3 October 2018

Emerging Markets Briefer

Switching slowly from red light to yellow

Emerging market risk measures hit a three-year high in August 2018. The previous high was when investors' confidence was dented by economic slowdown in China, sliding oil prices and an imminent hike by the Fed, the first since 2006. Yet the 2015 EM crisis did not lead to a 1997-98 like financial crisis, as macro fundamentals across EMs had become more solid.

Idiosyncratic imbalances have flared up across several EMs in an environment of tightening global liquidity, geopolitical woes and escalating trade wars. Inflamed Argentinian and Turkish markets have worsened sentiment and weighed on EM FX, pushing EM central banks to narrow the gap in monetary policies towards the tightening in developed economies. After the latest turmoil, we think emerging markets FX have become fairly undervalued and there may be good reasons for a recovery in 2019, though we acknowledge some challenges.

The Fed's monetary tightening seems fairly priced, which should not have an extra negative impact on EMs, unless the Fed turns significantly more hawkish. We think EMs with relatively solid fundamentals (e.g. China, Malaysia, Russia, Thailand) are more resilient to rising yields.

Deleveraging across EMs, especially in external debt, and tighter monetary policy should subdue the exchange-rate pass-through effect on inflation and stabilise EM currencies. As we argued in *The Remarkable Decline in Emerging Market Inflation*, 27 February, most EMs have adopted rigorous inflation targeting systems and given more autonomy to their central banks.

A new deal between China and the US could be seen later in 2019. Before a deal is reached, we see an escalation in the trade war between the two countries.

Oil prices could decrease on raised production by OPEC, especially Saudi Arabia, if US anti-Iran sanctions start causing a new oil shock. We see Brent in a USD74-77/bbl range in 2019, which should ameliorate damage for net oil importers like India, Turkey or CEE economies, but be enough to fuel the fiscal side of Brazil, Kazakhstan, Indonesia Mexico, Nigeria and Russia.

Emerging markets vulnerability table

		Fiscal		External				Sanctions risks
	Aggregate vulnerability indicator (0-16) 16=most vulnerable	Budget deficit	Public debt	Current account	NIIP	Short-term debt (% of foreign reserves)	Exchange rate overvalued? (REER in %-deviation of REER average 2010-now)	
Turkey	9	-2.9	28	-5.4	-37	109	-27	High
South Africa	8	-4.2	55	-2.9	-21	65	-3	Medium
India	8	-6.5	69	-2.3	-8	24	7	Medium
Argentina	7	-5.5	54	-5.1	9	98	-29	Low
Poland	6	-1.9	51	-0.9	-26	45	-3	Low
Mexico	6	-2.5	54	-1.9	-21	30	-18	Low
Brazil	6	-8.3	87	-1.6	-14	14	-15	Low
Colombia	6	-2.7	49	-2.6	-8	27	5	Low
China	6	-4.1	51	1.2	27	32	9	Medium
Thailand	4	-0.9	42	9.3	17	26	5	Low
Philippines	4	-0.5	37	-0.5	-4	18	-3	Low
Chile	4	-0.9	24	-1.8	33	47	5	Low
Indonesia	4	-2.5	30	-1.9	-16	38	-2	Low
Peru	4	-3.3	27	-0.7	7	13	6	Low
Malaysia	2	-2.7	54	2.4	2	0	-3	Low
Russia	2	0.0	19	4.5	22	12	-10	High
Vulnerability benchmarks:								
Red		<-3%	>60%	<-3%	<-20	>75%	>10%	High
Yellow		0%;-3	30%-60%	0%;-3%	0%;-20%	25%-75%	0%-10%	Medium
Green		>0%	<30%	>0%	>0%	<25%	<0%	Low

Note: All figures in % of GDP, unless noted. 2017 numbers or the latest

Source: IMF WEO, World Bank, Macrobond Financials, and Danske Bank

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Chief Analyst, Head of Emerging Markets Research
Jakob Ekholdt Christensen
+ 45 45 12 85 30
jakc@danskebank.dk

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

Senior Analyst
Morten Helt
+45 29 62 62 33
mohel@danskebank.dk

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

Analyst
Aïla Mihr
+45 45 12 85 35
amih@danskebank.dk

Poland: strong economic momentum will aide PLN

Macro and political outlook

- While macro momentum is currently strong, survey indicators have surprised a bit on the downside and give the first sign of some slowdown in the economy, which we expect to become more pronounced over the next year. In Q2, the economic growth was surprisingly strong at 5.1% y/y (or 1% q/q). PMI manufacturing declined further to 51.4 in august, marking a steady decline since late 2017. This should point to slowing industrial production, which recorded a solid 10.3% increase in July. Retail sales also came out weaker than expected, although increasing 7% in real terms, supported by still solid wage growth. Construction activity continues at a fast pace, however, even though the growth rate may have peaked in this cycle. The rapid growth in domestic demand is showing up in the trade balance, which is now hovering solidly in negative territory. Given the strong GDP numbers in H1, we lift our 2018 real GDP growth forecast to 4.7% and 3.5% in 2019 (4.5% and 3.3% previously, respectively).

Monetary policy outlook

- Inflation continues to remain muted with headline inflation staying at 2.0% y/y in August, while annual core inflation picked up speed slightly to 0.9% from 0.6% in July. In light of the subdued inflation pressures, the National Bank of Poland (NBP) led by Governor Adam Glapiński maintained at the meeting that rates are at an appropriate level now and at least until 2020. Financial markets have moved forward their rate-hike expectations and are now expecting the first 25bp hike by Q3 19, which we think is a bit on the dovish side as we already see the first rate hike given the likely uptick in inflation due to the tightening labour market.

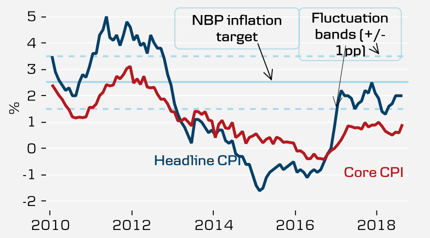
FX outlook

- The PLN has traded relatively weakly amid general sour sentiment against emerging markets, which is affecting investor sentiment against Poland as well. We revise our forecast for EUR/PLN up slightly, reflecting concerns about a further escalating trade war in late September and possible further weak sentiment. Our new forecast for the cross is 4.29 (previously 4.27) in 1M, 4.24 in 3M (previously 4.22), declining further to 4.20 in 6M and 4.18 in 12M (previously 4.18 and 4.16, respectively).

Risk factors

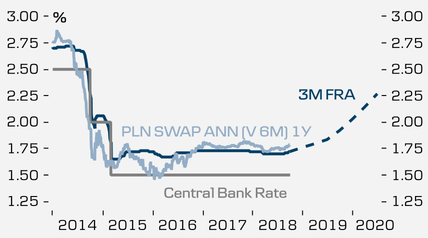
- Risks are skewed on the downside for our EUR/PLN forecast. The most prominent downside risk is improvement in sentiment around emerging markets and stronger economic releases, while upside risks to the cross include further tensions between the EU and Poland, as well as further escalation in the trade dispute between US and China.

Inflation pressures continue to remain subdued...



