Global Weekly Economic Monitor
NOMURA GLOBAL ECONOMICS

NOMURA

Basta!

Markets this week told Italy they have had enough. Further fiscal austerity and political change are the proposed responses, but time is running short.

11 November 2011

GLOBAL LETTER

REGIONAL ROUNDUPS

SPECIAL TOPICS

DATA AND OUTLOOKS

Nomura Securities International Inc.

Forecast Summary

	Real GDP (% y-o-y)			Consumer Prices (% y-o-y)			Policy Rate (% end of period)		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
Global	3.8	4.0 ↓	4.2	4.7	3.8	3.5	3.55 ↓	3.68 ↓	4.08 ↓
Developed	1.5	2.0	2.1 ↓	2.7	1.8	1.4	0.66 ↓	0.64	0.88
Emerging Markets	6.4	6.2	6.2	6.7 ↓	5.9	5.5	6.68 ↓	6.84 ↓	7.28 ↓
Americas	2.4	2.7	2.8	4.6	3.7	3.0	2.40	2.43	2.98
United States*	1.8	2.4	2.5	3.2	1.9	1.2	0.13	0.13	0.13
Canada	2.3	1.9	2.2	2.8	2.1	2.0	1.00	1.50	2.50
Latin America††	4.2	3.6	3.7	8.8	8.7	7.8	8.81	8.70	10.52
Argentina	8.0	4.0	3.5	24.4	25.4	18.0	12.00	11.00	14.00
Brazil	3.1	3.6	3.8	6.6	6.2	6.0	11.00	11.00	12.00
Chile	6.3	4.8	6.0	3.8	3.0	3.0	5.00	4.50	6.00
Colombia	5.0	4.5	4.5	3.5	3.7	3.7	4.50	5.00	7.00
Mexico	3.7	3.0	3.2	3.9	4.0	3.7	4.50	5.00	6.50
Venezuela	3.4	3.5	3.5	26.8	27.0	29.8	17.00	15.00	22.00
Asia/Pacific	6.0	6.7	6.5	5.0	4.1	4.1	5.12 ↓	5.32 ↓	5.60 ↓
Japan†	-0.6	2.5	1.8	-0.2	-0.2	0.0	0.05	0.05	0.05
Australia	2.2	4.6	3.1	3.5	3.6	3.8	4.50 ↓	5.00	5.25
New Zealand	2.0	3.5	3.6	4.2	1.9	2.3	2.50	4.00	4.00
Asia ex Japan, Aust, NZ	7.5	7.6	7.5	6.2	5.0	4.9	6.21 ↓	6.36 ↓	6.64 ↓
China	9.2	8.6	8.4	5.6	4.8	4.5	6.56	6.81	7.06
Hong Kong***	5.4	4.5	4.2	5.3	4.7	4.4	0.28	0.28	0.28
India**	7.3	7.9	8.1	9.4	6.8	7.1	8.50	8.50	8.50
Indonesia	6.5	7.0	7.0	5.6	5.8	5.3	5.75 ↓	5.50 ↓	6.00 ↓
Malaysia	4.7	5.1	5.0	3.1	3.2	3.1	3.00	3.50	3.75
Philippines	4.5	5.7	6.5	4.9	5.0	5.0	4.50	5.00	6.00
Singapore***	4.8	5.3	5.5	5.0	3.2	3.0	0.35	0.35	0.63
South Korea	3.5	5.0	4.0	4.2	3.5	3.0	3.25	3.50	4.00
Taiwan	4.3	4.7	5.2	1.4	1.2	1.4	1.88	2.25	2.75
Thailand	2.2	4.7	4.8	3.8	3.7	3.6	3.50	4.00	4.50
Vietnam	5.9	6.4	6.6	18.3	10.0	9.0	14.00	10.00	10.00
Western Europe	1.5	1.1 ↓	1.7 ↓	2.9	2.0	1.7	1.14	0.98 ↓	1.49 ↓
Euro area	1.5	1.0 ↓	1.5 ↓	2.7	1.8	1.5	1.25	1.00	1.50
Austria	3.2	1.7 ↓	2.1 ↓	3.5	1.7	1.6	1.25	1.00	1.50
France	1.5	1.0 ↓	1.3 ↓	2.2	1.6 ↑	1.5	1.25	1.00	1.50
Germany	2.9	1.5 ↓	1.7 ↓	2.5	1.5 ↑	1.3	1.25	1.00	1.50
Greece	-5.5	-3.4	0.8	2.9	0.8	0.4	1.25	1.00	1.50
Ireland	1.5	-0.6	1.8	1.0	0.9	1.0	1.25	1.00	1.50
Italy	0.6 ↓	0.1 ↓	0.5 ↓	2.9	2.7	1.7	1.25	1.00	1.50
Netherlands	1.8	1.3	1.8 ↓	2.5 ↓	1.7 ↓	1.7	1.25	1.00	1.50
Portugal	-1.5	-3.4	-1.8	3.3	2.0	1.3	1.25	1.00	1.50
Spain	0.7 ↑	0.6	1.6 ↓	3.1	1.9	1.7	1.25	1.00	1.50
United Kingdom	0.9	1.5	2.0	4.5	3.1	2.1	0.50	0.50	1.00
Norway	2.2	2.2 ↓	2.4 ↓	2.2	2.2	2.2	2.25	3.00	3.75
Sweden	4.0	1.6 ↓	2.3 ↓	3.1	2.7	2.8	2.00	2.75	3.50
Switzerland	1.6 ↓	0.8 ↓	1.7 ↑	0.3	-0.5 ↓	0.5 ↓	0.00	0.00 ↓	0.50 ↓
EEMEA	4.6	3.8	3.8	6.8	6.3	5.8	5.87	6.31	6.24
Czech Republic	1.9	2.1	2.7	1.8	3.8	1.9	0.75	1.00	2.00
Egypt††	1.2	3.1	2.5	12.1	9.5	8.0	8.25	9.00	9.00
Hungary	1.9	0.9	1.5	3.8	4.8	3.7	6.00	6.00	6.00
Israel	4.2	3.3	3.5	3.3	3.0	3.3	2.50	2.75	3.25
Kazakhstan	6.2 ↑	5.1	5.3	8.3	7.5	7.7	7.50	7.50	7.50
Poland	4.2	3.9	4.0	4.1	3.4	2.8	4.50	4.50	4.00
Qatar	20.2	14.0	10.0	3.6	3.5	3.2	1.50	2.00	2.50
Romania	1.5	1.7	2.5	6.4	3.5	3.0	6.00	6.00	6.50
Russia	4.2	3.6	3.4	8.5	7.0	6.7	8.25	8.75	7.50
Saudi Arabia††	6.0	4.0	4.0	5.6	5.0	5.0	2.00	2.00	2.00
South Africa	3.1	3.4	4.0	5.0	5.8	5.7	5.50	6.00	8.00
Turkey	6.7	4.0	5.0	7.5	8.3	7.1	5.75	7.00	8.00
Ukraine	4.8	3.8	3.5	8.1 ↓	11.1	10.5	7.75	8.00	8.00
United Arab Emirates	4.8	3.8	4.5	2.0	3.0	3.2	2.00	2.00	2.00

Note: Aggregates calculated using purchasing power parity (PPP) adjusted shares of world GDP; our forecasts incorporate assumptions on the future path of oil prices based on oil price futures, consensus forecasts and Nomura in-house analysis. Currently assumed average Brent oil prices for 2011, 2012 and 2013 are $110, $102 and $98 respectively, after $80 in 2010. *2011 and 2012 policy rate forecasts are midpoints of 0-0.25% target federal funds rate range. **Inflation refers to wholesale prices. ***For Hong Kong and Singapore, the policy rate refers to 3M Hibor and 3M Sibor, respectively. †Policy rate forecasts in 2011, 2012 and 2013 are midpoints of BOJ's 0-0.10% target unsecured overnight call rate range. ††CPI forecasts for Latin America, Egypt and Saudi Arabia are year-on-year changes for Q4. The ↑↓ arrows signify changes from last week.
Source: Nomura Global Economics.

Our View in a Nutshell *(changes from last week highlighted)*

Global

- We do not expect the global economy to return to recession or slow sharply, although the risks of that are uncomfortably high.
- Eurozone woes are set to be long-lived but our base case remains policy doing enough to prevent breakup or full-blown crisis.
- We see a Japan V-shaped recovery, a subpar US recovery continuing, but euro-area growth turning negative by year-end.
- We see headline inflation in the developed world continuing to trend down and inflation expectations remaining well anchored.
- We expect strong growth in China and India to hold up, rather than policy tightening derailing growth.
- Downside risks predominate: a worsening euro-area crisis; fiscal gridlock fallout in the US; an investment pullback in China.
- The eurozone sovereign debt crisis is set to keep the euro under increasing pressure, and the dollar is set to gain.

United States

- Recent data show the resilience of the recovery and seasonal factors point to somewhat stronger data in coming months.
- But an erosion of confidence and continued household de-leveraging should limit the upside growth potential in the medium term.
- A contentious debate this fall is likely to limit progress on long-term fiscal challenges.
- Ample unused capacity – evident in the high jobless rate – should restrain core inflation and contain inflation expectations.
- Absent a significant worsening of the European crisis we expect the Federal Reserve to stick to its current policies.

Europe

- We see the euro staying intact, with fiscal consolidation and debt restructuring, aided by official financing, restoring solvency.
- We expect euro-area growth in the second half to be near zero and then to pick up in 2012 to just above 1%.
- We expect a continued gradual recovery in UK growth despite the damping effect of deleveraging and fiscal consolidation.
- We expect inflation to stay over double the target in 2011 in the UK and in the euro area to fall, after peaking in September.
- We expect the ECB to cut rates by another 25bp in March and the BoE to further expand its asset purchases in February 2012.

Japan

- We expect a rapid recovery to continue, driven by reconstruction demand, with momentum tapering off in H2 2012.
- We expect a supplementary budget of ¥12trn to be passed in November, which should mitigate downside risks to growth.
- The BOJ increased its asset purchase program by ¥5trn in October and we expect the next move to be done by March 2012.
- The main risks relate to the nuclear plant and power shortages, a US/China slowdown and sharp appreciation of the yen.

Asia

- Asia has not decoupled: there is a tipping point where the economies could get hit hard if euro area/US sink into recession.
- China: We expect growth to slow only moderately, supported by solid domestic demand.
- *Korea: We expect the BOK's next move to be a 25bp hike in July 2012, when we see real policy rates turning positive.*
- India: The rate hike cycle has likely ended with clear signs of an economic slowdown, as signalled by the central bank.
- Australia: We see GDP growth recovering from natural disasters assisted by much stronger capex in the resource sector.
- Indonesia: BI is likely to keep cutting, given high external risks to growth and inflation expected to be below its 2012 target.

EEMEA (Emerging Europe, Middle East and Africa) and Latin America

- South Africa: With a very fragile domestic recovery the risks are skewed towards the SARB cutting rates in Q1.
- Hungary's commitment to lower debt and fiscal consolidation is clear but ultimately unsustainable, financial stability is at risk.
- Poland's growth should slow slightly but still outperform. We now see rates on hold through the end of next year.
- Russia's economy is set to be propelled by rising domestic consumption fuelled by pre-election fiscal loosening.
- Turkey: We see strong domestic demand and bigger imbalances, resulting in core inflation and current account pressures.
- Middle East: Unrest persists in some parts, while others engage in a gradual and sometimes volatile transition to democracy.
- Economic growth in Brazil is set to slow below potential this year, despite *two 50bp policy rate cuts* by the central bank.
- *Mexico: As exports slow, consumption is increasingly supporting growth. A weak MXN will keep monetary conditions loose.*
- With the output gap closed, Argentina's strong growth is likely to keep inflation high in 2011.

Economic Data Calendar

The Week at a Glance

For more detail see country and regional data previews

Previous, Nomura, Consensus

	Mon 14 Nov	Tue 15 Nov	Wed 16 Nov	Thu 17 Nov	Fri 18 Nov
North America		**US** **PPI** (Oct) % m-o-m 0.8, -0.5, 0.8 **US** **Retail sales** (Sep) % m-o-m 1.1, 0.1, 0.4 **US** **Empire State survey** (Nov) Index -8.5, -7.2, -2.2	**US** **CPI** (Oct) % m-o-m 0.3, 0.0, 0.0 **US** **Industrial production** (Oct) % m-o-m 0.2, 0.4 0.4	**US Philadelphia Fed survey** (Oct) Index 8.7, 5.6, 10.0 **Canada** **CPI – Total** (Oct) % y-o-y 3.2, 2.8, 2.7 **Canada** **CPI - Core** (Oct) % y-o-y 2.2, 1.8, 1.9	
Europe (ex-UK)	**Euro area** **Industrial production** (Sep) % m-o-m, sa 1.6, -2.5, -2.3	**Euro area** **GDP** (Q3-1st) % q-o-q, sa 0.2, 0.1, 0.2 **Germany** **GDP** (Q3-1st) % q-o-q, sa 0.1, 0.4, 0.5 **France** **GDP** (Q3-1st) % q-o-q, sa 0.0, 0.2, n.a.	**Euro area** **HICP inflation** (Oct-fin) % y-o-y 3.0, 3.1, 3.0 **Euro area** **HICP inflation Core** (Oct) % y-o-y 1.6, 1.7, 1.6 **Spain** **GDP** (Q3-2nd) % q-o-q, sa 0.0, 0.0, n.a.		**Germany** **Producer prices** (Oct) % y-o-y 5.5, n.a., 0.1
UK		**CPI** (Oct) % y-o-y 5.2, 5.1, 5.1 **RPI** (Oct) % y-o-y 5.6, 5.6, 5.5	**BoE Quarterly Inflation Report** **Jobless claims change** (Oct) k 17.5, 19.0, 20.0	**Retail sales (ex-auto fuel)** (Oct) % m-o-m, sa 0.7, 0.2, -0.3 **Retail sales (inc-auto fuel)** (Oct) % m-o-m, sa 0.6, 0.2, -0.2	
Japan	**GDP** (Q3-1st) % q-o-q, saar -2.1, 7.3, 5.9		**BOJ policy meeting** (from 15 Nov) % 0-0.10, 0-0.10, 0-0.10 **BOJ Governor's regular press conference**		
Asia	**India Wholesale price index** (Oct) % y-o-y 9.7, 9.6, 9.6	**Philippines Remittance from abroad** (Sep) % y-o-y 11.1, 9.5, n.a. **South Korea** **Import price** (Oct) % y-o-y 14.0, 10.0, n.a.	**Australia** **Wage cost index** (Q3) % y-o-y 3.8, 3.7, 3.8	**Singapore Non-oil domestic exports** (Oct) % y-o-y -4.5, -6.3, -7.7 **Hong Kong** **Unemployment rate** (Oct) % sa 3.2, 3.2, 3.2	**Malaysia** **Current account** (Q3) MYRbn 23.4, 23.4, n.a. **Malaysia** **GDP** (Q3) % y-o-y 4.0, 4.8, 4.6
Emerging Markets		**Czech Republic** **GDP** (Q3) % y-o-y 2.2, 1.4, 1.6 **Hungary** **GDP** (Q3) % y-o-y 1.5, 1.0, 0.7 **Chile Central bank policy mtg** (Nov) % 5.25, 5.25, 5.25	**South Africa** **Retail sales** (Sep) % y-o-y 8.2, 6.5, 6.4 **Hungary** **Central Bank minutes** **Israel** **GDP** (Q3) % y-o-y, saar 3.7, n.a., 2.7		**Hungary Average gross wages** (Sep) % y-o-y 6.5, 4.6, 5.0 **Poland** **Employment** (Oct) % y-o-y 2.8, 2.7, 2.5 **Chile** **GDP** (Q3) % y-o-y 6.8, 4.7, 4.8

Sources for consensus forecasts: Bloomberg.

Ann Wyman

Emerging markets batten down the hatches

European contagion risks are growing, and emerging markets are not immune. Policymakers should sharpen their crisis management tools and prepare for negative growth headwinds.

The European crisis has moved from bad to worse. Financial markets this week entered a new and more dangerous phase of disruption, and the risks of increasingly extensive spillover effects are rising. Contagion to emerging markets already began to take hold in the early autumn, when an acceleration of outflows from local bond and equity markets (some US$22bn since August) dragged currencies weaker and led to substantial share price sell-offs. Even taking into account the October rally, EM sovereign credit spreads are still 100bp above where they were in early August. Though recent weeks have seen outflows from EMs slowing, important risks remain.

But beyond the direct impact already being felt in financial markets, further channels of contagion to the emerging world could materialise as the European sovereign crisis deepens, increasing the risk of setting in motion much more nefarious feedback loops. In 2009, emerging markets saw almost US$200bn in capital outflows (the first contraction since 1988), stemming from both portfolio and other private (mostly banking sector) flows. In more negative outcomes for Europe, the repeat risk of such an exodus cannot be underestimated.

It is therefore not surprising that the potential for private sector deleveraging – in response to both European bank recapitalisation demands and a broad decline risk appetite – has become a preoccupation, particularly in Eastern Europe, given the significant presence of European banks (see "Eurozone deleveraging in Emerging Europe" in this issue). The potential shrinkage of European bank credit to other EM regions including Asia – where according to the BIS, European banks account for more than 20% of international bank loans – may have negative repercussions for increasingly challenging credit conditions there as well.

The global trade shock of 2008-09 hit emerging markets hard, and the risk of both export declines and deteriorating terms of trade (particularly for commodity exporters) remains important in the period ahead, too. Neither of these related shocks looks to have been set in motion yet. Admittedly, some indications of port activity may be signalling a modest slowing of global trade, and commodity prices have certainly softened, but declines have thus far been meaningfully less precipitous than in 2008-09. This space will undoubtedly be closely watched.

In preparation for these potential threats, emerging market policymakers have much to consider. Differing economic structures and starting conditions mean that each country's response will be unique, but in broad terms, we think policymakers would be well advised to:

Dust off the crisis management toolkits: Policymakers may once again be faced with questions about what policies they are able and willing to use to calm disorderly markets. Currency intervention and capital controls may become desirable, and the re-activation of central bank swap lines may also deserve consideration. Faced with risk that both institutions and individuals could incur meaningful losses on any exposure to European assets, policymakers may also need to think about how they might limit the contagion and associated deleveraging that could ensue in their own markets as a result.

Allow monetary policy to remain nimble, with an emphasis on communication: The prospects for slowing global activity can provide EM central banks a breather from the inflation pressures prevalent earlier this year. Policymakers must strike a careful balance – opportunities to improve credibility should not be squandered, but monetary easing can be a powerful tool, when accompanied by transparent communication.

Prime pumps, where fiscal space is available: While some EMs (particularly in Eastern Europe) are not in a position to provide fiscal stimulus in the face of a more severe economic downturn, countries with underlying strong fiscal positions – including China, and some of the large oil exporters – still have space for counter-cyclical fiscal policy. They should use it.

Engage in collective dialogue: We have already seen some consensus evolve among key EM economies around a willingness to provide financial support for Europe (possibly through the IMF). Common ground now needs to be found with the developed world. Ultimately, the interconnected nature of the global economy means that the dexterity of EM policymakers in coping with contagion will have repercussions far beyond emerging markets themselves.

Deficit-cutting deadline approaches

While the deficit-cutting committee has made some progress, significant reform remains unlikely and the threat of a further rating downgrade looms.

The JSCDR proposal deadline is less than two weeks away

With the deadline fast approaching, the US fiscal deficit is coiled and ready to spring back into the spotlight. By 23 November, the Joint Select Committee on Deficit Reduction (JSCDR) is required by the Budget Control Act (BCA) to present a plan to Congress to reduce the budget deficit by a minimum $1.2 trillion over the next 10 years (see US Special Topic: "A modest commitment," *Global Weekly Economic Monitor*, 5 August, 2011). Congress must then approve or reject the JSCDR proposal by 23 December. Failure to enact the Committee's recommendations, or recommendations that fall short of the required minimum, will trigger across-the-board cuts (the so-called sequestration) in discretionary and direct spending (evenly divided between defense and non-defense appropriations) starting in January 2013 to make up the difference.

A rift between Democrats and Republicans remains

Thus far, negotiations between the evenly split Republicans and Democrats on the 12-member committee have made some progress, but the sides remain far apart on key, red-flag issues (see US Special Comment: "The deficit-cutting dream team – or not," 12 August, 2011). According to the Center on Budget and Policy Priorities, Democrats have proposed changes that would generate $4.1 trillion in deficit reduction and include substantial, conciliatory cuts to Medicare and Medicaid (Figure 1). Republicans' initial response was to counter offer with a plan that provides deeper spending cuts, but little to no revenue increases, for a total of $3.1 trillion in deficit reduction. Subsequent press reports suggest that Republicans have offered to raise additional revenues by limiting income tax deductions but only if the Bush-era cuts in tax rates that are set to expire at the end of 2012 are extended permanently. While both sides have offered significant concessions on core issues (for Republicans, raising revenues and for Democrats, cutting entitlements) they remain far apart, reducing the odds of a multi-trillion dollar deal.

A smaller plan is the most likely outcome…

Negotiations are ongoing, however, and there exist overlapping, bipartisan aspects to both plans that can be hammered out to the liking of each party. In our view, there are three possible outcomes, which include: a total breakdown in negotiations, i.e., no proposal is put forth to Congress on 23 November; a sizable bipartisan plan on the order of $3 trillion or more that implements real fiscal consolidation; or a smaller plan that includes some revenue increases, but mostly spending cuts. The third outcome is the most likely, in our view, but runs the risk of failing to deliver significant reform. Substantial new revenues are currently not on the table, and would only likely be brought into discussion if the Committee chose to tackle comprehensive tax reform. With less than two weeks until the 23 November deadline, there is not enough time for the monumental task of reforming the tax code. Also unlikely, but possible, is a fourth outcome that includes a proposal from the Committee delaying deficit-cutting in lieu of a follow-on process of tax reform. This proposal would still require a vote by Congress, but is a way to stretch the deadline of the deficit-cutting process.

Without tax reform and the revenues it could generate, Democrats will unlikely support significant changes in entitlements. Consequently, the Committee will have to concentrate on

Figure 1. Deficit reduction proposals. Savings over fiscal 2012-2021 relative to current policy baseline

	Simpson-Bowles	Democratic proposal	Republican proposal
	$Billions (as of 31 October, 2011 publication date)		
Revenue increases	2,238	1,300	40
Medicare and Medicaid	402	475	685
Other mandatory programs (includes outlay effect of chained-CPI proposal)	364	385	685
Discretionary	1,295	1,300	1,150
Subtotal, spending cuts	2,061	2,160	2,520
Debt service savings	796	664	495
Deficit reduction	5,095	4,124	3,055

Note: Table details can be found at: http://www.cbpp.org/cms/index.cfm?fa=view&id=3606.
Source: Center on Budget and Policy Priorities; Nomura Global Economics.

cuts in discretionary spending. This will make the JSCDR's task more difficult. Any short-fall in the deficit reduction generated by the process will be sequestered. But the sequestration triggers in the Budget Control Act would not kick in until the beginning of 2013.

Controlling the baseline budget assumptions helps…

One aspect of the deficit-cutting process that works in favor of the JSCDR is the committee's ability to control the baseline budget assumptions when calculating savings. For example, the savings from the drawdown of troops from Iraq (45,000 by 2015) can be counted toward the committee's $1.2 trillion minimum. According to the Congressional Budget Office (CBO) the drawdown of troops amounts to a savings of $493 billion from 2012 to 2021, which effectively gets the JSCDR nearly halfway to its goal. Note that in Figure 1, both the Republican and Democratic proposals are adjusted to include $900 billion in discretionary savings from the spending caps imposed in the BCA. Cuts to meet the BCA caps need to be specified by the Committee, but to avoid sequester the JSCDR must go $1.2 trillion beyond what is anticipated in the BCA. Effectively, this means that to avoid sequester with only cuts to discretionary spending the Committee will need to come up with a minimum plan of $2.1 trillion.

…but may not be sufficient to avoid a downgrade

The credit ratings agencies are following the JSCDR process closely. Standard & Poor's, the only ratings agency to downgrade the US credit rating in August, has warned of a further downgrade should the Committee fail to come up with sufficient cuts to avoid sequestration. Fitch Ratings has said a deficit-cutting shortfall by the JSCDR "would likely result in negative rating action." To be sure, falling short of its statutory goal required by the BCA of cutting $1.2 trillion to $1.5 trillion will be yet another demonstration of the political obstacles to long-term deficit reduction.

The coming fiscal drag…

Regardless of the outcome of the JSCDR process, the US economy is facing moderate fiscal drag in 2012. Discretionary spending caps, troop drawdown, and other expiring tax provisions amount to $69 billion in fiscal drag in 2012, or 0.5% of GDP, according to the CBO and Joint Committee on Taxation (Figure 2). Current legislation also calls for the expiration of the payroll tax holiday and extended unemployment insurance benefits (combined worth $168 billion, or 1.1% of GDP) at the end of 2011. Extending these two measures, which we think is likely to happen one way or another could be easily folded into the JSCDR proposal, but doing so will add to the committee's burden of finding cost savings to pay for them.

…will prompt fiscal reform by the end of 2012

Looking beyond 2012, current law implies substantial fiscal drag in 2013. Taken alone, letting the Bush-era tax cuts expire at the end of 2012, as planned, would create a fiscal drag of $238 billion in 2013, or 1.5% of GDP – a drag that will be hard to handle for an economy growing below trend. If the JSCDR process does not generate meaningful fiscal reform this year, U.S. politicians will have a tremendous incentive to implement reforms after the next election in order to avoid the very sharp fiscal tightening that will happen if no action is taken. In this context, the end of 2012 may provide a better environment for fundamental fiscal reform than the end of this year.

