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FX Compass

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Santander GLOBAL CORPORATE BANKING

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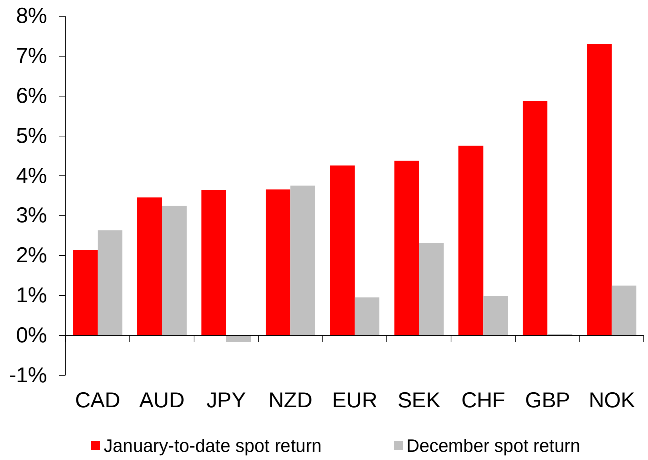
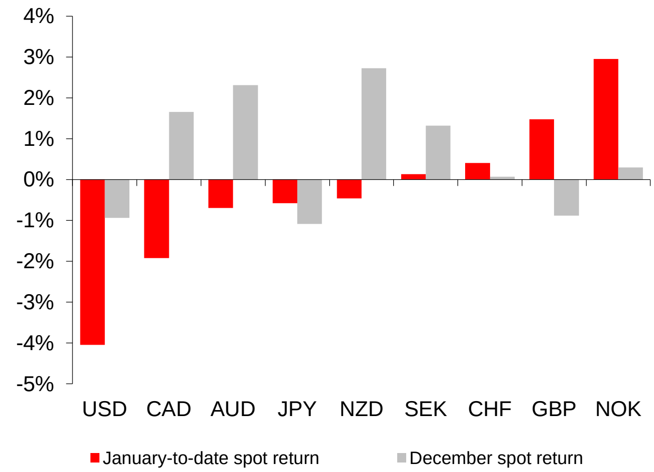
FX Spot Returns

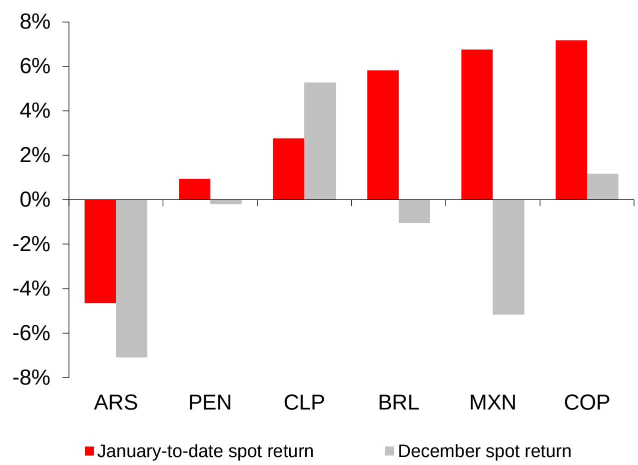
G10 spot returns vs. USD



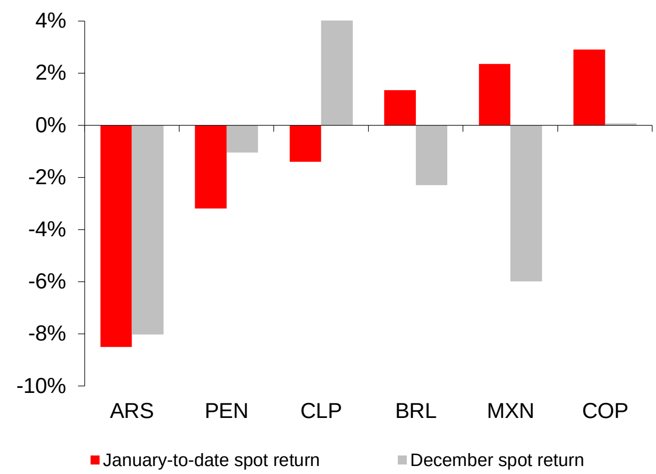
G10 spot returns vs. EUR



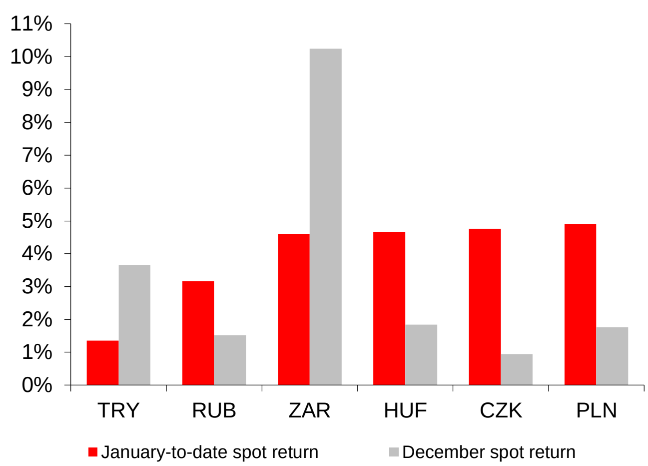
LatAm spot returns vs. USD



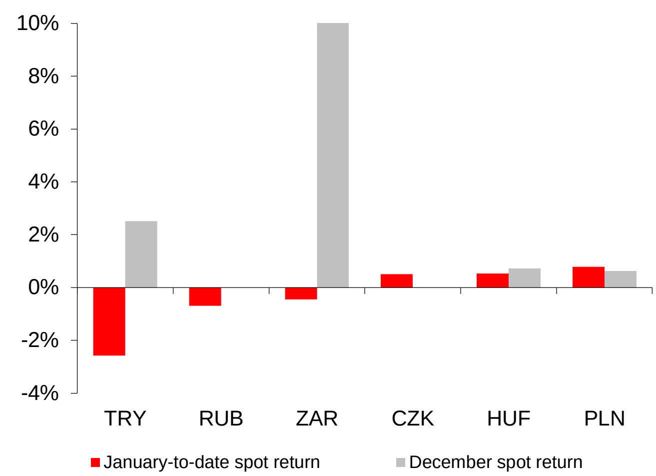
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 25 January 2018 at 15:30 GMT

FX Forecasts

G10 FX Forecasts

	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19
EUR-USD	1.21	1.22	1.24	1.26	1.22	1.24
GBP-USD	1.39	1.36	1.34	1.32	1.32	1.33
GBP-EUR	1.15	1.11	1.08	1.05	1.08	1.07
EUR-GBP	0.87	0.90	0.93	0.95	0.92	0.93
USD-JPY	114	116	117	118	120	122
EUR-JPY	138	142	145	149	146	151
USD-CNY	6.40	6.60	6.65	6.70	6.80	6.70
EUR-CHF	1.16	1.17	1.18	1.20	1.22	1.23
USD-CHF	0.96	0.96	0.95	0.95	1.00	0.99
EUR-SEK	9.6	9.5	9.3	9.0	8.8	8.6
EUR-NOK	9.2	9.1	9.1	9.0	8.9	8.7
USD-CAD	1.25	1.24	1.24	1.22	1.22	1.20
AUD-USD	0.78	0.76	0.76	0.77	0.79	0.80
NZD-USD	0.72	0.70	0.71	0.72	0.74	0.76

LatAm FX Forecasts

	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19
USD-BRL	3.28	3.38	3.50	3.50	3.40	3.30
USD-MXN	20.0	20.8	18.4	18.2	18.3	18.5
USD-CLP	605	605	615	630	625	620
USD-COP	2900	3000	2950	3000	2950	2900
USD-ARS	18.8	19.9	20.9	22.0	22.6	23.3
EUR-BRL	3.97	4.12	4.34	4.41	4.15	4.09
EUR-MXN	24.2	25.4	22.8	22.9	22.3	22.9
EUR-CLP	732	738	763	794	763	769
EUR-COP	3509	3660	3658	3780	3599	3596
EUR-ARS	22.7	24.2	26.0	27.7	27.6	28.8

CEE FX Forecasts

	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19
EUR-PLN	4.22	4.25	4.28	4.22	4.26	4.25
EUR-CZK	25.7	25.6	25.5	25.4	25.3	25.2
EUR-HUF	308	302	300	300	300	295
USD-RUB	56	55	53	52	52	52
EUR-RUB	68	67	66	66	63	64

Sources: Santander, Bank Zachodni Wbk

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	↗	↗	• The USD has continued to be sold at the start of 2018. Political issues are weighing on the currency, despite the outlook for USD-positive rate hikes • In addition, the US economy remains strong and set to outperform its peers, with inflation also higher in the US than many developed economies
EUR	↘	⇨	• The weak USD has helped pull EUR/USD higher. Hence, we have revised up our forecast profile • But our central scenario is unchanged. We feel that further EUR gains are hard to justify given the interest rate and growth gap with the US
GBP	↘	⇨	• The Pound has strengthened as the market appears willing to look beyond Brexit risks. Hence, our GBP forecast profile has been revised higher • But growth is slowing, we do not expect BoE a rate hike, Brexit concerns have not disappeared and further gains depend on the USD staying weak
JPY	↓	↓	• USD/JPY has recently been pulled lower by a strong USD and speculation that the BoJ may run a less loose monetary policy • But the BoJ confirmed that it will continue firmly with stimulus and the 0% JGB target, which, with US rate hikes, should weaken the Yen
CNY	↘	↘	• We expect USD/CNY to strengthen in 2018, as policymakers continue to focus on controlling financial risks and if US protectionist rhetoric mounts • Further, USD/CNY should garner support from expectations that the Fed will hike rates again by the end of the year
CHF	↘	↘	• The CHF remains “high”, but EUR/CHF has appreciated on the back of a stronger EUR/USD • The SNB’s CPI estimates indicate inflation remaining low over the coming year, so policy should remain loose, and CHF-negative
SEK	↑	↗	• Strong Swedish growth and upbeat inflation should encourage the Riksbank to hike rates in H2-18 (before the ECB), and boost the SEK • The property market is a potential stability risk, but cooling house prices are largely due to increased supply. The Riksbank expects a soft landing
NOK	↑	↗	• Despite a solid December/January, we continue to see the NOK as undervalued given current oil prices • The Norges Bank is unlikely to hike rates in 2018, but the prospect of hiking before the ECB does should support the currency against the EUR
AUD	↘	⇨	• AUD/USD rallied on a weaker USD in late 2017 and early 2018, but interest rate differentials suggest the pair is overbought • In February, the RBA is set to hit a record of 16 consecutive meetings with unchanged rates. Low wage growth implies limited CB support for the AUD
NZD	↘	⇨	• NZD/USD has rallied in recent months, but this is mainly due to USD weakness. The pair will likely continue to move off the USD in February • The RBNZ is unlikely to change its stance at its next two meetings, leaving the market to shift its focus to incoming Governor Orr (from 27 March)
CAD	⇨	↗	• The CAD should remain firm following BoC rate hikes, but more short-term gains may be hard to find if the Fed hikes US rates • A firm oil price should support the CAD, but may not be enough to pull it higher by itself amid concerns over NAFTA talks and export growth

↑ Bullish ↗ Mildly Bullish ⇨ Neutral ↘ Mildly Bearish ↓ Bearish

Source: Santander.

G10 FX Overview

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We still think that the market is too negative on the USD. US political concerns are a clear negative for the currency, as are signs that the administration is not bothered by a strong USD. But, the mix of a strong economy, higher interest rates and wider policy divergence to its peers, should, in our opinion, provide support.

The EUR has continued to strengthen in January, or the USD weakened! We have revised slightly higher our forecast profile for 2018, to reflect higher spot. We expect EUR/USD at 1.21 in Q1, up from 1.15, 1.22 at end H1 up from 1.17 and 1.26 at the end of 2018.

The Pound has posted a big recovery over the last few months. We are sceptical about whether this will continue, and still see it as vulnerable. However, the jump in the spot level has forced a revision to our forecast profile. We now expect GBP/USD at 1.39 in Q1, up from 1.30, 1.36 at end H1 up from 1.28 and 1.32 at the end of 2018.

We think the Yen has been overbought. Moderate economic recovery continues. However, monetary policy remains loose, and should remain so, as long as inflation remains off of the 2% target. Hence, the JPY looks too expensive given yields and equities/risk. Plus, the prospect of more US rate hikes in 2018 should pull USD/JPY higher.

We favour a firmer USD/CNY in 2018. But, the forecast profile has been reduced to reflect a weaker start to the year due to dollar weakness. Whilst GDP data exceeded expectations in Q4-17, the risk remains that policymakers efforts to reduce debt and the risk of a more protectionist trade policy from the US, will weigh on the CNY.

The CHF bias remains to the downside. The SNB still views it as ‘highly valued’, the Bank remains prepared to intervene to weaken it, and is unlikely to increase interest rates before the ECB. But, further CHF losses against the EUR will depend on the EUR continuing to strengthen; particularly as robust Swiss data is offering support.

The SEK should rise in 2018. Strong growth and CPI imply rate hikes in H2. Interest rate differentials may pull EUR/SEK lower. We still forecast EUR/SEK as falling to 9.0 by year-end, but have lifted our near term forecasts, as SEK gains have slowed in early 2018

We favour NOK gains in 2018. The economic outlook is brighter and the currency looks cheap given the oil price. The Norges Bank looks likely to hike before the ECB. EUR/NOK has fallen by over 4% since December, but we still consider the cross overbought. We continue to forecast EUR/NOK falling to 9.0 by year-end.

We are not keen on the AUD in H1-18. Employment data are improving, but wage growth is low. The RBA is set to keep rates on hold in February. We see downside risks for AUD/USD in 2018, but given the USD move, now see the pair at 0.78 in Q1-18 (from 0.76).

A mildly negative view prevails for NZD, as the currency’s rise in recent months looks overdone. We have lifted our Q1-18 NZD/USD forecast to 0.72 (0.70 previously), in light of the USD weakness, but still see the pair at 0.73 in Q4-18.

We retain a positive outlook for the CAD in 2018. A firm oil price and more BoC rate hikes should offer support. But NAFTA/export uncertainty remains a risk. Hence, gains versus the USD may be gradual, focussed on H2-18 and vulnerable to USD strength as the Fed hikes rates.

USD – Enough is enough?

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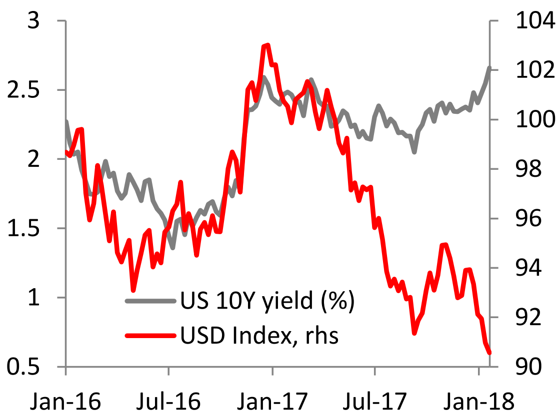
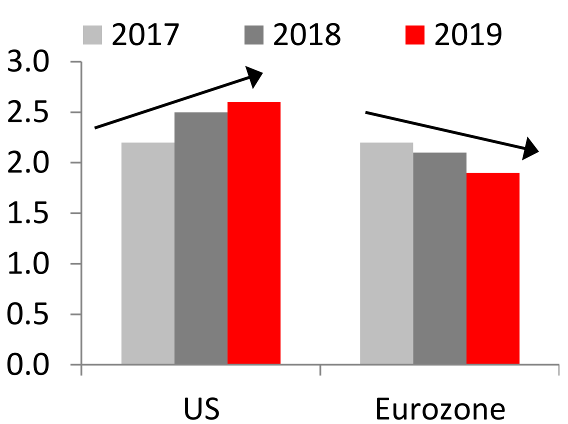
Chart 1: Yields and spreads just don't seem to matter anymore



Source: Bloomberg, Santander

Chart 2: Santander GDP forecasts: US v Eurozone



Source: Bloomberg, Santander

We still think that the market is too negative on the USD. US political concern, evidenced by the brief government "shutdown", is a clear negative for the currency, as are signs that the administration is not too bothered by a weak USD. But, the combination of a strong US economy, higher US interest rates and wider policy divergence vs. its peers, should provide support.

