# Emerging Markets View

## February 2019: The commodities' shadow

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EM FX has lost ground against the USD during February, lending support to our generally cautious view of these currencies this year. One of the many risks we see for EM FX is a possible decline in commodity prices, owing to an expected global slowdown and the subsequent reduction in demand for commodities. That will likely hurt EM FX in general, as the group is a net commodity exporter. In particular, the RUB, the KZT and the MXN are vulnerable to a big drop in energy prices. The CLP, the PEN and the BRL are sensitive to swings in metal prices. The BRL and the ARS would also be at risk if the US-China trade were to result in China buying more soybeans from the US than from these two countries. The good news is that another round of commodity and EM FX carnage similar to that of 2014-15 is very unlikely, thanks to the producers' plans to control supply and infrastructure demand from China. Moreover, EM producers' efforts to diversify their economies away from commodities should help the EM FX to decouple gradually from commodity prices.

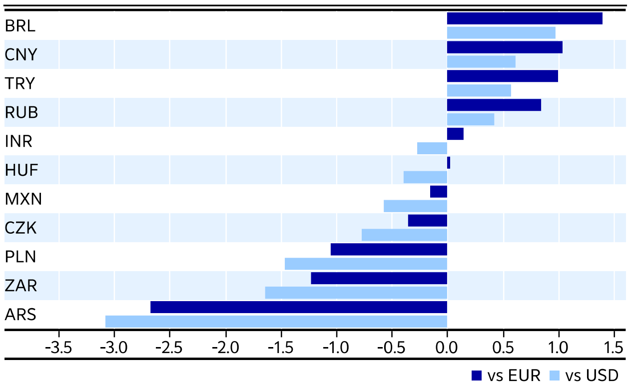
### CNY: Wake-up call
Optimistic expectations about the US-China trade talks pushed the CNY to overbought territory. The latest trade talk developments remind the market that uncertainty remains high. In our view, the risks to the CNY are tilted to the downside.

### RUB: In a sweet spot
The RUB has been performing quite well since the beginning of the year. However, volatility is likely to return as sanctions risks come back in focus.

### PLN: More downside risk in the short term
The Polish zloty is being pressured on several fronts. Unless the general EM sentiment improves, the upward pressure on the EUR/PLN will likely persist.

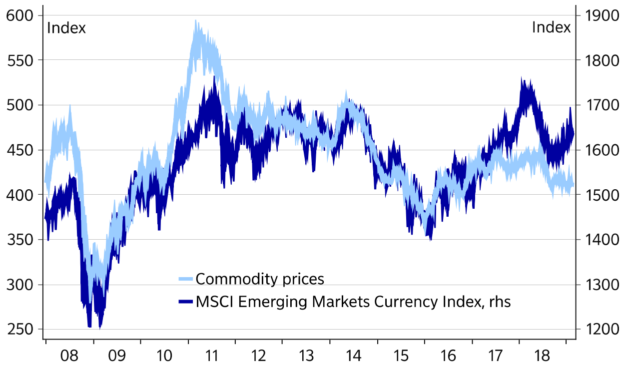
### In focus – RON: Not a laughing matter
A new package of taxes is causing uncertainty in Romania and prompted a weakening of the RON to record levels over the past two months. It is still unclear how this situation will play out, and we see no signs of a relief.


**EM FX PERFORMANCE SINCE OUR LAST EM VIEW, %**




Source: Nordea and Macrobond

**CLOSE LINK BETWEEN EM FX AND COMMODITY PRICES**




Source: Nordea and Macrobond

# The commodities' shadow

Despite EM commodity producers' efforts to diversify their economies, EM FX remains largely correlated with commodity prices. An expected global slowdown this year increases the downside risk to commodity prices and EM FX.

Commodity price drop is a risk for EM FX

Emerging markets' currencies face many risks this year. One of these risks is declining commodity prices, as the expected global slowdown raises the uncertainty surrounding the demand for commodities.

EM FX tracks commodity prices closely

EM FX has moved in tandem with commodity prices in the past. During the 2014-15 "commodity carnage", EM FX lost 15% against the USD. Both asset classes posted a v-shaped recovery in 2016-17. Currencies of commodity exporters, such as the RUB, the ZAR, the BRL and the CLP, led the gains among EM FX during this period.

Emerging markets are a net commodity producer and sensitive to commodity prices

The close link between EM FX and commodity prices is not hard to explain. Emerging markets, as a group, are a net commodity exporter. Higher commodity prices, regardless of demand or supply reasons, boost the dollar revenues for the producers and thereby their demand for local currencies.

If higher commodity prices are related to the expectation of a global expansion, the subsequent risk-on environment also buoys EM FX. That was the case during 2016-17, when the global recovery increased demand for raw materials and risk appetite.

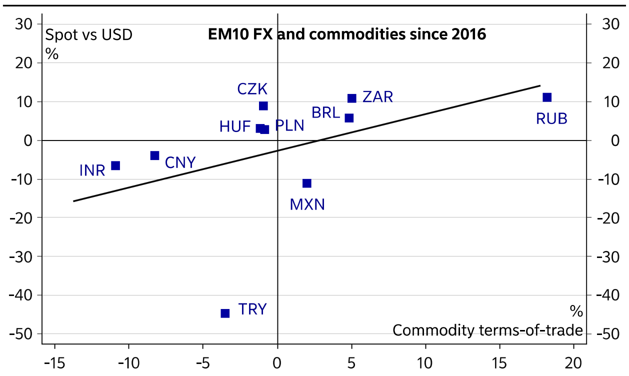
Global growth concerns are rising

However, the tides are shifting. Tighter financial conditions in the US, the US-China trade war and geopolitical uncertainties in Europe have sparked concerns about a global slowdown. That increases the downside risk for commodity prices and EM FX this year.

A commodity price collapse is not very likely, in our view

The likelihood of a commodity price collapse, like in 2014, is small though. The large oil producers' plans to control supply and infrastructure demand from China mitigate that risk.