Source: Macrobond Financial

...hence, the market is expecting only one rate hike until end-2019



Source: Macrobond Financial

PLN

Credit rating:

S&P: BBB+ (positive)

Currency regime:

Free float (freely convertible)

Inflation target:

2.5%±1pp

Macro forecasts

	2017	2018	2019	2020
GDP (% y/y)	4.7	4.7	3.5	3.0
GDP deflator (% y/y)	1.9	1.4	1.8	1.7
CPI (% y/y)	2.0	1.8	2.3	2.5
Private consumption (% y/y)	4.7	4.8	4.3	3.0
Fixed investments (% y/y)	3.1	6.4	4.4	3.0
Unemployment (%)	6.6	7.1	6.5	6.2
Current account (% of GDP)	-0.2	-0.5	-0.9	-1.5

Source: Macrobond Financial, Danske Bank

Interest rate forecast

National Bank of Poland (NBP)		
Policy rate	1.50	
Next meeting	07/11/2018	
Next change	+25bp	Q2, 2019
End-2018	1.50	

Source: Danske Bank

FX forecasts

EUR/PLN		
	Danske	Forward
01-Oct	4.28	
+3M	4.24	4.32
+6M	4.20	4.34
+12M	4.18	4.39
USD/PLN		
	Danske	Forward
01-Oct	3.69	
+3M	3.69	3.71
+6M	3.56	3.70
+12M	3.34	3.67

Source: Danske Bank

Hungary: mind the political risk

Macro outlook

- Economic growth continued strong accelerating to 4.6% y/y in Q2 18 according to the preliminary data versus 4.4% y/y in Q1 18. Manufacturing PMI stays firmly above 50.0, climbing to over 56.0 in August. At the same time there is a slowdown in the GKI Hungary economic sentiment indicator, which includes both consumer and business confidence. Industrial production growth remained solid, while the looming trade war between the EU and the US could hurt the expansion in H2 18 already. Yet, the current stance in monetary policy is beneficial for further economic expansion in 2019 and 2020, albeit on a lower path.
- Hungary is one of the CEE economies most exposed to escalating trade war concerns. The country's domestic market is smaller than Poland's, for instance, and dependence on exports to Germany is high. Increasing tariffs by the US on German exports would also hit Hungary's growth.
- As the EU has taken a tough stance on Hungary's Prime Minister Viktor Orbán's domestic policy introducing sanctions against the country, the escalating relationship between Brussels and Budapest could weigh on the HUF through the sentiment, but less on economic growth.

Monetary policy outlook

- The Hungarian central bank (MNB) kept rates unchanged at its September meeting and seems to be on hold for now. However, the headline inflation remains over the 3.0% target (3.4% y/y in August). While we previously expected the first key rate increase in mid-2019, changing inflation dynamics, strong economic growth and global monetary tightening could push MNB to deliver a 25bp hike in early 2019. We do not exclude implicit tightening through liquidity tools.

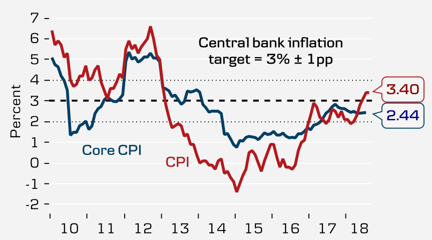
FX outlook

- We expect the HUF to be stronger in the medium and long term, while adjusting our forecast according to the current EUR exchange rate to EUR/HUF at 322 in 3M, 318 in 6M and 312 in 12M. The HUF would benefit from ECB's increasing hawkishness, as the euro area's monetary policy is set to be tightened in H2 19.

Risk factors

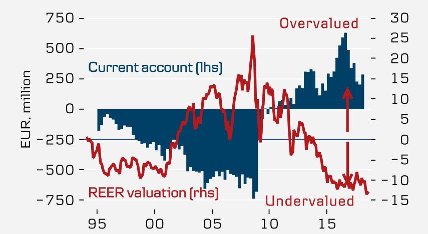
- A clear upside risk to our EUR/HUF forecast is further deterioration of global risk sentiment and increasing political risk on the standoff between Budapest and Brussels.

Inflation climbed on weakened HUF, which could cause additional monetary tightening



Source: Macrobond Financial, Danske Bank

Sustainable current account surplus is set to support HUF long term



Source: Macrobond Financial, Danske Bank

HUF

Credit rating:

S&P: 'BBB-' (stable)

Currency regime:

Free float (freely convertible)

Inflation target:

3% (medium term)

Macro forecasts

	2017	2018E	2019E	2020E
Real GDP (% y/y)	4.0	3.9	3.3	2.7
CPI (% average)	2.1	2.8	3.0	3.2
Unemployment (%)	3.8	3.8	3.7	3.9
Current account (% of GDP)	3.2	3.0	2.9	2.2

Source: Macrobond Financial, Danske Bank

Interest rate forecast

Hungarian Central Bank (MNB)		
Policy rate	0.90	
Next meeting	16/09/2018	
Next change	+25bp	2019
End-2018	0.90	

Source: Danske Bank

FX forecasts

EUR/HUF		
	Danske	Forward
01-Oct	322.8	
+3M	322.0	323.0
+6M	318.0	323.6
+12M	312.0	325.3
USD/HUF		
	Danske	Forward
01-Oct	278.61	
+3M	280.00	277.27
+6M	269.49	275.63
+12M	249.60	272.41

Source: Danske Bank

Czech Republic – strong macro outlook leaves more CZK appreciation in store

Macro and political outlook

- Despite the Czech Republic's continued solid growth performance, business and consumer sentiment signal some slowdown in economic activity ahead. We expect 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, but private consumption will in our view continue to be the key growth driver. Labour shortages continue to be an impediment to production. With the unemployment rate remaining below the natural level, nominal wage growth is expected to remain elevated and above its long-run average of 5%. We expect a high degree of policy continuity under the new ruling coalition of the ANO movement and Social Democrats and the probability of a push for EU-exit remains very low.

Monetary policy outlook

- Driven by energy prices and accelerating wage growth, inflation remains above the Czech National Bank (CNB) target, inducing the central bank to deliver another 25bp hike at the September meeting. The CNB projections currently imply a relatively stable interest rate profile in 2019, as policy tightening is expected to be achieved mainly through the exchange rate component. The timing of the Czech hiking cycle remains dependent on FX movements, but as the CZK continues to trade weaker than the CNB envisioned, we see scope for another 25bp rate hike at either the November or December meeting. For 2019 we currently foresee two additional interest rate rises which means that the policy rate will still remain below its long-run neutral level (estimated at c.3.0% by CNB).

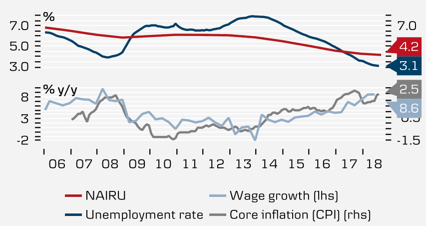
FX outlook

- We expect CZK to return to its gradual strengthening path soon, as the Czech macroeconomic backdrop remains favourable compared to the euro area and the CNB is continuing with its hiking cycle. We still expect a less steep EUR/CZK deprecation path compared to the CNB, as the Czech economy shifts into a lower gear and the ECB is also gradually moving towards policy normalisation. We forecast EUR/CZK at 25.50 in 1M, 25.40 in 3M, 25.00 in 6M and 24.80 in 12M.

Risk factors

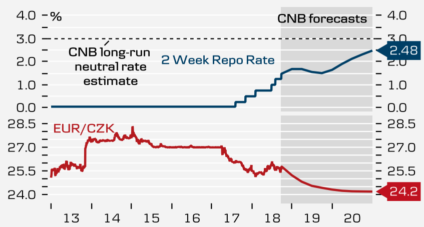
- The risk to our EUR/CZK forecast profile is skewed to the upside due to spill-overs from the current adverse EM risk sentiment and continued Fed hikes. Given the sizable amount of long CZK positions accumulated in the market prior to the floor exit, EUR/CZK is also still vulnerable to spikes higher.

