Financial forecasts

Nordea Research, 24 March 2014

Overview	Major forecast changes	
Central banks	Fed	*QE to end in 2014 – first rate hike next year*
	ECB	*Easing bias, increased focus on the exchange rate*
	The Riksbank	*Dovish but no further cuts*
	Norges Bank	*Weak NOK will keep rates unchanged*
	Danmarks Nationalbank	*In heightened state of alert*
Market rates	USD rates	*Yellen starts shooting*
	EUR rates	*Yields remain low for now*
Foreign exchange	USD	*Flat short term, bullish medium to long term*
	GBP	*Looking strong on solid fundamentals*
	JPY	*Strength on macro uncertainty*
	CHF	*Stable*
	SEK	*An inflation revision from the Riksbank could put pressure on the krona*
	NOK	*Redemptions keeping the cross on the weak side*
Commodities	Oil	*Seasonal weakness in demand, but Crimean turbulence supports prices*
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Changes in Economic Outlook

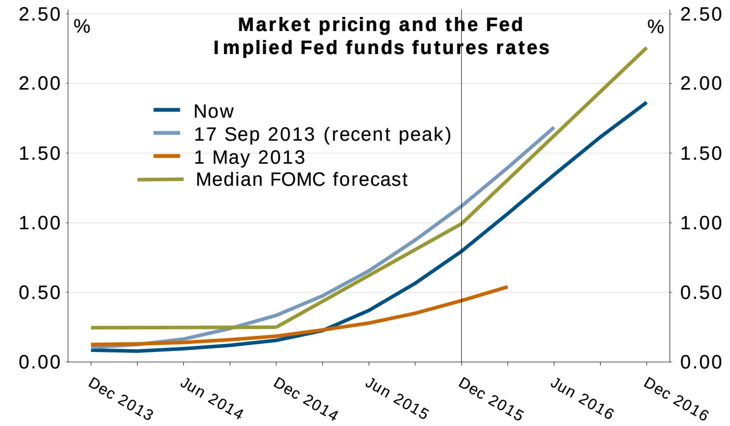
12 March we released a new Economic Outlook with updated real-economic forecasts for 2014 and 2015. We also updated our longer-term financial forecasts for central banks, rates, FX and commodities. We have made no changes since then, but this slide set is intended to give a quick overview of our main financial forecasts.

- **Fed:** We continue to expect the first Fed rate hike in Q1 2015, with the Fed funds rate reaching 1.25% by end-2015. **ECB:** No more easing in our baseline. **Riksbanken:** We changed our forecast for the Riksbank and now expect a hike in Dec 2014. Due to the persistently low inflation we pencil in only two additional rate hikes in 2015. **Norges Bank:** We still believe Norges Bank will eventually postpone the first rate hike beyond 2015.
- **Rates:** Risks remain skewed to the downside for rates in the near term. We keep our 3-months forecasts unchanged, but lowered our end-year forecasts for both EUR and USD rates.
- **FX:** we do not see a strong dollar move just around the corner, which is why our 3M forecast for EUR/USD remains at 1.38. We have lifted the end-14 forecast to 1.30 and end-15 to 1.25, though. **JPY** We still expect strengthening in the near term and have lowered our end-year USD/JPY forecast to 103. We have made modest upward revisions to our **EUR/SEK** and EUR/NOK forecasts for end-year.
- **Commodities:** We expect the Brent oil price to fall to USD 106/brl in Q2. We have made modest upwards revisions to coming quarters, but trend remains flattish for both ‘14 and ‘15.

Fed: QE to end in 2014 – first rate hike next year

- The slightly more aggressive rate path suggested by the FOMC participants' projections at the March meeting indicates that nervousness over the tightening of the labour market is now creeping in.
- The Fed seems to expect the first rate hike in Q2 2015 (based on Yellen's: "on the order of around six months, that type of thing" from the end of QE) or Q3 2015 (based on the so-called "dot chart" and an assumption of +25 bp tightening per meeting).
- We continue to expect the first Fed rate hike in Q1 2015, with the fed funds rate reaching 1.25% by end-2015, above the FOMC's current 1.0% median forecast.
- We expect the Fed to stick to the course set for tapering, reducing its monthly asset purchases by USD 10bn per FOMC meeting. QE is expected to end in October.

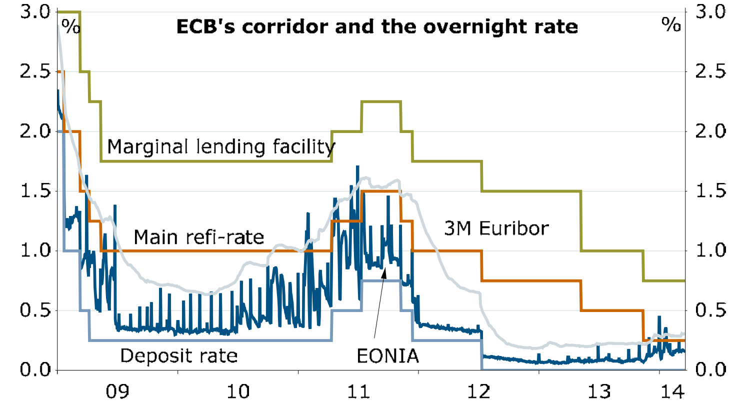
Source: Nordea Markets and Reuters Ecowin



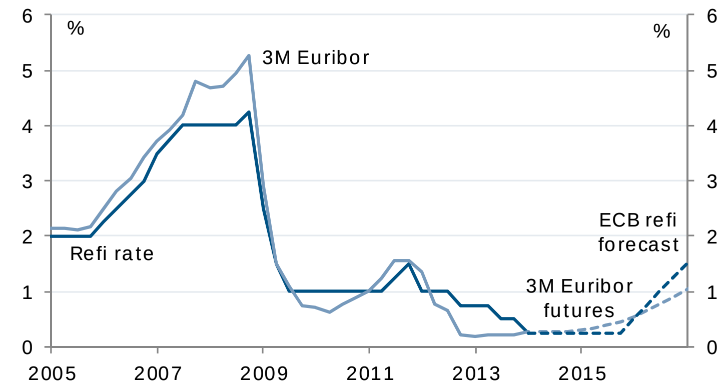
Source: Nordea Markets and Reuters Ecowin

ECB: Easing bias, increased focus on the exchange rate

- As long as 1) low-inflation worries do not increase significantly further, 2) money market conditions remain orderly and 3) the recovery remains intact, the ECB is unlikely to take further easing steps. We don't expect changes to rates through to Q3 2015.
- It is too early to assess whether events in and around Ukraine will have a sizable dampening effect on growth on the macro level. ZEW expectations for Germany and the Euro area fell in March – a warning sign, not more for now.
- A further strengthening of the EUR could make the ECB act on rates. ECB Governing Council members have started a mild form of verbal intervention. Pain thresholds are hard to pin down. However, should EUR/USD move to 1.45 – something we don't expect – the ECB would certainly move closer towards easing.



