Danske Bank

Market Guide

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Market overview

There is no way around a stronger dollar

Fears of systemic risk in the banking sector

Lately, fears of systemic risks in the banking sector has been the most prominent and important market theme. The collapse of the regional US Silicon Valley Bank (SVB) on 10 March triggered stress in markets with yields plummeting and volatility spiking. As a result, the Fed promptly set up an emergency program to avoid contagion to the broader US financial system. Nonetheless, concerns have still spread to European banks with most recently the Credit Suisse Group coming under pressure leading to an acquisition by the UBS. European bank stocks have heavily underperformed benchmark indices. Despite a broad repricing lower of major central banks' rate outlooks, the ECB stood its course raising all policy rates by 50bp at the March meeting. Overall, recent events highlight the rising trade-off facing central banks amid the need for a contractionary policy to bring inflation down and the risk of breaking something systemically important.

We are cautiously optimistic on subsiding systemic risk fears

Rising systemic risk fears have unsurprisingly led to higher FX volatility. In majors space, JPY and GBP have benefited while cyclical sensitive currencies have faced headwinds. USD has fluctuated wildly in tandem with US specific news, risk appetite and relative rates moves. After a temporary February rebound, both SEK and NOK have come under renewed pressure. Lower energy prices have market a hit to the notoriously risk appetite sensitive NOK but also SEK has suffered in recent weeks despite the Riksbank's renewed focus on imported inflation and hence currency weakness. Also the growth outlook and housing markets remain SEK headwinds.

In our base case, we are cautiously optimistic on systemic risk fears subsiding although we acknowledge that the outcome space is very wide. We maintain our strategic case for a lower EUR/USD and thus keep our downward sloping profile forecasting EUR/USD at 1.02 in 6-12M. We continue to expect the SEK to struggle over the medium-term horizon on the back of a relatively worse outlook for the Swedish economy compared to peers, valuation as well as an increased risk of overtightening by the Riksbank. In NOK, we acknowledge that the near-term prospects for NOK look more challenging than previously pencilled in and lift the short-end of our forecast profile, but keep the downward trajectory.

At present, the key risk is a more widespread crisis in the banking sector, which would create substantial downward pressure on inflation and growth prospects. A key assumption behind our FX forecasts is that of a stronger USD and tightening of global financial conditions. Risks to this assumption primarily lies in Fed delivering an actual policy pivot – possibly due to systemic risk fears or a weaker US economy than we expect.

USD

EUR/USD lower on tighter financial conditions

- In the US, the labour market remains much tighter and stronger than what the Fed can feel comfortable with. Financial conditions tightened amid concerns about bank stability, but notably market based inflation expectations have held up. It leaves both Fed and ECB with the classic monetary policy trade off with the choice of whether to continue to fight inflation or pausing due to concerns about bank stability. Systemic risk fears pose as a substantial downward risk to inflation and growth prospects.

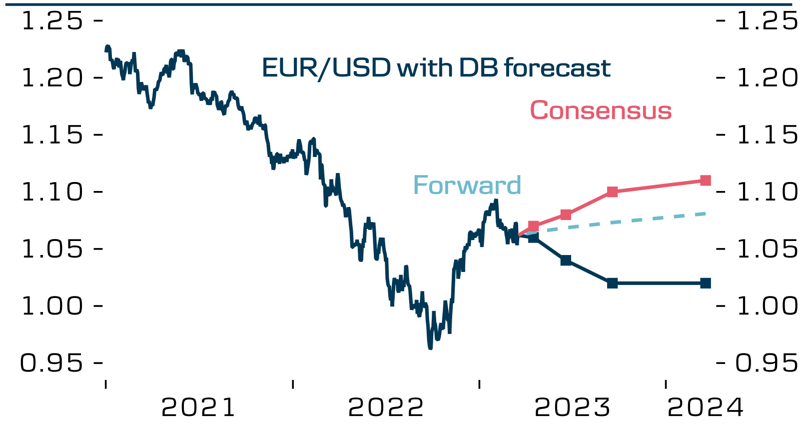
- We still pencil in Fed hiking policy rates by 25bp in March and May, which would bring policy rates above 5.00%. As for ECB, we still look for more hikes to bring the deposit rate to 4.00% in July. Volatility in rates market is high as market participants are divided on the outlook for monetary policy.