Tight labour market is fuelling core inflation



Source: Macrobond Financial, Danske Bank

CNB is expecting further monetary tightening



Source: CNB, Macrobond Financial, Danske Bank

CZK

Credit rating:

S&P: 'AA-' (stable)

Currency regime:

Managed float

Inflation target:

2%±1pp

Macro forecasts

	2017	2018	2019	2020
GDP (% y/y)	4.5	3.3	3.1	3.0
GDP deflator (% y/y)	1.5	2.2	2.0	1.9
CPI (% y/y)	2.5	2.1	2.0	2.0
Private consumption (% y/y)	4.4	3.9	3.2	2.7
Fixed investments (% y/y)	3.7	8.7	3.7	2.7
Unemployment (%)	4.2	3.2	3.2	3.3
Current account (% of GDP)	1.3	0.6	0.5	0.5

Source: Macrobond Financial, Danske Bank

Interest rate forecast

Czech National Bank (CNB)		
Policy rate	1.50	
Next meeting	01/11/2018	
Next change	+25bp	Q4, 2018
End-2018	1.75	

Source: Danske Bank

FX forecasts

EUR/CZK		
	Danske	Forward
01-Oct	25.79	
+3M	25.40	25.83
+6M	25.00	25.94
+12M	24.80	26.20
USD/CZK		
	Danske	Forward
01-Oct	22.26	
+3M	22.09	22.17
+6M	21.19	22.09
+12M	19.84	21.94

Source: Danske Bank

Russia: surrounded by sanctions

Macro outlook

- The Russian economy grew 1.9% y/y in Q2 18 versus 1.3% y/y a quarter earlier. The estimate was raised by 0.1pp versus the previous release. Industrial production growth has remained in positive territory through 2018 despite lower manufacturing PMI. Given the change in Russia's monetary policy stance since summer 2018 and the newly arisen risk of anti-Russia 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%) – also noting that geopolitical woes remain the major downside risk for our forecasts.
- Legislators passed the bill on pension reform in the final reading, taking into account the relief granted by President Putin on the increase in women's retirement age. It will be raised from the current 55 years to 60 instead of the originally planned 63. For men, the shift would be five years, from 60 to 65 years. Up to RUB4trn will be saved over the six years from the pension age increase, the Ministry of Finance estimates.
- While we estimate that the looming pension reform would bring relief for Russia's tight labour market and internal finances, the abolished pension payments would hit Russian consumers, especially in Russian provinces, where monthly salaries are much lower than in cities with more than one million habitants.

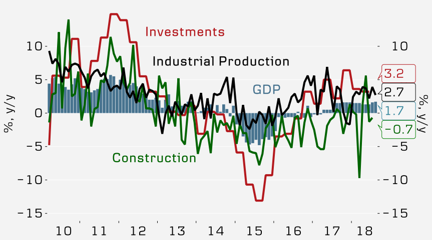
FX and monetary policy outlook

- Russia's central bank (CBR) surprisingly hiked the key rate by 25bp to 7.50% in September 2018, raising inflation projections and emphasising the risk of external factors. Inflation has started accelerating mostly due to a low base effect. In August, consumer prices rose 3.1% y/y versus 2.5% y/y a month earlier. We do not exclude the possibility of the CBR hiking again in Q4 18.
- The geopolitical premium in the RUB has continued to increase despite the rising oil price. While we do not observe any significant changes in the 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 in autumn 2018 and that strong anti-Russian rhetoric will escalate in the US ahead of the US mid-term election..

Risk factors

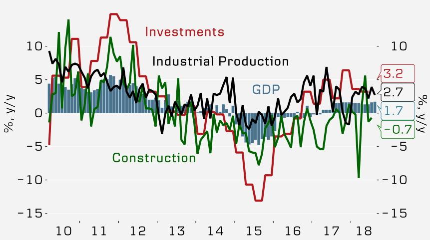
- Further geopolitical escalation is a serious short- to medium-term risk for the RUB, Russian stocks and government debt. Upside risks come from an increasing oil price and improving relations with the West.

Economic growth components stay in green on revised statistical data



Source: Macrobond Financial, Danske Bank

Private consumption could accelerate in Q4 18 on VAT increase plans



Source: Macrobond Financial, Danske Bank

RUB

Credit rating:
S&P: 'BBB-' (stable)

Currency regime:
Free float

Inflation target:
4.0%

Macro forecasts

	2017	2018E	2019E	2020E
Real GDP (% y/y)	1.5	1.6	1.3	1.4
Private consumption, real (% y/y)	3.3	3.0	2.5	2.9
Fixed investments, real (% y/y)	7.5	3.2	2.4	3.1
Brent oil price (USD, average, futures)	54.8	77.5	77.6	73.6
Brent oil price (% y/y)	21.4	41.5	0.2	-5.2
Exports in USD (average % y/y)	25.1	32.0	18.0	20.0
Imports in USD (average % y/y)	23.8	11.0	2.0	3.2
MosPrime 3 months rate (% average)	9.3	7.60	7.50	7.00
CPI (% Dec/Dec)	2.5	3.5	3.4	3.3
Unemployment (%)	5.2	5.1	5.0	5.0
Budget balance (% of GDP)	-1.7	0.8	0.5	0.5
Current account (% of GDP)	2.5	3.2	2.9	2.7

Source: CBR, Rosstat, Bloomberg, Macrobond Financial, Danske Bank estimates

Interest rate forecast

Bank of Russia (CBR)		
Policy rate	7.50	
Next meeting	26/10/2018	
Next change	-25bp	Q4, 2019
End-2018	7.50	

Source: Danske Bank

FX forecasts

EUR/RUB		
	Danske	Forward
01-Oct	75.91	
+3M	82.80	76.97
+6M	87.08	78.38
+12M	93.88	81.60

USD/RUB		
	Danske	Forward
01-Oct	65.52	
+3M	72.00	66.08
+6M	73.80	66.76
+12M	75.10	68.34

Source: Danske Bank

Turkey: sharp slowdown ahead

Macro outlook

- 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 stays under 50.0. The Turkish central bank's sharp monetary tightening is set to put an additional brake on economic expansion in the long-term. We expect 2018 GDP to grow 3.5% y/y, cutting our 2019 GDP growth projection to 1.8% y/y (previously 2.6% y/y) and to 2.1% from 2.8% in 2020. We see that risks of recession during the next 12 months have notably increased.
- In September 2018, Turkey's Treasury and Finance Minister Berat Albayrak announced a new economic programme, which forecasts below-potential GDP growth in 2019-20, emphasizing the importance of fiscal discipline. The government also aims to provide a financial structure assessment programme for the banking sector.

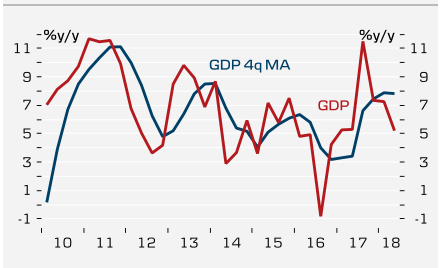
FX and monetary policy outlook

- Turkey's central bank (TCMB) surprised the markets with a 625bp hike of the one-week repo rate to 24.00%, which moved the USD/TRY to new lower levels. 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 continuing acceleration in inflation (+2.05pp to17.9% y/y in August) and risks of more weakening in the TRY, another hike is possible in Q4 18.
- We see falling volatility in the TRY in the medium term, as the TCMB is returning to a conventional monetary policy framework. We remain cautious in the medium to long term on pressure from a high oil price, volatile portfolio flows and a wide current account deficit.

