Danske Bank
Markets

FX Forecast Update

The Fed and the rest

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Danske Bank Markets

Main forecast changes part I

- The divergence between central bank policy is becoming even more evident. Over the past month, the Bank of Japan (BoJ), ECB, Bank of England (BoE) and Riksbank have been dovish, while the Fed is committed to beginning its rate hiking cycle in summer 2015. This divergence is reflected in our FX forecast updates.
- The Swedish growth outlook is still relatively healthy but we see downside risks to Swedish growth in 2015. Consequently, we choose to raise our 12M EUR/SEK forecast slightly to 8.90 (from 8.80). However, we still see downside potential in EUR/SEK over the medium term based on relative monetary policy, growth divergence and valuation. Therefore, we maintain our 1M, 3M and 6M targets.
- Danmarks Nationalbank has allowed EUR/DKK to decline further than we had previously expected, so we have revised our forecasts for 1M and 3M down from 7.4475 to 7.4425 and for 6M and 12M from 7.4450 to 7.4390.
- We have 'rolled' our 1M EUR/USD forecast from 1.25 to 1.24, maintaining our 3M, 6M and 12M forecasts at 1.22, 1.20 and 1.23, respectively. We continue to expect EUR/USD to head lower near term on monetary and growth divergence, while EUR/USD stabilises in H2 15 on European growth stabilisation.
- In light of the recent surprise move by the Bank of Japan and the portfolio weight reshuffle by the Japanese Government Pension Investment Fund, we have revised our USD/JPY forecasts higher. We expect a combination of portfolio flows and relative monetary policy to push the cross higher and we target 117 in 1M, 120 in 3M, 122 in 6M and 124 in 12M.
- With respect to NZD/USD, we expect carry performance and Japanese portfolio inflows to provide some support in the short run and, therefore, we lift our 1M forecast from 0.76 to 0.78. However, we still expect relative monetary policy and the USD's role as an asset currency to pull NZD/USD lower. We maintain our targets at 0.75, 0.74 and 0.73 for 3M, 6M and 12M, respectively.

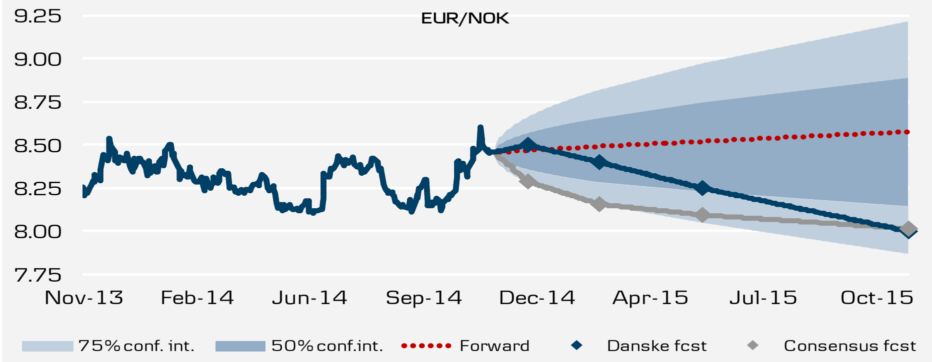
Main forecast changes part II

- We have revised our forecast for the CAD in a more negative direction compared with last month. Due to the collapse in oil prices and outlook for low oil prices, we now forecast USD/CAD at 1.14 (previously 1.12) in 1M, 1.14 (1.12) in 3M, 1.14 (1.12) in 6M and 1.13 (1.10) in 12M.
- For the EMEA markets, we have not made big changes to our FX forecasts compared with previous months. We have changed our forecast for the Hungarian forint in a more positive direction, as we think the sound economic growth and external position will continue to support the HUF. We now forecast EUR/HUF at 300, 300 and 305 on three-, six- and 12-month horizons, respectively Furthermore, we have changed our forecast for the Russian rouble following Russia's central bank's decision to let the rouble free float. Fundamental factors are likely to weigh on the rouble in the coming year – no matter what happens geopolitically. We expect these factors to be particularly negative on a three- to six-month horizon rather than on a 12-month horizon. Our new USD/RUB forecast are therefore 49, 51 and 51 on three-, six- and 12-month horizons. Overall, this is slightly more bullish on USD/RUB than forwards on a three- to six-month horizon and fairly 'neutral' on a 12-month horizon.

EUR/NOK – Norway can live with lower oil investments

- **Growth.** The Norwegian growth outlook has weakened somewhat over the past couple of months in the wake of the fall in the oil price. Based on the recent oil investment survey, we expect oil investments to fall 10% in 2015, subtracting around 0.6pp from mainland GDP. However, there are a lot of factors counteracting the negative effects, such as stronger global growth and a weaker NOK, which reduces downside risks. Hence, we continue to expect Norwegian growth to hold up well, around trend growth in 2015.
- **Monetary policy.** We expect Norges Bank to be on hold until early 2016 when we expect the first rate hike. Current market pricing suggests a close to one-third probability of a 25bp rate cut in December and a bit more than one cut priced in before June 2015. In our view, the current market pricing is justified only if domestic growth dips to the 1.00-1.25% range - even with lower global inflation and lower global rates.
- **Flows.** Norges Bank's NOK buying is modestly positive for the NOK. Speculative positioning in the NOK is light and thus does not pose a barrier for a stronger NOK.
- **Valuation.** Our PPP models put EUR/NOK at 8.11, suggesting the NOK is slightly weak.
- **Risks.** The risk is the oil price will continue to fall, which would have a negative impact on Norway's economy.

***Forecast:** 8.50 (1M), 8.40 (3M), 8.25 (6M), 8.00 (12M)*



EUR/NOK	1M	3M	6M	12M
Forecast (pct'ile)	8.50 (60%)	8.40 (40%)	8.25 (26%)	8.00 (16%)
Fwd. / Consensus	8.47 / 8.29	8.49 / 8.16	8.52 / 8.09	8.58 / 8.02
50% confidence int.	8.33 / 8.58	8.28 / 8.66	8.23 / 8.75	8.15 / 8.89
75% confidence int.	8.25 / 8.69	8.16 / 8.82	8.05 / 8.97	7.87 / 9.22

Source: Danske Bank Markets

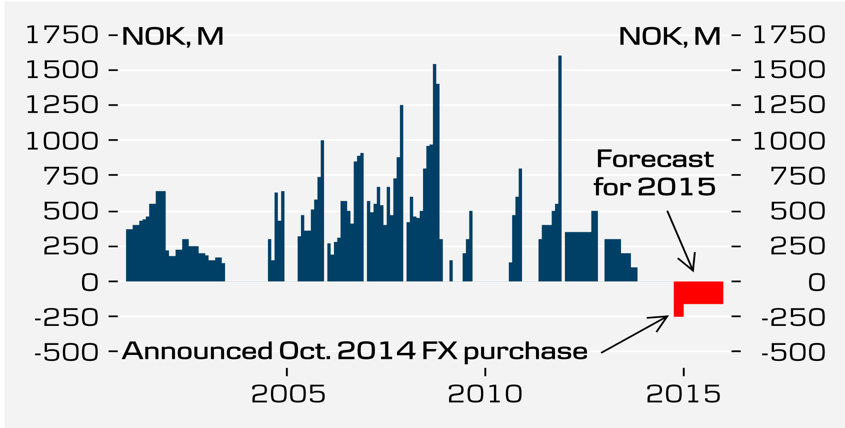
Conclusion. We expect EUR/NOK to be relatively trendless and volatile over the coming three months trading in broad ranges between 8.30 and 8.65. In the medium term, Norwegian growth outperformance relative to the eurozone, higher interest rates and a stabilising oil price should support the NOK. As such, we maintain our medium-term bearish view on EUR/NOK and our bullish view on the NOK. However, in light of lower oil prices and downside risks to Norwegian growth, we believe EUR/NOK will find it difficult to fall below 8.00 on a sustained basis over the coming 12 months.

EUR/NOK – important issues to watch

- **Norges Bank set to buy NOK 160-200m per day in 2015**
  In October and November, Norges Bank bought NOK250m per day, as taxes in NOK are not sufficient to cover the spending of petroleum revenues. Based on the assumptions in the 2015 Fiscal Budget, we expect Norges Bank to buy NOK250m per day in December. Looking further ahead, we expect Norges Bank to have to buy around NOK40-50bn in 2015, i.e. between NOK160m and NOK200m per day. An interesting observation is that Norges Bank will have to increase the buying of NOK if the oil price falls below the expected NOK650/bl. A rule of thumb indicates that oil taxes in NOK will fall by NOK2.5bn for every NOK10 per barrel the oil price falls. Hence, if the oil price stays at the current level (NOK560/bl), the amount of NOK purchased by Norges Bank will increase by NOK22.5bn in 2015, i.e. NOK90m per day.

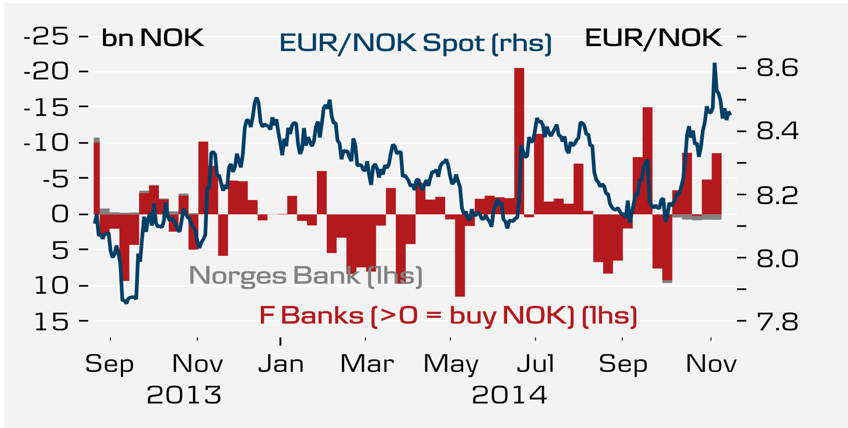
- **Speculators have been heavy sellers of NOK in recent weeks**
  Over the past five weeks, foreign banks (proxy for speculative flows) have been net sellers of an accumulated amount of NOK25.2bn. As such, we believe the speculative community is lightly positioned in the NOK and thus positioning does not pose a barrier for a stronger NOK. We note that Japanese investors were significant sellers of NOK assets in 2012-13. However, aggressive BoJ easing and pension reforms could reverse that trend given better valuations and Norway's solid fundamentals.

Norges Bank NOK buying should provide NOK support



Source: Macrobond Financial, Danske Bank Markets

Positioning does not pose a barrier for a stronger NOK

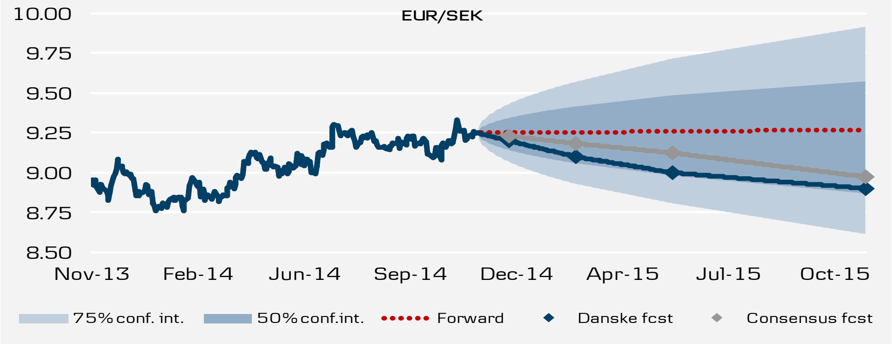


Source: Macrobond Financial, Danske Bank Markets

EUR/SEK – the Riksbank at the ZLB, inflation set to pick up

- **Growth.** Sweden's growth looks solid versus many European peers. While GDP could disappoint versus forecasts due to (1) a poorer outlook for euroland and (2) Swedish consumers feeling the pressure of slowing real wage growth, higher income tax and higher mandatory mortgage amortisation, the relative growth outlook firmly supports a lower EUR/SEK.
- **Monetary policy.** We expect the Riksbank to keep the repo rate unchanged for a long time (end-2016); the money market indicates a first hike in Q2 17. If inflation gets stuck at too-low levels, the Riksbank's next measure is to postpone rate hikes. QE, fixed repos or FX measures are not in the pipeline. Relative monetary policy continues to argue for a lower EUR/SEK.
- **Flows.** Export volumes have moved sideways since 2013. Foreign currency sellers could see current levels as increasingly attractive. If the SNB is forced to defend its currency floor, it could result in mechanical investments in SEK-denominated assets.
- **Valuation.** Fundamental arguments such as the current account surplus, solid public finances, relative inflation and relative growth suggest the SEK is significantly undervalued.
- **Risks.** EUR/SEK could move higher/lower than envisaged if, for example, the ECB does QE (lower), the SNB successfully defends its currency floor (lower), the Swedish political situation turns really messy (higher), the Riksbank signals SEK intervention (higher) or a housing collapse turns into a market theme (higher).

