Danske Bank
Markets

FX Forecast Update

The Scandi divergence

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Forecast review part I

- **EUR/NOK.** Despite our long-term strategic bullish view on the NOK we think the latest move lower has been a little too fast too soon. Given the vulnerable risk environment with political uncertainty, a Fed hike looming, a stronger USD, an OPEC agreement likely to fail and US oil production adjusting, we could well see the oil price erase the latest gains in the months to come supporting a higher EUR/NOK. Also, given the latest developments in Norwegian data, speculative NOK positioning and NOK-seasonality we expect the cross to end the year higher than the current spot. For 2017 we still see a fundamental story supporting a lower EUR/NOK on economic growth, real rate differentials and a higher oil price. We now forecast EUR/NOK at 9.10 in 1M (previously 9.30), 9.20 in 3M (9.30), 9.00 in 6M (9.10) and 8.80 in 12M (8.80).
- **EUR/SEK.** The strong EUR/SEK rally that broke key resistance levels surprised and we do not rule out that it has further to run. However, we also note that the pair is looking increasingly overbought technically and relative to our short-term financial models. Stretched valuation is a strong argument for lower levels but the question is when this comes into play. The cyclical backdrop is less favourable for the SEK, but it could be that this is already in the price. On the back of the recent sell-off in the SEK we raise the forecast profile to 9.70 (9.40), 9.50 (9.30), 9.40 (9.30) and 9.20 (9.10) in 1M, 3M, 6M and 12M, respectively.
- **EUR/DKK.** We forecast EUR/DKK will trade at 7.4425 on 1-12M, unchanged from last month. Should renewed DKK appreciation pressure arise on, for example, renewed political uncertainty in Europe, we still look for Danmarks Nationalbank (DN) to cap EUR/DKK downside around 7.4350 by selling DKK in FX intervention.
- **EUR/USD.** We lower our EUR/USD forecasts to 1.09 in 1M (1.12 previously), 1.08 in 3M (1.12), 1.11 in 6M (1.14) and 1.15 in 12M (1.18). Near term, we expect politics, relative growth expectations and interest rates to weigh on EUR/USD. In particular, we view the UK's recent signal that it will opt for a hard Brexit as a short-term EUR/USD negative. Longer term, we maintain our long-held view that the undervaluation of the EUR and the wide eurozone-US current account differential are longer-term EUR positives.
- **EUR/GBP.** EUR/GBP has increased sharply over the past few weeks, as Brexit has returned as a theme in the market following the statement by UK Prime Minister May that she will trigger Article 50 before March 2017, which implies that we might be heading for a 'hard Brexit'. As such we have increased our short-term forecasts slightly and now see the cross at 0.90 in 1M (from 0.87), 0.91 in 3M (from 0.88), but keep our 6M and 12M forecasts unchanged at 0.92 and 0.90, respectively.

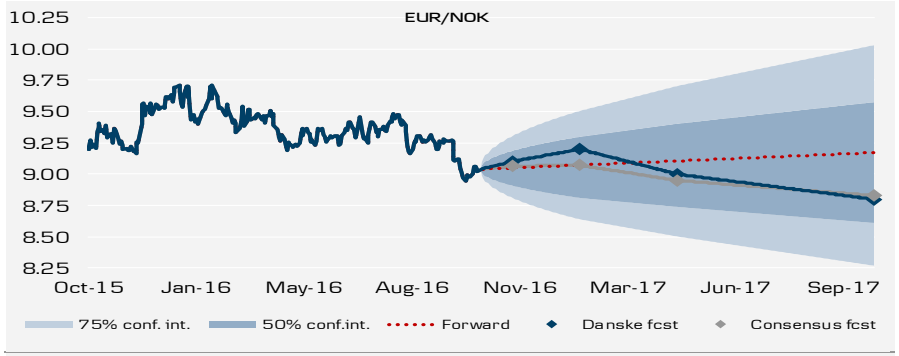
Forecast review part II

- **USD/JPY.** USD/JPY has rallied around 4% to the 104 level over the past month, driven primarily by relative rates as the market has raised expectations of a December hike by the Fed. In the short term, we think the cross is likely to remain supported by relative rates but only modestly so, as a December hike is already largely priced in. We have raised our USD/JPY forecast slightly as a Fed rate hike is moving closer. We now target 104 in 1M (101), 106 in 3M (102) and 106 (104) in 6-12M.
- **NZD/USD.** The NZD has depreciated more than 3% versus the USD since our previous update, reflecting a drop in dairy prices and rising expectations that the RBNZ will ease policy again in November. In the short term, we expect a temporary correction to 0.72 as the November cut is fully priced in. In 3-12M, we expect the NZD to continue its gradual drift lower as a result of rate convergence after Fed rate hikes resume.
- **USD/CNY.** We have lifted our forecasts slightly to 6.75 (6.70) +1M and 6.80 (6.75) +3M. Our forecasts for +6M and +12M are unchanged at 6.85 and 7.10, respectively. The small lift is a reflection of the recent move higher that happened on the back of broad USD strength. We continue to expect weakening of the CNY in coming years as financial risks are increasing, growth is under pressure and capital flows are less favourable for China, with net FDI flows now being negative.
- **EMEA**. Both the Polish and Hungarian economies are seeing a quite strong momentum. We expect EUR/PLN to slide to 4.30 in 1M (unchanged) as we expect Hillary Clinton to win the election and the Fed not to hike until the first half of 2017. Given the robust performance of the Polish economy and a possible falling risk premium from a resolution of the stand-off with the EU, we expect EUR/PLN to fall to 4.28, 4.26 and 4.22 in 3M, 6M and 12M, respectively. The HUF has been trading stronger than our relatively bullish call thanks to the rating upgrade by S&P and strong fiscal developments. As a result, we revise our EUR/HUF forecasts to 306 in 1M and 3M (from 308), 304 in 6M and 12M (from 306 and 304), respectively.
- **USD/RUB.** Russia's currency was a top-three performer among 150 global currencies over the past 30 days. We continue to be moderately bullish on the RUB in the long term. However, the political risk and possible intensification of Western sanctions (this time possibly linked to Syria) should be constantly kept in mind, as possible 'black swan' events could prevail over fundamentals. We lower our USD/RUB short- and medium-term profile, and see the cross at 63.30 (previously 64.30) in 1M, 62.00 in 3M (previously 63.00), 59.50 in 6M (previously 60.00) and 57.10 in 12M (unchanged).
- **USD/TRY.** Given the prevailing political uncertainty and rising concerns about the Fed's hike and economic slowdown, we raise our USD/TRY short- and medium-term forecasts to 3.04 in 1M (previously 2.98), 3.10 in 3M (previously 3.05) and 3.12 in 6M (previously 3.07) and keep our 12M forecast unchanged at 3.15.

EUR/NOK – Move lower has been too fast too soon

- **Growth**. Over the summer, economic data out of Norway surprised to the upside with not least the quarterly Regional Network Survey suggesting an improved growth outlook. However, since the Norges Bank meeting in September (see below), economic releases have been on the weak side with especially manufacturing production disappointing heavily. Also, the drop in core inflation to 2.9% y/y (from 3.3%) has removed the last worries of cost-push spirals; worries that initially triggered the Norges Bank's re-pricing. The robustness of economic data seen in light of the stronger NOK is set to be decisive for the future direction of economic- and not least monetary policy in Norway (see overleaf).
- **Monetary policy**. While it was widely expected that Norges Bank left the sight deposit rate unchanged at the September meeting, the central bank still managed to surprise markets by introducing an explicit 'neutral' bias in the statement. The rate path still suggests a 40% probability of a later cut but we interpret this as an insurance premium against weakening data and/or strong NOK appreciation. As we expect neither of the two, we think Norges Bank will leave rates unchanged over the next 12M.
- **Flows.** Foreign banks (proxy for speculative flows) have recently heavily bought NOK. From a historical perspective, this suggests that speculative NOK positioning has become stretched long.
- **Valuation.** While the NOK from a long-term perspective seems fundamentally undervalued, the relative development in unit labour costs suggests a more limited near-term upside potential. Our long-term PPP model has EUR/NOK at 8.19 while MEVA (medium-term) has 9.89 as 'fair'.
- **Risks.** The biggest risk factor to our forecast is a global risk-off event that would send the cross much higher than pencilled in. A further appreciation of the NOK could in our view well be reversed by weaker data/Norges Bank re-introducing an explicit dovish bias.

Forecast: *9.10 (1M), 9.20 (3M), 9.00 (6M), 8.80 (12M)*



EUR/NOK	1M	3M	6M	12M
Forecast (pct'ile)	9.10 (61%)	9.20 (66%)	9.00 (45%)	8.80 (34%)
Fwd. / Consensus	9.05 / 9.06	9.07 / 9.07	9.11 / 8.95	9.17 / 8.83
50% confidence int.	8.89 / 9.19	8.81 / 9.30	8.74 / 9.40	8.61 / 9.57
75% confidence int.	8.78 / 9.32	8.64 / 9.50	8.50 / 9.70	8.27 / 10.03

Source: Danske Bank Markets

Conclusion. While we have been long-term strategically bullish on the NOK, the tempo of last month's appreciation has been surprising. The move was not least triggered by a more hawkish NB than we and markets had pencilled in and the oil price rallying more than USD6/bl on speculations of an OPEC supply freeze. With the difficult details behind this OPEC supply cut yet to be worked out ahead of the official 30 November OPEC meeting, we still think achieving this objective will be easier said than done. Given the vulnerable risk environment with political uncertainty, a Fed hike looming, a stronger USD, and US oil production adjusting, we could well see the oil price erase the latest gains, re-settling in the low-end of the USD46-52/bl range before year-end.

Also given the latest developments in Norwegian data, speculative NOK positioning and NOK-seasonality (see overleaf) we do see risks of a move higher and expect the cross to end the year higher than the current spot. For 2017 we still see a fundamental story supporting a lower EUR/NOK on growth, real rate differentials and a higher oil price. We now forecast EUR/NOK at 9.10 in 1M (previously 9.30), 9.20 in 3M (9.30), 9.00 in 6M (9.10) and 8.80 in 12M (8.80).

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EUR/NOK – Important issues to watch

Economic policies becoming less accommodative

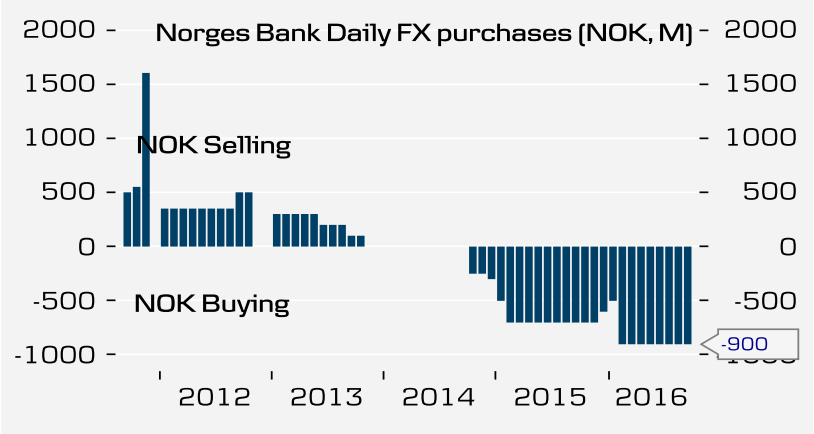
- As the economic outlook has improved it is not only monetary conditions that have become less accommodative. In the beginning of October the 2017 fiscal budget was released. The expansionary fiscal policy of the past two years has been a key factor in the turnaround in the Norwegian economy. According to the new budget proposal, the expansionary effect – measured as the change in the structural non-oil budget deficit as a share of trend GDP – is estimated to be 0.4 percentage points in 2017 (corresponding to a structural non-oil budget deficit of NOK225.6bn) down from 1.1pp this year. This is roughly NOK2bn, or around 0.1pp of GDP, less than the assumptions made by Norges Bank but will have a negligible impact on the rate path (for more details see Flash Comment Norway, 6 October).