**EM FX AND COMMODITY PRICES MOVE CLOSELY TOGETHER**




Source: Nordea and Macrobond

**CHINESE STIMULUS SUPPORTS COMMODITY DEMAND**

| China, 2017 | Consumption as share of world total | Imports as share of world total | Rank as consumer |
|---|---|---|---|
| **Fossil fuels** | | | |
| Oil | 13% | 19% | 2nd |
| Natural gas | 7% | 8% | 3rd |
| Coal | 51% | 14% | 1st |
| Carbon emission | 28% | N/A | 1st |
| **Metals** | | | |
| Iron ore | 64% | 66% | 1st |
| Steel | 47% | 4% | 1st |
| Copper | 47% | 27% | 1st |
| Gold | 34% | 15% | 1st |
| **Agriculture products** | | | |
| Rice | 30% | 12% | 1st |
| Corn | 24% | 2% | 2nd |
| Wheat | 16% | 2% | 1st |
| Soybean | 32% | 61% | 1st |

Source: Nordea, BP, IEA, The CIA's World Factbook, US Department or Agriculture

EM countries have tried to reduce their dependence on commodities

Another potential mitigating factor is improving macro policies in EM countries that aim to limit vulnerability to swift commodity price swings. In the decade after the 1998 financial crisis, some EM countries started to make their fiscal policy more rule-based. Among the most recent adopters are commodity exporters (ie Mexico, Russia, Colombia, Paraguay and Peru).

Russia is a good example

Russia is a vivid example of this trend, as its new fiscal rule adopted in 2017 has already allowed for an increase in the country's FX reserves of almost USD 100bn in two years and for a dramatic reduction in the correlation between the RUB and oil prices.

EM FX's link to commodity prices has weakened

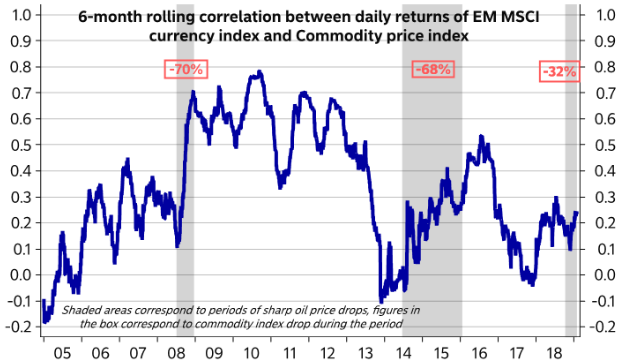
Wider implementation of countercyclical fiscal policies may be one of the reasons for the recently declining correlation between EM currencies and commodity prices, as evidenced by the three latest periods of sharp drops in commodity prices (2008, 2014-16 and 2018).

**But commodity prices still pose a risk to EM FX this year**

Even though macroprudential policies are likely to soften the negative impacts on EM FX stemming from possible drops in commodity prices, we still note that currencies of fuel exporters (ie Russia, Kazakhstan and Mexico) may be at risk in 2019.

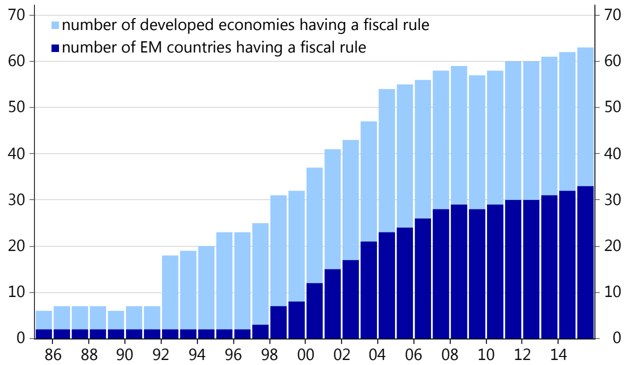
The RUB example illustrates that fiscal rules make a currency immune to oil price swings only up to a certain point. The currency almost did not react to the oil price drop from USD 85/bbl to USD 60/bbl in Q4 2018. However, a sharp drop from USD 60/bbl to USD 50/bbl (close to the Russian budget breakeven price) in December was quite painful for the RUB.

### EM FX AND COMMODITY LINK HAS WEAKENED OVER TIME




Source: Nordea and Macrobond

### EM COUNTRIES ADOPTED MACROPRUDENTIAL POLICIES




Source: Nordea and Macrobond

**Metal producers are vulnerable as well...**

Much like energy exporters, metal producers are equally vulnerable to a global slowdown. The most illustrative example is copper, which is widely used in industrial production and considered a "bellwether" for the global economy.

**...with risks particularly for the CLP**

The Chilean peso comes out on top as the currency that is most exposed to copper prices. Chile is the global leader in copper production, and copper exports account for around 50% of the country's total exports. China is the main buyer of Chilean copper and recent signs of a Chinese growth slowdown are worrying.

**...and for the PEN**

Peru is another major copper producer, which means that the PEN is highly exposed to the red metal too, although the risk is lower as its economy is less dependent on copper than Chile's. However, sound fiscal policy rules in both countries reduce the risk.

**The BRL is sensitive to soybean prices...**

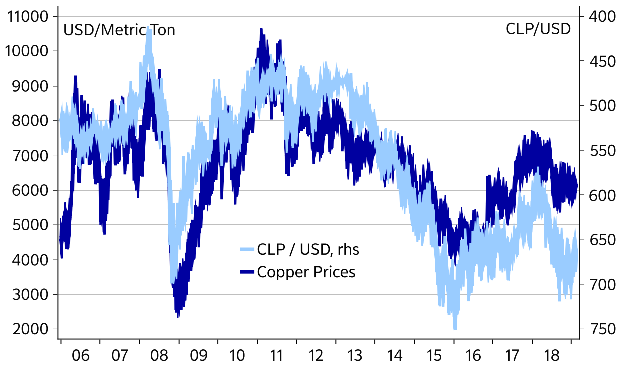
The US-China trade war has put soybeans in the spotlight and added uncertainty to the BRL. Brazil is the second-largest soybean producer globally after the US. China is the main purchaser of Brazilian soybeans. As such, developments in the US-China trade talks stand to impact Brazil's soybean exports to China and the BRL this year.

**...as is the ARS**

Argentina is a large soybean producer as well, although the link between the ARS and soybean prices is not as tight. Nevertheless, the magnitude of Argentina's soybean production relative to the GDP is noteworthy. Therefore, any Chinese desire to buy more American soybeans will be closely tracked by Argentinean farmers over the coming quarters. This adds to the downside risks to the ARS this year.

