Danske Bank

Markets

FX Forecast Update

The USD rally set to extend

15 September 2014

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Important disclosures and certifications are contained from page 31 of this report.

Main forecast changes part I

- The downward pressure on EUR/DKK has intensified following the ECB's Mario Draghi's Jackson Hole speech and further easing on 4 September. Hence, we are lowering our EUR/DKK forecasts to 7.4475 for 1M, 7.4475 for 3M, 7.4450 for 6M and 7.4450 for 12 months, from 7.4510 for one, three, six and 12 months previously. We continue to expect Danmark's Nationalbank (DN) to lower the certificate of deposit (CD rate) by 10bp to minus 0.15% within the coming three months, which would cap DKK appreciation pressure.
- The Scottish referendum on 18 September represents a significant short-term risk factor for GBP and, given current pricing, EUR/GBP is poised to move markedly after the referendum in either direction. We have kept our forecast unchanged at 0.78 in 3M, 0.77 in 6M and 0.76 in 12M but stress that a 'yes' on 18 September would most likely trigger an upward revision of our forecast. Nevertheless, we still expect EUR/GBP to continue to trade lower in the coming 12 months, driven primarily by divergent monetary policy, as we still believe the Bank of England (BoE) is on a very different path for monetary policy versus the ECB. This will hold even if the Scottish referendum comes out with a 'yes', although the downside potential in this scenario would be less than our current forecasts project.
- We expect a considerable USD/JPY appreciation to play out over the coming three to six months, driven by portfolio outflows in the wake of a likely pension fund reform forcing the Japanese Government Pension Investment Fund (GPIF) to lower its holdings of Japanese government bonds. Last week, we raised our 1M, 3M and 6M USD/JPY forecasts to 107, 110 and 112, respectively, from 102, 105 and 110, respectively, previously. We maintain our 12M USD/JPY forecast at 114.

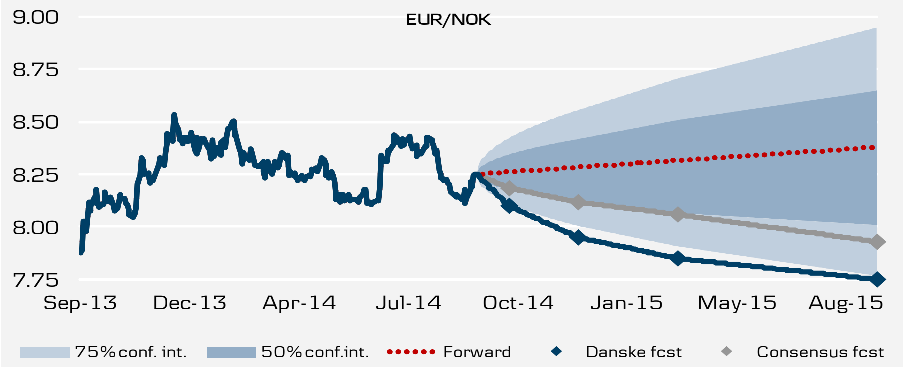
Main forecast changes part II

- The AUD has weakened sharply over the past week and we believe it has further to fall. We believe further AUD/USD weakness is in store in coming months, driven by a combination of a slowdown in China, a hawkish Fed and a weak AUD leg. In light of the recent fall in AUD/USD, we modify our 1M, 3M 6M and 12M forecasts to 0.89 (from 0.93), 0.88 (0.92), 0.87 (0.91) and 0.86 (0.90), respectively.
- RBNZ's 'on hold' stance has removed the upside potential in NZD/USD and we expect RBNZ to stay sidelined for the remainder of 2014. In addition, lower commodity prices (in particular dairy products and forestry) will continue to weigh on NZD in H2 14. In light of the USD rally, we lower our NZD/USD forecasts to 0.80 (from 0.86), 0.79 (0.85), 0.78 (0.84) and 0.77 (0.83) on one-, three-, six- and 12-month horizons, respectively.
- While the Fed seems likely to start moving in a more hawkish direction, deflationary fears remain in Europe – not only in the eurozone but also in the Central and Eastern European economies. As a consequence, we expect the CEE central banks to move towards monetary easing to curb deflationary pressures. This, combined with more expectations for the Fed, is not exactly good news for the CEE currencies (particularly against the US dollar). Therefore, we expect the CEE currencies to remain under pressure. However, this was reflected in our CEE FX forecast last month. Therefore, we have not changed our CEE FX forecast much. Regarding the Russian rouble, we expect the USD/RUB to climb significantly in 12 months, as the USD is set to strengthen significantly, and we see some seasonal relief for the rouble in Q1 15 on the back of a stronger CA balance. Our new USD/RUB forecasts are 38.66, 37.38 and 41.00 on three-, six- and 12-month horizons, respectively.

EUR/NOK – Norway can live with lower oil investments

- **Growth.** Norwegian data has been mixed in the last two weeks, after having been better than expected through August. This has triggered a retracement in EUR/NOK. The market continues to focus on falling oil investments hampering growth. However, we stress that oil investments have been falling for several quarters and historically the correlation between oil investments and GDP growth is relatively modest. Hence, we continue to expect Norwegian growth to hold up well, around trend growth in 2015.
- **Monetary policy.** At the Norges Bank (NB) meeting on 18 September, we expect the central bank to keep interest rates unchanged. In addition, it is likely to raise the interest rate path marginally in the short term, and down from 2016 onwards.
- **Flows.** Foreign banks have been buyers of NOK for the last three weeks after having been sellers of NOK in 11 of the previous 12 weeks. We judge that positioning is relatively light NOK currently.
- **Valuation.** Our PPP models put EUR/NOK at 8.09, suggesting that the NOK is slightly weak.
- **Risks.** The risk is that the NB is more dovish than expected on 18 September, triggering a bounce in EUR/NOK.

***Forecast:** 8.10 (1M), 7.95 (3M), 7.85 (6M), 7.75 (12M)*



EUR/NOK	1M	3M	6M	12M
Forecast (pct'ile)	8.10 (14%)	7.95 (8%)	7.85 (9%)	7.75 (11%)
Fwd. / Consensus	8.26 / 8.18	8.28 / 8.12	8.32 / 8.06	8.38 / 7.93
50% confidence int.	8.15 / 8.35	8.12 / 8.42	8.07 / 8.51	8.01 / 8.65
75% confidence int.	8.09 / 8.44	8.01 / 8.56	7.91 / 8.71	7.77 / 8.95

Source: Danske Bank Markets

Conclusion. We forecast EUR/NOK will fall over the coming three months on Norwegian growth outperformance and higher interest rates relative to the euro zone. The near-term risk is that NB is more dovish than expected. Medium term, the risk is that falling oil investments in 2015 will have a larger impact on Norwegian growth than we anticipate. As such, the risks for our EUR/NOK forecasts are skewed to the upside.

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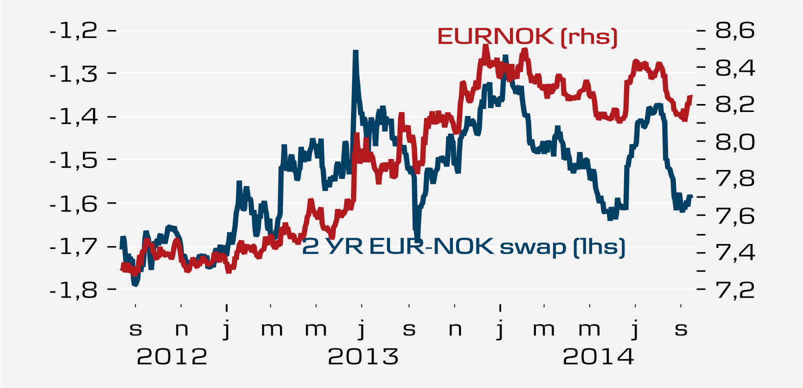
EUR/NOK – important issues to watch

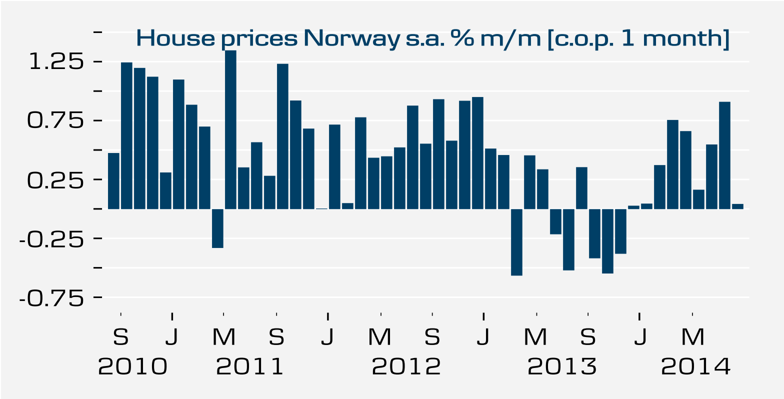
- **Inflation slightly above NB's projection**
  Norwegian core inflation fell to 2.2% in August from 2.6% in July, . However, core inflation has been roughly 0.2pp higher than NB expected back in June, which should reduce the risks of a very dovish central bank at its interest rate meeting on 18 September.
- **Norges Bank to lower long-term rate path**
  We expect NB to maintain interest rates unchanged. We expect the interest rate path to be revised up marginally in the short term (one year) and down from 2016 onwards. This is in line with current market pricing and hence should have limited market impact but the risks is skewed towards a more dovish NB
- **Housing prices were flat in August seasonally adjusted**
  The Norwegian housing market has recovered sharply in 2014. In August, house prices rose 1.6% m/m but seasonally adjusted prices were flat. This was weaker than the previous month, where prices were up 0.9%, seasonally adjusted. We expect more focus from the Norwegian authorities if prices continue to rise over the next couple of months.

Relative rates point to a lower EUR/NOK



Source: Macrobond Financial

The Norwegian housing market was flat in August



Source: Macrobond Financial, Danske Bank Markets

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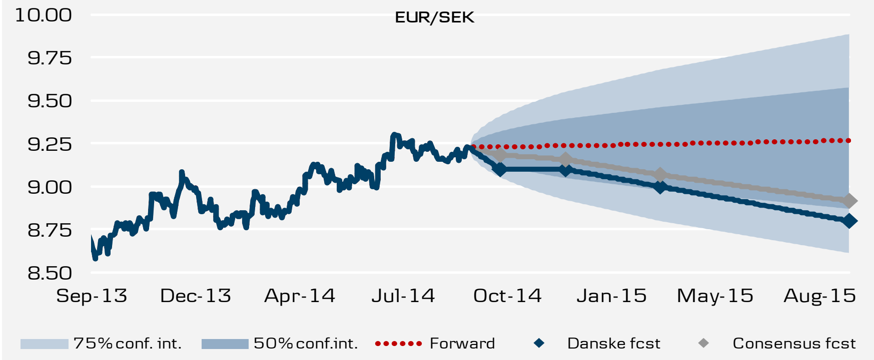
EUR/SEK – gradually lower

- **Growth.** We forecast a decent rebound in GDP in H2 after a bleak H1. Swedish growth, while not particularly impressive, will outperform Eurozone. Forecasters have already downgraded their estimates for Swedish GDP substantially. As a result, risk for further negative surprises has diminished. Instead, there should be scope for data to surprise to the upside.
- **Monetary policy.** The Riksbank stayed on hold in September and is, in our view, likely to do so for the foreseeable future. The money market is pricing in a slight chance for another rate cut while the first 25bp hike lies two years ahead. We place ourselves in the 'no further rate cuts' camp.
- **Flows.** Despite the recent moderation in current account surplus, commercial flows should act as a constraint on the upside in EUR/SEK. Direct investments have recovered recently. Debt flows will be sensitive to any further broad-based EUR sell-off and could thus turn SEK positive. The pressure on EUR/CHF could be a prelude to similar buying pressure on the Scandies.
- **Valuation.** Fundamental arguments like the current account, public finances, relative inflation, solid triple A status and more, suggest that the SEK is significantly undervalued.
- **Risks.** We do not think that the election will have a persistent negative impact but it cannot be ruled out either (SEK negative). Flows into 'European alternatives' on the back of broad-based EUR sell-offs could send EUR/SEK lower than we envisage.

