Danske Bank
Markets

FX Forecast Update

The Trump moment

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Forecast review part I

- **EUR/NOK.** We expect the cross to move gradually lower in 2017 on normalising growth and real rates, valuation and oil markets stabilising further. In terms of the oil price-NOK relationship, we emphasise that even a stable oil price on balance should be a NOK positive. We shift our EUR/NOK profile lower, forecasting the cross at 9.00 in 1M (from 9.10.), 8.90 in 3M (9.10), 8.80 in 6M (9.00) and 8.70 in 12M (8.80).
- **EUR/SEK.** Growth momentum has turned from a headwind into a tailwind for the SEK, which is part of the reason EUR/SEK has dropped recently from above 10.00 to 9.50, our 1M target. Another more important factor is the reassessment of the Riksbank. Our base case is that the Riksbank's latest QE programme will run throughout H1 but will not be extended and that the repo rate will not be cut further. However, should the krona appreciate too rapidly or inflation disappoint, we expect a response from the Riksbank. We think that the first line of defence is to postpone the first hike further. We forecast EUR/SEK at 9.50, 9.40, 9.30 and 9.20 in 1M, 3M, 6M and 12M, unchanged from our post-Riksbank December update.
- **EUR/DKK.** The market is likely to be reluctant to buy EUR/DKK this year with high uncertainty attached to the outcome of multiple political events in Europe, while hedging of USD assets by domestic investors is likely to continue as the USD is not done rising. The downward pressure on EUR/DKK triggered selling of DKK0.7bn in FX in December by Danmarks Nationalbank (DN). Even if DKK selling by DN continues in January, it is not likely to trigger an independent Danish rate cut or a rebound in EUR/DKK towards the central rate of 7.46038. We forecast EUR/DKK at 7.4350 in 1-3M (revised down from 7.4375) and 7.4400 in 6-12M (revised down from 7.4425).
- **EUR/USD.** We still think that growth and relative rates will continue to move in favour of a stronger USD in the near term. We target EUR/USD at 1.04 in 1M (1.02 previously) and 1.05 in 3M (1.04 previously) but stress that risks are skewed to the downside in the short term, conditional on Trump and the Fed. Longer term, we maintain our long-held view that the undervaluation of the EUR and the wide eurozone-US current account differential are EUR positives, targeting the cross at 1.08 in 6M and 1.12 in 12M (both unchanged).
- **EUR/GBP.** GBP has depreciated substantially since the beginning of 2017, as markets have turned their focus back to the Brexit theme. We have lifted our 1M EUR/GBP target to 0.89 (previously 0.84) and 0.88 (0.87) in 3M but stress that the risk is skewed to the upside relative to our forecasts in coming months as the triggering of article 50, which we expect by the end of March, moves closer. Longer term, we expect EUR/GBP to stabilise within the 0.84-0.88 range targeting the cross at 0.86 in 6M and 0.86 in 12M.

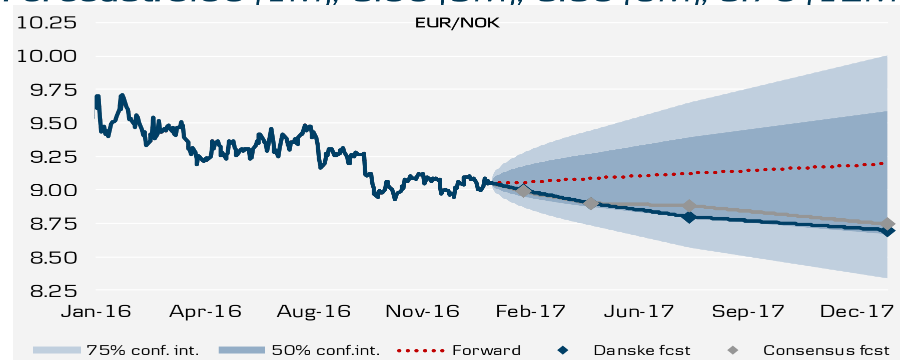
Forecast review part II

- **USD/JPY.** We still expect the JPY to continue suffering in an environment with rising global bond yields and a higher oil price and expect USD/JPY to increase further in the coming months. However, short term, momentum for additional yen weakening is likely to level off as the short JPY trade has become crowded. We target the cross at 117 in 1M (previously 121) and 118 in 3M (119). Longer term, we expect USD/JPY to stabilise, targeting 118 in 6-12M, as we expect portfolio outflows out of Japan to counter the underlying appreciation pressure on JPY stemming from fundamentals.
- **USD/CNY.** We keep our forecasts on CNY unchanged at 7.0 in 1M, 7.1 in 3M, 7.2 in 6M and 7.3 in 12M. This is higher than the forward market. While China has stepped in to stop the weakening of CNY and CNH in the short term, we expect the overall trend of a gradual weakening to continue as outflows continue, we look for slower growth in 2017 and financial risks keep rising.
- **EMEA**. The PLN and HUF have both staged a rebound over the past two weeks following the sell-off in the aftermath of Donald Trump's win in the US presidential election in November. We think that both currencies will hold on to their gains as their economic growth is continuing and they are fundamentally undervalued. However, there are significant near-term risks from the renewed global Trump reflation trade and worsening of the relations between the US and China. Our forecasts for the two currencies are: EUR/PLN is projected at 4.37 (4.42 previously) in 1M, expecting a fall to 4.35 (4.40 before) in 3M, 4.32 (4.35 before) and 4.30 in 3M, 6M and 12M, respectively. For the EUR/HUF, our forecast is 308 in 1M and 3M and then strengthening to 306 in 6M followed by 304 in 12M.
- **USD/RUB.** In 2016, the RUB was the best performer among 150 global currencies. Yet, if the stronger USD story continues in 2017 on Trump's fiscal expansion promises and the Fed's moderate tightening, it should cool the RUB's excessive appreciation. We roll our forecasts, expecting USD/RUB to hit 58.70 in 1M (previously 61.10), 56.10 in 3M (previously 60.05), 55.10 in 6M (previously 56.20) and 51.15 in 12M (previously 53.20).
- **USD/TRY.** Potential upside risks for the pair include unexpected moves by president Recep Tayyip Erdoğan in his internal policies and the central bank's too inert stance. The downside risks include a severe reaction by the central bank to halt the lira's depreciation, hiking the benchmark rate by 200-300bp. The Fed's monetary stance remains important for the pair. Fiscal expansion plans in the US and emerging market outflows could weigh on the TRY further. Given the factors listed above, we raise our USD/TRY short-, medium- and long-term forecasts significantly to 3.95 in 1M (previously 3.50), 4.15 in 3M (previously 3.60), 4.25 in 6M (previously 3.60) and 4.50 in 12M (previously 3.95).

EUR/NOK – lower in 2017

- **Growth.** Leading indicators still point to an improved growth outlook for 2017, albeit the last months' releases do point to a somewhat lower growth rate than previously indicated. We find comfort in the latest releases for the manufacturing sector, which to us limit the risk of severe second round effects. We forecast mainland growth of 1.8% in 2017 compared to 0.8% in 2016.
- **Monetary policy.** As widely expected, Norges Bank (NB) left the sight deposit rate unchanged at the December meeting whilst reiterating its neutral bias by stating "*the key policy rate will most likely remain at today's level in the period ahead*". We still expect NB to leave rates unchanged for the foreseeable future (at least next 12M) and emphasise that the 40% rate cut probability embedded into the December rate path reflects an insurance premium against a substantial weakening in data and/or an unwarranted strengthening of the NOK. Also, we think house prices in Oslo would have to cool off for NB to cut rates further even if inflation has disappointed recently (see overleaf).
- **Flows.** Foreign banks (proxy for speculative flows) have over the past month continued to increase their long NOK positions. From a historical perspective, speculative NOK positioning is borderline stretched long.
- **Valuation.** While the NOK from a long-term perspective seems fundamentally undervalued, the relative development in unit labour costs suggests a natural limit to near-term upside potential. Our PPP model has EUR/NOK at 8.28 as a long-term fair value anchor.
- **Risks.** The biggest risk factor to our forecast is a global risk-off event that would send the cross higher than pencilled in.

***Forecast:** 9.00 (1M), 8.90 (3M), 8.80 (6M), 8.70 (12M)*



EUR/NOK	1M	3M	6M	12M
Forecast (pct'ile)	9.00 (40%)	8.90 (28%)	8.80 (25%)	8.70 (26%)
Fwd. / Consensus	9.05 / 8.99	9.09 / 8.90	9.12 / 8.88	9.20 / 8.74
50% confidence int.	8.92 / 9.17	8.87 / 9.27	8.79 / 9.39	8.67 / 9.59
75% confidence int.	8.84 / 9.27	8.73 / 9.44	8.57 / 9.65	8.34 / 10.00

Source: Danske Bank Markets

Conclusion. As expected, EUR/NOK rose to the upper end of the 8.90-9.10 trading range in the final month of 2016 on year-end seasonality. Yet, in the new year, we still expect the cross to move gradually lower on normalising growth and real rates, valuation and oil markets stabilising further.

In terms of the oil price-NOK relationship, we emphasise that we do not expect the oil price rise to continue at the same pace as seen since the OPEC agreement as non-OPEC procuders gradually increase production. As such, we still forecast the oil price to reach USD59/bbl at end-2017. Yet, we think even a stable oil price on balance should be a NOK positive given the other factors mentioned above.

We shift lower our EUR/NOK profile, forecasting the cross at 9.00 in 1M (from 9.10.), 8.90 in 3M (9.10), 8.80 in 6M (9.00) and 8.70 in 12M (8.80).

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EUR/NOK – Important issues to watch

Inflation has surprised to the downside over the past few months

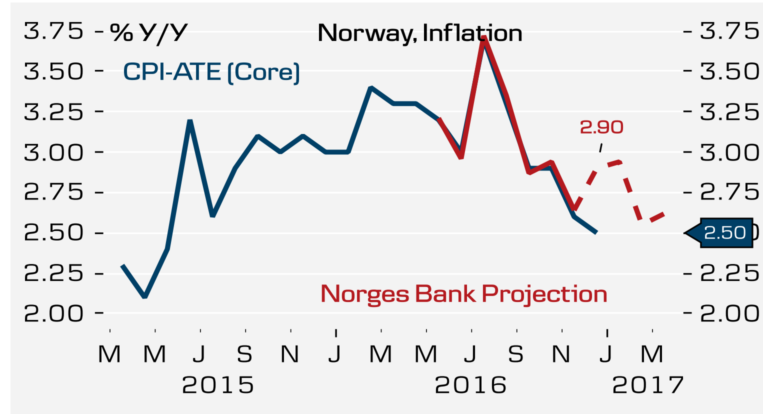
December core-inflation marked the fourth consecutive release of a below expectations print. This naturally leaves the question of whether inflation is becoming an argument for a 2017 NB rate cut?

… but Norges Bank still unlikely to cut rates

We think not. First NB has for some time been projecting a decline in inflation below its target and the December Monetary Policy Report projection has core inflation first bottoming out in 2019 at 1.7%. As such, it is rather the tempo of the decline that has been surprising. The surprisingly fast decline from the summer 2016 peak has primarily been due to the NOK stabilising and abnormal seasonal factors. For instance, the large drop in food prices during H2 must be seen in relation to the unusually large rise during H1, which was one of the key drivers for the sudden (high)inflation concerns appearing in August 2016. As a result, we do not think the large drop is a reflection of a change in the underlying inflation pressures and - like NB - we still pencil in a further drop in core inflation over the coming year on the back of not least a stronger NOK, productivity growth and lower wage pressures.

