15 March 2010

FX Forecast Update

Low rates for longer – Greek impact on EUR loses momentum

Low rates are here to stay – at least in the G4. It is becoming increasingly clear that central banks in Europe, the US, the UK and Japan are in no hurry to normalise monetary conditions. Fiscal tightening, needed to curb the soaring budget deficits, simply crowds out monetary tightening. For most currency pairs, relative rates as the dominant driver for can therefore be delayed for longer than previously projected. And equity prices – a proxy for risky behaviour, fuelled by lower rates – and commodity prices can thereby remain significant for future exchange rate movements.

The Greek debt problems have not been solved – but fears of a euro collapse are fading. We believe the fiscal situation in Greece is unsustainable and think it reasonable that financial markets have been concerned and reacted by selling Greek bonds and stocks. We do however think the euro sell-off is somewhat overdone. After all, Greece only constitutes 2-3% of Euroland GDP – much less than also debt-burdened California's 13% share of US GDP – and we think it very unlikely that the stronger Euroland countries won't join forces if the situation escalates further. We foresee that debt problems within Euroland will continue to pop up in the media, but that the risk premium currently attached to the euro will gradually decrease and weigh less on the single currency in the quarters to come.

The US is set to outpace Euroland, the UK and Japan in terms of economic growth in 2010. However, as we see it, it is growth on steroids; the US economy enjoys the tailwinds from the massive fiscal and monetary stimuli but the underlying trend might not be as strong as the last GDP numbers indicated. Even though it seems like something we have seen before – the US recovers first, Euroland and the UK lag behind and Japan is stuck in the mire, and currency implications perhaps therefore should be straightforward – we keep in mind the lessons from 2003-04. At that time, the world also recovered from recession, the Fed hiked rates one year before the ECB and despite that EUR/USD climbed higher. The same thing could happen again.

An 'A-team' and a 'B-team' among central banks are starting to be formed: The A-team consists of the leaders in hiking rates: RBA, Norges Bank and probably also in 2010 RBNZ, BoC, Riksbanken and perhaps also the Fed and the SNB. As we have seen with the AUD and the NOK, central bank hikes lead to currency appreciation almost no matter how anticipated they may be. The B-team consists of BoJ, ECB and BoE, from which we can expect only very moderate monetary tightening.

What to buy? With interest rates low, leading indicators still pointing towards economic expansion and risk appetite back in the saddle, we prefer currencies with a tendency to strengthen in good times. These include AUD, NZD and SEK. The latter we also like due to sound fiscal balances, higher interest rates to come and a good starting point from a valuation point of view. The NOK and the CAD are attractive due to several rate hikes in the pipeline and higher oil prices while the CHF is becoming interesting as the SNB is set to accept a stronger franc without intervening. The GBP has still sound potential against the EUR but patience is a virtue as the UK economy only recovers slowly and the financial sector remains under water for now. The JPY faces a losing streak as we see it

Key points

- The risk of uncontrolled EUR depreciation due to Greek debt problems is fading. USD negative factors remain. We maintain our slightly increasing EUR/USD profile.
- We look for further potential in the Scandies, but the road will likely be bumpy from here.
- GBP has bleak near-term outlook – but long-term potential remains.
- JPY weakening has begun and will continue

Forecast table (*detailed*)

	1M	3M	6M	12M
EURUSD	1.37	1.37	1.39	1.42
USDJPY	92	93	97	102
EURCHF	1.45	1.44	1.42	1.46
EURGBP	0.92	0.92	0.85	0.82
EURSEK	9.70	9.60	9.50	9.40
EURNOK	7.90	7.90	7.80	7.80
AUDUSD	0.92	0.94	0.94	0.86
NZDUSD	0.70	0.74	0.78	0.70
USDCAD	1.01	1.01	1.00	1.10
EURDKK	7.44	7.44	7.45	7.46

Links to detailed forecasts:

Exchange rate forecasts

	Forecast					Forecast vs forward outright, %			
	Spot	+1m	+3m	+6m	+12m	+1m	+3m	+6m	+12m
Exchange rates vs EUR									
USD	1.374	1.37	1.37	1.39	1.42	-0.3	-0.3	1.2	3.4
JPY	124.6	126	128	135	145	1.2	2.8	8.5	16.9
GBP	0.911	0.92	0.92	0.85	0.82	1.3	1.3	-6.5	-9.8
CHF	1.454	1.45	1.44	1.42	1.46	-0.4	-1.0	-2.3	0.8
DKK	7.44	7.44	7.44	7.45	7.46	-0.1	-0.1	-0.1	-0.1
NOK	8.02	7.90	7.90	7.80	7.80	-1.6	-1.8	-3.6	-4.5
SEK	9.72	9.70	9.60	9.50	9.40	-0.2	-1.2	-2.2	-3.4
Exchange rates vs USD									
JPY	90.7	92	93	97	102	1.4	3.1	7.2	13.1
GBP	1.51	1.49	1.49	1.64	1.73	-1.6	-1.5	8.2	14.6
CHF	1.06	1.06	1.05	1.02	1.03	-0.1	-0.7	-3.4	-2.6
DKK	5.42	5.43	5.43	5.36	5.25	0.2	0.2	-1.2	-3.4
NOK	5.83	5.77	5.77	5.61	5.49	-1.3	-1.6	-4.7	-7.7
SEK	7.08	7.08	7.01	6.83	6.62	0.1	-1.0	-3.4	-6.6
CAD	1.02	1.01	1.01	1.00	1.10	-0.8	-0.8	-1.8	7.7
AUD	0.91	0.92	0.94	0.94	0.86	1.0	3.8	4.9	-1.7
NZD	0.70	0.70	0.74	0.78	0.70	-0.2	5.9	12.3	2.4

Source: Danske Markets

EUR/USD – downside risks contained

EUR/USD fell from 1.51 in early December 2009 to below 1.35 on a mix of relative interest rates favouring the dollar and market fears that the Greek debt problems would spread to other European countries and lead to a break-up of the single currency. The pair has since recovered somewhat.