Risk factors

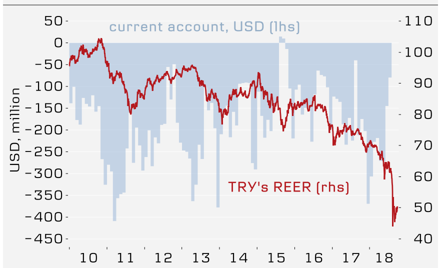
- Downside risks to our TRY forecasts are still geopolitical, if the confrontation with the US escalates, e.g. on the S-400 anti-aircraft weapon system deliveries by Russia, and the US continues to sanction the Turkish State. The TCMB's easing of political pressure and worsening macro factors also present downside risks to our TRY forecasts. Fed monetary tightening is the general emerging market downside risk for the TRY.

Turkey's GDP growth is facing a sharp slowdown on monetary tightening



Source: Macrobond Financial, Danske Bank

Current account deficit shrinks on seasonal factors



Source: Macrobond Financial, Danske Bank

TRY

Credit rating:

S&P: B+ (stable)

Currency regime:

Free float

Inflation target:

5.0% year-end 2018-20

Macro forecasts

	2017	2018E	2019E	2020E
Real GDP (% y/y)	7.4	3.5	1.8	2.1
Private consumption, real (% y/y)	6.1	3.1	1.6	2.0
Fixed investments, real (% y/y)	7.0	4.0	2.2	2.3
CPI (% average)	11.1	13.2	14.7	9.8
Unemployment (%)	10.9	10.2	10.6	11.0
Current account (% of GDP)	-5.2	-5.9	-5.1	-5.0

Source: Bloomberg, Danske Bank

Interest rate forecasts

C.B. of the Republic of Turkey (TCMB)	
Policy rate	24.00
Next meeting	25/10/2018
Next change	-100bp H1 2019
End-2018	24.00

Source: Danske Bank

FX forecasts

EUR/TRY		
	Danske	Forward
01-Oct	6.89	
+3M	7.36	7.39
+6M	8.14	7.89
+12M	9.38	9.01

USD/TRY		
	Danske	Forward
01-Oct	5.95	
+3M	6.40	6.34
+6M	6.90	6.72
+12M	7.50	7.54

Source: Macrobond Financial, Danske Bank

South Africa – ZAR hit by recessions fear and sour EM sentiment

Macro outlook

- The economic growth performance has been lacklustre this year, posing a significant challenge to the new South African government led by President Cyril Ramaphosa. Following the 0.7% contraction in real GDP in Q1 (compared with the previous quarter), economic growth was also negative in Q2 at 0.2%, taking the annual growth to a meagre 0.4%. Agriculture, transport and trade (weak net exports) were the main contributors to the further slowdown in Q2. The PMI also fell significantly in August, highlighting continuing challenges for economic growth.
- The weak H1 18 GDP numbers raise doubt about the rebound in the South Africa economy, which had been pencilled in after the appointment of the Ramaphosa government. The outlook for the South African economy has further been put in doubt due to global trade jitters and weakening EM sentiment. In response to the weakening economic prospects, the government on 21 September outlined a reform package seeking to boost infrastructure spending and promoting structural reform. However, we think this plan will first boost growth in coming years. Hence, as a result of the weak H1 GDP numbers and challenging external environment, we revise down our real GDP forecasts to 0.5% in 2018 (1.2% before), while keeping our forecast for 2019 more or less unchanged at 1.6 in 2019 (1.8% before).

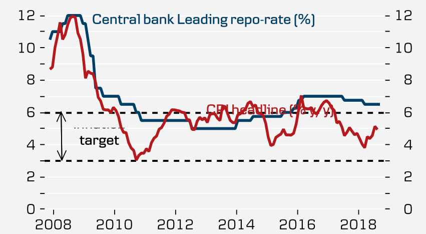
Monetary policy outlook

- The South African Reserve Bank (SARB) kept its benchmark repo rate unchanged at 6.50% at its 20 September meeting. The unchanged decision came with a slim majority as three out of seven members preferred a rate increase given the concern about upside risks to inflation in view of the weakening ZAR and higher oil prices, although current inflation rate is close to the mid of the SARB's target range. We see the SARB reacting to an upshot in inflation over the next months by raising its policy rate in November or December, given that the pressures on the ZAR are set to remain.

FX outlook

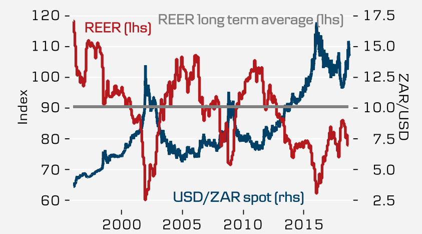
- The ZAR has been hit sharply by the combination of the weak economic growth, negative EM environment and domestic and external concerns about land reforms. The rand is now in undervalued territory after the recent weakening. However, we see the Rand being driven by external factors at the moment, which means more weakness in the short term. However, we see a possible resolution on the global trade front in 2019. As a result, our path for the USD/ZAR at 14.75 (previously 13.20) in 3M and with ZAR strengthening slightly to 14.00 in 6M and 12M as trade concerns ease and USD weakens.

Inflation is creeping up towards the upper part of SARB's target range



Source: Macrobond Financial

After recent weakening, the ZAR is slightly undervalued



Source: Macrobond Financial

ZAR

Credit rating:

S&P: BB (stable)

Currency regime:

Free float (freely convertible)

Inflation target:

3-6%

Macro forecasts

	2017	2018	2019	2020
GDP (% y/y)	1.3	0.5	1.6	2.1
GDP deflator (% y/y)	5.5	6.0	6.5	6.6
CPI (% y/y)	5.2	5.2	5.7	5.7
Private consumption (% y/y)	2.2	1.4	0.7	1.7
Fixed investments (% y/y)	0.4	-0.5	0.2	1.7
Unemployment (%)	26.7	26.4	26.9	27.3
Current account (% of GDP)	-2.4	-3.4	-3.6	-4.0

Source: Bloomberg, Danske Bank

Interest rate forecast

South African Reserve Bank (SARB)		
Policy rate	6.50	
Next meeting	22/11/2018	
Next change	+25bp	Q4, 2018
End-2018	6.75	

Source: Danske Bank

FX forecasts

EUR/ZAR		
	Danske	Forward
01-Oct	16.45	
+3M	16.96	16.86
+6M	16.52	17.19
+12M	17.50	17.90
USD/ZAR		
	Danske	Forward
01-Oct	14.20	
+3M	14.75	14.48
+6M	14.00	14.65
+12M	14.00	14.99

Source: Macrobond Financial, Danske Bank

Brazil: the election will set the path

Macro outlook

- Brazil's economic growth slowed to 1.0% y/y in Q2 18, from a 1.2% y/y expansion in Q1 18. The economy got support from manufacturing and construction. We cut our 2018 GDP growth forecast to 1.4% y/y from 2.2% y/y previously, as the more hawkish stance in the monetary policy is limiting the economic expansion. There was also some negative impact on the economy from the recent significant lorry drivers' strike. We expect GDP to expand 2.0% in 2019 (previously 2.4%) and 2.6% in 2020, as possibly resumed monetary easing could provide room for investment growth.
- In addition to the developments in emerging market sentiment and its impact on BRL flows, we expect all eyes to be on the presidential election in October 2018. The possible win of market-friendly presidential candidate Jair Bolsonaro would cause a rally in the BRL and other Brazilian assets, whereas a victory of leftist presidential candidate Fernando Haddad would hurt the sentiment. The primary concerns faced by a new president remain fiscal reform, unemployment and security.
- The increase in Brazil's public net debt as a percentage of GDP resumed in July hitting 52.0%. The restarted rise could fuel more uncertainty in Q4 18, affecting the BRL.

