Danske Bank
Markets

Investment Research

21 June 2016

Market Guide

British EU referendum causes uncertainty

- USD set to strengthen over the coming months
- Brexit or not, global yields are likely to stay low for now
- Renewed uncertainty about US rate hike

Important disclosures and certifications are contained from page 21 of this report.

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Editorial deadline 20 June 2016 *Investment 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 mid-August 2016.

Market overview

UK referendum on EU membership a close race

Recent opinion polls and bookmaker odds indicate a close race when the British vote on whether or not to remain a member of the EU later this week. Growing uncertainty about the outcome has left its mark on the financial markets. The GBP has weakened, equity markets have declined, commodity prices have fallen, gold is up and long-term yields are hitting new lows, with the yield on 10Y Bunds having reached negative territory.

Danish central bank puts a floor under EUR/DKK

EUR/DKK fell further in the past month to around EUR/DKK7.4355, which prompted Danmarks Nationalbank (DN) to intervene in FX markets selling DKK24bn in May. Intervention was necessary to avoid the DKK strengthening further. Hence, Denmark's currency reserves have begun to grow again having fallen steadily since February last year. Some of the DKK's strength can probably be attributed to increased demand for the currency on the back of uncertainty surrounding the future of the EU and potentially also the EUR. However, a more salient explanation of recent DKK strength can be found in domestic monetary policy. At the start of the year, the DN overdid reducing the rate spread to the ECB, which together with a fall in the volume of DKK in the money market contributed to the fall in EUR/DKK. Intervention helps reduce the tightness in the money market, but more is required to return to normal, so we expect the DKK will remain strong against the EUR irrespective of the result of the UK referendum. Nonetheless, we do not expect the DN to cut policy rates, as DKK selling would effectively be an indirect rate cut. EUR/DKK forwards have also fallen. In particular, 2Y forwards have fallen to around EUR/DKK7.41 and are thus trading somewhat below historical spot rates. DKK strength has also gone hand in hand with falling long bond and swap yields.

Doubts about Fed rate hike

US job growth has slowed in recent months and as inflation and inflation expectations have remained low and manufacturing activity still looks weak, the market is no longer quite so convinced the Federal Reserve will hike interest rates within the next few months. One bright spot is consumption, which has continued to look robust. However, that is also probably dependent on the UK voting to remain in the EU, as a vote to leave would likely hit business confidence and GDP growth. Meanwhile, uncertainty about an upcoming Fed rate hike has not affected EUR/USD, which is currently trading at around 1.1350 – just as it did one month ago. The reason is that while falling yields have had a negative impact on the USD, investors have at the same time been seeking a safe haven in the greenback ahead of the UK's vote on the EU and this has tended to support the USD. We expect EUR/USD to fall to 1.10 over the coming three months but estimate it will rise again to 1.18 on a 1Y horizon.

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Read more in Danske Bank's recent forecasts and publications

- *The Big Picture*
- *Nordic Outlook*
- *Yield Forecast Update*
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- *Weekly Focus*
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Global overview

Moderate recovery from 2015 slump

- **In 2015 the global economy moved into a slump driven primarily by two factors: (1) a big decline in the oil price that dealt a blow to US investment growth and (2) a hard landing in Chinese construction due to a big oversupply of houses. The slowdown spread to Emerging Markets outside China – especially commodity exporters.**
- **Both of the above drags have faded in 2016. The oil price has recovered and Chinese construction is seeing a lift on the back of strong home sales and lower inventories.**
- **New uncertainty regarding Brexit and the US election has come to the surface but overall the drags so far are smaller than last year's and we predict a moderate recovery in 2016 and into 2017. The biggest risk is a Brexit.**

GDP outlook: continued global recovery

% y/y	2016 Danske Bank	2016 Consensus	2017 Danske Bank	2017 Consensus
USA	1.9	1.9	2.3	2.3
Euro area	1.6	1.5	1.7	1.6
Japan	0.5	0.5	0.5	0.5
China	6.7	6.5	6.6	6.3
Global	3.1	3.1	3.5	3.5

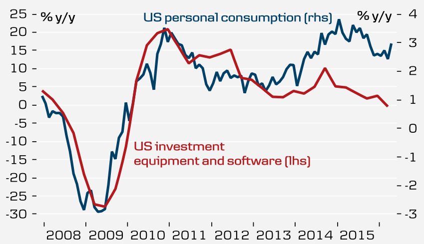
Source: Bloomberg, Danske Bank Markets

Drags lifting but political uncertainties remain

The global economy surprised to the downside in 2015 and early 2016. The US was pulled down by another drop in the oil price that put the economy at the brink of a new recession. Oil investment collapsed, banks started tightening credit standards and high yield spreads blew out. However, it seems that the worse may be over for the US economy and we forecast a gradual recovery from growth below 1% in Q1 to 2-2½% growth from Q2-Q4. The oil price has increased lately from below USD30 per barrel to around USD50 per barrel and energy investments can hardly fall further after the sharp drop last year.

Consumption growth has generally held up well in the US and has kept the economy from slipping into recession. Recent weakness in the labour market has been raised as a rising recession risk but in our view it is more an effect of the past slowdown in the US economy than a predictor of where the US is heading. Very solid housing data and robust consumer spending are likely to keep the US afloat around cruising speed for the rest of the year as the energy drag fades.

US investments have taken a hit while consumption is holding up well



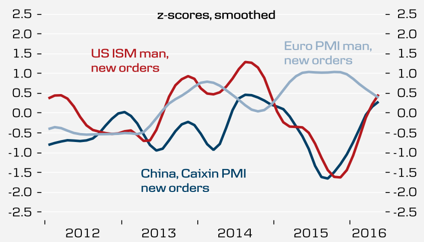
Source: Macrobond Financial, Danske Bank Markets

Another big headwind for the global economy in 2015 was the hard landing in Chinese construction and industry. A significant oversupply of houses weighed on the construction sector and at the same time dealt a blow to global commodity markets that in turn hit Emerging Markets commodity exporters. In 2016, though, inventory to sales levels in housing have normalised and home sales stayed very robust. This has paved the way for a recovery in Chinese construction growth. In combination with a boost to infrastructure this is lifting the overall economy. At the same time, debt levels keep rising, though, increasing the concern over a financial crisis at some point in the future.

In the euro area growth has continued around cruising speed at 1-2%. Sentiment took a hit after the EM turmoil in January and is now held back by the Brexit risk. We look for some improvement in H2 as the Brexit risk fades if the UK votes to remain in the EU as we expect.

While the Brexit risk should fade in H2, uncertainty over the US presidential election may take over, affecting global growth.

Signs of US and China recovery from weak 2015 – euro area weaker on Brexit uncertainty



Source: Macrobond Financial, Danske Bank Markets

Interest rate hedging

- **We expect global yields to stay low in coming months, given the ECB's increased QE purchases.**
- **However, we recommend that borrowers take advantage of the current attractive low interest rates levels or any fall in interest rates in coming months to increase the proportion of fixed-rate debt in their debt portfolios.**

Brexit or not, we expect global yields to stay low for now

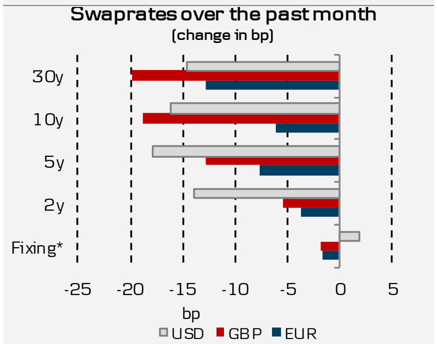
Recently we have seen a new dive in global yields. Part of the reason is concerns ahead of the upcoming UK EU referendum – safe-haven buying. Our main scenario is that the UK will remain in the EU. However, with the polls so close, a Brexit cannot be ruled out.

We do not expect global rates and yields to rise significantly over the next three to six months as the ECB is buying EUR80bn of bonds every month and given the still quite optimistic inflation forecast from the ECB we believe that later this year it will announce that the bond purchases will be prolonged for another six months, so that they run until September 2017 at least. In addition, the Bank of Japan (BoJ) looks set to continue buying bonds at a record pace in 2016 and 2017. Japanese yields are record low and negative beyond 15Y and could move even lower if the BoJ cuts rates to -0.3% next month as we expect. The negative JGB yield is forcing Japanese investors further out on the curve and abroad just to get a positive yield. Therefore, although we expect the Fed to hike rates once this year, we expect the effect on the long end of the curve to be modest. The 10Y US treasury yield is the only major government bond market that offers a yield close to 1.5% compared with zero in Germany and -0.20% in Japan.

