# Emerging Markets View

## November 2018: A bumpy ride in 2019

2018 has so far been a difficult year for emerging markets, as several currencies have suffered significant losses on the back of a rising USD, tighter global liquidity conditions and geopolitical uncertainty. Looking into 2019, the question is whether these factors will continue to weigh on EM FX. To a large extent, we tend to think so. However, new risk factors could also arise, paving the way for an extension of the current high volatility regime. Thus, according to our EM Traffic Light, fundamental risks in the EM economies are still on the rise, with one important factor being pass-through of this year's general FX weakness to higher inflation, which in turn should begin to hurt the real economy. In sum, we therefore remain cautious on EM going into 2019, and expect many of the currencies to continue trading close to current historical lows.

### CNY: Targeting stability, not a specific level

The People's Bank of China (PBoC) is concerned about the rising volatility of the USD/CNY. We think the main aim of its currency intervention is to maintain stability and prevent outflows, not to achieve a specific level.

### RUB: Better the devil you know

We find that the RUB is still too weak, even though oil prices are 20% lower than they were a month ago. Our view is that uncertainty over sanctions is keeping the currency undervalued and vulnerable to tough rhetoric from the US.

### PLN: Volatility is coming

Despite a lot of turmoil in emerging markets this year, the Polish zloty has been trading within relatively narrow ranges. However, we note that there are signs that 2019 could lead to a rebound in volatility. We give you three reasons why.

### In focus – INR: Not out of the woods

India’s external vulnerability and a looming banking crisis in the country leave it prone to another sell-off. The current INR relief may only be temporary.

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

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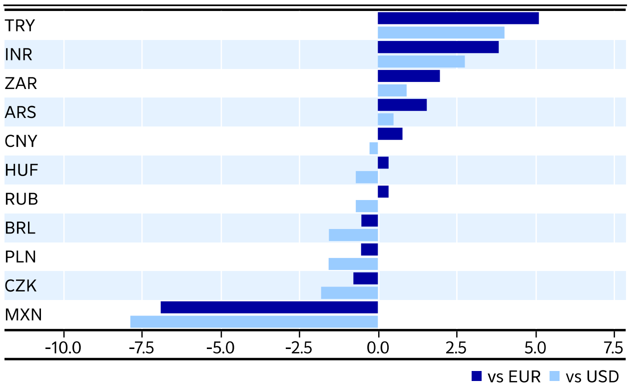
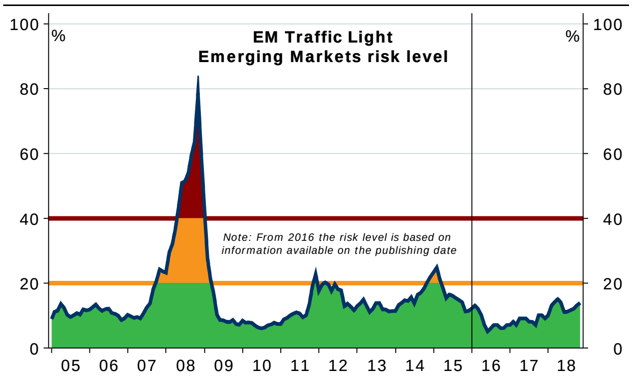
**EM FX PERFORMANCE SINCE LAST EM VIEW**




Source: Nordea and Macrobond

**RISING FUNDAMENTAL RISKS FROM LOW LEVELS**




Source: Nordea and Macrobond

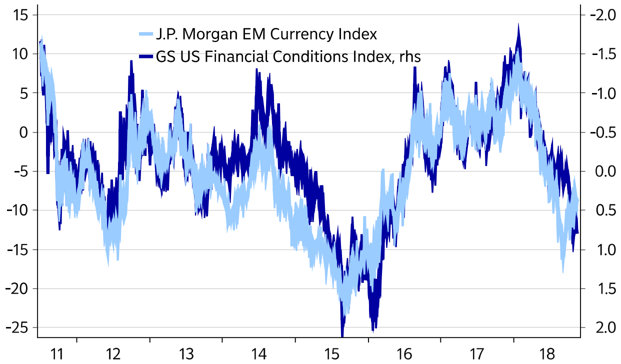
# A bumpy ride in 2019

Although 2018 has been among the worst EM FX years, the storm may not be over, as dark clouds linger on several fronts. Political risks remain high, major central banks keep tightening financial conditions, and spillover effects from this year's FX weakness may begin to hit the real economy.

Geopolitical and fundamental risks remain high going into 2019

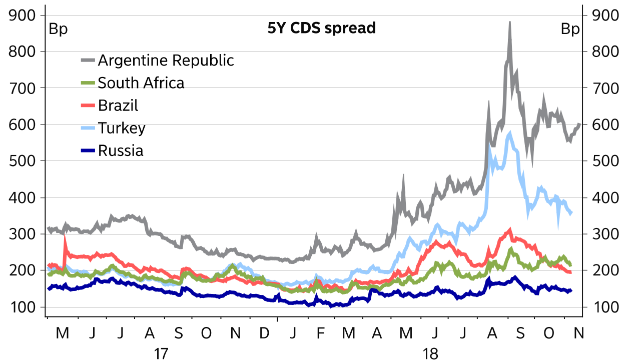
So far, it has been a troublesome year for emerging markets, with significant losses in the FX space. A stronger dollar and tighter financial conditions in the US, combined with increasing geopolitical risks, have been the main drivers behind the general EM FX weakness – factors that we believe will also play a crucial role in 2019. On top of this, we think another important theme will arise, as spillover effects from the general currency weakness to higher inflation may begin to take their toll on the real economy.

**TIGHTER FINANCIAL CONDITIONS HAVE PRESSURED EM FX**




Source: Nordea Markets and Macrobond

**SPIKING CDS SPREADS DRIVEN BY HIGHER POLITICAL RISKS**




Source: Nordea Markets and Macrobond

The 2019 political calendar is packed with important events

Looking into 2019, the political calendar is filled with interesting events. Elections are due in big EM economies such as India, South Africa and Poland, while IMF-dependent countries such as Argentina and Ukraine will also draw attention.