The USD has started 2018 in much the same way as it ended 2017, namely weak. The dollar is down against all of its developed-market peers so far in January. Indeed, the small gains that it posted against the JPY and GBP in December have more than reversed. Consequently, the momentum trade still appears to sell the USD. Indeed, in January, the dollar has only posted gains in excess of 0.1% against the Argentine peso. In our opinion, such USD pessimism appears excessive and at odds with the fundamental and monetary policy backdrop.

We are not suggesting that there is no justification for the market's USD negativity. Concerns over the political and policy outlook persist, as is clearly reflected by the administration's failure to agree a funding plan on time, resulting in a brief government shutdown, the first since 2013. Further, Treasury Secretary Mnchuin's comments at Davos that "a weaker dollar is good for trade", may imply little political push-back, at least from the US, to an even weaker USD.

However, whilst the shutdown appears an obvious dollar-sell signal, the currency actually held up comparatively well in the immediate aftermath. Perhaps this resilience in the face of such clear, and unexpected, uncertainty provides a sign that the sell-USD trade may start to run out of steam?.

Moreover, we can but reiterate the factors which we think should, even though they have failed to do so thus far, act as a brake on further USD weakness. The main support should be US yields and the outlook for US monetary policy compared to other developed-market currencies.

As we highlighted in "Brakes on for the USD as an unsustainable divergence from rates start to weigh?", published on 16 January, many of the USD pairs, crucially including EUR/USD, appear to have diverged, and are weaker, than the spreads at both the short and long ends of the curve would suggest.

The FX market, consumed by USD negativity, has preferred to focus on the possibility that the ECB and other central banks may adopt a less loose monetary policy, rather than the imminent Fed rate hikes. In essence, we believe monetary policy divergence is currently USD positive and implies the USD has been oversold. The outlook for monetary policy and yields is also USD positive.

The economic backdrop also remains USD supportive. Admittedly, Eurozone policymakers are more upbeat on the region's economy, but we think this should already have been priced via the EUR's gains. Meanwhile, the US economy is still expected to outperform, both this year and next. In addition, both US headline and core inflation are much higher than the Eurozone's. US core CPI was 1.8% YoY in December vs. Europe's 0.9% YoY, with the strong EUR pointing to the risk of this gap widening.

EUR – The glass looks full

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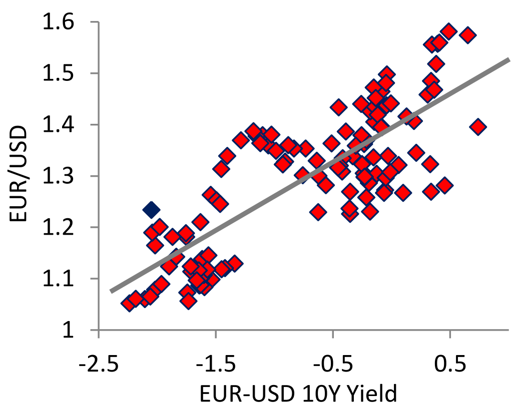
The EUR has continued to strengthen in January, or as the USD weakened! As such, we have revised our forecast profile for 2018 slightly higher, to reflect the rise in spot. We now expect EUR/USD at 1.21 in Q1, up from 1.15, at 1.22 at end-H1, up from 1.17, and at 1.26 at the end of 2018.

However, our central story remains the same: we believe that the EUR has been overbought, more so given the recent rise. The combination of a crowded long EUR trade, US rate hikes throughout 2018, sluggish Eurozone CPI and signs of ECB concern about persistent EUR strength should slow down and reverse EUR gains, in our view.

The Eurozone recovery has continued, supporting EUR sentiment. Business confidence indicators remain around record highs and unemployment is falling. However, we reiterate that economists still expect the Eurozone's recovery to be more than matched by the US's. Indeed, US growth is still expected to outperform the Eurozone's in 2018 and 2019, with the consensus expecting US GDP growth of 2.6% this year and 2.1% in 2019, compared to 2.2% and 1.8%, respectively, for the Eurozone. Hence, the relative growth story should caution against being too long EUR/USD.

The market was far too pessimistic on the EUR at the start of 2017, in our view, focusing on politics, economics and monetary policy. As these fears faded, the EUR rightly rebounded. However, there are signs that it is in danger of rebounding too far, and that it has already priced in the improved macro backdrop.

Chart 3: Higher US yields should temper further EUR/USD gains



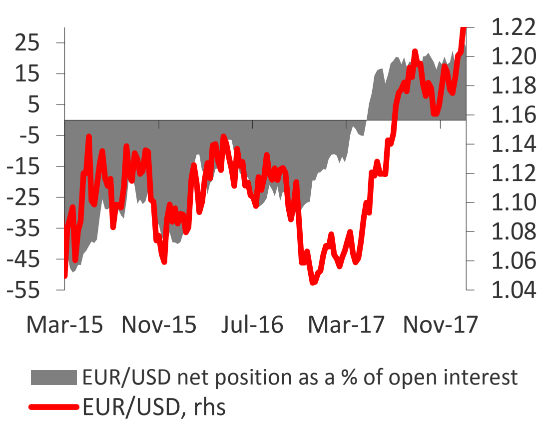
Monthly data since 2008. Blue is the latest data

Source: Bloomberg, Santander

For example, the IMM non-commercial position data for the week ended 9 January showed that the speculative net-long EUR/USD position was at an all-time high in absolute terms. The rise in long positions explains much of the EUR's gains. The correlation between the net EUR/USD position and EUR/USD has been 0.93 since the start of 2017. Consequently, if speculators continue to add to this position, the EUR looks certain to rise in the near term.

However, these speculative data tend to be viewed as a contrarian indicator. For instance, with the market already long the EUR, there should be less appetite to add to that position. The bullish EUR glass appears full. Possible profit-taking and unwinding of these positions could pull the EUR notably weaker in Q1-18.

Chart 4: The long EUR/USD position has been a good indicator for the pair, and remains very stretched



Source: CFTC, Bloomberg, Santander

A possible catalyst for the unwinding of EUR longs is signs that the ECB is becoming concerned about the impact of the strong EUR. Recently, the ECB's Constancio and Villeroy commented on the EUR. Plus, Draghi, at the January ECB meeting warned that EUR 'volatility' creates uncertainty, but this warning wasn't strong enough to prevent the EUR strengthening. Even so, we expect the Bank to be mnore vocal about the rise of FX strength over the coming weeks, if only to instil some two-sided risk in to the EUR.

In addition, we feel that the monetary policy outlook does not justify the recent scale of EUR strength. Draghi confirmed that asset purchases will remain in plase until September, and could be extended. Further, he sees very few chance of a rat ehike this year. Meanwhile, December's CPI data showed core CPI dipping to 0.9% YoY, whilst US core inflation is 1.8%. Hence, the Fed is expected to hike in March, and follow that up with –what should be– further USD-positive rate hikes over the remainder of the year.

GBP – Brexit, what Brexit!

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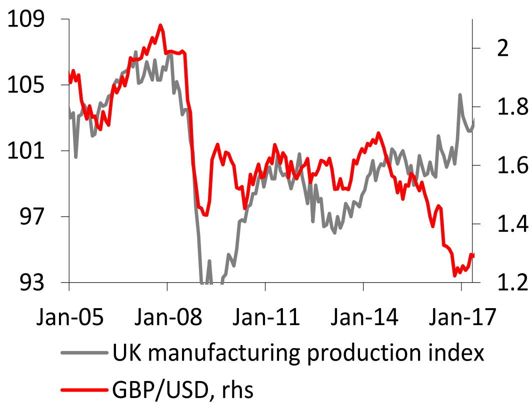
The Pound has posted a notable recovery against its developed-market peers over the last few months. We are sceptical about whether this will continue, and still see the Pound as vulnerable (indeed, even more so, given the extent of its recovery). However, the jump in the spot level has forced a revision to our forecast profile. We now expect GBP/USD at 1.39 in Q1, up from 1.30, at 1.36 at end-H1 up from 1.28, and at 1.32 at the end of 2018.

It has been a very positive few months for the Pound. To place things in context, over the last three months Sterling has strengthened against all the major currencies, is broadly flat against the COP and PLN, but has only recorded notable losses against the ZAR.

Why the rebound? 1) The market is currently less nervous about Brexit; 2) the post-EU referendum sell-off from June 2016 implied the Pound looked cheap in relation to current UK fundamentals; and 3) the USD has weakened, boosting GBP/USD.

Chart 5: Sterling playing economic catch-up?

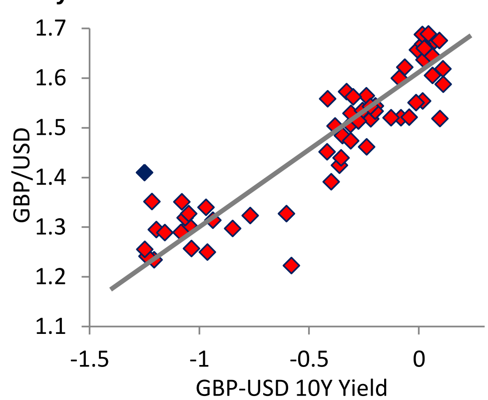


Source: Bloomberg, Santander

We have highlighted, for several months now, that whilst Brexit/political uncertainty was a justifiable constraint on the Pound, the currency was much weaker than UK economic data suggested it should be. We estimate that, given the historic link between UK joblessness and the Pound, the weak GBP was pricing in unemployment of over 8%, compared to the current 4.3%. Hence, a degree of the recent move may be the market pricing out such 'over' pessimism. The successful conclusion of the first phase of the Brexit negotiations in December will have helped here.

However, the rebound in GBP/USD owes a lot to the ongoing dollar sell-off, rather than UK-specific factors. The correlation between GBP/USD and the USD index has been -0.95 over the last three months. In addition, EUR/GBP has tended to move sideways, as a stronger EUR/USD, again helped by the weak USD, has cancelled out the stronger GBP/USD.

Chart 6: GBP/USD strength starting to diverge from yields



Monthly data since 2008. Blue is the latest data

Source: Bloomberg, Santander

Can Sterling, in particular GBP/USD, continue to strengthen? Yes. Whilst Cable's appreciation over the last three months is impressive, it has not happened at a pace that we would consider excessive and, therefore, at risk of a reversal. Plus, speculators' long GBP/USD position is still relatively small, with plenty of scope to be added to over the coming weeks.

However, other barriers may temper further Sterling strength. The economic outlook has held up better than most ecomists expected, but the UK is still forecast to underperform both the US and the Eurozone in 2018, growing by just 1.4%.

Plus, whilst there was scope for the Pound to rally as the post-referendum economic fears did not materialize, there should be a 'Brexit' ceiling on this reversal. GBP/USD averaged around 1.46 in June 2016, before the EU vote on 23 June. Further GBP/USD gains might take it close to ths level, almost implying that Brexit does not matter and uncertainty surrounding it is over. We would view this as premature, given that phase-2 talks are yet to start.

Moreover, we do not view the monetary policy outlook as a clear GBP positive. The market is pricing in a rate hike in November, but we think the BoE will hold off. Further, as with EUR/USD, the Fed is forecast to hike rates more aggressively in 2018 and 2019, which should be GBP/USD negative, as should the fact that the pair already appears overbought given UK-US yield spreads.

JPY – Looser for longer

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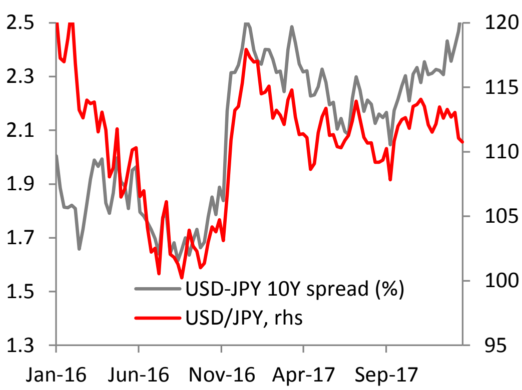
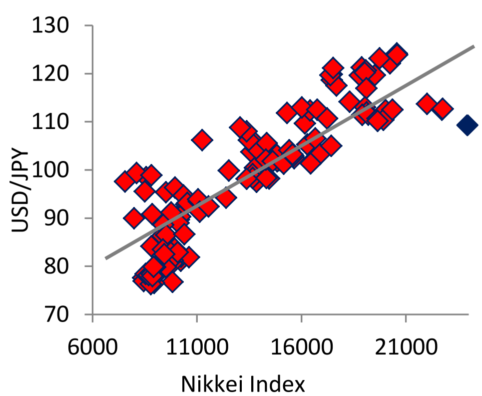
Chart 7: USD/JPY looks cheap in relation to yields



Source: Bloomberg, Santander

Chart 8: USD/JPY looks cheap in relation to equities



Monthly data since 2008. Blue is the latest data

Source: Bloomberg, Santander

We think the Yen has been overbought.The economy continues its moderate recovery and the BoJ made no changes in January. However, monetary policy is loose, and should remain so, as long as inflation stays below the 2% target. Hence, the JPY looks too expensive given yields and equities/risk. Plus, the prospect of more US rate hikes in 2018 should pull USD/JPY higher.

The Yen has performed well against the USD at the start of 2018, boosted by speculation that the BoJ might signal a looser monetary policy after it announced that, as part of its asset purchase programme, it would reduce the amount of bonds purchased at the long end of the curve. However, at the January BoJ meeting, Kuroda kept policy unchanged, stressed that it was not the time to consider an exit from the policy and stated that the tweaks in asset purchases were not signals of future policy.

The JPY did rise on that announcement, but quickly reversed those gains. In addition, the Yen is still underperforming most other developed-market currencies. This suggests to us that a lot of the move over the past several weeks has continued to be more about USD weakness rather than Yen strength. In our opinion, the key factor going forward is the BoJ's JGB targeting, rather than the asset purchase level. The Bank's focus, since September 2016, has been on yield curve control, rather than asset purchases, with the aim being to keep JGB yields around 0%. If this can be done with fewer bond purchases, then all the better.

That said, JGB yields have edged higher, partly as a response to the BoJ announcement. The 10Y yield reached 0.09% in January. This is still very low, but represents a clear drift from zero since November. However, the yield has tended to fluctuate within a 0.0% to 0.1% range since September 2016. Hence, it might require a break of 0.1%, with no counteraction by the BoJ, to convince us that the Bank is moving toward accepting higher yields and the stronger Yen

Further, the rise in Japanese yields since November has largely followed US yields. The correlation between the two since the start of November is 0.8. Consequently, the US-Japan 10Y yield has still been widening over the past few months, which should have been Yen negative. Indeed, we estimate, using data for the last year, that the current spread implies that USD/JPY should be closer to 115, and move higher in 2018, as the Fed hikes rates and US yields rise in line with consensus forecasts.

A similar divergence is still apparent between the Yen and equity markets. Firm equities imply a better risk backdrop and less demand for the Yen. The link between them has broken down over the last year but, using data for the last five years, we estimate the current Nikkei level implies USD/JPY above 120.

Yen bulls could point to positioning as a reason to buy the currency. The short Yen versus the USD speculative market positioning is stretched. Similar to the large net long EUR/USD position, this could be viewed as an indication that a big chunk of the market has sold the Yen so much there is little scope to sell further, and an unwinding of this position should boost the Yen. But, unlike with EUR/USD, the JPY positioning has not been a good indicator for USD/JPY over the last year, which raises some doubt as to whether a big reversal of these positions will automatically drag USD/JPY lower.

CNY – Protectionist threat looms

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We still favour a firmer USD/CNY in 2018. However, the forecast profile has been reduced to reflect a lower start to the year as the pair has been dragged lower by dollar weakness. Whilst China's GDP data exceeded expectations in Q4-17, the risk remains that policymakers' efforts to reduce debt and the risk of a more protectionist trade policy from the US will weigh on the CNY.

USD/CNY has weakened notably since mid-December 2017, with the pair dropping from just over 6.60 to sub 6.40 levels in January. The main reason for this, as with most USD pairs, is the dollar weakness. The correlation between USD/CNY and the USD index is 0.95 over the last year. Hence, the question remains, will the USD continue to weaken? Or, will China-specific factors that might weigh on the currency arise and pull USD/CNY higher?