***Forecast:** 9.20 (1M), 9.10 (3M), 9.00 (6M), 8.90 (12M)*



EUR/SEK	1M	3M	6M	12M
Forecast (pct'ile)	9.20 (41%)	9.10 (30%)	9.00 (26%)	8.90 (27%)
Fwd. / Consensus	9.25 / 9.23	9.25 / 9.18	9.26 / 9.12	9.27 / 8.97
50% confidence int.	9.13 / 9.35	9.06 / 9.42	8.98 / 9.49	8.87 / 9.57
75% confidence int.	9.05 / 9.45	8.93 / 9.57	8.81 / 9.71	8.62 / 9.91

Source: Danske Bank Markets

Conclusion. The Riksbank's cut sent EUR/SEK sharply higher but the rally was short lived and the pair has since traded close to our 1M 9.20 target. We see downside potential in EUR/SEK over the medium term based on relative monetary policy, growth divergence and valuation. Near-term risks are evenly skewed with the third-quarter GDP outcome (29 November), the parliamentary budget vote (3 December) and PPM flows (estimated second week of December) in the pipeline. The Swedish growth outlook still looks relatively healthy but we see downside risks to Swedish growth and as a consequence we choose to raise our 12M EUR/SEK forecast slightly to 8.90 (from 8.80).

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EUR/SEK – important issues to watch

Growth

- Third-quarter GDP is due for release on 29 November. Our estimate of c.2.0% y/y is close to the Riksbank's 2.3% forecast and thus not expected to prompt any meaningful forecast revisions on its behalf.

Inflation and the Riksbank

- Our inflation forecasts now run slightly above the Riksbank's until Q2 next year, suggesting the central bank will stay on hold. We see the first hike in late 2016, while market pricing indicates Q2 17. 'Forward guidance' should be the first line of defence, while SEK intervention is farfetched and, in our view, unjustified.

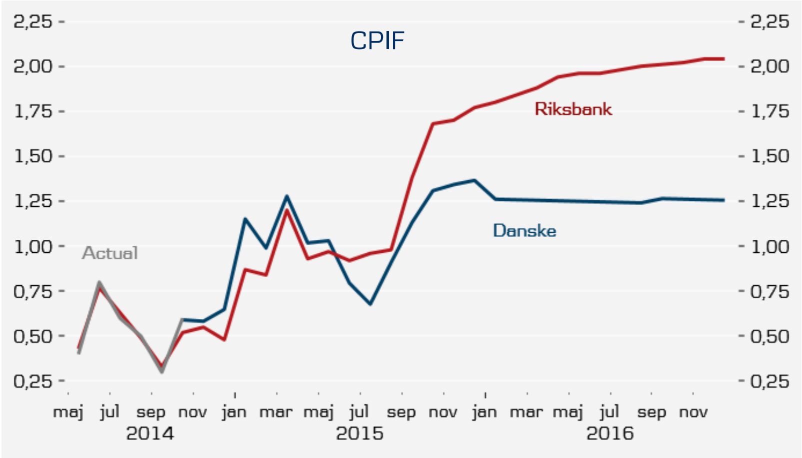
A messy parliamentary situation

- The weak Social Democratic-Green minority government cannot be sure of getting its budget proposal through the Riksdag on 3 December. It is highly likely that the Social Democratic party, which holds the balance of power will keep us on tenterhooks over coming weeks, which might weigh on the SEK. In the end, we think the budget will go through. Re-election is still a long shot.

PPM – no persistent effects on the krona

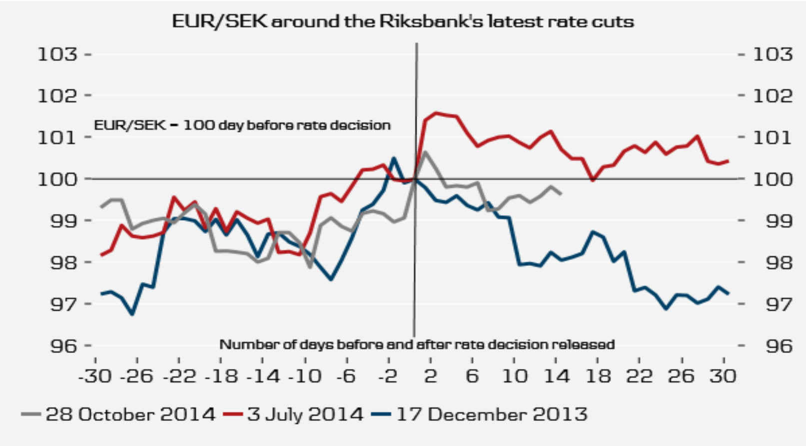
- In December, it's time for the yearly transfer of pension money. We expect a total transfer of SEK30-35bn, of which we expect SEK10-15bn to hit the SEK.

Inflation expected to pick up



Source: Macrobond Financial, Riksbank

Surprise cuts that do not bite



Source: Macrobond Financial, Riksbank, Danske Bank Markets

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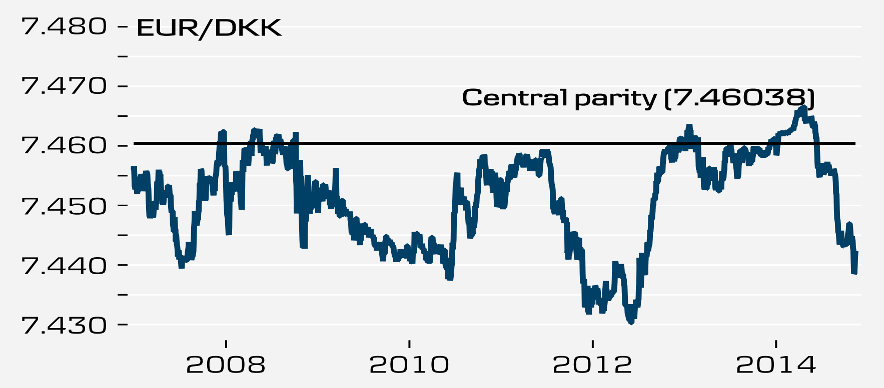
EUR/DKK– downward pressure mounts

- **Rates.** In September and October Danmarks Nationalbank (DN) made FX intervention purchases totalling DKK3.1bn. In November, EUR/DKK fell further as the ECB further clarified its balance sheet target. This indicates that the pressure is mounting on DN to react in order to cap the downside on EUR/DKK. Therefore, we stick to our view that DN will need to make additional FX intervention purchases and a unilateral 10bp cut to the rate on certificates of deposit to minus 0.15% before year-end. It will probably take around DKK10-20bn in FX intervention purchases to trigger a rate cut.
- **FX.** DN has allowed EUR/DKK to decline further than we had previously expected – it fell below 7.4400 in November for the first time since 2012 – and we have consequently revised our forecasts down. We expect EUR/DKK to remain more or less steady (on 1M and 3M) on the back of a DN rate cut, as the market is now pricing in a near-term rate cut with a relatively high probability. In 2015, we expect the downward pressure to resume as the ECB pushes forward with its balance sheet expansion.
- **Liquidity.** Liquidity in the DKK money market has received a temporary boost from payments of coupons and redemptions on Danish government bonds. However, excluding DN intervention, it is likely to tighten again towards the end of the year, adding to the downward pressure on EUR/DKK.

	14/11/2014		1M		3M		6M		12M	
Spot	7.4432		7.4425		7.4425		7.4390		7.4390	
3M Forward (ann. carry, bp)	7.4421	(-6)	7.4410	(-8)	7.4410	(-8)	7.4375	(-8)	7.4375	(-8)
6M Forward (ann. carry, bp)	7.4405	(-7)	7.4395	(-8)	7.4395	(-8)	7.4355	(-9)	7.4355	(-9)
12M Forward (ann. carry, bp)	7.4374	(-8)	7.4365	(-8)	7.4365	(-8)	7.4315	(-10)	7.4315	(-10)



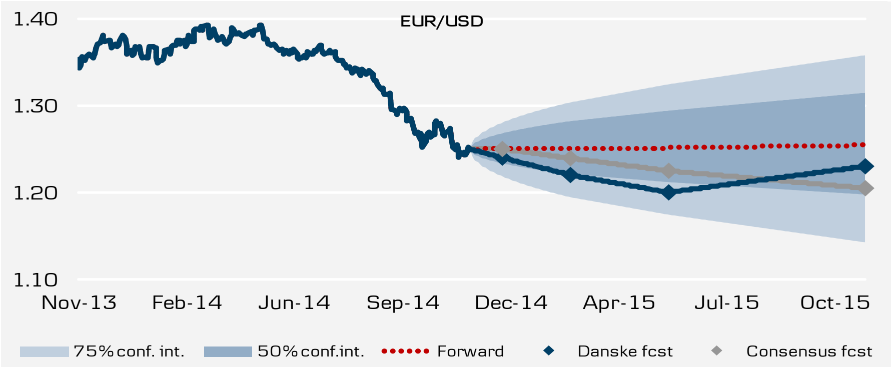
Source: Macrobond Financial, Danske Bank Markets

- **Flows.** The Danish current account surplus is close to 7% – the highest surplus accounted for in 60 years of available data. The large current account surplus supports a stronger DKK, despite portfolio flows having turned negative.
- **Conclusion.** Short-term easing from DN should cap the downside to EUR/DKK. The ECB's easing measures and relatively tight liquidity in the DKK money market should cap any upside risk in EUR/DKK due to lower EUR money market rates and a weaker EUR.

EUR/USD – consolidating before next leg lower

- **Growth**. US growth fell to 3.5% in Q3, from 4.6% in Q2, and we expect a further slowdown to 2.5% in Q4, as momentum has slowed a bit in consumption and exports. In 2015, we look for growth to pick up to 3% from Q2 onwards, as consumer fundamentals are still robust with decent real income growth and solid wealth gains in the past few years. The US will thus grow above the trend rate and we expect unemployment to continue to decline and hit the Fed's long run estimate at 5.4% in early spring.
- **Monetary policy.** We expect the Fed to begin its tightening cycle in June 2015 but the risk is skewed to an earlier hike though, due to the faster-than-expected tightening of labour resources. The latest ECB meeting supported our view that it is on hold waiting to see the take-up at the December TLTRO. However, we believe it will be difficult to expand the balance sheet enough to reach its official target and we expect the ECB to reach for more tools in early 2015.
- **Flows.** The eurozone continues to run large trade and current account surpluses. However, short-term trends in EUR/USD are driven by portfolio flows rather than trade flows.
- **Valuation**. EUR/USD PPP is currently around 1.27, so the EUR is close to fair value.
- **Risks.** IMM positioning shows that long USD speculative positioning is the biggest on record. Hence, a sharp weakening of US data will weigh on the USD given positioning.