- We have long argued the strategic case for a lower EUR/USD based on relative terms of trade, real rates (growth prospects) and relative unit labour costs. Meanwhile, we increasingly think there is a potential for the cross to also head lower on a short-term horizon driven by the market realisation that financial conditions need to tighten, relative rates as well as relative asset demand. Financial conditions have indeed tightened recently which help explain the drop in EUR/USD, but we think more could come and keep our forecast profile intact.

- We forecast the cross at 1.02 in 6-12M. New energy/real rate shocks are required for a return all the way to the September lows.

- The biggest risks related to our forecast profile is related to the relative attractiveness of Eurozone assets and hence growth prospects. Systemic risk fears significantly widens the outcome space in both directions.

EUR/USD



	1M	3M	6M	12M
Danske Bank	1.06	1.04	1.02	1.02
Consensus	1.07	1.08	1.10	1.11
Forward	1.06	1.07	1.07	1.08

Hedging recommendations

Income: Sell USD via risk reversals.

Expenses: Purchase USD via forwards.

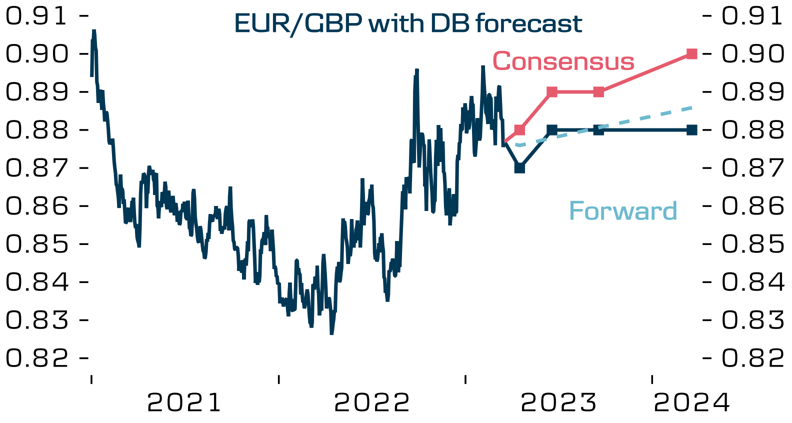
Source: Macrobond, Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of current or future results

GBP

To trade around the 0.88 mark

- The latest labour market report showed continued tightness as unemployment remained unchanged at 3.7% and unfilled vacancies moved only modestly lower. However, wage growth showed signs of slowing, supporting the BoE's monthly Decision Maker Panel survey which showed that expected year-ahead wage growth seemingly has peaked. Both headline and core inflation came in lower than expected, with core printing below 6% for the first time since last June. Overall, we do not see the outlook for the UK to be substantially different from the Euro Area, although we expect the recession to reach UK sooner.
- The EU and UK have reached an agreement on the Northern Ireland protocol effectively eliminating the tail risk of an EU-UK trade war.
- We expect the Bank of England (BoE) to hike the Bank Rate by a final 25bp in March bringing the policy rate to 4.25%. Market pricing is broadly in line with markets pricing a peak in the Bank Rate at 4.33%. Combined with too dovish pricing on the ECB, we see relative rates as a clear negative for the cross.
- In the very short-term, changes to systemic risk fears will remain the key driver of the cross. Further out, EUR/GBP is, in our view, stuck between opposing forces. On the one hand, we expect relative rates to act as a clear tailwind, while global growth slowdown and the relative appeal of UK assets acts as a headwind. At present, we do not see the relative growth outlook or global investment environment to create significant divergence between EUR and GBP. We thus expect the cross to remain range bound around 0.87-0.88.
- The key risk to seeing EUR/GBP substantially above our projection is a sharp sell-off in risk where capital inflows fade and liquidity becomes scares.