Chart 9: Chinese GDP growth ended 2017 on a high

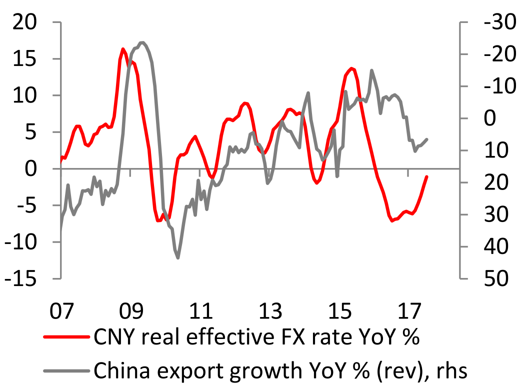
Source: Bloomberg, Santander

We see scope for the USD to reverse some of its recent decline, and feel the market has become overly negative on the currency. As highlighted in the USD section, we feel the dollar has been oversold, given that the US economy is expected to continue to outperform its peers and that the Fed is expected to hike rates in March, with further increases coming later in 2018 and 2019.

Further, it seems unlikely that the PBoC will have to respond to Fed hikes with its own increase in rates. Overall price pressure remains contained. The December inflation reports showed CPI edging slightly higher to 1.8% YoY, from 1.7%, but still below the 3% target. Plus, PPI dropped to 4.9% YoY from 5.8% YoY in November.

In addition, policymakers should remain wary of hiking rates amid concern over the impact on the economy, given China's large stock of domestic debt. Outstanding credit was reported at 264% of GDP at the end of 2017. Hence, officials should stick to the policy of containing the growth in credit/debt through regulatory changes, particularly targeting the shadow banking sector.

Chart 10: Export growth picking up – CNY positive, or trigger for US protectionism?



Source: Bloomberg, Santander

Indeed, January has already seen a slew of new regulations aimed at making it harder for less credit-worthy business to have access to financing. The escalation of such regulation could be viewed as a sign of optimism on the part of policymakers that the economy can handle more regulation and slower financing growth.

Indeed, the Chinese economy did grow faster than expected in Q4-17. The growth rate was 6.8% YoY, bringing full-year growth to 6.9% YoY, compared to 6.7% in 2016. We still suspect that the deleveraging process will weigh on activity, but the Bloomberg consensus shows growth is expected to remain at 6.8% YoY in Q1-18, a figure that, in itself, could support the CNY in Q1.

Moreover, China's trade balance for December also surprised to the upside with a surplus of USD54.7bn, compared to consensus' USD37bn estimate and November's USD38.98bn. Exports grew 10.9% YoY, but import growth slowed to 4.5% YoY, from 17.6%. The report implied that China's trade surplus with the US grew by 8.6% to reach a record high of USD276bn, or 65% of the total surplus. Usually, such positive external accounts would be currency positive, but the surplus with the US risks pushing the Trump administration toward a more protectionsit stance, which should weigh on the CNY and pull USD/CNY higher.

CHF – Thank you euro

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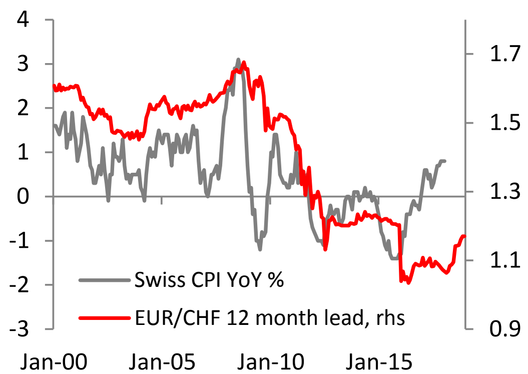
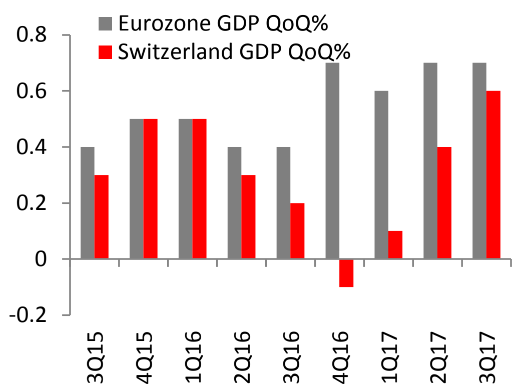
Chart 11: Swiss inflation is rising, but remains low



Source: Bloomberg, Santander

Chart 12: Swiss economic pick-up and current account surplus could eventually slow CHF depreciation



Source: Bloomberg, Santander

The CHF bias remains to the downside, at least against the EUR. The SNB still views the currency as “highly valued”, remains prepared to intervene to weaken it and is unlikely to increase interest rates before the ECB does. But, further CHF losses against the EUR will depend on the EUR continuing to strengthen; particularly as robust Swiss data are offering the CHF support.

The SNB kept monetary policy unchanged in December, with the deposit rate at -0.75%, and the three-month libor range at -0.25% to -1.25%. The SNB reiterated that the CHF is “highly” valued and that it will continue to intervene as required. Plus, the SNB’s President Jordan reaffirmed that the Bank would not raise rates for a “relatively long time”.

Hence, it still appears to be a case of a steady and unchanged policy for the SNB. Neither we, nor the market, expects the Bank to risk moving before the ECB. The ECB is not expected to hike rates until 2019, which might allow the SNB to consider increasing the depo rate but, even then, it should stay negative well into 2020.

That said, the markets seem keen to jump on any indication from a central bank that it may be considering moving away from an ultra-loose policy. Hence, the over-focus on the small upward revision to the Bank’s CPI forecasts: inflation is expected to average around 0.7% in Q4-17, with the forecast for 2018 increased to 0.7% YoY from 0.4%. The 2019 forecast was unchanged at 1.1%, with inflation not expected to climb above 2% until Q3-20.

We would be surprised if the SNB made any effort to back away from its very loose policy over the next year. The fear for policymakers will remain that any sign of a move to a less accommodating stance will encourage the market to buy the CHF, undermining the progress made over the last few months, and putting CPI under pressure.

Indeed, the recent experience of the Yen and the BoJ acts as a timely warning. The BoJ’s announcement that it will reduce bond purchases at the long end of the curve prompted FX markets to buy the Yen.

The weak dollar has also pulled USD/CHF lower. Indeed, over the last month, the CHF has strengthened more against the USD than the JPY. However, crucially, EUR/USD has risen more, keeping the upside pressure on EUR/CHF.

This spillover from recent currency moves continues to highlight that the Swiss policymakers remain ‘price takers’ when it comes to EUR/CHF. The pair has moved in the direction they want, temporarily to above 118, but due to factors beyond their control. As long as this remains the case, they will no doubt remain reluctant to change their policy stance.

In addition, the economic outlook continues to improve which, under a less loose policy, might be reason for the market to bid the CHF higher. The KOF index rose in December, as did the Swiss manufacturing PMI. Plus, the trade balance remains comfortably in surplus, with the Swiss current account surplus of 9.9% of GDP a clear CHF positive. Hence, the SNB forecasts growth of 2% in 2018, from 1% in 2017. The economy is strengthening, but we think the SNB will not allow the CHF to follow it higher.

SEK – The final 'extension'?

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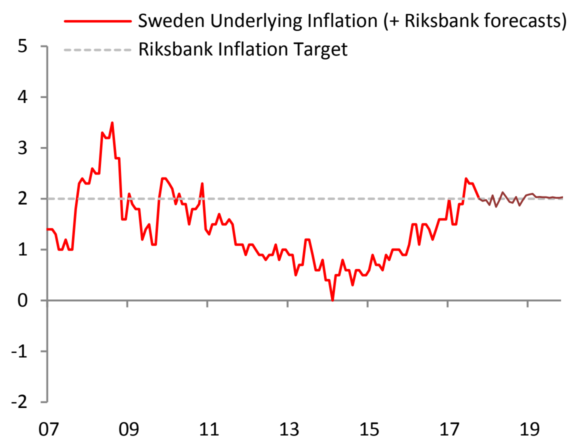
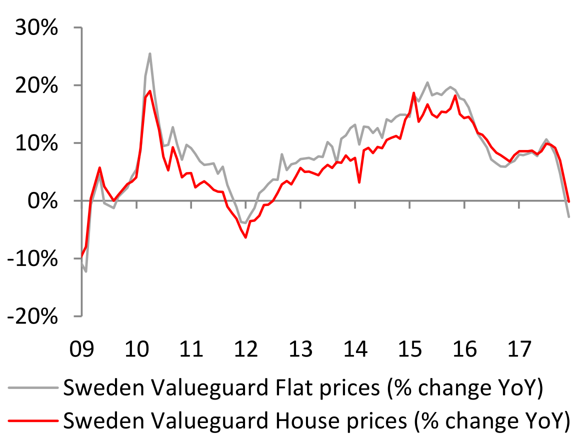
Chart 13: The Riksbank lifted its inflation forecasts, and now sees CPIF holding close to its 2% target



Source: Bloomberg, Santander. Note: Riksbank forecast from December Monetary Policy Report

Chart 14: Swedish house price growth turned negative in December



Source: Valueguard, Bloomberg, Santander

We are bullish the SEK in 2018. Strong growth and upbeat inflation should encourage the Riksbank to hike rates in H2-18. With the ECB set to keep rates on hold, we expect interest rate differentials to pull EUR/SEK lower. The property market is a potential stability risk, but the Riksbank expects the market to remain resilient to cooling prices. We continue to forecast EUR/SEK as falling to 9.0 by year-end, but have lifted our near term forecasts, as SEK gains have slowed in early 2018.

The Riksbank kept interest rates on hold at a record low -0.5% in December. The Bank did not technically extend its QE programme (which 'ended' in December 2017), but did announce, however, that it would reinvest some of the programme's future maturities and coupons from "as early as January 2018" to "the middle of 2019".

Many of these SEK inflows will not materialise for over a year, though, with the Riksbank set to reinvest maturities due in H1-19 (SEK50bn), as well as the 2018 and H1-19 coupon payments (SEK15bn). Hence, as discussed in Riksbank: An 'extension' by any other name? (published on 20 December), this means that while the Riksbank's QE programme will technically remain at SEK 290bn, in reality, the total amount of government bonds held will actually increase 'temporarily' during 2018 and early 2019.

To us, this is an 'extension' in all but name, albeit one that suggests a return to the current SEK290bn level in 2019. Deputy Governor Ohlsson has confirmed as much, calling the "reinvestment really an extension of the purchases".

The Riksbank continues to sound dovish and repeated its warnings that it is important the SEK does not appreciate too quickly. However, the Bank also continues to forecast a summer 2018 rate hike, with Governor Ingves saying that it "should be possible to raise rates before the ECB". As we continue to expect the ECB to keep rates on hold throughout 2018, interest rate differentials should be a EUR/SEK negative this year.

One potential risk for the SEK stems from any increase in financial instability caused by the recent downturn in house prices. Indeed, after years of rising house prices, this growth turned negative in December (see Chart 14). While this is a potential financial stability risk, the Riksbank is calm on the issue. Weaker house prices should imply a drop in construction, but non-construction growth is still strong, while consumer spending is relatively high. Further, the drop in house prices is largely due to a necessary increase in supply.

As such, the main risk to our SEK forecasts in 2018 is probably below-target inflation extending the wait for a rate hike. Underlying inflation is close to target, even if it did dip to 1.9% in December. The Riksbank expects this to rise above 2% in the coming months, but has proved too optimistic on inflation in recent years. We do not expect the Riksbank to hike rates aggressively this year, although the prospect of the Riksbank moving ahead of the ECB should, at the least, support the case for a stronger SEK in 2018.

NOK – Moving in the right direction

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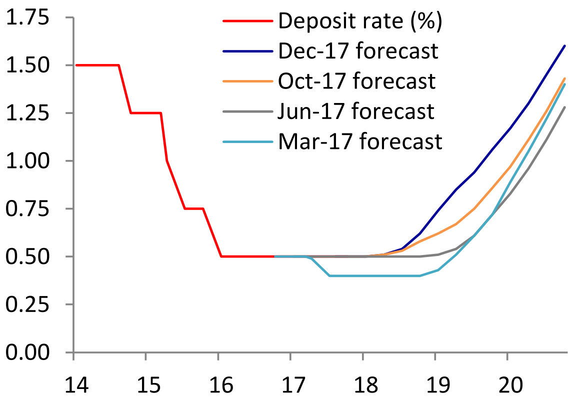
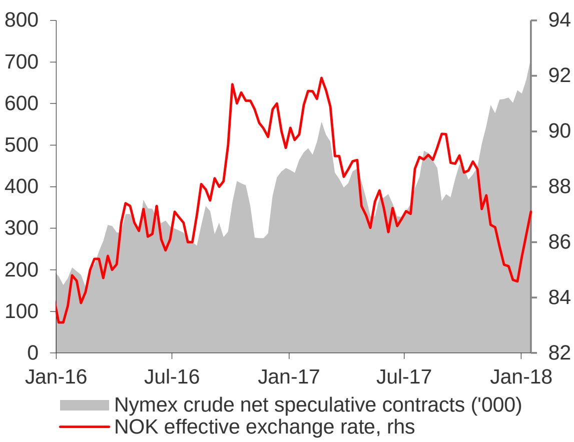
Chart 15: The Norges Bank raised its rate hike forecast profile during 2017, but still does not expect to hike rates for almost another year



Source: Bloomberg, Santander.

Chart 16: The speculative net-long oil position reached an all-time high in January, yet the NOK still appears too weak



Source: CFTC, Bloomberg, Santander

We are bullish the NOK in 2018. The worst is likely over for the Norwegian economy for now, while the strong oil price implies the NOK is too weak. The Norges Bank is unlikely to change rates for almost another year, but now looks more likely to hike before the ECB does, which should be positive for the currency. EUR/NOK has fallen by over 4% since its December high, so is moving in the right direction, in our view, but we still consider the cross overbought. We continue to forecast EUR/NOK falling to 9.0 by year-end.

As a small oil-exporting nation, Norway's economy, and its currency, has historically tended to follow the strength of the petroleum sector. While this sector has taken a notable hit in recent years, crude prices (WTI 1st future) have been on a firm upwards trend throughout the second half of 2017 and into 2018, rising from around USD45/bbl, to USD65/bbl in early 2018, a three-year high. Despite this 40% increase, the NOK is little changed over the same time period.

Norges Bank Govenor Olsen noted in late 2017 that there has been "some decoupling" of the NOK and oil prices as the correlation over time is fairly strong. We would suggest this wording is too soft, as the NOK and oil prices have moved in opposite directions in H2-17.

Indeed, the correlation between EUR/NOK and crude oil prices (WTI 1st future) over the past ten years is -0.82; yet, this correlation has been positive over the past 12-months, at 0.31. Such a decoupling between the currency and such a key input for the strength of the Norwegian economy is unlikely to last for an extended period of time, in our view.

With petroleum investment set to increase in 2018, and the net long speculative position in oil at an all-time high (Chart 16), our view is that the NOK is still too weak, even allowing for the 4% decline in EUR/NOK since its December high.

The Norwegian economy has strengthened over the past year. The market expects the unemployment rate to continue to decline in 2018, with higher imports among the country's trading partners helping boost Norwegian exports. Both the Norges Bank and the market consensus expect inflation to rise this year, albeit from a low base. Underlying CPI may have beaten expectations in December, rising to a six-month high at 1.4% (1.0% expected), but this is still well below the Norges Bank's 2.5% target.

From 2018, the Norges Bank is increasing the number of monetary policy meetings to eight (from six). Despite these extra rate decisions, it unlikely to hike rates in 2018, in our view. But the Bank has gradually been raising its interest rate outlook over the past year. As such, it now looks likely to increase rates before the ECB, albeit perhaps only by a few months, in early 2019, but this should still support the NOK against the EUR. As we see the Riksbank as more likely to move even sooner, this should allow scope for the NOK to decline against the SEK, perhaps with the cross even returning to parity by year-end.

