Currency Strategy

Busy doing nothing at all

June 2017

Currency Strategy: Busy doing nothing at all

BUSY DOING NOTHING AT ALL

Looking back over the past year the strong growth momentum globally has certainly overshadowed elevated political risks. But translating the bullish stance on risk appetite to FX forecasts and trade ideas is certainly not a straightforward process as FX markets have settled into tight ranges (*i.e.*, *Busy doing nothing at all*). This environment coupled with low and falling volatilities makes carry strategies look very attractive. But actual carry performance has been poor in the past few months as commodity prices have fallen. In the context of improving growth, we expect slightly higher commodity prices to lift EM and commodity currencies vs the USD in H2 2017.

The win by Macron in the presidential election has boosted hopes for much-needed French and indeed European economic and political reforms. An improving growth outlook supports the euro as equity investors favour European markets. This preference in combination with a hike in the deposit rate by the ECB in September as expected by SEB suggests that EUR/USD will continue to rally, touching 1.15 already in Q3. However, with HICP inflation falling back below 1.0% again in early 2018 and with an on-going QE-programme, we do not see any convincing reason for the euro to trade above its long-term fair value (1.15).

One of our strongest calls is short GBP/SEK. The UK is facing a Hard Brexit and a very uncertain political period ahead. Although undervalued, we think GBP will remain weak to compensate for the loss of access to the Single Market. NOK is oversold and we expect EUR/NOK to fall back to 9.00 by YE-17. The potential introduction of a lowered inflation target in Norway would be one catalyst for a slightly stronger NOK again.

SEB

FX Forecasts

FX forecasts	SEB					Fwd	Consensus*
	31-May	3m	6m	12m	Q4 18	12m	12m
EUR/USD	*1.12*	1.12	1.12	1.12	1.14	1.14	1.11
EUR/JPY	*124*	127	129	132	139	125	129
EUR/GBP	*0.87*	0.88	0.90	0.89	0.88	0.88	0.87
EUR/CHF	*1.09*	1.08	1.07	1.08	1.10	1.08	1.10
EUR/SEK	*9.76*	9.57	9.36	9.17	8.95	9.75	9.25
EUR/NOK	*9.44*	9.17	9.03	8.92	8.80	9.57	8.90
EUR/DKK	*7.44*	7.44	7.44	7.44	7.44	7.43	7.45
EUR/PLN	*4.17*	4.13	4.07	4.00	4.00	4.26	4.20
USD/RUB	*56.7*	59.5	61.5	63.2	64.5	60.62	61.00
USD/TRY	*3.53*	3.42	3.54	3.92	4.15	3.89	3.86
USD/JPY	*111*	113	115	118	122	109	116
GBP/USD	*1.28*	1.28	1.25	1.26	1.30	1.30	1.28
USD/CAD	*1.34*	1.32	1.30	1.26	1.22	1.34	1.35
USD/CHF	*0.97*	0.96	0.96	0.96	0.96	0.95	0.99
AUD/USD	*0.75*	0.77	0.78	0.76	0.74	0.74	0.74
NZD/USD	*0.71*	0.73	0.74	0.74	0.72	0.71	0.68
USD/SEK	*8.70*	8.54	8.36	8.19	7.85	8.52	8.33
GBP/SEK	*11.18*	10.94	10.45	10.32	10.17	11.07	10.67
JPY/SEK	*7.85*	7.56	7.27	6.94	6.44	7.83	7.18
CHF/SEK	*8.96*	8.86	8.75	8.49	8.14	8.99	8.41
NOK/SEK	*1.03*	1.04	1.04	1.03	1.02	1.02	1.04
USD/NOK	*8.42*	8.19	8.06	7.96	7.72	8.36	8.02
USD/CNY	6.81	6.87	7.00	7.00	6.80	7.03	7.05

**Bloomberg survey FX forecasts.*

How to trade it?

OUR TRADE IDEAS

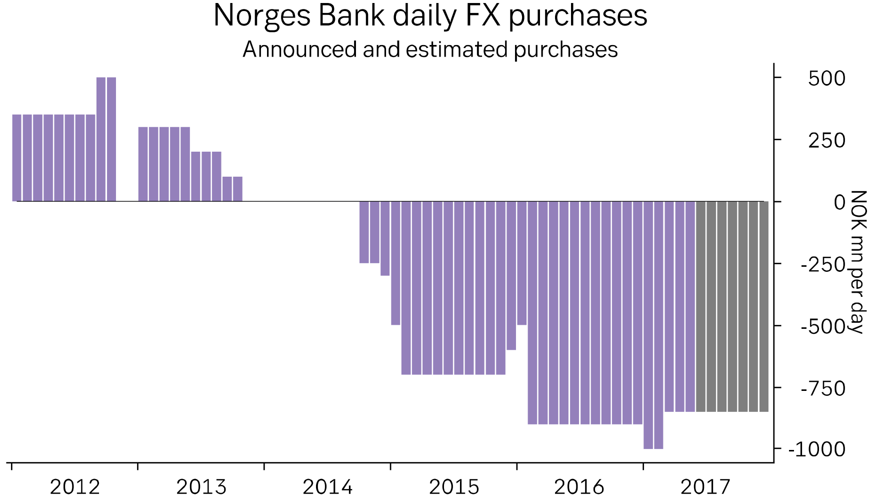
- **SELL GBP/SEK.** The UK is moving towards a Hard Brexit. Although Sterling is undervalued, it will depreciate further to stay competitive and to compensate for the economic and political uncertainties the country is going through. We forecast GBP/SEK to fall to the low 10s in 6–12 months' time.

- **SELL EUR/NOK.** SEB forecasts oil prices to head towards USD 55-60/bbl in H2 2017 and Norges Bank to continue to sell FX and buy NOK (currently NOK 850m/day). Norges Bank may also propose to lower its inflation target to 2.0% (see page 47) which if implemented would bring some short-term NOK buying. The currency is undervalued and levels around 9.50 have been good entry points for short trades historically.

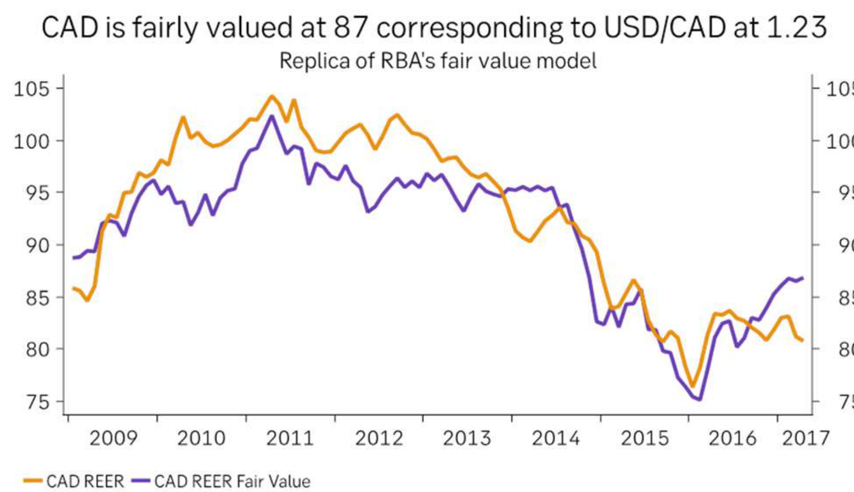
- **SELL EUR/PLN:** The PLN looks set to strengthen on the back of accelerating Polish GDP growth and rising inflationary pressures, despite a negative political backdrop. Gradually rising inflation will fuel speculations of tighter monetary policy, in turn pushing up the undervalued PLN. We target 4.05 in Q4 2017.

- **BUY EUR/JPY.** The euro is underpinned by a strengthening flow outlook and we expect EUR/USD to trend higher towards 1.15. At the same time, we expect USD/JPY to stabilise above 110 and rise towards 115 later this year.

- **SELL USD/CAD.** The Canadian dollar is undervalued and has been weakening due to political risks, lower oil prices and housing market risks. We forecast USD/CAD at 1.26 Q1 18.



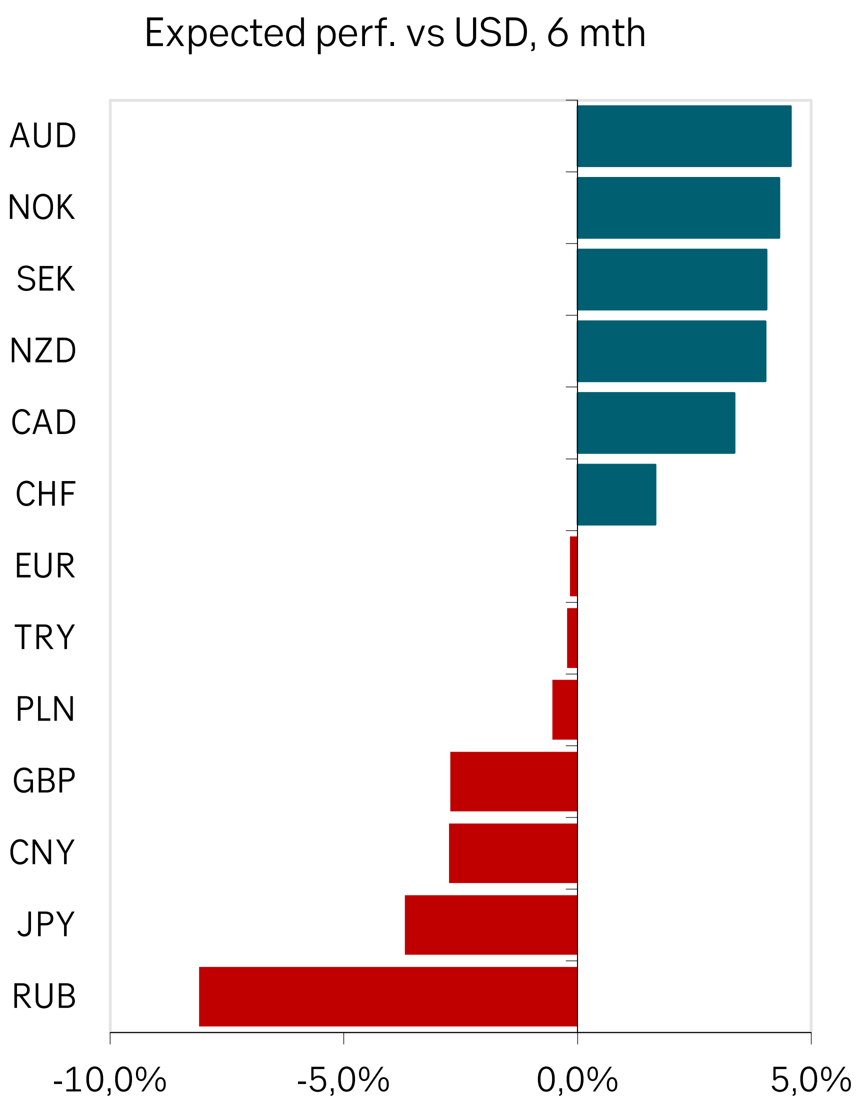
Source: SEB, Norges Bank



Source: SEB and Bloomberg

SEB

Currency overview



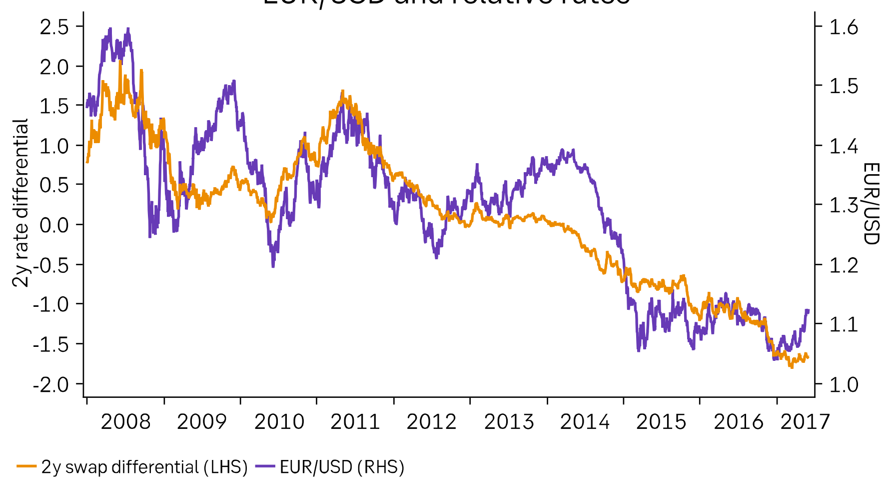
USD: The greenback has peaked

THE DOLLAR HAS PEAKED. Support from Fed tightening will ease going forward as other central banks begin to gradually normalize their monetary policy and the Fed starts to involve the balance sheet in normalizing its monetary policy. Moreover support from measures taken by the new Trump administration seems very limited as the President faces headwinds in Congress. Although it is unlikely that the dollar will fall sharply, it will remain at the upper end of the 1.05-1.15 range, as it has since the beginning of 2015.

SHORT-TERM: From being a broad consensus bet at the start of the year speculative accounts have scaled back significantly their net long dollar holdings. In fact speculative accounts have turned net long the euro against the dollar over the past couple of weeks. As a Fed rate hike in June is now fully priced by investors, it is unlikely to support the dollar, which makes it hard for us to identify a trigger that could change sentiment towards the greenback. The USD is too weak against the euro considering its traditional correlation with relative interest rates**.**

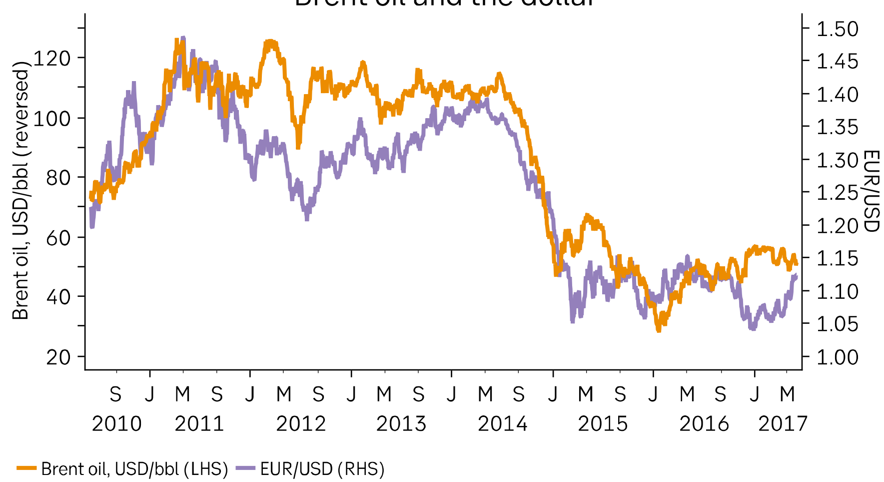
LONG-TERM: Although growth proved surprisingly slow in Q1, we share the Fed's view that current weakness is transitory. The central bank will continue to normalize monetary policy very gradually but the positive impact on the dollar from further Fed tightening seems uncertain. This year we expect two additional hikes by the central bank (June and September) before it begins to involve the balance sheet in tightening policy. Trump's policy has previously been seen as USD-positive. Large tax cuts, a border tax or a temporary reduction of corporate income tax to attract earnings retained overseas are upside risks for the dollar but no longer form part of our main scenario.

EUR/USD and relative rates



Source: Bloomberg

Brent oil and the dollar

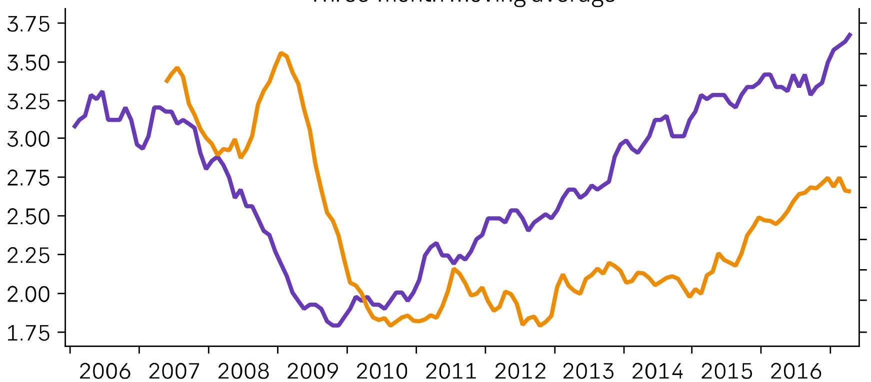


Source: Bloomberg

USD: Fed tightening rests on rising wages

Tighter labour market expected to push up pay

Three-month moving average



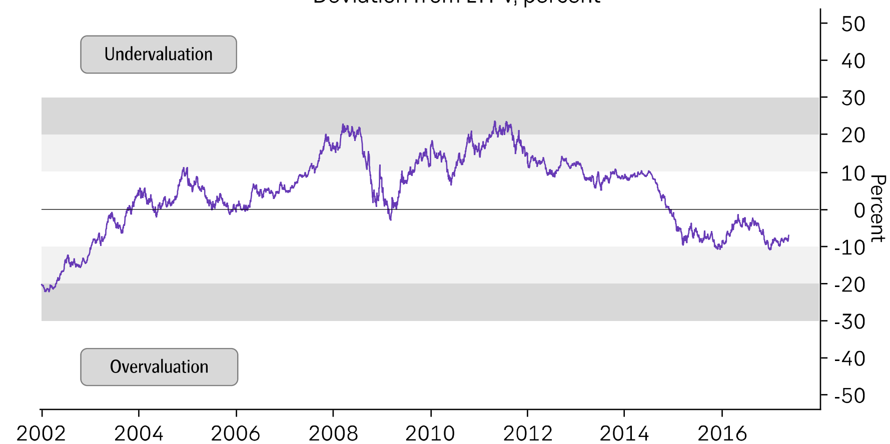
Rate of pay increases, year-on-year percentage change (LHS)

Percentage of small businesses having difficulty filling vacancies (RHS)

Source: NFIB, US Bureau of Labor Statistics

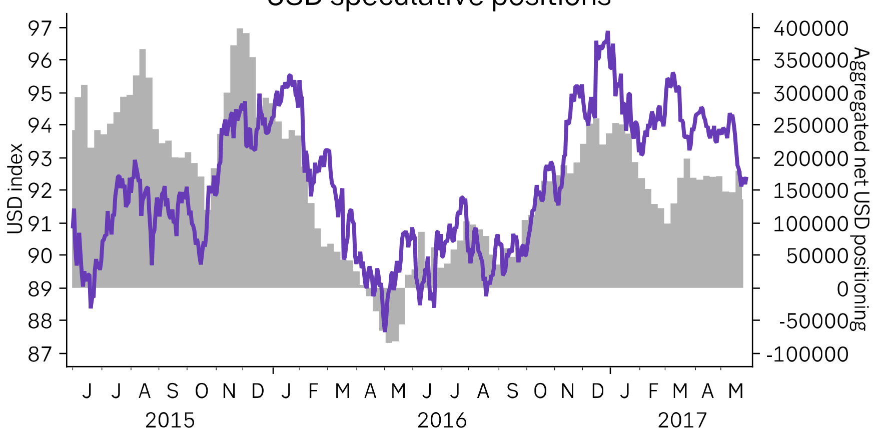
USD TWI

Deviation from LTFV, percent



Source: SEB, Macrobond

USD speculative positions

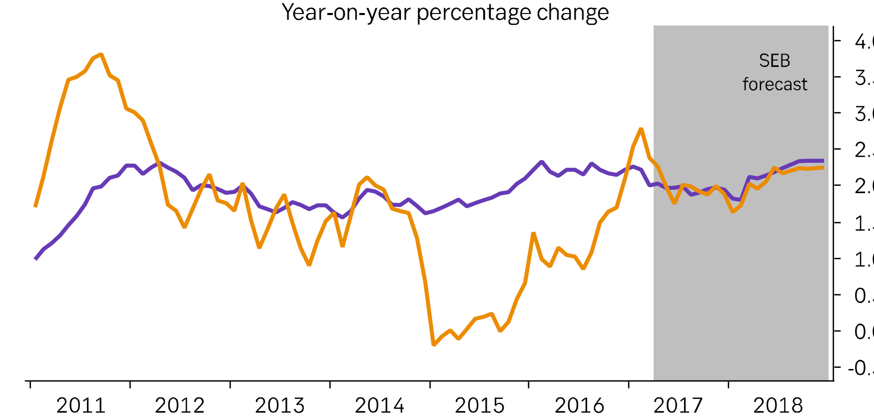


Fed USD Index (LHS) Net speculative position (RHS)

Source: CFTC

Inflation will speed up in 2018

Year-on-year percentage change



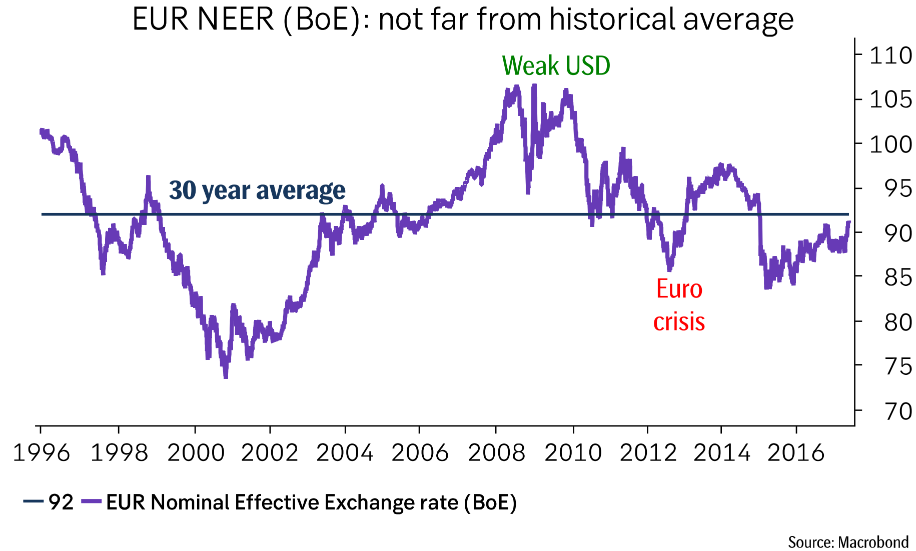
CPI Core

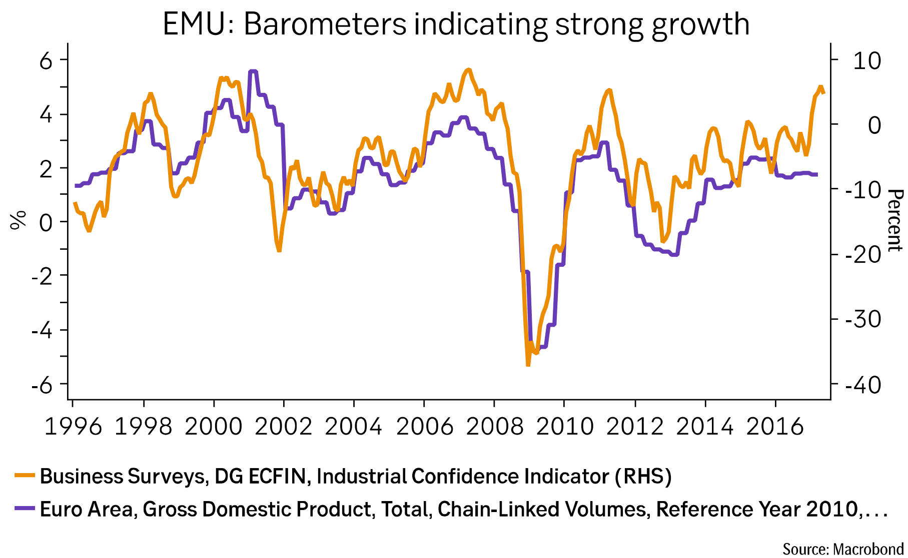
Source: SEB, US Bureau of Labor Statistics

EUR: Improving flow outlook supportive

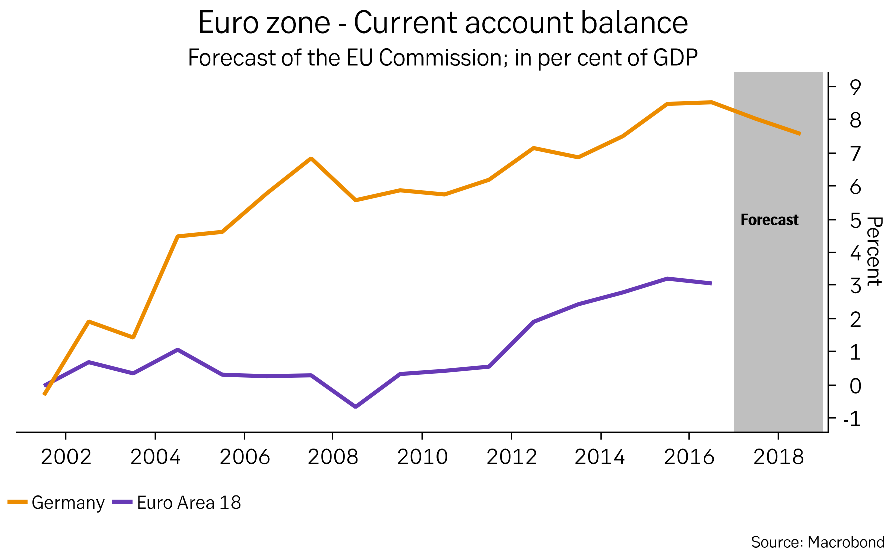
ECONOMIC IMPROVEMENTS STRENGTHEN THE EURO
The economic outlook has improved in line with the very positive picture indicated by business and consumer confidence barometers. In May, the IFO rose to a record high while general PMI for the euro-zone signal GDP growth well above trend (which stands at a mere 1% in the EMU). While unemployment is falling, it is too early to count on rising wages and ultimately wage-driven inflation. Improving economic growth and declining European political risk premiums following the Dutch and French elections coupled with still very expansionary monetary policy have increased the attraction of European equities. **It seems most portfolio managers have adopted an overweight stance, which has surely contributed to an improving euro flow outlook.** For the first time in three years, speculative investors are long EUR/USD. SEB expects the ECB to raise its deposit rate in September, which should also support the currency. However as the inflation outlook is not secured long-term near the target, the ECB will also guard against too strong a euro by intervening verbally near 1.15.

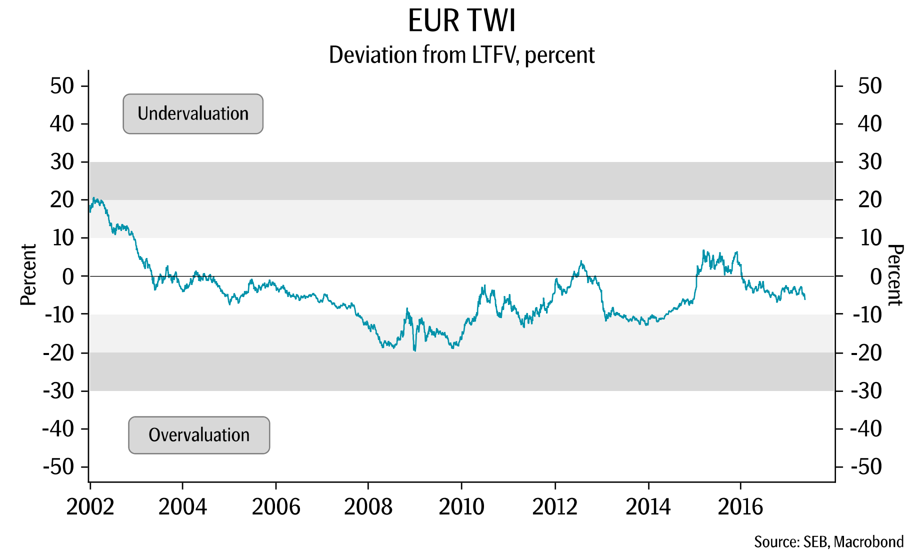
LONG-TERM OUTLOOK: CAN THE RALLY BE SUSTAINED?
As the trade-weighted euro is close to its historical average and the euro-zone still faces political risk premiums and large internal imbalances, the potential for a continued rally is limited. **For the euro to trade well above its average rate and long-term fair value would require: 1) stronger fiscal collaboration** within the euro-zone (the EU Commission will announce such proposals on May 31st); **2) internal imbalances in the euro zone decreasing** likely boosting domestic spending; and **3) the ECB starting to raise its refi rate/stop QE.** None is expected in the next 6-12 months.