Outlook

- We expect the low rate environment and improving global economic conditions to benefit the euro. Movements in relative rates are too small to matter and the situation in Greece is set to be solved internally in the European Union. We project EUR/USD at 1.37 at 3M, 1.39 at 6M, and 1.42 at 12M.

Key arguments

- In the near term, the euro will remain vulnerable towards the negative news regarding the Greek debt situation and if financial markets start to worry substantially on other debt-burdened countries' sustainability. We think however that the situation will be contained within the eurozone and do not expect the current inflated risk premium on the euro to remain on a 6-12 month horizon.
- Downside risks to EUR/USD are likely to have been reduced though, by the build-up in short EUR positions (as indicated by IMM data) and the recent significant sell-off.
- Even though the ECB will probably lag the Fed in terms of initiating the rate hiking cycle, the euro could strengthen on a relative basis anyway as the overall level of rates is set to be low, fuelling risk appetite which usually pushes EUR/USD higher.
- The widening of the US current account deficit in the coming years will weigh on the dollar. Euroland flows are more balanced.
- USD could lose ground if China starts appreciating CNY again, or if other dollar-peggers shift to a more free-floating currency policy.
- USD's share of global reserves is declining. Less dollar buying means less support for the dollar.

Key risks

- A more pronounced sell-off in risky assets (signalling a bear market) is likely to coincide with significant dollar strength against the euro.
- The European Community has signalled a strong intention to support Greece, but if no details are provided or the political determination fades, the euro could see an even further sell-off.
- EUR/USD is close to 5-10% above 'fair value' according to PPP analysis.

Things to look out for

- The coming months are expected to show some (very) positive non-farm payroll data, likely to provide some dollar support. Our bet is however that the equity channel will overshadow the immediate effect and push the euro higher instead.
- Central bank communication. Exit strategies and signs of tightening will be followed closely by market participants.
- The Fed will stop buying asset purchases in 2010 – this requires that the private sector takes over or that sovereign investors stand ready in order to prevent a rise in yields.
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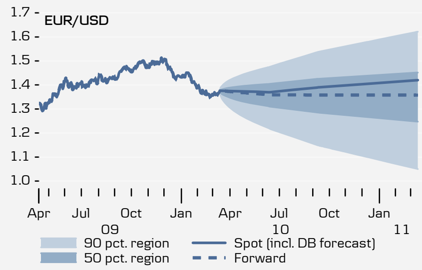
EUR/USD overview

EUR/USD

Recent moves		1W	1M	3M
Spot change		0.7%	0.6%	-5.3%
Spot, high		1.380	1.380	1.458
Spot, low		1.354	1.344	1.344
Outlook	**1M**	**3M**	**6M**	**1Y**
Forecast	1.37	1.37	1.39	1.42
Forward	1.37	1.37	1.37	1.37
Carry (pips)	0	0	3	11

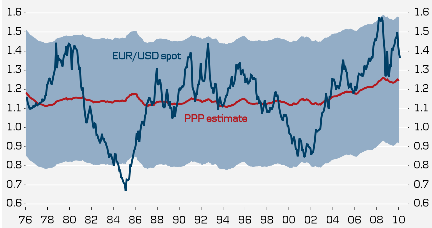
Source: Danske Markets

EUR/USD forecast and option implied probabilities



Source: Danske Markets

EUR/USD and PPP estimate



Source: Danske Markets

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USD/JPY – upward journey has begun

After briefly touching territory below 85 in late November, which triggered the BoJ emergency meeting, USD/JPY has traded higher, to reach a 93.77 high in early January, before correcting lower alongside a narrowing USD-JPY interest rate differential.

Outlook

- JPY weakness has begun and will continue in the coming quarters. We project USD/JPY at 93 in 3M, 97 in 6M, and 102 in 12M.

Key arguments

- The new MoF, Kan, is less opposed to currency intervention than his predecessor Fujii. We expect the potential for currency intervention to provide a ceiling for the yen – as also indicated by the unscheduled BoJ meeting in late November.
- Relative interest rates have been the dominating driver of the yen – the 100-day correlation between USD/JPY and the two-year swap spread is currently at a one-year high of 60%. With JPY rates contained by the outlook of a zero interest rate policy well into 2011, relative interest rates are almost exclusively driven by foreign rates.
- We expect USD rates to move higher from here, as the recent correction lower in rates is likely to have reduced downside risks and as the Fed is moving closer to unwinding its very accommodative monetary policy measures. Several Fed asset purchase programmes are scheduled to end within the coming three months, potentially adding to the upside pressure on yields. We expect the biggest movement in relative yields, however, towards the end of the forecast horizon.
- The BoJ is under pressure from having done too little in order to stimulate the economy via alternative measures. Additional easing cannot be ruled out. Furthermore, Japan is likely to stay in deflationary territory throughout 2010.

