Global Weekly Economic Monitor
NOMURA GLOBAL ECONOMICS

NOMURA

Learning the lessons from Japan

Europe's leaders need to act quickly, forcefully and confidently. It is a big ask, when the action needed is to fix a quasi-state's flawed economic architecture.

7 October 2011

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Note to readers
Having regard to the growing importance of Emerging Markets, we are pleased to announce that Ann Wyman will take up a new position of Head of Emerging Markets Thematic Research, while maintaining economics and strategy coverage of the Middle East, and that Olgay Buyukkayali will expand his role to Head of Emerging Market Economic and Strategy Research, Europe.

Nomura Securities International Inc.

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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	3.9	4.1	4.2	4.7	3.8	3.5	3.55 ↓	3.77 ↓	4.08 ↓
Developed	1.5	2.0 ↓	2.3	2.8 ↑	1.8	1.4	0.67	0.64 ↓	0.90 ↓
Emerging Markets	6.6	6.2	6.2	6.8	5.9	5.6	6.65 ↓	7.01 ↓	7.26 ↓
Americas	2.4	2.6 ↓	2.9	4.7	3.7	3.0	2.35 ↓	2.52 ↓	2.98 ↓
United States*	1.7	2.3	2.7	3.3	2.0	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††	4.4	3.7	3.6	8.8	8.7	7.8	8.61 ↓	9.07 ↓	10.52
Argentina	8.0	4.0	3.5	24.4	25.4	18.0	12.00	11.00	14.00
Brazil	3.6	3.9	3.5	6.6	6.2	6.0	10.50 ↓	11.50	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	7.00	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	6.2	6.7	6.5	5.0	4.2	4.1	5.13	5.45	5.58
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	3.7	3.4	3.8	4.75	5.00	5.50
New Zealand	2.2	3.5	3.6	4.6	2.9	2.7	2.50	4.00	4.00
Asia ex Japan, Aust, NZ	7.9	7.6	7.5	6.2	5.1	4.9	6.21	6.53	6.61
China	9.5	8.6	8.4	5.6	4.8	4.5	6.56	7.06	7.06
Hong Kong***	5.4	4.5	4.2	5.3	5.1	4.6	0.25	0.45	0.70
India**	7.7	7.9	8.1	9.4	6.8	7.1	8.25	8.25	8.25
Indonesia	6.5	7.0	7.0	5.6	5.8	5.3	6.75	7.00	6.50
Malaysia	4.7	5.1	5.0	3.1	3.2	3.1	3.00	3.50	3.75
Philippines	5.1	5.7	6.5	4.9	5.0	5.0	4.50	5.00	6.00
Singapore***	5.6	5.3	5.5	4.5	3.2	3.0	0.35	0.35	0.63
South Korea	3.5	5.0	4.0	4.5 ↑	3.7 ↑	3.0	3.25	3.50	4.00
Taiwan	4.5	5.0	5.2	1.8	2.7	2.4	2.00	2.50	3.00
Thailand	4.1	4.7	4.8	3.6	3.7	3.6	3.50	4.00	4.50
Vietnam	6.4	6.9	7.1	18.0	10.0	9.0	14.00	10.00	9.00
Western Europe	1.5	1.3	1.8	2.9	1.9 ↓	1.7 ↓	1.14	0.99	1.50
Euro area	1.5	1.1 ↓	1.7	2.7	1.7 ↓	1.6 ↓	1.25	1.00	1.50
Austria	3.2	1.9	2.2	3.6	1.9	1.7	1.25	1.00	1.50
France	1.5	1.7 ↑	2.1	2.3	1.7 ↓	1.5 ↓	1.25	1.00	1.50
Germany	3.0 ↑	1.8 ↑	1.8	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	0.1	2.0	1.0	0.9	1.0	1.25	1.00	1.50
Italy	0.7	0.4	0.7	2.8 ↑	2.3 ↑	1.7 ↓	1.25	1.00	1.50
Netherlands	1.8	1.4	1.9	2.5 ↓	1.8 ↓	1.7 ↓	1.25	1.00	1.50
Portugal	-1.5	-2.1	-0.1	3.3	2.0	1.3	1.25	1.00	1.50
Spain	0.6 ↓	0.7 ↓	1.7	3.1 ↑	2.2 ↑	1.7 ↓	1.25	1.00	1.50
United Kingdom	0.8 ↓	1.8	2.2	4.5	3.0	2.1	0.50	0.50	1.00
Norway	2.3	2.4	2.5	2.2	2.2	2.2	2.25	3.00	3.75
Sweden	4.4	2.0	2.5	3.1	2.7	2.8	2.00	2.75	3.50
Switzerland	2.1	1.7	1.5	0.4	0.6	1.6	0.00	0.25	1.00
EEMEA	4.7	3.8 ↓	3.9	6.8	6.1	5.7 ↓	5.90	6.34	6.26 ↓
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	1.6	2.0	3.9	4.1	3.4	6.00	6.00	6.00
Israel	4.2	3.3	3.5	3.3	3.0	3.3	3.25	3.75	4.00
Kazakhstan	6.0	5.1	5.3	8.3	7.5	7.7	7.50	7.50	7.50
Poland	4.2	3.9	4.0	4.3	3.8 ↑	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	6.25	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	5.5	5.9 ↓	5.50	6.00	8.00
Turkey	7.0	4.2	5.0	7.5	7.0	6.8	5.75	7.00	8.00
Ukraine	5.2	4.0 ↓	3.8	8.4 ↓	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.

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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*.
- Given the financial strains and policy rhetoric, the possibility of *various forms of tacitly coordinated policy action seems high*.
- We see a Japan V-shaped recovery, a step-up in US growth as H1 special factors dissipate, but near-zero euro-area growth.
- 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: euro fiscal crisis escalates; market rout damages confidence; investment pulls back in China.
- The eurozone sovereign debt crisis is set to put the euro under increasing pressure, and the dollar is set to gain.

United States

- We expect the high level of household debt to restrain growth as it has in recoveries after previous financial crises.
- Concerns about long-term deficits will make it difficult, but not impossible, to enact some of the president's proposed jobs bill.
- An erosion of confidence will likely hold down economic growth in the second half of 2011.
- Ample unused capacity – evident in the high jobless rate – should restrain core inflation and contain inflation expectations.
- Given recent volatility, the Fed's next move will depend on how financial conditions evolve.

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 in December *and 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 ¥13trn to be passed in November, which should mitigate downside risks to growth.
- We expect the BOJ to increase its asset purchase program by a further ¥3-5trn by December.
- 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 the market meltdown continues.*
- China: We expect growth to remain strong as the economy is increasingly driven by domestic demand.
- Korea: We believe the BOK will focus on slowing growth rather than rising inflation and not raise rates until February 2012.
- India: With the economy in a cyclical downturn and commodity prices headed lower, monetary policy is close to pausing.
- Australia: We see GDP growth recovering from natural disasters assisted by much stronger capex in the resource sector.
- Indonesia: BI seems to be signalling a more pro-growth bias amid external risks.

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: Political unrest is rising across the region, leading to economic challenges and increasing risk premia.
- Economic growth in Brazil is set to slow below potential this year, despite a 50bp policy rate cut by the central bank.
- Mexico: We lowered our 2011and 2012 GDP forecasts to 3.7% and 3.0%, respectively, on slower US growth.
- With the output gap closed, Argentina's strong growth is likely to keep inflation high in 2011.

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Economic Data Calendar

The Week at a Glance

For more detail see country and regional data previews

Previous, Nomura, Consensus

	Mon 10 Oct	Tue 11 Oct	Wed 12 Oct	Thu 13 Oct	Fri 14 Oct
North America	**US** **Columbus Day - bond market closed**	**US** **FOMC minutes** (Sep 20-21)		**US** **Trade Balance** (Aug) $bn -44.8, -45.6, -46.0 **US** **Budget statement** (Sep) $bn -34.6, n.a., -64.9	**US** **Retail sales** (Sep) % m-o-m 0.0, 0.7, 0.4 **US** **Import prices** (Sep) % m-o-m -0.4, -0.9, -0.4 **US Consumer sentiment** (Oct-pre) Index 59.4, n.a., 60.0
Europe (ex-UK)	**Germany** **Exports** (Aug) % m-o-m, sa -1.9, n.a., 1.3 **France** **Industrial production** (Aug) % m-o-m, sa 1.5, -0.7, -0.8 **Italy** **Industrial production** (Aug) % m-o-m, sa -0.7, -0.5, 0.2	**Slovakia's Parliament votes on changes to the EFSF**	**France** **HICP inflation** (Sep) % y-o-y 2.4, 2.8, 2.6 **Euro area** **Industrial production** (Aug) % m-o-m, sa 0.9, -0.7, -0.8 **Euro area** **ECB's Trichet speaks in London**	**Germany** **HICP inflation** (Sep-fin) % y-o-y 2.8, 2.8, 2.8	**Euro area** Germany's Weidmann and Schaeuble speak in Paris **Euro area** **HICP inflation** (Sep-fin) % y-o-y 2.5, 3.0, 3.0
UK		**Industrial production** (Aug) % m-o-m, sa -0.2, -0.2, 14.0 **Manufacturing production** (Aug) % m-o-m, sa 0.1, -0.3, -0.1	**Average weekly earnings ex-bonus** (Aug) % y-o-y, 3mma 2.1, 1.8, 2.0 **Jobless claims change** (Sep) k 20.3, 19.0, 24.5	**Global goods trade balance** (Aug) £mn -8922, -9100, -8750	
Japan	**Sports Day (holiday)**	**Current account** (Aug) ¥bn 990.2, 517.7, 453.6 **Consumer confidence index** (Sep) Index 37.0, n.a., 37.2 **Current economic conditions** (Sep) Index 47.3, n.a., 46.5	**Machinery orders** (Aug) % m-o-m -8.2, 4.6, 3.9	**Index of tertiary industry activity** (Aug) % m-o-m -0.1, -0.6, -0.3 **MPM Minutes** (9/6, 7)	**M2** (Sep) % y-o-y 2.7, 2.7, 2.7 **CGPI** (Sep) % y-o-y 2.6, 2.4, 2.5
Asia		**Indonesia Central Bank mtg, policy rate** (Oct) % 6.75, 6.75, 6.75 **Malaysia** **Industrial production** (Aug) % y-o-y -0.6, 3.4, 0.4	**S. Korea** **Unemployment rate** (Sep) % sa 3.1, 3.3, 3.2 **India** **Industrial production** (Aug) % y-o-y 3.3, 7.4, n.a.	**S. Korea Central Bank mtg, base rate** (Oct) % 3.25, 3.25, 3.25 **China** **Imports**(Sep) % y-o-y 30.2, 20.0, 24.6	**China** **CPI** (Sep) % y-o-y 6.2, 6.3, 6.1 **India Wholesale price index** (Sep) % y-o-y 9.8, 9.8, n.a.
Emerging Markets	**Hungary** **Trade balance** (Aug) EURmn 354.8, 450.0, 490.0 **Czech Republic** **CPI** (Sep) % y-o-y 1.7, 1.6, 1.7 **Turkey** **Industrial production** (Aug) %, nsa y-o-y 6.9, 8.0, 5.5	**Hungary** **CPI** (Sep) % y-o-y 3.6, 3.8, 14.0 **Israel** **GDP** (Q3) % y-o-y, saar 3.5, n.a., n.a. **Brazil** **Retail sales** (Aug) % y-o-y 7.1, n.a., 7.1	**South Africa** **Mfg production** (Aug) % y-o-y -6.0, 0.1, n.a. **Russia** **Trade balance** (Aug) US$bn 15.2, 13.5, 14.3 **Mexico** **Industrial production** (Aug) % y-o-y 3.2, 3.3, n.a.	**Poland** **CPI** (Sep) % y-o-y 4.3, 4.2, 4.1 **Egypt** **CBE rate decision** (Oct) % 8.25, n.a., n.a. **Chile** **Policy rate** (Oct) % 5.25, 5.25, 5.25	**Israel** **CPI** (Sep) % y-o-y 3.4, 2.9, 3.2 **Mexico** **Policy rate** (Oct) % 4.50, 4.50, 4.50 **Colombia** **Monetary policy meeting minutes**

Sources for consensus forecasts: Bloomberg.

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Is Europe turning into Japan?

Europe is doing too little, too late, too confusedly, too diffidently in dealing with its existential crisis.

Recently we have been arguing strongly that the US is "not turning into Japan" (see "The US is not 'turning into' Japan", "Japan and the US compared", Global Weekly Economic Monitor, 19 August 2011). The US is like Japan, of course, in that in both economies debt-fuelled asset price bubbles and their bursting left a huge debt overhang on private sector balance sheets, and the subsequent deleveraging was and (for the US) is a serious multi-year drag on growth. Our key message though has been that Japan's defining feature is its secular deflation, something that resulted largely from past and ongoing policy errors. The US, learning the lessons from Japan, avoided these policy errors and is unlikely to enter a Japan-like deflation path. But many clients are asking: what about Europe (or notably the euro area) – isn't it repeating Japan's mistakes?

What are the lessons from Japan's so-called "lost two decades"? We summarize them thus. When policymakers are faced with a major threat to financial or economic stability, we think they need to do four things: act quickly, act forcefully, act comprehensively (ie, pull all relevant policy levers), and act with confidence (that they have the tools) and determination (to use them). Of course, this defines the "perfect" policy response, which rarely, if ever, will be observed in the real world, but it gives a useful benchmark against which policy actions can be judged.

Judged on these criteria, we think Japan performed very poorly and the US very well in dealing with the aftermath of their respective financial crises (see "Lessons learned", Global Weekly Economic Monitor, 27 March 2009; "Revisiting the 'lessons from Japan'", 8 January 2010). In our view, Japan's key error was to drag its feet on injecting public funds to recapitalize the banking system – this was not done until March 1998 (seven and a half years after land prices started falling and three years after the crisis had "gone systemic"); the US injected capital quickly, forcefully and effectively. Japan's quantitative easing was also far too late in coming and "timid" when it arrived; benefiting from the BOJ's pioneering experience, the Fed acted quickly and forcefully. You will never hear Fed Chairman Bernanke utter the words "We have run out of ammunition (to fight deflation)", yet the BOJ's messaging was often tantamount to that.

How does Europe's scorecard look then? To answer that, it is necessary to distinguish two phases of the post-2008 financial crisis. In the first phase, Europe faced a "normal" financial crisis and recession, and judged by the four policy criteria, it seems reasonable to locate its performance somewhere between Japan, at one end, and the US at the other, but probably somewhat closer to the US. Perforce of the crisis, policymakers had no choice but to act quickly and, compared with Japan, the monetary and banking system policy levers were pulled fairly substantially (fiscal policy is another story), even if these actions looked timid relative to the US's.

But Europe's financial crisis quickly (from early 2010) morphed into something else: a full-fledged crisis of the functioning of, and market confidence in, the economic and monetary union. Europe's is no run-of-the-mill crisis: it is a crisis in which the operability and sustainability of the core economic architecture itself has been called into question. The European Union (EU) is not a mere collection of cooperating nation states: it is a "quasi-government" formed by the pooling, under binding treaty of (27) nation states, of certain elements of their sovereignty, including importantly (for 17 of them) their monetary autonomy. The political "glue" in the European Union and in the eurozone lends it surprising resilience in helping to hold it together, but at the same time makes fixing its flaws a devilishly difficult and protracted process.

In dealing with this second phase of its crisis then Europe appears to be much more like Japan: it delivering too little, too late, too reluctantly, and its leaders are hardly paragons of confidence and decisiveness. But in Europe's defence, fixing the flawed monetary union is a monumental challenge, one that is an order of magnitude more difficult than just dealing with the aftermath of a burst financial bubble. Almost certainly it will involve either some fragmentation of the existing eurozone (a sovereign act not contemplated in the Treaties) or infusing it with more elements of explicit or de facto fiscal union, something which is much resisted, particularly in the north.

Reasonable people might counsel that some patience is required. But, like it or not, markets will not be patient when they sense that governments are not in control of their destinies. We think Europe's leaders would be well advised to heed the lessons of Japan. Japan suffered a secular deflation as a result of its policy mistakes; the consequences for Europe could be more dire.

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United States | Roundup David Resler | Ellen Zentner

Auto sales cruise over the potholes

The supply-chain disruptions that cut deeply into US vehicle production have largely ended and gasoline prices have fallen from their peaks. Both are likely to boost growth in H2 2011.

Vehicle sales in early 2011 were on track for 12.7mn units...

In February 2011, US distributors of motor vehicles logged sales at a 13.3 million annual rate, the strongest sales pace since August 2009 when the short-lived "cash-for-clunkers" program temporarily boosted annualized sales to 14.2 million. With sales remaining encouragingly strong in the next two months, the three-month sales average rose to 13.2 million in April, the highest level since August 2008. At the time, it appeared that vehicle demand was rebounding faster than we had expected at the beginning of the year when we forecast that vehicle sales would total 12.7mn during 2011. But the earthquake and tsunami that struck Japan on 11 March dashed hopes that a stronger-than-expected recovery of this key sector might also propel faster growth across the entire economy.

…but then disaster struck.

The seismic disaster devastated a broad swath of Japanese industry and dealt an especially crippling blow to the automotive parts industry. Deprived of the orderly flow of critical supplies of key inputs, Japanese car companies cut their US motor vehicle production sharply (Figure 1). The contrast with the production of US car companies underscores the severity of the supply-chain effects. Vehicle assemblies by Japanese car companies during the second quarter fell by 32.3% from the same period a year ago while production from US car makers rose by 19.8%.

Forced production cuts made sought-after cars unavailable

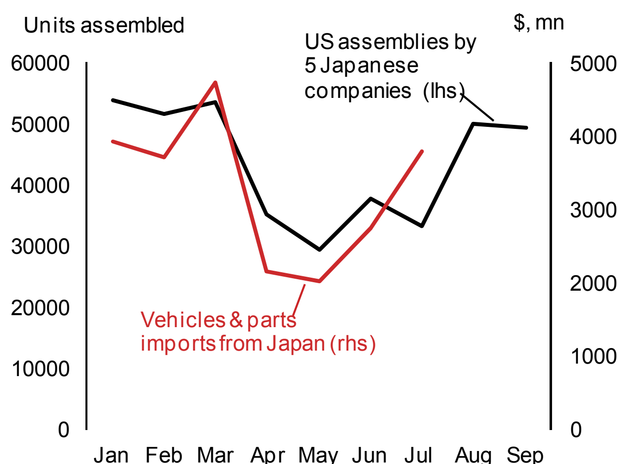
Strong overall sales during the months before and just after the earthquake/tsunami depleted dealer stocks of Japanese brand vehicles. Sales data suggest that car buyers loyal to Japanese brands decided to await the availability of those vehicles. As result overall vehicle sales fell to 11.7mn in May and 11.5mn in June as the shares of Japanese brand cars and light trucks fell well below their rising long-term trends (Figure 2). Since then – and lagging only slightly the resumption of more normal production by Japanese companies – vehicle sales have made a remarkable comeback. This week dealerships reported a September annual sales rate of 13.1mn units.

The Japanese lost market share despite rising gas prices

The surge in gasoline prices during the winter and early spring made the steep drop in Japanese brand shares look even more remarkable. Because car buyers perceive Japanese brand vehicles as relatively more fuel efficient when compared to their US brand equivalents, the Japanese brand share of vehicle sales tends to increase during periods of rising gasoline prices. For instance, we estimate that for the period of sharply rising gasoline prices during 2007-08, the Japanese-brand share of car and truck sales rose about 0.17 percentage points (pp) and 0.13pp, respectively, for every $0.10 increase in retail gasoline prices. That relationship appeared to be holding up during a similar surge in gasoline prices that began in 2010, but the deviations of "predicted" and actual shares of Japanese brands vehicles increased markedly after the earthquake and tsunami (Figure 3).

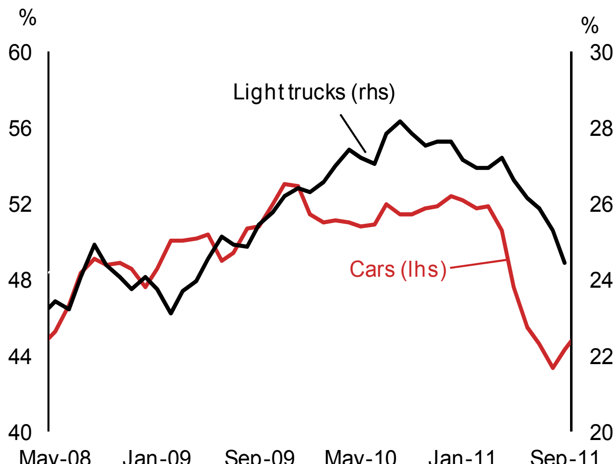
The revival of automobile production (and sales) since the depths of the supply chain disruptions is likely to continue – or even accelerate – as drivers resume a more normal "scrappage" rate.

