Emerging Markets FX Monocle

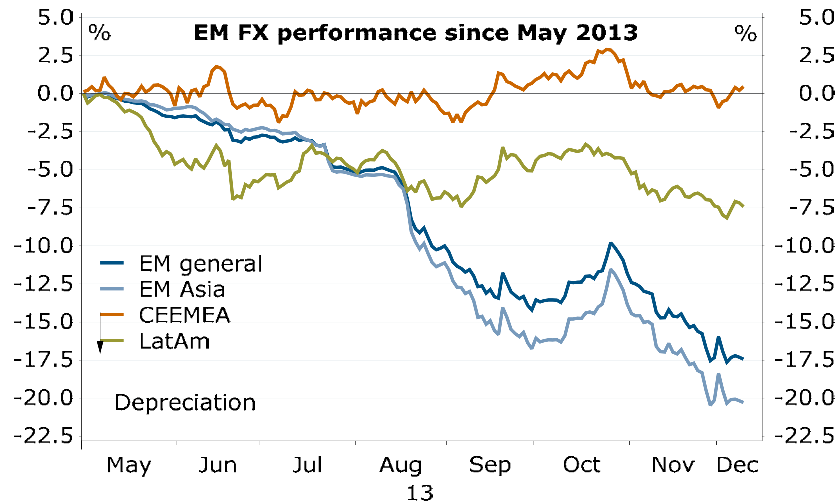
The aftershocks

13 December 2013

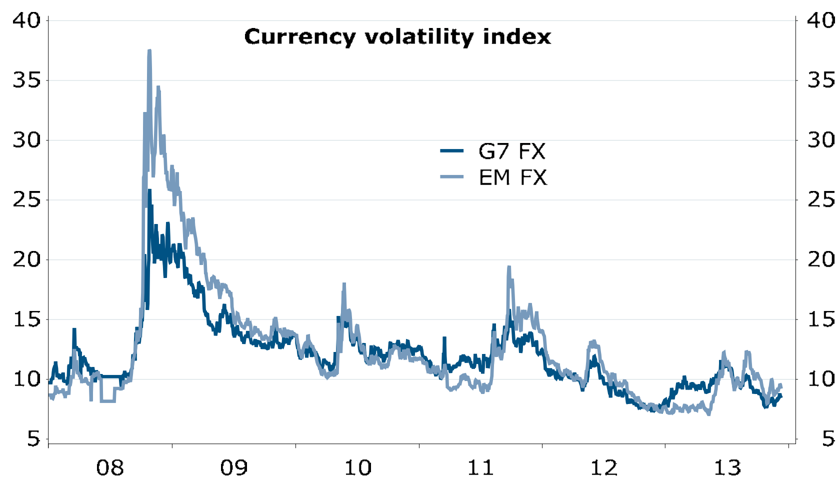
EM FX: The aftershocks

The EM currencies are still facing hardships. Actual tapering may kick off another round of flight to safety. Elections in H2 are also likely to jack up volatility.

- We expect EM FX volatility to pick up in 2014, driven by Fed actions in H1 and domestic issues, ie elections in a handful countries in H2.
- Beyond any doubt, the Fed tapering will continue to dictate the directions of EM currencies in the first part of next year.
- Although the earthquake is over, the aftershocks remain. The reaction to *actual* tapering, in January by our forecast, is likely to be less strong than to the *prospect* of tapering. The EM currencies, and some more than others, remain vulnerable to another round of outflows.
- The second part of 2014 is election time for some of the weakest EM countries. The election results and reform willingness are crucial for the long-term performance of these EM currencies.



Source: Reuters Ecowin and Nordea Markets



Source: Reuters Ecowin and Nordea Markets

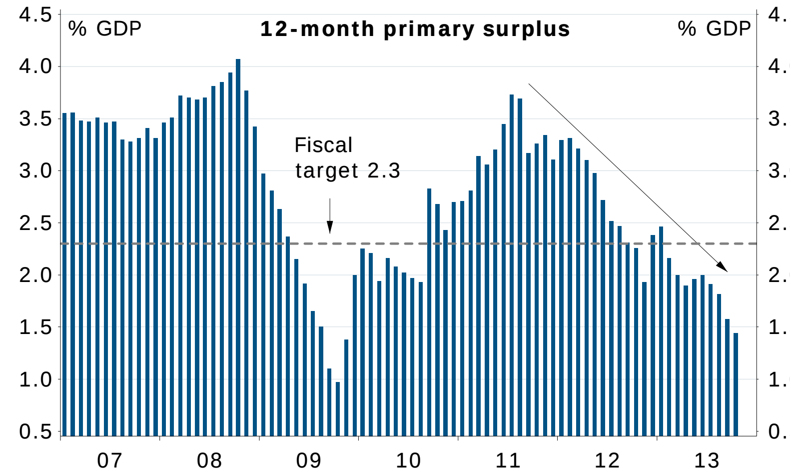
EM FX volatility to pick up in 2014

BRL: Under weakening pressure

2014 will be an interesting as well as a tough year for the BRL as uncertainties regarding the Fed's tapering plans, elections and the fiscal situation unwind.

- The BRL will continue weakening in 2014 – driven less and less by external factors and more by domestic ones such as still low growth/high inflation and a deteriorating fiscal outlook.
- Q3 GDP showed the largest contraction since 2009, as the rebound in investment recorded in the first half of 2013 reversed.
- President Rousseff will likely muddle through the election, as she struggles with low growth and runs against two solid opposition candidates.
- Any improvement in the deteriorating fiscal situation therefore seems unlikely and Brazil risks a credit rating downgrade by early 2015.
- The BCB has decided to extend its FX intervention programme into 2014. We look for a further 25 bp hike in January, before the BCB takes a pause from its hiking cycle as a courtesy to Rousseff.

FX intervention programme to persist into 2014



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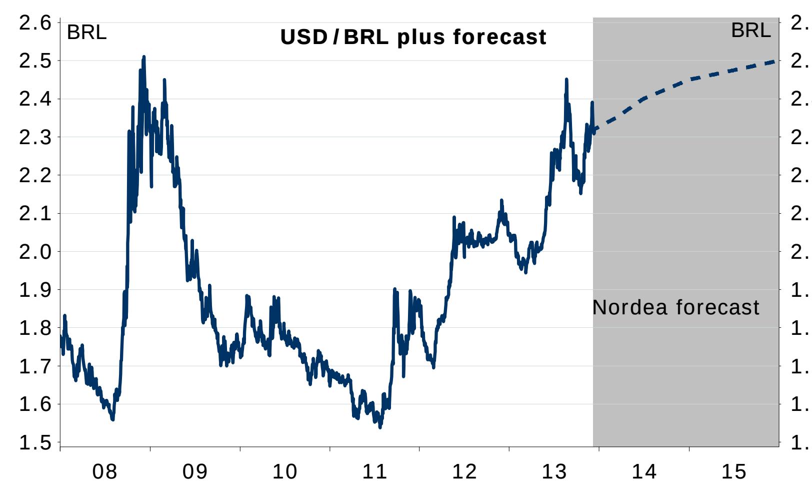


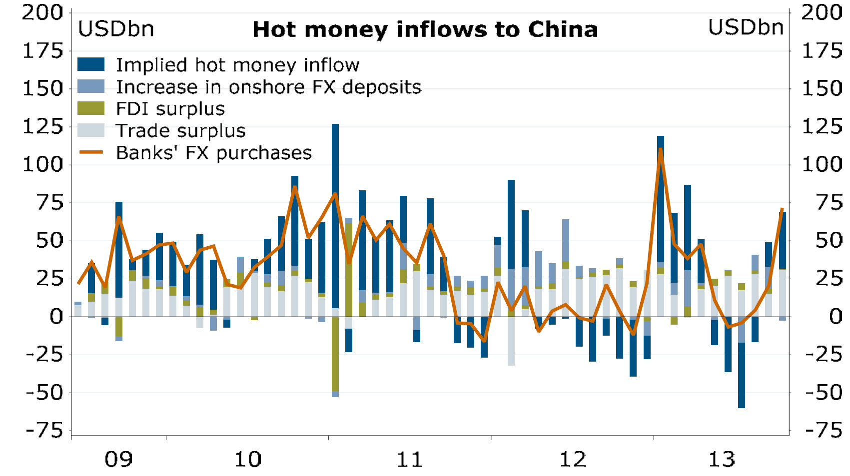
Source: Nordea Markets and Reuters Ecowin

CNY: The next reserve currency

Continued liberalisation means a fully convertible CNY in the foreseeable future. Currency policy and capital flows support a stronger yuan.

