29 June 2018

Emerging Markets Briefer

Trade war and shrinking liquidity add pressure on EM

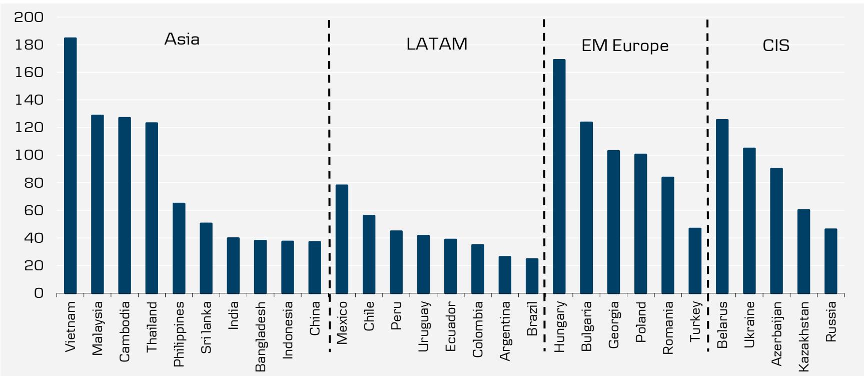
The fear of a global trade war, which started worrying financial markets in Q1 18, has become an overwhelming risk factor for the global economy. Previously, we saw two possible scenarios: (1) negotiations and a 'grand bargain' and (2) Donald Trump striking back again and entering a trade war. Despite the loss-loss setup for both the US and global economies on escalation of a trade war, scenario 2 has been playing out, putting aside any relief in financial markets, as we highlight in *US-China Trade – Trade war becomes a reality as Trump pushes further*, 19 June.

Currently, it looks to us very likely that a widespread trade war will hit global growth and hurt the export-dependent emerging markets, notably in the Asian, Central and Eastern European region, with the former remaining most exposed to the US both directly and indirectly, while the latter would suffer through exports to German contractors. While the downside risks to emerging markets have certainly increased, we are awaiting more clarity on how the trade dispute will play out, notably around 6 July, before revising our forecast in a substantial way. That said, **looking into H2 18**, growth differentials are still widening in favour of the US economy, global liquidity is shrinking and trade tensions are escalating: these factors are set to challenge emerging markets in short and medium term. **The Fed's fourth hike in 2018 seems to be priced in already, while 2019 remains open.** Thus, the Fed's growing dovishness represents an upside risk for emerging markets.

The most recent *OPEC decision* to increase output is good for oil importing countries such as India or Turkey (see *Flash Comment International – OPEC agrees to hike output*, 22 June). However, smaller-than-expected expansion of production would keep crude prices stable, favouring Brazil, the Middle East and North Africa region and Russia.

Macro fundamentals continue to look good for many emerging markets. Central banks in some emerging markets, such as Brazil and Russia, stopped their monetary easing cycle to avoid further divergence from developed markets and keep inflation subdued, supporting the attractiveness of local currencies. Staying negative on emerging markets in the short and medium term with increased downside risks, we see recovery potential long term.

Danske Bank World Trade Openness Index: higher number indicates higher vulnerability to trade wars. The index takes into account total foreign trade in % of GDP, export share to the US in % of GDP, exports % of GDP.



Source: IMF, Danske Bank

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Poland: global trade jitters and Italy concerns hit PLN

Macro and political outlook

- The Polish economy continues to grow strongly. In Q1, real GDP expanded by 5.2% y/y (or 1.6% q/q sa), which is the fastest growth since 2011. Indicators in Q2 also point to relatively strong growth in Q2, supported by private consumption (retail sales in real terms expanded by 6.1% y/y in May) and investment (construction output increased by 21% y/y in February). Due to the strong Q1, we have raised the 2018 real GDP growth estimate to 4.5%. Nevertheless, we think the Polish economy may have seen a peak in this business cycle and economic growth may slow in H2 and beyond, due partly to a more challenging external environment hit by trade concerns, but also waning effects on private consumption of the child benefit check. As a result, economic growth will slow to 3.3% in 2019, in our view.

Monetary policy outlook

- Inflation pressures in the Polish economy continue to be surprisingly subdued. Typically fast economic growth and tight labour market prompting high wage growth has been associated with a pickup in core inflation. However, core inflation grew by only 0.5% y/y in May and has now been on a declining trend since January. Meanwhile, energy and food price inflation has picked up somewhat, meaning headline inflation was 1.7%, still significantly below the central bank's target of 2.5%. In light of the relatively subdued inflation pressures, the National Bank of Poland (NBP) is in no hurry to raise rates, with board members stating that rates could stay unchanged for the next two years. Financial markets are pricing in one 25bp hike until end-2019, which we think is fair, although there may be upside risk to inflation from the weaker PLN.

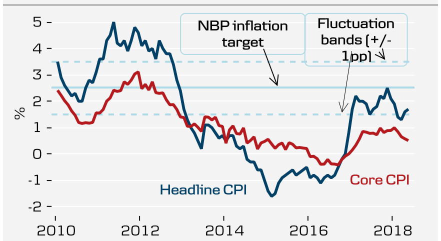
FX outlook

- The zloty has been hit by the deterioration in global risk sentiment and trade war jitters, but also a weakening euro given concerns about the Italian debt outlook. The weak inflation prints and a more dovish NBP have not helped the PLN either. Given these factors, we are more cautious on the outlook for the PLN, seeing the EUR/PLN treading in a higher range of 4.30-4.35 near term. As a result, we have raised 3M forecasts for EUR/PLN to 4.26, respectively (previously 4.18), assuming that the risk-off environment will vane over time and support the PLN. We expect a modest decline in the pair over time to 4.22 in 6M and 4.20 in 12M (previously 4.16 and 4.14).

Risk factors

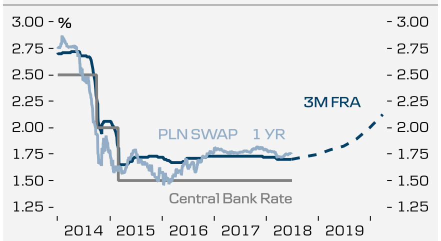
- The risk to our EUR/PLN forecast is slightly skewed to the upside given the possibility of further escalation in the global trade war, continuation of risk-off environment and tense relations with the EU. Downside risks include a surprise in Polish macroeconomic indicators, notably inflation, which could be aided by the weaker zloty, while also an improvement in global risk sentiment could boost the PLN more than we assume in our forecast.