Figure 1. Supply disruptions forced production cuts



Source: Automotive News; Commerce Department; Nomura.

Figure 2. Japan brand shares of US vehicle sales (6-mo avg)



Source: Automotive News; Nomura.

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Over the 12 years before the start of the Great Recession, sales of cars, trucks and sports utility vehicles (SUVs) averaged about 16.5mn per year. Over the same span, vehicle registrations, which represent the number of vehicles currently in service, rose by about 41.6mn or about 3.5mn per year.

Sales since 2007 have been below replacement demand

The difference between sales and registrations roughly approximates the number of old vehicles removed from usage. During the dozen years before the recession, vehicle owners scrapped an average of about 13mn vehicles or about 6.1% of the existing stock of vehicles (Figure 4). From the onset of the Great Recession through last month, however, the annualized sales rate has averaged only about 11.9mn vehicles. That implies that more than four million vehicles that would have been scrapped in more normal times remain in service. Consequently, the age of the US vehicle fleet has likely risen substantially. In March 2010, *USA Today* reported that the average age of the fleet of US registered vehicles stood at about 10.2 years.

High fuel costs encourage faster replacement

Although the persistent soft job market will likely force many drivers to hold onto these older cars for longer than they would like, high fuel costs provide a powerful incentive to replace older, less fuel-efficient vehicles. For instance, when the average-aged vehicle was first put into service a decade ago (in 2001), the retail price of regular grade gasoline averaged about $1.42 per gallon. In 2010, it averaged nearly twice as much – $2.78/gallon - and adjusted for changes in overall prices, “real” gasoline prices in 2010 were about 58% higher than a decade earlier.

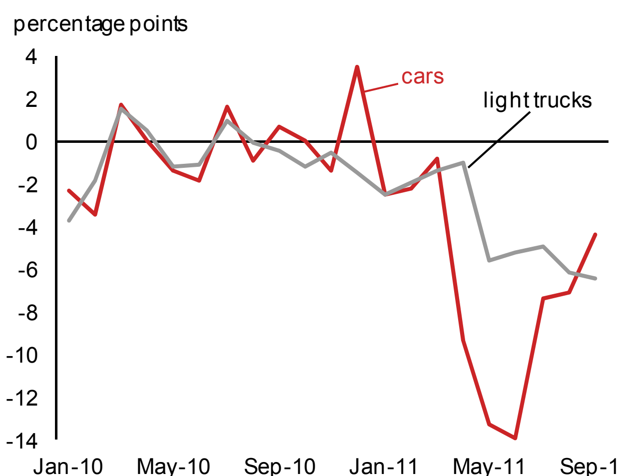
High gas prices cut into other spending too

Gasoline prices in 2011 have been considerably higher still. The price for a gallon of gasoline (all grades) in the US averaged $3.15 in January, but by early May had risen to about $4.02. The increase in gas prices from January to May also diverted an estimated $38.4 billion from discretionary spending categories to spending on gasoline in those months. Despite the near doubling rate of job growth in the first half of 2011 compared with the second half of 2010, the surge in energy costs resulted in a pronounced slowdown in real consumer spending – from a 3.1% rate in H2 2010 to just a 1.4% pace in H1 2011. Consumers and especially car-drivers will surely welcome the recent price retreat that cut average gas prices to a 31-week low of $3.49/gallon in the week ended 3 October, and prices should continue to incentivize the replacement of older cars.

The stars seem aligned for stronger car sales

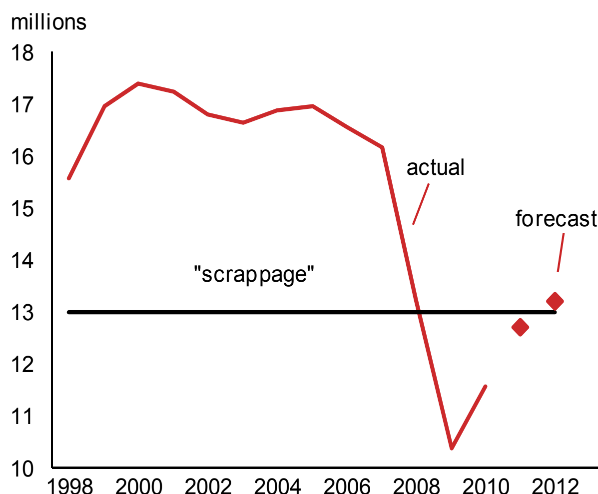
The revival of car sales in tandem with the restoration of normal production schedules reinforces our judgment that the cessation of supply-chain disruptions will provide a significant lift to growth in the second half of 2011. But the protracted period of depressed vehicle sales has left a legacy of pent-up demand that consumers are likely to fulfill gradually over the years ahead. We estimate that the number of registered drivers will increase by about 4.3mn by the end of 2012, and if car owners retire cars from service at the pre-recession rate sales could reasonably climb into the 14mn to 15mn range by the end of 2012. Anecdotal accounts suggesting car makers are gearing up for a 14mn sales pace by the end of Q1 2012 suggest that automakers also expect this pent-up demand to begin to assert itself in the year ahead.

Figure 3. Deviation of Japanese-brand sales (act. less pred.)



Source: Automotive News; Commerce Department; Nomura.

Figure 4. Annual vehicle sales and average “scrappage” rate



Source: Autodata; Federal Highway Administration; Nomura.

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Jens Sondergaard | Philip Rush

Easy now

This week, the Bank of England launched QE2, while the ECB kept rates on hold. But tighter credit conditions in the euro area suggest that policy rates will have to be lowered soon.

The ECB and BoE loosened monetary policy this week

This week, both the ECB and the BoE loosened their monetary policy stances. While the BoE launched outright QE2, the ECB kept its policy rate unchanged, but announced a further set of extraordinary policy measures that implicitly loosen monetary conditions in the euro area. Both central banks justified their policy actions by the detrimental effect the sovereign debt crisis has had on real activity, including conditions in the European banking sector.

A plan for recapitalising banks might be coming

Although European policymakers have not delivered a decisive policy response to the sovereign debt crisis, there has been some positive news. First, politicians and EU officials have signalled that there is a plan in the works to recapitalise banks across the euro area. There is a growing sense of urgency to do something soon. This week, the French and Belgian authorities were discussing how to prop up the Franco-Belgian lender, Dexia, a bank that has struggled to obtain short-term funding because of its large exposure to peripheral debt.

A different financing package for Greece is in the works for Q4

Second, the euro group finance ministers implicitly acknowledged during their meeting this week that a new solution has to be found to address the solvency of Greece. Specifically, the euro group postponed the decision about whether to release the next Greek loan disbursement to early November. Furthermore, according to the Athens News Agency, the Greek debt exchange has been postponed from mid-October to mid-December. We think policymakers are preparing the ground to launch a new and more substantial policy package for Greece in Q4.

No ECB rate cut this month ...

The ECB left policy rates unchanged ...

This week's ECB meeting was bound to be eventful: it was going to be President Trichet's last press conference before handing over control to Mario Draghi next month. But going into the meeting, there was a sense that, without any rate cut or new major policy initiative, markets could be set for disappointment. In the end, the ECB announcements were roughly in line with our expectations: first, they kept the policy rate unchanged at 1.5%.

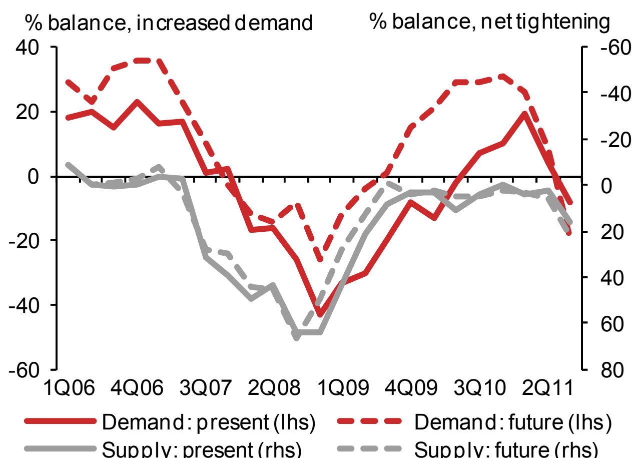
... but gave banks more liquidity...

Second, they launched a set of generous liquidity operations, which effectively give European banks certainty that plenty of liquidity will be available until at least mid-2012. Third, the ECB decided contrary to our expectations, to launch a new covered bond purchase programme, buying €40bn of covered bonds in both the primary and secondary markets over one year starting in November 2011. Full details will be announced next month including in which countries they will focus the purchases.

...and signalled a readiness to cut

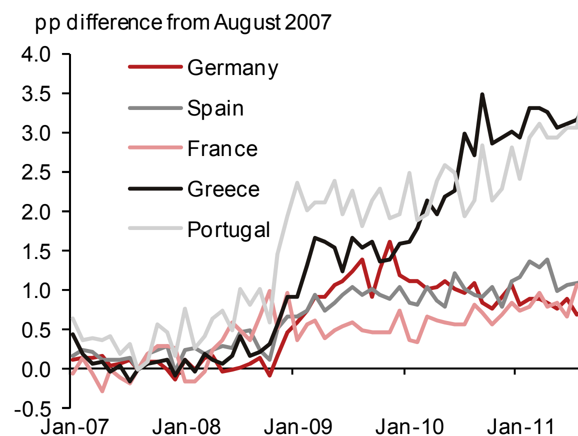
Finally, the tone of this month's introductory statement was more dovish, signalling a readiness to cut rates. But in our view, the ECB did not provide a firm signal of a November rate cut. The ECB may be saving the rate cut ammunition for any "bad event" possible on Greece. Thus, the timing of the rate cut will depend on how the Greek situation and how the data flow evolve. We remain comfortable with our call for a 25bp rate cut by December.

Figure 1. ECB credit conditions survey



Source: Nomura Global Economics.

Figure 2. Euro-area bank lending spreads



Source: ECB and Nomura Global Economics.

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The most interesting piece of news came during the press conference, when President Trichet stated that it was up to governments to decide whether the EFSF should be leveraged. But he also rejected the idea that the EFSF should be leveraged via the ECB. Clearly, the ECB continues to signal that it is up to the euro area governments to solve the sovereign debt crisis; the ECB looks to continue its bond buying for now, but there are limits to what it can and will do.

...but tighter credit conditions require looser monetary policy

Credit conditions are tightening in the euro area...

It is clear to us that the need for an ECB policy rate cut is increasing. The October 2011 Bank Lending Survey showed that euro area banks in Q3 substantially tightened credit standards for both households and corporations. And banks expect a further tightening in Q4. At the same time, banks reported a net decline in the demand for loans from both households and corporations (Figure 1). The policy prescription is clear to us: the central bank (i.e. the ECB) has to loosen monetary policy to offset the tighter credit conditions. This monetary loosening may require an outright cut in policy rates.

... requiring the ECB to offset with a policy rate cut

Looking across the euro area, credit conditions appear tighter in some parts than in others. The spread of corporate loans over funding costs – one proxy of credit conditions – has continued to increase in countries such as Greece and Portugal (Figure 2). This partly reflects the persistent headwinds facing the banking sector there, and even a 50bp ECB policy rate cut is unlikely to substantially loosen credit conditions there.

BoE: QE2 launched

The BoE is set to buy £75bn of assets in the next four months

Contrary to our and the consensus's expectations, the MPC launched QE2 at its October meeting. The MPC is evidently extremely concerned about the deterioration in the euro area and the persistently poor growth data (Figure 3). So it announced that it will purchase £75bn of assets over the next four months (starting 10 October, evenly split between 3-10, 10-25 and 25+ years). We had considered this to be more likely than the option of £50bn over three months, for which the market had been mostly positioned.

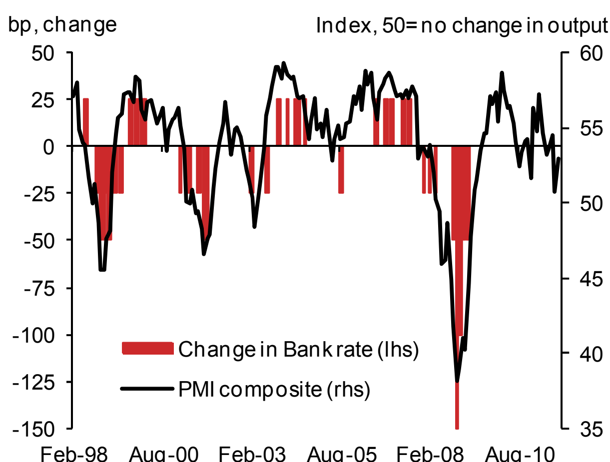
"Shock and awe" was delivered

By making purchases over four months, it has afforded itself the forecast round for the February *Inflation Report* to calibrate and communicate its next response. Meanwhile by ramping it up to £75bn, the MPC has delivered "shock and awe" and given itself sufficient ammunition to maintain a high run rate of gilt purchases. Indeed, the net issuance to the market will be similar to that in the first stage of QE1 (Figure 4). Purchases should be aimed at conventional gilts further out the curve than last time, owing to pre-existing ownership stakes and the MPC's perception of where it has the greatest potential to reduce yields.

We expect more asset purchases (£25bn) in February

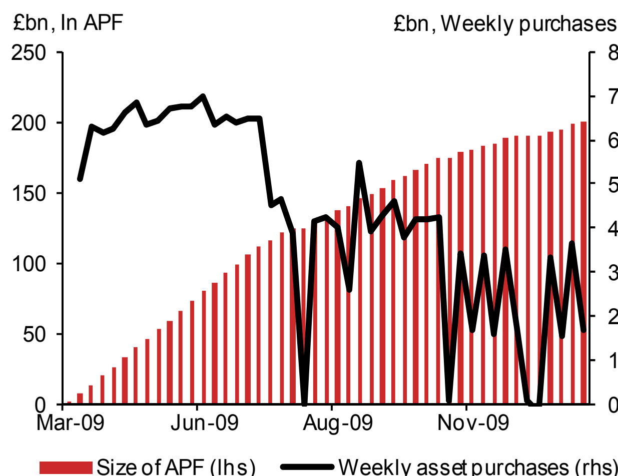
We still doubt whether QE2 is consistent with the inflation outlook, but the MPC is unlikely to reconsider this announcement, in our view. Indeed, we still expect the MPC to follow through with a further £25bn of asset purchases when it reassesses its forecasts in February. We also think the impact of these purchases will disappoint relative to the Bank's estimates of QE1's impact. Our working assumption is that the price level will be raised by about 0.5%, but the impact on real activity is only about half that (see "Leader: QE quandary" in UK Monthly Macro).

Figure 3. BoE growth reaction function



Source: Markit, Bank of England and Nomura Global Economics

Figure 4. BoE asset purchases in QE1



Source: Bank of England and Nomura Global Economics .

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Growth may slow but is unlikely to stall

The economy looks likely to slow, but because of the increase in auto production, the third supplementary budget and the BOJ's latest Tankan we do not expect it to stall completely.

The BOJ's Tankan pointed to continued economic stability

The BOJ's September Tankan survey, released on 3 October, was largely as expected, and indicated that the economy is likely to remain stable. The key current business conditions diffusion index (DI) for large manufacturers came in at +2, in line with the pre-announcement consensus. The future business conditions DI also rose once again, to +4, slightly above the consensus forecast of +3. The current business conditions DI improved markedly from -9 in the June survey, which reflected the immediate aftermath of the March quake, and has now returned to positive territory (Figure 1).

The auto sector is recovering, unlike electrical machinery

The most notable feature of the September Tankan was that, among all manufacturing sectors, the auto sector showed the largest improvement in the business conditions DI (for large companies). The 65 point quarter-on-quarter improvement in the current business conditions DI for the auto sector was the largest on record. This sector was hit hardest by the March quake largely through disruption to supply chains. The auto sector's future conditions DI also showed a sizeable improvement of 11 points. By comparison, there was only an 11 point improvement in the current business conditions DI for the electrical machinery sector, which was relatively unaffected by the earthquake, and only a 1 point improvement in its future business conditions DI. A comparison of these two sectors reflects the current situation in the Japanese economy as a whole. On the supply side, the negative impact of the disruption of supply chains is easing rapidly, while on the demand side the economy is beginning to feel the effects of the slowdown in overseas demand and the negative reaction to the surge in demand for flat-screen TVs ahead of the end of analog broadcasts.

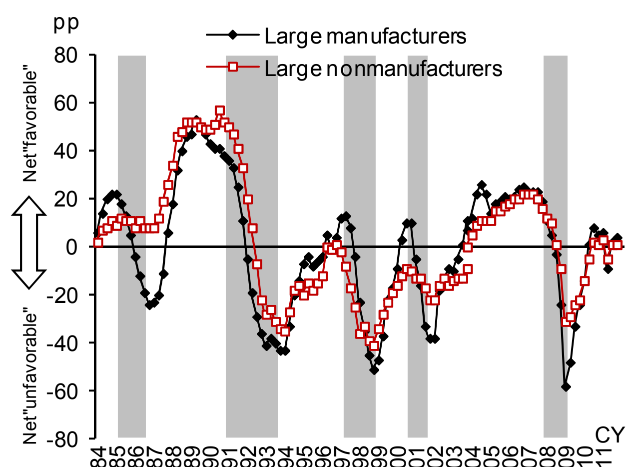
Capex forecasts were lower than expected

One set of data in the September survey Tankan that was well below pre-release forecasts was companies' capex forecasts. Expected capex growth in FY11 (all industries, all company sizes), at 0.2% y-o-y, was up marginally from 0.0% as of the June survey, but short of the pre-release consensus of 1.1%. In particular, expected capex growth at large companies in all industries was unexpectedly revised downward to 3.0%, from 4.2% as of the June survey.

Large companies revised down their profit forecasts

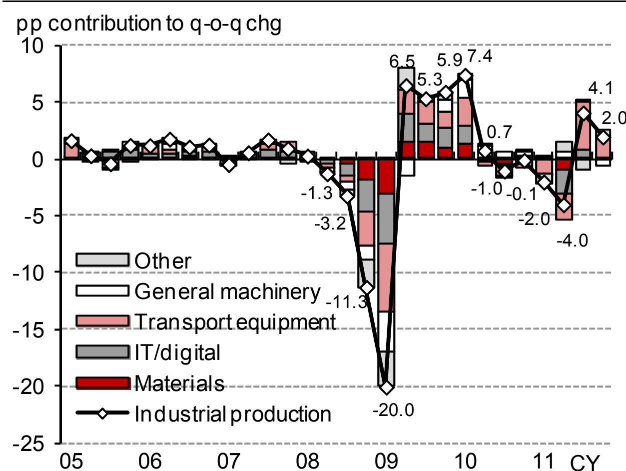
We see downward revisions to export forecasts, the strengthening of the yen, and the resulting downward revisions to earnings projections as the reasons why companies' capex forecasts, which had remained bullish following the March quake, fell well short of consensus forecasts in the September survey Tankan. Large manufacturers raised their FY11 domestic sales growth forecasts by 2.1pp from the June survey but lowered their export forecasts by 1.0pp. Large manufacturers also revised their USD/JPY assumptions for H2 FY11 in the direction of a

Figure 1. Business conditions DIs for large companies



Note: Latest data are future business conditions DIs as of September 2011 survey.
Source: BOJ's "September survey Tankan", Nomura Global Economics.

Figure 2. Industrial production by sector



Note: Data for Jul–Sep 2011 and Oct–Dec 2011 are estimates based on a survey of manufacturers' production forecasts. Basic materials sectors are the steel, nonferrous metals and chemicals sectors. IT/digital sectors are the electrical machinery, IT machinery, and electronic parts and devices sectors.
Source: Ministry of Economy, Trade & Industry data, Nomura Global Economics.

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stronger yen, from 82.59 as of June to 81.06 as of September. Large manufacturers also revised down their FY11 recurring profit growth forecast by 0.7pp to -0.3% y-o-y.