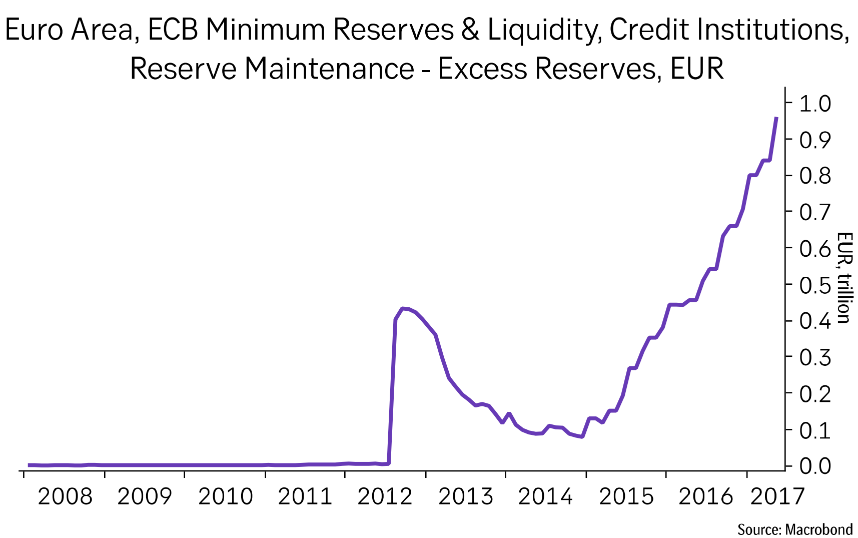


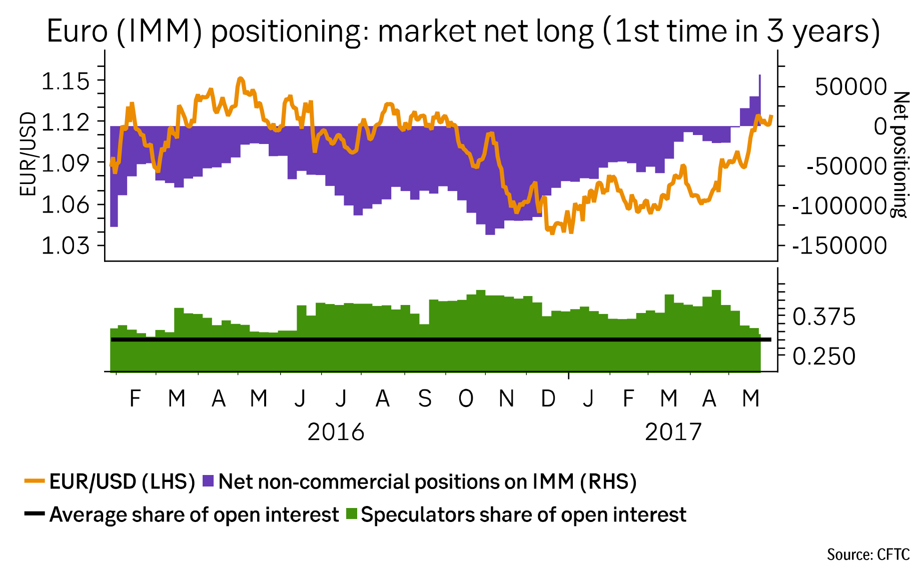


EUR: Not justified to trade above LT fair-value









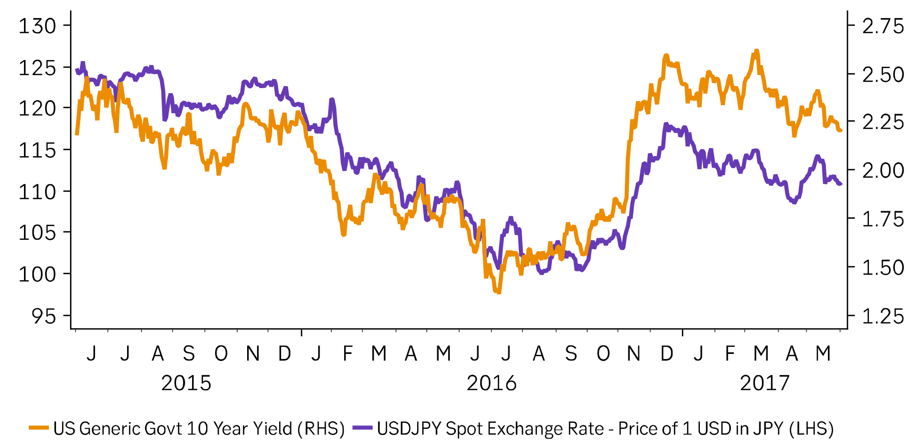
JPY: Trade the 108-118 range in USD/JPY

WE EXPECT JPY TO REMAIN WEAK
We think JPY will continue to weaken in 2017 as US rates remain high and BoJ remain accommodative. JPY will trade in the 108-118 range in 2017 compared to the 100-110 range in 2016. Short term events can push JPY below 110. However, they should be good buying opportunities.

The economy will stay stagnant around 0.5% in 2017 from 0.5% in 2016. We expect some stabilization in consumption since the VAT hike has been delayed until Oct 2019. Capex is slowly recovering with business confidence returning. Recovery in domestic demand should reduce the current account surplus. Japan's issue is that the economic recovery is too slow for inflation pressures to rise and hit Bank of Japan's 2% inflation target in 2017. BoJ's new policy of Yield Curve Control is highly beneficial when global interest rates are rising since Japan's rates are kept constant and the wider spread weakens JPY and loosens policy further. This will help the Japanese economy into 2017 and capital outflow will continue to keep JPY weak. Finally, BoJ board members have become even more dovish with 4 out of 9 who voted against negative interest rates will be all replaced by doves this year.

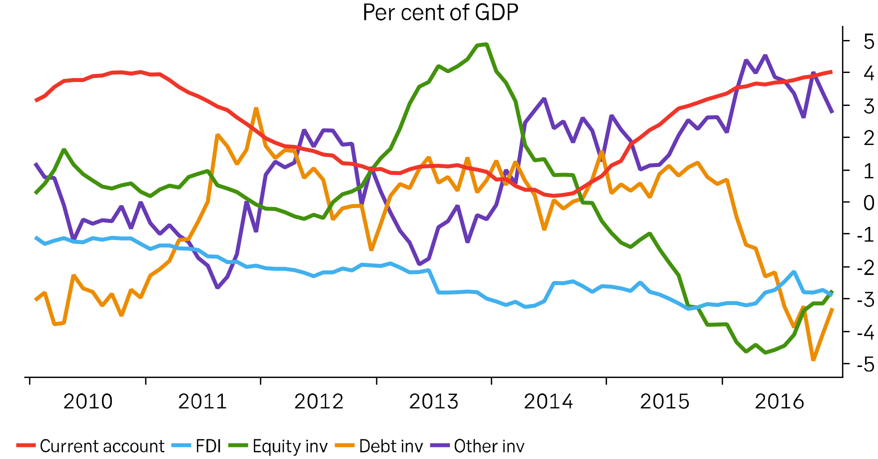
THE LONG-TERM OUTLOOK is for Yen weakness to be capped. The current account surplus may shrink but it still remains solid at above 2% of GDP. JPY's valuation improved in 2015 but recent weakness is bringing JPY back closer to fair value. Lastly, inflation expectations have finally turned higher, meaning that BoJ easing is finally having some impact. Beyond, 2017, more BoJ easing appears unlikely. In 2018, BoJ may either reduce the 80trn Yen target or increase the target on 10 year yield towards 10-20bps from 0%.

USD/JPY and US 10 year yield



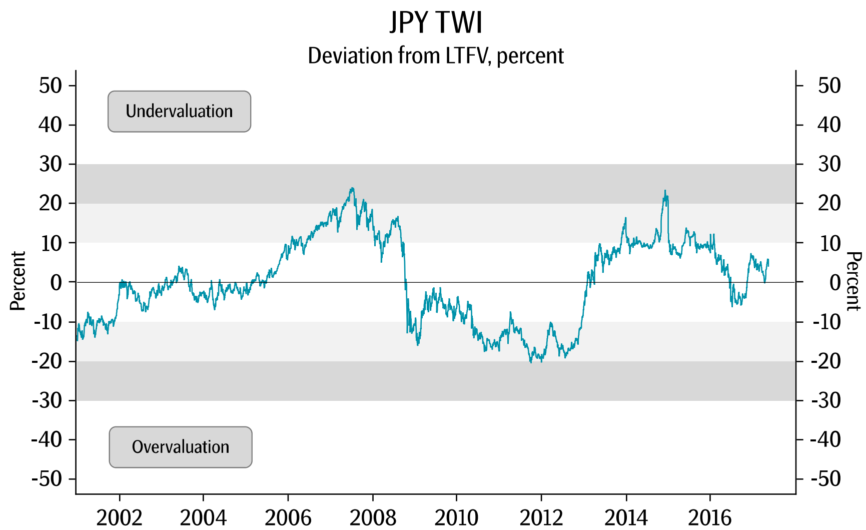
Source: Bloomberg

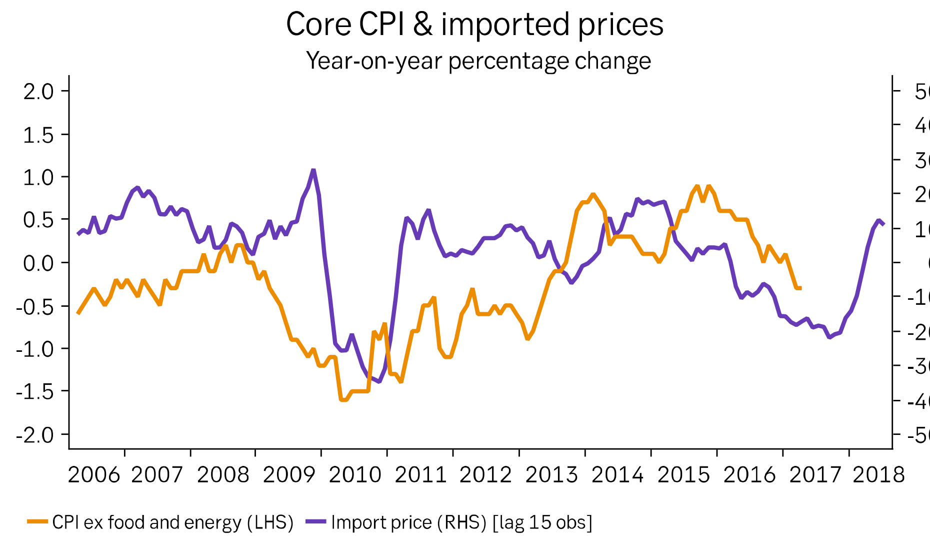
Japan BOP
Per cent of GDP



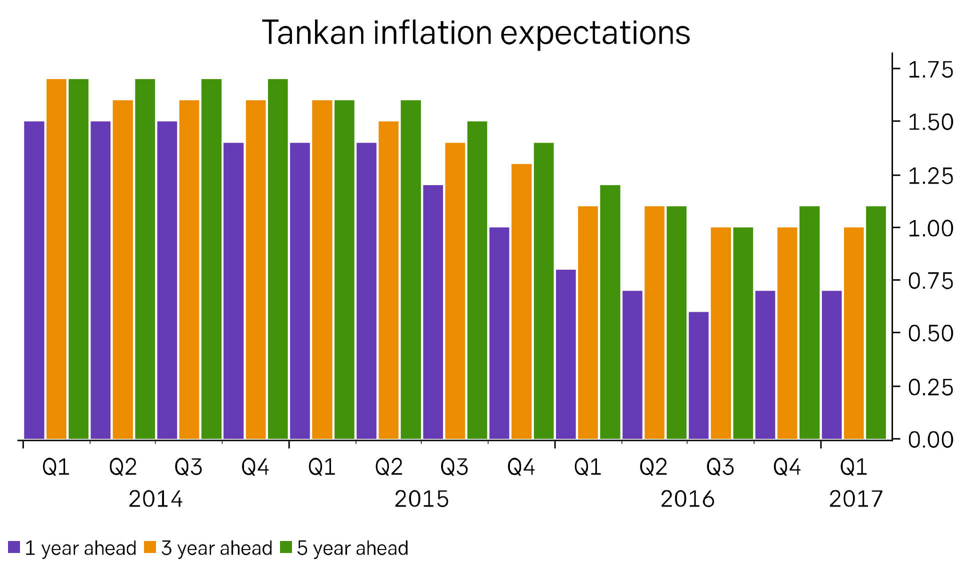
Source: Macrobond

JPY: BOJ to continue Yield curve control

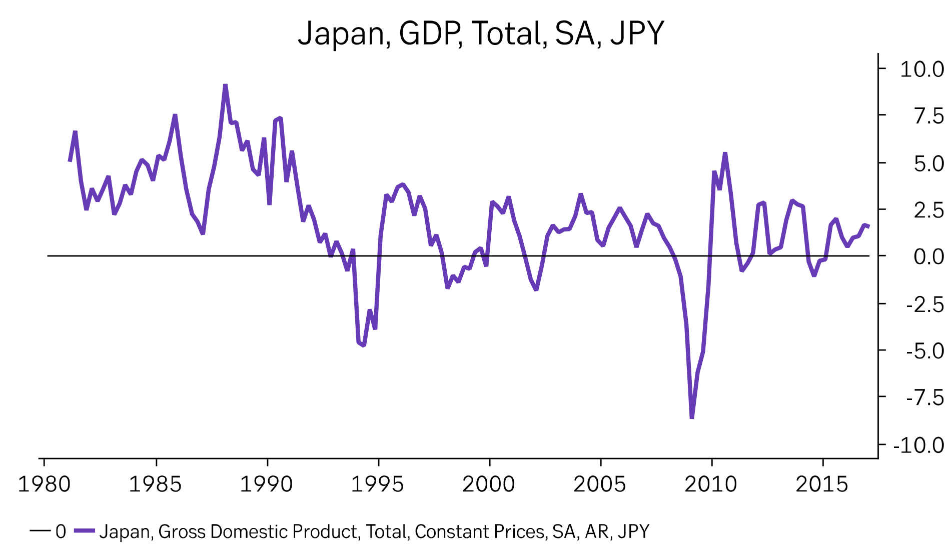




Source: Macrobond



Source: Macrobond



Source: Macrobond

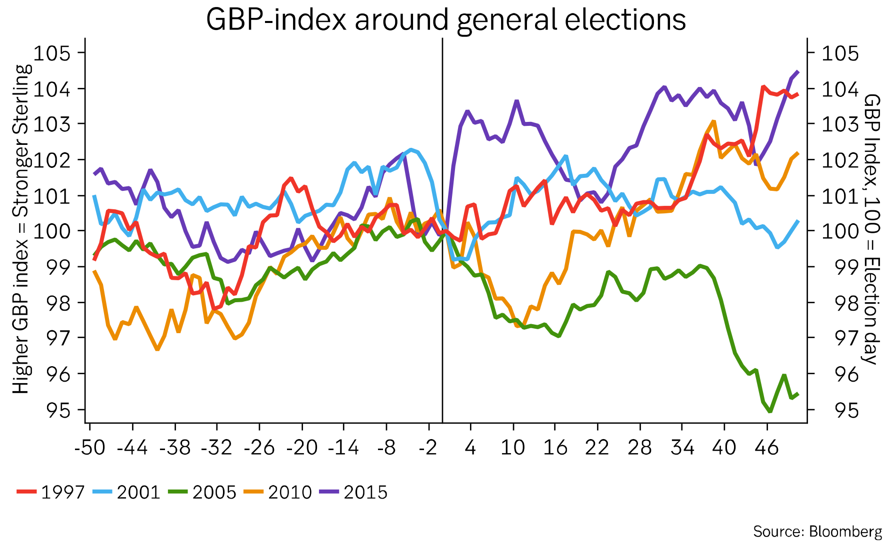
GBP: Brexit negotiations determine outlook

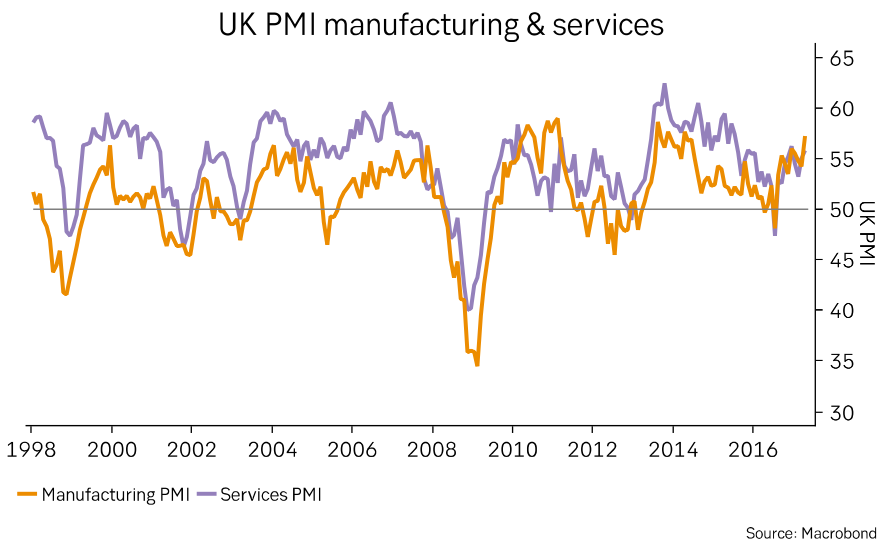
BREXIT NEGOTIATIONS WILL DETERMINE. On March 29 the British government declared that the country will leave the EU in accordance with Article 50 of the Treaty of Lisbon. So far the tone has been anything but friendly. Time is short and negotiations need to be constructive from the start. We expect these discussions to determine the fate of the GBP.

SHORT-TERM: When called the UK general election (Jun 8) seemed like a done deal. However, recent polls indicate the government lead has narrowed. We still expect the Tories to win, which is unlikely to rattle markets. EU/UK negotiations will be key for the near-term GBP outlook. We expect the EU to take a hard stance, **which may frighten financial markets and weaken Sterling additionally.**

LONG-TERM: The GBP is significantly undervalued after having weakened by up to 25% in trade weighted terms since the referendum was announced in late 2015. However, given the uncertainty created by UK plans to quit the EU, its low valuation seems reasonable. The long-term outlook for Sterling will be determined by a combination of progress in negotiations and the resilience of the economy. Obviously, talks will be tough with the UK government needing to realize it holds the weaker hand during discussions and that it should offer concessions. Despite the leave win in the referendum last year the economy has performed well as consumers have continued to spend. Indeed, growth in 2016 was stronger than in the previous year. However, there are signs this may be unsustainable. Businesses are likely to delay capital spending due to uncertainty and households are being squeezed by falling real wages, a slowing housing market and low savings, which will weigh on spending. Q1 growth was the weakest in a year and we believe it could slow even further.

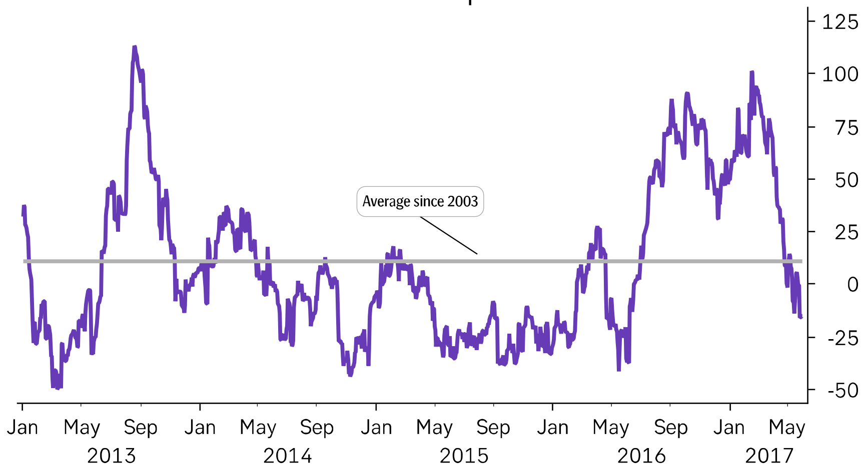
.





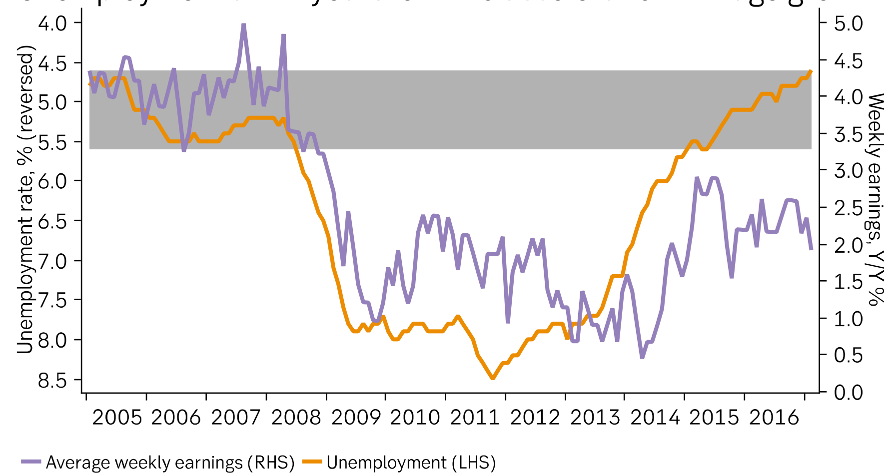
GBP: Market remains short but not excessively so

UK Economic surprise index



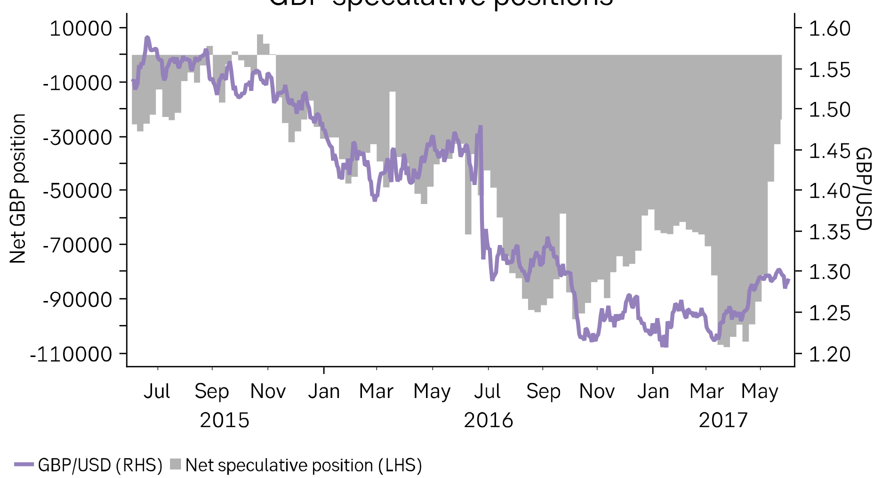
Source: Macrobond

Unemployment at 42 years low - no acceleration in wage growth



Source: Macrobond

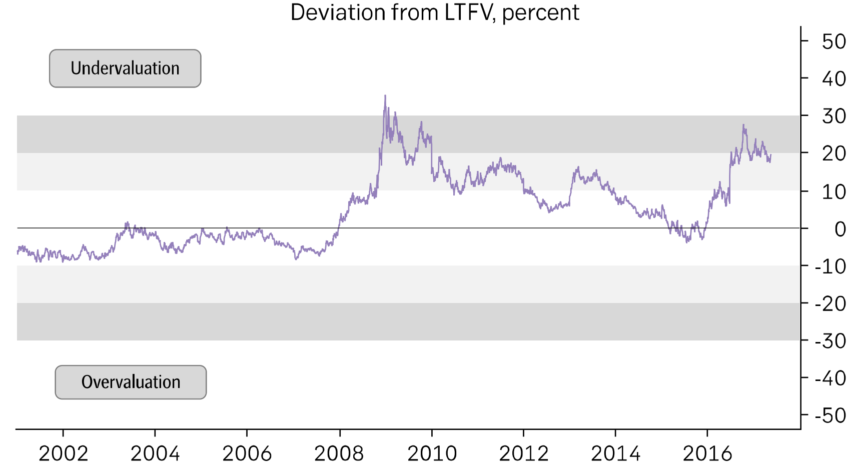
GBP speculative positions



Source: CFTC

GBP TWI

Deviation from LTFV, percent



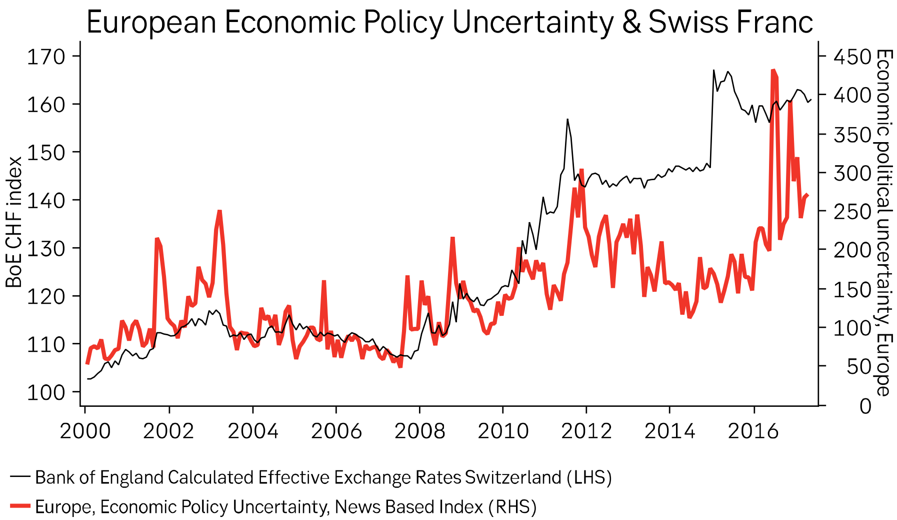
Source: SEB, Macrobond

SEB

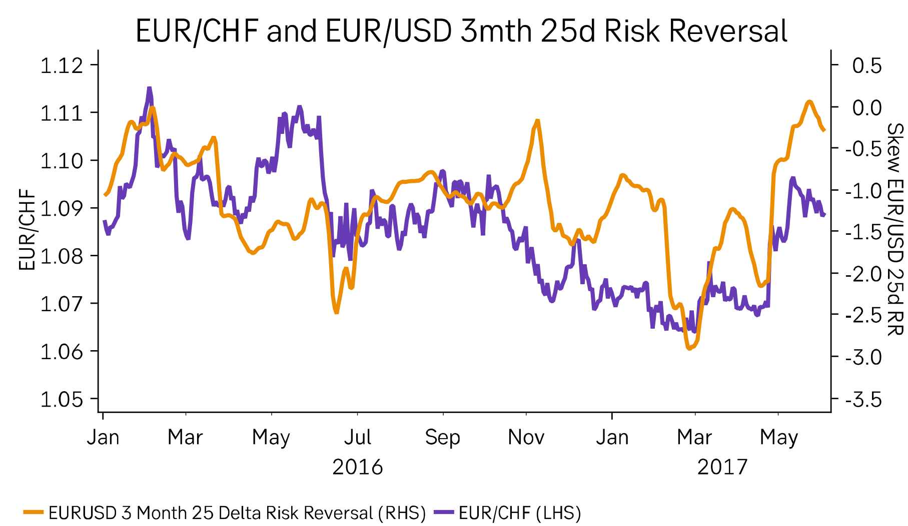
CHF: Finding a good equilibrium rate

TEMPORARY DECREASE IN EU POLITICAL RISKS?
Clearly the market bought the Swiss Franc ahead of the French presidential election on concerns that a more adverse outcome (a Le Pen win) was possible. With Macron installed as French president political risk premiums within the euro-zone have fallen back while the euro has appreciated. Consequently, our scenario of a strong CHF (which worked well in Q1 and early Q2) is now on hold. Speculators got this right by positioning short in the CHF ahead of the French election. **But three factors continue to support the Swiss franc in the medium-term: 1) Valuation (**as also stated in the Jan 2017 Currency Strategy) is not as stretched as most would think. Indeed, we estimate long-term fair value in EUR/CHF around 1.10-1.15 (see real effective exchange rate deviation chart on next page); **2) Political risks in Europe will remain high** as the upcoming election in Italy (perhaps as early as September) poses the greatest threat that an euro-negative government will be elected; **3) The Swiss external balance remains highly positive:** Once again, the current account exceeded 10% of GDP in 2016, while the basic balance was above 15% of GDP. The SNB expects inflation to remain just above 0% y/y, though CPI will rise above 1.0% in 2019. Growth has been weak with the economy only expanding at an annualised rate of 0.3% in the fourth quarter of 2016. The SNB forecasts the economy to grow by 1.5% in 2017.

LONG-TERM VIEW
1.10 in EUR/CHF is likely a good benchmark for where we will trade going forward. During H2 2017 we see a risk that capital flows will again seek shelter in Switzerland as the Italian election draws nearer. It remains hard to project a substantially weaker Swiss franc in the coming quarters.