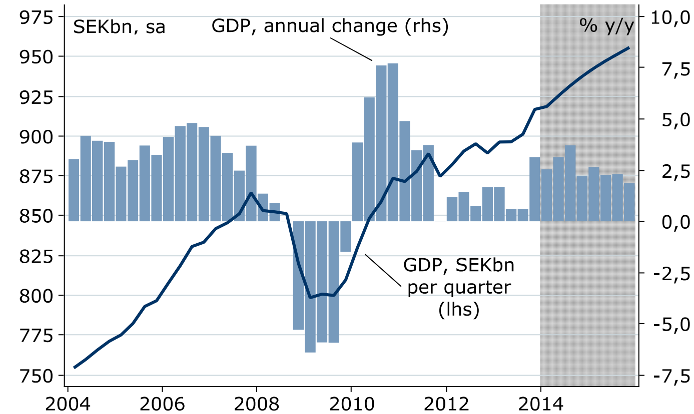
Source: Nordea Markets and Reuters Ecowin



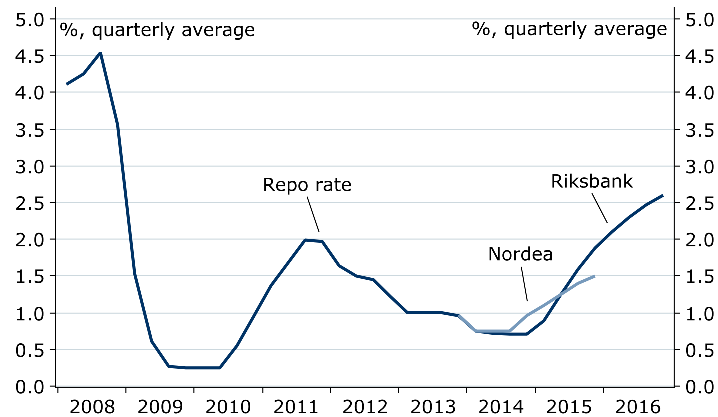
Source: Nordea Markets and Reuters Ecowin

The Riksbank: Dovish but no further cuts

- The Riksbank will probably revise down its inflation forecast in the April report. In the near term due to lower electricity prices and longer out due to lower unit labour costs as productivity growth recovered more than expected in H2 2013.
- In our view, this will not be enough to prompt a rate cut, but the Riksbank may strike a dovish tone in April, for example by keeping its short-term easing bias and pushing out the first rate hike in the rate path somewhat.
- On the other hand, the economy is recovering rather strongly. Labour market figures have recently been soft, but we read this as noise. The trend should stay positive.
- The housing market is heating up and household indebtedness should yet again flare up as a concern for the Riksbank.
- We forecast the Riksbank to hike as early as December 2014. Due to the persistently low inflation we pencil in only two additional rate hikes in 2015, leaving the repo rate at 1.50% at year-end.



Source: Nordea Markets and Macrobond

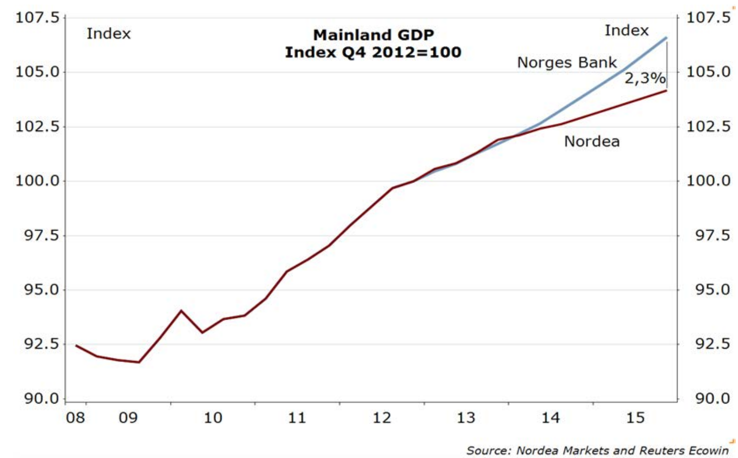


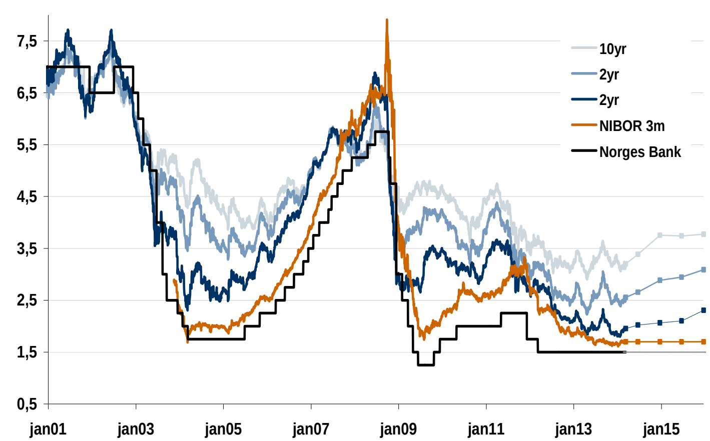
Source: Nordea Markets and Macrobond

Norges Bank: Weak NOK will keep rates unchanged

- We expect Norges Bank to maintain its stance on rates firmly on hold at the upcoming meeting (27 March). We do not expect any major revision of the new interest rate forecast, which is likely to continue to indicate unchanged rates well into 2015. We still believe in a softer development in the Norwegian economy than Norges Bank does going forward. When our view materialises we expect Norges Bank to further postpone the first rate hike beyond 2015. We do not believe in rate cuts as the NOK will weaken on the back of weak figures.