Forecast: *9.10 (1M), 9.10 (3M), 9.00 (6M), 8.80 (12M)*



EUR/SEK	1M	3M	6M	12M
Forecast (pct'ile)	9.10 (23%)	9.10 (32%)	9.00 (26%)	8.80 (20%)
Fwd. / Consensus	9.23 / 9.18	9.24 / 9.16	9.25 / 9.07	9.27 / 8.92
50% confidence int.	9.11 / 9.33	9.05 / 9.40	8.98 / 9.46	8.87 / 9.58
75% confidence int.	9.03 / 9.43	8.92 / 9.55	8.80 / 9.68	8.61 / 9.89

Source: Danske Bank Markets

Conclusion. The SEK has underperformed versus all G10 currencies over the past year. Given that no other G10 central bank has cut rates as aggressively as the Riksbank, one might conclude that it has been a reasonable depreciation of the krona. The fact that the krona is now undervalued will make the Swedish export sector more competitive and help fuel inflation. We think that USD/SEK will continue to go higher based on relative cyclical arguments and for the same reason we see lower levels in EUR/SEK in the year ahead. The SEK may trade with a risk premium in the next couple of weeks following the election but, in our view, the next big leg in EUR/SEK is lower.

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EUR/SEK – important issues to watch

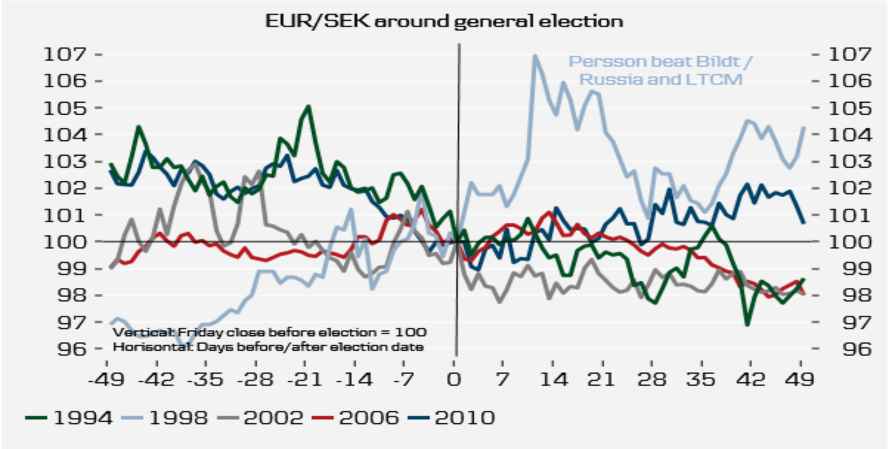
Will the Riksbank accept a stronger SEK?

- The Riksbank has become more 'dedicated' to the level of the exchange rate than it was say one or two years ago. The reasons are lower rates abroad and too low inflation at home. The Riksbank may therefore welcome continued SEK weakness in trade-weighted terms as it would help fuel real activity and inflation. However, the SEK has already weakened A LOT. From a fundamental and valuation perspective, EUR/SEK should be close to a turn-around.
- In our view, the Riksbank is likely to accept if EUR/SEK heads towards or even below 9.00 in the coming months *provided that* inflation really starts edging higher. Especially if the SEK continues to trade on a weak note versus the USD, NOK and GBP, which we think is quite likely, since that would balance the impact on the trade-weighted KIX index.
- Proposals that the Riksbank would go down the SNB path introducing a floor under EUR/SEK in order to avoid any appreciation of the krona is not only far-fetched but, in our view, not advisable for various reasons one of them being that the SEK is undervalued at current levels, in contrast to CHF.

Our CPIF forecast = the Riksbank's next couple of months

Source: Macrobond Financial, Danske Bank Markets

General elections tend not to have persistent SEK impact



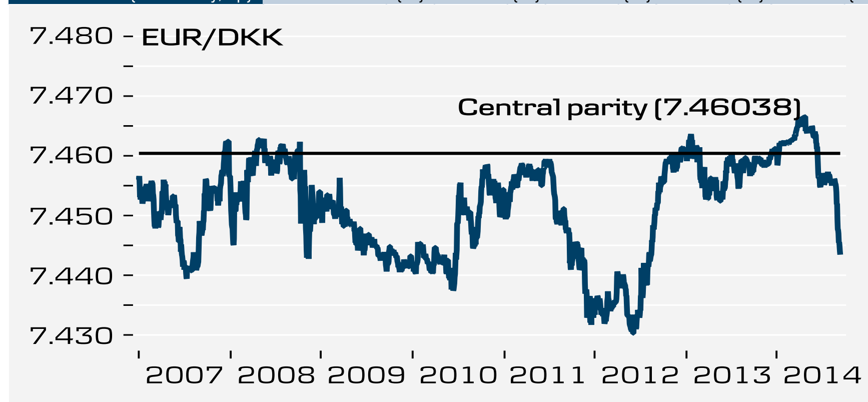
Source: Macrobond Financial, Danske Bank Markets

EUR/DKK – awaiting the central bank's response

- **Rates.** Danmarks Nationalbank (DN) tracked the ECB rate cut in September and lowered the rate of interest on certificates of deposits (CD rate) by 10bp to minus 0.05%. The lending rate and the current account rate were both left unchanged at 0.20% and 0.00%, which marks the effective lower bound for these two policy rates. Since late August EUR/DKK has dropped into the DN intervention zone. Since our intermediate forecast update, see *FX Edge: DN to cap DKK appreciation with a 10bp rate cut in 3M*, the downward pressure on EUR/DKK has intensified further. We therefore stick to our forecast that DN will need to make FX intervention purchases and lower the CD rate by 10bp to minus 0.15% within the coming three months.

- **FX.** Danske Bank's DKK EMPI turned further negative in August indicating rising appreciation pressure. The expected near-term FX intervention purchases and 10bp unilateral rate cut will ease the downward pressure on EUR/DKK and lift it slightly from the current low level. The negative carry on short EUR/DKK positions has declined sharply and even turned positive on shorter dates. The expected unilateral rate cut from DN should contribute to restore the negative carry. In the medium term the direction of EUR/DKK will hinge on the effect of the unconventional easing measures currently being implemented by the ECB. The risk here is clearly the downward pressure will resume.

	15/09/2014		1M		3M		6M		12M	
Spot	7.4436		7.4475		7.4475		7.4450		7.4450	
3M Forward (ann. carry, bp)	7.4433	(-2)	7.4460	(-8)	7.4460	(-8)	7.4445	(-3)	7.4445	(-3)
6M Forward (ann. carry, bp)	7.4414	(-6)	7.4445	(-8)	7.4445	(-8)	7.4430	(-5)	7.4430	(-5)
12M Forward (ann. carry, bp)	7.4373	(-8)	7.4415	(-8)	7.4415	(-8)	7.4400	(-7)	7.4400	(-7)



Source: Macrobond Financial, Danske Bank Markets

- **Flows.** The Danish current account (CA) surplus is around 7% – the highest surplus accounted for in 60 years of available data. The large CA surplus supports a stronger DKK, despite portfolio flows having turned negative.

- **Conclusion.** Short-term easing from DN will ease the downward pressure on EUR/DKK. The ECB's easing measures will cap any upside risk in EUR/DKK due to lower euro money market rates and a weaker EUR. We expect the effect to be pronounced from the third TLTRO auction scheduled in March 2015. From here on the risk is clearly that the downward pressure on EUR/DKK resumes.

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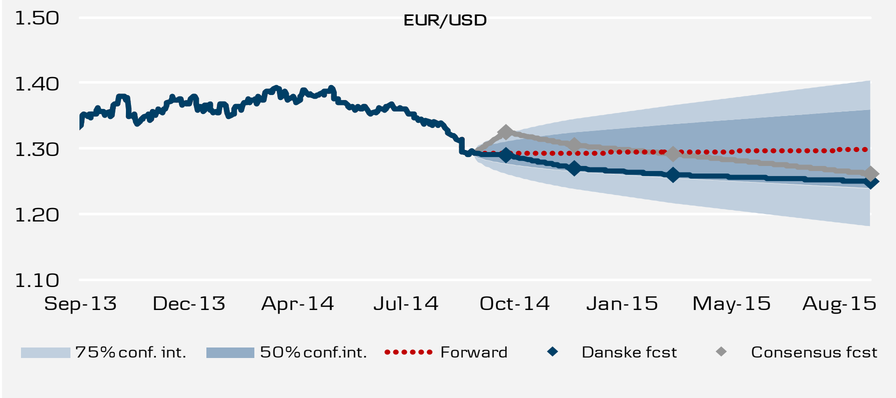
EUR/USD – growth, carry to support a lower EUR/USD

- **Growth**. We forecast US GDP growth of 3-3.25% in H2 14 with the monthly NFP set to reach 250-300,000 on average in 2015. The eurozone has reached a soft patch where we expect growth to be weak in Q3 before the gradual recovery resumes from Q4.
- **Monetary policy.** We expect the Fed to begin its tightening cycle in April 2015, as it will reach its target on employment and inflation in Q2. The ECB's easing on 4 September has reversed inflation expectations, at least for now. We believe that the ECB is on hold for the foreseeable future. However, the negative carry and expansions of the ECB's balance sheets should imply that the EUR will continue to be used as the funding currency of choice. Relative monetary policy will continue to be bearish for EUR/USD in coming months.
- **Flows.** The eurozone continues to run large trade and current account surpluses. However, the large trade surplus reflects a collapse in domestic demand rather than booming exports, which provides less cyclical support for the EUR. Short-term trends in EUR/USD are driven by portfolio flows rather than trade flows.
- **Valuation**. EUR/USD PPP is currently around 1.26, so the EUR appears to be slightly overvalued.
- **Risks.** The risks to our macro view are that European growth and inflation data could stabilise on the back of monetary easing and declining geopolitical risks. Given very stretched positioning where short EUR/USD positioning is back to summer 2012 levels, this could trigger a rebound.