Figure 2. Budgetary effects of selected policy alternatives

	2011	2012	2013	2014	2011	2012	2013	2014
		(Billions of dollars)				(Percent of GDP)		
Spending Initiatives								
Extension of UI Benefits (Dec-2010)	56	--	--	--	0.4	--	--	--
BCA								
Caps	0	-27	-49	-62	0.0	-0.2	-0.3	-0.4
Sequester	0	0	-111	-111	0.0	0.0	-0.7	-0.7
Troop drawdown overseas[a]	0	-18	-53	-86	0.0	-0.1	-0.3	-0.5
Revenues								
Payroll Tax Holiday (Dec-2010)	-112	--	--	--	-0.7	--	--	--
Extend Bush Tax cuts and Index AMT	0	11	238	340	0.0	0.1	1.5	2.0
Extend Other Expiring Tax Provisions	0	13	77	113	0.0	0.1	0.5	0.7

Note: a. Reduce the number of troops deployed for certain types of overseas military operations to 45,000 by 2015. This assumes funding for operations in Afghanistan, Iraq, or elsewhere would total $118 billion in 2012, $82 billion in 2013, $54 billion in 2014, and about $35 billion a year from 2015 on—for a total of $493 billion over the 2012–2021 period.
Source: Congressional Budget Office; Joint Committee on Taxation; Nomura Global Economics.

Italy's last chance

Faced with serious market pressure, Italy needs to regain market confidence. Further fiscal consolidation, reforms and political change are necessary but not sufficient conditions.

Italy is now at the epicentre of the European storm. The lack of a proper backstop facility at the euro-area aggregate level, political instability and the resulting sluggish response to the crisis, combined with a looming Greek debt restructuring, have all been weighing heavily on Italian yields since mid-October. But this week the situation escalated to unprecedented levels. At first Silvio Berlusconi's declaration that he would resign straight after the approval of the budget and the structural reform bill was well received by markets. Subsequently though, the uncertainty that this could have brought (perhaps elections in February 2012), coupled with the decision of the London clearing house, LCH.Clearnet, to increase the charges demanded for trading Italian bonds, pushed Italian 10-year yields to a post-euro historical high of 7.5% and the short end of the yield curve increased by almost 100bp in one day. Support from the ECB's Securities Markets Programme (SMP) bond buying, news of the likely swift formation of a technocrat government headed by Mario Monti as early as Monday and a good bond auction pushed Italian yields below the 7% "threshold" as of Thursday.

Some fear the crisis could put push Italian debt into a spiral

But the underlying problem remains worries about the high Italian debt level. We examine the sensitivity of the Italian debt burden to lower growth and higher interest rates, a key market concern at the moment. Steps need to be taken soon to restore market confidence before debt dynamics become excessively adverse. We see a committed technocrat government as Italy's best response and at this stage Italy's last resource. This, however, would be a necessary but not sufficient condition to restore confidence: other participants, including the ECB and the IMF, will likely have to play their part.

Ambitious fiscal consolidation

The government plans a 5pp swing in the primary surplus…

Italy's current fiscal consolidation plan is ambitious: the government expects a budget roughly in balance in 2013 (-0.1% of GDP) and a small surplus of 0.2% in 2014. The primary surplus is expected to increase to six times its current level, from 0.9% of GDP in 2011 to 5.4% in 2013, and then to nudge up to 5.7% in 2014. In terms of size and timing, the government's plan to achieve almost a 5pp-of-GDP swing in the primary balance in three years would be the largest fiscal adjustment since the late 1990s, when before joining the euro the primary balance rose by 4.3pp in three years (from 2.3% in 1994 to 6.6% in 1997).

…but we think only a 4pp swing can be achieved

On the basis of our updated projections, which now include a technical recession in the second half of this year and gloomier growth assumptions than the government in 2012 (0.1% vs 0.6%), 2013 (0.7% vs 0.9%) and 2014 (0.9% vs 1.2%), we now expect the fiscal deficit to shrink more gradually and reach 0.7% in 2014 and the primary balance to increase by almost 4pp and to hit almost 4.8% in 2014. On top of the gloomier macroeconomic scenario, we are sceptical about the ability of the government to achieve a fiscal consolidation of as much as 2.8% of GDP in

Figure 1. Changes (pp) in debt-to-GDP ratio in 2010-14

real GDP growth (%)* \ 10 year yields (%)	6.5/7	7.5/8	8.5/9	9.5/10	10.5/11
1.5	-11.5	-9.7	-7.9	-6.1	-4.3
0.6	-3.9	-1.9	-0.1	1.7	3.4
0.0	2.9	4.8	6.6	8.4	10.3
-0.3	5.7	7.5	9.1	11.2	13.0
-1.0	13.9	15.7	17.5	19.4	21.2

Note: *Average growth in 2012-2014.
Source: Nomura Global Economics.

Figure 2. Primary balance* (% GDP) to stabilise the debt at 120% of GDP in 2011-14

real GDP growth (%)* \ 10 year yields (%)	6.5/7	7.5/8	8.5/9	9.5/10	10.5/11
1.5	0.8	1.1	1.6	2.1	2.6
0.6	2.1	2.5	3.0	3.5	3.9
0.0	3.2	3.7	4.1	4.6	5.1
-0.3	3.7	4.2	4.6	5.0	5.5
-1.0	4.8	5.3	5.8	6.3	6.7

Note: *Average in 2011-2014.
Source: Nomura Global Economics.

2012 and 1.4% in 2013 – measured as the change in the structural primary balance. Thus, on the basis of our forecasts, the debt-to-GDP ratio looks set to peak at 121.4% and then gradually decline to 116.1% vs the government's more benign forecast of 112.6% by 2014.

The downtrend of the debt-to-GDP ratio could be derailed…

The need to achieve frontloaded fiscal consolidation (markets would not allow otherwise) at a time when growth could turn negative recalls the scenarios of a vicious cycle in Greece, whereby weaker growth triggers more fiscal consolidation, which in turn triggers weaker growth, pushing yields up further on debt-servicing and solvency concerns. Despite the rather long average maturity of Italian debt of around seven years (which means that the debt's sensitivity to rising yields is gradual as it takes seven years for an increase in interest rates to be fully reflected in the cost of servicing debt), sharp and persistent increases in interest rates can still weigh on the cost of servicing debt.

… if 10-year yields rise above 9.5%...

In Figure 1 we present our estimates of the changes in the debt-to-GDP ratio under a combination of real GDP growth and yields scenarios, assuming a 4pp swing in the primary balance between 2011 and 2014. It is clear that even if growth averages 0.6% over the next three years (in line with average growth recorded over the past 10 years) and 10-year yields stabilise at around 8-9%, under the current fiscal consolidation plan, the debt looks set to continue on its downward path, albeit at a more gradual pace. However, were yields to rise above 9.5% the debt-to-GDP ratio would end up being above the 2010 level by 2014.

For each scenario we have estimated the average primary balance in 2011-14 necessary to stabilise the debt-to-GDP ratio at around 120% (Figure 2). In the above scenarios, just to prevent the debt from rising above 120% the primary balance would need to average around 3% over the next three years.

…and under a recession scenario

However, as soon as we move into recession territory debt dynamics worsen considerably pushing the debt back onto an upward trajectory, with the debt ballooning to almost 130-140% should a catastrophic 2009-10 growth scenario (in which growth plunged by 5% and bounced back only by 1%) materialise. In these circumstances the primary balance would need to rise to as much as 6% on average just to stabilise the debt-to-GDP ratio at around 120%.

Super Mario II

A credible Monti technocrat government…

Italy requires an extended period of fiscal virtue. Steps need to be taken soon to gradually restore market confidence before the debt dynamics become excessively adverse, while in the near term the budgetary implications of the increase in interest rates, albeit substantial, remain manageable. Determined political response is the only tool that Italy has, as the ECB appears to be playing a "carrot and stick" game, withdrawing from the bond markets when the response from policymakers appears hesitant.

…is necessary to restore confidence, but not sufficient

This week a swift and credible response has been put on the table: the formation of a technocrat government headed by Mario Monti, a well respected economist nationally and internationally. Once the 2012 Budget Law and the structural reforms have received the green light in the Lower House (expected on Saturday), Mr Berlusconi will step down. With his resignation President Giorgio Napolitano will then start consultations with the majority and opposition parties to assess whether there is support for a technocrat government headed by Mr Monti.

It remains to be seen whether a government led by a technocratic prime minister would have a majority in parliament. At the moment it looks as if only part of the PdL (Berlusconi's party) is willing to back it. However, PD and UdC, the two main opposition parties, as well as FLI, have expressed their support, which would give the government a broad-based majority. Under this assumption, as early as Monday Mr Napolitano could appoint Mr Monti to form a government, likely including both technocrats and politicians, that would need to receive the parliament's blessing. This would give Italy 18 months (until elections in April 2013) to credibly and visibly implement medium-term fiscal adjustment plans and pro-growth structural reforms.

Others likely have to play their part

A sign that Italy is taking responsibility for its commitments would be welcomed by EU authorities and the ECB and may induce the Bank to purchase Italian debt on capital markets in larger size. However, as we have said previously, in return for ongoing ECB buying, Italy may eventually need to sign a Memorandum of Understanding (MoU), with the European Commission, the IMF and the ECB. Assessing when this might happen is difficult, although it could be easier once the technocrat government steps in. In our view, this could pave the way for the EFSF to eventually start buying Italian bonds in tandem with the ECB.

Why September's industrial production dived

In September, Japanese industrial production fell sharply. However, we think that this was partly the result of one-off factors and that the extent of the decline may have been exaggerated.

September industrial production surprised on the downside

The data for exports and (domestic) industrial production in September paint a mixed picture: while real exports (as reported by the BOJ) rose by 3.4% m-o-m, industrial production declined by 4.0%. This fall was a particularly negative surprise because it came in below not only the median market expectation (-2.1%) but also the lower end of the expectation range (-3.5%).

The decline looks too big to be true

Our view, however, is that the industrial production figure for September should not be taken at face value. Figure 1 plots the percentage of the index's components that has declined m-o-m. The percentage that declined m-o-m in September was 73.3%, a figure comparable to the largest since 2003, including the figures for the period just before and after the collapse of Lehman Brothers (77-83%) and just after the Great East Japan Earthquake (79.6%). However, there is no evidence that such an extensive economic shock occurred in September.

Even the transport equipment sector fell

Particularly surprising is the 6.0% m-o-m decline in the production of transportation equipment. Companies in the sector had announced that they expected to increase production significantly towards the end of FY11 in order to make up some of the ground they lost as a result of the Great East Japan Earthquake. This suggests to us that something unusual may have affected the overall production statistics for September.

A skew in the seasonal index may have contributed ...

One possibility is a skew in the seasonal index. The sharp contraction in production after the collapse of Lehman Brothers may have made it impossible to compute the seasonal index in the normal way. We have therefore plotted the extent to which the seasonal index has depressed the September production data since 2003 (Figure 2): this depressing tendency has been particularly marked since 2008. However, the negative impact in 2011 (-11.0%) was not significantly greater than the average for the period before the collapse of Lehman Brothers (-10.4%). In absolute terms, the impact could not have been more than about 0.6pp.

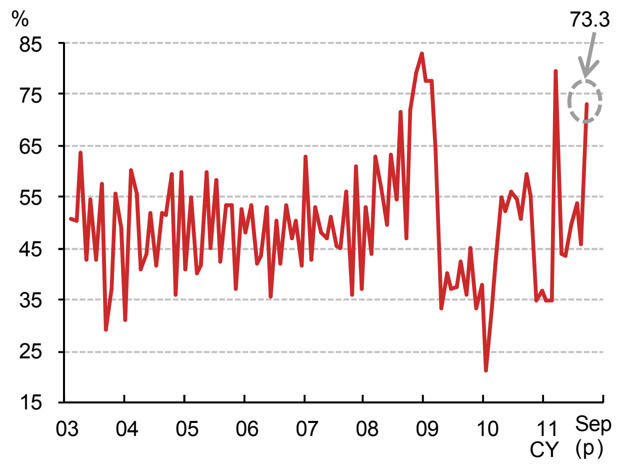
... but this does not appear to have been the main reason

Therefore, it does not appear that seasonal adjustment was the main reason for the sharp m-o-m fall in September. In fact, the (unadjusted) y-o-y data show that production turned down again (by 4.0%) in September after declining (by 3.0%) in July and rising (by 0.4%) in August. Production growth was weak in the run-up to September even on an unadjusted basis.

Another factor is the August's output level

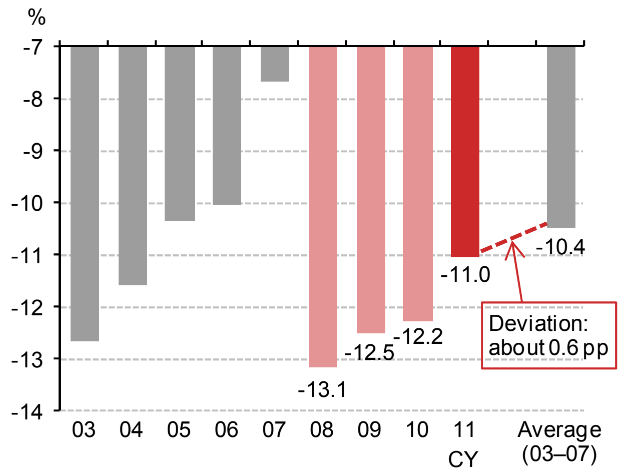
Just as it is difficult to argue that a skew in the seasonal index was the main reason for the sharp fall in the industrial production data this September, it seems pretty clear to us that production growth in Aug-Sep was weaker than usual (on a original basis) and that the actual production

Figure 1. Percentage of components in index recording m-o-m decline in production



Note: (1) As the actual components change from time to time, the chart simply shows the percentage of those the production of which has declined in the month in question.
(2) The figure for September 2011 was calculated using 432 components as the data are preliminary.
Source: Ministry of Economy, Trade and Industry, Nomura Global Economics.

Figure 2: Impact of the seasonal index on the m-o-m percentage change in production (September, industrial production)



Note: (1) Data computed using the following formula: {(previous seasonal index) / (current seasonal index) * 100 - 100}.
(2) The chart plots the impact of the seasonal index on the m-o-m percentage change of production data converted from unadjusted data.
Source: Ministry of Economy, Trade and Industry, Nomura Global Economics.

figure for September was also weak. However, it is possible that the adjustments to production this summer, as a result of the need to reduce electricity consumption, may have boosted the level of production in August and affected the growth of production in Aug-Sep.

August may be the source of the skew in the seasonal index

It may be surprising to suggest that the adjustments to production this summer may have boosted production in August. While the industrial production index grew by only 0.6% m-o-m in August, computing the seasonal index's skew for that month in the same way as we did for September shows that it may have depressed the industrial production index for August by 3pp (Figure 3). In other words, adjusted for this skew, the industrial production index for August grew by about 3.6% m-o-m. This is also consistent with other data, including (1) the above-mentioned fact that August was the only month in which the rate of growth in industrial production increased y-o-y on a seasonally unadjusted basis; (2) the 2.4% increase in the capacity utilization index for that month' and (3) the 1.3% increase in the index of total hours worked.

Firms adjusting to power cuts may have played a role

We attribute August's production to new production schedules, as companies adjusted to the power cuts. It has been reported that, as a result of these cuts, some companies have been unable to operate at full production during the day on weekdays and have shifted production to nights and public holidays. This may be the reason for the high level of production in August.

Monthly Labour Survey data confirm this

In order to assess the impact of this shift in production we take a look at the data from MHLW's Monthly Labour Survey (Figure 4). These show that in August (1) there was no change in the number of people working and that (2) the index of the total number of hours worked rose, mainly because of the number of scheduled hours worked and despite (3) a decline in the number of days worked per worker in real terms. We attribute this decline to the fact that, although the number of days worked increased slightly (by 0.1 days) y-o-y in absolute terms, it declined in real terms because August 2011 had one more working day than August 2010. Although we cannot prove it, the data suggest to us that the number of scheduled hours worked increased because, although companies limited production and their consumption of electricity by reducing the number of people working per day, they also operated on public holidays.

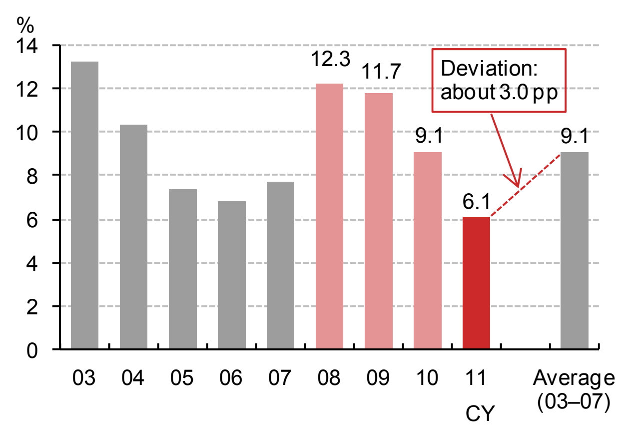
Firms may have operated during the O-bon holiday

This is, of course, mere conjecture. However, we calculated the impact of working during this year's O-bon holiday. Our calculations suggest that this would have boosted the industrial production index for August by about 1.0%. If we add to this the estimated impact of the skew in the seasonal index on the m-o-m percentage change in the production index for September, we calculate that the index would otherwise only have declined by about 2.4%.

Our calculated figure is in line with the market's expectation

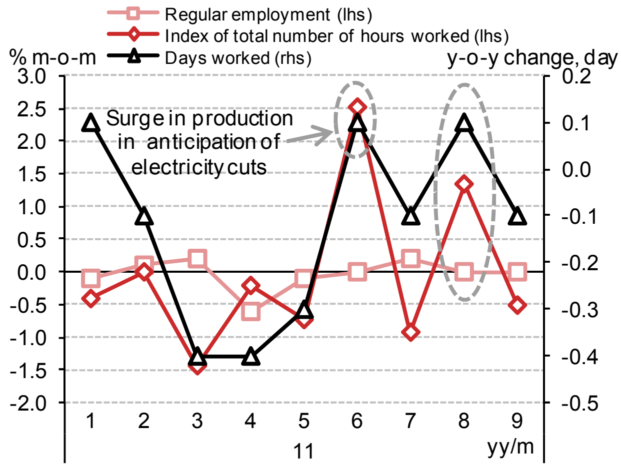
This is pretty close to the market expectation of a 2.1% decline in production. Of course, our calculation must be seen as approximate as it is based on some major assumptions. However, it does suggest that the fall in production in September and its implications for the economic outlook are not as dramatic as they seem.

Figure 3. Impact of the seasonal index on the m-o-m percentage change in production (August, industrial production)



Note: (1) Data computed using the following formula: {(previous seasonal index) / (current seasonal index) * 100 - 100}.
(2) The chart plots the impact of the seasonal index on the m-o-m percentage change of production data converted from unadjusted data.
Source: Ministry of Economy, Trade and Industry, Nomura Global Economics.

Figure 4. Number of workers, number of hours worked and number of days worked



Note: Data for manufacturers employing five or more full- or part-time workers.
Source: Ministry of Health, Labour and Welfare, Nomura Global Economics.

A condition for Asia's domestic-led growth

Asia is gradually shifting from being a manufacturing hub to a global growth engine. A strong global financial safety net is an important pre-condition for Asia's domestic-led growth to take off.

An increasing presence in the global market

Past recoveries have been led by exports

Economic growth in Asia ex-Japan during past recoveries has typically been led by exports (supported by currency depreciation), taking place when growth in advanced economies was rebounding. Relevant examples have been the recoveries after the 1997 Asian crisis and the 2001 dotcom bubble, which coincided with rebounds in the US and Europe.

Asia's relative position in the world is rising

Since the 2008 global financial crisis, Asia ex-Japan has increased its global market share of exports, gaining ground on advanced economies such as Japan and Germany. In Q2 2011, total global export value surpassed its previous peak of Q2 2008 by 5% (Figure 1). Surprisingly, Asia ex-Japan's aggregate exports increased by 24% over the same period, resulting in a higher global market share of 27% in Q2 2011 versus 22% in Q2 2008 (Figure 2). This does not necessarily mean that Asia has been growing at the expense of other regions. Indeed, we see that export-led growth in one economy can engender export-led growth in another (net trade positively contributed to the US and euro area growth in 1H 2011).

Asia boosted domestic demand in post-2008 crisis

Due to sound fundamentals, Asian economies were able to implement substantial stimulus when the 2008 crisis unfolded. Policy rate cuts have been four times greater than the average of past recessions; the fiscal response has been twice as large as that which followed the Asian crisis. Taken together, the size of fiscal and monetary policy easing was unprecedented, exceeding the G20 average. Relative to the G20, stimulus packages in Asia were more heavily weighted towards spending, with a particular emphasis on investment and infrastructure.

Multiplier effect felt on one country and then another

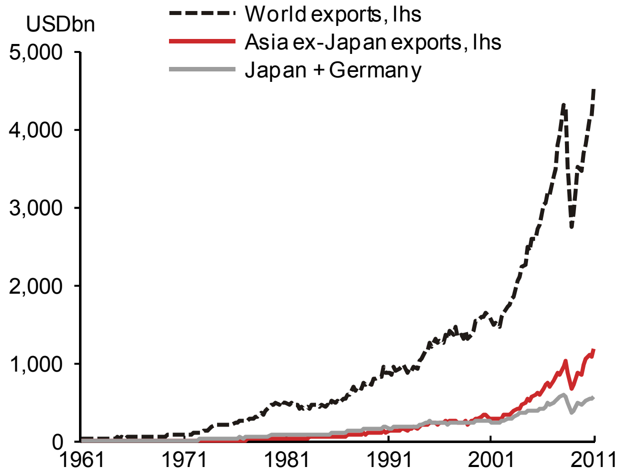
While the US economy has experienced permanent output loss due to the financial crisis, Asia only saw a slight fall in aggregate output. China and India, in particular, suffered no reduction in GDP relative to trend. Each Asian economy's ability to undertake substantial and credible policy responses has benefited the region as a whole. An increase in fiscal stimulus boosted intra-regional exports, inducing additional investment and labour. This, in turn, has contributed to higher household income and consumption – the so called "multiplier effect" of exports on domestic demand.

Similar to pre-1985 Japan and Germany

Japan and Germany saw domestic-led growth post-1985

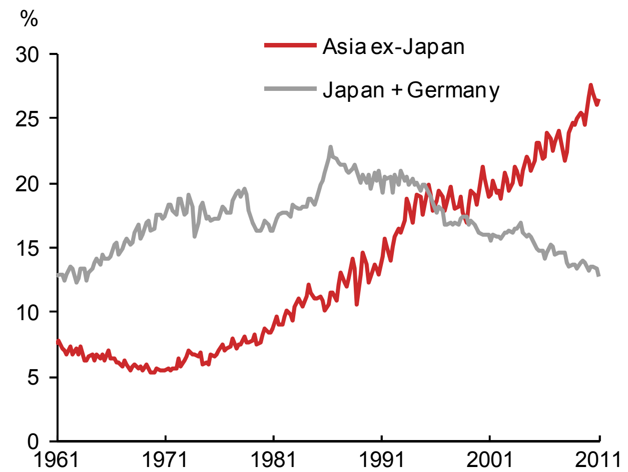
Asian ex-Japan's share of global GDP rose from 14% in 2007 to 18% in 2010 (Figure 3). The road Asia has taken so far is similar to that travelled by Japan and Germany before 1985. In the post-War era, both Japan and Germany focussed on boosting exports, benefitting from: 1) floating exchange rates (from 1971 as the Bretton Woods system ended), since both JPY and the DM were undervalued against USD before the Plaza Accord; 2) Asia's late industrialization; and 3) European economic integration. It was not until the 1985 Plaza Accord that the two economies were pushed towards domestic-driven growth. The G5 statement of 22 September

Figure 1. Export value



Note: Last data point is Q2 2011.
Source: IMF, Bloomberg and Nomura Global Economics.

Figure 2. Share of global exports



Note: Last data point is Q2 2011.
Source: IMF, Bloomberg and Nomura Global Economics.

1985 indicated an awareness that USD was overvalued and that increased domestic demand in Japan and West Germany (both of which were running current account surpluses) was needed. Thereafter, for example, growth in Japanese domestic demand accelerated from its five-year average of 2.7% through 1985 to an average 5.4% over the next five years. As a result, Japan's current account surplus, which had been around 4% of GDP contracted to just 1%. Meanwhile, the US current account deficit, which had been 3% of GDP, was almost eliminated in 1991 (Figure 4). The global economy then received a boost as the increased purchasing power of the Japanese and German economies allowed them to use their FX reserves for more imports from the rest of the world and more direct investments overseas than otherwise would have been the case. However, both returned to export-led growth in 1990 after the Japanese bubble burst and Germany went through the process of reunification.

Gradually shifting toward domestic-led growth

G20 is not as strong as the Plaza Accord

Holding huge FX reserves of USD5.1trn (46% of Asia ex-Japan's GDP in September), Asian policymakers could play a similar role to that of Japan and Germany after the 1985 Plaza Accord by allowing currency appreciation, increasing domestic demand and boosting the global economy. However, the G20 commitment to avoid persistent exchange rate misalignment and to refrain from competitive devaluation is not as binding as the Plaza Accord. We think Asian policymakers still fear sharp currency appreciation due to deep-rooted bad memories of the Asian crisis and the Japanese bubble bursting (it is often said that the Plaza Accord caused the Bank of Japan to aggressively ease monetary policy; see China risks, November 2011).

