2 April 2020

Emerging Markets Monthly

Undershooting in PLN, CZK, RUB followed by H2 rebound

- **EM have sold off significantly. We are now in a global recession, and we see a U-shaped global recovery - also in emerging markets by late 2020 (H2).**
- **External factors supportive of EM even now, more later - but corona shock will leave a permanent mark and we do not see a full recovery.**
- **We are bullish on PLN and CZK and cautiously optimistic on RUB, mostly in H2. However, oil markets are unlikely to turn for the better before summer.**

Over the past month, the key problem for many emerging economies has been the combination of a sudden stop in global economic activity, sharply declining commodity prices, and very broad-based risk aversion, driven by a combination of COVID-19 and the oil price skirmish. Most EM FX have sold off about 10-20% versus their regional reference. Near term, we are unlikely to see a marked pickup in activity, nor in commodity prices and this will weigh on industrial countries in e.g. Eastern Europe, highly indebted Latin America and not least Russia. The worst may well be over but we do not expect a quick recovery in EM FX.

However, it is not all gloom. The global fiscal policy response is very material and especially so in the US. This has improved sentiment and adds to our belief in a cyclical uptick later in the year. Further, financial support is material from almost all major central banks and the Fed in particular is clearly in the business of containing financial stress. This has yet to lead to material USD weakness and thus EM support, but it has calmed the downward pressure on EM FX a tad.

Historically, risk aversion leads to overshooting in EM FX (that is, a weaker domestic EM currency short term than the long-term ‘equilibrium’ level). In our view, this currently applies to not least EUR/PLN, EUR/CZK and EUR/RUB. In TRY, MXN and BRL, one should *not* expect the ‘strong’ levels to come back and an eventual global improvement will simply allow these currencies to stabilise, at best, but hardly strengthen much.

In **Poland**, we see potential for a rally in the zloty once the virus concerns ebb into the summer. The sizeable domestic fiscal package amounts to 9% of GDP and will help support the economy. In turn, our 12M forecast for EUR/PLN is 4.30. The **Czech** economy will similarly benefit from an eventual uptick in global industry and we target 26.5 on 12M. In **Hungary**, the HUF has sold off quite a bit as investors had little reason to be long in the first place (interest rates at zero) and also given the expected decline in economic fundamentals. Arguably, there is some overshooting in EUR/HUF, which could unwind. But, even if global activity picks up, EM sentiment improves and corona fears fade, we would expect HUF to be the last to gain. Our 12M target is 368 but near-term overshooting of that is possible.

In **Russia**, the economy can weather the storm, as inflation is low, and even after the 20-30% move in the rouble we are unlikely to see double-digit CPI. We also see EUR/RUB overshooting versus fundamentals, but we have lifted our 12M EUR/RUB forecast to 75.00 (from 60). Notably, it is likely to take a while before we see an end to the ongoing oil-price war.

Shocks to EM FX do tend to have a partially permanent effect on the level of exchange rates but normalisation, as we expect, is likely to help Eastern European currencies in H2. Near term, we are seeing stabilisation due to the policy measures being taken, but it is indeed fragile.

Quick view

- EUR/PLN to see downward pressure as the virus concerns in the global economy ease.
- EUR/HUF continues to drift higher; any HUF strength to prove short-lived.
- EUR/CZK has stabilised; near term, likely sideways to slightly lower.

- USD/RUB has likely overshot its fair value but still at risk from fragile oil market; RUB strength likely in H2 again though.
- USD/TRY set to rise by 8-10% annually yet again as the offsetting factor from high yields is gone.
- USD/ZAR is headed higher with South Africa downgraded to ‘junk’, economy in recession and commodity prices very, very weak.
- USD/CNY likely to range trade around 7.0 as virus fears settling down in China.
- USD/INR will likely move towards 72.00 when sentiment normalises.

Our most recent FX forecast update for G10 & EM can be found *here*. See also our weekly *FX Essentials*.

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What-to-watch: growth (virus), commodity prices, US foreign policy and Fed

Global growth — We view global growth as very low and we are still in a phase of slowing down rather than picking up pace. The latter is likely in H2.

