

FX Top Trades 2024

Our guide on how to position for the year ahead

- For the 15th time, we are happy to present our FX Top Trades for the year to come.
- As a foundation for all trades, we start with a “*Setting the FX scene for 2024*” section, in which we briefly lay out our views for the key drivers of FX markets in the coming year. We then revisit these potential drivers with concrete arguments for each trade.
- We distinguish between more tactical Q1 2024 views, strategic trades for H1 2024 and more structural views to play out even later in 2024.
- We include both spot/forward and option strategies, with the latter allowing us to express longer-term views if/when short-term risks, for example, may run in the opposite direction.
- All the trades presented below – both spot and options – are included in the Danske FX Trading Portfolio. We will provide regular P/L updates on these.
- Entry prices are based on Bloomberg fixings at 14.00 CET the business day before publication, which for this edition is 5 December 2023.

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The FX Top Trades 2024 matrix: trades X themes

Trade x Driver	Instrument	Expected horizon	Cycle	Valuation /ToT	Relative rates	Equity vol and sectors	Long duration	Hard landing (Wild card)
#1: Long USD/SEK	Spot	6M	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#2: Long EUR/NOK	Options	6M	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#3: Long EUR/GBP	Spot	6M	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#4: Short EUR/USD	Options	6M	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
#5: Short EUR/JPY	Spot	6M	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
#6: Long EUR/DKK	Forward	12M	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#7: Short AUD/USD	Spot	3M	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#8: Long CZK/PLN	Spot	6M	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#9: Long USD/CNH	Forward	12M	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
#10: Long NOK/SEK	Spot	3M	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Source: Danske Bank

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Setting the FX scene for 2024

As we look for FX trading opportunities in the year to come, we highlight the importance of the global cycle, valuation, terms of trades, relative rates, relative equity sector performance and the outlook for duration. Also, the tail risk of a ‘hard landing’ is key. The purpose of this introduction is to briefly evaluate these spot drivers, which we will then revisit as arguments for our FX Top Trades 2024.

Late-cycle dynamics and the relative rates outlook

The rate of change to growth and inflation should remain a key driver of FX spot performance in 2024. Chart 1 depicts the global business cycle as a function of sequential growth (proxied by composite PMI) and inflation. 2022 was characterised by weaker growth and higher inflation (“stagflation”). 2023 has been a year of two halves: first stronger growth and weaker inflation (“goldilocks”), but since summer both weaker growth and weaker inflation (“deflation”). As laid out in *Nordic Outlook*, 5 December we expect H1 2024 to be characterised by weaker growth and weaker inflation impulses, although importantly elevated wage growth should keep global monetary conditions in contractionary territory even when factoring in likely rate cuts. In this environment, the USD tends to perform while the Scandies tend to be vulnerable – and often considerably.

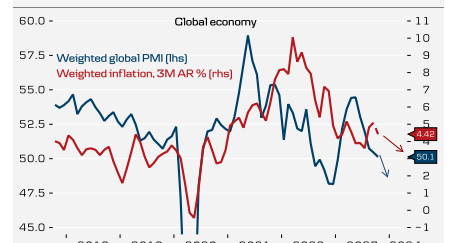
Monetary tightening has driven the global credit impulse to its tightest level since the GFC. Profit margins are pressured and labour markets are slowly but surely showing signs of weakness. Data releases increasingly exhibit late-cycle dynamics, and after a year characterised by one of the most aggressive rate-hiking cycles in history, next year looks to be more about rate cuts, barring a reacceleration of inflation. We expect the Fed to deliver its first 25bp rate cut in March, followed by corresponding cuts every quarter, totalling four 25bp cuts next year. For the ECB, we expect the first rate cut around summer, followed by two additional cuts, which is precisely the same as for the BoE. The BoJ is the only central bank in the G10 space where we expect a rate hike next year. We think the BoJ will end its negative interest rate policy in Q2. In the Scandies space, we think markets are wrong in pricing Norges Bank as a laggard in the cutting cycle and instead expect Norges Bank to be among the first central banks to cut rates – possibly as early as March. We also think the Riksbank is done hiking, and we pencil in the first rate cut in June, followed by two additional cuts over the year. Overall, we expect relative rates to be a headwind for the NOK, SEK, and GBP, while we expect relative rates to be a tailwind for the JPY. For EUR/USD, all else being equal, our expectations for the Fed and the ECB are a tailwind for the cross, but we highlight the importance of other drivers.

Tide is turning for the bond market

The level of yields and volatility in bond markets means the bond market should be key in 2024. We look for bond yields to decline next year, which would be positive for JPY and likely CHF. A key theme for the bond market next year, beyond development in monetary policy, will be how high-debt countries cope with a scenario with high deficits, high yields and falling inflation in terms of debt sustainability. E.g., if the bond market starts to worry about debt sustainability in the euro area or UK, it could hit the EUR and GBP.

While the ghost of 2022’s ‘mini-budget’ is still hovering over the UK and a landslide election win for the Labour party seems a very real possibility, we think ensuring solid public finances will be a key priority, regardless of the election outcome. Hence, we do not see the election as a big game changer for GBP. In terms of the US election, we do not expect big changes to fiscal policy, with the most likely outlook being a divided congress and thus more muted effect for the USD. In the event of Trump regaining the presidency, combined with Republicans taking both the House and the Senate, we see this as a negative scenario for risk sentiment given the elevated uncertainty it would bring.

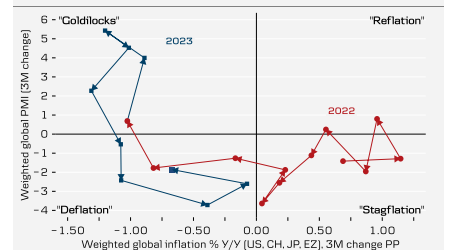
Chart 1: We expect 2024 to be a year of weaker growth and inflation



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

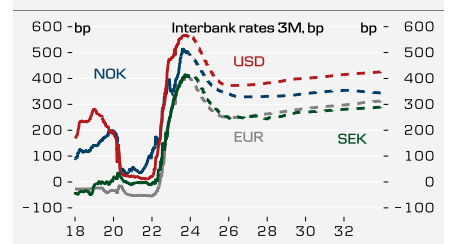
Chart 2: The global cycle depicted across four quadrants (growth x inflation)



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Chart 3: Central banks expected to initiate cutting cycles in 2024



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

FX winner persistence, valuation and 2024 as transition year

While PPP acts as a very long-term anchor for FX valuations – bar any Balassa Samuelson effects – we believe FX market performance in the medium-term first and foremost reflects the relative attractiveness of asset markets and thus the type of exposure each currency implicitly gives to global portfolio managers. We believe this is also why we see a very large persistence in the winners and losers of spot FX over periods of around 5-10 years.