- We maintain our view that the CNY could be fully convertible as early as late 2016. This would be a crucial achievement for it if it is to become a regional reserve currency by 2020.
- Thus, the PBoC is likely to slowly direct the fixing rate higher, leading to CNY strengthening.
- The next reform step is to widen the trading band by 50 bp to +/-1.5%. This will likely take place in early 2014 and lead to higher volatility.
- The PBoC recently published a bold policy proposal on the Shanghai Free Trade Zone, advising a floating yuan and free capital movements.
- The current growth recovery has attracted speculative capital flows back to China, a trend that may continue in coming years due to prospects of a liberalised financial market.

CNY a regional reserve currency by 2020



Source: Reuters Ecowin and Nordea Markets

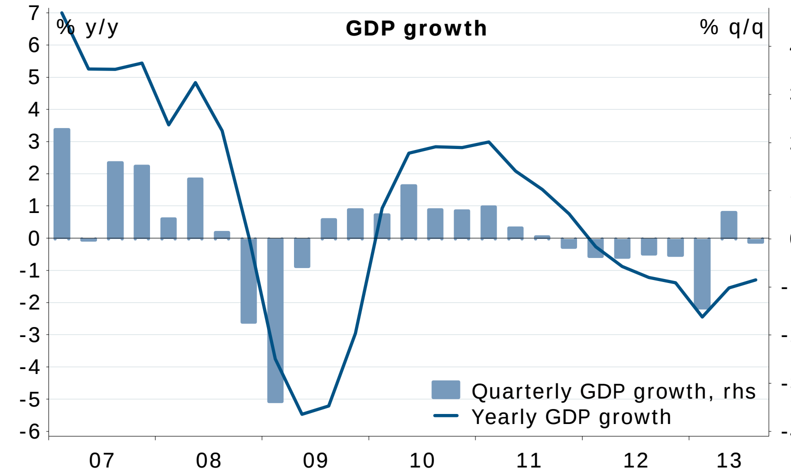
Source: Nordea Markets and Reuters Ecowin

CZK: Recovery slightly delayed

After more than a year of fiddling with the idea, the Czech National Bank decided to implement a Swiss-type floor to EUR/CZK in an attempt to avoid a deflation trap and protect the recovering economy.

- A minor contraction in quarterly GDP growth in Q3 of -0.1% coupled with a still-low November inflation print of 1.1% y/y indicates that economic recovery is slightly delayed and underscores the need for a weaker CZK.
- We expect the CNB to keep its EUR/CZK floor at 27 until inflation increases significantly, which is unlikely to happen before end-2014.
- Risks remain that the floor at 27 is too low to avoid deflation, in which case the CNB will have to raise it. Indeed, the CNB's preferences are asymmetric, favouring moves in EUR/CZK above 27.
- As it takes several months for FX moves to feed through to inflation, we are comfortable with maintaining our forecast of a flat EUR/CZK for now.

Asymmetric risks to the CZK



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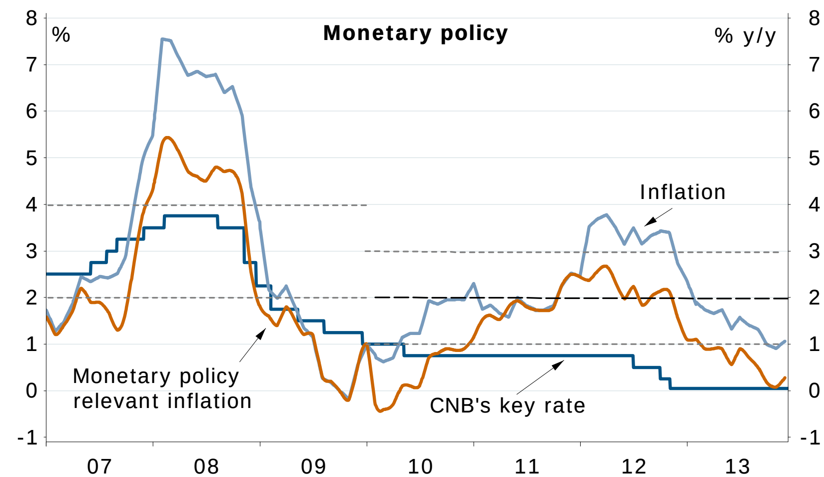


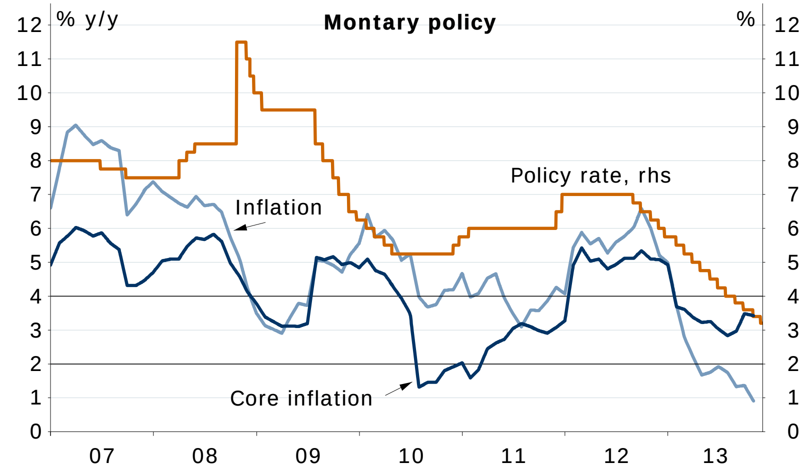
Source: Nordea Markets and Reuters Ecowin

HUF: Policy stimulus to boost growth

The Hungarian economy is rebalancing and finally growing. Further rate cuts together with domestic and external uncertainties will, however, weigh on the Hungarian forint in the first half of 2014.

- Inflation remains subdued due to large cuts in regulated prices, a negative output gap and a drop in imported inflation, leaving room for further rate cuts in H1 2014.
- We expect the ultra-dovish NBH to end its easing cycle at 2.80%, corresponding to additional cuts of 40 bp. Risks are tilted towards further rate cuts.
- The Q3 GDP print came out at 1.8% y/y, confirming that economic activity is slowly gaining momentum.
- We expect growth to accelerate to 2% in 2014 against a backdrop of improved demand from the Euro area, a pick-up in investment activity and domestic consumption.