Key risks

- A bigger sell-off in risky assets (triggering a bear-market signal) could imply JPY support – also via lower USD rates.
- Despite positive momentum in economic data and an upward trend in risky assets, US bond yields have failed to move markedly higher. Continued range-trading in yields might delay a potential JPY depreciation later in 2010.

Things to look out for

- The upcoming BoJ meeting could be very interesting and lead to further JPY weakness if the board decides to make up for the fact that Japan's central bank has provided very little stimulus to the economy during the recession.
- Capital flows – both Japanese and US – remain important to follow.
- The yen (more so than the US dollar) is a safe-haven currency and tends to strengthen when risk appetite escalates.

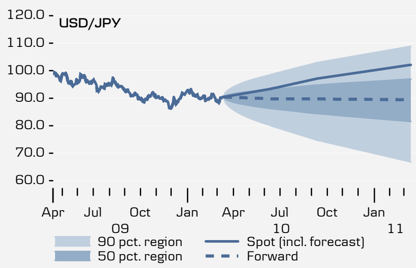
USD/JPY overview

Recent moves		1W	1M	3M
Spot change		1.6%	0.9%	-1.0%
Spot, high		91.0	92.1	93.8
Spot, low		89.6	88.1	88.1

Outlook	1M	3M	6M	1Y
Forecast	92	93	97	102
Forward	90.7	90.7	90.6	90.3
Carry (pips)	2	5	12	43

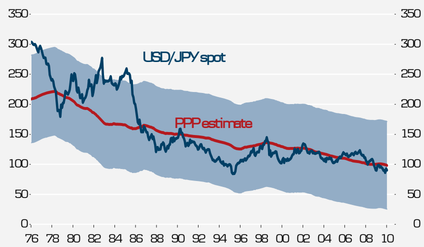
Source: Danske Markets

USD/JPY forecast and option implied probabilities



Source: Danske Markets

USD/JPY and PPP estimate



Source: Danske Markets

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EUR/GBP – BoE to stay put

The pound has been vulnerable in the past month due to very negative short-term dynamics. After falling towards below 0.85 by August, EUR/GBP has risen towards 0.91 in a violent move. The pair remains soft on the upside.

Outlook

- We expect to see sterling weak as long as the economic financial outlook remains bleak and worries on the upcoming election spook markets. The long-term outlook is bright as markets currently are too negative on the pound. We see EUR/GBP at 0.92 in 3M, 0.85 in 6M, and 0.82 in 12M.

Key arguments

- The UK remains in a process of de-leveraging, and the need to repair balance sheets dominates the private and the public sector alike. The UK consumer seems to have returned to the shops of late though: retail sales recovered markedly end 2009, and the January BoE agents' report showed that retailers witnessed stronger demand over the Christmas period compared with a year before.
- Although credit conditions have eased somewhat, lending data still look downbeat: mortgage approvals fell in December as did loans for house purchases. Even though house prices are reportedly rising and real estate agents have become more optimistic, it appears unlikely that the housing market will be able to rely on a 'mortgage-less recovery'. Lending must recover soon for the feeble upturn to prove sustainable.
- The latest stream of PMIs suggests that while the manufacturing sector continues to receive some tailwinds from e.g. past pound depreciation, the service sector may be losing some momentum. On the whole, the healing of the economy appears to be only slowly under way: the Q4 GDP report confirmed that the UK escaped the technical recession towards the end of 2009 but growth came in at a mere 0.1% q/q.
- At its February meeting, the MPC predictably kept the Bank rate unchanged at 0.5%. However, the asset purchase programme was paused and the target left unaltered at GBP200bn. The MPC has emphasised that it is the *stock* of QE purchases rather than the *flow* that determines the policy stance.
- The February IR took the MPC's assessment of both GDP and CPI over the forecast horizon down significantly. The report overall took a very soft tone, making it clear that the UK recovery will likely be slow and stressed that "the prospects for inflation remain unusually uncertain" with considerable risks in either direction.
- According to PPP analysis, sterling is one of the most undervalued G10 currencies; in contrast, the euro is the most overvalued. This misalignment could persist for some time yet but a 'return to valuation' could come into effect within our forecast horizon.

Key risks

- Introduction of new QE measures and/or an increase in the asset-purchase target.
- Additional banking failures adding to strained government finances.
- The crisis may have led to a permanent decline in potential GDP: if spare capacity is lower than expected, inflation could pick up more quickly than the BoE projects.

Things to look out for

- Comments from rating agencies: S&P has the UK on negative outlook.
- Changes in risk sentiment: rising risk appetite should be GBP-positive.
- General election mid-2010: a Tory government may find it easier to implement much-needed fiscal consolidation.