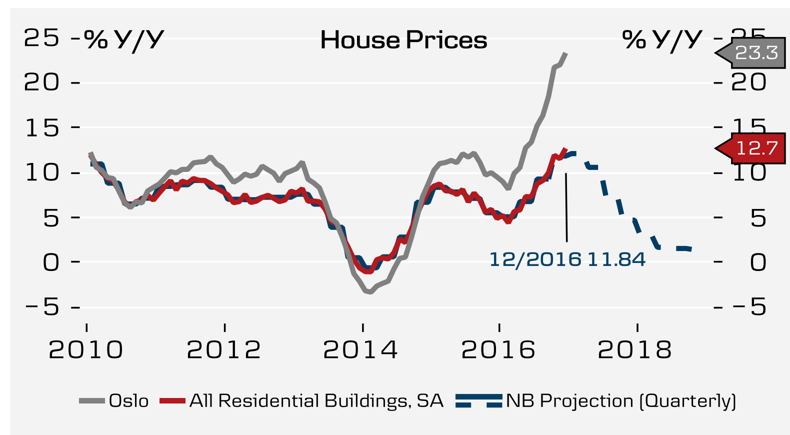
Another reason for NB not reacting to the lower-than-expected inflation is rising financial stability concerns with not least house prices in Oslo accelerating. In December, NB's rate path factors suggested a lower rate path, but the central bank instead introduced a new factor in the rate setting 'Financial imbalances and uncertainty', which countered the negative effect from e.g. inflation. NB could do this again in 2017.

Core inflation has fallen faster than projected …



Source: Macrobond Financial, Norges Bank, Danske Bank Markets

… but NB is unlikely to cut rates as financial stability concerns have risen.



Source : Macrobond Financial, Danske Bank Markets

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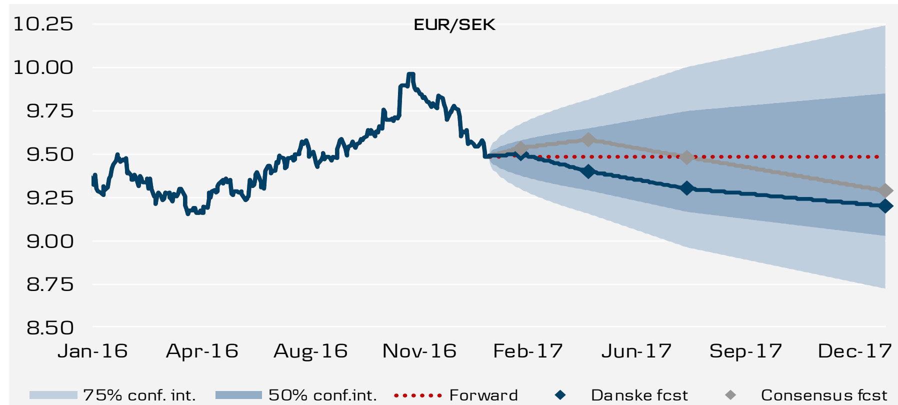
EUR/SEK – SEK headwinds turned into tailwinds

- **Growth.** The krona was under cyclical pressure for a large part of 2016 but a turnaround in growth momentum in Q4, both domestically and globally, helped to stabilise the battered krona. It is mainly soft data that has impressed so far, and we hope for hard data to follow suit. We forecast GDP growth of around 2-2.5% this year, which is sort of back to normal but still decent relative to peers.
- **Monetary policy.** The Riksbank's latest QE programme is set to run throughout H1 but will probably not be extended, in our view. The repo rate at -0.5% will not be cut further. However, on the other hand, the first hike may be postponed again, i.e. beyond 2018, for example, to mitigate a too rapid appreciation of the krona or an unwelcome setback in inflation.
- **Flows.** The weak SEK levels should be attractive for natural SEK buyers, both exporters and financial institutions.
- **Valuation.** After the recent sharp depreciation of the SEK, the krona's undervaluation has become stretched vis à vis our short-, medium- and long-term models.
- **Risks.** European political events (UK, Italy, France, Germany) could bring unwelcome setbacks in risk appetite and hurt currencies such as the SEK. At the same time, some of these event risks may fuel flows into European triple-A peripheries. The Swedish surprise index is at stretched levels, potentially a temporary SEK risk.

Forecast: *9.50 (1M), 9.40 (3M), 9.30 (6M), 9.20 (12M)*



EUR/SEK	1M	3M	6M	12M
Forecast (pct'ile)	9.50 (55%)	9.40 (40%)	9.30 (35%)	9.20 (35%)
Fwd. / Consensus	9.49 / 9.53	9.48 / 9.58	9.48 / 9.48	9.48 / 9.29
50% confidence int.	9.36 / 9.60	9.29 / 9.65	9.17 / 9.75	9.03 / 9.85
75% confidence int.	9.28 / 9.70	9.16 / 9.81	8.96 / 10.00	8.72 / 10.24

Source: Danske Bank Markets

Conclusion. Growth momentum has turned from a headwind into a tailwind for the SEK, which is part of the reason the EUR/SEK has dropped recently from above 10.00 to 9.50, our 1M target. Another more important factor is the market's reassessment of the Riksbank. The QE programme is set to run throughout H1 but will not be extended beyond that, in our view. The repo rate will not be cut further. However, should the krona appreciate too rapidly or inflation disappoint, we expect a response from the Riksbank. We think that the first line of defence is to postpone the first hike further. We forecast EUR/SEK at 9.50, 9.40, 9.30 and 9.20 in 1M, 3M, 6M and 12M.

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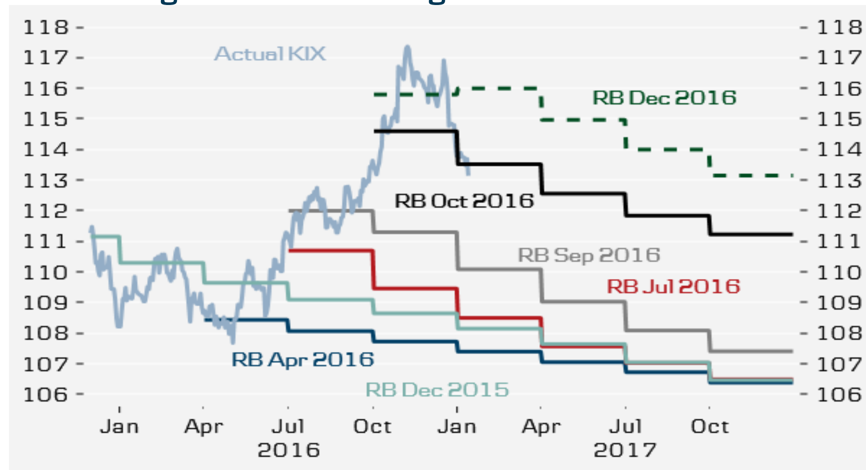
EUR/SEK – important issues to watch

Reassessing the Riksbank and the importance of the SEK

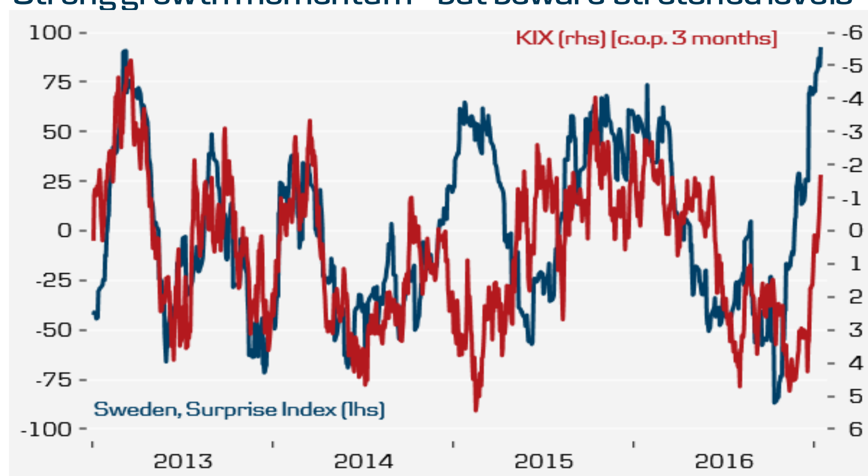
- EUR/SEK was hit twice on Thursday 12 January, which brought the pair to our 1M target of 9.50: first, by the inflation numbers, which were in line with our forecast but one-tenth above the Riksbank's and second, the Riksbank Minutes, which confirmed basically the hawkish read of the December decision, with the dissenters not only voting against QE but also preferring a higher repo rate path.
- Our base case is that the Riksbank's latest QE programme will run throughout H1 but will not be extended, and that the repo rate will not be cut further. However, the first hike may be postponed again in response to a too rapid appreciation of the krona or inflationary setbacks. The ECB's policies will continue to be an important input.
- The SEK rose sharply after the December meeting. KIX is now on a par with the current Riksbank Q3 17 forecast and 2.4% below the current Q1 17 forecast. We believe the Riksbank is taking note of this. However, we think it has become more patient towards SEK appreciation as inflation is higher and expectations are closer to target; and as the SEK is weaker and unintended consequences are more tangible/acknowledged/discussed.
- If KIX drops swiftly, say towards 110, the Riksbank may respond. The first line of defence: postponing the first rate hike.

Trade-weighted krona stronger than Riksbank's forecast



Source: Macrobond Financial

Strong growth momentum – but beware stretched levels

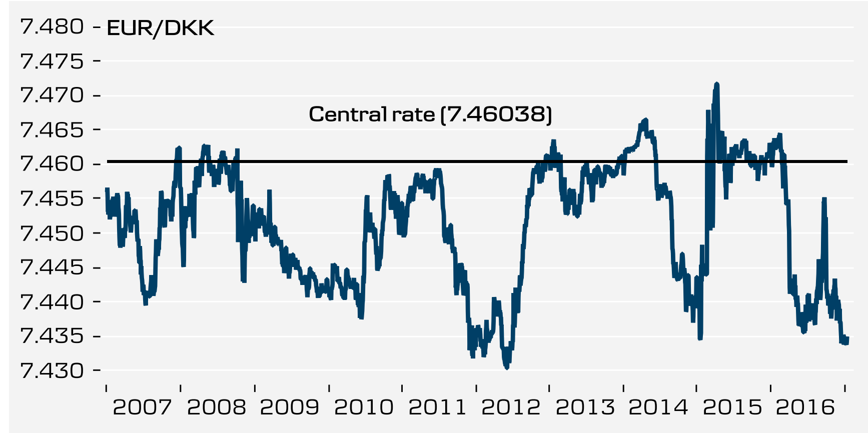


Source: Macrobond Financial, Danske Bank Markets

EUR/DKK – no rebound in sight

- **FX.** EUR/DKK is still trading around the low from December last year of 7.4340. The market is likely to be reluctant to buy EUR/DKK this year, with high uncertainty attached to the outcome of multiple political events in Europe, while hedging of USD assets by domestic investors is likely to continue as the USD is not done rising. The downward pressure on EUR/DKK triggered selling of DKK0.7bn by DN in FX intervention in December. Even if DKK selling by DN continues in January, it is not likely to trigger an independent Danish rate cut or a rebound in EUR/DKK towards the central rate of 7.46038. We forecast EUR/DKK at 7.4350 in 1-3M (revised down from 7.4375) and 7.4400 in 6-12M (revised down from 7.4425).
- **Rates.** We expect DN to keep the rate of interest on certificates of deposits unchanged at -0.65% in 12M. In May and June 2016, DN sold DKK50bn in FX intervention to fend off downward pressure on DKK ahead of the UK referendum on EU membership, while it refrained from lowering its policy rates. In our view, this was a clear signal that FX intervention selling of DKK is the preferred instrument for DN to cap the EUR/DKK lower bound.
- **Flows.** The Danish current account surplus was revised up to 9.2% of GDP last year. This supports a stronger DKK. We expect a large surplus over the next few years. More than one-third of the surplus is earned in the US though. Hence, we expect the DKK to monitor closely which policies President-elect Donald Trump will implement. In our view, a 'Homeland Investment Act 2' would probably not lead to significant outflows out of DKK as US companies have low foreign direct investment in Denmark.

***Forecast:** 7.4350 (1M), 7.4350 (3M), 7.4400 (6M) and 7.4400 (12M)*



Source: Macrobond Financial, Danske Bank Markets

- **Liquidity.** Conditions in the DKK money market have normalised on the back of DN selling DKK in FX intervention and buybacks of government bonds.
- **Regulation.** Over the coming year, large Danish banks need to meet liquidity requirements in significant currencies as part of the so-called liquidity coverage ratio in Basel III.
- **Conclusion.** In our view, EUR/DKK is set to trade close to the strong end of the historical trading range on a 12M horizon. We see limited downside risk from the current level, as DN stands ready to intervene in the FX market to cap EUR/DKK downside.