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+ (stable)

Currency regime:

Free float (freely convertible)

Inflation target:

2.5% ±1pp

Macro forecasts

	2016	2017	2018	2019	2020
GDP (% y/y)	2.9	4.6	4.5	3.3	3.0
GDP deflator (% y/y)	0.4	2.0	2.0	1.8	1.7
CPI (% y/y)	-0.6	2.0	2.0	2.5	2.5
Private consumption (% y/y)	3.8	4.8	4.5	3.6	2.9
Fixed investments (% y/y)	-7.9	3.3	5.6	3.7	2.9
Unemployment (%)	8.2	7.1	6.5	6.2	6.2
Current account (% of GDP)	0.2	-0.5	-0.9	-1.5	-1.7

Source: Macrobond Financial, Danske Bank

Interest rate forecast

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

Source: Danske Bank

FX forecasts

EUR/PLN		
	Danske	Forward
27-Jun	4.34	
+3M	4.26	4.38
+6M	4.22	4.41
+12M	4.20	4.45
USD/PLN		
	Danske	Forward
27-Jun	3.74	
+3M	3.64	3.75
+6M	3.52	3.75
+12M	3.36	3.73

Source: Danske Bank

Hungary – trade war risk is substantial

Macro outlook

- Economic growth continues to be strong, posting 4.4% y/y in Q1 18 versus 4.4% y/y in Q4 17. This, in turn, was stronger than Q3 17. Industrial production growth is slowing slightly on weaker manufacturing expansion. However, the growth remains sustainable, supported by growing food output. We continue to be less concerned about potential overheating of the economy, as the output gap is still in the process of closing. In our view, accelerating economic growth would increase concern about overheating should the Hungarian central bank maintain its dovish stance throughout 2018.
- 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.
- The parliamentary election on 8 April 2018 was not a market mover. Prime Minister Viktor Orbán and his political party Fidesz remained strong. In addition to trade war concerns, other factors affecting Hungary's macro economy and the HUF are EUR strength and political developments within the EU.

Monetary policy outlook

- The Hungarian central bank (the MNB) kept rates unchanged at its June meeting and seems to be on hold for now. In May, CPI inflation jumped to 2.8% y/y, approaching the central bank's 3.0% target. While the strong HUF is not a concern for the MNB anymore, the central bank started to sound more hawkish as the inflation target could be hit any time soon. We believe the risk of a rate hike by late 2018 is increasing.

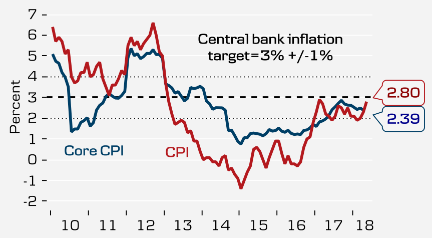
FX outlook

- The HUF has been hit mostly by the weaker EUR and rising global trade war tensions. While local macro fundamental factors are still benign for the HUF, we have updated our EUR/HUF forecasts given our latest EUR/USD forecast. In the long term, we expect the HUF to appreciate.

Risk factors

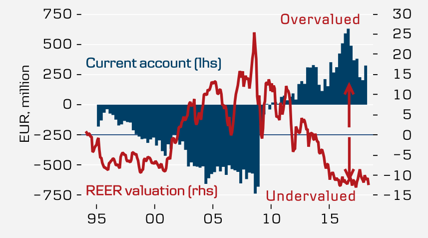
- A clear upside risk to our EUR/HUF forecast is further deterioration of global risk sentiment and political turbulence within the EU.

Inflation climbs on weaker HUF, leading to hawkish tone from the MNB



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- (positive)

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 (% Dec/Dec)	2.1	2.5	2.8	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	24/07/2018
Next change	+10bp 2019
End-2018	0.90

Source: Danske Bank

FX forecasts

EUR/HUF		
	Danske	Forward
27-Jun	327.0	
+3M	325.0	329.1
+6M	320.0	329.5
+12M	315.0	331.9
USD/HUF		
	Danske	Forward
27-Jun	282.08	
+3M	277.78	281.88
+6M	266.67	280.04
+12M	252.00	277.63

Source: Danske Bank

Czech Republic – CNB restarts hiking cycle

Macro and political outlook

- The strong growth story of the Czech economy continued in Q1 18 with growth of 4.4% y/y. We think household consumption and investment spending will remain the most important growth drivers in light of the upbeat consumer sentiment, rising wages and growing capacity constraints. Headwinds to growth will increasingly stem from the external side due to rising global trade tensions. We expect GDP growth to moderate to 3.3% in 2018, closer to potential, also on the back of tighter monetary conditions and supply-side bottlenecks. The unemployment rate remains the lowest in the EU. Following eight months of political vacuum, Prime Minister Andrej Babiš has finally secured a coalition deal with the Social Democrats. We do not expect significant policy changes under the new government, which is expected to take office in July.

Monetary policy outlook

- In light of the recent CZK depreciation, the central bank delivered another 25bp policy rate hike on 27 June. The timing of the Czech hiking cycle remains dependent on FX movements, but as the exchange rate remains roughly 2% weaker than projected by the CNB, we see increasing arguments as to why the CNB might favour an additional rate hike this year. For 2019, we currently expect two additional interest rate rises, which means that the policy rate will remain below its long-run neutral level (estimated at c.3.0% by the CNB).

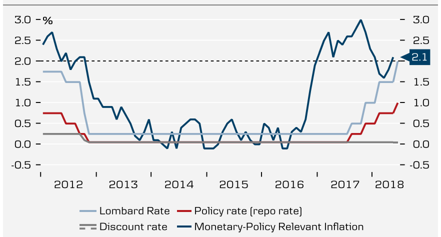
FX outlook

- The CZK has weakened over the past quarter on the back of capital outflows and a general deterioration in EM risk sentiment. Despite the CNB hike, EUR/CZK continues to trade around 25.80 and we project the cross will continue to hover around current levels in the short term. In the medium term, we expect the CZK to return to its moderate strengthening path, as the Czech macroeconomic backdrop remains very favourable and the CNB is likely to deliver its next interest rate increase within the next six months. That said, the deprecation pace is expected to abate compared to 2017, as the Czech economy shifts into a lower gear and the ECB is also gradually moving towards policy normalisation. We raise our 1M forecast to 25.70 (25.50 previously) and 3M forecast to 25.50 (25.40 previously). Our medium-term forecasts are unchanged at 25.00 in 6M and 24.80 in 12M.

Risk factors

- Given the sizable amount of long CZK positions accumulated in the market prior to the floor exit, EUR/CZK is still vulnerable to spikes higher. The risk to our EUR/CZK forecast is skewed to the upside due to still wobbly EM risk sentiment and global trade war concerns building, which would also have repercussions for a small open economy like the Czech Republic.