Forecast: *1.29 (1M), 1.27 (3M), 1.26 (6M) ,1.25 (12M)*



EUR/USD	1M	3M	6M	12M
Forecast (pct'ile)	1.29 (43%)	1.27 (28%)	1.26 (27%)	1.25 (28%)
Fwd. / Consensus	1.29 / 1.33	1.29 / 1.31	1.29 / 1.29	1.30 / 1.26
50% confidence int.	1.28 / 1.31	1.27 / 1.32	1.26 / 1.34	1.24 / 1.36
75% confidence int.	1.26 / 1.32	1.24 / 1.35	1.22 / 1.37	1.18 / 1.40

Source: Danske Bank Markets

Conclusion. We expect EUR/USD to fall near term on relative growth expectations and the EUR being the funding currency of choice. In addition, there are increasing signs that the USD is becoming an 'asset currency' as the US simply delivers higher expected returns, whether one invests in equities, bonds or real estate We have lowered our 1M EUR/USD forecast to 1.29 (previously 1.30), but maintain our 3M, 6M and 12M forecasts.

We expect EUR/USD to stabilise 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

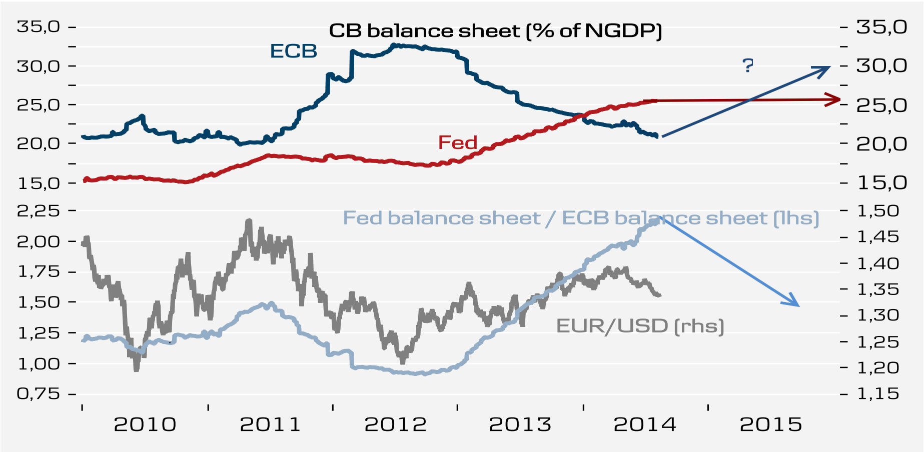
End of Fed QE and ECB's ambition to expand its balance sheet support a lower EUR/USD

- The Fed's purchase of Treasuries and mortgage-backed securities (MBS) will end in October. Meanwhile, the ECB signaled that it aims to bring back the balance sheet to the level it held in 2012.
- The end of Fed QE and the ECB's unconventional easing measure will reverse the trend in the two central banks' balance sheets, supporting the case for a lower EUR/USD.

Positioning suggests downtrend in EUR/USD will be gradual

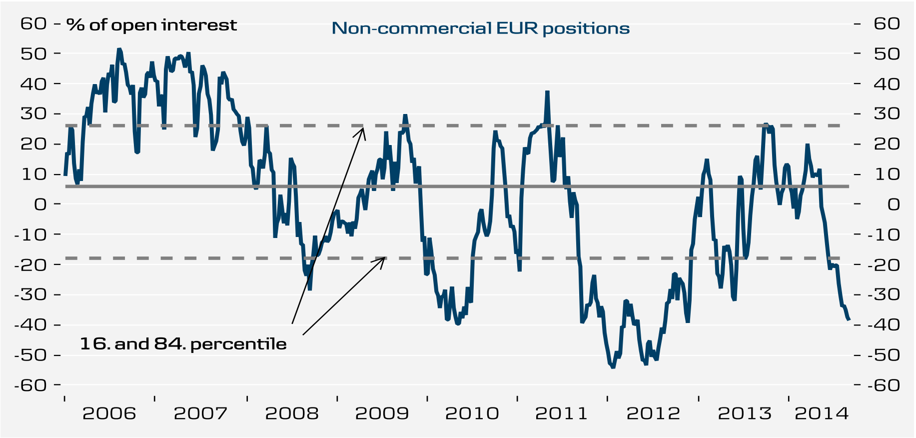
- IMM data shows that speculative short EUR/USD positioning is at stretched levels, currently at the 4th percentile. This is the most bearish signal since Draghi's 'whatever it takes' speech in July 2012.
- Short EUR positioning is a risk for our bearish EUR/USD call, but the downtrend remains firmly in place.

Trend in ECB's balance sheets to reverse



Source: Macrobond Financial, Danske Bank Markets

EUR shorts at stretched levels

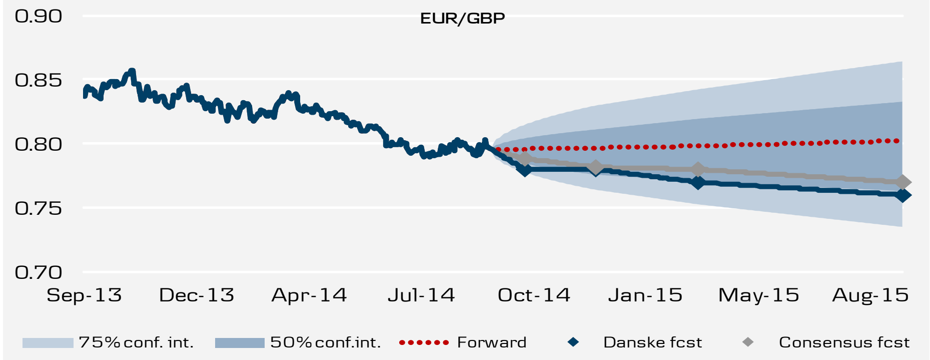


Source: CFTC, Danske Bank Markets

EUR/GBP – Scottish referendum is a short-term risk factor

- **Growth.** The UK economy expanded 0.8% q/q in Q2 led by services, the largest part of the economy, which grew 1% in Q2. Business surveys for the UK service sector remain high, pointing to ongoing growth. However, in line with most European countries, there has been some slowdown in the manufacturing sector over the summer. We expect the UK economy to continue to expand at a decent pace in the coming quarters, causing labour market slack to gradually vanish.
- **Monetary policy**. Minutes from the Bank of England's (BoE) rate setting meeting in August showed some dissent in voting with two members advocating a rate hike. While the timing of the first BoE rate hike will still largely depend on the development in the labour market (wage growth in particular), it is likely that the balance of the board will tilt further towards the hawks in the coming months as the economy expands further. We expect the BoE to deliver the first rate hike in January. This is not priced into the UK money market, which prices in the first hike in May 2015.
- **Flows.** Investors have recently reduced long GBP positions but raised GBP longs again in the week ending 9th September according to the IMM data.
- **Valuation**. PPP is around 0.77 for EUR/GBP suggesting that the GBP is slightly undervalued versus EUR.
- **Risks.** The Scottish independence referendum on 18 September represents a significant short-term risk factor for GBP. We estimate that the market currently has priced in a risk premium in GBP of 1-2% which instantly would be priced out in the event of 'No'. We expect GBP to decline another 2-3% in the event of a 'Yes'.

Forecast: 0.78 (1M), 0.78 (3M), 0.77 (6M) and 0.76 (12M)



EUR/GBP	1M	3M	6M	12M
Forecast (pct'ile)	0.78 (24%)	0.78 (30%)	0.77 (23%)	0.76 (22%)
Fwd. / Consensus	0.80 / 0.79	0.80 / 0.78	0.80 / 0.78	0.80 / 0.77
50% confidence int.	0.78 / 0.81	0.78 / 0.81	0.77 / 0.82	0.76 / 0.83
75% confidence int.	0.77 / 0.82	0.76 / 0.83	0.75 / 0.84	0.74 / 0.86

Source: Danske Bank Markets

Conclusion. The Scottish referendum on 18 September represents a significant short-term risk factor for GBP and given the current pricing, EUR/GBP is poised to move markedly after the referendum in either direction. We have kept our forecast unchanged at 0.78 in 3M, 0.77 in 6M and 0.76 in 12M but stress that a 'Yes' on 18 September most likely would trigger an upward revision of our forecast. Nevertheless, we still expect EUR/GBP to continue to trade lower in the coming 12M primarily driven by divergent monetary policy as we still believe the BoE is on a very different path for monetary policy versus the ECB. This will hold even if the Scottish referendum comes out with a 'Yes' albeit the downside potential in this scenario would be less than our current forecasts project.

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EUR/GBP – important issues to watch

- **Scottish independence: from tail risk to a reasonably likely scenario**
  - On 18 September, the Scots will vote on independence. A 'Yes' vote was previously thought to be a tail risk scenario by most investors. However, over the past couple of weeks the 'Yes' camp has gained remarkable support, triggering a re-pricing of risk premiums on UK financial markets as the assumed tail risk scenario has suddenly turned into a reasonably likely event.
  - The economic effects of a possible 'Yes' vote and consequently Scottish independence are difficult to predict. However, it is clear that the economic foundation for the remaining UK will change. First of all, the UK economy will get smaller. Scottish onshore GDP currently accounts for around 8% of UK GDP, but using a geographical division of oil and gas fields in the North Sea, UK GDP could decline by almost 10%.
  - Debt burden could increase by as much a 10 percentage points to above 100% of GDP in a scenario where the remaining UK takes over all existing liabilities (no debt split). On the other hand, the public deficit is expected to decline from 2.6% of GDP to 2.3% of GDP excluding Scotland in 2016/17.
  - Another important factor, especially for the FX market, will be the development in the UK's external balances which are likely to deteriorate further from already very high levels. This is a factor that could weigh on GBP going forward and increase the risk that investors will punish the currency for the size of its external imbalances.

Hypothetical debt burdens*

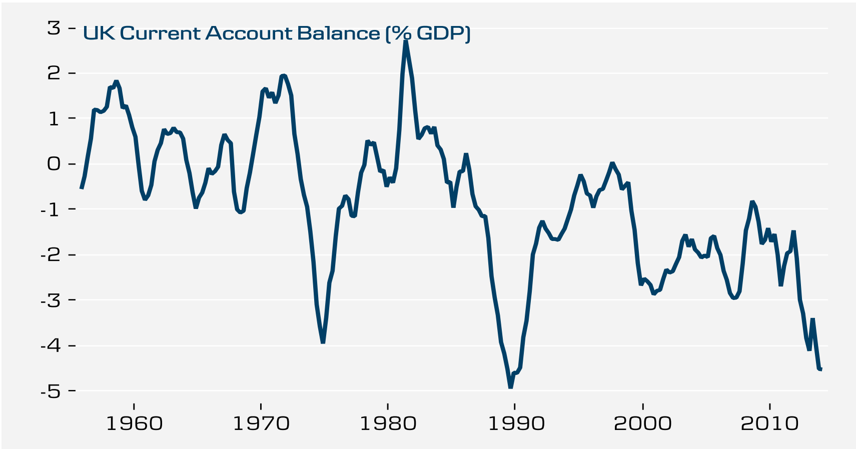
FY2016/17 estimates	No Scottish independency	
	Total debt, GBP	Debt/GDP [%]
PSDN	1497	78.7%
Maastricht	1748	91.9%

	Scottish independency, debt/GDP [%]		
	No debt split	*Debt divided per capita*	
	UK ex Scotland	UK ex Scotland	Scotland
PSDN	86.8%	79.5%	70.6%
Maastricht	101.4%	92.9%	82.4%