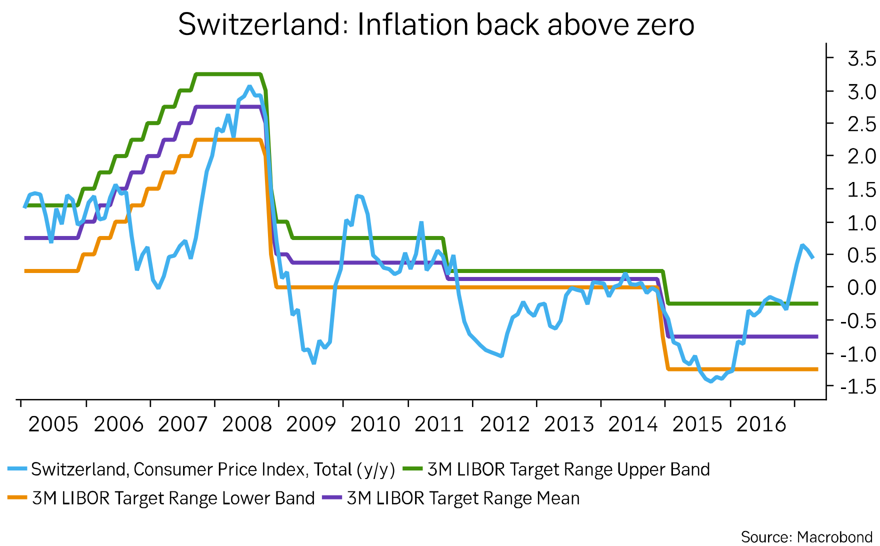


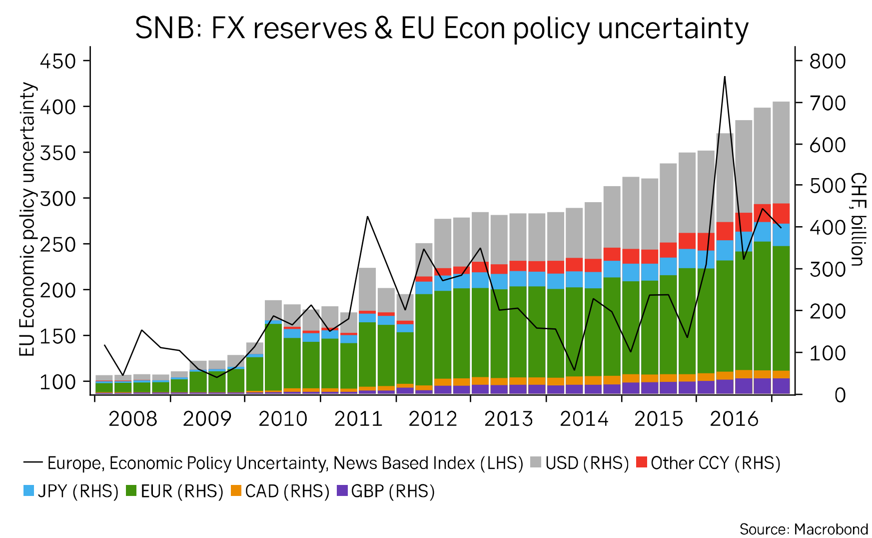
Source: Macrobond

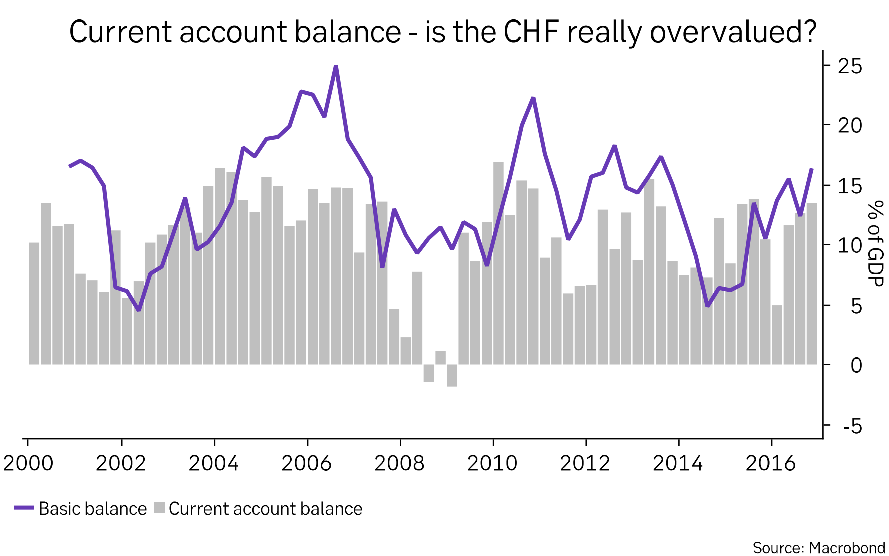


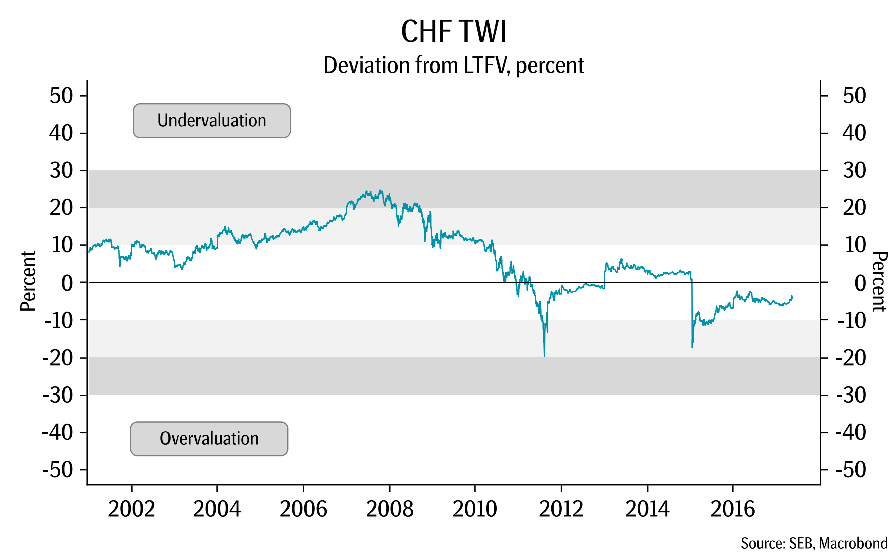
Source: Macrobond

CHF: Are capital inflows set to moderate?









SEB

CAD: Expected to appreciate H2 2017

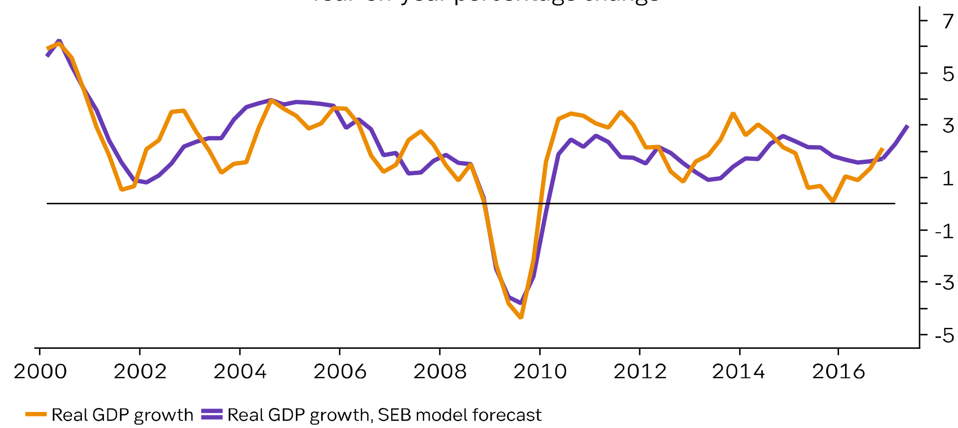
WE EXPECT THE CANADIAN DOLLAR TO STRENGTHEN. Recent economic data have been encouraging and the Bank of Canada now sees the output gap closing already in the fist half of 2018. Since excess capacity is expected to be absorbed within a year, the BoC may well start discussing policy normalization soon. While we do not expect actual hikes until 2018, the hiking bias should support CAD. In addition, the CAD should be supported by its extensive connections to its southern neighbour as US real GDP growth is poised to pick up. However, an increase in protectionist policies (e.g. the future of the NAFTA treaty) and softening commodity prices cloud the outlook while our estimations suggest that the CAD is undervalued. Overvalued house prices is a risk to our positive outlook.

SHORT-TERM: BoC's quarterly *Business Outlook Survey* shows that businesses are the most optimistic about investment and hiring since before the oil price slump in 2014. Employment growth has picked up in recent months while the unemployment rate has fallen well below the OECD estimate of the NAIRU although wage growth is still muted. Foreign trade has mostly shown surpluses in recent months and the strong run may well continue as lagged effects of the recent CAD depreciation is manifesting itself. However, the current account deficit widened in Q1 but is still way better than the levels seen last year. Inflation is running below target, thus making monetary policy normalization less urgent. Investors are currently net short the CAD, which is a positive.

LONG-TERM: The fundamentals are strong and economic activity will be supported by rising foreign demand, fiscal stimulus and accommodative monetary and financial conditions. We view the chance of a rate cut as small; instead we think the BoC may initiate the normalization cycle in Q1 2018 which is earlier compared to our previous forecast.

Canadian real GDP growth is picking up

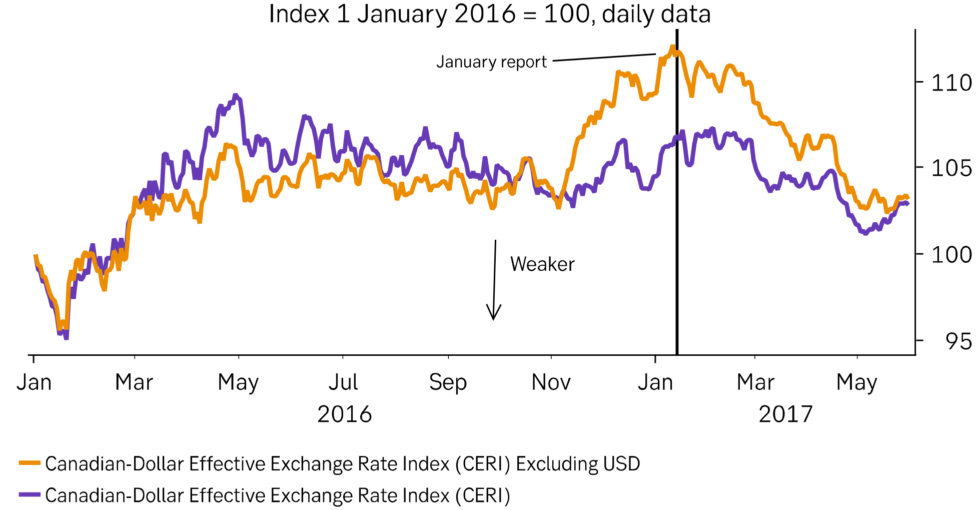
Year-on-year percentage change



Source: Macrobond, SEB

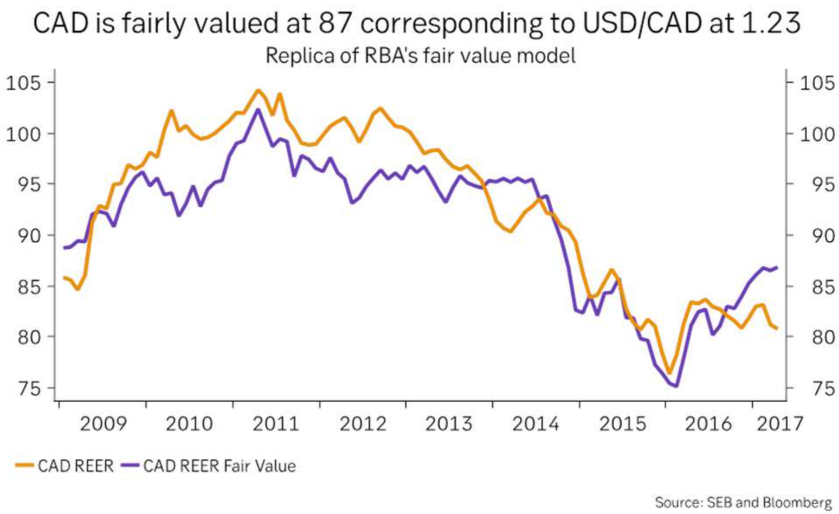
The Canadian dollar has depreciated in 2017

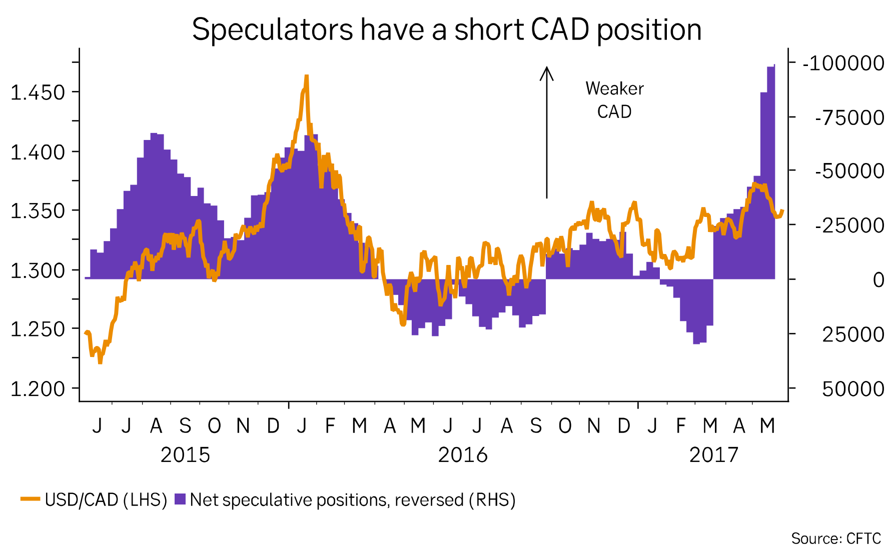
Index 1 January 2016 = 100, daily data

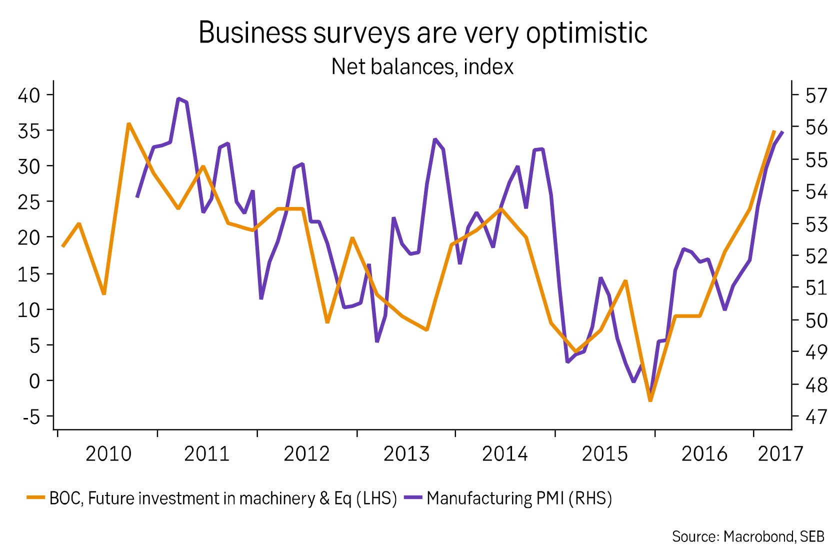


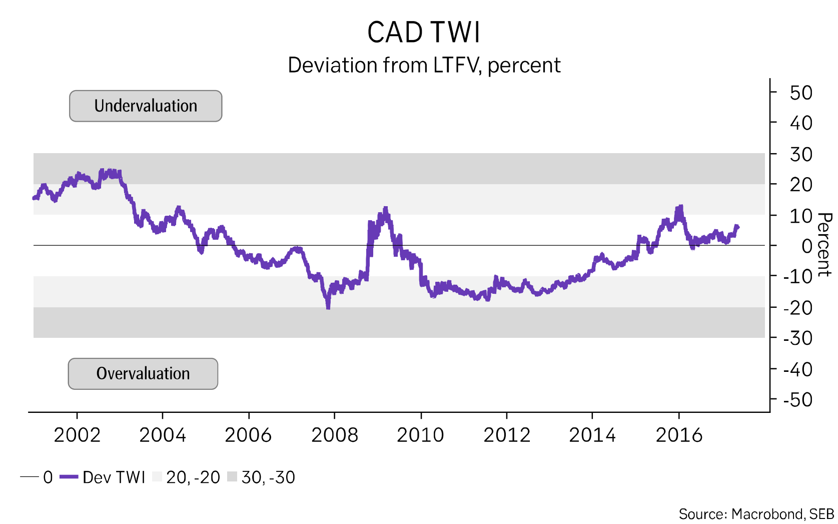
Source: Macrobond, SEB

CAD: Supported by economic data & valuation







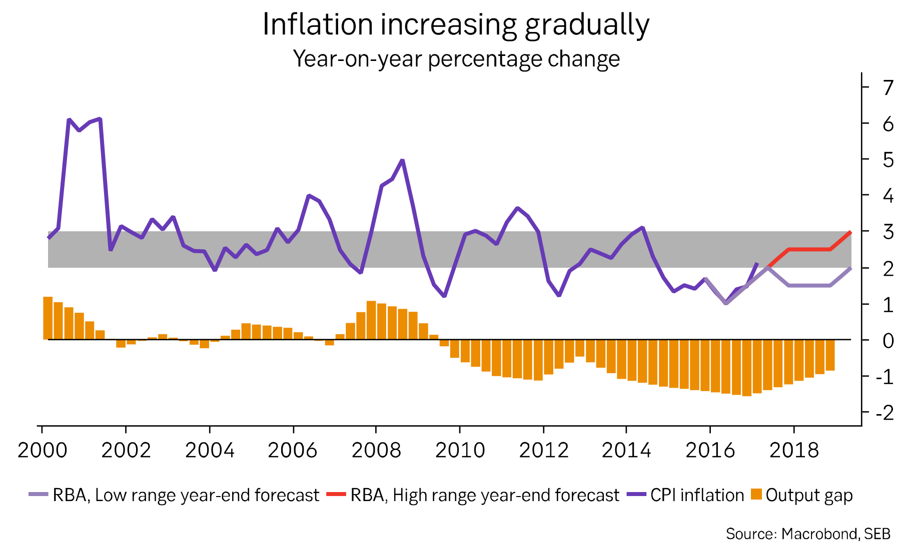


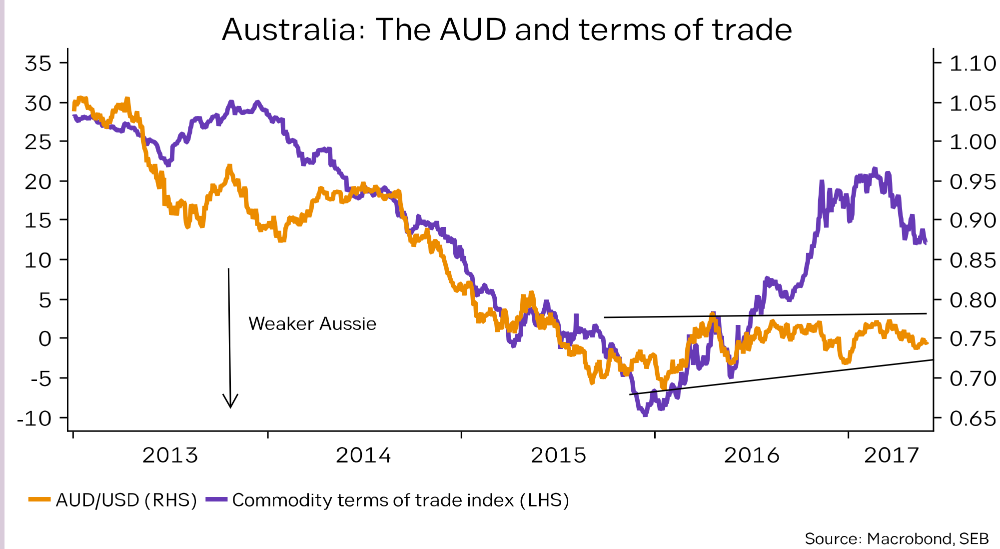
AUD: A case for a stronger Aussie

MORE CONFIDENCE IN THE RECOVERY
After the temporary weakness in the middle of 2016, the Australian economy is strengthening again and the outlook is looking favorable against the backdrop of the stronger global economy. Notwithstanding recent developments, commodity prices increased over 2016 and early 2017, resulting in a sizable rise in Australia's terms of trade. Inflation is rising too and is close to target. The AUD has traded in a narrow range against the USD since 2015 and is little changed in trade-weighted terms thus far in 2017. The RBA has upgraded its forecast for terms of trade and GDP growth and is no longer referring to inflation as "quite low". As such, we expect the RBA to start normalizing the cash rate from its current record low level in 2018. So from an economic fundamentals perspective there is a case for AUD appreciation.

Short-term: The RBA is factoring in a relatively weak backdrop for commodity prices; thus a stronger outcome more in line with our forecasts has the potential to boost employment, growth and AUD alike. For 2017, however, the chance of a cut in the cash rate is higher than the chance of a hike according to market pricing. However, the majority of analysts expect unchanged policy in 2017 and we agree. Instead we look for the first hike in August 2018; somewhat earlier compared to our previous forecast. Remember that the decisions to lower the cash rate in 2016 were due to low inflation which is much less of a problem today.

Long-term: The AUD remains substantially overvalued against its trade weighted index, which is a long-term risk for the currency. Strong house price growth in parts of the country is another concern, although there is hope that macroprudential efforts will mitigate the risks.

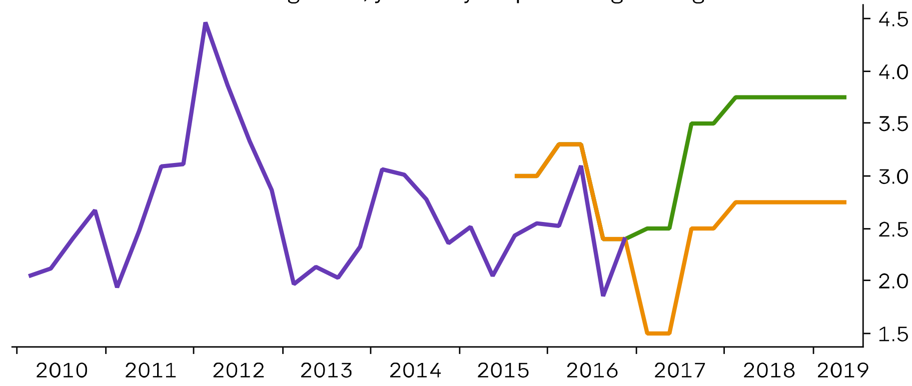




AUD: Economic fundamentals are supportive

More confidence in the economic recovery

Real GDP growth, year-on-year percentage change

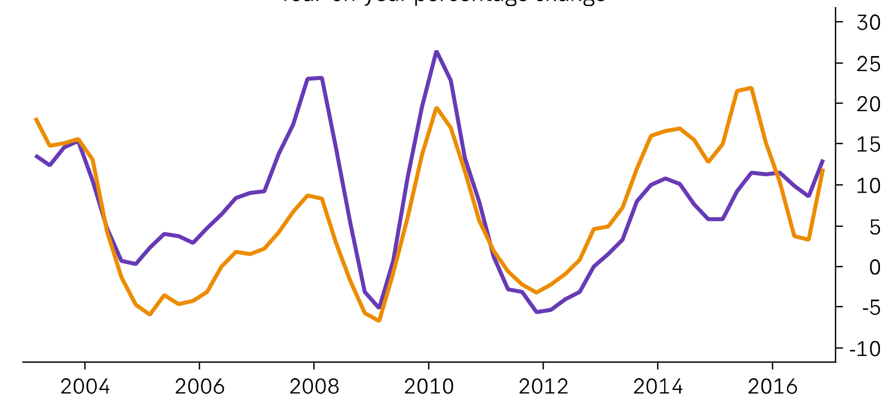


Real GDP growth — RBA, GDP Growth, low range at year end — RBA, GDP Growth, High range at year-end

Source: RBA, SEB

House price growth is accelerating

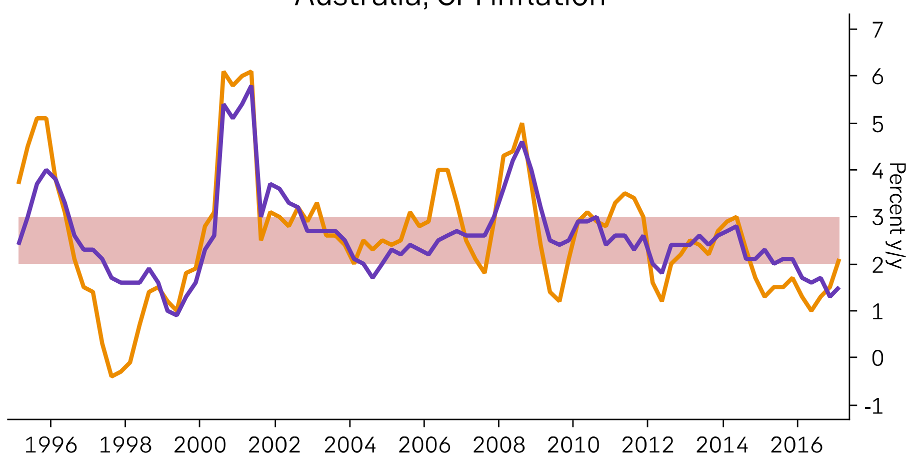
Year-on-year percentage change



Sydney — Melbourne

Source: Macrobond, SEB

Australia, CPI inflation

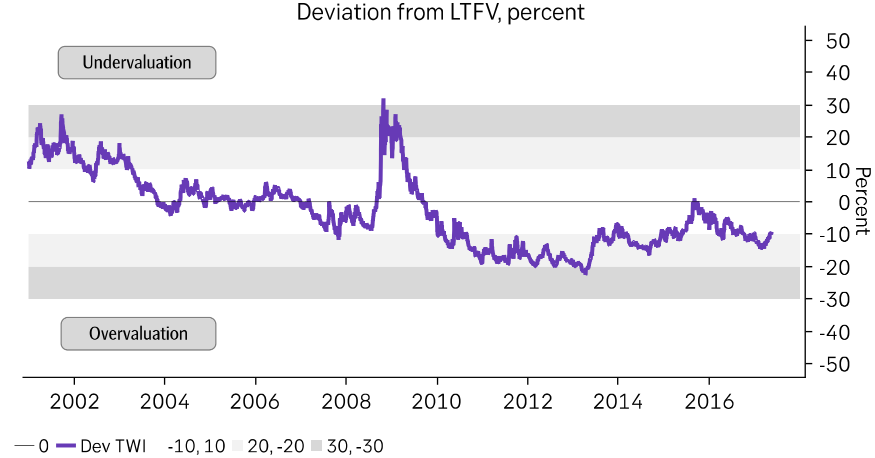


All Groups Excluding 'Volatile Items' — Total

Source: Macrobond, SEB

AUD TWI

Deviation from LTFV, percent



Source: Macrobond, SEB

NZD: Overvalued but supportive fundamentals

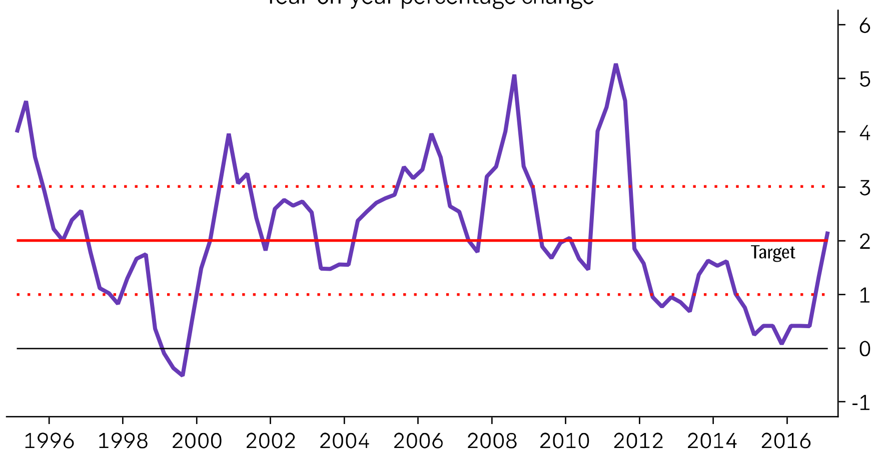
CAPACITY PRESSURE CONTINUES TO BUILD
GDP growth is still primarily driven by domestic demand. Consumption growth is supported by net migration, low interest rates and rising house prices. Construction remains another key source of growth and tourism provides a further boost. Terms-of-trade have improved and add to the positive growth outlook. The RBNZ forecasts GDP to grow by 3.1% in 2017. Above potential growth will cause capacity pressure to continue building, most notably in the construction sector.

CPI inflation was 2.2% in Q1; close to the target midpoint. The increase has primarily been driven by a sharp increase in tradables inflation. This is expected to be temporary but inflation will rise gradually over the medium term. Short-term inflation expectations have increased in recent quarters and long-term expectations remain well anchored at 2%. The housing market is still a key risk but total house price growth has moderated slightly. Increased housing construction, rising mortgage rates and tighter loan-to-value policy is expected to moderate price increases further.

