Investment Research

30 September 2016

Emerging Markets Briefer

Don't overestimate negative impact of US election on EMs

After a decent rally in emerging markets (EMs) over the summer, autumn clouds have gathered on the EM horizon. First, the Federal Reserve spooked markets in August with warnings of an impending rate hike (only to backtrack again). In the past week, focus has shifted to the US election, with the first presidential candidate TV debate, and to the possible damaging effects of a more restrictive US trade regime and possible global trade war on EM countries.

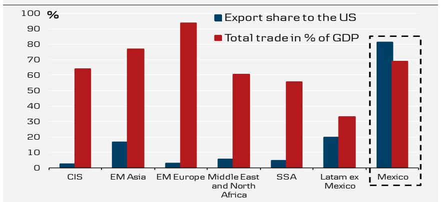
In our view, a Donald Trump presidency could significantly impact selected EMs, while the impact would be much more limited under Hillary Clinton. Trump has laid out his anti-free trade rhetoric in a seven-point trade plan, calling for renegotiation of the NAFTA agreement, cancellation of the trans-Atlantic Pacific trade pact (TPP) and aggressive action against China and other countries seen as playing an unfair trade game. Clinton has also voiced concerns about the impact of trade on US workers but with much less conviction than Trump.

Which EMs are most exposed to US trade action? In our view, Mexico, given its large trade share with the US and Trump's sharp rhetoric against the country, and Asian and other Latin American countries. Less affected by US trade action are Eastern European EMs, which have relatively little trade with the US, given that their main export markets are European countries. Furthermore, given Trump's positive view of Vladimir Putin, Russia could benefit from a more positive investor reaction in the short term, though we see a smaller effect in the longer term given concerns in Congress.

Increasing 'south-south' trade means more restrictive US and EU trade regimes would have less of an impact on EMs. According to UNCTAD, while only c.40% of EM exports went to other EMs in 1995, now two-thirds of exports are destined for other EMs. One could ask whether this is not just agriculture and raw materials but EM manufacturing exports have grown in importance over 30 years. Hence, a more restrictive trade regime in advanced economies would have less of an impact on EMs than before, provided EMs stick together and keep their borders open to each other.

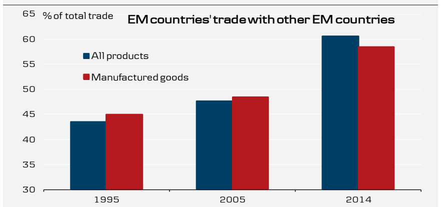
We think there is still a case for EMs. External factors are mildly conducive from a gradual Fed hiking cycle (we see good reasons for the Fed to be on hold at December's meeting), to a continuing rebound in the Chinese construction sector (very important for metal-producing EM), although with some moderation in 2017; and finally a stable to slightly improving outlook for commodity prices. Also, many EMs enjoy a virtuous cycle, as FX stability/strengthening has led to lower inflation, facilitating easier monetary policy, in turn increasing growth and spurring further capital inflows and FX strengthening. We think this is notably true for commodity-producing countries, such as Russia and Brazil.

Limited US trade shares in many regions...



Source: Macrobond Financial

...as 'south-south' trade has increased in importance



Source: UNCTAD Trade Book 2016

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Poland – uncertainty about fiscal outlook

Macro and political outlook

- Recent economic indicators showed that post-Brexit referendum sentiment towards the Polish economy is improving. ZEW August Investor Confidence for Poland jumped to 50% from 12% in July and PMI manufacturing improved to 51.5, exceeding expectations. Industrial production increased by 7.5%, rebounding from the weak reading in July. Private consumption seems to be holding up relatively well with retail sales growing by 5.6% in August, up from 2% in July, supported by a further decline in unemployment, falling further to 8.6% in July. Q2 real GDP rebounded to 0.9% q/q after a very weak Q1, in line with our estimate and our 2016 growth projection of 3.0%.

- On the political front, there are two main concerns: relations with the EU and the budget for 2017. In early August, the EU extended the deadline for Poland to address EU concerns regarding the rule of law. Although ultimately Hungarian support for Poland means that the EU cannot adopt a negative ruling, it may still weigh on investor sentiment. On 28 September, the government reshuffled the government, appointing Mateusz Morawiecki as the new minister of finance. At the same time, the government also approved the budget goals for 2017, targeting a deficit of 2.9% of GDP. While we think the government will attain the targets (partly due to strong revenue developments this year), the budget for 2017 will be a key issue for the markets in the autumn.

Monetary policy outlook

- The monetary policy committee of the National Bank of Poland (NBP) kept the policy rate unchanged at 1.5% at its 7 July meeting. This time, the central bank governor Adam Glapinski sounded hawkish, stating that there is ‘no temptation’ to cut interest rates, hinting that it could start rate increases near the end of 2017 on rising inflation. We expect the NBP to stay put for the time being.

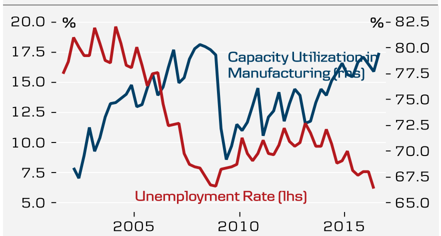
FX outlook

- After a strong rally over the summer, PLN strength has taken a pause. Policy uncertainty was reduced after Poland’s president’s office presented a revised plan on the conversion of Swiss franc loans, seen as less radical vis-à-vis banks. We expect EUR/PLN to remain around 4.30 in 1M, as we do not expect Fed hikes in 2016. However, given the robust performance of the Polish economy and possible falling risk premium from a resolution of the stand-off with the EU, we expect EUR/PLN to fall to 4.26 in 6M and 4.22 in 12M towards the fair-value estimate of about 4.00.

Risk factors

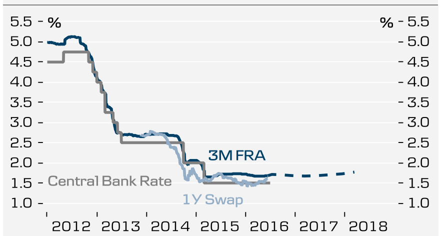
- The biggest risk to our forecasts is a deterioration in global risk sentiment should the Fed signal an increase in interest rates earlier than the market expects as well as a lack of fiscal efforts to reach 2017 budget targets. In our view, this would send EUR/PLN higher. A positive risk is stronger-than-expected Polish economic developments, prompting expectations of a tightening of monetary policy.

Economy operating close to full potential...



Source: Macrobond Financial

...and markets have started pricing out an interest rate cut



Source: Macrobond Financial

PLN

Credit rating:

S&P: BBB+ (negative)

Currency regime:

Free float (freely convertible)

Inflation target:

2.5% +/-1pp

Macro forecasts

	2015	2016	2017	2018
GDP (% y/y)	3.6	3.0	3.7	3.0
GDP deflator (% y/y)	0.4	1.2	1.8	1.7
CPI (% y/y)	-0.9	-0.1	2.1	2.0
Private consumption (% y/y)	3.0	3.0	3.9	2.8
Fixed investments (% y/y)	5.9	-1.8	2.9	2.7
Unemployment (%)	9.8	8.3	9.2	8.8
Current account (% of GDP)	-0.4	-0.5	-0.9	-1.5

Source: Macrobond Financial, Danske Bank Markets

Interest rate forecast

National Bank of Poland (NBP)		
Policy rate	1.50	
Next meeting	05/10/2016	
Next change	+25bp	Q2 2017
End-2016	1.50	

Source: Danske Bank Markets

FX forecasts

EUR/PLN		
	Danske	Forward
28-Sep	4.29	
+3M	4.28	4.32
+6M	4.26	4.34
+12M	4.22	4.38
USD/PLN		
	Danske	Forward
28-Sep	3.84	
+3M	3.82	3.83
+6M	3.74	3.83
+12M	3.58	3.84

Source: Danske Bank Markets

Hungary – buoyant consumers drive growth

Macro outlook

- The Hungarian economy saw growth accelerate in Q2, following temporary weakness in Q1. A flash estimate shows that Q2 real GDP accelerated to 1.1% q/q. We think the positive momentum will be sustained in H2 16 due to relatively solid private consumption, as private sector deleveraging has come to an end and absorption of EU funds is increasing. Due to the positive Q2 GDP number and smaller contraction in Q1, we revise up our full-year 2016 real GDP forecast to 2.0% while sticking to our projected 3.8% growth rate in 2017. On 16 September, Hungary was upgraded to investment grade by S&P, citing improving fiscal, external and growth expectations, while maintaining its stable outlook.