AUD – RBA set for record period of unchanged rates

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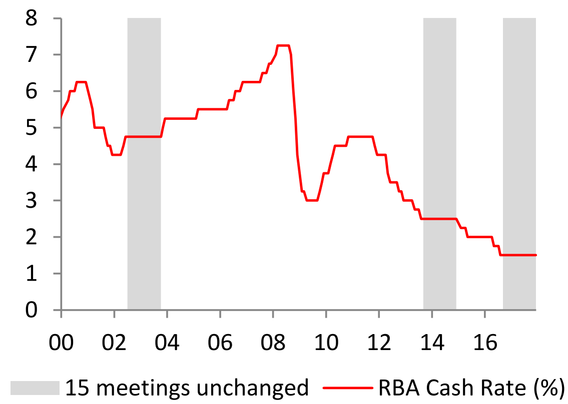
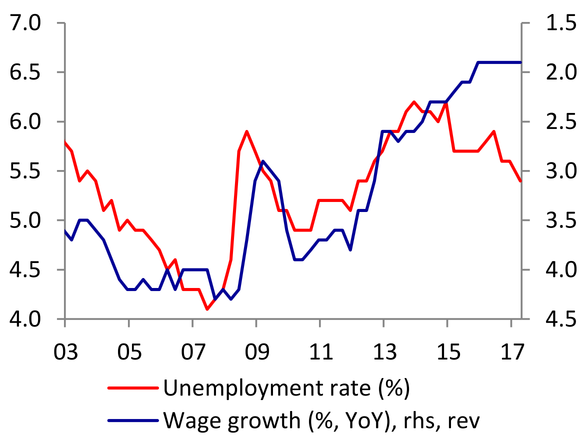
Chart 17: RBA looks set to break record for run of "unchanged" rate decisions



Source: Bloomberg, Santander

Chart 18: Australian unemployment is slowly improving, but wage pressures remain very low



Source: Bloomberg, Santander

We are negative the AUD in H1-18. Employment data are improving, but wage growth remains low and, until this picks up, the RBA is set to keep rates on hold. The Bank is almost certain to keep rates on hold in February, likely taking it to a record 16 consecutive meetings without a change. Weak CPI data, partly due to a "substitution bias", is also an AUD negative, although AUD/USD is being led by the USD, with the latter's weakness pulling the pair to above 0.80 in January. We see downside risks for AUD/USD in 2018, and forecast the pair at 0.77 in Q4-18.

AUD/USD fell to 0.75 briefly in December, but the pair has rallied over the past month, climbing to 0.80 in mid-January. The AUD has performed well during this time, as positive market sentiment has boosted risky currencies. However, the larger part of the AUD/USD move is due to USD weakness.

Interest rate differentials are usually a significant fundamental driver of the FX markets. Logically, if a central bank raises interest rates, there is a better return on that country's assets, making them more attractive to investors, with increased demand boosting the currency. However, as discussed in the USD section, despite the prospect of FOMC rate hikes, the USD has been weakening. Indeed, AUD/USD is 7.5% above its December low, despite the AU-US 2Y swap spread implying the pair should, if anything, have weakened.

The decline in this spread is due to higher US 2Y swaps, as Australian 2Y swaps are little changed since mid-December. This is not surprising, as the RBA has been firmly in 'no change' mode for over a year. In fact, if the Bank votes to keep its Cash Rate on hold, at 1.5%, as it almost certainly will do, on 6 February, this would take the RBA to a record 16 consecutive meetings with unchanged rates (Chart 17).

The RBA wants wages to rise before hiking rates, which could mean this record stretches to above 20 consecutive meetings in the second half of the year. Note that wage growth remains below 2% (Chart 18).

The unemployment rate continues to improve, falling to a five-year low in December. Also, jobs growth is strong (3% in 2017). In fact, monthly job gains are on a roll, with the 35k increase in December ensuring 15 consecutive months of jobs gains on a seasonally-adjusted basis. This is equal to the longest-ever streak of consecutive positive monthly job growth, recorded in July 1994.

Most recent domestic data are robust, but low wage growth, unchanged rates and negative investment growth imply limited upside pressure for the AUD in H1-18. Stronger Q4-17 CPI data (released on Wednesday, 31 January) should help the AUD, but the substitution bias implies downside risks to these data. A substitution bias occurs when index weights are not updated regularly and the effective weights diverge from the real-life weighting. The RBA estimates that substitution bias reached around 0.4 percentage points of annual CPI in Q3-17. If a similar impact keeps the Q4-17 data below 2% for a third consecutive quarter, that should imply a weaker AUD.

NZD – Rebound overdone

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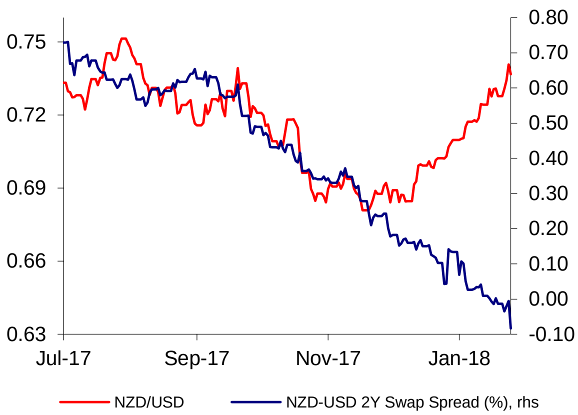
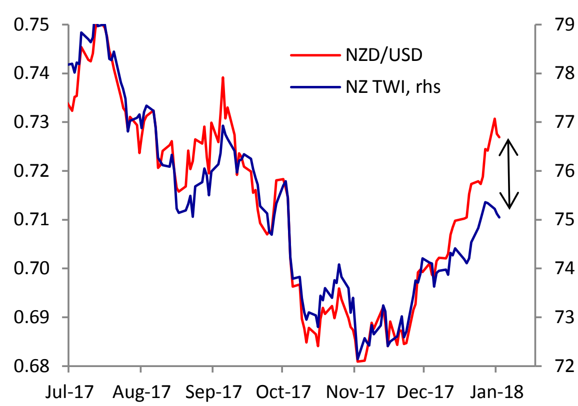
Chart 19: NZD/USD has rallied since mid-November, but the pair's correlation with NZ-US 2Y swaps is now firmly negative



Source: Bloomberg, Santander

Chart 20: The NZD has had a solid couple of months but, together with USD weakness, the NZD/USD rebound now looks overdone



Source: Bloomberg, Santander

We are negative NZD/USD in the short term. This opinion is primarily due to the currency's rebound in recent months looking overdone. The USD weakness has exaggerated the NZD/USD move higher, with the pair's c.8% gain since mid-November likely creating scope for weakening in the coming months. Hence, we have lifted our Q1-18 NZD/USD forecast to 0.72 (0.70 previously).

In H2-17, the NZD was the worst-performing G10 currency. This decline was led by domestic uncertainty, both before and after New Zealand's General Election in September. After nine years of a National government, market fears about the negative impact the pro-spending anti-immigration Labour-NZ First coalition could have on the economy weighed on the NZD. While the NZD/USD decline looked overdone to us in November, the rebound in December and January now looks similarly excessive.

We would highlight that the USD has comfortably been the weakest developed-market currency over this period and, therefore, that the NZD/USD move higher is due largely to this USD weakness. As discussed in the USD section, we view the Dollar as oversold given the likelihood of FOMC rate hikes this year. USD/G10 pairs have had a negative relationship with all their 2Y swaps spreads over the past month. With NZD/USD strengthening notably in recent months, despite the NZ-US 2Y swap spread falling, there may now be downside risks for the pair in the months ahead.

Further, expectations that the new government will reform the RBNZ's mandate, to include an employment component, suggests rates could stay on hold for longer, which would imply a weaker NZD. No clear decision has been made on the potential changes to the RBNZ. However, a review released by the government in mid-January identified four areas ripe for reform: formalising decision-making committees for monetary policy and financial regulation; formally acknowledging the Bank's broader remit in maintaining financial stability; narrowing the board's focus; and aligning legislation with practice.

Adrian Orr will begin a five-year term as RBNZ Governor on 27 March. Orr is a former Deputy RBNZ Governor and Chief Economist, and has headed up New Zealand's Sovereign Wealth Fund (NZ Superannuation) for the past decade. The market reaction to his appointment, by Finance Minister Grant Robertson on Monday, 11 December, was NZD positive, perhaps as the market deems him as lees likely to err on the dovish side than acting Governor Spencer. Certainly, we now expect the RBNZ to hike rates well before its "late-2019" forecast.

With the new Governor now named, the rhetoric of the RBNZ's acting Head may play a lesser role over the coming months. Indeed, the market is already expecting no change from the Bank at either its 7 February or 21 March monetary policy decisions. Hence, a greater focus will likely now be on any comments from Adrian Orr before he assumes control of the Central Bank on 27 March.

CAD – Three up

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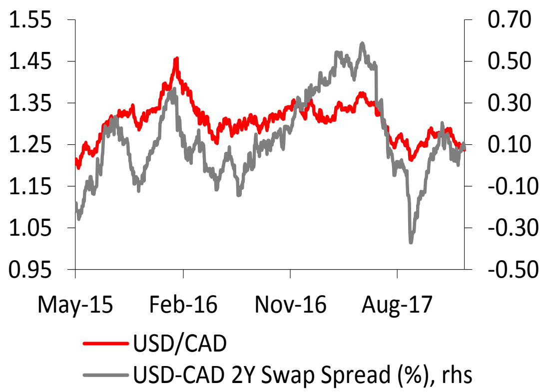
We retain a positive outlook for the CAD in 2018. A firm oil price and expected further rate hikes from the Bank of Canada should offer support. But NAFTA and export uncertainty will remain a risk. Hence, gains versus the USD may be gradual, focused on H2-18 and vulnerable to USD strength as the Fed hikes rates. Hence, the CAD may offer better value against other G10 currencies.

The BoC hiked rates at its 17 January meeting, raising the main rate 25bp to 1.25%, in the third such move since July 2017. The market had priced this in following a very strong December jobs report, which saw unemployment decline to 4.6%, the lowest since 1976. Together with BoC rhetoric that suggested it would remain cautious on further rate hikes, this helped to cap the CAD's post-BoC gains.

Despite the FX market's reaction, the general tone of Governor Poloz's comments remained upbeat. The Bank conceded that recent data had outpaced estimates, and that it expected growth of 2.5% in annualised terms in Q4-17. The GDP forecast for 2017 was cut slightly, to 3%, but the 2018 forecast increased to 1.8% from 1.7%. CPI is expected to hover around 2.1% in 2018.

Governor Poloz reaffirmed that further rate hikes are data dependent, but the consensus does not expect the data to weaken that much. Further, the output gap is now seen at around zero, implying stronger activity should put upside pressure on prices, even as wage growth remains muted. Admittedly, the Bank does believe that some monetary accommodation will still be needed. But, with Canada's neutral rate seen to be closer to 3%, the Bank can make more hikes whilst keeping some accommodation.

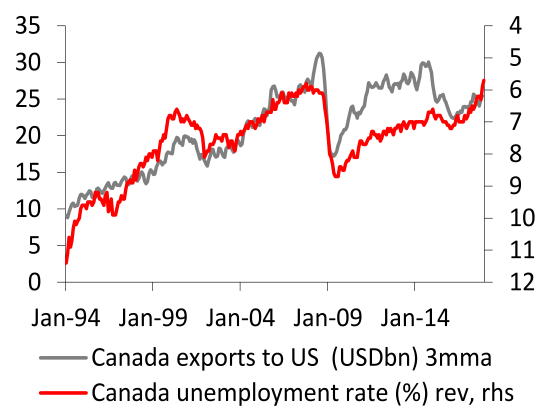
Chart 21: USD/CAD is back in line with rate spreads post the BoC



Source: Bloomberg, Santander

Given that most CAD/G10 crosses remain positively correlated with interest rate spreads at the short end of the curve and that the market is pricing in a 63% chance of another hike in April, the CAD should remain firm into the end of Q1-18 and start of Q2-18. However, the expected Fed rate hike in March implies USD/CAD may struggle to move away from its current 1.23 level, with the CAD offering better value against some of its other peers. In particular, we see a firmer CAD versus the NZD and NOK.

Chart 22: NAFTA talks remain crucial to the CAD



Source: Bloomberg, Santander

The main risk to this outlook continues to focus on NAFTA. The sixth round of NAFTA talks is currently taking place. Poloz did suggest that he could see positive signs for exports, despite recent weakness. However, export growth remains very subdued and, we think, that any adverse impact on exports to the US will threaten the recent improvements in the labour market.

Further, Governor Poloz continues to express concern about the risks posed by high debt. Canada's debt to disposable income is around 170%, an all-time high. However, new regulations, which should make it harder to get a mortgage, are expected to weigh on high house price growth. In addition, a firm oil price should prevent the CAD reversing its gains versus the USD, even as the Fed hikes rates. As an oil exporter, Canada's currency should appreciate as the oil price rises, although the correlation between the two has not been very robust over the last year, as the focus has been on the US and monetary policy. However, analysing the trade-off between WTI and USD/CAD over the last five years indicates that the pair is fairly valued around 1.25 with WTI at USD65/bbl.

LatAm FX: Main Themes

Currency	3M view	12M view	Main Themes
BRL	⇨	↘	• We maintain our call of Selic at 6.75% at YE2018, which would be its lowest since March 1999 • Our forecast for BRL/USD in 2018 (eop) is 3.5, which means 4% of real depreciation, driven by the impact of carry trade reduction and political uncertainty • Our forecast for real GDP growth in 2018 is 3.2%, with inflation at 3.8%, below the midpoint of the target range
MXN	⬇	↗	• Greater perception of risks related to NAFTA negotiations • Risks of financial volatility associated with the internal electoral process in 2018 • We expect NAFTA negotiations will continue throughout 2018, with positive news in 2H, and see economic policy continuity after the presidential election
CLP	↗	↘	• Positive local market sentiment after the election and upward trends in copper prices • A correction later on the year is likely, as local enthusiasm naturally fades and the USD gains some strength globally
COP	↘	⇨	• High oil prices are supportive of current COP levels in the very short term • Given the recent COP strengthening, we have revised down our short-term forecasts, but maintain our view that the currency will depreciate from its current levels • Lower interest rate expectations would add pressure to the currency
ARS	⇨	↘	• The government raised inflation targets on December 28, followed by a 75 bp compression of the Monetary Policy Rate. This unwound the CB policy tightening mode, accentuated after the October 22 mid-term elections. • Foreign flows betting on the local currency trade have dried up since year-end, after booming 4Q17 inflows • Uncertainty around the effectiveness of the inflationary targeting regime with a free-floating FX policy aimed at curbing double-digit inflation rates over a three-year horizon is centre stage. The FX market should remained on the side-lines till new government signals emerge

⬆ Bullish ↗ Mildly Bullish ⇨ Neutral ↘ Mildly Bearish ⬇ Bearish

Source: Santander.

BRL – A lower carry trade year

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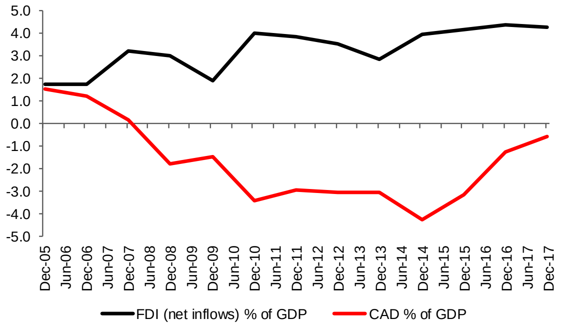
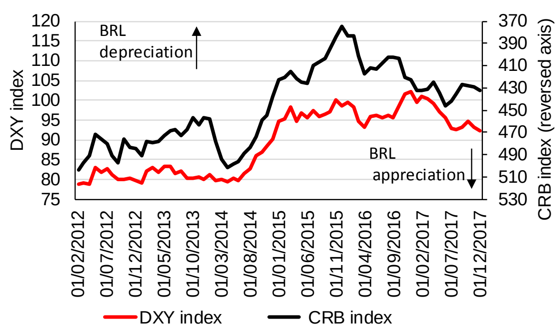
Chart 23: FDI and Current Account gap - 12 months, % GDP



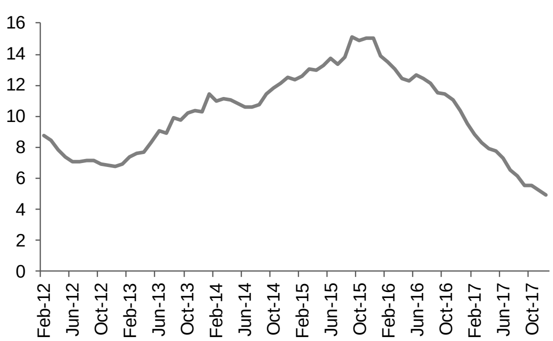
Source: BCB.