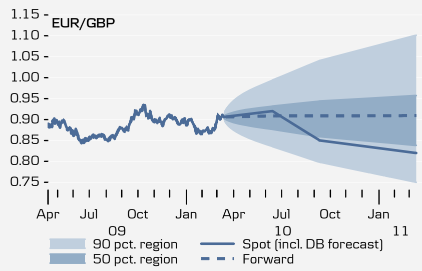
EUR/GBP overview

Recent moves	1W	1M	3M
Spot change	0.8%	4.9%	1.4%
Spot, high	0.913	0.915	0.915
Spot, low	0.901	0.866	0.860

Outlook	1M	3M	6M	1Y
Forecast	0.92	0.92	0.85	0.82
Forward	0.91	0.91	0.91	0.91
Carry (pips)	-2	-5	-7	-9

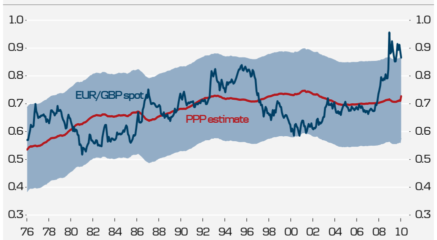
Source: Danske Markets

EUR/GBP forecast and option implied probabilities



Source: Danske Markets

EUR/GBP and PPP estimate (CPI-75)



Source: Danske Markets

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EUR/CHF – SNB slowly removing floor

- While the Swiss National Bank (SNB) reiterated its pledge to counteract an excessive appreciation of the Swiss franc, EUR/CHF has been allowed to drift below 1.46 following the 11 March meeting, without the interventions.

Outlook:

- We project EUR/CHF at 1.44 in 3M, 1.42 in 6M, and 1.46 in 12M.

Key arguments:

- *Short term:* High probability that intervention will see spikes higher in EUR/CHF. The SNB appears to have allowed EUR/CHF drift lower following its recent monetary policy meeting on 11 march. However, the SNB is still communicating that it will not a excessive appreciation of the franc and we doubt that EUR/CHF will move much lower in the coming months.
- *Medium term:* The recession in Switzerland has proven milder than first projected – also by the SNB – and with the outlook of the economic recovery maturing further in 2010, the emergency setting of monetary policy is becoming gradually more inappropriate. We expect the SNB to move further away from using intervention as a monetary policy tool. The SNB is expected to hike rates before year-end – prior to the first expected ECB hike – adding to downside pressure on EUR/CHF.
- *Longer term:* ECB is likely to tighten monetary policy more than the SNB (due to higher underlying price pressures and a more hawkish government council), which should see underlying flows reverse and take EUR/CHF higher on the 12-month horizon.

Key risks:

- The recent month's trading indicates that the SNB's December meeting marked a shift in how the bank implements its very accommodative monetary policy – the SNB moving away from EUR/CHF fine-tuning. The SNB may allow EUR/CHF to drift even lower without intervention.
- Uncertainties about the economic recovery remain significant, which coupled with absent price pressures (deflation fears) could postpone a move further away from intervention and secure a floor below EUR/CHF also longer term.

Things to look out for:

- Speeches by the members of the SNB governing board. SNB president Philipp Hildebrand stated on 11 March that the SNB will continue to seek to prevent "excessive appreciation" of the Swiss franc indicating that a policy imposed floor can still be found below EUR/CHF.

  If the current economic momentum is sustained in Switzerland, the SNB could move to interest rate hikes already on the September meeting – well before any signalled ECB hikes.

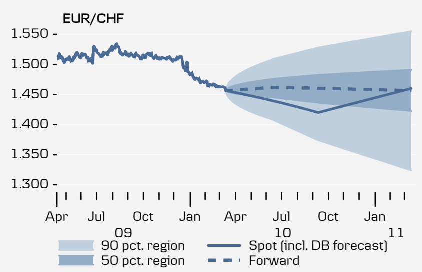
EUR/CHF overview

Recent moves	1W	1M	3M
Spot change	-0.6%	-0.7%	-1.5%
Spot, high	1.464	1.470	1.489
Spot, low	1.454	1.454	1.454

Outlook	1M	3M	6M	1Y
Forecast	1.45	1.44	1.42	1.46
Forward	1.45	1.45	1.45	1.45
Carry (pips)	4	11	28	67

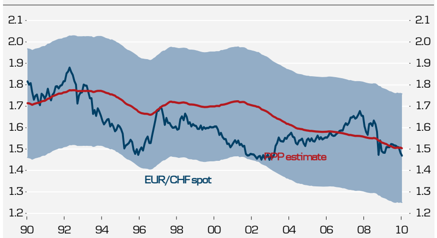
Source: Danske Markets

EUR/CHF forecast and option implied probabilities



Source: Danske Markets

EUR/CHF and PPP estimate



Source: Danske Markets

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EUR/SEK – near-term consolidation

- The SEK has performed strongly over the last few weeks, reflecting first and foremost a belief in more front-loaded rate hikes in Sweden compared with many of its peers and a broad-based EUR sell-off which has to do with debt problems within the euro area - problems that put the SEK in a relatively bright position. The technical picture is intact for a continued medium-term downtrend.

Outlook:

- We expect the SEK to continue taking back losses caused by the financial crisis and the deep recession and thus keep our medium-term bearish view on EUR/SEK. Most of the rebound is likely to be behind us though and we forecast EUR/SEK at 9.70 in one month, 9.60 in three, 9.50 in six and 9.40 in 12 months.

