Danske Bank
Markets

Investeringanalyse

24 October 2016

Market Guide

Scandinavian divergence

- Oil prices have picked up on prospects of OPEC deal
- Upward risk to interest rates and yields
- Divergence between NOK and SEK looks stretched

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Editorial deadline 24 October 2016 *Inves tment Research*

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Statistical sources: Macrobond Financial, OECD, IMF, Statistics Denmark and other national statistical institutions plus Danske Bank calculations.

The next issue of the Market Guide is due in mid-November 2016.

Market overview

OPEC reaches outline deal to cut production

At an extraordinary meeting held in Algeria at the end of September, the OPEC nations agreed to introduce a ceiling on OPEC's total output of around 32.5-33.0m barrels per day, which would imply a production cut from the current level. In doing so, OPEC has taken a large step towards working as a cartel once again. However, the impact on the oil market and oil prices remains to be seen and OPEC still needs to decide on how to distribute the output cut between the member nations. In this context, word has it that Iran, Libya and Nigeria may be exempt from the agreement, as these countries are currently producing at sub-par capacity. Most recently, Russia also became involved in negotiations and may contribute an independent cut or announce a production ceiling.

If OPEC should reach a final agreement, possibly together with Russia, it would push oil prices up. Indeed, oil prices have already gone up on expectations of an accord. However, we see no reason to fear a surge in crude prices. Firstly, we believe any final deal would cut OPEC production only slightly. Secondly, the agreement could pave the way for an increase in US oil production. Other things being equal, the latter would simply mean that the OPEC deal would move market share from OPEC to the US. We expect oil prices to remain around the USD50/bl mark for the rest of 2016 and to rise to USD58/bl towards the end of 2017.

Markets hoping for major monetary policy decisions in December

The US Federal Reserve stayed on hold at its meeting in September. Focus has now shifted to the December FOMC meeting, with fixed income markets currently pricing a 70% likelihood of a 25bp rate hike. The US labour market has continued to improve at a moderate pace, though without any signs of upward wage or inflationary pressures. Other US economic data have been a mixed bag. Growth in consumer spending has ground to a halt and the manufacturing industry is still struggling. The service sector, on the other hand, has its bright spots. Come the December meeting, we expect the Fed to once more lack the courage to hike and we do not expect a rate hike until in March next year. By December, the committee set up by the European Central Bank (ECB) to evaluate monetary policy is set to have completed its task. We expect the ECB to announce a further six-month extension of QE at its December meeting, extending the QE programme until September 2017.

Sterling has plummeted

Sterling has continued to weaken over the past month, with EUR/GBP now trading at around 0.89. The increase in EUR/GBP is due to the ripple effects of Brexit and the subsequent policy easing by the Bank of England (BoE). The weakening of sterling has cushioned the British economy, making the short-term economic consequences of Brexit bearable. For this reason, we do not expect a BoE rate cut until early next year. The long-term economic consequences of Brexit depend on what the world looks like post the UK's EU exit. The Brexit negotiations now look likely to commence early next year.

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Read more in Danske Bank's recent forecasts and publications

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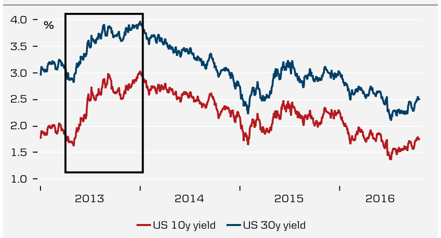
Interest rate hedging

- **It is too early to price a tapering of QE in the euro area and we continue to expect the ECB to announce a six-month extension of QE purchases at its December meeting (likely to maintain monthly purchases at EUR80bn).**
- **As such, we still do not expect EUR yields to rise significantly over the next three months. However, risks seem to have become more asymmetric (being skewed more on the upside than previously), as the big unknown is how the market would react to any tapering of the ECB's QE programme or a decision not to extend the purchases.**
- **We recommend that borrowers increase the proportion of fixed-rate debt in their debt portfolios. We continue to see most value at the long end of the EUR yield curve for 10Y-plus maturities.**
- **We generally recommend having a relatively high hedge ratio on USD liabilities and locking in rate exposure at all maturities from 2Y and beyond. However, we have lowered our liability duration recommendation slightly, as we expect US bond yields to fall over the next three months.**

Too early to price ECB tapering

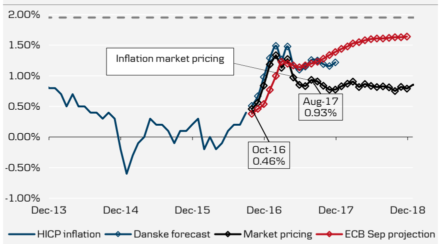
A couple of weeks ago, Bloomberg ran a story that, according to 'ECB sources', the ECB was considering tapering its current EUR80bn a month QE programme (scaling down bond purchases). If there is something global bond investors have respect for, it is tapering. When Fed Chairman Ben Bernanke signalled in May 2013 that the Fed would taper QE, it triggered a significant sell-off in which 10Y Treasury yields rose more than 135bp in five months. Indeed, yields peaked before the actual tapering started in January 2014. In other words, it was the 'taper announcement' the market reacted to, not the actual tapering. The ECB has been eager to 'kill the story' but the genie is out of the bottle and the market is now on 'tapering alert'. However, it is not our baseline view that the ECB is going to announce tapering within the next three months and we continue to expect the ECB to announce a six-month extension of QE purchases at its December meeting (monthly purchases to be maintained at EUR80bn). Hence, we keep our view that neither EUR short or long yields will rise significantly over the next three months.

The announcement of Fed tapering in May 2013 triggered a significant sell-off of US bonds



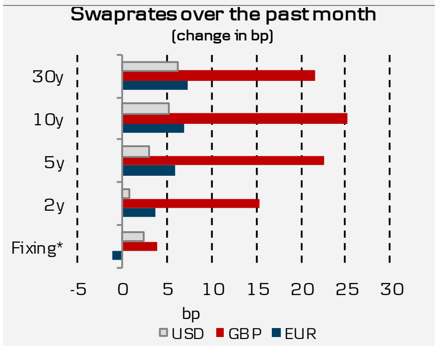
Source: Bloomberg, Danske Bank Markets

Eurozone inflation set to pick up over the next couple of months



Source: Bloomberg, Danske Bank Markets

EUR, USD and GBP yield curves have steepened over the past month



** EUR: 6M Euribor, GBP: 6M Libor, USD: 3M Libor*

Source: Bloomberg

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Upside risk to bond yields

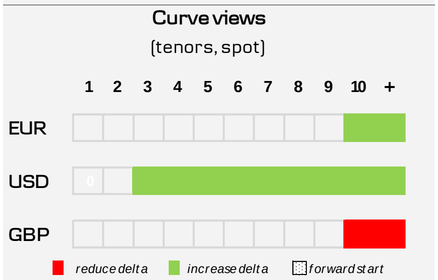
The big unknown is how the market would react over the next year if (contrary to our expectation) the ECB began tapering its QE programme or decided not to prolong purchases at all. Hence, even though we already expect to see mainly EUR 10Y rates rise on a 12M horizon, the risk has become more asymmetric, being skewed more on the upside, not only for 10Y but also for 5Y maturities, which are normally sensitive to changes in monetary policy outlook.

Saying this, the risk also seems more asymmetric on a 3M horizon. Over the next couple of months, we expect inflation to pick up in the euro area. Even though the pickup relates mainly to a base effect (higher oil prices), it would tend to push nominal yields higher. We have also seen resilient economic indicators from the euro area recently, indicating that the impact of Brexit on the euro area economy so far has been limited.

EUR hedging recommendation

Overall, we expect the ECB to announce an extension of QE at its December meeting (with purchases remaining at EUR80bn a month). As such, we expect no significant increase in EUR yields on a 3M horizon. However, as mentioned, risks have become more asymmetric (greater upside risk), so we keep our general recommendation of modestly overweighting duration on the EUR curve. As such, we recommend that borrowers increase the proportion of fixed-rate debt in their EUR portfolios. We continue to see most value at the long end of the EUR yield curve, i.e. from 10 years and beyond. As our forecast for EUR money market rates is broadly in line with forward curves, we recommend hedging with spot starting.

Hedge only very long end in EUR



Source: Danske Bank Markets

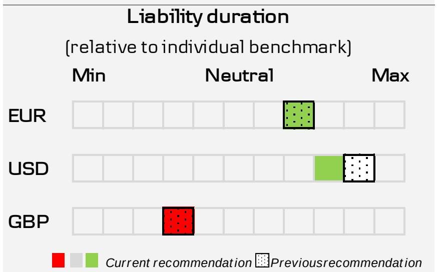
Close call on whether the Fed will hike this year

Another important event is the December Fed meeting. Admittedly, it is a close call as to whether or not the Fed will hike in December but we still think it will eventually decide to stay on hold, as we believe it was too optimistic on the current economic situation at the latest FOMC meeting in September – but here also the risk is skewed towards a rate hike.

