

Emerging Markets Monthly

Calming down - but yet another crisis looming for TRY

- **Stabilisation and mild strength across CEE in RUB, PLN, CZK and marginally HUF is largely playing out as expected.**
- **However, the Turkish central bank - and TRY with it - is playing with fire yet again.**

In general, data seem to be coming in on par with our base case of a deep recession in Q2 followed by a gradual rebound in H2. Notably, our view of stabilisation and mild strength across CEE in RUB, PLN, CZK and marginally HUF also appears to be playing out. However, TRY is going down a path where it could be flirting with yet another currency crisis within months.

USD/TRY spot might be going down an exponential path, as the central bank continues to lower nominal interest rates and it has burnt around one third of its gross FX reserve since March with this now standing at USD53bn, down from USD78bn in early 2020. The inflation outlook is what sets the market and the central bank (TCMB) apart, with the latter seeing a strong tapering of inflation pressures over the coming month.

While this may be a fair account of inflation-FX dynamics for developed economies, it is a rather shaky assumption in a high-inflation country. Indeed, when inflation is low (typically the case in DM), commodity prices are set to drive headline inflation; to some extent this may then spill into wage growth and thus core inflation. However, when inflation is high (such as the US in the 1980s, Turkey today, or Argentina), it is *not* commodity prices that matter.

Instead, high inflation becomes embedded in expectations and wage formation and thus ends up much stickier. In order to curb CPI, a very deep and prolonged recession will often be required. As such, it is essentially an erosion of the bargaining power for workers that is needed. In the Nordics, where union power is very strong (e.g. Sweden), this takes quite some time. However, in the case of Turkey, union power is minimal. Thus, if the recession is deep enough, it is not a problem to keep cutting rates because inflation will roll over by itself.

However, at the moment, the Turkish central bank seems increasingly to be front-running all of this. At this stage, it is not at all obvious that CPI will turn lower - but interest rates most surely will if recent central-bank actions are anything to go by. That leaves the central bank having to fight capital outflows to stem the TRY decline and mounting inflation pressure. At this point, in our view, we just need a small push in the wrong direction to lean into an outright currency crisis.

In sum, for a country like Turkey, the best way to ensure a stable currency is to aim for CPI stabilisation in the first part of a recession; this is in turn vital for the central bank in order to maintain financial stability. Only after a stable inflation path is ensured, lowering interest rates is a viable path. It goes without saying that the current Turkish path looks very unstable and we see a high probability of a currency crisis in coming months. That said, the TCMB strategy may still prove successful if broad EM sentiment turns strongly positive and the broad dollar starts declining. However, we do have our doubts when/if this will happen. While we may well end the year with USD/TRY in the low-to-mid 7s, overshooting near term seems highly likely right now.

Quick view

- EUR/PLN to see downward pressure as virus concerns in the global economy ease.
 - EUR/HUF continues to drift higher and HUF strength is likely to prove short-lived.
 - EUR/CZK has stabilised but near term likely sideways to slightly lower.
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- USD/RUB has likely overshot its fair value and we continue to be optimistic on RUB - 75.00 in 12M.
 - USD/TRY bid as TRY is on the verge of yet another FX crisis; TRY needs higher rates or that broad EM sentiment turns strongly.
 - USD/ZAR around 19-20 is probably enough for now; overshooting vs its nominal anchor and may give back a few figures over the coming year.
 - USD/CNY likely to range-trade around 7.0 as virus fears calm down in China.
 - USD/INR will likely move towards 72.00 when sentiment normalises.

Our most recent FX Forecast Update for G10 and EM can be found [here](#). See also our weekly *FX Essentials*.

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What-to-watch: growth (virus), commodity prices, US foreign policy and Fed

Global growth
We view global growth as very low and we are still in a phase of slowing down rather than picking up pace. The latter is likely H2.

US foreign policy
Given the US presidential campaign is starting up in earnest, we don't think the US will come up with major foreign policy changes, including harsh new sanctions against Turkey and Russia.

Fed Policy
Fed have cut interest rates substantially and are supporting the global economy. This has yet to suppress broad USD strength. Thus we view this as 'grey.'

Weak EMs
Many EM countries entered this crisis with low interest rates, weak growth and dysfunctional political situation. This will continue to run its course, especially in South Africa, Brazil and Turkey

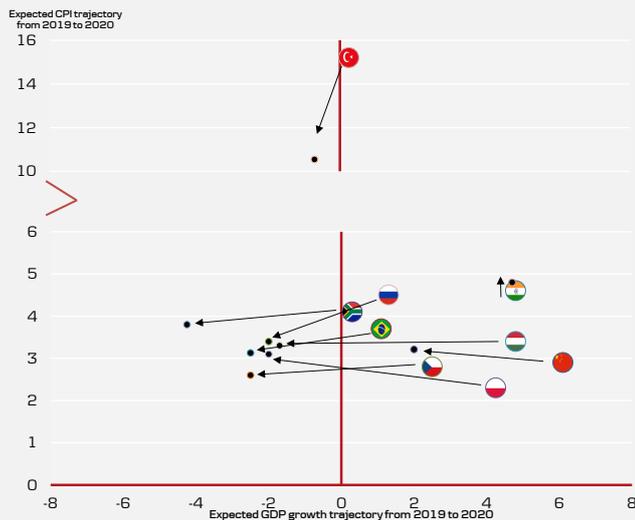
Note: Green reflects optimistic outlook, Red is negative and Grey is a neutral view. Source: Danske Bank