** GDP based on a geographic share of oil and gas fields in the North Sea*

Source: OBR, NIESR and Danske Bank Markets

UK current account deficit already near record high



Source: Macrobond Financial, Danske Bank Markets

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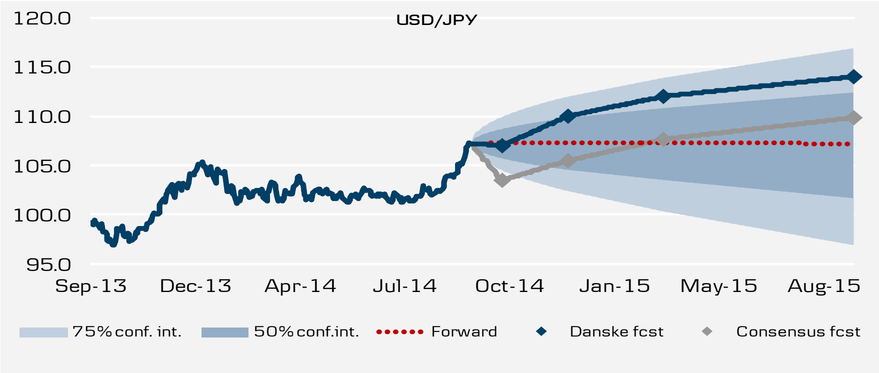
USD/JPY – pension reforms and portfolio flows to weaken the yen

- **Macro outlook.** The final revision of the Q2 GDP estimate showed that the economy contracted by an annual pace of 7.1% in the second quarter (q/q ann) which is a downward revision from the first estimate indicating a decline by 6.8% q/q ann. In all, the data suggests that the net negative impact from the consumption tax rise was substantial and has been larger than in 1997, when Japan also raised the consumption tax.
- **Monetary policy.** As expected, Bank of Japan (BoJ) did not announce any additional easing measures at the September meeting. Despite the subdued recovery in retail sales in the wake of the April sales tax hike and despite falling inflation expectations BoJ minutes also reveal that there are no signs of imminent further monetary easing. Hence, we no longer expect BoJ to ease further in 2014. In our view, it will be extremely difficult to reach the inflation target next year and thus further easing is still possible in Q2 15. However, any additional easing will only be marginal compared with the aggressive monetary easing BoJ is already doing and we stress that our call for a weaker JPY is not dependent on additional easing from BoJ.
- **Flows.** Japan is currently running a current account deficit and foreign direct investments have risen in recent years. Hence, fundamental flows have become much more yen negative.
- **Valuation.** USD/JPY PPP estimate of around 85.
- **Risk.** According to CFTC IMM data, speculative accounts are significantly short JPY, indicating an increased sensitivity of USD/JPY to the downside.

Forecast: *107(1M), 110 (3M), 112 (6M) and 114 (12M)*



USD/JPY	1M	3M	6M	12M
Forecast (pct'ile)	107.00 (46%)	110.00 (76%)	112.00 (80%)	114.00 (80%)
Fwd. / Consensus	107.24 / 103.49	107.24 / 105.48	107.24 / 107.64	107.23 / 109.84
50% confidence int.	105.63 / 108.82	104.54 / 109.85	103.51 / 110.83	101.66 / 112.42
75% confidence int.	104.30 / 110.07	102.39 / 111.98	100.33 / 113.89	96.90 / 116.90

Source: Danske Bank Markets

Conclusion: In FX strategy: USD/JPY is back in business; we target 114 (9 September), we changed our USD/JPY forecasts due to GPIF reforms and portfolio outflows. In addition, we continue to believe that the market is underestimating the Fed and that a re-pricing of the first Fed hike will support the USD going forward. Hence, our call for a weaker JPY is not dependent on additional easing from BoJ as the monetary easing is already aggressive while the Fed will gradually start to normalise monetary policy.

As such, we expect that USD/JPY appreciation will play out over the coming three to six months and we have raised our 1M, 3M and 6M USD/JPY forecasts to 107, 110, and 112, respectively, from 102, 105 and 110, previously. We maintain our 12M USD/JPY forecast at 114.

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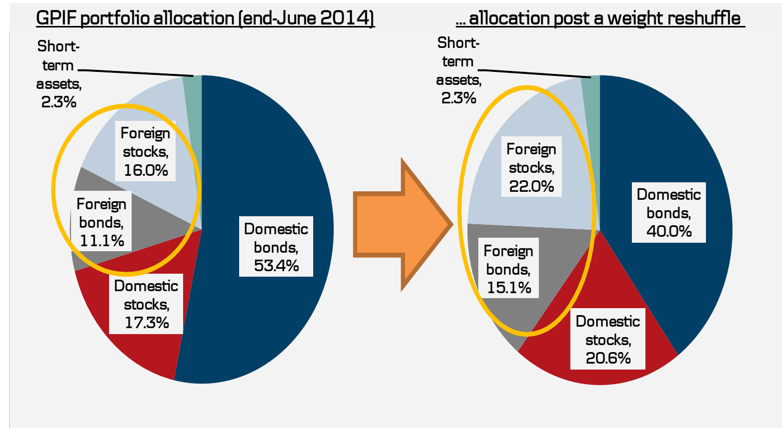
USD/JPY – important issues to watch

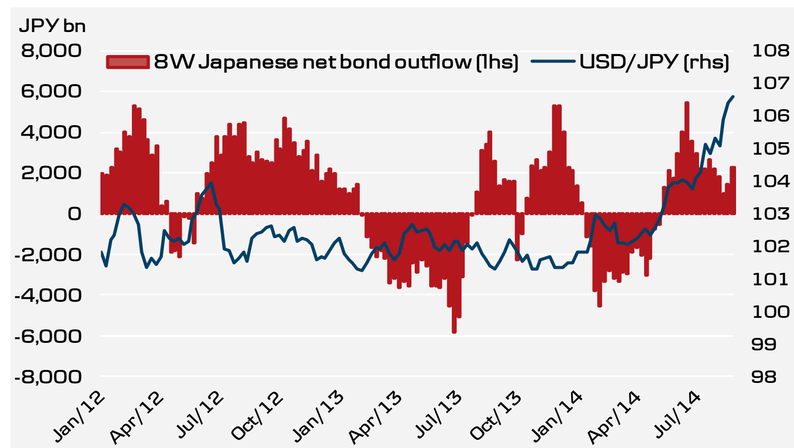
- **Pension fund reforms to drive increased foreign bond allocations and a weaker yen**
  - The appointment of Yasuhisa Shiozaki as new Health Minister has increased speculation of pension reform given his image as a pro-market reformer. The Japanese Government Pension Investment Fund (GPIF) is currently subject to the requirement of investing 60% of funds in domestic bonds with a buffer of eight percentage points. The latest figures for the GPIF portfolio allocation show that the share of domestic bonds is very close to the 52% lower bound. Consequently, the fund cannot decrease its share of domestic bonds further without a change in the weight requirement.
  - We expect such a change in the weight requirements to be announced in the coming months. Specifically, we expect the 60% share target of domestic bonds to be reduced by 20pp and that the released funds will be distributed by increasing the share of domestic stocks by 10pp, the share of foreign stocks by 6pp and the share of foreign bonds by 4pp.
  - Assuming an unchanged level of capital from June 2014, modifying the portfolio weights (see figure below) would lead to an net outflow of JPY12.7trn which would drive JPY weakness. In addition, public pension funds are likely to jump on the bandwagon and increase allocations to foreign assets.

GPIF allocation shifts to drive JPY weakness



Source: GPIF, Danske Bank Markets

Japanese purchases of foreign bonds have increased



Source: Macrobond Financial, Danske Bank Markets

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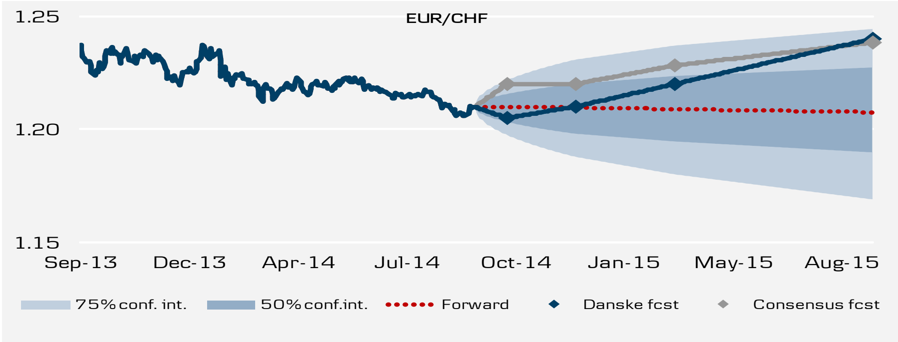
EUR/CHF – focus on SNB

- **Growth.** The Swiss economy stalled in Q2 as construction declined 0.7% and net trade dragged on growth as exports grew less than imports. CHF has appreciated over the past year on a trade-weighted basis which weighs on exports and clearly, the Swiss economy also suffers from weak demand from the euro area. Consumer prices were unchanged in August versus July, while inflation rose 0.1% from a year ago. Thus, deflation risk is still very much a concern.
- **Monetary policy.** The Swiss National Bank (SNB) is still in a trade-off between low inflation and economic growth on the one hand and the danger of an overheating housing market on the other. Given the latest ECB rate cut and the relatively weak economic data out Switzerland recently, the prospect of a SNB deposit rate cut has increased. However, we still believe that the 1.20 EUR/CHF floor will remain the SNB's key monetary instrument. Hence, in the event of a weakening of the EUR, we expect the SNB to first intervene in the FX market if EUR/CHF drops to 1.20 before it might consider alternative measures (i.e. negative deposit rates).
- **Flows.** According to the CFTC IMM data, speculative investors have added CHF shorts in recent weeks, bringing net positioning into neutral territory (slightly net short CHF).
- **Valuation**. The CHF is c.8% overvalued against the EUR, according to our G10 PPP model.
- **Risks.** Given the recent increase in EUR/CHF indicating increased speculations of a rate cut, the SNB meeting on 18 September represents a short-term risk factor. In addition, any re-escalation in geopolitical turmoil might also weigh on EUR/CHF.

Forecast: *1.205 (1M), 1.21 (3M), 1.22 (6M) and 1.24 (12M)*



EUR/CHF	1M	3M	6M	12M
Forecast (pct'ile)	1.205 (34%)	1.21 (51%)	1.22 (69%)	1.24 (84%)
Fwd. / Consensus	1.21 / 1.22	1.21 / 1.22	1.21 / 1.23	1.21 / 1.24
50% confidence int.	1.20 / 1.22	1.20 / 1.22	1.19 / 1.22	1.19 / 1.23
75% confidence int.	1.20 / 1.22	1.19 / 1.23	1.18 / 1.24	1.17 / 1.24

Source: Danske Bank Markets

Conclusion. Viewed in isolation, the recent ECB easing measures (negative deposit rate and TLTROs) should weigh on EUR/CHF and hence we have lowered our 1M-6M forecasts slightly However, the increase in liquidity combined with ultra-low interest rates is positive for risk sentiment, which is supportive for EUR/CHF. We still expect EUR/CHF to edge higher towards 1.24 in the coming 12 months, driven by a reversal of safe-haven flows and an increase in Swiss portfolio investments abroad.

Given the recent increase in EUR/CHF indicating increased speculations of a rate cut, the SNB meeting represents a short-term risk factor. We expect it to keep rates unchanged in September although we acknowledge that it might be a close call. However, if we are right, this should lead to a minor sell-off in EUR/CHF and we target 1.2050 in 1M.

