Danske Bank

FX Forecast Update
EUR/USD rocket – now on the launch pad

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Forecast review part I

- **EUR/NOK.** The biggest risk factor to our short-term forecasts of global risk-off weighing on NOK directly and indirectly via the oil price materialised in the final months of 2018. We think history will repeat itself as year-end weakness tends to be followed by year-start strength. We think markets have become too negative on global growth, which alongside OPEC+ production cuts is expected to send the oil price higher. Also, the domestic story is very constructive for the NOK as Norway is set to outperform peers in terms of both relative growth and rates. What is more, structural liquidity is set to tighten in Q1, which tends to coincide with a stronger NOK. In light of the EUR/NOK move higher, we raise our EUR/NOK forecast profile but still pencil in a lower spot. We now forecast EUR/NOK at 9.60 in 1M, 9.50 in 3M (previously 9.40), 9.40 in 6M (from 9.20) and 9.30 in 12M (9.10).

- **EUR/SEK.** As we expected, the Riksbank raised the repo rate in December and this lent support to the krona; EUR/SEK has trended slightly lower since then. That said, the dovish tilt and poor risk sentiment have capped the downside in EUR/SEK. The market doubts whether the Riksbank will deliver a second hike this year, as do we. For many years, the Swedish money market curve was too steep relative to peers, which suggested that re-pricing of the curve would push EUR/SEK higher. This is not the case anymore as market pricing of the Riksbank is now closely aligned with the ECB. The scope for re-pricing in relative terms is, in our view, perhaps more in favour of the SEK. However, we continue to look for a cyclical slowdown in 2019, a potential headwind for the krona. In all, we see only limited downside potential in EUR/SEK from here. We raise the 1M forecast to 10.20 and keep the 3, 6 and 12M forecasts intact at 10.10, 10.00 and 10.00.

- **EUR/DKK.** EUR/DKK rose close to 7.4680 in December – a move which triggered DKK12bn in FX intervention by Danmarks Nationalbank. EUR/DKK peaked in December and we expect it to head lower from here. It will probably be a slow process, as a firm recovery in equity markets is needed to spur DKK buying from domestic investors through rebalancing of FX hedges. At the same time, low front-end rates due to the high net position will slow the pace of DKK appreciation. We forecast EUR/DKK at 7.4640 in 1M, 7.4600 in 3M and 7.4550 in 6-12M.

- **EUR/USD.** A higher range – now around 1.15 – is justified by a move higher in real rate spreads as the Fed has withdrawn support. As Q1 progresses, we expect the second stage of the EUR/USD rebound that we forecast this year to be reached with another leg higher in the cross towards 1.20 mid-year. We have lifted our short-term profile a tad and see EUR/USD at 1.15 in 1M, 1.17 (1.13) in 3M, 1.20 (1.18) in 6M, and 1.25 (unchanged) in 12M. In other words, while we do not yet have lift-off in the sense of new cycle-highs being within reach, the EUR/USD 'rocket', which valuation suggests will eventually escape gravity, is now on the launch pad - but a trade deal and/or a first ECB hike is needed for next stages of the firing to be reached.

- **EUR/GBP.** Our EUR/GBP forecasts are based on our main scenario that May's Brexit plan eventually will be approved by parliament. We expect this to pave the way for a significant decline in EUR/GBP early spring. We target 0.84 in 3M, and 0.83 in 6-12M. However, Brexit is a 'digital event' and we emphasise that the key risk to our bullish GBP view is that Brexit clarifications are dragged out – even beyond 30 March if Article 50 is extended; in that case, GBP appreciation will be much more moderate and materialise later than our forecast (main scenario) implies.

- **USD/JPY.** Thus far, 2019 does not look to be particularly USD positive following recent more dovish tone from the Fed. We are however vigilant to recent disinflationary red flags in Japan. During the recent sell-off in equity markets, JPY appreciated on a broad basis. If negative sentiment returns, JPY could see renewed support. Overall, we have revised our USD/JPY forecast lower to 109 in 1M, 110 in 3-6M and 112 in 12M.

- **EUR/CHF.** Still-largely-absent Swiss inflation, fragile global risk sentiment and Brexit risks should keep EUR/CHF on the defensive short term. We have left our EUR/CHF profile little changed with only the 3M forecast upped a bit following recent support to the cross from a weaker USD (as a more flexible Fed holds a hand under EUR/USD). We now look for 1.13 in 1M, 1.14 (1.13) in 3M, 1.16 in 6M and 1.20 in 12M.

- **AUD, NZD, CAD.** The three risk-sensitive commodity currencies have rebounded sharply at the beginning of the year amid the Fed turning less hawkish, equities snapping higher and commodities erasing losses. Not least, the USD10/bbl rise in the oil price has benefitted the CAD. Near term, trade-talk developments between the US and China are instrumental for NZD and AUD. On the central banks, Bank of Canada has clearly put itself in a 'wait-and-see' mode but importantly at the January meeting, it still emphasised that the next move is a rate hike (not cut). For now, we stick to our view of two hikes in Canada, and unchanged policy rates in New Zealand and Australia over the next 12M. According to our PPP model, the CAD is undervalued whereas the AUD and the NZD are trading close to fair value (versus USD). We now forecast AUD/USD at 0.71 in 1M (unchanged), 0.72 in 3M (unchanged), 0.73 in 6M (unchanged) and 0.74 in 12M (unchanged); NZD/USD at 0.67 in 1M (unchanged), 0.68 in 3M (0.67), 0.68 in 6M (unchanged) and 0.70 in 12M (0.69). Finally, we forecast USD/CAD at 1.32 in 1M (1.33) 1.30 in 3M (unchanged), 1.27 in 6M (unchanged) and 1.25 in 12M (unchanged).

- **USD/CNY.** USD/CNY has pushed lower lately on overall USD weakness and optimism on a US-China trade deal. We have revised lower our forecast to 6.7 in 12M from 6.8. A trade deal, moderate Chinese recovery from Q2 and USD weakness is set to weigh on USD/CNY.

- **USD/RUB.** The geopolitical premium in the RUB vanished a bit, as the US did not hit Russia with harsh sanctions in autumn 2018. However, the new US Congress is starting its sessions and a focus on anti-Russia sanctions may return in Q1 19. A risk of escalation in the standoff between Russia and Ukraine also remains in place. We keep our previous USD/RUB profile unchanged, rolling the forecasts further: 69.10 (1M), 72.00 (3M), 73.80 (6M), 75.10 (12M).

- **EUR/PLN.** The EUR/PLN continues to trade in the 4.28-4.33 range, which has been broadly observed since October. We see headwinds from the global side for the next month, but then see a modest recovery in global economy, which should aide the Zloty together with the still solid performance of the domestic Polish economy, also boosted by slightly expansionary fiscal policy. As a result, we keep our forecast relatively unchanged for EUR/PLN at 4.29 in 1M, 4.27 in 3M, and 4.20 in 6M and 4.18 in 12M.

- **USD/TRY.** We raise slightly our TRY mid- and long-term outlook due to the currency stabilisation and more flexible Fed. However, large FX debt redemptions by the Turkish private sector will weigh on the TRY in 2019. Thus, we continue to remain bearish on the TRY in the long term expecting the USD/TRY at the following levels: 5.40 in 1M, 5.55 in 3M (5.90), 6.00 in 6M (6.10) and 6.25 in 12M (6.50).

- **EUR/HUF.** We see the HUF getting stronger in the short, medium and long term, as Italian woes vanish bringing relief to the EUR, which helps HUF's outlook, while the Hungarian economy remains in a good shape. We adjust the pair forecast according to the current EUR exchange rate and increased MNB hawkishness seeing EUR/HUF at 320.4 in 1M, at 319 in 3M (321.0), keeping the long-term forecast unchanged at 317.0 in 6M and in 12M at 310.0.

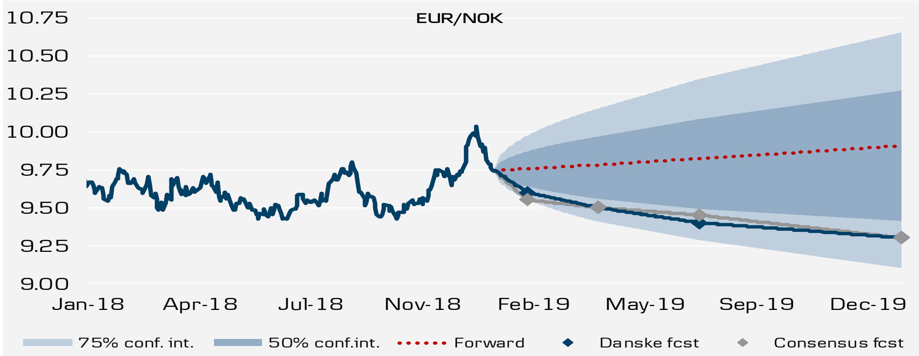
- **EUR/CZK.** In recent weeks, domestic drivers have gained more prominence over external ones and in light of improved EM risk sentiment, EUR/CZK seems to have returned to its gradual strengthening path. In light of the latest move, we revise our short-term forecasts to 25.50 in 1M and 25.40 in 3M (25.80), but leave our 6M and 12M forecasts unchanged at 25.10 and 24.80, respectively.

- **Oil.** We expect oil prices to recover over the course of 2019. In our view, the main reason for the tough ending to the year for the oil market was the deterioration in global risk sentiment. The month of April will be important for the oil market as current waivers on Iran sanctions expire by then, and OPEC+ is set to review its deal to cut production. We forecast Brent to average USD65/bbl in Q1 rising to USD80/bbl in Q4. OPEC+ cuts, recovery in global growth and a weaker USD will be the main factors underpinning a higher oil price.

EUR/NOK – perfect storm petering out

- **Growth.** The Regional Network Survey at the end of last year confirmed that the growth outlook in Norway remains strong: private consumption is on the rise amid higher real disposable income, housing investments have bottomed, business investments remain solid and finally oil investments are rebounding sharply. We expect growth to remain above trend in the coming years, which will drive a further rise in employment. As more people enter the labour market that reduces the downside potential for unemployment, yet we expect a rising upward pressure on wages and hence underlying inflation. The housing market has been flat since May and we expect only modest gains as higher rates and new supply hitting the market reduce the upside.
- **Monetary policy.** At the December monetary policy meeting Norges Bank left the sight deposit rate unchanged at 0.75%. On the back of primarily weaker global developments, the central bank lowered its rate path modestly, yet reiterated that markets should expect two rate hikes during 2019 with the next one set for March.
- **Flows.** Foreign banks (proxy for speculative flows) have been net sellers of NOK over the past few weeks. As foreign investors and Norges Bank return to the market in 2019, that leaves an upside potential for NOK.
- **Valuation.** From a long-term perspective, the NOK seems fundamentally undervalued. Our PPP model has 8.85 as 'fair'.
- **Risks.** The biggest risk factor to our forecast is broad based USD strength and/or a global risk-off event, which would weigh on the NOK directly and indirectly via the oil price. In addition, the risk that we underestimate the impact of a Chinese slowdown is relevant, as commodity FX in recent years has traded in a remarkably synchronised way, with turning points coinciding with the Chinese cycle. The latter could be connected to an escalating global trade war.