Monetary policy outlook

- Following dovish monetary stances being adopted across the EM universe, the National Bank of Hungary (NBH) kept its base rate constant at 0.9% at its 20 September meeting, while deflation raises concerns about further unconventional easing. Deflation continued in August, although core inflation held up pretty well, staying unchanged at 1.2% y/y in August. Hence, we expect the NBH to stay put until early 2017, when it may consider raising rates.

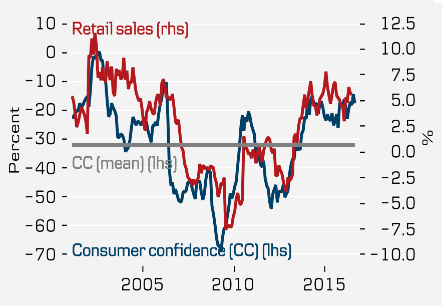
FX outlook

- EUR/HUF fell sharply following the surprise rating upgrade by S&P on 16 September. We think EUR/HUF will weaken a bit amid geopolitical uncertainty surrounding the US election and fears of a Fed hike in December. However, given the currency is fundamentally undervalued and the Hungarian economy is expected to pick up speed, we see the HUF strengthening on 6-12M basis. As a result, our forecast for EUR/HUF is 310 on 1M but then strengthening to 308, 306, and 304 on 3M, 6M, and 12M bases.

Risk factors

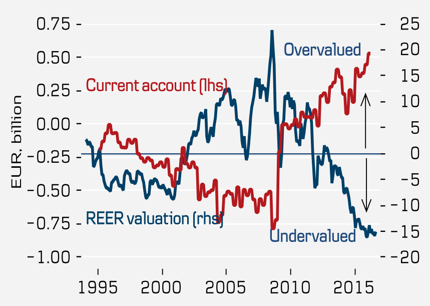
- The biggest risk to our forecasts is a deterioration in global risk sentiment around the US election, notably if Trump is set to win, and an earlier-than-expected Fed interest rate hike, possibly as early as by the end of 2016. Furthermore, we could see renewed concern about the future of the EU if the Hungarian migrant quota referendum surprises with a large 'No' vote on 2 October 2016.

Buoyant consumers driving economic growth...



Source: Macrobond Financial

...while an undervalued Forint brings record current account surpluses



Source: Macrobond Financial

HUF

Credit rating:

S&P: BBB- (stable)

Currency regime:

Free float (freely convertible)

Inflation target:

3% (medium term)

Macro forecasts

	2015	2016	2017	2018
GDP (% y/y)	2.9	2.0	3.8	3.3
GDP deflator (% y/y)	1.7	1.9	3.3	3.2
CPI (% y/y)	-0.1	1.2	2.1	2.0
Private consumption (% y/y)	3.0	5.5	4.7	3.0
Fixed investments (% y/y)	0.5	-8.0	-0.7	2.7
Unemployment (%)	6.2	4.9	5.0	4.8
Current account (% of GDP)	3.0	3.3	2.8	2.5

Source: Macrobond Financial, Danske Bank Markets

Interest rate forecast

Hungarian Central Bank (MNB)	
Policy rate	0.90
Next meeting	25/10/2016
Next change	+25bp Q2 2017
End-2016	0.90

Source: Danske Bank Markets

FX forecasts

EUR/HUF		
	Danske	Forward
28-Sep	308.3	
+3M	308.0	308.4
+6M	306.0	308.9
+12M	304.0	310.0
USD/HUF		
	Danske	Forward
28-Sep	275.43	
+3M	275.00	273.83
+6M	268.42	273.08
+12M	257.63	271.71

Source: Danske Bank Markets

Baltics – weak growth persists

- After weak growth in Q1 16, the second quarter posted even weaker numbers. Growth slowed down in Estonia, Latvia and Lithuania in Q2 16 and we expect it to remain weak throughout 2016. We expect a recovery to take firmer ground in 2017 and 2018, although growth rates in the short to medium term are set to remain far from pre-crisis figures.

Estonia

- Estonia has not had GDP growth higher than 2% for six quarters. While low growth in 2015 was primarily a result of a contraction in investment and exports, in H1 16 the key reason behind lower growth was the deterioration in the trade balance, due largely to much stronger growth in imports than in exports. On the positive side, investment has finally recovered from the downturn and posted 5.4% y/y growth in Q2 16.
- We expect growth ahead to be more balanced, with all key GDP components growing in the second half of 2016 and into 2017. However, we expect weak revenue growth in the private sector, coupled with rising labour costs, to continue to be a drag on business profits and thus overall economic activity.

Estonia

Credit rating: S&P: AA- (stable)

Currency: EUR since 1 Jan 2011

	2015	2016	2017	2018
GDP (% y/y)	1.1	1.5	2.1	2.4
HICP inflation (% y/y)	0.1	0.7	1.9	2.3
Private consumption (% y	4.8	3.9	4.2	3.9
Fixed investment (% y/y)	-5.8	1.8	3.1	4.2
Exports (% y/y)	-1.5	1.9	2.1	2.4
Gross wage growth (% y/y	6.1	6.7	6.2	5.9
Unemployment (%)	6.1	6.6	6.4	6.3

Source: Danske Bank Markets estimates

Latvia

- GDP growth in Latvia has taken on a downward trajectory lately. Following expansion of 2.1% y/y in Q1 16 and 2.0% in Q2 16, we expect growth to be lower than 2.0% in H2 16 due largely to the base effects of a strong GDP performance in H2 15.
- The key component that declined dramatically in H1 16 was investment, which contracted by 21% y/y, due largely to lower disbursement of EU funds from the EU's 2014-20 financial perspective. This was compensated for by strong growth in consumption (+3.6% y/y) and a recovery in exports (+1.6% y/y).

Latvia

Credit rating: S&P: A- (stable)

Currency: EUR since 1 Jan 2014

	2015	2016	2017	2018
GDP (% y/y)	2.7	1.8	2.7	2.9
HICP inflation (% y/y)	0.2	-0.1	2.0	2.4
Private consumption (% y	3.4	3.9	4.1	3.9
Fixed investment (% y/y)	2.1	-12.8	7.1	4.9
Exports (% y/y)	1.8	1.6	2.7	2.9
Gross wage growth (% y/y	6.9	5.3	6.3	6.4
Unemployment (%)	9.9	9.6	9.1	8.5

Source: Macrobond Financial, Danske Bank Markets estimates

Lithuania

- Lithuania did not manage to avoid a slump in GDP growth in Q2 16. Key factors that drove down growth were a sharp fall in business inventories and a contraction in investment (-3.8%) due to lower disbursement of EU funds.
- Consumption, driven by rising employment and fast wage growth (+7.5%), expanded by 5.4% y/y in H1 16. Export growth fell from 9.3% in Q1 16 to 1.5% y/y in Q2 16, due largely to a fall in the export of oil products and re-exports to CIS countries.

Lithuania

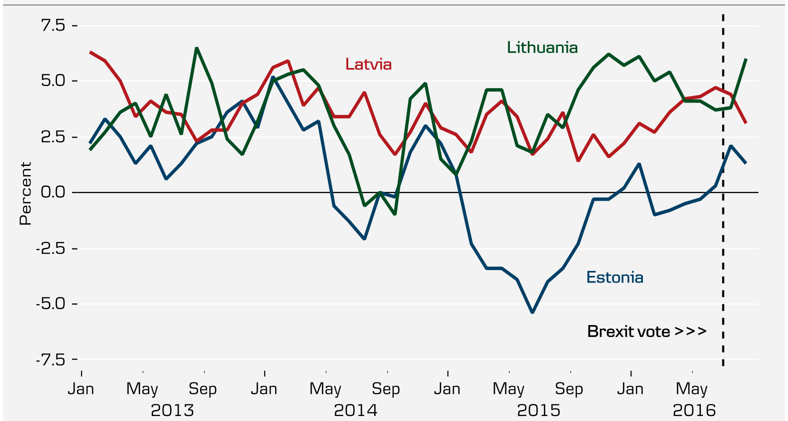
Credit rating: S&P: A- (stable)

Currency: EUR since 1 Jan 2015

	2015	2016	2017	2018
GDP (% y/y)	1.6	2.5	2.8	3.0
HICP inflation (% y/y)	-0.7	0.7	2.2	2.5
Private consumption (% y	5.2	5.3	4.6	4.4
Fixed investment (% y/y)	10.3	-1.6	6.7	5.5
Exports (% y/y)	1.2	3.7	3.1	3.4
Gross wage growth (% y/y	5.1	7.3	6.7	6.9
Unemployment (%)	9.1	8.4	7.7	7.1