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USD/CAD – BoC stays neutral despite improved economic data

- **Growth.** Q2 GDP showed stronger-than-expected growth, with the economy expanding by 3.1% annualised on the improved exports and improved household spending. Inflation slowed to 2.1% y/y in July from June's 2.4% y/y. Other economic data points to continued economic rebound. Economic growth in Canada is set to gradually gain strength over the coming years.

- **Monetary policy.** The Bank of Canada (BoC) has maintained its overnight lending rate at1.00% for the past two years and kept it unchanged also at its September's monetary policy setting meeting. The BoC considered the recent spike in inflation as temporary and expected inflation to fall back to 2%. The BoC sees the risk to inflation as roughly balanced and considers the current monetary policy stance to be appropriate and neutral with regard to the next change to the policy rate. We expect the BoC to stay on hold for some time to come.

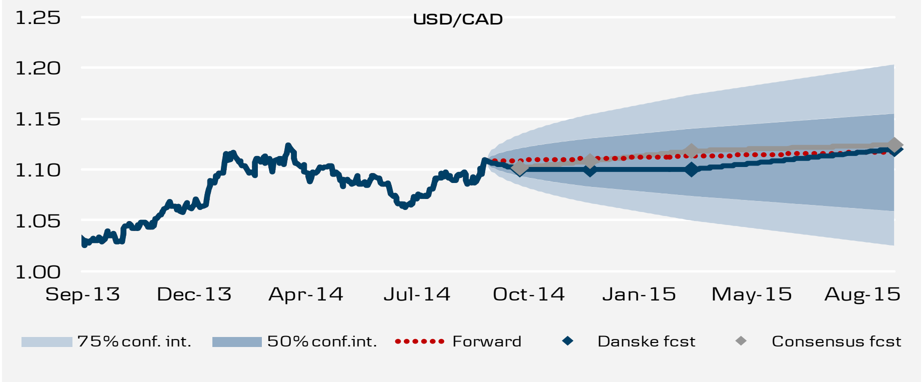
- **Flows.** Speculative positioning is net long for the CAD.

- **Valuation.** The CAD remains expensive by PPP measures.

- **Commodities.** We expect oil prices to head lower in years to come and this could weigh on the CAD. However, as oil production in Canada is rising, oil-related revenues will remain decent.

- **Risks.** Oil prices continue to fall more than assumed, economic recovery fails.

***Forecast**: 1.10 (1M),1.10 (3M), 1.10 (6M) and 1.12 (12M)*



USD/CAD	1M	3M	6M	12M
Forecast (pct'ile)	1.10 (36%)	1.10 (43%)	1.10 (46%)	1.12 (58%)
Fwd. / Consensus	1.11 / 1.10	1.11 / 1.11	1.11 / 1.12	1.12 / 1.12
50% confidence int.	1.09 / 1.12	1.08 / 1.13	1.07 / 1.14	1.06 / 1.16
75% confidence int.	1.08 / 1.13	1.07 / 1.15	1.05 / 1.17	1.03 / 1.20

Source: Danske Bank Markets

Conclusion. Canada stands to benefit from a US recovery, which we see materialising even further next year. However, as the Fed's first rate hike is moving closer, while the BoC's monetary policy remains neutral, support for USD/CAD should remain in place. However, we expect oil prices to stabilize close to current levels and expect them to head marginally higher over the coming 3-6 months. In conclusion, we expect USD/CAD to retrace over the coming months after the recent spike.

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AUD/USD – more downside in store

- **Growth.** The all important question for AUD is how the Australian economy and labour market handles the drop in mining investments and the transition from a commodity-focused economy to a more diversified model. GDP figures for Q2 14 were slightly better than anticipated but still showed a significant slowdown in Australian growth. In addition, recent survey data reveals that business and consumer confidence have fallen. At the same time unemployment is at a 12-year high. However, it is important to note that recent labour market reports were influenced by technical factors which have added uncertainty to the reliability of the releases.

- **Monetary policy.** As expected, the Reserve Bank of Australia (RBA) kept its cash rate target unchanged. In the statement, governor Stevens emphasised that the cash rate target is already at a historical low and that business investments of corporations is very important going forward. Inflation is currently at the upper 3% bound of RBA's inflation target. However, the rise in inflation has been driven by the 2013 AUD-weakness which suggests that inflation will pose less of a barrier for the RBA in cutting rates going forward.

- **Flows.** In the wake of weak commodity exports the trade balance returned to negative territory in Q2. According to IMM data, speculative AUD positioning is now broadly square.

- **Valuation.** Fundamentally, AUD remains overvalued, with a Danske Bank PPP-model estimate of c0.75.

- **Risks.** The downswing in the mining investment boom could turn out to have more severe effects on the economy than expected. This would prompt an easing bias from the RBA as the 2013 effects of a weaker AUD fall out of the yearly inflation rates. The AUD remains exposed to global risk sentiment and thereby an escalation in the Russian/Ukrainian crisis. El Niño weather later this year could spell trouble for the economy.

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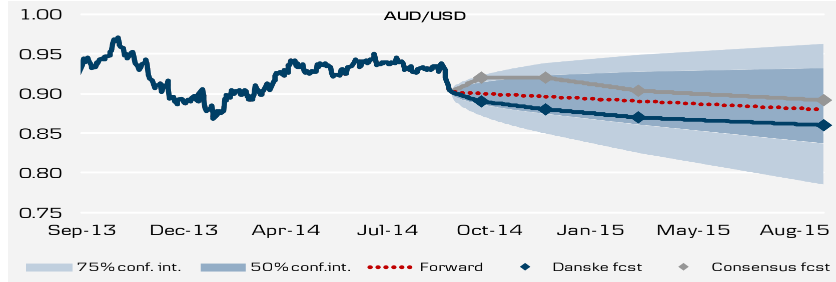
Forecast: *0.89 (1M), 0.88 (3M), 0.87 (6M) and 0.86(12M)*



AUD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.89 (29%)	0.88 (29%)	0.87 (29%)	0.86 (33%)
Fwd. / Consensus	0.90 / 0.92	0.90 / 0.92	0.89 / 0.90	0.88 / 0.89
50% confidence int.	0.89 / 0.92	0.87 / 0.92	0.86 / 0.93	0.84 / 0.93
75% confidence int.	0.87 / 0.93	0.85 / 0.94	0.83 / 0.95	0.79 / 0.96

Source: Danske Bank Markets

Conclusion. We expect the RBA to leave the cash rate target unchanged in the coming 12M. For the same period the market is currently pricing a 50% probability of a rate hike. We believe this is excessive and instead see risks skewed to rate cuts as falling mining investments and a weak labour market may turn out to be more severe than currently perceived.

Last week AUD/USD experienced the largest single weekly drop in more than a year. Although iron ore price concerns were contributing to the bearish sentiment, the move was primarily sparked by technical factors and a change of sentiment which sent AUD/USD below the 200-day MA. We expect that further AUD/USD weakness is in store in coming months. Specifically, we expect commodity prices and a slowdown in China to weigh on the AUD-leg and the strong USD-performance to continue.

Fundamentally, we do not think the outlook for the AUD-leg has changed where the outlook is bearish. However, in light of the recent drop in AUD/USD, we modify our 1M, 3M 6M and 12M forecasts to 0.89, 0.88, 0.87 and 0.86, respectively.

NZD/USD – RBNZ on hold on lower commodity prices, low CPI

- **Growth**. New Zealand's exports have suffered from lower commodity prices (in particular dairy products and forestry). Consequently, the trade balance turned negative in June for the first time since October 2013. The general inflationary pressure has also eased significantly, primarily reflecting lower wage increases, well-anchored 2Y inflation expectations, weak global inflation and the Q2 13 strengthening of NZD.

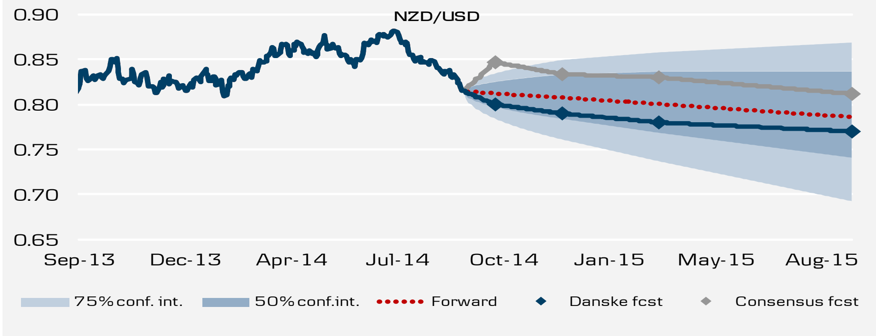
- **Monetary policy.** As expected, the Reserve Bank of New Zealand (RBNZ) kept its official cash rate unchanged at 3.5% at the September meeting. RBNZ emphasised that it is in 'a period of monitoring and assessment before considering further policy adjustment'. With inflation pressures easing, RBNZ does not have to raise rates immediately and can await the full effects of the commodity price falls and the 4 rate hikes in H1 14 on economic activity . Importantly, RBNZ also reiterated that the kiwi strength is 'unjustified and unsustainable'. The use of the word 'unjustified' is relevant as this has historically been a criterion for currency intervention.

- **Flows.** According to IMM data, speculators have slashed their net long NZD positions. Non-commercial NZD positioning is consequently now broadly square in a historical perspective. Lower commodity prices remain a worry for exports, which have slowed since March.

- **Valuation.** Fundamentally, NZD remains heavily overvalued, with a Danske Bank PPP-model estimate of about 0.66.

- **Risks.** In the short run, the General Election on 20 September poses a downside risk for NZD/USD. NZD remains exposed to global risk sentiment and thereby an escalation in the Russian/Ukrainian crisis. El Niño weather later this year could spell trouble for the economy.

***Forecast:** 0.80(1M), 0.79 (3M), 0.78 (6M) and 0.77 (12M)*



NZD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.80 (27%)	0.79 (29%)	0.78 (31%)	0.77 (36%)
Fwd. / Consensus	0.81 / 0.85	0.81 / 0.83	0.80 / 0.83	0.79 / 0.81
50% confidence int.	0.80 / 0.83	0.78 / 0.83	0.77 / 0.84	0.74 / 0.84
75% confidence int.	0.78 / 0.84	0.76 / 0.85	0.74 / 0.86	0.69 / 0.87

Source: Danske Bank Markets

Conclusion

RBNZ's 'on hold' stance has removed the upside potential in NZD/USD. With recent economic figures disappointing and inflation below the midpoint of RBNZ's 2% midpoint target, we believe RBNZ will stay sidelined for the remainder of 2014. This is also reflected in RBNZ's modification of their 90-day bill rate forecast (proxy for cash rate), which suggests that borrowing costs will not rise further in 2014. However, we believe that a combination of higher private consumption, business investments and construction works – partly driven by record high immigration – will force RBNZ to hike rates in Q1 15.

In light of the recent strong USD performance, we lower our NZD/USD forecasts to 0.80 (from 0.86), 0.79 (0.85), 0.78 (0.84) and 0.77 (0.83) on one-, three-, six- and 12-month horizons, respectively.

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Markets

EUR/RUB – volatility to stay high on tightening sanctions

- **Growth.** Economic growth in Russia is slowing further, expanding 0.8% y/y in Q2 14 versus 0.9% y/y in Q1 14. Our 2014 GDP forecast remains at -0.3% y/y due to remaining geopolitical risks, which have introduced both supply and demand side shocks.

