

EMEA Weekly

Dramatic escalation of geopolitical fears

Centre of attention moves to Crimea

This week there has been a sharp increase in geopolitical tension on the back of the violent in recent weeks and particularly since the Ukrainian parliament voted to oust President Viktor Yanukovich at the weekend and appointed a new caretaker president and a new government ahead of presidential elections, which are now scheduled to be held in May.

As we pointed out in *Flash Comment Ukraine – geopolitical risks increase*, the events over the weekend sharply increased geopolitical risk and we expected the focus of the markets to turn to eastern Ukraine and the peninsula of Crimea. The events this week have confirmed this.

We also note that most of the population in Crimea is ethnic Russian and many hold a Russian passport. During the Russian-Georgian conflict in 2008, fears about increased separatist sentiment in Crimea increased tensions between the then Ukrainian government and Russia. These concerns have now returned. This morning a group of apparently pro-Russian armed men seized Crimea's regional parliament and the government headquarters of the Russian-majority region.

Yesterday, Russian President Vladimir Putin ordered tests of the combat readiness of Russian armed forces in western and central Russia and today the Russian Ministry of Defence said it had put its fighter jets on 'combat alert' on its western border.

The new Ukrainian government has reacted angrily to recent geopolitical events. Hence, Ukraine's interim President Olexander Turchynov has warned Russia against any 'military aggression' in Crimea.

The clear escalation of the geopolitical situation is now having a very clear impact on not only the Russian and Ukrainian markets. Hence, over the past couple of weeks there has been some contagion – so far fairly moderate – to other central and eastern European markets but, as of today, it seems that we are seeing an even broader spillover as fears of an armed conflict have increased.

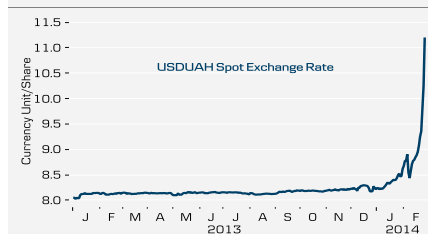
The Ukrainian hryvnia has fallen sharply this week and today alone it is down around 10% against the US dollar. The Ukrainian central bank has effectively stopped defending the hryvnia as it has more or less run out of foreign currency reserves. Furthermore, it is very clear to us that the banking sector has effectively stopped working in Ukraine and the country is close to default. Indeed, we think it is impossible to avoid a sovereign default unless the Ukrainian government receives foreign financial assistance. This is also reflected in the pricing of Ukraine's credit default swap.

The Russian rouble has also come under additional pressure. The rouble, which has been under pressure for some time and has lost some 20% in value over the past year, yesterday hit the weak end of the official fluctuation band against the basket of the euro and the US dollar.

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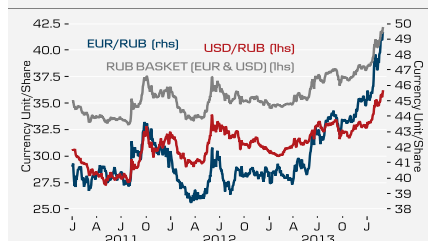
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Ukrainian hryvnia continues to weaken



Source: Macrobond

Russian rouble continues to slide



Source: Macrobond

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This morning USD/RUB reached 36.11 – a five-year high. The dual currency basket hit a record high of 42.11. The Russian central bank Bank Rossii has refrained from significant support of the rouble, intervening by around USD300m per day and shifting repeatedly up the rouble's trading band. We do not expect any significant turnaround in the rouble's rate this year or any significant support from Bank Rossii as the authorities believe the rouble's weakness helps the domestic economy.

As a direct consequence of recent events, we have changed our already very bearish forecast on the Ukrainian hryvnia to 15 against the dollar. This implies an almost 70% devaluation of the hryvnia compared with pre-crisis levels. We are also considering whether to revise our rouble forecast and it is obvious to us that there is considerable downside risk for the rouble if the geopolitical situation worsens further.

It is also obvious to us that these events have significant negative ramifications for both the Russian and Ukrainian economies.

