Emerging Markets View

October 2018: Casualties of war

Following another sell-off, emerging market currencies have stabilised over the past few weeks, but with the trade war escalating, EM FX is not out of the woods yet. The fear now is that the US-China sparring has morphed into the kind of slugfest from which either party could find it difficult to retreat. The trade war between the world's two largest economies could disrupt the global value chain and spell a slowdown in world trade. Elevated uncertainty from the trade war adds to the already dangerous cocktail of balance sheet reductions from the Fed, domestic political clouds and other US sanctions. The result is a murky outlook for EM FX. A fresh round of EM sell-offs, induced by the trade war, would likely hit the Asian currencies the hardest, especially the KRW, TWD and SGD, as they are small and open economies with high reliance on Chinese demand.

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CNY: Breaking seven

As a new tactic, the PBoC is keeping its currency intervention gunpowder dry for the battles ahead; this will likely buoy the USD/CNY, even to the psychologically important level of 7.0.

RUB: Not ready to surrender

The pressure on the RUB has substantially eased but sanctions risks still can't be dismissed all together. Optimism is fragile and can quickly be shattered by hostile rhetoric. But strong fundamentals ensure that new pressure episodes are likely to be short-lived.

PLN: Trade war showing its face in exports

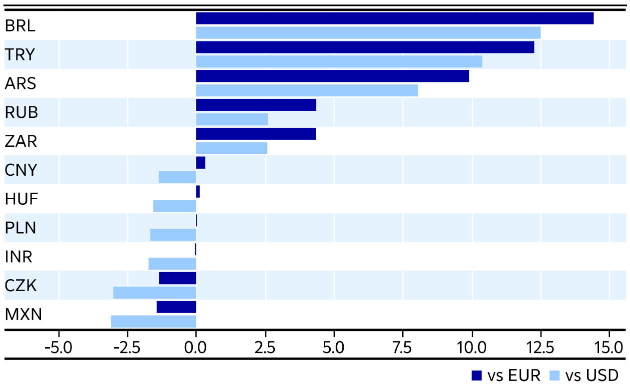
The zloty's primary driver remains the overall market sentiment. Longer out, politics and uncertainty about global trade are risk factors pointing to a moderate slowdown in growth.

In focus – BRL: Get ready for the "Tropical Trump"

The fate of the BRL is dependent on the outcome of the presidential election on 28 October, as Brazil needs reforms to stabilise public finances. However, market favourite Bolsonaro is only 'a lesser evil', making the BRL vulnerable in the long run irrespective of the outcome.

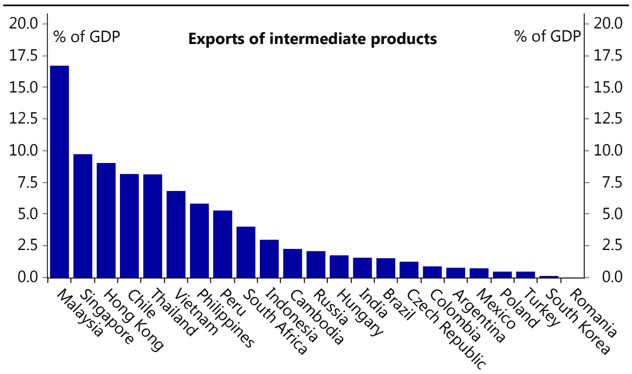
FX hedging considerations, the EM Traffic Light and financial forecasts are also covered in this publication.

EM FX STABILISATION SINCE OUR LAST EM VIEW, %



Source: Nordea and Macrobond

THE SINO-US TRADE WAR IS A SOURCE OF RISK FOR EM FX



Source: Nordea and Macrobond

Casualties of war

Despite a pause in the sell-offs, EM FX is still not out of the woods. The trade war between the US and China raises uncertainty, strengthens the USD and could spell a slowdown in global trade. It paints a bleak outlook for EM FX.

The Sino-US trade war is still making EM FX look vulnerable

EM FX has in general been well-behaved since our last issue of EM View. However, risk remains on the downside. The prospect of a protracted trade war between the US and China paints a bleak outlook for EM FX. Small and open economies that specialise in advanced manufacturing, such as South Korea, Taiwan and Singapore, are in a particularly vulnerable position.

A full-blown trade war that is more intense than expected

The trade war has escalated to a point that was unimaginable at the beginning of this year. The US has slapped tariffs on USD 250bn of Chinese goods, about half of its total imports from China. In response, China has raised duties on USD 110bn of US products, about 70% of its total imports from the US.

A long way to go before common ground is reached

A swift settlement in the near term is not on the cards, even though Trump and Xi will likely meet at the G20 summit in November. Both of them have an interest in appearing strong and not yielding to pressure.

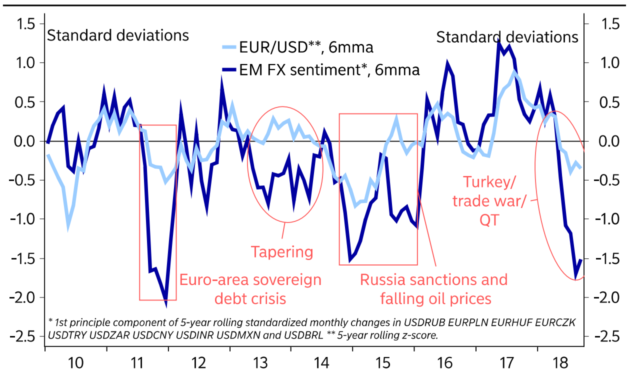
Moreover, it will likely take lengthy negotiations to find common ground. The US insists that China must compete fairly and enforce intellectual property rights laws. However, China perceives this as an unacceptable attempt to slow its technological development.

The trade war puts all EM FX at risk, regardless of fundamentals

EM FX is already prone to a sell-off owing to the Fed's monetary tightening. In this respect, EM countries with the weakest fundamentals have suffered the most. With the trade war in the background, not even EM countries with solid fundamentals are safe from the sell-off.