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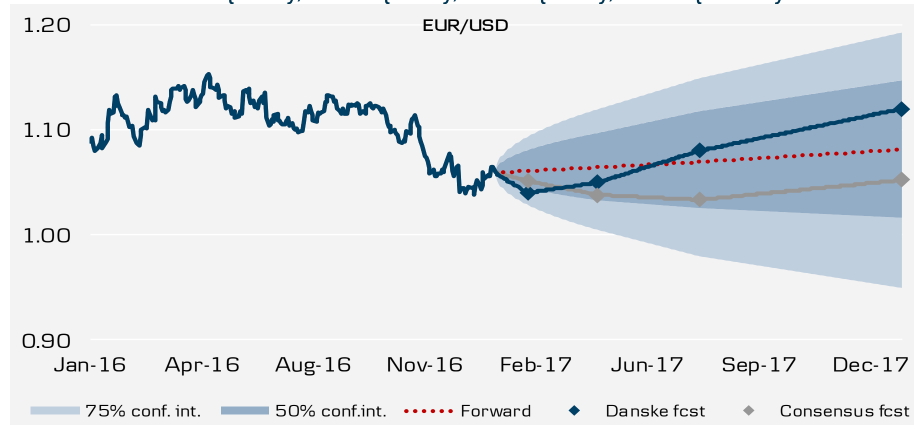
EUR/USD – in the hands of Trump and Fed near term

- **Growth**. US GDP expanded by an annualised pace of 3.5% in Q3 16. Leading indicators such as ISM and PMI figures have in general surprised on the upside in recent months, suggesting that the US economy gained speed after a weak H1 16. We estimate GDP increased 2.8% in Q4. We still do not know much about Donald Trump's actual economic plans but we generally expect his fiscal stimulus plans to be neutral for US growth in the short term, as they will take time to filter through to the economy.
- **Monetary policy.** We expect two hikes from the Fed this year (June and December) but believe risk is skewed towards three hikes as Fed Chair Janet Yellen sounded more hawkish than expected at the last FOMC meeting. Given that Trump's economic plan is likely to boost growth mainly in 2018, we expect three to four hikes in 2018 (up from two previously). One of the uncertain factors is how the Fed will react to the stronger US dollar. We see risk to the upside for US interest rates relative to market pricing, which currently implies a June hike with 70% probability and nearly two 25bp hikes in total before end-2017.
- **Flows.** The market is short EUR/USD, according to IMM data, but positioning is not significantly stretched at the moment.
- **Valuation.** Our recent MEVA model update gives a fair value of 1.27 for EUR/USD, while our PPP model suggests 1.29 is the long-term fair value. Hence, in our view, EUR/USD remains substantially undervalued.
- **Risks.** More clarification of Trump's actual political plans in, for example, an updated 100-day plan (might follow his inauguration on 20 January) and the debt-ceiling deadline on 15 March are two potentially important drivers for EUR/USD near term (see more details oberleaf).

Forecast: *1.04 (1M), 1.05 (3M), 1.08 (6M), 1.12 (12M)*



EUR/USD	1M	3M	6M	12M
Forecast (pct'ile)	1.04 (23%)	1.05 (36%)	1.08 (53%)	1.12 (64%)
Fwd. / Consensus	1.06 / 1.05	1.06 / 1.04	1.07 / 1.03	1.08 / 1.05
50% confidence int.	1.04 / 1.08	1.03 / 1.10	1.03 / 1.12	1.02 / 1.15
75% confidence int.	1.02 / 1.10	1.00 / 1.12	0.98 / 1.15	0.95 / 1.19

Source: Danske Bank Markets

Conclusion. EUR/USD has moved higher in the past few weeks, driven by a narrowing of the US-EU interest rate spread, the indirect effect of a lower USD/CNH, which transmitted to a more broad-based long USD covering. Moreover, the pricing of reflation has been taking a breather due to, among other things, the high uncertainty about Trump's economic policy plans. Near term, we believe growth and relative rates will continue to move in favour of a stronger USD. We target EUR/USD at 1.04 in 1M (1.02 previously) and 1.05 in 3M (1.04 previously) but stress that risks are skewed on the downside in the short term, conditional on Trump and the Fed. Longer term, we maintain our long-held view that the undervaluation of the EUR and the wide eurozone-US current account differential are EUR positives. In addition, the Fed may become worried about the strength of the trade-weighted USD, which would mitigate rate increases. We target EUR/USD at 1.08 in 6M and 1.12 in 12M.

EUR/USD – important issues to watch

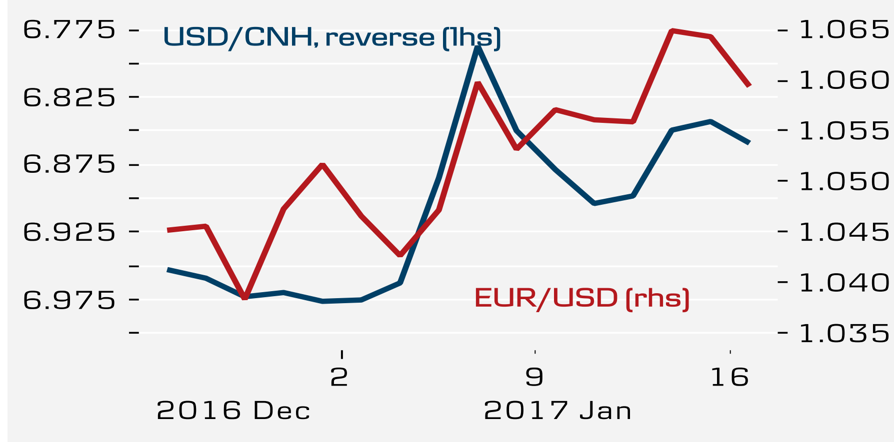
CNH short squeeze has weighed on USD

- The beginning of January saw the Chinese authorities expressing increased worries about rising outflows. In an attempt to halt the flows, China has intervened in the offshore market and drained liquidity, making it expensive to short CNH.
- Going into 2017, long USD/CNH was one of the highest conviction trades in FX markets, making the cross vulnerable to the Chinese CNH-short squeeze. As a result, we think the indirect effect of a lower USD/CNH was transmitted to a more broad-based long USD covering, aiding EUR/USD higher.
- The development in the Chinese offshore money market is important for the near-term EUR/USD outlook. As we expect the conditions to calm further, this would, all else being equal, be negative for EUR/USD.

Draw on USD cash buffer and US debt ceiling are potential USD negatives in Q1

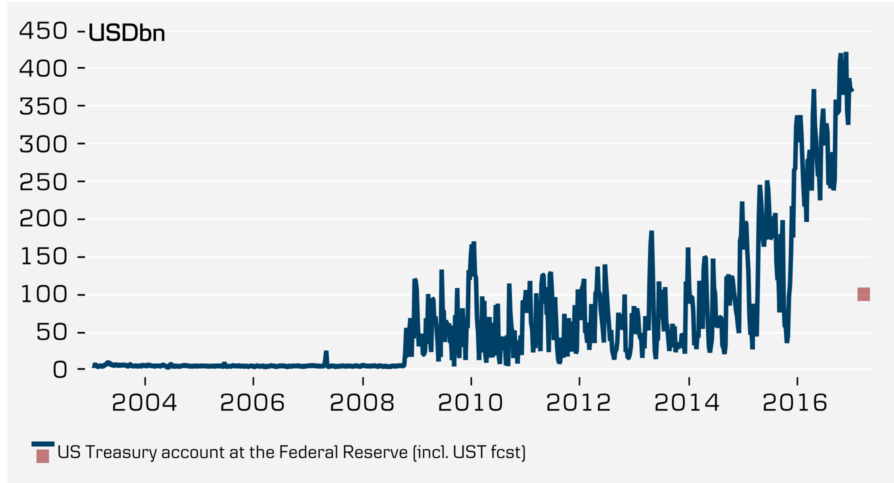
- The US Treasury has said it expects the treasury account to fall USD290bn during Q1. A large draw on the cash buffer in Q1 could weigh on the USD short term, as this would correspond to a c.8% increase in the monetary base.
- Moreover, on 15 March, the current suspension of the US debt limit expires. As the deadline moves closer, this theme could build further and potentially weigh on the USD. If the debt ceiling is not re-suspended or increased significantly above the present debt level before 15 March, the US Treasury may have to draw further from the cash buffer weighing additionally on USD.

CNH-short squeeze has been an explanatory factor for EUR/USD spike



Source: Macrobond Financial, Danske Bank Markets

Large draw on US Treasury account in Q1 likely to weigh on USD

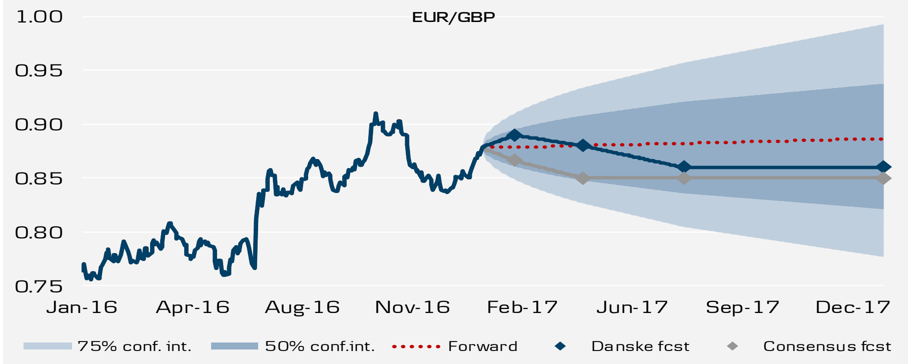


Source: Bloomberg, Danske Bank Markets

EUR/GBP – Brexit uncertainty is back on the agenda

- **Growth.** The UK economy has been remarkably resilient to Brexit uncertainty so far and, against expectations, growth continued at the same pace in H2 16 as before the EU vote. We expect GDP growth to slow but stay positive this year. We expect private consumption growth to slow, as the weaker GBP corresponds to a de facto wage cut. We also expect business investment growth to slow, as firms are likely to remain reluctant to invest due to the high uncertainty on the future UK/EU. We expect GDP growth to slow to 1.2% y/y in 2017, from 2.0% y/y in 2016.
- **Monetary policy.** We expect the Bank of England (BoE) to remain on hold for 12 months. The BoE reaction function has changed since the financial crisis, so the BoE puts more weight on growth/unemployment relative to inflation. In our view, the BoE seems to be more worried about slower growth than too-high inflation, as the latter is likely to be only temporary due to the depreciation of the GBP. Hence, while we think it is unlikely that the BoE will tighten monetary policy in a time of elevated political uncertainty, we think we need to see substantially slower growth and/or higher unemployment before additional easing becomes likely again.
- **Flows.** Investors have built up speculative short GBP positions following the Brexit vote.
- **Valuation.** EUR/GBP is trading above the fair value estimates implied by our PPP model (0.77) and our MEVA model (0.77).
- **Risks.** Uncertainty about the future relationship between the UK and the EU since the Brexit vote has increased uncertainty about near-term FDI and portfolio flows into the UK, which, along with the large current account deficit in the UK, implies a significant risk to the GBP.

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



EUR/GBP	1M	3M	6M	12M
Forecast (pct'ile)	0.89 (66%)	0.88 (52%)	0.86 (39%)	0.86 (41%)
Fwd. / Consensus	0.88 / 0.87	0.88 / 0.85	0.88 / 0.85	0.89 / 0.85
50% confidence int.	0.86 / 0.90	0.85 / 0.91	0.84 / 0.92	0.82 / 0.94
75% confidence int.	0.84 / 0.92	0.83 / 0.93	0.80 / 0.96	0.78 / 0.99

Source: Danske Bank Markets

Conclusion. EUR/GBP has increased substantially since the beginning of 2017, as markets have turned their focus back to the Brexit theme. In the short term, we are watching out for the Supreme Court's ruling, which is due any time soon. If the government wins its appeal, it would be likely to be a source of additional hard Brexit speculation and drive further GBP weakness. Irrespective, of the outcome of the Supreme Court ruling, we still see potential for further GBP weakness in coming months as the triggering of article 50, which we expect by the end of March, moves closer. We have lifted our 1M target to 0.89 (previously 0.84) and 0.88 (0.87) in 3M but stress that the risk is skewed on the upside relative to our forecasts.