USD hedging recommendation

We still recommend having a relatively high hedge ratio on USD liabilities and locking in rate exposure at all maturities from 2Y onward. However, we lower slightly our liability duration recommendation, as we expect US bond yields to fall over the next three months as markets price out a rate hike in 2016. As we expect US yields to rise again on a 3M-12M horizon as markets start pricing new rate hikes, we keep the recommended liability duration relatively high.

Moderate overweight duration in EUR



Source: Danske Bank Markets

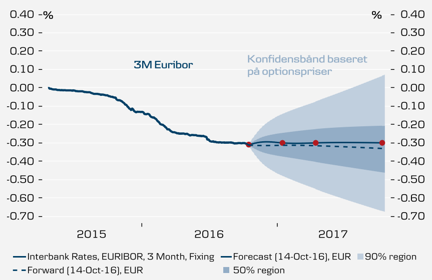
Interest rate outlook on 6M-12M horizon

	EUR	GBP	USD
Money markets	With ample liquidity due to the ECB's QE programme and the ECB set to maintain its deposit rate at -0.40% throughout the forecast period, we expect Euribor fixings to remain unchanged at around current levels for the next 12 months.	We expect the BoE to keep the Bank Rate unchanged until February, when we see more than a 50% chance of a rate cut from 0.25% to 0.10%. Markets have priced in a 3bp cut in February.	We do not rule out a Fed rate hike in December if economic data improve but this is not our baseline scenario. Note also that we continue to expect USD Libor fixings to increase on the effects of the US money market reform. As such, we forecast 3M USD Libor to be relatively high over the coming six months even though we do not expect a Fed hike this year.
Curves	The big unknown is how the market would react on a 3M and, not least, a 12M horizon if (contrary to our expectations) the ECB were to start tapering its QE programme or to decide not to prolong the purchases at all. Hence, even though we already expect to see mainly EUR 10Y yields increase on a 12M horizon, the risk has become more asymmetric, being skewed more on the upside, not only for 10Y but also for 5Y maturities, which are normally sensitive to changes in the monetary policy outlook.	After yields on Gilts fell sharply on the back of the restart of the BoE's asset purchase programme and expectations of further BoE easing, yields have increased significantly in recent weeks, driven by higher inflation expectations on the back of the weaker GBP. We expect UK yields to fall slightly in coming months as the ECB extends QE, a December Fed hike is priced out and we perhaps see temporary GBP strengthening before moving up again slightly in 6M-12M.	We expect US bond yields to fall over the next three months, as markets price out a rate hike this year. We forecast US 2Y and 10Y yields will decline to 0.80% and 1.70%, respectively, by the end of 2016. US yields will probably begin to increase again on a 3M-12M horizon as markets start pricing new rate hikes. We expect 2Y and 10Y yields to trade at 1.30% and 2.10%, respectively, 12 months from now.

Source: Danske Bank Markets

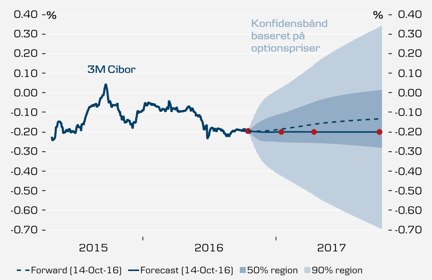
Danske Bank Markets' interest rate forecasts

3M Euribor and forecast



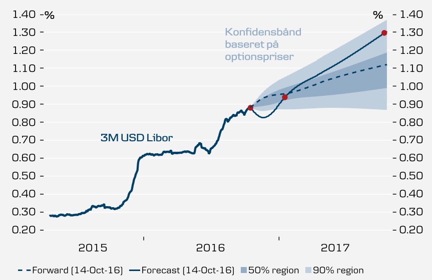
Source: Danske Bank Markets

3M GBP Libor and forecast



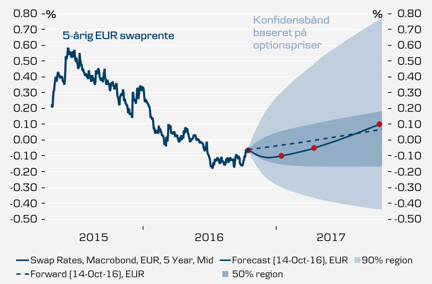
Source: Danske Bank Markets

3M USD Libor and forecast



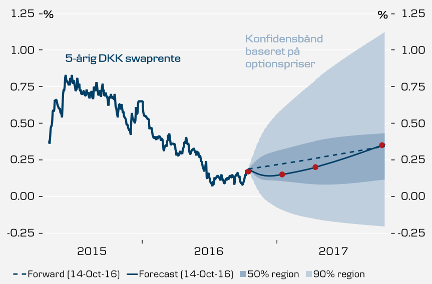
Source: Danske Bank Markets

5Y EUR swap rate and forecast



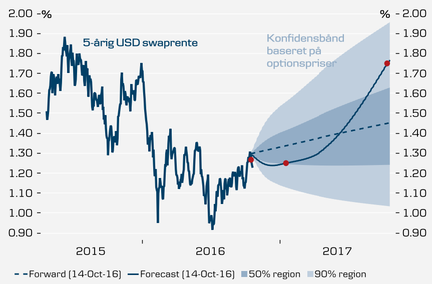
Source: Danske Bank Markets

5Y GBP swap rate and forecast



Source: Danske Bank Markets

5Y USD swap rate and forecast



Source: Danske Bank Markets

Danske Bank's yield forecast (14 October 2016))

	Horisont	CB rente	3m xIbor	2-årig swp	5-årig swp	10-årig swp	2-årig stat	5-årig stat	10-årig stat
USD	Spot	0.50	0.88	1.07	1.30	1.60	0.86	1.28	1.77
	+3m	0.50	0.94	1.05	1.25	1.70	0.80	1.25	1.80
	+6m	0.75	1.06	1.05	1.30	1.80	0.80	1.30	1.90
	+12m	1.00	1.30	1.55	1.75	2.00	1.30	1.70	2.10
EUR*	Spot	0.00	-0.31	-0.20	-0.06	0.42	-0.66	-0.49	0.05
	+3m	0.00	-0.30	-0.25	-0.10	0.40	-0.65	-0.50	0.00
	+6m	0.00	-0.30	-0.20	-0.05	0.60	-0.60	-0.45	0.20
	+12m	0.00	-0.30	-0.10	0.10	1.00	-0.50	-0.30	0.60
DKK	Spot	0.05	-0.20	0.01	0.19	0.69	-0.51	-0.28	0.17
	+3m	0.05	-0.20	-0.05	0.15	0.65	-0.55	-0.30	0.10
	+6m	0.05	-0.20	0.00	0.20	0.85	-0.50	-0.25	0.30
	+12m	0.05	-0.20	0.10	0.35	1.25	-0.40	-0.10	0.70

Note: * Tyske statsobligationer er benyttet

Source: Danske Bank Markets

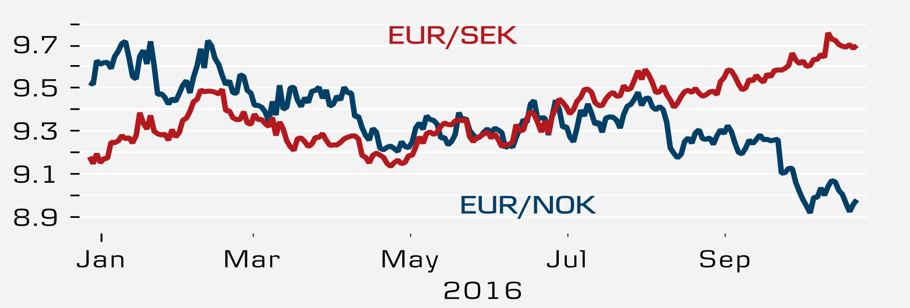
FX hedging

- **The NOK and the SEK have diverged considerably since July, with the NOK appreciating strongly and the SEK weakening.**
- **From a fundamental perspective, we continue to see both the NOK and the SEK appreciating against the EUR over the next 12 months. Short term, however, we expect divergence to fade, as both the NOK appreciation and the SEK weakening seem overdone.**
- **We expect EUR/NOK to climb towards 0.92 on a 3M horizon and we believe EUR/SEK is near the peak level.**
- **We recommend hedging SEK-denominated income through knock-in forwards with window barriers and hedging expenses through FX forwards.**
- **We recommend hedging NOK-denominated income to be received over the next three months through forward contracts, while longer tenor income may be hedged through knock-in forwards. An alternative to FX forward hedging would be 'accumulator' strategies allowing for the sale of the NOK at attractive levels over the next six months.**
- *See page 12 for our updated hedging recommendations for selected currencies.*

Strong NOK-SEK divergence

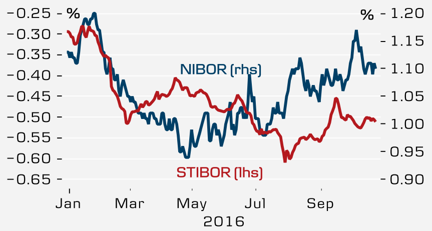
The NOK and the SEK have been diverging considerably since July, with the NOK appreciating strongly and the SEK weakening. A likely explanation is the effects deriving from the US money market reform, which have contributed to pushing up unsecured NOK money market rates over the summer while similarly depressing SEK rates. Also, Norwegian data have generally surprised on the upside, while Swedish data have fallen short of expectations, indicating a looming weakness in the Swedish economy.