- The budget proposal implies that NB will continue to buy NOK at a roughly unchanged pace in 2017 relative to this year (i.e. NOK900m/day,) although the budget does pose a risk of slightly larger purchases. It is, however, important to note that the purchases are not aimed at strengthening the NOK and simply reflect less NOK-exchange demand from oil companies due to falling revenues. On the contrary, the fiscal rule and the petroleum fund setup are aimed at preventing the NOK from appreciating too fast. Over time, only the size of the non-oil budget deficit can influence the net demand for NOK and as such, the budget in isolation remains a NOK-positive next year.

Seasonality could worsen an oil price drop in the coming months

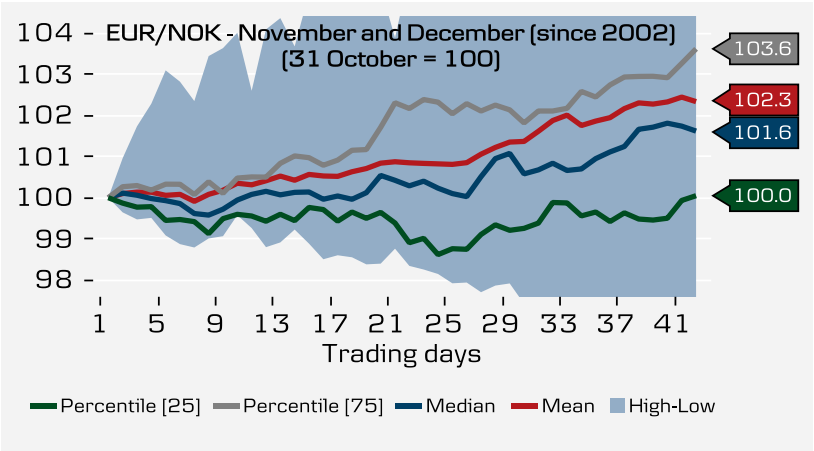
- We think the oil price is trading at the upper end of the USD52-46/bl range but seasonality could worsen the effect on EUR/NOK of a drop in the oil price in the coming months. Historically, year-end effects combined with worsening liquidity has sent the NOK c.2% weaker and even the 25th percentile is neutral, i.e. an unchanged EUR/NOK (see chart in the margin).

Norges Bank will continue to buy NOK but purchases simply reflect falling tax revenues from oil



Source: Macrobond Financial, Norges Bank, Danske Bank Markets

November and December have historically been bad months for the NOK



Source : Macrobond Financial, Danske Bank Markets

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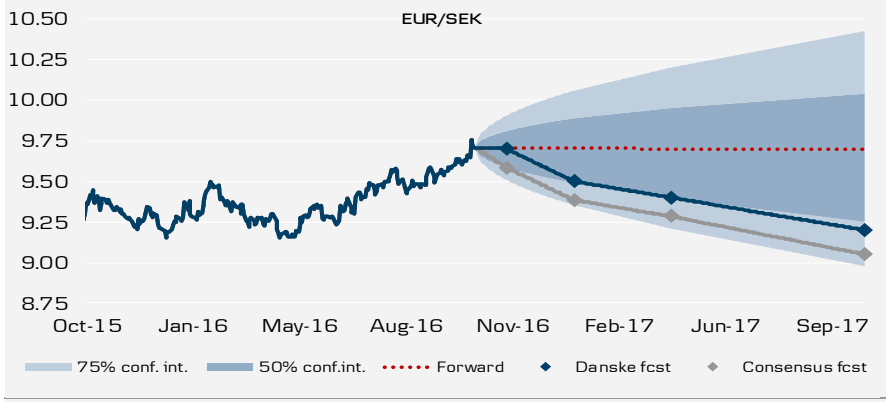
EUR/SEK – SEK to remain weak for longer

- **Growth.** Swedish growth-related data have continued to lose momentum in the past few weeks. It is not a question of sub-par or sub-peer growth but it is a clear downshift from how the year started off. Macro readings, real and inflation, have generally not lived up to expectations as illustrated by the macro surprise index (see next page), which has weighed on the SEK in the past couple of months.
- **Monetary policy.** Our base scenario that the Riksbank announces a (final?) extension of the current QE programme by six months and SEK20bn nominal bonds at 10bn index-linked at its October meeting, was supported by the big negative inflation surprise for September, which brought CPIF 0.4pp below the Riksbank forecast. It might choose to wait until December, given that the ECB is likely to wait until December and maybe with reference to the very weak krona.
- **Flows.** The weak SEK levels should be attractive for natural SEK-buyers, both exporters and financial institutions.
- **Valuation.** After the recent sharp depreciation of the SEK, undervaluation is extremely stretched vis à vis our short-, medium- and long-term models.
- **Risks.** The substantial selloff in the SEK opens up for substantial risks both ways, while the technical picture and momentum point towards higher levels with valuation pointing in the opposite direction. Apart from that, the Riksbank, the ECB and general risk sentiment could be decisive.

Forecast: *9.70 (1M), 9.50 (3M), 9.40 (6M), 9.20 (12M)*



EUR/SEK	1M	3M	6M	12M
Forecast (pct'ile)	9.70 (51%)	9.50 (25%)	9.40 (24%)	9.20 (22%)
Fwd. / Consensus	9.71 / 9.58	9.70 / 9.38	9.70 / 9.28	9.69 / 9.05
50% confidence int.	9.58 / 9.82	9.49 / 9.89	9.39 / 9.95	9.25 / 10.04
75% confidence int.	9.49 / 9.92	9.35 / 10.06	9.21 / 10.20	8.98 / 10.42

Source: Danske Bank Markets

Conclusion. The strong EUR/SEK rally with a break of key resistance levels surprised and we would not rule out that it has further to run. However, we also note that the pair is looking increasingly overbought technically and relative to our short-term financial models. Stretched valuation is a strong argument for lower levels but the question is when this comes into play. The cyclical backdrop is less favourable for the SEK but it could be that this is already in the price. On the back of the recent selloff in the SEK we raise the forecast profile to 9.70 (9.40), 9.50 (9.30), 9.40 (9.30) and 9.20 (9.10) in 1M, 3M, 6M and 12M, respectively.

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EUR/SEK – Important issues to watch

Monetary policy

- We expect the Riksbank to announce an extension of the QE but scale down the size – taper. We do not think there will be more rate cuts. On the other hand, we expect the ECB to extend its QE programme too, while we argue that the recent ECB taper talk is premature. Riksbank easing is in itself negative for the SEK. But *relative* monetary policy favours a lower EUR/SEK in our view. Our rates spread model suggests the pair is trading three standard deviations above fair value – an unusually big deviation.

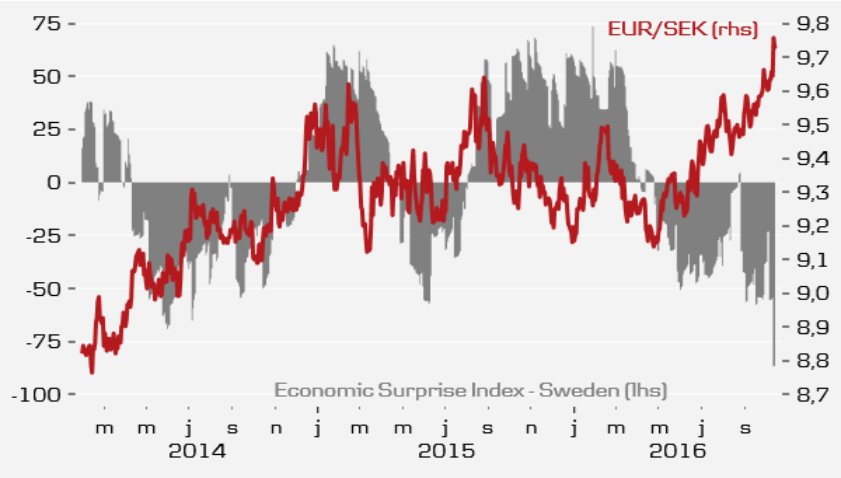
Data momentum negative – but watch out for a turn-around

- Swedish macro data have been weaker than anticipated for quite some time now. The surprise index has been in negative territory since April. In our view, it is a matter of time before it moves into positive terrain as it is mean reverting almost by construction. Then, a headwind for the SEK becomes a tailwind.

Valuation set to trump momentum?

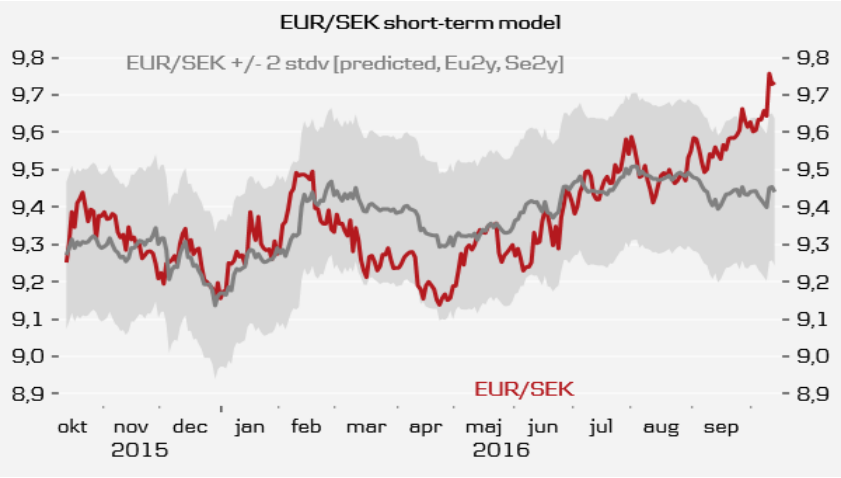
- The depreciation of the SEK is, in our view, way overdone in terms of underlying fundamentals. We argue that the SEK looks increasingly attractive from a medium- to long-term valuation perspective. On this note it is worth stressing that SNDO has asked for more flexibility in its FX mandate - part of the reason is the overly weak SEK.

Chart 1. Data momentum has weighed on the SEK



Source: Macrobond Financial

Chart 2. EUR/SEK substantially overbought



Source: Macrobond Financial, Danske Bank Markets

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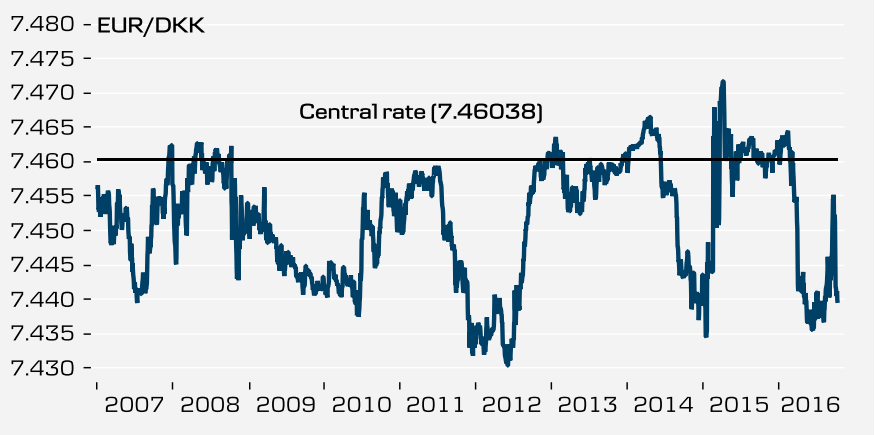
EUR/DKK – Down again after volatile month

- **FX.** The past month has been unusually volatile for EUR/DKK with the pair trading in the wide range of 7.4400-7.4550 without any significant change in fundamental drivers. The higher volatility did not prompt Danmarks Nationalbank (DN) to intervene in the FX market in September though. We forecast EUR/DKK will stay close to the present level and forecast it at 7.4425 on 1-12M. We see downside risk to our forecast in one or more of the multiple political events in Europe, e.g. Italian constitutional referendum, negotiations of the UK's withdrawal from EU membership and elections in Germany and France. All raise political uncertainty in Europe and could spur a new round of safe-haven DKK buying. We look for DN to cap EUR/DKK downside around 7.4350 by selling DKK in FX intervention.
- **Rates.** We expect DN to keep the rate of interest on certificates of deposits unchanged at -0.65% on 12M. However, if the need to sell DKK in FX intervention accelerates, or if the ECB decides to cut its deposit rate further (not our main scenario), DN may opt to cut to -0.75% – a level we still view as the lower bound for the key policy rate in Denmark.
- **Liquidity.** Conditions in the DKK money market have normalised on the back of DN selling DKK in FX intervention and buy backs of government bonds.
- **Regulation.** Large Danish banks will over the coming year need to meet liquidity requirements in significant currencies as part of the so-called liquidity coverage ratio in Basel III.