Inflation rebound induces the CNB to early restart of hiking cycle



Source: Macrobond Financial, Danske Bank

CZK has been weaker than the CNB envisioned

Source: Macrobond Financial, Danske Bank

CZK

Credit rating:

S&P: AA- (stable)

Currency regime:

Managed float

Inflation target:

2% ±1pp

Macro forecasts

	2017	2018	2019
GDP (% y/y)	4.6	3.3	3.1
GDP deflator (% y/y)	1.4	2.1	1.9
CPI (% y/y)	2.5	2.1	2.0
Private consumption (% y/y)	4.0	3.2	3.1
Fixed investments (% y/y)	5.9	7.6	3.4
Unemployment (%)	4.2	3.3	3.2
Current account (% of GDP)	1.1	1.0	1.2

Source: Macrobond Financial, Danske Bank

Interest rate forecast

Czech National Bank (CNB)		
Policy rate	1.00	
Next meeting	02/08/2018	
Next change	+25bp	H2, 2018
End-2018	1.25	

Source: Danske Bank

FX forecasts

EUR/CZK		
	Danske	Forward
27-Jun	25.87	
+3M	25.50	26.00
+6M	25.00	25.99
+12M	24.80	26.14
USD/CZK		
	Danske	Forward
27-Jun	22.31	
+3M	21.79	22.27
+6M	20.83	22.09
+12M	19.84	21.87

Source: Danske Bank

Russia: preparing for reforms

Macro outlook

- The Russian economy grew 1.3% y/y in Q1 18 versus 0.9% y/y in Q4 17 as gradual monetary easing helped private consumers see more relief and cold weather boosted gas and electricity production. However, early 2018 growth has been more muted than expected. Yet, we have seen a strong expansion in residential construction on a low base effect. We keep our GDP growth estimates at 2.0% for 2018, 2.1% for 2019 and 2.2% y/y in 2020.
- The presidential election in March 2018 was a non-event for the markets as broadly expected. Russia's new government did not surprise with new names either. Yet, discussions on unpopular economic moves have intensified: the legislators got a bill on the pension reform. According to the bill, the pension age for women would be increased by eight years from the current 55 years. For men, the shift would be five years from 60 years. While the chances of the bill passing all hearings with the legislators are very high, possible protests could soften the reform on President Vladimir Putin's order before he signs the document.
- While we estimate that the looming pension reform would bring relief for Russia's tight labour market and internal finances, 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.

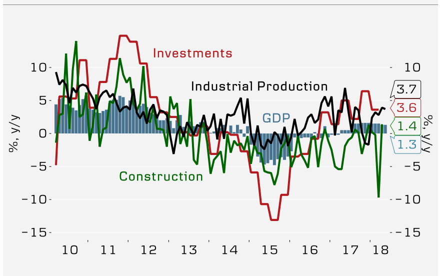
FX and monetary policy outlook

- In June 2018, the CBR kept its key rate at 7.25%, signalling that the current cautious stance is set to continue. In the environment of high emerging market turbulence and a looming VAT increase of 2pp to 20%, we consider the risks of an unchanged key rate in 2018 very high. We expect only one 25bp cut in 2018.
- Given the upcoming combination of FX flows (World Cup inflows versus outflows on dividend payments), we keep our view on the USD/RUB unchanged in the short term, enhancing the importance of geopolitical risks. In the long term, we see macro fundamentals supporting the RUB, keeping a geopolitical premium though, while we expect the Russian currency to stay strongly undervalued on FX purchases by the Ministry of Finance.

Risk factors

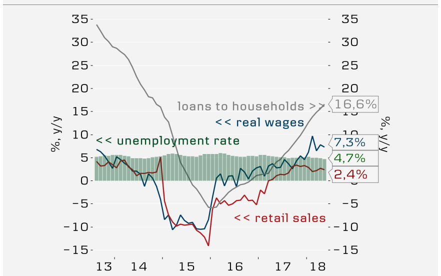
- Further geopolitical escalation is a serious short- to medium-term risk for the RUB, Russian stocks and government debt. Upside risks come from an increasing oil price and improving relations with the West.

Economic growth components stay in green also on revised statistical data



Source: Macrobond Financial, Danske Bank

Private consumption could accelerate in H2 18 on VAT increase plans



Source: Macrobond Financial, Danske Bank

RUB

Credit rating:

S&P: BBB- (stable)

Currency regime:

Free float

Inflation target:

4%

Macro forecasts

	2017	2018E	2019E	2020E
Real GDP (% y/y)	1.5	2.0	2.1	2.2
Private consumption, real (% y/y)	3.3	4.0	4.9	5.2
Fixed investments, real (% y/y)	7.5	8.4	8.7	9.0
Brent oil price (USD, average,	54.8	74.2	72.5	69.0
Brent oil price (% y/y)	21.4	35.6	-2.4	-4.8
Exports in USD (average % y/y)	25.1	14.0	18.0	20.0
Imports in USD (average % y/y)	23.8	10.0	2.0	3.2
MosPrime 3 months rate (%	9.3	7.25	6.7	6.0
CPI (% Dec/Dec)	2.5	3.3	3.3	3.0
Unemployment (%)	5.2	5.1	5.0	5.0
Budget balance (% of GDP)	-1.7	-0.1	0.2	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	7.25	
Next meeting	27/07/2018	
Next change	-25bp	Q4, 2018
End-2018	7.00	

Source: CBR, Danske Bank

FX forecasts

EUR/RUB		
	Danske	Forward
27-Jun	72.94	
+3M	70.32	74.20
+6M	69.96	75.44
+12M	69.63	78.00

USD/RUB		
	Danske	Forward
27-Jun	62.91	
+3M	60.10	63.74
+6M	58.30	64.30
+12M	55.70	65.43

Source: Danske Bank

Turkey – growth continues, while overheating fears mount

Macro outlook

- Turkey's economic growth remained solid in Q1 18: GDP expanded 7.4% y/y versus 7.3% y/y in Q4 17. Industrial production growth continues to slow, with the manufacturing PMI index anticipating this and staying below 50.0. Turkey's 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 to 3.5% y/y, as a high base effect keeps expansion figures lower and the central bank is likely to remain hawkish in order to provide TRY stability. We expect 2019 GDP growth to slow to 3.0% y/y and 2.8% y/y in 2020.
- Given President Recep Tayyip Erdoğan's double victory in the snap election on 24 June, we expect his strong mandate to rule the country and the economy to allow more fiscal austerity.

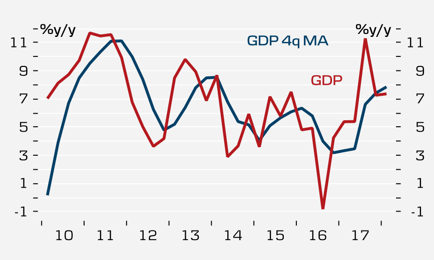
FX and monetary policy outlook

- Turkey's central bank (TCMB) provided a significant surprise at its June monetary policy meeting by exceeding the market's expectations on the rate decision. The TCMB delivered a super bold 125bp hike in the benchmark rate, causing a substantial rally in the TRY. The TCMB showed its great desire to restore credibility ahead of the snap election.
- Such a bold hike is a big shift in Turkey's central bank's monetary policy approach. 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 and widening current account deficit, which has hit its deepest level since late 2013.