EUR/GBP



	1M	3M	6M	12M
Danske Bank	0.87	0.88	0.88	0.88
Consensus	0.88	0.89	0.89	0.90
Forward	0.88	0.88	0.88	0.89

Hedging recommendations

Income: Sell GBP via FX forwards.

Expenses: Buy GBP via risk reversals.

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

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Divergent SEK forces set to diverge even more

SEK

- GDP Q4 was revised higher to -0.2% (-0.6%) but still leaves Sweden vulnerable to a technical recession. The 2022 +2.6% rise hides the fact that the GDP level edged lower during last year. Indicators point towards continued growth slowdown. We forecast a 1.2% contraction in 2023. Higher mortgage costs, higher inflation and negative wealth effects add pressure on households while construction has come to a halt. Swedish GDP growth is set to underperform European peers.

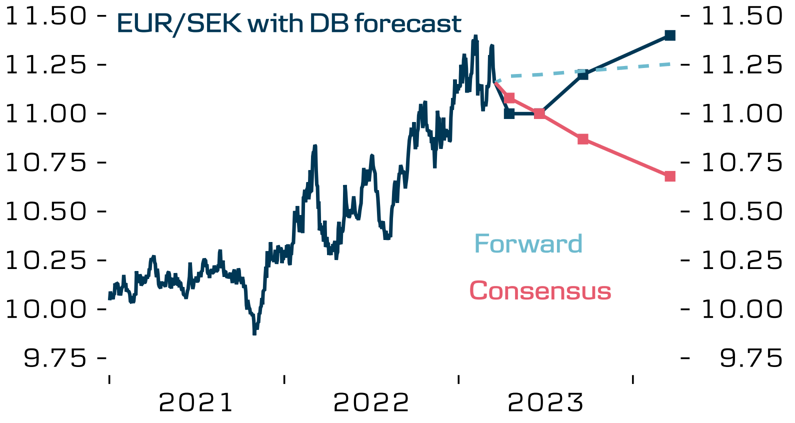
- After the February print showing accelerating inflation, we have revised our Riksbank call to 75bp (50) for April and 50bp (25) for June and the terminal rate to 4.25% (3.75). Based on our forecasts there is room to price in more on the RB, but even more so on the ECB. That said, the more they hike now, the worse the outcome for economic activity and the housing market, and the more they will have to cut next year.

- We expect relative rates to act as a positive for EUR/SEK. Likewise, the more the RB hikes now the more they have to cut next year as the economy is likely to take a harder hit. Relative fundamentals also continue to suggest a weaker SEK in the medium term.

- We keep the 1-6M forecasts intact and lift 12M to 11.40 (from 11.20).

- Risks are two-sided and substantial not least related to inflation and central bank surprises but also in relation to financial turmoil.

EUR/SEK



	1M	3M	6M	12M
Danske Bank	11.00	11.00	11.20	11.40
Consensus	11.08	11.04	10.87	10.68
Forward	11.19	11.20	11.22	11.25

Hedging recommendations

Income: Utilise any rebound in SEK to sell SEK via FX forwards.

Expenses: Buy SEK via risk reversals.

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

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NOK

Lifting our profile but maintaining a downward trajectory

- While realised economic data has kept up better-than-expected in recent months we still firmly believe in mainland growth and employment falling below trend in the quarters ahead. The February inflation print surprised to the downside with the details revealing a quite broad-based decline. The housing market has kept up better-than-expected and not least feared in recent months but we still expect higher rates and lower real disposable income growth to result in a decline in house prices in the coming year.

