Currency Strategy
Greenback in trouble?

September 2017

Currency Strategy: Greenback in trouble?

GREENBACK IN TROUBLE?

This summer has seen larger FX moves than we anticipated in the last *Currency Strategy* (June 1, 2017) entitled ”Busy doing nothing at all”. **Our trading ideas managed to capture these moves, as the US dollar and sterling weakened and the CAD, SEK and euro appreciated (see chart below).** What started as a euro appreciation as early as April has gained momentum, but the latest EUR/USD surge has come as a result of general USD weakness. The EUR/USD exchange rate is now above our – and most market participants' – forecasts and is at a level where the European Central Bank should be concerned about continued strength. Currently the USD is struggling on several fronts, including geopolitical risks with North Korea, severe weather and low US inflation, all making the case for the US Federal Reserve to put interest rate hikes on hold. **However, SEB still expects the Fed to hike interest rates later this year. We have thus retained a 3-month EUR/USD forecast indicating a lowering towards 1.17. The greenback is down but not out.**

FUNDAMENTALS STILL THE NAME OF THE GAME

FX markets remain driven by relative fundamentals and central bank expectations (more on page 4). **Our macro forecasts paint an optimistic picture of the global economy,** including yearly growth of nearly 4% in 2017/18. Meanwhile geopolitical tensions are the only strong obstacle holding back new risk appetite gains. Ultimately we believe risk appetite will be sustained by strong, synchronised global growth. Central banks are starting to signal tightening, but overall policies are very expansionary and will continue to support markets. **FX markets are doing most of the work for central banks, meaning hawkish signals will be rewarded by currency appreciation.**

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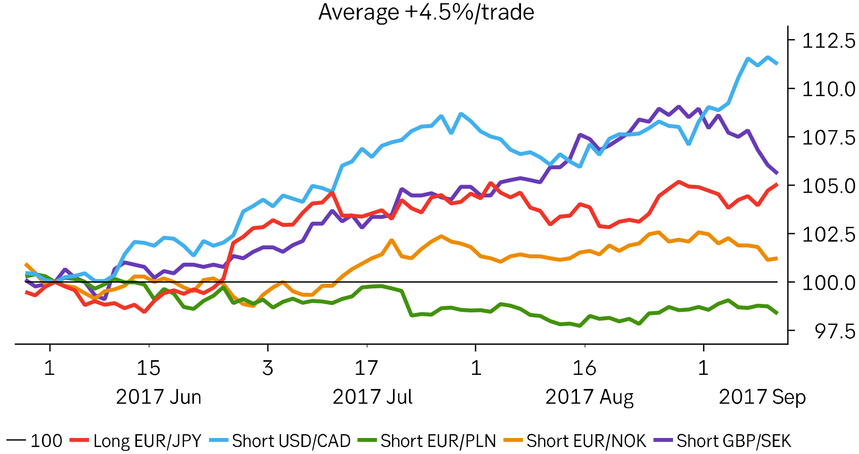
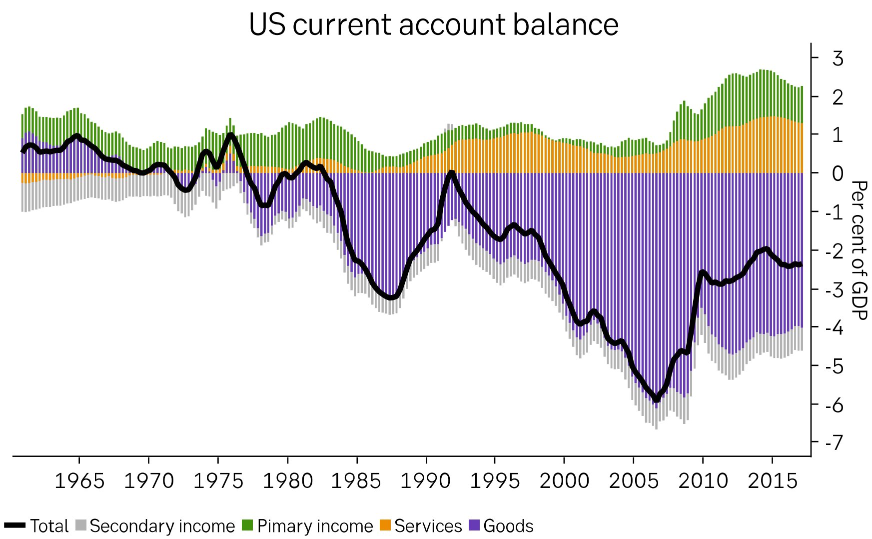
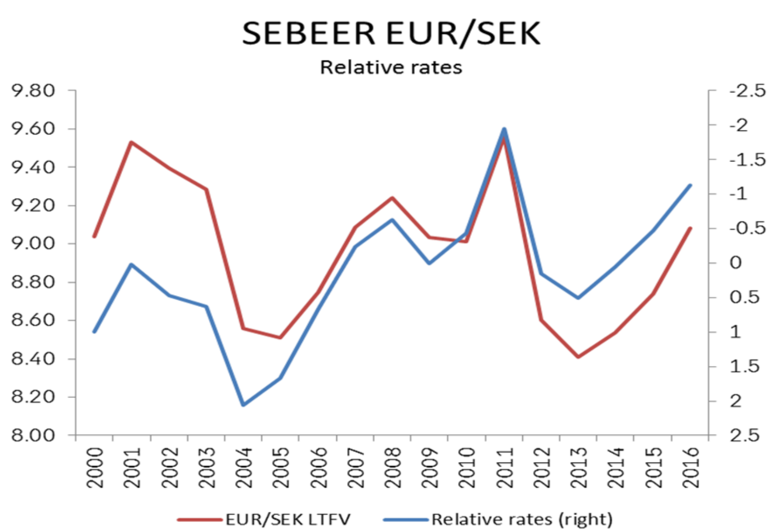
Average +4.5%/trade



Source: {Property Source not found.}, Macrobond, SEB

Currency Strategy: Greenback in trouble?





OUTLINE OF OUR NEW CURRENCY STRATEGY

Finding the right direction for the US dollar normally solves the puzzle for most other G10 currency projections. After a prolonged period of USD strength in 2014-2017 the greenback has given back 10% or so in the past 4 months. In the Themes section we outline our views on US macro, why the USD is not a safe haven currency and the US current account composition arguing it is **too early for the dollar to continue to fall below long-term fair-value levels.** But this forecast is also clearly dependent on our hawkish Fed forecast. **Monetary policy in Canada has turned very hawkish** and the Loonie has benefited. We have **compared relative macro developments in Sweden, Norway and Canada,** arguing that the time is ripe for hiking interest rates in Sweden as well. But the Riksbank is unlikely to listen to our calls just yet. Faith in the euro has revived much faster than most observers had expected, following the French presidential election. **The prospect of deeper EU integration is a long-term supportive euro factor as political risks decline.** But we believe that **ECB monetary policy will weight on the common currency in the coming 3-6 months**, before more positive long-term structural flows enter the euro zone and push EUR/USD even higher. Sterling has fallen with the weaker USD, and the market consensus has caught up on our bearish UK growth projections. **From here on, we are less bearish on the British currency, since its valuation will start to look attractive and we also anticipate a soft Brexit.** In the themes section we also take a deeper look at our long-term **fair value model for EUR/SEK – deeply negative Swedish real rates have pushed EUR/SEK fair-value above 9.00. Emerging markets have finally posted a strong return** since the rebound in commodity prices early in 2016, and we argue that there will be **more such positive momentum going forward.**

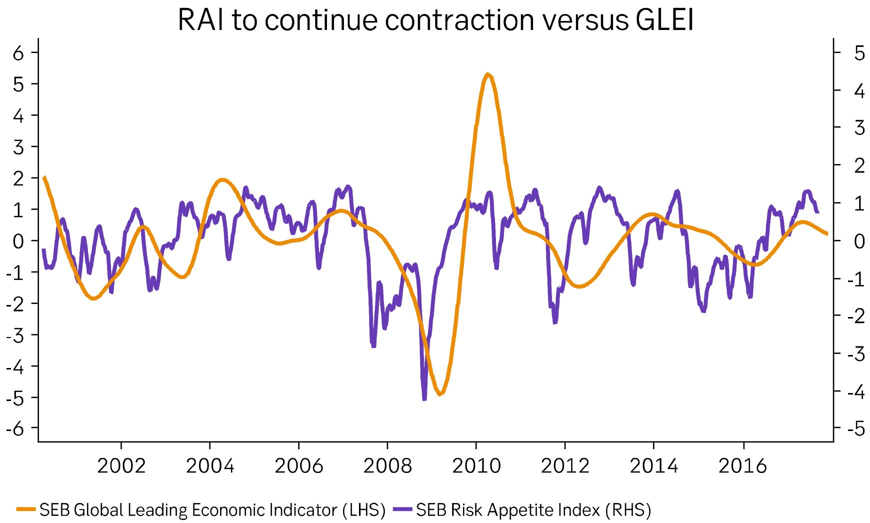
Investment styles: Growth style to flourish

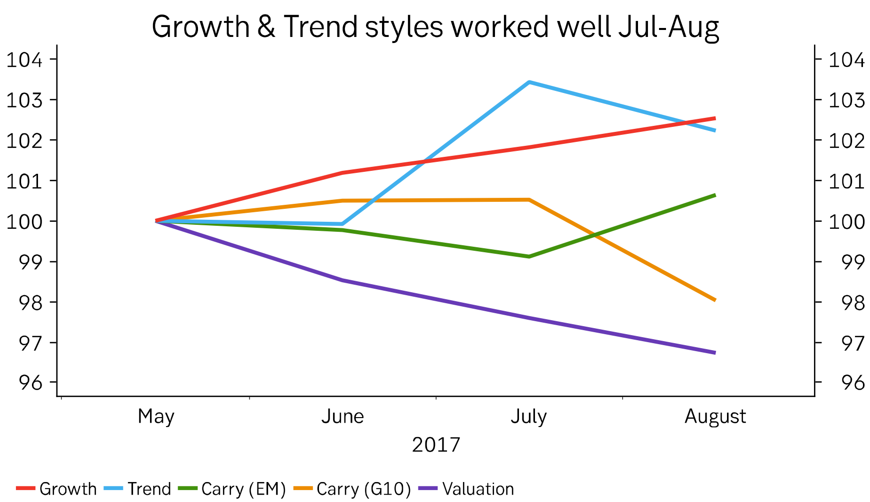
POLICY DIVERGENCE IN FOCUS
In the June *Currency Strategy* we expected the “carry” style to perform well during the summer, though falling risk appetite was seen as a risk to this call. As it turned out, risk appetite did fall and carry underperformed. **Instead the “growth” style, based on changes in rates, performed well.** In the January *CS* we had expected this style to become dominant as policy divergence between central banks would come more into focus in H2 2017. The “trend” style delivered a positive return this summer, due to a strong period in July when FX volatility rose.

Since we believe risk appetite will be OK, we expect the carry style to perform well in the coming months. Early autumn is known for being an uncertain period, but when looking at FX volatility in particular it tends to fall in both September and October (80% of the time in the past five years). As the trend style tends to be highly correlated with FX volatility, this leads us to believe in only modest performance for the trend style. **With no convincing valuation cases, we do not expect valuation to do well over the coming year.**

So we are siding with the belief that the **growth style has the greatest potential to deliver favourable returns** in the coming months. Using our scorecard approach, one may construct a proxy for a growth style portfolio by going long on the currencies with the highest monetary policy expectation scores and shorting the one with the lowest scores. As new information becomes available the ranking should change, but for now **such a strategy indicates the following portfolio:**

- **LONG**: USD & CAD
- **SHORT**: CHF





Source: Macrobond, SEB

SEB

FX Forecasts

FX forecasts	SEB					Fwd	Consensus*
	12/Sep	3m	6m	12m	Q4 18	12m	12m
EUR/USD	*1.19*	1.17	1.19	1.21	1.23	1.22	1.17
EUR/JPY	*131*	131	137	138	139	131	130
EUR/GBP	*0.90*	0.92	0.92	0.88	0.88	0.91	0.91
EUR/CHF	*1.15*	1.16	1.17	1.20	1.20	1.14	1.13
EUR/SEK	*9.54*	9.39	9.27	9.02	9.10	9.53	9.28
EUR/NOK	*9.38*	9.22	9.16	9.02	8.90	9.50	9.00
EUR/DKK	*7.44*	7.44	7.44	7.44	7.44	7.43	7.45
EUR/PLN	*4.25*	4.21	4.16	4.08	4.05	4.34	4.20
USD/RUB	*57*	61	61	62	63	61	59
USD/TRY	*3.43*	3.37	3.47	3.76	4.00	3.78	3.80
USD/JPY	*110*	112	115	114	113	108	111
GBP/USD	*1.33*	1.27	1.30	1.37	1.40	1.34	1.29
USD/CAD	*1.21*	1.19	1.17	1.15	1.14	1.21	1.27
USD/CHF	*0.96*	0.99	0.98	0.99	0.98	0.94	0.97
AUD/USD	*0.80*	0.77	0.77	0.77	0.76	0.80	0.75
NZD/USD	*0.73*	0.72	0.74	0.75	0.73	0.73	0.72
USD/SEK	*7.99*	8.03	7.79	7.45	7.40	7.82	7.93
GBP/SEK	*10.60*	10.19	10.13	10.21	10.36	10.50	10.23
JPY/SEK	*7.28*	7.17	6.77	6.54	6.55	7.26	7.15
CHF/SEK	*8.33*	8.09	7.92	7.52	7.58	8.36	8.21
NOK/SEK	*1.02*	1.02	1.01	1.00	1.02	1.00	1.03
USD/NOK	*7.86*	7.88	7.70	7.45	7.24	7.80	7.69
USD/CNY	*6.54*	6.68	6.70	6.42	6.30	6.66	6.71

**Bloomberg survey FX forecasts.*

How to trade it

OUR TRADE IDEAS

- **SELL EUR/CAD.** With a fast-improving labour market and rising resource utilisation, the BoC has signalled more rate hikes. We expect the euro to give back some of its recent gains and are hence switching from short USD/CAD to short EUR/CAD.

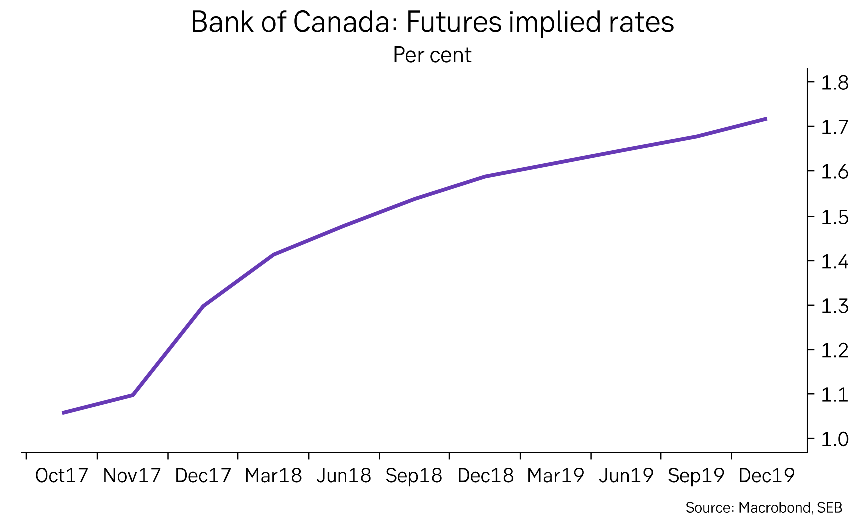
- **BUY USD/CNY.** The People's Bank of China recently removed the reserve requirement on trading FX forwards, showing that it does not want a one-sided yuan appreciation. We are targeting a USD/CNY rate of 6.70 by year-end.

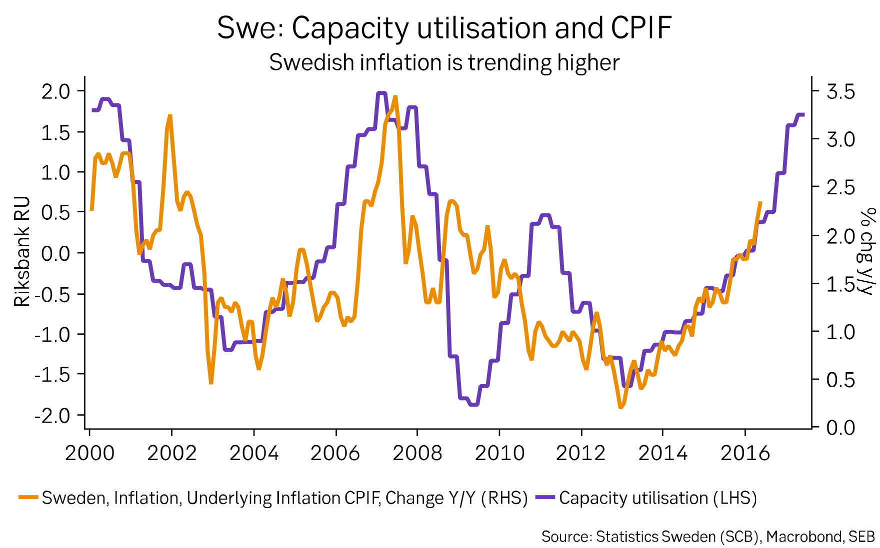
- **SELL EUR/TRY.** Relative domestic political stability as Turkey's AKP tries to boost support ahead of elections before November 2019, and high carry will support the TRY. We are targeting EUR/TRY to move down to 4.00 in the next 3 months.

- **BUY GBP/CHF.** We expect continued CHF depreciation as the EU political risk premium declines and the ECB heads for the exit door. Sterling is undervalued, and the terms for British EU exit will soon be finalised. Combined with our expectations of a soft Brexit, we expect a slightly stronger GBP over time.

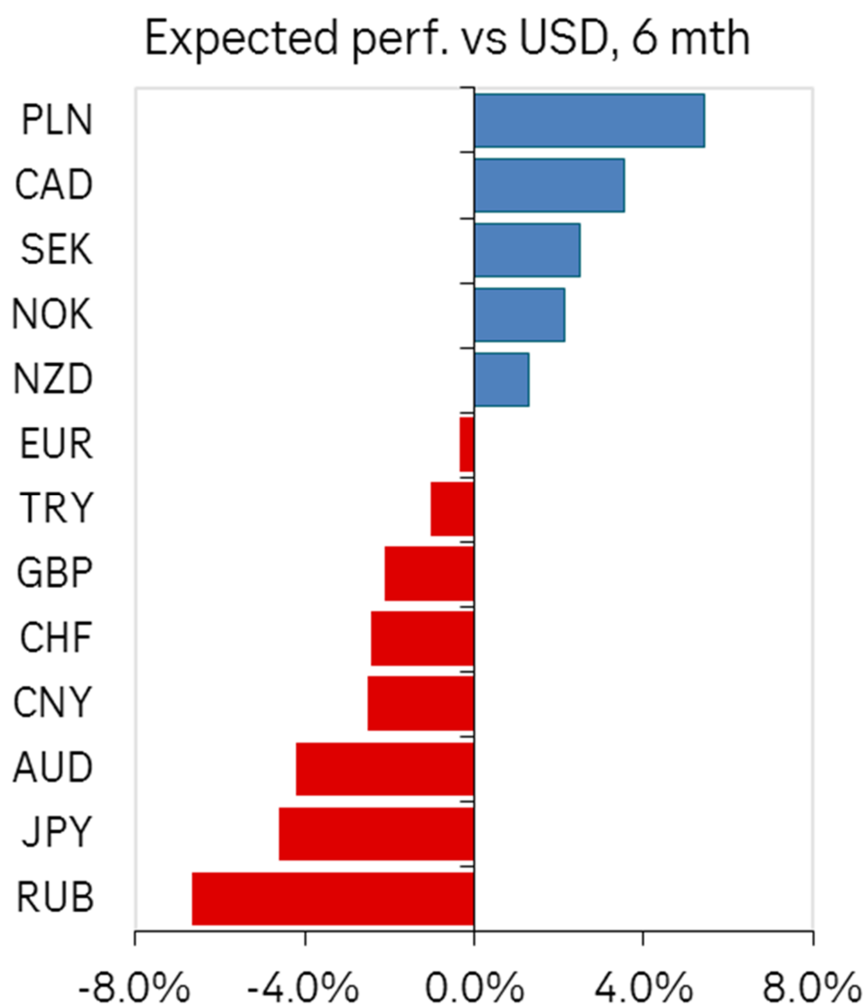
- **BUY USD/JPY.** We expect USD/JPY to continue range-trading at 108-115. Given our fairly hawkish Fed forecast, with 3 hikes in 2018 we expect USD/JPY to reach 115 by March 2018.

- **KEEP SHORT EUR/SEK.** We remain SEK bulls and expect EUR/SEK to decline towards 9.30/35 by year-end. Above target inflation makes Riksbank situation eventually untenable.





Currency overview



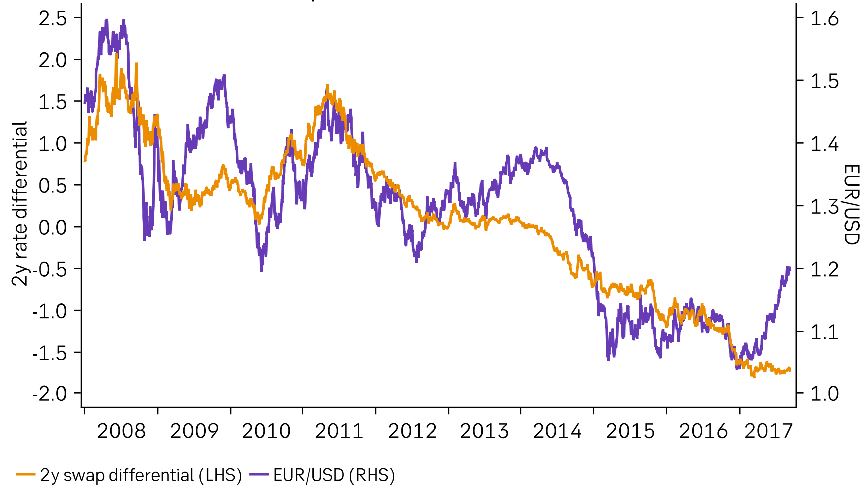
USD: Likely to recover, but only briefly

ONLY A BRIEF RECOVERY. Although the message in our last report was that the USD had peaked earlier this year, we must admit we failed to foresee how and quickly it could fall. Low inflation has almost removed expectations of future Fed tightening: one reason why the dollar is weak. But investors are too pessimistic about upcoming Fed hikes. Further tightening this year and next will trigger a dollar recovery, but only temporarily.

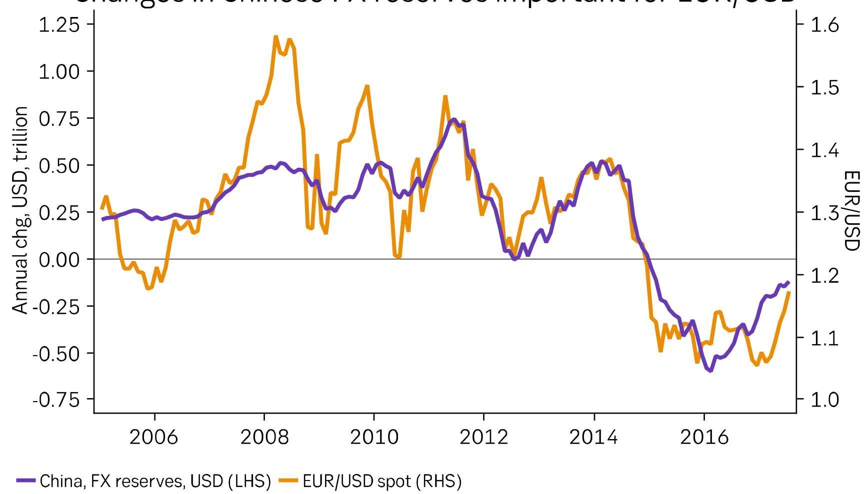
SHORT-TERM: The USD is too weak against the euro considering its traditional correlation with relative interest rates. These "gaps" are usually closed by a correction in the exchange rate, but we need a trigger. In contrast, political uncertainty and problems with raising the federal debt ceiling are near-term risks for the dollar. However, earlier experience indicates that the impact of such factors on the dollar is short-lived.

LONG-TERM: One of the things that actually fits the story of dollar weakness since before the summer is tentative signs of changed activity among global FX reserve managers. For example the traditional correlation between changes in Chinese reserves and the value of the dollar (see lower chart) still holds and indicates a weaker dollar. China's FX reserves have increased by almost USD 100bn this year (as of July). Although China has returned as a net buyer of US securities, growing FX reserves probably imply rebalancing out of the dollar as well. This is unlikely to be unique to China and will probably apply to several central banks. Structural rebalancing is one factor that could continue to weigh on the dollar long-term. US growth improved in Q2 and the economy looks set to grow around trend while the labour market continues to tighten. Eventually this will feed into higher inflation and faster wage growth, which is just what the Fed is looking for. The destiny of the dollar will depend on the relative strength of these two opposing forces.

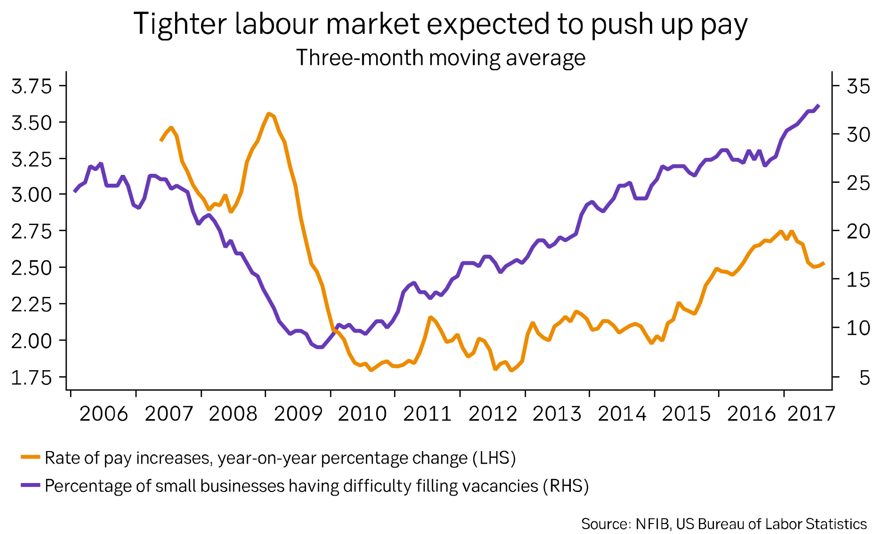
EUR/USD and relative rates

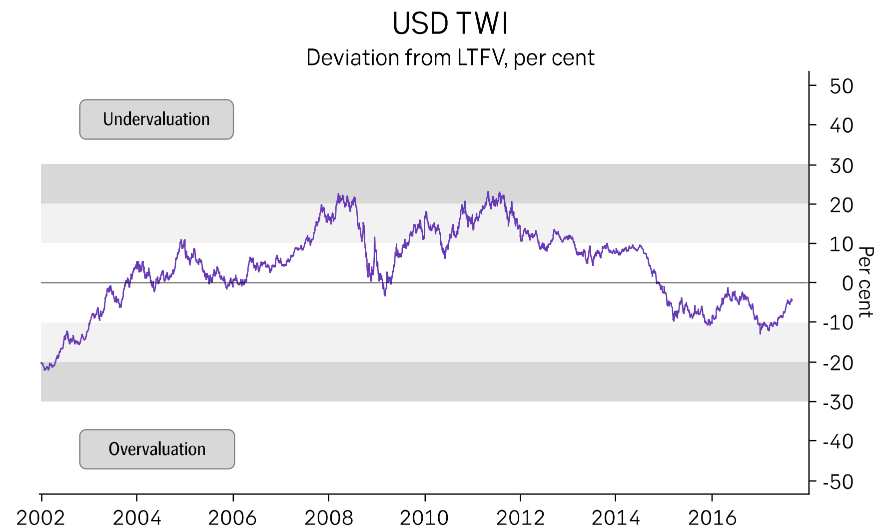


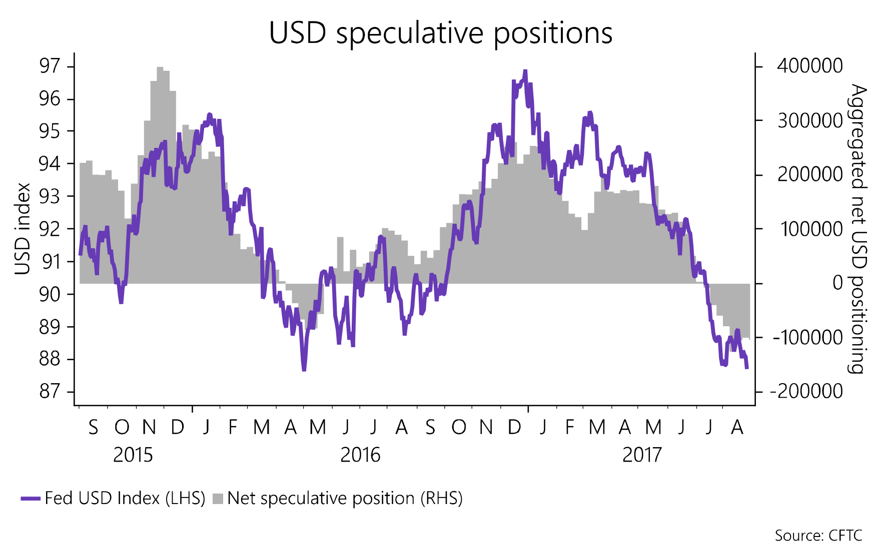
Changes in Chinese FX reserves important for EUR/USD

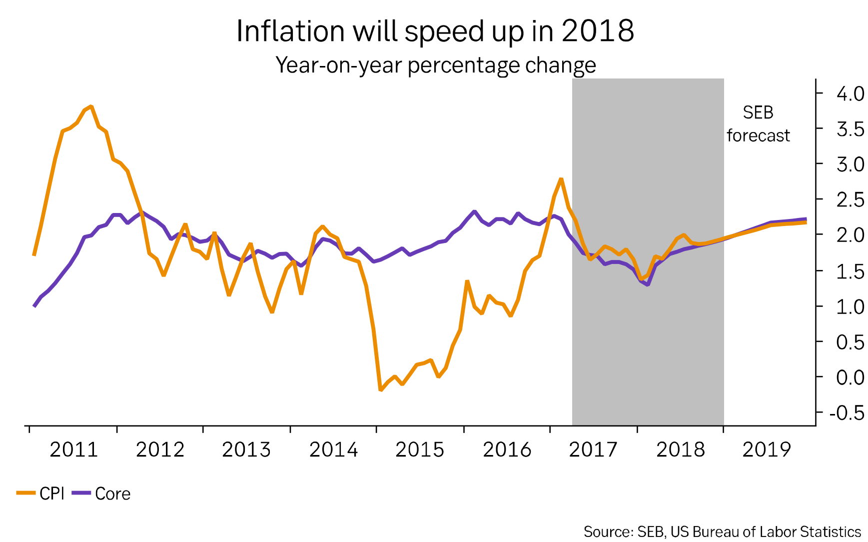


US: Fed tightening rests on rising wages





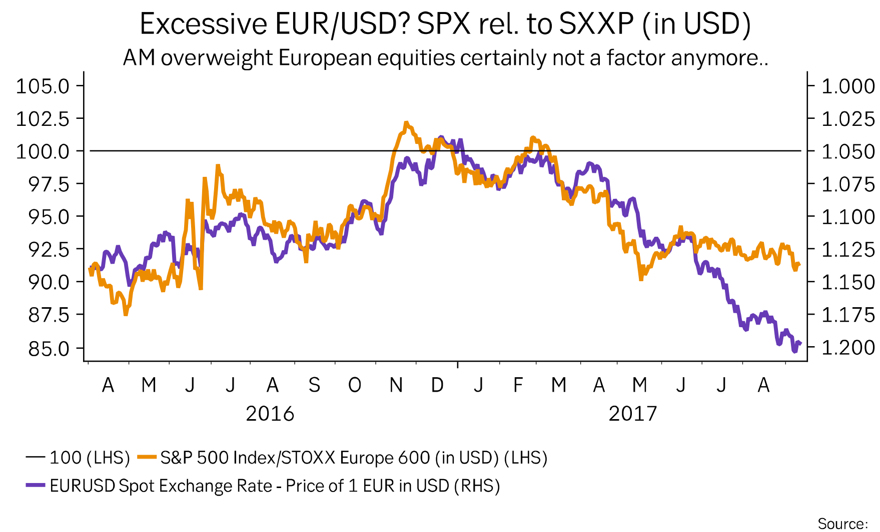


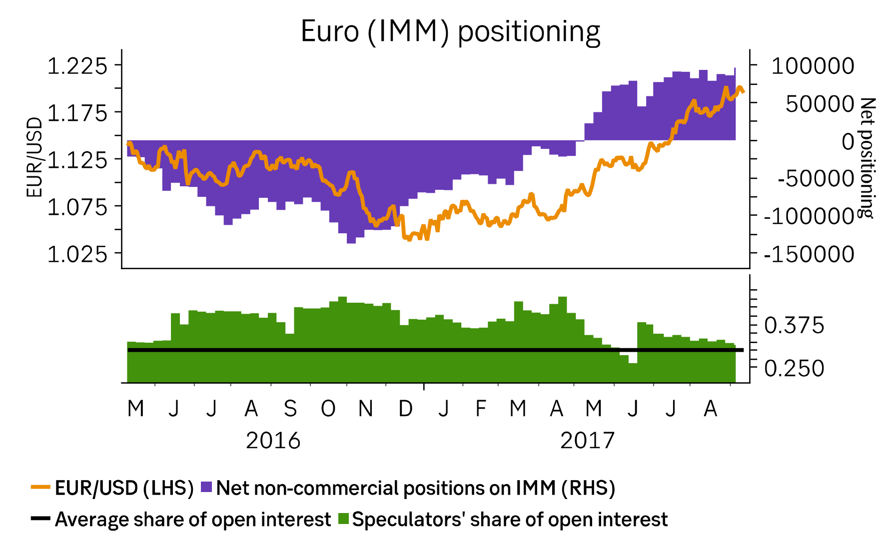


EUR: Is there a pain threshold, ECB?