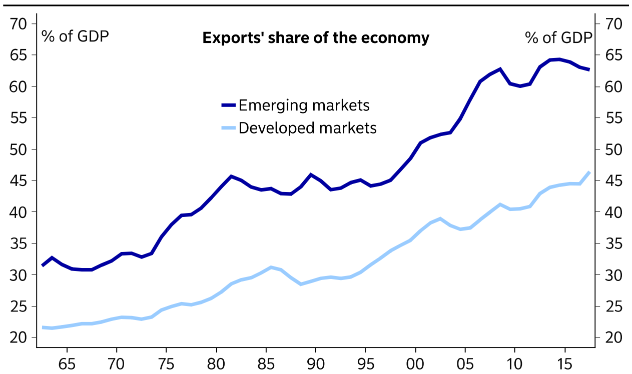
Uncertainty surrounding the trade war intensifies investor demand for safer dollar assets beyond that already triggered by the Fed's balance sheet reductions. The result is a stronger USD and weakening pressure on EM FX in general.

RISK SENTIMENT REMAINS NEGATIVE FOR EM



Source: Nordea and Macrobond

EM SUFFERS MORE FROM A GLOBAL TRADE SLOWDOWN



Source: Nordea and Macrobond

EM countries' export dependence makes them vulnerable to a possible global trade slowdown

Furthermore, a full-blown trade war between the world's two largest economies, which together account for a quarter of global imports, could spell a slowdown in global trade. That would hurt EM countries, as they are more export-dependent as a group than developed markets; in terms of FX, the CZK, HUF, MXN, SGD and VND are particularly vulnerable given their openness.

Countries with an especially high dependence on Chinese demand will likely suffer from the trade war

In addition to general export reliance, countries with an exceptionally high dependence on Chinese demand are vulnerable to the second-round effects of the trade war.

Chinese exports have decelerated and will likely start shrinking early next year against the backdrop of declining external orders. This is expected to slow GDP growth further and suppress manufacturing activity.

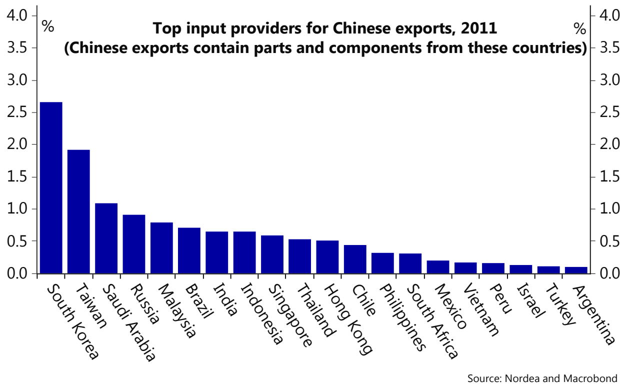
China's position as "the world's factory" means that it imports intermediate goods for assembly and re-export. About 30% of Chinese exports contain imported components.

Shrinking exports in China will likely reduce its imports of intermediate goods and hurt economies such as South Korea and Taiwan, which are top suppliers to Chinese exports. The latest available data from the OECD TiVA database is 2011. However, the data is likely still applicable, as the global value chain has not seen significant changes.

Concern about export losses explains why the KRW and TWD have lost 4-5% against the USD year-to-date despite having large current account surpluses. Given that intermediate goods account for more than half of Asian countries' exports on average, Asian currencies face a larger risk than currencies in other regions.

MORE HEADWINDS FOR CHINESE EXPORTS NEXT YEAR

SHRINKING EXPORTS HURT SOUTH KOREA AND TAIWAN



Agriculture producers could gain by exporting more to China, but manufacturers will see fierce Chinese competition

In the short term, some countries might be able to gain from the trade war. Agriculture producers will likely see their exports to China soar as the food products previously imported from the US have now become more expensive. This is particularly true for soybeans, which China is now buying from Brazil instead of the US.

Other countries might not be equally fortunate. The political push for higher domestic content in its manufacturing will likely reduce China's demand for foreign-made advanced manufactured components. This tendency could hurt high-end manufacturers, such as South Korea, Taiwan and Singapore.

The America First strategy means the US is not an easy trading partner

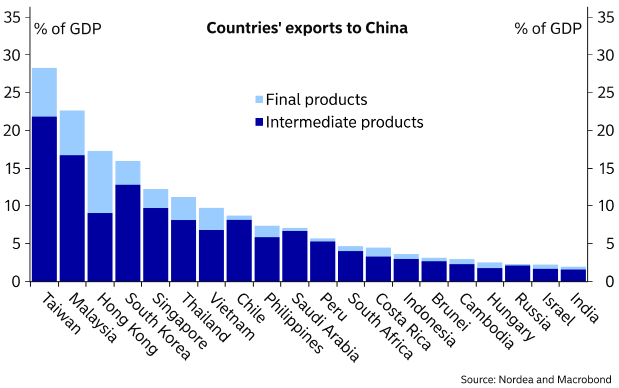
On the other hand, the US will likely not be an easy trading partner. Countries with comparatively lower labour costs hope to replace Chinese exports to the US, such as Mexico, Thailand and Vietnam. But Trump's American First strategy could make them the next potential target for US sanctions.

We have become more cautious in our forecasts

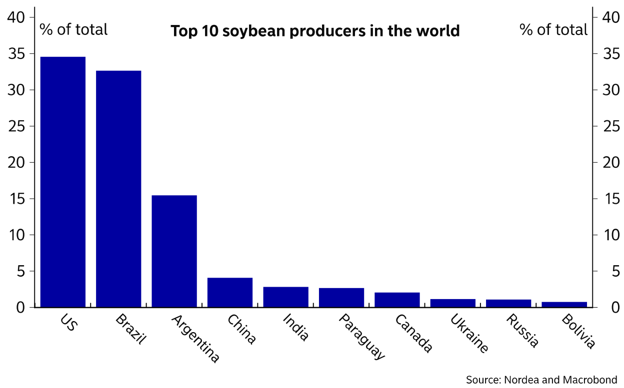
We revise our EM FX forecasts to reflect more cautiousness in 2019. Uncertainty about how the trade war will play out will likely cast a shadow on EM FX, as will the Fed's balance sheet reductions, domestic politics and other US sanctions. For most currencies, we still forecast gradual appreciation given our expectation that the USD will not maintain its current strength.

By Amy Yuan Zhuang

HONG KONG IS HIGHLY SENSITIVE TO CHINESE DEMAND



BRAZIL WILL SELL MORE SOYBEANS TO CHINA



CNY: Breaking seven

As a new tactic, the PBoC is keeping its currency intervention gunpowder dry for the battles ahead; this will likely buoy the USD/CNY, even to the psychologically important level of 7.0.