Chart 24: Commodities and DXY indices



Source: Bloomberg.

Chart 25: Interest rate differential (DI 1-year minus Fed funds 1-year)



Sources: Bloomberg.

According to our econometric models aimed at estimating a fair value for the exchange rate, the BRL should have strengthened in 2017 given the most important drivers for BRL performance: commodity prices, dollar value against other currencies, the country risk premium and/or market volatility, and interest rate differential. The country risk premiums decreased (for instance, Brazilian 5Y CDS to 160bp from 240bp 12 months earlier), the DXY index has also fallen (the USD lost 9.4% against a basket of major economies' currencies), commodities prices increased (with the CRB index up from 424 to 430); and the gap between FDI and the current account deficit widened to historical highs 3% of GDP. However, on the contrary, we saw a slight depreciation of BRL e.o.p in 2017. For 2018, our call for BRL is 3.50 per dollar at year-end, which means a depreciation of 4% in real terms (considering domestic inflation at 3.8% and external inflation at 2%).

In our opinion, the aggressive monetary easing cycle, reducing the Selic rate to 7% p.a. from 13.75%, and the postponement of the most important fiscal reform (that of social security) explained the BRL's behaviour in 2017. On the political side, although the executive branch and Congress intensified their efforts to put the pension reform back in motion last December, voting was postponed to February 2018, after the end of Congressional recess. Furthermore, the chances of approval remain low because of the wide support needed (2/3 of majority votes in Congress) and time constraints (less than six months before the beginning of election campaigns in August).

The reduction of premiums associated to fixed income investments in local markets vis-a-vis offshore investments could have eventually led to a more meaningful relationship between interest rate differentials and the exchange rate, to the detriment of other drivers. Since the adoption of an inflation target system in June 1999, monetary policy has focused on bringing inflation down to the target and preventing demand or FX-driven inflationary pressures, which have taken the primary interest rate (the Selic rate) above its neutral level for most of the last 18 years. These above-neutral interest rates have usually been consistent with attractive "carry trade", which was not in place in 2017.

Looking ahead, we think the interest rate differential (the carry trade) should remain compressed. On the monetary policy side, the perspective is that the Selic rate will be held at 6.75% through 2018, given the below-target inflation scenario, the still huge output gap and the BCB's high degree of credibility in terms of its ability and willingness to keep inflation around target. On the political front, uncertainties surrounding the upcoming elections and continued postponement of fiscal reforms –which is our baseline scenario for 2018– should lead to increased country risk, as proxied by the Brazilian 5Y CDS, an important driver for the BRL. These two components support our expectation of a weaker BRL.

MXN – New YE18 estimate of MXN$18.20/USD

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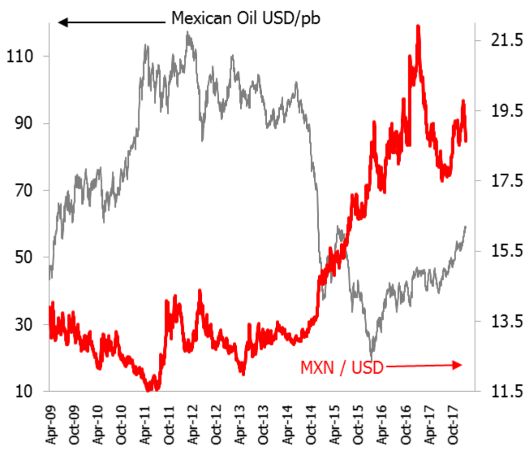
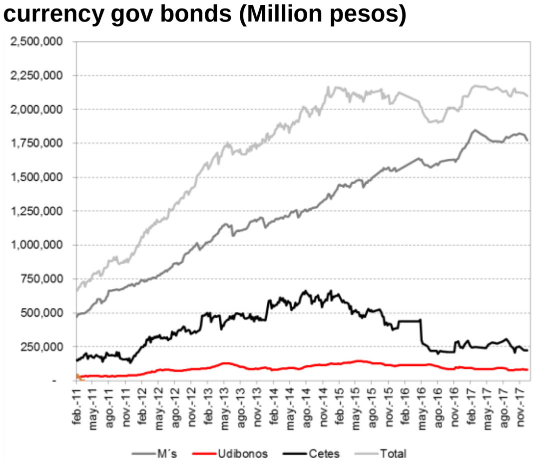
Chart 26: Mexican peso MXN and export oil price



Source: Santander, Bloomberg

Chart 27: Non-residents' holdings in local currency gov bonds (Million pesos)



Source: Banco de Mexico and Santander

Our new peso estimate for the year-end 2018 is 18.20 vs. our previous estimate of 17.50. Inflation will likely close the year at 4.2% in 2018. We expect Banxico to raise its policy rate twice in the first half of the year, pressured by FX and inflation. The risk factors we see are: the impact of the US fiscal reform on Mexico's economy, as well as uncertainty surrounding domestic oil output. We continue to assume that NAFTA will prevail and that there will be continuity in the economic policy after the July 1st presidential and congressional election.

We expect pressures on the peso in the short term (1H18) as a result of the following factors:

1. Greater perception of risks related to NAFTA negotiations due to controversial proposals by the US government.
2. Risks of financial volatility associated with the internal electoral process in 2018.
3. Upward pressures on US rates due to the impact of the tax reform on the budget deficit. We estimate that the Federal Reserve will raise its target interest rate by 75bp throughout the year, beginning at its March 21 meeting.
4. Weak oil output in Mexico, which fell 10%y/y in 2017 and could drop another 2.6% this year.

We expect MXN to weaken and trade between 21-22 towards April-May resulting in in additional pressures on inflation: energy, goods (core), coupled with volatility in the prices of some farm products. We now see CPI closing this year at 4.2%, which implies a moderate revision from our previous 4.1% call and explained by the fact that we expect peso appreciation in the second half of the year.

Thus, we now expect Banxico to hike by 25bp twice (February-8 and sometime in May-June) to 7.75%. Previously, we only anticipated the February rise. For 2018-2H, we have a positive MXN outlook and see it ending the year at MXN$18.2/USD (our previous estimate was MXN$17.50/USD) based on the following:

1. We expect NAFTA negotiations will continue throughout 2018, with positive news in the second half of the year. An agreement would benefit all three economies.
2. Moderate but sustained Mexico's economic activity: growth in the export sector, services, remittances and foreign investment. A cautious monetary policy stance, aiming to consolidate the inflation trend toward the target range.
3. We estimate a 25bp cut in the target rate to 7.50% toward the end of the year, supported by a stronger MXN, a downward trend in inflation and expectations below 4% by 2019.
4. Continuity of the economic policy favouring the implementation of structural reforms, the consolidation of public finances and Central Bank autonomy.

CLP – Election result opens up strong peso season

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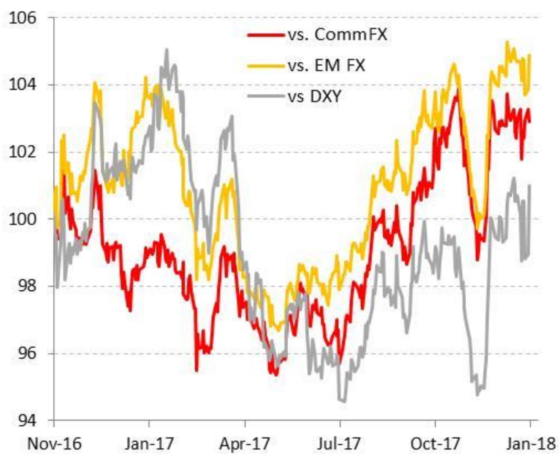
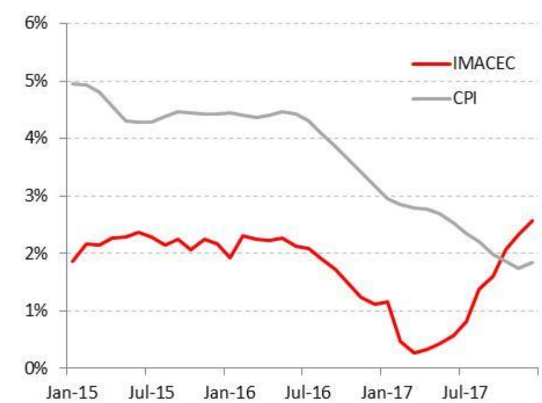
Chart 28: The CLP vs. selected benchmarks



Base 100=Nov 2,2016. Increases mean CLP appreciation and vice versa. Source: Santander, Bloomberg

Chart 29: Growth & Inflation



Last 6M averages of IMACEC and Headline CPI (y/y changes). Source: BCCh, INE, Santander.

Since our last report, the Chilean FX market has showed major gyrations. In the run-up to the second round of the presidential election, the USDCLP rate first spiked up to 656, reflecting a high dose of political uncertainty. But, after the victory of center-right candidate Sebastián Piñera by a solid nine-point margin in the 17 December vote, the Peso rallied massively, gapping to 620 on the market opening the following day. Afterwards, the global weakness of the US dollar, and the consolidation of copper prices above the US$3.20/lb level, helped maintain the Peso well bid, with the FX rate trading below 610 since the turn of the year.

On the growth front, the IMACEC index had two positive months in a row, averaging 3.0% in the October-November period. The mining sector has been a large driving force of late, with an expansion pace around 8% y/y, reflecting the upbeat global context of metal prices. The non-mining sector averaged +2.7% y/y, also showing some advance vs. previous months, therefore raising hopes of faster growth entering 2018. In general, private consumption continues to be the pillar of growth in Chile, with retail sales expanding at a robust 4.7% y/y in October and November. Analysts now expect 2018 GDP growth to reach 3.2% (from the 2.8% estimate in September), reflecting an improving mining sector, but also a substantial recovery in investment, given the more constructive political outlook.

Regarding inflation, CPI inflation closed 2017 at 2.3% y/y, vs. 1.9% in October. Overall, inflation rose at year-end due to specific fresh foodstuff items, but pressures remain subdued in general, mainly due to the strong CLP. As this FX trend has deepened in the last few weeks, we believe that inflation could trend to the downside in coming months, to 1.6%-1.7% in 2Q18. The stronger Peso would continue to reduce prices of new cars, apparel and electronics, and contain upward pressures coming from global fuel and food prices.

In terms of monetary policy, the BCCh kept rates at 2.50% in December, with a slightly dovish bias. The board is facing an increasing dilemma as growth expectations improve and inflation conditions soften further. Our call is that the Bank will stay on hold in 1H18, based on the strength of the real economy, and we still see rate hikes as likely in 2H18. However, as the Peso continues to appreciate, pressures to cut rates relatively soon in order to realign the currency seem to be on the rise. In this context, the outcome of the upcoming meetings (1 February and 20 March) appears to be a close call.

Net-net, positive market sentiment after the election plus soft global USD conditions suggest that the CLP will remain strong in upcoming weeks/months. Our valuation models, mostly based on external variables (including copper), indicate that the CLP's fair value is now around 605-610. So, we would not be surprised to see the market testing 600 or lower while local sentiment remains constructive on the growth and political fronts. Further ahead, we see the USDCLP rate bottoming out, following somewhat stronger global USD conditions. Santander's estimate for end-2018 is 630.

COP – The risk of reversal

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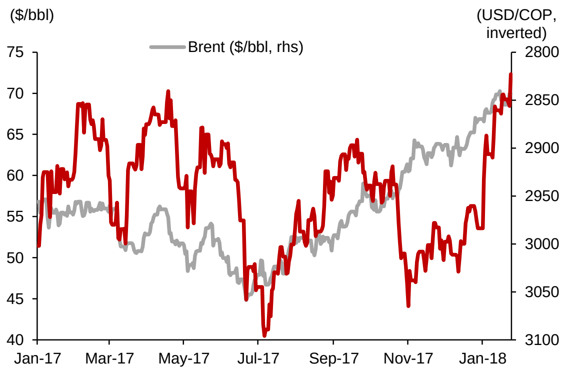
Since our last FX Compass (published November 30, 2017), the COP regained strength in the second half of December and started to follow an appreciating trend. In effect, in the last 15 days of 2017, the COP appreciated 1.5%, ending at 2984, marginally above the previous year's level. (+0.47% vs 2016). In 2018, the COP has continued to appreciate and year-to-date has gained 5.9% to become the second-best-performing currency in Latin America and among EM peers, only behind the MXN

This COP strength has been driven mainly by the recent surge in oil prices. Since December last year, Brent prices have increased 9.6%, moving up from $63/bbl to levels close to $70/bbl and even temporarily breaching the $70/bbl ceiling for the first time since 2014. Aiding this trend, the USD has also lost some steam, with the DXY index decreasing 4.2% in the past month and EM currencies overall gaining 4.1% against the USD.

Chart 30: Support from oil

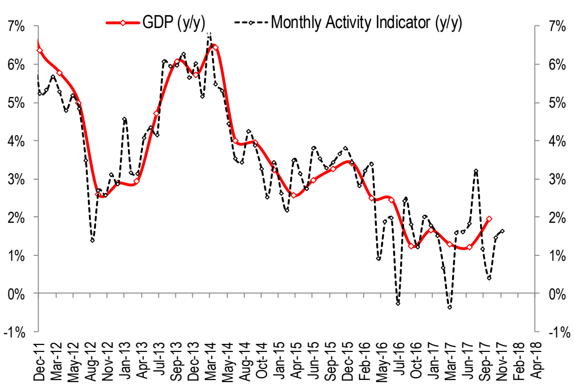


Source: Bloomberg, Santander

Given the recent support provided by higher oil prices, we have revised down our COP forecasts in the short term. We now see the COP ending Q1 at 2900, Q2 at 3000and Q3 at 2950, versus 3100, 3200 and 3100 previously. However, we maintain our view that the currency will depreciate from its current levels in the short term,

Despite the recent appreciation of the COP we still believe there are important factors that will put pressure on the currency in the next few months, including low growth, lower interest rates and a still high current account deficit.

Chart 31:Slow growth momentum



Source: DANE, Santander

Leading economic indicators suggest that economic activity in 4Q17 might surprise to the downside, signalling, in turn, that economic recovery momentum remains soft. In effect, the monthly economic activity indicator suggests that 4Q17 GDP might expand at similar levels as in 3Q17. Under this scenario, GDP for the year would be around 1.6% yoy, below the authorities' forecast of 1.8% yoy and increasing the risk that the 2.7% official forecast for 2018 might not materialize.

On the monetary policy front, the end of the easing cycle is near, with the authorities having recognized that the space for further easing is limited. Yet, we maintain our view that the Central Bank will deliver a final 75bp cut in 2H18 and maintain the reference rate at 4.00% for the remainder of the year. Under this scenario, we expect the interest rate differential with US to compress as the Fed continues normalizing its monetary policy, putting pressure on the COP.

Finally, we consider that Colombia's current account deficit will remain wide in comparison to its peers. We estimate that the current account deficit could adjust further this year, from 3.6% of GDP in 2017e to 3.3% of GDP in 2018f, on the back of better terms of trade and higher export demand. However, it would remain the second-biggest current account deficit among its Latam peers, behind Argentina, making the currency among the most vulnerable in the event of a risk-off move.

ARS – The FX path after monetary policy recalibration

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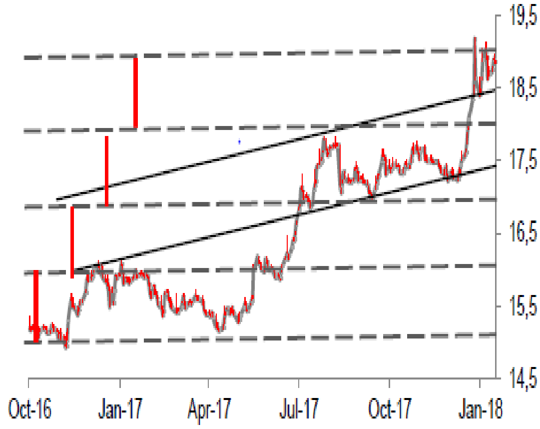
On December 28, the government surprised the market, adjusting its 2018-2020 inflation targets upward, then recalibrating monetary policy through a 75bp compression of its reference rate on January 9.

