Economic Outlook

January 2010

Markets

Data overview

Editor

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

Editorial deadline

14 January 2010

Visit us at:

www.nordea.com/e-Markets

Data sources:

Data sources are Reuters EcoWin, national statistical bureaus and own calculations unless otherwise noted.

The litmus test

At the threshold of the new decade it is clear that the world economy has finally moved out of recession. The huge financial sector rescue packages and significant concerted G20 easing of economic policies to kickstart the economies have thus been highly successful.

Economic growth especially in South-East Asia spearheaded by China has been strong. This is the only region in the world where industrial production is now higher than before the collapse of Lehman Brothers. Everywhere else production has been set back several years despite the increased momentum. Global capacity utilisation therefore remains weak, which dampens investment needs overall and worsens the labour market situation. In addition, it reduces the likelihood of strong private consumption growth, which is further limited by households in many countries consolidating their finances and increasing their savings.

So even though the situation has improved a great deal compared to just a few months ago, we still basically believe that the current economic upswing will be moderate and only gradually gain momentum. So far the upswing in the industrialised countries has been driven by expansionary economic policies and inventory changes following the dramatic downturn in production towards the end of 2008 and in early 2009. Consequently, in our view the coming six months will provide the ultimate litmus test of final demand and especially private consumption. After that period, we will know with greater certainty whether the upswing will be stronger or weaker than we currently envisage in our baseline scenario.

Global imbalances remain

The global imbalances, which are one of the root causes of the severe crisis, have yet to be resolved. China, which has emerged from the crisis strengthened and is about to take over Japan's role as the second-largest economy in the world, still boasts a high savings ratio and a large current account surplus. As China continues to gain market share at the expense of the industrialised countries, the US and the EU have increasingly implemented trade policy measures against China and demanded that the Chinese authorities abandon the peg to the USD and resume the gradual revaluation of the CNY versus the USD and the EUR. We expect this to happen in the course of the coming quarters, but let there be no doubt: the Chinese monetary authorities alone will decide when to revalue the CNY and at what pace.

The progress in China and investors' growing risk appetite have been the key factors driving the recent pick-up in commodity prices. Oil prices are now back at levels around USD 80 a barrel, but also metal prices and prices of soft commodities (sugar, fruit, coffee, soya beans, grain etc.) have skyrocketed. This increases the risk of a renewed setback to the world economy as the price increases ultimately will erode corporate profits and households' purchasing power. The latter is especially at risk because wage earners' chances of obtaining compensation for the higher commodity prices are very slim due to the international economic crisis.

In addition, the rising commodity prices have caused the currencies of commodity-producing countries to strengthen sharply. Brazil has even imposed capital restrictions to prevent its currency from appreciating too fast and too much, and in several other countries, including Russia, the monetary authorities have said that they consider similar measures.

Tighter economic policy

The rising commodity prices are not the only risk factor for global growth. Also the required tightening of monetary and fiscal policy, the so-called exit strategies, could impede a robust, self-sustaining economic upswing.

No doubt, the extremely accommodative monetary policies in the form of record low interest rates and quantitative easing measures are the key factors behind the incipient upturn in many national housing markets. Also, they support investment activity. This increases the chances of growth becoming self-sustaining and even stronger than in our baseline scenario.

However, the problem is that maintaining an accommodative monetary policy for too long could trigger both high inflation and new bubbles in the equity and property markets. While the inflation risk should not be exaggerated at this juncture due to the unfavourable market conditions for businesses and the labour market situation, it will clearly move higher up on the agenda in a few years' time unless policies are gradually tightened relatively soon. A number of central banks, including those in Norway, Australia and Israel, have started to hike rates, but in our view rates in the Euro area will not be hiked until end-2010 at the earliest, while the Fed in the US will likely wait until early 2011. We also believe that the rate hikes will be fairly moderate due to modest inflation pressure as a result of significant idle capacity throughout the forecast period. But the phasing out of quantitative easing measures should start earlier, probably beginning in early H2 2010.

Also fiscal policies will have to be tightened. In many countries budget deficits and the public debt have increased so dramatically that international rating agencies have found it necessary to downgrade these countries' credit ratings.

Moreover, in accordance with the excessive budget deficits procedure, the EU Commission has recommended most EU countries to take steps to significantly tighten their fiscal policies as early as this year.

Public finances also in the Nordic countries have deteriorated sharply over the past few years. However, thanks to these countries' initially strong finances the situation is still not alarming, at least not in an international context.

No state bankruptcies on the cards

In our view, the problems will not result in state bankruptcy or pose a real threat to for instance the EU or EMU, but obviously they could cause yield spreads between the individual government bond issues to widen noticeably. Also the required fiscal policy tightening could spark political tensions in the individual countries. In this context it is worth noting that the current problems are aggravated in many countries by their aging populations. In these countries public expenditure on pensions, health care and care for the elderly will rise dramatically over the coming 10-15 years while the tax base shrinks. Consequently, policymakers in the industrialised countries will face massive political challenges due to a demographically skewed population.

Yields determined by risk appetite

Based on our expectation of a moderate economic upswing we foresee only a relatively modest rise in long yields throughout the forecast period. We even consider it highly probable that long yields could turn south again if the trend in economic indicators disappoints the market and risk appetite wanes. This scenario is incorporated in our forecast on a 3-6-month horizon for both the US and the Euro area.

For several years there has been a very close correlation between the trend in the USD, commodity prices and risk appetite. But recently, the USD has again been mainly driven by interest rates and this pattern could become even stronger as central banks start implementing their exit strategies. This means that the USD may strengthen further versus the EUR short term. During the summer higher market rates in the Euro area should, however, contribute to weakening the USD until expectations of more aggressive rate hikes by the Fed than by the ECB trigger renewed USD appreciation towards year-end and well into 2011.

Also the Emerging Markets currencies will strengthen further, as will the SEK, the NOK and the GBP. Traditional funding currencies such as the JPY and the CHF, on the other hand, should weaken throughout the forecast period.

Springtime for the Nordic economies

In terms of economic growth 2009 looks set to become the worst year for the **Danish** economy since World War 2. This annus horribilis is now over and instead the Danish economy may be in for some years of growth in positive territory. The main reason is that budding signs of growth elsewhere has brightened the prospects for Danish exports to an extent not seen in a long time. At the same time consumer spending looks set to increase noticeably again this year after a significant setback in 2009. Income tax cuts and lower interest rates will boost households' overall disposable income this year despite a persistent increase in unemployment in 2010.

The **Swedish** economy deteriorated sharply at the end of 2008 and the beginning of 2009, but recovered slowly during the following quarters. Economic growth is expected to pick up in 2010, mainly driven by private consumption and restocking of inventories. Exports, supported by improved global trade, will also contribute to this increase. Employment stopped falling in late 2009 and will remain stable in 2010. Inflation was in negative territory in 2009, mainly due to temporary factors such as lower mortgage rates. Headline inflation is seen picking up in 2010, while core inflation will decline, thus remaining below the Riksbank's 2% target. With stronger growth, an improved labour market and high credit growth the Riksbank will likely start raising the repo rate during the year. We expect the repo rate to be 2.0% by end-2010.

In a historical context the setback in **Norway** was relatively strong, but compared to other countries it was fairly mild. In Q2 and Q3 last year growth in mainland production moved back into positive territory. Particularly the massive fiscal and monetary policy stimuli got the economy going again, and the effects of these measures will contribute to strong growth also in 2010. In 2011, on the other hand, growth in the economy may slow as a result of higher interest rates, fiscal policy tightening and a decline in oil investment. With strong growth throughout 2010, Norges Bank will hike rates further, but in 2011 the pace of monetary tightening will slow. Norwegian interest rates will rise less than the market currently prices in and should therefore not trigger significant NOK strengthening.

The **Finnish** economy returned to growth in the summer of 2009 after a steep export-led collapse during the winter. This year exports will rebound in tandem with world trade and also household demand will recover supported by increased consumer confidence. On the whole, in 2010 the Finnish economy should grow faster than the rest of the Euro area. The unemployment rate has so far risen less than feared and it is set to peak in the summer. Finnish public finances will remain in relatively good shape and the public sector deficit is not expected to exceed the 3% limit. Nevertheless, obviously there will be challenges to overcome if the government is to meet the ambitious medium-term surplus targets, and this will shape the political debate ahead of 2011 elections.

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

Growth, %

	2007	2008	2009E	2010E	2011E
World[1)]	4.8	2.3	-1.3	3.6	3.4
BIG-3[2)]	2.4	0.2	-3.4	1.9	1.7
USA	2.1	0.4	-2.5	2.2	2.0
Japan	2.3	-1.2	-5.2	1.6	1.2
Euro area	2.7	0.5	-3.9	1.7	1.5
Germany	2.6	1.0	-5.0	2.0	1.5
France	2.3	0.3	-2.2	1.5	1.5
Italy	1.5	-1.0	-4.7	1.3	1.3
Spain	3.7	1.2	-3.6	-0.1	1.4
Netherlands	3.5	2.0	-4.0	2.0	1.5
Belgium	2.6	1.5	-3.2	1.8	1.6
Austria	3.4	2.0	-3.6	2.0	1.7
Portugal	1.9	0.5	-2.6	1.0	1.4
Greece	4.0	3.0	-0.7	-0.5	0.6
Finland	4.2	1.0	-7.0	2.7	2.5
Ireland	6.3	-2.0	-6.6	0.0	1.5
Denmark	1.7	-0.9	-4.7	1.7	1.7
Sweden	2.5	-0.2	-4.4	3.2	2.4
Norway	5.6	2.2	-1.0	2.4	1.7
Iceland	5.6	1.3	-7.3	-4.9	2.3
UK	2.6	0.6	-4.6	1.9	1.6
Switzerland	3.6	1.8	-1.6	2.3	1.9
Russia	8.1	5.6	-8.5	2.8	4.2
Poland	6.8	4.9	1.6	3.0	4.0
Estonia	7.2	-3.6	-15.0	-0.5	4.0
Latvia	10.0	-4.6	-18.0	-3.0	2.7
Lithuania	9.8	2.8	-16.0	-2.5	3.0
China	13.0	9.0	8.7	10.1	9.6
India	9.1	6.1	5.8	7.6	8.3
Brazil	6.1	5.1	-0.1	4.3	4.2

Inflation, %

	2007	2008	2009E	2010E	2011E
World	3.1	4.6	0.7	2.3	2.1
BIG-3	2.2	3.3	-0.3	1.4	1.0
USA	2.9	3.8	-0.3	1.9	1.0
Japan	0.1	1.5	-1.3	-0.5	0.0
Euro area	2.3	3.3	0.3	1.4	1.5
Germany	2.3	2.8	0.4	1.3	1.5
France	1.6	3.2	0.2	1.4	1.3
Italy	2.0	3.5	0.6	1.4	1.6
Spain	2.8	4.2	-0.3	1.6	1.5
Netherlands	1.6	2.2	1.0	0.9	1.6
Belgium	1.8	4.5	0.0	1.4	1.6
Austria	2.1	3.2	0.4	1.3	1.5
Portugal	2.5	2.8	-1.0	0.8	1.2
Greece	3.0	4.3	1.3	1.9	1.7
Finland	2.5	4.1	0.0	1.0	2.5
Ireland	2.9	3.1	-1.6	-0.5	0.5
Denmark	1.9	3.4	1.3	1.8	1.7
Sweden	2.2	3.4	-0.3	1.7	2.4
Norway	0.8	3.8	2.2	1.9	1.9
Iceland	5.0	12.4	12.0	6.0	2.0
UK	2.3	3.5	2.1	2.0	1.8
Switzerland	0.7	2.4	-0.5	1.2	1.4
Russia	9.0	14.1	11.7	7.7	8.0
Poland	2.6	4.4	3.8	2.3	2.4
Estonia	6.7	10.6	-0.1	-1.0	1.5
Latvia	10.1	15.3	3.6	-3.0	-0.5
Lithuania	5.8	11.1	4.5	-1.0	1.0
China	4.8	5.9	-0.6	3.0	3.0
India	4.8	9.1	1.5	6.0	5.0
Brazil	3.6	5.7	4.7	4.2	4.5

1) Weighted average of countries in this table. Accounts for 70.5% of world GDP. Weights calculated using PPP adjusted GDP levels for 2006 according to the IMF's World Economic Outlook

2) US, Japan and the Euro area

Public finances, % of GDP

	2007	2008	2009E	2010E	2011E
BIG-3	-1.2	-2.7	-8.5	-7.9	-6.2
USA	-1.1	-3.1	-10.5	-8.8	-6.6
Japan	-2.5	-2.7	-7.6	-7.8	-6.2
Euro area	-0.6	-2.0	-6.2	-6.7	-5.8
Germany	-0.2	0.0	-3.5	-5.0	-4.5
France	-2.7	-3.4	-8.1	-8.2	-7.2
Italy	-1.5	-2.7	-5.5	-6.1	-5.7
Finland	5.2	4.5	-2.0	-3.0	-2.5
Denmark	4.8	3.4	-3.0	-5.5	-4.4
Sweden	3.8	2.5	-1.5	-1.7	-1.3
Norway	17.7	18.9	7.7	10.3	14.6
Iceland	5.4	-13.6	-15.0	-10.0	-5.0
UK	-2.8	-3.8	-11.0	-10.5	-8.5
Switzerland	2.1	1.0	-0.4	-1.5	-1.5
Russia	6.1	4.1	-6.3	-2.5	-1.0
Poland	-1.9	-3.9	-6.2	-7.0	-6.0
Estonia	2.6	-2.7	-3.0	-3.0	-2.8
Latvia	-0.3	-4.1	-9.0	-8.2	-6.0
Lithuania	-1.0	-3.2	-9.8	-8.5	-7.8
China	0.6	-0.4	-3.8	-3.4	-2.2
India	-2.7	-6.2	-8.0	-7.5	-7.2
Brazil	-2.2	-1.6	-3.2	-2.7	-2.0

Current account, % of GDP

	2007	2008	2009E	2010E	2011E
BIG-3	-	-	-	-	-
USA	-5.2	-4.9	-2.9	-2.5	-2.5
Japan	4.8	3.2	2.8	3.1	3.4
Euro area	0.2	-1.5	-0.8	-0.5	-0.7
Germany	7.8	6.6	4.6	5.0	5.2
France	-1.0	-2.3	-1.9	-1.5	-1.8
Italy	-2.4	-3.4	-3.3	-3.0	-3.0
Finland	4.2	3.0	1.6	2.4	2.4
Denmark	1.5	2.2	3.6	2.3	1.8
Sweden	9.1	9.6	7.7	7.3	7.0
Norway	15.9	17.7	13.8	16.5	19.9
Iceland	-20.6	-42.2	-10.0	3.0	5.0
UK	-2.9	-1.7	-1.2	-0.5	0.0
Switzerland	10.4	1.4	7.5	7.0	6.8
Russia	5.9	6.1	1.8	2.8	3.2
Poland	-4.7	-5.1	-1.2	-1.5	-2.2
Estonia	-17.9	-9.1	4.0	1.0	-2.0
Latvia	-22.5	-13.0	8.0	6.0	4.0
Lithuania	-15.0	-12.4	1.5	0.6	-0.2
China	10.7	9.6	6.5	6.1	4.3
India	-1.0	-1.2	-1.6	-1.6	-1.8
Brazil	0.1	-1.8	-1.5	-2.5	-3.0

Monetary policy rates

	14.1.10	3M	6M	12M	24M
US	0.25	0.25	0.25	0.25	2.00
Japan	0.10	0.10	0.10	0.10	0.50
Euro area	1.00	1.00	1.00	1.25	2.00
Denmark	1.05	1.00	1.00	1.35	2.25
Sweden	0.25	0.25	0.75	2.00	3.00
Norway	1.75	2.00	2.25	2.50	3.25
UK	0.50	0.50	0.50	0.50	2.50
Switzerland	0.25	0.25	0.25	0.25	1.00
Poland	3.50	3.50	3.75	4.25	4.75
Czech Rep.	1.00	1.00	1.00	1.00	2.25
Hungary	6.25	5.50	5.50	5.50	6.50

Monetary policy rate spreads vs Euro area

	14.1.10	3M	6M	12M	24M
US	-0.75	-0.75	-0.75	-1.00	0.00
Japan[1]	-0.15	-0.15	-0.15	-0.15	-1.50
Euro area	-	-	-	-	-
Denmark	0.05	0.00	0.00	0.10	0.25
Sweden	-0.75	-0.75	-0.25	0.75	1.00
Norway	0.75	1.00	1.25	1.25	1.25
UK	-0.50	-0.50	-0.50	-0.75	0.50
Switzerland	-0.75	-0.75	-0.75	-1.00	-1.00
Poland	2.50	2.50	2.75	3.00	2.75
Czech Rep.	0.00	0.00	0.00	-0.25	0.25
Hungary	5.25	4.50	4.50	4.25	4.50

1) Spread vs US

3-month rates

	14.1.10	3M	6M	12M	24M
US	0.25	0.30	0.40	0.75	2.50
Japan	0.26	0.30	0.30	0.35	0.70
Euro area	0.69	0.75	1.00	1.50	2.25
Denmark	1.50	1.40	1.40	1.80	2.75
Sweden	0.48	0.95	1.45	2.45	3.35
Norway	2.25	2.41	2.63	2.99	3.55
UK	0.61	0.65	0.70	0.90	2.80
Switzerland	0.25	0.30	0.30	0.40	1.20
Poland	4.26	4.30	4.40	4.70	5.10
Czech Rep.	1.56	1.50	1.55	1.60	2.50
Hungary	6.16	5.50	5.75	6.00	7.00
Estonia	2.78	2.50	2.20	2.00	1.70
Latvia	5.19	4.20	3.50	3.20	2.50
Lithuania	3.13	2.60	2.30	2.00	1.80

3-month spreads vs Euro area

	14.1.10	3M	6M	12M	24M
US	-0.43	-0.45	-0.60	-0.75	0.25
Japan[1]	0.01	0.00	-0.10	-0.40	-1.80
Euro area	-	-	-	-	-
Denmark	0.82	0.65	0.40	0.30	0.50
Sweden	-0.21	0.20	0.45	0.95	1.10
Norway	1.57	1.66	1.63	1.49	1.30
UK	-0.08	-0.10	-0.30	-0.60	0.55
Switzerland	-0.44	-0.45	-0.70	-1.10	-1.05
Poland	3.58	3.55	3.40	3.20	2.85
Czech Rep.	0.88	0.75	0.55	0.10	0.25
Hungary	5.48	4.75	4.75	4.50	4.75
Estonia	2.10	1.75	1.20	0.50	-0.55
Latvia	4.51	3.45	2.50	1.70	0.25
Lithuania	2.45	1.85	1.30	0.50	-0.45

1) Spread vs US

10-year government benchmark yields

	14.1.10	3M	6M	12M	24M
US	3.74	4.00	3.50	3.75	4.50
Japan	1.35	1.60	1.50	1.90	2.20
Euro area	3.32	3.50	3.30	3.60	4.00
Denmark	3.56	3.75	3.55	3.85	4.20
Sweden	3.38	3.55	3.70	3.90	4.30
Norway	4.04	4.39	4.30	4.44	4.59
UK	3.97	4.15	3.85	4.25	4.80
Switzerland	2.06	2.10	1.90	2.40	2.85
Poland	6.08	6.20	6.00	6.25	6.50
Czech Rep.	4.27	4.35	4.10	4.25	4.50
Hungary	7.58	7.50	7.25	7.40	7.50

10-year yield spreads vs Euro area

	14.1.10	3M	6M	12M	24M
US	0.42	0.50	0.20	0.15	0.50
Japan[1]	-2.39	-2.40	-2.00	-1.85	-2.30
Euro area	-	-	-	-	-
Denmark	0.25	0.25	0.25	0.25	0.20
Sweden	0.06	0.05	0.40	0.30	0.30
Norway	0.72	0.89	1.00	0.84	0.59
UK	0.65	0.65	0.55	0.65	0.80
Switzerland	-1.25	-1.40	-1.40	-1.20	-1.15
Poland	2.76	2.70	2.70	2.65	2.50
Czech Rep.	0.96	0.85	0.80	0.65	0.50
Hungary	4.27	4.00	3.95	3.80	3.50

1) Spread vs US

Exchange rates vs EUR

	14.1.10	3M	6M	12M	24M
EUR/USD	1.448	1.400	1.500	1.450	1.300
EUR/JPY	132.1	133.0	138.0	145.0	149.5
EUR/DKK	7.441	7.443	7.455	7.455	7.455
EUR/SEK	10.229	9.850	9.850	9.500	9.400
EUR/NOK	8.201	8.200	8.300	8.400	8.200
EUR/GBP	0.893	0.880	0.900	0.840	0.800
EUR/CHF	1.476	1.500	1.520	1.550	1.580
EUR/PLN	4.074	4.000	3.900	3.900	3.700
EUR/CZK	26.19	25.75	25.25	25.25	24.00
EUR/HUF	267.8	255.0	260.0	265.0	270.0
EUR/RUB	42.92	40.60	43.05	40.89	35.75
EUR/EEK	15.65	15.65	15.65	15.65	15.65
EUR/LVL	0.709	0.707	0.700	0.700	0.700
EUR/LTL	3.453	3.453	3.453	3.453	3.453
EUR/CNY	9.887	9.555	10.200	9.570	7.930

Exchange rates vs USD

	14.1.10	3M	6M	12M	24M
-					
USD/JPY	91.2	95.0	92.0	100.0	115.0
USD/DKK	5.138	5.316	4.970	5.141	5.735
USD/SEK	7.063	7.036	6.567	6.552	7.231
USD/NOK	5.663	5.857	5.533	5.793	6.308
GBP/USD	1.622	1.591	1.667	1.726	1.625
USD/CHF	1.019	1.071	1.013	1.069	1.215
USD/PLN	2.813	2.857	2.600	2.690	2.846
USD/CZK	18.08	18.39	16.83	17.41	18.46
USD/HUF	184.9	182.1	173.3	182.8	207.7
USD/RUB	29.64	29.00	28.70	28.20	27.50
USD/EEK	10.80	11.18	10.43	10.79	12.04
USD/LVL	0.490	0.505	0.467	0.483	0.538
USD/LTL	2.384	2.466	2.302	2.381	2.656
USD/CNY	6.827	6.825	6.800	6.600	6.100

Sharp rise in consumer spending this year

- Budding signs of growth elsewhere
- Bright prospects for consumer spending
- Perilous economic policy balancing act

As a small open economy, Denmark has been hard hit by the financial crisis and the global economic downturn. 2009 looks set to become the worst year for the Danish economy since World War 2, with a GDP erosion of nearly 5%. This decline is broadly based, with sharp setbacks in consumer spending, residential construction, business investment and exports.