Turkish corruption scandal just keeps getting worse

In November, a major corruption scandal broke in Turkey involving family members of key Turkish ministers and allies of Prime Minister Recep Tayyip Erdogan. This has thrown Turkey into the deepest political crisis in the country in more than a decade – some might even say decades.

This week the crisis took a new turn when the Turkish media released tapes of what appears to be Prime Minister Erdogan and his son speaking on the phone regarding the corruption scandal and making comments that are highly incriminating if true. Erdogan has said that the tapes are a 'fabrication' and claimed there is a conspiracy against him, his government and the country.

This has further increased political uncertainty in Turkey and we have already seen the first demonstrations against Erdogan this week and more demonstrations are planned.

Furthermore, there is widespread speculation in the Turkish media that more revelations could be on the way and some commentators have speculated that other tapes or even video footage might emerge ahead of local elections in Turkey in March. We have no knowledge about whether or not this will happen but it is very clear to us that Prime Minister Erdogan is under tremendous pressure to step down.

Not surprisingly, the Turkish markets have come under renewed pressure this week and it very hard to see what could turn sentiment around in the near term.

Slightly less colourful – NBP to keep rates on hold

Compared with the situation in Ukraine and Turkey, next week's Polish Monetary Policy Council meeting is likely to be somewhat less eventful. Hence, in line with consensus, we expect the Polish central bank to keep its key policy rate unchanged at 2.5%.

We have long argued that the NBP should ease monetary policy as inflation remains well below the NBP's official 2.5% inflation target. Indeed, the NBP itself forecasts inflation will remain below its inflation targets over the next couple of years. However, even though monetary easing clearly remains warranted in Poland, the NBP does not seem to have any intention of changing its monetary stance in a more dovish direction. Indeed, the communication from key monetary policymakers in Poland has been fairly hawkish recently.

Events in Poland's neighbour Ukraine might come up in connection with next week's monetary policy meeting but we doubt that this will be a major issue.

Calendar

EMEA Data and Events in Week 10

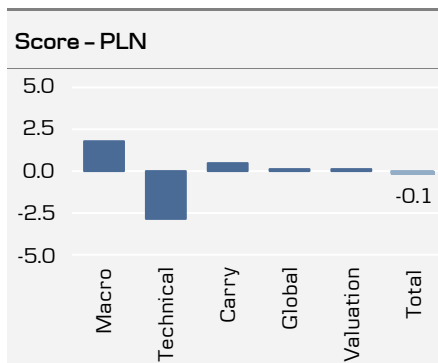
Monday, March 3, 2014				Period	Danske Bank	Consensus	Previous
CZK	-	Budget balance	CZK bn.	Feb			45.0
ZAR	-	Naamsa vehicle sales	y/y	Feb			-3.6%
RUB	6:00	PMI	Index	Feb			47.99
TRY	9:00	PPI	y/y	Feb			10.72%
TRY	9:00	CPI	y/y	Feb			7.75%
TRY	9:00	PMI	Index	Feb			52.67
PLN	9:00	PMI	Index	Feb			55.4
HUF	9:00	PMI	Index	Feb			57.9
CZK	9:30	PMI	Index	Feb			55.9
ZAR	10:00	PMI	Index	Feb			49.9
Tuesday, March 4, 2014				Period	Danske Bank	Consensus	Previous
RUB	-	CPI (4-5 Mar)	y/y	Feb			6.1%
RON	9:00	Retail sales	y/y	Jan			4.8%
Wednesday, March 5, 2014				Period	Danske Bank	Consensus	Previous
PLN	-	Monetary Policy Council meets	%		2.50%		2.50%
HUF	9:00	Retail trade	y/y	Jan			1.8%
RON	9:00	GDP (final)	y/y	4th quarter	5.2%		4.1%
HUF	14:00	Hungarian central bank releases Minutes from monetary-policy meeting					
Thursday, March 6, 2014				Period	Danske Bank	Consensus	Previous
HUF	9:00	Industrial production	y/y	Jan			4.4%
CZK	9:00	GDP (final)	y/y	4th quarter	0.8%		-1.2%
Friday, March 7, 2014				Period	Danske Bank	Consensus	Previous
RUB	-	Trade balance (7-11 Mar)	USD bn.	Jan			15.8