Forecast: 9.60 (1M), 9.50 (3M), 9.40 (6M), 9.30 (12M)



EUR/NOK	1M	3M	6M	12M
Forecast (pct'ile)	9.60 (21%)	9.50 (19%)	9.40 (19%)	9.30 (19%)
Fwd. / Consensus	9.76 / 9.55	9.78 / 9.50	9.82 / 9.45	9.91 / 9.30
50% confidence int.	9.62 / 9.87	9.56 / 9.97	9.49 / 10.08	9.41 / 10.27
75% confidence int.	9.53 / 9.98	9.41 / 10.15	9.29 / 10.34	9.10 / 10.65

Source: Danske Bank

Conclusion. The biggest risk factor to our short-term forecasts of global risk-off weighing on NOK directly and indirectly via the oil price materialised in the final months of 2018. In truth, the cocktail proved very ugly for the NOK in December as liquidity once again worsened while global risk sold off heavily. That said, we think history will repeat itself as year-end weakness tends to be followed by year-start strength (see overleaf). We think markets have become too negative on global growth, which alongside OPEC+ production cuts is expected to send the oil price higher. In addition, the domestic story is very constructive for the NOK as Norway is set to outperform peers in terms of both relative growth and rates. What is more, structural liquidity is set to tighten in Q1, which tends to coincide with a stronger NOK. In light of the EUR/NOK move higher, we raise our EUR/NOK forecast profile but still pencil in a lower spot. We now forecast EUR/NOK at 9.60 in 1M, 9.50 in 3M (9.40), 9.40 in 6M (from 9.20) and 9.30 in 12M (9.10).

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EUR/NOK – important issues to watch

NOK once again sold-off ahead of year-end...

- EUR/NOK once again sold-off going into year-end. Historically, the weakening in November and December has been in the magnitude of roughly 1-2% but 2018 saw the cross almost reach +5% (margin chart).
- Key to the move higher was the collapse in global risk sentiment and equities, which also weighed heavily on the oil price. As the oil price sold-off it amplified foreign investor worries of year-end, a worry that had already started in early autumn as it became clear Norges Bank was unlikely to hike rates again in December.
- While foreign investors have been net sellers of NOK over the last months the very modest net selling around year-end is striking as very limited flow had big spot impact. The reason for that was naturally worsening liquidity, which was also evident from the weekly flow statistics from Norges Bank. As expected, the central bank again halted its daily NOK purchases in the final weeks of the year, which likely added to the downside pressure on the NOK.

... but outlook remains strong. Year-start performance to resume

- Historically, year-end underperformance tends to be followed by year-end overperformance – especially in recent years (see margin chart).
- We expect this seasonal pattern to repeat itself as the markets normalise, Norges Bank and foreign investors return to the market and as structural liquidity gradually tightens.
- Naturally, our expectations are based on the assumption that global risk sentiment remains healthy in which case both a higher oil price and higher NOK rates should underpin a stronger NOK further.

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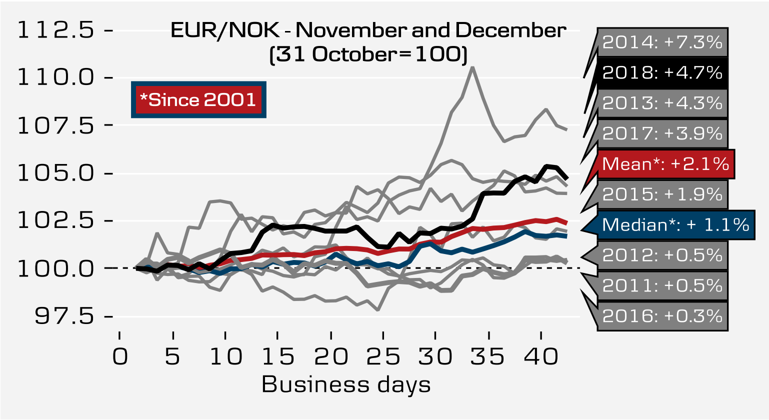
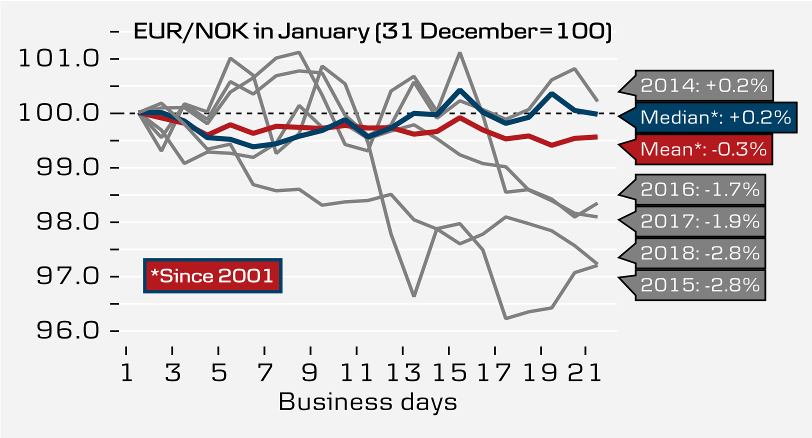
Seasonal year-end pattern repeated itself...



Source: Macrobond Financial, Norges Bank, Danske Bank

... and we expect the NOK to start 2019 on a strong note (again).

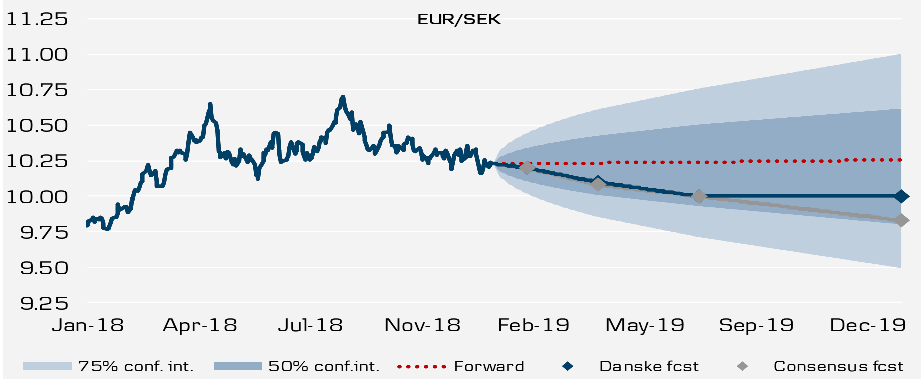


Source: Macrobond Financial, Norges Bank, Danske Bank

EUR/SEK – 'one and done' by the Riksbank?

- **Growth.** Swedish GDP growth is clearly slowing down, as is evident by the surprisingly weak Q3 print (1.6% y/y and -0.2% q/q, the first negative q/q print since 2013!). We expect a slight rebound in Q4, before the downturn continues with renewed vigour into 2019. We see 2018 GDP growth at 2.2 (2.4% in 2017) and 2019 at 1.4%. Growth is mainly hampered by decelerating housing investments and sluggish private consumption. The apparent global slowdown is also a headwind.
- **Monetary policy.** As per our call, the Riksbank delivered its first hike in seven years in December, raising the repo rate to -0.25%. The hike was, however, accompanied by somewhat dovish signals from the Board, stressing data dependency where we (as always) view inflation as key. Although the Riksbank's repo rate path indicates another hike in H2 2019, we have our doubts, which mainly stem from a less upbeat view on inflation, particularly core inflation.
- **Flows.** Net equity and net debt portfolio flows rebounded in the third quarter (for equities, first surplus since Q1 16), potentially SEK supportive, depending on hedging behaviour. Commercial SEK demand may have risen due to attractive SEK levels although the costly rate differentials (versus USD) suggest more muted demand.
- **Valuation.** We think ultra-easy monetary policy is the main reason for the trend depreciation of the krona. That said, part of it can be explained by 'long-term' fundamentals, for example, shrinking external balances and deteriorating productivity growth. Still, EUR/SEK is on the 'high side'.
- **Risks.** Further weakening of global sentiment risks weighing on the SEK, as the SEK usually performs poorly in risk-off environments. Other than this, the main risks are found in the political sphere, where both Brexit and the Swedish government formation remain to be dealt with. Swedish inflation, being the key macro driver, poses a symmetric risk to our forecast.

Forecast: 10.20 (1M), 10.10 (3M), 10.00 (6M), 10.00 (12M)



EUR/SEK	1M	3M	6M	12M
Forecast (pct'ile)	10.20 (45%)	10.10 (35%)	10.00 (30%)	10.00 (36%)
Fwd. / Consensus	10.23 / 10.20	10.23 / 10.08	10.24 / 10.00	10.26 / 9.83
50% confidence int.	10.10 / 10.35	10.01 / 10.43	9.93 / 10.51	9.80 / 10.62
75% confidence int.	10.01 / 10.46	9.86 / 10.61	9.71 / 10.76	9.50 / 11.00

Source: Danske Bank

- **Conclusion.** As we expected, the Riksbank raised the repo rate in December and as expected it lent support to the krona while EUR/SEK has trended slightly lower since then. That said, the dovish tilt and poor risk sentiment have capped the downside in EUR/SEK. The market doubts whether the Riksbank will deliver a second hike this year as do we. For many years the Swedish money market curve was too steep relative to peers which suggested that re-pricing of the curve would push EUR/SEK higher. This is not the case anymore as market pricing of the Riksbank is now closely aligned with the ECB. The scope for re-pricing in relative terms is, in our view, perhaps more in favour of the SEK. We continue to look for a cyclical slowdown in 2019, a potential headwind for the krona. All in all, we see only limited downside potential in EUR/SEK from here. We raise the 1M forecast to 10.20 and keep the 3, 6 and 12M forecasts intact at 10.10, 10.00 and 10.00.

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EUR/SEK – important issues to watch

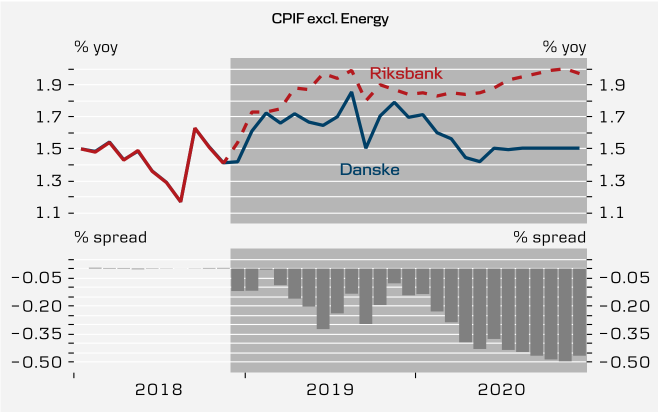
Riksbank finally delivered a hike – but can they manage another?

- The December hike materialized, although accompanied by a minor downward adjustment of the rate path, delaying the next hike to H2, giving the hike a slightly dovish tilt. Looking forward, we recognize that the Riksbank view is that of a macroeconomic slowdown, both globally and in Sweden. Although this should not be neglected, we would like to stress that inflation still remains the key for the board of governors. The minutes from the December meeting further stresses this data dependency moving forward. We see core inflation undershooting the Riksbank throughout 2019 (see chart). Hence, we see a less than 50% probability of a second hike during 2019.