Ultra-dovish central bank continues cutting



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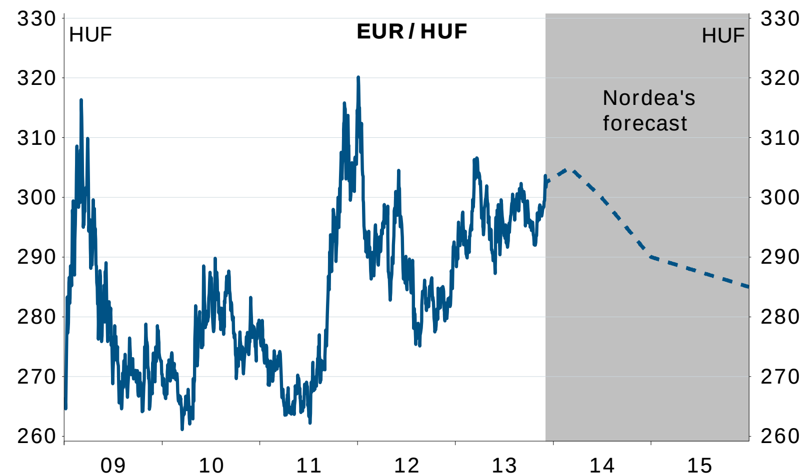


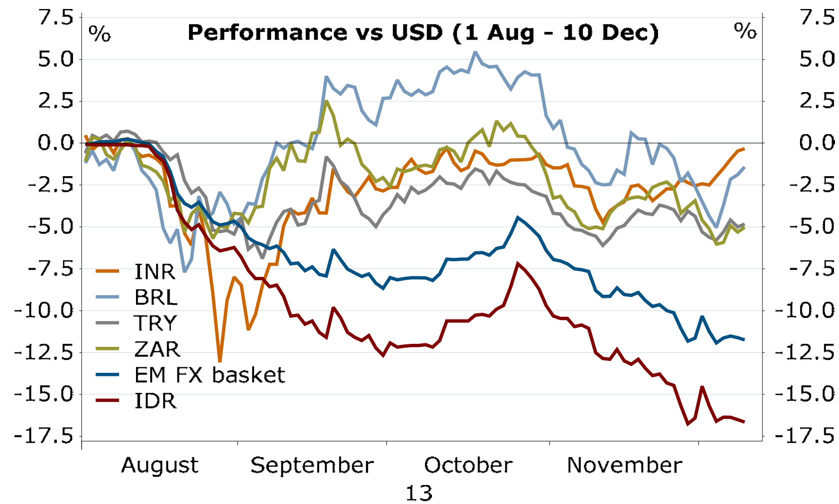
Source: Nordea Markets and Reuters Ecowin

IDR: The herd behaviour

Avoiding the IDR has become the new normal. This will keep weakening the IDR, especially if a tapering-related selloff resumes. Upside surprises may occur when investors realise things are not as bad as they thought.

- The IDR is considered to be among the EM currencies most vulnerable to capital outflows. However, economic fundamentals do not support the bearishness of the markets.
- First of all, GDP growth stood at 5.6% in Q3, which is higher than in most other EM economies.
- Secondly, the twin deficits have not reached alarming levels (C/A is 3.7% of GDP). The government's ongoing efforts of reducing the fuel subsidy will also improve the balance.
- Thirdly, total external debt is 30% of GDP, a significant reduction since the late 1990s.
- Finally, the reform-friendly Jakarta Governor Joko Widodo is likely to become premier from July next year. Structural reform may attract even more FDI, with even less reliance on portfolio inflows.

USD/IDR resistance level at 12,000



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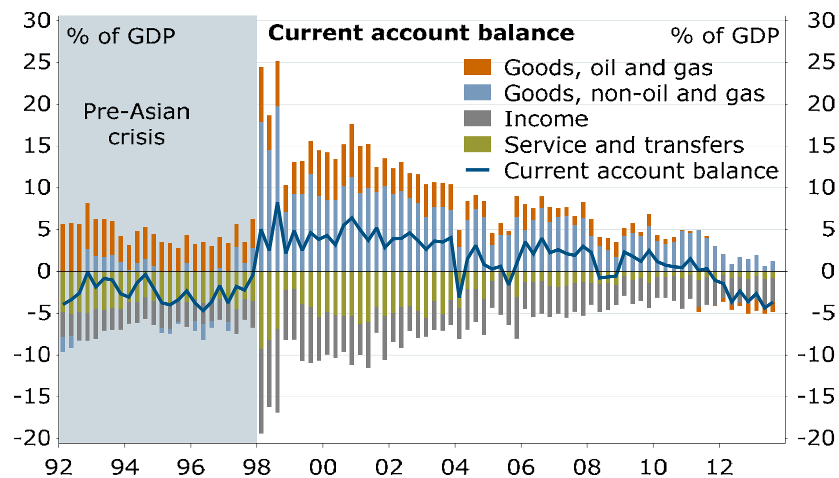


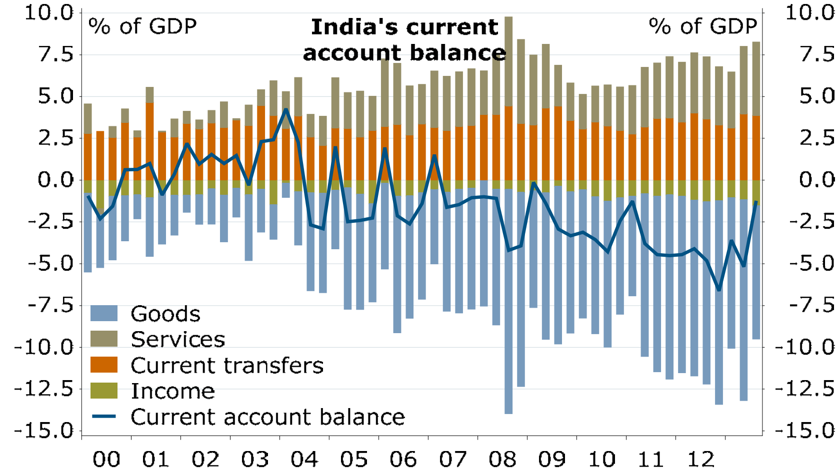
Source: Reuters Ecowin and Nordea Markets

INR: The power of gold

Restricting gold imports has effectively brought down India's current account deficit. With the prospect of reform next year, the INR could involve upside risks.

- Several ingredients are needed for India to regain its investment attractiveness. With the reduced current account deficit, we are one step closer.
- Tougher restrictions on gold imports have effectively reduced India's current account deficit to just 1.2% of GDP in Q3, the lowest level in more than four years. This is hardly a surprise as over half of the external deficit came from gold imports. The finance minister vowed to continue the ban.
- Emphasis on financial reform has earned the new RBI governor a decent reputation.
- Finally, if the pro-market strongman Modi becomes India's next premier, and he stands a real chance of doing that, businesses will cheer and confidence may be restored. After all, under his rule the state Gujarat has developed fast and the rest of India is eager to replicate his model.

The INR may surprise positively in 2014



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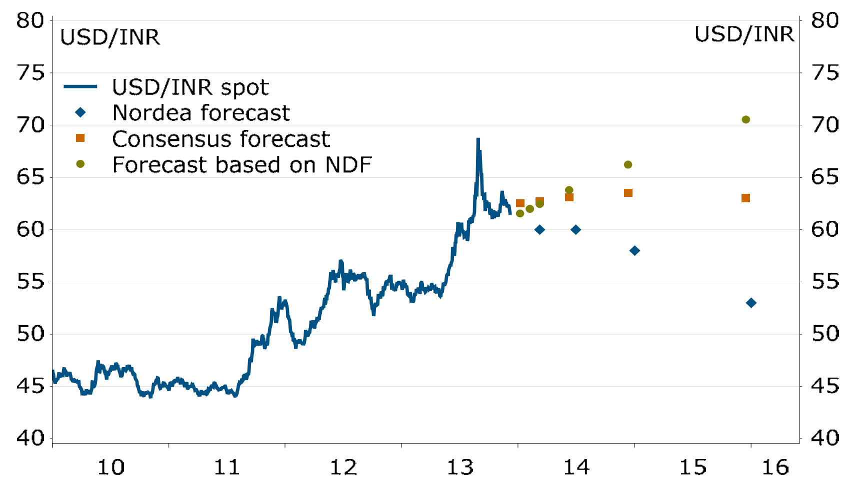