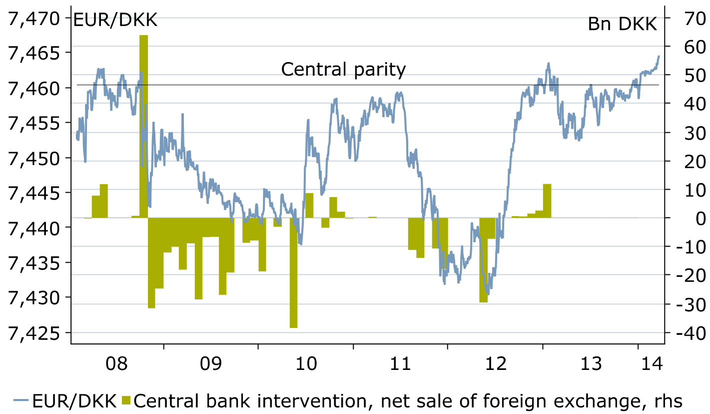
- With Norges Bank on hold longer than the current market expectations, our forecast for short rates is below that of the market in 2015. Higher rates abroad will, however, drive up Norwegian rates, the impact being strongest at the long end of the curve.





Danmarks Nationalbank: In heightened state of alert

- The DKK has weakened relatively sharply versus the EUR as a result of short money market rates in the Euro area rising relatively sharply, widening the spread to equivalent interest rates in Denmark.
- The weakening of the DKK means that the EUR/DKK cross is currently close to the levels where the Danish central bank has previously reacted.
- We believe that the central bank will try to ease current pressures on the DKK through minor open market operations.
- But we also believe that an actual isolated Danish rate hike is still some way off. The central bank will probably be relatively cautious about hiking rates in the current situation where there is still significant uncertainty about the ECB's future monetary policy line. Against this background, we do not think that the central bank will make the first isolated Danish rate hike until sometime during the autumn.

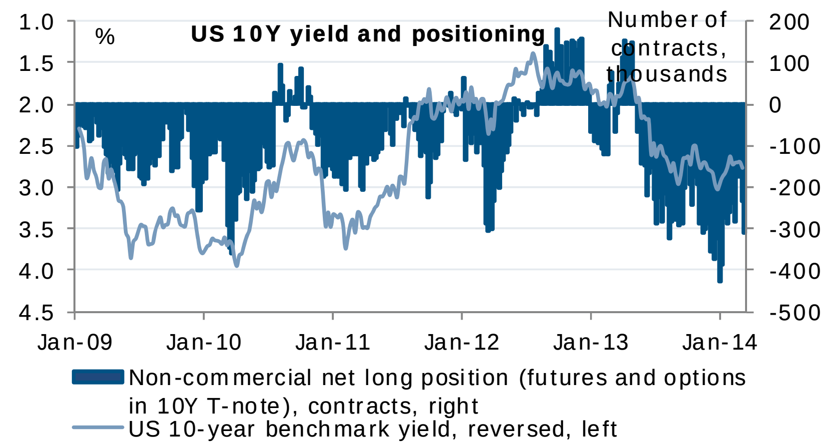


Source: Nordea Markets and Macrobond

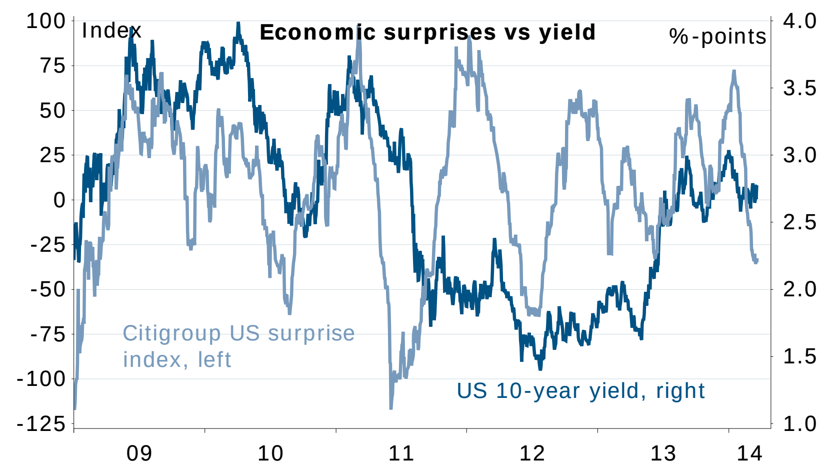
Denmark	Spot	3M	31Dec14	30Jun15	31Dec15
Leading rate	0.20	0.20	0.40	0.50	1.00
3M	0.30	0.35	0.45	0.55	1.05
2Y	0.70	0.65	1.05	1.30	1.90
5Y	1.32	1.30	1.80	2.10	2.55
10Y	2.15	2.25	2.70	2.95	3.15
30Y	2.77	2.85	3.25	3.35	3.55

USD rates: Yellen starts shooting

- Bonds have been caught between flight-to-safety demand due the crisis in Ukraine and a more hawkish message from the Fed.
- Yellen's comments had a surprisingly hawkish twist in her first meeting as Fed chair, though that was probably not her intention.
- US data to gradually start to improve as the weather effect fades.
- Speculative short positions remain high, leaving bonds performance potential if flight-to-safety returns.
- We expect the support level at around 2.50% of the US 10Y government yield to hold, but risks remain on the downside in the near term. Our 3-month forecasts remain unchanged.
- Longer out, we still expect market rates to move gradually higher as the US economic recovery gains more momentum and markets start to price in more Fed rate hikes in 2015 and 2016.