Risk factors

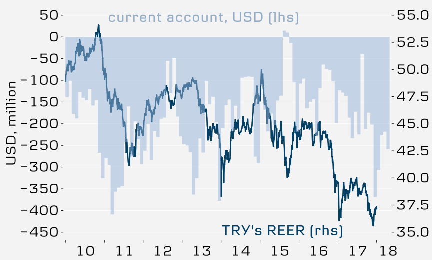
- Downside risks to our TRY forecasts are still geopolitical, if the confrontation with the US escalates, e.g. on the S-400 anti-aircraft weapon system deliveries by Russia. The TCMB's easing of political pressure and improving macro factors also present downside risks to our TRY forecasts. Fed monetary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

Turkey's GDP growth continues to be strong



Source: Macrobond Financial, Danske Bank

Current account deficit set to continue weighing on the TRY



Source: Macrobond Financial, Danske Bank

TRY

Credit rating:

S&P: BB- (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	3.0	2.8
Private consumption, real (% y/y)	6.0	3.1	2.7	2.5
Fixed investments, real (% y/y)	7.0	4.0	3.2	3.0
CPI (% Dec/Dec)	11.1	8.2	7.8	7.5
Unemployment (%)	10.9	10.0	10.4	10.5
Current account (% of GDP)	-5.2	-5.4	-5.1	-5.0

Source: Bloomberg, Danske Bank

Interest rate forecasts

C.B. of the Republic of Turkey (TCMB)		
Policy rate	17.75	
Next meeting	24/07/2018	
Next change	-100bp	2019
End-2018	17.75	

Source: Danske Bank

FX forecasts

EUR/TRY		
	Danske	Forward
27-Jun	5.33	
+3M	5.21	5.59
+6M	5.22	5.85
+12M	5.63	6.41
USD/TRY		
	Danske	Forward
27-Jun	4.60	
+3M	4.45	4.80
+6M	4.35	4.99
+12M	4.50	5.38

Source: Macrobond Financial, Danske Bank

South Africa – Ramaphosa is off to a good start

Macro outlook

- The new South African government led by President Cyril Ramaphosa got a reality check when the Q1 GDP numbers showed only meagre growth in the South African economy. Real GDP growth was only 0.8% y/y against the market expectation of 1.9% growth. Compared with the past quarter, real GDP declined by 0.5%. Agriculture, mining and manufacturing were the main contributors to the slowdown, with the electricity, construction and trade industries also recording negative growth. On the expenditure side, the main factors behind the lower growth were a sharp drop in exports but also investments. The decline in exports combined with higher oil prices also led to a weakening of the current balance to 4.8% of GDP in Q1.

- The weak Q1 GDP numbers raise doubts about the rebound in the South Africa economy, which was boosted by the appointment of the Ramaphosa government to power. The outlook for the South African economy has been put in doubt further due to global trade jitters and weakening EM sentiment. As a result of the weak Q1 GDP numbers and more challenging external environment, we revise down our real GDP forecasts to 1.2% in 2018 and to 2.2% in 2019 (previously 2.3% in 2018-19), which are above Bloomberg consensus for both years.

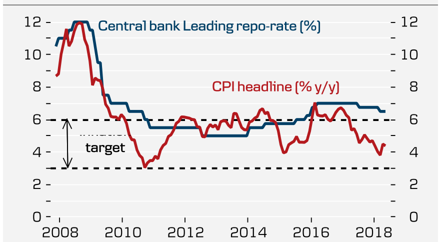
Monetary policy outlook

- The South African Reserve Bank (SARB) kept its benchmark repo rate unchanged at 6.50% at the 24 May meeting, in line with our expectations. Inflation pressures continue to remain under control despite higher oil prices. Both core and headline inflation were 4.4% in May, safely within the central bank's 3-6% inflation band. However, the combination of a weaker ZAR and higher oil prices will create upward inflation pressures in the next months. We think that SARB will keeps its policy rate unchanged throughout 2018 given the negative global EM environment and global trade concerns.

FX outlook

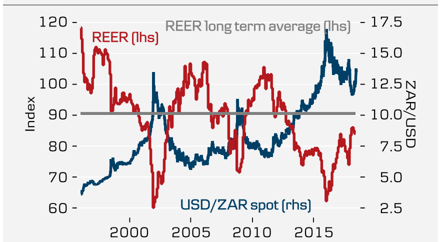
- The ZAR has been hit sharply by the combination of the weak economic growth and the negative EM environment surrounding higher US yields and dollar as well as global trade concerns. The rand is now hovering about its long-term value, providing limited upside in the short term. Hence, we think the USD/ZAR will be driven by external factors, most notably the EM sentiment and global trade discussions. Given the recent weakening, we lift our 3M forecast for USD/ZAR to 13.20 (previously 11.50), remaining broadly stable around 13.00 in 6M and 12M as trade concerns will continue to linger.

Inflation has fallen to the lower part of SARB's target range



Source: Macrobond Financial

Despite its recent strength, 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	2021
GDP (% y/y)	1.3	1.2	1.8	2.2	2.7
GDP deflator (% y/y)	5.5	6.1	6.6	6.7	6.7
CPI (% y/y)	6.6	5.2	5.0	5.2	5.3
Private consumption (% y/y)	2.2	2.6	1.9	1.9	2.4
Fixed investments (% y/y)	0.4	3.1	2.1	1.9	2.4
Unemployment (%)	26.7	26.4	27.2	27.5	27.6
Current account (% of GDP)	-2.8	-2.5	-2.3	-2.4	-2.5

Source: Bloomberg, Danske Bank

Interest rate forecast

South African Reserve Bank (SARB)		
Policy rate	6.50	
Next meeting	19/07/2018	
Next change	-25bp	Q1, 2019
End-2018	6.50	

Source: Danske Bank

FX forecasts

EUR/ZAR		
	Danske	Forward
27-Jun	15.90	
+3M	15.44	16.35
+6M	15.60	16.68
+12M	16.25	17.33

USD/ZAR		
	Danske	Forward
27-Jun	13.72	
+3M	13.20	14.01
+6M	13.00	14.17
+12M	13.00	14.50

Source: Macrobond Financial, Danske Bank

Brazil – growing on monetary easing

Macro outlook

- Brazil's economic growth slowed to 1.2% y/y in Q1 18, from a 2.1% y/y expansion in Q4 17. In early 2018, the economy received support from manufacturing, while agriculture slid the most. We keep our 2018 GDP growth forecast at 2.2% y/y, seeing downside risks from the recent significant lorry drivers' strike, expecting GDP to expand 2.4% y/y in 2019 and 2.6% y/y in 2020, as monetary easing provides 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 primary concerns faced by a new president remain fiscal reform, unemployment and security. The trade war issue is likely to dominate the external economic agenda.
- The increase in Brazil's public net debt as a percentage of GDP stopped in March at a 14-year high of 52.3%, falling marginally in April. If the rise restarts, it could fuel more uncertainty ahead of the presidential election, affecting the BRL.

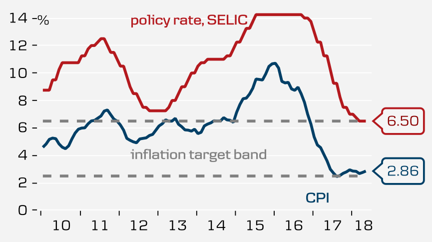
Monetary policy outlook

- 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 do not expect the BCB to use key rate hikes to support the BRL before USD/BRL climbs over the critical level of 4.00.