We expect Japan's economy to tread water temporarily

We see the lower-than-expected capex forecasts and the downward revisions to recurring profit forecasts at large companies, as well as the decline in future conditions DIs for small companies in both manufacturing and nonmanufacturing sectors, as causes for concern with regard to the outlook for the Japanese economy. Moreover, recently released economic data suggest that the Japanese economy has lost a great deal of momentum of late, after rebounding clearly from the spring, and is highly likely to tread water temporarily through the end of 2011. The industrial production figures are a key example of such data. Preliminary data for August show that industrial production rose for the fifth consecutive month, at +0.8% m-o-m, but this was well below both the 2.8% m-o-m figure in the survey of manufacturers' production forecasts and the average market forecast of +1.5% m-o-m. We expect industrial production to grow by more than 4% q-o-q in Q3 2011 (Jul-Sep), marking the first quarter-on-quarter increase in five quarters, but then expect it to lose speed in Q4 2011 (Figure 2). Indeed, the survey of manufacturers' production forecasts was down a substantial 2.5% m-o-m in September. The September Japanese manufacturing PMI also fell 2.6 points m-o-m and was below the 50 boom-bust line for the first time in five months.

Three factors are causing Japan's growth to slow

A combination of three factors is causing Japan's economic growth to slow, in our view. First, normalization of post-quake production activity has more or less run its course (the August industrial production index was 95.7% of the pre-quake February level). Second, the economy is now suffering a fall in sales of flat-panel TVs in reaction to the surge in demand for these products ahead of the switchover to digital broadcasts, as well as a decline in purchases of summer products such as air conditioners and Cool Biz apparel. Third, the external environment has deteriorated, with the slowdown in overseas economies and the strengthening of the yen.

We still see little risk that the economy will stall completely…

At the same time, however, we think there is still little risk that the Japanese economy will stall completely. The first reason for this view is that, although the normalization of production activity has largely run its course, production is increasing in the auto sector, which has a significant impact on the Japanese economy as a whole. We expect domestic auto production growth to rise from -3.9% y-o-y in Jul-Sep 2011 to +17.9% y-o-y in Oct–Dec 2011 and +46.7% y-o-y in Jan-Mar 2012. While it might seem strange that auto production is increasing at the same time that signs of an economic slowdown both in Japan and overseas are growing, this is due to the normalization of excessively low inventory levels. We calculate that, on a quarter-on-quarter annualized basis, the increase in auto production should push up real GDP growth by +2.9pp in Jul-Sep 2011, +1.1pp in Oct-Dec, and +1.4pp in Jan-Mar 2012. Moreover, the positive impact is likely to be greater than this if we also include the knock-on effects on parts makers, for example. The second reason why we see little risk that the Japanese economy will stall is that we expect a third supplementary budget, worth around ¥12trn, to be passed before the end of this year, and think that this will give a sharp boost to the economy from the beginning of next year. We estimate that this budget should boost real GDP growth in FY12 by around +1.2pp.

… a view supported by the BOJ's September Tankan

We should also point out that the BOJ's September Tankan survey gives no indication that the Japanese economy is going to stall. This view is based primarily on the improvement in the future business conditions DI for large manufacturers to +4. Other key indicators also improved, including both the current and future supply-demand and employment conditions DIs for large manufacturers. In addition, we think the improvement in the future DIs for financial position and lending attitude of financial institutions supports the view that financial instability in the US and Europe has yet to create funding pressures in Japan.

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Modelling Asian inflation

Our models predict CPI inflation will fall sharply in the coming quarters if commodity prices and Asian exchange rates stabilize at current levels; and more so if recent trends continue.

The data offer no clear signs yet of CPI inflation abating

The latest CPI data suggest that inflation has peaked, but it has yet to decisively abate. Our seasonally-adjusted favoured pulse measures of inflation, the % month-on-month and % 3-month-on-3-month annualised rates, show some signs of price pressures easing, but the more commonly quoted % year-on-year rates remain high in most countries, and for Asia overall it held constant at 6.4% in August (Figure 1). Of the data available for September, the % year-on-year rates eased in Indonesia, Korea and Thailand but rose in the Philippines and Taiwan, and next week we expect China to report an uptick to 6.3% y-o-y. Adding to the mixed picture, excluding food and energy items, core CPI inflation is still rising in six of the ten countries, while the latest surveys show that inflation expectations remain elevated (Figure 2). In Southeast Asia, inflation risks for October have risen temporarily, because of a likely surge in food prices due to typhoons and flooding in Thailand (the world's biggest rice exporter) and the Philippines, and potential for higher energy costs due to the closure of a major oil refinery in Singapore.

Opposing forces

Depreciating Asian currencies but falling commodity prices

Looking beyond bad weather, there are several more fundamental countervailing forces acting on Asian inflation, some of which are gaining in intensity. One is the economic growth outlook. Asia's economies have clearly entered a downcycle; so far, it has been relatively shallow, but we see the risks firmly skewed to it becoming deeper, in which case economic slack will open up, reducing demand-side price pressure. Another is the big drop in commodity prices. The CRB commodity price index – which, of the various commodity prices measures, we found to have the strongest empirical relationship with Asian CPI inflation – has fallen from 343 at the end of August to 305 in early October, an 11% drop. The impact of falling commodity prices on easing Asian inflation can be acute given that the average weight of food and energy items in CPI baskets in Asian countries is 44%. On the other hand, in the past month Asia has experienced large net capital outflows, causing Asian currencies to weaken against the USD, the most extreme cases include a 10% depreciation of the Korean won, followed by 6-8% depreciations of the Indian rupee, Malaysian ringgit and Singapore dollar. Weakening currencies raise the cost of imports, which can ultimately be passed through, increasing CPI inflation.

Nominal effective exchange rates are a better gauge

The different magnitudes of recent currency and commodity price changes must be considered. Asia's currencies, on average (weighted by GDP), depreciated by only 2.6% against the USD in September. Even after stripping out the Chinese renminbi, the average depreciation was 6.6%, which pales in comparison to the 13% fall in the CRB index. The more pronounced cycle for commodity prices was even more extreme in 2008-09, which is, perhaps, not surprising given the global turmoil is not sourced from Asia (Figure 3). Additionally, against a basket of currencies (a better metric to measure inflationary effects from currency movements) Asia's

Figure 1. Gauging Asia's inflation pulse

	% m-o-m (s.a.)			% 3m-o-3m (s.a.) annualized			% y-o-y		
	Jul	Aug	Sep	Jul	Aug	Sep	Jul	Aug	Sep
China	0.5	0.3	n.a.	6.9	7.3	n.a.	6.5	6.2	n.a.
HK	-0.4	-2.0	n.a.	5.8	0.9	n.a.	7.3	6.1	n.a.
India	0.1	0.6	n.a.	4.6	3.7	n.a.	9.2	9.8	n.a.
Indonesia	0.1	0.5	0.3	2.7	2.7	3.1	4.6	4.8	4.6
Malaysia	-0.1	0.0	n.a.	1.1	0.3	n.a.	3.4	3.3	n.a.
Philippines	0.0	0.1	0.4	1.8	1.0	1.1	4.6	4.3	4.6
Singapore	0.6	0.5	n.a.	5.1	6.0	n.a.	5.4	5.7	n.a.
Korea	0.6	0.7	0.2	2.4	4.4	5.8	4.7	5.3	4.3
Taiwan	-0.1	0.0	0.1	0.7	0.3	0.0	1.3	1.3	1.4
Thailand	0.4	0.5	0.1	3.2	3.2	3.4	4.1	4.3	4.0
Asia	**0.3**	**0.3**	**n.a.**	**5.3**	**5.3**	**n.a.**	**6.4**	**6.4**	**n.a.**

Source: CEIC.

Figure 2. Different survey measures of inflation expectations

	2006	2007	2008	2009	2010	2011-latest
China	74.1	80.7	53.1	73.4	81.7	74.8
Diffusion index (one quarter ahead)						
Hong Kong	1.0	17.0	5.0	15.0	11.0	27.0
Net balance (one quarter ahead)						
India	5.8	5.9	9.6	11.9	13.1	12.7
Inflation rate (one year ahead)						
Indonesia	163.2	179.4	156.8	158.8	164.3	170.2
Net balance (6 months ahead)						
Philippines	n.a.	7.4	8.8	8.7	7.6	8.5
Inflation rate (one year ahead)						
South Korea	3.1	3.0	4.0	3.2	3.7	4.3
Inflation rate (one year ahead)						
Thailand	3.9	3.8	3.4	2.7	3.5	3.8
Inflation rate (one year ahead)						

Note: 2011 latest data are for September 2011, except for India (Mar-11); Indonesia and Thailand (Aug-11).
Source: Central bank websites and CEIC.

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effective exchange rates depreciated by an even smaller amount (helped by a weakening euro); in fact, the Hong Kong dollar and Chinese renminbi have appreciated in effective terms over the past month. Another item of note is the extent to which producers pass on higher import costs to consumers. The pass-through is likely conditional on the strength of domestic demand. With slowing GDP growth, producers likely lose some pricing power and, therefore, at the margin, are less willing to pass on higher costs to consumers over concerns of losing market share.

Our models

Our models predict CPI inflation to fall in Q4 2011

We ran CPI regressions for each country over the period Q1 1996 to Q3 2011 (for details, please see the Appendix). For our models to predict inflation, we need forecasts of the explanatory variables: for the output gaps we use our GDP forecasts, which predict Asian growth slowing moderately to 7.6% in 2012; we have the commodity price index and nominal effective exchange rates (NEERs) holding constant at end-September levels; and money supply maintaining Q3 2011 growth rates. On these assumptions, our models predict Asia's average (GDP weighted) CPI inflation rate will fall from 6.3% y-o-y in Q3 to 5.1% in Q4 2011 (Figure 4).

We also simulated three shocks to our model's baseline

We also simulated three shocks to our model's baseline assumptions from Q4 2011 onwards:

Scenario 1 (S1). Same as baseline assumptions except the commodity price index falls by a further 20% in Q4 2011, and remains at this lower level through 2012.

Scenario 2 (S2). Same as baseline except the NEERs depreciate by a further 10% in Q4 2011, and stay at these weaker levels through 2012. The two exceptions are the NEERs of Hong Kong and China, which appreciate by 5% in Q4 2011 due to their heavily controlled exchange rates.

Scenario 3 (S3). Scenarios 1 and 2 combined.

The large fall in commodity prices is the dominant driver

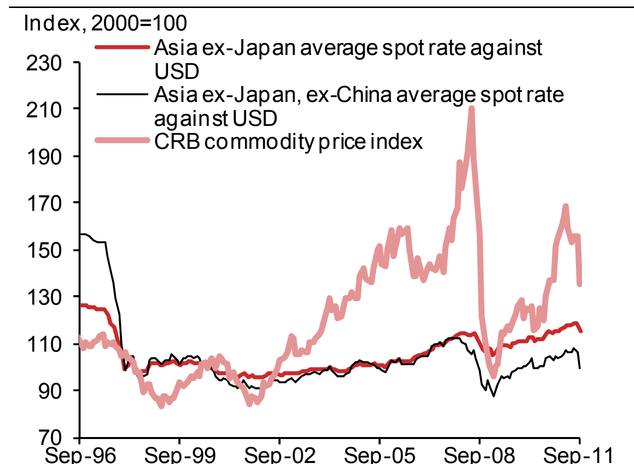
Allowing for the different magnitudes – the percent fall in commodity prices in S1 is twice that of NEER depreciation in S2 – the elasticity estimate of NEERs on CPI inflation is larger than that of commodity prices in most countries except China, Hong Kong, Malaysia and the Philippines. However, in most cases, the higher NEER elasticities are more than offset by the way – realistic in our view – we have set up the simulations, i.e., having commodity prices fall by twice as much as NEERs depreciate. Indeed, in S3, the overall net impact is that CPI inflation falls relative to baseline in all countries except Korea, Singapore, Taiwan and most notably, Indonesia. The bottom line is: if commodity prices and NEERs stabilise from here, our model baseline predicts a steep drop in Asian inflation; and if the recent trends in commodity prices and NEERs continue in most countries, our models suggest CPI inflation would be even lower still.

Some caveats

The model's results highlight downside risks to our forecasts

The model predictions are not Nomura's CPI inflation forecasts, as we need to also take into account each individual country's idiosyncratic factors. For example, in Hong Kong we expect the large CPI weight of property rentals, plus the long lag feeding into the CPI, to keep inflaton elevated, while in China we have identified many structural factors that will keep inflation high (see Asia Special Report, China: The case for structurally higher inflation, 21 September 2011). That said, we are cognizant of the downside risks to Asian inflation, given that, in most countries, our model predictions in 2012 are below our current Nomura forecasts.

Figure 3. Asia exchange rate and CRB commodity price index



Note: Average exchange rates are GDP (in USD) weighted.
Source: BIS; Bloomberg and CEIC.

Figure 4. CPI inflation predictions: baseline and 3 scenarios

	Q3 2011	Q4 2011	2012			
	Actual	Baseline	Baseline	S1	S2	S3
China	6.4	4.7	1.6	-0.1	1.4	-0.2
Hong Kong	6.7	6.3	5.2	3.4	5.1	3.3
India	9.2	8.3	5.7	3.3	7.4	4.9
Indonesia	4.7	4.0	1.7	-1.5	8.8	5.7
Korea	4.8	3.6	2.4	1.6	3.2	2.4
Malaysia	3.3	2.8	1.1	-1.0	1.6	-0.6
Philippines	4.8	3.9	1.5	-1.9	2.4	-1.0
Singapore	5.5	4.8	3.9	2.7	5.4	4.1
Taiwan	1.3	0.7	0.7	0.1	1.5	1.0
Thailand	4.1	3.6	2.8	0.8	4.1	2.0
Asia	**6.4**	**5.1**	**2.6**	**0.7**	**3.4**	**1.6**

Source: BIS; Bloomberg; CEIC and Nomura Global Economics.

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Appendix: OLS regressions of CPI inflation in Asia

The output gap, the exchange rate and commodity prices are key explanatory variables.

We used five different explanatory variables

Using quarterly data over Q1 1996 to Q3 2011, we model CPI inflation for 10 Asian countries by running Ordinary Least Squares (OLS) regressions. We used five explanatory variables:

1) Lagged CPI inflation: To capture adaptive inflation expectations and general inertia in price setting behaviour, we include the first lag of CPI inflation itself.

2) Economic slack: We use our measure of the output gap – the percentage deviation of actual GDP from its trend (we estimate trend rates using the Hodrick-Prescott filter).

3) Exchange rate: We use the nominal effective exchange rate (NEER) compiled by the BIS. A lower NEER means a weaker local currency against a trade-weighted basket of currencies.

4) Money supply: We use M2 or M3 broad money supply measures. In the long run, there tends to be a close link between broad money supply growth and CPI inflation.

5) Commodity prices: We tried oil prices and several commodity price indexes. We found that the Reuters-Jefferies CRB index and the RBA rural commodity price index were the statistically most significant. The high weighting of soft commodities in these indexes is consistent with the fact that food typically has two or more times the weight of energy in Asian CPI baskets.

Output gap, NEER and commodity prices are significant

All variables are measured in terms of year-on-year growth, except the output gap. We ran regressions with the current value and lags of up to four quarters of all variables, except for CPI inflation, where only the first-quarter lag is included. Variables with statistically insignificant coefficients were then omitted to arrive at the parsimonious OLS regressions (Figure 5). In terms of goodness of fit (measured by adjusted R-squared), all equations fared pretty well. The output gap is statistically significant in 8 of the 10 regressions, and in the majority of cases it is most significant when lagged by at least one quarter. The NEER is significant in all regressions except that of Malaysia. The commodity price index is highly significant at the 1% level in all regressions with no lag; the only exceptions are those for Indonesia and Taiwan (significant at 5%). In contrast, money supply is only significant in the regressions for China, Korea, Singapore and Thailand. One-quarter lagged CPI inflation is highly significant in all the regressions, suggesting inertia and adaptive expectations by price setters in Asia.

Figure 5. OLS regressions of CPI inflation (quarterly data over Q1 1996 to Q3 2011)

	China	HK	India	Indonesia	Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand
Constant	-1.08**	-0.10	1.31**	0.08	1.24**	-0.08	0.22	-0.14	-0.18	0.23
CPI inflation$_{t-1}$	0.74**	0.91**	0.71**	0.87**	0.44**	0.94**	0.89**	0.82**	0.61**	0.64**
Output gap$_t$	0.20**							0.12**		
Output gap$_{t-1}$		0.08	0.19						0.12*	
Output gap$_{t-2}$						0.10**				
Output gap$_{t-3}$				0.50**	0.09*					
Output gap$_{t-4}$							0.40**			0.10*
NEER$_t$			-0.08**	-0.27**	-0.06**					
NEER$_{t-1}$						-0.02	-0.04*	-0.07*		-0.08**
NEER$_{t-2}$									-0.07**	
NEER$_{t-3}$	-0.04*									
NEER$_{t-4}$		-0.05*								
Money supply$_t$					0.05**					
Money supply$_{t-1}$	0.08**									
Money supply$_{t-2}$										
Money supply$_{t-3}$									0.07	
Money supply$_{t-4}$								0.05**		0.08**
Commodity price index$_t$	0.04**	0.03**	0.07**	0.07*	0.03**	0.04**	0.07**	0.03**	0.02*	0.06**
Adjusted R-squared	0.95	0.94	0.78	0.95	0.87	0.79	0.87	0.92	0.66	0.90
Durbin-Watson statistic	1.75	2.08	1.10	1.21	1.68	1.48	1.20	1.88	2.16	1.42
S.E. of regression	0.67	0.82	1.11	3.48	0.57	0.73	0.87	0.57	0.82	0.81

Note: * (**) denotes that the t-statistic is significant at the 5% (1%) probability level. For China, Hong Kong and Singapore the RBA rural commodity price index is used instead of the Reuters-Jefferies CRB index because we found it to be statistically more significant. For India, the wholesale price index is used instead of the CPI. For Indonesia, to avoid the unusually large swing in inflation and IDR/USD in 1998-99, a dummy variable was used.
Source: CEIC, BIS, RBA, Reuters, Bloomberg and Nomura Global Economics.

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Andean Trip Notes

Policymakers in Andean economies are fairly concerned about the external environment and ready to act. Domestic political developments could have negative growth implications as well.

We met with central bank officials, academics, independent and local market analysts as well as clients in Chile, Colombia and Peru. Below are our main conclusions.

Chile

During our conversations with local contacts two prominent themes emerged: the impact of the current crisis on Chile and the political implications of the student protests.

Chile has adequate policy options to confront the crisis...

Growth outlook and monetary policy response: The general opinion is that Chile has substantial policy space to respond to the current crisis, which has already led to a 15% fall in the CLP since early September. The central bank (BCCh), we believe, will cut rates by the end of the year as a first response to the crisis, and if the crisis deepens fiscal policy could be brought into play.

China's outlook and how long the crisis lasts are concerns

Nonetheless, there is evident anxiety locally on two points: what will happen to China (Chile's largest trading partner) and how long the crisis will last. With copper representing 58% of exports and 20% of GDP, and with Chinese demand being the main determinant of copper prices, we think Chileans are right to worry much more about China than Europe. Moreover, the general consensus is that, while there is substantial policy room to respond if the present downturn lingers (remembering that in 2008-09 there was a "V" shaped recovery), countercyclical policy has at best a limited ability to cushion the Chilean economy.

Student protests could put pressure on public finances...

Student protests and political implications: Another important topic was the political implications of recent student protests. Unlike most countries, Chile has essentially a privatized education system, with families picking up around 80% of costs. Years of socialist governments have not substantially changed this, while the election of the centre-right administration of President Piñera unleashed a long, drawn-out student protest movement demanding free public education and other reforms. As protesters have found public support, the question is whether this is just the tip of the iceberg for more public services, which could increase pressure on Chile's healthy fiscal balances over time, or whether it is something more localized.

...and lead to long-term changes to the political status quo

Local opinion is split: some believe the education issue is special and will be dealt with accordingly (the 2012 budget proposal already earmarks more education funds), while others believe that having achieved middle income status, the quality, and not just the provision, of public services is key. Some analysts point out that the current student generation represents a demographic "peak," which will gain political ascendency over time. The other question being pondered is how the current protest will impact party politics, as there is a non-trivial chance that the movement transforms itself into a political party. There are also attempts by the opposition Socialists to incorporate the students. The general feeling is that, whatever happens, the protest will change the present political duopoly that has ruled Chile in the post-Pinochet area.

Colombia

Policymakers are now more worried about growth...

Growth: The meltdown of commodity prices, the rising risk aversion stemming from the sovereign debt crisis in Europe and a rising probability of a hard landing in China have triggered fears of a sudden economic slowdown. The authorities, which only a couple of months ago seemed preoccupied about the strong pace of bank lending to the private sector (growing at 20% y-o-y in real terms), are now worried that local banks could halt lending. Locals expect GDP to expand by 5.0% in 2011 but the outcome for 2012 is much less certain given the extreme headwinds from external economies. Growth could actually drop into negative territory. After all, more than 60% of Colombian exports go to the US (40%) and Europe (22%), which are precisely the two regions where risks of recession are rising.