EXCESSIVE STRENGTH SHORT-TERM. Economic indicators paint a strong outlook for European growth. **SEB expects the euro area to grow by 2.1% in 2017 and 2.2% in 2018.** Coupled with **declining political risk** premiums following the French election, faith has been restored in the common currency. But given the predominance of the G2 currencies; much of the recent euro upturn is driven by a weaker dollar and weaker Fed expectations. **Speculative flows are near record-long EUR/USD**, while there is **little to suggest that long-term structural flows (see below) have been kick-started already.** Expectations about the Fed are very muted (1 hike over the coming 18 months) and SEB expects another 4 rate hikes until end-2018. We would use levels above 1.21 to initiate a short EUR/USD trade as we expect EUR/USD to decline towards 1.17 in 3-6 months.

POLITICAL STABILITY TO BOOST EURO LONG-TERM. In the IMF's quarterly **COFER statistics on global FX reserves, the EUR remains at 19% – far below the near 30% noted in 2009-2010.** The strong economic recovery, reasonable equity valuations, political stability and "under-weighted" investors make a case for more promising positive and structural euro inflows in the next couple of years. **Political stability in Europe and capital account liberalisation in China may also undercut the USD's role as a global reserve currency.** A rather elevated current account surplus adds to the euro tailwind, but we never foresee external surpluses setting FX trends. The trade-weighted euro is now trading near long-term nominal averages; **our fair value model points towards a slight overvaluation. We target EUR/USD at 1.25 in 2019.**





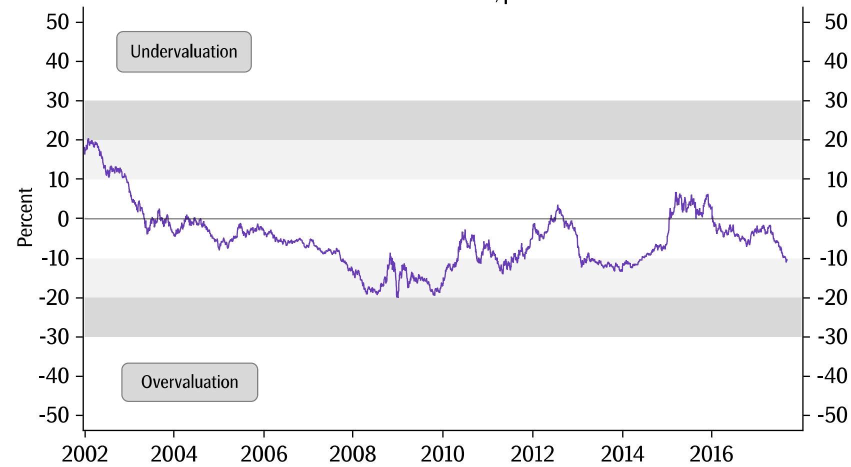
EMU: Improving economic fundamentals

Economic Surprise Index

Source: Citi, Macrobond, SEB

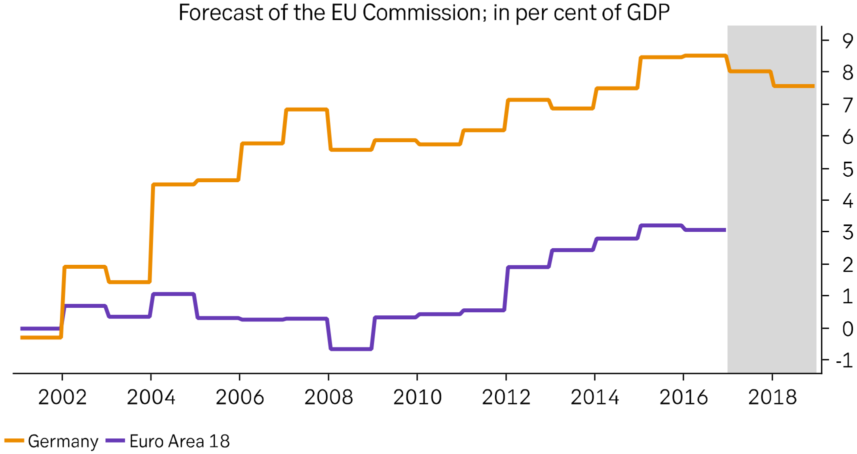
EUR TWI

Deviation from LTFV, percent



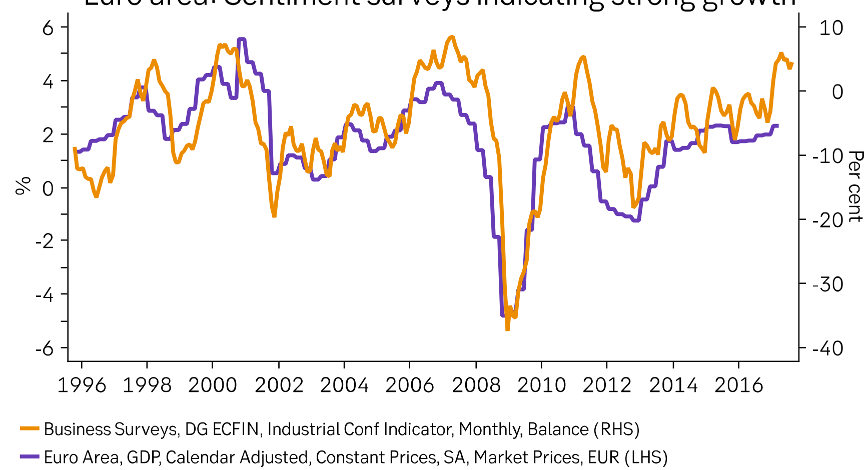
Euro zone - Current account balance

Forecast of the EU Commission; in per cent of GDP



Source: DG ECFIN, Eurostat

Euro area: Sentiment surveys indicating strong growth



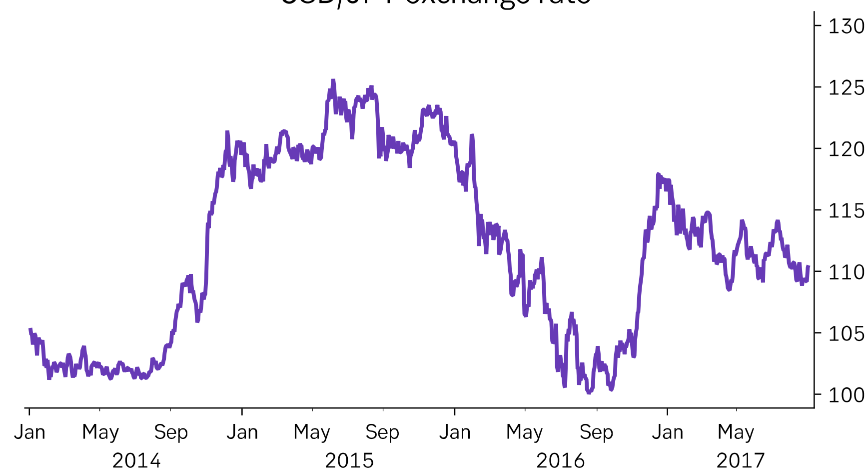
Source: DG ECFIN, Markit

JPY: Continued weakness

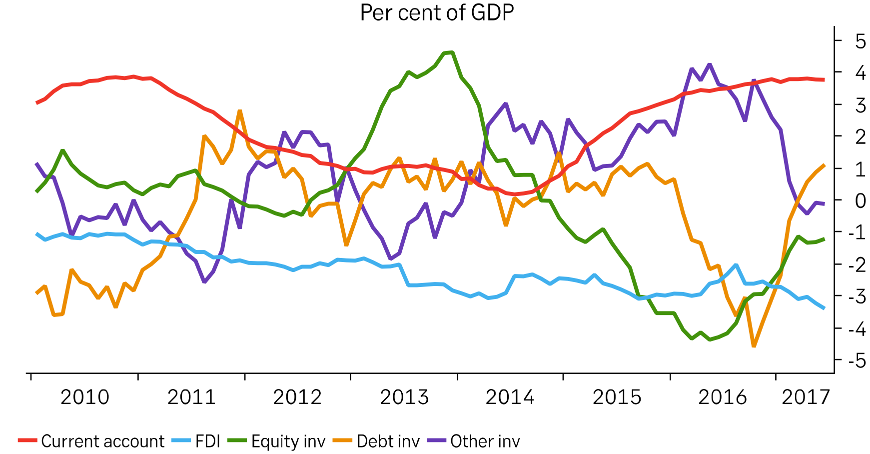
WE EXPECT THE JAPANESE YEN TO REMAIN WEAK. We think the JPY will continue to depreciate into 2018 as US monetary policy keeps tightening compared to the Bank of Japan (BoJ)'s accommodative stance. The JPY will continue to trade in the 108-114 range until the end of 2017. Short-term events such as geopolitical risks and severe weather in the US may push USD/JPY below 108 but if so that's an attractive level to sell the JPY.

The Japanese economy will accelerate to **1.3% growth in 2017**, boosted by fiscal stimulus and exports. Consumption is also holding up due to the delay until October 2019 of the agreed consumption tax increase. **In 2018, growth will slow to 0.8%** as fiscal stimulus wanes and exports slow. Investment has been disappointing, despite healthy business activity. Future consumption tax increases may make businesses more cautious during early 2019. Japan's problem has been that the economic recovery has been too weak to reach the BoJ's 2% inflation target. While most central banks are planning to exit their ultra-loose monetary policies, Japan is standing pat. In addition, BoJ's new Yield Curve Control policy is highly beneficial when global interest rates are rising due to more hawkish monetary policy in other countries. This will help the Japanese economy well into 2018, and **capital outflows will continue to keep the JPY weak.**

THE LONG-TERM OUTLOOK is for **yen weakness to be capped**. The **current account surplus may shrink but will still remain solidly above 3% of GDP.** The JPY's valuation strengthened in 2015 but recent weakness brings the currency back **closer to fair value.** Inflation expectations have finally turned higher, meaning that BoJ easing is having some impact. **Beyond 2017, more BoJ easing appears unlikely.** In 2018, BoJ may either reduce the JPY 80 trn asset-buying target or boost its target for 10-year yield towards 10-20bps from 0%.

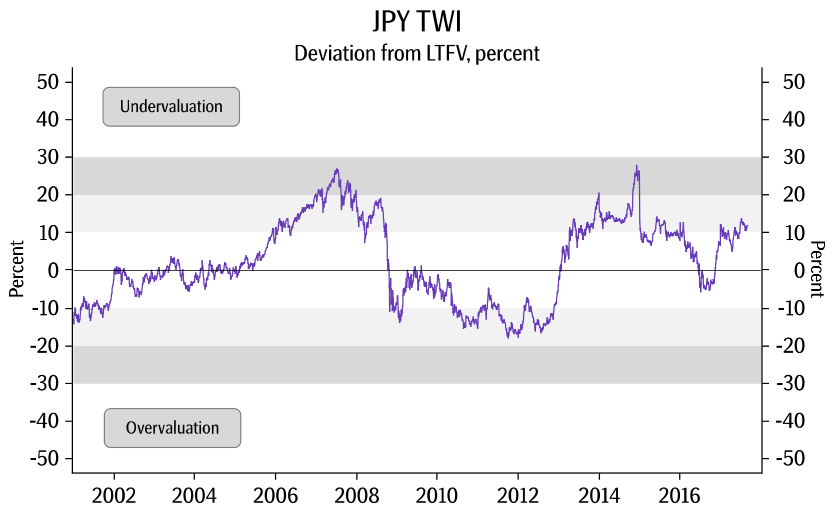


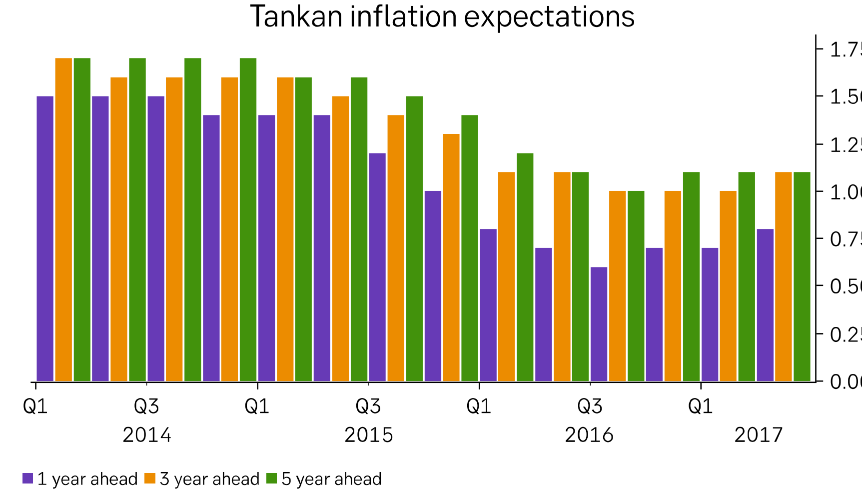
Source: SEB



Source: SEB

Japan: Growth to slow in 2018





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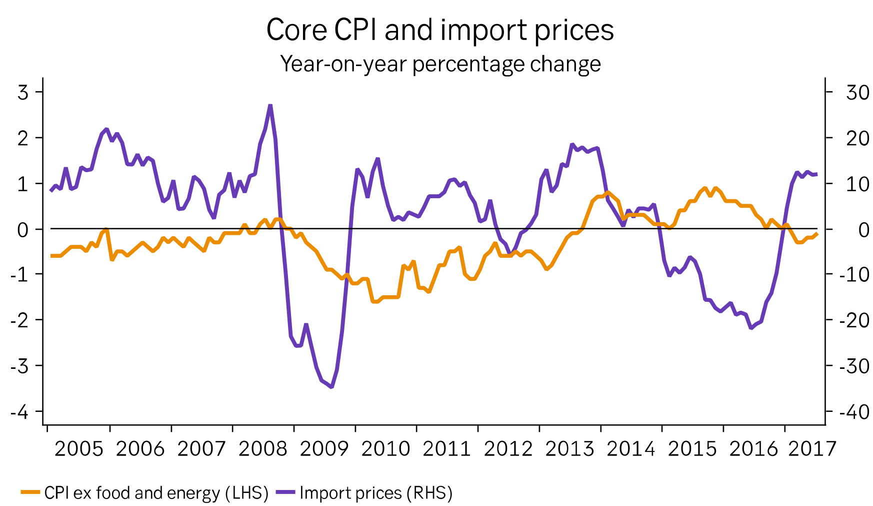

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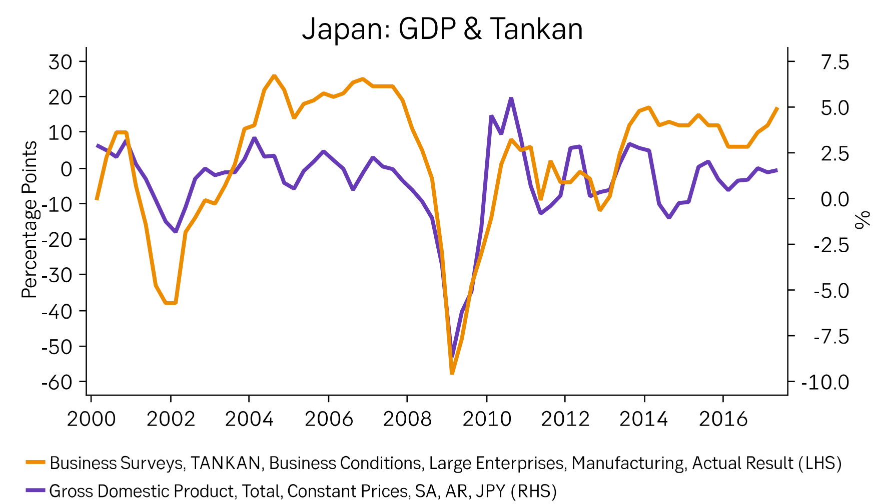


Source: Japanese Cabinet Office (CaO), Bank of Japan, Macrobond, SEB

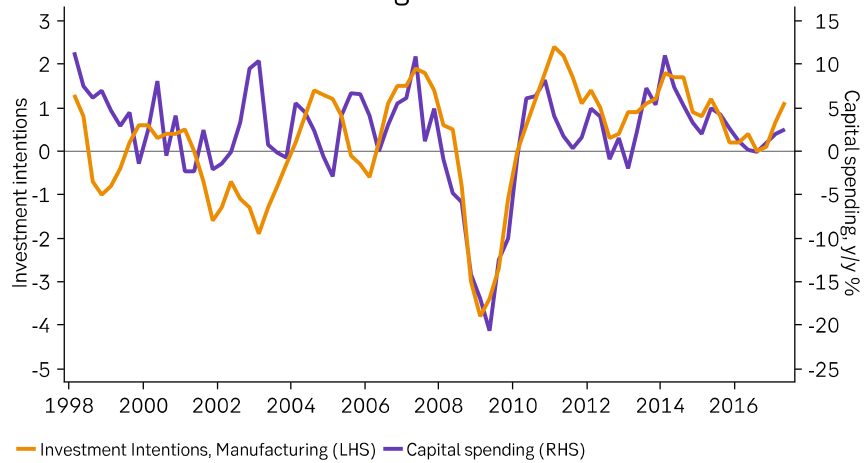
GBP: A lot of bad news has been priced in

REASONABLY PRICED. The GBP is cheap, but for good reasons. The economy has slowed significantly and negotiations with the EU have so far shown little progress. With a year left to negotiate a deal, a substantial risk premium on the GBP seems justified. But signs of progress should be rewarded by a stronger GBP.

BREXIT NEGOTIATIONS ARE ESSENTIAL FOR OUTLOOK. Although the GBP is significantly undervalued , it has weakened further this summer. In trade-weighted terms, the GBP is more than 20% undervalued. Although some of this weakness may be related to the fact that UK growth has slowed markedly due to weaker household demand, we still believe that most GBP weakness reflects a risk premium related to Brexit. Therefore the outcome of ongoing negotiations are essential to the GBP outlook. So far there are few signs of progress in negotiations between EU and the UK. The EU remains unwilling to discuss the future relationship until there is enough progress in discussions related to the exit. Earlier the British government had a very uncompromising tone, but more recently the British position seems to have softened. This clearly increases the chances of more constructive negotiations ending up in a deal and a transitional agreement. This should reduce the risk premium and support the GBP.

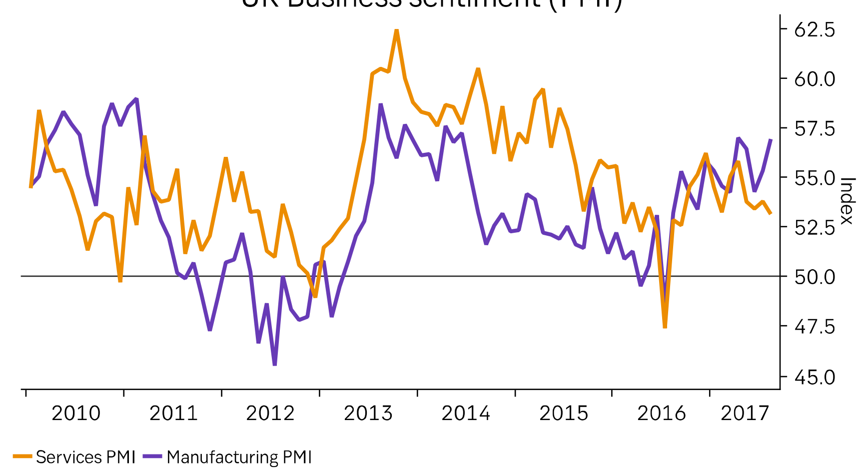
Moreover, the general view of the British economy has gradually turned more negative among pundits. Indeed, should a clean exit materialise it still has the potential to weigh substantially on the GBP. However, today there are some signs that the slowdown could be less severe than feared. Confidence in the manufacturing sector has reached the highest since 2014 and investment intentions have improved significantly since the end of last year. Maybe it is time to reconsider the outlook for the economy and the GBP?

UK Manufacturing investment intentions



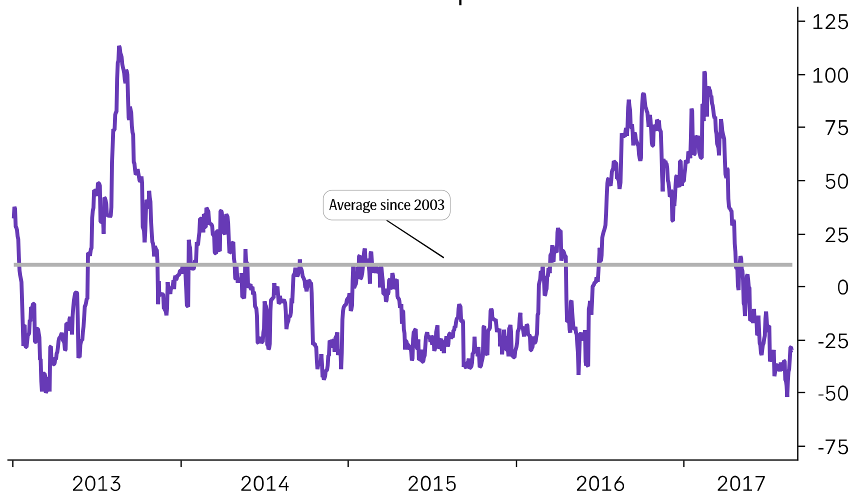
Source: Macrobond

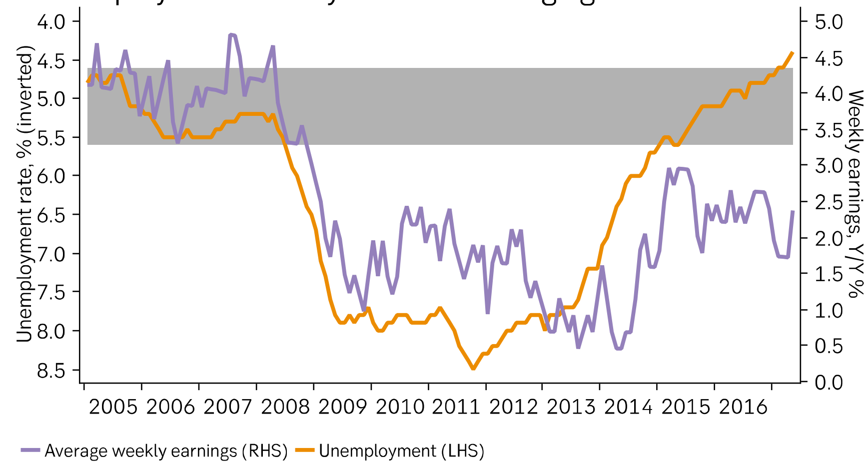
UK Business sentiment (PMI)



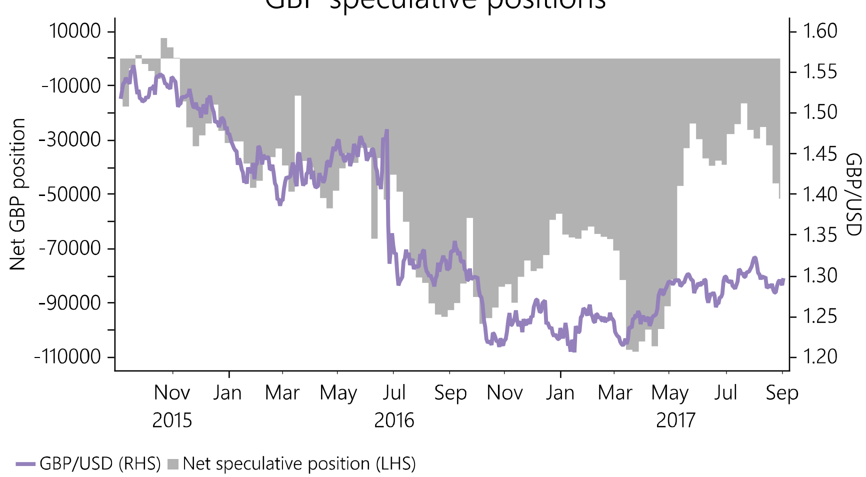
Source: Markit

UK: Valuation stretch

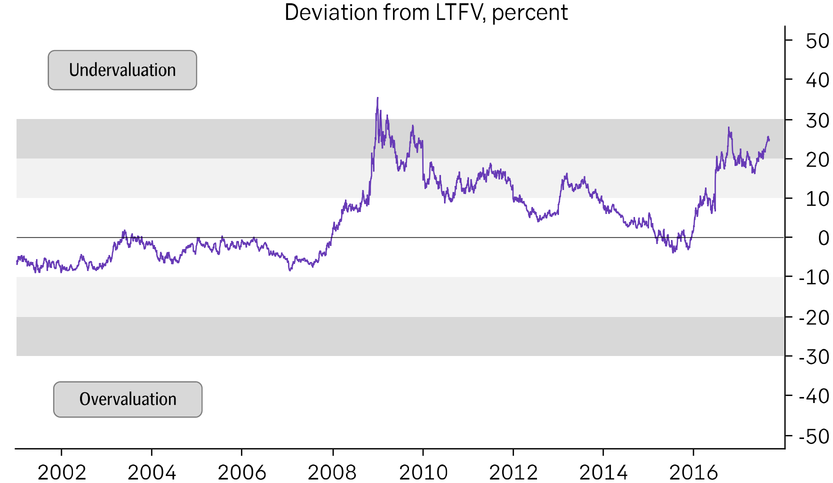




Source: Macrobond



Source: CFTC

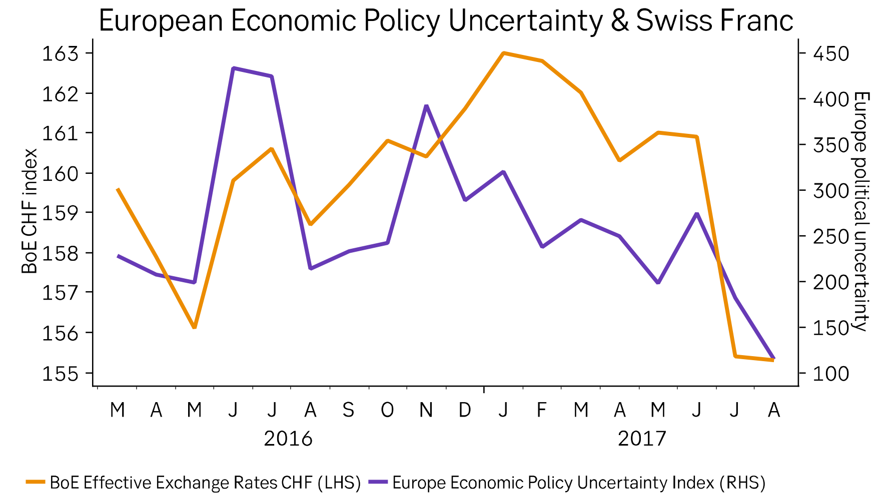


CHF: Less demand for a safe haven

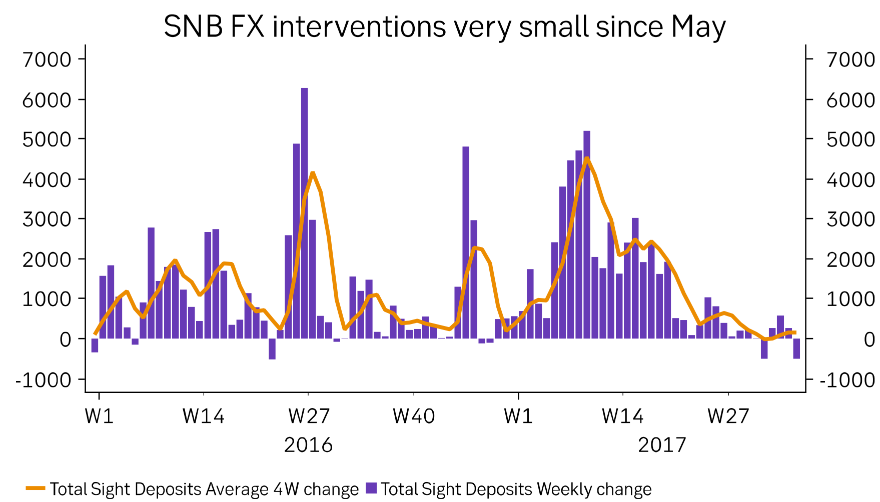
GRADUAL DEPRECIATION AS NEED FOR HAVEN DECLINES
CHF seems set to depreciate the coming months due to declining/reversing haven flows as well as monetary policy divergence as SNB remains with unchanged dovish policy. We expect EUR/CHF at 1.15 end Q3 and 1.16 end of year.

SHORT-TERM VIEW: FADING CAPITAL INFLOWS
The CHF is very sensitive to changes in European political uncertainty and has fallen 7% against the EUR since markets were calmed by Macron's French presidential election victory. Polls ahead of the German election indicate a far more stable political landscape than feared early in 2017. This should pave the way for further CHF depreciation although we see **three main reasons why the CHF will not fall back sharply: (1) Valuation** is fair around current levels; **(2) The Swiss external balance remains highly positive; (3) reverting safe haven flows may be offset by the central bank (SNB) scaling down its large FX reserves.** Another factor which could slow the CHF depreciation is falling interest in carry trades as the performance of these strategies has been rather bleak lately. Swiss growth is weak: In Q2, GDP rose 0.3% y/y which is the slowest pace in any quarter since 2008. Swiss inflation went from negative in 2016 to positive early in 2017. However it peaked in January 2017 and has been stuck between 0.4 and 0.7% since then. Weak growth, low inflation and the wish by SNB to keep CHF from appreciating will make SNB keep rates unchanged for the foreseeable future while the CHF depreciation has led to almost no FX interventions since May.

LONG-TERM VIEW: OVERSHOOT BEYOND LTFV?
1.13 is the long-term fair value for EUR/CHF, but assuming continued political as well as economic stabilisation in Europe we expect an overshoot of this level.



