Danske Bank
Markets

Investment Research

29 September 2016

Market Guide

Focus on US election

- Political uncertainty looms
- Fed on hold this year
- USD set to be range bound through 2016, then to weaken

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Editorial deadline 28 September 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-October 2016.

Market overview

Next US rate hike still on hold

The Federal Reserve again failed to agree on raising interest rates at its September meeting. A majority of FOMC members preferred to allow room for the economy to grow further by holding the Fed funds target rate unchanged at around 0.375%. However, the FOMC does expect to hike rates once this year. In contrast, we expect the Fed to once again get cold feet when decision-time arrives, and we do not foresee a rate hike materialising until next summer. The financial markets are pricing roughly a 50% probability of a hike before the end of the year. An unchanged Fed funds target rate in September came as no great surprise to FX markets, with EUR/USD continuing to trade close to 1.12.

Japan experiments in pursuit of inflation target

The Bank of Japan (BoJ) wants to appear determined to achieve its proclaimed goal of lifting inflation in the Japanese economy to 2%. In September, the BoJ therefore decided to add yet another dimension to its range of policy instruments, introducing a target for the yield on 10Y government bonds. The BoJ already set short rates and will continue to have a partial target for its asset purchases. Moreover, the BoJ has underlined that its accommodative stance will continue until inflation is stable and above 2%. However, the BoJ risks unduly complicating matters in its eagerness to demonstrate determination. The market's view was also quite clear, as the JPY strengthened in the hours following the central bank's announcement.

ECB keeps policy unchanged in September

At the September meeting, the ECB kept all policy rates unchanged whilst signalling that it still intends to end its QE purchases in March 2017. This was a disappointment to the market where many participants had expected further policy easing. Despite the September decision to keep the QE purchase horizon unchanged, we expect the ECB will extend purchases by six months at the meeting in December due to lack of any upward trend in the underlying price pressure.

OPEC unlikely to lift oil prices sustainably

Oil continues to trade below USD50/bl, which is causing particular pain for the major oil producers, such as those in the Middle East. OPEC and Russia are therefore once more trying to revive negotiations aimed at stabilising the oil market and lifting prices. The thrust of the talks is again to agree a production freeze at current levels. However, while the idea may look promising on paper, it would maintain OPEC production close-to status quo, so we doubt it would have any long-lasting effect on oil prices.

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- *The Big Picture*
- *Nordic Outlook*
- *Yield Forecast Update*
- *FX Forecast Update*
- *Weekly Focus*
- *Danske Daily*

Interest rate hedging

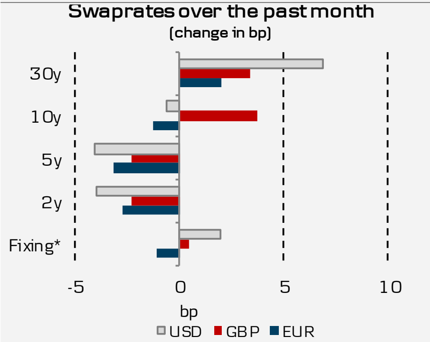
- **We expect global yields to stay low in coming months, with the ECB's increased QE purchases and the Fed on hold until next summer.**
- **We continue to recommend being moderately overweight EUR duration, given the historically low interest-rate levels and with long yields set to trend up in the longer term.**

The ECB disappointed the market in September

The ECB disappointed the market at its September meeting. Many market participants had expected further policy easing in the form of new interest rate cuts or an extension/expansion of QE. The ECB delivered none of the above and, if anything, was slightly more optimistic about the effects of its current policy programme. The ECB did, however, acknowledge a need to change the rules governing the instruments it can buy as part of its asset purchase programme. The issue has now been handed over to a committee, which is unlikely to present its recommendations until December.

The ECB's wait-and-see stance, combined with Fed members' rather hawkish rhetoric and a Bank of Japan (BoJ) apparently also hesitant to ease policy further, prompted a rise in global yields and a steepening of yield curves in September. However, the increase has been partially reversed by recent events, with the BoJ now focused on stabilising the 10Y yield around current levels (roughly 0%) and risk appetite coming under pressure.

Modest steepening of EUR, GBP and USD yield curves in past month



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

Source: Bloomberg

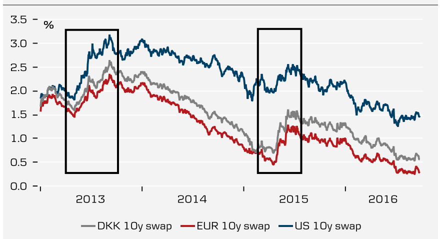
We do not seem to be facing an extended period of higher yields

The rise in global yields hit mainly the long end of the yield curve and the question is now: do we face an extended period of higher yields?

The past three years have witnessed two periods of rising global yields. In 2013, yields rose on the Fed announcing a tapering of its asset purchase programme. In spring 2015, German 10Y yields increased by almost one percentage point – ostensibly due to a combination of the market concluding that the ECB's QE was more than fully priced and bad positioning in the fixed income market. The latter should be viewed in light of the 'risk capacity' of banks now being much lower than before. Hence, major market movements could be reinforced in either direction, as there is no one to take the opposite position.

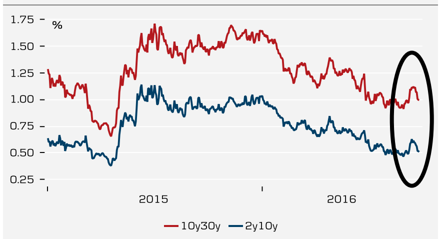
The future intentions of global central banks remain unclear and the market may well have been wrong-footed once again. Hence, we cannot rule out a repeat performance of the yield increases in spring 2015, when very few market participants had expected German 10Y yields to rise almost one percentage point within six weeks. However, our overall expectation is that global central banks will continue their expansionary monetary policies.

Two periods of rising global yields in past three years



Source: Bloomberg, Danske Bank Markets

Recent steepening of EUR curve partially neutralised



Source: Bloomberg, Danske Bank Markets

We do not expect the Fed to raise interest rates this year – especially in light of the recent weak numbers for the US economy. Given the still very low level of inflation, we also expect the ECB to extend its comprehensive QE programme to run throughout 2017 and not just until March. Furthermore, we believe global bond investors will take advantage of even minor yield rises to increase their positions and duration. While it may sound odd to many investors, a German 10Y yield in positive territory is a 'good deal'.

We generally maintain our forecast of long EUR yields being range-bound over the coming three to six months with a slight downside risk on a 3M horizon. However, we still see yields rising slightly on a 12M horizon as the Fed, despite everything, begins to raise rates and the market can begin to price the ECB ending its asset purchases by the end of 2017.

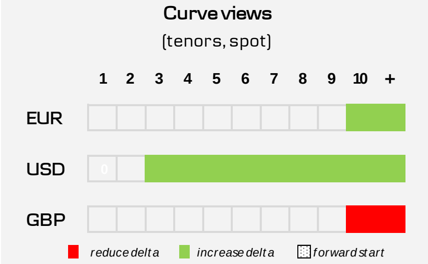
EUR curve hedging recommendation

In our view, the downward pressure on EUR yields is coming to an end. Hence, we keep our general recommendation of modestly overweighting duration on the EUR curve since current interest-rate levels are historically attractive and we continue to expect long yields to trend slightly higher on a 12M horizon. As such, we recommend that borrowers take advantage of current low interest-rate 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 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.

USD curve hedging recommendation

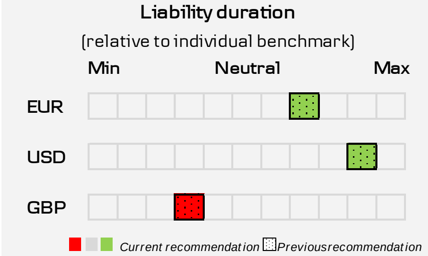
We still recommend having a relatively high hedge ratio on USD liabilities and locking in rate exposure at all maturities from 2Y and beyond and we maintain our liability duration recommendation just below maximum.