...and are trying to keep credit and spending growing

The authorities mentioned a "social pact", which was described to us as a heterodox plan that might encourage banks to keep lending, workers to refrain from asking for higher wages, and the government to accelerate infrastructure spending. The content of the still undefined social pact suggests that the government is worried about growth next year.

Potential growth also remains "too low" according to some of the local think tanks. Compared to the potential GDP growth in Brazil (3.5%) and Mexico (3.0%), the Colombian rate, estimated at

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around 4.5%, looks decent; but compared to similar economies such as Peru (6.5%) and Chile (5.5%), it does look low. According to locals, obstacles for a higher potential GDP include the lack of infrastructure, nascent signs of Dutch disease, labor market inflexibility and the dead trade relationship with Venezuela (Colombians required upfront payment from Venezuelan importers).

The central bank will likely be on hold

Monetary policy: Locals believe the central bank (BanRep) would certainly keep the policy rate unchanged at 4.5% for the remainder of the year. Some even believe BanRep would keep it unchanged throughout 2012. However, we didn't sense that a rate cut is imminent.

New arrangement would allow fairer royalty distributions

The recently approved fiscal proposals: The bylaws of the Royalty Law, soon to be published, would effectively allow for a fairer distribution of royalties between regions. Royalties, amounting to 1% of GDP each year (if commodity prices don't continue falling), used to benefit only commodities-rich regions and were a source of corruption and rent seeking. The approved law would foster infrastructure spending; approximately 30% of the royalties would be saved in a sovereign wealth fund outside the country.

Peru

Further growth deteriorations could lead to rate cuts

Monetary and fiscal policies: There is a real concern about the pace of deterioration of the sentiment and its impact on domestic growth, given the external backdrop. Further deterioration could trigger a strong reaction from the central bank (BCRP) that would likely include cuts in the policy rate (currently at 4.25%) and in reserve requirements (average: 13.4%; marginal: 25%) and larger amounts of dollar sales to stabilize the Peruvian peso (PEN). Similar to Colombia, Peruvian authorities believe that it is key to keep credit flowing to the private sector in order to counterbalance the external-led economic deceleration.

While there are serious bottlenecks that should prevent public spending from jump-starting the economy, authorities highlighted that, if needed, they would use part of the US$7bn fiscal stability fund to foster growth.

Mining royalties have been introduced with relative success

The recently approved mining royalty: Locals seem to agree that Humala's negotiation with mining companies allowed for a smooth passage of the law. The effective tax rate would increase to roughly 45% from around 40%, in line with Chile's tax rate. Consultant group Apoyo was apparently involved in the design of the proposal. The fact that Humala relied on pro-market and competent consultants is without doubt a positive sign. Interestingly, Humala's own Congressmen had to be brought in line to vote in favor of the law. Diez Canseco, a Congressman from Humala's "Gana Peru" party was the main opposition to the proposal.

Locals still fear Humala's likely radical policies

Humala: Suspicions about Humala's socialist tendencies should dissolve gradually. However, locals still believe that Humala could turn to populism, particularly if his popularity increases, which would embolden him to push for a radical social agenda, or decreases significantly. Humala's popularity is now around 70%. The main risks we sensed are that Humala might opt, maybe later in his term, to adopt economic policies that enlarge the government's influence à la Brazil or even worse, similar to Argentina.

Recent legislation could negatively impact the economy

There are two potentially negative developments: (1) the passage of a labor law that would increase rigidity in the economy; (2) the Congress also passed a law that would force mining companies to consult indigenous groups before starting new mining projects, which could potentially harm future investment projects. But it is still not clear who would have the last say. The "Consultation law" ("*Consulta Previa*" in Spanish) has been approved, but the bylaws haven't been finalized. Locals told us that the details will determine if indeed the law could potentially negatively impact the investment pipeline estimated in about US$40-50bn for the next five years.

Implementation of Humala's social agenda: Apparently, Nadine, Humala's wife is very involved in the social projects that include pensions for lower income seniors. We learnt that the IADB is involved in the design of the social programs, which in our view is positive.

2011 growth should remain strong but 2012 more uncertain

Growth: Peru's economy is set to expand by at least 6.0% in 2011. But in 2012, the main concern is that the global slowdown would drag Peru to a growth rate significantly lower, e.g., around 1-2%. Perhaps the most important question has to do with a probable decline in the potential GDP rate, currently estimated at 6.5%. Roughly speaking around 2.5% of such rate is a function of investment. However, the "Consultation law" and the implementation of more interventionist policies could reduce it. Time would tell.

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Indonesia: Capital flows – what's new and what's next?

The recent unwinding of foreign holdings of IDR assets reflects still-high vulnerability to global risk aversion. But there are significant buffers now and a supportive structural story.

Q3 was difficult for IDR assets

Indonesian financial markets had a volatile third quarter. The stock market hit a record high in July but has fallen 20% since. Yields in the front end of the government bond market spiked 70-100bp after hitting record lows just a few weeks back. The IDR was under stress, weakening by as much as 7.3% against the USD before recovering slightly. The vulnerability of these financial assets and the IDR is relatively high for a well-known reason: foreign investors have piled into Indonesian assets over the past two years and these portfolio investment inflows tend to be sensitive to a global risk-off environment. Foreign holdings of government bonds fell to USD24.8bn by end-September (31.3% of total outstanding) from USD26.5bn (35.5%) in July, and those of central bank bills (SBIs) fell to USD4.6bn from USD7.1bn in the same period. There are no similar data for equity securities but we estimate holdings at around USD64bn[1] after foreign investors sold USD1.1bn of Indonesian stocks in August and September.

More durable capital account surplus…

The mix of capital flows has improved

In the current turbulent environment it is easy for investors to focus on the risk of large capital outflows given still sizeable foreign investor portfolios. But we believe it is important not to lose sight of the bigger balance of payments (BOP) picture, and in particular, to keep in mind how the mix of capital flows has rendered it significantly more resilient now than in 2008.

FDI is now structurally higher…

On a net basis, FDI flows already comprised about one-third of the USD19bn capital account surplus in H1 2011, up from below 20% in 2009. But this masks what appears to be a more structural uptrend in *gross* FDI inflows (Figure 1). Following the election of President Yudhoyono in 2005, quarterly FDI inflows have averaged USD2bn from virtually zero in the last three years. The 2008-09 global financial crisis proved a temporary interruption in the rise of these inflows, as the quarterly average reached USD4bn in 2010. A significant chunk of these flows went into the resource-based sectors, in part to take advantage of the rise in commodity prices. But increasingly, they have also gone into manufacturing, underpinned by the stability of the political environment and improvements in the business climate. Geographically, FDI inflows from China in the last three years totaled USD0.6bn, nearly triple the accumulated FDI in all of 2003-07.

… while "other investment" is also more positive

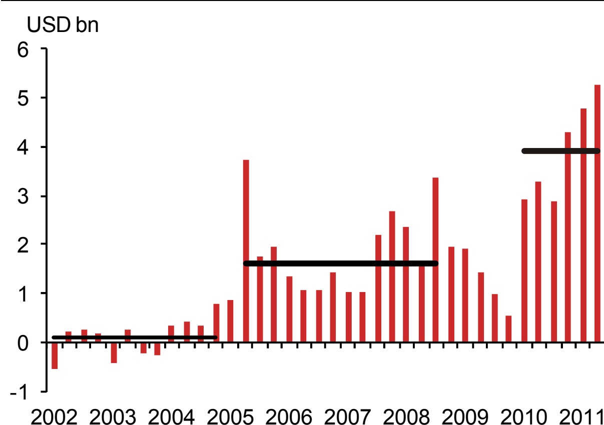
Net "other investment" inflows have also turned positive since mid-2010, driven by private sector loans and deposits (Figure 2). This follows several years of persistent net outflows which reflect the well-known practice of local investors taking cash offshore. This is now likely reversing: Indonesians are repatriating their offshore holdings which we think is being driven not just by the global uncertainty and the prospect of USD interest rates staying low for a sustained period but also, increasingly, rising confidence in their own currency.

… and enhanced backstops

Portfolio outflows remain a risk but backstops are better

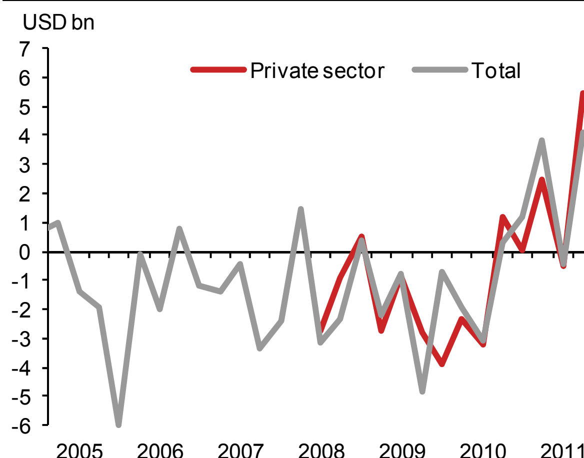
The reversal of portfolio inflows still poses a significant threat, which may also affect the pace of FDI and other investment inflows via confidence effects in the IDR. However, we believe the authorities have learned their lesson from 2008 and have put in place measures that should

Figure 1. FDI inflows



Source: CEIC, Nomura Global Economics.

Figure 2. Net other investment



Source: CEIC; Nomura Global Economics.

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provide confidence-boosting backstops. In 2008, the negative risk perception against Indonesian assets was fuelled by a confluence of factors including large external funding requirements, substantial reduction in FX reserves, unfavourable supply-demand dynamics of the government bond market given rising fiscal deficits, and the political distraction ahead of the 2009 elections. What helped restore confidence was the FX liquidity support from official creditors, including the USD5.5bn contingency financing facility and the USD30bn swap agreements under the Chiang Mai Initiative. These factors have turned around decisively since the crisis and FX liquidity support has been further enhanced by other measures, including the establishment of a bond stabilization fund, macro-prudential measures and a rapid accumulation of FX reserves.

There have been large interventions in bonds…

The authorities have been able to deploy these measures to counter the latest bout of market sell-off and we think they have been effective so far. Hence, we expect continued emphasis on their use, should risk conditions deteriorate further. Under its bond stabilization framework, the Indonesian authorities have been able to support the government bond markets with Bank Indonesia (BI) boosting its holdings of government bonds by IDR13trn in September. Commercial banks bought another IDR13bn, which, with the BI purchases, offset nearly all of the IDR30trn reduction in foreign holdings in September (Figure 3).[2] We do not expect measures against foreign holdings in the equity markets because the regional experience to slow these inflows has been counterproductive (for example, Thailand's unremunerated reserve requirement in 2006). Moreover, the bulk of the total USD4.5bn portfolio outflows in Q4 2008 were on debt securities (USD4bn), not equities. Meanwhile, on 3 October, BI passed a regulation requiring exporters to repatriate receipts, providing an additional FX liquidity buffer.

… and in FX markets

BI intervention in FX markets has also helped contain IDR depreciation, with BI revealing it has run down reserves by USD2.6bn in early September. By the end of the month, FX reserves stood at USD114.5bn from USD124bn in August, which implies BI has accelerated the drawdown amid more portfolio outflows. However, this is still more than twice 2008 levels and provides BI with plenty of ammunition (and hence credibility) to ward off further currency pressures. Figure 4 shows our forecasts of the Indonesia's BOP under our base-case and stress scenarios. [3] This shows the external financing position should be able to withstand a sharper deterioration in the global outlook. Under the stress case, FX reserves could fall by another USD3.0bn for the rest of 2011. For 2012, we forecast another USD3bn decline which will leave FX reserves at a still high USD108.8bn, or about 2.5x estimated short-term external debt levels.

Strong fundamentals remain in tact

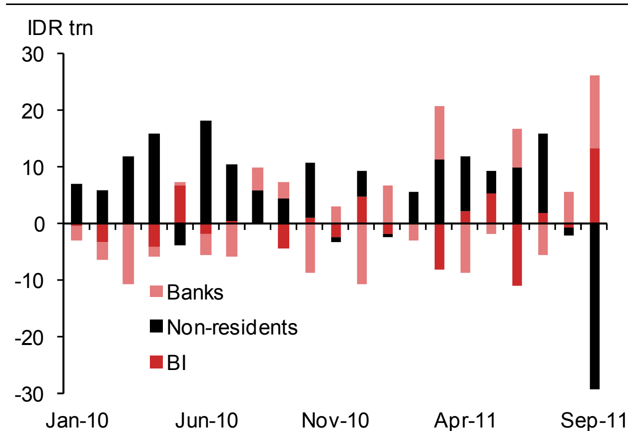
Finally, we emphasize that Indonesia's strong fundamental story remains intact (see Indonesia: Building momentum 7 June 2011) and we think the associated improvements in perception/sentiment over the last couple of years, given the more widespread recognition of this story, are likely to prove another robust backstop. The key is for the authorities to build on this momentum and stay on track with the reform agenda.

[1] This is based on estimates by the Central Securities Depository that foreign investors held USD58bn in equity securities at end-2008, and adding the cumulative net foreign purchases since then. However, this may overstate the extent of 'hot money' flows as it does include strategic investment by foreign investors.

[2] Interestingly, the IMF expressed some concern over the rationale behind BI's intervention in bond markets, suggesting that allowing yields to rise "is the volatility that foreign investors should be getting accustomed to."

[3] The assumptions in the stress scenario are based on the broad movements of the key accounts in 2008.

Figure 3. Change in holdings of government bonds



Source: CEIC, Nomura Global Economics.

Figure 4. BOP forecasts under base and stress scenarios

USD bn	2008	2009	2010	2011f Base	2011f Stress	2012f Base	2012f Stress
Current Account	0.1	10.6	5.6	3.4	3.0	4.2	1.5
Capital and Financial Account	-1.8	4.9	26.2	19.2	15.4	12.7	-1.3
FDI	3.4	2.6	10.7	12.7	10.7	9.0	5.0
Portfolio Investment	1.8	10.3	13.2	-1.7	-3.0	1.7	-1.3
Equities	0.0	0.4	2.0	-3.7	-4.0	1.2	0.2
Debt	1.7	9.9	13.2	2.0	1.0	0.5	-1.5
Other Investment	-7.3	-8.2	2.2	8.2	7.7	2.0	-5.0
Errors and Ommissions	-0.2	-3.0	-1.6	-2.0	-3.0	-2.0	-3.0
Overall Balance	-1.9	12.5	30.3	20.6	15.4	14.9	-2.8
Memo items:							
FX reserves	51.6	66.1	96.2	116.8	111.6	131.7	108.8
% of ST debt	151.0	175.8	242.9	278.0	265.8	292.7	241.8

Source: CEIC; Nomura Global Economics.

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Poland's policy plausibility problem

Markets are not reassured by the current policy response to the country's sizeable dual deficit, although we maintain our constructive attitude to Poland's long-run issues.

We have always retained a constructive (if sceptical) view of Poland's fundamentals, with clear growth outperformance, strong structural factors, a fiscal consolidation plan going at its own pace and not the market's, and a monetary policy which was (at least ex-post) credible. However, with markets now seemingly expecting an improved policy reaction, we see an increased probability of a flexible credit line (FCL) being activated, should the crisis take another serious downturn.

The lack of fiscal policy action is concerning markets...

The market has given Poland's fiscal policy credibility the thumbs down, because of its record deficits and a lack of meaningful action this year or next. While we would have liked larger structural reforms, we prefer to be forward-looking, and Poland's current plans show a primary balance being reached in 2014, with around 5.3pp of tightening (cyclically adjusted). We also see the budget this year beating initial expectations at -5% of GDP vs -5.6% of GDP originally, owing to revenue outperformance. However, looking at the breakdown, we do not see how the budget deficit target of -3.0% for 2012 can be met given the underestimation (in our view) of inflation. Furthermore, while the budget will be re-assessed after the October election, we expect only minimal changes, especially considering the risks of a new coalition complicating the process. Instead, we see the budget deficit reaching -3.55% next year.

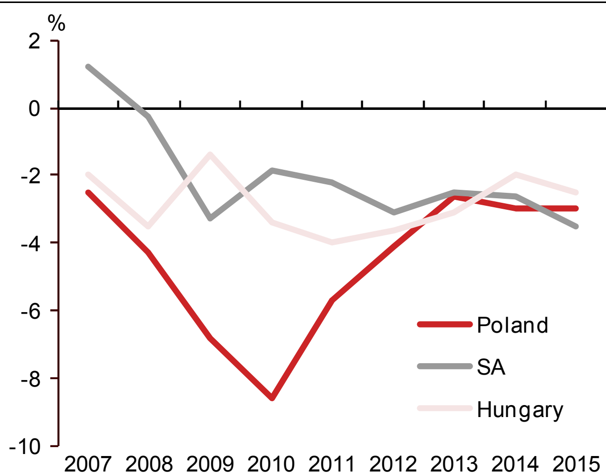
...and intervention is not perceived as a credible alternative

The past few weeks have seen daily zloty buying by Poland's state-owned bank, Bank Gospodarstwa Krajowego (BGK), bond purchases and, more significantly, the rare central bank intervention through FX sales. We believe that the backstop formed by these options, together with the IMF FCL, make a sudden stop in the balance of payments unlikely, although it is still much more possible in Poland (with a current account deficit set to be around -7.8% GDP) than in Hungary (with likely current account surpluses for the next three years). In addition, we would have thought that this sizeable backstop, combined with the still-decent level of carry, would be sufficient to contain zloty appreciation, but the currency remains not only a proxy hedge for wider regional trades, but is also selling off as investors test policymaker resolve. Markets have clear targets in mind for fighting intervention given they see a dual-deficit country doing nothing new to consolidate its budget. However, we think policymakers are not likely to fight back more aggressively until we approach year-end when the 55% debt limit comes into play, especially considering their firepower to do so. However, the dilemma here is one of credibility, because the more policymakers intervene, the more market perceptions turn negative.

But Poland should avoid recession again

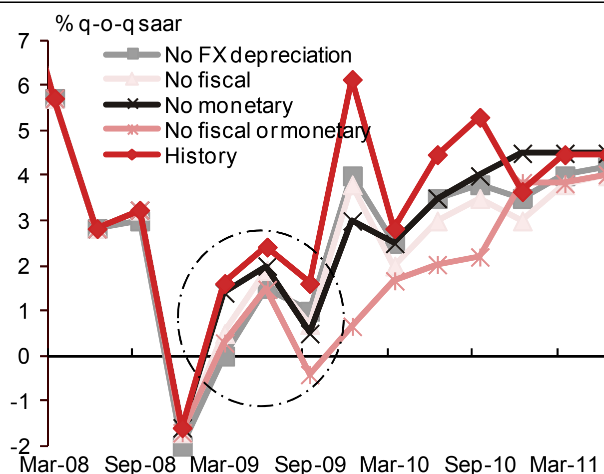
While Poland escaped recession in 2008-09, this time around there will not be the same monetary or fiscal stimulus. However, we believe that Poland is entering the current global slowdown in a fundamentally stronger position. Household and business balance sheets are much stronger. Correlations of many GDP components, especially consumption, with eurozone growth are lower now. Continued investment spending on the European Championships and the actual consumption effects when they occur should provide a boost. In addition, the effect of

Figure 1. Cyclically adjusted headline deficits



Source: Nomura Global Economics.

Figure 2. Counterfactual scenarios: still no recession



Source: Nomura Global Economics.

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additional stimulus can be over-emphasized. We have previously argued that the fiscal expansion of 2008-10 had a low multiplier. As Figure 2 shows, despite monetary policy having had a larger impact, by removing both sets of stimulus we can see there was still no recession in 2008-09 (admittedly just). Furthermore, it is important to remember that our baseline view is of a loss in global growth momentum, and not a major global trade recession. We expect emerging markets to keep growing, and so global trade demand should not experience the same rout it did previously. Even assuming a more severe recession, with three quarters of negative growth in the eurozone as a whole, growth in Poland could fall only to 2.3%. Anything more severe, and policy reaction would then cap the downside to avoid recession.

Monetary policy is more credible than markets believe

The market now sees the current retention of a tightening bias by the MPC as non-credible, and is focusing on how badly the economy would be hit by a recession in the eurozone. Given we are more bullish on that front, and with core inflation still forecast to peak in March near the top end of target, we think rates are appropriate at this level. We also feel with monetary loosening having already occurred via the currency, and considering monetary conditions are now in loose territory, rate cuts would do little more to stimulate the economy. While we think the MPC could be a little clearer by laying out the risks on either side, we think it is unfair to criticise Poland's current monetary policy stance.