Forecast: *7.4425 (1M), 7.4425 (3M), 7.4425 (6M) and 7.4425 (12M)*



Source: Macrobond Financial, Danske Bank Markets

- **Flows.** The Danish current account surplus was revised up to 9.3% of GDP last year, which puts Denmark in second place on the list of countries with large current account surpluses. This supports a stronger DKK. We expect a large surplus over the next few years.
- **Conclusion.** In our view, EUR/DKK is set to trade close to the strong end of the historical trading range on a 12M horizon. We see limited downside risk from the current level, as DN stands ready to intervene in the FX market to cap EUR/DKK downside.

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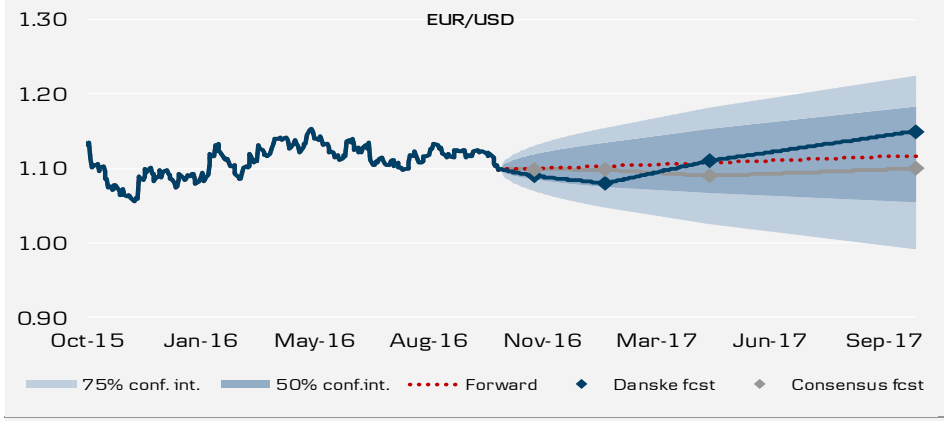
EUR/USD – Short-term downside-risk, still higher longer term

- **Growth**. Recently, US growth has risen gradually suggesting that the economy is picking up speed in H2 relative to H1 with employment growth being remarkably resilient. We expect US growth to grow close to trend at 2% in coming quarters. In the euro area, GDP growth showed decent GDP growth of 0.3% q/q in Q2 16 and initial survey indicators suggest fairly resilient economic conditions post the Brexit vote. In 2017, we expect growth to slow from lower investments and slightly weaker private consumption growth.
- **Monetary policy.** We still believe that the Fed will wait until H1 17 to raise interest rates but it is a close call whether it will act in December. Near term, the market is likely to focus on the Fed raising interest rates in December supporting the USD. The market is pricing in around two-thirds probability of a Fed December rate hike. Meanwhile, we expect the ECB in December to announce an extension of its current QE programme by six months to September 2017. We think it is unlikely that the ECB will cut interest rates further.
- **Flows.** The market is short EUR/USD, according to IMM data, but not in stretched territory. As such, this increases the sensitivity of the cross to any impetus from relative rates.
- **Valuation**. Our recent update of the MEVA model gives a fair value of 1.27 for EUR/USD exactly in line with our PPP model. Hence, EUR/USD is substantially undervalued
- **Risks.** Political risks in the eurozone and in the US are set to weigh on markets in coming months. We view this as slightly more EUR negative than US negative.

Forecast: *1.09 (1M), 1.08 (3M), 1.11 (6M), 1.15 (12M)*



EUR/USD	1M	3M	6M	12M
Forecast (pct'ile)	1.09 (31%)	1.08 (28%)	1.11 (47%)	1.15 (61%)
Fwd. / Consensus	1.10 / 1.10	1.10 / 1.10	1.11 / 1.09	1.12 / 1.10
50% confidence int.	1.08 / 1.12	1.07 / 1.13	1.07 / 1.15	1.05 / 1.18
75% confidence int.	1.07 / 1.13	1.05 / 1.15	1.03 / 1.18	0.99 / 1.22

Source: Danske Bank Markets

Conclusion. We lower our EUR/USD forecasts to 1.09 in 1M (from 1.12 previously), 1.08 in 3M (1.12), 1.11 in 6M (1.14) and 1.15 in 12M (1.18). Over the next one to three months, politics, relative growth expectations and interest rates will weigh on EUR/USD. In particular, we expect recent signals that the UK will opt for a hard Brexit to weigh on EUR/USD near term.

Longer term, we maintain our long-held view that the undervaluation of the EUR and the wide eurozone-US current account differential are EUR positives. In addition, we expect the Fed to raise interest rates very gradually. However, more sluggish medium-term growth prospects for the eurozone will imply that it will take longer time to reach the MEVA estimate of 1.27 in EUR/USD.

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EUR/USD – Important issues to watch

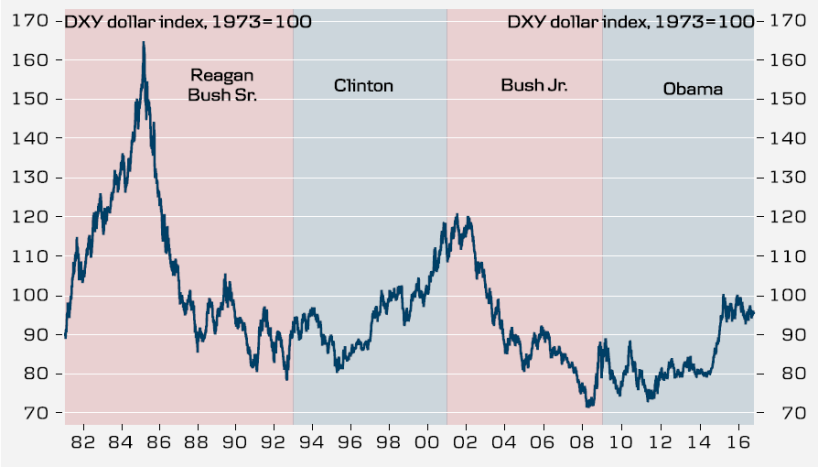
Focus on US Election: Trump versus Clinton

- We expect the US election outcome to have limited impact on EUR/USD short term but to have significant medium-term implications.
- Historically, Republican presidencies have coincided with a weaker USD since the 1980s. One of the reasons is that US growth tends to be stronger under Democratic presidencies.
- We view a Trump win as bullish EUR/USD medium term as large fiscal expansions have tended to drive a weaker USD in the medium term if they are not accompanied by a sharp increase in real interest rates. We view a Clinton win to have a marginal impact on EUR/USD short- and medium-term.

Political risks are rising in the eurozone

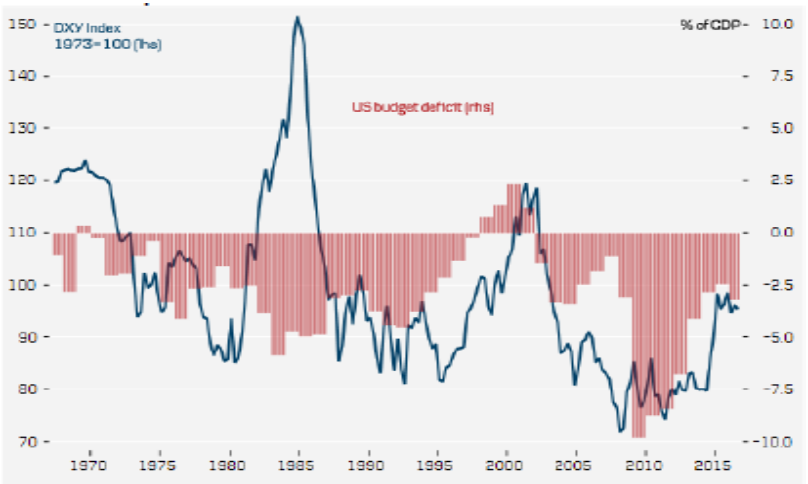
- In the eurozone, there are important political events over the coming year: (1) the Italian constitutional referendum on 4 December, (2) the French presidential election in April/May 2017 and (3) the German election in September/October 2017. Most importantly, UK's PM Theresa May has stated that the government will trigger Article 50 by end March 2017. It appears likely that the EU and the UK will begin the Brexit negotiations from a 'hard Brexit' stance.
- We view European politics as a negative for the EUR but only modestly so, as long as it does not put the EU/euro project in too much doubt. The French election, in our view, is the biggest risk as the main opposition leader, Marine Le Pen, has stated that she will call an EU referendum if she becomes president.

Republican presidencies have been bearish USD since mid-1980s



Source: Macrobond Financial, Danske Bank Markets

Fiscal expansions have tended to drive USD weakness with the exception of Reagan's first term in 1981-84

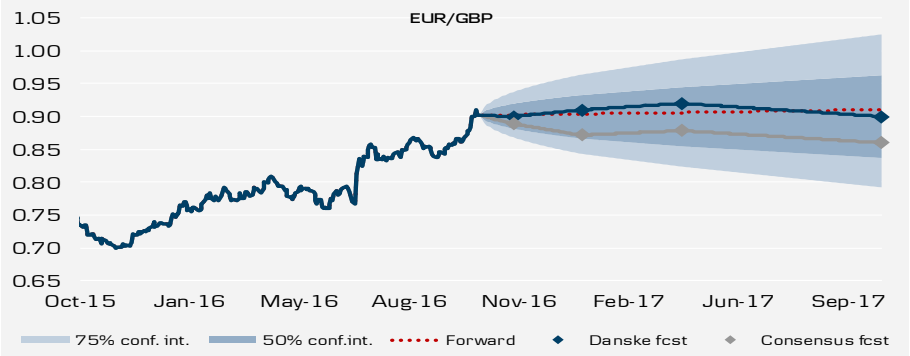


Source: Bloomberg, Danske Bank Markets

EUR/GBP – Risk of 'hard Brexit' set to weigh on GBP

- **Growth.** Economic data since the UK's EU vote has been much better than feared and better than the Bank of England (BoE) projected back in August in its latest Inflation Report. The latest Q3 GDP growth estimate from NIESR, which is usually a good predictor of actual GDP growth, suggests GDP grew 0.4% q/q in Q3. This is slower than before the EU vote but still a solid growth rate from a global perspective.
- **Monetary policy**. As the economy has been resilient to Brexit uncertainty so far, we no longer expect the BoE to provide additional stimuli to the economy at the November meeting. However, we see a risk that business confidence and growth may eventually take a hit from Theresa May's harsh stance on Brexit and we now expect the BoE to keep the Bank Rate unchanged until February, when we see more than a 50% chance of a rate cut from 0.25% to 0.10%. Markets have priced in a 2bp cut for February. Some have argued that the market weakening of the GBP means the BoE cannot ease further due to increasing inflation pressure from higher import prices. However, it is important to remember that the BoE has communicated that it accepts inflation will increase above the 2% target in coming years to support the economy.
- **Flows.** Investors have built up speculatively short GBP positions following the Brexit vote. Positioning looks increasingly stretched.
- **Valuation.** EUR/GBP is trading above the fair value estimates implied by our PPP model (0.77) and our MEVA model (0.768).
- **Risks.** Uncertainty about the future relationship between the UK and the EU since the Brexit vote has increased uncertainty about near-term FDI and portfolio flows into the UK, which along with the large current account deficit in the UK, implies a significant risk to the GBP.

Forecast: *0.90 (1M), 0.91 (3M), 0.92 (6M) and 0.90 (12M)*



EUR/GBP	1M	3M	6M	12M
Forecast (pct'ile)	0.90 (51%)	0.91 (59%)	0.92 (64%)	0.90 (52%)
Fwd. / Consensus	0.90 / 0.89	0.90 / 0.87	0.91 / 0.88	0.91 / 0.86
50% confidence int.	0.88 / 0.92	0.87 / 0.93	0.85 / 0.94	0.84 / 0.96
75% confidence int.	0.87 / 0.94	0.84 / 0.96	0.82 / 0.99	0.79 / 1.02

Source: Danske Bank Markets

Conclusion. EUR/GBP has increased sharply over the past few weeks, as Brexit has returned as a theme in the market following the statement by UK Prime Minister May, that she will trigger Article 50 before March 2017, which implies that we might be heading for a 'hard Brexit'.

