.30
Denmark	0.92	0.80	0.95	1.20	1.50
Sweden	0.87	0.95	1.00	1.20	1.75
Norway	1.61	1.70	1.80	1.95	2.30
UK	1.86	2.00	2.25	2.80	3.35
Poland	2.69	2.80	2.80	3.00	3.25

10-year yield spreads vs Euro area

	9.12.15	3M	30.6.16	31.12.16	31.12.17
US	1.53	1.80	1.95	2.00	2.20
Euro area	-	-	-	-	-
Denmark	0.25	0.30	0.30	0.30	0.20
Sweden	0.21	0.45	0.35	0.30	0.45
Norway	0.95	1.20	1.15	1.05	1.00
UK	1.19	1.50	1.60	1.90	2.05
Poland	2.03	2.30	2.15	2.10	1.95

Exchange rates vs EUR

	9.12.15	3M	30.6.16	31.12.16	31.12.17
EUR/USD	1.092	1.08	1.03	1.00	1.10
EUR/JPY	134.0	130	121	115	121
EUR/DKK	7.461	7.46	7.46	7.46	7.45
EUR/SEK	9.260	9.30	9.10	8.80	8.80
EUR/NOK	9.536	9.20	9.00	8.80	8.50
EUR/GBP	0.727	0.69	0.66	0.66	0.72
EUR/CHF	1.083	1.08	1.09	1.09	1.10
EUR/PLN	4.344	4.20	4.10	4.00	3.80
EUR/RUB	75.86	69.7	62.3	58.0	61.6
EUR/CNY	7.013	6.97	6.70	6.60	7.04
EUR/INR	72.87	71.3	67.0	64.0	66.0
EUR/BRL	4.165	4.21	4.02	3.80	4.13

Exchange rates vs USD

	9.12.15	3M	30.6.16	31.12.16	31.12.17
-					
USD/JPY	122.7	120	117	115	110
USD/DKK	6.835	6.91	7.24	7.46	6.77
USD/SEK	8.483	8.61	8.83	8.80	8.00
USD/NOK	8.737	8.52	8.74	8.80	7.73
GBP/USD	1.502	1.57	1.56	1.52	1.53
USD/CHF	0.992	1.00	1.06	1.09	1.00
USD/PLN	3.980	3.89	3.98	4.00	3.45
USD/RUB	69.50	64.5	60.5	58.0	56.0
USD/CNY	6.425	6.45	6.50	6.60	6.40
USD/INR	66.76	66.0	65.0	64.0	60.0
USD/BRL	3.816	3.90	3.90	3.80	3.75

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Appendix

SWEDEN: Macroeconomic indicators

	2012 (SEKbn)	2013	2014	2015E	2016E	2017E
Private consumption	1,715.0	1.9	2.2	2.4	2.5	2.1
Government consumption	954.9	1.3	1.3	2.2	4.0	2.5
Fixed investment	834.2	0.6	7.5	7.4	5.3	3.1
- industrial investment	165.3	1.8	3.9	1.7	2.0	1.5
- residential investment	127.1	0.9	19.8	16.5	7.7	4.3
Stockbuilding*	-1.0	0.2	0.1	0.0	0.0	0.0
Exports	1,706.9	-0.8	3.5	5.0	6.0	3.7
Imports	1,525.2	-0.1	6.3	4.6	5.8	3.8
Real GDP, % y/y		1.2	2.3	3.7	3.8	2.4
Real GDP (calendar adjusted), % y/y		1.2	2.4	3.5	3.5	2.6
Nominal GDP (SEKbn)	3,684.8	3,769.9	3,918.2	4,147.9	4,370.8	4,544.0
Unemployment rate, %		8.0	7.9	7.4	6.8	6.9
Employment, % y/y		1.0	1.4	1.3	1.4	0.9
Consumer prices, % y/y		0.0	-0.2	0.0	1.2	1.8
Underlying prices (CPIF), % y/y		0.9	0.5	0.9	1.6	1.7
Hourly earnings, % y/y		2.1	1.7	3.1	3.2	3.4
Current account balance (SEKbn)		229.0	214.5	266.6	299.0	303.4
Current account balance, % of GDP		6.1	5.5	6.4	6.8	6.7
Trade balance, % of GDP		3.8	3.0	2.9	2.9	2.8
General gov. budget balance (SEKbn)		-52.0	-74.8	-42.0	-57.8	-70.6
General gov. budget balance, % of GDP		-1.4	-1.9	-1.0	-1.3	-1.6
General gov. gross debt, % of GDP		39.8	44.9	43.5	42.1	41.1
Monetary policy rate (end of period)		0.75	0.00	-0.35	0.00	0.00
USD/SEK (end of period)		6.42	7.83	8.53	8.80	8.00
EUR/SEK (end of period)		8.85	9.48	9.27	8.80	8.80