It would be wrong, in our view, to believe that global yields will rise sharply if we do not see a Brexit on 23 June. The global 'hunt for yield' will not disappear. The ECB and BoJ will still be buying a substantial amount of bonds in the market and the concerns about the global economy will remain. We do not know whether the recent slowdown in the US labour market reflects an underlying weakness in the US economy or whether the US economy will regain speed as we forecast. Hence, we still expect 10Y German government bond yields to stay close to zero for the next six months even if we do not see a Brexit.

However, if we are correct that the Fed will resume its hiking campaign in the autumn, we could see small upward pressure on 10Y yields. We expect the resumption of Fed rate hikes to weigh on the short end of the US treasury market in particular but it would also be likely to push 10Y European yields higher. Remember, only one rate hike is priced in for the US over the next 18 months. Our view on the Fed is the main reason that we see European 10Y yields slightly higher on a 12M horizon.

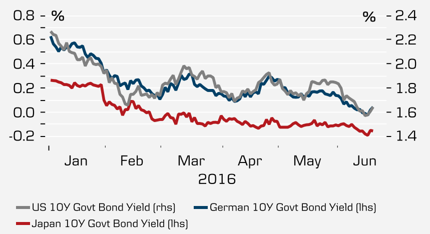
EUR, GBP and USD yields have fallen over the past month



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

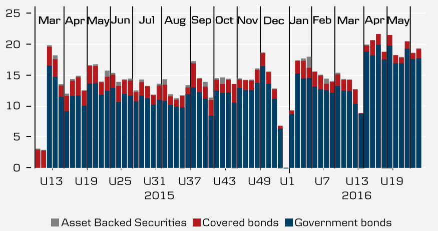
Source: Bloomberg

Falling 10Y government bond yields in Germany, Japan and US during the past month



Source: Macrobond Financial, Danske Bank Markets

ECB has increased government bond purchases since start of April



Source: Macrobond Financial, Danske Bank Markets

If Brexit becomes reality, the global downward pressure on yields is likely to intensify. The ECB will most likely come up with a policy response if it sees signs that the Eurozone economy is being affected, the Fed will effectively go on hold and the BoJ might have to react to an expected appreciation of the JPY. In a Brexit scenario, 10Y German yields could drop to -20bp or lower. Danish 10Y yields are also expected to drop below zero. If Brexit is accompanied by a currency inflow into Denmark as we saw in Q1 15, a rate cut to -0.75% in Denmark is not unlikely. In Sweden and Norway, a Brexit could also lead to further easing.

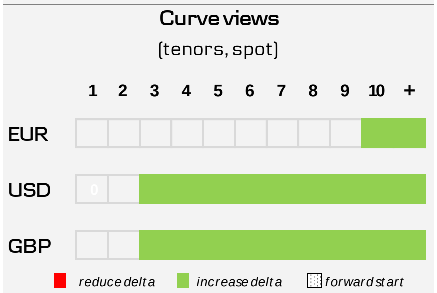
EUR curve hedging recommendation

We expect long yields to stay low during the coming months. However, we have changed our recommendation of modestly underweighting duration to modestly overweighting on the liabilities side on the EUR curve since current interest rates levels are historically attractive and we continue to expect long yields to trend higher in the medium term. Thus, we recommend capitalising on current low interest rates levels or any fall in interest rates during the next couple of months to increase the proportion of fixed-rate debt in debt portfolios. We continue to see most value at the long end of the yield curve, i.e. from 10 years and beyond on the EUR curve.

USD curve hedging recommendation

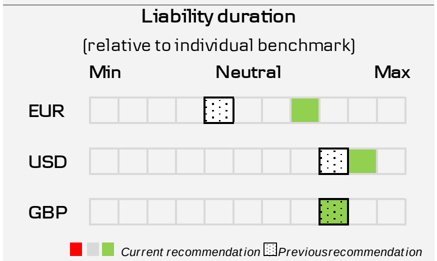
We have increased our recommended level of duration on liabilities on the USD curve. Thus, we still recommend having a relatively high hedge ratio on USD liabilities and locking in rate exposure at all maturities from 2Y and beyond, as US rates are likely to trend higher in the medium term. We maintain our liability duration recommendation just below maximum.

Hedge only the very long end in EUR



Source: Danske Bank Markets

Modest overweight of duration in EUR



Source: Danske Bank Markets

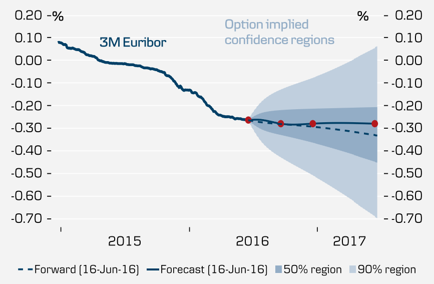
Interest rate outlook on 6-12M horizons

	EUR	GBP	USD
Money markets	With the latest ECB easing package, we expect Euribor fixings to remain below zero for the entire forecast period.	In our main scenario, assuming that the UK remains in the EU, we expect the BoE to hike interest rates in February 2017.	We remain confident that the Fed will stay side-lined until September 2016 and make only a single rate hike this year. We expect fixings to remain broadly unchanged over the next months, but we expect them to increase more than is priced into the forward market beyond this horizon.
Curves	We expect global rates to stay low in the coming months. We expect moderate upward pressure on bond yields on a 6-12M horizon due to the pass-through from the long end of the US yield curve. The ECB should still be able to anchor 2Y and 5Y rates through its asset purchases and with the deposit rate at minus 0.4%, so we continue to expect the 2-10Y and 5-10Y yield curves to steepen slightly.	We still forecast higher UK interest rates on a medium-term horizon driven by Bank of England rate increases and higher US interest rates. We forecast the five-year UK swap rate at 1.60% in 12M (revised down from 1.65%) and our 6M and 12M yield forecasts are above the forward market across the curve.	We see the 2-10Y yield curve flattening over the next three months as investors 'hunt' the higher US yields, so there will be little scope for higher yields in the short term. Looking a little further ahead, we expect the Fed to resume its hiking cycle, so we expect to see US bond yields trending up on a 6-12M horizon, even though monetary policy easing in the Eurozone and in Japan is likely to weigh on yields at the long end of the curve.

Source: Danske Bank Markets

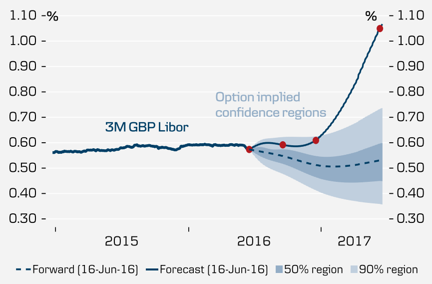
Danske Bank Markets' interest rate forecasts

3M Euribor and forecast



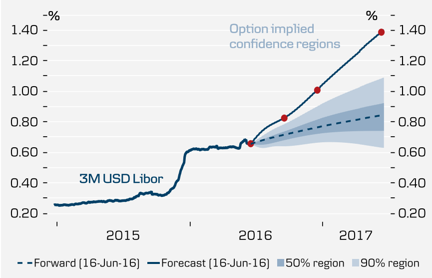
Source: Danske Bank Markets

3M GBP Libor and forecast



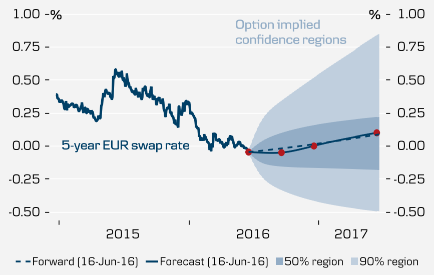
Source: Danske Bank Markets

3M USD Libor and forecast



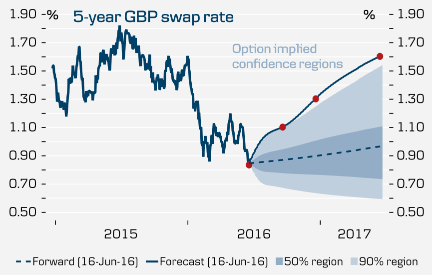
Source: Danske Bank Markets

5Y EUR swap rate and forecast



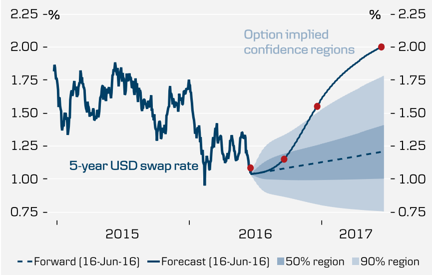
Source: Danske Bank Markets

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 (16 June 2016)