India and South Africa in need of reforms

Although the ruling parties among the biggest economies are expected to continue to hold power, next year's elections still constitute significant risks in terms of the reform outlook and growing populism. In India and South Africa, where the two respective presidents Modi and Ramaphosa are expected to stay in power, elections may still result in legislative gridlocks. This could stand in the way of much-needed economic reforms. India is on the brink of a banking crisis and is struggling with sluggish investment growth, while South Africa faces socio-economic challenges due to high unemployment, low productivity, corruption and a poor education system.

Poland's clash with the EU enters a critical stage next year

In contrast, in Poland the markets may actually fear further reforms. Poland has already implemented reforms that according to the EU erode the Rule of Law, and so another strong election by the ruling party – Justice and Law – could result in sanctions and cuts in Poland's structural funding.

IMF-dependent countries facing defining elections

Beyond the big EM countries, elections in relatively small economies such as Argentina and Ukraine still constitute big risks for the general EM sentiment, as both are currently under IMF bailout programmes. The renewal of these programmes hangs by a thread if the current presidents are replaced by the front-running opposition candidates, who in both cases favour higher public spending and an end of austerity.

| COUNTRY | DATE (EXPECTED) | LIKELYHOOD OF GOVERNMENT CONTINUITY | RISK TO REFORM OUTLOOK (MOST LIKELY ELECTION OUTCOME) | POTENTIAL FX IMPACT | COMMENT |
|---|---|---|---|---|---|
| Argentina | 27 October | | | High | Macri loss --> ARS negative |
| India | April-May | | | Medium | Modi loss --> INR negative |
| Indonesia | 17 April | | | Low | Jokowi loss -- IDR negative |
| Nigeria | 16 February | | | High | Buhari loss -- NGN negative |
| Poland | by November | | | Medium | PiS loss --> PLN positive |
| South Africa | May-August | | | High | Ramaphosa loss --> ZAR negative |
| Thailand | 24 February | | | High | Prayut loss --> TBT negative |
| Ukraine | 31 March | | | High | Poroshenko loss --> UAH negative |

Source: Nordea

**The 2019 list of geopolitical risks is long**

On top of domestic elections, numerous geopolitical risks look likely to persist in 2019. A prolonged US-China trade war, Brexit (especially a risk for CEE countries) and US sanctions on Russia/Saudi Arabia/Iran/North Korea are all factors that we deem will continue to weigh on EM FX in the coming year.

**FX weakness will turn into higher inflation and slower growth**

Besides domestic and geopolitical issues, we believe that the weak currency impact from 2018 will gradually become more pronounced in the economic activity and inflation trajectory next year.

**Links between a weaker currency and growth**

Following the EM sell-off, the IMF has already made downward revisions to its growth outlook for emerging countries. They are now expected to grow at 4.7% in 2019, which is 0.4 pp slower than assumed in the previous forecast made back in April. As weaker FX rates gradually pass through to higher inflation, real wage growth tends to slow down, restraining consumption. FX depreciations also depress investments that are usually import-intensive. In normal times this negative impact on internal demand is partly counterbalanced by a competitiveness gain that depreciation gives to exports. But this time around the picture is complicated by escalating trade war between the US and China, which has spillover effects on other EM countries (see October issue of EM view).

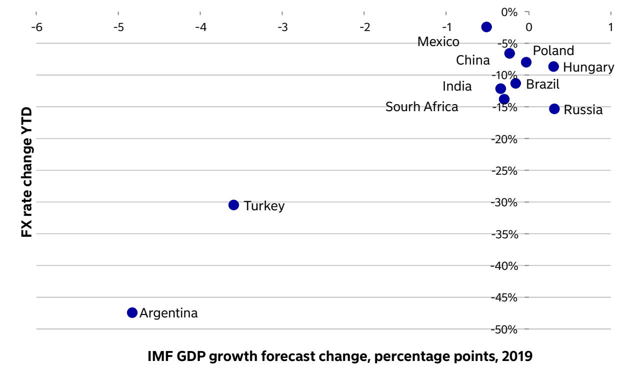
**2018 vs taper tantrum**

Compared to the taper tantrum in 2013, for now we expect this year's EM depreciation to have smaller spillovers to the real economy. However, the difference probably stems from a very deep oil price correction back in 2014-2015 as well as more limited FX depreciation of EM currencies in real effective terms (just 0.6% since the beginning 2018 according to BIS data vs 6% six months after the taper tantrum).

**The magnitude of the slowdown varies a lot across countries**

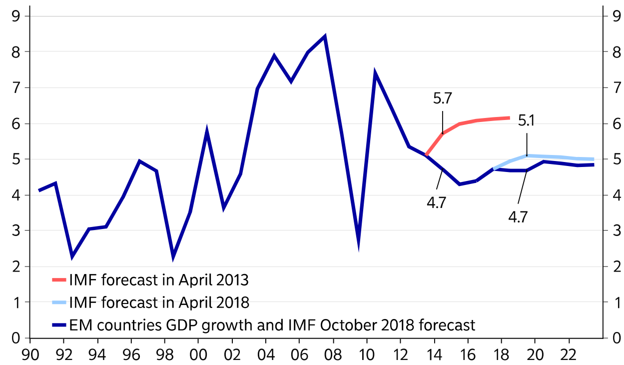
In most EM countries a cocktail of a weaker national currency and trade war could cut up to 0.5 pp off the previous growth forecasts for 2019. In Argentina and Turkey, which have suffered by far the largest FX pressure, a hard landing with double-digit inflation and recessions is probable. Fundamental weaknesses (twin deficits, overly loose monetary policy in case of Turkey and overly loose fiscal policy in Argentina) have accumulated in both countries for several years, provoking huge imbalances with no easy way out. Tighter budgets and massive interest rate hikes capable of breaking these vicious circles will undoubtedly depress growth in 2019. The banking sector in these countries and others with a high share of FX-denominated debt, such as Kazakhstan and Chile, is also likely to face more difficulties, as servicing this debt after depreciation is much costlier for companies (see September issue of EM view).