The trade-weighted NZD exchange rate has fallen recently but the SEB valuation model still indicates that the currency is overvalued. The RBNZ has kept the policy rate unchanged at 1.75% since the cut in November 2016 and has stated that the policy rate is "expected to remain low for a prolonged period". We do not expect any changes in the policy rate in 2017. Yields are still relatively high compared to other advanced countries providing some scope for carry trade inflows. The current account deficit is expected to remain around 3% of GDP. Speculative positioning have become less negative recently. We expect the NZD to strengthen slightly going forward.

New Zealand: Inflation is near the target midpoint

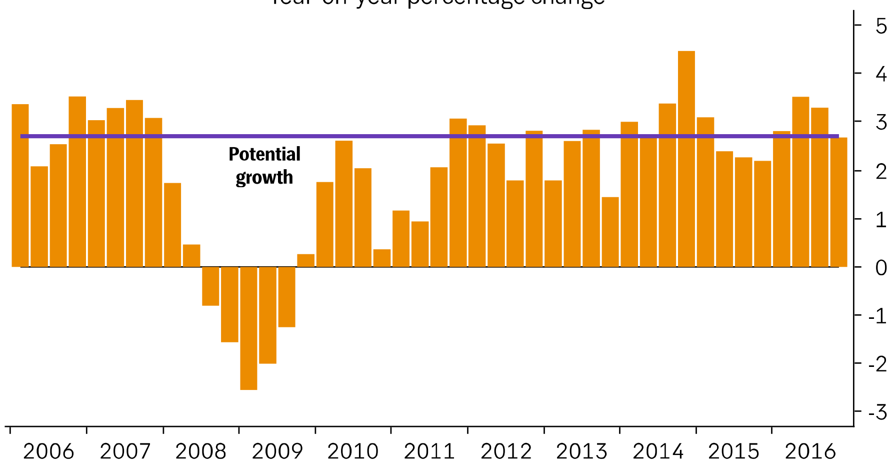
Year-on-year percentage change



Source: New Zealand National Statistical Office

New Zealand: GDP growth expected to rise above potential

Year-on-year percentage change

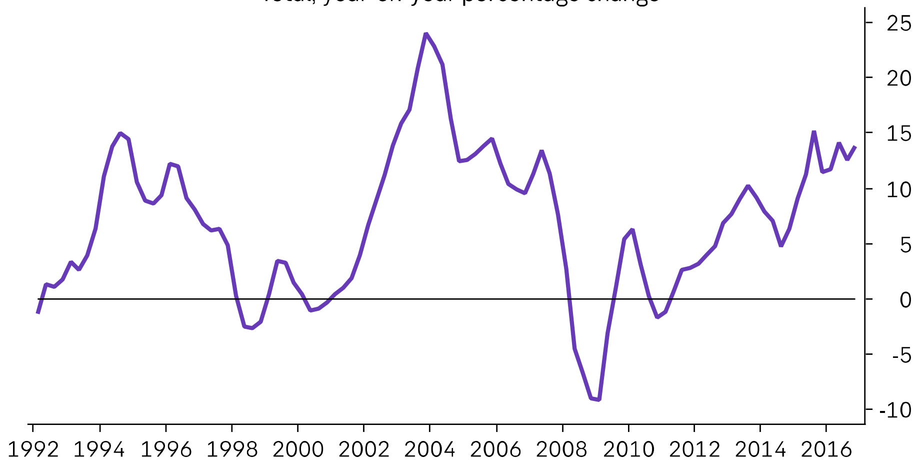


Source: New Zealand National Statistical Office

NZD: Improving terms of trade

New Zealand: House prices increases have moderated slightly

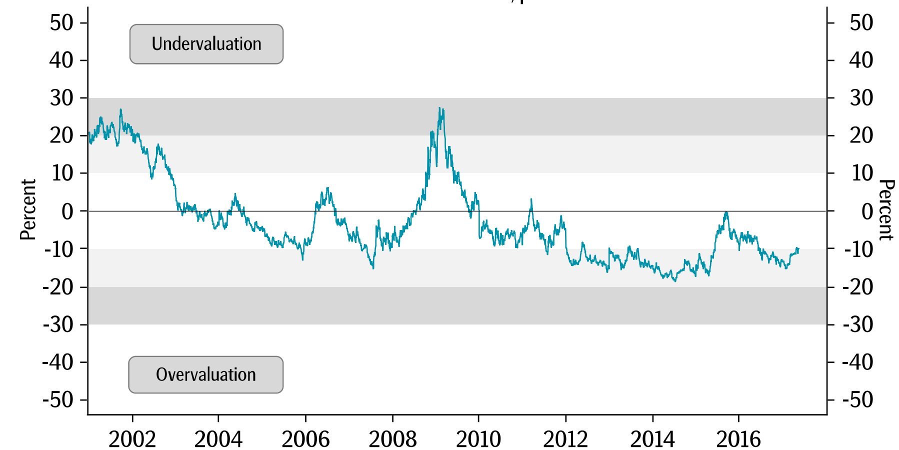
Total, year-on-year percentage change



Source: Quotable value

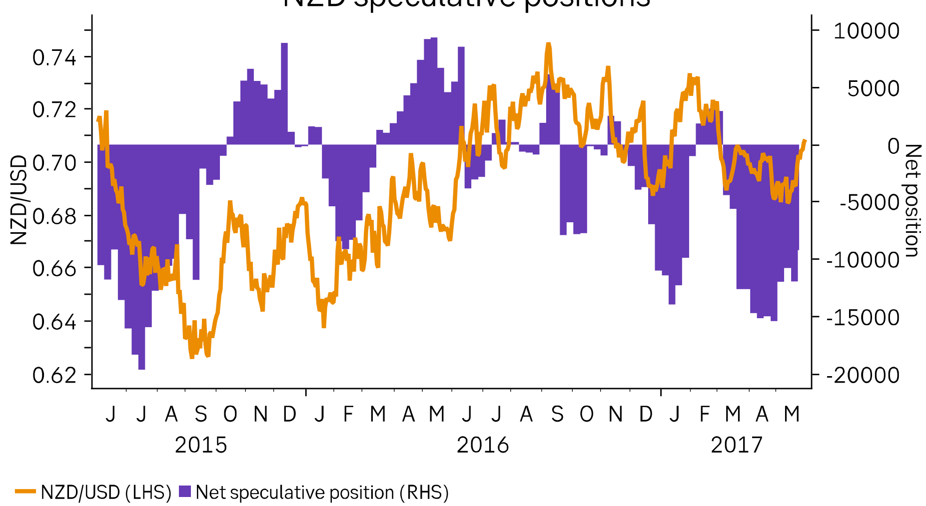
NZD TWI

Deviation from LTFV, percent



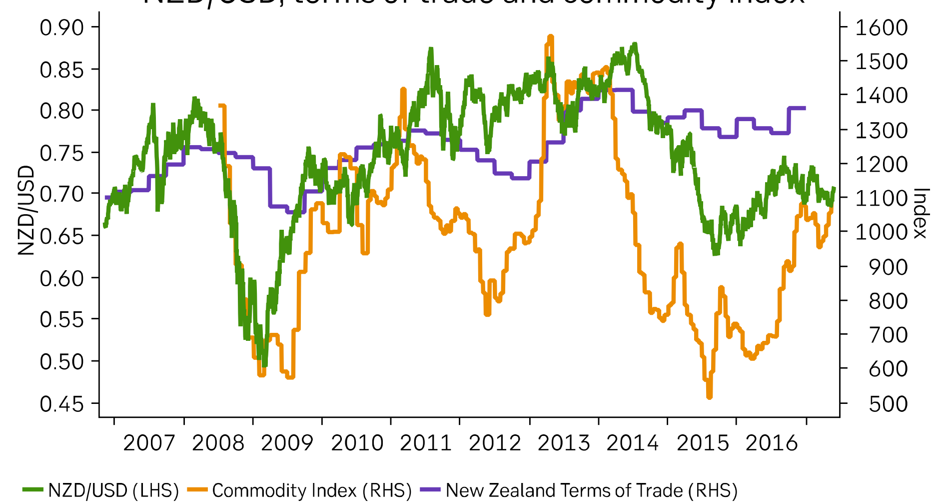
Source: SEB, Macrobond

NZD speculative positions



Source: Bloomberg, CFTC

NZD/USD, terms of trade and commodity index



Source: Global Dairy Trade, Macrobond, New Zealand National Statistical Office

SEB

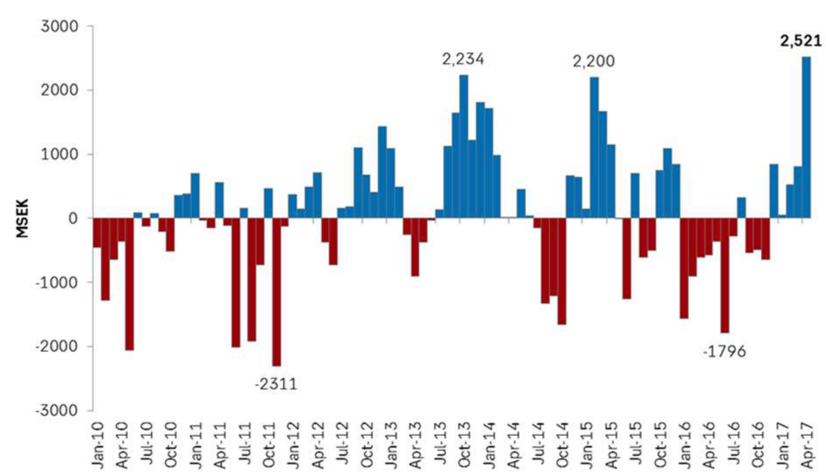
SEK: Funding currency of choice?

THE FUNDING CURRENCY OF CHOICE?
Swedish growth remains strong although GDP in Q1 was a disappointment (0.4/2.2) and SEB forecasts increases for 2017 of 3.1% and 2.8% in 2018. Growth is broad-based with most if not all sectors of the economy contributing. Further, inflation/ inflation expectations are close to the Riksbank's target of 2%. Problematically, Sweden "needs" to generate pay growth of 3.5-4.0% to drive inflation up to near the 2% target – wage negotiations (2.3%) and wage drift will not be high enough. Over the longer term the current monetary policy set-up carries risks for financial stability given the rate at which house prices are rising and high household indebtedness, although the Riksbank downplays every critical review saying Sweden needs less accommodative monetary policy. As a result, valuation is the sole supportive factor for the SEK currently.

Between March and May, the SEK weakened as equity dividends were paid out. As this period draws to an end we expect flows to turn more positive again. In some years, the SEK has also weakened over the summer. There are two possible reasons: 1) Swedish exporters stop selling FX/SEK; and 2) Swedes travel abroad and sell SEK buying FX. However, current account data for travel (see chart on the next page) actually shows that the year's lowest outflows occur in Q3. **Consequently, we do not expect the SEK to weaken over the summer.**

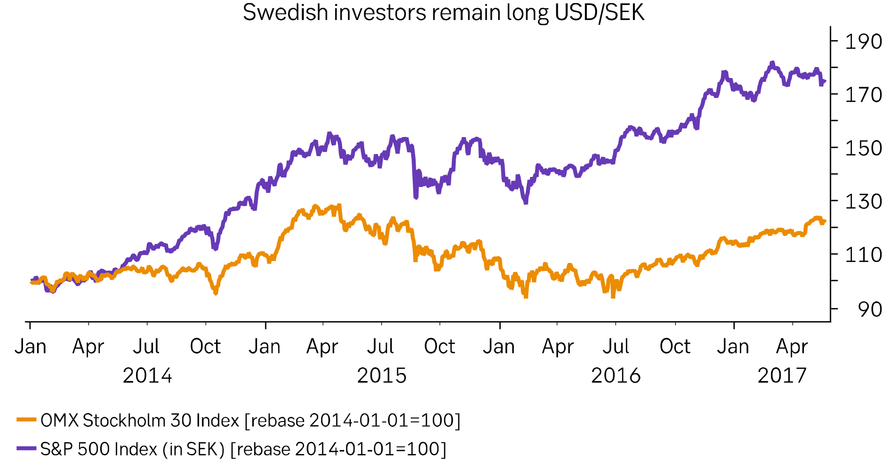
EUR/SEK NEAR-TERM: We recommend selling EUR/SEK at 9.77 as we expect domestic companies and institutions to use the present weak rate to increase their FX hedges. We target 9.40, which then requires Riksbank rate hikes to be broken.

Swedish EU equity fund flows



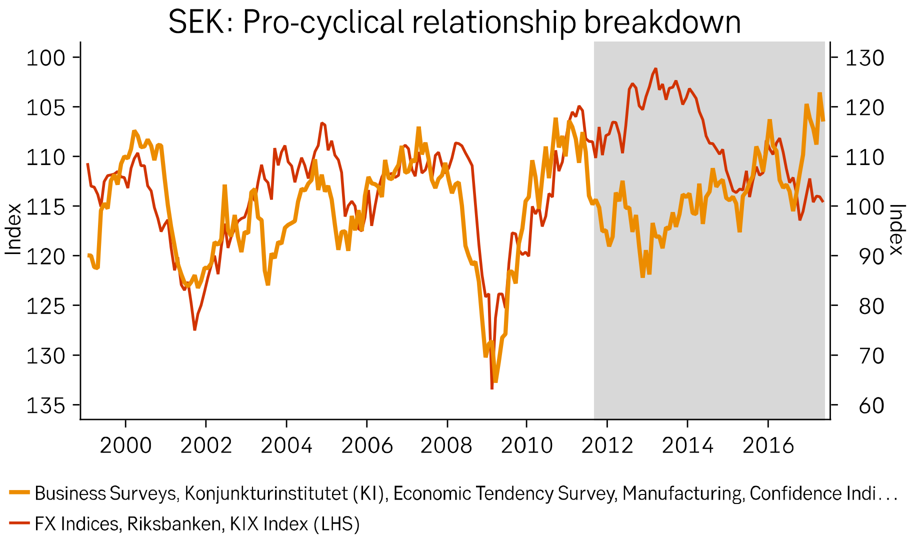
Source: Swedish Investment Fund Association

S&P 500 (in SEK) has outperformed massively
Swedish investors remain long USD/SEK

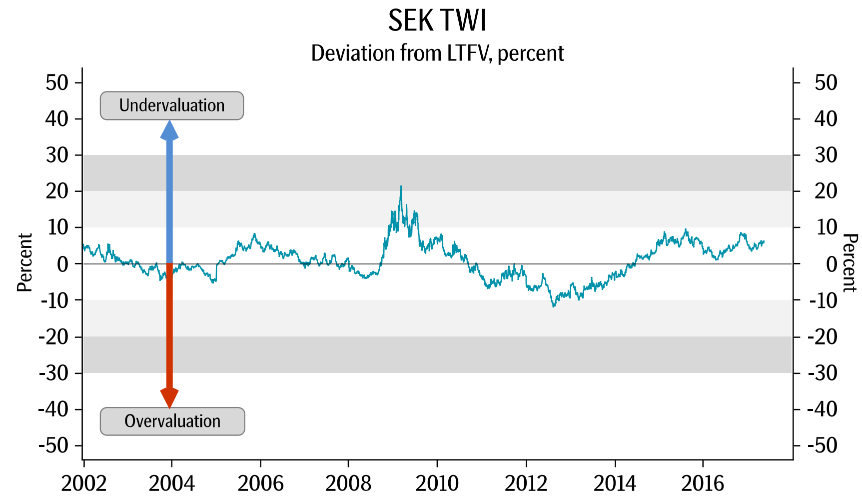


Source: Macrobond

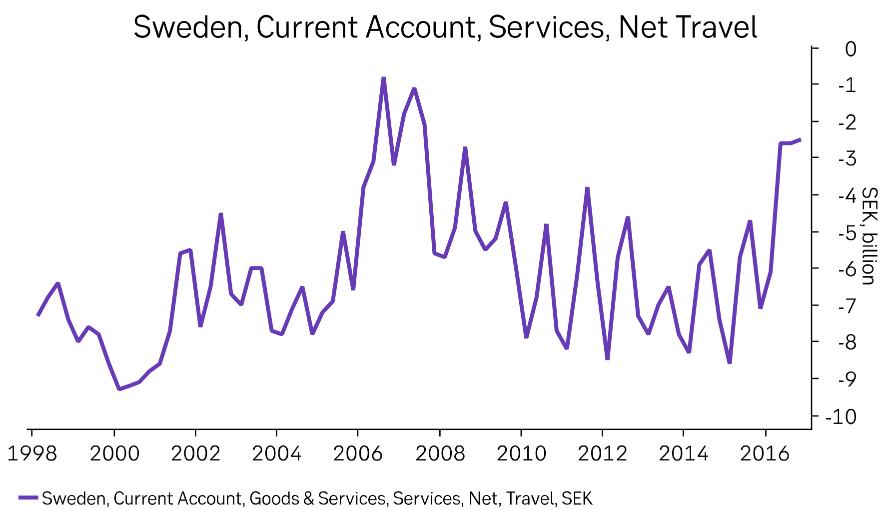
SEK: Attractive valuation supportive



Source: Macrobond



Source: SEB, Macrobond



Source: Macrobond

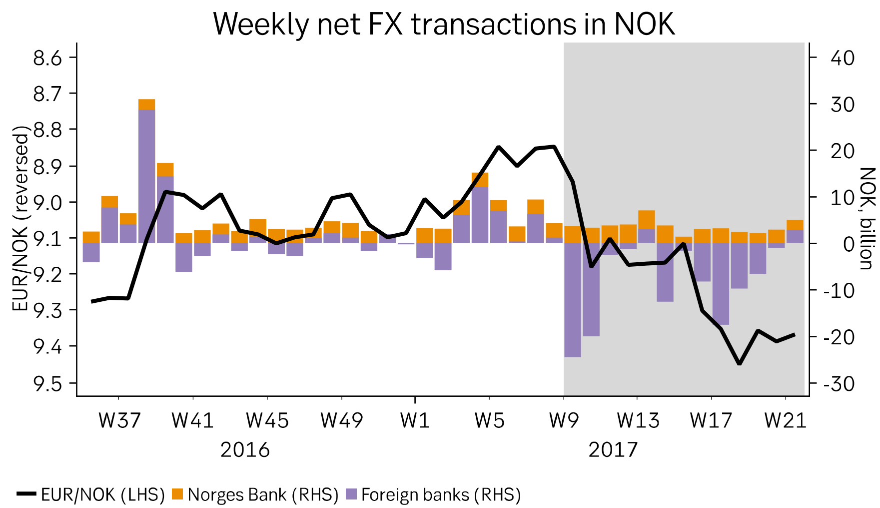
Source: Macrobond

NOK: Battered but not broken

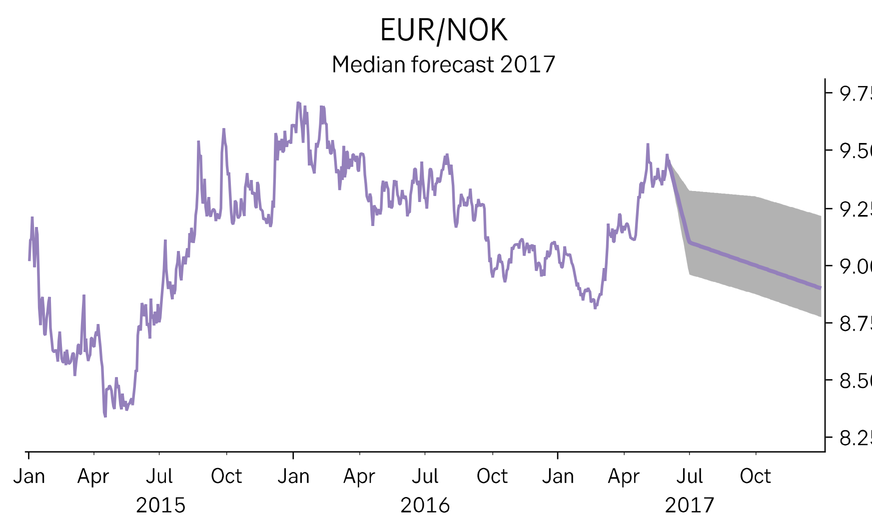
SET TO STRENGTEN. Data suggest that speculative accounts were behind the sharp move higher in EUR/NOK between mid-February and May. As a result, the NOK has decoupled from fundamentals. We expect further signs of stronger growth and a higher oil price to lift the NOK again, although upside potential is limited as Norges Bank probably prefers the currency to remain weak.

SHORT-TERM: Since oil continues to trade above $50/bbl and low inflation is unlikely to change the central bank's monetary policy, we regard the move higher in EUR/NOK, driven by short-term players, as unsustainable. Although inflation has fallen well below its target, Norges Bank is unlikely to ease further as rising house prices are clearly of concern. Reasonable triggers for a NOK recovery are an oil price above $55/bbl or additional signs of stronger growth.

LONG-TERM: Since the oil price started to fall in 2014 the NOK has been undervalued against most G10 currencies. Although the NOK has recovered from extremes it may appreciate by up to 10% in trade weighted terms without being considered expensive. While the flow outlook given Norges Bank's NOK purchases is not as supportive as we expected at the beginning of the year, clearly buying NOK 850mn/day for the remainder of the year will provide some support. While we hold a long-term constructive view on the NOK based on improving fundamentals, low inflation probably means Norges Bank will remain vigilant to prevent the currency from strengthening rapidly, as this may worsen the inflation outlook. Expectations of a stronger NOK among market players are not as "consensus" today as at the beginning of the year. This opens up for a NOK recovery once stronger data begins to convince.

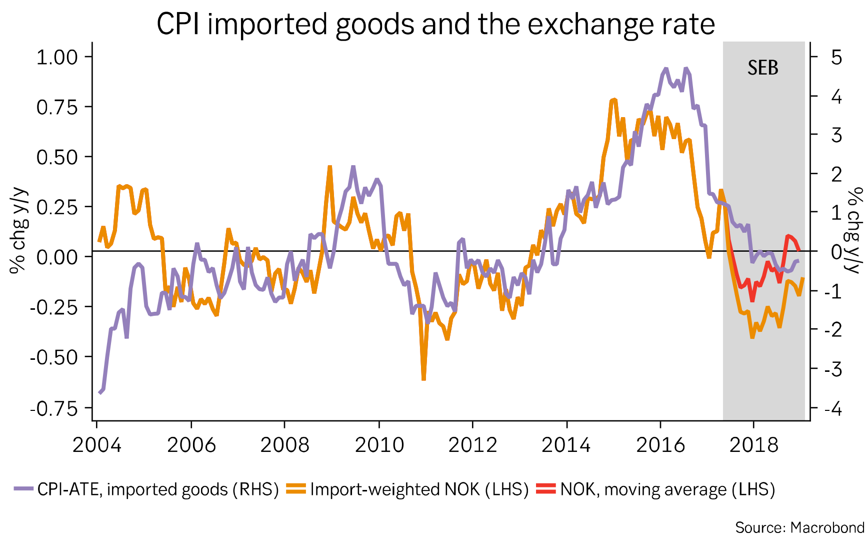


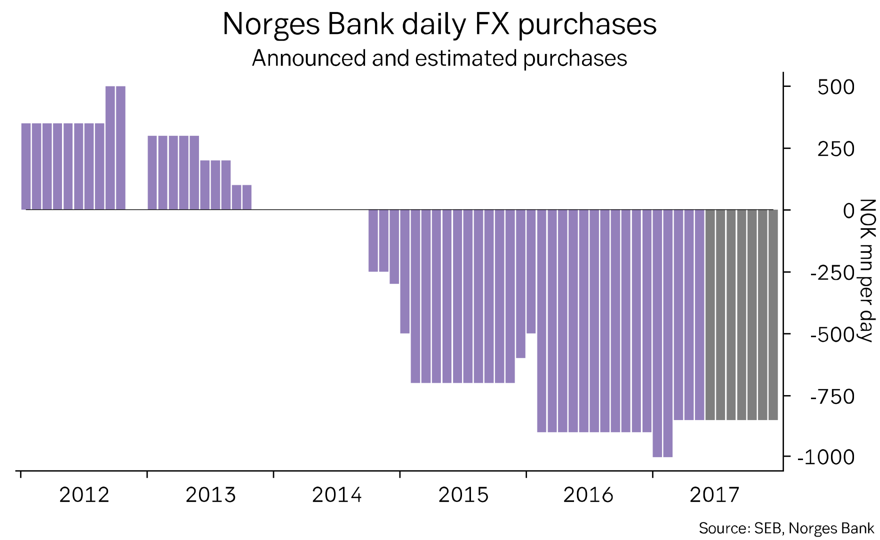
Source: Norges Bank

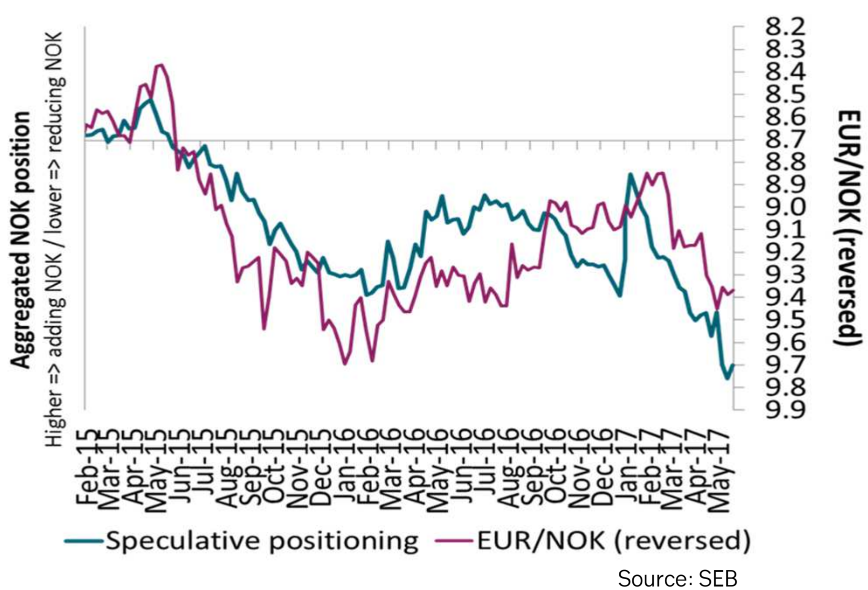


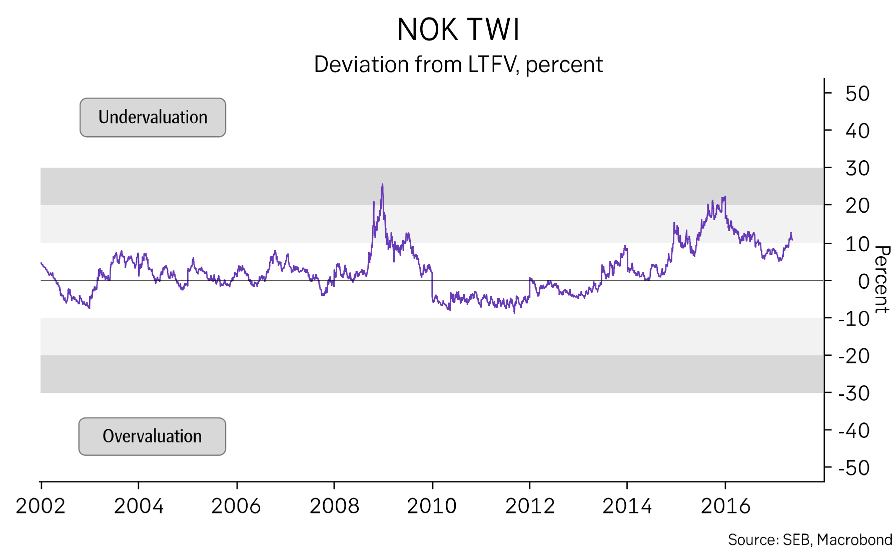
Source: Bloomberg

NOK: Fundamentals suggests krone to appreciate









PLN: Growth to propel zloty lift-off

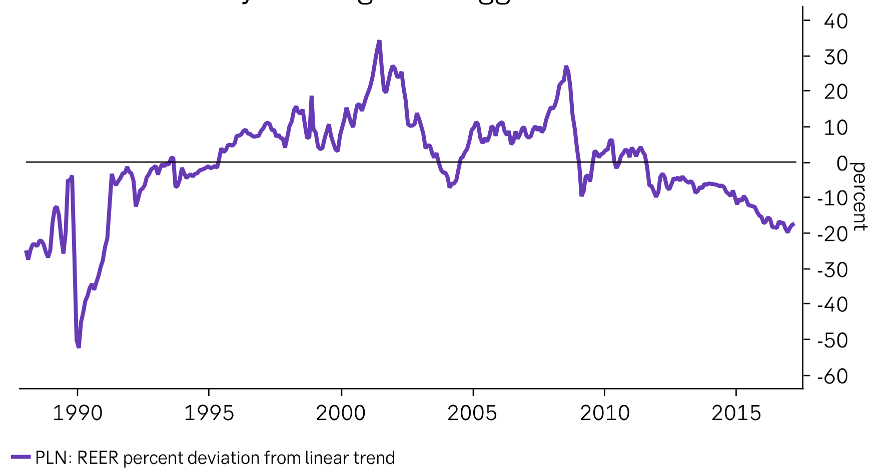
GROWTH AND INFLATION WILL LIFT PLN. The PLN will strengthen over the next 12 months. We expect that EUR/PLN will trade close to 4.20 in Q2, before moving down to 4.12 in Q3, 4.05 in Q4, and 4.04 in Q1 '18.