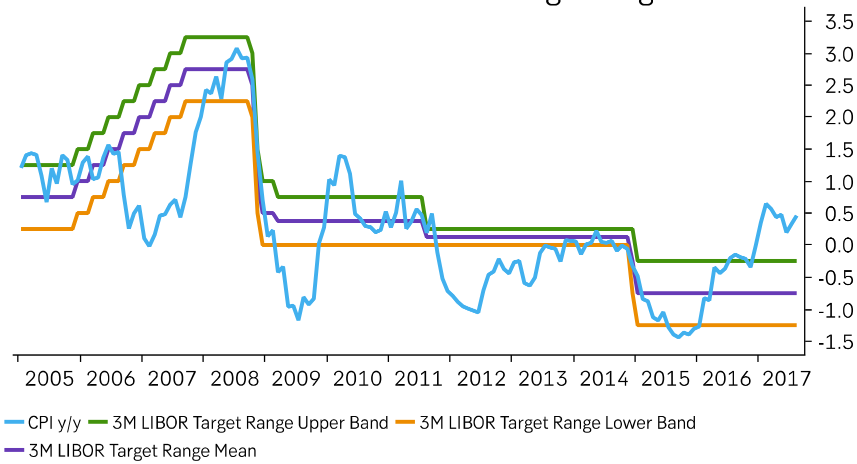
Source: Macrobond, BoE



Source: SNB, SEB

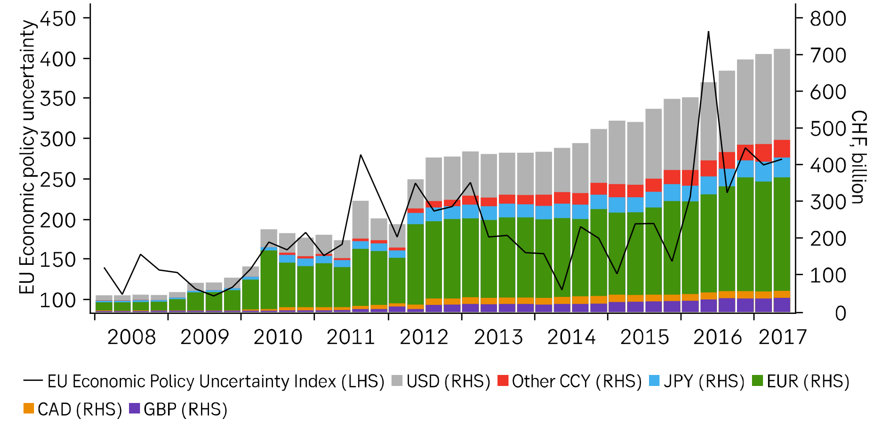
Switzerland: Capital inflows to moderate further?

SWI: CPI and SNB LIBOR target range



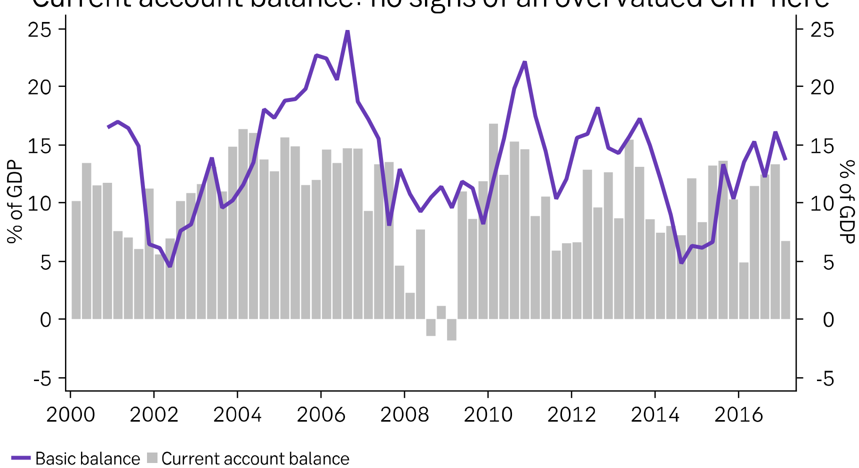
Source: Macrobond

SNB FX reserves lately growing due to valuation effects rather than interventions



Source: SNB, Macrobond

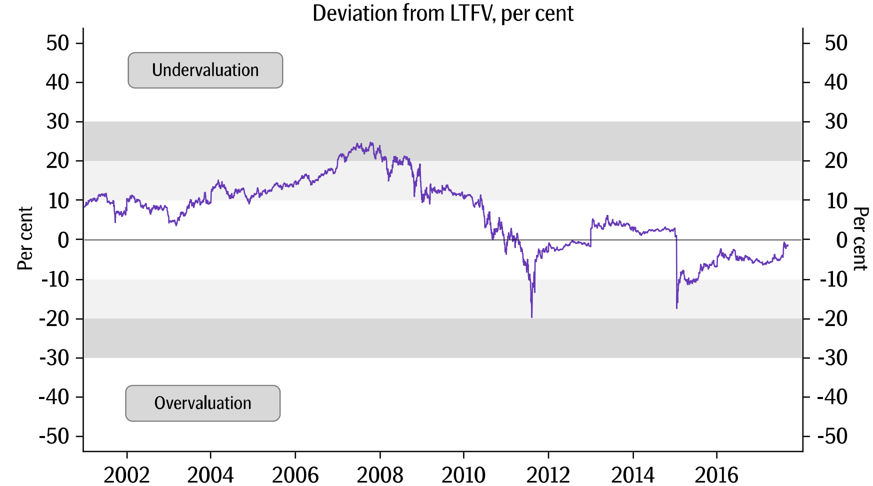
Current account balance: no signs of an overvalued CHF here



Source: Macrobond

CHF TWI

Deviation from LTFV, per cent

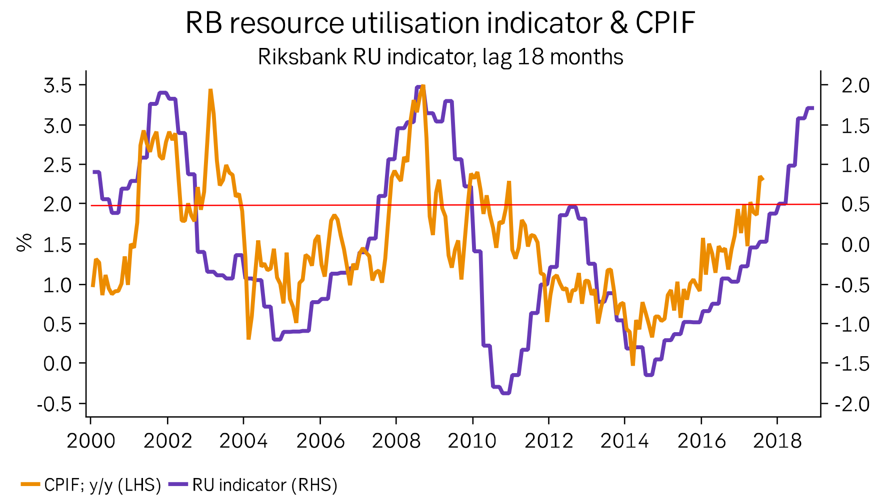


SEK: Waiting for the Riksbank signal

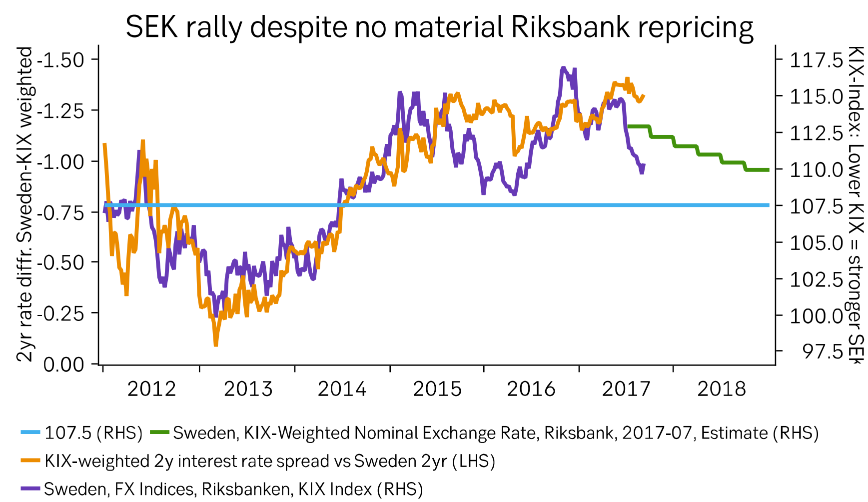
MISSION ACCOMPLISHED, RIKSBANK? Inflation is above Riksbank target and the economy is firing on all cylinders. But Riksbank remains concern over excessive SEK strength and with the KIX already at 110, **we are neutral SEK short-term.**

SHORT-TERM OUTLOOK: SIDEWAYS. In Q2 the Swedish economy grew at an annualised quarterly pace of almost 7%. We see few signs of growth slowing, although the housing market and implicitly residential invest-ments are a longer-term risk. The labour market is becoming increasingly tight: resource utilisation is approaching record-high levels, but it remains to be seen if wage growth will take off. Inflation has surprised on the upside in the last few months and CPIF is expected to remain above target this autumn. **Consecutive above-target inflation readings will trigger criticism of current extremely loose Swedish monetary policy stance.** The million dollar question is whether the Riksbank will alter its stance before 2018? The mere mentioning of "Exit" will be very SEK-positive as foreign investors are currently net short SEK and Swedish companies have a lower FX hedge ratio. Riksbank knows this, making the timing of the exit tricky. Near-term there are few signs Riksbank will change its stance, ultimately above target inflation will force a change in policy stance. **Stay short EUR/SEK with a stop above 9.60 on a daily close.**

LONG-TERM OUTLOOK: SEK CLOSE TO FAIR-VALUE. Our models regard KIX (the trade-weighted krona) as fairly valued at around 107-108. Recent USD and GBP depreciation has already taken KIX to 110. **Hence the SEK is not materially undervalued today.** This trade-weighted strength curbs its potential vs the euro near-term. Negative real interest rates has pushed our fair-value estimate for the EUR/SEK higher to 9.10. **We don't expect a material test below 9.00 anymore.**



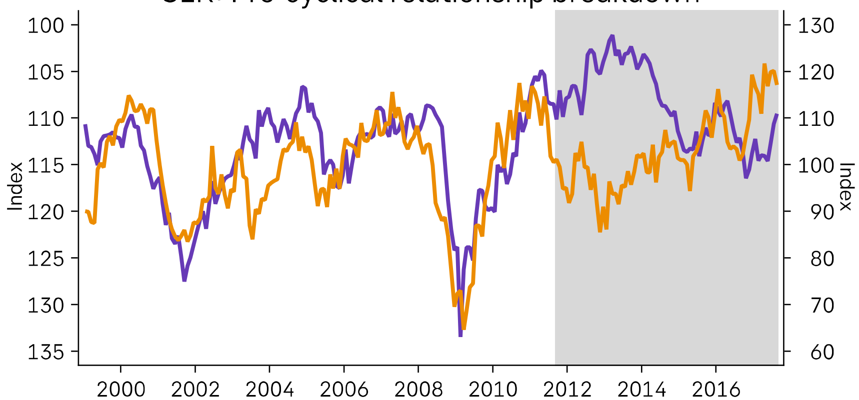
Source: Statistics Sweden (SCB), Macrobond, SEB



Source: Macrobond

Sweden: Lower LT fair-value as real rates plunge

SEK: Pro-cyclical relationship breakdown

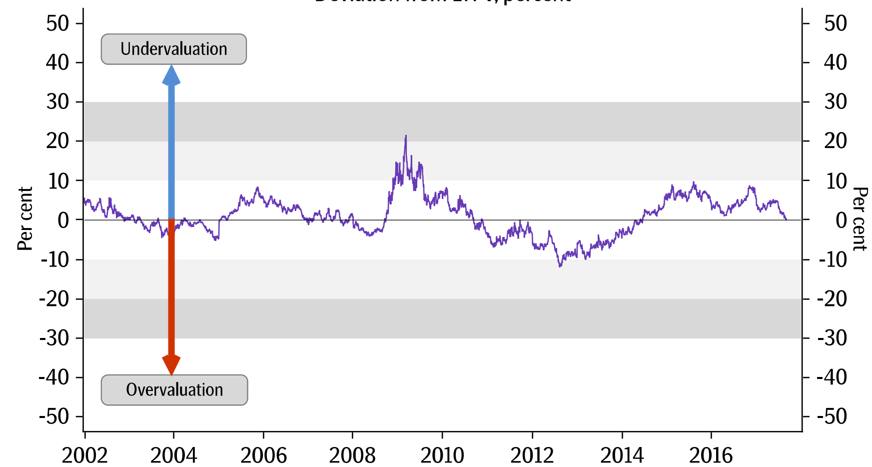


National Institute of Economic Research (NIER), Economic Tendency Survey, Manufacturing Confidence...
Sweden, FX Indices, Riksbank, KIX Index (LHS)

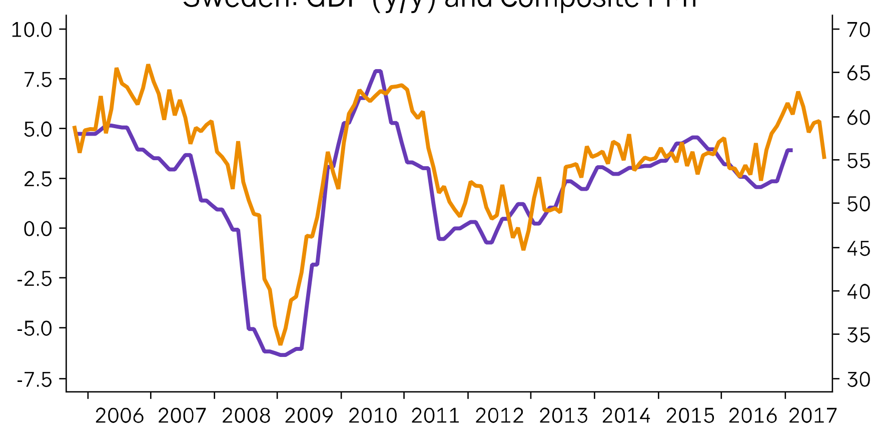
Source: NIER, The Riksbank

SEK TWI

Deviation from LTFV, percent



Sweden: GDP (y/y) and Composite PMI

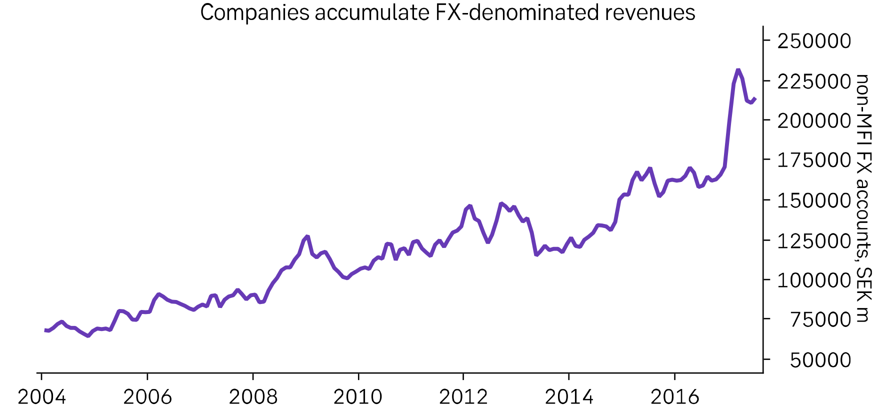


Sweden, Composite PMI (RHS) Sweden, GDP (y/y) (LHS)

Source: Macrobond

Sweden: Corporate FX-lending to Banks

Companies accumulate FX-denominated revenues



Corporate FX-lending to Swedish Banks (MFI)

Source:

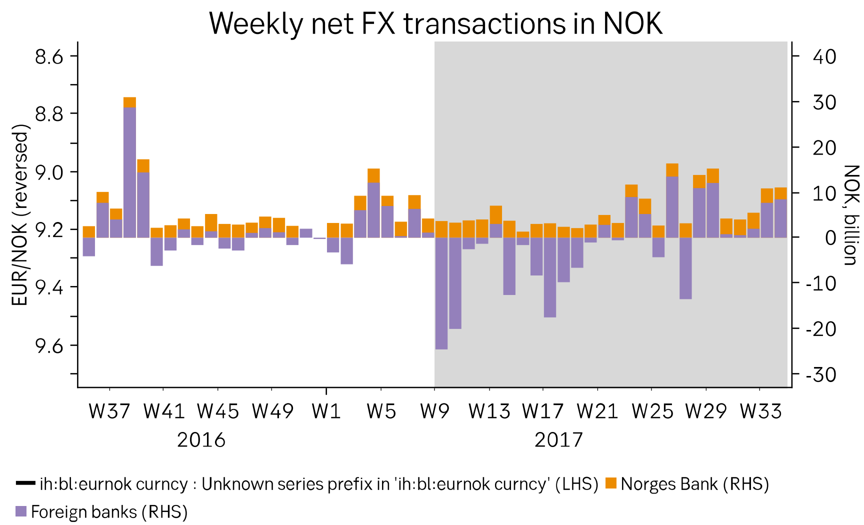
SEB

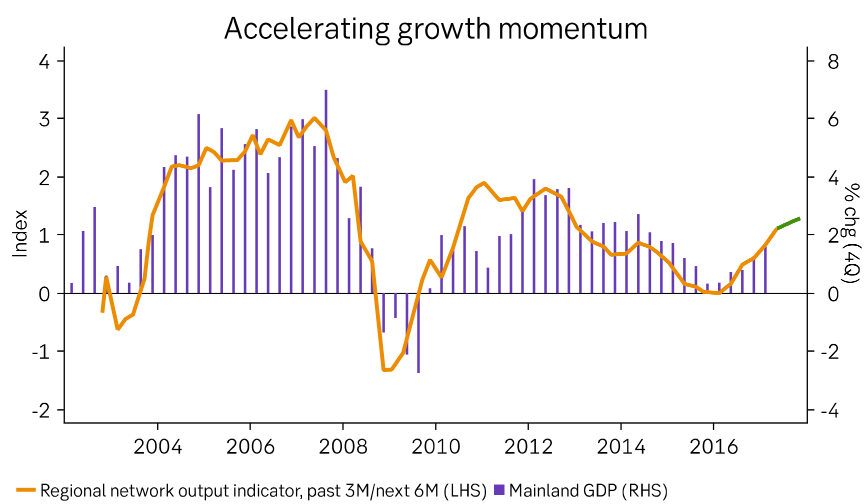
NOK: Low inflation limits upside potential

Fundamentals suggest the NOK should continue to recover and a more stable oil price should reduce correlation between the NOK and oil. Although we maintain a **positive view on the NOK, low inflation and a vigilant central bank will limit upside potential.**

SHORT-TERM: The correlation between oil prices and the NOK seems to have persisted, but this relationship should break down; **years of cost reductions and lower cash flow break-evens in the petroleum sector have made the broader economy less sensitive to oil price fluctuations going forward.** The more upbeat economic outlook, implying a broad-based acceleration in mainland GDP, has thus far not boosted the NOK significantly. **Inflation will remain below target in the next couple of years** which offers Norges Bank room to await normalisation by its European peers. **The outlook for central bank policy remains a NOK-negative factor.**

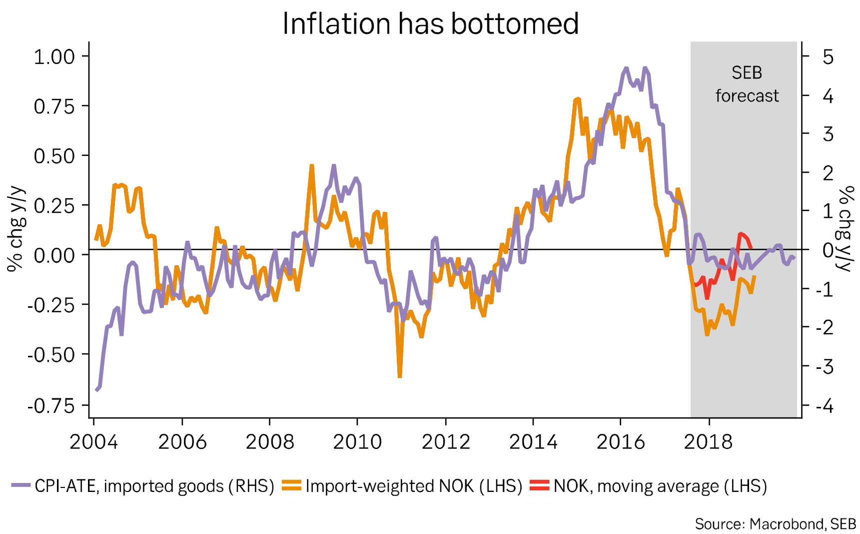
LONG-TERM: Since oil prices started to fall in 2014, the NOK has been undervalued against most G10 currencies. Expectations of improving fundamentals with stronger growth in the mainland economy and a revival of petroleum-related investments, which are now beginning to materialise, are reasons we have held a long-term positive view of the NOK. Household demand is improving amid rebounding wage growth and rising employment. This is likely to keep supporting domestic demand going forward. However, inflation is currently well below Norges Bank's target. This probably means that **the central bank will remain vigilant to prevent the currency from strengthening too rapidly or too much,** as this could further worsen the inflation outlook. Although an update of **our long-term fair value model (SEBEER) lowered the long-term fair value of the NOK,** which means it probably is less undervalued than previously anticipated, we see some further upside potential for the NOK over the medium to long term on the back of stronger fundamentals.

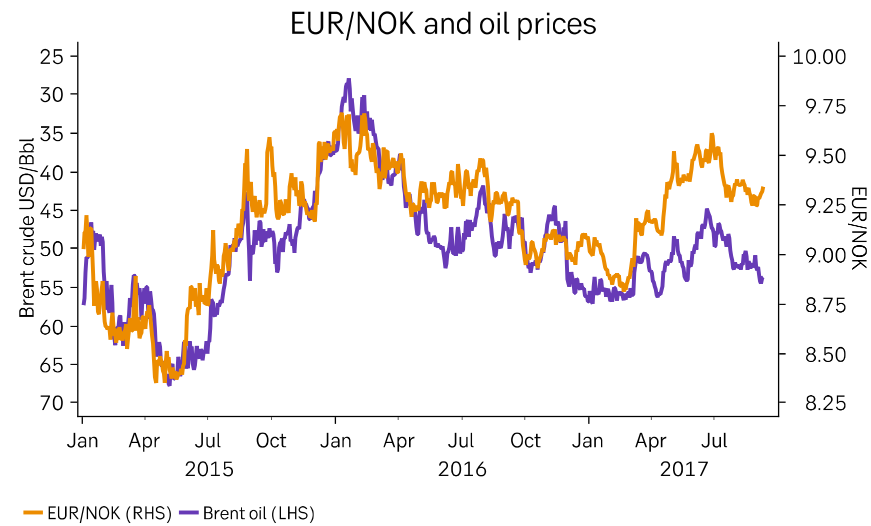


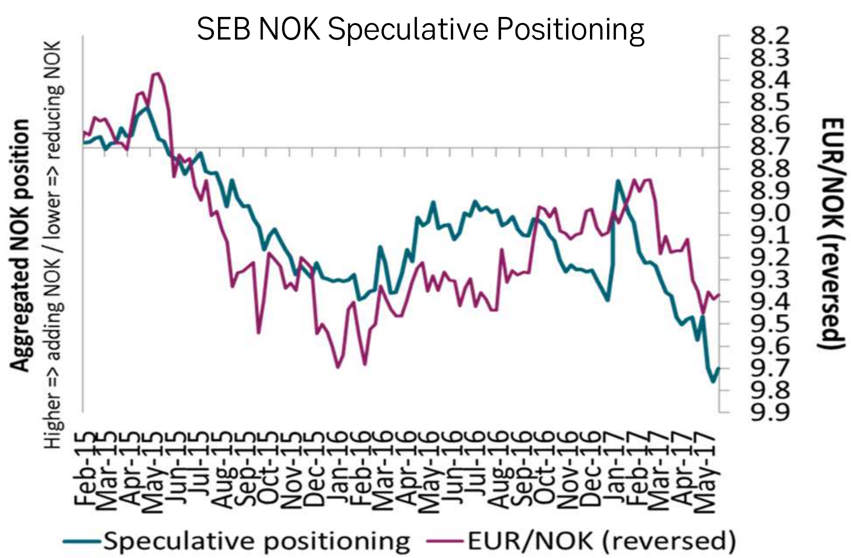


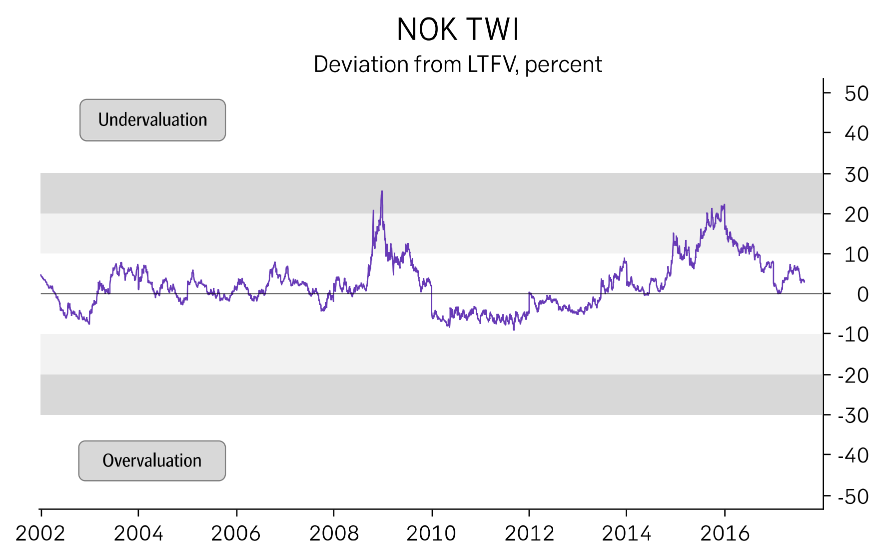
Source: Statistics Norway, Norges Bank, SEB

Norway: Fundamentals suggest NOK appreciation







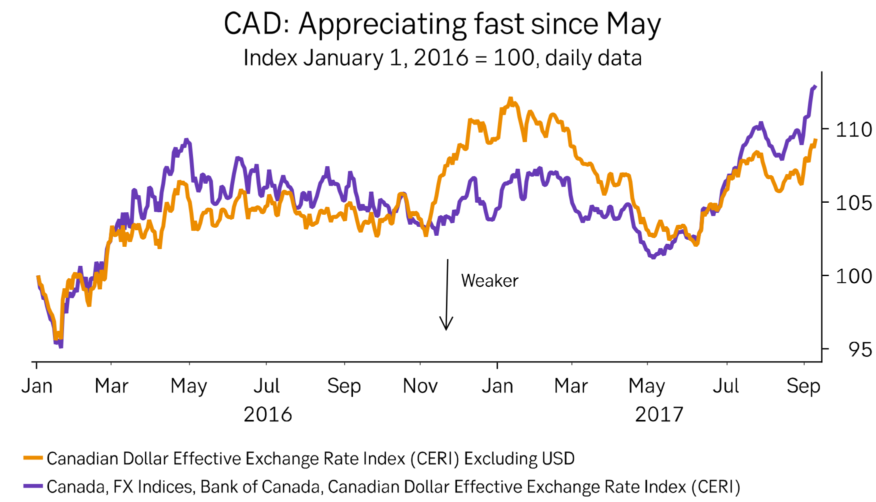


CAD: The BoC may surpass the Fed soon

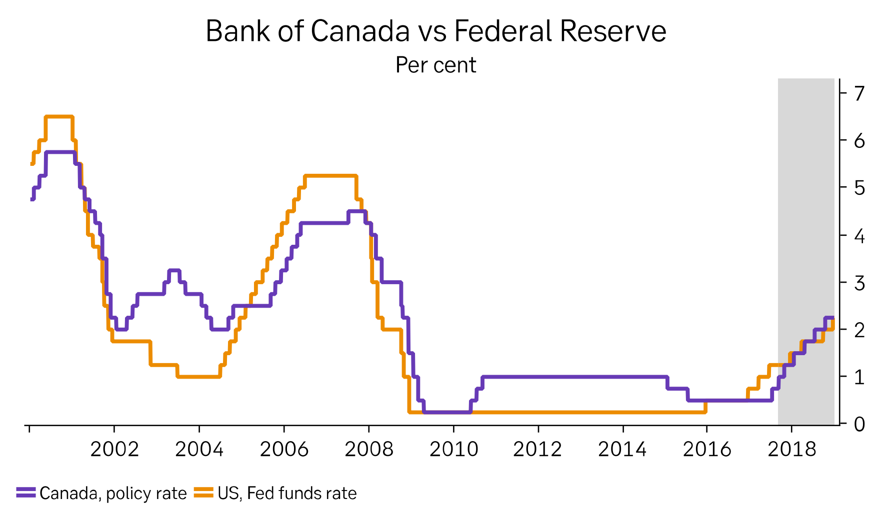
STRONGER CAD ON MONETARY POLICY TIGHTENING. The CAD will continue to strengthen as a result of the ongoing monetary policy normalisation. We expect CAD/USD to reach 1.19 by the end of Q4 2017, 1.17 in Q1 2018 and 1.15 in Q3 2018.

SHORT-TERM VIEW: OVERBOUGHT BUT FUNDAMENTALS ARE STRONG
Against the USD, the Canadian dollar has climbed fast since May, but appreciation is less against other currencies and the move to date is not enough to throw the Bank of Canada (BoC)off course. The big gap between the spot rate and the 200-day moving average suggests that the CAD is technically overbought. But fundamentals are strong and our FX scorecard is giving the CAD the highest score with respect to the 12-month outlook. Canada is in a very strong growth spurt and the economy is expanding at the fastest pace in the G7. Thus, the BoC has revised its GDP forecasts upward and has increased its confidence level that these projections will be achieved. Moreover, the BoC now sees excess capacity absorbing fast and the output gap closing as early as at the end of 2017. While inflation is below target, the closing of the output gap – something the BoC pays close attention to – is strongly suggesting more upward monetary policy movements ahead, even after delivering hikes at back-to-back policy meetings. When the gap is closed, an overnight rate of 2.75% is the norm. While that level is looking too aggressive now, the Bank's own models are probably saying that it is behind the curve and we are expecting five rate hikes between now and end-2018.

LONG-TERM VIEW: **HIGH DEBT LOADS A CONSTRAINT** The strong economy, fast home price growth and credit growth are reasons to start normalising rates. Insofar as the BoC moves ahead of the Fed, the CAD may strengthen well beyond LTFV. But high debt loads are also posing a constraint and suggesting that the BoC will move more cautiously on rates in 2018.