* Contribution to GDP growth (% points)

DENMARK: Macroeconomic indicators

	2012 (DKKbn)	2013	2014	2015E	2016E	2017E
Private consumption	895.6	-0.1	0.5	2.2	2.2	2.1
Government consumption	501.6	-0.7	0.2	1.0	0.7	0.6
Fixed investment	356.8	1.1	3.4	0.9	2.5	3.0
- government investment	43.6	-0.4	7.4	-2.5	-2.2	-2.0
- residential investment	77.2	-1.1	3.1	-1.7	2.6	4.2
- business investment	236.0	2.4	2.1	2.9	4.0	4.2
Stockbuilding*	9.9	-0.1	0.3	-0.4	0.0	0.0
Exports	1,008.6	0.9	3.1	-0.7	1.3	2.6
Imports	906.4	1.1	3.3	-1.2	1.6	2.8
Real GDP, % y/y		-0.2	1.3	1.4	1.7	1.9
Nominal GDP (DKKbn)	1,882.6	1,903.5	1,942.6	1,989.5	2,044.6	2,124.4
Unemployment rate, %		5.8	5.0	4.6	4.0	3.6
Gross unemployment level, '000 persons		153.7	134.0	122.3	106.9	95.9
Consumer prices, % y/y		0.8	0.6	0.5	1.1	1.9
Hourly earnings, % y/y		1.3	1.3	1.5	1.9	2.4
Nominal house prices, one-family, % y/y		2.7	3.4	6.6	3.3	2.3
Current account balance (DKKbn)		135.8	149.9	148.0	143.0	135.0
Current account balance, % of GDP		7.1	7.7	7.4	7.0	6.3
General gov. budget balance (DKKbn)		-20.0	34.6	-57.7	-54.3	-48.3
General gov. budget balance, % of GDP		-1.0	1.8	-2.9	-2.7	-2.3
General gov. gross debt, % of GDP		43.1	44.6	39.5	41.0	42.4
Monetary policy rate, deposit (end of period)		-0.10	-0.05	-0.75	-0.50	-0.30
USD/DKK (end of period)		5.41	6.15	6.88	7.46	6.77
EUR/DKK (end of period)		7.46	7.45	7.46	7.46	7.45

* Contribution to GDP growth (% points)