The government end game has arrived

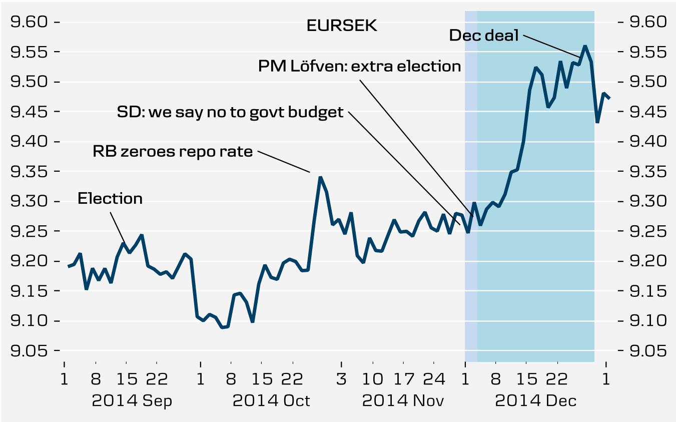
- Four months have now past since Election Day. The only concrete result is that the conservative (Moderate + Christ Democrat) budget gained approval in the parliament. Regarding the new PM of Sweden, however, the positions remains as locked as ever. The two main candidates, Stefan Löfven and Ulf Kristersson have both been voted down, and now only two attempts remain until a snap election is triggered. The speaker has announced that the next candidate is to be presented Monday 14 January, with a subsequent vote on Wednesday (16th). If the candidate is rejected by the parliament, the fourth (and final) vote will take place on 23 January. A snap election should take place no later than 21 April. If a government is formed within the next two weeks, we expect limited impact on the markets (if anything, slightly SEK positive). Should a snap election be triggered, we could see a small and probably temporary selloff in the SEK.

Core inflation remains muted – at least in our view



Source: Macrobond Financial, Danske Bank

SEK and the threat of a snap election



Source: Macrobond Financial, Danske Bank

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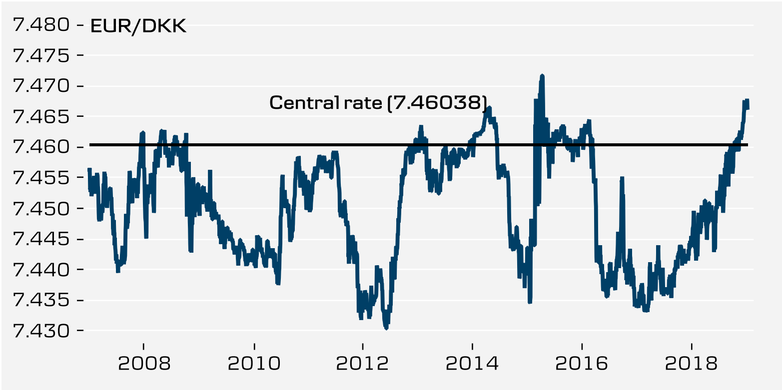
EUR/DKK – December's FX intervention signals peak

- **FX.** EUR/DKK rose close to 7.4680 in December – a move which triggered DKK12bn in intervention by Danmarks Nationalbank (DN). It was the first time since March 2017 that the DN has intervened in the market. In our view, it means that we have seen the peak in the short-term for EUR/DKK; hence, around the 7.4680 level. Besides that, our view remains unchanged. We look for a recovery in equity markets, a global trade deal and improved global growth prospects to benefit DKK over the course of 2019. We forecast EUR/DKK at 7.4640 in 1M, 7.4600 in 3M and 7.4550 in 6-12M. In Q1, the Swedish Riksbank will sell the equivalent of 0.5bn EUR/DKK as part of a change in the currency composition of its FX reserve.
- **Rates and Forwards.** We expect the DN to keep the rate of interest on certificates of deposit unchanged at minus 0.65% until December, where we forecast it will mirror a 20bp ECB hike. A high net position has pushed down CITA fixing and front-end EUR/DKK FX forwards.
- **Flows.** The Danish current account surplus remains large, but has moderated somewhat from the elevated level seen in past years. It still creates fundamental support for DKK. A high savings rate and low investment activity will maintain this situation in the coming years. Denmark has significant exposure to the US as around one third of the surplus is earned in the US.
- **Liquidity.** The net position rose to around DKK240bn at the beginning of January, about the highest since 2015. The government purchase of mortgage bonds funding social housing for DKK12bn in January, funded by a draw on its deposits, has been a factor in easing liquidity. We expect a high net position over the coming months. Pension tax payments, for example, will be small this year and will thus not weigh on liquidity as they normally do.

Forecast: 7.4640 (1M), 7.4600 (3M), 7.4550 (6M), 7.4550 (12M)



Source: Danske Bank

- **Conclusion.** EUR/DKK peaked in December and we expect it to head lower from here. It will probably be a slow process as a firm recovery in equity markets is needed to spur DKK buying from domestic investors through rebalancing of FX hedges. At the same time, low front-end rates due to the high net position will slow the pace of DKK appreciation. We forecast EUR/DKK at 7.4640 in 1M, 7.4600 in 3M and 7.4550 in 6-12M.

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EUR/USD – Fed 'on hold' is only first stage of the rocket

- **Growth.** Despite clear signs of momentum loss lately, the US continues to fare well and fiscal policy is set to provide a boost in 2019 as well. US inflation (PCE core) has fallen back below 2% but wage growth continues to pick up in an increasingly tight labour market. Wage growth is also picking up in the eurozone but inflation (CPI ex energy and food) remains stuck around 1% and a significant loss of growth momentum was seen in H2. The fiscal boost is a small eurozone positive for 2019 though.
- **Monetary policy.** The Fed delivered the widely expected 25bp hike in December, but has in recent months hinted at an increasingly flexible approach to tightening – most recently bringing the option of revisiting its balance-sheet run-off. We still look for two more hikes from the Fed this year; this compares with rather dovish market expectations after the Fed has been extensively repriced, with a 15bp cut now priced for 2020. The ECB officially ended its APP scheme in December but is in no hurry to hike rates. Indeed, on inflation the ECB remains more hopeful than outright confident which will keep rates dormant at least until the end of this year when the first 20bp hike could be seen – but risks are for a further postponement of this.
- **Flows.** IMM positioning data (not published since mid December due to the US government shutdown) suggest that speculators were broadly neutral EUR and stretched on USD longs going into the recent uptick in EUR/USD; this may imply some room to add EUR/USD shorts near term. However, we still see a case for eurozone capital outflows to fade and support EUR as the ECB phases out negative rates.
- **Valuation.** Our Medium-term Valuation (MEVA) model now suggests 1.30 is 'fair' for the cross, not far from our PPP estimate of 1.27.
- **Risks.** Political risks remain for the eurozone: an Italian debt crisis and/or a no-deal Brexit could weigh significantly on the euro.

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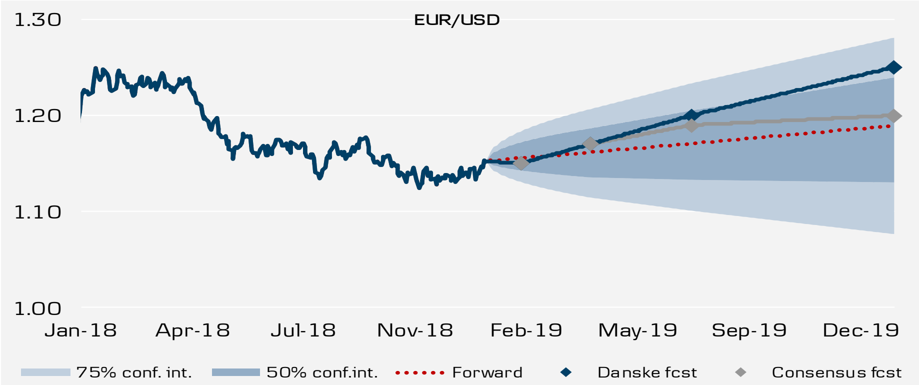
Forecast: 1.15 (1M), 1.17 (3M), 1.20 (6M), 1.25 (12M)



EUR/USD	1M	3M	6M	12M
Forecast (pct'ile)	1.15 (40%)	1.17 (59%)	1.20 (71%)	1.25 (78%)
Fwd. / Consensus	1.16 / 1.15	1.16 / 1.17	1.17 / 1.19	1.19 / 1.20
50% confidence int.	1.14 / 1.17	1.14 / 1.19	1.13 / 1.21	1.13 / 1.24
75% confidence int.	1.13 / 1.18	1.11 / 1.21	1.10 / 1.23	1.08 / 1.28

Source: Danske Bank

Conclusion. Crucially, Fed-induced USD support is now fading, but a trade deal will in our view be key for the next stage of a EUR/USD rebound. Further, while not a trigger for USD strength in itself, carry will support USD still. Also, short EUR/USD positioning should now be a tad lighter, if still stretched. Together with the risk of setbacks on trade talks and a still fragile macro environment, this leaves room for smaller EUR/USD setbacks near term. Ranges have moved higher with 1.15 now more likely to be the midpoint going forward. As Q1 progresses, we expect the second stage to be reached with a another leg higher materialising.

We have lifted our short-term profile a tad and see EUR/USD at 1.15 in 1M, 1.17 (1.13) in 3M, 1.20 (1.18) in 6M, and 1.25 (unchanged) in 12M.

EUR/USD – important issues to watch

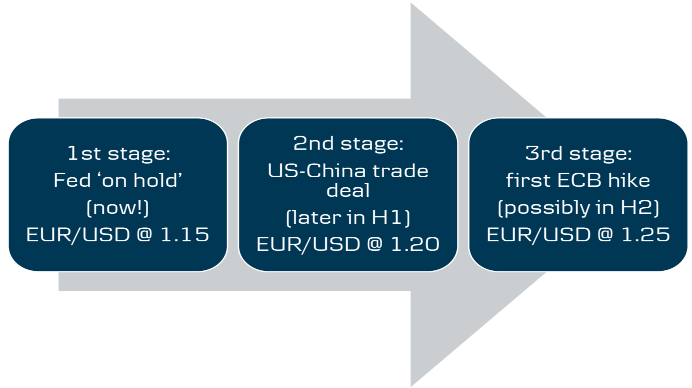
The EUR/USD rocket: three stages to orbit – Fed is only first stage

We have long been hinting that the next big move in EUR/USD will be higher on valuation grounds but stress that a rebound is a three-stage-rocket (upper figure) – and Fed 'on hold' is only first stage to orbit, see *FX Strategy – EUR/USD rocket – Fed 'on hold' is only 1 of 3 stages to orbit,* 10 January, for details.

- **1st stage (now): Fed goes 'on hold'.** Even if a few more hikes remain our baseline scenario, the Fed has now clearly signalled the tightening cycle is close to an end, with flexibility both with respect to rate hikes and balance-sheet reduction. This is an important signal for the USD.
- **2nd stage (later in H1): A US-China trade deal.** It is not imminent but it will come during H1. For EUR/USD, the trade war has been felt through both the China and the risk channel. Via China, Europe has arguably been affected negatively by the trade war from faltering private-sector confidence and via CNY appreciation lifting the trade-weighted EUR. A trade deal should both support EUR in itself and put pressure back on USD. Via the risk channel, a trade deal could further help turn the current risk sentiment – a small EUR positive.
- **3rd stage (possibly in H2): A first ECB hike** – maybe it will come this year but the risk of postponement remains high and the potential for euro short rates to rise is, after all, limited.