In the short term, we expect EUR/GBP to stabilise around the 0.90 level as the cross still looks technically overbought. We have lifted our 1M and 3M forecasts following the repricing of the Brexit risk premium. We now target EUR/GBP at 0.90 in 1M (0.87) and 0.91 in 3M (0.88). We still expect EUR/GBP to continue to trend higher in the coming six to nine months. This is due to the political uncertainty along with the considerable imbalances in the UK economy, where the significant current account deficit and the net foreign debt accumulated through several years of current account deficits are set to continue to weigh on the GBP. We have kept our 6M and 12M forecasts unchanged at 0.92 and 0.90, respectively, but stress that risks are skewed towards the cross overshooting our forecast in the coming three to 12 months – especially if we actually get a 'hard Brexit'.

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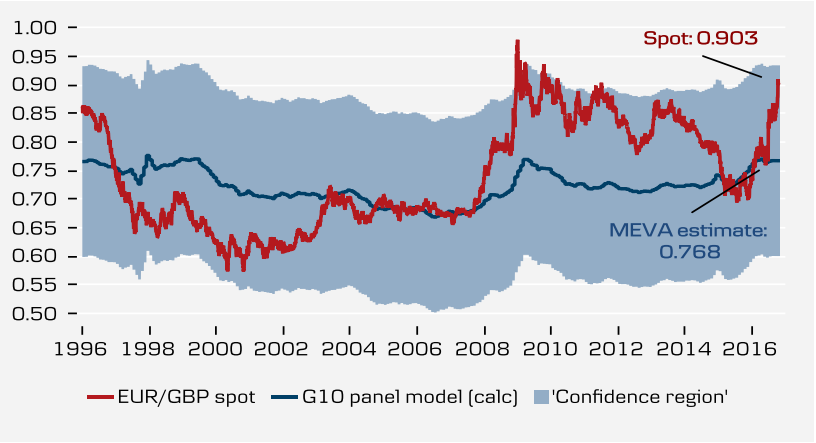
EUR/GBP – Important issues to watch

PM Theresa May implies that we are heading for a 'hard Brexit'

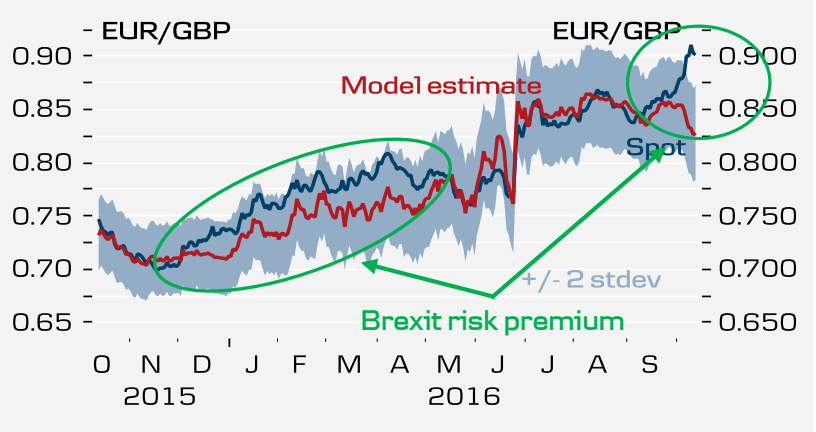
- On 2 October, Prime Minister Theresa May said the UK will trigger Article 50 'before the end of March' next year. This implies that the UK will officially leave the EU in April 2019.
- Theresa May took a hard line in her rhetoric, saying that control of immigration is the most important issue. She said that the UK is 'not leaving the EU only to give up control of immigration again'. Interpreted literally, this implies the UK leaving the single market (also called a 'hard Brexit'), as EU leaders have said that access to the single market means the UK will need to accept free movement of labour. Moreover, this also implies that UK financial institutions would lose the current passport access to the European internal market for financial services.
- May ruled out either a Norwegian or a Swiss model. A deal will be 'an agreement between an independent, sovereign UK and the EU'. Taken literally, it means a traditional free trade agreement is the only option left. Hence, it is also uncertain whether the UK will continue to contribute to the EU budget, which could cause more political turmoil in the EU, as the UK is a significant net contributor to the EU.
- From an economic and FX perspective, a hard Brexit would be a very negative outcome – especially for the UK and sterling but also for the EU. However, we still need some further clarification before we know what exactly the UK is aiming for in a new UK/EU deal. In all, we think that the repricing of Brexit risk premium is fair given the risk of a hard Brexit and we think the combination of significant economic imbalances (large current account deficit and a negative net international investment position) and Brexit uncertainties justifies a significant undervaluation of the GBP. We think it is likely to remain undervalued as long as the future relationship between the UK and the EU remains unclear.

Fundamental GBP undervaluation is fair given Brexit uncertainty and economic imbalances



Source: Bloomberg, Danske Bank Markets

EUR/GBP significantly overvalued, according to our short-term financial model, due to Brexit risk premium



Source: Danske Bank Markets

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USD/JPY – We expect the Bank of Japan to keep policy unchanged

- **Macro outlook.** Q2 GDP was revised higher to 0.2% q/q, from the initial estimate of 0.0% q/q and the PMI manufacturing business survey has bounced back in recent months. Moreover, the Q3 Tankan report came out more or less unchanged from Q2, suggesting a stabilisation in the manufacturing sector. The government's fiscal stimulus package is expected to lift growth by around 0.3pp in 2016 and 0.9pp in 2017 and we expect the economy to continue to grow above trend in the coming year. We forecast GDP growth of 0.6% in 2016 and 1.1% y/y in 2017.

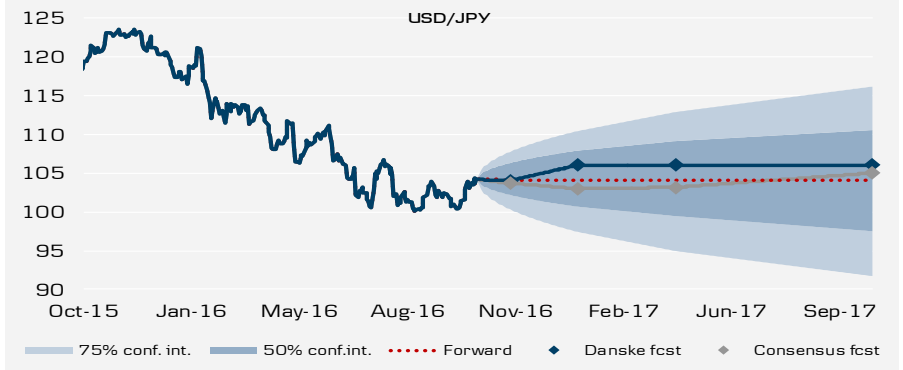
- **Monetary policy.** In line with our expectations, the Bank of Japan (BoJ) did not add new monetary easing at the 20-21 September monetary policy meeting. However, it introduced a new monetary policy framework called 'QQE with yield curve control' (see more details overleaf). In our main scenario, we expect the Japanese economy to continue to grow above trend in the coming year and we expect the BoJ to keep monetary policy unchanged throughout our 12-month forecast horizon. This implies that the BoJ will continue to expand its monetary base at an annual pace of around JPY80trn. We expect the BoJ to remain on an easing bias and the risk is skewed towards additional easing – not tightening. The BoJ maintained its negative interest rate policy and we think it will cut rates further into negative territory if additional easing is required.

- **Flows.** Japan's trade balance improved substantially in 2015 to a current account surplus of 3.3% of GDP, providing increasing support to the JPY.

- **Valuation.** PPP is around 82, while our MEVA model suggests that 101.20 is 'fundamentally' justified.

- **Risk.** USD/JPY remains highly correlated with investors' risk appetite. Non-commercial positioning is very long JPY, suggesting an increased correction risk towards a weaker JPY.

Forecasts: *104 (1M), 106 (3M), 106 (6M) and 106 (12M)*



USD/JPY	1M	3M	6M	12M
Forecast (pct'ile)	104.00 (44%)	106.00 (61%)	106.00 (59%)	106.00 (57%)
Fwd. / Consensus	104.13 / 103.71	104.13 / 103.00	104.12 / 103.15	104.11 / 105.00
50% confidence int.	102.09 / 106.48	100.67 / 107.88	99.45 / 109.11	97.51 / 110.53
75% confidence int.	100.04 / 107.95	97.43 / 110.39	94.96 / 112.85	91.73 / 116.12

Source: Danske Bank Markets

Conclusion. USD/JPY has rallied around 4% to the 104 level over the past month, driven primarily by relative rates as the market has raised expectations of a December hike by the Fed. In the short term, we think the cross is likely to remain supported by relative rates but only modestly so, as a December hike is already largely priced in. According to the IMM data, investors are still very long the yen and the stretched positioning is also a potential supporting factor for USD/JPY in the event that long JPY positions are closed down. Over the medium term, we expect the underlying support for the JPY, stemming from fundamental flows to remain intact but we see the effects diminishing as the yen is no longer undervalued. Moreover, we expect the market to continue to price in a probability of a BoJ rate cut in the future, which will remain a supporting factor for the cross. We have raised our USD/JPY forecast slightly as a Fed rate hike is moving closer. We now target 104 in 1M (101), 106 in 3M (102) and 106 (104) in 6-12M.

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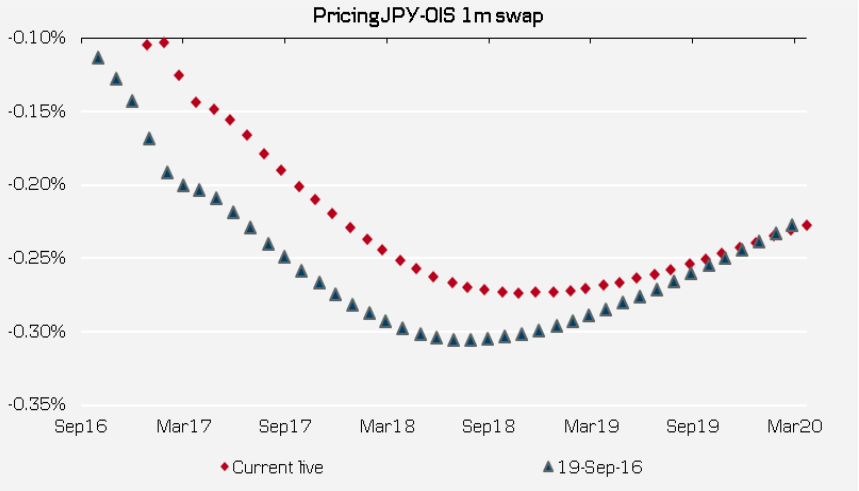
USD/JPY – Important issues to watch

New policy framework has prolonged BoJ's ability to ease policy

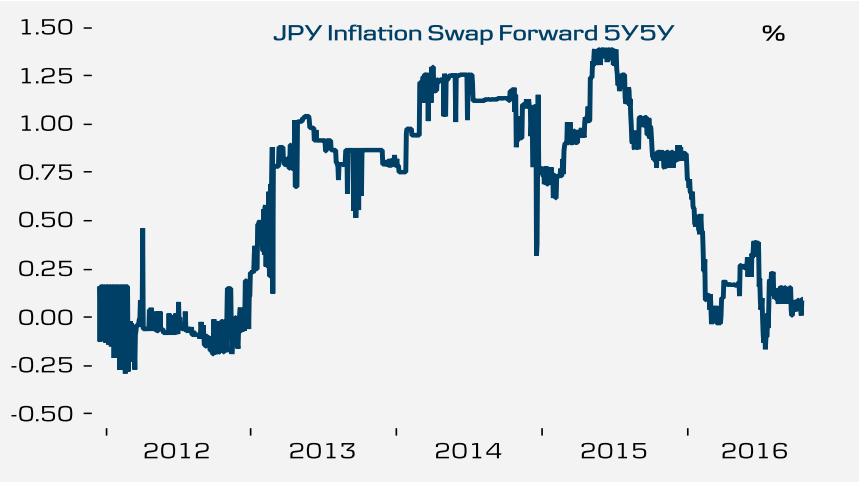
- As a result of the comprehensive assessment of its monetary policy, published in connection with the 20-21 September MPC meeting, the BoJ has introduced a new and more flexible monetary policy framework (QQE with yield curve control) in which it moves away from strictly targeting an increase in the monetary base to targeting the short-term interest rate and the 10-year Japanese government bond yield.
- The new BoJ policy framework consists of two major components.
  1. A new 'yield curve control' in which the BoJ will control short-term and long-term interest rates.
  2. An 'inflation-overshooting commitment' in which the BoJ commits itself to expanding the monetary base until the y/y rate of increase in the observed consumer price index (CPI) exceeds the price stability target of 2% and stays above the target in a stable manner.
- On the short-term policy interest rate, the BoJ kept its negative interest rate and reiterated that the interest rate can be cut further if needed. So, markets should continue to price in a probability of future BoJ rate cuts. On the long-term interest rate, the BoJ said it will purchase Japanese government bonds (JGBs) so that 10-year JGB yields will remain more or less at the current level (around 0%). The BoJ will continue to purchase JGBs more or less in line with the current annual pace of JPY80trn. However, in line with our expectations, this measure has been relaxed a bit, allowing the BoJ more flexibility in its operations.
- On inflation expectations, the BoJ concluded that it might take a long time to achieve 2% price stability. Hence, the change in the policy framework implies that the BoJ expects to continue to ease monetary policy for a long time and thus needed to adjust the framework to improve sustainability to avoid undesirable taper discussions at an early stage.