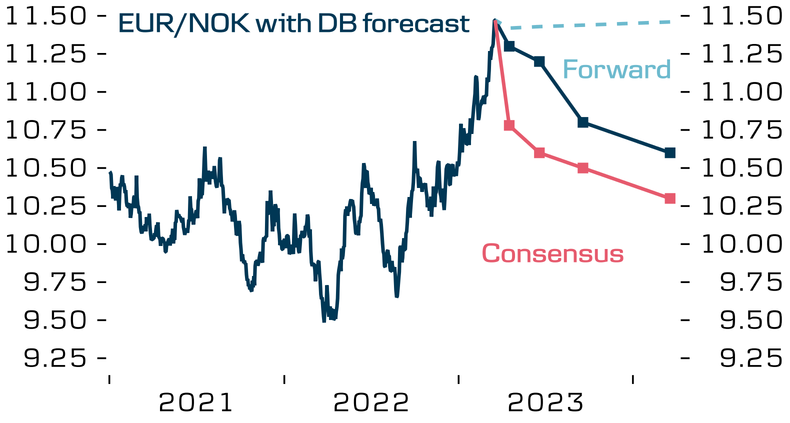
- Norges Bank (NB) has slowed its hiking pace from 50bp to 25bp. In December, NB hiked the sight deposit rate to 2.75% whilst indicating a final 25bp hike in March. This message was repeated at the interim January meeting. Given the recent set of data releases, we think things are set for an additional 25bp hike in Q2 which is slightly above current market pricing.

- In light of recent events we acknowledge that the near-term prospects for NOK look more challenging than previously pencilled in. In case systemic risk fears spread further NOK still looks vulnerable. However, in the situation that systemic risk fears subside the NOK rebound could also face headwinds down the road as this would opens the door for markets pricing back in central bank rate hikes. For this reason we lift the short-end of our forecast profile. We still firmly believe in a more bullish secular positive case building for the NOK years on commodities incl. energy constituting an outperforming equity sector.

- We forecast EUR/NOK at 11.20 in 3M and 10.60 in 12M.

- Near-term risks are closely connected to systemic risk and global recession fears. In particular the NOK is notoriously exposed in sessions of sharp risk-off and sell-offs in equities and commodities.

EUR/NOK



	1M	3M	6M	12M
Danske Bank	11.30	11.20	10.80	10.60
Consensus	10.78	10.60	10.50	10.30
Forward	11.42	11.43	11.44	11.46

Hedging recommendations

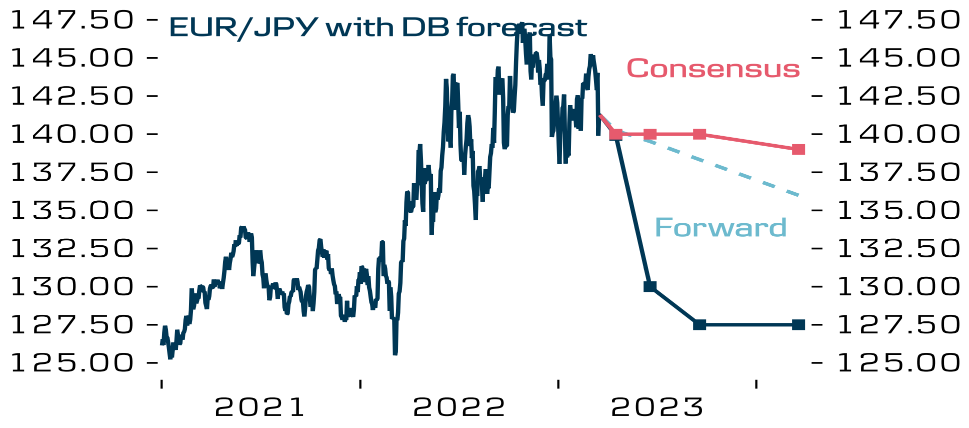
Income: Sell NOK via knock-in forwards.

Expenses: Buy NOK via FX forwards.