***Forecast:** 1.24 (1M), 1.22 (3M), 1.20 (6M) ,1.23 (12M)*



EUR/USD	1M	3M	6M	12M
Forecast (pct'ile)	1.24 (35%)	1.22 (24%)	1.20 (20%)	1.23 (37%)
Fwd. / Consensus	1.25 / 1.25	1.25 / 1.24	1.25 / 1.22	1.25 / 1.20
50% confidence int.	1.23 / 1.27	1.22 / 1.28	1.21 / 1.29	1.20 / 1.31
75% confidence int.	1.21 / 1.28	1.19 / 1.30	1.17 / 1.32	1.14 / 1.36

Source: Danske Bank Markets

Conclusion. We expect EUR/USD to grind lower on monetary and growth divergence. We expect the ECB to reach for more tools in early 2015, paving the way for further EUR weakness. Meanwhile, we expect the Fed to surprise markets and begin its tightening cycle in June 2015. We expect the USD to rally ahead of the Fed's tightening cycle. We expect EUR/USD to rebound on a six- to 12-month horizon as eurozone deflation risks disappear and the growth differential between the US and eurozone narrows.

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EUR/USD – important issues to watch

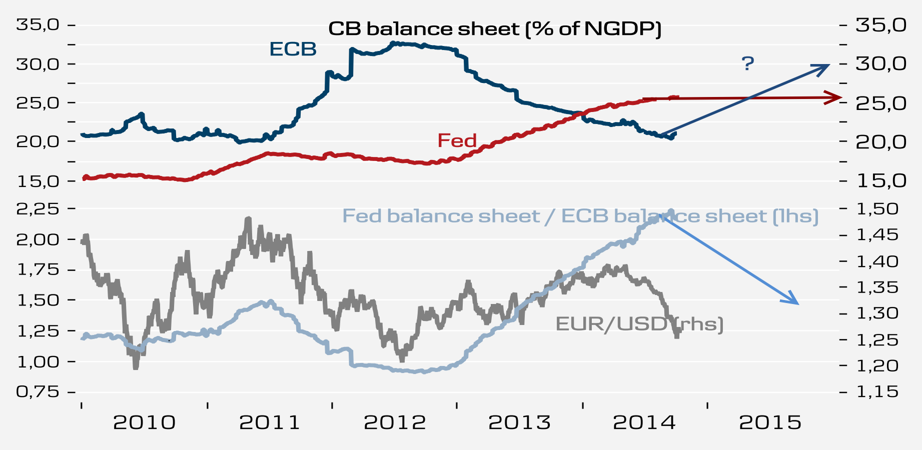
The ECB's ambition to expand its balance sheet supports a lower EUR/USD

- The ECB now officially targets its balance sheet to be the same size as in early 2012, which is effectively a target of EUR3trn. For the remainder of 2014, excess liquidity is unlikely to get a large boost, even as the second TLTRO settles in December. Overall, we believe it will be difficult to expand the balance sheet sufficiently and we expect the ECB to reach for more tools in early 2015.
- The Fed ended its purchase of Treasuries and mortgage-backed securities (MBS) in October and with the ECB's unconventional easing measure, the trend in the two central banks' balance sheets will reverse, supporting the case for a lower EUR/USD.

Positioning suggests that the downtrend in EUR/USD will be gradual

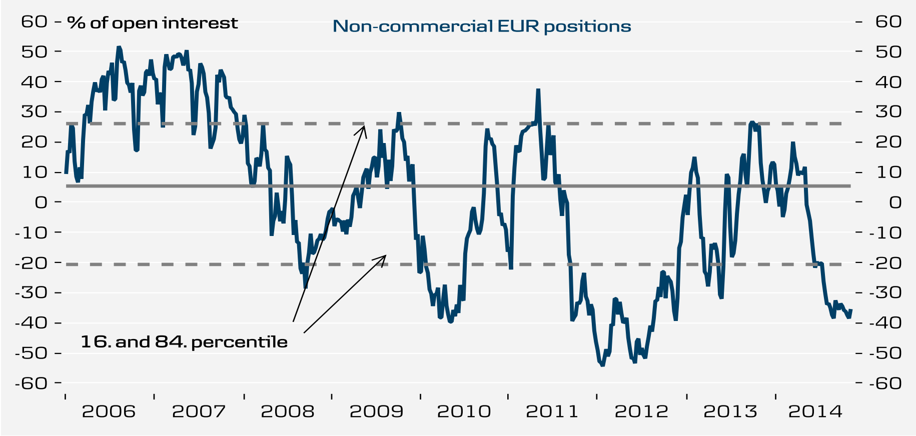
- IMM data show that speculative short EUR/USD positioning is at stretched levels, currently at the seventh percentile. EUR positioning has been relatively stable in recent weeks, suggesting a new catalyst is required to drive positioning further.
- Short EUR positioning is a risk for our bearish EUR/USD call but the downtrend remains firmly in place.

The trend in the ECB's balance sheets to reverse



Source: Macrobond Financial, Danske Bank Markets

EUR shorts at stretched levels



Source: CFTC, Danske Bank Markets

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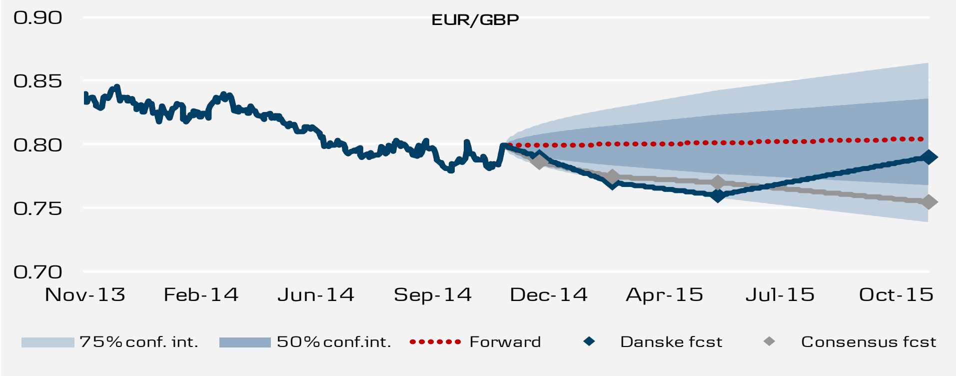
EUR/GBP – BoE backtracks rate hike expectations

- **Growth.** The preliminary estimate showed that GDP growth slowed to 0.7% q/q in Q3 from 0.9% in Q2. Manufacturing PMI unexpectedly rose to 53.8 in October after a steep decline over the summer, while both construction and service PMI fell more than expected. Overall, however, business surveys remain high, pointing to ongoing growth and still we expect the UK economy to continue to expand at a decent pace supported by household consumption, investments and a pickup in global demand.
- **Monetary policy**. The Bank of England was quite dovish in its November inflation report and revised down its inflation forecasts considerably but kept its growth and labour market projections broadly unchanged. Overall, the timing of the first rate hike remains entirely conditional on incoming data but the latest dovish stance from the MPC suggests it is much less likely the BoE will raise rates before H2 15. Consequently, we have moved our rate hike expectations a bit further out from Q2 (May) to Q3 15. Hence, we now expect the BoE to deliver the first rate hike in August, which is still more dovish than the consensus estimate (Q1 15) but also still more hawkish than the current market pricing.
- **Flows.** Investors have recently reduced long GBP positions and net speculative positioning is close to neutral, according to IMM data.
- **Valuation**. PPP around 0.77 for EUR/GBP.
- **Risks.** In the short term, a deterioration in the global business cycle remains the main risk factor for the timing of the first BoE rate hike and thus the pace of GBP strength.

***Forecast**: 0.79 (1M), 0.77 (3M), 0.76 (6M) and 0.79 (12M)*



EUR/GBP	1M	3M	6M	12M
Forecast (pct'ile)	0.79 (26%)	0.77 (11%)	0.76 (13%)	0.79 (39%)
Fwd. / Consensus	0.80 / 0.79	0.80 / 0.77	0.80 / 0.77	0.80 / 0.75
50% confidence int.	0.79 / 0.81	0.78 / 0.81	0.78 / 0.82	0.77 / 0.84
75% confidence int.	0.78 / 0.82	0.77 / 0.83	0.76 / 0.84	0.74 / 0.86

Source: Danske Bank Markets

Conclusion. We expect EUR/GBP to trade lower in the coming months, driven primarily by a divergent growth and monetary policy outlook. Despite the quite dovish November inflation report, the BoE is still on a very different path for monetary policy to the ECB. We have postponed our expectation for the first BoE rate hike from Q2 to Q3 15, which is still more hawkish than the market is pricing (Q4 15). We expect the EUR/GBP downside to unfold on a three- to six-month horizon, supported by a repricing of the UK money market and increased speculation about additional ECB easing, and we target the cross at 0.77 in 3M and 0.76 in 6M. In six to 12 months, we expect EUR/GBP to bottom as a weaker euro should support a rebound in growth and inflation expectations and we target EUR/GBP at 0.79 in 12M.

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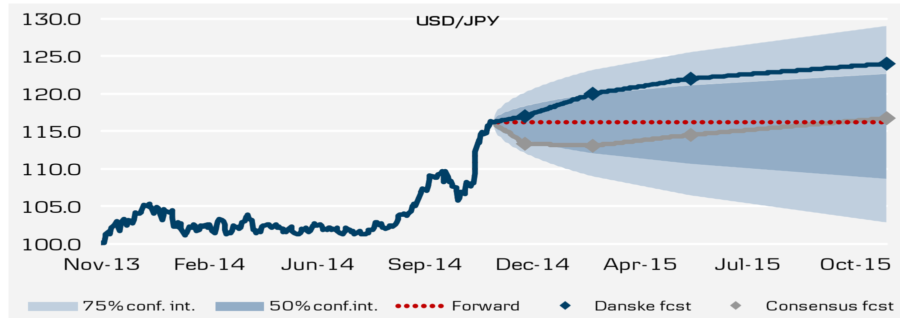
USD/JPY – almost to the universe and beyond

- **Macro outlook.** Recent economic data surprised positively. For instance, both retail sales and industrial production were much higher than expected, at 2.3% y/y (consensus 0.8%) and 2.7% (consensus -0.1%), respectively. September's 3.0% y/y inflation (excluding fresh food but *including* April's VAT hike) was in line with estimates.
- **Monetary policy.** In a big surprise move, the BoJ stepped up its already aggressive monetary policy at its October meeting. The move included three main features: expansion of its target for the annual expansion of the monetary base to JPY80trn (from JPY60-70trn), an increased focus on asset purchases relative to liquidity instruments and a rise in the average maturity of government bond purchases from seven years to 10 years. The decision to expand the QE programme was approved with the slimmest majority in a five to four vote. This highlights BoJ governor Haruhiko Kuroda's determinedness and his willingness to sacrifice a possible consensus of the BoJ board.
- **Flows.** The current account deficit has returned to positive territory after a build up of the primary income balance. Foreign direct investments have also risen in recent years.
- **Valuation.** Our USD/JPY PPP estimate is c.84.
- **Risk.** According to CFTC IMM data, speculative accounts remain very short JPY, although recent profit taking has meant a reduction in short positions. This has increased the sensitivity of the JPY on the downside.

Forecast: *117(1M), 120 (3M), 122 (6M) and 124 (12M)*



USD/JPY	1M	3M	6M	12M
Forecast (pct'ile)	117.00 (58%)	120.00 (75%)	122.00 (77%)	124.00 (78%)
Fwd. / Consensus	116.23 / 113.34	116.23 / 113.07	116.23 / 114.52	116.22 / 116.74
50% confidence int.	113.53 / 118.81	112.13 / 120.00	110.72 / 121.16	108.72 / 122.68
75% confidence int.	111.47 / 120.83	109.05 / 123.15	106.51 / 125.52	102.92 / 129.00

Source: Danske Bank Markets

Conclusion. We have been bearish on the JPY for a long time and believe a combination of relative monetary policy and an increase in portfolio flows out of Japan will be supportive factors for the cross (see next slide). Moreover, we expect any sell-off in the USD to be modest, as investors will use all opportunities to position for a stronger USD. Hence, we target USD/JPY at 117 in 1M and 120 in 3M, which is equivalent to a continuation of the current appreciation trend in coming months while the GPIF portfolio reshuffle takes place.

On a medium-term horizon, we expect USD/JPY to move gradually higher as US growth outperforms Japan's and relative monetary policy continues to be a supporting factor for the cross. We target USD/JPY at 122 (previously 116) in 6M and 124 (118) in 12M.

