30 November 2017, 14:15 GMT

FX COMPASS

Note: There will be no FX Compass in December. The next edition of the FX Compass will be published in late January 2018.

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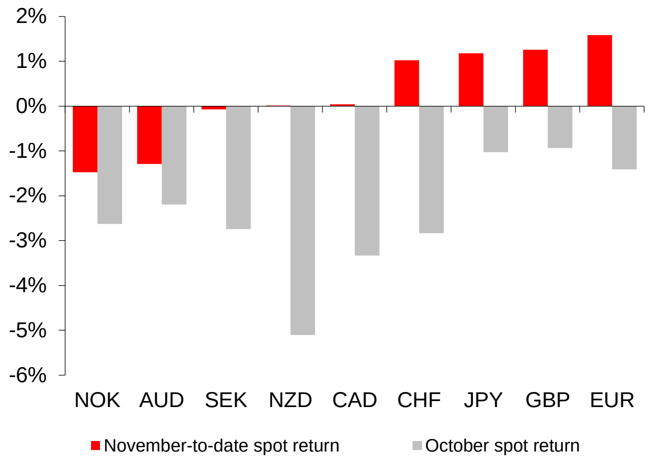
Santander GLOBAL CORPORATE BANKING

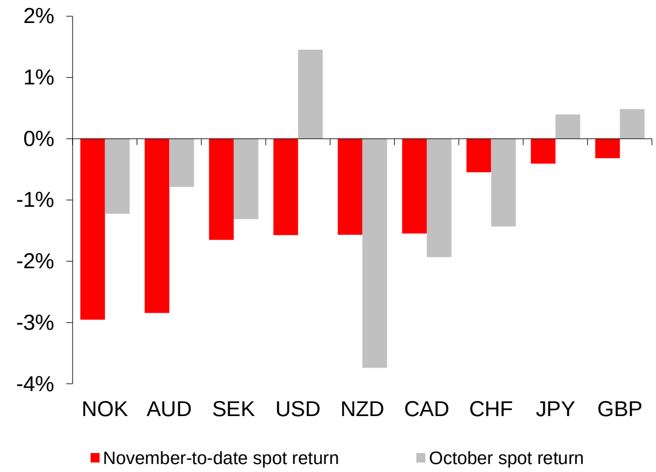
Santander Interest Rate & FX Strategy in Bloomberg: SRFS <GO>

FX Spot Returns

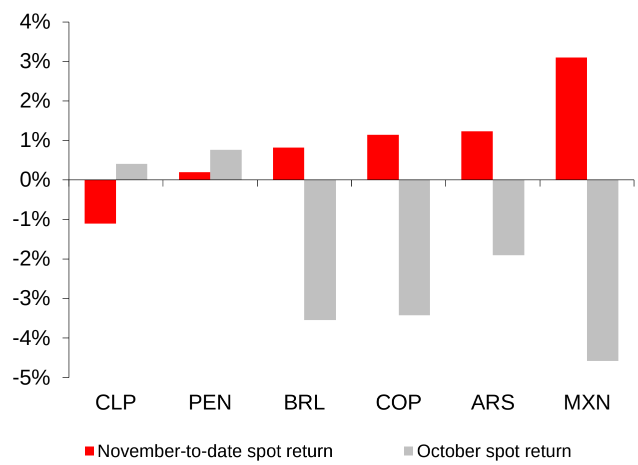
G10 spot returns vs. USD



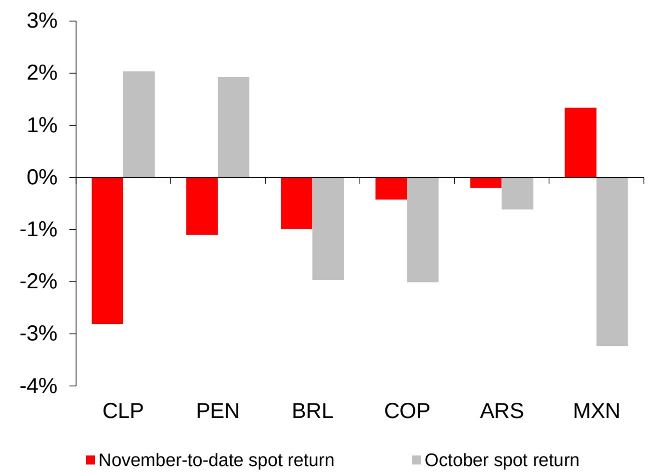
G10 spot returns vs. EUR



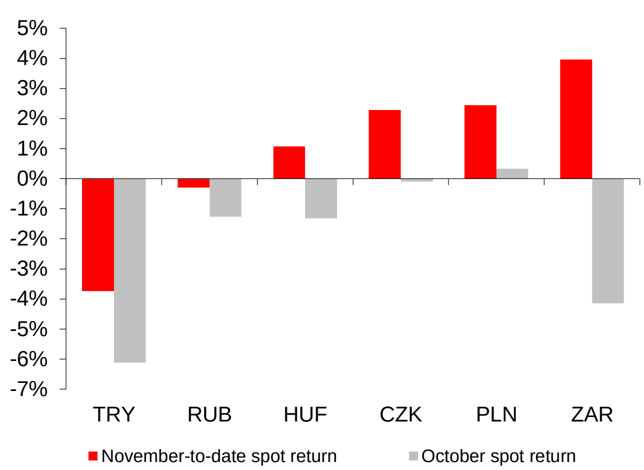
LatAm spot returns vs. USD



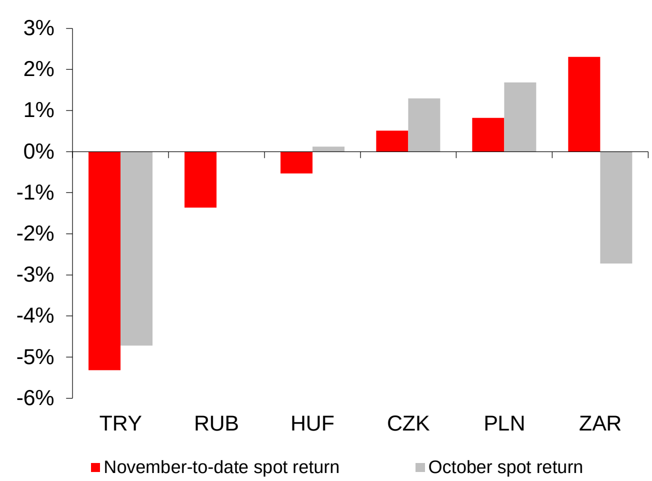
LatAm spot returns vs. EUR



CEEMA vs. USD



CEEMA vs. EUR



Source: Bloomberg, Santander. Note: Data current as at 30 November 2017 at 13:30 GMT

FX Forecasts

G10 FX Forecasts

	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19
EUR-USD	1.15	1.17	1.18	1.20	1.22	1.24
GBP-USD	1.30	1.28	1.26	1.25	1.25	1.27
GBP-EUR	1.13	1.09	1.07	1.04	1.02	1.02
EUR-GBP	0.88	0.91	0.94	0.96	0.98	0.98
USD-JPY	116	118	119	120	122	124
EUR-JPY	133	138	140	144	149	154
USD-CNY	6.80	6.90	6.95	7.00	6.80	6.70
EUR-CHF	1.16	1.17	1.18	1.20	1.22	1.23
USD-CHF	1.01	1.00	1.00	1.00	1.00	0.99
EUR-SEK	9.4	9.3	9.1	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	0.76	0.74	0.75	0.77	0.79	0.80
NZD-USD	0.70	0.69	0.71	0.73	0.75	0.77

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	19.7	17.9	17.5	17.6	17.6
USD-CLP	630	640	650	650	650	650
USD-COP	3100	3200	3100	3000	3000	2900
USD-ARS	18.3	18.8	19.4	20.0	20.4	20.9
EUR-BRL	3.77	3.95	4.13	4.20	4.15	4.09
EUR-MXN	23.0	23.0	21.1	21.0	21.5	21.8
EUR-CLP	725	749	767	780	793	806
EUR-COP	3565	3744	3658	3600	3660	3596
EUR-ARS	21.0	22.0	22.9	24.0	24.9	25.9

CEE FX Forecasts

	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19
EUR-PLN	4.22	4.23	4.23	4.23	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	300
USD-RUB	60	56	53	52	52	52
EUR-RUB	69	66	63	62	63	64

Sources: Santander, Bank Zachodni Wbk

G10 FX: Main Themes

Currency	3M view	12M view	Main Themes
USD	↗	↗	• The FOMC should hike rates in December and during 2018. These should be USD positive, as are expectations of US economic outperformance • The 'excessive' USD bearishness over the last few months should unwind, but less accommodating stances from other CBs may limit USD gains
EUR	↘	→	• We expect the EUR to overall remain firm in 2018, but in the short term now feel that the currency may have been overbought • The market was too negative about the currency earlier in 2017, but may now be overcompensating by being too positive too quickly
GBP	↘	↓	• The BoE rate hike provided only transitory support for Sterling, and slower inflation in 2018 should imply no more hikes for a while • Growth is slowing and the uncertainty surrounding Brexit has not disappeared and may remain a persistent Sterling-negative factor in 2018
JPY	↓	↓	• USD/JPY has been driven by global risks and safe-haven demand. A more stable geo-political situation should help reverse recent gains • Lower US yields have weakened USD/ JPY, but we expect those yields to rise in 2018 and the BoJ to stick with its loose monetary policy
CNY	↘	↘	• We expect the Chinese currency to weaken slightly against the USD in H1-18, as policymakers continue to focus on reducing debt and financial risks • 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 general EUR strength • The SNB expects 'slow' growth and CPI estimates to remain low. Monetary policy should remain loose, and CHF-negative into 2018
SEK	↑	↗	• Concerns over the housing market and a drop in inflation in October sent the SEK falling sharply in Q4-17, but we see this move as overdone • If the Riksbank refrains from extending its QE programme into 2018, and hikes rates next summer, the SEK should strengthen
NOK	↑	↗	• The NOK has been oversold, in our view, and the elevated oil price suggests EUR/NOK should weaken into year-end • The Norwegian economy is improving, but inflation is low, and the Norges Bank is unlikely to begin to tighten policy until early 2019
AUD	↘	→	• Iron ore prices, a large net long speculative AUD position and interest rate differentials could weigh on the AUD in the coming months • AUD/USD is unlikely to strengthen significantly until the RBA gets closer to hiking rates towards the end of 2018
NZD	→	↗	• Political uncertainty has weighed on the NZD in late 2017, but this should now be priced in. A strong economy in 2018 should be NZD supportive • Adding a jobs target to the RBNZ mandate may mean lower rates for longer. But, we expect a hike long before the RBNZ's late-2019 forecast
CAD	↗	↗	• The CAD should remain firm following BoC rate hikes, but more gains may require another rate change • A firm oil price should support the CAD, but may not be enough to pull it higher by itself amid concern over NAFTA talks and export growth

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

Source: Santander.

G10 FX Overview

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It has been a disappointing 2017 for USD bulls. Indeed, the dollar has been unable to reverse much of the 'selling' trend that began in January 2017, with the market concerned about the Trump administration's policy agenda, North Korea and, following the French Presidential election in May, a more positive view of the EUR, implying that the USD lost out by default. In fundamental terms, despite the market's possible reservations over the efficacy of Trump's policies, the USD may already have been oversold.

Indeed, we hold a generally positive view on the USD for 2018. The US politics and geo-political risks that have weighed on the USD this year are unlikely to disappear in 2018, which may limit the USD's gains, but an outperforming US economy and several more Fed rate hikes should imply an upside bias against most of its developed-market peers.

The fundamental backdrop for the EUR in 2018 should remain supportive. However, we believe the Single Currency has been slightly overbought at the end of 2017. We expect only gradual gains next year, as much of the 'good' economic news may now be priced in. Indeed, while we expect the Eurozone economy to grow 2.2% in 2018 after 2.3% this year, solid growth is no longer a guarantee of additional significant EUR gains. Plus, a market that is long the currency may be more vulnerable to any renewal of European political risk.

Since the start of 2016, the EUR has been more correlated with the improvement in European and German business sentiment. Plus, the market friendly outcome to the French Presidential vote in May, allowed the market to focus on EUR fundamentals, but there may now be a that the market is too sanguine about political risks in 2018. First, the Brexit negotiations and their impact may weigh on the EUR and the GBP, and undermine EUR/USD sentiment in H1-18. Second, planned Italian elections in May 2018 may re-ignite political worries and could, maybe as early as January, act as a catalyst to encourage a market that is now, unlike a year ago, very net long EUR/USD, to unwind those positions.

The 10Y spread is historically a good indicator for EUR/USD. It currently stands at -2% and, in line with the market, we expect the spread to end 2017 at -1.8%, but finish 2018 back at -2.25%. Hence, the outlook for yields suggests little pressure on the pair to move massively, in either direction, over the coming months.

We still favour a weaker Sterling in H1-18. The UK political, and Brexit, backdrop remains uncertain and should limit Sterling gains. In addition, we expect UK economic growth to be sluggish and inflation to gradually decline through the year. Hence, the MPC should be in no rush to hike rates, which should weigh on the Pound, as other central banks adopt less accommodative policies.

Domestic political sentiment and ongoing Brexit negotiations are likely to remain a key influence on the GBP in 2018. The UK's Government remains vulnerable following their 'disappointing' election result in June 2016, which left PM May without a clear majority in Parliament. Further, concerns over the direction and pace of Brexit negotiations with the EU appear unlikely to provide sustained support for Sterling sentiment over the coming months.

The Japanese economy is improving, but inflation should remain low in 2018, allowing the BoJ to maintain a very loose policy. Potential periods of low risk appetite could support the Yen. However, if JGB yields continue to be targeted at close to zero, the expected Fed hikes and higher US yields should pull USD/JPY back to 120 by the end of 2018. Hence, we still favour Yen weakness in 2018.

We are still negative on the CHF, and have revised our EUR/CHF forecast profile slightly higher for 2018. EUR/CHF has gained in 2017, but we still feel this is due to EUR strength, rather than CHF weakness. As such, a more stable EUR in 2018 may act as a brake on the cross's advance, even if the general economic/political/risk backdrop should still allow EUR/CHF to test 1.2000. As far as the SNB is concerned, the CHF ends 2017 in a similar position as it started the year, namely "over-valued", albeit by less than before.

The USD should remain the core driver for USD/CNY in 2018, and we suspect that Fed rate hikes will pull the USD higher. In addition, concern over the vulnerability of Chinese activity amid policymakers' efforts to reduce debt could also weigh on the CNY. As such, we still favour a firmer USD/CNY through 2018.

We are bullish the SEK in 2018. Concerns over the housing market and a decline in October inflation data sent the SEK falling sharply in Q4-17. We see this move as overdone and due for a correction. Growth remains upbeat, and inflation (despite the recent drop) is close to target. While there is significant uncertainty over whether the Riksbank will extend its QE programme into 2018, we think it will refrain from doing so. In addition, we expect the Bank to begin hiking rates next summer, which should support the currency in 2018. We continue to forecast EUR/SEK at 9.0 in Q4-18.

The NOK has weakened sharply in Q4-17, despite of the higher oil price. As such, we are now bullish the currency in the short term, as we consider the currency oversold at its current levels. Heading in to 2018, upsides pressure on the NOK may be more limited, as inflation is low, growth is expected to remain muted and the Norges Bank is therefore likely to keep rates on hold throughout 2018. As such, we remain more neutral the NOK over the coming year.

AUD/USD has largely followed rate differentials this year and, with the FOMC set to continue hiking rates while the RBA sits tight, this could yet pull the AUD even lower, especially if the 2Y AU-US swap spreads turn negative for the first time in 17-years. An unwinding of the still very large speculative net long AUD position could also weigh on the AUD in early 2018. Further ahead, though, the prospect of an RBA rate hike in H2-18 could offer the currency support. In fact, AUD/USD has shared a stronger relationship with the AU-US 10Y swap spreads, and these are expected to rise in 2018.

We are neutral the NZD in the coming months, but see NZD/USD rising during 2018. Uncertainty remains over the new government and potential changes to the RBNZ's mandate could result in a looser-for-longer stance at the Bank. However, we believe the NZD has weakened sufficiently, and could now strengthen in 2018.