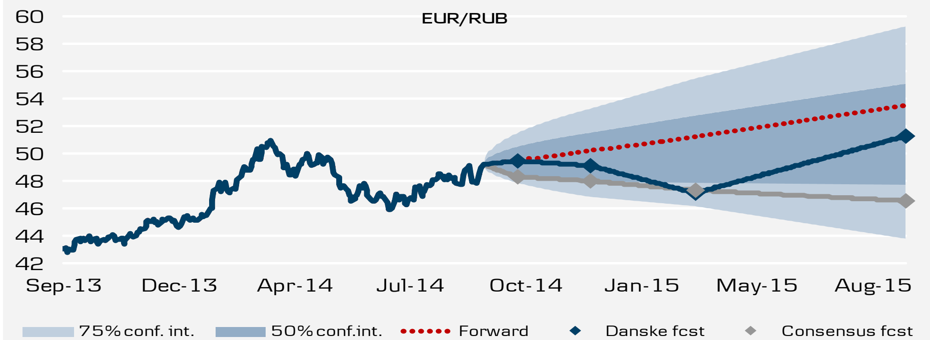
- **Monetary policy.** The Russian central bank left its main rates unchanged on 12 September amid a weakening rouble, accelerating inflation and toughening sanctions. We interpret the latest statement to be slightly hawkish in such an environment and do not exclude a 50bp rate hike in Q4 14 as CPI remains elevated due to food bans. The next rate decision is due to be published on 31 October.

- **Flows.** Net capital outflows slowed down to USD25.9bn in Q2 14 versus USD48.8bn in Q1 14 (excluding banks' FX operations). Yet, the amount remains extremely high and we expect net capital outflows to reach USD120bn in 2014.

- **Valuation.** EUR/RUB is trading significantly above its 1M average of 48.24. We see the current levels staying above fair value due to surged geopolitical woes.

- **Risks.** Bank Rossii's sudden rate hikes to support RUB and curb accelerating inflation. The ECB's more dovish stance will push EUR/RUB down. Escalation of sanctions. Geopolitical risks remain and may increase the RUB's volatility.

Forecast: *49.45 (1M), 49.10 (3M), 47.10 (6M) and 51.25 (12M)*



EUR/RUB	1M	3M	6M	12M
Forecast (pct'ile)	49.45 (54%)	49.10 (42%)	47.10 (17%)	51.25 (50%)
Fwd. / Consensus	49.48 / 48.29	50.16 / 47.99	51.22 / 47.31	53.47 / 46.54
50% confidence int.	48.27 / 50.43	47.99 / 51.52	47.88 / 52.77	47.74 / 55.09
75% confidence int.	47.57 / 51.38	46.84 / 53.26	46.16 / 55.46	43.80 / 59.25

Source: Danske Bank Markets

- **Conclusion.** We expect moderate and continued weakening of the RUB from current levels, as we see the Russian economy shrinking in 2014-15. The rouble's REER has been strengthening despite the nominal weakness. Rouble volatility has been increasing as Western sanctions and Russia's reply are weighing on sentiment.

- We do not exclude Russia's ratings being cut further to junk levels. We do not see any support from fundamentals in the long run.

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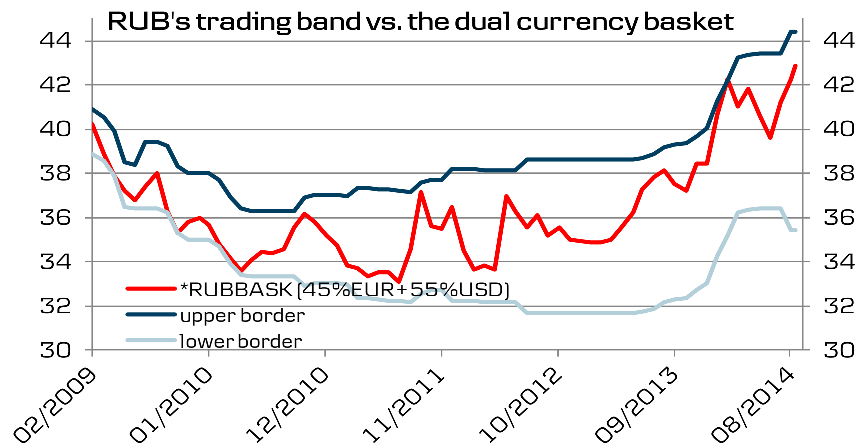
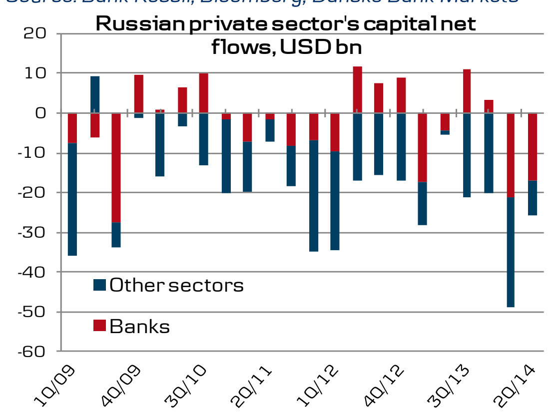
EUR/RUB – important issues to watch

- **Weakness set to continue in H2 14**
  - Over the past month, the RUB was the second worst performer against the EUR in the EMEA FX universe, dipping 1.6%. Despite Russia's tight monetary policy, the ECB's soft stance and a fragile truce in eastern Ukraine, sanctions against Russia have been toughening. Deteriorating sentiment is pushing investors out of the RUB seeking to guarantee FX funding amid financial sanctions. We continue to believe that the geopolitical risks remain, as the situation in eastern Ukraine is far from a peaceful solution and any escalation could trigger additional sanctions from both parties.
  - Bank Rossii is strongly expecting a freely floating RUB in 2015 and is rigidly sticking to inflation targeting. There has not been FX intervention since late June 2014 and the dual basket corridor has been widened by two roubles to nine roubles. We see upside risks for RUB rates, as surprise key rate hikes are possible in 2014 to curb CPI acceleration on the food import ban and to calm sudden RUB falls.
  - FX risks are very small among ordinary citizens and the RUB's real effective exchange rate remains high.



Source: Bank Rossii, Bloomberg, Danske Bank Markets



Source: Bank Rossii, Bloomberg, Danske Bank Markets

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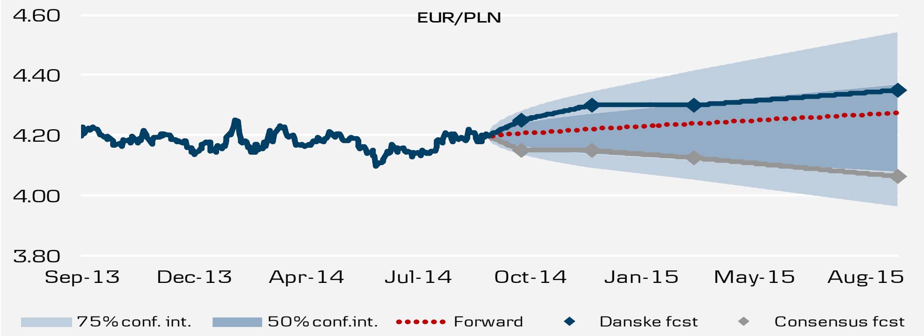
EUR/PLN – deflation and Ukrainian crisis weigh on zloty

- **Growth.** The outlook for the Polish economy has deteriorated recently and equally important the Polish economy is falling deeper and deeper into deflation. As a consequence we have revised down our growth and inflation forecasts. Hence, it has become even more clear 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 the coming years unless bold monetary easing is undertaken.
- **Monetary policy.** Given the outlook for fairly weak growth and continued very low inflation (even deflation), we think the NBP should have moved to monetary easing a long time ago. So far it has been very reluctant to cut interest rates. However, given the recent signals from the NBP, we think it very likely that it will cut its key policy rate by 25bp at the upcoming October Monetary Policy Council meeting. And further rate hikes are likely towards the end of the year.
- **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 in the Ukrainian-Russian conflict.

Forecast: *4.25 (1M), 4.30 (3M), 4.30 (6M) and 4.35 (12M)*



EUR/PLN	1M	3M	6M	12M
Forecast (pct'ile)	4.25 (80%)	4.30 (81%)	4.30 (74%)	4.35 (72%)
Fwd. / Consensus	4.21 / 4.15	4.22 / 4.15	4.24 / 4.13	4.27 / 4.06
50% confidence int.	4.16 / 4.24	4.14 / 4.27	4.12 / 4.31	4.08 / 4.37
75% confidence int.	4.14 / 4.28	4.09 / 4.34	4.05 / 4.41	3.97 / 4.54

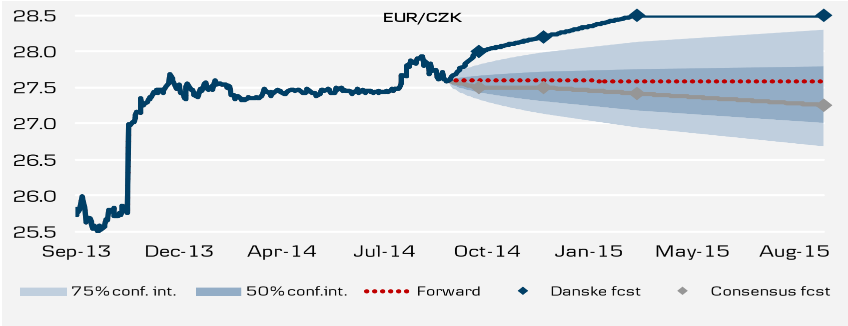
Source: Danske Bank Markets

Conclusion. While there seems to have been some easing of geopolitical risk in relation to the Ukrainian crisis – which should be supportive for the zloty – we believe the outlook for interest rate cuts in the coming months is likely to put further weakening pressure on the zloty, particularly on a 3-6 month horizon.

EUR/CZK – risk of weaker CZK remains intact

- **Growth.** Czech Q2 GDP was 2.7% y/y, down from 2.9% y/y in Q1. Domestic demand continues to contribute to grow while foreign trade somewhat less so. The economic recovery has lost some of the momentum in Q2. We have revised the GDP forecast slightly up for this year to 2.6% y/y (previously 2.4% y/y), down to 2.7% y/y in 2015 (previous 3.1 y/y). The Czech central bank expects GDP growth of 2.9% in 2014 and 3.0% in 2015. However, the Russia sanctions clearly represent downside risk to the Czech economy.
- **Monetary policy.** In line with expectations, the CNB left its key policy rate at a technical zero of 0.05% and also kept the Czech koruna cap 'near' 27/EUR in July. Even though there was no change in monetary policy, the statement from the CNB was perceived by the markets as dovish and the CZK weakened against the EUR. The discussion about a possible lift of the koruna cap strengthened and the market seems to be pricing in some action from the CNB. Given that inflation will increase slowly due to lower imported inflation, downside risks to the Czech economy from Russian sanctions increase the likelihood of a weaker CZK in the future.
- **Debt risks** are low. The Czech government sees the 2014 public finance gap at 1.8% of GDP and government debt at 44% of GDP.
- **Valuation.** From a long-term perspective, the CZK is undervalued (fair value is around 25 against the EUR).
- **Risks.** Increased deflation risks, weaker growth

Forecast: *28.0 (1M) 28.2 (3M), 28.5 (6M) and 28.5 (12M)*



EUR/CZK	1M	3M	6M	12M
Forecast (pct'ile)	28.00 (92%)	28.20 (91%)	28.50 (92%)	28.50 (90%)
Fwd. / Consensus	27.59 / 27.50	27.59 / 27.50	27.59 / 27.42	27.59 / 27.25
50% confidence int.	27.42 / 27.69	27.30 / 27.72	27.18 / 27.76	27.00 / 27.80
75% confidence int.	27.31 / 27.84	27.13 / 27.99	26.94 / 28.13	26.68 / 28.30

Source: Danske Bank Markets

Conclusion. The Czech koruna weakened quite sharply after July's board meeting but has regained somewhat as the geopolitical risk in CEE region has receded. Even though the CNB says that the weaker koruna cap is not currently justified and stronger deflationary risks would be needed for the CNB to change the EUR/CZK floor, the pressure on the CNB to deliver additional monetary easing remains intact, in our view. We therefore keep our EUR/CZK forecasts on all forecast horizons; 28.2, 28.5 and 28.5 in three-, six and 12-months.