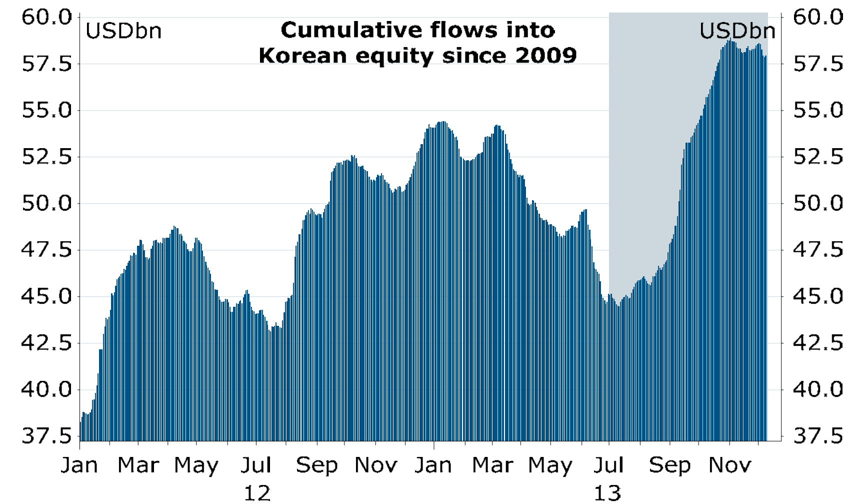
Source: Nordea Markets and Reuters Ecowin

KRW: Greener grass on the other side

For South Korea it is a mixed blessing to be the regional safe haven; it loses competitiveness on a stronger won. If the pressure persists, Seoul will have to intervene.

- While some EM economies fret about capital outflows and depreciation pressure, others lose sleep over excessive inflows and FX appreciation. South Korea belongs to the latter group.
- About USD 13bn has poured into Korean equities since July, when investors returned to the regional safe haven due to its ultra-strong fundamentals.
- Given the risk that resumed tapering talk may kick off another (smaller) round of flight to safety, the won may see further upward pressure.
- However, this would be countered by the authorities; they recently warned of FX intervention if the won rally continues. The central bank governor has in fact indicated concerns over too low inflation (0.9%), so the policy rate may be lowered from the current 2.5%.
- Q3 growth rebounded on solid public investment.

Authorities will intervene to weaken the won



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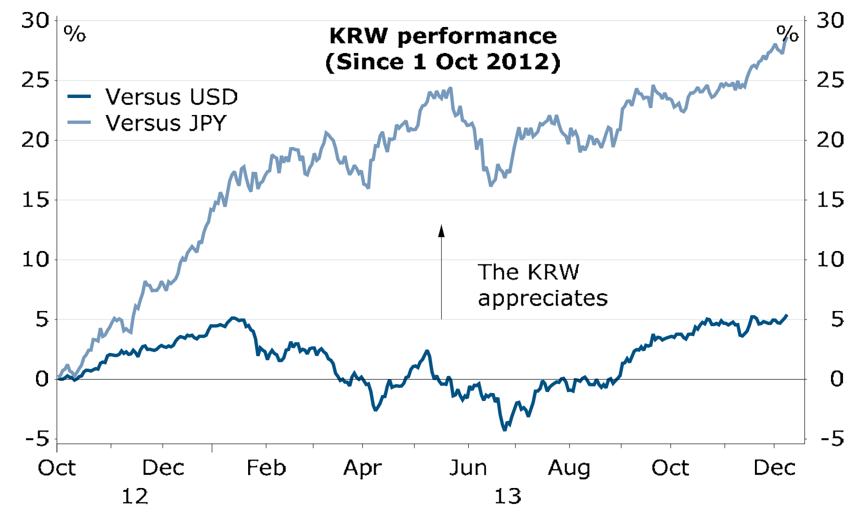


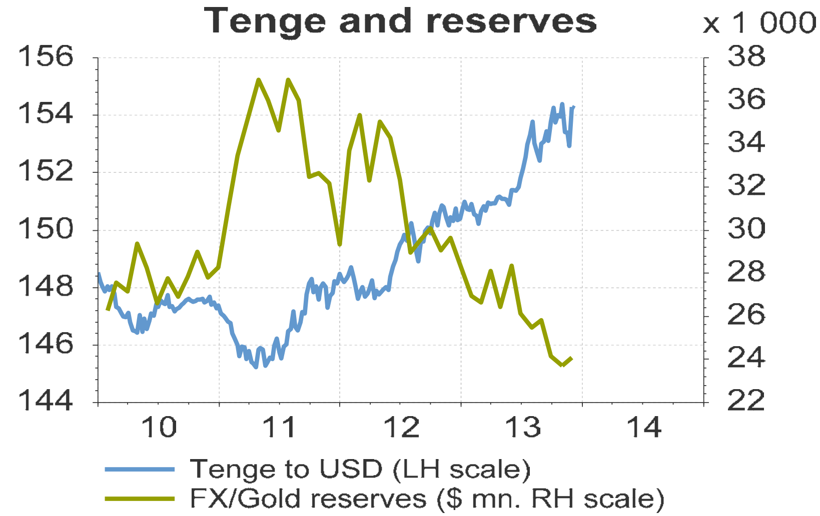
Source: Reuters Ecowin and Nordea Markets

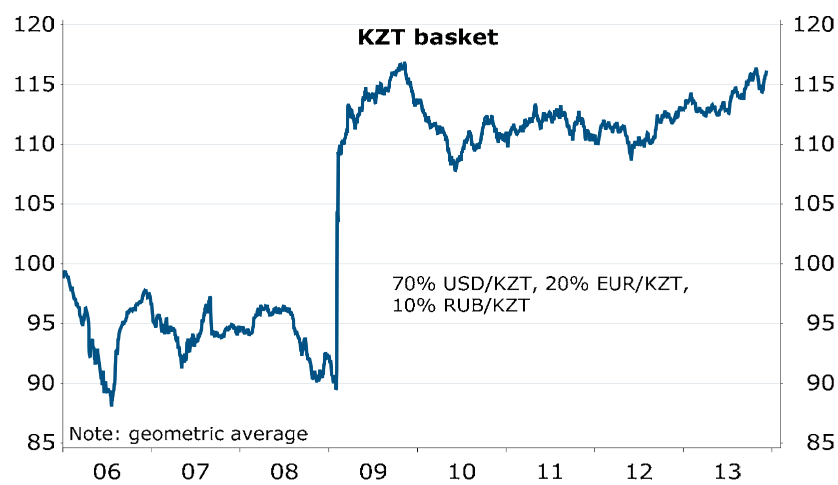
KZT: Mid-term stability vs long-term issues

The KZT will remain stable for now on robust growth, healthy balances and supportive oil prices. Longer out, downside pressure will come from falling C/A surplus.

- Kazakhstan GDP growth in 2013 is expected to be 5.25% boosted by oil and agricultural output. The risk of a slowdown in Russia and China is the main risk to the economy.
- The National Bank of Kazakhstan (NBK) supports the KZT via FX intervention. KZT volatility will likely stay at current low levels compared to other EM commodity currencies.
- The NBK has kept its rate on hold at 5.5% since August 2012 and is expected to keep it unchanged in coming months.
- The KZT may stay relatively stable in the medium term, supported by healthy public finances, a growing economy and relatively stable oil prices.
- The current account balance may enter deficit territory in coming quarters, which would put pressure on the KZT in the long term.