SHORT-TERM VIEW: PLN STRENGTHENING DELAYED BY LOW INFLATION AND DOVISH NBP. The PLN is currently pressured by low inflation and low interest rates. To see a sustainably stronger PLN, the carry needs to be more attractive versus the EUR, but soft energy and food prices are keeping down inflation and inflation expectations.

LONG-TERM VIEW: PLN IS A CONVERGENCE TRADE. Polish GDP per capita has increased from around 35% of the EU average in the early 1990s to around 70% today. The economy has not experienced a recession in more than 25 years. We see three main reasons why the PLN will strengthen. First, the zloty is under-valued. According to the detrended REER, the PLN is close to the lowest level since the economic collapse that followed the end of communist rule in 1989. Second, growth is picking up. It reached 4.0% in Q1, which should push real GDP growth to 3.4% in 2017. Third, inflationary pressures have started to build. The National Bank of Poland has so far dismissed speculations of a rate hike in 2017, and perhaps even in 2018. Yet, the labour market is tightening fast which will fuel already strong wage growth.

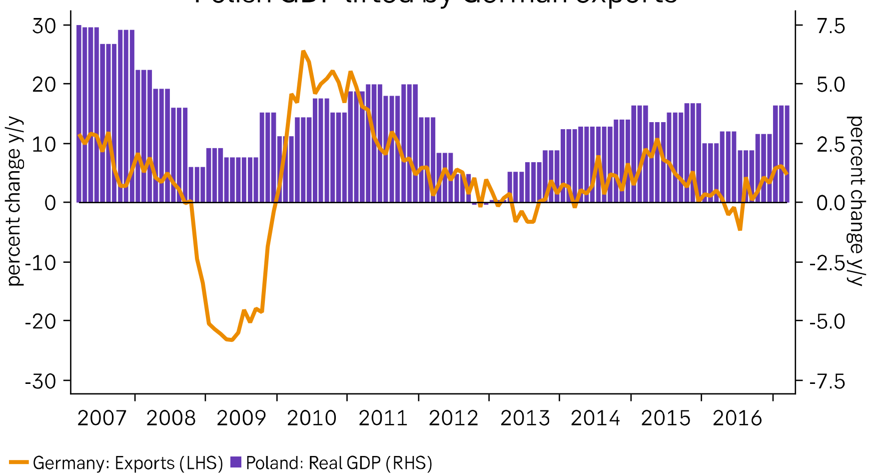
The largest risks to our outlook are another downturn in inflation, a deterioration in public finances (due to a populist fiscal policy), and a revival of President Duda's Swiss franc mortgage conversion plan, which would hurt the banking sector and Poland's growth outlook.

Polish zloty: Waiting for a trigger to turn the trend



Source: International Monetary Fund (IMF), Macrobond, SEB

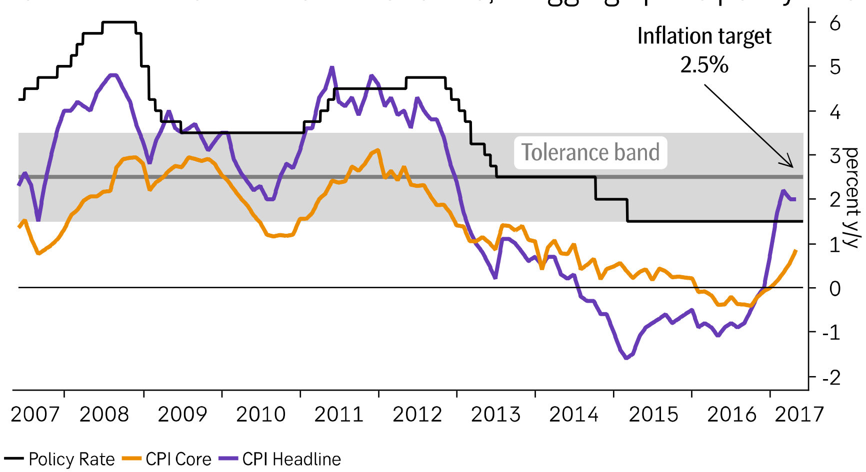
Polish GDP lifted by German exports



Source: Polish Central Statistical Office (GUS), Central Bank of Germany (Deutsche Bundesbank), Macrobond, SEB

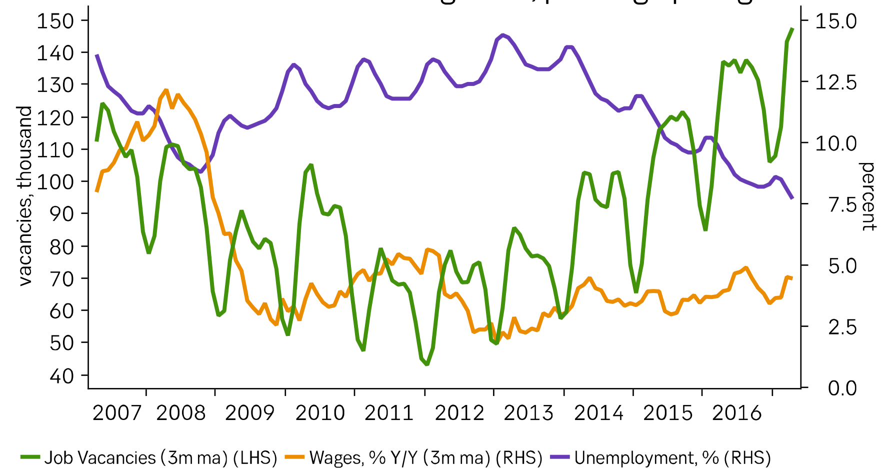
PLN: A convergence trade waiting to happen

Poland: Inflation will continue to rise, dragging up the policy rate



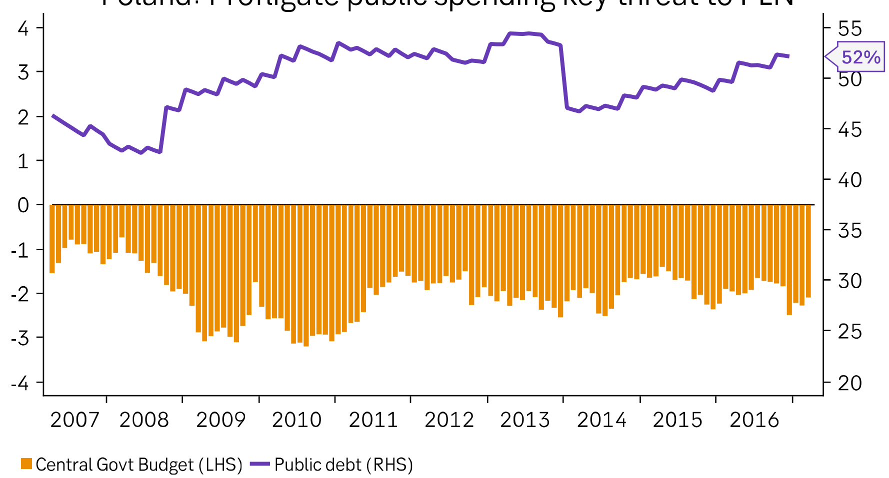
Source: Polish Central Statistical Office (GUS), National Bank of Poland, Macrobond, SEB

Poland: Labour market tightens, pushing up wages



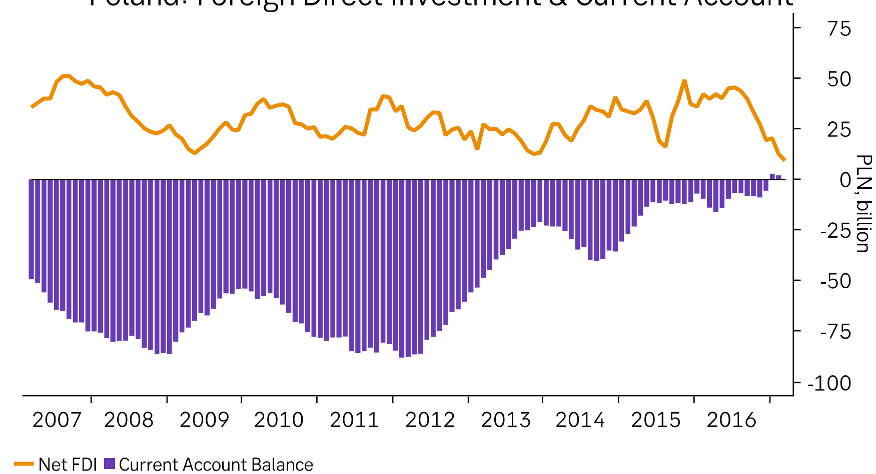
Source: Polish Ministry of Labour & Social Policy, Polish Central Statistical Office (GUS), Macrobond, SEB

Poland: Profligate public spending key threat to PLN



Source: Polish Central Statistical Office (GUS), Macrobond, SEB

Poland: Foreign Direct Investment & Current Account



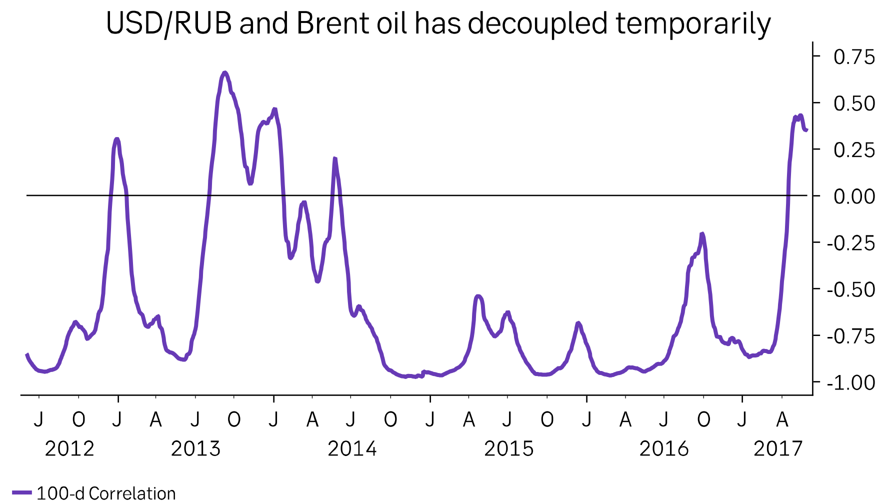
Source: National Bank of Poland, Macrobond, SEB

RUB: Weakness ahoy

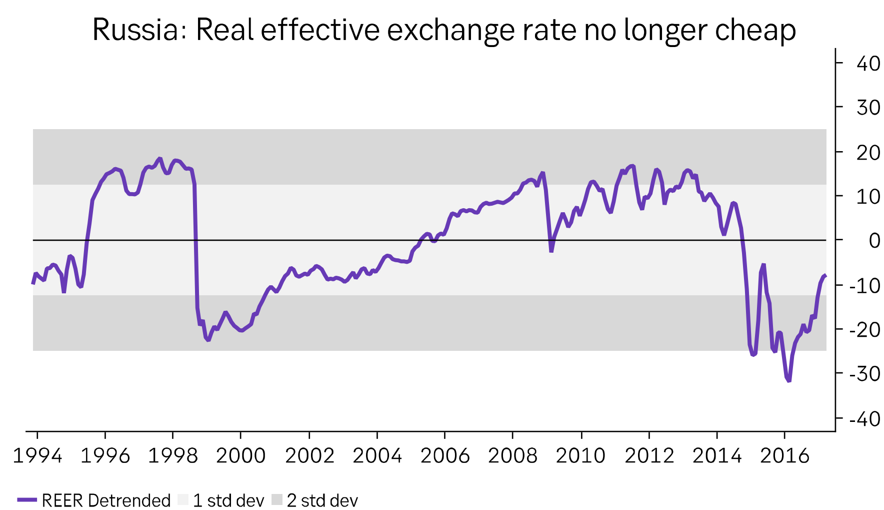
LOWER RUB NEEDED TO SHORE UP PUBLIC FINANCES. A tug of war is going on between the central bank and the finance ministry. The CBR has pursued a tight monetary policy to bring down inflation, with the side effect of strengthening the RUB. The finance ministry has been pulling for looser monetary policy partly to stimulate growth and partly to weaken the RUB, which would boost RUB revenue for every USD sold of oil. So far, the CBR, with the support of the Kremlin, has had the upper hand. However, with inflation reaching the 4% target already in mid-2017, the finance ministry will gain influence. Thus, USD/RUB will be 58.0 in 2Q, 60.3 in 3Q, 62.0 in 4Q, and 62.5 in 1Q 2018.

SHORT-TERM VIEW: EXPECT RUB RESILIENCE. The economy is coming out of a recession. External balances are healthy, albeit dependent on oil and gas. The finance ministry is signalling a strong determination to keep public finances under control. The CBR has been very hawkish and has committed to an orthodox monetary-policy approach. Oil prices are off the lows from last year and supported by an agreement between OPEC and Russia to cut production to bring down inventories. As a result of these factors, interest in Russian assets among both Russian and foreign investors has been strong. This positive sentiment will linger in 1H 2017 and keep the RUB relatively strong.

LONG-TERM VIEW: RUB VULNERABILITIES. The government intends to reduce the budget deficit gradually to 1.2% of GDP by 2019. However, in order to achieve this, especially with 2018 being an election year, they will need help from either higher oil prices or a weaker RUB. With oil prices unlikely to increase, we expect the CBR to buy foreign currency, especially in periods of RUB strength in 3Q and 4Q.

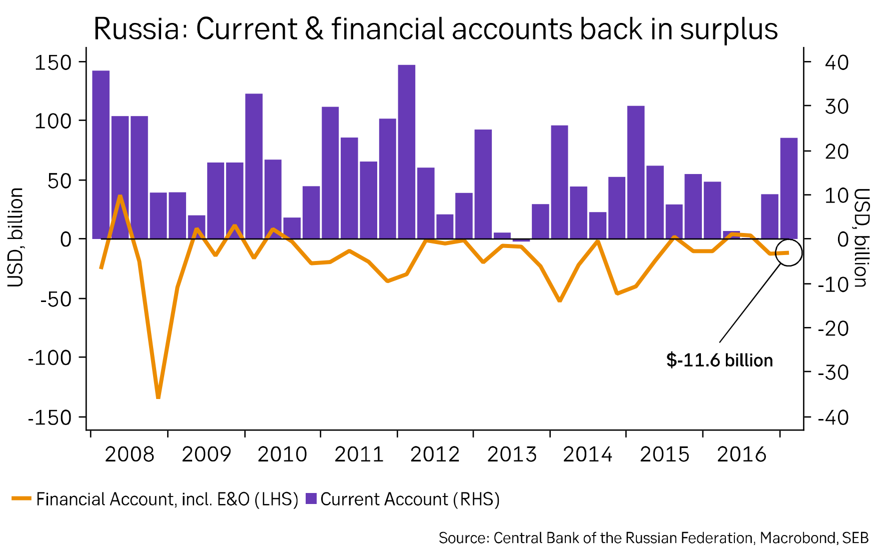


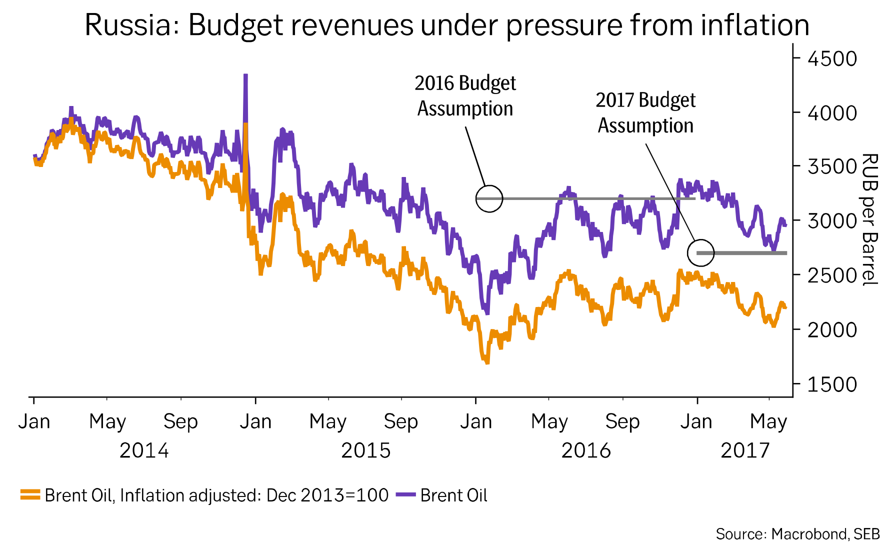
Source: Macrobond, SEB

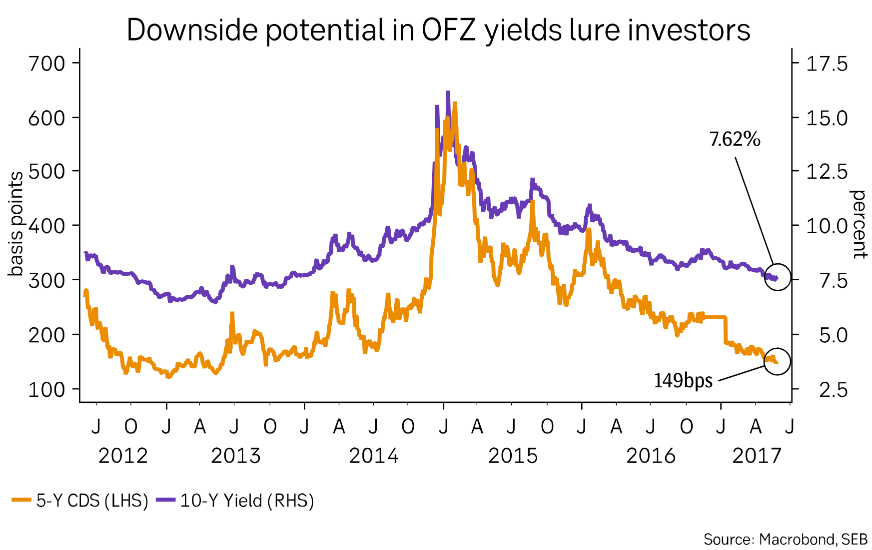


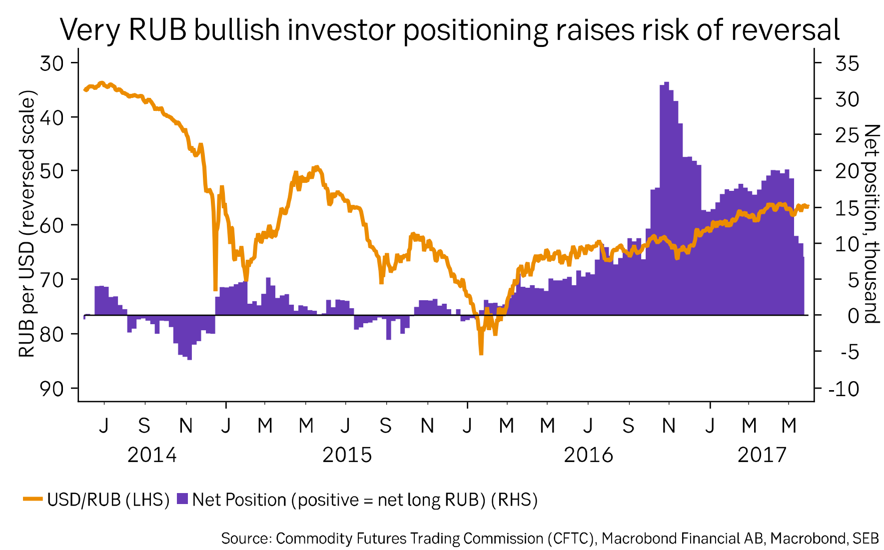
Source: International Monetary Fund (IMF), Macrobond, SEB

RUB: Oil & fundamentals point to S-T strength







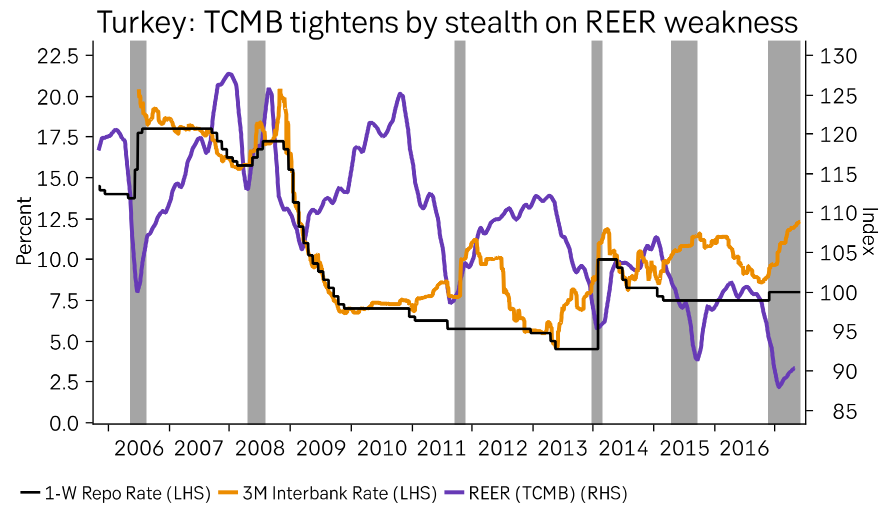


TRY: Carry is the pivotal factor

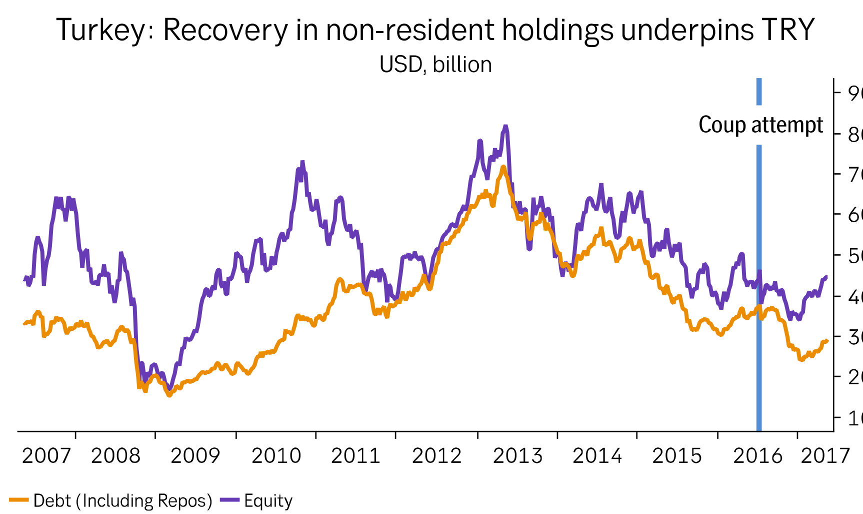
CARRY SUPPORTS TRY. The TRY will appreciate in the near term because the central bank needs help from a strengthening of the TRY to bring inflation under control (11.9% y/y in Apr). The CB will tighten policy using unorthodox means, which will strengthen the TRY. However, once the TRY recovers and inflation starts to moderate, the CB will succumb to political pressure and ease monetary policy, setting the stage for another cycle of TRY weakness and subsequent monetary policy tightening. We expect USD/TRY to end Q2 at 3.47, Q3 at 3.40, Q4 at 3.60, and Q1 '18 at 3.85.

SHORT-TERM VIEW: SUPPORTED BY NON-RESIDENTS. The fate of the TRY will be determined by monetary policy and global investor risk appetite. Turkish yields at over 10% are close to those in Brazil, making the TRY a very attractive carry trade target, especially with still very dovish central banks in developed markets. In addition, risk appetite for EM assets is being lifted by improving global and, in particular, EM growth prospects. We expect EM GDP growth to accelerate to 4.8% in 2017 from 4.3% in 2016, while Turkey should grow by around 2.3% in 2017. The TRY is somewhat undervalued, which limits, but does not remove downside risk.

LONG-TERM VIEW: POLITICAL RISK ON THE RISE. With inflation likely to average almost 10% in 2017, the TRY will depreciate in the second half of the 2017 and early 2018 in order to keep Turkish exports competitive and contain the current account deficit. Looking further ahead, Turkish politics has taken an authoritarian turn. From a market perspective, policies run the risk of becoming more interventionist through the use of quasi-fiscal policy to boost credit growth and investment, which over time will undermine public finances and the TRY.

