24 June 2022

Market Guide

Central banks rushing to remove the punchbowl

Market overview

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Fed hiked rates by 75bp, ECB pre-announced rate hikes

High inflation and commodity prices have been a theme all year, which was also highlighted with the release of US CPI reaching 1% m/m over one month. Advanced central banks are raising rates. The Fed raised interest rates by 75bp – the largest hike since 1994. The SNB hiked interest rates by 50bp (predicted by no-one in consensus) and the ECB is now firmly communicating rate hikes all the way through 2022. Norges Bank also hiked by 50bp. This highlight how global inflation pressures remain persistent. Demand is simply too high relative to global production capabilities and central banks no longer have the luxury of easing policy amid the risk of de-anchoring inflation expectations. In China, lockdowns and financial stress have eased a tad but continue to be a risk to global macro.

Broad USD strength as stagflation returns as a market theme

Over the past month, broad central bank repricing, commodity prices and widening credit spreads have been key drivers in FX markets. There has been a broad sell-off in commodity currencies such as NOK and AUD. SEK also sold off amid global growth slowing and poor risk sentiment. Central banks are still communicating that more tightening is in store. For example, Italian yields have risen so much that ECB held an emergency meeting to discuss possible measures to allow for stability in spreads while raising interest rates in the coming year. USD has been the clear winner (supported as a 'safe haven' and due to the large energy sector) with USD strength broadening, also versus SEK and NOK.

Generally, our forecasts are largely unchanged as we continue to expect a stronger USD and elevated levels in EUR/Scandies. The JPY weakness has been noticeable. In the short run, the global pressure for higher yields and the global energy crunch will keep weighing on JPY but the risk of Tokyo intervening has increased significantly over the recent weeks. Looking ahead, we expect a mild JPY strength over the coming 12m.

A key assumption behind our FX forecasts is that of a stronger USD and tightening of global financial conditions. Risks to this assumption include global inflation pressures fading fast, renewed focus on China easing, a global capex uptick and/or industrial production increasing, which could underpin a new reflation leg higher.

Chart 1. EUR/USD continues to move lower

Note: Past performance is not a reliable indicator of current or future results.
Sources: Bloomberg, Macrobond Financial

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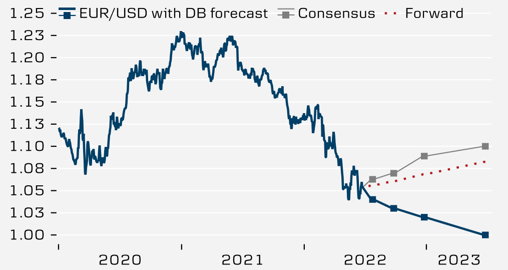
USD – further slowdown to weigh on spot

- Over the coming months, growth is set to be lower than it otherwise could have been, given continued elevated input costs and the manufacturing sector is likely to slow substantially – this will likely also spill in to services sector. US stands out as a relative winner, given large sectors in energy, agriculture and defense. In both economies, inflation is running hot and central banks are leaning against this.
- Fed focuses on a scenario of substantial rate hikes and unwinding the held bonds. ECB will equally seek to raise rates, though moderately – starting in July. In our view, this is set to substantially tighten financial conditions and is intended to ensure inflation peaks out over the year of 2022. We have already seen that risk-seeking behaviour is being strongly curtailed on the back of these coordinated CB efforts.
- Fundamentally, the US should continue to be a high(er) interest rate market and equities continue to appeal to foreign investors. This means the US is likely to attract capital, which helps the USD.
- The large negative terms-of-trade shock to Europe vs US, a further cyclical weakening among trading partners, the coordinated tightening of global financial conditions, broadening USD strength and downside risk to the euro area make us keep our focus on EUR/USD moving still lower (targeting 1.00) – a view not shared by consensus.
- The key risk to shift EUR/USD towards 1.15 is seeing global inflation pressures fade and industrial production increase. The upside risk also include a renewed focus on easing Chinese credit policy and a global capex uptick but neither appear to be materialising, at present.