Our 2018 CAD stance is upbeat and we expect the currency to appreciate against most of its peers, but the scale and sustainability of these gains should depend on three factors. First, possible Bank of Canada rate hikes. Second, NAFTA negotiations and external trade. Third, oil price developments. As long as at least two of these factors stay CAD positive in 2018, the currency should be able to add to its advance in H2-17.

USD – Things can only get better

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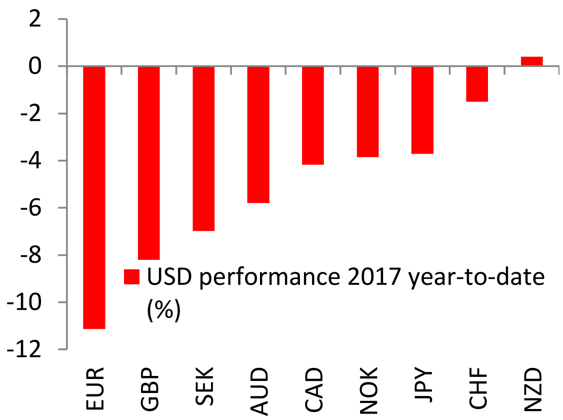
We hold a generally positive view on the USD for 2018. The currency's weakness in 2017 owed much to US politics and geo-political risks. These issues are unlikely to disappear in 2018, which may limit the USD's gains, but an outperforming US economy and several more Fed rate hikes should imply an upside bias against most of its developed-market peers.

It has been a disappointing 2017 for USD bulls. As at the end of November, the currency is the second-worst performing developed-market currency, year-to-date, only marginally pipped for the title by the NZD. The dollar has been unable to reverse much of the 'selling' trend that began in January 2017, with the market concerned about the Trump administration's policy agenda, North Korea and, following the French Presidential election in May, a more positive view of the EUR, implying that the USD lost out by default.

Chart 1: Not a good year for the USD in carry-adjusted terms

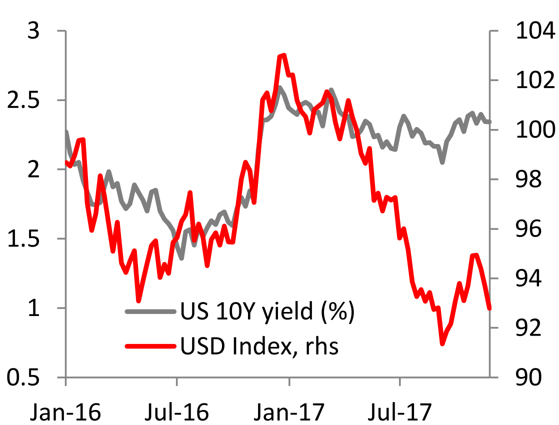


Source: Bloomberg, Santander

Will these USD-negative factors continue in 2018? Or, as with the EUR this year, will the market decide that the selling has gone too far? In fundamental terms, despite the market's possible reservations over the efficacy of Trump's policies, the USD may already have been oversold. We still expect the US economy to outperform most of its peers in 2018 and 2019, with growth of 2.5% and 2.6%, respectively.

Such robust US growth may not be enough to encourage the market to view the USD as a one-way bet to the upside, particularly given that the IMF expects positive growth in all developed economies. But it should be sufficient to place a floor under the currency and, at the very least, keep it stable. Solid growth would also allow the Fed to continue hiking rates. We expect the FOMC to hike by 25bp in December 2017, with a further three hikes likely in 2018, whereas the market appears to be priced for less than two hikes. We do not believe a change in the Fed Chair will alter the pace of hikes.

Chart 2: Mind the gap: focus on risk and politics suggests the USD index may still be too weak



Source: Bloomberg, Santander

A 'hawkish' Fed should provide pockets of USD support in 2018, and caution against adopting a USD-negative position. Hence, there remains scope for the USD to advance against other currencies whose central banks remain reluctant to reduce stimulus at the same pace. In particular, we see scope for USD/JPY gains, with downside EUR/USD pressure only contained by the fact that the EU-US 10Y yield spread is forecast to remain stable in a -1.8% to -2.2% range.

Admittedly, domestic politics and geo-political concerns could weigh on the USD. However, with mid-term elections due in September, the market may assume that the Republican Party and administration will pull together to advance legislation, tax reform, etc. ahead of that vote. Further, European politics, focusing on the German government and Italian elections, may be a stronger EUR-negative focus in H1-18.

Hence, we see many reasons to be USD positive, at best, and, at worse, not to be USD negative in 2018. In addition, the speculative market's short USD position has been cut significantly since October, suggesting fast money accounts also suspect the USD selling has been overdone. However, while that part of the market remains net short the USD, we suspect a further unwinding of these positions in Q1-18 will provide support for the dollar.

EUR – Staying firm

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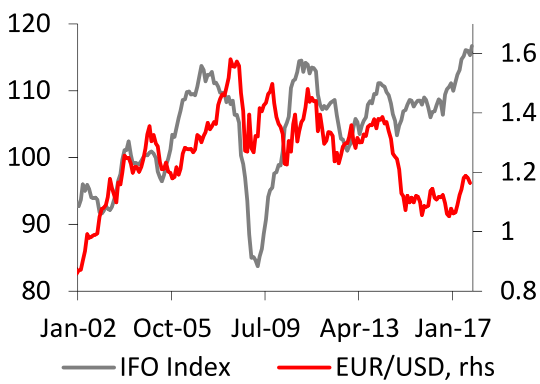
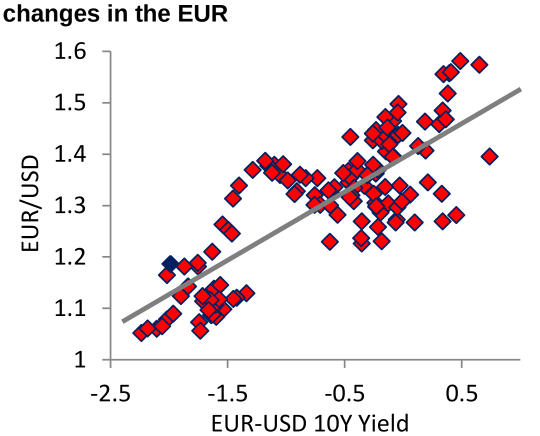
Chart 3: EUR gains have reflected the recovery in the Eurozone economy



Source: Bloomberg, Santander

Chart 4: EU-US 10Y spread is expected to remain close to -2% in 2018, which should limit changes in the EUR



Monthly data since 2007. Blue is the latest data

Source: Bloomberg, Santander

We expect the EUR to overall remain firm in 2018, but in the short term now feel that the currency may have been overbought. We expect only gradual and steady gains in 2018, as much of the 'good' economic news may now be priced in. Plus, a market that is long the currency may be more vulnerable to any renewal of European political risk.

The fundamental backdrop for the EUR in 2018 should remain supportive. We expect the Eurozone economy to grow 2.2% in 2018 after 2.3% this year. However, solid growth is no longer a guarantee of additional significant EUR gains. First, this 'good' economic story should be priced in. Second, the US economy is again expected to outperform in 2018, with growth of 2.5%.

The Eurozone economy has been improving since the end of 2015, but this was not reflected in the EUR, as market participants preferred to trade the currency based on perceived European risks, rather than a clear economic recovery. Since the start of 2016, the EUR has been more correlated with the improvement in European and German business sentiment.

Plus, the market friendly outcome to the French Presidential vote in May, allowed the market to focus on EUR fundamentals, but there may now be a that the market is too sanguine about political risks in 2018. First, the Brexit negotiations and their impact may weigh on the EUR and the GBP, and undermine EUR/USD sentiment in H1-18. Second, planned Italian elections in May 2018 may re-ignite political worries and could, maybe as early as January, act as a catalyst to encourage a market that is now, unlike a year ago, very net long EUR/USD, to unwind those positions.

The monetary policy outlook should also provide reason for caution about adopting too positive a stance on EUR/USD. In October, the ECB announced that it would extend its QE programme beyond December 2017, to at least September 2018. However, it will halve its monthly purchases to EUR30bn. The additional QE implies that the ECB's balance sheet and excess liquidity measure should remain high. As a percentage of GDP we expect the ECB's balance sheet to reach over 40%, compared to 20% and 15% for the Fed and BoE, respectively.

In essence, a lot of EUR's will continue to flush their way through the system, which should imply a cheaper EUR, everything else equal, and, at the very least, temper the market's appetite to buy the currency aggressively in H1-18. However, given that the BoJ's balance sheet is approaching 100% of GDP, this dynamic could still favour a stronger EUR/JPY.

In addition, we do not expect the ECB to hike rates until March 2019, at the earliest, by which time we forecast that the Fed will have hiked four times, starting in December 2017. Such policy divergence should, at the very least, produce pockets of EUR/USD weakness in 2018. Indeed, with regard to the interest rate outlook, it is only expectations that the EU-US yields will be unchanged in 2018 that prevent us from adopting a more USD-positive stance.

The 10Y spread is historically a good indicator for EUR/USD. It currently stands at -2% and, in line with the market, we expect the spread to end 2017 at -1.8%, but finish 2018 back at -2.25%. Hence, the outlook for yields suggests little pressure on the pair to move massively, in either direction, over the coming months.

GBP – Not out of the woods quite yet

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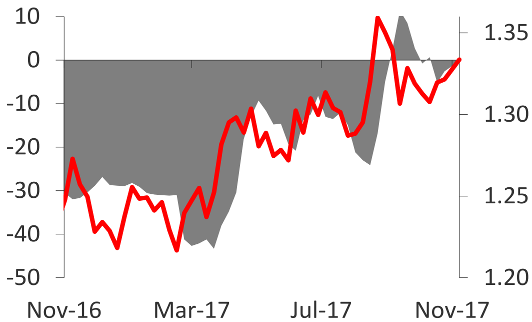
We still view Sterling as vulnerable in H1-18. The UK political, backdrop remains uncertain, although some recent progress on Brexit negotiations has boosted the Pound. In addition, we expect UK economic growth to be sluggish and inflation to gradually decline through the year. Hence, the MPC should be in no rush to hike rates, which should weigh on the Pound, as other central banks, particularly the Fed, adopt less accommodative policies.

Chart 5: GBP/USD positioning is neutral, but does that imply further gains in 2018, or scope to sell?



*OI=Total long and short contracts

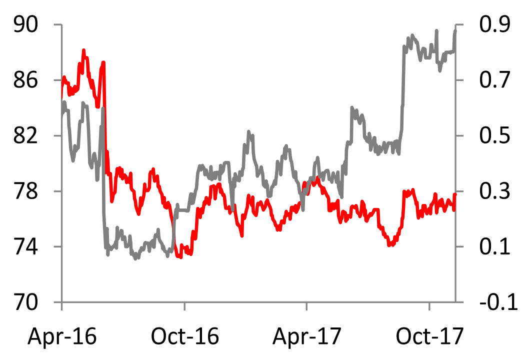
Source: CFTC, Bloomberg, Santander

Domestic political sentiment and ongoing Brexit negotiations are likely to remain a key influence on the GBP in 2018. The UK's Government may remain vulnerable following their 'disappointing' election result in June 2016, which left PM May without a clear majority in Parliament. Further, concerns over the direction and pace of Brexit negotiations with the EU may only intermittently offer support for Sterling sentiment over the coming months.

That said, the apparent agreement between the UK and EU on its 'divorce bill' did pull Sterling higher in late November. But, confirmation that the talks can now move on to the next stage may be required to ensure that the gains are sustained. Even then, the risk will probably remain that disagreements as to the UK's future relationship with the EU will act as a brake on the Pound in 2018. However, FX re-positioning could prompt movement in the Pound. Recall that speculators that pulled their net short GBP/USD position to a record high in Q1-17 are now neutral and, hence, have plenty of scope to re-establish either long, or short positions again, depending on the Brexit outlook and/or fundamentals.

The economic outlook seems to provide support for a softer GBP. Admittedly, we still think that the Pound has been oversold given the economic data over the last year, but a reversal of this decline may not be forthcoming in 2018. We expect that the UK economy will grow 1.5% in 2017 and then 1.4% in 2018. The 2018 estimate implies the UK growing at a lower rate than other developed economies and suggests that growth differentials could be a drag on the Pound.

Chart 6: Sterling remains soft despite interest rate increase as uncertainty continues to hold



Source: Bloomberg, Santander

Further, whilst UK CPI remains high and above its G10 peers', it may also provide less support for the GBP going forward. We expect headline UK CPI to slow from 3% in October 2017, to 2.2% at the end of 2018. Whilst 2.2% CPI would still be high, the direction of travel in 2018 should allow the MPC to hold off from hiking rates. We do not expect the next rate hike until 2019.

Given that we expect the Fed to continue to hike rates and the ECB to gradually adopt a more hawkish stance, the MPC's stance implies that the Pound may struggle against the USD and EUR, but perform better against the other G10 currencies whose central banks cling to their loose monetary policies, with yields set to remain low, in particular the JPY and CHF.

The correlation between UK-US 10Y yield spreads and GBP/USD is 0.93 over the last five years. That spread is currently -1%, but is forecast to be -1.7% by the end H1-18. Barring an improvement in the economy or positive signs from the Brexit talks, such a yield could allow the Pound to re-test its late-2016 lows. Plus, we forecast that the EU-UK 10Y spread will narrow to -0.45% by mid-2018 support our view that the cross will move back above 0.90.

Hence, fundamentals suggest little upside pressure on Sterling in H1-18, even if Brexit uncertainty does clear slightly. Plus, US rate hikes should imply pressure on GBP/USD, pulling it back below 1.30.

JPY – In it for the long-term

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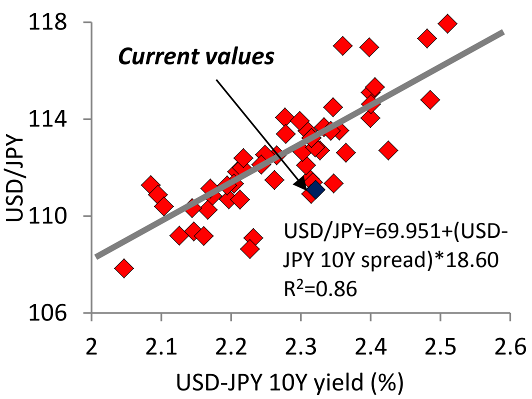
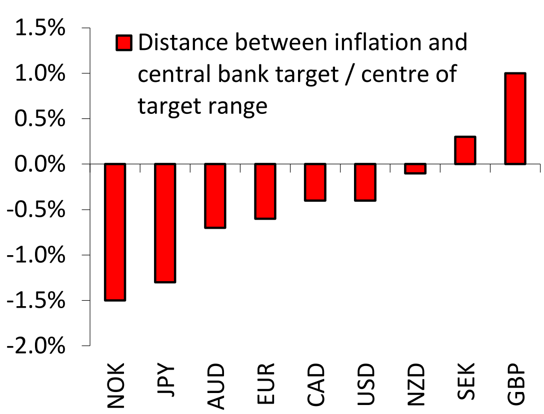
Chart 7: Forecast increase in US yields implies a higher USD/JPY as Japanese 10Y yields remain at zero



Weekly data since November 2016

Source: Bloomberg, Santander

Chart 8: BoJ should stick to an ultra-loose monetary policy as CPI and wage growth remains low



Source: Bloomberg, Santander

We still favour Yen weakness in 2018. The Japanese economy is improving, but inflation should remain low in 2018, allowing the BoJ to maintain a very loose policy. Potential periods of low risk appetite could support the Yen. However, if JGB yields continue to be targeted at close to zero, the expected Fed hikes and higher US yields should pull USD/JPY back to 120 by the end of 2018.

The BoJ made no change to monetary policy at its October 2017 meeting. The deposit rate remains at -0.1% and the Bank still target JGB yields at close to 0%. BoJ Governor Kuroda's term ends in April 2018. But, comments from PM Abe seem to suggest that he may be reappointed and continue with his 'powerful' easing programme. Hence, this ultra-loose monetary policy should be maintained throughout 2018, which remains the key reason that we continue to recommend being short the JPY.

The Bank's commitment to keep JGB yields around zero will be crucial to USD/JPY if, as expected the Fed hikes and US yields rise over the coming months. The 1Y correlation between USD/JPY and US-JPY 10Y yield spreads is 0.82. Currently, the pair looks fairly valued with the spread at 2.3%. However, the spread is forecast to increase to 3.1% by H1-18 and 3.5% by H2-18, which should pull USD/JPY back to, or above, 120.