Yuan sell-off returned in October

The Golden Week holiday in October was anything but golden for the Chinese currency. A sudden deterioration of risk sentiment pushed the yuan above 6.90 against the dollar, a level not seen since 2016 with the exception of a blip in August this year.

The PBoC's commitment to defend the yuan is in question

The PBoC's post-holiday response of setting a higher USD/CNY fixing rate has further rattled the market's confidence in the central bank's commitment to defend the yuan.

We still do not buy into the idea that China will devalue the currency to retaliate against the US, owing to reluctance to provoke the US and fear of capital flight.

A new strategy to prepare for increased selling pressure ahead

However, a prolonged trade war with the US has become consensus in Beijing. The prospect of persistent currency pressure in the long term has motivated the PBoC to adopt a new strategy: reducing intervention to keep its policy gunpowder dry for the battles ahead.

The USD/CNY could reach 7.0 in three months

The new tactic implies that the USD/CNY will continue rising, possibly to 7.0 in three months, when macro momentum sours further. Chinese exports will likely suffer a loss in 2019, when the latest tranche of US tariffs sees a rate increase to 25%.

We see little risk for the USD/CNY to break 7.0 before year-end. Relative stability is preferred ahead of a possible meeting between Xi and Trump in late November.

Further upside for the USD/CNY limited by fear of capital flight

The PBoC will likely maintain its top priority of preventing large-scale capital flight, which has worked well so far owing to strict capital controls. However, expectations of depreciation are rising, reflected by less willingness to hold the currency. For this reason, the PBoC is unlikely to tolerate the USD/CNY rising too much above 7.0.

By Amy Yuan Zhuang

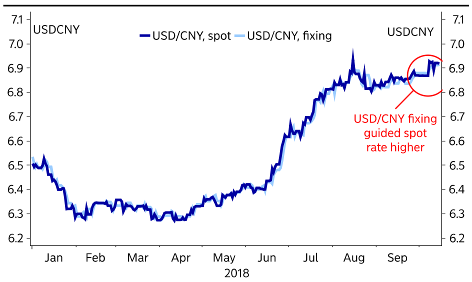
RISK FACTORS

- The PBoC stops defending the yuan
- Growth slowdown from the US trade war becoming more pronounced than expected
- Credit growth rises again

EM TRAFFIC LIGHT

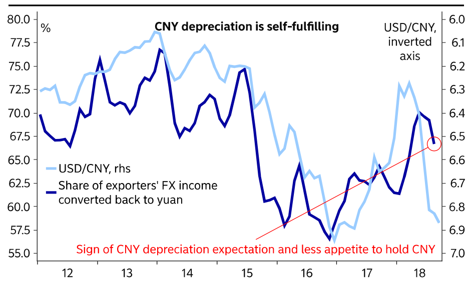
- Risk level: 16% (green, +1 pp from previous month)
- Credit risk is excessive

HIGHER FIXING UNNERVES THE MARKET



Source: Nordea estimates and Macrobond

RISING EXPECTATIONS OF DEPRECIATION



Source: Nordea and Macrobond

FINANCIAL FORECASTS – CHINA

The negative sentiment towards the yuan will likely continue next year, as the market is embracing the fact of a protracted trade war. The PBoC is preparing for the worst-case scenario and will likely become more cautious with currency intervention to preserve options for the long haul. Thus, we believe the USD/CNY could reach 7.0 in three months, but further upside should be limited by the fear of capital flight. The path of the USD/CNY still points to a gradual strengthening of the yuan, consistent with our USD forecast.

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
USD/CNY	6.94	7.00	6.90	6.80	6.60
Policy rate	4.35	4.35	4.35	4.35	4.35

Source: Nordea estimates

USD/CNY FORECAST

Source: Nordea estimates and Macrobond

RUB: Not ready to surrender

The CBR's decision to suspend FX purchases has borne fruit and the RUB is back to more fundamentally justified levels. However, the risks are not over yet even though the reaction to them will likely be short-lived.

Almost too optimistic

Market sentiment towards Russia has improved considerably since our previous EM View issue. The RUB has gained more than 2%, not least because of the CBR decision to suspend FX purchases until the end of the year. Still another positive factor is a sudden shift to a milder perception of sanctions risk. The deadlines of OFAC licences authorising continued maintenance operations with Rusal were extended until 12 December. The DASKAA sanctions bill has not moved an inch in the US Congress, and a timeline of future steps does not exist.

However, we remain cautious as sanctions risks are still present and deterioration could be fast. The second stage of Skripal-related sanctions is expected to come into effect on 27 November, potentially making markets more nervous as the date approaches. If these sanctions come into effect in a mild form and DASKAA remains stalled in Congress, the RUB could easily appreciate to 61-62 vs the USD by year-end.

Shored up by strong balance of payments

August-September showed that sanctions-related periods of pressure on the RUB are likely to be short-lived as long as oil remains at comfortable levels. In Q3, Russia enjoyed a very high current account surplus (USD 26bn) and is on its way to breaking the record set in 2008 (USD 104bn for the whole year). The decision to suspend regular FX purchases (done in accordance with the budget rule) has reduced the demand for hard currency by around USD 25bn over September-December. This is an ample amount to meet potential capital outflows caused by tougher sanctions.

Vulnerable to oil price correction

Oil prices have been marching upward since mid-August, supported by market worries about a potential shortage of oil in case US sanctions against Iran are followed in a concerted way by other countries. The market, guided by geopolitics, has been stubbornly disregarding lower oil demand forecasts and downward revisions of the global growth outlook. These factors may well come to the fore if third parties are not fully compliant with US sanctions against Iran.