	Horizon	Policy rate	3m xlbor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	0.50	0.65	0.82	1.04	1.43	0.66	1.05	1.55
	+3m	0.50	0.82	0.95	1.15	1.50	0.80	1.20	1.60
	+6m	0.75	1.01	1.40	1.55	1.70	1.25	1.50	1.80
	+12m	1.25	1.39	1.65	2.00	1.95	1.50	1.90	2.00
EUR *	Spot	0.00	-0.26	-0.18	-0.05	0.45	-0.59	-0.49	-0.01
	+3m	0.00	-0.28	-0.20	-0.05	0.45	-0.55	-0.45	0.00
	+6m	0.00	-0.28	-0.20	0.00	0.55	-0.55	-0.40	0.10
	+12m	0.00	-0.28	-0.15	0.10	0.75	-0.50	-0.30	0.30
GBP	Spot	0.50	0.57	0.69	0.84	1.20	0.34	0.66	1.11
	+3m	0.50	0.59	0.90	1.10	1.45	0.55	0.90	1.40
	+6m	0.50	0.61	1.10	1.30	1.60	0.75	1.10	1.55
	+12m	0.75	1.05	1.50	1.60	1.80	1.20	1.40	1.75

Note: * German government bonds are used, EUR swap rates are used

Source: Danske Bank Markets

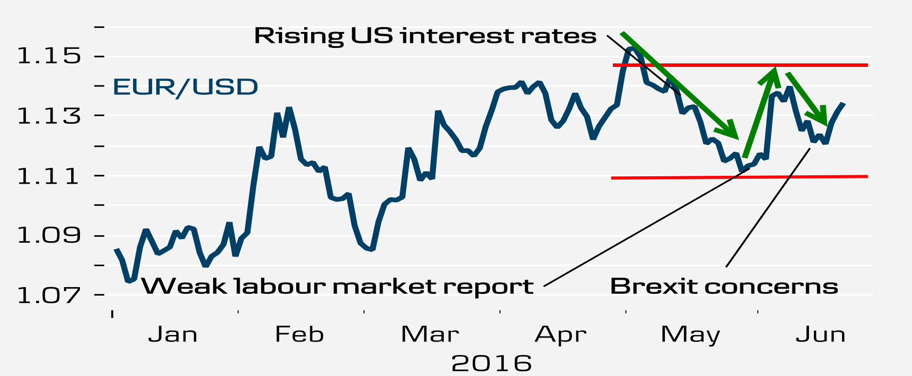
FX hedging

- **Relative rates, driven by a US rate hike in September, and cyclical trends point to a USD strengthening in the coming months. We expect EUR/USD to fall to 1.10 on a 3M horizon. In the event of a Brexit (not our baseline scenario), we expect EUR/USD to drop to 1.09.**
- **Fundamentals and current account differences continue to indicate further EUR/USD upside in the longer term. We see the cross at 1.14 in six months' time and a further increase to 1.18 in 12M.**
- **We recommend hedging USD-denominated expenses out to six months via FX forwards and USD expenses payable on 6M-12M horizons via knock-in forwards with window barriers.**
- **We recommend locking in USD-denominated income at current levels. Alternatively, consider hedging short- and medium-term USD income receivables up to six months from now via boosted risk reversals.**
- *See page 12 for our updated hedging recommendations for selected currencies.*

EUR/USD set to trend down in the months ahead

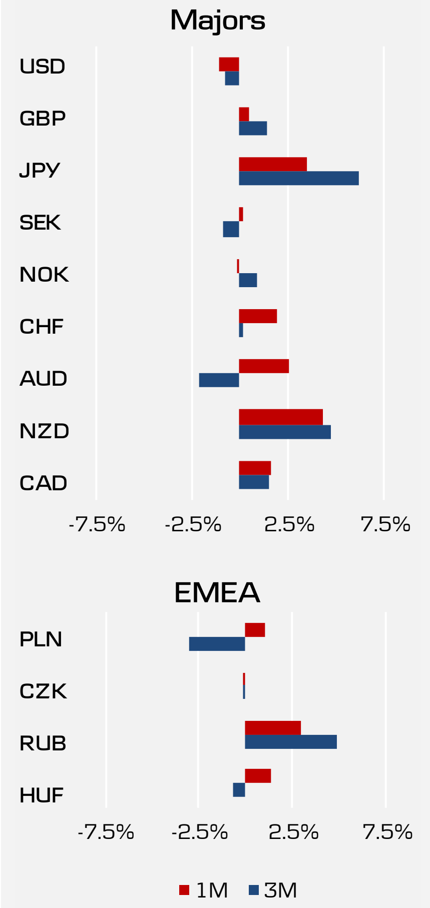
In the April issue of *Market Guide*, we argued that the USD weakening would take a break in the subsequent months after a period of significant weakening in the early months of the year. Since then, EUR/USD has traded both at the upper and lower ends of the 1.11-1.1450 range we predicted two months ago and the cross is now largely range-bound compared with April and very close to our 3M forecast from April of 1.12. The EUR/USD rollercoaster ride over the past few months has been primarily driven by a repricing of the Fed and financial markets' focus on Britain's EU referendum. The USD strengthened in May on expectations of a US rate hike over the course of the summer months. In early June, the market priced a 70% likelihood of a July rate hike. Then, a surprisingly weak US job report showing the lowest rise in employment since 2010 once again raised doubts about a US economic recovery, causing the Fed to postpone the rate hike. This sent EUR/USD higher and US rates sliding. During the past few weeks, the USD has recovered on growing concerns over Brexit risks. This was triggered by a shift in opinion polls, which currently indicate that a majority of British voters will tick the 'leave' box.

EUR/USD has moved sideways in recent months



Source; Macrobond Financial, Danske Bank Markets

FX movements relative to EUR



Source; Bloomberg, Danske Bank Markets

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The USD and the UK referendum

In the very short term the USD will continue to find support from the uncertainty surrounding the British EU referendum. Our baseline scenario is for Britain to remain in the EU. A 'Bremain' vote would initially send EUR/USD slightly higher following the referendum, whereas we expect a Brexit to cause a moderate fall in EUR/USD to 1.09.

The relatively narrow range of probability outcomes for EUR/USD relating to Britain's EU referendum is partly due to our expectation of US interest rate movements partially offsetting EUR/USD fluctuations. Any USD weakening would be partially offset by a moderate rise in interest rates on reduced uncertainty, while any USD appreciation driven by rising uncertainty following a Brexit vote would be offset by lower US interest rates, as the Fed would probably postpone a rate hike further in that scenario.

Relative rates and cyclical trends pointing to USD strengthening in the coming months

Our baseline scenario is for the Fed to hike in September. The market is currently pricing about a 50% probability of a rate hike in 2016. In other words, there is still some Fed repricing potential and a chance of US interest rates moving higher over the next few months, which would support the USD. We expect EUR/USD to fall to 1.10 on a 3M horizon.

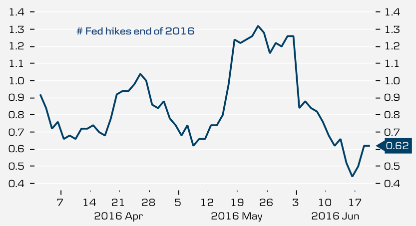
Note also that our cyclical models currently suggest that leading indicators favour the US over the European economy. For example, the US industrial cycle now looks stronger than the European cycle. This was not the case when EUR/USD bottomed at the end of 2015. From a currency perspective, this supports the potential for a fall in EUR/USD in the months ahead.

We still expect the USD to weaken in the medium term

Although several factors currently point to USD appreciation, we still expect EUR/USD to close the year above the current spot rate, as the USD has remained fundamentally overvalued. Our MEVA models indicate a fair value of about EUR/USD1.25-1.27. While currency pairs can deviate from fair value estimates, we often see sharp corrections when the deviation reaches extreme levels. Moreover, the fundamental flows related to current account imbalances in the eurozone versus the US are set to remain supportive of a higher EUR/USD in the coming years – and this could come to play a significant role as volatility in the market pricing of the ECB and the Fed eases. Indeed, the relative difference in external imbalances between the eurozone and the US is now down to its 2004 level, which was when we last witnessed a major increase in EUR/USD.