NOK and SEK going their separate ways



Source: Macrobond Financial, Danske Bank Markets

Divergent money market rates

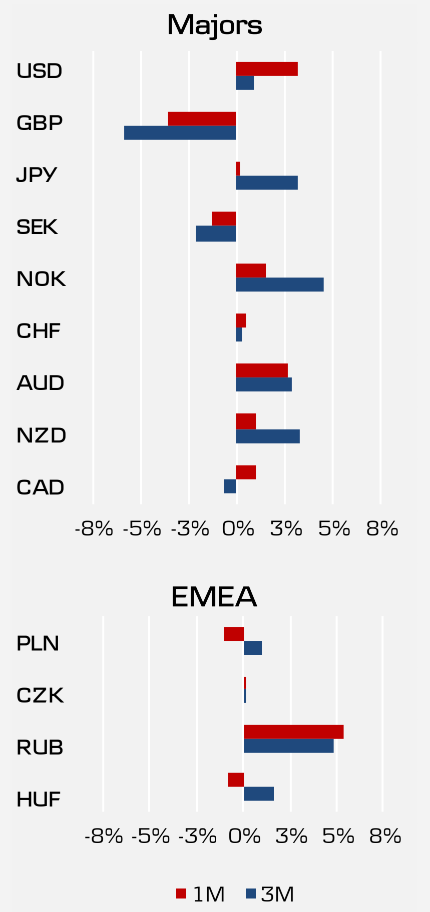


Source: Macrobond Financial, Danske Bank Markets

Key data also diverged over the summer

Source: Macrobond Financial, Danske Bank Markets

FX changes relative to EUR



Source: Bloomberg, Danske Bank Markets

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NOK outlook

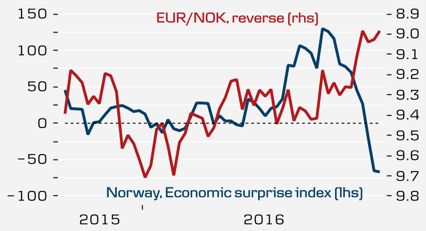
We continue to see the NOK as fundamentally cheap, expecting EUR/NOK to trade lower on a 6-12M horizon supported by growth, the real yield spread and oil prices. This said, we believe the recent appreciation is overdone. In our view, it is very likely that EUR/NOK is bound for a correction and will trade higher by the end of 2016. We expect the cross to trade at 9.20 on a 3M horizon.

We base our projection of EUR/NOK trading higher over the next few months on a number of factors. First, we believe the NOK needs to align to the consistently negative surprises provided by Norwegian data over the past month, which follow a string of positive moves over the summer.

The oil price has risen from around USD46/bl to USD52/bl since OPEC countries agreed in September to cap their oil output. The higher oil price has undoubtedly supported the NOK. We believe the market is too positive on the OPEC deal, because it may have little effect and reduce overall output by only a small margin. In addition, a Fed rate hike is certainly still on the table and while we do not expect the Fed to hike in December, we would not rule it out completely. A US rate hike would be US dollar supportive but would soften oil prices due to a lower risk appetite and a sluggish growth outlook. A stronger US dollar would also tend to weigh on oil prices. Near term, we see a risk of Brent falling to USD46-48/bl, which would mean stronger headwinds for the oil-reliant NOK.

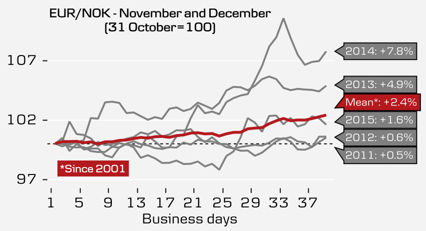
Last, but not least, we expect mounting NOK headwinds due to seasonal effects, which, combined with generally low liquidity late in the year, have historically tended to weaken the NOK. Since 2001, EUR/NOK has increased by an average of 2.4% over the final two months of the year.

NOK appreciating in October despite very disappointing data



Source: Macrobond Financial, Danske Bank Markets

NOK often weakens against EUR in the later months of the year



Source: Macrobond Financial, Danske Bank Markets

SEK outlook

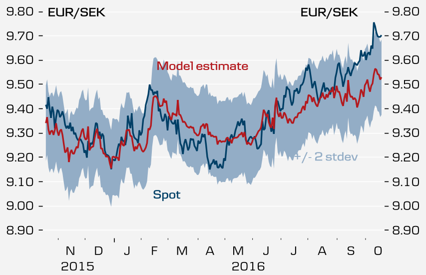
The strong EUR/SEK rally broke key resistance levels and we would not rule out that it has further to run near term. However, we also note that the pair is looking increasingly overbought technically and relative to our short-term financial models. A stretched valuation is a strong argument for lower EUR/SEK levels.

Swedish macro readings have fallen short of expectations for some time, with the economic surprise index in negative territory since April. The cyclical backdrop is becoming less favourable for the SEK but we believe much of this is already reflected in the current EUR/SEK rate. We believe it is only a matter of time before it moves into positive territory with key data providing tailwinds rather than headwinds for the SEK. **We expect EUR/SEK to edge gradually lower towards 9.20 on a 12M horizon.**

In the very short term, we expect the Riksbank's next policy meeting on 27 October to define the direction for the SEK. In our baseline scenario, the Riksbank is likely to extend its current QE programme by six months and increase it by SEK20bn in nominal bonds and SEK10bn in linkers. Our scenario was supported by the big negative inflation surprise in September, which brought CPIF 0.4pp below the Riksbank forecast. Looking a little further ahead, we also expect the Riksbank to be too optimistic in its inflation forecast, this being the main reason we expect further Riksbank easing.

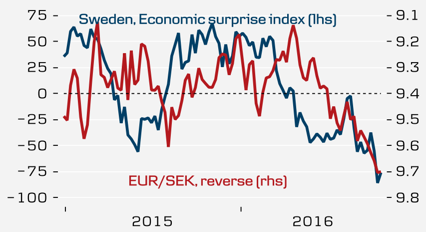
An October easing could temporarily weaken the SEK and keep it at current levels for some time. On the other hand, the recent EUR/SEK rally has made the Riksbank more likely to stay on the sidelines until its meeting on 21 December, waiting for signals from the ECB policy meeting on 8 December and a likely extension of the ECB QE programme by a further six months to September 2017.

EUR/SEK significantly overbought



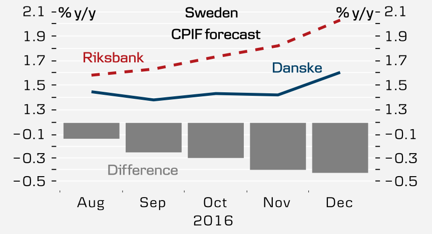
Source: Macrobond Financial, Danske Bank Markets

SEK set to find support in stronger Swedish data



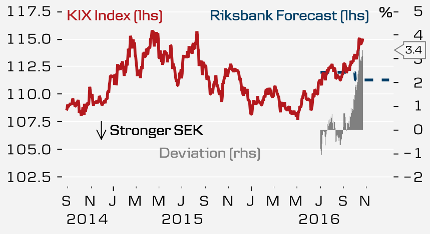
Source: Macrobond Financial, Danske Bank Markets

Riksbank inflation forecast too optimistic



Source: SCB, Riksbank. Danske Bank Markets

KIX index weaker than Riksbank forecast



Source: Riksbank. Danske Bank Markets

Hedging FX risk

Hedge SEK-denominated expenses via FX forwards

We generally recommend that companies lock in SEK-denominated expenses via FX forwards on a 12M horizon, which in our view look very attractive following the SEK weakening in recent months.

Hedge SEK-denominated income via options

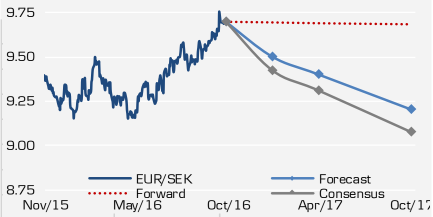
We generally recommend hedging SEK-denominated income via options that maintain a profit potential in the event of any SEK strengthening, while securing a worst-case exchange rate.

