Investment Research

Danske Bank

FX Forecast Update
USD strength set to remain until year-end

Christin Tuxen
Head of FX Research
tux@danskebank.dk

Morten Helt
Senior Analyst
mohel@danskebank.dk

Jens Nærvig Pedersen
Senior Analyst
jenpe@danskebank.dk

Kristoffer Kjær Lomholt
Senior Analyst
klom@danskebank.dk

Jakob Ekholdt Christensen
Head of Macro and EM Research
jakc@danskebank.dk

Stefan Mellin
Senior Analyst
mell@danskebank.dk

Vladimir Miklashevsky
Senior Analyst
vlmi@danskebank.com

Allan von Mehren
Chief Analyst
alvo@danskebank.dk

Joachim Waldemar Bratlie
Assistant Analyst
jobr@danskebank.dk

Aila Mihr
Analyst
amih@danskebank.dk

15 October 2018

Follow us on Twitter @Danske_Research

https://research.danskebank.com

Forecast review part I

- **EUR/NOK.** EUR/NOK has re-settled in the lower end of the 9.40-9.60 range following a turbulent period where fading NOK headwinds were countered by a dovish Norges Bank and tumbling risk sentiment. Going forward, we still expect EUR/NOK to move lower on valuation and that Norges Bank has indicated in its base case that it will out hike peers. In our view, market pricing of Norges Bank remains too soft but we are likely to have to wait for a significant repricing. With year-end creating an asymmetric balance of risk to foreign developments, this creates a tougher environment for EUR/NOK to break below the 9.40 threshold this side of the New Year. In light of December no longer being a live meeting for the next interest rate hike, we raise our 3M forecast profile. We now forecast EUR/NOK at 9.40 in 1M (unchanged), 9.40 in 3M (9.30), 9.20 in 6M (unchanged) and 9.10 in 12M (unchanged).

- **EUR/SEK.** We have a 3M bullish view on the SEK based on the Riksbank delivering its first hike in seven years. Our 3M EUR/SEK target is 10.20 (unchanged). Near term, we continue to see upside risks based on political events in Sweden and abroad. On the other hand, the Riksbank's October meeting could have the opposite effect. On balance, we merely roll the 1M forecast lower to 10.40 (10.50). Taking into account the latest batch of higher-than-expected inflation numbers and how these feed into the inflation forecast, one could argue that pricing is somewhat too dovish – more so when it comes to pricing further out. Hence, we opt to lower our 6M and 12M forecasts to 10.10 (10.20) and 10.10 (10.30), respectively.

- **EUR/DKK.** DKK is relatively more exposed to an escalation of the global trade war, as the Danish economy is small and very open and has significant exposure to global shipping. Furthermore, Denmark has net exposure to the stock market, in particular due to the Danish Life and Pension (L&P) sector's large holdings of US and euro-area stocks. This, in addition to the easier DKK liquidity situation and negative FX forwards, could help to explain the recent rise in EUR/DKK to the 7.4600 level. We expect the pair to trade around 7.4550 on 1M, 7.4525 in 3M and 7.4550 on 6-12M horizons.

- **EUR/USD**. The strong US economy will keep the Fed in the hiking game for now and add to the carry support to USD – notwithstanding recent Trump calls for slowing the tightening pace. Coupled with the risk of setbacks on Italy and Brexit negotiations, this should leave EUR/USD in a range around 1.15 on a 3M horizon. Medium term, the euro capital outflows of recent years will fade as the first ECB hike draws closer. Alongside valuation, this is set to support EUR/USD in 6-12M. We have kept our forecast profile unchanged and see EUR/USD at 1.15 in 1M, 1.15 in 3M, 1.18 in 6M, and 1.25 in 12M.

- **EUR/GBP.** Brexit optimism has improved since the Conservative Party Congress ended on 3 October. We are still sceptical that the EU and the UK will reach a deal at the EU Summit in October, which leaves EUR/GBP risks tilted to the upside near term. We target 0.88 in 1M. Longer term, we still expect EUR/GBP to trade lower eventually, driven by Brexit clarifications and fundamental valuations. We target EUR/GBP at 0.84 in 3M and 0.83 in 6M and 12M.

- **USD/JPY**. We expect USD/JPY to continue to trade mostly sideways within the 110-114.50 range in the near term with risk appetite and yields on 10Y UST as the main drivers. We target 112 in 1M and 113 in 3M (previously 112). Longer term, the Bank of Japan's (BoJ) monetary policy should remain supportive for USD/JPY, driven by widening US-Japan yield spreads and continued outflows out of Japan. However, USD/JPY appreciation will be a very gradual process in our view. We have lifted our 12M target to 115 (previously 114), mainly as a result of 'rolling the time' but we still target 114 in 6M.

- **EUR/CHF.** While CHF has proved surprisingly resistant to Italian risks and the equity sell-off lately, we stress that the risks of further Italy-EU confrontation as well as Brexit negotiation setbacks remain likely. This is set to weigh on EUR/CHF short term but we still see the cross re-invoking on a gradual move back towards 1.20 in 12M. It is likely to require a clear dip below 1.10 for the SNB to start intervening on a larger scale. We have left our EUR/CHF profile unchanged, and still look for 1.13 in 1M, 1.13 in 3M, 1.16 in 6M and 1.20 in 12M.

- **AUD, NZD, CAD.** While CAD has benefited from a higher oil price and the new 'NAFTA' deal, both AUD and NZD have suffered over the past month from tumbling risk sentiment. We still pencil in all three currencies outperforming the USD over the coming year, but in the near term, a stabilisation in growth is needed for the three currencies to recover. Easing of economic policy in China alongside stretched speculative positioning in all three currency pairs should aid the rebound. In terms of monetary policy outlook, the Reserve Bank of New Zealand is standing firm (no change in 12M) and still seems some way away from the first hike (we expect a 12M hike in H2 19). Meanwhile, with the USMCA deal, the Bank of Canada has gained more clarity on its biggest risk factor, which should pave the way for a rate hike already this month and a further two hikes in 2019. We now forecast AUD/USD at 0.72 in 1M (unchanged), 0.73 in 3M (previously 0.75), 0.74 in 6M (previously 0.76) and 0.75 in 12M (previously 0.77); NZD/USD at 0.66 in 1M (unchanged), 0.66 in 3M (previously 0.68), 0.67 in 6M (previously 0.69) and 0.68 in 12M (previously 0.71). Finally, we forecast USD/CAD at 1.30 in 1M (unchanged) 1.28 in 3M (previously 1.27), 1.25 in 6M (unchanged) and 1.23 in 12M (unchanged).

- **EUR/PLN.** The PLN has traded relatively weak amid general sour global risk sentiment, which is affecting investor sentiment in PLN as well. While the equity sell-off may wane in the near future, the lingering risk of a further escalation of the tensions between China and US and concerns about Italy will continue to provide headwinds for the PLN. As a result, we maintain our forecast for EUR/PLN at 4.29 in 1M, 4.25 in 3M, and 4.20 in 6M and 4.18 in 12M.

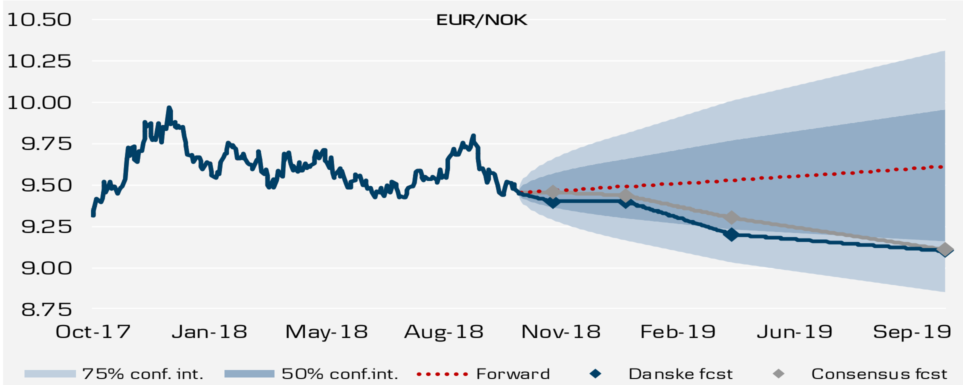
- **USD/CNY.** We look for USD/CNY to continue higher on divergence in monetary policy: The Fed is hiking while the People's Bank of China (PBoC) is easing. Our forecast continues to be 7.20 in 12 months.

- **Oil.** Following the recent price development, we have revised our forecast for Brent crude. We now forecast the price on Brent crude to average USD85/bbl in Q4 this year and trade within the USD85-87/bbl range in Q1-Q3 next year, as we expect supply concerns to stay high on the agenda in the oil market before falling to USD80/bbl in Q4 19 as these concerns ease.

EUR/NOK – eventually lower but mind seasonal vulnerability

- **Growth.** Economic data and indicators continue to suggest a solid Norwegian growth outlook despite slightly weaker global growth. The economy is especially supported by the combination of rising oil prices while the currency has stayed weak. This leaves the oil price denominated in NOK very close to historical peaks, which we now refer to as the 'oil boom years'. Also, Norwegian oil companies have significantly reduced their break-even prices, which means the petroleum sector in Norway is now enjoying strong profitability growth. A key development to follow is the degree to which this translates into higher wage growth and how that transmits to the rest of the economy.
- **Monetary policy.** Norges Bank delivered the first interest rate hike in seven years when it raised the sight deposit rate by 25bp to 0.75 at the September monetary policy meeting. Meanwhile, the central bank surprised markets by lowering the rate path slightly (see overleaf)
- **Flows.** Foreign banks (proxy for speculative flows) heavily net sold NOK during the thin summer markets. Over the past month, foreign investors have net bought NOK but not in the same amounts as were net sold. That still suggests NOK potential from a positioning perspective.
- **Valuation.** From a long-term perspective, the NOK seems fundamentally undervalued. Our PPP model has 8.52 as 'fair'.
- **Risks.** The biggest risk factor to our forecast is broad-based USD strength and/or a global risk-off event, which would weigh on the NOK directly and indirectly via the oil price. In addition, the risk that we underestimate the impact of a Chinese slowdown is relevant, as commodity FX in recent years has traded remarkably synchronised, with turning points coinciding with the Chinese cycle. The latter could be connected to an escalating global trade war. Importantly, we think the downside risks have diminished in recent months.

Forecast: 9.40 (1M), 9.40 (3M), 9.20 (6M), 9.10 (12M)



EUR/NOK	1M	3M	6M	12M
Forecast (pct'ile)	9.40 (35%)	9.40 (38%)	9.20 (22%)	9.10 (21%)
Fwd. / Consensus	9.46 / 9.46	9.49 / 9.44	9.53 / 9.30	9.61 / 9.11
50% confidence int.	9.35 / 9.56	9.30 / 9.66	9.23 / 9.77	9.16 / 9.96
75% confidence int.	9.27 / 9.65	9.16 / 9.81	9.03 / 10.01	8.85 / 10.31

Source: Danske Bank

- **Conclusion.** EUR/NOK has re-settled in the lower end of the 9.40-9.60 range following a turbulent month where fading NOK headwinds were countered by a dovish Norges Bank and tumbling risk sentiment. We still expect EUR/NOK to move lower on valuation and that Norges Bank has indicated in its base case already that it will out hike peers. In our view, market pricing of Norges Bank remains too soft but we are likely to have to wait for a significant repricing. With year-end creating an asymmetric balance of risk to foreign developments, this creates a tougher environment for EUR/NOK to break below the 9.40 threshold this side of New Year. In light of December no longer being a live meeting for the next interest rate hike, we raise our 3M forecast profile. We now forecast EUR/NOK at 9.40 in 1M (unchanged), 9.40 in 3M (9.30), 9.20 in 6M (unchanged) and 9.10 in 12M (unchanged).