The Bank will only take its foot off of the easing pedal when CPI is closer to the 2% target. However, Kuroda has suggested that it is difficult to dispel a deflationary mind-set, thus it might require a period of above-target CPI to convince Japan that inflation will stay high. In September, CPI was just 0.7% YoY. The consensus forecast is for CPI to remain below target at 0.8% in 2018 and 1% in 2019. Indeed, the BoJ slightly revised lower its CPI forecasts in October, warning that downside risks are bigger than upside risks.

In this regard, a key indicator for the Yen in 2018 will be wages. Wage growth is subdued and may have to increase notably before the BoJ is convinced that inflationary expectations are ingrained into the system. On the plus side, corporate profits are buoyant and the labour market is very tight, but this has not translated into higher earnings. Policymakers are hopeful that this will change over the coming months, but if it does not, inflation risks should stay low, policy loose and the Yen vulnerable.

Admittedly, the potential for periods of low risk appetite in 2018 could support the Yen as a safe-haven trade. A renewed focus on geopolitical risks over the coming months could bolster the currency. However, we would regard these as merely better levels at which to sell the currency.

Indeed, concern that equities may be too high and prone to a correction may support the Yen. The currency tends to strengthen when stocks weaken, as the latter acts as a proxy for risk. However, the liquidity provided by central banks is only expected to be removed gradually. The BoJ's balance sheet is around 100% of Japan's GDP. This, together with robust global GDP, with the IMF forecasting world growth of 3.7% in 2018, should help stocks.

Moreover, USD/JPY appears cheap given the current Nikkei level, suggesting that the currency has already priced in weaker stocks. Using data for the last five years we estimate that USD/JPY at 1.12 should imply a Nikkei closer to 18500, rather than the current 22500.

CNY – Balancing act

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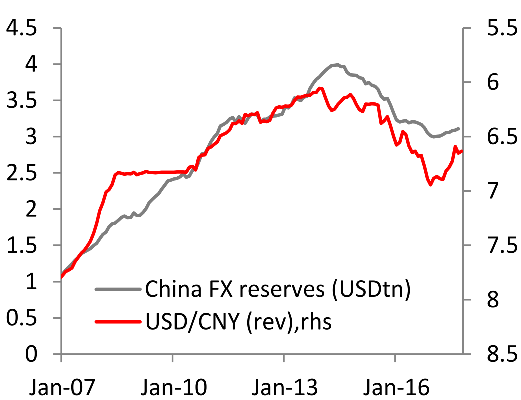
Chart 9: Policymakers face a balancing act between reducing financial risks/debt and ensuring that economic growth remains firm

Source: Bloomberg, Santander

Chart 10: Stemming capital outflows, stabilized reserves and helped the CNY



Source: Bloomberg, Santander

We still favour a firmer USD/CNY through 2018. The USD should remain the core driver for the pair, and we suspect that Fed rate hikes will pull the USD higher. In addition, concern over the vulnerability of Chinese activity amid policymakers' efforts to reduce debt could also weigh on the CNY. We look for USD/CNY at 6.9 by mid-2018 and 7.0 by the end of 2018

Year-to date, USD/CNY has, perhaps unsurprisingly, been strongly affected by the USD's movement. The correlation between USD/CNY and the USD index has been 0.92 in 2017. We expect this to continue in 2018 and, as highlighted in the USD section, we believe that the USD is well positioned to reverse some of its 2017 losses against most of its peers. The combination of a strong, and still outperforming, US economy, and several more US rate hikes should imply a firmer USD and support for the pair.

In fundamental terms, we believe the CNY will remain vulnerable to how successful policymakers are at handling the balancing act between reducing debt and financial risk, and supporting growth and liquidity. However, Chinese economic growth is expected to slow from 6.8% in 2017 to 6.4% in 2018 and 6.1% in 2019.

China's high overall debt levels prompted credit rating downgrades in 2017. Overall debt surged to 262% of GDP at the end of 2016, with the IMF warning of an "eventual" sharp adjustment if it is not reduced. The good news for the CNY is that policymakers are aware of the risk and are acting on it, but the threat remains that too swift a reduction in leveraging would increase financial risks, reduce growth and impact market sentiment.

In mid-November, further action was signalled to curtail the 'shadow banking' and wealth management sectors' impact on debt. New asset management regulation was proposed to contain the financial risks related to the sector, reduce the amount of fixed rate products and end an implicit guarantee that the government will help funds out if they get into trouble.

However, concern focused on whether efforts to unwind some of the positions held by the asset management industry will have negative spillover effects for financial stability and equity markets. Thus, to balance these risks, policymakers indicated that the new measures will not be implemented until mid-2019.

Also in November, other measures were announced that continue to open up Chinese markets. Limits on foreign ownership of banks will be removed, and overseas firms will be allowed to hold majority stakes in fund managers and insurers. The announcement may have been encouraged by President Trump's recent visit, but the move may also reflect a renewed reform push by President Xi after the Communist Party Congress in October. In addition, the import of foreign 'expertise' might help with China's deleveraging process.

Either way, the announcement does seem 'symbolically' important and suggests that policymakers will be willing to continue with reforms in 2018. Hence, if the PBoC is able to maintain a prudent and neutral monetary policy, that does not threaten activity, as well as monitor liquidity and reduce debt levels, more flexibility may be allowed in the FX markets. More stable FX reserves and outflows over the last few months should help, with FX reserves unchanged at around USD3.1trn since July.

CHF – Still playing on a ‘sticky wicket’

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We are still negative on the CHF, and have revised our EUR/CHF forecast profile slightly higher for 2018. EUR/CHF has gained in 2017, but we still feel this is due to EUR strength, rather than CHF weakness. As such, a more stable EUR in 2018 may act as a brake on the cross’s advance, even if the general economic/political/risk backdrop should still allow EUR/CHF to test 1.2000.

As far as the SNB is concerned, the CHF ends 2017 in a similar position as it started the year, namely “over-valued”, albeit by less than before. The CHF has lost around 9% of its value against the EUR since January 2017, but EUR/CHF is still below the 1.20 level that the SNB pegged the cross at between 2011 and 2015.

As such, the SNB should remain concerned about the impact a strong CHF may have in 2018 and keep its policy unchanged, at least until 2019, even as other central banks adopt a less accommodative stance. The deposit rate is -0.75% (the lowest rate in the developed world), with the three-month libor range at -1.25% to -0.25%.

In addition, the Bank remains willing to intervene when necessary. However, the fact that Swiss Total Sight Deposits –a proxy indicator for intervention– have barely changed for several weeks suggests that the Bank may not have been too active in terms of intervention recently and is content to see EUR/CHF around its current levels.

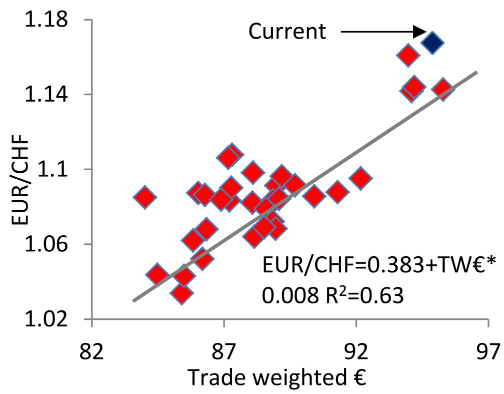
The fundamental outlook continues to highlight ambiguities with regard to the appropriate CHF level. On the one hand, the current account continues to be CHF positive. The Swiss current account surplus is over 10% of GDP, compared to the Eurozone’s 3% surplus and a US deficit of just over 2%. The inflow this represents can be viewed as a persistent CHF positive.

On the other hand, overall Swiss GDP is forecast to underperform. The SNB expects the economy to grow at just under 1% in 2017, compared to 2+% levels for both Europe and the US. Further, although the Bank revised up its CPI forecasts in October, it still expects averages of 0.4% in 2017 and 2018, and 1.1% in 2019. Indeed, headline inflation is not expected to move above 2% until 2020. As such, the SNB should remain cautious as to whether these rises are sustained.

We still feel that the SNB is a ‘price taker’ as far as the EUR/CHF is concerned. The correlation between the cross and the trade-weighted EUR has been 0.945 in 2017. Hence, the recovery in EUR/CHF has been due to the EUR and not the CHF. The key to our EUR/CHF view is the EUR staying firm. We think it should, given the mix of good EU growth, a gradually less accommodating ECB policy and a calm response to any Eurozone risks.

Unfortunately for policymakers, the CHF is still unlikely to reverse much of its risk-related gains of the past decade. The currency was quick to rise on EMU risks from 2008 on, but, partly due to SNB FX policy, then found it harder to weaken as risk diminished. For instance, we use the German-French 10Y spread as an indicator for EMU risk and, as the spread turned negative amid the credit/EMU crisis from 2008, EUR/CHF plummeted. But, as sentiment improved, and the spread narrowed, the cross did not revers these losses. Indeed, if the relationship between the spread and EUR/CHF from 2008 to 2011 had continued to hold, the cross would currently be trading closer to 1.5000.

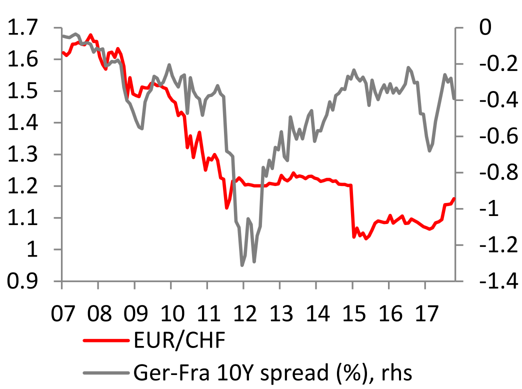
Chart 11: EUR/CHF has been, and should remain, a EUR trade



Monthly data since February 2015

Source: Bloomberg, Santander

Chart 12: CHF strengthened on EUR risk, but has not weakened enough given the pick-up in EMU sentiment



Source: Bloomberg, Santander

SEK – To extend or not to extend?

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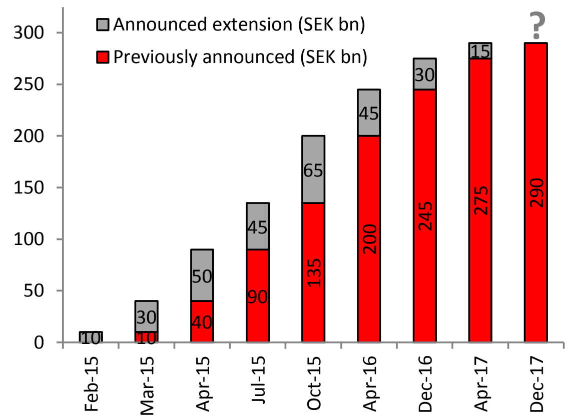
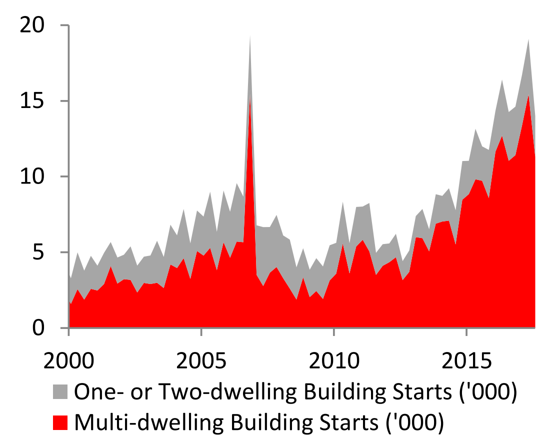
Chart 13: Will the Riksbank follow the ECB and extend its asset purchase programme into 2018?



Source: Statistics Sweden, Santander

Chart 14: Swedish housing starts have risen sharply in recent years, but prices are now declining



Source: Statistics Sweden, Santander

We are bullish the SEK in 2018. Concerns over the housing market and a decline in inflation in October sent the SEK falling sharply in Q4-17. We see this move as overdone and due for a correction. Growth remains upbeat, and inflation (despite the recent drop) is close to target. While there is significant uncertainty over whether the Riksbank will extend its QE programme into 2018, we think it will refrain from doing so. In addition, we expect the Bank to begin hiking rates next summer, which should support the currency in 2018. We continue to forecast EUR/SEK at 9.0 in Q4-18.

The SEK's direction this year has been dominated by the move over the past couple of months. While by no means the weakest developed market this quarter, it has fallen heavily against the EUR, with EUR/SEK touching above the 10-mark in late November.

The cross had been on an upwards trend throughout Q4-17, but these gains accelerated on 14 November after house price data raised alarm bells over the stability of the housing market and, perhaps more importantly, CPI data for October fell back below target, to a seven-month low.

Both of these issues are particularly sensitive as the Riksbank is set to decide, on 20 December, whether to extend its asset purchase programme into 2018, or else let it end in 2017. Until now, the Riksbank has tended to follow the ECB's lead when it comes to monetary policy, first by cutting its repo rate, then by beginning and extending its asset purchase programme.

There is currently no clear consensus on the Executive Board, with Deputy Governors Ohlsson and Floden being quite hawkish, and suggesting that they do not intend to vote to extend QE. Then again, Deputy Governor Skingsley thinks it is reasonable to halt QE, whereas Af Jochnick, and Jansson are more dovish, suggesting that it is difficult to halt Sweden's QE programme with the ECB extending its into 2018.

That leaves Governor Ingves, who made it clear in October that no decision had been made, and that the Bank had a couple of months to reflect on QE. The Riksbank could still go either way on this decision, but we believe it is more likely than not to signal an end to QE in December.

There is one more important data print before then, the 12 December inflation release. The October CPIF reading, the Riksbank's new preferred measure for inflation, fell to 1.8% YoY (from 2.3%). The Executive Board does not appear to be too concerned by this decline, as it was partially expected. However, a further sharp drop in the November print (published on 12 December) could yet spook the Board into extending QE.

With the SEK weak, GDP data firm and inflation close to target, the Riksbank should be in a position to begin hiking rates (albeit from a negative level) next summer. The repo rate may not actually turn positive until 2019, but the beginning of a tightening cycle, albeit at a very slow pace, should be SEK positive during 2018, especially given EUR/SEK is currently at such an elevated level.

NOK – Oversold

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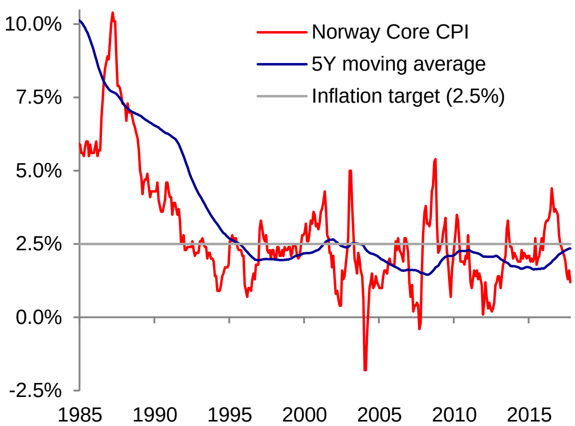
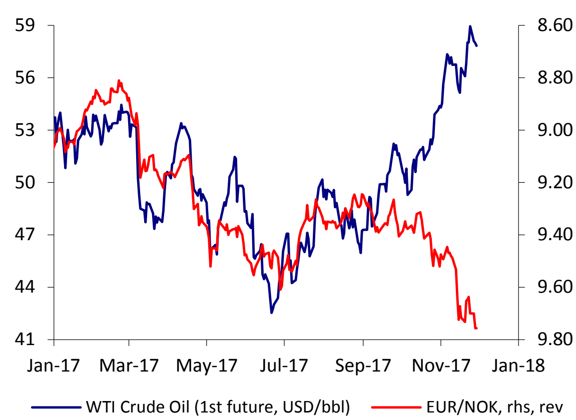
Chart 15: With core inflation still below target, the Norges Bank is unlikely to hike rates until 2019



Source: Bloomberg, Santander

Chart 16: While the NOK is no longer following the oil price, such divergence is unlikely to last for long in such an oil-dependent economy



Source: Bloomberg, Santander

Our EUR/NOK forecasts are unchanged. We continue to see the cross at 9.2 in Q1-17 and 9.0 in Q4-18. However, given the NOK's sharp fall in November, we are now bullish the currency in the short term. Indeed, with crude oil prices rising in Q4-17, we consider the NOK oversold at its current levels. Heading in to 2018, upsides pressure on the NOK may be more limited, as inflation is low, growth is expected to remain muted and the Norges Bank is therefore likely to keep rates on hold throughout 2018. As such, we remain more neutral the NOK over the coming year.