**ECONOMIC ACTIVITY MOST HURT IN ARGENTINA AND TURKEY**




Source: IMF, Nordea Markets

**LIMITED GROWTH IMPACT COMPARED TO TAPER TANTRUM**




Source: Nordea and Macrobond

**Monetary policy implications**

Unfortunately, countries whose currencies dropped the most in 2018 (ARS, TRY and RUB) have the least anchored inflation expectations, according to a recent IMF paper. Another failure to meet inflation targets can be quite damaging for the credibility of the central banks in these countries. They may be forced to keep interest rates at elevated levels for longer at the expense of higher GDP growth.

**We remain cautious in our EM view**

Second-round effects of EM sell-off on real economic activity, together with still elevated geopolitical risks and ample room for further Fed hikes, are all factors which we deem likely to result in a muted risk appetite in 2019. We therefore remain cautious on EM FX going into 2019, although we also see a number of EM countries tightening monetary policy, which should offer some support.

*By Morten Lund & Tatiana Evdokimova*

# CNY: Targeting stability, not a specific level

The People's Bank of China (PBoC) is concerned about the rising volatility of the USD/CNY. Its main aim with currency intervention is to maintain stability and prevent outflows, not to achieve a specific level.

The rising volatility of the USD/CNY is a concern for the PBoC

While the market continues to debate about whether the USD/CNY will break through the important psychological threshold of 7, it has overlooked an even more worrying tendency, namely the soaring volatility of the exchange rate.

Implied volatility for the USD/CNY has increased sharply since early October and is now close to the peak levels seen in February and August this year. This is primarily attributable to the elevated uncertainty surrounding the US-China trade war.

Volatility will likely remain high in the next few months

Even in a best-case scenario whereby the outcome of the Trump-Xi meeting in late November beats expectations, it will take months before a deal is signed. The odds of this actually happening became less likely after the recent clash between Xi and Pence at the APEC summit. The USD/CNY volatility will likely persist for a while.

High volatility increases currency risk for companies...

That is a concern for the Chinese authorities for two reasons. Firstly, the volatility increases the currency risk for Chinese exporters and importers, which already face rising cost challenges owing to the imposed tariffs.

... and damages confidence in the yuan

Secondly, volatility hurts investor confidence in the yuan and could spark another round of sell-offs. On a longer horizon, lack of trust in the yuan’s stability prevents it from becoming a regional currency anchor in Asia.

The PBoC will likely intervene to reduce volatility but not as aggressively as before

Thus, the PBoC will likely continue intervening in the currency market to keep volatility in check. It will likely use both the fixing rate and dollar selling. However, interventions will be less aggressive in order to keep the gunpowder dry for the long haul and to prevent a tightening of liquidity that could rupture the large credit bubble.

*By Amy Yuan Zhuang*

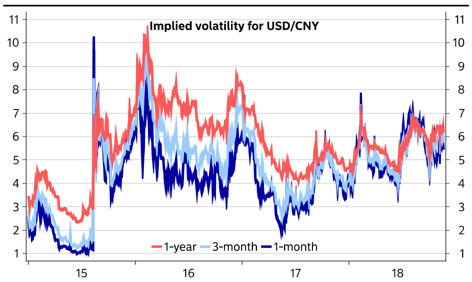
**RISK FACTORS**

- The PBoC makes a policy mistake
- The trade war escalates further
- Credit growth rises again

**EM TRAFFIC LIGHT**

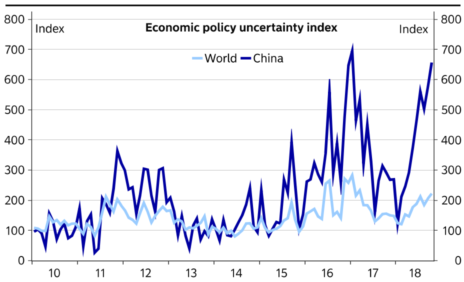
- Risk level: 16% (green, unchanged from previous month)
- High credit risk

**USD/CNY VOLATILITY RISES**




Source: Nordea and Macrobond

**HIGH UNCERTAINTY SURROUNDING CHINA**




Source: Nordea and Macrobond

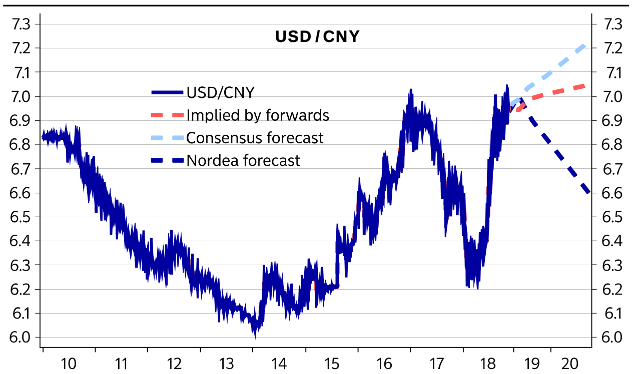
**FINANCIAL FORECASTS – CHINA**

Elevated uncertainty surrounding the trade war means the market will remain cautious towards the yuan. Volatility has increased accordingly. The PBoC will likely continue to intervene, albeit less aggressively than before, to keep volatility manageable and prevent large-scaled capital outflows. We do not believe that the PBoC has a targeted level for the USD/CNY. If volatility is not excessive and there are no signs of capital flight, the central bank will likely have nothing against the USD/CNY rising to 7 in the near term. We leave our forecasts unchanged.

| 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: Better the devil you know

The RUB is still too weak, even though oil prices are 20% lower than they were a month ago. Uncertainty over sanctions keeps the currency undervalued and vulnerable to tough rhetoric from the US.

Periodic short-term pressure is the new trading norm

Since the October EM View, the RUB has experienced another steep depreciation, followed by an equally sharp recovery. These periodic short-term 3-4% depreciations seem to be the new normal for the RUB now. Any slightly hostile comment from US officials about sanctions is capable of throwing the RUB off its fragile balance. This trading pattern may persist for quite some time; according to the latest declarations from US officials, there are no deadlines for final decisions on Russian sanctions.

Getting used to anticipating sanctions

As long as Russia doesn't give the US new reasons for fury, sanction deadlines may be postponed for months on end while Congress deals with more pressing issues. The much-anticipated meeting between Trump and Putin is unlikely to provide any answers. Trump will probably be less soft on Putin than in Helsinki, not to be drowned by a new wave of bipartisan condemnation.