Kristoffer Kjær Lomholt, Senior Analyst, klom@danskebank.com, +45 45 12 85 29

EUR/NOK – important issues to watch

Norges Bank hike rates for the first time in seven years …

- As widely expected and well communicated, Norges Bank delivered the first interest rate hike in Norway in seven years at the September monetary policy meeting. The key argument behind it initiating a hiking cycle is rising capacity utilisation, strong growth prospects, a tightening labour market and rising underlying inflation pressures.

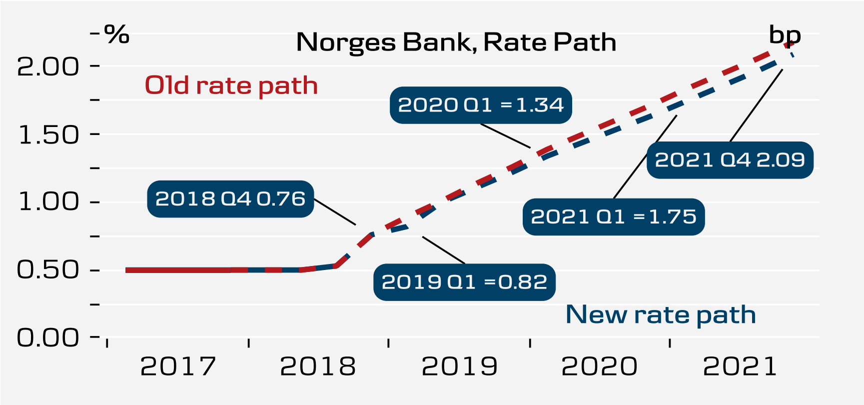
… but still manages to surprise by lowering the rate path

- Most analysts – ourselves included – had expected Norges Bank to accompany the rate hike with a firm signal that rates might rise at a slightly faster tempo than previously indicated; i.e. a higher rate path. Meanwhile, Norges Bank surprised markets by lowering the rate path instead. The arguments used were weaker near-term capacity utilisation, weaker-than-expected wage growth outlook, rising external risks and that the bank wants to proceed with caution when hiking rates from record lows.
- We think there is a decent likelihood that Norges Bank will be forced to lift the rate path already in December and that the central bank will eventually hike rates three times in 2019. However, given the dovish communication at the September meeting, a rate hike in December seems out of the picture, leaving March 2019 as the most likely timing for the next rate hike.

Beware of seasonal vulnerability

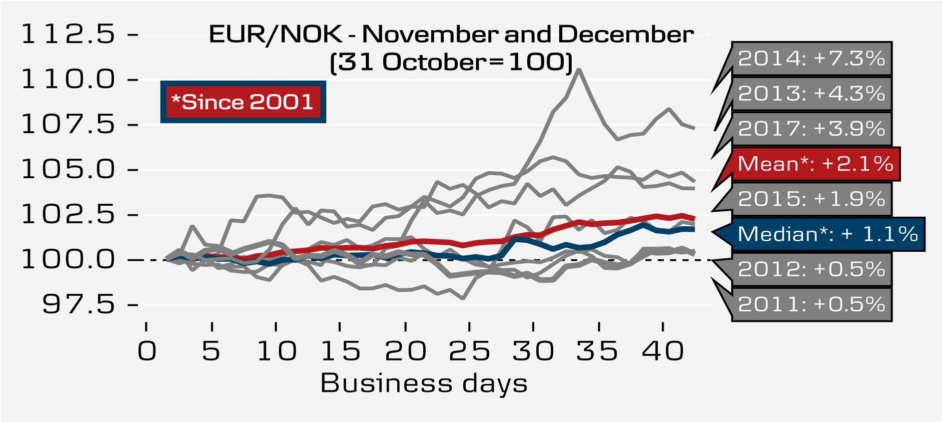
- We are now approaching the final two months of the year and investor attention is slowly returning to the fact that the NOK has historically suffered in Q4. As the chart to the right shows, EUR/NOK has on average (median) risen by more than 2% (1%) in November and December. The key factor behind the underperformance is the small size of the NOK market, which leaves the currency extra vulnerable to profit taking and external developments. This asymmetric balance of risk is important to take into account even if we do not forecast NOK weakness. For instance, in 2017, the NOK impact of investor flight from the SEK was amplified.

Norges Bank surprised markets by lowering the rate path; next hike in March 2019



Source: Macrobond Financial, Norges Bank, Danske Bank

NOK has a history of underperforming in November and December



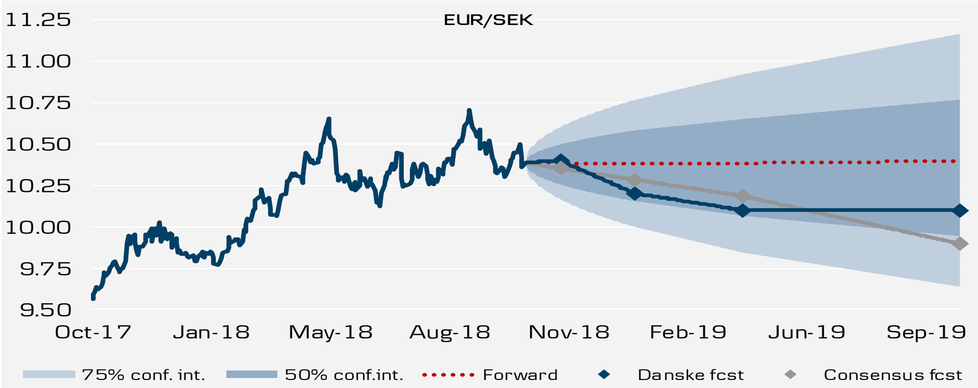
Source: Macrobond Financial, Norges Bank, Danske Bank

Kristoffer Kjær Lomholt, Senior Analyst, klom@danskebank.com, +45 45 12 85 29

EUR/SEK – first Riksbank rate hike in seven years

- **Growth.** GDP growth in Sweden has lost momentum in 2018 and we expect a continued slowdown in H2 and in 2019. The drag stems from housing investments and private consumption. Net exports will give a negative contribution amid a slowdown abroad. So far, the depreciation of the SEK has not provided much support to Swedish growth. Slower growth normally means a weaker SEK (higher EUR/SEK).
- **Monetary policy.** The Riksbank is preparing for a hike either in December or February. We look for 25bp in December. It would be the first in seven years and, as such, a milestone, which should help to support the SEK in Q4. After the September inflation data, which was higher than we expected but in line with the Riksbank, the probability of an additional hike in 2019 has increased. If anything, we think that pricing is somewhat on the soft side, which is to say that EUR/SEK has some potential on the downside next year.
- **Flows.** While net export (goods) to the eurozone have declined on a trend basis, natural SEK buyers may want to raise hedge ratios at low levels. Foreign net demand for Swedish debt has decreased over the past couple of years, while foreigners have shown a bigger appetite for Swedish equities.
- **Valuation.** We think ultra-easy monetary policy is the main reason for the depreciation of the krona. That said, part of it can be explained by 'long-term' fundamentals, for example, shrinking external balances and deteriorating productivity growth. Still, EUR/SEK is on the 'high side'.
- **Risks.** The main risk to our forecast is related to the Riksbank and thus inflation. If it again postpones the planned hike, our 3M forecast on EUR/SEK is too low. On the other hand, if the Riksbank significantly out hikes expectations, EUR/SEK should move well below 10 during 2019. As always, global risk sentiment, including Italy, is the wild card.

Forecast: 10.40 (1M), 10.20 (3M), 10.10 (6M), 10.10 (12M)



EUR/SEK	1M	3M	6M	12M
Forecast (pct'ile)	10.40 (55%)	10.20 (29%)	10.10 (27%)	10.10 (34%)
Fwd. / Consensus	10.38 / 10.35	10.38 / 10.28	10.38 / 10.18	10.40 / 9.90
50% confidence int.	10.24 / 10.51	10.15 / 10.58	10.06 / 10.65	9.94 / 10.77
75% confidence int.	10.14 / 10.63	10.00 / 10.76	9.84 / 10.92	9.64 / 11.16

Source: Danske Bank

- **Conclusion.** We have a 3M bullish view on the SEK based on the Riksbank delivering its first hike in seven years. Our 3M EUR/SEK target is 10.20 (unchanged). Near term, we continue to see upside risks based on political events in Sweden and abroad. On the other hand, the Riksbank's October meeting could have the opposite effect. On balance, we merely roll the 1M forecast lower to 10.40 (10.50). Taking into account the latest batch of higher-than-expected inflation numbers and how these feed into the inflation forecast, one could argue that pricing is somewhat too dovish – more so when it comes to pricing further out. Hence, we opt to lower our 6M and 12M forecasts to 10.10 (10.20) and 10.10 (10.30), respectively.

Stefan Mellin, Senior Analyst, mell@danskebank.se, +46 8 568 80592

Danske Bank

EUR/SEK – important issues to watch

Riksbank to confirm plan to hike at the October meeting

- We expect the October message to be a copy paste from last time, i.e., a hike in December or February. Possibly with a slightly more confident tone. We think the first hike in seven years (December) will support the SEK through to year-end, even though it is almost fully priced in. Taking into account the September inflation numbers and how these feed into the inflation forecast, one could argue that pricing is somewhat too dovish, which in turn should lend some further support to the SEK in 2019.

Italian turmoil weighs on SEK, especially vs USD

- In our view, Italy does not have the same implications for the krona today as the PIIGS crisis. Unlike 2012, (1) the risk of a euro breakup is negligible; (2) the interest rate spread is not significantly in favour of the SEK but negative; (3) a sharp SEK appreciation (plus deterioration in EZ) would reduce the Riksbank's incentive to raise rates.

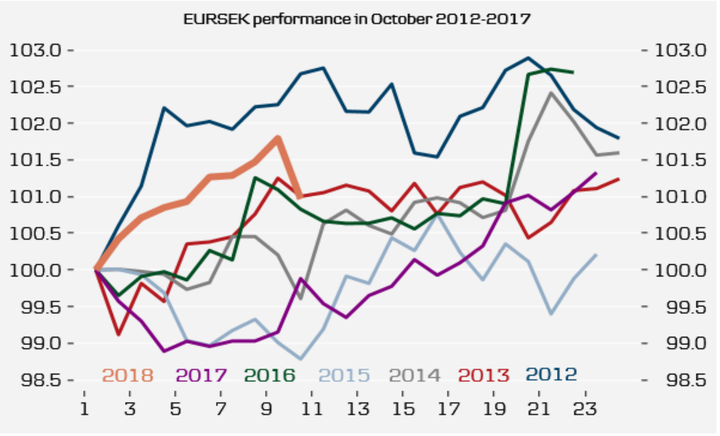
Government formation slow coming

- Moderate leader Ulf Kristersson has not given up his attempts to form a government, but must shift to Plan B (M or M+CD). In order to be accepted by parliament, such a government needs passive support from SD and C. If he fails, the task will probably go to the SDP leader. The first challenge for any new government is to get through a budget (trickier). We would still not write off the risk of an extra election.

October typically means a weaker SEK – maybe not this year though

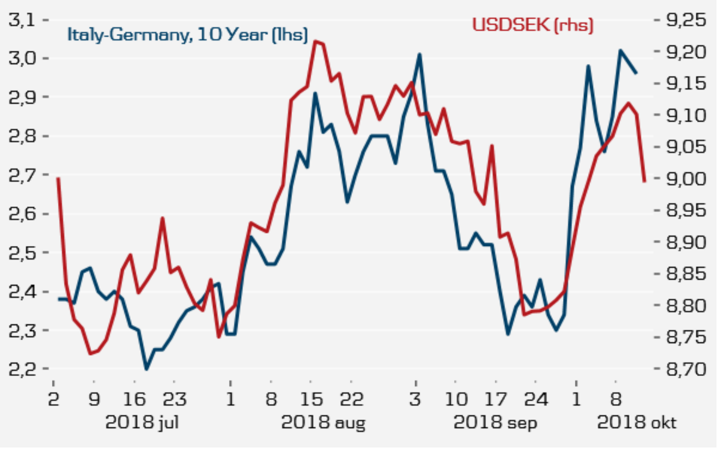
- EUR/SEK and USD/SEK have moved higher in October every year since 2011. One explanation for this seasonality has been dovish surprises from the Riksbank (2014, 2015 and 2016). See *FX Strategy SEK: Political risks, Seasonality and the Riksbank,* 5 October. This year could be different though, given the Riksbank arguments above.