Longer term, we expect EUR/GBP to stabilise within the 0.84-0.88 range targeting the cross at 0.86 in 6M and 0.86 in 12M. As more clarification on the outcome of Brexit negotiations becomes available, we see a case for GBP strengthening due to positioning and valuation as Brexit uncertainty declines. This represents downside risk to our 6-12M forecast.

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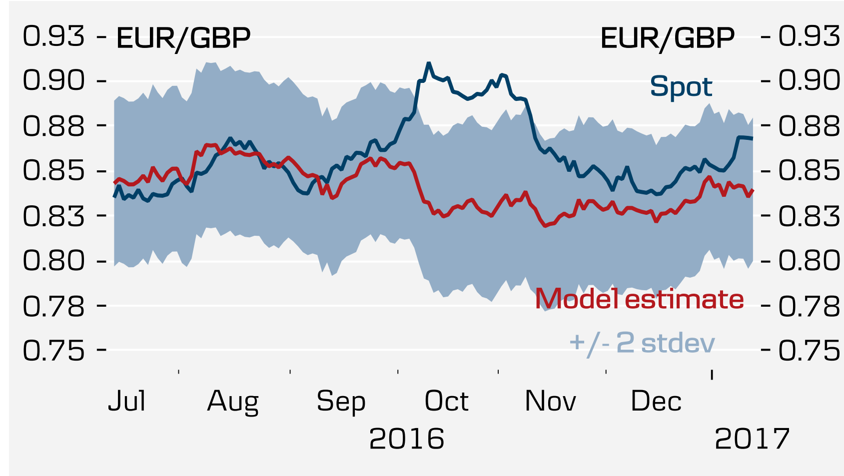
EUR/GBP – important issues to watch

Two important events are due within a few weeks: (1) Supreme Court ruling and (2) Prime Minister Theresa May's speech

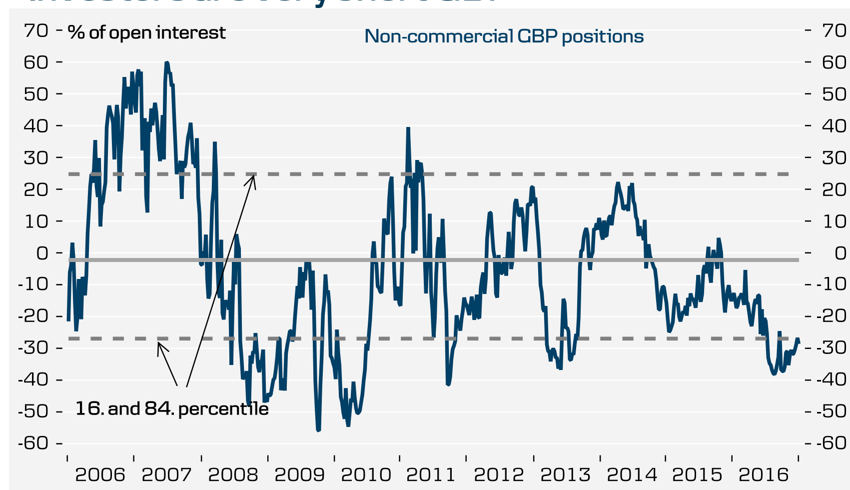
- EUR/GBP has increased substantially since the beginning of 2017, as Brexit has moved back into the spotlight after a recent TV interview with PM Theresa May where she repeated that control over immigration and national sovereignty are higher on the government's priority list than access to the EU single market. On 17 January, PM Theresa May's will present the governments Brexit plans. According to a story in The Times (15 January), Theresa May should be prepared to leave both the EU single market and the custom union in order to regain control over immigration. See Brexit Monitor # 20 - Hard Brexit fears have returned (16 January) for details.
- We still expect the UK to trigger Article 50 before the 'end of March' and then formally start exit negotiations with the EU. However, the process until the end of March could be a very messy political affair. Firstly, we are awaiting the Supreme Court's ruling regarding whether it is government or parliament that can trigger Article 50. This ruling is due any time soon and will be a very important driver for GBP. Secondly, PM May has said that she will present the Government's Brexit plans within a few weeks (most likely after the Supreme Court ruling).
- If the Government wins its appeal at the Supreme Court, the market is likely to price in a higher probability of a hard Brexit and thus drive further GBP weakness. If it does not, government has to negotiate with the parties in parliament in order to secure a vote in favour of triggering Article 50. This will probably not be an easy task, as the majority of members of parliament are actually against Brexit. In any case, we think increased political uncertainty is likely to weigh on the GBP in coming months.

EUR/GBP slightly oversold according to Danske Bank's short-term model – reflects political risk premium



Source: Macrobond Financial, Danske Bank Markets

Investors are very short GBP



Source: Danske Bank Markets

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USD/JPY – higher even if the short yen trade has become crowded

- **Macro outlook.** The Q3 GDP figures was revised down to 0.3% q/q (1.3% saar) from the initial estimate of 0.5% q/q (2.2% saar). The Tankan report showed that sentiment among large manufacturers improved in Q4, while business conditions among small companies remain challenging. Manufacturing PMI rose to 52.4 in December, suggesting the Japanese manufacturing sector (and thus exports) is likely to remain supported by the general improvement in the global manufacturing cycle and not least a weakening of the yen. We still expect the Japanese economy to continue growing above trend in coming years, supported by the government's fiscal stimulus package. We estimate real GDP expanded 0.4% q/q in Q4 and estimate annual GDP growth of 1.0% in 2016, 1.2% in 2017 (FY 2016: 1.3%, FY 2017: 1.1%).

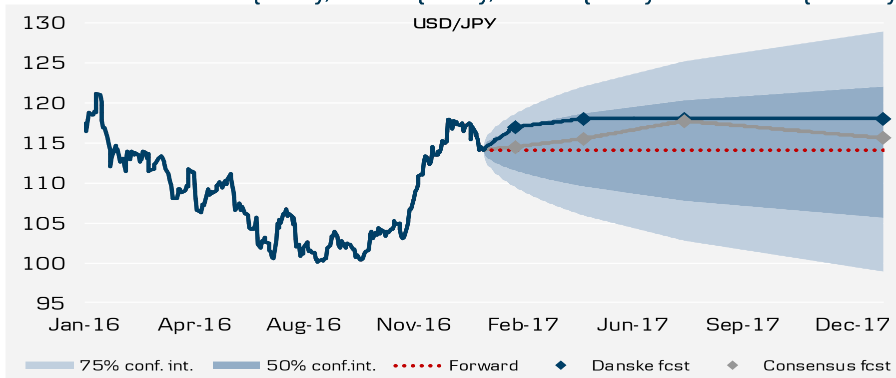
- **Monetary policy.** We expect the Bank of Japan to keep its monetary policy unchanged throughout our 12-month forecast horizon. This implies the BoJ maintaining its target for the short-term policy interest rate unchanged at -0.1% and continuing to purchase Japanese government bonds (JGBs) so yields on 10Y JGB remain around 0%. We expect the BoJ to remain on an easing bias but we think it would require significant negative inflation or growth surprises for the BoJ to cut rates further into negative territory.

- **Flows.** Japan's current account surplus rose to 3.6% of GDP in Q3 16, providing increasing support for the JPY.

- **Valuation.** PPP is around 82, while our MEVA model suggests that 100 is 'fundamentally' justified.

- **Risk.** USD/JPY remains highly correlated with investors' risk appetite. Non-commercial positioning has turned sharply from long to stretched short JPY in recent months suggesting stronger headwinds to a further increase in USD/JPY.

Forecasts: 117 (1M), 118 (3M), 118 (6M) and 118 (12M)



USD/JPY	1M	3M	6M	12M
Forecast (pct'ile)	117.00 (73%)	118.00 (71%)	118.00 (66%)	118.00 (63%)
Fwd. / Consensus	114.15 / 114.49	114.14 / 115.53	114.13 / 117.74	114.12 / 115.61
50% confidence int.	111.16 / 117.20	109.54 / 118.70	107.75 / 120.31	105.63 / 122.03
75% confidence int.	108.76 / 119.38	105.90 / 122.06	102.77 / 125.18	98.90 / 128.91

Source: Danske Bank Markets

Conclusion. USD/JPY has fallen in recent weeks as markets' pricing of reflation has taken a breather and the USD has declined as the lack of information on Trump's plans for the economy have weighed on investor sentiment. We still expect the JPY to continue suffering in an environment with rising global bond yields and a higher oil price and expect USD/JPY to increase further in coming months. However, short term, momentum for additional yen weakening is likely to level off as the short JPY trade has become crowded. Moreover, a stretched short yen positioning warrants a larger USD/JPY downside risk and higher sensitivity to investors' risk appetite. We target the cross at 117 in 1M (previously 121) and 118 in 3M (119).

Longer term, we expect USD/JPY to stabilise, targeting 118 in 6-12M, as we expect portfolio outflows out of Japan to counter the underlying appreciation pressure on JPY stemming from fundamentals.

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USD/JPY – important issues to watch

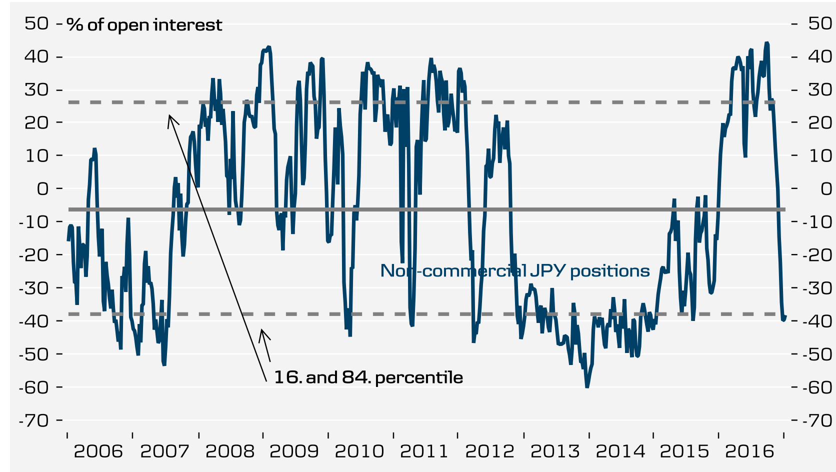
Short yen (the obvious reflation trade) has become crowded

- The yen has weakened significantly in recent months and investors have made a sharp U-turn from being long yen for most of 2016 to short yen, as the US reflation scenario has been priced. The short yen trade looks increasingly crowded to us, with USD/JPY positioning at its most stretched short since 2015, according to IMM data.
- USD/JPY has historically been highly correlated with yields on 10Y US Treasuries as a widening of the rate spread tends to support portfolio investment flows out of Japan. We expect the reflation theme to continue to keep the yen under pressure in coming months. However, as positioning has become increasingly stretched, momentum for additional yen weakening is likely to level off.

We expect BoJ to keep YCC unchanged despite rising global yields

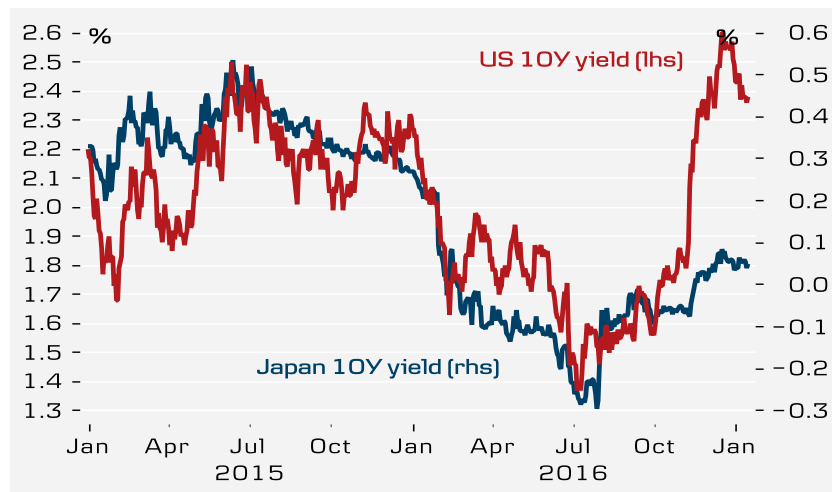
- With global yields on the increase, growth above trend in Japan and potentially rising inflation expectations in Japan, the Bank of Japan's (BoJ) willingness to maintain its yield curve control policy (YCC), through which it targets both the policy interest rate and the 10-year yield on Japanese government bonds, could be tested by the market this year.
- We expect the BoJ to keep its policy unchanged throughout our 12-month forecast horizon and possibly for the rest of Koruda's current term as BoJ governor, which ends in April 2018. Indeed, the BoJ could lift its target for the 10-year yield if global yields rise substantially, adding upward pressure to Japanese yields. However, in order to avoid tightening signals, we think the bar for policy changes is very high. Moreover, the BoJ has explicitly promised to continue easing until inflation expectations are above the 2% target on a sustainable basis.