Hedge only the very long end in EUR



Source: Danske Bank Markets

Moderate overweight duration in EUR



Source: Danske Bank Markets

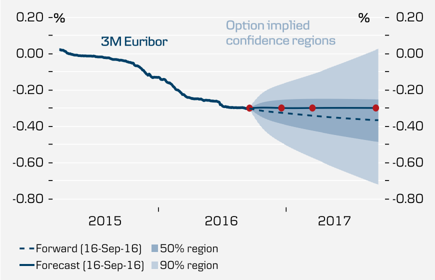
Interest rate outlook on 6-12M horizon

	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 still expect a 15bp rate cut from 0.25% to 0.10% in November but it is a close call and will depend largely on how data come out. There is only about a 5bp BoE rate cut priced in for November; therefore, we think markets are too complacent about the probability of further easing.	We expect the Fed to stay side-lined until June 2017 and to hike rates only once over the next 12 months, although we currently see a large upside risk to our Fed forecast.
Curves	We expect global rates to stay low and stable in coming quarters. We expect moderate upward pressure on bond yields on a 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 2Y-10Y and 5Y-10Y yield curves to steepen slightly next year.	After yields on Gilts fell sharply on the back of the restart of BoE's asset purchase programme and expectations of further BoE easing, 10Y Gilts yields have increased from the 0.52% low in the middle of August to 0.67% currently. We expect UK yields to trade mostly sideways in the autumn.	We see the 2Y-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 trend up on a 6M-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

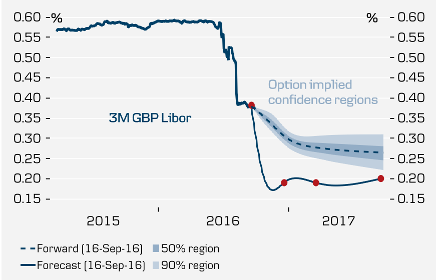
Danske Bank Markets' interest rate forecasts

3M Euribor and forecast



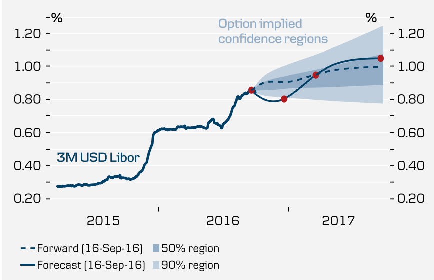
Source: Danske Bank Markets

3M GBP Libor and forecast



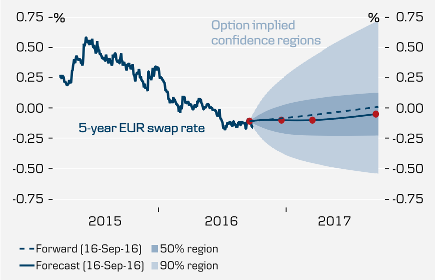
Source: Danske Bank Markets

3M USD Libor and forecast



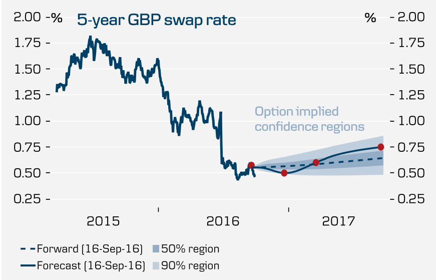
Source: Danske Bank Markets

5Y EUR swap rate and forecast



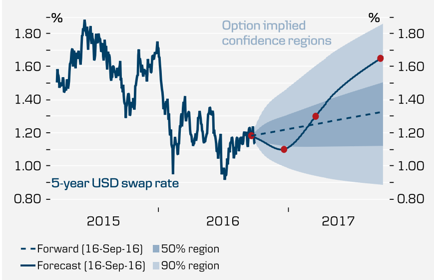
Source: Danske Bank Markets

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 September 2016)

	Horizon	Policy rate	3m xIbor	2-yr swap	5-yr swap	10-yr swap	2-yr gov	5-yr gov	10-yr gov
USD	Spot	0.50	0.85	0.99	1.19	1.50	0.73	1.17	1.67
	+3m	0.50	0.80	0.95	1.10	1.40	0.70	1.10	1.50
	+6m	0.50	0.95	1.05	1.30	1.60	0.80	1.30	1.70
	+12m	0.75	1.05	1.45	1.65	1.85	1.20	1.60	1.90
EUR*	Spot	0.00	-0.30	-0.22	-0.11	0.36	-0.65	-0.50	0.01
	+3m	0.00	-0.30	-0.22	-0.10	0.30	-0.62	-0.50	-0.10
	+6m	0.00	-0.30	-0.20	-0.10	0.40	-0.60	-0.50	0.00
	+12m	0.00	-0.30	-0.15	-0.05	0.70	-0.55	-0.45	0.30
GBP	Spot	0.25	0.38	0.44	0.55	0.87	0.14	0.29	0.87
	+3m	0.10	0.19	0.40	0.50	0.80	0.10	0.25	0.80
	+6m	0.10	0.19	0.40	0.60	0.95	0.10	0.35	0.95
	+12m	0.10	0.20	0.45	0.75	1.20	0.15	0.50	1.20

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

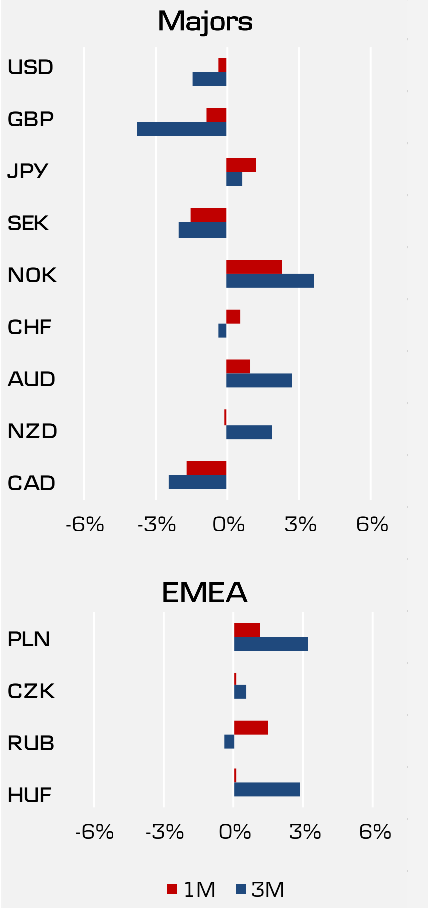
Source: Danske Bank Markets

FX hedging

- **Political uncertainty is likely to increase as the US presidential elections are moving closer. However, political risks are present on both sides of the Atlantic and could weigh on both the EUR and the USD.**
- **We view a Trump win as negative for the USD given his focus on protectionist policies while a Clinton win, which the market is expecting, will be slightly USD positive. We view European politics as a negative for the EUR.**
- **We expect EUR/USD to continue to trade in the 'post-Brexit' range of 1.10-1.1350 in the coming months, but still expect the cross to increase in the medium to long term. We target 1.18 in 12 months.**
- **We recommend hedging USD-expenses via knock-in forwards and USD-income via FX forwards. Alternatively, consider hedging USD-income via improver forwards.**

See page 12-19 for our updated hedging recommendations for selected currencies.

FX movements relative to EUR



Source: Bloomberg, Danske Bank

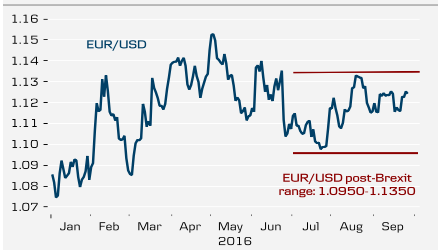
EUR/USD in range despite rising political uncertainty

EUR/USD has been very stable in the range of 1.10-1.1350 since the UK's vote to leave the EU on 23 June, as the so-called Brexit has not had the negative economic impact both on the Eurozone and globally as many expected. Secondly, political uncertainty has been remarkably muted after the election, as the UK government has not yet triggered Article 50. Thirdly, the market's expectations of a Fed rate hike have fluctuated back and forth over the summer, as the FOMC signalled that the tight labour market warrants a rate hike while weak US activity and survey data pushed rate hike expectations further out leaving EUR/USD trendless over the summer.