Source: Macrobond Financial, Danske Bank Markets estimates

Brexit has so far not had a limited impact on economic sentiment in the Baltics



Source: European Commission, Macrobond Financial

Russia – delayed recovery

Macro outlook

- According to the confirmed preliminary data, Russia's GDP shrank 0.6% y/y in Q2 16 versus a 1.2% y/y fall in Q1 16. Details by economic activity have been published and show agriculture expanded 2% y/y and manufacturing, mining and quarrying expanded by 0.3% y/y, while construction shrank 9.5% y/y and wholesale and retail fell 1.2%.
- Preliminary seasonally adjusted data for August shows 0.3% m/m GDP expansion for the first time since September 2015. We keep our GDP growth forecasts at -0.6% y/y for 2016 (given the Brent year average of USD48.6/bl) and 1.2% y/y for 2017.
- On 16 September, S&P upgraded its outlook on Russia's credit rating to 'stable' from 'negative', as external risks have diminished and it expects economic growth in coming years.
- The demand side is still in negative territory, while real wage growth remains unsustainable despite low unemployment and ongoing disinflation. We see consumer demand turning positive in late Q4 16 and early 2017.

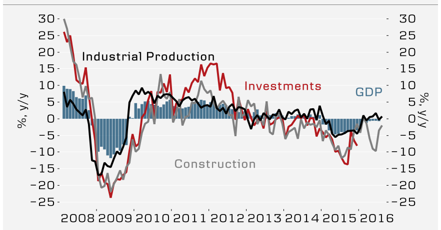
FX and monetary policy outlook

- On 16 September, Russia's central bank (CBR) cut its key rate by 50bp to 10.0%, in line with consensus and our expectation. Yet, contrary to market pricing and economists' expectations, the CBR's statement and governor Elvira Nabiullina's press conference notably emphasised that 'the current key rate needs to be maintained till end-2016 with a possibility to cut it in Q1-Q2 17', which we see as the cornerstone of the CBR's message on Russia's short-and medium-term monetary policy. Thus, we expect the next window for a cut to open by the end Q1 17.
- Inflation fell from 9.8% y/y in January to 6.6% y/y as of 12 September. Given a stabilisation in crude prices and balanced RUB exchange rate, our model signals that CPI will decline by under 6.0% y/y in December 2016.
- We continue to be moderately bullish on the RUB in the long term, rolling the forecasts as the Fed's dovishness and resilient Chinese data are supportive for emerging markets globally. We see the RUB being in a win-win situation. If Donald Trump wins, many investors will take RUB positions. If Hillary leads, investors' position is likely to be on emerging markets in general and the RUB follows the lead.

Risk factors

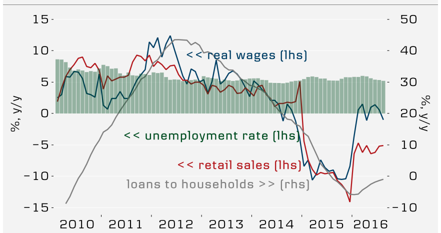
- Downside risks for the RUB include the Fed anticipating a rate hike in December 2016. We do not expect the revoking of sanctions. An escalation of geopolitical issues and a tumbling oil price are downside risks to our GDP growth forecasts.

Main macro indicators heading to zero



Source: Macrobond Financial, Danske Markets

Consumer demand still weak



Source: Macrobond Financial, Danske Markets

RUB

Credit rating:

S&P: BB+ (stable)

Currency regime:

Free float

Inflation target:

4% by the end of 2017

Macro forecasts

	2014	2015	2016E	2017E
Real GDP (% y/y)	0.6	-3.7	-0.6	1.2
Private consumption, real (% y/y)	1.3	-10.1	-4.5	2.0
Fixed investments, real (% y/y)	-2.0	-7.6	-6.0	2.8
Brent oil price (USD, average)	99.5	53.6	48.6	52.3
Brent oil price (% y/y)	-8.5	-46.1	-9.3	7.5
Exports in USD (% y/y)	-4.9	-31.8	-26.0	6.2
Imports in USD (% y/y)	-9.8	-37.0	-11.0	1.0
MosPrime 3 months rate (% average)	10.5	13.3	11.1	8.0
CPI (% Dec/Dec)	11.4	12.9	5.5	5.1
RUB/USD (% y/y)	-15.7	-37.7	-6.4	5.8
M1 (RUB, trn)	8.3	8.1	9.3	10.2
Unemployment (%)	5.2	5.6	5.6	5.3
Budget balance (% of GDP)	0.9	-2.4	-3.0	-3.2
Current account (% of GDP)	3.2	4.0	3.2	3.8

Source: CBR, Rosstat, Bloomberg, Macrobond Financial, Danske Bank Markets estimates

Interest rate forecast

Bank of Russia (CBR)		
Policy rate	10.00	
Next meeting	28/10/2016	
Next change	-25bp	Q1 2017
End-2016	10.00	

Source: Danske Bank Markets

FX forecasts

EUR/RUB		
	Danske	Forward
28-Sep	71.64	
+3M	70.56	72.61
+6M	68.40	74.40
+12M	67.38	77.83
USD/RUB		
	Danske	Forward
28-Sep	64.01	
+3M	63.00	64.47
+6M	60.00	65.77
+12M	57.10	68.21

Source: Danske Bank Markets

Turkey – slowing down on politics

Macro outlook

- Turkey's GDP growth slowed to 3.1% y/y in Q2 16 versus 4.7% y/y in Q1 16 (revised), which was worse than consensus of 3.7% y/y as tourist arrivals slumped (-41% y/y in July) and exports suffered from sanctions imposed by Russia. We continue to keep our 2.7% y/y GDP growth forecast for 2016 unchanged, staying under consensus, which is declining from month to month (current 3.3% y/y).
- Ratings agencies have downgraded Turkey's sovereign debt rating or lowered the country's outlook following the coup attempt in July 2016 raising concerns about high political uncertainty. On 20 July, S&P cut its rating to 'BB' (outlook 'negative'). In August, Fitch affirmed its rating at 'BBB-' while lowering its outlook to 'negative' from 'stable'. Moody's Investors Service cut Turkey's rating to junk on 24 September, pointing to risks related to external financing as economic growth is slowing down.
- While the current account balance remained in negative territory, posting a USD2.6bn deficit in July, it improved slightly from an almost USD5bn deficit a month earlier, as Turkey benefited from the global emerging market rally inflows in early July before the coup attempt happened. We expect the current account deficit to expand to around 5% of GDP in 2016, from 4.5% in 2015, as rising oil prices and shrinking exports (mainly of services) weigh on the balance.

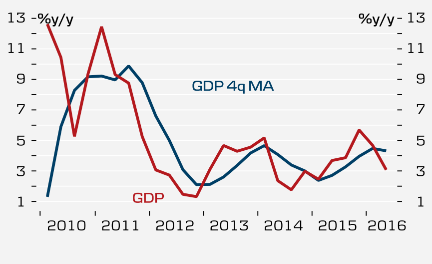
FX and monetary policy outlook

- Inflation spiked over 8.7% as the TRY fell on fears of increasing political uncertainty, declining to 8.1% in August. The Turkish central bank kept its policy rate unchanged at 7.50% in September, in line with both our estimate and consensus, while the overnight lending rate saw a 25bp cut, which was also widely expected. While the TRY weakness goes on, we expect the central bank to stay hawkish and independent.
- Given the political uncertainty and wide current account deficit on a rising oil price, we expect USD/TRY to stay at 2.98 in 1M, 3.05 in 3M, 3.07 in 6M and 3.15 in 12M.

Risk factors

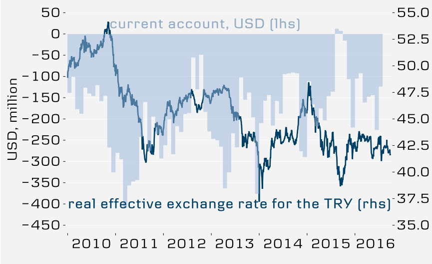
- Risks for Turkey's economy emerge from unexpected moves by President Recep Tayyip Erdoğan in internal politics, the negotiations with the EU, rate hikes, oil price increases and a deterioration of the geopolitical situation. Global drivers such as a possibly hawkish Fed do have some impact on economic growth through the rise in volatility in local financial markets and increasing financial burden.

