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Market Guide

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Danske Bank

Potential for near-term USD weakness

Higher long-end global real yields spook markets

Long-end global real yields have moved higher which in turn resulted in market nervousness in the beginning of January. Inflation fears have resurfaced amid the outlook for pro-growth and inflationary policies in the US, commodity prices have tracked higher, and political uncertainty has risen with Trump's impending return to the Oval Office. In the UK, the ripple effects from higher long-end yields have been felt given the country's fragile fiscal position. That said, lower-than-expected inflation data in the US and UK have recently offered some relief to markets raising the bar for a further fixed income sell-off. In the euro area, while hard data continues to show tight labour markets, survey indicators have significantly softened over the past months, lending support to a dovish ECB. We note how markets have reacted strongly to any news and rumours regarding tariff policy from incoming President Trump.

The past month, the USD has gained further tailwind from US real rates moving sharply higher, a re-tightening of financial conditions and risk-off sentiment. Conversely, the same forces have left GBP vulnerable given the UK's fragile fiscal position as it runs a large public debt and deficits, only further amplified by its current account deficit. During the past days, JPY has outperformed following hawkish comments from the BoJ, signalling a rate hike at the upcoming meeting.

Outlook: bullish on the USD and bearish on Scandies

We maintain a bearish medium-term view on EUR/USD, expecting the pair to gradually decline towards 1.00 over a 12M horizon on the back of anticipated pro-growth and inflationary policies in the US along with our expectation of relatively stronger US growth dynamics. In the near term, however, we believe many USD-positive factors are overcrowded, leaving the USD vulnerable to a setback, driven by potential downside surprises in US data or softer-than-expected initial tariff measures by the Trump-administration. We remain medium- to long-term negative on NOK on elevated unit labour cost, continued tightness in global monetary conditions and below-trend global growth. For the SEK, we expect a continued weak cyclical outlook, a stronger USD, structural saving flows and a Riksbank continuing to front run peers to remain medium-term headwinds for the SEK.

Risks to our forecasts primarily lie in a sharper economic downturn than what we pencil in and a resurge in inflation. A much harder landing than what we pencil in would require sharp easing of global monetary conditions, which would likely entail a much weaker USD (after an initial squeeze higher) and much weaker cyclically sensitive currencies than in our base case. With the US Red sweep, the risk of a re-acceleration of US inflation and hence USD real rates in the coming years has also risen.

USD

Potential near-term USD weakness

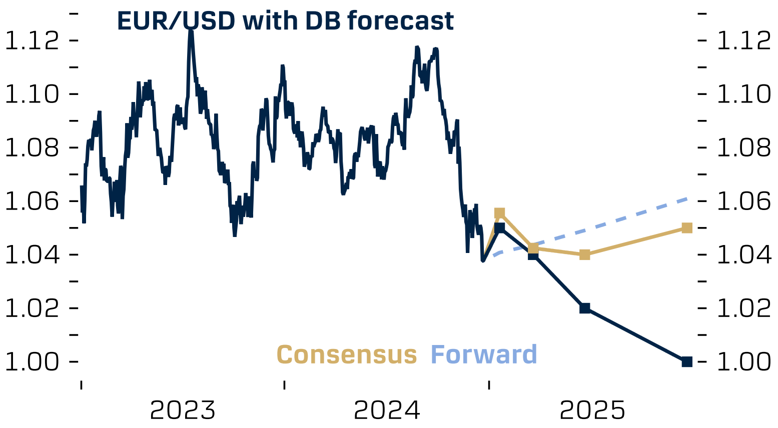
- The US economy remains on solid ground, as highlighted by the recent jobs report, which showed the highest job creation since last spring. On the inflation front, the downward trend appears likely to persist, as indicated by December's soft CPI print. Overall, macroeconomic data suggests that the Fed can continue to gradually transition toward a more neutral monetary policy stance. In the euro area, data points to weaker growth momentum and notably easing inflationary pressures, positioning the ECB to move more swiftly toward a neutral policy stance.

- Following the 50bp Fed cut in September last year, the Fed slowed its easing pace, delivering a 25bp cut in November and December. Strong US data since September has prompted markets to significantly reprice the outlook, with around 40bp of cuts now priced for 2025. In light of the Fed's hawkish signals at the December meeting, we have updated our forecast for the Fed Funds Rate, now expecting quarterly 25bp cuts starting in March 2025, which remains notably more dovish than current market pricing. For the ECB, we anticipate consecutive 25bp cuts through the summer of 2025. If our below-consensus expectations for both central banks materialize, monetary policy dynamics could act as a tailwind for EUR/USD, particularly in the near term.