PO is likely to remain the largest party despite a tight race…

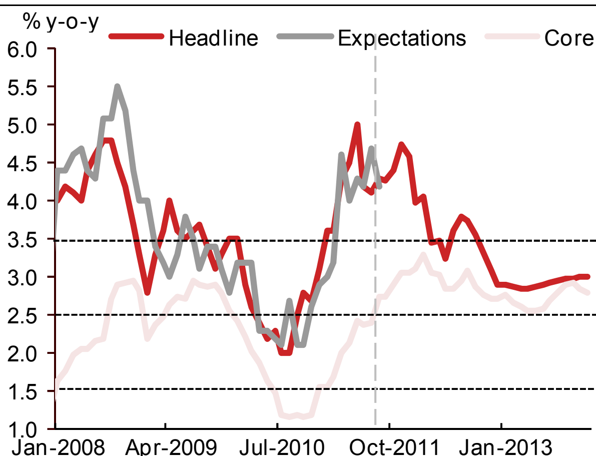
The 9 October elections have affected fiscal policy for at least the past 18 months. Currently, opinion polls are showing an increasingly tight race between PO (Civic Platform) and PiS (Law and Justice) to be the largest party, with the gap now as low as 4pp, down from as high as 30pp at the end of last year. We assign a 65% probability to PO being the largest party, and therefore a 35% probability to PiS being the largest party. Now that PJN (Poland Comes First) looks unlikely to re-enter parliament since its leader jumped ship to the PO, we set the probability of a highly market-negative PiS government being formed at only around 15%, since SLD (Democratic Left Alliance), PSL (Polish People's Party) and the newcomer RPP (The Movement to Support Palikot) are all more natural coalition partners of PO than PiS.

The most market-friendly result would be a PO/SLD/RPP coalition in our view, allowing new reforms that were previously blocked by PSL, such as countryside subsidies and cutting discretionary spending in rural areas. While SLD may still be an obstacle to major reform of benefits and social spending, RPP's nascent fiscal conservatism could have advantages in other areas of the budget. However, RPP is a relative unknown, and its views on a smaller, more efficient and secular state may well be unpopular if it tries to implement them in office.

...so policy plausibility could remain a problem

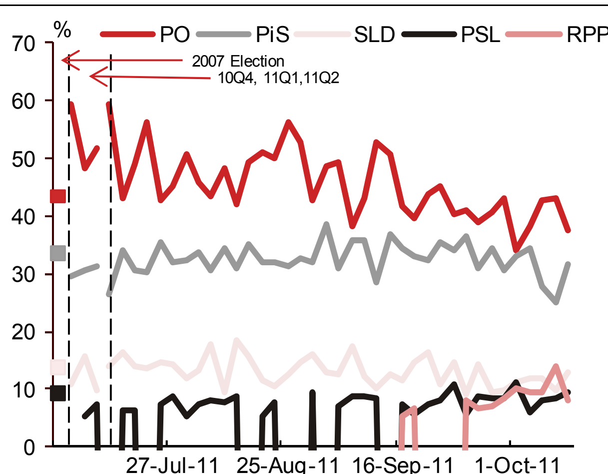
Overall, we expect the PO to be rewarded for its successful management of the economy and the lack of recession during the crisis. However, the rise of other parties offering more nuanced messages means PO should win fewer seats. While SLD has said it would hope to have responsibility for the Finance Ministry, which would have been a concern given its objections to social spending reforms, PO has been insistent that regardless of coalition partners, it will seek to retain the ministry. This situation reinforces our view that meaningful additional fiscal consolidation is unlikely following the election, with an expanded coalition becoming inherently less stable (as in Czech Republic). This in turn suggests that Poland's policy plausibility problem will not vanish after the election.

Figure 3. Inflation pressures still there



Source: Nomura Global Economics, NBP, CSOP.

Figure 4. Implied Sejm seat share



Source: Nomura Global Economics, various pollsters.

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Ukraine: Heading for devaluation?

Recent external indicators suggest that the authorities may be forced to allow the currency to weaken in the next few months, though they may find it undesirable before the elections.

External balances are worsening and FX reserves are falling

Ukraine's FX and gold reserves dropped sharply to $35bn in early October. In the past five weeks it seems that the National Bank of Ukraine (NBU) has sold more than $3bn worth of its reserves, effectively taking them back to their early 2011 level ($35.1bn as of January 2011). The other worrying development is the widening of the monthly current account deficit to $1bn in August vs. the July reading of $574mn (and to 4.3% of GDP vs. 4.0% of GDP on the 12-month rolling basis). This is the worst reading since February this year. Some of the deterioration is due to the widening in the trade deficit, to $1.4bn in August vs. $1.2bn in July (or 12.8% of GDP vs. 12.5% of GDP). This can be blamed on ballooning imports. Even though export growth accelerated to 38% y-o-y vs. 29% y-o-y in July, imports also posted strong growth of 35% y-o-y. If September imports remained flat vs. their August level ($7.3bn), the level of FX reserve coverage of imports must have dropped to 3.4x in September from 5.2x in August.

The NBU is finding it harder to keep UAH stable…

In recent weeks, NBU Governor Sergey Arbuzov said that the authorities aim to keep the hryvnia stable in the coming months. The authorities are trying to dampen the population's appetite for FX by administrative measures: in September, the NBU introduced a requirement for individuals to produce their passports when buying FX in exchange offices. The NBU estimates that this reduced demand for FX by about $0.5bn. However, such measures normally foster the black market and cannot be relied upon to stave off devaluation.

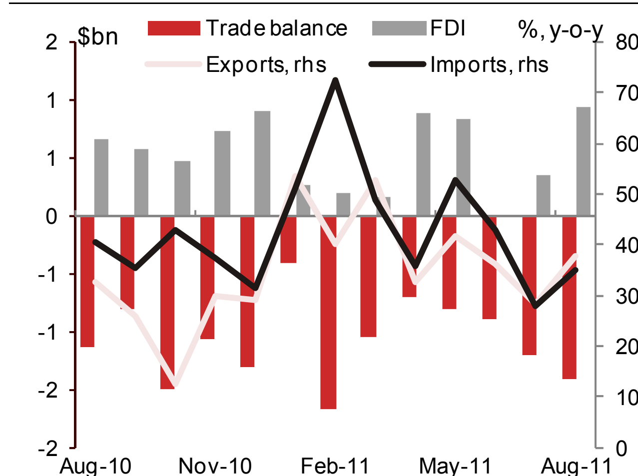
...and FX receipts are dwindling

Meanwhile, although the government had planned to issue Eurobonds this year, in the current market conditions it is unlikely to place them on favourable terms, and we would expect it to postpone the placement until better times. The trickle of FX proceeds from external borrowing by the private sector should weaken, for the same reason. With the global economic climate deteriorating, Ukrainian exporters are probably not in a hurry to sell their FX receipts. At the same time, companies with upcoming external debt payments may be hoarding FX. As for IMF financing, the likelihood of the government receiving it by the end of this year has diminished after the government dug in its heels on the issue of household gas tariff hikes. If no further IMF disbursements arrive by next spring, the government will have to find other sources to finance the repayment of IMF loans becoming due in the amount of SDR2.45bn.

Resurgence of state populism is UAH-negative

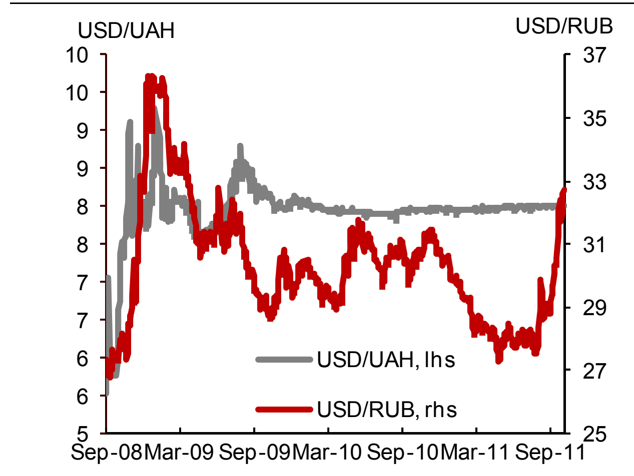
With 12 months remaining before the next Rada elections, we think there is a lot of room for populist action, which could make matters worse for the hryvnia by providing further boost to consumer goods imports. On 1 October, Interfax quoted President Yanukovich saying that he had instructed the government to look into further measures to compensate the population against the lost Soviet-era savings. The current draft 2012 budget envisages cutting the deficit to 2.5% of GDP from 3.5% of GDP targeted this year, but in an election year the risk of missing the fiscal targets will rise.

Figure 1. Ukraine: Balance of payments flows



Source: Nomura

Figure 2. USDRUB and USDUAH



Source: Nomura

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Talks with Russia raise hopes for a new gas accord

In late September, President Victor Yanukovich flew to Russia and met with the ruling tandem, Vladimir Putin and Dmitry Medvedev, who had just announced their intention to swap their roles as Russia's Prime Minister and President in 2012. Although no official announcements on the gas price for Ukraine have followed, the Ukrainian press reported that the next day Prime Minister Azarov informed his government that the negotiations had reached a good outcome. Ukrainian newspaper, Kommersant, wrote that the trio had agreed on a price reduction for Ukraine, which will be revealed later in October after the team of experts has finalised the relevant documents.

According to the Ukrinform agency, the parties agreed to form a gas transportation consortium with participation from the European Union. Prime Minister Mykola Azarov announced this at a meeting of the European Council Parliamentary Assembly. Mr Azarov said that Russia will lower the gas prices it charges to Ukrainian state-owned entities in exchange for Ukraine lowering gas transportation tariffs through its territory to cost level. However, according to Russian Kommersant, Gazprom denied that the parties had reached an agreement on the gas price. Kommersant quoted unsubstantiated sources that believe the parties should agree on prices by 18 October.

High gas prices inflate Ukrainian imports

According to the State Statistics Office, hydrocarbons accounted for 36% of all Ukrainian imports in January-July; gas imports were 19% of all imports. Due to the higher gas prices charged by Russian Gazprom, the US dollar value of gas imports rose nearly 85% y-o-y during the first seven months of this year compared with the same period of 2010. This must have contributed about 16pp to the import growth rate (total imports were up 44% y-o-y during the same period).

If gas talks fail, Belorussian-style devaluation may follow

Meanwhile, the gas price Ukraine is paying to Russia has not yet reached its potential maximum level. Under the terms of agreements entered into in winter 2009, the Ukrainian Energy Ministry expects the gas price to rise to $347 per thousand cubic meters in Q4 2011 (which is 37.6% higher than in Q4 2010). Moreover, the current 2012 draft budget sees a gas price of $414-416 per thousand cubic meters on average. This shows the importance of the country's negotiations with Russia over the price of Russian gas. A further 20% increase in the gas price in 2012 would provide a further fillip to import growth and may put the Ukrainian currency on the path to devaluation, Belorussian-style, prompted by fiscal easing and higher energy import bills.

If the gas talks succeed, UAH remains vulnerable

If the Russians and Ukrainians agree on a reduction of the gas price to $250 per thousand cubic meters for the Ukrainian state sector, this should help the government save about $1.5bn for its coffers next year, and reduce next year's current account deficit by about 1% of GDP. Although this should help UAH, it does not eliminate the threat of it coming under stronger depreciating pressure in the coming months. With steel accounting for about 30% of Ukrainian exports, they remain vulnerable to commodity shocks.

Russia has already allowed RUB to lose 14% of its value

At the current level of commodity prices, the NBU will probably not need to devalue the currency by as much as 60% as it did in late 2008 to bring its current account closer to balance. Neighbouring Russia has allowed RUB to lose nearly 14% of its value vs. the basket in the past two months. Comparing the magnitude of the 2008 devaluations, it seems to us that the NBU, which has so far only allowed UAH to weaken marginally to about 8.00 vs. USD from 7.98 in early August, should allow the hryvnia to weaken by about 24% to about 9.9 vs. USD to retain regional competitiveness.

We see a 70% chance of UAH falling in the short term

Domestic confidence is highly sensitive to currency shocks, and for this reason the authorities may try to keep UAH stable through intervention until the October 2012 elections. Previously, we thought that there was a 70% probability of the NBU being able to keep UAH steady vs the USD in the next 12 months. However, with the worsening external environment, and signs of increasing downward pressure on UAH, we have reassessed the risks. With a 70% probability we see the authorities allowing UAH to weaken beyond 2.5% in the next 12 months, and with a 30% probability UAH may be allowed to fluctuate within +/-2.5% around 8.00 vs. USD during that period. From the NBU's tactical viewpoint, it may be preferable to opt for a one-off devaluation now rather than watch FX reserves dwindle in the coming months and then be forced to devalue with only a few months remaining before elections. Therefore, we see a 50% probability of the devaluation materializing in the next 6 months, and only a 20% probability of it occurring in the six months preceding the October 2012 elections.

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United States | Economic Outlook David Resler | Ellen Zentner | Aichi Amemiya

Navigating through the newest potholes

The US economy has remained surprisingly resilient amidst the confidence-shaking turmoil in the financial markets. Available data still point to a rebound in the second half of the year.

Activity: Despite threats to the recovery from weakened financial conditions, we expect the pace of growth to quicken a bit in the second half of 2011. Although demand for new plant and equipment remains buoyant, rising uncertainty about the outlook may delay future projects. The labor market remains soft, with sluggish income growth, but stronger-than-expected job growth in September should ease recession fears. Meanwhile high levels of household debt and an weak markets for both financial and tangible assets have limited wealth accumulation. As a result, consumer spending continues to grow at only a lackluster pace. We expect the housing sector to remain weak until the foreclosure backlog subsides.

Inflation: The surge in commodity prices that raised headline inflation early in 2011 appears to have ended, and with oil prices now in retreat, headline inflation has begun to subside. However, the 12-month rate of "core" CPI inflation has risen from a record low of 0.6% late last year to 2.0% in August. A temporary supply-and-demand imbalance in the vehicle market accounts for much of this acceleration. As car production returns to normal, we expect these pressures to begin to reverse by late summer. Moreover, persistent excess capacity is likely to forestall a sustained acceleration in core inflation.

Policy: The Fed has launched a new and slightly different version of quantitative easing, aimed at putting "downward pressure on longer-term interest rates" and "make broader financial conditions more accommodative." The shakier economic outlook has pushed any step toward "normalization" far into the future and we do not expect the Fed to raise its policy rate until sometime beyond our forecast horizon, which ends in Q4 2013. We expect some parts of the proposed jobs bill to be passed, but we refrain from incorporating the impact of the bill into our economic outlook for now because of the uncertainty about the specifics of the final outcome.

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**	2.3	2.9	1.5	2.3	2.6	2.8	1.8	2.3	2.7
Personal consumption	**2.1**	**0.7**	1.5	2.4	0.2	2.0	2.4	2.9	2.2	1.6	2.8
Non residential fixed invest	**2.1**	**10.3**	4.6	7.7	8.3	8.5	7.2	5.6	7.6	7.6	5.5
Residential fixed invest	**-2.5**	**4.2**	2.1	7.6	9.2	10.3	12.6	12.0	-1.5	8.5	9.3
Government expenditure	**-5.9**	**-0.9**	-3.3	-1.9	-2.1	-2.5	-1.4	-0.2	-2.4	-2.0	-0.2
Exports	**7.9**	**3.6**	9.8	7.5	7.7	7.2	7.5	6.7	7.6	7.5	6.0
Imports	**8.3**	**1.4**	2.2	2.5	2.9	3.3	5.6	6.2	5.0	3.3	5.1
Contributions to GDP:											
Domestic final sales	**0.4**	**1.4**	1.0	2.3	1.0	1.9	2.5	2.9	1.7	1.8	2.7
Inventories	**0.3**	**-0.3**	0.4	0.1	0.0	0.0	0.0	0.0	-0.1	0.0	0.0
Net trade	**-0.3**	**0.2**	0.9	0.6	0.5	0.4	0.1	-0.2	0.1	0.4	-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**	**576**	597	630	654	682	755	773	596	716	815
Consumer prices	**2.2**	**3.3**	3.8	3.9	2.9	2.2	1.6	1.2	3.3	2.0	1.2
Core CPI	**1.1**	**1.5**	1.9	2.3	2.2	1.8	1.5	1.3	1.7	1.7	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**	0.50	0.50	0.40	0.40	0.40	0.50	0.40	0.50
TSY 2-year note	**0.80**	**0.45**	**0.24**	0.25	0.35	0.40	0.45	0.55	0.25	0.55	1.15
TSY 5-year note	**2.24**	**1.76**	**0.95**	1.20	1.30	1.35	1.40	1.50	1.20	1.50	2.50
TSY 10-year note	**3.47**	**3.18**	**1.92**	2.50	2.60	2.65	2.70	2.80	2.50	2.80	3.15
30-year mortgage	**4.86**	**4.51**	**4.03**	4.20	4.40	4.50	4.50	4.55	4.20	4.55	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 7 October 2011.
Source: Nomura Global Economics.

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

The week ahead

In a shortened week for the bond market, all eyes will be on the September FOMC minutes on Tuesday. Also on tap are retail sales and the first take on consumer sentiment for October.

FOMC minutes (Tuesday): In the September FOMC statement, the Committee surprised markets by providing as much monetary policy accommodation as they could possibly do without expanding the size of the Fed's balance sheet. The most notable move was the Fed's announcement that it would "support conditions in mortgage markets" by reinvesting "principle payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities." In the minutes of the September meeting, we hope to get more details on the "significant downside" risk to the outlook, but more importantly, what tools were discussed as indicated by the Committee's statement that, "The Committee discussed the range of policy tools available to promote a stronger economic recovery."

Weekly chain store sales (Wednesday): Gas prices have fallen sharply over the past few weeks. Lower prices along with better seasonal weather have helped boost sales recently.

Jobless claims (Thursday): Initial jobless claims increased by 6,000 to 401,000 in the week ending 1 October, while the 4-week moving average fell to 414,000. The downward trend in claims has resumed following technical adjustment problems that were exacerbated by the backlog of claims filings following the arrival of Hurricane Irene in early September.

Trade balance (Thursday): The trade deficit narrowed sharply in July, to $44.8 billion, as imports declined (-0.2%) while exports jumped (+3.6%). Imports will see continued weakness in August, held back by lower petroleum import prices, while exports are expected to give up some of July's gain. Our forecast for the August trade deficit is $45.6 billion.

US budget (Thursday): We estimate that Treasury receipts fell by 4.0% y-o-y in September, while government outlays grew by 14.5%. As such, the US budget deficit likely widened to $85.0 billion compared to $34.6 billion in September 2010. The US budget deficit is tracking -$1,319 billion in fiscal 2011 compared to -$1,294 in fiscal 2010.

Retail sales (Friday): ICSC reported that its measure of chain store sales came in ahead of expectations in September while automakers reported a strong increase in sales of motor vehicles, and seasonally adjusted gas prices increased. After falling flat in August, we expect an increase of 0.7% in headline retail sales, with an increase of 0.3% in sales excluding autos. The so-called "control" measure, which consists of retail sales excluding motor vehicles, gasoline stations, and building materials is expected to increase by 0.1% on top of a 0.1% gain in August.

Import prices (Friday): A sharp reversal in crude oil and other commodity prices, as well as an increase in the trade-weighted value of the US dollar will lead to a large headline drop in import prices on the order of 1.2% in September. Excluding the impact of petroleum, import prices are expected to rise by 0.1%. Export prices are expected to remain flat in September following an increase of 0.5% in August.

Monday 10 October		Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	Columbus Day - markets closed							
Tuesday 11 October								
14.00	FOMC minutes		Sep 20-21					
Wednesday 12 October								
7.00	Mortgage purchase applications	%w-o-w	7-Oct	10.0	9.3	-4.3	n.a.	n.a.
Thursday 13 October								
8.30	Initial jobless claims	000s	8-Oct	428	395	401	n.a.	n.a.
8.30	Trade Balance	$bn	Aug	-50.2	-51.6	-44.8		-46.0
15.00	US budget statement	$bn	Sep			-34.6	n.a.	-64.9
Friday 14 October								
8.30	Retail sales	% m-o-m	Sep	0.2	0.3	0.0	0.7	0.4
8.30	Retail sales ex-autos	% m-o-m	Sep	0.1	0.3	0.1	0.3	0.2
8.30	Import prices	% m-o-m	Sep	-0.7	0.3	-0.4	-0.9	-0.4
9.55	Consumer sentiment	Index	Sep-pre	63.7	55.7	59.4	n.a.	60.0
10.00	Business inventories	% m-o-m	Aug	0.9	0.4	0.4	n.a.	0.5

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

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Consumer sentiment (Friday): The final reading on sentiment in September showed households attitudes improving slowly to 59.4. Consensus is looking for another small increase to 60.1 in early October.