Key arguments:

- The global economic rebound is set to continue and a no-growth scenario is expected to be replaced by a slow-growth one. The Swedish economy is dichotomised in a relatively healthy growing household sector and a downbeat industrial sector. The latter is expected to gain traction in 2010 but the healing will be slow coming as demand for Swedish export goods is likely to be muted for a prolonged period, given the low level of global resource utilisation. Commercial flows should be mildly positive for the SEK going forward.
- Relative monetary policy is an argument for a continued downtrend in EUR/SEK in 2010. While the Riksbank has communicated more frontloaded rate hikes, starting in July or September, the opposite applies for the ECB which is now likely to stay on hold throughout this year. The Riksbank repo rate forecast is not essentially different from ours but given the soft macro data recently we stick to our long-held view that the first rate hike comes in September. Admittedly, inflation has come in somewhat higher than the Riksbank forecast. But at the same time the krona has markedly outperformed the Riksbank forecast which on the margin and ceteris paribus implies less need for proactive rate hikes. We see no reason why they should speed up the rate hike pace at the next policy meeting in April but rather, reiterate the message from February. The market is already pricing in close to 25bp per meeting starting in July. Hence, in the near term the impact from monetary policy is seen as more balanced.
- The SEK remains significantly undervalued from a long-term perspective and we expect this misalignment to be further reduced as markets conditions normalise.
- The SEK is backed by solid fundamentals which have grown even better on a relative basis during the global recession, as many countries now see their public debts rising sharply to levels far more troublesome than in Sweden. Reversing fiscal deficits over the coming years will be a key issue worldwide and from that perspective Sweden will start from a relatively strong position. Investors should take these differences in to account and reward currencies with relatively stable public finances.

Key risks:

- Risk aversion or a backlash in the economic recovery could delay the SEK rebound.
- More hawkish Riksbank or sharp EUR sell-off could prompt faster SEK appreciation.

Things to look out for:

- Riksbank monetary policy decision and the government budget bill, both in April.

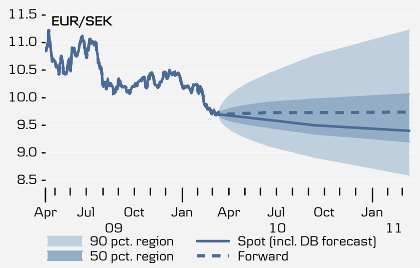
EUR/SEK overview

Recent moves	1W	1M	3M
Spot change	0.0%	-2.2%	-4.9%
Spot, high	9.75	9.90	10.29
Spot, low	9.68	9.67	9.67

Outlook	1M	3M	6M	1Y
Forecast	9.70	9.60	9.50	9.40
Forward	9.71	9.71	9.71	9.72
Carry (pips)	8	24	37	-85

Source: Danske Markets

EUR/SEK forecast and option implied probabilities



Source: Danske Markets

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EUR/NOK – still heading lower

The Norwegian krone has been relatively stable over the past month after the strong rally in the previous months and EUR/NOK has traded in a tight range between 8.10 and 8.00. The market has not been able to push the cross below the psychologically important level of 8.00. We have seen a number of slightly disappointing economic numbers out of Norway lately that has slowed the market interest in the NOK.

Outlook:

- We forecast that the Norwegian krone will continue to perform going forward, albeit at a much slower pace. We project EUR/NOK at 7.90 in 3M, 7.80 in 6M and 7.80 in 12M.

Key arguments:

- We forecast that Norges Bank will hike policy rates once again on 24 March by 25bp to 2.0%. This is a non-consensus call and should give some support to the NOK. However, Norges Bank is expected to underline that no hike should be expected in May. Furthermore, Norges Bank is at the same time expected to lower its interest rate forecast from 2.75% to 2.5% end-2010. Therefore, we should only expect a limited positive effect on the NOK. The rate hike should be seen as further step towards a normalisation of Norwegian interest rates and a reaction to the booming housing market.
- However, the Norwegian key numbers have been a bit weaker than expected lately. Mainland GDP growth rose just 0.3% and manufacturing PMI is still hovering around the 50-level. The Regional report from Norges Bank also indicated that growth is still quite modest. It underlines that the potential for further appreciation is limited despite a rate hike. But looking forward, we still expect healthy Norwegian growth supported by a low unemployment rate and growth in disposable income. The Norwegian savings rate is already running at a high level.
- Norwegian fundamentals are second-to-none with huge trade and public surpluses despite current high oil spending and a very strong credit rating. We believe investors will look for currencies with strong fundamentals in 2010, not least because of the debt problems in many countries in the eurozone.
- Note that EUR/NOK is now trading relatively close to fair-value implied by a simple PPP model.
- The NOK is in general expected to get support from oil that is expected to trade in a USD80 to 90 range for the rest of 2010.

Key risks:

- The market is speculatively long NOK, which could spark periods of profit-taking. The latest appreciation hurts competiveness and also poses a risk of too low inflation that inevitably would affect monetary policy going forward. A general setback in risk appetite, or the oil price, is expected to weigh on NOK. It is a very close call as to whether Norges Bank will hike rates on 24 March or not.

Things to look out for:

- The monetary policy meeting scheduled for March 24 and the new monetary policy report is the key release to watch. Keep also a close eye on development in speculative NOK positions in the market that can be followed in the weekly currency flow numbers from Norges Bank.