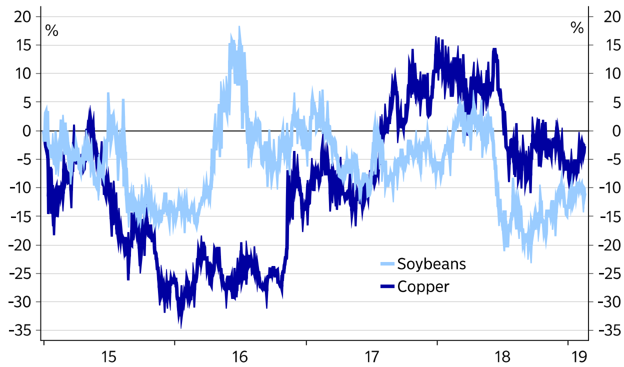
*By Amy Zhuang, Tatiana Evdokimova and Nick Fisker*

### CLP IS THE MOST SENSITIVE FX TO COPPER PRICES




Source: Nordea and Macrobond

### SHARP DECLINE IN COPPER AND SOYBEAN PRICES IN 2018




Source: Nordea and Macrobond

# CNY: Wake-up call

Optimistic expectations about the US-China trade talks pushed the CNY to overbought territory. The latest trade talk developments remind the market that uncertainty remains high. In our view, the risks to the CNY are tilted to the downside.

**CNY sentiment has turned sour lately**

The general sentiment towards the CNY is still dictated by the progress of the US-China trade talks, which have turned sour recently. Mixed signals from the latest round of meetings in mid-February suggest that an agreement to end the tariff war permanently is far from settled.

**The CNY is overbought owing to optimistic expectations about a trade deal**

The market has been highly optimistic about the negotiations, which was reflected in the CNY's strength since the beginning of the year. However, most technical indicators suggest that the CNY is overbought. The spot CNY returned to its 200-day moving average for the first time since June 2018, when the first round of tariffs was announced.

**Room for disappointment gives downside risks to the CNY**

Accordingly, room for disappointment in the trade talks implies that the CNY faces larger downside than upside risks – this is the same warning that we issued in our last EM View.

**A postponement of the 1 March deadline will keep volatility high**

The sticking point of the trade discussions is supposedly China's intellectual property protection framework, technology transfer and how the US can monitor that China is delivering on its promises.

Despite speculation about the truce deadline of 1 March being pushed back by 60 days, this would merely be an act of kicking the can down the road. In fact, the pressure for a deal to be made ahead of the new deadline (1 March + 60 days) has increased. The volatility in the CNY will likely remain elevated in the coming months.

**Deceleration of growth adds to our bearish view of the CNY this year**

Adding to our cautious view of the CNY is the deceleration of growth, as recent data continued to disappoint. Even though data at the beginning of the year should be taken with a pinch of salt owing to distortions from the Chinese New Year, anecdotal evidence confirms that the outlook is not too bright.

*By Amy Yuan Zhuang*

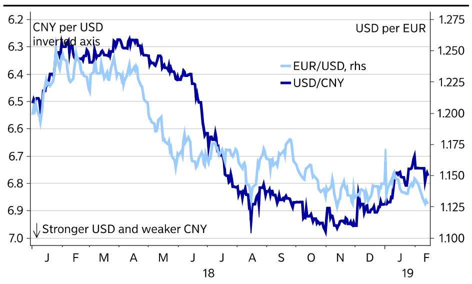
**RISK FACTORS**

- Negative surprises in trade talks
- A sharp growth slowdown
- Mismanaged currency reform

**EM TRAFFIC LIGHT**

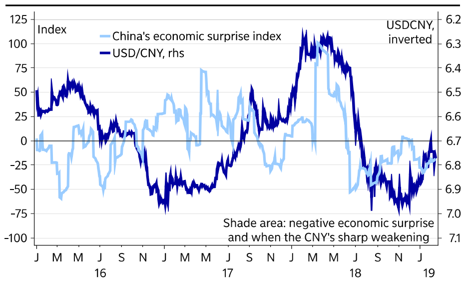
- Risk level: 11% (green, -1 pp from the previous month)
- Downside risk to growth

**CNY DOWNSIDE WITH SENTIMENT REVERSAL**




Source: Nordea Markets and Macrobond

**MACRO DATA IS ALSO CNY-NEGATIVE**




Source: Nordea and Macrobond

**FINANCIAL FORECASTS – CHINA**

Our USD/CNY forecasts are unchanged, and we still see risks to the CNY this year as being tilted to the downside. The CNY only saw improved momentum because a trade agreement was priced in by the market. While we expect a nominal trade deal to be made, we doubt that all tariffs will be removed. Mixed signals from the trade talks suggest uncertainty will remain high, which will weigh on the CNY against the USD, especially in H1 2019.

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| USD/CNY | 6.77 | 6.90 | 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: Too good to be true

The RUB has been performing quite well since the beginning of the year. However, volatility is likely to return as sanctions risks come back in focus.

The RUB is one of the best performing EM currencies since the start of the year

The RUB was enjoying, to the fullest, the general EM recovery fuelled by a softer Fed and hopes around a potential US-China deal. The oil price settled above the psychologically important USD 60/bbl threshold, which provided additional support. The sovereign rating upgrade from Moody's to investment level was another reason behind the strong appetite for Russian assets. As a result, by mid-February, the RUB appreciated by 5.8%, thereby showing the best performance among EM currencies.

Sanctions risks were almost forgotten by the market

With limited sanctions talk since autumn 2018 (except positive news on Rusal delisting from the SDN list), the market started to forget about sanctions. The country risk premium, as measured by CDS, has narrowed to just 130 points (lower than before the August sanctions wave). Foreign investors came back aggressively, buying record amounts of RUB-denominated bonds and stocks. RUB volatility briefly decreased below that of the EM average, touching the lowest level since the April sanctions episode. The RUB appreciated all the way to the robust support level of 65.5 vs the USD, and was about to test it, but a new wave of sanctions threats spoiled the party.