Central banks on hold and focus now turns to the December meetings

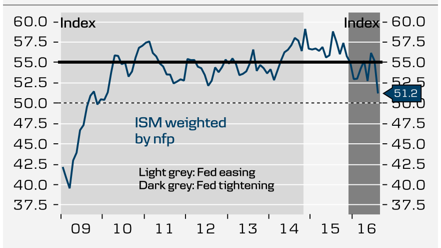
In line with our expectations, both the ECB and the Fed kept monetary policy unchanged in September. We believe the ECB will extend purchases by six months at the meeting on 8 December, when a 'committee' has looked into how the purchase programme can be extended without running into problems with the different rules. Next FOMC meeting is due on 2 November, but we doubt that the Fed will make much noise just prior to the US elections. Hence, all focus now turns to the December meetings with little prospects of relative interest rates moving EUR/USD in the meantime.

EUR/USD in range since Brexit



Source: Bloomberg, Danske Bank

The Fed is too optimistic in our view



Source: Bloomberg, Danske Bank

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Looking at the FOMC's new 'dots', four members want to hike twice or more this year while three members want to stay on hold for the rest of the year. Ten members expect one hike this year. The median 'dot' for next year now shows two hikes implying a shallower rate path compared to the three hikes pencilled in the previous dots. We do not expect the Fed to hike this year, as we think the Fed may be too optimistic about the current economic situation given the weakness in ISM and retail sales. However, we also acknowledge this is a close call – especially as the US labour market continues to tighten and as the FOMC appears to be eager to raise rates further.

US presidential election creates policy uncertainty

While uncertainty related to relative rates now has been parked until December, political uncertainty is likely to increase as the US presidential elections are moving closer. However, political risks are present on both sides of the Atlantic and could weigh on both the EUR and the USD and thus uncertainty is more likely to be a source of increased volatility rather than a directional risk.

US presidential election creates policy uncertainty

The US election is moving closer to its final stages and markets are set to focus on the tight race of the candidates in the opinion polls, where Hillary Clinton still has a small lead with 45.4% to 43.5% (see chart). In case of a Clinton win we expect to see policy continuity in terms of monetary and fiscal policy. A Trump win, on the other hand, would entail a sharp policy shift on many fronts, potentially leading to ballooning public debt levels, geopolitical frictions, uncertainty about Fed independence and an aggressive protectionist US trade policy.

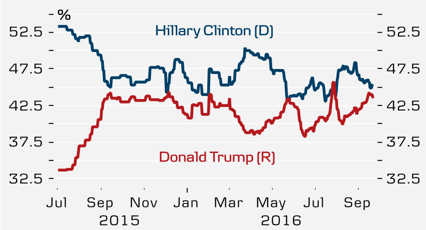
Both presidential candidates have pledged large infrastructure investments in their campaign to support US growth and productivity. Clinton's infrastructure programme of USD250bn over five years would mainly be financed by tax hikes, leaving the overall US debt projection more or less in line with official forecasts of the Congressional Budget Office (see chart). Trump has announced a similar spending programme, but at the same time promised tax cuts that would reduce revenues by USD3trn over 10 years. Such a fiscal plan would not only lead to sharply rising public debt levels, but also make his pledge of a balanced budget in 2024 impossible to achieve.

Weaker USD in case of Trump win

Historically, Republican presidencies have coincided with a weaker USD, while Democratic presidencies have coincided with a stronger USD (see chart). One of the reasons is that US growth tends to be stronger under Democratic presidencies. The future direction of the USD therefore crucially depends on the economic performance of the US economy.

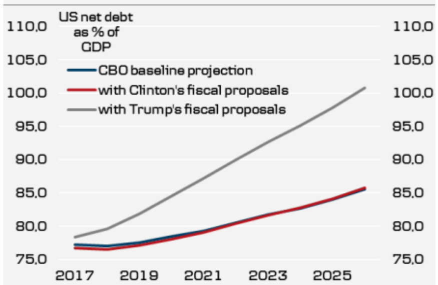
Although Clinton too has signalled favouring more restrictive trade policies, Donald Trump's radical protectionist trade proposals create a significant risk that previous trade agreements such as NAFTA would be revoked under a Trump presidency. Resistance in Congress and pressure from foreign partners would most likely moderate some of Trump's fiscal and foreign policy proposals, but trade policy is one area where the future US president has large powers to make unilateral decisions. Protectionist actions could trigger retaliatory trade measures from the affected countries and set in motion a global trade war that would not only hurt global trade but also economic growth. Additionally, the heightened risk of fiscal profligacy and monetary policy interference in case of a Trump win could have an adverse effect on economic and financial conditions in the US. Hence we view a Trump win as negative for the USD while a Clinton win, which the market is expecting, will be slightly USD positive.

A tight presidential race in the polls



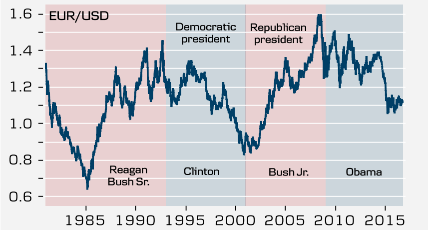
Source: Real Clear Politics, Danske Bank

US debt levels would rise sharply with Trump's fiscal plans



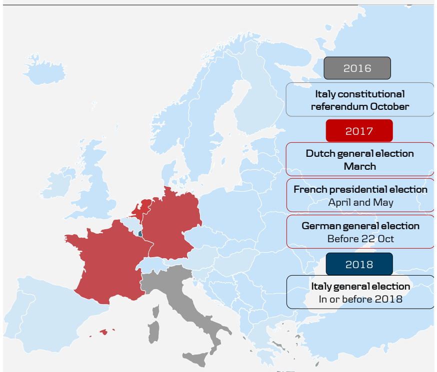
Source: Congressional Budget Office, Danske Bank

Republican presidencies are USD bearish



Source: Macrobond, Danske Bank

Upcoming elections in Europe



Source: Danske Bank

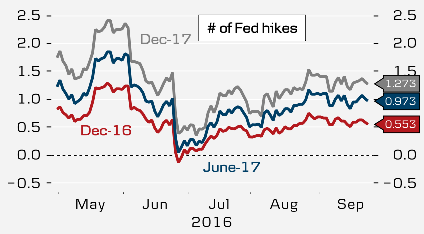
Political uncertainty in Europe mostly EUR negative

In the Eurozone, there are important political events over the coming year: (1) the Italian constitutional referendum in November; (2) the French presidential election in April/May 2017 and (3) the German election in September/October 2017.

Meanwhile, the uncertainty related to the UK's negotiations with the EU following Brexit is still lurking beneath the surface. UK PM Theresa May has said that she will not trigger Article 50 before year-end at the earliest due to preparations. Q1 17 seems more likely.

Overall, we view European politics as a negative for the EUR but only modestly so, as long as it does not put the EU/euro project in too much doubt. The French election, in our view, is the biggest risk as the main opposition leader, Marine Le Pen, has stated that she will call an EU referendum if she becomes president.

Market is pricing 55% probability of a Fed hike in 2016



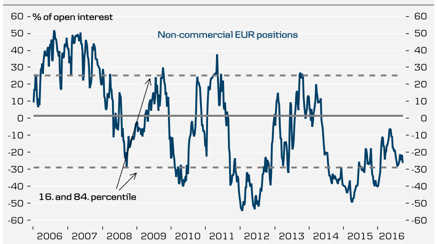
Source: Danske Bank

FX outlook

0-3 months

In the coming months, we expect EUR/USD to continue to trade in the 'post-Brexit' range of 1.10-1.1350. While political uncertainty is likely to cause higher volatility, we see little prospect of a big move in EUR/USD due to the outcome of the US election, as the political topics are more likely to have long-term than short-term implications for the US. As such, we see risks skewed to the downside in case the Fed hikes in December. The market is pricing around 55% probability of rate hike in December, suggesting that this should not be a big surprise. We expect that the potential rally in the USD following a US rate hike will be relatively shallow and short-lived. First of all, the pace of rate hikes will continue to be very shallow and secondly, investors are already very short EUR/USD according to the IMM data and EUR/USD tends to be less sensitive to relative rates when positioning is stretched, suggesting that the scope for a decline in EUR/USD might be limited. We target EUR/USD at 1.12 in 1-3M.