Turkey's GDP growth slows down



Source: Macrobond Financial

Current account deficit remains wide on weak exports



Source: Macrobond Financial

TRY

Credit rating:

S&P: BB (negative)

Currency regime:

Free float

Inflation target:

5.0%±2pp year-end 2016-18

Macro forecasts

	2014	2015	2016E	2017E
Real GDP (% y/y)	2.9	3.9	2.7	3.0
Private consumption, real (% y/y)	1.3	3.6	3.0	3.3
Fixed investments, real (% y/y)	-1.0	3.8	3.0	3.1
CPI (% Dec/Dec)	8.9	8.8	7.6	6.8
Unemployment (%)	10.4	10.3	10.3	9.5
Current account (% of GDP)	-5.4	-4.5	-5.0	-4.8

Source: Bloomberg, Danske Bank Markets

Interest rate forecasts

C.B. of the Republic of Turkey (TCMB)	
Policy rate	7.50
Next meeting	20/10/2016
Next change	Unchanged 2016
End-2016	7.50

Source: Danske Bank Markets

FX forecasts

EUR/TRY		
	Danske	Forward
28-Sep	3.34	
+3M	3.42	3.41
+6M	3.50	3.49
+12M	3.72	3.65
USD/TRY		
	Danske	Forward
28-Sep	2.99	
+3M	3.05	3.03
+6M	3.07	3.08
+12M	3.15	3.20

Source: Macrobond Financial, Danske Bank Markets

South Africa – crucial rating review ahead

Macro outlook

- South Africa continues to struggle with the aftermath of the collapse in commodity prices. Real GDP growth rebounded to 0.6% y/y in Q2 16 after a weak Q1. The major sectors leading the rebound were mining and manufacturing. Indicators in Q3 are pointing to a more subdued growth picture as PMI dropped sharply together with business confidence in August. We maintain our economic forecast, projecting real GDP to slow to 0.5% in 2016 and recover to 1.3% in 2017. On a more positive note, the higher gold prices are improving South Africa's terms of trade and the current account deficit narrowed to 3.1% of GDP in Q2 16 versus 5.3% of GDP in Q1.

- Politically, there is significant uncertainty about the future of the finance minister Pravin Gordhan, given his ongoing police investigation. This questions the ability to implement fiscal consolidation and growth-friendly reforms, which are critical to avoid a downgrade by S&P to junk status before December given the agency's negative outlook. The government plans to present a medium-term plan in October. We expect the government to adopt the plan and for Gordhan to stay, but it is a close call whether the country can avoid a downgrade (the market is probably pricing in a 50% chance of a downgrade).

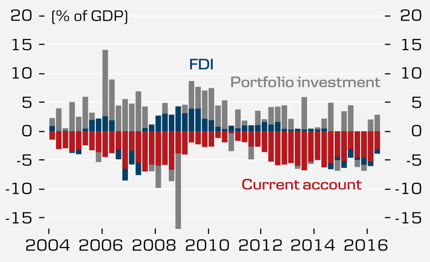
Monetary policy outlook

- As expected, the South African Reserve Bank (SARB) kept its benchmark repo rate unchanged at 7% on 22 September. This comes after a significant fall in inflation, which dropped from 7% in February to 5.9% in August, i.e. just within the inflation target band of 3.5-6%. We continue to believe that a relatively stable ZAR and idle capacity in the economy should reduce inflation pressures further. Hence, we expect the SARB to remain on hold for the time being but to begin an easing cycle at some stage in H1 17, provided inflation remains safely in the target band.

FX outlook

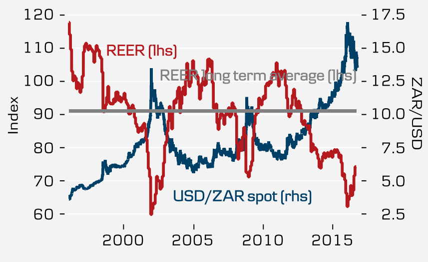
- The ZAR has been a top performer among EM currencies over the past three months. We did have a bullish view in the medium term (due to the ZAR being highly undervalued) but the size and timing of the strengthening has been a bit of a surprise to us. We think South Africa will muddle through with a reasonably strong medium-term plan and avoid a downgrade in 2016 and in addition, we expect the Fed to remain on hold this year; as a result we see the USD/ZAR trading at 13.8 on 3M, 14.2 on 6M and 14.5 on 12M. However, should South Africa be downgraded and Gordhan possibly lose his job, then the ZAR may weaken by about 10% as such an outcome is not fully priced in by the market.

CA deficit has finally started to narrow...



Source: Macrobond Financial

...given the ZAR is still in undervalued territory despite recent gains



Source: Macrobond Financial

ZAR

Credit rating:

S&P: BBB- (negative)

Currency regime:

Free float (freely convertible)

Inflation target:

3-6%

Macro forecasts

	2015	2016	2017	2018
GDP (% y/y)	1.3	0.5	1.3	2.1
GDP deflator (% y/y)	4.0	6.8	6.5	6.6
CPI (% y/y)	4.5	6.5	6.3	6.4
Private consumption (% y/y)	1.6	0.5	0.8	1.7
Fixed investments (% y/y)	1.4	0.9	0.9	1.7
Unemployment (%)	24.5	27.4	28.1	28.4
Current account (% of GDP)	-5.8	-5.1	-5.0	-4.7

Source: Bloomberg, Danske Bank Markets

Interest rate forecast

South African Reserve Bank (SARB)	
Policy rate	7.00
Next meeting	24/11/2016
Next change	Unchanged 2016
End-2016	7.00

Source: Danske Bank Markets

FX forecasts

EUR/ZAR		
	Danske	Forward
28-Sep	15.29	
+3M	15.46	15.62
+6M	16.19	15.96
+12M	17.11	16.65
USD/ZAR		
	Danske	Forward
28-Sep	13.66	
+3M	13.80	13.87
+6M	14.20	14.11
+12M	14.50	14.59

Source: Macrobond Financial, Danske Bank Markets

Brazil – now new government has to deliver

Macro outlook

- There are tentative signs that the recession in the Brazilian economy is abating. Real GDP fell by 3.8% y/y in Q2 versus a fall of 5.4% y/y in Q1. Short-term indicators such as retail sales and industrial production are suggesting that the economy has bottomed in Q3. As a result, we raise our real GDP growth forecast to -3.5% and 1.4% in 2016 and 2017 respectively (from -3.8% and 1.2% previously and Bloomberg consensus of -3.4% and 1.0%).
- The new government led by vice-president Temer is facing a huge challenge in improving the public finances and reinvigorating economic growth. The first priority is implementing a fiscal spending cap with a proposal now being reviewed by a parliamentary committee with a target of getting the cap approved in parliament as early as October. Another priority is a privatisation programme to reduce state involvement in the economy and pay down public debt. Getting these programmes approved is a very important litmus test for the new government.

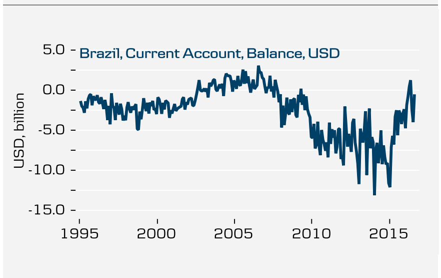
Monetary policy outlook

- The new central bank governor Ilan Goldfajn, who was sworn in as Brazil's central bank president in June, has come across as a hawk. The central bank (BCB) kept its leading Selic rate constant at 14.25% on 31 August. However, inflation pressures have started to ease with the stabilisation in the BRL and the increasing slack in the economy. Dependent on approval of the fiscal spending cap, we think the BCB will cut its policy rate, maybe not at the October meeting as we previously expected, but surely at the November meeting.

FX outlook

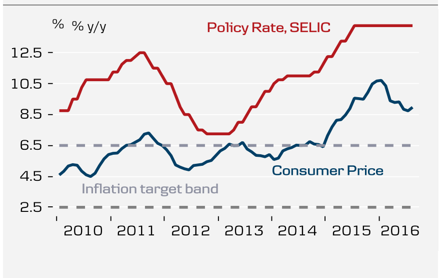
- Our out-of-consensus call for a strengthening of the BRL vis-à-vis the USD over the past few months has proved right (although admittedly the strengthening was stronger than we expected). The real is now in line with its fair value. Looking ahead, we think that the BRL will continue to perform relatively well in the near term due to both solid iron ore demand from China, fiscal consolidation and a hawkish central bank policy. However, over time, the real will face upward pressure from declining but still high inflation and a possible Fed tightening. As a result, our USD/BRL forecast is 3.25 in 1M, 3.30 in 3M, 3.40 in 6M and 3.45 in 12M. The most important negative risks are the failure to pass fiscal consolidation measures and early tightening by the Fed in December 2016.