Seasonal pattern suggests weaker SEK in October – this year may be different



Source: Macrobond Financial, Danske Bank

Italian turmoil weighs on SEK, especially vs USD



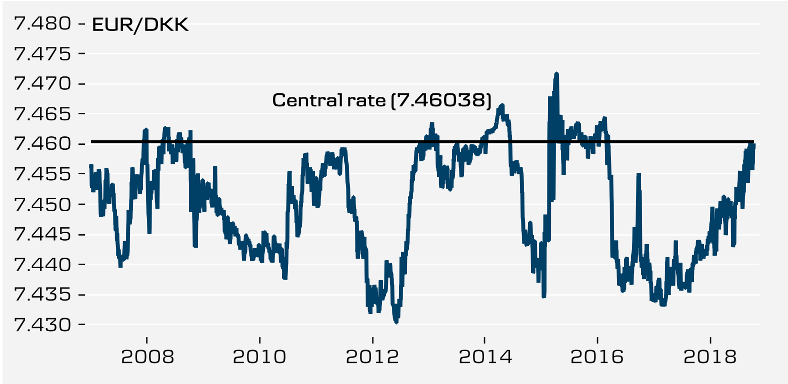
Source: Macrobond Financial, Danske Bank

Stefan Mellin, Senior Analyst, mell@danskebank.se, +46 8 568 80592

EUR/DKK – Move to 7.46 is temporary

- **FX.** EUR/DKK rose above 7.46 in September for the first time since 2016. The move did not trigger a response from Danmarks Nationalbank in terms of FX intervention. EUR/DKK remains supported by negative FX forwards and Denmark's net exposure to the global trade and the US and European stock markets. We expect EUR/DKK to fall back towards 7.4525 on 3M before rising to 7.4550 on 6-12M. In 2015-16, Danmarks Nationalbank sold EUR/DKK in FX intervention around the level of 7.4610-30. We expect it to stick to this reaction function.
- **Rates & Forwards.** We expect Danmarks Nationalbank to keep the rate of interest on certificates of deposit unchanged at -0.65% on 12M. Easy DKK liquidity and portfolio outflows have put downward pressure on EUR/DKK FX forwards and the former will continue to do so in 2019.
- **Flows.** The Danish current account surplus remains large but has moderated somewhat from the elevated level seen in past years. It still creates fundamental support for DKK. A high savings rate and low investment activity will maintain this situation in coming years. Denmark has significant exposure to the US as around a third of the surplus is earned in the US.
- **Liquidity.** The net position bottomed around Easter and is set to rise further in H2. The government has scaled down net issuance to relieve the strain on liquidity from the improvement in government finances seen earlier this year. We expect the net position to be around DKK200bn at the end of the year. Next year, DKK liquidity is likely to stay ample, as the government will continue to use funds from its account at Danmarks Nationalbank to fund the budget deficit and redemptions.

Forecast: 7.4550 (1M), 7.4525 (3M), 7.4550 (6M), 7.4550 (12M)



Source: Danske Bank

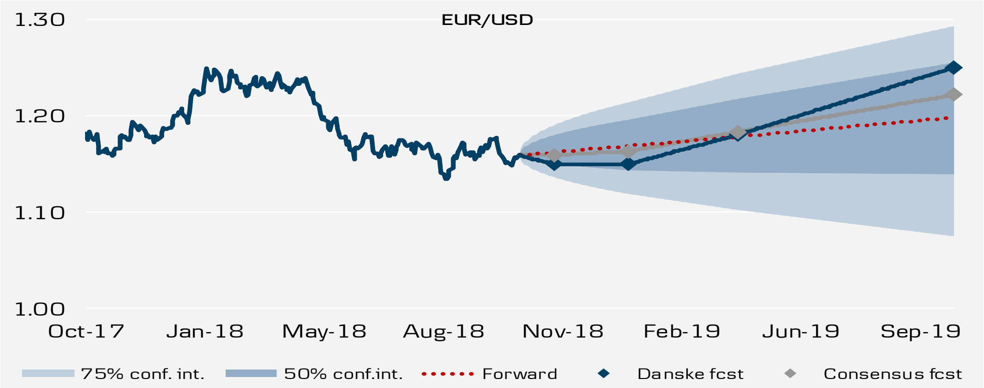
- **Conclusion.** DKK is relatively more exposed to an escalation of the global trade war as the Danish economy is small and very open and has significant exposure to global shipping. Furthermore, Denmark has net exposure to the stock market due to in particular the Danish Life and Pension (L&P) sector's large holdings of US and euro-area stocks. This, in addition to the easier DKK liquidity situation and negative FX forwards, can help explain the recent rise in EUR/DKK to 7.4600 level. We expect the pair to trade around 7.4550 on 1M, 7.4525 in 3M and 7.4550 on 6-12M.

Jens Nærvig Pedersen, Senior Analyst, jenpe@danskebank.dk, +45 45 12 80 61

EUR/USD – mind the USD carry

- **Growth.** The US economy has proved recently that it is still going strong. While we still look for some loss of momentum into 2019, fiscal tailwinds remain. Meanwhile eurozone data has come out slightly on the weaker side lately, putting the outlook for the relative cyclical outlook to shift in favour of a higher EUR/USD on hold. Our quantitative business cycle models hint that both the eurozone and the US cycle should stabilise in coming months.
- **Monetary policy.** While ECB president Draghi did point to the likelihood of a vigorous pickup in eurozone inflation after a rather uneventful September meeting, the minutes gave us no reason to change our call for a 20bp hike in December 2019. The Fed delivered the widely expected 25bp hike in September and will most likely deliver another in December. The outlook for relative rates is thus still tilted in favour of a lower EUR/USD near term. However, pricing of the ECB is also on the dovish side of our expectations and we cannot rule out that the Fed might go on hold sometime next year.
- **Flows.** Positioning is now broadly neutral EUR but stretched on USD longs. We still see a case for eurozone capital outflows to fade and support EUR as the ECB 'normalises' policy; the first signs of this are now visible but we do not expect an acceleration just yet.
- **Valuation.** Our Medium-term Valuation (MEVA) model now suggests 1.31 is 'fair' for the cross, not far from our PPP estimate of 1.29.
- **Risks.** The US-led trade war lingers as a USD driver ahead of the US mid-term elections. If the US Treasury denounces China as a currency manipulator, USD weakness could come to the fore. We also note the small but non-negligible risk that the Trump administration could opt for intervention to weaken USD as a 'quick fix' to the current account deficit and/or in case of a faltering growth outlook.

Forecast: 1.15 (1M), 1.15 (3M), 1.18 (6M), 1.25 (12M)



EUR/USD	1M	3M	6M	12M
Forecast (pct'ile)	1.15 (29%)	1.15 (29%)	1.18 (48%)	1.25 (73%)
Fwd. / Consensus	1.16 / 1.16	1.17 / 1.16	1.18 / 1.18	1.20 / 1.22
50% confidence int.	1.15 / 1.18	1.14 / 1.20	1.14 / 1.22	1.14 / 1.26
75% confidence int.	1.13 / 1.19	1.12 / 1.21	1.10 / 1.24	1.08 / 1.29

Source: Danske Bank

- **Conclusion.** The strong US economy will keep Fed in the hiking game for now and add to the carry support to USD – notwithstanding recent Trump calls for slowing the tightening pace. Coupled with the risk of setbacks on Italy and Brexit negotiations, this should leave EUR/USD in a range around 1.15 on a 3M horizon. While the ECB is increasingly confident regarding the inflation outlook, we think Draghi and co are in no hurry to push for a fast 'normalisation' of monetary policy. However, medium term, the euro capital outflows of recent years will fade as the first ECB hike draws closer. Alongside valuation, this is set to support EUR/USD in 6-12M.
- We have kept our forecast profile unchanged and thus see EUR/USD at 1.15 in 1M, 1.15 in 3M, 1.18 in 6M, and 1.25 in 12M.

Christin Tuxen, Chief Analyst, tux@danskebank.dk, +45 45 13 78 67

EUR/USD – important issues to watch

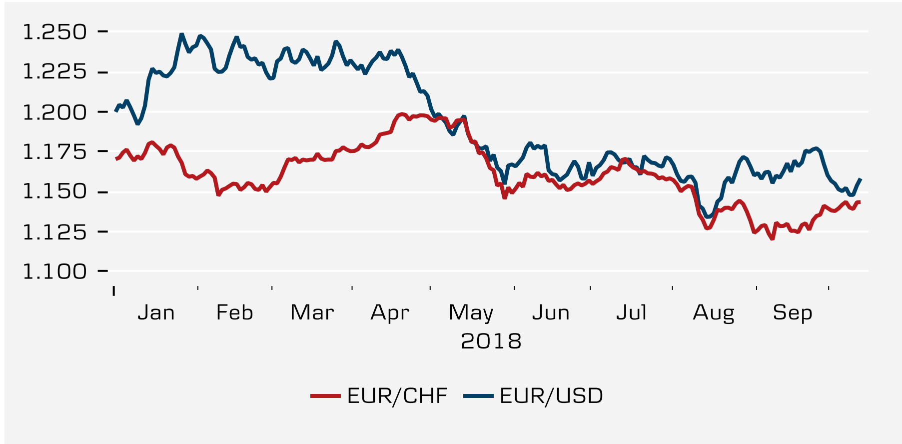
EUR resilience amid Italy worries

- In assessing the FX impact of the risk of an eventual Italian exit from the eurozone, we note that the early October drop in EUR/USD was driven largely by USD strength. See *FX Strategy - Italy? No big deal for EUR and Scandies*, 5 October.
- Notably, EUR/CHF – usually a good bellwether of euro risks – has been edging higher during this period. Indeed, a US economy that is still going strong and a Fed that is willing to add to the carry in USD still provides broad-based USD support. With the risk of an Italian euro exit being a very remote one, EUR downside should be limited at this stage.
- Still, 'Italian fiscal noise' may weigh on EUR at times near term, but we stress that the significant and rising USD carry remains crucial. This should keep EUR/USD in a range around 1.15 and possibly fuel tests of this year's low (1.1301) ahead of year-end.

Reserve-currency status of USD challenged?

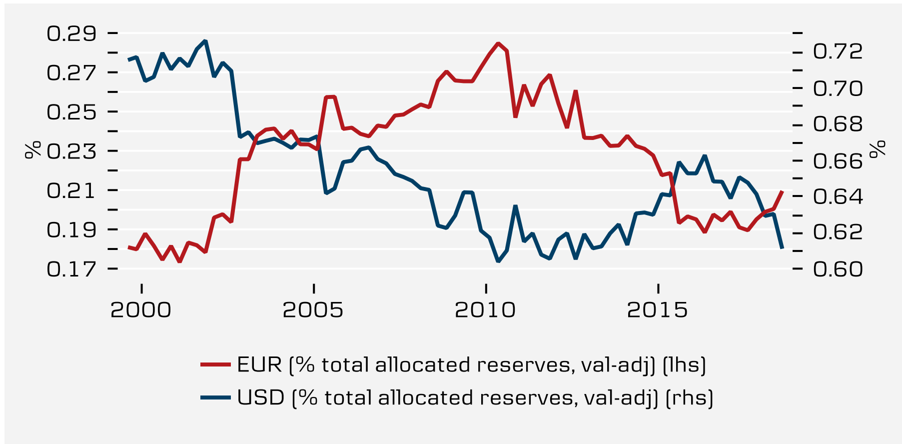
- The IMFs latest data on the composition of global FX reserves (COFER) shows that reserve managers' holdings of USD has continued to decline to stand just above 60% currently. Meanwhile, the share of EUR, its key opponent, has risen slightly to just above 20%. We are still far from the closing of the 'gap' seen ahead of the euro debt crisis in 2010 when the EUR share was around 28%. Notably, both GBP and JPY have increased their shares recently.
- Two factors could be affecting the relative interest of reserve managers of EUR vs USD ahead: (i.) negative yields are likely to be keeping some investors out of EUR assets; this is set to change as the ECB 'normalises', likely starting in late 2019.(ii.) Trump's 'America first' rhetoric may lead investors to question the reserve-currency status of the dollar going forward; however, this is a slow-moving process.