Investors are still short EUR/USD

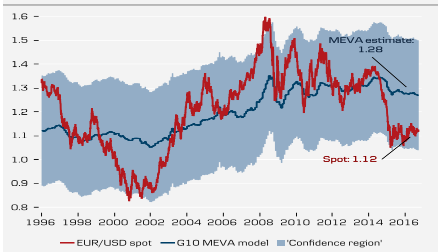


Source: Macrobond, Danske Bank

3-12 months

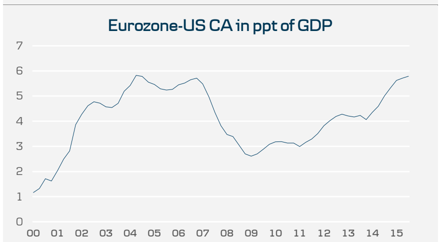
We still expect the undervaluation of the EUR and the wide Eurozone-US current account differential to be longer-term EUR positives. Hence, we maintain our long-held view that EUR/USD will reach 1.20 before it reaches 1.00. We target 1.14 in 6M and 1.18 in 12M.

EUR/USD is fundamentally undervalued



Source: Bloomberg, Danske Bank Markets

Eurozone-US current account differential at Q4-04 levels



Source: Bloomberg, Danske Bank Markets

Hedging FX risk

Hedge USD expenses via options

We recommend that companies hedge the exchange-rate risk on USD-denominated expenses via options that maintain a profit potential in the event of any USD weakening, while securing a worst-case exchange rate.

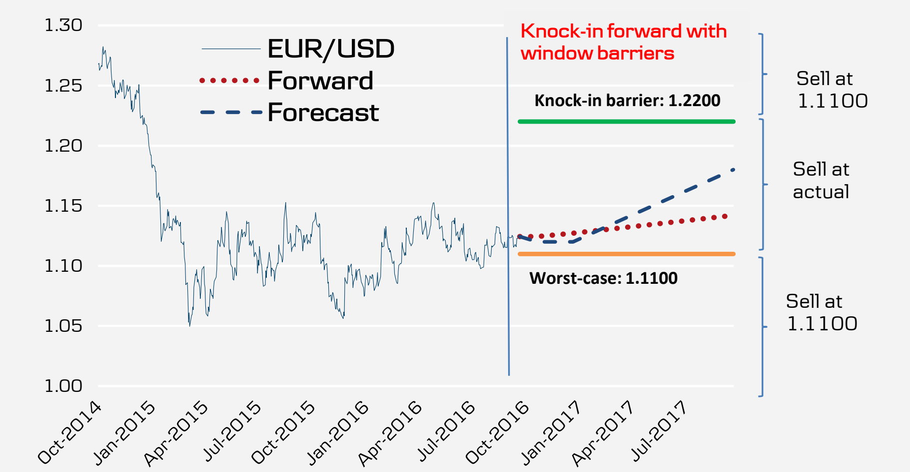
Specifically, we recommend hedging USD-denominated expenses via knock-in forwards with window barriers, with the barrier open for one month before each maturity date. A 12M strategy including 12 independent payments (the first on 28 October 2017) could, for example, be entered at zero cost (indicative pricing, spot ref. 1.1250) and would allow one to take advantage of any increase in EUR/USD to 1.2200 (a USD weakening of almost 8.5% from current spot), while securing a minimum EUR/USD rate of 1.1100, which would leave one protected against any USD strengthening of around. 1.3 %. As such, this strategy would enable one to take advantage of any significant increase in EUR/USD, while guaranteeing a favourable selling rate over the entire strategy period.

If EUR/USD is trading below 1.1100 on a settlement date, one would have the right to sell EUR/USD at 1.1100. If EUR/USD has traded above 1.2200 at any time during the month before a settlement date, one would be obliged to sell EUR/USD at 1.1100. Finally, if EUR/USD is trading above 1.1100 on a settlement date and the spot rate has not traded above 1.2200 in the month before settlement, one would have the option of selling EUR/USD at the spot rate on that date. Given our forecast of EUR/USD at 1.18 in 12 months and with the strategy securing a favourable worst-case exchange rate, we find the strategy very attractive.

We emphasise that the payments are independent, so even if EUR/USD should trade above 1.22 in one of the 12 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 should again trade in the 1.1100-1.2200 range.

The chart below illustrates the strategy.

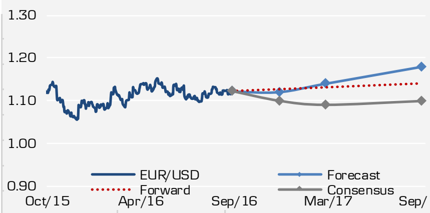
Hedge USD expenses via knock-in forwards with window barriers



The structure illustrated above is a 12M hedging strategy for USD-denominated expenses. It is a knock-in forward strategy with window barriers (the first payment on 28 October 2016 and the last on 28 September 2017). The strategy is a zero-cost strategy (indicative pricing, spot ref.: 1.1250) with a lower worst-case exchange rate of 1.1100 and a knock-in window barrier of 1.2200.

Source: Danske Bank Markets

EUR/USD forecast



	3M	6M	12M
DB forecast	1.12	1.14	1.18
Forward	1.13	1.13	1.14
Cons. Forecast	1.10	1.09	1.10

Source: Bloomberg, Danske Bank Markets

Hedge USD income via FX forwards – alternatively, consider hedging income via an improving forward strategy

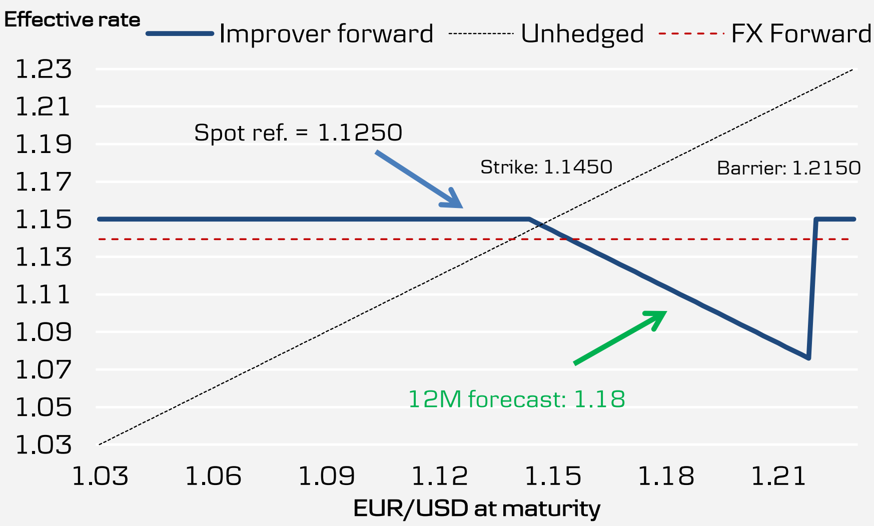
We generally recommend locking in USD-denominated income at current levels, which are very attractive from a historical perspective.

Alternatively, consider taking advantage of the borderline cheap options volatility to enter an improving forward strategy, which would enable one to profit from any USD weakening. The disadvantage is that the worst-cast exchange rate is slightly less attractive for improving forwards relative to forwards.

Specifically, a 12M strategy with 12 monthly payments (the first on 28 October 2016) could be entered at zero cost (spot ref. 1.1250). The chart on the right illustrates that the strategy guarantees a worst-case exchange rate of 1.1450 on each of the 12 payment dates. Also, the EUR/USD buying rate will improve in the range from 1.1450 up to 1.2150 by an amount matching the change in the spot rate. If EUR/USD spot is trading above 1.2150 on a settlement date, one would have the right to buy EUR/USD at 1.1450 but would not maintain the profit potential from 1.1450-1.2150. We emphasise that the payments are independent. So, if EUR/USD should trade above 1.2150 on a settlement date, one would not forego the option of buying EUR/USD at the improved exchange rate in the following month if EUR/USD spot has traded in the 1.1450-1.2150 range in that month.

Given our 12M EUR/USD forecast of 1.18 and the borderline cheap volatility, we find this alternative attractive relative to ordinary FX forwards.