Investors are now short yen again



Source: Bloomberg, Danske Bank Markets

BoJ likely to maintain 0% ceiling on 10Y JGB



Source: Bloomberg, Danske Bank Markets

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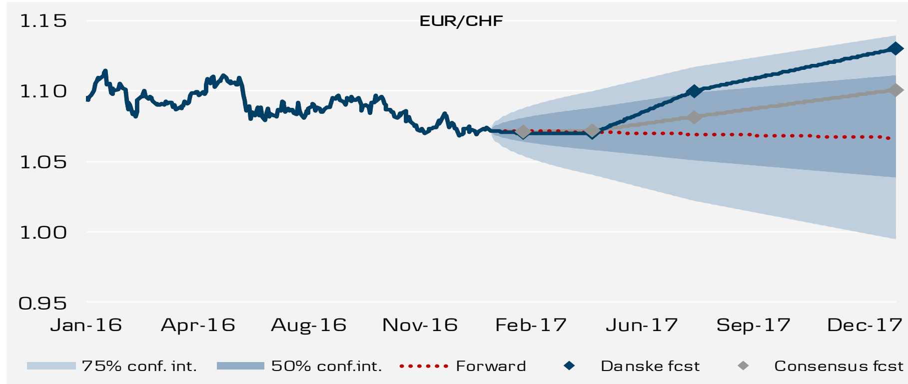
EUR/CHF – set to stay low near term on political uncertainty

- **Growth.** The real economy continues to progress at a decent pace. Both the KOF leading indicator and the PMI manufacturing index surprised at high levels. The PMI manufacturing index is currently hovering around the level of 56 – the highest since 2013.
- **Monetary policy.** Switzerland escaped the doldrums of deflation in December, when CPI inflation was 0.0% – up from minus 0.3% y/y in November. M2 money supply growth remains subdued though – it fell to 2.0% y/y in November. The SNB's currency reserve stood at CHF645bn in December. Due to high political uncertainty in Europe this year, SNB may need to sell CHF to meet safe-haven demand and to defend CHF around the level of 1.07 for EUR/CHF. This will continue to be first line of defence. We expect the SNB to keep the Libor target at the midpoint and the sight deposit rate at -0.75% in the near future.
- **Flows.** Positioning on the CHF is moving into short territory, while EUR positioning is less stretched short than in the beginning of 2016.
- **Valuation**. Both our PPP and MEVA models suggest that a level 1.29-1.30 for EUR/CHF is 'fundamentally' justified; hence, the cross is undervalued on both measures.
- **Risks.** SNB's commitment to preventing sustained CHF appreciation has limited the downside risks to EUR/CHF. However, the SNB has no specific target for EUR/CHF but focuses more on a trade-weighted CHF measure.

***Forecast:** 1.07 (1M), 1.07 (3M), 1.10 (6M) and 1.13 (12M)*



EUR/CHF	1M	3M	6M	12M
Forecast (pct'ile)	1.07 (41%)	1.07 (41%)	1.10 (75%)	1.13 (84%)
Fwd. / Consensus	1.07 / 1.07	1.07 / 1.07	1.07 / 1.08	1.07 / 1.10
50% confidence int.	1.06 / 1.08	1.06 / 1.09	1.05 / 1.10	1.04 / 1.11
75% confidence int.	1.05 / 1.09	1.04 / 1.10	1.02 / 1.12	0.99 / 1.14

Source: Danske Bank Markets

Conclusion. Political uncertainty in Europe, coupled with rising geopolitical risks following the election of Donald Trump as the next US president, has supported CHF and put pressure on SNB to act to curb CHF appreciation pressure. Political uncertainty looks to be a key theme for FX markets again this year. EUR/CHF is still trading close to 1.07. We expect it to stay here in the near term as focus turns to European political uncertainty. Longer term, we continue to expect fundamentals to support a higher EUR/CHF and keep our 6M and 12M forecasts unchanged at 1.10 and 1.13, respectively.

USD/CAD – gravitating forces set to pull cross lower after near-term spike

- **Growth.** Economic releases still point to the Canadian economy gradually recovering from the negative effects of the Q2 wild fires. The latest Business Outlook Survey from Bank of Canada (BoC) points to a much improved outlook for 2017, as, not least, the domestic demand and export outlooks have improved. In contrast, inflation has continued to disappoint, with the average of the new BoC 'three preferred measures of core inflation' falling to 1.6% in November.

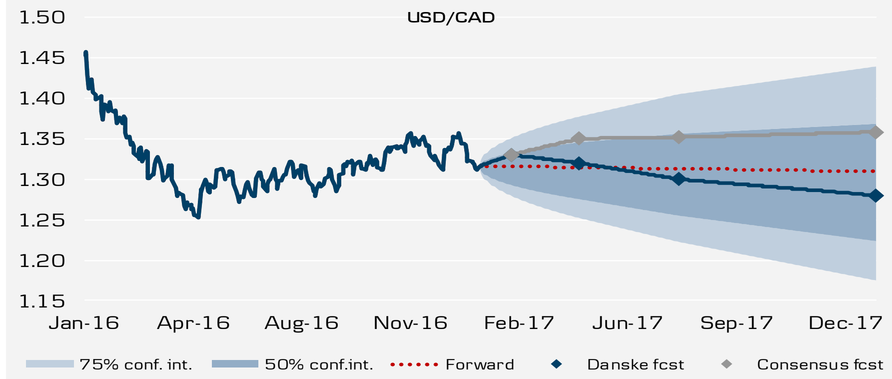
- **Monetary policy.** As widely expected, the BoC kept the policy rate unchanged at 0.5% at its December meeting, while stating that 'the current stance of monetary policy remains appropriate'. We expect the BoC to keep rates unchanged for the next 12 months and expect the central bank to reiterate at the upcoming January meeting that risks are 'balanced' even if the development in the BoC's stated risk factors has on balance developed in a hawkish direction (in the latest monetary policy report from October, the BoC emphasised the following risk factors in a new format: (1) stronger growth in the US, (2) higher oil prices, (3) sluggish business investments in Canada, (4) slower growth in emerging markets and (5) weaker domestic household spending.

- **Flows.** According to IMM data, speculative CAD positioning is in 'neutral' territory.

- **Valuation.** Our valuation models suggest that USD/CAD is overvalued with our MEVA and PPP estimates for USD/CAD at 1.22 and 1.20, respectively.

- **Risks.** In the short term, the biggest risk factor to our forecasts is a global risk-off event.

Forecast: *1.33 (1M), 1.32 (3M), 1.30 (6M) and 1.28 (12M)*



USD/CAD	1M	3M	6M	12M
Forecast (pct'ile)	1.33 (69%)	1.32 (59%)	1.30 (48%)	1.28 (46%)
Fwd. / Consensus	1.32 / 1.33	1.31 / 1.35	1.31 / 1.35	1.31 / 1.36
50% confidence int.	1.29 / 1.33	1.28 / 1.35	1.25 / 1.36	1.22 / 1.37
75% confidence int.	1.28 / 1.35	1.25 / 1.38	1.22 / 1.40	1.17 / 1.44

Source: Danske Bank Markets

Conclusion. USD/CAD has moved sharply lower over the past few weeks, after reaching our previous 1M forecast. The move has been driven primarily by a broad-based setback in the USD. With the outlook for some USD-recovery near term, we think the cross will move higher in the coming month. We think the oil price will remain supported, which should limit the near-term downside potential for the 'loonie'.

In the medium to longer run, we still expect the fundamentally overvalued USD/CAD to move lower, as the improved growth outlook and stabilising oil markets on balance work as a gravitating force on the cross. Also, positioning leaves room for bearish builds. We forecast USD/CAD at 1.33 in 1M (previously 1.35), 1.32 in 3M (1.34), 1.30 in 6M (1.30) and 1.28 in 12M (1.28).

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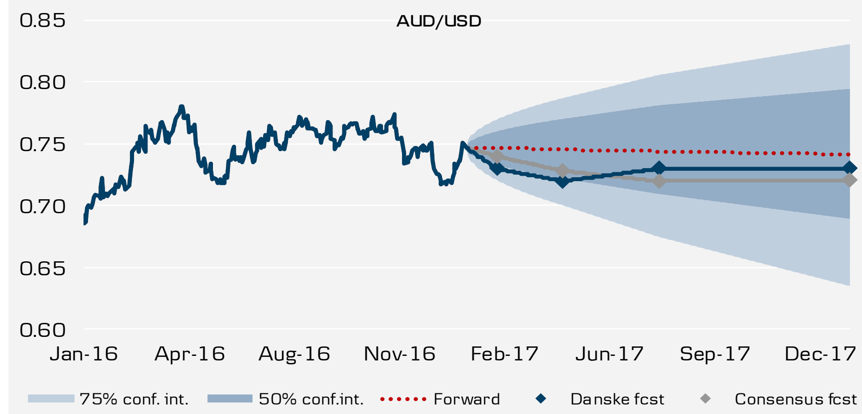
AUD/USD – broader USD moves dominate the pair

- **Growth.** In Q3, the Australian economy contracted 0.5% from the previous quarter and expanded 1.8% from the previous year. A slowdown in growth was expected but the magnitude was a surprise as market consensus estimated a 0.1% contraction on a quarterly basis and 2.2% annual growth. The Australian economy continues to adjust to the abrupt end of the mining boom. Business investment is still slow, even though business sentiment indicators point to activity being better than average. The rise in commodity prices continues to support Australia's terms of trade but inflation is still below the central bank's target. In Q3 16, annual inflation picked up to 1.3% from 1.0% in Q2. Q4 inflation figures are due to be released in late January.
- **Monetary policy.** The Reserve Bank of Australia (RBA) left the key rate at 1.5% in December as we expected. Market pricing for further rate cuts has changed dramatically since early November, as the markets have digested expectations of a pickup in global growth and higher commodity prices. Whereas in early November, the market was pricing in around a 30% probability of an RBA rate cut in 2017, currently, the market is pricing in a higher probability of a hike than a cut in 2017. We would still be cautious in terms of expecting policy tightening, as the RBA does not want to promote AUD strength, which would exacerbate economic transition after the end of a mining boom. In addition, house price inflation has eased off from highs. For example, in Sydney, house price inflation dropped to 3.2% in Q3 16 from 19.9% a year earlier. Thus, we expect the RBA to keep rates unchanged in 2017.
- **Flows.** Positioning is on a neutral level after speculative players have scrapped long AUD positions.
- **Valuation.** Fundamentally, AUD/USD is still overvalued, with our PPP and MEVA models having 0.72 and 0.69 as fair, respectively.
- **Risks.** Implications of Trump's victory in the US presidential elections as well as the future direction of US economic, trade and foreign policies are very uncertain and could affect the AUD in the medium to long term.

***Forecast:** 0.73 (1M), 0.72 (3M), 0.73 (6M) and 0.73 (12M)*



AUD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.73 (21%)	0.72 (23%)	0.73 (37%)	0.73 (41%)
Fwd. / Consensus	0.75 / 0.74	0.75 / 0.73	0.74 / 0.72	0.74 / 0.72
50% confidence int.	0.73 / 0.76	0.72 / 0.77	0.71 / 0.78	0.69 / 0.79
75% confidence int.	0.72 / 0.77	0.70 / 0.79	0.67 / 0.81	0.64 / 0.83

Source: Danske Bank Markets

Conclusion. AUD moves since December have been led by the broad USD index. The appreciation momentum of USD has eased in January as Chinese officials have taken decisive measures to support the CNY (and weaken the USD). Another reason for the USD rally taking a breather could be that markets are starting to lose patience as the lack of details and concrete economic plans mark the upcoming inauguration of Donald Trump. Led by the USD developments, AUD sank to a seven-month low before year-end. In January, the cross has recovered an impressive 4%, pushing the AUD to overbought territory. Thus, we see the pair reversing back to 0.72-0.73 in 1-3M. For 6-12M, we keep our forecasts unchanged and expect monetary policy divergence (Fed hikes) to be the key factor curbing AUD strength even though stronger global growth and higher commodity prices give support.