An example is the decade between the global financial crisis and outbreak of COVID-19, in which commodity and industrial FX lost out to tech-FX and not least the USD – a complete opposite of the price action in the preceding noughties. Regimes of equity sector- and hence FX-persistency often end with some inflationary or deflationary shock. Examples of such are the breakdown of Bretton Woods, the re-unification of Germany, China membership of WTO, Lehman Brothers etc. In the initial aftermath of such a shock, a transition period follows in which markets evaluate and try to adapt to the new market environment, often driven by some policy response – similar to what we have seen in 2023.

The COVID-19 crisis and subsequent policy-induced inflation shock have the potential to change the equity sector and FX regime for the decade ahead. However, in our base case, 2024 will turn out as yet another transitional year in which the key question remains the global economy’s degree of resilience to the last few years’ historic monetary tightening. Consequently, we believe much of the 2024 opportunities in the FX space will be founded in more traditional valuation-, relative rates- and cycle-style strategies.

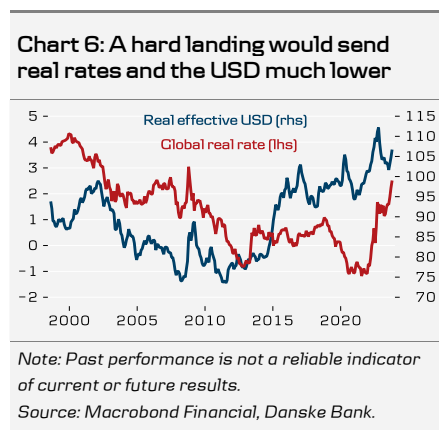
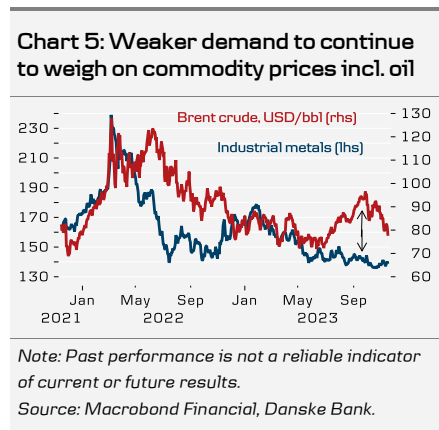
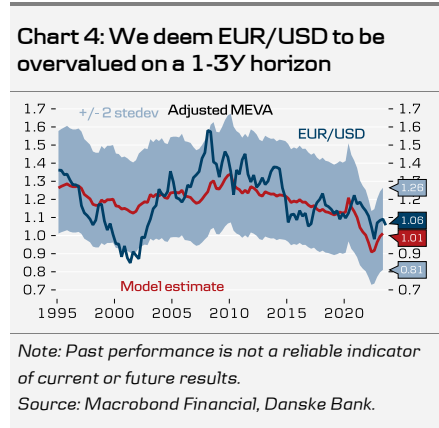
As our followers will know, we like to look at 1-3Y valuation as a function of three variables: relative terms of trades (margin proxy), unit labour costs (cost-adjusted productivity proxy) and real rates (growth proxy). In our view, these variables go a long way in describing residuals from PPP. In this framework we still expect some gravitational force to weigh on EUR/USD in 2024 as the US on a relative basis enjoys lower unit labour costs, higher real rates and not least the benefit of being a net energy exporter. The signals for the Scandies are blurrier – and very sensitive to the global business cycle.

Wide outcome space for commodities and the hard landing risk

The outcome space for commodity prices and in particular energy prices next year is wide. The market has to encompass tail risk ranging from a hard landing of the global economy that would likely trigger a sharp sell-off to a further escalation of geopolitical tensions that could trigger a spike in prices. These tail risks are important to keep in mind when looking at the outlook for G10 currencies via the terms of trade channel. In our view, commodity price hikes would benefit USD and likely the commodity basket of AUD, CAD, NZD and NOK, while hurting JPY and EUR.

We doubt a geopolitical-induced rise in commodity prices would lead central banks to tighten further – they would likely keep their eyes on core inflation – but a hard landing-induced price drop could be a precursor to monetary easing. More broadly, a risk-off environment in the case of an escalation in geopolitical tensions would benefit CHF, JPY and USD and leave the cyclically sensitive Scandies under pressure. While we do not expect an escalation, neither do we see a near-term resolution on the cards.

A key risk is that of a much harder ‘landing’ for the global economy. If we look at USD OIS real rates and inflation curves, markets still price a very soft version of the global landing. The dollar indisputably remains crucial for global monetary conditions via USD pegs and USD-denominated debt, commodities and trade invoices. Consequently, in a hard landing scenario we would expect the USD to weaken substantially – after an initial squeeze higher – while cyclically sensitive currencies like NOK, SEK and AUD look vulnerable.



Ten FX Trades

Trade # 1. Long USD/SEK

- We recommend to buy USD/SEK on relative fundamentals, a bleak global growth outlook, relative rates and global equity volatility.
- We recommend a long USD/SEK spot position with a soft target of 11.05.
- The biggest risk is related to a much more benign environment for global equities.

November drop in USD/SEK – a correction, not a trend reversal

November proved to be the worst month for USD/SEK since the aftermath of the Global Financial Crisis, with a substantial intra-month drop of 97 figures. Like in July, the USD decline accelerated after a mid-month surprise in US CPI data, which has been among the most important general macro market movers this year, triggering a USD selloff, lower US yields and higher equities (chart 1.1). As such, both relative yield convergence (rates channel) and flight from dollar-negative and rebalancing flows (risk channel) have weighed on USD/SEK. We do not think this move will extend into 2024.

With rate cuts of around 125bp priced in from the Fed next year, we think the room to price in an even steeper easing trajectory where it moves more aggressively, also vs peers, is limited – at least in a soft-landing scenario. In a hard landing scenario, we would expect all central banks to cut rates aggressively but USD/SEK would likely rise in the immediate market environment following such repricing. Hence, we expect USD headwinds from relative yields and a rebound in risk appetite to be contained. Given the outlook for tighter margins and lower global demand we expect heightened equity volatility. In a scenario where the US, and thus the global economy, heads towards a hard landing, cyclical currencies like the SEK should face headwinds vs USD.

Besides the fact that a slowdown in global growth momentum is inherently positive for USD/SEK, the cross is underpinned by relative GDP growth, where the US economy has significantly outpaced Sweden (chart 1.2) while highly indebted and rate-sensitive Swedish households and real estate suffer heavily from higher interest rates.

Relative monetary policy has been a negative factor for the SEK during the global tightening cycle as the Riksbank has lagged peers and, most importantly, lagged the Fed. Now, we think that both are done and we pencil in a gradual easing cycle where the Fed starts in late Q1 with a total of 100bp cuts through 2024, and where the Riksbank starts in late Q2 with a total of 75bp cuts through next year. Hence, in contrast to the Fed ‘pivot’, where the Fed proceeds much more aggressively than other central banks, we expect them to move more in tandem.

For FX, this means that the USD yield advantage will probably still apply throughout 2024. Specifically, we do not think that the Riksbank will be a laggard when it comes to making monetary policy less restrictive, since this would arguably do too much harm to the domestic economy, which is already an Achilles’ heel for the SEK. Hence, relative yields will likely continue to be a medium-term headwind for the SEK. After the recent correction, USD/SEK has moved from being slightly overbought to distinctly oversold given current pricing of monetary policy (chart 1.3). We see the recent correction as temporary and an attractive opportunity to enter a long position in USD/SEK.