External imbalances are improving fast...



Source: Macrobond Financial

...and the monetary policy stance seems reasonably tight



Source: Macrobond Financial

BRL

Credit rating:

S&P: BB (negative)

Currency regime:

Free float (non-convertible)

Inflation target:

4.5% +/- 2% points

Macro forecasts

	GDP		Inflation	
	Danske	Consensus	Danske	Consensus
2015	-3.8	-3.8	9.0	9.0
2016	-3.5	-3.5	8.0	8.8
2017	1.4	1.0	5.0	5.6

Source: Bloomberg, Danske Bank Markets

Interest rate forecasts

Central Bank of Brazil (BCB)		
Policy rate	14.25	
Next meeting	19/10/2016	
Next change	-25bp	November 2016
End-2016	14.00	

Source: Danske Bank Markets

FX forecasts

EUR/BRL		
	Danske	Forward
28-Sep	3.64	
+3M	3.70	3.73
+6M	3.88	3.84
+12M	4.07	4.05

USD/BRL		
	Danske	Forward
28-Sep	3.25	
+3M	3.30	3.31
+6M	3.40	3.40
+12M	3.45	3.55

Source: Macrobond Financial, Danske Bank Markets

China – CNY to continue weakening trend

Macro outlook

- The Chinese economy continued to grow 6.7% y/y in Q1 driven by a moderate recovery in the industry and construction sector. The service sector still grew robustly above 10%. The housing market has picked up over the past six months with strong home sales that has fed increasingly into higher construction activity – especially in the big so-called tier-1 cities. Fiscal stimulus through increased infrastructure spending has also been a feature of the improvement. Following the stronger activity data equity markets have recovered from the sharp declines in January.
- Looking ahead, we look for a continued gradual recovery in the rest of 2016 as construction and infrastructure continue to underpin growth. Exports are benefiting from a 10% weakening of the trade-weighted CNY. Infrastructure investment is supported by fiscal stimulus but this is set to fade a bit in H2 and 2017. We expect the consumption and service sector growth to remain fairly robust. The Chinese government's growth target for 2016 is 6.5-7%. Our forecast for GDP growth is unchanged at 6.7% for 2016 and 6.6% for 2017.
- China continues to face medium-term challenges from a still-rapid build-up of debt in the corporate sector, overcapacity in certain sectors and a difficult rebalancing of growth from industry to service/consumption. China will need to slow down the build-up of debt sooner or later but, for now, we believe the government has the tools to deal with the debt and a recapitalisation of the banks should avert a banking crisis. However, a need for deleveraging will dampen the medium-term growth potential. China is still competitive as witnessed by a significant current account surplus of 3% of GDP and a continued gain of market shares on global export markets.

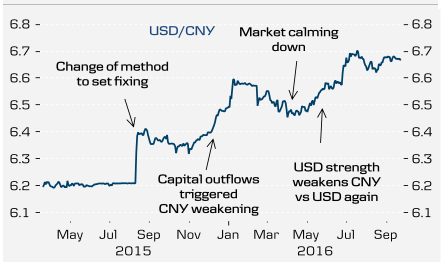
Monetary policy outlook

- The People's Bank of China (PBoC) has an easing bias but is signalling that monetary policy is on hold due to worries over (a) increasing leverage in the financial markets and (b) regional housing bubbles. Fiscal policy is the preferred tool to fine-tune growth. However, looking into next year, growth is likely to taper off a bit again and a new rate cut cycle is in the pipeline at some point during H1. Inflation is still subdued below 2% – far from the 3% target.

FX outlook

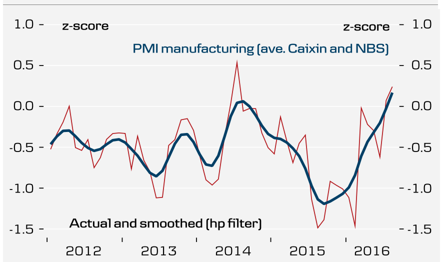
- China saw significant CNY selling pressure in January but managed to stabilise outflows by pushing up offshore (CNH) money market rates. Better economic data has since kept markets calm also. We expect the CNY to continue a gradual depreciation path due to (a) a need for further easing of monetary policy in 2017 while the Fed is projected to hike, (b) a deterioration in net FDI flows and (c) concern over the high debt. We look for a move towards 7.1 in +12M versus the USD, a depreciation of around 5% and an increase in EUR/CNY to 8.38 +12M (more than 10% weakening).

Pressure on CNY has eased



Source: Macrobond Financial

Chinese economy recovered in H1



Source: Macrobond Financial

CNY

Credit rating:

S&P: AA- (negative)

Currency regime:

Managed exchange rate versus basket

Inflation target:

3.0% for 2016

Macro forecasts

	GDP		Inflation	
	Danske	Consensus	Danske	Consensus
2015	6.9	6.9	1.4	1.4
2016	6.7	6.5	2.0	2.0
2017	6.6	6.3	1.9	2.0

Source: Danske Bank Markets, Bloomberg

Interest rate forecast

People's Bank of China (PBOC)	
Policy rate	4.35
Next meeting	No regular meetings
Next change	- 25 bp Q2 2017
End-2016	4.35

Source: Danske Bank Markets

FX forecasts

EUR/CNY		
	Danske	Forward
28-Sep	7.47	
+3M	7.56	7.54
+6M	7.81	7.59
+12M	8.38	7.68

USD/CNY		
	Danske	Forward
28-Sep	6.67	
+3M	6.75	6.70
+6M	6.85	6.71
+12M	7.10	6.73

Source: Macrobond Financial, Danske Bank Markets

India – a murky picture

Macro outlook

- India's GDP growth was 7.1% y/y in Q2, still one of the highest rates in the world. However, there are some reasons to think that this is too good to be true. Car sales have been broadly flat for five years having grown steadily in the previous decade. Both import and export growth is hovering around zero, as is industrial production growth. Hence we believe that economic activity is much more subdued than the official numbers show. There are some tentative signs of improvement over the past quarters though.
- India's external balance has become more positive as the current account deficit has declined over the past two years to close to 1% of GDP – partly a reflection of better terms of trade due to the big decline in the price of commodity imports. The fiscal deficit is still too high, around 7% of GDP. Overall though, India is no longer regarded as among the 'fragile' emerging markets.

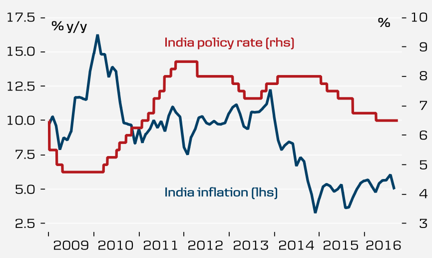
Monetary policy outlook

- The Reserve Bank of India (RBI) has kept rates unchanged since the rate cut in April by 25bp. RBI is targeting consumer price inflation within 4% +/-2%. It is a gradual adjustment with the target for Jan-2016 being below 6%. For Mar-2017 the target is 5%. Inflation is currently at 5.0% and thus in line with the target. In late August it was announced that Dr. Urjit Patel would become the new governor of the RBI replacing Dr. Raghuram Rajan. He took office on 4 September. However, as he has similar views as Dr. Rajan and served as the Deputy Governor since January 2013, policy continuity is expected. We look for India to cut rates further in October by 25bp.

FX outlook

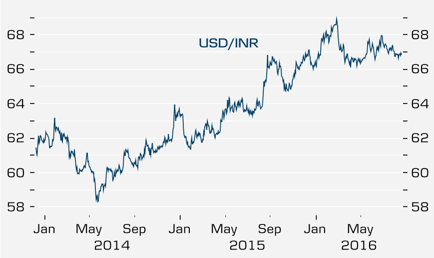
- The change of governor has had little impact on the INR which has moved broadly sideways against the USD this year as EM sentiment has improved somewhat and the Fed has been fairly dovish. However, the medium trend is still expected to be a gradual weakening of the INR as inflation is running above the US and the Reserve Bank of India has an easing bias, whereas the Fed is tightening policy. We look for a move in USD/INR to 68.5 +3M, 69.0 +6M and 70 +12M.