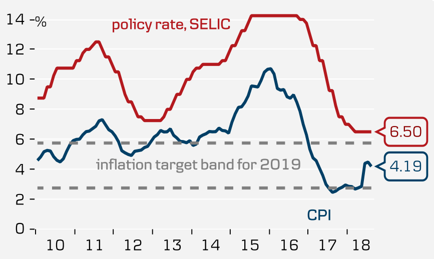
Monetary policy outlook

- As expected, Brazil's central bank (the BCB) has turned semi-hawkish, keeping the key rate unchanged as global turbulence in the emerging market universe hit the BRL. The BCB has tamed BRL's volatility by providing an abundant FX swap line. We expect the BCB to stay on hold in 2018, while we do not exclude a 25bp hike, if the BRL slides significantly after market-negative outcome in the presidential election.

FX outlook

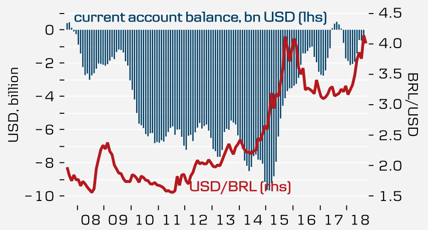
- Slightly improved global emerging market sentiment and the election polls have been driving the BRL over the past month. Long-term prospects for the BRL will depend to a large extent on the presidential election outcome and persuaded reforms by the newcomer.
- We update our USD/BRL forecast levels to reflect the recent developments in emerging market sentiment and the election candidates' setup. The projections are election neutral, though. A rapid approval of reforms by the government, stabilising the political situation after the presidential election would be BRL positive.

Central bank is set to stay on hold in 2018, while risks for a hike arise as emerging market volatility shakes BRL



Source: Macrobond Financial, Danske Bank

Shrinking current account deficit is supporting the BRL in the long-term



Source: Macrobond Financial, Danske Bank

BRL

Credit rating:

S&P: BB- (stable)

Currency regime:

Free float (non-convertible)

Inflation target:

4.5% ±1.5pp in 2018

4.25% ±1.5pp in 2019

4.0% ±1.5pp in 2020

3.75% ±1.5pp in 2021

Macro forecasts

	2017	2018E	2019E	2020E
Real GDP (% y/y)	1.0	1.4	2.0	2.6
Private consumption, real (% y/y)	1.0	1.5	2.6	3.2
Fixed investments, real (% y/y)	0.0	3.0	3.2	4.5
CPI (% Dec/Dec)	2.95	3.2	3.9	4.2
Unemployment (%)	12.9	12.0	11.2	10.6
Current account (% of GDP)	-0.5	-1.0	-1.2	-1.6

Source: Bloomberg, Danske Bank

Interest rate forecasts

Central Bank of Brazil (BCB)		
Policy rate	6.50	
Next meeting	31/10/2018	
Next change	-25bp	H2, 2019
End-2018	6.50	

Source: Danske Bank

FX forecasts

EUR/BRL		
	Danske	Forward
01-Oct	4.67	
+3M	4.49	4.64
+6M	4.54	4.72
+12M	4.69	4.89
USD/BRL		
	Danske	Forward
01-Oct	4.03	
+3M	3.90	3.98
+6M	3.85	4.02
+12M	3.75	4.10

Source: Macrobond Financial, Danske Bank

China: slowdown but no hard landing

Macro outlook

- Chinese growth has slowed down moderately in 2018 following two years of robust activity. Financial tightening and the deleveraging campaign are the main reasons, but uncertainty around the trade war has also weighed on activity in recent months.
- The US-China trade war has escalated and we see a high probability of further escalation involving up to 25% tariffs on all US imports (worth USD505bn) from China. This could be a significant drag on Chinese growth. However, China can counter this with an easier monetary policy and fiscal stimulus. China emphasised that the trade war is strengthening its focus on reform and a technological upgrade and could prove positive for its longer-term outlook. Chinese President Xi Jinping said China has to be more self-reliant, sending a clear signal that it aims to reduce its dependence on the US. China announced further reductions in tariffs covering 1,585 goods that would come into effect by 1 November this year.
- While we see a high likelihood of further escalation in the US-China trade war, we still look for a deal in 2019. When the US President has used all his weapons and the cost to the US is more visible, we believe negotiations will get more serious. So far, Trump's strategy seems to be to pressure China as much as possible before returning to the negotiating table.
- China has continued its deleveraging push and crackdown on the shadow banking system. As a result, corporate defaults have risen and credit growth is weak. This is causing short-term pain in some sectors but is a necessary step for China to defuse the debt bomb. We believe China will continue the deleveraging push in the coming years, although the trade war may slow the pace. China aims to keep the pressure on large state-owned companies to cut debt while improving credit availability for small and medium-sized companies.

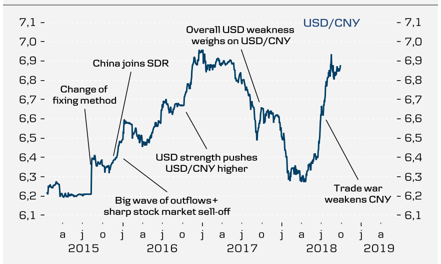
Monetary policy outlook

- The People's Bank of China (PBoC) has eased policy twice this year by lowering the Reserve Requirement Ratio. This frees up liquidity and is targeted at smaller companies. We expect the PBoC to ease policy further to offset the effects of the US-China trade war.

FX outlook

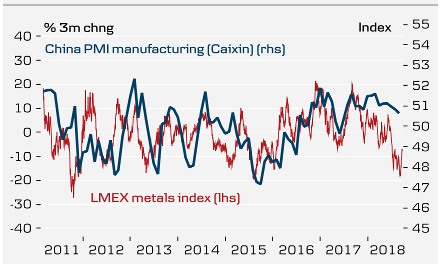
- The monetary policy easing has weakened the CNY significantly as it has happened alongside higher policy rates from the Fed in the US. We look for further weakening of the CNY towards 7.2 in 12M, as we expect the two countries' monetary policies to continue to move in opposite directions and due to continued uncertainty over the trade war.

CNY hit by trade war - more to come



Source: Macrobond Financial, Bloomberg

Drop in commodity prices points to slowdown in growth



Source: Macrobond Financial, PBoC, Markit

CNY

Credit rating:

S&P: A+ (stable)

Currency regime:

Managed exchange rate versus basket of currencies

Inflation target:

3.0% for 2018

Macro forecasts

	GDP		Inflation	
	Danske	Consensus	Danske	Consensus
2017	6.9	6.9	1.6	1.6
2018	6.6	6.5	2.2	2.2
2019	6.4	6.3	2.2	2.3
2020	6.2	6.0	2.2	2.4

Source: Bloomberg, Danske Bank

Interest rate forecast

People's Bank of China (PBoC)	
Policy rate	4.35
Next meeting	No regular meetings
Next change	No change over next year
End-2018	4.35

Source: Danske Bank

FX forecasts

EUR/CNY		
	Danske	Forward
01-Oct	7.96	
+3M	7.94	8.05
+6M	8.26	8.14
+12M	9.00	8.32

USD/CNY		
	Danske	Forward
01-Oct	6.87	
+3M	6.90	6.91
+6M	7.00	6.94
+12M	7.20	6.96

Source: Bloomberg, Danske Bank

India: clouds have gathered

Macro outlook

- India's GDP growth increased to 8.2% in Q2 18 from 7.7% in Q4 17. Exports have been growing strongly at a rate close to 30% in nominal terms and the domestic economy has been robust as well.
- However, India has been pulled into the EM turmoil recently. A banking crisis, a current account deficit rising to a five-year high and an ongoing large fiscal deficit has led to some capital flight. As a net oil importer, the rise in oil prices has led to a deterioration in the terms of trade and contributed to the worsening of the current account balance.
- The headwinds for India's financial markets may continue in the short term as an overall drag on EM from higher Fed rates and the ongoing US-China trade war is likely to stay with us for a while. However, a further monetary policy rate increase would provide some confidence that India is ready to take further measures to contain the crisis. India has increased tariffs on a range of imports to stave off the increase in the current account deficit, but it is unlikely to have a big impact in our view.
- While India is facing short-term challenges, we still see decent long-term growth potential. India needs to move further on reforms, though, and clean up the banking system. On a micro level, one of India's big problems is the high amount of bureaucracy and corruption, which needs to be dealt with to unleash its potential.
- The main downside risk to growth is further deterioration in the EM turmoil and further capital flight that triggers more INR weakness and forces the Reserve Bank of India to take other steps to restore confidence. However, we do not believe that imbalances are significant enough to trigger a deep, prolonged crisis.