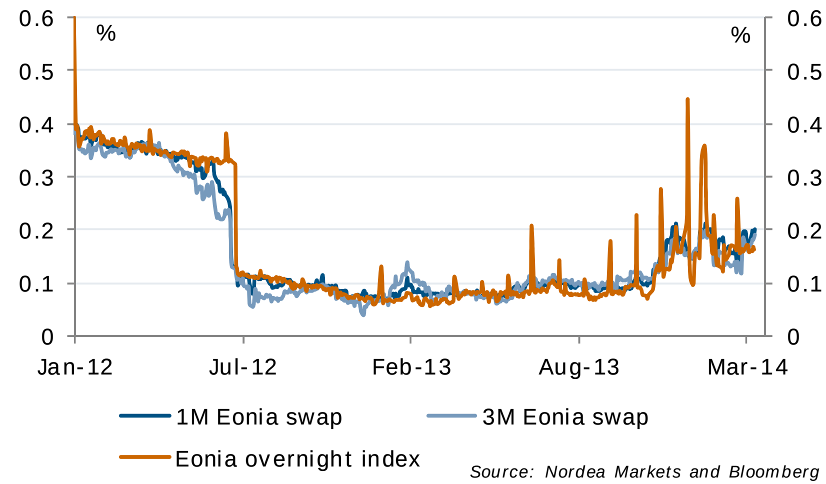
Source: Nordea Markets and Bloomberg



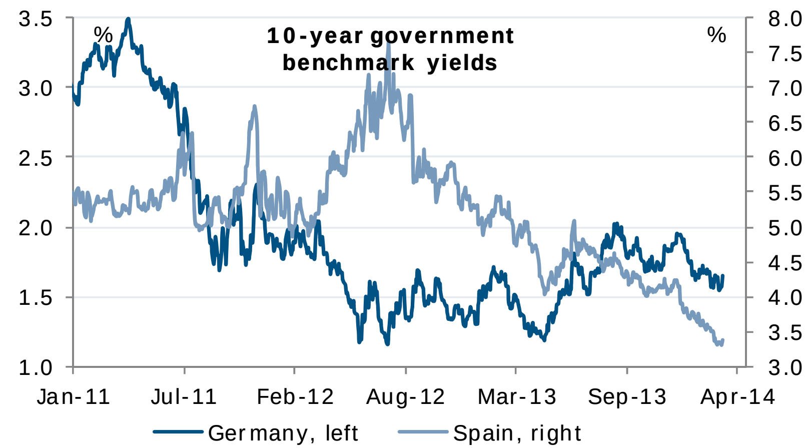
Source: Nordea Markets and Reuters Ecowin

EUR rates: Yields remain low for now

- A less dovish message than expected from the ECB did only limited damage to bonds.
- Despite gradually improving momentum in the Euro-zone economy, short-term risks remain on the downside for yields as geopolitical tensions could easily increase. Our 3-month forecasts remain unchanged.
- Upward pressure on money market rates gradually increasing again as excess liquidity continues to fall.
- Appetite for peripheral bonds continues to be strong, and for example the Spanish 10Y benchmark yield has fallen to 8-year lows (below 3.5%).
- We still see gradually rising rates beyond the 3-month horizon as fundamentals are gradually improving.



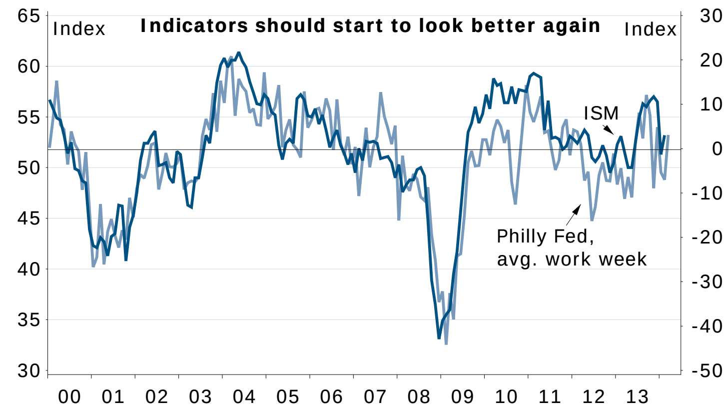
Source: Nordea Markets and Bloomberg



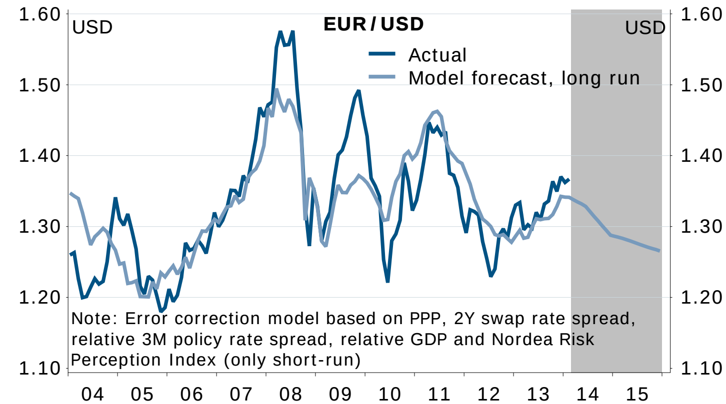
Source: Nordea Markets and Reuters Ecowin

USD: Flat short term, bullish medium to long term

- The Fed struck a more hawkish tone than expected at the March FOMC meeting, which sent EUR/USD lower. Yellen expects to hike rates around 6 months after the QE programme is completely phased out. That implies a first hike in Q2 2015.
- However, we don't see a strong dollar move just around the corner, which is why our 3M forecast for EUR/USD remains at 1.38.
- But long term we expect the US economy to outpace the Euro area and this should keep interest rate spreads supportive for the USD going forward.
- Hence, we expect a gradually stronger USD. The end-2014 EUR/USD forecast is 1.30 and the end-2015 forecast is 1.25.