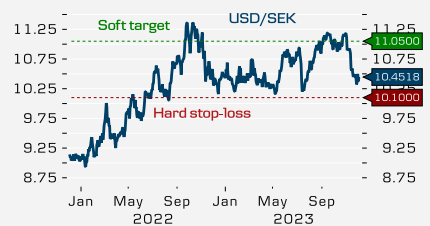
Key risks: the Fed significantly out-cuts peers

We identify three risks to the trade: the Fed cuts significantly more than markets are currently pricing, global equities have a stellar year ahead and/or the global economy and the Swedish in particular surprise strongly to the upside.

Trade # 1. Long USD/SEK

Long USD/SEK spot outright

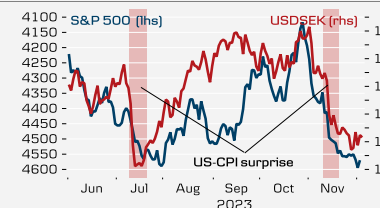
Entry date	5 December 2023
Spot ref.	10.4518
Target (soft)	11.0500
Stop-loss (hard)	10.1000



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

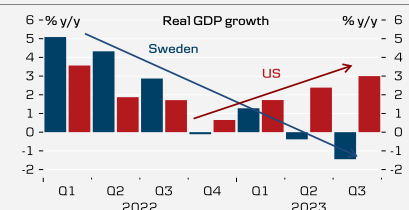
Chart 1.1: Drop in USD/SEK amid higher equities – not a repeated game



Note: Past performance is not a reliable indicator of current or future results.

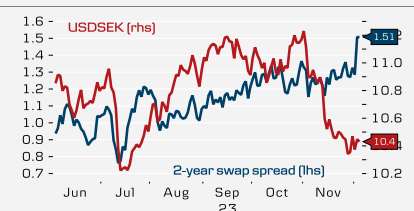
Source: Macrobond Financial, Danske Bank.

Chart 1.2: Real GDP growth momentum favours USD/SEK



Source: Macrobond Financial, Danske Bank.

Chart 1.3: Oversold USD/SEK



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Trade #2. Long EUR/NOK

- External investment environment, domestic macro looks set to weigh on NOK.
- We recommend to buy EUR/NOK as a 6M strategic trade.
- Year-start NOK performance is a risk, which is why we favour options to spot.

2024 likely to prove another poor year for NOK

We recommend to buy topside exposure in EUR/NOK as a 6M trade, on two arguments.

Global investment environment. We still believe that the NOK first and foremost should be treated as a higher beta derivative of the global investment environment and, by extension, the global business cycle and relative equity sector outlooks. In the environment that we pencil in for next year, where growth weakens, inflation impulses fade on loosening labour markets and monetary conditions globally remain tight, the NOK almost never performs well. In fact, in the G10 space NOK has been among the most vulnerable in such environments, with clear left-skewed return distribution (large drawdown risk) clearly favouring a short NOK position. Also, given our view on the asymmetric balance of risks (skewed to the downside) for energy prices, this should also limit the strength potential amid OPEC+ increasingly running empty on production cut capabilities.

Finally, from a pure tail risk perspective, we note how real rates and inflation markets still price in a very extreme version of the soft landing. Should things turn out as we outline (slightly harder landing) or even uglier than that, the NOK looks set to suffer and potentially even considerably more than in our base case. In our view, the tail risk related to a hard landing requires a higher risk premium built into NOK FX than is currently the case.

Domestic macro case. Markets still price Norges Bank as a laggard in the global rate cutting cycle next year. We think that is wrong. Not only do we believe that Norges Bank will leave rates unchanged at the 14 December meeting but we also think that Norges Bank could be among the first to cut policy rates in the G10 – possibly as early as March. We see clear signs of the mainland economy slowing, and recent data on inflation expectations, employment growth and the Regional Network Survey clearly suggests that Norges Bank has vastly overestimated the output gap and the 2024 wage growth outlook. Also, if we are right in inflation coming sharply lower in the coming months, we think the flexible medium-term and model-based approach to setting policy rates could weigh sharply on NOK-EUR rates spreads during 2024.

Key risks and the choice of options

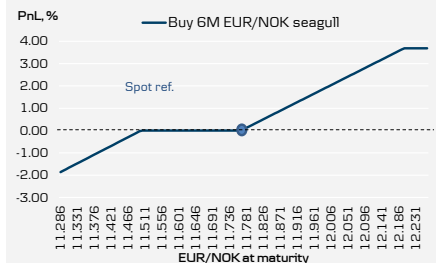
The primary risk related to our trade is if we are wrong in our call on the global environment for H1 2024. Should global growth re-accelerate, a short NOK position is likely to suffer. By extension, valuation is also a risk factor. NOK has been on a weakening path since 2013 in a move we attribute to two things: elevated unit labour costs and a hit to the financial account (portfolio and direct investments) stemming from the underperformance of energy and commodities over the last decade. We expect the next 5Y to be much better for NOK. However, as described in “Setting the Scene”, we think 2024 will be another transitional year that should postpone the NOK potential for at least a year. That said, near term there is a risk of a January-start rebalancing induced NOK performance (see Trade #10), which is why we prefer to express our view via options.

In sum, we like to express our bullish H1 2024 view on EUR/NOK via options. We recommend to enter a 11.5000-11.7661-12.2000 6M bullish seagull (spot ref 11.7661, cost neutral), which creates the topside exposure but with a lower near-term delta.

Trade #2. Long EUR/NOK

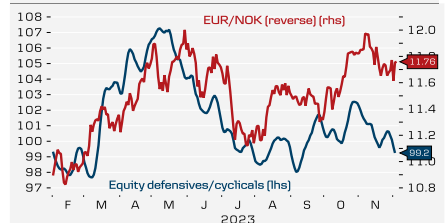
Long EUR/NOK via 6M bullish seagull

Entry date	5 December 2023
Strategy	Sell 6M 11.5000 put Buy 6M 11.7661 call Sell 6M 12.2000 call
Spot ref:	11.7661
Cost:	Cost neutral (indicative prices)
Stop (spot)	11.2500



Source: Bloomberg, Danske Bank.

Chart 2.1: We like the EUR/NOK upside on an underperformance of cyclically sensitive assets ...