Sanctions risks set to come back in focus

As a new sanctions bill is being pushed forward through the US Congress, news flow on the subject will intensify in the coming months. Even though there is still a long way to go before new waves of sanctions are implemented (if implemented at all), this topic will again become the focus of the market, promising more pressure on the RUB and more volatility. As the market is warned that sanctions risks are not off the table, the levels around 65.5 vs the USD and 74 vs the EUR should remain the limit for RUB appreciation.

*By Tatiana Evdokimova*

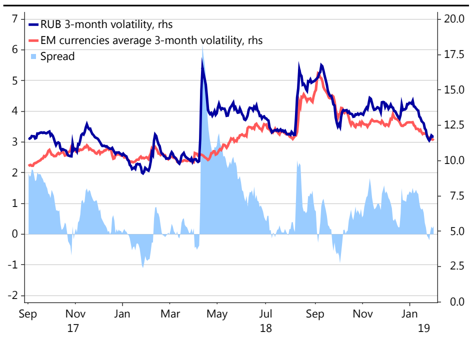
**RISK FACTORS**

- Sanctions are pushed rapidly through Congress
- Concerns about a global slowdown re-emerge
- Fed switches to harsher rhetoric

**EM TRAFFIC LIGHT**

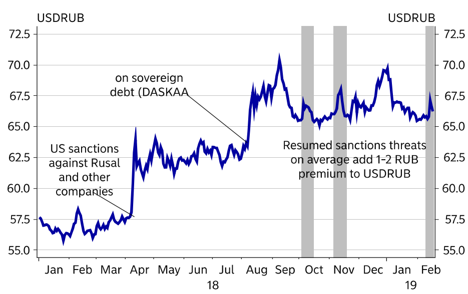
- Risk level: 29% (yellow; +6 pp from the previous month)

**RUB VOLATILITY BRIEFLY BELOW EM AVERAGE**




Source: Nordea and Macrobond

**THE PRICE OF HIGHER SANCTIONS RISKS IS RUB 1-2**



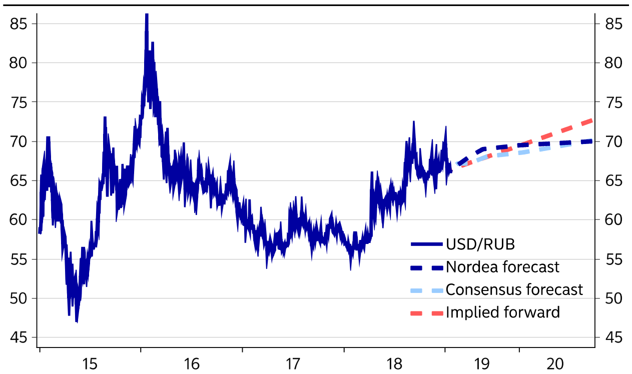

**FINANCIAL FORECASTS — RUSSIA**

Sanctions risks remain central for the RUB, even though the market is gradually getting used to them. If sanctions talk intensifies, the RUB may face more downside pressure in the coming months. However, the likelihood of negative tail scenarios is low, thanks to Russia's strong fundamentals. Prices responded moderately to the VAT hike, making fast monetary tightening less likely. Given that external risks are numerous, we still see the possibility of one to two rate hikes this year.

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| USD/RUB | 66.6 | 68.0 | 69.0 | 69.5 | 70.0 |
| Policy rate | 7.75 | 8.00 | 8.25 | 8.25 | 7.75 |

Source: Nordea estimates

**USD/RUB FORECASTS**




Source: Nordea estimates and Macrobond

# PLN: More downside risk in the short term

The Polish zloty is being pressured on several fronts. Unless the general EM sentiment improves, the upward pressure on the EUR/PLN will likely persist.

**EUR/PLN testing the 4.35 threshold**

The EUR/PLN has increased in February and is testing levels close to 4.35, which has functioned as the upper threshold since last autumn. The pressure on the zloty is caused by three factors, all of which we expect to continue to weigh on the currency in the short term.

**A stronger USD typically leads to a weaker PLN**

First, owing to geopolitical uncertainty and fears of global growth slowing, the USD has strengthened somewhat, which usually correlates with a weaker zloty (see left-hand chart below). Although we do not expect the dollar to appreciate much more from current levels in the short term, we do expect it to remain strong, especially against EM currencies.

**The Polish economy is feeling the pain from slowing Euro area growth**

Second, as we flagged in the latest EM View, the weakening momentum in the European industrial cycle has led to negative spillovers to the Polish economy and the PLN (see right-hand chart). In line with the recent sluggish PMI figures from the Euro area, we judge that this underlying pressure should continue to drag the PLN downwards.

**Expect inflation forecasts to be revised down in March**

Third, the central bank is still on a very defensive path. Thus, more fuel has been added to the dovish NBP fire as the government has decided to freeze electricity prices at the 2018 level, and combined with lower oil prices, it is likely that inflation will remain below 2% in 2019. Consequently, the risk is also clearly tilted towards a downward revision of the inflation and growth forecasts in the inflation report due at the next central bank meeting in March.

In sum, the negative factors for the PLN are currently outweighing the positive – especially on the domestic front in terms of inflation, slower growth (although still above potential) and politics. Therefore, it is hard to see the PLN rallying in the short term unless the general EM sentiment (the external side) improves by means of either a weaker dollar or lower US treasury yields.

*By Morten Lund*

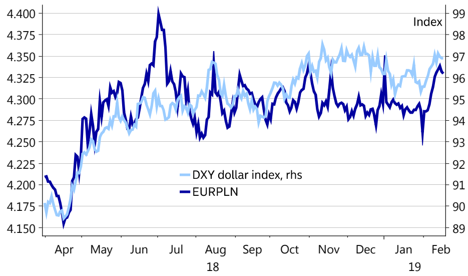
### RISK FACTORS

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

### EM TRAFFIC LIGHT

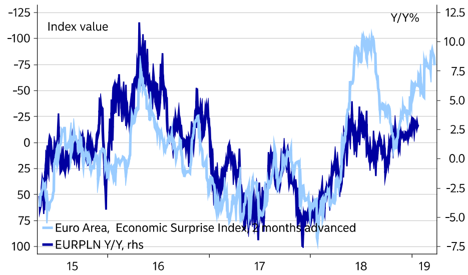
- Risk level: 12% (green, unchanged from the previous month)