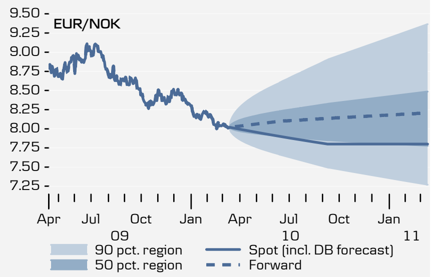
EUR/NOK overview

Recent moves	1W	1M	3M
Spot change	-0.3%	-0.9%	-1.8%
Spot, high	8.067	8.112	8.349
Spot, low	8.006	7.998	7.998

Outlook	1M	3M	6M	1Y
Forecast	7.90	7.90	7.80	7.80
Forward	8.03	8.06	8.09	8.17
Carry (pips)	-120	-358	-729	-1448

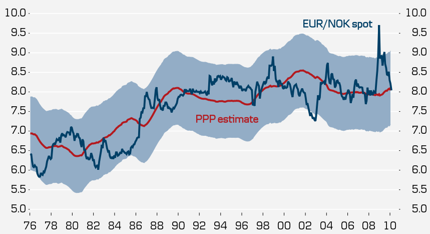
Source: Danske Markets

EUR/NOK forecast and option implied probabilities



Source: Danske Markets

EUR/NOK and PPP



Source: Danske Markets

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EUR/DKK – krone remains strong

EUR/DKK has stayed low in 2010 and the Danish central bank has countered the solid inflow of foreign currency through two rate cuts in the repo-rate of 5bp and 10bp respectively, bringing the official spread for Euroland to an historical low of 5bp.

Outlook

- We believe the Danish central bank will keep the krone on the strong side in the coming months before drifting back toward central parity on a 12M horizon. We project 7.44 at 3M, 7.45 at 6M, and 7.46 at 12M.
- Our base case scenario is that the repo-rate spread between Denmark and Euroland will stay at 5bp throughout our forecast horizon. In the event of additional inflow in the short run, we expect the Danish central bank to cut the deposit rate and current account rate by 10bp each, but leave both the lending and discount rate unchanged. In the event of a very rapid liquidity withdrawal in Euroland, independent Danish rate *hikes* cannot be ruled out.

Key arguments

- EUR/DKK trades in a +/-2.25% band around a central parity of 7.46038 (7.29252-7.62824). In practice, the central bank has kept EUR/DKK within a much tighter band of 7.423-7.468 (-0.1% - +0.5%). Most recently, the Danish central bank has shown a strong dedication to keeping EUR/DKK very stable and preferably somewhat stronger than central parity.
- EUR/DKK is still subject to some downward pressure as some investors find it attractive to exploit the higher Danish yield, at least in the short term. This trick has, however, lost some of its attractiveness as EUR/DKK upside risks are evident.
- EUR/DKK is likely to rise toward parity when the ECB starts draining liquidity and Danish money market rates therefore tighten against euro-rates. Central bank buying of DKK certainly cannot be ruled out during this process.

Key risks

- If the financial crisis accelerates, smaller currencies will naturally be at risk.
- The higher-than-necessary DKK/EUR rate spread has generated some inflows of "hot money". If everybody wants to get out of the same door at the same time, rapid movements can occur.

Things to look out for

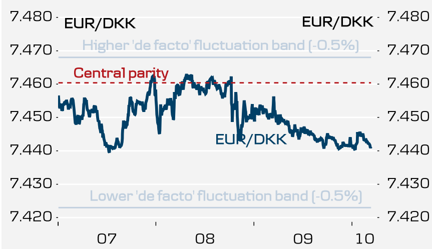
- Developments in money market spreads. The Danish central bank can only control one leg here, the Danish. If the ECB starts to withdraw liquidity, leading to higher European money market rates, the positive carry on DKK will decline further and EUR/DKK will climb higher.
- Currency reserve announcements (second bank day in the month). Central bank comments regarding the desired size of the currency reserve. Governors Bernstein and Nielsen have both said that "a larger reserve is required than what has been the case in previous years".
- The Danish central bank does not have scheduled meetings and does not announce rates at a specific time. Recently, normal procedure has been to cut rates on Thursdays at 16.00 CET.

EUR/DKK overview

Recent moves		1W	1M	3M
Spot change		0.0%	0.0%	0.0%
Outlook	**1M**	**3M**	**6M**	**1Y**
Forecast	7.44	7.44	7.45	7.46
Forward	7.44	7.45	7.45	7.47
Carry (pips)	-27	-76	-131	-257

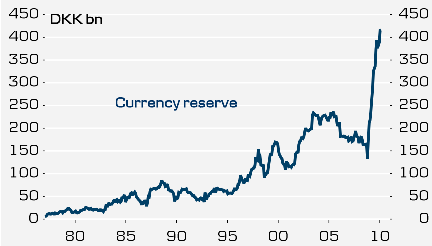
Source: Danske Markets

EUR/DKK spot rate



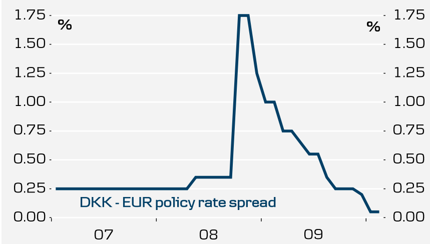
Source: Danske Markets

Record-high Danish currency reserve



Source: Danske Markets

Normalisation of policy rate spread



Source: Danske Markets

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AUD/USD – higher, but no new high

- As risky assets have rebounded from January's sell-off, so has the Australian dollar which is once again trading well above 0.90 against the dollar.