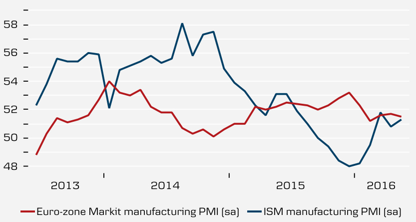
We expect EUR/USD to trade at 1.14 in six months' time and to increase further to 1.18 on a 12M horizon.

Market pricing a 50% probability of a US rate hike in 2016



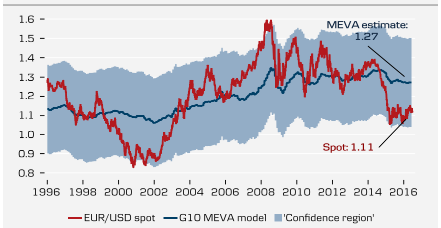
Source: Macrobond Financial, Danske Bank Markets

US industrial cycle no longer trailing Europe



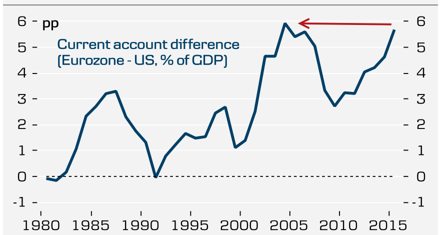
Source: Macrobond Financial, Danske Bank Markets

Our medium-term (MEVA) model indicates EUR/USD fair value of 1.27



Source: E-views, Macrobond Financial, Danske Bank Markets

Relative external imbalances back at 2004-2006 levels



Source: Bloomberg, Danske Bank Markets

Hedging FX risk

Hedge short- and medium-term USD-denominated expenses via FX forwards and long-term USD expenses via options

We recommend that companies hedge USD-denominated expenses payable up to six months from now via FX forwards. This would protect against a USD strengthening over the coming months that we expect to materialise regardless of whether the UK remains in or leaves the EU. Moreover, using FX forwards would secure a premium on the forward exchange rate relative to the spot rate due to the EUR-USD yield spread.

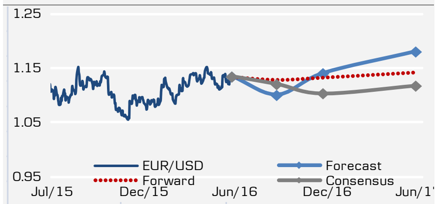
USD-denominated expenses payable on 6M-12M horizons should, in our view, be hedged via options that maintain a profit potential if EUR/USD increases, while securing a worst-case exchange rate. More specifically, we recommend hedging USD-denominated expenses via knock-in forwards with window barriers, with the barrier open for one month before each maturity date. A 6M strategy including six independent payments (the first on 19 January 2017) could, for example, be entered at zero cost (indicative pricing, spot ref. 1.1340) and would allow you to take advantage of any increase in EUR/USD up to 1.2625 (an increase of more than 11% from current spot), while securing a minimum EUR/USD rate of 1.1050, which would leave one protected against any USD appreciation of 2.6 % from current spot. As such, this strategy would enable one to take advantage of a significant increase in EUR/USD, while also guaranteeing a favourable selling rate over the entire strategy period.

If EUR/USD is trading below 1.1050 on a settlement date, one would have the right to sell EUR/USD at 1.1050. If EUR/USD has traded above 1.2625 at any time during the month before a settlement date, one would be obliged to sell EUR/USD at 1.1050. Finally, if EUR/USD is trading above 1.1050 on a settlement date and the spot rate has not traded above 1.2625 during the month before settlement, one would have an option of selling EUR/USD at the spot rate on that date. Given our forecast of the EUR/USD exchange rate peaking at 1.18 in 12 months and as the strategy secures a profitable worst-case exchange rate, we find the strategy very attractive.

We emphasise that the payments are independent, so even if EUR/USD trades above 1.2625 in one of the six settlement months, one would not forego the option of selling EUR/USD at the spot rate on the relevant settlement date if, at any time in a following month, EUR/USD again trades in the 1.1050-1.2625 range.

The chart below illustrates the strategy described here.

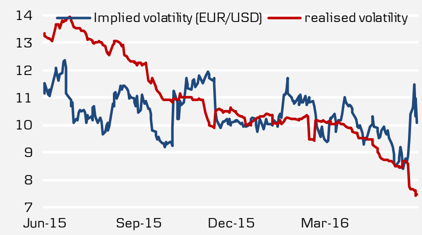
EUR/USD forecast



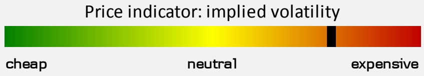
	3M	6M	12M
DB forecast	1.10	1.14	1.18
Forward	1.13	1.13	1.14
Cons. Forecast	1.12	1.10	1.12

Source: Bloomberg, Danske Bank Markets

Implied USD options market volatility is expensive

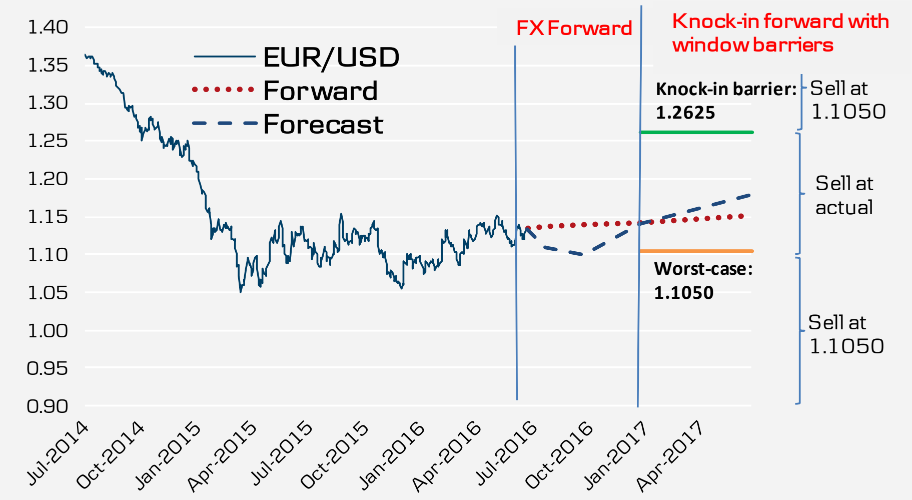


Price indicator: implied volatility



Source: Bloomberg, Danske Bank Markets

Hedge USD-denominated expenses payable over the next six months via FX forwards and expenses payable over the following six months via knock-in forwards with window barriers



The structure illustrated above is a EUR/USD 12M strategy for USD-denominated expenses with monthly payments. The first six months are hedged via FX forwards and the following six months via a knock-in forward strategy with window barriers (the first payment due on 19 January 2017 and the last on 19 June 2017). It is a zero-cost structure (indicative pricing, spot ref.: 1.1340) with a lower worst-case exchange rate of 1.1050 and a knock-in window barrier of 1.2625.

Source: Danske Bank Markets

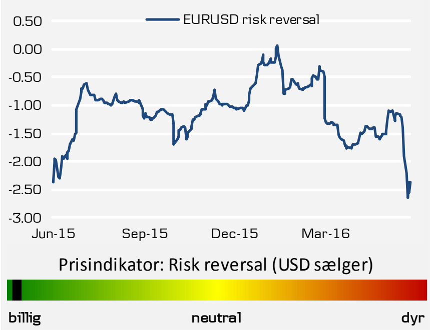
Hedge USD income via FX forwards – alternatively, consider hedging income receivable up to six months from now via boosted risk reversals

We generally recommend locking in USD-denominated income to current levels, which are very attractive from a historical perspective.

Alternatively, one could consider positioning for a stronger USD over the coming six months via a boosted risk reversal strategy. This strategy would retain a profit potential in the event of a fall in EUR/USD, while securing a historically attractive buying rate. We emphasise that the strategy would not guarantee a worst-case exchange rate in the event of a sharp USD appreciation, as one would be obliged to buy a double EUR/USD notional. However, as we consider the potential for a significant USD appreciation to be limited – even in a Brexit scenario – we find the strategy attractive.

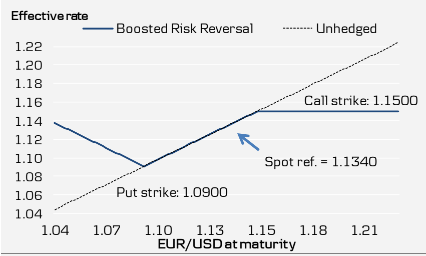
Specifically, a 6M strategy with six monthly payments could be entered at zero cost (spot ref. 1.1340). The chart on the right illustrates that on each of the six settlement dates (the first on 21 July 2017), one would have the right to buy EUR/USD at 1.1500 if the spot rate is trading above 1.1500 on a settlement date. If the spot rate is trading below 1.0900 on a settlement date, one would be obliged to buy the double notional at 1.0900. As such, a worst-case exchange rate for any large falls in EUR/USD would not be guaranteed. Nonetheless, we consider the strategy an attractive alternative, as the spot rate would have to trade below around 1.04 (i.e. a new cycle low) on a given settlement date to produce a less attractive effective EUR/USD buying rate relative to hedging via FX forwards.