### PLN DRIVEN BY RISK SENTIMENT...




Source: Nordea and Macrobond

### ...AND NEGATIVE SPILLOVERS FROM THE EA




Source: Nordea and Macrobond

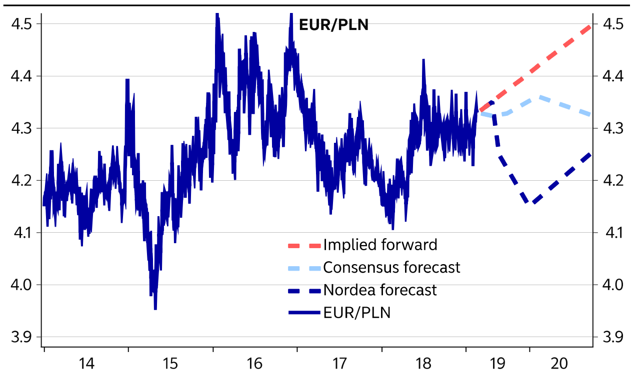
### FINANCIAL FORECASTS – POLAND

Owing 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 4.35 in the short term. Further ahead, 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 | 4.35 | 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 estimates and Macrobond

# RON: Not a laughing matter

A new package of taxes is causing uncertainty in Romania and prompted a weakening of the RON to record levels over the last two months. It is still unclear how this situation will play out, and we see no signs of a relief.

**Markets surprised by tax measures**

Romania's shocking package of tax measures launched in an attempt to address the budget deficit continues to put pressure on the RON. In particular, the tax on banks' financial assets, which was introduced unexpectedly last December, sent stocks tumbling and the EUR/RON rising to new highs of 4.77 at the end of January. There has been no real recovery yet.

**The central bank's hands are tied**

The newly introduced bank tax is tied to the ROBOR money market rate. This leaves the central bank dangerously defenceless against rising inflation or movements in the exchange rate, as increasing the policy rate would lead to higher bank taxes and pose risks to financial stability.

**Inflation landed within target range**

The fact that inflation stood at 3.3 percent, within the central bank's target range, in January is a small relief considering its high inflation track record from the past year and the inflationary pressures that may arise from the new tax measures. Nonetheless, we confidently expect the policy rate to stay at its current level of 2.5 percent for the coming year based on the central bank's forward guidance.

**Criticism about budget plans creates credibility issues**

The latest developments in Romania come on top of current uncertainty surrounding the growing twin deficits. The Romanian government had already been under pressure from Brussels concerning corruption practices and its fiscal deficit of 2.9 percent. Now, the Romanian government has received angry letters from the ECB, the EBRD and the IFC for having neither consulted them nor assessed the impacts of the tax measures.

The budget plan for 2019 was finally approved last Friday, providing some clarity. The budget targets a fiscal deficit of 2.76 percent, but is said by some to be based on unrealistic growth prospects. We view the RON as facing mainly downside risks from the political, fiscal and financial unrest and from the limited room for manoeuvre for the central bank.

*By Inge Klaver*

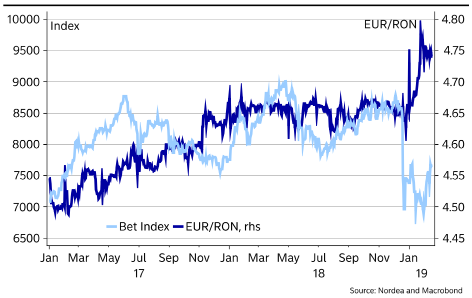
### RISK FACTORS

- Inflation
- Threat to financial stability
- Capital outflow

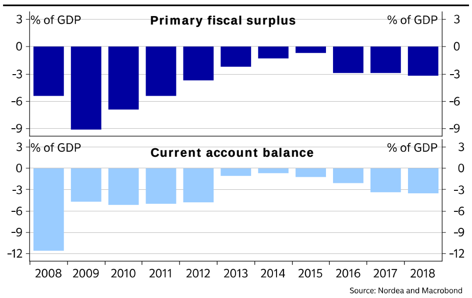
### EM TRAFFIC LIGHT

- Risk level: 13% (green, -3 pp from the previous month)

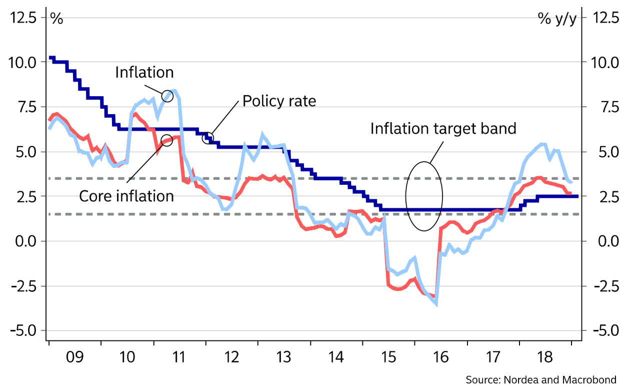
### STOCK MARKET TUMBLE AT THE END OF 2018



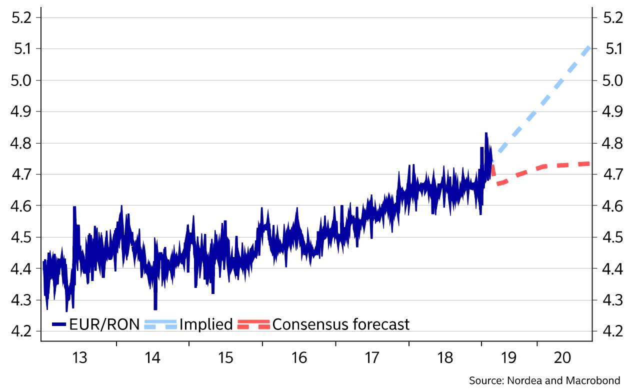

### GROWING TWIN DEFICITS




### INFLATION WITHIN TARGET




### EUR/RON FORECAST



# Hedging considerations

## CNY vs EUR

### Income

Nordea sees downside risk for the CNY, ie a high hedge ratio in the short term, using mainly FX forwards as EUR/CNY forward premiums are below EUR/CNY forecasts; a high hedge ratio in the long term, using mainly FX forwards and zero-cost option strategies, eg participating forwards.