Rate cut expectations remain intact



Source: Danske Bank Markets

Inflation expectations are back at pre-Abenomics levels



Source: E-Views, Bloomberg, Danske Bank Markets

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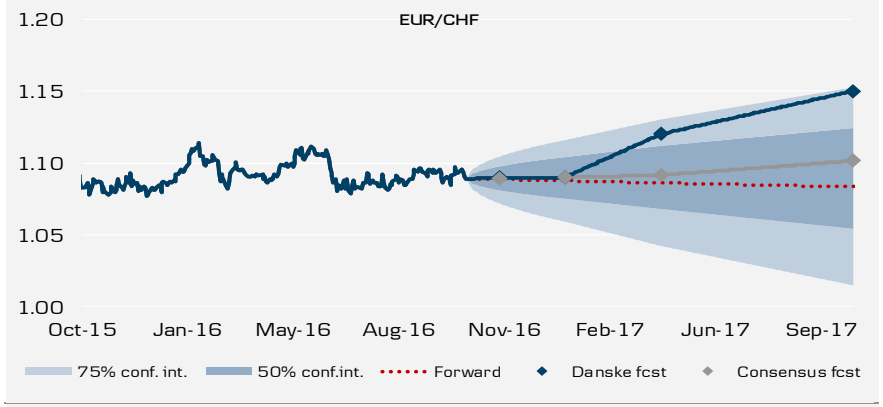
EUR/CHF – Appreciation pressure has eased

- **Growth.** The Swiss economy expanded 0.6% q/q in Q2 and September's manufacturing PMI rose further to 53.2, suggesting that real economic activity in Switzerland is holding up reasonably well. Consumer prices rose less than expected in September though, sending CPI inflation down to -0.2% y/y.
- **Monetary policy.** The Swiss National Bank (SNB) has continued to intervene in the FX market post the Brexit vote in order to curb CHF appreciation pressure. The SNB's currency reserve rose slightly in September to CHF628bn, indicating that appreciation pressure on CHF has eased. As the ECB has moved the fingers from the rate cut button, the pressure on CHF from relative rates has eased. We expect the SNB to keep both the Libor target at the midpoint and the sight deposit rate at -0.75% for the foreseeable future. We expect the SNB to continue to use intervention as a first line of defence should franc appreciation pressure re-emerge.
- **Flows.** Positioning remains broadly neutral on the CHF and is less stretched on EUR shorts than at the start of the year.
- **Valuation.** Both our PPP and our MEVA model suggest that a level 1.28-1.29 for EUR/CHF is 'fundamentally' justified; hence, the cross is undervalued on both measures.
- **Risks.** SNB's commitment to prevent sustained CHF appreciation has limited the downside risks to EUR/CHF. However, the SNB has no specific target for EUR/CHF, but focuses more on a trade-weighted CHF measure.

Forecast: *1.09(1M), 1.09 (3M), 1.12 (6M) and 1.15 (12M)*



EUR/CHF	1M	3M	6M	12M
Forecast (pct'ile)	1.09 (50%)	1.09 (47%)	1.12 (81%)	1.15 (86%)
Fwd. / Consensus	1.09 / 1.09	1.09 / 1.09	1.09 / 1.09	1.08 / 1.10
50% confidence int.	1.08 / 1.10	1.08 / 1.10	1.07 / 1.11	1.05 / 1.12
75% confidence int.	1.07 / 1.10	1.06 / 1.12	1.04 / 1.13	1.02 / 1.15

Source: Danske Bank Markets

Conclusion. EUR/CHF has been trading in the 1.08-1.09 range over the summer as the SNB has capped CHF appreciation via FX interventions. We expect the SNB to remain active in the FX market and still expect EUR/CHF to remain range bound in the coming months, targeting the cross at 1.09 in 1M and 3M. Longer term, we continue to expect fundamentals to support a higher EUR/CHF and keep our 6M and 12M forecasts unchanged at 1.12 and 1.15, respectively.

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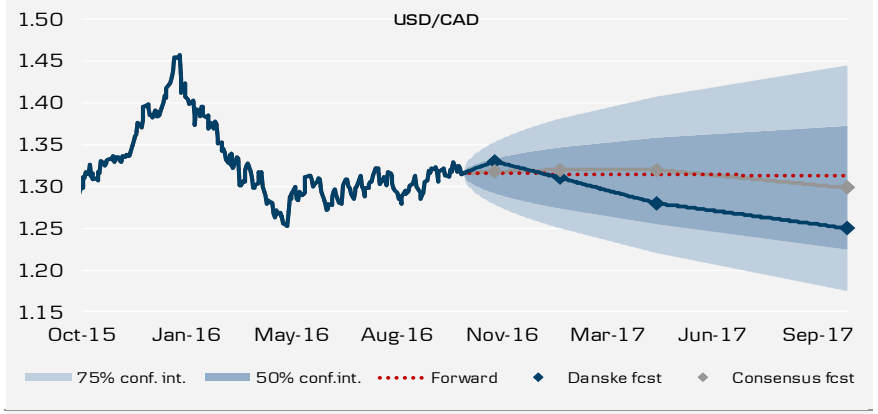
USD/CAD – In the hands of oil, Fed as BoC remains on hold

- **Growth.** Leading indicators paint an improved outlook for the Canadian economy, albeit PMIs and the OECD's composite leading indicator have levelled off slightly. Overall it still suggests that the outlook remains heavily dependent on the US economy (by far the most important export destination). Recent data for merchandise exports and the labour market have been encouraging after a dismal Q2. Also, inflation expectations have moved slightly higher over the past month.
- **Monetary policy.** As widely expected, the Bank of Canada kept the policy rate unchanged at 0.5% at the September meeting. Surprisingly, the BoC twisted its language on the balance of risk for inflation from 'roughly balanced' (in July) to 'tilted somewhat to the downside'. We – alongside markets – still expect BoC to leave rates unchanged for the next 12M.
- **Flows.** According to IMM data, speculative CAD positioning is in 'neutral' territory.
- **Valuation**. Our MEVA estimate for USD/CAD is around 1.23, while our PPP model points to 1.20.
- **Commodities.** Oil constitutes a substantial part of Canadian activity and is generally high cost. Canada thus stands to lose from a new and lower normal level for the oil price. A large share of Canada's oil is of a poorer quality and trades at a substantial discount to WTI.
- **Risks.** In the short term the biggest risk factor to our forecasts is a global risk-off event. Also the Bank of Canada is set to renew its monetary policy target at end-2016.

Forecast: *1.33 (1M), 1.31 (3M), 1.28 (6M) and 1.25 (12M)*



USD/CAD	1M	3M	6M	12M
Forecast (pct'ile)	1.33 (69%)	1.31 (52%)	1.28 (37%)	1.25 (33%)
Fwd. / Consensus	1.32 / 1.32	1.31 / 1.32	1.31 / 1.32	1.31 / 1.30
50% confidence int.	1.29 / 1.34	1.27 / 1.35	1.25 / 1.36	1.22 / 1.37
75% confidence int.	1.27 / 1.36	1.25 / 1.38	1.22 / 1.41	1.17 / 1.44

Source: Danske Bank Markets

Conclusion. Near-term a stronger USD and a setback in oil prices could send the cross temporarily higher. In the medium- to longer run we still expect the fundamentally undervalued 'loonie' to appreciate gradually on the back of valuation and a gradually higher oil price

We lift our USD/CAD forecasts to 1.33 in 1M (from 1.32) and 1.31 in 3M (1.30). We leave the 6M and 12M projections unchanged.

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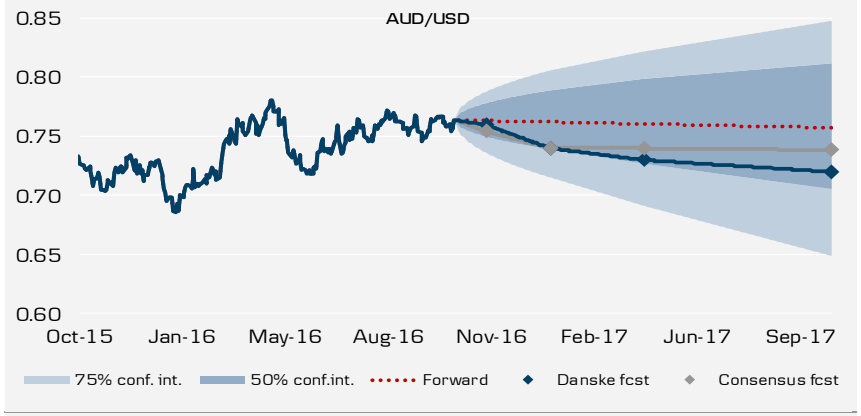
AUD/USD – Range-trading until Fed makes a move

- **Growth.** The Australian economy has continued its solid performance. In Q2, the economy expanded 0.5% from the previous quarter and 3.3% from the previous year. The decline in mining investment is currently offset by growth in residential construction, public demand and exports. Household consumption growth is robust and the latest retail sales data surprised on the upside. House price inflation moderated to 4.1% in Q2 from 6.8% in Q1. Fears of an overheating housing market have abated somewhat as the rate of price increases has dropped significantly from 10.7% in Q3 last year.
- **Monetary policy**. RBA kept the cash rate unchanged in October after having eased its policy at the May and August meetings this year. The October meeting was the first one chaired by the new governor Philip Lowe. Overall, the tone was pretty much unchanged. The statement, to a large extent, repeated the message of the two previous meetings acknowledging the benefits of a lower exchange rate but maintaining the warning that an appreciation could complicate the necessary adjustment in the economy. Governor Lowe is expected to put slightly more emphasis on financial stability concerns than his predecessor Glenn Stevens. Thus, studying the case for potential further easing, the new governor can be relieved by the recent moderation in house price inflation. The central bank would not hesitate to act if needed but at the moment it does not seem eager to cut rates further. The probability of a rate cut this year, according to market pricing, has halved from 30% a month ago to 15%. We expect the central bank to stay put for now and watch the impact of its latest measures working their way through the economy.
- **Flows.** Speculative players are still long AUD but to a lesser extent than in summer months.
- **Valuation.** Fundamentally, AUD/USD is still overvalued, with our PPP and MEVA models showing 0.72 and 0.71 as fair, respectively.
- **Risks.** We expect the Fed to postpone its next rate hike until next year. An earlier hike could lead to the AUD depreciating faster than we expect.