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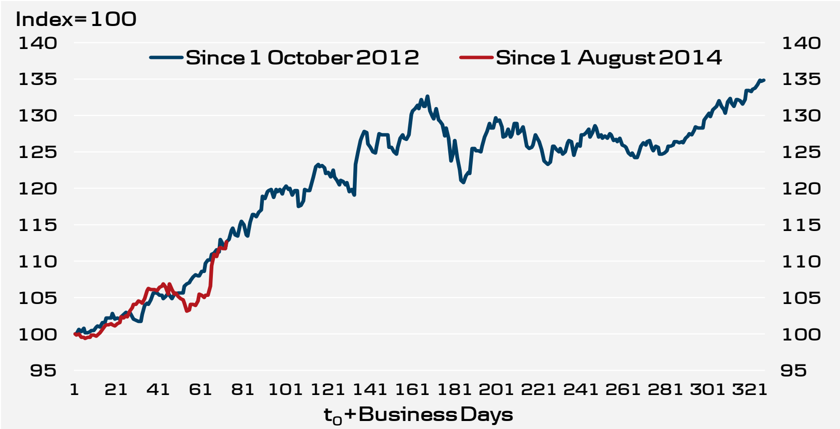
USD/JPY – important issues to watch

Fundamental differences from the 2012/13 trend

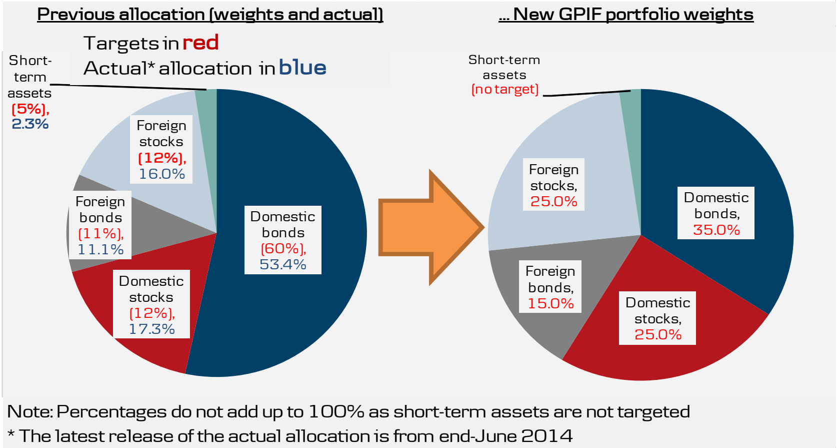
- The BoJ's recently announced easing measures are much less drastic than the April 2013 ones, suggesting the current move higher is overdone. However, the current situation differs from 2012/13 in two important ways, supporting our view that USD/JPY is likely to continue its trend at around the same pace in coming months.
  - **Relative monetary policy.** First, the Fed was on an easing bias in the period to May 2013, with the latest round of QE (QE3) introduced as recently as September 2012. The Fed has ended its QE programme and the question is when it will hike rates from the historical low. We still believe the market underestimates the Fed and that a repricing of the first hike will support the USD. In addition, measured by the new expansion targets of the BoJ's balance sheet, the easing is more than 2.5x as aggressive as the Fed's QE at its peak. Thus, although the risk of postponement of the planned October 2015 sales tax hike might spark speculation of an earlier BoJ exit strategy, we still believe the argument of relative monetary policy pushing USD/JPY higher is far stronger now than in 2012/13.
  - **Significant portfolio outflows**. With respect to portfolio flows, the situation is also fundamentally different. In 2012/13, Japanese investors were significant net sellers of foreign assets and we believe FX risks at that time were mostly hedged. We now believe we will see a greater portfolio outflow out of Japan driven by GPIF and other public pension funds that jump on the bandwagon. Importantly, GPIF has explicitly stated that it will not hedge the currency risk stemming from the increase in foreign investments. This is a de facto reduction in the hedge ratio, which increases the upside potential in USD/JPY.

We expect the trend higher to continue



Source: Bloomberg, Danske Bank Markets

GPIF portfolio weight reform to drive portfolio flows out of Japan



Source: GPIF, Danske Bank Markets

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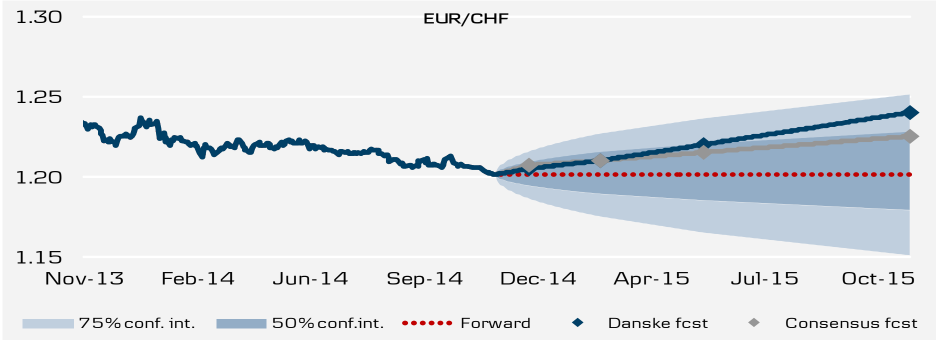
EUR/CHF – the floor to hold; EUR/CHF to rise medium term

- **Growth.** Consumer prices were unchanged in October on both a yearly and a monthly basis (consensus -0.1% y/y and -0.1% m/m). Thus, the risk of deflation is still very much a concern for the Swiss National Bank (SNB). Also, although the KOF leading indicator for October was better than expected, it is still below the long-term average.
- **Monetary policy.** The SNB has recently faced increased appreciation pressure on the Swiss franc in light of speculation about further ECB stimulus and speculation on a new gold stock restriction on the SNB's balance sheet (see next slide). At the same time, the SNB still faces a trade-off between low inflation and the danger of an overheating housing market. This has sparked speculation on a deposit rate cut into negative territory.
- **Flows.** According to the latest CFTC IMM data release, speculators have increased their bearish positions relative to mid-October. This increases the upside sensitivity in EUR/CHF.
- **Valuation.** According to the Danske Bank PPP model estimate of c.1.33, EUR/CHF is undervalued. Our short-term financial models also indicate an undervalued EUR/CHF with a fair value model estimate of 1.207.
- **Risks.** Switzerland remains one of the preferred safe havens for investors, making CHF forecasts vulnerable to geopolitical turmoil and general risk-off sentiment.

Forecast: *1.205 (1M), 1.210 (3M), 1.220 (6M) and 1.240 (12M)*



EUR/CHF	1M	3M	6M	12M
Forecast (pct'ile)	1.205 (59%)	1.210 (64%)	1.220 (74%)	1.240 (82%)
Fwd. / Consensus	1.20 / 1.21	1.20 / 1.21	1.20 / 1.22	1.20 / 1.23
50% confidence int.	1.19 / 1.21	1.19 / 1.22	1.19 / 1.22	1.18 / 1.23
75% confidence int.	1.19 / 1.22	1.18 / 1.23	1.17 / 1.24	1.15 / 1.25

Source: Danske Bank Markets

Conclusion. While the 30 November Swiss gold referendum and speculation on additional ECB easing could put further downside pressure on EUR/CHF short term, speculation on additional ECB easing also raises the likelihood of a reaction from the SNB. Moreover, the low level of inflation and slowing of the KOF leading indicator and M3 money growth mean the likelihood of an SNB rate cut to negative in December has risen. We still expect the SNB 1.20 floor to be maintained for a prolonged period no matter what the outcome of the Swiss gold referendum (see next slide).

We still expect EUR/CHF to edge gradually higher towards 1.24 in 12M, driven mainly by a reversal of safe-haven flows and an increase in Swiss portfolio investments abroad. We maintain our targets of 1.2050 in 1M, 1.2100 in 3M and 1.2200 in 6M.

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EUR/CHF – important issues to watch

The 'Save the Swiss Gold' Referendum

- In Switzerland, any voter who can collect 100,000 signatures within 18 months can request an initiative. As a result, on 30 November, Switzerland will vote on the popular initiative 'Save the Swiss Gold', which consists of three proposals: (1) the SNB may not sell gold, (2) a minimum of 20% of the SNB's assets must consist of gold and (3) all the SNB's gold must be held in Switzerland. While 1 would come into force immediately, the time frame is five years for 2 and two for 3. Since 2000, around 15% of popular proposals (out of 66) have been passed. Internet polls currently suggest a limited risk of the proposal being passed.
- Importantly, an eventual passage of the referendum would not alter SNB's independence but it would affect its balance sheet flexibility and thus the incentive to pursue balance sheet related unconventional policy measures.
- If referendum is passed SNB would have to raise its current holding of 7.5% of gold to 20.0%. It could do this by **(A)** maintaining the current balance sheet size and purchasing gold using FX reserves, **(B)** expanding the balance sheet with CHF and using the extra funds to purchase gold, **(C)** a combination of A and B and **(D)** reducing the current balance sheet by selling FX reserves and thereby lifting the current share of gold. We believe D is highly unlikely and that some version of C is the most viable. Currently, the SNB FX reserve consists primarily of EUR. As a result, a version of C would be likely to increase the short-term downward pressure on EUR/CHF.
- In the event of a 'yes' vote, there is a risk speculators will test the SNB's willingness to defend the floor as the initiative essentially makes up a restriction on the balance sheet. However, due to the long five-year implementation period, this leaves plenty of time for the SNB to continue with its unlimited intervention until the CHF weakens on a reversal of safe-haven flows and on an increase in Swiss portfolio investments abroad. We believe the SNB will stay very committed to the EUR/CHF 1.20 floor under both the 'yes' and 'no' scenarios and we expect the floor to be in place for a prolonged period of time. In the event of a 'yes', we believe the SNB would be likely to introduce a negative deposit rate in order to reduce the attractiveness of holding long CHF positions.

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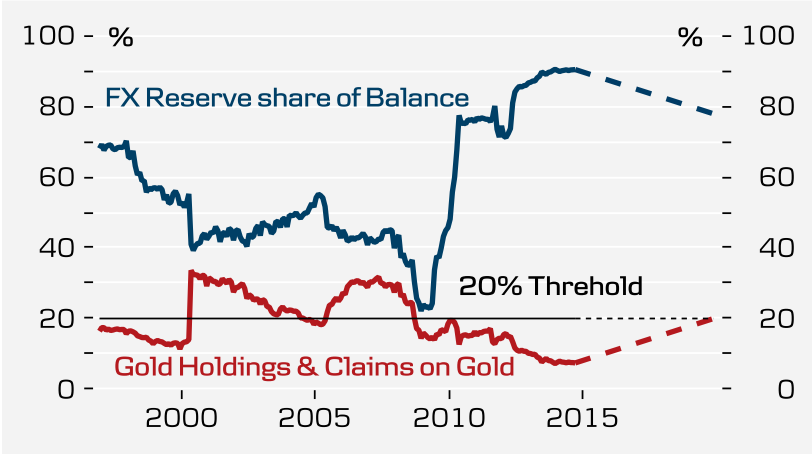
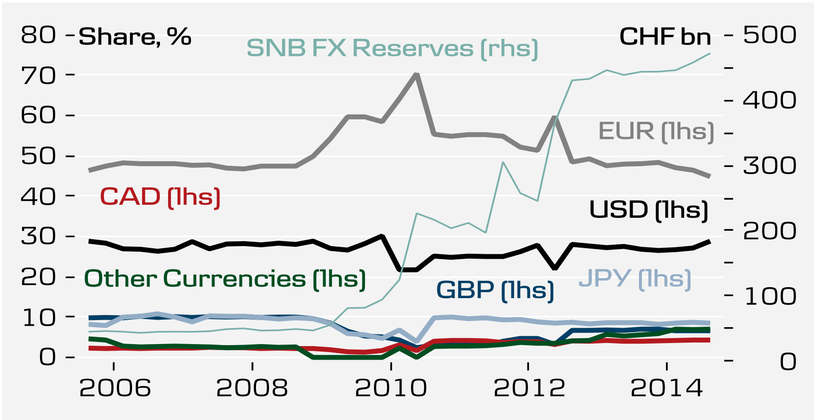
Gold share must increase from 8% to 20% in 5 years



Note: Other assets' share is assumed constant at c.2%
Source: SNB, Danske Bank Markets

EUR makes up the majority of FX reserves



Source: Macrobond Financial, SNB, Danske Bank Markets

USD/CAD – oil price set to drive the CAD

- **Growth.** The economic recovery seems to be losing some of its momentum as the fall in oil prices is starting to bite into the economy. Q3 GDP is very likely to slow further compared with Q2. In 2014, GDP should not exceed 2.3%. Low oil prices represent a main downside risk to the Canadian economy. Inflation has been inching lower as expected and it is now exactly 2% y/y, which is the official inflation target. We expect inflation to fall further in coming months.