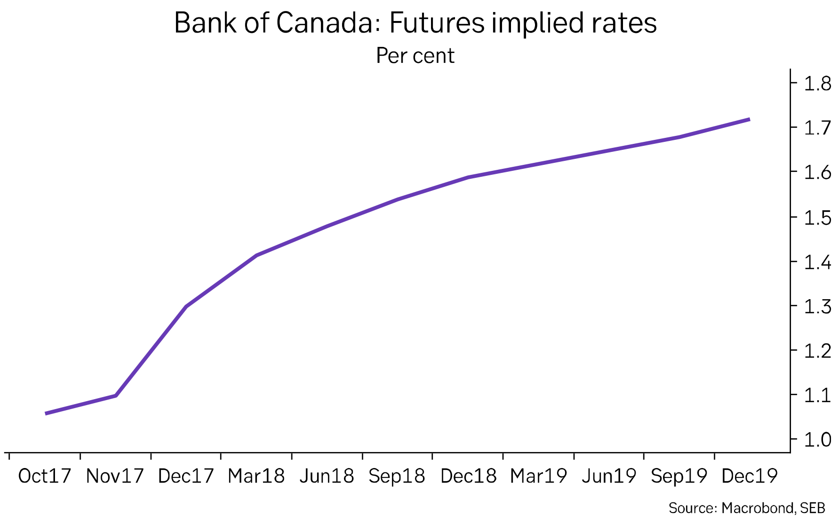


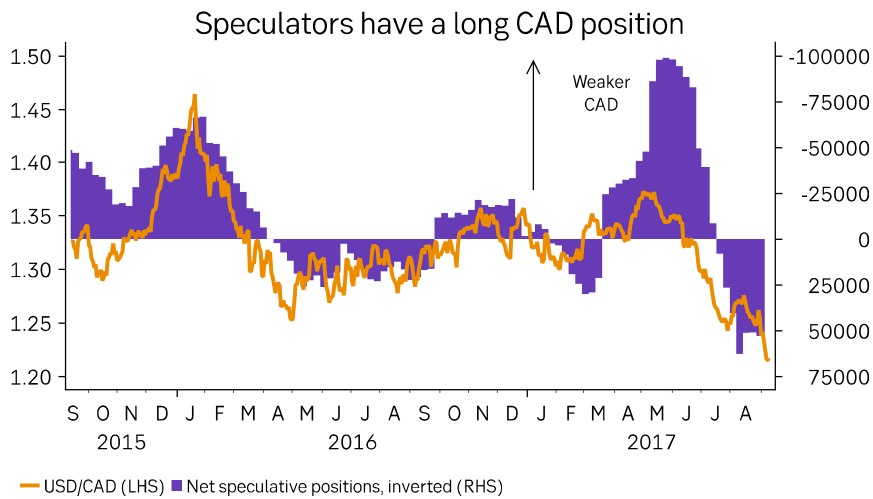
Source: Macrobond, SEB

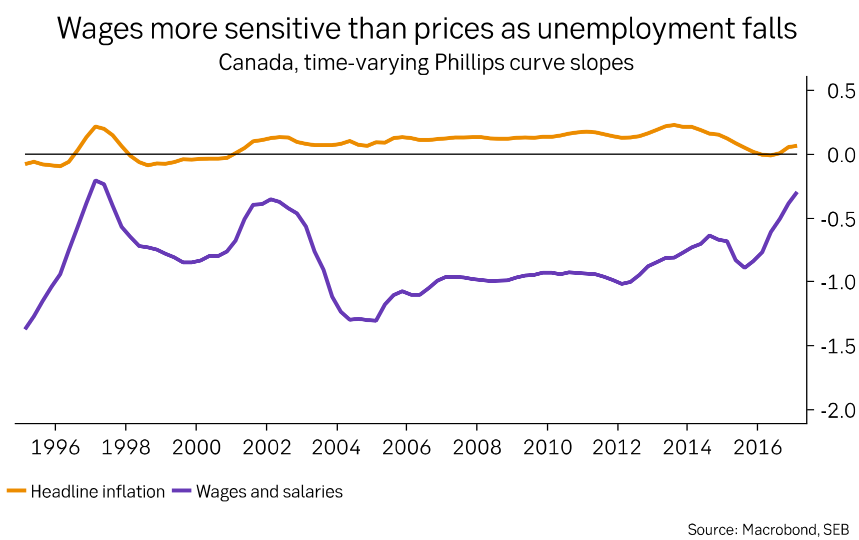


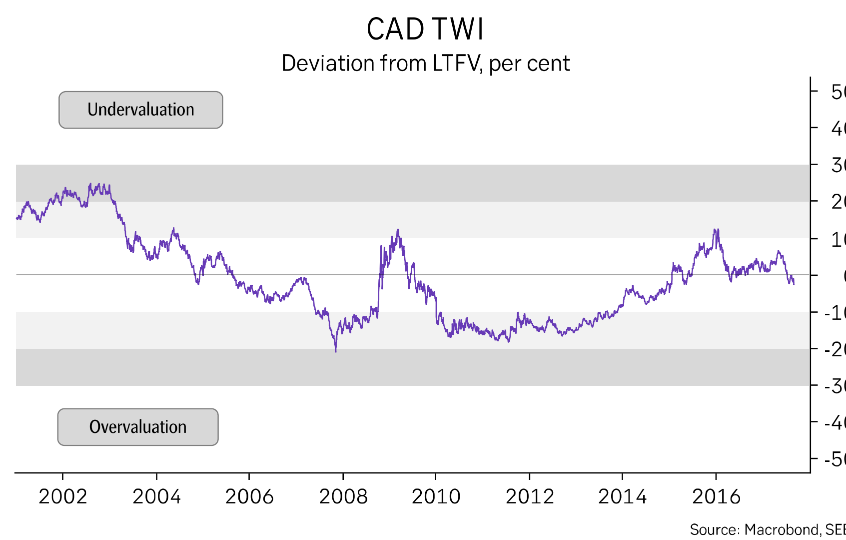
Source: Bank of Canada, Macrobond, SEB

CAD buoyed by economic data/spec positions







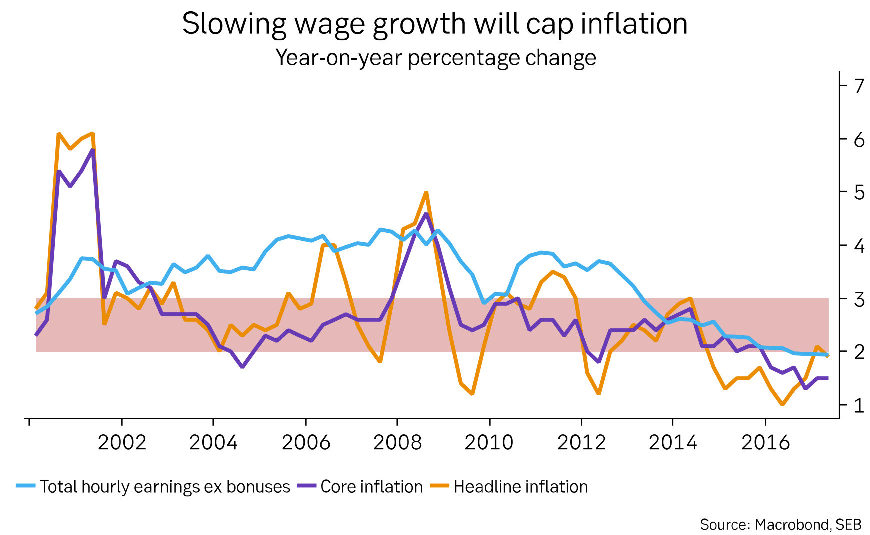


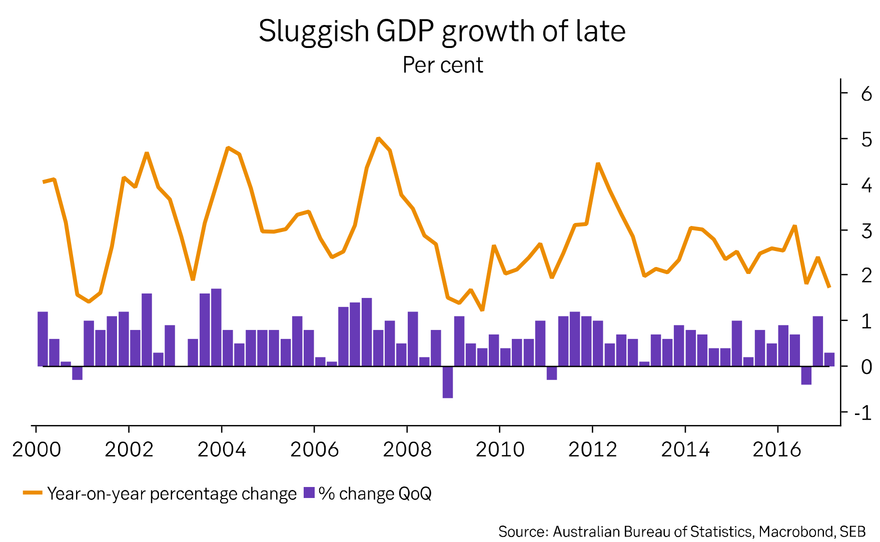
AUD: RBA rate hikes are not imminent

PATIENT RBA WEAKENS AUD MOMENTUM. As RBA rate hikes are not imminent we expect AUD/USD to reach 0.77 by the end of Q4 2017 and 0.77 in Q1 2018 and 0.76 in q4 2018.

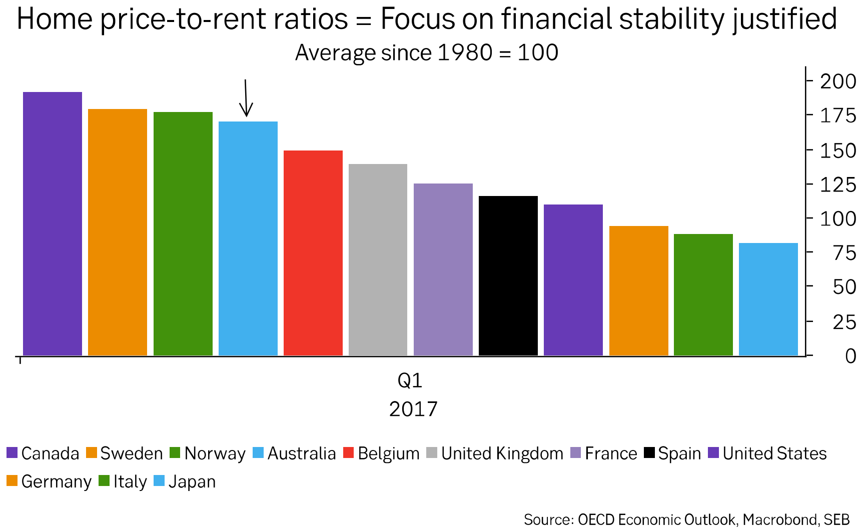
SHORT-TERM VIEW: 2018 RATE HIKES A SUPPORT
GDP growth has been sluggish of late, and after cutting the cash rate to a record-low 1.5% in August 2016, the Reserve Bank of Australia (RBA) is on hold as it waits for activity to pick up. While inflation is close to the bottom of the 2%-3% target range, low wage growth will probably cap core inflation in the near term. Moreover the higher AUD (the currency is up more than 10% against the USD this year) is eroding competiveness and revenue streams for exporters, thus weighing on the outlook, the RBA says. While monetary policy is firmly on hold now, the focus on financial stability (e.g. the housing market) is suggesting normalisation further ahead. In 2018 we expect two rate hikes, in May and November. Home price gains have moderated, thus weakening one of the key arguments for an early interest rate hike. Instead it seems as if the government's macro-prudential actions have had some effect – for example on risky interest-only loans. Spec positioning says that the AUD is overbought; corrections tend to set in above the 90th 52-week percentile and we are at the 98th percentile now. The surprise index is correcting lower too.

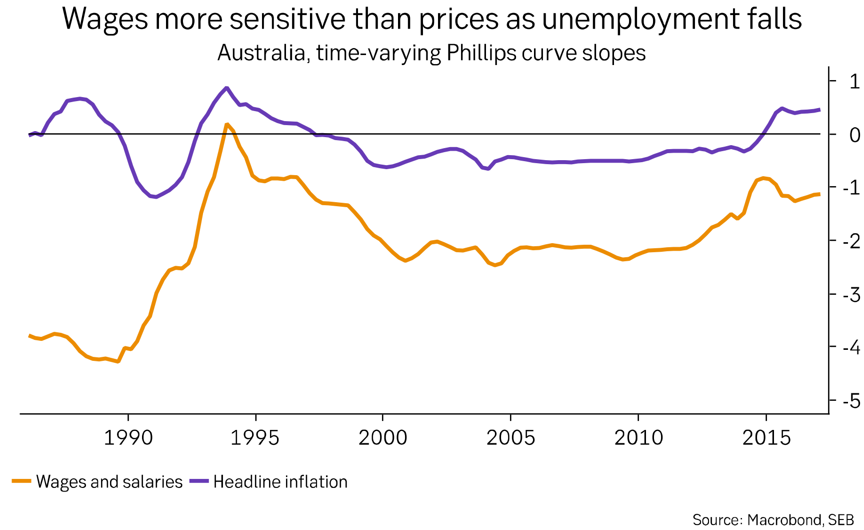
LONG -TERM VIEW: VALUATION IS A HEADWIND
The AUD remains substantially overvalued against its trade-weighted index: a long-term risk for the currency. The cash rate is currently 200bp below the RBA's estimate of the neutral rate. So there is a good chance that normalisation, when it begins, will happen faster than expected. Strong home price growth in parts of the country is still a concern, although there is hope that macro-prudential efforts will mitigate the risks. More work needs to be done; metrics of home price valuation such as price-to-income ratios or price-to-rent ratios say that homes are highly overvalued.

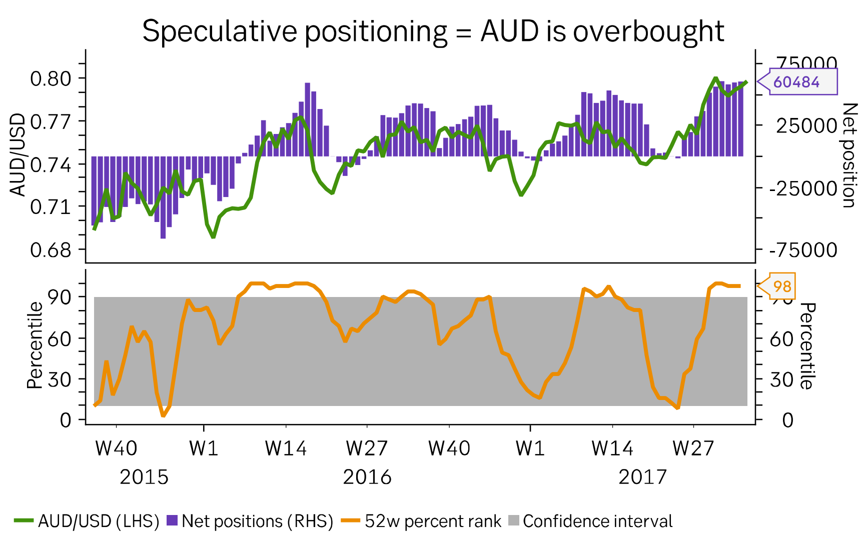


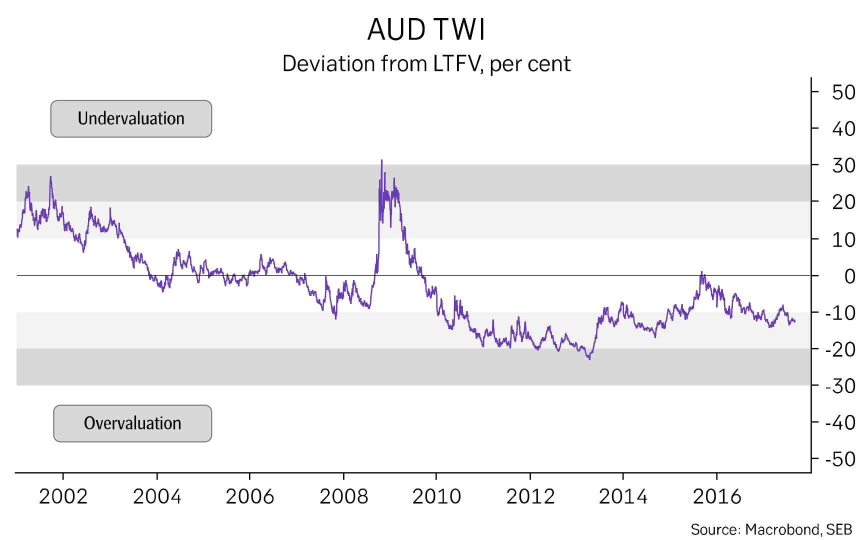


AUS: long positioning/valuation AUD headwinds









NZD: High valuation will temper appreciation

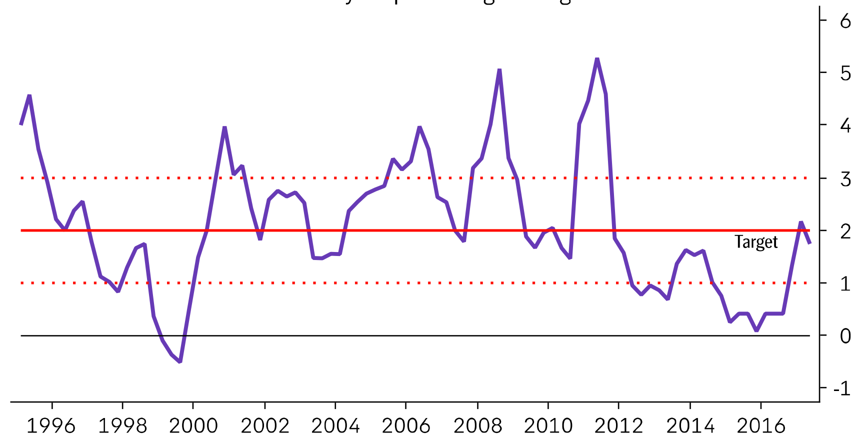
SUPPORT FROM FUNDAMENTALS AND CARRY FLOWS
GDP growth in New Zealand is mainly driven by domestic demand. Consumption continues to expand strongly thanks to population growth, rising disposable incomes, a tightening labour market and rising home prices. Terms-of-trade have also improved this past year. Growth has slowed a bit recently but the outlook is positive; the Reserve Bank (RBNZ) forecasts yearly GDP growth of 3.4% in the next two years. **Above-trend growth will cause capacity pressure to keep building.**

CPI inflation slowed down to 1.7% in Q2; slightly below the target midpoint. Headline inflation is expected to decline in the coming quarters, but rising non-tradables inflation will bring it to the midpoint of the range over the medium term. Inflation expectations have been stable. The housing market is still a risk but total home price growth has moderated following the tightening of the loan-to-value policy. Home price increases should moderate further going forward.

LONG-TERM OUTLOOK: The trade-weighted NZD exchange rate has appreciated since the RBNZ's May policy meeting. **The SEB valuation model indicates that the NZD is overvalued.** The central bank has kept its policy rate unchanged at 1.75% since the cut in November 2016, and in August repeated that the policy rate is "projected to remain low for a prolonged period". We expect the RBNZ to remain on hold until H2 2018. The current account deficit will remain around 3% of GDP. Yields are high compared to other advanced countries, providing scope for carry trade. Speculative positioning indicate that investors have gone long NZD. However, traders have scrambled to protect against a sell-off following the September 23 election. We expect high valuation to keep the NZD close to current levels against the USD over the next 12 months despite support from fundamentals and carry flows.

New Zealand: Inflation is near the target midpoint

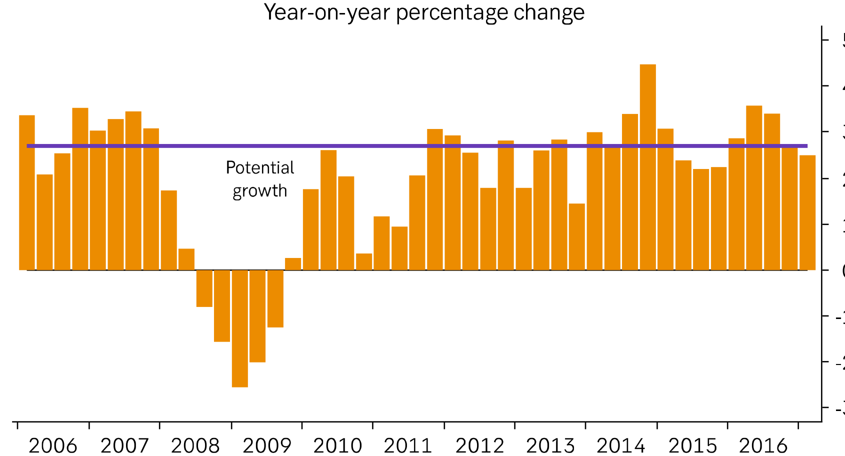
Year-on-year percentage change



Source: New Zealand National Statistical Office, Macrobond, SEB

New Zealand: GDP growth expected to rise above potential

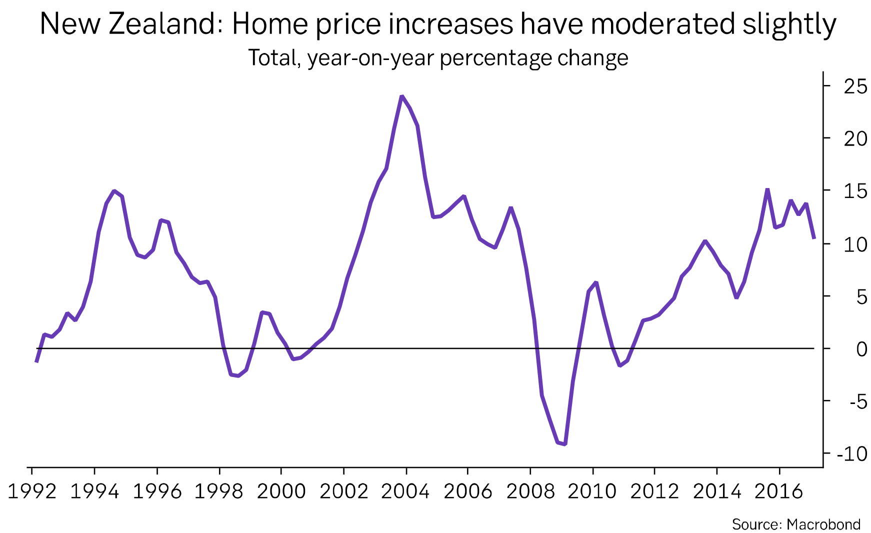
Year-on-year percentage change

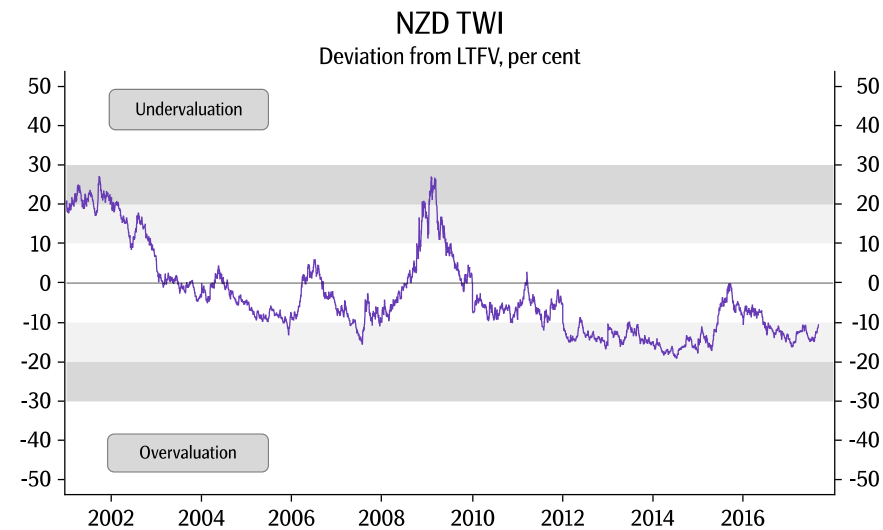


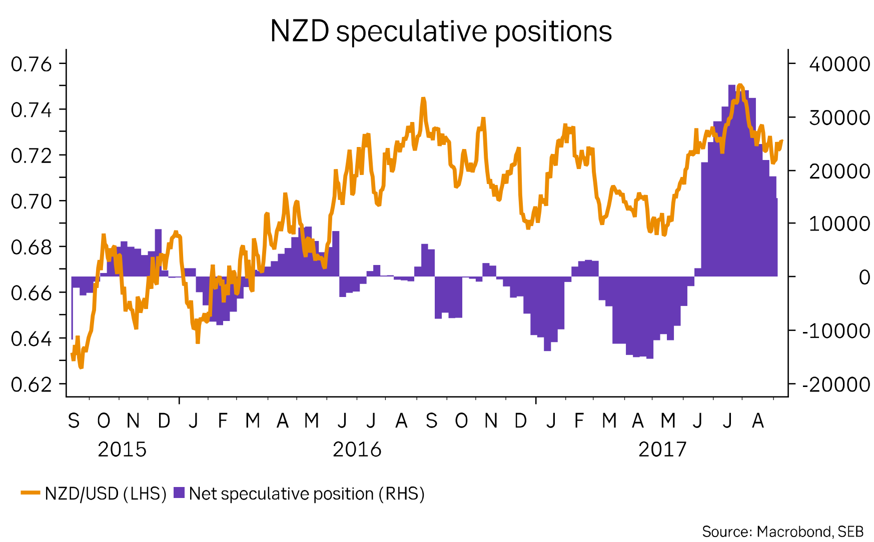
Source: New Zealand National Statistical Office, Macrobond, SEB

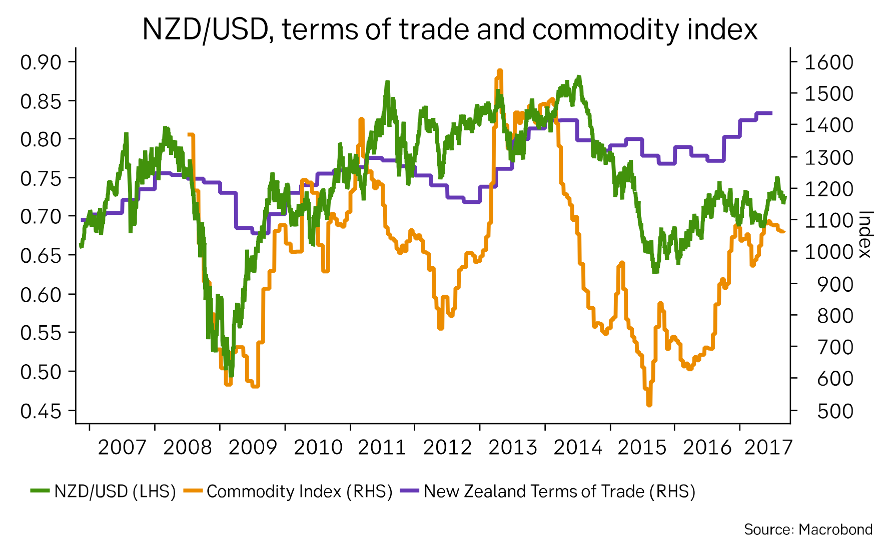
SEB

New Zealand: Home price growth is slowing









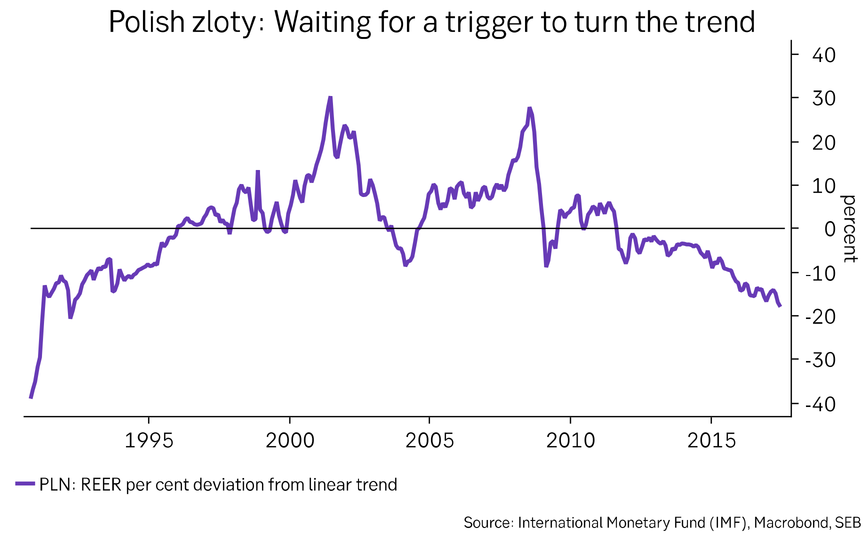
SEB

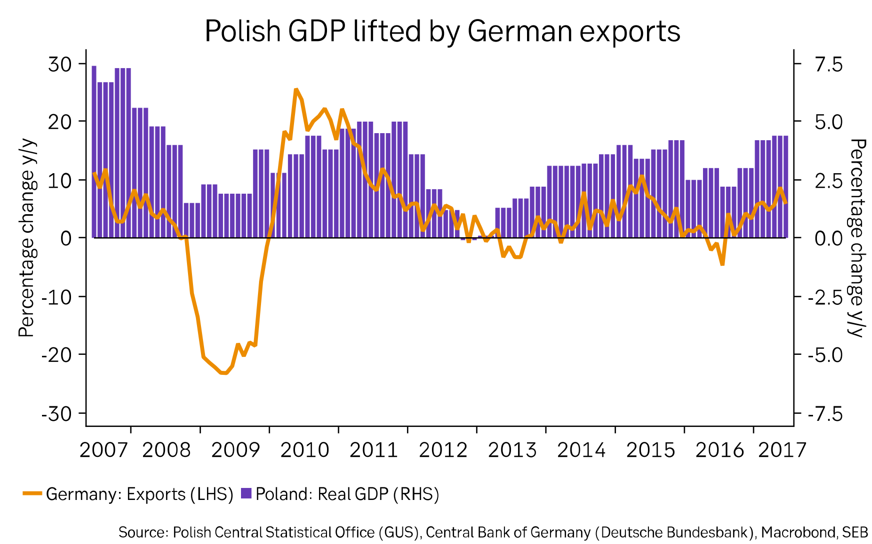
PLN: Dovish NBP delays zloty strength

INFLATION AND TIGHTENING MONETARY POLICY WILL STRENGTHEN PLN. The PLN will appreciate over the next 12 months, albeit not as fast as we had anticipated in our May *CS*. We expect that EUR/PLN exchange rate will reach 4.20 in Q4, before moving down to 4.15 in Q1 '18, 4.10 in Q2, and 4.08 in Q3.

SHORT-TERM VIEW: PLN APPRECIATION DELAYED BY DOVISH NBP. The PLN is severely undervalued, but a sharp correction is prevented by the dovish National Bank of Poland (NBP), with Governor Glapinski signalling that the **policy rate may remain on hold at 1.50% through 2018.** Similarly to the euro zone, brisk employment growth has not boosted inflation, leaving the NBP keen on supporting growth through low rates. Nevertheless, upward wage pressures are increasing and will keep markets betting on a NBP hawkish turn.

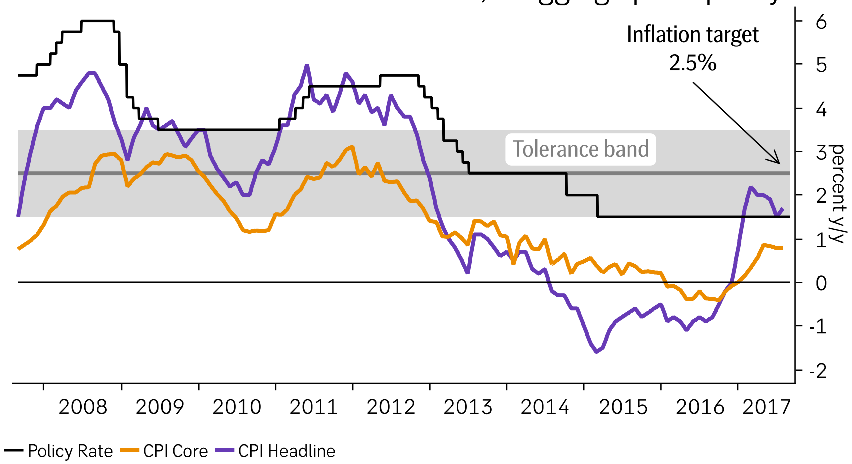
LONG-TERM VIEW: PLN WILL APPRECIATE GRADUALLY TOWARDS ITS FAIR VALUE. Polish GDP per capita is catching up with the EU average. Real GDP expanded by 4.0% y/y in Q1 and 3.9% in Q2 2017. **Yet, the PLN has weakened both in nominal and real effective terms since 2011.** Part of the reason for the weakness is Poland's current account deficit, although that has closed lately. Another is weak capital inflows (exacerbated by low carry) and relatively low central bank reserves to protect against external shocks. A third reason has been weak growth in Germany (Poland's largest trading partner), which is now picking up. Lastly, the PiS government's quarrel with the EU has weighed on sentiment.
Nevertheless, over the coming 6-12 months, we expect inflationary pressures to build on the back of an EU-wide recovery and drive up interest rate expectations. Continued political risk will not be enough to weaken the PLN when carry increases.