NORWAY: Macroeconomic indicators

	2012 (NOKbn)	2013	2014	2015E	2016E	2017E
Private consumption	1,176.4	2.7	1.7	2.3	1.6	2.0
Government consumption	618.9	1.0	2.9	2.4	3.1	2.9
Fixed investment	659.8	6.3	0.0	-3.2	-1.0	-0.5
- gross investment, mainland	478.3	2.9	1.3	1.2	2.1	0.8
- gross investment, oil	174.7	19.3	-2.9	-14.0	-10.0	-5.0
Stockbuilding*	129.2	0.4	0.5	0.0	0.0	0.0
Exports	1,204.4	-1.7	2.2	4.2	3.2	1.5
- crude oil and natural gas	610.8	-5.5	1.9	3.5	3.0	0.5
- other goods	309.6	1.3	2.5	5.7	4.0	2.8
Imports	821.0	4.9	1.5	1.6	1.7	1.8
Real GDP, % y/y	2,965.2	1.0	2.2	1.9	1.9	1.4
Real GDP (Mainland), % y/y	2,365.4	2.3	2.3	1.4	1.4	1.7
Unemployment rate, %		3.5	3.5	4.4	4.8	4.9
Consumer prices, % y/y		2.1	2.0	2.2	2.4	1.5
Core consumer prices, % y/y		1.6	2.4	2.7	2.4	1.4
Annual wages, % y/y		4.0	3.9	2.7	2.7	2.7
Current account balance (NOKbn)		314.2	307.0	206.4	191.4	228.4
Current account balance, % of GDP		10.2	9.7	6.3	5.6	6.5
Trade balance, % of GDP		10.7	9.2	6.3	7.1	8.0
General gov. budget balance (NOKbn)		331.3	282.9	229.3	184.2	211.5
General gov. budget balance, % of GDP		10.8	9.0	7.0	5.4	6.0
Monetary policy rate, deposit (end of period)		1.50	1.25	0.75	0.25	0.25
USD/NOK (end of period)		6.07	7.49	8.52	8.80	7.73
EUR/NOK (end of period)		8.36	9.07	9.23	8.80	8.50

* Contribution to GDP growth (% points)

FINLAND: Macroeconomic indicators

	2012 (EURbn)	2013	2014	2015E	2016E	2017E
Private consumption	109.1	-0.3	0.5	0.4	0.3	0.4
Government consumption	48.7	0.8	-0.2	-0.2	-0.2	-0.3
Fixed investment	44.5	-5.2	-3.3	-2.3	1.6	2.9
Stockbuilding*	0.4	-0.4	0.4	-0.5	0.1	-0.3
Exports	78.9	1.1	-0.7	-1.4	2.2	2.4
Imports	0.0	0.0	0.0	-2.9	2.2	1.8
Real GDP, % y/y		-1.1	-0.4	-0.2	0.5	0.7
Nominal GDP (EURbn)	199.8	202.7	205.2	208.4	212.4	215.8
Unemployment rate, %		8.4	8.7	9.5	10.0	10.3
Industrial production, % y/y		-0.6	-0.3	-1.5	1.0	1.5
Consumer prices, % y/y		1.5	1.0	-0.2	0.8	1.0
Hourly earnings, % y/y		2.1	1.4	1.2	0.8	0.7
Current account balance (EURbn)		-3.6	-4.5	-2.0	-0.2	-0.3
Current account balance, % of GDP		-1.8	-2.2	-1.0	-0.1	-0.1
Trade balance (EURbn)		0.2	0.9	2.9	4.1	3.9
Trade balance, % of GDP		0.1	0.5	1.4	1.9	1.8
General gov. budget balance (EURbn)		-5.1	-6.8	-6.7	-6.5	-6.3
General gov. budget balance, % of GDP		-2.5	-3.3	-3.2	-3.1	-2.9
General gov. gross debt (EURbn)		112.7	121.1	130.2	139.1	147.6
General gov. gross debt, % of GDP		55.6	59.0	62.5	65.5	68.4
Monetary policy rate (end of period)		0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)		1.38	1.21	1.08	1.00	1.10

* Contribution to GDP growth (% points)

ESTONIA: Macroeconomic indicators

	2012 (EURbn)	2013	2014	2015E	2016E	2017E
Private consumption	9.1	3.8	3.5	5.1	2.9	2.7
Government consumption	3.3	1.5	3.0	1.4	1.5	1.9
Fixed investment	4.8	3.2	-3.1	-4.1	3.6	4.7
Exports	15.6	4.7	1.8	-2.1	3.1	4.4
Imports	15.4	4.5	1.4	-2.9	3.5	4.8
Real GDP, % y/y		1.6	2.9	1.3	2.7	2.9
Nominal GDP (EURbn)	18.0	19.0	20.0	20.6	21.6	22.9
Unemployment rate, %		8.6	7.3	6.1	6.1	7.0
Consumer prices, % y/y		2.8	-0.1	-0.4	1.7	2.9
Gross wages, % y/y		7.8	5.6	5.8	4.6	5.7
Current account balance, % of GDP		-0.1	1.1	2.4	1.4	1.1
General gov. budget balance, % of GDP		-0.2	0.8	0.2	-0.3	-0.2
Monetary policy rate (end of period)		0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)		1.38	1.21	1.08	1.00	1.10