Outlook:

- We expect to see sustained support for AUD/USD in the short-term and project AUD/USD at 0.94 in 3M, 0.94 in 6M and 0.86 in 12M.

Key arguments:

- The Reserve Bank of Australia has begun tightening monetary policy and we expect the policy rate to reach 4.50-5.00% before the end of 2010. Although the February RBA decision indicated that policy tightening will be less front-loaded than previously expected, strong data (not least on the labour market) suggest that further hikes are warranted.
- The Federal Reserve is unlikely to raise the policy rate before late 2010. Hence, relative monetary policy is expected to remain AUD-favourable on a 6-month horizon.
- Australia has been among the economies most sheltered from the global recession and we expect the cyclical position of the Australian economy to continue to justify an overvalued level in AUD/USD throughout the forecast horizon.
- A continued improvement in the global growth outlook should support commodity prices further and secure an additional improvement in the Australian terms of trade.
- Close to half of Australia's exports go to emerging Asia, which we expect to continue to lead the global recovery.
- Indications that the Federal Reserve will tighten monetary policy is likely to mark a turnaround in the bullish AUD/USD trend. We expect a narrowing of the AUD/USD interest rate differential by late 2010 to put downside pressure on AUD/USD (just as in December) and take the pair away from, by long-term measures, very overvalued territory – risks are that this could come sooner than expected.

Key risks:

- Our equity research team is expecting the recent correction in risky assets to run further (leaving the S&P500 index to test the 950-1,000 area). If this materialises without an AUD-favourable re-pricing of the RBA (more rate hikes being priced) AUD/USD will likely correct lower once again.
- China hiked policy rates marginally in January marking what we believe is the return to a policy of gradual monetary policy tightening. If China decides to act pre-emptively by reducing excess demand in the economy, this could imply a sell-off in risky assets and a weaker Australian dollar. Recent higher-than-expected Chinese inflation data suggest that this is a viable risk.

Things to look out for:

- Speculative investors are currently long AUD implying that the risk of a downward correction in AUD/USD from a position squeeze remains – this is probably what we saw in December and early February.
- AUD/USD is trading at highly overvalued levels when benchmarked against long-term valuation measures (PPP estimate stands at 0.75).

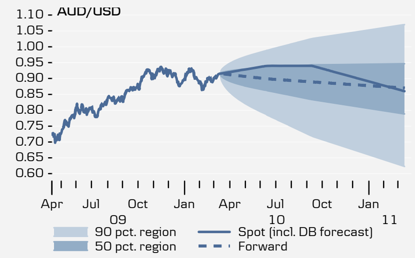
AUD/USD overview

Recent moves	1W	1M	3M
Spot change	1.2%	3.7%	-1.5%
Spot, high	0.919	0.919	0.933
Spot, low	0.906	0.880	0.861

Outlook	1M	3M	6M	1Y
Forecast	0.92	0.94	0.94	0.86
Forward	0.91	0.90	0.89	0.87
Carry (pips)	32	92	190	389

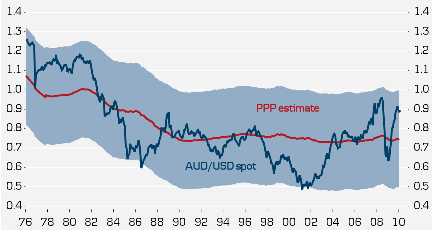
Source: Danske Markets

AUD/USD forecast and option implied probabilities



Source: Danske Markets

AUD/USD and PPP estimate



Source: Danske Markets

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NZD/USD – limits to the upside

- The New Zealand dollar has rebounded alongside risky assets in recent weeks to trade back above 0.70, after having reached a ??? low in January's correction.

Outlook:

- We project NZD/USD at 0.74 in 3M, 0.78 in 6M and 0.70 in 12M.

Key arguments:

- A sustained positive trend in global economic data combined with ample global liquidity (secured by low policy rates) is expected to fuel further demand for risky assets and the New Zealand dollar.
- Monetary policy tightening is coming closer in New Zealand and is likely to materialise at the June or July meeting – well before any tightening from the Federal Reserve.
- Indications that the Federal Reserve will tighten monetary policy are likely to mark a turnaround in the upwards NZD/USD trend. We expect a narrowing of the NZD/USD interest rate differential by late 2010 to put downside pressure on NZD/USD and take the pair away from, by long-term measures, very overvalued territory.
- We expect that NZD will continue to trade at weak levels against AUD and CAD on relative macroeconomic performance, and as we see less potential for New Zealand's main commodity exports. New Zealand is a large exporter of agricultural products (mainly dairy products), which are less cyclical than for example metals, coal and oil.

Key risks:

- If interest rate hikes in New Zealand become more front-loaded than currently priced in the market, NZD/USD is likely to rise more than factored into our forecast.
- New Zealand's large external imbalances will have to be addressed at some point. Historically we often see large currency depreciation coinciding with a correction of a current account deficit. This remains a key risk to NZD.
- China has begun to gradually scale back its accommodative monetary policy setting. If China decides to act pre-emptively by reducing excess demand in the economy, this could imply a sell-off in risky assets and weaker New Zealand dollar.

Things to look out for:

- NZD/USD remains positively and highly correlated with global equity prices (proxy for risk sentiment).
- NZD/USD is trading at highly overvalued levels when benchmarked against long-term valuation measures (PPP estimate stands at 0.60).