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Chart 2.2: ...and the NOK return distribution clearly favours a short NOK position

	Monthly return (ann.) by growth x inflation quadrants (last 15Y)			
	Stagnation	Deflation	Reflation	Goldilocks
USD	3%	13%	-10%	4%
NOK	5%	-13%	7%	-2%
SEK	-2%	-5%	5%	-1%
GBP	0%	-1%	5%	-9%
AUD	5%	-8%	7%	-1%
BRL	5%	18%	2%	-1%
CAD	4%	-4%	5%	-4%
CHF	3%	7%	-2%	8%
CZK	1%	-3%	4%	1%
HUF	-5%	-9%	2%	3%
JPY	2%	16%	17%	2%
MXN	5%	-7%	3%	-4%
NZD	2%	-8%	14%	-3%
PLN	-3%	-10%	5%	5%
ZAR	-7%	-13%	6%	5%

Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Trade #3. Long EUR/GBP

- 2024 is set to be a challenging year for the GBP on the back of central bank repricing and diverging growth outlooks.
- We recommend a long outright spot EUR/GBP position with a 6M investment horizon. We set a soft target of 0.9050 and a hard stop-loss at 0.8350.
- The key risk to this trade is the UK economy outperforming the euro area and a hawkish repricing of the Bank of England.

Diverging growth outlooks and central bank repricing

After a sharp decline in the spring of 2023, EUR/GBP has steadily climbed higher during the autumn. We believe there is room for further topside over the course of the next year, on the back of diverging growth outlooks and central bank repricing.

We see the inflation picture as a double-edged sword for GBP. If inflation broadly declines in line with rest of peers (our base case), this would likely trigger markets to front-load rate cuts in line with our call, acting as a headwind for GBP. In inflation proves to be more persistent on the back of elevated wage growth or inflationary fiscal policy, it might add near-term support to GBP. But if rates are to stay elevated for a prolonged period of time or the BoE is forced to trigger a sharper downturn in the economy to get inflation back to target, we ultimately believe it would also act as a negative for GBP. Additionally, we expect the UK economy to perform worse than the euro area while challenged by the fiscal backdrop and continued concerns over debt sustainability.

By extension, we see relative rates as an argument to be short GBP vis-à-vis EUR. We expect both the BoE and the ECB to deliver the first 25bp cut in June 2024 and subsequently cut once a quarter for the remainder of 2024. Where markets already expect the first 25bp cut from the ECB in April, markets recently have scaled back on BoE expectations, now expecting the first cut in August (chart 3.1).

In our base case, we pencil in a soft landing for the global economy, where we expect the first half of 2024 to be characterised by weaker growth and weaker inflation impulses. However, there is a key risk of a much harder ‘landing’ for the global economy. In this event, coupled with a sharp sell-off in risk, GBP becomes vulnerable, especially if capital inflows dry out and liquidity becomes scarce. This is because the UK runs a large current-account deficit. This was particularly evident during the COVID-19 pandemic and the global financial crisis (see chart 3.2). Likewise, as illustrated in chart 3.3, the outcome space is asymmetric for GBP when considering daily returns in the equity space. Over the past 10 years, the negative effect on GBP vs EUR on a day where equities performed poorly largely outweighed the corresponding positive days.

In sum, we recommend entering a spot outright short GBP position vs EUR with a soft target of 0.9050 and a hard stop-loss of 0.8350 as a play on relative growth outlooks and central bank repricing. There is negative carry of 130bp (annualised), which is slightly less than past years.

Key risks: UK economy outperforming and sharp BoE repricing

The key risk to our trade is the UK economy considerably outperforming the euro area. Likewise, inflation sustainably returning to target, coupled with an acceleration in global growth, poses a downside risk to the cross. While we ultimately believe a sharp repricing of the BoE would prove negative for GBP, it could add support in the near term.

Trade #3. Long EUR/GBP

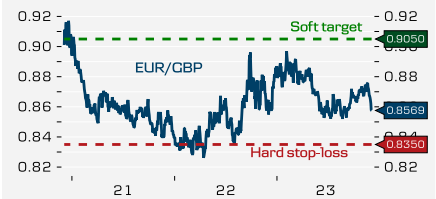
Long EUR/GBP spot outright

Entry date 5 December 2023

Spot ref. 0.8569

Target (soft) 0.9050

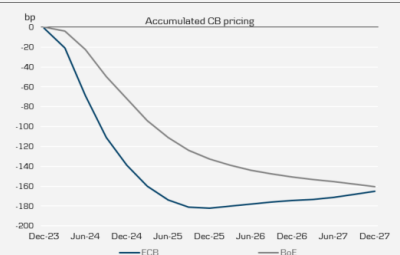
Stop-loss (hard) 0.8350



Note: Past performance is not a reliable indicator of current or future results.

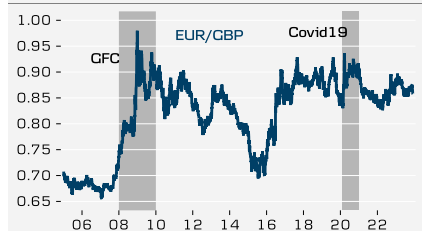
Source: Macrobond Financial, Danske Bank.

Chart 3.1: Diverging CB pricing



Source: Macrobond Financial, Danske Bank.

Chart 3.2: Liquidity shocks leave GBP vulnerable



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Chart 3.3: Asymmetric outcome space for GBP

10Y History Percentiles	MSCI LOC Corresp levels	Groups	GBPUSD	GBPCHF	GBPEUR
001	-2.69%	<0.01	-0.9%	-1.0%	-0.8%
005	-1.39%	0.01 to 0.05	-0.3%	-0.4%	-0.3%
01	-0.89%	0.05 to 0.1	-0.2%	-0.2%	-0.1%
05	0.06%	0.1 to 0.9	0.0%	0.0%	0.0%
09	0.94%	0.9 to 0.95	0.2%	0.2%	0.1%
095	1.32%	0.95 to 0.99	0.3%	0.3%	0.2%
099	2.32%	>0.99	0.3%	0.3%	0.1%

Note: Past performance is not a reliable indicator of current or future results.

Source: Bloomberg, Danske Bank.

Trade #4. Short EUR/USD

- We generally believe the global investment environment will be characterised by weak global growth, declining inflation, and elevated volatility.
- In this environment, we like being short EUR/USD in 2024.
- The key risks to this trade are either declining inflation linked with accelerating growth or a hard landing.

Growth fundamentals to underpin a stronger USD

We expect the narrative of weaker growth and declining inflation since the summer to continue into the first half of 2024. We would expect this kind of environment to be favourable for the USD. Given our expectations for the Fed and the ECB, the prospect of a narrowing rate spread between the US and the euro area would, all else being equal, be a tailwind for EUR/USD. However, we expect growth fundamentals to outweigh this effect. Despite weakening signs in the US economy during Q4, on a relative basis, we deem the US economy is on a stronger footing than the underwhelming euro area economy, which is also susceptible to various risks, such as a surge in energy prices, debt sustainability and/or weak Chinese growth.

Our medium-term fair value (1-3Y horizon) for EUR/USD is just above parity at 1.01, and hence we believe that the cross is currently overvalued from a fundamental perspective. IMM positioning is long the EUR, indicating investors are skewed towards higher EUR/USD. Generally, the consensus view is a stronger EUR/USD next year. This overexposure could precipitate sharper movements on adverse news or data releases, e.g., if investors begin to shift their focus from waning inflation momentum to weaker sequential growth, this could initiate a risk-off period that negatively impacts high-yielding assets and supports the broad USD.