Given the severity of the downturn, real GDP will not reach the 2007 pre-crisis level until 2013. Yet, the good news is that the adverse impact of the crisis seems to be fading and the economy should be poised for a new recovery. Notably the outlook for consumer spending and exports is better than it has been for a long time. But challenges abound, and low capacity utilisation and growing joblessness are acting as a drag.

Sharp rise in consumer spending next year

In 2009 there were signs of budding optimism among Danish consumers. Consumer confidence grew nicely, and especially consumers' expectations for the next 12 months rose to a record high. Growing financial wealth, rising disposable incomes and payments from the Special Pension scheme did not make consumers spend more in 2009, though. In fact, during a period of growing unemployment, households chose to bolster their savings and bide their time. But this year consumer spending looks set to increase fairly strongly.

The savings ratio has already risen to a high level, and households generally can look forward to a substantial increase in disposable income with this year's tax cuts. At the same time homeowners with adjustable-rate mortgages will benefit from a much easier interest burden i 2010. In addition, salary payments deferred from 2009 to 2010 to take advantage of the tax reform contribute to delaying any extra spending from 2009 to 2010. So consumer spending is set to rise sharply this year.

Budding signs of growth elsewhere

The significant fiscal stimulus packages and the central banks' record-low interest rates are now starting to feed through. We are seeing an impact on most of Denmark's key trading partners, including Sweden, Norway, the US, Germany and the Euro area as a whole, which all broke free from the grip of recession in 2009. The coming years exports are set to rise given the prospect of continued growth in Denmark's export markets in 2010 and 2011. And import growth goes hand in hand with rising exports. Following the sharp setback in 2009, a fairly solid rise is on the cards for 2010, partly driven by the acceleration in consumer spending.

Competitiveness faltering

As noted above, Danish exports will benefit from budding signs of growth elsewhere leading to an overall rise in demand. But the erosion of competitiveness that has been evident for a number of years is a negative factor. Due to higher wage growth in Denmark than in other countries, DKK appreciation versus a basket of the currencies of Denmark's competitors and lower productivity gains than abroad, Danish competitiveness has deteriorated. Consequentlty, Denmark loses market share in its export markets and is overtaken by a growing number of nations on the list of the world's richest countries.

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

	2006 (DKKbn)	2007	2008	2009E	2010E	2011E
Private consumption	787	2.4	-0.2	-4.8	2.9	2.6
Government consumption	423	1.3	1.6	2.1	1.4	1.2
Fixed investment	356	2.9	-4.7	-13.5	-5.8	0.4
- government investment	32	-3.3	-2.9	5.4	24.8	1.4
- residential investment	108	3.4	-14.2	-16.9	-8.2	-1.6
- business fixed investment	216	3.5	-0.7	-14.2	-8.3	1.7
Stockbuilding*	15	-0.3	0.3	-1.7	1.2	0.3
Exports	850	2.2	2.4	-9.6	2.9	4.2
Imports	798	2.6	3.3	-13.7	5.1	4.9
GDP		1.7	-0.9	-4.7	1.7	1.7
Nominal GDP (DKKbn)	1,632	1,692	1,737	1,675	1,721	1,794
Unemployment rate, %		2.7	1.8	3.6	5.6	6.2
Unemployment level, '000 persons		77.6	48.1	100.0	155.7	173.4
Consumer prices, % y/y		1.9	3.4	1.3	1.8	1.7
Hourly earnings, % y/y		3.9	4.5	2.9	2.1	2.0
House prices, one-family, % y/y		4.5	-4.5	-14.0	0.0	2.0
Current account (DKKbn)		25.0	38.0	60.0	39.0	33.0
- % of GDP		1.5	2.2	3.6	2.3	1.8
General govt. budget balance (DKKbn)		80.6	59.8	-50.3	-94.4	-79.0
- % of GDP		4.8	3.4	-3.0	-5.5	-4.4
Gross public debt, % of GDP		26.8	33.4	38.5	41.8	46.4

* Contribution to GDP-growth (% points)

The reasons behind this are manifold. One reason is the previously overheated labour market with upward pressure on wages. At the same time investment activity has been insufficient to compensate for the overheated labour market. To this should be added the fact that the recovery to some extent has been driven by construction; a sector well know for low productivity. Productivity trends have been particularly unfavourable during the transition from economic expansion to economic contraction. Companies have waited until the very last minute before letting go of staff that were hard to recruit when the economy was growing. And companies continued to hire staff despite the erosion of demand. As a result, Denmark went through a period when a higher number of employees produced a lower output.

Perilous economic policy balancing act

The return to positive economic growth internationally is largely attributable to the accommodative economic policy pursued, with low monetary policy rates and expansionary fiscal policy measures. In Denmark, only government consumption and government investment will display growth in positive territory in both 2009 and 2010.

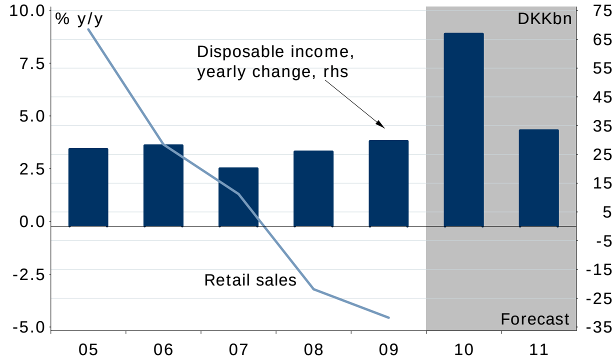
As a result, the public debt is rising sharply after several years of debt trimming. While that may be acceptable for a few years as Denmark's public debt is relatively modest by international standards, it is unsustainable over the long term if confidence in the Danish economy is to be maintained and sufficient funds to finance the welfare state of the future are to be ensured.

Against this backdrop, the government's 2015 plan has been put on the back burner; the bill has been postponed and the requirements for future government budgets have thus become very strict. It is now important to tighten fiscal policy as soon as the recovery proves sustainable. But there is also a risk of tightening policy too soon before the recovery has gained traction.

A similar balancing act is necessary as regards monetary policy, although in the case of Denmark this is chiefly the domain of the ECB. Here the important thing is not to push the problems into the future and thus create new bubbles and imbalances because monetary policy was left too accommodative for too long. But at the same time the recovery should not be choked off by tightening moves before gaining momentum in earnest. That is the perilous economic policy balancing act that central banks and heads of government face in the years ahead.

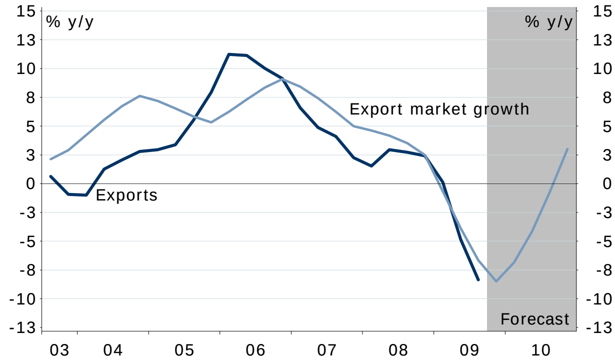
Troels Theill Eriksen
troels.t.eriksen@nordea.com +45 3333 2448

Consumers put off spending in 2009



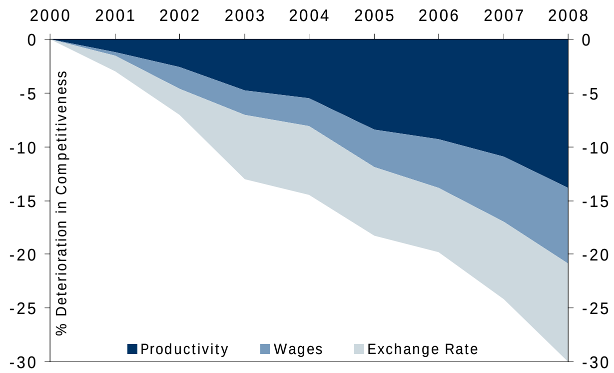
Sources: Statistics Denmark, Ministry of Finance and Nordea Markets

Bright prospects for exports



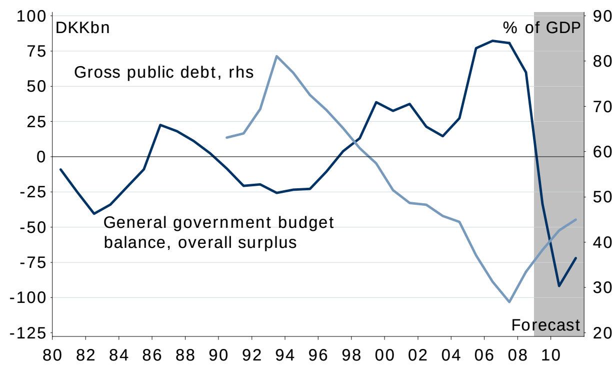
Sources: Statistics Denmark and Nordea Markets

Competitiveness faltering



Source: Ministry of Finance

Excessive public spending unacceptable long term



Sources: Statistics Denmark and Nordea Markets

Labour market stabilisation

- Expansionary conditions lifts GDP
- Labour market has already stabilised
- Riksbank to hike the repo rate to 2.00% in 2010

Recovery has started

Thanks to expansionary domestic conditions and a tentative pick-up in global trade, the Swedish economy is expanding again. Still, due to the dramatic downturn at the turn of 2008/2009, GDP contracted more in 2009 than in any other single year since World War II.

The same factors that got the economy back on track in 2009 will lift growth in 2010. Longer out, when economic policies in Sweden and elsewhere become less expansionary, and when several countries are still struggling with imbalances, economic growth will slow somewhat.

Dual economic trends

The outlook for household consumption has improved recently, whereas the upswing in the export sector has been more sluggish than expected. Exports admittedly grew in Q3, but production rose somewhat more modestly than expected. Moreover, both exports of goods and industrial production fell back in Q4. One of the reasons for the weak trend is probably continued inventory problems. The composition of Swedish exports, with a large concentration of investment goods, also holds back progress. As investments are normally undertaken later in the economic cycle and several countries have tight credit standards, demand for this type of products is still low. However, all indicators suggest that a more definite recovery is underway, and we look for healthy growth figures for the export sector going forward.

During H2 2009 the duality of the Swedish economy became increasingly clear with a severely hit export sector on the one hand and a domestic economy in relatively good shape on the other hand. Before the crisis Sweden's financial balances were by and large sound which now shows through in relatively strong domestic demand. First and foremost, strong government finances made it possible to launch fiscal policy stimuli measures without jeopardising the long-term sustainability of public finances. Second, households' savings were not uncomfortably low before the crisis and the housing market downturn has been mild.

The expansionary fiscal policy includes tax cuts for households in both 2009 and 2010. Lower taxes and interest rates as well as higher equity prices and the rebound in the housing market have apparently been considered more important by households than the rise in unemployment. Household consumption rose fairly rapidly as early as Q2 and Q3 2009, and with the labour market stabilisation this favourable trend will continue. However, once the Riksbank starts to hike its policy rate, households will be affected, resulting in somewhat more subdued trends in both consumption and the housing market.

Investment activity looks set to develop better than feared. The unprecedented slump in investment in early 2009 has been halted. Again, the areas mainly related to the domestic economy seem to be doing relatively well, for instance residential construction, parts of the service sector and public sector investment – the latter largely as a result of the expansionary fiscal policy. However, due to low investment needs in the manufacturing industry total investment will decline slightly also in 2010 before rising again in 2011.

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

	2006 (SEKbn)	2007	2008	2009E	2010E	2011E
Private consumption	1,373	3.0	-0.2	-0.5	2.8	2.2
Government consumption	762	0.3	1.4	2.1	1.8	0.6
Fixed investment	528	7.5	2.6	-12.9	-1.0	4.1
- industry	83	11.4	2.2	-18.7	-3.9	4.0
- residential investment	92	8.7	-5.4	-20.8	-3.2	5.7
Stockbuilding*	0	0.8	-0.6	-1.4	1.2	0.1
Exports	1,494	5.8	1.8	-12.9	5.2	4.6
Imports	1,257	9.4	3.0	-13.2	5.4	4.4
GDP		2.5	-0.2	-4.4	3.2	2.4
Nominal GDP (SEKbn)	0	3,063	3,155	3,095	3,226	3,339
Unemployment rate, %		6.2	6.1	8.3	9.0	8.9
Employment growth		2.4	0.9	-2.1	-0.5	0.3
Consumer prices, % y/y		2.2	3.4	-0.3	1.7	2.4
Underlying inflation (CPIF), % y/y		1.5	2.7	1.9	1.7	1.2
Hourly earnings, % y/y		3.1	4.4	3.1	2.3	2.4
Current account (SEKbn)		279.0	304.0	238.0	237.0	233.0
- % of GDP		9.1	9.6	7.7	7.3	7.0
Trade balance, % of GDP		4.6	4.0	4.1	4.0	3.6
General govt budget balance (SEKbn)		116	80	-48	-55	-43
- % of GDP		3.8	2.5	-1.5	-1.7	-1.3
Gross public debt, % of GDP		40.5	38.1	41.8	42.6	43.6

* Contribution to GDP growth (% points)

Strong labour market but low inflation

The relatively favourable trend in the domestic economy also shows through in the labour market. The decline in the number of hours worked and the number of persons employed has already stopped. The drop in employment thus stops at 130,000 persons, which is significantly better than forecast only six months ago. With decent GDP growth, the number of employed persons should start picking up again as early as in H2 2010.

The strong labour market trend can partly be explained by the labour market structure and surprisingly low productivity. The manufacturing industry, which normally boasts the highest level of productivity growth, has seen a steep drop in output and productivity, while trends in the service sector are more favourable.

Despite the low productivity, inflation pressures will be moderate during most of the forecast period. Lower wage growth than in recent years will to some extent counter the lower efficiency improvements. We expect this year's major pay round and some degree of wage drift to result in total wage growth of slightly over 2%. The past year's SEK erosion has boosted prices of many imported goods and lifted various measures of underlying inflation to the highest levels in many years. As the SEK has strengthened and is expected to firm further, these inflation impulses will fade. CPI inflation will rise, though, as mortgage rates are forecast to increase. Energy prices, the key uncertainty factor in the inflation forecast, are likely to gradually increase in future (see the section on oil).

Higher short rates and stronger SEK

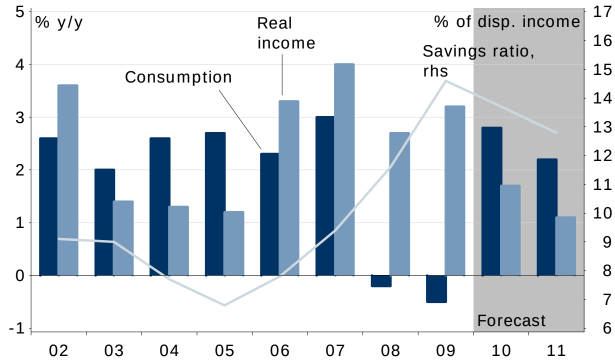
Capacity utilisation is low in the Swedish economy, which warrants an expansionary economic policy. However, in our view the Riksbank should reassess Swedish capacity utilisation, as labour market trends are much stronger than expected. Higher capacity utilisation leads to rising inflation longer out, which warrants a higher policy rate. Moreover, a policy rate of close to zero is too low against the backdrop of increasing credit growth among households. That is why we expect the Riksbank to take its foot off the accelerator and hike the policy rate sooner than the autumn of 2010 as the bank currently signals. According to our forecasts the Riksbank's repo rate will be hiked gradually to 2.0% at the end of 2010.

The Riksbank is expected to be among the central banks that will embark on a rate hiking cycle relatively early, which will bolster the SEK. Generally improved economic conditions and increasingly stronger confidence in the financial markets also create a more favourable backdrop for the SEK. The exchange rate of the SEK versus the EUR is estimated to be about 9.50 in one year.

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

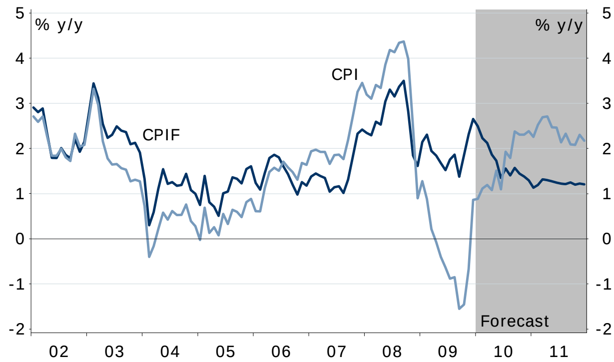
Recovery in goods exports

Scope for consumption growth



Labour market stabilisation

Underlying inflation to fall



Growth to slow again in 2011

- Relative strong growth in 2010 slows in 2011
- Norges Bank to hike rates, albeit slowly
- Rate hikes largely discounted, and the import-weighted NOK rate will only change marginally

Back on the growth track

In Q2 and Q3 2009 mainland production was back on the growth track, but despite the positive growth trend production in Q3 was still 1.5% below the Q2 2008 peak level. In a historical context the setback experienced in Norway last year was quite significant, but in an international context, it was quite moderate. Economic developments in Norway during the autumn of last year were largely in line with our September 2009 forecasts. However, once again we have to revise down our unemployment forecasts for 2009 and 2010. But unlike previously when economic growth and the rate of increase in employment surprised us on the upside, this time a decline in the labour supply has caused the unemployment rate to remain largely unchanged.

Strong, but slowing consumption growth

The economic turnaround in Norway is mainly attributable to strong growth in consumer spending. As we have probably not yet seen the full effect on consumption of last year's major rate cuts, we look for strong consumption growth throughout 2010. But during the latter part of 2010 and especially in 2011 we expect consumption growth to slow as a result of higher interest rates. With moderate real wage growth and employment gradually picking up, consumer spending should, however, continue to grow in 2011.Very strong growth in government consumption was the other major contributor to the milder setback in Norway. But the government budget for 2010 reflects slowing public sector demand during the year. And if the government is to meet its goal of reducing the use of oil money to a level complying with the spending rule before the end of the current parliamentary term (2013), government consumption growth should be low in 2011. Government expenditure growth must be slowed to a level below the rate of growth in government revenues from the mainland economy. Hence, the room for manoeuvre in government spending will be very limited as public pension costs via the National Insurance scheme ("Folketrygden") are growing at a faster rate. We have therefore sharply revised down our forecast for government consumption growth in 2011.

