

Forecast update: Carry EURNOK lower

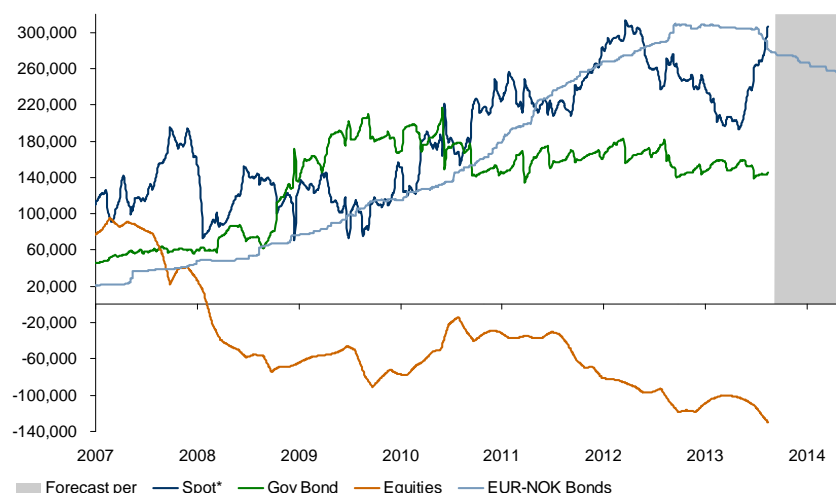
- Large NOK-outflows seem to be replaced with the carry-trade
- The environment with negative EUR-rates should give NOK strength
- Norwegian economy doing better than feared
- EURNOK end of year forecast revised to 7.80.

Outflows being replaced by the carry trade in NOK

During the last couple of months we have seen large redemptions of NOK-investments. Even so NOK has kept its strength. The reason seems to be appetite for the carry-trade and positive key data surprises. During the European debt crisis international investors bought NOK in lack of a safer alternative, now they seem to be buying NOK in lack of a higher yielding alternative.