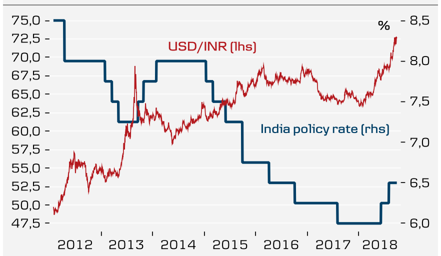
Monetary policy outlook

- The Reserve Bank of India raised rates in early August for the second time this year, citing growing inflationary pressures from higher oil prices, rising inflation expectations and financial turmoil putting pressure on the currency. While inflation moved lower to 3.7% in August (below the 4% target), we expect another 25bp hike on 5 October, to counteract the inflationary pressure from the weaker INR and stave off outflow pressures that could weaken the currency even further.

FX outlook

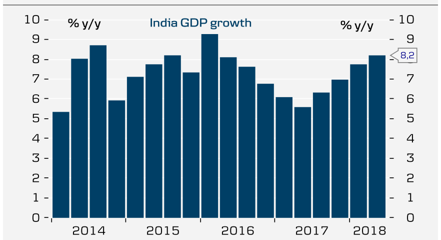
- We expect continued headwinds for the INR in the short term as the trade war continues and the US raises rates further. However, we look for some stabilisation in 2019 as we expect a trade deal to be reached and the outlook for Fed hikes to moderate.

Short-term pressure on INR – RBI to hike again



Source: Macrobond Financial, Danske Bank

GDP growth has been robust in H1



Source: Macrobond Financial, Danske Bank

INR

Credit rating:

S&P: BBB- (stable)

Currency regime:

Free float

Inflation target:

4%±2pp

Macro forecasts

	GDP		Inflation	
	Danske Bank	Consensus	Danske Bank	Consensus
2017	6.3	6.3	3.3	3.3
2018	7.8	7.2	4.4	4.6
2019	7.5	7.4	4.5	4.6
2020	7.2	7.5	4.5	4.4

Source: Bloomberg, Danske Bank

Interest rate forecast

Reserve Bank of India (RBI)	
Policy rate	6.50
Next meeting	5/11/2018
Next change	+25bp Q4, 2018
End-2018	6.75

Source: Danske Bank

FX forecasts

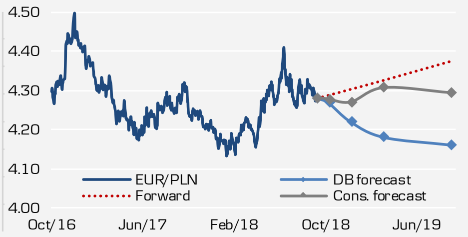
EUR/INR		
	Danske	Forward
01-Oct	84.71	
+3M	81.65	85.82
+6M	84.96	87.59
+12M	88.75	90.94
USD/INR		
	Danske	Forward
01-Oct	73.13	
+3M	71.00	73.68
+6M	72.00	74.61
+12M	71.00	76.16

Source: Danske Bank

Danske Bank's hedging recommendations: EMEA

Currency	Instrument – Income	Instrument – Expenses
PLN	We recommend hedging PLN income via knock-in forwards.	We recommend hedging PLN expenses via FX forwards.

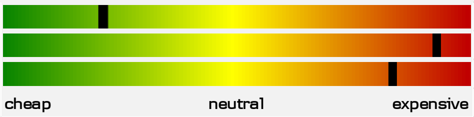
Forecast



	1M	3M	6M	12M
DB forecast	4.27	4.22	4.18	4.16
Forward	4.29	4.30	4.33	4.38
Cons. forecast	4.28	4.27	4.31	4.29

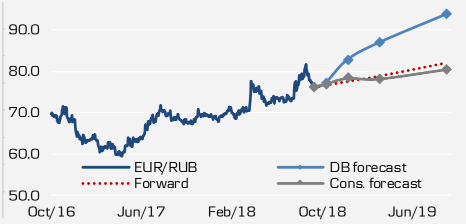
Price indicators

Implied volatility
Risk reversal (PLN seller)
Forward rate (PLN seller)



Currency	Instrument – Income	Instrument – Expenses
RUB	We recommend hedging RUB income via FX forwards.	We recommend hedging RUB expenses via risk reversals.

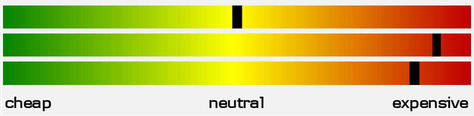
Forecast



	1M	3M	6M	12M
DB forecast	77.05	82.80	87.08	93.88
Forward	76.58	77.54	78.88	82.08
Cons. forecast	76.89	78.30	78.19	80.51

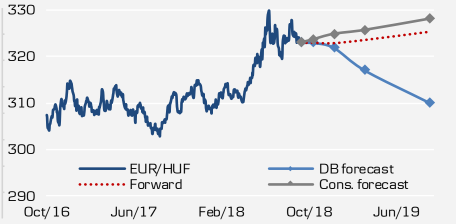
Price indicators

Implied volatility
Risk reversal (RUB seller)
Forward rate (RUB seller)



Currency	Instrument – Income	Instrument – Expenses
HUF	We recommend hedging HUF income via knock-in forwards.	We recommend hedging HUF expenses via FX forwards.

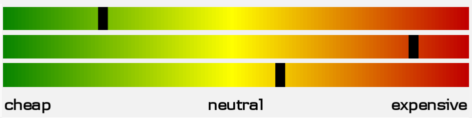
Forecast



	1M	3M	6M	12M
DB forecast	323.00	322.00	317.00	310.00
Forward	323.03	322.95	323.65	325.43
Cons. forecast	323.57	324.81	325.67	328.06

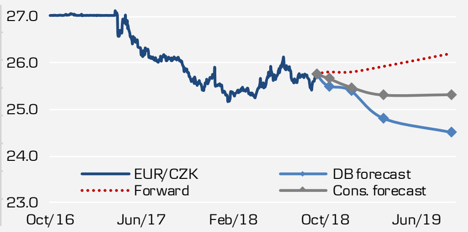
Price indicators

Implied volatility
Risk reversal (HUF seller)
Forward rate (HUF seller)



Currency	Instrument – Income	Instrument – Expenses
CZK	We recommend hedging CZK income via knock-in forwards.	We recommend hedging CZK expenses via FX forwards.