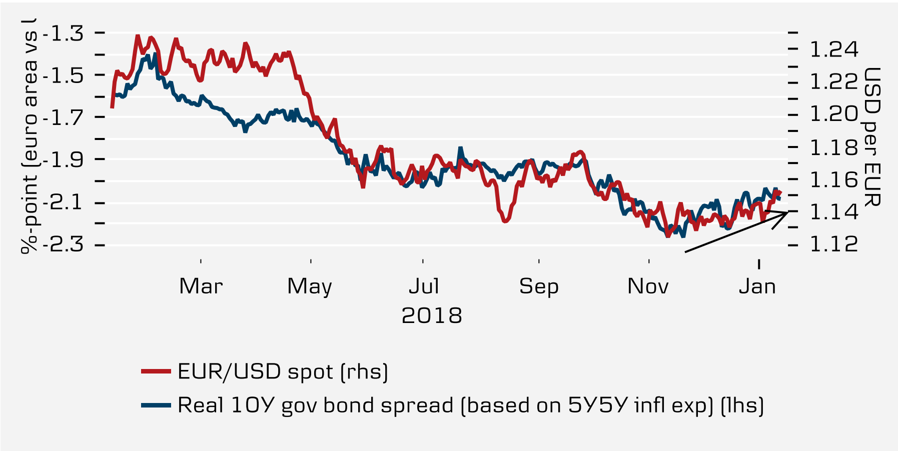
Real long-term spreads have tracked EUR/USD well lately (see lower chart), and our rate strategists see risks tilted towards a further drop in US real rates near term as inflation expectations should pick up on the back of the Fed's rhetoric shift and support to oil prices. This supports EUR/USD at higher levels.

Stages of EUR/USD rebound: Fed is only first stage in lift-off



Source: Danske Bank.

Relative 10Y real rates supporting move higher in EUR/USD



Source: Macrobond Financial, Bloomberg, Danske Bank.

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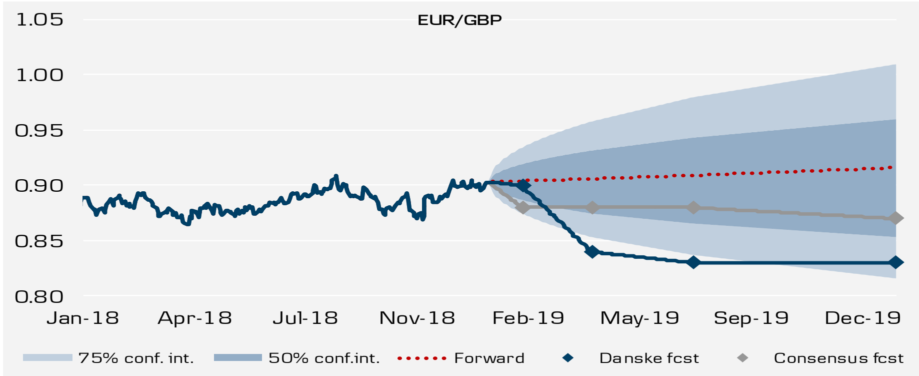
EUR/GBP –Article 50 extension is a risk to our bullish GBP view

- **Growth.** UK economy expanded 0.6% q/q in Q3. The relatively strong pace is partly due to rebounds from a weak H1 18, and the falling PMI business indicators implies that growth is likely to be lower in Q4. Growth in the UK is mainly driven by private consumption and government consumption. Business investments fell 1.2% q/q. It was the third quarter in a row with negative business investment growth, something the UK has not experienced since the financial crisis and can be explained be Brexit uncertainty. We forecast GDP growth of 1.3% in 2018, 1.6% in 2019 and 1.5% in 2020 but stress that Brexit remains a big source of uncertainty
- **Monetary policy.** As expected, the Bank of England (BoE) voted unanimously to keep the Bank Rate at 0.75% in November. We expect the BoE to hike around once a year and our base case is that the next hike will arrive in May 2019. However, given the risk of Brexit clarifications dragging out and not least a softer outlook for global growth implies that the next BoE rate could be postponed to H2 19. The UK money market curve is very flat, with the next BoE rate hike priced to arrive in September 2020, which very dovish compared to our main scenario.
- **Flows.** The UK runs a current-account deficit, notably against EU countries, which is a fundamental supporting factor for EUR/GBP. However, continued recovery in foreign investors' appetite for UK assets supports the case for a stronger GBP over the medium term.
- **Valuation.** GBP remains fundamentally undervalued: Our G10 MEVA model puts EUR/GBP at 0.78 (our Brexit-corrected MEVA estimate for the cross is around 0.83), while our PPP estimate is 0.76.
- **Risks.** In our view, uncertainty regarding Brexit negotiations should keep GBP undervalued and volatile for longer. Timing market's reprising of a Brexit risk premium is nearly impossible.

Forecast: 0.90 (1M), 0.84 (3M), 0.83 (6M), 0.83 (12M)



EUR/GBP	1M	3M	6M	12M
Forecast (pct'ile)	0.90 (46%)	0.84 (7%)	0.83 (10%)	0.83 (16%)
Fwd. / Consensus	0.90 / 0.88	0.91 / 0.88	0.91 / 0.88	0.92 / 0.87
50% confidence int.	0.88 / 0.92	0.87 / 0.93	0.87 / 0.94	0.85 / 0.96
75% confidence int.	0.87 / 0.94	0.85 / 0.96	0.84 / 0.98	0.82 / 1.01

Source: Danske Bank

- **Conclusion.** In the near term, we expect EUR/GBP to stay boxed in the current 0.88-0.9060 range. As the 29 March Brexit deadline approaches, upside risks to EUR/GBP may dominate unless we get further clarifications. We thus raise our 1M EUR/GBP forecast from 0.88 to 0.90. Longer term, our EUR/GBP FX forecast is based on our main scenario that May's Brexit plan eventually will be approved by parliament. We expect this to pave the way for a significant decline in EUR/GBP. We target 0.84 in 3M, and 0.83 in 6-12M. However, it is a close call and we would like to emphasise that the key risk to our bullish GBP view is that Brexit clarifications are dragged out – even beyond 30 March if Article 50 is extended, and the GBP appreciation consequently will be much more moderate and materialise later than our forecast (main scenario) implies.

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EUR/GBP – important issues to watch

Key risk to our bullish GBP view is that Brexit clarifications are dragged out – even beyond 30 March if Article 50 is extended, and the GBP appreciation consequently will be much more moderate and materialise later than our forecast (main scenario) implies.

Potential triggers for an extension of the Article 50 could e.g. be if a second referendum is called, or if Theresa May resigns as a result of an escalation of a Uk government crisis.

Potential triggers for Article 50 extension

2nd EU referendum

Base case:
- Referendum in September (June cannot be ruled out)
- Most likely only one extension

FX implications: EUR/GBP in 0.82-86 range until referendum

PM May resigns and/or snap election

Base case:
- 3-6 months extension of Article 50 (risk skewed towards longer extension)
- Risk of further extensions

FX implications: EUR/GBP up in 0.90-0.95 range

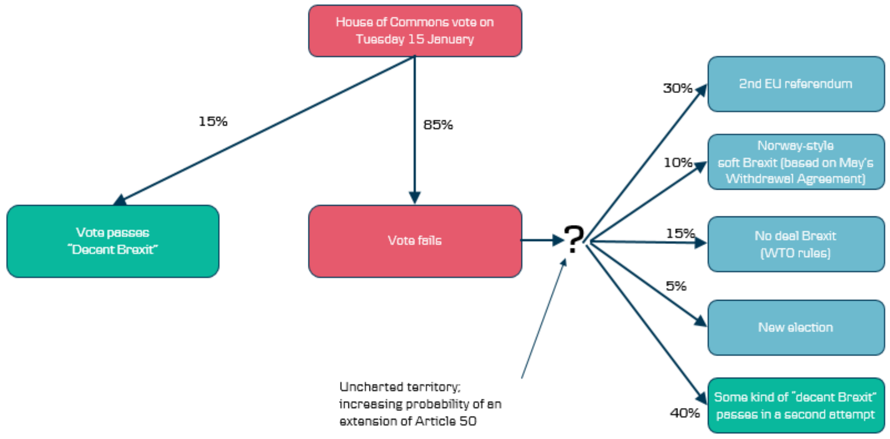
New EU-UK negotiations on future relationship

Could be relevant if UK and EU agree to finalise agreement before the transition phase starts.

Base case:
- 9-12 months extension of Article 50
- Risk skewed towards longer extension and/or further extensions

FX implications: "Status quo": EUR/GBP to stay in current range but volatile for a prolonged period

Brexit scenarios



Source: Danske Bank

Brexit scenarios and EUR/GBP outcome

Brexit Scenario	EUR/GBP outcome	Horizon
Decent Brexit	0.83	1-3M after clarification
No deal Brexit	1.00	0-1M after clarification
2nd referendum	0.82-0.86	Range until referedum
No Brexit	0.76-0.80	1-3M after clarification
Theresa May resigns and/or new eleciton	0.90-0.95	Range 0-1M

Source: Danske Bank

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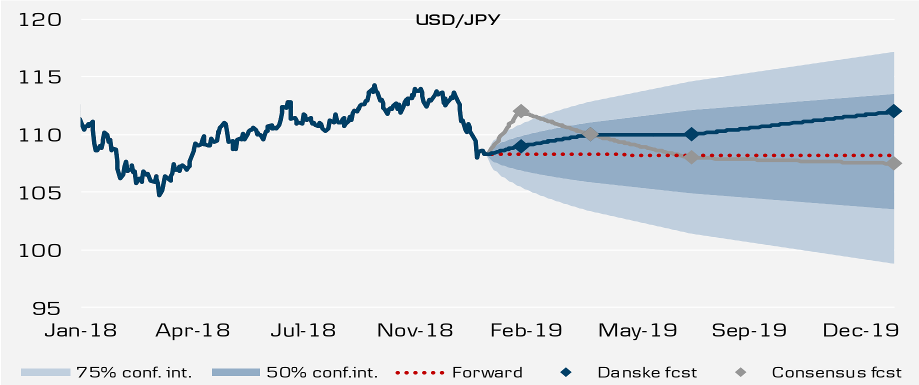
USD/JPY – JPY strength to fade again

- **Inflation and monetary policy.** The acceleration in Japanese money supply growth and CPI inflation seen in 2016 and 2017 faded last year. This has also started to carry over to nominal GDP growth. In particular, we think it is important to monitor the slowing growth of the Japanese monetary base, which seems to be at the centre of the development outlined above. The Bank of Japan (BoJ) continues to emphasise its willingness to keep monetary policy accommodative and we expect no changes before the end of 2019 at the earliest. However, its actions are starting to look contradictory as in our view slowing monetary growth will not bring the BoJ closer to its inflation aim – it could furthermore start to become a JPY positive.
- **Terms of trade.** The recent sell-off in oil and base metal prices will benefit Japan's terms of trade and JPY in effective terms. In our view, JPY is less exposed to the rising global trade tensions.
- **Flows.** Japan continues to be a significant capital exporter via its large current account surplus of close to 4% of GDP, which further depresses Japanese real interest rates. However, we have seen some indicative signs that domestic investment activity has picked up in Japan last year.
- **Money market.** Growth in JPY excess liquidity slowed down last year and with the BoJ on hold it is unlikely to pick up again in the short-term. For Japanese investors and USD/JPY, USD money market conditions remain more important still. JPYUSD XCCY basis has tightened over the past couple of months. Towards Q4 last year we saw indicative signs that Japanese investors may be looking towards US Treasuries again.
- **Valuation.** PPP is around 80, while our MEVA model suggests 104 is 'fundamentally' justified.
- **Positioning.** Investors were stretched short positioned in JPY and stretched long positioned in USD/JPY before the surge in JPY towards the end of last year.