Oil investment activity may slow …

The trend in new orders to parts of the oil service sector and the latest survey of oil companies' investment plans suggest that our forecasts for oil investment in 2010 and 2011 in the latest issue of *Economic Outlook* were too optimistic. We have revised down our estimates and now expect oil investment to decline over the coming years. Production in the oil service industry will likely also decline during those years. So going forward, growth in the Norwegian manufacturing industry overall will be lower than in many other countries.

… but mainland investment will grow over time

The initially high level of investment activity in most sectors, declining production, uncertainty about future developments and tighter credit standards have contributed to the sharp drop in mainland investment. This downtrend will likely continue well into 2010. But later in 2010 investment should start to pick up again. Credit conditions have already improved, and with moderate economic growth the need for new investment will increase. The drop in housing starts has already ended.

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

	2006 (NOK bn)	2007	2008	2009E	2010E	2011E
Private consumption	882	5.4	1.3	0.0	4.0	2.0
Government consumption	413	3.0	4.1	6.0	3.0	1.5
Fixed investment	424	12.5	1.4	-7.5	-2.2	1.1
- gross investment, mainland	308	15.7	1.0	-11.2	-2.0	2.3
- gross investment, oil	99	7.2	-1.0	6.0	-3.0	-2.0
Stockbuilding*	51	-1.3	0.5	-1.9	0.0	0.0
Exports	1,003	2.3	0.9	-4.6	2.0	1.8
- crude oil and natural gas	498	-2.4	-2.0	-2.0	1.0	1.0
- other goods	272	8.5	4.3	-8.0	3.5	3.0
Imports	613	8.6	2.2	-10.9	2.5	2.4
GDP	2,160	2.7	1.8	-1.0	2.0	1.5
GDP, mainland	1,581	5.6	2.2	-1.0	2.4	1.7
Unemployment rate, %		2.5	2.6	3.1	3.5	3.7
Consumer prices, % y/y		0.8	3.8	2.2	1.9	1.9
Core inflation, % y/y		1.4	2.6	2.6	1.5	1.9
Annual wages (incl. pension costs), % y/y		5.6	6.0	3.6	4.3	4.2
Current account (NOKbn)		320.7	473.2	332.0	434.1	572.5
- % of GDP		15.9	17.7	13.8	16.5	19.9
Trade balance, % of GDP		15.3	19.2	14.4	16.9	19.9
General govt budget balance		402.6	480.0	185.0	270.0	420.0
- % of GDP		17.7	18.9	7.7	10.3	14.6

* Contribution to GDP growth (% points)

Moderate export growth

Mainland export growth rose sharply in Q3 2009, reflecting the pick-up in global trade. After a full recovery to the levels prevailing before the sharp downturn in global trade in late 2008 and early 2009 we expect export growth to moderate somewhat. Relatively modest growth in Norway's export markets and a lasting erosion of Norwegian competitiveness support this view.

Moderate growth and low inflation

All in all, we expect fairly good growth in the mainland economy during most of 2010, but markedly lower growth in 2011. Growth in the coming 2-year period is not likely to be strong enough to boost employment much. Hence, unemployment may increase over the forecast period. Slightly higher joblessness and mixed profitability levels in the corporate sector suggest that wage growth after the sharp decline in 2009 will be moderate. This, in turn, indicates that prices of goods and services made in Norway will rise only slightly, which will contribute to keeping core inflation below target. Core inflation especially in 2010 may turn out very low as the NOK appreciation throughout 2009 will act as a drag on the prices of imported consumer goods.

Modest rate hikes in the pipeline

Our growth and inflation forecasts for 2010 are not very different from Norges Bank's. Hence, we expect the central bank to hike rates at every second meeting during the year. Our forecasts for 2011, however, reflect less aggressive tightening than projected by the central bank. Still, the initial low level of interest rates and the pick-up in rates internationally indicates that the Norwegian policy rate will be hiked also in 2011. We base our interest rate forecast on the assumption that Norges Bank's rate hikes will feed through to mortgage rates. Norwegian long yields should gradually rise driven by expectations of higher yields in the Euro area. But with lower economic growth in Norway in 2011 and central bank moves that disappoint on the downside, Norwegian long yields may rise slightly less than Euro-area yields.

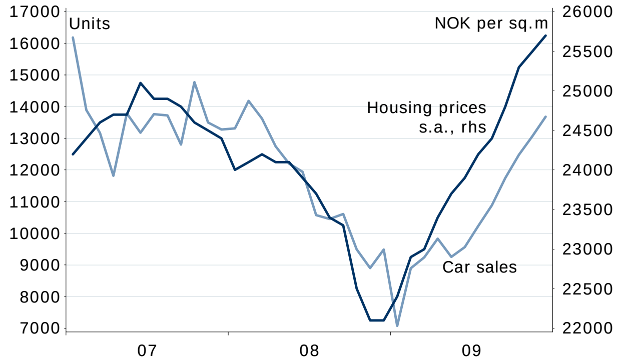
Relatively stable NOK

NOK strengthened markedly in H2 2009, reflecting partly a correction from extremely weak levels and partly expectations of more aggressive monetary policy tightening in Norway than elsewhere. Against this backdrop we do not expect the import-weighted NOK to strengthen markedly further as a result of cautious rate hikes in line with expectations. Still, a strengthening of the SEK, GBP and USD versus the EUR may cause the NOK to follow suit. If, on the other hand, growing concern about public finances in some EMU countries prompts the EUR to generally weaken, the NOK/EUR may strengthen.

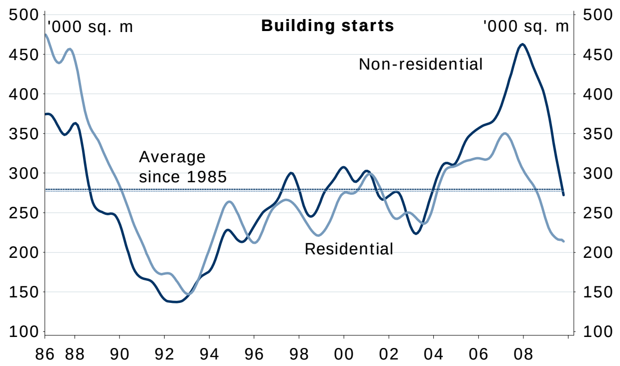
Erik Bruce
erik.bruce@nordea.com +47 2248 7993

Declining employment and labour supply

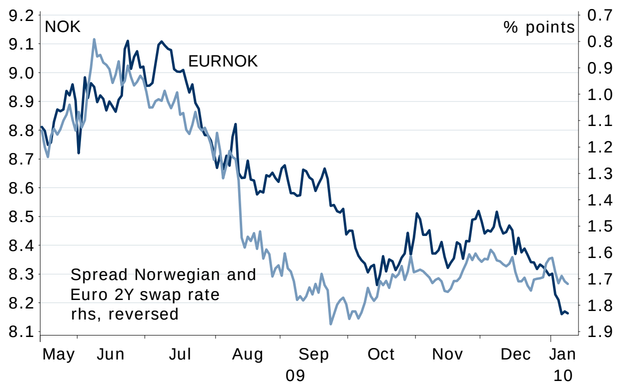
Rising household demand



Construction activity slows



NOK strengthens on higher interest rate expectations



Employment to rise in second half-year

- GDP growth set to strengthen
- Unemployment to peak in the summer
- Inflation to continue its roller coaster ride
- Public finances will be a positive surprise

The Finnish economy resumed growth in the summer of 2009 after the collapse in the winter. GDP contracted very sharply in the winter, but only for a short period of time. The primary reason was the downturn in world trade, which typically affects exports in Finland more than in most countries, even though such fluctuations are somewhat concurrent. In addition to the pick-up in the world economy, household demand will boost the Finnish economy this year. In fact, in 2010 the Finnish economy will grow faster than the rest of the Euro area. Of course, the starting level is low, but whereas the surprise in 2009 was a negative one, this year the odds are on the positive side.

Exports to jump into growth

Exports stopped plunging as early as in the spring, and many leading indicators suggest that exports will rebound in the winter after the acceleration phase in the autumn. Finnish exports fluctuate concurrently with but more sharply than in many other countries as a result not only of the structure of exports but also the high share of large companies. Furthermore, Finnish exporters' woes in 2009 can partly be explained by the strong recession in the Russian economy. Exports were further hindered by the weakening currencies of some rival countries and the general strength of the euro.

The same factors that weighed on exports last year are boosting exports this year. World trade is about to jump higher than global GDP growth figures would suggest. On average, Finland will benefit more from the upturn than other countries, particularly as some key export areas, such as Russia, are recovering fairly rapidly. Also the impact of exchange rates is likely to turn positive.

Households boosting the economy

In addition to exports, household demand has also begun to recover. It is often thought that in a small open economy such as Finland, consumption reflects export trends with a lag. This time, however, household demand began to decline and also resumed an upward path at least at the same pace as exports. Last winter, the savings rate rose steeply as households were alarmed by the global news flow about the problems in the financial markets. Nevertheless, confidence was restored fairly rapidly. Thanks to previous savings, favourable income trends and low interest rates, consumption has bounced from its weakest levels in the spring despite a drop in employment.

In 2010, private consumption will continue to grow. It is driven by reduced saving due to low interest rates and increasing consumer confidence due to the economic recovery. The bad news is that further weakening of employment and increasingly sluggish wage growth will ensure that any increases in disposable income remain small. Therefore, consumption will recover fairly slowly on a 12-month horizon. However, consumption growth will strengthen towards the end of the year and further into 2011 as the labour market situation improves.

Household demand also led to increases in the housing market as early as in the spring after a few quarters of decline. Home prices returned to their peak level after a couple of quarters. Towards the end of 2009, the turnaround in the market began to feed through to construction. Residential construction actually looks set to grow faster in 2010 than previously estimated.

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

	2006 (EURbn)	2007	2008	2009E	2010E	2011E
Private consumption	86	3.3	1.9	-1.8	1.2	2.0
Government consumption	37	0.8	2.0	1.5	0.5	0.5
Fixed investment	32	8.7	0.3	-14.0	-2.4	4.0
Stockbuilding*	4	-0.3	-0.9	-0.4	0.6	0.0
Exports	75	8.1	7.3	-24.0	7.0	6.0
Imports	67	6.5	7.0	-23.0	4.2	5.8
GDP		4.2	1.0	-7.0	2.7	2.5
Nominal GDP (EURbn)	167.0	179.7	184.7	174.3	180.8	187.8
Unemployment rate, %		6.9	6.4	8.3	9.8	9.4
Industrial production, % y/y		8.6	0.1	-20.0	5.0	4.0
Consumer prices, % y/y		2.5	4.1	0.0	1.0	2.5
Hourly wages, % y/y		3.3	5.6	4.0	2.7	2.0
Current account (EURbn)		7.6	5.6	2.8	4.4	4.5
- % of GDP		4.2	3.0	1.6	2.4	2.4
Trade balance (EURbn)		8.7	5.9	3.7	4.8	4.8
- % of GDP		4.8	3.2	2.3	2.7	2.6
General govt budget balance (EURbn)		9.4	8.2	-3.5	-5.4	-4.5
- % of GDP		5.2	4.5	-2.0	-3.0	-2.5
Gross public debt (EURbn)		63.2	63.0	70.0	81.0	90.0
- % of GDP		35.2	34.1	40.2	44.8	48.0

* Contribution to GDP growth (% points)

However, other construction activity will continue to decrease, and therefore construction as a whole will remain at a subdued level. Overall, business investment will also remain sluggish in 2010, although the worst decline is over.

Unemployment to remain lower than feared

As GDP grows again, the next major milestone will be the recovery of the labour market. The economy must expand at a rate of a good couple of per cent at least for a few quarters in order for more jobs to be created. So, an upturn in the labour market is not on the cards until the latter half of 2010. Employment has weakened largely as expected, but so far unemployment has increased less than expected even by the most optimistic observers. This is largely due to a reduction in the labour force. The baby boomers are nearing retirement, and the recession has sped up the transition. It is likely that this trend will strengthen further next year. Unemployment will probably increase fairly moderately in comparison with the large drop in GDP. The increase in unemployment is also dampened by the fact that the drop in GDP originated from the capital-intensive export sector.

Inflation to accelerate again

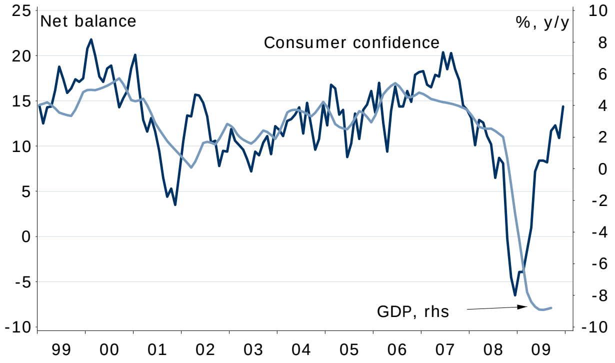
Towards the year-end, inflation moved well into negative territory measured by the national consumer price index. The VAT cut on food as well as the declining interest rates on loans, which are also included in the national index, pushed down the inflation rate. In 2010, fundamental inflation pressures will decrease further, as wage growth slows down, among other things. Energy prices, however, have again begun to boost inflation. By the end of the year, all of the extraordinary factors now pushing inflation into negative territory will again speed up the rise of the consumer price index. During the year, inflation will jump from negative and well into positive territory. The EU countries' harmonised index fluctuates considerably less since it does not include loan interest rates. Measured by the harmonised index, inflation will remain rather stable within the ECB's target range also in 2010-2011.

Government deficit to remain reasonable

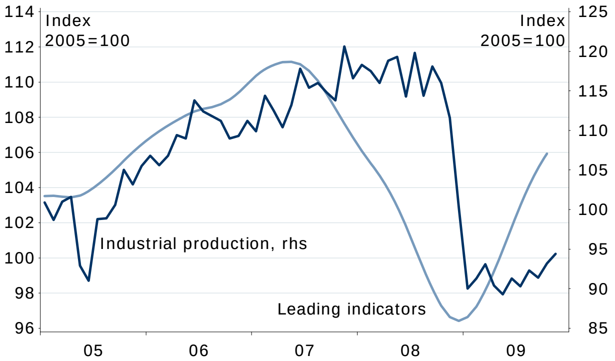
The deficit of government finances will increase further in 2010, but the situation is moderate in an international comparison and better than expected against official estimates. Companies have been able to stabilise their earnings performance rather quickly. The rise in unemployment seems to prove smaller than feared, and the pick-up in consumer demand will boost revenues from indirect taxation. Hence, we expect the government deficit to remain at a level which many countries will not achieve until after several years. Public debt will remain below 50% of GDP this year and increase only moderately in the next few years.

Reijo Heiskanen
reijo.heiskanen@nordea.com +358 9 165 59942

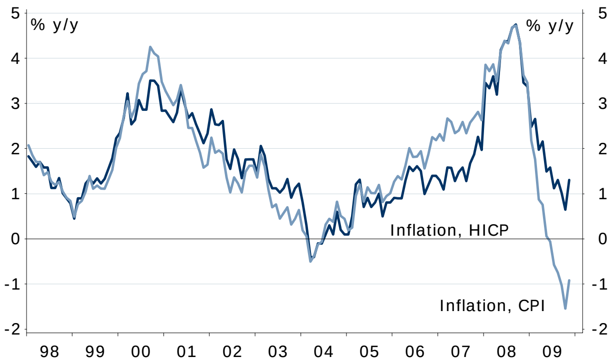
Consumer optimism to lift consumption



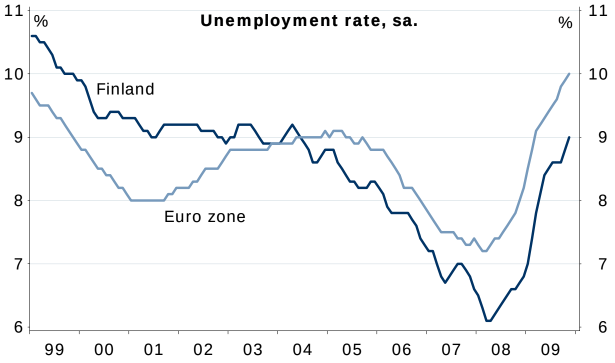
Industrial recovery to gain strength



Inflation to rebound



Unemployment to peak in the summer



Slowly overcoming the crisis

The economy has contracted sharply since the collapse of the financial sector one year ago with GDP growth for 2009 expected at -7.3%. But the contraction has been smaller than earlier expected as private consumption has started to increase again on a quarterly seasonally-adjusted basis. Despite the severe situation, households had some tailwind from less pronounced real wage declines and the halt in the ISK weakening due to intervention and introduction of tight capital control. Looking ahead, private consumption growth will remain subdued, one of the drags being the tax hikes that are part of the government's economic programme.

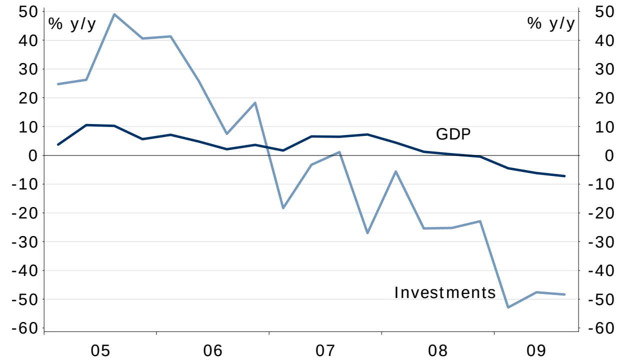
Investment has fallen dramatically as domestic funded investment has suffered from the general pessimism and the dysfunctional financial system, whereas foreign direct investment in for instance more aluminium smelters is hampered by the capital controls. Thus, total domestic demand growth will end as low as -20% in 2009 and remain negative in 2010. Exports are the only clear bright spot, buoyed by the export-favourable exchange rate development and increasing prices of the main export goods, aluminium and fish. The futures market for aluminium is pricing in slightly increasing prices over the forecast period.

The restructuring process of the banking sector is closer to completion, which bodes well for the whole economy going forward. But uncertainties have increased again since the president refused to approve the law in which Iceland agrees to compensate depositors in the collapsed banks. There is a risk that the IMF lending programme will be postponed or even stopped completely. The loans are a main element in the process of overcoming the crisis.

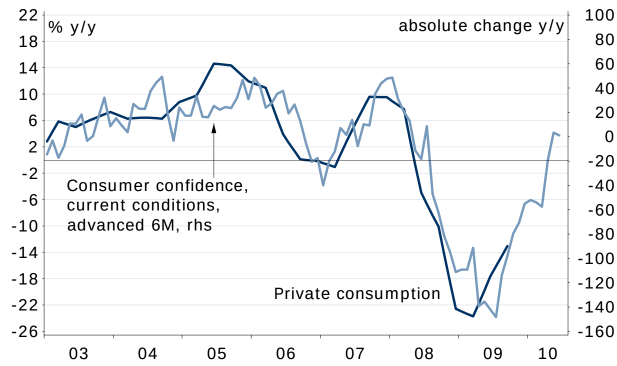
The very strict capital restrictions have been relaxed slightly as limitations on FX inflow were lifted last autumn. It has yet to be seen when the rest of the intended relaxation will be implemented.