The NOK has struggled in the fourth quarter, having weakened by around 4% so far, more than fully reversing its Q3-17 gains. Most of this move was prompted by GDP data as Norwegian growth in the third quarter fell to 0.7% QoQ (1.1% previously). At the same time, the release of a better-than-expected GDP print in Germany sent the EUR flying, with EUR/NOK reaching a high of 9.8004 on 15 November. Prior to this move, EUR/NOK had spent the month glued to the 9.5 mark.

The NOK decline has now been overdone, in our view. Especially when considering that Germany is one of Norway's largest trading partners, so a strong German economy should ultimately be a positive for the Norwegian economy, exports and, therefore, also the NOK.

In addition, oil prices have been rising throughout H2-17, with WTI crude reaching USD59/bbl in November, from below USD44/bbl in June. As the petroleum industry makes up such a large part of the Norwegian economy, the NOK tends to follow oil prices closely. However, as Chart 16 shows, there has been a clear divergence between WTI crude prices and EUR/NOK over the past couple of months.

This divergence is unlikely to last, in our view. Such an elevated oil price may be dependent on OPEC confirming the extension of its output limits at today's meeting (30 November). However, if the market is correct in forecasting crude oil in a USD55-60/bbl range in 2018, this implies EUR/NOK should be closer to 9.0. Hence, our market recommendation would be to sell EUR/NOK at 9.85, targeting a move to 9.10, with stop loss at 10.23.

While central bank decisions on monetary policy tend to be a major factor driving the currency markets, this is less likely to be the case for the NOK in 2018. Norges Bank Governor Olsen believes the economy is on the right track, with growth picking up and unemployment coming down, but that there is still a long way to go.

Inflation has dipped sharply over the past year, with the core rate at just 1.1% in October. Inflation is expected to rise in 2018, though, while the 5Y average is close to the Bank's long-term 2.5% target. This does, however, imply very little pressure on the Norges Bank to hike rates in 2018.

There are now some concerns over stability risks stemming from the housing market, but the Norges Bank expects a soft landing, even stating that a correction is needed in Oslo. In addition, Norway is the only G10-currency economy with both current account and fiscal account surpluses, as well as a USD1trn pension fund to support the economy.

AUD – Following the yield

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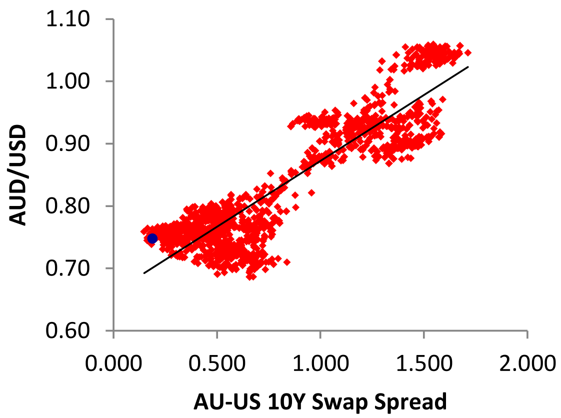
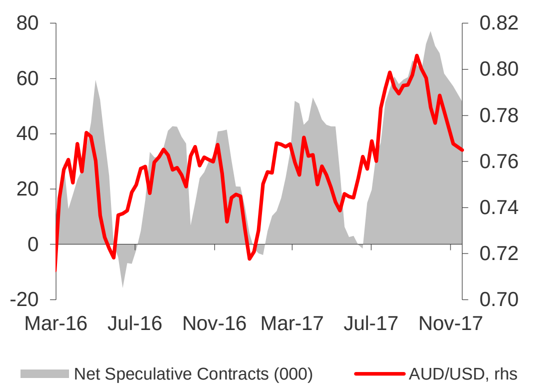
Chart 17: AUD/USD has followed yield differentials in 2017, and the pair will likely struggle to strengthen significantly until the RBA gets closer to a rate hike



Source: Bloomberg, Santander. Note: 5Y of daily data

Chart 18: With speculators still notably net long AUD/USD, any profit-taking could weigh further on the pair in the coming months



Source: CFTC, Bloomberg, Santander

We are neutral the AUD during 2018, but still see risks to the downside in the near term. AUD/USD has largely followed rate differentials this year and, with the FOMC set to continue hiking rates while the RBA continues to sit tight, this could yet pull the AUD even lower. Also, any unwinding of the still very large speculative net long AUD position could weaken AUD/USD in early 2018. Further ahead, though, the prospect of an RBA rate hike in H2-18 could offer the currency support. Hence, while we still see AUD/USD falling to 0.74 in Q2-18, we anticipate it rising to 0.77 by Q4-18.

We do not foresee any significant moves in the AUD in 2018, but see risks to the downside in the short term. One of these risks stems from the large net long speculative AUD/USD position. The addition of further AUD longs is unlikely, while any pick-up in USD optimism towards year-end, perhaps as the market focuses on the likely FOMC rate hike or US tax bill, could prompt a further unwinding of USD shorts (see Chart 18), which could pull AUD/USD lower.

Iron ore is another risk for the AUD in the short term. The price of Australia's largest export has fallen 15% since August, but China's campaign to curb pollution this winter by ordering plants to halt steel production could weigh further on iron prices, and the AUD, in the coming months.

The outlook for the Australian economy is uncertain, with data quite mixed. Growth is expected to rise to around 3% YoY next year, but neither the RBA nor the market expects the unemployment rate to fall materially from its current 5.4% level. CPI data remain below the RBA's 2-3% target range. Inflation is expected to rise in 2018 but, until it does, the RBA is unlikely to begin discussing a rate rise.

Indeed, in mid-November, Governor Lowe noted that, while the next move in rates will likely be up, it is increasingly likely inflation will remain subdued for some time yet. The market continues to price in a September 2018 rate hike, but we see a November hike as more likely at this stage. If the RBA keeps rates on hold until Q4-18, this would imply little upwards pressure for Aussie yields over the coming months.

After New Zealand, Australian yields are the next highest of the G10-currency countries, although this does not have to be the case. If the FOMC hikes rates in December, and again in H1-18, this could see yield differentials pull AUD/USD lower. The current AU-US 2Y yield differential is 0.20, which the market consensus sees falling to 0.00 in Q4-18. If this spread were to turn negative for the first time since 2001, AUD/USD could depreciate.

However, in recent years, the AU-US 10Y yield differential has displayed an even stronger relationship with the currency (0.90 correlation over five years, vs 0.65 for the 2Y yield differential). The current AU-US 10Y yield differential is also at 0.20, but is expected to rise to 0.34 in Q4-18. Hence, while yield differentials may imply short-term risks to AUD/USD, if the RBA is ready to hike rates by late 2018, the pair could then begin to follow yield differentials higher.

NZD – Weak enough already

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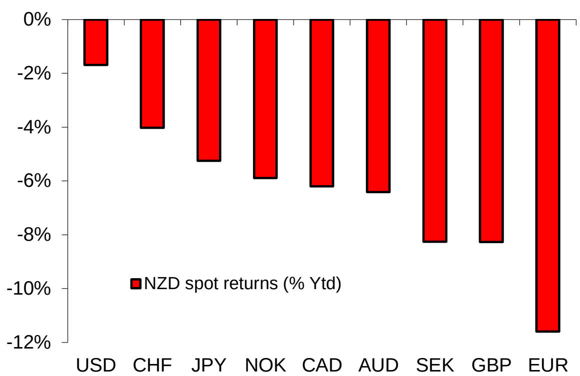
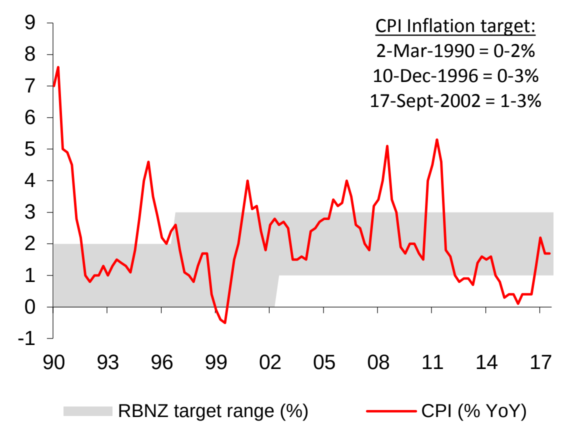
Chart 19: After a large sell-off in 2017, we see the NZD as weak enough already, and actually see scope for gains in 2018



Source: Bloomberg, Santander

Chart 20: The RBNZ inflation target has changed over the years, but its importance is less clear if an employment target is added to the Bank's mandate



Source: RBNZ, Bloomberg, Santander

We are neutral the NZD in the coming months, but see NZD/USD rising during 2018. Uncertainty remains over the new government and potential changes to the RBNZ's mandate could result in a looser-for-longer stance at the Bank. However, we believe the NZD has weakened sufficiently, and could now strengthen in 2018. We continue to forecast NZD/USD at 0.70 in Q1-18 and 0.73 in Q4-18.

The NZD was the worst developed-market performer in Q3-17 and is again bottom of the currency pile so far in Q4-17. In fact, the kiwi is the only developed-market currency to have weakened against the USD in 2017.

Political uncertainty has weighed on the NZD since the run-up to the 23 September election. However, with NZD/USD falling to below 0.68 in November, a 17-month low, we believe the NZD has now weakened sufficiently.

The new Labour-led government has said it will focus on creating more jobs and higher wages for New Zealanders. Wage pressures were already rising, though, while the unemployment rate is now at an eight-year low (4.6%) with the participation rate reaching a record high in Q3-17.

The economic outlook should be NZD supportive, as 2018 growth expectations are still at an elevated 3% YoY. Meanwhile, with inflation data holding close the RBNZ's 2% target for three consecutive quarters, there is no need for the Bank to loosen monetary any further.

In addition, with speculators now net short the NZD, we see scope for profit-taking to boost the NZD in early 2018. In H2-18, a potential RBNZ rate hike could also support the NZD. However, the uncertainty of both a new RBNZ Governor and, potentially, a new RBNZ mandate from Q2-18 makes monetary policy in 2018 more difficult to predict.

The Reserve Bank of New Zealand Act 1989 declares the RBNZ as responsible for formulating and implementing monetary policy, promoting a sound and efficient financial system, and carrying out other functions and exercising other powers as set out in the Act. This act was placed under review by the government at the start of November. The review will be divided into two phases:

- ❖ Phase One: focus on adding full employment to the Bank's price stability objective, and changing to a committee decision-making model for monetary policy decisions.
- ❖ Phase Two: produce a list of areas where further investigations of the Bank's activities may be desirable. This is expected to be outlined in early 2018.

These potential changes are unlikely to effect the RBNZ's next two rate decisions under Acting Head Spencer. However, after his tenure, things are less clear from Q2-18, as there is the collective uncertainty of not knowing who the next RBNZ Governor or what the RBNZ's exact mandate will be. We continue to assume that the RBNZ is unlikely to hike rates until late 2018, but this is dependent on the above.

CAD – Two strikes and you're out

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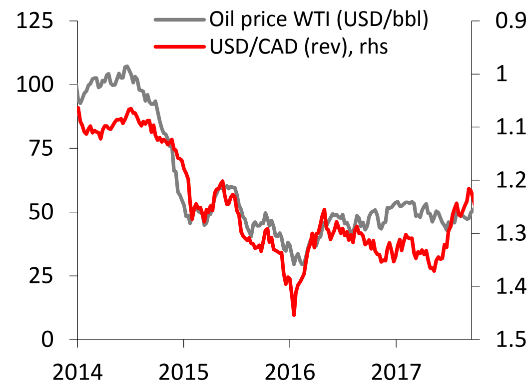
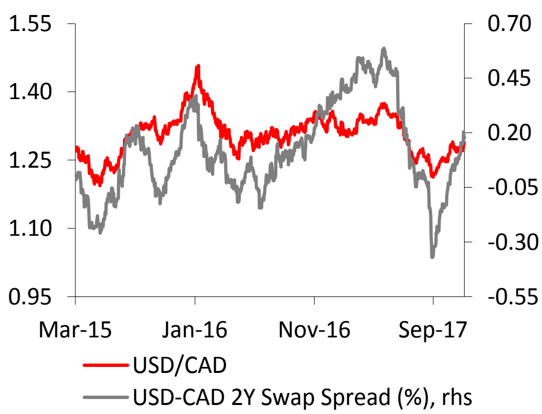
Chart 21: The outlook for oil prices remaining firm should provide support for the CAD…



Source: Bloomberg, Santander

Chart 22: …but the BoC may have to keep up with Fed hikes to propel the CAD higher



Source: Bloomberg, Santander

We remain positive about the CAD in 2018. We expect the currency to appreciate against most of its peers, but the scale and sustainability of these gains should depend on three factors. First, possible Bank of Canada rate hikes. Second, NAFTA negotiations and external trade. Third, oil price developments. As long as at least two of these factors stay CAD positive in 2018, the currency should be able to advance through 2018 as a whole..

2017 was very much a year of two halves for the Canadian dollar. The trade-weighted CAD was sluggish during the first half of the year, moving sideways up to mid-June. However, a surprise adoption of hawkish rhetoric by the BoC, followed by 25bp rate hikes in both July and September, propelled the CAD higher. Hence, the index rose 10% between mid-June and September.

The BoC outlook is expected to be a key driver for the CAD again in 2018. The currency has given back some of those earlier gains since September, as the BoC adopted more cautious rhetoric and decided not to hike rates again. However, our central scenario is that the Bank will tighten policy again in 2018, at least twice, with the first move in April. This should be CAD positive. But, given that the Fed should also be hiking rates in 2018, USD/CAD losses could still be contained, with the CAD better placed to outperform some of its other developed-market peers.

The BoC continues to believe that economic growth moderated in H2-17, but still forecasts growth of 3.1% in 2017 and 2.1% in 2018, implying that activity should grow at close to potential rates over the next couple of years. Given that the Bank also believes that the output gap has almost been closed, such activity growth should put upside pressure on inflation. The headline CPI rate is forecast to end 2018 at 2.1%, with core measures also heading higher.

Consequently, the fundamental outlook should provide sufficient support for the CAD next year. However, a key risk to activity, and confidence, comes in the form of the NAFTA renegotiations. The BoC expects exports to improve in line with foreign demand, but with 75% of Canadian exports going to the US, any disruption of that trade would impact Canadian activity and the CAD. We assume that the NAFTA talks will reach an amicable conclusion, but the risk they represents in H1-18 could drag on the CAD.

The third factor is oil. Canada is a commodity/oil exporter and hence its currency often moves in line with the oil price. Indeed, the 5Y correlation between the trade-weighted CAD and WTI is 0.93, with the relationship implying that the currency is fairly valued given the current oil level. However, Bloomberg's consensus oil forecasts predict WTI slipping to USD50/bbl by the end of H2-18, despite OPEC production cuts. IEA data suggest that the unwinding of oil inventories may have peaked.

However, CAD bulls can take some comfort from the fact that, over the last year, the link between oil and the CAD has weakened, as monetary policy, domestic growth and inflation have become the more important drivers of the CAD. Consequently, as long as the oil price does not crash in 2018, the CAD may still be able to strengthen, albeit at a slower rate, as long as the BoC hikes rates and NAFTA talks go well. But, the risk to our view will be that both oil and NAFTA, or the BoC turn CAD negative.