By Tatiana Evdokimova

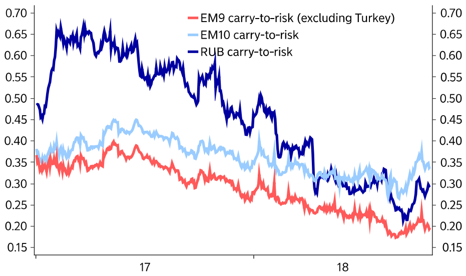
RISK FACTORS

- Oil price correction
- Tougher sanctions
- New wave of EM pressure

EM TRAFFIC LIGHT

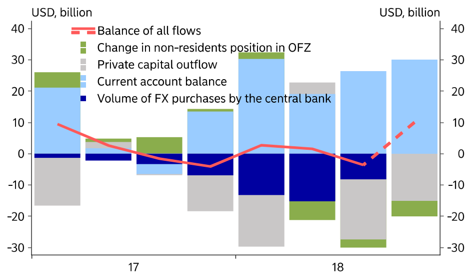
- Risk level: 16% (green, unchanged from previous month)

CARRY-TO-RISK IMPROVES IN OCTOBER



Source: Nordea and Macrobond

NO FX PURCHASES + HUGE C/A SURPLUS



Source: Nordea and Macrobond

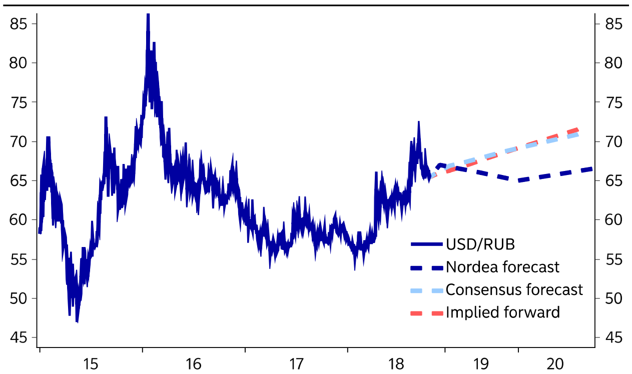
FINANCIAL FORECASTS — RUSSIA

We became more positive on the RUB as, without CBR FX purchases, the currency is better able to withstand capital outflows caused by tougher sanctions. Our view on 2019 is guided by the assumptions of a slightly weaker USD and potential return of foreign investors into Russian assets as the sanctions framework becomes clearer. These supportive factors are partly counterbalanced by expected lower oil prices and resumed FX purchases.

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
USD/RUB	65.61	67.00	66.00	65.00	66.50
Policy rate	7.50	7.75	7.75	7.50	7.00

Source: Nordea estimates

USD/RUB FORECAST



Source: Nordea estimates and Macrobond

PLN: Trade war showing its face in exports

The zloty's primary driver remains the overall market sentiment. Longer out, politics and uncertainty about global trade are risk factors pointing to a moderate slowdown in growth.

EUR/PLN has stabilised

Since the last edition of our EM View, the EUR/PLN has been trading within relatively narrow intervals, as the general EM sentiment – which has been the single most important driver of the zloty for several months - has stabilised somewhat.

Weaker-than-expected results for PiS in local elections...

Another stabilising factor for the EUR/PLN has been the weaker than expected local election results for the ruling, non-market-friendly Law & Justice (PiS) party. Although PiS came out as the winner in more provinces than in 2014, the result with 32% of total votes was lower than what pre-election polls had indicated and lower than the 38% that PiS won in the 2015 general election. Consequently, the likelihood of PiS losing its majority in next year's general election has increased.

...could increase incentive to boost public spending

On the flip side, the weak result for PiS may give the government an incentive to boost public spending. In effect, this could result in a negative assessment of Poland's credit rating in the future. Thus, S&P's recent rating upgrade was partly based on Poland's strict fiscal approach and in general better macro fundamentals in recent years.

We expect growth has topped

Robust growth is another important part of the equation in terms of Poland's current rating outlook. Hence, Poland has seen itself in a "Goldilocks scenario" in the last couple of years with high growth, low inflation and increasing real wages. However, we believe growth has now peaked and that inflation will gradually pick up.

Poland dependent on global trade momentum – tariffs on Germany is the biggest threat

One reason why we (and the NBP) expect growth to slow is the ongoing trade dispute between the US and China. Although trade linkages between Poland and US/China are relatively limited, a small, open economy like Poland is still dependent on overall strong global trade and investments. Thus, we believe uncertainty surrounding the trade war is already visible in the latest low PMIs for new export orders (lowest since 2014), which in turn have been weighing on recent manufacturing activity. In this sense, we think the biggest threat in the coming years is if the US decides to impose tariffs on Poland's biggest trading partner, Germany, and in particular the automotive sector, given Poland's significant role in the German supply chain.

By Morten Lund

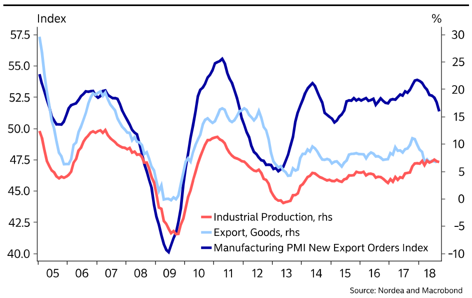
RISK FACTORS

- Weak EM sentiment
- Politics
- Low core inflation/dovish NBP

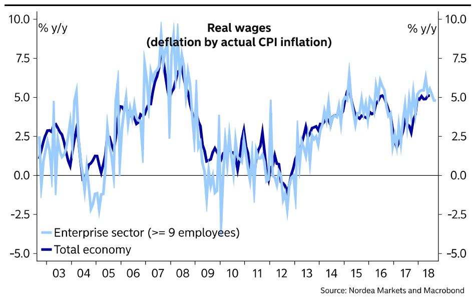
EM TRAFFIC LIGHT

- Risk level: 17% (green, +2 pp from previous month)

TRADE WAR SHOWING UP IN NEW ORDERS



GOLDILOCKS SCENARIO: BOOST TO WAGES



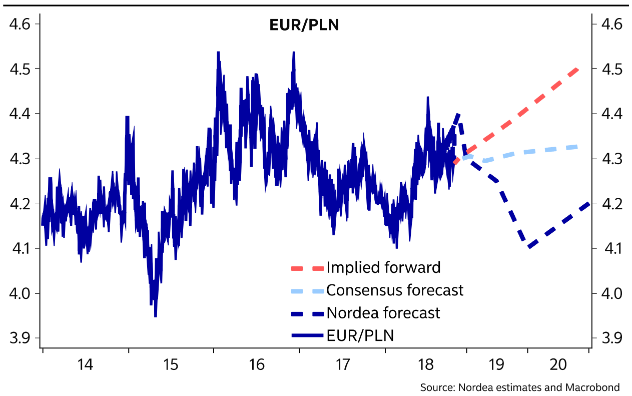
FINANCIAL FORECASTS – POLAND

Due to a combination of lukewarm market sentiment, a dovish central bank and rising political uncertainty, we still expect EUR/PLN to keep testing levels up to 4.40 in the short term. In 2019, we expect a mild PLN appreciation as market tensions cool off and the NBP gets closer to a rate hike. However, slowing growth limits EUR/PLN downside.