Bjarke Roed-Frederiksen
bjarke.roed-frederiksen@nordea.com +45 3333 5607

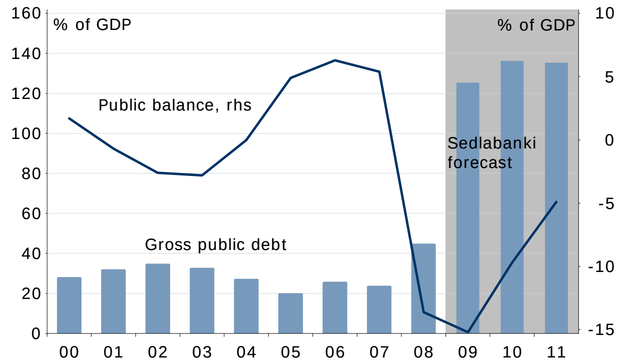
Especially investment is down on its knees



Private consumption will slowly recover



Restructuring weighs on public finances



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

	2006 (ISKbn)	2007	2008	2009E	2010E	2011E
Private consumption	680	5.6	-7.8	-14.6	-0.4	4.1
Government consumption	285	4.1	4.6	-0.5	-7.6	-6.1
Fixed investment	398	-12.2	-20.4	-46.8	8.9	6.2
Stockbuilding*	13	-0.6	-0.4	0.1	-0.4	0.0
Exports	377	17.7	7.1	2.8	3.6	5.8
Imports	585	-0.7	-18.3	-22.2	11.2	5.1
GDP		5.6	1.3	-7.3	-4.9	2.3
Nominal GDP (ISKbn)	1,168	1,339	1,618	1,486	1,498	1,588
Unemployment rate, %		1.0	1.6	8.0	10.0	9.0
Consumer prices, % y/y		5.0	12.4	12.0	6.0	2.0
Current account - % of GDP		-20.6	-42.2	-10.0	3.0	5.0
General govt. budget balance, % of GDP		5.4	-13.6	-15.0	-10.0	-5.0

* Contribution to GDP growth (% points)

Upswing will continue, but at slower pace

- Relatively weak upswing with high unemployment
- Weakness in households and small companies
- Large companies may surprise on the upside
- But first rate hike still a long way off

The good news here at the beginning of the year is that the US economy is still showing signs of moderate improvement – definite progress compared to one year ago when the economy was shrinking at an alarming pace. Uncertainties are still rife but we consider it most likely that growth will remain positive during the forecast period and that employment starts to pick up in early 2010.

But later this year the economy is expected to lose momentum as the temporary stimulus from fiscal policy measures and slower destocking fades. An expected new rescue package this year will hardly be of a size sufficient to counter the contractionary fiscal policy effects in late 2010 and 2011 when some of the public growth initiatives expire. The huge public budget deficit severely restricts the fiscal room for manoeuvre and in itself constitutes a significant risk factor for the economy.

Throughout most of 2010 and 2011 economic growth is projected to be lower than the estimated annual growth potential of about 2½%. Consequently, unemployment is unlikely to be reduced much from the current level of some 10%, as employment growth is not expected to exceed the demographically-led labour force expansion until late in the forecast period.

Consumers still do not contribute much to economic growth. Despite the strong stock market gains in 2009 and recent months' rising home prices, consumer confidence remains lower than at any time during the past three recessions prior to the recession that ended in mid-2009. Households have now embarked on debt reduction and the savings ratio is estimated to rise further. This only leaves room for a slight uptick in consumer spending, as households will at the same time experience very weak wage growth due to the labour market situation. Even declining nominal wages in 2010 is not an unrealistic scenario. Our baseline scenario incorporates a rise in households' savings ratio from currently 4.75% to the historical average of 8% at end-2011.

Despite recent months' increases, home prices have probably not bottomed yet. An additional price drop of 5-10% from the current level is likely in light of the prospect of a massive supply of foreclosure sales, as 20m homeowners (25% of homeowners with mortgage loans) have negative home equity. The government's efforts to secure debt rescheduling for beleaguered homeowners seem to have had limited success. However, the recently adopted extension of tax rebates for first-time buyers may defer the price adjustment.

Consumers and small enterprises, which are reliant on the banks, still find it difficult to obtain funding. Banks are still tightening their credit standards, albeit at an increasingly slower pace. In addition to the high unemployment and fragile housing market, the current downturn in the commercial property market presents an obstacle for the banks. The reason for the banks' reduced lending activity increasingly seems to be weak demand, though. Not until banks' loan volumes start to grow again will the economy really be on the way back to the growth track. It is difficult to predict when that happens.

Companies' persistently low capacity utilisation points to overall slow business investment. Substantial corporate investments, possible in connection with a sweeping

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

	2006 (USDbn)	2007	2008	2009E	2010E	2011E
Private consumption	9,322.7	2.7	-0.2	-0.6	1.6	1.2
Government consumption and investment	2,518.4	1.7	3.1	2.2	2.2	0.5
Private fixed investment	2,267.2	-2.1	-5.1	-18.7	-1.6	5.3
- residential investment	761.9	-18.5	-22.9	-20.3	8.1	11.1
- equipment and software	1,071.7	2.6	-2.6	-17.7	-1.9	3.9
- non-residential structures	433.7	14.9	10.3	-19.4	-9.1	2.4
Stockbuilding*	60.0	-0.3	-0.3	-0.7	0.8	0.1
Exports	1,471.1	8.7	5.4	-10.5	6.6	7.9
Imports	2,240.4	2.0	-3.2	-14.4	5.1	4.8
GDP		2.1	0.4	-2.5	2.2	2.0
Nominal GDP (USDbn)	13,399	14,078	14,441	14,245	14,741	15,258
Unemployment rate, %		4.6	5.8	9.3	10.3	10.2
Industrial production, % y/y		1.5	-2.2	-11.0	4.0	4.0
Consumer prices, % y/y		2.9	3.8	-0.3	1.9	1.0
Consumer prices ex. energy and food, % y/y		2.3	2.3	1.7	0.8	0.2
Hourly earnings, % y/y		4.0	3.8	2.9	2.0	1.8
Current account (USDbn)		-726.6	-706.1	-413.1	-368.5	-381.4
- % of GDP		-5.2	-4.9	-2.9	-2.5	-2.5
Federal budget balance (USDbn)		-161.5	-454.8	-1,500.0	-1,300.0	-1,000.0
- % of GDP		-1.1	-3.1	-10.5	-8.8	-6.6
Gross public debt, % of GDP		65.7	74.3	88.7	97.5	104.0

* Contribution to GDP growth (% points)

consolidation process, could uncork a positive surprise in relation to economic growth, though. Large companies are doing much better than the small ones given their easier access to the capital markets and bigger scope for benefitting from the upturn in exports supported by the weak USD. Exports may also surprise on the upside. The USD is not forecast to firm versus the EUR until the latter part of the forecast period.

Falling core inflation

The y/y rate of consumer price increases is estimated to peak at around 2.5% in H1, mainly driven by base effects as a result of commodity price increases in H2 2009. In the latter part of the forecast period, headline inflation is expected to fall. Core inflation (excluding energy and food) is expected to show a sharp drop throughout the period where the ample capacity will make it difficult to hike wages and prices. Also a further decline in rents owing to the record-high number of vacant rental properties is estimated to curb core inflation. More specifically, core inflation is forecast to fall to close zero at end-2010 and remain largely unchanged in 2011.

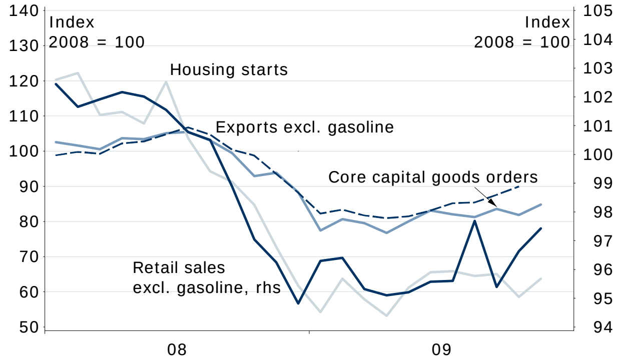
No Fed rate hikes in the near future

During H1 the Fed may come under pressure to tighten its monetary policy relatively fast. At this point employment finally looks set to rise, supported by a temporary uptick in public-sector employment of up to 1-1.5 million persons in the first five months of the year in connection with this year's census. These jobs will be scrapped in June and the following months.

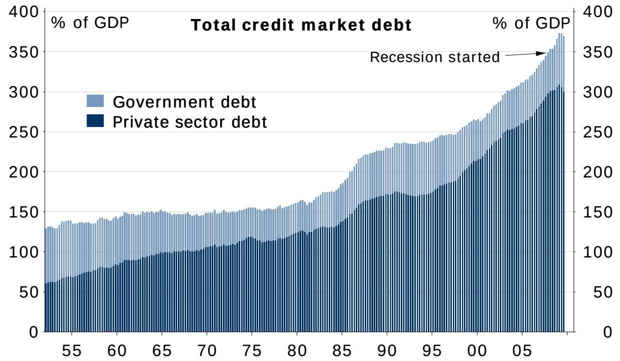
However, we maintain the view that the Fed will not hike its policy rate until the beginning of 2011 at the earliest. Even with a somewhat stronger economic upswing than we forecast, it will take years to reduce unemployment to more normal levels. And that worries the Fed. Moreover, experience shows that the Fed does not hike its policy rate until a definite downtrend in unemployment has been evident for quite some time. The central bank still signals that is does not want to use the interest rate weapon solely to counter the risk of a new wave of asset price inflation. Instead, it considers regulation to be an appropriate tool for that task. In line with the historical pattern the Fed will probably also put off monetary policy tightening until clear signs emerge that banks' lending activity has risen again. And given the weak demand that still characterises the economy, significant improvement in this area is also a long way off. On the other hand, interest rates will likely be hiked at a relatively swift pace once the normalisation finally starts. Prior to the first rate hike we expect the Fed to start absorbing some of the extra liquidity that it has pumped out to stimulate the economy. But given the prospect of a weak economic upswing and downward pressure on inflation, the withdrawal of the extra liquidity is estimated to be gradual.

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

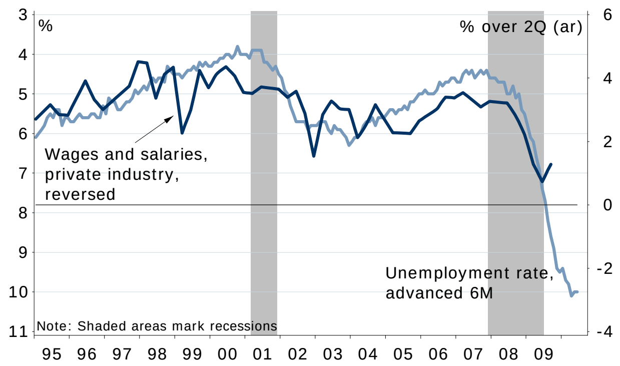
Indicators slowly moving in the right direction



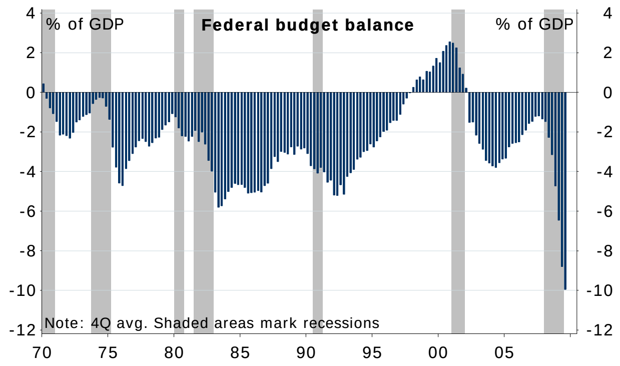
Debt reduction only just started



Falling nominal wages this year?



Unsustainable fiscal policy



Greater divergence between members characterises recovery

- Export growth and inventory rebuilding continue
- Consumption and investment likely to recover
- Fiscal consolidation could drag growth lower
- The ECB to begin policy tightening in H2 2010

Recovery continues at modest pace

The recovery in the Euro area has been less buoyant than we expected last September, but the momentum seems to be strong enough to ensure continued growth well into the first half of 2010. In the second half of 2010, we expect growth to moderate as fiscal stimulus and global inventory rebuilding fade as growth drivers. With moderate growth foreseen over the next two years, economic activity will remain below the peak seen at the beginning of 2008. This implies a substantial amount of spare capacity and high unemployment, which should keep a firm lid on inflationary pressures. In addition, the prospects of a continued recovery are still clouded by substantial uncertainty dominated by risks on the downside. First, the recovery in the Euro area remains highly dependent on a continued rebound in world trade. Second, the recession has resulted in large budget deficits in several member states, and these countries are likely to be forced to undertake substantial fiscal consolidation as early as in 2010. Lastly, the lingering effects of the credit crisis could still constrain investment, particularly in housing, where Spain and other member states are still struggling with large inventories of unsold homes. On the upside, the extremely low level of interest rates and the substantial easing of fiscal policy seen in Germany and to a lesser extent France could facilitate a more robust recovery. The ECB has repeatedly expressed concern that the ample liquidity supplied in the wake of the credit crisis could lead to new bubbles threatening financial stability. Hence, we expect the ECB to continue its gradual withdrawal of the extraordinary liquidity support.

Recovery led by the manufacturing sector

Just as the recession in the Euro area was focused on the manufacturing sector, this sector is also enjoying the strongest rebound. The rebound is driven by inventories and exports following last winter's nosedive. In particular, export demand from neighbouring countries and to some extent Asia, excluding China, seems to be reviving, while exports to the US continue to decline, probably explained by the weakness of the USD. The strengthening of the Euro area's effective exchange rate over the past year will of course weigh on exports going forward, and this may be particularly problematic to the Euro area's southern member states, which have lost competitiveness over several years. For the Euro area as a whole, the headwind from exchange rates should be more than outweighed by the revival of demand in export markets. Next year, we expect exchange rate developments to support Euro-area exports, with the currencies of nearly all export markets strengthening against the EUR.

Fiscal expansion followed by consolidation

Even though the recovery in industrial production and orders has brightened the prospects for business investment, the fact that spare capacity remains near record highs, suggests that investment growth will be fairly moderate. The lingering effects of the credit crisis could also hamper investment growth, even though Euro-area banks seem to be less keen on tightening credit conditions further and spreads for corporate bonds have narrowed considerably. Regarding private consumption, our forecast of a continued rise in unemployment in 2010, the slowdown in wage growth and the commodity price induced lift in inflation all point to fairly weak growth over the next two years. However, the rebound in financial

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

	2006 (EURbn)	2007	2008	2009E	2010E	2011E
Private consumption	4,956	1.6	0.3	-1.0	0.5	1.2
Government consumption	1,739	2.2	2.1	2.4	1.7	1.1
Fixed investment	1,831	4.7	-0.5	-9.8	1.0	2.5
Stockbuilding*	28	0.0	0.0	-0.5	0.5	0.0
Exports	3,452	6.3	0.8	-13.5	7.1	6.2
Imports	3,354	5.5	0.8	-11.3	6.5	6.2
Net exports*	98	0.4	0.0	-1.2	0.3	0.0
GDP		2.7	0.5	-3.9	1.7	1.5
Nominal GDP (EURbn)	8,560	9,006	9,259	9,002	9,285	9,422
Unemployment rate, %		7.5	7.6	9.6	10.9	10.6
Industrial production, % y/y		3.2	-2.3	-13.6	4.0	1.5
Consumer prices, % y/y (HICP)		2.3	3.3	0.3	1.4	1.5
- core inflation		2.0	2.4	1.3	0.9	1.2
Hourly labour cost, wages and salaries % y/y		2.8	3.5	3.3	2.3	1.8
Current account (EURbn)		15	-141	-68	-50	-70
- % of GDP		0.2	-1.5	-0.8	-0.5	-0.7
General govt budget balance, % of GDP		-0.6	-2.0	-6.2	-6.7	-5.8
Gross public debt, % of GDP		66.0	69.3	77.5	81.8	86.4

* Contribution to GDP growth (% points)

wealth and the low level of interest rates both suggest that household savings could decline from the current peak, and this will provide some growth in private consumption.

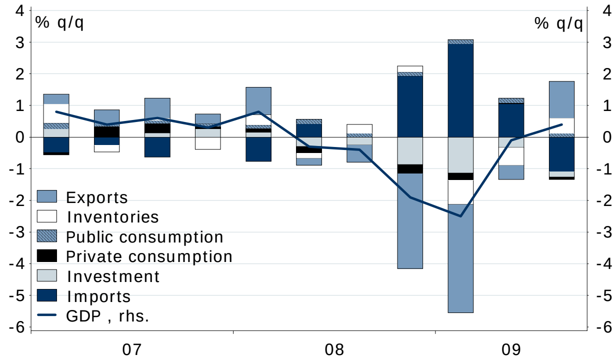
Fiscal policy is likely to support private consumption in the first half of 2010, but later the picture becomes less certain. The EU Commission has recommended that Belgium, France, Ireland, Italy, Portugal, Spain, Slovenia and Slovakia begin fiscal consolidation as early as in 2010, and Greece will most likely be ordered to reduce its deficit following a clear breach of the Stability and Growth Pact's rules on budget deficits. Not all countries may have the political will to follow this recommendation, but it certainly reduces the scope for further easing. The example of Greece shows that politicians cannot ignore calls for fiscal consolidation, as markets have become much more discerning with respect to the credit quality of individual member states, leading to much wider interest rate spreads than seen prior to the credit crisis. Hence, it is primarily Germany which has scope for a further easing of policy in 2010, but even here the bulk of fiscal easing will occur in the first half of the year.

The ECB is inching towards exit strategy

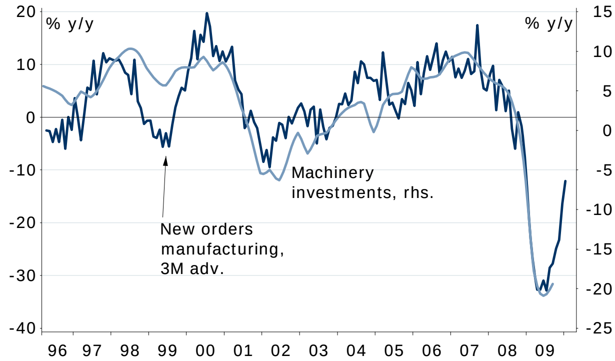
Headline inflation has moved back into positive territory after six months with negative readings in 2009, but the higher inflation is entirely due to base effects associated with the low level of oil prices last winter and spring. We expect energy prices to pull headline inflation further upwards and peak just below the ECB's definition of price stability next summer. The rise in inflation should not be of much concern to the ECB, however, as core inflation will remain subdued in the face of high unemployment and large amounts of spare capacity. Consequently, we only expect the ECB to begin any significant withdrawal of liquidity in the second half of 2010, leading to a gradual rise in short-term money market rates and followed by the first rate hike towards the end of the year. Historical experience indicates that the ECB does not hike interest rates until unemployment is declining and bank lending is rising at a sufficiently fast clip. Moreover, the ECB will find it far easier to withdraw liquidity when the 12-month refi operation from June last year expires on 2 July. Next year we expect the ECB to continue hiking interest rates by 25 bp at quarterly intervals until the refi rate reaches 2.00% next September. In our view, this can be considered "the normal trough" for ECB rates in a situation with ample spare capacity. Hence, the ECB will only continue hiking interest rates, if growth turns out to be faster than we currently expect. On the other hand, the ECB may also delay the tightening of monetary policy, if EUR/USD moves significantly higher than we currently expect.

Anders Matzen
anders.matzen@nordea.com +45 3333 3318

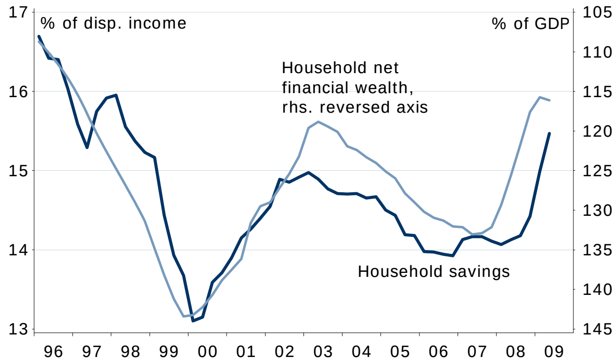
Exports and inventories behind Euro-area recovery



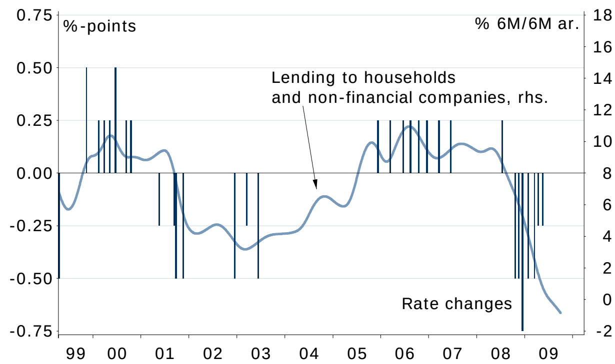
Improving prospects for business investment



Rebound in equity markets could reduce savings rate



No ECB rate hikes until lending growth recovers



Bright spots thanks to growth in neighbouring countries

After a severe setback in late 2008 exports rebounded during 2009. The improvement is mainly thanks to the Asian countries where the decline in exports has nearly been recovered, while progress in the US and the Euro area is more modest. With continued growth in the global economy, exports should continue to develop favourably. The export outlook is particularly bright in the rest of Asia, which absorbs more than half of Japan's exports.