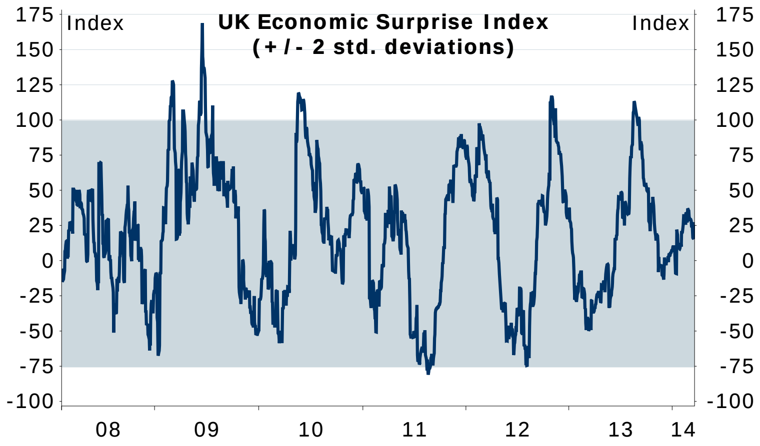
Source: Nordea Markets and Reuters Ecowin



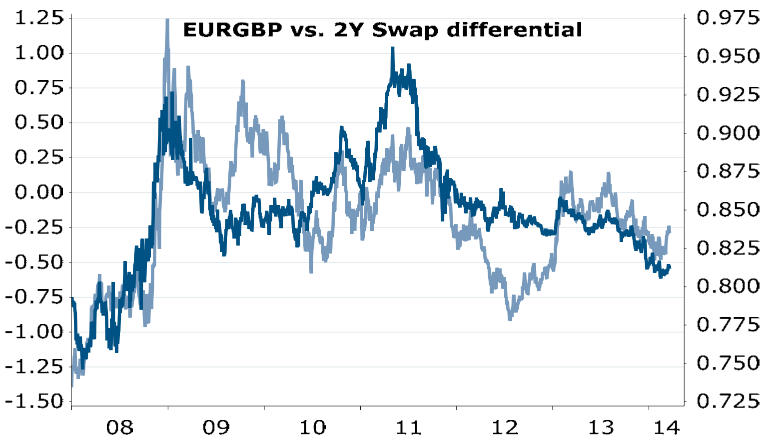
Source: Nordea Markets and Reuters Ecowin

GBP: Looking strong on solid fundamentals

- After a strong development in the labour market as well as in the economy as a whole, the BoE has now skipped its explicit forward guidance and has instead introduced a wider set of qualitative guidance measures.
- The GBP has taken just a slight hit on this change in policy guidance, but strong fundamentals continue to support an increasingly hawkish policy line from the BoE.
- We therefore think that a relatively faster growing UK economy vs the Euro area will keep interest rate spreads in support of the GBP vs the EUR, but not against the USD (see chart).



Source: Nordea Markets, Citigroup and Reuters Ecowin

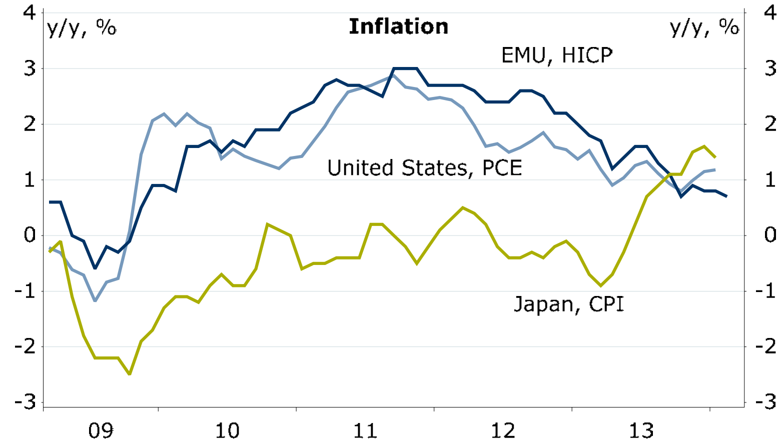


Source: Nordea Markets and Reuters Ecowin

Aurelija Augulyté and Amy Zhuang

JPY: Strength on macro uncertainty

- We expect the JPY to strengthen in the short term, as stock markets could take a further slight hit (after +70%) ahead of the April consumption tax hike. JPY short positions are still very high – risks of an ugly unwind.
- The Japanese inflation could still rise a few ticks, while US rates will probably stay within the current trading band. Short term we could therefore see a move below 100 in USD/JPY.
- We maintain our JPY depreciation forecast in the longer term, ie December 2015 = 110. Monetary policy will remain relatively aggressive compared to the US. Abenomics will only be called a success when structural reforms aimed at lifting potential growth are introduced, which is unfortunately not the case yet.



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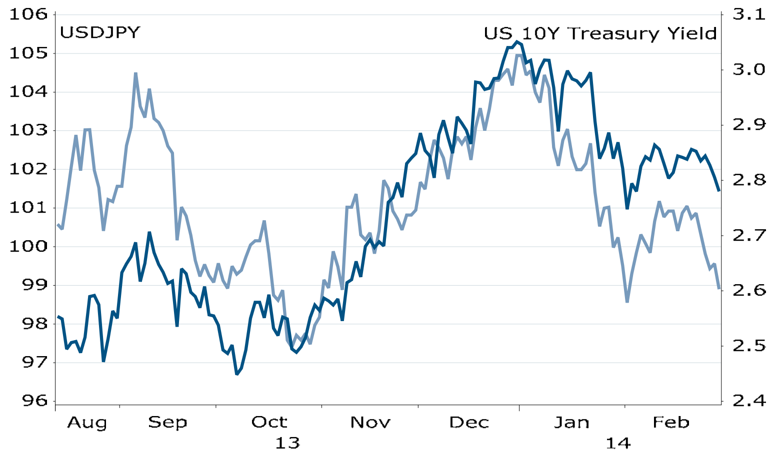
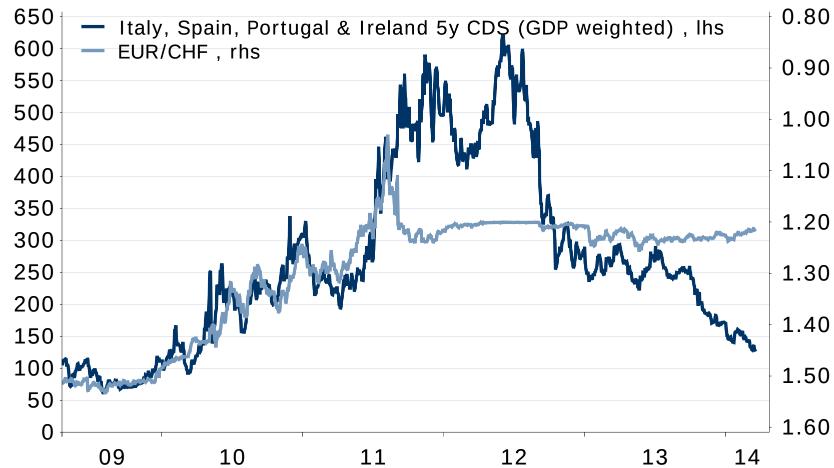