Factors supporting a stable medium-term KZT





Source: Nordea Markets and Reuters Ecowin

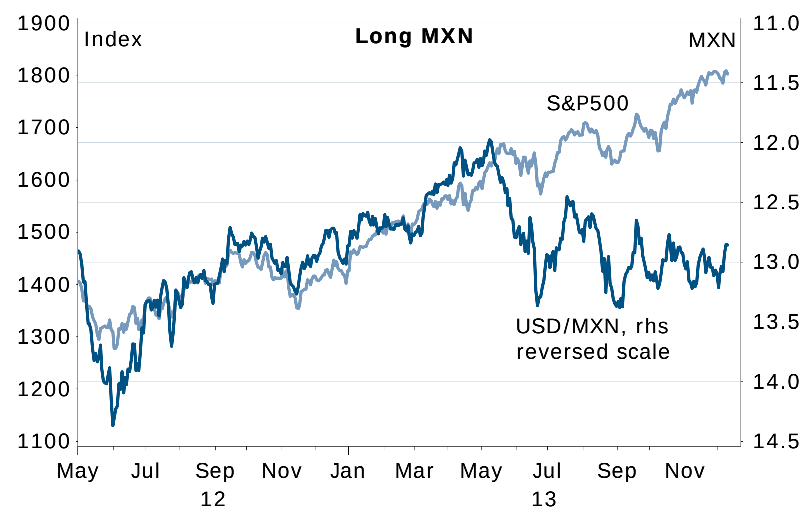
MXN: Faster, stronger!

We see a stronger Mexican peso against a backdrop of recovering growth, relatively strong fundamentals and promising reform prospects, which will likely improve the flow of foreign funds into Mexico.

- The two main drags on Mexico's slow growth in 2013 – weak US activity and a contraction in public spending – are expected to reverse and contribute positively to growth in 2014.
- We expect growth to accelerate to 3.5% in 2014.
- Several productivity enhancing reforms have already been adopted, pushing potential growth higher – the key one being the energy reform.
- By opening up the gas and oil sector to foreign investors, we expect the energy reform to have meaningful impact on FDI flows to Mexico.
- Banxico has closed the door to further easing and we expect it to remain closed throughout 2014.
- The MXN is the only currency in Latin America likely to appreciate against the USD in 2014.

MXN to outperform its LatAm peers

Source: Nordea Markets and Reuters Ecowin



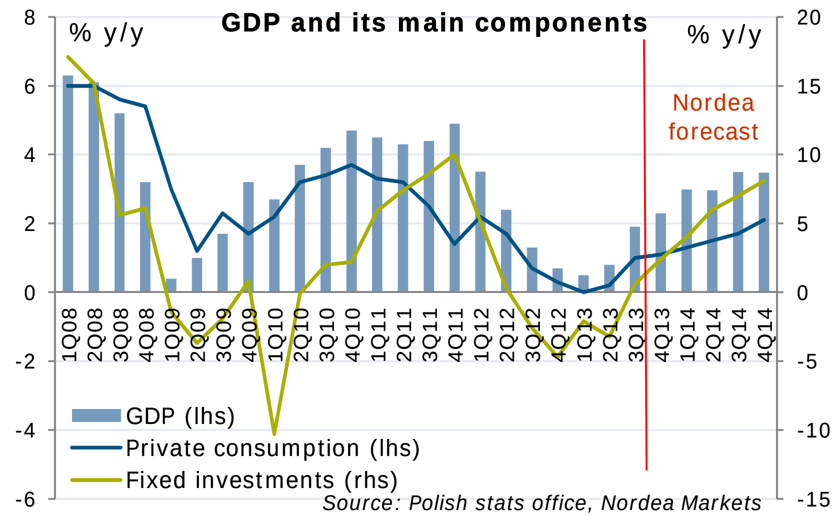
Source: Nordea Markets and Reuters Ecowin

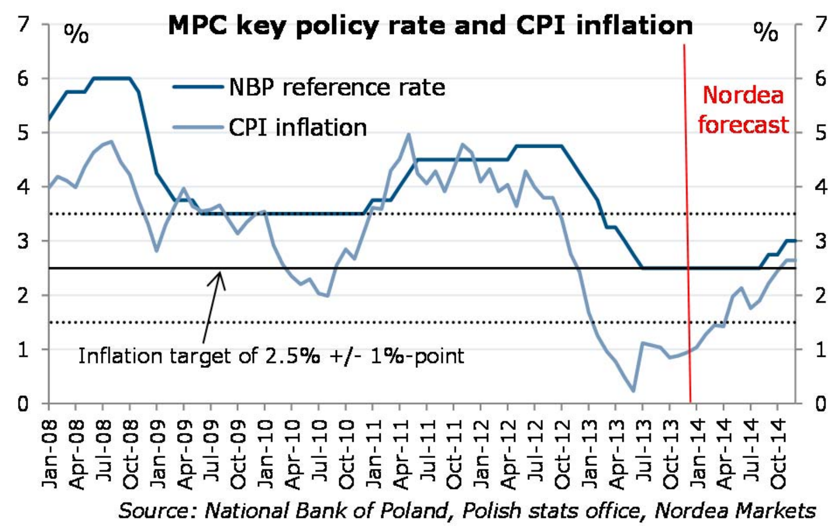
PLN: Stuck between conflicting forces

Sideways movement in the PLN over the past few months. The currency remains stuck between stronger economic fundamentals and QE tapering. We still believe that positive factors will prevail.

- With a large share of foreign holding of local bonds, Poland is potentially vulnerable to possible EM outflows prompted by QE exit, but strong local fundamentals and a slow pace of tapering should help the PLN avoid significant turbulence.
- The PLN is supported by the relatively conservative policy of the Polish central bank, especially versus its CEE peers. The central bank pledged in its forward guidance that rates will not be hiked at least until mid-2014, but it also hinted that there will be no further easing.
- The clearly improving balance of payments position (first ever quarterly trade and C/A surpluses plus strong inflow of long-term capital) and cyclical economic recovery should outweigh the negative factors and lead to gradual appreciation of the PLN in the medium term.

PLN to gain during 2014 despite QE3 tapering



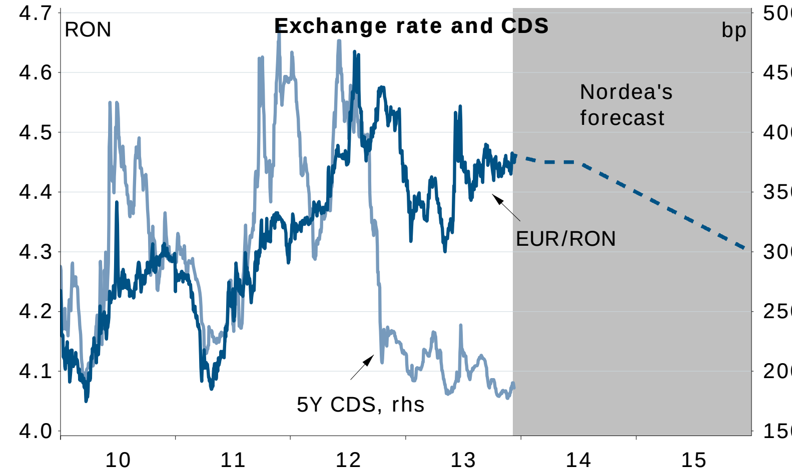


RON: More rate cuts in the pipeline

The Romanian leu has been trading sideways since the August sell-off, with little signs of major changes. GDP growth is set to improve in 2014 and 2015.

- The RON has been stuck in a 1% range against the EUR since August and nothing is likely to change that anytime soon. EUR/RON flat in the short term.
- We expect more rate cuts in 2014, justified by disinflation, contracting domestic demand and a slowdown in lending activity (in nominal terms).
- Small C/A deficit in 2013 and possibly minor surpluses in 2014 and 2015 should help shield the RON from rising global rates.
- Likely credit rating upgrade next year due to further fiscal consolidation despite elections.
- GDP growth expected to accelerate slightly in 2014 towards 2.5% due to improved external demand conditions.