Oil slump neglected by the RUB

Meanwhile, this lack of certainty keeps the RUB undervalued. At the beginning of the year, when oil was trading at roughly the same prices as now, USD/RUB traded at around 57 (versus 66 at the end of November). That is probably why the RUB did not seem to react much to the 20% drop in the oil price in October-November. The RUB lost just 1%, as it was already much weaker than it could have been with the same oil price. OPEC reacted swiftly to the latest oil price slump, hinting at production cuts next year. This shows OPEC's readiness to act as a balancing power on the oil market, curbing the oil price risks for the RUB in future.

CBR will likely return to the FX market in 2019

FX purchases (regular conversion of excess budget oil revenue into FX), which were suspended in September because of extreme RUB pressure, will likely be resumed in 2019. RUB volatility has decreased and non-residents' outflow from the sovereign debt market has dried up. The FX market therefore seems pretty balanced to us. The CBR's decision to return to its practice of replenishing FX reserves may cause an initial negative reaction on the market, but it will likely be short-lived as the volume of operations is small.

*By Tatiana Evdokimova*

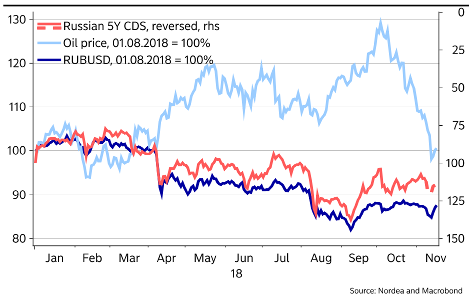
### RISK FACTORS

- FX purchases resumed without proper communication with the market
- Sanctions rhetoric intensifies after Trump and Putin meet
- Oil price correction continues

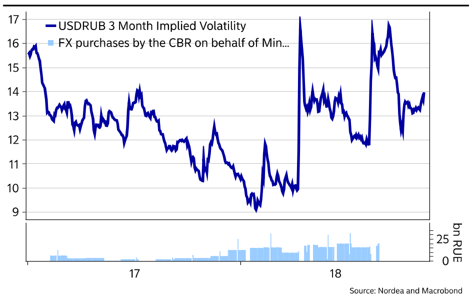
### EM TRAFFIC LIGHT

- Risk level: 18% (green, +1 pp from the previous month)

### RUB WEAK FOR THE CURRENT OIL PRICE




### FX PURCHASES TO BE RESUMED IN 2019



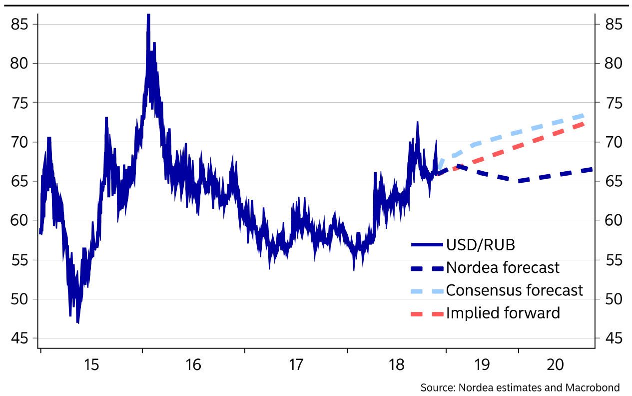

### FINANCIAL FORECASTS — RUSSIA

We keep our forecast unchanged for now and expect more short-term RUB spikes ahead. With no clarity on future modifications of sanctions available, we still forecast quite a weak RUB. But when this information becomes available, the RUB may rebound quite quickly to firmer levels than in our forecast. There are some signs that a mild sanctions scenario is more probable than a tough one.

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| USD/RUB | 65.9 | 67.0 | 66.0 | 65.0 | 66.5 |
| Policy rate | 7.50 | 7.75 | 7.75 | 7.50 | 7.00 |

Source: Nordea estimates

### USD/RUB FORECAST



# PLN: Volatility is coming

Despite a lot of EM turmoil this year, the PLN has been trading within relatively narrow ranges. However, there are signs that volatility could rebound in 2019. We give you three reasons why.

**Volatility in EM has been increasing in 2018, but not for the zloty**

EM volatility has been on the rise in 2018, as many currencies have been pressured by USD appreciation and political uncertainty. However, this has not been the case for the PLN. Realised volatility on a one-year horizon has been trading steadily throughout 2018 at close to historical lows, and option markets show that FX volatility is cheap.

**Three factors behind the current low volatility**

We believe that three factors can explain why the PLN volatility has been remarkably low in 2018. First, Poland has via improved macro fundamentals been able to take a stricter fiscal approach and reduce public debt. This has been a key to upgrades from rating agencies and, in our view, made the zloty more resilient to external shocks. Second, core inflation has been relatively stable in 2018, advocating for the MPC to be on autopilot with a still dovish rhetoric. Third, although political risks are high in Poland, clarity on, for instance, EU funding after 2020 remains unsolved.

**These three factors may, however, turn in favour of higher volatility in 2019**

However, looking into next year, the above-mentioned parameters may not support the low volatility environment in the same way. Thus, 2019 is an election year, which normally bodes well for volatility, and considering how a strong result for the ruling Justice and Law party could potentially lead to a cut in EU's structural funding, we expect to see more fluctuations in the EUR/PLN as we approach the election. Related to the election, the government may choose to increase spending to attract centric voters – especially after October's somewhat weak local election results. This could be at the cost of recent years' fiscal austerity and ultimately Poland's credit rating.

**Indicators point to higher inflation next year along with a more hawkish NBP**

Finally, cost pressure is building as labour shortages are increasing, growth is high and wage increases are hovering around 7.5% y/y – all factors that point to core inflation picking up next year. This could in turn lead to the central bank becoming more hawkish. Hence, we expect the NBP to deliver a rate hike in Q4 2019, which stands in contrast to Governor Glapinski's view that "no rate hike is likely in 2019/2020". So in sum, we see several reasons why PLN volatility will pick up from current low levels.

