

Emerging Markets Monthly

Dovish NBP and external headwinds capping PLN upside

- The dovish signals from the NBP have made us a bit more cautious on the prospects of substantial tightening despite inflation staying elevated.
- Our base-case is still that they will turn more hawkish in November, but our conviction has declined. We have consequently raised the trajectory for EUR/PLN.
- Persistently elevated unit labour costs, rapid rise in US yields and Dollar or further souring of the risk sentiment remain key upside risks for EUR/PLN.

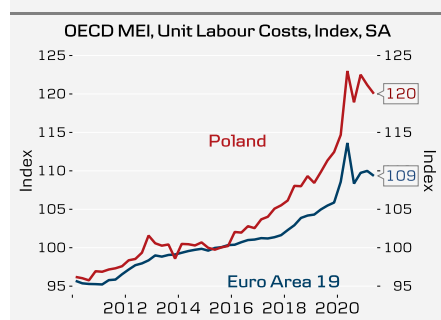
While activity in the Polish economy remains brisk, the delta variant and a stalling vaccination process have turned the NBP more cautious, challenging the market's hawkish pricing of returning to 1.0 % within one year.

We still see a case for higher rates and more hawkish NBP in November, although with less conviction. Core inflation remains above NBP's target range (1.5% to 3.5%) at 3.9% y/y, and the prolonging supply chain challenges and rising energy prices pose upside risks to near-term outlook. Rising inflation expectations and unit labor costs strengthen the view of persisting inflation beyond the pandemic's transitory effects (Chart 1). Yet, governor Glapinsky sees the price pressures as temporary and driven by supply shocks outside the remit of monetary policy. This carries considerable risk in our view as supply side driven price pressures can still lead to higher wage demands and more chronic inflation.

While we do not see the case yet for revising our expectation for the fundamental fair value of EUR/PLN, a failure to respond to higher inflation would imply a level shift higher. The real effective exchange rate of PLN is still in "undervalued" territory (chart 2) but this has been due to the weakening of the spot. The terms of trade is hit by higher gas and oil prices, which together with the rise in ULC relative to Euro Area is worsening the current account.

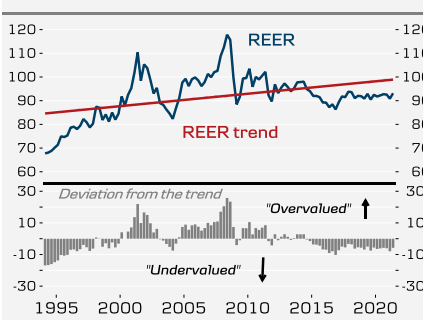
Poland's large external refinancing needs leave PLN exposed to rise in US yields/dollar. Risks of further souring in global risk sentiment, EU tensions and the Covid-situation also loom in the background, especially given NBP's focus on the pandemic developments. In light of the above we have turned more cautious on the upside potential for PLN in the latest FX update, targeting the EUR/PLN at 4.55 in 3M (instead of 4.48).

Chart 1: Elevated ULC pose an upside risk to inflation unless NBP reacts



Source: Macrobond, OECD.

Chart 2: Real Effective Exchange Rate remains below trend thanks to weaker spot



Source: Macrobond, BIS

Quick view

- EUR/PLN We expect modest strengthening of PLN given the continuing reopening of the economy and possibility of a more hawkish central bank
- EUR/HUF likely bottoming out around 350's. The hawkish central bank has likely been fairly reflected in spot now.
- EUR/CZK should go lower. Risks are tilted towards more CZK strength as economy recovers and central bank raises interest rates.
- USD/RUB has moved lower amid higher commodity prices and fading geopolitical risks related to the Ukrainian situation.
- USD/TRY to move higher as pricing of a regime shift has faded.
- USD/ZAR has moved lower as investors have been pushed to hunt for yield and amid higher commodity prices. We do not expect this to last through 2021: Chinese credit tightening & weak fundamentals are likely to become new themes.
- USD/CNY to rise from here on the back of overall USD appreciation
- USD/INR recovered after a pandemic related spike in April. Slight weakening ahead as USD strengthens

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What-to-watch: Growth, vaccines, China and elevated asset prices amid uncertainty

Global growth
Reopening of economies supported by vaccines and warmer weather boost global growth during Q2. Relative picture of Chinese outperformance will reverse in favor of US during 2021.