Specifically, we recommend hedging SEK-denominated income via knock-in forwards with step window barriers, with the barrier open for one month before each maturity date and the barrier being raised gradually over the life of the strategy. A 12M strategy including 12 independent payments (the first on 23 November 2016) could, for example, be entered at zero cost (indicative pricing, spot ref. 9.6930) and would allow one to take advantage of any fall in EUR/SEK down to 9.4000 in the first three months, EUR/SEK 9.2500 in the following three months, EUR/SEK 9.0800 in the next three months and 8.9700 in the final three months. Also, the strategy would secure a maximum EUR/SEK rate of 9.8500 for the entire period. As such, this strategy would enable one to take advantage of an expected SEK appreciation, while protecting one against any further weakening of the SEK.

If EUR/SEK is trading above 9.8500 on a settlement date, one would have the right to buy EUR/SEK at 9.8500. If EUR/SEK has traded below 9.4000 at any time in the month before a settlement date in the first three months of the strategy, one would be obliged to buy EUR/SEK at 9.8500 on the specific settlement date. Likewise, if EUR/SEK has traded below 9.2500 at any time during the fourth and six months, one would be obliged to buy EUR/SEK at 9.8500 on the following settlement date. If EUR/SEK has traded below 9.0800 at any time in the seventh and ninth months, one would be obliged to buy EUR/SEK at 9.8500 on the following settlement date. Finally, if EUR/SEK has traded below 8.9700 at any time in the 10th and 12th months, one would be obliged to buy EUR/SEK at 9.8500. If the spot rate is trading below EUR/SEK 9.8500 on a settlement date and EUR/SEK has not traded below 9.400, 9.2500, 9.0800 or 8.9700, respectively, in the month before settlement, one would have the option of buying EUR/SEK at the spot rate on that date. Given our forecast of EUR/SEK trading at 9.20 in 12M, combined with an attractive worst-case exchange rate, we find this strategy attractive.

We emphasise that the 12 payments are independent, so if, for example, EUR/SEK has traded below 9.4000 in a month during the first three-month period of the strategy, this would affect only the payment on the following payment date. If EUR/SEK again increases above 9.4000, all the following payments would be unaffected. As such, one would only lose the option of buying EUR/SEK at the spot rate if EUR/SEK has traded below the relevant barrier in the month before settlement.

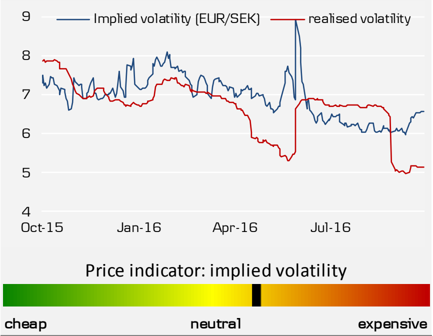
EUR/SEK forecast



	3M	6M	12M
DB forecast	9.50	9.40	9.20
Forward	9.70	9.69	9.69
Cons. Forecast	9.42	9.31	9.07

Source: Bloomberg, Danske Bank Markets

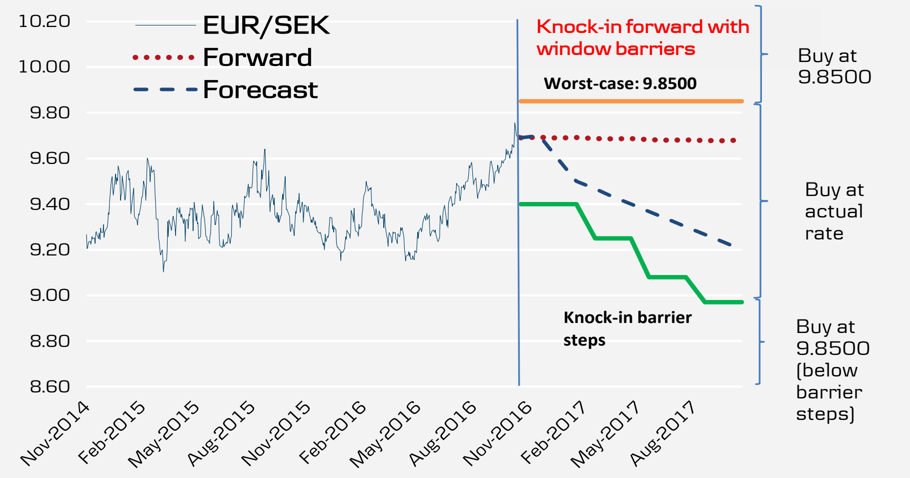
SEK volatility in neutral territory



Source: Bloomberg, Danske Bank Markets

The chart below illustrates the strategy

Hedge SEK-denominated income via knock-in forwards with step window barriers



Note: The structure illustrated above is a 12M hedging strategy for SEK-denominated income. It is a knock-in forward strategy with window barriers (the first payment on 23 November 2016 and the last on 23 October 2017). The strategy is a zero-cost strategy (indicative pricing, spot ref. 9.6930) with an upper worst-case exchange rate of 9.8500 and knock-in window barriers of 9.4000, 9.2500, 9.0800 and 8.9700, respectively.
Source: Danske Bank Markets

Hedge NOK-denominated expenses via FX forwards – alternatively, consider a participating forward strategy for the first three months

We generally recommend that companies lock in NOK-denominated expenses at current levels, which look very attractive from a long-term perspective, in our view.

In the short term, consider taking advantage of the decline in NOK volatility to enter a participating forward strategy for the coming three months. Contrary to a regular FX forward, a participating forward would enable one to capitalise on any weakening of the NOK towards the end of the year. A negative is that in this strategy, the worst-case exchange rate is slightly less attractive relative to the forward exchange rate. On 4M-12M horizons, we recommend hedging NOK-denominated expenses via regular FX forwards.

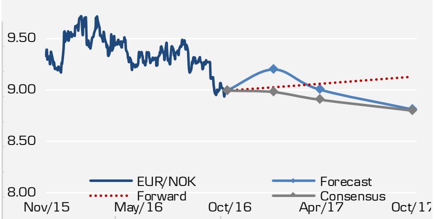
Hedge long-term NOK-denominated income via options and short-term NOK income via FX forwards – alternatively, consider an accumulator

We generally recommend that companies lock in short-term NOK-denominated income at current levels, as we see potential for a short-term NOK weakening following the significant NOK appreciation over the past month. Specifically, we recommend hedging FX risk via FX forwards in the coming three months.

On 4M-12M horizons, we recommend hedging NOK-denominated income via options that maintain a profit potential in the event of any NOK strengthening, while securing a worst-case strategy. Specifically, we recommend hedging via a knock-in forward strategy with step window barriers for income receivable over the next 4-12 months (see the description of this strategy under SEK-denominated income above). This strategy would allow one to take advantage of any decline in EUR/NOK down to a specified level, while securing an attractive worst-case exchange rate.

Alternatively, consider using an accumulator to hedge FX risk in the coming six months. This strategy would allow one to buy EUR/NOK at more attractive levels relative to the forward exchange rate if EUR/NOK is trading in a given range on a settlement date. Note, though, that the strategy does not guarantee a worst-case exchange rate.

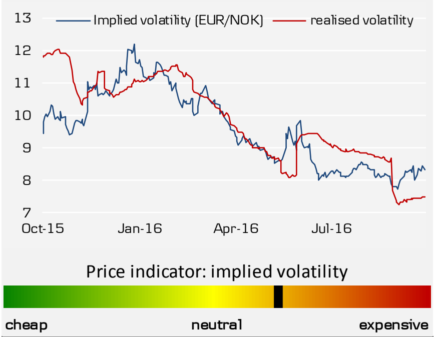
EUR/NOK forecast



	3M	6M	12M
DB forecast	9.20	9.00	8.80
Forward	9.02	9.05	9.12
Cons. Forecast	8.97	8.90	8.79