Inflation below target should pave the way for another rate cut in October



Source: Macrobond Financial, Danske Bank Markets

INR sideways but long-term trend is still for gradual weakening



Source: Macrobond Financial, Danske Bank Markets

INR

Credit rating:

S&P: BBB- (stable)

Currency regime:

Free float

Inflation target:

4% by end-2017

Macro forecasts

	GDP		Inflation	
	Danske Bank	Consensus	Danske Bank	Consensus
2015	7.3	7.3	5.9	5.0
2016	7.4	7.5	5.7	5.2
2017	7.5	7.6	4.5	5.1

Source: Danske Bank Markets, Bloomberg

Interest rate forecast

Reserve Bank of India (RBI)	
Policy rate	6.5
Next meeting	4 October 2016
Next change	-25bp Oct 2016
End-2016	6.25

Source: Danske Bank Markets

FX forecasts

EUR/INR		
	Danske	Forward
28-Sep	74.43	
+3M	76.72	75.46
+6M	78.66	76.94
+12M	82.60	79.98
USD/INR		
	Danske	Forward
28-Sep	66.50	
+3M	68.50	67.00
+6M	69.00	68.02
+12M	70.00	70.09

Source: Macrobond Financial, Danske Bank Markets

FX hedging

CNY depreciation trend set to continue in coming years

China has made two important changes to policy over the past year. First, the daily reference rate has become more market based. Second, the CNY is managed against a basket of currencies rather than the USD. China aims for a stable currency around the equilibrium level but has not been explicit about the extent of fluctuation it will tolerate.

We look for continued CNY and CNH to weaken gradually against the USD as the Fed resumes raising rates and China resumes easing monetary policy in 2017. We expect USD/CNY to increase to 7.10 in 12 months, while we look for EUR/CNY to increase to 8.38 in 12 months, which is 6% weaker than the 12 months forward rate.

CNH money market rates start normalisation

The CNH-CNY spread has been quite stable after calm was restored in February. We expect the spread to stay at around zero or slightly above throughout the forecast horizon. Hence, basis risk in hedging CNY exposure through CNH is expected to be limited. If the spread moves out, the PBoC is likely to use higher CNH money market rates (by draining liquidity) to pull it down close to zero again.

We recommend hedging CNY exposure through the CNH market as the liquidity is better than in the CNY NDF market.

CNY hedge recommendations

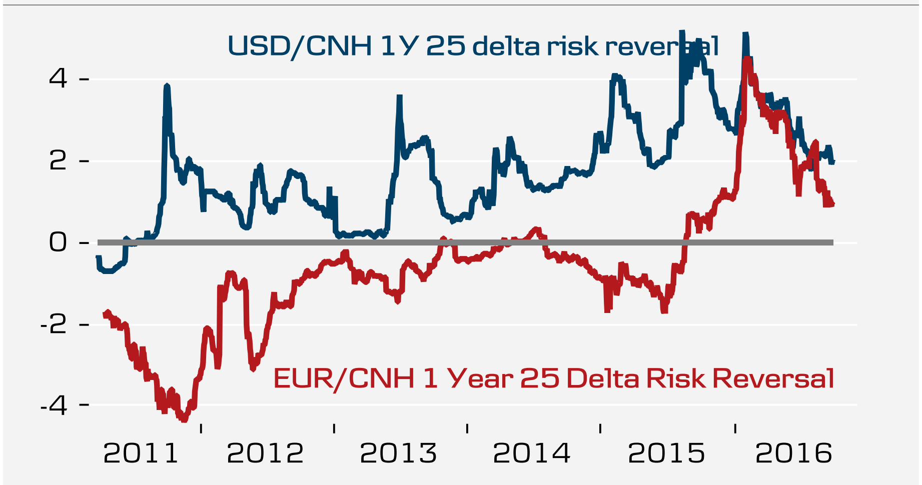
CNY receivables

As we look for continued CNY and CNH weakening in the medium to long term we recommend both EUR- and USD-based clients hedge CNY receivables via USD/CNH respectively EUR/CNH FX forwards.

CNY payables

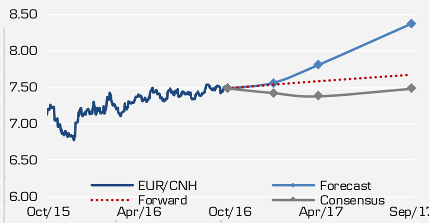
We recommend EUR- and USD-based clients to hedge CNY payables via options that maintain a profit potential in the event of further CNY weakening, while securing a worst-case exchange rate. Specifically, we recommend to hedge CNY payables via risk reversals which benefits from the positive carry and the skewed pricing between 25 delta USD/CNH call and put options and EUR/CNH call and put options, respectively.

EUR/CNH and USD/CNH risk reversals



Source: Bloomberg, Danske Bank Markets

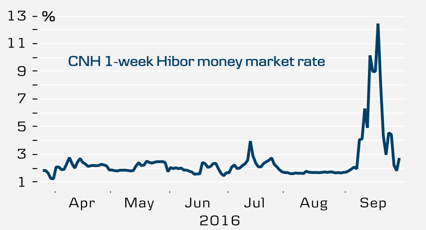
FX forecasts



	3M	6M	12M
DB forecast	7.56	7.81	8.38
Forward	7.54	7.59	7.68
Cons. Forecast	7.42	7.38	7.48

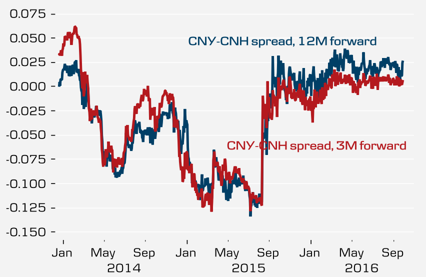
Source: Bloomberg, Danske Bank Markets

1-week CNH Hibor rate coming down



Source: Bloomberg, Danske Bank Markets

CNY-CNH spread has stabilised



Source: Bloomberg, Danske Bank Markets

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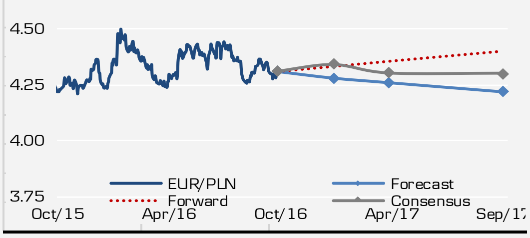
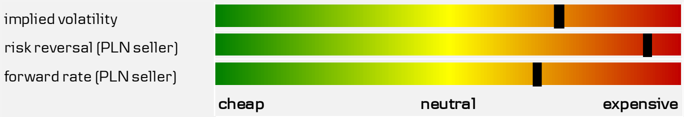
Danske Bank Markets' hedging recommendations: EMEA

Currency	Instrument: Income	Instrument: Expenses	Forecast
PLN	We recommend hedging PLN income via knock-in forwards.	We recommend hedging PLN expenses with a risk-reversal strategy.	

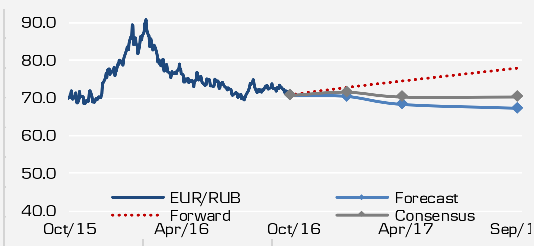


	3M	6M	12M
DB forecast	4.28	4.26	4.22
Forward	4.33	4.35	4.40
Cons. Forecast	4.34	4.30	4.30

Price indicators

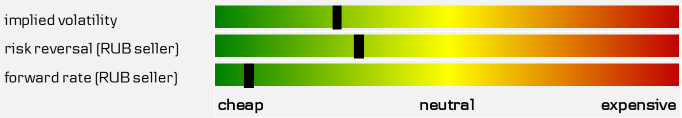


Currency	Instrument: Income	Instrument: Expenses	Forecast
RUB	We recommend hedging RUB-income via knock-in forwards.	We recommend hedging RUB expenses via risk-reversal strategies.	