Fed Policy — Fed has cut interest rates substantially and is supporting the global economy. This has yet to suppress broad USD strength. Thus we view this as 'grey.'

US foreign policy — Given the US presidential campaign is starting up in earnest, we don't think the US will come up with major foreign policy changes, including harsh new sanctions against Turkey and Russia.

Weak EMs — Many EM countries entered this crisis with low interest rates, weak growth and a dysfunctional political situation. This will continue to run its course, especially in South Africa.

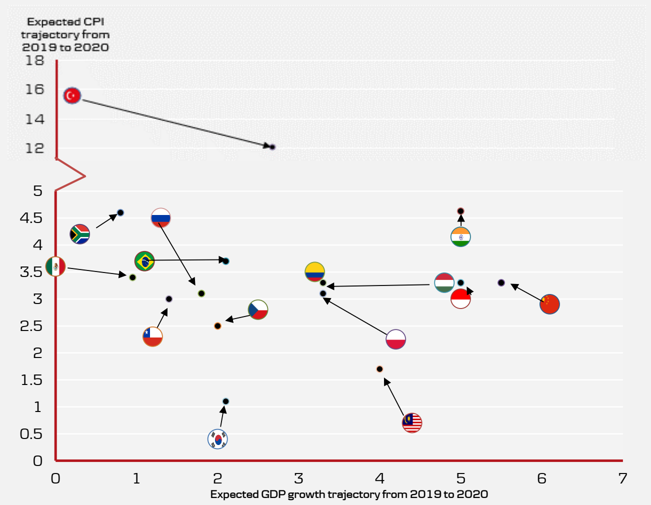
Note: Green reflects optimistic outlook, Red is negative and Grey is a neutral view.

Near-term negative EM environment, but turning more positive in 2020 as coronavirus fades

		2019				2020			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
External	China	weak	stimulus effects	trade uncertainty	improving macro	Coronavirus	Fading virus impact	Recovery post-virus	
	Fed	no hike		two cuts	one cut	Fed takes rates to zero, provides USD funding			
	Trade war/commodities	ceasefire	escalation		trade talks	phase 1 deal	phase 2 trade talks & cyclical uptick		
Regions	CEE	broad-based slowdown in CEE				stabilizing but inflation adds pressure			
	Latin America	significant growth downgrades			social turmoil	Brazil weak, Mexico in recession		stabilization	
	Asia	slowing			China drives recovery	Coronavirus	Fading virus impact	Recovery post-virus	

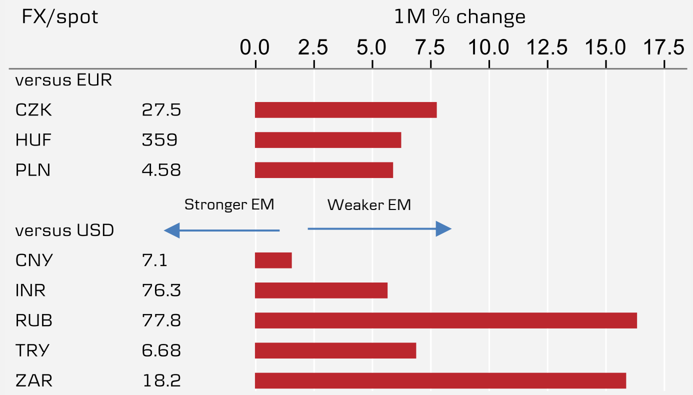
Note: Green reflects optimistic outlook, Red is negative and Grey is a neutral view. Colours reflect a broad macroeconomic view and not necessarily FX specific.