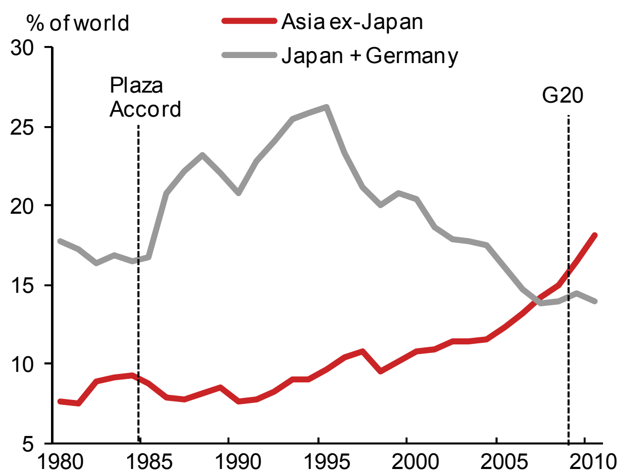
A financial safety net and a larger role are crucial for Asia

In this regard, strengthening its financial safety net and increasing its role in the international monetary system are crucial elements to support Asia's use of its FX reserves for its own organic growth. One way to achieve this is to have Asian countries reduce G3 bonds and increase Asian bonds in their FX reserves. Indeed, a number of steps have already been taken in this direction as Asian central banks and sovereign wealth funds have diversified their assets to the region (see Korea: falling, converging bond yields, October 2011). Korea has also agreed to increase its bilateral currency swap with China (from USD26bn to USD56bn) and with Japan (from USD13bn to USD70bn). The IMF has extended a new precautionary and liquidity line to provide on a case-by-case basis, increased, more flexible short-term liquidity to countries with strong policies and fundamentals facing exogenous shocks, and a single facility to fulfil the emergency assistance needs of its members.

Asia still has room to respond if Europe turns down sharply

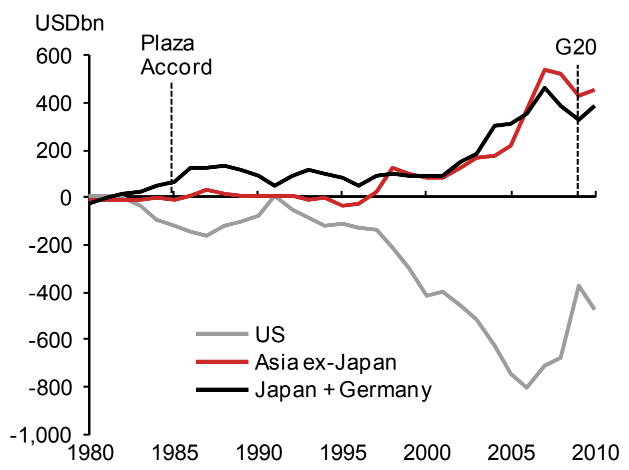
Our European economics team sees the ongoing sovereign debt crisis – and the resulting negative banking sector feedback effect – as posing downside risks to its growth forecasts. If there is a sharp downturn in the euro zone due to the credit crunch, the negative impact on Asia would be smaller than in 2008, but inevitable, as European banks have exposure to the region (3.5% of Asia ex-Japan's GDP in June). In this case, we would expect sizable fiscal stimulus and monetary easing in Asia (see Global market turbulence: Implications for Asia, August 2011). This should accelerate the region's domestic-led growth through the wealth transfer from state (i.e., FX reserves) to the private sector, if this is associated with stronger Asian currencies supported by a strong financial safety net.

Figure 3. Share of global GDP



Source: IMF and Nomura Global Economics.

Figure 4. Current account balance



Source: IMF and Nomura Global Economics.

Emerging Markets | Roundup Peter Attard Montalto | Tatiana Orlova | Olgay Buyukkayali

Eurozone deleveraging in Emerging Europe

Emerging European economies need to be aware of the impact of eurozone deleveraging on their economies, although action may not be required yet.

The eurozone is currently at the start of a forced deleveraging process, with banks having to ensure core tier-1 capital is at least 9%, implying a capital increase of some €106bn is required – as announced at last week's European Council summit. The effect on Emerging Europe, however, is much less certain.

Calculating the impact on Eastern European countries

Banks will use a mix of policies to delever their businesses

As discussed in our recent publication (Delving into Eurozone deleveraging in Emerging Europe, 4 November 2011), the markets for this €106bn of capital are very limited at present – European bank equities are down a third this year and primary equity markets outside mining are also very weak. The provision of capital by governments is severely limited given ongoing fiscal consolidation efforts which cannot be jeopardised – indeed, eurozone leaders made it clear that capital would have to come from private sources before national treasury financing could be tapped. The alternative is to shed risky assets (around €1.2trn if all the adjustment were to be via that route) or use retained earnings. We think the eventual strategy is likely to be a little of all three – some capital raising, some non-tier-1 asset sales and potentially (given nine months to get there) quite a bit of retained earnings. It is the asset sales that we are concerned with. Such deleveraging of balancing sheets has the potential to affect asset prices, to create destabilising FX flows and to affect banks' business plans, thereby acting as a drag on growth though a lack of new lending.

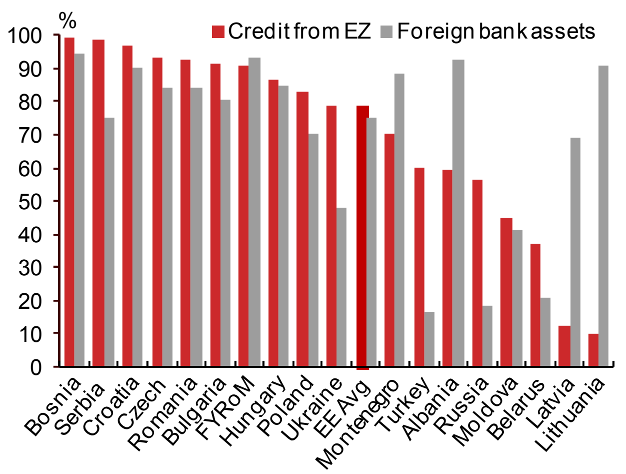
Emerging Europe could be at risk of asset disposals

We believe eurozone countries with higher exposures to Emerging Europe will be at risk of targeting countries in this region for asset sales. As such, it is important to see which countries are particularly reliant on foreign credit (provided by foreign banks, not FX credit). We can see this in Figure 1, both for foreign bank assets as a percentage of total bank assets locally and for credit provided by European banks. The picture is unsurprisingly worrying for most countries in Central and Eastern Europe (CEE) and Southern Emerging Europe (SEE). The risk there is of asset sales that are large in comparison to the economy. We can try to work out how much these could be in each country, but there are large degrees of freedom in any such calculation. We look simply at a pessimistic situation based on a bank mainly selling its foreign assets to deleverage with limited direct capital raising, and a more optimistic scenario whereby domestic asset sales are included and around a third of the required tier-1 ratio comes from capital raising.

We calculate the potential impact on countries

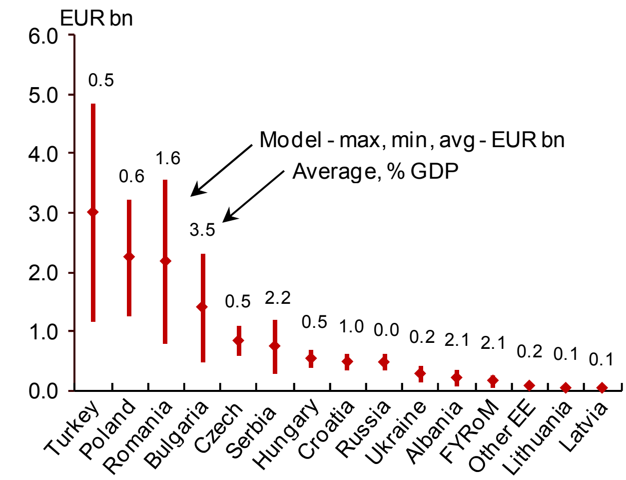
We present the two cases plus their average in Figure 2, stressing that this is a very rough "back of the envelope" calculation with many potential errors, simply to give an idea of how countries could be affected, and orders of magnitude. We also exclude known or suspected sales (such as Millennium in Poland). The key simplifying assumption is that deleveraging is in the same proportion as foreign asset holdings. We can see the possible contribution of Emerging Europe to the deleveraging process is between €5bn and €20bn with an average of €13bn. To be clear,

Figure 1. Foreign dependence – assets and credits



Source: BIS, EBRD, Nomura Global Economics.

Figure 2. Potential deleveraging numbers by country



Source: BIS, Nomura Global Economics.

we are looking at how eurozone bank needs can be satisfied in the short space of nine months through asset sales. This could be also thought of as the potential amount of Emerging Europe currency/euro selling. That said inflows for other, non-eurozone foreigners buying such assets could offset this gross amount and a large amount of the flow could go via central bank balance sheets and through reserves. The impact may also be less depending on funding sources, deposits, or external or parent company funding. Of course, with a view that risks to the eurozone crisis are very much skewed to the downside, risks are that the deleveraging impact on Emerging Europe could be all the greater (with a disorderly Greek default, eurozone exit, and more meaningful contagion to Greece and Spain).

Stressed balance sheets make fire-sales look more likely

This €13bn figure is interesting, however. We have assumed the funding sources are either external (resulting in no net capital flow) or domestic, which would require an increase in the savings rate either though higher taxes to pay for nationalisation or higher interest rates to attract more deposits to fund these purchases. Where household and corporate balance sheets are stressed (which they are in most of Emerging Europe), such an increased savings rate looks less likely and so fire-sales are more likely.

....although there is a low risk in countries with open markets

We believe three countries – Turkey, Poland and Russia – have what we would call "willing buyer willing seller" (WBWS) markets and also the possibility of open market ABS (and other associated securities and loan portfolio) sales. In other words, in these markets, we do believe there would be buyers given a significant discount in asset prices within a quarter. In these countries we judge the risk of fire-sales to be minimal and hence the risks to the economy and functioning of the banking system are lessened. Other countries risk fire-sales with deleveraging where there is a lack of willing buyers or where there are no "liquid", open markets for bank asset portfolios. In general, this is the case in smaller SEE countries and where assets are severely impaired or where there is significant regulator uncertainly (e.g. in Hungary). Countries with WBWS and open ABS markets are more likely to be used for asset sales, though where these markets do not exist, the impact of even small scale fire-sales is likely to be disruptive.

There may be lower lending rates in some countries

In general we believe the "business rotation" we have seen from 2009 to the present can continue. By this we mean that parent companies have slowed new lending business in countries with lower growth, rapidly rising NPLs and lower profitability in favour of lending to stronger growth, more profitable alternatives such as Poland and Turkey in particular, causing countries like the Czech Republic and Hungary to suffer. The dynamic may well be similar again. However, the paradox is that those businesses that are less profitable are less likely to be sold without fire-sale prices. There is also an interesting case, whereby a number of distressed countries' banks have used Emerging Europe interbank and swap markets, as well as deposits, to fund parent companies. Overall countries which are used as funding conduits even if they remain less profitable are less likely to be sold.

The impacts will be different on each country

Overall, then, there are some factors that reduce the chances of Emerging Europe being hit and some that raise them. Given many of these factors work in different directions for the same country, decisions will be made on a bank-by-bank, country-by-country basis.

Policy reactions

A Vienna 2.0 could be introduced....

There are a number of "backstops" against the risks identified above. The first is at an EU level, with the ECB and Commission pushing for deleveraging to be limited to reduce the harm to countries. That may sway the proportion of capital raising vs deleveraging in favour of the former. The most interesting prospect we see for Emerging Europe, however, is the European Bank for Reconstruction and Development's recently floated idea of a Vienna 2.0. A Vienna 2.0 would focus on shielding Emerging European countries from external risks and deleveraging. It could aim to ensure that asset sales within a country are orderly, that fire-sales are prevented and that order is maintained, but overall we think at best capital flight could be prevented (on a net basis) and new business and credit extension could once again not be ensured like in 2009.

...alongside domestic policies to stop excess deleveraging

Domestic reactions could consist of monetary policy changes, capital controls and asset nationalisations. Rate hikes could be used, or reserves drawn upon, to offset currency weakness caused by capital flight. However, as most deleveraging would be offset by foreign investors coming in and purchasing FX, due to the low possibility of sales to domestic investors, we are not overly concerned about any meaningful currency weakness. We view capital controls as a last resort, as they could provoke portfolio flight and are not easy to implement within EU law. We also see little fiscal room in the entire Emerging Europe region to begin nationalising assets, with only a small amount of off-balance-sheet moves possible.

Tightening another notch

The euro area is heading towards more fiscal belt tightening in 2012. We estimate the additional austerity measures will knock a further 0.1-0.2pp off annual GDP growth in 2012-13.

More austerity and fiscal consolidation...

Governments across the euro area have announced their spending plans for 2012. More austerity and fiscal consolidation are planned, not only in the periphery but also in countries such as France and the Netherlands. An even tighter fiscal policy stance is likely to come at the expense of lower growth. But under pressure from financial markets and the rating agencies, the Northern European countries appear willing to make this sacrifice to preserve their prized AAA ratings:

- **Germany** is sticking with its existing spending plans and withdrawing its stimulus packages. However, €6bn in income tax cuts has been agreed for 2013.
- **France** has unveiled additional budget savings worth €18.6bn over 2012-13, on top of the €11bn austerity savings planned for 2012 (France: Downgrade on fiscal slippage pushed back, for now, 8 November 2011).
- **Italy** has already announced fiscal tightening measures. As the political situation is clarified, another round of spending cuts may be announced to hit deficit targets. (Italy's fiscal austerity: waiting for the green light from parliament, 8 September 2011)
- In **Spain**, the 2012 budget has been delayed because of general elections. Without further measures, Spain is likely to miss budget targets. After the election, we expect plans to further trim government consumption.
- Despite a weaker growth outlook, the **Netherlands** is sticking with its consolidation measures (job cuts in the public sector and cuts in social security spending).

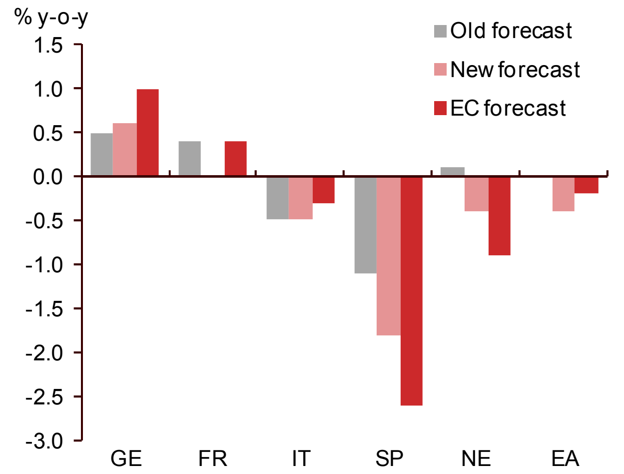
... seem ambitious in the current situation...

These spending cuts are in addition to what euro-area governments already announced last year. With the revised spending plans, we now expect government spending to decline in real terms over 2012 by 0.4% and fall by only 0.1% in 2013 (Figure 1). During the first decade of the EMU, government spending grew by 0.5% per quarter. And during 1994-95, when governments were tightening policy to meet the Maastricht budget deficit criteria, government spending actually grew by 0.3% per quarter. Thus, in a historical context, the announced euro-area austerity plans look ambitious.

... as they will add a further drag on weak economic growth

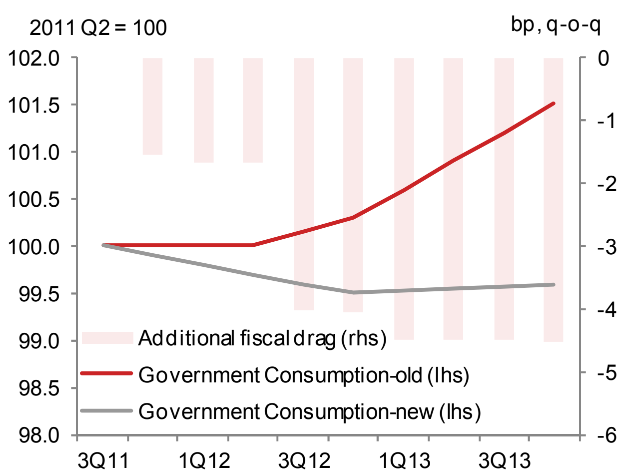
We do wonder whether governments can actually carry out these spending cuts in a more challenging low-growth environment. This is especially so as more fiscal tightening will act as an additional drag on growth. Using our in-house forecasting model for the euro-area economy, we estimate that these *additional* spending cuts will potentially shave another 0.1pp and 0.2pp from GDP growth in the euro area in 2012 and 2013 respectively (Figure 2). We now believe that the cumulative growth drag from fiscal headwinds could be 0.6-1pp in 2012; a very significant headwind given potential GDP growth of 1.0-1.5%. We incorporate these new fiscal headwind estimates into our GDP forecasts in this week's Euro area Economic Outlook.

Figure 1. Government spending forecasts for 2012



Source: European Commission and Nomura Global Economics.

Figure 2. Additional fiscal drag from spending cuts



Source: Nomura Global Economics.

Russia: WTO dream coming true?

Following Georgia's consent to its accession, Russia's WTO membership may be announced at a WTO conference in mid-December.

Georgia's vote is critical for Russia's WTO bid

The last stumbling block has been removed

Earlier this year Russian officials (including Minister for Economic Development Elvira Nabiullina, whose ministry is formally responsible for WTO negotiations) predicted the country's WTO membership by the end of 2011. Until very recently, Georgia, whose relations with Russia have been acrimonious since the short war between the two countries in August 2008, was the last WTO member with power to block Russia's bid that still had to formally agree to Russia's membership. But in late October, Russia and Georgia agreed on independent monitoring of cross-border trade in the breakaway republics of South Ossetia and Abkhazia, proposed by the Swiss mediators. This effectively means that the two countries have reached an agreement on the terms of accession. On 10 November, the WTO working group formally confirmed that the terms of Russia's accession have been finalised. An official announcement about Russia joining the WTO now looks likely to be made at the WTO conference on 15-17 December 2011. Then the Duma will have six months to ratify the WTO accession documents. Russia will formally join the WTO a month after their ratification.

The longest road to WTO

Russia is the largest economy still outside the WTO

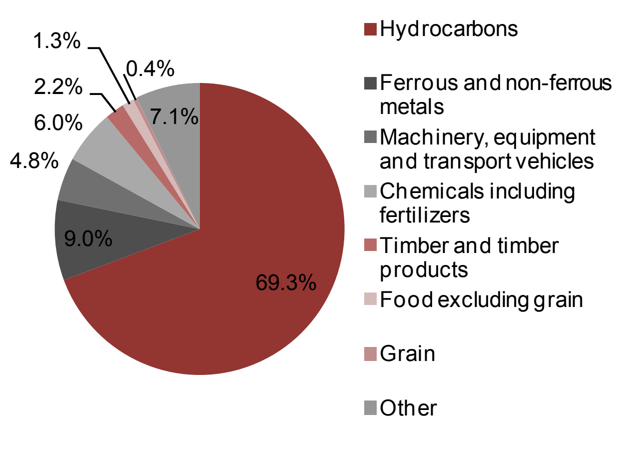
Russia opened its WTO accession process in1993, 18 years ago. The number of its negotiating partners has kept growing over the years, and the latest working group had 60 members – the largest working group ever in the history of WTO. Russia's most difficult negotiations were with the US (the bilateral protocol was signed in November 2006) – and the thorniest issue was poultry and meat imports. In October 2010 Finance Minister Alexei Kudrin announced that the two countries had finally ironed out all their differences. The negotiations with the EU were of the same length, and finished in 2004. Russia is currently the largest economy that does not have WTO membership.

Is economic breakthrough around the corner?

WTO accession could bring $132bn in extra annual output

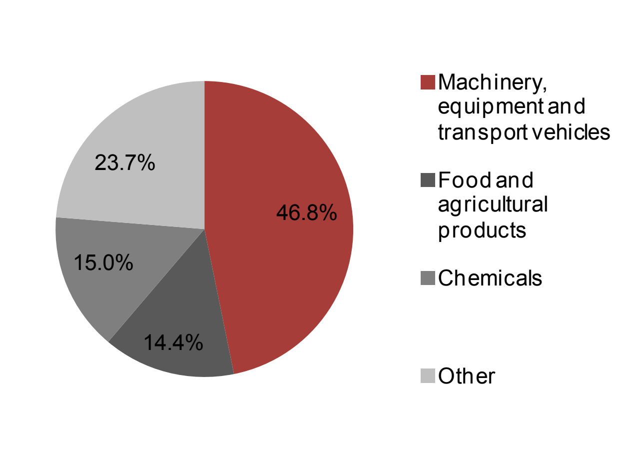
World Bank economists estimate that WTO accession would bring Russia $40bn (2.7% of 2010 GDP) in extra output per year in the short term and even more, $132bn (9% of 2010 GDP), in the longer term, after all the associated benefits from the better business environment have materialised. These findings are taken from the IMF paper, *Russian Trade and Foreign Direct Investment Policy at the Crossroads*, by David Tarr and Natalya Volochkova (March 2010). An earlier study by Mr Tarr, *Russian WTO accession: Achievements, impacts, challenges*, published in 2008, contains a detailed estimate of the expected WTO membership benefits for Russia. As of 2008 when the report was published, he found that overall gains to Russia from WTO accession should be equivalent to a more modest 4.3% of GDP.

Figure 1. Russia: Commodity structure of exports, 2011*



Note: * Jan-Aug 2011.
Source: Bloomberg, Nomura Global Economics.

Figure 2. Russia: Commodity structure of imports, 2011*



Note: * Jan-Aug 2011.
Source: Bloomberg, Nomura Global Economics

Largest gains are seen in business services, not goods trade

Russian economy is not highly protected by tariffs

According to Mr Tarr, for Russia, liberalisation of foreign trade in goods is not likely to be the main source of gains from its WTO accession. In his 2008 report, he argues that the Russian economy has not been highly protected by tariffs, which averaged about 13-14.5% in the early 2000s. By 2005, the average tariffs were already down to 12.1%. Russia has agreed to reduce its tariffs to 8% on average following its WTO accession. For comparison, China had an average level of tariff protection of about 23% when it started its WTO accession process in the mid-1990s; it then agreed to reduce it to an average level of 10% in the four years following its WTO accession in 2001.

85% of gains to come from FDI in services

He estimates that about 85% of the gains from WTO accession will be derived from the reduction in barriers to FDI in services. In particular, Russia will allow 100% ownership of non-life insurance companies, banks and non-insurance institutions. It will ensure market access and national treatment for a wide variety of professions, including lawyers, architects, accountants, engineers, health care professionals, and advertising, marketing and management specialists.

Less than 10% of gains to come from better market access

Only about 10% of the gains will accrue from the liberalisation of international trade; and even less than that should come from improved market access for Russian exporters, according to the report. The author believes that among the exporting sectors, ferrous metals, non-ferrous metals and chemicals will benefit most as these sectors export most intensively. They will also be better protected from anti-dumping cases following Russia's WTO accession.

WTO accession to hurt some Russian industries

Agricultural subsidies remain an unresolved issue

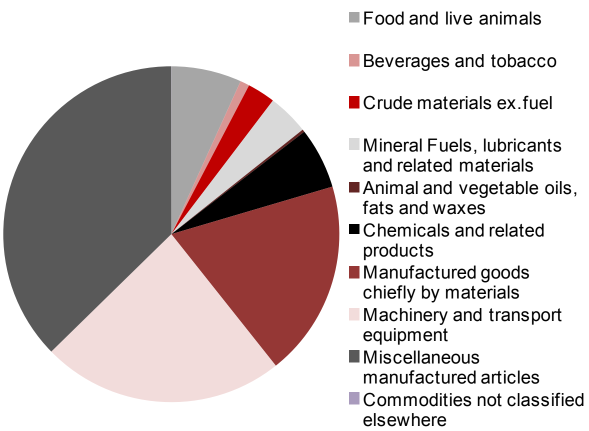
The sectors focused on domestic consumption will decline in some regions as they are highly protected. Russia is a net food importer (see Figures 1 and 2) and therefore it will suffer from the elimination of agricultural subsidies. In light of this, it is not surprising that agricultural issues have been most contentious during Russia's WTO negotiations. Russia is yet to agree with the members of its working group on agricultural subsidies, which it wants to increase to $9bn in 2012, and then gradually scale back to the current level by 2017. Another area where negotiations have been challenging is the timber industry. Russia progressively raised its timber export duties in 2006-08, trying to create a better climate for it. However, under pressure from Scandinavian countries, which rely on Russian timber exports for their own timber processing industries, Russia scrapped its plans to raise the duty to the prohibitive level of 80%. Presumably the Scandinavian countries will insist on Russia keeping these duties low following its formal WTO accession.