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

Others

EUR/JPY



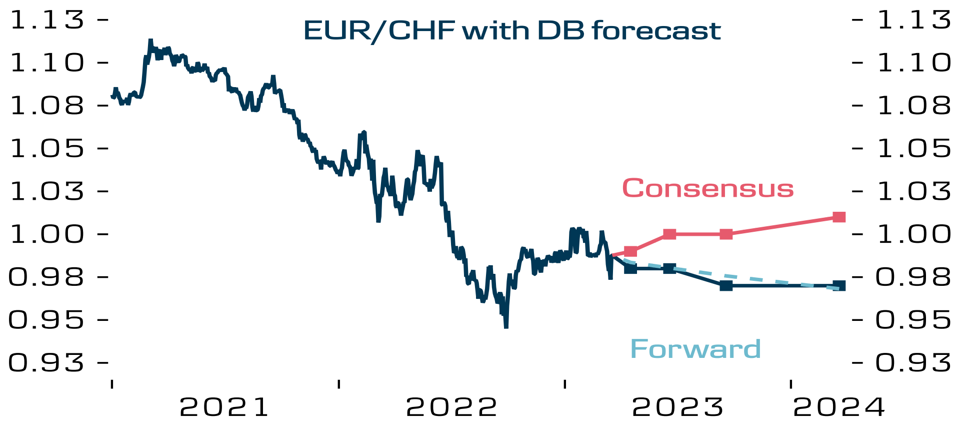
Hedging recommendations

Income: Sell JPY via risk reversals.

Expenses: Buy JPY via forwards.

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

EUR/CHF



Hedging recommendations

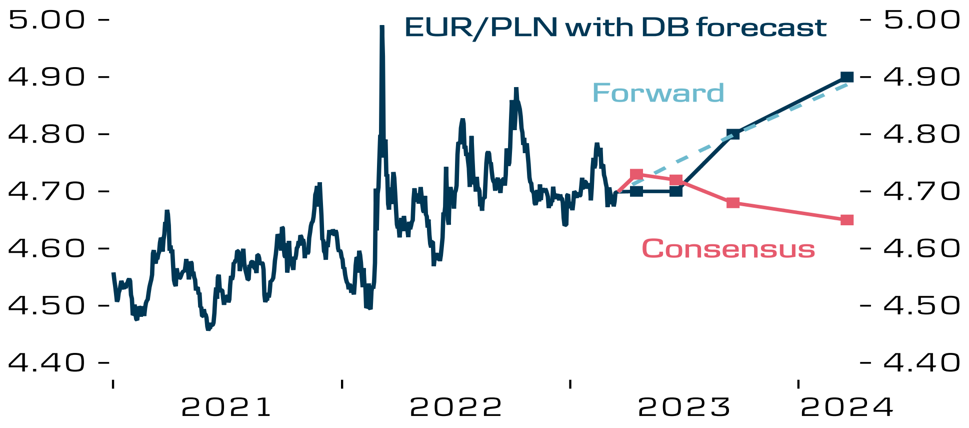
Income: Sell CHF via risk reversals.

Expenses: Buy CHF via forwards.

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

Others

EUR/PLN



Hedging recommendations

Income: Sell PLN via forwards, alternatively via KI-forwards.

Expenses: Buy PLN via risk reversals.

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

FX Forecast Table

Exchange rates vs EUR

Danske Bank

G10	Spot	+1m	+3m	+6m	+12m
				Last Update:	21/03/2023
Exchange rates vs EUR					
EUR/USD	1.08	1.06	1.04	1.02	1.02
EUR/JPY	142.71	140	130	128	128
EUR/GBP	0.88	0.87	0.88	0.88	0.88
EUR/CHF	1.00	0.98	0.98	0.97	0.97
EUR/SEK	11.12	11.00	11.00	11.20	11.40
EUR/NOK	11.34	11.30	11.20	10.80	10.60
EUR/DKK	7.45	7.4425	7.4425	7.4450	7.4500
EUR/AUD	1.61	1.56	1.53	1.52	1.52
EUR/NZD	1.74	1.68	1.68	1.67	1.67
EUR/CAD	1.47	1.45	1.44	1.42	1.42

EM	Spot	+1m	+3m	+6m	+12m
EUR/PLN	4.70	4.70	4.70	4.80	4.90
EUR/HUF	391.15	400	400	410	430
EUR/CZK	23.82	23.8	23.9	24.1	24.2
EUR/TRY	20.53	20.5	20.6	21.2	22.7
EUR/ZAR	20.05	19.2	18.5	17.9	17.3
EUR/CNY	7.41	7.31	7.23	7.24	7.24
EUR/INR	88.85	87.5	86.3	85.2	85.2

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