Interestingly, government authorities decided to keep the 2018-2019 fiscal goals unaltered, ignoring IMF recommendations to deepen the primary deficit reduction process, as set out in the 2017 Article IV Consultation press release.

Chart 32: ARS/USD nominal quotation



Source: Bloomberg, Santander

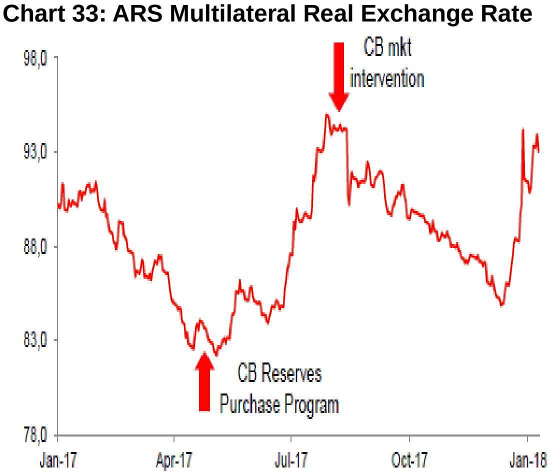
The Peso has depreciated further after the inflationary targets adjustment, and the dollar quote ended December with a 7.6% spike, while the FX market has remained particularly volatile in January. Foreign flows aimed at betting on the local carry trade have dried up since year-end, after booming inflows in 4Q17.

Economists and pundits from the IMF to S&P, among others, are warning that, despite the fact that “Macri’s decision to preserve social and political stability by gradually tackling a challenging fiscal situation has been welcome by the market”, fiscal and monetary targets might be inconsistent with the goal to achieve one-digit inflation in 2020.

A huge fiscal deficit, combined with a floating FX regime, is seen an impediment to the government’s ambitious disinflationary path, while the Central Bank’s passive role in acquiring Treasury dollar sales –i.e. US$15bn in 2017– is sometimes considered unsustainable.

Besides, experts favouring the use of FX as a complementary disinflationary anchor have started to talk more emphatically, especially now that inflation is not converging with the government’s ambitious original path.

Chart 33: ARS Multilateral Real Exchange Rate



Base 100 = December 2015

Source: INDEC and Santander

Uncertainty around the effectiveness of the inflationary target regime to curb double-digit inflation over a three-year horizon has led to speculations on the rule being replaced.

In addition, reaching the inflationary goals is viewed as necessary to speed up the reduction in the government primary deficit to above targets.to The Central Bank eliminating its onerous quasi-fiscal debt and no longer accumulating new short-term debt is at the centre of the debate after ad hoc BCRA notes (“Leliq”) were launched two weeks ago.

Since the nominal stock of Lebac owed by BCRA is lower than the nominal value of the financial Treasury assets on the BCRA balance sheet, S&P recently recommended that BCRA to rid itself of the Lebac stock, exchanging these liabilities for marketable Treasury papers.

We believe a more volatile FX market will dominates till new government definitions emerge on the fiscal and quasi-fiscal fronts, and the monetary policy rate is fully ratified as the only anchor to inflation.

For the time being, analysts have adjusted their FX forecasts upward, more in with expected inflation, thus, significantly reducing the 2018 expected carry trade.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	↘	→	• EUR/PLN maintained its downward trend at the turn of the year, with strong demand for risky assets and the Ministry of Finance selling cEUR3bn at the year-end in a context of low liquidity. We think the zloty may give up some of its gains as the dollar could recover in the short term and the MPC rhetoric has become even more dovish, with the “hawkish” members sounding a bit more reserved after inflation slowed
CZK	↘	↗	• EUR/CZK fell to its lowest since March 2013 on strong macro data and the market pricing in a rate hike again. We think the downward trend could pause in the coming weeks as the scenario of further monetary policy normalization has already been priced in
HUF	→	↑	• Over the last two months EUR/HUF fell to 308 from 315. This move was fuelled by local factors as well as by buying of CEE T-bonds • Expectations that the tightening cycle will start in 2H19 could intensify in 2H18, which could push EUR/HUF down to 300
RUB	→	↗	• In the last two months rising oil prices and increasing oil, gas and soft commodities exports pushed down the USD/RUB to 56.30 from 58.50 • In the coming weeks we expect USD/RUB to stabilise, while in the next months the Russian ruble should appreciate, thanks to energy and soft commodities exports rising

↑ Bullish ↗ Mildly Bullish → Neutral ↘ Mildly Bearish ↓ Bearish

Source: Bank Zachodni WBK.

PLN – Little room for further appreciation

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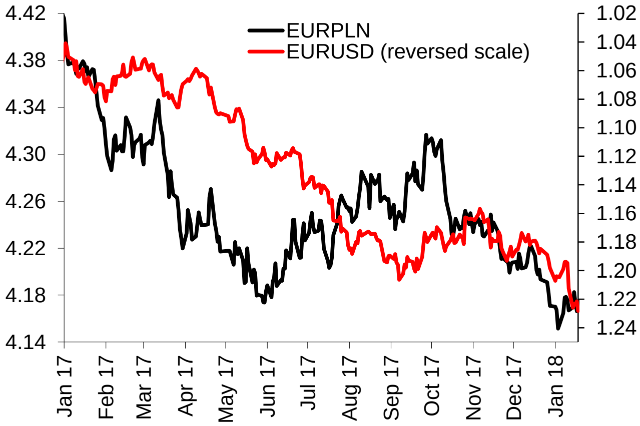
Chart 34: EUR/PLN and EUR/USD



Source: Reuters, Bank Zachodni WBK.

EUR/PLN maintained its downward trend at the turn of the year amid high demand for risky assets and with the Ministry of Finance selling cEUR3bn at the year-end in a context of low liquidity. We think the zloty may give up some of its gains, as the dollar could recover in the short term and the MPC's rhetoric has become even more dovish with the "hawkish" members sounding a bit more reserved after inflation decelerated.

Technical analysis oscillators show EUR/PLN is oversold and implied volatilities are running at multi-month lows. The 3M 25 delta risk reversal implied volatility is around the level last seen in late December 2015 (which was the lowest reading since 2008) and early 2016 showed a sharp rise of EUR/PLN to 4.50 from 4.20. We do not see factors to trigger such a big move this year, but this is yet another reason for us to be cautious about expecting further zloty appreciation in the short term.

Additionally, we think that the dollar may recover in the coming weeks. Chart 34 shows EUR/PLN has been tracking EUR/USD pretty closely in recent weeks. If the dollar starts to recover, this may generate upside pressure on EUR/PLN.

Recent weeks proved interesting in Polish politics. In late 2017, Prime Minister Beata Szydlo was replaced by the Deputy PM, Minister of Finance and Development Mateusz Morawiecki, and in early January Morawiecki announced a government reshuffle. The new minister of finance will be former deputy minister Teresa Czerwinska. The new head of the Ministry of Investment and Development is former deputy Jerzy Kwiecinski. The Polish market has not reacted to these changes. The new ministers are widely experienced in their areas and personnel changes should not affect economic policy.

Poland's 3Q17 GDP growth reached 4.9% y/y. Private consumption remained the main engine of expansion, rising 4.8% y/y, and net exports surprised positively, adding 1.1pp to GDP growth. Meanwhile, fixed investments picked up only slightly (3.3% y/y), showing that the long-awaited recovery in this area is happening more slowly than expected. Monthly economic activity data for 4Q17 support our 4.8% y/y forecast of GDP growth in the final quarter of 2017. Flash data for GDP growth in the whole of 2017 will be released at the end of January.

CZK – Rate hikes already priced in

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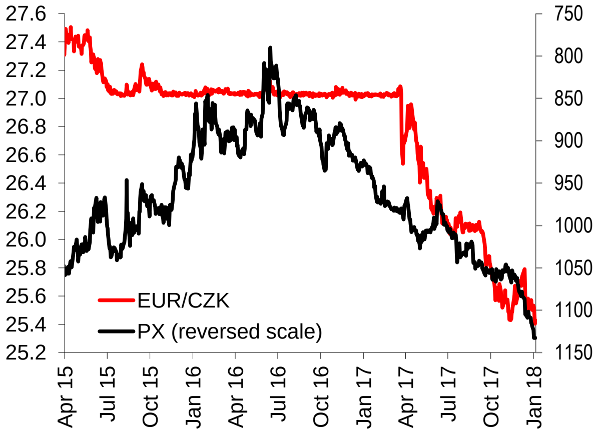
Chart 35: EUR/CZK and Prague stock index



Source: Reuters, Bank Zachodni WBK.

EUR/CZK fell to its lowest since March 2013 on strong macro data and the market pricing in a rate hike again. We think the downward trend could pause in the coming weeks as the scenario of further monetary policy normalisation has now been priced in.

In December 2017, the Czech National Bank (CNB) refrained from hiking rates for the third time that year, citing the strength of the koruna as one of the reasons for a pause. In late January, CNB head Jiri Rusnok said that the next hike could take place in early February. The FRA market is now pricing in a 50bp hike in the next three months and a total of 100bp in the next 12 months, which implies there is little room for more aggressive pricing, particularly in the short term.

In mid-January Czech PM Andrej Babis and his minority government lost a confidence vote and resigned. They will continue as an acting government while they try to find a coalition partner, which could take at least several weeks. Although Babis is accused of a subsidy fraud, his ANO movement has still high public support and so the eight remaining parliamentary parties may not be willing to force an election and could try to form a coalition instead.

Although the political clash seems not to worry investors much while economic data are robust and stock prices are rising, prolonging the deadlock may curb further koruna gains.

HUF – Industrial activity supports the forint

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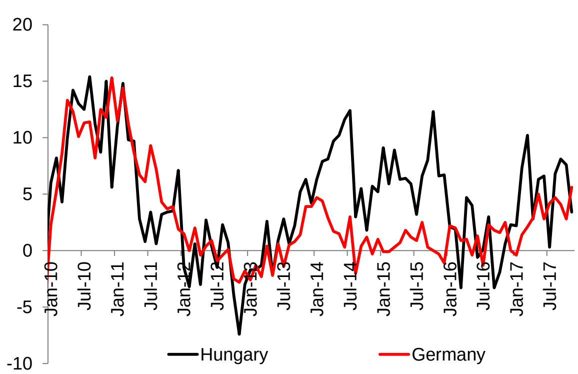
Chart 36: Industrial output % y/y



Source: Reuters, Bank Zachodni WBK.

The end of the last year and the beginning of 2018 brought Hungarian forint appreciation vs the euro, as part of a wave of buying of CEE currencies. As a result, EUR/HUF fell to 308 from 315. This move was fuelled by local factors as well as by massive buying of CEE bonds.

In the short term, we expect stabilisation of EUR/HUF. In the longer horizon (three to six months), we anticipate the Hungarian forint strengthening should continue. This move should be supported by the high level of industrial sector activity in Hungary and by the market maintaining its positive view of CEE currencies. In our opinion, the high PMI reading for Euro zone industry points to strong Hungarian industrial production readings (for 1Q18), as Hungarian industry is closely integrated with the Euro zone (especially with the German car industry). Simultaneously, we are seeing a dynamic and broad-based rise in wages (fuelled by demography and increases in the minimum wage). As a result, the market has started to expect interest rates hikes, although so far this has only been priced in on the FX market. The activity of the Hungarian central bank (like forward guidance and the announcement of central bank interest rate swap instruments and the mortgage bond purchase programme) pushed the Hungarian yield curve down markedly.

According to the Hungarian central bank projections, the inflation target will be reached in mid-2019. In our opinion, expectations that the tightening cycle will start in 2H19 could intensify in 2H18, likely pushing EUR/HUF down to 300.

RUB – Higher oil prices lifted the Russian ruble

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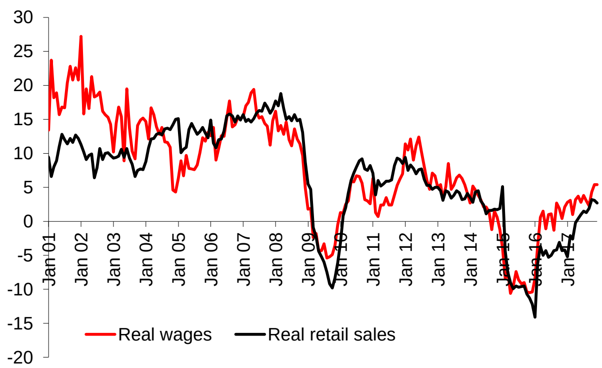
Char 37: Wages and retail sales growth % y/y, Russia



Source: Reuters, Bank Zachodni WBK

Over the last two months, we saw the USD/RUB fall to 56.30 from 58.50 on the back of rising oil prices (to c70 from c63 USD/barrel) and increasing oil, gas and soft commodity exports (after the negative shock in 2014-15 on price falls and increasing trade barriers), which resulted in 4.4% export growth in 3Q17. In combination with the better fiscal situation, this translated into an improvement in the labour market (the unemployment rate fell to 5.0% in 3Q17 from 5.2% in 2Q17, while the real wage growth accelerated to 5.4% y/y in December) and in private consumption (retail sales rose by 2.7% y/y in December). Simultaneously, we observed a reversal of the negative trend in the credit market, where lending conditions continued to ease and demand increased. As a result, credit rose by 8.0% in the year. The positive influence of domestic factors aside, the ruble was supported by bullish global sentiment towards emerging bonds and currencies.

In the next few weeks we expect USD/RUB to stabilise, while in the coming months we see the ruble appreciating. This move should be supported by exports rising at a moderate pace (where losses on the European oil market are neutralised by a rising share in the Asian market). The recovery of exports (visible since the beginning of 2016), accompanied by the labour market improvement and rebound in domestic demand, should help the Russian ruble to appreciate.

Moreover, the Russian ruble will likely be supported by investment demand connected with the World Cup football championship scheduled for June-July 2018. Besides supporting the investment goods and construction sectors, this should give an additional boost to private consumption growth. In the case of industrial output, the stimulus should be visible in a slower fall or a stabilisation rather than in actual growth in production. The reason for this is a strong negative impact of prolonged international sanctions against Russia (focused on the oil and financial sectors and freshly extended to the railway and steel sectors).

The risks to this scenario are a fall in oil prices in the rest of this year and the prospect of cuts in interest rates, given falling inflation and the Russian central bank's declaration that a neutral level of interest rates is 6%-7% (vs the current 7.75%). Even so, we see USD/RUB at 55.0 in mid-2018.

G10 FX: IMM Speculative Positioning

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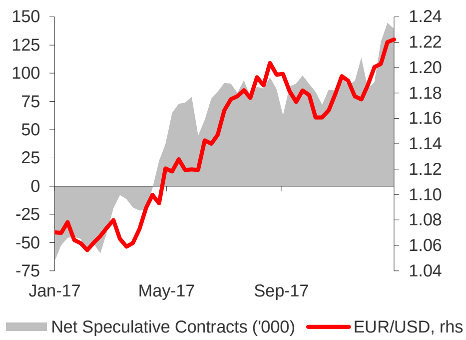
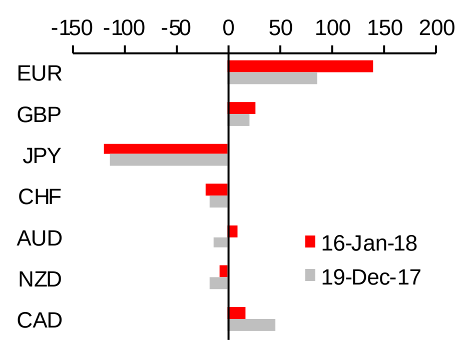
IMM commitment of traders report: EUR/USD position



- **The net long EUR position reached an all-time high in January.** In 20 years of CFTC data, the net long EUR position reached 145k contracts for the first time in the week ended 9 January, before slipping slightly, to 140k contracts, in the latest week's data (ended 16 January). With this position continuing to look very large, any reversal would likely pull the Single Currency lower.
- **Speculators again increased their net long GBP position.** While the current 26k contracts is a long way off its historic high, it is the most net long speculators have been on Sterling since September 2014. Similar to the EUR, the GBP looks increasingly at risk of this position being unwound.
- **AUD positioning turned net long in January**, albeit by just 10k contracts. Despite this AUD-positive positioning shift, AUD/USD now looks too strong, and may struggle to log gains even if this position continues to improve.
- **The net long CAD position fell to 18k contracts,** more than halving over the past month, in spite of January's BoC rate hike.