RON to continue trading sideways



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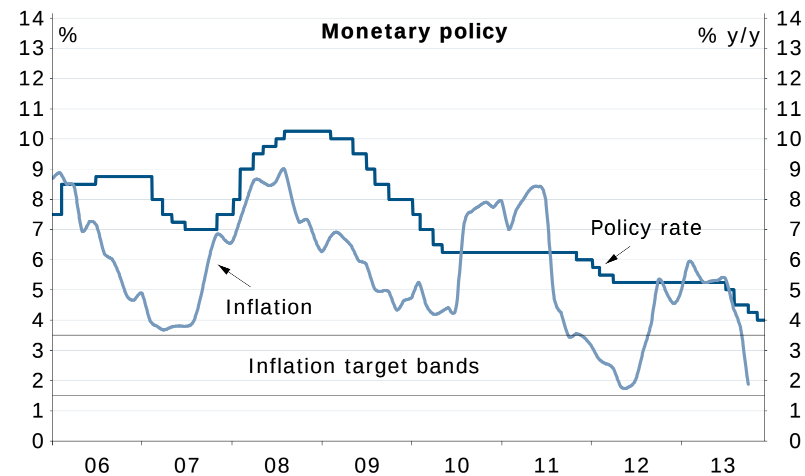
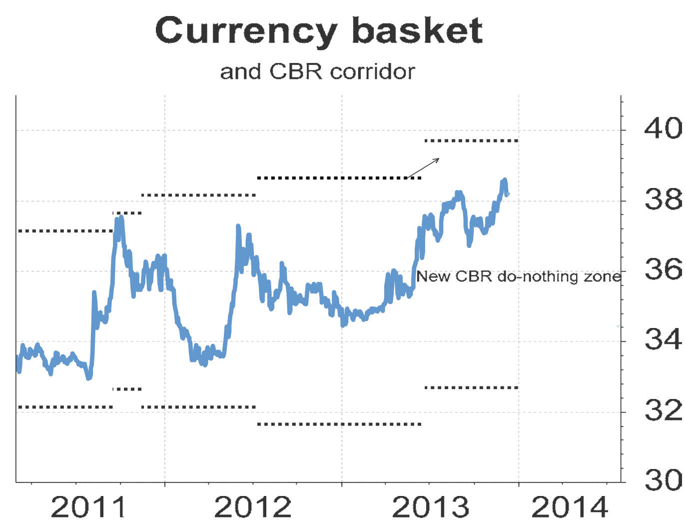


Source: Nordea Markets and Reuters Ecowin

RUB: Getting used to low economic growth

Low growth in Russia (1.2%-1.5%) and QE tapering are major mid-term threats to the RUB. Relatively high oil prices support a stable USD/RUB, while EUR/RUB may even strengthen in the long term.

- Economic growth is decelerating in Russia on weak investment activity and stagnant exports.
- The RUB will become more volatile given the CBR's plan of a floating RUB by 2015.
- The pace of capital outflow is expected to stay stable. The RUB has adapted to an outflow of USD 60-70bn per year. Seasonal acceleration of outflows at the end of the year may temporarily put additional pressure on the RUB.
- Our average oil price forecast of USD 103-108/bbl for 2014-2015 remains RUB-supportive and the RUB continues to trade in close correlation with oil market dynamics.
- The RUB has room to gain vs the EUR because of our call for the EUR/USD, which is anticipated to fall in the long term.



Horizon	Nordea USDRUB	Nordea EURRUB
3M	33,15	44,10
30-Jun-14	33,00	42,90
31-Dec-14	32,60	40,75

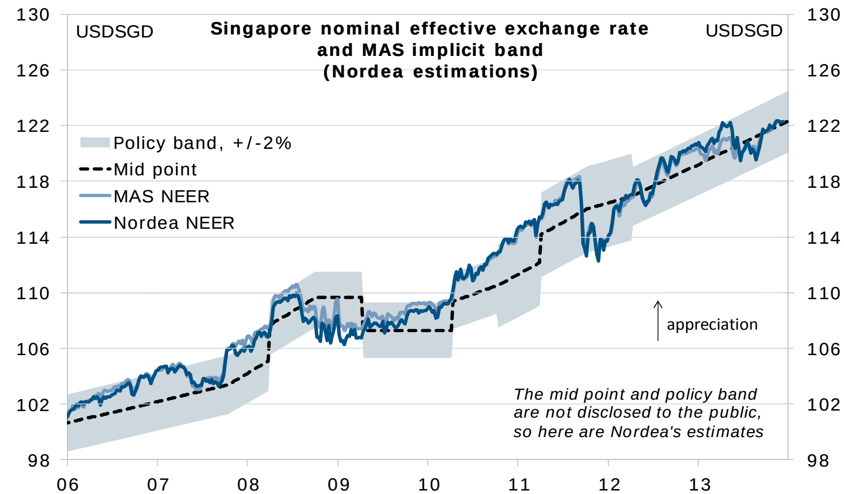
RUB stable vs USD and stronger vs EUR

SGD: Tapering-proof

The SGD is likely to stay at the current level (1.25) for a while. Due to its mature financial markets and strong balances, its safe haven status remains intact.

- The spot SGD has always tracked the NEER. After strengthening almost non-stop for years, both the spot and the NEER are at historically high levels.
- The spot SGD has lost vs the USD on three occasions: during the Asian crisis in 1997 and after the Lehman shock in 2008 and the US downgrade in 2011.
- During the tapering-initiated EM selloff earlier this year, the SGD proved to be quite resilient. It fluctuated around 1.25, a level which it is likely to stay for some time.
- Singapore is seen as a regional safe haven in Asia due to its impressively large surpluses (C/A surplus of 20% of GDP and public finances 5% of GDP).
- In addition, Singapore is expected to deliver robust growth this and next year (3.8% and 3.9%) according to a central bank survey.

Stay resilient at 1.25



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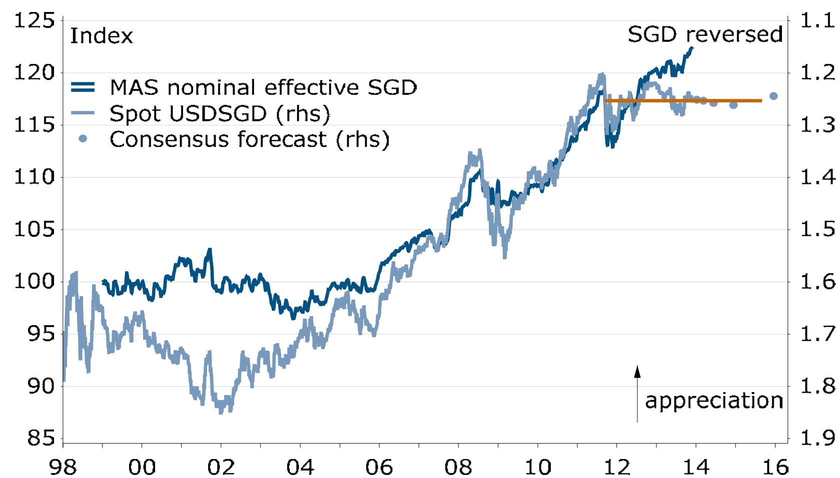
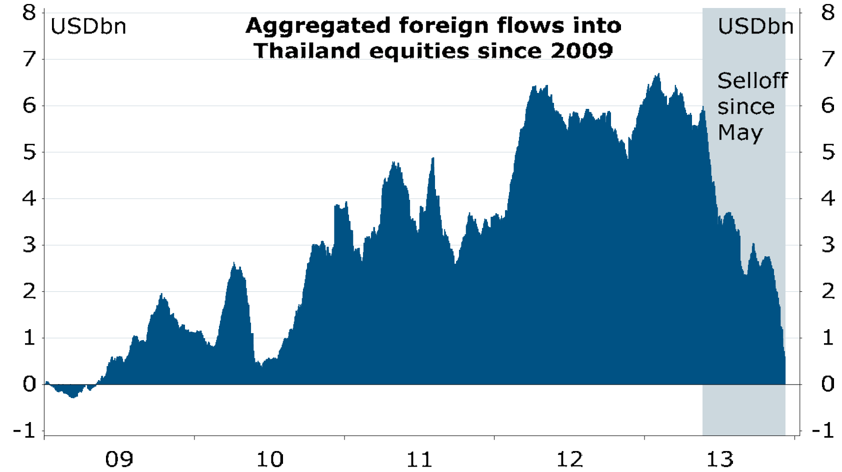


Source: Reuters Ecowin and Nordea Markets

THB: The triple whammy

Despite relatively strong fundamentals, the THB may face downward pressure from three negatives: political turmoil, growth deceleration and EM selloff triggered by renewed taper talk.