Source: Bloomberg, Danske Bank Markets

NOK volatility has fallen to 'neutral' levels

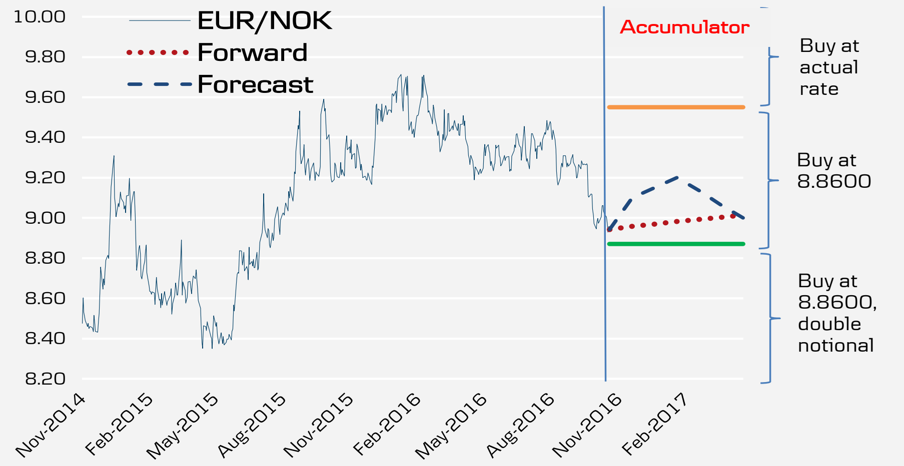


Source: Bloomberg, Danske Bank Markets

The accumulator with one monthly payment would include six independent payments and would allow one to buy EUR/NOK at 8.8600 on each settlement date if EUR/NOK is trading in the 8.8600-9.5700 range at settlement. As the forward premium goes against a company wanting to hedge NOK-denominated income, the accumulator would secure a more attractive EUR/NOK buying rate than a regular FX forward. However, if EUR/NOK is trading above 9.5700 on a settlement date, the entire hedge would be lost and one would have to buy EUR/NOK at the spot rate on that date. Although we see potential for a short-term NOK weakening, we see only a modest risk of EUR/NOK rising to its February peak and we forecast EUR/NOK will peak at 9.20 three months from now. If EUR/NOK is trading below 8.8600 on a settlement date, one would be obliged to buy the double EUR/NOK notional at 8.8600, so the strategy would effectively leave one with a theoretically unlimited risk of loss.

The chart below illustrates the strategy.

Alternative strategy: hedge NOK-denominated income via an accumulator



Note: The structure illustrated above is a 6M accumulator hedging strategy for NOK-denominated income. It is a zero-cost strategy (indicative pricing, spot ref. 8.9550). The first payment is due on 23 November 2016 and the last on 24 April 2017).
Source: Danske Bank Markets

USD – short-term downside risk, still higher longer term

Short-term, we see downside-risk in EUR/USD, with relative growth expectations and relative interest rates set to weigh on the cross. Longer term, we maintain our view that fundamentals will move the cross higher. We target the cross at 1.09 in 1M, 1.08 in 3M, 1.11 in 6M and 1.15 in 12M.

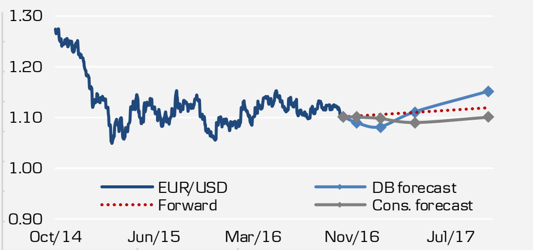
Outlook for EUR/USD

- Recently, US growth has risen gradually, suggesting that the economy is picking up speed in H2 relative to H1, with employment growth being remarkably resilient. We expect US growth to grow close to trend at 2% in coming quarters. In the euro area, GDP growth showed decent GDP growth of 0.3% q/q in Q2 16 and initial survey indicators suggest fairly resilient economic conditions post the Brexit vote. In 2017, we expect growth to slow from lower investments and slightly weaker private consumption growth.

- We still believe that the Fed will wait until H1 17 to raise interest rates but it is a close call whether it will act in December. Near term, the market is likely to focus on the Fed raising interest rates in December supporting the USD. The market is pricing in around two-thirds probability of a December Fed rate hike. Meanwhile, we expect the ECB to announce in December an extension of its current QE programme by six months to September 2017. We think it is unlikely the ECB will cut interest rates further.

- Over the next one to three months, we expect politics, relative growth expectations and interest rates to weigh on EUR/USD. In particular, we expect recent signals the UK will opt for a hard Brexit to weigh on EUR/USD near term. 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, we expect the Fed to raise interest rates very gradually.

EUR/USD



	1M	3M	6M	12M
DB forecast	1.09	1.08	1.11	1.15
Forward	1.10	1.11	1.11	1.12
Cons. forecast	1.10	1.10	1.09	1.10

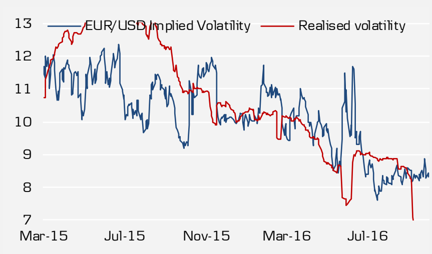
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

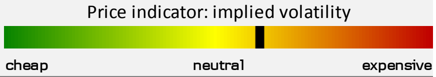
Income	Expenses
We recommend hedging USD income in the coming three months via a risk-reversal strategy. We recommend utilising a move lower in EUR/USD to lock in USD income longer term via FX forwards.	We recommend that companies hedge USD-denominated expenses in the coming months via FX forwards. Longer term, we recommend hedging via knock-in forwards.

Source: Bloomberg, Danske Bank Markets

3M volatility



Price indicator: implied volatility



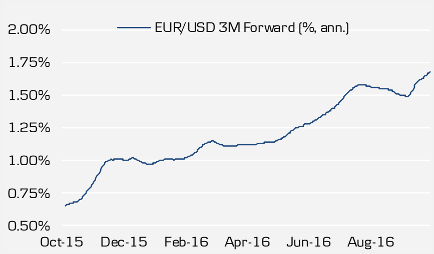
Source: Bloomberg, Danske Bank Markets

3M risk reversal

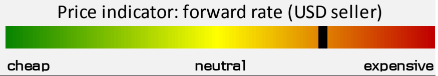
Price indicator: risk reversal (USD seller)

Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Price indicator: forward rate (USD seller)



Source: Bloomberg, Danske Bank Markets

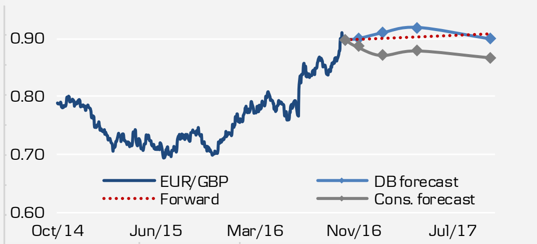
GBP – risk of 'hard Brexit' set to weigh on GBP

Economic data out of the UK has been better than feared but with indications of a 'hard Brexit' the GBP has weakened over the past month. We target EUR/GBP at 0.90 in 1M, 0.91 in 3M, 0.92 in 6M and 0.90 in 12M.

Outlook for EUR/GBP

- Economic data since the UK's EU vote has been much better than feared and better than the BoE projected back in August in its latest Inflation Report. The latest Q3 GDP growth estimate from NIESR, which is usually a good predictor of actual GDP growth, suggests GDP grew 0.4% q/q in Q3. This is slower than before the EU vote but still a solid growth rate from a global perspective.
- As the economy has been resilient to Brexit uncertainty so far, we no longer expect the BoE to provide additional stimuli to the economy at the November meeting. However, we see a risk that business confidence and growth may eventually take a hit from Theresa May's harsh stance on Brexit and we now expect the BoE to keep the Bank Rate unchanged until February, when we see more than a 50% chance of a rate cut from 0.25% to 0.10%. Markets have priced in a 2bp cut for February. Some have argued that the market weakening of the GBP means the BoE cannot ease further due to increasing inflation pressure from higher import prices. However, it is important to remember that the BoE has communicated that it accepts inflation will increase above the 2% target in coming years to support the economy.
- EUR/GBP has increased sharply over the past few weeks, as Brexit has returned as a theme in the market following the statement by UK Prime Minister May, that she will trigger Article 50 before March 2017, which implies that we might be heading for a 'hard Brexit'.

EUR/GBP



	1M	3M	6M	12M
DB forecast	0.90	0.91	0.92	0.90
Forward	0.90	0.90	0.90	0.91
Cons. forecast	0.89	0.87	0.88	0.87

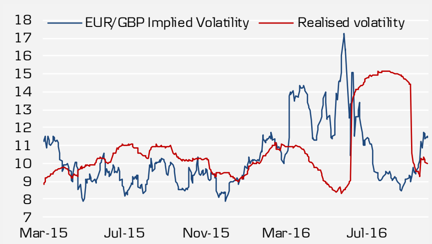
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

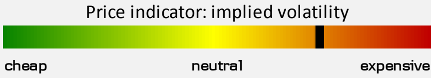
Income	Expenses
We recommend that companies hedge the exchange-rate risk on GBP-denominated income receivable via FX forwards.	We recommend hedging GBP expenses payable over the coming 12 months via a risk-reversal strategy.