China
PMIs and peak in commodity prices signal that Chinese growth momentum is already moderating. We expect GDP growth to align with pre-corona trend as fiscal tightening and deleveraging continue.

spot FX price
The case for a stronger TRY is now over and we expect moderate weakening. Slowing growth in Asia with higher US yields is negative for most EM FX but we maintain a positive view on RUB.

Corona virus
While DM economies are expected to reopen during Q2, EM picture remains mixed. Most EM countries still rely on the Chinese vaccines.

Source: Danske Bank

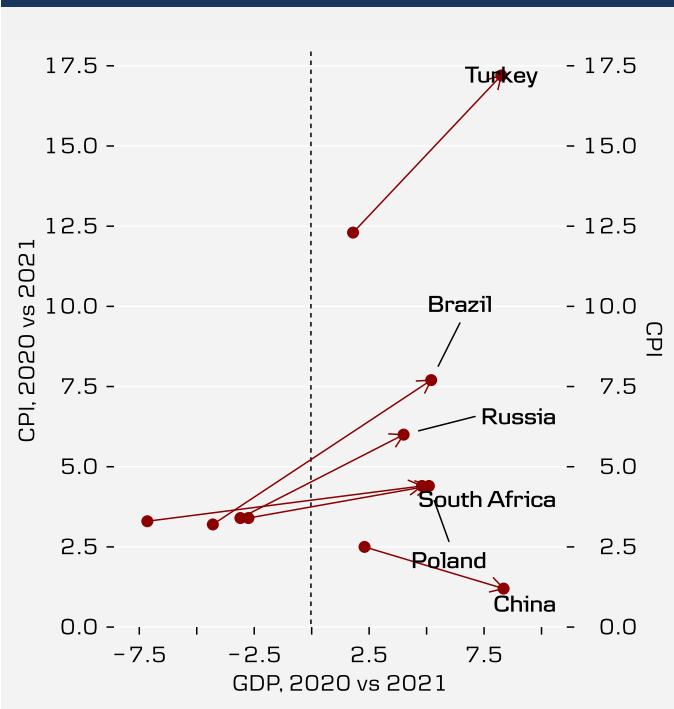
Moderating Chinese growth limits upside for commodity prices and EM FX

		2020				2021			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
External	China	Coronavirus	Fading virus impact	Recovery post-virus		China curbs credit, pace of growth comes down			
	Fed	Fed takes rates to zero, provides USD funding				Fed relatively sidelined			
	Trade war/commodities	phase 1 deal	cyclical uptick		tensions are to stay but more gradual and less disruptive				
Regions	CEE	high cpi	Corona shock	Fading virus impact	Recovery post-virus	Gradual recovery in CEE, inflation to stay			
	Latin America	Brazil weak, Mexico in recession		stabilization		Econs to remain low-growth environment			
	Asia	Coronavirus	Fading virus impact	Recovery post-virus		Asia remains relatively strong, tailwind from China fades			

Note: Green reflects optimistic outlook, red is negative and grey is a neutral view; colours reflect a broad macroeconomic view and are not necessarily FX specific.

Source: Danske Bank

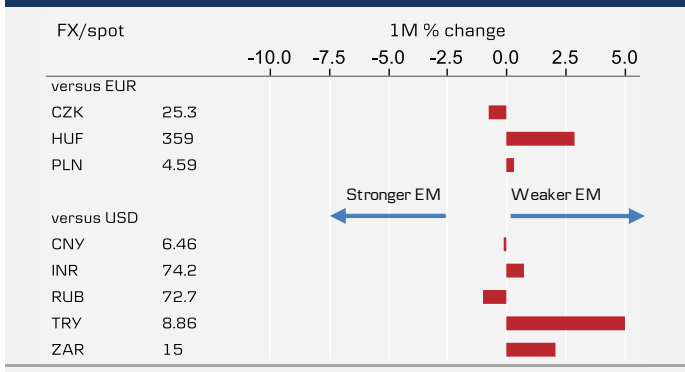
2021 generally brings GDP-recovery versus 2020



Note: Arrows indicate the change in Bloomberg consensus forecasts for growth and inflation from 2020 to 2021