The outlook for domestic demand is definitely not as bright; in the past six quarters growth was negative. Unemployment has not surged, but with a shrinking labour force and negative wage growth, the potential for private consumption is very limited. Investment prospects are not good either, as many companies are under pressure from falling prices and a strong JPY.

The public debt is ballooning and issuance of government bonds is record high. In order to restore credibility about public finances, the government has imposed a ceiling on bond issuance of JPY 44trn from the next fiscal year. By comparison this year's issuance is expected to total JPY 53trn. This upper limit means that the likelihood of new fiscal policy rescue packages is very slim.

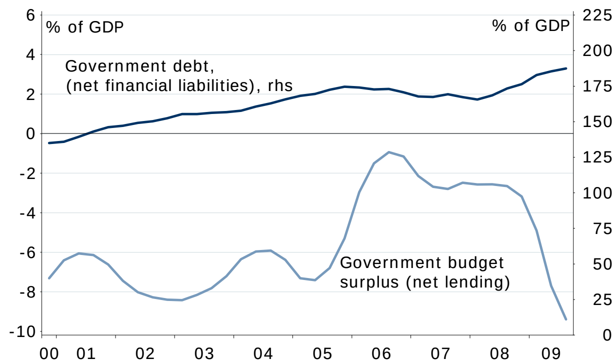
Inflation has plunged to well below zero. Coupled with uncertainty about the sustainability of public deficits, this has lifted real interest rates to higher levels than before the financial crisis erupted. Recent months' data show falling prices of more than 60% of the product groups included in the statistics. The government has publicly announced that deflation is a reality. And with the economy still expanding at a snail's pace, there is little prospect of inflation reaching positive territory in the near future. So there is very little reason to expect rate hikes until near the end of the forecast horizon.

We expect the JPY to weaken – mainly as rate hikes seem to be a very long way off and owing to the very high public debt.

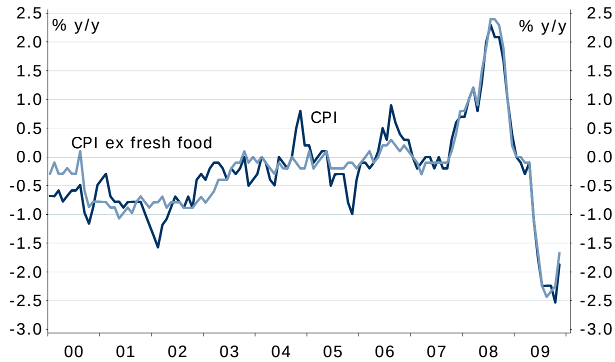
Martin Ipsen
m.ipsen@nordea.com +45 3333 3171

Revival of exports

Surging public debt



Hit by deflation



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

	2006 (JPYtrn)	2007	2008	2009E	2010E	2011E
Private consumption	289.6	1.6	-0.7	-1.0	0.7	1.3
Government consumption	90.7	1.5	0.2	1.3	1.9	1.1
Gross fixed capital formation	118.6	-1.1	-2.6	-15.0	-4.7	2.5
Stockbuilding*	2.3	0.3	-0.4	0.0	0.5	0.1
Exports	81.6	8.4	1.9	-24.9	11.7	4.3
Imports	75.3	1.6	0.8	-17.2	4.6	4.7
GDP	-	2.3	-1.2	-5.2	1.6	1.2
Nominal GDP (JPYtrn)	501.1	507.0	506.6	474.0	479.1	484.8
Unemployment rate, %		3.8	4.0	5.1	5.4	5.6
Consumer prices, % y/y		0.1	1.5	-1.3	-0.5	0.0
Current account, % of GDP		4.8	3.2	2.8	3.1	3.4
General government budget balance, % of GDP		-2.5	-2.7	-7.6	-7.8	-6.2

* Contribution to GDP growth (% points)

Several signs of improvement

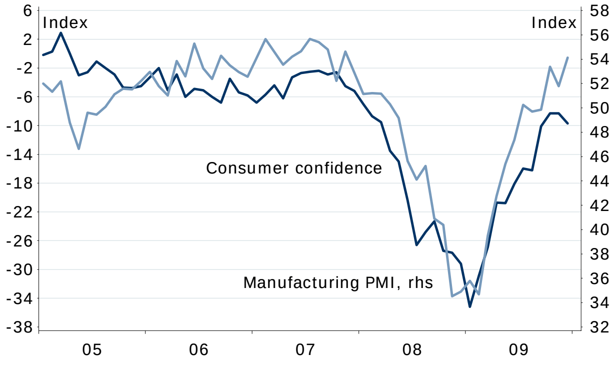
Both consumer confidence and UK purchasing managers' view on the economy (the PMI) improved sharply throughout most of 2009 after a dramatic nosedive in 2008. Households get a helping hand from rising housing wealth and share prices. However, as they are still burdened by high debt, growing unemployment and low wage growth, it would be too optimistic to expect a major spending spree. In light of companies' low capacity utilisation, investment growth is not set to skyrocket either, but the level has probably bottomed. Exporters benefit from the significant weakening of the GPB versus most other currencies. Export growth has been disappointing so far, though, and imports grew at a faster clip than exports in Q3 2009. But the main driver behind imports was an explosive surge in car sales as a result of the popular temporary scrap premium. And as import demand from the Euro area looks set to be very promising and the car scrappage scheme expires in February, export growth will likely eventually outstrip import growth.

As a result of rising energy prices and the weak GBP, inflation has been brought back close to the Bank of England's (BoE) target of 2%. With the expiry on 1 January of the temporary VAT cut from 17.5% to 15% and the higher energy prices, inflation should rise further. However, given the low capacity utilisation this trend should be short-lived and we do not believe that the BoE will hike interest rates until early 2011.

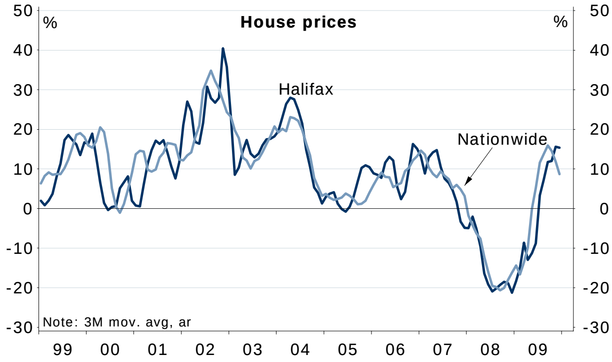
According to our model the GBP is significantly undervalued, and we thus expect the GBP to appreciate fairly sharply versus the EUR. The GBP is supported by a decreasing current account deficit and the BoE's refraining from further quantitative easing. The GBP will strengthen in earnest in six months' time when the USD starts to gain versus the EUR and expectations of more aggressive BoE rate hikes could be priced in by the market. In addition, we expect worries over the UK's public debt problems to ease.

Martin Ipsen
m.ipsen@nordea.com +45 3333 3171

Consumers and businesses stepping out of the dark



Housing prices rising again



GBP weakened sharply versus most other currencies

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

	2006 (GBPbn)	2007	2008.0	2009E	2010E	2011E
Private consumption	849.5	2.1	1.0	-3.0	0.3	1.2
Government consumption	285.2	1.2	2.5	1.9	1.0	-0.4
Fixed investment	227.4	7.8	-3.3	-14.5	-2.3	3.2
Stockbuilding*	4.8	0.2	-0.4	-1.3	1.2	0.1
Exports	377.9	-2.8	1.0	-10.7	7.0	6.2
Imports	419.4	-0.7	-0.8	-12.5	4.3	4.7
GDP	5.3	2.6	0.6	-4.6	1.9	1.6
Nominal GDP (GBPbn)	1325.8	1398.9	1448.1	1413.4	1469.1	1519.5
Unemployment rate, %		2.9	2.8	4.9	6.2	6.0
Consumer prices, % y/y		2.3	3.5	2.1	2.0	1.8
Current account, % of GDP		-2.9	-1.7	-1.2	-0.5	0.0
General govt budget balance, % of GDP		-2.8	-3.8	-11.0	-10.5	-8.5
Gross public debt, % of GDP		43.9	52.0	65.0	76.5	83.5

* Contribution to GDP growth (% points)

Thriving domestic demand

The international economic crisis seems to have had relatively little impact on Switzerland. Private consumption has stayed on the growth track and investment activity has not been entirely quelled. Exporters have come up against a strong headwind, though.

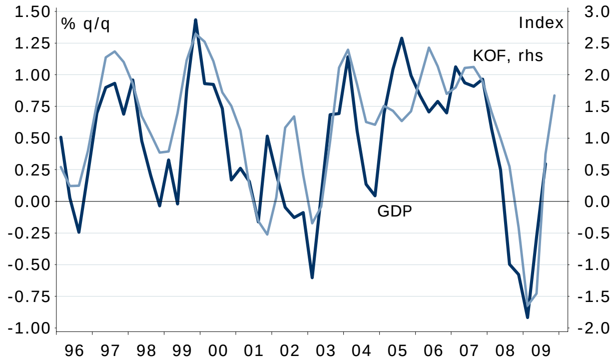
The leading business confidence indicator (KOF) has risen sharply in recent months and the level indicates relatively healthy economic growth rates in the coming quarters. This tallies well with rising import demand from the Euro area enabling the export sector to regain the ground lost, although the strong CHF curbs companies' international competitiveness. At the same time, domestic demand looks set to maintain momentum. The cocktail of low unemployment and positive wage growth fuels hopes of continued private consumption growth as well as moderate lifts to public spending and investment.

The Swiss National Bank (SNB) has done a lot to counter the risk of deflation and limit the CHF strengthening versus the EUR. The bank has cut its policy rate to 0.25%, injected extra liquidity into the economy and on several occasions intervened in the currency market to weaken the CHF. The SNB is still cautious about the potential for economic growth, and its latest inflation report showed very limited price increases. Hence, we do not expect any significant monetary policy tightening anytime soon, and we expect the BoE to sanction the first rate hike in March 2011.

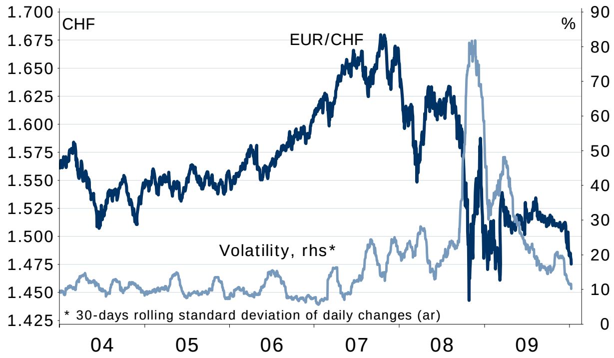
The CHF has traded at a relatively stable level versus the EUR since April. We expect this flat trading pattern to continue over the coming three to six months. A drop in risk appetite due to disappointing US key indicators could cause the CHF to gain versus the EUR, but the SNB will likely intervene and buy foreign currency if necessary. When the market starts to discount expectations of a widening interest rate differential between the Euro area and Switzerland, we expect the CHF to gradually weaken versus the EUR.

Martin Ipsen
m.ipsen@nordea.com +45 3333 3171

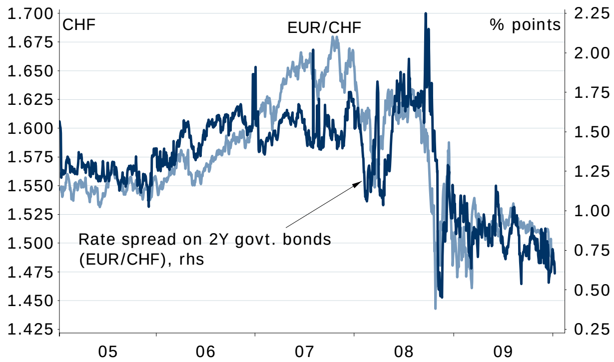
The KOF suggests healthy economic growth rates



CHF volatility continues to decrease



Rising interest rate differential will weaken the CHF



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

	2006 (CHFbn)	2007	2008	2009E	2010E	2011E
Private consumption	286.4	2.4	1.7	1.2	1.0	1.2
Government consumption	55.2	0.5	-0.1	2.2	0.8	0.6
Fixed investment	104.4	5.2	0.4	-2.0	0.5	2.0
Stockbulding*	0.0	-1.3	-0.7	1.2	0.8	0.0
Exports	257.5	9.5	2.9	-10.2	6.0	5.6
Imports	217.0	6.0	0.4	-6.1	5.8	5.4
GDP		3.6	1.8	-1.6	2.3	1.9
GDP nominal (CHFbn)	490.5	521.1	541.8	533.8	553.2	571.0
Unemployment rate, %		2.8	2.6	3.7	4.5	4.0
Consumer prices, % y/y		0.7	2.4	-0.5	1.2	1.4
Current account, % of GDP		10.4	1.4	7.5	7.0	6.8
General govt. budget balance, % of GDP		2.1	1.0	-0.4	-1.5	-1.5

* Contribution to GDP growth (% points)

Gradual recovery ahead

- Risks skewed slightly more towards a faster recovery
- Resilient labour market
- Budget risks persist, privatisations pivotal
- First rate hike towards the middle of the year

The recovery continues. We expect it will continue during the coming two years while gradually becoming more broad based and sustainable. The good news is that industrial production has started to grow more briskly, that the labour market has proven more resilient and that consumers may start to accelerate spending earlier than we had previously thought. Still, a number of risks persist and the new forecasts are in fact not that different from the most recent ones, but risks are skewed slightly more towards a faster recovery.

We maintain the overall scenario that we have had during autumn, namely that exports will remain the most important driver of the recovery while the domestic economy is likely to be more stagnant during at least the first half of 2010 when we see more weakening of the labour market and when uncertainty about the general outlook will remain elevated. During the second half of the year, we expect that the labour market will start to improve, paving the way for a more broadly-based and somewhat stronger recovery

Exports have improved

Demand for Polish goods from abroad started picking up speed during the latter half of last year, as the main export markets stabilised and Polish exporters benefitted from the weakened PLN. As a result, industrial production increased at almost double-digit rates towards the end of last year and activity indicators such as the manufacturing PMI even point to more speed in the near term. Part of the demand for industrial goods is related to rebuilding of inventories abroad as well as by domestic companies, which may continue for some quarters more. After that, however, we see more moderate demand from abroad, as the big economies will take years to fully overcome the global financial crisis.

Resilient labour market

Employment has fallen less than expected given the economic downturn. Actually, looking at employment in enterprises with ten or more employees (and after applying our own seasonal adjustment) the drops have been smaller for each quarter during last year, which raises hopes that these companies will start to generate new jobs very soon. Moreover, we expect employment in the whole economy to start increasing sometime during the second half of the year. This means that the total number of jobs lost during the downturn will correspond to not much more than a tenth of the total number of jobs created in the boom years since EU accession in 2004.

Consumer spending gaining some momentum

In our new forecasts, we expect the unemployment rate to average 12% in 2010, which is not much above the current level. As a consequence, average wage increases for the whole economy are likely to moderate further, but should remain safely in positive territory. And, with some help from falling inflation, households' purchasing power should improve slightly even this year, which, in turn, means that consumers may start to accelerate spending earlier than previously thought. In fact, and somewhat surprisingly, consumer spending started to gain some momentum as early as Q3 last year. The big question mark is the savings rate, which increased significantly during the second half of last year. With unemployment still on the rise during the first half of this year and high uncertainty in general, there is a clear risk that the savings rate might increase much more and thus keep the domestic economy weak for a longer period.

Uncertain prospects for investment

Prospects for investment appear uncertain. On the one hand, the economic outlook at home and abroad has improved and the inflow of EU funds is significant and should keep especially infrastructure investment high. Moreover, real interest rates are very low. On the other hand, capacity utilisation is also low and has not recovered much from the trough, and bank lending to the non-financial corporate sector continues to fall. Therefore, we expect a slow recovery of fixed business investment.

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

	2006 (PLNbn)	2007	2008	2009E	2010E	2011E
Private consumption	653	4.9	5.4	3.2	2.6	4.1
Government consumption	194	3.7	7.2	2.3	1.3	1.2
Gross fixed capital formation	208	17.2	8.3	-0.7	3.4	7.8
Stockbuilding*	15	1.7	-0.9	-2.5	1.1	0.2
Exports	428	9.1	5.8	-8.8	6.7	5.4
Imports	447	13.6	6.0	-12.9	8.5	7.1
GDP		6.8	4.9	1.6	3.0	4.0
Nominal GDP (PLNbn)	1,115	1,177	1,273	1,341	1,411	1,502
Unemployment rate, %		12.7	9.8	10.9	12.0	11.9
Consumer prices, % y/y		2.6	4.4	3.8	2.3	2.4
Current account, % of GDP		-4.7	-5.1	-1.2	-1.5	-2.2
General government budget balance, % of GDP		-1.9	-3.9	-6.2	-7.0	-6.0

* Contribution to GDP growth (% points)

Budget risks persist, privatisations pivotal

The biggest macroeconomic risk is public finances. Indeed, the general government budget deficit may be close to 7% in 2010 by EuroStat methodology and it will take years before the 3% criteria for EMU membership will be met. Therefore EMU membership cannot be expected before 2014 at the earliest. Moreover, government debt may increase above the prudency limit of 55% of GDP unless the government is successful in getting privatisation receipts large enough to finance a significant part of the budget shortfall. So far, the privatisation process has been too slow with only around PLN 7bn of the planned 37bn realised and the risk of political obstacles will probably increase as the elections come closer. Thus, we are becoming slightly more sceptical about the privatisation process. Possible breach of the prudency limits will require fiscal policy tightening, which will dampen the recovery.

The presidential election will take place in October this year and general elections are due in autumn 2011. However, since Poland will have the EU presidency in the second half of 2011, general elections may be moved forward to early spring. Current polls suggest that the PO (Civic Platform) – the leading party of the incumbent government – can continue with a stronger mandate and that it will also take over the presidency.

Inflation to fall

Inflation will fall significantly in early 2010 and is seen falling further until at least the middle of the year. We expect especially core inflation, which excludes food and energy prices, to fall fast due to lagged effects of the low capacity utilisation. On the other hand, energy prices, and perhaps also food prices, should continue increasing and will prevent consumer price inflation from falling below the lower boundary of the central bank's inflation target of 2.5% +/-1% point.

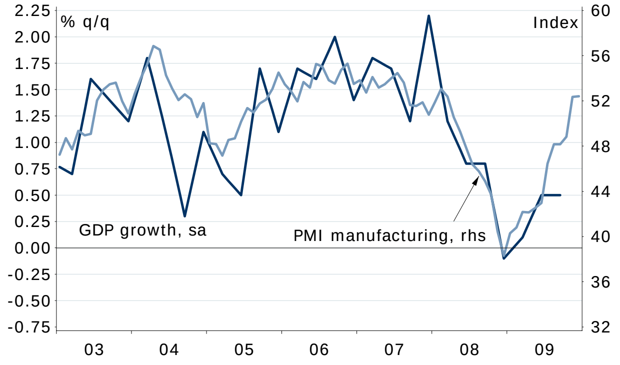
Monetary policy will be on standby in the near term, as nine of the ten members of the monetary council will be replaced during January and February. The new members will probably need a few months to get in step. The first rate hike could then come in the middle of the year, say June, when the economy will look stronger and inflationary pressures will start to emerge on the horizon.

PLN to strengthen

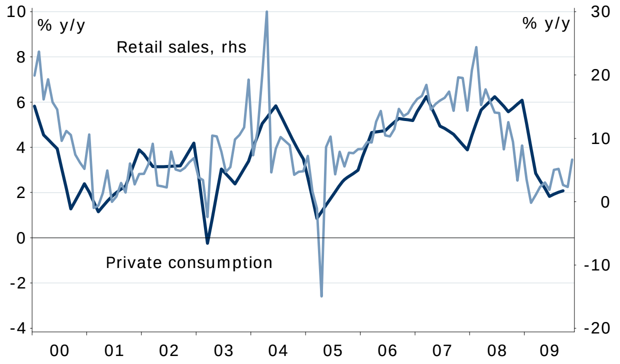
We expect the PLN to strengthen further against the EUR. This is not least because we expect interest rate differentials to gradually become more important drivers in FX markets, as volatility normalises and the financial crisis abates. And not only has the National Bank of Poland ended its easing cycle at a somewhat higher interest rate level than the Euro area, but it will also start hiking earlier due to Poland's stronger fundamentals.