Source: Bloomberg, Danske Bank Markets

3M volatility

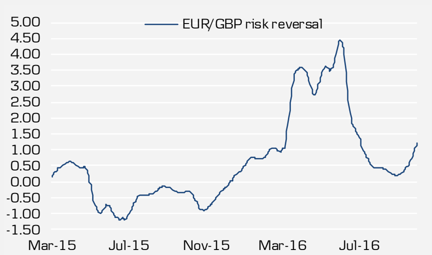


Price indicator: implied volatility



Source: Bloomberg, Danske Bank Markets

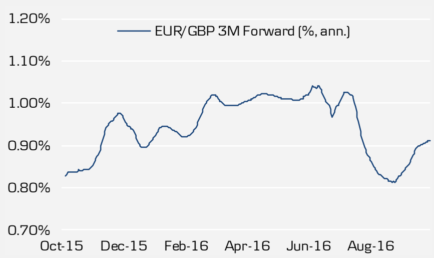
3M risk reversal



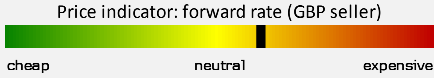
Price indicator: risk reversal (GBP seller)

Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Price indicator: forward rate (GBP seller)



Source: Bloomberg, Danske Bank Markets

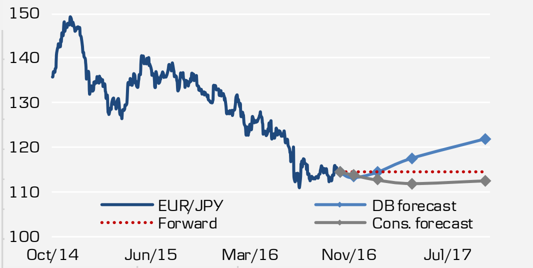
JPY – we expect the BoJ to keep policy unchanged

With the ECB and BoJ on hold for now, we see the cross trading sideways near term. Longer term, EUR/JPY should move higher, as the EUR remains under-valued. We target EUR/JPY at 113 in 1M, 114 in 3M, 118 in 6M and 122 in 12M.

Outlook for EUR/JPY

- Q2 GDP was revised higher to 0.2% q/q, from the initial estimate of 0.0% q/q and the PMI manufacturing business survey has bounced back in recent months. Moreover, the Q3 Tankan report was more or less unchanged from Q2, suggesting a stabilisation in the manufacturing sector. We expect the government's fiscal stimulus package to lift growth by c.0.3pp in 2016 and 0.9pp in 2017 and we expect the economy to continue growing above trend in the next year. We forecast GDP growth of 0.6% in 2016 and 1.1% y/y in 2017.
- In line with our expectations, the Bank of Japan (BoJ) did not add new monetary easing at the 20-21 September monetary policy meeting. However, it introduced a new monetary policy framework called 'QQE with yield curve control'. In our main scenario, we expect the Japanese economy to continue growing above trend in the coming year and we expect the BoJ to keep monetary policy unchanged throughout our 12-month forecast horizon. This implies that the BoJ will continue to expand its monetary base at an annual pace of around JPY80trn. We expect the BoJ to remain on an easing bias and the risk is skewed towards additional easing – not tightening. The BoJ maintained its negative interest rate policy and we think it will cut rates further into negative territory if additional easing is required.
- Over the medium term, we expect the underlying support for the JPY, stemming from fundamental flows to remain intact but we see the effects diminishing as the yen is no longer undervalued. Moreover, we expect the market to continue to price in a probability of a BoJ rate cut in the future, which would remain a supporting factor for the cross.

EUR/JPY



	1M	3M	6M	12M
DB forecast	113.36	114.48	117.66	121.90
Forward	114.57	114.57	114.57	114.53
Cons. forecast	113.89	112.80	112.00	112.59

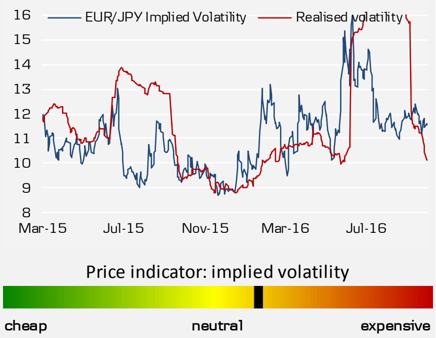
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

Income	Expenses
We recommend hedging JPY income via FX forwards.	We recommend hedging JPY expenses via knock-in forwards.

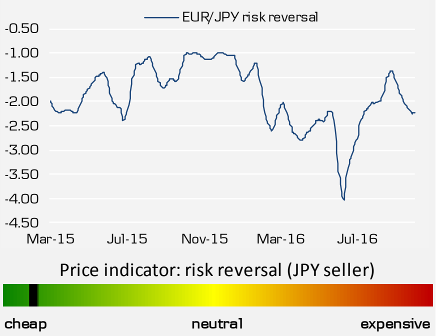
Source: Bloomberg, Danske Bank Markets

3M volatility



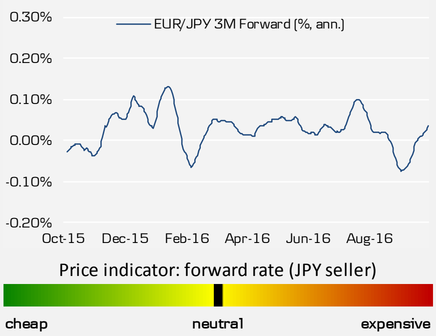
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

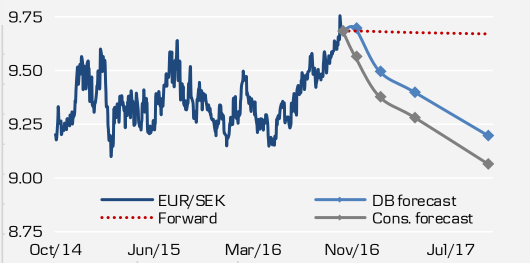
SEK – SEK set to remain weak for longer

Disappointing data out of Sweden has led to a weakening of the SEK. Valuation is still SEK supportive but it may be some time before this comes into play. We target EUR/SEK at 9.70 in 1M, 9.50 in 3M, 9.40 in 6M and 9.20 in 12M.

Outlook for EUR/SEK

- Swedish growth-related data have continued to lose momentum in the past few weeks. It is not a question of sub-par or sub-peer growth but it is a clear downshift from how the year began. Macro readings, real and inflation, have generally not lived up to expectations as illustrated by the macro surprise index, which has weighed on the SEK in the past couple of months.
- Our base scenario that the Riksbank announces a (final?) extension of the current QE programme by six months and SEK20bn nominal bonds and SEK10bn index-linked at its October meeting was supported by the big negative inflation surprise for September, which brought CPIF 0.4pp below the Riksbank's forecast. It might choose to wait until December, given that the ECB is likely to wait until December and maybe with reference to the very weak krona.
- The strong EUR/SEK rally with a break of key resistance levels surprised and we would not rule out that it has further to run. However, we also note that the pair is looking increasingly overbought technically and relative to our short-term financial models. The stretched valuation is a strong argument for lower levels but the question is when this comes into play. The cyclical backdrop is less favourable for the SEK but it could be that this is already in the price.

EUR/SEK



	1M	3M	6M	12M
DB forecast	9.70	9.50	9.40	9.20
Forward	9.69	9.69	9.68	9.68
Cons. forecast	9.57	9.38	9.28	9.06

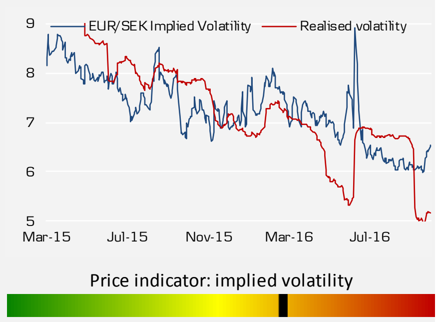
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

Income	Expenses
We recommend hedging SEK income via knock-in forwards. See pages 9-10 for details and an illustration.	We recommend hedging SEK expenses via FX forwards.

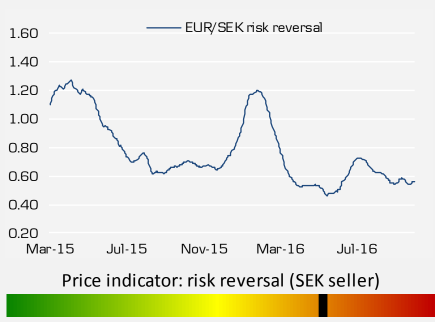
Source: Bloomberg, Danske Bank Markets

3M volatility



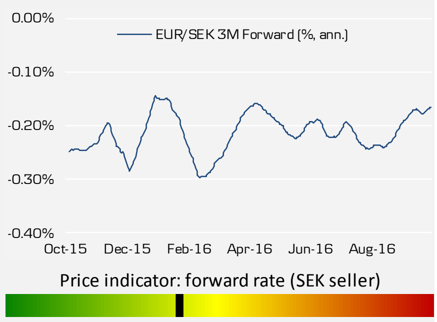
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

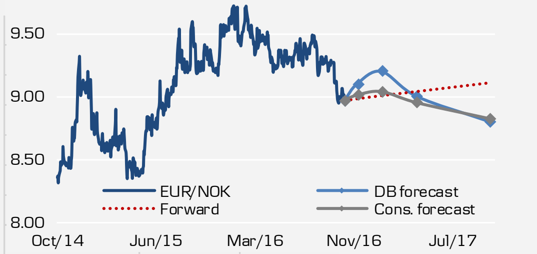
NOK – move lower has been too fast too soon

We believe that the recent move lower in EUR/NOK is premature and see several factors suggesting a move higher over the next couple of months. However, for 2017, we do see fundamental support for a stronger NOK. We target EUR/NOK at 9.10 in 1M, 9.20 in 3M, 9.00 in 6M and 8.80 in 12M.