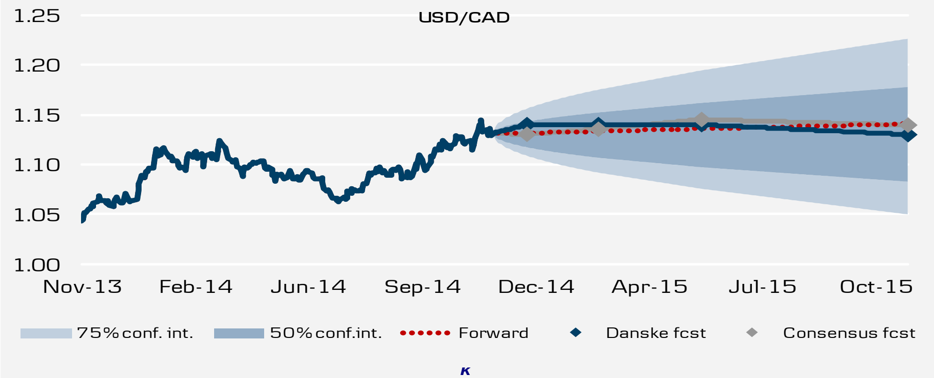
- **Monetary policy.** The Bank of Canada (BoC) maintained its overnight lending rate at 1.00% at its October meeting, although there was a change. The BoC removed the notorious 'neutral' from its statement. In our view, the removal of 'neutral' means the bank does not want financial markets to rely too much on one word and, in the case of Canada, to use this as forward guidance. Looking ahead, we expect the BoC to stay on hold until at least Q2 15, as we expect the low oil price and headwinds from the global economy to put downward pressure on the economy.

- **Flows.** Speculative positioning is net short for the CAD.

- **Commodities.** We expect oil prices to continue to weigh on the CAD.

- **Risks.** The oil price could continue to fall more than assumed; or the economic recovery could fail.

***Forecast**: 1.14 (1M),1.14 (3M), 1.14 (6M) and 1.13 (12M)*



USD/CAD	1M	3M	6M	12M
Forecast (pct'ile)	1.14 (69%)	1.14 (63%)	1.14 (60%)	1.13 (52%)
Fwd. / Consensus	1.13 / 1.13	1.13 / 1.14	1.14 / 1.15	1.14 / 1.14
50% confidence int.	1.12 / 1.14	1.11 / 1.15	1.10 / 1.16	1.08 / 1.18
75% confidence int.	1.11 / 1.16	1.09 / 1.18	1.08 / 1.19	1.05 / 1.23

Source: Danske Bank Markets

Conclusion. Canada should start to benefit from a US recovery; however, there is a lag, which is likely to continue, between the positive spill-over from the US recovery into the Canadian economy due to the sharp fall in oil prices. A collapse in oil prices is a clear downward risk to the Canadian economy. The current sharp fall in oil prices is also behind the ongoing CAD sell-off. Given our expectation of low oil prices for longer, we expect the CAD to remain on the weak side. We have revised our forecast for the CAD in a more negative direction. However, our forecasts are in line with current market pricing.

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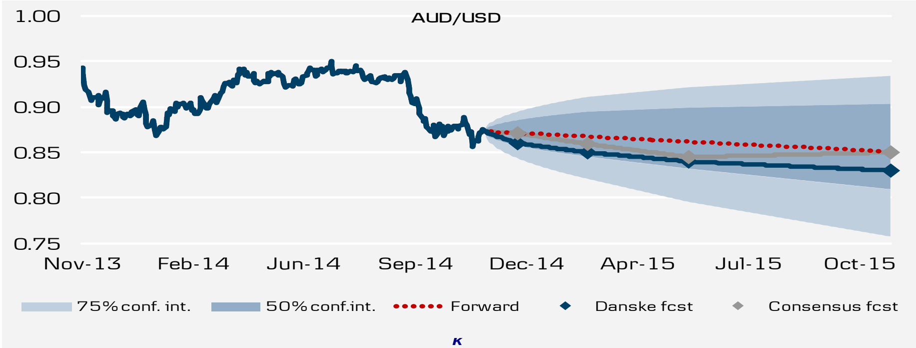
AUD/USD – more downside in store

- **Growth.** Q3 inflation was in line with our estimate at 2.3% y/y (consensus 2.3%) – a fall from 3.0% in Q2. For the first time since Q2 13, both tradables and non-tradables inflation fell. This is a result of the 2013 AUD weakness falling out of the yearly calculations and the general low domestic price pressure in the Australian economy. The all-important question is still how the Australian economy and labour market will handle the fall in mining investments. Recent releases give a mixed picture, with unemployment seemingly stabilising at a high level (still some uncertainty related to the labour market statistics), retail sales surprising on the upside and subdued non-mining investments.
- **Monetary policy.** The RBA kept its cash rate target unchanged at the November meeting. In both the immediate rate decision comment and the quarterly monetary policy statement released on 7 November, the RBA maintained its rhetoric that AUD remains fundamentally overvalued and said 'the most prudent course is likely to be a period of stability in interest rates'.
- **Flows.** CFTC IMM data reflect a continued change in sentiment towards the AUD with investors having added bearish builds in nine of the past 10 weeks. Non-commercial AUD positioning has consequently returned to the stretched short levels seen last year, suggesting a higher sensitivity of the AUD to the upside.
- **Valuation.** Fundamentally, the AUD remains overvalued with a Danske Bank PPP model estimate of c.0.73.
- **Risks.** Short term, a strong carry performance versus the JPY, in particular, and portfolio flows into Australia from Japanese funds might provide some temporary resistance to short-term AUD weakness. The downswing in the mining investment boom could have more severe effects on the economy than expected. The AUD remains exposed to global risk sentiment.

***Forecast:** 0.86 (1M), 0.85 (3M), 0.84 (6M) and 0.83(12M)*



AUD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.86 (29%)	0.85 (28%)	0.84 (29%)	0.83 (33%)
Fwd. / Consensus	0.87 / 0.87	0.87 / 0.86	0.86 / 0.84	0.85 / 0.85
50% confidence int.	0.86 / 0.89	0.85 / 0.89	0.83 / 0.90	0.81 / 0.90
75% confidence int.	0.84 / 0.90	0.82 / 0.91	0.80 / 0.92	0.76 / 0.93

Source: Danske Bank Markets

Conclusion. Falling inflation figures have eased the pressure on the RBA and leave room for a rate cut should the fall in mining investments turn out to have a more severe effect than expected. We maintain our base-case view that the RBA will leave the cash rate target unchanged until Q1 16.

In the very short term, carry performance and Japanese portfolio inflows may provide some support. However, fundamentally, we still believe AUD/USD has more downside in store. In particular, we expect commodity prices (e.g. iron ore prices) to continue to weigh on the AUD leg going forward. In addition, we still expect US growth outperformance, relative monetary policy and the USD's role as an asset currency to pull AUD/USD lower.

We maintain our targets of 0.86, 0.85, 0.84 and 0.83 for 1M, 3M, 6M and 12M, respectively.

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NZD/USD – fundamentally overvalued

- **Growth**. New Zealand's Q3 inflation fell to 1.0% (previously 1.6%) – markedly lower than consensus (1.2% y/y), the RBNZ's own forecast and its medium-term 2% inflation target. Generally, the New Zealand economy continues to struggle due to the marked fall in commodity prices. In particular, milk powder prices have fallen sharply (down 50% since February), contributing to the trade balance returning to a deficit. Survey data give a mixed picture: while manufacturing looks strong and consumer and business confidence remain low. Lastly, the latest QV price release showed the housing market continues to cool, with the lowest annual increase in house prices in two years.

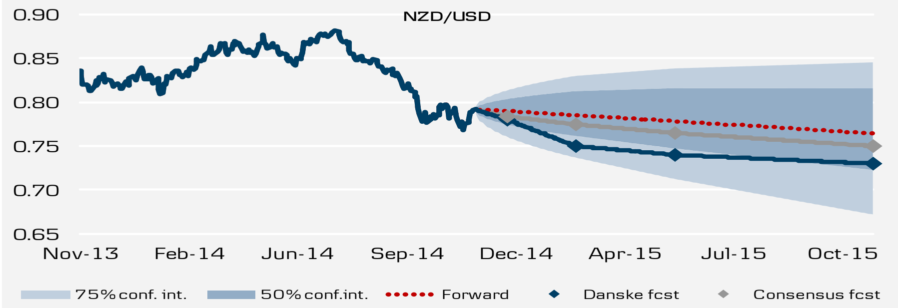
- **Monetary policy.** The Reserve Bank of New Zealand (RBNZ) kept its official cash rate unchanged at 3.5% at the October meeting. More interestingly, however, the RBNZ left out its explicit tightening bias in the statement that 'some further policy tightening will be necessary'. The RBNZ reiterated that the value of NZD is 'unjustified and unsustainable'. Last week, RBNZ maintained the high loan-to-value restriction on banks due to the fear of renewed price pressure on the housing market from surging immigration and low borrowing costs. This decision lowers the hiking pressure on the RBNZ further.

- **Flows.** According to IMM data, speculative NZD accounts are net short, although close to broadly square in a historical perspective. The latest trade balance figures showed a larger-than-expected current account deficit due to an unexpected rise in imports.

- **Valuation.** Fundamentally, the NZD remains overvalued, with a Danske Bank PPP model estimate of around 0.64.

- **Risks.** Short term, strong carry performance vis-à-vis, in particular, the JPY and portfolio flows into New Zealand from Japanese funds might provide some temporary resistance to short-term NZD weakness. The NZD remains exposed to global risk sentiment.

Forecast: 0.78(1M), 0.75 (3M), 0.74 (6M) and 0.73 (12M)



NZD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.78 (32%)	0.75 (18%)	0.74 (22%)	0.73 (27%)
Fwd. / Consensus	0.79 / 0.78	0.79 / 0.77	0.78 / 0.76	0.76 / 0.75
50% confidence int.	0.77 / 0.81	0.76 / 0.81	0.75 / 0.82	0.72 / 0.82
75% confidence int.	0.76 / 0.82	0.74 / 0.83	0.71 / 0.84	0.67 / 0.85

Source: Danske Bank Markets

Conclusion. In light of the recent fall in inflation to the lower bound of RBNZ's 1-3% inflation target, we do not think a rate hike is imminent. With inflation pressure also easing globally, the RBNZ does not have to raise rates immediately and can await the full effect on economic activity of commodity price falls and the four rate hikes in H1 14. Thus, we expect the RBNZ to remain in a period of monitoring and assessment and see the first rate hike in Q4 15. The past months' FX reserve data also show the RBNZ is back in the FX market. We believe the RBNZ will utilise situations of thin liquidity in the market to intervene to bring the NZD lower from the RBNZ termed 'unjustified and unsustainable' level.

In the very short term, carry performance and Japanese portfolio inflows may provide some support, so we lift our 1M target to 0.78. However, we still expect relative monetary policy and the USD's role as an asset currency to pull NZD/USD lower., We keep our targets at 0.75 for 3M, 0.74 for 6M and 0.73 for 12M.