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
EUR/PLN	4.29	4.40	4.25	4.10	4.20
Policy rate	1.50	1.50	1.50	1.75	2.00

Source: Nordea estimates

EUR/PLN FORECAST



BRL: Get ready for the "Tropical Trump"

The fate of the BRL is dependent on the outcome of the presidential election on 28 October, as Brazil needs reforms to stabilise public finances. However, market favourite Bolsonaro is only 'a lesser evil', making the BRL vulnerable in the long run irrespective of the outcome.

The choice between Bolsonaro and Haddad will have a significant impact on the BRL

On 28 October, Brazilians will once again go to the polls, as they will decide whether national conservative Jair Bolsonaro (PSL) or arch-socialist Fernando Haddad (PT) will become the next president – a choice that could have a significant impact on both the Brazilian economy and the BRL going forward.

Brazil needs reforms to deal with unsustainable debt levels

Thus, Brazil is in great need of reforms, most notably in the pension system, that can secure the long-term sustainability of public finances. Running a deficit on the primary balance since the commodity prices meltdown in 2014-15, Brazil's government debt has ballooned to around 85% of GDP. Accordingly, markets favour the candidate who is most willing to gain control over the debt burden with a conservative fiscal policy. In the eyes of the markets, this is Bolsonaro, as Haddad is against the pension reform.

Bolsonaro leads comfortably – the markets are happy

As Bolsonaro delivered a strong first-round result, securing 46% of the votes (Haddad won 29%), and looks like a winner according to polls, the BRL has rallied recently. Should Haddad, on the other hand, stage a dramatic comeback, we would expect USD/BRL to bounce back to the highest levels seen this year at around 4.15-4.25.

Bolsonaro is only a lesser evil from a market perspective

Although a Bolsonaro win would be the most market-friendly outcome in the run-off with Haddad, he is far from a good candidate in the eyes of the markets. Thus, Bolsonaro's populist views and harsh rhetoric against minorities are red flags, reminding markets of other populist EM presidents such as Turkey's Erdogan.

Limited upside for the BRL in the coming years

Hence, we do not expect the political risk premium to disappear regardless of which candidate is elected. Combined with vulnerable public finances, a down-sloping oil futures curve (representing our oil forecast) and tightening financial conditions in the US, this means we expect USD/BRL to stay at relatively high levels from a historical perspective in the coming years.

By Morten Lund

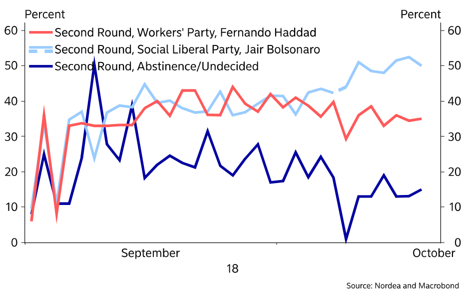
RISK FACTORS

- Politics
- Public finances
- Decreasing commodity prices

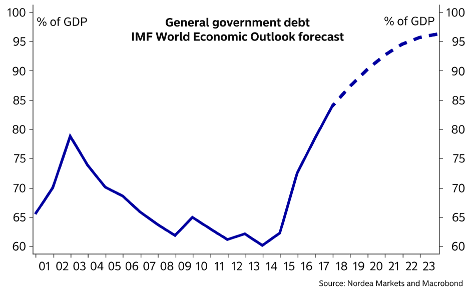
EM TRAFFIC LIGHT

- Risk level: 22% (yellow, +4 pp from previous month)

BOLSONARO LOOKS LIKE A CERTAIN WINNER



CURRENT DEBT PATH IS UNSUSTAINABLE



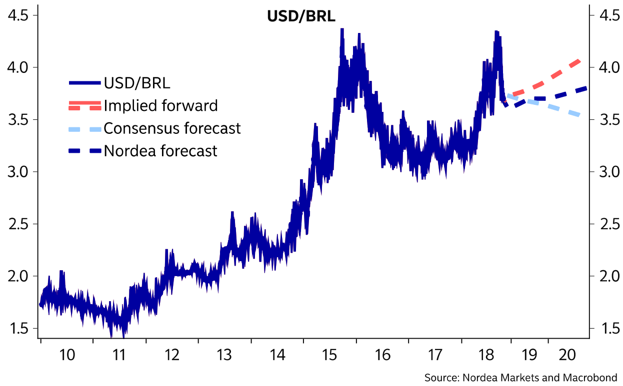
FINANCIAL FORECASTS – BRAZIL

A Bolsonaro win is already being priced in by the markets, limiting USD/BRL downside in the short term. The mix of continued political uncertainty, weak public finances, an expected decline in oil prices and tightening financial conditions in the US are factors that lead us to believe that the BRL will remain weak in the coming years and above the USD/BRL consensus.

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
USD/BRL	3.67	3.60	3.70	3.70	3.80
Policy rate	6.50	6.50	7.00	7.50	8.00

Source: Nordea estimates

USD/BRL



Hedging considerations

CNY (vs EUR)

Income

Middle to high hedge ratio in the short term, using mainly FX forwards. High hedge ratio in the long term – high share of zero-cost option strategies, eg participating forwards.

Expenses

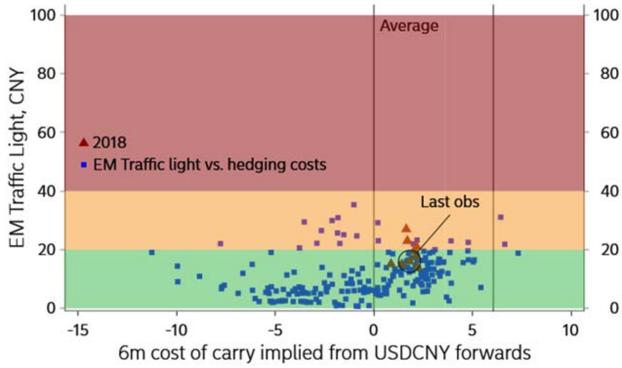
Low hedge ratio in the short term, using a mix of FX forwards and zero-cost strategies. High hedge ratio in the long term, using FX forwards and benefiting from high forward premiums.