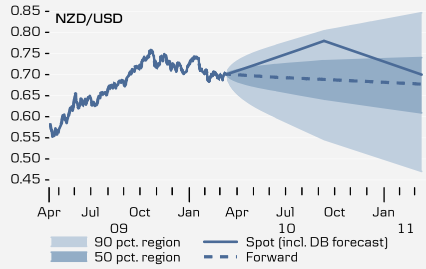
NZD/USD overview

Recent moves	1W	1M	3M
Spot change	1.8%	1.5%	-5.4%
Spot, high	0.71	0.71	0.74
Spot, low	0.70	0.68	0.68

Outlook	1M	3M	6M	1Y
Forecast	0.70	0.74	0.78	0.70
Forward	0.70	0.70	0.69	0.68
Carry (pips)	15	44	93	204

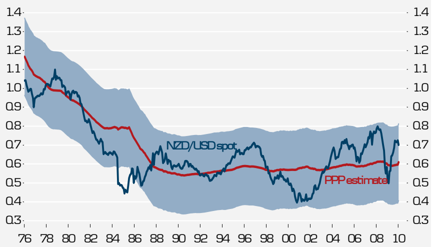
Source: Danske Markets

NZD/USD forecast and option implied probabilities



Source: Danske Markets

NZD/USD and PPP estimate



Source: Danske Markets

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USD/CAD – strong fundamentals

The Canadian dollar has outperformed the remaining G10 currencies over the past month, being the main beneficiary of the recent rally in risky assets. However, strong Canadian economic data and a more upbeat BoC have also lent support to the CAD.

Outlook

- We still look for commodities to tick higher in the coming months which should give support to CAD, given that oil constitutes a key Canadian export. In contrast, higher commodity prices will weigh on the USD. Relative rates have moved in favour of the CAD recently and could yield further support once the hiking cycle commences. Accordingly, CAD is likely to remain at strong levels in the coming months.
- We have taken our 3M and 6M forecasts lower, as economic data has improved further, BoC hikes have drawn closer and as the outlook for commodity prices remains positive. Our forecasts are: 1.01 (3M), 1.00 (6M) and 1.10 (12M).

Key arguments

- The BoC has recently reiterated its conditional commitment to keep rates unchanged until Q3 10. While the bank will almost certainly stick to its pledge, inflation is ticking upwards and the bettering on the labour market seems well established.
- We have previously highlighted the oddity of the market pricing in roughly the same interest rate path for the Fed and the BoC, despite a more positive outlook for the Canadian economy. However, in recent weeks, that has changed, with the market now pricing in roughly 60bp more tightening in Canada on a one-year horizon. In the short run, we see limited further CAD upside from movements in relative interest rates, but the confirmation of a BoC hike in Q3 should lend support to the Canadian currency.
- Given the prospects of global central banks keeping rates low for some time to come, risky assets should have further upside potential, boding well for the cyclical CAD.
- The Canadian economy is in better shape than the US, with stronger labour and housing markets and a less severely hit banking sector. Also, Canada has much healthier balances, despite the slight government budget deficit. Thus, the degree of structural adjustment is nowhere near that needed in the US.

Key risks

- Comments from the BoC addressing the level of the currency have previously been effective in curbing CAD strength and could limit further CAD upside.
- As a pro-cyclical currency, CAD remains exposed to changes in general market sentiment and could be sold off if we see a sharp correction.
- The pair will also be exposed to hints of an earlier-than-expected tightening of the Fed monetary policy. However, we expect the BoC to move first.

Things to look out for

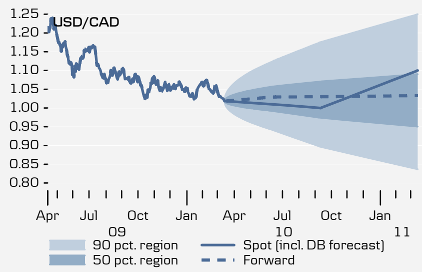
- BoC meeting on 20 April: Since the upcoming meeting is coupled with the release of a Monetary Policy Report, we could see the bank provide more guidance on the outlook for monetary policy beyond the second quarter. Also, given the recent improvement in economic data, the BoC is likely to revise its assessment of risks to its projections in a more positive direction.
- Canadian economic data, e.g. CPI (19 March) and employment (9 April).
- Any comments from BoC officials regarding the level of the CAD (Carney scheduled to speak on 24 March).

USD/CAD overview

Recent moves		1W	1M	3M
Spot change		-1.3%	-3.6%	-1.3%
Spot, high		1.032	1.068	1.078
Spot, low		1.017	1.017	1.017
Outlook	**1M**	**3M**	**6M**	**1Y**
Forecast	1.01	1.01	1.00	1.10
Forward	1.02	1.02	1.02	1.02
Carry (pips)	0	-1	-5	-33

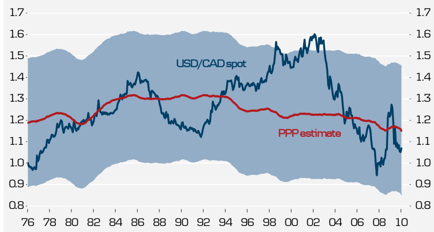
Source: Danske Markets

Forecast and option implied confidence regions



Source: Danske Markets

USD/CAD and PPP estimate



Source: Danske Markets

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