*By Morten Lund*

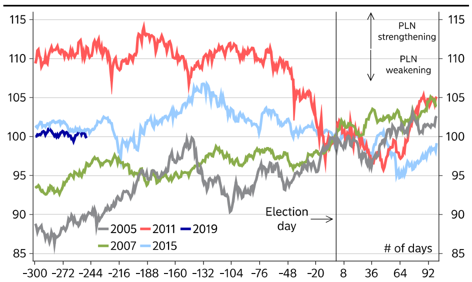
### RISK FACTORS

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

### EM TRAFFIC LIGHT

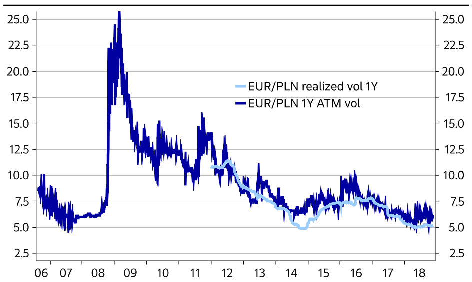
- Risk level: 14% (green, -3 pp from previous month)

### NORMALLY HIGH PLN VOL PRE-ELECTIONS




Source: Nordea Markets and Macrobond

### VOLATILITY CLOSE TO HISTORICALLY LOWS




Source: Nordea and Macrobond

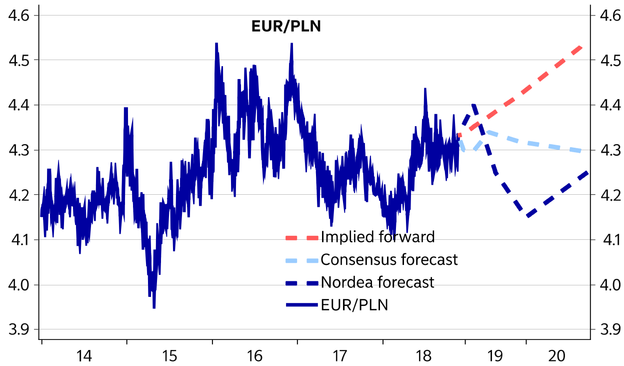
### FINANCIAL FORECASTS – POLAND

Due to a combination of lukewarm market sentiment, a dovish central bank and rising political uncertainty, we still expect the EUR/PLN to keep testing levels up to 4.40 in the short term. Longer out, we expect a mild PLN appreciation as the NBP gets closer to a rate hike.

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| EUR/PLN | 4.33 | 4.40 | 4.25 | 4.15 | 4.25 |
| Policy rate | 1.50 | 1.50 | 1.50 | 1.75 | 2.00 |

Source: Nordea estimates

### EUR/PLN FORECAST




Source: Nordea Markets and Macrobond

# INR: Not out of the woods

India's external vulnerability and the country's looming banking crisis leave it prone to another sell-off. The current INR relief may only be temporary.

The INR recovery may only be temporary

After reaching a historically high level of 74.4 in early October, the USD/INR has declined since. This is largely attributable to plunging oil prices, which relieves the pressure on India's current account balance.

However, the relief may prove to be temporary. Elevated global geopolitical risks, tighter financial conditions in the US and domestic challenges are just some of the issues that will cast a dark shadow over the INR's recovery in 2019.

India's external balance is vulnerable to a reversal of the oil price

India's current account deficit has long been its Achilles' heel. Its dependence on oil imports implies that the INR could weaken again if the oil price starts to rise. The latter is not unlikely given the OPEC's recent signal of a possible production cut next year.

A looming banking crisis in India has taken its toll on confidence

Adding to India's external vulnerability is a brewing banking crisis. The non-performing loan ratio is at a record-high 11.6%. Several scandals and defaults this year have tanked confidence in the banking sector. Liquidity has been squeezed and default risk has risen. The credit default swaps rate is nearing a two-year high.

Banking woes pose a systemic risk to the economy

More worryingly, the state-owned banks are worst hit due to their heavy exposure to non-performing infrastructural loans. This creates a systemic risk as they dominate India's financial system.

The government and the RBI quarrelling about the banking problem is further tanking confidence

Furthermore, the RBI's efforts to resolve bad debts have been challenged by the government. With a looming election next spring, the Modi administration hopes to use public bank lending to support populist policies.

The government has previously attempted to influence the RBI's decisions, which left the market questioning the RBI's independence. A quarrel between the two would cause confidence in the INR to dwindle even further.

*By Amy Yuan Zhuang*

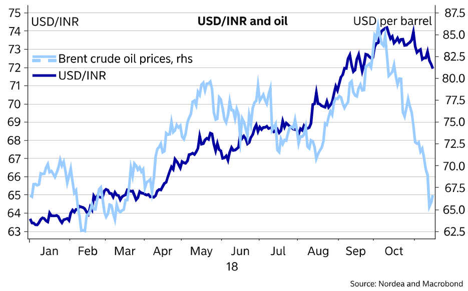
### RISK FACTORS

- Liquidity crunch in the financial system
- The government and the RBI quarrelling over how to resolve the banking problem
- Rising current account deficit

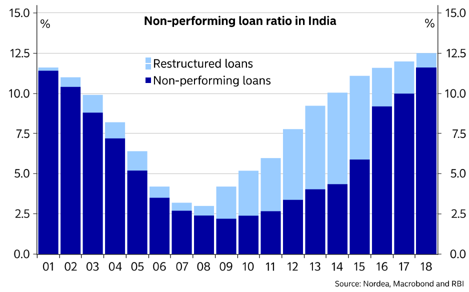
### EM TRAFFIC LIGHT

- Risk level: 9% (green, -2 pp from previous month)
- Excessive credit risk

### INR RECOVERY LED BY OIL PRICE DECLINE




### A LOOMING BANKING CRISIS IN INDIA



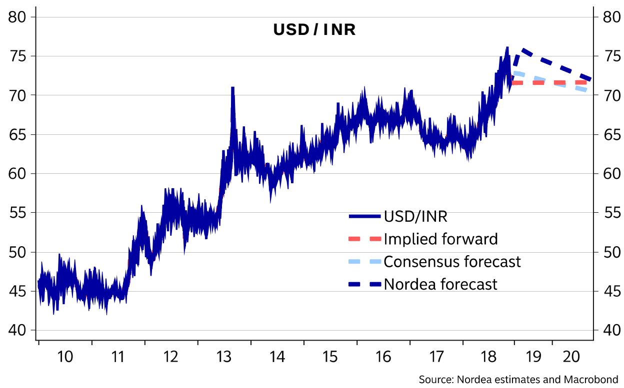

### FINANCIAL FORECASTS – INDIA

Despite the current relief for the INR, India remains vulnerable to domestic and external woes. Its weak external fundamentals leave it prone to another round of sell-offs. Moreover, a liquidity crunch in the financial system combined with excessive bad debts among banks diminishes confidence in Indian assets. We expect the rupee to weaken against the dollar on a 3M horizon before gradually recovering after the election next spring.