NORDEA ESTIMATES

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
EUR/CNY	7.95	8.12	8.21	8.36	8.45
Policy rate	4.35	4.35	4.35	4.35	4.35

Source: Nordea estimates

COST OF CARRY VS RISK LEVEL



Source: Nordea estimates and Macrobond

Implied ATM vol (6M)	25D RR (6M)	Forward (6m)
7.09	0.31	8.16

Source: Bloomberg

RUB (vs EUR)

Income

Middle hedge ratio in the short term, using mainly FX forwards. Middle to high hedge ratio in the long term, using a mix of FX forwards and zero-cost option strategies, eg forward extra.

Expenses

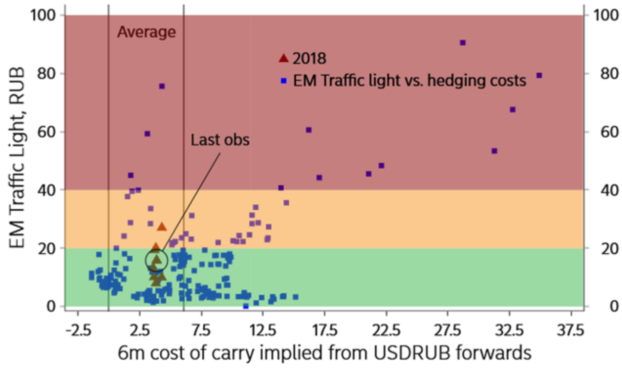
Middle hedge ratio in the short term, using a mix of forwards and zero-cost option strategies, eg risk reversals, benefiting from cheap RUB calls and expensive RUB puts. High hedge ratio in the long term, using FX forwards and benefiting from high forward premiums.

NORDEA ESTIMATES

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
EUR/RUB	75.1	77.7	78.5	80.0	85.1
Policy rate	7.50	7.75	7.75	7.50	7.00

Source: Nordea estimates

COST OF CARRY VS RISK LEVEL



Source: Nordea estimates and Macrobond

Implied ATM vol (6M)	25D RR (6M)	Forward (6m)
13.64	4.06	77.66

Source: Bloomberg

PLN (vs EUR)

Income

High hedge ratio in the short term, using FX forwards. Low to middle hedge ratio in the long term – high share of zero-cost option strategies, eg participating forwards.

Expenses

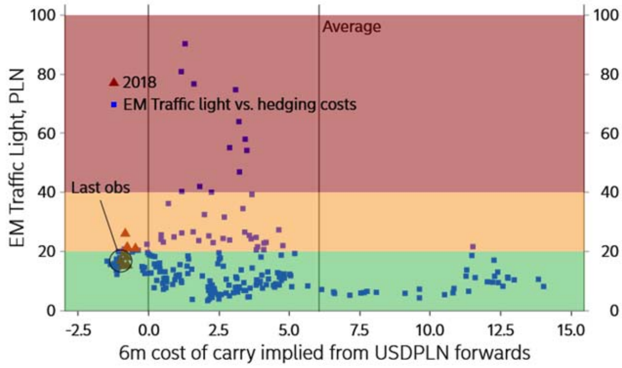
Middle hedge ratio in the short term, using FX forwards. High hedge ratio in the long term, using FX forwards mainly. Consider using zero-cost risk reversal option strategies – benefiting from RR biased towards EUR calls.

NORDEA ESTIMATES

Forecasts	Spot	3M	Mid-2019	End-2019	End-2020
EUR/PLN	4.30	4.40	4.25	4.10	4.20
Policy rate	1.50	1.50	1.50	1.75	2.00

Source: Nordea estimates

COST OF CARRY VS RISK LEVEL



Source: Nordea estimates and Macrobond

Implied ATM vol (6M)	25D RR (6M)	Forward (6m)
5.43	1.41	4.34

Source: Bloomberg

EM Traffic Light

EM TRAFFIC LIGHT

ISO	Country	Risk level	Credits	ST external debt	Inflation	GDP	Capital flows	Rating	FX overvaluation	Commodities	Contagion
CLP	Chile	30%									
TRY	Turkey	27%									
ILS	Israel	27%									
TWD	Taiwan	25%									
SAR	Saudi Arabia	25%									
HUF	Hungary	25%									
CZK	Czech Republic	24%									
BRL	Brazil	22%									
KRW	South Korea	22%									
ZAR	South Africa	21%									
MXN	Mexico	20%									
BGN	Bulgaria	20%									
KES	Kenya	20%									
HRK	Croatia	19%									
SGD	Singapore	18%									
RSD	Serbia	17%									
PLN	Poland	17%									
PHP	Philippines	17%									
COP	Colombia	16%									
CNY	China	16%									
RUB	Russia	16%									
THB	Thailand	15%									
RON	Romania	14%									
HKD	Hong Kong	14%									
MYR	Malaysia	14%									
PEN	Peru	13%									
INR	India	11%									
ARS	Argentina	11%									
IDR	Indonesia	9%									
UAH	Ukraine	9%									
KZT	Kazakhstan	7%									
NGN	Nigeria	5%									
EGP	Egypt	3%									
	EM general	13%									

*Note: **The risk level** is the probability of extreme currency pressure in at least one of the next six months, where extreme is a 2 standard deviation weakening (2.5% event). **Credits(+, change)** : The change in the ratio of money supply (M2) to GDP. **Short-term external debt(+, change)** : The ratio of short-term foreign claims on domestic banks over FX reserves. **Inflation (+, change)** : Change in CPI inflation . **GDP (-, change):** Change in real GDP growth. **Capital flows(-, level and +, change):** The level of and change in the ratio of net foreign assets to GDP. **Rating(+, change):** The change in the sovereign rating from S&P. **FX overvaluation(+, level):** The strengthening of FX spot not explained by relative CPI inflation and relative productivity growth. **Commodities (-, change):** The change in the commodities terms of trade, ie the change in export prices less the change in import prices. **Contagion (+, level):** the number of currencies under pressure plus a recent history of pressure on the currency in question.*

Source: Nordea estimates and Macrobond

Latest EM Traffic Light:

- **EM Traffic Light:** September 2018 (2 Oct)
- **New signals:** BGN, MXN, KRW, BRL and CZK. All from green to yellow.
- **Biggest changes:** The biggest changes involve the TRY (+6 pp) and the UAH (-6 % pp)