Note: The editors do not guarantee the accuracy of the figures, hours or dates stated above

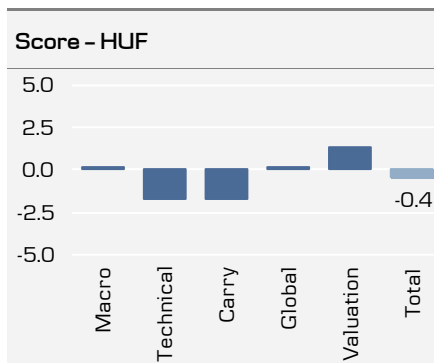
All release times are CET

Source: Danske Bank Markets

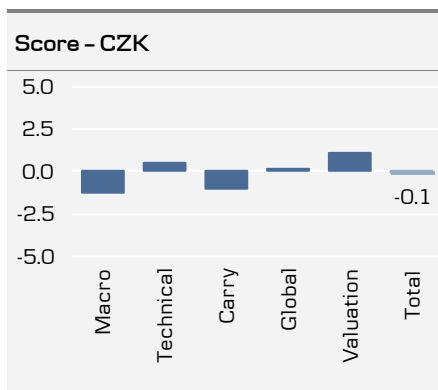
EMEA FX scorecard overview



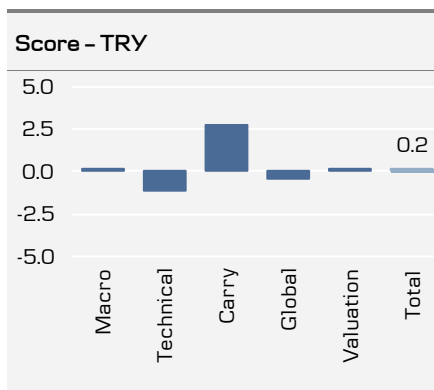
Source: Danske Bank Markets calculations



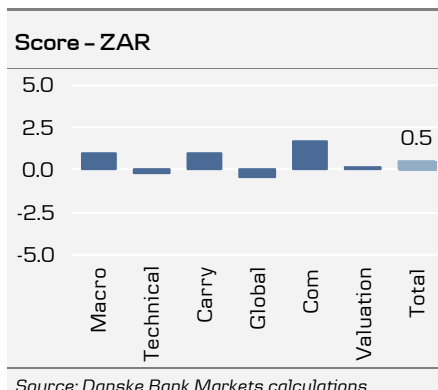
Source: Danske Bank Markets calculations



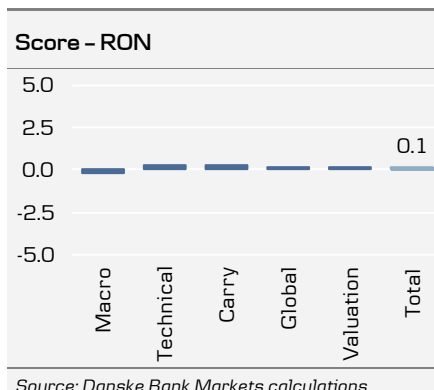
Source: Danske Bank Markets calculations



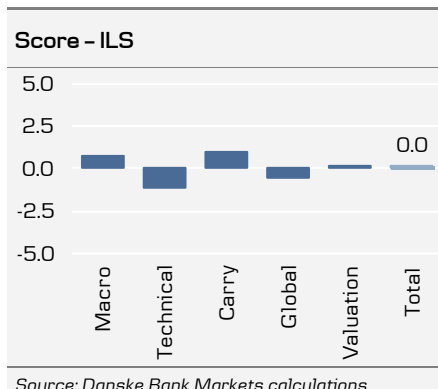
Source: Danske Bank Markets calculations



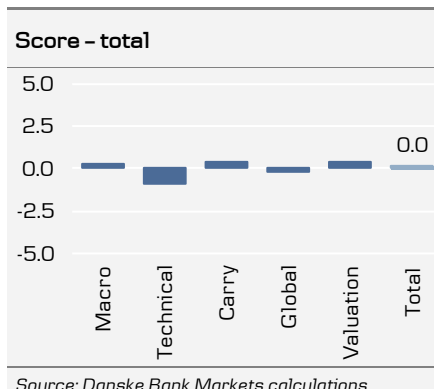
Source: Danske Bank Markets calculations