Forecast: 109 (1M), 110 (3M), 110 (6M), 112 (12M)



USD/JPY	1M	3M	6M	12M
Forecast (pct'ile)	109.00 (58%)	110.00 (64%)	110.00 (59%)	112.00 (67%)
Fwd. / Consensus	108.27 / 112.00	108.26 / 110.00	108.25 / 108.00	108.24 / 107.50
50% confidence int.	106.69 / 110.09	105.89 / 111.06	104.92 / 112.14	103.54 / 113.53
75% confidence int.	105.16 / 111.20	103.39 / 112.86	101.43 / 114.62	98.83 / 117.18

Source: Danske Bank

- **Risks.** During the recent sell-off in equity markets, JPY appreciated on a broad basis. If negative sentiment returns, JPY could see renewed support. Another risk to keep in mind is the potential for oil prices to overshoot if, for example, sentiment around Iran sanctions deteriorates when temporary waivers expire in April. That in turn would be JPY negative.
- **Conclusion.** 2019 does not look to be particularly USD positive following the recent more dovish tone from the Fed. We are however vigilant to recent disinflationary red flags in Japan. Overall, we have revised our USD/JPY forecast lower to 109 in 1M, 110 in 3-6M and 112 in 12M.

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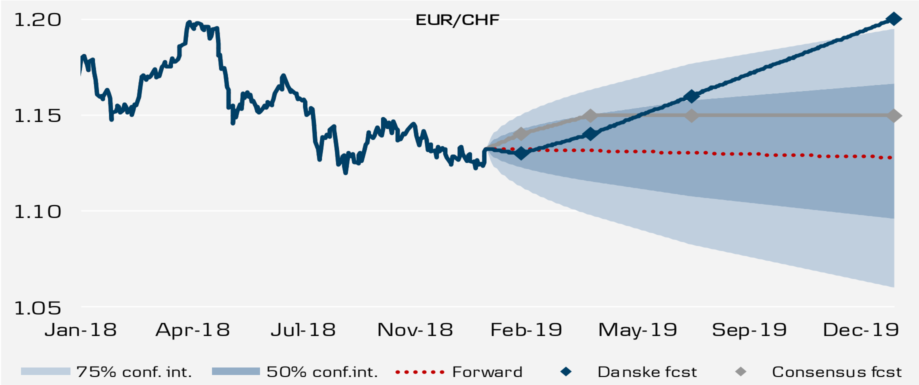
EUR/CHF – SNB waiting for Godot?

- **Growth.** Data out of Switzerland continues to deteriorate with the KOF leading indicator in particular weakening sharply. Unemployment remains low, yet inflation is largely absent, with core CPI at 0.3% in December. Swiss GDP fell back to 2.2% y/y in Q3 but a US-China trade deal – as we look for during H1 – could help stabilise the eurozone growth outlook and Swiss activity with it.
- **Monetary policy.** The SNB has been on hold at -0.75% on key policy rates since January 2015 – and we believe this is unlikely to change any time soon. At the December meeting the SNB, as widely expected, kept both policy rates unchanged at -0.75%. The central bank also maintained the saying that the franc is 'highly valued' and reserved its right to intervene to curb CHF strength. We think the SNB will stay focused on the franc as it awaits policy 'normalisation' elsewhere; it will likely require a drop in EUR/CHF towards 1.10 for intervention to come into play. SNB still eagerly awaits ECB policy 'normalisation' to bring EUR strength. At present, the SNB is essentially priced to shadow the ECB on rate hikes over the next few years, i.e. with a first hike around New Year 2019/20 but with less than one other hike priced in the year thereafter. This seems largely 'fair' in our view.
- **Flows.** IMM positioning data (not published since mid-December due to the US government shutdown) suggest that even in the face of souring risk sentiment, speculators added CHF shorts ahead of New Year.
- **Valuation.** Both our G10 MEVA and PPP models suggest the cross should move higher over the medium to long term with both at 1.27.
- **Risks**. While CHF at times showed good resilience to rising Italian debt concerns during 2018, renewed focus/worries over Italian fiscal sustainability and/or a no-deal Brexit could fuel CHF strength considering the lack of SNB policy tools to go firmly against it.

Forecast: 1.13 (1M), 1.14 (3M), 1.16 (6M), 1.20 (12M)



EUR/CHF	1M	3M	6M	12M
Forecast (pct'ile)	1.13 (41%)	1.14 (60%)	1.16 (77%)	1.20 (88%)
Fwd. / Consensus	1.13 / 1.14	1.13 / 1.15	1.13 / 1.15	1.13 / 1.15
50% confidence int.	1.12 / 1.14	1.12 / 1.15	1.11 / 1.16	1.10 / 1.17
75% confidence int.	1.11 / 1.15	1.10 / 1.16	1.08 / 1.18	1.06 / 1.19

Source: Danske Bank

- **Conclusion.** EUR/CHF has been under pressure during the autumn risk sell-off and briefly dipped below 1.12 in connection with the flash crash in JPY right after New Year. Still-largely-absent Swiss inflation, fragile global risk sentiment and Brexit risks should keep EUR/CHF on the defensive short term. The SNB will remain reluctant to change its communication in light of the stubbornly subdued inflationary pressure and a still somewhat distant first hike from the ECB. But, in the absence of new political risks, policy 'normalisation' in Europe should allow EUR/CHF to restart a gradual move back towards 1.20. We have left our EUR/CHF profile little changed with only the 3M forecast upped a bit following recent support to the cross from a weaker USD (as a more flexible Fed holds a hand under EUR/USD); we now look for 1.13 in 1M, 1.14 (1.13) in 3M, 1.16 in 6M and 1.20 in 12M.

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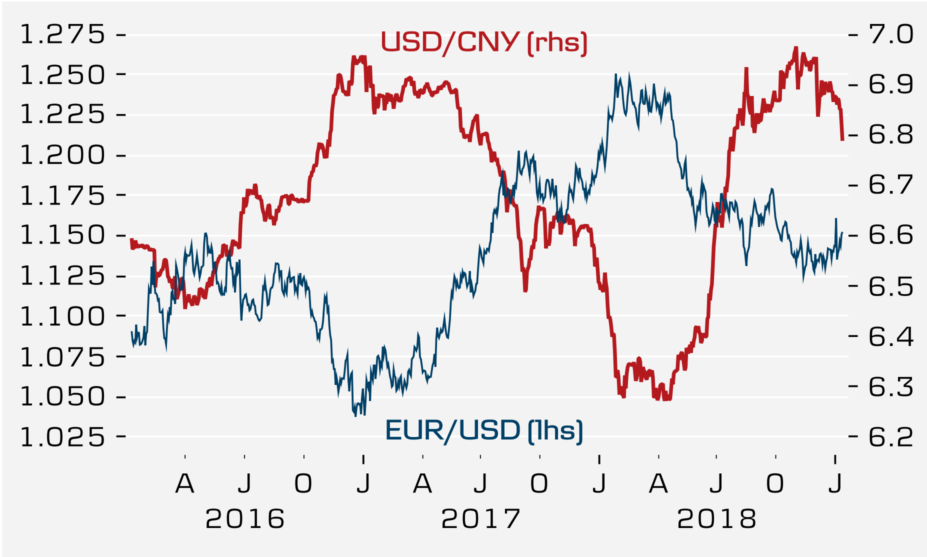
USD/CNY – moderate decline on trade deal and China recovery in 2019

- **Growth.** Chinese growth dropped to 6.5% y/y in Q3 from 6.7% y/y in Q2 – the lowest rate since 2009. PMI manufacturing has also dropped in recent months below the 50-level. We look for Chinese activity to get worse before it gets better. The trade war is putting a drag on export orders, private investments and consumption of durables. The campaign to deleverage and crack down on shadow banking is also weighing on Chinese growth. We expect to see a bottom in Q2 as stimulus kicks in. We also look for a trade deal between US and China in Q2, which should pave the way for a lift to exports and private demand again.
- **Monetary policy.** Chinese money market rates and bond yields have fallen sharply as monetary policy has been eased further. In January China announced the fourth reduction in the reserve requirement ratio in a year and we expect another reduction in Q2. After that we expect monetary policy to step to the side-lines and wait for the economy to recover. In the short term the rate spread to the US is expected to move sideways as the Fed is also stepping to the side-lines. However, we look for the Fed to resume tightening in mid-2019 and hike rates twice this year, which will put some upward pressure on USD/CNY.
- **FX policy**. CNY continues to be a managed peg against a basket of currencies. The PBoC has allowed the market to play a bigger role but at the same time intervenes to avoid too rapid movements that could cause instability. We believe that China will commit to stopping further CNY weakness versus USD as part of a trade deal with the US. Apart from relative rates, the overall development in the USD is a key driver for USD/CNY. Our call for a weaker USD in 12M will work in favour of a lower USD/CNY.
- **Flows.** While there were signs of moderate outflows in H2 18 the flows have calmed down again. FX reserves for December increased slightly.

Forecast: 6.80 (1M), 6.80 (3M), 6.75 (6M), 6.70 (12M)



Source: Danske Bank

- **Valuation.** The CNY is still close to fair valuation.
- **Conclusion.** We look for USD/CNY to continue slightly lower in 12M to 6.70. A trade deal with the US and a bottoming out of growth in H1 will give some tailwind to the CNY. A weaker USD will also work in favour of lower USD/CNY.
- **Risks.** We see risks in both directions. A US-China trade deal in Q2 and a Chinese recovery could lead to more strengthening of the CNY than we expect. On the other hand if the US and China fail to reach a trade deal, the CNY is headed for more weakness.