We like to express our macro view by an options trade instead of a spot trade, due to our view of upside risk to EUR/USD in the near term. From a risk-reward perspective, we find value in buying a 6M ATM put-spread. We deem that the current volatility looks neutral-to-cheap and would expect volatility to go higher during the horizon (chart 4.4). This strategy provides a structured approach to benefit from a potential decline in EUR/USD, while defining and limiting the risks associated with the options structure.

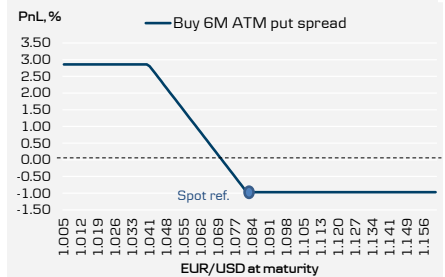
Key risks: re-acceleration in global growth or a hard landing

The key risks are inflation sustainably returning to target, coupled with acceleration in global growth. In that case, markets would likely be driven by a positive risk appetite, hurting the broad USD. Additionally, a hard landing scenario would likely ultimately result in a substantially weaker USD after an initial squeeze higher.

Trade #4. Short EUR/USD

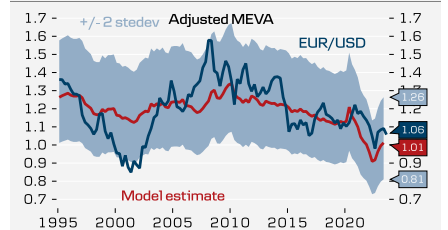
Long 6M ATM put-spread in EUR/USD

Entry date	5 December 2023
Strategy	Sell 6M 1.0400 put Buy 6M 1.0814 put
Spot ref:	1.0814
Premium:	105 pips paid (indicative prices)



Source: Bloomberg, Danske Bank

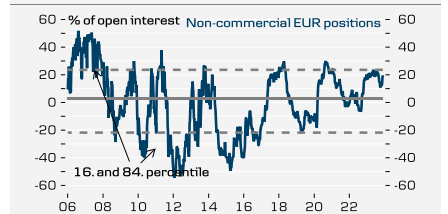
Chart 4.1: Medium-term EUR/USD fair value just above parity



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

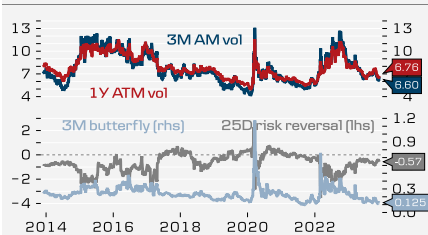
Chart 4.2: Long EUR positioning suggests asymmetric outcome space



Note: Past performance is not a reliable indicator of current or future results.

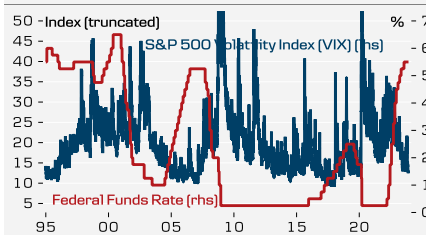
Source: Macrobond Financial, Danske Bank.

Chart 4.3: EUR/USD vol. has declined



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond Financial, Danske Bank.

Chart 4.4: Fed tightening cycles usually leads to higher volatility



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond Financial, Danske Bank.

Trade #5. Short EUR/JPY

- We think global yields have peaked, which should be a headwind for EUR/JPY in 2024.
- Weak euro area growth and declining inflation will probably force the ECB to cut rates during next year, while it could be the year when the BoJ abandons the YCC and hikes the (still negative) policy rate.
- Key risks consist of rising energy prices and/or upward pressure on global yields.

Declining global yields and weaker global growth suggest changing fortunes for the JPY

The long JPY trade has been the widow-maker in the past couple of years. Relative to both the USD and the EUR, the JPY was clearly the worst performer in the G10 space in 2023. Specifically, the diverging rate differentials, dictated by the Fed and the ECB on one side and the BoJ on the other, have been the main reasons for JPY weakness in 2023. That divergence could switch in 2024, where generally we expect global bond yields to decline, potentially a turning point for the JPY. Furthermore, we expect persistent inflationary pressures in Japan to pave the way for the BoJ to exit its yield curve control (YCC) policy and raise the short-term policy rate out of the current negative territory, a move we anticipate by Q2. Two key events for such a shift are a US soft landing and the outcome of the spring wage negotiations for the fiscal year 2024 in Japan, which could result in another year of elevated broad-based wage growth.

Short EUR/JPY is notoriously a negative carry trade, and carry-to-risk for short EUR/JPY is also in negative territory. According to IMM non-commercial positioning, investors are stretched short the JPY.

We express our bearish EUR/JPY view by selling EUR/JPY spot outright with a soft target of 149.9 and a stop-loss of 164.3. We acknowledge it is an expensive trade with negative carry amounting to 170 pips on 3M, but we believe there is scope for the JPY to appreciate in the G10 space next year. The trade should also be favourable in tail-risk scenarios, such as the aforementioned hard landing.

Key risks: rising energy prices and/or renewed surge in global yields

The biggest risks to the trade are a sharp rise in the oil price, for example due to OPEC+ cutting oil output significantly. Additionally, a renewed rise in global bond yields also poses a risk to this trade.

Trade #5. Short EUR/JPY

Short EUR/JPY spot outright

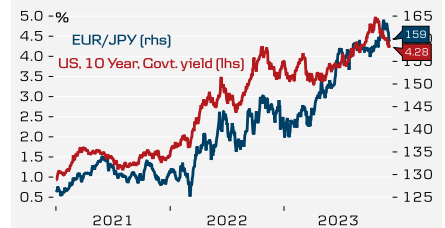
Entry date	5 December 2023
Spot ref.	159.04
Target (soft)	149.9
Stop-loss (hard)	164.3



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Chart 5.1: Trajectory of EUR/JPY hinges on the outlook for US Treasury yields



Note: Past performance is not a reliable indicator of current or future results.

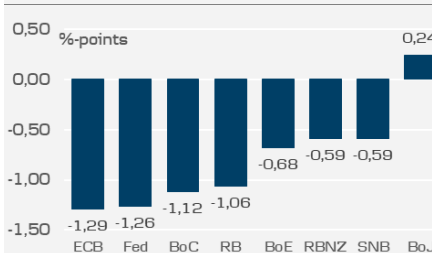
Source: Macrobond Financial, Danske Bank.

Chart 5.2: Inflation expectations in Japan do not align with a negative policy rate



Source: Bloomberg, Danske Bank

Chart 5.3: Despite a consensus of rate cuts in G10, pricing suggests the BoJ will exit negative policy rate next year



Source: Bloomberg, Danske Bank

Trade #6. Long EUR/DKK

- We go long EUR/DKK on a 12M forward outright below recent intervention level.
- Outcome space for the spot is symmetrical at current level. Carry is still high.
- Long EUR/DKK 12M FX forward outright offers a low-risk carry trade.