Relative options market pricing plus high volatility ...



Source: Bloomberg, Danske Bank Markets

.. make a boosted risk reversal hedging strategy attractive



Source: Bloomberg, Danske Bank Markets

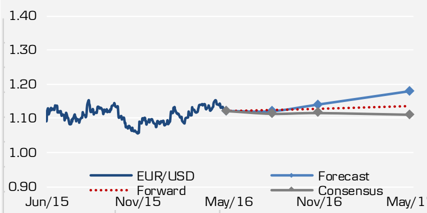
USD – Stronger in the months ahead

Relative rates, driven by a US rate hike in September, and cyclical trends point to a USD strengthening in the coming months. We expect EUR/USD to fall to 1.10 on a 3M horizon. Fundamentals and current account differences continue to indicate further EUR/USD upside in the longer term. We see the cross in 1.14 in six months' time and a further increase to 1.18 in 12M.

Outlook for EUR/USD

- In the very short term, the USD will continue to find support from the uncertainty surrounding the British EU referendum. Our baseline scenario is for Britain to remain in the EU. A 'Bremain' vote would initially send EUR/USD slightly higher following the referendum, whereas we expect a Brexit to cause a moderate fall in EUR/USD to 1.09.
- We expect the Fed to hike in September. The market is currently pricing about a 50% probability of a rate hike in 2016. In other words, there is still some Fed repricing potential and a chance of US interest rates moving higher over the next few months, which would support the USD. We expect EUR/USD to fall to 1.10 on a 3M horizon.
- Although several factors currently point to USD appreciation, we still expect EUR/USD to close the year above the current spot rate, as the USD has remained fundamentally overvalued. Our MEVA models indicate a fair value of about EUR/USD1.25-1.27. While currency pairs can deviate from fair value estimates, we often see sharp corrections when the deviation reaches extreme levels. We expect EUR/USD to trade at 1.14 in six months' time and to increase further to 1.18 on a 12M horizon.

EUR/USD



	3M	6M	12M
DB forecast	1.12	1.14	1.18
Forward	1.12	1.13	1.14
Cons. Forecast	1.11	1.12	1.11

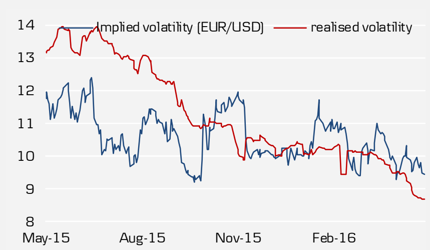
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

Income	Expenses
We generally recommend locking in USD-denominated income to current levels, which are very attractive from a historical perspective. Alternatively, you could consider positioning for a stronger USD over the coming six months via a boosted risk reversal strategy. For more details, see page 11.	We recommend that companies hedge USD-denominated expenses payable up to six months from now via FX forwards. For USD-denominated expenses payable on 6M-12M horizons, we recommend to via knock-in forwards with window barriers, with the barrier open for one month before each maturity date.

Source: Bloomberg, Danske Bank Markets

3M volatility

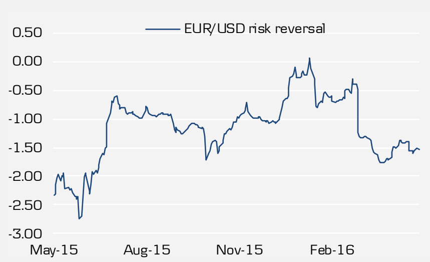


Price indicator: implied volatility

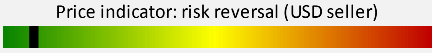
cheap neutral expensive

Source: Bloomberg, Danske Bank Markets

3M risk reversal



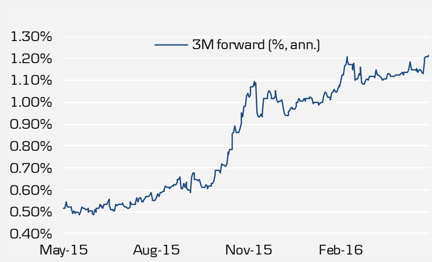
Price indicator: risk reversal (USD seller)



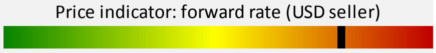
cheap neutral expensive

Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Price indicator: forward rate (USD seller)



cheap neutral expensive

Source: Bloomberg, Danske Bank Markets

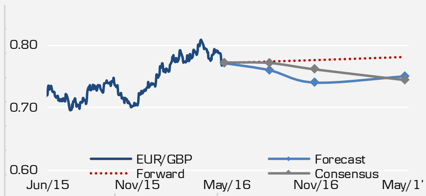
GBP – it is all about the EU referendum

The upcoming EU referendum represents a significant event risk to GBP and poses a medium- to long-term risk. We target EUR/GBP at 0.76 in 1M, 0.76 in 3M, 0.74 in 6M and 0.75 in 12M.

Outlook for EUR/GBP

- Real GDP expanded 0.4% q/q in Q1 following an increase of 0.6% q/q in Q4 15. PMI bounced back somewhat in May following the decline in April to a three-year low across sectors and while it remains above 50, the UK economy most likely slowed further in Q2, partly due to Brexit uncertainties. The unemployment rate fell to 5.0% in April and although the labour market report showed that employment growth has slowed significantly in 2016 so far compared to 2013-15, it still seems that the UK has done ok in Q2. Currently growth in Q2 is expected to be in the range 0.25-0.50%.
- In our main scenario, assuming that the UK remains in the EU, we expect the BoE to hike interest rates in February 2017. Given the recent indications that the UK economy is slowing, risks are skewed towards a later hike – especially if the economy slows further post the EU referendum. In the event of a Brexit, economic uncertainties would increase and the UK would be likely to fall into recession in H2 16, which could force the BoE to ease its monetary policy. Mark Carney has explicitly said that the BoE's first response would be to cut interest rates. A renewed round of QE cannot be ruled out in this scenario.
- Given the high uncertainty surrounding the EU referendum, we see risks skewed to the upside for EUR/GBP ahead of 23 June. The outlook for EUR/GBP very much depends on the outcome of the EU referendum.

EUR/GBP



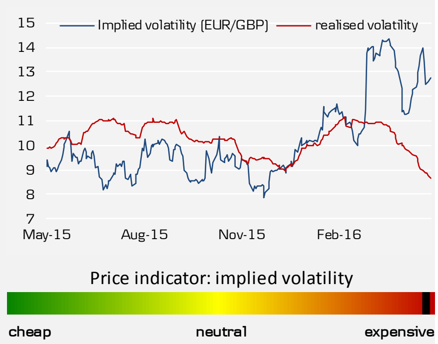
	3M	6M	12M
DB forecast	0.76	0.74	0.75
Forward	0.77	0.78	0.78
Cons. Forecast	0.77	0.76	0.74

Source: Bloomberg, Danske Bank Markets

Hedging recommendations	
Income	**Expenses**
Given the considerable 'digital' risk related to the UK/EU referendum we recommend hedging GBP-income via options. As an alternative to buying GBP put-options consider hedging via a 'boosted' risk reversal strategy that utilises the elevated levels in implied volatility.	Given the risk of a substantial GBP-fall in case of a 'Brexit', we recommend hedging 50% of GBP-income to be received via FX forwards.