Business inventories (Friday): Inventory building has slowed from a torrid pace earlier in the year, increasing by 0.5% in July. The consensus forecast expects an increase of 0.5% in August. Downside risk to expectations could come in the form of lower energy prices.

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 Charles St-Arnaud

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**	1.80	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 6 October 2011.

Source: Bank of Canada, Statistics Canada, Nomura Global Economics.

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Euro area | Economic Outlook Jens Sondergaard | Lavinia Santovetti | Stella Wang

In the eye of the storm

Markets continue to be unsettled by the lack of a credible policy response. We think the tensions will ease once political uncertainty surrounding Greece and the EFSF has been resolved.

***Forecast change**: We expect Q3 GDP to contract in Italy by 0.1% q-o-q (vs flat in our previous forecast) and Spain by 0.2% (vs flat in our previous forecast). As a result we now look for a 0.1% q-o-q contraction at the euro-area aggregate level in Q3.*

Activity: Financial market turmoil and the lack of political cohesion among euro-area policymakers have made us more pessimistic about the near-term economic outlook and we now expect contraction in Q3 and stagnation in Q4. Assuming that financial market confidence is restored in Q4 and that any negative feedback effects on the banking sector and the real economy are short-lived, the recovery should continue, albeit more gradually. On the one hand investment remains cyclically low and once confidence is restored, the investment upturn should gain pace; labour market conditions should also improve if confidence recovers, thus supporting domestic consumption. 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: Inflation looks set to have peaked at 3.0% y-o-y in September. We now expect it to gradually decline and fall below the ECB's target from the second half of 2012 before it hits the close-to-but below 2% 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 throughout the forecast horizon.

Policy: Financial markets remain in extreme flux and there is much uncertainty about near-term growth prospects. But the ECB is set to continue with its bond-buying programme until the EFSF is ready to buy bonds (we assume by end Q4 2011). The ECB has also launched generous liquidity operations and a new covered bond purchase programme. In terms of monetary policy, we expect the ECB to cut rates by 25bp in December 2011 and March 2012 and then to stay on hold until H1 2013. We expect two rate hikes in H2 2013 taking rates back to 1.50%.

Risks: The risks to the growth forecast are on the downside and mainly stem from the ongoing sovereign debt crisis and the resulting negative banking sector feedback effects. A further downside risk stems from additional 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	0.1	1.4	2.4	1.8	1.7	1.5	1.1	1.7
Household consumption	**0.7**	**-0.1**	0.5	0.2	1.2	1.6	1.4	1.4	0.6	1.0	1.5
Fixed investment	**7.7**	**2.4**	-1.8	-1.0	0.8	5.6	6.4	5.8	2.3	2.1	5.2
Government consumption	**1.7**	**-0.7**	-0.4	0.0	0.0	0.0	0.6	0.6	0.4	0.0	0.9
Exports of goods and services	**7.8**	**4.3**	1.0	3.4	4.8	7.8	5.2	5.3	6.0	4.7	5.5
Imports of goods and services	**6.3**	**2.1**	-0.7	1.6	3.8	7.3	6.4	6.1	4.5	3.8	6.3
Contributions to GDP:											
Domestic final sales	**2.2**	**0.2**	-0.1	-0.1	0.9	2.0	2.1	2.1	0.6	0.6	1.9
Inventories	**0.1**	**-0.7**	-0.8	-0.7	0.0	0.0	0.0	-0.1	0.1	0.0	0.0
Net trade	**0.7**	**1.1**	0.8	0.8	0.5	0.4	-0.4	-0.2	0.8	0.5	-0.2
Unemployment rate	**10.0**	**10.0**	10.0	9.9	9.9	9.8	9.7	9.6	10.0	9.8	9.4
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)									-4.4	-3.4	-2.4
Current account balance (% GDP)									-0.6	-0.3	-0.2
Consumer prices	**2.5**	**2.8**	2.7	2.8	2.2	1.8	1.7	1.3	2.7	1.7	1.6
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 7 October 2011. Source: Eurostat, ECB, DataStream and Nomura Global Economics..

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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 in Q4 by unseasonably bad weather, 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 August, CPI inflation rose by another 0.1pp to 4.5% owing to discretionary goods price rises. We forecast it to spike sharply in September when most utility price hikes were implemented. Inflation's persistent elevation looks set to continue but eventually the disinflationary effect of excess capacity and base effects should drag CPI inflation back toward the target. However, if realised, inflation will have been above 3% for well over two years and averaged 3.2% over the preceding five.

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, October 2011.

Details of the forecast

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP	**1.6**	**0.4**	1.1	0.5	2.0	2.5	3.9	1.3	0.8	1.8	2.2
Private consumption	**-2.5**	**-2.4**	0.8	0.5	1.8	1.9	4.1	1.0	-0.9	1.4	2.4
Fixed investment	**-10.6**	**6.9**	-0.9	0.3	4.7	4.8	3.9	3.2	-2.0	3.1	2.0
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**	3.0	5.0	6.4	7.0	8.2	5.4	5.1	5.2	6.0
Imports of goods and services	**-11.3**	**-1.3**	0.2	3.3	4.4	3.6	4.9	2.4	0.2	3.1	3.1
Contributions to GDP:											
Domestic final sales	**-2.6**	**0.5**	0.3	0.1	1.4	1.5	2.7	0.8	-0.5	1.1	1.4
Inventories	**-1.6**	**1.1**	0.0	-0.1	0.1	0.0	0.1	-0.3	-0.1	0.1	-0.1
Net trade	**5.8**	**-1.2**	0.8	0.5	0.5	1.0	1.0	0.9	1.4	0.6	0.9
Unemployment rate	**7.7**	**7.9**	8.1	8.2	8.2	8.1	8.0	7.8	8.0	8.0	7.4
Fiscal balance (% GDP)									-7.4	-5.7	-4.2
Current account balance (% GDP)									-2.3	-1.7	-1.8
Consumer prices (CPI)	**4.1**	**4.4**	4.6	4.8	3.6	3.2	2.9	2.3	4.5	3.0	2.1
Retail prices (RPI)	**5.3**	**5.1**	5.2	5.4	4.0	3.8	3.7	3.1	5.3	3.6	3.1
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	2.30	2.45	2.55	2.65	2.80	2.30	2.80	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 7 October 2011.
Source: ONS, Bank of England, DataStream, Nomura Global Economics.

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Europe | Data Preview Philip Rush | Lavinia Santovetti | Stella Wang

The week ahead

Inflation releases around the euro area and industrial production data for many nations across Europe are the main themes this week.

France industrial production (Monday): We expect French industrial production to have declined by 0.7% m-o-m in August after the strong growth of 1.5% in July, mainly reflecting a payback effect and weak new orders in that month.

Italy industrial production (Monday): Italian industrial production declined for three months in a row to July. All the survey data are pointing to another weak reading in August and we look for

Monday 10 October			Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	Greece	Industrial production	%y-o-y	Aug	-10.0	-13.1	-2.8	n.a.	n.a.
7.00	Germany	Exports	%m-o-m, sa	Aug	4.4	-1.2	-1.9	n.a.	1.3
7.00	Germany	Trade balance	EURbn, nsa	Aug	14.8	12.7	10.4	n.a.	9.5
7.45	France	Industrial production	%m-o-m, sa	Aug	2.3	-1.5	1.5	-0.7	-0.8
7.45	France	Manufacturing production	%m-o-m, sa	Aug	1.5	-1.8	1.4	n.a.	0.1
9.00	Italy	Industrial production	%m-o-m, sa	Aug	-0.6	-0.8	-0.7	-0.5	0.2
18.00	UK	BoE MPC member Miles speaks on Monetary Policy and Financial Dislocation							
Tuesday 11 October									
	European Union	European Commission issues Quarterly Report							
0.01	UK	RICS house price balance	%	Sep	-26	-22	-23	n.a.	-24
8.00	Spain	HICP inflation	%y-o-y	Sep-fin	3.0	2.7	3.0	3.0	n.a.
8.30	Netherlands	Industrial production	%m-o-m, sa	Aug	0.2	0.1	0.2	-0.6	n.a.
9.30	UK	Industrial production	%m-o-m, sa	Aug	0.8	0.0	-0.2	-0.2	-0.2
9.30	UK	Manufacturing production	%m-o-m, sa	Aug	1.8	-0.3	0.1	-0.3	-0.1
9.30	UK	CLG house prices	%y-o-y	Aug	-2.2	-2.0	-1.5	n.a.	n.a.
10.00	Ireland	Industrial production	%m-o-m, sa	Aug	0.5	-1.6	0.9	n.a.	n.a.
Wednesday 12 October									
6.30	France	Consumer price index	%m-o-m	Sep	0.1	-0.4	0.5	n.a.	0.1
6.30	France	Consumer price index	%y-o-y	Sep	2.1	1.9	2.2	n.a.	2.4
6.30	France	CPI ex-tobacco	Index	Sep	122.5	121.9	122.6	123.0	n.a.
6.30	France	HICP inflation	%m-o-m, nsa	Sep	0.1	-0.5	0.6	0.3	0.1
6.30	France	HICP inflation	%y-o-y	Sep	2.3	2.1	2.4	2.8	2.6
6.30	UK	Average weekly earnings ex-bonus	%y-o-y, 3mma	Aug	2.1	2.3	2.1	1.8	2.0
9.30	UK	Average weekly earnings inc-bonus	%y-o-y, 3mma	Aug	2.3	2.7	2.8	2.9	2.7
9.30	UK	Claimant count rate	%	Sep	4.8	4.9	4.9	5.0	5.0
9.30	UK	Jobless claims change	k	Sep	31.3	33.7	20.3	19.0	24.5
9.30	UK	LFS unemployment rate (ILO)	%3mma	Aug	7.7	7.9	7.9	8.0	8.0
10.00	Euro area	Industrial production	%m-o-m, sa	Aug	0.2	-0.7	0.9	-0.7	-0.8
19.30	Euro area	ECB's Trichet speaks in London							
Thursday 13 October									
	Spain	Business Confidence	Index	Q3	-20.5	-16.2	-9.2	n.a.	n.a.
	Greece	Unemployment rate	%	Jul	15.8	16.6	16.0	n.a.	n.a.
7.00	Germany	Consumer price index	%m-o-m	Sep-fin	0.4	0.0	0.1	n.a.	0.1
7.00	Germany	Consumer price index	%y-o-y	Sep-fin	2.4	2.4	2.6	n.a.	2.6
7.00	Germany	HICP inflation	%m-o-m, nsa	Sep-fin	0.5	0.0	0.1	0.1	0.1
7.00	Germany	HICP inflation	%y-o-y	Sep-fin	2.6	2.5	2.8	2.8	2.8
9.00	Euro area	ECB Monthly bulletin							
9.30	UK	Global goods trade balance	£mn	Aug	-8467	-8873	-8922	-9100	-8750
9.30	UK	Total trade balance	£mn	Aug	-4049	-4496	-4450	-4720	-4200
10.00	Portugal	HICP inflation	%y-o-y	Sep	3.3	3.0	2.8	n.a.	n.a.
Friday 14 October									
	Euro area	Germany's Weidmann and Schaeuble speak in Paris							
	Italy	Bank of Italy releases the Quarterly Economic Bulletin							
	Belgium	Trade balance	EURmn	Aug	-307.7	-190.4	761.9	n.a.	n.a.
9.00	Austria	Consumer price index	%y-o-y	Sep	3.3	3.5	3.4	n.a.	n.a.
10.00	Euro area	HICP inflation - core	%y-o-y	Sep	1.6	1.2	1.2	1.0	1.5
10.00	Euro area	HICP inflation	%m-o-m, nsa	Sep-fin	0.0	-0.6	0.2	0.8	0.8
10.00	Euro area	HICP inflation	%y-o-y	Sep-fin	2.7	2.5	2.5	3.0	3.0
10.00	Euro area	HICP inflation	Index	Sep	112.75	112.03	112.23	113.15	n.a.
10.00	Euro area	Trade balance	EURbn, sa	Aug	-1.2	-2.5	-2.5	n.a.	-4.0
10.00	Italy	Consumer price index	%m-o-m, nsa	Sep-fin	0.3	0.3	0.1	n.a.	0.1
10.00	Italy	Consumer price index	%y-o-y	Sep-fin	2.7	2.8	3.1	n.a.	3.1
10.00	Italy	HICP inflation	%m-o-m, nsa	Sep-fin	-1.7	0.4	1.9	1.9	1.9
10.00	Italy	HICP inflation	%y-o-y	Sep-fin	2.1	2.3	3.5	3.5	3.5

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

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a 0.5% m-o-m decline. However, upside risks arise from the slight improvement in new orders (3m average) and volatility of the series.

Netherlands industrial production (Tuesday): Dutch industrial production (manufacturing only) is likely to decline by 0.6% m-o-m in August, mainly reflecting the sharp decline in producer confidence and capacity utilisation.

UK industrial output (Tuesday): An intensification of the sovereign debt crisis shocked the global economy in August. Because of the manufacturing sector's sensitivity to this, we expect it to decline by 0.3% m-o-m. Some long overdue support from the extraction industries may lift this to a fall of 0.2% m-o-m, despite weak utilities output.

French inflation (Wednesday): We expect French HICP to have increased by 0.3% m-o-m (nsa) in September, which should push the year-on-year rate up to 2.8%. The CPI ex-tobacco index is expected to print at 112.95 (nsa).

Euro-area industrial production (Wednesday): The smaller-than-expected decline of industrial production in Germany and positive growth in Spain seem to have provided some buffer for the euro area on aggregate. We therefore look for a 0.7% m-o-m decline in August.

UK labour market report (Wednesday): With growth still weak, we expect the commensurate softening in the labour market to continue. We expect the jobless claimant count to rise by 19k in September, lifting the rate to 5.0% and the LFS unemployment rate to tick up to (a low) 8.0% in the three months to August. Over the same period, we expect total earnings to have risen by 2.9% or by 1.8% excluding bonuses.

UK external trade (Thursday): We expect the sovereign debt crisis to have caused a small global trade shock, which on balance widened the UK's trade deficit. So we expect it to widen to £9.1bn in goods and to £4.7bn in total.

Euro-area inflation (Friday): We expect the final estimate of euro-area HICP to confirm that inflation rose by 3.0% in September. We forecast this to be consistent with a 0.8% m-o-m (nsa) increase, the bulk of which should reflect a strong post-summer sales bounce-back in the core component (exacerbated by the new methodology to harmonise the treatment of seasonal products, namely clothing and footwear and unprocessed food). Among the key non-core components, we expect food to have ticked up by 0.2% m-o-m (nsa) and energy by 0.4% (nsa). Finally, we forecast the HICPxT index to print at 113.15 (nsa).

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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 have worsened just as production was returning to normal following the earthquake, and we believe there is an increased possibility of the Japanese economy entering 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 we also believe the passage of a third supplementary budget by the new Noda administration will be positive. We project the economy to remain on a recovery path in 2012 amid benefits from post-quake reconstruction policies.

Inflation: Japan has returned to deflation 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 around mid-2013.

Policy: Japan's Diet has passed a ¥4trn first supplementary budget and a ¥2trn second supplementary budget. A third budget to fund post-earthquake reconstruction measures looks likely to be passed by November. The Bank of Japan (BOJ) has expanded its asset purchasing program by ¥10trn in coordination with the government's FX intervention, against a backdrop of growing concerns over an economic slowdown overseas and the appreciation of the yen. With fears of an overseas slowdown unlikely to be assuaged any time soon, and with the yen likely to continue rising in value while these concerns persist, we expect the BOJ to expand the program by a further ¥3-5trn as an additional easing measure by December.

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**	5.7	2.1	3.6	2.3	1.5	1.1	-0.6	2.5	1.8
Private consumption	**-2.5**	**-0.1**	1.0	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**	7.2	6.5	5.7	3.9	4.7	5.9	0.3	4.9	5.8
Residential fixed invest	**0.9**	**-7.1**	5.3	5.3	4.5	3.8	2.7	3.1	2.9	3.5	4.2
Government consumption	**3.4**	**2.3**	1.0	4.2	3.4	-0.9	1.6	-2.3	2.4	1.8	0.6
Public investment	**-2.8**	**18.3**	13.3	20.1	27.3	19.6	-13.7	-11.2	-1.4	13.0	-11.7
Exports	**0.0**	**-18.1**	31.9	-2.0	2.6	4.0	5.5	6.7	0.8	4.3	6.7
Imports	**5.8**	**-0.2**	5.5	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**	2.1	3.1	3.3	1.7	1.0	0.6	-0.2	2.1	1.1
Inventories	**-1.2**	**0.4**	-0.2	-0.4	-0.2	0.1	0.2	0.1	-0.1	-0.1	0.2
Net trade	**-0.8**	**-3.2**	3.8	-0.6	0.5	0.5	0.3	0.4	-0.3	0.5	0.5
Unemployment rate	**4.7**	**4.6**	4.6	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**	0.1	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**	0.30	0.35	0.40	0.45	0.50	0.50	0.35	0.50	0.55
JGB 10-year yield	**1.26**	**1.13**	0.95	1.10	1.20	1.25	1.30	1.35	1.10	1.35	1.45
JPY/USD	**83.1**	**80.6**	77.0	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 7 October. All forecasts are modal forecasts (i.e., the single most likely outcome). Numbers in bold are actual values, others forecast.
Source: Cabinet Office, Ministry of Finance, Statistics Bureau, BOJ, and Nomura Global Economics.

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The week ahead

We expect August's core machinery orders, due out next week, to rise 4.6% m-o-m. With peripheral statistics also trending firmer, we think data will point to an ongoing recovery in capex.

September Economy Watchers Survey (Tuesday): In the September survey we expect the current conditions DIs to be either slightly down or pegging level, and future conditions DIs to be slightly higher. We expect household activity-related current conditions DIs to be depressed by weak sales at consumer electronics discount stores, and corporate activity-related current conditions DIs to be dented by the lull in the recovery in output and slowing overseas economic activity. We expect a modest improvement in the future conditions DIs, based on the fully-fledged recovery in production in the transportation equipment industry, as well as the improvement in the employment conditions DI revealed in the September Tankan.

August machinery order statistics (Wednesday): We expect August's core machinery orders (private-sector orders excluding those for ships and from the electric power sector) to rise 4.6% m-o-m, versus a decline of 8.2% in July, marking the first increase in two months. We expect August's core machinery orders to turn upwards again, because of increases in peripheral statistics for August, and the steep m-o-m decline in core machinery orders in July. That said, July's core machinery orders were bolstered by large-scale orders in the transportation and communications sector, and so without that boost we would expect a m-o-m decline of around 3%. As we think it would be reasonable to expect m-o-m growth of around 7–8% in August core machinery orders versus July's low comparison base, our forecast looks for a 4.6% m-o-m rise, if July's large orders are excluded. If August's core machinery orders come in as we expect, it would mean a modest average decline of 0.4% in Jul–Aug versus the Apr–Jun quarter. Core machinery orders have been on an upward trend, albeit with some fluctuations along the way, since bottoming in Jul–Sep 2009, but more recently have shown a marked loss of momentum, versus +5.6% q-o-q in Q1 2011 and +2.5% in Q2. We think that the slowdown in the European and US economies and the associated yen appreciation have probably been depressing capex sentiment. Nevertheless, we look for post-quake reconstruction demand to take off from now onwards, and while we expect the pace of growth in core machinery orders to slow somewhat, we do not expect it to stall completely. We therefore expect the overall upward trend to be maintained.

September's corporate goods price index (Friday): We expect a 2.4% y-o-y rise in the September domestic corporate goods price index, marking a slight downturn from August's increase of 2.6%. On a m-o-m basis we look for a decline of 0.3%, marking the second consecutive monthly drop after August's fall of 0.2%. Electricity and gas charges have continued to rise owing to fuel price adjustments, and we expect higher electricity, city gas, and water charges. However, we expect corporate goods prices to be lower on items such as basic materials and commodities, reflecting lower crude oil prices, as well as the impact of the yen's appreciation and the slowdown in overseas economic activity. Since October 2010, domestic corporate goods prices had been trending upwards, taking their cue from rising commodity prices, but from now onwards we expect them to weaken overall owing to the correction in commodity prices, the rising yen, and slowing overseas economies.