### Expenses

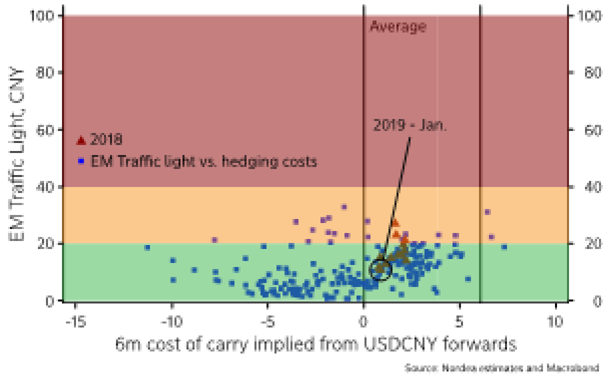
A low hedge ratio in the short term, using FX forwards and zero-cost strategies; a higher hedge ratio in the long term, using mainly FX forwards. Our forecast converges with forwards towards the end of 2020.

**NORDEA ESTIMATES**

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| EUR/CNY | 7.72 | 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**




| Implied ATM vol (6M) | 25D RR (6M) | Forward (6m) |
|---|---|---|
| 6.28 | -0.04 | 7.75 |

*Source: Bloomberg*

## RUB vs EUR

### Income

A middle hedge ratio in the short term, using mainly FX forwards; a middle to high hedge ratio in the long term, using forwards and zero-cost option strategies.

### Expenses

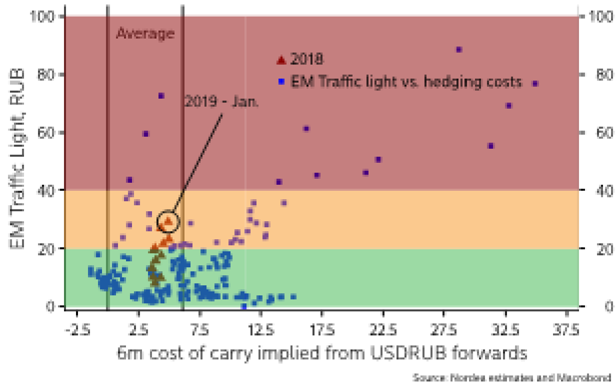
A middle hedge ratio in the short term, using a mix of forwards and zero-cost option strategies, eg risk reversals, benefiting from cheap RUB calls and expensive RUB puts; a high hedge ratio in the long term, using FX forwards and benefiting from high forward premiums.

**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 | 7.75 | 8.00 | 8.25 | 8.25 | 7.75 |

Source: Nordea estimates

**COST OF CARRY VS RISK LEVEL**




| Implied ATM vol (6M) | 25D RR (6M) | Forward (6m) |
|---|---|---|
| 12.25 | 3.42 | 77.68 |

*Source: Bloomberg*

## PLN vs EUR

### Income

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

### Expenses

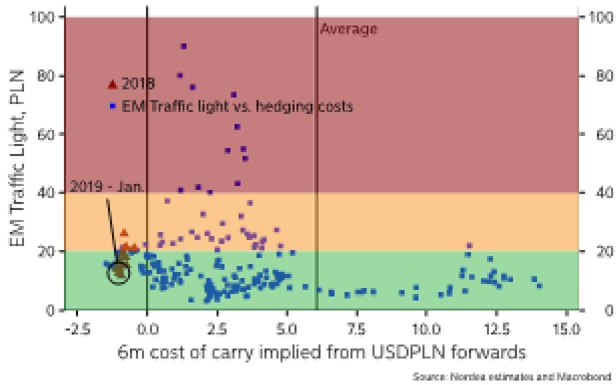
A low to middle hedge ratio in the short term, using a mix of FX forwards and zero-cost option strategies; a high hedge ratio in the long term, using FX forwards, mainly to take advantage of high forward premiums on EUR/PLN.

**NORDEA ESTIMATES**

| Forecasts | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| EUR/PLN | 4.29 | 4.35 | 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**




| Implied ATM vol (6M) | 25D RR (6M) | Forward (6m) |
|---|---|---|
| 5.08 | 1.25 | 4.38 |

*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 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ARS | Argentina | 33% | | | | | | | | | |
| RUB | Russia | 29% | | | | | | | | | |
| BRL | Brazil | 26% | | | | | | | | | |
| CLP | Chile | 25% | | | | | | | | | |
| ZAR | South Africa | 23% | | | | | | | | | |
| SAR | Saudi Arabia | 21% | | | | | | | | | |
| CZK | Czech Republic | 21% | | | | | | | | | |
| HUF | Hungary | 20% | | | | | | | | | |
| ILS | Israel | 19% | | | | | | | | | |
| KZT | Kazakhstan | 18% | | | | | | | | | |
| MXN | Mexico | 18% | | | | | | | | | |
| COP | Colombia | 18% | | | | | | | | | |
| BGN | Bulgaria | 17% | | | | | | | | | |
| RSD | Serbia | 17% | | | | | | | | | |
| PEN | Peru | 17% | | | | | | | | | |
| TWD | Taiwan | 17% | | | | | | | | | |
| KRW | South Korea | 15% | | | | | | | | | |
| KES | Kenya | 15% | | | | | | | | | |
| UAH | Ukraine | 14% | | | | | | | | | |
| TRY | Turkey | 14% | | | | | | | | | |
| SGD | Singapore | 14% | | | | | | | | | |
| RON | Romania | 13% | | | | | | | | | |
| PLN | Poland | 12% | | | | | | | | | |
| HRK | Croatia | 12% | | | | | | | | | |
| MYR | Malaysia | 12% | | | | | | | | | |
| PHP | Philippines | 11% | | | | | | | | | |
| HKD | Hong Kong | 11% | | | | | | | | | |
| CNY | China | 11% | | | | | | | | | |
| THB | Thailand | 10% | | | | | | | | | |
| INR | India | 9% | | | | | | | | | |
| IDR | Indonesia | 8% | | | | | | | | | |
| NGN | Nigeria | 4% | | | | | | | | | |
| EGP | Egypt | 2% | | | | | | | | | |
| | 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: January 2019 (4 February)
- New signals: ARS to yellow from green; no changes from green from yellow
- Biggest changes: ARS (+21% points) and the ZAR (-5% points)