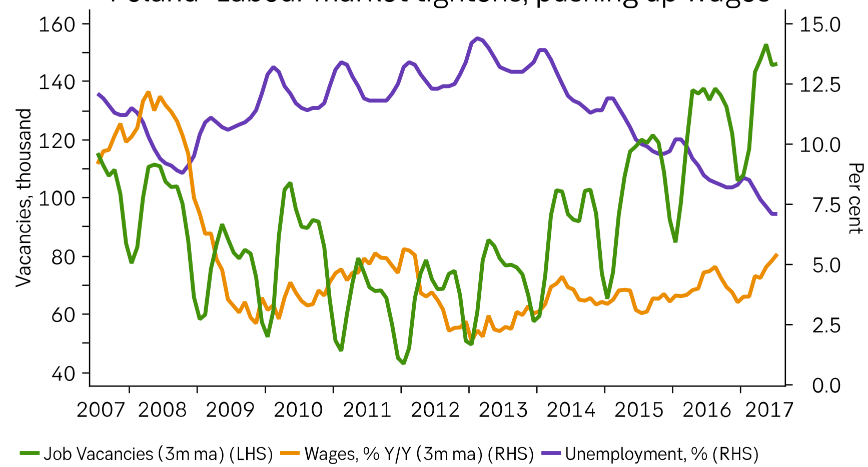
Poland: A convergence trade waiting to happen

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



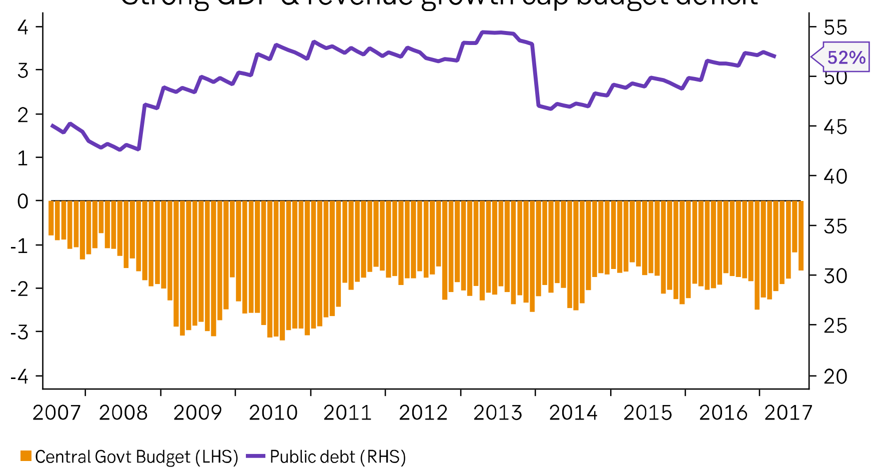
Source: Polish Central Statistical Office (GUS), National Bank of Poland, Macrobond, SEB

Poland: Labour market tightens, pushing up wages



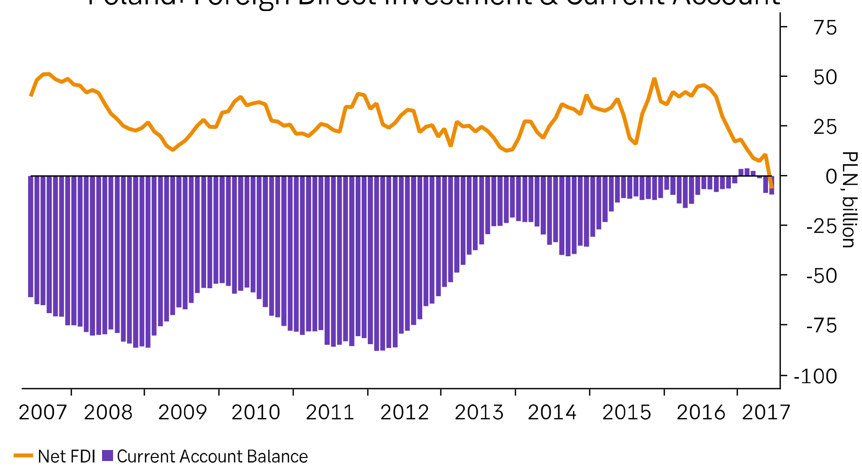
Source: Polish Ministry of Labour & Social Policy, Polish Central Statistical Office (GUS), Macrobond, SEB

Strong GDP & revenue growth cap budget deficit



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

Poland: Foreign Direct Investment & Current Account



Source: National Bank of Poland, Macrobond, SEB

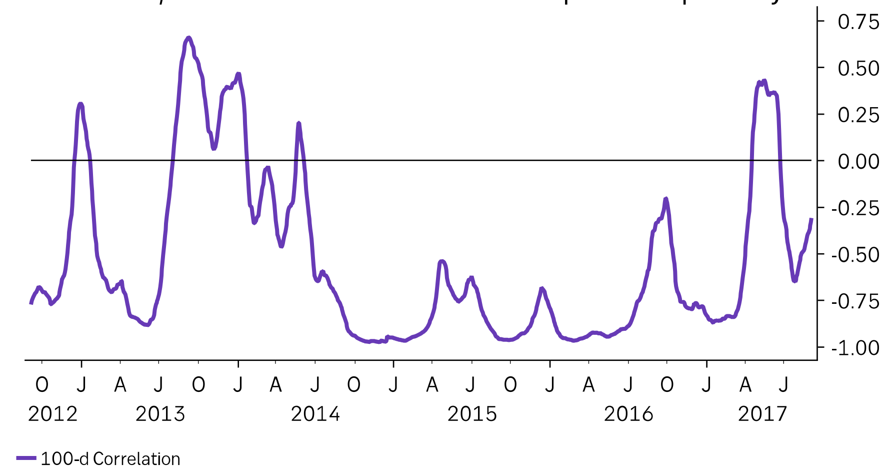
RUB: Modest weakness due to monetary easing

WEAKER RUB ON MONETARY POLICY EASING. The RUB looks set to depreciate somewhat as a result of monetary easing over the next 6-12 months. We expect USD/RUB to reach 61.00 by the end of Q4 ‘17, 61.50 in Q1 ‘18 , 62.00 in Q2, and 62.50 in Q3.

SHORT-TERM VIEW: RESILIENCE ON STABLE OIL PRICES. First, with oil averaging close to $55/bbl in 2017 and 2018, **the risk is small of a sharper than expected decline in the rouble.** Oil appears to have reached a floor, which will support the RUB. The correlation between oil and the RUB is not as strong and stable as it was in 2014-16, but even if the RUB will occasionally move on factors other than oil, it remains a key factor for the currency. Second, the central bank (CBR) has taken an orthodox approach to monetary policy, only cautiously cutting its key interest rate on lower inflation. It also wants to bring down inflation expectations. According to the CBR, inflation expectations fell sharply in August to 9.5% y/y from 10.7% in July, while CPI inflation fell to 3.3% y/y in August. **Expectations that the CBR will cut rates have attracted foreign capital inflows into the OFZ market. These flows have supported the RUB for the time being, but will fade when the CBR cuts rates in H2 2017 and H1 2018.**

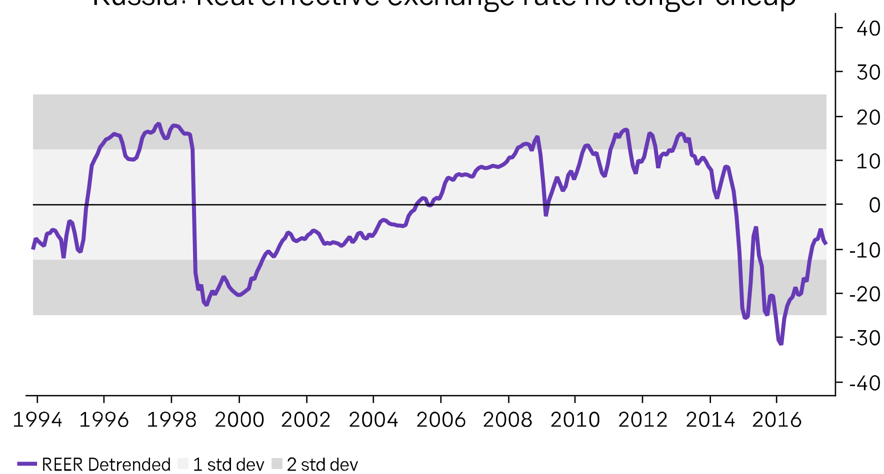
LONG-TERM VIEW: RUB WILL SUFFER FROM SHORT-COMINGS IN ECONOMIC STRUCTURE. Real GDP growth has come in above expectations, hitting 2.5% y/y in 2Q. We forecast that growth will reach 1.9% in 2017 on government stimulus, especially through infrastructure investments. However, private investments are weak and sustainably higher productivity and GDP growth rates are unlikely. Inflation will stay low by historical standards, but higher than that of European trading partners. **Russian-produced goods will need support from a weak RUB to stay competitive.**

USD/RUB and Brent oil have decoupled temporarily



Source: Macrobond, SEB

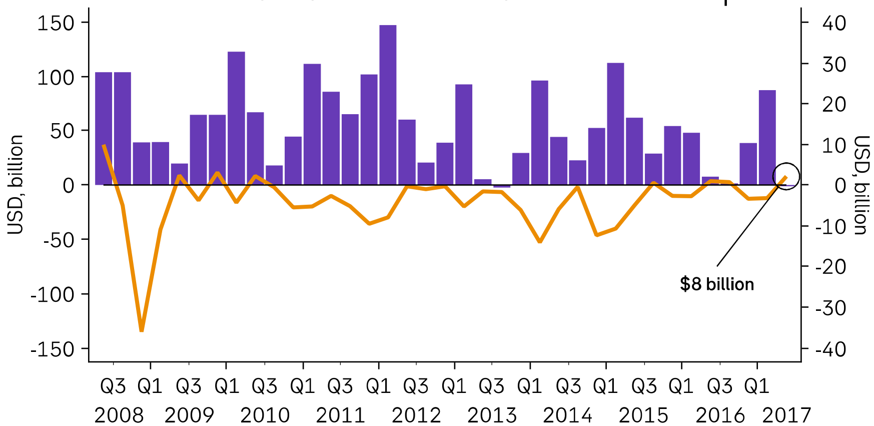
Russia: Real effective exchange rate no longer cheap



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

Russia: Reduced volatility ahead

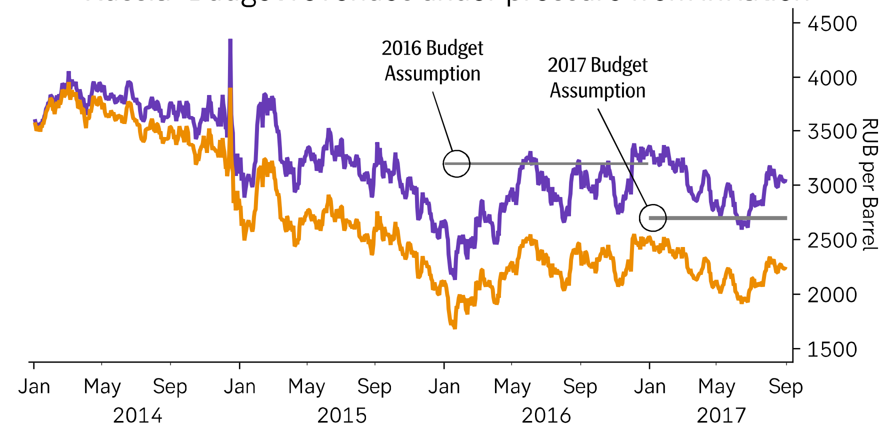
Russia: Current & financial accounts back in surplus



Financial Account, incl. E&O (LHS) Current Account (RHS)

Source: Central Bank of the Russian Federation, Macrobond, SEB

Russia: Budget revenues under pressure from inflation



Brent Oil, Inflation adjusted: Dec 2013=100 Brent Oil

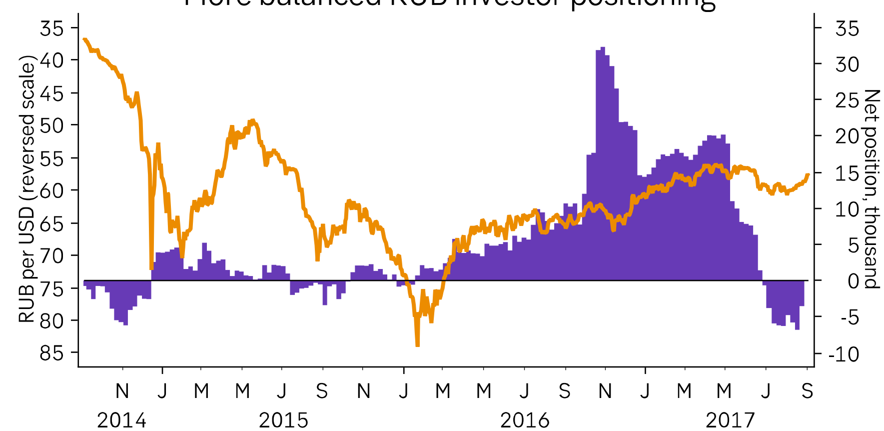
Source: Macrobond, SEB

Downside potential in OFZ yields lure investors

5-Y CDS (LHS) 10-Y Yield (RHS)

Source: Macrobond, SEB

More balanced RUB investor positioning



USD/RUB (LHS) Net Position (positive = net long RUB) (RHS)

Source: Commodity Futures Trading Commission (CFTC), Macrobond Financial AB, Macrobond, SEB

SEB

TRY: To recover lost ground, partially

SHORT-TERM STRENGTH, LONG-TERM WEAKNESS

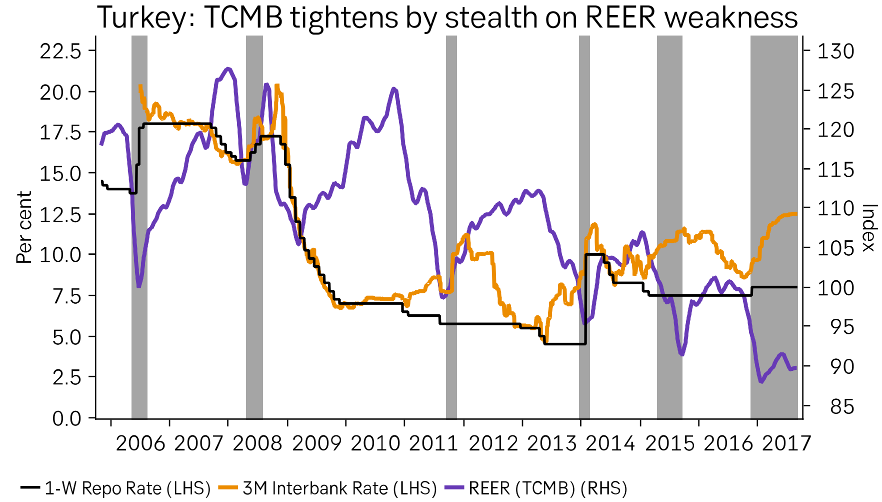
We expect the USD/TRY rate to end Q4 at 3.36, Q1 2018 at 3.50, Q2 at 3.60, and Q3 at 3.80. In the near term, **the risk is for an even lower USD/TRY rate as a result of a dovish US Fed and sticky Turkish inflation**, supporting a high TRY carry. In a 6-12 month time frame, the Turkish lira will depreciate in line with the inflation differential compared to Turkey's main trading partners.

SHORT-TERM VIEW: ECONOMIC GROWTH AND RELATIVE POLITICAL CALM TO SUPPORT TRY

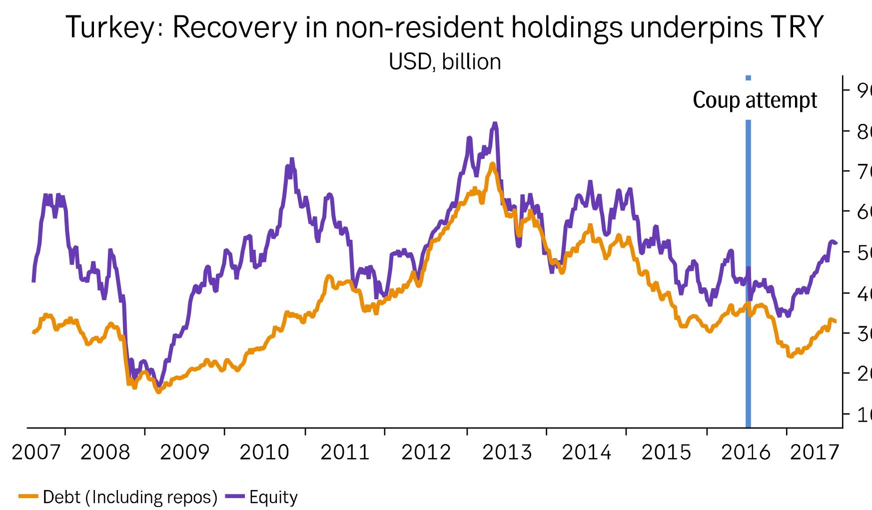
GDP growth was a strong 5.1% y/y in H1 2017. Although it will slow in H2 as the government's credit guarantee scheme winds down, growth will remain strong enough to sustain generally positive investor sentiment. Inflation will barely fall below 10% y/y by the end of the year, leaving the central bank with few options but to maintain a tight monetary policy stance in order to attract foreign portfolio flows to cover the excessive 25% of GDP external financing requirement. In addition, with the referendum on constitutional change out of the way, we expect politics to enter a period of consolidation. President Erdogan and his AK Party will try to boost their popularity through pork-barrel spending and by avoiding controversial domestic policy steps. **The combination of decent growth, albeit driven by consumption, political stability and high yields will support the TRY for now.**

LONG-TERM VIEW: INFLATION AND DETERIORATING POLITICAL OUTLOOK WILL WEAKEN TRY

The CB's inflation target is 5.0%, but inflation will stay above 8% next year. **The TRY will depreciate to keep Turkish exports competitive and contain the current account deficit.** In addition, with politics taking an authoritarian and state-interventionist turn, **investment and growth will suffer and weigh on the TRY.**



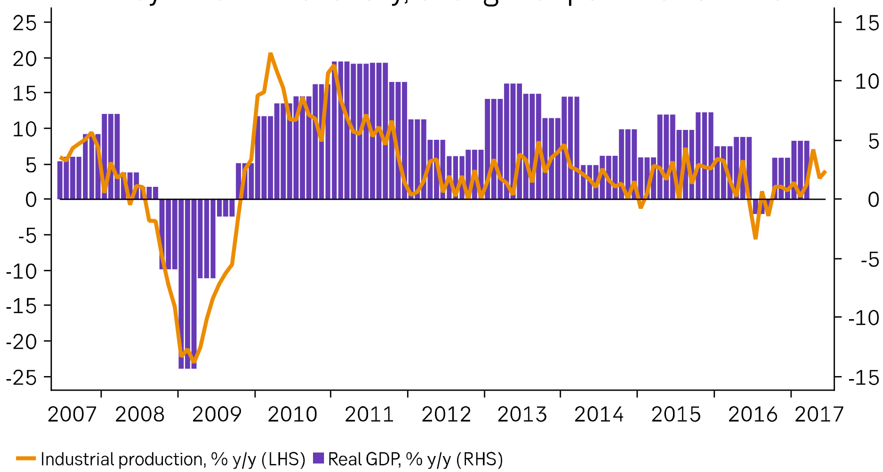
Source: Central Bank of the Republic of Turkey (TCMB), Bank Association of Turkey, Macrobond, SEB



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

Turkey: Achilles' heel is short-term external debt

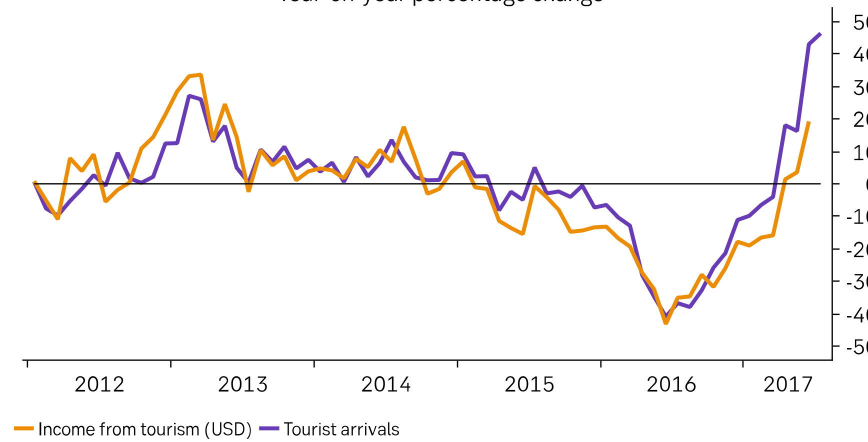
Turkey: Growth recovery, enough for positive sentiment



Source: Turkish Statistical Institute (TurkStat), Macrobond, SEB

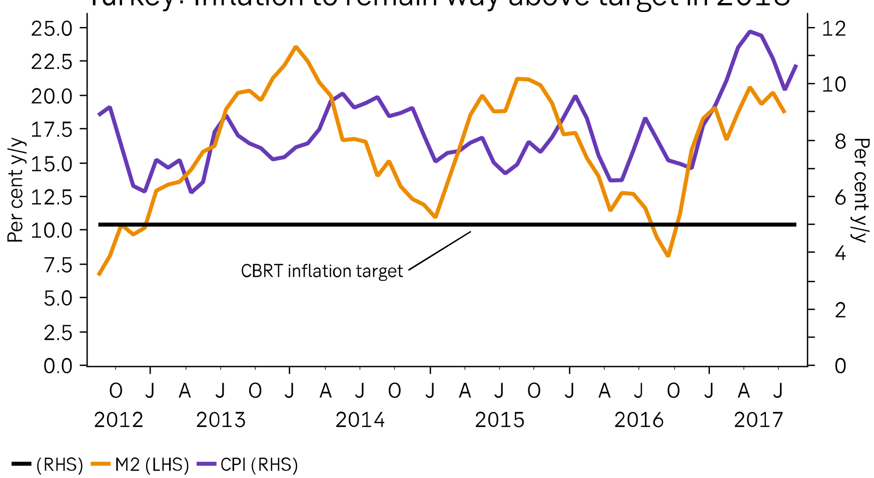
Turkey: Tourists return, but spend less

Year-on-year percentage change



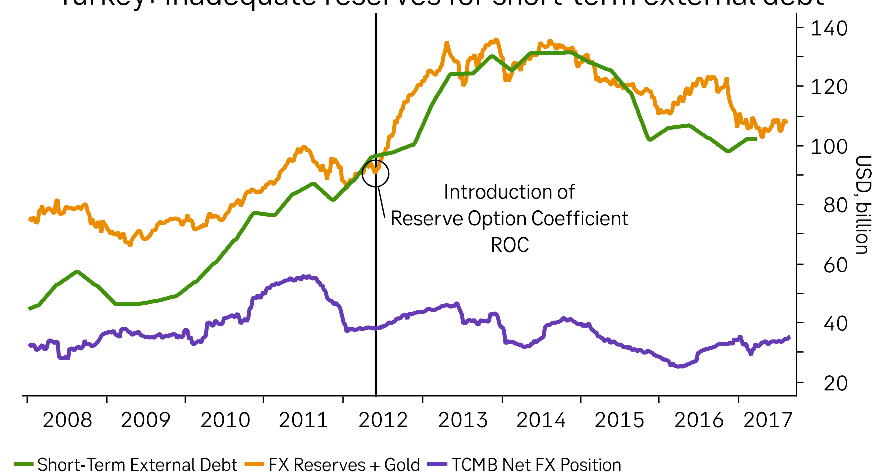
Source: Turkish Ministry of Culture & Tourism, Turkish Statistical Institute (TurkStat), Macrobond, SEB

Turkey: Inflation to remain way above target in 2018



Source: Turkish Statistical Institute (TurkStat), Central Bank of the Republic of Turkey (TCMB), Macrobond, SEB

Turkey: Inadequate reserves for short-term external debt



Source: Central Bank of the Republic of Turkey (TCMB), Turkish Prime Ministry Undersecretariat of Treasury, Macrobond, SEB

CNY: Stability amid a political transition

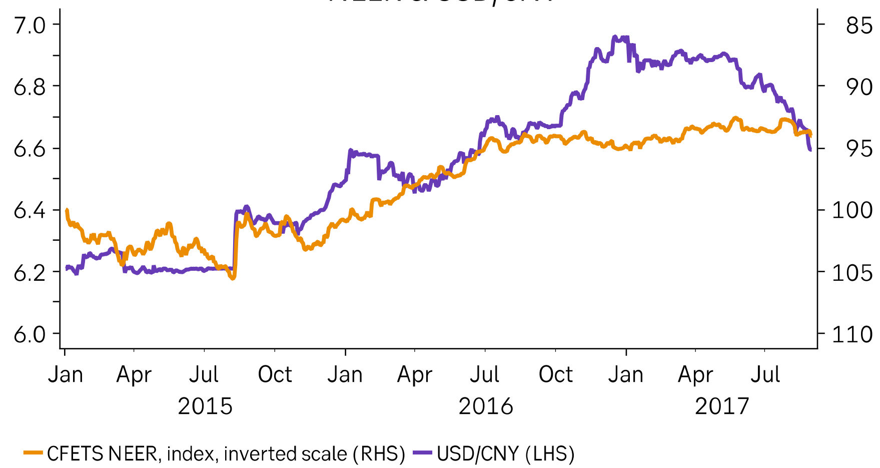
THE CNY WILL WEAKEN TO 6.70 END-2017. Politics trump economics. China's Communist Party has a once-in-five-years political reshuffle on Oct 18. Before these major transitions, the government likes to keep the economy – including the currency – stable. Growth is slowing but has been stronger than market expectations. The government has been applying the brakes in the economy by reducing debt growth and implementing austerity measures in the real estate market. However, upside export surprises have kept growth higher. We expect GDP increases to slow, but at a steady pace ahead of the political shift. Growth will reach 6.8% in 2017, almost flat compared to last year's 6.9%.

Monetary policy will remain neutral for the rest of the year due to politics. The government is leaning towards a tighter stance and the risk is that in 2018, the People's Bank of China (PBoC) will follow. However, inflation is currently too low: around 1.5%, compared the PBoC's unofficial target of 3%. The central bank will not be a in a rush to tighten monetary policy.

Official CNY policy changed in 2017 to prevent depreciation. Depreciation was causing capital outflows, which were hard to control. China is also trying to attract foreign inflow into the domestic equity and bond markets, and a stable currency helps attract more inflows. Hence we see the USD/CNY exchange rate ending the year at around 6.70. On a CNY NEER basis, we think it will remain stable at between 94 and 95.

IN 2018, WE EXPECT THE CNY TO STRENGTHEN TO 6.30. The policy will remain the same, with China wanting to keep CNY NEER stable. However, we expect the EUR/USD to strengthen to 1.25, putting downward pressure on our USD/CNY forecast.

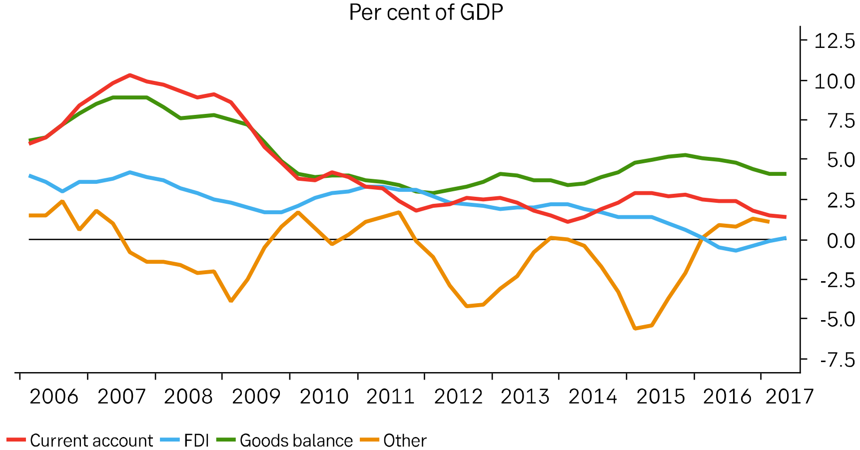
NEER & USD/CNY



Source: SEB

China, balance of payments (BOP)

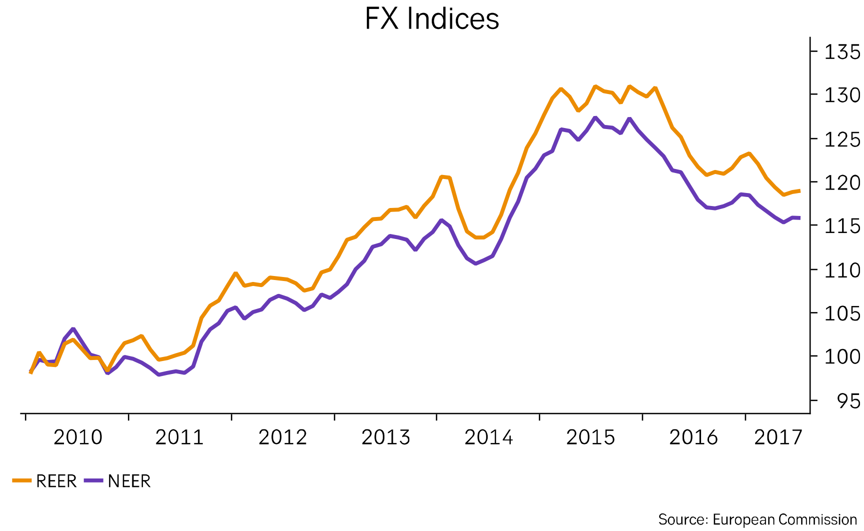
Per cent of GDP

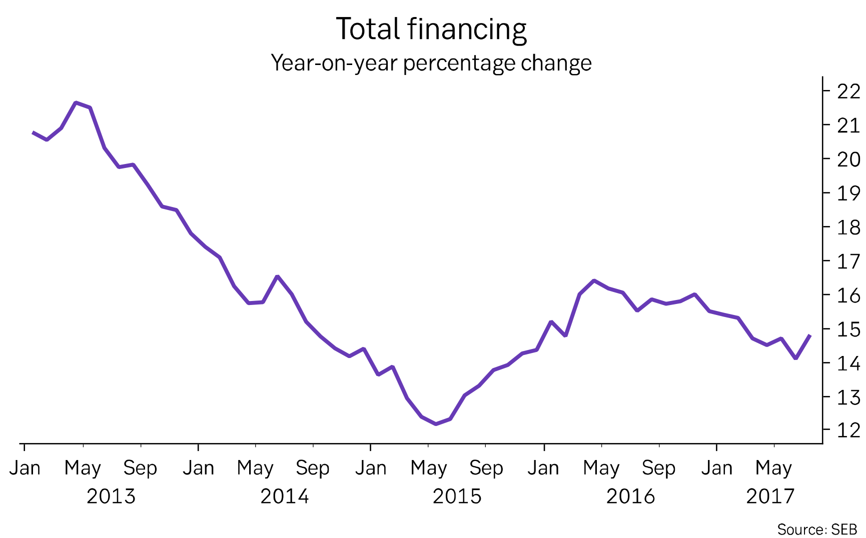


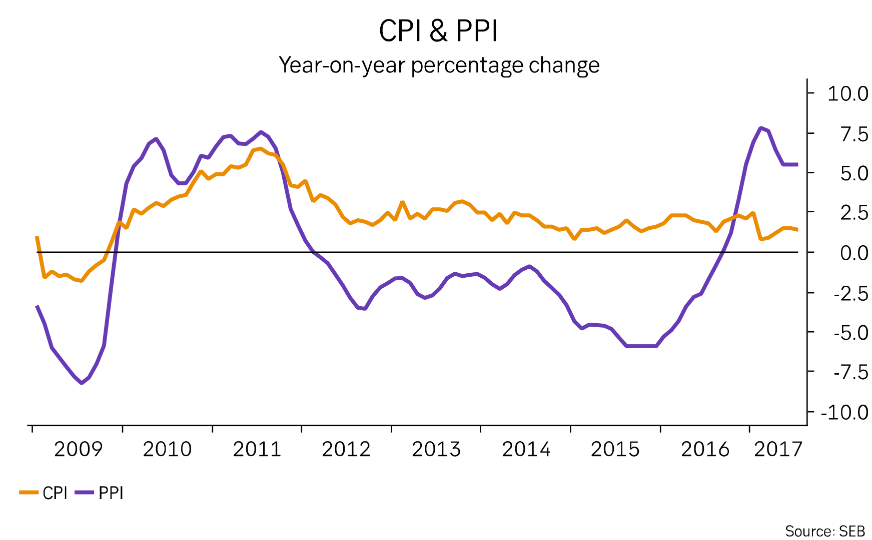
Source: SEB

SEB

China: relatively balanced developments







Themes

US economy: Continued above-trend GDP growth

REBOUND AFTER A WEAK START TO 2017

GDP grew by a weak 1.2% annualised rate in the first quarter. However, activity accelerated in Q2, driven by a rebound in private consumption that helped push GDP growth to 3%. Most sentiment indicators remain at historically high levels, and there are plenty of other indicators suggesting that the economy will keep growing at a healthy pace. The political turbulence surrounding Trump is not significantly affecting the economy, but it is now unlikely that any tax cuts will be enacted in 2017. We expect GDP growth to remain in the 2.5% to 3.0% range in the second half of 2017, which is above trend.

CONSUMPTION NOT DEPENDENT ON TAX CUTS

We predict that private consumption will do well even without tax cuts and contribute to a 2.2% increase in GDP during 2017. The combination of continuing labour market tightening, growing household wealth and low mortgage interest rates means that there is potential for consumption growth to remain healthy.