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

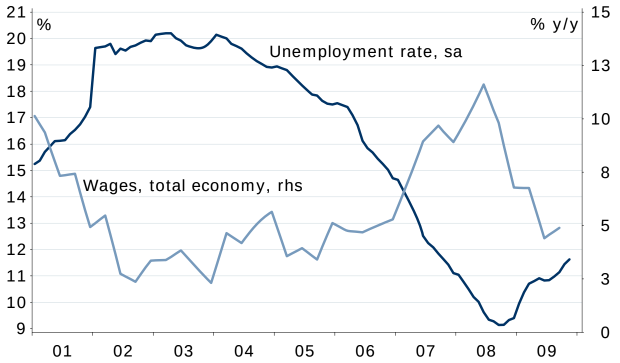
Risk of faster recovery



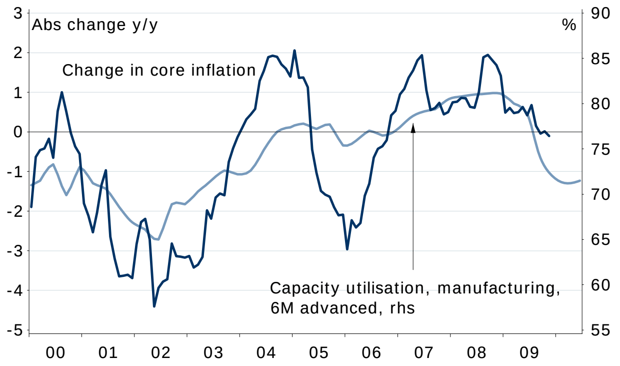
Consumer spending gaining momentum



Labour market resilience



Core inflation to fall



Weak domestic demand constrains economic recovery

- Private spending to recover slowly during the year
- High oil prices support the budget and export sector
- Rouble likely to appreciate further in the long term

Economic rebound approaching

The third quarter surprised with its steeper-than-expected decline, but in Q4 the economy is expected to have strengthened significantly. Indications to that end include stronger exports and production, although weakness in domestic demand and investment is limiting the growth opportunities of the economy. Hence, we expect modest growth this year, as the economy is still searching for a foothold, particularly during the early part of the year.

Private consumption made up about 48% of GDP in 2008, and together with growth in investment strengthening consumption is important for the economic recovery. However, private consumption is on precarious ground at the moment, as unemployment is rising and real wages are declining. Unemployment is expected to increase further this year, as companies strive to improve their earnings by cutting costs. Consumption is further weighed down by an increased propensity to save, as uncertainty about the economy and labour markets highlight the need to save for a rainy day. On the other hand, disposable income has continued to increase slowly. The clear downward trend in inflation, which is expected to continue this year, also supports consumers' purchasing power. We expect consumption to pick up over the coming year as the export-driven recovery gains momentum.

Uncertainty in the economy is still high, and for example lower-than-expected oil prices would depress both export revenues and government tax receipts. Furthermore, uncertainty about losses in the banking sector causes concern, with the proportion of non-performing loans in the loan portfolio has been estimated at 10-30% this year. However, the government is expected to support the largest, government-owned banks if necessary, and a broader banking crisis is unlikely. Nevertheless, problems in the banking sector may cause uncertainty, thus slowing down the recovery.

High oil prices support the budget

The oil price is an important variable particularly in government finances, with higher prices increasing revenues. As a result of stimulus measures and lower oil prices 2009 will be the first year in a decade with a deficit. The Reserve Fund assets, transferred gradually to the government budget, are expected to run out this year, and there are also plans of using the National Welfare Fund to pay for pensions. Despite the strong oil price and burgeoning signs of economic recovery, the Ministry of Finance has announced its plans to go forward with a Eurobond loan of about USD 18 billion.

Before the crisis, the government budget was well in surplus and oil revenues received through high taxation were channelled into the reserves, which has allowed for large-scale economic support measures. In addition, government debt remains at a relatively low level. Stimulus measures to revive the economy were directed for example at individual sectors, such as the financial sector and the auto industry, as well as households. Another significant support measure for consumption is the pension hikes, which the government hopes will support the domestic economy due to the domestically-oriented consumption of pensioners. As expected, the stimulus measures have been more limited than planned, and no tangible results are yet visible from many longer-term structural reforms, such as reduction of corruption.

Diversification of exports a future challenge

Although the energy sector is among the most important sectors of the economy, oil investment has been modest in recent years, which limits the sector's medium-term growth potential. Oil, oil products and gas currently make up the majority of Russian exports, and due to the restricted growth potential a diversification in exports is needed in the medium-term. Authorities have promised to reduce the country's dependence on commodities, but no concrete measures have so far been seen.

On the other hand, the growth potential for natural gas exports is boosted by the NordStream project, enabling the fulfilment of the EU's natural gas demand through an undersea pipeline. The project is expected to be completed in 2012. In the energy sector there are also plans

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

	2006 (RUBbn)	2007	2008	2009E	2010E	2011E
Private consumption	13,041	13.6	11.2	-7.5	3.5	4.5
Government consumption	4,589	3.4	2.5	1.7	1.2	1.5
Fixed investment	4,981	21.1	10.0	-18.5	4.0	5.0
Exports	9,079	6.3	0.5	-6.5	3.5	4.0
Imports	5,657	26.5	15.0	-32.0	2.0	3.0
GDP		8.1	5.6	-8.5	2.8	4.2
Nominal GDP (RUBbn)	26,904	33,111	41,668	43,001	47,388	53,169
Unemployment rate, %		5.6	5.6	7.5	7.2	6.8
Consumer prices, % y/y		9.0	14.1	11.7	7.7	8.0
Current account, % of GDP		5.9	6.1	1.8	2.8	3.2
Central govt budget balance, % of GDP		6.1	4.1	-6.3	-2.5	-1.0

of increasing the long-term export capacity by increasing the amount of nuclear power plants. Some loosening is also foreseen in laws restricting the possibilities of foreign companies to invest in the oil, gas and metal sectors. However, raw material deposits deemed as the strategically most important will likely still remain out of reach for foreign companies. From Russia's point of view, foreign companies' investments and more advanced technology would be a welcome boost for oil production.

Political uncertainty and corruption still constitute a challenge, and Transparency International's most recent corruption index does not reflect any significant improvement. From foreign investors' point of view consistent policy and legislation as well as reduced corruption would be major steps towards improving the business atmosphere. Negotiations about WTO membership also remain at a standstill due to uncertainty as to whether Russia wishes to join alone or as a customs union with Kazakhstan and Belarus. Russia has agreed to submit a report to the WTO regarding its membership plans, but accession during this year is unlikely. The biggest obstacles to membership have been duties on wood exports to Europe and for example copyrights and patents in the US.

RUB has upside potential in the long term

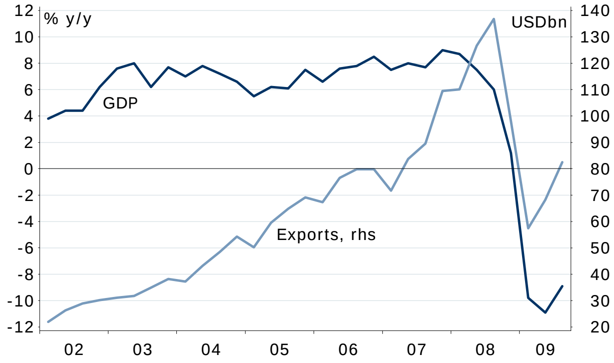
The temporary depreciation of the rouble against the basket (45% EUR and 55% USD) has been seen as a correction to the appreciation in the autumn. The weakening was supported by the central bank's comments on measures aimed at slowing down the appreciation, a dip in oil prices and Dubai's debt problems, which reduced global risk appetite.

However, we believe the beginning of the year will bring upward pressure due to high oil prices and the recovering economy. A strengthening world economy supports commodity prices, which increases government revenues and supports the rouble. The interest rate spread, which is still high, also supports the rouble. The central bank reduced its policy rate by 425 bp last year, but the rate still stands at 8.75%, and the Mosprime reference rate, albeit relatively low by historical standards, is still around 7%. All in all, we see the rouble continuing to appreciate in the longer term.

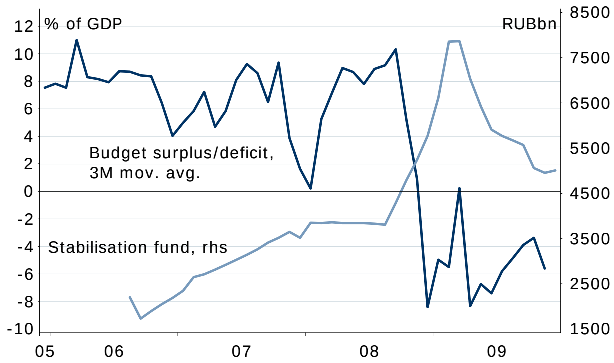
The central bank is expected to continue to decelerate the appreciation of the rouble by being actively present in the foreign currency markets. Furthermore, there have been discussions regarding different measures to reduce speculation and limit companies' possibilities to borrow significant amounts from abroad. However, we do not believe drastic anti-speculation measures will be utilised

Annika Lindblad
annika.lindblad@nordea.com +358 9 1655 9940

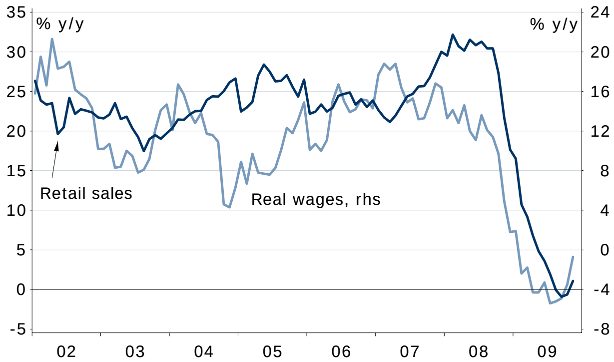
Rise in exports expected to continue



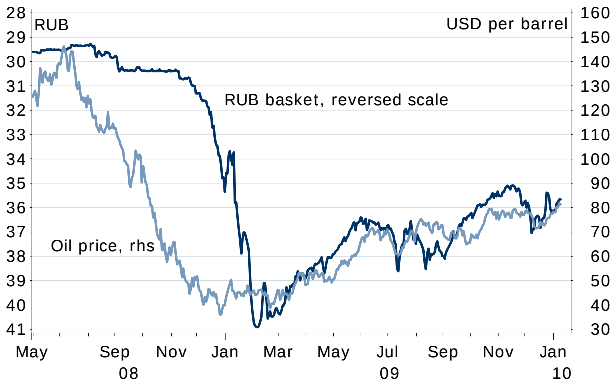
Government budget has turned into clear deficit



Consumption growing slowly



High oil price to support rouble in longer term



EMU membership not a magic wand

Although for instance private consumption still remains clearly below last year's levels, many indicators, such as monthly foreign trade statistics and industrial production, have shown signs of stabilisation or even growth from the previous month. The steepest decline has been seen in investment, and we believe the plunge continued in Q4.

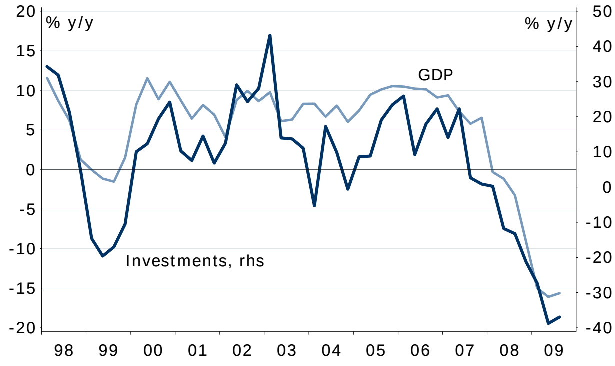
The drop in exports, however, is expected to slow down as foreign demand picks up, lending support to the economy. The Nordic countries in particular play a key role in driving Estonia's export demand. Domestic demand is expected to still weigh on the economy next year, as unemployment rises and wages decline. Hopes of early EMU membership are likely to have supported consumer confidence, but consumption has not risen in the wake of stronger confidence, at least not so far. We expect the economy to rebound in 2011, although growth rates will be clearly below those seen a couple of years ago.

Estonia's goal is to join the EMU in 2011, which would require an approval from the EU by early summer. As the inflation target has been reached and government debt is very low, the biggest problem is the government budget deficit, which threatens to exceed 3%. In comparison to many Euro-area countries, however, the deficit is still moderate. However, in order to grant EMU membership, the EU also needs to be convinced that the consolidation measures constitute permanent improvements. We still consider EMU membership in 2011 a possibility, but the risks of a postponed entry are significant.

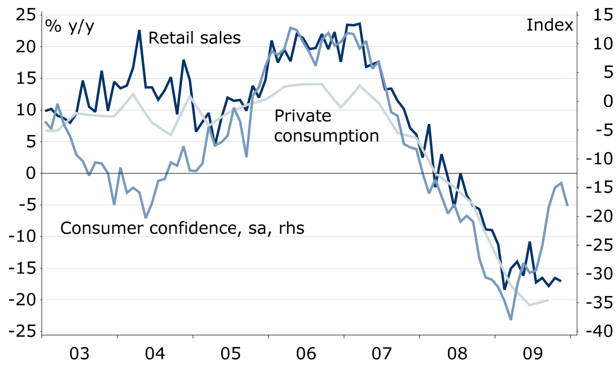
At any rate, the euro will not solve all problems of the economy, particularly as regards any improvement in competitiveness. Therefore it is likely that the high expectations attached to the euro are exaggerated. Even if EMU membership was delayed, we expect the Estonian currency to remain stable against the euro. The risk of a change in the country's currency policy remains fairly low, as competitiveness is improved by slashing wages and prices.

Annika Lindblad
annika.lindblad@nordea.com +358 9 1655 9940

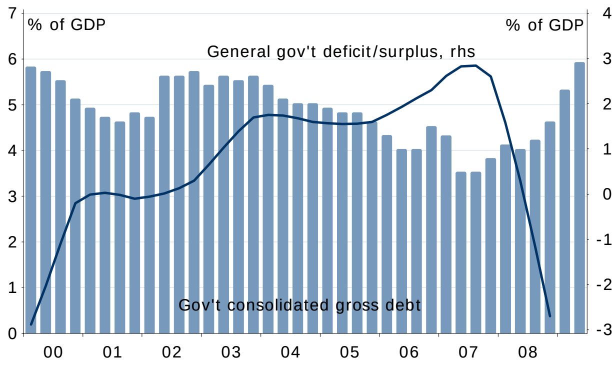
The decline in GDP slowing down



Stronger confidence predicts turnaround in spending



Government debt still at low levels



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

	2006 (EEKbn)	2007	2008	2009E	2010E	2011E
Private consumption	113.3	9.0	-4.7	-18.0	-3.5	2.5
Government consumption	33.8	3.7	4.1	-0.8	-2.2	0.5
Fixed investment	69.5	9.0	-12.1	-32.0	-5.0	5.0
Exports	165.9	0.0	-0.7	-12.0	3.5	5.0
Imports	189.5	4.7	-8.7	-26.0	2.5	4.8
GDP		7.2	-3.6	-15.0	-0.5	4.0
Nominal GDP (EEKmn)	205.0	238.9	248.1	210.7	207.5	217.9
Unemployment rate, %		4.7	5.5	13.8	17.0	16.5
Consumer prices, % y/y		6.7	10.6	-0.1	-1.0	1.5
Current account, % of GDP		-17.9	-9.1	4.0	1.0	-2.0
General govt budget balance, % of GDP		2.6	-2.7	-3.0	-3.0	-2.8

Budget cuts lay a solid foundation for long-term growth

Signs of a recovery are still scarce, but the worst plunge in the economy seems to be over. Domestic demand and investment are still exerting the main pressure on the economy, and hopes are focused on the export sector, which turned into an upswing last year. However, almost a third of Latvia's exports goes to the other Baltic countries, which limits the short-term recovery potential of export demand. We thus expect the economy to show export-driven growth over the next year.

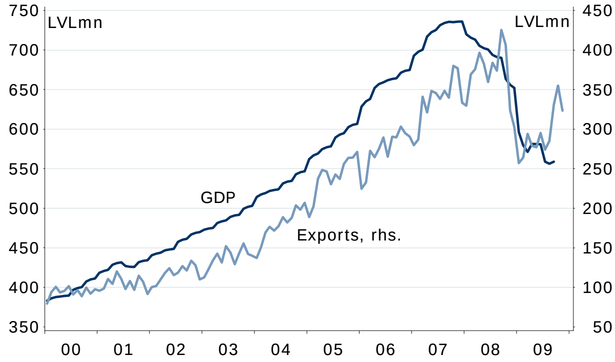
Consumer confidence has started to improve cautiously, but the difficulties in the labour market weigh on consumption. Unemployment will continue increasing in 2010 and disposable income will be dampened by the government savings measures, cutting public income and increasing taxes. The 2010 budget, with the deficit below the required 8.5% of GDP, was approved by parliament, and is likely to enable the next payments of the EU and IMF loan. The government has thus proven prepared to take unpopular measures to ensure foreign funding.

The 2009 deficit may come clearly below the agreed 10% of GDP, which would bolster confidence in the economy. In addition, Latvia has undertaken to reduce its deficit gradually to 3% in 2012 by cutting costs and improving the efficiency of the public sector, laying a foundation for sustainable economic growth. Political uncertainty remains high and a collapse of the government before October's parliamentary election cannot be excluded. In the absence of significant problems with the next international loan payments attention will begin to shift to whether the economy will survive on its own when the final payments have been completed in 2011.

Although devaluation speculations have again subsided they are likely to re-emerge in 2010, in particular, if there is a political crisis or a failure in obtaining further funding. However, due to the central bank's strong reserve position a forced devaluation is unlikely, and we do not expect the central bank to choose to abandon the peg. Thus, we see the internal adjustment continuing in 2010.

Annika Lindblad
annika.lindblad@nordea.com +358 9 1655 9940

Exports risen clearly in recent months



Confidence improving only slowly

LVL still on weak ground

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

	2006 (LVLmn)	2007	2008	2009E	2010E	2011E
Private consumption	7,281	14.8	-5.4	-23.5	-6.0	2.0
Government consumption	1,855	3.7	1.5	-7.8	-3.5	-1.0
Fixed investment	3,644	7.5	-15.6	-35.0	-6.0	4.0
Exports	5,014	10.0	-1.3	-16.0	3.0	4.8
Imports	7,412	14.7	-13.6	-34.0	2.0	3.5
GDP		10.0	-4.6	-18.0	-2.9	2.7
Nominal GDP (LVLmn)	11,172	14,780	16,243	13,904	13,000	13,260
Unemployment rate, %		6.0	7.5	17.3	19.5	19.0
Consumer prices, % y/y		10.1	15.3	3.6	-3.0	-0.5
Current account, % of GDP		-22.5	-13.0	8.0	6.0	4.0
General govt budget balance, % of GDP		-0.3	-4.1	-9.0	-8.2	-6.0

Domestic demand restricts growth

The economic downward spiral came to a halt in the third quarter due to rising inventories, among other things, but the overall economic picture did not improve significantly, as for example the annual declines of investment and consumption steepened from Q2. Only tentative signs of a recovery are visible, and thus Q4 2009 may surprise negatively. We expect 2010 to be a difficult year, and also the closure of the Ignalina nuclear plant puts pressure on both production and exports. The hopes of recovery largely rely on the export sector, but so far demand from the main export partners is only growing cautiously from the previous month. We expect the economy to resume growth in 2011, yet the pace is anticipated to remain relatively modest.

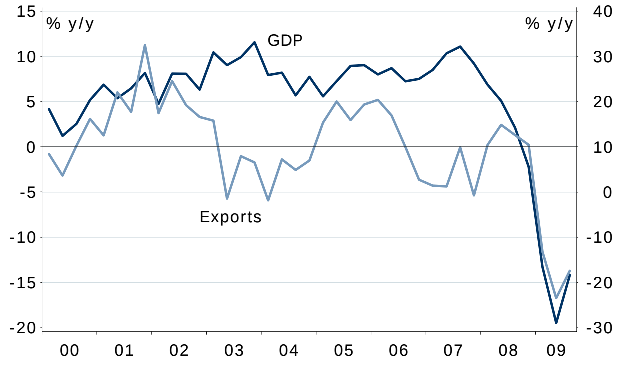
Households' situation has remained difficult, reflected in the weak retail sales figures. Still, the cautious improvement of consumer confidence indicates that the plunge in consumption is slowing down. Yet we foresee only a slow recovery in private consumption. The measures taken to curb the growing budget deficit, such as a VAT hike and wage cuts, continue to weigh on households' consumption possibilities. Although decreasing wages support the export sector in the long term, they put pressure on consumption in the short term.