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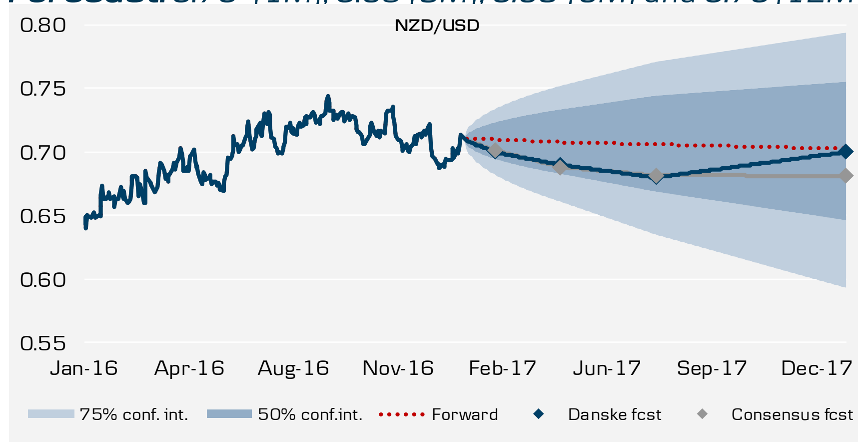
NZD/USD – markets could speculate on RBNZ hike towards year-end

- **Growth.** In Q3, New Zealand economy expanded 1.1% from previous quarter and 3.5% from previous year. Growth was better than consensus and the central bank expected. Domestic growth continues to be supported by population growth, construction, tourism and monetary easing. Recent dairy auctions have been mostly positive but uncertainty around future developments remains. Strong NZD continues to generate negative inflation in tradables sector and, thus, the RBNZ is still determined to curb excessive NZD strength.
- **Monetary policy.** In November, the RBNZ cut the official cash rate by 25 basis points to a new historical low of 1.75% as both we and consensus expected. The cut was 80% priced in, so the market reaction was muted. As we expect the global economy to strengthen and for commodity prices to continue rising, the market is almost certain that the RBNZ will abandon the historically low rate space later this year. More precisely, the OIS market is pricing in around a 65% probability of a hike in Q3 and an 80% probability of a hike in Q4. We do see a risk of monetary policy tightening, especially as the house price inflation continues to run high. In December, house price inflation in Auckland was 11.2% versus 20.7% a year earlier. However, expectations of housing demand and supply still pose an upside risk to prices in Auckland. We expect RBNZ to keep the official key rate unchanged at least for the first half of the year. In H2, a realisation of NZD depreciation (which we expect) together with a more favourable economic outlook and a tighter housing market could inspire the central bank to start gradual hikes.
- **Valuation.** Looking at the relative strength index, the NZD is slightly overbought at the moment. Fundamentally, NZD/USD is still overvalued. Our MEVA and PPP models have 0.67 and 0.64 as fair, respectively.
- **Risks.** Implications of Trump's victory in U.S. presidential elections as well as future direction of U.S. economic, trade and foreign policies are very much uncertain and could affect NZD in the medium to long term.

Forecast: *0.70 (1M), 0.69 (3M), 0.68 (6M) and 0.70 (12M)*



NZD/USD	1M	3M	6M	12M
Forecast (pct'ile)	0.70 (32%)	0.69 (30%)	0.68 (30%)	0.70 (47%)
Fwd. / Consensus	0.71 / 0.70	0.71 / 0.69	0.71 / 0.68	0.70 / 0.68
50% confidence int.	0.69 / 0.73	0.68 / 0.73	0.67 / 0.74	0.65 / 0.76
75% confidence int.	0.68 / 0.74	0.66 / 0.75	0.64 / 0.77	0.59 / 0.79

Source: Danske Bank Markets

Conclusion. Led by the USD developments, NZD sank to a six-month low in December. However, in January, the cross has recovered 2%. In the short term, we see broader USD developments and market expectations of changes in US economic policy and growth as key to the pair. In the longer term, we expect NZD/USD to continue its gradual drift lower. Even though the markets could speculate on the RBNZ hiking rates towards year-end, we still see relative monetary policies supporting the USD in the short term. We keep our forecast unchanged and expect the NZD to bottom in 3-6M before heading slightly higher towards the year-end. Our 6M forecast is 0.68 and 12M target 0.70.

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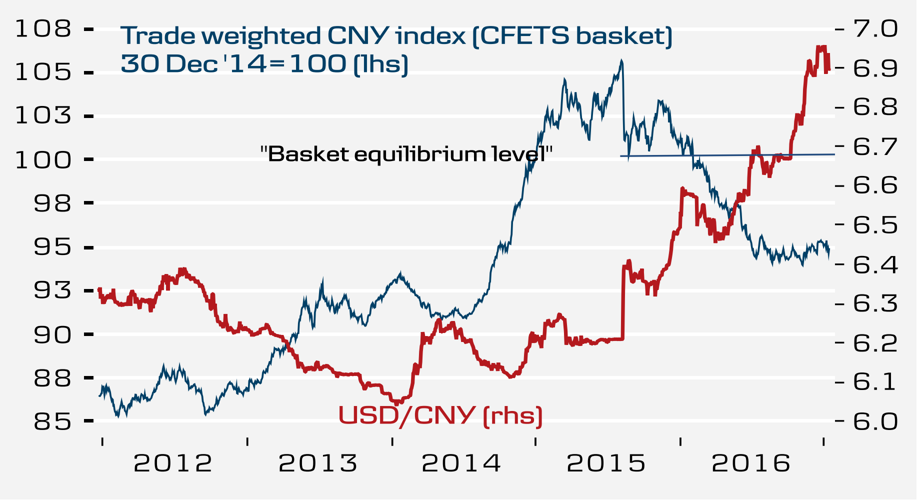
USD/CNY – depreciation trend to continue in coming years

- **Monetary policy.** Chinese growth recovered in 2016 and the recent PMI activity indicator points to a further increase in Q4. However, we believe growth will peak in early 2017 as the boost from construction and infrastructure starts to fade. Rates are likely to be on hold for a long time but de facto policy is tighter as 3M money market rates have moved up by 90bp since October. The tightening is likely a response to stronger growth, rising leverage and effort to dampen housing. Fiscal policy will be the preferred tool if China needs to support growth again in 2017.
- **FX policy.** China's FX policy has two main features: (1) CNY is a managed currency but with an increasing role for market forces, (2) CNY is managed against a basket of currencies and no longer just the USD. The basket was extended in December to include another 11 currencies. China's policy is to aim for a stable currency against the basket. While CNY has weakened against USD for some time, the basket has actually been stable since early summer 2016. China may be labelled a currency manipulator by the US government this year. Overall, we see a clear risk that China will collide with the US over a range of policy issues in 2017, not least trade and currency.
- **Valuation.** China's currency is seen broadly as close to equilibrium.
- **Risks.** The main risk is a sharper-than-expected depreciation of CNY triggered by financial turmoil or a bigger drop in growth in 2017.

Forecast: *7.00 (1M) 7.10 (3M), 7.20 (6M) and 7.30 (12M)*



Source: Macrobond Financial, Danske Bank Markets

Conclusion. We look for CNY to weaken gradually as growth is under pressure, debt risks are rising, the Fed is resuming rate hikes and net FDI flows are no longer positive for China.. However, we do not expect a bigger devaluation as the CNY is not overvalued and China wants stability for its currency. However, against EUR, we still expect CNY to depreciate close to 10% on a 12M horizon.

The CNH-CNY spread moved into negative territory in early January as the CNH strengthened sharply on the back of Chinese intervention in the offshore market, which led to a big capitulation of short CNH positions. However, we expect the spread to come back gradually to around zero as the situation calms down again.

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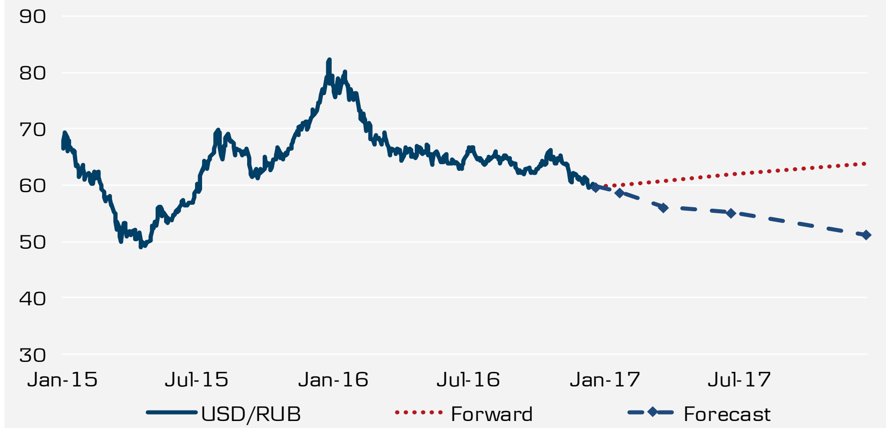
USD/RUB – good reasons to head south

- **Growth.** Russia's Federal Statistics Service revised its 2015 GDP growth estimate to -3.0% y/y, from -3.7% previously. In Q3 16, GDP shrank 0.4% y/y. Seasonally-adjusted GDP growth stayed at 0.0% m/m in October 2016 as manufacturing and construction expanded. We keep our 2016 GDP growth forecast at -0.6% y/y, 2017 GDP growth at 1.2% y/y and expect the economy to expand 1.4% y/y in 2018.
- **Monetary policy.** On 16 December, Russia's central bank (the CBR) kept its key rate at 10.0%, in line with consensus and our expectation. The general tone of the CBR's statement has remained consistently cautious, being somewhat more optimistic on deflation and economic prospects. The CBR stated it 'will consider an opportunity of cutting the key rate in H1 17' instead of 'Q1-Q2 17' previously. It is just a formal change, which has the same meaning. Since October 2016, we have been expecting the first cut to be delivered in Q2 17. During her press conference Q&A session, the CBR's governor Elvira Nabiullina mentioned the cut would be 'rather in Q2 17'.
- **Flows.** The significant slowdown in capital outflows continues to support the RUB. We expect the trend to continue, seeing outflows at USD15.5bn in 2016 versus USD151.0bn in 2015.
- **Valuation.** Crude and the RUB's correlation continued to diverge. Given an 11% m/m fall in the 30-day average of the Brent price, the RUB 30-day average against the USD strengthened 5% m/m, as the RUB has seen carry-trade inflows on a hawkish monetary stance and solid real rates. In our view, the USD/RUB pair is hovering around its 'fair value'.

Forecast: *58.70 (1M), 56.10 (3M), 55.10 (6M) and 51.15 (12M)*



	1M	3M	6M	12M
Forecast	58.70	56.10	55.10	51.15
Fwd. / Consensus	60.06 / 60.36	60.78 / 61.36	61.84 / 61.31	63.81 / 61.08

Source: Danske Bank Markets

Risks. Given the uncertainty on Trump's fiscal policy plans, there are clear upside and downside risks for our forecasts on the pair. Soaring reflation expectations in the US would weigh on global emerging market sentiment and weak oil would hit the RUB, while an improving Russia-US relationship and eased sanctions would create appetite for the RUB. If the oil deal does not hold, it will weigh on the RUB through falling crude.

Conclusion. In 2016, the RUB was the best performer among 150 global currencies. Yet, if the stronger USD story continues in 2017 on Trump's fiscal expansion promises and the Fed's moderate tightening, it will cool down RUB's excessive appreciation.