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 real GDP growth is 0.8% in 2017 and 3.2% in 2018. • The significant reduction in the carry trade and the BRL's stability suggest the exchange rate is not far from long-term equilibrium, and will probably not be a source of uncontrolled inflation for at least the next few years.
MXN	↓	↑	• The MXN and local assets have experienced heavy selling pressure already, but should remain volatile in the short term. • The interplay between NAFTA and Mexico's presidential elections is challenging; the MXN should continue to act as the key pressure valve. • NAFTA-termination risk premia seems already in the price but the election risk is not factored in yet.
CLP	→	→	• Second-round of Chile's presidential election on 17 December. • Depending on the election results, growth recovering in line with rising copper prices… • …and monetary policy normalization likely in 2018.
COP	↘	↘	• COP continues to lose ground on the back of a strong USD while higher oil prices provide some relief. • More dovish MPC and lower interest expectations would add pressures to the currency. • Presidential elections and discussions on the fiscal rule to create volatility in the coming months.
ARS	↑	↗	• Encouraging October mid-term elections, plus 250bp of monetary policy rate hikes, have paved the way for more stable local FX conditions. • Ex-ante real interest rate now above 9%. The CB's hawkish stance has opened a second round of carry trades with local assets. • The CB might be ready to use the FX as a complementary anchor to the interest rate to curb the short-term upward inflationary trend.

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

Source: Santander.

BRL – The efficiency of monetary policy

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After a cutting cycle of 675bp, the last Copom decision reduced the pace of rate cuts to 75bp and the statement affirmed that the monetary authority's strategy is for the coming decisions to mark a gradual end to the current easing cycle. In our opinion, inflation and the economic recovery are in line with the CB's scenario. Thus, Copom should keep reducing the pace of rate cuts to 50bp in the December 6 meeting, then to 25bp in the first meeting of 2018, taking the Selic rate down to 6.75% p.a..

We expect this "lowest interest rate level" environment to prevail until at least mid-2019, mainly as a result of the: huge production slack in the economy (labour and capital) due to the recent deep recession; low inflation (below the lower bound of the target range); and reduced external financial needs (CAD at 0.5% of GDP).

For 2018, we expect both the IPCA (YoY measure) and expectations to reverse their downward trends of the last two years, due to the reversal of foodstuff inflation towards its historical average of 7% (2006-2016). However, we do not see this upward inflation dynamic as posing a threat to inflation targets. This is mainly because we foresee the core inflation at around 3% in the upcoming year, slightly below the 3.2% that we estimate for2017.

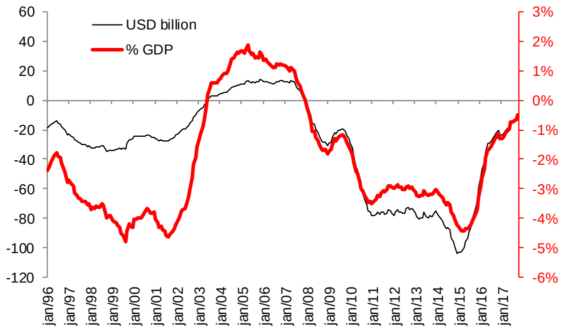
Although food and controlled prices should be important vectors to define the direction of the IPCA, we believe that, at the end of the day, idle capacity in the economy will remain an important anchor for non-food free prices (which could be measured by the core –ex food and energy– measure). We estimate the idle capacity in the economy at -3.8%.

We maintain our forecast for the BRL at 3.20/USD at YE2017 and at 3.50/USD for YE2018. According to our estimate, this magnitude of BRL weakening does not mean a significant pass-through effect in the headline inflation.

On the political side, the executive branch and Congress have intensified their efforts to put the pension reform back in motion, with a softer version expected to be submitted to a floor vote in the Lower House in the first week of December. Compared to the proposal approved by the Special Commission in the Lower House last April, the new version preserves the bulk of the fiscal and distributional effects. But, our estimates indicate that this new version corresponds to roughly 57% (BRL 480bn) of the savings associated with the original reform proposal. Thus, we believe there is no room for any additional relaxation of the proposed changes without losing the main improvements of reform.

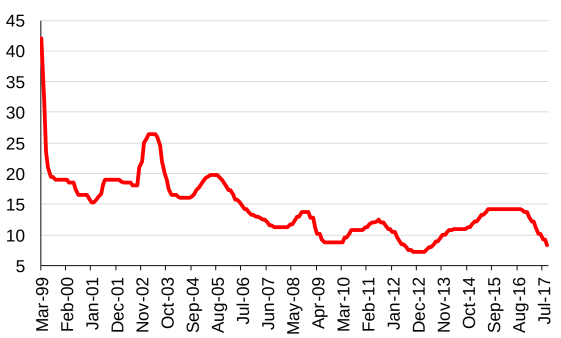
We remain sceptical regarding the possibility of the approval of the social security reform, not only because of the wide support needed (2/3 of majority votes in Congress) but also because of time constraints. The Congressional recess starts in three weeks (on Dec 22), and once Congress reconvenes next February, there will be less than six months before the beginning of election campaigns. Such a tight timetable could prove challenging, particularly in light of the lack of consensus around social security reform.

Chart 23: Current account - 12 months, USD billion and % GDP



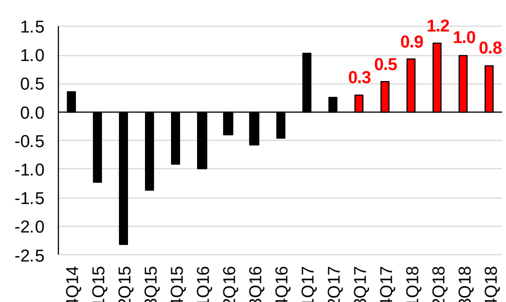
Source: BCB.

Chart 24: Monetary policy



Source: BCB.

Chart 25: Real GDP growth (% QoQ)



Sources: IBGE and Santander forecasts.

MXN – Rough Interplay: NAFTA and elections

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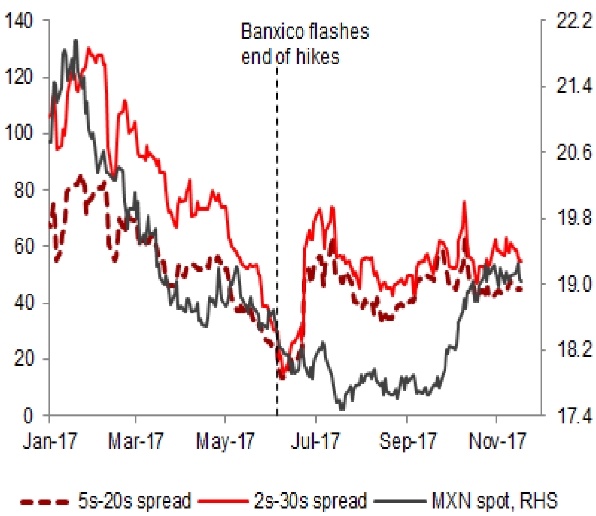
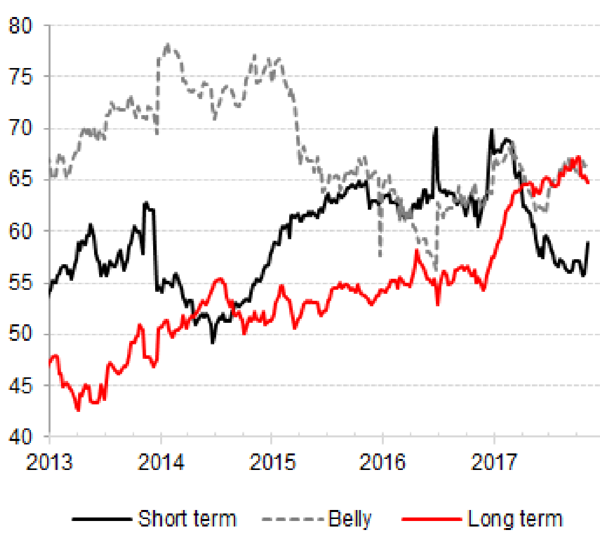
Chart 26: MXN looks consistent with yield curve



Spreads are for the MBonos yield curve.
Source: Santander, Bloomberg

Chart 27: Ownership of MBonos by foreigners



% of total MXN-denominated bonds outstanding
Source: Santander, Banxico

The combination of a stronger USD and heightened idiosyncratic risks, which largely reflect NAFTA termination uncertainty, implies heavy selling pressure across local assets, particularly the MXN. Still, the Mexican peso remains a winner this year despite the fact that nearly half of its once stellar gains (19% YTD through late July) have evaporated. The recent price correction also brought the MXN more in line with the shape of the local yield curve (Chart 26). Note a disconnection between fixed income and FX opened up after Banxico hinted that its preemptive tightening cycle had been completed after a final 25bp hike to 7%. The super flat yield curve of the summer then quickly corrected with the Board's clarification in the minutes that no easing was on the cards.

The recent correction provides helpful insight into how participants are setting up strategies in order to cope with the two unusual risk events ahead in Mexico: NAFTA renegotiations and the presidential elections (July 2018). First, foreign investors (owners of nearly two-thirds of outstanding MBonos) have kept their duration position stable, amid the MXN's sharp correction, hinting that many participants may have hedged their FX exposure (a typical reaction in very stressed episodes) Second, hedging through swaps (rates and FX options) is also underway. Indeed, the TIIE-MBonos spread widened (mainly in the 20y tenor), but to nowhere near crisis levels (i.e. taper tantrum). Third, the MXN speculative position has declined yet remains long (40% of all-time peak reached in 2015). Looking forward, the NAFTA-elections interplay is very challenging, so the MXN is set to remain the main pressure valve.

We see the following as key catalysts until the turn of the year (our expected asset impact in brackets). **1. NAFTA Round 5**. These talks were more technical with less political noise. Informal discussions are expected in December, before Round 6 kicks off in Montreal in January (neutral-positive). **2. Minimum wage hike.** Relevant for inflation and Banxico's reaction function. Recall that the Board turned hawkish, so additional hikes cannot be ruled out. We expect a moderate increase of around 7% (neutral for MXN, positive if above 10%). **3. New Banxico Governor.** President Peña announced central bank board member Alejandro Diaz de Leon as the next governor, opting for an orthodox technocrat who is expected to safeguard the institution's inflation mandate (limited market impact). **4. Presidential candidates.** We expect the governing PRI and the PAN-PRD alliance to act fast and make this key announcement before year-end, ahead of the Feb-15 deadline (positive for MXN and bonds if Meade runs for PRI and Anaya runs for the alliance). Lopez is likely to lead in most polls before the race starts (Mar-30), thus fueling MXN volatility. **5. Banxico's next policy decision** on Dec-14. The Board is MXN dependent and needs clarity on its performance. We still expect a pause at 7% (positive for MXN in case of a surprising hike). **6. Debt buyback** in the short end of the curve worth some MXN40bn (positive for MXN and short bonds).

CLP – Political surprise

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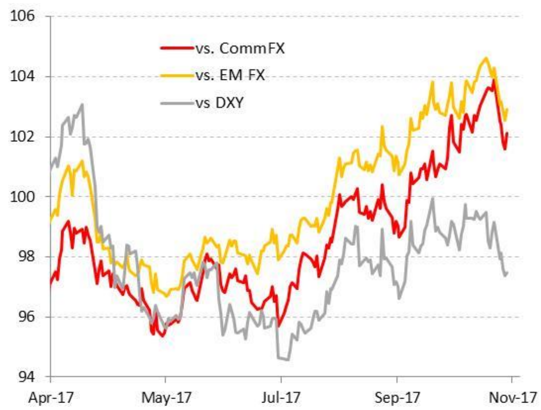
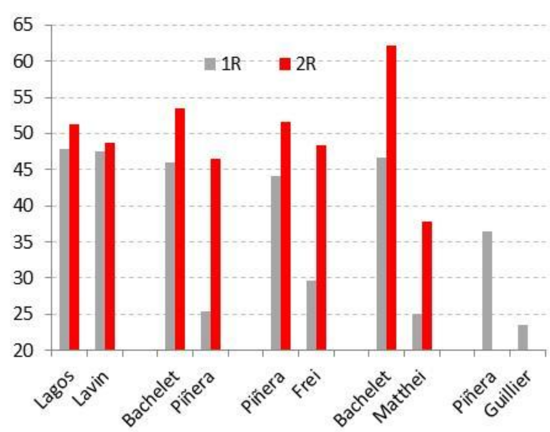
Chart 28: The CLP vs. selected benchmarks



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

Chart 29: First- and second-round results of presidential elections (2000/2005/2009/2013)



Source: Santander.

The key domestic issue this month was the first round of the presidential elections, which center-right Sebastián Piñera won with 37%, 14 points ahead of the governing coalition's candidate, Alejandro Guillier, but short of the 42%-44% take polls had anticipated. Piñera and Guillier will now compete in a second round on 17 December and, although no first-round winner has been defeated in the ballotage since 1990, according to pollsters both candidates are virtually neck and neck at present. The center-right coalition came very close to achieving an outright majority in Congress (45% of seats in the Lower House and Senate), but the leftist Frente Amplio surprised with a significant third place, with 20% of the presidential votes, so feelings about Chile's political direction after the election are fairly mixed.

Before the election, the CLP had outperformed peers in a context of a relatively strong global USD, hitting 627 at 17 November. The Peso had rallied 4% vs G6 currencies, and 7% vs. EM and commodity currencies in the previous three months, probably discounting improved political conditions. However, after Sunday's results, the USD/CLP rate jumped 2% in the early hours of Monday, reflecting some investor unease surrounding the final voting outcome.

On the growth front, the September IMACEC disappointed markets, posting a 1.3% y/y increase vs. an initial consensus estimate of above 2%. The mining sector's contribution remained very positive (output growth was 8.5% y/y), but the non-mining sector expanded by a meager 0.7% y/y, mainly suffering from the persistent drag of the construction industry (falling by 5%-6% y/y in the last 12 months). The market expects GDP growth to pick up to 3.0% in 2018 (from 1.5% this year), but the real economy still shows signs of fragility. Regarding inflation, October's CPI brought another large surprise, this time on the opposite side: 0.6% m/m, vs. consensus at 0.3% (in September, the surprise was negative by around 50bp). The year-on-year measure has returned to a more normal 1.9%, and fears of broad disinflationary trends across the economy have receded notably. The key elements behind low inflation in Chile are the strong CLP and deflation in fresh food items, which are expected to last for some time, but should rebound sharply in 2H18, as per our estimates.

Regarding monetary policy, the BCCh kept rates unchanged at 2.50% with a neutral bias. The board continues to face the dilemma of improving growth expectations and falling inflation, but has decided to wait until 'green shoots' in the real economy start to materialize (or not). This probably means the next crucial BCCh meeting will be that on 1 February.

Net-net, the CLP is likely to underperform peers until the second-round of the election, as polls have lost some credibility as reliable indicators, and local investors will unlikely add much risk in a context of a very close call. The second-round results will determine, in our view, if the CLP starts to trade with a premium or discount vs. fair value, which, given current external conditions, we estimate at 635.

COP – The domestic factor

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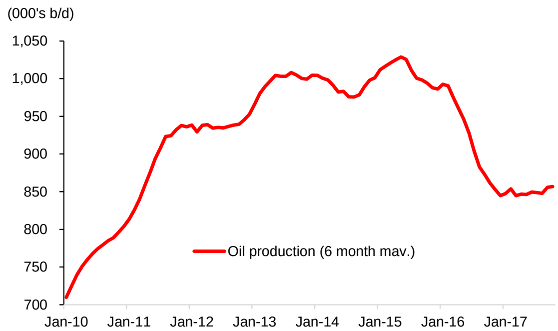
Since our last FX Compass, published on October 19, the COP jumped from trading in a 2920-2950 range to 2980-3020, posting nominal depreciation of 2.3% during the month. The COP was the second worst-performing currency among the EM economies and the worst among its Latam peers. As in past months, external factors continue in the driver's seat, but domestic events will also play a role this month and in the coming months.

Similar to its EM peers, the COP was being pressured by the stronger USD until recently, while the increase in oil prices (WTI: +12.61%) provided some marginal relief. Overall, the correlation with oil prices has been significantly lower this year (58%) than in the previous seven years (94%). The weaker correlation can be partially explained by the still low oil production (-8.6% from the 2010-16 average). However, we consider that the most recent divergence reflects the still weak domestic fundamentals in comparison to other EM currencies, as well as seasonal outflows and the more dovish monetary policy.