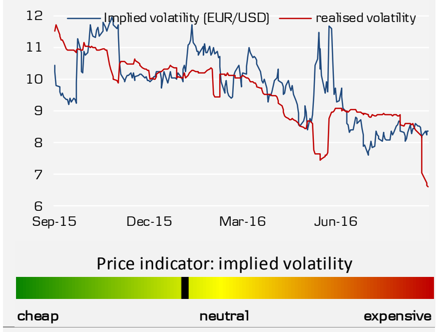
Improving FX forwards are an attractive alternative to FX forwards



The structure illustrated above is a 12M hedging strategy for USD-denominated expenses. It is an improver forward strategy with window barriers (the first payment on 28 October 2016 and the last on 28 September 2017). The strategy is a zero-cost strategy (indicative pricing, spot ref.: 1.1250) with a worst-case exchange rate of 1.1450 and a knock-in window barrier of 1.2150.

Source: Danske Bank Markets

Implied USD options volatility is cheap



Source: Bloomberg, Danske Bank Markets

USD – range-bound short term, still higher longer term

Short term, political risks will affect the cross, but with uncertainty in both the US and Euro area there is no clear direction on the effect. Longer term we still see fundamentals moving the cross higher. We target the cross at 1.12 in 1M, 1.12 in 3M, 1.14 in 6M and 1.18 in 12M.

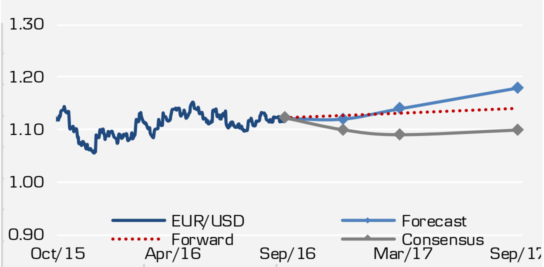
Outlook for EUR/USD

- US GDP growth has slowed markedly to just around 1% q/q AR over the past three quarters and the ISM activity indicators are at the weakest level since 2010, suggesting that growth in Q3 may disappoint as well. In the euro area, GDP growth showed fairly solid GDP growth of 0.3% q/q in Q2 16 and initial survey indicators suggest fairly resilient economic conditions post the Brexit vote.

- Weak US data have not supported the case for a Fed rate hike and we still believe that the Fed will wait until H1 17 to raise interest rates again. At its September meeting the Fed kept rates unchanged, in line with our and the market's expectations. It kept the door open for a December hike, but we believe that it is too optimistic about the current economic situation. Meanwhile, the ECB maintained its monthly QE purchases of EUR80bn and still intends to end its purchases in March 2017. In our view, the ECB will eventually announce an extension of QE to September 2017. The extension announcement could occur in December when the ECB may also revise its inflation forecasts. We think it is unlikely that it will cut interest rates further.

- The US election is moving closer and 'officially' starting with the first presidential debate on 26 September. The election is due to take place on 8 November and, in the meantime, markets are set to focus on opinion polls and speculation. See the FX Theme page 8 for more on the election and its effect on the US economy.

EUR/USD



	3M	6M	12M
DB forecast	1.12	1.14	1.18
Forward	1.13	1.13	1.14
Cons. Forecast	1.10	1.09	1.10

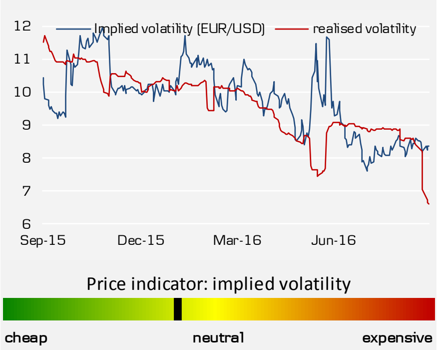
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

Income	Expenses
We recommend locking in USD income via FX forwards. Alternatively consider an improver forward strategy (see page 11 for more details).	We recommend that companies hedge USD-denominated expenses via knock-in forwards with window barriers, with the barrier open for one month before each maturity date.

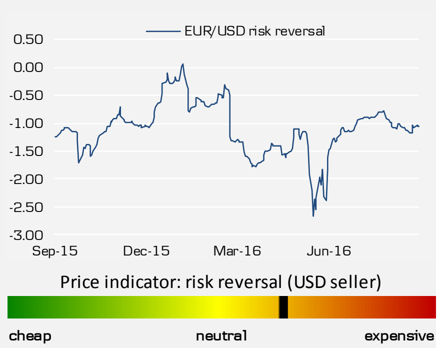
Source: Bloomberg, Danske Bank Markets

3M volatility



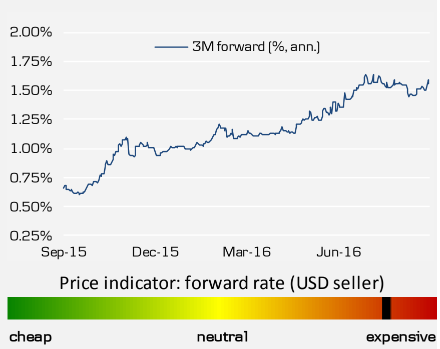
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

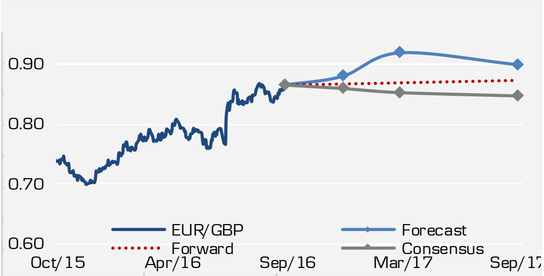
GBP – no Brexit recession but we still expect a BoE rate cut

Economic indicators suggest better than feared growth post Brexit, but further Bank of England easing and imbalances in the UK economy will weaken GBP. We target EUR/GBP at 0.87 in 1M, 0.88 in 3M, 0.92 in 6M and 0.90 in 12M.

Outlook for EUR/GBP

- Soft economic indicators suggest that the UK rebounded in August after the initial deceleration in July, suggesting that the UK economy may avoid a Brexit recession. PMIs have rebounded sharply across sectors: the NIESR GDP estimate has been positive and consumer confidence is still at a relatively high level. As the economic data have been better than expected, we now expect quarterly GDP growth to stay positive during H2 16. However, the economy is still expected to slow markedly versus pre-referendum growth rates due to Brexit uncertainty.
- As expected, the Bank of England (BoE) kept its monetary policy unchanged at the 15 September MPC meeting. It left the door open for more easing later this year if data meet expectations from August projections. However, the BoE signals that the probability has declined, as near-term indicators have been better than expected. We still expect a 15bp rate cut from 0.25% to 0.10% in November but it is a close call and will depend largely on how data come out. There is only a 5bp BoE rate cut priced in for November; therefore, we think markets are too complacent about the probability of further easing.
- Our forecast of a weaker GBP is driven not only by BoE easing but also by the considerable imbalances in the UK economy, not least the significant current account deficit. In addition, net foreign debt accumulated through several years of current account deficits has made the GBP very fragile. Given the stronger-than-expected economic development post the UK's EU referendum, we have, however, revised our 1-6M EUR/GBP forecasts slightly lower.

EUR/GBP



	3M	6M	12M
DB forecast	0.88	0.92	0.90
Forward	0.87	0.87	0.87
Cons. Forecast	0.86	0.85	0.85

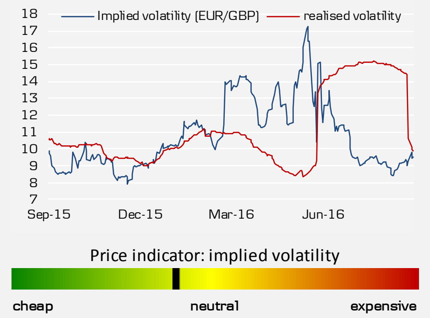
Source: Bloomberg, Danske Bank Markets

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 knock-in forwards.