CEE facing weaker growth



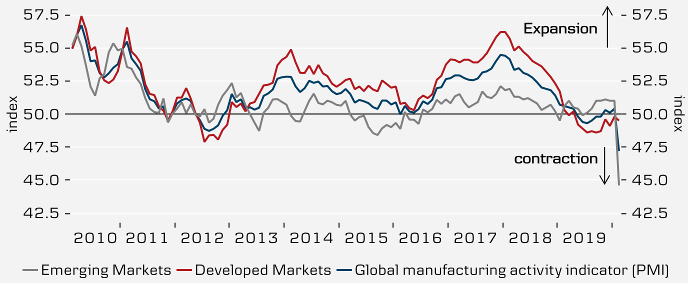
Note: Arrows indicate the change in Bloomberg consensus forecasts for growth and inflation from 2019 to 2020.
Source: Bloomberg, Macrobond Financial, Danske Bank

EM FX have generally weakened some 10-20%



Note: An increase reflects a stronger currency versus EUR or USD.
Source: Bloomberg, Macrobond Financial, Danske Bank

Global demand is taking a big hit from the virus



Source: Bloomberg, Macrobond Financial, Danske Bank

Danske Bank EM FX forecast vs. majors: USD, EUR

USD	Spot	+1m	+3m	+6m	+12m
USD/PLN	4.191	4.33	4.11	4.07	4.02
USD/HUF	329	336	341	343	344
USD/CZK	25.094	26.67	26.64	25.23	24.77
USD/RUB	77.773	81.00	81.00	75.00	70.00
USD/TRY	6.677	6.60	6.70	6.90	7.00
USD/ZAR	18.136	18.00	18.50	19.00	19.00
USD/CNY	7.10	7.20	7.15	7.10	7.05
USD/INR	76.27	71.00	71.00	71.50	72.00
EUR	**Spot**	**+1m**	**+3m**	**+6m**	**+12m**
EUR/PLN	4.584	4.55	4.40	4.36	4.30
EUR/HUF	360	360	365	367	368
EUR/CZK	27.446	28.00	28.50	27.00	26.50
EUR/RUB	85.069	85.05	86.67	80.25	74.90
EUR/TRY	7.324	6.93	7.17	7.38	7.49
EUR/ZAR	19.841	18.90	19.80	20.33	20.33
EUR/CNY	7.768	7.56	7.65	7.60	7.54
EUR/INR	83.430	74.55	75.97	76.51	77.04

Source: Danske Bank

Danske Bank EM FX forecast vs. Scandies: DKK, SEK, NOK

DKK	Spot	+1m	+3m	+6m	+12m
PLN/DKK	1.628	1.642	1.698	1.713	1.737
HUF/DKK	2.08	2.08	2.05	2.04	2.03
CZK/DKK	0.272	0.267	0.262	0.277	0.282
RUB/DKK	0.088	0.088	0.086	0.093	0.100
TRY/DKK	1.022	1.078	1.042	1.012	0.997
ZAR/DKK	0.376	0.395	0.378	0.367	0.367
CNY/DKK	0.961	0.988	0.977	0.983	0.990
INR/DKK	0.089	0.100	0.098	0.098	0.097
SEK	**Spot**	**+1m**	**+3m**	**+6m**	**+12m**
PLN/SEK	2.39	2.51	2.59	2.52	2.56
HUF/SEK	3.04	3.17	3.12	3.00	2.99
CZK/SEK	0.40	0.41	0.40	0.41	0.42
RUB/SEK	0.13	0.13	0.13	0.14	0.15
TRY/SEK	1.49	1.65	1.59	1.49	1.47
ZAR/SEK	0.55	0.60	0.58	0.54	0.54
CNY/SEK	1.408	1.508	1.490	1.448	1.458
INR/SEK	0.131	0.153	0.150	0.144	0.143
NOK	**Spot**	**+1m**	**+3m**	**+6m**	**+12m**
PLN/NOK	2.46	2.64	2.61	2.52	2.44
HUF/NOK	3.13	3.33	3.15	3.00	2.85
CZK/NOK	0.41	0.43	0.40	0.41	0.40
RUB/NOK	0.13	0.14	0.13	0.14	0.14
TRY/NOK	1.54	1.73	1.60	1.49	1.40
ZAR/NOK	0.57	0.63	0.58	0.54	0.52
CNY/NOK	1.450	1.587	1.503	1.448	1.392
INR/NOK	0.135	0.161	0.151	0.144	0.136

Source: Danske Bank

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Jakob Christensen, Head of Emerging Markets Research, and Lars Sparresø Merklin, Senior Analyst, FX Strategy.

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