Forecast: *0.76 (1M), 0.74 (3M), 0.73 (6M) and 0.72 (12M)*



AUD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.76 (40%)	0.74 (25%)	0.73 (26%)	0.72 (29%)
Fwd. / Consensus	0.76 / 0.75	0.76 / 0.74	0.76 / 0.74	0.76 / 0.74
50% confidence int.	0.75 / 0.78	0.74 / 0.79	0.73 / 0.80	0.71 / 0.81
75% confidence int.	0.74 / 0.79	0.72 / 0.81	0.69 / 0.82	0.65 / 0.85

Source: Danske Bank Markets

Conclusion. The AUD has been stuck in the range of 0.745-0.770 for the second half of this year. In October, the AUD diverged from the oil price development as the commodity currency depreciated despite an upbeat central bank and oil price rally. Key drivers have been increased expectations of an upcoming Fed rate hike and a general risk-off mode. We are relatively positive about the emerging markets and expect a gradual increase in commodity prices. Still, we expect the AUD to gradually drift lower as a result of less attractive relative yield once the Fed resumes rate hikes. While waiting for the Fed's next move, we can expect the range-trading to continue and daily moves to be driven mainly by general risk-on/-off sentiment. We leave our forecast unchanged.

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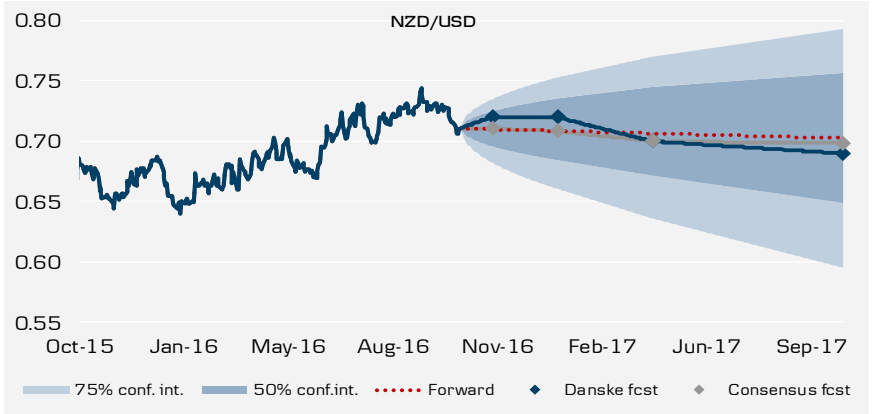
NZD/USD – November rate cut fully priced in

- **Growth.** The New Zealand economy has continued its relatively strong performance as GDP expanded 0.9% in Q2. Ahead of the November monetary policy meeting, the market is focusing on the Q3 inflation print to be published on 18 October. Inflation is expected to slow down further, from 0.4% in Q2 to 0.2% in Q3. Slow inflation will keep the central bank's foot on the easing pedal despite the robust performance of the domestic economy. The domestic economy is benefitting from strong net immigration, construction activity, tourism and monetary policy easing. However, exports are still challenged as dairy prices dropped by 3% at the first October auction. Dairy prices are 40% below their peak in 2014, thus posing a heavy drag on the New Zealand economy overall.
- **Monetary policy**. In September, the Reserve Bank of New Zealand kept the official cash rate unchanged after cutting to a historical low of 2.0% in August. Market speculation of a November cut intensified in October, as the RBNZ kept its explicit easing bias and dairy auctions disappointed. The market is pricing an 85% probability of a cut at the next meeting (vs a 59% probability a month ago) and analysts on Bloomberg unanimously expect a cut in November. Mirroring those expectations, the NZD has depreciated more than 3% after our previous update. The recent depreciation has pushed the trade-weighted NZD to 76.04, consistent with the central bank forecast for TWI in Q3 and Q4. We also expect RBNZ to cut rates in November and to express it is content with the recent NZD depreciation. Along with the rate cut, we expect the central bank to take a slightly more neutral stance as inflation is expected to speed up in Q4 due to base effects.
- **Valuation.** Looking at the relative strength index, the NZD is close to oversold territory and we can expect a temporary correction in the short term. Fundamentally, NZD/USD is still overvalued. Our MEVA and PPP models have 0.65 and 0.64 as fair, respectively.
- **Risks.** If dairy prices continue to drop against our expectations of gradual recovery, the NZD could depreciate faster than we expect.

Forecast: *0.72 (1M), 0.72 (3M), 0.70 (6M) and 0.69 (12M)*



NZD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.72 (64%)	0.72 (59%)	0.70 (42%)	0.69 (41%)
Fwd. / Consensus	0.71 / 0.71	0.71 / 0.71	0.71 / 0.70	0.70 / 0.70
50% confidence int.	0.69 / 0.73	0.68 / 0.74	0.67 / 0.75	0.65 / 0.76
75% confidence int.	0.68 / 0.74	0.66 / 0.75	0.64 / 0.77	0.60 / 0.79

Source: Danske Bank Markets

Conclusion. The NZD has depreciated faster than we expected. Approaching the oversold territory, we expect to see a temporary move higher in NZD/USD as the RBNZ cut in November is fully priced in. We are relatively positive on EM and expect a gradual recovery in commodity prices. Attractive carry has supported the NZD during the era of global monetary easing, causing further downward pressure on inflation. We expect monetary policy divergence to remain the main driver for NZD/USD and see the pair drifting down to 0.69 next year as the Fed resumes its hiking cycle and RBNZ keeps its cautious tone.

We expect a temporary correction in NZD/USD to 0.72 in 1M as the market has already fully priced in a November rate cut. For 3M, 6M and 12M, we keep our forecasts unchanged at 0.72, 0.70 and 0.69, respectively.

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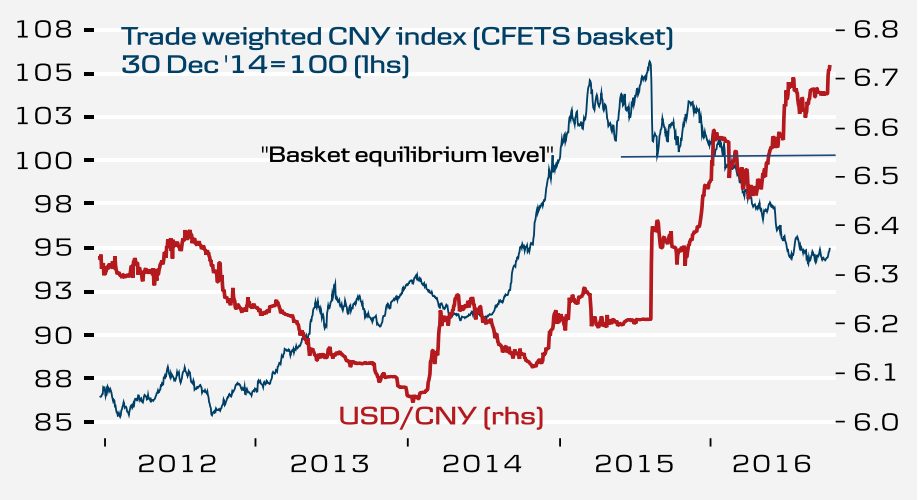
USD/CNY – Depreciation trend set to continue in coming years

- **Monetary policy.** Chinese growth recovered in Q2, driven by infrastructure, construction and a moderate recovery in exports. However, a decline in credit growth in past months suggests the boost from infrastructure spending will fade soon, with growth likely to lose some momentum again in 2017. We expect the People's Bank of China to be on the sideline for the rest of 2016, as China has signalled it will turn to fiscal policy if more policy support is needed to keep growth up. However, in 2017, we expect renewed monetary easing as economic momentum fades again.
- **FX policy.** China has made two important changes to policy over the past two years. First, the currency has become more market based. Second, the CNY is managed against a basket of currencies rather than the USD. China aims for a stable currency around the equilibrium level but has not been explicit about the size of fluctuations it will tolerate. The CNY is still labelled as 'stable' by the PBoC despite a 10% depreciation from the peak in 2015. We believe China will quietly aim for a continued gradual weakening of the CNY but step in if the move becomes too fast, to secure financial stability. Capital outflows could pick up again if the debt concern intensifies when growth slows down and debt continues to grow. However, China is using CNH money-market rates to stem a too rapid depreciation of the CNY.
- **Valuation.** Despite the CNY's appreciation in recent years, we do not regard it as overvalued as (1) China's share of global export markets continues to improve and (2) China still has a robust current account surplus of close to 3% of GDP.
- **Risks.** There is a risk that the CNY could depreciate faster in the medium term if growth slows down and/or debt worries create a new confidence crisis.

Forecast: *6.75 (1M) 6.80 (3M), 6.85 (6M) and 7.10 (12M)*



Source: Macrobond Financial, Danske Bank Markets

Conclusion. We look for CNY to weaken gradually as growth is under pressure, debt risks are rising, the Fed is resuming rate hikes and net FDI flows are no longer positive for China.. However, we do not expect a very big devaluation, as the CNY is not overvalued and China wants stability on its currency. Against the EUR, we expect the CNY to depreciate close to 10% +12M.

The CNH-CNY spread has been quite stable since calm was restored in February. We expect the spread to stay at around zero or slightly above throughout the forecast horizon. Hence, we expect basis risk in hedging CNY exposure through CNH to be limited. If the spread moves out, the PBoC is likely to use higher CNH money-market rates (by draining liquidity) to pull it down close to zero again.

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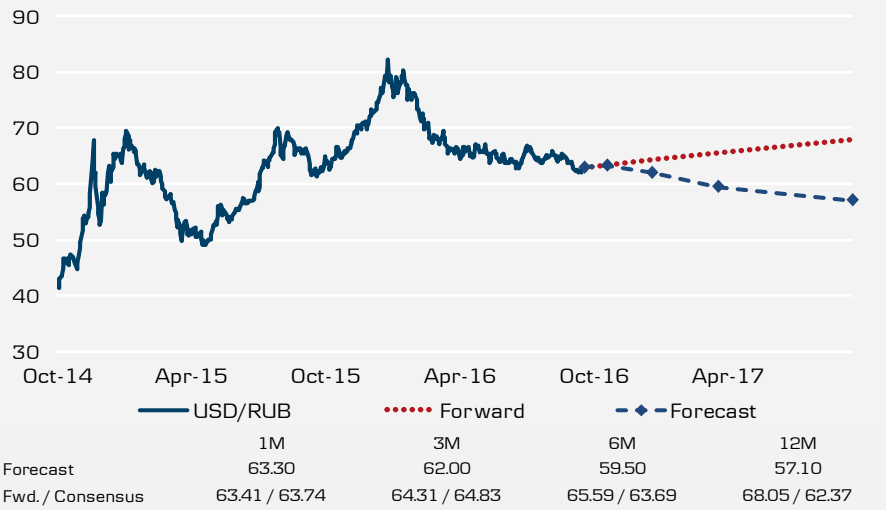
USD/RUB – Keep calm, stay cautiously short

- **Growth.** Russia's GDP shrank 0.6% y/y in Q2 16 versus a 1.2% y/y fall in Q1 16. In January-August 2016, the economy shrank 0.7% y/y, growing 0.3% m/m S.A. in August as manufacturing, agriculture and services to households expanded. We keep our 2016 GDP growth forecast at -0.6% y/y and 2017 GDP growth at 1.2% y/y.
- **Monetary policy.** On 16 September, Russia's central bank (the CBR) cut its key rate by 50bp to 10.0%, in line with consensus and our expectation. Yet, contrary to the market pricing and economists' expectations, the CBR in its statement and the governor Elvira Nabiullina during her press conference emphasised that 'the current key rate needs to be maintained until end-2016 with a possibility to cut it in Q1-Q2 17', which we see as the cornerstone of the CBR's message on Russia's short- and medium-term monetary policy. We expect the next cut to come in late Q1 17 at the earliest.
- **Flows.** Over the past nine months, capital outflows slowed to USD9.6bn supporting the RUB, and we expect the trend to continue.
- **Valuation.** Given an 0.8% m/m increase in the 30-day average of the Brent price, the RUB 30-day average against the USD strengthened 2.1% m/m, as the RUB has seen carry-trade inflows on a hawkish monetary stance and solid real rates. The USD/RUB pair is hovering around its 'fair value'.

Forecast: *63.30 (1M), 62.00 (3M), 59.50 (6M) and 57.10 (12M)*



Source: Danske Bank Markets

Risks. The geopolitical tensions surrounding the Ukraine crisis are again out of the main news but any serious escalation could weaken the RUB. A more hawkish Fed monetary stance in early 2017 could weigh on the RUB further.