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| USD/INR | 71.42 | 76.00 | 75.00 | 74.00 | 72.00 |
| Policy rate | 6.50 | 6.50 | 6.75 | 6.75 | 6.75 |

Source: Nordea estimates

### USD/INR FORECAST



# 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

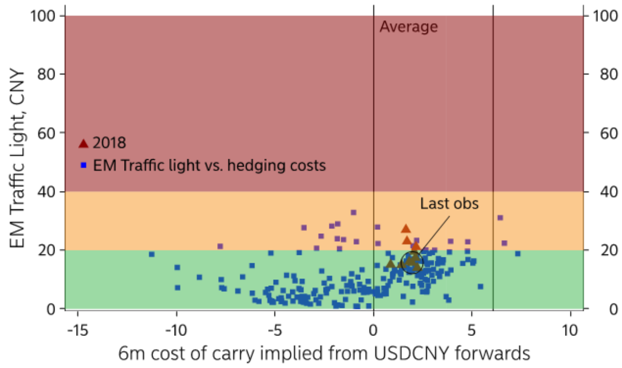
Middle to high hedge ratio in the short term, using a mix of FX forwards and zero-cost strategies. High hedge ratio in the long term, using FX forwards and benefiting from high forward premiums.

**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) |
|---|---|---|
| 7.35 | 0.28 | 8.08 |

*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 high share of zero-cost option strategies, eg forward extra.

### Expenses

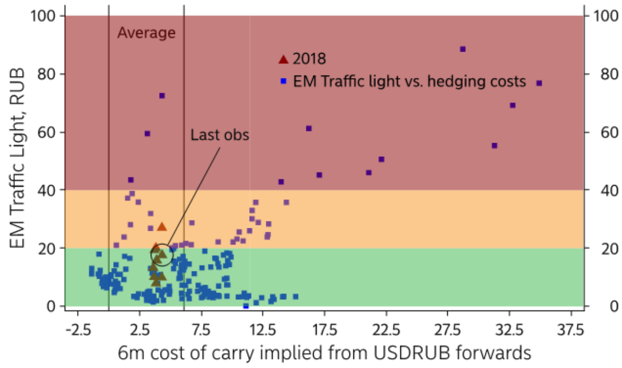
Middle hedge ratio in the short term, using a mix of forwards and zero-cost option strategies, eg risk reversals, benefiting from cheap RUB calls and expensive RUB puts. High hedge ratio in the long term, using FX forwards and benefiting from high forward premiums.

**NORDEA ESTIMATES**

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| EUR/RUB | 75.4 | 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) |
|---|---|---|
| 13.83 | 4.02 | 78.20 |

*Source: Bloomberg*

## PLN (vs EUR)

### Income

High hedge ratio in the short term (3M), using FX forwards. Low to middle hedge ratio in the long term as we expect PLN to strengthen during 2019 – high share of zero-cost option strategies, eg participating forwards as EUR/PLN volatility is quite low.

### Expenses

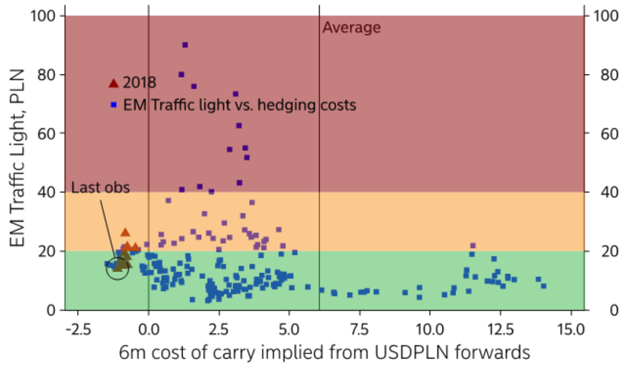
Low to middle hedge ratio in the short term, using a mix of FX forwards and zero-cost option strategies. High hedge ratio in the long term, using FX forwards mainly taking advantage of high forward premiums on EUR/PLN

**NORDEA ESTIMATES**

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| EUR/PLN | 4.33 | 4.40 | 4.25 | 4.15 | 4.25 |
| 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) |
|---|---|---|
| 5.98 | 1.50 | 4.35 |

*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 | 34% | | | | | | | | | |
| BRL | Brazil | 31% | | | | | | | | | |
| TWD | Taiwan | 27% | | | | | | | | | |
| TRY | Turkey | 27% | | | | | | | | | |
| ILS | Israel | 24% | | | | | | | | | |
| HUF | Hungary | 24% | | | | | | | | | |
| ZAR | South Africa | 22% | | | | | | | | | |
| KES | Kenya | 22% | | | | | | | | | |
| KRW | South Korea | 21% | | | | | | | | | |
| BGN | Bulgaria | 21% | | | | | | | | | |
| PEN | Peru | 21% | | | | | | | | | |
| CZK | Czech Republic | 20% | | | | | | | | | |
| SAR | Saudi Arabia | 18% | | | | | | | | | |
| RUB | Russia | 18% | | | | | | | | | |
| HRK | Croatia | 17% | | | | | | | | | |
| UAH | Ukraine | 17% | | | | | | | | | |
| ARS | Argentina | 17% | | | | | | | | | |
| SGD | Singapore | 16% | | | | | | | | | |
| RSD | Serbia | 16% | | | | | | | | | |
| CNY | China | 16% | | | | | | | | | |
| PHP | Philippines | 15% | | | | | | | | | |
| MXN | Mexico | 15% | | | | | | | | | |
| RON | Romania | 15% | | | | | | | | | |
| THB | Thailand | 15% | | | | | | | | | |
| COP | Colombia | 14% | | | | | | | | | |
| PLN | Poland | 14% | | | | | | | | | |
| MYR | Malaysia | 13% | | | | | | | | | |
| HKD | Hong Kong | 11% | | | | | | | | | |
| IDR | Indonesia | 9% | | | | | | | | | |
| INR | India | 9% | | | | | | | | | |
| KZT | Kazakhstan | 8% | | | | | | | | | |
| NGN | Nigeria | 4% | | | | | | | | | |
| EGP | Egypt | 3% | | | | | | | | | |
| | EM general | 14% | | | | | | | | | |