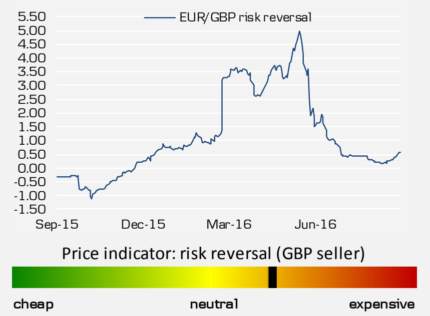
Source: Bloomberg, Danske Bank Markets

3M volatility



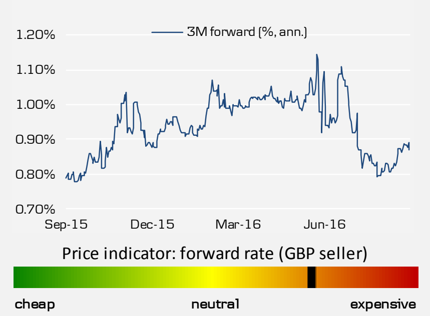
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

JPY – BoJ assessment: policy adjustments but no easing

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 undervalued. We target EUR/JPY at 113 in 1M, 114 in 3M, 119 in 6M and 123 in 12M.

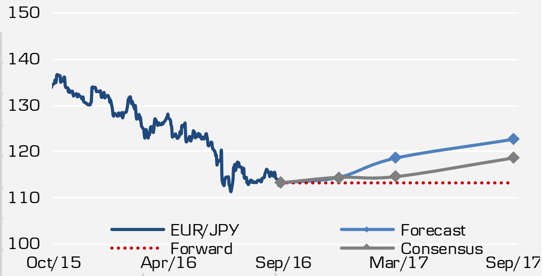
Outlook for EUR/JPY

- 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, suggesting a stabilisation in the manufacturing sector. Moreover, with the government's fiscal stimulus package, which is expected to lift growth by about 0.3pp in 2016 and 0.9pp in 2017, the economy is expected to continue to grow above trend in the coming year. We forecast GDP growth of 0.6% in 2016 and 1.1% y/y in 2017.

- At the September MPC meeting, the Bank of Japan (BoJ), in line with our expectations, did not add new monetary easing. However, as a result of the comprehensive assessment of its monetary policy, the BoJ introduced a new and more flexible monetary policy framework (QQE with yield curve control) in which it moves away from strictly targeting an increase in the monetary base to targeting the 10-year Japanese government bond yield.

- Underlying support for JPY stemming from fundamental flows is likely to remain intact, but we believe the effects are diminishing as the JPY is no longer undervalued. Furthermore, we expect the market to continue to price in a future BoJ rate cut, as the BoJ explicitly said that the interest rate can be cut further if needed. This will dampen the JPY appreciation pressure.

EUR/JPY



	3M	6M	12M
DB forecast	114.24	118.56	122.72
Forward	113.03	113.01	112.99
Cons. Forecast	114.30	114.45	118.63

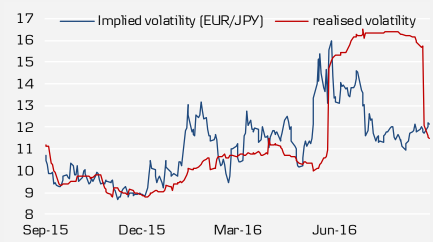
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

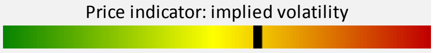
Income	Expenses
We recommend hedging JPY income via FX forwards.	We recommend hedging JPY expenses via knock-in forwards.

Source: Bloomberg, Danske Bank Markets

3M volatility



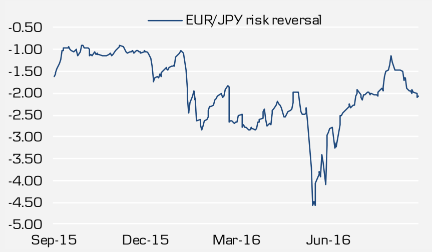
Price indicator: implied volatility



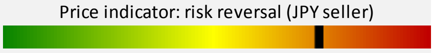
cheap neutral expensive

Source: Bloomberg, Danske Bank Markets

3M risk reversal



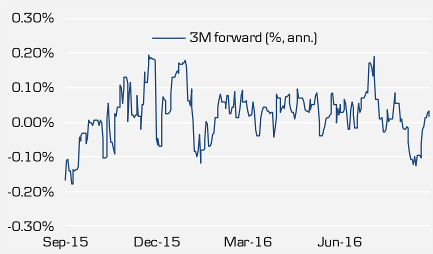
Price indicator: risk reversal (JPY seller)



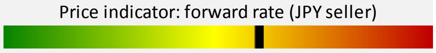
cheap neutral expensive

Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Price indicator: forward rate (JPY seller)



cheap neutral expensive

Source: Bloomberg, Danske Bank Markets

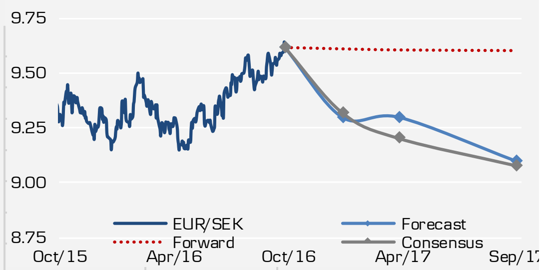
SEK – stronger but slower

The Riksbank and a slowdown in growth will keep the SEK fundamentally weak throughout 2016. We target EUR/SEK at 9.40 in 1M, 9.30 in 3M, 9.30 in 6M and 9.10 in 12M.

Outlook for EUR/SEK

- Swedish GDP growth has moderated, weighing on the SEK over the summer. We look for GDP growth of around 3% for 2016. This would be above trend and peers but less spectacular than last year. Net exports remain a drag. Private consumption and fixed investments remain key drivers, albeit to a lesser extent.
- As expected the Riksbank left policy unchanged at its September meeting, reassured by the uptrend in inflation, strong economic performance and long-term inflation expectations in line with its target. We expect it to extend its QE programme in October until June 2017, as the Riksbank will try to match the ECB because inflation, in our view, is set to disappoint. Monetary policy should help keep the EUR/SEK elevated.
- Fundamentals and valuation are extremely favourable for the SEK. Cyclical tailwinds have moderated, which has weighed on the SEK recently. Note, however, that in relative terms the growth outlook is still supportive of the SEK. The Riksbank will match the ECB on QE extension as a way to counter any premature SEK appreciation. This is likely to keep EUR/SEK elevated for longer.

EUR/SEK



	3M	6M	12M
DB forecast	9.30	9.30	9.10
Forward	9.61	9.61	9.61
Cons. Forecast	9.32	9.20	9.08

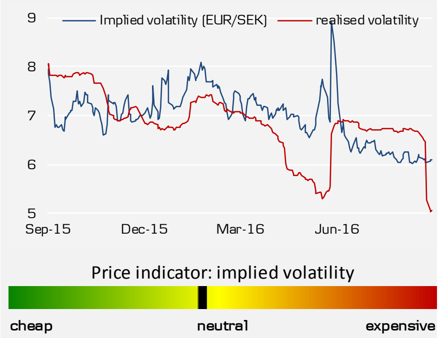
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

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

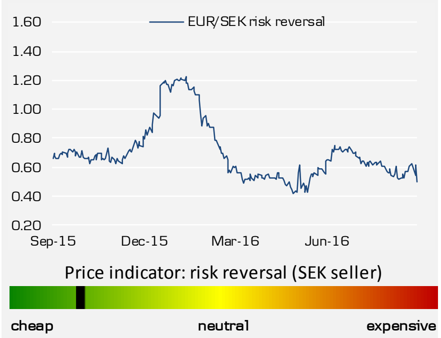
Source: Bloomberg, Danske Bank Markets

3M volatility



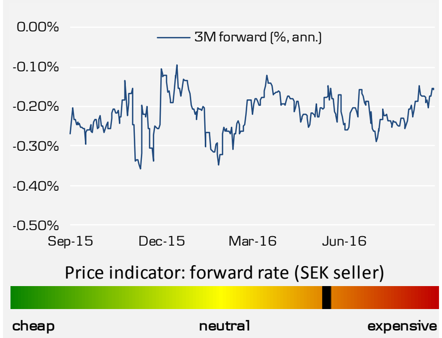
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



Source: Bloomberg, Danske Bank Markets

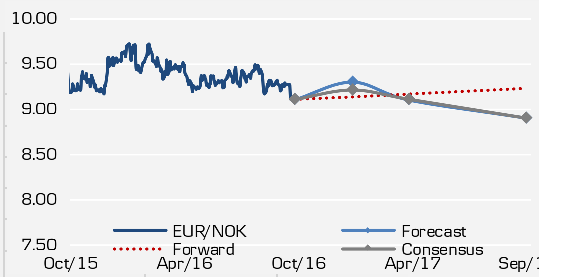
NOK – Norges Bank turning to neutral bias

The outcome of the Norges Bank (NB) meeting raises the downside risk to our forecasts for EUR/NOK but we still do not expect sustainable NOK appreciation before 2017 and see risks skewed to a rebound in the cross. We target EUR/NOK at 9.30 in 1M, 9.30 in 3M, 9.10 in 6M and 8.90 in 12M.