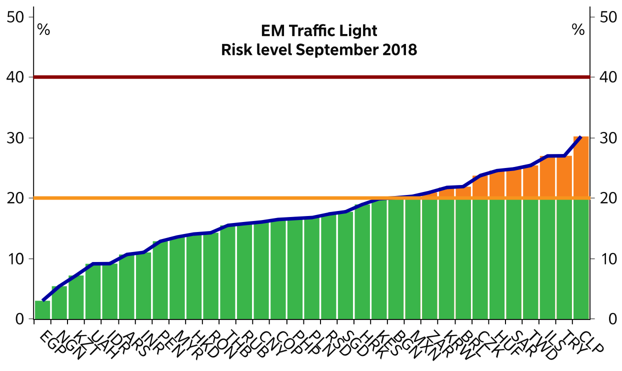
Methodology note:

- EM Traffic Light – methodology note

Track record:

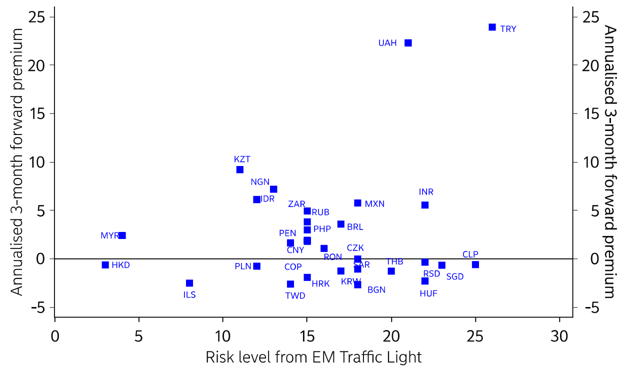
- EM Traffic Light – Track record - September 2018