Monday 10 October		Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	Sports Day (holiday)							
Tuesday 11 October								
8.50	Current account	¥bn	Aug	590.7	526.9	990.2	517.7	n.a.
14.00	Consumer confidence index	Index	Sep	35.3	37.0	37.0	n.a.	n.a.
14.00	Current economic conditions	Index	Sep	49.6	52.6	47.3	n.a.	n.a.
Wednesday 12 October								
8.50	Machinery orders	% m-o-m	Aug	3.0	7.7	-8.2	4.6	n.a.
Thursday 13 October								
8.50	Index of tertiary industry activity	% m-o-m	Aug	0.9	1.8	-0.1	-0.6	n.a.
8.50	MPM Minutes (9/6, 7)							
Friday 14 October								
8.50	M2	% y-o-y	Sep	2.9	3.0	2.7	2.7	n.a.
8.50	CGPI	% y-o-y	Sep	2.5	2.9	2.6	2.4	n.a.

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

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Softer near-term growth, but stronger into 2012

Strong trade links to a resilient Asia, greater potential policy flexibility than most and a currency that responds quickly to global changes should provide protection from global growth risks.

Activity: We expect 2011 GDP growth of 2.2% in the wake of the firm Q2 GDP report. Growth should accelerate strongly in 2012 (4.6%) 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, given high borrowing interest rates through 2012 and 2013. Strong growth in exports and an exponential rise in resource investment underpin our strong base case GDP growth forecast for 2012. The recent (late-September) confirmation of the $A29bn Wheatstone liquefied natural gas project in Western Australia brings confirmed investment spending on energy projects alone to more than $A120bn, sufficient to contribute 2 percentage points to 2012 GDP growth.

Inflation: Inflation in Q2 was surprisingly high with the CPI at 3.6% y-o-y and the average underlying rate at 2.7% y-o-y (revised in an ABS methodology change to 2.6%). After allowing for the new series of CPI weights to take effect in the Q3 release in late October and with a greater weighting for services than goods, we still expect relatively high inflation. We forecast key underlying annual inflation will still push above 3% by the end of 2011 and stay above 3% in 2012 and 2013. Our forecasts are not altered by recent global financial turmoil.

Policy: We believe policymakers cannot entirely ignore inflation risk, even after the financial market turmoil of late. On our new 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. The RBA has some capacity to stay on policy hold for a while longer. We are pushing out our call of a 25bp rate hike to 5.00% from November to February 2012, with no further hikes in 2012. Only in the event that our worse case global growth view starts to develop would we see a case for the RBA to cut rates, and even then, any 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, limiting the need for rate changes.

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**	**-3.1**	2.0	15.0	33.0	33.0	33.0	33.0	7.3	33.0	27.0
Consumer prices	**3.3**	**3.6**	3.8	4.0	3.2	3.1	3.4	3.9	3.7	3.4	3.8
Trimmed mean	**2.3**	**2.6**	3.1	3.4	3.3	3.2	3.3	3.7	2.9	3.4	3.7
Weighted median	**2.2**	**2.7**	3.1	3.2	3.2	3.1	3.2	3.6	2.8	3.3	3.6
Federal deficit (% of GDP) FY end-June									-3.6	-1.5	0.2
Current account deficit (% GDP)									-1.8	-2.3	-2.8
Cash rate	**4.75**	**4.75**	**4.75**	4.75	5.00	5.00	5.00	5.00	4.75	5.00	5.50
90-day bank bill	**4.89**	**4.96**	**4.78**	4.80	5.25	5.25	5.25	5.25	4.80	5.25	5.60
3-year bond	**5.04**	**4.76**	**3.63**	4.00	5.20	5.20	5.20	5.20	4.00	5.20	5.70
10-year bond	**5.50**	**5.21**	**4.25**	4.50	5.40	5.40	5.30	5.30	4.50	5.30	5.80
AUD/USD	**1.03**	**1.07**	**0.98**	1.05	1.05	1.05	1.05	1.05	1.05	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 7 October 2011.
Source: Australian Bureau of Statistics; Reserve Bank of Australia and Nomura Global Economics.

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Zhiwei Zhang | Chi Sun

Robust growth ahead despite external uncertainty

We expect growth to remain strong as the economy is increasingly driven by domestic demand.

Activity: Real GDP growth moderated to 9.5% y-o-y in Q2 from 9.7% in Q1 partly due to tighter monetary policy. We expect GDP growth to ease only slightly further in Q3 before stabilising in Q4. Industrial production growth dropped to 13.5% y-o-y in August from 14.0% in July. Nominal retail sales growth slipped to 17.0% from 17.2% in July. M2 money supply growth dropped to 14.7% y-o-y from 15.9% in June and new (net) RMB loans grew by RMB492.6bn in July, RMB141.3bn less than in June. Against these are some encouraging data. The official PMI moved higher in September. Urban fixed asset investment grew by 25% y-o-y in Jan-Aug and is likely to remain robust for the rest of 2011, supported by the policy to boost low-end housing. Imports surged by 30.9% y-o-y in August, which shows domestic demand remains strong.

Inflation: CPI inflation dropped from 6.5% y-o-y in July to 6.2% in August, mostly due to base effects. PPI inflation also dipped, to 7.3% y-o-y in August from 7.5% in July. We expect CPI inflation to fall in the coming months, largely due to continued base effects, but we expect the pace of the decline to be slow as food prices still face upward pressure. We expect CPI inflation to remain elevated at 4.8% in 2012 and 4.5% in 2013, driven by rising input costs and wages, utility price deregulation, excess liquidity and reduced overcapacity.

Policy: Premier Wen Jiabao has signalled his concern about the risk of overtightening in a long *Qiu Shi* article published on 1 September. This article and the high likelihood that inflation peaked in July reinforce our call for no further interest rate or RRR hikes for the rest of 2011, and that the policy stance is firmly in "wait and see" mode. We do not expect policy to loosen in the near term, as coincident indicators like industrial production remain strong, and inflation continues to be elevated. Beyond 2011, we expect monetary policy to rely less on quantitative measures and exchange rate targeting and more on higher interest rates to curb inflation.

Risks: The three main risks facing China are a greater-than-expected weakening of external demand, inflation surprising on the upside and a sharp decline in property investment. If the global situation becomes a replay of 2008, China's GDP growth may drop to 9% in 2011, but we would expect robust growth of 8.8% in 2012, supported by monetary and fiscal policy responses. CPI inflation has dropped in August, but food prices have been volatile and upside risks cannot be ruled out. In the property market, sales have been lacklustre, and growth of land space purchased by developers has fallen in recent months, signalling a slowdown of commodity housing investment. We expect this to be partly offset by public housing projects, but the downside risk is worthy of attention given that housing investment accounts for 25% of total FAI.

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**	9.3	9.5	9.1	8.8	8.4	8.1	9.5	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**	2.6	2.7	2.5	2.8	2.9	3.0	2.5	2.8	2.6
Retail sales (nominal)	**16.3**	**17.0**	18.0	18.2	18.3	17.9	18.0	18.2	17.4	18.1	18.8
Urban Fixed-asset investment (nominal, ytd)	**25.0**	**25.6**	24.5	24.1	23.5	23.0	22.5	22.0	24.1	22.0	20.1
Industrial production (real)	**14.4**	**13.9**	14.0	14.5	14.2	14.0	13.7	13.8	14.1	13.9	13.5
Exports (value)	**26.5**	**22.1**	18.8	15.0	10.1	13.0	13.0	13.0	20.1	12.4	11.0
Imports (value)	**32.6**	**23.1**	20.9	20.0	15.0	18.0	17.0	17.9	23.8	17.0	16.0
Trade surplus (US$bn)	**-1.0**	**46.7**	69.5	52.2	-21.1	31.4	61.0	36.8	167.5	108.1	19.0
Current account (% of GDP)									2.9	1.4	0.5
Fiscal balance (% of GDP)									-1.3	-1.0	-1.2
Net increase in RMB loans (RMBtrn)									8.0	8.4	9.6
1-yr bank lending rate (%)	**6.06**	**6.31**	**6.56**	6.56	6.56	6.81	6.81	7.06	6.56	7.06	7.06
1-yr bank deposit rate (%)	**3.00**	**3.25**	**3.50**	3.50	3.75	4.00	4.25	4.50	3.50	4.50	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 7 October 2011.
Source: CEIC and Nomura Global Economics.*FX forecasts are currently under review for revision.

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India | Economic Outlook Tomo Kinoshita | Aman Mohunta

Losing growth momentum

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. We expect the slowdown to continue into 2012, making it the second consecutive year of below-potential growth, a necessary outcome to ease supply-side bottlenecks in order to bring down inflation. Industrial production growth fell to 3.3% y-o-y in July from 8.7% in June, and we expect the slow growth to continue as production of intermediate and consumer-related goods remains weak. Overall, we expect below-potential GDP growth of 7.7% in 2011 and 7.9% in 2012, and deteriorating external conditions present downside risks to our forecasts.

Inflation: Headline WPI inflation rose to 9.8% y-o-y in August from 9.2% in July due to higher food as well as core inflation. We expect WPI inflation to stay around 9% till November, but then to moderate sharply in December owing to the recent correction in global commodity prices and weaker demand. We expect WPI inflation to fall 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: As widely expected, the Reserve Bank of India (RBI) hiked the repo rate by 25bp on 16 September. However, the RBI's statement revealed that it has softened its hawkish stance, highlighting its expectation of moderating inflation and downside risks to growth. We continue to believe that this is the last policy rate hike in the current policy cycle as we expect inflation 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, 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**	8.3	7.7	7.9	8.0	7.7	7.8			
Real GDP	**7.8**	**7.7**	7.5	7.7	7.8	8.1	7.6	8.2	7.7	7.9	8.1
Private consumption	**8.0**	**6.3**	5.6	6.6	7.0	5.2	5.6	6.8	6.6	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**	7.1	9.4	9.2	9.8	9.8	10.3	6.0	9.8	11.5
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**	8.3	11.2	8.4	6.9	8.3	8.4	8.5	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	-1.6	-1.1	-1.0	-0.9	-0.7
Wholesale price index	**9.6**	**9.6**	9.6	8.8	7.0	6.2	6.7	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**	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
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**	8.35	8.20	8.10	8.10	8.10	8.35	8.10	8.10
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 year ending March 2012. Table reflects data available as of 7 October 2011.
Source: CEIC and Nomura Global Economics.

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Signalling a pro-growth bias

The policy bias has shifted to supporting growth and mitigating disruptive capital reversals.

Forecast change: We now forecast USD/IDR will be 9050 at end-2011 and 8500 at end-2012.

Activity: We forecast 2011 GDP growth of 6.5%, but acknowledge increasing downside risks from the global outlook. The authorities seem to share our concerns. In addition to signalling a strong easing bias, on 3 October, Bank Indonesia (BI) implemented a measure requiring exporters to repatriate USD receipts onshore, which should help provide additional FX liquidity onshore amid risks of capital outflows. The trade surplus rose to a higher-than-expected USD3.8bn in August from USD1.4bn in July, with exports remaining robust, in contrast to the weakness we see elsewhere in the region. Longer-term, we remain optimistic on Indonesia's growth prospects with progress on infrastructure and other structural reforms, and favourable consumption and investment dynamics (see Indonesia: Building momentum, 7 June 2011).

Inflation and monetary policy: CPI inflation eased to 4.6% y-o-y in September from 4.8% in August, normalizing from the rise associated with the Idul Fitri holiday in August. We maintain our forecast for headline inflation ending the year closer to 5% due to a weaker IDR and continued strong credit demand. Average inflation in August and September (to remove the holiday effects) stood at 4.7%, above July's 4.6% and indicates that inflation pressures remain. Core inflation also continues to exceed headline. We maintain our view that BI will be on-hold for the remainder of 2011, given the risks to inflation and a resilient growth picture. Rate cuts at this point may be viewed as premature, but we see BI implementing other measures to counter external shocks. For example, BI has been buying government bonds (see feature article in this edition). Capital-flow management measures such as more stringent constraints on short-term external debt may be implemented to shore up confidence in Indonesian financial markets.

Fiscal policy: Higher infrastructure spending and government plans to raise expenditure realization rates are providing some fiscal tailwinds this year. Parliament approved a revised budget for 2011 which raises the fiscal deficit to 2.1% of GDP from 1.8% versus the 2010 outturn of 0.6%. The revision reflects the increase in fuel subsidies by 35% to IDR130trn (1.8% of GDP) due to higher oil prices, but the allocation for capital spending was maintained. The 2012 budget reduces the deficit to 1.5% of GDP, reflecting a 16% increase in tax revenues, a 12% reduction in subsidies and a 19% rise in capital spending, with a heavy emphasis on infrastructure projects. We believe the budget prioritises well and maintains fiscal conservatism.

Risks: In a worse-case scenario of a recession in the US and euro area, growth is likely to be most resilient in ASEAN given ample fiscal firepower, the policy rate is far from the zero bound, and domestic demand drivers dominate. In the financial channels, large foreign holdings of Indonesian bonds and equities leave bond and stock prices vulnerable, but the bond stabilization fund 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**	**6.5**	6.2	6.9	6.5	7.0	7.0	7.5	6.5	7.0	7.0
Private consumption	**4.5**	**4.6**	5.1	5.2	5.3	5.3	5.3	5.3	4.8	5.3	5.7
Government consumption	**2.8**	**4.5**	4.0	5.0	6.0	5.0	4.5	4.5	4.2	4.9	10.0
Gross fixed capital formation	**7.3**	**9.2**	10.2	11.0	11.7	12.0	11.9	12.0	9.5	11.9	11.0
Exports (goods & services)	**12.3**	**17.4**	10.7	10.7	10.7	11.5	11.5	11.5	12.7	11.3	11.5
Imports (goods & services)	**15.6**	**16.0**	12.0	12.4	12.6	12.6	12.6	12.6	13.9	12.6	15.2
Contributions to GDP (% points):											
Domestic final sales	**4.5**	**5.1**	5.6	6.3	6.1	6.2	6.3	6.6	5.4	6.3	6.8
Inventories	**0.5**	**1.0**	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.0
Net trade (goods & services)	**0.1**	**2.1**	0.6	0.6	0.3	0.8	0.7	0.9	0.9	0.7	-0.3
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**	**37.4**	20.1	13.0	13.0	12.8	14.2	14.6	24.5	13.6	18.2
Imports	**32.0**	**36.4**	23.6	20.2	15.6	13.9	16.6	16.7	27.6	15.7	22.3
Merchandise trade balance (US$bn)	**8.7**	**9.7**	8.0	7.8	8.8	10.5	8.2	8.0	34.2	35.5	34.2
Current account balance (% of GDP)	**1.1**	**0.1**	0.7	-0.2	0.9	0.4	0.6	-0.1	0.4	0.4	0.0
Fiscal Balance (% of GDP)									-1.7	-1.6	-1.4
Bank Indonesia rate (%)	**6.75**	**6.75**	**6.75**	6.75	6.75	7.00	7.00	7.00	6.75	7.00	6.50
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 7 October 2011. Source: CEIC and Nomura Global Economics.

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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 changes: We edge up our CPI inflation forecasts from 4.4% to 4.5% for 2011 and from 3.6% to 3.7% for 2012 as we see lower oil prices largely offsetting a weaker KRW/USD (our forecasts changed to 1195 from 1020 at end-2011 and to 1100 from 960 at end-2012).

Activity: We maintain our below-consensus 3.5% GDP growth forecast for 2011, although we see downside risks due to recent market turmoil. GDP growth slowed from 1.3% (sa) q-o-q in Q1 to 0.9% in Q2. Industrial output growth fell 1.9% (sa) m-o-m in August, after falling 0.3% in July. These monthly data support our forecast of a further slowdown in GDP growth to 0.5% in Q3 before an uptick to 0.8% in Q4 as domestic demand should remain weak and foreign demand diminishes. In 2012, 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). 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 3.7% in 2012 from 4.5% in 2011.

Policy: Given our near-term view that inflation will ease and GDP weaken, we expect the BOK to remain on hold before delivering its next 25bp hike in February 2012. We believe the BOK is likely to pause again ahead of the elections in 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. However, 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**	2.0	3.2	6.1	6.1	7.0	5.7			
Real GDP (sa, % q-o-q)	**1.3**	**0.9**	0.5	0.8	1.5	1.5	1.7	1.4			
Real GDP	**4.2**	**3.4**	3.3	3.6	3.7	4.4	5.6	6.2	3.5	5.0	4.0
Private consumption	**2.8**	**3.0**	2.1	2.4	3.0	4.2	4.7	4.6	2.6	4.1	3.1
Government consumption	**1.7**	**2.1**	3.6	5.5	5.4	6.7	6.7	6.1	3.1	6.2	4.6
Business investment	**11.7**	**7.5**	2.8	4.3	6.6	3.5	5.6	9.3	6.4	6.2	7.4
Construction investment	**-11.9**	**-6.8**	-6.7	-5.3	2.6	3.0	4.6	4.9	-7.9	3.8	4.1
Exports (goods & services)	**16.8**	**9.6**	8.3	7.7	6.9	8.8	9.8	10.9	10.4	9.1	9.3
Imports (goods & services)	**10.8**	**7.9**	5.5	7.1	8.5	8.2	9.8	10.9	7.8	9.4	10.9
Contributions to GDP growth (% points):											
Domestic final sales	**1.2**	**1.2**	1.1	2.0	4.9	4.0	4.4	4.7	0.8	4.4	3.9
Inventories	**-0.1**	**0.7**	0.4	0.6	-1.0	-0.6	0.4	0.5	0.9	0.0	0.0
Net trade (goods & services)	**3.1**	**1.4**	1.8	0.9	-0.2	1.1	0.9	1.0	1.9	0.7	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	4.5	3.7	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**	**0.7**	0.5	0.5	1.0	1.0	0.5	0.5	4.0	3.0	2.0
BOK official base rate (%)	**3.00**	**3.25**	**3.25**	3.25	3.50	3.50	3.50	3.50	3.25	3.50	4.00
3-year T-bond yield (%)	**3.74**	**3.77**	**3.56**	3.50	3.75	3.75	3.75	3.75	3.50	3.75	4.10
5-year T-bond yield (%)	**4.12**	**4.01**	**3.67**	3.75	4.00	4.00	4.15	4.15	3.75	4.15	4.30
Exchange rate (KRW/USD)*	**1097**	**1068**	**1178**	1195	1160	1140	1120	1110	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 7 October 2011.
Source: Bank of Korea, CEIC and Nomura Global Economics.

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The week ahead

We expect Q3 GDP flash estimates to rebound in Singapore while inflation remains elevated in China and India. In Korea and Indonesia, we expect policy rates to remain unchanged.

Activity: In Singapore, we expect the flash estimates of Q3 GDP to rebound sharply following a biomed-led surge in industrial output in August. In Malaysia, we expect industrial output growth to rise given stronger than expected export growth and normalization in mining output. Likewise in India, industrial output growth is likely to rise in August as we expect strong payback in capital goods output after a large contraction in July. In Australia, we expect owner-occupier housing finance to rise for a fifth consecutive month, assisted by the lengthy period of stable housing interest rates and revival in activity in Sydney, Australia's largest housing market.

Inflation: In China, we expect CPI inflation to rise slightly to 6.3% y-o-y in September from an already elevated 6.2% in August because of an increase in food prices. In India, we also expect WPI inflation to remain elevated at 9.8% y-o-y in September, again due to a pick-up in food prices.

Policy: We expect the Bank of Korea to keep rates unchanged at 3.25% in October despite above-target CPI inflation as the downside risks to growth are substantial due to problems in Europe. We expect Bank Indonesia to keep its policy rate unchanged but continue to signal in its policy statement a readiness to cut rates, should external conditions warrant such a move. In Singapore, we expect the MAS to announce a lower slope of the SGD NEER appreciation band given rising external risks.

Trade: In China, we expect export growth to slow in September because of weaker external demand. We also expect import growth to slow, after unexpectedly strong growth in August.

Employment: In Australia, we expect employment growth to rebound in September after back-to-back falls in August and July, allowing for stronger job vacancies in the three months to August, indicating that the soft patch in monthly labour force readings may be coming to an end.