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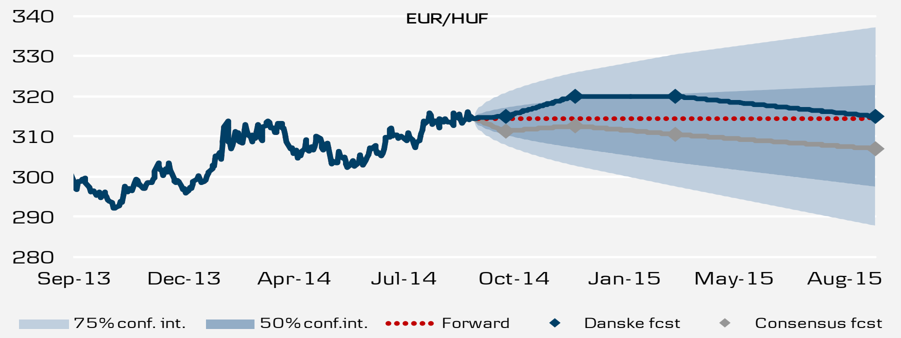
EUR/HUF – strong external balances support the HUF

- **Growth.** Growth is clearly picking up in Hungary and after years of stagnation, it is becoming one of the fastest growth economies in central and eastern Europe. However, both structural problems and weak domestic demand are continuing 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 initiated a policy of baby-step rate cuts. 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 would also stress that the drop 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 Ukrainian-Russian conflict is also a key risk.

Forecast: 315 (1M), 320 (3M), 320 (6M) and 315 (12M)



EUR/HUF	1M	3M	6M	12M
Forecast (pct'ile)	315.00 (59%)	320.00 (76%)	320.00 (73%)	315.00 (61%)
Fwd. / Consensus	314.53 / 311.33	314.54 / 312.65	314.55 / 310.53	314.58 / 306.95
50% confidence int.	310.29 / 317.65	307.14 / 319.37	303.53 / 320.67	297.55 / 322.90
75% confidence int.	307.69 / 321.32	302.76 / 326.00	297.64 / 330.51	287.89 / 337.25

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, the HUF could even strengthen moderately against the EUR on a 12-month horizon, while the short-term outlook is likely to be dependent on the general emerging markets outlook as well as developments in the Russian-Ukrainian conflict. We have lifted our EUR/HUF modestly on a 6-12 months horizon to reflect the overall negative EM outlook. The biggest risks to the HUF remain the political uncertainty and the Hungarian government once again taking a 'misstep' in economic policy.

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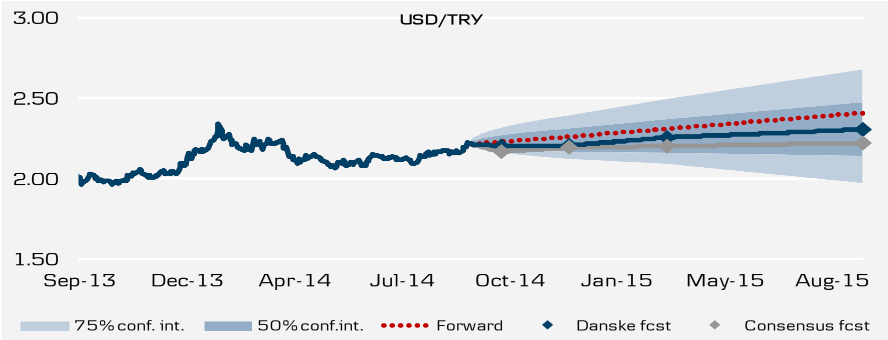
USD/TRY – attractive valuation and high carry

- **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. The continued high inflation (9.1% y/y in 2014) and the large current account deficit continue to be a problem from a fundamental perspective.
- **Monetary policy.** Recently Turkish inflation has increased further and there is now a clear risk of double-digit inflation in the coming months. That said, with growth remaining weak, the underlining inflation pressures are likely to ease off in the coming months. Furthermore, we would stress that the recent increase in inflation to a large extent is 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 reminder of the year, but we could see rates coming down during 2015 as inflation eases off.
- **Valuation.** Overall we think the lira is close to 'fair value'. However, a continued large current account deficit and high inflation continue to be a problem from a fundamental perspective.
- **Risks.** Continued large macroeconomic imbalances, political risks and the overall fragile global emerging market environment continue to be the key risks to the lira.

Forecast: *2.20 (1M), 2.20 (3M), 2.25(6M) and 2.30(12M)*



USD/TRY	1M	3M	6M	12M
Forecast (pct'ile)	2.20 (40%)	2.20 (40%)	2.25 (51%)	2.30 (52%)
Fwd. / Consensus	2.23 / 2.17	2.26 / 2.19	2.31 / 2.20	2.41 / 2.22
50% confidence int.	2.18 / 2.26	2.17 / 2.31	2.16 / 2.37	2.14 / 2.47
75% confidence int.	2.15 / 2.31	2.12 / 2.39	2.09 / 2.49	1.97 / 2.68

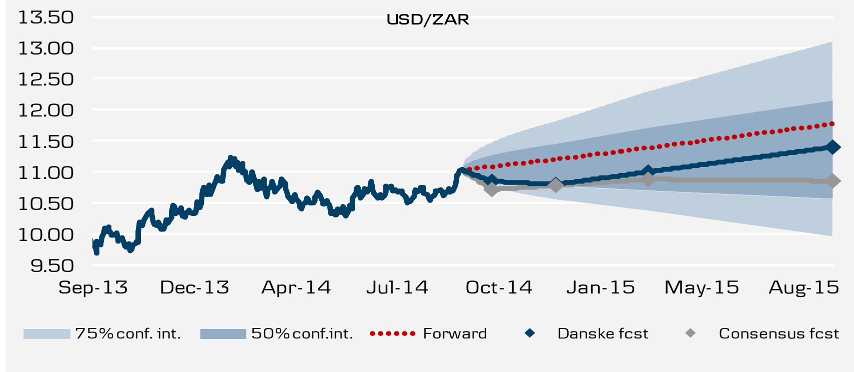
Source: Danske Bank Markets

Conclusion. Continued fairly high inflation and a large current account deficit are likely to continue to weigh on the lira over the longer term. Furthermore, the recent negative news on the economic front is certainly having a negative impact on the lira. As a consequence, we expect the lira to remain under some pressure over the coming three to 12 months. That said, compared with market pricing, we are relatively neutral over the medium term.

USD/ZAR – positive carry should support the rand near-term

- **Growth.** The South African economy continues to weaken. The prolonged strike had a very negative impact on the economic activity while also private consumption keeps weakening. Q2 GDP numbers came out lower than expected with GDP of 1.0% y/y, down from 1.6% y/y in Q1. We have revised down our GDP forecast for 2014 further to 1.6% y/y (previously 1.9% y/y) and to 2.1% y/y for 2015 (2.3% y/y). The South African central bank (SARB) forecasts GDP growth 1.7% this year and 2.9% in 2015.
- **Monetary policy.** The SARB continues to face contradictory policy choices. On the one hand, growth is very weak and clearly requires accommodative monetary policy, while accelerating inflation puts pressure on the SARB to tighten monetary policy to stem inflationary pressures. At July's MPC meeting, the central bank reacted to rising inflation with a 25bp rate hike. However, this is not likely to be enough, in our view, and the SARB could be forced to hike again. Indeed, we see a high chance that it might deliver yet another 25bp at next week's MPC meeting in September. The outcome of the decision is highly uncertain.
- **Debt risks.** A budget deficit of 4.0% of GDP is projected for 2013/14 (lower than projected in October).
- **Valuation.** ZAR remains fundamentally overvalued (fair value around 12.50).
- **Risks.** Deepening of the socioeconomic and structural problems, further downgrade by the rating agencies, a widening current account deficit.

***Forecast:** 10.85 (1M), 10.8 (3M),11.0 (6M) and 11.4 (12M)*



USD/ZAR	1M	3M	6M	12M
Forecast (pct'ile)	10.85 (23%)	10.80 (26%)	11.00 (41%)	11.40 (55%)
Fwd. / Consensus	11.09 / 10.72	11.20 / 10.78	11.39 / 10.88	11.77 / 10.86
50% confidence int.	10.86 / 11.24	10.78 / 11.45	10.70 / 11.71	10.57 / 12.15
75% confidence int.	10.74 / 11.44	10.56 / 11.81	10.38 / 12.30	9.97 / 13.10

Source: Danske Bank Markets

Conclusion. The rand came under pressure after the release of the Q2 current account data, which showed widening of the deficit to 6.2% of GDP. We have lifted our USD/ZAR forecasts modestly without changing the profile. We still expect the rand to strengthen over the coming 3 months as higher carry might be supportive for the rand in the short run. On a six to 12-month horizon, we remain bearish given the fundamental overvaluation on the back of the large external imbalances.