Source: Nordea Markets and Reuters Ecowin

CHF: Stable

- CHF has strengthened recently vs the EUR, probably reflecting both a weaker USD and worries about Ukraine/Russia.
- On 20 March, as expected, the SNB confirmed both the 1.20 EUR/CHF exchange rate floor and the 0-0.25% Libor target range. The SNB expects very low inflation through to 2016 and pointed towards various risks that could cause the CHF to strengthen.
- We keep our 3-month forecast of 1.25. It will probably take a longer period of calm markets and more clear evidence of a sustainable improvement in the Euro area for the CHF to weaken again.
- We expect the SNB to keep rates unchanged and the floor untouched at 1.20. Our base case is for EUR/CHF to remain in the 1.20-1.30 range this year and the next with risk perception likely to be the main driver.
- A break above 1.30 would make us change our longer-term view on the economy, the SNB and the CHF.

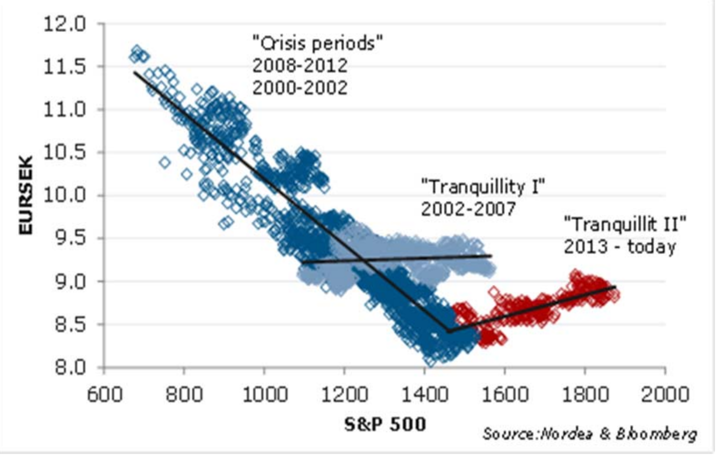


Source: Nordea Markets and Reuters Ecowin

Henrik Unell and Alexander Wojt

SEK: An inflation revision from the Riksbank could put pressure on the krona

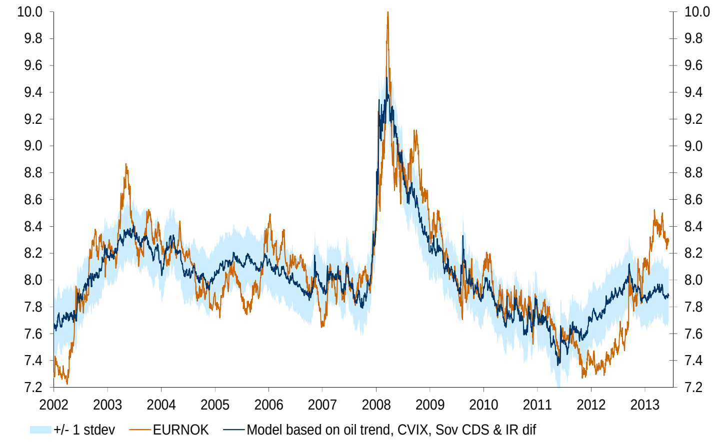
- We find growth arguments supportive of a slightly stronger SEK. There might however be short term risks to our 3m EURSEK forecast of 8.70. Chances are that the Riksbank will revise its inflation forecast lower at their next meeting 9/4, and the first hike might be postponed further. That would probably dent the SEK short term. Although it needs to be said that rate levels and the SEK have lately parted.
- Days of dividends for Swedish companies are here again. FX flows could arise due to foreign owners repatriate some of the dividend. If anything, such flows could be SEK negative. The net flow might be offset by the Scania/Volkswagen deal, the offer period expires April 25, and, if anything, this could generate a SEK positive flow.
- Ukraine tension and risk aversion does not automatically mean a weak SEK since it depends on the intensity of such a move.



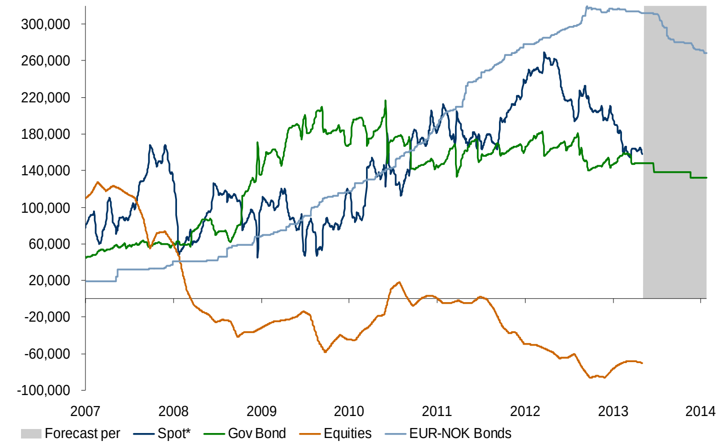
NOK: Redemptions keeping the cross on the weak side

- The NOK weakened along with Emerging Markets at the beginning of the year. With improved risk sentiment and key figures on the strong side, EUR/NOK came down from its 4.5-year high of around 8.54.
- A high volume of eurobonds in NOK will mature in the coming months. The combined volume is around NOK 30bn during April and May. In addition to this, we will see redemption of Norwegian T-bills on 22 March, of which foreigners own NOK 9bn. Add to this dividend payments in May of around NOK 13bn.
- The amount maturing might of course be reinvested, but with our take on the Norwegian economy, such an outcome is not obvious, and we find it hard to believe in a stronger NOK in the coming months.