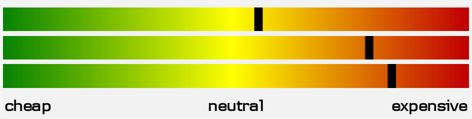
Forecast



	1M	3M	6M	12M
DB forecast	25.50	25.40	24.80	24.50
Forward	25.80	25.80	25.92	26.20
Cons. forecast	25.66	25.47	25.30	25.31

Price indicators

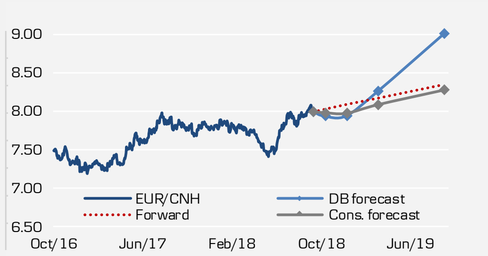
Implied volatility
Risk reversal (CZK seller)
Forward rate (CZK seller)



Source: Danske Bank

Danske Bank's hedging recommendations: other emerging markets

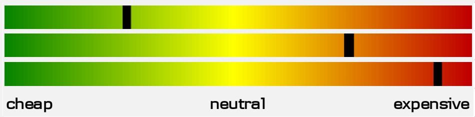
Currency	Instrument: Income	Instrument: Expenses	Forecast
CNH (CNY)	We recommend hedging CNY-denominated income using FX forwards, as we are more bearish on the CNY than the market.	Hedge CNY-denominated expenses via risk reversals to profit from any further CNY weakening	



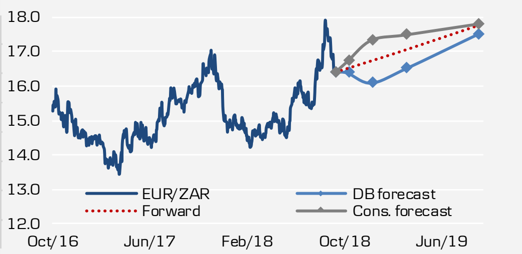
	1M	3M	6M	12M
DB forecast	7.94	7.94	8.26	9.00
Forward	8.02	8.09	8.17	8.34
Cons. forecast	7.98	7.97	8.08	8.27

Price indicators

Implied volatility
Risk reversal (CNH seller)
Forward rate (CNH seller)



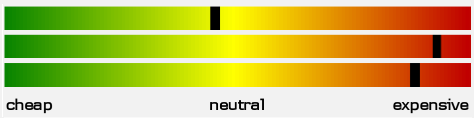
Currency	Instrument: Income	Instrument: Expenses	Forecast
ZAR	We recommend hedging ZAR income with knock-in forwards.	We recommend hedging ZAR expenses via FX forwards.	



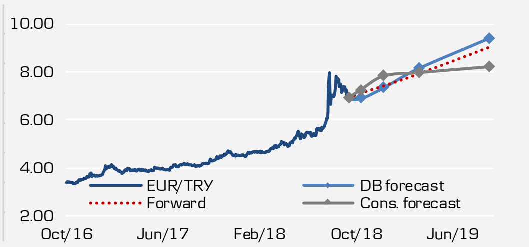
	1M	3M	6M	12M
DB forecast	16.39	16.10	16.52	17.50
Forward	16.53	16.75	17.07	17.77
Cons. forecast	16.73	17.34	17.50	17.81

Price indicators

Implied volatility
Risk reversal (ZAR seller)
Forward rate (ZAR seller)



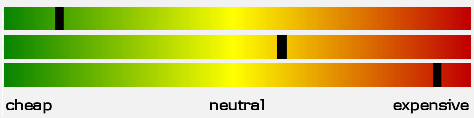
Currency	Instrument: Income	Instrument: Expenses	Forecast
TRY	We recommend hedging TRY income via risk reversals.	We recommend hedging TRY expenses via FX forwards.	



	1M	3M	6M	12M
DB forecast	6.90	7.36	8.14	9.38
Forward	7.10	7.41	7.90	9.01
Cons. forecast	7.24	7.83	7.97	8.21

Price indicators

Implied volatility
Risk reversal (TRY seller)
Forward rate (TRY seller)



Source: Danske Bank

FX forecast

Core- major

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
EUR	01-Oct			1.16		745.6		1036.2		945.1	
	+3M			1.15	1.16	745.3	745.0	1020.0	1038.4	920.0	946.7
	+6M			1.18	1.17	745.5	744.6	1020.0	1039.5	920.0	950.3
	+12M			1.25	1.19	745.5	743.7	1030.0	1039.5	910.0	958.3
USD	01-Oct	1.16				643.6		894.5		815.8	
	+3M	1.15	1.16			648.0	639.6	887.0	891.4	800.0	812.7
	+6M	1.18	1.17			631.8	634.2	864.4	885.4	779.7	809.5
	+12M	1.25	1.19			596.4	622.8	824.0	870.5	728.0	802.5
JPY	01-Oct	132.0		113.9		5.65		7.85		7.16	
	+3M	128.8	131.3	112.0	112.8	5.79	5.67	7.92	7.91	7.14	7.21
	+6M	134.5	131.4	114.0	111.9	5.54	5.67	7.58	7.91	6.84	7.23
	+12M	142.5	131.5	114.0	110.1	5.23	5.66	7.23	7.91	6.39	7.29

Source: Macrobond Financial, Danske Bank

Wider CEE

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	01-Oct	4.28		3.69		174.3		242.3		221.0	
	+3M	4.24	4.32	3.69	3.71	175.8	172.6	240.6	240.6	217.0	219.3
	+6M	4.20	4.34	3.56	3.70	177.5	171.6	242.9	239.6	219.0	219.0
	+12M	4.18	4.39	3.34	3.67	178.3	169.6	246.4	237.0	217.7	218.5
HUF	01-Oct	322.8		278.6		2.31		3.21		2.93	
	+3M	322.0	323.0	280.0	277.3	2.31	2.31	3.17	3.22	2.86	2.93
	+6M	318.0	323.6	269.5	275.6	2.34	2.30	3.21	3.21	2.89	2.94
	+12M	312.0	325.3	249.6	272.4	2.39	2.29	3.30	3.20	2.92	2.95
CZK	01-Oct	25.79		22.26		28.91		40.18		36.64	
	+3M	25.40	25.83	22.09	22.17	29.34	28.84	40.16	40.20	36.22	36.65
	+6M	25.00	25.94	21.19	22.09	29.82	28.70	40.80	40.08	36.80	36.64
	+12M	24.80	26.20	19.84	21.94	30.06	28.39	41.53	39.68	36.69	36.58

Source: Macrobond Financial, Danske Bank

CIS

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
RUB	01-Oct	75.91		65.52		9.82		13.65		12.45	
	+3M	82.80	76.97	72.00	66.08	9.00	9.68	12.32	13.49	11.11	12.30
	+6M	87.08	78.38	73.80	66.76	8.56	9.50	11.71	13.26	10.56	12.12
	+12M	93.88	81.60	75.10	68.34	7.94	9.11	10.97	12.74	9.69	11.74

Source: Macrobond Financial, Danske Bank

MEA

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
TRY	01-Oct	6.89		5.95		108.2		150.4		137.2	
	+3M	7.36	7.39	6.40	6.34	101.3	100.8	138.6	140.5	125.0	128.1
	+6M	8.14	7.89	6.90	6.72	91.6	94.4	125.3	131.8	113.0	120.5
	+12M	9.38	9.01	7.50	7.54	79.5	82.6	109.9	115.4	97.1	106.4
ZAR	01-Oct	16.45		14.20		45.3		63.0		57.5	
	+3M	16.96	16.86	14.75	14.48	43.9	44.2	60.1	61.6	54.2	56.1
	+6M	16.52	17.19	14.00	14.65	45.1	43.3	61.7	60.5	55.7	55.3
	+12M	17.50	17.90	14.00	14.99	42.6	41.5	58.9	58.1	52.0	53.5