FX outlook

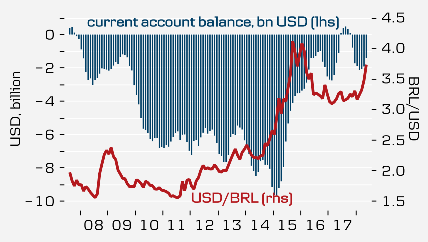
- Sour global emerging market sentiment and trade war concerns have been driving the BRL over the past month. Currently, additional pressure on the currency is coming from domestic political issues. Long-term prospects for the BRL look brisker on an economic recovery and still attractive carry, while we believe pre-election woes are set to weigh further on the currency in 2018.
- We update our USD/BRL forecast levels to reflect the recent developments in emerging market sentiment. The most important negative risks have now shifted from the idiosyncratic ones to global ones. Upside risks include a more dovish Fed and US President Donald Trump's retreat from his hawkish trade war rhetoric. The Brazilian economy and a rapid approval of reforms by the government, stabilising the political situation ahead of the presidential election, would also be BRL positive.

Central bank is set to stay on hold in 2018 as emerging market volatility shakes BRL



Source: Macrobond Financial, Danske Bank

Deteriorating current account weighs on BRL



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

Macro forecasts

	2017	2018E	2019E	2020E
Real GDP (% y/y)	1.0	2.2	2.4	2.6
Private consumption, real (% y/y)	1.0	2.8	3.0	3.2
Fixed investments, real (% y/y)	0.0	3.5	4.0	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 Danske Bank

Interest rate forecasts

Central Bank of Brazil (BCB)	
Policy rate	6.50
Next meeting	01/08/2018
Next change	-25bp 2019
End-2018	6.50

Source: Danske Bank

FX forecasts

EUR/BRL		
	Danske	Forward
27-Jun	4.45	
+3M	4.39	4.52
+6M	4.38	4.58
+12M	4.38	4.72

USD/BRL		
	Danske	Forward
27-Jun	3.84	
+3M	3.75	3.87
+6M	3.65	3.89
+12M	3.50	3.95

Source: Macrobond Financial, Danske Bank

China: downside risks from trade war

Macro outlook

- After robust growth in 2016 and 2017, there are signs that activity is slowing in 2018. Our baseline scenario is a soft landing this year pulled by weaker housing and a dampening of export growth. Our growth forecast for 2018 is 6.6% following 6.9% in 2017.
- However, the trade conflict with the US looks like it is morphing into an actual trade war, which puts growth at risk, and the outlook for CNY.
- After the US and China showed progress in trade negotiations mid-May, US President Donald Trump changed course at the end of May and decided to continue with his plans to slap tariffs on China. This has put us back on a track with escalation and a tit-for-tat pattern, see *US-China Trade - trade war becomes a reality as Trump pushes further*, 19 June 2018.
- Trump has signalled that the US has the strongest hand in the trade fight and has moved back to a course of confrontation. While China has made concessions in a range of areas (lower tariffs, opening further for investments, better protection of intellectual property rights and a stop of technology transfer in joint ventures) it is unlikely to meet the US demand to scrap the ‘Made in China 2025’ strategy. This strategy puts investment in technology and innovation at the centre of growth in the years ahead and is seen as a cornerstone in climbing the value chain and avoiding the so-called ‘Middle Income Trap’.
- China has continued the deleveraging push and crackdown on the shadow banking system. As a result corporate defaults have moved higher and credit growth is weak. It is causing some short-term pain in some sectors but it is a necessary step for China to defuse the debt bomb. We believe China will continue the deleveraging push in coming years but the trade war could make it pull back a little bit to limit the hit to growth.

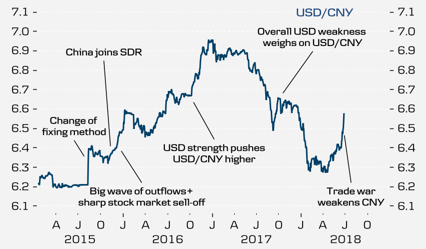
Monetary policy outlook

- The People’s Bank of China (PBoC) has eased policy twice recently by lowering the Reserve Requirement Ratio (RRR). It frees up liquidity and is targeted at small and micro companies that have tended to have worse credit availability relative to the big state-owned companies. We expect the PBoC to ease policy further to accommodate the downward pressure on growth from the trade war with the US.

FX outlook

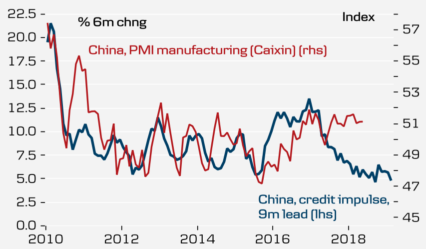
- The CNY has weakened sharply recently due to the uncertainty about a trade war and a sharp decline in equity markets. We have revised our CNY outlook and now look for further weakening towards 6.7 in 12M. See *FX Strategy: Downward revision to our CNY outlook*, 26 June 2018.

CNY hit by trade war – more to come



Source: Macrobond Financial

Financial tightening set to slow activity



Source: Macrobond Financial

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	2.2
2020	6.2	6.1	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	-25bp	Q1, 2019
End-2018	4.35	

Source: Danske Bank

FX forecasts

EUR/CNY		
	Danske	Forward
27-Jun	7.67	
+3M	7.72	7.76
+6M	7.98	7.85
+12M	8.38	8.04
USD/CNY		
	Danske	Forward (NDF)
27-Jun	6.60	
+3M	6.60	6.64
+6M	6.65	6.66
+12M	6.70	6.71

Source: Bloomberg, Danske Bank

India: robust growth continues

Macro outlook

- **Growth.** India's GDP growth increased to 7.7% in Q1 18 from 7.0% in Q4 17. India's economy has benefited from the strong global economy, which has underpinned exports, and the domestic economy has grown at a decent rate underpinned by reforms by the Modi government and overall macroeconomic stability. Import growth has generally proven a fairly good indicator of India's business cycle. The development in imported goods suggests that the pace of growth is easing a bit in early 2018 in line with what we see in other emerging markets.

- The long-term growth potential is robust and we expect the economy to grow a solid 7.0% in 2018 supported by effects of recent reforms. Positive effects from the goods and service tax (GST) reform have been praised by the IMF as has some liberalisation in the Foreign Direct Investment framework. However, on a micro level, one of India's big problems is still lots of bureaucracy and a high level of corruption.

- The main downside risk is that India could get caught in the crossfire of the US-China trade war. Weaker Chinese growth would reduce Indian export demand and could also hurt investments due to the uncertainty. India itself has put tariffs on US goods in retaliation to Trump's tariffs on steel and aluminium.

- **Macroeconomic stability and balances.** India has achieved a high degree of macroeconomic stability with inflation under control and a robust current account balance with a small deficit around 1% of GDP down from 5% of GDP five years ago. The fiscal deficit is still too high, however, at around 6% of GDP. Moody's upgraded India's sovereign debt rating in November 2017 for the first time since 2004 on optimism that Narendra Modi's reforms will reduce the risk of a sharp increase in debt.