EUR/USD



	1M	3M	6M	12M
Danske Bank	1.04	1.03	1.02	1.00
Consensus	1.06	1.07	1.09	1.10
Forward	1.06	1.06	1.07	1.08

Hedging recommendations

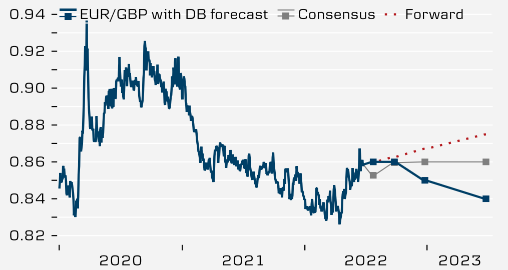
- **Income**: Sell USD via risk reversals.
- **Expenses**: Purchase USD via forwards.

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

GBP – renewed Brexit fears may start to weigh on GBP

- We expect the UK expansion will continue although at a slower pace due to high inflation eroding consumers' purchasing power and because the easy part of the post-covid recovery is now behind us.
- The Bank of England (BoE) hiked the Bank Rate by another 25bp to 1.25% in June and we expect two additional 25bp rate hikes this year, fewer than what markets are pricing in, although risks are definitely skewed to faster tightening. Relative rates have weighed on EUR/GBP for quite some time but not anymore. Looking forward, relative rates seem more supportive for EUR/GBP.
- It is still worth keeping an eye on the EU-UK negotiations on the implementation of the Northern Ireland protocol. Tensions are increasing, which may weigh on GBP in coming months.
- EUR/GBP has been trending higher lately. Looking forward, on one hand, the positive USD environment is usually benefitting GBP relative to EUR. On the other hand, relative rates now seem supportive for EUR relative to GBP. Overall, we keep our 12M EUR/GBP target unchanged at 0.84 despite we are likely to see some support to the cross near-term.
- A hit to global risk sentiment usually weakens GBP but if the war turns worse and/or the West imposes tougher sanctions on Russia, we are likely to see EUR/GBP moving somewhat lower again. EUR/GBP will move higher if ECB turns more hawkish. EU-UK tensions remain a risk.

EUR/GBP



	1M	3M	6M	12M
Danske Bank	0.86	0.86	0.85	0.84
Consensus	0.85	0.86	0.86	0.86
Forward	0.86	0.86	0.87	0.87

Hedging recommendations

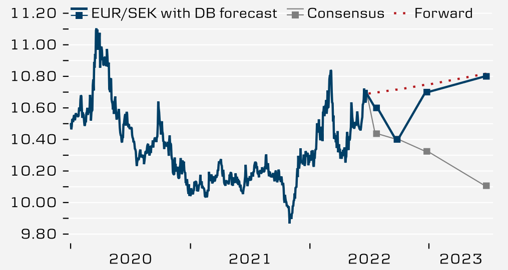
- **Income**: Sell GBP via forwards.
- **Expenses**: Buy GBP via forwards

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

SEK – weakness in store

- The Swedish economy contracted by 0.8% during Q1 (q/q) and data received thus far in Q2 is far from encouraging. Consumer confidence has plunged amid high inflation and the prospect of higher rates is starting to affect the housing market as well.
- Inflation continues to surprise to the upside and the Riksbank will tighten monetary policy significantly, just like it is the case for other central banks. We now expect 3x50bp, starting in June, before a final 25bp in February 2023 brings the repo rate to our end-point of 2.0%. This still falls somewhat short of money market pricing, which goes for an aggregate of 180bp until year-end (vs ours 150bp), which should cap the downside in EUR/SEK.
- Potential M&A related flows during usually illiquid summer months might push SEK-crosses a tad lower. The SEK has proven surprisingly resilient to the continued equity selloff during the past weeks, but there is still further downside if the selloff continues.
- Over the last month, EUR/SEK has moved higher hand in hand with ECB being re-priced even more aggressively than the Riksbank, poor risk sentiment and the significant selloff in equities. Our updated RB call falls short of market is pricing, hence, not an argument for additional SEK strength. However, we could still see a temporary rebound in SEK if risks improve and possible M&A flows.
- Meanwhile, we look for weaker SEK in the 6-12M perspective, e.g. on back of growing global recession risks.