Carry still looks attractive despite higher spot level

For the third year in a row, we go long EUR/DKK in a 12M forward outright in our FX Top Trades. EUR/DKK spot trades around 7.4557 (indicative mid) with roughly two figures of distance to either side of the historical trading range. Hence, the spot level for entering a long position is not as attractive as in the past two years, where it traded in the low end of the trading range at this time of the year.

However, carry still favours going long EUR/DKK. A 12M FX forward offers 253 pips (indicative mid) in carry, which leaves the forward outright below the 7.4360-65 level, where Danmarks Nationalbank (DN) bought EUR/DKK in FX intervention in 2022. Hence, the basic argument for our trade still holds: the trade should earn a profit when held to maturity as long as DN floors EUR/DKK around 7.4360-65.

A rise in the spot would add to the return. Although we expect the spot to trade around the current level next year, it would be susceptible to a sudden rise if global financial markets were hit by a bout of negative risk sentiment. Such a scenario would hit DKK along with SEK and NOK. Domestic investors already look to be long positioned in EUR/DKK, which would make a persistent rise more difficult.

Key risks: MTM risk from sudden inflow to DKK

If DN maintains the EUR/DKK spot within the historical trading range, risk to the trade, if it is held to maturity, is minimal. However, mark-to-market on the FX spot and forward points are at risk if investors, both foreign and domestic, suddenly rush into DKK as in 2015, in which case the spot would drop and the discount in FX forwards would rise significantly. In other words, the 12M FX forward outright trades around 200 pips higher than it did at the same time last year. It is possible to reduce the mark-to-market risk on the FX forward points slightly by going long on the 9M tenor instead, which (indicative mid) trades around the 7.4360-65 floor.

Trade #6. Long EUR/DKK

Long EUR/DKK 12M Forward outright

Entry date	5 December 2023
Spot ref:	7.4557
Forward ref:	-253 pips
Target (soft):	7.4730 (spot)
Stop-loss (hard)	7.4350 (spot)
Leverage*:	10x

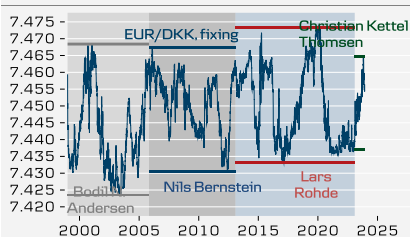
*We leverage this trade to have a total return target, which is on par with other low vol trades such as EUR/USD.



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank

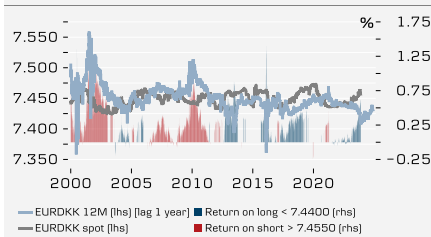
Chart 6.1: Spot in the middle of the range



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Chart 6.2: High hit ratio on long position in 12M fed below 7.4400



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Trade #7. Short AUD/USD

- Global growth is set to cool in 2024 as monetary policy remains restrictive.
- Weaker demand outlook is already weighing on commodity exporters' terms-of-trade.
- Market underestimates the likelihood of RBA cutting rates already in 2024.

Relative monetary policy and risk sentiment bring headwinds to AUD

November was characterised by weaker economic data fuelling optimism around cooling inflation, but we doubt the uptick in risk-sensitive currencies will persist far into 2024. We continue to see cyclical headwinds for most major economies, which should eventually turn markets' focus from inflation back to recession risks. We think that an environment of slow global growth and restrictive monetary policy favours USD vis-à-vis cyclical currencies.

We prefer to play this by going short AUD/USD spot. Australian terms-of-trade has weakened in 2023, and given the modest outlook for global growth and Chinese stimulus, we do not foresee a significant recovery in the prices of key Australian export commodities. We also forecast Chinese GDP growth remaining below potential in 2024.

In addition, relative monetary policy is likely to turn into a headwind for the cross. While the Reserve Bank of Australia (RBA) surprised by delivering another hike at the November meeting, the latest PMI data clearly suggests that the Australian economy is now headed for a slowdown. The market prices in around 20% probability of an additional hike and the first chance of a cut only in late 2024, which we consider too tight given the economic outlook. Meanwhile, in the US, markets are now pricing 125bp worth of Fed rate cuts for 2024 as a whole, which is more than our call of four 25bp cuts. We see the relative probability of RBA cuts as larger than the probability of the Fed having to cut rates faster than thought.

On a structural basis, we think that the US economy's potential growth remains on a more solid footing, backed by fiscal policy, faster productivity growth and recovering labour supply. This should continue to underpin demand for USD-denominated assets over the medium term.

Relative monetary policy, terms-of-trade, structural growth trends and the near-term outlook for risk sentiment all favour a downtick in the cross. We go short AUD/USD spot with a soft target of 0.6300 and a hard stop-loss of 0.6750. The time horizon for the trade is three months. The trade has a small positive carry.

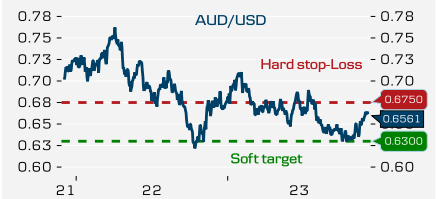
Key risks: growth recovery, rapid US disinflation

Some leading indicators for the global manufacturing cycle have appeared to bottom out lately, and a stronger-than-expected uptick for global manufacturing could provide further support for AUD/USD as well. Furthermore, while we expect to see gradual cooling in US inflation pressures towards 2024, signs of faster US disinflation could fuel weakening in broad USD. Finally, renewed geopolitical tensions could spark two-way volatility in the cross via both higher commodity prices (positive ToT shock for AUD) and weaker risk sentiment (safe haven demand for USD).

Trade 7. Short AUD/USD

Short AUD/USD spot outright

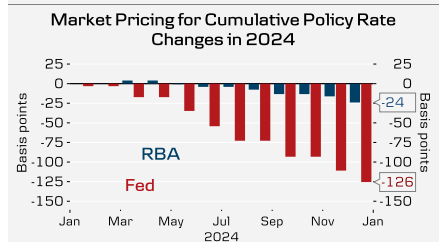
Entry date	5 December 2023
Spot ref.	0.6561
Target (soft)	0.6300
Stop-loss (hard)	0.6750



Note: Past performance is not a reliable indicator of current or future results.

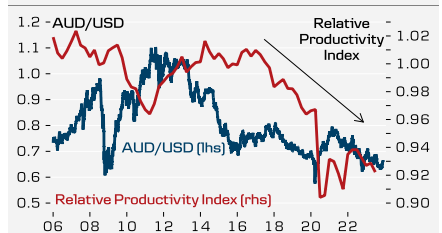
Source: Macrobond Financial, Danske Bank

Chart 7.1: Market underestimates the probability of RBA rate cuts relative to the Fed



Source: Refinitiv

Chart 7.2: Stronger potential growth favours USD in the long run



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, OECD

Trade #8. Long CZK/PLN

- A lot of positives already look priced into PLN...
- ... whereas CZK unjustifiably has lagged CEE peers.
- Cyclical outlook and investment environment favours long CZK/PLN.