Mind the lack of EUR/CHF downside



Source: Danske Bank, Macrobond Financial

EUR vs USD share of global FX reserves



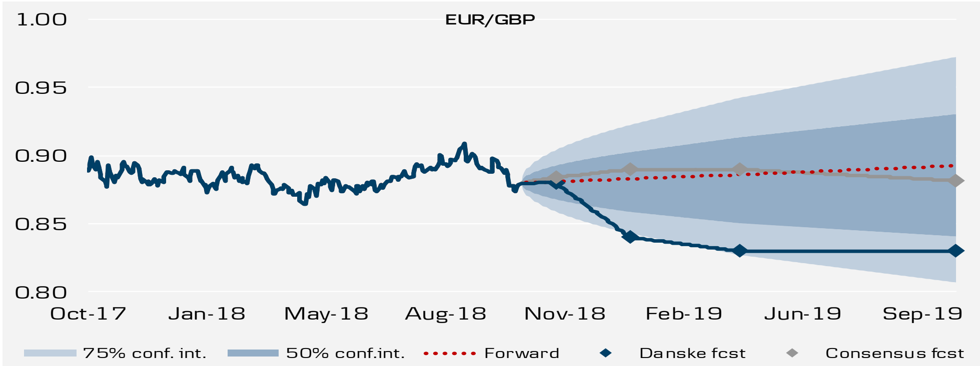
Source: IMF/COFER, Danske Bank, Macrobond Financial

Christin Tuxen, Chief Analyst, tux@danskebank.dk, +45 45 13 78 67

EUR/GBP – warning – Brexit bumps ahead

- **Growth.** UK GDP growth disappointed in August, but the weak monthly print should not be overinterpreted as the 3m/3m GDP growth remains strong at 0.7% q/q. Growth is still driven mainly by services, and while the service sector PMI inched lower to 53.9 in September from 54.3 in August, we still look for GDP growth of around 0.4% on average per quarter going forward. CPI inflation inched higher to 2.7% y/y in August. We still expect the downward pressure on CPI inflation to continue this year due to the fading impact of previous depreciation of sterling.
- **Monetary policy.** As expected, the Bank of England (BoE) voted unanimously to keep the Bank Rate at 0.75% in September. We expect the BoE to hike around once a year and our base case is that the next hike will arrive in May 2019. The UK money market curve is relatively flat, with the next BoE rate hike priced in to arrive in September 2019. While this is slightly dovish compared to our expectations, we think the market's pricing is fair for now – especially given the uncertainty related to Brexit.
- **Flows.** Speculative accounts are stretched short GBP, which should help curb upside potential in EUR/GBP. The UK is running a current account deficit, notably against EU countries, which is a fundamental supporting factor for EUR/GBP. However, the basic balance of the UK balance of payment shows that net inflows into the UK were positive in Q4 17 and Q1 18. A continued recovery in foreign investors' appetite for UK assets supports the case for a stronger GBP over the medium term.
- **Valuation.** GBP remains fundamentally undervalued. Our G10 MEVA model puts EUR/GBP at 0.77 (our Brexit-corrected MEVA estimate for the cross is around 0.83), while our PPP estimate is 0.76.
- **Risks.** In our view, uncertainty regarding Brexit negotiations will keep GBP undervalued and volatile for longer. Timing the market's repricing of a Brexit risk premium is nearly impossible.

Forecast: 0.88 (1M), 0.84 (3M), 0.83 (6M), 0.83 (12M)



EUR/GBP	1M	3M	6M	12M
Forecast (pct'ile)	0.88 (50%)	0.84 (11%)	0.83 (13%)	0.83 (20%)
Fwd. / Consensus	0.88 / 0.88	0.88 / 0.89	0.89 / 0.89	0.89 / 0.88
50% confidence int.	0.87 / 0.89	0.86 / 0.90	0.85 / 0.91	0.84 / 0.93
75% confidence int.	0.86 / 0.91	0.84 / 0.92	0.83 / 0.94	0.81 / 0.97

Source: Danske Bank

- **Conclusion.** Brexit negotiations are now entering a critical phase and we expect EUR/GBP to remain very volatile and sensitive to Brexit news in coming months. We target 0.89 in 1-3M, with risks skewed to the upside in the very near term ahead of the annual UK Conservative Party congress (30 Sept-3 Oct), which in our view is an important hurdle and potential source of volatility, before the final Brexit negotiations. As such, a stretched short speculative GBP positioning and fairly neutral UK interest rates should help to curb EUR/GBP upside potential. However, Brexit will be key driver and stretched positioning is not an obstacle for a significant break higher in EUR/GBP if the likelihood of a 'no deal' scenario increases.
- Longer term, we still expect EUR/GBP to eventually trade lower driven by Brexit clarifications and fundamental valuations. We target EUR/GBP at 0.84 in 6M and 0.83 in 12M.

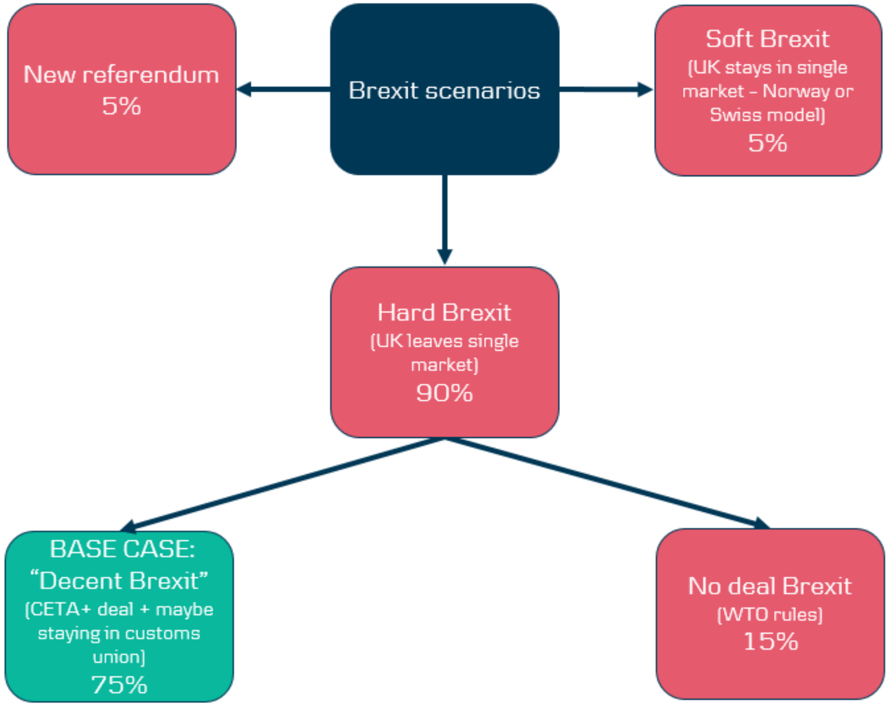
Morten Helt, Senior Analyst, mohel@danskebank.dk, +45 45 12 85 18

EUR/GBP – important issues to watch

Brexit end-game is fast approaching

- We are fast approaching the end-game of the Brexit negotiations, which must be concluded before the formal exit date, as both the EU and especially the UK need time for ratification of the final withdrawal bill, which will probably take a few months. In case of an agreement, we think it will be approved easily by the EU institutions, but it may be more difficult in the UK parliament.
- While the aim previously was to reach an agreement at the EU summit in October, it is more likely to happen at the extraordinary EU summit on Brexit in November or, if postponed again, at the ordinary EU summit in December.
- Our base case remains what we have labelled a 'decent Brexit' (75% probability), which is hard in the sense that the UK leaves the EU single market but soft in the sense that the two parts will reach an agreement, which would keep the UK and EU closely connected.
- ***The final and legally binding free trade agreement is set to be negotiated during the transition period lasting until 1 January 2021.*** We think the deal will look something like the EU-Canada free trade deal (CETA) but it could be more aligned/harmonised on standards and rules than is the case for Canada in order to make trade more frictionless.
- The main obstacle is the issue with the Irish border, as both the UK and the EU want to avoid a hard border, which is difficult when the UK wants to leave the single market (and customs union) and the EU wants to protect the integrity of the single market. The withdrawal text is 80-90% agreed upon but the backstop solution on the Irish border (i.e. how do you avoid a hard border after transition ends in the event no permanent solution is found) is interpreted differently by the two sides and is currently being renegotiated.
- See *Brexit monitor: Get ready for the end-game,* 27 September.

Brexit scenarios



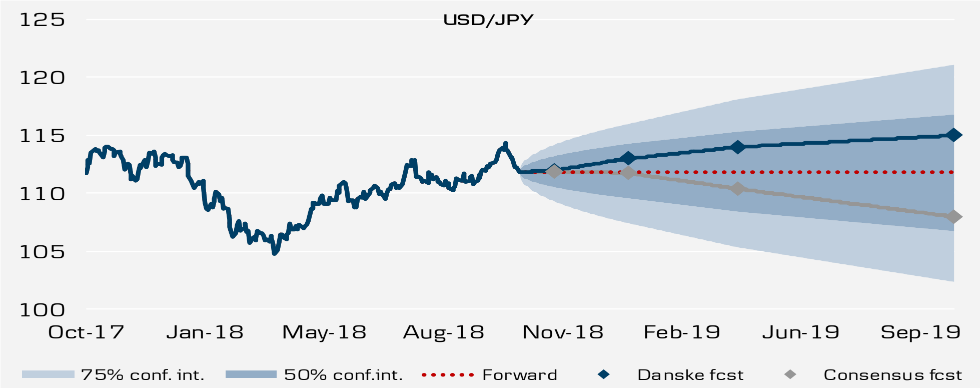
Source: Danske Bank

Morten Helt, Senior Analyst, mohel@danskebank.dk, +45 45 12 85 18

USD/JPY –flows are supportive but risk appetite remains key driver

- **Growth.** The Q3 Tankan business report showed that sentiment decreased to 19 from 21 in Q2 for large manufacturers. However, bad weather, natural disasters and rising raw material costs explain most of the decline. Manufacturing PMI was unchanged at 52.5 in September compared to August with a solid outlook for domestic orders, which points to further business investments. This is good news for an economy facing an historically tight labour market. CPI inflation excluding fresh food, the BoJ's preferred inflation measure, rose to 0.9% y/y in August from 0.8% y/y in July. More than half of the inflation is only energy though, and the underlying price pressure in Japan thus remains very weak despite recent increases in cash earnings.
- **Monetary policy.** The BoJ announced a series of adjustments to its policy at its monetary policy meeting on 31 July. Most importantly, the BoJ will now allow more flexibility in yields around the 0% target going forward. Moreover, the BoJ also introduced forward guidance and now intends to maintain the current extremely low levels of short- and long-term interest rates for an extended period. We expect the BoJ to keep its current policy intact until the end of 2019 at least.
- **Flows.** Japan is running a sizeable current account surplus. However, the trade balance has become negative recently due to rising energy costs, suggesting that Japanese corporates' net buying of yen has eased. See the next page. Non-commercial JPY positioning is very short JPY, according to IMM, which leaves USD/JPY risks skewed to the downside.
- **Valuation.** PPP is around 80, while our MEVA model suggests 104 is 'fundamentally' justified.
- **Risks.** Concerns about the Trump administration's protectionist agenda and the case for higher inflation in the US represent downside risks to USD/JPY. Chinese growth concerns and CNY depreciation could potentially weigh on Japan's main growth engine – exports.