Outlook for EUR/NOK

- The NB Regional Network Survey for Q3 suggests a much improved economic outlook in Norway, with all sectors facing higher output growth. This is encouraging as monetary policy has implicitly been tightened over the summer with the Nibor policy rate spread widening on the back of regulatory changes in the US money market. Core inflation dropped 0.4pp to 3.3% y/y as the one-off effects in the likes of airfares and food-prices – which drove the July surprise – dropped back. Finally, house prices have surprised to the upside, driven by not least a tight supply side in Oslo.
- NB left the sight deposit rate unchanged at 0.50% at its September meeting whilst signalling a 40% probability of a later rate cut. The policy report and the press release were all in all on the hawkish side and the Board has turned to a neutral bias. Hence, it will take some negative surprises or a significant stronger NOK to trigger a rate cut now. Given our economic projections, we think NB will leave rates unchanged throughout 2017.
- Overall, the outcome of the Norges Bank meeting raises the downside risk to our forecasts for EUR/NOK but we still do not expect it to be the trigger for sustainable NOK appreciation as: (1) strong NOK appreciation could be the trigger for a rate cut, (2) the global business cycle is vulnerable, (3) we are not near-term optimistic on the oil price given point two and (4) relative unit labour cost developments suggest limited NOK upside potential in the short term. In our base case we first expect EUR/NOK to sustainably move lower in 2017 when valuation, positioning, a gradually higher oil price, relative rates and fundamentals will weigh on the cross.

EUR/NOK



	3M	6M	12M
DB forecast	9.30	9.10	8.90
Forward	9.13	9.16	9.23
Cons. Forecast	9.20	9.10	8.90

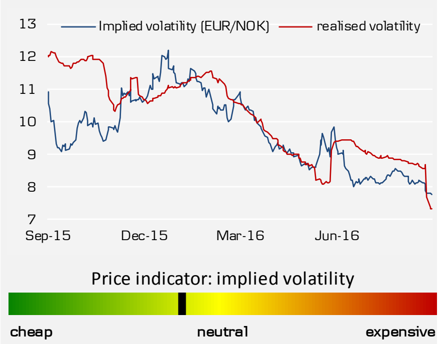
Source: Bloomberg, Danske Bank Markets

Hedging recommendations

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

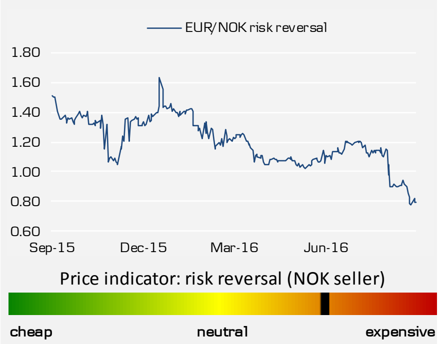
Source: Bloomberg, Danske Bank Markets

3M volatility



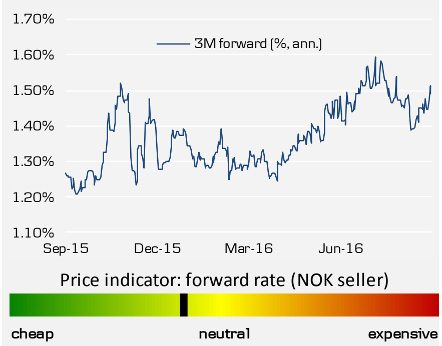
Source: Bloomberg, Danske Bank Markets

3M risk reversal



Source: Bloomberg, Danske Bank Markets

3M forward premium (% p.a.)



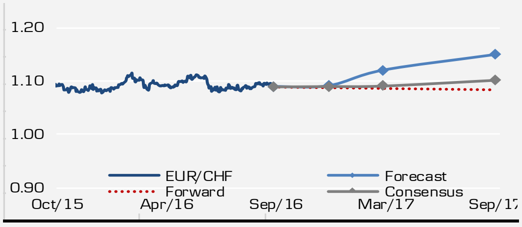
Source: Bloomberg, Danske Bank Markets

Danske Bank Markets' hedging recommendations: other majors

Currency	Instrument – Income	Instrument – Expenses	Forecasts
CHF	We recommend hedging CHF income via risk-reversals.	Hedge CHF expenses via knock-in forwards.	

CHF

Price indicators

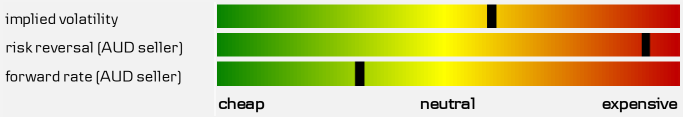


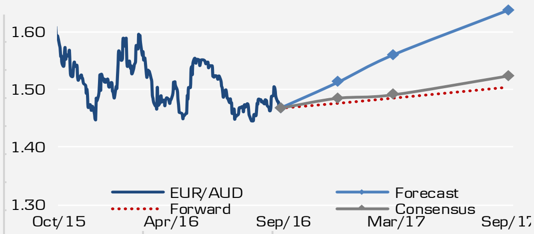
	3M	6M	12M
DB forecast	1.09	1.12	1.15
Forward	1.09	1.09	1.08
Cons. Forecast	1.09	1.09	1.10

Currency	Instrument – Income	Instrument – Expenses	Forecasts
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.	

AUD

Price indicators



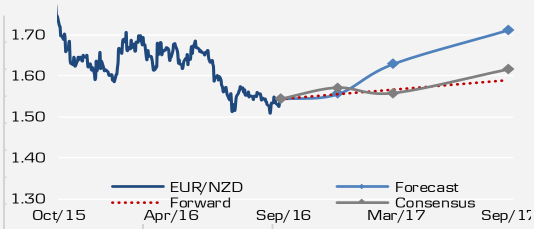


	3M	6M	12M
DB forecast	1.51	1.56	1.64
Forward	1.48	1.49	1.51
Cons. Forecast	1.49	1.49	1.53

Currency	Instrument – Income	Instrument – Expenses	Forecasts
NZD	We recommend hedging NZD income with knock-in forwards.	Hedge NZD expenses via a risk-reversal strategy.	

NZD

Price indicators

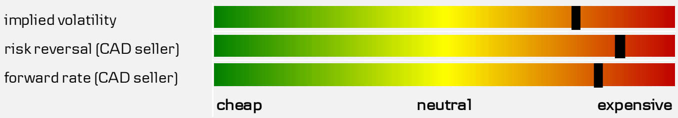


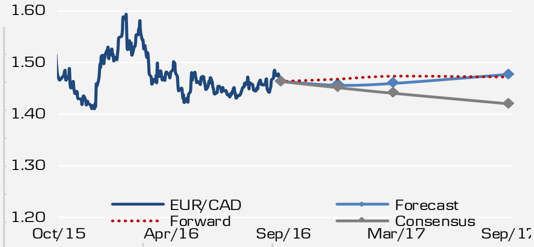
	3M	6M	12M
DB forecast	1.56	1.63	1.71
Forward	1.56	1.57	1.59
Cons. Forecast	1.57	1.56	1.61

Currency	Instrument – Income	Instrument – Expenses	Forecasts
CAD	Hedge CAD income via knock-in forwards.	Hedge CAD expenses via risk-reversals.	