Unjustified CEE divergence to reverse in 2024?

Following a rough start to the year, the Polish zloty is one of the top performers within EM FX with a YTD gain vs EUR just above 7%. However, it has been quite a volatile ride, and following a dovish surprise by the Central Bank of Poland (NBP) in September, the zloty found itself, albeit briefly, back at square one. Since then, we have seen a renewed rally on the back of yet another NBP turn (this time hawkish) and, more importantly, the pro-EU opposition win in the general election held in October. The latter is key for unlocking frozen EU funds of EUR35bn, and as such is seen as bullish for Polish assets, including the zloty. At the other end of the spectrum we find the Czech koruna, which has lagged peers (PLN, HUF) and instead weakened 4% vs EUR since the end of Q1 from headwinds relating to weak domestic growth and dovish bets on the Czech Central Bank (CNB), which notably are yet to materialise as actual rate cuts. The diverging fortunes of PLN and CZK during the last few quarters have pushed down CZK/PLN to the lowest levels since late 2021, and with arguably a lot of positive news already being priced into the PLN, we deem the cross increasingly ripe for corrections higher in the short term.

The Polish equity market, as arguably the most investable (at least in terms of liquidity) within CEE, has had a stellar year, with Wig20 outperforming not only European peers but also its Czech counterpart, the latter by almost 10%. This has likely contributed to increased PLN inflows throughout the year and has seemingly helped the PLN outperform peers (see chart 8.1). However, the tide might soon turn. As laid out in “Setting the Scene”, we expect at least the first half of 2024 to be characterised by weaker growth and inflation impulses: a deflationary environment that in previous cycles has proven more painful for the PLN than the CZK. Additionally, although the CZK has suffered more from gloomy growth prospects during 2023, the Polish economy is as exposed, if not more, to European cyclicality and especially German growth prospects. Although the prospect of a relatively near-term disbursement of the previously frozen EU funds (EUR35bn) is rightly seen as a positive for Polish growth prospects, it is unlikely to be a fix-all solution in a scenario whereby European growth disappoints. Finally, the CNB has shown constraint and defied market expectations of interest rate cuts, citing the need to proceed with caution and with a methodological (and credible approach). This is in stark contrast to recent actions by NBP, which have been unpredictable, to say the least. Although the CNB is likely to start cutting rates during the first half of 2024, we believe it will still retain a positive rate differential against the NBP as the latter is likely to recommence with rate cuts around the same time.

As such, with cyclical headwinds still in place for 2024 and uncertainty still running high, we argue that too much positivity is currently priced into the PLN, especially compared to the historically more reliable CZK. Hence, we recommend to go long CZK/PLN spot at 0.1775, with a target of 0.1900 and a hard stop-loss at 0.1700 with a 6M time horizon.

Key risks: dovish CNB and/or resilient global risk sentiment

One of the key risks is that the CNB turns around sharply and starts cutting interest rates aggressively, outpacing cuts from NBP. An additional risk relates to the global investment environment, where a prolonged period of benign risk sentiment is likely to continue to favour PLN over CZK.

Trade #8. Long CZK/PLN

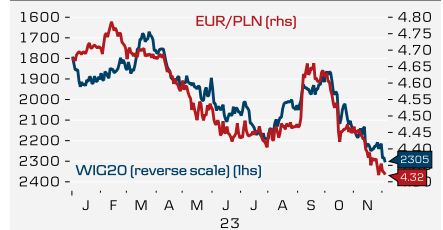
Long CZK/PLN spot outright

Entry date	5 December 2023
Spot ref.	0.1775
Target (soft)	0.1900
Stop-loss (hard)	0.1700



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond Financial, Danske Bank.

Chart 8.1: PLN tailwinds from equities to be reversed in 2024



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond Financial, Danske Bank.

Chart 8.2: In contrast to market expectations, we expect CZK to retain carry advantage vs PLN



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond Financial, Danske Bank.

Trade #9. Long USD/CNH

- The Chinese economy continues to face headwinds over the coming year from the housing crisis, low consumer confidence and weak exports.
- We look for USD/CNH to stay in an upward trend towards 7.50 in 12M on the back of a weak Chinese macro backdrop and expectation of renewed USD strength during 2024. Positive carry also speaks in favour of the trade.
- We recommend a long USD/CNH position spot outright with 12 months' investment horizon. We set a soft target of 7.50 and a hard stop loss at 6.95.

Weak growth, USD strength and carry support long USD/CNH

We continue to see the trend in USD/CNH to be upwards, despite the recent pause. First, Chinese growth continues to be soft and will be in need of policy support as the housing crisis shows little sign of easing (chart 9.1) and the service sector has weakened lately. We expect more monetary easing through a lowering of the Reserve Requirement Ratio and possible further rate cuts on top of more fiscal stimulus. Second, the outlook for a stronger USD on a 12M horizon also speaks in favour of a further rise in USD/CNH as USD strength tends to be associated with USD appreciation against the CNH as well (chart 9.2). Finally, we like the trade because it has a decent positive carry as US rates are markedly higher than Chinese rates (chart 9.3).

Key risks: USD weakness and Chinese recovery

One key risk to the trade would be if the USD fails to strengthen on a 12M horizon, as a weaker USD tends to push USD/CNH lower as well. Another risk would be if China's government initiates more drastic measures and manages to turn the housing crisis and lift sentiment on China. Finally, PBOC has put the renminbi on a shorter leash lately by keeping the daily fixing at a stronger level than the spot rate. If it chooses to strengthen this semi-peg it could put a cap on USD/CNH below our target.

Trade #9. Long USD/CNH

Long USD/CNH 12M forward outright

Entry date	5 December 2023
Spot ref.	7.1552
Forward, 12M:	6.9795
Target (soft)	7.5000
Stop-loss (hard)	6.9500



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank

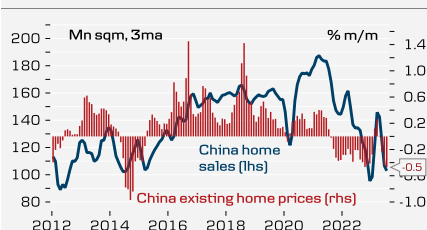
Chart 9.3: Positive carry in long USD put upside pressure on USD/CNH



Note: Past performance is not a reliable indicator of current or future results.

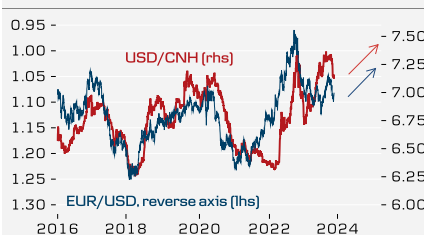
Source: Macrobond Financial, Danske Bank.

Chart 9.1: China's housing crisis shows little sign of easing



Source: Macrobond Financial, Danske bank

Chart 9.2: A stronger USD tends to push up USD/CNH



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Trade # 10. Long NOK/SEK

- We think NOK/SEK could find 1-3M support from valuation, seasonality.
- We favour a tactical long spot position.
- In our base case, we look to book a profit on the trade towards end-January.