- Thailand's political riot over the past month escalated when the protesters rejected Premier Yingluck Shinawatra's election call. They insist to overthrow her for a royally appointed leader.
- The THB has weakened 3.2% since 1 November and foreign investors have sold a net of USD 2.1bn of Thai equities in the same period. The large uncertainty will lead to more capital flight.
- Without the political turmoil, Thailand might have been able to escape a new round of EM selloff, triggered by renewed taper talk. But now, the country risk has heightened and investors cannot flee fast enough.
- Thailand's growth outlook has deteriorated to just 2.7% in Q3. Consumption and investment vanished once the post-flood stimuli faded.



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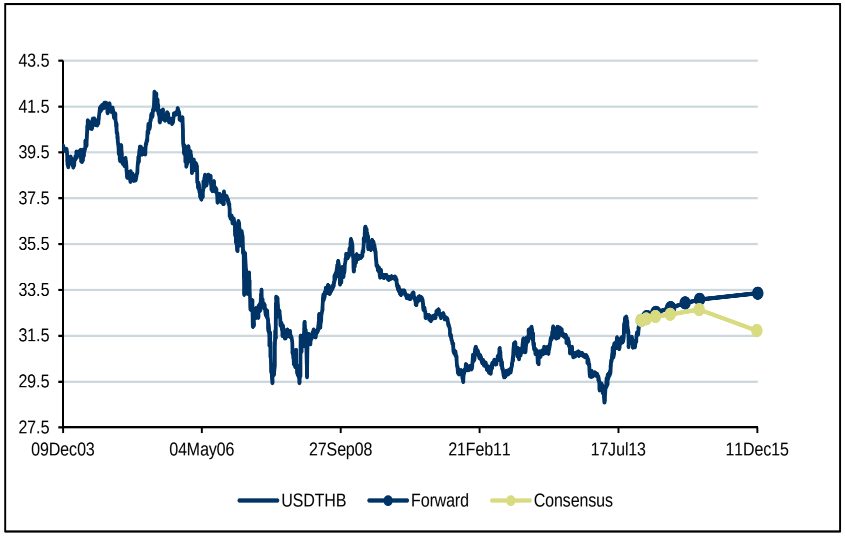


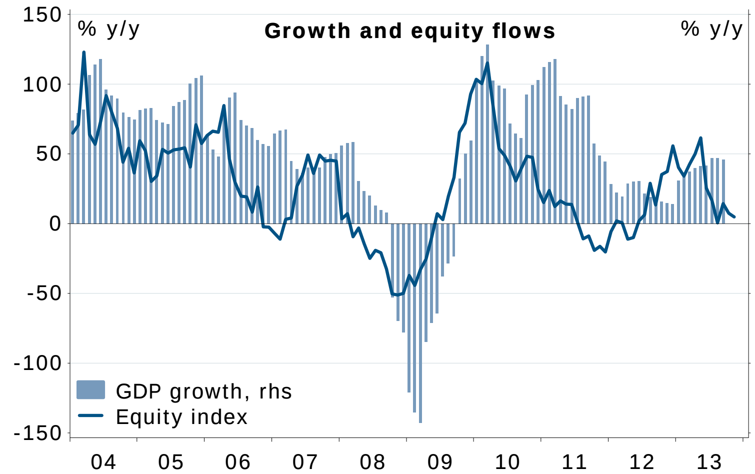
Three negative forces a drag on THB

TRY: Vulnerability to persist

The Turkish lira remains vulnerable to shifts in global risk appetite due to Turkey's large external funding requirements.

- Q3 GDP growth surprised on the upside, at 4.4% y/y, as strong domestic demand and investment offset weaker exports.
- Tightened liquidity, higher bank lending rates and macroprudential measures will likely lower domestic demand momentum looking ahead.
- Yearly inflation eased to 7.3% in November from a high of 8.9% in July, but is still uncomfortably high and well above the CBRT's target.
- We expect the CBRT to finally start hiking rates in H2 2014, indicating a move towards more conventional monetary policy, which will be crucial for determining the future path of the TRY.
- In 2014, we see a weaker TRY against the USD and a slightly stronger TRY versus the EUR. The balance of risk for both forecasts is tilted towards further weakness.

Monetary policy crucial for TRY path



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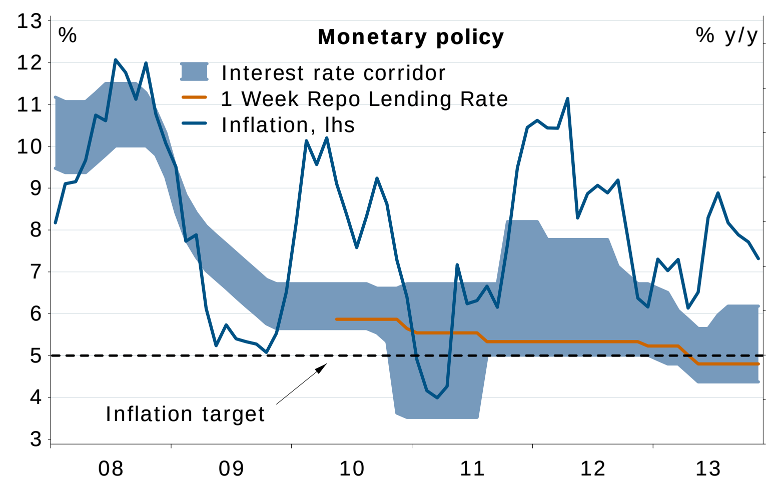


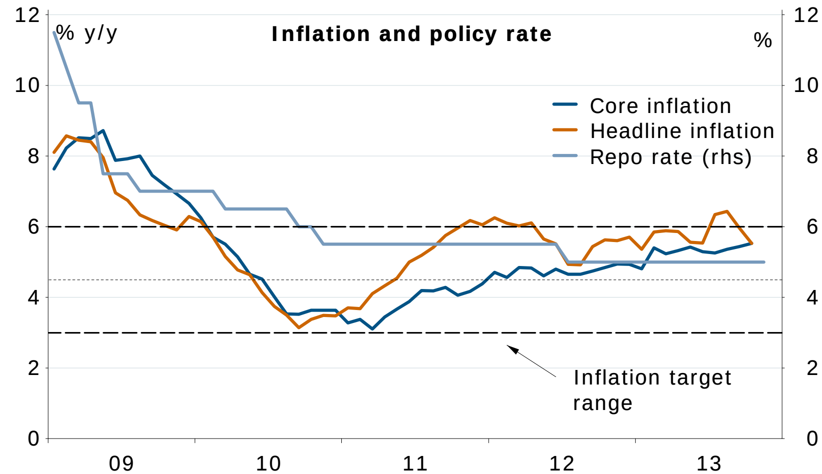
Source: Nordea Markets and Reuters Ecowin

ZAR: Weakness is here to stay!