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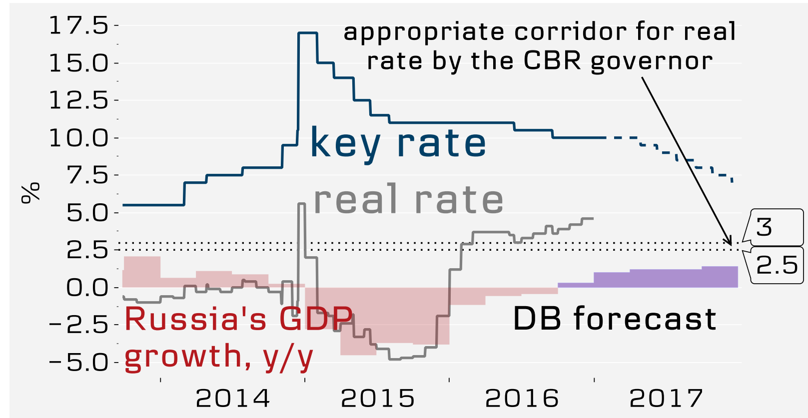
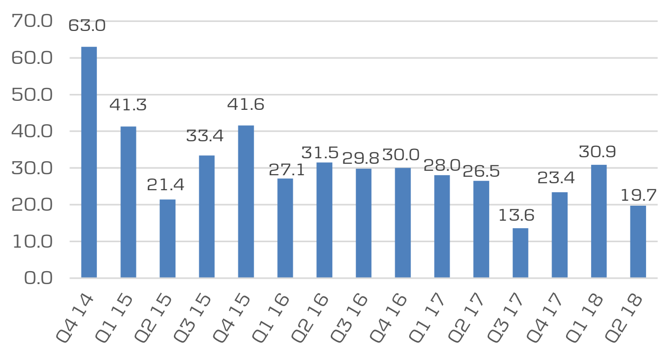
USD/RUB – important issues to watch

- **Russia's currency has good reasons to strengthen further**
  - The RUB continues to be an inherent part of the global emerging markets story, linked closely to the sentiment derived from the Fed's monetary stance, rising US treasury yields and oil price fluctuations. Yet, we see the RUB to be protected better from the Fed's hawkishness than many others EM currencies. Deleveraging goes on, the CBR favours high real rates and the economy is set to expand for the first time in two years. Global flows into Russian assets continue. In mid-December, we turned on Russia's local debt (OFZs), recommending buying before Q2 17.
  - The CBR's hawkish stance is set to continue until Q2 17.



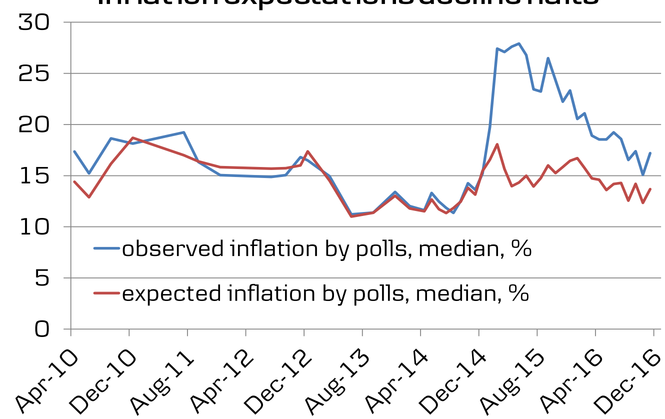
Source: Macrobond Financial, Danske Bank Markets

Payment schedule of Russia's external debt incl. interest payments: corporate sector (banks+other sectors) as of Q2 16, bn USD



Source: CBR, Danske Bank Markets

Inflation expectations decline halts

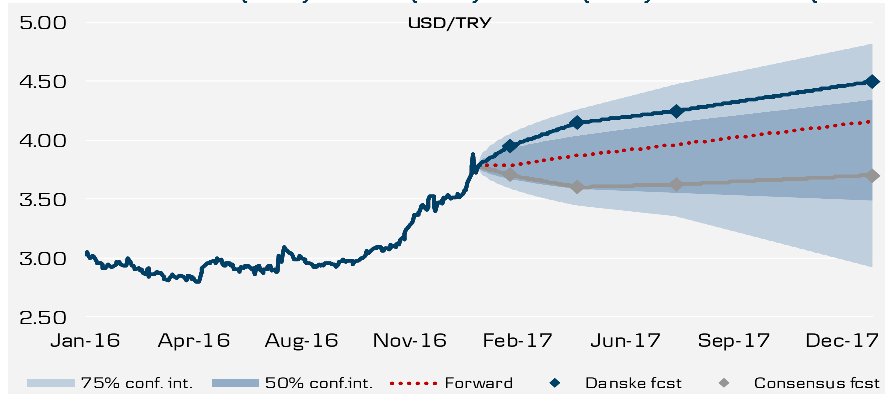


Source: CBR, Danske Bank Markets

USD/TRY – lira's weakness ignored by the central bank so far

- **Growth.** According to the new GDP chain-linked series revised in December 2016, Turkey's GDP growth shrank 1.8% y/y in Q3 16, as household consumption fell, exports have not recovered significantly and foreign tourist arrivals continued to contract. While the normalising economic relationship with Russia poses upside risks to economic growth forecasts, we do not expect the effect to have a notable impact on GDP growth in 2017. To be in line with the new GDP series, we adjust our 2016 GDP forecast to 1.4% y/y from 2.7% y/y and cut our 2017 GDP forecast to 1.9% y/y (3.0% y/y previously).
- **Monetary policy.** Inflation rocketed to 8.5% y/y in December 2016, up from 7.0% y/y a month earlier, as the TRY's significant depreciation continued. After a 50bp hike in November 2016, the Turkish central bank kept its policy rate unchanged at 8.0% in December, despite continuing turmoil in the TRY. We expect the central bank to keep its key rate unchanged in the near future due to pressure from the government, while tightening liquidity for local banks. However, the ongoing turmoil in the TRY and rapidly accelerating inflation could still push the central bank to an unexpected move on 24 January, delivering a surprise hike over 100bp.
- **Valuation.** The TRY has diverged from its 'fair value', as the market stays USD bullish and local politics are weighing heavily on the currency. In our view, fears of an upcoming Fed rate hike in 2017 and concerns about a greater-than-expected slowdown in the economy are weighing on the lira excessively.

***Forecast:** 3.95 (1M), 4.15 (3M), 4.25 (6M) and 4.50 (12M)*



USD/TRY	1M	3M	6M	12M
Forecast (pct'ile)	3.95 (79%)	4.15 (82%)	4.25 (79%)	4.50 (80%)
Fwd. / Consensus	3.78 / 3.71	3.87 / 3.60	3.96 / 3.63	4.16 / 3.70
50% confidence int.	3.61 / 3.91	3.59 / 4.04	3.55 / 4.15	3.49 / 4.35
75% confidence int.	3.51 / 4.06	3.45 / 4.26	3.36 / 4.48	2.92 / 4.82

Source: Danske Bank Markets

Risks. Potential upside risks for the pair include unexpected moves by president Recep Tayyip Erdoğan in his internal policies and the central bank's too inert stance. The Fed's monetary stance remains important for the pair. The possibility of Fitch deciding to cut Turkey's sovereign rating below the investment grade on 27 January will weigh on the TRY to some extent. A cut has only been priced in merely during the sell-off.

Conclusion. We raise our USD/TRY short- and medium- and long-term forecasts significantly to 3.95 in 1M (3.50), 4.15 in 3M (3.60), to 4.25 in 6M (3.60) and 4.50 in 12M (3.95).

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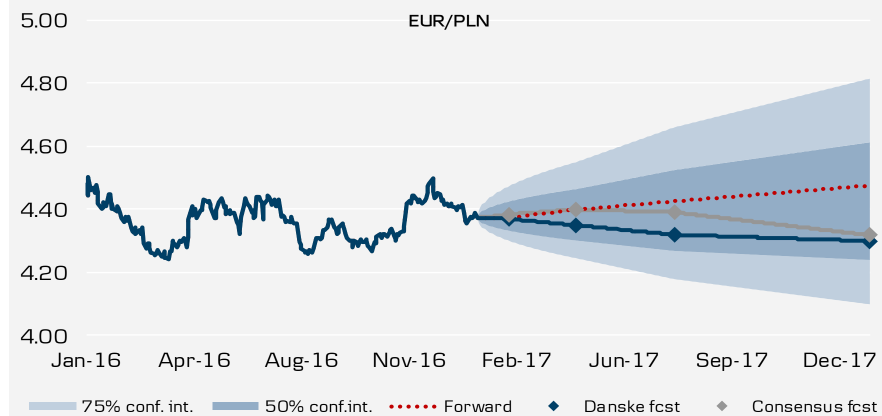
EUR/PLN – Improving PLN sentiment

- **Growth.** Economic indicators are painting a slightly better picture of the Polish economy than in December. Retail sales have recovered backed by solid wage growth and record-low unemployment. The manufacturing sector PMI has also seen a rebound, as it increased to 54.3 in December, breaking recent months' negative trend towards the 50 benchmark. On 11 January, the World Bank lowered its real GDP growth forecast for Poland to 2.5% and 3.1% in 2016-17, respectively. While we agree on its estimate for 2016, we are somewhat more cautious about 2017, seeing only a growth of real GDP of 2.9%. Fitch on 13 January affirmed its A- rating with stable outlook, while Moody's passed a deadline for revising its A2 rating despite a negative outlook.
- **Monetary policy.** The monetary policy committee of the National Bank of Poland (NBP) kept its policy rate unchanged at 1.5% at its 10-11 January meeting, despite the emergence of inflation as the CPI index increased by 0.8% y/y in December versus 0.0% y/y in November. At the meeting, the central bank signalled that in its view there is no need for raising interest rates in 2017, as inflation will first reach its 2.5% target in 2018. We do see a slight risk that inflation will rise faster than the central bank thinks due to the tightness of the labour market and global reflation.
- **Risks.** Faster-than-expected rise in Polish inflation and further slipping momentum in the US economy may lower EUR/PLN. However, if global risk appetite declines in the wake of an increasing standoff between the US and China on Taiwan or the UK and EU on Brexit negotiations then EUR/PLN may edge higher.

***Forecast:** 4.37 (1M), 4.35 (3M), 4.32 (6M) and 4.30 (12M)*



EUR/PLN	1M	3M	6M	12M
Forecast (pct'ile)	4.37 (54%)	4.35 (40%)	4.32 (35%)	4.30 (33%)
Fwd. / Consensus	4.37 / 4.38	4.40 / 4.40	4.43 / 4.39	4.48 / 4.32
50% confidence int.	4.32 / 4.41	4.30 / 4.46	4.27 / 4.52	4.24 / 4.61
75% confidence int.	4.29 / 4.46	4.25 / 4.55	4.18 / 4.66	4.10 / 4.81

Source: Danske Bank Markets

Conclusion. The PLN has staged a slightly faster comeback than we thought in December. Part of the reason is the improvement in macro-data but also a weaker momentum in the Trump reflation trade, which had hurt the PLN through a global bond sell-off. Furthermore, the dispute about the Sejm and budget 2017 has been resolved. However, we think renewed momentum in the Trump trade and deterioration in global risk sentiment will be a negative factor for the PLN. As a result, we expect the PLN to remain around current levels in 1-3M and then to strengthen further out. Hence, our forecast for EUR/PLN is 4.37 (4.42 previously) in 1M, expecting a fall to 4.35 (4.40 before) in 3M, 4.32 (4.35 before) in 6M and 4.30 in 12M, respectively.