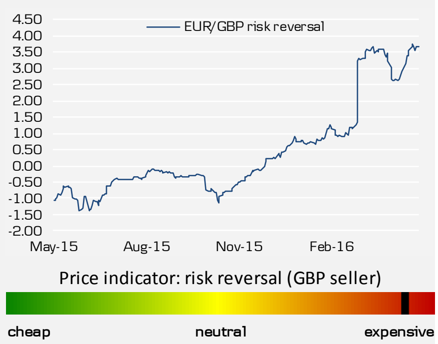
Source: Bloomberg, Danske Bank Markets

3M volatility



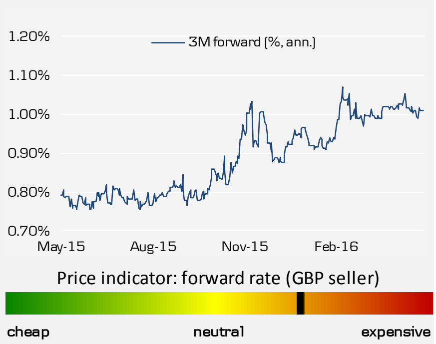
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

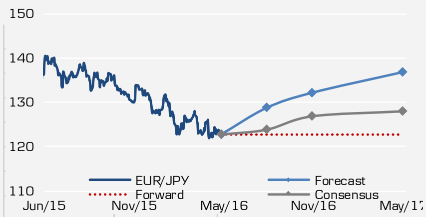
JPY – July cut still in store

We still expect the BoJ to cut rates at its July meeting and expect the Japanese government to announce a fiscal stimulus package in H2 16. We target EUR/JPY at 120 in 1M, 123 in 3M, 128 in 6M and 132 in 12M.

Outlook for EUR/JPY

- Economic activity in Q1 proved to be much stronger than initially expected and GDP was actually revised even higher from 0.4% q/q to 0.5% q/q for Q1 due to upward adjustments to capex and private consumption. Data have in general surprised positively in recent months indicating that the Japanese economy is doing ok in Q2 as well. However, despite positive data surprises, business surveys (PMI and Tankan) indicate further deterioration in the manufacturing sector in coming quarters. Manufacturing PMI for April showed the steepest decline since 2014, reflecting the downside risks to the economy from the Kumamoto earthquake (in mid-April).
- The Bank of Japan (BoJ) kept its monetary policy unchanged in June with a quantitative target of Japanese government bonds purchases of JPY80trn annually and the key policy rate at -0.1%. We still expect the BoJ to cut its policy rate by 20bp to -0.3% in July and to announce additional qualitative measures including a scale up of ETF purchases and a maturity extension of its government purchases. In the event of a Brexit (not our main scenario), we expect the BoJ to intervene in the FX markets in order to curb JPY appreciation.
- In our previous forecast we anticipated a coordinated fiscal and monetary easing package would be announced in late May or in June. So far, the Japanese government has postponed the implementation of the planned VAT hike from April 2017 to September 2019. At the same time, the government announced that a fiscal stimulus package will be announced later this year. This effectively means that the coordinated response that we called for did not materialise and thus the case for a near-term rally in EUR/JPY has weakened.

EUR/JPY



	3M	6M	12M
DB forecast	128.80	132.24	136.88
Forward	122.84	122.80	122.66
Cons. Forecast	123.86	126.95	128.09

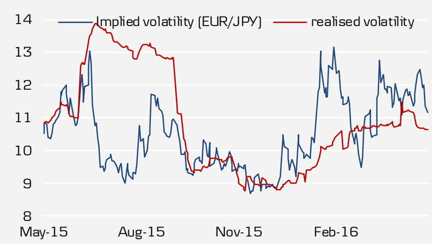
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

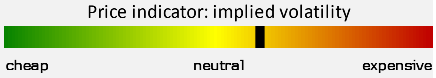
Income	Expenses
We recommend hedging JPY income via FX forwards.	We recommend hedging JPY expenses via knock-in forwards.

Source: Bloomberg, Danske Bank Markets

3M volatility

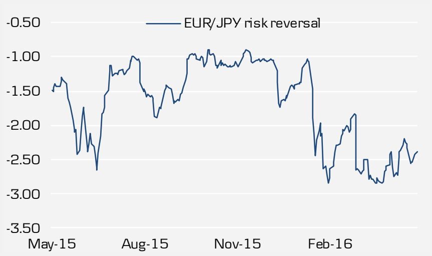


Price indicator: implied volatility

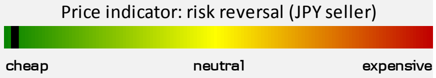


Source: Bloomberg, Danske Bank Markets

3M risk reversal

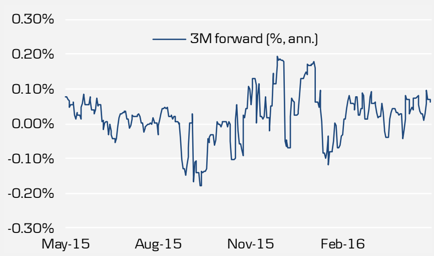


Price indicator: risk reversal (JPY seller)

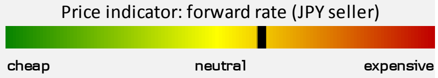


Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Price indicator: forward rate (JPY seller)



Source: Bloomberg, Danske Bank Markets

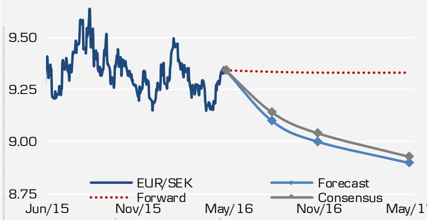
SEK – Risk appetite vs fundamentals

Risk appetite will affect the cross near term, while the macro backdrop is SEK supportive. We target EUR/SEK at 9.30 in 1M, 9.20 in 3M, 9.10 in 6M and 9.00 in 12M.

Outlook for EUR/SEK

- After seeing the recent GDP numbers where Q1 was up 4.2% y/y, there is still, in our view, a compelling 'growth case' for a stronger SEK. We do expect a gradual slowdown this year as previous stimulus tailwinds go away, anything else would truly be sensational. However, with GDP set to grow more than 3% in 2016 it is hardly a collapse we are talking about. Moreover, it will probably be yet another year with substantially higher growth than in the Eurozone.
- We think that monetary policy will be rather boring for the next few months, with inflation expected to come in close to the Riksbank forecast at least until September and with no 'news' from the ECB. That said, both the inflation outlook (Riksbank too optimistic in our view) and the ECB (we expect QE extension beyond Q1 17) suggest the Riksbank is closer to easing monetary policy further than tightening. Our base case is that the Riksbank has finished easing.
- EUR/SEK has traded closely with risk sentiment recently ahead of the UK referendum. The macro backdrop and fundamental valuation models remain highly supportive for the SEK. However, as long as the Riksbank is guarding against 'premature' SEK appreciation, we think the downside potential in EUR/SEK is limited. Also risk aversion in a broader sense (e.g. global growth and stock market valuation concerns) is SEK negative.

EUR/SEK



	3M	6M	12M
DB forecast	9.10	9.00	8.90
Forward	9.33	9.33	9.33
Cons. Forecast	9.14	9.04	8.93

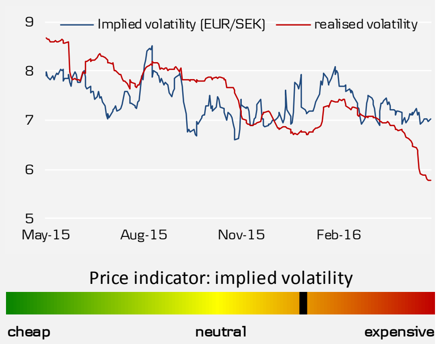
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

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

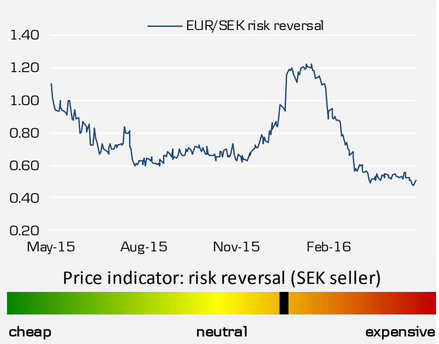
Source: Bloomberg, Danske Bank Markets

3M volatility



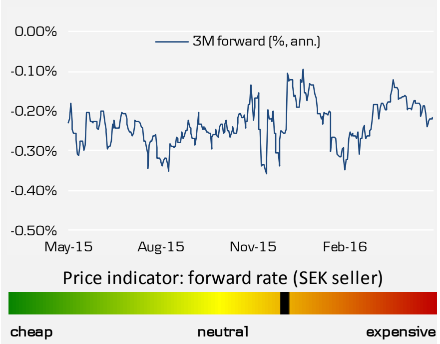
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

NOK – short-term risks skewed towards weaker NOK

In the short term the UK EU referendum poses the biggest risk to our EUR/NOK forecasts, while potential lagged effects from the oil market pose a medium term risk to growth expectations. We target EUR/NOK at 9.40 in 1M, 9.30 in 3M, 9.20 in 6M and 8.90 in 12M.