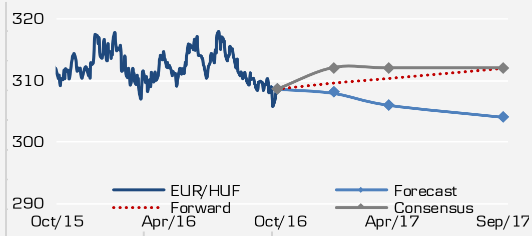


	3M	6M	12M
DB forecast	70.56	68.40	67.38
Forward	72.73	74.50	77.98
Cons. Forecast	71.50	70.37	70.39

Price indicators

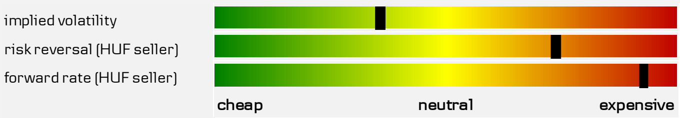


Currency	Instrument: Income	Instrument: Expenses	Forecast
HUF	We recommend hedging HUF-income via FX forwards.	We recommend hedging HUF-expenses via risk-reversal strategies.	

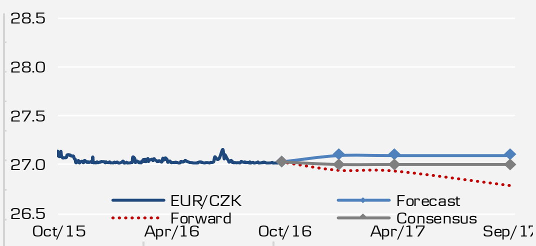


	3M	6M	12M
DB forecast	308.00	306.00	304.00
Forward	309.67	310.42	312.02
Cons. Forecast	312.04	312.00	311.99

Price indicators

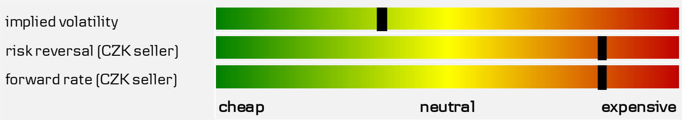


Currency	Instrument: Income	Instrument: Expenses	Forecast
CZK	We recommend hedging CZK income via risk-reversals.	We recommend hedging CZK expenses via a knock-in forward strategy.	



	3M	6M	12M
DB forecast	27.10	27.10	27.10
Forward	26.94	26.93	26.79
Cons. Forecast	27.00	27.00	27.00

Price indicators

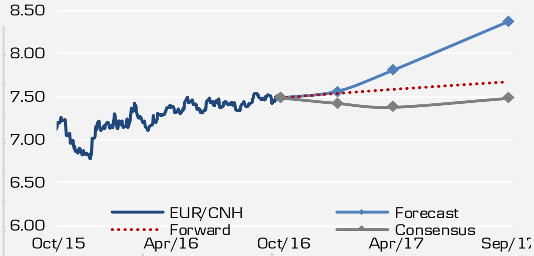


Source: Danske Bank Markets

Danske Bank Markets' hedging recommendations: other emerging markets

Currency	Instrument – Income	Instrument – Expenses
CNH	We recommend hedging CNH-income via FX forwards.	We recommend hedging CNY payables via a risk-reversal strategy.

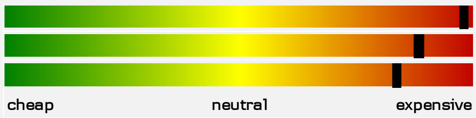
Forecast



	3M	6M	12M
DB forecast	7.56	7.81	8.38
Forward	7.54	7.59	7.68
Cons. Forecast	7.42	7.38	7.48

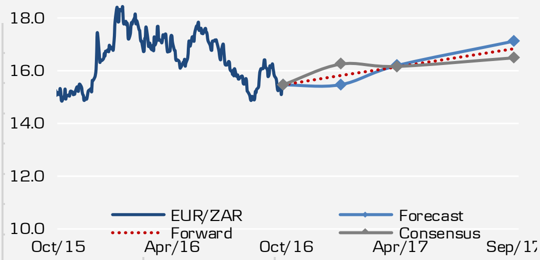
Price indicators

implied volatility
risk reversal (CNH seller)
forward rate (CNH seller)



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

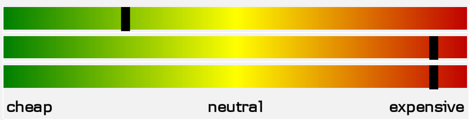
Forecast



	3M	6M	12M
DB forecast	15.46	16.19	17.11
Forward	15.82	16.16	16.87
Cons. Forecast	16.25	16.17	16.49

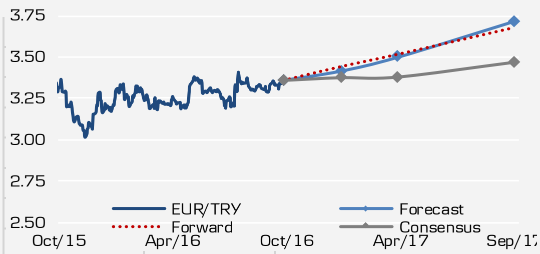
Price indicators

implied volatility
risk reversal (ZAR seller)
forward rate (ZAR seller)



Currency	Instrument – Income	Instrument – Expenses
TRY	Hedge TRY income via FX forwards.	We recommend hedging TRY expenses via knock-in forwards.

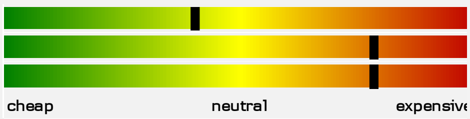
Forecast



	3M	6M	12M
DB forecast	3.42	3.50	3.72
Forward	3.44	3.52	3.68
Cons. Forecast	3.38	3.38	3.46

Price indicators

implied volatility
risk reversal (TRY seller)
forward rate (TRY seller)



Source: Danske Bank Markets

FX forecasts

Core – major

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
EUR	28-Sep			1.12		745.2		963.2		906.4	
	+3M			1.12	1.13	744.3	745.0	930.0	959.4	930.0	904.9
	+6M			1.14	1.13	744.3	744.6	930.0	958.1	910.0	908.2
	+12M			1.18	1.14	744.3	744.0	910.0	958.1	890.0	914.9
USD	28-Sep	1.12				665.9		860.6		809.8	
	+3M	1.12	1.13			664.5	661.5	830.4	851.8	830.4	803.4
	+6M	1.14	1.13			652.9	658.2	815.8	847.0	798.2	802.9
	+12M	1.18	1.14			630.7	652.1	771.2	839.7	754.2	801.8
JPY	28-Sep	112.7		100.7		6.61		8.55		8.04	
	+3M	114.2	113.0	102.0	100.4	6.51	6.59	8.14	8.49	8.14	8.01
	+6M	118.6	112.9	104.0	99.9	6.28	6.59	7.84	8.48	7.68	8.04
	+12M	122.7	112.9	104.0	99.0	6.06	6.59	7.42	8.49	7.25	8.10

Source: Macrobond Financial, Danske Bank Markets

Wider CEE

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	28-Sep	4.29		3.84		173.6		224.3		211.1	
	+3M	4.28	4.32	3.82	3.83	173.9	172.6	217.3	222.3	217.3	209.7
	+6M	4.26	4.34	3.74	3.83	174.7	171.6	218.3	220.9	213.6	209.4
	+12M	4.22	4.38	3.58	3.84	176.4	170.0	215.6	218.9	210.9	209.0
HUF	28-Sep	308.3		275.4		2.42		3.12		2.94	
	+3M	308.0	308.4	275.0	273.8	2.42	2.42	3.02	3.11	3.02	2.93
	+6M	306.0	308.9	268.4	273.1	2.43	2.41	3.04	3.10	2.97	2.94
	+12M	304.0	310.0	257.6	271.7	2.45	2.40	2.99	3.09	2.93	2.95
CZK	28-Sep	27.02		24.14		27.58		35.64		33.54	
	+3M	27.10	26.97	24.20	23.94	27.46	27.63	34.32	35.57	34.32	33.55
	+6M	27.10	26.87	23.77	23.75	27.46	27.72	34.32	35.66	33.58	33.81
	+12M	27.10	26.72	22.97	23.42	27.46	27.85	33.58	35.86	32.84	34.24

Source: Macrobond Financial, Danske Bank Markets

CIS

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
RUB	28-Sep	71.64		64.01		10.40		13.44		12.65	
	+3M	70.56	72.61	63.00	64.47	10.55	10.26	13.18	13.21	13.18	12.46
	+6M	68.40	74.40	60.00	65.77	10.88	10.01	13.60	12.88	13.30	12.21
	+12M	67.38	77.83	57.10	68.21	11.05	9.56	13.51	12.31	13.21	11.76