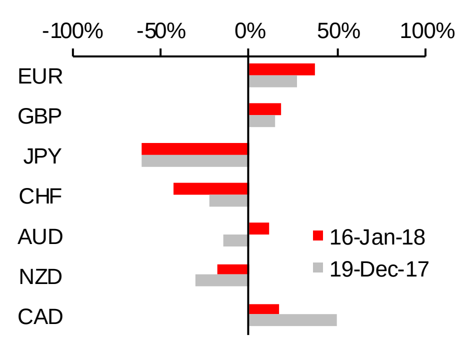
Net Speculative Contracts ('000s)*

	16-Jan-18	19-Dec-17	4w chg	YtD chg
USD***	-91.7	-45.4	-46.3	-410.8
EUR	139.5	86.2	53.3	209.5
GBP	26.2	20.4	5.8	90.9
JPY	-119.4	-114.4	-5.0	-32.6
CHF	-21.1	-17.4	-3.7	-7.7
AUD	10.1	-12.7	22.7	13.3
NZD	-8.0	-16.6	8.6	3.4
CAD	17.6	45.9	-28.3	21.4



Net Speculative Contracts as % of Open Interest**

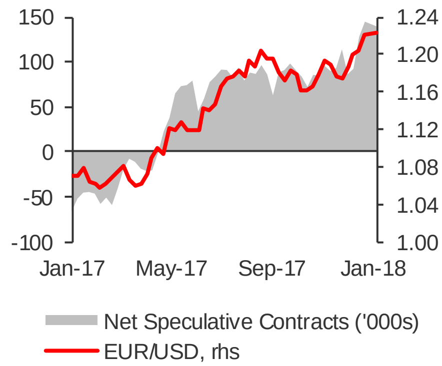
	16-Jan-18	19-Dec-17	4w chg	YtD chg
USD***	-8%	-4%	-4%	-38%
EUR	38%	28%	10%	59%
GBP	18%	15%	3%	55%
JPY	-61%	-61%	0%	-8%
CHF	-43%	-23%	-20%	-6%
AUD	11%	-14%	25%	14%
NZD	-18%	-30%	12%	0%
CAD	17%	50%	-34%	21%



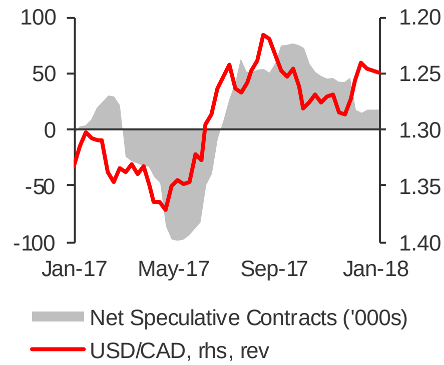
Sources: CFTC, Bloomberg, Santander. Note: *Net Speculative Contracts = Long non-commercial traders contracts minus short non-commercial traders contracts, **Open Interest = The total number of outstanding long and short futures contracts, ***USD composite index = USD composite index uses AUD, CAD, CHF, EUR, GBP, JPY, NZD and MXN IMM positioning to arrive at an aggregate USD position.

G10 FX: IMM Speculative Positioning

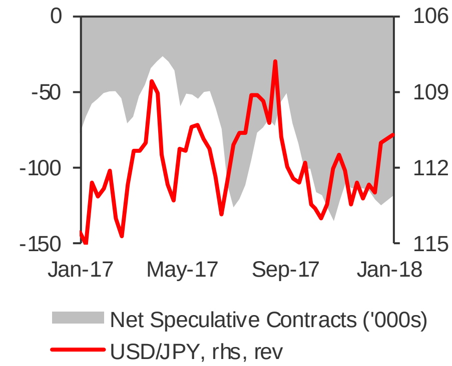
EUR/USD



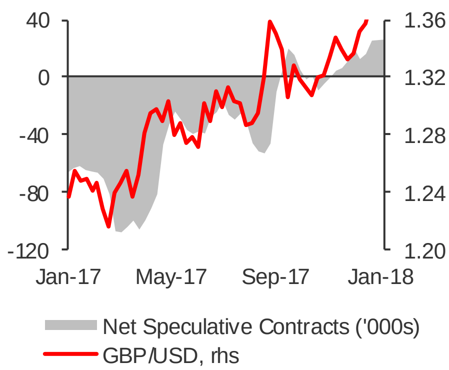
USD/CAD



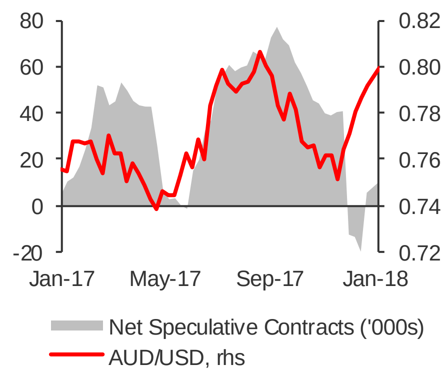
USD/JPY



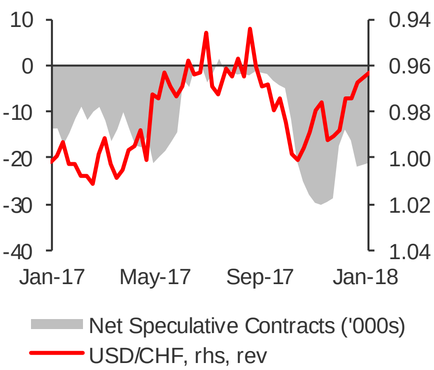
GBP/USD



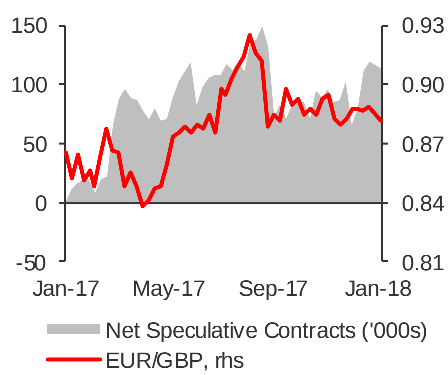
AUD/USD



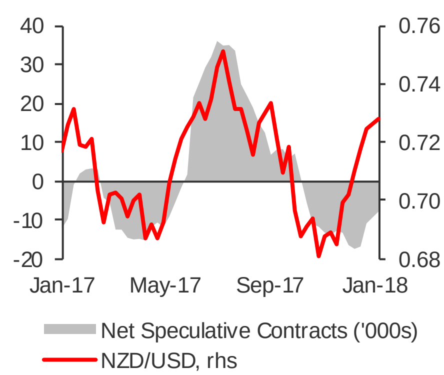
USD/CHF



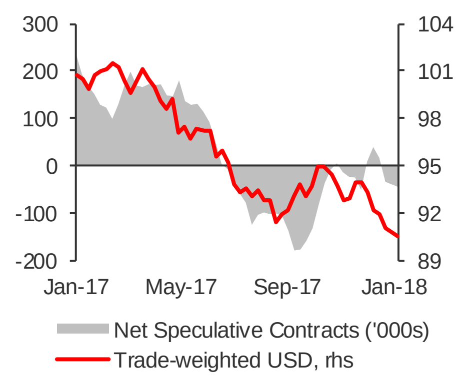
EUR/GBP



NZD/USD



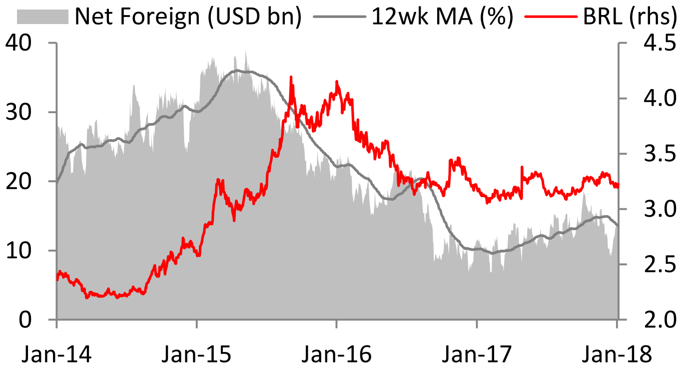
USD minus MXN



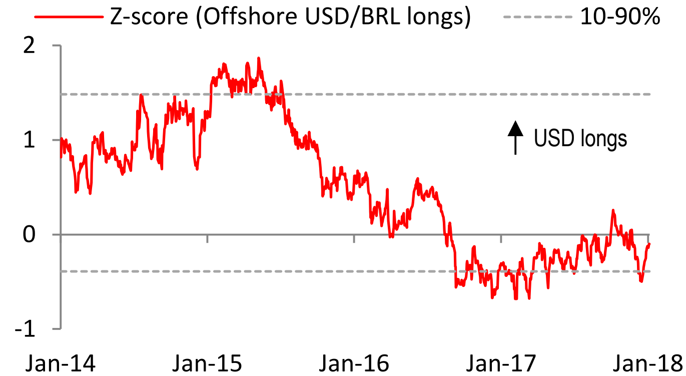
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report

Latin America FX: Positioning indexes (Z-scores)

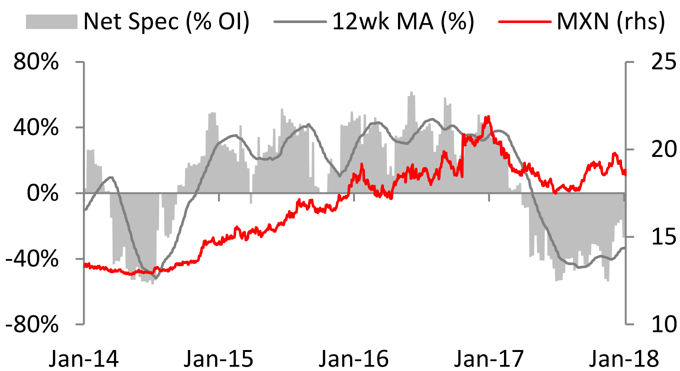
USD/BRL



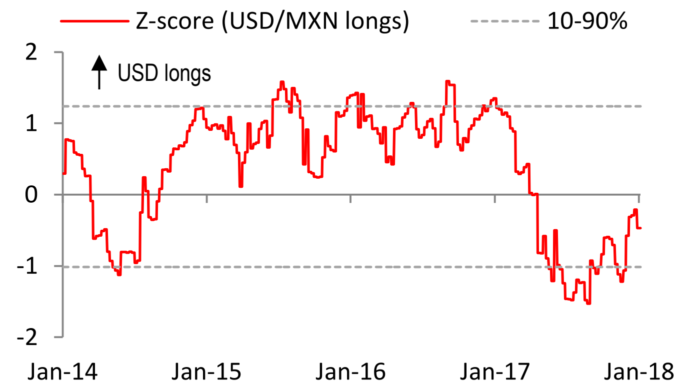
Z-score USD/BRL



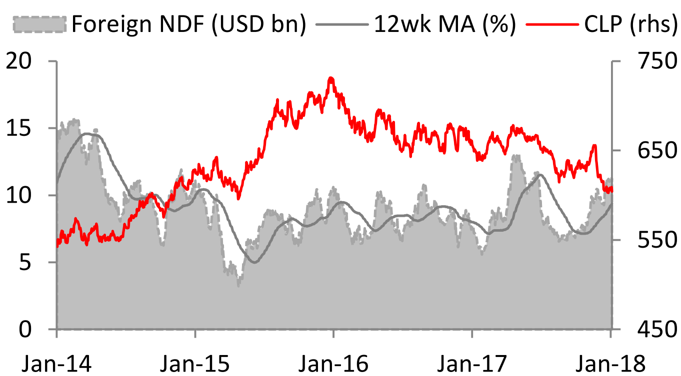
USD/MXN



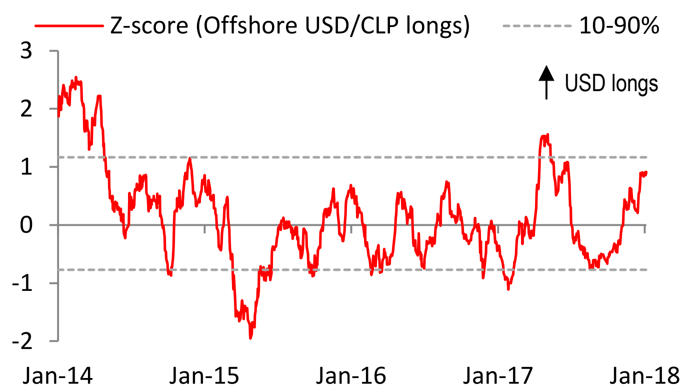
Z-score USD/MXN



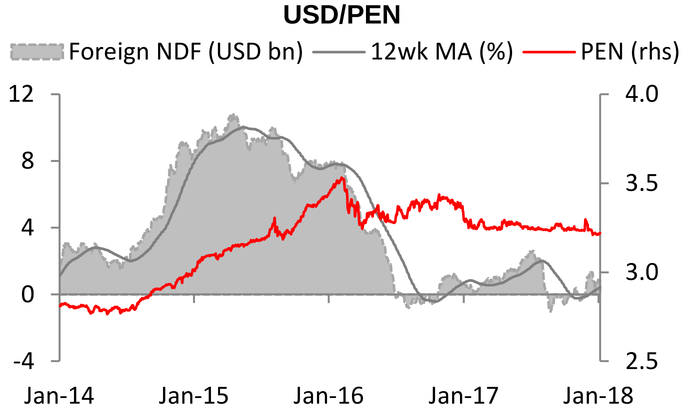
USD/CLP



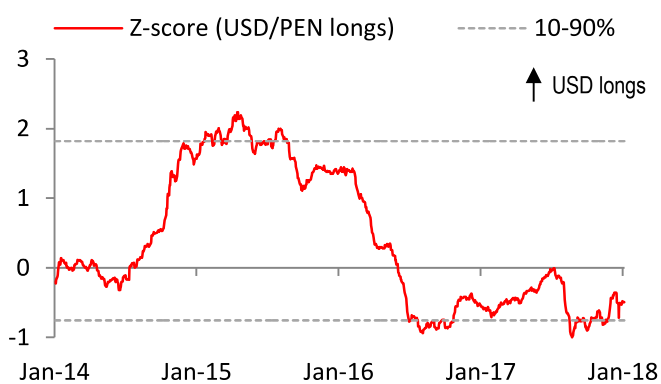
Z-score USD/CLP



USD/PEN



Z-score USD/PEN



Sources: BM&F, CFTC, BCCh, BCRP, Bloomberg and Santander.