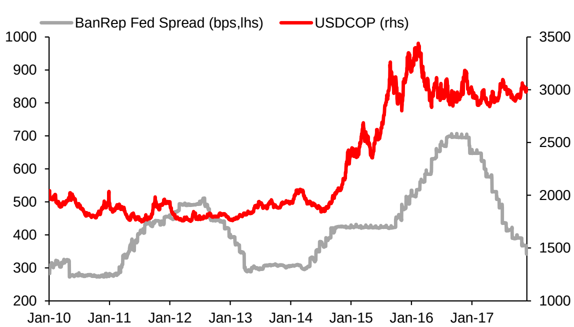
Chart 30: Oil production stable but low



Source: Santander, Bloomberg

In effect, the MPC surprised the market with a 25bp cut in October, and maintained its dovish stance and delivered an additional 25bp cut in November, taking the interest rate down to 4.75%. In the latest statement, the board considered that better inflation forecasts and the weakness in the economy warranted the cut. Indeed, the MPC noted that the better-than-expected inflation results in the past months hint that convergence to 3% will occur sooner than expected. Moreover, the MPC also remains concerned about economic activity, as GDP growth in 3Q17 came below their expectation (2.0% vs 2.3%).

Chart 31: Decreasing BanRep/Fed spread



Source: Santander, Bloomberg

After November's decision, the market is now pricing for the MPC to extend the cycle to 2Q18 and take the interest rate to 4.00%. If inflation continues to surprise to the downside, the MPC could validate the market's view. This scenario of lower domestic interest rates and higher US rates will put pressure on the COP, as the spread between BanRep and Fed interest rates could surpass the lowest level registered in the past seven years.

In addition to lower rates, the presidential elections race is starting to cause some noise. Former VP German Vargas Lleras has announced his political agenda, which includes revising the fiscal target, causing some jitters in the market. While ratings agencies did not consider the proposal to be credit negative, Fitch believes that it could harm the authorities' credibility. Fiscal consolidation will continue to be one of the main discussions during the election campaign, and thus a source of volatility in the coming months.

Moving forward, we maintain our mildly bearish view on the COP as we consider that domestic factors will add more downward risks to the currency, while the pressures from the expectation of higher US rates and a stronger USD persist.

ARS – The battle against inflation

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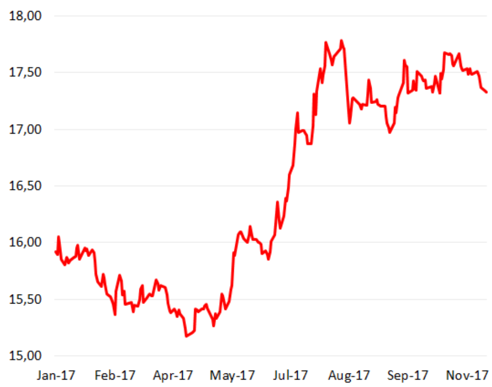
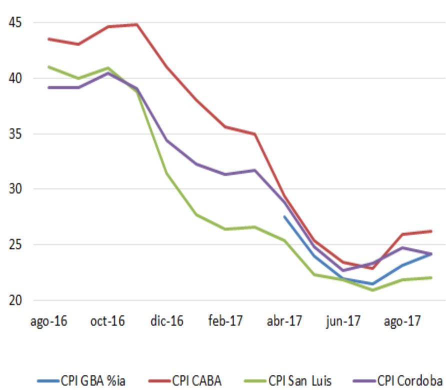
Chart 32: ARS/USD nominal quotation



Source: Bloomberg, Santander

Chart 33: CPI indexes have reverted their annual downward trend



Source: INDEC, Santander

Supported by a successful mid-term election result, the government has decided to accelerate the structural reforms the country desperately needs. Draft bills on tax, labour and social security reforms have been sent to the Congress for approval, while the Central Bank has deepened its fight against inflation.

Two days after the October 22 mid-term elections, the monetary authority surprised the market by hiking the monetary policy rate by 150bp. The move was followed by a further 100bp adjustment, two weeks later.

In mid-April, inflationary expectations started to move upward, while all inflation indexes in the last 12 months reverted their previous downward trends since July.

The weakening of the Peso resulted from, first, the correlation with the Brazilian Real since mid-May and, later, Cristina Kirchner's decision to run for a seat as Buenos Aires province Senate representative. The dollar quotation jumped more than 13% between May 17 and August 11, with a pervasive widespread impact on all wholesale and consumer price indices.

In the months to come, the Central Bank will maintain its tight monetary stance, as a critical guide for labour contract negotiations. In Argentina, labour contracts are negotiated between business and *Peronist* labour leaders, on an annual basis early in the year.

The disinflationary process lead by government authorities, in turn, requires 2018 salary adjustments be set based on a forward-looking approach, i.e. not higher than a 14% to 16% range. This should result in lower adjustments than those derived from labour unions demands, which are supported by backward-looking arguments. In other words, the 2017 annual inflation rate would end at 22%, well above the 15% increase expected in 2018.

Based on the Central Bank's commitment to curb inflation further next year, the monetary authorities might be ready to use the FX as a complementary anchor to the monetary policy rate, though Governor Sturzenegger has publicly denied this possibility.

To this end, the Central Bank might acquire only a fraction of the US Dollars to be sold by the Treasury in the future. Bear in mind, that so far this year, the Central Bank has purchased more than US$14.5bn from the government, printing money that later needs to be sterilized issuing Lebac.

If only a portion of the Treasury Dollar sales were acquired by the monetary authority and the rest sold directly to the market, as governor Sturzenegger suggested two weeks ago, two crucial variables would be impacted. On the one hand, the monetary authority would print less money and, on the other, the dollars the Treasury offers the market would put downward pressure on the price of the greenback, helping meet the inflationary stabilization goal.

CEE FX: Main Themes

Currency	3M view	12M view	Main Themes
PLN	↘	⇨	• We are leaving our EUR/PLN forecasts unchanged as we think it could be difficult for the zloty to hold onto its gains until the end of the year. In our view, positive news flow from Poland has been largely priced in and profit taking could take place in the final weeks of 2017.
CZK	⇨	↗	• EUR/CZK fell to 25.4, a level last seen in November 2013, just before the central bank introduced a 27.0 floor. The koruna's gain is thanks to mounting expectations of more rate hikes and despite political deadlock.
HUF	⇨	↑	• We change our view for the EUR/HUF. In the next three months we anticipate a stabilisation. • In 2Q18 and 3Q18 we expect some appreciation of the forint, mainly due to the continuation of positive trends in the economy and the expiry of the effects of non-standard monetary policy measures.
RUB	↘	↗	• We have updated our forecasts. In the next three months we anticipate some depreciation of the Russian ruble vs USD due to expected poor macro data. • In two or three quarters' time we forecast some improvement of the economic picture, thanks to an increase in activity connected with the football World Cup and high levels of commodities exports.

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

Source: Bank Zachodni WBK.

PLN – Dollar rebound may hit zloty

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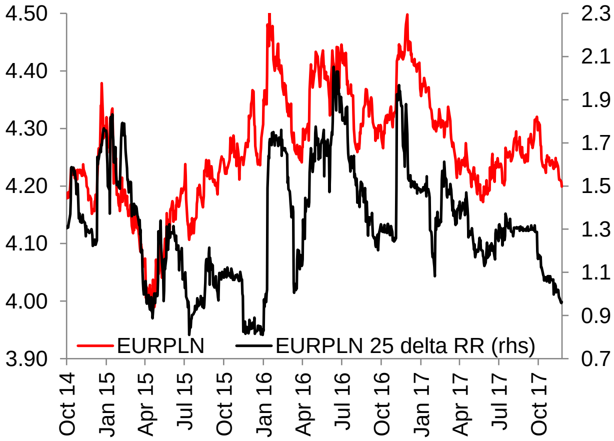
Chart 34: EUR/PLN and 25 delta risk reversal



Source: Reuters, Bank Zachodni WBK.

Since our FX Compass in October, EUR/PLN was stable at around 4.24 for some time and the zloty only resumed its upward trend in mid-November. In our view, this was largely driven by the decision of the Hungarian central bank to ease monetary policy further (details in the HUF section), which made the zloty more attractive versus the forint in terms of the monetary policy outlook.

We are leaving our EUR/PLN forecasts unchanged as we think it could be difficult for the zloty to hold onto its gains until the end of the year. In our view, positive news flow from Poland has been largely priced in and profit taking could take place in the final weeks of 2017.

Statistically, in December EUR/PLN declines much more often than it rises. However, in the last three years the Polish currency experienced quite a significant depreciation somewhere around the turn of the year (in 2014 it was in late December, in 2015 in mid-January and in 2016 in late November). Those three cases were justified by specific fundamental triggers (respectively: weak local data boosting hopes of a rate cut, S&P's downgrade of Poland's rating and the 'Trump trade' after the US elections). This time we think the trigger could be a possible USD appreciation thanks to the imminent Fed rate hike, which may weigh on EM currencies.

The uncertainty about the Polish government reshuffle does not seem to be affecting the currency and we think that if there is a change of prime minister, the move – if any – should be limited and short lived.

Implied volatilities are trading at their lowest since early 2016, clearly showing that the Polish FX market is very calm. Recall that periods of stability are followed by sharp swings and emerging market currencies usually depreciate when volatility rises. This is yet another reason for us to be cautious about expecting the zloty to strengthen in the short term.

3Q17 GDP growth was 4.9% y/y, above the flash estimate of 4.7%. 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. The persistent weakness in investments and the capacity constraints reported in the manufacturing sector signal, in our view, that the investment recovery in the coming quarters may be weaker than we had anticipated. However, the good news is that the extremely supportive external environment (recovery in the Euro zone) should boost Polish exports, while consumption growth should remain strong as well. As a result, we expect GDP growth in Poland to remain decent in the coming quarters. It could be well above 4% in 4Q17as well.

From the central bank's point of view, the strong GDP print is not necessarily going to change the balance of votes for a rate hike due to the continuing weakness of investment.

CZK – Ignoring political uncertainty

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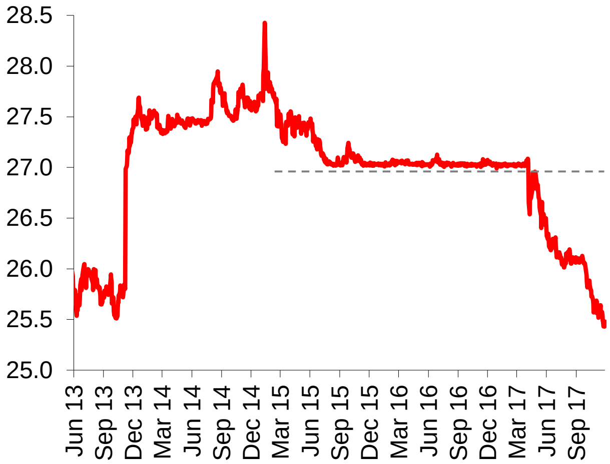
Chart 35: EUR/CZK



Source: Reuters, Bank Zachodni WBK.

EUR/CZK fell to 25.4, a level last time seen in November 2013, just before the central bank introduced a 27.0 floor. The koruna gain is thanks to mounting expectations of more rate hikes and despite political deadlock. We think the slide in EUR/CZK may pause ahead of the expected Fed rate hike and likely profit taking when the Czech central bank also raises rates.

More than a month since the parliamentary elections, the candidate for Prime Minister, Andrej Babis, has still not been able to find a coalition partner for his ANO party. President Zeman said he will nominate Babis for PM in December but the government is likely to lose a confidence vote and it could take months before there is a second attempt to form a government.

Political deadlock does not seem to worry investors: the koruna is appreciating vs the euro thanks to the increasing chance of more rate hikes. Czech FRAs are pricing in a full 25bp December hike and nearly next 75bp for 2018 (which is more aggressive than the survey consensus). Comments by Czech central bankers are still hawkish, which looks to be justified as 3Q GDP growth was 5% (its highest for two years) and inflation is just a touch below the upper end of allowed fluctuation range (1%-3% y/y). Central Bank Governor Jiri Rusnok said he still has not decided how he will vote in December and there is a chance that the tone after the meeting might not sound too hawkish.

RUB – Weak ruble but strong exports

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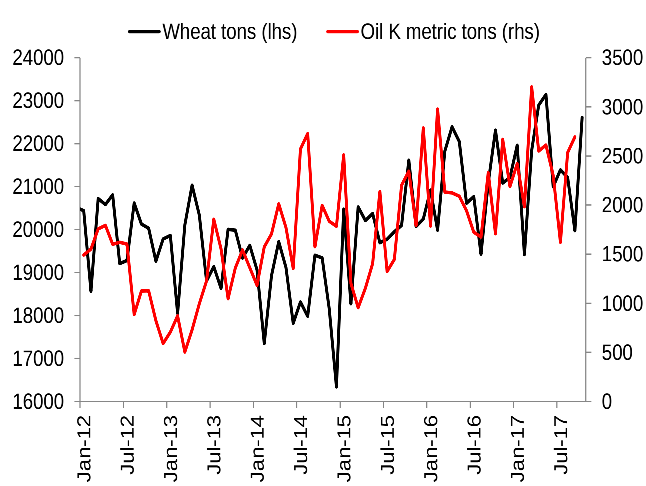
Chart 36: Russian exports of oil and wheat



Source: Reuters, Bank Zachodni WBK.

The picture for the Russian economy has deteriorated in November, despite the dynamism of oil exports (one of the most important contributors to the Russian Federation's budget) and record high wheat exports in October. USD/RUB surged to 60.20 in mid-November, fuelled by a weak PMI Manufacturing reading, lower reserve asset data and the trade balance report. Moreover, GDP rose only by 1.80% y/y in 3Q17 (vs the 2.0% forecast and 2.5% in 2Q17), mainly due to slower investment growth after the solid 2Q data. Private consumption numbers were also disappointing, with retail sales data and real disposable income data for October below the levels the market was expecting.

In the next month we expect some upward movement in the USD/RUB ahead of the anticipated rate cut in December (to 8.0% from the current 8.25%). We think that the ruble's weakening will still be supported by the inflation reading (inflation figures have surprised on the negative side for the last four months in a row) and we expect manufacturing PMI and industrial production to remain weak (they have been declining since August). We see good reason for the market's expectations of another interest rate cut in 1Q18 to intensify.

However, in the longer run (end of 1Q18) we forecast a recovery in the ruble thanks to hopes of a positive signal from private consumption. In our opinion, the positive impulse will be triggered by consumer and investment demand connected with the World Cup football championship, scheduled to be held in Russia in June-July 2018.

HUF – MNB policy dominates

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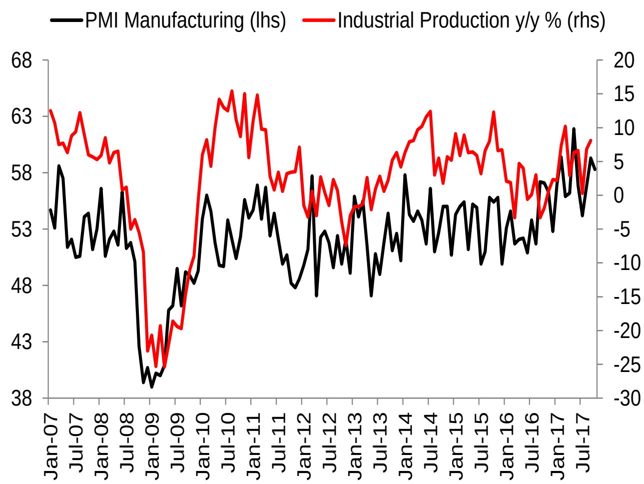
Chart 37: PMI and industrial production in Hungary



Source: Reuters, Bank Zachodni WBK

The Hungarian central bank's (MNB) decision to ease monetary policy by using non-standard measures (which will formally start in January 2018) helped to weaken the Hungarian forint in November. EUR/HUF climbed from below 311 at the beginning of the month to above 313 in late November and prompted us to change our forecast for EUR/HUF. In the next three months we anticipate a stabilisation, but in 2Q18 we expect some appreciation of the forint, mainly due to the continuation of positive trends in the economy and the expiry of the effects of non-standard monetary policy measures.

The MNB move towards even more unconventional monetary policy tools (announced in October) pushed the long end of the curve down by 40bp during the month. The central bank said it wants to start using swap operations with five- and ten-year maturities. According to the MNB, the quarterly allocation of planned unconditional interest rate swap contracts will be set at HUF300bn. The bank also said it wants to launch a mortgage bond purchase program for maturities of over three years. Operational details will be announced in December. According to the MNB, the purpose of those programs is to increase of the share of long-dated credit at fixed interest rates.