Negative on both; but near-term topside NOK/SEK potential

As explained in Trades #1 and #2, we are negative on both NOK and SEK in trade-weighted terms for 2024. In fact, we see many similarities when it comes to headwinds for the two Scandi currencies in the year ahead. Both currencies are very sensitive to the global investment environment, have central banks with the potential to lead a global rate-cutting cycle, and both represent economies with vulnerable households amid very potent monetary policies. That said, while we are negative on both NOK and SEK, we think long NOK/SEK is an attractive position, which also delivers a partial hedge to our portfolio as we enter the new year. Consequently, we recommend a long NOK/SEK spot position, which we consider to be a 1-3M trade. In our base case, we plan to book a profit towards the end of January.

The primary reasons for this trade are two-fold: valuation and seasonal drivers. First, on valuation, we can explain roughly two thirds of the daily volatility in NOK/SEK via three variables: i) relative rates, ii) relative terms of trade, i.e. energy prices, and iii) relative equity sector performance. Chart 10.1 shows such a regression model for the last 10Y with stationary residuals. Following the last month's SEK rally, the model signal is very clear: NOK/SEK is substantially oversold with a fair-value estimate of 1.03. While we will always be cautious in over-interpreting such model signals we do intuitively also believe that the cross has come down too rapidly over the last month, and borderline technical oversold signals support this. Also, even when taking into account the recent substantial underperformance of the energy complex in the equity space, the sell-off in NOK/SEK looks overdone and on balance we see topside potential in energy vs industrials in the equity space in the near term.

Secondly, NOK/SEK could find some support in the beginning of January on both rebalancing flows and on NB lowering its fiscal NOK FX sales amount. As chart 10.2 shows, NOK/SEK has historically had a very clear seasonal pattern in January and February and we expect this to be repeated irrespective of whether Norges Bank hikes rates or not.

Key risks: a sharp deterioration to global risk appetite

The biggest risk to this trade is a sharp sell-off in global equities and/or energy prices, in which case we would expect NOK/SEK to come lower. However, we think that the potential for a move lower in NOK/SEK is much more limited from current levels.

Trade # 10. Long NOK/SEK

Long NOK/SEK spot outright

Entry date 5 December 2023

Spot ref: 0.9606

Target (soft) 1.0100

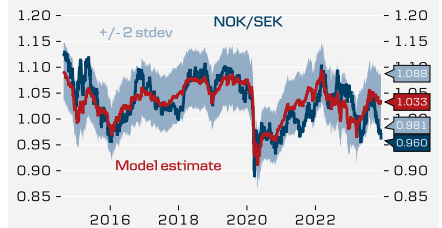
Stop-loss (hard) 0.9350



Note: Past performance is not a reliable indicator of future results.

Source: Macrobond Financial, Danske Bank

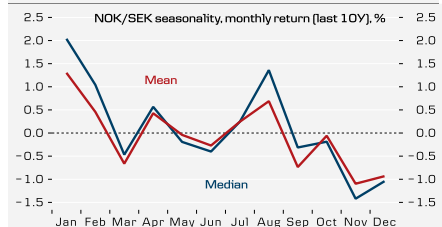
Chart 10.1: NOK/SEK explained by relative rates, energy prices and relative equity sector performance.



Note: Past performance is not a reliable indicator of future results.

Source: Macrobond Financial, Danske Bank.

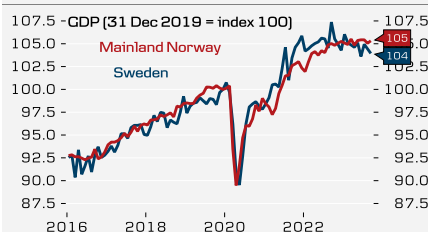
Chart 10.2: NOK/SEK tends to rise in the beginning of the year



Note: Past performance is not a reliable indicator of future results.

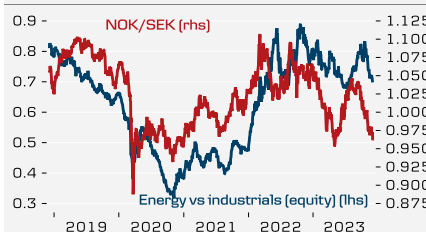
Source: Macrobond Financial, Danske Bank.

Chart 10.3: The growth backdrop looks slightly weaker in Sweden...



Source: Macrobond Financial, Danske bank

Chart 10.4: ... and we favour the energy complex to industrials in 1-3M



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank.

Top Trades P&L log

- FX Top Trades has been running since 2010.
- The average hit ratio (weighted) is 66%, with an average return of 1.1%.
- Our FX Top Trades 2023 yielded a loss – for only the second time in the history of the publication.

Table 1: Danske Bank FX top trades – P&L history since inauguration

Year	Hit Ratio	Avg. Return	Acc. Return	Best Trade	Worst Trade
2010	80%	3.7%	37.0%	10.5%	-4.6%
2011	80%	3.5%	35.0%	11.0%	-1.8%
2012	80%	2.1%	21.0%	7.1%	-2.2%
2013	60%	1.9%	19.0%	11.5%	-2.9%
2014	60%	0.8%	8.0%	6.9%	-2.9%
2015*	50%	-6.1%	-24.4%	4.3%	-19.2%
2016	75%	0.2%	1.1%	5.5%	-5.1%
2017	67%	0.7%	5.8%	3.9%	-6.8%
2018	57%	1.3%	9.1%	7.6%	-2.5%
2019	71%	1.1%	7.4%	3.2%	-1.8%
2020	71%	1.4%	9.7%	5.5%	-2.9%
2021	63%	0.6%	4.6%	2.8%	-4.4%
2022	67%	0.1%	0.5%	6.0%	-6.9%
2023	44%	-0.5%	-4.5%	4.1%	-3.7%
Avg.**	66%	1.1%	9.2%	6.4%	-4.8%

* SNB's removal of EUR/CHF floor

** Weighted average by number of trades

Past performance is not a reliable indicator of current or future results.

Source: Bloomberg, Danske Bank.

Table 2. Closed FX Top Trades 2023 (sorted by date of closure)

Trade	Closed	PnL
Short SEK vs USD and AUD (basket)	04/01/23	2.3%
Long CHF vs PLN and HUF	11/01/23	-3.0%
Long NOK/SEK via 1.03-1.06-1.10 seagull	10/02/23	-2.3%
Long EUR/DKK 12M FX forward	14/02/23	1.4%
Short EUR/CNH via 6M FX forward	26/04/23	-2.9%
Short EUR/GBP via sold 0.85-0.90 call spread	01/06/23	1.2%
Short EUR/USD via sold 1.00-1.05 call spread	01/06/23	-1.5%
Short USD/JPY via options	30/11/23	-3.7%
Long CZK and RON vs EUR	30/11/23	4.1%

Past performance is not a reliable indicator of current or future results

Source: Bloomberg, Danske Bank.

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