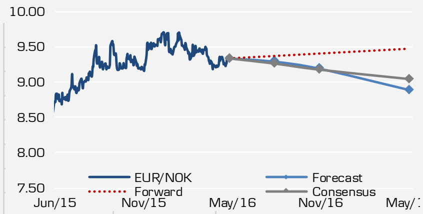
Outlook for EUR/NOK

- Economic data out of Norway have sent very mixed signals over the past months. While the worst in the manufacturing sector seems to be behind us and the NAV labour market reports have shown clear signs of improvement, retail sales and the oil investment outlook have disappointed. The Regional Network Survey showed an improved outlook across sectors – not least for the important commercial services – but overall the growth outlook for H2 remains weak.

- As expected, Norges Bank (NB) left the sight deposit rate unchanged at the May monetary policy meeting while reiterating the dovish bias from the March meeting. The NB rate path has a full 25bp rate cut embedded before Q4 16 and a 20% probability of an additional rate cut to 0%. We expect NB to cut the sight deposit rate in September, marking the bottom in the sight deposit rate.

- We think the short-term risks – not least up until the EU referendum - remain skewed to the upside as the NOK is no longer a safe-haven currency and as the oil price remains vulnerable to global demand shocks which a Brexit would constitute. Having said this, we maintain that even under a 'Bremain' scenario the downside potential remains limited as the fundamental outlook for a significant short-term NOK appreciation is still not present. Indeed, NB could well remind markets of the need for a weak currency at the forthcoming June meeting by signalling what we expect will constitute the final rate cut in September. In our base case of a 'Bremain' we expect that higher growth in Norway, a gradually higher oil price, and a repricing of monetary policy will send EUR/NOK lower on a longer horizon.

EUR/NOK



	3M	6M	12M
DB forecast	9.30	9.20	8.90
Forward	9.38	9.41	9.47
Cons. Forecast	9.27	9.18	9.04

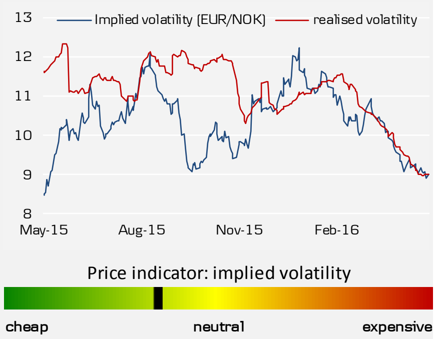
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

Income	Expenses
We recommend hedging NOK income via knock-in forwards.	We recommend hedging short-term (<3M) NOK expenses via risk-reversal strategies. On a longer horizon we recommend locking in NOK-expenses via FX forwards

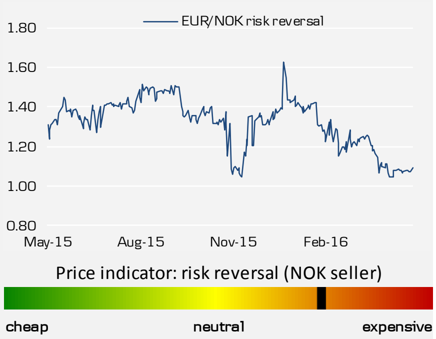
Source: Bloomberg, Danske Bank Markets

3M volatility



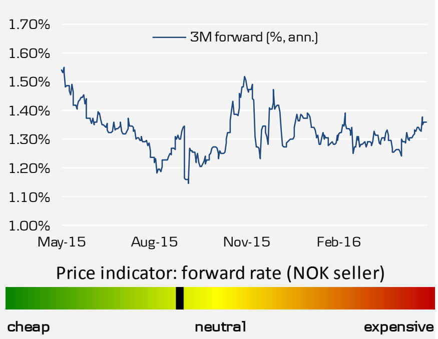
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



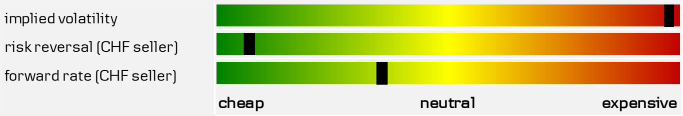
Source: Bloomberg, Danske Bank Markets

Danske Bank Markets' hedging recommendations: other majors

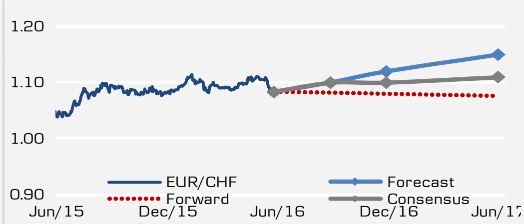
CHF

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

Price indicators



Forecasts

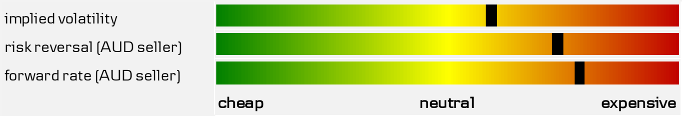


	3M	6M	12M
DB forecast	1.10	1.12	1.15
Forward	1.08	1.08	1.08
Cons. Forecast	1.10	1.10	1.11

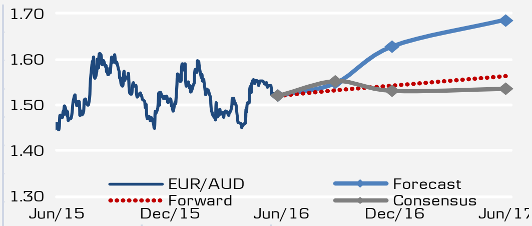
AUD

Currency	Instrument: Income	Instrument: Expenses
AUD	We recommend hedging AUD income via FX forwards despite the considerable interest differential between AUD and EUR.	We recommend hedging AUD expenses via knock-in forwards.

Price indicators



Forecasts



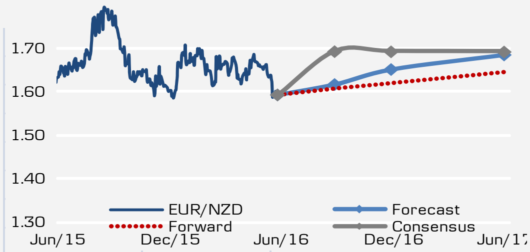
	3M	6M	12M
DB forecast	1.55	1.63	1.69
Forward	1.53	1.54	1.56
Cons. Forecast	1.55	1.53	1.54

NZD

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

Price indicators

Forecasts

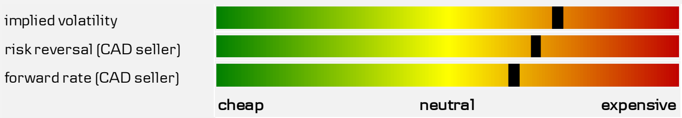


	3M	6M	12M
DB forecast	1.62	1.65	1.69
Forward	1.61	1.62	1.64
Cons. Forecast	1.69	1.69	1.69

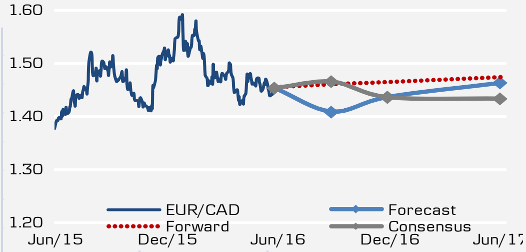
CAD

Currency	Instrument: Income	Instrument: Expenses
CAD	Hedge CAD income via knock-in forwards.	Hedge CAD expenses with FX forwards.

Price indicators



Forecasts

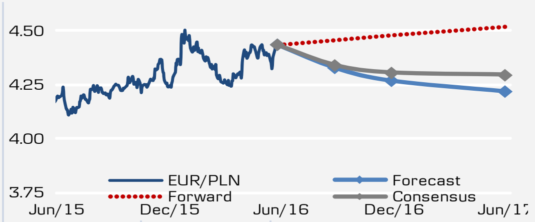


	3M	6M	12M
DB forecast	1.41	1.44	1.46
Forward	1.46	1.46	1.47
Cons. Forecast	1.47	1.44	1.43

Source: Danske Bank Markets

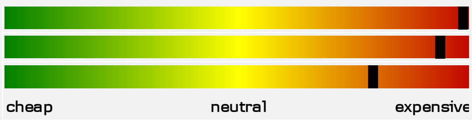
Danske Bank Markets' hedging recommendations: EMEA

Currency	Instrument – Income	Instrument – Expenses	Forecast
PLN	We recommend hedging PLN income via knock-in forwards.	We recommend hedging PLN expenses with FX forwards. Given the big uncertainty related to the PLN one could alternatively consider a boosted risk reversal-strategy on a 6-12M horizon (for more details see *Emerging Markets Briefer*, 20 June).	