Forecast: 112 (1M), 113 (3M), 114 (6M), 115 (12M)



USD/JPY	1M	3M	6M	12M
Forecast (pct'ile)	112.00 (49%)	113.00 (61%)	114.00 (65%)	115.00 (66%)
Fwd. / Consensus	111.83 / 111.90	111.82 / 111.75	111.81 / 110.42	111.79 / 108.00
50% confidence int.	110.44 / 113.41	109.59 / 114.29	108.44 / 115.32	106.76 / 116.81
75% confidence int.	109.04 / 114.43	107.43 / 116.00	105.37 / 118.11	102.39 / 121.09

Source: Danske Bank

- **Conclusion.** The range for USD/JPY has shifted upwards as the flow picture has become less JPY supportive and as 10 year US yields now effectively has settled above the 3% level. FX positioning remains stretched short JPY and given the overall fragile risk environment, we expect USD/JPY to continue to trade mostly sideways with in a 110-114.50 range in the near term with risk appetite and yields on 10Y UST as main drivers. We target 112 in 1M and 113 in 3M (previously 112).
- Longer term, the BoJ's monetary policy should remain supportive for USD/JPY driven by widening US-Japan yield spreads and continued outflows out of Japan. However, USD/JPY appreciation will be a very gradual process in our view. We have lifted our 12M target to 115 (previously 114), due mainly to 'rolling the time' but still target 114 in 6M.

Morten Helt, Senior Analyst, mohel@danskebank.dk, +45 45 12 85 18

USD/JPY – important issues to watch

Trade balance deficit and FDI outflows – a JPY-negative cocktail

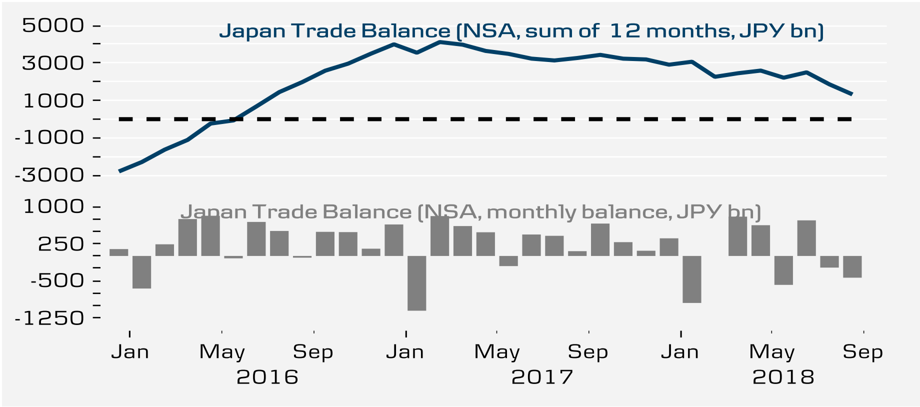
- Japans trade balance has deteriorated substantially in 2018 and has been negative during five out of eight months so far this year. As such, weak export momentum is one of reasons behind the decline in the trade balance. However, the deterioration in the terms of trade has been putting downside pressure on the trade balance gradually, with higher oil prices (especially in JPY terms) playing a significant role as Japan relies heavily on oil imports.
- The income account balance is likely to remain strong due to higher global (foreign) yields, which means that the current account balance is likely to remain in surplus.

  However, Japanese corporate foreign direct investments remain high, which together with the deterioration in the trade balance suggest that the corporate-related FX flows have been turning more JPY negative.

Correlation restored: US yields key driver for USD/JPY

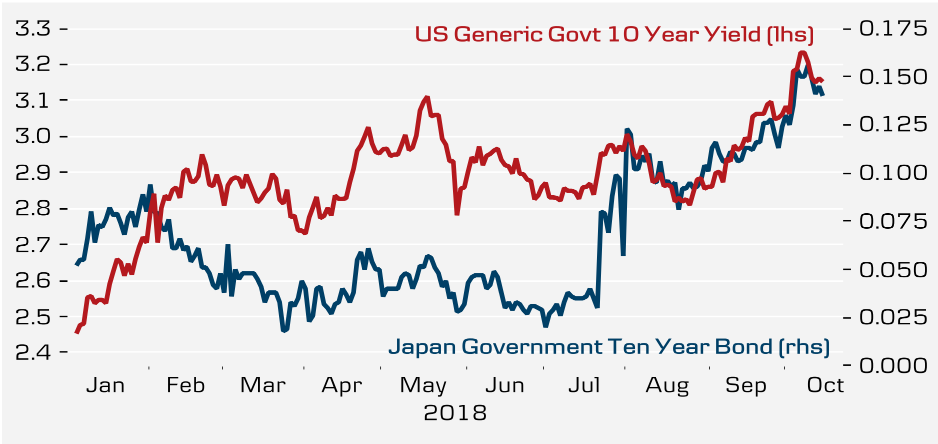
- Since the BoJ introduced a more flexible target and now allows the yield on 10-year Japanese government bonds to fluctuate +/-20bp around the Bank's 0% target, Japanese yields now trade more in tandem with US and global yields. The 10-year yield in Japan has increased substantially along with the sell-off in the US bond market.
- As such, the BoJ's policy and the 10-year US-Japan yield spread still supports a higher USD/JPY longer term, and the correlation between USD/JPY and 10Y US yields remains high. However, given that there is now more two-way volatility in Japanese yields, the current yield target policy is having a somewhat dampening cyclical effect on the yen, as the upside potential in USD/JPY stemming from rising US yields is lower than before the yield target was adjusted.

Trade balance deficit and FDI outflows – a JPY-negative cocktail



Source: Macrobond Financial, Danske Bank:

10Y yields in Japan has increased along with the sell-off in US fixed income market



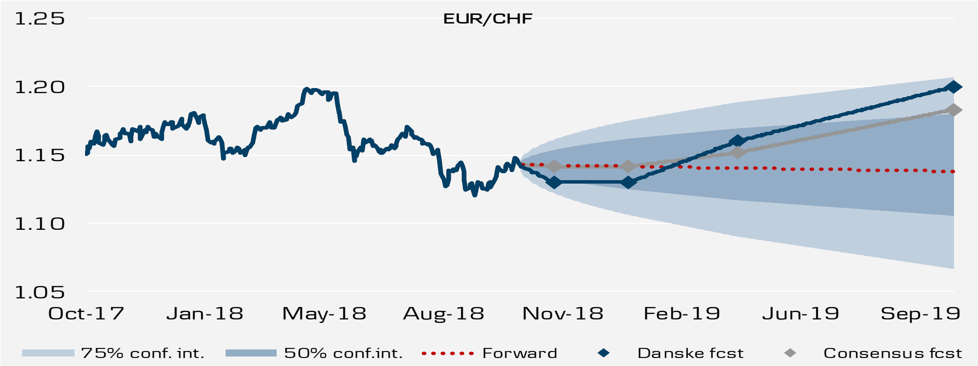
Source: Macrobond Financial, Danske Bank

Morten Helt, Senior Analyst, mohel@danskebank.dk, +45 45 12 85 18

EUR/CHF – resistance to souring risk sentiment may not last

- **Growth.** The Swiss economy looks in good shape with the latest stream of data coming in on the positive side of expectations. But the manufacturing PMI and the KOF leading indicator have been moving apart lately, leaving some uncertainty as to where growth is headed short term. Unemployment remains steadily low and headline inflation continues to pick up, albeit from very low levels, but core inflation has stabilised below 0.4% for now.
- **Monetary policy.** The SNB has been on hold at -0.75% on key policy rates since January 2015, and we believe this is unlikely to change any time soon. At the September meeting, as widely expected, it kept both policy rates unchanged but made downward adjustments to its conditional inflation profile, which suggests that any 'exit' from negative rates will be long underway. Furthermore, the SNB kept the saying in its statement that CHF is 'highly valued' and kept open the option of using intervention to fight CHF strength. However, this has seemingly not been needed recently despite Italy risks. Since the September meeting the effective CHF has weakened close to 2%, which will be welcomed by the SNB.
- **Flows.** Speculators have covered a good deal of CHF shorts recently despite Italy risks, and both EUR and CHF positioning is close to 'neutral'.
- **Valuation.** Both our G10 MEVA and PPP models suggest the cross should move higher over the medium to long term, with both at 1.27.
- **Risks**. CHF has been remarkably insensitive to rising concerns regarding the expansionary fiscal budget from the new Italian government. In general, the FX market has proved rather resilient to Italy worries with USD strength dominating the picture. Even during the latest equity-market rout CHF has stood firm. We stress however that if risk sentiment sours further, the market could be ripe for noteworthy CHF appreciation.

Forecast: 1.13 (1M), 1.13 (3M), 1.16 (6M), 1.20 (12M)



EUR/CHF	1M	3M	6M	12M
Forecast (pct'ile)	1.13 (22%)	1.13 (30%)	1.16 (65%)	1.20 (84%)
Fwd. / Consensus	1.14 / 1.14	1.14 / 1.14	1.14 / 1.15	1.14 / 1.18
50% confidence int.	1.13 / 1.15	1.12 / 1.16	1.12 / 1.17	1.11 / 1.18
75% confidence int.	1.12 / 1.16	1.11 / 1.18	1.09 / 1.19	1.07 / 1.21

Source: Danske Bank

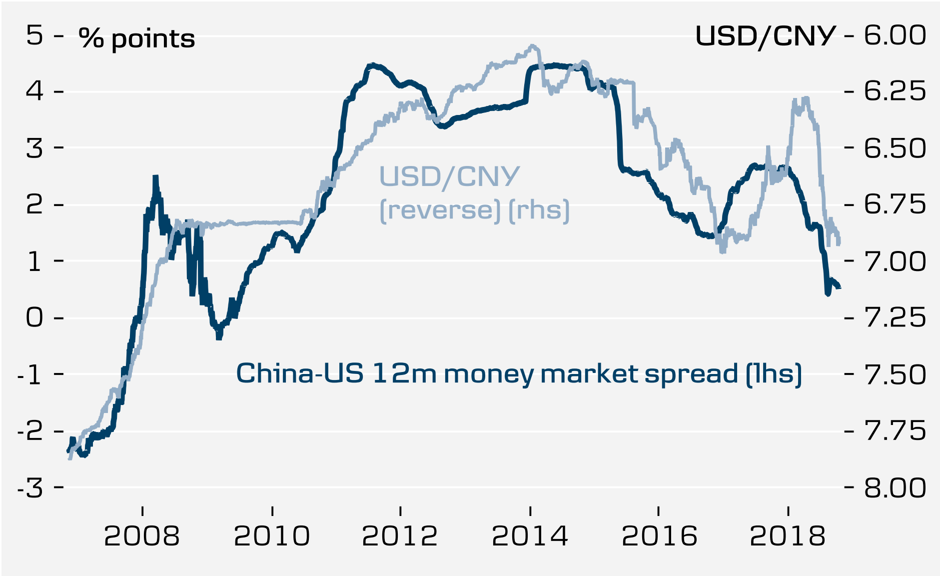
- **Conclusion.** While CHF has proved surprisingly resistant to Italian risks and the equity sell-off recently, we stress that the risk of further Italy-EU confrontation as well as Brexit negotiations setbacks remain likely. This should weigh on EUR/CHF short term. The SNB will remain reluctant to change its communication in light of the stubbornly subdued inflationary pressure and a still-distant first hike from the ECB. In the absence of new political risks, this should allow EUR/CHF to re-invoke on a gradual move back towards 1.20 in 12M. It is likely to require a clear dip below 1.10 for the SNB to start intervening on a larger scale.
- We have left our EUR/CHF profile unchanged, and still look for 1.13 in 1M, 1.13 in 3M, 1.16 in 6M and 1.20 in 12M.