LATVIA: Macroeconomic indicators

	2012 (EURbn)	2013	2014	2015E	2016E	2017E
Private consumption	13.8	5.1	2.3	3.4	4.0	3.5
Government consumption	3.8	1.6	4.9	3.0	2.0	2.0
Fixed investment	5.6	-6.0	0.5	2.0	4.0	5.5
Exports	13.4	1.1	3.1	1.8	3.0	4.0
Imports	14.4	-0.2	0.8	2.4	4.0	4.5
Real GDP, % y/y		3.5	2.5	2.4	3.0	3.5
Nominal GDP (EURbn)	21.8	22.7	23.6	24.2	25.2	26.7
Unemployment rate, %		11.8	10.8	9.8	9.0	8.0
Consumer prices, % y/y		0.0	0.6	0.3	1.3	2.6
Gross wages, % y/y		4.7	6.9	6.7	5.0	5.0
Current account balance, % of GDP		-2.3	-1.9	-1.2	-2.0	-2.0
General gov. budget balance, % of GDP		-0.9	-1.5	-1.7	-1.2	-1
Monetary policy rate (end of period)		0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)		1.38	1.21	1.08	1.00	1.10

LITHUANIA: Macroeconomic indicators

	2012 (EURbn)	2013	2014	2015E	2016E	2017E
Private consumption	20.8	4.9	3.6	5.3	4.5	3.5
Government consumption	5.8	1.1	1.2	2.3	2.5	2.0
Fixed investment	5.8	8.4	5.3	9.7	3.5	6.0
Exports	27.2	9.7	2.9	0.6	3.0	4.5
Imports	26.9	10.4	2.8	6.6	2.5	5.0
Real GDP, % y/y		3.7	3.0	1.8	4.0	3.5
Nominal GDP (EURbn)	33.3	35.0	36.5	37.2	39.6	42.1
Unemployment rate, %		11.9	10.7	9.4	8.5	7.5
Consumer prices, % y/y		1.0	0.1	-0.8	1.8	2.6
Gross wages, % y/y		5.0	4.5	5.0	6.0	6.0
Current account balance, % of GDP		1.5	3.6	-2.0	-1.0	-1.0
General gov. budget balance, % of GDP		-2.2	-0.7	-0.9	-1.2	-0.5
Monetary policy rate (end of period)		0.25	0.05	0.05	0.05	0.05
EUR/USD (end of period)		1.38	1.21	1.08	1.00	1.10

RUSSIA: Macroeconomic indicators

	2012 (RUBbn)	2013	2014	2015E	2016E	2017E
Private consumption	31,019	5.0	1.3	-7.0	-0.2	1.5
Government consumption	11,675	1.1	-0.1	0.0	0.0	0.0
Fixed investment	13,639	0.9	-2.0	-6.0	0.8	3.0
Exports	18,365	4.6	-0.1	-25.0	6.0	9.0
Imports	13,853	3.8	-7.9	-35.0	2.0	5.0
Real GDP, % y/y		1.3	0.6	-3.7	0.3	1.1
Nominal GDP (RUBbn)	62,176	66,190	71,406	73,010	77,723	83,293
Unemployment rate, %		5.5	5.2	5.5	6.2	6.1
Consumer prices, % y/y		6.8	7.8	15.5	8.8	6.6
Current account balance, % of GDP		1.6	2.9	3.5	2.5	2.0
General gov. budget balance, % of GDP		-0.8	-0.7	-4.0	-3.0	-2.0
Monetary policy rate (end of period)		0.00	17.00	10.86	8.00	7.00
USD/RUB (end of period)		32.85	58.06	66.84	58.00	56.00
EUR/RUB (end of period)		45.28	70.26	72.43	58.00	61.60