The forint's depreciation happened despite the solid macro numbers released in November. Most of the macro indicators beat market forecasts (PMI manufacturing, industrial production data, trade balance figures, wages). The exception was inflation for October, which undershot the forecast by 0.1pp. However, the central bank's plan to introduce new non-standard measures in January prevailed on the FX market and pushed the forint down.

We have increased our forecasts for EUR/HUF in 1Q18 from 300 to 310 because of the MNB's determination to offset the positive effect of solid macro numbers on the Hungarian forint by using non-standard measures to ease monetary policy conditions. We expect a stabilization of EUR/HUF at around 300 from 3Q18, due to some deceleration of growth momentum in Hungary in the second half of next year.

G10 FX: IMM Speculative Positioning

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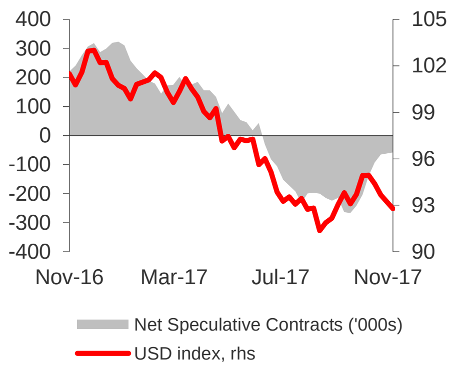
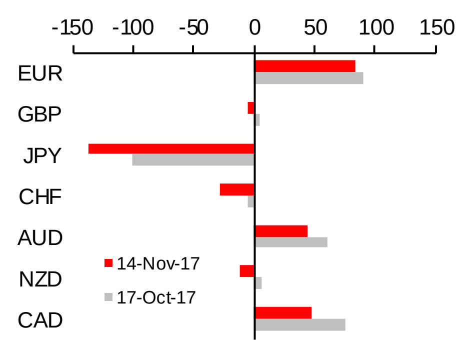
IMM commitment of traders report: USD Composite position



- **Speculators turning less bearish the USD in Q4-17,** with the net short USD Composite position falling to just 58k contracts in the week ended 14 November 2017. This is the least negative speculators have been the USD since June, with almost a 150k improvement in the net USD Composite position over the past four weeks. The USD Index has yet to follow this move higher.
- **The net short JPY position rose to a four-year high,** at 136k contracts, in late November, as a more upbeat USD stance saw speculators increase their negative view on the JPY.
- **EUR and GBP positioning little changed in November,** although speculators are slightly less upbeat the EUR, and negative the GBP again.
- **Speculators have increased their negative CHF stance,** with the net short position rising to 28k contracts, the largest since May 2013. This is a sharp contrast to the steady neutral +/-5k contracts held through the summer months.
- **Upbeat CAD, AUD and NZD speculative positions scaled back** in November, largely due to increased optimism on the USD. Speculators reduced their bullish CAD and AUD positions to around 45k contracts, while turning bearish the NZD again, taking this position to -11k contracts.

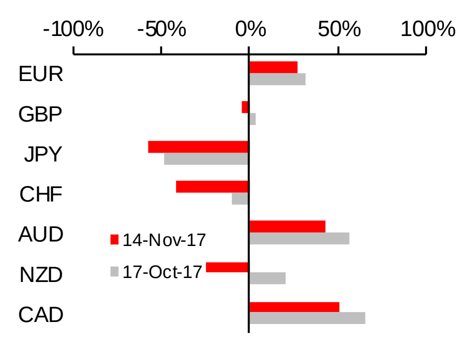
Net Speculative Contracts ('000s)*

	14-Nov-17	17-Oct-17	4w chg	YtD chg
USD***	-58.1	-204.2	146.1	-377.3
EUR	84.6	90.5	-5.9	154.6
GBP	-4.5	5.0	-9.6	60.2
JPY	-136.0	-101.3	-34.7	-49.2
CHF	-28.0	-4.9	-23.1	-14.5
AUD	44.0	61.8	-17.8	47.3
NZD	-11.9	7.0	-18.9	-0.5
CAD	47.3	75.1	-27.8	51.2



Net Speculative Contracts as % of Open Interest**

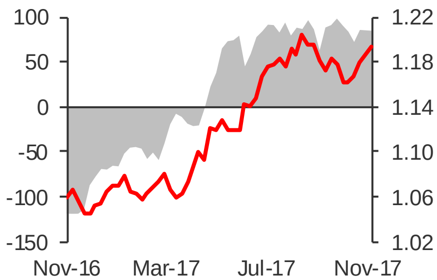
	14-Nov-17	17-Oct-17	4w chg	YtD chg
USD***	-5%	-19%	14%	-35%
EUR	27%	32%	-5%	48%
GBP	-4%	4%	-8%	33%
JPY	-58%	-48%	-10%	-5%
CHF	-42%	-10%	-32%	-6%
AUD	43%	56%	-13%	46%
NZD	-25%	21%	-45%	-6%
CAD	51%	66%	-15%	55%



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.

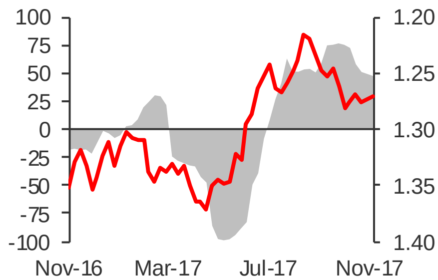
G10 FX: IMM Speculative Positioning

EUR/USD



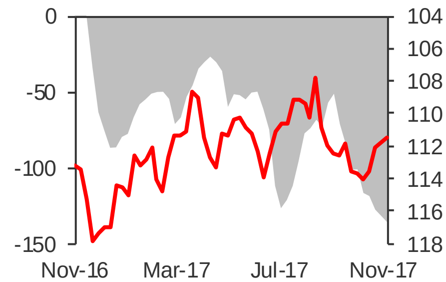
Net Speculative Contracts ('000s)
EUR/USD, rhs

USD/CAD



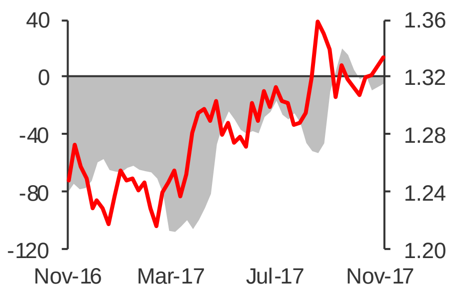
Net Speculative Contracts ('000s)
USD/CAD, rhs, rev

USD/JPY



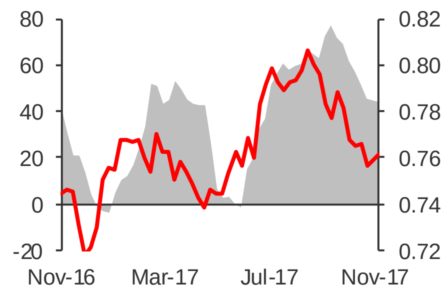
Net Speculative Contracts ('000s)
USD/JPY, rhs, rev

GBP/USD



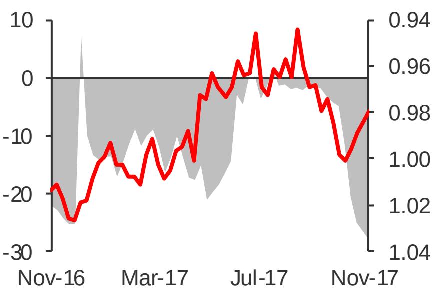
Net Speculative Contracts ('000s)
GBP/USD, rhs

AUD/USD



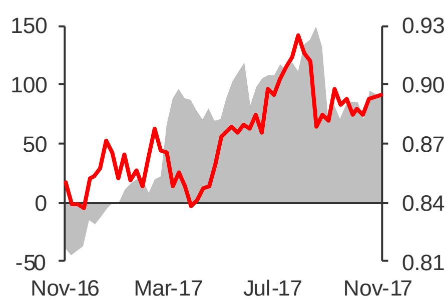
Net Speculative Contracts ('000s)
AUD/USD, rhs

USD/CHF



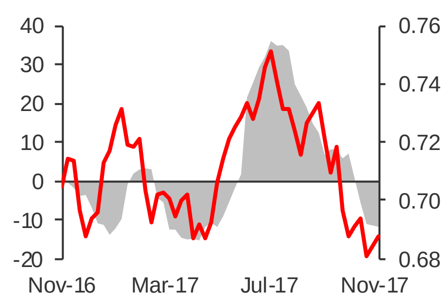
Net Speculative Contracts ('000s)
USD/CHF, rhs, rev

EUR/GBP



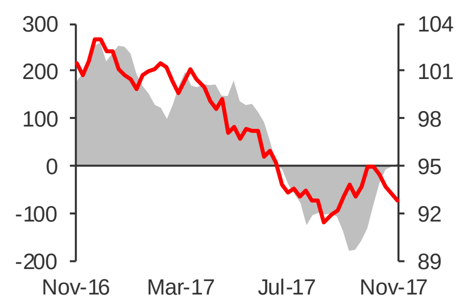
Net Speculative Contracts ('000s)
EUR/GBP, rhs

NZD/USD



Net Speculative Contracts ('000s)
NZD/USD, rhs

USD minus MXN

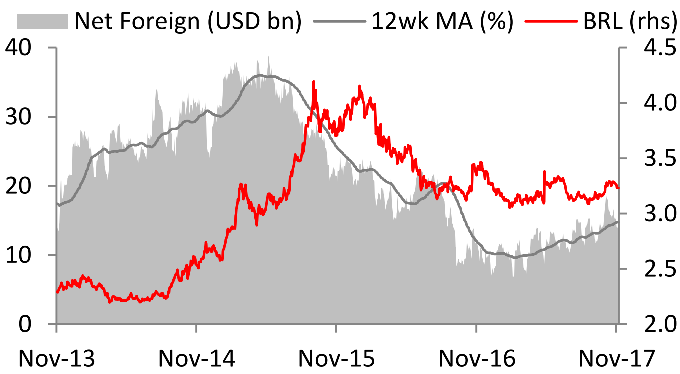


Net Speculative Contracts ('000s)
Trade-weighted USD, rhs

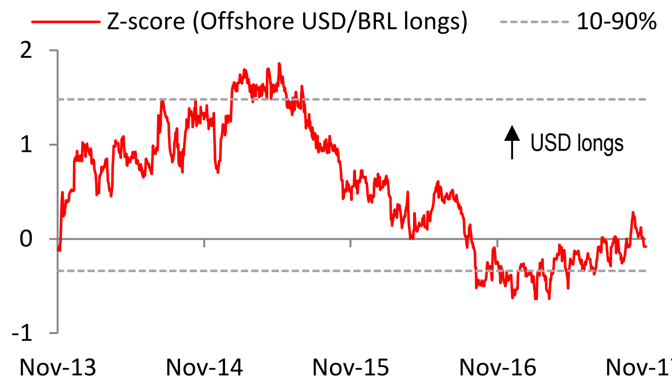
Sources: CFTC, Bloomberg and Santander. Note: IMM commitment of traders report

Latin America FX: Positioning indexes (Z-scores)

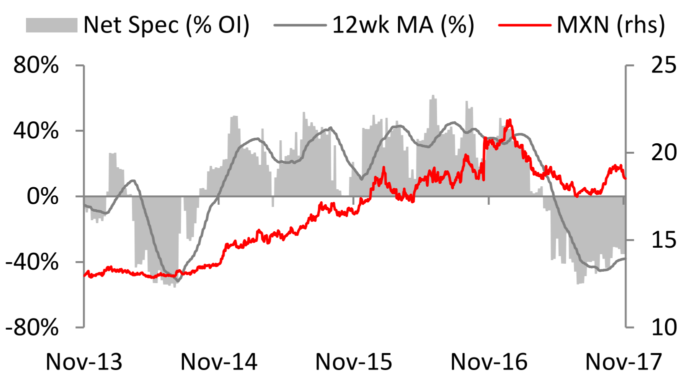
USD/BRL



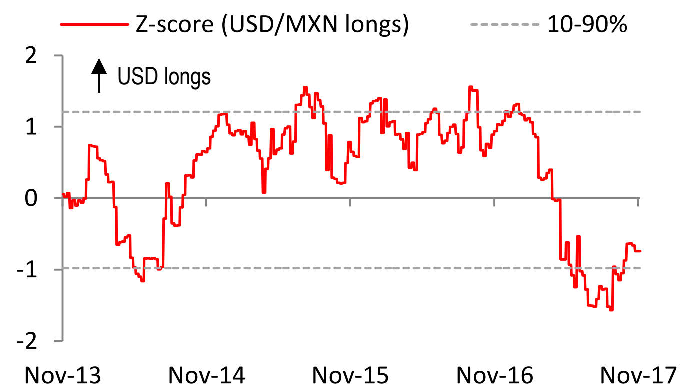
Z-score USD/BRL



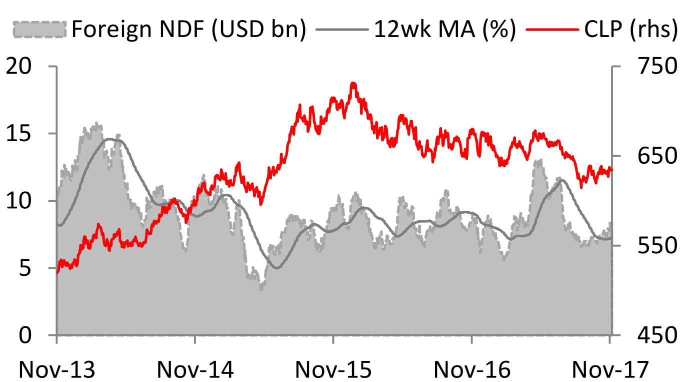
USD/MXN



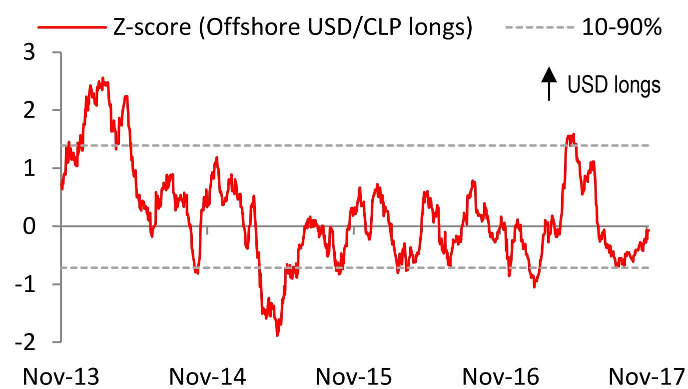
Z-score USD/MXN



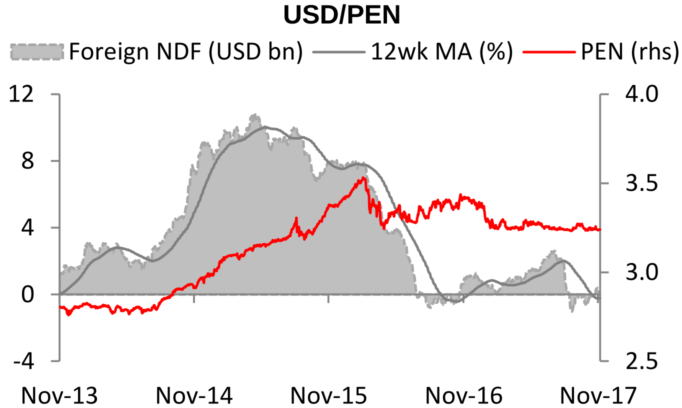
USD/CLP



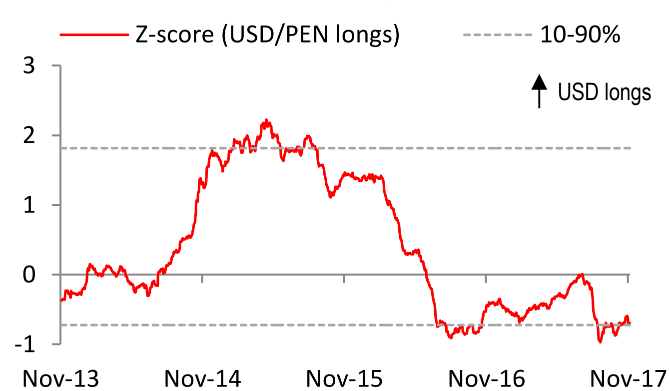
Z-score USD/CLP



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	-0.79	-0.70	-0.70	-0.60	-0.55
2y	-0.70	-0.45	-0.30	-0.15	0.05
5y	-0.34	0.00	0.15	0.35	0.55
10y	0.34	0.70	0.95	1.10	1.25
30y	1.18	1.55	1.75	1.85	1.90