Christin Tuxen, Chief Analyst, tux@danskebank.dk, +45 45 13 78 67

USD/CNY – diverging policy to drive further CNY weakness

- **Growth.** We look for a slowdown in growth this year on the back of the trade war with the US. However, easing of both fiscal as well as monetary policy will dampen the downturn.
- **Monetary policy.** Chinese money markets rates have fallen sharply over the past months as the PBoC has increased liquidity. It contributed to the sharp depreciation of the CNY. Relative monetary policy versus the US has thus turned very CNY negative (see chart). We still see a risk that the trade war could escalate further, but there is some ray of light given that Xi Jinping and Donald Trump are scheduled to meet at the end of November in connection with the G20 summit. As the Fed is set to keep tightening, relative rates should work in favour of further USD strength and CNY weakness.
- **FX policy.** Continues to be a managed peg against a basket of currencies. The basket has weakened sharply over the past months to the weakest level since mid-2017. On 3 August, China reinstalled a reserve requirement of 20% on buying of some FX forwards in a move to stem the decline of the CNY. We see no signs that China is using the currency as a tool in the trade war; rather that the depreciation is a result of the easing of monetary policy relative to the US.
- **Flows.** There are no signs as yet of big outflows as was the case in 2015/16. However, China has intervened slightly to halt the CNY depreciation by pushing up CNH money market rates: an instrument that has proved effective to stop CNY weakening.
- **Valuation.** The CNY is still broadly seen as being close to fair value.
- **Risks.** The main risk is that the trade war escalates more than expected.

Forecast: 6.90 (1M), 6.95 (3M), 7.0 (6M), 7.2 (12M)



Source: Danske Bank

- Conclusion. We look for further CNY weakening in the medium term on diverging monetary policy.
- We look for USD/CNY at 6.95 on 3M (previously 6.90) and 7.20 on 12M.

Allan von Mehren, Chief Analyst, alvo@danskebank.com, +45 45 12 80 55

USD/RUB –US sanctions drama approaches with the mid-term elections

- **Growth.** The Russian economy grew 1.9% y/y in Q2 18 versus 1.3% y/y a quarter earlier, according to the preliminary data release. The estimate was raised by 0.1pp versus the previous release. Industrial production growth has remained in positive territory throughout 2018 and manufacturing PMI has recovered. Given the change in Russian monetary policy stance since the summer and the newly-arisen risk of anti-Russian sanctions amid a shaky EM environment, we cut our GDP growth estimates to 1.6% for 2018 (previously 2.0%), 1.3% for 2019 (previously 2.1%) and 1.4% for 2020 (previously 2.2%), while seeing that geopolitical woes remain the major downside risk for our forecasts.

- **Monetary policy.** Against expectations, Russia's central bank (CBR) hiked the key rate by 25bp to 7.50% in September 2018, raising inflation projections and emphasising risk of external factors. Inflation has started to accelerate, due mostly to low base effect. In September, consumer prices rose 3.4% y/y versus 3.1% y/y a month earlier. We believe the CBR could hike again in Q4 18 as global monetary tightening, increased volatility in EM FX and looming US sanctions are set to push inflation expectations up on rising RUB volatility.

- **Flows.** Pressure on the RUB from the sell-off in OFZs has prevailed. We expect non-residents to remain cautious on Russian assets ahead of an eventful Q4 18. The risk of increasing outflows remains. FX purchases under the budget rule have been put on hold until 2019 to avoid additional RUB weakening.

- **Valuation.** As FX purchases under the budget rule have been paused, a tiny positive correlation between RUB and oil has returned. While the Brent 30-day average rose 8.2% over the past 30 days, as of 11 October 2018, RUB/USD had gained 1.8% over the same period. We see the RUB/USD as strongly undervalued at current oil prices and stable macro.

Forecast: 69.10 (1M), 72.00 (3M), 73.80 (6M), 75.10 (12M)

USD/RUB	1M	3M	6M	12M
Forecast	69.10	72.00	73.80	75.10
Fwd./Consesus	65.90 / 68.55	66.28 / 67.62	67.01 / 66.79	68.65 / 65.22

Source: Danske Bank

- **Conclusion.** The geopolitical premium in the RUB remains high despite the rising oil price. While we do not observe any significant changes in fundamental factors driving the RUB, we still project our new RUB forecasts assuming that harsh US sanctions against Russia (the so-called *'bill from hell'*) could become law this autumn and strong anti-Russian rhetoric will escalate in the US ahead of the US mid-term elections. We keep our previous USD/RUB profile unchanged, rolling the forecasts further.

- **Risks.** Geopolitical risks will remain the major driver this autumn. If more anti-Russia sanctions are not introduced in Q4 18, the RUB could see a notable rebound.

Vladimir Miklashevsky, Senior Economist/Trading Desk Strategist, vlmi@danskebank.com, +358 10 546 7522

USD/RUB – important issues to watch

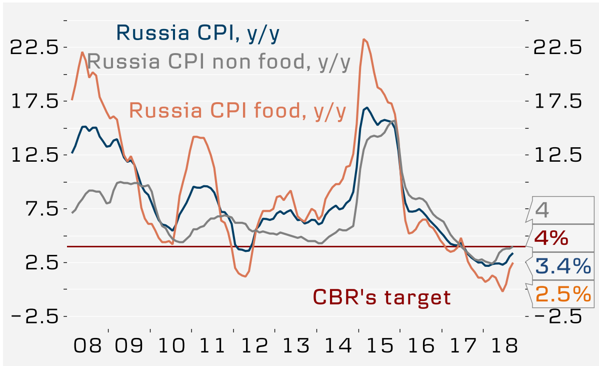
US anti-Russian rhetoric in light of US mid-term elections and new anti-Russia sanctions

- As the US Congress is back to full activity after the summer vacation, it will be important to watch the legislative process regarding the bill to introduce harsh sanctions against Russia. There have been several hearings within the US Senate Committee already on banking regarding anti-Russia sanctions.
- The second wave of US sanctions by the Trump administration against Russia could come into force in late November 2018. If implemented, this round would be extremely negative for the RUB.
- Negative news from the conflict in the Eastern Ukraine could cause sudden RUB outflows, weakening the currency.

Malign external environment could add to CBR's hawkishness

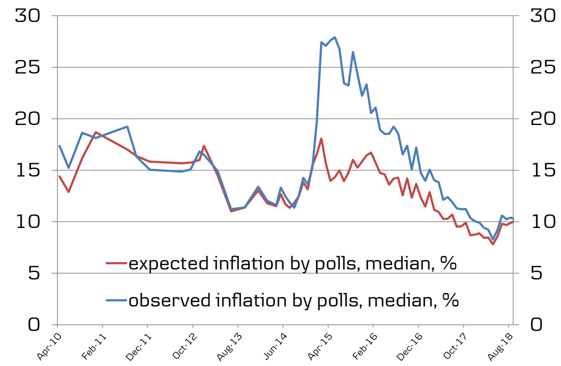
- A shaky global environment and more tightening across emerging markets could push the CBR for another hike in Q4 18. Harsh US sanctions would make the possible hike more likely.
- Rising inflation expectations could push the CBR to deliver another 25bp hike in Q4 18.
- The CBR's hawkish tone could vanish if external conditions ease in 2019.

Inflation is set to see temporary acceleration above 5% in early 2019 due to the increase in VAT, some excise taxes and RUB weakness



Source: CBR, Bloomberg, Macrobond Financial, Danske Bank

Inflation expectations remain elevated on recent RUB's turbulence and expected VAT increase



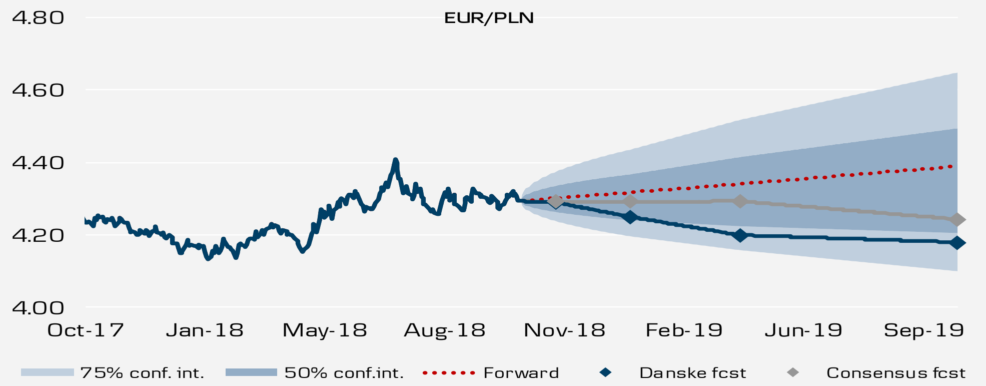
Source: CBR, Danske Bank

Vladimir Miklashevsky, Senior Economist/Trading Desk Strategist, vlmi@danskebank.com, +358 10 546 7522

EUR/PLN – weak global risk sentiment continues to weigh on PLN

- **Economic developments.** While macro indicators still point to strong economic growth, indicators have surprised slightly on the downside and are showing signs of a slowdown in the economy, which we expect to become more pronounced over the next year. PMI manufacturing declined further to 50.5 in September and could fall below the important 50 benchmark, suggesting a slowdown in the economic activity. On a positive note, retail sales continue to grow fairly strongly around 7% in real terms, supported by still solid wage growth. Construction activity continues at a fast pace, growing 20% in August. The rapid growth in domestic demand is showing up in the trade balance, which is now hovering solidly in negative territory.
- **Political and geopolitical developments.** Tensions between the EU and Poland continue to simmer and the EU has threatened to present a case against the Polish government's lowering of the retirement age to the European Court of Justice in the coming months.
- **Monetary policy.** Inflation continues to remain muted with headline inflation declining to 1.8% in September and core inflation coming in at 0.9% in August. In light of the subdued inflation pressures, the National Bank of Poland (NBP), led by Governor Adam Glapiński, continues to maintain that rates could stay unchanged toward end-2019, and if nothing changes, even further. Financial markets are almost pricing in a rate hike by October next year, which we think is fair.
- **Risks.** Risks are skewed to the upside for EUR/PLN in the near term given the risk of an escalation in the stand-off between Italy and the EU as well as the EU and Poland and the continued equity rout, which could weigh on PLN. The most prominent downside for the EUR/PLN is improvement in risk sentiment and stronger than economic releases.

Forecast: 4.29 (1M), 4.25 (3M), 4.20 (6M), 4.18 (12M)



EUR/PLN	1M	3M	6M	12M
Forecast (pct'ile)	4.29 (48%)	4.25 (28%)	4.20 (19%)	4.18 (21%)
Fwd. / Consensus	4.30 / 4.29	4.32 / 4.29	4.34 / 4.29	4.39 / 4.24
50% confidence int.	4.26 / 4.33	4.24 / 4.37	4.22 / 4.41	4.21 / 4.49
75% confidence int.	4.23 / 4.37	4.20 / 4.44	4.16 / 4.52	4.10 / 4.65

Source: Danske Bank

- **Conclusion.** The PLN has traded relatively weak amid general sour global risk sentiment, which is affecting investor sentiment in PLN as well. While the equity sell-off may wane in the near future, the lingering risk of a further escalation in tensions between China and the US and concerns about Italy will continue to provide headwinds for the PLN. As a result, we maintain our forecast for EUR/PLN at 4.29 in 1M, 4.25 in 3M, and 4.20 in 6M and 4.18 in 12M.