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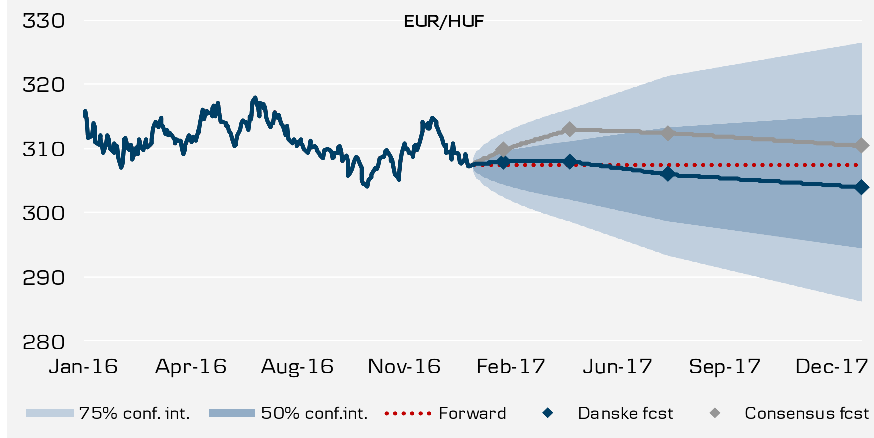
EUR/HUF – Trump anxiety expected to weigh on HUF near term

- **Growth.** The Hungarian economy is still supported by fairly strong momentum in private consumption, while investment activity is subdued due to slow absorption of new EU funds. Retail sales grew at a healthy 4.7% y/y in November (2.6% y/y in October), supported by low unemployment and continued improvement in consumer confidence (now at the strongest level in more than a decade). However, industrial production grew only 0.6% y/y in November, albeit higher than the contraction of 2.1% in October. Manufacturing PMI is also weakening a bit, possibly as the economy lacks the impulse from EU-related investment. We think real GDP growth will be 2.0% in 2016, increasing to 3.8% this year, driven by higher private and public consumption growth as well as increasing investment financed by EU funds.
- **Monetary policy.** The National Bank of Hungary (NBH) kept its base rate constant at 0.9% at its meeting on 20 December. We expect the central bank to stay on hold for the time being. However, we think that the inflation rate should continue to rise solidly from the already strong increase of 1.8% y/y in December. Core inflation has also started to edge up. We see a risk of inflation temporarily hitting the central bank's 3% target, which should prompt the central bank to pull back some of the QE measures mid-year.
- **Risks.** A clear risk for our EUR/HUF forecast is a deterioration in global risk sentiment if the stand-off between China and the US worsens in the coming month. However, there are also downside risks from a better-than-expected global risk environment and also stronger-than-expected economic and inflation developments in Hungary.

Forecast: 308 (1M), 308 (3M), 306 (6M) and 304 (12M)



EUR/HUF	1M	3M	6M	12M
Forecast (pct'ile)	308.00 (61%)	308.00 (60%)	306.00 (52%)	304.00 (49%)
Fwd. / Consensus	307.54 / 309.81	307.54 / 313.00	307.54 / 312.48	307.54 / 310.44
50% confidence int.	304.22 / 309.90	302.04 / 311.18	298.70 / 313.34	294.48 / 315.36
75% confidence int.	302.29 / 312.85	298.64 / 316.20	293.37 / 321.32	286.18 / 326.53

Source: Danske Bank Markets

Conclusion. The HUF has strengthened significantly in the past two weeks as the negative EM sentiment has evaporated. However, the strong economic momentum in the Hungarian economy will increase inflation pressures and provide tailwind to the HUF. Furthermore, the positive external balance and undervalued exchange rate are also supporting factors. However, near term renewed Trump reflation pressures may hit the HUF. Hence, we think EUR/HUF will weaken a bit near term to 308 in 1M and 3M and then strengthen to 306 in 6M followed by 304 in 12M.

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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	1.059	1.04	1.05	1.08	1.12	-1.9	-1.3	1.0	3.6
JPY	120.9	122	124	127	132	0.6	2.4	5.4	9.3
GBP	0.879	0.89	0.88	0.86	0.86	1.2	-0.1	-2.6	-3.1
CHF	1.072	1.07	1.07	1.10	1.13	-0.1	-0.1	2.9	5.9
DKK	7.4362	7.4350	7.4350	7.4400	7.4400	0.0	0.0	0.1	0.2
NOK	9.05	9.00	8.90	8.80	8.70	-0.7	-2.0	-3.5	-5.4
SEK	9.49	9.50	9.40	9.30	9.20	0.1	-0.9	-2.0	-3.0
Exchange rates vs USD									
JPY	114.2	117	118	118	118	2.6	3.8	4.3	5.5
GBP	1.21	1.17	1.19	1.26	1.30	-3.1	-1.2	3.7	6.9
CHF	1.01	1.03	1.02	1.02	1.01	1.9	1.3	1.8	2.2
DKK	7.02	7.15	7.08	6.89	6.64	2.0	1.3	-0.9	-3.3
NOK	8.55	8.65	8.48	8.15	7.77	1.3	-0.7	-4.5	-8.7
SEK	8.96	9.13	8.95	8.61	8.21	2.1	0.4	-2.9	-6.4
CAD	1.32	1.33	1.32	1.30	1.28	1.1	0.4	-1.0	-2.2
AUD	0.75	0.73	0.72	0.73	0.73	-2.2	-3.4	-1.9	-1.6
NZD	0.71	0.70	0.69	0.68	0.70	-1.3	-2.5	-3.7	-0.4
RUB	59.68	58.70	56.10	55.10	51.15	-2.3	-7.7	-10.9	-19.9
CNY	6.90	7.00	7.10	7.20	7.30	1.2	2.4	3.5	4.6

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

Source: Danske Bank Markets

Danske Bank Markets FX forecasts vs DKK

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs DKK									
EUR	7.4362	7.4350	7.4350	7.4400	7.4400	0.0	0.0	0.1	0.2
USD	7.02	7.15	7.08	6.89	6.64	2.0	1.3	-0.9	-3.3
JPY	6.15	6.11	6.00	5.84	5.63	-0.6	-2.4	-5.0	-8.3
GBP	8.46	8.35	8.45	8.65	8.65	-1.2	0.1	2.8	3.4
CHF	6.94	6.95	6.95	6.76	6.58	0.1	0.1	-2.7	-5.4
NOK	0.82	0.83	0.84	0.85	0.86	0.7	2.1	3.8	5.9
SEK	0.78	0.78	0.79	0.80	0.81	-0.1	0.9	2.1	3.3
CAD	5.34	5.38	5.36	5.30	5.19	0.9	0.9	0.1	-1.1
AUD	5.25	5.22	5.10	5.03	4.85	-0.3	-2.1	-2.8	-4.8
NZD	4.98	5.00	4.89	4.68	4.65	0.7	-1.2	-4.6	-3.6
PLN	1.70	1.70	1.71	1.72	1.73	0.3	1.1	2.6	4.3
CZK	0.28	0.28	0.28	0.28	0.29	0.0	-0.3	-0.7	4.7
HUF	2.42	2.41	2.41	2.43	2.45	-0.1	0.1	1.0	2.3
RUB	0.12	0.12	0.13	0.13	0.13	4.4	9.9	11.3	20.7
CNY	1.02	1.02	1.00	0.96	0.91	0.7	-1.0	-4.3	-7.6

Source: Danske Bank Markets

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	9.49	9.50	9.40	9.30	9.20	0.1	-0.9	-2.0	-3.0
USD	8.96	9.13	8.95	8.61	8.21	2.1	0.4	-2.9	-6.4
JPY	7.85	7.81	7.59	7.30	6.96	-0.5	-3.3	-6.9	-11.3
GBP	10.80	10.67	10.68	10.81	10.70	-1.1	-0.8	0.6	0.0
CHF	8.85	8.88	8.79	8.45	8.14	0.3	-0.9	-4.7	-8.5
NOK	1.05	1.06	1.06	1.06	1.06	0.8	1.2	1.6	2.5
DKK	1.28	1.28	1.26	1.25	1.24	0.1	-0.9	-2.1	-3.2
CAD	6.81	6.87	6.78	6.62	6.42	1.0	0.0	-2.0	-4.3
AUD	6.69	6.67	6.45	6.29	6.00	-0.1	-3.0	-4.8	-7.9
NZD	6.36	6.39	6.18	5.86	5.75	0.8	-2.1	-6.5	-6.7
PLN	2.17	2.17	2.16	2.15	2.14	0.4	0.2	0.4	1.0
CZK	0.35	0.35	0.35	0.34	0.36	0.1	-1.2	-2.8	1.3
HUF	3.09	3.08	3.05	3.04	3.03	0.0	-0.8	-1.0	-1.0
RUB	0.15	0.16	0.16	0.16	0.16	4.5	8.9	9.0	16.8
CNY	1.30	1.30	1.26	1.20	1.13	0.9	-1.9	-6.2	-10.5

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	9.05	9.00	8.90	8.80	8.70	-0.7	-2.0	-3.5	-5.4
USD	8.54	8.65	8.48	8.15	7.77	1.3	-0.7	-4.5	-8.7
JPY	7.49	7.40	7.18	6.91	6.58	-1.3	-4.4	-8.4	-13.4
GBP	10.30	10.11	10.11	10.23	10.12	-1.9	-2.0	-1.0	-2.4
CHF	8.45	8.41	8.32	8.00	7.70	-0.6	-2.0	-6.2	-10.7
SEK	0.95	0.95	0.95	0.95	0.95	-0.8	-1.1	-1.6	-2.4
DKK	1.22	1.21	1.20	1.18	1.17	-0.7	-2.0	-3.6	-5.5
CAD	6.49	6.51	6.42	6.27	6.07	0.2	-1.2	-3.5	-6.6
AUD	6.38	6.32	6.10	5.95	5.67	-1.0	-4.1	-6.3	-10.1
NZD	6.07	6.06	5.85	5.54	5.44	0.0	-3.2	-8.0	-9.0
PLN	2.07	2.06	2.05	2.04	2.02	-0.4	-0.9	-1.2	-1.5
CZK	0.33	0.33	0.33	0.33	0.34	-0.7	-2.3	-4.3	-1.2
HUF	2.94	2.92	2.89	2.88	2.86	-0.8	-2.0	-2.6	-3.4
RUB	0.14	0.15	0.15	0.15	0.15	3.7	7.6	7.2	14.0
CNY	1.24	1.24	1.19	1.13	1.06	0.1	-3.0	-7.7	-12.7

Source: Danske Bank Markets

Danske Bank EMEA FX forecasts

		EUR		USD		DKK		SEK		NOK	
		Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward	Danske	Forward
PLN	16-Jan-17	**4.37**		**4.13**		**170**		**217**		**207**	
	+1M	4.37	4.38	4.20	4.13	170	170	217	216	206	207
	+3M	4.35	4.40	4.14	4.14	171	169	216	216	205	207
	+6M	4.32	4.43	4.00	4.14	172	168	215	214	204	206
	+12M	4.30	4.48	3.84	4.14	173	166	214	212	202	205
HUF	16-Jan-17	**308**		**290**		**2.42**		**3.09**		**2.94**	
	+1M	308	308	293	290	2.41	2.42	3.08	3.08	2.92	2.94
	+3M	308	308	293	290	2.41	2.41	3.05	3.08	2.89	2.95
	+6M	306	309	283	289	2.43	2.41	3.04	3.07	2.88	2.95
	+12M	304	310	271	287	2.45	2.39	3.03	3.06	2.86	2.96
CZK	16-Jan-17	**27.0**		**25.5**		**27.5**		**35.1**		**33.5**	
	+1M	27.0	27.0	26.0	25.5	27.5	27.5	35.2	35.1	33.3	33.6
	+3M	27.0	26.9	25.7	25.3	27.5	27.6	34.8	35.2	33.0	33.7
	+6M	27.0	26.8	25.0	25.0	27.6	27.8	34.4	35.4	32.6	34.1
	+12M	25.5	26.6	22.8	24.6	29.2	27.9	36.1	35.6	34.1	34.5
RUB	16-Jan-17	**63.2**		**59.7**		**11.8**		**15.0**		**14.3**	
	+1M	61.0	63.7	58.7	60.1	12.2	11.7	15.6	14.9	14.7	14.2
	+3M	58.9	64.7	56.1	60.8	12.6	11.5	16.0	14.7	15.1	14.0
	+6M	59.5	66.1	55.1	61.9	12.5	11.2	15.6	14.3	14.8	13.8
	+12M	57.3	69.0	51.2	63.8	13.0	10.8	16.1	13.7	15.2	13.3
TRY	16-Jan-17	**4.01**		**3.78**		**186**		**237**		**226**	
	+1M	4.11	4.05	3.95	3.81	181	184	231	234	219	224
	+3M	4.36	4.12	4.15	3.87	171	180	216	230	204	221
	+6M	4.59	4.24	4.25	3.96	162	175	203	224	192	215
	+12M	5.04	4.50	4.50	4.16	148	165	183	211	173	204
CNY	16-Jan-17	**7.31**		**6.90**		**102**		**130**		**124**	
	+1M	7.28	7.33	7.00	6.92	102	101	130	129	124	124
	+3M	7.46	7.38	7.10	6.94	100	101	126	129	119	123
	+6M	7.78	7.44	7.20	6.96	96	100	120	128	113	123
	+12M	8.18	7.54	7.30	6.98	91	98	113	126	106	122

Source: Danske Bank Markets

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Disclosures

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