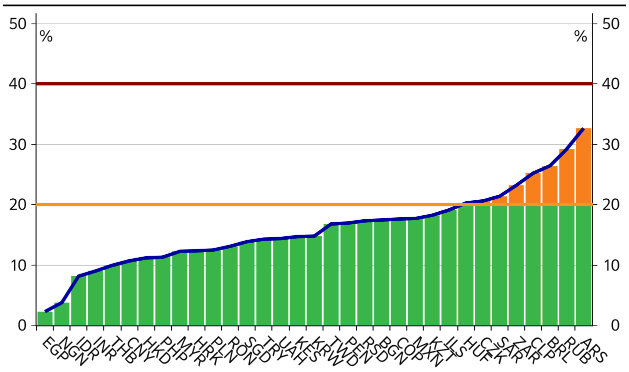
## Methodology note:

- EM Traffic Light: Methodology note

## Track record:

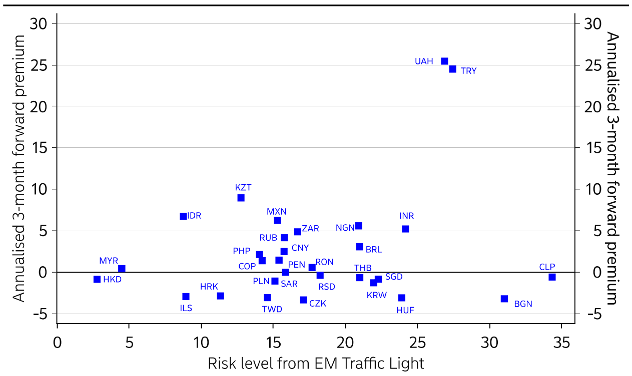
- EM Traffic Light: Track record – January 2019