We expect domestic uncertainties, external imbalances and weak global demand to gradually weaken the South African rand going into 2014-15.

- During the EM selloff in August, South Africa's large C/A deficit was a main driver of the ZAR's weakness, as investors expected US Fed to taper.
- The C/A deficit has swelled to 6.8% of GDP, mainly due to a growing trade deficit, which is under pressure from the high oil prices.
- Q3 GDP growth slowed more than expected, underscoring the weak economic outlook. We expect growth around 1.5% for 2013.
- The SARB is challenged by ZAR weakness, large external financing requirements and inflation, but is still unlikely to hike rates in the near term.
- Elevated inflation coupled with stagnating economic activity adds to the trend of ZAR depreciation.
- SA risks a credit downgrade before end-2014.

Stagnating economic activity



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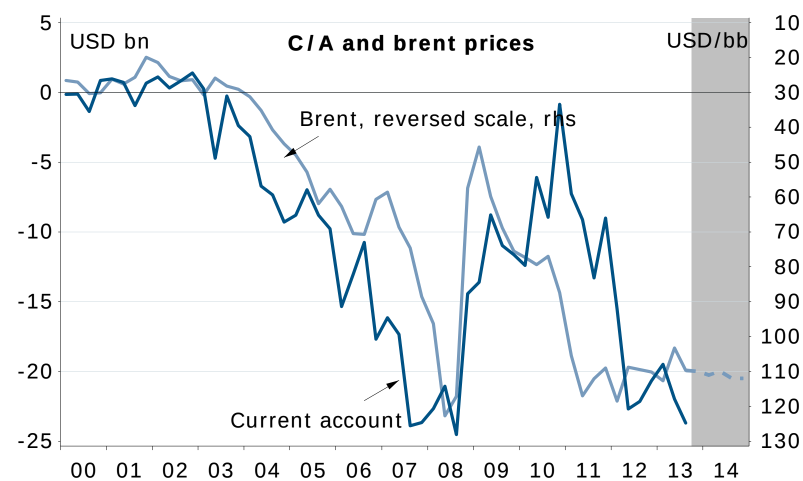

Source: Nordea Markets and Reuters Ecowin

Nordea FX forecasts

Exchange rates vs EUR

	12.12.13	3M	30.06.14	31.12.14	31.12.15
EUR/USD	1.38	1.33	1.30	1.25	1.20
EUR/JPY	141.40	129.01	136.50	137.50	132.00
EUR/DKK	7.46	7.46	7.46	7.46	7.46
EUR/SEK	9.03	8.60	8.45	8.35	8.35
EUR/NOK	8.44	8.10	8.35	8.25	8.20
EUR/GBP	0.84	0.84	0.83	0.81	0.78
EUR/CHF	1.22	1.25	1.25	1.30	1.35
EUR/PLN	4.18	4.15	4.05	4.00	3.95
EUR/CZK	27.43	27.00	27.00	26.40	25.60
EUR/HUF	303.37	305.00	300.00	290.00	285.00
EUR/RON	4.45	4.45	4.45	4.40	4.30
EUR/TRY	2.81	2.75	2.70	2.65	2.50
EUR/KZT	213.12	202.16	198.90	192.50	186.00
EUR/RUB	45.13	44.09	42.90	40.75	39.00
EUR/LVL	0.70	0.70	0.70	0.70	0.70
EUR/LTL	3.45	3.45	3.45	3.45	3.45
EUR/ZAR	14.32	13.70	13.52	13.13	12.72
EUR/CNY	8.38	8.11	7.80	7.44	7.02
EUR/INR	84.69	79.80	78.00	72.50	63.60
EUR/BRL	3.23	3.13	3.12	3.06	3.00
EUR/MXN	17.83	16.89	16.12	15.25	14.40

Exchange rates vs USD

	12.12.13	3M	30.06.14	31.12.14	31.12.15
-					
USD/JPY	102.54	97.00	105.00	110.00	110.00
USD/DKK	5.41	5.61	5.73	5.96	6.21
USD/SEK	6.55	6.47	6.50	6.68	6.96
USD/NOK	6.12	6.09	6.42	6.60	6.83
GBP/USD	1.64	1.58	1.57	1.54	1.54
USD/CHF	0.89	0.94	0.96	1.04	1.13
USD/PLN	3.03	3.12	3.12	3.20	3.29
USD/CZK	19.89	20.30	20.77	21.12	21.33
USD/HUF	220.45	229.32	230.77	232.00	237.50
USD/RON	3.24	3.35	3.42	3.52	3.58
USD/TRY	2.04	2.07	2.08	2.12	2.08
USD/KZT	154.47	152.00	153.00	154.00	155.00
USD/RUB	32.72	33.15	33.00	32.60	32.50
USD/LVL	0.51	0.53	0.54	0.56	0.59
USD/LTL	2.50	2.60	2.66	2.76	2.88
USD/ZAR	10.38	10.30	10.40	10.50	10.60
USD/CNY	6.07	6.10	6.00	5.95	5.85
USD/INR	61.38	60.00	60.00	58.00	53.00
USD/BRL	2.35	2.35	2.40	2.45	2.50
USD/MXN	12.93	12.70	12.40	12.20	12.00

Nordea rates forecasts

Monetary policy rates

Country	Spot	3M	30.06.14	31.12.14	31.12.15
United States	0.25	0.25	0.25	0.25	1.25
Japan	0.10	0.10	0.10	0.10	0.10
Euroland	0.25	0.25	0.25	0.25	0.75
Denmark	0.20	0.20	0.20	0.40	1.00
Sw eden	1.00	1.00	1.00	1.25	1.75
Norw ay	1.50	1.50	1.25	1.00	1.00
United Kingdom	0.50	0.50	0.50	0.50	1.25
Sw itzerland	0.00	0.00	0.00	0.00	0.75
Poland	2.50	2.50	2.50	3.00	3.50
Russia	8.25	5.25	5.25	5.00	4.75
China	6.00	6.00	6.00	6.25	6.50
India	7.75	8.00	8.00	7.50	7.00
Brazil	10.00	10.25	10.25	10.50	11.00
Czech Republic	0.05	0.05	0.05	0.05	0.50
Hungary	3.20	2.80	2.80	2.80	3.50
Romania	4.00	3.75	3.50	3.50	3.50
Turkey	4.50	4.50	4.50	5.50	6.00

10-year government

Country	Spot	3M	30.06.14	31.12.14	31.12.15
United States	2.83	2.75	2.90	3.25	3.90
Euroland	1.83	1.75	2.10	2.40	2.75
Denmark	1.89	1.85	2.20	2.50	2.85
Sw eden	2.34	2.40	2.85	3.15	3.50
Norw ay	2.86	2.86	3.13	3.37	3.40
United Kingd	2.89	2.80	3.00	3.25	3.75
Poland	4.41	4.50	4.80	5.00	5.20

3-month rates

	Spot	3M	30.06.14	31.12.14	31.12.15
United States	0.24	0.30	0.35	0.55	1.60
Euroland	0.27	0.20	0.20	0.20	0.75
Denmark	0.26	0.30	0.35	0.45	1.00
Sw eden	1.05	1.25	1.25	1.60	2.30
Norw ay	1.64	1.70	1.38	1.20	1.20
United Kingd	0.52	0.50	0.50	0.60	1.40
Poland	2.65	2.75	2.80	3.25	3.75
Russia	7.01	6.75	6.55	6.45	6.50
Latvia	0.25	0.20	0.30	0.35	1.00
Lithuania	0.40	0.50	0.50	0.35	1.00
Czech Repul	0.38	0.45	0.50	0.65	1.30
Hungary	3.17	3.50	3.50	3.60	4.60

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