Outlook for EUR/NOK

- Over the summer, economic data out of Norway surprised on the upside, with, not least, the quarterly Regional Network Survey suggesting an improved growth outlook. However, since the Norges Bank meeting in September (see below), economic releases have been on the weak side with manufacturing in particular production disappointing heavily. Also, the fall in core inflation to 2.9% y/y (from 3.3%) has removed the last worries of cost-push spirals; worries that initially triggered the Norges Bank's repricing. The robustness of economic data seen in light of the stronger NOK is set to be decisive for the future direction of economic and, not least, monetary policy in Norway.
- While Norges Bank was widely expected to leave the sight deposit rate unchanged at September's meeting, it still surprised markets as it introduced an explicit 'neutral' bias in the statement. The rate path still suggests a 40% probability of a later cut but we interpret this as an insurance premium against weakening data and/or strong NOK appreciation. As we expect neither, we expect Norges Bank to leave rates unchanged over the next 12M.
- While we have been long-term strategically bullish on the NOK, the tempo of last month's appreciation has been surprising. The move was not least triggered by a more hawkish Norges Bank than we and markets had pencilled in and the oil price rallying more than USD6/bl on speculations of an OPEC supply freeze. Near term, we see a risk of Brent falling to USD46-48/bl, which implies stronger headwinds for the oil-reliant NOK.

EUR/NOK



	1M	3M	6M	12M
DB forecast	9.10	9.20	9.00	8.80
Forward	8.99	9.01	9.04	9.11
Cons. forecast	9.01	9.04	8.95	8.82

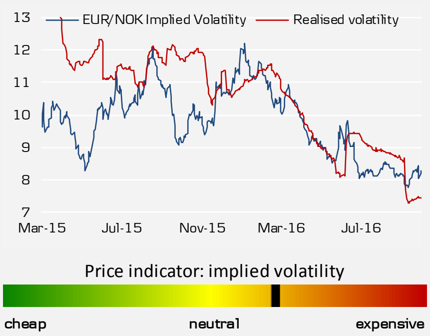
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

Income	Expenses
We recommend hedging short dated (<3M) NOK income via FX forwards. Longer term, we recommend hedging via knock-in forwards. As an alternative to hedging FX forwards in coming months, we would consider entering a 6M accumulator strategy. See pages 10-11 for details.	We recommend hedging NOK expenses via FX forwards. Consider hedging short dated expenses (<3M) via participating forwards.

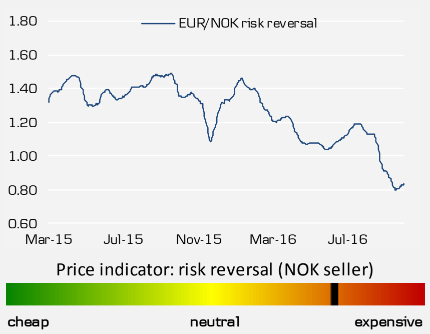
Source: Bloomberg, Danske Bank Markets

3M volatility



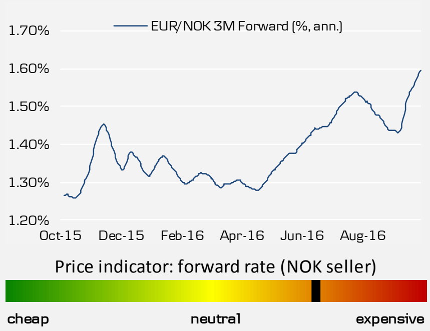
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

Danske Bank Markets' hedging recommendations: other majors

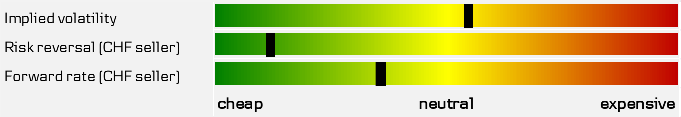
CHF

Instrument

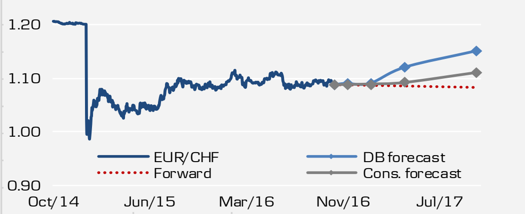
Income: We recommend hedging CHF income via FX forwards. Alternatively consider hedging via risk-reversals and thereby utilising the attractive option skew.

Expenses: Hedge CHF expenses via knock-in forwards.

Price indicators



Forecasts



	1M	3M	6M	12M
DB forecast	1.09	1.09	1.12	1.15
Forward	1.09	1.09	1.09	1.08
Cons. forecast	1.09	1.09	1.09	1.11

AUD

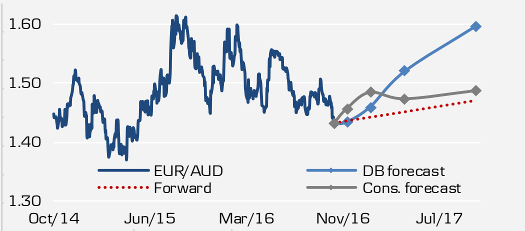
Instrument

Income: We recommend hedging AUD income via FX forwards despite the considerable interest differential between AUD and EUR.

Expenses: We recommend hedging AUD expenses via knock-in forwards.

Price indicators

Forecasts



	1M	3M	6M	12M
DB forecast	1.43	1.46	1.52	1.60
Forward	1.44	1.44	1.45	1.47
Cons. forecast	1.46	1.48	1.47	1.49

NZD

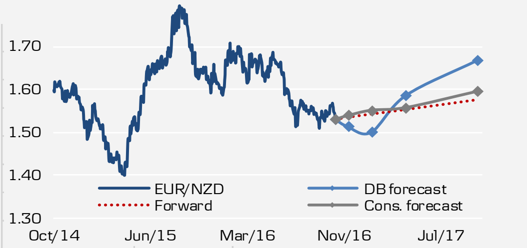
Instrument

Income: We recommend hedging short-dated (>3M) NZD income via knock-in forwards. Longer term, we recommend hedging via FX forwards.

Expenses: Hedge NZD expenses up to 3 months via FX forwards. Longer term, we recommend hedging via knock-in forwards.

Price indicators

Forecasts



	1M	3M	6M	12M
DB forecast	1.51	1.50	1.59	1.67
Forward	1.53	1.54	1.55	1.58
Cons. forecast	1.54	1.55	1.56	1.59

CAD

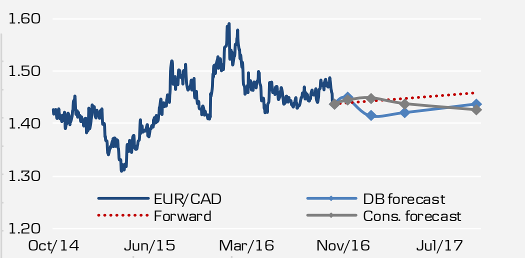
Instrument

Income: Hedge CAD income via knock-in forwards.

Expenses: We recommend hedging CAD expenses via FX forwards.

Price indicators

Forecasts



	1M	3M	6M	12M
DB forecast	1.45	1.41	1.42	1.44
Forward	1.44	1.44	1.45	1.46
Cons. forecast	1.44	1.45	1.44	1.43

Source: Danske Bank Markets

Danske Bank Markets' hedging recommendations: EMEA

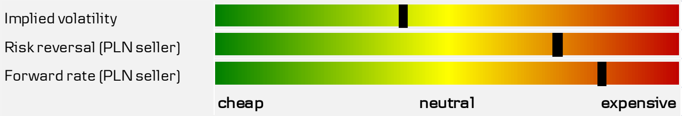
PLN

Instrument

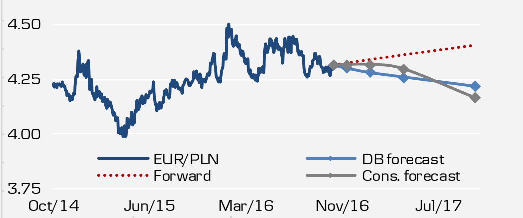
Income: We recommend hedging PLN income via knock-in forwards.

Expenses: We recommend hedging PLN expenses via risk-reversal strategies.