Russia is unlikely to emulate China's post-accession surge

The party has shown support for liberal economic policies

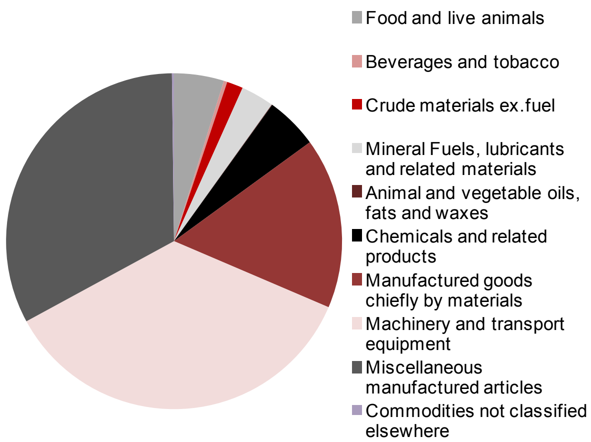
We have looked at other IMF research papers to gauge whether the results of Russia's WTO accession can be predicted using the example of other countries. A number of international economists have advocated WTO membership for Russia, citing the example of China as a country whose economic success was helped by its WTO membership. On the surface, there are similarities – China's accession process was also among the longest in WTO history (15 years), and China is also one of the BRICs. However, in many ways the structures of export and import markets and, importantly, labour markets of the two countries could not be more different.

Figure 3. China: Commodity structure of exports, 1996



Source: Bloomberg, Nomura Global Economics.

Figure 4. China: Commodity structure of exports, 2001



Source: Bloomberg, Nomura Global Economics.

Russia's exports of labour-intensive goods are low

In *China: International Trade and WTO Accession*, (IMF working paper, 2004) the authors, Thomas Rumbaugh and Nicolas Blancher, note that "increased market access overseas is the most immediate benefit from WTO accession". Easier market access boosted labour-intensive exports in a number of sectors, including electronics (see Figures 3 and 4). While in the early 1990s, the share of machines and transport (which includes electronics) in China's overall exports was 17%, it rose to 41% by 2003. Its traditional exports, textiles and products of other light industries, also received a fillip from WTO accession. In contrast, Russia's exports are primarily commodities (nearly 80% of exports in the first eight months of 2011). In particular, 69% of exports were oil and gas (see Figure 1), which are not covered by WTO rules. The share of value-added goods in its exports is rather small: the largest category – machinery and equipment – accounts for only 4.8% of all exports. Therefore, Russia is unlikely to see a sharp increase in its exports: as noted above, this effect will likely be responsible for no more than 10% of accession gains.

No room for further urbanisation in Russia

In China, 53% of the population still lived in the countryside in 2010 following years of rapid urbanisation. Industrialisation, helped by WTO accession, is still driving millions of new workers into the industrial sector, with the rate of urbanisation currently at 2.3%. In Russia, the mass exodus from the countryside into cities began in the 1920s and 1930s under Stalin's rule, when the traditional village communities were destroyed and replaced with collective farms. In the 1930s the Soviet Union began its large-scale industrialisation programme, which further fuelled urbanisation. Only 26% of Russians currently live in villages, and the rate of urbanisation is negative (-0.2%). The only potential source of cheap industrial labour is immigration but there is great resistance to it, with ethnic tensions already running high.

We expect no immediate economic gains from WTO accession

Some benefits of harmonisation must already be at work

We think that it would be naïve to expect an almost overnight improvement in the business climate if Russia manages to join the WTO by the end of 2011. First of all, the announcement of WTO accession would simply certify the fact that the long and tedious process of harmonising legislation and customs tariffs with the WTO rules has finished. During the 18 years of the accession, the Duma passed into law 42 significant legislative packages. Given this, some (if not most) of the benefits under the WTO membership must have already been at work. The agreement with Georgia on monitoring border trade in itself should have a negligible economic effect. The WTO membership should prevent the authorities from introducing protectionist measures in the future; however, it is hard to estimate any positive impact of this now.

Poor investment climate will not improve overnight

Thus we believe no sharp improvement in economic conditions should be expected once Russia is formally accepted into the WTO. It will not resolve the main problems underpinning the country's notoriously poor investment climate – the high level of corruption, weak institutions and judiciary, the lack of respect of property rights and unpredictability of tax policy.

China also began to reap its WTO benefits before admission

Interestingly, the authors of the IMF report on China's WTO accession thought that the main effect of WTO accession had already materialised during the 15-year accession process ($35bn). They believed the country should be able to reap only $10bn worth of extra benefits from the smaller reduction in protection between 2001 and the end of the implementation period.

Russia has already cried wolf a few times...

WTO accession is hardly a priority for Russia's leadership

We note that in the past few years, the Russian leadership seemed to grow colder towards the goal of WTO accession, and took several decisions which complicated the accession process. The most prominent example was Prime Minister Putin's announcement that the members of the newly created Customs Union would be applying for WTO membership together, which nearly derailed Russia's accession efforts in summer 2009. Thus we see a risk that if the global economic situation keeps deteriorating, the authorities could assign a higher priority to protectionist measures, introduction of which could again bring the accession process to a halt.

Market reaction to the news may be subdued

Hardly any of the last five years have passed without official reassurances that Russia was very close to the end of the WTO accession process and that it could be finished in that year. As a result, the markets have become immune to these announcements. Following all the positive headlines about Russia's imminent acceptance to the WTO, the event itself is unlikely to be viewed as a "black swan" by the markets. Although the positive news could provide some support to Russian asset prices, we would not be surprised to see a muted reaction from the markets, which are preoccupied with the unfolding crisis in the eurozone.

David Resler | Ellen Zentner | Aichi Amemiya

Picking up speed in second half

The US economy has remained surprisingly resilient amid the confidence-shaking turmoil in the financial markets. Available data reinforce our expectations for moderate second-half growth.

Activity: Despite threats to the recovery from tumultuous financial markets and slowing growth in Europe, the pace of US growth appears to have quickened in the second half of 2011. Specifically, we look for a robust 2.9% GDP growth rate in Q4 on top of the advance estimate of 2.5% in Q3. Though lingering uncertainty about the outlook may delay future projects, demand for new plant and equipment remains buoyant. The labor market remains soft but the drop in the jobless rate to 9.0% in October alongside upward revisions to recent gains in private payrolls suggests condtions are improving. While consumer sentiment has fallen sharply, much of the decline appears to reflect a loss of confidence in policymaking rather than a deterioration in individuals' financial circumstances. Despite low confidence, consumer spending continues to grow at a moderate, but steady pace.

Inflation: The surge in commodity prices that raised headline inflation early in 2011 appears to have ended, and with softening oil prices, headline inflation has begun to subside. The 12-month rate of growth in "core" CPI moderated in September as a replenishment of inventories has eased price pressures for motor vehicles, and apparel prices appear to be reversing earlier gains due to the lagged effects of higher cotton prices.

Policy: Absent a significant deterioration of the situation in Europe, we expect the Federal Reserve to stick to its current policies for the foreseeable future. Persistent downside risks for growth have pushed any step toward "normalization" of the Federal Resrve's balance sheet far into the future. We expect some parts of the proposed jobs bill to be passed, but the debate over fiacal policy is likely to be highly contentious in coming months. We expect little progress on long-term fiscal challenges and fiscal policy is likely to be neutral to contractionary in 2012.

Risks: Powerful headwinds during a prolonged period of deleveraging continue to keep risks skewed to the downside. The unresolved European sovereign debt crisis remains a threat while budget restraint by state and local governments and slowing growth abroad magnify the downside risks. However, new policy initiatives could counter some of those risks.

Details of the forecast

%	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**0.4**	**1.3**	**2.5**	2.9	1.5	2.5	2.7	2.6	1.8	2.4	2.5
Personal consumption	**2.1**	**0.7**	**2.4**	2.5	0.7	2.1	2.5	2.5	2.3	1.9	2.4
Non residential fixed invest	**2.1**	**10.3**	**16.3**	9.7	9.2	9.3	8.2	6.3	9.2	9.9	6.2
Residential fixed invest	**-2.5**	**4.2**	**2.4**	3.6	2.9	2.8	4.4	4.2	-1.7	3.3	5.5
Government expenditure	**-5.9**	**-0.9**	**0.0**	-1.9	-2.0	-2.5	-1.5	-0.3	-2.0	-1.6	-0.2
Exports	**7.9**	**3.6**	**4.0**	7.5	6.8	6.9	7.1	6.3	6.9	6.4	5.5
Imports	**8.3**	**1.4**	**1.9**	4.4	2.5	2.4	4.4	4.8	5.1	3.1	3.9
Contributions to GDP:											
Domestic final sales	**0.4**	**1.4**	**3.4**	2.5	1.1	2.0	2.5	2.5	2.0	2.2	2.5
Inventories	**0.3**	**-0.3**	**-1.1**	0.2	-0.1	-0.1	0.1	0.1	-0.3	-0.2	0.0
Net trade	**-0.3**	**0.2**	**0.2**	0.2	0.5	0.5	0.2	0.0	0.0	0.3	0.1
Unemployment rate	**8.9**	**9.1**	**9.1**	9.0	8.9	8.8	8.7	8.6	9.0	8.8	8.3
Nonfarm payrolls, 000	**166**	**97**	**96**	120	100	150	150	150	120	138	180
Housing starts, 000 saar	**582**	**572**	**615**	630	654	682	755	773	600	716	815
Consumer prices	**2.2**	**3.3**	**3.8**	3.6	2.8	2.0	1.6	1.4	3.2	1.9	1.2
Core CPI	**1.1**	**1.5**	**1.9**	2.2	2.1	1.8	1.4	1.3	1.7	1.6	1.5
Federal budget (% GDP)									-9.2	-8.3	-7.2
Current account balance (% GDP)									-3.1	-3.1	-3.4
Fed securities portfolio ($trn)	**2.40**	**2.64**	**2.64**	2.64	2.64	2.64	2.64	2.64	2.64	2.64	2.44
Fed funds	**0-0.25**	**0-0.25**	**0-0.25**	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
3-month LIBOR	**0.30**	**0.25**	**0.48**	0.40	0.45	0.45	0.45	0.50	0.40	0.50	0.60
TSY 2-year note	**0.80**	**0.45**	**0.24**	0.35	0.30	0.40	0.55	0.70	0.35	0.70	1.25
TSY 5-year note	**2.24**	**1.76**	**0.95**	1.25	1.20	1.35	1.50	1.55	1.25	1.55	2.50
TSY 10-year note	**3.47**	**3.18**	**1.92**	2.50	2.25	2.50	2.65	2.75	2.50	2.75	3.30
30-year mortgage	**4.86**	**4.51**	**4.03**	4.20	4.15	4.30	4.45	4.60	4.20	4.60	4.90

Notes: Quarterly real GDP and its contributions are seasonally adjusted annualized rates (saar). The unemployment rate is a quarterly average as a percentage of the labor force. Nonfarm payrolls are average monthly changes during the period. Inflation measures and calendar year GDP are year-over-year percent changes. Interest rate forecasts are end of period. Housing starts are period averages. Numbers in bold are actual values. Table reflects data available as of 11 November 2011.
Source: Nomura Global Economics.

United States | Data Preview
Ellen Zentner | Aichi Amemiya | Jeff Greenberg

The week ahead

Early November readings on regional manufacturing conditions and data on retail sales, industrial production, and price indicators will help guide expectations for Q4 economic growth.

Weekly chain store sales (Tuesday): Chain store sales started November on a weaker note. However, retailers have traditionally regarded the first half of November as "transitional" with the bulk of the monthly sales coming in the final few days of the month after "Black Friday," the traditional launch of the holiday sales season on the day after Thanksgiving.

Retail sales (Tuesday): ICSC reported that its measure of chain store sales in October grew at the slowest rate since March 2011, weighed down by special factors such as unfavorable weather and a shift in the timing of promotions. An increase in unit sales of motor vehicles will be tempered by a drop in sales at gasoline stations (driven by lower gas prices) in October. Following a jump of 1.1% in September, we expect an increase of just 0.1% in headline retail sales, with a decline of 0.1% in sales excluding autos.

PPI (Tuesday): Producer prices will be weighed down at the headline level by lower wholesale prices for food, while energy prices are expected to be flat. We are looking for a decline of 0.3% in the October PPI following an increase of 0.8 in October. Stripping out the effects of food and energy we expect core prices to increase by 0.1%.

Empire State survey (Tuesday): The FRBNY survey is released early in the month and as such, tends to reflect at least some of the prior month's activity. Financial market volatility remained high in early November so we are looking for continued weakness in the regional manufacturing surveys, though better levels than October. We forecast an increase to -7.2 in November from -8.5 in October.

Business inventories (Tuesday): Inventory building has slowed from a torrid pace earlier in the year, increasing by 0.5% in August. The consensus forecast is for an increase of 0.3% in September. Upside risk to expectations could come in the form of higher energy prices.

CPI (Wednesday): Food and housing will contribute the most to headline consumer inflation in October, while energy, new vehicles, and apparel prices are expected to decline. We forecast an unchanged reading in the CPI compared with 0.3% in September. Stripping out energy and food prices will result in an increase of 0.1% in the core CPI. A data release in line with our expectation will hold the year-over-year growth rate in the core CPI at 2.0% in October.

Industrial production (Wednesday): Aggregate hours worked increased in the manufacturing and mining sectors in October. Further, utility output is expected to rebound from an interruption by power outages due to Hurricane Irene, which struck the east coast on the cusp of August/September. We are looking for an increase of 0.4% in industrial production in October with capacity utilization increasing to 77.7%.

NAHB builder sentiment (Wednesday): After jumping 4 points to a level of 18 in October, consensus is looking for a tick back down to a level of 17 for this metric. Housing activity remains depressed as builders cite credit conditions and price competition from distressed sales as an impediment to new home buying.

Jobless claims (Thursday): Initial jobless claims fell by 10,000 to 390,000 in the week ending 5 November, while the 4-week moving average moved down to 400,000. There is a moderate downward trend in jobless claims that points to continued slow improvement in the labor market.

Housing starts (Thursday): Following a surge (+15.0%) in housing starts in September that was boosted by rebuilding efforts following the destruction of Hurricane Irene, we forecast a decline of 8.7% (601k units saar).

Philly Fed survey (Thursday): The Philly Fed survey has improved sharply following an alarming drop in August (to -30.7). Similar to the Empire State survey, this early read on November manufacturing sentiment is likely to reflect business conditions that have improved since August, but remain uncertain. We are forecasting a reading of 5.6 in November following a big jump to 8.7 in October (from -17.5 in September).

Leading indicators (Friday): We are looking for an increase of 0.6% in the October index of leading economic indicators. The majority of the gain will come from the yield curve, manufacturing work week, and S&P 500 components.

Monday 14 November			Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	US	No indicators will be released							
Tuesday 15 November									
8:30	US	PPI	% m-o-m	Oct	0.2	0.0	0.8	-0.3	-0.1
8:30	US	Core PPI	% m-o-m	Oct	0.4	0.1	0.2	0.1	0.1
8.30	US	Retail sales	% m-o-m	Oct	0.4	0.3	1.1	0.1	0.4
8.30	US	Retail sales ex-autos	% m-o-m	Oct	0.4	0.5	0.6	-0.1	0.2
8:30	US	Empire State survey	Index	Nov	-7.7	-8.8	-8.5	-7.2	-2.2
10.00	US	Business inventories	% m-o-m	Sep	0.4	0.5	0.5	n.a.	0.3
Wednesday 16 November									
7.00	US	Mortgage purchase applications	%w-o-w	11-Nov	4.9	0.2	10.3	n.a.	n.a.
8:30	US	CPI	% m-o-m	Oct	0.5	0.4	0.3	0.0	0.0
8:30	US	Core CPI	% m-o-m	Oct	0.2	0.2	0.1	0.1	0.1
9:00	US	TIC data	$bn	Sep	3.4	9.5	57.9	n.a.	n.a.
9:15	US	Industrial production	% m-o-m	Oct	1.1	0.1	0.2	0.4	0.4
9:15	US	Capacity utilization	%	Oct	77.4	77.3	77.4	77.7	77.7
10:00	US	NAHB builder sentimeint	Index	Nov	15.0	14.0	18.0	18.0	18.0
Thursday 17 November									
8.30	US	Initial jobless claims	000s	12-Nov	406	400	390	n.a.	n.a.
8:30	US	Housing starts	000s	Oct	615	572	658	601	610
8:30	US	Housing starts	% m-o-m	Oct	0.0	-7.0	15.0	-8.7	-7.3
8:30	US	Building permits	000s	Oct	601	625	589	590	600
8:30	US	Building permits	% m-o-m	Oct	-2.6	4.0	-5.0	0.2	1.9
10:00	US	Philadelphia Fed survey	Index	Oct	-30.7	-17.5	8.7	5.6	10
Friday 18 November									
10:00	US	Leading indicators	% m-o-m	Oct	0.6	0.3	0.2	0.6	0.5

Note: Eastern Daylight Time (EDT).
Source: Bloomberg, Haver Analytics, Nomura Global Economics.

Looking beyond the Q2 pothole

Growth should recover in H2, following an avalanche of temporary negative shocks in Q2. But a weaker global economy and high consumer debt will likely hold back growth.

Activity: The economy contracted by 0.4% q-o-q ar. in Q2 as a result of temporary factors. The supply-chain disruptions and temporary shutdowns in the oil industry have sharply reduced exports, while high oil prices and bad weather have held back consumption. However, this weakness should be quickly reversed and business investment in machinery and equipment is expected to remain robust over the forecast period, supported by the need to rebuild capital after almost two years of weak investment. However, slower global growth and weaker commodity prices are likely to be a small drag on growth over the forecast period. In addition, weak income growth and levels of high debt will also likely hold back consumer spending.

Inflation: Higher commodity prices in recent months, especially oil and food, have pushed headline inflation higher, reaching more than 3% in June. However, the recent decline in commodity prices should bring total inflation gradually closer to target. Sizeable spare capacity in the economy and the strong Canadian dollar will likely keep inflationary pressures well contained. We expect core inflation to remain below the Bank of Canada (BoC)'s target over the next few quarters before gradually converging to 2%.

Policy: There is considerable monetary stimulus in place, but with modest growth and significant downside risk over the forecast period, we expect that the BoC to remain on hold until mid-2012. We forecast the BoC to be cautious in tightening monetary policy and to bring rates to 1.50% by the end of 2012. With the housing market in Canada showing increasing signs of overheating and the BoC reluctant to hike rates in the current context, we expect the government to intervene by tightening the mortgage rules again and rein in household debt and prevent further imbalances in the housing market. On fiscal policy, we expect some spending cuts to be announced in the 2013 budget.

Risks: Most of the downside risks are linked to external factors and to increased uncertainty. The risks from a disorderly resolution of the European debt crisis, a slower US and global economy are the most important, because of their impact on exports and commodity prices. Another big risk is the current imbalances in the household sector and the housing market. There is a risk of a disorderly resolution to these imbalances having a disruptive impact on domestic demand. On the positive side, global growth could surprise on the upside, and consumer spending and residential construction may prove more resilient than expected.

Details of the forecast

%	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2010	2011	2012	2013
Real GDP	**3.6**	**-0.4**	2.4	1.9	1.9	2.0	2.2	2.3	**3.2**	2.3	1.9	2.2
Personal consumption	**-0.1**	**1.6**	1.6	1.8	1.8	1.9	2.0	2.0	**3.3**	1.8	1.8	1.9
Non residential fixed invest	**12.9**	**15.5**	8.0	7.2	7.0	6.8	7.0	7.0	**7.3**	14.0	7.6	6.7
Residential fixed invest	**7.5**	**0.7**	2.0	2.0	2.0	2.0	4.0	4.0	**10.2**	1.5	2.3	4.5
Government expenditure	**0.1**	**1.6**	0.3	0.3	0.3	0.0	0.0	0.0	**4.7**	1.7	0.3	-0.2
Exports	**7.7**	**-8.3**	7.0	5.0	4.7	4.2	4.0	4.2	**6.4**	3.6	4.0	4.2
Imports	**9.5**	**10.0**	4.8	4.8	4.5	4.2	4.0	4.0	**13.1**	7.3	4.8	4.1
Contributions to GDP:												
Domestic final sales	**1.8**	**3.0**	2.0	2.0	2.0	2.0	2.2	2.2	**4.6**	3.0	2.1	2.1
Inventories	**2.4**	**2.3**	-0.3	-0.1	-0.1	0.0	0.0	0.0	**0.6**	0.4	0.1	0.0
Net trade	**-0.6**	**-5.7**	0.6	0.0	0.1	0.0	0.0	0.1	**-1.9**	-1.2	-0.3	0.0
Unemployment rate	**7.8**	**7.5**	7.2	7.2	7.2	7.2	7.2	7.1	**8.0**	7.4	7.2	7.2
Employment, 000	**101**	**87**	50	40	50	50	60	60	**70**	69	55	58
Consumer prices	**2.6**	**3.4**	3.0	2.9	2.6	1.8	2.1	2.1	**1.8**	2.8	2.1	2.0
Core CPI	**1.3**	**1.6**	1.8	1.9	2.2	1.9	2.1	2.0	**1.7**	1.6	2.0	2.0
Fiscal balance (% GDP)									**-5.6**	-2.0	-1.7	-1.2
Current account balance (% GDP)									**-3.1**	-2.3	-2.0	-1.8
Overnight target rate	**1.00**	**1.00**	**1.00**	1.00	1.00	1.25	1.50	1.50	**1.00**	1.00	1.50	2.50
3-month T-Bill	**0.93**	**0.93**	**0.80**	0.95	1.00	1.30	1.55	1.80	**0.97**	0.95	1.80	2.05
2-year government bond	**1.82**	**1.59**	**0.88**	1.20	1.50	1.70	1.90	2.10	**1.67**	1.20	2.10	2.40
5-year government bond	**2.71**	**2.30**	**1.39**	1.70	2.10	2.30	2.40	2.60	**2.45**	1.80	2.60	2.90
10-year government bond	**3.35**	**3.11**	**2.15**	2.50	2.80	3.00	3.20	3.30	**3.11**	2.50	3.30	3.60
USD/CAD	**0.97**	**0.96**	**1.05**	0.95	0.95	0.95	0.96	0.96	**0.99**	0.95	0.96	0.97

Notes: Quarterly real GDP and its contributions are seasonally adjusted annualized rates (saar). The unemployment rate is a quarterly average as a percentage of the labour force. Employment is the average monthly change during the period. Inflation measures and calendar year GDP are year-over-year percent changes. Interest rate forecasts are end of period. Numbers in bold are actual values. Table reflects data available as of 11 November 2011.
Source: Bank of Canada, Statistics Canada, Nomura Global Economics.

Euro area | Economic Outlook

Jens Sondergaard | Lavinia Santovetti | Stella Wang

In the eye of the storm

The ECB delivered a surprise rate cut. But financial markets remain unsettled by uncertainty and the implementation risks of the EU policy package. Risks of a technical recession remain high.

Forecast change: We cut 2012-13 GDP forecasts by 0.1-0.2pp due to larger fiscal headwinds.

Activity: Financial market turmoil and signs that credit conditions are tightening have made us more pessimistic about the near-term economic outlook. The Q4 survey data signals that activity is slowing rapidly in both the services and the manufacturing sector. With Italy heading for technical recession, risks of a euro-area-wide recession are clearly increasing. The policy challenge remains how to contain the sovereign debt crisis, minimise the spillover effects to the banking sector (including maintaining financial stability) and hopefully minimise the collateral damage already done to the real economy. Looking into 2012, investment remains cyclically low and once confidence is restored, investment growth should pick up. On the other hand, we now see greater fiscal headwinds in 2012 even in the larger economies, reflecting announcements of more fiscal tightening in Italy and France.

Inflation: We think inflation peaked at 3.0% y-o-y in September. We expect it to gradually fall below the ECB's "close-to-but-below" 2% target from H2 2012 before it hits the target by end-2013. We expect domestically generated inflation pressure (i.e. wages) to progressively increase as the output gap gradually narrows over the forecast horizon, but less frothy commodity prices should put downward pressure on inflation. A sharper-than-expected slowdown in economic activity would significantly diminish inflationary pressures.

Policy: European leaders have announced a number of policy measures aimed at addressing the euro-area sovereign debt crisis. Meanwhile, though, financial markets remain unsettled amid uncertainty about whether these policy measures will work and the deteriorating economic outlook. We think the ECB will continue with its bond-buying programme eventually in tandem with the EFSF when it is clear that the enhanced EFSF is ready, and able to buy bonds. The ECB has also launched generous liquidity operations and a new covered bond purchase programme. Having cut the policy rate by 25bp to 1.25% at its November meeting, we expect the ECB to cut rates by 25bp again in March 2012 and then to stay on hold until mid-2013.

Risks: The risks to the growth forecast are on the downside, mainly stemming from the ongoing sovereign debt crisis and the resulting negative banking sector feedback effects, as well as further fiscal tightening measures. Risks around the inflation outlook are skewed to the downside.