Jakob Christensen, Chief Analyst, jakc@danskebank.dk, +45 45 12 85 30

USD/TRY – the lira calms down as Fed's path becomes clearer

- **Growth.** Turkish GDP growth slowed down to 5.2% y/y in Q2 18 from 7.4% y/y a quarter earlier. Industrial production growth continues to slow down as the manufacturing PMI index fell to its lowest. Turkey's central bank's sharp monetary tightening is set to put additional brakes on economic expansion in the long term. We expect 2018 GDP to grow 3.5% y/y, cutting our 2019 GDP growth projection to 2.6% y/y (previously 3.0% y/y).
- **Monetary policy.** Turkey's central bank (TCMB) surprised the markets with a 625bp hike of the one-week repo rate to 24.00%, which moved USD/TRY to new lower levels and helped EM FX across the globe. We expected a 300bp hike and Bloomberg consensus anticipated a 325bp increase. In its most recent statement, the TCMB signalled that 'if needed, further monetary tightening will be delivered'. Given the continuing acceleration in inflation (+6.62pp to 24.52% y/y in September) and risks of more weakening in the TRY, another hike is possible in Q4 18, as the real rate has become negative
- **Valuation.** Net flows into Turkish bonds turned positive in September, as fallen Turkish assets are seen as a buying opportunity on the Fed's clearer path for the coming months. According to technical analysis (Relative Strength Index), the USD/TRY has returned to 'the fair value' following the significant hike.
- **Risks.** Major downside risks to our TRY forecasts include further geopolitical escalation and a deepening trade war between Turkey and the US. The central bank's passive stance towards the current currency crisis could be another downside risk for our TRY view.

Forecast: 6.00 (1M), 6.40 (3M), 6.90 (6M) and 7.50 (12M)

USD/TRY	1M	3M	6M	12M
Forecast	6.00	6.40	6.90	7.50
Fwd./Consesus	5.91 / 6.07	6.14 / 6.47	6.51 / 6.46	7.35 / 6.72

Source: Danske Bank

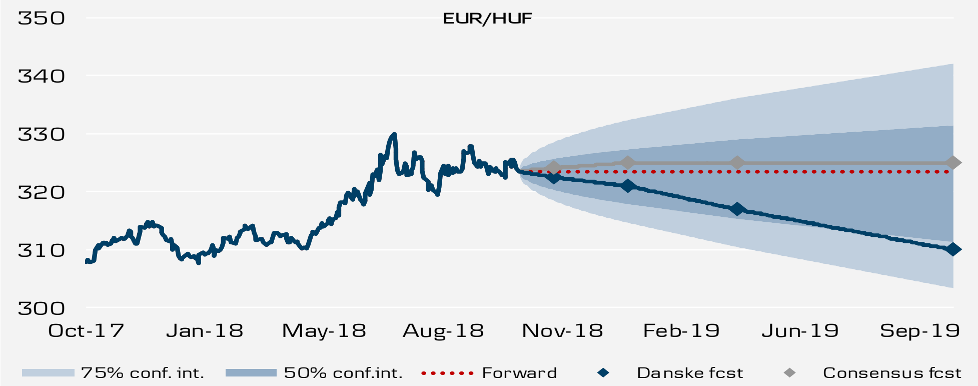
- **Conclusion.** We maintain our USD/TRY forecast levels. Given that we expect more tightening fromthe TCMB (both implicitly and explicitly), we see only a moderate rise in the USD/TRY in the long term. A rate hike in Q4 18 would boost TRY's short- and medium-term prospects. However, we continue to remain bearish on the TRY in the long term and forecast the USD/TRY at the following levels: 6.00 in 1M, 6.40 in 3M, 6.90 in 6M and 7.50 in 12M.

Vladimir Miklashevsky, Senior Economist/Trading Desk Strategist, vlmi@danskebank.com, +358 10 546 7522

EUR/HUF – growing risks of hawkish MNB set to support the HUF

- **Growth.** Economic growth continued, accelerating to 4.6% y/y in Q2 18, according to preliminary data, versus 4.4% y/y in Q1 18. Manufacturing PMI has remained firmly above 50.0, decreasing to 53.8 in September. At the same time there is a slowdown in GKI Hungary economic sentiment indicator, which includes both consumer and business confidence. Industrial production growth remained solid, while risk of looming trade war between the EU and the US could hit the expansion in early 2019. Yet, current stance in monetary policy is beneficial for further economic expansion in 2019 and 2020 although on a lower path, as a risk of earlier rate hike has arisen.
- **Monetary policy.** The Hungarian central bank (MNB) kept rates unchanged at its September meeting and seems to be on hold for now. However, headline inflation remains over the 3.0% target (3.6% y/y in September). While we have previously expected the first key rate increase in mid-2019, changing inflation dynamics, strong economic growth and global monetary tightening could still push the MNB to deliver a 25bp hike in H1 19. We do not exclude implicit tightening through liquidity tools.
- **Risks.** An upside risk to our EUR/HUF forecast now comes from prolonged EUR weakness. An escalating trade war between the EU and the US would hit Hungarian exports and the HUF, if tariffs on German exports rise further. Rapid acceleration in CPI could cause an early and more aggressive than 25bp rate hike, supporting the HUF. As the EU has taken a tough stance on Hungary's Prime Minister Viktor Orbán's domestic policy, introducing sanctions against the country, the increasingly fractious relationship between Brussels and Budapest could weigh on the HUF.

Forecast: 322.50 (1M), 321 (3M), 317 (6M) and 310 (12M)



EUR/HUF	1M	3M	6M	12M
Forecast (pct'ile)	322.50 (47%)	321.00 (42%)	317.00 (30%)	310.00 (22%)
Fwd. / Consensus	323.53 / 324.12	323.53 / 325.00	323.54 / 325.00	323.56 / 325.00
50% confidence int.	320.13 / 325.89	317.88 / 327.33	315.35 / 329.04	311.36 / 331.46
75% confidence int.	318.18 / 328.97	314.65 / 332.37	310.51 / 336.12	303.41 / 342.09

Source: Danske Bank

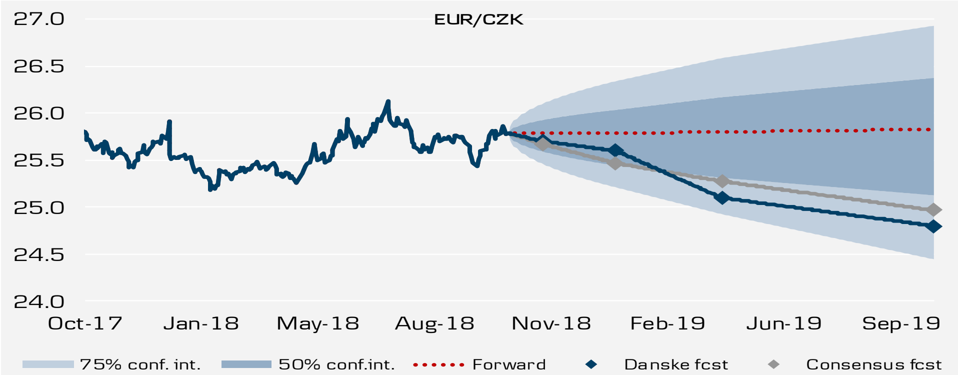
- **Conclusion.** While EUR's weakness on Italian woes could shake the HUF, we still see the HUF as stronger in the short, medium and long term, while adjusting the pair forecast according to the current EUR exchange rate. We forecast EUR/HUF at 322.50 in 1M, at 321 in 3M, 317 in 6M and in 12M at 310.

Vladimir Miklashevsky, Senior Economist/Trading Desk Strategist, vlmi@danskebank.com, +358 10 546 7522

EUR/CZK – still in the hands of global risk sentiment

- **Growth.** Business and consumer confidence continue to rise and the growth momentum in Czech Republic remains dynamic. That said, PMI signals and hard data point to some slowdown in economic activity ahead, with industrial activity in Q3 also being hampered by negative spill-overs from the German car sector. We expect annual GDP growth to moderate to 3.3% in 2018 and 3.1% in 2019 on the back of tighter monetary conditions and biting capacity constraints. The labour market remains tight and with the unemployment rate (3.0% in September) significantly below NAIRU, nominal wage growth is expected to remain elevated at 8.5% in 2018.
- **Monetary policy.** Czech inflation at 2.3% in September remains above the Czech National Bank's (CNB) target, and we expect it to remain so in coming months driven by energy prices and accelerating core inflation. As widely expected, the CNB raised the policy rate by another 25bp to 1.50% at the September meeting. In light of persistent CZK weakness, we now expect another 25bp hike at the meeting on 1 November, when the CNB will also update its interest rate and FX forecasts. The timing of the Czech hiking cycle remains dependent on FX movements, but as long as CZK continues to trade weaker than the CNB envisions, we expect it to continue speeding up monetary tightening through the interest rate channel. For 2019, we currently expect two additional interest rate rises, which means that the policy rate will remain below its long-run neutral level (estimated at c.3.0% by the CNB).
- **Risks.** The risk to our EUR/CZK forecast profile is skewed to the upside due to spill-overs from the current adverse EM risk sentiment and continued Fed hikes. Given the sizable amount of long CZK positions accumulated in the market prior to the floor exit, EUR/CZK is also still vulnerable to spikes higher.

Forecast: 25.70 (1M), 25.60 (3M), 25.10 (6M), 24.80 (12M)



EUR/CZK	1M	3M	6M	12M
Forecast (pct'ile)	25.70 (40%)	25.60 (39%)	25.10 (16%)	24.80 (17%)
Fwd. / Consensus	25.79 / 25.67	25.79 / 25.47	25.80 / 25.28	25.83 / 24.97
50% confidence int.	25.59 / 25.94	25.44 / 26.03	25.31 / 26.17	25.13 / 26.37
75% confidence int.	25.46 / 26.11	25.21 / 26.34	24.93 / 26.58	24.45 / 26.93

Source: Danske Bank

- **Conclusion.** The September CNB hike was fully anticipated by the market and EUR/CZK subsequently moved back towards the 25.80 level due to a combination of profit taking on long CZK positions accumulated in the market, Fed hikes and still wobbly EM risk sentiment. The domestic macro backdrop of Czech Republic remains very favourable compared to the euro area, but CZK is currently more driven by global risk sentiment than domestic factors. Although we expect CZK to return to its gradual strengthening path eventually - not least due to continued monetary policy divergence - the timing remains difficult to judge. Once domestic drivers take over again, CZK appreciation could happen relatively quickly. We keep our long-term EUR/CZK forecast unchanged at 24.80 in 12M, but due to lingering headwinds, we revise our short-run forecasts up to 25.70 in 1M (25.50 previously), 25.60 in 3M (25.40) and 25.10 in 6M (25.00).

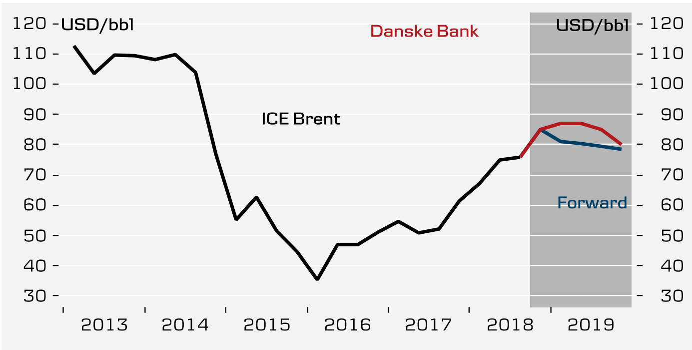
Aila Mihr, Analyst, amih@danskebank.dk

Danske Bank

Oil – supply concerns

- **Macro.** We have seen growing supply concerns in the oil market as sanctions on Iran have started to bite and there has been an easing of global trade tensions following the trade deal between the US, Canada and Mexico. At the same time, the US is in the midst of a strong hurricane season. With regard to the global market balance, what we note is that spare capacity in OPEC excluding Iran and Venezuela has dropped to around 1.7mb/d – the lowest in several years. It leaves only small room to mitigate a further decline in output in Venezuela and Iran. Furthermore, Saudi Arabia is already producing close to all-time highs. Hence, the leading producer in OPEC could be tested on the availability of its remaining spare capacity. Following concerns about OPEC supply, focus naturally turns to inventory levels. Here, we note that crude inventories in the US are still high. However, they are more than 100mb below the peak from early 2017. Hence, the US has less room to withstand a sudden supply squeeze in the oil market.
- **Forward curve.** The Brent crude oil market forward curve remains in backwardation. The recent rise in prices on front-end forward contracts has not been seen further out the curve, leading to a widening of backwardation.
- **Positioning.** Speculative positioning in the oil market remains in stretched long territory.
- **Risks.** Risks to oil prices are two-fold, in our view. On the one hand, we see a risk of a severe tightening of the market balance if output falls much further in Iran and Venezuela. This scenario could lead prices to overshoot our forecast. On the other hand, the market is sensitive to a renewed escalation in trade tensions and/or a deterioration in risk sentiment.