EUR/NOK on the high side of fundamentals …

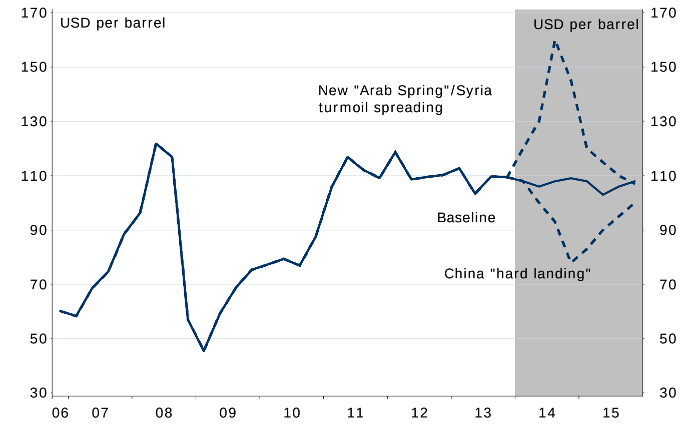


… and redemptions argue for continued weak NOK

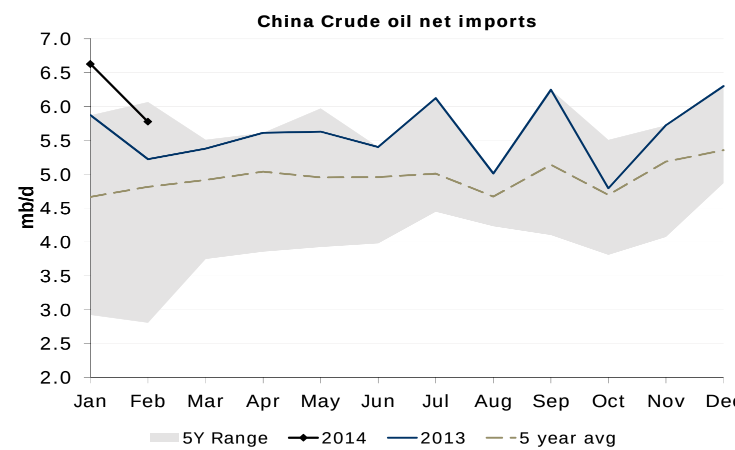


Oil: Seasonal weakness in demand, but Crimean turbulence supports prices

- Brent oil prices expected to fall to USD 106/barrel on seasonal weakness in demand.
- The demand for crude hits a seasonal low in mid-April as refineries are moving into maintenance season. Risk of weaker demand growth from China.
- Supply: expect supply growth to pick up in North America after cold winter storms slowed production in Q4.
- Political instability high in Nigeria, Libya and South Sudan – putting supply at risk.
- Crimean turbulence supports prices as the market worries that sanctions may influence oil deliveries from Russia.
- Market balance: oil market balance is expected to soften in April as demand is seasonally weaker and North American production rises. Upside risk to prices as the political risk is increasing.



Source: Nordea Markets and Reuters Ecowin



Tables

Policy rates

Policy rates

Country	Spot	3M	*chg*	31-Dec-14	*chg*	30-Jun-14	31-Dec-15	*chg*
US	0.25	0.25	-	0.25	-	0.75	1.25	-
Japan	0.10	0.10	-	0.10	-	0.10	0.10	-
Euro area	0.25	0.25	-	0.25	-	0.25	0.75	-
Denmark	0.20	0.20	-	0.40	-	0.50	1.00	-
Sweden	0.75	0.75	-	1.00	- 0.25	1.25	1.50	- 0.25
Norway	1.50	1.50	-	1.50	-	1.50	1.50	-
UK	0.50	0.50	-	0.50	-	0.75	1.25	-
Switzerland	0.00	0.00	-	0.00	-	0.25	0.75	-
Poland	2.50	2.50	-	2.75	- 0.25	3.25	3.50	-
Czech Rep.	0.50	0.05	-	0.05	-	0.05	0.50	-
Hungary	2.70	2.70	- 0.10	2.70	- 0.10	2.70	3.00	- 0.50
Romania	3.50	3.50	-	3.50	-	3.50	3.50	-
Turkey	10.00	10.50	- 0.50	11.00	-	12.00	12.00	1.00
Russia	5.50	7.00	1.75	5.50	0.50	5.25	5.00	-
Kazakhstan	5.50	5.50	-	6.00	-	6.00	7.00	-
South Africa	5.50	6.00	0.50	6.50	1.50	7.00	7.00	0.75
China	6.00	6.00	-	6.00	- 0.25	6.25	6.25	- 0.25
India	8.00	8.00	-	8.00	0.50	7.75	7.50	0.50
Brazil	10.75	11.00	-	11.00	-	12.00	12.00	1.00
Mexico	3.50	3.50	-	3.50	-	3.50	3.50	-

Note: "chg" is the change in percentage points from forecasts 24 February to current forecasts.