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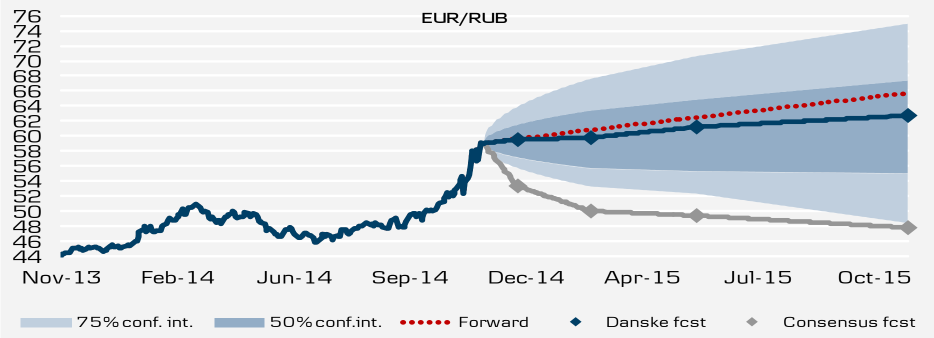
EUR/RUB – a free jump into free float

- **Growth.** Economic growth in Russia surprised on the positive side, expanding 0.7% y/y in Q3 14 compared with consensus of 0.3% and 0.8% in Q2 14. However, the stronger-than-expected growth was due to expansion in agricultural production.
- **Monetary policy.** The Russian central bank (Bank Rossii) has been the major newsmaker in the Russian economy in recent weeks. On 31 October, it hiked its key rate by an unexpected 150bp (consensus 50bp, our estimate 100bp) to save the sinking rouble and curb accelerating inflation. It also threatened to keep an eye on rouble liquidity and squeeze it if needed to support the currency. On 10 November, it abolished the rouble's trading band moving into free float.
- **Flows.** Net capital outflows slowed to USD13bn in Q3 14 versus USD23.7bn in Q2 14. We expect acceleration of capital outflows in Q4 14 on the rouble's rapid devaluation.
- **Valuation.** EUR/RUB is trading significantly above its 1M average of 55.16. Based on the RUB REER, we see the current levels as not far from fair value.
- **Risks.** Bank Rossii's sudden rate hikes to support RUB and curb accelerating inflation. Escalation of sanctions. Geopolitical risks remain and may fuel RUB volatility.

***Forecast:** 59.52(1M), 59. 78(3M), 61.20 (6M) and 62.73 (12M)*



EUR/RUB	1M	3M	6M	12M
Forecast (pct'ile)	59.52 (56%)	59.78 (55%)	61.20 (60%)	62.73 (60%)
Fwd. / Consensus	59.61 / 53.35	60.80 / 50.01	62.46 / 49.40	65.70 / 47.80
50% confidence int.	56.15 / 61.98	55.72 / 63.38	55.30 / 64.83	55.03 / 67.38
75% confidence int.	54.18 / 64.86	53.32 / 67.63	52.37 / 70.65	48.43 / 74.98

Source: Danske Bank Markets

- **Conclusion.** We remain bearish on the outlook for the Russian rouble and we expect it to remain under some pressure going forward. The oil price risk is high and correlation with the rouble spot rate has been increasing.
- The oil price risk is now weighing more on the RUB than pure geopolitics. In our view, the free float regime will keep volatility elevated, as the rouble is trying to find a new equilibrium. We do not see any support from fundamentals in the long run.

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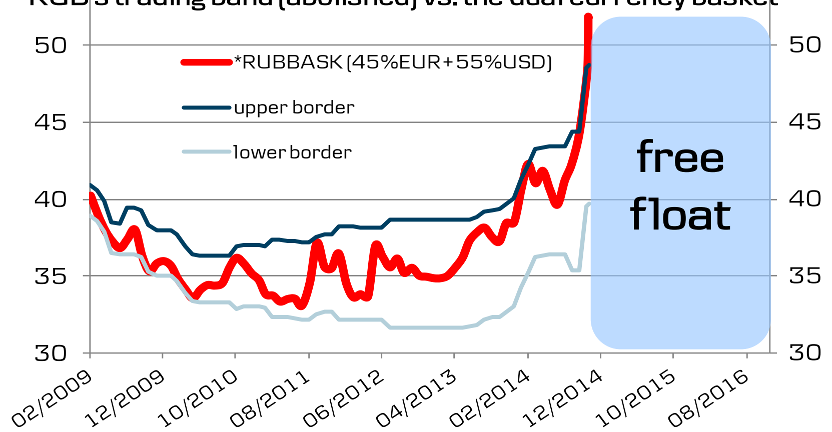
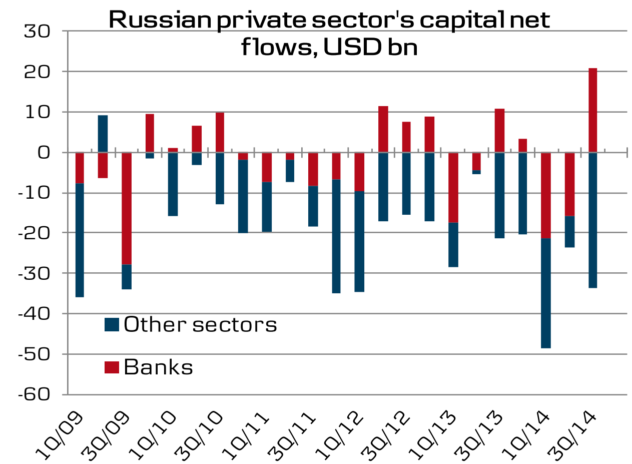
EUR/RUB – important issues to watch

Weakness set to continue on surged volatility

- The RUB has continued to be the worst currency performer against the EUR in the EMEA FX universe for the past 30 days. It dipped a substantial 12.3% and hit an all-time low of 60.26 on 7 November 2014 despite Bank Rossii's tightening and numerous verbal interventions. Yet, the move into free float is playing against speculative positions, helping the rouble to find the new equilibrium with the Brent price falling under USD80/bl. Sanctions against Russia are likely to be tightened further.
- Despite the move into free float, Bank Rossii leaves open the right to intervene at any time 'in case of financial stability threats'. We believe the change in the regime was necessary to protect FX and gold reserves as Bank Rossii's previous actions have done nothing to stop the rouble's fast devaluation. Russia's international reserves have shrunk by 13.3% since the Ukraine crisis began in late February 2014.
- The ECB's dovish monetary stance should mitigate EUR/RUB's surge in the short run.



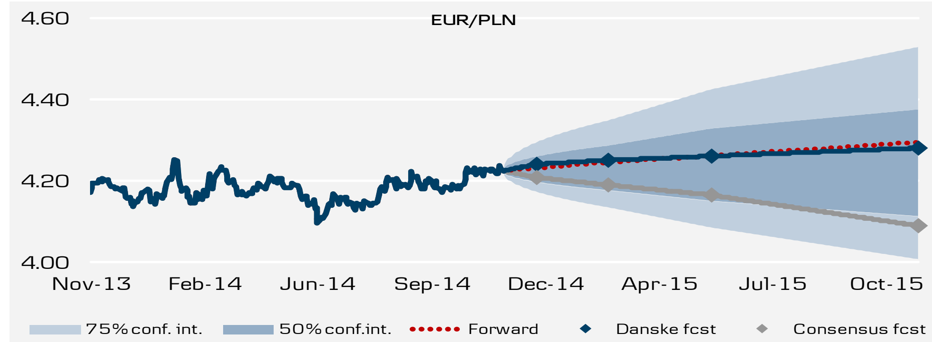


Source: Bank Rossii, Bloomberg, Danske Bank Markets (both charts)

EUR/PLN – the 'boring' zloty

- **Growth.** The outlook for the Polish economy has deteriorated recently. The economy is falling deeper and deeper into deflation and it has become even clearer that growth remains well under potential growth and that inflation is likely to remain well below the Polish central bank's official 2.5% inflation target in coming years unless bold monetary easing is undertaken. Weaker domestic demand and lower external demand due to the Ukrainian crisis and general weakness in the European economy are weighing on Polish growth.
- **Monetary policy.** Despite deflation in the Polish economy having deepened, the Polish central bank (NBP) has been very reluctant to cut interest rates, including at the latest monetary policy council meeting. Even though we continue to think the NBP will cut rates further in 2015, it is unlikely to move faster than currently expected by the markets.
- **Valuation.** The PLN is trading close to its fair value level, so valuation is unlikely to have any major near-term impact.
- **Risks.** The biggest risk to the PLN in the near term is the possibility of a re-escalation of the Ukraine-Russia conflict.

Forecast: *4.24 (1M), 4.25 (3M), 4.26 (6M) and 4.28 (12M)*



EUR/PLN	1M	3M	6M	12M
Forecast (pct'ile)	4.24 (64%)	4.25 (61%)	4.26 (58%)	4.28 (59%)
Fwd. / Consensus	4.23 / 4.21	4.24 / 4.19	4.26 / 4.16	4.29 / 4.09
50% confidence int.	4.19 / 4.26	4.18 / 4.29	4.15 / 4.33	4.11 / 4.37
75% confidence int.	4.17 / 4.29	4.14 / 4.35	4.09 / 4.42	4.01 / 4.53

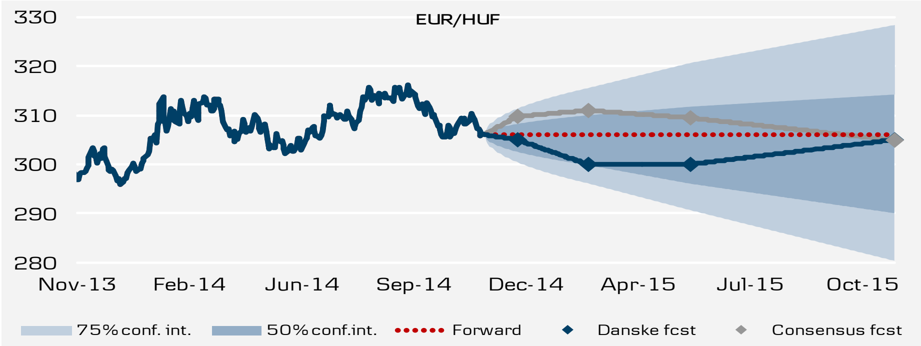
Source: Danske Bank Markets

Conclusion. While the deflationary situation in Poland warrants significant monetary easing, the NBP is not likely to act in the near term, in our view. This effectively means the NBP is keeping monetary policy too tight, which is giving some support to the zloty. With EUR/PLN close to 'fair value', we do not expect any major movement in the zloty in the next 12 months.

EUR/HUF – large current account supports the forint

- **Growth.** Growth has been picking up in Hungary and after years of stagnation it is becoming one of the fastest growth economies in central and eastern Europe. However, structural problems and weak domestic demand continue to weigh on economic activity. We now expect real GDP growth to be 3.5% y/y in 2014 – up from 1.2% y/y in 2013. We expect growth to remain at 3.5% y/y in 2015.
- **Monetary policy.** The Hungarian central bank (MNB) has been cutting interest rates in baby-steps. This has been justified, as there is actually now deflation in Hungary (despite higher growth) and there is certainly a risk of further deflation in coming months. However, we also stress that the fall in inflation reflects supply-side factors to a greater extent than in, for example, Poland and the Czech Republic and we therefore expect inflation to pick up somewhat over the coming year, which should push the MNB in a slightly more hawkish direction.
- **Valuation.** The HUF has fairly attractive long-term fundamentals and the relatively large current account surplus is particularly helpful.
- **Risks.** The biggest risks to the HUF remain the political uncertainty and the Hungarian government once again taking a 'misstep' in economic policy. The Ukraine-Russia conflict is also a key risk.

***Forecast:** 305 (1M), 300 (3M), 300 (6M) and 305 (12M)*



EUR/HUF	1M	3M	6M	12M
Forecast (pct'ile)	305.00 (44%)	300.00 (25%)	300.00 (38%)	305.00 (58%)
Fwd. / Consensus	306.05 / 309.77	306.06 / 310.97	306.07 / 309.47	306.09 / 304.93
50% confidence int.	302.89 / 308.42	299.88 / 310.09	296.11 / 311.83	290.13 / 314.30
75% confidence int.	300.82 / 311.28	296.19 / 315.63	290.77 / 320.73	280.50 / 328.44

Source: Danske Bank Markets

Conclusion. We continue to believe that Hungary's fairly strong external position is likely to be supportive for the HUF in the medium term, as will the increasingly stronger recovery in growth. As a consequence, we believe we could see the forint continuing to strengthen (moderately) on a three- to six-month horizon.