Details of the forecast

%	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**3.1**	**0.6**	0.2	-0.7	1.3	2.3	1.6	1.6	1.5	1.0	1.5
Household consumption	**0.7**	**-0.1**	0.5	0.0	1.2	1.6	1.4	1.4	0.6	0.9	1.4
Fixed investment	**7.7**	**2.4**	-1.8	-2.5	0.7	5.5	6.2	5.5	2.2	1.7	4.9
Government consumption	**1.7**	**-0.7**	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	0.3	-0.4	-0.1
Exports of goods and services	**7.8**	**4.3**	1.0	3.1	4.9	7.7	5.0	5.0	6.0	4.6	5.3
Imports of goods and services	**6.3**	**2.1**	-0.7	1.3	3.7	7.1	5.8	5.6	4.5	3.6	5.7
Contributions to GDP:											
Domestic final sales	**2.2**	**0.2**	-0.1	-0.6	0.7	1.9	1.9	1.8	0.6	0.4	1.6
Inventories	**0.1**	**-0.7**	-0.4	-1.0	-0.1	0.0	0.0	-0.1	0.1	0.0	0.0
Net trade	**0.7**	**1.1**	0.8	0.8	0.6	0.5	-0.2	-0.1	0.8	0.5	-0.1
Unemployment rate	**10.0**	**10.0**	**10.1**	10.2	10.2	10.1	10.0	9.9	10.1	10.1	9.7
Compensation per employee	**2.3**	**2.3**	2.8	2.7	2.2	2.1	2.1	2.3	2.5	2.2	2.6
Labour productivity	**2.1**	**1.3**	0.8	0.7	0.2	0.6	0.9	1.1	1.2	0.7	1.0
Unit labour costs	**0.2**	**1.2**	2.1	2.1	2.1	1.4	1.2	1.2	1.4	1.5	1.7
Fiscal balance (% GDP)									-4.3	-3.4	-2.4
Current account balance (% GDP)									-0.6	-0.3	-0.2
Consumer prices	**2.5**	**2.8**	**2.7**	2.9	2.3	1.8	1.8	1.3	2.7	1.8	1.5
ECB main refi. rate	**1.00**	**1.25**	**1.50**	1.25	1.00	1.00	1.00	1.00	1.25	1.00	1.50
3-month rates	**1.24**	**1.55**	**1.55**	1.15	1.12	1.23	1.26	1.29	1.15	1.29	1.78
10-yr bund yields	**3.35**	**3.01**	**1.86**	1.75	1.85	2.00	2.15	2.30	1.75	2.30	3.50
$/euro	**1.40**	**1.44**	**1.38**	1.30	1.30	1.32	1.34	1.35	1.30	1.35	1.35

Notes: Quarterly real GDP and its contributions are seasonally adjusted annualised rates. Unemployment rate is a quarterly average as a percentage of the labour force. Compensation per employee, labour productivity, unit labour costs and inflation are y-o-y percent changes. Interest rate and exchange rate forecasts are end of period levels. Numbers in bold are actual values, others forecast. Table reflects data available as of 11 November 2011.

Source: Eurostat, ECB, DataStream and Nomura Global Economics.

Inflation nation in a state

Intensification of the euro-area crisis has made activity take another turn for the worse and prompted the MPC to launch QE2, despite persistently high inflation. We expect more to come.

Activity: Underlying growth (excluding the volatile construction sector) has slowed in Q3 from weak rates, albeit ones that were probably better than the headlines suggested – e.g. output was depressed by unseasonably bad weather in Q4 2010, and an extra bank holiday for the Royal Wedding curbed activity in April. Loose monetary policy and the persistent weakness of sterling continue to provide considerable stimulus throughout our forecast horizon. Headwinds come from the euro area crisis, fiscal consolidation programme, poor credit availability, a deterioration of real wages and a shaky housing market, but we think the tailwinds will win out. Together, these considerable offsetting gales should provide an environment conducive to rebalancing.

Inflation: Inflation has been, and should continue to be, boosted by "one-off" shocks such as changes to VAT and energy prices. In September CPI inflation surged by 0.7pp to 5.2% owing to utility and transport price rises. We forecast it to remain near this rate for the next two months before base effects cause a sharp fall around the turn of the year. Notwithstanding that, inflation's persistent elevation looks set to continue through at least 2012.

Policy: Weaker global growth and subdued domestic demand caused the MPC to launch QE2 in October with £75bn more gilt purchases. These will carry it through until February when we expect it to announce another £25bn. We expect the MPC to then remain on hold until August 2013, but fear that this may be too late to return inflation to target in the medium term. Fiscal consolidation plans were broadly unchanged in Budget 2011 and remain consistent with aims to take the current structural deficit into surplus by 2014-15. We expect fiscal policy to subtract 1.5% from GDP in fiscal year 2011-12.

Risks: Although the risks to our growth forecasts lie to the downside, we think that they lie to the upside for our inflation forecasts. The risks to our BoE call are skewed toward more easing.

For full details of our UK view, please see UK Monthly Macro, November 2011.

Details of the forecast

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**1.6**	**0.4**	1.6	0.6	1.8	1.6	3.0	1.1	0.9	1.5	2.0
Private consumption	**-2.5**	**-2.4**	0.2	0.3	1.8	2.0	4.0	1.8	-1.0	1.4	2.6
Fixed investment	**-10.6**	**6.9**	0.9	0.7	3.9	6.7	4.8	3.3	-1.8	3.7	3.2
Government consumption	**3.2**	**4.6**	-0.4	-1.1	-1.6	-1.6	-1.6	-1.6	1.6	-1.0	-1.8
Exports of goods and services	**6.2**	**-5.2**	3.7	2.3	3.9	6.1	7.5	4.6	5.1	3.9	5.2
Imports of goods and services	**-11.3**	**-1.3**	1.4	1.3	4.3	7.1	6.4	3.2	0.2	3.7	3.6
Contributions to GDP:											
Domestic final sales	**-2.6**	**0.5**	0.2	0.1	1.4	1.9	2.8	1.3	-0.5	1.2	1.7
Inventories	**-1.6**	**1.1**	0.8	0.3	0.6	0.1	-0.1	-0.6	0.0	0.3	-0.2
Net trade	**5.8**	**-1.2**	0.7	0.3	-0.2	-0.4	0.3	0.4	1.4	0.0	0.5
Unemployment rate	**7.7**	**7.9**	8.2	8.4	8.4	8.4	8.3	8.2	8.0	8.3	7.8
Fiscal balance (% GDP)									-8.3	-7.4	-6.2
Current account balance (% GDP)									-0.7	-0.9	-1.1
Consumer prices (CPI)	**4.1**	**4.4**	4.7	4.9	3.8	3.4	3.0	2.3	4.5	3.1	2.1
Retail prices (RPI)	**5.3**	**5.1**	5.2	5.4	4.1	3.8	3.6	3.0	5.3	3.6	2.9
Official Bank rate	**0.50**	**0.50**	**0.50**	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00
10-year gilt	**3.69**	**3.38**	**2.48**	2.65	2.70	2.75	2.85	2.95	2.65	2.95	3.80
£ per euro	**0.84**	**0.89**	**0.87**	0.85	0.84	0.83	0.83	0.82	0.85	0.82	0.80
$ per £	**1.55**	**1.62**	**1.56**	1.53	1.55	1.58	1.61	1.65	1.53	1.65	1.69

Notes: Quarterly figures are % q-o-q changes at a seasonally adjusted annualised rate. Annual figures are % y-o-y changes. Inventories include statistical discrepancy. Inflation is % y-o-y. Interest rates and currencies are end-of-period levels. The fiscal deficit is based on the PSNB measure for the calendar year. Numbers in bold are actual values; others forecast. Table reflects data available as of 11 November 2011.
Source: ONS, Bank of England, DataStream, Nomura Global Economics.

Europe | Data Preview

Philip Rush | Lavinia Santovetti | Stella Wang

The week ahead

A busy week with some event risks: GDP and inflation are the main euro-area highlights, while in the UK eyes are on the BoE inflation report, the labour market report, inflation and retail sales.

Monday 14 November			Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	Germany	Merkel attends CDU annual party congress in Leipzig (to 15 Nov)							
10.00	Euro area	Industrial production	%m-o-m, sa	Sep	-0.6	1.1	1.6	-2.5	-2.3
10.00	Portugal	GDP	%q-o-q, sa	Q3-1st	-0.5	-0.6	0.0	n.a.	n.a.
Tuesday 15 November									
	Greece	GDP	%q-o-q, sa	Q3-1st	-1.6	-2.8	0.2	n.a.	n.a.
6.30	France	GDP	%q-o-q, sa	Q3-1st	0.3	0.9	0.0	0.2	n.a.
6.30	France	GDP	%y-o-y, sa	Q3-1st	1.4	2.2	1.7	1.4	n.a.
7.00	Germany	GDP	%q-o-q, sa	Q3-1st	0.5	1.3	0.1	0.4	0.5
7.00	Germany	GDP	%y-o-y, wda	Q3-1st	3.8	4.6	2.8	2.4	2.5
7.00	France	Nonfarm payrolls	%q-o-q	Q3-1st	0.3	0.5	0.2	n.a.	n.a.
8.00	Austria	GDP	%q-o-q, sa	Q3	0.6	0.8	0.7	n.a.	n.a.
8.00	Spain	HICP inflation	%m-o-m, nsa	Oct	-1.2	0.0	1.2	0.4	0.5
8.00	Spain	HICP inflation	%y-o-y	Oct-fin	2.7	3.0	3.0	3.0	3.0
8.30	Netherlands	GDP	%q-o-q, sa	Q3-1st	0.7	0.8	0.2	0.1	0.1
9.30	UK	Consumer price index	%m-o-m	Oct	0.0	0.6	0.6	0.2	0.2
9.30	UK	Consumer price index	%y-o-y	Oct	4.4	4.5	5.2	5.1	5.1
9.30	UK	Retail price index	%m-o-m	Oct	-0.2	0.6	0.8	0.2	0.1
9.30	UK	Retail price index	%y-o-y	Oct	5.0	5.2	5.6	5.6	5.5
9.30	UK	RPI ex mortgage interests payments	%y-o-y	Oct	5.0	5.3	5.7	5.7	5.7
10.00	Euro area	GDP	%q-o-q, sa	Q3-1st	0.3	0.8	0.2	0.1	0.2
10.00	Euro area	GDP	%y-o-y, sa	Q3-1st	1.9	2.4	1.6	1.3	1.4
10.00	Euro area	Trade balance	EURbn, sa	Sep	-2.9	-3.7	-1.0	n.a.	-1.3
10.00	Germany	ZEW index (economic sentiment)	Index	Nov	-37.6	-43.3	-48.3	-50.5	-52.5
10.00	Italy	Bank of Italy releases public finance supplement		Sep					
Wednesday 16 November									
	Germany	Chancellor Merkel answers 10 questions from YouTube viewers (to record. The first of three interviews to be posted on 18 Nov)							
	Belgium	Trade balance	EURmn	Sep	-190.4	-54.8	-1562.9	n.a.	n.a.
	Portugal	Unemployment rate	%, nsa	Q3	11.1	12.4	12.1	n.a.	n.a.
8.00	Spain	GDP	%q-o-q, sa	Q3-2nd	0.4	0.2	0.0	0.0	n.a.
8.00	Spain	GDP	%y-o-y	Q3-2nd	0.9	0.8	0.8	0.8	n.a.
9.00	Italy	Consumer price index	%y-o-y	Oct-fin	2.8	3.0	3.4	n.a.	3.4
9.00	Italy	HICP inflation	%m-o-m, nsa	Oct-fin	0.4	2.0	0.9	0.9	0.9
9.00	Italy	HICP inflation	%y-o-y	Oct-fin	2.3	3.6	3.8	3.8	3.8
9.30	UK	Jobless claims change	k	Oct	33.7	19.1	17.5	19.0	20.0
9.30	UK	Claimant count rate	%	Oct	4.9	4.9	5.0	5.0	5.1
9.30	UK	LFS unemployment rate (ILO)	%3mma	Sep	7.9	7.9	8.1	8.1	8.2
9.30	UK	Average weekly earnings ex-bonus	%y-o-y, 3mma	Sep	2.3	2.1	1.8	1.6	1.6
9.30	UK	Average weekly earnings inc-bonus	%y-o-y, 3mma	Sep	2.7	2.9	2.8	2.5	2.5
10.00	Euro area	HICP inflation	%m-o-m, nsa	Oct	-0.6	0.2	0.8	0.4	0.3
10.00	Euro area	HICP inflation	%y-o-y	Oct-fin	2.5	2.5	3.0	3.1	3.0
10.00	Euro area	HICP inflation - core	%y-o-y	Oct	1.2	1.2	1.6	1.7	1.6
10.00	Euro area	HICP inflation ex-tobacco	Index, nsa	Oct	112.03	112.23	113.08	113.50	n.a.
10.30	UK	BoE Quarterly Inflation Report							
13.00	Germany	Chancellor Merkel speaks at a retail conference							
13.30	Euro area	Irish PM Kenny and German FM Schaeuble speak on 'Ireland's way to growth' in Berlin							
Thursday 17 November									
8.00	Euro area	German FM Schaeuble and EU Barnier speak at an event in Berlin							
8.30	Netherlands	Unemployment rate	%	Oct	5.3	5.4	5.6	5.6	5.6
9.30	UK	Retail sales (ex-auto fuel)	%m-o-m, sa	Oct	-0.1	-0.4	0.7	0.2	-0.3
9.30	UK	Retail sales (ex-auto fuel)	%y-o-y	Oct	-0.7	-1.1	0.4	0.4	-0.2
9.30	UK	Retail sales (inc-auto fuel)	%m-o-m, sa	Oct	0.0	-0.4	0.6	0.2	-0.2
9.30	UK	Retail sales (inc-auto fuel)	%y-o-y	Oct	-0.5	-0.8	0.6	0.4	-0.1
10.00	Euro area	Construction output	%m-o-m, sa	Sep	-1.1	1.8	0.2	n.a.	n.a.
Friday 18 November									
7.00	Germany	Producer prices	%y-o-y	Oct	5.8	5.5	5.5	n.a.	0.1
8.30	Netherlands	Consumer confidence	Index	Nov	-21	-30	-33	-35	-35
9.00	European Union	Ecofin Budget Council meeting							
9.15	Euro area	ECB Gonzalez-Paramo speaks in Madrid							
9.30	Euro area	ECB Bini-Smaghi speaks in Florence							
15.00	Portugal	Bank of Portugal releases monthly economic indicators report							
Sunday 20 November									
	Spain	General election							

Note: London time.
Source: Bloomberg, Reuters and Nomura Global Economics.

Euro-area industrial production (Monday): We expect euro-area industrial production to decline by 2.5% m-o-m in September given the already known numbers for Germany (-2.9%), France (-1.7%), Italy (-4.8%), Spain (-1.6%) and the Netherlands (-1.2%). However, we should allow for ±0.3pp deviation due to the difference in methodologies used by Eurostat and national statistical offices for seasonal adjustment.

Euro-area Q3 GDP (Tuesday): The euro-area economy is likely to have grown moderately by 0.1% q-o-q in Q3, unchanged from Q1. By country, we expect German economic activity to accelerate in Q3, growing by 0.4% q-o-q from 0.1% in Q2. Although the survey data point to a weaker performance, we see upside risks to this forecast owing to the strong hard data, such as industrial production. However, we see this as payback from the very weak number in Q2 and in our opinion Q4 will register a poor reading. In France, we look for GDP to grow by 0.2% q-o-q (from 0% in Q2), mainly reflecting the rebound in household consumption. And in the Netherlands, we expect GDP to grow by 0.1% q-o-q, further slowing from 0.2% previously.

UK inflation (Tuesday): Our forecast for CPI inflation to ease to 5.1% y-o-y is caused by weak recreation, alcohol and transport prices more than offsetting the support from the final utility price hikes of this round. We do not expect this to be enough to slow RPI inflation from 5.6%, with the index printing at 238.4.

Euro-area Inflation (Wednesday): The October final estimates of German and French inflation have surprised on the upside. Thus we see a possibility that euro-area inflation could be revised up to 3.1% y-o-y, which would be consistent with a 0.4% m-o-m (nsa) increase. On the core side, we expect HICP to have increased by 1.7% y-o-y. Finally, we forecast the HICPxT index to print at 113.50 (nsa).

BoE Inflation Report (Wednesday): We expect the Inflation Report to encourage dovish expectations for monetary policy, but not to pre-commit to further easing. Besides Mervyn King's dovish tone, this would be broadcast by the ribbon chart pointing to a below-50% probability of inflation overshooting the target in the medium term. GDP forecasts are likely to be significantly hacked back, but the lower rate profile and QE2 should stimulate growth further out to a similar pace.

UK labour market report (Wednesday): Activity appears to have deteriorated in October and we expect this to cause the change in jobless claims to rise slightly to 19k. However, we do not expect this to be enough to budge the unemployment rate from 5.0% or indeed for the LFS rate to rise above 8.1% 3mma in September. We also expect a gloomy picture from the wage growth data for this period, with a 2pp slowdown to 1.6% ex-bonuses and 2.5% including them.

UK retail sales (Thursday): We expect sales volumes growth to slow from its September strength to 0.2% m-o-m in October. Our forecast is supported by growth in food store sales, owing to the heavily publicised supermarket price cuts, which counteracts the renewed weakness of household goods sales in our forecast.

Recovery to be driven by reconstruction demand

We expect the economic recovery to continue to be underpinned by post-earthquake reconstruction policies, though the export environment is likely to deteriorate.

Activity: External conditions worsened just as production was returning to normal following the earthquake, and we believe there is an increased possibility for the Japanese economy to enter a soft patch, marked by a slight slowdown through the end of the year. However, we see little evidence of economic conditions rapidly deteriorating, and also believe the passage of a third supplementary budget by the new Noda administration will be positive. We project the economy will remain on a recovery path in 2012 amid benefits from post-quake reconstruction policies.

Inflation: Japan has returned to a deflationary environment, as the CPI was pushed 0.6-0.8 percentage points lower year-on-year owing to August's base-year revision. We expect the core CPI to rise temporarily in H2 2011, but then to fall again. We project consistent core CPI year-on-year growth from mid-2013.

Policy: Japan's Diet has passed a ¥4trn first supplementary budget and a ¥2trn second supplementary budget. We believe a third budget to fund post-earthquake reconstruction measures is likely to be passed by November. The Bank of Japan (BOJ) expanded its asset purchasing program by ¥5trn, the entirety of which has allotted to the purchase of long-term JGBs. With fears of an overseas slowdown unlikely to be assuaged any time soon, and with the yen likely to continue appreciating while these concerns persist, we expect the BOJ to expand the program by a further ¥3-5trn, and extend the maturities of JGBs purchased by the BOJ as an additional easing measure. The timing for further monetary easing depends largely on what happens in the financial markets. Our main scenario assumes that this could happen in Jan-Mar 2012, as the end of Japan's fiscal year approaches.

Risks: Overseas developments constitute the main risks for the economy, in our opinion. In particular, we are concerned about the European sovereign debt crisis deepening and becoming more protracted, waning confidence in US politics and the slowing global economy, all of which could have a negative impact on the Japanese economy by way of financial market turbulence (yen appreciation, stock market losses). A more appreciable slowdown in the US, China and other major overseas economies may put the Japanese economy at risk of falling into recession.

Details of the forecast

%	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**-3.7**	**-2.1**	7.3	2.1	3.6	2.3	1.5	1.1	-0.6	2.5	1.8
Private consumption	**-2.5**	**-0.1**	2.5	1.0	1.2	0.8	1.0	1.0	-0.7	0.9	1.0
Private non res fixed invest	**-5.5**	**-3.6**	3.8	6.5	5.7	3.9	4.7	5.9	0.3	4.9	5.8
Residential fixed invest	**0.9**	**-7.1**	19.8	5.3	4.5	3.8	2.7	3.1	2.9	3.5	4.2
Government consumption	**3.4**	**2.3**	4.4	4.2	3.4	-0.9	1.6	-2.3	2.4	1.8	0.6
Public investment	**-2.8**	**18.3**	-4.3	20.1	27.3	19.6	-13.7	-11.2	-1.4	13.0	-11.7
Exports	**0.0**	**-18.1**	34.9	-2.0	2.6	4.0	5.5	6.7	0.8	4.3	6.7
Imports	**5.8**	**-0.2**	13.2	2.4	-1.2	1.0	4.8	6.3	4.2	2.0	5.2
Contributions to GDP:											
Domestic final sales	**-1.7**	**0.7**	3.1	3.1	3.3	1.7	1.0	0.6	-0.2	2.1	1.1
Inventories	**-1.2**	**0.4**	0.8	-0.4	-0.2	0.1	0.2	0.1	-0.1	-0.1	0.2
Net trade	**-0.8**	**-3.2**	3.4	-0.6	0.5	0.5	0.3	0.4	-0.3	0.5	0.5
Unemployment rate	**4.7**	**4.6**	**4.4**	4.5	4.4	4.3	4.2	4.2	4.6	4.3	4.0
Consumer prices	**-0.5**	**-0.5**	**0.1**	-0.1	-0.2	0.0	-0.4	-0.2	-0.2	-0.2	0.0
Core CPI	**-0.8**	**-0.3**	**0.2**	0.0	-0.1	-0.2	-0.4	-0.2	-0.2	-0.2	0.0
Fiscal balance (fiscal yr, % GDP)									-10.2	-9.5	-10.1
Current account balance (% GDP)									2.1	3.3	4.5
Unsecured overnight call rate	**0-0.10**	**0-0.10**	**0-0.10**	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10
JGB 5-year yield	**0.49**	**0.42**	**0.37**	0.35	0.40	0.45	0.50	0.50	0.35	0.50	0.55
JGB 10-year yield	**1.26**	**1.13**	**1.02**	1.10	1.20	1.25	1.30	1.35	1.10	1.35	1.45
JPY/USD	**83.1**	**80.6**	**76.8**	79.0	80.0	80.0	82.5	85.0	79.0	85.0	90.0

Note: Quarterly real GDP and its contributions are seasonally adjusted annualized rates. Unemployment rate is as a percentage of the labor force. Inflation measures and CY GDP are y-o-y percent changes. Interest rate forecasts are end of period. Fiscal balances are for fiscal year and based on general account. Table reflects data available as of 4 November. All forecasts are modal forecasts (i.e., the single most likely outcome). Numbers in bold are actual values, others forecast. Forecasts for 2011, 2012, and 2013 do not reflect forecast changes in Q3 2011. Figures will be revised after the first preliminary GDP estimate which will be released 14 November.
Source: Cabinet Office, Ministry of Finance, Statistics Bureau, BOJ, and Nomura Global Economics.

The week ahead

We expect the first preliminary estimate of Q3 2011 real GDP to be +7.3% q-o-q annualized, indicating a robust economic recovery, driven by net exports and consumer spending.

Q3 2011 real GDP (first preliminary estimate) (Monday): We estimate that real GDP increased 7.3% q-o-q annualized (+1.8% q-o-q) in Q3 2011. We think the first preliminary GDP estimate will likely demonstrate to the market how Japan's level of economic activity has recovered strongly from its post-quake decline. We attribute the robust recovery chiefly to net exports and consumer spending. We estimate that real exports rebounded by 7.8% q-o-q on the reopening of domestic production facilities. Our estimate of external demand's quarterly contribution to real GDP is 0.7pp. Consumption is likely to have been inflated by replacement demand for TVs with the switchover to digital broadcasts and by a carryover effect from the pickup in consumption through end-June. We think that consumer spending could exceed market expectations as raw material and semi-finished product inventories may have increased sharply in Q3. However, consumer spending could also come in below market projections, given that the Composite Index of Consumption Expenditures was down 0.6% m-o-m in September but up 0.5% q-o-q in Q3. Overall, we think risk that the figure will beat market projections due to growth in inventories is greater, but the amount by which it beats expectations could be comparatively modest. (See *Japan: first preliminary Q3 2011 GDP estimates, solid growth on strong post-quake recovery, we estimate real GDP grew 7.3% q-o-q annualized*, issued on 28 October, for more details.)

BOJ monetary policy meeting (Tuesday & Wednesday): We think the BOJ will leave monetary policy unchanged at the next meeting and that no one in the market expects a change in policy at the meeting either. After the BOJ eased monetary policy at the last meeting, as expected the Japanese government intervened in the forex market and succeeded for a time in establishing a resistance line against yen appreciation at around ¥78. However, with European leaders failing to indicate a solution to the debt crisis, market concern increased and the vicious circle of self-fulfilling prophecy making the problem worse has continued. That positive economic signs have started to emerge in parts of China and the US is good news, but this has not yet reached a point where we can foresee an ending of concern about the strong yen and falling share prices rooted in financial crisis fears stemming from the situation in Europe. We think the BOJ will maintain a wait-and-see stance while the market is going through the current lull. However, our view remains that the BOJ could implement additional easing measures if the financial markets become more uncertain, with, for example, the yen appreciating and share prices falling further. We are looking out for some kind of hint, including in the media, that the BOJ will introduce new, additional monetary policy easing measures, while monitoring senior BOJ officials' views of financial market trends and the European debt crisis.

Monday 14 November		Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
8.50	Real GDP	% q-o-q annlzd	Q3-fir	-2.4	-3.7	-2.1	7.3	5.9
Tuesday 15 November								
	No indicators							
Wednesday 16 November								
	BOJ policy meeting (15-)	%			0-0.1	0-0.1	0-0.1	0-0.1
	BOJ governor's regular press conference							
Thursday 17 November								
	No indicators							
Friday 18 November								
	No indicators							

Note: Tokyo time.
Source: Cabinet Office, Ministry of Economy, Trade, and Industry, BOJ, and Nomura Global Economics.

One and done

The RBA's 25bp cash rate cut in November tweaked monetary conditions to a neutral setting. Barring much weaker global growth, we see little to shift the RBA from neutral until H2 2012.