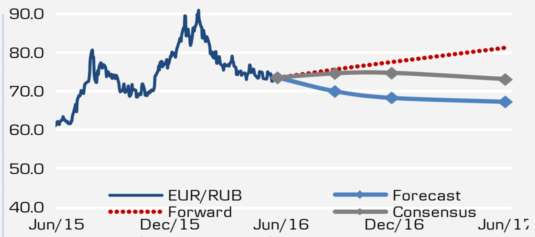
Price indicators

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



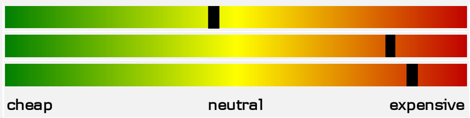
	3M	6M	12M
DB forecast	4.33	4.27	4.22
Forward	4.46	4.48	4.52
Cons. Forecast	4.34	4.31	4.30

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



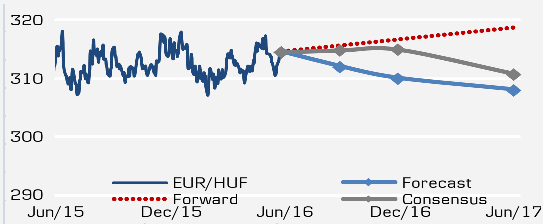
Price indicators

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



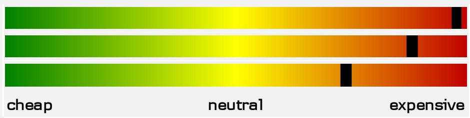
	3M	6M	12M
DB forecast	70.07	68.40	67.38
Forward	75.71	77.63	81.28
Cons. Forecast	74.70	74.78	73.16

Currency	Instrument – Income	Instrument – Expenses	Forecast
HUF	We recommend hedging HUF-income via knock-in forwards.	We recommend hedging short-term HUF-expenses via risk-reversal strategies. On longer horizons we recommend FX forwards.	



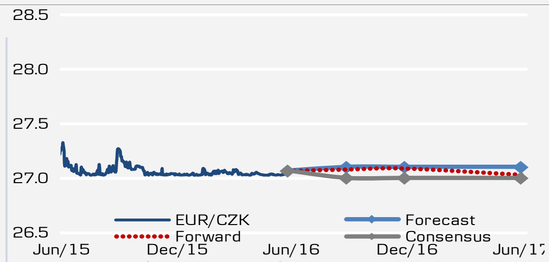
Price indicators

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



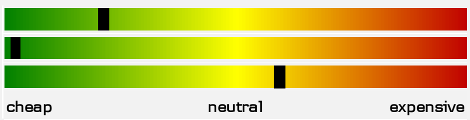
	3M	6M	12M
DB forecast	312.00	310.00	308.00
Forward	315.59	316.66	318.72
Cons. Forecast	314.86	315.00	310.71

Currency	Instrument – Income	Instrument – Expenses	Forecast
CZK	We recommend hedging CZK income via knock-in forwards.	Hedge CZK expenses with knock-in forwards.	



Price indicators

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



	3M	6M	12M
DB forecast	27.10	27.10	27.10
Forward	27.08	27.09	27.03
Cons. Forecast	27.00	27.00	27.00

Source: Danske Bank Markets

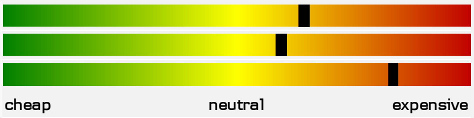
Danske Bank Markets' hedging recommendations: other emerging markets

CNH (CNY)

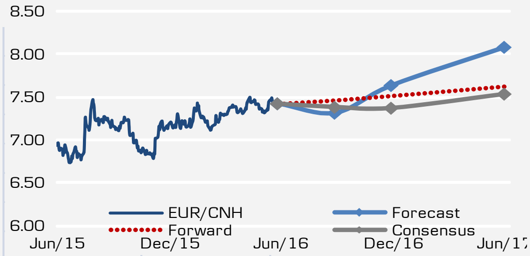
Currency	Instrument: Income	Instrument: Expenses
CNH (CNY)	We recommend hedging CNH-income via FX forwards.	We recommend hedging short-term CNY payables via FX forwards and longer-dated CNY-expenses via risk reversals.

Price indicators

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



Forecast



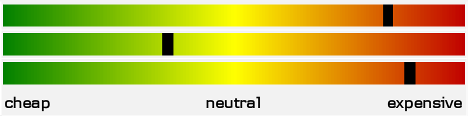
	3M	6M	12M
DB forecast	7.32	7.64	8.08
Forward	7.47	7.52	7.63
Cons. Forecast	7.38	7.37	7.54

ZAR

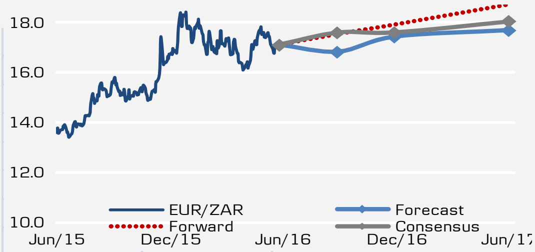
Currency	Instrument: Income	Instrument: Expenses
ZAR	Hedge ZAR income via knock-in forwards.	We recommend hedging ZAR expenses via FX forwards.

Price indicators

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



Forecast



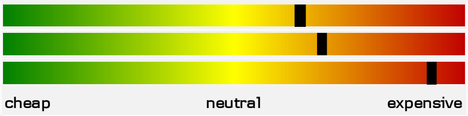
	3M	6M	12M
DB forecast	16.83	17.44	17.70
Forward	17.52	17.91	18.71
Cons. Forecast	17.61	17.61	18.07

TRY

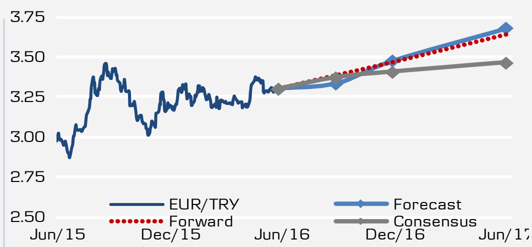
Currency	Instrument: Income	Instrument: Expenses
TRY	Hedge TRY income via knock-in forwards.	We recommend hedging TRY expenses via risk-reversal strategies.

Price indicators

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



Forecast



	3M	6M	12M
DB forecast	3.33	3.48	3.68
Forward	3.38	3.47	3.64
Cons. Forecast	3.37	3.41	3.46

Source: Danske Bank Markets

FX forecasts

G10	Spot	+1m	+3m	+6m	+12m
				Last Update:	20/06/2016
Exchange rates vs EUR					
EUR/USD	1.134	1.11	1.10	1.14	1.18
EUR/JPY	118.5	120	123	128	132
EUR/GBP	0.775	0.76	0.76	0.74	0.75
EUR/CHF	1.089	1.100	1.100	1.120	1.150
EUR/SEK	9.339	9.30	9.20	9.10	9.00
EUR/NOK	9.358	9.40	9.30	9.20	8.90
EUR/DKK	7.436	7.4355	7.4375	7.4375	7.4375
EUR/AUD	1.518	1.542	1.549	1.629	1.686
EUR/NZD	1.593	1.632	1.618	1.652	1.686
EUR/CAD	1.449	1.454	1.408	1.436	1.463
EM	**Spot**	**+1m**	**+3m**	**+6m**	**+12m**
EUR/PLN	4.399	4.36	4.33	4.27	4.22
EUR/HUF	313	312	312	310	308
EUR/CZK	27.058	27.10	27.10	27.10	27.10
EUR/RUB	72.758	72.82	70.07	68.40	67.38
EUR/TRY	3.292	3.31	3.33	3.48	3.68
EUR/ZAR	16.836	16.87	17.05	17.44	17.70
EUR/BRL	3.841	3.77	3.69	3.76	3.78
EUR/CNY	7.462	7.33	7.32	7.64	8.08
EUR/INR	76.267	74.99	75.35	78.66	82.60

Source: Danske Bank Markets

Disclosures

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of this research report are Thomas Harr (Global Head of FICC Research), Arne Lohmann Rasmussen (Chief Analyst), Morten Helt (Senior Analyst), Jakob Ekholdt Christensen (Chief Analyst), Christin Tuxen (Senior Analyst), Jens Nærvig Pedersen (Senior Analyst), Kristoffer Kjær Lomholt (Analyst) and Mathias Røn Mogensen (Analyst)

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