Source: Bloomberg

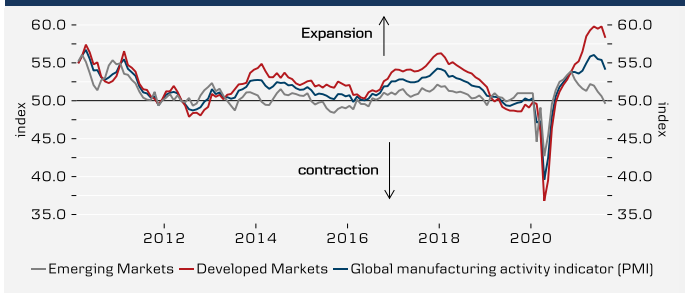
EM slightly weaker last month (after US FOMC meeting)



Note: An increase reflects a weaker currency versus EUR or USD.

Source: Bloomberg

Emerging markets staying in slight expansionary mode



Source: Bloomberg

Danske Bank EM FX forecast vs majors: USD and EUR

USD					
	Spot	+1m	+3m	+6m	+12m
USD/PLN	3,929	3,91	3,92	3,96	3,98
USD/HUF	306	306	306	316	321
USD/CZK	21,759	20,85	21,81	22,02	22,12
USD/RUB	72,684	72,00	72,00	71,00	70,00
USD/TRY	8,845	8,80	9,00	9,20	9,40
USD/ZAR	15,076	15,00	15,00	15,50	16,50
USD/CNY	6,46	6,55	6,60	6,70	6,80
USD/INR	73,84	74,50	74,50	75,00	76,00
EUR					
	Spot	+1m	+3m	+6m	+12m
EUR/PLN	4,595	4,58	4,55	4,52	4,50
EUR/HUF	358	355	355	360	363
EUR/CZK	25,4	24,4	25,3	25,1	25,0
EUR/RUB	85,0	84	84	81	79
EUR/TRY	10,35	10,3	10,4	10,5	10,6
EUR/ZAR	17,63	17,6	17,4	17,7	18,6
EUR/CNY	7,56	7,66	7,66	7,64	7,68
EUR/INR	86,4	87,2	86,4	85,5	85,9

Source: Danske Bank

Danske Bank EM FX forecast vs Scandies: DKK, SEK and NOK

DKK					
	Spot	+1m	+3m	+6m	+12m
PLN/DKK	1,62	1,62	1,64	1,65	1,65
HUF/DKK	2,08	2,09	2,10	2,07	2,05
CZK/DKK	0,29	0,30	0,29	0,30	0,30
RUB/DKK	8,75	8,83	8,91	9,20	9,41
TRY/DKK	0,72	0,72	0,71	0,71	0,70
ZAR/DKK	0,42	0,42	0,43	0,42	0,40
CNY/DKK	0,98	0,97	0,97	0,97	0,97
INR/DKK	0,086	0,085	0,086	0,087	0,087
SEK					
	Spot	+1m	+3m	+6m	+12m
PLN/SEK	2,21	2,23	2,24	2,28	2,33
HUF/SEK	2,84	2,87	2,87	2,86	2,89
CZK/SEK	0,40	0,42	0,40	0,41	0,42
RUB/SEK	0,12	0,12	0,12	0,13	0,13
TRY/SEK	0,98	0,99	0,98	0,98	0,99
ZAR/SEK	0,58	0,58	0,59	0,58	0,56
CNY/SEK	1,346	1,331	1,332	1,349	1,366
INR/SEK	0,118	0,117	0,118	0,120	0,122
NOK					
	Spot	+1m	+3m	+6m	+12m
PLN/NOK	2,19	2,25	2,29	2,35	2,33
HUF/NOK	2,81	2,90	2,93	2,94	2,89
CZK/NOK	0,40	0,42	0,41	0,42	0,42
RUB/NOK	0,12	0,12	0,12	0,13	0,13
TRY/NOK	0,97	1,00	1,00	1,01	0,99
ZAR/NOK	0,57	0,59	0,60	0,60	0,56
CNY/NOK	1,332	1,344	1,358	1,388	1,366
INR/NOK	0,117	0,118	0,120	0,124	0,122

Source: Danske Bank

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