- We maintain a bearish medium-term outlook for EUR/USD, forecasting a gradual decline toward 1.00 over a 12M horizon. The outcome of the US election supports this view, given the anticipated pro-growth and inflationary policies, alongside our expectation of relatively stronger US growth dynamics. However, in the near term, we believe many USD-positive factors are overcrowded, leaving the greenback vulnerable to a setback, driven by potential downside surprises in US data or softer-than-expected initial tariff measures by the Trump-administration.

- Significant weakness in the US economy poses a risk to our forecast, as does a marked improvement in the euro area economy, potentially supported by a rebound in the fragile global manufacturing sector.

EUR/USD



	1M	3M	6M	12M
Danske Bank	1.05	1.04	1.02	1.00
Consensus	1.03	1.03	1.03	1.05
Forward	1.03	1.03	1.04	1.05

Hedging recommendations

Income: We recommend hedging 2025 income via risk reversals. Consider hedging short-term income via FX forwards.

Expenses: We recommend hedging via FX forwards.

Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

Debt concerns expected to wane

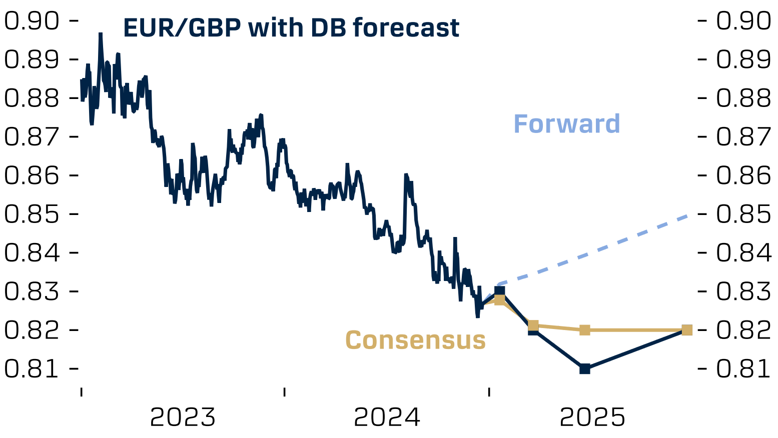
- After a strong start to the year, the UK economy slowed to 0.1% q/q in Q3, with activity indicators pointing towards zero-growth in Q4. With underlying domestic demand holding up combined with a boost from government spending, we expect a rebound in growth in 2025. While underlying inflationary pressures remain elevated, the downside surprise should offer some relief to the BoE that service inflation is easing. The labour market continues its gradual loosening with vacancies moving lower but wage growth still proving remarkably sticky, especially in the private sector.

- The Bank of England (BoE) decided to keep the Bank Rate unchanged at 4.75% in December, in line with expectations. The MPC continues to signal a cautious and gradual cutting cycle. Our base case of a continuous gradual easing cycle is further amplified by the expansionary fiscal stance. We continue to expect the BoE to deliver the next 25bp cut in February and deliver quarterly rate cuts at the meetings associated with updated economic projections. We expect the Bank Rate to end the year at 3.75%. We see relative rates as a positive for EUR/GBP as we think markets underestimate the degree of easing from the BoE in 2025.

- UK assets have had a tough start to the year with EUR/GBP rising from below 0.83 to above 0.84. Tightening global financial conditions and rising long-end global real rates leave the UK vulnerable due to its fragile fiscal position amid a large public debt and deficits. We are cautiously optimistic that the move in UK markets is overdone and expect long-end global yields to decline. More broadly, we think a relatively hawkish BoE, and a UK growth pickup relative to the euro area in 2025 will weigh on the cross going forward – further amplified by continued tight credit spreads and a return to the positive correlation for GBP to a USD positive investment environment.

- The key risks to our forecast are related to global risk sentiment and by extension the UK's fragile fiscal position. If risk sentiment sours and/or global real yields continue to climb, GBP is left vulnerable. Additionally, if the BoE opts for a more front-loaded cutting cycle, this would act as a headwind for GBP. Other risks are closely related to the developments in the relative growth outlook between the euro area and the UK.