EUR/SEK



	1M	3M	6M	12M
Danske Bank	10.60	10.40	10.70	10.80
Consensus	10.44	10.40	10.32	10.11
Forward	10.70	10.72	10.75	10.82

Hedging recommendations

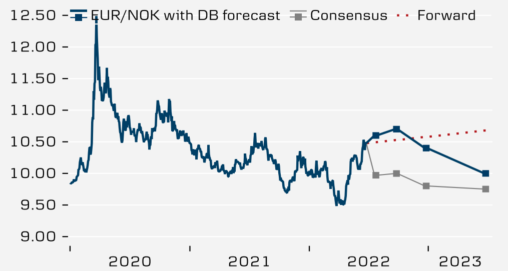
- **Income**: Sell SEK via forwards. Alternatively, consider knock-in forwards.
- **Expenses**: Sell SEK via forwards.

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

NOK – short-term risks still skewed to the topside

- Norwegian growth has picked up during spring amid the full reopening of the economy and corona restrictions getting lifted. Meanwhile, there are now clear indications that growth will slow in the second half of the year albeit to levels still above trend growth. In turn this move forward the tricky trade-off facing NB in terms of balancing employment against rising inflation.
- Norges Bank (NB) has now hiked policy rates by a total of 125bp after the recent 50bp hike. We are still not convinced that NB will deliver on its hawkish rate path (or according to market pricing) and hence we regard relative rates to be a negative factor for NOK FX compared to peers.
- With NB turning a NOK seller (now of NOK 1.5bn per day) a substantial tailwind to NOK from recent years has eased.
- We still regard the global investment environment to be key for NOK. In the current environment of weakening growth prospects and central banks still tightening financial conditions NOK remains vulnerable. We, however, still forecast a turnaround in NOK in the second half of the year based on a turn in the global credit impulse and slower tightening of financial conditions.
- We forecast EUR/NOK at 10.70 in 3M and 10.00 in 12M.
- A widespread global recession and a sharp sell-off in risk could send EUR/NOK substantially above our projection. On the other hand, a persistent move higher in oil and natural gas prices combined with an improved growth outlook could send EUR/NOK lower earlier-than-projected.

EUR/NOK



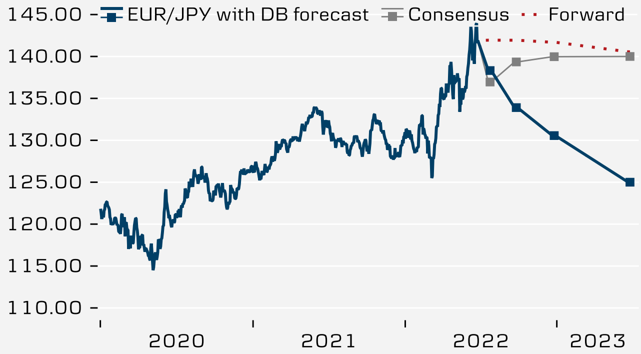
	1M	3M	6M	12M
Danske Bank	10.60	10.70	10.40	10.00
Consensus	9.97	10.00	9.80	9.75
Forward	10.49	10.53	10.58	10.68

Hedging recommendations

- **Income**: Sell NOK via forwards
- **Expenses**: Buy NOK via risk-reversals
- **Given the high uncertainty as for where NOK is headed next, we generally recommend a conservative approach to hedging.**

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

EUR/JPY



	1M	3M	6M	12M
Danske Bank	138.32	133.90	130.56	125.00
Consensus	136.95	139.35	139.97	140.00
Forward	141.94	141.94	141.69	140.56

Hedging recommendations

- **Income**: Sell JPY via risk reversals.
- **Expenses**: Buy JPY via forwards.