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USD/TRY – lower oil prices are good news for the lira

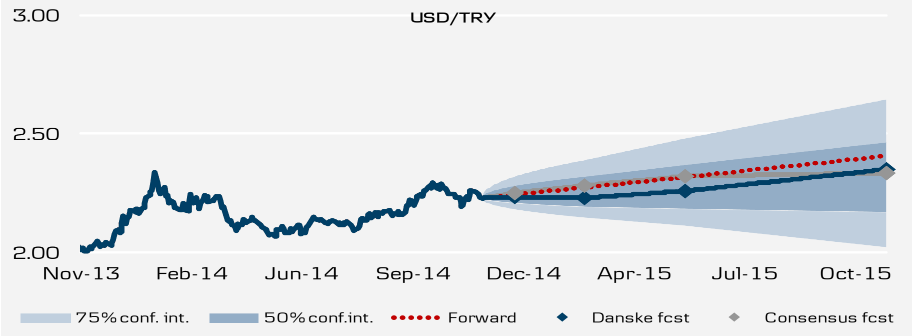
- **Growth**. The Turkish economy has been showing quite clear signs of slowing over the past couple of years and recently there have been further signs of growth deceleration. We now expect 2.7% y/y real GDP growth in 2014 and 2.8% y/y in 2015. Lower oil prices are likely to reduce the large Turkish current account deficit significantly in the coming quarters.

- **Monetary policy.** Recently, Turkish inflation has increased further and there is now a clear risk of double-digit inflation in coming months. That said, with growth remaining weak, the underlying inflation pressures are likely to ease off in the coming months. Furthermore, we would stress that the recent increase in inflation is to a large extent driven by supply-side factors (primarily food prices), which could be an argument against any monetary tightening. Therefore, we expect the Turkish central bank to stay on hold for the remainder of the year but we could see rates coming down in 2015 as inflation eases off.

- **Valuation.** Overall, we think the lira is close to 'fair value'.

- **Risks.** The strengthening of the US dollar is clearly a risk to the lira. Furthermore, the increased military fighting close to the Turkey-Iraq border and the general increase in geopolitical tension in the region is becoming an increasing risk for the lira.

***Forecast:** 2.23 (1M), 2.23 (3M), 2.26 (6M) and 2.35 (12M)*



USD/TRY	1M	3M	6M	12M
Forecast (pct'ile)	2.23 (50%)	2.23 (40%)	2.26 (47%)	2.35 (58%)
Fwd. / Consensus	2.24 / 2.25	2.27 / 2.28	2.32 / 2.32	2.41 / 2.33
50% confidence int.	2.20 / 2.27	2.19 / 2.32	2.18 / 2.37	2.17 / 2.46
75% confidence int.	2.18 / 2.31	2.15 / 2.39	2.11 / 2.48	2.02 / 2.65

Source: Danske Bank Markets

Conclusion. Continued fairly high inflation and a large current account deficit are likely to continue to weigh on the lira over the longer term. This said, the recent sharp fall in oil prices means we are likely to see a significant improvement in the current account situation in coming quarters. This should lend some support to the lira and will limit the risk of a major sell-off in the currency. Overall, we think the lira could perform better than what is implied by futures.

EUR/CZK – CNB prefers weaker CZK

- **Growth.** The Czech Republic's preliminary Q3 GDP growth was 2.3% y/y, which is weaker than expected and lower than the 2.5% y/y seen in Q2 14. The economic recovery is clearly losing momentum. We maintain our GDP forecasts of 2.6% y/y for 2014 and 2.7% y/y for 2015. Risks to our forecasts are on the downside. The Czech central bank (CNB) has revised its GDP forecasts down for this year and next. It now expects GDP growth of 2.5% this year and in 2015.

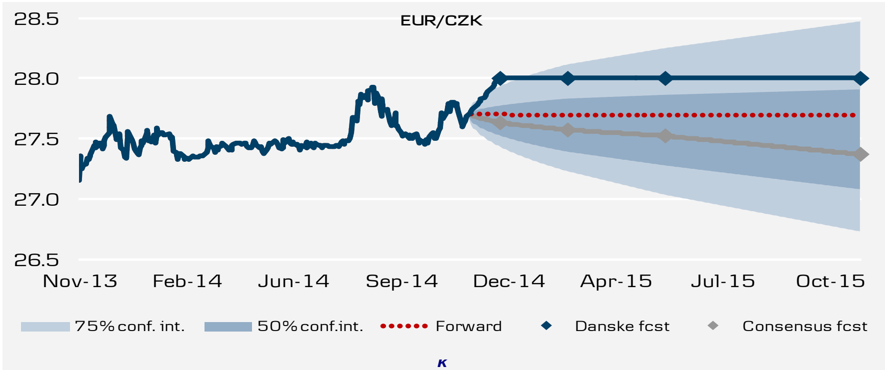
- **Monetary policy.** The CNB left its key policy rate at a technical zero of 0.05% and kept the Czech koruna cap 'near' 27/EUR in November. Although it said that the economy has begun to generate some inflationary pressure and that economic growth has been restarted, it revised its GDP growth forecast down for next year and postponed the koruna cap exit into Q1 16, from Q3 15. Furthermore, the CNB said that having the CZK weaker than the cap helps to boost inflation and fuel growth. The CNB clearly signalled that it prefers CZK closer to 28/EUR than closer to the cap 27/EUR.

- **Debt risks** are low. The Czech government sees the budget deficit at around 2% and government debt at around 44% of GDP.

- **Valuation.** From a long-term perspective, the CZK is undervalued (fair value is around 24.50 against the EUR).

- **Risks.** Increased deflation risks, weaker growth.

Forecast: *28.0 (1M) 28.0 (3M), 28.0 (6M) and 28.0 (12M)*



EUR/CZK	1M	3M	6M	12M
Forecast (pct'ile)	28.00 (89%)	28.00 (83%)	28.00 (80%)	28.00 (77%)
Fwd. / Consensus	27.70 / 27.63	27.70 / 27.57	27.70 / 27.52	27.70 / 27.37
50% confidence int.	27.52 / 27.80	27.39 / 27.84	27.28 / 27.87	27.08 / 27.91
75% confidence int.	27.42 / 27.97	27.23 / 28.12	27.04 / 28.25	26.73 / 28.48

Source: Danske Bank Markets

Conclusion. The Czech koruna hovers weaker than the CNB's koruna 27/EUR cap at around 27.6. Despite the fairly balanced CNB inflation outlook, it acknowledges that a weaker CZK than the cap is helping to bring inflation to target more quickly and to fuel economic growth. The CNB is giving a clear signal that it prefers the EUR/CZK closer to 28. However, the CNB also says that it is not discussing lifting the EUR/CZK floor. Hence, while we do not expect the CNB to raise the EUR/CZK floor, we expect it to 'talk' the CZK weaker. Hence, we maintain our negative forecast on all forecast horizons versus spot and market pricing. We maintain our EUR/CZK forecasts at 28.0, 28.0 and 28.0 in three, six and 12 months, respectively.

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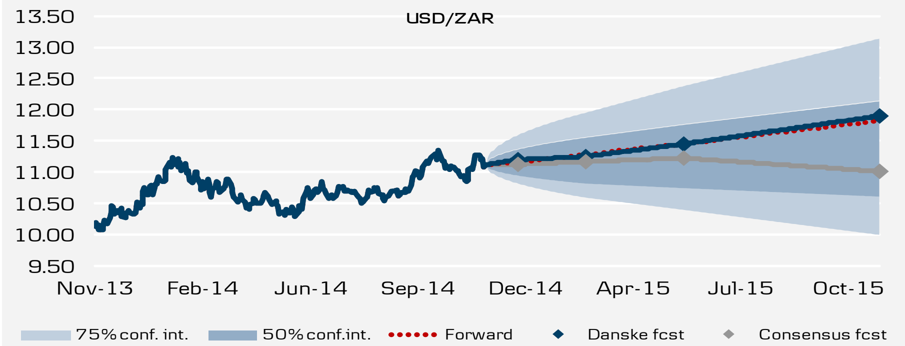
USD/ZAR – prolonged ZAR weakness

- **Growth.** The South African economy remains very weak. The prolonged strike had a very negative impact on economic activity, while private consumption keeps weakening. Q2 GDP numbers were weak, with GDP of 1.0% y/y, down from 1.6% y/y in Q1. We forecast GDP growth of 1.6% y/y for 2014 and 2.1% y/y for 2015. The South African central bank (SARB) has revised its GDP forecasts down further to 1.5% (down from 1.7%) for 2014 and 2.8% for 2015 (2.8%).
- **Monetary policy.** The SARB continues to face contradictory policy choices. Growth is very weak and clearly requires accommodative monetary policy, while inflation is stubbornly high and is hovering at the upper end of the inflation target of 3-6%. However, the growth worries currently seem to outweigh somewhat higher inflation (due mainly to the exchange rate). Due to the weak economy, the SARB decided to stay on hold at its MPC meeting in September. Given that growth is very weak, headwinds from the global economy have increased and oil prices are declining, which is positive for South African inflation, we believe the SARB is likely to stay on hold at the MPC meeting in November. However, we still expect the next move to be upward.
- **Debt risks.** A budget deficit of 4.0% of GDP is projected for 2013/14 .
- **Valuation.** ZAR remains fundamentally overvalued (fair value around 13:00).
- **Risks.** Deepening of the socioeconomic and structural problems, further downgrades by rating agencies and a widening current account deficit.

***Forecast:** 11.20 (1M), 11.25 (3M),11.45 (6M) and 11.90 (12M)*



USD/ZAR	1M	3M	6M	12M
Forecast (pct'ile)	11.20 (61%)	11.25 (57%)	11.45 (63%)	11.90 (70%)
Fwd. / Consensus	11.16 / 11.13	11.28 / 11.17	11.45 / 11.23	11.82 / 11.01
50% confidence int.	10.92 / 11.34	10.82 / 11.55	10.75 / 11.76	10.61 / 12.14
75% confidence int.	10.78 / 11.55	10.59 / 11.94	10.40 / 12.37	9.99 / 13.13

Source: Danske Bank Markets

Conclusion. Given South Africa's external imbalances, the rand remains highly exposed to swings in risk sentiment. With ongoing woes over global growth and falling commodity prices, risk aversion remains high and the rand is under pressure. Given the weak economy, downward pressure from commodity prices and South Africa's large current account deficit, we are negative on the rand on all forecast horizons. However, we are somewhat less negative on a short- to medium-term horizon than market pricing.

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USD/CNY – appreciation expected to slow temporarily

- **Monetary policy.** Growth is losing some momentum as credit growth slows and the impact of fiscal easing earlier in the year has started to wane. Exports have remained resilient, while import growth has slowed on the back of subdued investment demand and lower import prices. For this reason, China's trade balance surplus has increased in recent months. The main downside risk for growth is the property market and a possible slowdown in export growth in the wake of slower global growth.

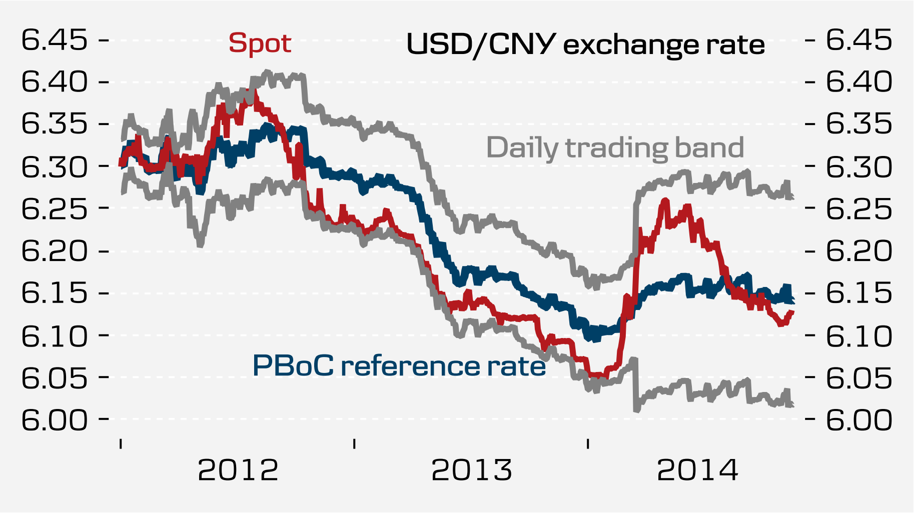
  With inflation currently at just 1.6% y/y and below the government's 3.5% threshold, there is room to ease both fiscal and monetary policy if needed. This limits downside risk for growth. The PBoC currently has an easing bias but is expected to stick to modest targeted easing measures and not cut the reserve requirement or the leading interest rate.