Source: Macrobond Financial, Danske Bank

Latin America

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
BRL	01-Oct	4.67		4.03		159.8		222.1		202.5	
	+3M	4.49	4.64	3.90	3.98	166.2	160.5	227.4	223.8	205.1	204.0
	+6M	4.54	4.72	3.85	4.02	164.1	157.9	224.5	220.5	202.5	201.5
	+12M	4.69	4.89	3.75	4.10	159.0	152.1	219.7	212.6	194.1	196.0

Source: Macrobond Financial, Danske Bank

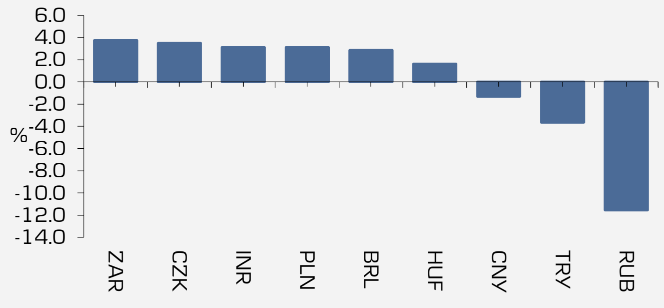
Emerging markets Asia

		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
CNY	01-Oct	7.96		6.87		93.7		130.2		118.8	
	+3M	7.94	8.05	6.90	6.91	93.9	92.5	128.5	129.0	115.9	117.6
	+6M	8.26	8.14	7.00	6.94	90.3	91.4	123.5	127.7	111.4	116.7
	+12M	9.00	8.32	7.20	6.96	82.8	89.4	114.4	125.0	101.1	115.2
INR	01-Oct	84.71		73.13		8.80		12.23		11.16	
	+3M	81.65	85.82	71.00	73.68	9.13	8.68	12.49	12.10	11.27	11.03
	+6M	84.96	87.59	72.00	74.61	8.77	8.50	12.01	11.87	10.83	10.85
	+12M	88.75	90.94	71.00	76.16	8.40	8.18	11.61	11.43	10.25	10.54

Source: Macrobond Financial, Danske Bank

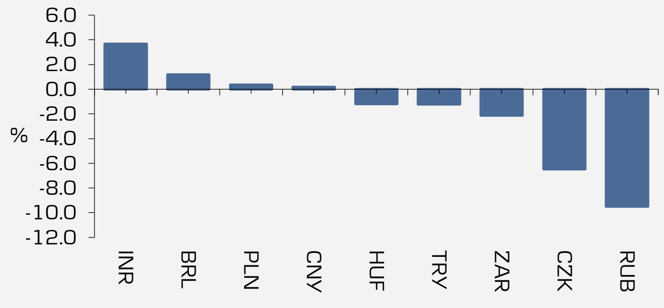
Forecast vs forwards

3M – base currency EUR



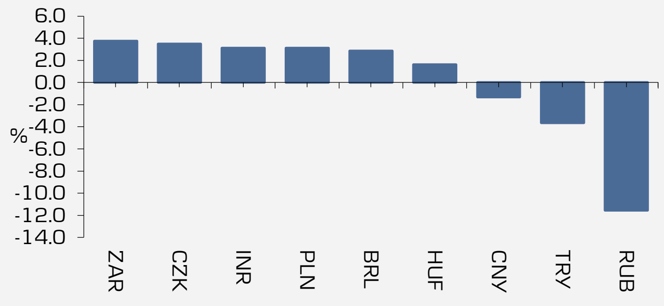
Source: Macrobond Financial, Danske Bank

3M – base currency USD



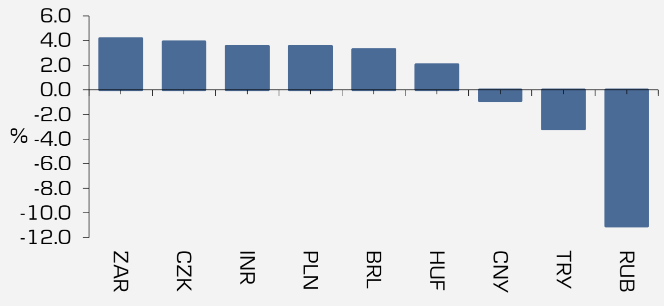
Source: Macrobond Financial, Danske Bank

6M – base currency EUR



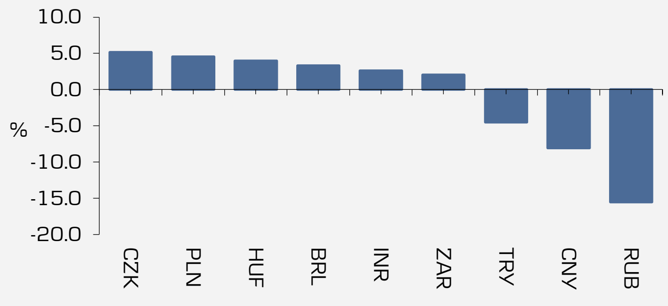
Source: Macrobond Financial, Danske Bank

6M – base currency USD



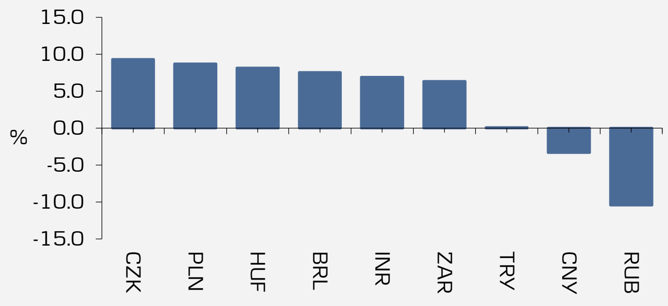
Source: Macrobond Financial, Danske Bank

12M – base currency EUR



Source: Macrobond Financial, Danske Bank

12M – base currency USD



Source: Macrobond Financial, Danske Bank

Monetary policy calendar

Calendar

	Policy Rate (%)	Latest Change		Next Change		Next Meeting	Year-end 2018 (%)
	3 October 2018						
Wider CEE							
PLN	1.50	- 50 bp	Mar, 2015	+25bp	Q2, 2019	7-Nov-18	1.50
HUF	0.90	- 15 bp	May, 2016	+25bp	2019	16-Oct-18	0.90
CZK	1.50	+25 bp	Sep, 2018	+25bp	Q4, 2018	01-Nov-18	1.75
TRY	24.00	+625 bp	Sep, 2018	-100bp	H1, 2019	25-Oct-18	24.00
CIS							
RUB	7.50	+25 bp	Sep, 2018	-25bp	Q4, 2019	26-Oct-18	7.50
MEA							
ZAR	6.50	- 25 bp	Mar, 2018	+25bp	Q4, 2018	22-Nov-18	6.75
LATAM							
BRL	6.50	-25 bp	Mar, 2018	-25bp	H2, 2019	31-Oct-18	6.50
EM Asia							
CNY	4.35	- 25 bp	Nov, 2015	No change over next year		No regular meetings	4.35
INR	6.50	+ 25 bp	Aug, 2018	+ 25 bp	Q4, 2018	5-Oct-18	6.75

Source: Danske Bank

Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Jakob Christensen, Chief Analyst, Allan von Mehren, Chief Analyst, Morten Thrane Helt, Senior Analyst, Vladimir Miklashevsky, Senior Analyst and Aila Mihr, Analyst.

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Date of first publication

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