EUR/GBP



	1M	3M	6M	12M
Danske Bank	0.83	0.82	0.81	0.82
Consensus	0.84	0.83	0.83	0.83
Forward	0.84	0.84	0.84	0.85

Hedging recommendations

Income: With our call for a stabilisation in UK markets we favour vol-selling strategies like e.g. knock-in forwards.

Expenses: We recommend to hedge via FX forwards.

Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

Weaker SEK in store

SEK

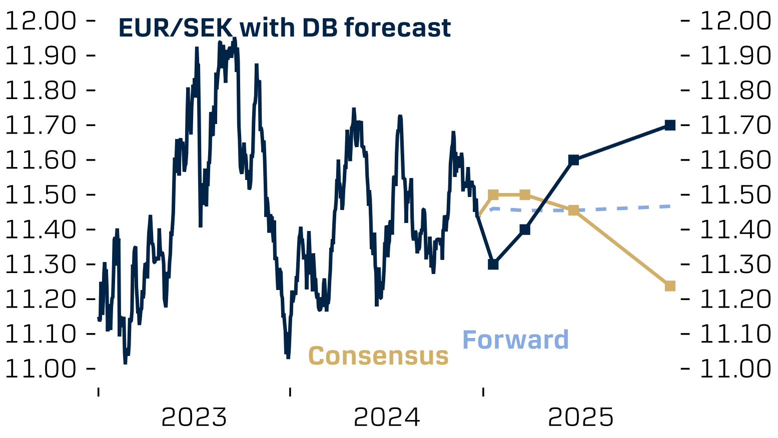
- Following two consecutive negative prints, the GDP indicator shone some light on the much-postponed Swedish recovery, printing a strong +1.4% m/m growth for November. Although this is just the kind of print that we have been waiting for, there is still reason for caution as the GDP indicator is prone to substantial revisions. Nevertheless, a good sign of what is hopefully to come in, as we continue to see the Swedish economy outperforming the eurozone in 2025. On balance, a positive for the SEK but still not enough to counter the structural headwinds facing SEK.

- The hawkish first impression of the December monetary policy meeting was somewhat moderated by the meeting minutes, showing a more balanced outlook for coming meetings. The Riksbank base case is for one final cut in Q1 and a terminal rate at 2.25%, but a majority of the board stated that they remain open for further easing should data warrant it. We have decided to frontload our call slightly, still seeing two more cuts but now in January and May, for a terminal rate of 2.00%. Although our central bank calls (ECB at 1.50% by Q3) now implies that the previous monetary policy headwinds vs EUR is moderated, the substantial policy differential vs the USD is expected to remain as a considerable headwind for broad SEK.

- Since late-November, EUR/SEK has been consolidating around 11.50, defying to align with our short-term model's 'fair-value' estimate currently at 11.30. Our updated Riksbank call implies a slight frontloading of the two projected cuts, limiting the near-term downside in EUR/SEK. That said, we still see scope for a slightly lower EUR/SEK in the short-term. As for the medium-term, both the cyclical and the monetary policy outlook might be considered as more balanced for EUR/SEK. However, a continued, possibly even growing, policy gap between the Fed and the rest of G10 is likely to weigh on broad SEK.

- Near-term upside risks relate to a continuation of the USD rally, while medium-term downside risks are related to potential shifts in portfolio flows towards SEK assets.

EUR/SEK



	1M	3M	6M	12M
Danske Bank	11.30	11.40	11.60	11.60
Consensus	11.70	11.43	11.34	11.17
Forward	11.60	11.59	11.58	11.57

Hedging recommendations

Income: We recommend to hedge income via FX forwards. Utilise a potential short-term rise in SEK by lifting hedge ratios.

Expenses: We recommend to hedge expenses via risk reversals.

Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

NOK

We expect the cross to end the year above the 12.00 figure

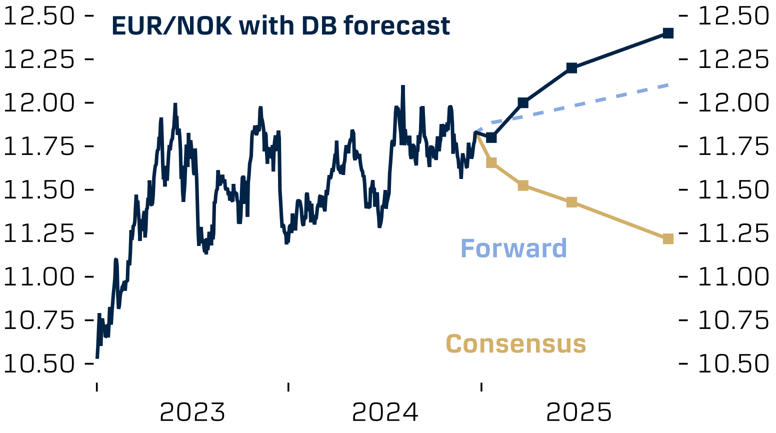
- It has been limited with macro news out of Norway over the last month. Generally, the biggest macro news in Norway in recent months remains the revision of the national account figures which now show that 2022 growth was higher-than-expected while 2023-2024 has fared somewhat better than initial estimates. Importantly, the rise was driven by improved productivity as the number of hours worked was revised lower. All in all, that leaves us with a picture of less elevated unit labour costs – albeit still elevated in a relative context. This in turn might help explain why inflation consistently has printed to the low side of expectations – this was also the case for the December print just released.

- At the December meeting Norges Bank (NB) strongly indicated the beginning of a cutting cycle in March. The rate path firmly indicated a close to 0% probability of a cut in January and a close to 100% probability for a 25bp cut in March and two additional cuts in the rest of 2025 with the balance of risk skewed to three additional cuts. While our economic analysis is fairly close to that of NB we still pencil in a more negative output gap and lower core inflation than NB. As such, For this reason, we still pencil in four rate cuts in both 2025 and 2026 while markets pencil in but four total cuts.

- We remain negative on NOK for the coming years. This is not least due to divergence in unit labour costs between Norway and most of Norway's trading partners which over time adds a real appreciation pressure on NOK and makes Norwegian assets less attractive for foreign investors. In the absence of a sharp move higher in unemployment the only way for this to be sustained is via sharper monetary policy easing and/or a weaker NOK. Also, with the outlook for continued tightness in global monetary conditions, below-trend global growth and with an OPEC+ that increasingly is pressured on its cohesiveness the global backdrop is unlikely to sustainably turn NOK supportive. We do not think that NB's new NOK buying flows in capping the FX reserve will be enough to change this narrative.

- Risks are connected to the global investment environment, US monetary policy, and geopolitical events impacting energy prices.

EUR/NOK



	1M	3M	6M	12M
Danske Bank	11.60	11.70	12.00	12.30
Consensus	11.72	11.57	11.47	11.24
Forward	11.71	11.74	11.80	11.92

Hedging recommendations

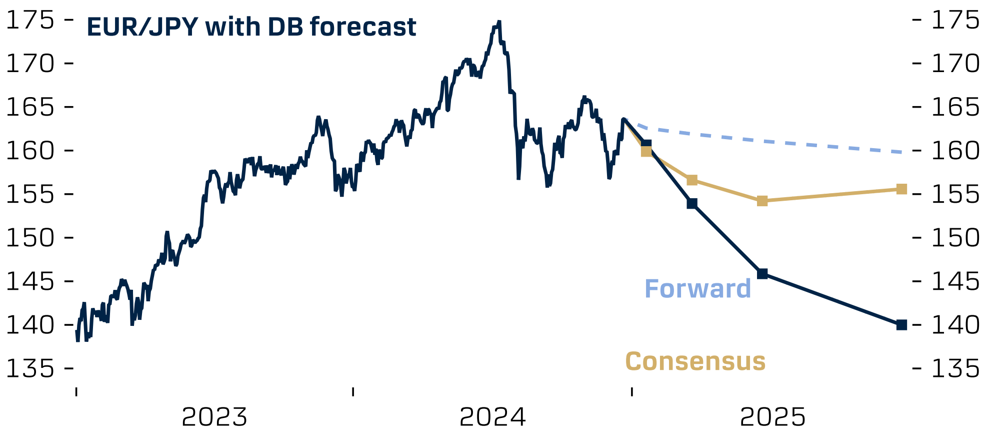
Income: We recommend to hedge NOK income via FX forwards.

Expenses: We recommend to hedge NOK expenses via risk reversals.