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	-0.28	-0.23	-0.13
2y	-0.19	0.05	0.15	0.25	0.40
5y	0.21	0.45	0.60	0.75	0.90
10y	0.81	1.15	1.35	1.50	1.60
30y	1.48	1.85	2.00	2.10	2.15

US Interest Rate Forecasts

Government Bond yield Forecasts

US	Current	1Q18	2Q18	3Q18	4Q18
FOMC *	1.25	1.50	1.75	2.00	2.25
3m	1.27	1.35	1.60	1.90	2.15
2y	1.76	2.10	2.40	2.70	3.00
5y	2.07	2.50	2.75	3.00	3.20
10y	2.33	2.90	3.10	3.30	3.50
30y	2.75	3.15	3.30	3.45	3.60

Swap rate forecasts

US	Current	1Q18	2Q18	3Q18	4Q18
FOMC *	1.25	1.50	1.75	2.00	2.25
3m	1.48	1.55	1.80	2.10	2.35
2y	1.93	2.30	2.60	2.90	3.20
5y	2.14	2.55	2.80	3.05	3.25
10y	2.33	2.90	3.10	3.30	3.50
30y	2.53	2.90	3.05	3.20	3.35

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	0.42	0.40	0.37	0.37	0.42
2y	0.46	0.70	0.50	0.35	0.40
5y	0.73	1.25	0.90	0.80	0.90
10y	1.25	1.60	1.40	1.30	1.50
30y	1.80	2.30	2.10	1.80	2.00

Swap rate forecasts

UK	Current	1Q18	2Q18	3Q18	4Q18
MPC	0.50	0.50	0.50	0.50	0.50
3m	0.52	0.55	0.52	0.52	0.52
2y	0.82	1.10	0.80	0.70	0.80
5y	1.06	1.50	1.15	1.15	1.20
10y	1.31	1.60	1.50	1.40	1.55
30y	1.50	1.95	1.70	1.40	1.60

G10 Central Bank Calendar

	Current Rate	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
FOMC *	1.25	-	Unch.	+25bp	Unch.	-	**	-	Unch.	13	31	-	21
ECB (Depo)	-0.40	Unch.	-	Unch.	Unch.	-	Unch.	**	-	14	25	-	8
BoE	0.50	-	Unch.	Unch.	-	Unch.	Unch.	-	+25bp	14	-	8	22
BoJ	-0.10	Unch.	-	Unch.	Unch.	-	Unch.	Unch.	-	21	23	-	9
SNB	-0.75	-	-	Unch.	-	-	Unch.	-	-	14	-	-	22
BoC	1.00	Unch.	Unch.	-	+25bp	-	+25bp	Unch.	-	6	17	-	7
RBA	1.50	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	5	-	6	6
RBNZ	1.75	-	Unch.	Unch.	-	Unch.	Unch.	-	Unch.	-	-	7	21
Norges Bank	0.50	-	Unch.	Unch.	-	-	Unch.	Unch.	-	14	25	-	15
Riksbank	-0.50	**	-	-	Unch.	-	Unch.	Unch.	-	20	-	14	-

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, Riksbank extended its government bond purchase programme until December 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	7.50	6.75	6.75	6.75	6.75
NTNF Jan' 19s	7.09	7.00	8.00	8.25	8.50
NTNF Jan.' 25s	10.13	10.00	10.00	10.20	10.25

Government Bond yield

Mexico	Current	1Q18	2Q18	3Q18	4Q18
Banxico fondeo	7.00	7.00	7.00	6.75	6.50
Mbono Jun. '22s	7.09	7.15	7.10	6.60	6.30
MBono Jun. '27s	6.81	7.40	7.30	6.75	6.50

Chile/Colombia Interest Rate Forecasts

Government Bond yield

Chile	Current	1Q18	2Q18	3Q18	4Q18
BCCh TPM	2.50	2.50	2.50	2.75	3.25
BCP 5Y	3.95	3.95	3.95	4.00	4.20
BCP 10Y	4.54	4.60	4.60	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	5.79	5.73	5.76	5.81	5.96
TES 10Y	6.58	6.59	6.72	6.87	7.10

LatAm Central Bank Calendar

	Current Rate	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Brazil	7.50	-100bp	-100bp	-	-100bp	-	-100bp	-75bp	-	6	-	7	21
Mexico	7.00	-	+25bp	+25bp	-	Unch.	Unch.	-	Unch.	14			
Chile	2.50	-25bp	-25bp	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	14	-	1	20
Colombia	4.75	-50bp	-25bp	-50bp	-25bp	-25bp	Unch.	-25bp	-25bp	14			
Argentina	28.75	+150bp	Unch.	Unch.	Unch.	Unch.	Unch.	+150bp	+100bp	*	*	*	*

CEE Interest Rate Forecasts

Poland

Poland	Current	1Q18	2Q18	3Q18	4Q18
Reference Rate	1.50	1.50	1.50	1.50	1.75
2y	1.53	1.87	2.19	2.32	2.44
10y	3.32	3.72	3.80	3.78	3.86

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	8.25	8.00	8.00	8.00	7.75

CEE Central Bank Calendar

	Current Rate	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Poland	1.50	Unch.	Unch.	Unch.	Unch.	-	Unch.	Unch.	Unch.	5	10	7	7
Czech Republic	0.50	**	Unch.	Unch.	-	+20bp	Unch.	-	+25bp	21	-	1	29
Hungary	0.90	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	Unch.	19	30	27	27
Russia	8.25	-50bp	-	-25bp	Unch.	-	-50bp	-25bp	-	15	-	9	23

Source: Santander, BZWBK. 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. *The Argentina Central Bank decides on monetary policy on a fortnightly basis. **At an unscheduled meeting on 6 April 2017, the Czech Central Bank ended the EUR/CZK Cap on 30 March 2017 after more than three years.

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

EUR/USD	1.15	1.17	1.18
vs.forward	-2.8	-1.2	-0.3
vs.consensus forecast	-1.7	-0.8	-1.7

GBP/USD	1.30	1.28	1.26
vs.forward	-3.4	-4.9	-6.4
vs.consensus forecast	-0.8	-2.3	-4.5

EUR/GBP	0.88	0.91	0.94
vs.forward	0.6	3.9	6.5
vs.consensus forecast	-1.7	1.6	2.9

USD/JPY	116	118	119
vs.forward	3.2	4.9	5.8
vs.consensus forecast	1.8	3.5	4.8

EUR/JPY	133	138	140
vs.forward	0.2	3.7	5.5
vs.consensus forecast	0.3	2.3	3.3

EUR/CHF	1.16	1.17	1.18
vs.forward	-0.7	0.2	1.1
vs.consensus forecast	0.0	0.0	0.0

USD/CHF	1.01	1.00	1.00
vs.forward	2.2	1.4	1.4
vs.consensus forecast	1.9	2.0	3.1

EUR/SEK	9.4	9.3	9.1
vs.forward	-5.2	-6.3	-8.3
vs.consensus forecast	-1.1	-1.1	-1.6

EUR/NOK	9.2	9.1	9.1
vs.forward	-6.3	-7.4	-7.4
vs.consensus forecast	-1.1	-1.3	-0.7

USD/CAD	1.25	1.24	1.24
vs.forward	-3.0	-3.8	-3.8
vs.consensus forecast	0.0	-0.8	0.0

AUD/USD	0.76	0.74	0.75
vs.forward	0.4	-2.2	-0.9
vs.consensus forecast	-1.3	-5.1	-5.1

NZD/USD	0.70	0.69	0.71
vs.forward	2.3	0.9	3.8
vs.consensus forecast	0.0	-2.8	0.0

USD/BRL	3.28	3.38	3.50
vs.forward	1.1	4.2	7.9
vs.consensus forecast	0.9	4.0	6.1

EUR/BRL	3.77	3.95	4.13
vs.forward	-2.0	2.8	7.3
vs.consensus forecast	-0.8	3.1	4.3

USD/MXN	20.0	19.70	17.90
vs.forward	7.5	5.9	-3.8
vs.consensus forecast	5.8	4.6	-4.5

EUR/MXN	23.0	23.0	21.1
vs.forward	4.4	4.7	-4.1
vs.consensus forecast	4.0	3.7	-6.1

USD/CLP	630	640	650
vs.forward	-2.1	-0.6	1.0
vs.consensus forecast	0.0	2.4	3.6

EUR/CLP	725	749	767
vs.forward	-5.1	-2.0	0.4
vs.consensus forecast	-1.7	1.5	1.9

USD/COP	3100	3200	3100
vs.forward	3.1	6.4	3.1
vs.consensus forecast	2.4	6.0	3.3

USD/ARS	18.3	18.8	19.4
vs.forward	4.7	7.9	11.3
vs.consensus forecast	1.6	3.4	4.9

EUR/PLN	4.22	4.23	4.23
vs.forward	0.4	0.6	0.6
vs.consensus forecast	0.2	0.7	0.7

EUR/CZK	25.7	25.6	25.5
vs.forward	0.8	0.4	0.0
vs.consensus forecast	1.2	1.2	1.4

EUR/HUF	308	302	300
vs.forward	-1.4	-3.3	-4.0
vs.consensus forecast	-0.6	-2.6	-3.2

EUR/RUB	69	66	63
vs.forward	-0.6	-5.6	-9.9
vs.consensus forecast	1.3	-5.0	-9.6

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	1.183	1.345	112.4	132.9	151.1	0.986	1.166	1.326
1M	1.186	1.347	112.2	133.0	151.0	0.983	1.166	1.324
2M	1.188	1.348	112.0	133.0	150.9	0.981	1.165	1.322
3M	1.190	1.349	111.8	133.0	150.9	0.979	1.165	1.321
6M	1.197	1.353	111.2	133.1	150.5	0.972	1.164	1.316
9M	1.204	1.358	110.6	133.2	150.1	0.965	1.163	1.310
12M	1.212	1.362	109.9	133.2	149.7	0.958	1.162	1.305

ATMf vol.

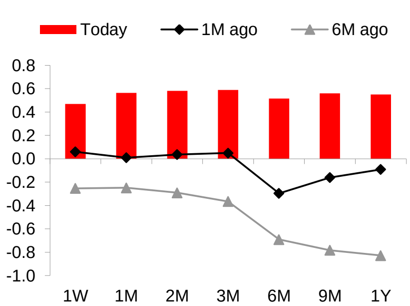
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	6.6%	8.3%	7.9%	7.4%	10.3%	6.2%	5.7%	7.9%
1M	6.5%	7.5%	8.0%	7.4%	9.5%	6.3%	5.4%	7.4%
2M	6.7%	7.4%	8.0%	7.6%	9.2%	6.5%	5.6%	7.6%
3M	6.6%	7.5%	8.1%	7.8%	9.4%	6.6%	5.6%	7.7%
6M	7.1%	7.9%	8.7%	8.7%	9.8%	7.1%	5.9%	8.0%
9M	7.3%	8.1%	9.0%	9.1%	10.0%	7.4%	6.0%	8.2%
12M	7.4%	8.3%	9.1%	9.3%	10.1%	7.6%	6.0%	8.4%

Implied/realized vol. ratio

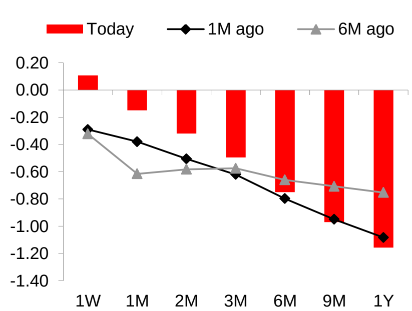
	EUR/USD	GBP/USD	USD/JPY	EUR/JPY	GBP/JPY	USD/CHF	EUR/CHF	GBP/CHF
1W	1.13	0.97	1.22	1.13	1.02	1.13	1.24	0.84
1M	1.09	1.00	1.20	1.12	1.09	1.00	1.07	0.91
2M	1.12	1.01	1.22	1.19	1.08	1.05	1.11	0.96
3M	0.99	0.94	1.09	1.11	0.98	0.91	0.99	0.88
6M	1.04	0.98	1.14	1.17	0.99	0.96	1.03	0.90
9M	1.05	1.03	1.14	1.08	1.02	1.05	1.10	0.98
12M	1.00	0.97	1.04	1.08	0.97	1.05	1.17	0.99

25-delta risk reversals

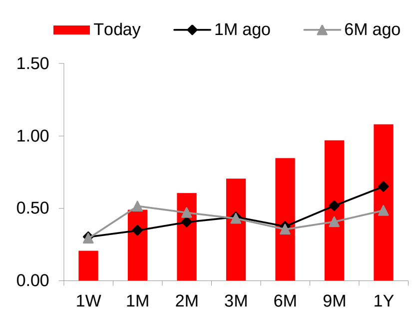
EUR/USD



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	17.43	3.24	644	3007	18.6	3.23
1M	17.74	3.25	643	3016	18.7	3.24
2M	18.09	3.27	644	3023	18.8	3.24
3M	18.40	3.28	644	3028	18.9	3.25
6M	19.40	3.31	645	3047	19.2	3.26
9M	20.38	3.35	646	3068	19.5	3.27
12M	21.25	3.39	647	3086	19.8	3.28

ATMf vol.

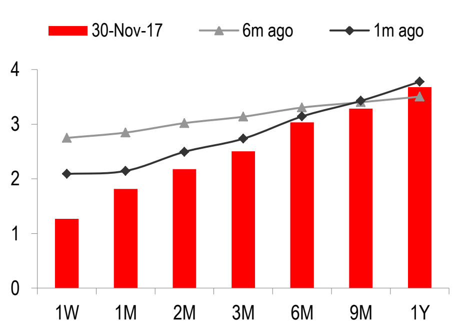
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	9.08	13.21	9.79	10.49	10.40	3.51
1M	11.30	12.09	10.72	10.65	10.27	3.73
2M	12.40	12.05	10.03	11.09	11.11	4.06
3M	13.35	12.18	9.77	11.36	11.51	4.33
6M	14.95	12.90	9.43	11.93	12.57	4.96
9M	16.43	13.82	9.38	12.30	14.55	5.67
12M	17.23	14.85	9.35	12.48	14.38	6.14

Implied/realized vol. ratio

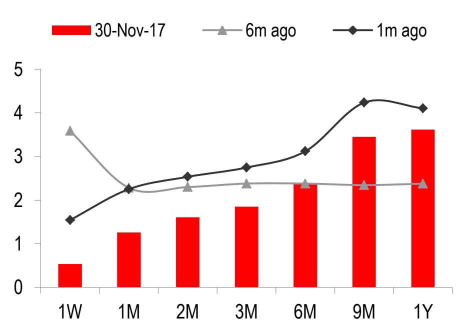
	USD/ARS	USD/BRL	USD/CLP	USD/COP	USD/MXN	USD/PEN
1W	2.34	1.70	1.65	1.54	1.17	2.25
1M	2.09	1.15	1.41	1.34	1.11	1.48
2M	1.81	1.20	1.34	1.53	1.05	1.56
3M	1.79	1.31	1.33	1.63	1.12	1.66
6M	1.60	1.41	1.42	1.60	1.26	1.92
9M	1.89	0.99	1.35	1.49	1.37	1.83
12M	2.06	1.11	1.26	1.38	1.27	1.71

25-delta risk reversals

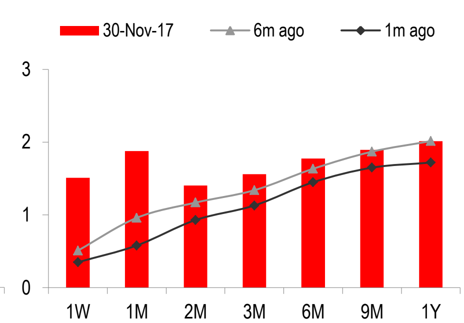
USD/BRL



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.
*****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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