Activity: We expect 2011 GDP growth of 2.2% following the firm Q2 GDP report and likely quite strong Q3 and Q4 reports too. Growth should accelerate strongly in 2012 (4.6%), partly on a rebound in mining and rural output after the severe weather-related output disruption affecting much of 2011, before settling back to near its long-term trend in 2013 (3.1%). We expect spending by the leveraged household sector to remain relatively cautious, even with borrowing interest rates back to their long-term average through H1 2012 after the RBA's November rate cut. An exponential rise in resource investment underpins our strong base case GDP growth forecast for 2012.

Inflation: Q3 CPI inflation was a touch lower than our 0.7% q-o-q forecast at 0.6%, reducing annual headline inflation marginally to 3.5% y-o-y from 3.6% in Q2. The Q3 underlying inflation readings were low at 0.3% q-o-q, but are subject to revision (average Q2 underlying inflation was revised up to 0.8% q-o-q from 0.6%). The RBA has lowered its 2012 and 2013 inflation forecasts, more in line with its 2-3% target. We are less convinced that inflation will hold lower in 2013 given that strong 2012 growth should renew capacity pressures.

Policy: We believe policymakers cannot entirely ignore medium-term inflation risk, even after the financial market turmoil of late. On our base-case GDP growth forecasts, the government would maintain its mildly restrictive budget course, although there is ample room to adopt expansionary policy if a worse-case global growth scenario develops. As the stronger 2012 growth outlook firms up, we now expect the RBA to reverse the November 25bp rate cut in Q3 2012 and add a 25bp hike to 5.00% in Q4 2012. We see one further 25bp rate hike to 5.25% in 2013. Only in the event that our worse-case global growth view starts to develop would we see a case for the RBA to continue cutting rates further, and even then, further rate cuts would likely be limited given that we have forecast inflation persistently above the top of the RBA's 2-3% target band. The free-floating Australian dollar also provides a buffer to global shocks.

Risks: The current global financial risk flare-up could become much worse, increasing bank funding costs and intensifying deleveraging in Australia's heavily indebted household sector. Any major setback in Chinese growth beyond our current forecasts would also present a downside risk, as would a worsening La Niña. A major and persistent improvement in risk asset sentiment and a renewed surge in commodity prices represent upside risks to growth.

Details of the forecast

% y-o-y growth unless otherwise stated	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP (sa, % q-o-q, annualized)	**-3.5**	**4.7**	6.0	8.0	3.2	4.2	2.7	1.9			
- % q-o-q, sa	**-0.9**	**1.2**	1.5	2.0	0.8	1.1	0.7	0.5			
- % y-o-y	**1.0**	**1.4**	2.6	3.8	5.6	5.4	4.6	3.0	2.2	4.6	3.1
Household consumption	**3.5**	**3.2**	3.3	3.4	3.3	3.0	2.8	2.9	3.3	3.0	3.3
Government (total spending)	**2.0**	**1.2**	1.0	0.5	0.2	0.6	0.9	1.0	1.2	0.7	1.5
Investment (private)	**6.7**	**6.4**	11.5	17.6	19.4	23.7	22.2	21.3	10.6	21.7	6.5
Exports	**-4.4**	**-3.7**	1.3	2.0	13.2	13.9	12.3	10.3	-1.2	12.4	9.5
imports	**9.4**	**10.5**	9.4	10.3	12.8	11.8	15.8	16.5	9.9	14.3	10.5
Contributions to GDP growth (% points):											
Domestic final sales	**3.9**	**3.4**	4.6	5.8	6.3	7.3	7.1	7.1	4.5	7.0	3.7
Inventories and statistical discrepancy	**0.3**	**1.4**	-0.1	0.0	-0.4	-2.0	-1.3	-2.3	0.1	-1.7	0.0
Net trade	**-3.2**	**-3.4**	-1.9	-2.0	-0.3	0.1	-1.2	-1.8	-2.6	-0.7	-0.6
Unemployment rate	**5.0**	**5.0**	**5.2**	5.1	4.9	4.7	4.5	4.4	5.1	4.6	4.3
Employment, 000	**15.3**	**-3.4**	**1.8**	15.0	33.0	33.0	33.0	33.0	7.2	33.0	27.0
Consumer prices	**3.3**	**3.6**	**3.5**	3.6	3.0	3.2	3.7	4.3	3.5	3.6	3.8
Trimmed mean	**2.2**	**2.6**	**2.3**	2.6	2.7	2.7	3.5	3.8	2.4	3.2	3.5
Weighted median	**2.6**	**2.9**	**2.6**	2.8	3.0	3.1	3.9	4.2	2.7	3.6	3.6
Federal deficit (% of GDP) FY end-June									-3.4	-1.5	0.2
Current account deficit (% GDP)									-1.8	-2.3	-2.8
Cash rate	**4.75**	**4.75**	**4.75**	4.50	4.50	4.50	4.75	5.00	4.50	5.00	5.25
90-day bank bill	**4.89**	**4.96**	**4.78**	4.55	4.60	4.60	4.90	5.25	4.55	5.25	5.35
3-year bond	**5.04**	**4.76**	**3.63**	3.80	4.20	4.50	5.00	5.20	3.80	5.20	5.45
10-year bond	**5.50**	**5.21**	**4.25**	4.30	4.70	5.00	5.20	5.30	4.30	5.30	5.60
AUD/USD	**1.03**	**1.07**	**0.98**	0.98	0.98	1.00	1.02	1.05	0.98	1.05	1.00

Note: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. All forecasts are modal forecasts (i.e., the single most likely outcome). Table reflects data available as of 11 November 2011.
Source: Australian Bureau of Statistics, Reserve Bank of Australia and Nomura Global Economics.

China | Economic Outlook

Zhiwei Zhang | Chi Sun

Growth set to slow moderately

Domestic demand helps support a soft landing. Policy has been marginally loosened.

Activity: Real GDP growth moderated to 9.1% y-o-y in Q3 from 9.5% in Q2, partly due to tighter monetary policy. We expect GDP growth to ease further in Q4 to 8.6%, with export growth dropping to 8% y-o-y. The growth rates for industrial production and retail sales dropped to 13.2% and 17.2%, respectively in October, from 13.8% and 17.7% in September, while growth of urban fixed asset investment remained flat at 24.9%. Leading indicators such as the PMI, OECD CLI and trade readings suggest a further soft landing ahead. In particular, housing investment looks set to drop faster in coming months as new floor space starts and sales fell sharply in October.

Inflation: CPI inflation fell from 6.1% y-o-y in September to 5.5% in October mainly on base effects and lower food prices, while PPI inflation fell sharply to 5.0% from 6.5% over the same period. We expect CPI inflation to trend down through Q4 and drop below 5% in November, largely reflecting continued base effects. Over the medium term, we expect CPI inflation to remain structurally high, at 4.8% in 2012 and 4.5% in 2013, driven by rising input costs and wages, utility price deregulation, and loose global liquidity.

Policy: In light of Premier Wen's speech in Tianjin on 25 October, we believe that a marginal policy loosening have started, as the PBC has toned down its liquidity withdrawal through open market operations and money market rates have fallen. However, we believe a major change in policy stance is unlikely to happen soon, with reserve requirements and interest rates left unchanged at least for the rest of 2011. PBC advisor Li Daokui told the International Finance Forum conference on 10 November that "China should not change the direction of [its] monetary policy stance… If loosening policy in the short term brings problems for the medium term, it would be bad for China and the world economy". We expect that policymakers will continue to observe to what extent weakening external demand affects China's economy. The Central Economic Working Conference in December will set the tone for the policy stance for 2012.

Risks: We see two main risks ahead. First, external demand may weaken more than we expect. Second, leading indicators show that housing investments may fall quickly in the coming month. If these factors lead to a sharp downturn of the economy, we expect China may respond again with loose monetary and fiscal policies, but it takes time for these measures to affect the real economy, so we need to be vigilant for the risk of a temporary sharp economic downturn. In the long run, such measures may delay the macroeconomic rebalancing, and raise the risk of a hard landing beyond 2012.

Details of the forecast

% y-o-y growth unless otherwise stated	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**9.7**	**9.5**	**9.1**	8.6	8.2	8.5	8.7	8.7	9.2	8.6	8.4
Consumer prices	**5.1**	**5.7**	**6.3**	5.4	4.2	4.4	5.0	5.4	5.6	4.8	4.5
Core CPI (excl. food & energy)	**2.2**	**2.4**	**2.4**	2.2	2.0	2.8	2.9	3.0	2.3	2.7	2.6
Retail sales (nominal)	**16.3**	**17.0**	**17.3**	16.8	17.3	17.9	18.4	18.9	16.9	18.1	18.8
Urban Fixed-asset investment (nominal, ytd)	**25.0**	**25.6**	**24.9**	23.8	21.0	22.0	23.0	22.0	23.8	22.0	20.1
Industrial production (real)	**14.4**	**13.9**	**13.8**	13.3	12.0	12.7	13.4	13.4	13.9	12.9	12.5
Exports (value)	**26.5**	**22.1**	**20.6**	8.0	8.0	12.0	14.0	15.0	18.6	12.5	11.0
Imports (value)	**32.6**	**23.1**	**24.9**	15.0	15.0	16.0	17.0	17.0	23.4	16.3	16.0
Trade surplus (US$bn)	**-1.0**	**46.7**	**63.8**	41.5	-28.8	35.2	59.1	39.0	151.3	104.5	16.0
Current account (% of GDP)									4.5	4.0	3.5
Fiscal balance (% of GDP)									-1.3	-1.0	-1.2
Net increase in RMB loans (RMBtrn)									7.3	8.0	9.0
1-yr bank lending rate (%)	**6.06**	**6.31**	**6.56**	6.56	6.56	6.56	6.56	6.81	6.56	6.81	7.06
1-yr bank deposit rate (%)	**3.00**	**3.25**	**3.50**	3.50	3.50	3.50	3.75	4.00	3.50	4.00	4.50
Reserve requirement ratio (%)	**20.00**	**21.50**	**21.50**	21.50	21.50	21.50	21.50	21.50	21.50	21.50	21.50
Exchange rate (CNY/USD)	**6.50**	**6.47**	**6.40**	6.33	6.25	6.16	6.10	6.08	6.33	6.08	5.88

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. All forecasts are modal forecasts (i.e., the single most likely outcome). Table reflects data available as of 11 November 2011.
Source: CEIC and Nomura Global Economics.

Tomo Kinoshita | Aman Mohunta

RBI signals the end of its hiking cycle

We expect real GDP growth to remain below potential and inflation to moderate as tight monetary policy and weaker global growth cap demand.

Activity: GDP growth eased to 7.7% y-o-y in Q2 from 7.8% in Q1. Leading indicators suggest that growth will moderate further in H2, as high interest rates weigh on consumer demand and exports demand weaken due to the slowdown in global growth. GDP growth should rebound only slightly in H1 2012, supported by higher fixed investments. We expect GDP growth to rise from 7.3% in 2011 to 7.9% in 2012, making it the second consecutive year of below-potential growth (our estimation is around 8-8.5%). Such a sub-par growth is a necessary outcome to ease supply-side bottlenecks in order to bring down inflation.

Inflation: Headline WPI inflation eased slightly to 9.7% y-o-y in September from 9.8% in August owing to a moderation in food and core inflation. We expect WPI inflation to stay around 9% until November, but then to moderate to around 8% in December owing to weaker domestic and external demand. We expect WPI inflation to fall further to below 7% by March 2012. Our expectation of a slightly negative output gap in 2011-12 and lower commodity prices should keep inflation at around 7.0% y-o-y during 2012-13.

Policy: The Reserve Bank of India (RBI) hiked the repo rate by 25bp to 8.50% on 25 October. Further, its statement indicated that a hike in December is unlikely and that it will stay on hold as long as inflation continues to come down, as the RBI expects. We expect the RBI to be on hold as we also expect inflationary pressures to wane and the growth slowdown to broaden in the coming months. On the fiscal front, rising subsidies and lower revenue should result in a higher fiscal deficit of 5.5% of GDP in FY12 versus the budget estimate of 4.6%. We expect a budget deficit of 4.9% of GDP in FY13 and FY14, above the medium-term target of 4.1% and 3.5%, respectively, leaving very little room for any fiscal policy boost even if external conditions worsen.

Risks: If global conditions continue to deteriorate, we believe exports will be hit badly, and corporate investments will slow on weaker demand expectations. Further depreciation of INR due to capital outflows, would mitigate any positive effects on inflation from falling commodity prices. Other key downside risks include further rate hikes (which are not associated with stronger domestic demand), while a revival of the reform process is the key upside risk.

Details of the forecast

% y-o-y growth unless otherwise stated	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP (sa, % q-o-q, annualized)	**8.1**	**7.3**	5.2	5.7	9.8	9.0	7.2	6.7			
Real GDP	**7.8**	**7.7**	6.9	6.7	7.5	8.1	7.8	8.2	7.3	7.9	8.1
Private consumption	**8.0**	**6.3**	5.4	6.3	7.0	5.1	5.7	6.9	6.5	6.2	7.0
Government consumption	**4.9**	**2.1**	2.7	2.7	3.7	4.1	4.9	3.2	3.1	3.9	6.2
Fixed investment	**0.4**	**7.9**	5.4	8.4	8.6	9.7	9.7	10.0	5.3	9.5	11.1
Exports (goods & services)	**25.0**	**24.3**	23.7	12.0	10.2	7.2	8.9	11.3	21.0	9.4	14.7
Imports (goods & services)	**10.3**	**23.6**	21.1	24.7	11.8	4.6	11.8	12.4	19.9	10.1	13.6
Contributions to GDP (% points)											
Domestic final sales	**5.3**	**9.2**	7.8	10.2	8.1	6.9	8.5	8.4	8.1	8.0	8.2
Inventories	**0.2**	**0.2**	0.2	0.2	0.2	1.0	1.0	0.9	0.2	0.8	0.6
Net trade	**2.3**	**-1.7**	-1.0	-3.7	-0.8	0.2	-1.7	-1.1	-1.0	-0.9	-0.7
Wholesale price index	**9.6**	**9.6**	**9.6**	8.8	7.0	6.2	6.8	7.2	9.4	6.8	7.1
Consumer price index	**8.6**	**8.9**	10.3	9.4	8.6	9.2	7.7	9.2	9.4	8.7	8.4
Current account balance (% GDP)									-2.8	-2.4	-2.6
Fiscal balance (% GDP)									-5.5	-4.9	-4.9
Repo rate (%)	**6.75**	**7.50**	**8.25**	8.50	8.50	8.50	8.50	8.50	8.50	8.50	8.50
Reverse repo rate (%)	**5.75**	**6.50**	**7.25**	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25
Cash reserve ratio (%)	**6.00**	**6.00**	**6.00**	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
10-year bond yield (%)	**8.02**	**8.33**	**8.41**	8.65	8.50	8.40	8.40	8.40	8.65	8.40	8.40
Exchange rate (INR/USD)	**44.7**	**44.7**	**49.2**	49.8	49.0	48.3	47.8	47.2	49.8	47.2	45.6

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. CPI is for industrial workers. Fiscal deficit is for the central government and for fiscal year, eg, 2011 is for the year ending March 2012. Table reflects data available as of 11 November 2011.
Source: CEIC and Nomura Global Economics.

Euben Paracuelles

A more aggressive BI

Bank Indonesia (BI) has room to cut rates further given the high external risks to growth and our expectation for inflation to stay within its 2012 target.

Forecast change: Following the 50bp cut by BI, we revised our end-2011 policy rate forecast to 5.75% from 6.25%, and our end-2012 forecast to 5.5% from 6.0%.

Activity: GDP growth held up well at 6.5% y-o-y in Q3 driven by strong domestic demand, particularly private consumption and investment spending. In addition, and perhaps somewhat surprisingly, net exports contributed 3.3 percentage points to headline growth, with exports rising 18.5% y-o-y, the fastest rate in nearly two years. This helped the current account balance remain positive in Q3, but, in line with robust domestic demand conditions, it has already dropped to USD0.2bn from USD2.1bn in Q1. 2011 GDP growth remains on track for our 6.5% forecast, but, given the external risks, our 7.0% forecast for 2012 looks increasingly optimistic.

Inflation and monetary policy: Bank Indonesia (BI) unexpectedly cut its policy rate by 25bp to 6.5% in its 11 October meeting, and followed it with another 50bp cut on 10 November. The two main reasons for this more aggressive move are: 1) both headline CPI and core inflation surprised to the downside in October, leaving the real policy rate above the BI's estimate for the neutral level of 0.5-1%, and 2) the bigger cut was deemed warranted given the increased downside risks. Indeed, BI reiterated that the cut was "to anticipate a worsening in the global economy." Looking ahead, the manageable inflation environment allows BI to focus on supporting growth amid rising global uncertainty. We think there is scope for another 50bp of easing in the near-term. Even then, the policy stance would still not be too accommodative relative to where the BI sees the neutral level of the real policy rate and the risks to the growth outlook. In parallel to this, BI will likely maintain a highly interventionist stance in FX and bond markets, which are sensitive to a risk-off environment. This should reduce risks of financial market instability and mitigate potential weakening of the IDR from further policy easing.

Fiscal policy: The 2012 budget reduces the deficit to 1.5% of GDP from a revised deficit of 2.1% of GDP this year, which reflects a 16% increase in tax revenues, a 12% reduction in subsidies and a 19% rise in capital spending. There is a heavy emphasis on infrastructure projects, and we think this should accelerate once parliament enacts the land acquisition bill.

Risks: In a worse-case scenario of a recession in the US and euro area, growth in Indonesia is likely to be most resilient among ASEAN given ample fiscal firepower, the policy rate at a level still far from zero, and robust domestic demand. In the financial channels, large foreign holdings of Indonesian bonds and equities leave bond and stock prices vulnerable, but the bond stabilization framework and FX reserves have been utilized to buffer against capital reversals.

Details of the forecast

% y-o-y growth unless otherwise stated	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**6.5**	**1. 6.5**	**2. 6.5**	6.6	6.5	6.8	7.1	7.5	6.5	7.0	7.0
Private consumption	**4.5**	**4.6**	**4.8**	5.0	5.3	5.3	5.3	5.3	4.7	5.3	5.7
Government consumption	**2.8**	**4.5**	**2.5**	3.0	6.0	5.0	4.5	4.5	3.2	4.9	10.0
Gross fixed capital formation	**7.3**	**9.4**	**7.1**	11.0	11.7	12.0	11.9	12.0	8.7	11.9	10.7
Exports (goods & services)	**12.5**	**17.5**	**18.5**	10.7	10.7	11.0	11.5	11.5	14.7	11.2	11.0
Imports (goods & services)	**14.4**	**15.3**	**14.2**	12.4	12.6	12.6	12.6	12.6	14.0	12.6	16.2
Contributions to GDP (% points):											
Domestic final sales	**4.5**	**5.1**	**4.6**	5.9	6.1	6.2	6.2	6.6	5.0	6.3	6.7
Inventories	**0.8**	**1.4**	**0.3**	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0
Net trade (goods & services)	**0.6**	**2.4**	**3.3**	0.6	0.4	0.6	1.0	0.9	1.8	0.7	-0.9
Consumer prices index	**6.8**	**5.9**	**4.7**	5.0	4.8	6.2	6.2	5.9	5.6	5.8	5.3
Exports	**30.6**	**38.3**	**32.8**	13.0	13.0	12.8	3.2	14.6	27.9	10.8	18.2
Imports	**32.0**	**37.8**	**34.5**	20.2	15.6	13.9	7.2	16.7	30.6	13.3	22.3
Merchandise trade balance (US$bn)	**8.7**	**9.6**	**9.6**	7.8	8.8	10.4	8.2	8.0	35.7	35.3	34.1
Current account balance (% of GDP)	**1.1**	**0.2**	**0.1**	-0.2	0.9	0.4	-0.5	-0.1	0.3	0.2	0.0
Fiscal Balance (% of GDP)									-1.7	-1.6	-1.4
Bank Indonesia rate (%)	**6.75**	**6.75**	**6.75**	5.75	5.50	5.50	5.50	5.50	5.75	5.50	6.00
Exchange rate (IDR/USD)	**8708**	**8591**	**8950**	9050	8900	8750	8650	8500	9050	8500	8200

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. All forecasts are modal (i.e., the single most likely outcome). Table reflects data available as of 11 November 2011.
Source: CEIC and Nomura Global Economics.

South Korea | Economic Outlook

Young Sun Kwon

High beta

We expect GDP growth to underperform the global average in 2011, but outperform in 2012 as a weaker KRW/JPY and domestic demand related to elections should support growth strongly.

Forecast change: We pushed back our call for the next 25bp hike from February to July 2012.

Activity: GDP growth slowed from 0.9% (sa) q-o-q in Q2 to 0.7% in Q3 as solid exports and construction investment failed to offset weaker consumption, business investment and inventory run-down. Going forward, the negative impact from the August-September global market sell-off will likely impact Q4 GDP, and we now expect a mere 0.4% gain. In 2012, however, we expect a modest global demand recovery and a sizable fiscal stimulus (ahead of the general election in April and the presidential election in December). Also, the weaker KRW/JPY will likely boost Korean exporters' global market share through export price competitiveness. All in all, we expect Korea's GDP growth to slow to 3.5% (versus global GDP growth of 3.9%) in 2011 before rising to 5.0% (versus global GDP growth of 4.1%) in 2012.

Inflation: We expect CPI inflation to slow modestly in Q4 and 2012 as negative wage growth, lower oil prices and KRW movements (which should continue to weaken in Q4, but strengthen from Q1 2012 onward) will likely put downward pressure on inflation. We forecast CPI inflation to slow to 3.5% in 2012 from 4.2% in 2011.

Policy: We expect the BOK's next move to be a 25bp hike in July 2012, – when we see real policy rates turning positive. We believe the BOK is likely to pause ahead of the presidential election in December 2012 and deliver a total of 50bp of hikes in 2013.

Risks: Korea's economy is still very open: exports made up 52% of GDP in 2010; the external debt to GDP ratio has fallen (from 48% in 2009 to 37% in 2010) but is still relatively high; and it is one of Asia's largest net importers of oil (6.3% of GDP in 2010). As such, the economy is vulnerable to sudden changes in global economic conditions and financial markets. We judge that a number of the policy measures announced after the 26 October EU summit should reduce the downside risks to our outlook, but Greek domestic politics are adding more uncertainty. We believe that large FX reserves (USD303bn in September 2011), a flexible exchange rate regime, room to cut rates and a sound fiscal position should provide a buffer to further external deterioration. On North Korea, we view a major escalation of geopolitical tensions as a low probability for now, but that could rise as the presidential election in December 2012 draws nearer.

Details of the forecast

% y-o-y growth unless otherwise stated	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP (sa, % q-o-q, annualized)	**5.4**	**3.6**	**3.0**	1.6	6.1	6.1	7.0	5.7			
Real GDP (sa, % q-o-q)	**1.3**	**0.9**	**0.7**	0.4	1.5	1.8	1.7	1.4			
Real GDP	**4.2**	**3.4**	**3.4**	3.4	3.6	4.5	5.5	6.6	3.5	5.0	4.0
Private consumption	**2.8**	**3.0**	**2.2**	2.3	2.9	4.0	4.5	4.6	2.6	4.0	3.1
Government consumption	**1.7**	**2.1**	**3.4**	5.1	5.0	6.3	6.4	6.1	3.0	6.0	4.6
Business investment	**11.7**	**7.5**	**1.4**	2.8	5.0	2.1	5.6	9.3	5.6	5.5	7.4
Construction investment	**-11.9**	**-6.8**	**-4.2**	-2.7	5.4	5.8	4.6	4.9	-6.6	5.2	4.1
Exports (goods & services)	**16.8**	**9.6**	**9.4**	7.7	7.0	8.8	8.8	10.9	10.7	8.9	9.3
Imports (goods & services)	**10.8**	**7.9**	**6.4**	7.5	8.9	8.6	9.3	10.9	8.1	9.4	10.9
Contributions to GDP growth (% points):											
Domestic final sales	**1.2**	**1.2**	**1.1**	2.0	4.9	4.3	4.7	5.1	0.8	4.5	3.9
Inventories	**-0.1**	**0.7**	**0.5**	0.6	-1.0	-0.7	0.2	0.5	0.9	0.0	0.0
Net trade (goods & services)	**3.1**	**1.4**	**1.8**	0.8	-0.3	0.9	0.5	1.0	1.9	0.5	0.1
Unemployment rate (sa, %)	**3.9**	**3.6**	**3.5**	3.4	3.4	3.4	3.4	3.4	3.6	3.4	3.4
Consumer prices	**4.5**	**4.2**	**4.8**	4.4	3.9	4.2	3.5	3.3	4.2	3.5	3.0
Current account balance (% of GDP)									2.0	1.3	0.3
Fiscal balance (% of GDP)									0.1	-0.3	0.2
Fiscal balance ex-social security (% of GDP)									-1.0	-1.5	-1.0
Money supply (M2)	**5.3**	**5.0**	6.0	6.5	7.0	7.5	8.0	8.5	5.7	8.0	7.0
House prices (% q-o-q)	**2.3**	**2.0**	**1.5**	0.2	1.0	1.0	0.5	0.5	6.0	3.0	2.0
BOK official base rate (%)	**3.00**	**3.25**	**3.25**	3.25	3.25	3.25	3.50	3.50	3.25	3.50	4.00
3-year T-bond yield (%)	**3.74**	**3.77**	**3.56**	3.50	3.50	3.50	3.75	3.75	3.50	3.75	4.00
5-year T-bond yield (%)	**4.12**	**4.01**	**3.67**	3.75	3.75	3.75	4.00	4.00	3.75	4.00	4.00
Exchange rate (KRW/USD)*	**1097**	**1068**	**1178**	1195	1160	1140	1120	1100	1195	1100	1050

Notes: Numbers in bold are actual values; others forecast. Interest rate and currency forecasts are end of period; other measures are period average. All forecasts are modal forecasts (i.e., the single most likely outcome). Table reflects data as of 11 November 2011.
Source: Bank of Korea, CEIC and Nomura Global Economics.