In need of yields rather than a safe haven

Foreigners' flows aggregated since oct 05

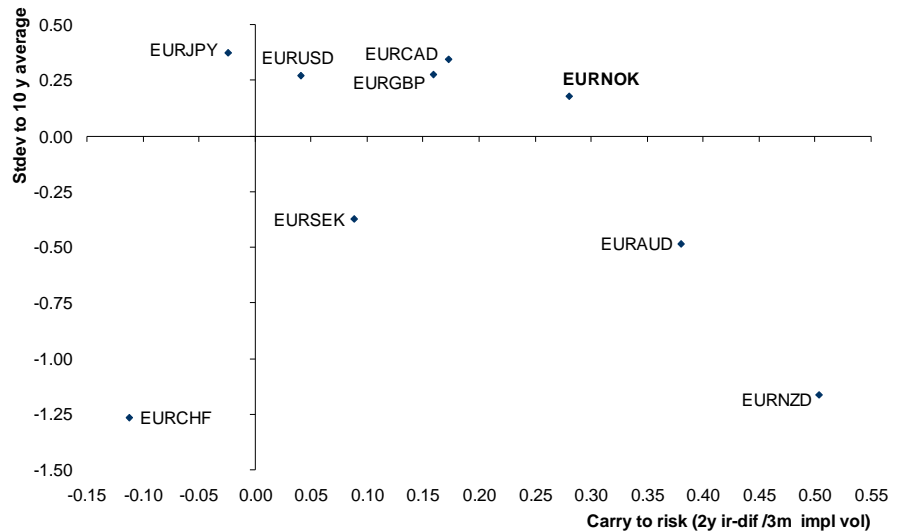


Source: Bloomberg, VPS, Norges Bank

Negative EUR-rates will increase the NOK interests

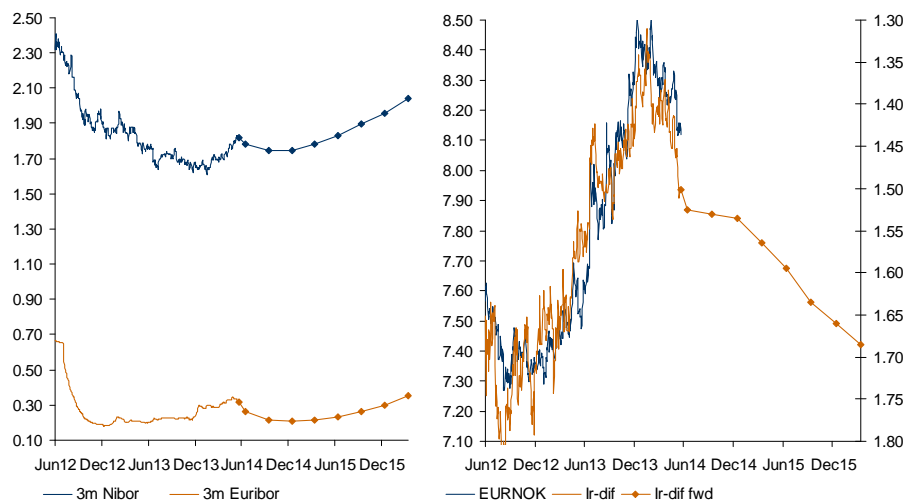
The interest rate differential seems to be quite important for the EURNOK development, especially the 3m Nibor vs 3m Euribor. With the last policy change from ECB it seems quite obvious that Euribor will stay low for quite some time. Judging from the forward curves in the two currencies the spread will increase from today's level. Carry trading has probably also been heavily affected by the risk appetite. Carry to risk (interest rate differential divided by implied volatility) is at high levels in many of the carry-currencies, EURNOK is in addition standing out as at the high side of historical averages.

High carry-to-risk in EURNOK compared to other EUR-crosses



Source: Bloomberg

Interest rate differentials could drive EURNOK lower



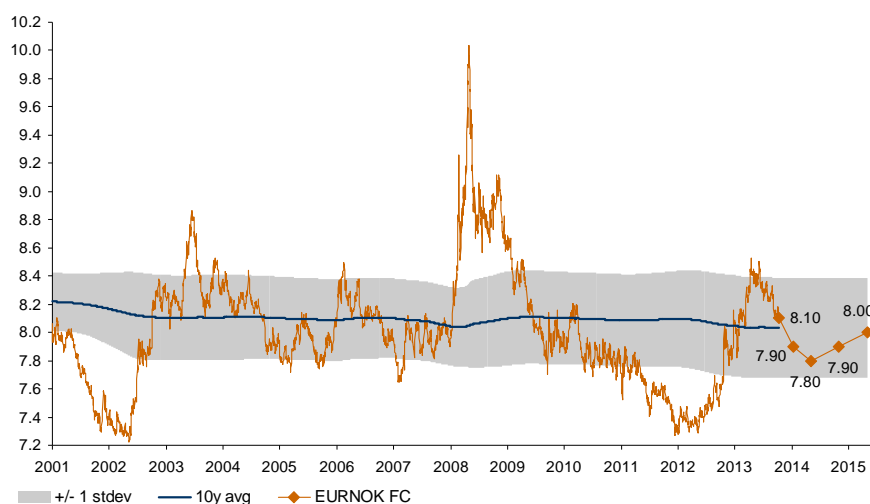
Source: Bloomberg

EURNOK to grind lower

Outlook for the Norwegian Economy is better than we feared it would be, but oil-investments could still end up at the weak side and hurt the longer term outlook. Short term it seems like the market theme will be lack of inflation in major economies. As long as both Fed and ECB are running an expansionary monetary policy, risk appetite should stay high. In such environment EURNOK should have substantial downside potential, but judging from history, that kind of downside is normally quite slow. The end of QE from FED in second half of 2014 or rate hikes in 2015 might bring more risk aversion as well. With those two drivers in mind we have chosen

to revise our forecast to 7.80 end of year. We still see challenges for the Norwegian economy on the longer term horizon, and EURNOK is quite a mean reverting currency; so longer term we see EURNOK hovering around historical averages at 8.00.

Downside potential for EURNOK short to medium term



Source: Bloomberg and Nordea

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