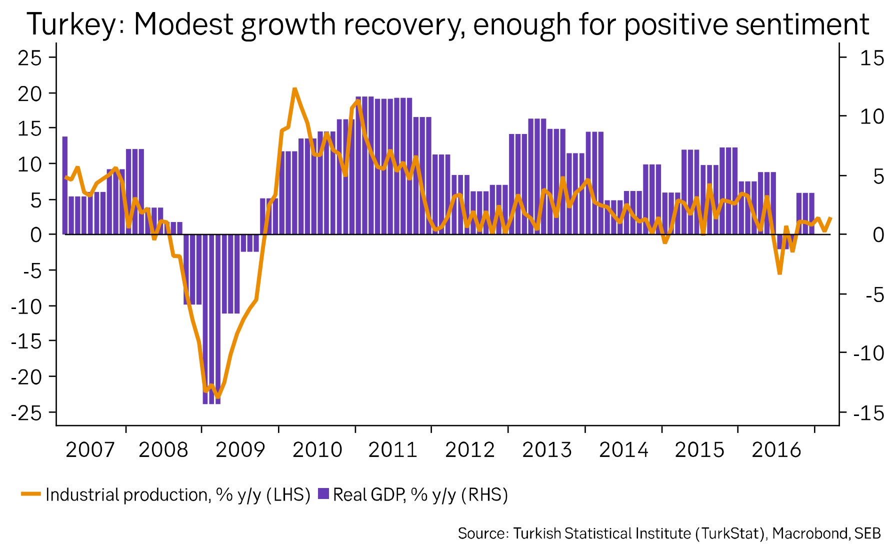


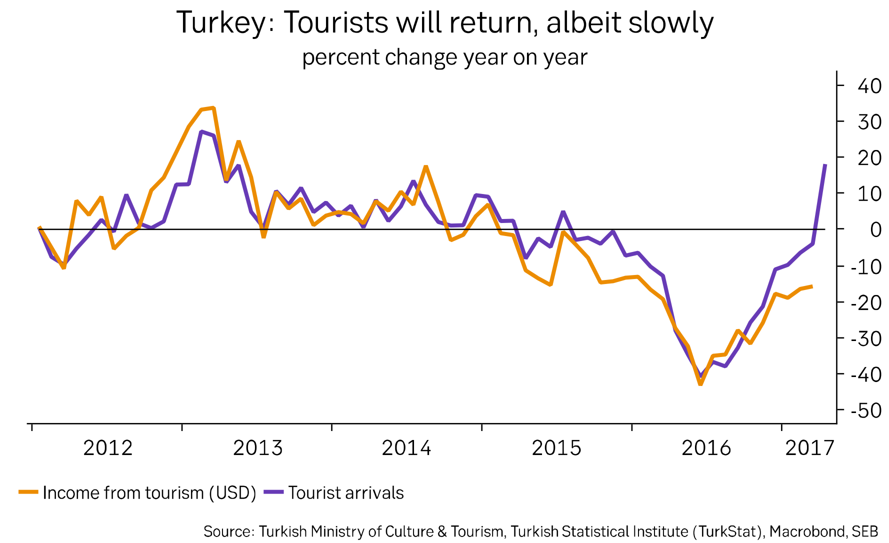
Source: Central Bank of the Republic of Turkey (TCMB), Bank Association of Turkey, Macrobond, SEB

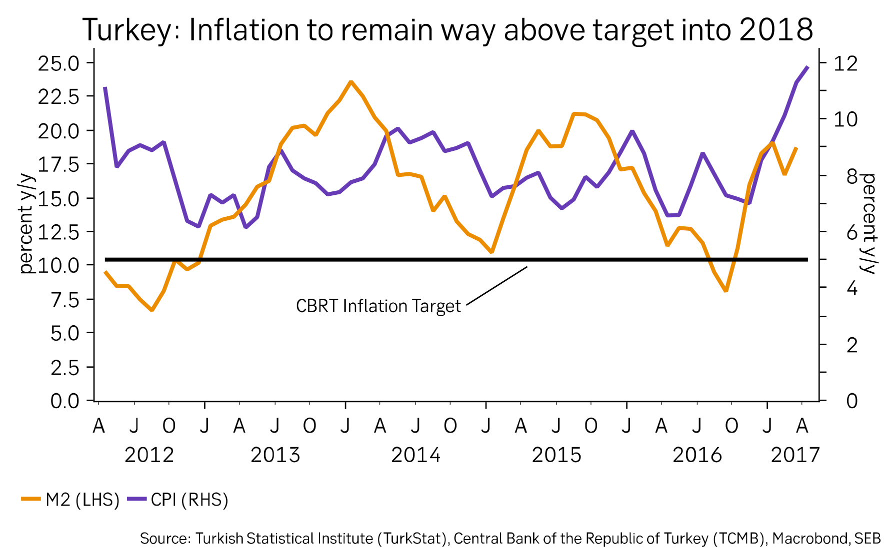


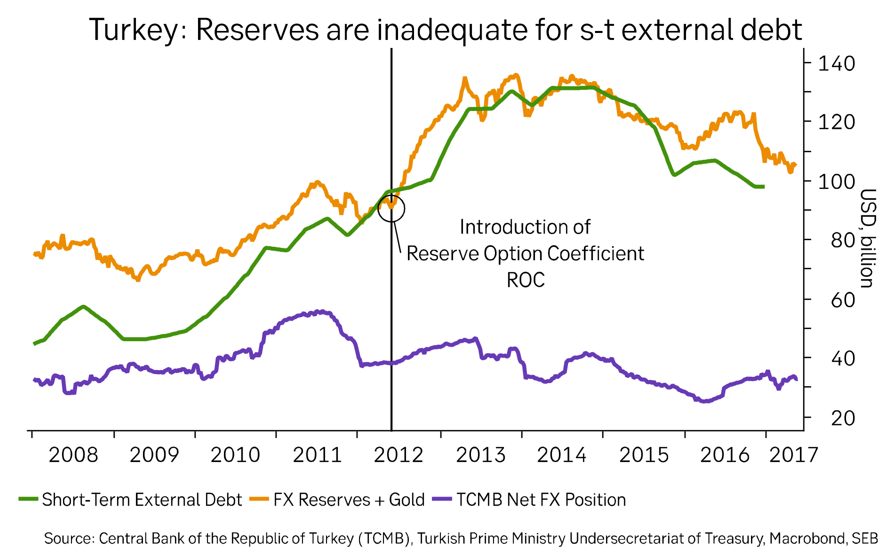
Source: Central Bank of the Republic of Turkey (TCMB), Macrobond, SEB

TRY: Achilles' heel is S-T external debt







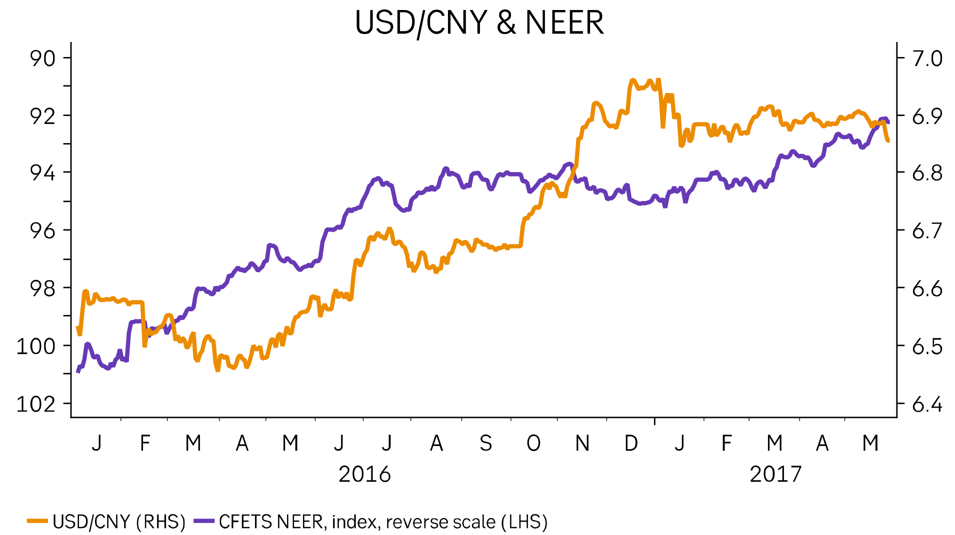


CNY: Gradual depreciation expected 2017

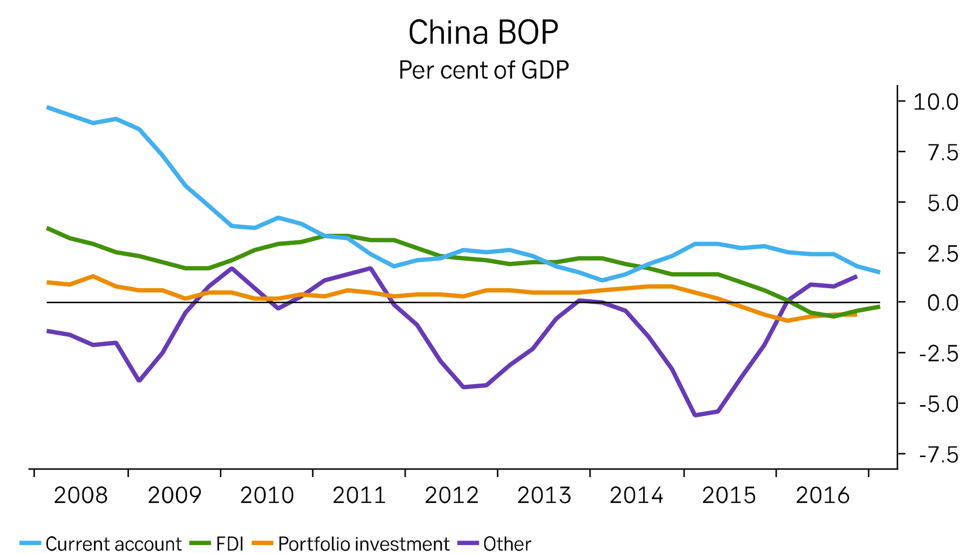
USD/CNY TARGETS 7.05 BY DEC-2017
Relative fundamentals of weaker China growth vs an accelerating US economy with rate hikes will weaken CNY. CNY will become a cyclical currency like all other currencies and we don't see a recovery in CNY until economic fundamentals accelerate. The economy will continue its slow grind lower from 6.9% (2016) to 6.7% (2017). Manufacturing and heavy industry will be the main drag on growth as the government rebalances towards less capital and debt intensive services and consumption. President Xi will move forward with lower growth as a cost to avoid a debt crisis in the future.

Monetary policy has switched to a tighter stance, which will reduce the pace of CNY weakness but not enough to reverse the trend. The government will tighten to prevent reverting to the old borrow and grow model and rising property prices that can increase hard landing risks. The government adjusts by regulation and window guidance and thus interest rate levels will not change much. CNY weakness will also be limited in 2017 because of the political transition and President Xi will limit volatility before the transition. CNY policy changed in 2016 to be managed more on a basket rather than vs USD. Current policy is to keep CNY stable on a trade weighted basis. Recently, CNY NEER has weakened and PBoC will strengthen CNY short term to correct this. Over-all, we don't see big moves in either direction into year end.

LONG-TERM: CNY will be under weakening pressure until it further opens up the capital account. Current account surplus is diminishing as Chinese tourists travel more abroad. Capital outflows are occurring as Chinese savings get diversified into non-RMB assets. China needs to allow more foreign investors to get the currency back on an appreciation path. China is making some adjustments but progress is slow.



Source: Macrobond

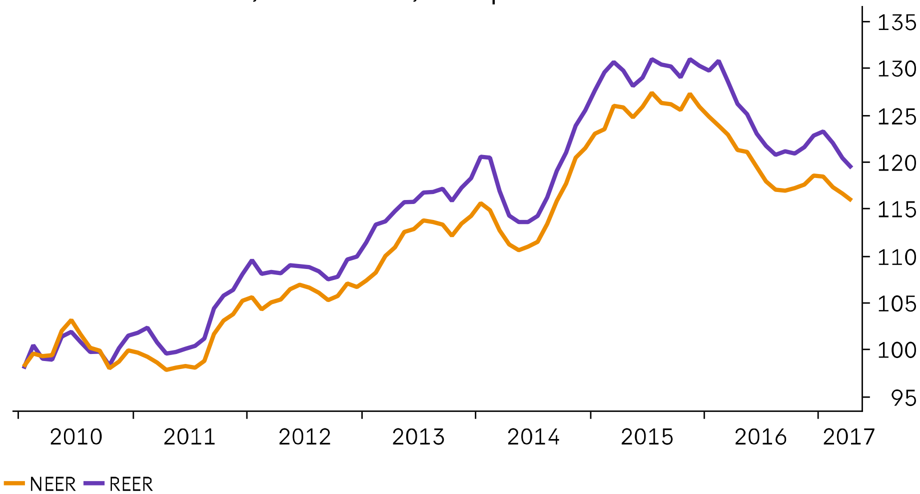


Source: Macrobond

SEB

CNY: Economy continues to grow 6.5-7.0%

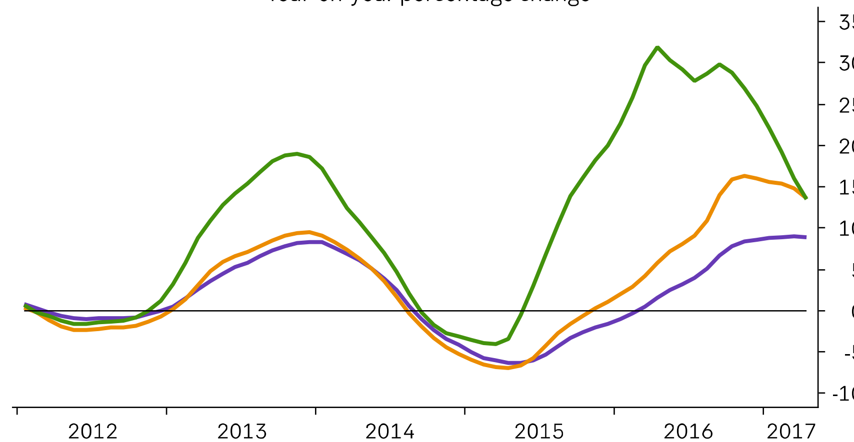
China, FX Indices, European Commission



Source: Macrobond

New residential property price

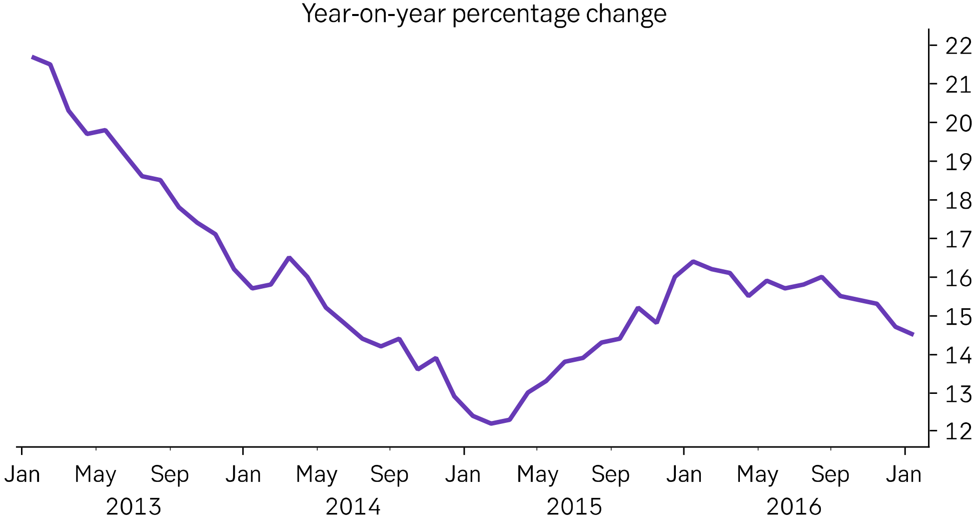
Year-on-year percentage change



Source: Macrobond

Total financing

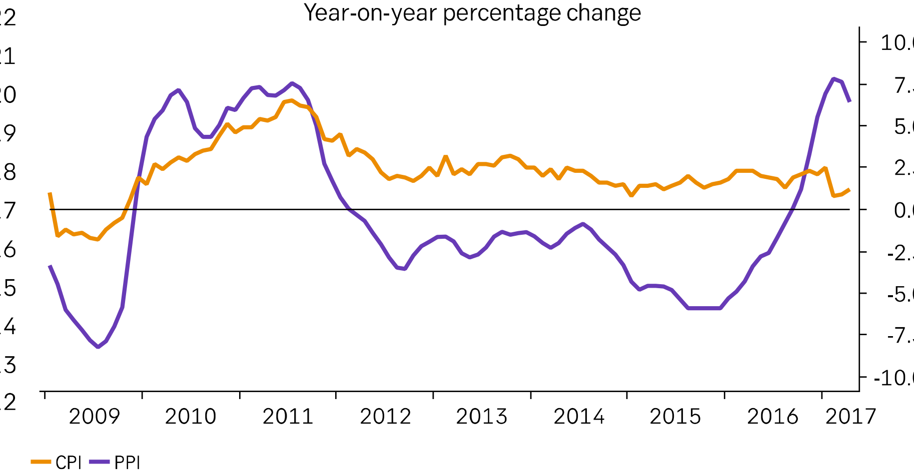
Year-on-year percentage change



Source: Macrobond

CPI & PPI

Year-on-year percentage change



Source: Macrobond

Themes

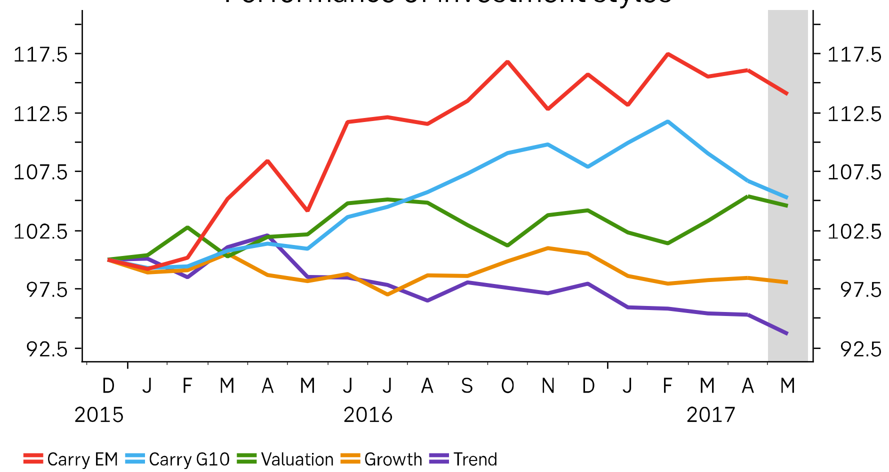
Investment styles: Carry versus Valuation

CARRY TO RE-EMERGE AS DRIVER DURING SUMMER
Carry, and especially EM carry, was the best performing strategies in 2016. In CS January we expected carry styles to continue outperform besides glimpses of periods ahead of the French election when we expected the valuation style to outperform. So far we have been right as carry outperformed Jan to Feb while valuation did so Mar-Apr during the time the market focused on the French presidential election.

Since then **markets seem to be in an “in-between state” in May**. We thought the low volatility environment would have worked in the carry styles favor and that these styles once again would have begun to outperform in May. However, this does not seem to be the case and furthermore no one of the investment styles have performed well so far in May. Hence, markets seems to be “Busy doing nothing at all” currently though **we expect a resumed carry seeking mood** now as volatility once again is low and the hunt for yield continues.

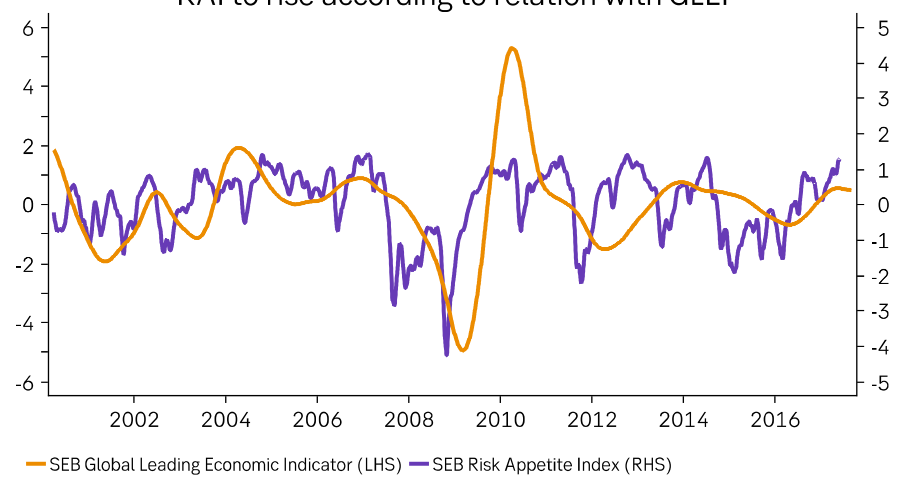
SEB’s forward looking GLEI and risk appetite are closely correlated (see bottom chart). The GLEI has peaked and with RAI already a bit high there is an increased risk that risk appetite will converge and head lower the coming months. **If risk appetite falls we doubt carry will be the best strategy in the coming months**. However, as may be seen in the top chart on the next page, carry performance and risk appetite have not been in a closer relationship in 2017. So maybe the GLEI indication for RAI might not spell as bad an omen for carry performance as usual.

Performance of investment styles



Source: Bloomberg

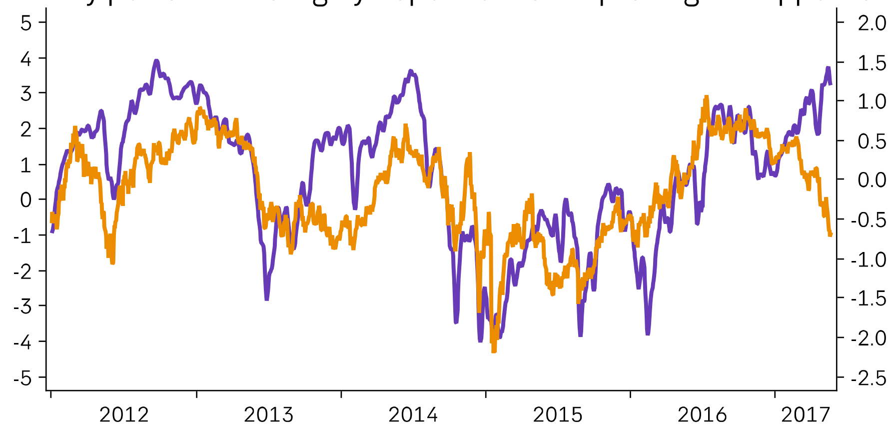
RAI to rise according to relation with GLEI



Source: SEB, OECD

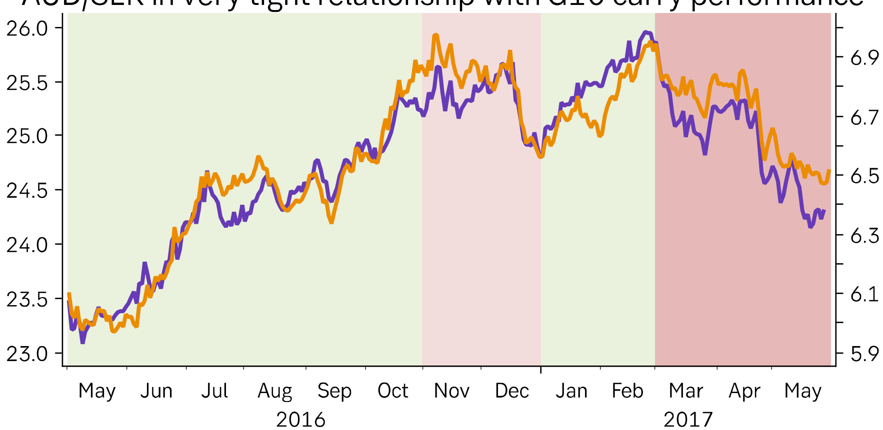
Carry supports AUD, NZD and hurts SEK and CHF

Carry performance highly dependent on improving risk appetite



Source: SEB calculations, Bloomberg and Macrobond data

AUD/SEK in very tight relationship with G10 carry performance



Source: Bloomberg

CARRY A DRAG ON SEK AND CHF

If the market returns to a carry seeking mood during the summer (as last summer once the Brexit turmoil had passed) money should flow into Carry strategies which would support AUD and NZD while work detrimental to funding currencies such as SEK and CHF.

G10 CARRY POSITIONS

Looking into our own investment style for G10 carry the proposed positioning is:

- Long: NZD and AUD
- Short: CHF and SEK

The tight relationship between AUD/SEK and Carry performance (chart to the left) backs that long AUD/short SEK is one major position in general G10 carry strategies.

The performance of G10 carry since the summer 2016 can be divided into four distinct periods with different environment:

- **May-Oct:** Low volatilities and carry focused market
- **Nov-Dec:** Politically determined market without carry focus
- **Jan-Feb**: Growth and risk-on supported carry styles
- **Mar-Apr:** Political risk with Trump trade fading and French election – valuation rather than carry friendly market
- **May+:** Will there be a repeat of the carry focus we experienced in 2016? Political risks could disrupt during times with UK snap election, French election, Italian and German elections coming up.

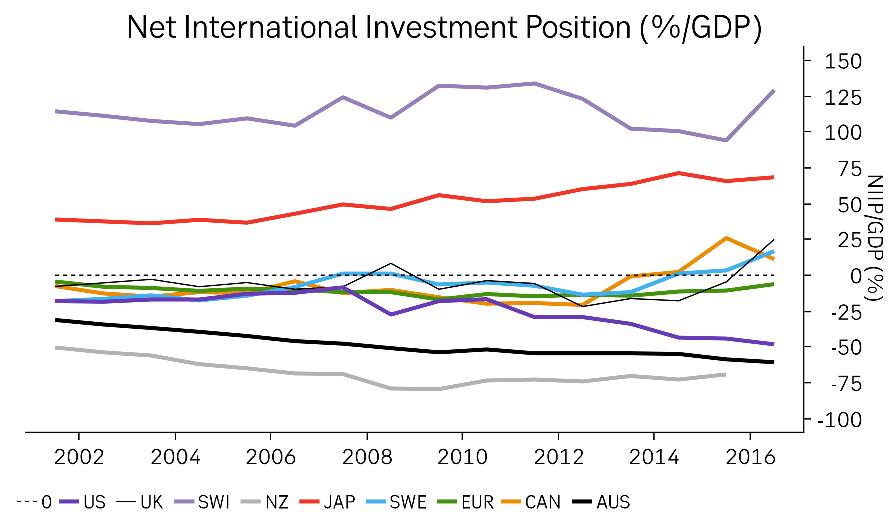
Theme: Central banks, CPI and FX

ARE CENTRAL BANKS STILL TARGETING CURRENCIES?
With unconventional monetary policy near its limits, the FX market has been monitored (manipulated) by central banks as one last means by which they may reach their inflation targets (through weaker CCY and rising imported inflation). Over the past year or so it seems central banks have been more relaxed, possibly **as inflation in most G10 countries is near target.** The economic outlook has also improved.

RIKSBANK HAS WEAKEST INTERVENTION MANDATE
So which countries still have reason to be aggressive towards their own currency to bolster imported inflation? In recent years spot inflation has been much more important to central banks than FX valuation. This is of course because such institutions are trying to boost import prices (rather than exports). **Low CPI and an overvalued currency together suggest a continued aggressive policy, which is what is presently expected from the BOJ and SNB.** The ECB can afford to be relaxed regarding the euro as is the Fed -> a EUR/USD rate around 1.15-1.20 would be regarded as ”neutral” for both central banks, although we believe the ECB will start to verbally intervene at 1.15+. The **BOE has reasons to be concerned as the weak Sterling is now feeding CPI well above target,** leaving the UK as the only G10 central bank facing CPI far above target. **Finally, the Scandies. Our table (right) suggests Norway and Sweden in particular have the least cause to be monetarily aggressive:** CPIF is near its 2% target, **the countries'** currencies are undervalued and their CA/NIIP* very positive -> the Riksbank has no strong reasons to continue with negative rates/QE. The logical shift away from non-conventional policy will surely strengthen the SEK when that happens. The question remains when?!

	CB attitude to CCY		FX Valuation	CPI	Curr Acc	NIIP
	Offical	*Watching*		(y/y)	%/GDP	%/GDP
FED	Relaxed	Balance sheet	Overvalued	2.0%	-2.5%	-48%
ECB	Relaxed	Low HICP 2018	Fair	2.0%	3,3%	-6%
BOJ	Aggressive	CPI	Fair	0,4%	3,8%	68%
BOE	Concerned	High(er) CPI	Undervalued	2,7%	-4,3%	25%(?)
SNB	Aggressive	EUR/CHF 1.06	Overvalued	0,7%	12,0%	129%
RBA	Relaxed	Credit growth	Fair	2,1%	-2,6%	-61%
RBNZ	Concerned	Kiwi	Overvalued	2,2%	-2,8%	-70%
BOC	Relaxed	NAFTA	Undervalued	1,6%	-3,3%	11%
RIX	Concerned	Imported CPI	Undervalued	2.0%	4,7%	32%
NB	Relaxed	Imported CPI	Undervalued	1.7%	4,6%	>200%

Source: IMF, Macrobond



Source: Macrobond

* CA = Current Account, NIIP = Net International Investment Position

The Phillips Curve is still alive in G10

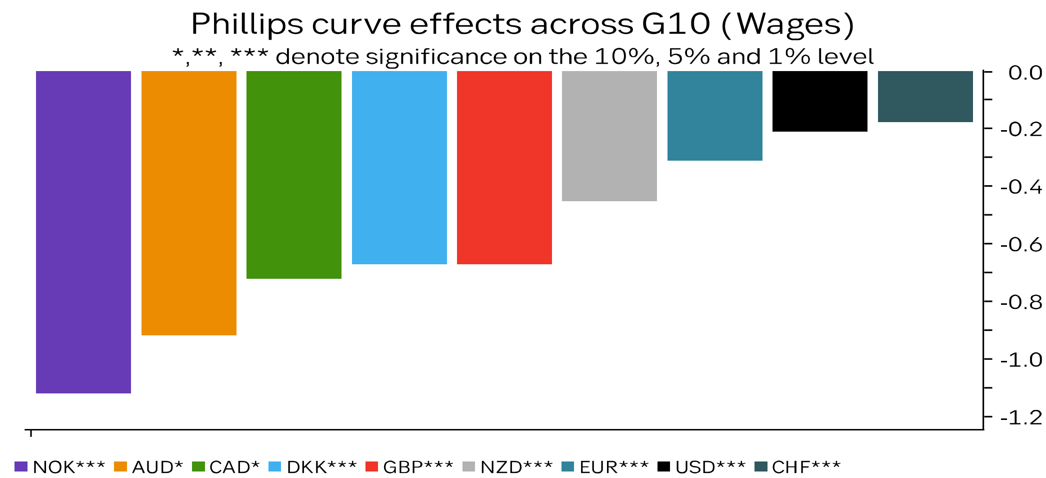
The Phillips curve is one of the most important relationships in macroeconomics. It shows how inflation changes when unemployment changes and vice versa. The logic is that when unemployment is low, bargaining power is high and employers have to pay more to attract workers. Ultimately, this feeds into inflation and **the inflation effects should be particularly strong when the jobless rate is below the NAIRU**.

But the Phillips curve has not worked so well recently; in recent years core inflation has been remarkably low and stable, notwithstanding pretty big swings in the unemployment rate.

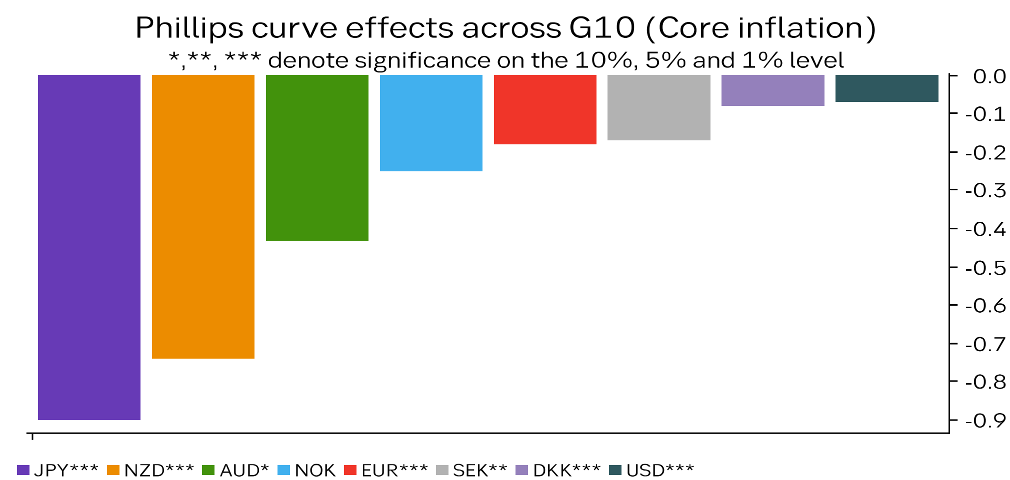
But when empirically testing for it, we **find statistically significant and meaningful effects in most G10 countries** which is what the charts to the right are suggesting. Also when testing the Phillips curve relationship on a large OECD panel from 1996 we find that that the traditional relationship between economic slack and inflation still holds thus **providing confidence in the inflation outlook**!