Conclusion. Russia's currency was a top-three performer among 150 global currencies over the past 30 days. We continue to be moderately bullish on the RUB in the long term. However, the political risk and possible intensification of Western sanctions (this time possibly linked to Syria) should be constantly kept in mind, as possible 'black swan' events could prevail over fundamentals.

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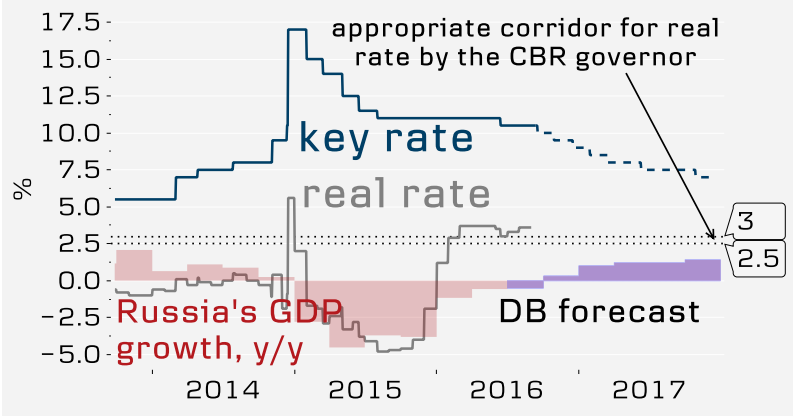
USD/RUB – Important issues to watch

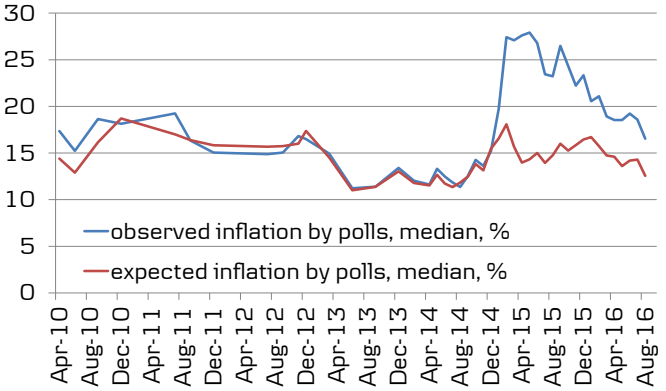
- **Upside risks for RUB on privatisation programme**
  - The RUB continues to be part of the global emerging markets story, linked closely to the sentiment derived from the Fed's monetary stance and oil price. Russian oil giant Rosneft's acquisition of oil company Bashneft for RUB330bn could push the RUB up late in 2016, depending on how the deal is financed. We keep our moderately bullish stance on the RUB and neutral stance on OFZs.
  - The CBR's renewed hawkish stance is set to continue over Q1 17. However, we do not see a significant impact on the RUB from future rate cuts, as global factors are firmly leading the RUB's dance.



Source: Macrobond Financial, Danske Bank Markets

Source: CBR, Danske Bank Markets

Inflation expectations decline further supporting the CBR in its CPI target of 4% y/y by end-2017



Source: CBR, Danske Bank Markets

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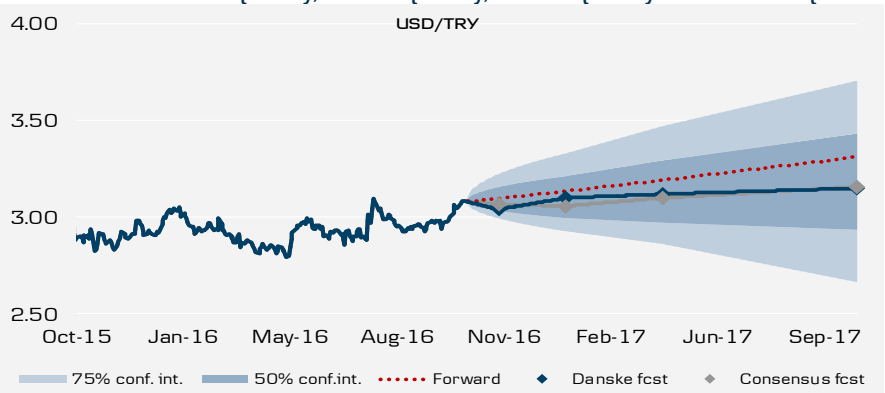
USD/TRY – More hawkish Fed and economic slowdown weigh on lira

- **Growth.** Turkey's GDP growth slowed to 3.1% y/y in Q2 16, which is worse than consensus of 3.7% y/y, as economic activity is cooling on a double-digit slump in the number of foreign tourist arrivals. While the normalising economic relationship with Russia poses upside risks to economic growth forecasts, we expect the effect to be seen in 2017 at the earliest.
- **Monetary policy.** Inflation eased to 7.3% y/y in September, down from 8.1% y/y in August, as the TRY stabilised in September. The Turkish central bank kept its policy rate unchanged at 7.50% in September, continuing to trim the overnight lending rate by 25bp. We expect the central bank to keep its key rate unchanged in the near future to stabilise the TRY and push consumer prices down to pre-coup attempt levels under 7% y/y while narrowing the rate corridor.
- **Valuation.** The TRY has diverged slightly from its 'fair value', as the current account deficit surprised on the downside. In our view, fears of a Fed hike in December 2016 and concerns about a greater-than-expected slowdown in the economy are weighing excessively on the lira. Renewed exports to Russia and rising tourist arrivals would support the current account in the future, limiting the TRY's depreciation in the long term.

Forecast: *3.04 (1M), 3.10 (3M), 3.12 (6M) and 3.15 (12M)*



USD/TRY	1M	3M	6M	12M
Forecast (pct'ile)	3.04 (32%)	3.10 (51%)	3.12 (50%)	3.15 (48%)
Fwd. / Consensus	3.10 / 3.07	3.13 / 3.06	3.19 / 3.10	3.31 / 3.16
50% confidence int.	3.02 / 3.15	3.00 / 3.21	2.97 / 3.29	2.94 / 3.43
75% confidence int.	2.98 / 3.21	2.93 / 3.33	2.86 / 3.47	2.67 / 3.70

Source: Danske Bank Markets

Risks. Potential upside risks for the pair include unexpected moves by president Recep Tayyip Erdoğan in his internal politics. The Fed's monetary stance remains important for the pair, while pressure could grow further before the December 2016 rate decision in the US.

Conclusion. Given the prevailing political uncertainty and rising concerns about a Fed hike, we raise our USD/TRY short- and medium-term forecasts to 3.04 in 1M (previously 2.98), 3.10 in 3M (previously 3.05) and 3.12 in 6M (previously 3.07) and keep our forecast unchanged at 3.15 in 12M.

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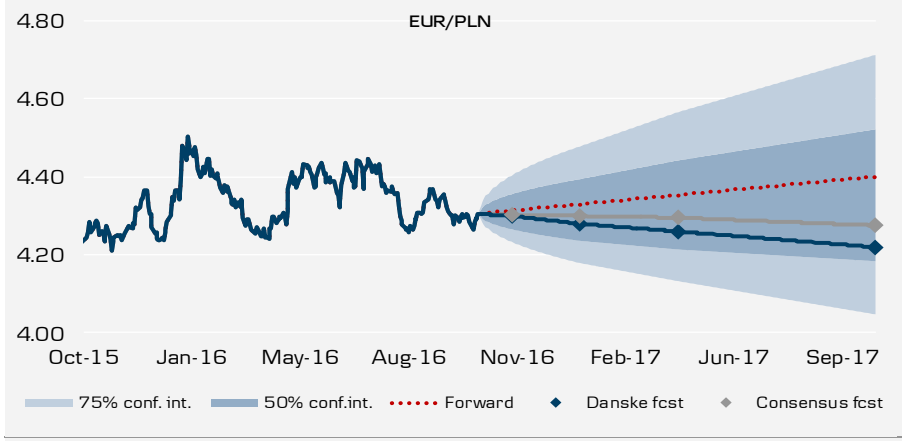
EUR/PLN – Steady ahead of the US elections and Fed decision

- **Growth.** Recent economic indicators showed that post-Brexit referendum sentiment towards the Polish economy is improving. PMI manufacturing increased further to 52.5 in September from 51.5 in August, while industrial production increased by 7.5%, rebounding from the weak reading in July. Private consumption seems to be holding up relatively well with retail sales growing 5.6% in August, up from 2% in July, supported by a further decline in unemployment, falling further to 8.5% in August, the lowest level since 1991. Q2 real GDP rebounded to 0.9% q/q after a very weak Q1, in line with our estimate and our 2016 growth projection of 3.0%.
- **Monetary policy.** The monetary policy committee of the National Bank of Poland (NBP) kept the policy rate unchanged at 1.5% at its 5 October meeting. This time, the central bank governor Adam Glapinski confirmed a relatively hawkish stance, hinting that it could start rate increases near the end of 2017 on rising inflation. We expect the NBP to stay put for the time being.
- **Risks.** The biggest risk to our forecasts is a deterioration in global risk sentiment should Donald Trump win the US election. Furthermore, if the Fed - against our expectation - signals it intends to raise interest rates in December, global sentiment may also weaken. Both factors would send EUR/PLN higher. A positive risk is stronger-than-expected economic developments, prompting expectations of a tightening of monetary policy.

Forecast: *4.30 (1M), 4.28 (3M), 4.26 (6M) and 4.22 (12M)*



EUR/PLN	1M	3M	6M	12M
Forecast (pct'ile)	4.30 (47%)	4.28 (38%)	4.26 (34%)	4.22 (30%)
Fwd. / Consensus	4.31 / 4.30	4.33 / 4.30	4.35 / 4.30	4.40 / 4.28
50% confidence int.	4.26 / 4.35	4.24 / 4.39	4.21 / 4.44	4.18 / 4.52
75% confidence int.	4.23 / 4.40	4.18 / 4.48	4.13 / 4.57	4.05 / 4.71

Source: Danske Bank Markets

Conclusion. In line with our expectation, EUR/PLN has been relatively stable around 4.30 over the past month. The US election and a possible rate hike by the Fed in December may weigh on EM currencies, including the PLN, over the next months. However, in the base case of a Hillary Clinton win and continuing strong growth in the Polish economy, we expect the PLN to continue to trade relatively stable over the next month, but then to strengthen slightly thereafter. Hence, we expect EUR/PLN to remain around 4.30 in 1M and then to fall to 4.28, 4.26, and 4.22 in 3M, 6M and 12M, respectively.

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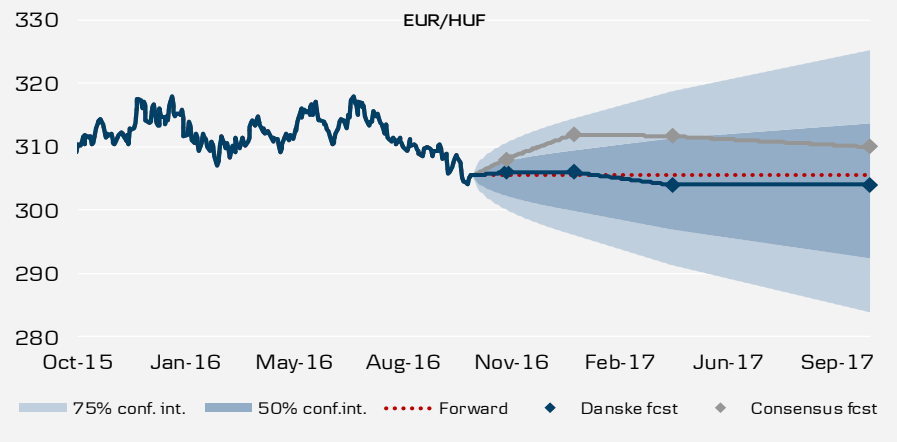
EUR/HUF – Strong economic developments support the HUF

- **Growth.** The Hungarian economy continues to perform on a strong footing. Industrial production increased by 3.5% y/y in August, beating expectations and increasing from -0.1% in July. Furthermore, manufacturing PMI increased to 57 in September, from 51.3 in August. Furthermore, in line with our expectation of a strong pickup in private consumption, as private sector deleveraging has come to an end, retail sales increased by 4.3% y/y in August. Due to the strong economic developments we revised up our real GDP growth forecast for 2016 to 2.0% at end-September, from 1.2% previously. On 16 September, Hungary was upgraded to investment grade by S&P, citing improving fiscal, external and growth expectations, while maintaining its stable outlook. Furthermore, the concern about the future of the EU eased as the Hungarian migrant quota referendum on 2 October 2016 did not get sufficient votes to be deemed valid.
- **Monetary policy.** The National Bank of Hungary (NBH) kept its base rate constant at 0.9% at its 20 September meeting. The status quo in monetary policy was supported by the strong economic developments starting to help raise the inflation rate, which increased to 0.6% in September up from -0.1% in August, while core inflation edged up to 1.4%. Hence, we expect the NBH to stay put until early 2017.
- **Risks.** The biggest risk to our forecasts is a deterioration in global risk sentiment should the Fed move to raise rates in December or if Donald Trump wins the election in November.