Euro Interest Rate Forecasts

Government Bond yield Forecasts

Germany	Current	1Q18	2Q18	3Q18	4Q18
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.66	-0.80	-0.75	-0.70	-0.60
2y	-0.58	-0.60	-0.50	-0.40	-0.20
5y	-0.13	-0.20	-0.10	0.05	0.20
10y	0.58	0.45	0.60	0.80	0.95
30y	1.31	1.34	4.45	4.65	4.75

Swap rate forecasts

Euro	Current	1Q18	2Q18	3Q18	4Q18
ECB Depo	-0.40	-0.40	-0.40	-0.40	-0.40
3m	-0.33	-0.33	-0.33	-0.31	-0.26
2y	-0.13	-0.10	-0.05	0.00	0.15
5y	0.39	0.30	0.35	0.45	0.60
10y	0.98	0.95	10.50	1.20	1.35
30y	1.55	1.65	1.75	1.90	2.00

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	1Q18	2Q18	3Q18	4Q18
FOMC *	1.50	1.75	2.00	2.00	2.25
3m	1.43	1.65	1.85	2.00	2.25
2y	2.08	2.05	2.25	2.50	2.85
5y	2.42	2.40	2.60	2.85	3.15
10y	2.64	2.55	2.70	2.95	3.25
30y	2.92	2.90	3.00	3.20	3.50

Swap rate forecasts

US	Current	1Q18	2Q18	3Q18	4Q18
FOMC *	1.50	1.75	2.00	2.00	2.25
3m	1.75	1.90	2.10	2.25	2.50
2y	2.26	2.20	2.35	2.55	2.85
5y	2.50	2.40	2.55	2.75	3.05
10y	2.67	2.55	2.65	2.85	3.15
30y	2.78	2.70	2.80	2.95	3.25

UK Interest Rate Forecasts

Government Bond yield Forecasts

UK	Current	1Q18	2Q18	3Q18	4Q18
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.49	0.40	0.40	0.37	0.42
2y	0.58	0.60	0.70	0.40	0.50
5y	0.91	1.00	1.20	0.90	1.00
10y	1.40	1.60	1.80	1.40	1.60
30y	1.88	2.20	2.30	2.00	2.20

Swap rate forecasts

UK	Current	1Q18	2Q18	3Q18	4Q18
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.53	0.55	0.52	0.52	0.52
2y	0.90	1.00	1.10	0.70	0.80
5y	1.23	1.25	1.45	1.25	1.30
10y	1.48	1.65	1.80	1.50	1.70
30y	1.61	1.90	2.00	1.60	1.80

G10 Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
FOMC *	1.50	Unch.	-	**	-	Unch.	+25bp	31	-	21	-	2	13
ECB (Depo)	-0.40	Unch.	-	Unch.	**	-	Unch.	Unch.	-	8	26	-	14
BoE	0.50	-	Unch.	Unch.	-	+25bp	Unch.	-	8	22	-	10	21
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	9	27	-	15
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	22	-	-	21
BoC	1.25	+25bp	-	+25bp	Unch.	-	Unch.	+25bp	-	7	18	30	-
RBA	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	6	6	3	1	5
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	-	-	7	21	-	9	27
Norges Bank	0.50	-	-	Unch.	Unch.	-	Unch.	Unch.	-	15	-	3	21
Riksbank	-0.50	Unch.	-	Unch.	Unch.	-	Unch.	-	14	-	26	-	-

Source: Bloomberg, Santander. Note: Current levels as at 30-November-2017. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month *FOMC rate refers to upper bound rate. **FOMC announced it would begin to reduce its balance sheet from October 2017 and ECB extended QE until September 2018 at EUR30/month

Brazil/Mexico Interest rate forecasts

Government Bond yield

Brazil	Current	1Q18	2Q18	3Q18	4Q18
SELIC	7.00	6.75	6.75	6.75	6.75
NTNF Jan' 19s	6.79	7.00	7.50	8.25	8.50
NTNF Jan.' 25s	9.54	10.00	10.00	10.20	10.50

Government Bond yield

Mexico	Current	1Q18	2Q18	3Q18	4Q18
Banxico fondeo	7.25	7.50	7.75	7.75	7.50
Mbono Jun. '22s	7.37	7.65	7.60	7.35	7.20
MBono Dec. '27s	6.81	7.75	7.70	7.40	7.30

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	1Q18	2Q18	3Q18	4Q18
BCCh TPM	2.50	2.50	2.50	2.75	3.00
BCP 5Y	3.90	3.90	3.90	4.00	4.15
BCP 10Y	4.50	4.50	4.50	4.70	4.90

Government Bond yield

Colombia	Current	1Q18	2Q18	3Q18	4Q18
Banrep O/N	4.75	4.25	4.00	4.00	4.00
TES 5Y	5.62	5.43	5.47	5.54	5.69
TES 10Y	6.37	6.38	6.51	6.70	6.94

LatAm Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Brazil	7.00	-100bp	-	-100bp	-75bp	-	-50bp	-	7	21	-	16	20
Mexico	7.25	-	Unch.	Unch.	-	Unch.	+25bp	-	8	-	12	17	21
Chile	2.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	-	1	20	-	3	13
Colombia	4.75	-25bp	-25bp	Unch.	-25bp	-25bp	Unch.	29	23	20	27	31	29
Argentina	27.25	Unch.	Unch.	Unch.	+150bp	+100bp	Unch.	-150bp	*	*	*	*	*

CEE Interest Rate Forecasts

Poland

Poland	Current	1Q18	2Q18	3Q18	4Q18
Reference Rate	1.50	1.50	1.50	1.50	1.75
2y	1.52	1.68	1.70	1.92	1.97
10y	3.34	3.33	3.42	3.52	3.48

Hungary/Czech Republic/Russia Base Rates

CEE	Current	1Q18	2Q18	3Q18	4Q18
Hungary	0.90	0.90	0.90	0.90	0.90
Czech Republic	0.50	0.75	0.75	1.00	1.25
Russia	7.75	7.75	7.25	7.00	6.75

CEE Central Bank Calendar

	Current Rate	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Poland	1.50	Unch.	-	Unch.	Unch.	Unch.	Unch.	Unch.	7	7	11	16	6
Czech Republic	0.50	-	+20bp	Unch.	-	+25bp	Unch.	-	1	29	-	3	27
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	30	27	27	24	22	19
Russia	7.75	Unch.	-	-50bp	-25bp	-	-50bp	-	9	23	27	-	15

Source: Santander, BZWBK. Note: Current levels as at 25-January-2018. For meetings that have already taken place, decision identified as +/- in bp, or "unch" for no change. "-" denotes no meeting taking place that month. *The Argentina Central Bank decides on monetary policy on a fortnightly basis.

Forecasts and returns vs. forwards and consensus (% non-annualised)

	3M	6M	9M
EUR/USD	**1.21**	**1.23**	**1.25**
vs.forward	-2.3	-1.2	0.4
vs.consensus forecast	1.1	2.2	2.2
GBP/USD	**1.38**	**1.35**	**1.33**
vs.forward	-3.3	-5.1	-6.5
vs.consensus forecast	2.2	0.2	-2.7
EUR/GBP	**0.88**	**0.91**	**0.94**
vs.forward	1.0	4.1	7.4
vs.consensus forecast	-1.2	1.9	3.9
USD/JPY	**115**	**116**	**117**
vs.forward	5.3	6.8	7.7
vs.consensus forecast	1.5	2.9	4.8
EUR/JPY	**139**	**143**	**146**
vs.forward	2.9	5.6	8.2
vs.consensus forecast	3.1	4.9	7.6
EUR/CHF	**1.16**	**1.17**	**1.19**
vs.forward	-0.5	0.4	1.5
vs.consensus forecast	-0.6	-0.6	-0.3
USD/CHF	**0.96**	**0.96**	**0.95**
vs.forward	1.8	1.6	1.1
vs.consensus forecast	-2.2	-1.4	-1.9
EUR/SEK	**9.6**	**9.4**	**9.2**
vs.forward	-2.6	-3.9	-6.3
vs.consensus forecast	-1.9	-2.2	-3.2
EUR/NOK	**9.2**	**9.1**	**9.1**
vs.forward	-4.4	-5.1	-5.5
vs.consensus forecast	-4.5	-4.2	-3.5
USD/CAD	**1.25**	**1.24**	**1.23**
vs.forward	1.2	0.6	0.1
vs.consensus forecast	-1.1	-0.8	-0.5
AUD/USD	**0.77**	**0.76**	**0.76**
vs.forward	-4.3	-5.9	-5.5
vs.consensus forecast	-0.9	-3.8	-4.6
NZD/USD	**0.71**	**0.70**	**0.71**
vs.forward	-3.3	-4.7	-3.3
vs.consensus forecast	0.5	-2.3	-0.9

	3M	6M	9M
USD/BRL	**3.31**	**3.42**	**3.50**
vs.forward	5.2	8.6	11.2
vs.consensus forecast	1.9	3.6	4.5
EUR/BRL	**4.02**	**4.20**	**4.36**
vs.forward	2.9	7.4	11.7
vs.consensus forecast	3.1	5.9	6.8
USD/MXN	**20.3**	**20.00**	**18.33**
vs.forward	9.8	8.4	-0.6
vs.consensus forecast	5.6	5.3	-2.5
EUR/MXN	**24.6**	**24.5**	**22.9**
vs.forward	7.4	7.1	-0.2
vs.consensus forecast	6.7	7.6	-0.4
USD/CLP	**605**	**608**	**620**
vs.forward	0.8	1.4	3.3
vs.consensus forecast	-1.6	-0.5	1.7
EUR/CLP	**734**	**746**	**773**
vs.forward	-1.5	0.1	3.7
vs.consensus forecast	-0.5	1.7	3.9
USD/COP	**2933**	**2983**	**2967**
vs.forward	4.9	6.7	6.1
vs.consensus forecast	0.5	1.1	0.6
USD/ARS	**19.1**	**20.2**	**21.3**
vs.forward	-2.5	3.0	8.4
vs.consensus forecast	1.8	6.6	9.2
EUR/PLN	**4.23**	**4.26**	**4.26**
vs.forward	2.0	2.7	2.7
vs.consensus forecast	1.2	2.2	2.7
EUR/CZK	**25.7**	**25.6**	**25.5**
vs.forward	1.1	0.7	0.3
vs.consensus forecast	1.0	1.5	1.9
EUR/HUF	**306**	**301**	**300**
vs.forward	-1.1	-2.6	-3.0
vs.consensus forecast	-1.3	-2.8	-2.9
EUR/RUB	**68**	**67**	**66**
vs.forward	-2.6	-3.9	-5.3
vs.consensus forecast	-1.4	-4.3	-6.0

Direct returns of long currency positions against the USD (or EUR), in %. Equivalent tenors for forwards. FX forecasts interpolated from end-of-quarter forecasts. Sources: Bloomberg and Santander.

G10 FX: Spot and forward rates

	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
Spot	1.251	1.431	108.7	136.1	155.6	0.931	1.165	1.332
1M	1.254	1.432	108.6	136.1	155.5	0.929	1.164	1.330
2M	1.256	1.433	108.4	136.1	155.4	0.927	1.164	1.329
3M	1.259	1.435	108.2	136.1	155.3	0.924	1.163	1.327
6M	1.267	1.441	107.5	136.2	154.9	0.917	1.162	1.322
9M	1.275	1.446	106.9	136.3	154.5	0.910	1.161	1.316
12M	1.285	1.452	106.1	136.3	154.0	0.902	1.160	1.310

ATMf vol.

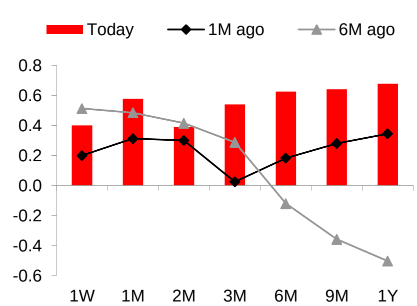
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	9.5%	11.1%	9.4%	7.8%	10.1%	9.0%	5.4%	7.3%
1M	7.7%	9.0%	8.1%	7.3%	9.3%	7.7%	5.0%	7.0%
2M	8.0%	8.7%	8.4%	8.3%	9.5%	7.8%	5.3%	7.2%
3M	7.7%	8.4%	8.3%	8.2%	9.4%	7.7%	5.3%	7.1%
6M	7.5%	8.2%	8.4%	8.4%	9.4%	7.8%	5.4%	7.3%
9M	7.5%	8.2%	8.4%	8.6%	9.5%	7.8%	5.4%	7.5%
12M	7.4%	8.1%	8.5%	8.7%	9.6%	7.9%	5.4%	7.6%

Implied/realized vol. ratio

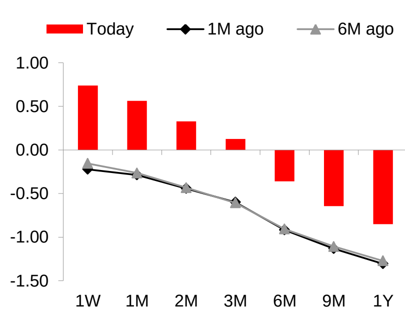
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.09	1.17	1.10	1.05	1.17	0.97	0.87	0.98
1M	1.02	1.24	1.17	1.01	1.23	1.02	0.95	1.12
2M	1.19	1.15	1.21	1.25	1.13	1.10	1.05	0.95
3M	1.20	1.15	1.23	1.24	1.14	1.13	1.03	0.95
6M	1.09	1.08	1.14	1.19	1.06	1.04	0.91	0.90
9M	1.11	1.05	1.12	1.15	1.00	1.08	0.99	0.90
12M	1.08	1.03	1.06	1.07	0.98	1.12	1.04	0.93

25-delta risk reversals

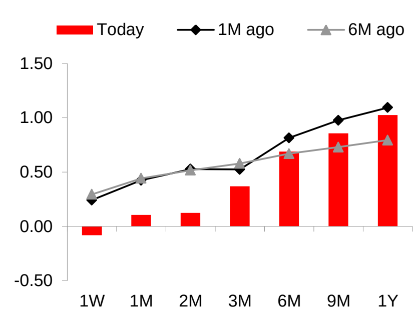
EUR/USD



GBP/USD



EUR/GBP



Sources: Bloomberg and Santander.

Latin America FX: Spot and forward rates

	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
Spot	19.53	3.14	599	2785	18.4	3.21
1M	19.87	3.15	599	2792	18.5	3.21
2M	20.18	3.16	599	2799	18.6	3.22
3M	20.49	3.17	599	2806	18.7	3.22
6M	21.41	3.20	600	2824	19.0	3.23
9M	22.18	3.23	601	2844	19.3	3.24
12M	23.05	3.27	602	2863	19.6	3.25

ATMf vol.

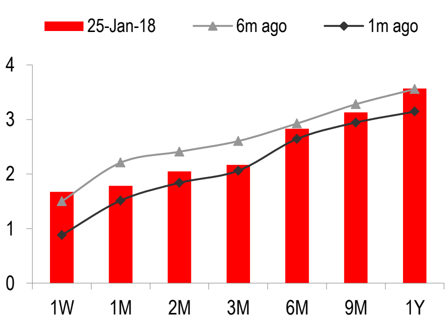
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	8.09	13.02	8.22	11.17	14.77	3.92
1M	10.95	11.64	8.22	11.14	12.60	3.87
2M	12.19	11.91	8.19	11.45	12.62	4.26
3M	13.12	12.06	8.22	11.65	12.60	4.51
6M	14.70	12.50	8.47	12.05	14.99	5.03
9M	15.72	13.51	8.73	12.33	14.37	5.43
12M	16.29	13.73	8.76	12.47	14.07	5.62

Implied/realized vol. ratio

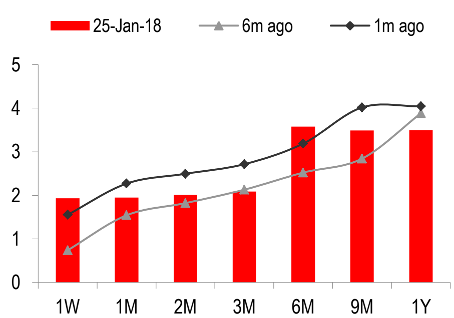
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	0.70	1.16	1.25	0.74	1.12	1.66
1M	0.99	1.31	1.13	1.05	1.03	1.48
2M	1.03	1.14	0.97	1.30	1.14	0.93
3M	1.29	1.14	1.00	1.33	1.19	1.12
6M	1.48	1.30	1.12	1.57	1.46	1.52
9M	1.59	0.99	1.20	1.50	1.38	1.59
12M	1.77	1.05	1.19	1.48	1.27	1.56

25-delta risk reversals

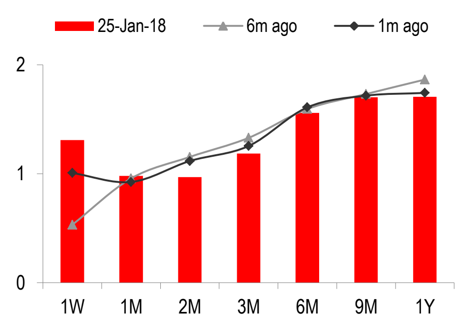
USD/BRL



USD/MXN



USD/CLP



Sources: Bloomberg and Santander.

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EXPLANATION OF THE RECOMMENDATION SYSTEM

RECOMMENDATIONS	
	Definition
Long / Buy	Appreciation of a given currency with an expected return of at least 5% in 3 months.
Short / Sell	Depreciation of a given currency with an expected return of at least 5% in 3 months.

NOTE: Given the recent volatility seen in the financial markets, the recommendation definitions are only indicative until further notice.

DEFINITIONS

***Net Speculative Contracts**	Long non-commercial traders contracts minus short non-commercial traders contracts.
****Open Interest**	The total number of outstanding long and short futures contracts. These data may not be the same as the IMM's total open interest data.
*****USD composite index**	USD composite index uses AUD, CAD, CHF, EUR, GBP, JPY, NZD and MXN IMM positioning to arrive at an aggregate USD position.

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