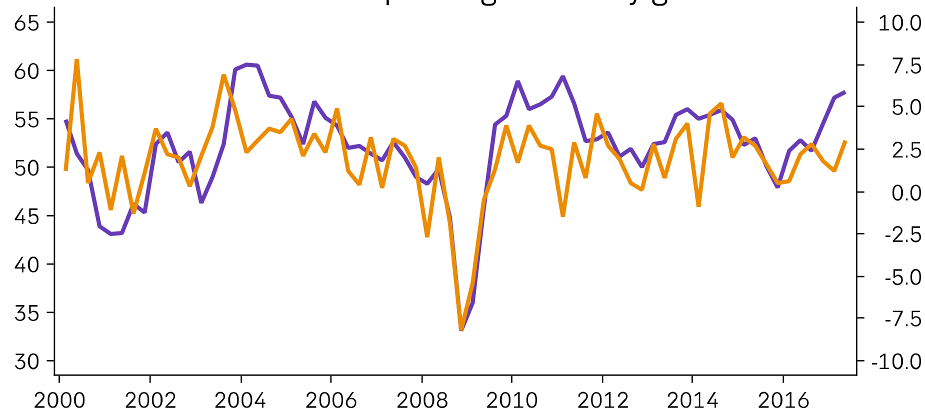
CAPITAL SPENDING WILL SUSTAIN GROWTH

Capital spending slowed down in Q2 but will continue to support growth. Housing investments are set to recover, while industrial production is benefiting from the weaker dollar and stronger global economic conditions. Capacity utilisation continues to climb and will stimulate capital spending. Exports have risen significantly during 2017, driven by dollar weakness. Net exports are set to make a small positive contribution to GDP growth, after having been negative in recent years.

HARVEY AND IRMA WILL AFFECT Q3 GROWTH

It is a little early to assess the effects of hurricanes Harvey and Irma, but the most likely outcome is a small negative effect on growth in Q3 that will be reversed in Q4.

Indicators are pointing to healthy growth

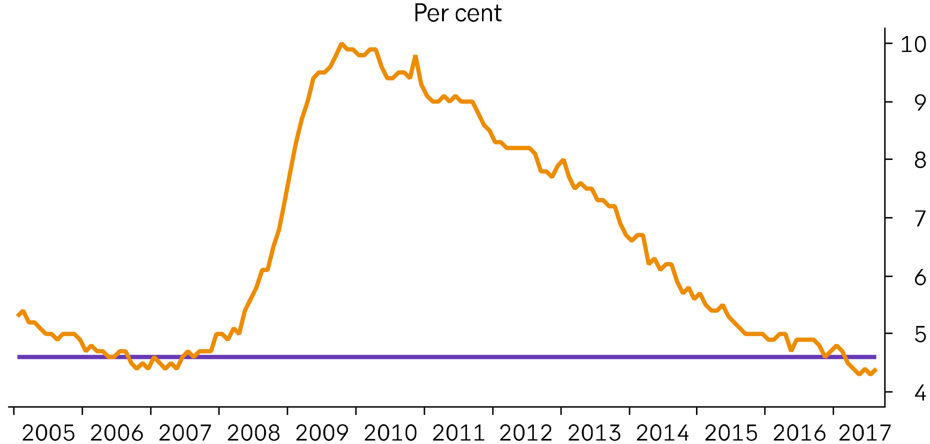


GDP, annualised quarterly growth, per cent (RHS)
ISM purchasing managers' index, manufacturing (LHS)

Source: Institute for Supply Management (ISM), U.S. Bureau of Economic Analysis (BEA), Macrobond, SEB

US unemployment below long-term equilibrium level

Per cent



Unemployment — NAIRU (4.6)

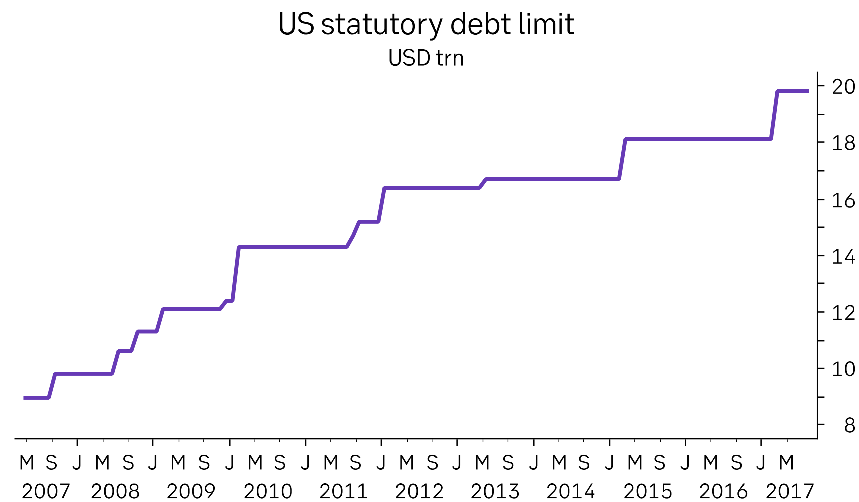
Source: U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

US debt ceiling showdown should not affect USD

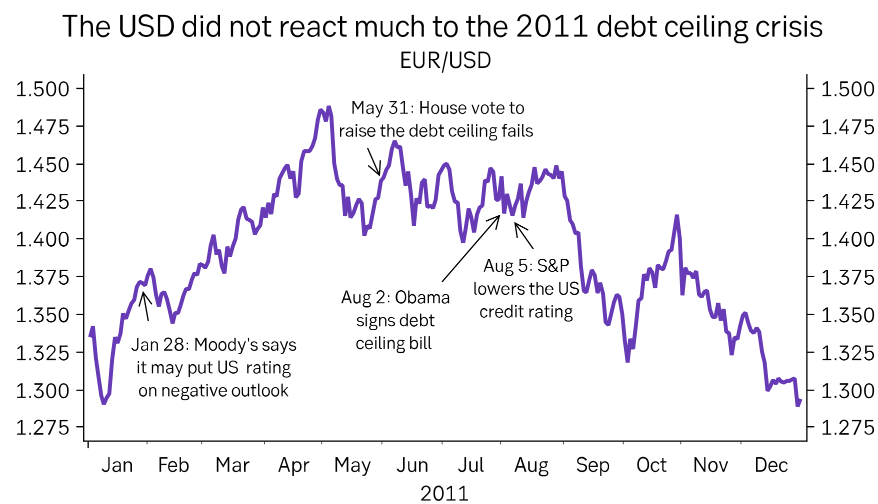
BACKGROUND
The US Congress must periodically raise the cap on the amount of money that the federal government can borrow. Failure to do so means that the US Treasury would lack legal authority to borrow and **the US could default in a worst case scenario**. In 2011 Republicans used the ceiling to force policy concessions. Although the showdown ended with disaster being avoided, it caused financial volatility.

CURRENT SITUATION
In early September, President Trump unpredictably forged a deal with Democrats in congress to suspend the debt limit until December 8. The agreement was passed by the Republican-led Congress and means that the debt ceiling issue should be off the table for now. However, it is possible that the Democrats will try to use the debt limit vote later in the year to win concessions on the tax cuts that Trump wants to implement. Another possibility is that the debt ceiling will be removed altogether.

THE USD SHOULD BE SAFE, BUT EQUITIES AND BONDS COULD SUFFER
We **expect the debt ceiling to be raised or abolished** later in the year, but both equities and bonds could suffer in a scenario encompassing a political stand-off over the debt ceiling issue. This is what happened in 2011. The USD should not be affected, however, as long as the very unlikely event of a US default is avoided.



Source: U.S. Department of the Treasury



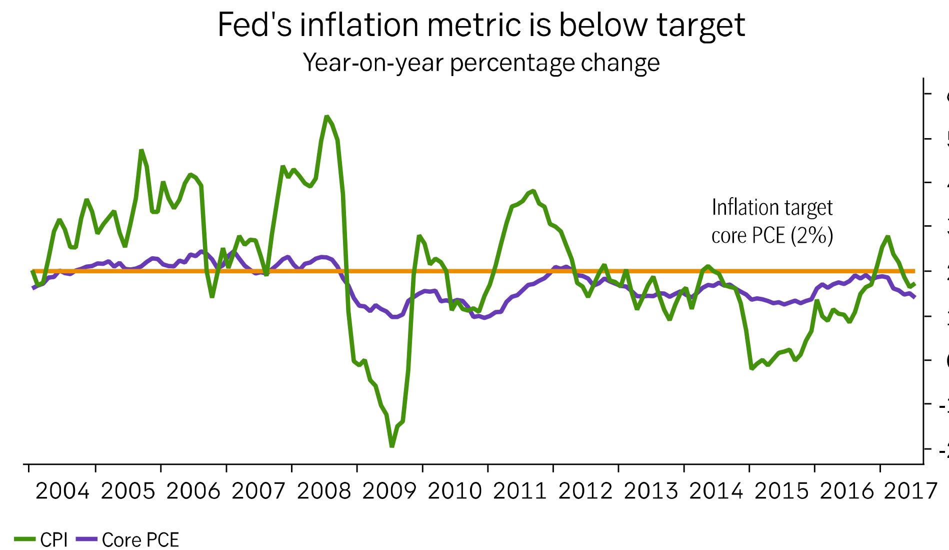
Source: ECB (European Central Bank), SEB

Fed forecast withstands Irma and Harvey

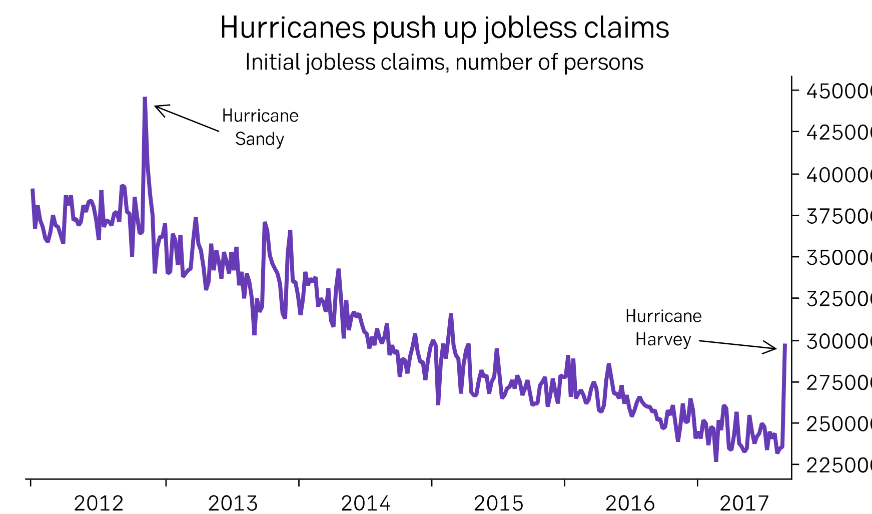
OUR FED VIEW
We expect the Fed to leave the key rate unchanged at its September 19-20 policy meeting **but believe that the central bank will hike this rate in December 2017. In 2018 we expect three more hikes.** In September we expect the Fed to **formally decide to start reducing its balance sheet** in October. With a US debt ceiling crisis postponed until December, the only possible obstacle to a normalisation of the balance sheet has been removed.

UNCERTAINTY ABOUT FED HIKES
The Fed's dual mandate related to inflation and employment is creating a dilemma. The Fed has clearly communicated that the tight labour market means it has achieved its employment objective, but low inflation has created a dilemma. **Our prediction of a December rate hike is dependent on inflation starting to accelerate in the next few months, moving closer to the Fed target.** This is in line with FOMC members arguing for a "wait-and-see" approach. However, some members are clearly worried that the combination of a tightening of the labour market and easing financial conditions could result in a sharp acceleration in inflation. While the Fed still projects one more rate hike in 2017, markets are unconvinced.

HURRICANES HAVE LIMITED IMPACT
The economic impact of Harvey and Irma on the aggregate US economy will likely be small. Hurricanes tend to have a limited negative impact on economic activity and most is reversed later when rebuilding efforts start. We will probably see a small dent in Q3 GDP growth that will be reversed in Q4. This means that **the effect on our full-year 2017 GDP growth forecast (2.2%) should be minimal**. However, there will be volatility in economic data in the short-term, such as higher initial jobless claims and rising petrol prices. There could also be negative effects on retail sales and possibly on non-farm payroll growth in September.



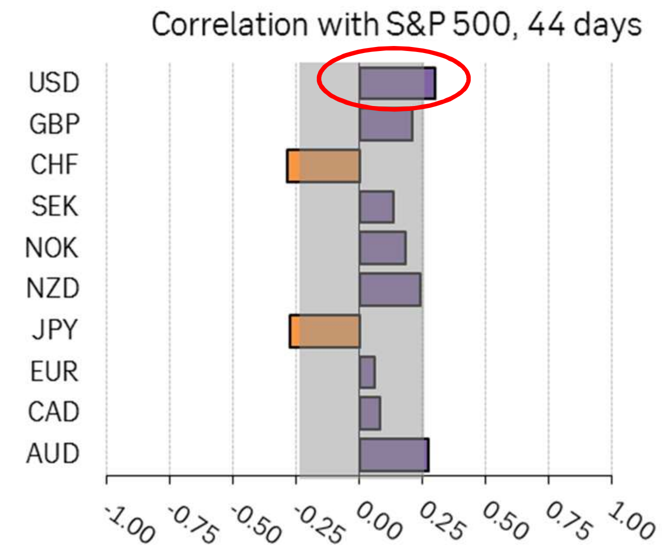
Source: U.S. Bureau of Economic Analysis (BEA), U.S. Bureau of Labor Statistics (BLS), Macrobond, SEB

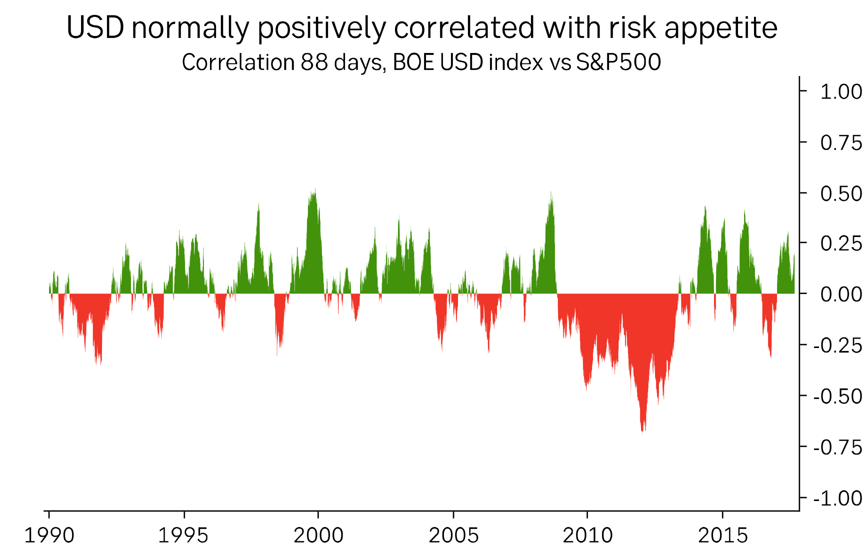


Source: U.S. Department of Labor, SEB

The dollar is NOT a classical safe haven currency

- Since 2013, the correlation between the dollar (DXY) and risk appetite (S&P 500) has been positive or very close to zero.
- In fact, among G10 currencies the dollar currently (during the past 44 days) has the highest positive correlation with risk appetite measured as the S&P 500.
- However, it seems as if the general view is that this is just a short-lived behaviour that will eventually disappear and that the dollar will normally react positively to a setback in global risk appetite, just like the JPY and the CHF.
- This view is probably related to the way the dollar behaved during the 2008 financial crisis and until 2012, when the dollar benefited from very low global risk appetite.
- But as illustrated in the lower chart, this was probably an exceptional period. Prior to 2008 the correlation between the dollar and global risk appetite was mostly negative, although quite low. This means the dollar, if anything, normally tends to benefit when global risk appetite improves.
- Although it is not clear-cut based on history, it seems as if the dollar tends to turn into a quality currency (negative correlation with S&P 500) **in times of severe stress in financial markets**, such as financial crises. Moreover, history suggests that the **correlation is stronger if the USD is substantially undervalued to begin with, just like in 2008.**
- Recent behaviour, with the dollar benefiting from rising global risk appetite and suffering from increased stress in financial markets, is not exceptional but is in fact its normal behaviour. Consequently, the dollar is likely to continue to react negatively or not at all to setbacks in global risk appetite.

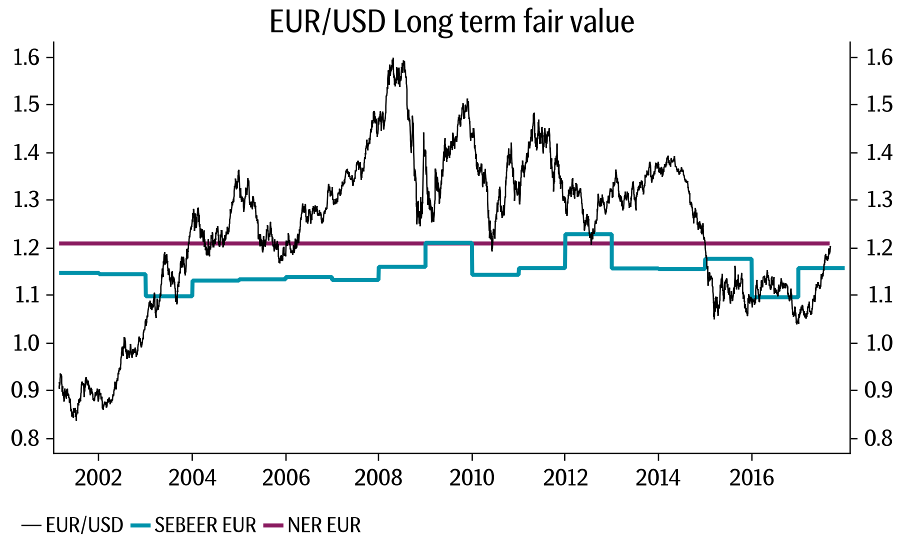


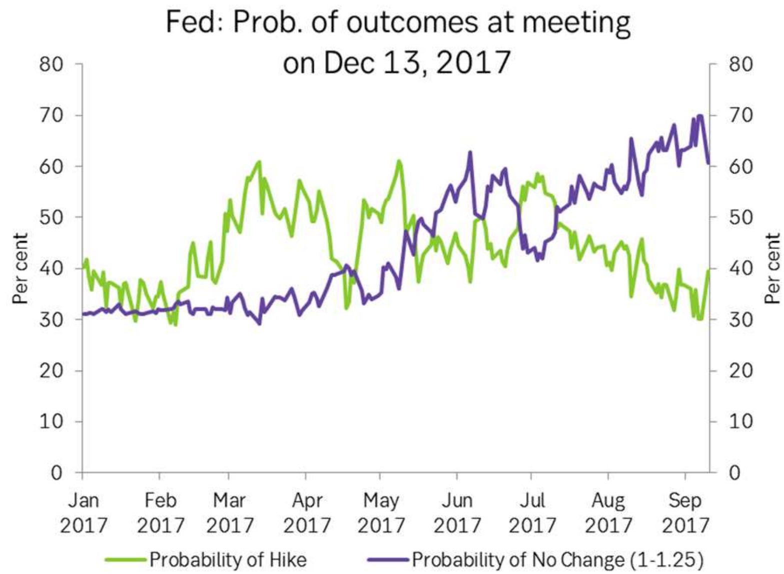


How far could EUR/USD go?

- On January 3 the EUR/USD rate touched a low of 1.0340. After spending most of Q1 in the 1.05-1.10 range, EUR/USD moved above 1.10 following the outcome of the French election.
- **The EUR has appreciated by 13% over the past 6 months and by 16% since the beginning of the year**. In a historical context this is not an extreme move for this currency pair. The most extreme move in EUR/USD during a 12-month period was 25%. **If this happens again, it suggests that EUR/USD could reach almost 1.30 by year-end.**
- Disappointingly low US inflation combined with stronger fundamentals in the euro area have weakened the dollar and strengthened the euro as investors have scaled back expectations on the Fed sharply, while the ECB has shown very limited concern about a stronger euro.
- The dollar was clearly overvalued below 1.05, but currently the EUR/USD is trading at close to its long-term fair value of around 1.20.
- Speculative market positioning has moved from net long the dollar in the beginning of the year to net short the dollar, and Fed expectations reflect basically just one hike until end-2018.
- **Although this year's EUR/USD movement is not extreme, several things suggest it is time for consolidation or even a temporary recovery for the dollar.**

EUR/USD changes 2002-2017				
	12m	6m	3m	1m
Max, %	25	18	14	13
Min, %	-28	-23	-23	-16
In 2017				
EUR/USD, %	7	13	9	5

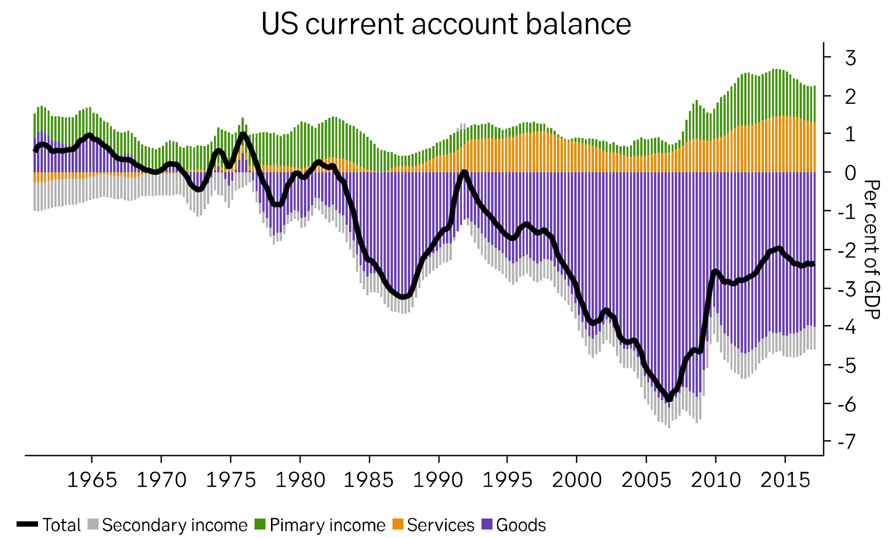


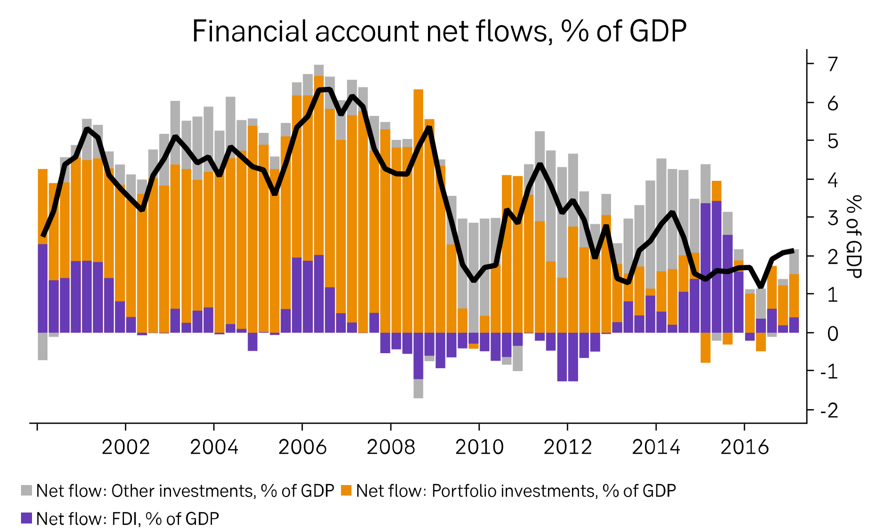


Source: Bloomberg

USD: Current account deficit not an issue

- The US current account deficit has been quite stable at between 2 and 3% of GDP since 2010.
- Lower imports of crude oil have more or less cancelled out a growing deficit in non-petroleum goods trade with the rest of the world, while the trade surplus related to services remains stable.
- Furthermore the US continues to generate positive income flows, which is the return on its overseas investments.
- Of course, the deficit has to be financed by capital inflows. In recent quarters the main source of foreign capital inflows has been portfolio investments.
- Digging a little further into the details of net portfolio flows, it turns out that what is mostly attracting net capital inflows is purchases of long-term debt instruments, which have generated net inflows of around USD 300bn a year.
- In contrast, equity-related net portfolio flows have been quite negative (almost USD -500bn annually) since 2014, although they improved sharply last year and are currently almost in balance.
- For a long time, the US current account deficit has been discussed as a negative factor for the USD. However, since it possesses the single most important reserve currency, the US economy has the ability to attract sufficient capital inflows into debt-related securities to fund the current account deficit. This will be the case going forward as well.

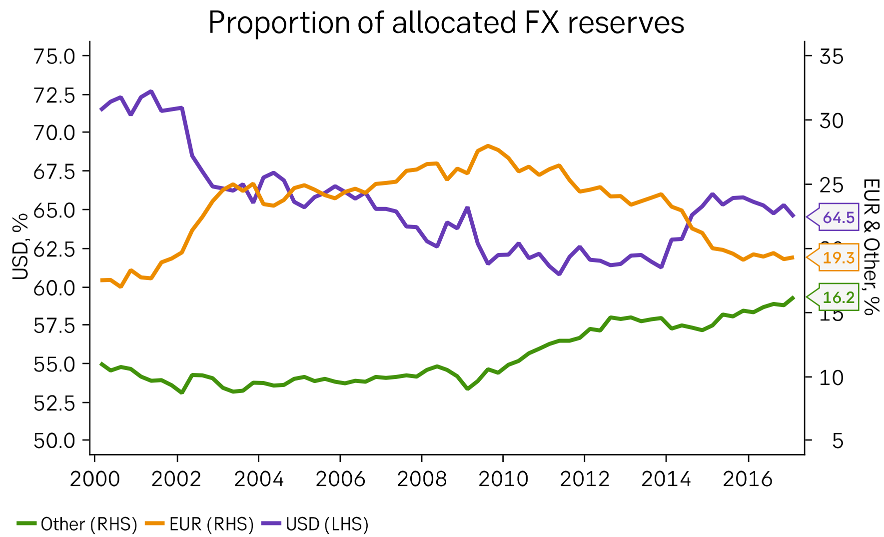


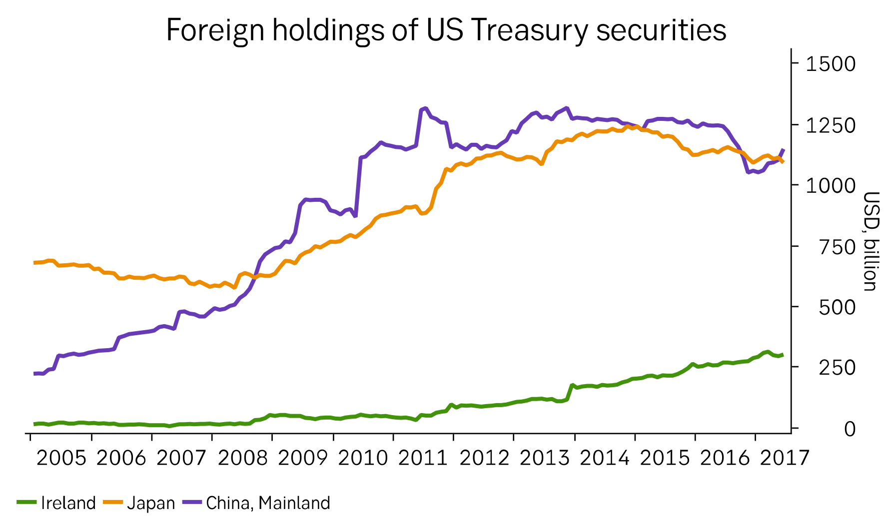


SEB

USD may suffer from renewed rebalancing flows

- The appreciation of the dollar since mid-2014 and an uncertain outlook for the euro area boosted the dollar's proportion of global central bank reserves substantially. This proportion is now roughly back where it was in 2007.
- Meanwhile the euro's proportion of global reserves has fallen substantially, dropping below 20%, which means it is back at the same proportion as in 2001/2002.
- Instead, global reserve managers appear to have favoured diversifying their reserve holdings into other smaller currencies. This trend started in 2009 on the back of the euro crisis and seems to be ongoing.
- Going forward, rebalancing of reserve holdings could become a USD-negative factor, since reserve managers are probably unwilling to raise the USD proportion further from current levels.
- In fact, the trend suggests that diversification into smaller currencies will continue at the expense of dollar holdings, while exposure to the euro will probably stay around its current level.
- Last year, China net-sold treasury securities amid capital outflows and falling currency reserves. Since the beginning of this year, Chinese currency reserves have started to grow again and consequently China has returned as a net buyer of US treasury securities.





Source: US Department of the Treasury, Macrobond, SEB

What moves EUR/USD?

EUR/USD DRIVEN BY INFLATION FOCUS

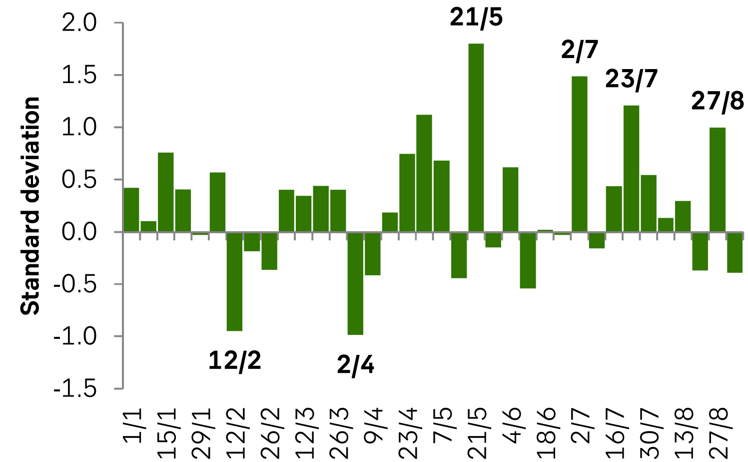
Looking both at weekly and daily EUR/USD changes* it is very clear that the major factor to cause large swings in 2017 has been the trend of inflation including central bank comments (on inflation).

Large weekly changes and explanations		
Date	**EUR/USD**	**Event/Data**
12-Feb	-0.9	High NFP and FOMC hike beginning to be priced in
2-Apr	-1.0	EU **HICP** downside surprise & US **PCE** upside surprise
21-May	1.8	EU **HICP** increasing, GDP in line & scaledown of Trumponomic trades
2-Jun	1.5	EU **HICP** upside surprise & US **PCE** in line but falling
23-Jul	1.2	ECB rate meeting & EU **HICP** in line
27-Aug	1.0	Jackson Hole speeches by Yellen and Draghi

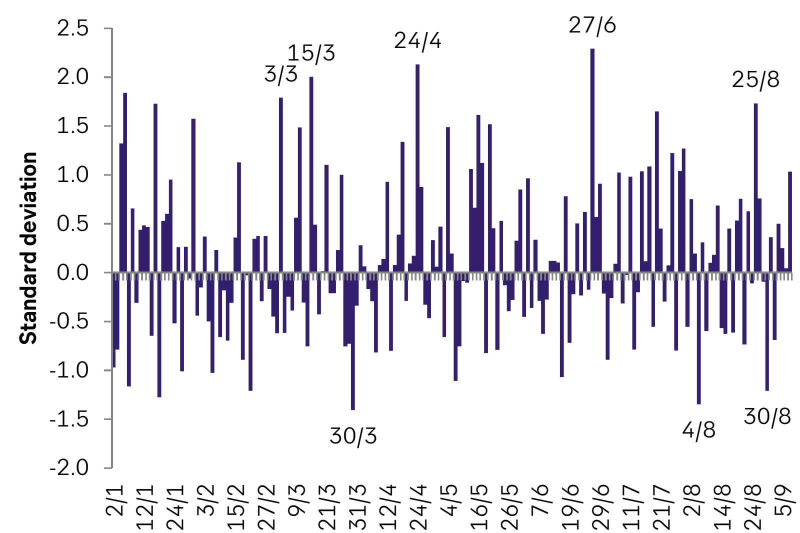
Large daily changes and explanations		
Date	**EUR/USD**	**Event/Data**
3-Mar	1.8	Yellen speech about development of employment and **inflation**
15-Mar	2	FOMC & US **CPI**
30-Mar	-1.4	US core **PCE** upside surprise (1.3 exp 1.2)
24-Apr	2.1	Macron wins French presidential election
27-Jun	2.3	Yellen speech mentioning **inflation** & Italian solution for distressed banks
4-Aug	-1.3	NFP & Hourly earnings
25-Aug	1.7	Jackson Hole
30-Aug	-1.2	US **PCE** remained low (0.9%)

* Measured by the Z-score of the weekly change i.e. the deviation from the average change expressed in standard deviations.