So far, Lithuania has been able to raise funding in the international markets and has not been forced to turn to the IMF. Lithuania is likely to be able to continue borrowing without external support as long as its debt remains under control and the economy does not contract more sharply than expected. Decreasing government revenues increase the need to cut expenditures further, so as to keep the deficit at a reasonable level.

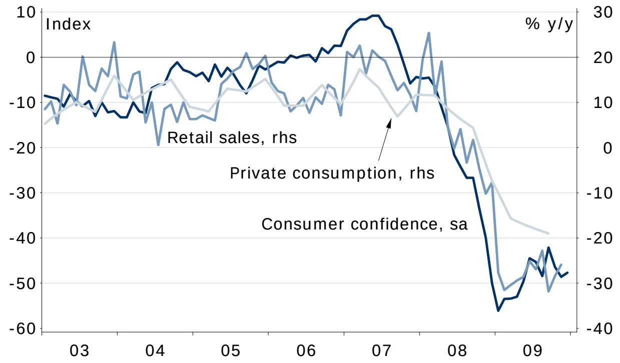
However, the budget cuts are insufficient in view of EMU membership in the near future. The hopes of adopting the euro will be postponed at least until 2014, as the budget deficit exceeds the 3% limit. However, as speculations of devaluation in Latvia have settled, fears have also subsided in Lithuania

Annika Lindblad
annika.lindblad@nordea.com +358 9 1655 9940

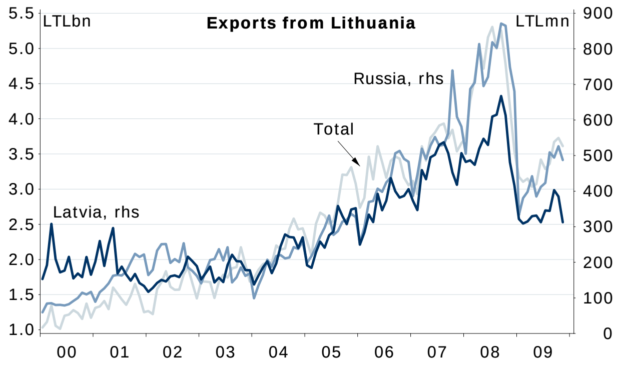
GDP has remained near Q1 levels



Drop in consumption has levelled off



Demand by main export partners remains weak



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

	2006 (LTLmn)	2007	2008	2009E	2010E	2011E
Private consumption	53,449	12.1	3.6	-17.5	-4.5	2.0
Government consumption	15,966	3.2	7.9	-0.4	-1.5	0.5
Fixed investment	20,841	23.0	-6.5	-39.0	-5.0	4.5
Exports	48,917	3.0	12.2	-17.5	2.8	4.5
Imports	57,343	10.7	10.5	-30.0	2.2	4.0
GDP		9.8	2.8	-16.0	-2.4	3.0
Nominal GDP (LTLmn)	82,792	98,138	111,498	98,676	94,926	98,438
Unemployment rate, %		4.3	5.8	15.0	18.2	18.0
Consumer prices, % y/y		5.8	11.1	4.5	-1.0	1.0
Current account, % of GDP		-15.0	-12.4	1.5	0.6	-0.2
General govt budget balance, % of GDP		-1.0	-3.2	-9.8	-8.5	-7.8

In for a long tough haul

The Hungarian economy was hard hit by the global crisis, resulting in a record-breaking IMF loan. The government was replaced, and the new one tightened fiscal policy partly to be able to meet the IMF requirement that the size of the budget deficit should be reduced relative to GDP.

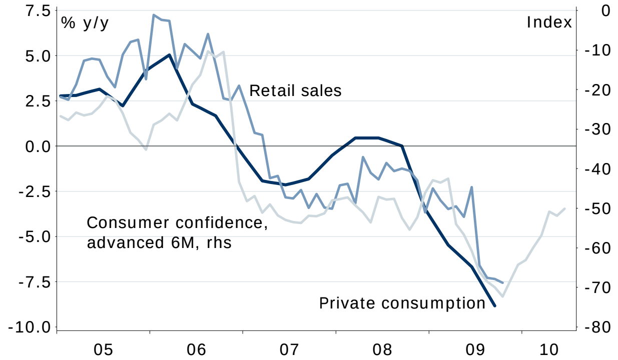
Foreign demand has been subdued as a consequence of the global crisis and private consumption curtailed by tighter credit standards and fiscal policy. Growth reversed marginally in Q3, though, and should subsequently become less negative, reaching positive territory in H2 2010. The recovery will be slow and Hungary will lag behind the other central European countries. However, exports and thus notably German demand will still be a key driver of the recovery.

General elections are scheduled for April, and the polls suggest that the opposition party Fidesz will come into power. The tight policy course is unlikely to be changed markedly, but uncertainties about what might happen could impact the currency. Also the expiry of the current IMF accord in October could give rise to some uncertainties, but we expect the deal to be extended in some form or other.

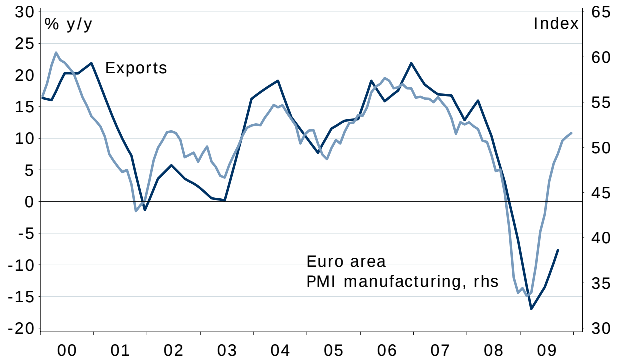
The second and last phase of the VAT hikes will be implemented from January 2010, but the long-term effect is expected to be minimal given weak domestic demand. Overall, inflation should thus be on a downtrend in the coming years. The policy rate is very close to bottoming and will stay on hold for the next couple of years.

Anette Skovgaard
anette.skovgaard@nordea.com +45 3333 5496

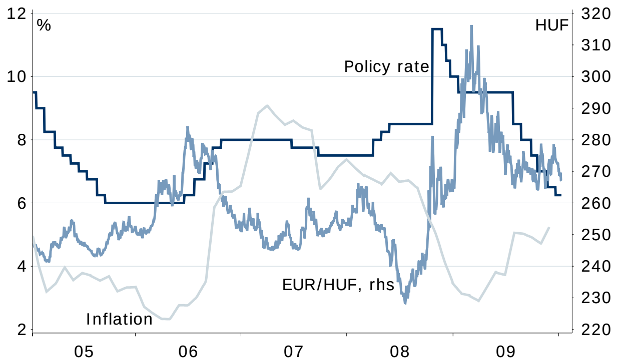
Slow upturn in private consumption ….



… so hopes pinned on European demand



Policy rate on hold for a very long time to come



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

	2006 (HUFbn)	2007	2008	2009E	2010E	2011E
Private consumption	12,384	0.5	-0.5	-6.4	-2.8	2.9
Government consumption	2,430	-4.5	-1.9	-4.0	-3.0	1.5
Fixed investment	5,131	1.8	-2.6	-10.0	1.0	4.9
Exports	18,330	16.4	4.8	-15.0	4.6	7.5
Imports	18,495	13.4	4.7	-17.9	2.8	7.3
GDP		1.2	0.6	-6.5	0.0	2.9
Nominal GDP (HUFbn)	23,775	25,479	26,621	24,893	24,882	25,602
Unemployment rate, %		7.4	7.8	10.7	11.0	9.9
Consumer prices, % y/y		8.0	6.1	4.2	3.7	3.2
Current account, % of GDP		-6.4	-7.1	-0.4	-2.4	-3.5
General government budget balance, % of GDP		-4.9	-3.8	-3.9	-3.8	-3.3

Suffering from austerity measures

Recovery is ongoing, as the economy is benefitting significantly from the global recovery, as it is one of the most open economies in the world. Exports have also been supported by the weakened CZK, the car scrappage incentives in various countries and rebuilding of inventories. As a consequence, in November last year, industrial production was higher than a year earlier for the first time since the Lehman collapse. Going forward, we expect a moderate recovery in exports and industrial production, as we expect a modest increase in demand from the important markets in the Euro area and as most of the car scrappage programmes have ended.

Domestic demand will not pick up speed until 2011. Private consumption is suffering from the higher VAT and the cancellation of deductions on social security contributions, which is a part of the austerity measures taken to limit the government budget deficit. Moreover, the labour market will continue to weaken during most of the year and hence private consumption growth will not pick up in earnest until 2011. Investment should benefit from the recovery of exports, but capacity utilisation is low and access to credits is not yet normalised for small and medium-sized companies. Therefore, also investment is expected to recover at a modest pace.

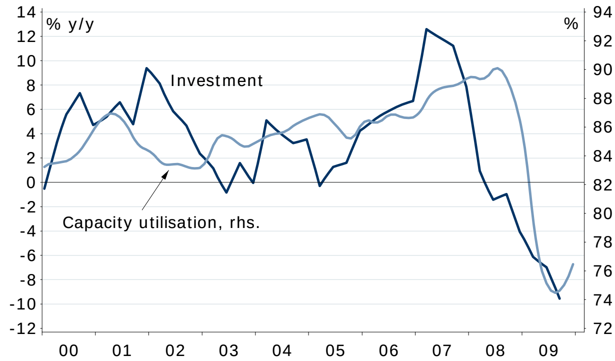
The general elections are scheduled to take place in June. Polls do not provide a clear picture of the next government, but policies are most likely to be roughly unchanged. It is crucial that the next government will be strong enough to solve the budget situation and restart the reform programme, though. EMU entry will not be possible until 2014 at the earliest and financial markets do not usually react to political news.

Inflation will not be a problem for a long time and therefore we find it a bit premature to talk about rate hikes this year. The Czech National Bank (CNB) will also worry about the effect on the CZK from hiking before the ECB, which we expect to hike in December. We expect the first hike from the CNB in early 2011.

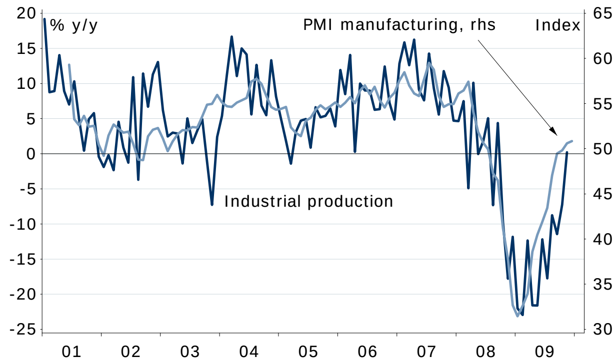
Anders Svendsen
anders.svendsen@nordea.com +45 3333 3951

Recovery

Industrial production back in black



Capacity utilisation remains low



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

	2006 (CZKbn)	2007	2008	2009E	2010E	2011E
Private consumption	1562	4.9	3.5	1.2	1.0	2.5
Government consumption	687	0.7	1.0	4.0	1.5	1.0
Fixed investment	796	10.8	-1.5	-6.9	2.0	6.0
Stockbuilding*	64	-0.2	-0.5	-1.3	0.6	0.4
Exports	2462	15.2	5.6	-13.4	7.8	7.5
Imports	2352	14.2	4.3	-11.0	8.0	8.5
GDP		6.1	2.3	-4.0	2.0	2.8
Nominal GDP (CZKbn)	3222	3535	3706	3593	3727	3908
Unemployment rate, %		6.6	5.4	8.1	9.5	8.9
Consumer prices, % y/y		2.9	6.3	1.0	1.7	2.0
Current account, % of GDP		-3.2	-3.1	-1.5	-2.1	-2.9
General government budget balance, % of GDP		-0.6	-1.5	-6.3	-5.5	-5.0

* Contribution to GDP growth (% points)

CNY appreciation soon to resume

China recovered very fast from the global economic crisis as especially public investment took over as the main growth driver when exports plunged. The authorities have explicitly stated that one of their goals is to rebalance growth so as to give private consumption a bigger role and promote the service sector on behalf of manufacturing. But over the forecast horizon investment will likely remain the most important growth driver, with private residential investment gradually replacing public infrastructure investment. Exports will regain further strength during 2010 as global demand increases, but so will imports, so that the surpluses on the current account and trade balance will continue to diminish.

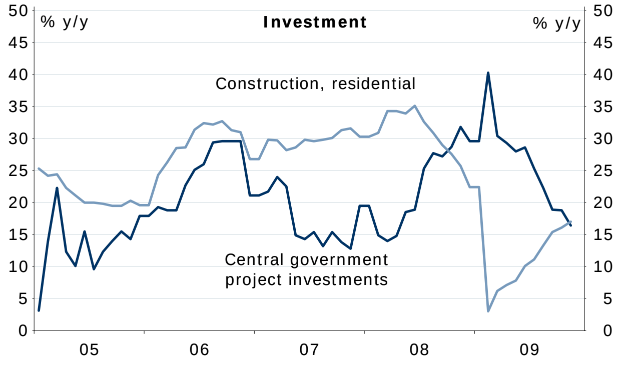
Inflation has turned slightly positive again – lower energy subsidies being one of the reasons. But despite the very strong money supply growth, there is not yet reason to be afraid of general inflationary pressure as there is still on average idle capacity in the economy. Asset price inflation is on the other hand a more immediate threat and property prices have already started to increase again.

The loose fiscal and monetary policy is expected to be scaled back gradually. Monetary tightening aimed at specific sectors such as the steel sector where overcapacity is evident has already been introduced, and we expect more targeted regulatory tightening as well as interest rate hikes and higher reserve requirements in the coming months.

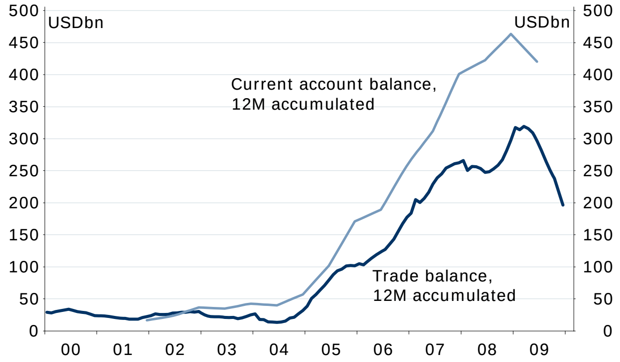
We expect the gradual appreciation of the CNY versus the USD to resume from Q2. Being pegged to the USD, the CNY has weakened 10% versus a trade-weighted basket of currencies. Furthermore, a stronger CNY will help aligning internal imbalances, and a stronger CNY is also necessary once the authorities eventually decide to lift capital controls. The main prerequisite for CNY appreciation is that the export sector shapes up again, of which there is already growing evidence.

Bjarke Roed-Frederiksen
bjarke.roed-frederiksen@nordea.com +45 3333 5607

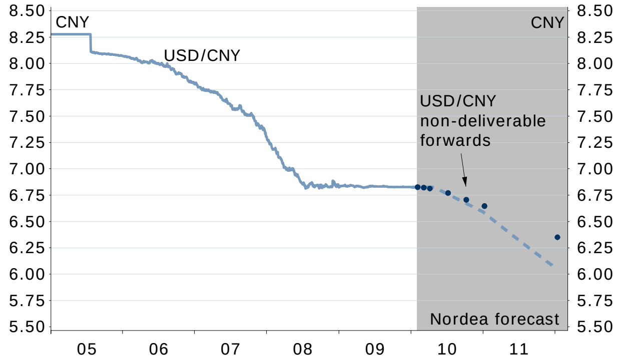
Residential investment to replace infrastructure



External imbalances set to diminish – not disappear



Renewed CNY strengthening expected soon



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

	2006 (CNYbn)	2007	2008	2009E	2010E	2011E
Private consumption	8,048	10.4	8.4	8.8	9.5	10.0
Government consumption	3,012	11.0	8.2	12.0	10.8	10.1
Fixed investment	9,015	11.2	10.1	14.1	12.0	11.5
Stockbuilding*	425	0.7	0.2	-0.4	0.0	0.0
Exports	8,465	20.4	13.9	-8.2	9.0	10.0
Imports	6,799	18.5	15.2	-7.5	10.0	12.0
GDP		13.0	9.0	8.7	10.1	9.6
Nominal GDP (CNYbn)	22,165	26,324	30,686	33,172	37,517	42,244
Unemployment rate, %		4.0	4.2	4.5	4.2	4.0
Consumer prices, % y/y		4.8	5.9	-0.6	3.0	3.0
Current account, % of GDP		10.7	9.6	6.5	6.1	4.3
General government budget balance, % of GDP		0.6	-0.4	-3.8	-3.4	-2.2

* Contribution to GDP growth (% points)

Stimuli to continue until growth is sustainable

The worst of the crisis is now over and economic prospects are clearing up, with strong growth to be expected in 2010 and 2011. This is partly due to the vast fiscal stimulus, and the recovery is both reflected in rising investment activity and renewed industrial production growth.

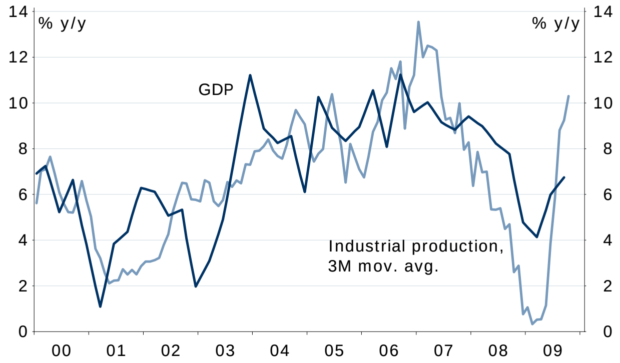
The poor monsoon season and consequential partial drought caused severe damage to the summer harvest. This has now led to a notable rise in food prices and combined with higher international commodity prices, this has resulted in sky-rocketing consumer price inflation. In 2010, the negative effect of the drought is still a risk factor since the agricultural sector represents 13% of the economy. A severe downturn in growth should be avoided, though, as long as the outcome of the winter harvest turns out alright. Rising general domestic and international demand might increase producers' pricing power, contributing to upward inflationary pressure. Given these factors it will prove a challenge for the government to facilitate growth without feeding inflation.

The UPA government has shifted its focus towards investments in infrastructure. This is recognised as an important aspect if growth is to be supported on a more structural level. As an example, the government's 100-day agenda includes a target of building 20 km of national highway a day. Improved infrastructure could lead to large productivity improvements, but it has yet to be seen whether the plans will be fully implemented. Increased government spending may add to the problem of continued large public deficits.

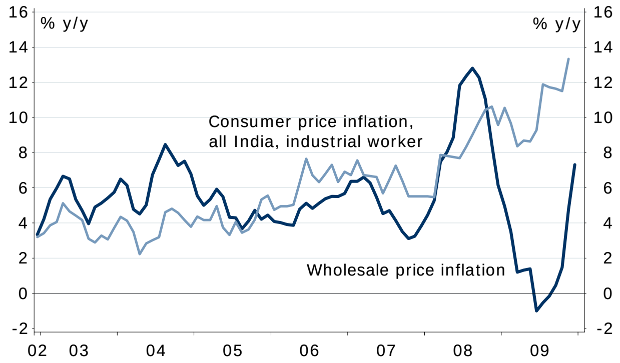
The INR is supported by high interest rates and strong capital inflows. In light of growth picking up and rising inflationary pressure, gradual monetary policy tightening is expected throughout 2010. In addition, the INR might be allowed to strengthen somewhat against a trade-weighted currency basket.