- **FX policy.** Since the PBoC widened the daily trading band from +/-1% to +/-2% in March it has intervened less in the FX market and allowed more two-way volatility in the exchange rate. The wider trading band should also be regarded as another small step towards a floating exchange rate.

- **Valuation.** China's market share of global export markets continues to improve and the current account surplus also appears to be increasing again. This suggests the CNY remains slightly undervalued. However, a surge in China's outbound foreign direct investment is starting to offset partly the trade balance surplus.

- **Risks.** CNY could depreciate further if GDP growth slows below 7% and/or money market stress returns. In the longer term, liberalisation of China's capital account could also weaken the CNY.

Forecast: *6.13 (1M), 6.15 (3M), 6.10 (6M) and 6.00 (12M)*



Source: Macrobond Financial, Danske Bank Markets

Conclusion. We expect the CNY to continue appreciating moderately, supported by a larger surplus on the current trade balance and less intervention in the FX market by the PBoC. However, the trade balance tends to be smaller in Q1, so flows are expected to be temporarily less supportive for appreciation of the CNY. Hence, CNY could depreciate slightly in coming months. We also expect to see increasing two-way volatility in the exchange rate as China slowly moves towards a floating exchange rate and a convertible currency.

Danske Bank Markets 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	1.250	1.24	1.22	1.20	1.23	-0.8	-2.5	-4.1	-2.0
JPY	145.3	145	146	146	153	-0.2	0.8	0.9	5.2
GBP	0.799	0.79	0.77	0.76	0.79	-1.2	-3.8	-5.2	-1.8
CHF	1.201	1.205	1.210	1.220	1.240	0.3	0.8	1.7	3.5
DKK	7.4435	7.4425	7.4425	7.4390	7.4390	0.0	0.0	0.0	0.0
NOK	8.45	8.50	8.40	8.25	8.00	0.5	-0.9	-3.0	-6.6
SEK	9.25	9.20	9.10	9.00	8.90	-0.5	-1.6	-2.8	-4.0
Exchange rates vs USD									
JPY	116.3	117	120	122	124	0.7	3.3	5.2	7.3
GBP	1.56	1.57	1.58	1.58	1.56	0.4	1.4	1.1	-0.1
CHF	0.96	0.97	0.99	1.02	1.01	1.1	3.3	6.1	5.6
DKK	5.96	6.00	6.10	6.20	6.05	0.8	2.5	4.3	2.0
NOK	6.76	6.85	6.89	6.88	6.50	1.3	1.6	1.1	-4.7
SEK	7.40	7.42	7.46	7.50	7.24	0.3	0.9	1.4	-2.0
CAD	1.13	1.14	1.14	1.14	1.13	0.7	0.5	0.3	-1.0
AUD	0.87	0.86	0.85	0.84	0.83	-1.3	-2.0	-2.5	-2.4
NZD	0.79	0.78	0.75	0.74	0.73	-1.3	-4.5	-4.9	-4.5
RUB	48.00	48.00	49.00	51.00	51.00	0.4	0.5	1.9	-2.9
CNY	6.13	6.13	6.15	6.10	6.00	-0.2	-0.3	-1.7	-4.2

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

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs DKK

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs DKK									
EUR	7.4435	7.4425	7.4425	7.4390	7.4390	0.0	0.0	0.0	0.0
USD	5.96	6.00	6.10	6.20	6.05	0.8	2.5	4.3	2.0
JPY	5.12	5.13	5.08	5.08	4.88	0.1	-0.8	-0.9	-4.9
GBP	9.31	9.42	9.67	9.79	9.42	1.2	4.0	5.5	1.9
CHF	6.20	6.18	6.15	6.10	6.00	-0.3	-0.8	-1.7	-3.4
NOK	0.88	0.88	0.89	0.90	0.93	-0.5	1.0	3.1	7.1
SEK	0.81	0.81	0.82	0.83	0.84	0.5	1.7	2.8	4.1
CAD	5.26	5.26	5.35	5.44	5.35	0.1	2.0	4.0	3.1
AUD	5.20	5.16	5.19	5.21	5.02	-0.5	0.5	1.7	-0.4
NZD	4.72	4.68	4.58	4.59	4.42	-0.5	-2.1	-0.9	-2.6
PLN	1.76	1.76	1.75	1.75	1.74	-0.2	-0.1	0.0	0.4
CZK	0.27	0.27	0.27	0.27	0.27	-1.1	-1.1	-1.2	-1.2
HUF	0.24	0.24	0.25	0.25	0.24	0.5	2.4	2.7	1.8
RUB	0.13	0.13	0.12	0.12	0.12	0.5	2.1	2.4	5.1
CNY	0.97	0.98	0.99	1.02	1.01	1.0	2.9	6.1	6.6

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs SEK

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs SEK									
EUR	9.25	9.20	9.10	9.00	8.90	-0.5	-1.6	-2.8	-4.0
USD	7.40	7.42	7.46	7.50	7.24	0.3	0.9	1.4	-2.0
JPY	6.36	6.34	6.22	6.15	5.84	-0.4	-2.4	-3.6	-8.7
GBP	11.57	11.65	11.82	11.84	11.27	0.7	2.3	2.6	-2.2
CHF	7.70	7.63	7.52	7.38	7.18	-0.8	-2.4	-4.4	-7.2
NOK	1.09	1.08	1.08	1.09	1.11	-1.0	-0.7	0.3	2.8
DKK	1.24	1.24	1.22	1.21	1.20	-0.5	-1.6	-2.7	-4.0
CAD	6.54	6.51	6.54	6.58	6.40	-0.4	0.3	1.1	-1.0
AUD	6.46	6.38	6.34	6.30	6.01	-1.0	-1.1	-1.1	-4.4
NZD	5.86	5.79	5.59	5.55	5.28	-0.9	-3.6	-3.5	-6.4
PLN	2.19	2.17	2.14	2.11	2.08	-0.7	-1.7	-2.7	-3.6
CZK	0.33	0.33	0.33	0.32	0.32	-1.6	-2.7	-3.9	-5.2
HUF	0.30	0.30	0.30	0.30	0.29	0.0	0.7	-0.1	-2.2
RUB	0.16	0.15	0.15	0.15	0.14	-0.1	0.4	-0.4	0.9
CNY	1.21	1.21	1.21	1.23	1.21	0.5	1.2	3.2	2.3

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs NOK

		Forecast				Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs NOK									
EUR	8.45	8.50	8.40	8.25	8.00	0.5	-0.9	-3.0	-6.6
USD	6.76	6.85	6.89	6.88	6.50	1.3	1.6	1.1	-4.7
JPY	5.81	5.86	5.74	5.64	5.25	0.7			
GBP	10.57	10.76	10.91	10.86	10.13	1.7	3.0	2.3	-4.8
CHF	7.03	7.05	6.94	6.76	6.45	0.2	-1.7	-4.7	-9.8
SEK	0.91	0.92	0.92	0.92	0.90	1.0	0.7	-0.3	-2.8
DKK	1.13	1.14	1.13	1.11	1.08	0.5	-0.9	-3.0	-6.6
CAD	5.97	6.01	6.04	6.03	5.76	0.7	1.0	0.8	-3.7
AUD	5.90	5.90	5.85	5.78	5.40	0.0	-0.5	-1.4	-7.0
NZD	5.35	5.35	5.16	5.09	4.75	0.1	-3.0	-3.8	-9.0
PLN	2.00	2.00	1.98	1.94	1.87	0.3	-1.0	-3.0	-6.3
CZK	0.30	0.30	0.30	0.29	0.29	-0.6	-2.0	-4.2	-7.8
HUF	0.28	0.28	0.28	0.28	0.26	1.0	1.4	-0.4	-4.9
RUB	0.14	0.14	0.14	0.13	0.13	1.0	1.1	-0.7	-1.9
CNY	1.10	1.12	1.12	1.13	1.08	1.5	1.9	2.9	-0.5

Source: Danske Bank Markets

Danske Bank Markets

Danske Bank EMEA FX forecasts

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	**17-Nov-14**	**4.22**		**3.38**		**176**		**219**		**200**	
	+1M	4.24	4.23	3.42	3.38	176	176	217	219	200	200
	+3M	4.25	4.25	3.48	3.39	175	175	214	218	198	200
	+6M	4.26	4.26	3.55	3.41	175	175	211	217	194	200
	+12M	4.28	4.29	3.48	3.42	174	173	208	216	187	199
HUF	**17-Nov-14**	**306**		**245**		**24.3**		**3.02**		**2.76**	
	+1M	305	307	246	245	24.4	24.3	3.02	3.02	2.79	2.76
	+3M	300	307	246	246	24.8	24.2	3.03	3.01	2.80	2.76
	+6M	300	308	250	246	24.8	24.1	3.00	3.00	2.75	2.76
	+12M	305	310	248	247	24.4	24.0	2.92	2.98	2.62	2.76
CZK	**17-Nov-14**	**27.7**		**22.2**		**26.9**		**33.4**		**30.5**	
	+1M	28.0	27.7	22.6	22.2	26.6	26.9	32.9	33.4	30.4	30.5
	+3M	28.0	27.7	23.0	22.1	26.6	26.9	32.5	33.4	30.0	30.6
	+6M	28.0	27.7	23.3	22.1	26.6	26.9	32.1	33.4	29.5	30.7
	+12M	28.0	27.6	22.8	22.0	26.6	26.9	31.8	33.5	28.6	31.0
RUB	**17-Nov-14**	**59.2**		**47.4**		**12.6**		**15.6**		**14.3**	
	+1M	59.5	59.8	48.0	47.8	12.5	12.4	15.5	15.5	14.3	14.1
	+3M	59.8	61.0	49.0	48.8	12.4	12.2	15.2	15.2	14.1	13.9
	+6M	61.2	62.7	51.0	50.1	12.2	11.9	14.7	14.8	13.5	13.6
	+12M	62.7	65.9	51.0	52.5	11.9	11.3	14.2	14.1	12.8	13.0
TRY	**17-Nov-14**	**2.79**		**2.23**		**267**		**332**		**303**	
	+1M	2.76	2.81	2.23	2.25	270	265	333	329	308	301
	+3M	2.72	2.85	2.23	2.27	274	262	335	325	309	298
	+6M	2.71	2.90	2.26	2.32	275	256	332	319	304	293
	+12M	2.89	3.02	2.35	2.41	257	246	308	307	277	283
ZAR	**17-Nov-14**	**13.9**		**11.1**		**53.5**		**66.5**		**60.7**	
	+1M	13.9	14.0	11.20	11.2	53.6	53.3	66.2	66.2	61.2	60.5
	+3M	13.7	14.1	11.25	11.3	54.2	52.7	66.3	65.4	61.2	60.0
	+6M	13.7	14.4	11.45	11.5	54.1	51.8	65.5	64.4	60.0	59.2
	+12M	14.6	14.9	11.90	11.8	50.8	50.0	60.8	62.4	54.7	57.6

Source: Danske Bank Markets

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of this research report are Thomas Harr (Chief Analyst), Stefan Mellin (Senior Analyst), Stanislava Pravdová-Nielsen (Analyst), Morten Helt (Senior Analyst), Jens Naervig Pedersen (Analyst), Lars Christensen (Chief Analyst), Kristoffer Lomholt (Analyst), Morten Helt (Senior Analyst) and Vladimir Miklashevsky (Analyst).

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