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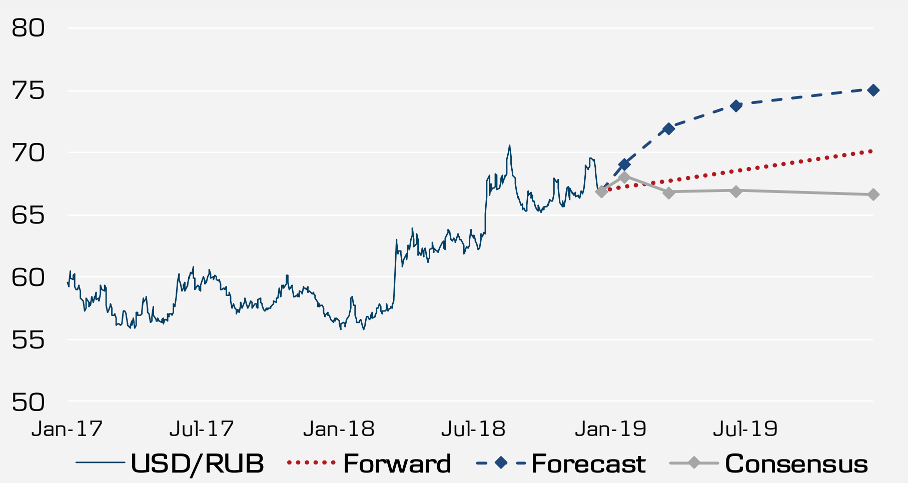
USD/RUB – major risk factors for the RUB are still in place

- **Growth.** The Russian economy grew 1.5% y/y in Q3 18 versus 1.9% y/y a quarter earlier according to Russian statistics service Rosstat. The expansion was 1.8% in January-November 2018, the Russian Ministry for Economic Development estimates. Due to a high base in 2017, agriculture continues to see moderate negative growth, while transport and construction continued to expand in November 2018. We expect Russia's GDP to grow 1.3% in 2019 and 1.4% in 2020, seeing that geopolitical woes remain the major downside risk for our forecasts and emphasising increased risk of technical recession in 2019.
- **Monetary policy.** Russia's central bank (CBR) raised the key rate by 25bp to 7.75% in December 2018 as we expected, while Bloomberg consensus saw no change. Inflation continues its moderate acceleration mostly due to a low base effect and a fuel price surge. In December consumer prices rose 4.2% y/y versus 3.8% y/y a month earlier. We see that there is a big chance the CBR could deliver another 25bp hike in February if inflation expectations continue to rise, new anti-Russia sanctions are introduced and global risk-on sentiment vanishes.
- **Flows.** Pressure on the RUB from a sell-off in OFZs has eased, but non-residents continue to exit their positions ahead of possible US sanctions and geopolitical uncertainty. The current risk-on sentiment has encouraged inflows into Russian assets, but that could change quickly. While Russian monetary authorities are resuming FX purchases, it will weigh on the RUB near term.
- **Valuation.** While the Brent 30-day average fell 10% over the past 30 days, as of 9 January 2019 RUB/USD slid just 1.7% over the same period. We see the RUB/USD as strongly undervalued at current oil prices and stable macro.

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



USD/RUB	1M	3M	6M	12M
Forecast	69.10	72.00	73.80	75.10
Fwd./Consesus	67.21 / 68.09	67.71 / 66.84	68.48 / 66.97	70.17 / 66.68

Source: Danske Bank

- **Conclusion.** The geopolitical premium in the RUB vanished a bit as the US did not hit Russia with harsh sanctions in autumn 2018, while it revoked previous sanctions on a Russian aluminium giant. However, the new US Congress is starting its sessions and a focus on anti-Russia sanctions may return as early as Q1 19. The risk of escalation in the stand-off between Russia and Ukraine also remains in place. If realised, it would send the RUB lower. We keep our previous USD/RUB profile unchanged, rolling the forecasts further.
- **Risks.** Geopolitical risks remain the major driver in the future. If more anti-Russia sanctions are not introduced in Q1 19, the RUB could see support.

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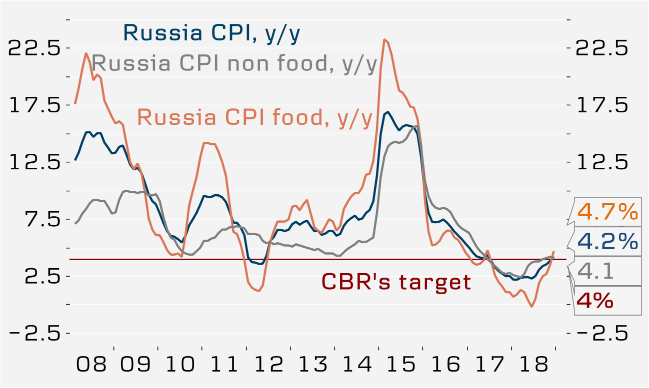
USD/RUB – important issues to watch

US anti-Russia rhetoric and new anti-Russia sanctions could be triggered any moment in Q1 19

- RUB has seen some relief as the US Congress looks too busy with domestic issues to push through the anti-Russian 'bill from hell' sanctions. Also, the US revoked sanctions against aluminium giant Rusal. However, if pressure on the US President Donald Trump increases, he is likely to introduce the second stage of anti-Russian sanctions linked to the Sergei Skripal case.
- In Q1 19, the focus will be on the Russia-Ukraine relationship as Ukraine is electing its new President in March 2019, and the new President could change his view on the current situation.

Inflation is set to see temporary acceleration over 5% in H1 19 due to an increase in VAT, some excise taxes and the RUB's weakness

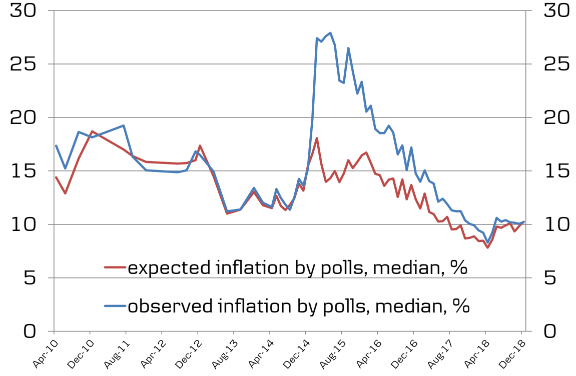


Source: CBR, Bloomberg, Macrobond Financial, Danske Bank

CBR's next hike is possible, but not guaranteed, in February 2019

- Deterioration in global sentiment and harsh anti-Russia sanctions could push the CBR for a 25bp hike February 2019, we believe.
- Rising inflation expectations would be another argument for a February hike.
- We expect the CBR to return to monetary easing in 2020.

Inflation expectations remain elevated as consumers face VAT and fuel price increases



Source: CBR, Danske Bank

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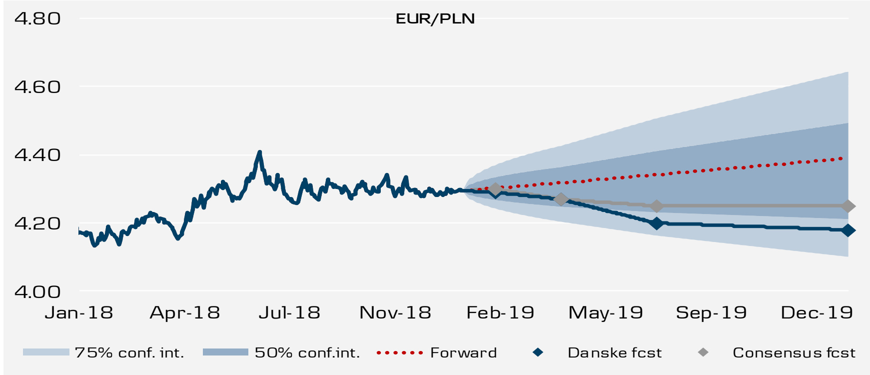
EUR/PLN – first signal of a rate hike?

- **Economic developments.** Recent indicators point to slowing momentum in the Polish economy. Along with the important trading partner Germany's PMIs, Polish PMIs have declined steadily to now 47.6 from 54 in June. We see a risk of the index dropping a little bit further in the coming months but then expect the global cycle to see a moderate recovery. Private consumption remains a key engine of growth with retail sales growing 6.9% y/y in real terms in December, in view of the still solid wage growth (which in nominal terms grew 7.7% in November). Construction activity is showing signs of weakening momentum but was still growing a healthy 17.1% in November. Overall we see real GDP growth slowing to 3.7% in 2019 from an estimated 5.1% in 2018.
- **Political and geopolitical developments.** The government adopted a budget envisaging a general government deficit of only 1.8% of GDP based on real GDP growth of 3.8% and inflation targeted at 2.3%.
- **Monetary policy.** Inflation pressure continues to remain muted; the flash December headline inflation declined to 1.1% from 1.3% in November, driven by falling energy prices, while core inflation also declined to 0.7% in November. At the most recent policy meeting on 9 January, the monetary policy committee (MPC) of the central bank of Poland struck a relatively dovish tone, highlighting the weaker growth momentum, a lower trajectory for inflation and possible enacting of unorthodox monetary policy easing if downside risks to growth materialise. The market has almost completely priced out a rate hike over the next two years, which we see as slightly on the dovish side.
- **Risks.** Risks are balanced for EUR/PLN in the near term: Among upside risks for the cross are further deterioration in global risk sentiment and a disorderly Brexit, while downside risks include improvement in risk sentiment, a further rebound in the EUR and strong economic releases in Poland.

Forecast: 4.29 (1M), 4.27 (3M), 4.20 (6M), 4.18 (12M)



EUR/PLN	1M	3M	6M	12M
Forecast (pct'ile)	4.29 (47%)	4.27 (34%)	4.20 (17%)	4.18 (20%)
Fwd. / Consensus	4.30 / 4.30	4.32 / 4.27	4.34 / 4.25	4.39 / 4.25
50% confidence int.	4.26 / 4.33	4.25 / 4.36	4.23 / 4.41	4.21 / 4.49
75% confidence int.	4.24 / 4.36	4.20 / 4.43	4.16 / 4.51	4.10 / 4.64

Source: Danske Bank

- **Conclusion.** The EUR/PLN continues to trade in the 4.28-4.33 range which has been broadly observed since October. The pair has remained stable despite large swings in global market risk sentiment which normally affect the Zloty significantly. We see headwinds from the global side for the next month, but then see a modest recovery in global economy, which should aide the Zloty together with the still solid performance of the domestic Polish economy, also boosted by slightly expansionary fiscal policy. As a result, we keep our forecast relatively unchanged for EUR/PLN at 4.29 in 1M, 4.27 in 3M, and 4.20 in 6M and 4.18 in 12M.

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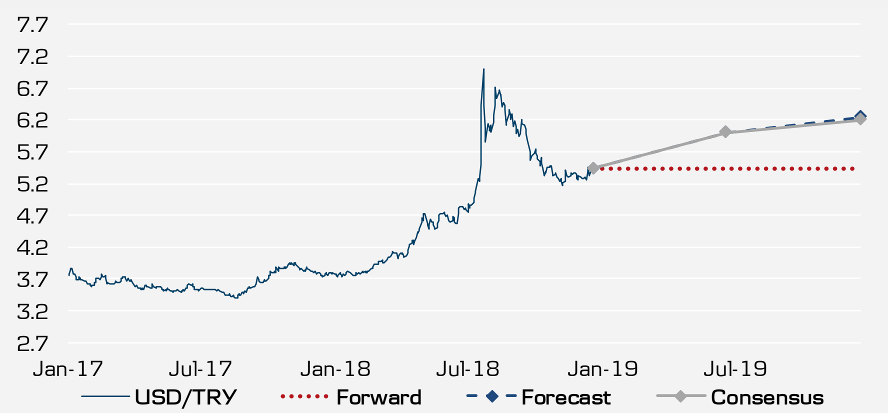
USD/TRY – external factors bring relief for the lira

- **Growth.** Turkish GDP growth slowed sharply to 1.6% y/y in Q3 18 from 5.3% y/y (revised up) a quarter earlier. In Q3 18, adjusted q/q GDP shrank 1.1% versus Q2 18. The construction sector was among the biggest losers, while growth in services expanded. The manufacturing PMI index remains well under 50.0. Given our expectations of a quarter-to-quarter GDP contraction in Q4 18, Turkey has likely faced a technical recession. We expect 2019 GDP growth to reach 1.1% y/y and 2020 GDP to expand 2.1% y/y.
- **Monetary policy.** Turkey's central bank (TCMB) kept the one-week repo rate at 24.00% in December 2018, as the TRY has stabilised and started gaining on the quickly improving geopolitical environment around Turkey, as the country returned to mutually positive dialogue with the US. The December 2018 inflation print fell further to 20.3%. A further decline could move the TCMB onto a monetary easing path as early as H1 19.
- **Valuation.** Recent net flows into Turkish bonds were negative on profit taking, while a more flexible Fed and the stable geopolitical situation could trigger new inflows. According to technical analysis (Relative Strength Index), the USD/TRY continues near 'the fair value' where it returned after the massive hike in September.
- **Risks.** Major downside risks to our TRY forecasts include geopolitical escalation between Turkey and the US in Syria. Excessively fast monetary easing ahead of local elections held in March 2019, could weigh on the TRY.