Fixed income forecasts

Govies

US	Spot	3M	***chg***	31-Dec-14	***chg***	30-Jun-14	31-Dec-15	***chg***
Leading rate	0.25	0.25	-	0.25	-	0.75	1.25	-
3M	0.23	0.30	-	0.55	-	1.05	1.60	-
2Y	0.45	0.40	-	1.00	- 0.50	1.65	2.25	- 0.25
5Y	1.74	1.65	-	2.15	- 0.25	2.70	3.25	-
10Y	2.75	2.90	-	3.25	- 0.25	3.60	3.90	-
30Y	3.60	3.80	-	4.00	-	4.20	4.40	-
5Y-2Y	1.29	1.25	-	1.15	0.25	1.05	1.00	0.25
10Y-2Y	2.30	2.50	-	2.25	0.25	1.95	1.65	0.25
30Y-10Y	0.85	0.90		0.75	0.25	0.60	0.50	-

Swap rate

US	Spot	3M	***chg***	31-Dec-14	***chg***	30-Jun-14	31-Dec-15	***chg***
2Y	0.39	0.60	-	1.25	- 0.60	1.85	2.90	-
5Y	1.43	1.85	-	2.20	- 0.60	2.80	3.70	-
10Y	2.74	2.90	- 0.15	3.05	- 0.70	3.50	4.35	-
30Y	3.67	3.80	-	3.95	- 0.30	4.25	4.70	-
5Y-2Y	1.04	1.25	-	0.95	-	0.95	0.80	-
10Y-2Y	2.35	2.30	-0.15	1.80	- 0.10	1.65	1.45	-
30Y-10Y	0.93	0.90	0.15	0.90	0.40	0.75	0.35	-

Govies

Germany	Spot	3M	***chg***	31-Dec-14	***chg***	30-Jun-14	31-Dec-15	***chg***
Leading rate	0.25	0.25	-	0.25	-	0.25	0.75	-
3M	0.32	0.30	-	0.20	- 0.10	0.20	0.75	- 0.05
2Y	0.20	0.15	-	0.50	- 0.35	0.80	1.60	- 0.05
5Y	0.70	0.75	-	1.25	- 0.30	1.55	2.20	-
10Y	1.64	1.75	-	2.10	- 0.30	2.40	2.75	-
30Y	2.49	2.60	-	3.00	-	3.10	3.25	0.05
5Y-2Y	0.50	0.60	-	0.75	0.05	0.75	0.60	0.05
10Y-2Y	1.44	1.60	-	1.60	0.05	1.60	1.15	0.05
30Y-10Y	0.85	0.85	-	0.90	0.30	0.70	0.50	0.05

Swap rate

EUR	Spot	3M	***chg***	31-Dec-14	***chg***	30-Jun-14	31-Dec-15	***chg***
2Y	0.53	0.45	-	0.70	- 0.35	1.00	1.80	- 0.05
5Y	1.06	1.05	-	1.45	- 0.30	1.75	2.40	-
10Y	1.88	2.00	-	2.35	- 0.30	2.65	3.00	-
30Y	2.53	2.65	-	3.00	- 0.25	3.25	3.45	- 0.05
5Y-2Y	0.53	0.60	-	0.75	0.05	0.75	0.60	0.05
10Y-2Y	1.35	1.55	-	1.65	0.05	1.65	1.20	0.05
30Y-10Y	0.65	0.65	-	0.65	0.05	0.60	0.45	- 0.05

Note: "chg" is the change in percentage points from forecasts 24 February to current forecasts.

FX forecasts

Currencies	Spot	3M	*chg*	31-Dec-14	*chg*	30-Jun-14	31-Dec-15	*chg*
EUR/USD	1.382	1.38	-	1.30	4.0	1.28	1.25	4.2
EUR/JPY	141.81	133.9	-	133.9	- 2.6	134.4	137.5	4.2
EUR/GBP	0.837	0.83	0.0	0.78	-	0.78	0.78	-
EUR/CHF	1.220	1.25	-	1.30	-	1.320	1.35	-
EUR/SEK	8.867	8.70	-	8.50	1.8	8.400	8.40	0.6
EUR/NOK	8.356	8.40	-	8.35	1.2	8.250	8.10	-
EUR/PLN	4.194	4.10	- 1.2	4.05	1.3	4.000	3.95	-
EUR/RON	4.486	4.50	1.1	4.45	1.1	4.400	4.25	- 1.2
EUR/CZK	27.45	27.00	-	27.00	-	27.00	26.00	1.6
EUR/TRY	3.091	3.10	-	3.00	-	2.800	2.70	1.9
EUR/RUB	49.91	48.30	3.2	44.85	6.8	43.52	42.13	4.8
USD/JPY	102.63	97.00	-	103.00	- 6.4	105.00	110.00	-
USD/GBP	1.651	1.66	- 0.0	1.67	4.0	1.641	1.60	4
USD/TRY	2.236	2.25	-	2.31	- 3.8	2.188	2.16	- 2.2
USD/CHF	0.883	0.91	-	1.00	- 3.8	1.031	1.08	- 4.0
USD/DKK	5.402	5.41	-	5.74	- 3.8	5.828	5.97	- 4.0
USD/SEK	6.417	6.30	-	6.54	- 2.1	6.563	6.72	- 3.4
USD/NOK	6.047	6.09	-	6.42	- 2.7	6.445	6.48	- 4.0
USD/PLN	3.035	2.97	- 1.2	3.12	- 2.6	3.125	3.16	- 4.0
USD/RUB	36.12	35.00	3.2	34.50	2.7	34.00	33.70	0.6
USD/CNY	6.212	6.05	0.8	5.95	0.8	5.900	5.80	-
USD/INR	60.69	60.00	-	58.00	-	55.00	53.00	-
USD/BRL	2.324	2.40	2.1	2.50	2.0	2.550	2.60	4.0
USD/KZT	182.3	185.00	-	180.00	-	177.5	175.00	-
USD/MXN	13.21	13.20	3.9	13.10	7.4	12.600	12.20	1.7
USD/ZAR	10.856	11.00	6.8	11.20	6.7	11.250	11.30	6.6

Note: “chg” is the percentage change from forecasts 24 February to current forecasts.

Commodities

Metals	Spot	2014	***chg***	2015	***chg***
Aluminum	1,677	1,745	- 455	1,860	- 490
Copper	6,539	7,275	- 225	7,300	- 200
Nickel	15,990	14,750	- 1,250	16,000	-
Zinc	1,952	2,125	- 75	2,300	- 100

Oil	Old	New	chg
Spot		108	
31/03/2014	108	108	-
30/06/2014	104	104	-
30/09/2014	108	108	-
31/12/2014	107	107	-
31/03/2015	107	107	-
30/06/2015	103	103	-
30/09/2015	106	106	-
31/12/2015	108	108	-

Note: "chg" is the change from forecasts 24 February to current forecasts.

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