Weekly changes in EUR/USD



Daily changes in EUR/USD



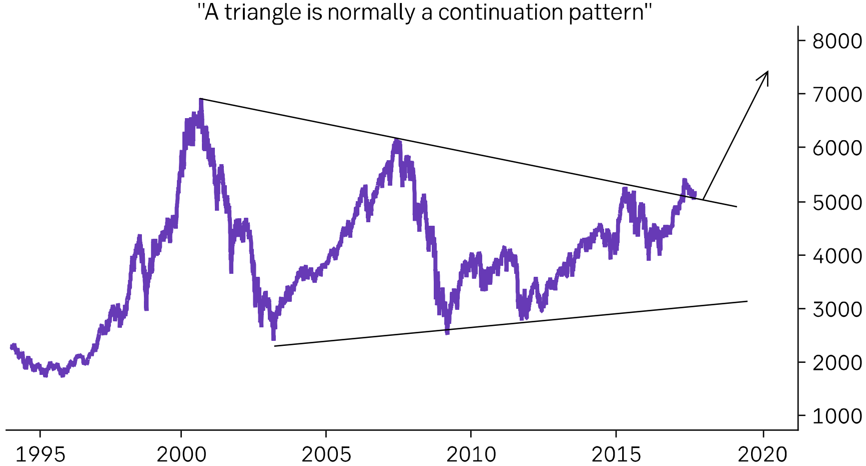
EMU: Premature rise in political stability?

TOWARDS REAL ECONOMIC AND MONETARY UNION (EMU): POTENTIAL FOR POSITIVE EURO FLOWS

In March 2017 the European Commission published its *White Paper on the Future of Europe*, presenting different scenarios for the pace of EU integration until 2025. This paper was followed up by several reflection papers on how to deepen the EMU, the future of European defence and EU finances etc. These policy proposals and other ideas for more EU integration will be discussed ahead of European Parliament elections in May 2019. The election of Emanuel Macron as French President and the probable re-election of Angela Merkel in Germany later this month also have further potential to kick-start European integration efforts. It is clear that these two leading economies in Europe are looking at options to deepen the EU at a time when its foundation is being shaken by the ongoing Brexit negotiations. Later this year, the IMF/EU/ECB will look at the potential for a Greek debt write-down. Germany holds the key here: if Merkel agrees to the undebatable need for a large haircut on outstanding Greek debt, it will be opening a Pandora's Box for mutualising EU debt and broadening common EU fiscal policy. A banking union, a common fiscal budget and ultimately a political union are necessary to make the euro a long-term stable currency. The strong European economic recovery and lower political risk make it possible to increase democratic support for this to happen, but it will take a long time. This development remains EU equity market-positive. If Macron succeeds in reforming the French labour market and making France more competitive, we will likely continue to see portfolio inflows that will be euro-positive too (the technical outlook certainly calls for a substantial upside).

CAC 40 Index

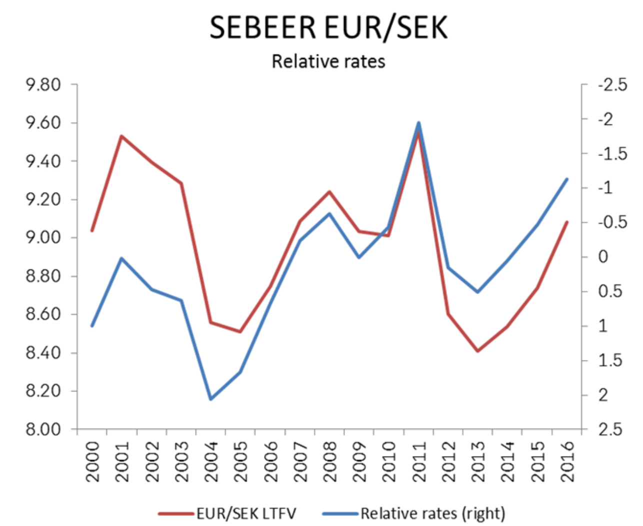
"A triangle is normally a continuation pattern"

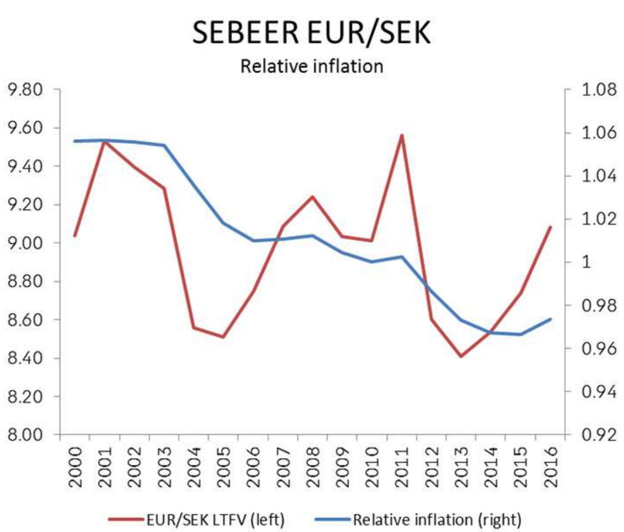


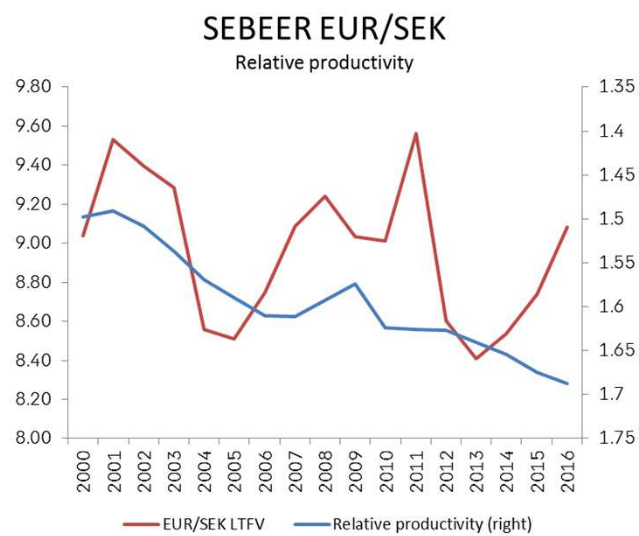
Source: {Property Source not found.}, Macrobond, SEB

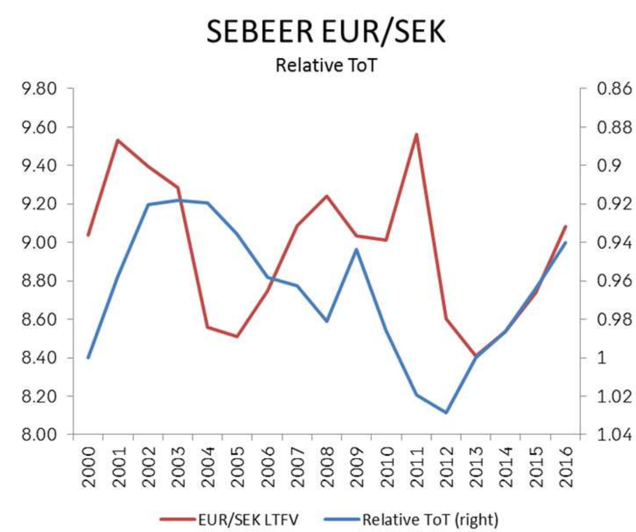
EUR/SEK long-term valuation is now above 9.00

- The long-term fair value estimate for the EUR/SEK exchange rate, based on the SEBEER model and the long-term nominal trend, is 9.12.
- As one input to our long-term fair value (LTFV) estimates for currencies, we use the SEBEER model.
- The model, which is based on four variables (relative inflation, real interest rates, productivity and terms of trade) was recently updated. It then raised the **SEBEER estimate of EUR/SEK from 8.74 last year to 9.08**, which was the first time the estimate moved above 9.00 since 2011.
- The charts illustrate the trends for each of the four explanatory factors going into the model.
- These suggest there are two reasons behind a higher long-term valuation in EUR/SEK **– the relative real interest rate and relative terms of trade between Sweden and the euro, which clearly have been unfavourable for the krona in recent years.**









What moves EUR/SEK?

EUR/SEK ALSO DRIVEN BY INFLATION FOCUS

Looking both at weekly and daily EUR/SEK changes* it seems that inflation has been key for EUR/SEK as well. Especially the upside surprises in Swedish CPIF y/y in July and August resulted in substantial SEK appreciation.

Large weekly changes and explanations

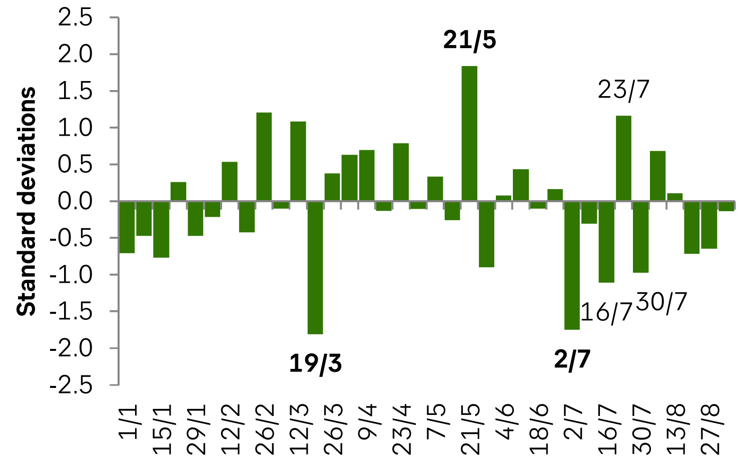
Date	EUR/SEK	Event/Data
19-Mar	-1.8	Swe **CPIF** upside surprise reaching Rix target of 2.0%
21-May	1.8	EU **HICP** rises to 1.9 from 1.5%, GDP in line & scaledown of Trumponomic trades
2-Jul	-1.8	EU **HICP** falls & anticipation ahead of Rix meeting
16-Jul	-1.1	Swe **CPIF** upside surprise
23-Jul	1.2	Dovish Rix minutes
30-Jul	-1.0	Swe GDP upside surprise (4.0 vs exp 2.7%)

Large daily changes and explanations

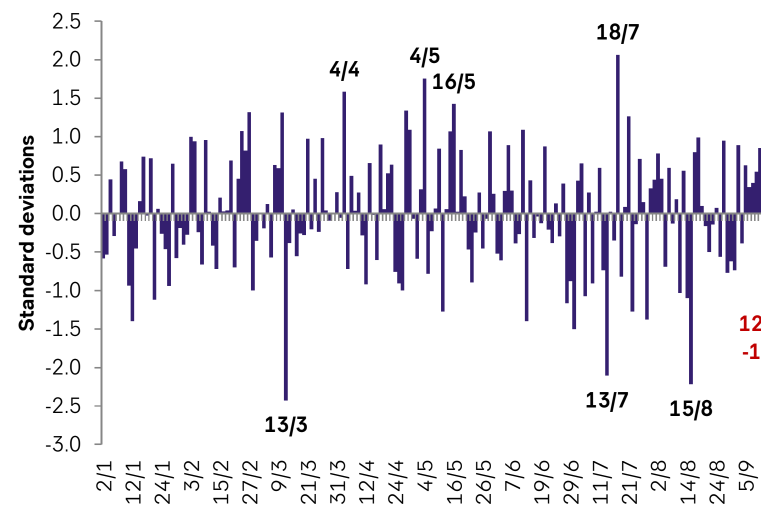
Date	EUR/SEK	Event/Data
13-Mar	-2.4	Anticipation ahead of Swe **CPIF** expected above Rix target
4-Apr	1.6	EU retail sales upside surprise & Weak SEK due to equity dividend flows
4-May	1.8	EUR strength after FOMC rate decision the day before
16-May	1.4	Riksbank opinion on **infaltion** target variable and variation band
13-Jul	-2.1	Swe **CPIF** upside surprise (1.9 vs 1.7)
18-Jul	2.1	Riksbank Minutes (Dovish)
15-Aug	-2.2	Swe **CPIF** upside surprise (2.4 vs 2.1)
12-Sep	-1.1	Swe **CPIF** upside surprise (2.3 vs 2.2)

* Measured by the Z-score of the weekly change i.e. the deviation from the average change expressed in standard deviations.

Weekly changes in EUR/SEK



Daily changes in EUR/SEK



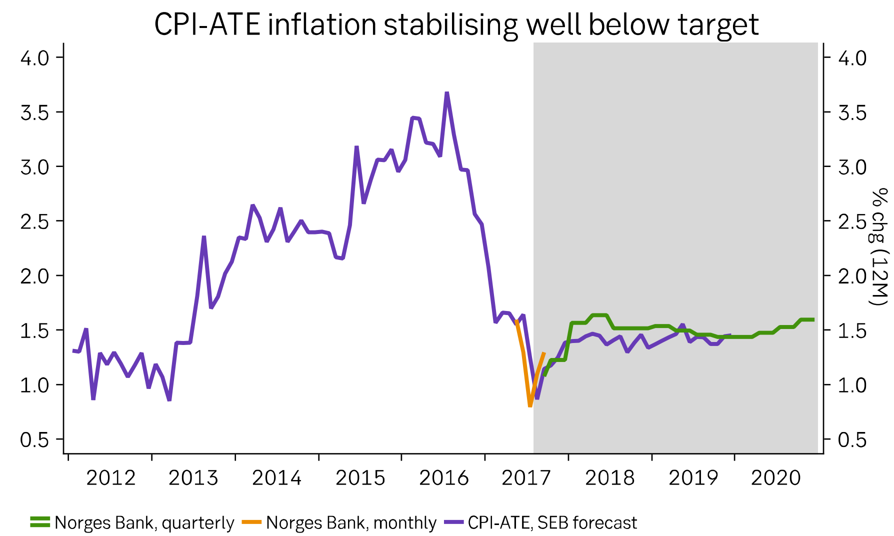
NOK: "The Norges Bank equation"

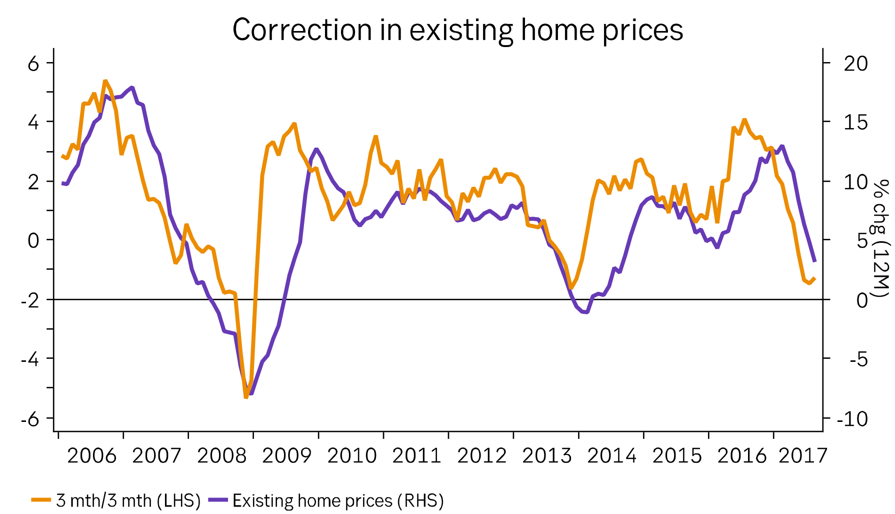
Strong economic growth to fuel NOK? Growth momentum has accelerated this year and the upturn has been broad-based. The outlook has thus been lifted and Norges Bank's current projections are cautious, in our view. Nonetheless, the impact on the NOK has been modest. We see two reasonable explanations for this:

1. Inflation below target: Demand for NOK has likely suffered from the sharp decline in core inflation over the past year. Norges Bank has lowered its inflation trajectory on several occasions, signalling CPI-ATE (core inflation) well-below target until 2020. We expect inflation to stabilise going forward, but there is little yet suggesting a major rise in core inflation. Our CPI-ATE forecast implies a downside risk to the Bank's 1.6% y/y forecast for 2018.

2. Lower home prices: During the most recent economic downturn, Norges Bank refrained from lowering the key rate further from 0.50% due to financial stability considerations. Keeping a higher key rate in the short run in exchange for "lower for longer" has been Norges Bank's *modus operandi*. This argument is now fading; after rising some 8% in 2016, existing home prices have shown sequential declines since April and Norges Bank's forecast is trailing actual developments. Solid fundamentals suggest a price collapse (and thus a rate cut) is unlikely. Nonetheless, Norges Bank is in no hurry to hike rates.

To conclude, stronger growth will not be sufficient to lift Norges Bank's inflation trajectory meaningfully. While weak growth trumped high inflation in the monetary policy equation throughout 2015, the reaction function is not expected to be symmetric. Hence, subdued inflation pressures combined with easing risks related to financial stability, suggest Norges Bank is in no rush to hike its rates. Strong growth momentum will thus have only a modestly positive impact on the NOK this year. For the krone to appreciate more rapidly, inflation must surprise on the upside.





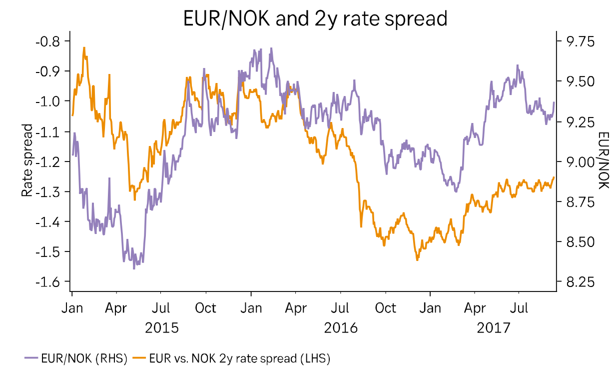
Source: Real Estate Norway (Eiendom Norge), Macrobond, SEB

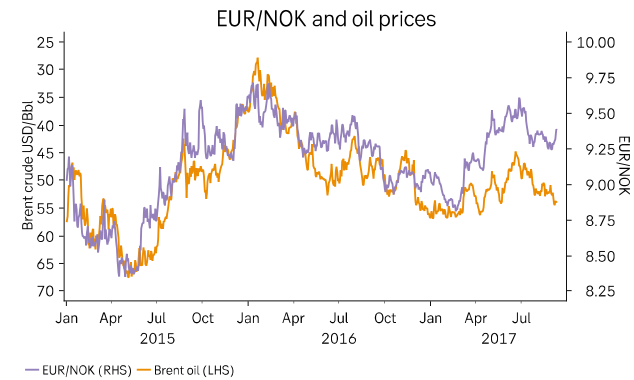
NOK should recover, but not because of oil

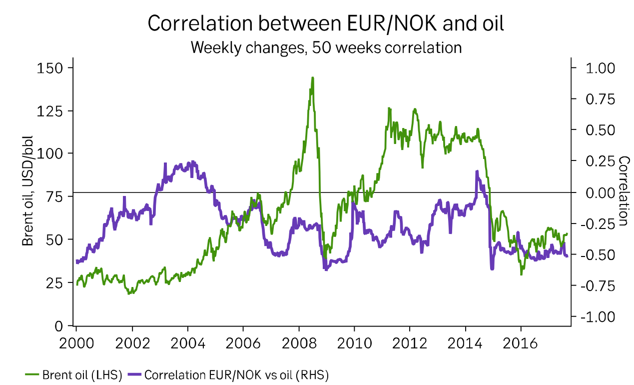
- During the past couple of years, the Norwegian krone has traded close to relative monetary policy expectations (captured by the 2-year relative rate) and oil price changes.
- With the Brent oil price at around USD 54/barrel, the relationship since 2014 would suggest a stronger NOK: around 8.90 against the euro.
- Similarly, relative rates between Norway and the euro area suggest EUR/NOK should trade around 8.80.
- Why does the NOK remain so weak?

ONCE BURNED, TWICE BURNED, THRICE SHY
Several years of aggressive central bank policy interventions (verbally and through policy changes) to weaken the currency and the 2014-2015 sell-off in oil, combined with thin liquidity, have caused abnormal moves in the NOK in recent years. This probably created substantial losses among investors and speculative accounts. We believe it led many of them to abandon the NOK market and we doubt they have returned. Today this makes the NOK market vulnerable whenever 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.

PREVIOUS NOK/Oil RELATIONSHIP ABOUT TO RETURN
Since oil prices started to fall sharply in mid-2014 the correlation between oil and the NOK has been around -0.50, which is an unusually tight relationship. Historically (except in 2008-2010) the NOK has been more or less uncorrelated with changes in oil prices (-0.25). As oil prices now seems to be stabilising around USD 50/bbl this traditionally weak relationship should return, with the NOK being almost uncorrelated with changes in the oil price going forward.

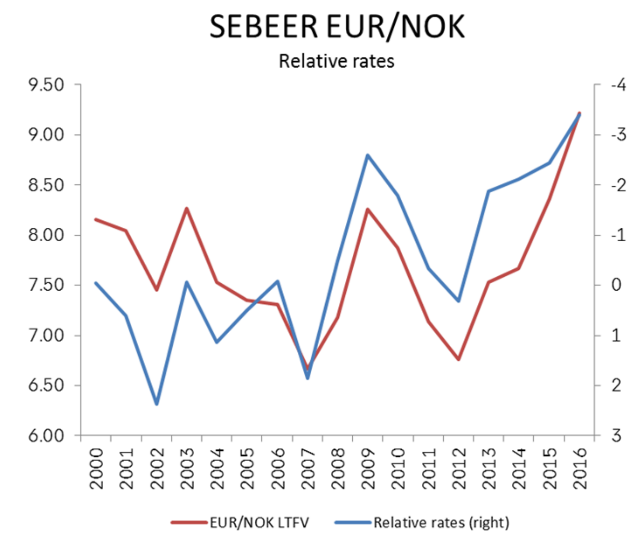


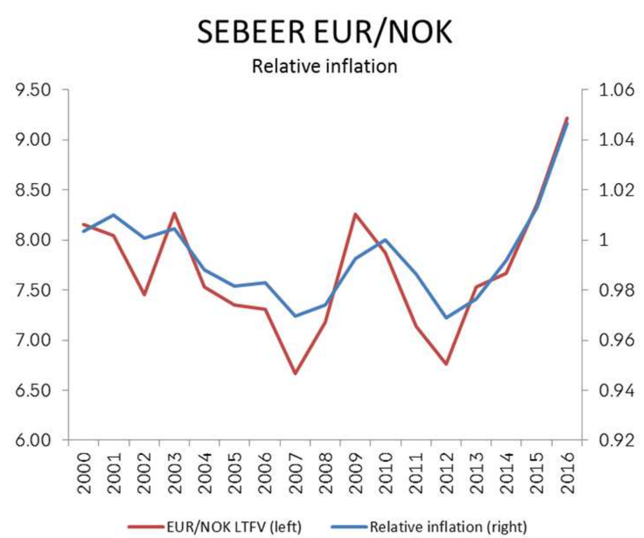


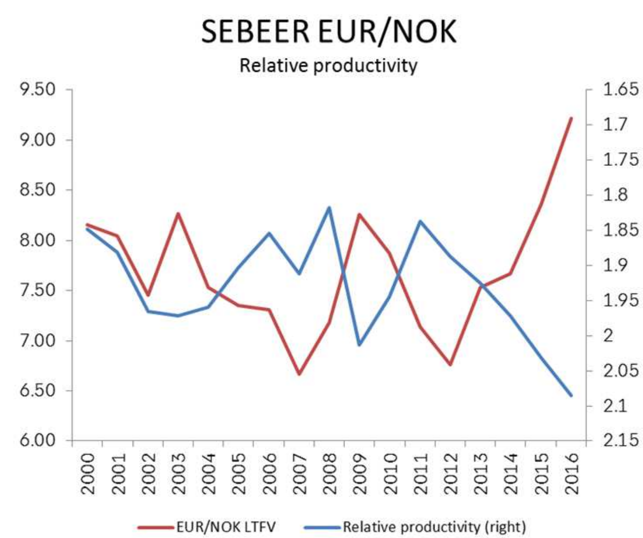


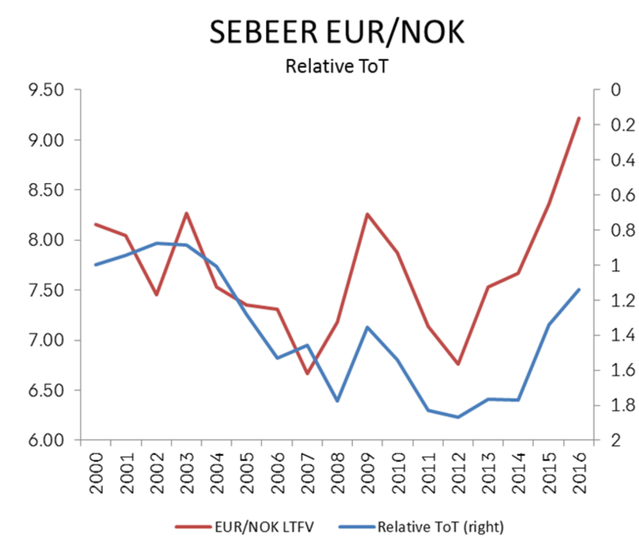
NOK long-term valuation falls dramatically

- The long-term fair value estimate for the EUR/NOK exchange rate, based on the SEBEER model and the long-term nominal trend, is **8.70**, which is a substantial revision from around 8.25 last year. In fact the EUR/NOK LTFV has risen from around 7.50 in 2013. What is going on?
- The explanation is found in the SEBEER model, based on four variables (relative inflation, real interest rates, productivity and terms of trade), which was recently updated. It then raised the **SEBEER fair-value estimate for EUR/NOK to 9.22 from 8.36 last year**. It means the EUR/NOK SEBEER estimate today is above the EUR/SEK SEBEER estimate.
- The charts illustrate changes in each of the four explanatory factors going into the model.
- These suggest that NOK should be much weaker fundamentally (higher long-term valuation of EUR/NOK) since **relative inflation in Norway has been much higher than in the euro area (should be reversed next year), the Norwegian real rate has dropped substantially and there is clear deterioration in Norwegian ToT on the back of lower oil prices.**
- **Most likely the long-term fair value of EUR/NOK will fall next year as sharply lower inflation in Norway this will feed into the estimate.**









NAFTA breakup would hurt MXN more than CAD

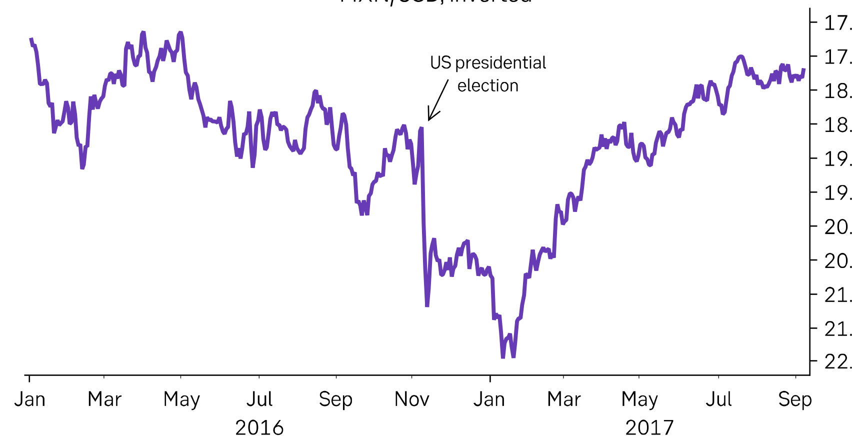
NAFTA BACKGROUND
US protectionism was a central part of Donald Trump's election campaign, but trade policy has been less confrontational than expected. North American Free Trade Agreement (NAFTA) renegotiations began in August and will provide the first real litmus test for where US trade policy is headed. The ambition is to finalise talks by the end of 2017 or early 2018. While Trump has threatened to withdraw the US from NAFTA if Mexico and Canada do not offer concessions, the most likely outcome is a renegotiated agreement that can be presented as a "win" to Trump's voters. We assign a 10% probability to a NAFTA breakup. This would be harmful to Mexico and Canada; their currencies would take a hit.

THE MXN: HIGHLY DEPENDENT ON NAFTA REPLACEMENT
Mexican exporters are highly dependent on the US. In 2016, Mexico sent 80% of its exports to the US. The peso weakened sharply after Trump's election victory led to fears of increasing trade barriers between Mexico and the US. It has since recovered as the US has adopted a more conciliatory tone. Yet if worse comes to worst and NAFTA breaks down, the peso would tumble sharply, with USD/MXN potentially surpassing the 21.95 high from January 19, 2017. The MXN would likely not stabilise before signs of what might replace NAFTA becomes available.

THE CAD: A NEW DEAL MAY BE BETTER FOR CANADA
Canada sends about 75% of its exports to the US, but Trump has mainly directed his trade rhetoric against China and Mexico. Canada is also less trade-dependent than Mexico, and the CAD has been more resilient to protectionist fears. A contrarian view is that it is debatable if Canada has benefited much from the current deal; the trade balance has swung from a positive CAD 100 billion in the 1990s to close to zero today (constant prices). So while a breakup is a negative, a new deal may well be better than the existing one.

The Mexican peso weakened on fears of US protectionism

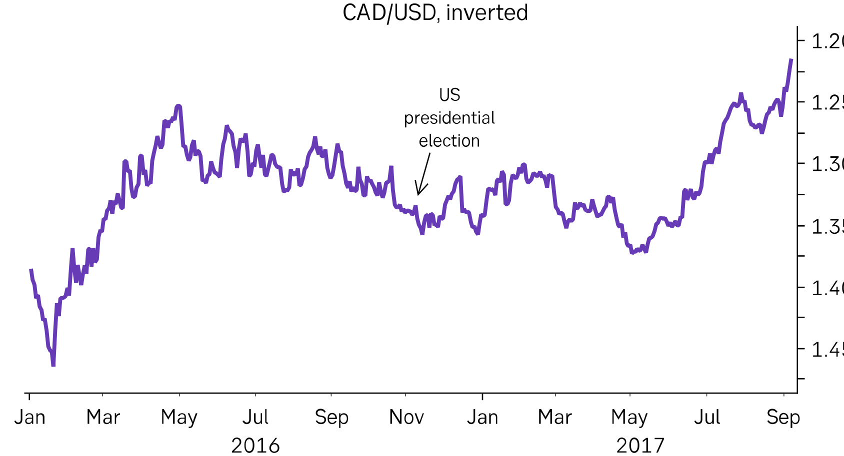
MXN/USD, inverted



Source: Macrobond

The Canadian dollar has been Trump-resilient

CAD/USD, inverted



Source: Macrobond

SEB

Hawkish Bank of Canada supports the Loonie

Even after hiking interest rates at back-to-back policy meetings, the Bank of Canada (BoC) is signalling that more hikes are coming; **only <u>“some”</u> of the <u>“considerable”</u> stimulus has been taken away**...

We are expecting another interest rate hike in 2017, possibly as early as the October 25 policy meeting if economic data (the labour market in particular) stay reasonably strong. In particular, **should the unemployment rate continue its decline** the Canadian policy rate may already surpass the Fed funds rate this year. The current unemployment level as well as our **“labour gap” Taylor rule** are consistent with a 3% policy rate. That offers one explanation why the **BoC is currently acting as if it is behind the curve**.

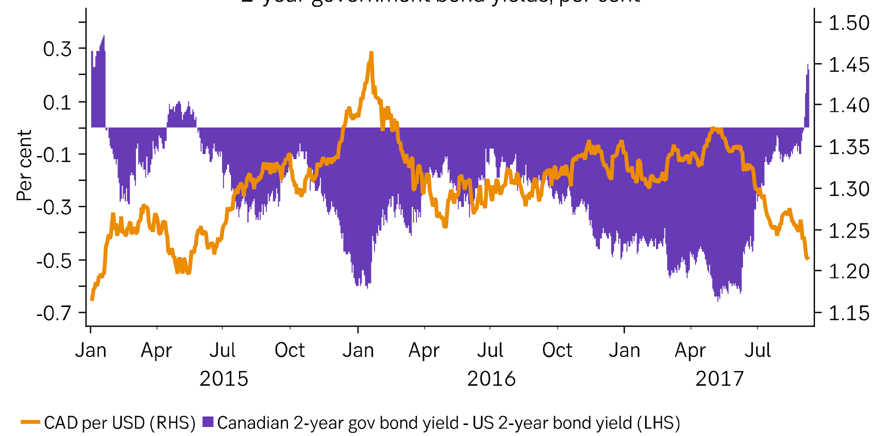
For 2018, we forecast four hikes – thus taking the target rate to 2.25%. The NAFTA renegotiations are a downside risk; should they break down, this may well derail the recovery since 75% of Canadian exports go directly south of the border.

The housing market is both a reason to normalise rates and a factor that may be stopping the BoC from running too fast. The housing sector appears to be cooling in some local markets because of recent changes in tax and housing finance policies – but it **still showing a green light with respect to ongoing normalisation**. Looking further ahead, the bank is paying close attention to the interest rate sensitivity of the economy, given Canada’s high household debt.