OVERALL RISK LEVEL



Source: Nordea estimates and Macrobond

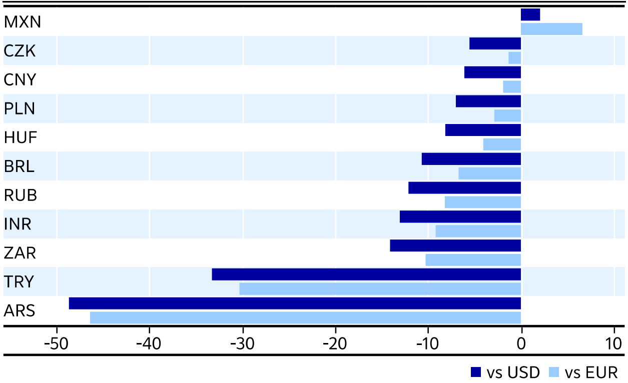
TRAFFIC LIGHT VS COST OF CARRY



Source: Nordea and Macrobond

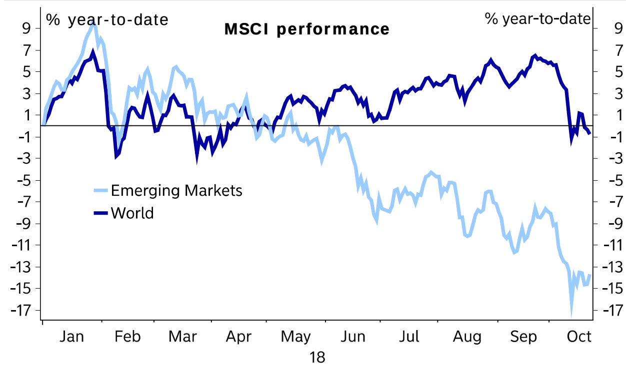
Emerging market performance

YTD EM FX PERFORMANCE



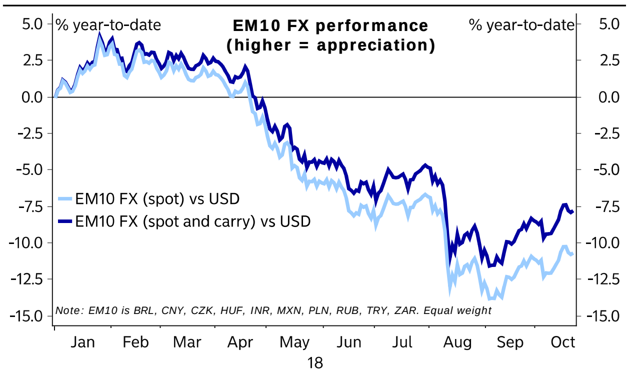
Source: Nordea and Macrobond

YTD EQUITIES PERFORMANCE



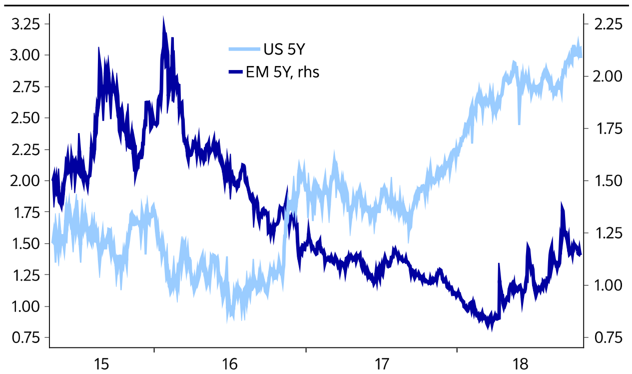
Source: Nordea and Macrobond

YTD FX PERFORMANCE, CARRY ADJUSTED



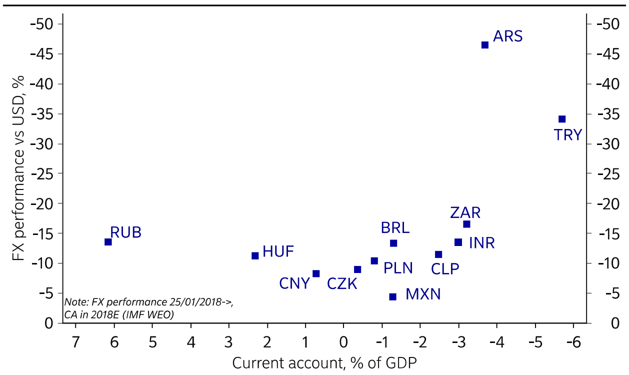
Source: Nordea and Macrobond

SWAPS



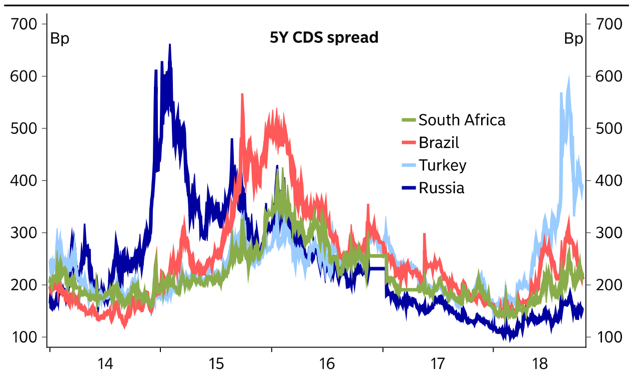
Source: Nordea and Macrobond

YTD FX PERFORMANCE VS CURRENT ACCOUNT



Source: Nordea and Macrobond

CDS SPREADS



Source: Nordea estimates and Macrobond

Forecast overview

FX FORECASTS AGAINST EUR

	Spot	3M	Mid-2019	End-2019	End-2020
EUR/BRL	4.257	4.18	4.40	4.55	4.86
EUR/CNY	7.953	8.12	8.21	8.36	8.45
EUR/CZK	25.79	25.5	24.8	24.5	24.5
EUR/HUF	322.8	325	320	315	320
EUR/INR	84.29	88.2	89.3	91.0	92.2
EUR/PLN	4.296	4.40	4.25	4.10	4.20
EUR/MXN	22.28	23.2	21.4	20.9	21.8
EUR/RUB	75.11	77.7	78.5	80.0	85.1
EUR/TRY	6.649	6.80	7.30	7.70	8.00
EUR/ZAR	16.54	16.8	17.9	19.1	20.5
EUR/USD	1.146	1.16	1.19	1.23	1.28
EUR/SEK	10.37	10.3	10.2	10.0	9.70
EUR/NOK	9.51	9.50	9.15	9.00	9.00
EUR/DKK	7.46	7.46	7.46	7.46	7.46

Source: Nordea estimates

FX FORECASTS AGAINST USD

	Spot	3M	Mid-2019	End-2019	End-2020
USD/BRL	3.715	3.6	3.70	3.70	3.80
USD/CNY	6.939	7.00	6.90	6.80	6.60
USD/CZK	22.5	22.0	20.8	19.9	19.1
USD/HUF	281.7	280	269	256	250
USD/INR	73.55	76.0	75.0	74.0	72.0
USD/MXN	19.44	20.0	18.0	17.0	17.0
USD/PLN	3.749	3.79	3.57	3.33	3.28
USD/RUB	65.54	67.0	66.0	65.0	66.5
USD/TRY	5.802	5.86	6.13	6.26	6.25
USD/ZAR	14.43	14.5	15.0	15.5	16.0

Source: Nordea estimates

POLICY RATE FORECASTS, %

Policy rates	Spot	3M	Mid-2019	End-2019	End-2020
Russia	7.50	7.75	7.75	7.50	7.00
Poland	1.50	1.50	1.50	1.75	2.00
Hungary	0.90	0.90	0.90	1.20	1.50
Czech Republic	1.50	1.75	2.00	2.25	2.50
Turkey	16.50	24.00	24.00	24.00	20.00
South Africa	6.50	6.75	6.50	6.25	6.00
Brazil	6.50	6.50	7.00	7.50	8.00
Mexico	7.75	7.75	7.50	7.25	6.75
China	4.35	4.35	4.35	4.35	4.35
India	6.50	6.50	6.75	6.75	6.75

Source: Nordea estimates

Brazil

We adjust our short-term USD/BRL forecast downward, as the BRL has rallied on the back of Bolsonaro's strong lead in the polls. Long term, we keep our slightly negative view on the BRL.

China

The PBoC has likely become less aggressive in currency intervention. That leaves room for more upside for USD/CNY, which will likely reach 7.0 in early 2019.

Czech Republic

Based on the hawkish minutes from the CNB's latest meeting, we now expect another rate hike before year-end. We lift our EUR/CZK forecast for 2020, reflecting a more conservative long-term view in general on CEE.

Hungary

We lift our EUR/HUF forecast for 2020, reflecting a more conservative long-term view in general on CEE.

India

We revise our USD/INR expectations upwards across the forecast horizon. The INR outlook is clouded by its vulnerability to the global risk-off sentiment, elevated oil prices and political uncertainty ahead of the general election in April 2019. We expect inflation to undershoot the RBI's target in the coming months, supporting the argument for no rate changes until Q1 next year.

Mexico

No changes.

South Africa

Despite inflation being below 6% now and throughout the central bank's forecast horizon, three out of seven members voted for a rate hike at the September meeting. This indicates a new reaction function for the SARB. We therefore expect a rate hike in either November or January. Accordingly, we adjust USD/ZAR slightly downwards for the short term. However, we keep our long-term negative bias on the ZAR.

Poland

We lift our EUR/PLN forecast for 2020, reflecting a more conservative long-term view in general on CEE.

Russia

We became more positive on the RUB given a robust balance of payments. We still expect some weakness at the end of the year due to more sanctions deadlines but reappreciation in 2019 as foreign investors turn more positive on Russia again.

Turkey

The political risk premium stemming from the diplomatic tensions with the US has faded after the release of American priest, Andrew Brunson. As a consequence, we adjust our EUR/TRY forecast downward across the horizon.

Recent research and profile descriptions

Recent Emerging Markets Research

- China: Lowest GDP growth in a decade (19 October)
- Russia 2024: Similar targets, new deadlines (10 October)
- Brazil election: Get ready for the "tropical Trump" (8 October)
- INR: Sharp drop after RBI no-hike (5 October)
- China monthly: Looking beyond the trade war (4 October)
- Brazil election: A hope for a lesser evil 4 October)
- China: PMI got a bite from trade war (1 October)
- TRYing to restore confidence (13 September)

Previous Emerging Markets Views

- Emerging Markets View September 2018: House of Cards (20 September)
- Markets View August 2018: Thunderstruck (23 August)

Latest EM Traffic Light

- EM Traffic Light September 2018 (2 October)

Latest Financial Forecast Update

- Majors forecast update: The end of the USD cycle is approaching (24 October)

Latest Economic Outlook

- Nordea Economic Outlook: The wage engine (5 September)

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