Source: Bloomberg, Danske Bank.
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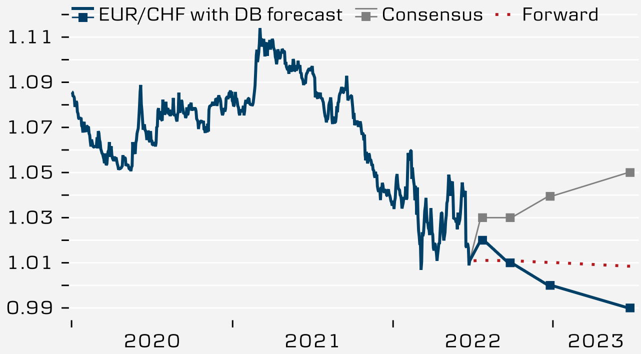
EUR/CHF



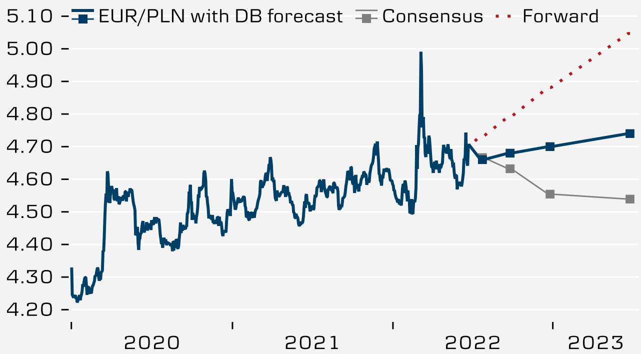
	1M	3M	6M	12M
Danske Bank	1.02	1.01	1.00	0.99
Consensus	1.03	1.03	1.04	1.05
Forward	1.01	1.01	1.01	1.01

Hedging recommendations

- **Income**: Sell CHF via risk reversals.
- **Expenses**: Buy CHF via forwards.

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

EUR/PLN



	1M	3M	6M	12M
Danske Bank	4.66	4.68	4.70	4.74
Consensus	4.67	4.63	4.55	4.54
Forward	4.73	4.79	4.88	5.05

Hedging recommendations

- **Income**: Sell PLN via forwards.
- **Expenses**: Buy PLN via forwards.

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

EUR/RUB

Hedging recommendations

- Given the high degree of uncertainty with respect to sanctions and the outlook for RUB markets, we have decided to temporarily suspend our RUB FX forecast.
- The market is highly dysfunctional at present and our general recommendation is to limit RUB exposure to the extent possible.
- As we get more clarity on the state of Russian markets, sanctions and RUB in the coming months we will revise this decision.

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

Danske Banks' FX forecasts

G10				Last Update:	24/06/2022
	Spot	+1m	+3m	+6m	+12m
Exchange rates vs EUR					
EUR/USD	1.053	1.04	1.03	1.02	1.00
EUR/JPY	141.6	138	134	131	125
EUR/GBP	0.858	0.86	0.86	0.85	0.84
EUR/CHF	1.011	1.02	1.01	1.00	0.99
EUR/SEK	10.69	10.60	10.40	10.70	10.80
EUR/NOK	10.49	10.60	10.70	10.40	10.00
EUR/DKK	7.4388	7.4400	7.4425	7.4450	7.4500
EUR/AUD	1.523	1.49	1.49	1.50	1.52
EUR/NZD	1.671	1.63	1.63	1.65	1.64
EUR/CAD	1.367	1.36	1.37	1.37	1.34
EM					
	Spot	+1m	+3m	+6m	+12m
EUR/PLN	4.708	4.66	4.68	4.70	4.74
EUR/HUF	401	400	403	405	410
EUR/CZK	24.8	24.7	24.7	24.5	24.0
EUR/RUB	57.1	SUSP	SUSP	SUSP	SUSP
EUR/TRY	18.30	18.7	20.6	21.4	23.0
EUR/ZAR	16.77	16.6	16.5	16.3	17.0
EUR/CNY	7.05	7.07	7.06	7.09	7.10
EUR/INR	82.5	80.6	80.3	80.1	79.0

Source: Bloomberg, Danske Bank

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