Forecast: 5.40 (1M), 5.55 (3M), 6.00 (6M) and 6.25 (12M)



USD/TRY	1M	3M	6M	12M
Forecast	5.40	5.55	6.00	6.25
Fwd./Consesus	5.44 / 5.53	5.44 / 5.73	5.44 / 6.00	5.44 / 6.20

Source: Danske Bank

- **Conclusion.** We slightly raise our TRY medium- and long-term outlook due to the currency stabilisation and more flexible Fed. However, large FX debt redemptions by the Turkish private sector will weigh on the TRY in 2019. Thus, we continue to remain bearish on the TRY in the long term expecting the USD/TRY at the following levels: 5.40 in 1M, 5.55 in 3M (previously 5.90), 6.00 in 6M (previously 6.10) and 6.25 in 12M (previously 6.50).

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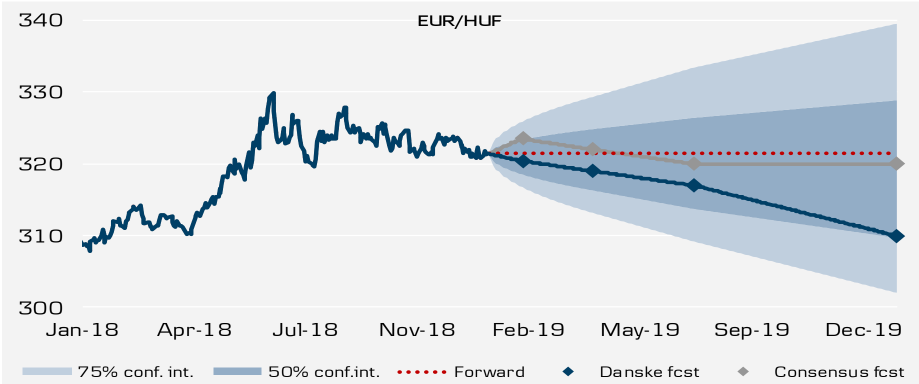
EUR/HUF – a turn towards monetary hawkishness to support the HUF

- **Growth.** Economic growth continued strong, posting 4.8% y/y in Q3 18 versus 4.9% y/y (revised up) in Q2 18. Manufacturing PMI accelerated to 54.2 in December 2018 from 53.5 a month earlier. At the same tim, the GKI Hungary economic sentiment indicator, which includes both consumer and business confidence, accelerated in December. The current stance in monetary policy is still beneficial for further economic expansion in 2019 and 2020 although on a lower path, as the risk of an earlier rate hike remains.
- **Monetary policy.** The Hungarian central bank (MNB) kept rates unchanged at its December meeting. Hungary's inflation in November eased to 3.1% y/y, while core inflation stayed at 2.6% y/y. The MNB Council noted in the most recent minutes that core inflation, excluding indirect tax effects, is rising, signalling 'the strengthening of persistent inflationary trends'. According to the MNB, 'persistent inflationary trends warranted even more attention than usual in judging the sustainable achievement of the inflation target'. We expect a 25bp rate hike in Q2 19, but implicit monetary tightening is likely to happen during Q1 19.
- **Risks.** An upside risk to our EUR/HUF forecast comes now from prolonged EUR weakness derived from postponed ECB tightening. An escalating trade war between the EU and the US would hit Hungarian exports and the HUF, if tariffs on German exports rise further. Fast acceleration in CPI could cause an early and more aggressive than 25bp rate hike, supporting the HUF. As the EU has taken a tough stance on Hungary's Prime Minister Viktor Orbán's domestic policy, introducing sanctions against the country, escalating tensions in the relationship between Brussels and Budapest could weigh on the HUF.

Forecast: 320.4 (1M), 319 (3M), 317 (6M) and 310 (12M)



EUR/HUF	1M	3M	6M	12M
Forecast (pct'ile)	320.40 (45%)	319.00 (41%)	317.00 (38%)	310.00 (25%)
Fwd. / Consensus	321.40 / 323.50	321.40 / 322.00	321.41 / 320.00	321.42 / 320.00
50% confidence int.	318.52 / 323.34	316.30 / 324.82	313.72 / 326.40	309.70 / 328.84
75% confidence int.	316.83 / 325.89	313.19 / 329.29	309.19 / 333.39	302.05 / 339.50

Source: Danske Bank

- **Conclusion.** We see the HUF getting stronger in the short, medium and long term, as Italian woes vanish bringing relief to the EUR and Hungarian economy remains in a good shape. We adjust the pair forecast according to the current EUR exchange rate and increased MNB hawkishness seeing EUR/HUF at 320.4 in 1M (previously 322.6), at 319 in 3M (previously 321.0), keeping the long-term forecast unchanged at 317.0 in 6M and in 12M at 310.0.

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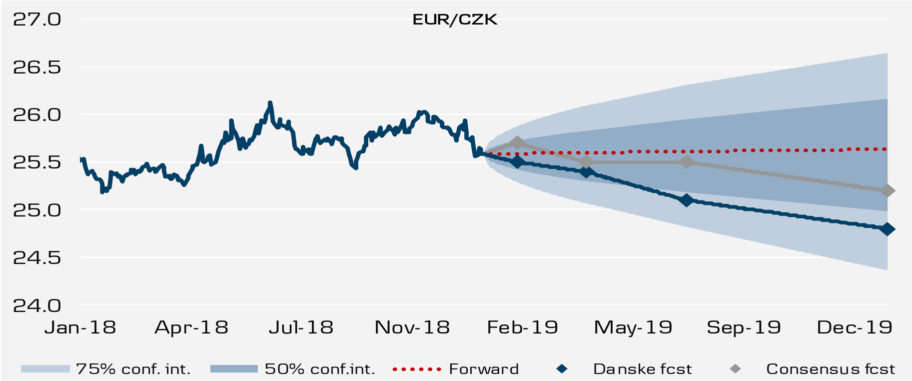
EUR/CZK – reviving the appreciation path

- **Growth.** In Q3, GDP growth (0.6% q/q) was driven both by domestic and foreign demand, but private consumption remains the key growth engine. Compared to 2017, the growth momentum in the Czech Republic has moderated in light of biting capacity constraints (especially in the labour market) and export performance is also faced with increasing global headwinds. In December manufacturing PMI fell below the 50 level for the first time since July 2016. As a small open economy, the Czech Republic remains susceptible to the global economic climate, but strong wage growth fuelling domestic demand should compensate for some of the external headwinds. We expect annual GDP growth to stay around potential, at 3.0% in 2018 and 2.9% in 2019.
- **Monetary policy.** With inflationary pressures showing signs of easing, the Czech National Bank (CNB) refrained from another policy rate hike at the December meeting, as we expected. Despite of this, hawkish signs from some CNB board members and Fed repricing supported the Czech koruna in recent weeks. For CNB the overall monetary conditions are crucial and hence the timing of the Czech hiking cycle remains dependent on FX movements. Should CZK continue to trade weaker than the CNB envisions in 2019, we expect the CNB to continue speeding up monetary tightening through the interest rate channel. We currently foresee two additional interest rate rises for next year, which means that the policy rate will still remain below its long-run neutral level (estimated at c.3.0% by the CNB).
- **Risks.** Risks to the growth outlook are tilted to the downside in light of continued weak activity in key export markets, and intensifying fears of a global slowdown could also have negative repercussions for CZK. Given the sizable amount of long CZK positions accumulated in the market prior to the floor exit, EUR/CZK remains vulnerable to changes in global investor sentiment.

Forecast: 25.50 (1M), 25.40 (3M), 25.10 (6M), 24.80 (12M)



EUR/CZK	1M	3M	6M	12M
Forecast (pct'ile)	25.50 (39%)	25.40 (33%)	25.10 (21%)	24.80 (20%)
Fwd. / Consensus	25.59 / 25.70	25.60 / 25.50	25.61 / 25.50	25.63 / 25.20
50% confidence int.	25.41 / 25.72	25.30 / 25.83	25.18 / 25.95	24.98 / 26.16
75% confidence int.	25.29 / 25.88	25.07 / 26.09	24.82 / 26.31	24.36 / 26.64

Source: Danske Bank

- **Conclusion.** In recent weeks domestic drivers have gained more prominence over external ones and in light of improved EM risk sentiment EUR/CZK seems to have returned to its gradual strengthening path. Macro fundamentals in the Czech Republic remain favourable compared to the euro area and the positive interest rate differential vis-à-vis the euro area will likely increase with the ECB still on hold and CNB leaving the door open for further policy tightening in 2019. Unless CNB communication suddenly shifts into a more dovish direction, we expect gradual CZK appreciation to persist over the forecast horizon, with occasional 'hiccups' as CZK has become much more susceptible to global investor sentiment. In light of the latest move we revise our short-term forecasts to 25.50 in 1M and 25.40 in 3M (25.80), but leave our 6M and 12M forecasts unchanged at 25.10 and 24.80, respectively.

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Oil – poised to rebound on OPEC+ cuts and growth recovery

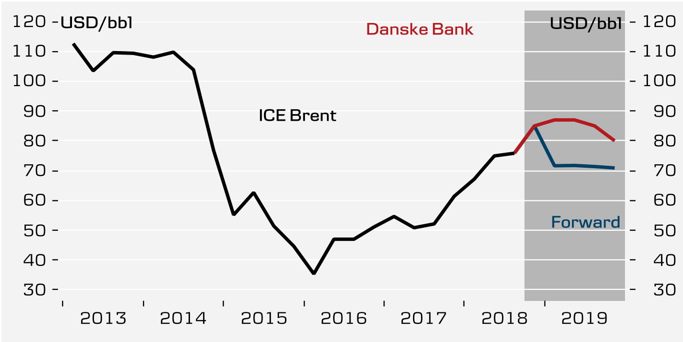
- **Macro.** In our view, the main reason for the tough ending to the year for the oil market was the deterioration in global risk sentiment. While macroeconomic key figures are likely to stay weak through Q1, we think that the more dovish tones from the Federal Reserve and the high likelihood of a trade deal over the coming months should underpin oil demand over the medium term. In addition, OPEC+ output cuts are feeding through to markets from the beginning of the year. Overall, this should help keep the oil market fairly balanced.