The week ahead

We expect Q3 GDP growth in Malaysia to increase; WPI inflation in India to moderate slightly and NODX growth in Singapore to decline further.

Activity: In Malaysia, we expect GDP growth in Q3 to rise due to robust exports growth and a bounce-back from the supply chain disruption caused by the Japan earthquake, while in Singapore we estimate that the actual Q3 GDP may be slightly higher than flash estimates, given the higher-than-expected industrial production print in September. In the Philippines, we expect remittances to remain resilient.

Monetary: In India, we expect WPI inflation to moderate slightly on the back of a reduction in prices of non-food components, even as food inflation is likely to remain elevated. In Australia, we expect annual wages growth to fall slightly to 3.7% y-o-y in Q3, reflecting a lack of progress in public sector wage negotiations.

External: In Singapore, we expect non-oil domestic exports in October to decline further, although, based on the bounce back in electronics PMI, that decline may be limited. In Malaysia, we expect the current account balance for Q3 to remain in surplus.

Sometime in the week			Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	Singapore	Real GDP (final)	% y-o-y	Q3	12.0	9.3	1.0	6.2	n.a.
	Singapore	Real GDP (final)	% q-o-q, saar	Q3	3.9	27.2	-6.3	2.9	n.a.
	S. Korea	Department store sales	% y-o-y	Oct	8.5	8.3	6.5	7.0	n.a.
Monday 14 November									
14.30	India	Wholesale price index	% y-o-y	Oct	9.4	9.8	9.7	9.6	9.6
Tuesday 15 November									
	Philippines	Remittance from aboard	% y-o-y	Sep	7.0	6.1	11.1	9.5	n.a.
05.00	S. Korea	Export price	% y-o-y	Oct	-1.3	1.8	5.8	3.0	n.a.
05.00	S. Korea	Import price	% y-o-y	Oct	9.8	10.0	14.0	10.0	n.a.
08.30	Australia	Reserve Bank's Board October minutes							
13.00	Singapore	Retail sales (value)	% y-o-y	Sep	11.3	10.7	3.3	3.8	3.0
Wednesday 16 November									
08.30	Australia	Wage cost index	% y-o-y	Q3	3.9	3.9	3.8	3.7	3.8
Thursday 17 November									
08.30	Singapore	Non-oil domestic exports	% y-o-y	Oct	-2.9	3.9	-4.5	-6.3	-7.7
16.30	Hong Kong	Unemployment rate	% sa	Oct	3.4	3.2	3.2	3.2	3.2
Friday 18 November									
	Malaysia	Current account balance	MYRbn	Q3	23.8	25.9	23.4	23.4	n.a.
18.00	Malaysia	Real GDP	% y-o-y	Q3	4.8	4.9	4.0	4.8	4.6

Note: Hong Kong times.
Source: Bloomberg, Reuters and Nomura Global Economics.

Tony Volpon

A new policy regime

Policymakers are aiming to target growth, inflation and the exchange rate simultaneously. The new framework will likely lead to lower growth potential, higher inflation and a weaker currency.

Activity: After posting 7.5% growth in 2010, the Brazilian economy is experiencing a broad-based slowdown, and we expect it to expand by only 3.1% this year. After raising rates at the beginning of the year, fearing a greater growth slowdown, the central bank surprised markets and slashed the Selic policy rate by 50bp in August, with another 50bp cut in October. We expect more cuts ahead with Selic reaching 9.5% by Q2 2012, as policymakers, with a very negative view of the global outlook, are determined to boost economic growth, even at the cost of higher inflation. We expect the easing of monetary policy to boost growth to 3.6% in 2012,. As inflation threatens to go above the top of the current band, we think policy rates will have to rise back to the 11.00% region.

Inflation: Inflation has been elevated throughout 2011, running at 7.31% y-o-y as of September, above the 6.5% upper bound of the target range for six straight months. Non-tradable goods inflation is running close to 8%, owing partly to the buoyant labor market as unemployment has been hitting several record lows this year. Commodity prices, especially food prices, have remained high, adding further pressure to inflation. As policymakers appear to be targeting inflation below the top of the band (6.5%), instead of the centre (4.5%), inflation expectations should gradually drift up towards the 6-6.5% range. In the light of recent pressure on food and transport prices, we revised our end-2011 inflation forecasts to 6.55% from 6.25%. Our end-2012 inflation projection, taking into account a de-anchoring of inflation expectations from the centre of the current target, rises to 6.15%.

Policy: In our view, policymakers are attempting to operate a new economic regime with three targets – keeping growth above 3.5%, keeping inflation below the top of the current band (6.5%), and keeping the exchange rate from appreciating further. More discretion and non-market-based measures will be employed in the course of policy execution, leading to less transparency and more uncertainty for overall policymaking, which will lower potential growth.

Risks: Given a more complex and discretionary policy framework that seems to have multiple targets, policy uncertainty is today higher in Brazil. We believe the multiple-targeting framework will lead to a "stop-and-go" monetary policy, with inflation risks higher.

Details of the forecast

% y-o-y change unless noted	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**4.2**	**3.1**	2.1	2.9	3.2	2.9	4.5	3.5	3.1	3.6	3.8
Personal consumption	**5.9**	**5.5**	1.9	2.9	2.7	3.5	4.5	3.7	3.9	3.2	4.3
Fixed investment	**8.8**	**5.9**	0.1	1.1	2.9	3.9	5.4	4.3	3.8	4.1	4.0
Government expenditure	**2.1**	**2.5**	4.0	3.7	6.7	4.3	3.3	1.4	3.1	3.8	2.2
Exports	**4.3**	**6.0**	4.4	3.5	6.5	2.0	1.4	1.9	1.9	3.2	1.9
Imports	**13.1**	**14.6**	4.9	4.9	8.1	3.6	3.6	4.6	9.0	4.9	2.0
Growth of GDP components:											
Industry	**3.5**	**1.7**	3.1	3.4	2.3	2.0	2.0	1.3	2.9	1.9	2.9
Agriculture	**3.1**	**0.1**	6.7	11.9	8.7	6.6	-11.2	-13.2	4.6	-1.2	3.2
Services	**4.0**	**3.5**	3.6	3.5	3.7	4.1	3.7	3.6	3.6	4.4	4.1
IPCA (consumer prices)	**6.30**	**6.71**	**7.31**	6.55	6.10	6.05	6.12	6.15	6.55	6.15	6.00
IGPM (wholesale prices)	**10.95**	**8.65**	**7.46**	6.85	7.41	7.12	6.80	6.49	6.85	6.49	6.00
Trade balance (US$ billion)	**20**	**18**	**19**	15	6	2	2	1	15	1	0
Current account (% GDP)									-2.5	-3.0	-3.0
Fiscal balance (% GDP)									-2.0	-2.0	-2.0
Net public debt (% GDP)									39.0	36.0	35.0
Selic %	**11.75**	**12.25**	**12.00**	11.00	10.00	9.50	9.50	11.00	11.00	11.00	12.00
BRL/USD	**1.63**	**1.56**	**1.88**	1.75	1.73	1.71	1.68	1.65	1.75	1.65	1.55

Notes: Annual forecasts for GDP and its components are year-over-year average growth rates. Annual CPI forecasts are year-on-year changes for Q4. Trade data are a 12-month sum. Interest rate and currency forecasts are end of period. GDP components do not include taxes. Numbers in bold are actual values, others forecast. Table reflects data available as of 11 November 2011.
Source: Nomura Global Economics.

Growth supported by domestic demand

With exports to the US decelerating, growth is increasingly supported by domestic demand. A weaker MXN has relaxed monetary conditions. We expect the first rate hike in Q4 2012.

Activity: The Mexican economy is on track to expand at potential, which we estimate at 3.0%, in the remainder of the year and in 2012. However, there is significant risk to growth associated with an outlook of decelerating economic activity in the US and the possibility of a recession in Europe, as these are Mexico's largest trade partners. On the positive side, domestic demand in Mexico has finally started to pick up, evidenced by strong private consumption and investment. Consumption has been supported by credit and a stabilization of remittances from workers in the US. In addition the turbulence in manufacturing activity, due to the supply-chain disruptions after the earthquake in Japan, dissipated by Q3 2011.

Inflation: We expect inflation to be above the 3.0% target but below the 4% upper bound of the target band throughout 2012. While the labor market continues to indicate that there is slack in the economy, our estimation is that the output gap has already closed. The combination of MXN weakness and a positive, albeit small, output gap, will put upward pressure on inflation. Gasoline prices, expanding at 10% y-o-y will be another source of inflation pressure.

Policy: Under our base case scenario, we expect the central bank of Mexico (Banxico) to initiate a very gradual and short monetary policy tightening cycle sometime in H2 2012. However, if the US enters a severe recession then Banxico could cut its policy rate. The MXN depreciation has eased monetary conditions, allowing Banxico to avoid a policy rate cut from the current 4.5% level, a historical low. In fact, we forecast the MXN to remain under pressure and above 13 throughout 2012 due to a complicated external backdrop. Unlike monetary policy, there is little degree of freedom in fiscal policy, as economic contraction and falling oil prices would severely limit government revenues. Therefore, similar to 2008, we would expect the government to limit spending and the fiscal deficit to widen to 2.5% of GDP, which is in line with the approved 2012 budget.

Risks: The main risk to Mexico is a double-dip recession in the US economy. In terms of inflation, we see the following risks to our call: (1) rising commodity prices; (2) increases in gasoline prices; and (3) a sizable depreciation of the exchange rate.

Details of the forecast

% y-o-y change unless noted	1Q11	2Q11	3Q11	4Q11	1Q11	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**4.6**	**3.3**	3.3	3.1	3.3	3.0	2.9	3.0	3.7	3.0	3.2
Personal consumption	**4.9**	**6.2**	1.6	3.3	2.9	2.0	2.4	2.8	3.9	2.5	3.5
Fixed investment	**7.7**	**7.4**	5.2	4.5	4.6	5.2	4.5	3.9	6.1	4.5	4.0
Government expenditure	**1.3**	**0.7**	2.3	3.5	3.8	3.5	3.4	3.3	2.0	3.5	2.8
Exports	**14.1**	**12.2**	12.6	13.8	11.7	9.7	10.5	11.2	13.1	10.8	5.0
Imports	**10.9**	**11.3**	11.4	16.5	15.6	13.1	11.5	10.4	12.6	12.5	5.0
Contributions to GDP (pp):											
Industry	**1.4**	**1.0**	1.0	0.9	1.0	0.9	0.8	0.9	1.1	0.9	0.9
Agriculture	**0.2**	**-0.1**	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Services	**3.0**	**2.3**	2.1	2.0	2.1	1.9	1.8	1.9	2.4	1.9	2.0
CPI	**3.04**	**3.28**	3.79	3.89	3.95	3.90	3.94	3.97	3.89	3.97	3.70
Trade balance (US$ billion)	**19.1**	**14.3**	-5.0	-5.0	-4.0	-4.0	-4.1	-3.9	-18.0	-12.0	-15.0
Current account (% GDP)									-0.9	-1.5	-1.5
Fiscal balance (% GDP)									-2.5	-2.0	-2.0
Gross public debt (% GDP)									34.0	34.0	32.0
Overnight Rate %	**4.50**	**4.50**	**4.50**	4.50	4.50	4.50	4.50	5.00	4.50	5.00	6.50
USD/MXN	**11.90**	**11.71**	**13.90**	13.50	13.45	13.30	13.15	13.00	13.50	13.00	12.80

Notes: Annual forecasts for GDP and its components are year-over-year average growth rates. Annual CPI forecasts are year-over-year changes for Q4. Trade data are period sums. Interest rate and currency forecasts are end of period. Contributions to GDP do not include taxes. Numbers in bold are actual values, others forecast. Table reflects data available as of 10 November 2011.
Source: Nomura Global Economics.

Oil no longer propelling the economy

This year's focus is on year-end parliamentary elections and the candidates for the presidential race. WTO accession now seems possible before the end of 2011.

Activity: The rise in oil prices in H1 2011 failed to lift GDP growth above 4%. Moreover, GDP growth decelerated to 3.4% y-o-y in Q2 vs 4.1% y-o-y in Q1 despite the average Brent price of $117/bbl in Q2. Consumer confidence is improving because of growing real wages; this has translated into rapidly growing retail sales. The government accepts that the economy's development is being hindered by the high level of state ownership, and has announced an expansion of its privatisation programme for 2012-17. It is now planning to sell controlling stakes in a few state-owned flagship enterprises during this period. The 2012 budget assumes an average Urals oil price of $100/bbl; the government is again planning to channel some of its windfall oil revenues into the Reserve Fund in early 2012. Next year's budget is expansionary; on top of annual pension hikes, which have become traditional during Vladimir Putin's rule, it envisages a 30% hike in teachers' salaries and a two- to three-fold increase in payments to the military. This should support household consumption. Companies have been hit by the increase in the effective rate on social tax from 26% to 34% in January this year; a partial reversal of the tax hike has now been pencilled in for 2012-14. Net capital outflows this year are likely to exceed $60bn, and these may be partly explained by uncertainty on future economic and tax policy.

Inflation: Headline inflation has fallen to 7.2% y-o-y in September; positive base effects should help it fall into the target range of 6-7% y-o-y by year-end. Inflationary pressures have picked up in Q4 owing to the seasonal effects and the substantial rouble weakening in August-September. On the other hand, the government has decided to postpone regulated utility tariff hikes from January 2012 to mid-2012. This may help headline inflation to remain at historical lows, within a 5-7% range in H1 2012; however, we expect it to return to the 7-8% range in mid-2012. Further pre-election fiscal loosening, protracted rouble weakness and a poor harvest next year are the main risks to this forecast.

Policy: With falling food and commodity prices and the planned shift in the timing of the utility tariff hikes, it is increasingly likely rate hikes will be postponed until the late summer of 2012. The CBR is gradually moving towards inflation targeting and the rouble trading band will likely be widened further next year. The budget will now be balanced if the Urals oil price averages $115/bbl next year following years of fiscal expansion.

Politics: Although parliamentary elections are due at the end of 2011, the most interesting political question this year has already been answered. Vladimir Putin will again run in the presidential election, which is due to take place in early 2012, and we think he should win with a substantial margin. He has already announced his intention to appoint Dmitry Medvedev his prime minister. Because of the weakness of the opposition and the high (7%) threshold for entering the Duma, we think the ruling party, United Russia, will likely retain a majority in the Duma.

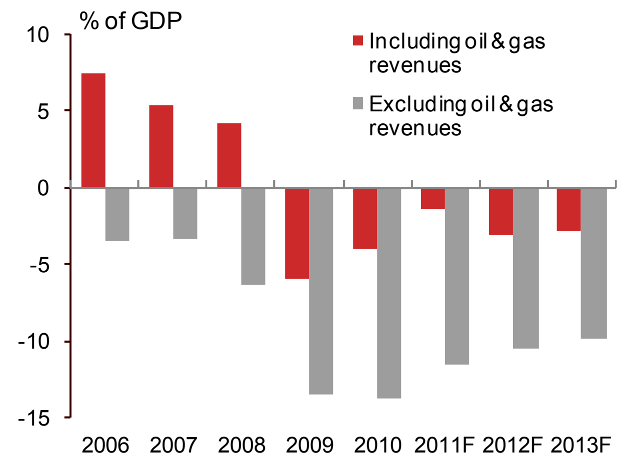
Figure 1. Details of the forecast

	2010	2011	2012	2013
Real GDP % y-o-y	**4.0**	4.2	3.6	3.4
Contributions to GDP (pp)				
Consumption	**3.6**	1.9	2.9	1.6
Gross investment	**1.2**	1.0	1.2	1.7
Net exports	**-4.3**	-0.5	-3.7	0.9
CPI % y-o-y **	**6.9**	8.5	7.0	6.7
Federal budget % GDP	**-4.0**	-0.1	-1.7	-1.6
Current account % GDP	**5.0**	5.1	4.1	1.6
FX reserves, gross USD bn	**479**	515	564	578
CRB policy rate %*	**7.75**	8.25	8.75	7.50
USDRUB, end of period	**30.53**	30.84	30.37	32.31
RUB Basket***	**35.17**	35.00	35.08	37.50

*End of period, **Period average, Bold is actual data.
***45% EURRUB and 55% USDRUB

Source: Nomura Global Economics.

Figure 2. Federal budget balance, official fiscal projections



Source: Russian Finance Ministry, Nomura Global Economics.

More fragile than expected

The domestic recovery has proved to be much more fragile than expected and is threatened further by weakening export demand. Rate hikes now look unlikely before end-2012.

Activity: South Africa is having a surprisingly fragile, spluttering recovery. We look for growth of 3.1% in 2011 and 3.4% in 2012 after 2.8% in 2010. The spurt in exports in the past year, led by Asian demand, is petering out as momentum slows in Asia and is being augmented by a wider global slump, though the manufacturing sector has remained robust despite the currency being 25% overvalued. The sector has been helped by a positive terms of trade shock. We do not expect a recession mainly due to a renewed spurt in infrastructure investment, government spending on its jobs agenda and some pent up demand. Corporates are still deleveraging and not investing and household balance sheets remain constrained by high leverage. Households will also be constrained by a still weak labour market – jobs growth is recovering slowly as productivity increases and businesses continue to lay off staff and this is countering high real wage growth. Overall we see the output gap only being closed by mid-2012.

Currency: The government took action to weaken the rand, relaxing exchange controls and accumulating FX deposits. Risk aversion and some portfolio outflows are now serving to weaker the currency further, but the prospect of further G7 easing means we see strength into year end.

Inflation and rates: More fragile domestic demand suggests second-round and demand-led inflationary pressures are unlikely to materialise until H2 next year. Add to this lower commodity prices and that the rand could maintain its strength (it has been remarkably well behaved recently), and overall inflationary pressures look less concerning. We still see inflation breaching target in December this year but then coming back deeper within target before moving up and oscillating around the 6% level through H2 next year, but not meaningfully breaching. In this environment with increasing growth concerns internally and external growth risks, as well as lower commodity prices and the reduced threat of inflationary pressures we believe the MPC will keep rates on hold until Q4 next year. Although in our opinion they *should* cut rates in this environment, we believe they will be cautious about over stimulating the economy, about expectations and feel happy keep rates at current record lows.

Politics and fiscal: At the local elections in May the ANC lost ground to the DA. Although the proportion of votes lost was small it has greatly concerned the ANC. We now expect the party to concentrate on its developmental state agenda, which will require additional spending. National Health Insurance, recently announced, is the most costly in short term and uncertain in the long run. As such we think the government's "long-run deficit" comfort zone has moved from 3% to 3.5% of GDP to 4% to 4.5% GDP. Currently, policy risk is key, in particular the formation of a new politicised FDI process under Minister Patel. Also mine and bank nationalisation and land redistribution are a major focus owing to pressure from the ANC Youth League. Although we strongly believe this pressure will not turn into policy, we are concerned about potential increased government involvement in these areas. The major sovereign risk event comes next year, with the ANC's elective conference at which Jacob Zuma may be forced out.

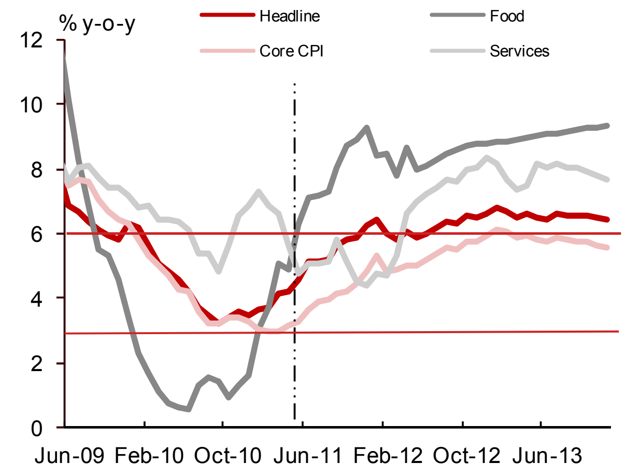
Figure 1. Details of the forecast

	2010	2011	2012	2013
Real GDP % y-o-y	**2.8**	3.1	3.4	4.0
Current account % GDP	**-2.8**	-3.8	-4.5	-5.5
PSCE % y-o-y*	**5.5**	6.5	9.6	11.3
Fiscal balance % GDP	**-4.9**	-5.7	-6.1	-5.2
FX reserves, gross USD bn*	**43.8**	51.4	51.5	51.3
CPI % y-o-y *	**3.5**	6.4	5.6	5.9
CPI % y-o-y **	**4.3**	5.0	5.8	5.7
Manufacturing output % y-o-y	**4.9**	2.3	6.1	4.2
Retail sales output % y-o-y	**5.1**	5.1	4.6	4.3
SARB policy rate %*	**5.50**	5.50	6.00	8.00
EURZAR*	**8.9**	9.0	9.8	11.5
USDZAR*	**6.63**	6.90	7.25	8.50

*End of period, **Period average, Bold is actual data
PSCE- Private sector credit extentions

Source: Nomura Global Economics.

Figure 2. CPI and underlying components



Source: Nomura Global Economics.

Rebalancing has started

Loose monetary and fiscal policy has supported the continuation of domestic demand-led growth. Decelerating global activity is not necessarily bad for Turkey, which has started its rebalancing.

Activity: According to our forecasts Turkey came out of recession with relatively strong growth of 8.9% in 2010. We expect 2011 growth to remain above-potential at 6.7% (2 percentage points lower than we initially expected), driven largely by continued double-digit growth in private investment. Private consumption's contribution should moderate reducing net imports' negative contribution to GDP. We think risks are on the upside owing to the strong policy response from construction and public investment ahead of the elections. Furthermore, our scenarios do not assume significant stock building, another upside risk for our base case. Our calculations suggest the output gap probably closed during Q4 2010. Strong upside surprises in Q1 and Q2 growth (11.6% and 8.8% y-o-y respectively) suggest that the Turkish economy was overheating. We expect a deceleration in activity in Q3 and Q4.

Inflation: Food, energy and core inflation are likely to move higher in 2011 which would still leave headline inflation above the 5.5% target at around 7.5% y-o-y. With pricing power rising, real wages together with lower unemployment all point to risks on the upside for core inflation. There are signs of pricing power in service price inflation. Currently, six of the nine core series are at or above 7% y-o-y.

Policy: Monetary policy remains loose and fiscal policy has tightened. The postmodern approach of policy rate cuts and macro prudential hikes have paused and the TCMB is reversing quantitative tightening through reducing reserve requirements. The TCMB has still not signalled a return to orthodoxy yet. Nevertheless, because of the widening divergence between core inflation and the inflation target, the latest 50bp cut was probably the last one with rates currently standing at 5.75%. Concerns about the health of the global economy appear to be the main reason behind the latest move. Fiscal policy is starting to help the monetary authorities, as the government has decided to utilise recent outperformance on the revenue side as a buffer for rainy days. The risks are for stronger fiscal performance.

Risks: Faster growth and terms-of-trade shocks (oil prices) are no longer the main risks as the global economy is showing signs of slowing. The bigger risk is sudden stops of capital inflows, and the TCMB's recent efforts to counter currency weakness are proving ineffective. In that scenario, inflation could easily reach double digits with unwarranted currency weakness resulting in a sharp fall in consumer confidence. This is, however, not our base case. The political climate looks stable. We think the risks of capital controls being implemented, should the currency appreciate rapidly, are extremely low.

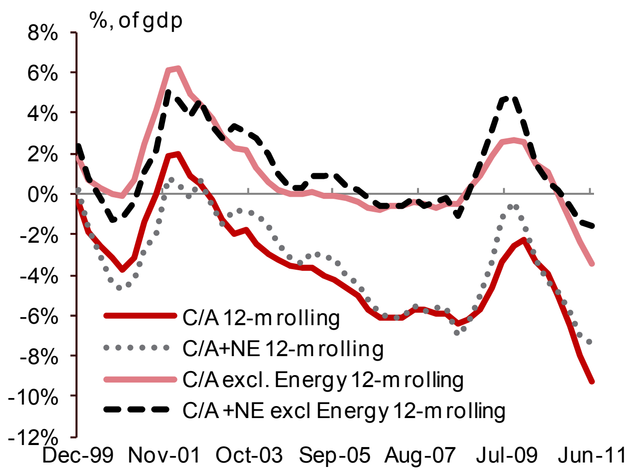
Figure 1. Details of the forecast

	2010	2011	2012	2013
Real GDP % y-o-y	**8.9**	6.7	4.0	5.0
CPI % y-o-y *	**6.4**	9.0	7.7	6.5
CPI % y-o-y **	**8.6**	7.5	8.3	7.1
Budget balance % GDP	**-3.6**	-1.0	-2.5	-3.5
Current account % GDP	-6.1	-8.8	-7.0	-6.0
TCMB policy rate %*	**6.50**	5.75	7.00	8.00
USDTRY*	**1.54**	1.70	1.60	1.55

*End of period; **Period average; Bold is actual data

Source: Nomura Global Economics.

Figure 2. Current account



Source: TCMB, Nomura Global Economics.