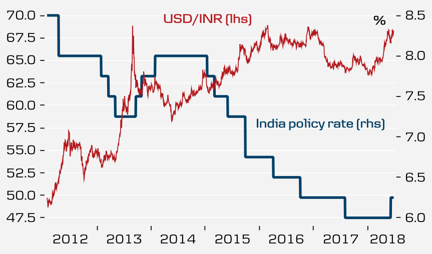
Monetary policy outlook

- The Reserve Bank of India raised rates in June for the first time in four years, citing growing inflationary pressures from higher oil prices and financial turmoil putting pressure on the currency. We expect another hike during H2 to stave off outflow pressures due to the current emerging market pressures and the rise in oil prices.

FX outlook

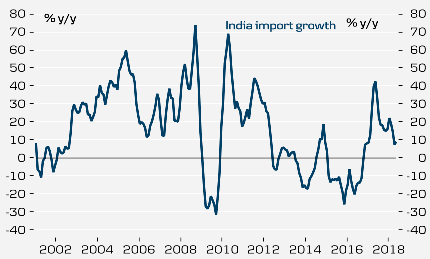
- The INR has not escaped the broader EM FX sell-off and USD/INR has moved towards the highest level seen in two years. We look for further upside in USD/INR, as continued EM uncertainty is set to continue and the spill-over from China is set to weigh on the currency.

USD/INR weaker recently, RBI hiked



Source: Macrobond Financial, Danske Bank

Import growth suggests growth momentum slowed a bit 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	7.3	7.2	4.4	4.8
2019	7.2	7.6	4.5	4.7
2020	7.0	7.6	4.5	4.6

Source: Bloomberg, Danske Bank

Interest rate forecast

Reserve Bank of India (RBI)	
Policy rate	6.25
Next meeting	01/08/2018
Next change	+ 25bp H2 2018
End-2018	6.50

Source: Danske Bank

FX forecasts

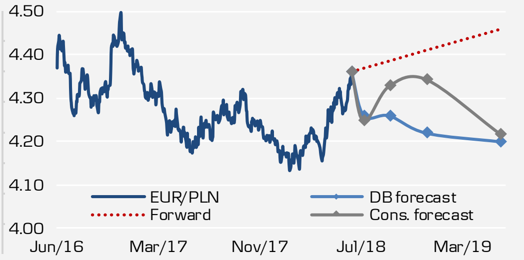
EUR/INR		
	Danske	Forward
27-Jun	79.59	
+3M	80.73	80.97
+6M	84.00	82.54
+12M	88.75	85.63

USD/INR		
	Danske	Forward
27-Jun	68.65	
+3M	69.00	69.35
+6M	70.00	70.14
+12M	71.00	71.64

Source: Macrobond Financial, Danske Bank

Danske Bank hedging recommendations: EMEA

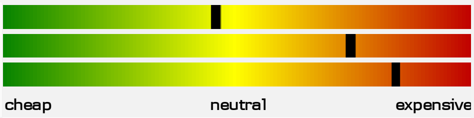
Currency	Instrument: Income	Instrument: Expenses	Forecast
PLN	We recommend hedging PLN income via knock-in forwards.	We recommend hedging PLN expenses via FX forwards.	



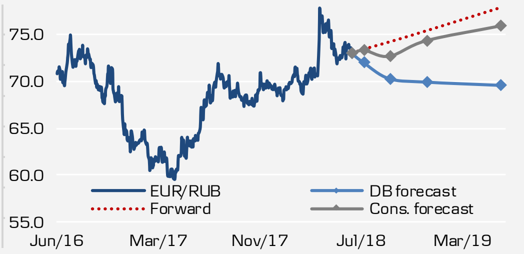
	1M	3M	6M	12M
DB forecast	4.26	4.26	4.22	4.20
Forward	4.37	4.39	4.41	4.46
Cons. forecast	4.25	4.33	4.34	4.22

Price indicators

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



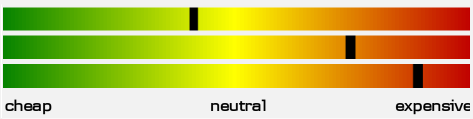
Currency	Instrument: Income	Instrument: Expenses	Forecast
RUB	We recommend hedging RUB-income via knock-in forwards.	We recommend hedging RUB expenses via FX forwards.	



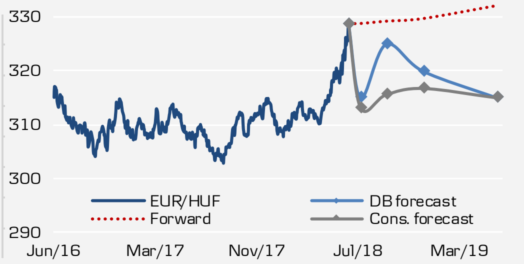
	1M	3M	6M	12M
DB forecast	71.96	70.32	69.96	69.63
Forward	73.39	74.18	75.40	77.95
Cons. forecast	73.36	72.72	74.34	75.88

Price indicators

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



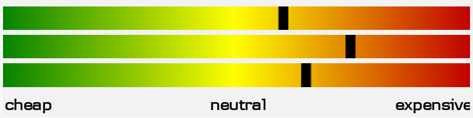
Currency	Instrument: Income	Instrument: Expenses	Forecast
HUF	We recommend hedging HUF income via knock-in forwards.	We recommend hedging HUF expenses via FX forwards.	



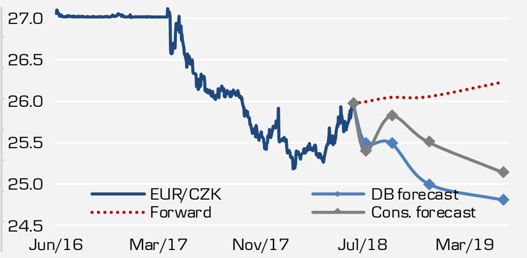
	1M	3M	6M	12M
DB forecast	315.00	325.00	320.00	315.00
Forward	328.86	329.28	329.77	332.21
Cons. forecast	313.11	315.57	316.76	315.00

Price indicators

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



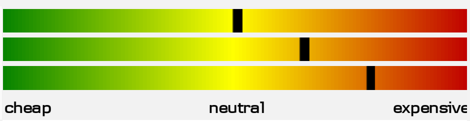
Currency	Instrument: Income	Instrument: Expenses	Forecast
CZK	We recommend hedging CZK income via knock-in forwards.	We recommend hedging CZK expenses via FX forwards.	