*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:** November 2018 (5 Nov)
- **New signals:** To yellow from green, PEN. To green from yellow, CZK, MXN, SAR.
- **Biggest changes:** The biggest changes involve the BRL (up 9 pp) and the SAR (-7 pp).

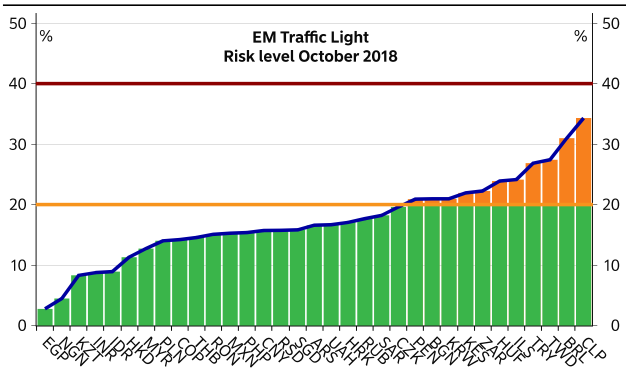
## Methodology note:

- EM Traffic Light – Methodology note

## Track record:

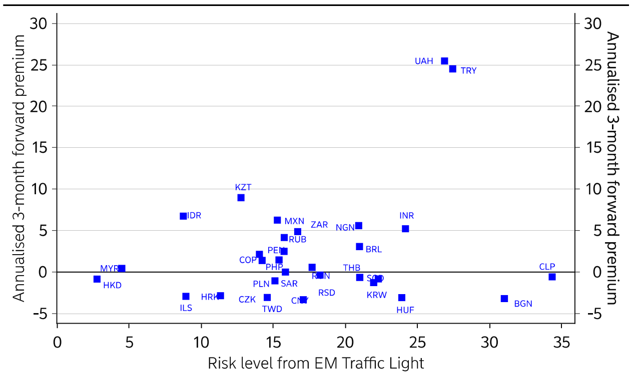
- EM Traffic Light – Track record – October 2018