Sometime in the week			Units	Period	Prev 2	Prev 1	Last	Nomura	Consensus
	Singapore	Advance GDP estimates	% y-o-y	Q3	12.0	9.3	0.9	7.4	5.2
	Singapore	Advance GDP estimates	% q-o-q, saar	Q3	3.9	27.2	-6.5	7.7	1.0
	Singapore	Monetary policy statement			Lower slope of SGD NEER band				
	China	Money supply, M2	% y-o-y	Sep	15.9	14.7	13.5	13.3	14.0
	China	New RMB loans	RMBbn	Sep	633.9	492.6	548.5	550.0	550.0
Monday 10 October									
	Asia	No data release today							
Tuesday 11 October									
	Indonesia	Central bank policy meeting, policy rate, %		Oct	6.75	6.75	6.75	6.75	6.75
08.30	Australia	NAB business confidence	Index	Sep	0.0	2.0	-8.0	n.a.	n.a.
09.00	Philippines	Exports	% y-o-y	Aug	-3.1	-9.4	-1.7	-6.6	-4.4
12.01	Malaysia	Industrial production	% y-o-y	Aug	-5.6	1.3	-0.6	5.3	0.5
Wednesday 12 October									
	S. Korea	Unemployment rate	% sa	Sep	3.3	3.3	3.1	3.3	3.2
08.30	Australia	Home loans	% m-o-m, sa	Aug	2.3	0.6	1.0	1.5	1.0
11.00	S. Korea	Money supply, M2	% y-o-y	Aug	3.7	3.0	3.2	3.2	n.a.
13.30	India	Industrial production	% y-o-y	Aug	5.9	8.8	3.3	7.4	n.a.
Thursday 13 October									
08.30	Australia	Employment change, '000	m-o-m, sa	Sep	14.4	-4.1	-9.7	10.0	10.0
08.30	Australia	Unemployment rate	% sa	Sep	5.0	5.1	5.3	5.3	5.3
09.00	S. Korea	Central bank policy meeting, base rate, %		Oct	3.25	3.25	3.25	3.25	3.25
10.00	China	Trade balance	US$bn	Sep	22.3	31.5	17.8	20.3	16.9
10.00	China	Exports	% y-o-y	Sep	17.9	20.4	24.5	20.0	20.8
10.00	China	Imports	% y-o-y	Sep	19.3	22.9	30.2	20.0	24.6
Friday 14 October									
05.00	S. Korea	Export price	% y-o-y	Sep	-0.4	-1.3	1.8	2.0	n.a.
05.00	S. Korea	Import price	% y-o-y	Sep	10.5	9.8	10.0	10.0	n.a.
10.00	China	Producer price index	% y-o-y	Sep	7.1	7.5	7.3	7.1	6.9
10.00	China	Consumer price index	% y-o-y	Sep	6.4	6.5	6.2	6.3	6.1
13.00	Singapore	Retail sales (value)	% y-o-y	Aug	9.8	11.1	10.7	10.0	5.8
14.30	India	Wholesale price index	% y-o-y	Sep	9.5	9.2	9.8	9.8	n.a.

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

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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 3.6% 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. We expect more cuts ahead with Selic reaching 9.5% by Q1 2012, as policymakers, with a very negative view of the global outlook, are determined to keep economic growth above 3.5%, even at the cost of higher inflation. We expect the easing of monetary policy to boost growth to 3.9% in 2012, with growth falling below potential in 2013. As inflation threatens to go above the top of the current band, we think policy rates will have to rise back to the 12.00% region.

Inflation: Inflation has been elevated throughout 2011, running at 6.87% y-o-y as of July, above the 6.5% upper range of the target band for four 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**	3.7	3.4	4.3	4.0	3.9	3.6	3.6	3.9	3.5
Personal consumption	**5.9**	5.5	3.7	3.6	4.3	5.4	4.6	3.5	4.5	4.5	3.0
Fixed investment	**8.8**	5.9	1.0	3.0	2.9	5.0	5.8	4.7	4.3	4.6	4.4
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	5.9	4.4	7.4	2.9	1.4	1.9	1.9	3.5	1.9
Imports	**13.1**	14.6	7.9	7.9	10.0	5.4	2.5	3.5	10.6	5.2	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**	7.29	6.55	6.10	6.05	6.12	6.15	6.55	6.15	6.00
IGPM (wholesale prices)	**10.95**	**8.65**	9.44	9.69	8.41	8.12	7.80	7.49	9.69	7.49	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**	10.50	9.50	9.50	10.00	11.50	10.50	11.50	12.00
BRL/USD	**1.63**	**1.56**	**1.88**	1.65	1.68	1.70	1.72	1.75	1.65	1.75	1.85

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 06 October 2011.
Source: Nomura Global Economics.

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Benito Berber

Muddling through

As long as the US does not enter a recession, Mexico should continue to grow above potential. We now expect the first rate hike in Q4 2012, versus our previous projection of Q1 2012.

Forecast changes: *We revised our Mexican peso forecast. With the sovereign debt crisis in Europe deepening and lukewarm US growth, the peso will likely remain weak in the short-term.*

Activity: The Mexican economy expanded by 4.6% y-o-y in Q1 2011 after rebounding by 5.5% in 2010. However, the outlook has turned substantially less positive due to severe corrections in US equity prices and considerable uncertainty about the European sovereign debt crisis. Nomura's economics team has shaved its GDP forecast for the US for 2011 and 2012. Taking into account these forecasts we now project Mexican GDP to expand by only 3.7% as opposed to 4.0% for 2011. For 2012 we lowered our forecast to 3.0% from 3.4%. On the positive side, the turbulence in manufacturing activity due to the supply-chain disruptions after the earthquakes in Japan seems to have ended. In addition, domestic demand in Mexico has finally started to pick up, evidenced by private consumption growing almost 5.0% y-o-y in Q1 2011.

Inflation: We continue to expect inflation to be slightly below 4.0% y-o-y in 2011 as we estimate the output gap to remain around zero for the rest of 2011. While the recent MXN weakness will have put upward pressure on inflation, we think the currency could start rising again once the volatility in international markets subsides. Agricultural goods prices and government tariffs have risen between 3.0% and 3.5% y-o-y this year, contributing to low inflation. But in 2012 we expect them to resume their upward trend. We expect inflation to accelerate in 2012 due to pressures on the demand side and less favourable non-core price dynamics.

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. Previously we expected Banxico to start hiking in Q1 2012. However, if the US enters a severe recession then Banxico will likely cut its policy rate. 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 marginally above 3.0% of GDP.

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**	12.80	12.70	12.60	12.50	12.40	12.80	12.40	12.20

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 07 October 2011.
Source: Nomura Global Economics.

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Tatiana Orlova

Oil no longer propelling the economy

This year's focus is on year-end parliamentary elections and the announcement of the candidates for the presidential race.

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; however, instead of translating into high demand for domestic goods, this is leading to an increase in imports. 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 amended 2011 budget assumes an average Urals oil price of $105/bbl; the government is again planning to channel some of its windfall oil revenues into the Reserve Fund, and has decided to divert some of this revenue into a new fund, which will co-finance modernisation projects with foreign investors. It has also raised its annual expenditure target by about 3% in the run-up to the elections. This should support household consumption, but fixed investment has so far remained anaemic. 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 year to date have exceeded $45bn, 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 as early as October. Inflationary pressures may pick up in Q4 owing to 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. Further pre-election fiscal loosening and protracted rouble weakness 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 $108/bbl this 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.

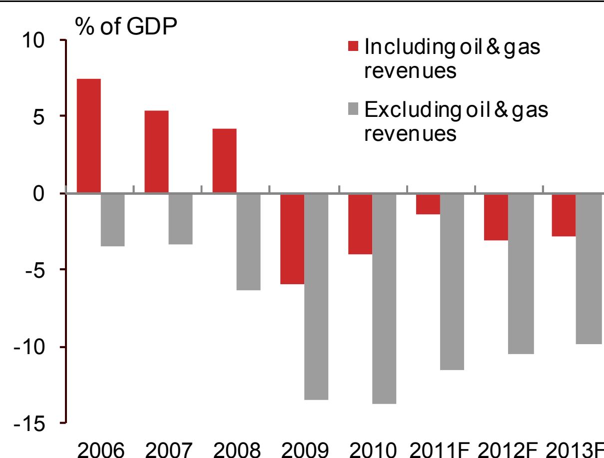
Figure 1. Details of the forecast

	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**	4.0	1.9	1.3
FX reserves, gross USD bn	**479**	550	570	585
CRB policy rate %*	**7.75**	8.25	8.75	7.50
USDRUB, end of period	**30.53**	31.85	30.37	32.31
RUB Basket***	**35.17**	36.15	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.

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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

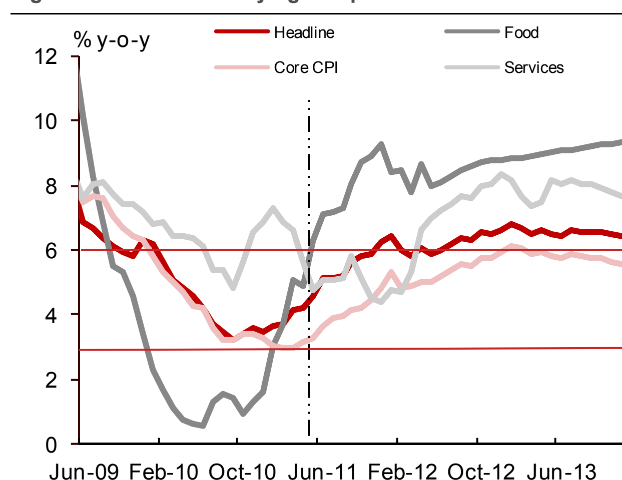
	2010	2011	2012	2013
Real GDP % y-o-y	**2.8**	3.1	3.4	4.0
Current account % GDP	**-2.8**	-3.8	-4.5	-5.5
PSCE % y-o-y*	**5.5**	6.8	9.6	11.3
Fiscal balance % GDP	**-4.9**	-5.6	-6.1	-5.5
FX reserves, gross USD bn*	**43.8**	51.4	51.4	51.3
CPI % y-o-y *	**3.5**	6.1	5.8	6.0
CPI % y-o-y **	**4.3**	5.0	5.5	6.0
Manufacturing output % y-o-y	**4.9**	-0.3	2.2	4.3
Retail sales output % y-o-y	**5.2**	2.5	2.2	4.0
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.

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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 7.0% (a percentage point higher 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.

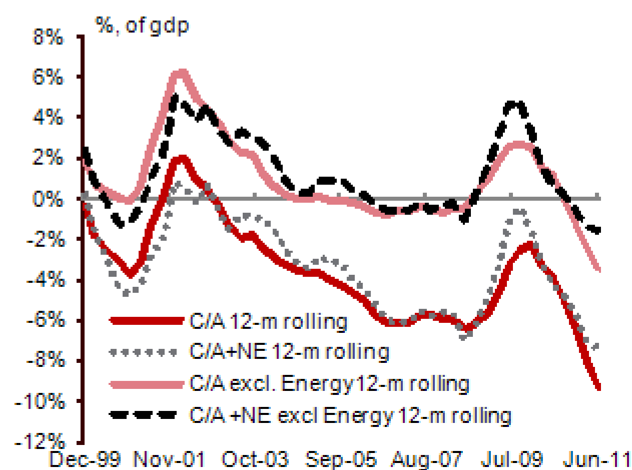
Figure 1. Details of the forecast

	2010	2011	2012	2013
Real GDP % y-o-y	**8.9**	7.0	4.2	5.0
CPI % y-o-y *	**6.4**	7.7	7.2	6.5
CPI % y-o-y **	**8.6**	7.5	7.0	6.8
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.

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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	1.6	2.0
Nominal GDP USD bn	**130.5**	137.9	148.7	154.1
Current account % GDP	**0.5**	1.5	0.8	0.3
Fiscal balance % GDP	**-4.2**	1.1	-4.0	-3.1
CPI % y-o-y *	**4.7**	3.7	4.0	3.4
CPI % y-o-y **	**4.9**	3.9	4.1	3.4
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	96.0	92.1
Public debt % GDP	**80.9**	75.2	73.9	71.5
MNB policy rate %*	**5.75**	6.00	6.00	6.00
EURHUF*	**279**	275	280	285

*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**	473.3	565.3	596.6
Current account % GDP	**-1.8**	-6.5	-7.8	-7.2
Fiscal balance % GDP	**-7.8**	-4.5	-3.4	-3.0
CPI % y-o-y *	**3.1**	4.8	3.1	2.8
CPI % y-o-y **	**2.6**	4.3	3.8	2.8
Population mn	**38.0**	38.0	37.9	37.8
Unemployment rate %	**12.3**	11.5	11.0	10.5
Reserves USD bn **	**93.5**	120.0	130.0	140.0
External debt % GDP	**67.1**	65.2	64.7	63.9
Public debt % GDP	**53.3**	54.1	53.8	53.1
NBP policy rate %*	**3.50**	4.50	4.50	4.00
EURPLN*	**3.96**	4.00	3.75	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**	201.2	224.2	239.6
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	3.5	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.

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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**	5.2	4.0	3.8
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**	33.2	15.9	14.5
Imports, % y-o-y	**35.2**	43.5	12.0	10.8
CPI % y-o-y *	**9.4**	8.4	11.1	10.5
Consolidated budget % GDP**	**-5.8**	-3.1	-5.5	-4.2
Current account % GDP	**-2.1**	-4.8	-1.9	-2.2
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 is 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 remains in deficit, 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**	6.0	5.1	5.3
Consumption % y-o-y	**10.2**	8.5	4.0	4.5
Gross investment % y-o-y	**3.8**	4.0	7.0	9.0
Exports % y-o-y	**43.3**	31.4	-0.5	6.3
Imports % y-o-y	**9.4**	30.8	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**	5.5	4.2	4.4
FX reserves, gross USD bn	**28.2**	45.4	50.3	55.3
NBK official rate %*	**7.00**	7.50	7.50	7.50
USDKZT*	**147**	148	146	143

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

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

- Manufacturing, which propelled the economy in 2010, has retained some of its momentum. We expect robust growth supported by strong FDI inflows.
- The weaker oil price outlook means less appreciating pressure on the tenge. We have trimmed down our forecasts for the current account surplus and have therefore revised our end-2011 and 2012 forecasts from 146 and 143 to 148 and 146, respectively.
- 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**	6.25	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.

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Ann Wyman | Olgay Buyukkayali

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**	3.25	3.75	4.00
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. Monetary policy should remain unchanged for the rest of 2011.

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.

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Rest of Latin America | Economic Outlook 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 7 October 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 likely to put pressure on international reserves.
- Presidential elections next October may be relatively uneventful.

Chile: Robust economic growth to continue amid global uncertainties

Growth will 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 7 October 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	7.00	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 7 October 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 central bank started its tightening cycle in February and paused in August. We expect the policy rate to stay at 4.5% until year-end.
- 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 .

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The week ahead

The central banks of Mexico and Chile will decide on policy rates, while their Colombian counterparts will release minutes. Czech Republic, Hungary and Poland will release CPI data.

Czech Republic, CPI (Monday): We expect CPI to come in below the previous and consensus estimates, at 1.6% y-o-y as core deflation continues and there is little currency weakness to feed through. As such demand dynamics are the key driver.

Turkey, Industrial production (Monday): We expect Turkish industrial production to be at 8% y-o-y for August, as the deceleration in activity should be limited thanks to base effects and a limited month-on-month seasonally adjusted recovery.

Hungary, CPI (Tuesday): We look for CPI to increase to 3.8% y-o-y in September from 3.6% previously as currency weakness starts to feed through and offset lower commodity prices and negative demand dynamics. Most pass-through should not occur, however, until the end of the year given lags but we see CPI remaining elevated in the coming months, compounded by forthcoming the excise and VAT increase which will all ultimately feed through to core inflation as well. For now core should remain more muted given the drag on domestic demand from the currency via FX loans and also due to the weak labour market.

South Africa, Manufacturing production (Wednesday): We expect manufacturing to rebound to 0.1% y-o-y in August from -6.0% previously. We see the July number as a one-off because of strike action, and the lagged impact of that disruption should still be felt in these new data. However, we believe the underlying trend is still for a worsening in the growth rate of manufacturing, led by lower export demand and a spluttering internal recovery. The data should add to the case for a rate cut but should not be sufficient, yet, to tip the MPC into action.

Poland, CPI (Thursday): We expect CPI to beat consensus and come in at 4.2% y-o-y in September, just a notch down from the previous month (mainly due to base effects). It is too early to expect FX pass-through but we think increases in energy costs and core inflation remaining at 2.7% will be key factors supporting headline inflation. The rise in CPI (both core and headline) should resume from next month and we still see headline peaking at 4.7% in

Sometime this week				Period	Prev 2	Prev 1	Last	Nomura	Survey
	Poland	Budget balance, ytd	EUR mn	Sep	-20222	-21084	-20681	n.a.	n.a.
	Russia	PPI	% y-o-y	Sep	18.6	16.1	18.5	19.1	18.8
Monday 10 October				**Period**	**Prev 2**	**Prev 1**	**Last**	**Nomura**	**Survey**
08:00	Hungary	Trade balance	EUR mn	Aug	705.6	609.3	354.8	450.0	490.0
08:00	Czech Republic	CPI	% y-o-y	Sep	1.8	1.7	1.7	1.6	1.7
08:00	Czech Republic	Unemployment	%	Sep	8.1	8.2	8.2	8.2	8.1
12:00	Turkey	Industrial production, NSA	% y-o-y	Aug	8.0	6.8	6.9	8.0	5.5
	Egypt	CPI	% y-o-y	Sep	11.8	10.4	8.5	n.a.	n.a.
Tuesday 11 October									
08:00	Hungary	CPI	% y-o-y	Sep	3.5	3.1	3.6	3.8	3.7
08:00	Romania	CPI	% y-o-y	Sep	7.9	4.9	4.3	4.1	4.0
08:00	Turkey	Current account	USD bn	Aug	-7.9	-7.7	-5.3	n.a.	-3.8
	Israel	GDP, SAAR	% y-o-y	Q3	7.5	4.7	3.5	n.a.	n.a.
	Israel	Trade balance	USD mn	Sep	-1444	-1612	-1793	n.a.	n.a.
13:00	Brazil	Retail sales	% y-o-y	Aug	6.3	7.1	7.1	n.a.	7.10
Wednesday 12 October									
12:00	South Africa	Manufacturing production	% y-o-y	Aug	1.0	0.8	-6.0	0.1	n.a.
	Russia	Trade balance	USD bn	Aug	16.2	17.3	15.2	13.5	14.3
	Russia	Weekly CPI	% w-o-w	10-Oct	0.0	0.0	0.0	-0.1	n.a.
14:00	Mexico	Industrial production	% y-o-y	Aug	4.6	3.7	3.2	3.3	n.a.
Thursday 13 October									
09:00	Czech Republic	Current account	CZK bn	Aug	-22.5	-8.3	-12.8	n.a.	-15.0
13:00	Poland	CPI	% y-o-y	Sep	4.2	4.1	4.3	4.2	4.1
13:00	Poland	Current account	EUR mn	Aug	32	-1596	-1611	-1575	-1525
	Egypt	CBE rate decision	%, policy rate	Oct	8.25	8.25	8.25	n.a.	n.a.
22:00	Chile	Policy rate	%, policy rate	Oct	5.25	5.25	5.25	5.25	5.25
Friday 14 October									
08:00	Hungary	Industrial production	% y-o-y	Sep	2.3	0.9	2.7	n.a.	-0.4
13:00	Israel	CPI	% y-o-y	Sep	4.2	3.4	3.4	2.9	3.2
15:00	Mexico	Policy rate	%, policy rate	Oct	4.50	4.50	4.50	4.50	4.50
	Colombia	Monetary policy meeting minutes							

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

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November with core peaking at 3.3% in February next year.

Chile, Policy rate (Thursday): We expect the central bank of Chile (BCRP) to keep the policy rate unchanged at 5.25% while signalling its willingness to cut rates in the near future, given the fact that international scenarios have further deteriorated, domestic activities are slowing and inflation is hovering around the target. For more details regarding Chile's monetary policy outlook, please see this week's Emerging Markets Roundup.

Israel, CPI (Friday): We forecast Israel CPI to fall 0.2% m-o-m in September. There are strong downside risks around the extent of food deflation and some upside risks around energy and electricity prices (spillovers from August). Even with very cautious assumptions of domestic demand moderation in different subgroups and a limited clothing deflation history, we expect a comfortable headline m-o-m deflation for the month. Risks are on the downside, in our view.

Mexico, Policy rate (Friday): We expect the central bank of Mexico (Banxico) to keep the policy rate on hold at 4.5%. The Mexican peso's significant depreciation in August and September has eased monetary conditions substantially, making it fairly unlikely that Banxico will cut rates.

Colombia, Monetary policy meeting minutes (Friday): The central bank of Colombia (BanRep) kept its policy rate unchanged at 4.5% at its last monetary policy meeting and revamped its FX intervention program, making a commitment to intervene by US$200mn on both sides if the peso appreciates or depreciates. We will look to the minutes for a better understanding of BanRep's rationale.

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