While the effects on inflation are quite small in some countries, notably in the US, Denmark, Sweden and in the Eurozone, they are bigger (and significant) in countries like Japan, New Zealand and in Australia. As such, if the labour market continues to tighten we would **expect to see meaningful inflation effects in these countries** in particular.

Given the prospects for wage-driven inflation dynamics, we think that the above is suggesting **a more hawkish rate outlook in NZD and AUD in particular** – see the next slide.

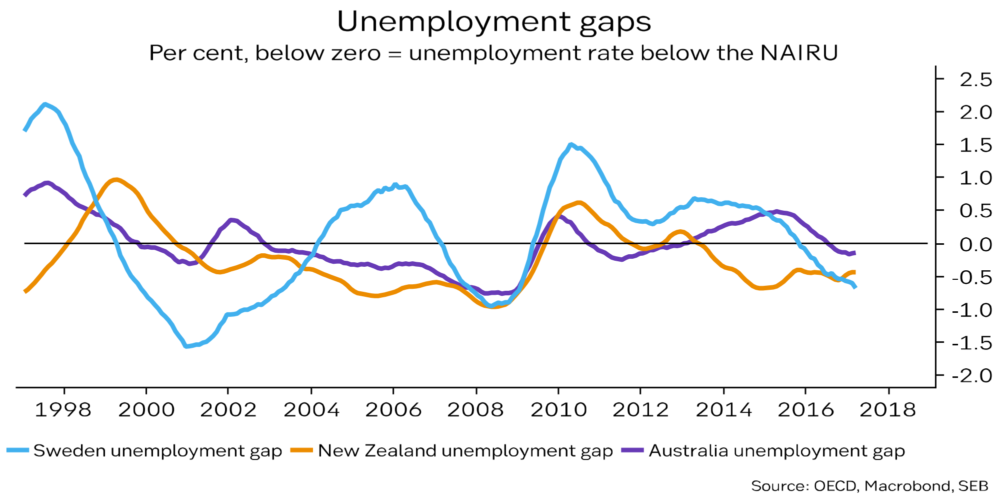


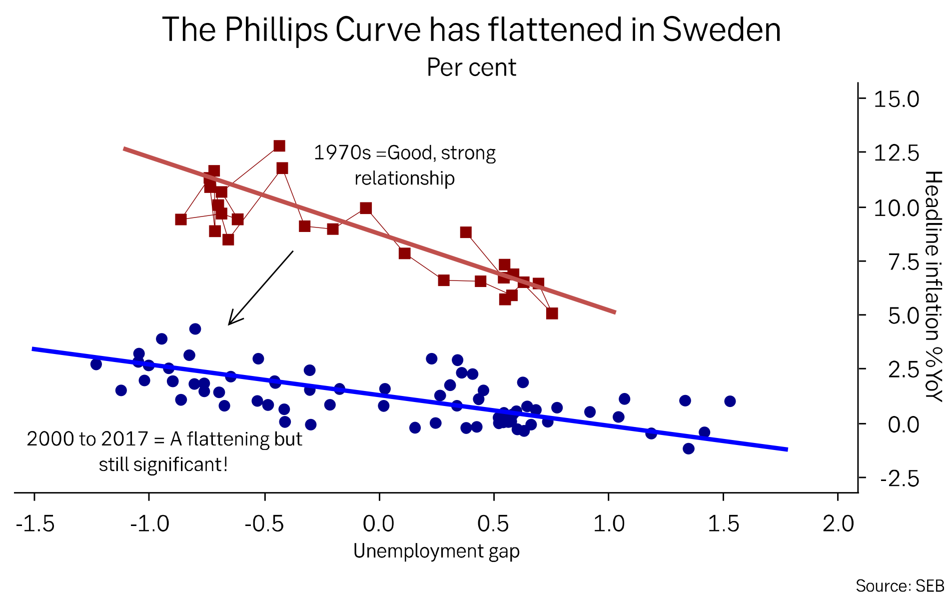
Source: SEB



Source: SEB

The Phillips curve is flattish in Sweden





THE SUPPORT FOR THE PHILLIPS CURVE IS STRONG
We construct a panel data set of OECD countries that includes core CPI, wage growth, hourly earnings, the unemployment rate and the NAIRU and build models that explain YoY inflation (or YoY wage growth) with a constant and the unemployment gap. Country fixed effects are always included but models both with and without time fixed effects (which captures the global cycle and other common shocks) are estimated. The results are robust/significant for the 1996-2017 period.Then we estimate Phillips curve relationships for the G10 countries individually (main results on the first slide).

THE SWEDISH PHILLIPS CURVE: the results suggest that strong unions are priortizing employment growth over wage growth – the **small beta is saying that a drop in the unemployment gap will only have small inflation effects**. For the full sample, the Swedish results are significant for both core and headline inflation vs the unemployment gap, but the relationship is strongest for headline inflation; not surprising since rate changes have direct effects on CPI inflation but not on CPIF (core) inflation. **Thus far in the recovery (2010-2017), the Swedish Phillips curve seems to be broken**, however.

With respect to the **best FX-plays**, a drop in the unemployment gap will have the **largest effects on inflation in JPY, NZD and AUD** according to our findings. In the latter two, the labor markets are drum tight thus suggesting a more meaningful wage-inflation dynamics taking hold in New Zealand and Australia, respectively. As such there is a **good chance that the RBNZ and the RBA will err on the hawkish side** relative to current market pricing going forward.

Sweden's Phillips Curve, 5-year spans (headline inflation vs u-gaps): 1990-1995: -1.06*, 1995-2000: 0,00, 2000-2005: -1.06*, 2005-10: -1.27*, 2010-17: -0.11 **[**= significant at the 1% level]**

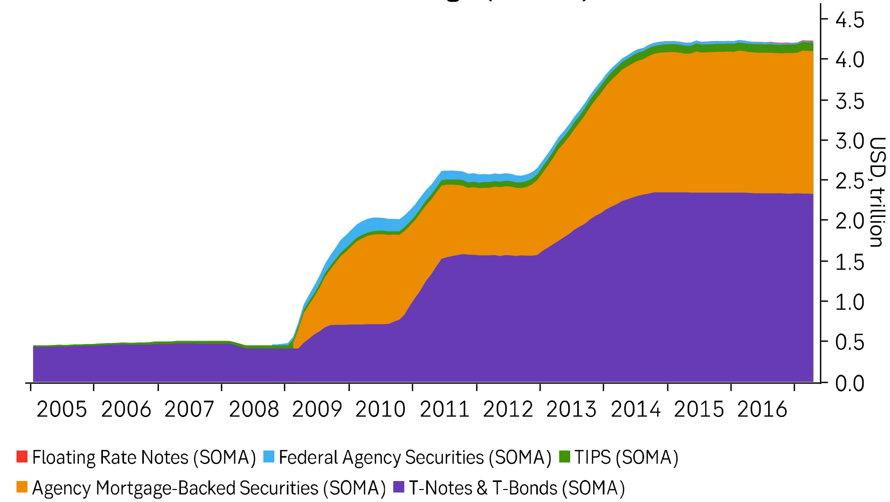
Fed's balance sheet reduction: watching paint dry

WHY?
- Fed's monetary policy normalisation uses two tools: rate hikes and a reduction in the balance sheet
- In the wake of the financial crisis, the Fed boosted its balance sheet to circumvent the zero bound restriction implying that the balance sheet is now massively oversized for the state of the economy.

HOW?
- The aim is to reduce securities holdings in a "gradual and predictable manner".
- According to the May meeting minutes, Fed would announce gradually increasing caps and only the amounts of securities repayments exceeding these caps would be reinvested each month.
- Caps would initially be small and actual run offs each month might be smaller yet.
- "Nearly all" Fed policymakers support this approach.
- There are still plenty of unanswered questions. We expect the Fed to provide additional details along with the June policy meeting statement.

WHEN?
- Nearly all participants agree that balance sheet normalization should begin "this year".
- September is a probable starting point but a launch later on in 2017 is also possible.

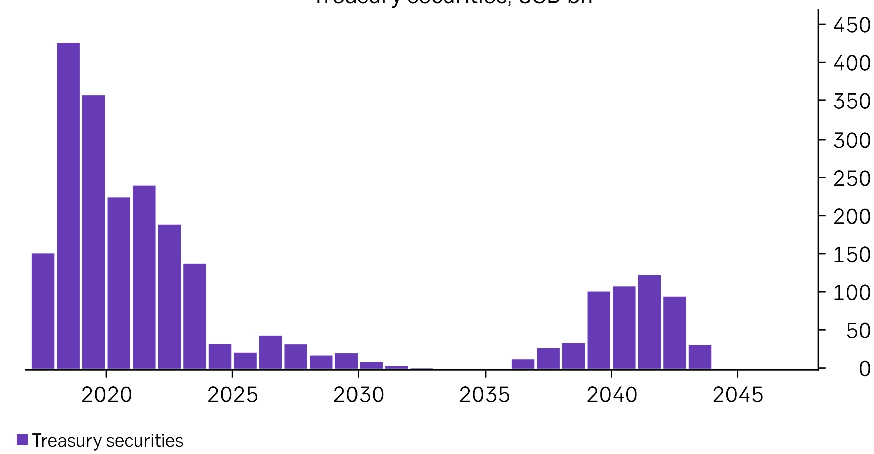
Fed holdings (SOMA)



Source: Fed

Fed SOMA maturity diestribution

Treasury securities, USD bn



Source: Fed

EUR/USD: The battle of the titans

The euro

+

- ✓ The ECB surprises this year by announcing further steps towards normalizing policy, like an increase of the deposit rate or further tapering of bond purchases
- ✓ Portfolio inflows to euro zone equity markets accelerates
- ✓ An unexpected rise in EZ inflation
- ✓ Strong growth in Germany broadens to most euro area economies
- ✓ Successful Brexit negotiation after UK concessions

−

- ✓ Renewed political turmoil related to an Italian snap election or the banking sector increases the risk premium related to the euro to rise
- ✓ Plans to deepen the economic and monetary union have limited support among national leaders
- ✓ The economy slows unexpectedly
- ✓ Inflation falls much more than currently anticipated which alters expectations on the ECB
- ✓ Brexit negotiations break down completely
- ✓ Increased political tensions related to North Korea

The dollar

+

- ✓ President Trump finalize a deal with Congress on more expansionary budget, including substantial tax cuts that boosts US growth
- ✓ Signals that the Fed will continue with frequent increases in the Fed funds rate simultaneously with reductions of the balance sheet.
- ✓ Tight labour market finally generates a more noticeable upward pressure on US wages and inflation
- ✓ Increased political tensions related to North Korea
- ✓ President Trump impeached and forced to step down?

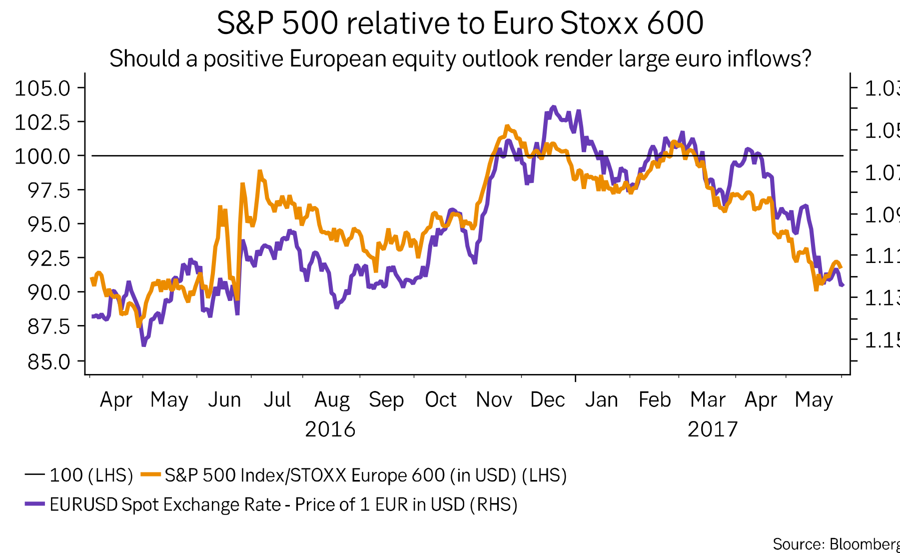
−

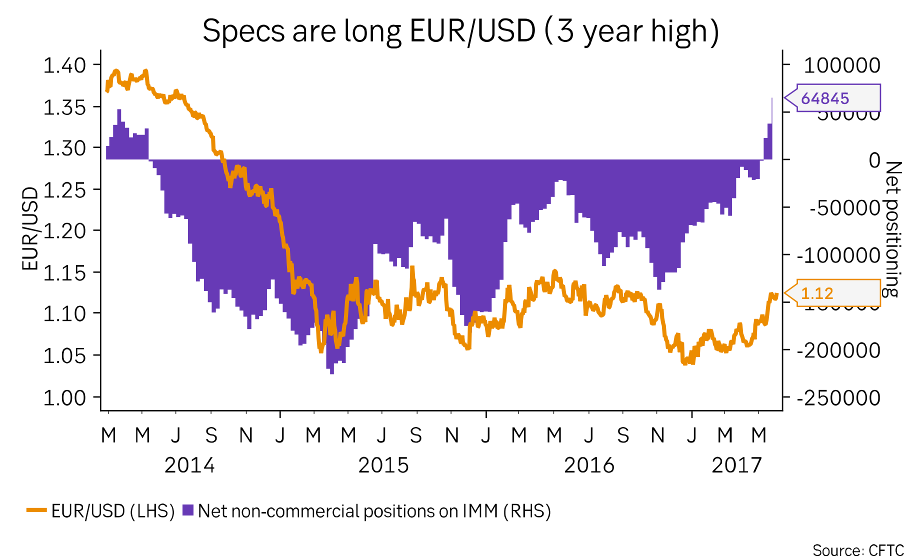
- ✓ Foreign investors scale down holdings of US Treasuries which creates substantial capital outflows
- ✓ Growth weakness from Q1 continues, which forces the Fed to halt current tightening cycle
- ✓ A significant and unexpected rise in the oil price
- ✓ President Trump impeached and forced to step down

EUR: Flows are finally positive

EUR SUPPORTIVE PORTFOLIO FLOWS FOR NOW
The marked improvement in the economic outlook coupled with declining (temporary?) European economic and political risks are tempting **investors to overweight "cheap" European equity markets.** Some equity analysts had this idea and view already in 2015 but back then the euro outlook was undermined by the ECB QE-expansion now expected to be gradually tapered and finished next year. So you could argue the need to hedge the euro exposure is less marked now (for the equity investor). Perhaps that's also what is driving EUR/USD as the relative equity performance (in common currency) and EUR/USD is showing a strong relationship. Furthermore, the IMM/CFTC data reveals the speculative market is now net long EUR/USD (3 year positive extreme) and the scaling back of euro shorts has definitely contributed to the euro appreciation since April.

WHAT ABOUT THE CURRENT ACCOUNT?
Regular currency analysis holds the euro zone current account as one very positive euro factor (approx. 3.4%/GDP). But 80% is generated from the German export sector meaning the internal distribution of gains from competitive exports are still very concentrated in one country in addition adding to already large internal euro zone imbalances (also in the Target 2 system). In times of lower euro zone financial stress (e.g. manifested by low intra euro sovereign bond spreads) the current account is a euro positive factor. But should political risks rise again this factors is fast replaced by concerns for financial stability again. **Hence the current account is one positive factor but only in times of political stability. And the euro zone still needs to work out <u>how to lower the internal imbalances in the euro zone.</u>**





ECB as the trigger for Riksbank policy

HAWKISH ECB SPILLS OVER TO RIKSBANK AND SEK
In SEK Views April 2017 we presented a study on the historical reaction function of the Riksbank. The study **identified ECB policy to be one important part of the reaction function for the Riksbanks.** With talk about a possible turn in ECB policy already at their next meeting (June 8) we thought it would be interesting to see if/how this relation ship between ECB policy and Riksbank policy has been picked up by the currency market.

Our analysis clearly shows that the market has taken notice of the Riksbanks close relationship to ECB actions. As may be seen in the table to the right, SEK has generally strengthened versus USD following hawkish ECB rate decisions. This is particularly clear the day after the ECB policy meeting and for the period between the ECB meeting and the day of the upcoming Riksbank rate decision where USD/SEK fell on all occasions.

This analysis was conducted by selecting the ECB rate decisions taking place before Riksbank rate decisions and determining if the market interpretation was hawkish or dovish by the daily change in EUR/USD. Following this we looked at the reaction in USD/SEK on different time horizons to see how interpretation "spilled over" on SEK.

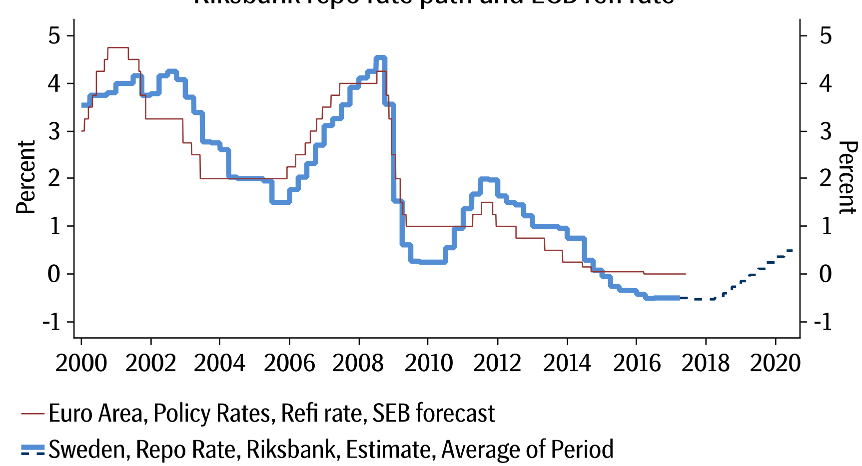
*We concentrated on the period 2015 and forward as the Riksbank focus on ECB policy has been most pronounced since then but found a similar pattern, albeit slightly less robust, starting 2013 as well.

Hawksish ECB and USD/SEK reactions

USD/SEK	1d	2d	3d	4d	5d	Next Rix
Up	**0%**	20%	14%	14%	14%	**0%**
Down	**100%**	80%	86%	86%	86%	**100%**

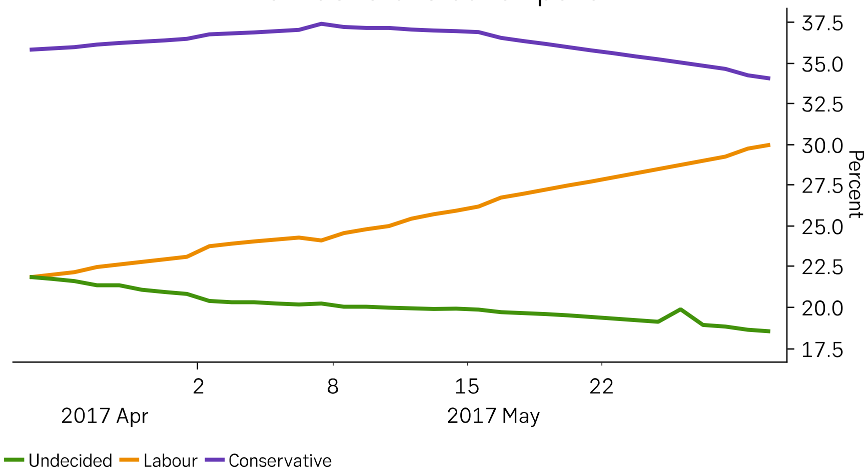
Source: Bloomberg, SEB

Riksbank repo rate path and ECB refi rate

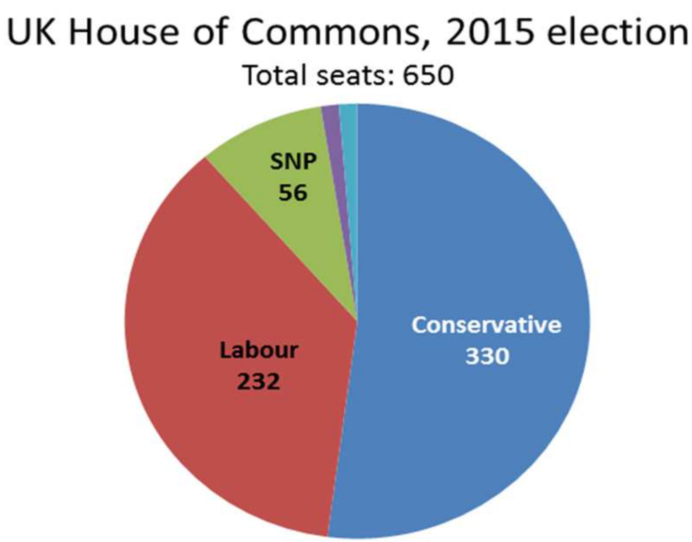


Source: Macrobond

UK: Early election to secure power



Source: New York Times



Source: Wikipedia

- **Early election on 8th of June to increase the influence of the government party and PM May**
  - Increase the power in the house of commons
  - Delay the next general election to 2022, well after Brexit.
  - Strengthen the position of PM May within the Conservative party.
- Currently the Conservative party holds 330 out of 650 seats in the House of Commons => 11 seats majority.
- According to opinion polls the support for the largest opposition party, Labour, is weak. However, the lead of the conservative party has decreased in recent weeks with support for the government falling to **33.7% vs 29.8% for Labour**, while 20% remain undecided.
- Probability for a Conservative victory in the general elections based on betting odds is an overwhelming 93% vs 11% for the Labour party.
- Polls were far from correct in the 2015 General Election or in the 2016 Brexit referendum.
- In the 2015 General Election polls showed a tie => underestimating support for Conservatives and overestimating the support for the Labour party.
- Main scenario is a comfortable win for Conservatives, which would increase power in the Parliament ahead of the upcoming Brexit talks with the EU.
- The GBP is unlikely to react much following a win by the Conservative party. In contrast would the Labour party win unexpectedly we expect the GBP to weaken significantly.

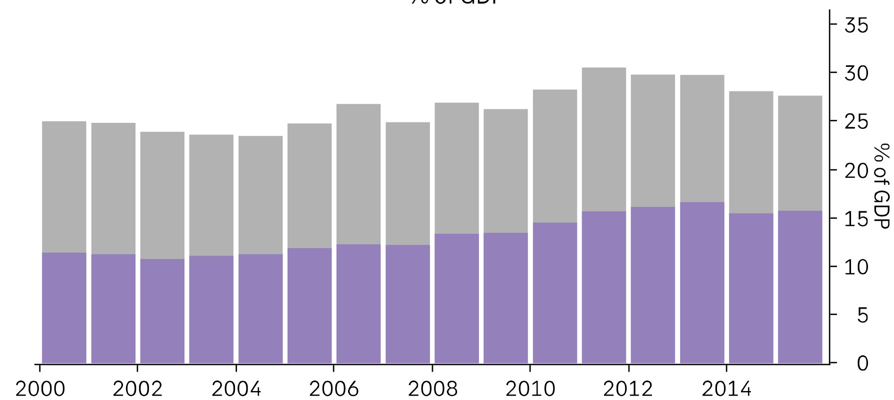
UK: Hard Brexit would be bad for the economy

- **The British government and Theresa May have maintained a tough stance against EU in the election campaign reiterating that *"no deal is better than a bad deal"*.**
- Currently almost 44% of UK exports (goods and services) representing 12% of British GDP go to countries within the EU.
- Leaving the EU without a new FTA with the EU would undoubtedly be negative for the economy if the UK instead had to rely on WTO-regulation, which means the UK will face tariffs on exports to the EU.
- According to IMF estimates a hard Brexit would cause UK GDP to fall by approximately 5% to 2020.
- The total value of UK imports from other EU countries is substantial. In 2015 the UK trade deficit with the rest of EU was almost EUR 90bn. However, the proportion of exports going to the UK is much smaller relative to the size of the economy in most EU countries except Ireland, Luxembourg and Malta.
- The British financial sector is also vulnerable. According to the IMF approximately one third of exports of UK financial services are to EU countries.
- Financial sector; Loosing its passporting rights estimates indicate that 40-50% of EU-related activity may disappear with a hard Brexit, representing around GBP 18-20bn in annual revenue and more than 30,000 jobs in the financial services sector *(i.e. roughly 5-10% of all jobs in the financial sector).

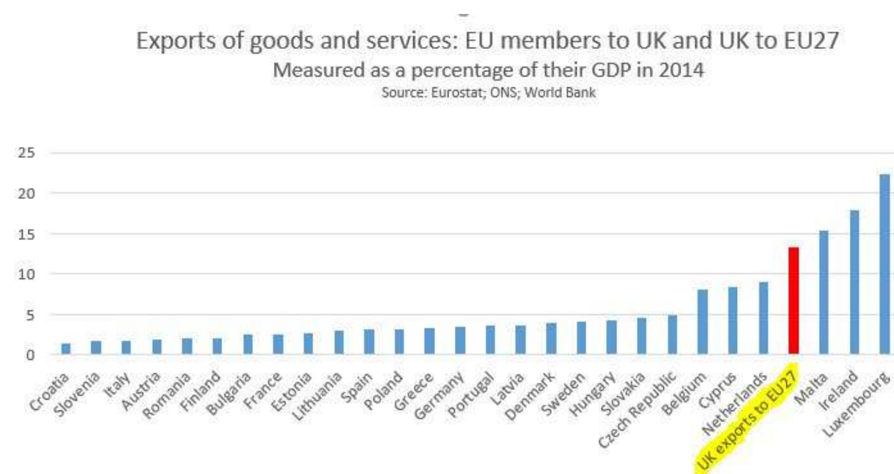
* Report by Oliver Wyman

UK exports to EU and the rest of the world

% of GDP



Source: Macrobond



Source: Macrobond

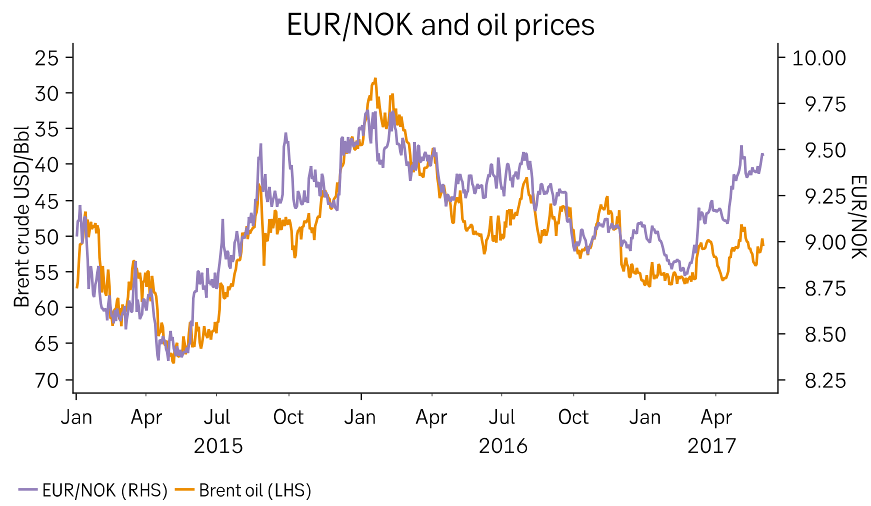
NOK: Normal drivers suggest stronger NOK

- The past couple of years the NOK has traded closely related to relative monetary policy expectations (captured by the 2 year relative rate) and changes in the oil price.
- With the Brent oil price around $52/bbl the relationship since 2014 would suggest a stronger NOK around 9.00 against the euro
- Similarly relative rates between Norway and the euro area suggest EUR/NOK should trade around 8.80..

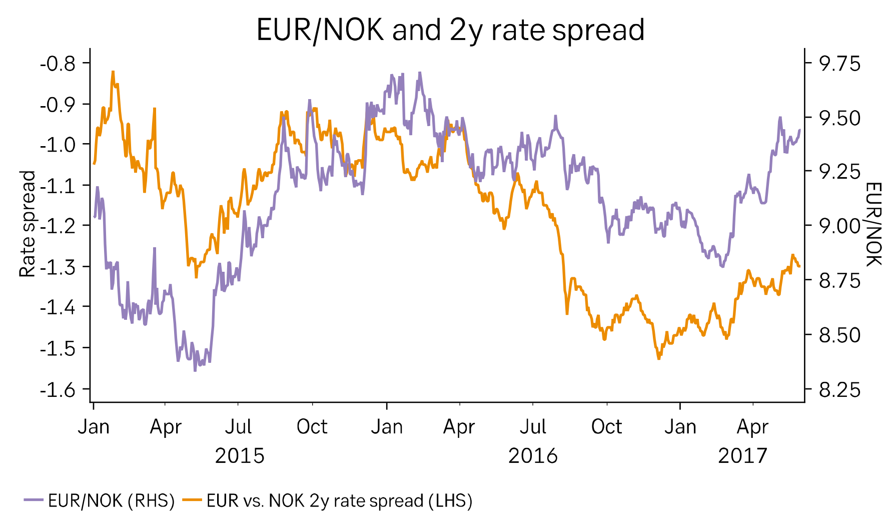
How come the NOK remains so weak?