Forecast: *306 (1M), 306 (3M), 304 (6M) and 304 (12M)*



EUR/HUF	1M	3M	6M	12M
Forecast (pct'ile)	306.00 (59%)	306.00 (58%)	304.00 (50%)	304.00 (53%)
Fwd. / Consensus	305.47 / 308.07	305.48 / 312.00	305.49 / 311.69	305.50 / 310.00
50% confidence int.	302.25 / 307.99	299.91 / 309.45	296.95 / 311.37	292.44 / 313.71
75% confidence int.	300.01 / 310.72	296.13 / 314.47	291.34 / 318.78	283.93 / 325.25

Source: Danske Bank Markets

Conclusion. EUR/HUF has fallen significantly following the S&P upgrade of and fairly strong economic developments in the Hungarian economy. We think EUR/HUF will trade around current levels for the next 1-3M but then strengthen further as the NBH moves to tighten monetary policy in Q2 17, given our expectation of a pickup in inflation and economic activity. Hence, our EUR/HUF forecasts are 306 in 1M and 3M, 304 in 6M and 304 in 12M.

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Danske Bank Markets FX forecasts vs EUR and USD

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs EUR									
USD	1.097	1.09	1.08	1.11	1.15	-0.8	-2.0	0.3	3.1
JPY	114.3	113	114	118	122	-0.9	0.1	2.9	6.7
GBP	0.900	0.90	0.91	0.92	0.90	-0.1	0.8	1.7	-1.0
CHF	1.087	1.09	1.09	1.12	1.15	0.3	0.4	3.3	6.4
DKK	7.4415	7.4425	7.4425	7.4425	7.4425	0.0	0.0	0.0	0.1
NOK	9.02	9.10	9.20	9.00	8.80	0.8	1.6	-1.0	-3.9
SEK	9.70	9.70	9.50	9.40	9.20	0.0	-2.0	-3.0	-5.0
Exchange rates vs USD									
JPY	104.2	104	106	106	106	-0.1	2.2	2.6	3.5
GBP	1.22	1.21	1.19	1.21	1.28	-0.7	-2.8	-1.4	4.1
CHF	0.99	1.00	1.01	1.01	1.00	1.1	2.5	3.0	3.2
DKK	6.78	6.83	6.89	6.70	6.47	0.8	2.0	-0.3	-2.9
NOK	8.22	8.35	8.52	8.11	7.65	1.6	3.7	-1.3	-6.7
SEK	8.84	8.90	8.80	8.47	8.00	0.8	-0.1	-3.4	-7.9
CAD	1.31	1.33	1.31	1.28	1.25	1.2	-0.2	-2.5	-4.6
AUD	0.76	0.76	0.74	0.73	0.72	-0.2	-2.6	-3.8	-4.7
NZD	0.71	0.72	0.72	0.70	0.69	1.7	1.9	-0.6	-1.5
RUB	62.96	63.30	62.00	59.50	57.10	-0.2	-3.6	-9.3	-16.1
CNY	6.73	6.75	6.80	6.85	7.10	0.0	0.5	1.0	4.3

Note: GBP, AUD and NZD are denominated in local currency rather than USD

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs DKK

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs DKK									
EUR	7.4415	7.4425	7.4425	7.4425	7.4425	0.0	0.0	0.0	0.1
USD	6.78	6.83	6.89	6.70	6.47	0.8	2.0	-0.3	-2.9
JPY	6.51	6.57	6.50	6.33	6.11	0.9	-0.1	-2.8	-6.2
GBP	8.27	8.27	8.18	8.09	8.27	0.1	-0.8	-1.7	1.1
CHF	6.85	6.83	6.83	6.65	6.47	-0.3	-0.4	-3.2	-5.9
NOK	0.83	0.82	0.81	0.83	0.85	-0.7	-1.6	1.0	4.1
SEK	0.77	0.77	0.78	0.79	0.81	0.0	2.1	3.2	5.4
CAD	5.16	5.13	5.26	5.24	5.18	-0.4	2.3	2.2	1.9
AUD	5.17	5.19	5.10	4.89	4.66	0.7	-0.6	-4.0	-7.4
NZD	4.81	4.92	4.96	4.69	4.47	2.6	4.0	-0.9	-4.3
PLN	1.73	1.73	1.74	1.75	1.76	0.3	1.4	2.4	4.5
CZK	0.28	0.27	0.27	0.27	0.27	-0.3	-0.6	-0.7	-1.3
HUF	2.44	2.43	2.43	2.45	2.45	0.1	0.3	1.2	1.8
RUB	0.11	0.11	0.11	0.11	0.11	1.0	5.8	9.9	15.7
CNY	1.01	1.01	1.01	0.98	0.91	0.8	1.5	-1.3	-6.9

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs SEK

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs SEK									
EUR	9.70	9.70	9.50	9.40	9.20	0.0	-2.0	-3.0	-5.0
USD	8.84	8.90	8.80	8.47	8.00	0.8	-0.1	-3.4	-7.9
JPY	8.49	8.56	8.30	7.99	7.55	0.9	-2.1	-5.8	-11.0
GBP	10.78	10.78	10.44	10.22	10.22	0.1	-2.8	-4.6	-4.1
CHF	8.93	8.90	8.72	8.39	8.00	-0.3	-2.4	-6.1	-10.7
NOK	1.08	1.07	1.03	1.04	1.05	-0.8	-3.6	-2.1	-1.3
DKK	1.30	1.30	1.28	1.26	1.24	0.0	-2.0	-3.1	-5.1
CAD	6.73	6.69	6.71	6.62	6.40	-0.4	0.2	-0.9	-3.3
AUD	6.73	6.76	6.51	6.18	5.76	0.7	-2.7	-6.9	-12.1
NZD	6.27	6.41	6.33	5.93	5.52	2.6	1.9	-3.9	-9.2
PLN	2.25	2.26	2.22	2.21	2.18	0.5	-0.7	-0.7	-0.8
CZK	0.36	0.36	0.35	0.35	0.34	-0.3	-2.6	-3.7	-6.4
HUF	3.18	3.17	3.10	3.09	3.03	0.2	-1.7	-1.9	-3.4
RUB	0.14	0.14	0.14	0.14	0.14	1.0	3.7	6.5	9.8
CNY	1.31	1.32	1.29	1.24	1.13	0.8	-0.5	-4.3	-11.7

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs NOK

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs NOK									
EUR	9.02	9.10	9.20	9.00	8.80	0.8	1.6	-1.0	-3.9
USD	8.22	8.35	8.52	8.11	7.65	1.6	3.7	-1.3	-6.7
JPY	7.89	8.03	8.04	7.65	7.22	1.6	1.5	-3.8	-9.9
GBP	10.02	10.11	10.11	9.78	9.78	0.9	0.8	-2.6	-2.9
CHF	8.30	8.35	8.44	8.04	7.65	0.4	1.2	-4.1	-9.6
SEK	0.93	0.94	0.97	0.96	0.96	0.8	3.7	2.2	1.3
DKK	1.21	1.22	1.24	1.21	1.18	0.7	1.6	-1.0	-4.0
CAD	6.26	6.28	6.50	6.33	6.12	0.3	3.9	1.2	-2.2
AUD	6.26	6.34	6.30	5.92	5.51	1.4	0.9	-5.0	-11.1
NZD	5.83	6.01	6.13	5.68	5.28	3.3	5.7	-1.9	-8.1
PLN	2.10	2.12	2.15	2.11	2.09	1.3	3.0	1.4	0.4
CZK	0.33	0.34	0.34	0.33	0.32	0.5	1.0	-1.7	-5.2
HUF	2.95	2.97	3.01	2.96	2.89	0.9	1.9	0.2	-2.2
RUB	0.13	0.13	0.14	0.14	0.13	1.7	7.5	8.8	11.2
CNY	1.22	1.24	1.25	1.18	1.08	1.6	3.1	-2.3	-10.6

Source: Danske Bank Markets

Danske Bank EMEA FX forecasts

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	16-Oct-16	**4.31**		**3.93**		**173**		**225**		**209**	
	+1M	4.30	4.32	3.94	3.93	173	173	226	224	212	209
	+3M	4.28	4.34	3.96	3.94	174	172	222	224	215	209
	+6M	4.26	4.36	3.84	3.94	175	171	221	222	211	208
	+12M	4.22	4.41	3.67	3.95	176	169	218	220	209	208
HUF	16-Oct-16	**306**		**279**		**2.44**		**3.17**		**2.95**	
	+1M	306	306	283	279	2.43	2.43	3.17	3.17	2.97	2.95
	+3M	306	307	283	279	2.43	2.42	3.10	3.16	3.01	2.95
	+6M	304	308	274	278	2.45	2.42	3.09	3.15	2.96	2.95
	+12M	304	309	264	277	2.45	2.41	3.03	3.13	2.89	2.96
CZK	16-Oct-16	**27.0**		**24.6**		**27.5**		**35.9**		**33.4**	
	+1M	27.1	27.0	24.9	24.6	27.5	27.5	35.8	35.9	33.6	33.4
	+3M	27.1	26.9	25.1	24.5	27.5	27.6	35.1	36.0	33.9	33.6
	+6M	27.1	26.9	24.4	24.3	27.5	27.7	34.7	36.0	33.2	33.8
	+12M	27.1	26.7	23.6	23.9	27.5	27.8	33.9	36.3	32.5	34.3
RUB	16-Oct-16	**69.0**		**63.0**		**10.8**		**14.1**		**13.1**	
	+1M	69.0	69.6	63.3	63.4	10.8	10.7	14.1	13.9	13.2	13.0
	+3M	67.0	70.8	62.0	64.3	11.1	10.5	14.2	13.7	13.7	12.8
	+6M	66.0	72.6	59.5	65.6	11.3	10.3	14.2	13.4	13.6	12.5
	+12M	65.7	75.9	57.1	68.1	11.3	9.8	14.0	12.8	13.4	12.1
TRY	16-Oct-16	**3.39**		**3.09**		**219**		**286**		**266**	
	+1M	3.31	3.42	3.04	3.11	225	218	293	284	275	264
	+3M	3.35	3.47	3.10	3.15	222	215	284	279	275	261
	+6M	3.46	3.55	3.12	3.21	215	210	271	273	260	256
	+12M	3.62	3.72	3.15	3.33	205	200	254	261	243	246
CNY	16-Oct-16	**7.40**		**6.73**		**101**		**131**		**122**	
	+1M	7.36	7.42	6.75	6.75	101	100	132	131	124	122
	+3M	7.34	7.46	6.80	6.77	101	100	129	130	125	121
	+6M	7.60	7.50	6.85	6.78	98	99	124	129	118	121
	+12M	8.17	7.59	7.10	6.80	91	98	113	128	108	121

Source: Danske Bank Markets

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of this research report are Thomas Harr (Global Head of FICC Research), Christin Tuxen (Senior Analyst), Morten Helt (Senior Analyst), Jens Naervig Pedersen (Senior Analyst), Kristoffer Kjær Lomholt (Analyst), Jakob Ekholdt Christensen (Chief Analyst), Stefan Mellin (Senior Analyst),, Vladimir Miklashevsky (Senior Analyst), Allan von Mehren (Chief Analyst), Minna Emilia Kuusisto (Analyst), Aila Mihr (First-year Analyst) and Nicolai Pertou Ringkøbing (Assistant Analyst).

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