Forecast: USD85/bbl (Q4 18), USD87/bbl (Q1 19), USD87/bbl (Q2 19), USD85/bbl (Q3 19), USD80/bbl (Q4 19)



Source: Danske Bank

- **Conclusion.** Following the recent price development, we have revised our forecast for Brent crude. We now forecast the price on Brent crude to average USD85/bbl in Q4 18 and trade in the USD85-87/bbl range in Q1-Q3 19 as supply concerns will stay high on the agenda in the oil market before falling to USD80/bbl in Q4 19 as these concerns ease.

Jens Nærvig Pedersen, Senior Analyst, jenpe@danskebank.dk, +45 45 12 80 61

Danske Bank

Danske Bank 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	1.160	1.15	1.15	1.18	1.25	-1.1	-1.6	0.1	4.3
JPY	129.6	129	130	135	144	-0.6	0.2	3.7	10.8
GBP	0.881	0.88	0.84	0.83	0.83	-0.2	-4.9	-6.4	-7.1
CHF	1.143	1.13	1.13	1.16	1.20	-1.1	-1.0	1.7	5.4
DKK	7.4605	7.4550	7.4525	7.4550	7.4550	-0.1	0.0	0.1	0.2
NOK	9.45	9.40	9.40	9.20	9.10	-0.7	-0.9	-3.4	-5.3
SEK	10.39	10.40	10.20	10.10	10.10	0.1	-1.8	-2.7	-2.9
Exchange rates vs USD									
JPY	111.8	112	113	114	115	0.4	1.9	3.6	6.2
GBP	1.32	1.31	1.37	1.42	1.51	-0.9	3.5	7.0	12.2
CHF	0.99	0.98	0.98	0.98	0.96	0.0	0.6	1.6	1.1
DKK	6.43	6.48	6.48	6.32	5.96	1.0	1.6	-0.1	-3.9
NOK	8.15	8.17	8.17	7.80	7.28	0.4	0.7	-3.6	-9.2
SEK	8.96	9.04	8.87	8.56	8.08	1.2	-0.1	-2.9	-6.8
CAD	1.30	1.30	1.28	1.25	1.23	-0.1	-1.5	-3.6	-4.9
AUD	0.71	0.72	0.73	0.74	0.75	0.9	2.2	3.5	4.5
NZD	0.65	0.66	0.66	0.67	0.68	1.0	0.9	2.3	3.5
RUB	65.67	69.10	72.00	73.80	75.10	4.9	8.6	10.1	9.4
CNY	6.92	6.90	6.95	7.00	7.20	-0.3	0.4	1.2	4.0

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

Source: Danske Bank

Danske Bank

Danske Bank FX forecasts vs DKK

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs DKK									
EUR	7.4605	7.4550	7.4525	7.4550	7.4550	-0.1	0.0	0.1	0.2
USD	6.43	6.48	6.48	6.32	5.96	1.0	1.6	-0.1	-3.9
JPY	5.76	5.79	5.73	5.54	5.19	0.6	-0.3	-3.5	-9.6
GBP	8.47	8.47	8.87	8.98	8.98	0.1	5.2	6.9	7.8
CHF	6.53	6.60	6.60	6.43	6.21	1.0	1.0	-1.6	-5.0
NOK	0.79	0.79	0.79	0.81	0.82	0.6	0.9	3.6	5.8
SEK	0.72	0.72	0.73	0.74	0.74	-0.2	1.8	2.9	3.1
CAD	4.94	4.99	5.06	5.05	4.85	1.1	3.1	3.7	1.0
AUD	4.59	4.67	4.73	4.68	4.47	1.9	3.9	3.4	0.4
NZD	4.20	4.28	4.28	4.23	4.06	2.0	2.6	2.2	-0.6
PLN	1.74	1.74	1.75	1.78	1.78	0.2	1.6	3.4	5.2
CZK	0.29	0.29	0.29	0.30	0.30	0.4	0.7	3.4	5.8
HUF	2.31	2.31	2.32	2.35	2.40	0.3	0.8	2.4	5.5
RUB	0.10	0.09	0.09	0.09	0.08	-3.7	-6.5	-9.3	-12.2
CNY	0.93	0.94	0.93	0.90	0.83	1.3	1.2	-1.2	-7.7

Source: Danske Bank

Danske Bank FX forecasts vs SEK

	Prognose					Prognose ift. termin, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Valutakurs ift. SEK									
EUR	10.39	10.40	10.20	10.10	10.10	0.1	-1.8	-2.7	-2.9
USD	8.96	9.04	8.87	8.56	8.08	1.2	-0.1	-2.9	-6.8
JPY	8.01	8.07	7.85	7.51	7.03	0.8	-2.0	-6.2	-12.3
GBP	11.80	11.82	12.14	12.17	12.17	0.3	3.3	3.9	4.5
CHF	9.09	9.20	9.03	8.71	8.42	1.2	-0.8	-4.4	-7.9
NOK	1.10	1.11	1.09	1.10	1.11	0.8	-0.8	0.7	2.6
DKK	1.39	1.40	1.37	1.35	1.35	0.2	-1.7	-2.8	-3.0
CAD	6.88	6.96	6.93	6.85	6.57	1.3	1.4	0.8	-2.1
AUD	6.39	6.51	6.47	6.33	6.06	2.1	2.1	0.5	-2.7
NZD	5.85	5.97	5.85	5.73	5.49	2.2	0.8	-0.6	-3.6
PLN	2.42	2.42	2.40	2.40	2.42	0.4	-0.2	0.5	2.0
CZK	0.40	0.40	0.40	0.40	0.41	0.6	-1.0	0.5	2.6
HUF	3.21	3.22	3.18	3.19	3.26	0.5	-0.9	-0.5	2.3
RUB	0.14	0.13	0.12	0.12	0.11	-3.5	-8.1	-11.8	-14.8
CNY	1.29	1.31	1.28	1.22	1.12	1.5	-0.6	-4.0	-10.5

Source: Danske Bank

Danske Bank FX forecasts vs NOK

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs NOK									
EUR	9.45	9.40	9.40	9.20	9.10	-0.7	-0.9	-3.4	-5.3
USD	8.15	8.17	8.17	7.80	7.28	0.4	0.7	-3.6	-9.2
JPY	7.29	7.30	7.23	6.84	6.33	0.0	-1.2	-6.9	-14.5
GBP	10.74	10.68	11.19	11.08	10.96	-0.5	4.2	3.2	1.9
CHF	8.27	8.32	8.32	7.93	7.58	0.4	0.1	-5.1	-10.2
SEK	0.91	0.90	0.92	0.91	0.90	-0.8	0.8	-0.7	-2.5
DKK	1.27	1.26	1.26	1.23	1.22	-0.6	-0.9	-3.5	-5.5
CAD	6.26	6.29	6.39	6.24	5.92	0.5	2.2	0.1	-4.5
AUD	5.82	5.89	5.97	5.77	5.46	1.3	2.9	-0.2	-5.1
NZD	5.33	5.39	5.39	5.22	4.95	1.4	1.6	-1.3	-6.1
PLN	2.20	2.19	2.21	2.19	2.18	-0.4	0.6	-0.2	-0.5
CZK	0.37	0.37	0.37	0.37	0.37	-0.2	-0.2	-0.3	0.0
HUF	2.92	2.91	2.93	2.90	2.94	-0.3	-0.1	-1.2	-0.3
RUB	0.12	0.12	0.11	0.11	0.10	-4.3	-7.3	-12.4	-17.0
CNY	1.18	1.18	1.18	1.11	1.01	0.7	0.3	-4.7	-12.7

Source: Danske Bank

Danske Bank

Danske Bank EMEA FX forecasts

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	**15-Oct-18**	**4.29**		**3.70**		**174**		**242**		**220**	
	+1M	4.29	4.30	3.73	3.70	174	173	242	241	219	220
	+3M	4.25	4.32	3.70	3.69	175	173	240	240	221	220
	+6M	4.20	4.34	3.56	3.68	178	172	240	239	219	219
	+12M	4.18	4.39	3.34	3.66	178	170	242	237	218	219
HUF	**15-Oct-18**	**324**		**279**		**2.31**		**3.21**		**2.92**	
	+1M	323	324	280	278	2.31	2.30	3.22	3.21	2.91	2.92
	+3M	321	324	279	277	2.32	2.30	3.18	3.21	2.93	2.93
	+6M	317	324	269	275	2.35	2.30	3.19	3.20	2.90	2.94
	+12M	310	327	248	272	2.40	2.28	3.26	3.18	2.94	2.94
CZK	**15-Oct-18**	**25.8**		**22.2**		**28.9**		**40.3**		**36.7**	
	+1M	25.7	25.8	22.3	22.2	29.0	28.9	40.5	40.2	36.6	36.6
	+3M	25.6	25.8	22.3	22.1	29.1	28.9	39.8	40.2	36.7	36.8
	+6M	25.1	25.9	21.3	22.0	29.7	28.7	40.2	40.1	36.7	36.7
	+12M	24.8	26.2	19.8	21.9	30.1	28.4	40.7	39.7	36.7	36.7
RUB	**15-Oct-18**	**76.1**		**65.7**		**9.8**		**13.6**		**12.4**	
	+1M	79.5	76.6	69.1	65.9	9.4	9.7	13.1	13.6	11.8	12.4
	+3M	82.8	77.5	72.0	66.3	9.0	9.6	12.3	13.4	11.4	12.2
	+6M	87.1	79.0	73.8	67.0	8.6	9.4	11.6	13.2	10.6	12.1
	+12M	93.9	82.3	75.1	68.7	7.9	9.0	10.8	12.6	9.7	11.7
TRY	**15-Oct-18**	**6.72**		**5.79**		**111**		**154**		**141**	
	+1M	6.90	6.88	6.00	5.91	108	108	151	151	136	138
	+3M	7.36	7.18	6.40	6.14	101	104	139	145	128	132
	+6M	8.14	7.68	6.90	6.51	92	97	124	135	113	124
	+12M	9.38	8.82	7.50	7.35	80	84	108	118	97	109
CNY	**15-Oct-18**	**8.02**		**6.92**		**93**		**129**		**118**	
	+1M	7.94	8.04	6.90	6.92	94	93	131	129	118	118
	+3M	7.99	8.09	6.95	6.92	93	92	128	128	118	117
	+6M	8.26	8.15	7.00	6.92	90	91	122	127	111	117
	+12M	9.00	8.30	7.20	6.92	83	90	112	125	101	116
ZAR	**15-Oct-18**	**16.7**		**14.4**		**44.6**		**62.0**		**56.4**	
	+1M	16.4	16.9	14.25	14.5	45.5	44.2	63.5	61.6	57.4	56.1
	+3M	17.0	17.1	14.75	14.6	43.9	43.6	60.1	60.8	55.4	55.5
	+6M	16.5	17.4	14.00	14.8	45.1	42.8	61.1	59.6	55.7	54.7
	+12M	17.5	18.1	14.00	15.1	42.6	41.0	57.7	57.3	52.0	53.0

Source: Danske Bank

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Christin Tuxen (Head of FX Research), Morten Helt (Senior Analyst), Jens Naervig Pedersen (Senior Analyst), Kristoffer Kjær Lomholt (Senior Analyst), Jakob Ekholdt Christensen (Chief Analyst), Stefan Mellin (Senior Analyst), Vladimir Miklashevsky (Senior Analyst), Allan von Mehren (Chief Analyst), Joachim Waldemar Bratlie (Assistant Analyst) and Aila Mihr (Analyst).

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Monthly.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research report has been prepared by Danske Bank (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided herein.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/A, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Report completed: 15 October 2018, 14:43 CEST

Report first disseminated: 15 October 2018, 16:30 CEST