Source: Macrobond, Bloomberg, Danske Bank Note: Past performance is not a reliable indicator of current or future results

Others

EUR/JPY



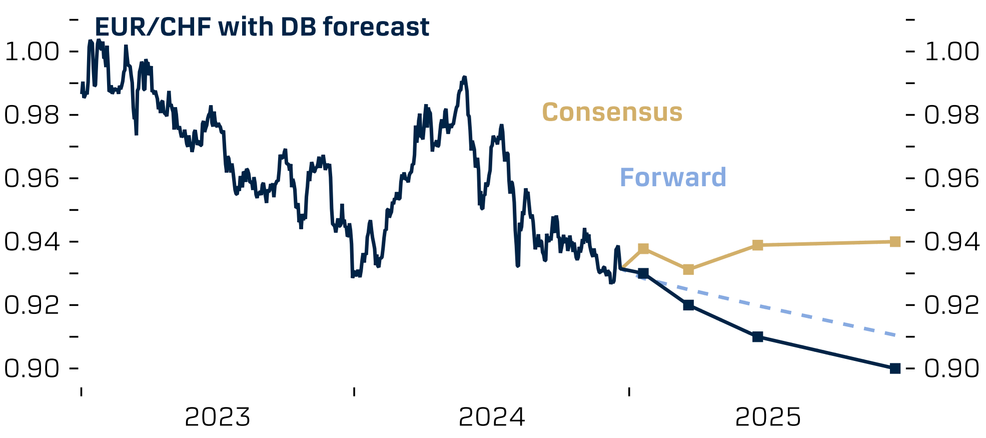
Hedging recommendations

Income: Sell JPY via risk reversals.

Expenses: Buy JPY via forwards.

Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

EUR/CHF



Hedging recommendations

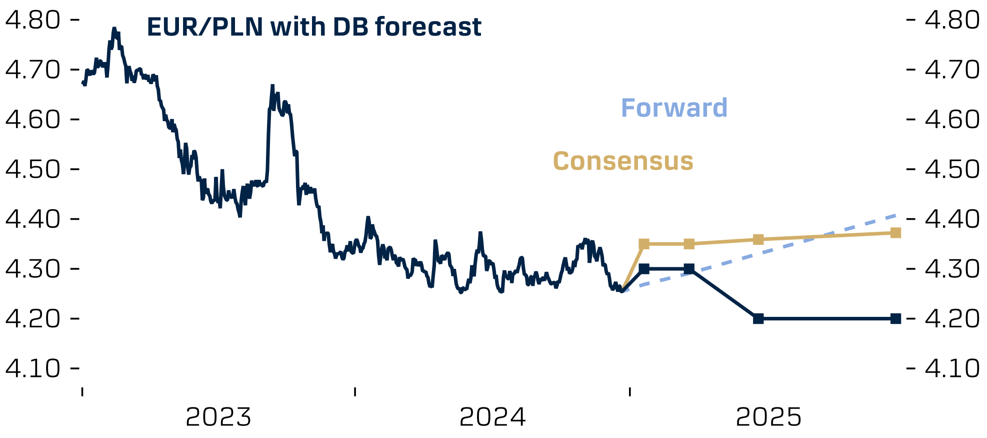
Income: Sell CHF via risk reversals.

Expenses: Buy CHF via forwards.

Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

Others

EUR/PLN



Hedging recommendations

Income: We recommend to hedge via knock-in forwards.

Expenses: We recommend to hedge via FX forwards.

Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

FX Forecast Table

Exchange rates vs EUR

G10				Last Update:	17-01-2025
	Spot	+1m	+3m	+6m	+12m
Exchange rates vs EUR					
EUR/USD	1.03	1.05	1.04	1.02	1.00
EUR/JPY	160	161	154	146	140
EUR/GBP	0.85	0.84	0.83	0.82	0.82
EUR/CHF	0.94	0.93	0.92	0.91	0.90
EUR/SEK	11.50	11.40	11.40	11.60	11.70
EUR/NOK	11.75	11.80	12.00	12.20	12.40
EUR/DKK	7.4608	7.4600	7.4575	7.4550	7.4550
EUR/AUD	1.66	1.67	1.68	1.67	1.64
EUR/NZD	1.84	1.81	1.82	1.79	1.75
EUR/CAD	1.49	1.49	1.49	1.47	1.45

EM					
	Spot	+1m	+3m	+6m	+12m
EUR/PLN	4.26	4.30	4.30	4.20	4.20
EUR/HUF	413	410	420	430	440
EUR/CZK	25.3	25.2	25.1	25.0	25.0
EUR/TRY	36.6	37.8	38.6	39.5	41.9
EUR/ZAR	19.3	19.8	19.5	19.1	18.5
EUR/CNY	7.55	7.70	7.70	7.65	7.60
EUR/INR	89.2	90.3	90.0	88.7	87.5

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