## OVERALL RISK LEVEL




Source: Nordea estimates and Macrobond

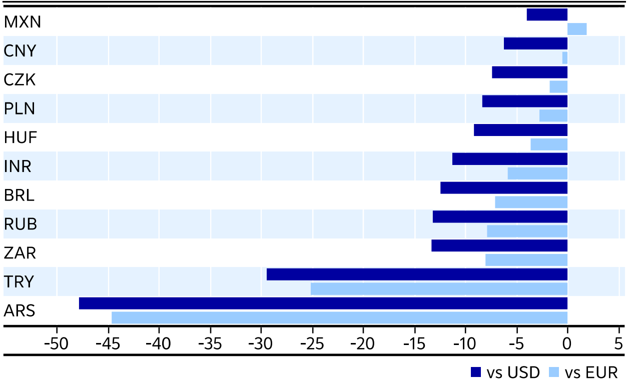
## TRAFFIC LIGHT VS COST OF CARRY




Source: Nordea and Macrobond

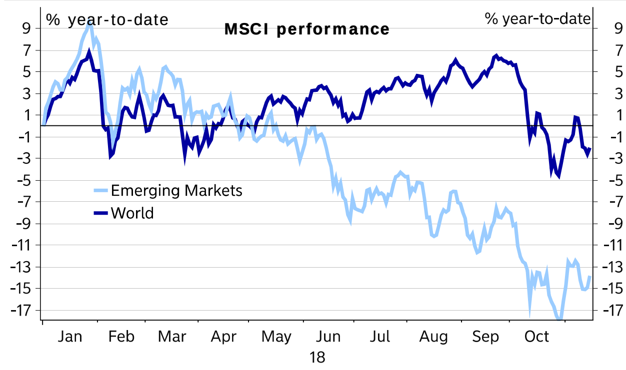
# Emerging market performance

### YTD EM FX PERFORMANCE



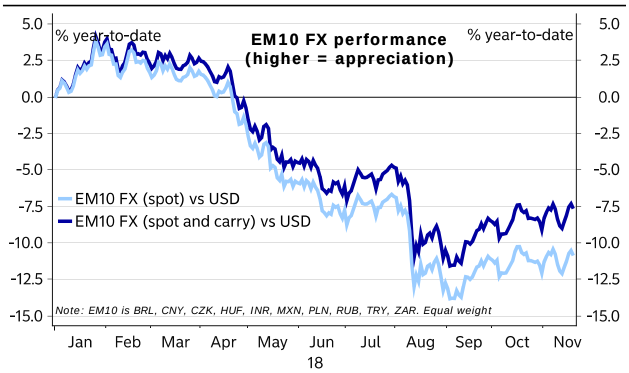

Source: Nordea and Macrobond

### YTD EQUITIES PERFORMANCE



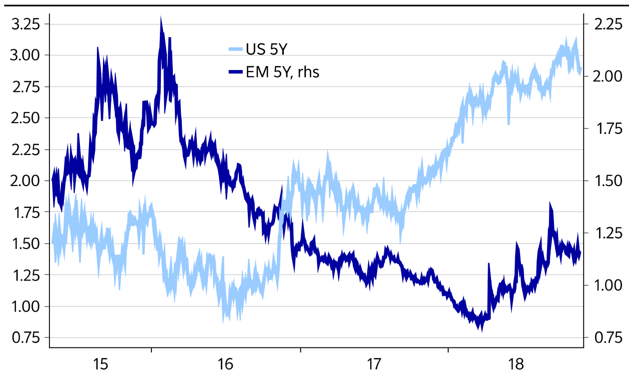

Source: Nordea and Macrobond

### YTD FX PERFORMANCE, CARRY ADJUSTED



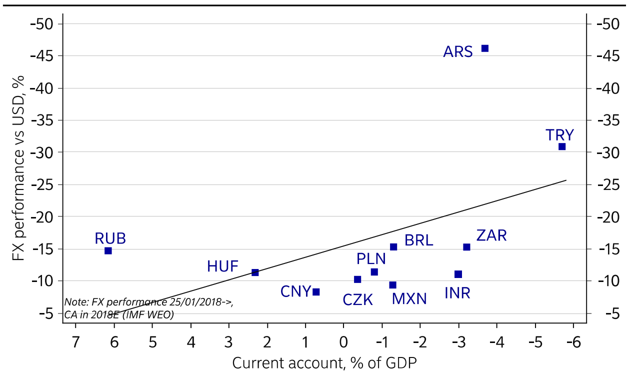

Source: Nordea and Macrobond

### SWAPS



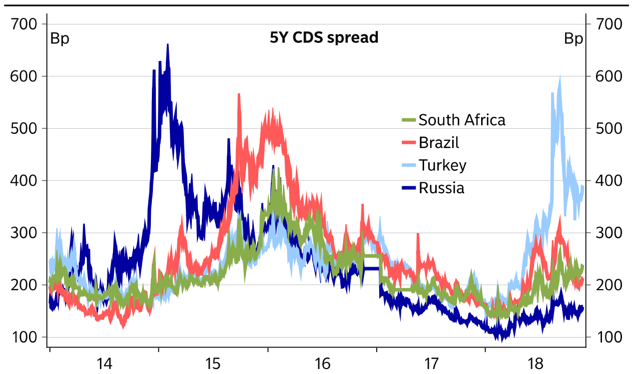

Source: Nordea and Macrobond

### 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 | 4.288 | 4.41 | 4.58 | 4.80 | 5.12 |
| EUR/CNY | 7.924 | 8.12 | 8.21 | 8.36 | 8.45 |
| EUR/CZK | 26.05 | 26.0 | 25.5 | 25.0 | 27.0 |
| EUR/HUF | 321.1 | 325 | 320 | 315 | 320 |
| EUR/INR | 81.55 | 88.2 | 89.3 | 91.0 | 92.2 |
| EUR/PLN | 4.313 | 4.40 | 4.25 | 4.15 | 4.25 |
| EUR/MXN | 23.3 | 23.8 | 23.8 | 23.4 | 24.3 |
| EUR/RUB | 75.24 | 77.7 | 78.5 | 80.0 | 85.1 |
| EUR/TRY | 6.167 | 6.40 | 7.00 | 7.50 | 8.00 |
| EUR/ZAR | 16.04 | 16.8 | 17.9 | 19.1 | 20.5 |
| EUR/USD | 1.141 | 1.16 | 1.19 | 1.23 | 1.28 |
| EUR/SEK | 10.33 | 10.3 | 10.2 | 10.0 | 9.70 |
| EUR/NOK | 9.748 | 9.50 | 9.15 | 9.00 | 9.00 |
| EUR/DKK | 7.463 | 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 | 3.758 | 3.8 | 3.85 | 3.90 | 4.00 |
| USD/CNY | 6.945 | 7.00 | 6.90 | 6.80 | 6.60 |
| USD/CZK | 22.83 | 22.4 | 21.4 | 20.3 | 21.1 |
| USD/HUF | 281.5 | 280 | 269 | 256 | 250 |
| USD/INR | 71.48 | 76.0 | 75.0 | 74.0 | 72.0 |
| USD/MXN | 20.42 | 20.5 | 20.0 | 19.0 | 19.0 |
| USD/PLN | 3.78 | 3.79 | 3.57 | 3.37 | 3.32 |
| USD/RUB | 65.95 | 67.0 | 66.0 | 65.0 | 66.5 |
| USD/TRY | 5.406 | 5.52 | 5.88 | 6.10 | 6.25 |
| USD/ZAR | 14.06 | 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 | 1.75 | 2.00 | 2.25 | 2.50 | 2.50 |
| Turkey | 24.00 | 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 | 8.00 | 8.25 | 8.25 | 8.25 | 7.75 |
| 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**

No changes.

**China**

No changes.

**Czechia**

Despite four consecutive rate hikes, the koruna has been sliding. We adjust our EUR/CZK forecasts upwards and bring forward the date of our next expected rate hike to Q1 2019, with risk tilted towards a move as early as December.

**Hungary**

No changes.

**India**

No changes.

**Mexico**

Banxico hiked the policy rate in mid-December due to recent pressure on the MXN (after AMLO's decision to cancel the construction of the new Mexico City airport) and a worsened inflation outlook. The MPC also has a clearly hawkish bias going forward, which is why we accordingly bring forward a rate hike.

**South Africa**

No changes.

**Poland**

No changes.

**Russia**

No changes.

**Turkey**

The Turkish lira has stabilised somewhat recently, as diplomatic tensions with the US have cooled off. Therefore, we adjust our EUR/TRY forecasts downwards for the short term. However, we still expect the lira to suffer in the medium to long term, as this year's extreme FX weakness could begin to hit the real economy more than markets anticipate, and as political risk remains high.

# Recent research and profile descriptions

### Recent Emerging Markets Research
- India: A brewing banking crisis (16 November)
- Russian GDP growth: 1.5% trap (14 November)
- China monthly: Chicken game (7 November)
- Russian budget: how sensitive to sanctions? (7 November)

### Previous Emerging Markets Views
- Emerging Markets View: Casualties of war - October 2018 (25 October)
- Emerging Markets View September 2018: House of Cards (20 September)

### Latest EM Traffic Light
- EM Traffic Light November 2018 (5 November)

### 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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