Once burned, twice burned, thrice shy:
Thin liquidity and aggressive central bank policy interventions (verbally and through policy changes) to weaken the currency and sell-off in oil have generated abnormal moves in NOK in recent years. This probably created substantial losses among foreign and domestic investors. We believe this caused many of them to abandon the NOK-market and we doubt they have returned. Today this makes the NOK market vulnerable whenever it gets exposed to corrections regardless of the trigger as the NOK moves in a very unpredictable way. This is clearly a negative factor for the krone.

Currency market worries more for low inflation:
In 2014-2015 a lower oil price resulted in both lower rates and a weaker NOK. This has not been the case over the past 2-3 months since market's expectations for Norges Bank have been rather stable while the NOK has weakened substantially. Given our more positive view on the Norwegian economy it seems the FX market has pushed it too far, while the reaction in the fixed income market seems more rational.

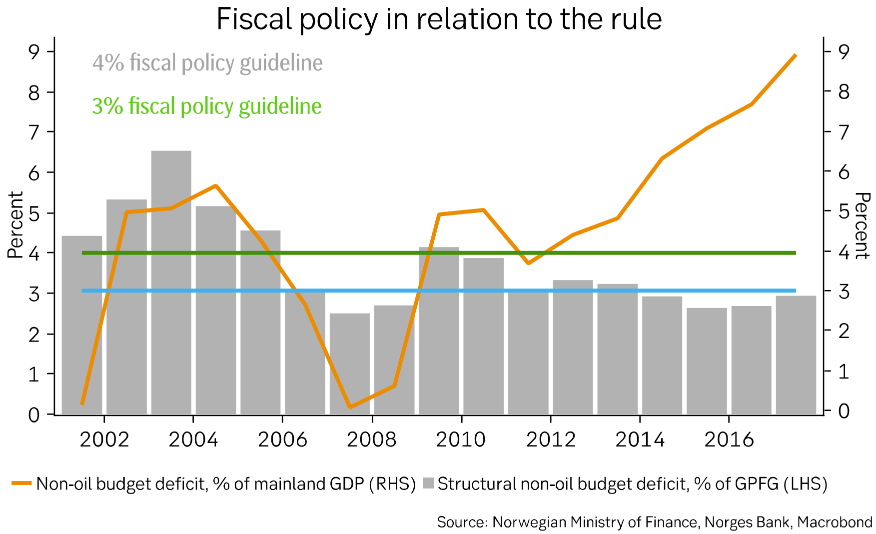


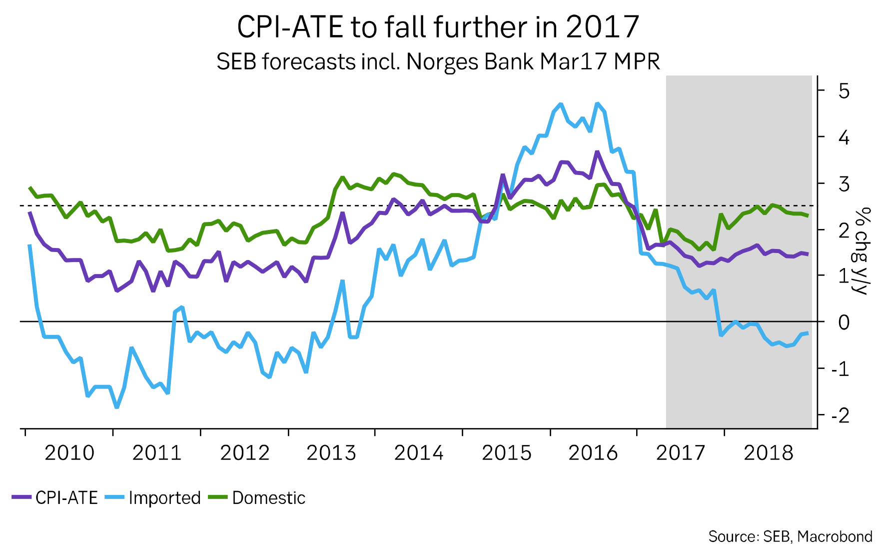
Source: Macrobond



Source: Macrobond

Lowering the inflation target is NOK positive





- There have been discussions surrounding a potential lowering of the inflation target in Norway
- A committee, which is expected to publish its work on June 30, may suggest the inflation target is lowered to 2%.
- Current inflation target of 2.5% was introduced in 2001 together with the fiscal policy rule or spending rule, which stipulates how much oil revenues that could be spent annually by the government
- It was then acknowledged that phasing in petroleum revenues to the economy would create a positive demand impulse over time which warranted a slightly higher inflation target than what is generally used in most countries
- The government has recently lowered the spending rule to 3% from 4%. The use of petroleum revenues in NOK will still increase over time, but not faster than expected growth in trend-GDP
- Considering that the target was set in relation to the fiscal policy rule in 2001, it is not unreasonable that the inflation target will also be revised lower
- **A lowering of the target to 2.0% should be positive for the NOK**
  - ✓ Norges Bank would likely shift to a neutral policy stance considering inflation would be closer to target, ruling out any speculations of a potential rate cut
  - ✓ The first rate hike would likely be moved forward
  - ✓ Norges Bank would also be more tolerant towards NOK appreciation

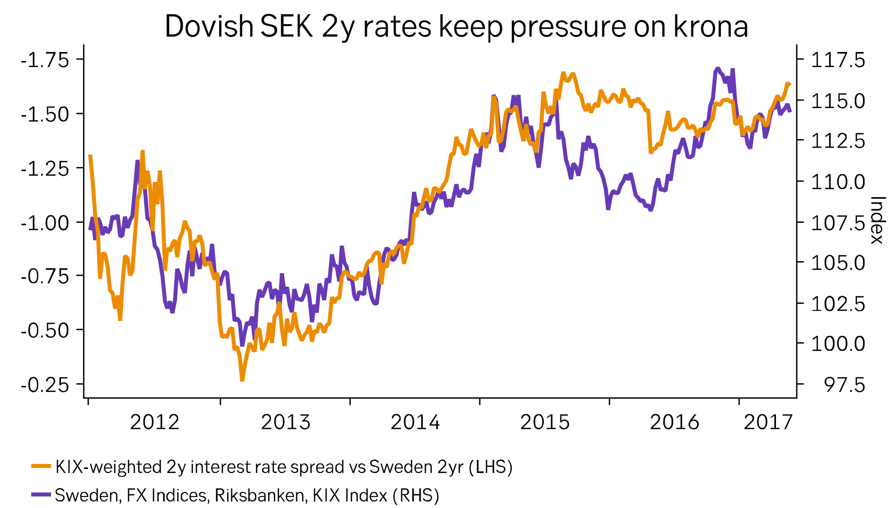
SEK: The puzzle of current weakness

STRONG MACRO OUTLOOK IGNORED BY MARKETS

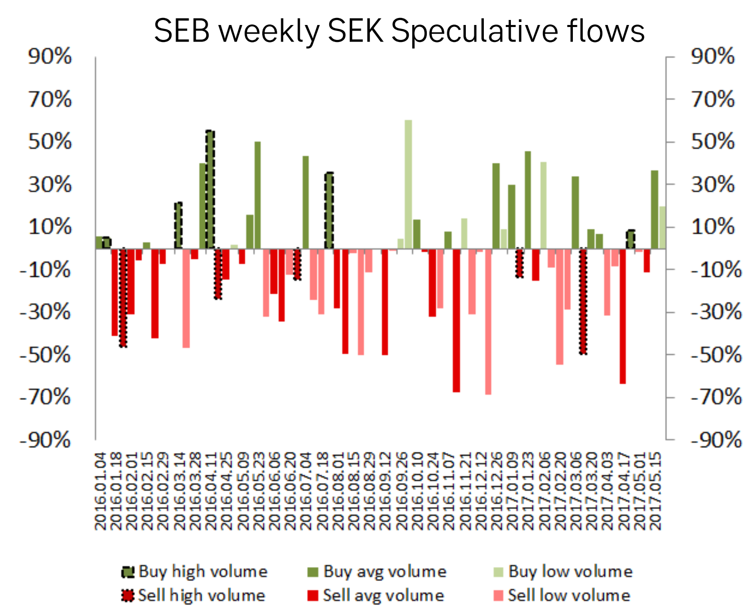
The rebound higher in EUR/SEK from 9.40/50 area has been driven by several factors: 1) Riksbank monetary policy clearly works making SEK a funding currency (graph top right). As long as Riksbank maintains negative repo rate/interest rates, the outlook for SEK is weak. It obviously also makes holding SEK expensive hence triggering profit taking on long SEK positions when spot is not trending in a stronger (SEK) direction. 2) As written elsewhere the equity dividend season b/w march – may involved SEK 10-20bn worth of SEK selling and this certainly contributed to upside pressure in EUR/SEK. 3) The domestic market is long SEK tactically (they have bought SEK on dips) however they are strategically underweighted SEK as FX hedges remain high and corporates have historically large FX-denominated accounts in the Swedish banking system. Finally 4) Foreign Speculative accounts/Macro funds have not been lured into buying SEK as they have probably let go of the thought Riksbank would tighten policy ahead of ECB. Rather foreign speculative funds have been net sellers of SEK throughout H1 2017: we interpret this as closure of previous longs (bet on more positive outlook for monetary policy) and potentially also driven by more systematic/momentum/trend following accounts using SEK as a funding currency.

WHAT WILL CHANGE THE OUTLOOK?

We have shown that the Riksbank reaction function is very much tied to ECB policy (obviously). And SEK developments remain highly dependent on monetary policy. Hence, there is little to speak for a fast turnaround in SEK flows currently although our anticipated deposit rate hike from the ECB may open for a more hawkish pricing of future Riksbank policy (see also page 43).



Source: Bloomberg



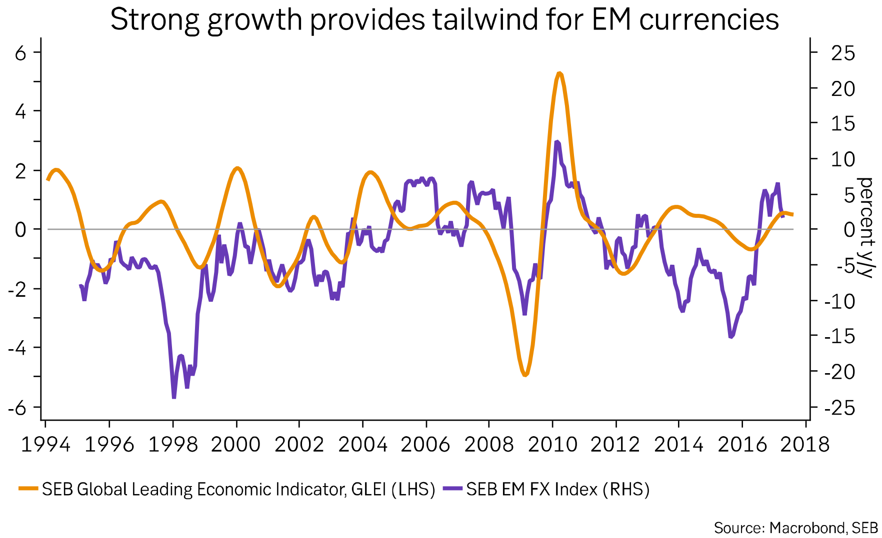
EM currencies: Resilience on strong growth

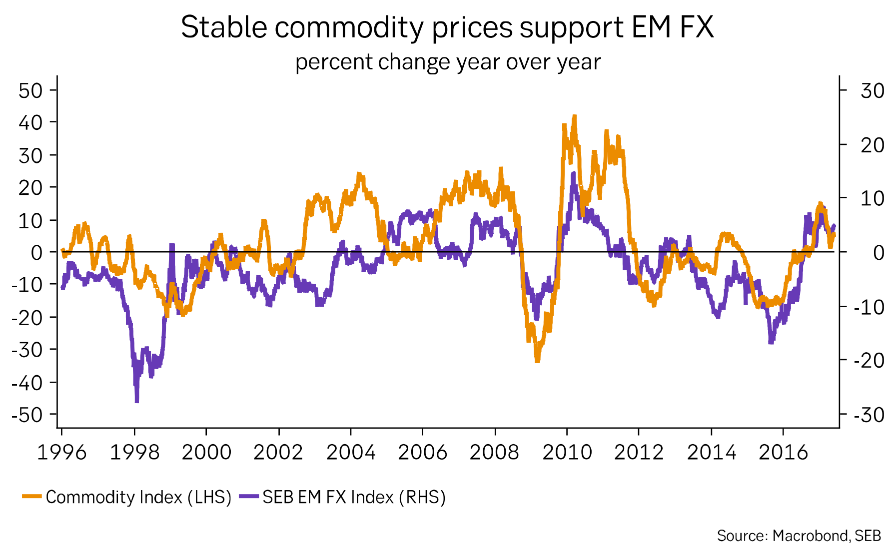
THE EM REBOUND WILL LAST. Global economic activity is on the mend. We expect world real GDP growth to accelerate to 3.7% in 2017 from 3.2% in 2016, driven by a gradual recovery in the US and EU, as well as continued strong growth in China. With the recessions in Russia and Brazil coming to an end, growth in EM will also increase, hitting a very strong 4.8% in 2017. The improvement is broad based. Although EM industrial production moderated in April, it remains at high levels. Trade is also on an upward trend, despite threats of increasing protectionism. Against this background of improving economic conditions, the outlook for EM currencies is one of strength.

COMMODITY PRICES WILL PROVIDE SUPPORT. While overcapacity in important commodity groups such as metals (especially iron ore) and food will exert downward pressure on commodity prices, accelerating global growth will prevent a fall. The price of oil will be supported by an agreement between OPEC and, most importantly, Russia to cut production to reduce inventories.

In addition, central banks in developed markets will unwind parts of the exceptionally loose monetary policy initiatives put in place since the global financial crisis. Nevertheless, rates will remain historically very low. EM yields will compare very favourably, especially in an environment of accelerating growth. The US Fed has sent clear signals that it intends to hike interest rates in 2017, but non-resident portfolio flows to EM between January and April have surged to the highest level since 2013.

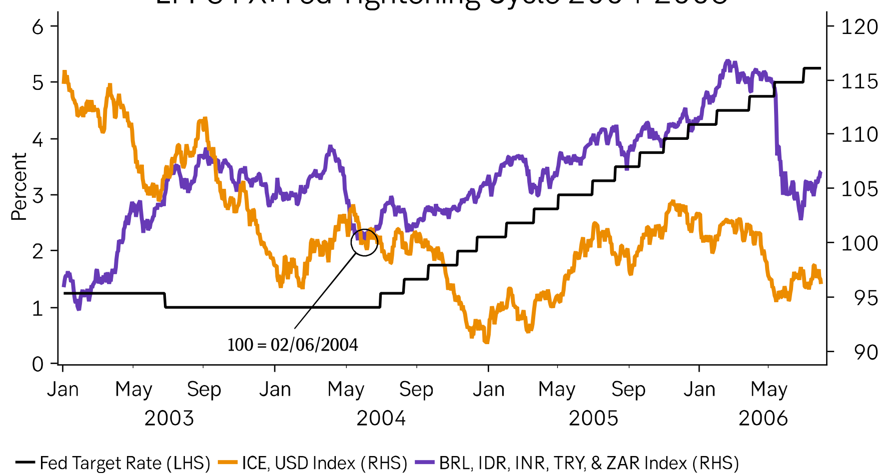
Valuations are also generally low in the EM space following three years of depreciation since the "Taper Tantrum" in 2013.





EM currencies to weather gradual US hikes

EM-5 FX: Fed Tightening Cycle 2004-2006



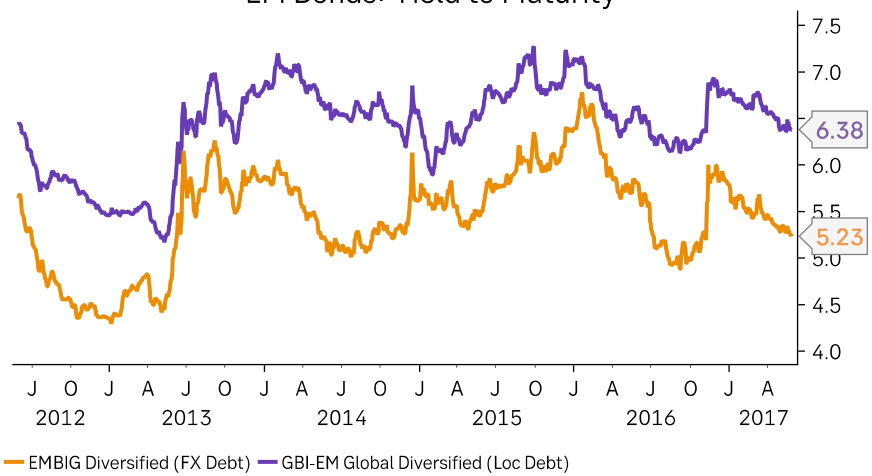
Source: Macrobond Financial AB, Intercontinental Exchange (ICE), Federal Reserve, SEB

Judging by the US rate-hiking cycle in 2004-2006, as long as rates are below roughly 4.5% and hikes are gradual and expected, EM currencies will benefit from faster growth, a recovery in demand for commodities, and strong risk appetite.

The key risks to our bullish EM outlook are a sharper-than-expected slowdown in China, potentially as a result of policy mistakes when the economy goes from being driven by exports and investments to services and consumption. Another key risk is potentially erratic US trade policies, or much sharper protectionist turn.

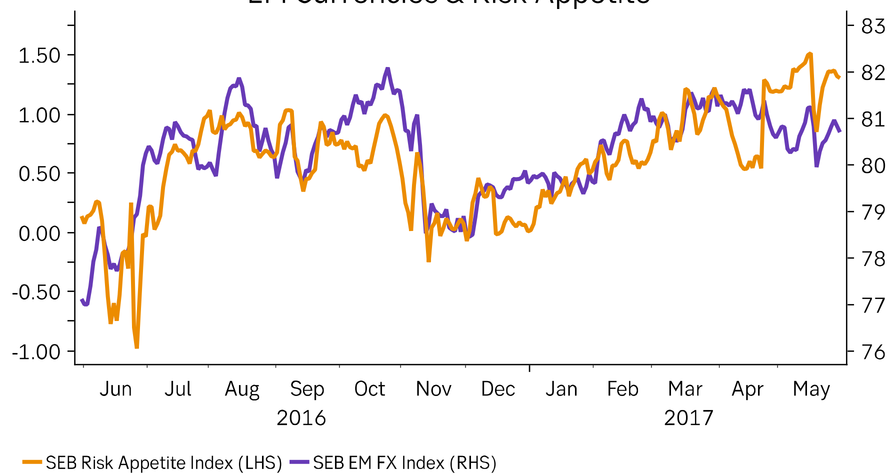
Nevertheless, we expect the Chinese authorities to manage a gradual slowdown and President Trump to be reined in by business interests in favour of trade.

EM Bonds: Yield to Maturity



Source: JP Morgan, Macrobond, SEB

EM Currencies & Risk Appetite



Source: Macrobond, SEB

Contacts

Mattias Bruér (AUD, CAD)
+46 8 763 8506

Richard Falkenhäll (GBP, NOK, USD)
+46 8 506 231 33

Per Hammarlund (PLN, RUB, TRY)
+46 8 506 231 77

Carl Hammer (Editor, SEK, EUR, CHF)
+46 8 506 231 28

Andreas Johnson (NZD)
+46 8 506 232 95

Karl Steiner
+46 8 506 231 29

Sean Yokota (CNY, JPY)
+65 6505 0583

Disclaimer

Important: This statement affects your rights

All research (reports, studies and publications) produced by SEB Merchant Banking, a division of Skandinaviska Enskilda Banken AB (publ) ("the Bank"), is produced for institutional investors only. It is not intended for private clients or Private Customers (as defined by the UK Financial Services Authority, (the "FSA")) and must not be distributed to private clients or Private Customers.

The Bank has offices in Copenhagen, Frankfurt, Helsinki, London, New York, Oslo, Paris, Singapore and Stockholm. This report is produced for private information of recipients and SEB Merchant Banking's research department is not soliciting any action based upon it. Opinions contained in this research report represent SEB Merchant Banking's research department present opinion only and are subject to change without notice.

All information contained in this report has been compiled in good faith from sources believed to be reliable. However, no representation or warranty, expressed or implied, is made with respect to the completeness or accuracy of its contents and the report is not to be relied upon as authoritative. Recipients are urged to base their investment decisions upon such investigations, as they deem necessary. To the extent permitted by applicable law, no liability whatsoever is accepted for any direct or consequential loss arising from the use of this document or its contents.

Your attention is drawn to the fact that the Bank, a member of, or any entity associated with the Bank or its affiliates, officers, directors, employees or shareholders of such members may from time to time (a) have a long or short position or holding in the securities or options of such companies mentioned herein, (b) buy or sell or participate in an issue of such securities or options, (c) provide corporate finance services to such companies or in relation to such securities or options, (d) be represented on the board of directors or similar supervisory entity of such companies. The Bank may make a market in the securities mentioned in this report.

Authors' statement of independence (Analyst Certification)
We, the authors of this report, hereby confirm that notwithstanding the existence of any potential conflicts of interest referred to herein, the views expressed in this report accurately reflect our personal views about the companies and instruments covered. We further confirm that we have not been, nor are or will be, receiving direct or indirect compensation in exchange for expressing any of the views or the specific recommendation contained in the report. We are not registered or qualified as research analysts, representatives or associated persons under the rules of any US exchange, regulatory organization or State

This statement affects your rights
This report is confidential and may not be reproduced, redistributed or republished by any recipient for any purpose or to any person.

Recipients
SEB Research is approved and issued by Skandinaviska Enskilda Banken AB (publ) (“SEB”), a bank organized under the laws of the Kingdom of Sweden, on behalf of itself and its affiliates for institutional investors. SEB is not a registered Broker-Dealer under the US Securities and Exchange Act of 1934. This report must not be distributed to retail clients except those of SEB Oslo Branch and, in case of research distributed via SEB Helsinki Branch, to its retail clients located in Finland.

Use
This research report is produced for the private information of recipients - if you are not a client of ours, you are not entitled to this research report, and should destroy it. The document is not, and should not be construed as, an offer to sell or solicitation of an offer to buy any securities. Opinions contained in the report represent the author's present opinion only and may be subject to change. In the event that the author's opinion should change or a new analyst with a different opinion becomes responsible for our coverage of the company concerned, we shall endeavour (but do not undertake) to disseminate any such change, within the constraints of any regulations, applicable laws, internal procedures within SEB, or other circumstances.

Good faith and limitations
All information, including statements of fact, contained in this research report have been obtained from SEB, Bloomberg or Macrobond and compiled in good faith from sources believed to be reliable. However, no representation or warranty, express or implied, is made by SEB with respect to the completeness or accuracy of its contents, and it is not to be relied upon as authoritative and should not be taken in substitution for the exercise of reasoned, independent judgement by you. Recipients are urged to base their investment decisions upon such investigations as they deem necessary. To the extent permitted by applicable law, no liability whatsoever is accepted by SEB for any direct or consequential loss arising from the use of this document or its contents.

Distribution
This research report has been prepared by SEB or its affiliates and is being distributed by SEB offices in Stockholm, Copenhagen, Oslo, Helsinki, Frankfurt, London, Tallinn, Vilnius, Singapore and Hong Kong. Research reports are prepared and distributed in Lithuania by AB SEB bankas and in Estonia by AS SEB Pank in accordance with the requirements of the local laws and Financial Supervision Authority's conduct of business rules. It is being distributed in the United States by SEB Securities Inc. ('SEBSI'), a wholly owned subsidiary of SEB organized under the laws of the State of Delaware, USA. Any United States institutional investor receiving the report, who wishes to obtain further information or to effect a transaction in any security discussed in the report, should do so only through SEBSI and not its affiliates. Addresses and Phone numbers for each office can be found at the end of the report.

Disclaimer

The SEB Group: members, memberships and regulators
SEB is a member of, inter alia, Nasdaq OMX Nordic, Oslo Stock Exchange, the London Stock Exchange, NYSE Euronext, Frankfurt Stock Exchange, Tallinn Stock Exchange as well as certain European MTF's such as BATS-Chi-X, Turquoise, Burgundy, XUBS, POSIT and Sigma-X. SEB is regulated by Finansinspektionen in Sweden and, for the conduct of investment services business, in (i) Denmark by Finanstilsynet, (ii) Norway by Finanstilsynet, (iii) Finland by Finanssivalvonta, (iv) Germany by Bundesanstalt für Finanzdienstleistungsaufsicht, (v) the UK by the Financial Conduct Authority and Prudential Regulation Authority (details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request), (vi) Estonia by the Estonian Financial Supervision Authority, (vii) Lithuania by the Bank of Lithuania, (viii) Singapore by the Monetary Authority of Singapore, and (ix) Hong Kong by Securities and Futures Commission. SEBSI is a U.S. broker-dealer, registered with the Financial Industry Regulatory Authority (FINRA). SEBSI is a subsidiary of SEB. SEBSI is authorized to engage in the underwriting of securities but does not make markets or otherwise engage in any proprietary trading in any securities. SEB's research reports are prepared in accordance with the industry standards and codes of conduct applicable to financial analysts in the countries where they are based. In Denmark, Finland, Norway and Sweden, analysts act in accordance with the rules of ethics of each country's Society of Financial Analysts. Analysts comply with the recommendations and industry standards of the Danish, Norwegian and the Swedish Securities Dealers Associations and with those of the Federation of Finnish Financial Services. Analysts certified by the CFA Institute also comply with the Code of Ethics of the CFA Institute.

Prevention and avoidance of conflicts of interest
All research reports are produced by SEB's Research department, which is separated from the rest of its activities by an Information Barrier; as such, research reports are independent and based solely on publicly available information. Following standard practice, recommendations and target share prices are removed from research on companies which are the subject of public offers on which SEB is advising. The remuneration of staff within the Research department is determined exclusively by research management and senior management and may include discretionary awards based on the firm's total earnings, including investment banking income; however, no such staff receive remuneration based upon specific investment banking transactions. SEB's Compliance department monitors the production of research and the observance of the group's procedures designed to prevent any potential conflicts of interest from affecting the content of research.

Your attention is also drawn to the fact that:
The current market price of the instruments shown in this report is the price prevailing at the close of the business day preceding the date of publication or when applicable a more recent price than that. Unless explicitly stated otherwise in this report, SEB expects (but does not undertake) to issue updates to this report following the publication of material new figures or forecasts relevant to the instruments covered, or upon the occurrence of other events which could potentially have a material effect on it. The instruments discussed in this research report may not be eligible for sale in all countries, and such instruments may not be suitable for all types of investors. Offers and sales of instruments discussed in this research report, and the distribution of this report, may be made only in countries where such instruments are exempt from registration or qualification or have been so registered or qualified for offer and sale, and in accordance with applicable broker-dealer and agent/salesman registration or licensing requirements. Additional recommendation history for the instrument is available at http://www.seb.se/research.

Methodology
SEB Research & Strategy determines the global economic backdrop and outlook for fixed income, FX and commodity markets using; 1) own analysis and aggregation tools, including proprietary models and indicators and amended by publicly available data providers (free and fee-based) such as Macrobond, Bloomberg and others; 2) input from other research units within SEB; 3) Various research reports (free and fee-based). The various sources being integrated must fulfil the principles of consistency, plausibility and must be backed by fact. Final consideration as to any valuations, projections and forecasts contained in this report are based on a number of assumptions and estimates and are subject to contingencies and uncertainties, and their inclusion in this report should not be regarded as a representation or warranty by or on behalf of the Group or any person or entity within the Group that they or their underlying assumptions and estimates will be met or realized. Different assumptions could result in materially different results. Past performance is not a reliable indicator of future performance. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related investment mentioned in this report. In addition, investors in securities, such as ADRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk

THIS REPORT IS NOT INTENDED TO BE PUBLISHED OR DISTRIBUTED IN THE UNITED STATES.

The Bank is incorporated in Stockholm Sweden with limited liability and is a member of the Stockholm Stock Exchange, The London Stock Exchange, the IPE, and the OM, EDX, Euronext Liffe, Euronext Paris, Eurex and Pulpex exchanges. The Bank is regulated by Finansinspektionen (the Swedish Financial Supervisory Authority), and, for the conduct of designated investment business in the UK, by the FSA.