Source: Macrobond Financial, Danske Bank Markets

MEA

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
TRY	28-Sep	3.34		2.99		223.0		288.3		271.3	
	+3M	3.42	3.41	3.05	3.03	217.9	218.3	272.2	281.1	272.2	265.2
	+6M	3.50	3.49	3.07	3.08	212.7	213.5	265.7	274.8	260.0	260.5
	+12M	3.72	3.65	3.15	3.20	200.2	204.0	244.8	262.7	239.4	250.8
ZAR	28-Sep	15.29		13.66		48.7		63.0		59.3	
	+3M	15.46	15.62	13.80	13.87	48.2	47.7	60.2	61.4	60.2	57.9
	+6M	16.19	15.96	14.20	14.11	46.0	46.7	57.4	60.0	56.2	56.9
	+12M	17.11	16.65	14.50	14.59	43.5	44.7	53.2	57.6	52.0	55.0

Source: Macrobond Financial, Danske Bank Markets

Latin America

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
BRL	28-Sep	3.64		3.25		204.9		264.8		249.2	
	+3M	3.70	3.73	3.30	3.31	201.4	199.7	251.6	257.2	251.6	242.6
	+6M	3.88	3.84	3.40	3.40	192.0	193.8	239.9	249.3	234.8	236.3
	+12M	4.07	4.05	3.45	3.55	182.8	183.8	223.5	236.7	218.6	226.1

Source: Macrobond Financial, Danske Bank Markets

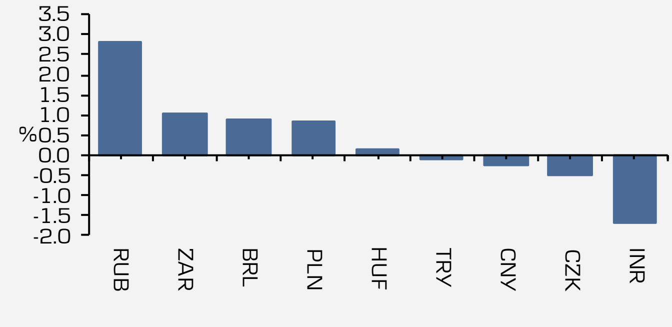
Emerging markets Asia

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
CNY	28-Sep	7.47		6.67		99.8		128.9		121.3	
	+3M	7.56	7.54	6.75	6.70	98.4	98.8	123.0	127.2	123.0	120.0
	+6M	7.81	7.59	6.85	6.71	95.3	98.1	119.1	126.2	116.5	119.6
	+12M	8.38	7.68	7.10	6.73	88.8	96.8	108.6	124.7	106.2	119.1
INR	28-Sep	74.43		66.50		10.01		12.94		12.18	
	+3M	76.72	75.46	68.50	67.00	9.70	9.87	12.12	12.71	12.12	11.99
	+6M	78.66	76.94	69.00	68.02	9.46	9.68	11.82	12.45	11.57	11.80
	+12M	82.60	79.98	70.00	70.09	9.01	9.30	11.02	11.98	10.77	11.44

Source: Macrobond Financial, Danske Bank Markets

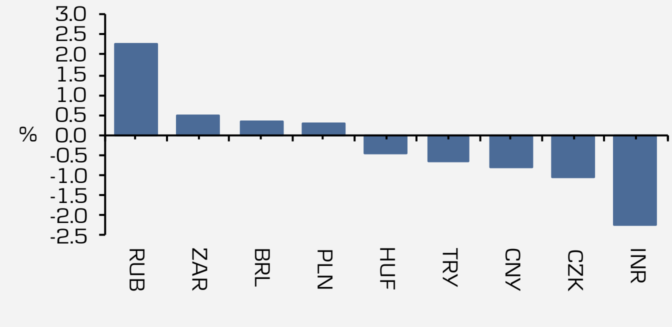
Forecasts vs forwards

3M – base currency EUR



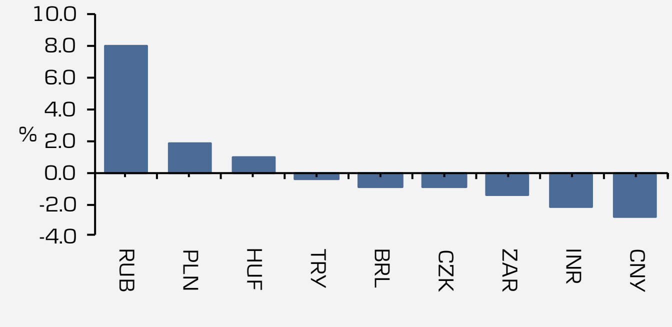
Source: Macrobond Financial, Danske Bank Markets

3M – base currency USD



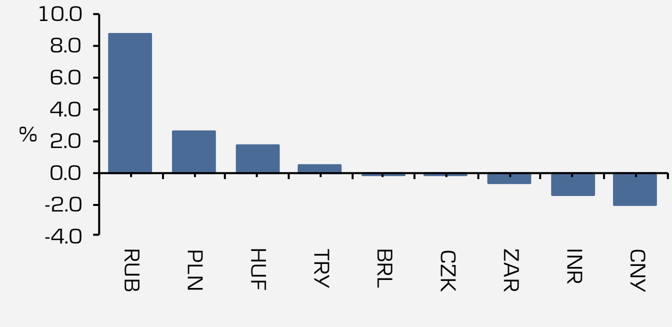
Source: Macrobond Financial, Danske Bank Markets

6M – base currency EUR



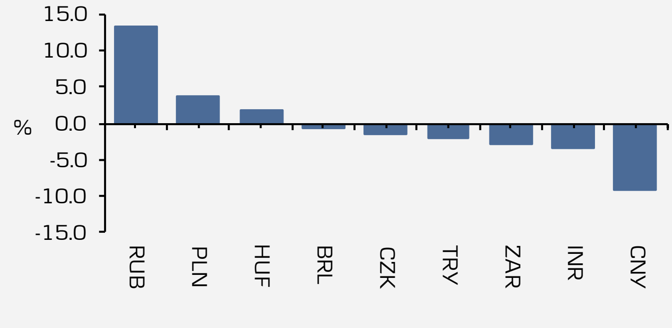
Source: Macrobond Financial, Danske Bank Markets

6M – base currency USD



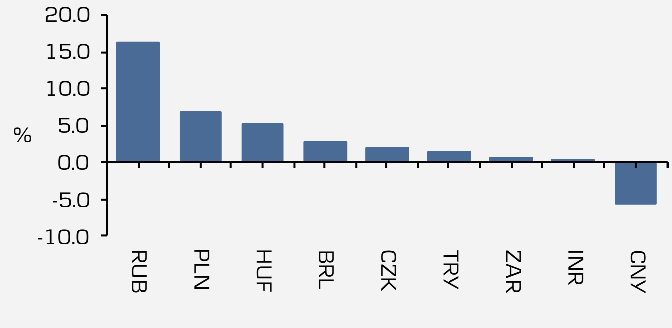
Source: Macrobond Financial, Danske Bank Markets

12M – base currency EUR



Source: Macrobond Financial, Danske Bank Markets

12M – base currency USD



Source: Macrobond Financial, Danske Bank Markets

Monetary policy calendar

Calendar

	Policy Rate (%)	Latest Change		Next Change		Next Meeting	Year-end 2016 (%)
	29 September 2016						
Wider CEE							
PLN	1.50	- 50 bp	Mar, 2015	+25bp	Q2 2017	05/10/2016	1.50
HUF	0.90	- 15 bp	May, 2016	+25bp	Q2 2017	25/10/2016	0.90
CZK	0.05	- 20 bp	Nov, 2012	-	Unchanged 2016	Not announced	0.05
TRY	7.50	-25 bp	Feb, 2015	-	Unchanged 2016	20/10/2016	7.50
CIS							
RUB	10.00	-50bp	Sep, 2016	-25bp	Q1 2017	28/10/2016	10.00
MEA							
ZAR	7.00	+ 25 bp	Mar, 2016	-	Unchanged 2016	24/11/2016	7.00
LATAM							
BRL	14.25	+ 50 bp	Jul, 2015	-25bp	November 2016	19/10/2016	14.00
EM Asia							
CNY	4.35	- 25 bp	Nov, 2015	-25bp	Q2 2017	Not announced	4.35
INR	6.50	- 25 bp	April, 2016	-25bp	October 2016	04 October 2016	6.25

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 Jakob Ekholdt Christensen (Chief Analyst), Allan von Mehren (Chief Analyst), Morten Helt (Senior Analyst), Vladimir Miklashevsky (Analyst) and Rokas Grajauskas (Analyst).

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