CAD

Price indicators





	3M	6M	12M
DB forecast	1.46	1.46	1.48
Forward	1.47	1.47	1.47
Cons. Forecast	1.45	1.44	1.42

Source: Danske Bank Markets

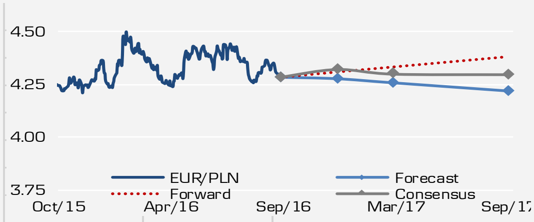
Danske Bank Markets' hedging recommendations: EMEA

PLN

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

Price indicators

Forecast



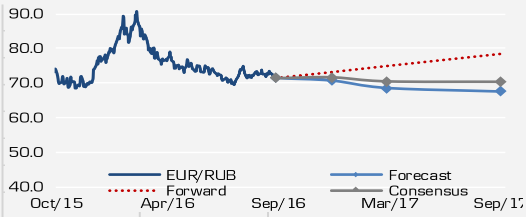
	3M	6M	12M
DB forecast	4.28	4.26	4.22
Forward	4.31	4.33	4.38
Cons. Forecast	4.32	4.30	4.30

RUB

Currency	Instrument: Income	Instrument: Expenses
RUB	We recommend hedging RUB-income via knock-in forwards.	We recommend hedging RUB expenses via a risk-reversal strategy.

Price indicators

Forecast

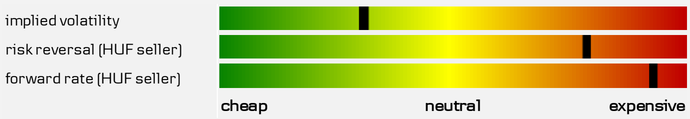


	3M	6M	12M
DB forecast	70.56	68.40	67.38
Forward	72.98	74.76	78.27
Cons. Forecast	71.50	70.45	70.35

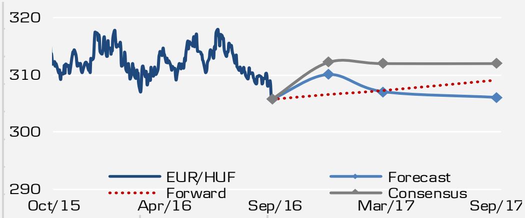
HUF

Currency	Instrument: Income	Instrument: Expenses
HUF	We recommend hedging HUF-income via FX forwards.	We recommend hedging HUF-expenses via risk-reversal strategies.

Price indicators



Forecast

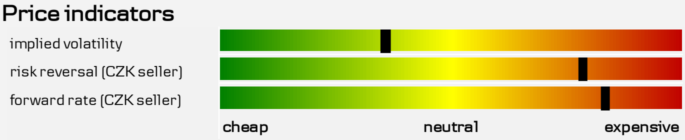


	3M	6M	12M
DB forecast	310.00	307.00	306.00
Forward	306.49	307.19	309.01
Cons. Forecast	312.17	312.00	312.00

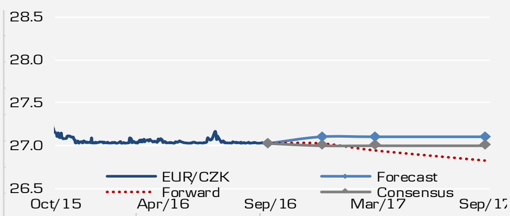
CZK

Currency	Instrument: Income	Instrument: Expenses
CZK	We recommend hedging CZK income via risk-reversals.	Hedge CZK expenses with knock-in forwards.

Price indicators



Forecast



	3M	6M	12M
DB forecast	27.10	27.10	27.10
Forward	27.02	26.94	26.82
Cons. Forecast	27.00	27.00	27.00

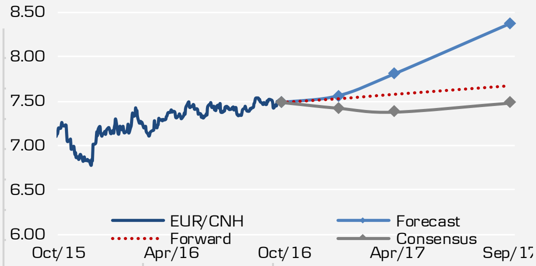
Source: Danske Bank Markets

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 CNY payables via a risk reversals.

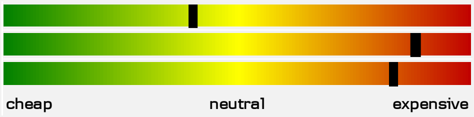
Forecast



	3M	6M	12M
DB forecast	7.56	7.81	8.38
Forward	7.53	7.58	7.68
Cons. Forecast	7.42	7.38	7.48

Price indicators

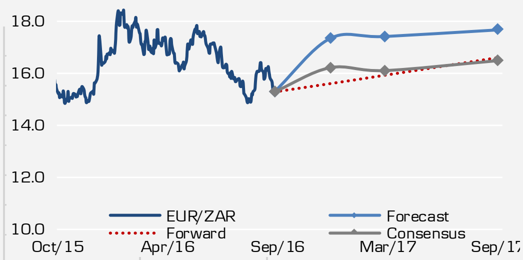
implied volatility
risk reversal (CNH seller)
forward rate (CNH seller)



ZAR

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

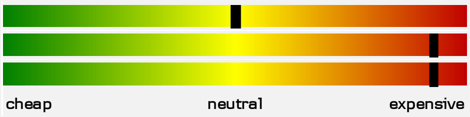
Forecast



	3M	6M	12M
DB forecast	17.36	17.44	17.70
Forward	15.59	15.93	16.62
Cons. Forecast	16.20	16.09	16.47

Price indicators

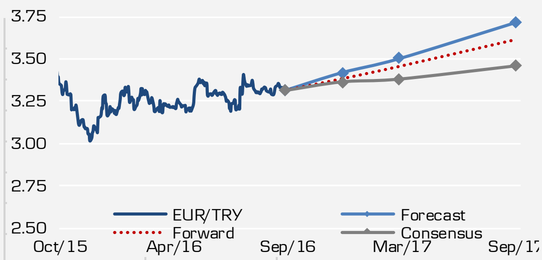
implied volatility
risk reversal (ZAR seller)
forward rate (ZAR seller)



TRY

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

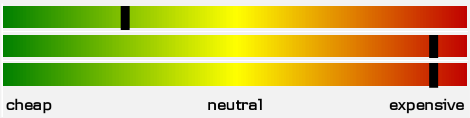
Forecast



	3M	6M	12M
DB forecast	3.42	3.50	3.72
Forward	3.38	3.45	3.61
Cons. Forecast	3.36	3.38	3.46

Price indicators

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



Source: Danske Bank Markets

FX forecasts

G10				Last Update:	28/09/2016
	Spot	+1m	+3m	+6m	+12m
Exchange rates vs EUR					
EUR/USD	1.122	1.12	1.12	1.14	1.18
EUR/JPY	113.0	113	114	119	123
EUR/GBP	0.863	0.87	0.88	0.92	0.90
EUR/CHF	1.090	1.090	1.090	1.120	1.150
EUR/SEK	9.630	9.40	9.30	9.30	9.10
EUR/NOK	9.098	9.30	9.30	9.10	8.90
EUR/DKK	7.452	7.4425	7.4425	7.4425	7.4425
EUR/AUD	1.462	1.474	1.514	1.562	1.639
EUR/NZD	1.546	1.514	1.556	1.629	1.710
EUR/CAD	1.483	1.478	1.456	1.459	1.475
EM					
	Spot	+1m	+3m	+6m	+12m
EUR/PLN	4.291	4.30	4.28	4.26	4.22
EUR/HUF	308	310	310	307	306
EUR/CZK	27.021	27.10	27.10	27.10	27.10
EUR/RUB	71.737	72.02	70.56	68.40	67.38
EUR/TRY	3.340	3.34	3.42	3.50	3.72
EUR/ZAR	15.109	17.02	17.36	17.44	17.70
EUR/BRL	3.626	3.81	3.75	3.76	3.78
EUR/CNY	7.486	7.50	7.56	7.81	8.38
EUR/INR	74.565	75.19	76.72	78.66	82.60

Source: Danske Bank Markets

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Date of first publication

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