Canada has superior GDP growth performance vis-à-vis the US, and while US rates have peaked at a higher level in previous cycles it is not uncommon for the Canadian policy rate to be sitting above the US Fed funds rate – it happened last in the 2010 to 2015 period.

2-year bond yield spread consistent with CAD 1.20 per USD

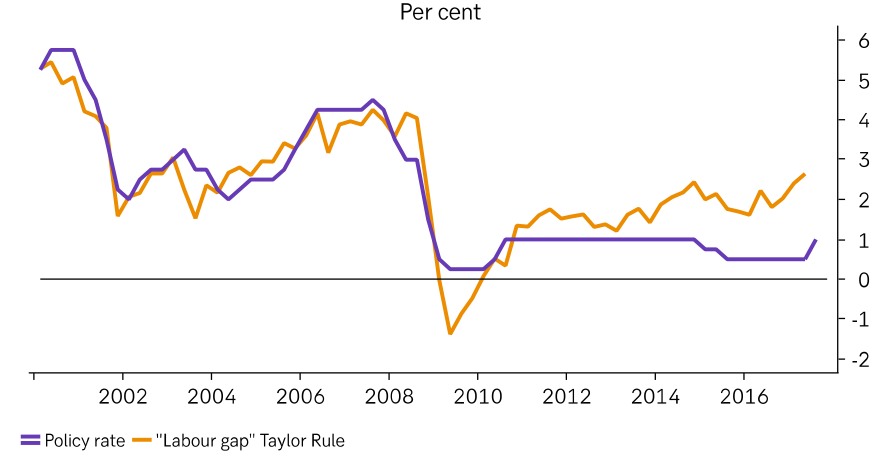
2-year government bond yields, per cent



Source: Bank of Canada, Macrobond Financial AB, Macrobond, SEB

BoC: Our Taylor rules say normalisation is long overdue

Per cent

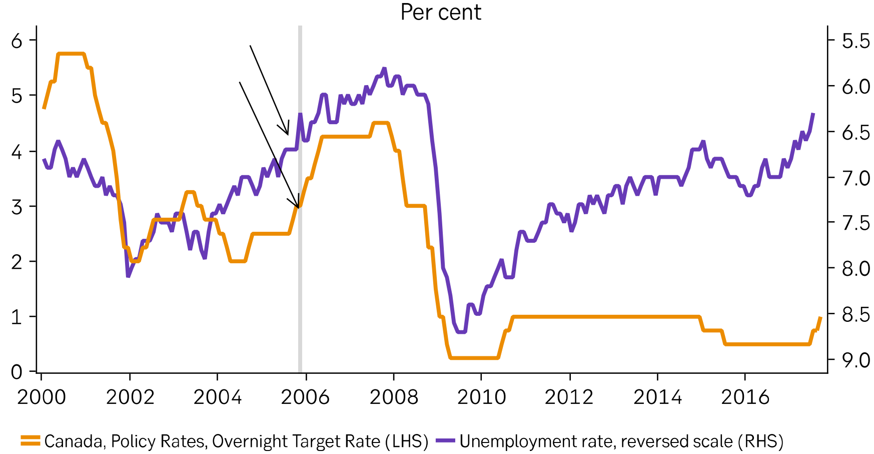


Source: Bank of Canada, Macrobond, SEB

BoC is doing old-school central banking

Low unemployment rate suggests rate normalisation urgency

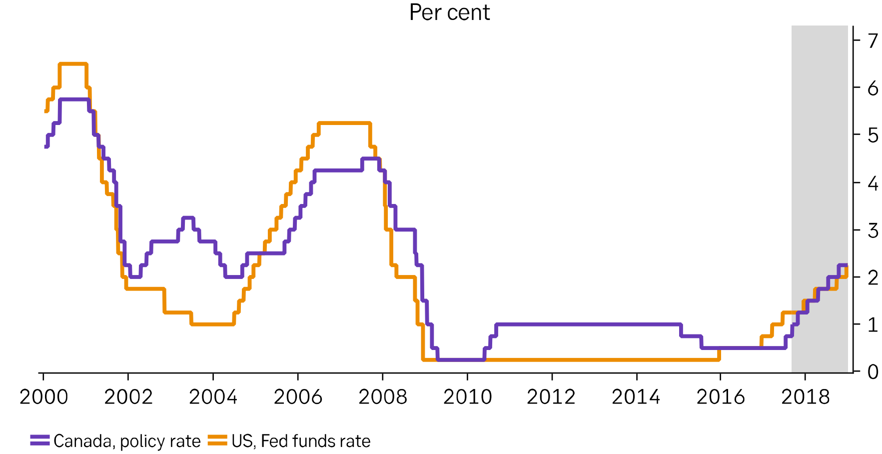
Per cent



Source: Statistics Canada, Bank of Canada, Macrobond, SEB

Bank of Canada vs the Federal Reserve

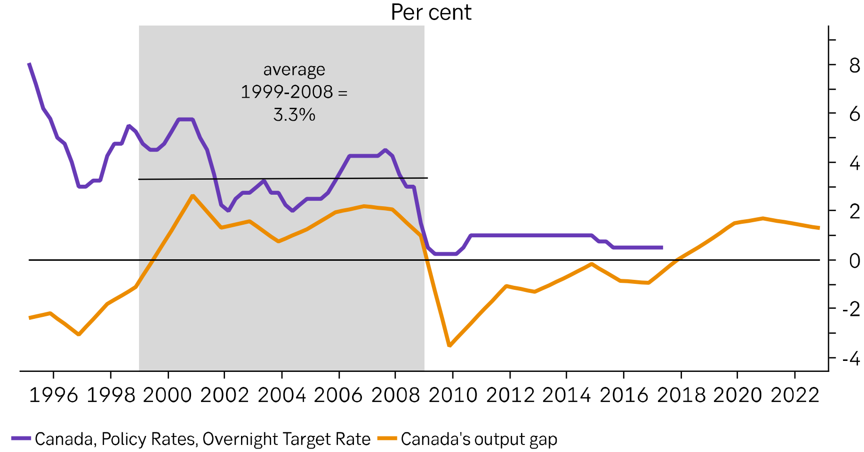
Per cent



Source: Bank of Canada, Macrobond, SEB

When Canada's output gap is closed, policy rates are high

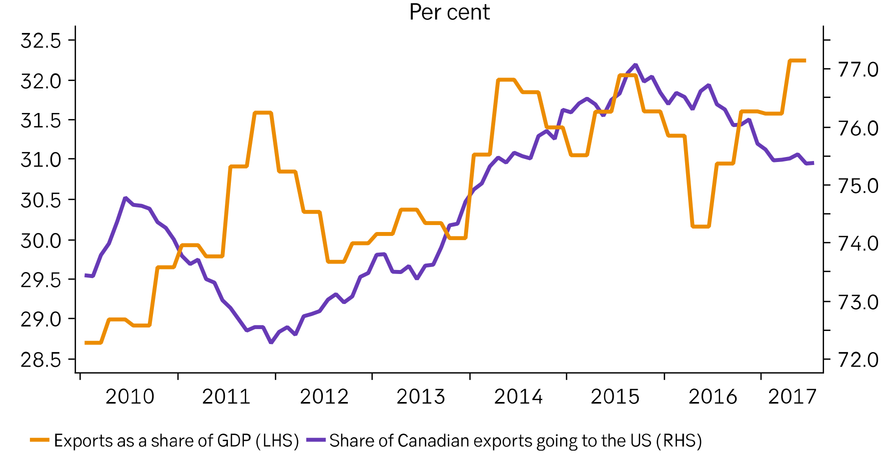
Per cent



Source: Bank of Canada, Macrobond, SEB

Most Canadian exports go south of the border

Per cent



Source: Industry Canada, Statistics Canada, Macrobond, SEB

Why is the BoC hiking rates but not the Riksbank?

A central bank can change its monetary policy strategy rapidly – just look at the Bank of Canada's actions this summer/autumn. **Growing sources of BoC concern:** the housing market and rising household debt. The risks to financial stability were highlighted despite record-low inflation figures; low inflation is probably temporary against the backdrop of a rapidly closing output gap in Canada.

Comparisons between Canada, Sweden and Norway are interesting. There are many similarities, such as social welfare systems and export dependence. Also the challenge of maintaining inflation targets in the shadow of dominant southern neighbours (Fed, ECB).

All three countries: tight resource situations, home prices that have increased fast and very high household debt ratios.

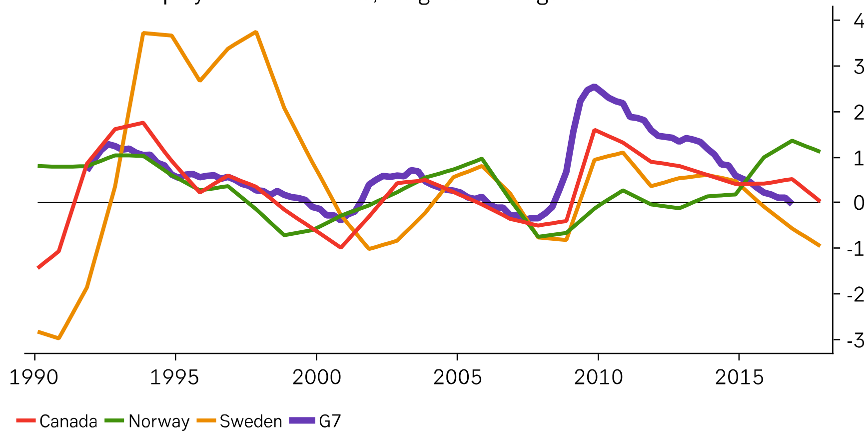
Home prices in Can, Nor, Swe are overvalued too according to **price-to rent ratios** (a measure of the profitability of owning a house) and **price-to-income ratios** (a measure of affordability).

On the inflation front, the differences are bigger. While Canadian inflation has declined, Swedish inflation is showing an upward trend and is currently above target. In Norway, meanwhile, inflation has been high but is now dropping below target.

The main conclusion is that **you don't find the answer why the BoC is hiking rates but not the Riksbank in economic data**; from the perspective of economic data, the Riksbank has the biggest reasons to hike while Norway's economy is still lagging. Clearly it is the ECB and fears of the SEK strengthening that are stopping the Riksbank, while Fed hikes are making it easier for the BoC to normalise its rates.

The labour market gaps are closing

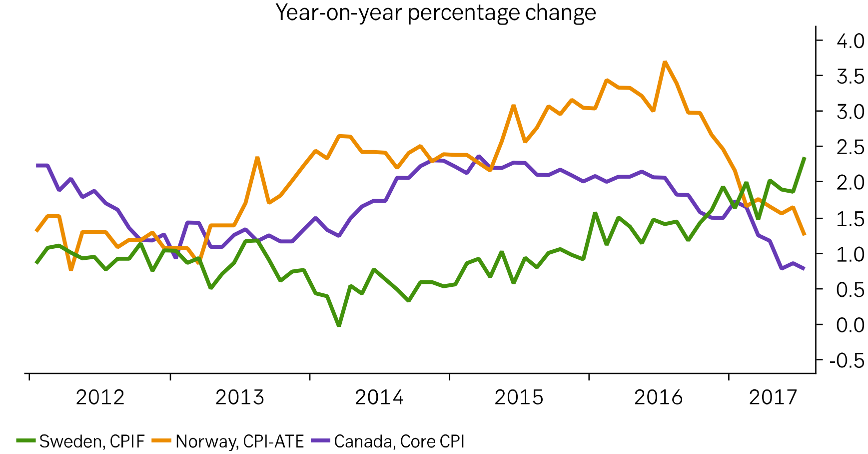
Unemployment less NAIRU, weighted average based on PPP for G7



Source: OECD (Organisation for Economic Co-operation & Development), Macrobond, SEB

Diverging inflation trends

Year-on-year percentage change

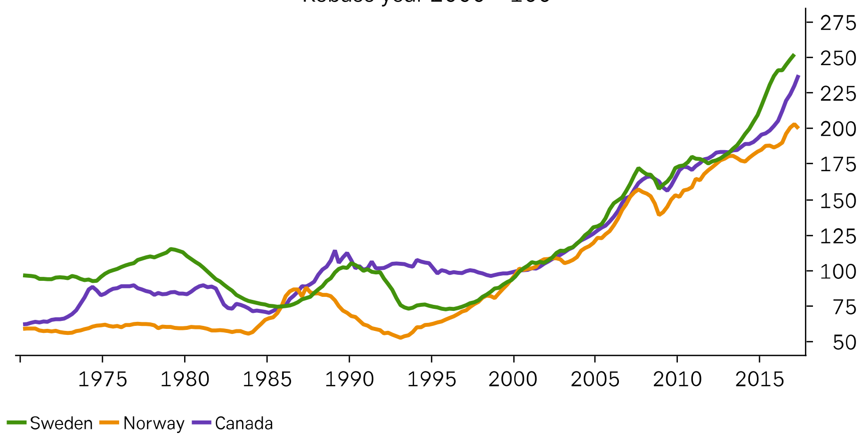


Source: Statistics Canada, Statistics Norway, Statistics Sweden (SCB), Macrobond, SEB

Why is the BoC hiking rates but not the Riksbank?

Real home prices

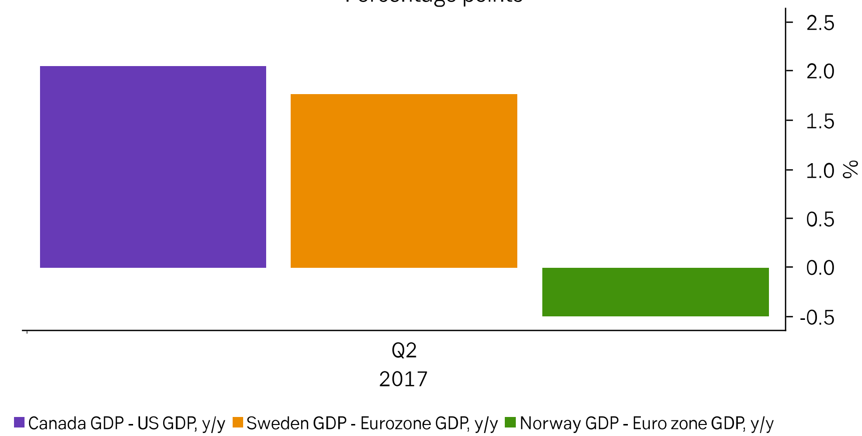
Rebase year 2000 = 100



Source: OECD Economic Outlook, Macrobond, SEB

Sweden/Canada have superior GDP growth performance

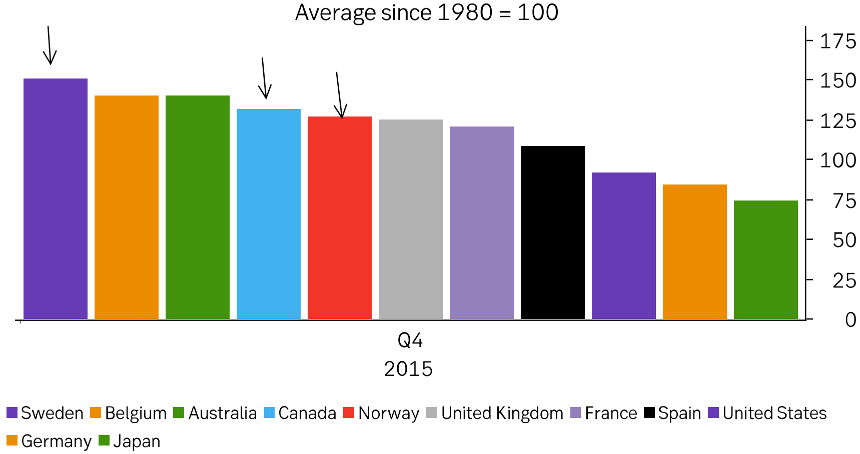
Percentage points



Source: Statistics Canada, Statistics Sweden (SCB), Statistics Norway, Macrobond, SEB

Home price-to-income ratios

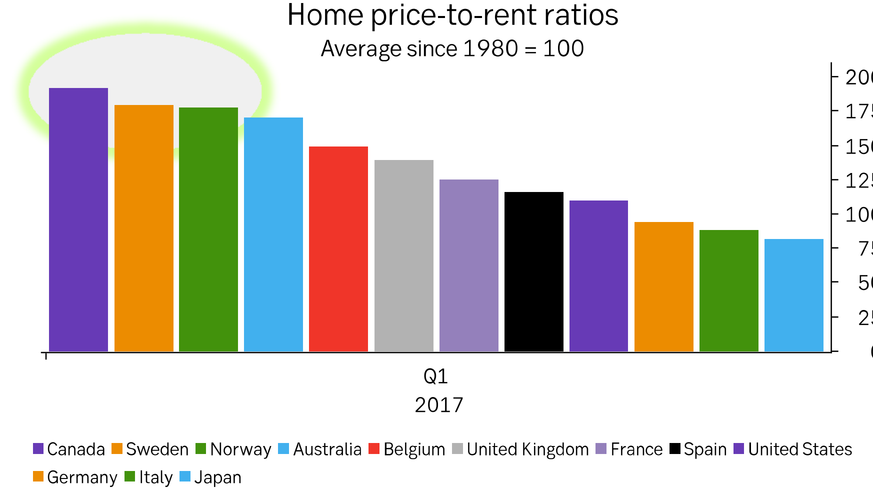
Average since 1980 = 100



Source: OECD Economic Outlook, Macrobond, SEB

Home price-to-rent ratios

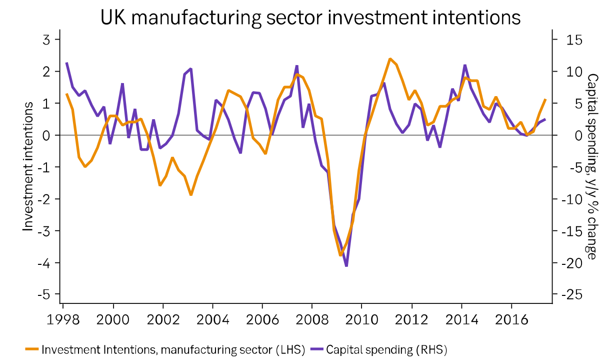
Average since 1980 = 100

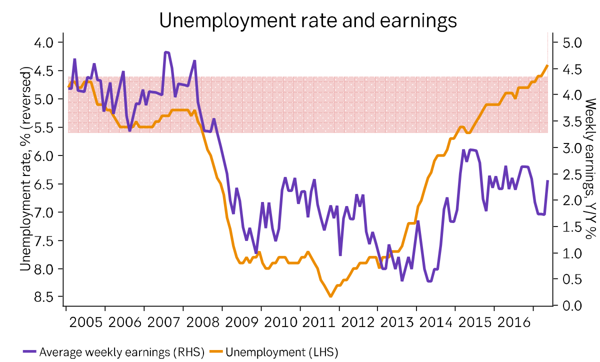


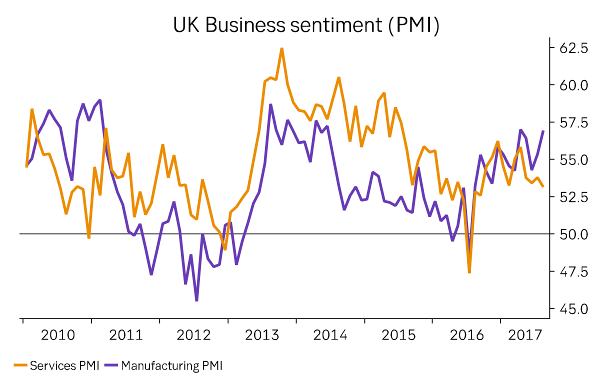
Source: OECD Economic Outlook, Macrobond, SEB

UK economy: Not completely gloomy

- We have been very negative about the outlook for the British economy since the United Kingdom voted to leave the EU. However, it is not just related to negative effects from expectations of lower exports and falling investments. It is also related to the household sector, where spending is being squeezed by falling real wages, already low savings and a slowdown in the housing market. Much of this has already materialised, and in recent months pundits have lowered their outlook for growth.
- However, there are some positive signs as well:
  - ✓ The UK **labour market** remains solid; new jobs are being created and participation is increasing. Unemployment has dropped to 4.4%, which is the lowest level since the early 70s => if you want to work, you will find a job.
  - ✓ GBP weakness and solid growth in the euro area seem to be boosting export demand. This is probably why **manufacturing sentiment** has increased to its highest level since 2014, while sentiment in the service sector is at an acceptable level.
  - ✓ However, most surprisingly, **investment intentions** in the manufacturing sector have picked up significantly since the end of last year. Usually this is a good predictor of capital spending and suggests that investments will grow faster going forward.
- The economy has surprised on the downside since the beginning of the year. However, more recently outcomes have been more aligned with expectations. This suggest that sluggish growth and uncertainty are already discounted. Of course, if the economy should take a turn for the worse it will not stop further GBP weakness, but a lot is already priced. Should the economy improve, which is not so unlikely, this is likely to feed into a stronger GBP.







Brexit negotiations: What is going on?

What is going on in the negotiations?

- In the last week of August, the EU and the UK met for **the third round** of exit negotiations. Previous rounds had focused on discussing the forms of the negotiations. Negotiations will be structured **in two phases** , beginning with withdrawal terms and followed by negotiations on the future EU-UK relationship as soon as there is sufficient progress in phase 1.
- UK is now open to working indirectly with the European Court of Justice and publicly acknowledges that it will pay an exit bill to the EU. **A transitional deal** is now favoured, perhaps featuring ongoing membership of the customs union, and there is less talk about bespoke trade deals. Still, there is virtually no movement on **how large the financial settlement should be**.
- After criticism for being unclear, and possibly in order to speed up negotiations on the future relationship, the UK government has **published several position papers** on future customs arrangements and on the future border between the Republic of Ireland and Northern Ireland.
- The British prime minister, Theresa May, is **hungry for new trade agreements** with non-EU countries to show the benefits of Brexit. However, for instance Japan told her that **negotiations with the UK will be difficult** until there is clarity about its future relationship with the EU.
- In late September **PM May will give a speech** that will try to speed up the tempo of Brexit negotiations by explaining how a raft of position papers published by the government offers a vision of a "deep and special partnership" with the EU.

Phase II: A new deal between EU & UK

This phase will be allowed to negotiate by the European council only **when SUFFICIENT PROGRESS has been achieved** in withdrawal negotiations.

An agreement on future relationship can only be concluded once the UK has become a third country => negotiate an **overall UNDERSTANDING ON THE FRAMEWORK** for the future relationship

Negotiations to determine **TRANSITIONAL ARRANGEMENTS** to provide for bridges towards the framework for the future relationship

An ambitious **FREE TRADE AGREEMENT** and a customs agreement between the EU and UK, BUT it can never amount to participation in the single market.

Partnership in other areas and in particular in the fight against terrorism, international crime, security and defence

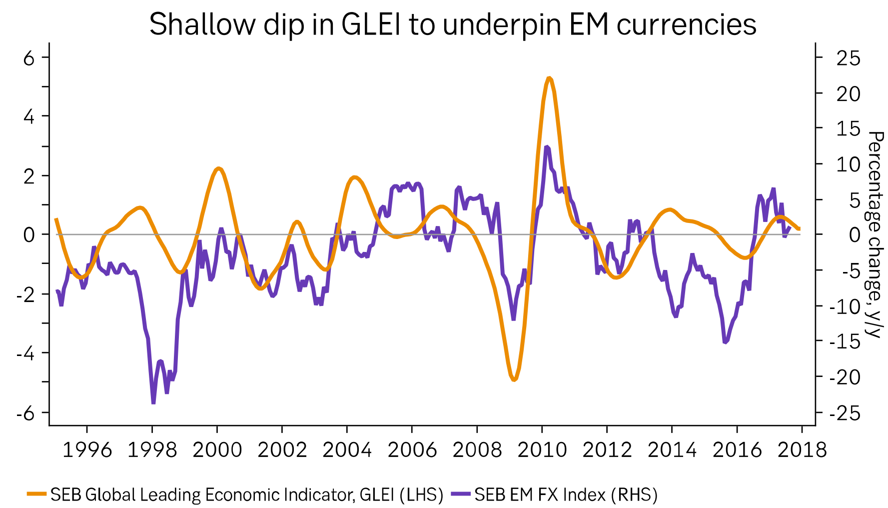
SEB

EM FX: No repeat of 2013 taper tantrum

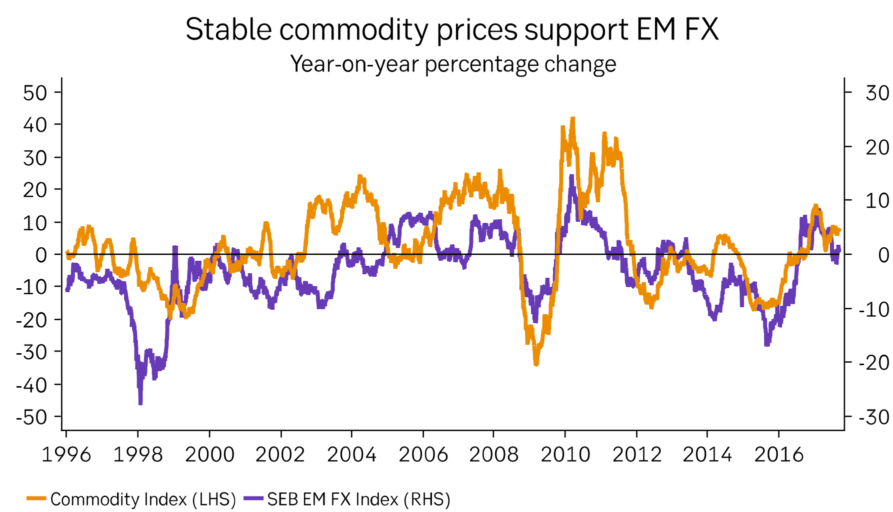
EM CURRENCIES CAN HANDLE ECB, FED TIGHTENING
Some time this autumn, the ECB will announce its plans for how to roll back its QE programme, while the US Fed will continue its tightening cycle. The mere mention of the possibility of Fed tapering in May 2013 triggered a sharp selloff in EM assets, but this time is different. While EM currencies have recovered since their lows in January 2016, they are well below levels in 2013, suggesting that their downside potential is limited now. More importantly, the global economy is on a recovery path. World GDP growth (PPP basis) will accelerate to 3.8% in 2017 from 3.1% in 2016 and EM growth to 4.9% from 4.3%. In addition, current account deficits have narrowed, suggesting more balanced EM economies than in 2013 and less vulnerability to capital outflows. Lastly, EM inflation will edge up but stay low by historical standards, with a few exceptions, keeping capital flowing into local bonds.

ONLY SMALL DRAG BY COMMODITIES ON EM
As a result of a rising number of IT companies in developing countries, EM equities are less dependent on commodities. Yet commodities and the weather remain key for EM GDP growth and consequently for the FX and bond markets. We expect an increasing supply of metals (especially iron ore) and food to be only partially offset by rising demand, keeping prices subdued. Nevertheless, with global growth picking up, commodity prices will be rising gradually or sustained around current levels.

VALUATIONS NO LONGER CHEAP, BUT NOT EXPENSIVE Our EM FX index (20 EM currencies against a basket of USD, EUR, JPY, GBP and CHF) has appreciated almost 12% since its trough in January 2016 but has a long way left to 2013 levels. EM local and hard currency bonds have seen a similar trend, albeit disrupted



Source: Macrobond, SEB



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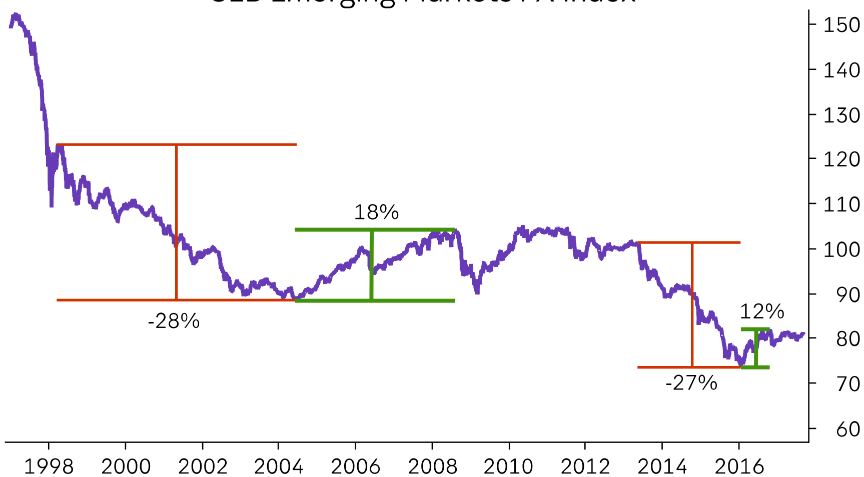
Propitious environment for EM carry

SEB Emerging Markets FX Index



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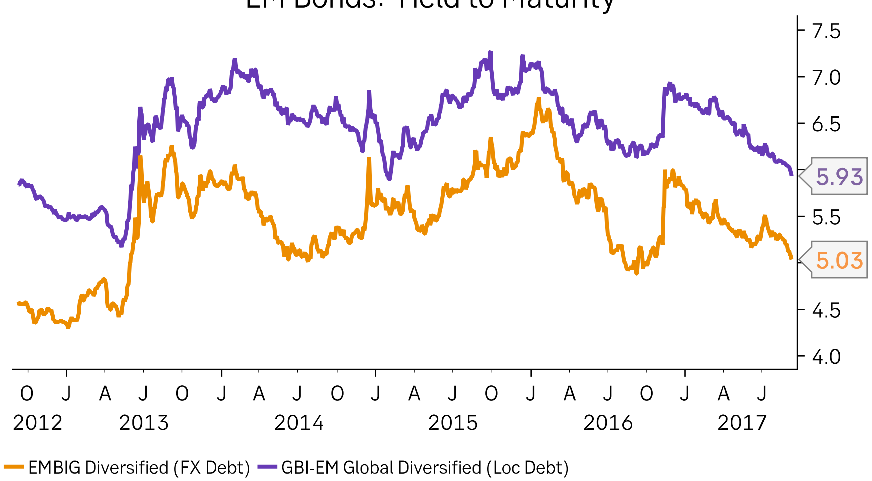
by the election of Donald Trump. EM equities have started to catch up to their developed market (DM) counterparts on the back of large non-resident capital flows into EM equities, but estimated forward earnings-to-price ratios remain below their 10-year average compared to DM equivalents. In sum, with a very slow policy normalisation in the US and the euro area, and with EM yields and growth prospects looking favourable, EM assets will perform well.

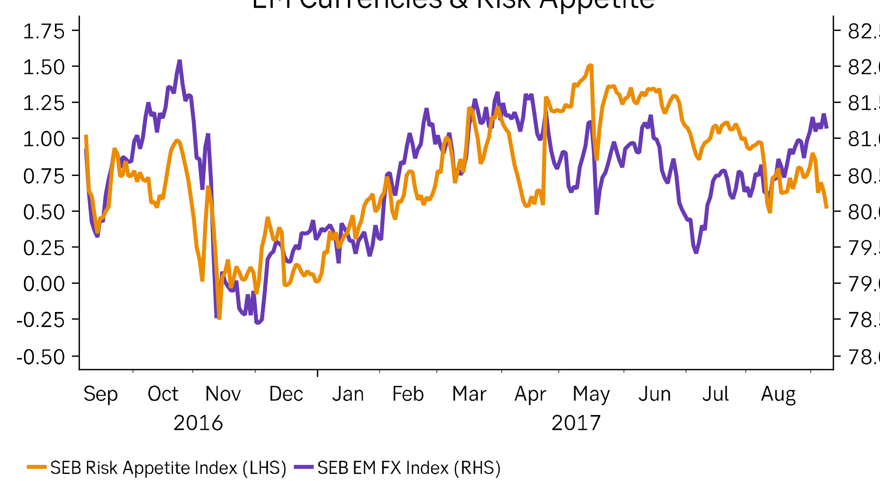
The key risk to our bullish EM outlook is a sharper-than-expected slowdown in China, potentially as a result of policy mistakes when the economy goes from being driven by exports and investments to services and consumption. Signs of sharply accelerating wage inflation in the US and Europe followed by a hawkish turn in Fed and ECB policies and a spike in real rates are other serious potential risks.

EM Bonds: Yield to Maturity



Source: JP Morgan, Macrobond, SEB

EM Currencies & Risk Appetite



Source: Macrobond, SEB

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