	1M	3M	6M	12M
DB forecast	25.50	25.50	25.00	24.80
Forward	26.00	26.06	26.06	26.24
Cons. forecast	25.40	25.83	25.51	25.14

Price indicators

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



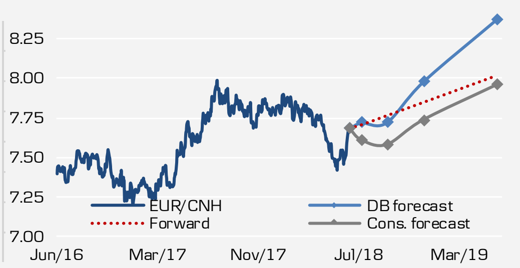
Source: Danske Bank

Danske Bank hedging recommendations: other emerging markets

CNH

Currency	Instrument: Income	Instrument: Expenses
CNH	We recommend hedging CNH income via FX forwards.	We recommend hedging CNH payables via a risk-reversal strategy. Longer term, we recommend hedging via FX forwards.

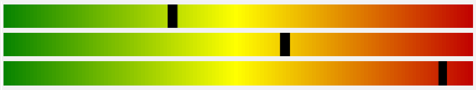
Forecast



	1M	3M	6M	12M
DB forecast	7.72	7.72	7.98	8.38
Forward	7.70	7.76	7.85	8.02
Cons. forecast	7.61	7.58	7.73	7.96

Price indicators

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

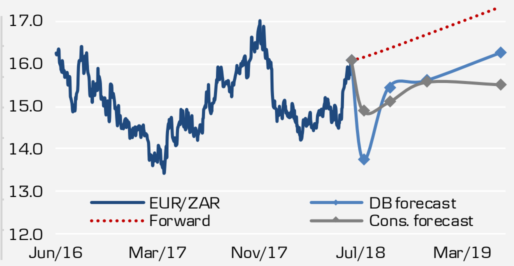


cheap neutral expensive

ZAR

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

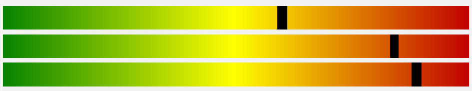
Forecast



	1M	3M	6M	12M
DB forecast	13.75	15.44	15.60	16.25
Forward	16.14	16.35	16.67	17.33
Cons. forecast	14.89	15.10	15.56	15.51

Price indicators

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

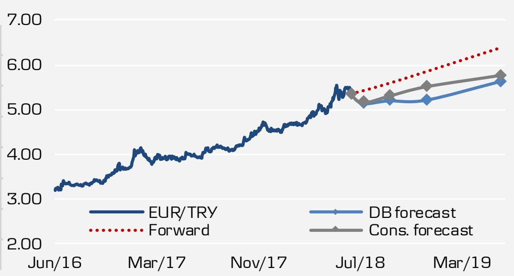


cheap neutral expensive

TRY

Currency	Instrument: Income	Instrument: Expenses
TRY	Hedge TRY income with FX forwards.	We recommend hedging TRY expenses with FX forwards. Alternatively, one may consider using a risk-reversal strategy.

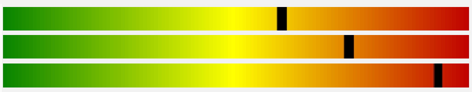
Forecast



	1M	3M	6M	12M
DB forecast	5.15	5.21	5.22	5.63
Forward	5.41	5.57	5.83	6.37
Cons. forecast	5.16	5.31	5.51	5.76

Price indicators

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



cheap neutral expensive

Source: Danske Bank

FX forecasts

Core – major

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
EUR	27-Jun			1.16		745.1		1035.0		945.4	
	+3M			1.17	1.17	744.5	744.7	1020.0	1042.5	930.0	950.8
	+6M			1.20	1.18	744.5	744.3	1040.0	1042.3	930.0	954.5
	+12M			1.25	1.20	744.3	743.6	1020.0	1042.3	920.0	962.3
USD	27-Jun	1.16				642.6		892.7		815.4	
	+3M	1.17	1.17			636.3	637.9	871.8	892.9	794.9	814.3
	+6M	1.20	1.18			620.4	632.5	866.7	885.7	775.0	811.2
	+12M	1.25	1.20			595.4	622.1	816.0	872.0	736.0	805.1
JPY	27-Jun	128.1		110.5		5.82		8.08		7.38	
	+3M	128.7	127.9	110.0	109.5	5.78	5.82	7.93	8.15	7.23	7.44
	+6M	134.4	127.9	112.0	108.7	5.54	5.82	7.74	8.15	6.92	7.46
	+12M	140.0	127.9	112.0	107.1	5.32	5.81	7.29	8.15	6.57	7.52

Source: Macrobond Financial, Danske Bank

Wider CEE

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	27-Jun	4.34		3.74		171.7		238.5		217.9	
	+3M	4.26	4.38	3.64	3.75	174.8	169.9	239.4	237.8	218.3	216.9
	+6M	4.22	4.41	3.52	3.75	176.4	168.9	246.4	236.5	220.4	216.6
	+12M	4.20	4.45	3.36	3.73	177.2	167.0	242.9	234.1	219.0	216.1
HUF	27-Jun	327.0		282.1		2.28		3.16		2.89	
	+3M	325.0	329.1	277.8	281.9	2.29	2.26	3.14	3.17	2.86	2.89
	+6M	320.0	329.5	266.7	280.0	2.33	2.26	3.25	3.16	2.91	2.90
	+12M	315.0	331.9	252.0	277.6	2.36	2.24	3.24	3.14	2.92	2.90
CZK	27-Jun	25.87		22.31		28.80		40.01		36.55	
	+3M	25.50	26.00	21.79	22.27	29.20	28.64	40.00	40.09	36.47	36.56
	+6M	25.00	25.99	20.83	22.09	29.78	28.64	41.60	40.10	37.20	36.72
	+12M	24.80	26.14	19.84	21.87	30.01	28.45	41.13	39.87	37.10	36.81

Source: Macrobond Financial, Danske Bank

CIS

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
RUB	27-Jun	72.94		62.91		10.21		14.19		12.96	
	+3M	70.32	74.14	60.10	63.50	10.59	10.04	14.51	14.06	13.23	12.82
	+6M	69.96	75.38	58.30	64.06	10.64	9.87	14.87	13.83	13.29	12.66
	+12M	69.63	77.91	55.70	65.18	10.69	9.54	14.65	13.38	13.21	12.35

Source: Macrobond Financial, Danske Bank

MEA

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
TRY	27-Jun	5.33		4.60		139.7		194.0		177.2	
	+3M	5.21	5.57	4.45	4.77	143.0	133.8	195.9	187.3	178.6	170.8
	+6M	5.22	5.83	4.35	4.96	142.6	127.6	199.2	178.7	178.2	163.7
	+12M	5.63	6.37	4.50	5.33	132.3	116.8	181.3	163.7	163.6	151.1
ZAR	27-Jun	15.90		13.72		46.9		65.1		59.4	
	+3M	15.44	16.35	13.20	14.01	48.2	45.5	66.0	63.8	60.2	58.1
	+6M	15.60	16.68	13.00	14.17	47.7	44.6	66.7	62.5	59.6	57.2
	+12M	16.25	17.33	13.00	14.50	45.8	42.9	62.8	60.1	56.6	55.5