- **Forward curve.** The Brent crude oil market forward curve moved into contango following the sell-off at the front-end of the curve last year. The curve should flatten again as oil prices recover.

- **Positioning.** Speculative long positioning in the oil market was reduced towards the end of last year, which brought positioning closer to neutral territory. Hence, there is now potential for a rebuild of long positions as risk sentiment recovers.

- **Risks.** April will be important for the oil market. At that point, current waivers on Iran sanctions expire. OPEC+ is also set to review its deal to cut production. If waivers are not extended further it will lead to a large decline in Iran production and we will likely see OPEC+ adjust output cuts accordingly to mitigate this effect. Hence, over the medium term it should not have that big an impact on oil prices. In the short term uncertainty could haunt the oil market and lead to higher volatility.

Forecast: USD65/bbl (Q1), USD70/bbl (Q2), USD75/bbl (Q3), USD80/bbl (Q4)



Source: Danske Bank

- **Conclusion.** We expect oil prices to recover over the course of 2019. We forecast Brent to average USD65/bbl in Q1 rising to USD80/bbl in Q4. OPEC+ cuts, recovery in global growth and a weaker USD will be the main factors underpinning a higher oil price.

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Danske Bank FX forecasts vs EUR and USD

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs EUR									
USD	1.149	1.15	1.17	1.20	1.25	-0.2	1.0	2.8	5.4
JPY	124.5	125	129	132	140	0.7	3.3	6.0	12.4
GBP	0.897	0.90	0.84	0.83	0.83	0.2	-6.7	-8.1	-8.8
CHF	1.130	1.13	1.14	1.16	1.20	0.0	0.9	2.8	6.6
DKK	7.4637	7.4640	7.4600	7.4550	7.4550	0.0	0.0	0.0	0.1
NOK	9.77	9.60	9.50	9.40	9.30	-1.8	-3.1	-4.5	-6.3
SEK	10.24	10.20	10.10	10.00	10.00	-0.4	-1.4	-2.5	-2.6
Exchange rates vs USD									
JPY	108.3	109	110	110	112	0.9	2.3	3.1	6.6
GBP	1.28	1.28	1.39	1.45	1.51	-0.4	8.3	11.9	15.6
CHF	0.98	0.98	0.97	0.97	0.96	0.2	-0.1	0.0	1.1
DKK	6.49	6.49	6.38	6.21	5.96	0.2	-1.0	-2.8	-5.1
NOK	8.50	8.35	8.12	7.83	7.44	-1.6	-4.1	-7.1	-11.1
SEK	8.91	8.87	8.63	8.33	8.00	-0.2	-2.4	-5.1	-7.6
CAD	1.33	1.32	1.30	1.27	1.25	-0.4	-1.7	-3.8	-5.0
AUD	0.72	0.71	0.72	0.73	0.74	-1.4	-0.1	1.2	2.2
NZD	0.68	0.67	0.68	0.68	0.70	-1.8	-0.4	-0.5	2.1
RUB	67.06	69.10	72.00	73.80	75.10	2.6	6.1	7.5	6.8
CNY	6.76	6.80	6.80	6.75	6.70	0.6	0.7	0.0	-0.5

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

Source: Danske Bank

Danske Bank FX forecasts vs DKK

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs DKK									
EUR	7.4637	7.4640	7.4600	7.4550	7.4550	0.0	0.0	0.0	0.1
USD	6.49	6.49	6.38	6.21	5.96	0.2	-1.0	-2.8	-5.1
JPY	5.99	5.95	5.80	5.65	5.33	-0.6	-3.2	-5.7	-11.0
GBP	8.32	8.29	8.88	8.98	8.98	-0.2	7.2	8.8	9.7
CHF	6.60	6.61	6.54	6.43	6.21	0.0	-0.9	-2.8	-6.1
NOK	0.76	0.78	0.79	0.79	0.80	1.9	3.2	4.7	6.8
SEK	0.73	0.73	0.74	0.75	0.75	0.4	1.4	2.5	2.7
CAD	4.90	4.92	4.90	4.89	4.77	0.6	0.7	1.1	-0.1
AUD	4.67	4.61	4.59	4.54	4.41	-1.2	-1.1	-1.6	-3.0
NZD	4.43	4.35	4.34	4.22	4.17	-1.6	-1.4	-3.3	-3.1
PLN	1.74	1.74	1.75	1.78	1.78	0.4	1.2	3.4	5.1
CZK	0.29	0.29	0.29	0.30	0.30	0.6	1.3	3.0	5.3
HUF	2.32	2.33	2.34	2.35	2.40	0.4	0.9	1.6	4.5
RUB	0.10	0.09	0.09	0.08	0.08	-2.3	-6.7	-9.6	-11.2
CNY	0.96	0.95	0.94	0.92	0.89	-0.4	-1.7	-2.8	-4.6

Source: Danske Bank

Danske Bank

Danske Bank FX forecasts versus SEK

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs SEK									
EUR	10.24	10.20	10.10	10.00	10.00	-0.4	-1.4	-2.5	-2.6
USD	8.91	8.87	8.63	8.33	8.00	-0.2	-2.4	-5.1	-7.6
JPY	8.23	8.14	7.85	7.58	7.14	-1.1	-4.6	-7.9	-13.3
GBP	11.41	11.33	12.02	12.05	12.05	-0.6	5.7	6.2	6.8
CHF	9.06	9.03	8.86	8.62	8.33	-0.4	-2.3	-5.1	-8.6
NOK	1.05	1.06	1.06	1.06	1.08	1.4	1.7	2.2	4.0
DKK	1.37	1.37	1.35	1.34	1.34	-0.4	-1.4	-2.4	-2.7
CAD	6.72	6.72	6.64	6.56	6.40	0.2	-0.7	-1.3	-2.7
AUD	6.41	6.30	6.22	6.08	5.92	-1.6	-2.5	-4.0	-5.5
NZD	6.07	5.94	5.87	5.67	5.60	-2.0	-2.8	-5.6	-5.7
PLN	2.38	2.38	2.37	2.38	2.39	-0.1	-0.3	0.9	2.3
CZK	0.40	0.40	0.40	0.40	0.40	0.1	-0.2	0.5	2.5
HUF	3.18	3.18	3.17	3.15	3.23	0.0	-0.5	-0.8	1.7
RUB	0.13	0.13	0.12	0.11	0.11	-2.8	-8.1	-11.8	-13.5
CNY	1.32	1.30	1.27	1.23	1.19	-0.8	-3.1	-5.1	-7.1

Source: Danske Bank

Danske Bank FX forecasts versus NOK

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs NOK									
EUR	9.77	9.60	9.50	9.40	9.30	-1.8	-3.1	-4.5	-6.3
USD	8.50	8.35	8.12	7.83	7.44	-1.6	-4.1	-7.1	-11.1
JPY	7.84	7.66	7.38	7.12	6.64	-2.5	-6.2	-9.9	-16.7
GBP	10.88	10.67	11.31	11.33	11.20	-2.0	3.9	3.9	2.7
CHF	8.64	8.50	8.33	8.10	7.75	-1.8	-4.0	-7.1	-12.1
SEK	0.95	0.94	0.94	0.94	0.93	-1.4	-1.7	-2.1	-3.8
DKK	1.31	1.29	1.27	1.26	1.25	-1.8	-3.1	-4.5	-6.4
CAD	6.41	6.32	6.25	6.17	5.95	-1.3	-2.4	-3.4	-6.4
AUD	6.12	5.93	5.85	5.72	5.51	-3.0	-4.2	-6.0	-9.2
NZD	5.79	5.59	5.52	5.33	5.21	-3.4	-4.4	-7.6	-9.3
PLN	2.27	2.24	2.22	2.24	2.22	-1.5	-1.9	-1.2	-1.6
CZK	0.38	0.38	0.37	0.37	0.38	-1.3	-1.9	-1.6	-1.5
HUF	3.04	3.00	2.98	2.97	3.00	-1.4	-2.2	-2.9	-2.2
RUB	0.13	0.12	0.11	0.11	0.10	-4.1	-9.6	-13.6	-16.8
CNY	1.26	1.23	1.19	1.16	1.11	-2.2	-4.7	-7.1	-10.7

Source: Danske Bank

Danske Bank EMEA FX forecasts

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	**11-Jan-19**	**4.30**		**3.74**		**174**		**238**		**227**	
	+1M	4.29	4.30	3.73	3.74	174	173	238	238	224	227
	+3M	4.27	4.32	3.65	3.73	175	173	237	237	222	227
	+6M	4.20	4.34	3.50	3.72	178	172	238	236	224	227
	+12M	4.18	4.39	3.34	3.70	178	170	239	234	222	226
HUF	**11-Jan-19**	**322**		**280**		**2.32**		**3.18**		**3.04**	
	+1M	320	322	274	279	2.33	2.32	3.18	3.18	3.00	3.04
	+3M	319	322	273	278	2.34	2.32	3.17	3.18	2.98	3.05
	+6M	317	322	264	276	2.35	2.31	3.15	3.18	2.97	3.05
	+12M	310	324	248	273	2.40	2.30	3.23	3.17	3.00	3.07
CZK	**11-Jan-19**	**25.6**		**22.3**		**29.2**		**40.0**		**38.2**	
	+1M	25.5	25.6	22.2	22.3	29.3	29.1	40.0	40.0	37.6	38.1
	+3M	25.4	25.7	21.7	22.2	29.4	29.0	39.8	39.8	37.4	38.1
	+6M	25.1	25.9	20.9	22.2	29.7	28.8	39.8	39.7	37.5	38.1
	+12M	24.8	26.1	19.8	22.0	30.1	28.6	40.3	39.4	37.5	38.1
RUB	**11-Jan-19**	**77.1**		**67.1**		**9.7**		**13.3**		**12.7**	
	+1M	79.5	77.6	69.1	67.3	9.4	9.6	12.8	13.2	12.1	12.6
	+3M	84.2	78.6	72.0	67.8	8.9	9.5	12.0	13.0	11.3	12.5
	+6M	88.6	80.1	73.8	68.6	8.4	9.3	11.3	12.8	10.6	12.3
	+12M	93.9	83.3	75.1	70.3	7.9	8.9	10.7	12.3	9.9	11.9
TRY	**11-Jan-19**	**6.32**		**5.50**		**118**		**162**		**154**	
	+1M	6.21	6.45	5.40	5.60	120	116	164	159	155	152
	+3M	6.49	6.69	5.55	5.78	115	111	156	153	146	146
	+6M	7.20	7.06	6.00	6.05	104	106	139	145	131	139
	+12M	7.81	7.77	6.25	6.55	95	96	128	132	119	128
CNY	**11-Jan-19**	**7.77**		**6.76**		**96**		**132**		**126**	
	+1M	7.82	7.79	6.80	6.76	95	96	130	132	123	126
	+3M	7.96	7.82	6.80	6.76	94	95	127	131	119	125
	+6M	8.10	7.88	6.75	6.75	92	95	123	130	116	125
	+12M	8.38	7.99	6.70	6.73	89	93	119	129	111	124

Source: Danske Bank

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Date of first publication

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