### OVERALL RISK LEVEL




Source: Nordea estimates and Macrobond

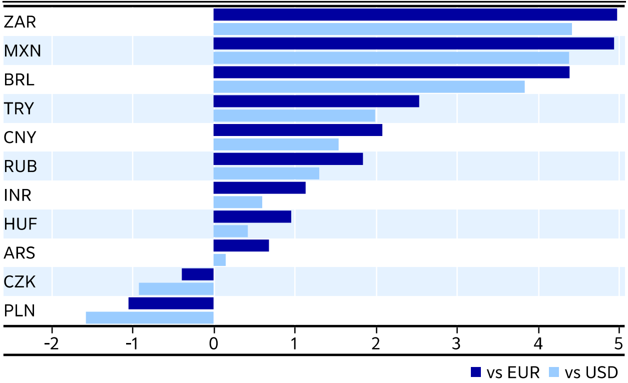
### TRAFFIC LIGHT VS COST OF CARRY




Source: Nordea and Macrobond

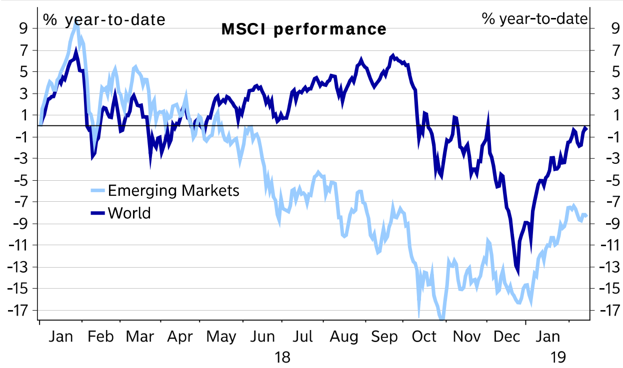
# Emerging market performance

## YTD EM FX PERFORMANCE



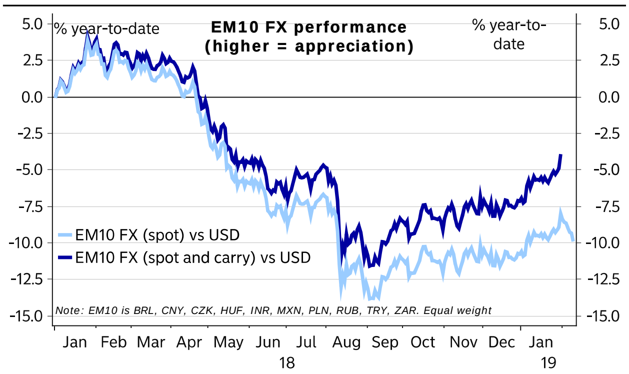

Source: Nordea and Macrobond

## EQUITIES PERFORMANCE



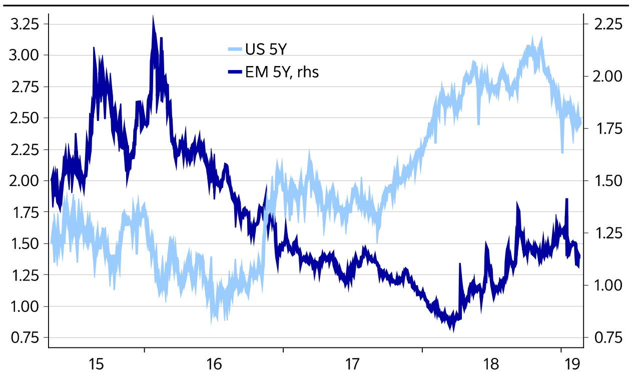

Source: Nordea and Macrobond

## FX PERFORMANCE, CARRY ADJUSTED



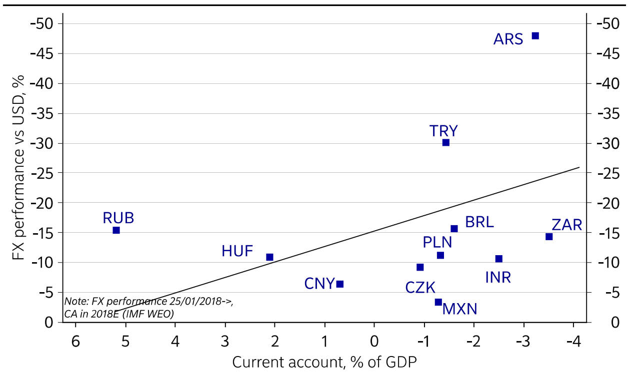

Source: Nordea and Macrobond

## SWAPS



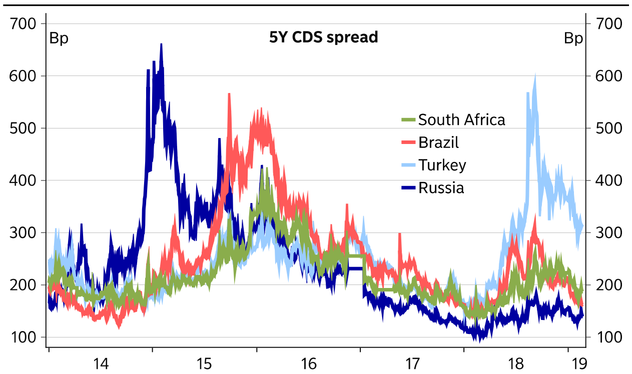

Source: Nordea and Macrobond

## FX PERFORMANCE (2018) VS CURRENT ACCOUNT




Source: Nordea and Macrobond

## CDS SPREADS




Source: Nordea estimates and Macrobond

# Forecast overview

**FX FORECASTS VS EUR**

| | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| EUR/BRL | 4.229 | 4.41 | 4.58 | 4.80 | 5.12 |
| EUR/CNY | 7.651 | 8.12 | 8.21 | 8.36 | 8.45 |
| EUR/CZK | 25.73 | 25.5 | 25.0 | 25.0 | 27.0 |
| EUR/HUF | 318.1 | 318 | 318 | 315 | 320 |
| EUR/INR | 80.74 | 88.2 | 89.3 | 91.0 | 92.2 |
| EUR/PLN | 4.33 | 4.35 | 4.25 | 4.15 | 4.25 |
| EUR/MXN | 21.79 | 23.8 | 23.8 | 23.4 | 24.3 |
| EUR/RUB | 74.9 | 77.7 | 78.5 | 80.0 | 85.1 |
| EUR/TRY | 6.008 | 6.20 | 6.40 | 6.70 | 7.00 |
| EUR/ZAR | 15.99 | 16.8 | 17.9 | 19.1 | 20.5 |
| EUR/USD | 1.131 | 1.16 | 1.19 | 1.23 | 1.28 |
| EUR/SEK | 10.47 | 10.3 | 10.2 | 10.0 | 9.70 |
| EUR/NOK | 9.737 | 9.50 | 9.15 | 9.00 | 9.00 |
| EUR/DKK | 7.461 | 7.46 | 7.46 | 7.46 | 7.46 |

Source: Nordea estimates

**FX FORECASTS VS USD**

| | Spot | 3M | Mid-2019 | End-2019 | End-2020 |
|---|---|---|---|---|---|
| USD/BRL | 3.74 | 3.85 | 3.90 | 4.00 | 4.10 |
| USD/CNY | 6.766 | 6.90 | 6.90 | 6.80 | 6.60 |
| USD/CZK | 22.76 | 22.4 | 21.4 | 20.3 | 21.1 |
| USD/HUF | 281.3 | 280 | 269 | 256 | 250 |
| USD/INR | 71.4 | 72.0 | 70.0 | 71.0 | 70.0 |
| USD/MXN | 19.27 | 19.5 | 20.0 | 19.0 | 19.0 |
| USD/PLN | 3.829 | 3.79 | 3.57 | 3.37 | 3.32 |
| USD/RUB | 66.24 | 68.0 | 69.0 | 69.5 | 70.0 |
| USD/TRY | 5.313 | 5.52 | 5.88 | 6.10 | 6.25 |
| USD/ZAR | 14.14 | 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 | 7.75 | 8.00 | 8.25 | 8.25 | 7.75 |
| 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 | 2.00 | 2.25 | 2.50 |
| Turkey | 24.00 | 24.00 | 24.00 | 20.00 | 18.00 |
| South Africa | 6.75 | 6.75 | 6.50 | 6.50 | 6.25 |
| Brazil | 6.50 | 6.50 | 6.75 | 6.75 | 7.25 |
| Mexico | 8.25 | 8.25 | 8.50 | 8.50 | 8.00 |
| China | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 |
| India | 6.25 | 6.25 | 6.25 | 6.25 | 6.25 |

Source: Nordea estimates

**Brazil**

We lower our policy rate forecasts by 50 bp for the end of 2019 and the end of 2020. Actual and expected inflation have been consistently lower than the target. Wide economic slack will likely keep inflation tamed.

**China**

No changes.

**Czech Republic**

No changes.

**Hungary**

No changes.

**India**

We change our policy rate to reflect the unexpected rate cut of 25 bp in February.

**Mexico**

No changes.

**South Africa**

No changes.

**Poland**

No changes.

**Russia**

No changes.

**Turkey**

The Turkish lira (TRY) has been stable for the past few months. Therefore, we adjust our EUR/TRY estimates downwards across the forecast horizon. We still expect the TRY to weaken from current levels, however, as Turkey's economy is likely in a recession. The reserve requirement rate cut could be seen as a test balloon for an upcoming rate cut, but we do not factor in rate cuts before the end of the year.

# Recent research and profile descriptions

### Recent Emerging Markets Research
- Russian GDP: What's behind the highest growth rate since 2012 (14 February)
- INR: Rate cut a risk to RBI credibility (7 February)
- China monthly: Déjà vu ( 7 February)
- China: Plunging PMI ahead of the Pig's year (1 February)
- CBR preview: The benefit of proactivity (31 January)

### Previous Emerging Markets Views
- Emerging Markets View: China touchdown (24 January)
- Emerging Markets View: Fearing the Fed (18 December)
- Emerging Markets View: A bumpy ride in 2019 (22 November)

### Latest EM Traffic Light
- EM Traffic Light January 2019 (4 February)

### Latest Financial Forecast Update
- Majors Forecasts: The scope for higher interest rates has diminished  (28 January)

### Latest Economic Outlook

- Nordea Economic Outlook: Shaky ground (28 January)

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