Source: Danske Bank Markets calculations



Source: Danske Bank Markets calculations



Source: Danske Bank Markets calculations

EMEA FX scorecard outline

- All scores are computed on a scale from +5 to -5. A score is then derived by combining the different sub-scores.
- **Macro:** calculates the growth momentum in different monthly macro indicators.
- **Technical:** calculates the momentum in different volatility measures, short- and longer term moving averages and the level of the relative strength index.
- **Carry:** calculates the momentum in local three-month rates, carry-to-risk, spread versus EUR or USD three-month rates and spread versus peers.
- **Global:** consists of a global growth score based on leading global indicators, a liquidity score based on G3 real rates and a sentiment score based on performance in global equity markets and traditional funding currencies.
- **Valuation:** calculates whether currencies are over/undervalued compared with the long-term trend in the real effective exchange rate (REER). The trend is adjusted for external imbalances, i.e. an imbalance-adjusted REER. The scores are calibrated to reflect the short-term impact of the valuation on FX.

Currency forecasts, EMEA

Currency forecasts, EMEA						
Feb 27, 2014		EUR	USD	SEK	NOK	DKK
USD	Actual	1.37	-	653	605	546
	+3m	1.34	-	657	612	557
	+6m	1.30	-	669	623	574
	+12m	1.26	-	675	635	592
PLN	Actual	4.18	3.06	214	198	179
	+3m	4.20	3.13	210	195	178
	+6m	4.20	3.23	207	193	178
	+12m	4.25	3.37	200	188	176
HUF	Actual	311	227	2.87	26.63	2.40
	+3m	315	235	2.79	2.60	2.37
	+6m	310	238	2.81	2.61	2.41
	+12m	305	242	2.79	2.62	2.45
CZK	Actual	27.4	20.0	32.6	30.3	27.3
	+3m	27.7	20.7	31.8	29.6	26.9
	+6m	28.0	21.5	31.1	28.9	26.6
	+12m	28.5	22.6	29.8	28.1	26.2
LTL	Actual	3.45	2.53	258	240	216
	+3m	3.45	2.57	255	238	216
	+6m	3.45	2.65	252	235	216
	+12m	3.45	2.74	246	232	216
RON	Actual	4.50	3.29	198	184	166
	+3m	4.45	3.32	198	184	168
	+6m	4.45	3.42	196	182	168
	+12m	4.45	3.53	191	180	168
BGN	Actual	1.96	1.43	456	423	382
	+3m	1.96	1.46	450	419	381
	+6m	1.96	1.50	445	414	381
	+12m	1.96	1.55	435	409	381
TRY	Actual	3.05	2.23	293	272	245
	+3m	2.88	2.15	306	285	259
	+6m	2.86	2.20	304	283	261
	+12m	2.84	2.25	299	282	263
RUB	Actual	49.46	36.2	18.0	16.7	15.1
	+3m	47.9	35.8	18.4	17.1	15.6
	+6m	48.8	37.5	17.8	16.6	15.3
	+12m	49.1	39.0	17.3	16.3	15.2
UAH	Actual	15.23	11.25	58.0	53.8	48.5
	+3m	20.10	15.00	43.8	40.8	37.1
	+6m	19.50	15.00	44.6	41.5	38.3
	+12m	18.90	15.00	45.0	42.3	39.5
ZAR	Actual	14.70	10.75	60.7	56.3	50.8
	+3m	14.87	11.10	59.2	55.1	50.2
	+6m	14.50	11.15	60.0	55.9	51.5
	+12m	14.36	11.40	59.2	55.7	51.9
ILS	Actual	4.80	3.51	185.9	172.4	155.5
	+3m	4.76	3.55	185.0	172.4	156.8
	+6m	4.62	3.55	188.5	175.5	161.6
	+12m	4.54	3.60	187.4	176.4	164.5

Source: Bloomberg, Danske Bank Markets

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