Source: Macrobond Financial, Danske Bank

Latin America

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
BRL	27-Jun	4.45		3.84		167.4		232.5		212.4	
	+3M	4.39	4.52	3.75	3.87	169.7	164.9	232.5	230.9	212.0	210.6
	+6M	4.38	4.58	3.65	3.89	170.0	162.6	237.4	227.6	212.3	208.5
	+12M	4.38	4.72	3.50	3.95	170.1	157.4	233.1	220.6	210.3	203.7

Source: Macrobond Financial, Danske Bank

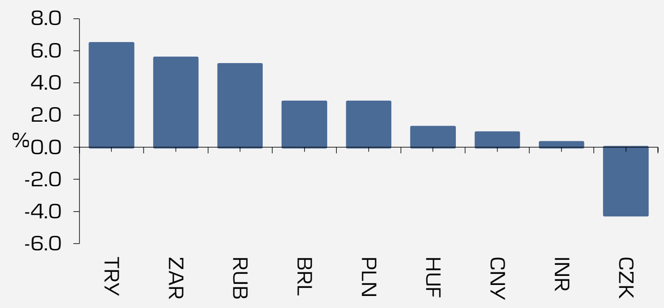
Emerging markets Asia

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
CNY	27-Jun	7.65		6.60		97.4		135.3		123.6	
	+3M	7.72	7.79	6.60	6.68	96.4	95.6	132.1	133.8	120.4	122.0
	+6M	7.98	7.89	6.65	6.70	93.3	94.4	130.3	132.2	116.5	121.1
	+12M	8.38	8.06	6.70	6.75	88.9	92.2	121.8	129.3	109.9	119.3
INR	27-Jun	79.59		68.65		9.36		13.00		11.88	
	+3M	80.73	80.97	69.00	69.35	9.22	9.20	12.63	12.88	11.52	11.74
	+6M	84.00	82.54	70.00	70.14	8.86	9.02	12.38	12.63	11.07	11.56
	+12M	88.75	85.63	71.00	71.64	8.39	8.68	11.49	12.17	10.37	11.24

Source: Macrobond Financial, Danske Bank

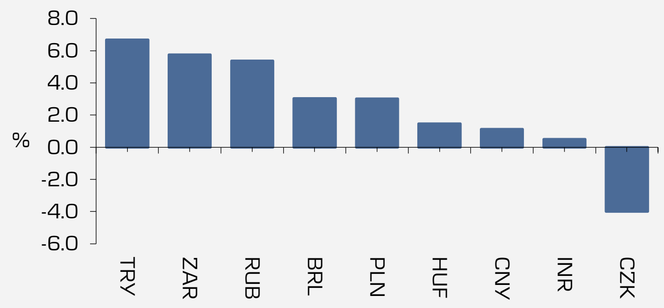
Forecasts vs forwards

3M – base currency EUR



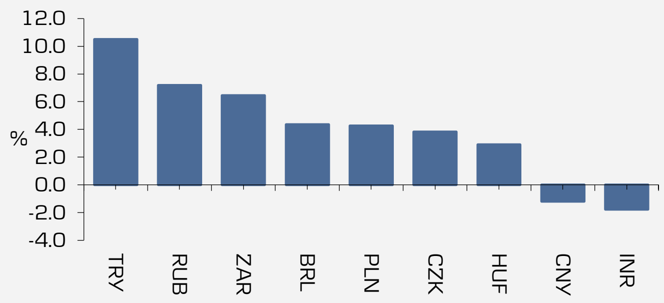
Source: Macrobond Financial, Danske Bank

3M – base currency USD



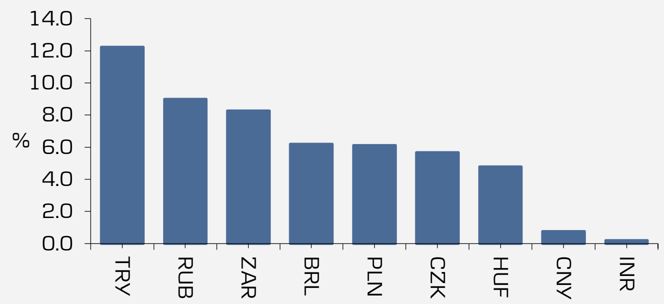
Source: Macrobond Financial, Danske Bank

6M – base currency EUR



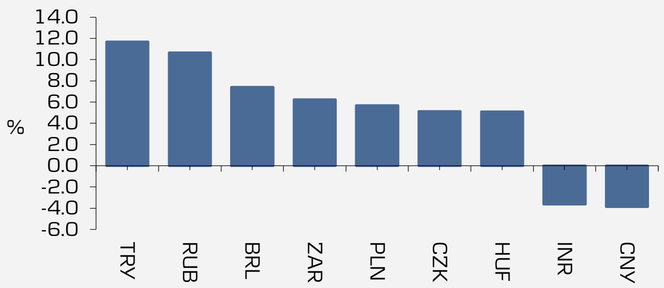
Source: Macrobond Financial, Danske Bank

6M – base currency USD



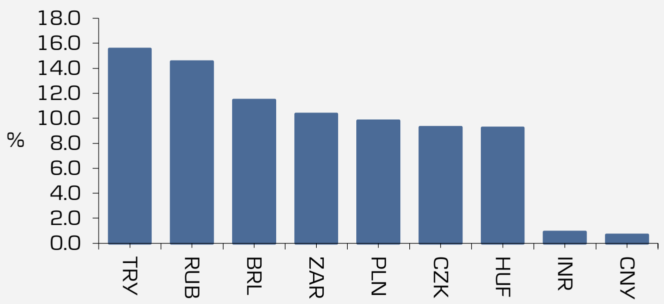
Source: Macrobond Financial, Danske Bank

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 (%)
	28 June 2018						
Wider CEE							
PLN	1.50	- 50 bp	Mar, 2015	+25bp	Q2, 2019	11/07/2018	1.50
HUF	0.90	- 15 bp	May, 2016	+10bp	2019	24/07/2018	0.90
CZK	1.00	+25 bp	Jun, 2018	+25bp	H2, 2018	02/08/2018	1.25
TRY	17.75	+125 bp	Jun, 2018	-100bp	2019	24/07/2018	17.75
CIS							
RUB	7.25	-25 bp	Mar, 2018	-25bp	Q4, 2018	27/07/2018	7.00
MEA							
ZAR	6.50	- 25 bp	Mar, 2018	-25bp	Q1, 2019	19/07/2018	6.50
LATAM							
BRL	6.50	-25 bp	Mar, 2018	-25bp	2019	01/08/2018	6.50
EM Asia							
CNY	4.35	- 25 bp	Nov, 2015	-25bp	Q1, 2019	No regular meetings	4.35
INR	6.25	+ 25 bp	June, 2018	+ 25 bp	H2 2018	01/08/2018	6.50

Source: Danske Bank

Disclosures

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Monthly.

Date of first publication

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Report completed: 29 June 2018, 07:30 CEST

Report first disseminated: 29 June 2018, 12:45 CEST