Price indicators



Forecast



	1M	3M	6M	12M
DB forecast	4.30	4.28	4.26	4.22
Forward	4.32	4.34	4.36	4.41
Cons. forecast	4.32	4.32	4.30	4.16

RUB

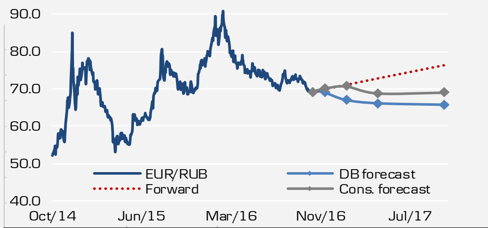
Instrument

Income: We recommend hedging RUB income via knock-in forwards.

Expenses: We recommend hedging RUB expenses via FX forwards.

Price indicators

Forecast



	1M	3M	6M	12M
DB forecast	69.00	66.96	66.05	65.67
Forward	69.89	71.05	72.78	76.20
Cons. forecast	70.05	70.71	68.78	69.00

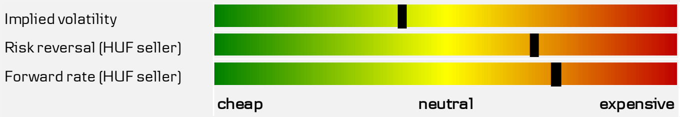
HUF

Instrument

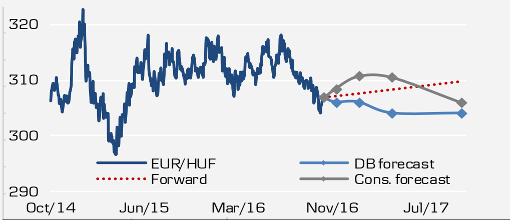
Income: We recommend hedging HUF income via knock-in forwards.

Expenses: We recommend hedging HUF expenses via risk-reversal strategies.

Price indicators



Forecast



	1M	3M	6M	12M
DB forecast	306.00	306.00	304.00	304.00
Forward	307.02	307.49	308.24	309.74
Cons. forecast	308.44	310.62	310.43	306.04

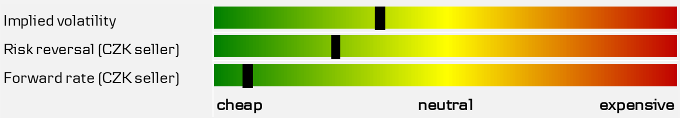
CZK

Instrument

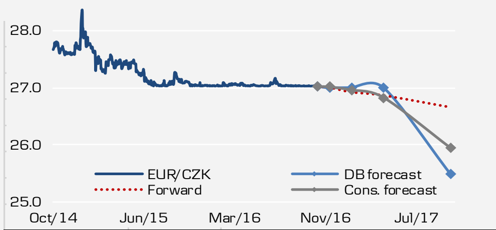
Income: We recommend hedging CZK income via risk-reversals.

Expenses: We expect EUR/CZK to decline considerably once the CNB abandons the EUR/CZK floor in the second half of 2017. Therefore, we recommend EUR- and DKK-based corporate clients hedge CZK payables to increase the hedge ratio and duration on CZK hedges via FX forwards. See FX Strategy: Prepare for a lifting of the EUR/CZK floor (24 October) for details.

Price indicators



Forecast



	1M	3M	6M	12M
DB forecast	27.00	27.00	27.00	25.50
Forward	27.02	26.93	26.87	26.66
Cons. forecast	27.02	26.96	26.83	25.94

Source: Danske Bank Markets

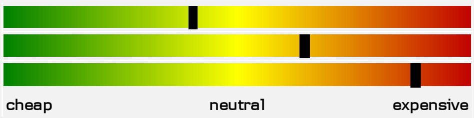
Danske Bank Markets' hedging recommendations: other emerging markets

CNH (CNY)

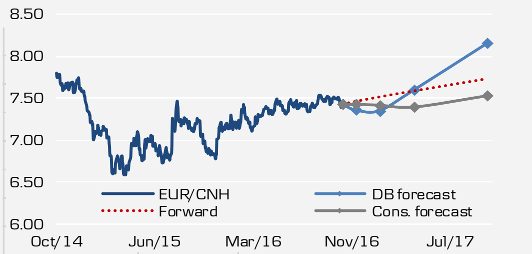
Currency	Instrument: Income	Instrument: Expenses
CNH (CNY)	We recommend hedging CNH income via FX forwards.	We recommend hedging CNH payables via a risk reversal strategy.

Price indicators

Implied volatility
Risk reversal (CNH seller)
Forward rate (CNH seller)



Forecast



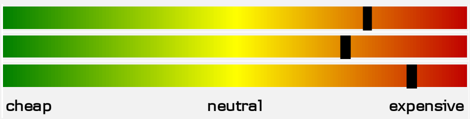
	1M	3M	6M	12M
DB forecast	7.36	7.34	7.60	8.17
Forward	7.46	7.51	7.59	7.73
Cons. forecast	7.43	7.42	7.40	7.53

ZAR

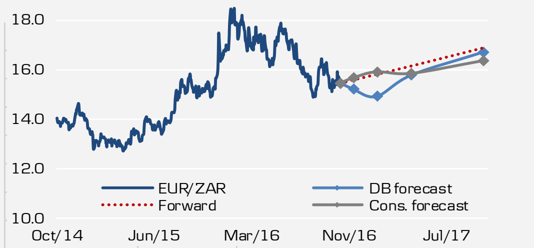
Currency	Instrument: Income	Instrument: Expenses
ZAR	Hedge ZAR income with knock-in forwards.	We recommend hedging ZAR expenses via FX forwards.

Price indicators

Implied volatility
Risk reversal (ZAR seller)
Forward rate (ZAR seller)



Forecast



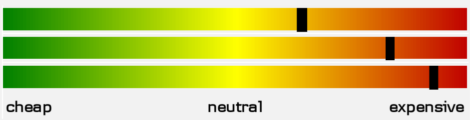
	1M	3M	6M	12M
DB forecast	15.23	14.90	15.76	16.68
Forward	15.56	15.79	16.14	16.86
Cons. forecast	15.65	15.91	15.85	16.37

TRY

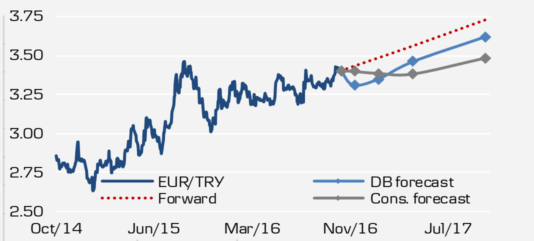
Currency	Instrument: Income	Instrument: Expenses
TRY	Hedge TRY income with knock-in forwards.	We recommend hedging TRY expenses via FX forwards.

Price indicators

Implied volatility
Risk reversal (TRY seller)
Forward rate (TRY seller)



Forecast



	1M	3M	6M	12M
DB forecast	3.31	3.35	3.46	3.62
Forward	3.43	3.48	3.56	3.73
Cons. forecast	3.40	3.39	3.38	3.49

Source: Danske Bank Markets

FX forecasts

G10	Spot	+1m	+3m	+6m	+12m
				Last Update:	17/10/2016
Exchange rates vs EUR					
EUR/USD	1.099	1.09	1.08	1.11	1.15
EUR/JPY	114.5	113	114	118	122
EUR/GBP	0.903	0.90	0.91	0.92	0.90
EUR/CHF	1.086	1.090	1.090	1.120	1.150
EUR/SEK	9.704	9.70	9.50	9.40	9.20
EUR/NOK	9.037	9.10	9.20	9.00	8.80
EUR/DKK	7.441	7.4425	7.4425	7.4425	7.4425
EUR/AUD	1.445	1.434	1.459	1.521	1.597
EUR/NZD	1.546	1.514	1.500	1.586	1.667
EUR/CAD	1.446	1.450	1.415	1.421	1.438
EM	**Spot**	**+1m**	**+3m**	**+6m**	**+12m**
EUR/PLN	4.313	4.30	4.28	4.26	4.22
EUR/HUF	306	306	306	304	304
EUR/CZK	27.025	27.10	27.10	27.10	27.10
EUR/RUB	69.182	69.00	66.96	66.05	65.67
EUR/TRY	3.398	3.31	3.35	3.46	3.62
EUR/ZAR	15.721	15.23	14.90	15.76	16.68
EUR/BRL	3.517	3.54	3.56	3.77	3.97
EUR/CNY	7.397	7.36	7.34	7.60	8.17
EUR/INR	73.360	73.41	73.98	76.59	80.50

Source: Danske Bank Markets

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of the research report are Thomas Harr (Global Head of FICC Research), Mathias Røn Mogensen (Analyst) and Morten Thrane Helt (Senior Analyst).

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None.

Date of first publication

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