Bjarke Roed-Frederiksen
bjarke.roed-frederiksen@nordea.com +45 3333 5607

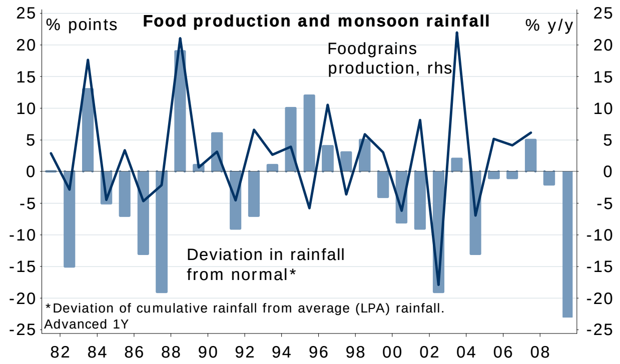
Growth in GDP and investment is picking up



CPI rising well above wholesale prices



Poor rainfall has sent food prices sky-rocketing



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

	2006 (INRbn)	2007	2008	2009E	2010E	2011E
Private consumption	23,078	8.5	2.9	4.7	5.5	5.9
Government consumption	4,215	7.4	20.2	8.0	7.0	7.0
Fixed investment	13,438	12.9	8.2	8.8	11.0	12.5
Exports	6,747	9.0	30.3	6.2	12.0	14.0
Imports	7,830	12.0	41.0	9.4	10.0	12.0
GDP	41,292	9.1	6.1	5.8	7.6	8.3
Nominal GDP (INRbn)	41,292	47,234	53,218	57,101	64,856	73,450
Wholesale prices, % y/y		4.8	9.1	1.5	6.0	5.0
Current account, % of GDP		-1.0	-1.2	-1.6	-1.6	-1.8
General government budget balance, % of GDP		-2.7	-6.2	-8.0	-7.5	-7.2

The economy is recovering – and now it's election year!

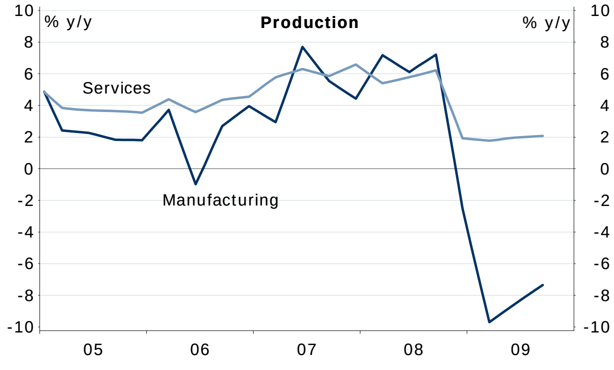
Although economic growth probably ended close to zero for 2009 as a whole, the economic recovery is well underway and 2010 is set to show another year of strong growth. Renewed credit growth, particularly via the government-owned banks, and lower interest rates have supported domestic demand. And the perhaps most important factor has been fiscal stimuli in the form of for instance tax rebates on cars and higher public spending. Fiscal policy is expected to remain loose throughout 2010 and not to be tightened until 2011 as the presidential election is due in October. President Lula is not eligible for re-election, but he likely intends to remain beloved by the people and to try to let his popularity spill over to his preferred candidate, current administration head Dilma Rousseff, who is behind the opposition's candidate Jose Serra in the polls.

With the economy soon running at full capacity again, inflationary pressure could build up even though overall inflation currently is kept in check by the much stronger BRL than one year ago. The crisis mainly hit the capital-intensive manufacturing industry, while the impact on the labour-intensive service sector was less severe. Unemployment is now back at the pre-crisis level.

If monetary policy is not tightened, inflation and inflation expectations could well take off. We thus expect the central bank to enter into a rate hiking cycle later this year. Currently, the most important drivers for the BRL are global commodity prices and the strong capital inflows, even though the authorities have tried to curb BRL appreciation by imposing a 2% tax on portfolio inflows. There might be room for even more BRL strengthening short term. But with the trade and current account balance set to worsen as domestic demand recovers faster than external demand, the strengthening trend for the BRL might come to a halt a quarter or two into 2010.

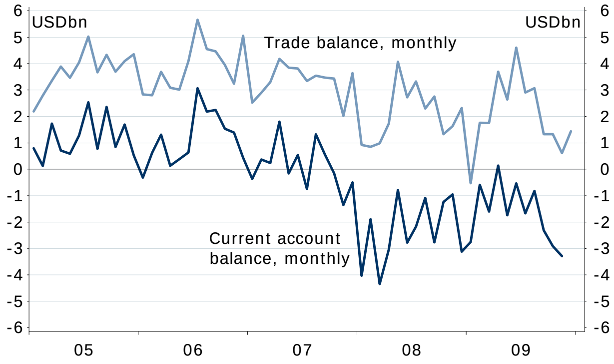
Bjarke Roed-Frederiksen
bjarke.roed-frederiksen@nordea.com +45 3333 5607

The labour-intensive service sector less hit



Labour and capacity utilisation again high

Looming trade balance deficit



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

	2006 (BRLbn)	2007	2008	2009E	2010E	2011E
Private consumption	1,428.9	6.1	7.0	2.3	4.7	5.0
Government consumption	474.8	5.1	1.6	2.8	4.0	3.5
Gross fixed capital formation	389.3	13.8	13.4	-11.1	8.5	8.8
Stockbuilding*	8.0	0.7	0.5	-0.2	0.0	0.0
Exports	340.5	6.3	-0.8	-10.5	6.3	5.3
Imports	271.7	19.8	18.0	-12.7	13.3	14.0
GDP		6.1	5.1	-0.1	4.3	4.2
Nominal GDP (INRbn)	2,369.8	2,661.3	3,004.9	3,252.6	3,648.2	4,074.0
Unemployment rate, %		9.3	7.9	8.3	7.9	7.5
Consumer prices, % y/y		3.6	5.7	4.7	4.2	4.5
Current account, % of GDP		0.1	-1.8	-1.5	-2.5	-3.0
General government budget balance, % of GDP		-2.2	-1.6	-3.2	-2.7	-2.0

* Contribution to GDP growth (% points)

Economy on strong growth path

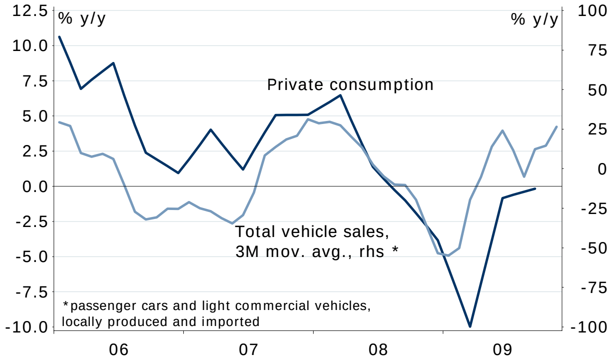
The global crisis hit Turkish exports and rapidly spread to the rest of the economy, with record negative growth in Q1 2009. In response, the government introduced temporary tax cuts for several sectors. Especially tax cuts on car sales fuelled private consumption, albeit only for a while.

We still do not expect a new IMF deal to be sealed partly as the government seems very determined to live up to its announced medium-term fiscal plan. Hence, the government will probably tighten its fiscal stance this year to keep budgets under control. This will slow private consumption more than would otherwise have been the case. Increased economic momentum globally should, however, underpin growth. Notably the recovery in the Euro area with Germany as the largest trading partner should act as a key driver. This year's relatively solid growth is expected to be mainly driven by exports and also stock building

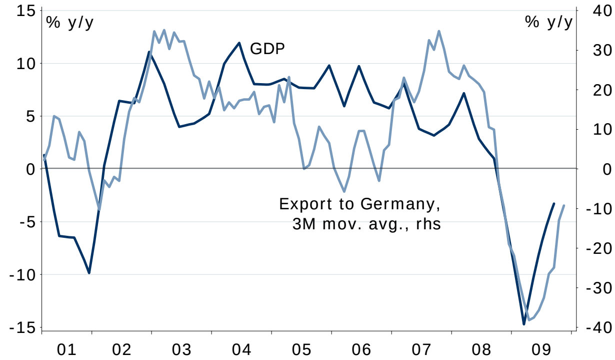
The monetary policy steering rate has been slashed but has now bottomed and we expect rates to be on hold until end-2010. We see a gradual TRY firming versus the EUR over the next two years. There are several reasons for that. Firstly, we expect relatively massive rate hikes from end-2010 which means that the policy rate will be hiked more aggressively than in the Euro area, widening interest rate differentials have historically proved beneficial for the TRY. Secondly, we foresee a continued economic reform process to strengthen TRY. This applies in terms of the medium-term fiscal plan presented as well as the EU process.

Anette Skovgaard
anette.skovgaard@nordea.com +45 3333 5496

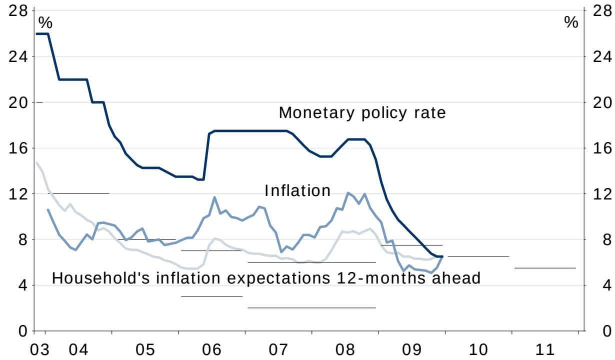
Private consumption growth likely to be moderate …



… so growth depends to a large extent on exports



Massive rate hikes on the cards at year-end



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

	2006 (TRYbn)	2007	2008	2009E	2010E	2011E
Private consumption	564.9	3.9	0.1	-5.0	3.6	4.5
Government consumption	93.5	6.5	1.9	2.0	2.0	2.0
Fixed investment	169.0	5.4	-7.1	-16.0	5.5	8.0
Exports	172	7.3	2.3	-10.0	6.0	5.5
Imports	209	10.7	-3.8	-18.5	6.0	8.0
GDP		4.7	0.9	-6.0	3.7	4.2
Nominal GDP (TRYbn)	758	843	950	893	926	965
Unemployment rate, %		9.9	11.0	14.4	14.2	14.1
Consumer prices, % y/y		8.8	10.4	6.2	6.3	6.1
Current account, % of GDP		-5.9	-5.7	-2.3	-4.0	-4.1
Public sector balance, % of GNP		-1.6	-1.8	-6.7	-4.5	-4.0

All eyes soon back on capacity constraints

Oil prices are expected to rise and accelerate at the end of the forecast period as the world economy gradually strengthens and the oil fundamental balance tightens. Inventories have declined markedly, but are still high by historical standards. OPEC spare production capacity is at comfortable levels. There is a risk that prices may fall below the underlying trend in the short term. Changes in the USD and risk appetite may also cause short-term deviations from the underlying price trend. The demand for oil is sensitive to global economic cycles. The global economy is now gradually recovering and industrial production is picking up pace. Robust growth in oil-intensive emerging economies is expected to be a key driver of oil demand. Urbanisation and increasing living standards, especially in countries with large populations such as China and India, are expected to accelerate the demand for energy and continue to boost car sales. Transport fuel is expected to increase its share of total oil consumption. Although the Copenhagen Accord was weaker than expected, we still anticipate binding deals on climate gas emissions to be signed within the forecast period. In the long term binding requirements for emission cuts are expected to gradually change the framework for the total energy spectrum.

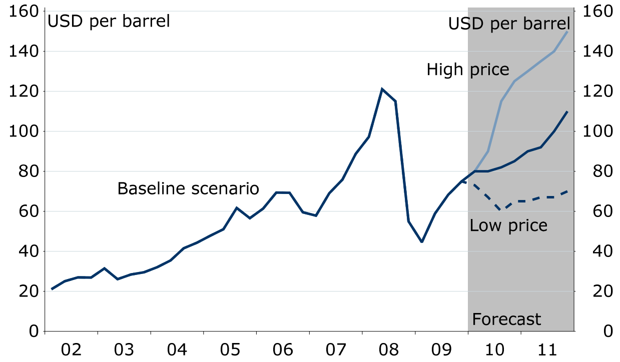
As oil demand now gradually recovers, the market will soon shift its focus back to a world that is running out of accessible oil and rapidly falling production at 6.4% per year from old mature oil fields. Huge investments are necessary just to offset losses from steep production falls in areas such as the North Sea, Alaska, the Mexican Cantarell field and West Siberia in Russia. Increasing investments are also needed to expand capacity to meet the world's growing need for energy. High costs, the financial crisis and global recession have put adequate investments in new capacity at risk. Timely investments in the Middle East are essential as a growing share of the future oil production is expected to take place in this region. The region has around 60% of the world's proven oil reserves. Last year's licensing rounds for Iraqi oil fields have increased the capacity potential in the medium term. But the obstacles to invest are many such as sovereignty over oil reserves, increasing national protectionism and political unrest. Aggravating the risk of inadequate investments to meet future supply requirements is the unfavourable investment climate in other oil regions such as Nigeria, Venezuela and Russia. Russian oil production increased, surprisingly, in 2009 after peaking for the second time in 2007. However, the upside potential is limited without further tax cuts. Limited access to investing in areas with larger reserves at lower costs forces oil companies to invest in higher cost areas, which also contribute to higher prices

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

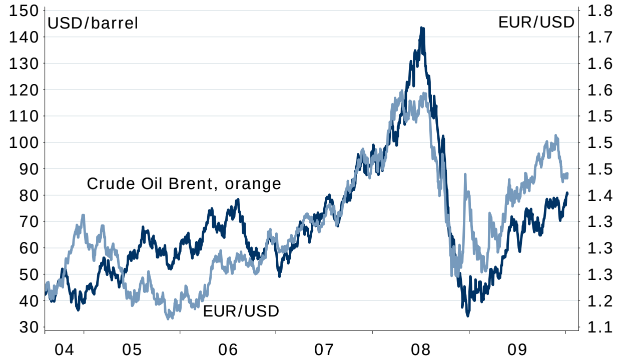
Oil price forecast – baseline (Brent spot – USD/barrel)

	Q1	Q2	Q3	Q4	Year
2007	57.8	69.0	75.8	88.7	72.8
2008	97.2	121.0	115.0	55.0	97.0
2009E	44.6	58.9	68.3	75.0	61.7
2010E	80.0	80.0	82.0	85.0	81.8
2011E	90.0	92.0	100.0	110.0	98.0

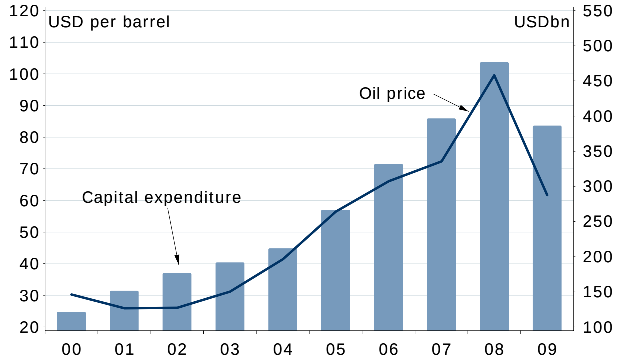
Oil price scenarios – baseline, high and low price



Brent oil price and EUR/USD exchange rate



Oil price and upstream oil & gas investment budgets



Metal prices to remain high

Metal prices rose steeply and surprisingly in 2009. Prices of base metals surged 108%. Around the turn of the year, the price level was about the same as at the time when Lehman Brothers collapsed – 23% below the all-time high in 2007. Copper prices rose most sharply, while the most moderate gains were seen in aluminium prices.

The increases in metal prices at such an early stage of the economic cycle are exceptional. Inventories have mainly continued to increase, and the metal markets are expected to remain in surplus also in the coming year. However, interpretation of the inventory statistics is complicated by the fact that part of the inventories may be held by investors.

The steep rise in prices is mainly explained by actions taken by China and investors. China hoarded especially copper in the first half of 2009. The low interest rates and ample liquidity have driven investor demand, which has supported prices after the strongest buying wave from China subsided. In addition, the weak USD has supported metals quoted in USD.

The world economy began to recover as early as last spring, and it will grow at a relatively decent clip in the years ahead. In 2010 GDP will again exceed the level of activity seen in 2008. Production, not to mention growth, will be increasingly concentrated in Emerging Markets, where growth is considerably more centred on commodities than in developed markets. The demand for metals is clearly picking up.

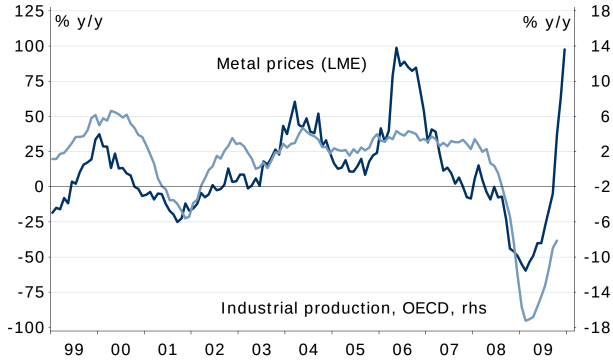
However, the metal markets will still be characterised by excess supply, as rising prices attract more capacity to the markets. Furthermore, investors' interest may decline when liquidity becomes tighter and the USD appreciates. Hence, we do not expect metal prices to continue to rise to any significant degree. The various factors mostly even out each other, and prices will vary in 2010 without any clear trend. Indeed, at times market trends may fluctuate heavily, as markets try to interpret mixed signals.

However, a slight rise in prices from the level at end-2009 is more likely than a significant downward correction. Developments during the recession show that there is demand if the price level drops. Particularly the ever increasing role of Emerging Markets will sustain demand as well as investors' attention. Longer out, solid growth in Emerging Markets will, at any rate, require more base metals and other commodities. Supply may have a hard time keeping pace, and production costs will increase in any case.

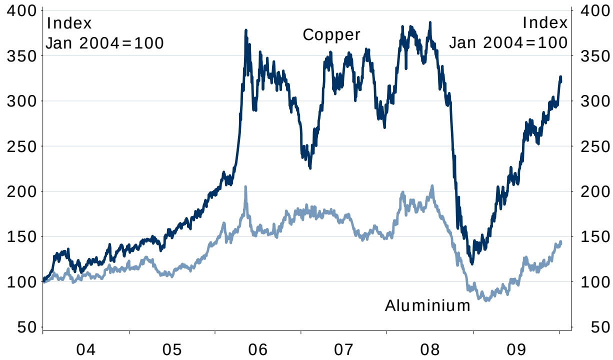
Reijo Heiskanen
reijo.heiskanen@nordea.com +359 9 165 59942

Stabilisation after a huge rally?

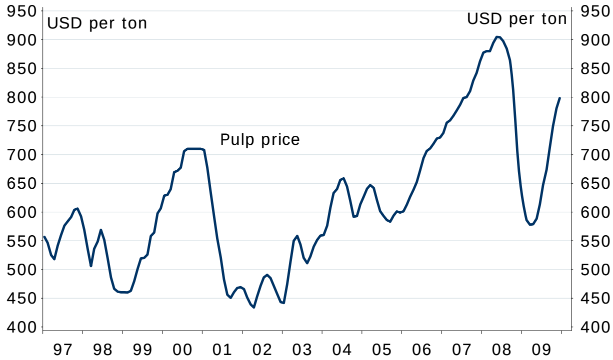
Prices ahead of the cycle



Chinese demand has boosted copper prices



Pulp price has followed the trend in metals



Economic Research Nordea:

Denmark:

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

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

Anders Matzen, Chief Analyst
anders.matzen@nordea.com, tel. +45 3333 3318

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

Troels Theill Eriksen, Senior Analyst
troels.theill.eriksen@nordea.com, tel +45 3333 2448

Bjarke Roed-Frederiksen, Analyst
bjarke.roed-frederiksen@nordea.com, tel. +45 3333 5607

Anette Skovgaard, Analyst
anette.skovgaard@nordea.com, tel. +45 3333 5496

Martin Ipsen, Analyst
m.ipsen@nordea.com, tel +45 3333 3171

Sif K. Lundsvig, Assistant Analyst
sif.lundsvig@nordea.com, tel. +45 3333 5115

Ianna G. Yordanova, Assistant Analyst
ianna.yordanova@nordea.com, tel. +45 3333 3901

Christine A. Hansen, Assistant Analyst
christine.a.hansen@nordea.com, tel. +45 3333 3901

Finland:

Martti Nyberg, Chief Economist Finland
martti.nyberg@nordea.com, tel. +358 9 1655 9941

Reijo Heiskanen, Chief Analyst
reijo.heiskanen@nordea.com, tel. +358 9 1655 9942

Annika Lindblad, Analyst
annika.lindblad@nordea.com, tel. +358 9 1655 9940

Norway:

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

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

Thina M. Saltvedt, Senior Analyst
thina.margrethe.saltved@nordea.com, tel. +47 2248 7993

Katrine Godding Boye, Analyst
katrine.godding.boye@nordea.com, tel. +47 2248 7977

Sweden:

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

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

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

Rickard Hellman, Junior Analyst
rickard.hellman@nordea.com tel. +46 8 6148726

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

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

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

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