Near-term negative EM environment, but turn in store in H2 as virus woes fade

		2019				2020			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
External	China	weak	stimulus effects	trade uncertainty	improving macro	Coronavirus	Fading virus impact	Recovery post-virus	
	Fed	no hike		two cuts	one cut	Fed takes rates to zero, provides USD funding			
	Trade war/commodities	ceasefire	escalation		trade talks	phase 1 deal	phase 2 trade talks & cyclical uptick		
Regions	CEE	broad-based slowdown in CEE				stabilizing but inflation adds pressure			
	Latin America	significant growth downgrades			social turmoil	Brazil weak, Mexico in recession		stabilization	
	Asia	slowing		China drives recovery	Coronavirus	Fading virus impact	Recovery post-virus		

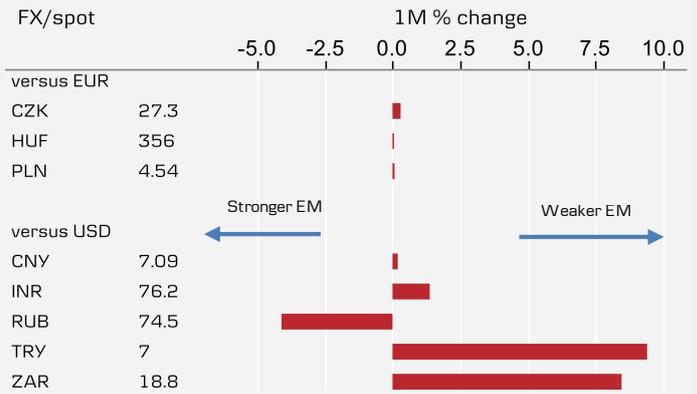
Note: Green reflects optimistic outlook, Red is negative and Grey is a neutral view. Colours reflect a broad macroeconomic view and not necessarily FX specific. Source: Danske Bank

Major EM revisions amidst a global recession



Note: Arrows indicate the change in Bloomberg consensus forecasts for growth and inflation from 2019 to 2020. Source: Bloomberg, Macrobond Financial, Danske Bank

TRY, ZAR stand out with continued weakness



Note: An increase reflects a stronger currency versus EUR or USD. Source: Bloomberg, Macrobond Financial, Danske Bank

Global activity taking a big hit from virus closures



Source: Bloomberg, Macrobond Financial, Danske Bank

Danske Bank EM FX forecast vs majors: USD, EUR

USD						
	Spot	+1m	+3m	+6m	+12m	
USD/PLN	4.183	4.17	4.08	4.11	4.07	
USD/HUF	328	320	321	336	341	
USD/CZK	25.160	24.77	24.77	24.77	24.53	
USD/RUB	74.496	73.00	72.00	70.00	70.00	
USD/TRY	6.996	6.90	7.00	7.20	7.50	
USD/ZAR	18.769	19.00	18.50	17.50	17.00	
USD/CNY	7.09	7.20	7.15	7.10	7.00	
USD/INR	76.16	78.00	78.00	74.00	72.00	
EUR						
	Spot	+1m	+3m	+6m	+12m	
EUR/PLN	4.535	4.55	4.45	4.40	4.35	
EUR/HUF	356	349	350	360	365	
EUR/CZK	27.275	27.00	27.00	26.50	26.25	
EUR/RUB	80.753	79.57	78.48	74.90	74.90	
EUR/TRY	7.584	7.52	7.63	7.70	8.03	
EUR/ZAR	20.345	20.71	20.17	18.73	18.19	
EUR/CNY	7.682	7.85	7.79	7.60	7.49	
EUR/INR	82.543	85.02	85.02	79.18	77.04	

Source: Danske Bank

Danske Bank EM FX forecast vs Scandies: DKK, SEK, NOK

DKK

	Spot	+1m	+3m	+6m	+12m
PLN/DKK	1.645	1.641	1.678	1.695	1.714
HUF/DKK	2.10	2.14	2.13	2.07	2.04
CZK/DKK	0.273	0.277	0.277	0.282	0.284
RUB/DKK	0.092	0.094	0.095	0.100	0.100
TRY/DKK	0.983	0.993	0.979	0.968	0.929
ZAR/DKK	0.367	0.361	0.370	0.398	0.410
CNY/DKK	0.971	0.952	0.958	0.982	0.995
INR/DKK	0.090	0.088	0.088	0.094	0.097

SEK

	Spot	+1m	+3m	+6m	+12m
PLN/SEK	2.38	2.42	2.47	2.55	2.57
HUF/SEK	3.03	3.15	3.14	3.11	3.07
CZK/SEK	0.40	0.41	0.41	0.42	0.43
RUB/SEK	0.13	0.14	0.14	0.15	0.15
TRY/SEK	1.42	1.46	1.44	1.45	1.40
ZAR/SEK	0.53	0.53	0.55	0.60	0.62
CNY/SEK	1.404	1.402	1.411	1.474	1.495
INR/SEK	0.131	0.129	0.129	0.141	0.145

NOK

	Spot	+1m	+3m	+6m	+12m
PLN/NOK	2.51	2.48	2.49	2.50	2.41
HUF/NOK	3.20	3.24	3.17	3.06	2.88
CZK/NOK	0.42	0.42	0.41	0.42	0.40
RUB/NOK	0.14	0.14	0.14	0.15	0.14
TRY/NOK	1.50	1.50	1.45	1.43	1.31
ZAR/NOK	0.56	0.55	0.55	0.59	0.58
CNY/NOK	1.481	1.440	1.424	1.448	1.402
INR/NOK	0.138	0.133	0.131	0.139	0.136

Source: Danske Bank

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