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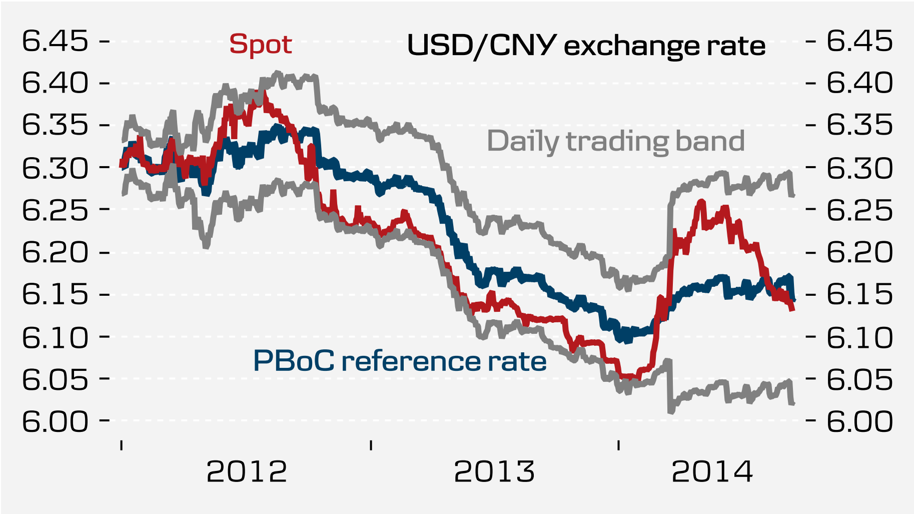
USD/CNY – CNY remains on a longer term appreciation trend

- **Monetary policy.** Growth is losing some momentum as credit growth continues to slow and the impact from fiscal easing earlier in the year has started to wane. Exports have remained resilient while import growth has slowed markedly on the back of subdued investment demand and markedly lower import prices. For that reason China's trade balance surplus has also increased markedly in recent months. The main downside for growth outlook risk at the moment is a weak property market and a possible severe credit crunch in the wake of excessive credit growth in recent years.
- With inflation currently at just 2.0% 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. While PBoC will only ease cautiously through injection of liquidity through its open market operations, a cut in the leading interest rates can no longer be ruled out.
- **FX policy.** CNY initially weakened substantially after the PBoC widened the daily trading band from +/-1% to +/-2% in March. In our view, the PBoC is not targeting a major depreciation of CNY but is mainly hoping that that more two-way volatility in the exchange rate will deter speculative capital inflows into China.
- **Valuation.** China's market share on global export markets continues to improve and the current account surplus appears to be increasing again, suggesting that CNY remains slightly undervalued.
- **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 CNY.

***Forecast:** 6.13 (1M), 6.11 (3M), 6.07 (6M) and 6.00 (12M)*



Source: Macrobond Financial, Danske Bank Markets

Conclusion. Despite some moderation in growth we expect CNY to continue to appreciate moderately supported by an increasing trade balance surplus. In general, there will be more two-way volatility in the exchange rate in the future. We recommend hedging CNY expenditures as forwards currently discount a slight depreciation. We recommend using offshore CNH forwards, as they currently discount the largest depreciation.

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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	1.292	1.29	1.27	1.26	1.25	-0.2	-1.8	-2.6	-3.7
JPY	138.6	138	140	141	143	-0.4	1.0	1.8	3.2
GBP	0.796	0.78	0.78	0.77	0.76	-2.0	-2.0	-3.5	-5.3
CHF	1.210	1.205	1.210	1.220	1.240	-0.4	0.0	0.9	2.7
DKK	7.4443	7.4475	7.4475	7.4450	7.4450	0.0	0.0	0.0	0.1
NOK	8.25	8.10	7.95	7.85	7.75	-1.9	-4.0	-5.6	-7.6
SEK	9.23	9.10	9.10	9.00	8.80	-1.4	-1.5	-2.6	-5.0
Exchange rates vs USD									
JPY	107.2	107	110	112	114	-0.2	2.9	4.5	7.2
GBP	1.62	1.65	1.63	1.64	1.64	1.8	0.2	0.9	1.6
CHF	0.94	0.93	0.95	0.97	0.99	-0.2	1.8	3.6	6.6
DKK	5.76	5.77	5.86	5.91	5.96	0.2	1.9	2.8	3.9
NOK	6.38	6.28	6.26	6.23	6.20	-1.8	-2.3	-3.0	-4.0
SEK	7.14	7.05	7.17	7.14	7.04	-1.2	0.3	0.0	-1.4
CAD	1.11	1.10	1.10	1.10	1.12	-0.9	-1.0	-1.2	0.2
AUD	0.90	0.89	0.88	0.87	0.86	-1.0	-1.7	-2.2	-2.1
NZD	0.81	0.80	0.79	0.78	0.77	-1.4	-2.0	-2.4	-1.9
CNY	6.14	6.13	6.11	6.07	6.00	-0.5	-1.1	-2.1	-4.0

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

Source: Danske Bank Markets

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	7.44	7.4475	7.4475	7.4450	7.4450	0.0	0.0	0.0	0.1
USD	5.76	5.77	5.86	5.91	5.96	0.2	1.9	2.8	3.9
JPY	5.37	5.40	5.32	5.28	5.21	0.5	-1.0	-1.7	-3.1
GBP	9.36	9.55	9.54	9.67	9.80	2.1	2.0	3.7	5.6
CHF	6.15	6.18	6.15	6.10	6.00	0.5	0.0	-0.9	-2.5
NOK	0.90	0.92	0.94	0.95	0.96	2.0	4.2	5.9	8.1
SEK	0.81	0.82	0.82	0.83	0.85	1.5	1.5	2.8	5.4
CAD	5.20	5.25	5.33	5.37	5.32	1.1	2.9	4.0	3.7
AUD	5.20	5.14	5.16	5.14	5.12	-0.8	0.1	0.5	1.7
NZD	4.70	4.62	4.63	4.61	4.59	-1.2	-0.2	0.2	1.8
PLN	1.77	1.75	1.73	1.73	1.71	-1.0	-1.8	-1.3	-1.6
CZK	0.27	0.27	0.26	0.26	0.26	-1.4	-2.1	-3.2	-3.2
HUF	0.24	0.24	0.23	0.23	0.24	0.1	-1.3	-1.0	1.5
RUB	0.15	0.15	0.15	0.16	0.15	0.1	2.0	8.0	3.4
CNY	0.94	0.94	0.96	0.97	0.99	0.6	2.9	4.8	7.8

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	9.23	9.10	9.10	9.00	8.80	-1.4	-1.5	-2.6	-5.0
USD	7.14	7.05	7.17	7.14	7.04	-1.2	0.3	0.0	-1.4
JPY	6.66	6.59	6.50	6.38	6.15	-1.0	-2.5	-4.3	-8.0
GBP	11.60	11.67	11.65	11.69	11.58	0.6	0.5	0.9	0.3
CHF	7.63	7.55	7.52	7.38	7.10	-1.0	-1.5	-3.5	-7.5
NOK	1.12	1.12	1.14	1.15	1.14	0.6	2.7	3.1	2.7
DKK	1.24	1.22	1.22	1.21	1.18	-1.4	-1.5	-2.7	-5.1
CAD	6.44	6.41	6.51	6.49	6.29	-0.3	1.4	1.2	-1.5
AUD	6.44	6.28	6.31	6.21	6.05	-2.2	-1.4	-2.2	-3.5
NZD	5.82	5.64	5.66	5.57	5.42	-2.6	-1.7	-2.5	-3.3
PLN	2.20	2.14	2.12	2.09	2.02	-2.4	-3.2	-4.0	-6.7
CZK	0.33	0.33	0.32	0.32	0.31	-2.8	-3.6	-5.8	-8.2
HUF	0.29	0.29	0.28	0.28	0.28	-1.4	-2.8	-3.7	-3.7
RUB	0.19	0.18	0.19	0.19	0.17	-1.4	0.5	5.4	-1.6
CNY	1.16	1.15	1.17	1.18	1.17	-0.8	1.3	2.0	2.5

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	8.25	8.10	7.95	7.85	7.75	-1.9	-4.0	-5.6	-7.6
USD	6.38	6.28	6.26	6.23	6.20	-1.8	-2.3	-3.0	-4.0
JPY	5.95	5.87	5.68	5.57	5.42	-1.5			
GBP	10.37	10.38	10.18	10.19	10.20	0.0	-2.1	-2.2	-2.4
CHF	6.82	6.72	6.57	6.43	6.25	-1.5	-4.0	-6.4	-9.9
SEK	0.89	0.89	0.87	0.87	0.88	-0.6	-2.6	-3.0	-2.6
DKK	1.11	1.09	1.07	1.05	1.04	-2.0	-4.1	-5.6	-7.6
CAD	5.76	5.71	5.69	5.66	5.54	-0.9	-1.3	-1.8	-4.1
AUD	5.76	5.59	5.51	5.42	5.33	-2.7	-3.9	-5.2	-6.0
NZD	5.21	5.02	4.95	4.86	4.77	-3.2	-4.3	-5.4	-5.8
PLN	1.97	1.91	1.85	1.83	1.78	-2.9	-5.8	-6.9	-9.1
CZK	0.30	0.29	0.28	0.28	0.27	-3.4	-6.1	-8.7	-10.6
HUF	0.26	0.26	0.25	0.25	0.25	-1.9	-5.3	-6.6	-6.2
RUB	0.17	0.16	0.16	0.17	0.15	-1.9	-2.1	2.2	-4.2
CNY	1.04	1.02	1.02	1.03	1.03	-1.4	-1.3	-1.1	-0.2

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	**15-Sep**	**4.20**		**3.25**		**177.3**		**219.7**		**196.8**	
	+1M	4.25	4.21	3.29	3.26	175.2		214.1	219.3	190.6	
	+3M	4.30	4.22	3.39	3.27	173.2	176.3	211.6	218.7	184.9	196.5
	+6M	4.30	4.24	3.41	3.28	173.1	175.5	209.3	218.0	182.6	196.4
	+12M	4.35	4.28	3.48	3.29	171.1	174.0	202.3	216.7	178.2	196.3
HUF	**15-Sep**	**315**		**243**		**2.37**		**2.93**		**2.63**	
	+1M	315	315	244	243.6	2.36		2.89	2.93	2.57	
	+3M	320	315	252	243.9	2.33	2.36	2.84	2.93	2.48	2.63
	+6M	320	316	254	244.4	2.33	2.35	2.81	2.92	2.45	2.63
	+12M	315	319	252	245.9	2.36	2.33	2.79	2.90	2.46	2.63
CZK	**15-Sep**	**27.6**		**21.4**		**27.0**		**33.4**		**30.0**	
	+1M	28.0	27.6	21.7	21.3	26.6		32.5	33.5	28.9	
	+3M	28.2	27.6	22.2	21.3	26.4	27.0	32.3	33.5	28.2	30.1
	+6M	28.5	27.6	22.6	21.3	26.1	27.0	31.6	33.5	27.5	30.2
	+12M	28.5	27.5	22.8	21.2	26.1	27.0	30.9	33.6	27.2	30.5
RUB	**15-Sep**	**49.19**		**38.07**		**15.13**		**18.75**		**16.80**	
	+1M	49.45	49.49	38.33	38.3	15.06		18.40	18.65	16.38	
	+3M	49.10	50.16	38.66	38.8	15.17	14.84	18.53	18.41	16.19	16.54
	+6M	47.10	51.23	37.38	39.6	15.81	14.53	19.11	18.05	16.67	16.26
	+12M	51.25	53.45	41.00	41.2	14.53	13.92	17.17	17.34	15.12	15.70
TRY	**15-Sep**	**2.86**		**2.21**		**260**		**322**		**289**	
	+1M	2.84	2.88	2.20	2.23	262		320	320	285	
	+3M	2.80	2.92	2.20	2.26	266	255	325	316	284	284
	+6M	2.84	2.99	2.25	2.31	262	249	317	310	276	279
	+12M	2.88	3.12	2.30	2.41	259	238	306	297	269	269
ZAR	**15-Sep**	**14.26**		**11.03**		**52.2**		**64.7**		**58.0**	
	+1M	14.00	14.33	10.85	11.09	53.2		65.0	64.4	57.9	
	+3M	13.72	14.48	10.80	11.20	54.3	51.4	66.3	63.8	58.0	57.3
	+6M	13.86	14.73	11.00	11.38	53.7	50.5	64.9	62.7	56.6	56.5
	+12M	14.25	15.28	11.40	11.77	52.2	48.7	61.8	60.6	54.4	54.9

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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