Rest of EEMEA | Economic Outlook

Peter Attard Montalto

Hungary: Government sacrificing growth for aggressive fiscal consolidation

We believe the 2011-13 policy mix will not encourage growth and is ultimately politically unsustainable

	2010	2011	2012	2013
Real GDP % y-o-y	**1.2**	1.9	0.9	1.5
Nominal GDP USD bn	**130.5**	130.7	146.1	156.5
Current account % GDP	**0.5**	1.5	0.8	0.3
Fiscal balance % GDP	**-4.2**	1.8	-3.5	-3.2
CPI % y-o-y *	**4.7**	3.7	5.0	3.6
CPI % y-o-y **	**4.9**	3.8	4.8	3.7
Population mn	**9.88**	9.86	9.84	9.82
Unemployment rate %	**10.8**	10.5	10.0	9.5
Reserves EUR bn ***	**32.3**	31.3	29.8	26.1
External debt % GDP***	**116.6**	101.1	96.8	93.3
Public debt % GDP	**80.9**	75.2	73.9	71.5
MNB policy rate %*	**5.75**	6.00	6.00	6.00
EURHUF*	**279**	290	285	280

*End of period, **Period average, Bold is actual data
***Includes IMF/EU funds
Source: CSO, CNB, Nomura Global Economics.

- The economic recovery has almost entirely been driven by exports. Domestic demand has remained lacklustre owing to the overhang from FX loans, a lack of bank lending because of the banking tax and policy uncertainty leading to subdued FDI. As the external dynamic becomes weaker growth should fall back.
- We think the government will continue to implement aggressively its reform plan despite lower growth in 2012. Although many of the core policies are good, many are dependent on growth having a full effect. Because of pension reforms, the government should achieve a fiscal surplus in 2011 and reduce debt over the next two years, but we do not see this as politically sustainable over the medium run.
- Inflation is under control because of the lack of core inflation pressures. However, the MPC believes it cannot cut, because of risk premia concerns. As such we see rates are on hold through end-2013.

Poland: Slower growth but still outperforming

Fiscal policy can remain on track but hikes now look unlikely with the next move probably a cut.

	2010	2011	2012	2013
Real GDP % y-o-y	**3.8**	4.2	3.9	4.0
Nominal GDP USD bn	**447.0**	434.5	526.9	593.1
Current account % GDP	**-1.8**	-6.5	-7.8	-7.2
Fiscal balance % GDP	**-7.8**	-5.0	-3.5	-3.0
CPI % y-o-y *	**3.1**	4.0	3.2	2.8
CPI % y-o-y **	**2.6**	4.1	3.4	2.8
Population mn	**38.0**	38.0	37.9	37.8
Unemployment rate %	**12.3**	11.5	11.0	10.5
Reserves EUR bn **	**70.0**	72.0	71.5	72.5
External debt % GDP	**67.2**	65.6	65.3	64.7
Public debt % GDP	**53.3**	54.3	53.8	53.1
NBP policy rate %*	**3.50**	4.50	4.50	4.00
EURPLN*	**3.96**	4.35	4.00	3.80

*End of period, **Period average, Bold is actual data
Source: CSOP, NBP, Nomura Global Economics

- Poland should maintain its growth momentum through 2012 despite the weaker external dynamic as it does not suffer the same household balance sheet impairment, its economy is more closed, disposable income has grown and loose policy should continue to stimulate.
- Demand pressures could keep core inflationary pressures elevated into Q1 2012, but as non-core pressures fall back we see inflation returning to target by end-2012. As such we think the MPC will look to this longer term, be more concerned about potential growth contagion and keep rates on hold. Hikes are possible if the currency weakens much further from here.
- Politics and complacency on growth have led to fiscal slippage in 2009 and 2010, though the threat of breaching the 55% of GDP public debt limit has abated with pension reforms. After October's parliamentary elections more meaningful steps on fiscal consolidation may occur, and we see Poland returning to a sustainable -3% of GDP by 2013.

Czech Republic: Fiscal drag, political drag

The fiscally hawkish coalition has been politicking; the CNB shouldn't hike till end next year

	2010	2011	2012	2013
Real GDP % y-o-y	**2.3**	1.9	2.1	2.7
Nominal GDP USD bn	**191.7**	201.3	224.2	239.7
Current account % GDP	**-3.8**	-3.5	-3.0	-2.8
Fiscal balance % GDP	**-5.0**	-4.2	-3.8	-3.5
CPI % y-o-y *	**2.3**	1.7	3.6	1.8
CPI % y-o-y **	**1.5**	1.8	3.8	1.9
Population mn	**10.1**	10.1	10.0	10.0
Unemployment rate %	**9.6**	7.6	7.0	6.5
Reserves USD bn **	**44.0**	43.5	45.0	47.5
External debt % GDP	**46.7**	51.2	48.8	46.9
Public debt % GDP	**41.3**	44.1	44.8	46.1
CNB policy rate %*	**0.75**	0.75	1.00	2.00
EURCZK*	**25.0**	24.30	24.00	23.50

*End of period, **Period average, Bold is actual data
Source: CSO, CNB, Nomura Global Economics.

- We expect lower growth in 2011 thanks to fiscal drag and lower external demand. Internal demand should not kick in until mid-2012. This open economy's recovery is delayed by a weaker external dynamic.
- The fiscal drag and a strong CZK suggest there are no meaningful core inflation pressures. Thus we believe the CNB will keep rates on hold until Q4 next year.
- Although the coalition got off to a strong, fiscally hawkish start, scandal and politicking have bogged the government down. Most short to medium run consolidation reforms are now in place though – and concern is more focused on difficult long-run reforms, the pace of which should now slow.

Tatiana Orlova | Peter Attard Montalto

Ukraine: Without IMF support, UAH is at risk of devaluation

October 2012 elections are already weighing on policies

	2010	2011	2012	2013
Real GDP % y-o-y	**4.2**	4.8	3.8	3.5
Consumption, % y-o-y	**6.9**	9.5	4.4	2.5
Gross investment	**3.6**	2.1	4.0	5.0
Exports, % y-o-y	**29.2**	35.3	15.9	14.5
Imports, % y-o-y	**35.2**	43.5	12.0	10.8
CPI % y-o-y *	**9.4**	8.1	11.1	10.5
Consolidated budget % GDP**	**-5.8**	-4.0	-5.5	-4.2
Current account % GDP	**-2.1**	-5.0	-3.7	-1.3
FX reserves, gross USD bn	**34.6**	29.5	31.2	34.0
NBU discount rate %***	**7.75**	7.75	8.00	8.00
USDUAH*	**7.94**	7.99	9.50	8.92

*Period average, ** Excluding Naftogaz, ***End of period, Bold is actual data.

Source: National Bank of Ukraine, Nomura Global Economics.

- The government has received no IMF funds year to date, and the likelihood of receiving further tranches this year has diminished as it has decided not to hike household gas prices, which is one of the IMF's key conditions.
- Budget revenues are supported by higher-than-expected economic growth, which reduces the immediate need for IMF support. Inflation has dropped below 6% owing to a fall in food prices.
- The current account deficit has deepened, while financial account inflows are drying up. We believe there is an increased probability of substantial hryvnia weakening in the next 12 months.

Kazakhstan: Driven by industrial recovery

The pace of KZT appreciation is to remain slow

	2010	2011	2012	2013
Real GDP % y-o-y	**7.3**	6.2	5.1	5.3
Consumption % y-o-y	**10.2**	7.2	4.0	4.5
Gross investment % y-o-y	**3.8**	6.5	7.0	8.0
Exports % y-o-y	**43.3**	32.7	-0.5	6.3
Imports % y-o-y	**9.4**	31.0	12.6	14.0
CPI % y-o-y **	**7.2**	8.3	7.5	7.7
Government budget % GDP	**1.5**	2.5	2.2	2.6
Current account % GDP	**3.2**	6.4	5.6	5.7
FX reserves, gross USD bn	**28.2**	34.2	48.2	55.3
NBK official rate %*	**7.00**	7.50	7.50	7.50
USDKZT*	**147**	147	146	143

*End of period, **Period average, Bold is actual data.

Source: Agency of Statistics of the Republic of Kazakhstan, Nomura Global Economics.

- At the oil price above $100/bbl, budget revenues are way above projected, which translates into build-up of the sovereign fund. We expect robust growth supported by rising domestic consumption and strong FDI inflows.
- However, the authorities are not keen on switching to a more flexible FX regime, and absorb FX market pressures with interventions. We expect marginal tenge appreciation and further accumulation of FX reserves..
- Presidential elections on 3 April were a non-event. The recent concerns about President Nazarbayev's health put the open issue of succession back into the spotlight.

Romania: A challenging road ahead

Twin deficits leave little room for supporting growth in a challenging external demand environment

	2010	2011	2012	2013
Real GDP % y-o-y	**-1.2**	1.5	1.7	2.5
Current account % GDP	**-4.2**	-4.5	-5.0	-5.3
Fiscal balance % GDP	**-6.5**	-4.5	-3.5	-3.2
CPI % y-o-y *	**8.0**	4.9	3.2	3.0
CPI % y-o-y **	**6.1**	6.4	3.5	3.0
External debt % GDP	**73.0**	70.0	70.0	72.0
Public debt % GDP	**35.2**	36.5	38.0	36.0
NBR policy rate %*	**6.25**	6.00	6.00	6.50
EURRON*	**4.28**	4.10	4.25	4.10

*End of period; **Period average; Bold is actual data

Source: Ministry of Statistics, Nomura Global Economics.

- The political background has improved with a less united opposition and the failure of the opposition's no-confidence votes. There appears to be commitment to sustainable public finances, but risks on exposure to periphery Europe remain a concern for the banking system.
- Romania has now come out of recession with positive growth in Q1 2011, but the outlook is weak. Ongoing fiscal consolidation and weaker trade may knock the recovery off course and will certainly lead to softer growth this year and next.
- Inflation should ease given excess capacity and the expected fall from the 5% VAT increase a year ago. However, commodity price pressures suggest inflation may remain high and sticky throughout the year. The central bank appears to be using FX strength to control inflationary pressures, as policy rates rises are unlikely owing to weak domestic demand.

Egypt: Anticipating political transition

Growth prospects will be challenged in the post-Mubarak era as tourism and foreign investment slow

	2010	2011	2012	2013
Real GDP % y-o-y**	**5.3**	1.2	3.1	2.5
Nominal GDP, USDbn	**212.0**	239.6	269.8	290.0
CPI % y-o-y *	**10.3**	12.1	9.5	8.0
Budget balance % GDP**	**-8.3**	-10.4	-8.9	-9.0
Public sector debt, % GDP	**73.9**	78.1	79.8	81.0
Current account % GDP	**-2.5**	-3.2	-2.7	-3.1
FX reserves, gross USD bn	**36.0**	25.1	26.0	26.0
External debt % GDP	**16.3**	17.7	18.2	19.1
Policy rate %*	**8.25**	8.25	9.00	9.00
USDEGP*	**5.80**	6.10	6.40	6.80

*End of period, **Fiscal year ending June, Bold is actual data
Source: Ministry of Finance, Nomura Global Economics.

- As a result of the political crisis, we have revised our growth forecast down sharply for both 2011 and 2012. Activity in many sectors—from retail and wholesale trade to manufacturing to tourism—has ground to a halt.
- Inflation should remain high given supply disruptions and global oil price increases. Nonetheless, we doubt the central bank will increase interest rates in the near term because of the potentially destabilising impact, and an assessment that price pressures are likely temporary.
- Political focus should turn to ensuring a smooth transition to elections. Parliamentary elections are now expected in September, and presidential elections in December.

Israel: Growth continues to advance

Israel's output gap has closed, inflation pressures are rising

	2010	2011	2012	2013
Real GDP % y-o-y	**4.5**	4.2	3.3	3.5
Consumption % y-o-y	**3.0**	3.5	3.0	3.0
Gross investment % y-o-y	**2.5**	3.2	3.8	3.7
Exports % y-o-y	**2.5**	3.8	4.5	3.5
Imports % y-o-y	**3.3**	4.0	3.9	3.8
CPI % y-o-y *	**2.7**	3.3	3.4	3.3
CPI % y-o-y **	**2.7**	3.3	3.0	3.3
Budget balance % GDP	**-3.8**	-3.0	-3.0	-3.5
Current account % GDP	**3.0**	2.0	1.2	1.0
Policy rate %*	**2.00**	2.50	2.75	3.25
USDILS*	**3.52**	3.45	3.25	3.25

*End of period, **Period average, Bold is actual data
Source: BOI, Nomura Global Economics.

- Israel's export-driven economy outperformed the region in the post-crisis environment thanks to an aggressive monetary policy response resulting in a healthy domestic demand.
- Inflationary pressures appear to have subsided and inflation expectations are well anchored. The outcome of local protests on rent prices represents a key issue that could influence inflation levels further.
- Strong domestic demand could still risks inflation moving higher, but also shrinks the current account surplus. We expect BoI to cut twice more (25 bp) each over the next three meetings.

Saudi Arabia: Oil supports fiscal stimulus

Increasing oil prices help finance further fiscal stimulus, but regional political turmoil is weighing on sentiment

	2010	2011	2012	2013
Real GDP % y-o-y	4.0	6.0	4.0	4.0
Hydrocarbon % y-o-y	2.4	5.5	2.9	3.0
Nonhydrocarbon % y-o-y	3.7	3.5	3.2	3.5
Nominal GDP, USDbn	443.7	492.5	524.0	550.0
CPI % y-o-y **	**5.4**	5.6	5.0	5.0
Budget balance % GDP	4.5	2.0	3.0	1.5
Current account % GDP	11.5	20.4	12.5	14.0
External debt, USDbn	105.3	110.0	120.4	122.0
External debt, % GDP	23.7	22.9	23.6	22.2
Short-term interest rates %	**2.00**	2.00	2.00	2.00
USDSAR*	**3.75**	3.75	3.75	3.75

**Period average, Bold is actual data
Source: Ministry of Statistics, SAMA, Nomura Global Economics.

- We have increased our growth forecasts for Saudi Arabia on the back of higher global oil prices, increased production (to compensate for lost Libyan output), and substantial fiscal stimulus. Inflation may pick up modestly as a result, though investment to increase the housing stock could help keep rental prices contained. .
- Non-hydrocarbon growth should continue to increase over the next five years, as should its share in output, driven by government-led infrastructure spending.
- Concerns about regional political unrest have taken their toll on the local equity markets. For now, concerns about the risks to production appear overdone, though investors are likely to focus on developments in neighbouring Bahrain as a bellwether for Saudi stability.

Boris Segura | Tony Volpon | Benito Berber

Argentina: More moderate growth, but still high inflation

High inflation is likely to remain the main macroeconomic policy challenge for the authorities.

	2010	2011	2012	2013
Real GDP % y-o-y	**9.2**	8.0	4.0	3.5
Consumption % y-o-y	**9.0**	8.6	5.8	3.5
Gross Investment % y-o-y	**21.2**	17.1	9.3	5.0
Exports % y-o-y	**14.6**	7.9	9.0	4.4
Imports % y-o-y	**34.0**	5.5	9.0	7.0
CPI % y-o-y *	**10.9**	10.9	10.8	10.0
CPI % y-o-y **	**25.9**	24.4	25.4	18.0
Budget balance % GDP ***	**1.7**	-0.5	1.0	1.5
Current account % GDP	**1.8**	1.3	1.0	1.0
Policy Rate %	**10.81**	12.0	11.0	14.0
USDARS	**3.98**	4.40	4.50	5.00

* Official data, ** Private estimate, ***Primary budget balance, Bold is actual data

Note: Table reflects data available as of 11 November 2011.
Source: Nomura Global Economics.

- Inflation has become the most challenging policy issue, as the economy shows signs of overheating
- Fiscal and monetary policies are lax and are likely to remain so until at least the general elections in October 2011.
- The trade surplus is shrinking and, along with incipient capital flight, is putting pressure on international reserves.
- Will President Fernandez de Kirchner address the main vulnerabilities of "the model" in her second term?

Chile: Robust economic growth to continue amid global uncertainties

Growth should remain strong as long as China stays on track. Global turmoil should put rates on hold, for longer.

	2010	2011	2012	2013
Real GDP % y-o-y	**5.2**	6.3	4.8	6.0
Consumption % y-o-y	**9.3**	8.8	5.5	6.5
Gross Investment % y-o-y	**18.8**	13.0	11.0	16.0
Exports % y-o-y	**1.9**	8.0	6.5	7.0
Imports % y-o-y	**29.5**	12.0	11.0	10.0
CPI % y-o-y *	**3.0**	3.8	3.0	3.0
CPI % y-o-y **	**1.4**	3.2	3.0	3.0
Budget balance % GDP	**-0.3**	-1.0	1.0	1.0
Current account % GDP	**1.9**	1.5	1.0	1.0
Policy Rate % *	**3.25**	5.00	4.50	6.00
USDCLP *	**468.00**	485.00	480.00	465.00

* End of period, ** Period average, Bold is actual data

Note: Table reflects data available as of 11 November 2011.
Source: Nomura Global Economics.

- Chile's economy continues to grow above potential, on the back of hot domestic demand and strong exports. As long as growth in China remains on track and copper prices do not plunge, we see fairly limited downside risks to growth.
- 2011 inflation will likely be close to the 4% target upper bound. Prices of non-tradable goods should stay elevated, given the heated labor market; while falling oil prices would probably provide some relief.
- The Central Bank of Chile (BCCh) has turned more dovish recently, as a result of global uncertainties, slowing domestic growth and stable inflation. We expect the BCCh to cut the policy rate (TPM) by 25bp in the coming months, taking TPM to 5% by end-2011 and 4.5% by end-2012.

Colombia: Well balanced recovery

Economic recovery will likely continue in 2011 & 2012 with robust FDI inflows supporting the currency.

	2010	2011	2012	2013
Real GDP % y-o-y	**4.3**	5.0	4.5	4.5
Consumption % y-o-y	**4.5**	5.0	4.5	4.4
Gross Investment % y-o-y	**10.6**	8.0	9.0	9.2
Exports % y-o-y	**2.2**	6.0	7.0	6.5
Imports % y-o-y	**15.5**	8.0	9.0	8.0
CPI % y-o-y *	**3.2**	3.5	3.7	3.7
CPI % y-o-y **	**2.3**	3.5	3.7	3.7
Budget balance % GDP	**-3.8**	-3.4	-3.0	-2.5
Current account % GDP	**-3.1**	-3.0	-3.5	-3.0
Policy Rate % *	**3.00**	4.50	5.00	7.00
USDCOP *	**1907.70**	1875.00	1800.00	1700.00

* End of period, ** Period average, Bold is actual data

Note: Table reflects data available as of 11 November 2011.
Source: Nomura Global Economics.

- We forecast 2011 GDP to expand by 5.0% on the back of strong domestic demand and to converge to potential growth of 4.5% in 2012 and 2013. The policy rate should stay at 4.5% until year-end. We now forecast a small increase to 5.0% in the policy rate by the end of 2012.
- Congress passed a fiscal rule to address some of the weaknesses on the fiscal front. As a result the three major rating agencies upgraded the country's credit rating to investment grade and the Ministry of Finance issued US$2bn in global bonds.
- We revised our COP target to 1875 for end-2011 and 1800 for end-2012, from 1760 and 1750 respectively, as a result of mounting global uncertainties.

The week ahead

The Czech Republic, Hungary and Chile will release their Q3 GDP figures. Poland's new prime minister will present the government's program.

Hungary, GDP (Tuesday): We look for a strong, above-consensus 1.0% growth rate in Q3. While private sector investment and consumption should continue to flatline we expect net trade to be an increasingly large contributor to growth, and government spending and public sector investment should also continue their slow growth before the bulk of slowdown and reform hits in Q4 through year-end.

Czech Republic, GDP (Tuesday): We look for growth of just 1.4% in Q3. Trade should be an increasing drag from the 2.2% recorded in the previous quarter. Consumption and private sector investment should, however, show some underlying resilience as the last round of fiscal consolidation starts to wane (and before the next round comes in next year).

Poland, CPI (Tuesday): We look for October CPI to reverse its previous fall and tick up to 4.0% y-o-y. Core inflation should also resume its upward trend. Currency passthrough should start to be felt from recent months' weakness while still supportive retail sales demand and labour market dynamics also pass through. Nevertheless, softer commodity prices during the month and recent stronger negative seasonal factors mean the CPI's rise is slower than first thought.

Chile, Policy rate (Tuesday): We expect the central bank of Chile (BCCh) to keep its policy rate constant at 4.25%. October CPI came in higher than expected (3.7% vs. 3.5%), while IMACEC GDP index also expanded more strongly than expected in September (5.7% vs. 5.2%). We believe the incoming data only reinforce the BCCh's view, as expressed in its last minutes, that the "impact of the negative external environment on the domestic economy is scant", and makes it difficult to implement an imminent rate cut.

South Africa, Retail Sales (Wednesday): We look for a strong 6.5% print for September retail sales. The consumer remains remarkably strong given partly pent-up demand after the

Sometime this week				**Period**	**Prev 2**	**Prev 1**	**Last**	**Nomura**	**Survey**
	Russia	GDP	% y-o-y	Q3	4.5	4.1	3.4	5.1	5.0
	Russia	PPI	% y-o-y	Oct	16.1	18.5	18.0	16.9	17.1
	Russia	Industrial production	% y-o-y	Oct	5.2	6.2	3.9	2.7	3.5
	Russia	Retail Sales	% y-o-y	Oct	5.7	7.8	9.2	6.0	8.5
Monday 14 November				**Period**	**Prev 2**	**Prev 1**	**Last**	**Nomura**	**Survey**
Tuesday 15 November									
08:00	Hungary	Industrial production	% y-o-y	Sep-Fin	1.0	2.7	-0.4	n.a.	3.0
08:00	Czech Republic	GDP	% y-o-y	Q3	2.7	2.8	2.2	1.4	1.6
08:00	Hungary	GDP	% y-o-y	Q3	1.9	2.5	1.5	1.0	0.8
08:00	Romania	GDP	% y-o-y	Q3	-0.6	1.7	1.4	n.a.	n.a.
08:00	Czech Republic	PPI	% y-o-y	Oct	5.4	5.7	5.6	5.8	5.6
08:00	Turkey	Unemployment rate	%	Aug	9.4	9.2	9.1	n.a.	n.a.
08:00	Turkey	Current account	USD bn	Sep	-7.6	-5.3	-4.0	n.a.	n.a.
09:00	Czech Republic	Current account	CZK bn	Sep	-8.3	-12.8	-33.7	n.a.	-16.4
13:00	Poland	Current account	EUR mn	Sep	-1994	-2044	-1730	-1790	-1842
13:00	Poland	CPI	% y-o-y	Oct	4.1	4.3	3.9	4.0	4.0
14:00	Poland	Budget balance, ytd	EUR mn	Oct	-21084	-20681	-21920	n.a.	n.a.
16:30	Israel	CPI	% y-o-y	Oct	3.4	3.4	2.9	n.a.	2.8
21:00	Chile	Policy rate	%, policy rate	Nov	5.25	5.25	5.25	5.25	5.25
Wednesday 16 November									
11:00	South Africa	Retail sales	% y-o-y	Sep	2.4	3.0	8.2	6.5	6.1
13:00	Hungary	Central Bank Minutes							
	Israel	GDP, SAAR	% y-o-y	Q3	7.5	4.7	3.7	n.a.	2.7
	Russia	Weekly CPI	% w-o-w	Oct	0.1	0.2	0.2	0.2	n.a.
Thursday 17 November									
Friday 18 November									
08:00	Hungary	Average gross wages	% y-o-y	Sep	4.7	6.2	6.5	4.6	5.0
13:00	Poland	Employment	% y-o-y	Oct	3.3	3.1	2.8	2.7	2.6
13:00	Poland	Average gross wages	% y-o-y	Oct	5.2	5.4	5.2	5.1	5.2
	Poland	Prime Minister Tusk presents new Government's program							
11:30	Chile	GDP	% y-o-y	Q3	5.8	10.0	6.8	4.7	4.5
21:00	Colombia	Industrial production	% y-o-y	Sep	2.8	4.0	9.5	n.a.	n.a.
21:00	Colombia	Retail sales	% y-o-y	Sep	12.0	11.9	9.7	n.a.	n.a.

Source: Bloomberg, National Statistics Offices, Nomura Global Economics.

July/August strike season, but also strong real wage growth and some employment growth recovery in the quarter. This is accompanied by lower credit growth to already highly indebted households. This is the last important component of Q3 data from which we can get some idea of GDP. We think it is currently tracking at a stronger 3.1%.

Chile, Q3 GDP (Friday): We expect Q3 GDP to grow by 4.7% y-o-y, decelerating from the 6.8% growth in Q2. The slowdown can be primarily attributed to temporary disruptions in mining production, which occurred in September. Despite some growth deceleration, we believe the economy is still expanding at a healthy pace, with the September GDP index growing at 5.7% y-o-y.

Poland, Prime Minister Tusk's speech (Friday): We will be watching Prime Minister Tusk closely on Friday to understand the government's plans for the four years of this new Sejm session. This event has been brought forward from the second week of December in order to try to allay market fears and risk of eurozone contagion. In reality, there are major political limits to what Prime Minister Tusk can put forward. However, we expect enough to be announced to keep markets onside and avoid a ratings downgrade. At the start of the previous session an ambitious programme of reform was also announced but only partially implemented. This time around we expect a range of pension changes, a number of structural changes to boost competitiveness, healthcare changes and perhaps some smaller benefit changes. Local government reforms may also pushed further.

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